



TWO HARBORS
Investment Corp.
A Pine River Capital Managed Company

Fourth Quarter 2013 Letter to Stockholders

NYSE: TWO



March 7, 2014

Dear Fellow Stockholders,

We are pleased with Two Harbors' accomplishments in 2013. We enjoyed both a strong total return on book value and significant sector outperformance. The year was also distinguished by noteworthy achievements related to our new investment initiatives. Comprehensive income for the year ended December 31, 2013 was \$327.3 million, or \$0.93 per diluted weighted average share, which represents a return on average equity of 8.5%. During the fourth quarter, we generated comprehensive income of \$171.4 million, or \$0.47 per diluted weighted average common share.

Our book value for the fourth quarter was \$10.56 per diluted common share, representing a 4.5% return on book value after accounting for a dividend of \$0.26 per share. Our philosophy of maintaining conservative exposure with regard to risk and leverage has served us well by driving solid returns for the year both on an absolute basis and relative to overall performance in the mortgage REIT sector. Our total return on book value in 2013 of 10.4%⁽¹⁾, after accounting for cash dividends of \$1.17 per share⁽²⁾, compares favorably to the Pine River™ Mortgage REIT Index total return of negative 5.9%⁽³⁾ for the same period. We are proud to have produced positive total return on book value every year since our inception, which is a testament to our rigorous security selection and sophisticated hedging.

For the year, we repurchased approximately 2.5 million shares of our common stock at a cost of \$23.9 million. With a total authorization to repurchase up to 25 million shares, we have considerable capacity to continue repurchasing our common stock and will evaluate share repurchases going forward based on other available investments.

There are a number of topical macroeconomic events that we monitor closely. Perhaps the most important topic currently is the potential impact of the Federal Reserve's reduction of its market participation, or "tapering." This will be a powerful determinant of outcomes within the mortgage REIT space during the upcoming year. Unemployment remains stubbornly high, although recent jobs reports show some strength in job creation. Employment data is an important factor within our non-Agency portfolio. Home prices continue to appreciate, which reduces probability of default and improves recoveries and is impactful on non-Agency performance. Non-Agency price appreciation was meaningful in 2013. In terms of policy updates, there have been a few changes in Washington. There is a new director of the Federal Housing Finance Agency, Mel Watt. Janet Yellen has replaced retired Federal Chairman Ben Bernanke. Following their respective organization's policy decisions will, of course, be important to our business going forward.

We achieved notable milestones in 2013 on a number of key strategic initiatives that we believe will increase Two Harbors' franchise value over the long term. In the second quarter, we acquired Matrix Financial Services Corp., which amongst other things, had the requisite approvals from the agencies (Fannie, Freddie, Ginnie) to acquire mortgage servicing rights (MSR). Concurrently, we received a private letter ruling from the IRS verifying that MSR were a "good" REIT asset in respect of tax regulations. MSR are attractive because they presently have a positive option-adjusted spread, mitigate spread risk and hedge interest rate exposure. In the fourth quarter, we completed both a substantial bulk purchase of MSR from Flagstar Bank and a flow sale agreement with PHH Mortgage.

In 2013, we completed two prime jumbo securitizations totaling over \$800 million, including the first using our own depositor. Both of these deals enabled us to invest in attractive credit and IO bonds. We now have more than 30 originators in various stages of approval, and continuing to expand our network of high-quality originators remains a key focus for 2014. Our team has formed a high-quality operational platform that spans many interrelated components of the mortgage market and gives us considerable investment flexibility for the future.

In December, our wholly owned subsidiary, TH Insurance Holdings Company LLC, was granted membership to the Federal Home Loan Bank of Des Moines. This membership provides a diversified funding source and increased portfolio flexibility through a variety of products and services provided by the FHLB. This financing is quite attractive for a number of assets, but especially residential mortgage loans and products of securitization.

The investments we made in 2013 have created the foundation necessary to support our MSR and conduit initiatives today, as well as advance them even further over the next several years. We have added more than 30 professionals to support both MSR and conduit activities, including technology, servicing and underwriting staff.

There is a commonality to the counterparties and administrative functions required to run conduit and MSR businesses, which promotes efficiency. Each is also a logical diversification of our legacy businesses and dovetail with our core competencies of managing interest rate and credit risk. We feel that they will also increase returns, dampen volatility and build franchise value as operating businesses.

With a market capitalization of \$3.8 billion⁽⁴⁾, we are the largest hybrid mortgage REIT focused on investing in residential mortgage assets. Two Harbors' mission is simple in nature, but the implementation is complex; we want to be recognized as the industry-leading mortgage REIT. We plan to ultimately accomplish this by optimizing shareholder value through rigorous risk management systems, strong administrative infrastructure, and best practice disclosure and corporate governance. In a challenging year across the board for mortgage REITs, Two Harbors again displayed alpha generation of our portfolio by outperforming the sector on a total return basis. Thank you for the confidence and enthusiasm demonstrated by your investment in Two Harbors Investment Corp.

As always, please let us know if you have questions or if we may be helpful in any way.

Sincerely,



Thomas Siering
President and Chief Executive Officer

- (1) Total return on book value is calculated from book value and dividends from the period of January 1 to December 31, 2013. Includes first quarter 2013 special dividend of Silver Bay common stock amounting to \$1.01 per share.
- (2) Two Harbors declared cash dividends to stockholders totaling \$427.1 million, or \$1.17 per share, not inclusive of the dividend of Silver Bay common stock amounting to \$343.5 million, or \$1.01 per share, for the year ended December 31, 2013.
- (3) Median total return on book value is calculated from book value and dividends from the period of January 1 to December 31, 2013. Pine River Mortgage REIT Index (PRMRI) calculation has been estimated after removing Two Harbors' total return. PRMRI constituents include: NLY, AGNC, HTS, CYS, ARR, CMO, MFA, IVE, ANH, MTGE, CIM, RWT, PMT, AMTG, MITT, DX, NYMT, WMC, NRZ. Fourth quarter consensus book value estimates used for: CIM, NYMT, WMC, NRZ.
- (4) Source: Bloomberg as of March 7, 2014

Forward-Looking Statements

This letter includes "forward-looking statements" within the meaning of the safe harbor provisions of the United States Private Securities Litigation Reform Act of 1995. Actual results may differ from expectations, estimates and projections and, consequently, readers should not rely on these forward-looking statements as predictions of future events. Words such as "expect," "target," "assume," "estimate," "project," "budget," "forecast," "anticipate," "intend," "plan," "may," "will," "could," "should," "believe," "predicts," "potential," "continue," and similar expressions are intended to identify such forward-looking statements. These forward-looking statements involve significant risks and uncertainties that could cause actual results to differ materially from expected results, including, among other things, those described in our Annual Report on Form 10-K for the year ended December 31, 2013 and any subsequent Quarterly Reports on Form 10-Q, under the caption "Risk Factors." Factors that could cause actual results to differ include, but are not limited to, higher than expected operating costs, changes in prepayment speeds of mortgages underlying our residential mortgage-backed securities, the rates of default or decreased recovery on the mortgages underlying our non-Agency securities, failure to recover credit losses in our portfolio, changes in interest rates and the market value of our assets, the availability of financing, the availability of target assets at attractive prices, our ability to manage various operational risks associated with our business, our ability to maintain our REIT qualification, limitations imposed on our business due to our REIT status and our exempt status under the Investment Company Act of 1940, the impact of new legislation or regulatory changes on our operations, the impact of any deficiencies in the servicing or foreclosure practices of third parties and related delays in the foreclosure process, our ability to acquire mortgage loans or securitize the mortgage loans we acquire, our involvement in securitization transactions, the timing and profitability of our securitization transactions, the risks associated with our securitization transactions, our ability to acquire mortgage servicing rights, the impact of new or modified government mortgage refinance or principal reduction programs, unanticipated changes in overall market and economic conditions, and our exposure to claims and litigation, including litigation arising from our involvement in securitization transactions.

Readers are cautioned not to place undue reliance upon any forward-looking statements, which speak only as of the date made. Two Harbors does not undertake or accept any obligation to release publicly any updates or revisions to any forward-looking statement to reflect any change in its expectations or any change in events, conditions or circumstances on which any such statement is based. Additional information concerning these and other risk factors is contained in Two Harbors' most recent filings with the Securities and Exchange Commission (SEC). All subsequent written and oral forward looking statements concerning Two Harbors or matters attributable to Two Harbors or any person acting on its behalf are expressly qualified in their entirety by the cautionary statements above.