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## The Week Ahead: Positions Part 2: Making Better Sense of Early 2018

Last Friday's Day Ahead was all about positions. [Read it HERE](#), if you haven't done so or need a refresher. It advocated caution with respect to floating or otherwise being optimistic based on early gains because those early gains were likely a product of short-covering. Rampant short-covering is only a concern when short positions are uncommonly abundant. In turn, that sort of abundance is uncommon. It **relies on a sea-change** in some critical component of the market such as **Fed policy, labor markets, fiscal policy, or inflation**.

That's where things might get **frustrating** this year--because how much have any of those factors really changed? Let's break them down:

- 1. Fed policy.** No major change. We expected a more aggressive Fed hike path in late 2017 and nothing in early 2018 has materially changed that. Same story with the balance sheet normalization.
- 2. Labor markets.** Less than no change! Job growth has been strong and stable for a long time. Despite the news stories focusing on epic wage growth, it's just been decent and stable for several years with no major surprises.
- 3. Fiscal policy.** We already knew we should expect a big ramp up in Treasury issuance by the end of 2017 thanks to the tax bill and other probable policies that would require increased government debt
- 4. Inflation.** No major changes here with Core CPI continuing to run under 2% despite slight upticks that are easily traced back to a stabilization and bounce in oil prices (exactly as the Fed predicted. Spooky, eh?)

The point is that nothing took a major turn for the worse in 2018 when it comes to the stuff we can point to as being a major headwind for bond markets. Yet bonds themselves took a major turn for the worse! **What gives?!**

## 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
<b>Mortgage News Daily</b>			
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
<b>Freddie Mac</b>			
30 Yr. Fixed	6.35%	-0.51	0.00
15 Yr. Fixed	5.51%	-0.65	0.00
<b>Mortgage Bankers Assoc.</b>			
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

"What gives" is that the short list of critical components above needs a quick revision. That list consisted of components that could create an abundance of positions. But what if an **abundance of positions** was the component itself?! Stay with me here. This is both elegantly simple and potentially confusing.

	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

At first glance, positions are most easily understood as a product of some fundamental motivation (i.e. more Treasury issuance expected, so traders adjust positions to be shorter in the bond market--they're betting on higher rates). While that's almost entirely true, timing can play an important role. The beginning of any given new year can provide **striking examples** of this as there is occasionally a glut of new positions waiting to be taken.

Part of my challenge in relating the beginning of 2018 to other examples of selling sprees (like in this excellent post which compared it to 2013), is that I was looking at selling sprees specifically. But what if we just look at the sort of overabundance of positions mentioned above? If we broaden the search to moves that are both positive and negative, we quickly see that 2016 is almost a **perfect mirror image** of 2018. Just as the past 1.5 months offered up an uncannily relentless sell-off, early 2016 offered a rally that was just as seemingly inexplicable.

The answer is POSITIONS. When traders are compelled to hold onto certain positions for the end of any given year, and when other traders are tactically adding to that momentum by riding the same bandwagon, the glut of opposite positions that washes over markets in the new year can defy fundamental explanation. But forget all these words! Just look at the chart of 2015/2016 compared to 2017/2018. Massively sideways in the last 1.5 months of the previous year, and then uncannily "trending" in the first 1.5 months of the following year. **Simply put**, this is the flood of "new year" positions.



If 2016 is any indication, this evil phantom force of bond market negativity could be close to running its course. Keep in mind though, that's only a reference to the unseen hand of positional imbalances. Bonds can still be impacted positively or negatively by new developments in the big fundamental inputs (Fed, Fiscal, Econ, Inflation). We'll get several Fed speeches throughout the week (including FOMC Minutes on Wed afternoon) as well as some input on the effects of fiscal policy by way of the biggest week of Treasury issuance on record.

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