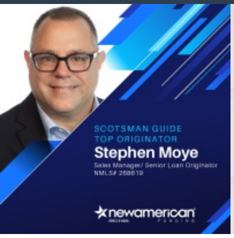

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A Message from Stephen Moye:

"This is a great explanation of something that can be difficult to explain. Reach out if you have any ?s, and I always appreciate you sharing this"

The Day Ahead: Short-Term Rates Are Responsible For Recent Pain; Is It Over Yet?

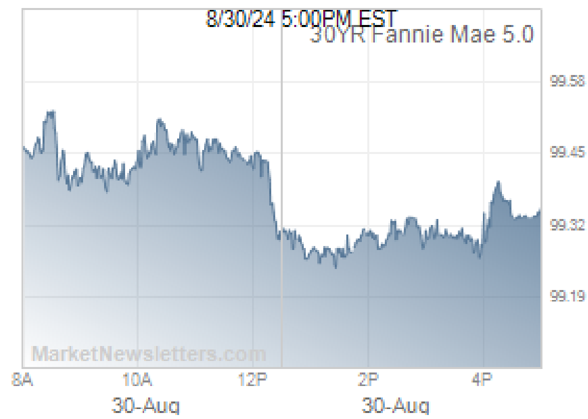
A certain reality of the recent rate spike needs to be revisited based on conversations I've had with a few clients. Thankfully, it's pretty simple: short term rates have been pushing all rates higher.

In general, short-term rates rise toward long-term rates during economic expansions. When they get close enough (or when short-term rates rise **ABOVE** long-term rates), it's often a sign that a broader reversal is soon to follow. With that in mind, we're moving in that direction, but still have a ways to go.

MBS & Treasury Market Data

	Price / Yield	Change
MBS UMBS 5.0	99.37	+0.02
MBS GNMA 5.0	99.93	+0.02
10 YR Treasury	3.9068	+0.0029
30 YR Treasury	4.1960	+0.0028

Pricing as of: 9/1 7:34PM EST



Average Mortgage Rates

	Rate	Change	Points
Mortgage News Daily			
30 Yr. Fixed	6.43%	+0.02	0.00
15 Yr. Fixed	5.95%	0.00	0.00
30 Yr. FHA	5.82%	+0.02	0.00
30 Yr. Jumbo	6.62%	0.00	0.00
5/1 ARM	6.28%	-0.01	0.00
Freddie Mac			
30 Yr. Fixed	6.35%	-0.51	0.00
15 Yr. Fixed	5.51%	-0.65	0.00
Mortgage Bankers Assoc.			
30 Yr. Fixed	6.44%	-0.06	0.54
15 Yr. Fixed	5.88%	-0.16	0.68
30 Yr. FHA	6.36%	-0.06	0.85

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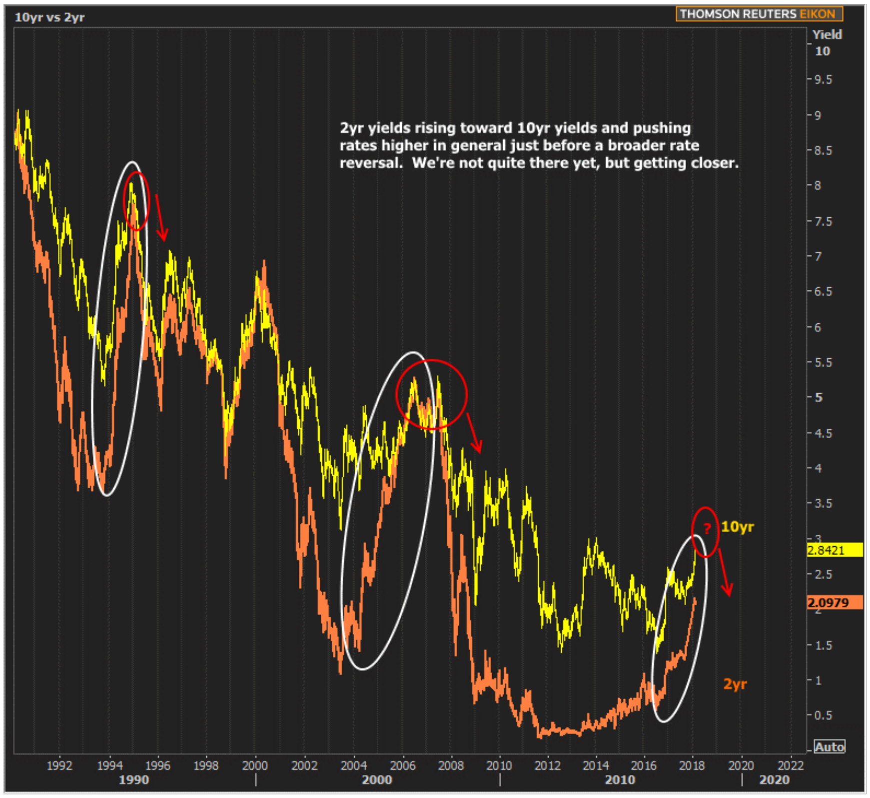
	Rate	Change	Points
30 Yr. Jumbo	6.75%	+0.07	0.39
5/1 ARM	5.98%	-0.27	0.65

Rates as of: 8/30



For the record, the gradual rise in the orange line in the chart above is largely a function of Fed policy expectations. Short term rates are infinitely more vulnerable to the **Fed's rate hike outlook**, so when markets saw the Fed becoming more and more willing to hike, 2yr yields began moving up from their long-term floor and put pressure on longer-term yields. The latter took a hit of their own after the presidential election due to concerns over increased supply, a steeled resolve for the Fed to exit asset purchases, and inflation concerns.

We can take a more detailed look at this phenomenon by plotting the yield curve (the spread between 2 and 10yr yields). The post-election jolt to 10yr yields caused the yield curve (the spread between 2 and 10yr yields) to rise/steepen to levels that were in line with the last major floor. This can be seen in the following chart. When the yield curve bounced, **longer-term yields also recovered.** And now, the yield curve is once again approaching levels that had acted as a floor in the recent past.

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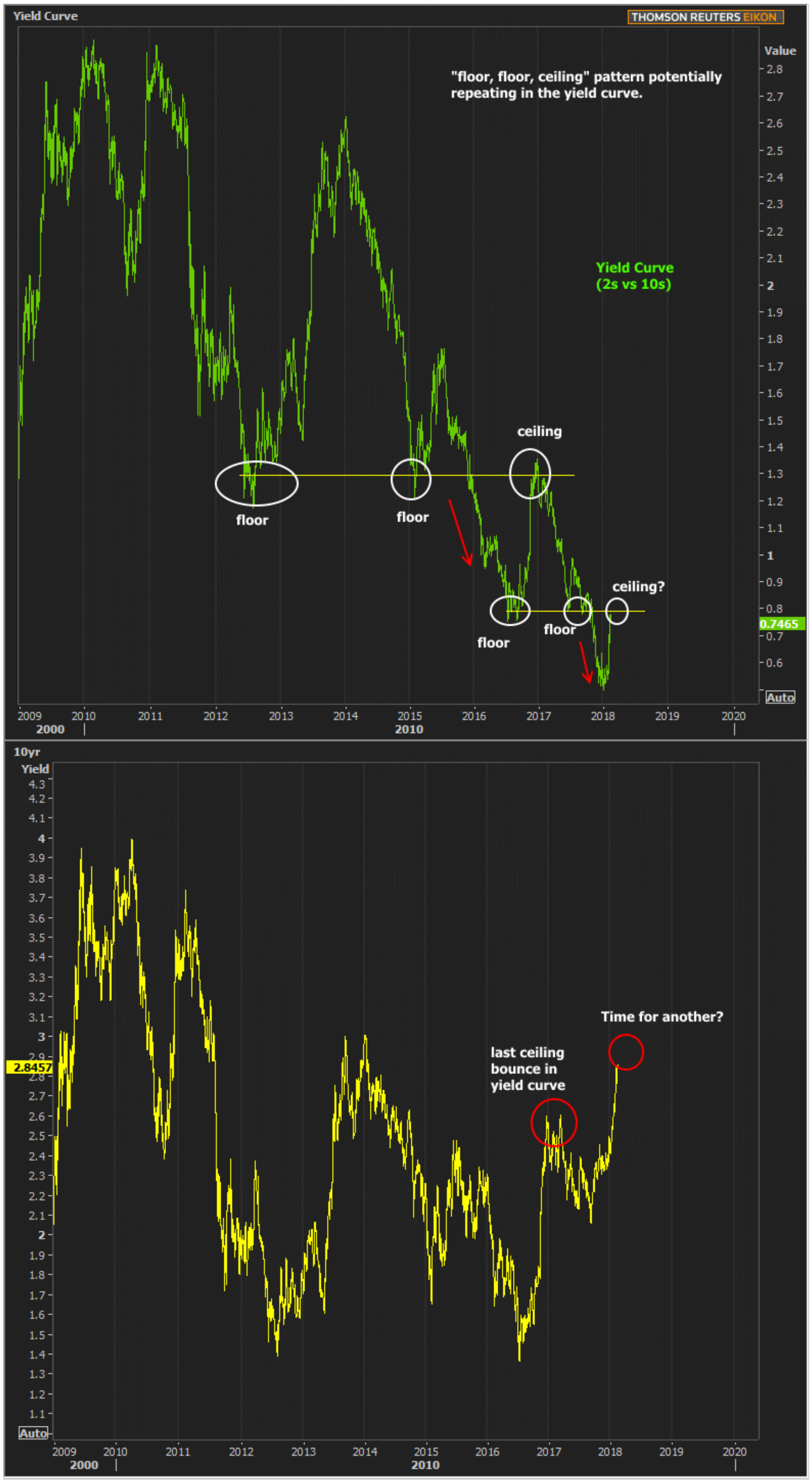

If these yield curve levels turn out to be a ceiling in the same way as late 2016 levels, then we're close to seeing broader support for longer-term rates. A **word of caution** though: the yield curve and long-term rates are chickens and eggs. In other words, it's not just short-term rates that drive long-term rates. Long-term rates have some of their own considerations as well. It will be very hard for long-term rates to gain meaningful ground while staring down the barrel of decreased Fed bond buying and potentially increasing growth and inflation.

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Thankfully, much of that "very hard to gain" mentality is priced in to the recent selling spree. Investors continue looking for a longer-term ceiling. Granted, that could be quite a bit higher still (higher than 3%), but in a bigger-picture context, we're getting closer. From here, 10yr yields can benefit from an asset allocation trade (fund managers and retail investors seeing value in yields near 3% in an environment where perpetual stock gains are being called into question). This is a gradual story that would play out over months.

In the near term, inflation can also help (or hurt). With that in mind, every release of the Consumer Price Index (CPI) provides an opportunity for markets to adjust their inflation tracking, thus making for big potential changes in longer-term rates. The next CPI release is tomorrow morning! Between now and then, huge moves are unlikely, but a "lead-off" is always possible ahead of big data.

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