

With respect to yesterday's note below, an error was made in the translation to my assistant that is important to clarify. Premium coupon mbs were not off 4 points, rather lost 4 to 8 **ticks** relative to lower current coupons, which is still very notable. The only explanation for a move like this was fear over these two research reports, released suspiciously simultaneously, as if they were a trial balloon.

If the Admin announces this program, then premium coupons will experience coupon chaos where a four point loss on the premium coupon speculative mega-bubble will come in a tick, taking speculators out in a flash. And premium coupons are indeed in a spec coupon cutting bubble -- Fannie 6.5's are around 110-, which is 4 to 6 full points higher than anytime during the bubble years.

Sorry about the confusion. But don't let it take your eye off this ball. With respect to this stimulus, it is easy to implement and would be well accepted vs. turning on the printing press again. Hey, if .gov is on the hook for all these mortgages with an average 6% rate then being on the hook at 4.5% to 5% can only benefit their risk profile. And for the Fed who owns most of the less liquid 4% and 4.5% GSE coupons this puts a better bid into their portfolio allowing for a much better unwind. For incumbents in Nov, this could also be a huge win.

Longer term, however, there will be unintended consequences, as this will be the last refi-boom for the indefinite future regardless of where mortgage rates go. A lot of businesses and jobs depend on a solid flow of refi's. And I don't think it will effect the default and foreclosures universe much. Those that would qualify for this program do not fit the profile of the typical defaulter. More than likely without this program, this borrower would apply and qualify for a mortgage mod and complete the trail period just fine. If they chose to strategically default, then they would chose a short sale vs. walking away...short sale volume is what could be really impact from this.

Will update later today if anything new comes.

Mark

forgot to attach the coupon stack for GSE mbs showing the divergence (lower cpns green and spec premium coupons red) between lower and premium coupons. Really interesting. Note the outta sight speculative prices for the 5.5% to 6.5% cpns.

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TW Tradeweb FNMA 30 Year TBA MBS (COMPTBAFNMA303)																																				
		Main		Lists		Blot		Book		Msg		Pmon		Pref		Admin																				
		1Sec		One Sec		TW Tradeweb FNMA																														
Favorites										Tradeweb FNMA 30 Year TBA MBS																										
		3.5-6.0		4.0-5.5		Chg-4:45pm		Dir		Coupon		Month																								
FNMA303	4.000	Aug	102-02+/05+	+0-01+	1- 1	5.500	Aug																													
GNMA303	4.000	Sep	101-20+/23+	+0-01+		5.500	Sep																													
USRATES	4.000	Oct	101-09 /11	+0-02+		5.500	Oct																													
30SWAP	4.000	Aug/Sep	136/ 137		1- 2	5.500	Aug/Sep																													
GNM5.0	4.000	Sep/Oct	122/ 123		1- 2	5.500	Sep/Oct																													
US	4.500	Aug	104-08+/09	+0-01+	2- 1	6.000	Aug																													
MBS	4.500	Sep	103-28+/30	+0-01		6.000	Sep																													
TRSY	4.500	Oct	103-18 /19	+0-01		6.000	Oct																													
AGCY	4.500	Aug/Sep	11+/ 115		2- 2	6.000	Aug/Sep																													
IRS	4.500	Sep/Oct	102/ 10+		2- 2	6.000	Sep/Oct																													
CORP	5.000	Aug	106-10+/12	-0-01	1- 3	6.500	Aug																													
CDS	5.000	Sep	105-21+/00+	-0-09		6.500	Sep																													
CONV	5.000	Oct	105-12 /23	-0-09		6.500	Oct																													
CP	5.000	Aug/Sep	113/ 11+		2- 2	6.500	Aug/Sep																													
ADN	5.000	Sep/Oct	092/ 10		2- 2	6.500	Sep/Oct																													
REPO											Roll Analysis		FN																							
Europe	TRSY	2 yr	100-01 /012	+0-002	0.609-605	Cpn	Cpr	Drp																												
Canada	IRS	3 yr	100-066/07	+0-012	0.928-925	4.0	16.8	0-136																												
CAN GVT		5 yr	100-04+/046	+0-043	1.721-719	4.5	25.6	0-11+																												
PROV		7 yr	100-20+/21	+0-01	2.399-396	5.0	34.7	0-113																												
CAMM		10 yr	104-06+/07	-0-01+	3.001-999																															
		30 yr	104-26 /27	-0-12	4.094-092																															
Asia											Main		30		15		Rolls		FN30		FN15		PC30		PC15		GN30		GN15		Sw30		Sw15		Basis	
STP																																				

Careful - this got a lot of play in the mortgage cap markets today. Yesterday, both MS (attached) and Bassman over at ML put out exact reports speculating about an instant auto-refi program for GSE and FHA loans taking millions of borrowers to current market rates literally overnight.

Bottom line: There are millions of American's with rates much higher than market rates who can't refi due to lack of equity or income needed to qualify for a new vintage loan. Or, because after all of the new vintage loan level adjustments to the rate and fee structure for being less than perfect it makes the current 4.5% rate into a 6% rate taking away any benefit. We have discussed all of this ad nauseum over the past couple of years.

Their solution is to quickly identify all of the borrowers who are making payments on time and send them a one page refi form, which instantly takes their rate to current market. There would be

a few other borrower hurdles but not many. The savings to the home owning consumer would be about \$45bb per year, more than the cost of the recent extension to unemployment benefits.

This rumor has a lot of credibility behind it -- all of a sudden copycat reports come out from two credible mortgage shops and GSE premium coupons (5.5% to 6.5%) took a beating this morning -- down 4 POINTS on average. This is because these would get crushed if an auto-refi program was announced.

On a side note if this were suddenly announced it would be coupon chaos crushing the massive number of speculators in the premium coupons, which happens to be just about everybody now days.

Best Regards,

Mark Hanson

From MS

Slam Dunk Stimulus

David Greenlaw (New York)

If it were possible to inject a significant amount of stimulus into the household sector of the US economy over the near term and this stimulus had zero impact on the budget deficit, did not require an exit strategy, did not distort the markets, and took effect almost immediately, wouldn't it seem like a slam dunk? Such an option actually exists in the form of a change to mortgage refinancing requirements. The Fed – and market forces – have pushed mortgage rates to historic lows (see Exhibit 1). However, many homeowners are unable to take advantage of the low rates because they are blocked from refinancing by a high loan-to-value ratio (LTV), appraisal problems, unemployment, and low credit score, etc. This problem could be addressed if the Government merely recognized the guarantee that already exists on the principal value of a very large portion of the mortgage market – specifically, the mortgages that are backed by Fannie, Freddie and Ginnie – and acted to streamline the refi process.

From Merrill

Our Recommendation:

The Government should immediately create **CARP** – the **C**orporation for the **A**ccelerated **R**efinancing of **P**rincipal. The Government would instruct all GSE Servicers to insert a single page **CARP** authorization form into the next mortgage statement for all loans created before January 1, 2009 with a coupon rate above 5.49%. This mitigates buy-out limitations for MBS bonds. Using a random number generator, these specified loans will be purchased out of the MBS, re-wrapped with no additional fees from the same GSE, and delivered into the TBA market. Randomness eliminates the risk of litigation from selection bias. **CARP** could be an arm of the FED to facilitate the funding and secondary marketing issues. The FED could sell TBAs forward for **CARP**'s benefit or execute a coupon swap and take delivery from **CARP**. Alternately, if the FED elected to resume the LSAP, they could simply fund the bonds on their balance sheet. Alternately, **CARP** could be part of HUD, capitalized by the Government, and transact with the FED at arm's length. In any case, **CARP** should not earn revenues greater than their expected expenses nor should it provide a subsidy to borrowers. If rates rise by a sufficient amount to make a refinance non-economic, then the process will stop until it becomes viable again.

One might think that the markets will take away this opportunity once **CARP** is announced, we beg to differ. As Bernanke implied at his recent congressional testimony, the FED will most likely keep rates low for an extended period. So it certainly seems unlikely that rates will be rising *significantly* any time soon. But

even if MBS rates do increase by 50bps to 75bps, these two million high coupon loans are so far in the money they could all still refinance.

Since there is no free lunch, who takes the hit ? Hard to believe, it is not the Government. Only 15% of the FED + US Treasury holdings are in 5.5s and 6.0s. Most of the MBS they own are in new production 4s and 4.5s, so they will not incur large prepayment losses. The losers will be speculators who have bet upon the ineffectiveness of the Government by bidding up premium MBS. And truth be told, this will not constitute a loss of capital but rather just a partial give back of the excess carry gains earned mostly due to an aggressive FED policy.

In summary, **CARP** would provide savings to borrowers who are current on their loans, reduce GSE credit risk, increase liquidity in the MBS market by vastly expanding the float of par bonds, reduce household leverage and increase consumer spending. All at no cost to the Government (or implied Moral Hazard). Most importantly, it would squirt some oil into the MBS gearbox to allow FED policy to be efficiently transmitted to the markets, just as Milton Friedman had hoped.

While I am not a socialist (or a communist for that matter), I do believe that macro Government benefits should be showered fairly across the spectrum.

CARP will do precisely that. Let's just hope that someone is listening.

Best Regards,

Mark Hanson

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