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The Month In Review

April 2005

What's New At Compass?

We look forward to seeing many of you here in San Francisco for the National Secondary Marketing Conference on May 2nd and 3rd.

New in CompassPoint™!

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

- Expanded Coupon Level Best Execution
- Streamlined Reporting
- Expanded WAC Asset Functionality
- Cash Flow Based Arm Bucketing/Hedge Tool
- Additional Eurodollar Future Tools

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 415-925-2812 or e-mail at rkessel@compass-analytics.com.

Market Update

The last month for bonds has been one primarily defined by volatility and consolidation. After breaking through resistance at the beginning of March, the 10-yr yield has spent the past few weeks bouncing – sometimes quickly – between 4.40% and 4.60%. Economic data over the last month has been sufficiently mixed to contain further increases in long-term yields, at least for the moment.

Much of the sentiment and concern in the bond community has switched from leading inflation indicators, like industrial growth and manufacturing reports, to the actual inflation measures themselves, like PPI and PCE. Core inflation readings for February remained muted, which also helped contain the break out in interest rates. Oil prices helped drag up the overall inflation readings, but as we saw last fall, oil prices can provide contradicting forces on bond yields. On the one hand, high energy prices would logically feed into core inflation at some point, which would put upward pressure on yields. On the other hand, high energy prices can subdue growth and damage consumer confidence, thus constraining stock market increases and bond yield increases.

Indeed, February consumer confidence and consumer sentiment reports slipped from the January readings. Production and manufacturing were mixed with the Philly Fed and ISM indexes falling and the Chicago



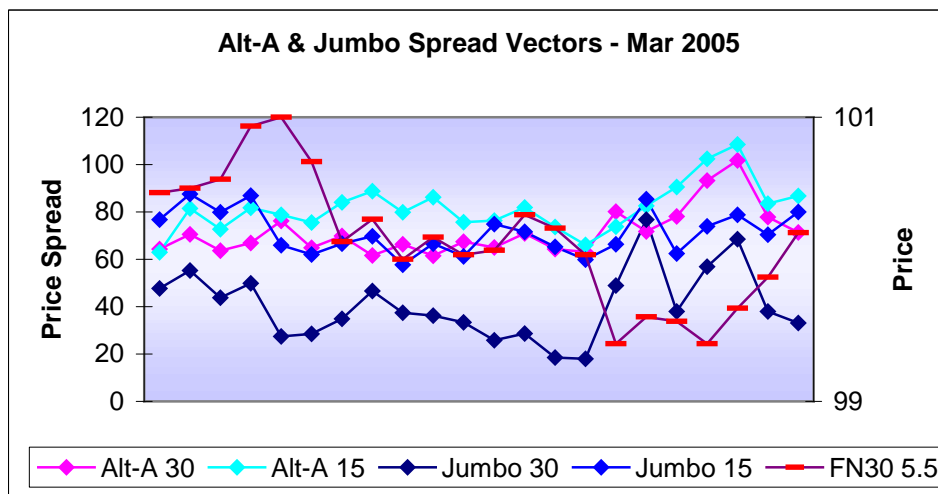
PMI rising in the latest releases. New home sales in February jumped as potential buyers rushed to get in ahead of expected increases in mortgage rates. Housing starts dropped in February, but remained at lofty levels.

Not much surprise from the Fed. The FOMC continued its tightening cycle with another .25% increase in Fed Funds at the March 22nd meeting. The accompanying statement kept pressure on bonds as the Fed opined that inflation pressures had picked up in recent months, but the 10-yr yield was able to close the week at the 4.60% resistance level. The futures market for Fed Funds has .25% increases priced in for at least the next two meetings, though yields at the long end may not yet be prepared.

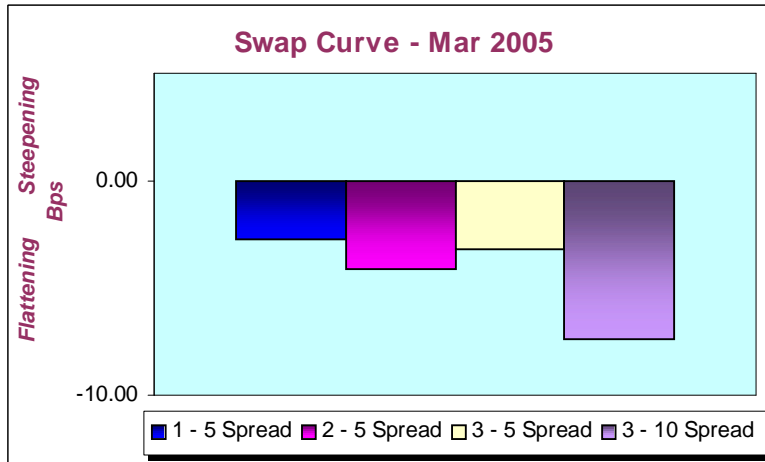
To help solidify the near-term range for bond yields, March employment growth, released on April 1st, came in at about half of the expected number (+110,000 vs. +225,000). The 10-yr yield dropped quickly to 4.40%, moved quickly higher, then dropped once again to finish the day at 4.45%. While much of the focus has moved to the actual inflation readings, weak employment reports still have the power to define trading in the short term. All eyes are still on higher rates by year-end, but the move up in rates will likely be a bumpy one as high energy prices and spotty job growth provide significant breaks in the march higher.

Alt A and Jumbo Spreads

Alt-A and Jumbo spreads remained stable throughout the first half of March, with volatility picking up in the third week. The release of the FOMC announcement indicating a 25 bp increase in rates spiraled a sell off in the MBS market, causing FN30 5.5's to drop more than 60 bps. Unlike past behavior in such instances, spreads only moved moderately, with the exception of the Jumbo 30-yr spread, which widened 30 bps. As can be seen in the graph below, spreads exhibited much more volatility after the rate hike, compared to the first half of the month in which spreads moved by an average of 5 bps day over day. Much of the volatility in spreads can most likely be attributed to the volatility in the market in general. Compass valued five Alt-A and Jumbo Fixed bulk bids in March, for which our valuation derived prices within an average of 30 bps. The range of bids from investors was as high as 175 bps for one, certainly not uncommon given what we have observed in the past. Although last month we saw one bulk come in with a 27 bp range between the highest and lowest bids, and not too far behind we saw another tight range this month for one bulk which had a range of 50 bps between the high and low.



Hybrid Arm Hedge Analysis



| Month Ending | Hedge Performance | |
|--------------|-------------------|-------------|
| | ED (Bps) | Dwarf (Bps) |
| Mar 31 2005 | | |
| 3/1 Arm | (34) | (48) |
| 5/1 Arm | (1) | (19) |
| 7/1 Arm | 22 | 4 |

Although signs of a steeper curve crept up in February, March reverted to the flat shape we have become accustomed to in the last several months. We saw the most flattening in the belly of the curve where the 3-10 spread decreased by almost 10 bps. Given that the front end of the curve flattened marginally, it is not surprising that March proved to be a challenging month for shorter-term ARM hedgers. The 3/1 ARMs realized a hedge loss in both hedge scenarios; nevertheless, the Eurodollar Future hedge outperformed the Dwarf hedge by 14 bps. The Eurodollar Futures further outperformed the Dwarfs for both the 5/1 and 7/1 ARMs.

Production Index

March lock volume was very steady throughout the month, with one weak day near month end, coinciding with Good Friday. The FN30 RNY displayed a monthly range of 5.562% to 6.019%, an average yield of 5.78%, and surged above 6% for the first time since June 2004. Volume remained unshaken as the FN30 RNY yield rose on inflation worries near the end of March.

