Proposed "Slam-Dunk Stimulus" Program
By Jeffrey Gundlach
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There are two rumors circulating in the market regarding government programs directed at the Agency MBS market as a form of economic stimulus and voter suasion as the mid-term elections approach.

The first rumor is that the government may be considering a principal forgiveness program that would bring mortgage Loan-To-Value (LTV's) down to or below 100% for homeowners who are currently "upside down" on their home loans. While principal forgiveness on a voluntary basis at the servicer level was rolled out in the first quarter of this year as part of an outline for a potential "HAMP 2.0", significant hurdles remain in place for such a program to be implemented proactively by the GSEs FNMA and FHLMC themselves. Specifically, Trust agreements do not allow modification or buyout of performing loans, so only delinquent loans would be eligible. This greatly minimizes the scope such a program could have, and therefore limits its effect on the market for Agency guaranteed pass-throughs. Although agreements and charters can always be changed, the practical mechanics for doing so imply any such change could only occur over a time frame inconsistent with a political play aimed at this November's Congressional elections.

The second rumor that is swirling in the marketplace is that the government will soon announce its sponsorship of an instantaneous refinancing program that would eliminate the barriers now in place preventing many homeowners from refinancing higher rate loans (say, 6% and above) into market rate loans with interest rates of approximately 4.5%. Essentially the rumor is that the government will come up with something like a 4.5% mortgage for everyone with no fees and no risk-based pricing. This program is in the opinion of DoubleLine much more likely in the current time frame than the principal forgiveness program discussed above. In fact, DoubleLine has been contemplating the potential for the ultimate emergence of such a program for several months, and has structured MBS investment portfolios with the potentiality for such a program as a part of the analytic process. Even so, DoubleLine agrees with the current Wall Street research consensus that even this program is not likely to be imminent. Government officials have issued statements that no such program is being pursued at present, which is corroborated by the observable price action in the MBS pass-through market where the prices for premium MBS that would be directly affected by such a program in a substantial way have adjusted downward only modestly, in the range of one-quarter to three-eighths of 1%.

To repeat, notwithstanding DoubleLine's view that the rumors in the market are not likely timely, DoubleLine does believe that the potential exists down the road for a widespread government refinancing program should economic conditions weaken significantly. DoubleLine has therefore directed investment activities in a manner that would minimize detrimental effects of such a program to DoubleLine MBS investments. In the case of DoubleLine's Total Return Strategy, the current weightings reflect less than 4% of a portfolio's market value allocated to securities exposed to current prepayment activity which are backed by Agency guaranteed loans with homeowners paying in excess of 5.75%. Additionally, approximately 55% of the portfolio is invested in non-Agency guaranteed MBS with an average cost of 78.5 cents on the dollar. Virtually all of these securities are backed by loans with homeowner interest rates far above current market rates. To the extent that government interference might create a large scale refinancing opportunity by removing credit impairment barriers, the cash flows and return potential of these securities and a DoubleLine Total Return portfolio in aggregate would likely be improved.

Of course, we will be monitoring these issues on a continuing basis and are happy to answer any questions investors may have on these issues.

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