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## The Month in Review

January 2012

### **Don't Miss!**

#### **Conference Attendance/Presentations**

Don't miss Senior Hedge Manager Bob Gundel Speaking at the following conferences!

#### Southern Secondary Market Conference

January 18 & 19, 2012 (Woodlands, TX)

#### Eastern Secondary Market Conference

February 15-17, 2012 (Amelia Island, FL)

#### Mortgage Servicing Conference

April 17-19, 2012 (Houston, TX)

Contact [Kmccann@compass-analytics.com](mailto:Kmccann@compass-analytics.com) for more info.

## What's New?

***Best Wishes in the New Year from all of us here at Compass Analytics!***

### **Webinars**

Compass will be hosting the following webinar training sessions at the end of January. Please take a look at the webinar schedule below:

#### **Pipeline Strat Report Building**

Wednesday, 1/25 at 11:30 am PST (2:30 pm EST)

Hosted by Senior Hedge Manager Brandon Case

#### **MSR Strat Report Building**

Thursday, 1/26 at 10:00 am PST (1:00 pm EST)

Hosted by Managing Director Vimi Vasudeva

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](mailto:kmccann@compass-analytics.com) with the name of the webinar you would like to attend

# Tool of the Month

## GPS Pooling Tool

As part of a new initiative to get clients up and running on certain tools, Compass will be concentrating on specific tools in the upcoming months. In February the GPS Pooling Tool will be highlighted with webinars, webcasts, and training available for clients. Stay tuned for details!

## New in CompassPoint™

Compass is pleased to report that we will be rolling out a production code update next weekend and that there will be many new and exciting features for CompassPoint™ users, including those features reported below and in previous newsletters since our last production update.

- Pipeline Processing: GFee Adjustor & Expanded Ship Date Calculator for Early Delivery Price Adjustments
- MSR Retain/Release Loan-Level Tax Wedge Calculation
- Pooling Summary: Improved Loan/Existing Cash Trade Matching Logic
- Hedge Selection Tool: Better Error Handling for Alt Grouping, What-If Cash Durations
- Company Cash Flow Hedge Enhancements
- File Import Tool - Improved Duplicate Loan Handling in Bulk Mode

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](mailto:rkessel@compass-analytics.com).

## Market Update

Over the past month, treasury and MBS prices have continued to grind higher as more discouraging news from the eurozone kept a flight-to-quality bid in place. Nine of the seventeen eurozone countries received downgrades to their sovereign debt as talks between Greece and private bond holders failed to reach an agreement. European leaders are still faced with tough decisions on fiscal tightening as well as on the establishment and financing of a bailout fund for European banks. Given the lack of a substantive agreement over the last several months, market participants remain skeptical that the latest vow to speed the pace of talks will bear fruit.

Closer to home, the congressionally-mandated G-Fee increases, established in part to pay for extensions of the payroll tax cut and unemployment benefits, has created somewhat of a disconnect between MBS prices and lender rate sheet prices. It creates an *interesting* dynamic when the government is purchasing MBS to keep rates low and help fuel a recovery in housing, and yet the same government is increasing rates on the G-Fee side, increases that will trickle directly down to the borrowers that are hoped will lead a housing recovery.

Other than the continually weak housing sector, domestic economic reports have been mostly encouraging of late with many reports showing at least modest gains. Employment and production measures are creeping higher and consumer confidence measures have shown some improvement. Given the apparent overbought condition in bonds, some correction may be in store in the short term. But minus any significant action out of Europe, it's not hard to see rates remaining relatively low for the time being.

**- Lindsay Hill**

# Specified Pool Commentary

Pay-ups for specified pools resumed their historic ascent in January as levels continue to trade at or near record highs. The gains were not quite as impressive as those seen from November to December but most coupons did see improvement. Once again, demand was vigorous for the call protection as prepay speeds are expected to linger at elevated levels or even increase in 2012. However, prepayment speeds for lower coupon 30yr conforming mortgages actually dipped slightly in December but are expected to increase again in January based on the end of year rally. Going forward much will also depend on further government involvement in US housing as chatter around a national refinance programs has recommenced. In addition to the political uncertainty, volatility in roll costs is expected to pick up with the implementation of delivery fail costs looming February. Higher roll costs can eat away at specified pay-ups as it makes them more expensive to hedge. (See attached link for more information <http://www.sifma.org/services/standard-forms-and-documentation/securitized-products/securitized-products-fails-charge-trading-practice/>).

\$85k max FNCL 4% pools improved 2/32nds and are now trading +36/32nds above TBA levels and even current coupon FNCL 3.5% improved to 9.5/32nds. On the flip side, pay-ups for 10yr production have been hit hard as high dollar prices and increased roll costs have diminished investor appetite. The FN10yr 3.0% coupon is only receiving a 24/32<sup>nd</sup> pay-up vs last month's levels that were closer to 46/32nds.

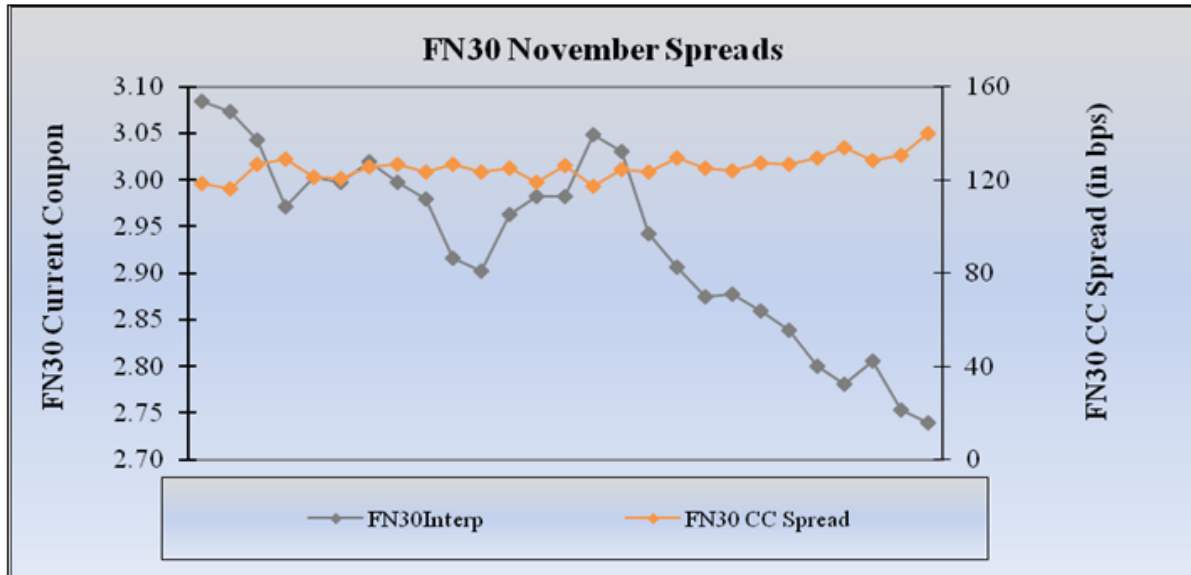
30yr FN	\$85k	\$110k	\$125k	\$150k	\$175k	New Prod	NOO - Inv	20 year	FNCK	FNCQ
3.5	9.5	7	3	2.5	0.5	0.25	0.5	31	-40	-8
4	38	31	22	18	12	3	11	16	-46	30
4.5	76	64	35	31	17	14	18	8	-64	70
5	80	64	44	36	23	17	21	-	-	68

15yr FN	\$85k	\$110k	\$125k	\$150k	\$175k	New Prod	FNCJ	10 year
3	10	7	4	2	1	1	-26	24
3.5	36	30	24	18	12	6	-28	19
4	60	48	38	30	18	15	-40	10

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

**-Jeff Casella**

# Margin Tracker

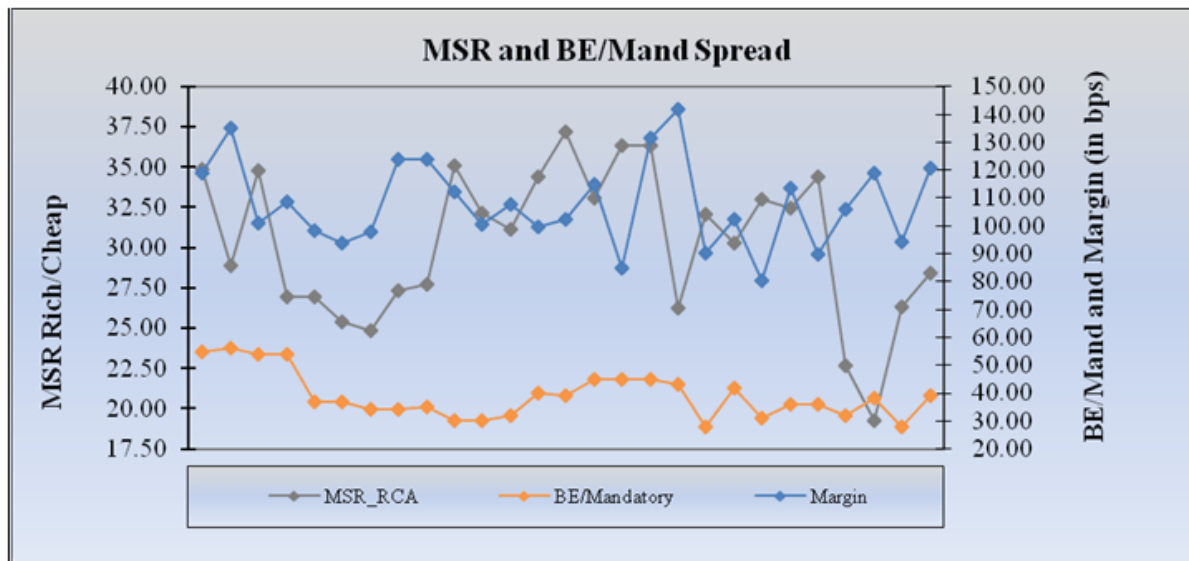


The FN30 CC Spread is the difference between the FN30 Note Rate and the FN30 Current Coupon, in basis points. Rates grinding lower and light volatility throughout the month of December and into the first part of the New Year, resulted in a 34bp peak to trough differential between FN30 NR and FN30CC, an increase of 2bps over last month's reading. Mortgage rates and note rate-level spreads over current coupon are typically negatively correlated, which is exactly what we observed as rates declined throughout December and early January, (FN30Interp ranged from a high of 3.08% early in the month, to a low of 2.74% on the final day captured in this analysis). The tightest the spread got was 116bps; the widest was 140bps; the average was 126bps. 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.

**-Bob Gundel**

# MSR Rich/Cheap & Mandatory/Best Effort Spread

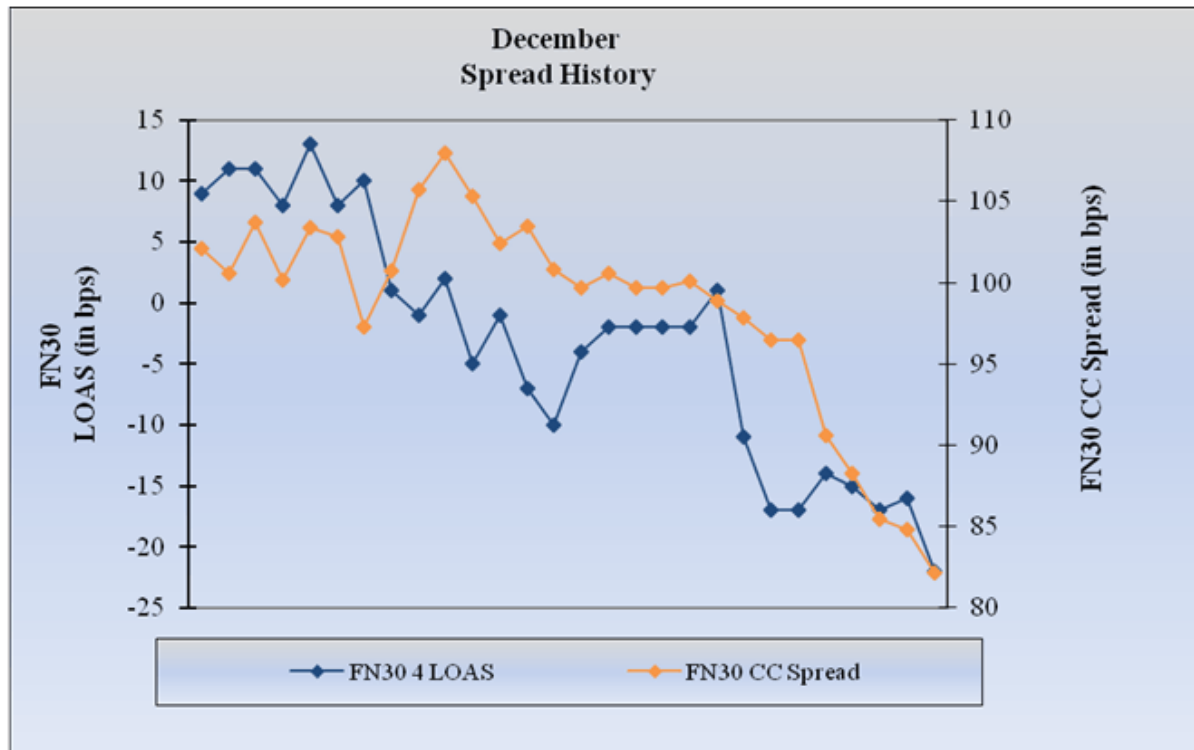
Again, reduced volatility for was the theme for the Retain/Release Rich/Cheap IRR, Mandatory-Best Efforts Spreads and Profit Margins throughout the month of December and carrying into the first week of the New Year. With some of the larger Aggregators continuing to keep their bid for servicing soft, the MSR Rich/Cheap averaged 30.16%, a slight decrease of 0.37% over November's average reading. The peak IRR value was 37.2% and the low was 19.2%. The Conventional BE/Mandatory Spread continued to tighten helped by the low volatility in mortgage rates, displaying an average reading of 39bps. The average value was 10 bps less than the reading in November, with a peak of 56bps and a trough of 28bps. The 30-year gross profit margin also tightened, with an average of 108bps, a peak of 142bps and a trough of 81bps. Again this month, the reduced market volatility, and resulting reduced hedge costs was the likely cause of margins tightening.



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.

- **Bob Gundel**

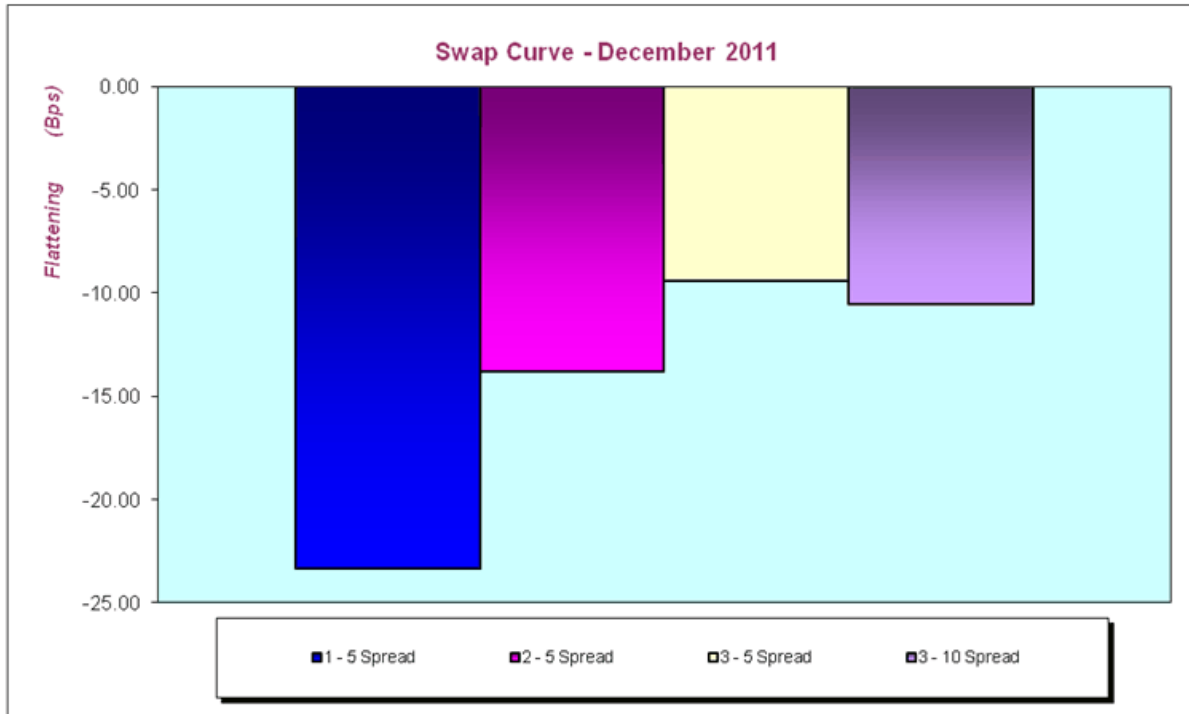
# Monthly Spreads



The Treasury curve experienced substantial tightening over the past six weeks, with the 2-10 spread decreasing 12 basis points to close January 9<sup>th</sup> at 171 basis points. Strengthening US economic data, particularly in the retail and manufacturing sectors, continues to be overshadowed by the tumultuous European credit situation. Large institutions, including the World Bank, have cut global growth forecasts for 2012 and ratings agencies continue to downgrade Euro-zone countries. On a LIBOR-OAS basis, mortgage yield trended steadily downward over the period, dropping 31 basis points since December 1<sup>st</sup>. This indicates that investors believe prepayments are on the rise and likely reflects shorter durations and tighter OASs due to HARP 2.0. Mortgage yield, measured as a spread over a blend of the 2 and 10 year swap curve yields, decreased 20 basis points over the period, indicating solid appetite for mortgage yield in this low rate environment.

*-Dylan Faerstein*

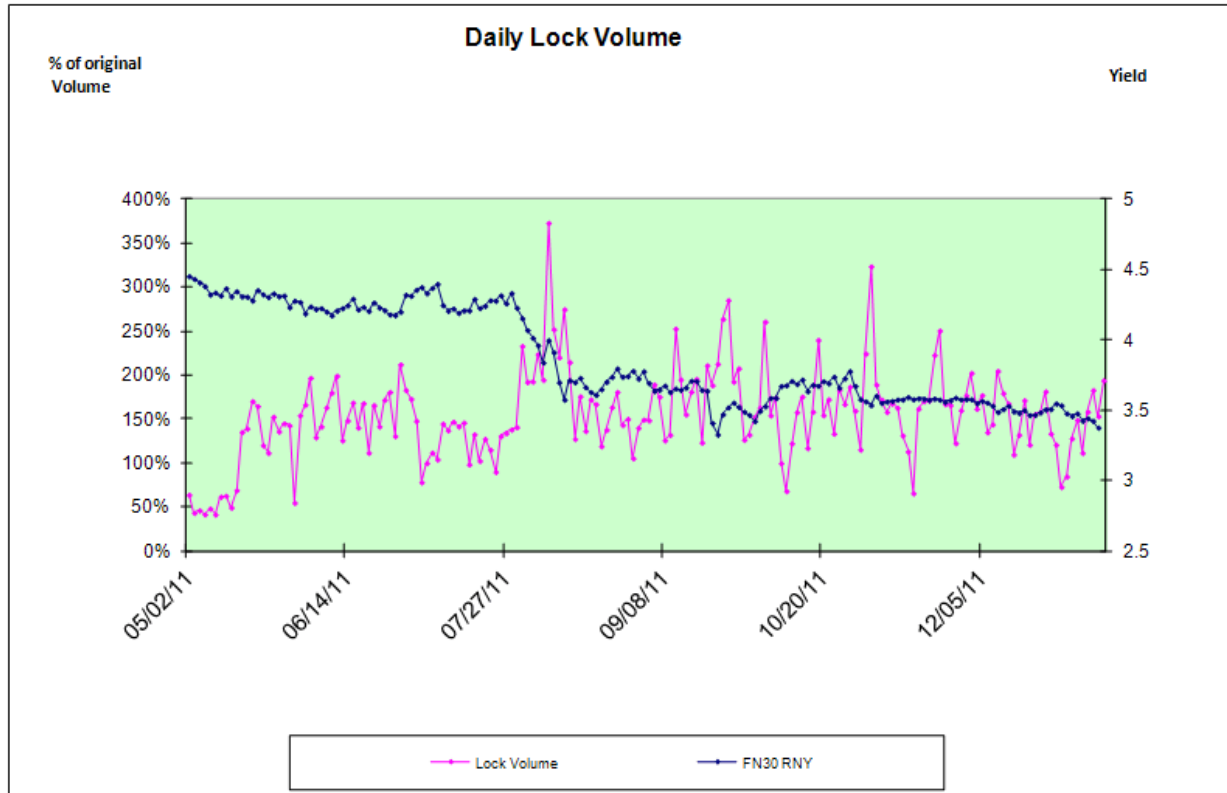
# Swap Curve Analysis



12 month LIBOR increased 6 basis points over the past six weeks while the 2 year swap yield fell 3 basis points and the 5 year swap yield fell 17 basis points. Despite dipping as low as 200 basis points in mid December, the 10 year swap yield closed on January 9<sup>th</sup> at 209 basis points - down 18 from its December 1<sup>st</sup> level. News about the European debt situation continued to dominate markets; in the period's biggest daily move, the 10 year yield dropped 10 basis points on December 28<sup>th</sup> as record overnight balance levels in the European banking system heightened credit concerns. Despite some optimistic investors citing strong U.S. economic data and putting money to work in equities, the bleak global picture seems to have placed a ceiling over interest rates. We find ourselves progressing into 2012 with a much flatter curve. The 2-10 swap spread closed the period at 145, tightening 15 basis points since December 1<sup>st</sup>.

**-Dylan Faerstein**

# Production Index



Production in the 30-day period ending January 9, 2012 decreased while rates traded in a wider range (17 bp range in this period versus 11 bp in the prior period), with the average yield decreasing month over month by 9 bps. Average volume for the last 30 days was 141% of our base volume (vs. 166% in the prior period) ranging from a low of 73% to a high of 194%. The average yield on the FN30 RNY in this period was 3.48% (vs. 3.57% in the prior period) ranging from a low of 3.38% to a high of 3.55%.

**-Brandon Case**

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