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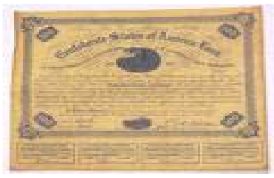

Economics & Financial Markets

United States Fixed Income Note

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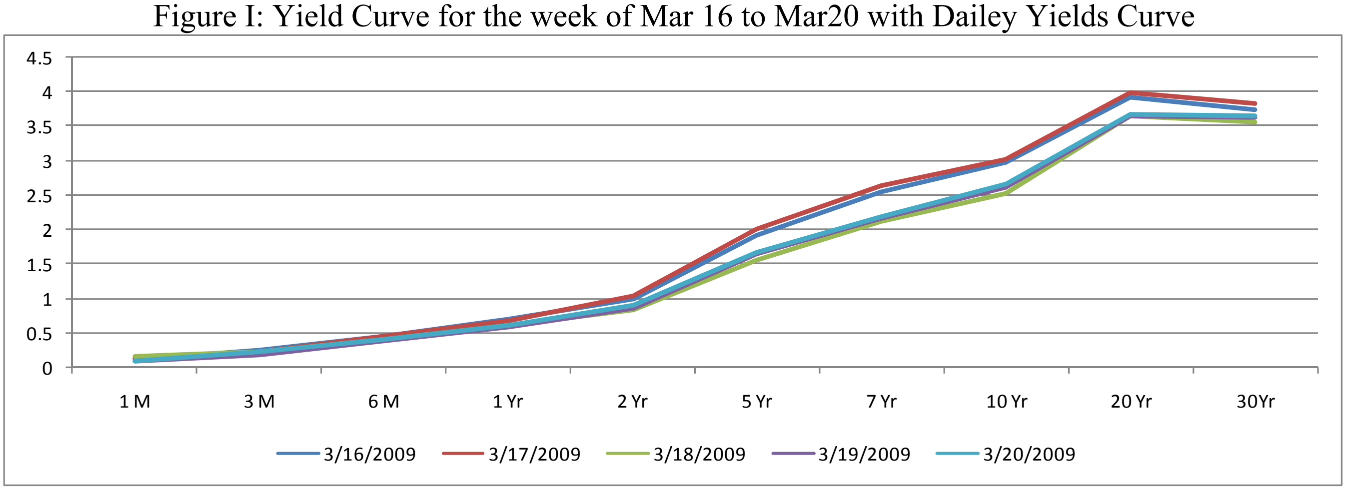
Mortgage Rates less 10 Year Returning to Historical Relationship of Plus 1.7%, Currently at 1.86%

I. Introduction

Figure I: Yield Curve for the week of Mar 16 to Mar20 with Dailey Yields Curve



Source: Department of Treasury, SISR

On the afternoon of March 18, 2009 the FOMC committee made major news with their press release of the events of the meeting. There were 5 key points to the press release.

1. Maintaining the target range for the federal funds rate at 0 to 1/4%.
2. To support mortgage lending and the housing markets, the Committee this year will direct the purchase up and additional 750 Billion of agency mortgage-backed securities bring the total to $1.25 Trillion.
3. Will increase its purchase of other agency debt by $100B to a total of $200B.

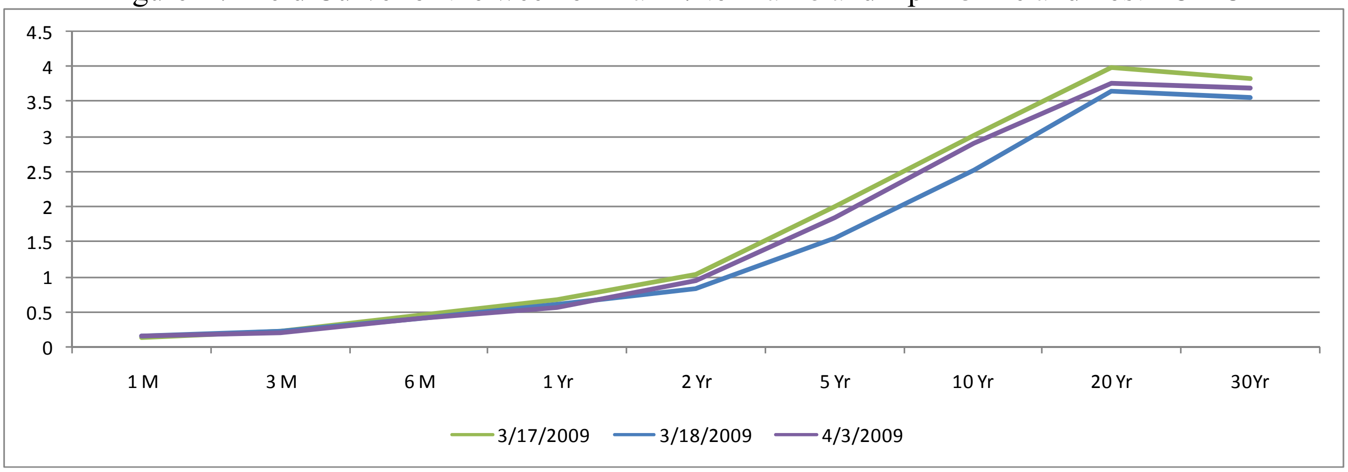
4. Will direct the purchase of $300B of longer term Treasury Securities over the next 6 months.
5. TALF was launched to extend credit to extend credit to households, student loans, credit cards, small businesses and the real estate market.

Following the meeting on March 18th the yield on the long end of the bond immediately dropped as seen in Figure I above.

II. Yield Curve on April 3, 2009

Within two weeks later, however by April 3, 2009, following the initial decline almost the entire drop has been given back Figure II. The 10 year was 3.02% and is currently at 2.92% after falling to 2.51% at the close of March 18th.

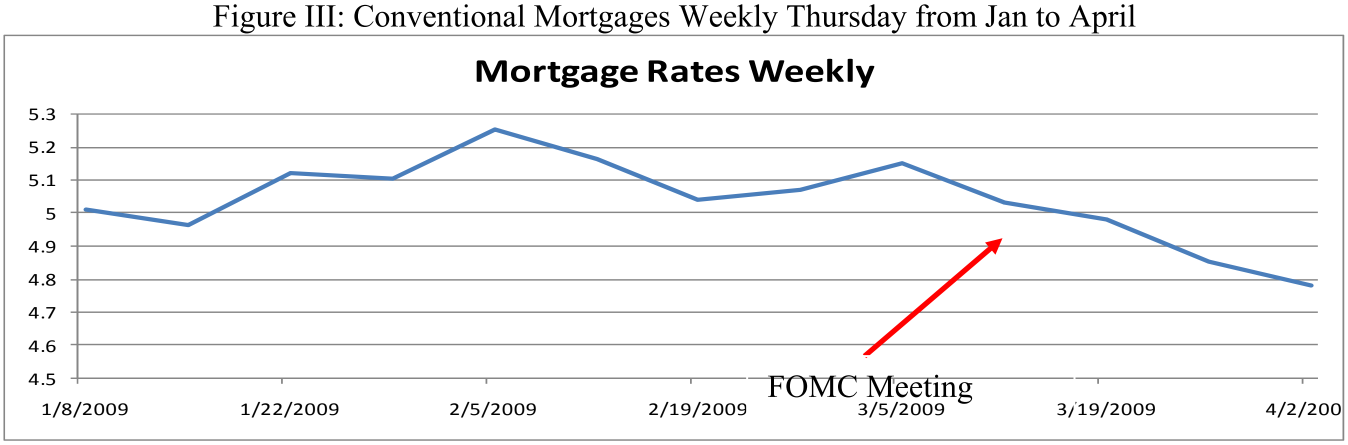
Figure II: Yield Curve for the week of Mar 17 to Mar18 and April 3 Pre and Post FOMC



Source: Department of Treasury, SISR

We expect a significant goal of the meeting was to lower the yield curve as well as the mortgage rate with the purchase of the securities, and the expected impact was immediate. However, within two weeks we have seen the 10 year return to nearly the same rate that it had been two weeks prior. However, the mortgage rate did have the desired effect, at least so far and has actually continued to decline.

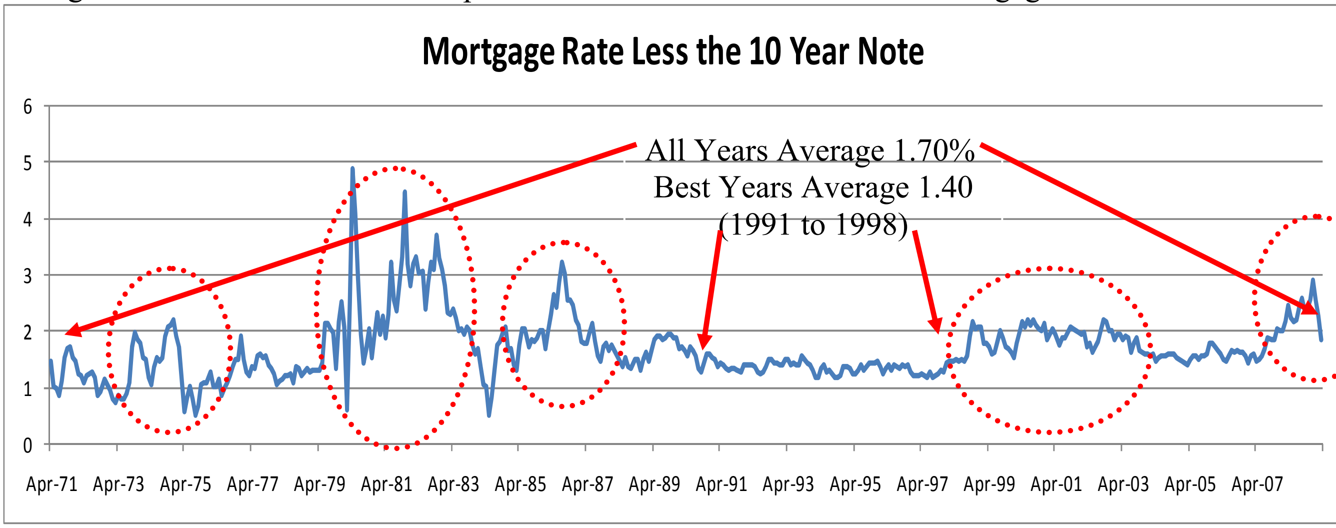
Figure III: Conventional Mortgages Weekly Thursday from Jan to April



Source: Department of Treasury, SISR

III. The 10year to Mortgage Rate: Historical Relationship

Figure IV: Historical Relationship between the 10 Year Note and the Mortgage Rate: 1971 to 2009



Source: Department of Treasury, SISR

From Figure IV we can see that there during every recession the mortgage rate less the 10 Year Notes spread expands out. It is interesting; because at the exact time that one would hope that mortgage rates would be low they expand out. This is likely because as the economy begins to struggle so do the banks and the risk factors to making loans also increase, which causes the banks to increase the mortgage rate relative to the 10 year note.

For all years the average spread is 1.70%, whereas during an extended period of no recessions from 1991 to 1998 we have a low average of 1.41%. Currently the spread is still relatively high at 1.86%, which is down form a December high of 2.91%. We would expect that within the next few months the relationship will eventually move back to the historical parity of 1.5 to 1.6% from the current 1.86%.

IV. Implications

There are various implications that can be drawn from this analysis:

1. It is likely that the spread between the 10 Year and the Mortgage rate will return to some form of historical parity relationship as the economy emerges from this recession. That would indicate that mortgage rates are likely to rise at a slightly slower rate than the 10 year rate, given that mortgage rates are at historic lows.
2. Currently the mortgage rate is not yet favorable relative to the 10 year when compared to the historical average, indicating that the recovery still has a few steps to go before this component is consistent within a stable recovery period range, but the spread at least, is heading in the correct direction.
3. This spread can be used as another metric for projecting when the housing crisis will finally be behind us, and banks feel they can lend with a normal expected risk and return.

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