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WealthManagement

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Market Insights

A periodic newsletter from Idaho Trust

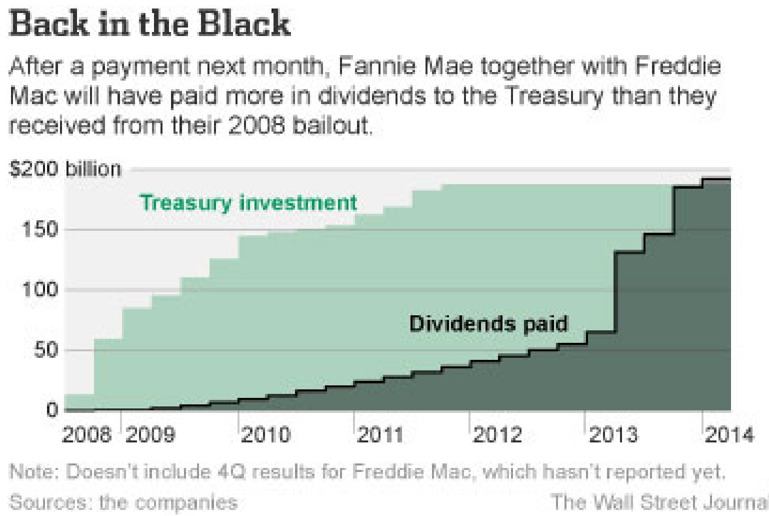
The Government's plans for mortgage giants Fannie Mae and Freddie Mac are taking shape. Fannie and Freddie have now paid the government back more than they have received in bailout funds since returning to profitability. Federal Reserve Chair Janet Yellen's comments from the last Federal Open Market Committee meeting have the market preparing for an anticipated rate hike in 2015, about six months after the expected end of the Federal Reserve's current quantitative easing program.

The Fate of Fannie and Freddie

Next month Fannie Mae and Freddie Mac, the two mortgage giants that were taken over by the Federal Government in 2008, will have paid back more money to the government than they received in the form of bailout funds during the great recession. Fannie and Freddie profit by buying mortgage loans from lenders, those who originally underwrite the mortgage, package bundles of loans into mortgage backed securities and sell them as investments to investors. However, Fannie and Freddie also provide guarantees that they will cover losses on the loans that they package which leaves them exposed to the health of the housing market and potential mortgage delinquencies. In September of 2008, when mortgage delinquencies were reaching epic proportions, the Government took over Fannie Mae and Freddie Mac after determining that they did not have enough cash set aside to cover mounting losses. Since that time, Fannie and Freddie have received a combined total of $187.5 billion in bailout funds. Both Fannie and Freddie have now returned to profitability as mortgage delinquencies have fallen and as of

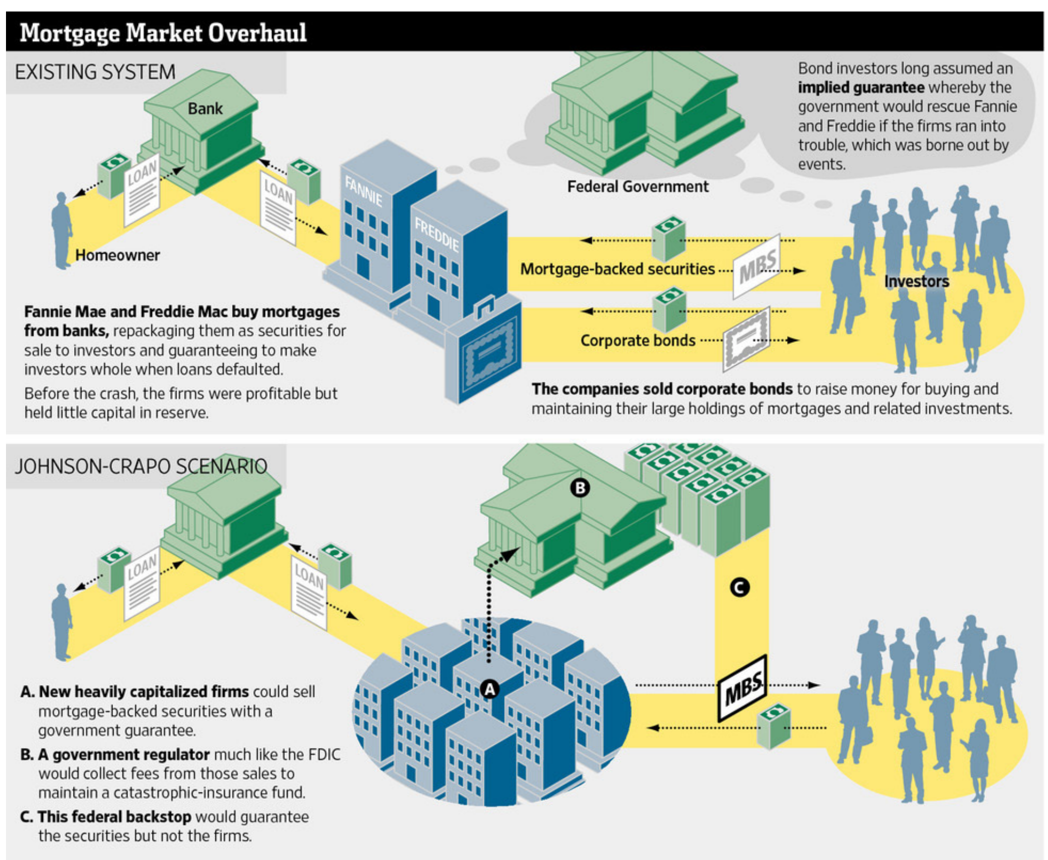
Idaho Trust Bank offers total wealth solutions including its LifeNeeds™ investing process. The LifeNeeds™ investment process utilizes proven strategies and techniques delivered by a highly trained staff of wealth management professionals.

LifeNeeds™ wealth management accounts feature optimized asset allocations, robust security screening and Idaho Trust's unique TacticLogic™ investment process. All of which are tailored to our clients' unique financial needs.



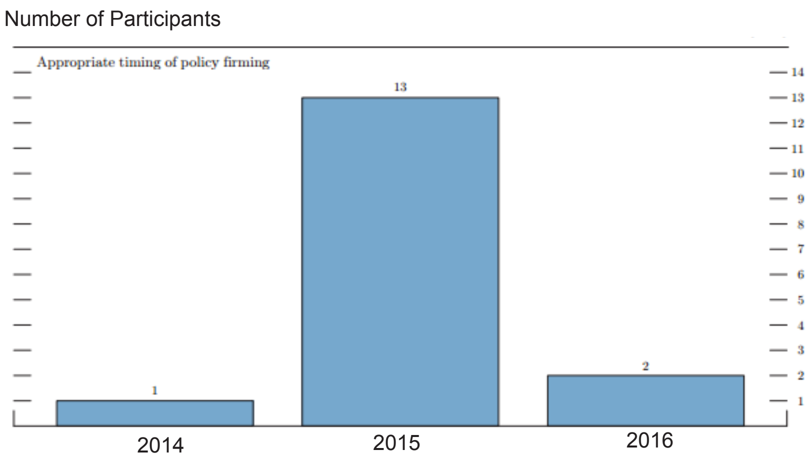
next month they will have paid back the Government $192.5 billion, which is more than the bailout funds that they received (see graphic). While still under Federal conservatorship, both Fannie and Freddie are required to pay their profits to the Government.

Recently, lawmakers are closing in on plans to restructure the mortgage giants and resolve one of the last items of unfinished business from the great recession. They are planning on unwinding the mortgage giants and overhauling the $10 trillion mortgage market. Although any concrete plans are far from formalized, current thinking suggests that they would unwind Fannie and Freddie and replace them with a system of private insurers. These private insurers could purchase a government guarantee for their mortgage securities but would be still be required to absorb any losses on the securities before the government. The fee collected by the government would go into a catastrophic-insurance fund to protect against future emergencies.



Federal Reserve's Comments

Short-term interest rates have been rising since the Federal Reserve's March meeting notes were released. Markets have speculated from these comments that the first interest rate hike may occur in 2015. Federal Reserve Chair Janet Yellen stated that the Federal Reserve may begin raising rates as soon as six months after it ends its current quantitative easing program. The Federal Reserve has been tapering its current quantitative easing program for some time now and it is projected that the program will terminate near the end of this year. Implied yields on federal percent futures traded show that the market is assigning a 64% probability of the first rate hike since 2008 to occur in June of 2015. Coinciding with that is the Federal Reserve's own economic projections that show the majority of Federal Reserve committee members are also expecting a rate hike in 2015 (see graphic).



The Federal Reserve

In anticipation of a rate hike, shorter-term interest rates, which are largely controlled by the Federal Reserve's primary monetary policy tool, the Fed funds rate, have risen. The U.S. treasury's 5-year yields have increased from 1.50% to 1.70% in one month. This rise in rates may create headwinds for the recovering economy as financing purchases will become more expensive. The housing market is especially vulnerable to rising interest rates. As interest rates increase, the interest rates for mortgages and thus the potential mortgage payments for potential home buyers would be higher, making purchasing a home more expensive or maybe too expensive for some potential buyers. As short-term interest rates have risen, it has caused the difference in the amount of yield offered by 30-year treasuries compared to the yield offered by 5-year treasuries to be the smallest amount in four years. It is also projected that the U.S. current 10-year treasury yield of 2.68% will rise to around 3.35% by year's end suggesting that rates still have room to rise.

Conclusion

Housing giants Fannie and Freddie's return to profitability are good signs. Hopefully soon we will see what lawmakers are planning for restructuring the mortgage market and what it will offer. In the coming months, the continued tapering from the Federal Reserve and the possible rise in the Federal Reserve's Fed Funds rate may have significant impacts on the bond market in the short-term. In the 4th quarter of 2013 the economy produced a GDP of 2.6% which was down from the 3rd quarter of 4.1% but still showed growth.

S&P 500 Index

3 Month	1.80%
Year-to-Date	1.80%
1 Year	21.83%
3 Year	14.61%
5 Year	21.12%

MSCI EAFE Net Index

3 Month	0.66%
Year-to-Date	0.66%
1 Year	17.56%
3 Year	7.21%
5 Year	16.01%

Barclays Aggregate Bond Index

3 Month	1.84%
Year-to-Date	1.84%
1 Year	-0.10%
3 Year	3.74%
5 Year	4.80%

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