TWO HARBORS
Investment Corp.
A Pine River Capital Managed Company

First Quarter 2018 Letter to Stockholders

NYSE: TWO

May 30, 2018

Dear Fellow Stockholders,

During the first quarter, interest rates once again moved higher against a backdrop of better economic and employment data, as well as the market adjusting to a higher likelihood of the Federal Reserve continuing to increase interest rates throughout 2018. Additionally, as the Federal Reserve continued to reduce its balance sheet holdings in U.S. Treasuries and Agency securities, yields were higher and spreads were wider on these securities. Consistent with our historical practice, we continued to take a prudent approach to hedging, limiting our book value and net income exposure to rising rates.

On April 26, 2018 we announced our entry into an agreement to acquire CYS Investments, Inc. (NYSE: CYS). We believe that this transaction represents a unique opportunity to create value for our stockholders in the following ways:

- ✓ **Additional capital supports continued growth in target assets:** A larger capital base will support the continued growth across our target assets, and positions us to take advantage of market opportunities as they arise.
- ✓ **Improved cost structure:** Expect that the combination of the companies will create cost efficiencies and decrease our other operating expense ratio by 30 to 40 basis points. Additionally PRCM Advisers' agreement to reduce its base management fee on the new CYS equity will further enhance operating cost efficiencies in the year following the close of the transaction.
- ✓ **Anticipate improved Agency spreads in 2018:** If so, we believe this deal will be accretive to earnings and further endorses the capital raising attendant to this transaction.
- ✓ **Enhanced scale and liquidity with potential for premium valuation:** With a pro forma equity base of nearly $5.0 billion, our stockholders will benefit from the scale, liquidity and capital alternatives of a larger combined company. Additionally, larger capitalized mortgage REITs have historically carried premium valuations.
- ✓ **Expect to maintain $0.47 per share quarterly dividend:** Following the close of the transaction, we anticipate that our current quarterly dividend of $0.47 will be sustainable through 2018, subject to market conditions and the discretion and approval of our Board of Directors.

We anticipate that this transaction will close in the third quarter of this year. After the transaction closes, we expect to reallocate the capital from CYS's portfolio into our target asset classes and in 2019 our capital allocation to Agency securities, mortgage servicing rights (MSR) and Credit should look substantially similar to what it looks like today. Additionally, upon closing, we intend to have a similar hedging strategy that is in line with our current low level of interest rate and spread exposure. As we have emphasized frequently, we have an acute focus on protecting book value, and part of this involves not taking undue interest rate risk.

Turning to our results in the first quarter, we incurred a Comprehensive Loss of ($23.7 million), or ($0.14) per basic common share, which represented a return on average common equity of (3.3%). At March 31st, our book value was $15.63, which represented a (1.3%) total return on book value, inclusive of our $0.47 quarterly dividend. While our hedges and MSR performed as we expected them to in a rising rate environment, the underperformance of higher coupon Agencies and specified pools in March, which is the majority of the Agency securities we own, led to a diminution of our book value.

This quarter we began reporting Core Earnings including dollar roll income[1] from Agency to-be-announced securities (TBA). TBAs are contracts that provide for the future delivery of Agency pools, and our investment team may choose to invest in TBAs rather than Agency pools for various liquidity, hedging and leverage benefits. Importantly, our ability to invest in more significant TBA exposure benefitted from our recent receipt of a tax opinion that allows us to hold these investments in the REIT and limit tax friction. We believe this metric is a better representation of our underlying earnings power and provides our stockholders with greater transparency. In the first quarter, Core Earnings including dollar roll income represented a return on average common equity of 11.8%.

In our Rates[2] strategy, Agency spreads widened and higher coupons, especially specified pools, underperformed lower coupon Agencies. Our objective is to provide strong returns through a variety of rate environments, and MSR is a key component of this. We believe that the combination of Agency RMBS and MSR has the potential to drive a higher return with less basis risk compared to Agencies hedged only with swaps. MSR now represents about 20% of our capital allocation, and we continue to find plentiful opportunities to add MSR through both bulk purchases and our flow-sale arrangements. Additionally, during the quarter we were able to increase the capacity of one of our MSR financing facilities by $100 million, to an aggregate of $400 million, which we believe will allow us to continue to grow our portfolio and further benefit our Rates[2] strategy.

Our Credit[3] strategy performed well, generating a positive return each month of the first quarter. Residential credit continues to benefit from fundamental improvement in the housing market, including re-equification by borrowers resulting in increased prepayments, lower loan-to-value ratios, and fewer delinquencies, defaults and severities. We believe these positive tailwinds could drive bond prices higher, generating strong total returns and benefitting our book value going forward.

The foundation of our success in 2018 and beyond is rooted in our key areas of focus: (1) acute focus on our Rates[2] and Credit[3] strategies, leveraging our competitive advantages in MSR and legacy non-Agency RMBS; (2) maintaining our sophisticated approach to risk management; (3) managing the balance sheet composition to optimize earnings and stockholder returns; and (4) emphasizing technology efficiencies to grow our MSR platform. Each of these areas of focus supports our overall goal to provide book value stability through a variety of interest rate environments.

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

Sincerely,

Thomas Siering
President and Chief Executive Officer

(1) Core Earnings is a non-U.S. GAAP measure that we define as comprehensive (loss) income attributable to common stockholders, excluding "realized and unrealized gains and losses" (impairment losses, realized and unrealized gains and losses on the aggregate portfolio, reserve expense for representation and warranty obligations on MSR and non-cash compensation expense related to restricted common stock). 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. Dollar roll income is the economic equivalent to holding and financing Agency RMBS using short-term repurchase agreements. We believe the presentation of Core Earnings, including dollar roll income, provides investors greater transparency into our period-over-period financial performance and facilitates comparisons to peer REITs.
(2) Assets in "Rates" include Agency RMBS, MSR and other interest rate sensitive assets.
(3) Assets in "Credit" include non-Agency securities and other credit sensitive assets.