



Mid Valley Financial

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The Real Reason Rates Reacted to The Fed This Week

The Federal Reserve finally pulled the trigger on its much-anticipated balance sheet normalization plan. This was billed as **big news**--a major turning point in US monetary policy. While that's arguably true, markets were **far more interested** in other parts of the Fed announcement.

The Fed meets to set policy 8 times a year. On 4 of those occasions, the Fed also releases its economic projections (**forecasts** about the economy and the Fed Funds Rate from each Fed member) and the Fed Chair holds a press conference to discuss monetary policy developments in greater detail.

Markets have grown to expect the biggest policy shifts at these "on-cycle" meetings (the ones with the additional events) and the Fed hasn't done anything to challenge that assumption. Indeed, they **all but guaranteed** this week's meeting would mark the official start of the balance sheet normalization plan first released in early July.

"Balance sheet normalization" simply means the Fed will buy slightly fewer bonds and mortgage-backed-securities (MBS) each month. To be clear, the Fed was **adding** more and more bonds each month under the various quantitative easing (QE) programs. This caused the balance sheet to **grow**.

The "taper tantrum" of 2013 had to do with a gradual **decrease** in the amount of **new** bond buying (tapering officially started in early 2014). Since the end of QE3 in October 2014, the Fed has been keeping its balance sheet steady by simply **replacing** bonds in its portfolio as they were paid down. This is generally referred to as the Fed's "reinvestment policy."

Balance sheet normalization refers to the winding-down of this reinvestment policy. In other words, the Fed will be **buying fewer and fewer** Treasuries and MBS.

Reinvestments account for the **lion's share** of purchase demand for newly originated Fannie and Freddie 30yr Fixed mortgages. They're also a major source of demand for Treasuries. As such, reinvestments are one of the **key ingredients** in the low rate environment.

Naturally, investors were (and still are) **concerned** about the effects of normalizing the balance sheet, but the Fed has done a good job of convincing markets that it will be an even more gradual process than the tapering of QE purchases, and that the balance sheet will end up leveling-off at a **much**

National Average Mortgage Rates



	Rate	Change	Points
Mortgage News Daily			
30 Yr. Fixed	6.89%	0.00	0.00
15 Yr. Fixed	6.33%	+0.01	0.00
30 Yr. FHA	6.33%	+0.01	0.00
30 Yr. Jumbo	7.05%	0.00	0.00
5/1 ARM	6.58%	0.00	0.00

Freddie Mac

30 Yr. Fixed	6.77%	-0.09	0.00
15 Yr. Fixed	6.05%	-0.11	0.00

Rates as of: 7/22

Market Data

	Price / Yield	Change
MBS UMBS 5.5	99.51	+0.12
MBS GNMA 5.5	99.92	+0.15
10 YR Treasury	4.2296	-0.0229
30 YR Treasury	4.4547	-0.0178

Pricing as of: 7/23 8:51AM EST

Recent Housing Data

		Value	Change
Mortgage Apps	Jul 10	206.1	-0.19%
Building Permits	Mar	1.46M	-3.95%
Housing Starts	Mar	1.32M	-13.15%
New Home Sales	Mar	693K	+4.68%
Pending Home Sales	Feb	75.6	+1.75%
Existing Home Sales	Feb	3.97M	-0.75%
Builder Confidence	Mar	51	+6.25%

higher dollar amount than before the Financial Crisis.

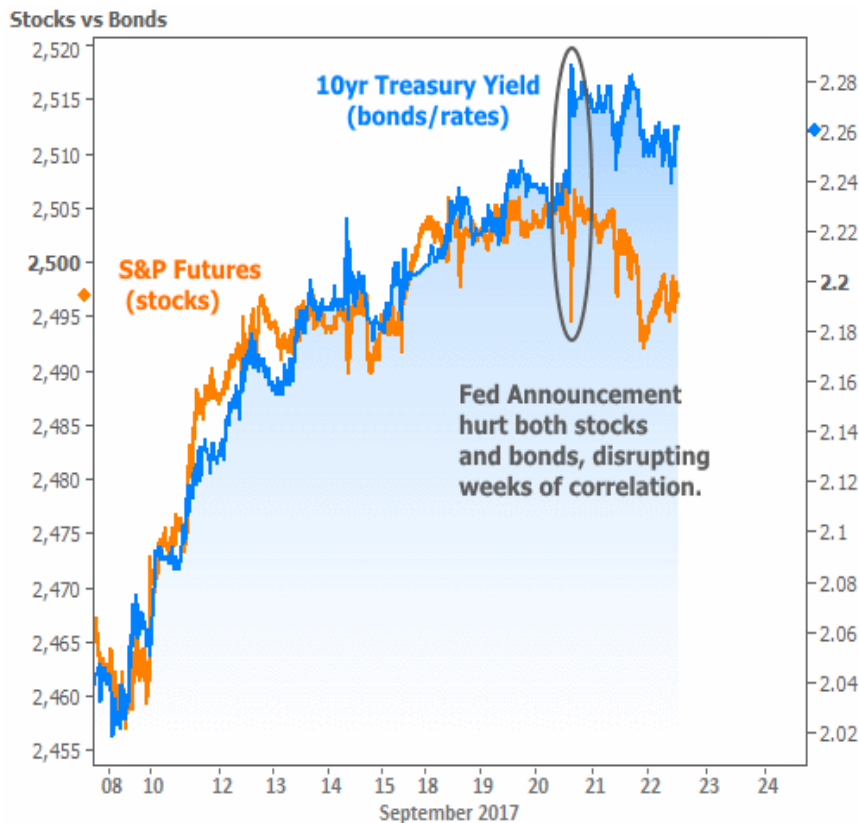
All of the above meant that this week's official normalization announcement was a **mere formality**. Every sane market participant knew this was coming ahead of time. And when markets know something ahead of time, they'll always do their best to trade accordingly.

What markets CAN'T know ahead of time is how the Fed's rate hike outlook had evolved between now and the last set of official projections back in June. More than a few traders figured the Fed would convey a much slower pace of rate hikes based not only on the economic data over the past few months, but also on several Fed speeches. Some of those speeches were unequivocal in conveying doubts about the pace of rate hikes in the future.

Ultimately though, the individual speeches only represent the individual Fed member doing the speaking. When the rest of the Fed forecasts were included, the median viewpoint of the Fed Funds Rate through the end of 2018 was **unchanged** from the June meeting!

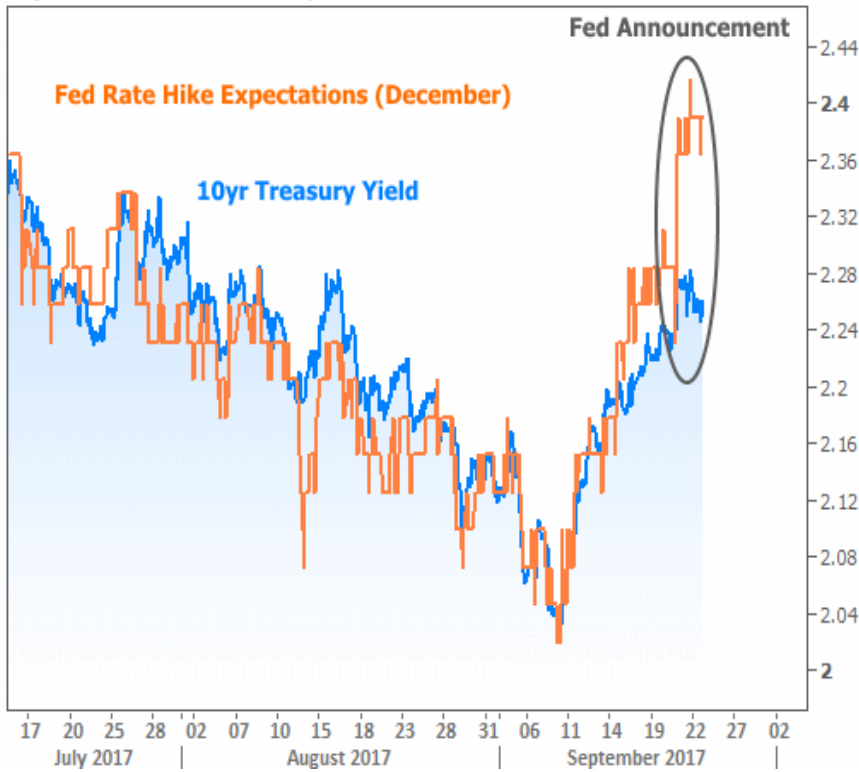
Market participants weren't necessarily expecting a huge deceleration in the rate hike outlook based on recent Fed speeches, but they were certainly expecting something better than "unchanged." **Simply put**, market expectations were out of line with the Fed's reality, and trading levels had to correct fairly quickly.

Both stocks and bonds like **low** rates, so both stocks and bonds sustained damage after the Fed forecasts. The chart below shows this in the form of higher rates and lower stock prices.

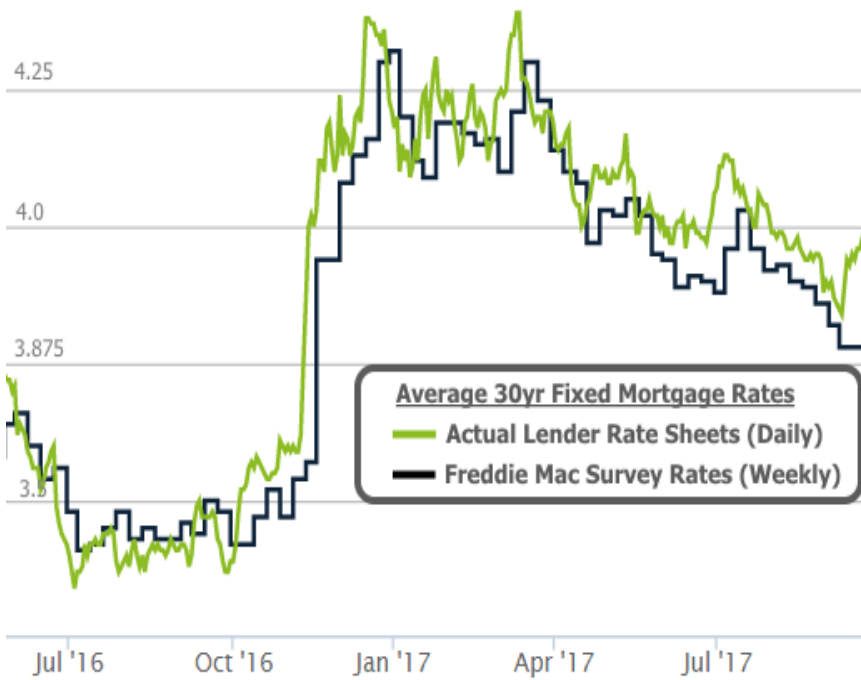


A longer-term view shows the relationship between 10yr Treasury yields (the best benchmark for general momentum in longer-term rates) and Fed Rate Hike Expectations (based on Fed Funds Futures--securities that can be traded by way of betting on where the Fed's rate winds up in the future). This chart does a good job of conveying a strong directional correlation (i.e. the two lines almost always move in the same direction) but one that varies in intensity (i.e. rate hike expectations **took the news harder** than long-term rates in the bigger picture).

10yr Yields vs Fed Rate Hike Expectations



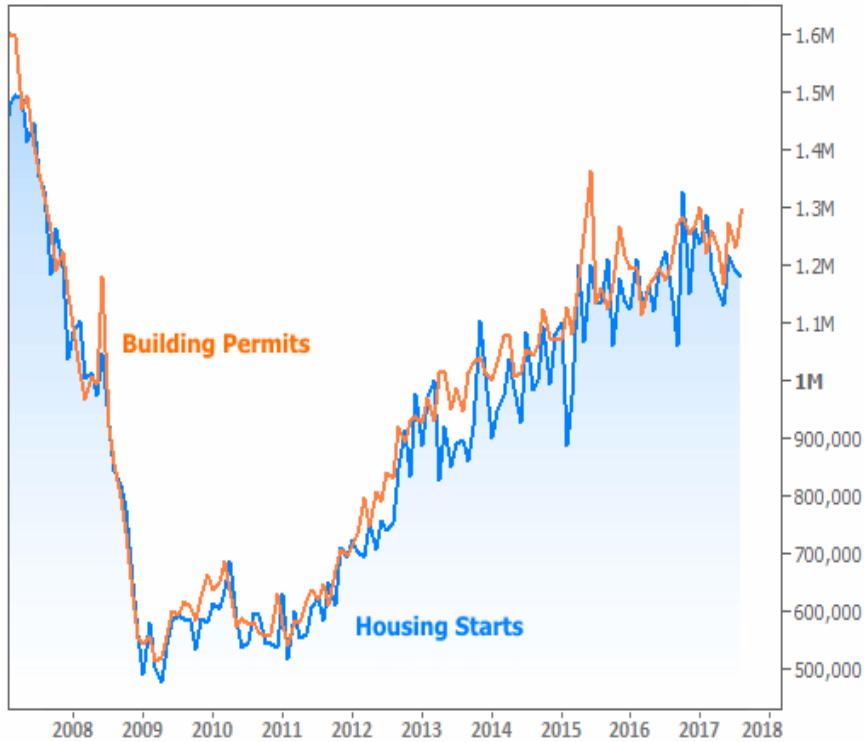
In terms of the effect on mortgage rates, you have to be careful what you read this week. Rates are definitely higher. The issue is that the widely-quoted **weekly** rate survey from Freddie Mac suggests rates only moved up 0.04% from recent long-term lows. In reality, rates have risen 2 to 3 times that much based on **daily** data from actual lender rate sheets. Also worth noting is that rates were already rising briskly last week when the Freddie survey pegged them as "unchanged."



The implications for the housing and mortgage markets depend on how things evolve from here. For now, rates have only moved up about an eighth of a percentage point from recent lows--**not enough** to do major damage to purchase and refi demand in and of itself. If rates continue higher, however, housing metrics would increasingly risk turning a corner.

At the very least, higher rates won't help us break through the stagnation seen in some of this week's housing reports. According to the [Census Bureau](#), **Housing Starts and Building Permits** continue to hover in the 1.1 to 1.3 million range. We first entered that range more than 2 years ago!

Housing Starts and Building Permits



Existing Home Sales took a turn for the worse this month, but the National Association of Realtors notes that the numbers would have been more stable were it not for **Hurricane Harvey's impact**. Even so, Existing Sales already dipped below a 5.5 million annual pace last month, bringing them back in line with the range that also began in early 2015.

Existing Home Sales



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Recent Economic Data

Date	Event	Actual	Forecast	Prior
Tuesday, Sep 26				
9:00AM	Jul CaseShiller 20 yy (%)	5.8	5.8	5.7
10:00AM	Sep Consumer confidence	119.8	120.0	122.9
10:00AM	Aug New home sales chg mm (%)	-3.4	3.3	-9.4
1:00PM	2-Yr Note Auction (bl)	26		
Wednesday, Sep 27				
8:30AM	Aug Durable goods (%)	1.7	1.0	-6.8
10:00AM	Aug Pending Home Sales (%)	-2.6	-0.5	-0.8
1:00PM	5-Yr Note Auction (bl)	34		
Thursday, Sep 28				
8:30AM	Q2 GDP Final (%)	3.1	3.0	3
1:00PM	7-Yr Note Auction (bl)	28		
Friday, Sep 29				
8:30AM	Aug Personal Income (%)	0.2	0.2	0.4
8:30AM	Aug Consumer Spending (Consumption) (%)	0.1	0.1	0.3
8:30AM	Aug Core PCE (y/y) (%)	1.3		1.4
9:45AM	Sep Chicago PMI	65.2	58.5	58.9
10:00AM	Sep U Mich Sentiment Final (ip)	95.1	95.3	95.3

Event Importance:

- No Stars = Insignificant
- ☆ Low
- ★ Moderate
- ★★ Important
- ★★★ Very Important

Who is Mid Valley Financial?

Mid Valley Financial, located in Fresno, CA, is the Central Valley's premier destination for a wide range of residential and commercial real estate loans. Our commitment to excellence has made us a trusted partner for property buyers and investors seeking tailored financial solutions.

****Why Choose Us:****

With a track record spanning back to our inception in 1985, we have established ourselves as a reliable and innovative lender. We proudly serve properties exclusively within California, having funded loans in all 58 counties of the state. Our deep-rooted experience enables us to navigate complex loan scenarios with expertise and efficiency.

****Our Approach:****

At Mid Valley Financial, we prioritize your financial goals. Whether you're a first-time homebuyer, envisioning your dream property, refinancing an existing mortgage, or looking to tap into your property's equity, our seasoned loan officers offer a wealth of knowledge and over 300 years of collective experience. We ensure that your funds are prepared when you need them, providing a smooth and swift loan process.

****Unlocking Possibilities:****

As one of California's leading direct lenders, we've streamlined the loan process, minimizing obstacles that often deter borrowers. Many of our clients receive approvals within an hour, showcasing our dedication to quick and hassle-free solutions.

****Your Journey with Us:****

Contact the MVF team today and let us put your journey to property ownership on cruise control. Our mission is to empower borrowers while fostering enduring and meaningful relationships. With highly competitive rates, a commitment to transparency, and a dedication to your financial success, Mid Valley Financial is your partner in realizing your real estate aspirations.

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