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Should You Wait For Lower Rates?

Mortgage rates have fallen more aggressively than ever and they've been remarkably willing to set record after record. So is there any reason you **shouldn't** wait for them to go even lower?

This is an age old question any time rates fall to long-term lows. In the past, the answer has been **pretty easy**. If rates had fallen more than 1.5% from their previous high over the course of several years, and if something obvious happened to push them just a bit lower, it was time to refi!

For example, the Fed's policy shift (in favor of mortgages) in September 2012 and the Brexit vote in 2016 both pushed rates quickly lower. Both were singular events with finite information, that allowed markets to react and move on.

Coronavirus has filled this role in a different way. Like past events, it hit a market that had already seen rates fall **significantly** for more than a year. Unlike past events, it's vastly more complex with implications that are infinitely more uncertain. It's also very much **ONGOING** as opposed to finite.

The net effect has been an **uncanny** ability for rates to hit record low after record low with little apparent risk of a rebound. In an environment like this, it makes sense that rates could go even lower, but only for so long.

Naturally, rates will have to stop setting new record lows at some point. Unfortunately, it's **impossible** to know exactly when that will be (or if it has already happened). But there are a few things we **DO** know.

As we discussed last week, mortgage rates were only able to fall so steadily in recent months because they jumped so much higher in March. The following chart shows the gap opening up between mortgages and 10yr Treasury yields (often used as a benchmark for longer term rates like mortgages) and the subsequent closing of that gap.

National Average Mortgage Rates

	Rate	Change	Points
Mortgage News Daily			
30 Yr. Fixed	7.37%	-0.04	0.00
15 Yr. Fixed	6.82%	-0.02	0.00
30 Yr. FHA	6.82%	-0.06	0.00
30 Yr. Jumbo	7.55%	-0.05	0.00
5/1 ARM	7.42%	-0.08	0.00
Freddie Mac			
30 Yr. Fixed	7.22%	-0.22	0.00
15 Yr. Fixed	6.47%	-0.29	0.00

Rates as of: 5/2

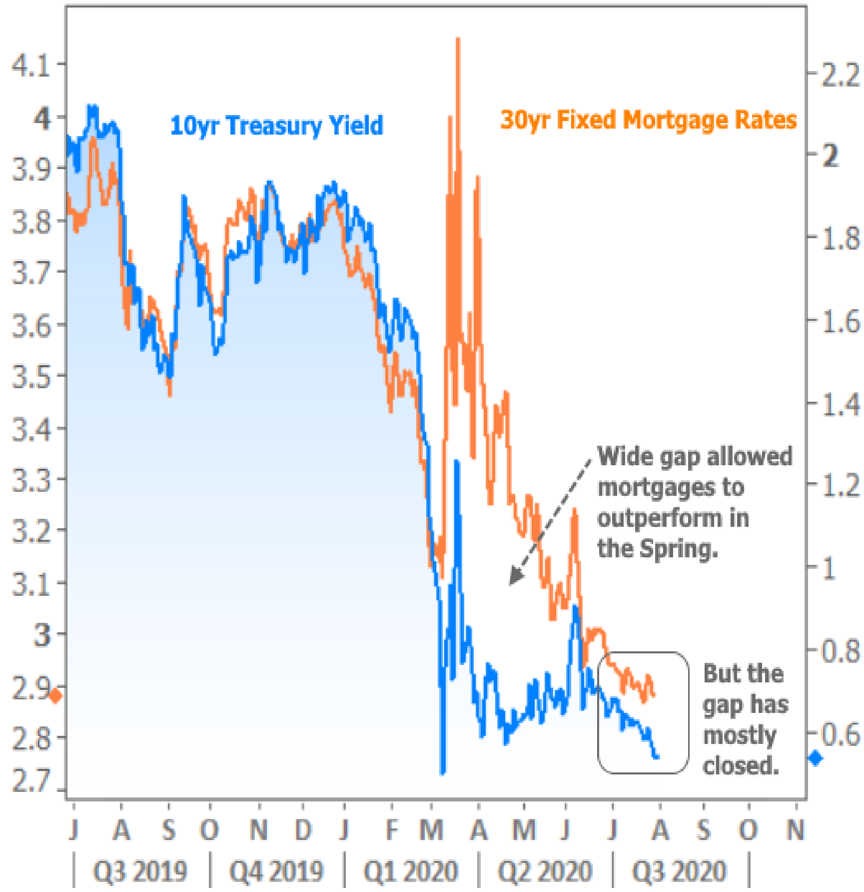
Market Data

	Price / Yield	Change
MBS UMBS 6.0	99.78	+0.32
MBS GNMA 6.0	100.74	+0.26
10 YR Treasury	4.6191	-0.0154
30 YR Treasury	4.7290	0.0000

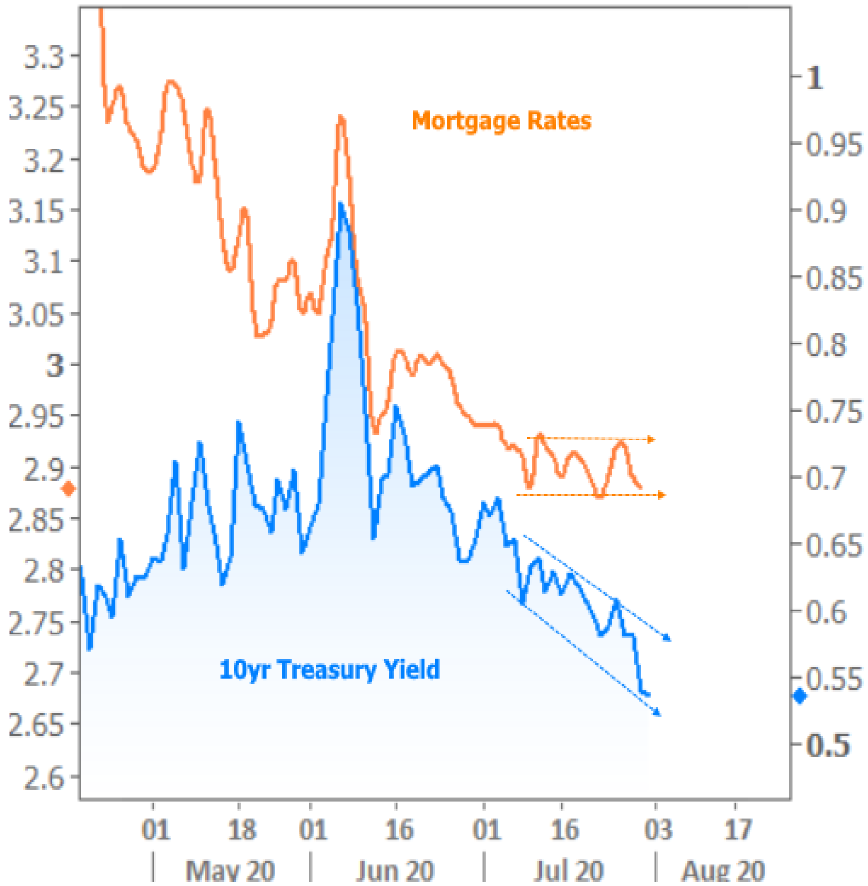
Pricing as of: 5/2 10:25PM EST

Recent Housing Data

		Value	Change
Mortgage Apps	Apr 24	196.7	-2.67%
Building Permits	Mar	1.46M	-3.95%
Housing Starts	Mar	1.32M	-13.15%
New Home Sales	Mar	693K	+4.68%
Pending Home Sales	Feb	75.6	+1.75%
Existing Home Sales	Feb	3.97M	-0.75%
Builder Confidence	Mar	51	+6.25%



If we zoom in to a narrower field of view with the same two lines, we can see how Treasury yields have been willing to move lower even as mortgage rates have resisted.



Unlike past examples where mortgage bonds were straying from Treasuries, this is actually an issue specific to mortgage lenders (and not the bond market they sell into). We can verify this by comparing the movement in mortgage bonds versus mortgage rates. These two lines almost always track each other perfectly. We've never seen them open up this kind of gap before.

Simply put, lenders are already too overloaded. Lower rates would only make things worse. The bond market is telling the mortgage market that rates **can** go lower, but the mortgage market is saying "no can do!"

So you should wait, right?

If you could be sure that the bond market would maintain current levels for several months, or get even better, then sure! There would be relatively low risk in waiting. But the flattening out of the orange lines above suggests there might not be as much benefit as you'd hope. If bonds happen to reverse course before rates catch up, you'd be out of luck.

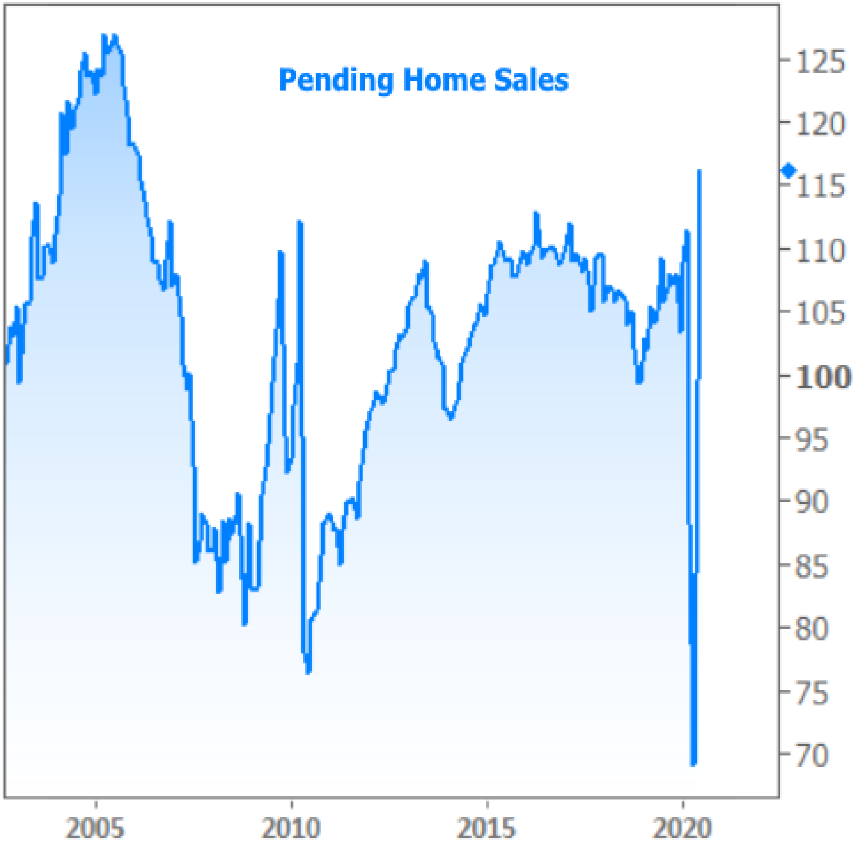
So what's the best way to play this?

No one can say for sure, but we can look at the same math from last week to formulate a game plan that's just as good as anything. Last week we discussed the limitations on mortgage rates due to the structure of the mortgage bond market. Long story short, the conclusion was that in a perfect world, rates could go about 0.75% lower before facing an unprecedented level of resistance.

The great thing about that level of (potential) improvement is that if rates do manage to fall that much, it would make financial sense to refinance again in addition to refinancing right now. This has the added benefit of allowing you to capitalize on the interest savings between now and then. Moreover, if rates happen to move higher instead of lower, you won't have missed the opportunity. It's as close to a win-win as we typically see in a game that can only truly be won with clairvoyance.

In other news and the week ahead...

The housing market has bounced back with a vengeance according to home sales numbers released this week from the National Association of Realtors. The Pending Sales Index, in the space of 2 months, has catapulted from the lowest levels ever to the highest levels in over 15 years.



The first reading of US GDP for Q2 was released on Thursday and it was almost exactly as bad as predicted. This was a non-event for financial markets which had long since priced-in the economic impacts of covid.

Financial markets also price in the offsetting forces from the Fed and fiscal stimulus. The Fed reiterated its commitment in its periodic policy announcement this week and Fed Chair Powell said the accommodative stance isn't changing any time soon.

Looking ahead, next week brings the typically important jobs report on Friday as well as another chance for lawmakers to hone in on another installment of fiscal stimulus. Earnings season continues in full swing throughout the week.

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Recent Economic Data

Date	Event	Actual	Forecast	Prior
Monday, Jul 27				
8:30AM	Jun Durable goods (%)	7.3	7.0	15.7
11:30AM	2-Yr Note Auction (bl)	48		
1:00PM	5-Yr Note Auction (bl)	49		
Tuesday, Jul 28				

Event Importance:

No Stars = Insignificant
☆ Low
★ Moderate
★★ Important
★★ Very Important

Date	Event	Actual	Forecast	Prior
9:00AM	May CaseShiller 20 yy (%)	3.7	4.0	4.0
10:00AM	Jul Consumer confidence	92.6	94.5	98.1
1:00PM	7-Yr Note Auction (bl)	44		
Wednesday, Jul 29				
7:00AM	w/e Mortgage Refinance Index	3955.9		3973.3
7:00AM	w/e MBA Purchase Index	306.1		310.9
10:00AM	Jun Pending Sales Index	116.1		99.6
10:00AM	Jun Pending Home Sales (%)	+16.6	15.0	44.3
2:00PM	N/A FOMC rate decision (%)	0.000 - 0.250	0.125	0.125
2:30PM	Powell Press Conference			
Thursday, Jul 30				
8:30AM	w/e Jobless Claims (k)	1434	1450	1422
Friday, Jul 31				
8:30AM	Jun Core PCE Inflation (y/y) (%)	0.9	1.0	1.0
9:45AM	Jul Chicago PMI	51.9	43.9	36.6
10:00AM	Jul Consumer Sentiment (ip)	72.5	73.0	73.2
Monday, Aug 03				
10:00AM	Jun Construction spending (%)	-0.7	1.0	-2.1
10:00AM	Jul ISM Manufacturing PMI	54.2	53.6	52.6
Tuesday, Aug 04				
10:00AM	Jun Factory orders mm (%)	6.2	5.0	8.0
Wednesday, Aug 05				
7:00AM	w/e MBA Purchase Index	300.7		306.1
7:00AM	w/e Mortgage Refinance Index	3688.1		3955.9
8:15AM	Jul ADP National Employment (k)	167	1500	2369
10:00AM	Jul ISM N-Mfg PMI	58.1	55.0	57.1
10:00AM	Jul ISM N-Mfg Bus Act	67.2	60.0	66.0
Friday, Aug 07				
8:30AM	Jul Non-farm payrolls (k)	1763	1600	4800
8:30AM	Jul Unemployment rate mm (%)	10.2	10.5	11.1
3:00PM	Jun Consumer credit (bl)	8.95	10.00	-18.28

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Jeff Statz