THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

TWO - Q1 2016 Two Harbors Investment Corp Earnings Call

EVENT DATE/TIME: MAY 05, 2016 / 1:00PM GMT

CORPORATE PARTICIPANTS

July Hugen *Two Harbors Investment Corp. - Director of IR*

Tom Siering *Two Harbors Investment Corp. - President & CEO*

Brad Farrell *Two Harbors Investment Corp. - CFO & Treasurer*

Bill Roth *Two Harbors Investment Corp. - Chief Investment Officer*

CONFERENCE CALL PARTICIPANTS

Douglas Harter *Credit Suisse - Analyst*

Eric Hagen *Keefe, Bruyette & Woods - Analyst*

Mark DeVries *Barclays - Analyst*

Trevor Cranston *JMP Securities - Analyst*

Joel Houck *Wells Fargo Securities, LLC - Analyst*

Jessica Ribner *FBR Capital Markets & Co. - Analyst*

Brock Vandervliet *Nomura Securities Intl - Analyst*

PRESENTATION

Operator

Good day ladies and gentlemen and welcome to the Two Harbors Investment Corporation first-quarter 2016 financial results conference call.

(Operator Instructions)

As a reminder, this conference is being recorded. And now I'd like to turn the conference over to our host July Hugen, Director of Investor Relations. You may begin.

July Hugen - *Two Harbors Investment Corp. - Director of IR*

Thank you, Tawanda and good morning. Welcome to our first-quarter 2016 financial results conference call.

With me this morning are Tom Siering, President and Chief Executive Officer; Brad Farrell, Chief Financial Officer; and Bill Roth, Chief Investment Officer. After my introductory comments Tom will provide a recap of our quarterly results, Brad will highlight some key items from our financials and Bill will review our portfolio performance.

The press release and financial tables associated with today's conference call were filed yesterday with the SEC. If you do not have a copy you may find them on our website and the SEC's website.

This call is being broadcast live over the Internet and may be accessed on our website in the Investor Relations section under the Events and Presentations link. We encourage you to reference the accompanying presentation to this call which can be found on our website in the same location. Reconciliation of non-GAAP financial measures to GAAP can also be found in the appendix of the accompanying presentation.

We wish to remind you that remarks made by management during this conference call and the supporting slide presentation may include forward-looking statements. Forward-looking statements reflect our views regarding future events and are typically associated with the use of words such as anticipate, target, expect, estimate, believe, assume, project and should or other similar words.

We caution investors not to rely unduly on forward-looking statements. They imply risks and uncertainties and actual results may differ materially from expectations.

We urge you to carefully consider the risks described in our filings with the SEC which may be obtained on the SEC's website at www.SEC.gov. We do not undertake any obligation to update or correct any forward-looking statements if later events prove them to be inaccurate.

I will now turn the call over to Tom.

Tom Siering - *Two Harbors Investment Corp. - President & CEO*

Thank you, July, and good morning everyone. Let's begin with a brief summary of our first-quarter financial results as detailed on slide 3. In the first quarter core earnings were $0.21 per weighted average share, while we incurred a GAAP loss of $0.25 per weighted average share.

We realized a comprehensive loss of $67.6 million or $0.19 per share. Book value at March 31 was $9.70 per share which represents a total return on book value of negative 1.8% for the quarter.

During the quarter we repurchased 8.0 million shares representing 2.3% of common shares outstanding as of December 31st, 2015 at an average purchase price of $7.64 per share. This was accreted to book value.

50.9 million shares remain available for repurchase under our existing program. We continue to evaluate share buybacks with considerations to a number of factors, including balancing the prevailing share price to book and available investment alternatives.

Turning to Slide 4, in the first quarter we closed on three commercial real estate assets and we are continuing to see attractive opportunities in the sector. The fundamentals of commercial real estate market are strong and lending standards remain prudent.

Moving to MSR, we're seeing ample opportunity to add to our portfolio. Our focus continues to be on adding flow MSR and in the quarter we added four sellers.

Recently we saw a pickup in monthly volume. We also continue to evaluate bulk purchases and closed on one bulk deal.

With respect to the mortgage loan conduit, we sponsored two securitizations in the first quarter, with a total UPB of approximately $628 million.

The mortgage market is temporal. In the first quarter we saw an opportunity to add some Agency RMBS to our portfolio at attractive spreads. Bill will expand upon this shortly.

Moving to slide 5, let's briefly review the macroeconomic environment and some of our and the macroeconomic environment. In the first quarter interest rates moved lower as the Fed's commentary indicated caution with regard to future rate hikes. Currently, the market suggests there is a 14% chance of a June rate hike and a 45% probability of a September rate hike.

Whatever the future holds, lower for longer seems increasingly likely. We are optimistic about the current investment landscape, particularly for commercial real estate and MSR as these asset classes have appealing return profiles.

One of the benefits of our recent conservative risk positioning and low leverage is we are able to take advantage of better investment opportunities when they arise. We deployed capital to these investments in the first quarter, which should drive returns for stockholders.

I will now turn the call over to Brad.

Brad Farrell - *Two Harbors Investment Corp. - CFO & Treasurer*

Thank you, Tom. Let's turn to Slide 6.

As Tom noted, book value ended the quarter at $9.70 per share compared to $10.11 at December 31st, and we declared a $0.23 per share dividend.

We incurred a comprehensive loss which is primarily driven by unrealized losses in our interest rate swaps and swaptions and on MSR, partially offset by gains on our Agency securities. Stock repurchases in the quarter were accreted to book value by over $0.05 per share.

Please turn to Slide 7. Core earnings were $0.21 per share in the first quarter, representing a $0.01 per share increase over the prior quarter as we benefited from the deployment of capital into Agency RMBS, MSR and commercial real estate on a smaller capital base due to share repurchases. On the right-hand side of this page we have provided a detailed quarter-over-quarter analysis of core earnings.

Please turn to Slide 8 for an overview of our financing profile. During the first quarter, we secured a second $250 million facility for senior commercial real estate loans, further expanding our financing capability. Our debt-to-equity on commercial real estate assets was 1.3 times at March 31st, up from about 0.7 times at December 31. We expect our debt-to-equity ratio to trend higher as we fully utilize these facilities.

Our FHLB advances totaled $4.0 billion at March 31st with a weighted average borrowing rate of 0.59%. In the quarter, we added senior commercial real estate collateral with an amortized cost of $168.4 million, bringing our total pledged amount to $421.2 million.

Our repurchase agreements totaled $6.2 billion at March 31st, up from $5.0 billion at December 31st due to the purchase of Agency RMBS securities. Importantly, the repo market for RMBS continues to function efficiently in a normal manner for us. We have 20 active counterparties and continue to ladder our repo maturities to protect against the disruption in our financing.

Subsequent to quarter-end we introduced direct lending with one counterparty. We believe this can further diversify our funding sources as well as lower our overall repo costs.

As exemplified by the addition of a second commercial real estate financing facility and the introduction of direct lending, we continue to focus on diversifying our financing profile. With a wide variety of available tools, we believe that we have the ability to navigate various regulatory and market impacts on financing. We have provided some additional details on our borrowings on Appendix Slide 25.

I will now turn the call over to Bill for a portfolio update.

Bill Roth - *Two Harbors Investment Corp. - Chief Investment Officer*

Thanks, Brad. Turning to Slide 9, let's review our portfolio performance and yields.

Our annualized net interest spread was 3.37%, up 11 basis points from the fourth quarter. Net interest spread was positively impacted by solid IO and MSR performance and strong yields across our Credit and Commercial strategies.

Agency and Credit spreads widened in the quarter, which was a negative for book value but advantageous for putting capital to work. We took this opportunity to increase our debt-to-equity from 2.5 to 3 times, taking advantage of wider Agency spreads, while still maintaining low overall interest-rate exposure.

Please turn to Slide 10. As of March 31st, the portfolio was $12.2 billion in assets with roughly 56% of capital allocated to the Rate strategy, 33% to credit and 11% to commercial. While we have indicated that we anticipate our capital allocation to Agency and legacy non-Agency RMBS to generally move lower over time, this quarter we added about $3.4 billion in Agencies, on a net basis, in both pool and TBA form, as spreads became attractive during the quarter.

Our capital allocation to Agencies moved back into the low 40s, consistent with levels throughout most of 2015. Our increased holdings were predominantly 30-year pools as we believe they provide the best value and are also a good hedge to our growing MSR investments.

On the Credit side, while we continue to selectively sell certain non-Agencies that we believe had reached full value; we are still seeing good tailwinds to this strategy. The combination of strong employment statistics and low gas prices bode well for legacy RMBS borrowers, particularly in the subprime space. Additionally, due to continued HPA and low interest rates we are seeing favorable prepayment speeds and fewer delinquencies, both of which benefit discounted non-Agency bonds.

Capital to the conduit decreased in the quarter due to lower lock volume and the sale of some previously retained Agate Bay bonds, while the commercial real estate capital allocation continues to grow moving up to 11% from 8% at December 31st of 2015.

Now, let's move to Slide 11. Our investments in commercial real estate continued to grow as we added three assets, bringing the total carrying value to $744 million. The assets in our portfolio are secured by a diverse group of properties located throughout the U.S., with an average initial LTV of 73% and average spread of LIBOR plus 496 basis points.

Opportunities in the commercial market remain quite attractive with a wave of impending maturities in the next few years and high transaction volumes occurring. Meanwhile, traditional lenders are more constrained by regulatory requirements and there is continuing disarray in the CMBS market. This is leading more borrowers to look to balance sheet lenders like us to provide them with financing.

As a result, today we are able to make loans at wider spreads but with the same or lower LTVs than even six months ago. Given the attractiveness of commercial real estate, it is our anticipation that we will continue to deploy capital to this strategy after completing our initial $500 million equity commitment sometime in the third quarter.

Post quarter-end, we closed on another two loans for $125 million, bringing our total holdings to about $870 million. At the end of April, we had deployed close to $400 million of equity capital to the commercial strategy.

Turning to Slide 12, this was an exciting quarter for MSR, as we increased our portfolio to $55 billion UPB, via both flows sale arrangements and a bulk purchase. Notably, our MSR flow volume has increased significantly in the last few quarters, as you can see in the chart on the bottom of this slide.

We anticipate that near-term flow sale volumes will be around $1.5 billion to $2 billion per month, demonstrating the benefit of our focus on adding flows sale partners. This will allow us to continue to improve the economics of our Rates strategy.

MSR realized an attractive 8.1% yield in the quarter, which doesn't take into account -- into consideration the hedging benefit. While we expect yields to be impacted by prepay speeds in the future, we are pleased with this first quarter result.

On the conduit, our Agate Bay brand continues to gain traction with investors and we are seeing both repeat and new investors in our program. In the first quarter, we sponsored two securitizations, selling senior AAA bonds, while retaining the attractive credit pieces.

As you may recall, we had opted to retain some AAA rated bonds from some prior securitizations due to where spreads were when those deals came to market. With improvement in AAA spreads late in the quarter, we sold some of these to meet market demand. Spreads continued to improve in April, allowing us to continue this trend.

As I noted earlier, the capital allocation to the conduit was lower this quarter, primarily due to the AAA bond sales, but also due to much lower lock volumes, which over the last six months have decreased materially. The combination of regulatory constraints like TRID and competitive pricing from the big banks have led to a challenging market environment for aggregating loans for securitization. Our pipeline of prime jumbo loans and interest rate lock commitments with $558 million UPB at March 31st.

We are excited about the opportunities that we are seeing available in the market today, particularly as our hybrid model allows us to opportunistically allocate capital to the most attractive investments. While first quarter spread widening hurt our book value, we increased our leverage to invest in Agency bonds and take advantage of the wider spreads in that sector.

We have further increased our leverage post quarter-end as we converted some of our TBA positions into pools and have continued to invest in other attractive sectors, particularly commercial real estate and MSR. We expect that this will drive earnings throughout the remainder of the year.

I will now turn the call back over to Tawanda for Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Douglas Harter, Credit Suisse.

Douglas Harter - *Credit Suisse - Analyst*

Thanks. Bill, I was hoping you could talk about the types of returns you saw in Agency that kind of led you to add to those assets and how that compares to returns in the other businesses right now?

Bill Roth - *Two Harbors Investment Corp. - Chief Investment Officer*

Hey, good morning Doug, thanks for joining us. Yes, so just I mean to give some color, nominal Agency spreads got to the cheapest levels in five years during the first quarter and we viewed that as a great opportunity to add. As you know our Agency and overall leverage has been low as we didn't really like spreads, but things are more interesting now.

We've been on defense for quite a while, which has been the right thing to do. But honestly it's fun to be on offense for a change.

So, what happened was when Agency spreads and other spreads kind of blew out we saw returns into the double digits. And you can't just go out, and buy a lot of whether it was legacy non-Agencies or CMBS or CRE or MSR. And Agencies is by far the easiest and quickest way to take advantage of wider spread.

So you know, today we'd see those in the 10% area and we're certainly happy with holding what we have. I'd say that as I mentioned we increased our leverage converting TBAs into pools.

CRE and MSR are probably more in the 12% to 13% range. So I'd say that going forward you should expect to see leverage potentially drift higher as we move capital into those, which obviously takes more time than buying pools.

Douglas Harter - *Credit Suisse - Analyst*

And then just on the Agencies, to the extent that spreads sort of tighten back and is that something that you would look to then opportunistically reduce leverage again or kind of given that you've locked them in at attractive returns you would look to hold them? How are you thinking about this the duration of how long you really want to hold that investment?

Bill Roth - *Two Harbors Investment Corp. - Chief Investment Officer*

Well, if you look back to where Agency spreads were say in more recent history, they were fairly unappealing, but it really kind of depends what we can do with the money. One of the benefits of MSR, MSR plus Agencies are sort of in like I mentioned 12% to 13% and you've got a very good basis hedge, so you're not as concerned about spreads. But look, we have moved capital around.

We've been more conservative, obviously more defensive recently. So, I guess it's fair to say that if spread got really narrow we would probably tend to move that way.

We're not necessarily viewing this as a trade, though, because we like the assets, we have good spreads on the books. It will really depend on what we can do with the money at any given point in time.

Tom Siering - *Two Harbors Investment Corp. - President & CEO*

Yeah Doug, it's Tom. You know our history. We don't view investments where we got into them, but rather where they exist in the marketplace today.

So, spreads got back to the punkish level, so we saw last year recently you could expect us to reduce leverage. We don't anticipate that today, but we're not married to any of these positions if the economics don't warrant that.

Douglas Harter - *Credit Suisse - Analyst*

All right. I appreciate that. Thank you.

Operator

Bose George, KBW.

Eric Hagen - *Keefe, Bruyette & Woods - Analyst*

Thanks, good morning, guys. It's Eric on for Bose.

Just trying to reconcile the MSR mark this quarter given that we saw some smaller value changes from other financial institutions. Or those others with big MSR book. Thanks.

Bill Roth - *Two Harbors Investment Corp. - Chief Investment Officer*

Thanks for joining us. Yeah, you know it's interesting, some people seem to view MSR as a stand-alone asset and then when the market rallies there is markdown and when it sells off it goes up.

You know, it's just not, at least not for Two Harbors. MSR is a hedge for our MBS holdings and the MBS, Agency MBS as you know have positive duration.

So, you know, in markets where the rates fall, MSR is going to get marked down and pools are going to get marked up. And then when rates go up it's going to go the other way. So, you can't really view MSR, at least not for us in isolation.

Tom Siering - *Two Harbors Investment Corp. - President & CEO*

Yeah, I mean in the first quarter hour rates fell pretty precipitously by more or less 50 basis points. So, you would expect MSR to fall in value, that's what they are supposed to do in that sort of rate move but it's a beautiful hedge to our Agency portfolio.

Bill Roth - *Two Harbors Investment Corp. - Chief Investment Officer*

The other thing I'd say is you could also look at it if we didn't have MSR and we had swaps, swaps would have gotten written down.

Brad Farrell - *Two Harbors Investment Corp. - CFO & Treasurer*

One thing I would add, too, from a technical perspective if that's where your question was headed is we're obviously very active in the market, so we have a very good flavor on where the market is trading and then from a pricing perspective we actually obtained two independent pricing providers in the market. So, from a technical of where we're marking our book I cannot comment on others in the market, but there is some color on kind of how we approach the valuation of MSR.

Eric Hagen - *Keefe, Bruyette & Woods - Analyst*

So, if I were to look at the IOS index on Bloomberg, which is an MSR index -- or it's really an IO index, but I treat the two the same, would that be a reasonably accurate direction for the market?

Bill Roth - *Two Harbors Investment Corp. - Chief Investment Officer*

Absolutely. MSR essentially is an IO product. Now you might not get it down to the penny for sure. In fact, you won't.

Tom Siering - *Two Harbors Investment Corp. - President & CEO*

Yes, it's not a perfect correlation because there are spaces between IO and MSR for sure just to be clear.

Bill Roth - *Two Harbors Investment Corp. - Chief Investment Officer*

If IOS goes from 5 mult to 4 mult you can assume that MSR went in the same direction by roughly the same magnitude with a lot of margin for error. And vice versa if it was from 5 to 6 or whatever you can I think that's a good approach.

Tom Siering - *Two Harbors Investment Corp. - President & CEO*

Yes, (multiple speakers) if there is some deviation because there is basis, but you'll get it more or less right.

Eric Hagen - *Keefe, Bruyette & Woods - Analyst*

That's really helpful. One more for me if you guys don't mind.

On the jumbo securitizations have your loss and prepay assumptions changed at all since you entered the business? And then on a similar token what yield are you expecting to earn on that very bottom piece, the first loss piece in the securitization?

Bill Roth - *Two Harbors Investment Corp. - Chief Investment Officer*

Yes, so you know it's interesting. When we underwrite these and do these securitizations we do assume some amount of losses. So far, in all our securitizations currently at least we don't have one loan that's 60 days, so maybe our lapse assumptions are conservative, but we're not making any changes to them.

Standard prepay assumptions for this collateral is 15 CPR and so in short we haven't really made any changes. You know, with regard to typically we're retaining the bottom three pieces plus the IO. In some cases we might retain other pieces as we said before depending on market conditions and with the small amount -- the best way to answer it is really with a small amount of leverage those retained gets you into that low to mid double digits in ROE.

Tom Siering - *Two Harbors Investment Corp. - President & CEO*

Yeah, Just to speak to that for a second. You know, mathematicians are always looking for the super metric and the super metric in respect to probability and default in anything including a prime jumbo mortgage is going to be the LTV. In other words, if the owner has equity he's not going to default and because of our very prudent underwriting standards that speaks to why our delinquencies have been essentially nonexistent.

Eric Hagen - *Keefe, Bruyette & Woods - Analyst*

Right. Very helpful guys. Thanks.

Operator

Mark DeVries, Barclays.

Mark DeVries - *Barclays - Analyst*

Yeah, thanks. First question is around the MSR investments.

Can you give us a sense of how much more capacity you have that MSR given where the size of your Agency book is now? And then on returns there with one of the bigger previous acquirers Walter now becoming a seller of MSR, are you seeing signs of improved returns on new investment?

Bill Roth - *Two Harbors Investment Corp. - Chief Investment Officer*

Hey Mark, thanks for joining us. Yes, so MSR on a standalone basis is sort of high single-digit yields and now what we're talking about, keep in mind, is new production, high-quality Agency. We're not talking about distressed or any servicing that's high touch.

This is talking about like new production. So, when you add MBS to that as I mentioned earlier, you get up into that 12% to 13% range, which we think is a great combination because it removes a lot of basis risk. You know, we did see the market widen out a little bit in the first quarter, but that could have been in sympathy with other spreads being wider.

It's a very large market. There is a lot of competitors and we haven't seen substantial widening as a result of any one seller regardless of who it is. There have been other sellers in the past who have been big who have sold, but I would say at this point given where interest rates are and the point of the cycle that we love accumulating MSR with very low rates at those kind of ROEs.

Now in terms of size, currently we said before that that could be roughly 20% of capital to match our MBS holdings, so that would be roughly $700 million. So, we are quite a ways away from that.

If you just want to do simple math and you said we were doing I mentioned $1.5 billion to $2 billion a month, let's say that's $20 million a month, that's going to more than offset pay downs, but we're not going to get to that kind of number for quite a while. So, we have plenty of room to grow that effort. And we particularly like doing it on these flow sale arrangements because they are fairly sticky and you have a lot of different partners and it provides value to both us as well as the sellers.

Mark DeVries - *Barclays - Analyst*

Okay, great. And then on the conduit business I mean I think you commented on some of the challenges you're seeing in that business, you've even seen some of your smaller competitors step away from it. Are you able to generate high enough yields or coupons on the mortgages that you're making that the economics are still attractive to you here?

Bill Roth - *Two Harbors Investment Corp. - Chief Investment Officer*

Yeah, well look we all know the markets are cyclical and we've just been through a situation where some of the regulatory impacts have been felt. We're very pleased that the CFPB came out and said that they were going to clarify things because we think that will help quite a bit.

Fortunately we have a lot of really good things to do with our capital today that's away from the conduit. But as we said over time that when that market opens up and becomes robust again it's particularly exciting to have one of the main seats at the table. So, while right now volumes there are light, that could certainly change as we move forward in time.

Mark DeVries - *Barclays - Analyst*

Okay, got it. Thanks.

Operator

Trevor Cranston, JMP Securities.

Trevor Cranston - *JMP Securities - Analyst*

Hey, thanks, good morning. A question on the CRE side.

Bill, I think you mentioned that you said kind of generically you were seeing more attractive spreads on the lending you were doing. Can you say where you are seeing loan rates in the first quarter versus where they were kind of over the second half of 2015?

And also how you think sort of the recovery in CMBS spreads we've seen in the last month or so will impact loan rates for the second quarter? Thanks.

Bill Roth - *Two Harbors Investment Corp. - Chief Investment Officer*

Yes, sure, thanks for joining us, Trevor and for getting up so early to do so. Yes, I'd say that generally on senior loans sort of versus mid last year I think it's probably fair to say that spreads are call it maybe 50 wider.

It kind of depends on the asset. Sometimes you see these very high profile trophy assets get very, very competitively bid, you know, the big multi-hundred million dollars loans. As we said we're competing more in the generally $10 million to $100 million, so I'd say certainly at least 25 and potentially 50 wider on seniors.

And then what we've seen in CMBS space obviously is you know, BBBs widened out from call it -- BBB minuses widened out from call it 350 to as wide as 900 in February. Those are in the 600 to 700 range now and the other pieces on the capital stack widened and then subsequently returned but not all the way.

So, you know, we're seeing frankly less interest by borrowers to going to conduit lenders just because of the uncertainty. I would say that we would expect to see CMBS volumes pick up just because spreads have retraced or at least picked up from what the expectation was.

But if you are a borrower and you are trying to buy a building you want to make sure you get financing I think people are going to be, borrowers are going to be definitely factoring that into the consideration vis-a-vis price. So, I'd say total volume at CMBS were projected, at one level they came down 30%- 40% for the year and they are probably bounced up a little bit.

Tom Siering - *Two Harbors Investment Corp. - President & CEO*

Good morning, Trevor, it's Tom. You know whenever there's tumult in the commercial mortgage-backed security market it benefits our business model because obviously people want to have the knowledge that they can close on a transaction and whenever there's turmoil within the CMBS market that drives marginally people toward us. So, generally speaking these market conditions are very favorable to us and that's why we have seen improved pricing.

Trevor Cranston - *JMP Securities - Analyst*

Got it. That's helpful.

And on the financing side, can you maybe give us a little bit of color on sort of what the process is like for adding a direct repo counterparty and maybe also just some general color on who you think are the types of counterparties out there who are sort of interested and capable of having that kind of relationship with someone like yourselves? Thanks.

Brad Farrell - *Two Harbors Investment Corp. - CFO & Treasurer*

Great questions and I think there's just because the market is quite new is a good way to describe it, there is kind of a developing market, there are broker relationships out there who can help us make the introductions and start engaging. I would say because the market is new finding the right match is probably more of a time-consuming process and working through contracts and how we can both benefit from the relationship is probably more cumbersome than your kind of developed repo market.

So I say it's new, it's going to take time to develop. The players out there I really probably not in a position yet to comment on who's necessarily coming to the table. So, I'd probably say there's more to talk about in the coming quarters on direct lending.

Trevor Cranston - *JMP Securities - Analyst*

Okay, thank you.

Operator

Joel Houck, Wells Fargo.

Joel Houck - *Wells Fargo Securities, LLC - Analyst*

Thanks guys for having the call. Question on the increased allocation of Agency.

When you look at the spread widening that occurred, you know, predominantly in the first part of the first quarter, how much of the volatility on the credit side played into the decision to maybe increase the allocation to Agency? I understand that all spreads widen, but when you look at kind of volatility and your tolerance for book value moves, did that play a role or is just simply the Agency returns were attractive enough that it kind of hit your bid and you went in?

Bill Roth - *Two Harbors Investment Corp. - Chief Investment Officer*

Hey Joel, good morning, thanks for joining us. It's actually sort of a combination of both. You know, the thing is in the credit markets, when spreads widen a lot of times bonds just don't trade.

So, you know, the bid side goes down it's like I'd love to buy bonds there but that doesn't mean you can buy them there. So, you look at it's like, wow, Agencies look good, non-Agencies look good, and so we have been underweight if you want to call that term Agencies for a long time. So, it's very easy and those returns look really good.

I will say that we did buy some legacy non-Agencies. We did buy some CMBS, although not enough to break out at this point. But we did take advantage to add in the credit space, just it's a little harder to do when volumes are much lower.

Tom Siering - *Two Harbors Investment Corp. - President & CEO*

And it's important to note, Joel that the Agency space obviously is the easiest one to get in and importantly out of, when levels suggest those actions. So as Bill said we did add some credit pieces but what really moves the needle obviously for us is the Agency market and respective ability to add meaningful size to our portfolio.

Joel Houck - *Wells Fargo Securities, LLC - Analyst*

And maybe as a corollary to that question, how much further appetite both in terms of Agency exposure to percent of capital would also leverage could there be from if that asset class remains attractive? Or are you at kind of capacity for allocation and leverage in that asset class?

Bill Roth - *Two Harbors Investment Corp. - Chief Investment Officer*

No I mean so look, our leverage as I said I leverage at April 29th is in the mid-3s which is higher than it was at quarter-end. We converted TBAs into pools.

That number could probably float higher as we add leverage to CRE as well as potentially to MSR, which is something we're looking at. In terms of the future mix, honestly that's just going to depend on what sectors we think are the most attractive and where the opportunity is.

Joel Houck - *Wells Fargo Securities, LLC - Analyst*

Thanks, I had missed that you were up 3.5 in April, so that's a good clarification. The final one is on the commercial real estate. When you guys say initial loan-to-value of 72.9% on Slide 11, is that loan-to-value calculated based on stabilized rents or is it at projects -- I shouldn't say, is it based on projected stabilized rents or is it based on kind of trailing 12-month actual rents?

Bill Roth - *Two Harbors Investment Corp. - Chief Investment Officer*

No, it is based on at the time. On stabilized that number would be lower. I don't actually have it handy with me, but it would be lower than that.

Joel Houck - *Wells Fargo Securities, LLC - Analyst*

Okay. I think -- thanks for the answer -- I think that's an important distinction because it means that your LTV is fairly conservative.

A lot of the commercial players use that as stabilized. So just to clarify you guys don't get unfairly punished people think, I mean 72.9% is a good number but it would be even better if you used a number or a methodology that your peers used. So thanks again.

Brad Farrell - *Two Harbors Investment Corp. - CFO & Treasurer*

One thing we'd point you is on page 24 of the earnings presentation, we do present a stabilized LTV. And our aggregate portfolio right now is at 67.5%.

Joel Houck - *Wells Fargo Securities, LLC - Analyst*

Oh yes, okay great. Thank you.

Operator

Jessica Ribner, FBR.

Jessica Ribner - *FBR Capital Markets & Co. - Analyst*

Good morning guys, thank you for taking my question. Most of my questions at this point have been asked and answered, but one just around the buybacks.

How can we think about that going forward in terms of is there a level that you find more attractive to buy back your stock? Or are you more interested in deploying that capital towards more opportunistically in the agency and credit markets and even the MSR market as they become more attractive?

Tom Siering - *Two Harbors Investment Corp. - President & CEO*

Thanks, Jessica, it's Tom, good morning. So in the quarter we bought back 8 million shares, in the fourth quarter last year we bought 12.3 million shares and in fiscal 2015 we bought back 13.7 million shares. So, in sum that's about 6% of the shares outstanding.

So, I think we've shown really good judgment and care in this respect. And how we've consistently thought about this and how we've consistently conveyed the message around this is that we view it in the context of where our shares are trading relative to book value and available investment alternatives.

So, to the extent that our shares are trading closer to book value and there's attractive investment alternatives, you can reasonably expect that we will buy back little or no stock, but when the contrary is true you can expect us to buy back a fair amount of stock. So, that's how we think about it and I think we've had a consistent track record in that practice.

Jessica Ribner - *FBR Capital Markets & Co. - Analyst*

Okay great. Thank you so much.

Operator

Brock Vandervliet, Nomura.

Brock Vandervliet - *Nomura Securities Intl - Analyst*

Thanks for taking the question. So, I guess more generally beyond the Agate Bay activities, but connected to securitization with respect to the changes in risk retention, is there an ability or an opportunity for you to for example buy the equity tranche of a third-party securitization number one and number two, is that something from a risk return perspective you would entertain?

Bill Roth - *Two Harbors Investment Corp. - Chief Investment Officer*

Hey, good morning. Thanks for joining us. Yeah, I mean the biggest determinant of that to be honest with you would be what the economics of that investment might be.

In our deals since they all qualify, there's not a specific risk retention required. So, if it's somebody else's then it really depends on do theirs qualify or do they not and we would have to do a full underwriting. It's more likely that we're going to stick with what we're making.

But if you buy CRT for instance you're basically, that's what you're buying. If you buy a private label, you have to do all the work and it's a substantial amount of work. So, it really would depend on is that worthwhile from an investment standpoint or not.

Tom Siering - *Two Harbors Investment Corp. - President & CEO*

I wouldn't suggest though that you're likely to see any significant activity from us in that regard.

Brock Vandervliet - *Nomura Securities Intl - Analyst*

Okay. And I guess just as a general follow-up, as one of the largest hybrid REITs what are your thoughts on consolidation in the sector?

Tom Siering - *Two Harbors Investment Corp. - President & CEO*

Obviously there's been a couple of transactions, a couple of them have been related party and obviously there was one involved in Hatteras. I don't know, we don't anticipate significant activity within the M&A space in the mortgage REIT space.

We certainly could be wrong but we don't anticipate it. The first couple I think were unique, sort of one-off sort of situations. But we don't anticipate significant activity, but we'll see what the future holds.

Brock Vandervliet - *Nomura Securities Intl - Analyst*

Okay, thank you.

Operator

There are no further questions in the queue. I would now like to turn the call back over to Tom Siering for closing remarks.

Tom Siering - *Two Harbors Investment Corp. - President & CEO*

Thanks Tawanda. Thank you for joining our first quarter conference call today. We hope to see you at our Annual Meeting in May.

Please call investor relations to RSVP. Have a wonderful day and thanks again for joining us.
