

A Quick Note on Why Rates Seem to Drop More Quickly as They Approach Certain Thresholds

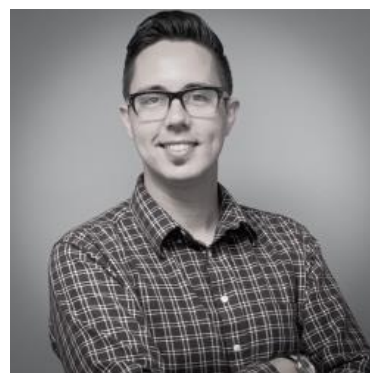
It may seem like today's bond market movement alone (3/8ths higher in MBS and 0.09% in 10yr yields) doesn't explain the pace of improvement in mortgage rates. For that, we'd need to consider the arcane underpinnings of the mortgage-backed securities (MBS) market. These are the bond-like instruments that represent large groups of mortgage debt that can be traded among investors.

MBS are broken out into coupons in 0.5% increments. Only certain mortgage rates are allowed in certain MBS coupons (think of them like buckets). The bucket that had been the most active could hold rates up to 6.625% and it is suddenly losing favor to the next lower bucket which holds rates up to 6.125%.

One need not necessarily understand all of that--just the implication that rates can drop more quickly than normal as they approach the upper limits of the next lower bucket. In other words, the recent stint of rates near 6.5% meant that the 6.625% bucket was hanging onto relevance and the 6.125% bucket was still a bit out of reach. Now today, the 6.125% is vying for higher relevance, thus the slippery slide down toward 6.125%.

NERD ALERT: for those that truly desire the underlying specifics, the upper bucket is a 5.5% UMBS coupon which can accommodate rates from 5.75 to 6.625 and the suddenly more fashionable bucket is the 5.0% UMBS coupon which holds rates from 5.25-6.125. MBS investors desire a certain sense of certainty about how long the underlying loans will last before mortgage borrowers refinance. By exhibiting stronger demand for the 5.0% UMBS coupon (the bucket that tops out at 6.125%), investors are basically saying they'd rather sacrifice a bit of present-day rate of return in exchange for more certainty of collecting that rate of return for a longer period of time in a market where rates are falling. Reason being: if they bought 5.5 UMBS and mortgage borrowers refinanced in the near future, that principal would now need to be reinvested at rates that could be even lower than they are today.

There's an even deeper dive in the MBS Live knowledge base [HERE](#).



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