Hedge Commander Review

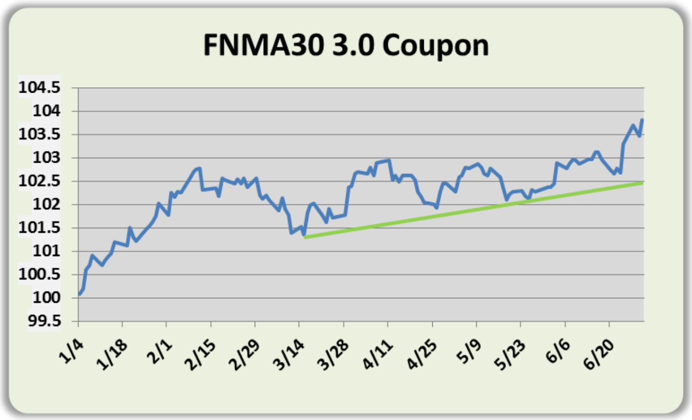
www.mortcap.com

JUN 2016

Welcome to mortgage capital management's newsletter. Though we produce a daily market commentary for clients, we felt it would be useful for our team to review trends, projects, principles of pipeline management, and fundamentals on a quarterly basis.

In This Issue:

Technicals & Fundamentals



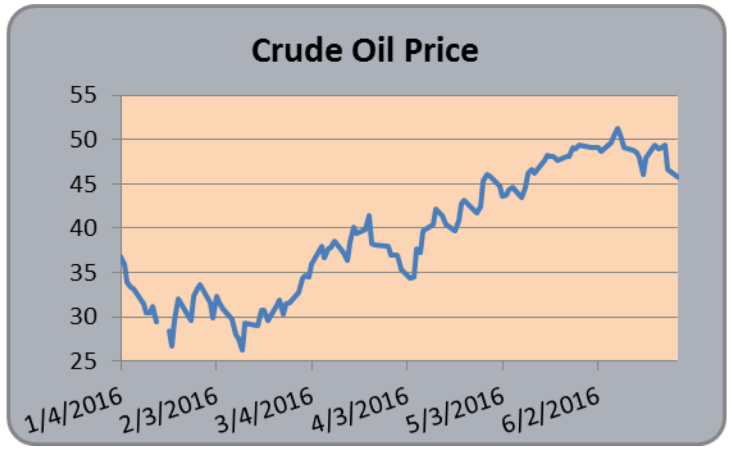
The first half of the year saw a nice rally in bonds and mortgages. There was a little stall in the middle of the quarter, but a continued rise going into the end of June. The UKs referendum to exit the Eurozone was the topic of speculation for much of the 2nd quarter with the vote from the people coming on June 23rd. The uncertainty investors had over the economic impact caused increased volatility through much of May and June. The potential for economic global melt down from BREXIT took center stage and most other economic data was sidelined as far as impact to the markets. When the day of voting came and passed, voters did indeed pass the referendum and the UK was no longer part of the Eurozone. Equity markets sold off, and bonds rallied in a flight to quality style move. The FNMA30 3.0 coupon rallied, but not nearly as much as the US Treasuries. None the less the 103 handle on the coupon, that had been a resistance level, broke and the price moved to near 104. The move higher caused a serious rally in the 2.5 coupon to rally nearly one and a half points to 101 4/32nds going into the quarter. The coupon had been trading in the 98 and low 99 handle area previously. Not only did we see the 3 coupon become the predominant coupon during the 1st quarter, but now the 2.5 coupon looked like it may make a run to be the new current coupon.

The concerns of the global economy and the impact of BREXIT on our own economy put the Fed on the sidelines as far as raising the discount rate. Initially, coming into 2016, the Fed anticipated as many as 4 rate hikes during 2016. That moved down to 2 by March of the New Year and now many believe there may be only on rate hike for the whole year.

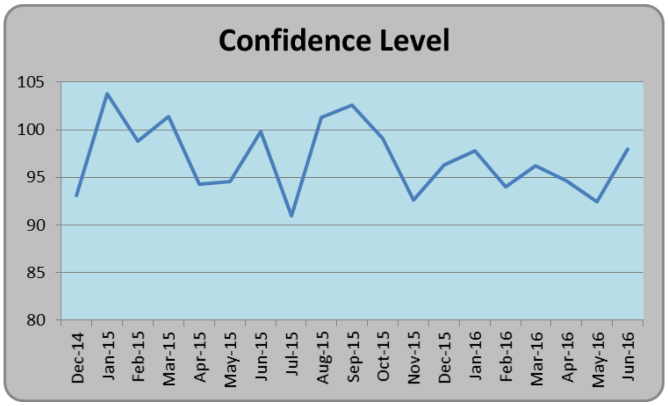
The 10-year treasury yield has an inverse relationship to the price of the FNMA30 3.0 coupon price chart. A similar type story but in a reverse fashion versus the FNMA30 3.0 coupon chart. The chart is showing a downward trend-line pattern dating back to late December of the 4th quarter. The yield fell from 2.30% down to a low of 1.65% in just over a month before it gradually moved higher for the remainder of the 2nd quarter. Once again, you can see the flight to quality in action once BREXIT became a reality. The 10 year yield fell to 1.45%, nearing record low territory at 1.38%. This was the lowest the 10 year yield had hit since back in the 3rd quarter of 2012.

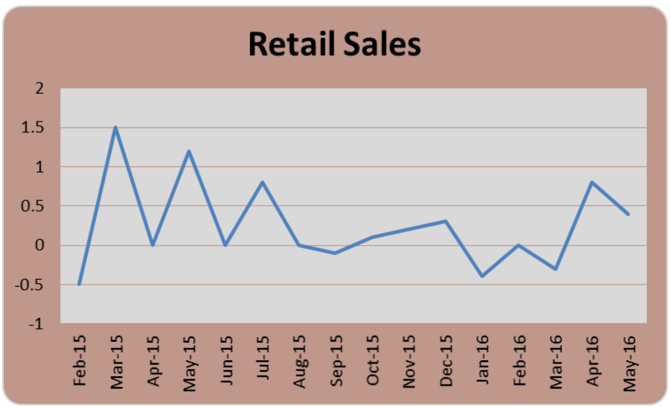
Fundamentals

- With one half of the year now in the books not only did the Fed not raise rate, they fell back down to near historic lows. The Fed tried to look for ammunition to continue raising rates, but for every slight bit of positive news there was, there was more concern over the negative. Global concerns persisted and inflation was still held in check. On the positive side for the economy, the price of oil began a rally that started in March and continued through mid-June, a sign of inflationary pressure. Retail sales showed some life in May. New home sales continued to show signs of improvement and even manufacturing seemed to turn the corner after nearly 2 years of decline. On the negative side Non-Farm Payrolls began to descend, rapidly. April fell to 125,000 in new payrolls and May was a dismal 38,000 in May. Consumer confidence was stagnant for the quarter as global concerns weighed on them.
- The story of employment and wage inflation remain a concern for the Fed. Even when there was increasing payrolls, the unemployment rate stalled at 4.9% and the consumer was still not spending as the Fed would have liked to see. So, overall inflation continues to remain below the Fed's target rate of 2%. This is even with the price of oil nearly doubling since hitting its bottom. This continues to suggest that many remain underemployed and wage inflation is not what the Fed wanted to see.

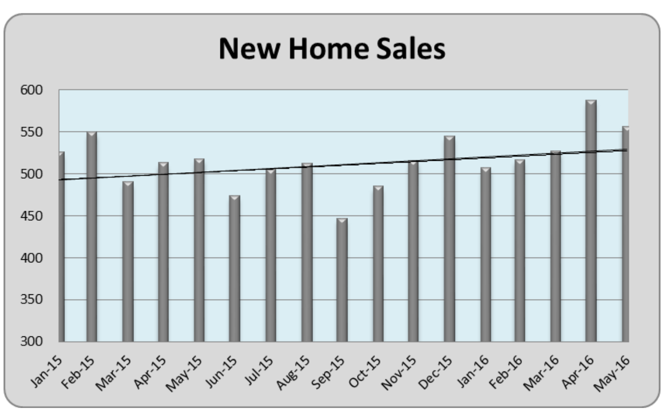


- Consumer Confidence has remained at levels below 100 for the whole 1st half of the year. Consumers continue to be wary about a strengthening economy going forward. Between oil rising, global economic concerns, and election for a new president getting closer, the consumer remains cautious. The price of oil rose to over $50 per barrel after hitting a low of $26 per barrel back in early February. The quasi tax credit of lower gas prices subsided somewhat during the 2nd quarter and consumer spending continues to be lack luster.



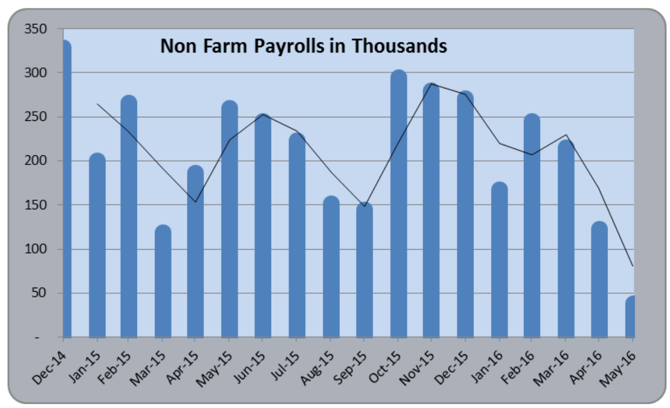


- Home Sales during the first quarter continued to show some resilience, and the general trend has moved steadily higher during the year at above 500,000 units on an annualize basis. Home Builders confidence has stalled from the highs they felt going into the end of last year. Regardless, the index value for home builder confidence remains close to near term highs.

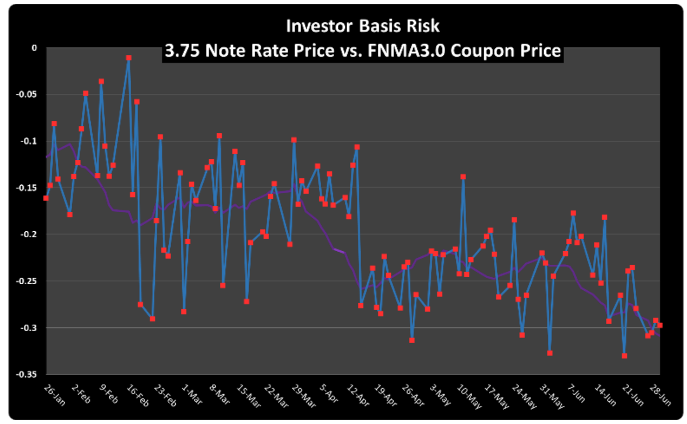


- Manufacturing improved during the 1st quarter, but stalled in the 2nd quarter.

- Payrolls held in for the 1st quarter of the year, however it was quite a different story for the 2nd quarter, culminating in a dismal May reading. The weakness in payrolls helped keep Yellen and the rest of the FOMC on the fence for raising rates.

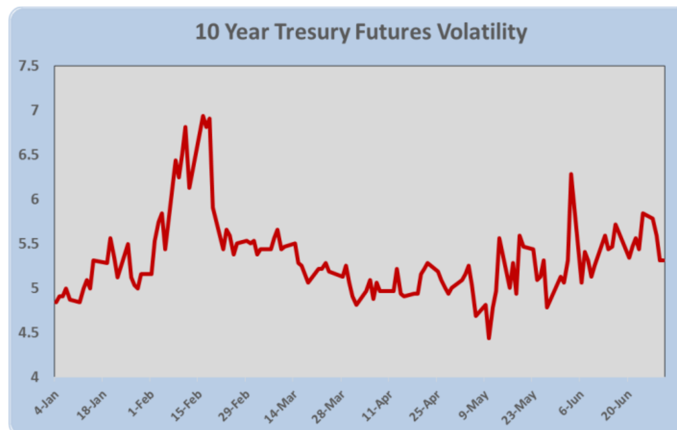


While the Fed would love to increase rates there have been too many concerning reports and the fragile European situation with BREXIT to make any attempt at making a move. While some of the hawkish voters still contend they should be raising rates, there has been a majority of the committee that felt differently. BREXIT has been the big wild card and it could be months before the impact may be seen in any economic data. Add it the less than optimal inflation, the weak employment, a stagnant consumer and you have a very tentative situation. It is conceivable that we could end this year with no raise in rates at all.



Market Volatility and Basis Risk

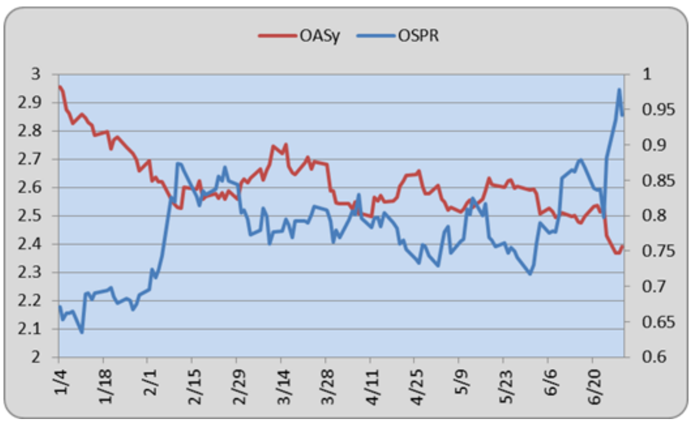
The second quarter after starting with limited volatility, sprang up for much of the quarter, The volatility was pretty much a result of the impending BREXIT vote and the unknown of the UK potentially leaving the Eurozone. The higher volatility prevented future opportunities to add option coverage out for those that utilize options as a strategy to help reduce the ebbs and flows of fall out. While the levels were not as high as they reached in February, they were high enough in increase premiums to unattractive levels.



Couple the increased volatility with declining investor prices relative to client hedges and the result could end in lower profitability. Part of the decline in investor pricing could be attributed to lower servicing valuations that hit the market after BREXIT. The trend lower started much before resistance levels were broken and prices headed to new highs. Additionally, after BREXIT loans with high balances were priced worse by 3/8ths of a point or more depending on the note rate. Investors were not only hitting servicing valuations, they were also hitting the price of high balance loans. Interestingly the changes in valuation far exceeded the increase in the price of the loans. The net affect was really prices to borrowers that were the same or worse than before BREXIT price moves.

Basis Spreads

Basis spreads between the current coupon FNMA30 3.0 and the 10 year yield remained in the range for most of the quarter until BREXIT became a reality. Flight to quality ensued after the referendum for BREXIT was passed and the spreads moved significantly wider. The spread widened to 97 basis points which was more than the previous top of the range by 10 basis points. That spike in spread indicates that the 10 year yield fell by 15 basis points in yield versus the mortgage rates. Couple that with investors backing off their servicing valuations by as much as 25 basis points in price and the net effect was more like 100 basis point spread. It left many loan officers wondering why they were not seeing price improvements and rate dropping. Many mortgage bankers pay attention to the 10 year yield to get a sense of where mortgage yields or prices may go. In this case it was a bad indicator.



1. Projects & Release Dates

At Mortgage Capital Management, Inc., we pride ourselves on having the gold standard in mortgage pipeline hedging analytics. We strive to constantly improve our product to our clients. In addition to our core analytics, we provide many other tools for our clients on our website to assist them in making decisions to sell loans at the best execution price. We are currently in Beta Testing with our best execution-pooling tool and are well into loan level best execution analysis to enhance our pooling tool. The enhanced tool will:

- Pool Loans using a Goal Programming Method to maximize pools according to stated criteria
- Best execution based pricing for each loan and pool according to a variety of investors and executions including:
  - Assignment of Trade and Direct Trade executions
  - Mandatory Pricing
  - Agency Retained
  - Agency Released
  - Securitization
  - Bulk Pricing

The Best Execution Model will include all Loan Level Price Adjustments according to what execution turned out to be best, State Adjusters, and Investor Service Released Premiums. It will allow our Partnership Accounts the ability to upload their individual SRP schedules and Investor Rate Sheets to the website.

Other projects that are in the works include:

On line trade Blotters and Trade Tickets to track outstanding trades. It is designed to track paired off trades that have not settled in the event a client has elected to have trades removed upon assignment. These new features will provide:

- Summary of information by dealer, by product and by settlement month.
  - Tracking reports showing combined trades to indicate where the client stands in relation to their margining thresh holds.

- Trade tickets that allows the trader to enter the trade information in a user friendly manner
- A trade blotter and entry system that creates an e-mail trade tickets and tracking mechanism that can be sent to targeted individuals.

Market Report,

Spreads & Bid Indications

During the quarter Fannie Mae opened up Low Bal pricing for its approved sellers. This opened the window for non securitizers to take advantage of the payups offered for low bal loans. Spreads generally narrowed as markets rallied during the quarter, but continue to offer decent payups. On the high bal arena, spreads have widened out since the beginning of April by nearly ¾ of a point across the board. The largest move came after the BREXIT referendum passed, and remained at high levels into the end of the quarter.

FN 30YR	85K	110K	150K	HLB2	20YR	10YR
3	18	13	12	1	30	10
3.5	43	32	30	9	29	5
4	62	42	40	24	40	2
4.5	88	62	48	32	20	1
Payup vs FN30 yr (32nds)						vs 15 yr

DOW 17,755

S&P 2,099

GOLD 1,318

Oil 48.33

Euro 1.11

Yen 103.25

UE Rate 4.9%

Mtg Apps 535,476 +9.2%

2. Web Based Training

Mortgage Capital Management is continually improving and creating new systems, reports, and analytics available to our clients on their individually supported and defined website. In order to assure that our clients understand all the tools, reporting and analytics available, we conduct training seminars periodically. The seminars will be web based with a question and answer period at the end of each session. Seminars will typically last 30 to 45 minutes depending on the subject matter plus a 15 minute question and answers session. Each will begin at 10:00 AM PST.

Topics will be repeated upon demand at specified dates in the future so if you miss one, chances are it will be offered again!

The next Web Based Training will be on May 12 at 10am PST.

Web Based training Schedule

25-AUG	Option Analysis