REIT Growth and Income Monitor

REIT Sector Comments

Financial Mortgage REITs

09/08/2009

Notes:

Financial Mortgage REITs are among the best performing REIT sectors for 2009, trading up 28% on average year to date for 2009, compared to average gain of 13% for all REITs followed by **REIT Growth and Income Monitor**. Expansionary monetary policy pursued by the Federal Open Market Committee maintains low interest rates, providing a favorable operating environment for Financial Mortgage REITs.

Yields on Financial Mortgage REITs range from 6.0% for **Redwood Trust** to 16.9% for **Anworth Mortgage Asset**. Valuations, as measured by ratio of total capitalization to annualized EPS, ranges from 25.8X for **Annaly Capital Management** to 47.5X for **Capstead Mortgage**.

News on housing trends appears to support additional gains for Financial Mortgage REITs. National Association of Realtors reported 7% increase in home sales for July, 2009, marking a fourth consecutive month of improvement. This positive news was offset by higher mortgage delinquencies, up (44%) to 4 million. As most of the MBS held by Financial Mortgage REITs are conforming loans guaranteed by federal agencies, this continuing credit concern is unlikely to impact Financial Mortgage REIT stock price performance.

Annaly Capital Management is reporting outstanding profitability improvement, as EPS gained 71% from the previous quarter to $1.08 per share for 2Q 2009. **Annaly Capital Management** continues to enjoy wide investment spread on its MBS portfolio, with NIM (net interest margin) of 2.47%, up 0.48% from the previous quarter.

Today's environment of low interest rates and a steep yield curve provides a positive environment for Financial Mortgage REITs to continue to outperform, until the yield curve flattens or inverts. **MFA Financial** was able to increase NIM by 0.54% from 1.77% for March, 2009 to 2.31% for June, 2009, due to higher portfolio yields and lower borrowing costs. **Capstead Mortgage** and **Anworth Mortgage Asset** also enjoyed impressive profitability for 2Q 2009.

In contrast, Financial Mortgage REITs that are mortgage originators face serious challenges. Portfolio exposure to states experiencing high unemployment, including California and New York, is a significant risk factor for **Redwood Trust**, with a portfolio concentrated in non-conforming jumbo residential mortgages. We maintain SELL rank on **Redwood Trust**, expecting portfolio impairments and loan chargeoffs to impact EPS for the rest of 2009.