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METWEST

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Fixed Income Commentary

Monthly Update: Private Demand Supports Agency MBS

Mortgages outperformed Treasuries for the first half of April, mainly driven by strong supply-demand technicals. While light origination volume continued to offset the termination of the Fed MBS purchase program, money managers, foreign investors, and CMO desks have stepped in to strengthen demand for mortgage paper. In the second half of the month, however, a widening of swap spreads, a pickup in implied volatility and market concern over financial regulation and Greek contagion resulted in agency mortgages underperforming their Treasury hedge ratios. Month-over-month, FNMA 5.5s and 6.5s underperformed the 10-year Treasury by 17 ticks, using a 30-day empirical hedge ratio, while FNMA 4.0s and 4.5s lost four ticks and seven ticks, respectively, on a 10-year Treasury-hedged basis.

As it promised, FNMA began its multi-month delinquency buyout program and by the April reporting date it has bought out the four-month consecutive delinquent loans in the vast majority of 6.5s and greater coupon pools. As a result, the aggregate fixed rate FNMA prepayment rate was up 89% to 27.6 CPR from 14.6 CPR. Excluding the 6.5s and 7s, FNMA 30-year prepayment rate increased 28% due to a 3.5 day pickup in day count and a temporary rise in HAMP-related mandatory buyouts. The aggregate post-buyout Freddie Mac prepayment rate came in at 17.9 CPR, which is higher than the pre-buyout January prepayment rate due to elevated HAMP modification. Surprisingly, Ginnie Mae released the third straight month of slower prepayments, with 6's leading the way, down 26% to 23.9 CPR. From Freddie's March volume summary, both the 90-119 day and 120+day delinquencies were lower compared to February. Interestingly, the roll rate from 90-119 day to 120+day delinquencies was lower as well.

April gross agency pool issuance dropped to $93 billion, due to lower new home sales and reduced cash out and ARM-to-fixed refinances. On the demand side, buyers including banks, overseas investors (due to the new fiscal year) and reinvestment from the GSE buyouts, continued to remove float from the sector. According to this new supply-demand equilibrium, market forecasters have reduced their estimates for net new supply of agency mortgages for 2010 to near zero.

Since the beginning of the year, a drop in the GNMA supply coupled with strong demand from overseas investors, banks and CMO desks have propelled GNMA/FNMA 4.5s and 5.0s swaps higher. They ended up by 18-22 ticks by end of the first quarter. Weaker existing home sales and tighter guidelines on FHA streamline refinancing are key factors of the recent slowdown in supply. During the month of April, 4.5s and 5.0s GNMA/FNMA swaps had experienced some headwind in valuation as the market realized that FHA is the only game in town for lower credit borrowers and this drop in supply is only a temporary phenomenon.

Pay-ups for specified pools remain well supported by the increasing activities from CMO desks, as CMO arbitrage stays attractive for high WALA pools and non-deliverables. Meanwhile, money managers continue to sell higher pay-up specified pools and trade into TBA and lower pay-up collateral.

Monthly Update: Private Demand Supports Agency MBS (cont'd)

According to the MBA weekly survey, for the week ending April 23, the purchase index came in at 257.9, a 6.13% increase from March 26. Meanwhile, the Refi index was down 20.16% to 2161.8. The average contract interest rate for a 30-year fixed mortgage increased 4 bps to 5.08% over the month, and average contract rate for a 15-year fixed rate mortgage was 4.38%.

The newly released HAMP report indicated that in March, 57,000 trial modifications were started, a 29.63% drop from February; however, more than 61,000 trials became permanent compared to almost 53,000 in February, which brings the total number of conversions to 228,000.

Coupon Stack Performance

30 Year FNMA	April Month End Price	Monthly Price Change	Monthly Performance Vs. 10 Year Treasury	April Month End Libor OAS	Libor OAS Monthly Change
4.0	97-27	28/32	-4/32	+20.2bp	+4.9bp
4.5	100-26	19/32	-7/32	+21.3	+3.3
5.0	103-17	12/32	-9/32	+22.1	+12.4
5.5	105-11	-2/32	-17/32	+13.8	+23.4
6.0	106-24	17/32	4/32	+9.1	+15.2
6.5	108-04	-8/32	-17/32	-20.6	+23.0

Source: TCW, Barclays

Benchmark Performance

	April Month End Price	Monthly Price Change	April Month End Yield	Yield Change
2 Yr Treasury	100-02	4/32	0.96%	-0.06%
5 Yr Treasury	100-12	21/32	2.42%	-0.14%
10 Yr Treasury	99-23	46/32	3.66%	-0.17%
30 Yr Treasury	101-19	97/32	4.53%	-0.18%
2/10 Curve			269bp	-0.12%
2 Yr SWAP Spread			22.9bp	0.07%
10 Yr SWAP Spread			0.1bp	0.02%
1*10 Swaption Vol			114.7bp	0.06%
5*10 Swaption Vol			112.9bp	0.09%

Source: TCW, Citigroup

Issuer Performance

	April GNMA/FNMA	Monthly Price Change
4.5	23/32	-7/32
5.0	24/32	-0+/32
5.5	26/32	-14+/32
6.0	15/32	4/32
6.5	2/32	22/32

Source: JPM, TCW

Agency Debentures

	Month End Spread to UST	Monthly Change in Spread	Month End Yield
2 Yr	+16bp	2bp	1.13%
5 Yr	+24	-3	2.68%
10 Yr	+23	-2	3.93%

Source: GS indications only (mid)

Specified Pool Pay-up Grid

FNMA 30 Yr	Weighted Average Life (WALA)			
Coupon	20 Months	40 Months	60 Months	80 Months
4.5	3/32	15/32	26/32	40/32
5	0	6/32	19/32	27/32
5.5	0	0	15/32	24/32
6	1/32	4/32	30/32	56/32
6.5	1/32	0	30/32	54/32

Loan Balance Pay-up Grid

Coupon	Low Loan Balance	Medium Loan Balance	High Loan Balance
4.5	12/32	8/32	4/32
5	19/32	12/32	5/32
5.5	42/32	32/32	14/32
6	56/32	42/32	24/32
6.5	54/32	36/32	20/32

Coupon	INV	20 Year	JUMBO	10/20
4.5		60/32	-8/32	-34/32
5	3/32	40/32	-10/32	-28/32
5.5	28/32	26/32	-42/32	-32/32
6	20/32		-52/32	-32/32
6.5	18/32			-32/32

Source: GS as of 4/30/2010