



Update

March 12, 2020

FOR AD&CO MODEL USERS

AD&Co's Response to the Volatile Market

As you are aware, key benchmark interest rates have experienced notable moves over the last two weeks, fluctuating into historically low ranges with much higher than normal volatility. The impact of this environment on prepayments and defaults is still very uncertain.

Over the next few weeks, Andrew Davidson & Co., Inc. will continue to monitor several key metrics that drive or signal mortgage prepayments: the Ten-Year Treasury rate; the current coupon yield, the Freddie Mac Primary Mortgage Market Survey rate (PMMS); the MBA Refinance Application Index; and others. A Federal Open Market Committee (FOMC) meeting is set for March 17-18, at which time the benchmark interest rate could possibly be lowered again. As we observe movements in these key indicators, we will continue to run our analyses, observe how the models react, and determine if any adjustments are needed.

In addition to market interest rates, we will be monitoring the primary-secondary spread. Typically, there is a gradual transition between changes in the secondary rate and the primary rate, and the primary rate does not usually fully adjust to changes in the secondary rate. We have heard anecdotal evidence that some firms are increasing primary market rates in response to this certainly atypical situation. The path of primary mortgage rates is likely to have significant volatility which will affect prepayment behavior.

We are also identifying sectors of borrowers who are most likely to refinance and assess the level of potential prepayments. Based on our analyses so far, loans originated from 2017 to present are the target group, as they hold rates that are noticeably above current offered rates. One of the strengths of our modeling framework is the ability to efficiently implement model tunings. If forecasts suggest the need for an adjustment, tuning files will be available to clients who choose to implement them,

During this uncertain time, we will keep you updated on a regular basis, and welcome any feedback you may have. Please feel free to reach out to us at support@ad-co.com.

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