



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

The Month in Review

September 2011

Don't Miss!

Don't miss Managing Partner Rob Kessel at the [New England Mortgage Bankers Conference](#) in Newport, Road Island. He will be presenting the below:

Strategies and Considerations in Selling Servicing Retained and Servicing Released - Rob Kessel and Dean DeMeritte, Executive Vice President of Phoenix Capital
Thursday, September 22

What's New?

Thank you to everyone who attended our annual Compass Analytics User Conference in San Francisco on September 13th. We had a terrific turn out, tons of fun with all our attendees and many of new ideas for the future!

Webinars

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

Month-to-Date P&L Reporting

Hosted by Dylan Faerstein
Thursday, 9/29 at 10 am PST (1 pm EST)

AOT Best Execution

Hosted by Brandon Case
Wednesday, 10/12 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:

- Rate Sheet Enhancements (Max Rate Sheet Price, DR Weighted Tolerance Check, Alternate Grouping)
- Prepayment Model (AdCo 2h Tuner File References)
- CCF Improvement (Additional Elements Exposed to Scalars, Production & Margin Curves)
- File Import/Export Encryption Options
- Additional XML ULDD and Ginnie Net Fixes
- Miscellaneous Bug Fixes
- Beta CCF as a Hedge
- Beta Key Rate Hedge Selection Screen

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

Though it's never been far from the front page in the last several months, the European debt crisis has jumped back into the headlines, recently. Try as they might, the ECB has not been able to allay fears of a default in Greek debt. For Greece, and other countries facing similar problems, the ability to raise euro funding for TARP-like programs is, essentially, non-existent. The required path may be towards bank nationalization and an exit from the euro-zone economy. These nations would then need to reintroduce a sovereign currency to fund the banks. The ECB would be left holding the bag on sovereign debt and repo write downs, with Germany bearing the brunt of the damage.

The thought of bank failures across Europe has increased the pressure on equities and helped push US treasury yields to their lowest levels in over 50 years. For the time being, the 10-yr treasury yield has dropped below 2.0% and mortgages rates have also pushed lower, bringing in some of the best lock volume numbers of the year. In addition to the European crisis, the markets have been faced with the possibility of additional US programs designed to refinance mortgages that were unable to take advantage of current or prior programs. Although rumors of a new mortgage refinance program persist, President Obama has not offered a clear push towards a large-scale program in recent policy speeches. Another possibility to help boost the housing market is an extension of the high-balance conforming loan limits currently in place. The current high-balance program is approaching expiration, so action would need to take place soon to continue the increased loan limits without interruption.

While the housing sector continues to drag, it is not the only macro issue for the US economy. The employment picture appears to be weakening, again. Following a period from March through May that saw decent and consistent payroll growth, the last three months have slipped again with the August payroll growth coming in at zero. While it sounds like a broken record, it will be tough to create any momentum in the economy with both housing and employment languishing. The news from Europe may be grabbing the majority of the financial headlines, but it's far from the only issue facing the markets.

-Lindsay Hill

Specified Pool Commentary

Demand for call protection specified pools has spiked over the last month as mortgage rates have hit historic lows. It's hard to believe but the 30yr current coupon is now firmly planted between 3.0% and 3.5%. With US recession risks rising, it is apparent that rates will remain depressed for the foreseeable future. Prepayment speeds picked up in August and are expected to increase even more dramatically in September.

In addition to these "natural" prepayment risks, investors are continuously trying to hedge against the likelihood of a large scale national refinance program. The probability that a plan will ever be agreed upon is difficult to determine and the likely outcomes are even more difficult. It remains to be seen if a potential plan further expands LTVs to help underwater borrowers and/or if it expands the credit guidelines to include those troubled credit. However, most investors agree that the convexity profile of low loan balance pools are likely to hold up well under most scenarios.

In the current rate environment, the FN 30yr 4.5% coupon is now very "refinancible" and even speeds on FN 4.0s are expected to increase significantly. Not surprisingly, investors are now willing to offer significant pay-ups on FN 4.0s. For example, \$85k max FN 4.0 pools are now garnering a 24/32 pay-up. That is twice the 12/32nd premium that investors were willing to pay last month. Pay-ups on similar type 4.5s have jumped by more than half a point and are now roughly 51/32nds. Lenders who have lingering production in these coupons could benefit if they are able to sort and sift these loans out and create specified pools. Please call the trade desk if you have any questions or would like more information.

30yr FN	\$85k	\$110k	\$125k	\$150k	\$175k	New Prod	NOO - Inv	20 year	FNCK	FNCQ
3.5	0	0	0	0	0	0	0	65	-30	-
4	24	17	13	11	8	0.5	6	36	-37	-12
4.5	51	40	32	23	16	8	12	12	-56	15
5	64	50	43	36	23	16	17	4	-62	30
5.5	64	52	41	28	18	22	32	0	-64	32

15yr FN	\$85k	\$110k	\$125k	\$150k	\$175k	New Prod	FNCJ	10 year
3.5	25	18	15	12	8	0.5	-16	20
4	27	22	17	15	6	5	-19	8

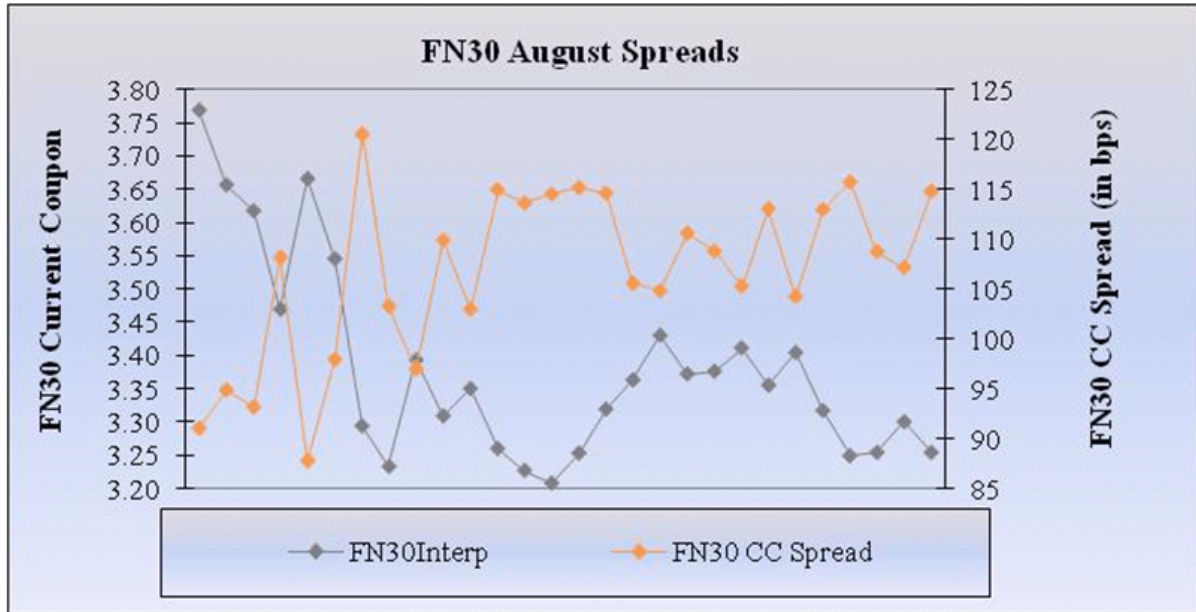
New Production (0-1WALA)

50bps spread between gross and net rate

Levels are for indicative purposes only

-Jeff Casella

Margin Tracker

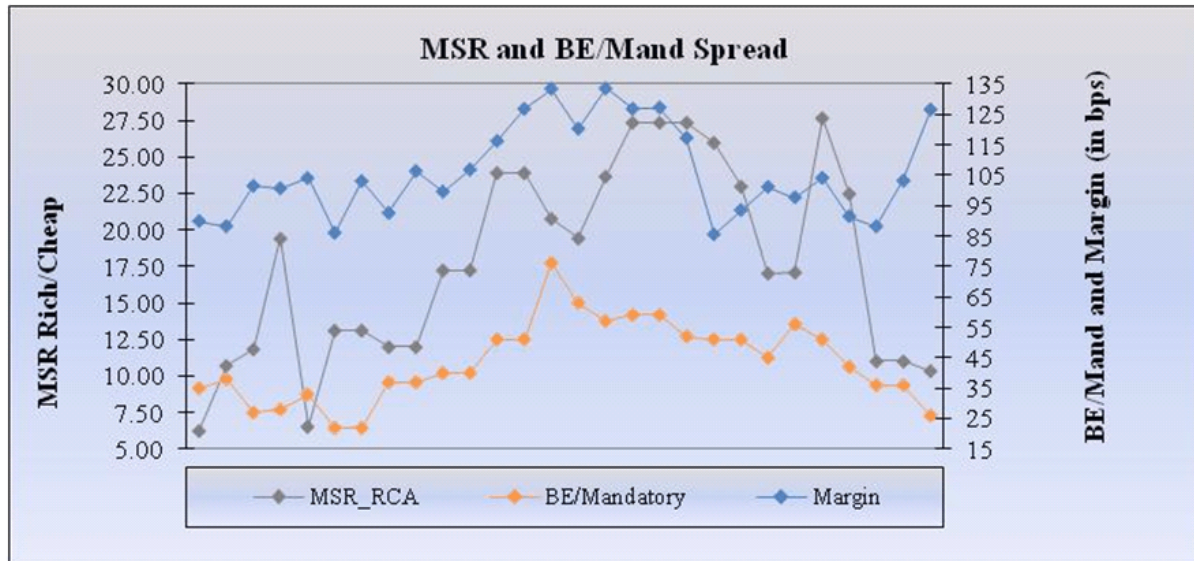


The FN30 CC Spread is the difference between the FN30 Note Rate and the FN30 Current Coupon, in basis points. During the continued rally that took place during the month of August and into September, there was a 56bp peak to trough differential. Shown in the chart above, there is a noticeable negative correlation between rates and spreads. As rates screamed lower over the course of the month (from a high of 3.77% to a low of 3.21%), spreads widened pretty consistently. The tightest the spread got was 88bps; the widest was 120bps; the average was 107bps. 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

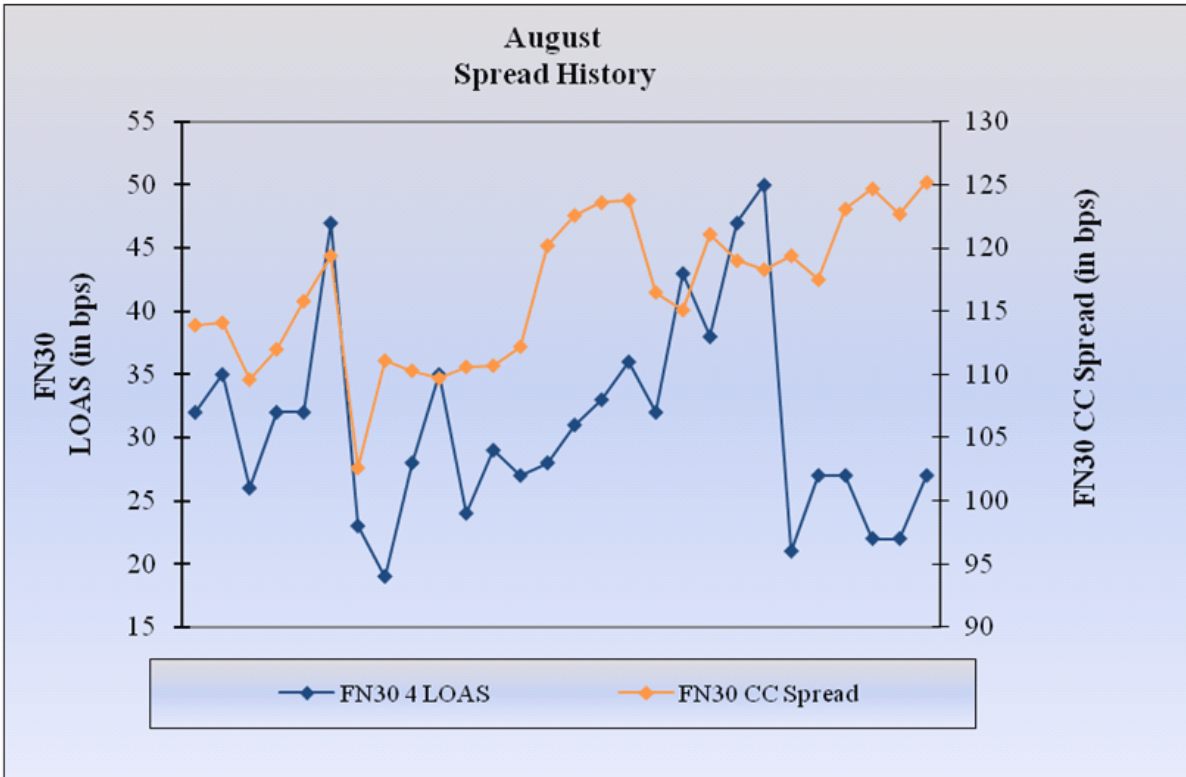
There was considerable volatility for Retain/Release Rich/Cheap IRR, Mandatory-Best Efforts Spreads and Profit Margins over the course of the month. The MSR Rich/Cheap averaged 17.8% with a peak of 27.7% and a low of 6.3%. The Conventional BE/Mandatory Spread averaged 44bps with a peak of 76bps and a trough of 22bps. With the downward push in rates, one would expect spreads, particularly the BE/Mand, to widen as production remains elevated. This spread will be worth tracking as the cycle progresses. The 30-year gross profit margin averaged 106bps with a peak of 134bps and a trough of 86bps.



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

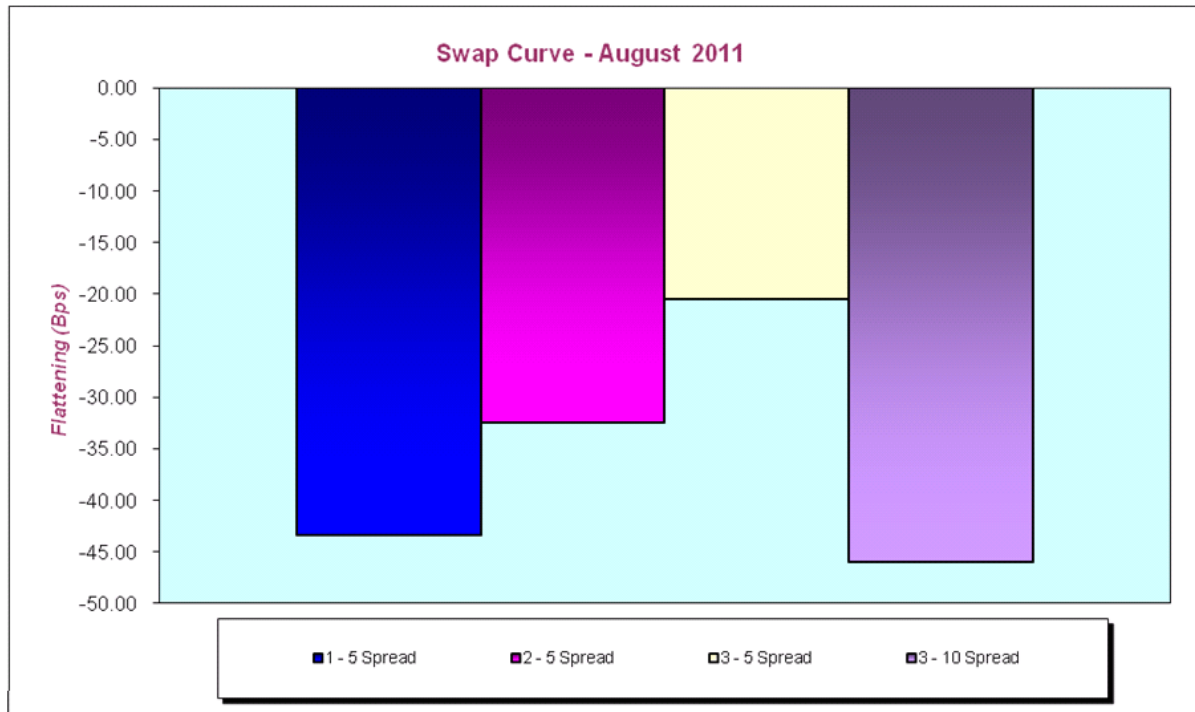
Monthly Spreads



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 Euro zone'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

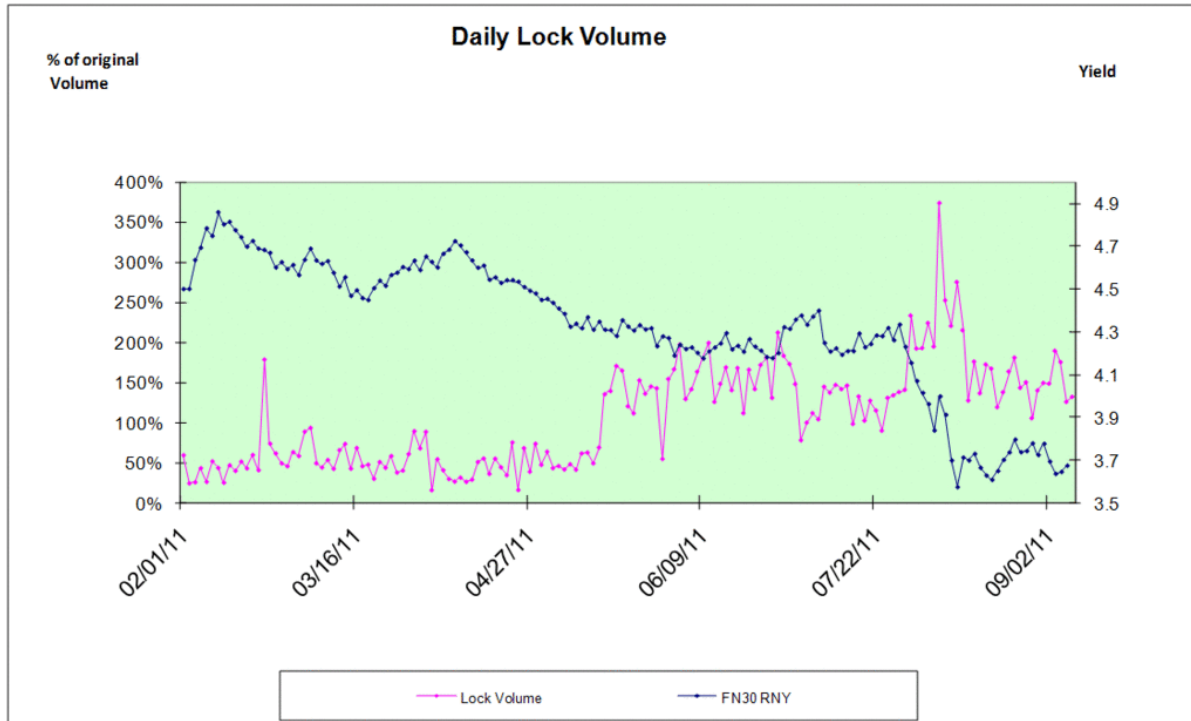
Swap Curve Analysis



Although 12 month LIBOR increased 5 basis points over the past six weeks, long-end swap yields decreased dramatically. On September 7th, the 2 year swap yield closed down 5 basis points, the 5 year down 38 basis points, and the 10 year down 63 basis points from their August 1st levels. Rates markets rallied to begin August, as decidedly soft economic data caused "QE3" discussions to heat up and growth expectations globally to decline. On August 9th, following the first session since S&P's downgrade of US debt, the FOMC explicitly stated their intention to keep rates quite low through mid 2013, causing money to pour into bonds. The 10 year Treasury yield below 2% reflects the stagnant growth expectations for the U.S. economy. Weak economic data and the flattening yield curve are causing analysts to revise their estimated likelihoods of a double-dip.

-Dylan Faerstein

Production Index



Production in the 30-day period ending September 8, 2011 decreased while rates traded in a narrower range (34 bp range in this period versus 63 bp in the prior period), with the average yield decreasing month over month by 44 bps. Average volume for the last 30 days was 159% of our base volume (vs. 168% in the prior period) ranging from a low of 105% to a high of 275%. The average yield on the FN30 RNY in this period was 3.71% (vs. 4.14% in the prior period) ranging from a low of 3.58% to a high of 3.91%.

-Brandon Case

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