



Quarterly Letter to Stockholders

February 19, 2013

Dear Fellow Stockholders,

This year was truly a remarkable period for our stockholders, as we delivered total return on book value of 47% with dividends of \$1.71 per share. Our investment team generated \$1.05 billion in total comprehensive income during the year, and we grew our business three-fold thus becoming the biggest hybrid mortgage REIT as measured by market capitalization. While it has never been our ambition to be biggest, it has always been our ambition to be the best in the sector. We believe the growth in our business can be attributed to our alpha generation and our best practice policies in respect of corporate governance and disclosure.

As many of you well know, the key to our pursuit of excellence is our team, and this year was transformative for both our investment and administrative teams. This year on the investment side of our business, Bill Roth became our sole Chief Investment Officer after serving as co-CIO since the inception of our company in 2009. We expanded our senior management team with the hires of Nick Smith, Dan Koch and Bill Greenberg. These notable hires enhance our ability to diversify our business model and drive stockholder value over time. We also have a dedicated administrative team, which we believe is important to the long-term success of our business. Effective as of the beginning of 2012, we named Brad Farrell Chief Financial Officer, and most recently named Rebecca Sandberg as General Counsel, effective March 1, 2013. Brad had previously served as Two Harbors' Controller and Rebecca was previously our Deputy General Counsel, so these transitions have been seamless and natural.

In the fourth quarter we announced a dividend of \$0.55 per share. There were a few factors that impacted our quarterly dividend, including turnover in our Agency portfolio. Some of our Agency securities appreciated to what we believe were full value. So, from a risk management and valuation perspective, it made sense to capture these gains and rotate into more attractive securities. The resulting gains increased our taxable income for the year, as did taxable gains from the contribution of our single-family homes to Silver Bay Realty Trust Corp. ("Silver Bay"). As many of you may know, REIT requirements dictate that we distribute at least 90% of our taxable income, and this year we distributed approximately 98%. This requirement coupled with expected changes to tax policy in 2013 prompted Two Harbors to declare the \$0.55 dividend. *It is important to note that this dividend should not be considered indicative of our future dividends.*

In the fourth quarter, we contributed our portfolio of single-family homes to Silver Bay, concurrent with its IPO in mid-December. In exchange for the contribution, we received approximately 17.8 million shares of Silver Bay common stock. Since the IPO, the shares have appreciated approximately 10%. The shares we hold are subject to a 90-day lockup, which expires in mid-March. As we have discussed previously, subject to the approval of our Board, it is our intention to distribute the Silver Bay shares to our stockholders by means of a special dividend at some point following the expiry of the 90-day lock-up. We will continue to keep you advised if and when the Board should make such a determination.

There were a number of developments during 2012 in the macroeconomic landscape. Recent home price performance was a bright spot amid otherwise murky data. According to CoreLogic, home prices increased 7.5% in 2012 on a rolling 12-month basis. Most forecasts call for a continuation of home price appreciation in the next several years, albeit at a slower pace than in 2012. Unemployment metrics have continued to languish at a level higher than we would like to see, although they, too, generally seem to be improving.



Another metric we obviously track closely are interest rates.. While still low by historic levels, they have moved a bit higher lately on the back of improving economic data and market sentiment. We continue to prudently hedge against a spike in interest rates and select securities with prepayment-protected characteristics, in order to reduce re-investment and hedging risks. We believe that over 98% of our portfolio has either implicit or explicit prepayment protection. Consequently, we expect a minimal impact to our portfolio in the event of an interest rate increase. We also continue to monitor developments regarding policy and regulatory changes.

Our number one priority is to optimize value for our stockholders and provide attractive risk-adjusted returns over the long-term. As a hybrid mortgage REIT, we have the flexibility to take advantage of opportunities in both the Agency and non-Agency market. Last quarter, we outlined a variety of investment opportunities that we are evaluating. I would note that several of the things we are evaluating have the potential to diversify our business and provide returns uncorrelated to our existing Agency and non-Agency securities portfolios. Importantly, we believe each of these opportunities is grounded in our current core competencies. We will continue to keep stockholders informed regarding these opportunities.

In closing, Two Harbors' economic returns in 2012 were exceptional. We believe this is a testament to our rigorous security selection and the talent of our investment team. As we look ahead to 2013, we are excited about our ability to continue to drive stockholder value over the long-term. On a final note, I would like to encourage you to listen to our ongoing webinar series. We have most recently released a webinar titled "*Primer on Agency Prepayments Part 2: Concepts in Agency Valuation*", which is available on our website. We are looking forward to introducing a "mini-webinar" series in the future, covering topics such as "*Mortgage REIT Primer*" as well as future installments in our regular webinar series.

As always, please let us know if you have questions or if we may be helpful in any way.

Sincerely,

Thomas Siering
President and Chief Executive Officer

Forward-Looking Statements

This letter 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 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," "predict," "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. Factors that could cause actual results to differ include, but are not limited to, higher than expected operating costs, changes in prepayment speeds of mortgages underlying our RMBS, the rates of default or decreased recovery on the mortgages underlying our non-Agency securities, failure to recover certain losses that are expected to be temporary, changes in interest rates or the availability of financing, the impact of new legislation or regulatory changes on our operations, the impact of any deficiencies in the servicing or foreclosure practices of third parties and related delays in the foreclosure process, our ability to hire and retain key personnel, the inability to diversify our business or operate new business lines in a profitable manner, the performance of Silver Bay common stock and our decision to hold or distribute those shares to our stockholders, the impact of new or modified government mortgage refinance or principal reduction programs, and unanticipated changes in overall market and economic conditions.

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. 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.