MBS Mantra's view of Economics, Finance and MBS Markets

Macro View

Brexit – an unexpected and shocking reality – came to pass on June 23, 2016, also putting to bed the question of whether the Fed will raise rates. A powerful 'flight-to-quality' resulted, driving down US 10yr yields to below 1.5%, and the Yen to below 105.

The appreciation of the Yen from inflows of capital into Japan continues, in spite of NIRP, and was accompanied by the highest difference in Japanese M3-M2 (Investible Capital) since 2000. This resulted in an 8.5% appreciation in the Nikkei index between June 24th and July 13th. Euro M3-M2, on the other hand, declined between March and June. (The US does not report M3.)

US stock markets also rallied after a brief initial selloff, reaching new levels recently, reflecting strong inflows of capital into the US – this was also reflected in the stronger Dollar versus the Pound and Euro.

As we discussed in 'Interest Rate Swaps as a Benchmark', we believe that US Treasuries are cheap relative to other sovereign debt, and we expect global flows into the US to keep US rates low. We also expect US spread assets, such as MBS, to continue their strong performance, as global capital seeks US assets to invest in.

MBS View

The Countrywide settlement was finally paid out in June. Countrywide bonds appear to be trading well post-settlement, in spite of selling as the trade is closed out by hedge funds – real money appears to be purchasing these bonds as their credit enhancement has increased in many cases, and their spreads are still attractive.

With US rates having rallied, most discount MBS bonds will benefit from increased refinancing activity, and cashflows should remain healthy.

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