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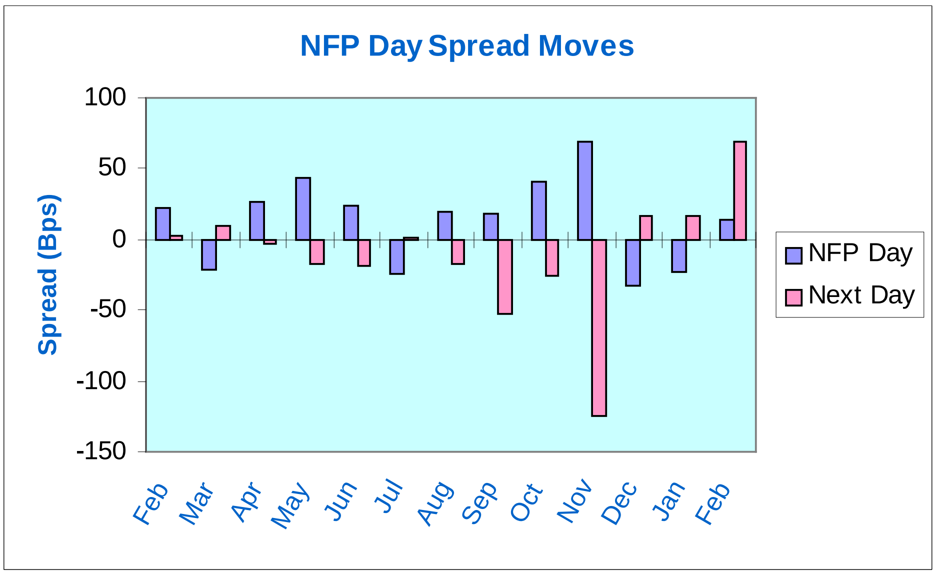
Topic of the Month: When to Avoid Selling Non-Conforming Product



The range of investor bids for Alt-A and Jumbo Fixed rate packages has continued to diverge in the last several months. Previously, the average range between the highs and lows was 80 basis points (bps), with an average cover back from the wining bid of 20 bps. The average range has increased substantially, specifically in the last two months in which the tightest range was 120 bps and several packages observed ranges greater than 200 bps. The volatility in investor appetites could be a corollary of collateral characteristics in packages, changing margins, or simply the time of month, and in some cases, year. Often times, investors have reached quotas for certain products by the end of the month and as a result, bid less aggressively than if bidding on a pool at an earlier or later date.

In analyzing of our daily spread history, it reinforces accepted knowledge that market volatility causes spreads to widen. The spread vectors, derived from conduit, cash mandatory pricing, delineate where such products are trading relative to conforming conventional products. Expectedly, spreads tend to widen (above and beyond market price movement) on days of significant market movement. One example of the forgoing is observed when monitoring non-conforming spreads on the day of the monthly release of the Non-Farm Payroll data, one of the most significant of economic data releases. The blue bars in the graph above represent the spread change from the day before to the day of the NFP release, using the largest change observed between Alt-A, Jumbo 30 and 15 year spreads. In 9 of the last 13 months, spreads widened significantly more than the average daily change of 5 bps, as much as 70 bps on the release in November. The pink bars represent the spread change from the NFP release to the following day, which show several instances of spreads returning near to levels pre the NFP release.

Stating what many originators already know, the above analysis confirms that originators should avoid selling (or accepting bids) on volatile market days. –*Vimi Vasudeva*

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