



## Financial Mortgage REIT Sector Comments

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### Summary and Outlook

Financial Mortgage REITs traded up 14% during the first 8 months of 2014, showing stark contrast to decline for Financial Commercial REITs. The highest yielding sector among all REIT stocks, with an average annual dividend yield of 10.2%, stocks of Financial Mortgage REITs still offer unusual discounts to book value, reflecting fear of renewed bond market volatility, as the Federal Reserve sees the end to program of monetary ease. While principal repayment is assured for Financial Mortgage REITs invested in agency guaranteed Residential MBS, GAAP accounting requires that book value reflect unrealized portfolio gains and losses. Portfolio net interest income varies from quarter to quarter as yields and repayments impact portfolio holdings. Underlying demand growth for mortgages parallels growth of the US housing sector, with new demand for mortgages and mortgage refinancings driven by home prices and by variability in mortgage rates. Fannie Mae reform has been debated by Congress during 2014, with much opposition from liberal representatives and industry experts. Given hesitancy to upset the status quo, most likely scenario is that actual change will be postponed beyond the 2016 elections.

### Yield Range

Yields for Financial Mortgage REITs range from 5.8% for **Redwood Trust** to 13.7% for **CYS Investments**. Average yield for Financial Mortgage REITs is 10.2%. Most Financial Mortgage REITs adjust cash dividend distributions quarterly, reflecting variability in net interest income.

### Capitalization Range

Market cap for Financial Mortgage REITs totals \$23 billion, representing 3% of total market cap for all REITs followed by **REITMonitor.net**. Financial Mortgage REITs report total capitalization (including market cap, as well as debt, preferred stock and non-trading equity) in a range of 26.6X-165.7X to annualized FFO. Lowest valuation is **CYS Investments** and highest is **Anworth Mortgage Asset**.

### S&P 500 Index Financial Mortgage REITs

At this time, there are no Financial Mortgage REITs included in the S&P 500 Index. The largest Financial Mortgage REIT market cap is **Annaly Capital Management** (at market cap of \$11 billion, yielding 10.1%). Although **Annaly Capital Management's** market cap is adequate for inclusion in the S&P 500 Index, it appears unlikely to be included as a financial investment company, whereas most financial stocks in the S&P 500 Index are banks, stockbrokers and insurance companies.

### Financial Mortgage REIT Rankings

Opportunity to buy Financial Mortgage REITs at significant discounts to book value caused us to raise recommendations to our highest BUY rank for **Annaly Capital Management**, **Capstead Mortgage**, **CYS Investments** and **Hatteras Financial**. Other BUY rankings include **Anworth Mortgage Asset**, **New Residential Investment** and **MFA Financial**. We maintain HOLD rank on **Redwood Trust**, reflecting lower dividend yield and difficulty securitizing non-conforming mortgages.

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