TWO HARBORS
Investment Corp.
A Pine River Capital Managed Company

Third Quarter 2014 Letter to Stockholders

NYSE: TWO

November 21, 2014

Dear Fellow Stockholders,

Two Harbors had an excellent third quarter of 2014. We are pleased to report that our book value for the quarter was $11.25 per diluted common share, representing a 3.8% return on book value after accounting for a dividend of $0.26 per share.(1) Performance in the quarter was driven by strong returns in both our Rates(2) and Credit(3) strategies, despite our defensive portfolio positioning and low leverage profile. This brings our total return on book value for the first nine months of the year to 13.9%(1). 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%.

Both our Rates(2) and Credit(3) strategies performed well during the third quarter. Notably, within the Credit(3) strategy, we achieved several meaningful accomplishments with regards to our mortgage loan conduit. We closed two securitizations and, after completing these deals, the company's prime jumbo holdings and pipeline was approximately $770 million. Our pipeline is robust and we intend to complete other securitizations as market conditions permit. We are also pleased to announce that subsequent to quarter-end we began working with our originator partners on high-LTV and non-Prime mortgage loan products. There continues to be a huge national cohort of people able to responsibly purchase a home that simply have been unable to get a mortgage heretofore. These products are intended to expand the availability of mortgage credit to such borrowers. This is an exciting development for our business. The success of our mortgage loan conduit demonstrates the work we have done advancing our existing originator relationships and we are identifying additional candidates for inclusion in our program.

Legacy and new issue non-Agency yields were generally consistent with the second quarter, while legacy non-Agency bond price appreciation contributed to our book value performance. Our Credit(3) portfolio remains weighted toward legacy non-Agency securities, particularly subprime. As you may recall, last quarter we released a webinar on housing price appreciation (HPA) and its effect on this market and we maintain our belief that upside optionality remains for deeply discounted non-Agency securities as the economy and housing market continue to improve. Unemployment figures during the quarter dropped to 5.9% in September. Additionally, CoreLogic reported that home prices were up 6.4% on a rolling 12-month basis as of August 31, 2014. These metrics are tailwinds for an improving foundation for the performance of our Credit strategy.(3)

The Rates(2) strategy was driven largely by our positioning in shorter duration assets and from a curve flattening bias in our rate hedges. In general, opportunities in Agency securities space remained limited during the quarter and, as such, we continue to have low leverage on our Agency RMBS portfolio. We are also keeping our basis risk exposure low and are protected against the impact of potentially wider spreads in the future. As always, we hedge prudently to preserve book value, which is in the best interest of our stockholders.

Mortgage servicing rights (MSR) continue to be an excellent asset for our portfolio on a yield basis and as a hedge to mitigate interest rate and spread risk. We have made, and will continue to make, a concerted effort to position our MSR portfolio for long term growth and we continue to explore opportunities to add MSR on a flow and bulk basis from a variety of partners.

As expected, the Federal Reserve announced the final reduction in its asset purchases following its October meeting. Despite the end of quantitative easing (QE), it appears the Federal Reserve will continue to make significant reinvestments of mortgage-backed securities (MBS) paydowns for the foreseeable future. The Federal Reserve has also made dovish commentary, which suggests that it will not raise interest rates until the economy can support it; however, the timing of this remains unclear. We believe the end of the Federal Reserve's accommodative policy will likely continue to impact the MBS market in the coming months.

There are a number of legislative proposals that have the potential to impact our business in the future, including the FHFA's proposed rulemaking regarding membership in the FHLB system. Obviously, we are disappointed with this proposed change that would preclude "captive" insurers such as ours from FHLB membership. We have a strong relationship with the FHLB Des Moines and we feel our mission aligns perfectly with that of the FHLB system. Additionally, we believe that our secured financings are consistent with their safety and soundness mantra. Even if the rulemaking were to be implemented in its current form, final rules would not take effect for some time. We plan to submit a response during the comment period, which was recently extended to early 2015, possibly indicating that a large number of constituents plan to weigh-in on this important matter affecting housing.

As most would agree, the health of the housing market heavily influences the psyche of our country. With the multitude of policy and regulatory considerations percolating in Washington, we consciously increased our efforts to engage on these topics. In September, we hired Beth Mlynarczyk to serve as our Vice President-Policy and Strategy. Ms. Mlynarczyk was formerly with the Treasury Department, and she will help guide us on policy matters. We believe mortgage REITs like Two Harbors, as a source of permanent capital to the U.S. housing market, will play an integral part in providing stability over the long term. Two Harbors continues to distinguish itself through a hybrid investment approach, which enables us to opportunistically shift our asset allocation, driving stockholder returns and building franchise value.

Thank you for your interest in Two Harbors.

Sincerely,

Thomas Siering
President and Chief Executive Officer

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