Industry Update
Estimates Change

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Residential Mortgage REITs 3Q12 Preview

Summary--
We expect generally lower earnings for most of the residential MBS REITs in 3Q12 versus 2Q12, driven by lower spreads on new investments and slightly higher prepayments. The 10-year US Treasury yield was relatively flat during the quarter, but the Fannie Mae 30-year current coupon declined 73 bps. We believe increasing book values will be the biggest story of 3Q, given the strong rally in both Agency MBS and non-Agency MBS. Lower coupon Agency MBS have outperformed following the Fed's announcement of QE3, and HARP and other prepayment-protected securities have also continued to outperform generic pools. GSE monthly prepayment data showed increases in CPRs during 3Q, and we expect prepayments to continue to trend up. We are reducing our 3Q12 estimates for ANH, CMO, and HTS, and increasing our 3Q12 estimate for PMT.

Key Points--

- We expect generally lower earnings for the residential MBS REITs in 3Q12 versus 2Q12 driven by narrower spreads on new investments and rising prepayments. GSE monthly data showed a pick-up in prepayments in 3Q, and we expect further increases in 4Q.
- We expect higher book values for the Agency MBS REITs. Thirty-year and 15-year fixed rate Agency MBS prices ended the quarter up 0.5%-2% for most coupons with lower coupons outperforming higher coupons. The Fed's QE3 program targets lower coupon, fixed-rate MBS. Additionally, prepayment protected securities, such as bonds backed by mortgages that have refinanced through HARP, continued to outperform by an estimated 0.25% to 1% over generic MBS. Swap rates declined moderately during 3Q.
- We believe book values for non-Agency MBS investors performed well as non-Agency MBS prices continued their rally during the quarter, especially during September. The indexes we track for subprime AAA assets ended the quarter up 17% on average, while the indexes we track for prime non-Agency MBS were up a more moderate 4-5% on average. We believe that non-Agency cash bonds were likely less volatile. The hybrid mortgage REITs have also benefited from increasing Agency MBS values. Given the continued rally in non-Agency MBS prices, we believe book values have increased since quarter-end.
- We are reducing our 3Q EPS estimates for ANH, CMO, and HTS. Our estimates assume modestly lower net spreads. Given the anticipated high prepayment environment, we believe that the hybrid mortgage REITs are a more appealing at the moment. Our favorite name in the space is Two Harbors (TWO), which is now trading a very small premium to book value. Among the Agency MBS REITs, American Capital Agency (AGNC) also provides meaningful prepayment protection.

	Market	Rating		Target		Current Qtr.		2012E EPS		2013E EPS	
Symbol	**Price**	**To**	**From**	**To**	**From**	**To**	**From**	**To**	**From**	**To**	**From**
AGNC	$32.59	Outperform	Outperform	$35.00	$35.00	$1.13	$1.13	$4.59	$4.59	$4.20	$4.20
ANH	$6.20	Outperform	Outperform	$7.50	$7.50	$0.15	$0.17	$0.68	$0.72	$0.68	$0.68
CIM	$2.58	Market Perform	Market Perform	$3.00	$3.00	$0.09	$0.09	$0.38	$0.38		
CMO	$12.43	Outperform	Outperform	$14.00	$14.00	$0.36	$0.38	$1.58	$1.60	$1.52	$1.52
HTS	$26.54	Outperform	Outperform	$29.00	$29.00	$0.80	$0.83	$3.41	$3.46	$3.32	$3.32
IVR	$20.73	Market Perform	Market Perform	$20.00	$20.00	$0.63	$0.63	$2.66	$2.66	$2.40	$2.40
MFA	$8.16	Outperform	Outperform	$8.50	$8.50	$0.20	$0.20	$0.83	$0.83	$0.80	$0.80
MTGE	$24.46	Outperform	Outperform	$26.00	$26.00	$0.84	$0.84	$3.55	$3.55	$3.20	$3.20
NLY	$16.04	Market Perform	Market Perform	$17.50	$17.50	$0.44	$0.44	$1.78	$1.78	$1.70	$1.70
PMT	$24.28	Market Perform	Market Perform	$21.00	$21.00	$0.73	$0.69	$2.87	$2.81	$2.60	$2.60
RWT	$14.36	Market Perform	Market Perform	$13.00	$13.00	$0.23	$0.23	$0.94	$0.94	$1.08	$1.08
TWO	$11.66	Outperform	Outperform	$11.50	$11.50	$0.34	$0.34	$1.36	$1.36	$1.30	$1.30

3Q12 Residential MBS REITs Earnings Preview

Variance to Consensus

	KBW EPS Estimates			Prior			Consensus			KBW vs. Consensus		
	3Q12	2012	2013	3Q12	2012	2013	3Q12	2012	2013	3Q12	2012	2013
AGNC	$1.13	$4.59	$4.20	$1.13	$4.59	$4.20	$1.12	$4.13	$4.51	$0.01	$0.46	($0.31)
ANH	$0.15	$0.68	$0.68	$0.17	$0.72	$0.68	$0.18	$0.73	$0.76	($0.03)	($0.05)	($0.08)
CIM	$0.09	$0.38	NA	$0.09	$0.38	-	$0.11	$0.50	$0.47	($0.02)	($0.12)	-
CMO	$0.36	$1.58	$1.52	$0.38	$1.60	$1.52	$0.38	$1.62	$1.56	($0.02)	($0.04)	($0.04)
HTS	$0.80	$3.41	$3.32	$0.83	$3.46	$3.32	$0.84	$3.50	$3.38	($0.04)	($0.09)	($0.06)
IVR	$0.63	$2.66	$2.40	$0.63	$2.66	$2.40	$0.66	$2.71	$2.68	($0.03)	($0.05)	($0.28)
MFA	$0.20	$0.83	$0.80	$0.20	$0.83	$0.80	$0.22	$0.86	$0.91	($0.02)	($0.03)	($0.11)
NLY	$0.44	$1.78	$1.70	$0.44	$1.78	$1.70	$0.46	$1.92	$1.87	($0.02)	($0.14)	($0.17)
PMT	$0.73	$2.87	$2.60	$0.69	$2.81	$2.60	$0.79	$2.93	$3.14	($0.06)	($0.06)	($0.54)
RWT	$0.23	$0.94	$1.08	$0.23	$0.94	$1.08	$0.24	$1.08	$1.14	($0.01)	($0.14)	($0.06)
TWO	$0.34	$1.36	$1.30	$0.34	$1.36	$1.30	$0.36	$1.43	$1.51	($0.02)	($0.07)	($0.21)
MTGE	$0.84	$3.55	$3.20	$0.84	$3.55	$3.20	$0.82	$3.42	$3.13	$0.02	$0.13	$0.07

Source: KBW Research, SNL, and Bloomberg.

Agency MBS REITs

We expect lower operating earnings for most of the Agency MBS REITs in 3Q12 relative to 2Q driven by lower spreads on new investments and higher prepayments.

American Capital Agency. American Capital Agency (AGNC) announced a $1.25 dividend for 3Q12, unchanged from 2Q. The company reported 2Q12 GAAP and operating EPS of ($0.88) and $0.94, respectively. The company's 2Q results were negatively impacted by an upward adjustment to its lifetime CPR assumption. We are maintaining our 3Q operating estimate of $1.13 and our 4Q estimate of $1.10. Our full year 2012 estimate is $4.59. We believe AGNC is the best positioned among the Agency MBS REITs in the current operating environment given its focus on prepayment protected MBS.

Annaly. Annaly (NLY) announced a 3Q12 dividend of $0.50, down from $0.55 in 2Q12. This was in line with our $0.50 estimate. The company reported 2Q12 GAAP and operating EPS of ($0.10) and $0.46, respectively. We are maintaining our 3QE of $0.44 which assumes modestly weaker operating trends versus 2Q. Our 4Q estimate remains $0.44, and our full year 2012 estimate is $1.78. Annaly continues to operate with the lowest leverage among the Agency MBS REITs at 5.9x. The company's 2Q CPR was 19% and we expect this to increase to the mid 20% range.

Anworth. Anworth (ANH) announced a 3Q12 dividend of $0.15 per share, down from $0.18 in 2Q12. This was below our estimate of $0.17 per share. The company reported 2Q12 GAAP and operating EPS of $0.18, and we are reducing our 3Q12 EPS estimate to $0.15, in line with the dividend. We are lowering our 4Q12 EPS estimate to $0.15 as well, which reduces our full year 2012 EPS estimate to $0.68 from $0.72 per share. The reduction is driven by lower expected net spreads on new investments and slightly higher prepayments.

Capstead. Capstead (CMO) announced a 3Q12 dividend of $0.36, down from $0.40 in 2Q12. CMO reported 2Q operating EPS of $0.40. We are reducing our 3Q EPS estimate to $0.36 from $0.38 due primarily to lower expected net spreads. We reduce our 4Q estimate to $0.36 from $0.38 and our full year 2012 estimate to $1.58 to $1.60, also driven by lower expected spreads. While we believe CMO has protection against meaningful increases in prepayments given its low weighted average coupon (3.44% in 2Q), we believe the portfolio net spread will continue to decline as short reset ARMs reset to lower rates reflecting the current interest rate environment.

Hatteras. Hatteras (HTS) announced a 3Q dividend of $0.80, down from $0.90 in 2Q12, and below our $0.83 estimate. While the dividend was down sequentially, core EPS in 2Q was $0.79, so the 3Q dividend suggests that operating trends have not changed as meaningfully as the decline in the dividend. We believe that the dividend cut was a result of slightly higher prepayments and tighter spreads on new investments. The company recently disclosed its prepayments for 3Q, which have remained in check. Through mid-September, the average 3Q CPR was 20.5%, up modestly from 19.7% in 2Q12. The September CPR of 20.8% was up from 20.4% in August and 20.3% in July. We reduce our 3Q and 4Q EPS estimates to $0.80 from $0.83 for both quarters, and our full year 2012 estimate to $3.41 from $3.46 to reflect lower net spreads on new investments and slightly higher prepayments.

Non-Agency & Hybrid MBS REITs

Chimera. Chimera (CIM) announced a 3Q12 dividend of $0.09, flat from 2Q12. This was in line with our $0.09 estimate. The company has not filed complete financials since 3Q11. On September 14, the company announced that it has received a four- month extension for listing of its stock on the NYSE. The company must provide its Annual Report (10-K) by January 15, 2013. We are maintaining our 3Q EPS of $0.09, in line with the dividend. Our 4Q estimate is $0.09 and our full year 2012 estimate is $0.38.

PennyMac. PennyMac (PMT) has yet to announce its 3Q12 dividend. The company usually does so when it announces earnings. PennyMac paid a 2Q12 dividend of $0.55 and we are forecasting a flat dividend in 3Q. PMT reported 2Q12 EPS of $0.79. Second quarter earnings reflected strong results in the correspondent business, driven by increased loan fundings. We are increasing our 3Q EPS estimate to $0.73 from $0.69, and our 4Q estimate to $0.69 from $0.68, as we expect the company's correspondent business to grow and contribute meaningfully to earnings. As a result, our full year 2012 estimate goes to $2.87 from $2.81. The decline in earnings QoQ reflects lower forecast gains from the company's distressed loan portfolio.

Invesco Mortgage Capital. Invesco (IVR) announced a 3Q12 dividend of $0.65, unchanged from 2Q. This was in line with our dividend estimate. IVR reported core EPS of $0.64 and GAAP EPS of $0.68 in the second quarter. The company has effectively managed its prepayments (13.3% CPR in 2Q), and we forecast a modest increase to 15% in 3Q. We maintain our 3Q estimate of $0.63. Our 4Q estimate is $0.63 and our full year 2012 estimate is $2.66.

MFA Financial. MFA announced a 3Q dividend of $0.21, down from $0.23 in 2Q. This was in line with our dividend estimate. The company reported GAAP and operating EPS of $0.20 in 2Q. We are maintaining our 3Q and 4Q estimates of $0.20 per share. Our full year 2012 estimate remains $0.83.

Two Harbors. Two Harbors (TWO) announced a $0.36 dividend for 3Q12, down from $0.40 in 2Q, and versus our estimate of $0.35. The company reported 2Q12 GAAP EPS of $0.11 and operating EPS of $0.35 per share. We are maintaining our 3Q operating EPS estimate of $0.34. Our 4Q estimate is $0.33 and our full year 2012 estimate is $1.36. At its October 10 Investor Day, the company disclosed that its book value increased during 3Q to well above $11 per share, which suggests that the shares are trading fairly close to book value.

Redwood Trust. Redwood (RWT) announced a 3Q12 dividend of $0.25, unchanged from 2Q. This was in line with our estimate. Redwood generated GAAP and operating EPS of $0.24 and $0.23, respectively, in 2Q. The company recognized $1.8 million of mortgage banking income in 2Q and we estimate more modest gains in 3Q. We are maintaining our 3Q12 estimate of $0.23. Our 4Q estimate is $0.26 and our full year 2012 estimate is $0.94.

American Capital Mortgage. We initiated coverage of American Capital Mortgage (MTGE) on September 20th, 2012. The company announced a 3Q12 dividend of $0.90, unchanged from 2Q. We assume that the dividend remains stable through year end 2012. We are maintaining our 3Q EPS estimate of $0.84. Our 4Q estimate is $0.84 and our full year 2012 estimate is $3.55.

Exhibit 1 shows historical dividends for most companies and our dividend estimate for PennyMac. Exhibit 2 shows our 3Q12 EPS estimates.

Exhibit 1: MBS REIT Dividend History

	AGNC	ANH	CIM	CMO	HTS	IVR	MFA	NLY	PMT	RWT	TWO	MTGE
1Q10	$1.40	$0.27	$0.17	$0.50	$1.20	$0.78	$0.24	$0.65	$0.00	$0.25	$0.36	-
2Q10	$1.40	$0.25	$0.17	$0.36	$1.10	$0.74	$0.19	$0.68	$0.35	$0.25	$0.33	-
3Q10	$1.40	$0.23	$0.18	$0.26	$1.10	$1.00	$0.23	$0.68	$0.42	$0.25	$0.39	-
4Q10	$1.40	$0.22	$0.17	$0.39	$1.00	$0.97	$0.24	$0.64	$0.42	$0.25	$0.40	-
1Q11	$1.40	$0.25	$0.14	$0.41	$1.00	$1.00	$0.24	$0.62	$0.42	$0.25	$0.40	-
2Q11	$1.40	$0.25	$0.13	$0.48	$1.00	$0.97	$0.25	$0.65	$0.50	$0.25	$0.40	-
3Q11	$1.40	$0.23	$0.13	$0.44	$1.00	$0.80	$0.25	$0.60	$0.50	$0.25	$0.40	$0.20
4Q11	$1.40	$0.21	$0.11	$0.43	$0.90	$0.65	$0.25	$0.57	$0.55	$0.25	$0.40	$0.80
1Q12	$1.25	$0.21	$0.11	$0.43	$0.90	$0.65	$0.24	$0.55	$0.55	$0.25	$0.40	$0.90
2Q12	$1.25	$0.18	$0.09	$0.40	$0.90	$0.65	$0.23	$0.55	$0.55	$0.25	$0.40	$0.90
3Q12	$1.25	$0.15	$0.09	$0.36	$0.80	$0.65	$0.21	$0.50	$0.55	$0.25	$0.36	$0.90

Note: PMT's 3Q12 dividend is KBW's estimate. MFA's 4Q11 dividend excludes a $0.02 special dividend.

Source: Company reports and KBW Research.

Exhibit 2: MBS REIT 3Q12 EPS Estimates

	AGNC	ANH	CIM	CMO	HTS	IVR	MFA	NLY	PMT	RWT	TWO	MTGE
1Q10	$0.80	$0.27	$0.19	$0.51	$1.21	$0.77	$0.29	$0.61	$0.07	$0.17	$0.29	-
2Q10	$0.98	$0.21	$0.19	$0.35	$1.01	$0.91	$0.16	$0.59	$0.48	$0.25	$0.26	-
3Q10	$1.11	$0.19	$0.16	$0.27	$1.11	$1.01	$0.27	$0.60	$0.45	$0.25	$0.29	-
4Q10	$1.26	$0.21	$0.14	$0.40	$0.99	$1.00	$0.21	$0.52	$0.43	$0.16	$0.36	-
1Q11	$1.30	$0.24	$0.15	$0.41	$0.96	$1.01	$0.27	$0.60	$0.35	$0.25	$0.32	-
2Q11	$1.41	$0.24	$0.14	$0.48	$1.04	$0.99	$0.22	$0.70	$0.59	$0.19	$0.41	-
3Q11	$1.16	$0.22	$0.13	$0.43	$1.04	$0.79	$0.23	$0.55	$0.73	$0.17	$0.40	$0.23
4Q11	$0.95	$0.20	$0.11	$0.43	$0.92	$0.66	$0.19	$0.54	$0.70	$0.09	$0.40	$0.86
1Q12	$1.42	$0.20	NA	$0.44	$0.89	$0.72	$0.23	$0.44	$0.65	$0.22	$0.34	$1.07
2Q12	$0.94	$0.18	$0.09	$0.40	$0.86	$0.65	$0.21	$0.46	$0.70	$0.19	$0.35	$0.80
3Q12E	$1.13	$0.15	$0.09	$0.36	$0.80	$0.63	$0.20	$0.44	$0.73	$0.23	$0.34	$0.84

Note: Core EPS for AGNC, NLY, CIM, RWT, TWO, and MTGE.

Source: Company reports and KBW Research.

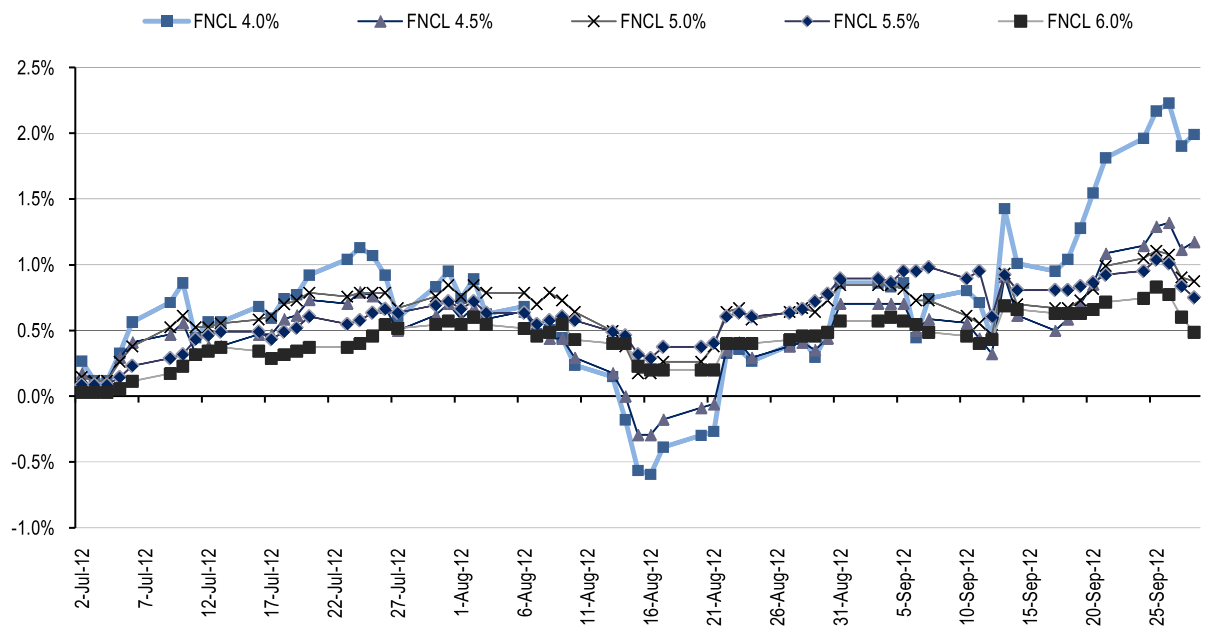
Book Value Changes in 3Q12

We believe that book values for most of the RMBS REITs were up meaningfully during 3Q. Thirty-year fixed rate Agency MBS prices ended the quarter up roughly 0.5% to 2% depending on the coupon. Lower-coupon MBS have performed particularly well since the Fed's announcement of QE3. Additionally, prepayment protected securities, such as bonds backed by mortgages that have refinanced through HARP, continued to outperform by an estimated 0.25% to 1% over generic MBS. Fifteen-year fixed rate MBS prices and Agency ARMs were generally strong as well. Swap rates declined with shorter dated swaps down more than longer-dated swaps. The 3-year swap rate declined 19 bps through 3Q while the 5-year swap rate was down 20 bps.

Credit assets have rallied sharply since June. The indices we track for subprime AAA assets ended up on average more than 15%, while non-Agency senior MBS prices ended up a more moderate 4-5% on average. However, we believe cash bonds generally did not move as much.

Exhibit 3 shows the change in prices for 30-year fixed-rate Agency MBS in 3Q12. Exhibit 8 at the end of this report shows our mark-to-market book value estimates for the companies.

Exhibit 3: 3Q12 Agency MBS Price Change



Source: Bloomberg.

Exhibit 4 shows the change in prices for the ABX and PrimeX indices during the quarter. While we use the ABX indices as a proxy for subprime bonds and the PrimeX as a proxy for non-Agency prime bonds, these indices are usually far more volatile than cash bonds. Also given the variety of bonds, price changes can vary meaningfully from the indices.

Exhibit 4: Non-Agency MBS Price Changes in 3Q12

	7/2/2012	7/30/2012	8/31/2012	9/28/2012	3Q12 % Chg.
Subprime AAA					
ABX.HE.AAA.06-2	51.06	53.42	55.46	58.45	14.5%
ABX.HE.AAA.07-1	40.40	42.02	43.24	47.02	16.4%
ABX.HE.AAA.07-2	36.68	41.39	43.07	45.63	24.4%
ABX.HE.PENAAA.06-2	74.14	75.98	76.68	78.90	6.4%
ABX.HE.PENAAA.07-1	51.67	54.06	56.11	59.20	14.6%
ABX.HE.PENAAA.07-2	37.85	43.38	45.37	49.17	29.9%
Average					**17.7%**
Non-Agency Senior (Jumbo)					
PRIMEX.FRM.1	106.49	107.51	108.49	109.46	2.8%
PRIMEX.FRM.2	97.91	99.36	100.41	102.24	4.4%
PRIMEX.ARM.1	104.57	106.44	107.63	108.95	4.2%
PRIMEX.ARM.2	93.04	95.19	96.49	99.58	7.0%
Average					**4.6%**

Source: Markit.com and KBW Research.

Prepayments Up in 3Q Although Down in September: We Expect an Increase in 4Q12

Prepayments declined in September after four consecutive months of increases. A big driver of the decrease was a lower day count in September. Exhibits 5 and 6 show monthly prepayment data for Fannie Mae and Freddie Mac through September. The weighted average CPR for Fannie Mae MBS decreased to 26.1% in September from 29.2% in August and was roughly flat with July, while the average CPR for Freddie Mac MBS came in at 27.9% in September from 30.5% in August and 27.3% in July. While we believe that mortgage industry capacity constraints should limit significant spikes in prepayment activity, we expect prepayments to increase in 4Q as mortgage rates trend down driven by QE3.

Exhibit 5: Fannie Mae Monthly Prepayment Summary

SUMMARY OF FANNIE MAE PREPAYMENT DATA														
						2012								
Coupon	RPB(MM)	WAC	WAM	WALA	% Chg	Sep CPR	Aug CPR	Jul CPR	Jun CPR	May CPR	Apr CPR	Mar CPR	Feb CPR	Jan CPR
FNM30	1,615,630.70	5.1	311.0	43.0	-10%	28.0	31.2	28.0	25.7	24.8	23.7	25.8	24.9	21.6
FNM20	108,879.60	4.6	207.0	30.0	-11%	22.4	25.1	22.1	19.1	18.4	18.6	21.6	20.7	18.1
FNM15	385,481.00	4.2	141.0	35.0	-11%	21.0	23.6	21.0	19.2	18.5	18.7	21.6	20.9	18.8
FNM10	40,169.00	3.9	95.0	22.0	-10%	20.2	22.6	20.0	18.2	17.1	16.0	18.5	18.3	16.8
LIBOR	86,558.40	3.6	322.0	38.0	-15%	22.4	26.4	24.1	23.3	22.2	20.0	21.2	20.1	17.5
TREAS	12,014.40	3.1	252.0	107.0	-21%	13.7	17.3	16.3	15.6	15.0	13.7	12.0	11.5	10.0
LIBOR-IO	38,501.20	4.2	302.0	58.0	-11%	24.8	27.9	25.6	25.8	25.4	22.7	21.9	20.2	18.1
TREAS-IO	3,119.40	3.6	277.0	83.0	-23%	25.0	32.5	29.8	25.8	26.9	22.8	21.0	20.0	16.4
Total / Wtd. Avg.	**2,290,353.70**	**4.8**	**274**	**41**	**-10%**	**26.1**	**29.2**	**26.2**	**24.0**	**23.2**	**22.3**	**24.4**	**23.6**	**20.6**

Source: eMBS, Inc.

Exhibit 6: Freddie Mac Monthly Prepayment Summary

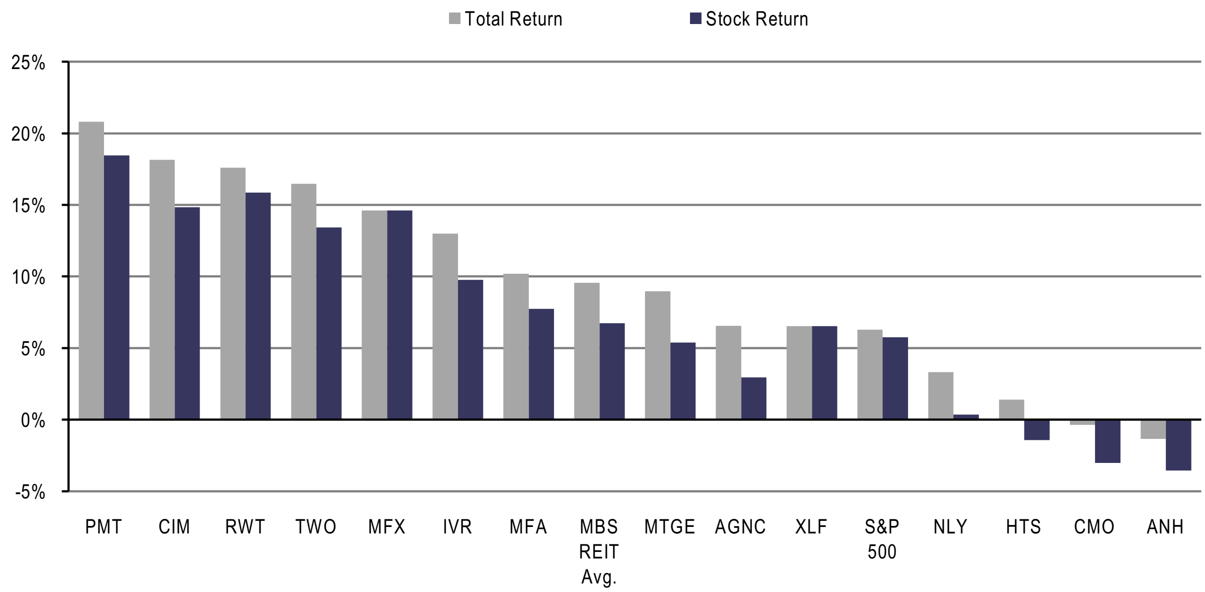
SUMMARY OF FREDDIE MAC PREPAYMENT DATA														
						2012								
Coupon	RPB(MM)	WAC	WAM	WALA	% Chg	Sep CPR	Aug CPR	Jul CPR	Jun CPR	May CPR	Apr CPR	Mar CPR	Feb CPR	Jan CPR
FHLG30	965,127.00	5.2	307.0	46.0	-8%	29.7	32.3	29.0	27.2	27.2	26.2	28.2	26.7	23.4
FHLG20	72,056.30	4.7	200.0	37.0	-7%	24.2	26.1	22.7	20.3	19.9	20.5	23.0	21.5	20.0
FHLG15	242,013.70	4.2	136.0	39.0	-9%	23.4	25.7	22.5	21.2	20.3	20.1	22.8	22.5	20.8
FHLG10	9,238.30	3.9	92.0	25.0	-6%	24.0	25.7	23.3	20.8	19.0	17.8	19.6	18.9	16.7
LIBOR	50,239.00	3.4	330.0	30.0	-13%	25.0	28.8	26.5	26.1	24.2	22.8	22.4	20.8	18.8
TREAS	14,339.40	3.3	260.0	100.0	-14%	17.0	19.7	18.8	20.4	20.2	18.1	16.5	14.9	13.6
LIBOR-IO	24,309.30	4.5	292.0	68.0	-15%	28.0	33.1	29.8	31.3	32.4	28.3	25.7	22.7	21.3
TREAS-IO	5,321.30	4.0	280.0	80.0	-10%	28.8	32.2	30.9	32.8	32.4	28.9	23.5	20.2	17.6
Total / Wtd. Avg.	**1,382,644.30**	**4.9**	**270.0**	**44.7**	**-8.5%**	**27.9**	**30.5**	**27.3**	**25.7**	**25.5**	**24.6**	**26.5**	**25.2**	**22.4**

Source: eMBS, Inc.

MBS REITs Outperformed the Broader Market

The MBS REITs outperformed the broader market in 3Q12 with an average total return of 9.6% versus 6.3% for the S&P 500. Returns reflected both strong share price appreciation and dividends (the average dividend yield came in at 2.8% unannualized). PMT and CIM were the best performers in the sector with total returns of 20.8% and 18.2%, respectively. Exhibit 7 shows the 3Q12 performance of the mortgage REITs versus the S&P 500.

Exhibit 7: 3Q12 Share Price Performance and Total Return for the MBS REITs



Source: FactSet, company reports, and KBW Research.

We Are More Positive on Hybrid Mortgage REITs

We remain positive on a number of the residential mortgage REITs. Given our concerns about prepayment we generally prefer hybrid REITs, such as TWO, MTGE, and MFA, that invest in both Agency MBS and non-agency MBS. In the Agency MBS space, we believe AGNC provides an attractive prepayment protected portfolio. Exhibit 8 shows our mortgage REIT universe and includes our mark-to-market book value estimates for the companies.

Exhibit 8: Residential Mortgage REIT Universe

MBS REITs	Agency MBS					Hybrid MBS				Non-Agency MBS		
	Annaly NLY	Hatteras HTS	Capstead CMO	Anworth ANH	American AGNC	MFA MFA	Invesco IVR	Two Harbors TWO	American MTGE	Chimera CIM	Redwood RWT	PennyMac PMT
Rating	MP	OP	OP	OP	OP	OP	MP	OP	OP	MP	MP	MP
Price Target	$17.50	$29.00	$14.00	$7.50	$35.00	$8.50	$20.00	$11.50	$26.00	$3.00	$13.00	$21.00
Market Capitalization (billions)	$16.00	$2.69	$1.25	$0.88	$11.51	$3.04	$2.42	$3.36	$0.93	$2.75	$1.15	$1.43
Current price	$16.17	$26.92	$12.51	$6.24	$33.07	$8.25	$20.83	$11.71	$24.77	$2.62	$14.47	$24.07
1Q11 Book Value	$15.76	$26.11	$12.15	$6.92	$25.96	$7.86	$21.24	$9.90	NA	$3.18	$13.76	$18.67
2Q11 Book Value	$16.55	$26.72	$12.46	$7.06	$26.76	$7.48	$19.34	$9.73	NA	$3.08	$13.04	$18.82
3Q11 Book Value	$16.22	$26.32	$12.50	$6.93	$26.90	$7.16	$16.47	$9.30	$19.96	$3.01	$12.22	$19.04
4Q11 Book Value	$16.06	$27.08	$12.52	$6.96	$27.71	$6.74	$16.41	$9.03	$20.87	$2.82	$11.36	$19.22
1Q12 Book Value	$16.18	$27.30	$13.04	$7.17	$29.06	$7.49	$18.42	$9.67	$21.78	$2.76	$12.22	$19.21
2Q12 Book Value	$16.23	$27.45	$13.23	$7.19	$29.35	$7.45	$18.40	$9.94	$22.08	$2.87	$12.00	$19.43
Current Estimated Book Value	$16.72	$28.96	$13.74	$7.54	$32.29	$7.80	$19.36	$11.25	$23.65	$2.87	$12.14	$20.05
Current price/book	**97%**	**93%**	**91%**	**83%**	**102%**	**106%**	**108%**	**104%**	**105%**	**91%**	**119%**	**120%**
Target Price/Book	105%	100%	102%	99%	108%	109%	103%	102%	110%	105%	107%	105%
12 mo. Forward Dividend Est.	$1.80	$3.32	$1.52	$0.68	$5.00	$0.84	$2.60	$1.35	$3.20	$0.36	$1.00	$2.20
12 mo. Forward Dividend Yield	**11.1%**	**12.3%**	**12.2%**	**10.9%**	**15.1%**	**10.2%**	**12.5%**	**11.5%**	**12.9%**	**13.7%**	**6.9%**	**9.1%**
Target Dividend Yield	10.3%	11.4%	10.9%	9.1%	14.3%	9.9%	13.0%	11.7%	12.3%	12.0%	7.7%	10.5%
Total Price Upside	8.2%	7.7%	11.9%	20.2%	5.8%	3.0%	-4.0%	-1.8%	5.0%	14.5%	-10.2%	-12.8%
Total Estimated Return	**19.4%**	**20.1%**	**24.1%**	**31.1%**	**21.0%**	**13.2%**	**8.5%**	**9.7%**	**17.9%**	**28.2%**	**-3.2%**	**-3.6%**

Note: OP = Outperform, MP = Market Perform.

Source: Company reports, FactSet, and KBW Research. Priced as of October 10, 2012.

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KBW

			*IB Serv./Past 12 Mos.	
Rating	**Count**	**Percent**	**Count**	**Percent**
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Market Perform [HOLD]	**359**	**53.66**	**96**	**26.74**
Underperform [SELL]	**56**	**8.37**	**9**	**16.07**
Restricted [RES]	**0**	**0.00**	**0**	**0.00**
Suspended [SP]	**81**	**12.11**	**19**	**23.46**
Covered -Not Rated [CNR]	**2**	**0.30**	**1**	**50.00**

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