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Could Higher Bank Stocks Support a Stabilization of Mortgage Rates?

Bank Stocks Trending Higher

Second quarter earnings reports have been favorable to bank stocks. Equity valuations across financials are closing the gap to the S&P Index. While rising deposit costs and unrealized losses on securities holdings at various regional banks weighed on stock valuations in the spring, these stocks are now rallying too.

Clearing through Q2 earnings without any negative surprises has been a notable feat. The takeover of PacWest by Banc of California was also well digested by the market.

Bank Stocks Rallying, Closing Gap to Broader Equity Market⁽¹⁾

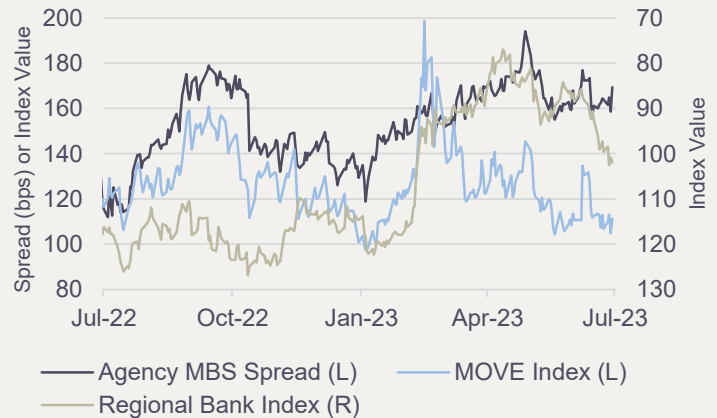


Finding Support in Agency Mortgage Spreads

Agency MBS spreads have moved closely in line with bank stock valuations since the spring. Banks own almost the same amount of agency MBS as the Federal Reserve does, the latter allowing their securities holdings to run off under Quantitative Tightening (QT). Banks have paralleled these declines in securities holdings, with some forced sales coming through the FDIC auctions from failed banks.

The agency MBS sector's performance has been driven by these sales alongside weaker sentiment given concerns of more bank collapses. A continued rally in bank stocks could lend support to agency MBS spreads.

MBS Spreads Have Been Closely Correlated to Bank Stock Valuations⁽¹⁾

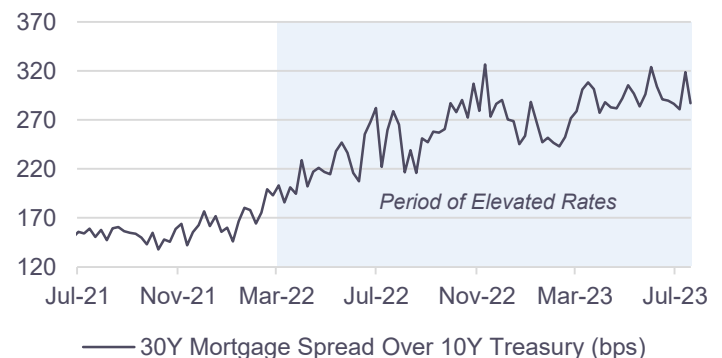


Stability for Mortgage Rates?

Mortgage rates are dependent on Treasury yields and agency MBS spreads. The spread of mortgage rates to the 10-year Treasury yield grew wider as the Federal Reserve began hiking rates in early 2022. The gap widened even further as the pace of rate increases stepped up to 75bps in July 2022. While they narrowed briefly, the bank collapses in March 2023 caused spreads to increase again.

On watch ahead will be any relief in sentiment and continued strength in stock valuations that could potentially lend support to agency MBS spreads, stabilizing mortgage rates.

Mortgage Spreads Remain Wide⁽¹⁾



(1) Source: Bloomberg.

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