TWO HARBORS Investment Corp.
A Pine River Capital Managed Company

Third Quarter 2018 Letter to Stockholders

NYSE: TWO

November 20, 2018

Dear Fellow Stockholders,

The third quarter was highlighted by the acquisition of CYS Investments, Inc. ("CYS") and the progress we made in the redeployment of capital from that transaction. On a GAAP basis, we incurred a Comprehensive Loss of ($102.8) million, or ($0.46) per weighted average basic common share. We generated strong Core Earnings, including dollar roll income, of $0.48 per basic share in the quarter, which represented a return on average common equity of 12.4%.[1] We reported book value of $14.81 per common share, representing a (2.6%) total return on book value when including our quarterly dividends amounting to $0.47 per common share.[2] Our book value decrease quarter over quarter is primarily attributable to both the 2% dilution from the CYS acquisition and the widening of Agency mortgage spreads.

Our objective is to drive strong and stable returns for our stockholders and with this in mind we continuously examine opportunities for growth and the optimization of our business model. Looking back, in July 2016 we announced that we were discontinuing our mortgage loan conduit program in order to reduce our operating complexity and costs. Then, in 2017, we formed and spun off Granite Point Mortgage Trust Inc. (NYSE: GPMT), creating a stand-alone vehicle for our commercial business that we had established in 2015. Finally, earlier this year we identified a unique opportunity to acquire CYS to further grow and expand our business. This acquisition was a milestone for our company: we grew our market capitalization and equity base, increased the liquidity of our stock and expect that our expense ratio will decrease going forward. We believe that our enhanced scale supports growth in our target assets – including mortgage servicing rights (MSR) and non-Agency securities – and expect that the redeployment of the capital acquired in the CYS acquisition into these assets will generate better long-term returns.

In the third quarter interest rates rose, the curve flattened and Agency mortgage spreads were mixed. We believe that the Fed will likely move the Fed Funds rate into the 2.5-3.0% range by the end of 2019 and that longer term rates will drift higher over time. Given this outlook, we continue to maintain prudent exposures to interest rates, curve and mortgage spreads through our overall positioning and active risk management. Our overall book value and net interest income sensitivities to interest rate changes are low and because of our substantial MSR holdings, our exposure to mortgage spreads remains moderate despite owning 30-year Agency residential mortgage-backed securities (RMBS). We believe that our strategy, which utilizes a variety of hedging tools, is a superior approach to managing risk and provides stability in our results through periods of market volatility.

In our Rates[3] strategy we added over $10 billion of Agency securities when the CYS acquisition closed on July 31st. We initially moved these new Agency holdings from 15-years and ARMs into higher coupon 30-years. Consistent with our plan, we then began reallocating that capital and we were active participants in the MSR market in the third quarter, adding almost $16 billion in unpaid principal balance through both bulk and flow channels. We expect the market for MSR to remain robust, largely as a result of higher interest rates, difficult origination margins and the consolidation of originators. We believe that we are well positioned to continue to grow this asset class as a result of our larger capital base.

Our Credit[4] strategy performed well in the quarter, benefitting from strong yields and stable spreads. We took advantage of several opportunities to add low dollar-priced legacy non-Agencies, increasing our holdings by approximately $500 million. We continue to add legacy non-Agencies at a run rate of about $100-200 million a month. Despite higher rates and slightly decreasing affordability, employment data remains strong and we expect home prices over the next several years to be stable to higher. These tailwinds further bolster the strong double digit total returns that we expect to generate in this strategy, and we continue to see opportunities to add bonds that we like to our portfolio.

In conclusion, we believe that we operate a superior business model through our diversified Rates[3] and Credit[4] strategies and our sophisticated approach to risk management. Additionally, we maintain a keen focus on optimizing our balance sheet to enhance earnings. Our results speak for themselves: not only have we generated more stable book value than our peers, but we are one of only two companies in our peer cohort that has grown book value since 2009.[5] You can see these statistics in our quarterly investor presentation, which can be found on our website at www.twoharborsinvestment.com.

We are very excited about the opportunities ahead for our company, especially as we continue to reallocate capital from the CYS transaction into MSR and non-Agencies, as we believe these asset classes currently present the best investment opportunity. We expect as we are able to increase capital to these asset classes, that we will decrease our overall risk sensitivities and drive better returns for our stockholders.

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, non-cash compensation expense related to restricted common stock, transaction costs related to the contribution of TH Commercial Holdings LLC to Granite Point and restructuring charges) and transaction costs and purchase premium associated with the acquisition of CYS. 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) Return on book value for the quarter ended September 30, 2018 is defined as the decrease in book value per common share from June 30, 2018 to September 30, 2018 of $0.88, plus dividends declared amounting to $0.47 per common share, divided by June 30, 2018 book value of $15.69 per common share.

(3) Assets in "Rates" include Agency RMBS, MSR and other interest rate sensitive assets.

(4) Assets in "Credit" include non-Agency securities and other credit sensitive assets.

(5) Peer cohort represents comparable mortgage REIT peers. Peer average book value figures are based on publicly reported data and have not been adjusted for the return of capital from dividends, if any, to peer stockholders during the same period.

Forward-Looking Statements

Certain statements in this fact sheet that are neither reported financial results nor other historical information are forward-looking statements. Forward-looking statements are not guarantees of future performance and involve risks and uncertainties, including those described under the caption "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2017, and any subsequent Quarterly Report on Form 10-Q, as filed with the Securities and Exchange Commission. Our actual results and our plans and objectives may differ materially from those expressed in any forward-looking statements expressed herein, and you are cautioned not to place undue reliance on them.