TWO HARBORS
Investment Corp.
A Pine River Capital Managed Company

Second Quarter 2014 Letter to Stockholders

NYSE: TWO

August 13, 2014

Dear Fellow Stockholders,

The second quarter of 2014 was an excellent quarter -for the company. Our book value for the second quarter was $11.09 per diluted common share, thus representing a 6.0% return on book value after accounting for a dividend of $0.26 per share.[1] This brings our total return on book value for the first six months of the year to 9.9%.[1] Over the last twelve months, we have delivered a total return on book value of 16.0% which we are proud of considering the volatility in the interest rate environment.[1] Comparatively, the 10-year treasury has returned only 3.7% during the same time period.[2] Our performance illustrates our investment team's ability to manage our portfolio and generate alpha across various rate and mortgage environments. In the quarter, we also delivered Comprehensive Income of $230.8 million, or $0.63 per diluted weighted average share, which represents a return on average equity of 23.0%.

Another highlight from the quarter is the considerable progress we made on our mortgage loan conduit and mortgage servicing rights (MSR) platforms. Our conduit pipeline continues to gain momentum. At quarter-end, we had over $1 billion of prime jumbo holdings and pipeline locks on a combined basis, up from approximately $300 million at the end of the first quarter. This success demonstrates the work we have done advancing our existing originator relationships, and we are identifying additional candidates for inclusion in our pipeline. Subsequent to quarter-end, we completed a securitization, Agate Bay Mortgage Trust 2014-1. After completing this deal, the company's prime jumbo holdings and pipeline totaled approximately $1 billion, as of August 6. We intend to complete other securitizations as market conditions permit. From a financing perspective, we expect to continue utilizing funding from the Federal Home Loan Bank of Des Moines to support our conduit activities, which will allow us to provide consistent pricing to our originator partners and is an important way for us to optimize our overall funding mix.

We are continuing to explore opportunities to add MSR on a flow and bulk basis from a variety of partners. In the second quarter, we completed a bulk acquisition of MSR from Flagstar Bank, FSB and continued to acquire MSR through our flow-sale arrangement with PHH Corp. Going forward, we expect to see opportunities in the MSR sector for both flow-sale arrangements and bulk transactions through our originator relationships. As we have said in the past, we are focused primarily on new production MSR given its attractive yield and hedge benefits to our portfolio.

Both our Rates[3] and Credit[4] strategies performed well during the second quarter. Agency RMBS benefitted from tighter spreads in the quarter and non-Agency RMBS continued to appreciate. This quarter, we wanted to take an in-depth look at the performance of our non-Agency portfolio by putting together a webinar as a case study for how home price appreciation (HPA) has impacted the performance of one of the bonds in our portfolio. The webinar can be found at www.twoharborsinvestment.com under the "Investors" and "Webinars" links. This webinar profiles a subprime bond that we held in our portfolio for several years and have referred to in past webinars and presentations. We recently sold this bond at a price close to par, which we were happy about as we had purchased it at a significant discount. That said, home prices remain well off peak levels and coupled with low mortgage rates and other factors, has contributed to high home affordability. This data indicates that upside potential remains for deeply discounted non-Agency RMBS.

There are a number of macroeconomic events and legislative proposals that could impact our business. Unemployment figures improved during the quarter, dropping to 6.1% in June. This metric, coupled with continued positive home price appreciation, creates an improving foundation for the performance of our Credit strategy. (4) The Federal Reserve has announced that they intend to fully end its quantitative easing program after the October 2014 meeting, assuming the economy progresses as expected. The Federal Reserve also noted that it would likely maintain its current Fed Funds target range of 0.00% to 0.25% for a considerable time after the program ends, especially if inflation remains below the 2.0% target. We believe the end of the Federal Reserve's accommodative policy will likely continue to impact the mortgage-backed securities market in the coming months.

The future role of the GSEs remains a popular topic in Washington, as a number of proposals have been presented over the past few months regarding GSE reform. That being said, there is widespread recognition of the need for private capital to support the U.S. housing market. We believe that permanent capital providers, such as mortgage REITs like Two Harbors, can play an integral role in reducing the government's footprint in the mortgage market. To that end, we have maintained a dialogue with many in Washington to help create solutions to the challenges facing the mortgage market.

We believe that Two Harbors distinguishes itself through alpha generation and best-in-class governance practices. We continue to innovate and grow our business prudently and incrementally. We feel the future is very bright.

Thank you for your interest in Two Harbors.

Sincerely,

Thomas Siering
President and Chief Executive Officer

(1) Total return on book value is calculated as the increase in book value, plus dividends declared, for the indicated time period as measured from June 30, 2014.
(2) Source: Bloomberg as of June 30, 2014.
(3) Assets in "Rates" include Agency RMBS, Agency Derivatives (inverse interest-only securities) and MSR.
(4) Assets in "Credit" include non-Agency RMBS, prime jumbo residential mortgage loans, net economic interest in securitization trusts and credit sensitive loans.