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MBS Mid-Day: Biggest Rally in 2 Months. Why?

Bond markets are in the midst of their best day of trading since October 2nd. For perspective, that says less about how strong things are today and more about how weak the past 2 months have been. For instance, Fannie 3.5s are up a mere quarter point on the day, and only 3/8ths of a point trough to peak, but that's enough to claim the top spot. 10yr yields are down 5.4bps (almost 9 from peak to trough) and that completely obliterates anything since early October.

The point is that bond markets have either been selling-off or tepidly recovering for the past 2 months and today is the first day that stands out as **something new and different.**

Why is this happening?

At first glance, this morning's ISM report **looks like a culprit**. It came in under 50 for the first time since late 2012--the lowest level since 2009, actually. It also missed the median forecast of 50.5 by quite a wide margin. There are only 3 little problems with giving it all the credit.

First, ISM Manufacturing **hasn't** been a terribly potent market mover in 2015. We know that manufacturing has been slumping and ongoing weakness is no surprise. Perhaps this was a "last straw" of sorts, but I still think markets could have shrugged this one off under different circumstances.

Second, the rally was **already well underway** by the time ISM data came out. 10yr yields were already well past their recent lows by 10am (near the lowest levels in a month actually). The ISM data simply kicked the rally into a higher gear.

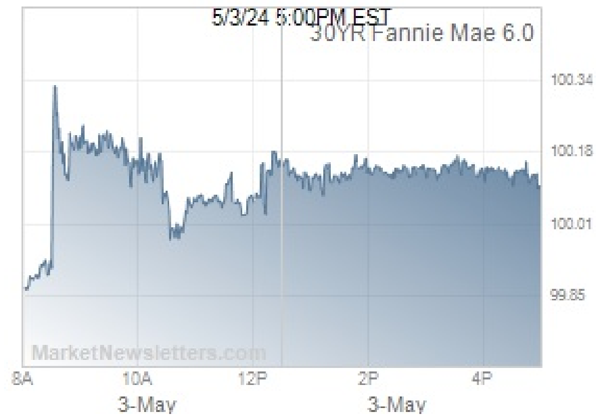
Finally, if we consider the fact that the **Employment** component of the ISM data was the only positive piece of the report, AND that the employment components of both ISM reports tend to get more scrutiny on NFP week, we can further conclude that the strength is about something other that just the data. The data is helping, to be sure, but it's not acting alone and perhaps not even leading the effort.

The **bigger deal** is likely the **bigger picture**. If the rally had to do with fear about the Fed having a change of heart, we'd be seeing the shorter term yields (like 2yr notes) falling faster than longer term yields, but they are not. Additionally, Fed Funds Futures are little-changed. Instead, this rally

MBS & Treasury Market Data

	Price / Yield	Change
MBS UMBS 6.0	100.09	+0.31
MBS GNMA 6.0	101.03	+0.29
10 YR Treasury	4.5138	-0.0657
30 YR Treasury	4.6711	-0.0579

Pricing as of: 5/3 5:04PM EST



Average Mortgage Rates

	Rate	Change	Points
Mortgage News Daily			
30 Yr. Fixed	7.28%	-0.09	0.00
15 Yr. Fixed	6.75%	-0.07	0.00
30 Yr. FHA	6.70%	-0.12	0.00
30 Yr. Jumbo	7.48%	-0.07	0.00
5/1 ARM	7.35%	-0.07	0.00
Freddie Mac			
30 Yr. Fixed	7.22%	-0.22	0.00
15 Yr. Fixed	6.47%	-0.29	0.00
Mortgage Bankers Assoc.			
30 Yr. Fixed	7.24%	+0.11	0.66
15 Yr. Fixed	6.75%	+0.11	0.64
30 Yr. FHA	7.01%	+0.11	0.94
30 Yr. Jumbo	7.45%	+0.05	0.56
5/1 ARM	6.64%	+0.12	0.87

Rates as of: 5/3

probably has more to do with the bigger-picture considerations like the outlook for the economy in the years ahead.

On a more esoteric note, we could also be seeing a fair amount of momentum simply due to the way traders have closed out November's trading positions and set up new positions for December. This hand-off between any 2 months can often create **momentum of its own accord**. I wouldn't chalk today's rally up to that exclusively, but it's probably helping. On a final, simple note, short-covering could also be contributing. Keep in mind that today is the first break below 2.20 in 10yr yields since the lat October selling spree took yields to nearly 2.38. 2.20 is right about mid-point in that sell-off, which could be a cue for many traders to avoid further erosion of their profits by covering those shorts (aka, bets on rates moving higher).

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