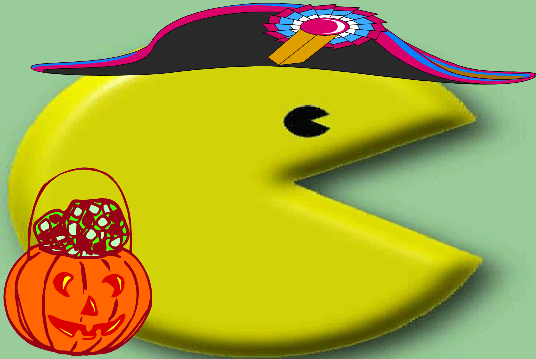


Newsletter - Vol. 8 Issue 10

October 2011

mortgagestraightTalk.com

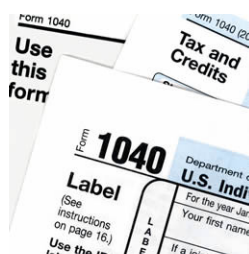
Tel: 760-726-4600 Cel: 760-717-8584

Fax: 760-639-0785

Rod@MortgageStraightTalk.com

IN THIS MONTH'S ISSUE:

* INDEXES REVISITED
* GDP REPORT: ECONOMIC GROWTH WEAK, BUT BETTER
* NATIONAL DEBT: WHY TAX REVENUE HAS TO GO UP
* AUGUST JOBS REPORT: HIRING GRINDS TO A HALT



* THE MONTH IN REVIEW
* RATE SUMMARY
* SPECIAL(S) OF THE MONTH
* MORTY'S MAILBAG
* MORTGAGE MIRTH

THE MONTH IN REVIEW

9/1-9/2 **New unemployment benefit claims fell to 409,000 in the week ending Aug. 27, the Labor Department said. The yield on the 10-year Treasury note dropped to 2.01% from 2.15% late Thursday.** The 10-year yield hit a record low of 1.99% on Aug. 18. **Stocks were slammed by a dismal jobs report as the Dow slid 253-points.**

9/6-9/9 As fears about a slowing U.S. economy and a deepening European debt crisis continued to grow, it boosted demand for the safety of U.S. government debt. Consequently**, prices rose and the yield on the 10-year bond fell to a record low of 1.91%,** from about 2% on Friday. **Stocks surged 276 points, Wednesday** as concerns over Europe'sdebt crisis eased. But **they retreated, Thursday, giving up about 50% of the previous day's gains,** after Bernanke made a speech cautioning Congress about putting the economic recovery at risk. **Filings for first-time unemployment benefits rose 2,000 to 414,000 in the week ending Sept. 2,** the Labor Department reported Thursday. **Deepening fears about the debt crisis in Europe plunged the market into a 303-point sell-off Friday.**

9/12-9/16 **The Producer Price Index, a measure of wholesale inflation, was unchanged in August,** which was in line with expectations. **Retail sales were flat in August,** following a 0.3% rise the previous month. The government's weekly report on **initial claims for jobless benefits came in higher than expected, with claims rising to 428,000 in the latest week** from 414,000 the previous week. Economists had expected a modest decline. **Stocks rose 185-points, Thursday,** in response to a collaborative effort involving five central banks to quell European economic worries. **The Consumer Price Index rose 3.8% in August compared to a year earlier. That's up from 3.6% in July and is the highest reading since September 2008.**

9/19-9/23 **U.S. stocks dropped 108-points Monday, following a global sell-off, as investors fretted over the possibility of a Greek default.** The National Association of Realtors said **EXISTING home sales rose 7.7% in August** to an annual rate of 5.03 million homes. Economists were expecting sales to have risen only 0.6% during the month. **Moody's Investors Service announced the downgrade of Citigroup,**

Wells Fargo, and Bank of America, three of the United States' top banks. Stocks fell 284 points, on Wednesday after the Fed unveiled its plans to boost the economy. Thursday, the Dow plunged another 391-points as stocks sank on worries about a slow-down on global growth. **As investors rushed into bonds the yield on 10-year Treasuries hit a new low of 1.671% early Friday. (**Bond prices are inversely related to their yields).

9/26-9/30 August sales of NEW homes declined by 2.3%, to an annual rate of 295,000, slightly better than the 293,000 annual rate that economists had predicted.

Reports of a new plan to ease Europe's debt crisis propelled the Dow to a 272-point gain, Monday, in the last hour of trading. **The hint of a resolution was enough to boost stocks for a second-straight day. Home prices rose 0.9% in July** compared with June, but they're still 4.1% lower than 12 months ago according to the latest S&P/Case-Shiller home price index of 120 major cities. (**For San Diego, the rise was 0.1%) Investors staged a retreat when they saw the meager size of the proposed 640 billion euro bail out of the Euro zone's debt crisis.**

The stock market dove 179-points in response. New claims for jobless benefits fell to 391,000 last week, the lowest level since April 2. A report from the National Association of Realtors showed **pending home sales fell 1.2% in August**. That was better than economists had anticipated.

THIS ISSUE'S TOPIC: INDEXES REVISITED

(This issue's main topic may be a little technical for some, but it is also mercifully short. Engineers seem to have a keener interest in it than most).

Frequent readers of the newsletter are aware that I am a big proponent of Adjustable Rate Mortgages (ARMs) because they give you the lowest rates—and for the least money. The reason that I am so high on these instruments is because most borrowers opt for a 30-yr. fixed rate mortgage that costs them about one and a half to two points more in rate than say a 5/1 ARM. And on average most people refinance within the first 4 years and or sell their home within the first 6 years. Thus, they have paid a 1-2% premium for something that they will never use. In fact, only 3% of all 30 yr. fixed rate mortgages are held to completion, which means that 97% of mortgagors who purchased 30 yr. fixed rate mortgages paid 1-2% more in rate for something they never used.

Incredibly, many borrowers mistakenly believe that adjustable rate mortgages only adjust upward. They can certainly adjust downward, too. As an example, I put my stepfather into a 5/1 ARM back in 2003 at 5.25% which guaranteed that his rate would remain fixed at 5.25% for the next five years, which it did. Since that time his rate has adjusted downward a number of times because the Index dropped. His rate right now is just a tad above 3%. He's had this loan for the past 8 years and given the economic climate it will probably remain under 5% for several more years.

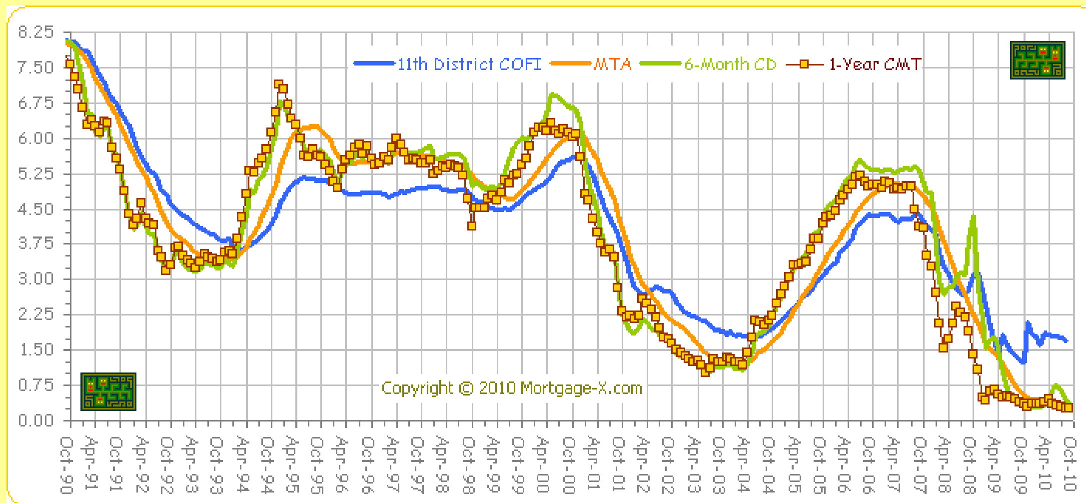
Unfortunately, although a comparative bargain, they remain among the most misunderstood of all loan products, yet, they are really quite simple. The fixed component of an ARM is the MARGIN; it is in effect the lender's profit margin. It never changes. The INDEX is the variable component of an ARM; it is nothing more than a statistical indicator which changes with time and/or the cost of money. It determines how much the actual interest rate will increase (or decrease) over a specified period, be it a month, six-months or a year. It is also the subject of this month's newsletter.

As already touched upon, there are two components to an ARM loan: the INDEX and the MARGIN. When added together, the index and the margin, yield what is termed the fully-indexed or actual interest rate. So, for example, if one's indexed rate is 0.25% and one's margin is 2.75%, then the fully-indexed or actual rate is 3%.

In years gone by there were several different indexes. Among the little used acronymic indexes of yesteryear are the Cost Of Funds Index (COFI), the 12-**M**onth **T**reasury **A**verage (**MTA**), the **C**ertificate **o**f **D**eposit **I**ndex (**CODI**) and the **C**ost **o**f **S**avings **I**ndex (**COSI**). The latter two no longer exist as the COSI was an index specific to World Savings which was acquired by Wachovia. Wachovia had the CODI as their specific index. But after acquiring World Savings, it was, in turn, bought by Wells Fargo Bank. The COFI and the MTA indexes were widely used for products with monthly interest rate adjustments, but they fell into disuse as Option ARM loans fell into disfavor. These days, for the majority of loans, there are just two indexes: the **C**onstant **M**aturity **T**reasury (**CMT**) and the **L**ondon **I**nter**B**ank **O**ffering **R**ate (**LIBOR**). Each one has a distinct market and fluctuates differently. We will look at each of them in turn.

Constant Maturity Treasury (CMT) Index

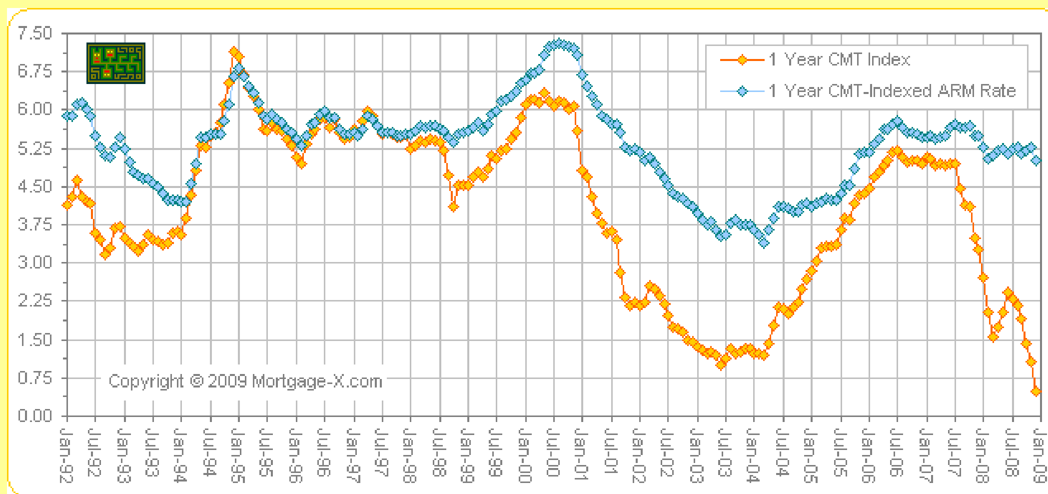
This is the most widely used index. Roughly half of all ARMs are based on this index. It's used on ARMs with annual rate adjustments. It is also referred to as the 1-Year Treasury Bill (1Yr T-Bill) [see note], the 1-Year Treasury Security (1Yr T-Sec), or the 1-Year Treasury Spot index.



1-Year CMT Index vs. national average mortgage rate on 1-year CMT-indexed adjustable rate mortgages, 1992-2010. There are also 1-,3-,5-Year CMT Indexes which are based on the Average yields on U.S. Treasury securities. These indexes are the weekly or monthly average yields on U.S. Treasury securities adjusted to constant maturities of 1, 3, or 5 year(s) correspondingly. The CMT indexes are volatile and move with the market. They reflect the state of the economy, and respond quickly to economic changes.

The following CMT indexes are the most often used for ARMs:

1-yr. Constant Maturity Treasury Index (1 Yr CMT)



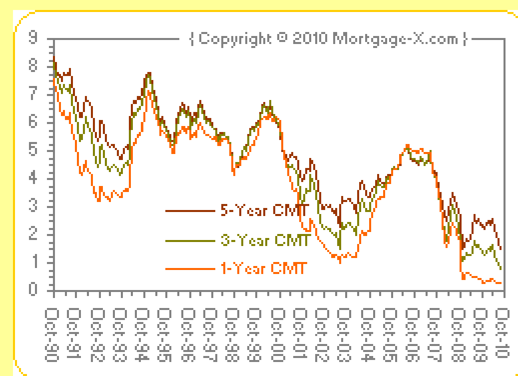
1-Year CMT Index vs. national average mortgage rate (start rate) on 1-year CMT-indexed adjustable rate mortgages, 1992-2010

3-Year Constant Maturity Treasury index (3 Yr CMT)

This index is less popular than the 1-Year CMT. ARMs based on the 3 Year CMT will adjust every three years (3 Year ARMs). It may be referred to as the 3-Year Treasury Security (3Yr T-Sec) index.

5-Year Constant Maturity Treasury index (5 Yr CMT)

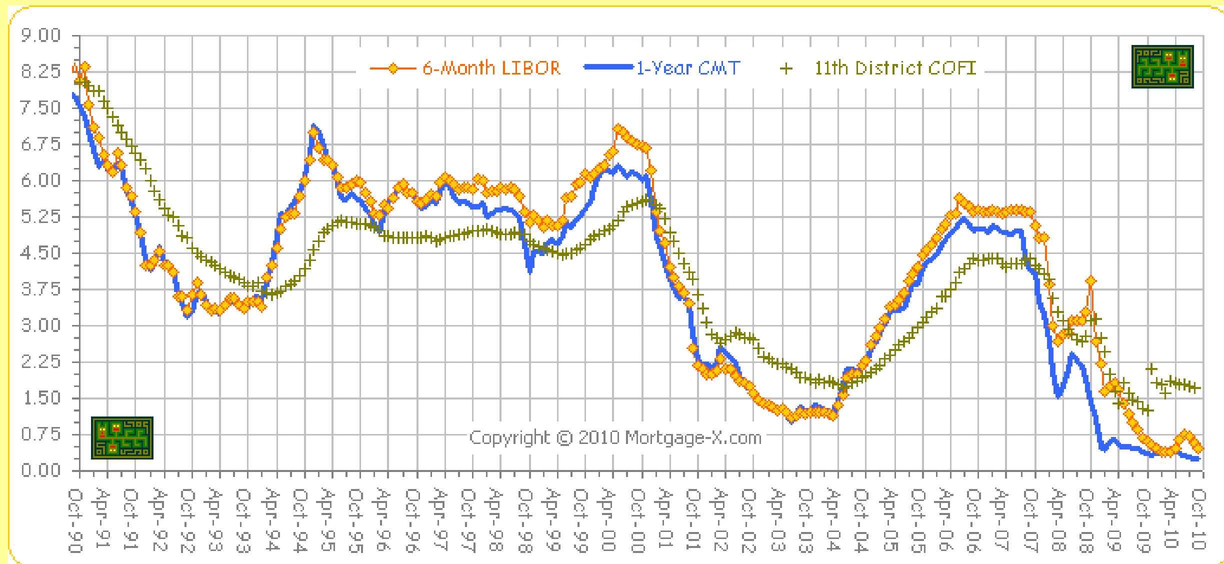
Same as the 3 Year CMT, but ARM loans indexed to the 5 Year CMT will adjust once every five years (the ARM's adjustment period is usually the same as the security's constant maturity).



1-, 3-, and 5-Year CMT, 1990-2010

London Inter Bank Offering Rates (LIBOR) Index

London Inter Bank Offering Rate (LIBOR) is an average of the interest rate on dollar-denominated deposits, also known as Eurodollars, traded between banks in London. The Eurodollar market is a major component of the International financial market. London is the center of the Euromarket in terms of volume.



6-Month LIBOR vs. 1-Yr CMT, 11th District COFI, 1990-2010

The LIBOR is an international index which follows the world economic condition. It allows international investors to match their cost of lending to their cost of funds. The LIBOR compares most closely to the 1-Year CMT index and is more open to quick and wide fluctuations than the COFI rate, as shown on the graph.

There are several different LIBOR rates widely used as ARM indexes: 1-, 3-, 6-Month, and 1-Year LIBOR. The 6-Month LIBOR is the most common.

LIBOR-indexed ARMs offer borrowers aggressive initial rates, but with increased volatility. With LIBOR ARMs borrowers are generally protected from wide fluctuations in interest rates by periodic and lifetime interest rate caps.

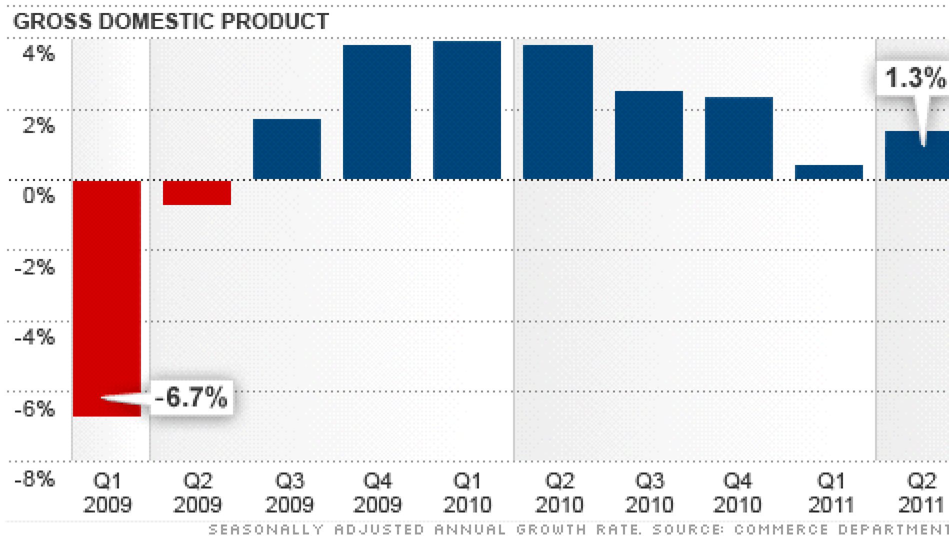
SUMMARY

The CMT and the LIBOR indexes are the most widely used indexes for ARM loans. They track each other very closely. The shorter the time frame of the index, the more volatile it is (e.g. 1-yr. CMT vs. 5 yr. CMT). The CMT index is reflective of the state of the national economy; the LIBOR more closely mirrors global economic conditions.

GDP REPORT: ECONOMIC GROWTH WEAK, BUT BETTER

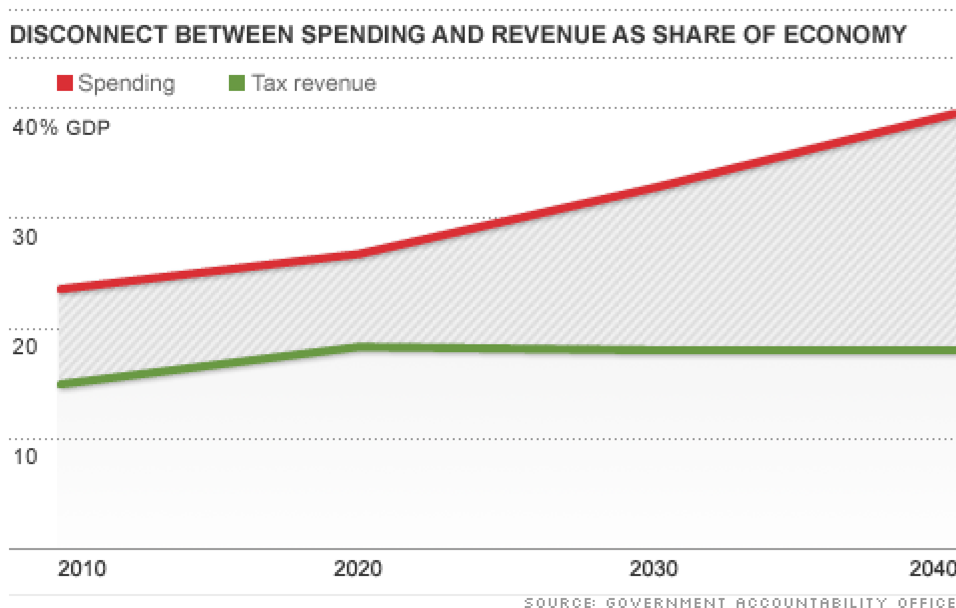
Economic growth remained very weak in the second quarter, but was slightly better than previously thought, according to the government's final reading on U.S. economic health. Gross domestic product, the broadest measure of the nation's economy, grew at a 1.3% rate in the three months ending in June, the Commerce Department reported. That's an improvement from the 1.0% growth rate in the previous estimate from a month ago.

Economists were expecting growth of only 1.1% in the final second quarter reading, and predict only 1.8% growth in the third quarter. Growth of at least 3% is generally needed for the economy to produce enough jobs to meaningfully lower the unemployment rate. But economists are projecting growth to remain well below 3% through the end of 2012.



NATIONAL DEBT: WHY TAX REVENUE HAS TO GO UP

Nobody likes having to pay more in taxes. And it's true that the country is on track to spend more than it can afford. So why can't Congress just cut spending to put the federal budget on a more sustainable path?



First answer: The problem is too deep to fix with spending cuts alone.

Here's just how deep: Say lawmakers wanted to permanently freeze the national debt held by the public where it is today -- 67% of GDP. They would need to cut spending by 35%, or about $1.2 trillion, immediately. And those cuts would need to be permanent, according to the Government Accountability Office.

How hard would that be? Consider that in 2010, all of discretionary spending—including defense—totaled $1.4 trillion. Even permanently cutting $1.2 trillion wouldn't be the end of the story. Public debt at 67% is still well above the country's four-decade historical average of 37%. So more cutting would need to occur in subsequent decades.

What's more, even if it were feasible to focus only on the spending side of the ledger, the truth is a lot of spending can't be turned off quickly. Changes to Medicare and Social Security benefits, for instance, would need to be phased in over time so future retirees can adjust their plans. And curbing rising medical costs will take years since it's still not clear what will be most effective in tamping down health care cost inflation.

Finding a way to bring in some revenue is a crucial piece of the puzzle to lower deficits in the medium term [10 years], because there is only so much spending that can be cut over a ten-year time period. At the same time, economists have warned against cutting spending and raising taxes abruptly because the economy is still fragile. That's why fiscal experts recommend a two-pronged approach: pair policies that support near-term recovery with a long-term debt reduction plan that will kick in when the economy is stronger.

Second answer: The country doesn't just have a spending problem

The country has continually spent more than it has been willing to collect in taxes. Over the past four decades, tax revenue has averaged 18% of GDP -- while spending has averaged 21%. Today, the gap is much wider since revenue is at a 60-year low and spending at a 60-year high. Thank you, economic downturn. But even after the economy recovers, if current policies—including pricey tax cuts—remain in place, the gap is projected to grow at an accelerated pace because of retiree and health care costs. Baby Boomers are aging and there are a lot of benefits we provide for people 65 and older. Even if we could slow the growth in health care costs to the rate of GDP, demographics alone would push up government spending.

Third answer: It's not either/or it's both.

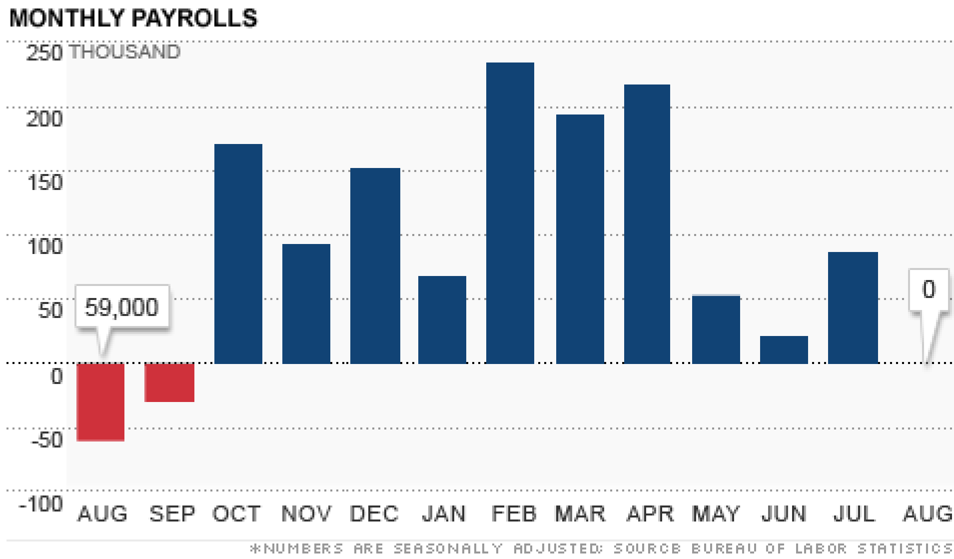
So does the country have a spending problem or a revenue problem? In truth, it's both. Everybody would like low taxes. And they'd like government to do everything that they think government should do. But the arithmetic can be a problem.

In other words, there is a major disconnect between the programs people want and what they're willing to pay for them. Reducing the debt will involve fixing that disconnect or at least narrowing it considerably. Of course, Congress doesn't have to hike tax rates in order to raise more revenue. In fact, fiscal experts would prefer that lawmakers lower rates while eliminating or reducing the hundreds of tax credits, deductions and exemptions on the books. Such "tax expenditures" deprive federal coffers of more than $1 trillion a year.

Tax breaks are geared to benefit specific groups and encourage specific economic activities. But they also contribute to the complexity of the tax code and the sense that the code is unfair. By reducing tax breaks, but especially by closing tax loopholes that let taxpayers legally get around being taxed on certain activities, you remove the opportunity for inefficient tax avoidance. That is, people will spend less time diverting their money into tax-favored activities and instead they'll put it where it makes the best economic sense. And that, in turn, may help the economy grow.

AUGUST JOBS REPORT: HIRING GRINDS TO A HALT

Ironically, as we headed into the Labor Day weekend, the Labor Department reported that the economy added no jobs in August. Zero, zilch, nada. Meanwhile, the unemployment rate remained at 9.1**%.** The report was partially helped by 22,000 state workers in Minnesota returning to work after a temporary government shutdown in July, but was also hurt by 45,000 Verizon workers on strike in August. Adjusting for those events, the economy probably added more like 23,000 jobs in August--still dismal compared with monthly gains of about 200,000 earlier this year.



Economists typically estimate the nation needs to add about 150,000 jobs each month to keep up with population growth alone. It needs even stronger growth to recover the 8.8 million jobs lost during the financial crisis. Weak hiring in August was hardly a surprise. The month started with Congress haggling about the debt ceiling, Standard & Poor's downgrading the United States credit rating and the stock market swinging wildly up and down. Consumer confidence plunged to its lowest level since the recession and fears of an even weaker economy likely kept employers on the sidelines, instead of hiring.

Even so, economists had predicted the economy would add 75,000 jobs in August. They also expect job growth to remain weak for the balance of the year, with the economy adding an average of 110,000 jobs each month and the unemployment rate barely ticking down to 8.9%. The White House said that it predicts the unemployment rate will remain stubbornly high, not falling below 6% until 2017.

Another 2.6 million people were considered "marginally attached" to the workforce in August. They wanted and were available for work, and had looked for a job sometime in the last year, but were not counted in the unemployment figures because they weren't actively searching for a job in August. Overall, the so-called *under*employment rate, which includes those people, as well as people who want to work full-time but are forced to work part-time, rose to 16.2%. The last time the government reported exactly zero jobs added in a month was in February 1945.

CORRECTION RE:

HIGH BALANCE LOAN LIMITS

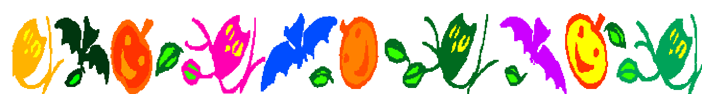
In the August issue I incorrectly stated that the previous maximum of $697,500 for Fannie Mae and Freddie Mac loan limits in San Diego County would drop to $625,500 as of October 1, 2011. The ACTUAL limit is $546,250. While the maximum high-cost loan limit will be reduced from $729,750 to $625,500, this applied to Los Angeles and Orange Counties. FHA loan limits will once again be set by county, resulting in a fairly significant reduction in the maximum allowable loan amount in some areas. The new VA high balance loan limit (100% financing) is now $537,500 and for the HomePath program the limit has been reduced to $417,000 from the previous $697,500.

RATE SUMMARY:

Rates IMPROVED, this month.

***Conventional conformings—DOWN by an 1/8th to a 1/4th**
***Jumbos—DOWN by an 1/8th**
***Governments (FHA/VA)—MOSTLY UNCHANGED**

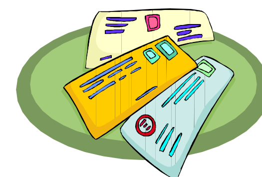
FOR CURRENT INTEREST RATES FOR THE 16 MOST POPULAR PROGRAMS GO TO:
www.mortgagestraighttalk.com Then, click on the menu tab labeled "RATES". The rate sheets are updated every Friday.



SPECIAL(S) OF THE MONTH:

The Conf. 30 yr. fixed @ 3.625%
The Conf. 5/1 ARM @ 2.50%
The Conf. 15 yr. fixed @ 3.00%
The Jumbo 5/1 ARM @ 3.25%
The FHA Conf. 30 yr. fixed @ 3.50%
The Home Ownership Accelerator @ 3.321%

MORTY'S MAILBAG



There were no letters in the mailbag this month.

Recipients of the newsletter are invited to Ask Morty any real estate or financing questions. The answer to the question will be answered either by phone or email and posted in the next issue for the benefit of all. Questions may be forwarded via mail phone or fax. Due to the high incidence of spam, if you email me a question it needs to identified as "real estate question" on the subject line of the email. (See front of issue for phone and fax numbers). Morty's email address is....
Morty@mortgagestraightTalk.com

MORTGAGE MIRTH

A man asked an American Indian,
"What is your wife's name?"

He replied, "She called Five Horses".

The man said, "That's an unusual name for your wife. What does it mean?"

The Old Indian answered, "It old Indian name.
It mean 'Nag, Nag, Nag, Nag, Nag'!"

If you'd care to share one that you've heard, please email it to me at.... **Rod@mortgagestraightTalk.com**

NEXT ISSUE'S TOPIC:
SHORT SALES 2.0