TWO HARBORS Investment Corp.
A Pine River Capital Managed Company

Second Quarter 2018 Letter to Stockholders

NYSE: TWO

August 17, 2018

Dear Fellow Stockholders,

In the second quarter, the Federal Reserve raised interest rates once, the yield curve flattened and mortgage spreads experienced intra-quarter volatility before ultimately ending relatively unchanged from March 31st. Despite this, our results exceeded consensus estimates: our book value grew to $15.69 per common share, representing a 3.4% return on book value[1] and our Core Earnings, including dollar roll income, increased to $0.53 per basic common share[2]. While the current investing environment for residential mortgage REITs can be viewed as challenging, our performance during the quarter underscores that there is continued opportunity. We strive to provide book value stability through a variety of interest rate environments and our strong results highlight that our diversified investment strategy and sophisticated approach to risk management is effective, despite rate volatility.

Post quarter-end, on July 31st we completed the acquisition of CYS Investments, Inc. At the effective time of the merger, each share of CYS common stock was converted into the right to receive 0.4680 shares of newly issued Two Harbors common stock and a cash consideration of $0.0965 per share. As an illustrative example, if a CYS stockholder held 1,000 shares, that stockholder would have received approximately 468 shares of Two Harbors' common stock and an additional $96.50 of cash. As previously communicated, we believe for the following reasons that this transaction will benefit our stockholders:

- ✓ **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.
- ✓ **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 about $4.8 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 common 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.

As part of the merger, we declared an interim dividend in July of approximately $0.16 per common share, which represented a partial payment of our total anticipated $0.47 per common share third quarter dividend. We expect to declare the remaining $0.31 per common share of our third quarter dividend in the normal course in September.

Turning to our portfolio as of June 30th, during the second quarter we allocated capital from Agency residential mortgage-backed securities (RMBS) into mortgage servicing rights (MSR) and non-Agency securities as we took advantage of attractive opportunities in the market. Additionally, we reduced our Agency RMBS holdings in favor of adding Agency to-be-announced (TBA) 4.5 positions. All of these actions helped drive our strong results.

In our Rates[3] strategy, higher rates and a flatter yield curve had little impact on our holdings, consistent with our expectations given our low risk positioning. While we reduced our pool positioning in favor of adding Fannie Mae TBA 4.5s, we anticipate that over time our TBA positioning will fluctuate depending on the availability and attractiveness of specified pools relative to TBAs. With respect to our MSR investments, during the quarter we added $10.5 billion UPB through a bulk purchase and our ongoing monthly flow-sale arrangements. We are confident that we will continue to find opportunities to add MSR. The market for bulk packages remains quite active due to a variety of factors, including higher rates, difficult origination margins and the consolidation of originators. As we've discussed in the past, MSR is a key component of our hedging strategy because of the negative duration, hedge to mortgage spread risk, positive yield and benefits of float income.

Our Credit[4] strategy performed well in the quarter benefitting from strong yields and stable spreads as residential credit continued to benefit from fundamental improvement in the housing market. This quarter we increased our holdings of low dollar priced legacy non-Agencies by approximately 18%, as we saw substantial opportunity in this asset class. We anticipate that over time these holdings will generate double digit total returns through a combination of both strong yields and price appreciation. We remain constructive on residential credit and expect our legacy holdings to continue to benefit from fundamental improvement in the housing market, as this leads to lower losses and higher prepayments from turnover and refinancings.

One of our distinguishing features is our focus on protecting book value. We actively manage our risk profile, maintaining prudent exposures to interest rates, curve and mortgage spreads. As a result of our substantial MSR holdings, our exposure to mortgage spreads remains low despite owning 30-year Agency MBS. 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.

The foundation of our success in 2018 and beyond is rooted in our four key areas of focus: (1) our acute focus on our Rates[3] and Credit[4] strategies, leveraging our competitive advantages in MSR and legacy non-Agency RMBS; (2) maintaining our sophisticated approach to risk management; (3) managing our 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. We are committed to generating strong returns for our stockholders and believe that our larger company will enhance our ability to do so.

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

Sincerely,

Thomas Siering
President and Chief Executive Officer

(1) Return on book value for the quarter ended June 30, 2018 is defined as the increase in book value per common share from March 31, 2018 to June 30, 2018 of $0.06, plus the dividend declared of $0.47 per common share, divided by March 31, 2018 book value of $15.63 per common share.
(2) 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 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.
(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.