



Tom Payne

Senior Loan Consultant, loanDepot
 NMLS# 1017004 #174457 Licensed in all 50 States
 2835 St. Rose Parkway, Suite 120 Henderson, NV 89052

Office: 702-303-0243
 Mobile: 702-303-0243
tompaynemortgage@gmail.com
[View My Website](#)

Is It Time To Worry About Rising Rates?

In about 2 weeks, the big bond rally of 2019 (i.e. the big drop in rates!) will officially be 1 year old (because it actually began in the 2nd week of November). This has been a uniquely interesting year for rates. Granted, there are plenty of other years with the same sort of big overall movement, blatantly obvious motivations, paradoxically subtle motivations, and uncertainty-inducing curveballs, but few have combined all of those components.

The uniqueness of the rally makes it hard to say exactly what might happen next. In fairness, that's **always** hard when it comes to financial markets. The market has a nasty tendency to go out of its way (or so it would seem) to prove people wrong just when they think they have things figured out.

I'm speaking in generalities here, but there is hard math underlying the point (or a hard hypothesis anyway) known as the Efficient Markets Theory. In a nutshell, it says asset prices (like those for the bonds that determine interest rates) reflect **everything** that can be known about them today. Therefore, they will only react to genuinely **NEW** information.

To make matters even more uncertain, a lot of time, effort, and money go into trying to predict what that new information will be. Those predictions in turn become part of "everything that can be known today." What that means, in essence, is that you'd actually have to predict something that **no one else can predict** in order to get a leg up on future potential movement in stocks, interest rates, etc.

What we can do is talk about what we're **already seeing** in the charts and what the implications **MIGHT** be. This can help us prepare for risks and opportunities associated with various outcomes.

Many rate watchers are keeping a close eye on the breakdown of the long-term rally trend as it relates to moving averages and simple trend lines. A moving average is just that: the average rate on any given day for the past x number of days.

Some market watchers believe moving averages **hold power** to act as floors, ceilings, or indicators of an impending shift. But for any prediction someone might make based on a moving average, there are plenty of past examples where the opposite held true.

National Average Mortgage Rates



	Rate	Change	Points
Mortgage News Daily			
30 Yr. Fixed	6.89%	0.00	0.00
15 Yr. Fixed	6.33%	+0.01	0.00
30 Yr. FHA	6.33%	+0.01	0.00
30 Yr. Jumbo	7.05%	0.00	0.00
5/1 ARM	6.58%	0.00	0.00
Freddie Mac			
30 Yr. Fixed	6.77%	-0.09	0.00
15 Yr. Fixed	6.05%	-0.11	0.00

Rates as of: 7/22

Market Data

	Price / Yield	Change
MBS UMBS 5.5	99.39	-0.01
MBS GNMA 5.5	99.78	+0.00
10 YR Treasury	4.2272	-0.0107
30 YR Treasury	4.4598	-0.0127

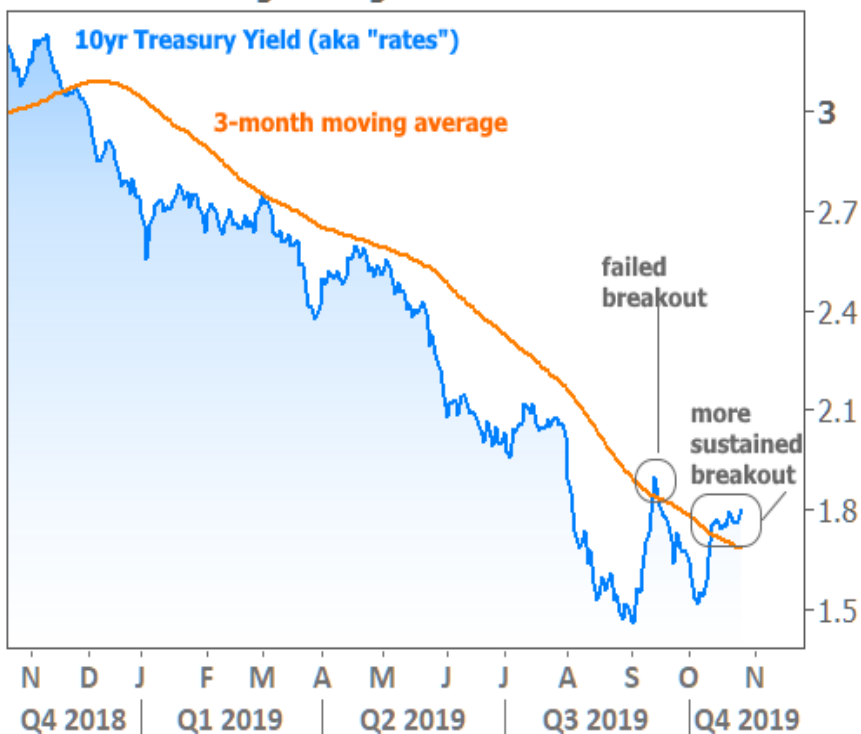
Pricing as of: 7/22 10:50PM EST

Recent Housing Data

		Value	Change
Mortgage Apps	Jul 10	206.1	-0.19%
Building Permits	Mar	1.46M	-3.95%
Housing Starts	Mar	1.32M	-13.15%
New Home Sales	Mar	693K	+4.68%
Pending Home Sales	Feb	75.6	+1.75%
Existing Home Sales	Feb	3.97M	-0.75%
Builder Confidence	Mar	51	+6.25%

What a moving average **CAN** do for us, however, is serve to emphasize the point that a particular trend is **"having second thoughts,"** as it were. The following chart shows one way to look at this with a quarterly moving average (the average 10yr yield for the preceding 3 months). The first "failed breakout" could also be seen as the first instance of "second thoughts." Some would see the "more sustained breakout" as evidence that the 2019 rally may be over.

Rates and Moving Average



The next chart provides another way to essentially arrive at a similar conclusion. The consolidation pattern that came into focus over the past few months is the most pronounced of its kind in 2019. These pennant-shaped patterns of lower highs and higher lows often emerge when **investors are pumping the brakes** on the prevailing trend.

And that's really the only thing such patterns tell us. They do not, for example, imply the size and direction of the next move. That said, breaking out from the **upper** line is logically more discouraging for fans of low rates than breaking the **lower** line. If we think of the two red lines as competing trends, this is like saying the trend toward higher rates (represented by the lower red line in the chart below) is "the winner."

10yr Treasury Yield



While neither of the above charts predict a bleak future for rates, they can serve to remind us of that possibility. Indeed, few instances of downward movement in rates have covered as much ground or lasted as long as 2019's example. **But remember**, if we look back far enough, we can usually find examples that argue the other side of the point.

So if you're **not** ready for rates to move **higher** yet, then root for a 2011 type of scenario where rates stayed sideways in a volatile range through the middle of the following year before ultimately going LOWER. Without the benefit of the following charts axis labels, it would be easy to mistake it for 2019.

10yr Treasury Yield



What's the point of all this? Mostly just to advocate against complacency after an awesome run for rates. As always, the uncertain outcomes of data and events in the coming months have the best chance to set the tone. These include economic data at home and abroad, US/China trade relations, Brexit developments, geopolitical developments, and the global central bank response to all of the above.

Speaking of central bank responses, next week brings yet another installment of the latest policy announcement from the Federal Reserve. As you may have heard, the Fed is almost certain to cut rates yet again. If you think that's great news, think again! Remember that Efficient Market Theory discussed above.

Financial markets have **already assumed and acted upon** the probability of next week's Fed rate cut. That means any effect it would have on mortgage rates has already been felt (mortgage rates can move daily whereas the Fed only changes its rate once every 6 weeks). If you need more convincing, just revisit [THIS NEWSLETTER](#) from a few weeks back.

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Recent Economic Data

Date	Event	Actual	Forecast	Prior
Tuesday, Oct 22				
10:00AM	Sep Existing home sales (ml)	5.38	5.45	5.49
10:00AM	Sep Exist. home sales % chg (%)	-2.2	-0.7	1.3
1:00PM	2-Yr Note Auction (bl)	40		
Wednesday, Oct 23				
7:00AM	w/e MBA Purchase Index	241.7		250.6

Event Importance:

- No Stars = Insignificant
- ☆ Low
- ★ Moderate
- ★★ Important
- ★★★ Very Important

Date	Event	Actual	Forecast	Prior
7:00AM	w/e Mortgage Refinance Index	2076.9		2505.8
9:00AM	Aug Monthly Home Price yy (%)	4.6		5.0
1:00PM	5-Yr Note Auction (bl)	41		
Thursday, Oct 24				
8:30AM	Sep Durable goods (%)	-1.1	-0.8	0.2
8:30AM	w/e Jobless Claims (k)	212	215	214
9:45AM	Oct U Markit Mfg PMI Flash	51.5	50.7	51.1
9:45AM	Oct U Markit Svcs PMI Flash	51.0	51.0	50.9
9:45AM	Oct U Markit Comp Flash PMI	51.2		51.0
10:00AM	Sep New home sales-units mm (ml)	0.701	0.701	0.713
10:00AM	Sep New home sales chg mm (%)	-0.7	-0.7	7.1
1:00PM	7-Yr Note Auction (bl)	32		
Friday, Oct 25				
10:00AM	Oct Consumer Sentiment (ip)	95.5	96.0	96.0
Tuesday, Oct 29				
9:00AM	Aug CaseShiller 20 yy (%)	+2.0	2.1	2.0
10:00AM	Oct Consumer confidence	125.9	128.0	125.1
10:00AM	Sep Pending Sales Index	108.7		107.3
10:00AM	Sep Pending Home Sales (%)	+1.5	0.9	1.6
Wednesday, Oct 30				
7:00AM	w/e MBA Purchase Index	247.2		241.7
7:00AM	w/e Mortgage Refinance Index	2066.0		2076.9
8:15AM	Oct ADP National Employment (k)	125	120	135
8:30AM	Q3 GDP Advance (%)	1.9	1.6	2.0
2:00PM	N/A FOMC rate decision (%)	1.500 - 1.750	1.625	1.875
Thursday, Oct 31				
7:30AM	Oct Challenger layoffs (k)	50.275		41.557
8:30AM	Sep Personal Income (%)	+0.3	0.3	0.4
8:30AM	Sep Core PCE Inflation (y/y) (%)	+1.7	1.7	1.8
8:30AM	w/e Jobless Claims (k)	218	215	212
9:45AM	Oct Chicago PMI	43.2	48.0	47.1
Friday, Nov 01				
8:30AM	Oct Non-farm payrolls (k)	128	89	136
8:30AM	Oct Unemployment rate mm (%)	3.6	3.6	3.5
10:00AM	Oct ISM Manufacturing PMI	48.3	48.9	47.8
10:00AM	Sep Construction spending (%)	0.5	0.2	0.1

Update: Buyer Broker Agreement

After requests from real estate companies, a nonprofit consumer watchdog group the Consumer Federation of America has developed a list of factors to consider when creating a buyer contract in preparation for upcoming practice changes in the industry.

CFA released its "Proposed Criteria for Evaluating Home Buyer Contract Forms" on Tuesday. The 15 criteria focus on the contracts' form – whether the documents are readable and understandable – and content – whether they are fair to homebuyers.

- the document's expiration date (CFA recommends buyers asks for a three-month contract and never sign one longer than six months)
- the right to terminate the contract
- the disclosure that compensation is negotiable
- the broker's compensation clearly stated and that the buyer broker can't receive additional compensation for facilitating a sale
- that any additional fees, such as for showing a home, will be deducted from the broker's commission if there is a successful sale
- that the commission is due only if there is a successful closing
- that buyers have an obligation – for no longer than 60 days, CFA recommends – to pay a broker who earlier showed them a home they purchased after the contract ended
- seller concessions paid directly to buyers
- dual agency not pre-approved by the contract
- an explanation of how a broker treats different buyer clients interested in the same property
- that buyers should not be required to first go through mediation or arbitration if they have a complaint

Contact me for more information. 702-303-0243 or TPayne@loandepot.com

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