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THE FED RATE CUT HAS NOTHING TO DO WITH MORTGAGE RATES

The Fed announced an emergency rate cut of 50bps today (0.50%). Great! So your mortgage rate could be 0.5% lower, right?

WRONG!

And to be clear, that's not one of those all-caps, bold lettered internet claims made by some guy with an agenda who may or may not be worthy of your trust. It's bona fide, verifiable documentable, incontrovertible fact. Those who fail to understand it (or at least accept it) really need to read the rest of this article.

The crux of the thesis, with more caps-lock and emphasis: THE FED DOESN'T SET MORTGAGE RATES.

Here are several recent examples of the same thesis for those that really want to dig in to the underlying science and track record:

Worst Week For Rates in 6 Years. Fed Rate Cut Won't Help
The Fed Did NOT Cut Mortgage Rates
Why a Fed Rate Cut Might Mean Higher Rates
The Fed Will Hike, But Rates Could Keep Falling

If you're not the link-clicking type, away we go with the full explanation!

One of the key sources of confusion here is that mortgage rates **definitely DO care** about what the Fed does. This is especially true in cases where the Fed changes its policies on buying the bonds that directly affect mortgage rates. It's even true when the Fed changes its stance on the Fed Funds Rates (the thing that they cut by 50 bps just now), but that's where the correlation gets tricky.

There are 3 key ways to understand the paradox.

1. **The Fed Rate is a Battleship in a River**

MBS & Treasury Market Data

	Price / Yield	Change
MBS UMBS 5.5	99.39	-0.01
MBS GNMA 5.5	99.78	+0.00
10 YR Treasury	4.2369	-0.0156
30 YR Treasury	4.4547	-0.0178

Pricing as of: 7/23 12:50AM EST

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
Mortgage Bankers Assoc.			
30 Yr. Fixed	7.00%	-0.03	0.60
15 Yr. Fixed	6.63%	+0.07	0.61
30 Yr. FHA	6.87%	-0.03	0.92
30 Yr. Jumbo	7.13%	+0.02	0.38
5/1 ARM	6.22%	-0.16	0.60

Rates as of: 7/22

The Fed meets to MAYBE change its rate only 8 times a year, barring emergencies (like today). Mortgage-backed bonds and Treasuries, on the other hand, can change thousands of times a day. Mortgage lenders update rate sheets at least once every business day. In short, mortgage rates and the bond market are FAR MORE NIMBLE than the Fed and, to whatever extent they are going to take guidance from a Fed rate decision, they ALWAYS move WELL in advance because Fed rate changes are very well-telegraphed these days (even today's emergency cut). Bottom line, mortgages react to the Fed rate cut BEFORE it ever happens, but even then, a Fed cut might not convince mortgage rates to move lower due to the other 2 factors.

2. The Fed Rate is a Different Animal Compared to Mortgage Rates

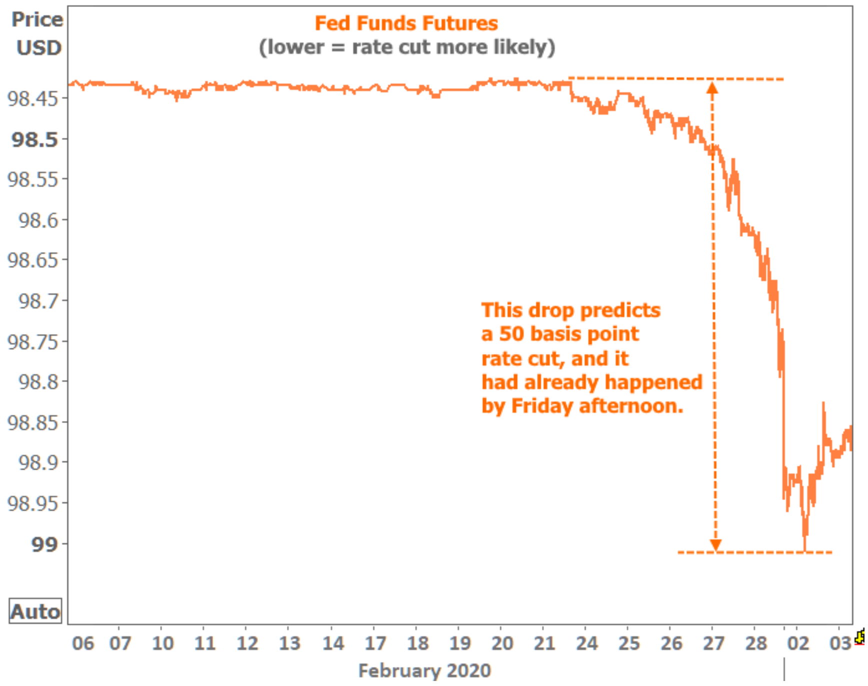
The Fed Funds Rate applies to loans with a term of up to 1 day (essentially last minute money shuffling between banks in order to ensure everyone has the money they need for the day if the previous day happened to create an imbalance). Mortgages, of course, can be loans of up to 30 years. Quite simply, investor preferences can vary greatly depending on the duration of a loan. If you've heard about the inverted yield curve, that's a quintessential example of shifting investor preferences between longer and shorter term debt. It doesn't get any shorter than the Fed Funds Rate nor much longer than mortgage rates. Consequently, they move in opposite directions all the time.

3. Fed Policy is About Much More Than The Rate Itself

The Fed Funds Rate is only one of the aspects of the Fed's monitor policy communication. Markets care about it, but again, they usually know what it's going to be ahead of time. Even then, markets typically care much more about how the rate will move in the future. To that end, they're very focused on the economic realities that are likely to shape future Fed moves. Markets also care quite a lot about any changes in the Fed's bond buying plans, and we didn't see that today.

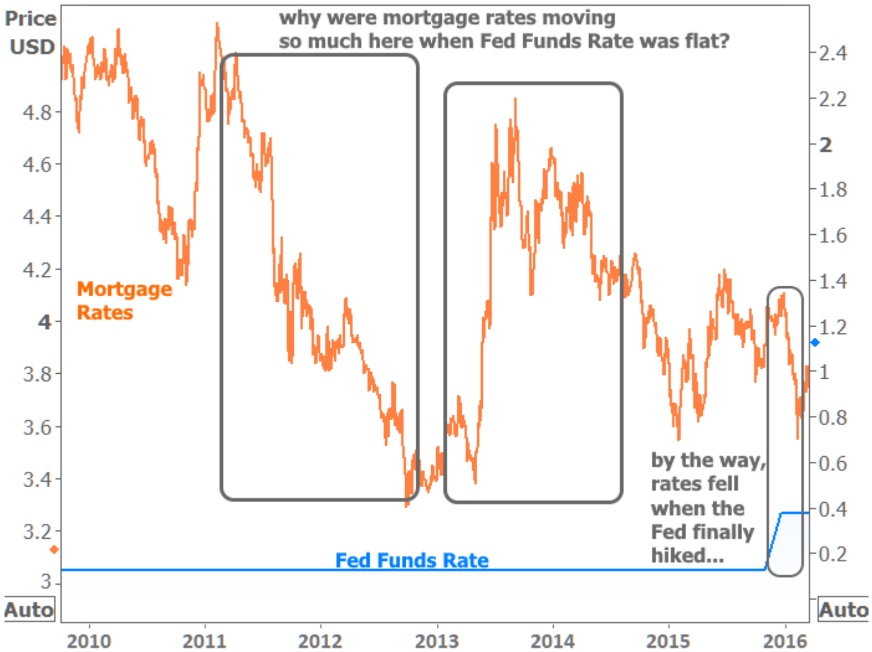
If you take nothing else away from the above, take this: the bond market (which includes mortgages rates) has been able to react to coronavirus implications for weeks, and there's been no Fed meeting during that time. It took an emergency, unscheduled rate change for the Fed to even bring itself into line with market expectations. They're a battleship in a river, and that river has been swift.

Let's prove all this with charts. The most obvious and most compelling is simply the futures contract for the Fed Funds Rate in April. It allows markets to bet on the level of the Fed Funds Rate by the end of the month. As of last Friday, traders were already fully betting on a 0.50% drop (i.e. the one we just saw today).

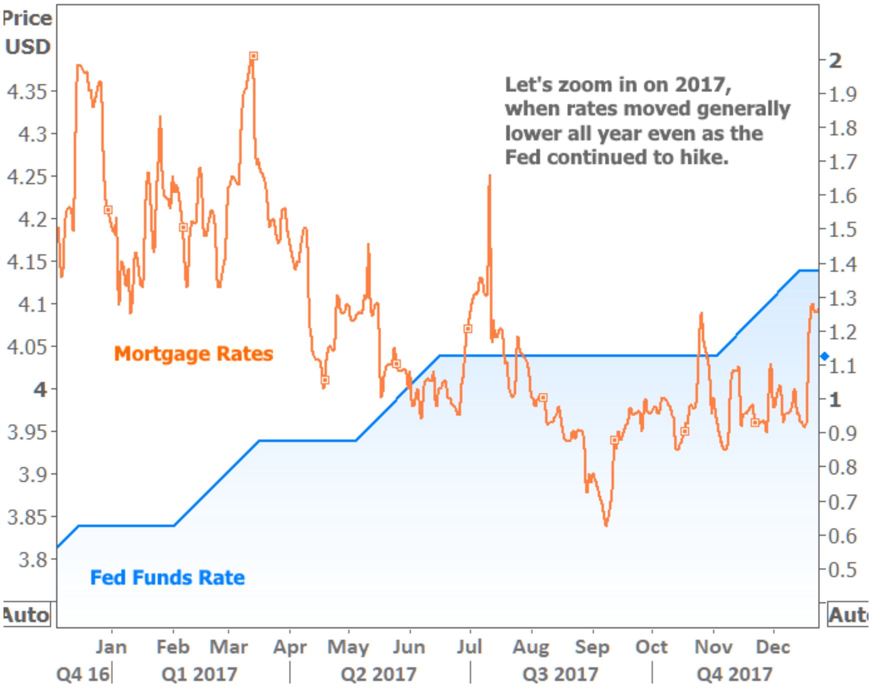


And how about some historical charts showing mortgage rates completely ignoring (or leading) the Fed? In all of the following, the Fed Funds Rate is in blue and the daily average mortgage rate is in orange.

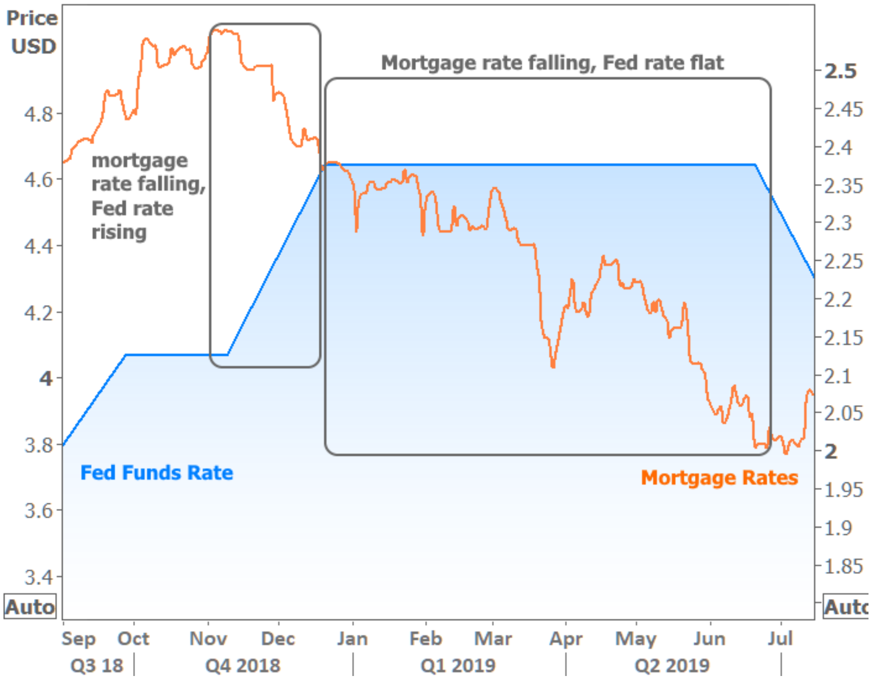
First up, take a look at these massive swings in mortgage rates. More than anything, this serves as a reminder about just how many other things the mortgage market can have on its mind BEYOND the Fed Funds Rate. The big drop was due to the European credit crisis and the big bounce happened when the Fed said it would stop buying so many bonds.



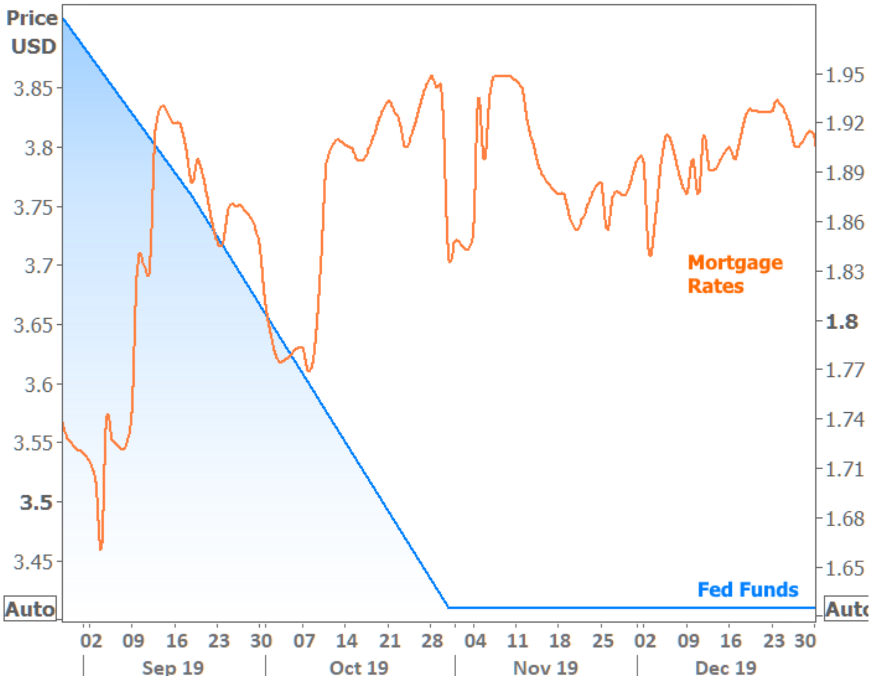
In 2017, the Fed's rate hike cycle was underway. Mortgage rates were already positioned for that and were thus able to move lower, even as the Fed raised rates.



Similar story in 2018/2019 where mortgage rates had been very high and then saw the writing on the wall with respect to the Fed being unable (or unwise) to continue hiking rates. Mortgages began falling/correcting back toward lower levels. It was as if they were betting on the Fed's next course of action (or betting on the economic realities that would inform the Fed's next course of action). They were right! And eventually, the Fed did indeed cut rates several times.



Last but not least, how about rising rates during a Fed rate cut cycle? That's exactly what we saw at the end of 2019. The reason? Mortgage rates were able to move lower in a major way in response to the trade war. They went as far as they were willing to go and then had nowhere to go but up. Meanwhile, the Fed was still slowly responding to the last time its Fed Funds Rate was too high (and finally wrapping up their rate cut campaign).



Bottom line: mortgage rates can move for weeks and weeks before the Fed ever has a chance to move. Moreover, financial markets instantly "price-in" expected Fed rate cuts/hikes, and today's cut was widely expected (and unequivocally traded, based on the first chart above).

Mortgage rates are indeed very low, but they are not now, nor will they be 50 basis points lower due to today's Fed rate cut.

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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

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