PennyMac Mortgage Investment Trust is pleased to provide you with this investment update from our manager, PNMAC Capital Management (PCM), for the month of October 2011.

PNMAC Capital Management Investment Update

November 18, 2011

We are beginning to see signs that the stagnant U.S. economy may be improving. On November 2nd, the Federal Open Market Committee (FOMC) policy statement put a slightly more positive tone on its evaluation of the economy. The statement noted that "economic growth strengthened somewhat in the third quarter" compared with the Fed's assessment in September which indicated that "economic growth remains slow." The Fed also added that growth reflects "in part a reversal of the temporary factors that weighed on growth earlier this year." For instance, the unemployment rate edged down to 9.0% in October from 9.1% in September. A broader measure of unemployment, that includes those working part-time because they cannot find full-time jobs and those who want to work but have not looked for a job in the past year fell to 16.2% from 16.5% in September.

After implementing significant policy changes at the August and September FOMC meetings, the Fed left current policies intact and opted not to take any action on November 2nd. The Fed initiated "Operation Twist" on September 21st with the goal of guiding long-term rates to a lower level. Although the 10-year Treasury yield closed at a low of 1.72% on the day after the new policy was instituted, as of October 28th, it had risen to 2.33%. The 30-year mortgage rate dropped briefly to 3.94% but is back up to 4.10% as of October 27th, levels seen just prior to the announcement. It appears "Operation Twist" has yet to achieve its objectives.

In the housing market, the volume of distressed properties for sale and the negative equity position of borrowers remain the two major problems troubling the sector. The National Association of Realtors (NAR) noted that 30% of existing home sales during September were of distressed properties. This month's report also noted that 22.6% of outstanding home mortgages exceed the current market value of the home.

The Federal Housing Finance Agency (FHFA), the regulator of Fannie Mae and Freddie Mac, announced on October 24th, modifications to the original Home Affordable Refinance Program (HARP) passed in 2009. The main objective of this program is to make refinancing easier for people with mortgages backed by Fannie Mae and Freddie Mac. HARP allows borrowers whose mortgage exceeds the current value of their homes to refinance and take advantage of the current low interest rate environment.

The major changes to the program address loan-to-value limits, delinquency restrictions, and loan level pricing adjustments. For fixed-rate mortgages, the FHFA eliminated the current 125% LTV limit. However, the 105% max LTV limit for adjustable rate mortgages will continue to remain in place. Another noteworthy change to HARP is new delinquency restrictions. For same-servicer refinancing, borrowers must have been current for the past six months and may have at most one 30-day delinquency in the past twelve months. Earlier, candidates for a HARP refinance were not allowed any delinquencies in the past twelve months. The HARP program also will reduce the fees associated with loan level pricing adjustments.

The large supply of foreclosed properties presents a challenge and bodes poorly for a rapid improvement of home prices. CoreLogic data show the median price of an existing single-family home fell 5.5% from a year ago and the seasonally unadjusted inventory of unsold single-family homes raised one notch to an 8.5-month supply in September. The elevated inventory situation of existing homes is another strain on home prices.

The seasonally adjusted Case-Shiller Price Index held steady in August compared with July. On a year-to-year basis, the index fell 3.8%, the smallest decline since February 2011. The FHFA House Price Index of August dropped 4.0% from a year ago, the smallest reduction since December 2010. The decelerating declines of both home price indexes suggests that home prices are stabilizing at a national level, albeit gradually.

Turning to the whole loan market, activities for distressed residential whole loans in October decreased markedly from September. Our investment team reviewed approximately $415 million in unpaid principal balance (UPB) of distressed whole loans for purchase in October. The MBA and ABS East conferences were both held during the month of October and attributed to the lighter volume for the month.