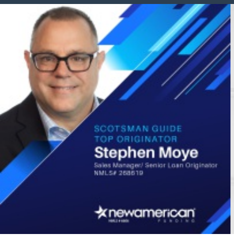

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The Day Ahead: Bonds Making Case For Friendly Bounce But Data Could Disagree

Here's a **quick recap** of the past year or so. Bond yields were near long-term highs in the first part of 2018 following the passage of the tax bill and generally strong economic data. Rates surged to even higher long term highs in October and November (ongoing improvement in US econ data, hawkish Fed, rotation into stocks). At that point, a combination of European/Chinese weakness, a potentially overly-hawkish Fed, and high rates sent the stock market into a tailspin. Bonds benefited in a big way.

After dropping **70bps in less than 2 months**, 10yr yields took a breather in the 2.55-2.80 range for the next two months. We turned our attention to the March 20th Fed announcement to cause the next big move. It did. In not so many words, the Fed was surprisingly helpful to bonds. They also mentioned EU/China again, and 2 days later there was exceptionally weak EU economic data to validate their point. That pushed a snowball buying spree that resulted in rates as low as 2.34% by the end of March.

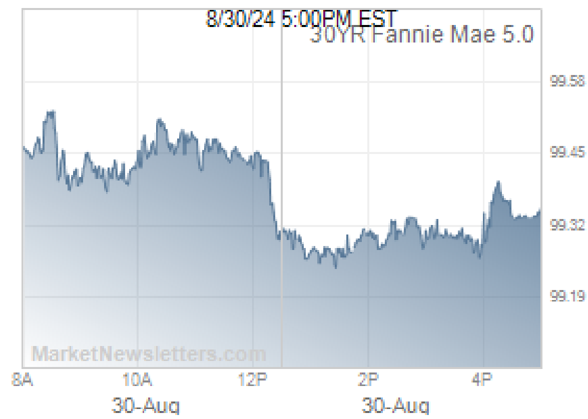
A correction made sense at that time. After all, rates had dropped 90bps peak to trough since November, and March was the single best month for mortgage rates since 2011 or 2008 depending on the lender. There has been and continues to be some question as to whether this correction will take 10yr yields back up and over 2.55% or 2.62% (both important technical levels). **2.55% has obviously been broken**, but not convincingly so. Yields danced around the upper 2.5% range for the past week and a half until yesterday's nice rally down to 2.52%.

That rally was important (potentially) not only because it broke yields back below 2.55%, but also because it resulted in a "cross" of the longer term stochastic lines (a piece of technical analysis that attempts to measure momentum). When the **green line crosses below the teal line** at the bottom of the following chart, it's technically a "buy" signal for bond traders (assuming they were relying solely on that single piece of analysis for trading cues). The fact that it coincides with a faster version of the stochastic study giving the same signal (blue/red lines) and the breakouts of both the trend-line (lower yellow line) and 2.55% makes the bullish conclusion all the more convincing.

MBS & Treasury Market Data

	Price / Yield	Change
MBS UMBS 5.0	99.35	-0.16
MBS GNMA 5.0	99.91	-0.04
10 YR Treasury	3.9039	+0.0424
30 YR Treasury	4.1932	+0.0468

Pricing as of: 8/30 5:59PM 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

	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

In fact, it may be too clear... too convincing. When breakouts and technical signals happen this perfectly, it's a sure bet that every bond trader is aware of it. That's why I think it doesn't make a ton of sense to assume that we're looking at confirmation of a new, big, friendly move in rates. Now, that's NOT to say we couldn't see such a move, but if we do, I think it will have more to do with the balance of economic data tomorrow and next week. Long story short, we're probably looking at a **false positive** unless the data starts coming in surprisingly weak.

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