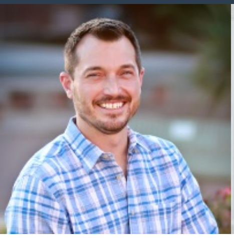

The Arizona Loan Baron

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A Message from The Arizona Loan Baron:

"In other words - The Fed will hike very short term interest rates today at 11am AZ time, but the markets have already priced it into longer term rates (like mortgage rates) because they knew it was coming. Rates are already higher. Going forward, the Fed's outlook on FUTURE rate hikes (also to be released today) is what will drive markets (rates) up or down."

The Day Ahead: Paradoxical Reaction Potential For Today's Fed

In trying to put together a chart for this morning, I kept running into a wall. It had to do with the likely outcomes associated with different Fed forecast scenarios today. To keep things simple, the 2 scenarios I'm considering are "friendly Fed" (i.e. rate hike outlook less aggressive than expected) and "unfriendly Fed" (vice versa).

The **paradoxical conclusions** have to do with how rates will react to either scenario--especially if we're trying to predict the reaction for both longer and shorter-term rates. At first glance, we would expect a friendly Fed to put downward pressure on both ends of the curve (i.e. 2yr and 10yr yields fall together), and indeed, that's highly likely to be the case. This is the less variable of the two scenarios.

But what about a more aggressive Fed that ratchets up its rate hike outlook? The **only real given** in this case would be upward pressure on 2yr yields. That's not to say that 10yr yields wouldn't feel some pain today. There's definitely a risk that a more hawkish Fed causes a brief move to new long-term highs. But the more I think about, the more I'm convinced that would just be an initial, knee-jerk reaction.

Why?

Simply put, the more aggressive the Fed gets with respect to tightening policy (aka hawkish), the more they're effectively hitting the brakes on the current economic expansion. Granted, they're not the be all, end all of economic growth, but an inverted yield curve will eventually give way to economic **cooling** no matter what any pundit on TV may say (unless it's me).

MBS & Treasury Market Data

	Price / Yield	Change
MBS UMBS 6.0	100.39	+0.19
MBS GNMA 6.0	100.53	+0.14
10 YR Treasury	4.3602	-0.0724
30 YR Treasury	4.5297	-0.0761

Pricing as of: 7/3 5:59PM EST

Average Mortgage Rates

	Rate	Change	Points
Mortgage News Daily			
30 Yr. Fixed	7.08%	-0.05	0.00
15 Yr. Fixed	6.45%	-0.02	0.00
30 Yr. FHA	6.55%	-0.05	0.00
30 Yr. Jumbo	7.25%	-0.04	0.00
5/1 ARM	7.07%	-0.03	0.00
Freddie Mac			
30 Yr. Fixed	6.86%	-0.01	0.00
15 Yr. Fixed	6.16%	+0.03	0.00
Mortgage Bankers Assoc.			
30 Yr. Fixed	7.03%	+0.09	0.62
15 Yr. Fixed	6.56%	+0.09	0.54
30 Yr. FHA	6.90%	+0.11	0.95
30 Yr. Jumbo	7.11%	-0.01	0.50
5/1 ARM	6.38%	+0.11	0.54

Rates as of: 7/3

Bottom line, 2yr Treasuries have to pay pretty close attention to the Fed's stance and trade accordingly. 10yr Treasuries may look like they're doing the same, but will quickly consider the implications of an even more hawkish Fed (i.e. a quicker end to this economic expansion). In other words, if the Fed's rate hike outlook is more aggressive than expected, it doesn't necessarily spell certain doom for longer-term rates.

Remember, the Fed is **REACTING** to information that Treasuries have already had a chance to trade.

A couple of risks to this paradoxical outlook:

1. I'm not highly confident about getting this sort of reaction TODAY. Today is anyone's guess, and of course a break of the long-term ceiling at 3.126% could prompt follow-through selling in 10's.

2. It can be hard to label any given layout of the Fed's forecasts as decidedly hawkish or dovish. Markets expect a slight acceleration in the hike outlook. If 2yr yields aren't screaming higher, we'd be left to conclude the forecasts weren't a big shock, and that could ultimately make traders think the economic expansion will last longer (more inflation/growth pressure pushing 10yr yields higher and higher)

3. If the Fed says something hawkish about its reinvestment policies that would directly impact longer-term rates

4. I could be completely wrong and traders might not be thinking that far ahead for whatever reason (month-end portfolio holding constraints, corporate issuance, etc).

One thing we can be sure of: the festivities begin at 2pm sharp. We know traders are very interested in today's Fed releases and that the POTENTIAL for a reaction is fairly big. Be ready for big moves in either direction.

Subscribe to my newsletter online at: http://mortgagenewsletter.net/timothybaron

The Arizona Loan Baron

The Arizona Loan Baron is at your service!

I would appreciate the opportunity to share with you my extensive mortgage lending experience. My client focused approach has allowed me to build long lasting relationships and partnerships throughout Arizona. I know this market. I live here and work here. Please allow me the opportunity to be your mortgage lending partner.

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