



Compass Analytics | 580 California Street, Suite 1725 | San Francisco, CA 94104 | 415-462-7500 | www.compass-analytics.com

The Month in Review

August 2011

Don't Miss!

Check out our monthly feature "Specified Pool Commentary" by Managing Director Jeff Casella as he discusses specified pay-ups.

Also, don't miss our Annual **User Conference** in San Francisco on September 13th and corresponding Days on The Desk. Conference breakout topics include: Company Profit and Balance Sheet Forecasting, Pooling Analytics, Pipeline Hedging Primer, MSR Economic Value vs Market Value, Pricing MSRs Static vs OAS, New MSR Hedging Analytics, and more.

If you would like more information on the event or would like to attend, please email kmccann@compass-analytics.com.

What's New?

Congratulations to Vimi Vasudeva, Virgil Caselli and Dave Bennett who have all been promoted to Managing Directors! Vimi, Virgil and Dave will continue to manage accounts while taking on additional roles and responsibilities in Operations, Analytics and Desk Operations respectively.

Compass has updated the look of our Monthly Newsletter and Morning Color as well as add a new section to the Morning Color--Pipeline Metrics. The new section will include previously published metrics such as Conventional Gross Profit Margin and Production changes (Day over Day Change and % of 10 Day Change) and new metrics such as Purchase and Refinance percentages, Average Lock Length and a new Production Index metric (Average of the last 3 days relative to a 10-day average from one month ago).

Webinars

Compass will be hosting two webinar training sessions in August and September. Please take a look at the webinar schedule below:

Company Profitability and Balance Sheet Forecasting

Hosted by Lindsay Hill

Wednesday, 8/24 at 10 am PST (1 pm EST)

Should Lock Term be a driving factor of Profit Margin?

Hosted by Bob Gundel

Wednesday, 9/7 at 10 am PST (1 pm EST)

There is no fee for webinars and the material is suitable for various levels of expertise so feel free to pass it on to anyone in your organization who may benefit. If you would like to participate in any of these training sessions, please RSVP to kmccann@compass-analytics.com with the name of the webinar you would like to attend. Space is limited so RSVP early to insure a spot.

New in CompassPoint™!

Compass is pleased to report its recent development progress in CompassPoint™, including:

- New Pipeline Mark-to-Commitment Lock Grids Option and Sell MBS Outright Feature
- PGP/Zip File NPPI File Encryption Options - Import/Storage and Extract Transmission
- Improved Integration between GPS Interactive Position and Hedge Selection Tools
- Additional Grouping, Cross Hedging and MSR/SRP Analytics in Hedge Selection Tool
- Expanded LoanSifter Rate Sheet Feed
- Miscellaneous Bug Fixes, Improved Workflow in Pooling Summary Tool

CompassPoint™ features and capabilities reflect the business needs as defined and requested by its users. For additional information on new features or to submit suggestions and requests, please contact Rob Kessel at 415-462-7500 or e-mail at rkessel@compass-analytics.com.

Market Update

Not much to say except, "yikes!" For a variety of reason, all somewhat worrisome from a big-picture, economic perspective, bonds have been on a tear in the last couple of weeks, and to a lesser extent, going back further. Regarding the Fannie Mae 30-yr 4.0 coupon TBA in September, July 27th saw a closing price of approximately 99 30/32. Just 10 trading sessions later, the bond finished nearly five points higher in price - and that's with a one-point down day thrown in there for good measure.

Equities, on the other hand, have taken it on the chin of late with three multi-percentage point drops in the value of the Dow happening in just the last five sessions. As stocks tumbled, TBA mortgage bonds have benefitted from riding the flight-to-quality bid in treasuries - not withstanding US treasury bonds' new position as AA+ securities. In addition, some recent sessions have seen mortgages tighten to treasuries as investors seek-out some yield beyond the plunging rates of the 10-yr and similar maturity treasuries.

The Fed also made mortgages more attractive by explicitly stating their intention of keeping overnight rates low for the next two years. The carry and roll trade for mortgage holders gets a big boost in such an environment.

For those tasked with hedging a mortgage pipeline in such an environment, headaches abound. Pull-through estimates tested in the last sharp rally may face different circumstances as new compensation rules and underwriting guidelines may make rate locks less portable and/or less likely to renegotiate. Many firms have also cut staff levels as volumes have dropped only to be newly-flush with production and are left wondering how long it will last. Unfortunately, there are never any easy answers in this business. It's easy to say each morning that following such a sharp rally, today must be the day the market takes a breather. And then...

-Lindsay Hill

Specified Pool Commentary

Not surprisingly, specified pay-ups have steadily improved over the course of the last month. Call protection became increasingly sought after as the mortgage market has rallied significantly since the last posting. However, pay-ups were somewhat inconsistent late in July while markets became skittish from the political uncertainty during the debt ceiling debates. Eventually pay-ups resumed their saunter higher as the debates ended and S&P dropped its down grade bomb.

Of note, FN 30yr 4.5% pay-ups are now approaching one point for \$85k pools. Levels on this coupon noticeably increased as it has suddenly become very "refinancible" with current 30-year rates dipping into the low to mid 4's. If prices settle in or improve off these levels it is likely that the pay-ups on FN 4.0s will also begin to move higher seeing that front month prices are at a 104 handle! Currently, 4s and 4.5s represent the bulk of current production and should provide ample opportunities for lenders looking to create specified pools. On the flip side, pay-ups on 20yr and 10yr paper have deteriorated since demand for the extension protection these products provide has diminished.

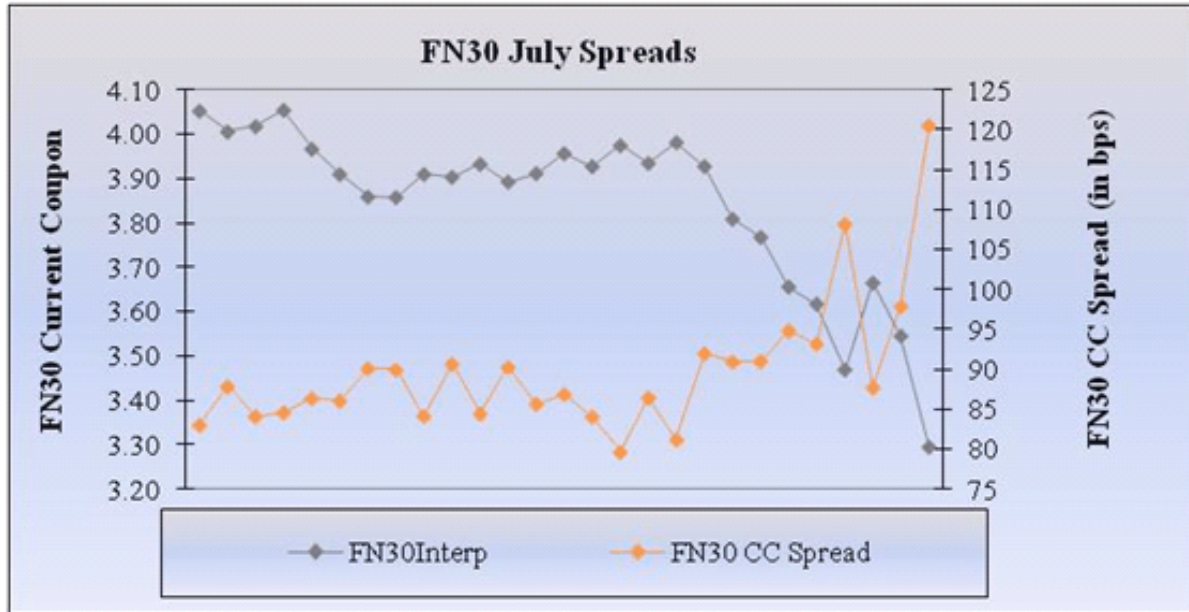
30yr FN	\$85k	\$110k	\$125k	\$150k	\$175k	New Prod	NOO - Inv	20 year	FNCK	FNCQ
3.5	0	0	0	0	0	0	0	82	-	-
4	12	8	5	4.5	2	+	2	44	-26	-18
4.5	31	26	16	15	7	2	7	20	-36	1
5	40	29	26	23	14	14	16	11	-48	24
5.5	65	47	41	36	18	22	22	2	-64	26

15yr FN	\$85k	\$110k	\$125k	\$150k	\$175k	New Prod	FNCJ	10 year
3.5	11	9	6	5	1	1	-18	41
4	27	22	17	15	6	5	-21	30

New Production (0-1WALA)
 50bps spread between gross and net rate
 Levels are for indicative purposes only

-Jeff Casella

Margin Tracker

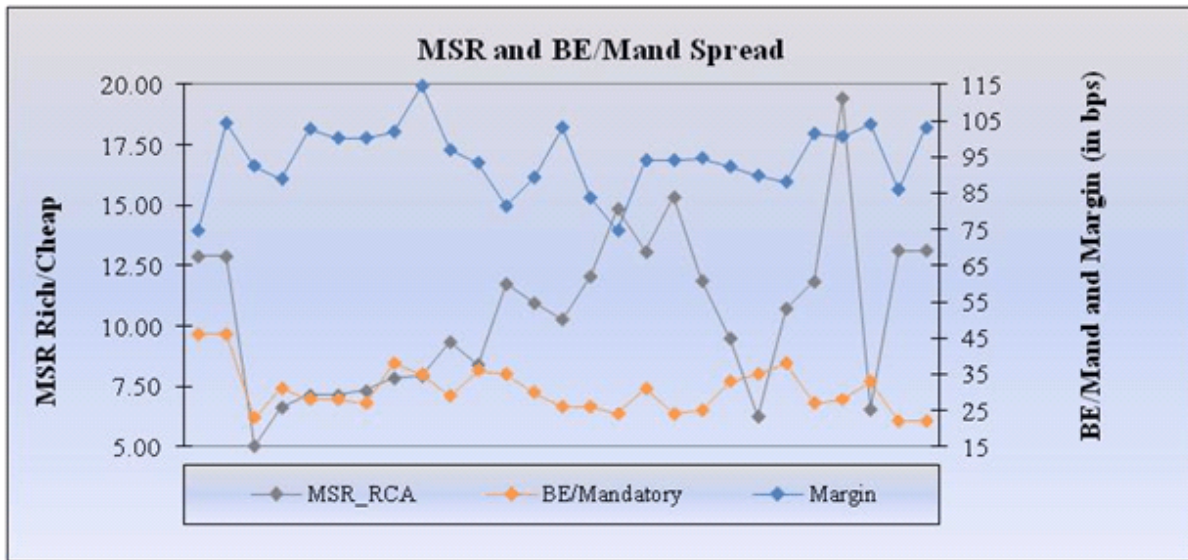


The FN30 CC Spread is the difference between the FN30 Note Rate and the FN30 Current Coupon, in basis points. During the dramatic rally that took place during the month of July and into August, there was a 76bp peak to trough differential. Shown in the chart above, there is a noticeable negative correlation between rates and spreads. As rates screamed lower over the course of the month (from a high of 4.05% to a low of 3.29%), spreads widened pretty consistently. The tightest the spread got was 80bps; the widest was 120bps; the average was 90bps. The FN30 NR is the average conventional note rate across a subset of Compass's client base normalized for volume. The FN30 CC is the Fannie 30-year Mortgage Backed Security yield at par 30 days out. The difference between these numbers gives an indication as to how much margin is priced into the secondary market. The primary factors are interest rates and warehouse line constraints. Lenders may also be slower to improve rates during a rally, and quick to drop their pricing during a sell-off.

-Dave Bennett

MSR Rich/Cheap and Mandatory/Best Efforts Spread

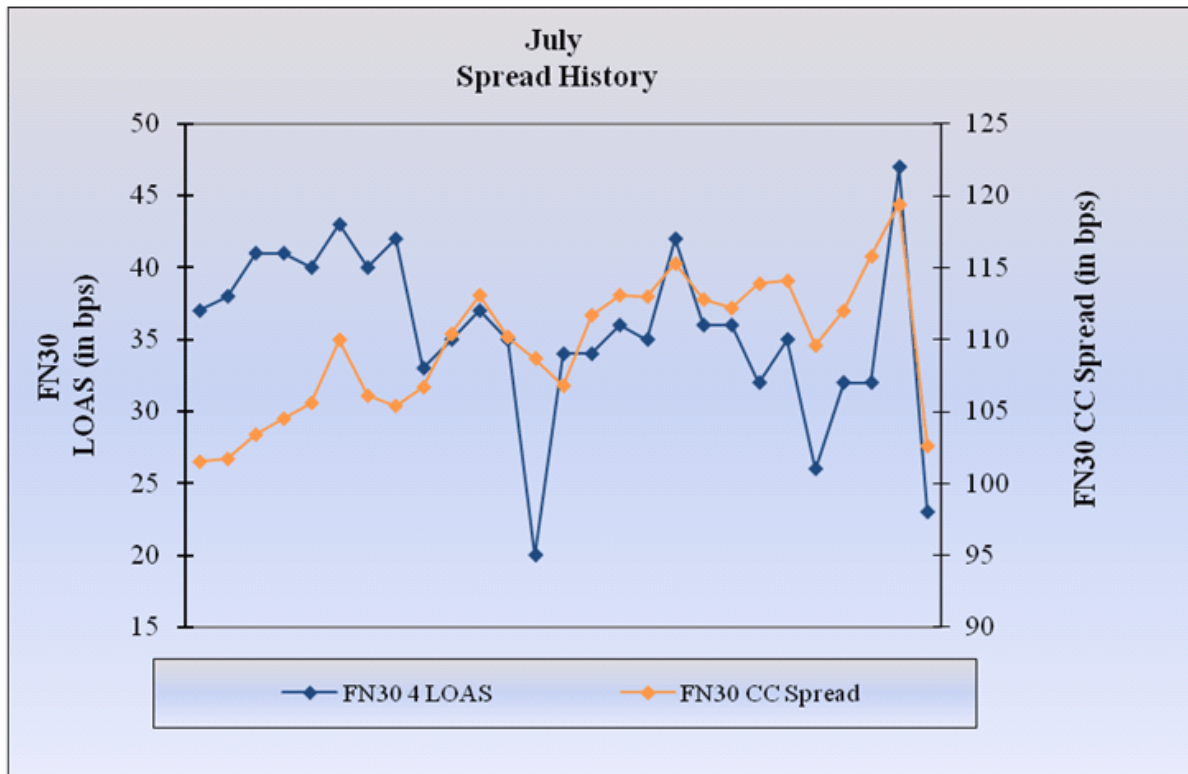
There was considerable volatility for Retain/Release Rich/Cheap IRR, Mandatory-Best Efforts Spreads and Profit Margins over the course of the month. The MSR Rich/Cheap averaged 10.5% with a peak of 19.4% and a low of 5.1%. The Conventional BE/Mandatory Spread averaged 31bps with a peak of 46bps and a trough of 20bps. With the upward push in rates, one would expect spreads, particularly the BE/Mand, to tighten a shade as production starts to decrease. This spread will be worth tracking as the cycle progresses. The 30-year gross profit margin averaged 95bps with a peak of 115bps and a trough of 75bps.



The MSR Rich/Cheap gives the internal rate of return for retaining servicing and provides a general measure of how aggressive aggregators are in their servicing bid. If a client is considering retaining servicing, or is deciding between retaining or selling servicing-released on any given day, this number can serve as a guide. Compass uses best execution across aggregators each day for note rates bracketing the FN30NR. The Mandatory/BE spread tracks the difference of a representative seller's basis point pick-up using mandatory delivery instead of best efforts. Compass uses several investors, for best efforts and mandatory, and compares the best execution of each of the two delivery methods for note rates flanking the FN30NR. The Conventional 30-year average gross profit margin tracks the originator's gross profit margin, i.e. the difference between what the originator pays for the loan (what is posted on a rate sheet) and what the originator could sell the loan for into the secondary market.

-Dave Bennett

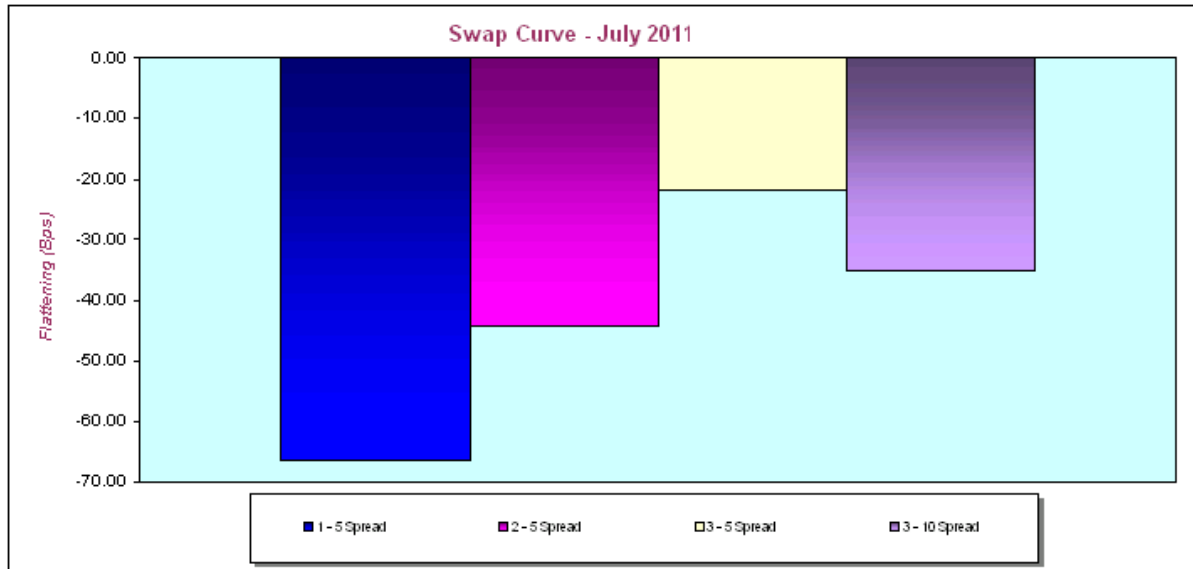
Monthly Spreads



The Treasury 2-10 spread tightened a whopping 65 basis points over the past five weeks, closing August 9th at 206 bps. On a LIBOR-OAS basis, mortgage yield widened to begin July as mortgage credit risk increased relative to other investments. Fannie 30-year LIBOR-OAS, tightened dramatically following the Eurozone's second bailout of Greece, spiked following S&P's downgrade of US and tightened the next day following reassurance from the FOMC. Mortgage yield, measured as a spread over a blend of the 2 and 10 year swap curve yields, also trended upward as safety assets rallied. It peaked on August 8th, following S&P's downgrade, at 119 basis points.

-Dylan Faerstein

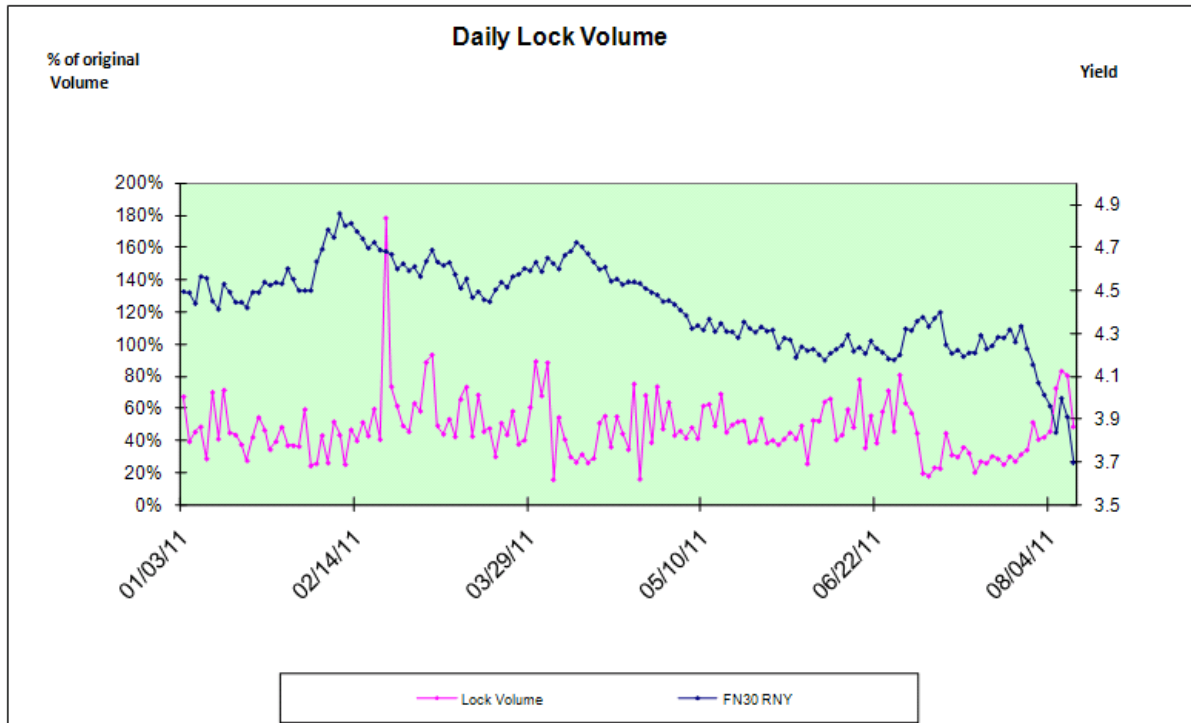
Swap Curve Analysis



Although 12 month LIBOR increased 3 basis points over the past six weeks, swap yields decreased dramatically. Rates markets rallied to begin July, as sovereign European troubles and a surprisingly weak employment report sparked talks of another round of quantitative easing. Decidedly soft economic data thus far in August has caused "QE3" discussions to heat up and growth expectations globally to decline. The 10 year swap yield is down 76 basis points from July 1st, the 5 year down 63 basis points and the 2 year down 19 basis points. The recent rally has brought rates to the lows we saw during the 2008 collapse and has brought mortgage-backed security dollar prices to record highs.

-Dylan Faerstein

Production Index



Production in the 30-day period ending August 10, 2011 decreased while rates traded in a wider range (19 bp range in this period versus 14 bp in the prior period), with the average yield decreasing month over month by 14 bps. Average volume for the last 30 days was 40% of our base volume (vs. 48% in the prior period) ranging from a low of 20% to a high of 83%. The average yield on the FN30 RNY in this period was 4.14% (vs. 4.18% in the prior period) ranging from a low of 3.70% to a high of 4.33%.

-Brandon Case

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