MBS Market: Thumb on the Scale

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1. “Core” Themes
2. Prepayment Update
3. Application

“Core” Themes

- **The prepay profile of the MBS market is starting to take center stage once again.** Rates are lower, there are more coupons that are prepayable, and prepays are picking up.

- **The convexity of the overall MBS market is worsening.** There are several factors contributing to this, covered in next section.

- **Supply/demand dynamics greatly favor MBS investors.** Affordability still very low, and GSE buying will be significant.

- **Longer-term measures of valuation are now tight vs. rates, cheap vs. competing spread product.** Mortgages are still a cheap spread product, but less so than this time last year.

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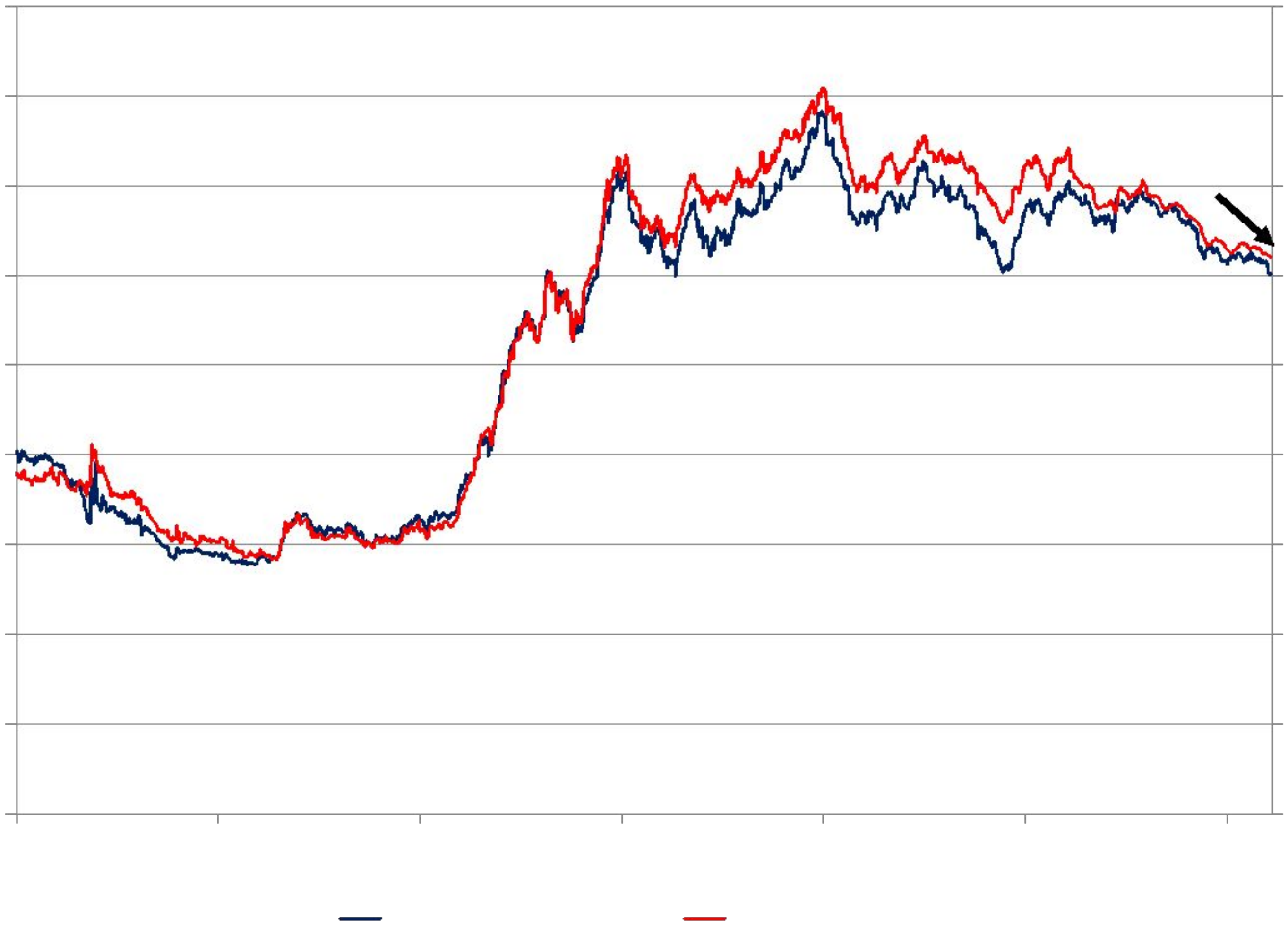
New Primary Mortgage Rates Do Not Look Low in Longer Context, But They Are Affecting Prepays



- Recent drop in rates of ~50 bps similar to 3Q24.
- Survey (Bankrate) and reported closed (Optimal Blue) more in 2025 drop.
- Prepay response this time has been more extensive (full data in section II of presentation).

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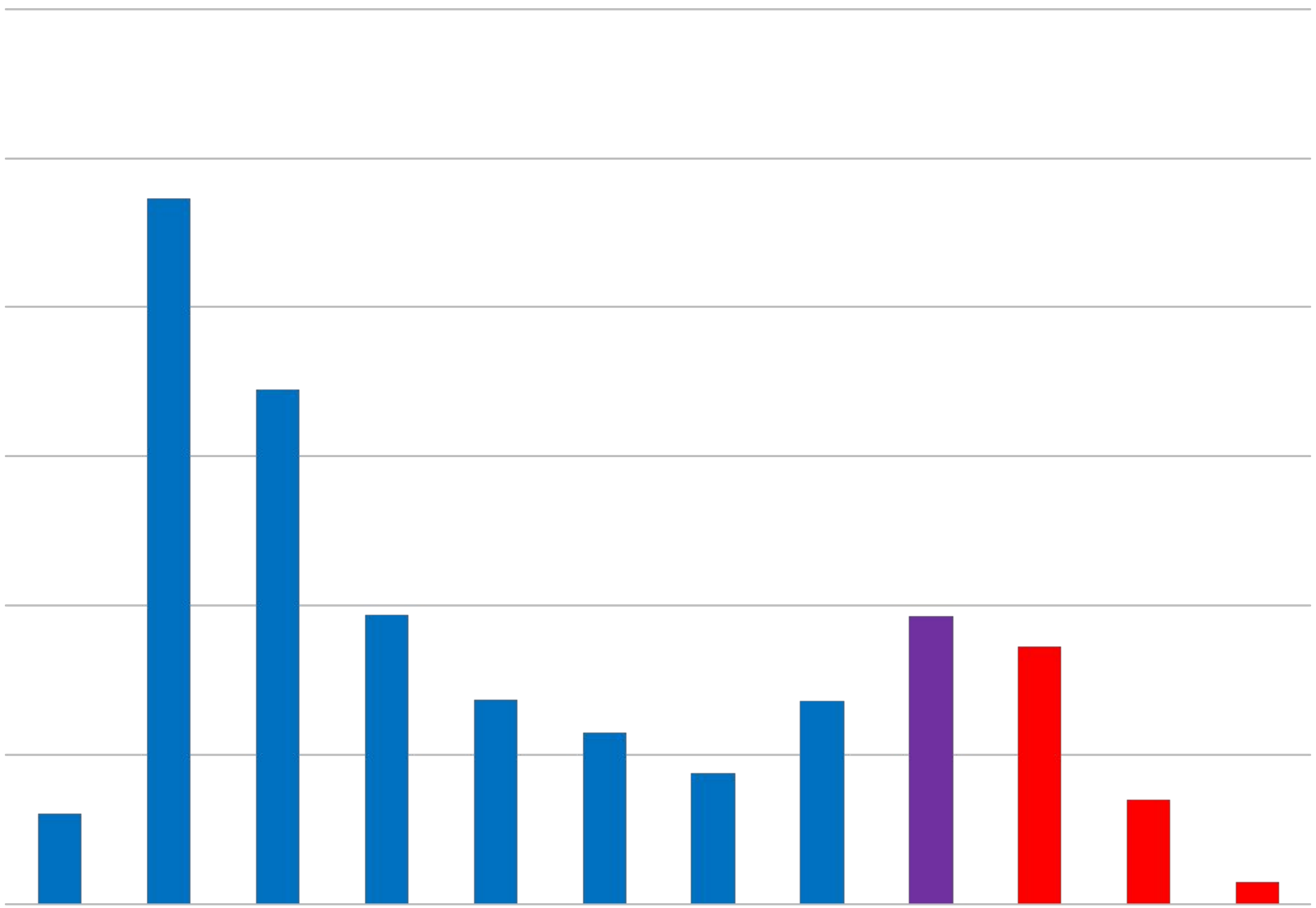
Source: FHN Financial and Bloomberg

“Out-of-the-Money”, But It is the “Cuspiest” Market in Years



- The deep discounts still dominate the MBS market in terms of market value and UPB.
- The middle coupons of 3.5s through 5.0s are under-represented on the stack.
- Most of the prepay action is – and will be – in the 5.5 and higher coupons.

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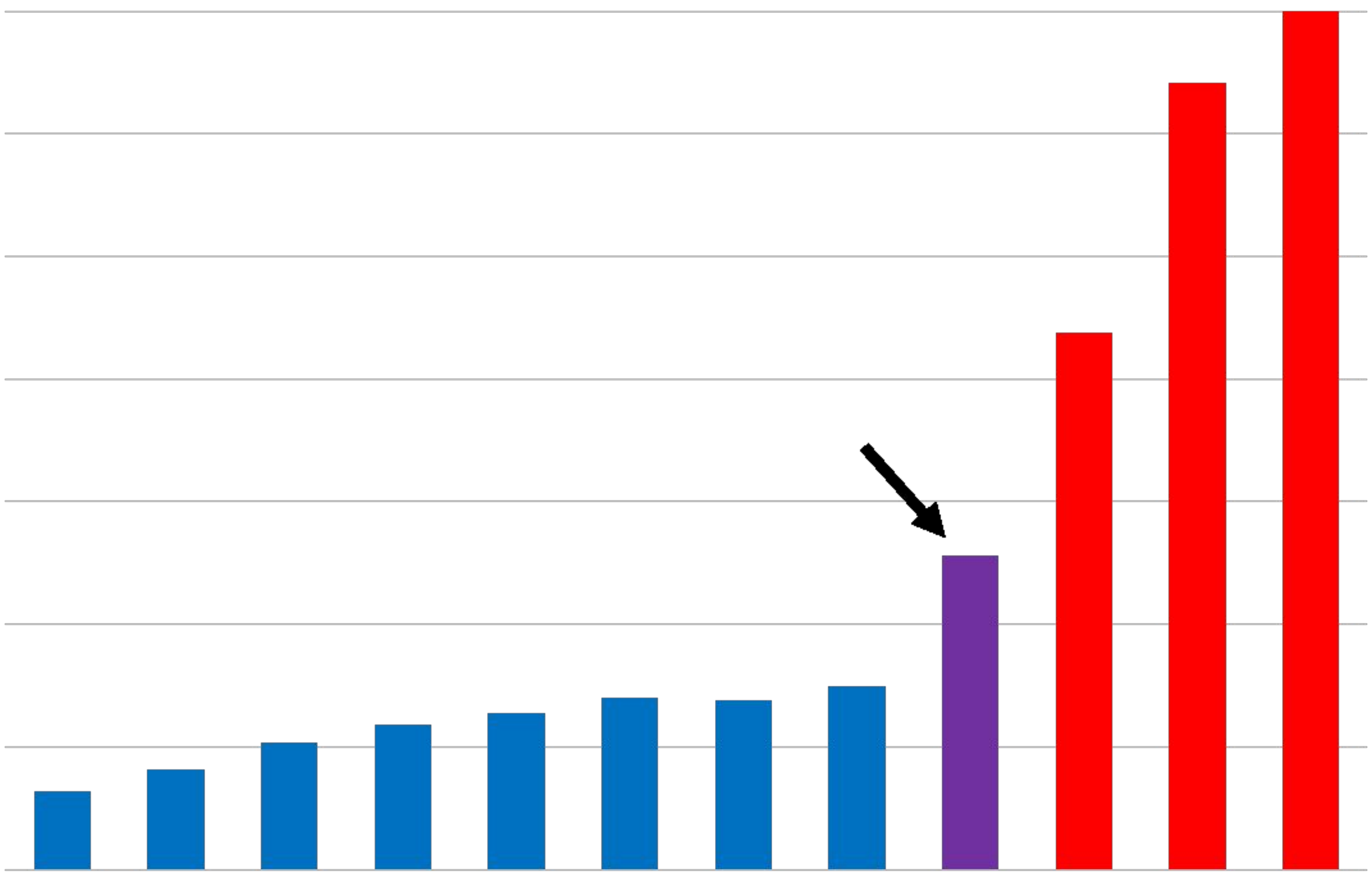
Source: FHN Financial and Bloomberg

The 5.5 Coupon is the Fulcrum; Prepayments for In-the-Money Coupons Have Already Increased



- The refi "wave", however large it becomes, has already begun.
- The current position of the 30yr 5.5 coupon is "at the cusp".
- Discount speeds *may* increase somewhat, but this will be a market in which investors seek call protection.

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Source: FHN Financial and CPRCDR

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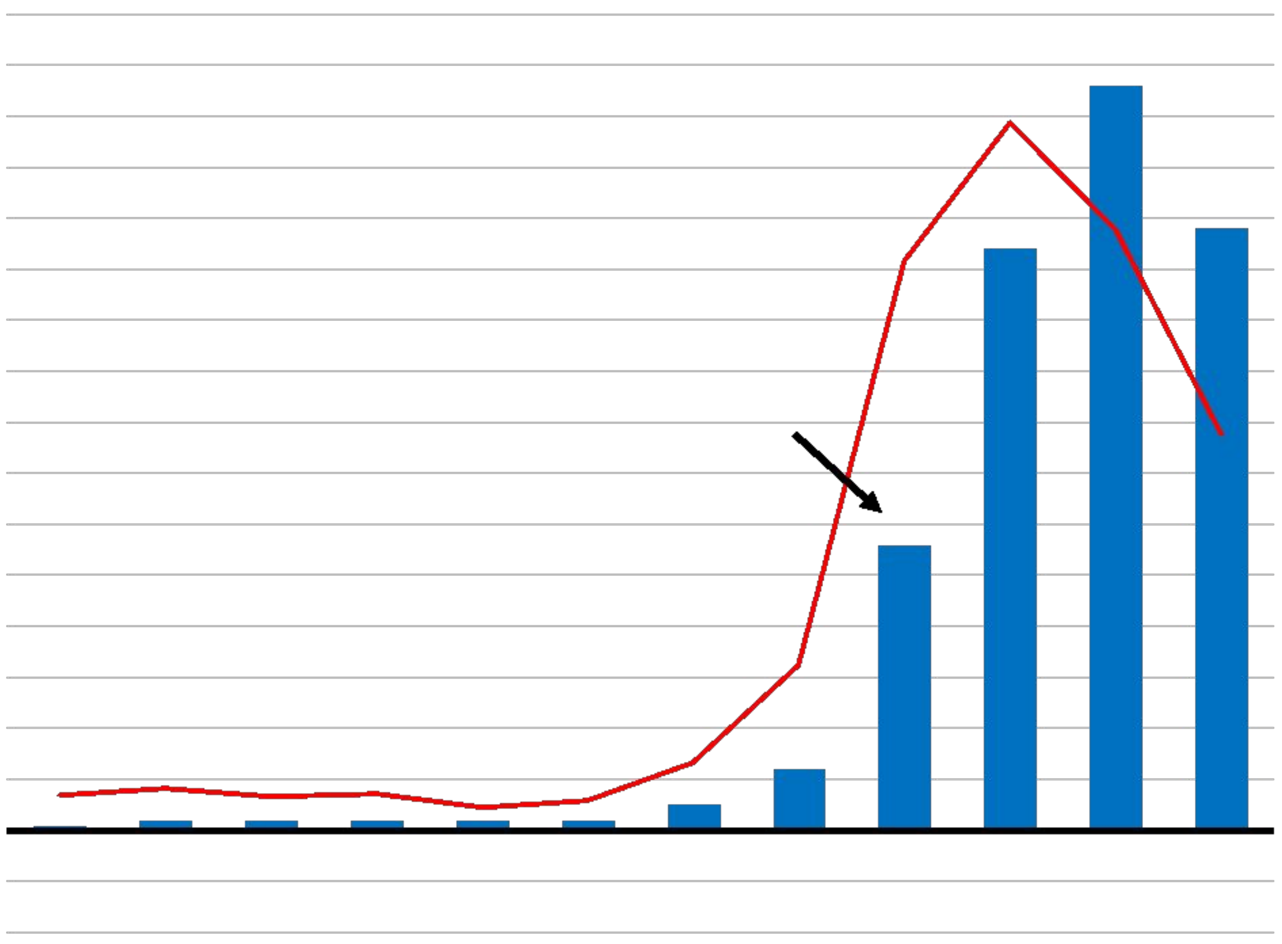
Definition of Worsening Convexity for the MBS Sector



- The fulcrum, the 5.5 coupon, saw speeds increase by 26% in aggregate in September.
- Premium coupon prepayment speeds are growing rapidly in nominal and percentage terms.
- Prepays on G2 5.5s (not pictured) increased by 4.5 CPR or ***46%***.

Source: FHN Financial and CPRCDR

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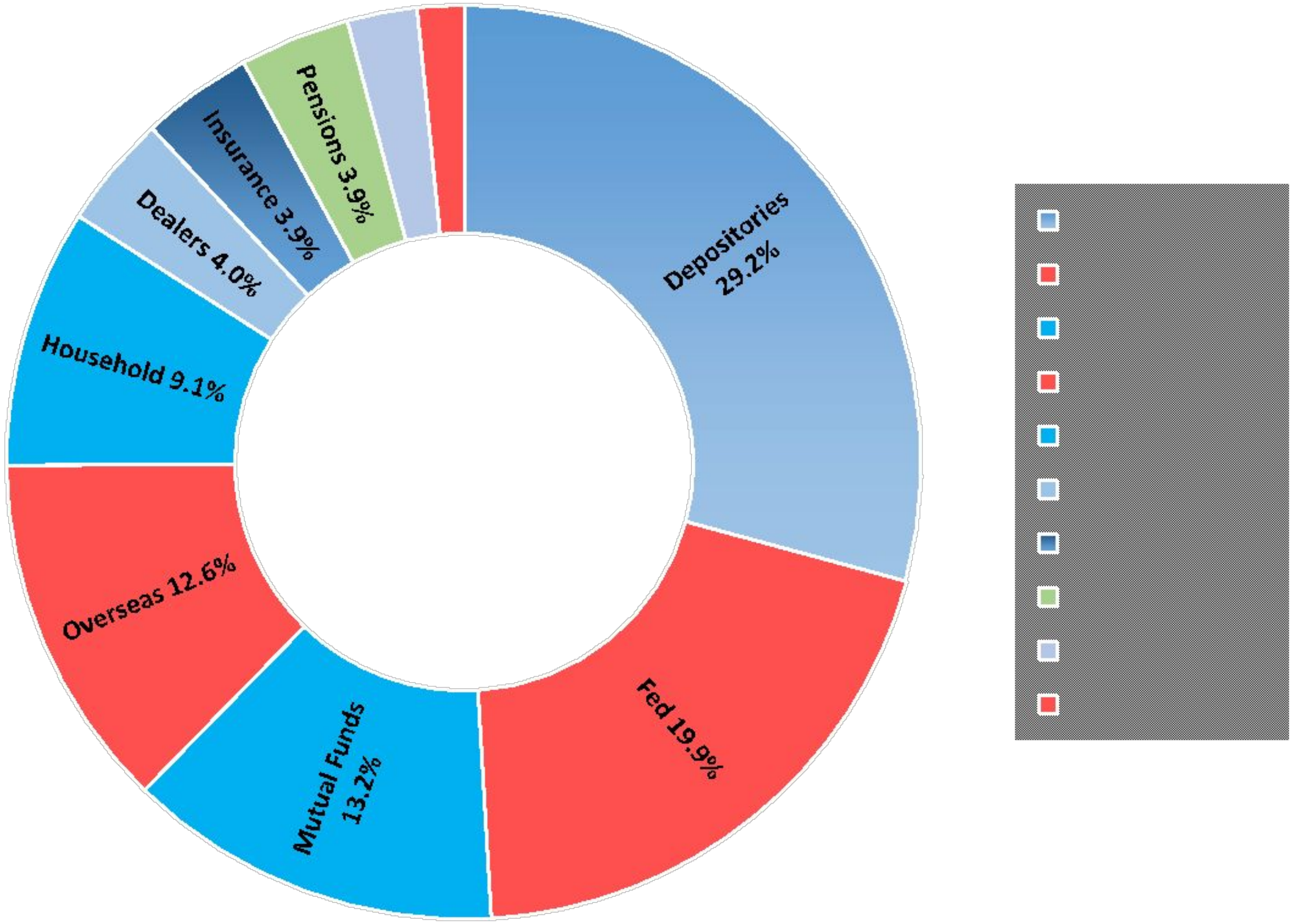
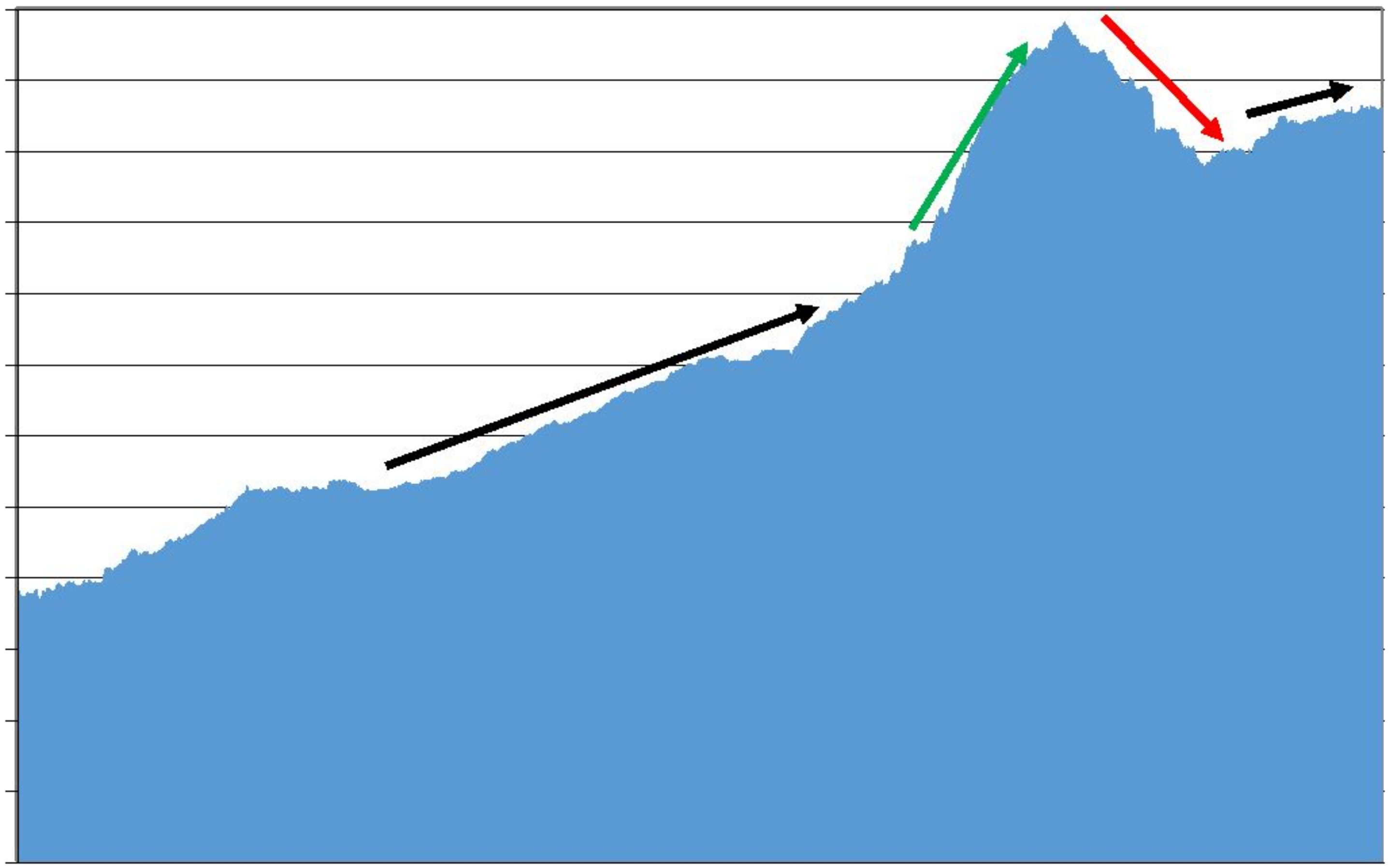
Current State of Funding of the Agency MBS Market



- Ownership structure dominated by banks and then the Fed, which is in roll-off mode.
- Overseas investors and asset managers have been the main marginal buyers, and banks are re-emerging.
- Hedge funds, pensions, and insurance cos. can move markets during any given session.

Source: FHN Financial, Federal Reserve, Bloomberg, Various Company Disclosures

Banks Still Adding After Long Period of Roll-off



- Banks have added consistently since late last year.
- Still room to add if the curve steepens from here.
- Boom/bust cycle with pandemic lockdowns over, and holdings have returned to long-term growth trend.

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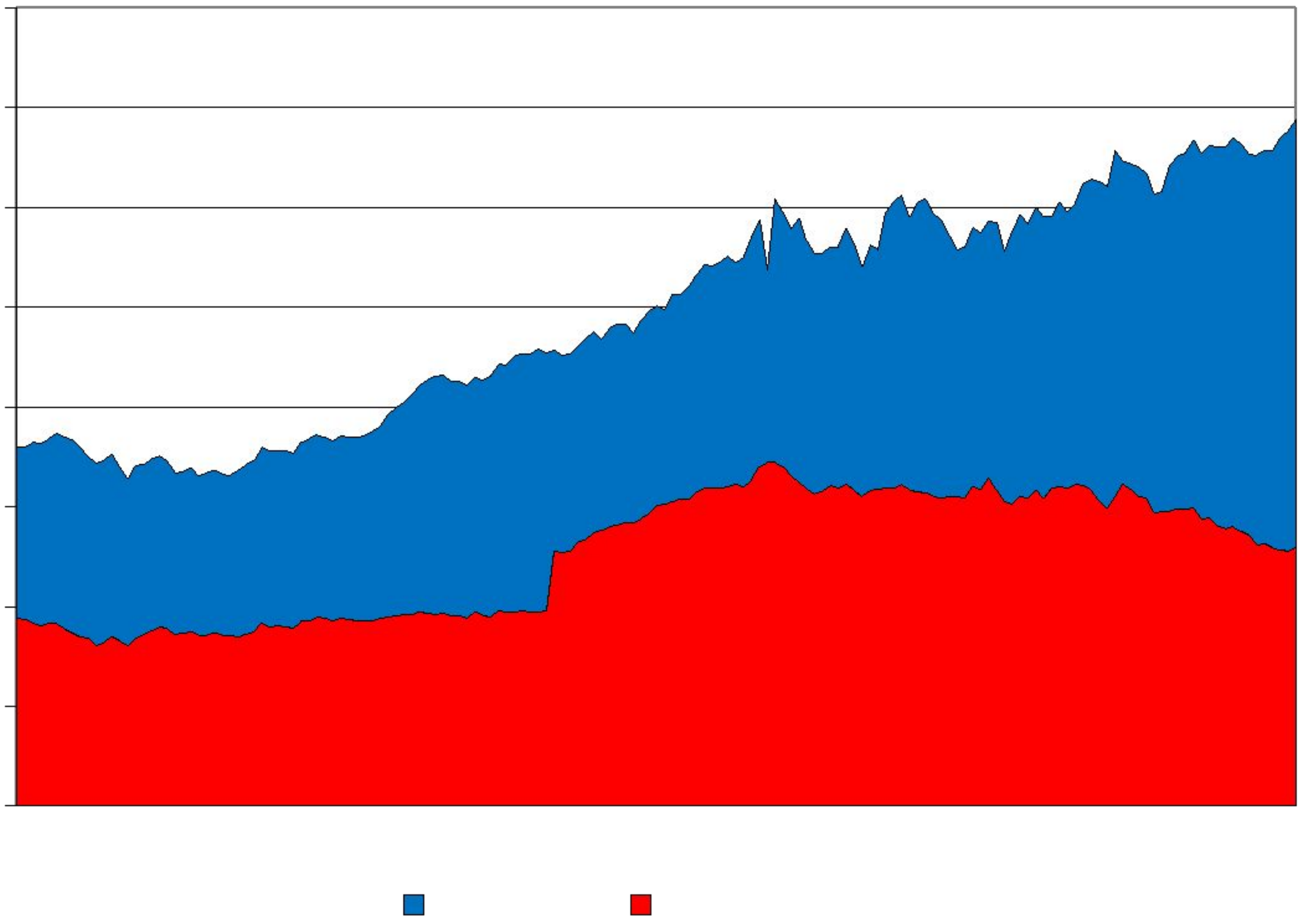
Source: FHN Financial and US Treasury

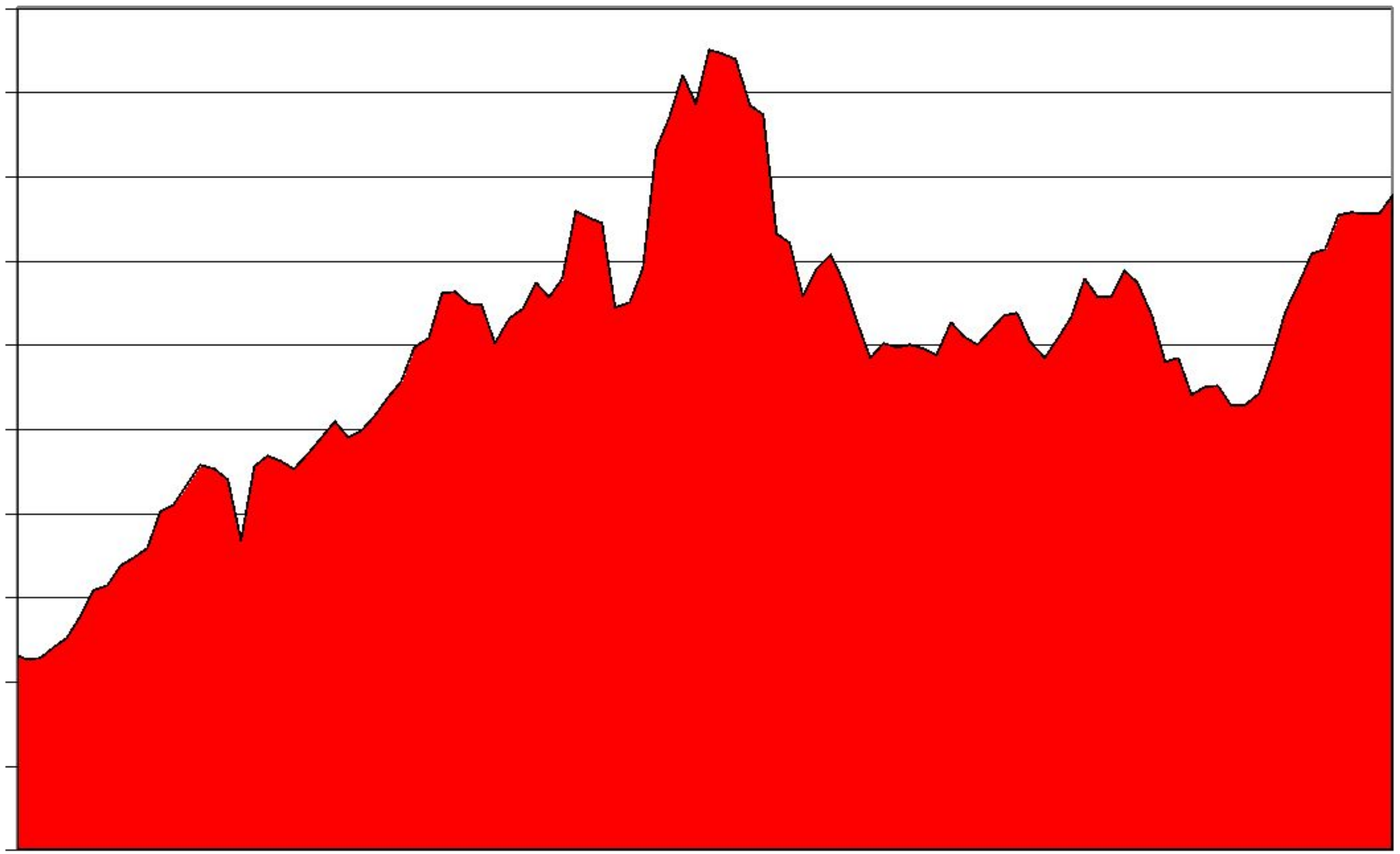
Foreign Holdings of MBS Moved Noticeably Higher in Recent Months



- Carry trade for Asia-based investors.
- Concern that demand may weaken with lower current account surplus overseas in US Dollars.
- Demand best when currency markets not in flux – hedging costs are lower.

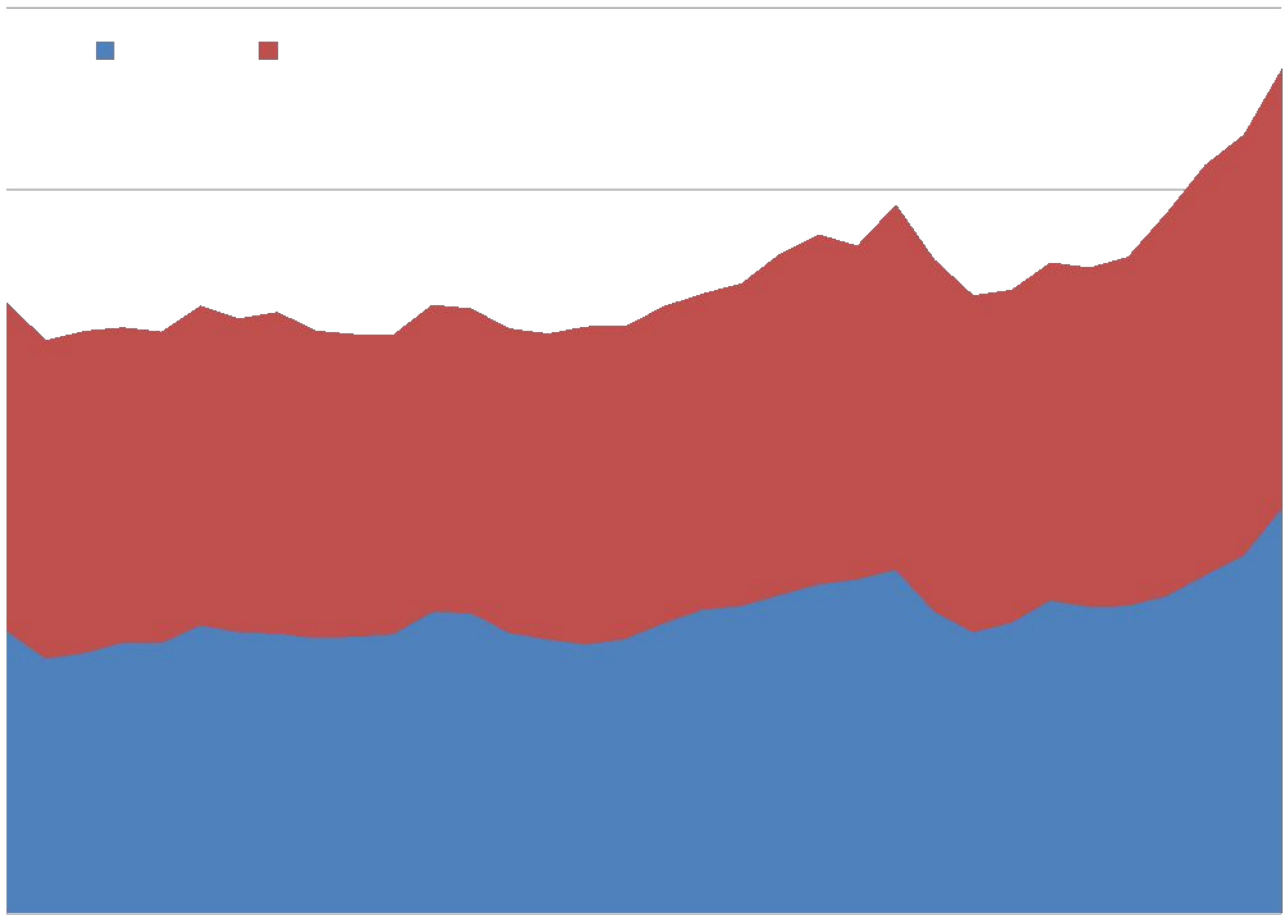
Source: FHN Financial and US Treasury

Money Managers Growing Allocations Again, Remain A "Swing Vote"



- Asset managers longer than at any time since 2013.
- Tend to move in and out more quickly than banks.
- Historically tight corporate credit valuations make MBS relatively attractive.

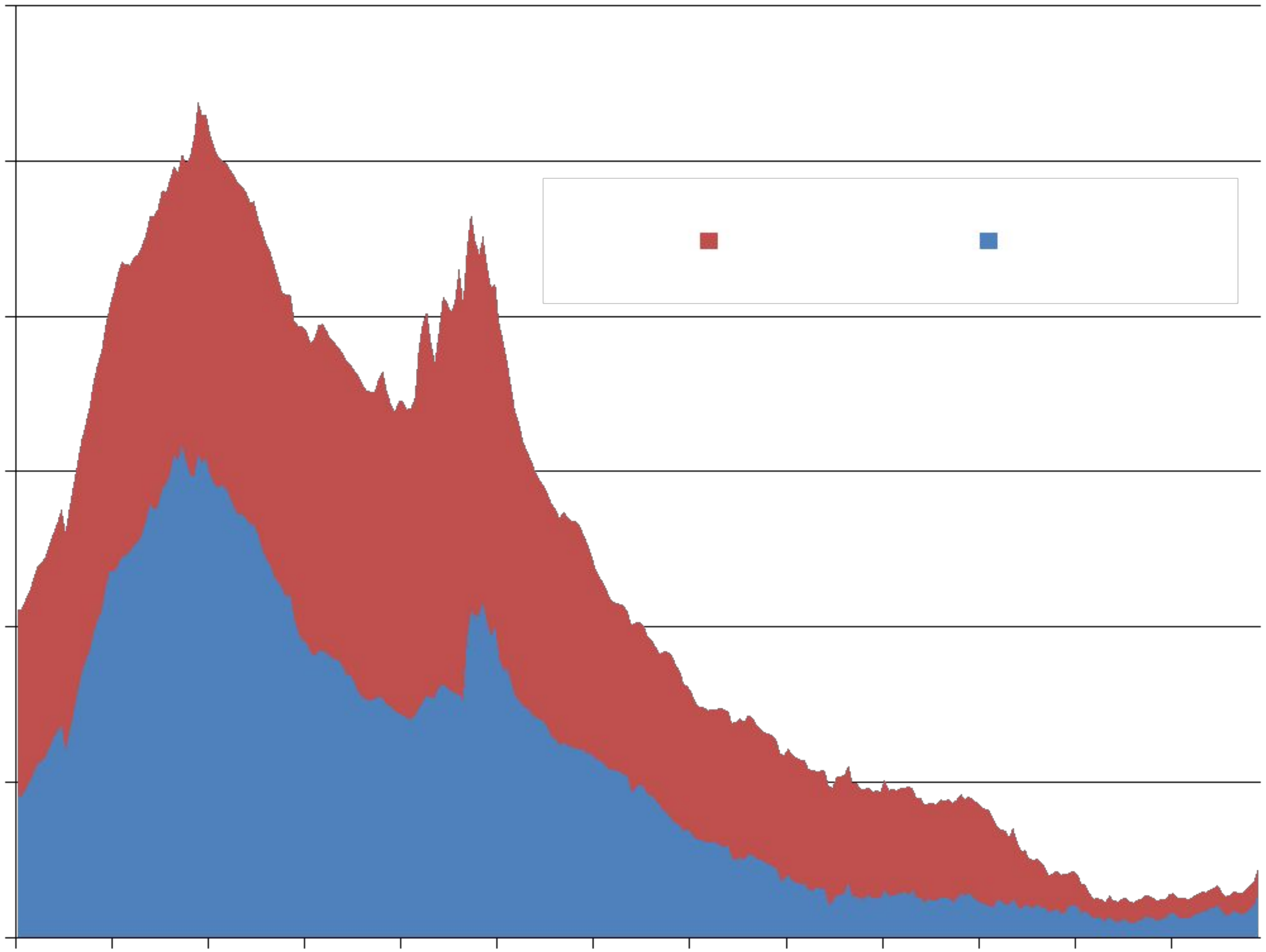
Portfolios After January 8 “Truth Social” Post



- Majority of current retained portfolios in the loan sector.
- Noticeable growth in both portfolios since mid-2025.
- Most recent data show net gain of $14 billion in combined MBS portfolios.

Source: FHN Financial and Federal Reserve

Meaningful Portfolio Growth for First Time in Years



- GSEs dominated MBS market with 35% market share 20 years ago before accounting issues.
- No capacity to get anywhere near prior levels, but new purchases still quite meaningful vs. ***net supply.***

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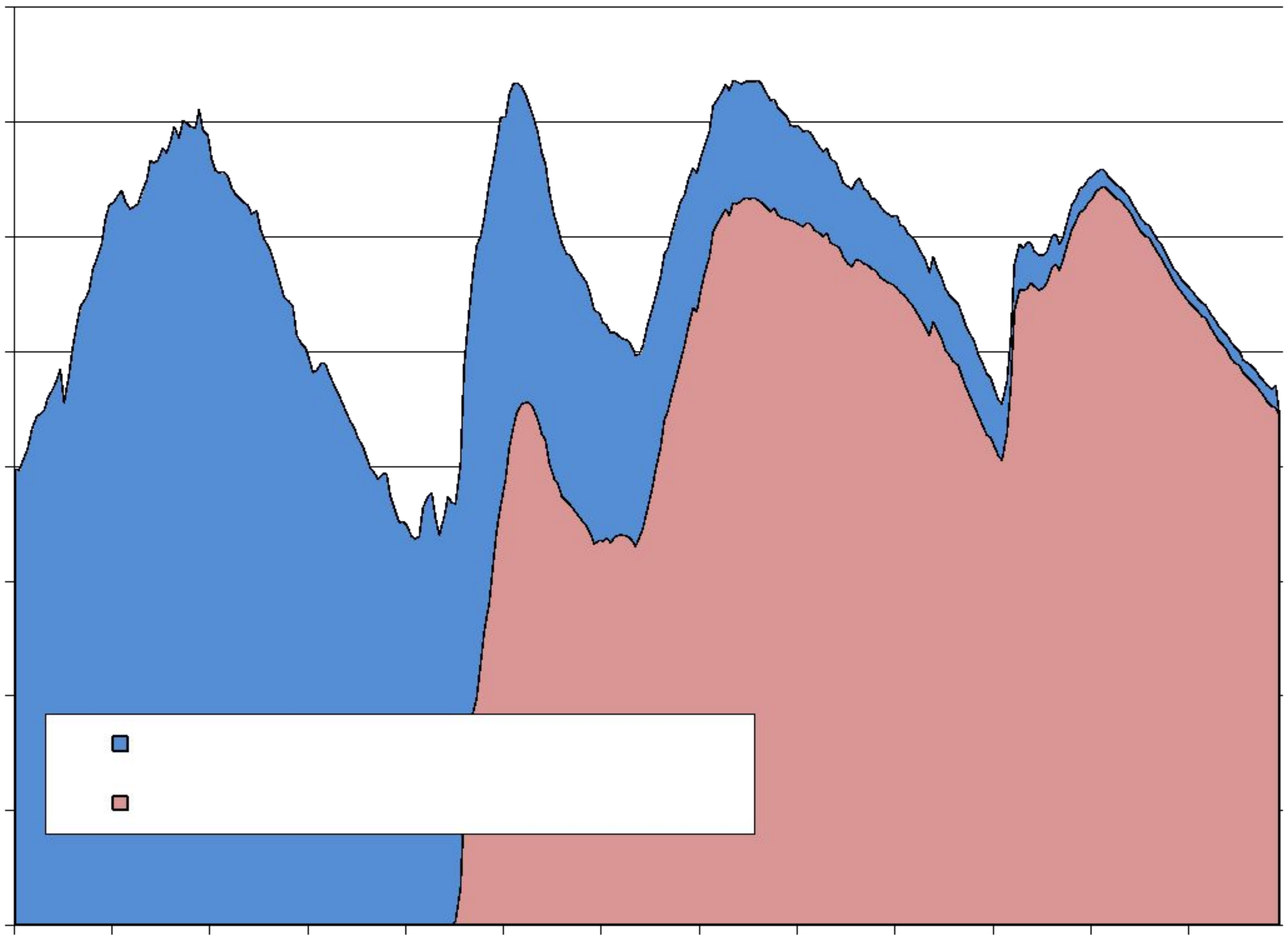
Source: FHN Financial and Federal Reserve

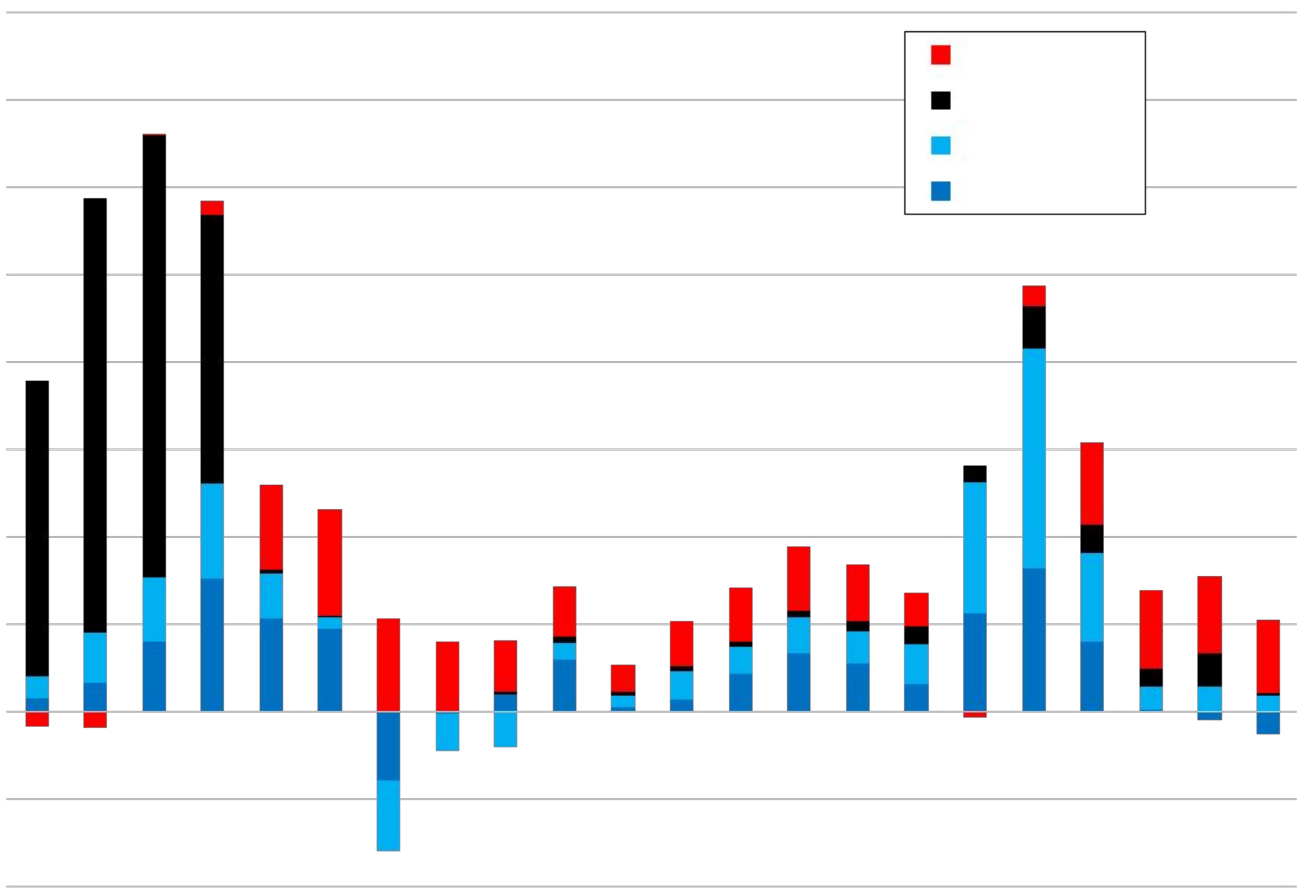
The MBS Market Has Always Enjoyed a "Buyer of Last Resort" Due to Its Unique Payoff Profile



- US MBS is a $9 trillion market, but it is an anomaly due to its payoff profile.
- A "buyer of last resort" function has always been played by either the GSEs or the Fed to regulate the unique convexity features of the market.

Source: FHN Financial and Federal Reserve

Net Annual Agency MBS Issuance Finding a Range in $200–$300 Billion Area



- Normally, ***net issuance*** increases when prepayments decline.
- Net issuance in 2023 was short of $300 billion.
- Now dominated by Ginnie despite faster prepays in that sector.

Source: FHN Financial, CPRCDR

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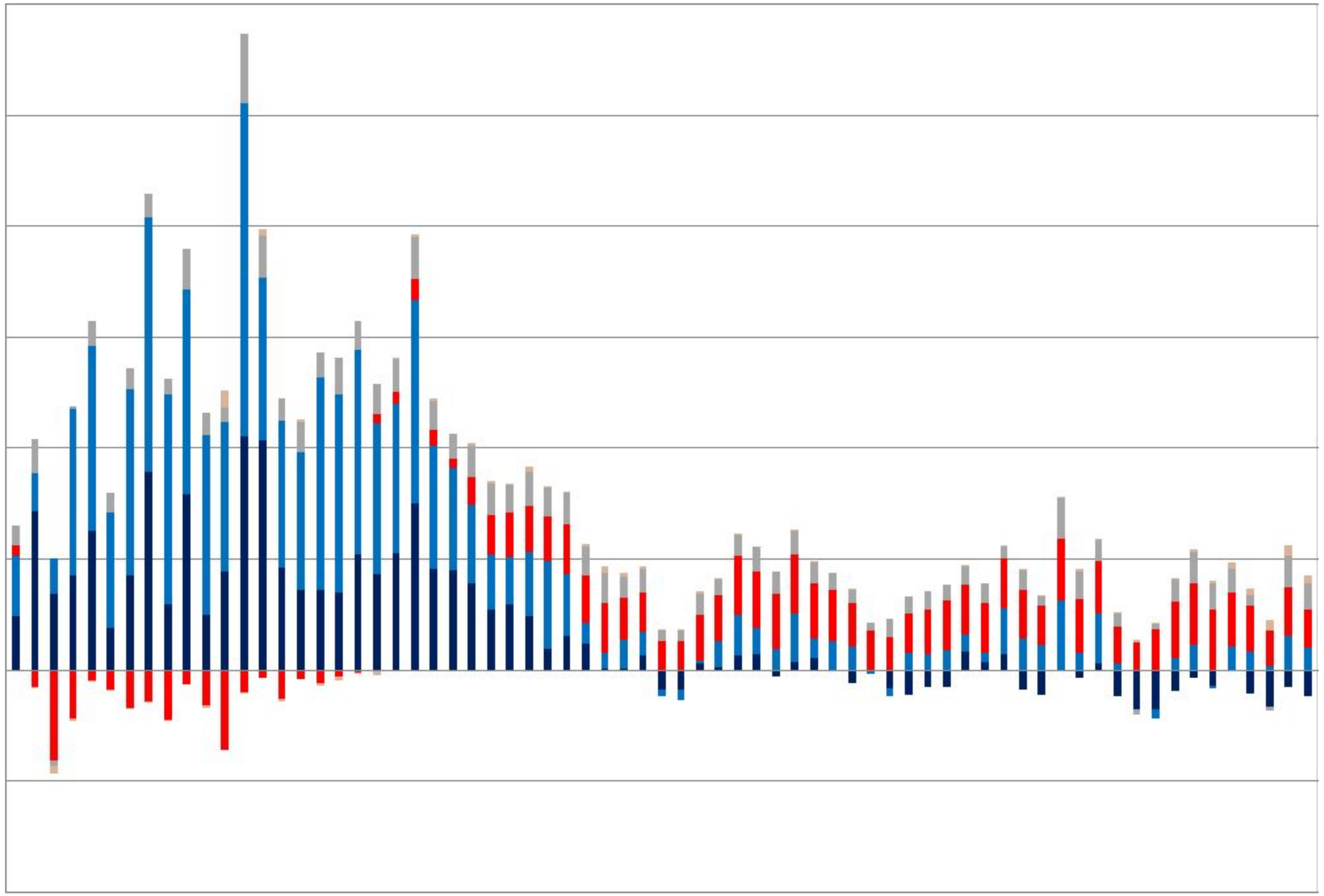
Current Trend Now Around $20 bln/mo; Stronger Seasonal Period Now Over



- Monthly detail highlights how dramatically net issuance has declined.
- There is a little bit of strength returning during the past few months after ***almost negative*** net issuance a few months ago.
- Conventional MBS is now experiencing *negative* net supply.

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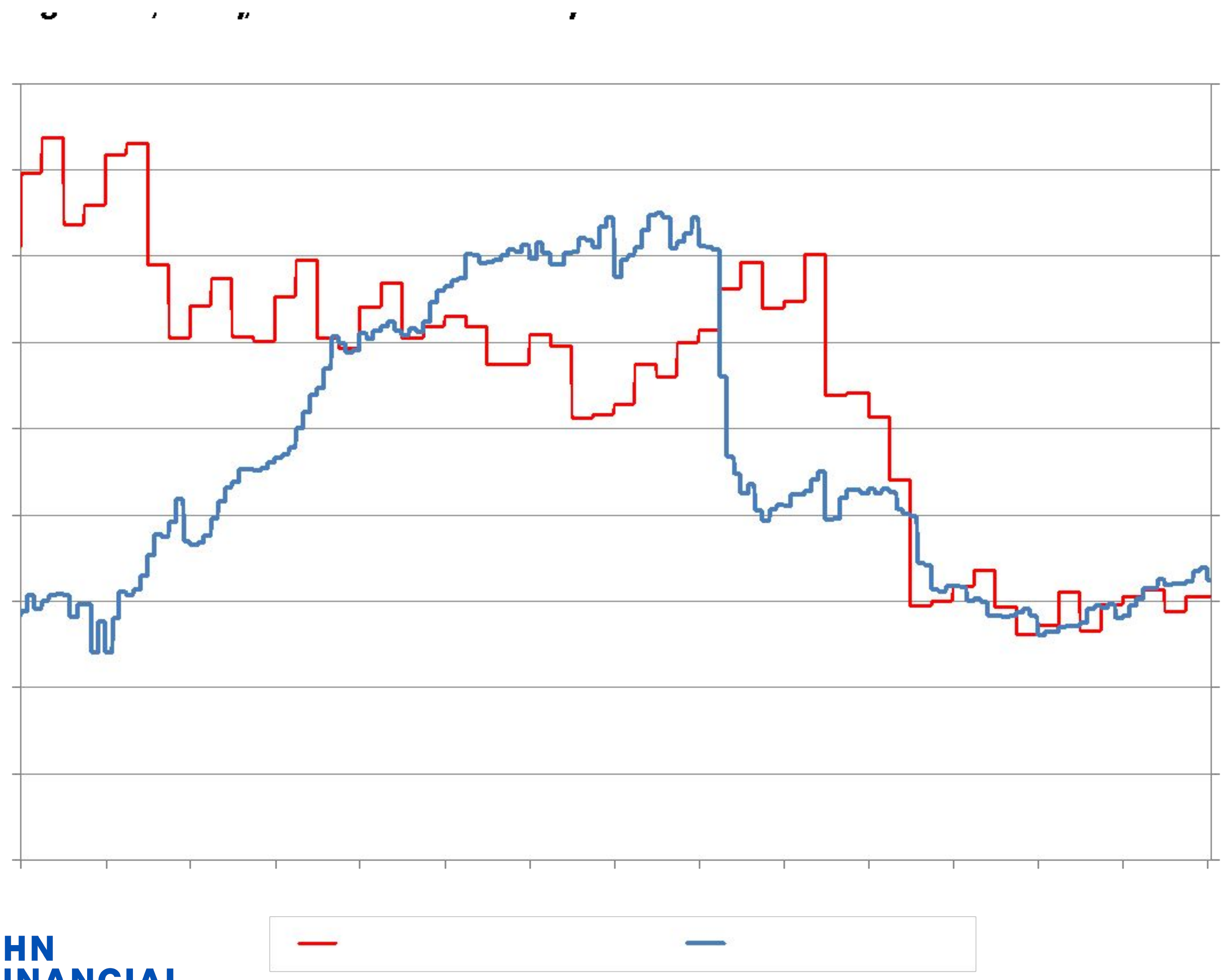
Source: FHN Financial, CPRCDR

Net Supply Not Likely to Be a Headwind for MBS As Long As Housing Affordability is Difficult



- Affordability is a function of both interest rates and home prices.
- Credit availability is a function of rates and the general lending environment.

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Source: FHN Financial, Bloomberg, NAR, MBA

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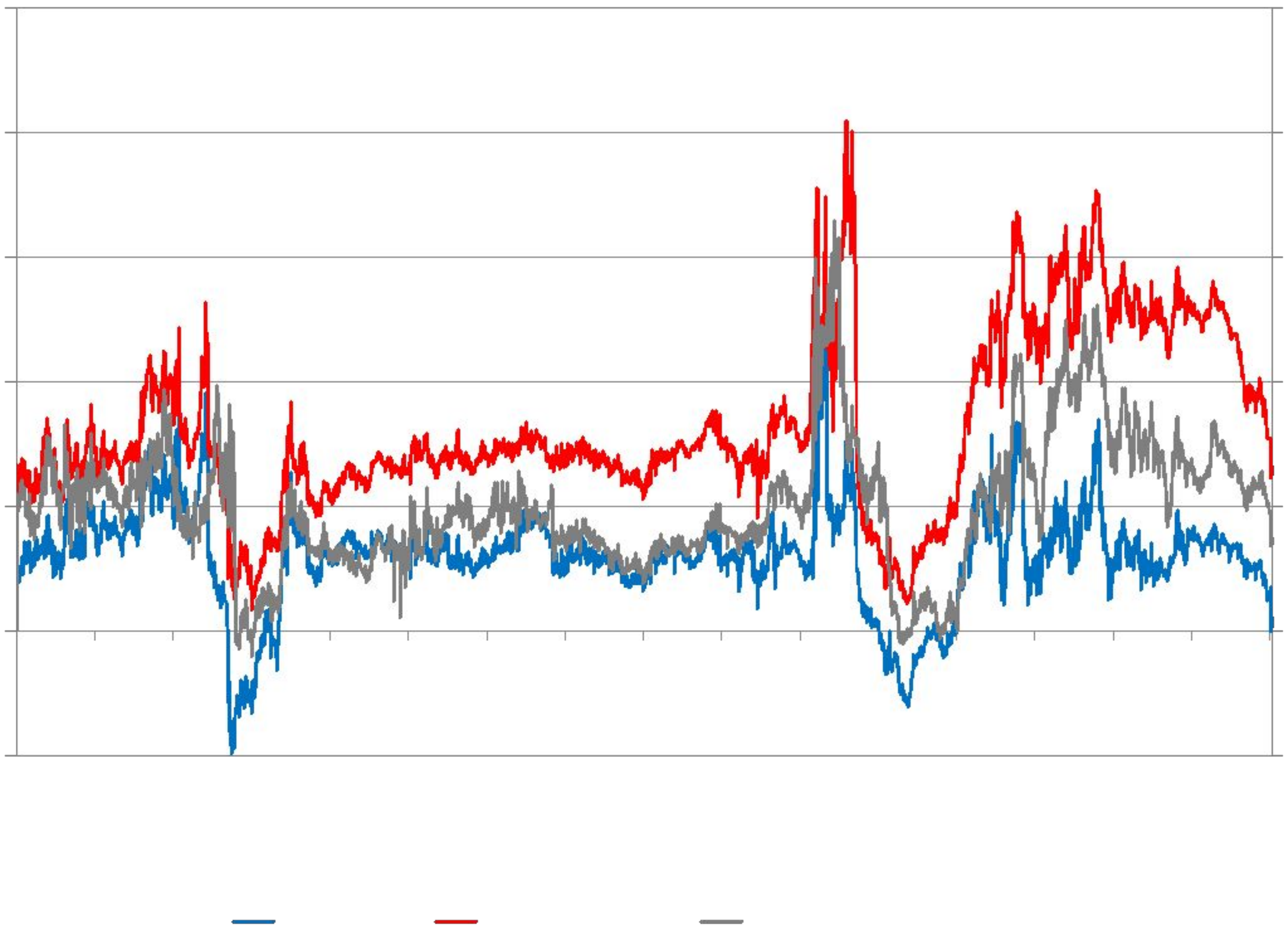
- **Longer-term measures of valuation are now tight vs. rates, cheap vs. competing spread product.** Mortgages are still a cheap spread product, but less so than this time last year.

All Measures of MBS Current Coupon Spreads Are Now Tight vs. Rate Benchmarks



- 30yr CC z-spread now very similar to most of the QE “maintenance” period of 2014-2018.
- 15yr has also performed and is in a similar position to its own history.
- Despite still-low implied volatility, the current coupon OAS is quite tight.

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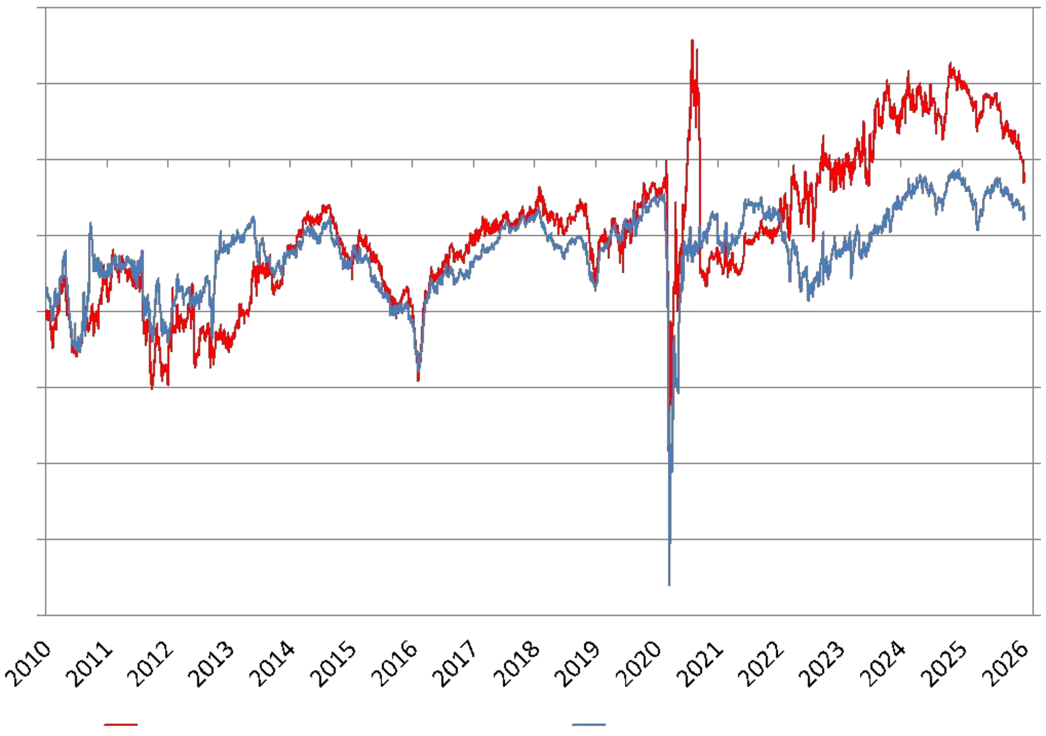
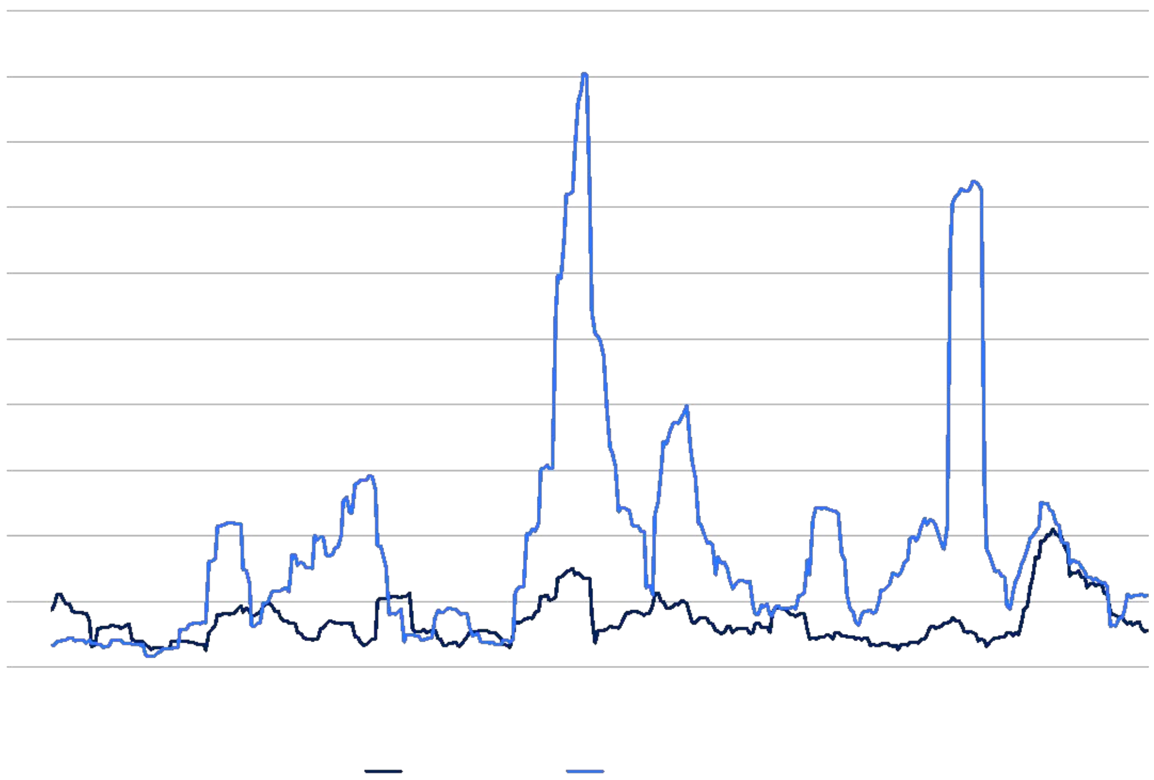
Source: FHN Financial and Bloomberg

Corporate Returns/Spreads More Volatile Over Time





Source: FHN Financial and Bloomberg

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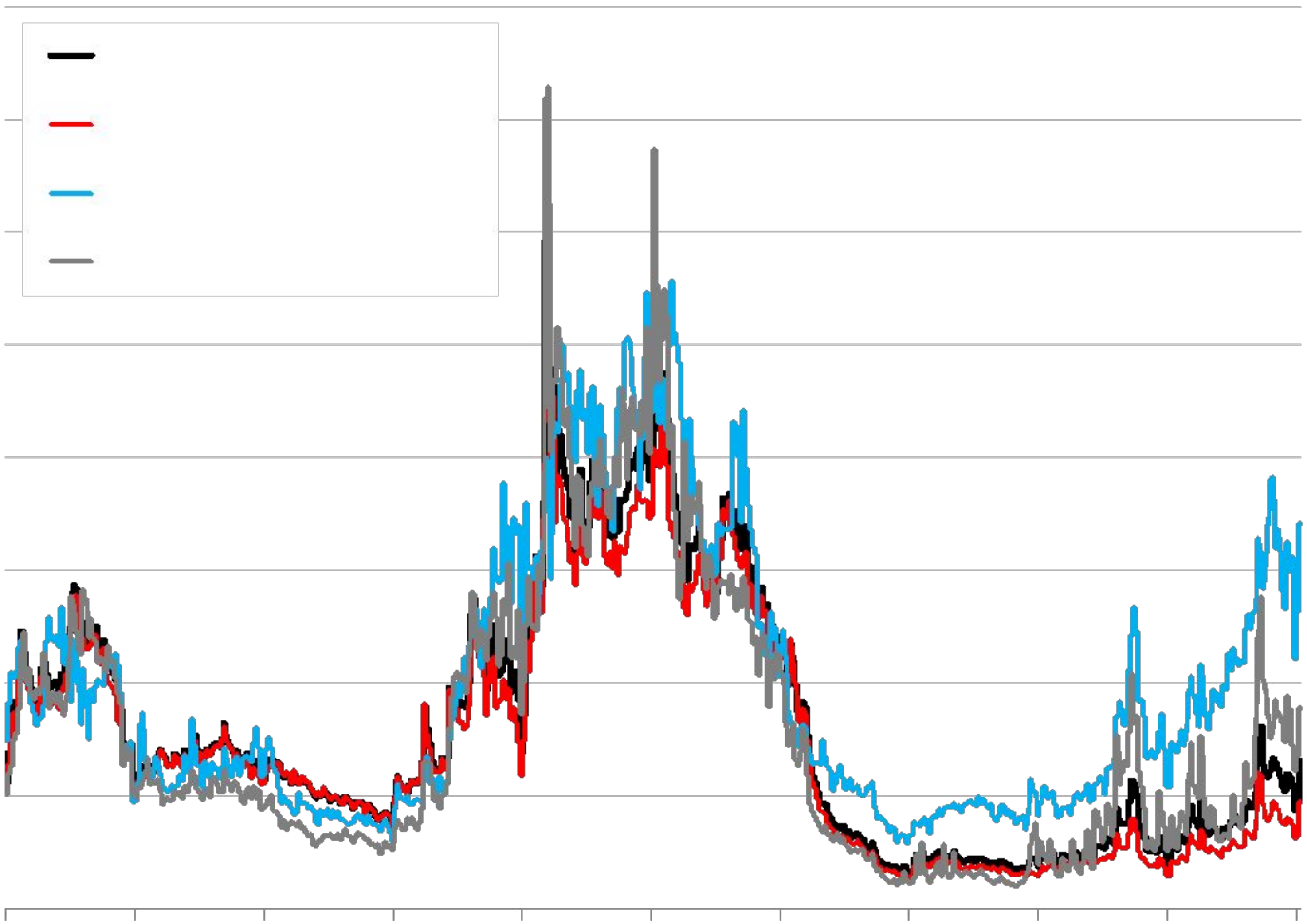
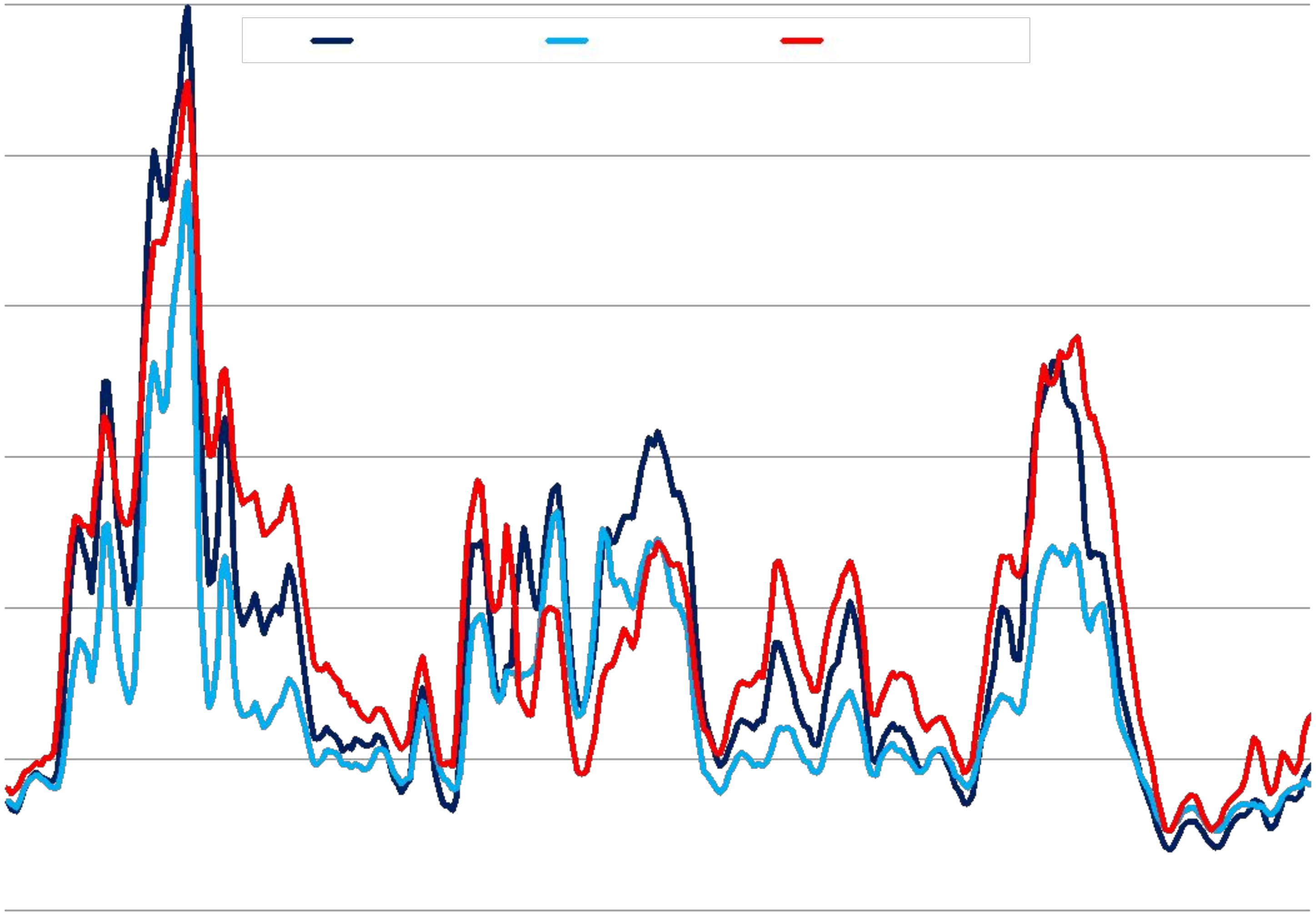
Refi Index Starting to Percolate



- August/September rate drop triggered refi surge.
- Refi applications are 40% higher than this time last year.
- ***IMPORTANT:*** Borrowers immediately responded to lower rates in August and September. When rates fell to similar levels in 2024, refi's did NOT spike as dramatically. Borrowers are no longer holding out for sustained, MUCH lower rates.

Source: FHN Financial and Bloomberg,

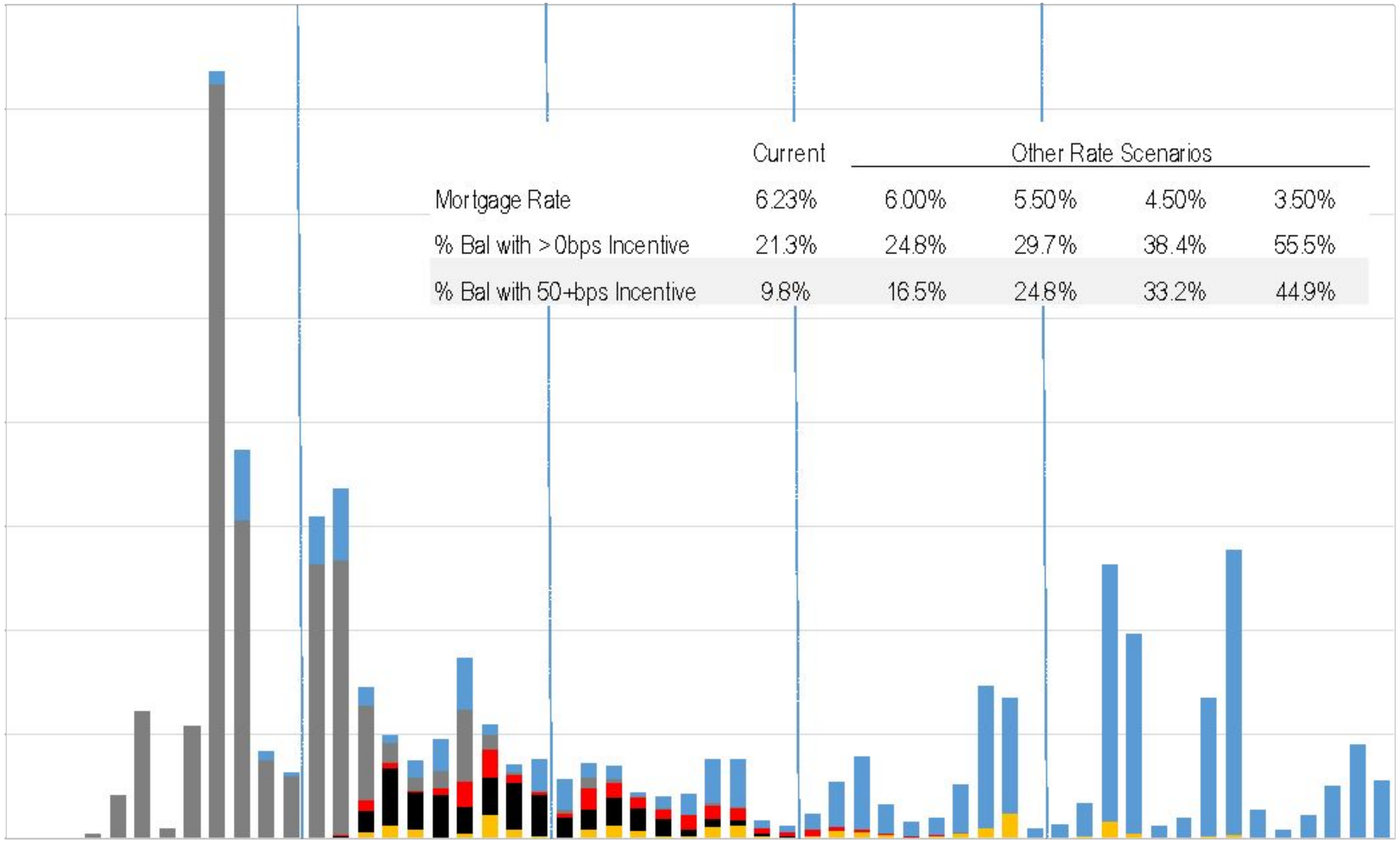
Prepays are Picking Up, Have MUCH More Upside



- Aggregate speeds are ~25% faster year-over-year. Speeds faster for Ginnie driven by VA streamline refinancing.
- Recent refi spike in high coupons was partially offset some by slower seasonal turnover in lower coupons.
- **Speeds for 30yr G2 5.5s and 6.0s, along with UMBS 6.0s and 6.5s, increased by 40% between August and September.**
- 2023 and 2024 were the slowest years in over 20 years.

Source: FHN Financial and CPRCDR

One-Fifth of Outstanding MBS Has Refi Incentive



	Current	Other Rate Scenarios			
Mortgage Rate	6.23%	6.00%	5.50%	4.50%	3.50%
% Bal with > 0bps Incentive	21.3%	24.8%	29.7%	38.4%	55.5%
% Bal with 50+bps Incentive	9.8%	16.5%	24.8%	33.2%	44.9%

- Rates would have to fall to near 5.5%, before 20% of the balance would have at least 50bps of incentive.
- Coupon distribution is starting to look more like a barbell.
- Not all ~20bps rate declines have an equal effect.
- Current coupons very callable. Growing share of borrowers who bought with a ***"marry the house, date the rate"*** strategy.

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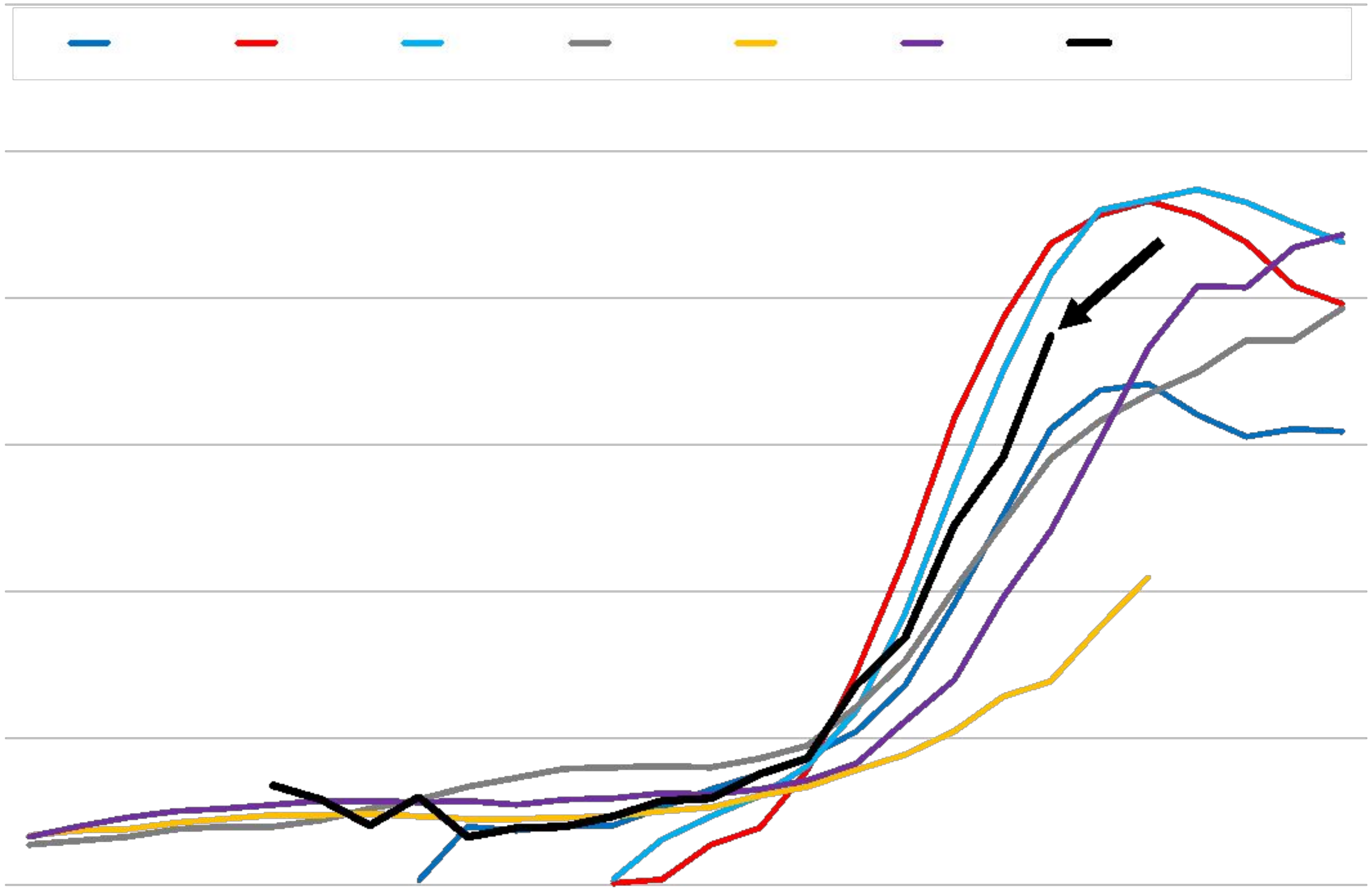
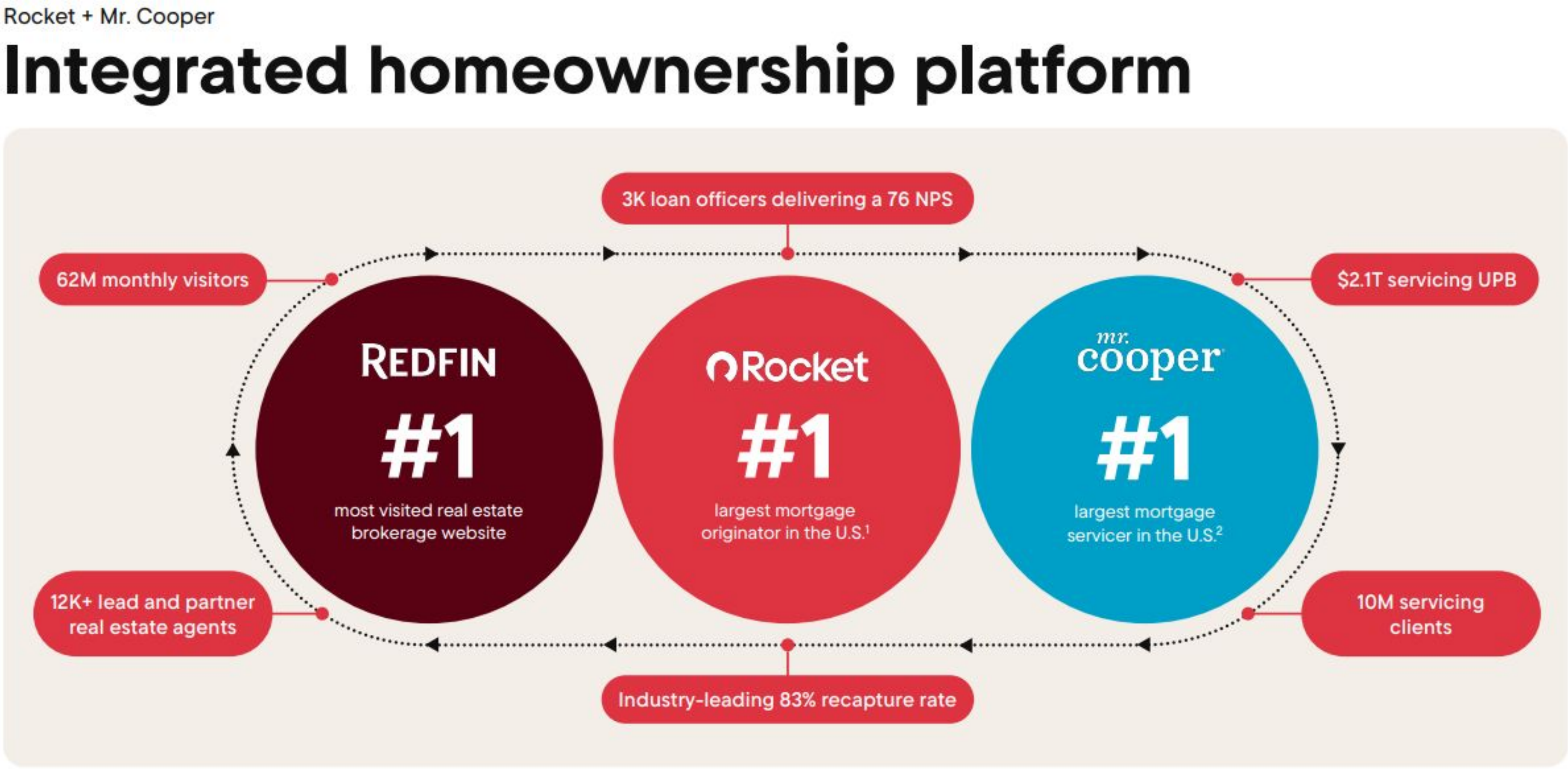
Source: FHN Financial, Bloomberg, and CPRCDR

Current S-Curve Starting to Steepen Again; A Rally Could Steepen It Further

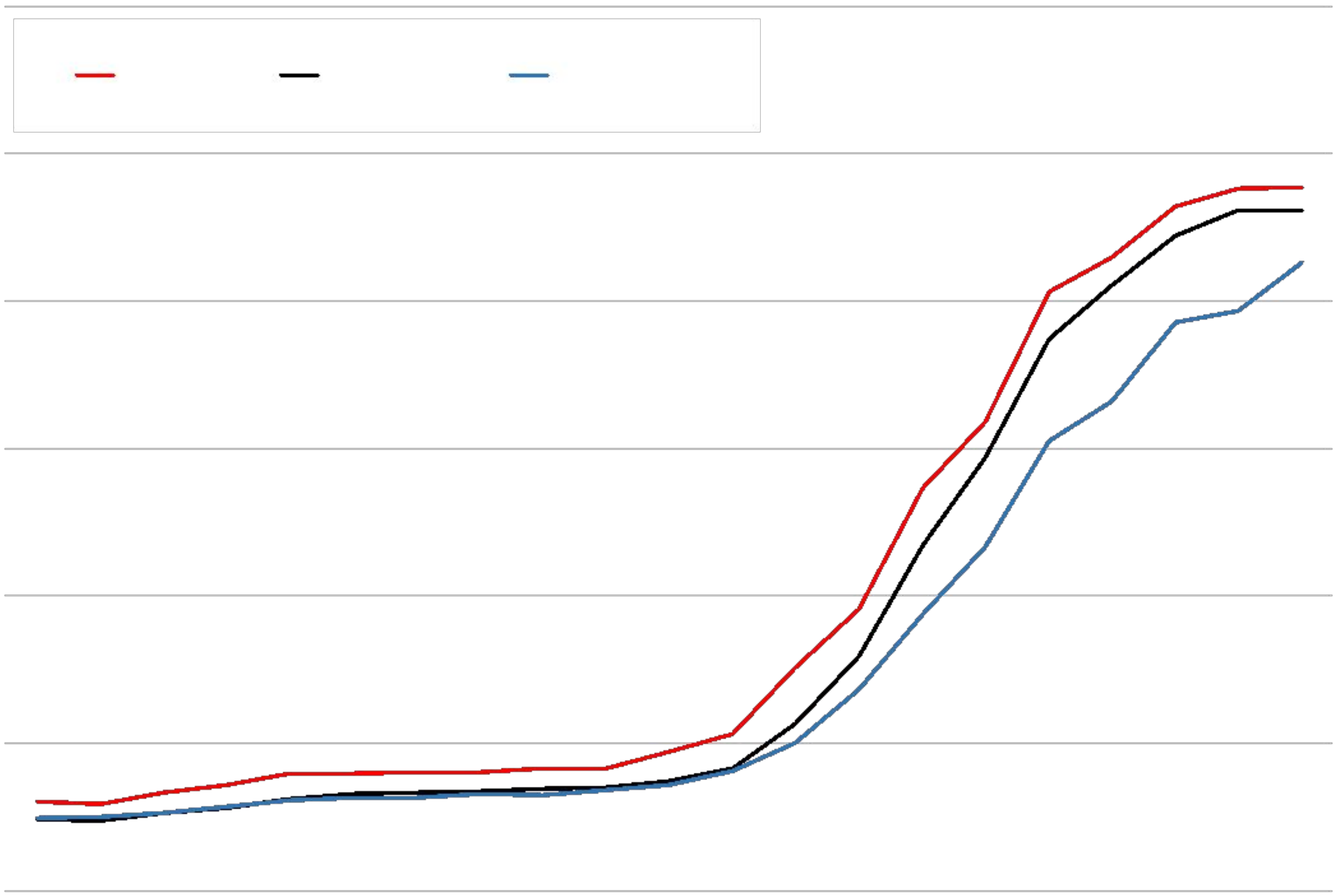


- Current s-curve very close to 2021 experience.
- Convexity of the market worsening, lower coupons slowing down and higher coupons more responsive = **Steeper Curve**
- Media effect + technology improvements + servicer distribution = **Higher Curve**

Consolidation Heightens Prepay Risk



Transfer Risk in Real-Time: Rocket to Acquire Mr. Cooper



- A loan's servicer can change over time due to MSR transfers.
- ***Post-merger, Rocket is now the largest servicer in the United States***, 2x larger than the next largest servicer. It will service approximately one out of every six U.S. mortgages.
- Prepayments on loans previously serviced by Mr. Cooper may rise, reflecting Rocket's historically faster servicing behavior. To date, transferred loans continue to exhibit legacy servicing behavior.

Source: FHN Financial and CPRCDR

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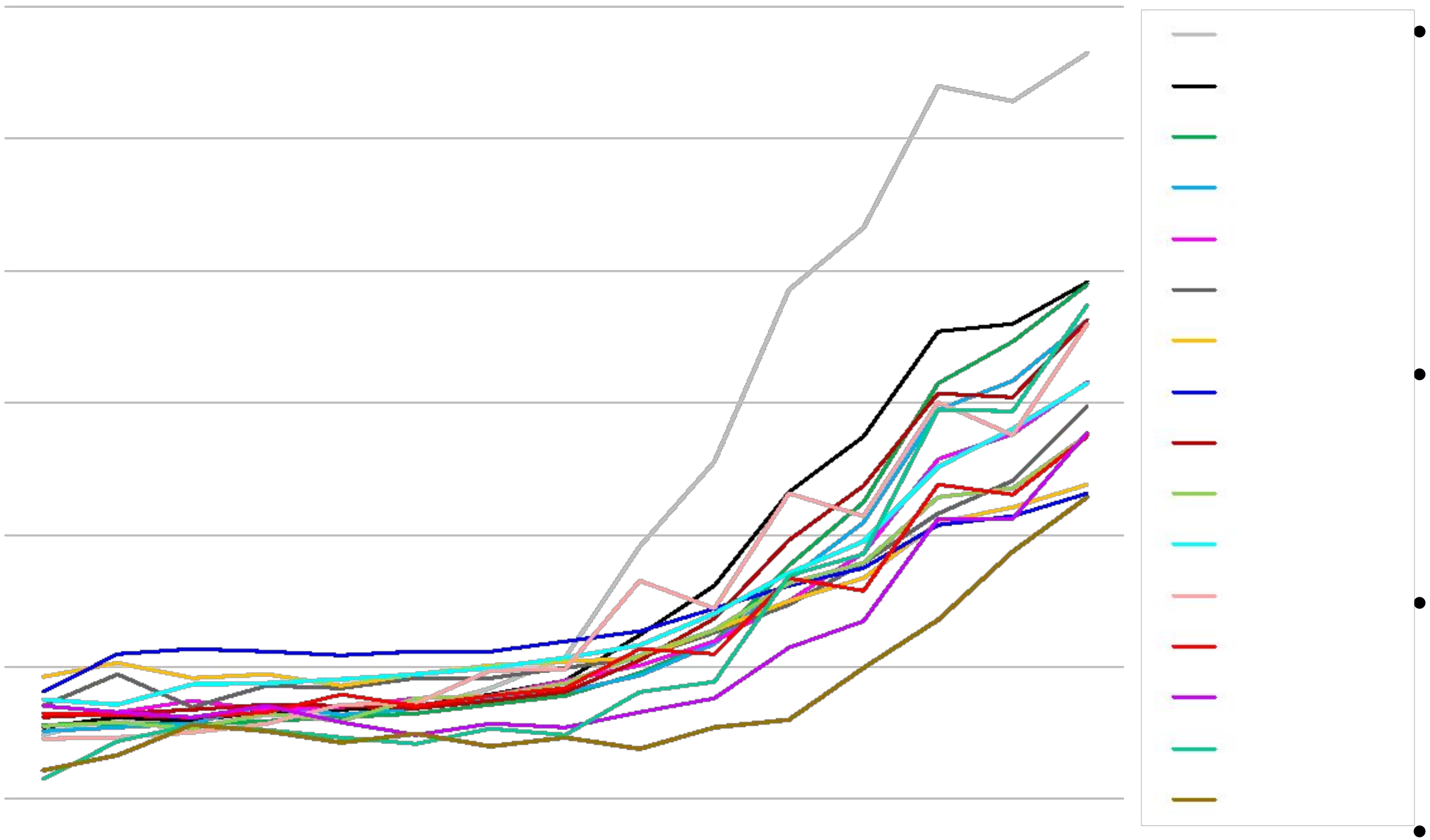
Focus on Lower Payup Collateral in a Rally



- Over *HALF* of all 30yr issuance was in spec pools in 2025. *One QUARTER* of all issuance was in LOAN BALANCE spec pools.
- Middle loan balance pools, 200-275k, have the best convexity profile.
- FL speeds are in line with 175k Max. TX call protection is slightly less robust.
- HFA and Social collateral add value when available.

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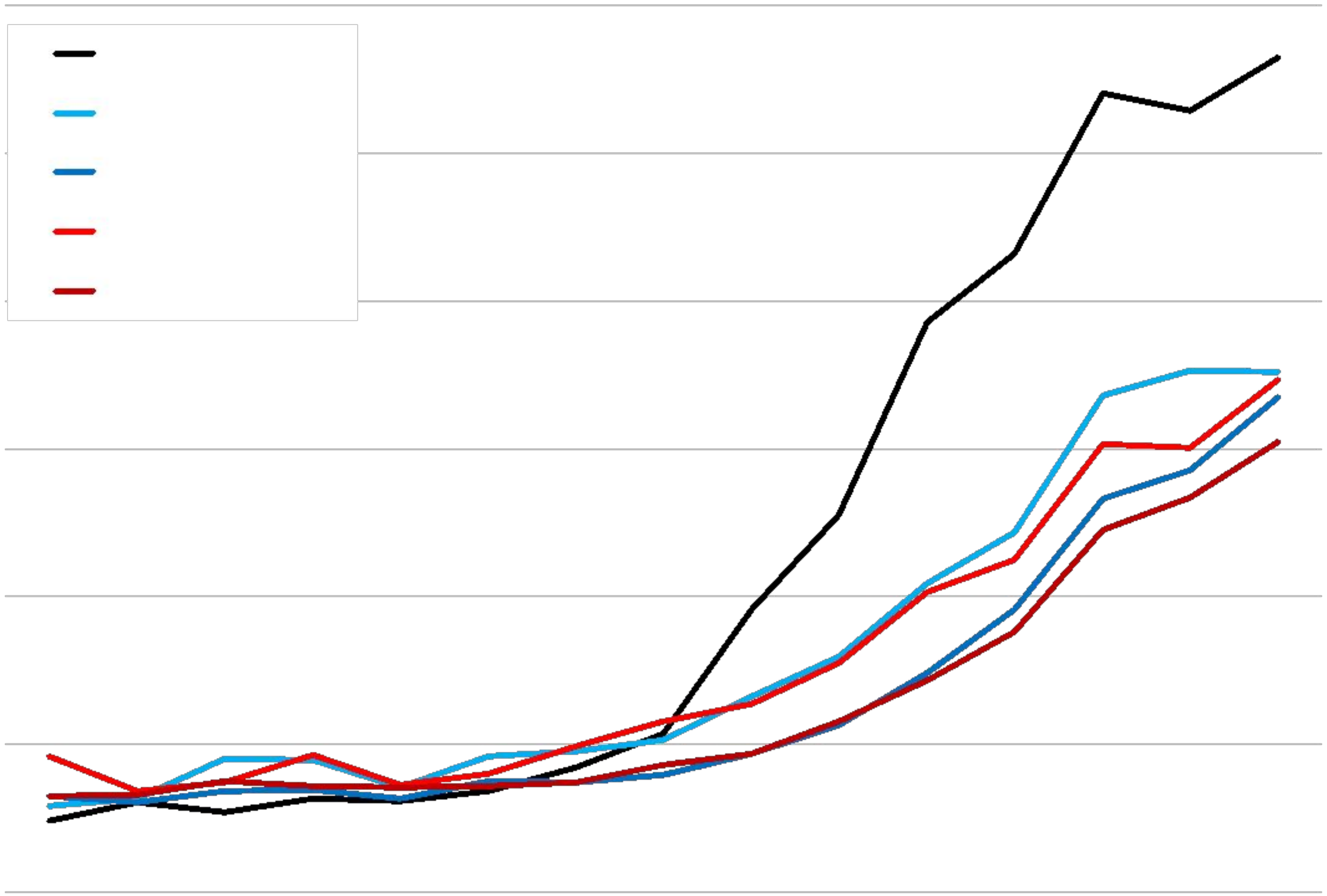
Source: FHN Financial and CPRCDR

Servicer/Story Offset is Often Cheap Call Protection



- ***Value in "dirty" collateral.*** Take advantage of higher coupon, spec loans serviced by Rocket when the discount is larger than the prepay difference implies.
- To start the year, Rocket loan balance pool payups are 20/32s to 24/32s lower than non-Rocket serviced loan balance pool payups.
- ***Investor gets 75% of the call protection for just 20% of the payup.***

Source: FHN Financial and CPRCDR

Preparing for a Prepay Comeback

- **Mortgage rates are at 3-year lows and refi application rates are at 3-year highs. Expect faster aggregate speeds at key mortgage rate thresholds going forward.**
- **Most of the mortgage market is still "locked-in".** 70% of borrowers have mortgage rates at or below 5.0%. 60% of borrowers have mortgage rates at or below 4.0%. The average borrower is still more than 200 bps out-of-the-money.
- **20% of the market has incentive at current rates.** Most mortgages originated over the past three years are now in refi range and could see a material increase in prepayments if mortgage rates decline to 5.5% or lower.
- **Even if rates remain above 6.0%, expect moderately faster speeds** due to borrower responsiveness, heightened media effect, steeper yield curve, servicer consolidation, and technology efficiencies.
- **Value is in lower payup call protection stories** including higher LB cut-off's, low FICO, Florida, Texas, and HFA.

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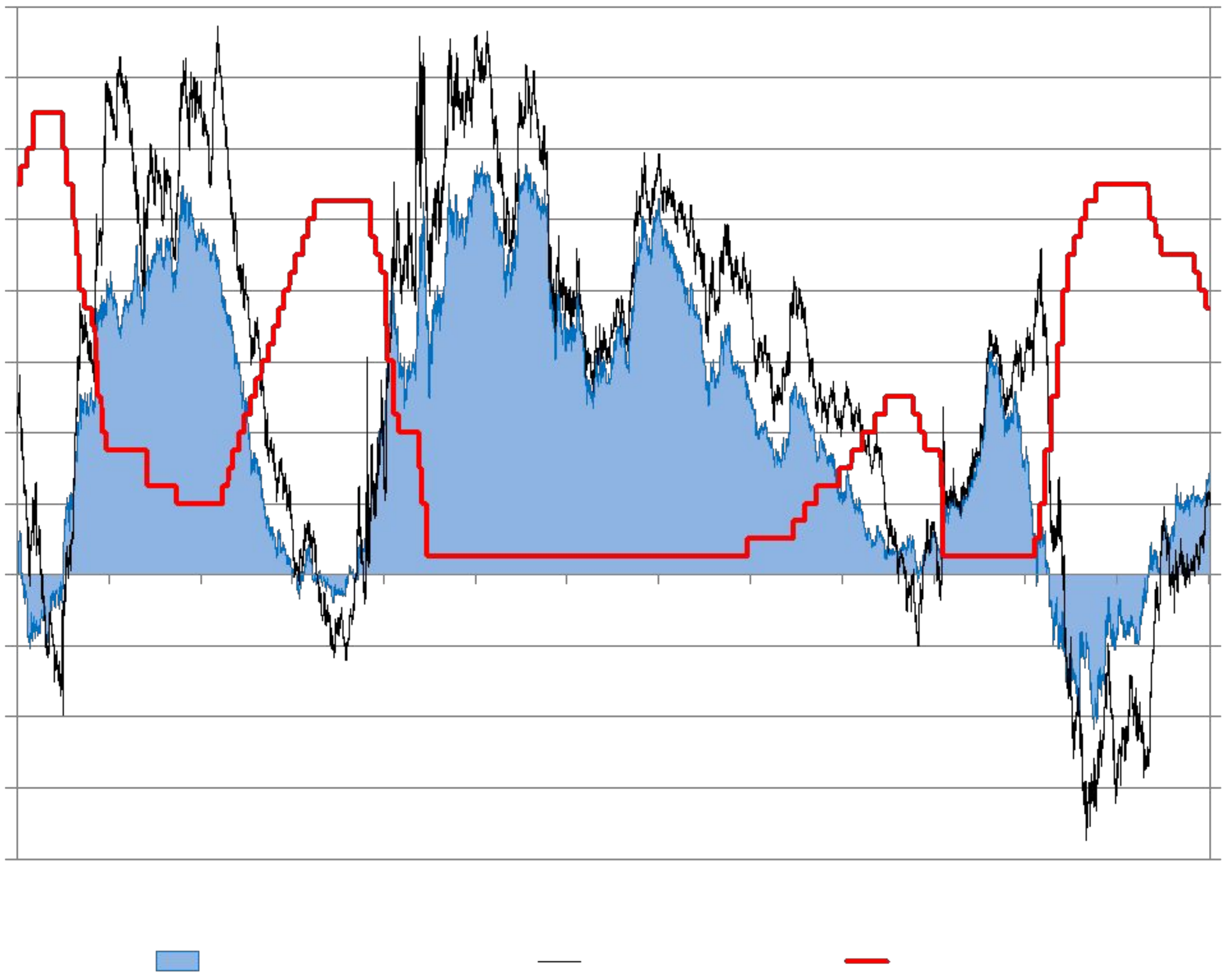
Three Basic Levers to Pull In Fixed Income

- **Duration:** Yield curve has embarked on its return to “normal” after an unusually long period of inversion.
- **Credit:** Bloomberg/Barclays High Grade Index OAS/Spread is still very near historical lows, after retreating from recent vol-induced bounce.
- **Optionality:** The BofA MOVE index recently retreated after a big spike in early April and is well below long-term historical averages. Value in MBS now depends on strong policy demand and lack of viable alternatives.

Volatile Curves Are Starting to Converge Steeper; Both Curves in Full Steepening Mode



- Fed Funds target rate now coming down after highest since late 2000.
- Quick FOMC policy response in 2022 to inflation caused inverted Yield Curve.
- Curve shape going forward is an indicator of the market's expectation for Fed

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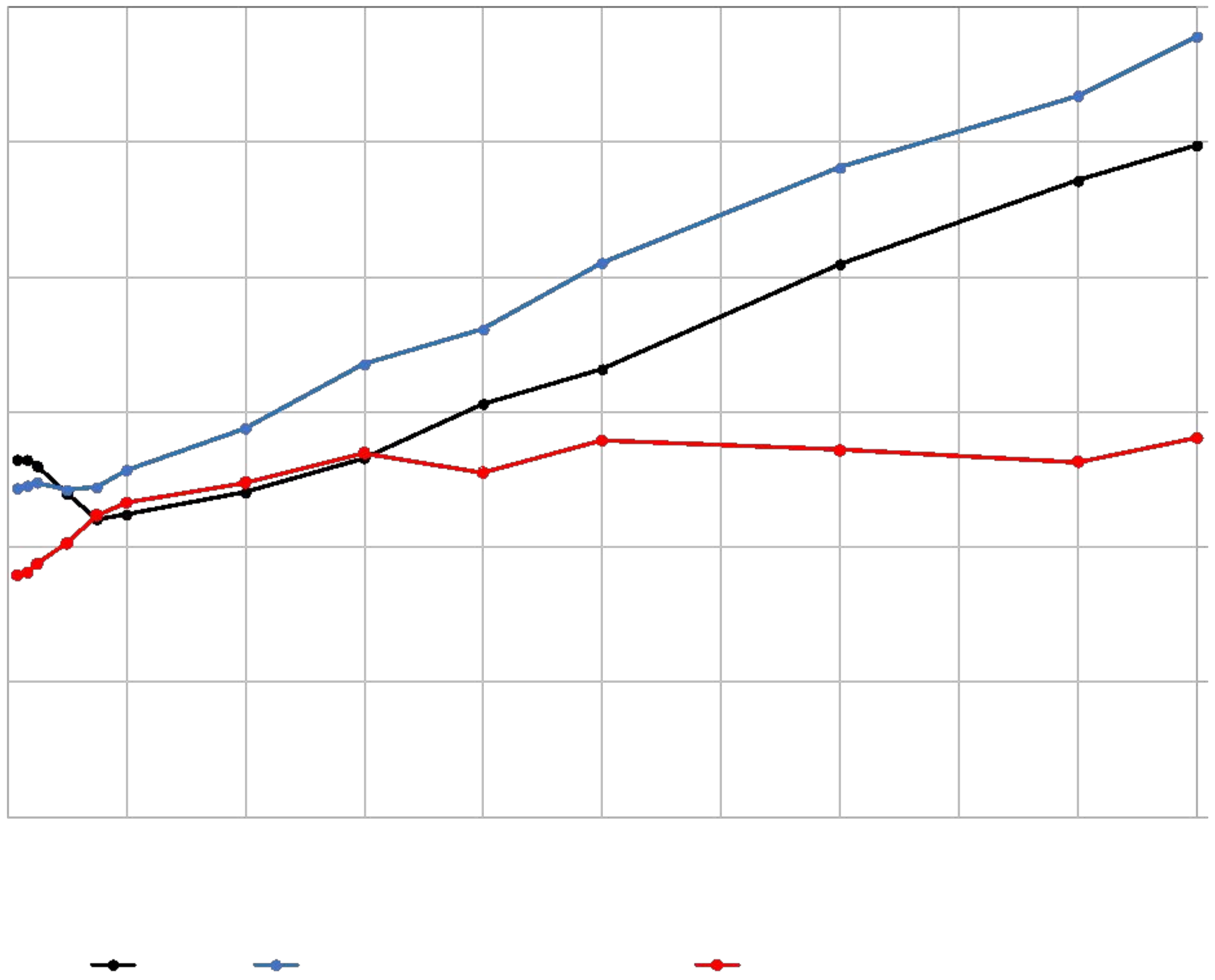
Source: FHN Financial and Bloomberg

Forward Curve Now Higher in a Parallel Move



- Forward Curve is an ***arbitrage-free*** math formula.
- It is ***neither*** a fundamental economic projection ***nor*** a technical market analysis.
- Inverted yield curves ***always*** produce bull steepener forward curves.
- Very little change in forward curve during past two months.

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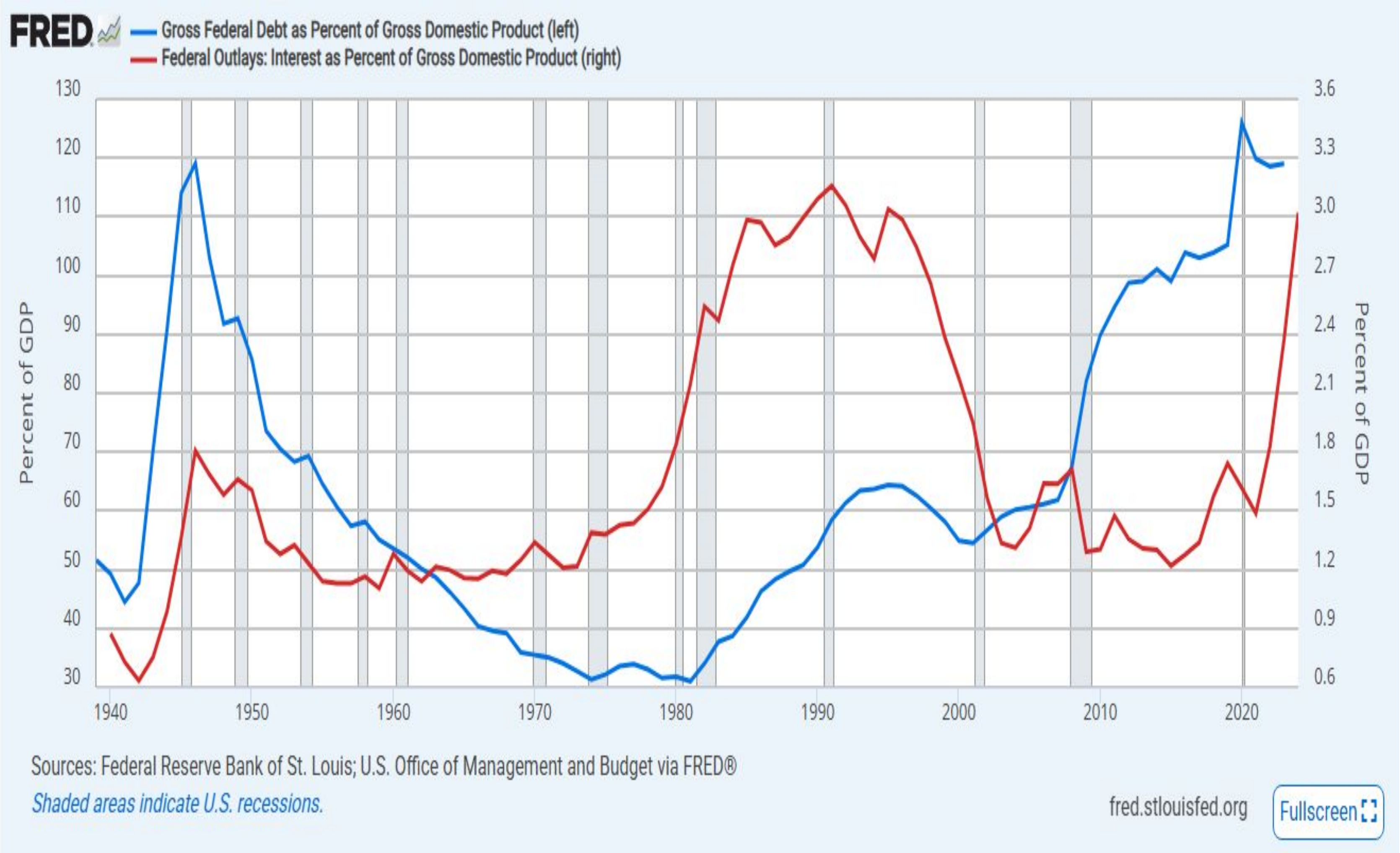
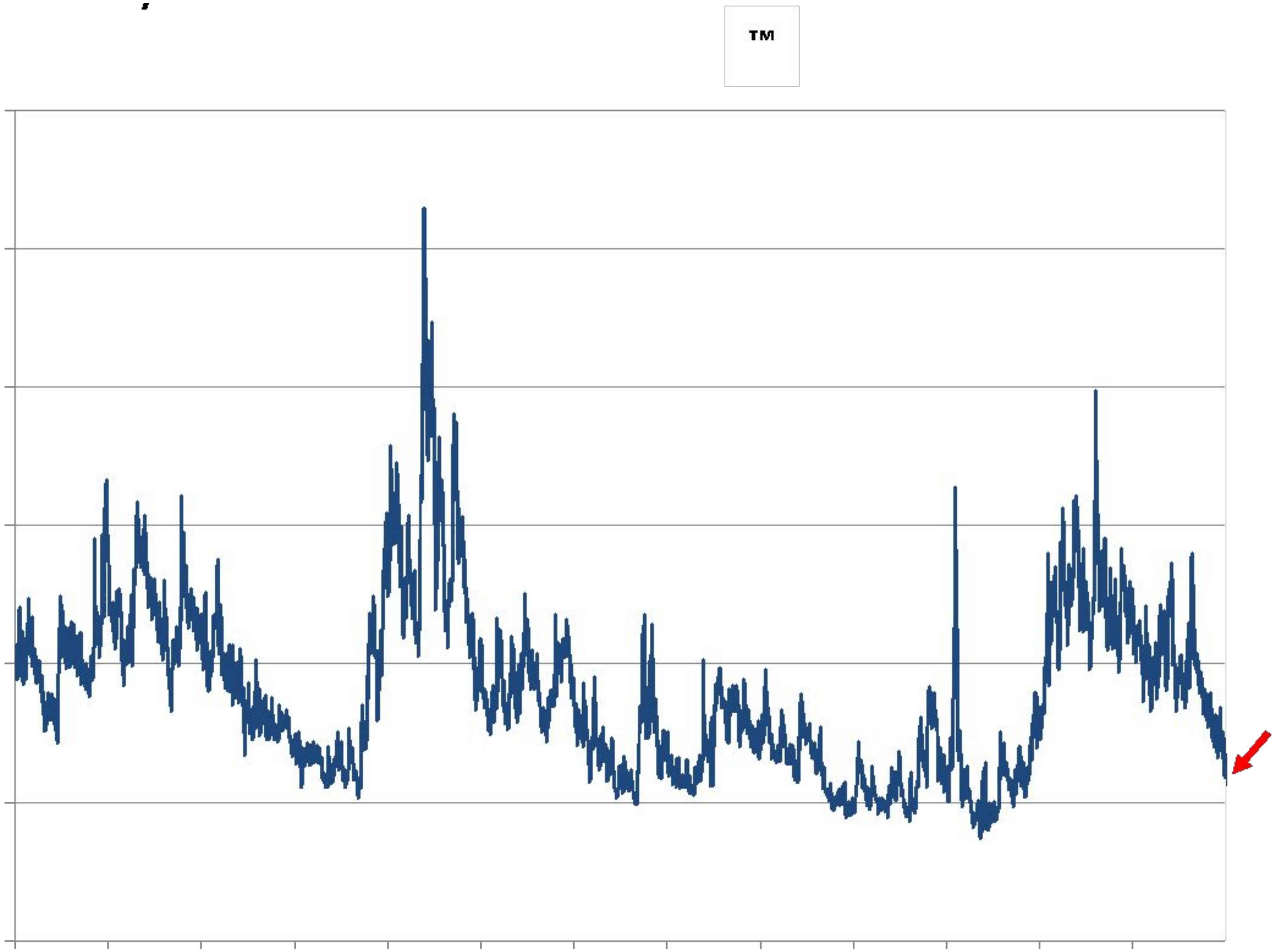
Source: FHN Financial and Bloomberg

Macro-Economic Backdrop Still Points to Steepener



- Federal Debt now more than $30 trillion outstanding.
- Higher debt levels and rising rates – *both relative to GDP* – can create a vicious cycle.
- Desire to term out debt when rates are still relatively low creates a *steepener bias.*
- ***Crowding out creates a tightening bias for spread product.***

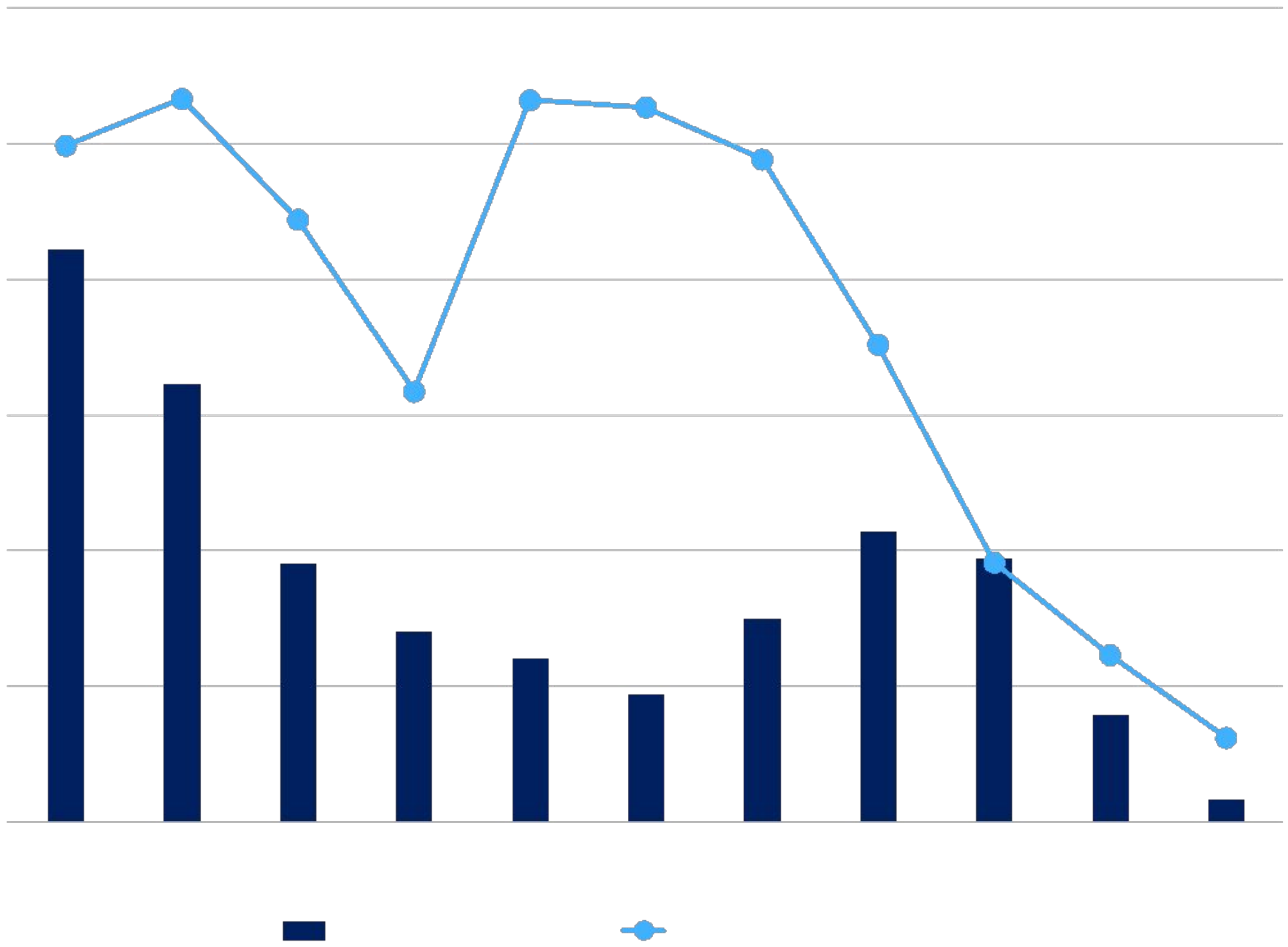
Implied Volatility Has Recovered and Now Well Below Long-Term Historical Averages



- Main driver of MBS spreads is ***implied volatility.***
- MBS is ***long*** a FN/FH bullet, and ***short*** options to the mortgage borrower.
- ***Implied volatility*** drives the price of those options.
- Better to be a ***seller of options*** when implied volatility is high.

Source: FHN Financial and Bloomberg

Recent Post Caused Smallest Components to Perform



- Best performers were 4.0s and 4.5s.
- Among smallest coupons by market cap are 4.0s and 4.5s.
- 2.0s and 2.5s have performed well in past two weeks
- UIC has lagged significantly on this move.

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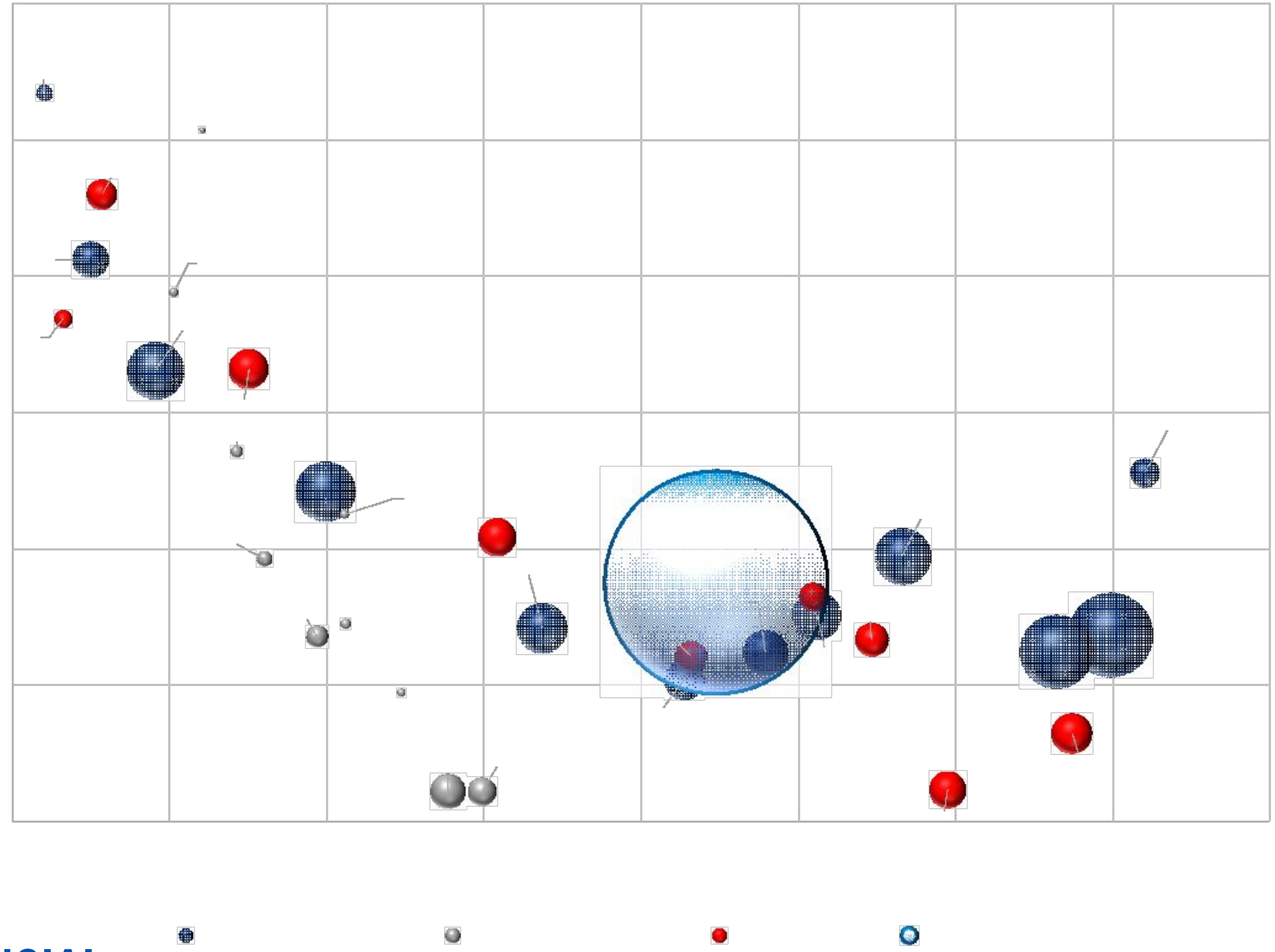
Source: FHN Financial and Bloomberg

Near-Par Coupons Now Quite Over-Valued in Index



- 3.5s through 5.0s performed post "Truth Social" and are now expensive.
- Coupon barbell cheap vs. middle.
- OAS model likes high-coupon *seasoned* 30yr Conventional and Ginnie despite prepay risk. ***We still like CMO floaters for short carry alternative.***

Source: FHN Financial and Bloomberg

Yield Curve Positioning “Cheat Sheet”

Curve Steepener

- Up-in-coupon.
- IO/IIO.
- Tight Window.
- 15yr vs. 30yr.
- Hybrid ARM vs. Passthru.
- CMO vs. Passthru.
- Bullet vs. Barbell.

Curve Flattener

- Down-in-coupon.
- Floater
- Wide Window.
- 30yr vs. 15yr.
- Passthru vs. Hybrid ARM.
- Passthru vs. CMO.
- Barbell vs. Bullet.

MBS Tight vs. Rates, Cheap vs. Other Spread Sectors

- **CURRENT COUPON MBS spreads are now inside fair vs. rates:** Middle/current coupons have performed. Buy cheap forms of call protection (i.e. Rocket Loan Bal) and BARBELL coupon exposure.

- **Prepays have started to increase, get ready for more of the same:** The current coupons ARE highly callable in the event of another rally, *so pay attention and buy call protection stories in alternative markets*.

- **Figure out the STEEPENER:** Down-steep and up-steep produce very different outcomes/relative value points. Small additions/payups for convexity with fuller coupons can go a long way to enhance TRR. Some CMOs and hybrid ARMs have good steepener partials. *CMO (and other) Floaters perform if the curve remains relatively flat.* **15/30 is a steepener, but it is quite expensive. There are cheaper alternatives vs. 15yrs, in many cases.**

- **Diversification and Dollar-Cost Averaging remain steadfast recommendations.**

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