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Market Comment

The Federal Reserve's goal last week was to lube the credit-markets' sticky gears. Mission accomplished. First, the Fed buckled and agreed to serve as guarantor of last resort for Bear Stearns – a once mighty Wall Street investment house – and its rapidly depreciating portfolio of mortgage-backed securities (MBS). In turn, the guarantee prompted another Wall Street firm, JP Morgan, to buy Bear for little more than a song and a quick two-step dance.

The Fed then applied more gear-lubing grease with a 75-basis point cut in the fed funds rate. "The outlook...has weakened further," the Fed said in an accompanying statement. "Financial markets remain under considerable stress, and the tightening of credit conditions and the deepening of the hous-

ing contraction are likely to weigh on economic growth."

The cut in the Fed funds rate was actually less than what many pundits wanted, but salubrious nonetheless: Stocks soared and the credit-market gained much-needed traction. Fixed-rate mortgages improved dramatically across the nation. The benchmark 30-year fixed-rate mortgage dropped 41 basis points, to average 5.98%, while the 15-year fixed-rate mortgage fell 39 basis points, to average 5.46%, according to Bankrate's survey of large mortgage lenders.

Even homebuilders managed to maintain a stiff upper lip. The National Association of Home Builders (NAHB)/Wells Fargo Housing Market Index for March remained at 20, still two points above the historic low of 18 reached in December. It wasn't the greatest news, but at least it suggests that things aren't getting worse.

Economic Indicator	Release Date and Time	Consensus Estimate	Analysis
Consumer Confidence (March)	Tues. March 25, 10:00 am, et	73 Index	Important. Sagging confidence could dim prospects for a quick economic recovery.
Mortgage Applications	Wed. March 26, 7:00 am, et	None	Important. Refinancing activity continues to drop, but purchase activity is holding steady.
New Home Sales (February)	Wed. March 26, 10:00 am, et	575,000 (Annualized)	Important. Fewer new homes will help clear excess inventory.
Personal Income & Expenditures (February)	Fri. March 28, 8:30 am, et	Income: 0.3% (Increase) Expenditures: 0.1% (Increase)	Important. Expenditures continue to decelerate, which is to be expected in an economic slowdown.

The Beginning of a Recovery?

The collapse of Bear Stearns was as stunning as it was quick. In less than a week, the 85-year-old investment bank went from Wall Street master-of-the-universe to just another bankrupt mortgage company. Bear erred, egregiously in hindsight, by relying on short-term borrowing to finance its portfolio of long-term mortgage-backed securities. When Bear was no longer able to roll over its short-term borrowings, it was no longer able to finance its long-term holdings. (A good analogy is being cut off from credit-card debt and forced to sell everything at fire-sale prices when you can't pay balances in full.)

The Federal Reserve, attempting to contain what could have fast become a debilitating contagion, agreed to take Bear's \$30

billion MBS portfolio on its books. JP Morgan will inject \$300 billion of capital into Bear and will capture the upside on Bear's MBS portfolio with little downside risk. We should all be so lucky to stumble upon such a deal.

With all this, the Fed is attempting to supply a commodity that's in short supply – confidence. A lot of that confidence is tied to the instruments that supply mortgage financing: namely, mortgage-backed securities. If investors are more confident purchasing MBS, lenders will more confidently supply credit, and home buyers will have greater access to credit to finance their purchase.

The Fed's rescue of Bear is rife with moral hazards and unintended consequences, to be sure. With any luck, though, one of those unintended consequences will be a quicker-than-expected credit and housing market recovery.

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