TWO HARBORS
Investment Corp.
A Pine River Capital Managed Company

Third Quarter 2017 Letter to Stockholders

NYSE: TWO

December 13, 2017

Dear Fellow Stockholders,

We delivered a strong third quarter, generating an economic return of 4.6%[1]. Our performance demonstrates the benefit of our hybrid model and the execution on our previously articulated plan for 2017, which is centered on maximizing stockholder returns through running a more focused business model, while maintaining a sophisticated approach to risk management.

Most notably, aligned with our plan, we formed Granite Point Mortgage Trust Inc. (NYSE: GPMT) ("Granite Point"). We believe that creating a standalone vehicle for our commercial business will better reflect the embedded value in the platform that we had established in 2015. We are pleased to announce that subsequent to quarter-end, on November 1st, we completed the distribution of the 33.1 million shares of common stock of Granite Point that we acquired in connection with the contribution of our commercial real estate portfolio to Granite Point. Concurrent with the distribution, we also effected a one-for-two reverse stock split of our common stock. We believe that the reverse stock split will make our stock more broadly available to investors, as a double digit stock price is preferable for many institutional holders, and will likely improve the marketability and liquidity of our stock.

Additionally, we took advantage of opportunities to enhance our balance sheet and capital structure to benefit stockholders. Specifically, as of the date of this letter, we had successfully executed a convertible debt and three preferred stock offerings in 2017. We believe these offerings will be accretive to our earnings going forward. We continue to focus on the diversification of our financing profile through traditional repurchase agreements, FHLB advances, revolving credit facilities and the convertible senior notes. We are particularly excited to announce that post quarter-end we closed a $300 million mortgage servicing rights (MSR) financing facility with a large banking counterparty. We believe this facility will allow us to continue to grow our MSR portfolio with potentially higher returns.

Turning to our portfolio, we maintain two core strategies: Rates[2] and Credit[3]. These strategies are rooted in our core competencies of understanding and managing interest rate, mortgage prepayment and credit risks. Our objective in our Rates[2] strategy is to provide strong returns through a variety of rate environments. MSR is a key component of this. We believe that the combination of Agency residential mortgage-backed securities (RMBS) and MSR drives a higher return with less basis risk than Agencies hedged only with swaps. With the Federal Reserve reducing its RMBS reinvestments, it is estimated that over $400 billion of net supply of Agency RMBS will need to be absorbed by the market in 2018[4]. This will likely cause mortgage spreads to widen, which has the potential to hurt mortgage REIT book values. In this scenario, MSR is a significant benefit to our portfolio because it increases in value when mortgage spreads widen. Pairing MSR with Agencies therefore positions us to protect book value in a spread-widening environment. Yet, at wider spreads, we also believe there could be a tremendous investment opportunity to add Agencies.

Our Credit[3] strategy continues to realize benefits from fundamental improvement in the housing market and the overall economy. Yields have been strong and bond prices have improved during 2017. We expect future residential credit performance to remain strong, driven by increasing prepayments and lower delinquencies, defaults and severities. To take advantage of this, we have kept our portfolio positioned primarily in deeply-discounted legacy non-Agency assets. Potential price appreciation, as a result of these tailwinds, in turn could positively affect book value. Given our expectation for continued improvement in residential credit metrics for legacy assets, including increasing prepayments, we believe that the opportunity still exists for strong total returns going forward.

The execution of our plan in 2017 has manifested itself through Core Earnings[5] growth, book value stability and three dividend increases. Since inception in 2009, we have grown book value by 10.6%, compared to our peer median over the same time period of (21.8%)[6]. Importantly, this book value growth has been accomplished with significantly less volatility than the peer group. Additionally, since inception, we have paid out $20.00 per share of common stock dividends with an average dividend yield of 13%.

Going forward, our vision for Two Harbors is simple: we intend to be the industry leading hybrid mortgage REIT. With this in mind, we believe that focusing our business model on our residential Rates[2] and Credit[3] strategies allows us to run a more focused business. Through close attention to asset selection, we will opportunistically allocate capital to the most attractive investment opportunities across our strategies. Additionally, we will continue to diversify our financing profile and manage our capital structure to optimize earnings and stockholder returns. Historically, higher interest rates have been the bane of mortgage REITs. However, we believe that our rigorous approach to risk management, of which MSR is a distinguishing factor, will allow us to deliver strong results and book value stability through a variety of interest rate environments. As the Fed becomes less aggressive with their reinvestments in Agency RMBS, we think this creates a lot of opportunity for our company going forward.

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

Sincerely,

Thomas Siering
President and Chief Executive Officer

Note: On November 1, 2017, the company completed its previously announced one-for-two reverse stock split of its outstanding shares of common stock. In accordance with generally accepted accounting principles, all common share and per common share amounts presented herein have been adjusted on a retroactive basis to reflect the reverse stock split.

(1) Return on book value for the quarter ended September 30, 2017 is defined as the increase in book value per common share from June 30, 2017 to September 30, 2017 of $0.38, plus the dividend declared of $0.52 per common share, divided by June 30, 2017 book value of $19.74 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: J.P. Morgan and Citi research.
(5) Core Earnings is a non-U.S. GAAP measure that we define as comprehensive income attributable to common stockholders, excluding “realized and unrealized gains and losses” (impairment losses, realized and unrealized gains or losses on the aggregate portfolio, reserve expense for representation and warranty obligations on MSR, certain upfront costs related to securitization transactions, non-cash compensation expense related to restricted common stock, restructuring charges and transaction costs related to Granite Point’s initial public offering). As defined, Core Earnings includes interest income or expense and premium income or loss on derivative instruments and servicing income, net of estimated amortization on MSR. We believe the presentation of Core Earnings provides investors greater transparency into our period-over-period financial performance and facilitates comparisons to peer REITs.
(6) Book value growth measured from December 31, 2009 through September 30, 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; 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.