Difference in Fannie, Freddie and Ginnie

* Fannie and Freddie are GSE’s
* Buy mortgages from the secondary market and sell them to investors in MBS open market
* Fannie: buys from commercial banks and mortgage lender
* Low down payment program, as low as 3% down payment
* Freddie: buys from smaller banks
* Lower down payment loans as low as 5% down

What goes into a Fannie Mae MBS

* Prepayment Risk: option to prepay more quickly or slowly than expected, affecting the average life of the investment and perhaps the yield
* Market Risk: price fluctuation, closely intertwined with prepayment risk
* Price is based on several factors: prevailing interest rates, the coupon rate, the length of time the security is expected to be outstanding
* Interest rate fluctuation have a greater impact on MBS than traditional fixed income investments because they affect prepayment rates which affect the average life and yield of the MBS
* Credit Risk: risk that the investor may not receive all or part of the principal invested because the borrower of the underlying mortgage defaulted
* Principal repayment: MBS repays principal throughout the life of the investment, and the timing and rate of the principal repayment occurs are major factors affecting the MBS yield
* Higher interest rate results in a slower anoritization of principal for the loan
* Prepayment can be from volunteering to, or from a sale
* **Both are not happening**
* MBS purchased at a price of par the yield is not significantly affected by prepayments

Analysts say the term premium has been depressed by about 100bps

“Shrinking the balance sheet is likely to reverse the portfolio rebalancing effects of quantitative easing—which lowered the market supply and increased the prices of risky assets—on asset prices,” said Daan Struyven, economist at Goldman Sachs in a research note earlier this week.

Agency and MBS debt: cap starts at 4 bn a month and increases in steps of 4 bn to a terminal pace of 20 bn

Treasuries is at 6bn a month with increases of 6 bn a month to a terminal pace of 30 bn a month