Rich E. Blanchard
Managing Director, RICH Home Loans LLC
NMLS: 492461
1550 Wewatta St., 2nd Floor Denver, CO 80202

Office: 720.619.9900
Mobile: 303.328.7047
Fax: 214.975.2874
richblanchard@richhomeloans.com
View My Website

The Day Ahead: Oil Adding Fuel to Bonds' Inflationary Fire Fears

Yesterday we discussed the **positive** impact of month-end bond buying. The only **problem** with month-end buying that occurs on the day before month-end is that it can leave an imbalance of sellers on the last day of the month. This is a bit counterintuitive because there's a tendency to view month end buying as the overall bond market needing to hold certain levels to meet month-end index values (read the link if you're not sure what I'm talking about). In practice, that's not how it works at all.

Month-end index extensions provide cues for a certain subset of traders to hold a certain mix of bonds. Once they've bought enough bonds to achieve that mix, they're out. They **no longer** need to buy or sell for month-end purposes. So if most of those traders get most of their buying done on the day before month-end, it can certainly leave an imbalance of sellers afterward.

All that having been said, we need a few reasons for an imbalance of sellers to arise in the first place. Today's **OPEC meeting** is providing plenty!

Now, I'll be the first to remind you that oil prices definitely **do not** correlate perfectly with bond yields. For every strong example of short-term correlation, there is an equally compelling example of the correlation completely reversing. But at the moment, when bond markets are very interested in longer-term inflation implications due to potential policy changes, anything that speaks to longer-term inflation pressure (like rising oil prices) adds fuel to the fire, so to speak.

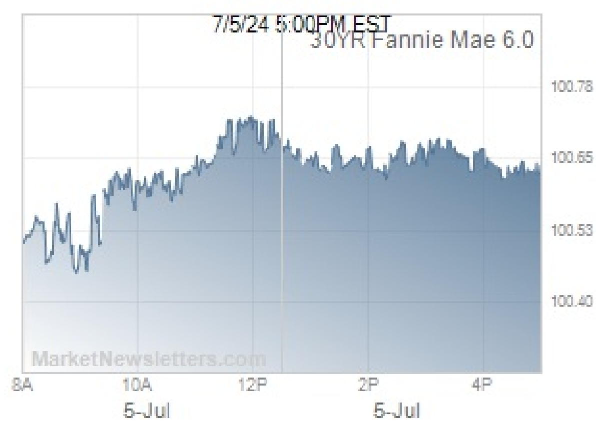
There's also the matter of **short-term** oil price fluctuations versus those that result from long-term, **general** agreements like those ostensibly occurring at today's OPEC meeting. Could it be smoke and mirrors? Could it be reversed? Could it be changed? Sure! But for now, the takeaway from the OPEC meeting is "yes, we will limit production in order to get the price of oil to move a bit higher."

As such, today's oil price spike is **being taken more seriously** than the spike seen 2 weeks ago, even though outright prices are about the same (again, it's all about the long-term agreement to limit production as opposed to today's specific trading response). That said, correlation will look better today because the long-term, general agreement is putting upward pressure on oil prices and bond yields simultaneously.

MBS & Treasury Market Data

	Price / Yield	Change
MBS UMBS 6.0	100.61	+0.22
MBS GNMA 6.0	100.74	+0.21
10 YR Treasury	4.2818	-0.0784
30 YR Treasury	4.4857	-0.0440

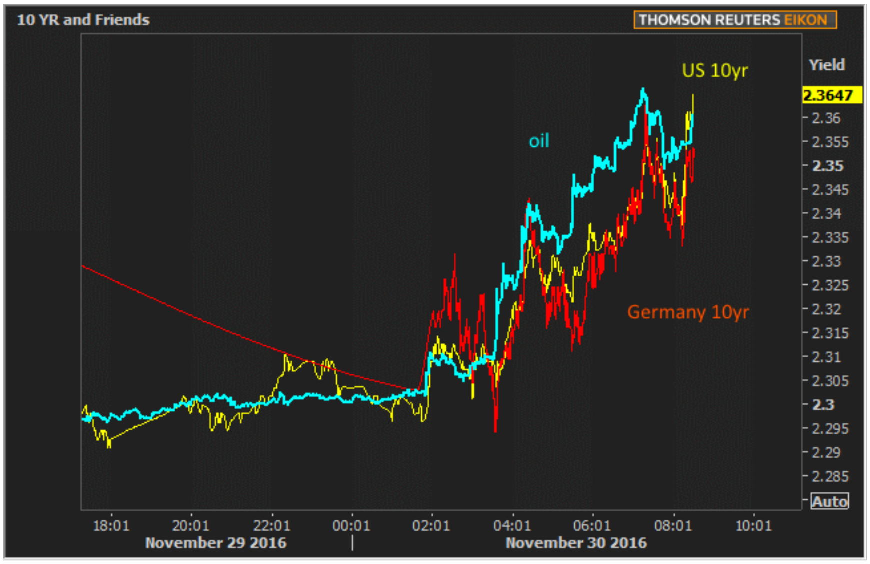
Pricing as of: 7/5 5:59PM EST



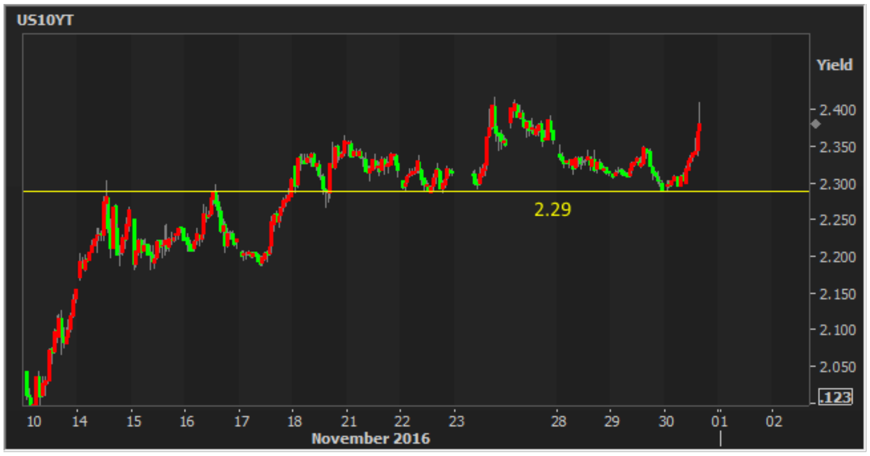
Average Mortgage Rates

	Rate	Change	Points
Mortgage News Daily			
30 Yr. Fixed	7.03%	-0.05	0.00
15 Yr. Fixed	6.44%	-0.01	0.00
30 Yr. FHA	6.50%	-0.05	0.00
30 Yr. Jumbo	7.24%	-0.01	0.00
5/1 ARM	7.05%	-0.02	0.00
Freddie Mac			
30 Yr. Fixed	6.95%	+0.09	0.00
15 Yr. Fixed	6.25%	+0.09	0.00
Mortgage Bankers Assoc.			
30 Yr. Fixed	7.03%	+0.09	0.62
15 Yr. Fixed	6.56%	+0.09	0.54
30 Yr. FHA	6.90%	+0.11	0.95
30 Yr. Jumbo	7.11%	-0.01	0.50
5/1 ARM	6.38%	+0.11	0.54

Rates as of: 7/5



Given that the overnight session saw 10yr yields hit (and, importantly, **FAIL** to break below the **critical** 2.29% pivot point), today's technicals are as negative as yesterday's were positive. The significance of these technical levels are not lost on bond traders, and as we discussed yesterday, the current set of pivot points is pretty obvious. There's no question that a bounce at 2.29% is its own compelling reason to sell bonds.



In terms of daily candlesticks, today is shaping up to finish off a negative formation known as "rising 3 methods."

There are a **few caveats** though. First of all, candlestick patterns sound "cool," but they're no more of a crystal ball than any other technical approach. Additionally, Wed the 23rd would have needed to close in weaker territory to truly fit the description of the rising 3 methods. You can read more about the formation here. The best way to approach it is to view it as a modestly negative anecdote for current momentum. If 10yr yields manage to hold below 2.42% today, that will be a modestly positive anecdote.

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