TWO HARBORS
Investment Corp.
A Pine River Capital Managed Company

Second Quarter 2017 Letter to Stockholders

NYSE: TWO

August 29, 2017

Dear Fellow Stockholders,

Two Harbors delivered a strong second quarter while taking key steps to maximize shareholder value. We generated quarter-over-quarter increases in both Comprehensive Income and Core Earnings, and delivered a total return on book value of 2.2%[1]. These results were driven by solid performance across our strategies, as our team took advantage of market opportunities. Our performance this quarter again demonstrates the benefit of our hybrid model and our ability to deliver strong returns for stockholders.

The most notable highlight of the quarter was the formation of Granite Point Mortgage Trust Inc. (Granite Point) as a standalone publicly-traded company for our commercial real estate business. Granite Point began trading on the New York Stock Exchange on June 23rd under the ticker symbol “GPMT.” We believe that the creation of Granite Point will better reflect the embedded value in the commercial business that we built over the past two and a half years. In exchange for contributing our portfolio of commercial real estate assets, Granite Point issued to Two Harbors approximately 33.1 million shares of common stock of Granite Point. Subject to the approval of our Board of Directors, it is our intention to distribute these shares to Two Harbors’ common stockholders by means of a special dividend following the expiration of a 120-day lockup period. Prior to this distribution, Granite Point will remain a majority-owned subsidiary of Two Harbors and its financial results will be included in our consolidated financial statements.

Additionally, we continue to use our balance sheet to benefit stockholders. Post quarter-end, we were able to successfully access the preferred equity markets through the offering of our Series B preferred shares. The underwriters exercised their full overallotment option, resulting in total offering proceeds, net of offering costs, of approximately $278 million. We intend to use the proceeds from this offering to invest in Agency residential mortgage-backed securities (RMBS), mortgage servicing rights (MSR) and Credit[3] assets. We also believe this capital raise will be accretive to our earnings.

Our objective in our Rates[2] strategy is to provide strong returns through a variety of rate environments, and a core component of this strategy is our investment in mortgage servicing rights. We believe that the combination of Agency RMBS and MSR drives a higher return with less basis risk than Agencies hedged only with swaps. This is important given it is widely anticipated that the Federal Reserve will reduce their reinvestments in Agency RMBS [over time], which will likely cause mortgage spreads to widen. MSR provides an advantage to our portfolio in this scenario, as it benefits from wider mortgage spreads, thus mitigating the potential impact to our book value. We intend to continue to grow MSR as a part of our Rates[2] strategy going forward.

Our Credit[3] strategy continues to benefit from fundamental improvement in the housing market and positive market technicals. Housing prices are up 6.7%[4] on a rolling 12-month basis, which is supported by the tailwinds of affordability, low housing supply and strong demand. These tailwinds are quite meaningful, and we believe future residential credit performance will continue to be strong, driven by increasing prepayments, lower delinquencies, defaults and loss severities. To benefit from this, we have positioned our portfolio primarily into deeply-discounted, pre-crisis assets due to the upside that these assets can realize from improving performance. To emphasize this point, we continue to realize both better credit performance and faster prepayments than our initial expectations, and as a result of this, in the quarter we released another $13.9 million in credit reserves against this portfolio, bringing the total amount of credit reserves released over the past 12 months to $38.2 million. We continue to see opportunity to realize strong returns in this sector and have used some of the proceeds from the preferred stock offering in the third quarter to purchase similar bonds with upside potential.

We believe that we are in an excellent position for the future. Our team continues to execute on our previously articulated plan for 2017, which is focused on running a more efficient business model and maximizing returns for our stockholders. Through close attention to asset selection, we opportunistically allocate capital to the most attractive investment opportunities across our Rates(2) and Credit(3) strategies. We continue to find ways to diversify our financing profile and manage our balance sheet and capital structure to optimize earnings and shareholder returns. Most importantly, we believe that our sophisticated and disciplined approach to risk management, of which MSR is a key component and a distinguishing factor, allows us to deliver strong results and book value stability through a variety of rate environments.

Thank you for your interest in and support of Two Harbors.

Sincerely,

Thomas Siering
President and Chief Executive Officer

(1) Return on book value for the quarter ended June 30, 2017 is defined as the decrease in book value per common share from March 31, 2017 to June 30, 2017 of $0.04 per common share, plus the dividend declared of $0.26 per common share, divided by March 31, 2017 book value of $9.91 per common share.
(2) Assets in “Rates” include Agency RMBS, Agency Derivatives, MSR and Ginnie Mae buyout residential mortgage loans.
(3) Assets in “Credit” include non-Agency MBS, net economic interests in securitization trusts, prime jumbo residential mortgage loans and credit sensitive residential mortgage loans.
(4) Source: CoreLogic Home Price Index rolling 12-month change as of June 2017.

Forward-Looking Statements
This presentation 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
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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, 2016, 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: the state of credit markets and general economic conditions; changes in interest rates and the market value of our assets; changes in prepayment rates of mortgages underlying our target assets; the rates of default or decreased recovery on the mortgages underlying our target assets; the occurrence, extent and timing of credit losses within our portfolio; the concentration of credit risks we are exposed to; declines in home prices; our ability to establish, adjust and maintain appropriate hedges for the risks in our portfolio; the availability and cost of our target assets; the availability and cost of financing; changes in the competitive landscape within our industry; our ability to effectively execute and to realize the benefits of strategic transactions and initiatives we have pursued or may in the future pursue; our ability to manage various operational risks and costs associated with our business; interruptions in or impairments to our communications and information technology systems; our ability to acquire mortgage servicing rights (MSR) and successfully operate our seller-servicer subsidiary and oversee our subservicers; the impact of any deficiencies in the servicing or foreclosure practices of third parties and related delays in the foreclosure process; the state of commercial real estate markets; our anticipated distribution of Granite Point shares to the holders of our common stock; our exposure to legal and regulatory claims; legislative and regulatory actions affecting our business; the impact of new or modified government mortgage refinance or principal reduction programs; our ability to maintain our REIT qualification; and limitations imposed on our business due to our REIT status and our exempt status under the Investment Company Act of 1940.
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.