Mortgage Broker's Best
Financing Your Future!

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Insanity Continues; What's The Fed Doing And Will They Buy MBS?

Let's clear a few things up.

The Fed was already buying $60bln / month of bonds. Yesterday's announcement meant that the composition of those bonds was changing.

Yesterday's announcement said nothing and implied nothing about mortgage-backed securities (MBS). Yesterday's announcement may have been taken by some to imply the Fed would soon be willing to buy more MBS.

The Fed is currently doing nothing MBS-related with the first $20bln per month of proceeds on its existing MBS portfolio (the first $20 bln goes to Treasuries). Anything beyond that is being reinvested as new MBS purchases. These amounts have been relatively small after the Fed phased in the $20bln cap policy. The biggest month of proceeds last year was under $30bln (i.e. under $10bln of new MBS buying) and recent months have seen far less than that ($1-3 bln). In other words, this is not a meaningful contribution to the buy side of the MBS equation

I referred to yesterday's announcement as QE4. But that's a bit of an overstatement considering the Fed originally specified this $60bln as being for temporary liquidity through the 2nd quarter of 2020. Moreover, if its intention is to offset liquidity constraints, it's arguably not the same sort of QE we know from the past, which absolutely juiced the Fed's balance sheet.

With all that in mind, some smart people are convinced the Fed will announce such a balance sheet juicing at or before next week's meeting. A subset of those smart people are convinced the Fed will make MBS a part of that new "true QE" (which will likely involve a higher monthly dollar amount than we've seen previously). I haven't been keen to agree with this point for a few reasons.

The Fed wouldn't want to increase refi demand in an already overloaded market. Or if they do, they're dumb. The Fed also would probably wait to see if spreads heal on their own, which is only in question due to the super low Treasury yields we're currently seeing. Otherwise, the precedent has been well established for MBS to not freak out to the extent they require Fed intervention since 2012. Even then, there was no telling if the problem would have self corrected, but the Fed left nothing to doubt with QE3 in September 2012 (which specifically targeted MBS, as if to say "don't worry... we won't let spreads blow out").

MBS and Treasury

	Price / Yield	Change
MBS UMBS 6.0	100.20	+0.45
10 YR Treasury	4.8941	-0.0762
30 YR Treasury	5.2858	-0.0460

Pricing as of: 11/4 12:35PM EST



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Those have been my counterpoints anyway. Now today, watching MBS spreads blow out yet again, it's starting to look like the market is attempting to force the Fed's hand. I'm not saying to count on a new round of Fed MBS buying, but I am saying I wouldn't rule it out as of today.

As far as financial markets are concerned, for those wondering just what the hell is going on with bonds in general. Treasuries are telling us they found bottom at 0.318% and have since been in the throes of a technical bounce. This doesn't mean rates have to continue relentlessly higher back into the mid-1% 10yr yield range, simply that a new range will be determined at some level that's higher than 0.318%.



The chart above (10yr yields) doesn't give the impression of a technical correction that's strayed too far from "orderly" given the ground covered in previous weeks. The chart below (MBS) is a different story. Last week's candlesticks show the onset of their inner conflict. On the one hand, Treasuries were rallying so hard that MBS was compelled to try to keep some semblance of pace. On the other hand, MBS were really starting to worry about a huge ramp in supply. This week, as Treasuries stopped their incessant rally (see the orderly technical correction above), MBS have completely given themselves over to correcting their over-supplied condition. Treasuries were driving the car and MBS were starting to get sick. As soon as the car pulled over, MBS opened their door and let out everything they'd been doing their best to hold in.

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