

10 Year Fixed Rate Mortgage-Backed Securities

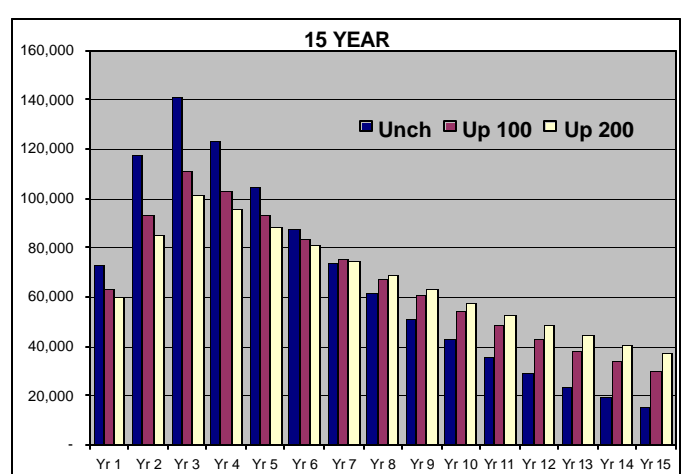
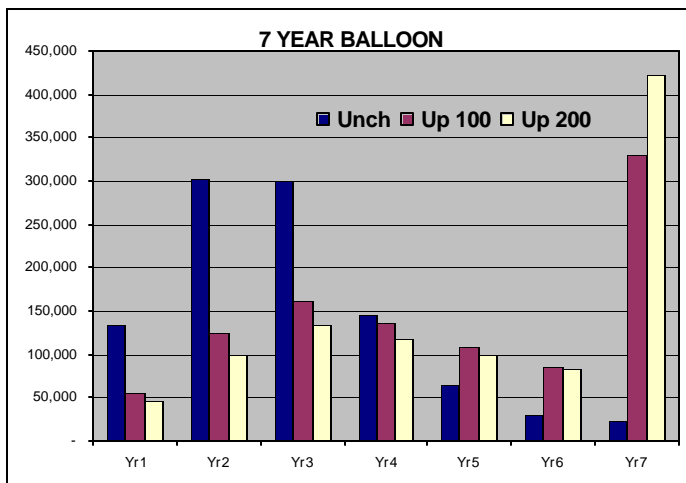
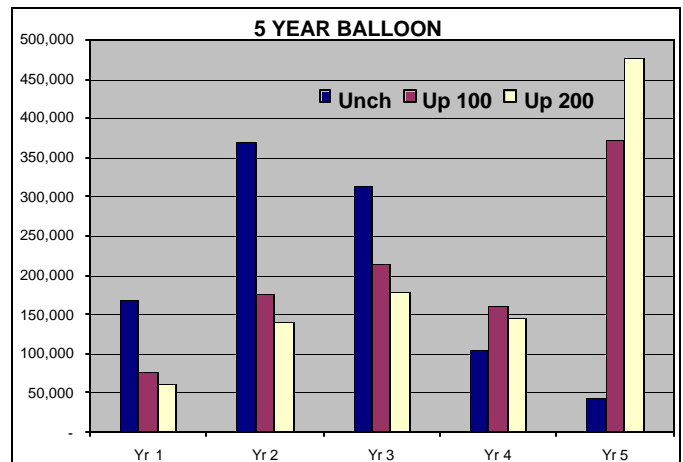
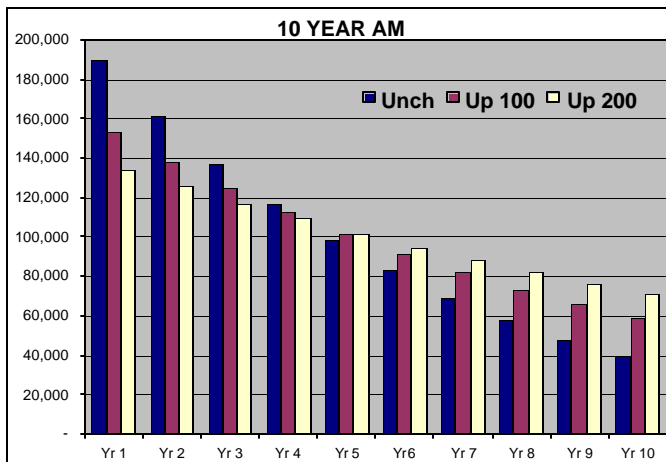
Question:

Could you use a security with relatively little cash flow volatility and still pick up a good spread to Treasuries? Do you need an alternative to Callable Agencies, CMO's, Balloons, and 15, 20, or 30-year Mortgage-Backed Securities? If so, perhaps 10-year fixed rate Mortgage-Backed Securities make sense for your portfolio.

GENERAL CHARACTERISTICS OF 10 FNMA YEAR MBS PRODUCT

- Coupon range 4.0 – 5.0%
- Primarily issued by FNMA
- \$18.5 Billion in issuance for 2003 in this coupon range

One of the main benefits of this product is the amortization of principal payments over the 10 year term of the underlying mortgage loans. The graphs below will illustrate cash flow profiles on a \$1,000,000 principal face for various types of 4.5% Coupon MBS product in an unchanged, then Up 100 basis point, & Up 200 basis point move, run under street prepayment assumptions.



Which cash flow profile would compliment your existing ladder best? Most commonly, the answer is the **10 Year Amortization Bond** due to the average life profile and consistency of cash flows in a dynamic interest rate environment.

This products' cash flow consistency can be attributed to the fact that many individuals that refinance long-term mortgages, do so with 10 year fixed rate mortgages. More often than not, these borrowers are less inclined to be candidates for housing upgrades or relocation. The table, on the next page, represents the historical speeds for a range of current coupon 10 Year Amortization bonds.

FNMA 10 Year Amortization Prepayment Speeds by Coupon:

Coupon	3 Month CPR	6 Month CPR	1 Year CPR	Issue CPR	Months of Seasoning
4.0%	4.7	5.6	NA	3.7	6
4.5%	7.0	10.7	13.9	7.4	7
5.0%	12.4	21.7	23.2	16.5	11
5.5%	22.6	37.5	37.2	25.4	23
6.0%	29.6	40.3	40.0	26.9	36

Source: Bloomberg Mortgage Security Generic Pool History

Spreads on 10 Year Amortization Bonds are relatively attractive given the cash flow stability of this product. The table below is a comparison of different 4.5% coupon MBS products and their spreads.

Product	Coupon	Spread	Life CPR	Average Life	Yield
5 Year Balloon	4.5%	+120	33.2	2.01	3.04
7 Year Balloon	4.5%	+161	19.5	2.44	3.66
10 Year Am	4.5%	+126	7.4	3.69	3.88
15 Year MBS	4.5%	+124	4.8	5.28	4.45

Source: Bloomberg Yield Table w/Consensus Speeds

Answer:

With stable, predictable performance and no bells or whistles that could make these bonds a regulatory concern, spreads at much tighter levels could easily be justified. For those institutions looking to layer in cash flow stability into the portfolio, this product should not be overlooked.

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