



## Stephen Moye

Sales Manager/Senior Loan Officer NMLS:  
268619/CA-DBO268619, New American Funding Corporation. NMLS: 6606, Equal Housing Lender  
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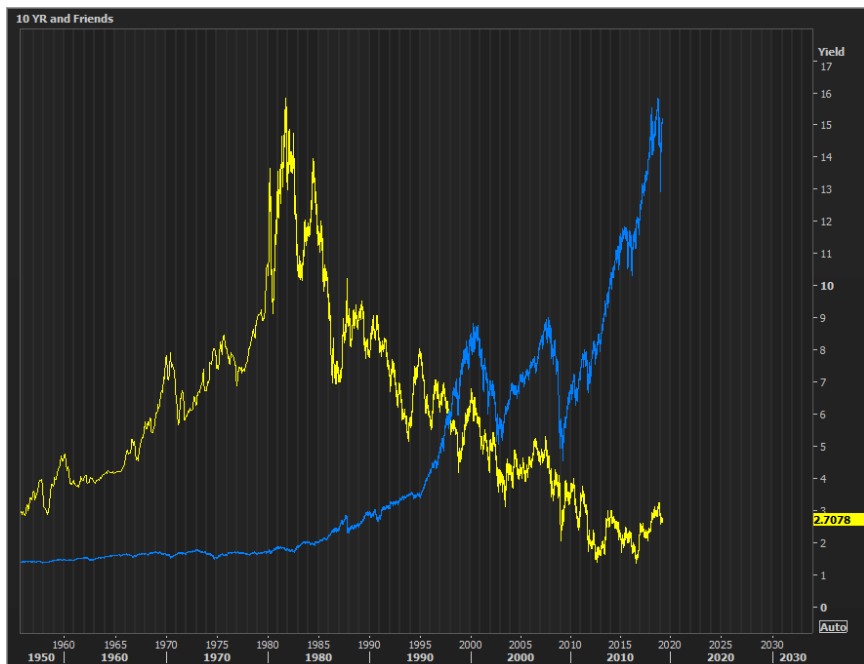
Under the California Residential Mortgage Lending Act  
CA-DBO268619 Corp. NMLS: 67180 Equal Housing Lender  
1615 Murray Canyon Road #1050 San Diego, CA 92108

Office: 619-309-1678  
Mobile: 619-895-8128  
Fax: (619) 793-1026  
[stephen.moye@nafinc.com](mailto:stephen.moye@nafinc.com)  
[View My Website](#)

## The Day Ahead: What's Up With Stocks Versus Bonds Recently?

If you're a frequent reader, you're likely tired of hearing about "the range." Such is life when bonds are range-bound, but that doesn't mean we can't change things up. Let's check in with the good old stock lever (our shorthand reference the conventional wisdom that suggests stocks rally on positive economic developments while bonds sell).

As we've often discussed, the stock lever is far from perfect. In fact, it's exceedingly imperfect and prone to major caveats depending on underlying market movers and especially the passage of time. Specifically, the longer the time frame, more the correlation breaks down.



We're far more likely to see "stock lever" style correlations when we zoom in to the shortest time frames.

## 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

### Freddie Mac

30 Yr. Fixed	6.35%	-0.51	0.00
15 Yr. Fixed	5.51%	-0.65	0.00

### Mortgage Bankers Assoc.

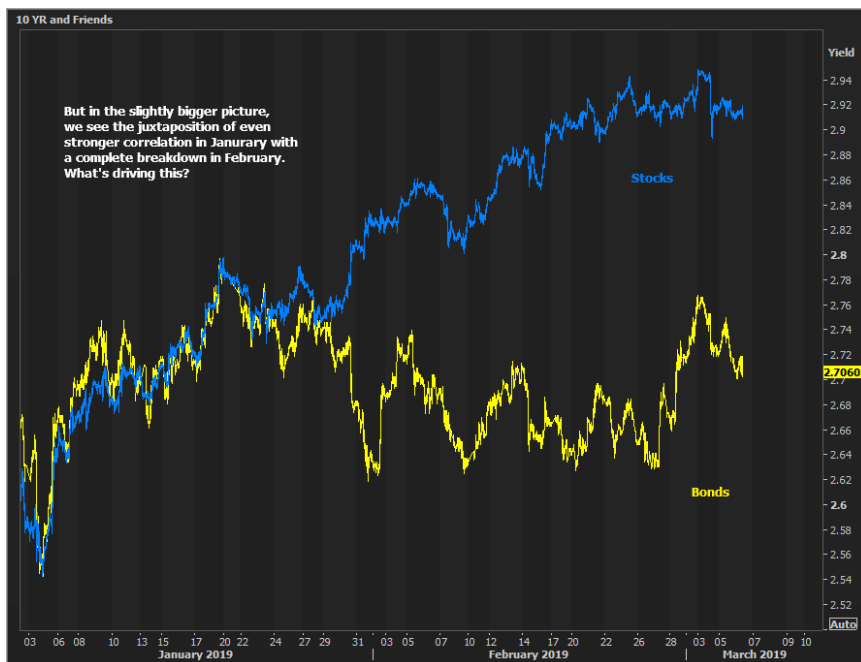
30 Yr. Fixed	6.44%	-0.06	0.54
15 Yr. Fixed	5.88%	-0.16	0.68
30 Yr. FHA	6.36%	-0.06	0.85



	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

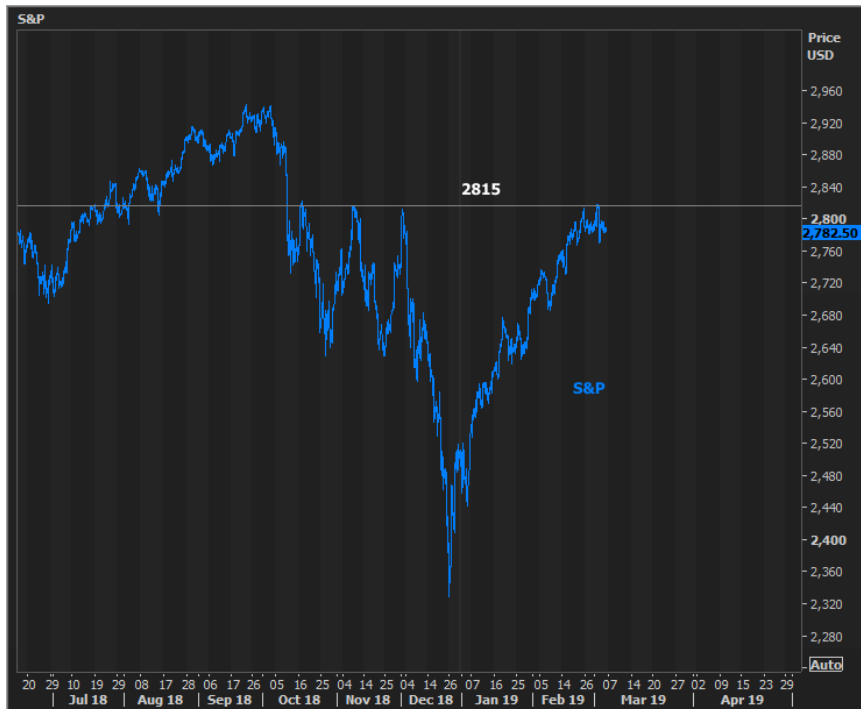
Over intermediate time frames, we often see juxtaposition of extreme correlation and then the complete breakdown of that correlation. For instance, stocks and bonds were **right on top of each other** in January only eschew that relationship forcefully in Feb.



NOTE: look at the 2nd chart above (of the past 3 days). The y-axis scaling is different than the medium-term chart above. The scaling could be **manipulated** in such a way as to show pockets of decent correlation over other short time horizons in February. The medium term scaling is intended to show the general "decoupling" that took place in Feb relative to January's extreme correlation. In other words, just because the blue/yellow lines aren't close to each other in the chart above, it doesn't mean we couldn't find correlation if we adjusted the chart scaling. Over time, these instances of decoupling lead to the long-term phenomenon seen in today's first chart.

But let's get back to the question of what's driving these breaks in correlation. 9 times out of 10, at least since the Financial Crisis, it's been a "Fed accommodation trade." Simply put, when the Fed is friendlier than expected, stocks and bonds both benefit, so the lines in the chart will move away from each other (blue line higher, yellow line lower). That's exactly what happened at the end of January, when the Fed came out with its surprisingly friendly policy announcement.

Fed reactions aside, bonds will always be willing to pick up the pieces when the stock market undergoes more significant selling. The rally may not be commensurate with the move in stocks, but the direction should be the same. With that in mind, consider that stocks are having a very tough time breaking through a ceiling. Also consider that ceiling has become so clearly-defined at this point that any big bounce or break could easily be followed by significant momentum. This adds a **complicating factor** for bonds in the weeks ahead (in addition to the primary goal, which is to react to economic data/events). At the moment, the resistance in stocks seems to be helping bonds, but we'd need to see S&P futures fall below 2700 for a more pronounced reaction.



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