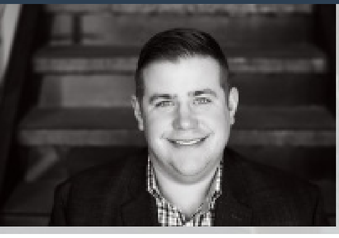

Michael Baker
Senior Mortgage Loan Officer, Fountain Mortgage
Individual NMLS: 259076 Company NMLS: 2579
8340 Mission Rd, Ste 240 Prairie Village, KS 66206

Office: 913-735-8455
Mobile: 913-735-5363
mbaker@fountainmortgage.com
View My Website

Everyone's Talking About Rates, But Not For All The Right Reasons

So far this year, interest rates (including mortgages) have spiked at the **quickest pace** since the US presidential election. They're currently at levels not seen since early 2014. It was all anyone in financial news could talk about this week, but some of that conversation should be taken with a grain of salt.

I'm not here to minimize the impact of the rate spike. There's no doubt that it's been quick or that it brings rates into unpleasant territory. The move has also been more methodical and determined than past examples of big rate spikes. Bond markets (which dictate rates) spent the 4th quarter winding up for the next big move in a very linear consolidation pattern (red dotted lines below) centered on 2017's previous highs (red circles). When rates finally broke out, there was **no question** as to which side they'd chosen.

The methodical and determined nature of the move is one of the problems. Market commentators prefer to pin big moves on clearly-defined, individual events or phenomena. For instance, following the election, the best guess was that Trump's probable policy path would create growth, inflation, or simply more bond market supply than traders wanted to buy. All of the above were **logical reasons** for the quick spike in rates. While a lot

National Average Mortgage Rates

	Rate	Change	Points
Mortgage News Daily			
30 Yr. Fixed	7.37%	-0.04	0.00
15 Yr. Fixed	6.82%	-0.02	0.00
30 Yr. FHA	6.82%	-0.06	0.00
30 Yr. Jumbo	7.55%	-0.05	0.00
5/1 ARM	7.42%	-0.08	0.00
Freddie Mac			
30 Yr. Fixed	7.22%	-0.22	0.00
15 Yr. Fixed	6.47%	-0.29	0.00

Rates as of: 5/2

Market Data

	Price / Yield	Change
MBS UMBS 6.0	99.78	+0.32
MBS GNMA 6.0	100.74	+0.26
10 YR Treasury	4.5795	0.0000
30 YR Treasury	4.7290	0.0000

Pricing as of: 5/2 10:25PM EST

Recent Housing Data

		Value	Change
Mortgage Apps	Apr 24	196.7	-2.67%
Building Permits	Mar	1.46M	-3.95%
Housing Starts	Mar	1.32M	-13.15%
New Home Sales	Mar	693K	+4.68%
Pending Home Sales	Feb	75.6	+1.75%
Existing Home Sales	Feb	3.97M	-0.75%
Builder Confidence	Mar	51	+6.25%

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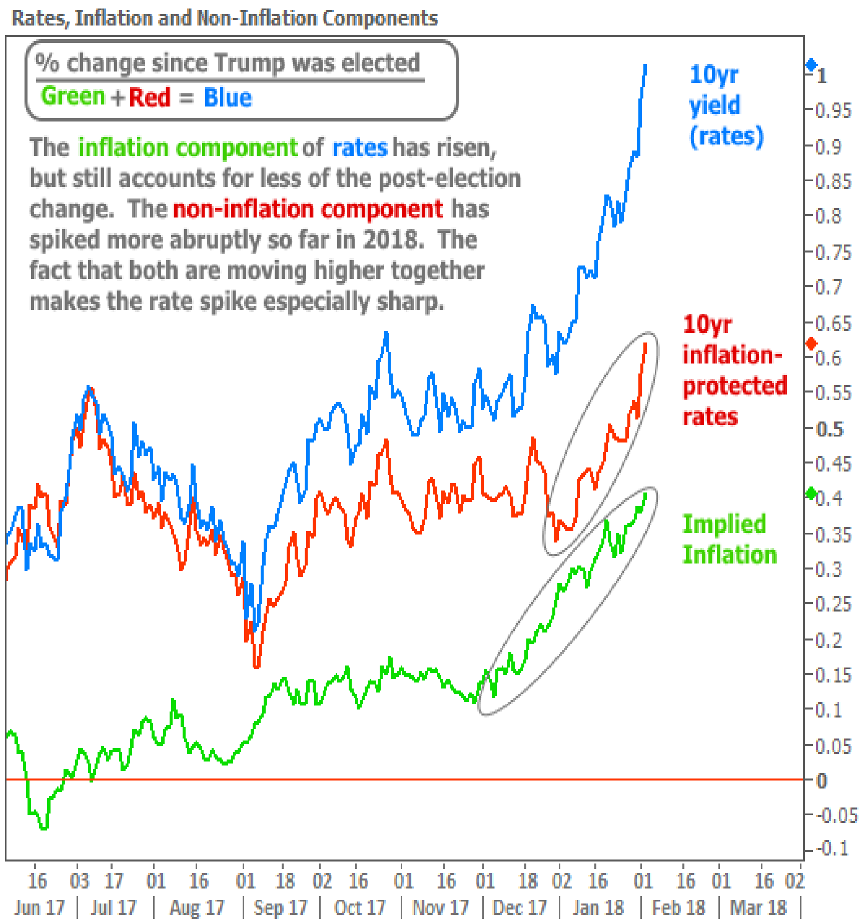
more could be added to that conversation, there was no question about the catalyst because **more than half** of the damage was done in the 3 days following the election.

This time around, there's no similar example of concentrated movement following a major event. It's really been a team effort. Still, there are **a few usual suspects** to examine any time rates make a big move without an immediately apparent motivation.

The first suspect is inflation. Higher **inflation** (actual or expected) pushes rates higher, all other things begin equal. So it's only logical to take a hard look at inflation if we're having a hard time explaining a rate move. But while inflation expectations are certainly a factor in the current move, a closer look quickly shows us it can't possibly be the only motivation.

The following chart breaks out the 10yr Treasury yield (the quintessential benchmark for longer-term lending rates in the US) into an inflation-adjusted component, and an implied inflation component. In other words, **rates are essentially 2 things:** inflation expectations and everything else. Adding them together gives us the actual 10yr yield. As seen in the chart, the non-inflation component still accounts for most of the post-election rise in rates. It also accounts for more of the abrupt move seen so far in 2018 (the inflation component has been moving higher more steadily and for longer, by comparison).



The other usual suspects are **monetary policy** (i.e. how friendly the Federal Reserve will be toward bond markets) and **fiscal policy** (i.e. how many new bonds will the government need to issue). In general, the Fed and other major central banks have been less and less friendly toward bond markets. The Fed is expected to continue hiking shorter term rates and to continue decreasing the amount of bonds it buys. Both actions put upward pressure on longer-term rates.

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On the fiscal side, the first year of the new tax system (as well as any other new spending initiatives) carry implications for increased Treasury issuance. In other words, the government is going to issue more debt so it can pay for "stuff." More debt supply implies lower debt prices, and lower debt prices result in **higher rates**.

In short, we have **all of the usual suspects** in play this time around. They're **all** looking guilty. In fact, it looks like they've all been **working together** to do **maximum damage** to rates. As you can appreciate, without one singular event to mark a shift in Fed policy, inflation, or fiscal policy, it's only logical that we would **NOT** have the same sort of 3-day spike seen after the presidential election. It's unfortunate that most "experts" feel compelled to explain things in the context of singular developments, but if you didn't already know better, now you do.

Adding to the problem was the fact that Friday's news showcased **two great examples** of convenient "singular development" type explanations. Both were bogus.

The **first** was that the as-expected jobs report caused a massive intraday rate spike. The theory varied depending on who was explaining it. Some pundits said the jobs number was just "really solid," while others focused on the wage growth component of the data coming in at the best annual pace of the entire recovery.

This point about the annual wage growth number **borders on comical** because the wage component of this month's data fell **perfectly** in line with the median forecast. The previous month was revised a tenth of a percentage point higher, resulting in 2.9% year-over-year wage growth as opposed to the 2.8% expectation. A tenth of a percentage point in year-over-year wage growth is not now, nor has it ever been, a basis for a rapid move to the highest rates in more than 4 years. Does it help? No... but it isn't what hurt us.

What hurt us is the fact that **traders are increasingly lining up to get out** of the bond market because they're increasingly seeing the writing on the wall from the usual suspects discussed above. Different traders realize and react to this reality at different paces and by different magnitudes. The change over from January to February was a natural barrier for certain traders who had to hold a certain mix of bonds for month-end reporting. They were suddenly free to make new trades as February began. This resulted in a huge rate spike on Thursday. Then on Friday, they waited to make sure there wouldn't be a big miss in the jobs number as that would have cost them a lot of money in short order (traders definitely use the jobs report as a focal point for short-term strategy). When the jobs report came out in stronger territory, it opened the floodgates. Importantly, the strong jobs number did NOT create the flood. The historical street cred of the data simply acted as the floodgate.

Friday's other singular development actually used rates as an explanation for the big losses in the stock market. You couldn't see 30 seconds of financial news without someone blaming the rate spike for the stock sell-off.

Is this true?

Not really. While there are surely plenty of investors out there who might jump off the fence and decide to sell stocks because someone else said higher rates are scary, there are surely nowhere near enough of them to cause a sudden, sharp shift in equities. Don't overcomplicate this one... People are selling stocks **because other people are selling stocks** (and because everyone's nervous about how high and stable stock prices have been). When higher rates actually exert pressure on stocks, it's a much slower and more subtle phenomenon. If anyone argues this point with you, just show them all the recent examples of stocks and rates moving higher TOGETHER.

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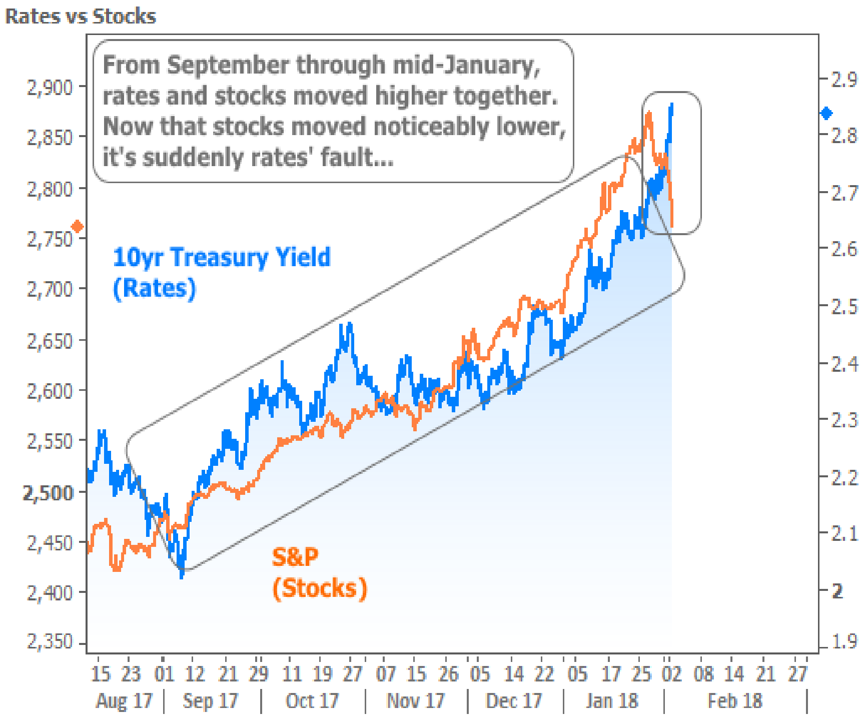
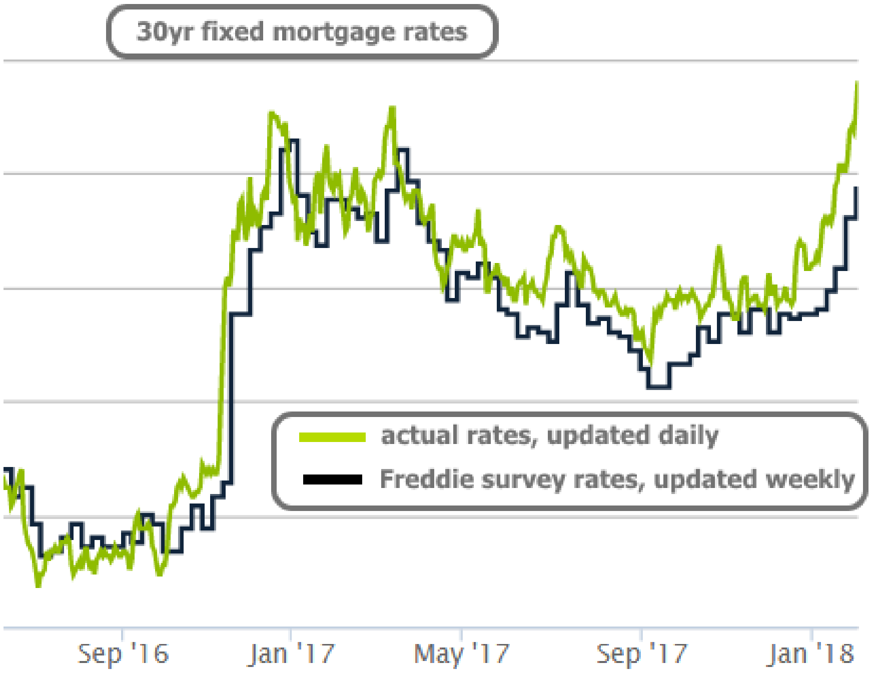


How is all of this drama playing out in the **housing and mortgage markets?** Any time 10yr Treasury yields are at multi-year highs, mortgage rates aren't likely to be too far behind. Mortgages hadn't quite crossed that dubious threshold as of last week, but this week was a different story. Although this chart doesn't show it, you'd have to go back to early 2014 to see higher rates. Many lenders are up into the mid 4's on conventional 30yr fixed quotes for well-qualified borrowers.



In terms of refi demand, the **silver lining** to languishing application numbers is that they just don't tend to go much lower. Higher values have kept the cash-out refi demand fairly steady. If we're to see fallout in mortgage apps, the purchase side of the market looks like it has more to lose, but it's certainly not showing signs of distress at the moment.

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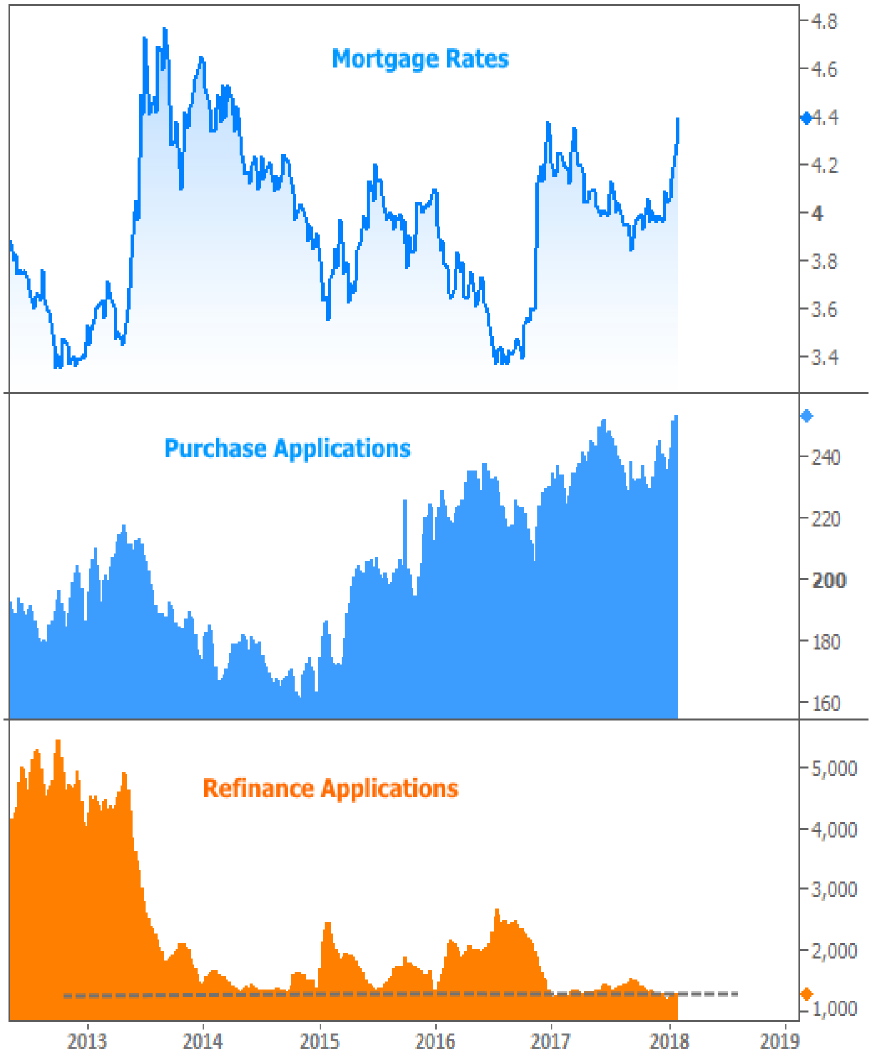

Home sales data has been similarly **free from distress**. This week's biggest sales report was the National Association of Realtors' Pending Homes Index, which is something of an advance indicator for the bigger Existing Home Sales report. Pending sales gained a bit more than economists expected, but the caveat is that the data was collected before this week's rate spike took place.

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Pending Home Sales Index

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Recent Economic Data

Date	Event	Actual	Forecast	Prior
Monday, Jan 29				
8:30AM	Dec Personal Income (%)	+0.4	0.3	0.3
8:30AM	Dec Consumer Spending (Consumption) (%)	+0.4	0.4	0.6
Wednesday, Jan 31				
7:00AM	w/e Mortgage Refinance Index	1288.0		1325.8
7:00AM	w/e MBA Purchase Index	255.5		264.4
8:15AM	Jan ADP National Employment (k)	234	185	250
9:45AM	Jan Chicago PMI	65.7	64.1	67.8
10:00AM	Dec Pending Home Sales (%)	+0.5	0.4	0.2
2:00PM	N/A FOMC rate decision (%)	1.250 - 1.500	1.375	1.375
Thursday, Feb 01				
8:30AM	Q4 Labor Costs Preliminary (%)	2.0	0.8	-0.2
8:30AM	Q4 Productivity Preliminary (%)	-0.1	1.0	3.0
8:30AM	w/e Jobless Claims (k)	230	230	233
10:00AM	Jan ISM Manufacturing PMI	59.1	58.8	59.7
10:00AM	Dec Construction spending (%)	+0.7	0.4	0.8
Friday, Feb 02				
8:30AM	Jan Non-farm payrolls (k)	200	180	148
8:30AM	Jan Unemployment rate mm (%)	4.1	4.1	4.1

Event Importance:

No Stars = Insignificant
☆ Low
★ Moderate
★★ Important
★★ Very Important

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Date	Event	Actual	Forecast	Prior
8:30AM	Jan Average earnings mm (%)	0.3	0.3	0.3
10:00AM	Dec Factory orders mm (%)	1.7	1.5	1.3
Monday, Feb 05				
10:00AM	Jan ISM N-Mfg PMI	59.9	56.5	55.9
Tuesday, Feb 06				
8:30AM	Dec International trade mm $ (bl)	-53.1	-52.0	-50.5
1:00PM	3-Yr Note Auction (bl)	26		
Wednesday, Feb 07				
7:00AM	w/e Mortgage Market Index	416.3		413.4
Thursday, Feb 08				
8:30AM	w/e Jobless Claims (k)	221	228	230
Friday, Feb 09				
10:00AM	Dec Wholesale inventories mm (%)	0.4	0.2	0.2
Wednesday, Apr 11				
1:00PM	10-yr Note Auction (bl)	21		
Thursday, Apr 12				
1:00PM	30-Yr Bond Auction (bl)	13		

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About Michael

If you are thinking about buying or refinancing a home in the Kansas City area, you've probably faced the dilemma of hiring the right Loan Officer to handle your mortgage. You may be concerned about working with someone that doesn't know the area, or who doesn't listen to you. Maybe you're worried about a loan officer who is more concerned with a commission than making sure you're properly taken care of.

Great news - I can help!

IF YOU ARE THINKING OF BUYING A HOME... I would love to share with you the mortgage loan products that are available to you, and also talk about what homes might be coming onto the market very soon. As a Kansas City resident who also went to college just down the street in Lawrence, I'm not just your loan officer but also your neighbor. I'd love to talk to you about my knowledge not only about the Kansas City market, and what neighborhoods would be perfect to you but also help you truly understand the landscape of the mortgage industry today, and introduce you to great Real Estate Agents that are ready to go to work for you and find you the perfect home. I'll help guide you through appraisals, inspections, title searches, and finally closing.

IF YOU ARE A REALTOR LOOKING FOR A REFERRAL PARTNER... I would love to sit down with you over a cup of coffee and show you ways to generate leads for your business and help you grow your clientele through some easy processes that NO other Real Estate Agents are doing. I am a growing Social Media guru that can show you my tips and tricks on how I've doubled my Twitter base in just a month!

If it sounds like I can help you, please contact me directly through Linked In, email me at mbaker@affinityhomeloan.com or call/text me at 913-735-5363. If you’re not yet ready for a conversation, but you’d like to learn more about me and how I can help you or about the mortgage process in general, including great blog posts to send out to your clients, check out my website at http://www.michaelbakerhomeloans.com.

Michael Baker 

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