MORTGAGE: READ & LEARN
Understanding the Basics of the Mortgage Markets

**A message from Marc Erickson:**

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# Why Mortgage Rates Move in Jumps Instead of Smooth Lines

**Why Mortgage Rates Move in Jumps, Not Smooth Lines**

Mortgage rates often "jump" as they approach certain cutoffs. The reason isn't just daily moves in Treasuries. It's how mortgages get bundled and sold as mortgage-backed securities (MBS).

**Quick primer**

- Mortgages are pooled into MBS that trade like bonds.
- MBS come in 0.50% "coupon" buckets: 5.0%, 5.5%, 6.0%, etc.
- Only certain note rates are eligible for each bucket. Buckets have upper limits.

**Why the .125 and .625 cutoffs matter**

Retail mortgage rates can accelerate as they near **.125%** or **.625%** endings because those are the practical edges of key MBS buckets. When investors shift demand to a lower coupon, lenders rush to price loans that qualify, and consumer rates can drop faster than the day's bond move would suggest.

**Plain-English example**

Suppose the 5.5% MBS coupon (can hold rates roughly from 5.75% to 6.625%) has been the workhorse. If markets improve and investors favor the 5.0% coupon (holds rates up to 6.125%), lenders pivot. That creates a quick slide toward **6.125%** as pricing realigns to fit the lower bucket.

**Why MBS coupons don't equal your note rate**

Mortgage rates are higher than their underlying MBS coupons because certain costs come off the top to pay for things like Fannie/Freddie guaranty fees and loan servicing. The result is that a rate of, say, **5.625%** may only have about **5.0%** of interest available to an investor. As such, it would be a perfect candidate for a **5.0% MBS coupon**.

**Investor preference and refinancing risk**

Investors like predictable cash flows. When rates are falling, they prefer lower coupons, trading a bit of yield today for a better chance the loans won't refinance quickly. That demand shift is what makes movements



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near **.125** and **.625** feel sharp.

**Practical takeaway**

- Don't expect rates to move in a straight line.
- Watch how close prevailing quotes are to **.125%** and **.625%.**
- As pricing nears a lower bucket's upper limit, rate sheets can reprice quickly.

**Nerd corner (optional)**

- The 5.5% UMBS coupon typically accommodates ~5.75%–6.625% note rates.
- The 5.0% UMBS coupon typically accommodates ~5.25%–6.125% note rates.
- Lower coupons tend to be more sensitive when momentum shifts.

**Bottom line**

When investor demand migrates to a lower MBS coupon, lenders reprice to fit that bucket, and consumer rates can lurch toward **.125%** or **.625%** faster than headline bond moves would imply.

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