



The housing market looks likely to keep improving over the next two or three years while still punching below its historic weight in GDP. Reduction in supply and an increase in household formation look most likely to keep things on the mend. Credit looks less likely to change. And for investors in MBS, that means supply generally running below the pace that built the \$5.4 trillion market outstanding today.

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Ginnie Mae RV revisited

Selling short TBA Ginnie Mae 30-year 4.0% and even 4.5% contracts against Fannie Mae's TBA still looks good more than two months after FHA surprised the market with a change in mortgage insurance premiums. That change reset fair value in Ginnie Mae MBS by scrambling the prepayment relationship to Fannie Mae. In "Adding up to fair value in G2/FN," Ian Carow and Jeana Curro build up the fair value of Ginnie Mae MBS step-by-step: the value of the longer Ginnie Mae delay, its poorer liquidity, its better credit and the new increase in its negative convexity. The result: fair value everywhere except in the 4.0% and 4.5%, where Ginnie Mae looks rich.

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The view in rates

Fed Chair Yellen last week opened the door to a rate hike this year while signaling yet again that a return to neutral policy would take a long time. The most notable change was the move down in the FOMC dots projecting fed funds through 2018 and beyond. The market has consistently made money since at least 2012 by positioning for rates below the ones expected by the Fed, and that still looks like the right trade; the market, in fact, continues to do that. Eurodollar contracts show rates well below the Fed dots through 2018 and beyond. Low growth, low inflation, even a lower NAIRU should keep yields below Fed dots. Against the market's forward rates, the curve looks broadly like fair value. Neutral on rates.

The view in spread markets

No material change in core positions, but the arc of MBS supply is worth some attention. Outstanding agency MBS looks like it is on track to finish the first quarter down \$5 billion, well below Deutsche Bank's forecast of a \$20 billion gain. Supply again is proving difficult to predict.

Broad:

- Neutral the MBS-Treasury basis
- Long 30-year 4.0% MLB and 4.5% LLB, MLB or HLB pools
- Overweight Fannie Mae 30-year 5.0% or other up-in-coupon positions, underweight 30-year 3.5% and 4.0%
- Short Ginnie Mae 30-year 4.0% and 4.5% pass-throughs against long positions in Fannie Mae
- Neutral 15-year against 30-year

Narrow:

- Short 15-year 4.0%/3.5% coupon swap to play the flatter curve and market technicals
- Short FNCL 4.0% against a market value and duration neutral blend of low pay-up seasoned FNCL 3.5% pass-throughs and IOS 3.5% of 2012
- Favor last cash flow PACs and Zs, and CMO floaters over open window structures to benefit from flatter curve and add convexity
- Long IIO backed by MHA95 and MHA100 pools