

U.S. Treasury Bonds			
Maturity	Yield	Last Week	Last Month
5 Year	3.42	3.31	3.29
10 Year	4.18	4.02	4.11
30 Year	4.94	4.79	4.92

Treasury Market Summary:

Treasuries took the worst tumble since May this week as Q2 clean up, up-beat Fed-speak and brightening data drove yields higher. The curve had a pretty wild ride, having narrowed the 2-10-years to a 52-week low of 144.7, and then bouncing back to 157 Friday. The ISM release added weight to the market when the factory employment component popped to 58.1 from 55.7. The options market saw good action with early put selling to take advantage of the pop in implied volatilities and direction and saw a blast of volume as mortgage-backed players sold out of long call positions (70K of the Dec 114 strike in the 10-years alone) and rolled a portion into the Mar expiration. The equities action helped sap some strength and trade tangoed back and forth with energy prices. All the long suffering sell-sider sliders are finally getting some satisfaction, but would be wise to play it with very tight stop levels until the big Friday jobs report, which could flip this whole thing over.

MORTGAGE BACKED SECURITIES

With the general trend of interest rates decreasing over the last two decades and current rates at record low levels, yield hungry investors have bid fixed income securities to sky high levels. Apart from bonds, mortgage backed securities have become increasingly popular as they usually have a higher yield but still bring the level of security investors desire.

A mortgage backed security is created by a financial institution when it decides to sell part of its residential mortgage portfolio to investors. The mortgages are put into a pool and investors acquire a stake in these pooled securities by buying a portion. These units are referred to as mortgage-backed securities. In essence it is a security that entitles the owner to a share of the cash flows generated from the pool of residential mortgages.

The mortgages in a pool are generally guaranteed by a government related agency like the Government National Mortgage Association (GNMA) or the Federal National Mortgage Association (FNMA) which protects the investors against defaults. This is what makes the mortgage-backed securities sound like fixed income bonds issued by various levels of government.

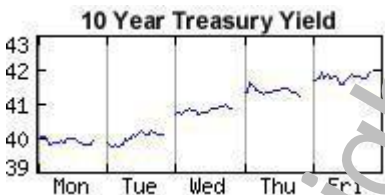
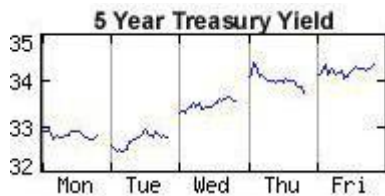
However, a critical difference here is that the mortgages in the MBS pool have prepayment privileges that can be quite valuable to the home owner. US mortgages usually last for 25-30 years but can be prepaid at any time. Prepayments can occur for several reasons, including one of the more popular these days; refinancing.

If interest rates decrease dramatically, the homeowner might decide to refinance at the lower rate or take equity out of their house. The mortgage might be pre-paid if the house is being sold. The pre-payment option is a risk to mortgage backed security investors as when interest rates decrease, they might not keep getting the higher yields if homeowners continue to refinance to take advantage of the lower rates.

So a regular bond would still have the coupon rate from when it was issued, the "coupon rate" from a pool of mortgages can vary. This means that investors require a higher rate of interest on a mortgage backed security than on other fixed income securities to compensate for the prepayment options that have been written. Mortgage backed securities might be guaranteed by certain government institutions, but they do have risks. Interest rates, credit worthiness, foreign investments, currencies, securities lending, and derivatives can have impacts on the net returns for the investor.

In most cases, mortgage backed securities should be considered by investors who seek a regular income, are looking for a conservative portfolio mix and prefer low-to-medium investment risk. The risks associated with mortgage backed securities could dramatically increase if the rate of defaults on household mortgages increases sharply and the government has to issue its own debt to cover the payments.

One should consult with a qualified mortgage planning professional prior to implementing any mortgage planning strategies. If you are an estate planning, real estate, tax or insurance planning professional receiving this newsletter, please call our office and introduce yourself to us. We are always seeking to grow our referral network and expose more service professionals to our client base.



Economic Indicators for this week that could impact the mortgage or

real estate markets include...

Initial Claims	Oct 7
Consumer Credit	Oct 7
Hourly Earnings	Oct 8
Unemployment Rate	Oct 8
Wholesale Inventories	Oct 8

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