CYS Investments, Inc.
Form 10-Q
October 19, 2012
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2012

OR

¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to .

Commission file number 001-33740

CYS Investments, Inc.
(Exact name of registrant as specified in its charter)

Maryland (State or other jurisdiction of incorporation or organization)	20-4072657 (IRS Employer Identification No.)
890 Winter Street, Suite 200 Waltham, Massachusetts	02451
(Address of principal executive offices)	(Zip Code)

(617) 639-0440
(Registrant’s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. Check one:

Large accelerated filer	x	Accelerated filer	¨
Non-accelerated filer	¨ (Do not check if a smaller reporting company)	Smaller reporting company	¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

Indicate the number of shares outstanding of each of the issuer’s classes of common stock, as of the latest practicable date.

Class	Outstanding at October 17, 2012

Common Stock ($0.01 par value)	174,950,026

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PART I. Financial Information
Item 1. Financial Statements
CYS INVESTMENTS, INC.
CONDENSED STATEMENTS OF ASSETS AND LIABILITIES (UNAUDITED)

(In thousands, except per share numbers)	September 30, 2012	December 31, 2011*
ASSETS:		
Investments in securities, at fair value (including pledged assets of $14,752,504 and $8,412,295, respectively)	$22,646,305	$9,466,128
Interest rate cap contracts, at fair value	125,331	5,966
Cash and cash equivalents	20,496	11,508
Receivable for securities sold and principal repayments	20,423	5,550
Interest receivable	50,433	27,815
Other assets	1,129	1,090
Total assets	22,864,117	9,518,057
LIABILITIES:		
Repurchase agreements	13,911,977	7,880,814
Interest rate swap contracts, at fair value	111,725	79,476
Payable for securities purchased	6,084,047	463,302
Payable for cash received as collateral	47,960	—
Distribution payable	79,677	—
Accrued interest payable (including accrued interest on repurchase agreements of $5,086 and $3,747, respectively)	19,389	15,617
Accrued expenses and other liabilities	4,606	1,390
Total liabilities	20,259,381	8,440,599
Commitments and contingencies (note 6)	—	—
NET ASSETS	$2,604,736	$1,077,458
Net assets consist of:		
Series A Cumulative Redeemable Preferred Stock, $0.01 par value, 50,000 shares authorized (3,000 and 0 shares issued and outstanding, respectively, liquidation preference of $25.00 per share or $75,000 and $0 in aggregate, respectively)	$72,488	$—
Common Stock, $0.01 par value, 500,000 shares authorized (174,942 and 82,753 shares issued and outstanding, respectively)	1,749	828
Additional paid in capital	2,236,234	997,884
Retained earnings	294,265	78,746
NET ASSETS	$2,604,736	$1,077,458
NET ASSET VALUE PER COMMON SHARE	$14.46	$13.02

* Derived from audited financial statements.

See notes to condensed financial statements.

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CYS INVESTMENTS, INC.
CONDENSED SCHEDULES OF INVESTMENTS
SEPTEMBER 30, 2012 (UNAUDITED)
INVESTMENTS IN SECURITIES – UNITED STATES OF AMERICA

(In thousands)	Face Amount	Fair Value
Fixed Income Securities - 869.4%(c)		
Mortgage Pass-Through Agency RMBS - 867.5%(c)		
Fannie Mae Pools - 829.0%(c)		
2.290%, due 11/1/2042(b)	$100,000	$104,438
2.350%, due 12/1/2042(b)	100,000	104,438
2.399%, due 9/1/2042(a)(b)	39,731	41,576
2.416%, due 7/1/2042(a)(b)	49,772	52,059
2.438%, due 10/1/2042(b)	201,410	211,042
2.443%, due 7/1/2042(a)(b)	50,121	52,500
2.448%, due 10/1/2042(a)(b)	55,392	58,025
2.455%, due 6/1/2042(a)(b)	58,484	61,237
2.510%, due 10/1/2042(b)	52,000	54,730
2.516%, due 10/1/2042(a)(b)	99,646	104,529
2.564%, due 7/1/2042(a)(b)	53,369	56,079
2.584%, due 8/1/2042(a)(b)	34,823	36,577
2.618%, due 7/1/2042(a)(b)	49,168	51,679
2.641%, due 4/1/2042(a)(b)	36,977	38,937
2.707%, due 6/1/2042(a)(b)	70,311	74,028
2.789%, due 1/1/2042(a)(b)	43,772	46,176
2.792%, due 3/1/2042(a)(b)	45,622	48,130
2.795%, due 4/1/2042(a)(b)	186,713	197,142
2.804%, due 2/1/2042(a)(b)	26,924	28,419
2.808%, due 2/1/2042(a)(b)	50,760	53,546
2.811%, due 2/1/2042(a)(b)	60,944	64,271
2.819%, due 4/1/2042(a)(b)	54,944	58,035
2.837%, due 2/1/2042(a)(b)	35,708	37,713
2.857%, due 12/1/2041(a)(b)	56,874	60,082
2.867%, due 1/1/2042(a)(b)	62,266	66,113
2.904%, due 2/1/2042(a)(b)	43,257	45,637
2.995%, due 1/1/2041(a)(b)	32,811	34,327
3.000%, due 9/1/2026 - 12/1/2032(a)	7,757,362	8,236,480
3.022%, due 12/1/2040(a)(b)	111,353	116,493
3.054%, due 9/1/2041(a)(b)	41,862	44,085
3.056%, due 9/1/2041(a)(b)	38,752	40,939
3.164%, due 9/1/2041(a)(b)	34,151	36,252
3.170%, due 11/1/2041(a)(b)	30,140	31,990
3.176%, due 10/1/2041(a)(b)	41,800	44,371
3.216%, due 9/1/2041(a)(b)	93,117	98,647
3.237%, due 3/1/2041(a)(b)	16,366	17,298
3.242%, due 10/1/2041(b)	78,850	83,688
3.246%, due 4/1/2041(a)(b)	42,976	45,322
3.292%, due 9/1/2041(a)(b)	72,379	76,731
3.300%, due 5/1/2041(a)(b)	34,624	36,505

3.302%, due 6/1/2041(a)(b)	93,557	98,639

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CYS INVESTMENTS, INC.
CONDENSED SCHEDULES OF INVESTMENTS - (Continued)
SEPTEMBER 30, 2012 (UNAUDITED)

	Face Amount	Fair Value
3.305%, due 10/1/2041(a)(b)	$117,613	$124,637
3.366%, due 8/1/2041(a)(b)	28,702	30,875
3.369%, due 5/1/2041(a)(b)	18,800	19,813
3.372%, due 6/1/2041(a)(b)	88,645	93,826
3.376%, due 4/1/2041(a)(b)	41,233	43,634
3.500%, due 7/1/2021(a)	224,154	238,674
3.500%, due 12/1/2025 - 5/1/2027(a)	2,516,746	2,680,835
3.500%, due 8/1/2042 - 12/1/2042(a)	4,105,608	4,392,654
3.514%, due 8/1/2040(a)(b)	29,486	31,228
3.621%, due 6/1/2041(a)(b)	52,201	55,497
3.651%, due 7/1/2040(a)(b)	31,181	32,953
3.665%, due 8/1/2040(a)(b)	28,671	30,413
3.710%, due 5/1/2040(a)(b)	26,062	27,726
3.789%, due 7/1/2040(a)(b)	25,580	27,191
3.937%, due 10/1/2039(a)(b)	24,479	25,896
3.990%, due 9/1/2039(a)(b)	11,947	12,642
4.000%, due 10/1/2024 - 6/1/2026(a)	1,288,581	1,378,755
4.000%, due 8/1/2042	118,750	128,994
4.500%, due 10/1/2024 - 6/1/2025(a)	56,508	61,060
4.500%, due 4/1/2030 - 11/1/2030(a)	130,880	142,333
4.500%, due 11/1/2041(a)	268,801	291,875
5.000%, due 11/1/2042	800,000	872,250
Total Fannie Mae Pools	20,273,716	21,592,666
Freddie Mac Pools - 33.5%(c)		
2.435%, due 6/1/2042(b)	39,657	41,570
2.451%, due 7/1/2042(a)(b)	49,813	52,158
2.518%, due 9/1/2042(a)(b)	129,907	136,378
2.539%, due 7/1/2042(a)(b)	42,137	44,231
2.605%, due 3/1/2042(a)(b)	37,454	39,546
2.796%, due 12/1/2041(a)(b)	45,655	48,163
3.237%, due 2/1/2041(a)(b)	32,655	34,612
3.270%, due 6/1/2041(a)(b)	35,001	36,904
3.287%, due 1/1/2041(a)(b)	37,191	39,473
3.407%, due 9/1/2041(a)(b)	38,644	40,967
3.500%, due 4/1/2026 - 2/1/2027(a)	205,171	217,276
3.630%, due 6/1/2041(a)(b)	34,960	36,897
4.000%, due 10/1/2025(a)	40,748	43,368
4.500%, due 12/1/2024 - 5/1/2025(a)	57,325	61,502
Total Freddie Mac Pools	826,318	873,045
Ginnie Mae Pools - 5.0%(c)		
3.500%, due 7/20/2040(a)(b)	108,238	115,472
4.000%, due 1/20/2040(a)(b)	14,712	15,756
Total Ginnie Mae Pools	122,950	131,228
Total Mortgage Pass-Through Agency RMBS (Cost - $22,146,485)	21,222,984	22,596,939
U.S. Treasury Bills - 1.2%(c)		

0.060%, due 2/7/2013(a)(d)	30,000	29,989

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CYS INVESTMENTS, INC.
CONDENSED SCHEDULES OF INVESTMENTS - (Continued)
SEPTEMBER 30, 2012 (UNAUDITED)

Total U.S. Treasury Bills (Cost - $29,985)	$30,000	$29,989
Other investments (Cost - $13,221)(e) - 0.7%(c)	20,473	19,377
Total Investments in Securities (Cost - $22,189,691)	$21,273,457	$22,646,305

Interest Rate Cap Contracts - 4.8%(c)

Expiration	Cap Rate		Notional Amount	Fair Value
12/30/2014	2.073	%	$ 200,000	$64
10/15/2015	1.428	%	300,000	489
11/8/2015	1.360	%	200,000	374
5/23/2019	2.000	%	300,000	7,007
6/1/2019	1.750	%	300,000	7,998
6/29/2019	1.500	%	300,000	9,057
7/2/2019	1.500	%	300,000	9,389
7/16/2019	1.250	%	500,000	17,770
7/16/2022	1.750	%	500,000	36,610
7/25/2022	1.750	%	500,000	36,573
Total Interest Rate Cap Contracts (Cost, $139,793)			$ 3,400,000	$125,331

Interest Rate Swap Contracts - (4.3%)(c)(f)

Expiration	Pay Rate		Notional Amount	Fair Value	
5/26/2013	1.600	%	$ 100,000	$(822	)
6/30/2013	1.378	%	300,000	(2,315	)
7/15/2013	1.365	%	300,000	(2,425	)
12/15/2013	1.309	%	400,000	(4,670	)
12/16/2013	1.264	%	400,000	(4,452	)
12/16/2013	1.281	%	500,000	(5,625	)
12/17/2013	1.323	%	400,000	(4,717	)
7/1/2014	1.720	%	100,000	(2,377	)
7/16/2014	1.733	%	250,000	(6,137	)
8/16/2014	1.353	%	200,000	(3,711	)
9/23/2014	1.312	%	500,000	(9,342	)
10/6/2014	1.173	%	240,000	(3,875	)
2/14/2015	2.145	%	500,000	(20,823	)
6/2/2016	1.940	%	300,000	(15,471	)
(g)12/19/2016	1.426	%	250,000	(7,961	)
(h)4/24/2017	1.310	%	500,000	(11,536	)
7/13/2017	0.860	%	750,000	(4,835	)
9/6/2017	0.768	%	250,000	(124	)
9/6/2017	0.775	%	500,000	(443	)
9/6/2017	0.765	%	250,000	(64	)
Interest Rate Swap Contracts (Cost, $0)			$ 6,990,000	$(111,725	)

LEGEND

(a) Securities or a portion of the securities are pledged as collateral for repurchase agreements or interest rate swap contracts.

(b) The coupon rate shown on floating or adjustable rate securities represents the rate at September 30, 2012.

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CYS INVESTMENTS, INC.
CONDENSED SCHEDULES OF INVESTMENTS - (Continued)
SEPTEMBER 30, 2012 (UNAUDITED)

(c) Percentage of net assets.
(d) Zero coupon bond, rate shown represents purchase yield.
(e) Comprised of investments that were individually less than 1% of net assets.
(f) The Company’s interest rate swap contracts receive a floating rate set quarterly to three month LIBOR.
(g) The interest rate swap effective date is December 19, 2012 and does not accrue any income or expense until that date.
(h) The interest rate swap effective date is April 24, 2013 and does not accrue any income or expense until that date.

See notes to condensed financial statements.

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CYS INVESTMENTS, INC.
CONDENSED SCHEDULES OF INVESTMENTS - (Continued)
DECEMBER 31, 2011 (UNAUDITED)*

INVESTMENTS IN SECURITIES – UNITED STATES OF AMERICA

(In thousands)	Face Amount	Fair Value
Fixed Income Securities - 878.6% (c)		
Mortgage Pass-Through Agency RMBS - 869.9% (c)		
Fannie Mae Pools - 785.0% (c)		
2.820%, due 3/1/2042(b)	$20,000	$20,627
2.840%, due 1/1/2042(b)	36,000	37,288
2.850%, due 1/1/2042(b)	16,000	16,575
2.880%, due 12/1/2041(b)	63,081	65,342
2.900%, due 2/1/2042(b)	50,000	51,750
2.940%, due 1/1/2042(b)	15,000	15,572
2.979%, due 10/1/2040(a)(b)	43,981	45,730
3.005%, due 1/1/2041(a)(b)	40,986	42,804
3.028%, due 12/1/2040(a)(b)	150,737	157,242
3.050%, due 9/1/2041(a)(b)	48,486	50,252
3.054%, due 9/1/2041(a)(b)	48,199	50,255
3.120%, due 1/1/2042(b)	50,000	52,016
3.168%, due 9/1/2041(a)(b)	39,736	41,366
3.176%, due 1/1/2042(b)	36,000	37,530
3.178%, due 10/1/2041(a)(b)	50,099	52,153
3.179%, due 7/1/2041(a)(b)	36,737	38,265
3.200%, due 6/1/2041(a)(b)	180,296	187,753
3.214%, due 11/1/2040(a)(b)	37,557	39,183
3.224%, due 7/1/2040(a)(b)	41,581	43,485
3.238%, due 9/1/2041(a)(b)	110,829	115,419
3.239%, due 3/1/2041(a)(b)	17,931	18,644
3.246%, due 4/1/2041(a)(b)	59,124	61,544
3.251%, due 10/1/2041(a)(b)	101,419	105,830
3.255%, due 11/1/2040(a)(b)	42,699	44,561
3.258%, due 12/1/2040(a)(b)	62,487	65,219
3.263%, due 6/1/2041(a)(b)	51,090	53,186
3.282%, due 5/1/2041(a)(b)	41,835	43,569
3.284%, due 9/1/2041(a)(b)	89,046	92,760
3.287%, due 6/1/2041(a)(b)	115,948	120,770
3.308%, due 6/1/2041(a)(b)	33,112	34,480
3.308%, due 10/1/2041(a)(b)	145,746	151,824
3.356%, due 8/1/2041(a)(b)	31,291	32,620
3.366%, due 5/1/2041(a)(b)	22,685	23,661
3.387%, due 4/1/2041(a)(b)	52,425	54,583
3.391%, due 4/1/2041(a)(b)	46,394	48,322
3.396%, due 6/1/2041(a)(b)	109,987	114,549
3.500%, due 7/1/2021 (a)	272,115	284,948
3.500%, due 12/1/2025 - 1/1/2027(a)	2,337,971	2,446,851
3.546%, due 8/1/2040(a)(b)	37,780	39,569
3.564%, due 7/1/2040(a)(b)	13,746	14,405

3.574%, due 7/1/2040(a)(b)	16,592	17,388
3.577%, due 8/1/2040(a)(b)	37,002	38,791

CYS INVESTMENTS, INC.
CONDENSED SCHEDULES OF INVESTMENTS - (Continued)
DECEMBER 31, 2011 (UNAUDITED)*

	Face Amount	Fair Value
3.599%, due 6/1/2041(a)(b)	$64,248	$67,400
3.616%, due 6/1/2041(a)(b)	62,636	65,703
3.677%, due 7/1/2040(a)(b)	39,283	41,115
3.682%, due 8/1/2040(a)(b)	37,852	39,770
3.699%, due 5/1/2040(a)(b)	31,975	33,665
3.701%, due 8/1/2040(a)(b)	9,420	9,902
3.734%, due 9/1/2039(a)(b)	25,442	26,734
3.811%, due 7/1/2040(a)(b)	33,941	35,739
3.951%, due 9/1/2039(a)(b)	14,578	15,410
3.965%, due 10/1/2039(a)(b)	30,165	31,831
4.000%, due 10/1/2024 - 6/1/2026(a)	1,689,232	1,783,467
4.000%, due 9/1/2030 - 12/1/2030(a)	392,940	415,235
4.500%, due 5/1/2023 - 3/1/2026(a)	369,311	393,873
4.500%, due 4/1/2030 - 11/1/2030(a)	158,827	169,867
5.000%, due 4/1/2041 - 5/1/2041(a)	239,747	259,123
Total Fannie Mae Pools	8,053,327	8,457,515
Freddie Mac Pools - 71.2% (c)		
2.983%, due 9/1/2041(a)(b)	48,696	50,838
3.025%, due 9/1/2041(a)(b)	49,029	51,159
3.236%, due 12/1/2040(a)(b)	42,661	44,466
3.240%, due 2/1/2041(a)(b)	39,068	40,779
3.246%, due 1/1/2041(a)(b)	46,017	48,037
3.272%, due 6/1/2041(a)(b)	45,131	46,984
3.423%, due 9/1/2041(a)(b)	48,337	50,535
3.500%, due 4/1/2026(a)	180,607	188,414
3.645%, due 6/1/2041(a)(b)	46,075	48,390
4.000%, due 10/1/2025(a)	57,327	60,183
4.500%, due 7/1/2024 - 5/1/2025(a)	129,517	137,334
Total Freddie Mac Pools	732,465	767,119
Ginnie Mae Pools - 13.7% (c)		
3.500%, due 7/20/2040(a)(b)	78,468	82,891
3.500%, due 7/20/2040(a)(b)	44,331	46,830
4.000%, due 1/20/2040(a)(b)	17,026	18,099
Total Ginnie Mae Pools	139,825	147,820
Total Mortgage Pass-Through Agency RMBS (Cost - $9,148,730)	8,925,617	9,372,454
U.S. Treasury Bills - 7.0% (c)		
0.060%, due 2/9/2012(d)	75,000	74,999
Total U.S. Treasury Bills (Cost - $74,995)	75,000	74,999
Other investments (Cost - $15,318)(e) - 1.7%(c)	27,944	18,675
Total Investments in Securities (Cost - $9,239,043)	$9,028,561	$9,466,128

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CYS INVESTMENTS, INC.
CONDENSED SCHEDULES OF INVESTMENTS - (Continued)
DECEMBER 31, 2011 (UNAUDITED)*

Interest Rate Cap Contracts - 0.6%[(c)]

Expiration	Cap Rate	Notional Amount	Fair Value
12/30/2014	2.073 %	$200,000	$656
10/15/2015	1.428 %	300,000	3,062
11/8/2015	1.360 %	200,000	2,248
Total Interest Rate Cap Contracts (Cost, $13,722)		$700,000	$5,966

Interest Rate Swap Contracts - (7.4%)[(c)(f)]

Expiration	Pay Rate	Notional Amount	Fair Value
5/26/2013	1.600 %	$100,000	$(1,266)
6/30/2013	1.378 %	300,000	(3,000)
7/15/2013	1.365 %	300,000	(3,034)
12/15/2013	1.309 %	400,000	(4,587)
12/16/2013	1.264 %	400,000	(4,230)
12/16/2013	1.281 %	500,000	(5,421)
12/17/2013	1.323 %	400,000	(4,695)
7/1/2014	1.720 %	100,000	(2,375)
7/16/2014	1.733 %	250,000	(6,149)
8/16/2014	1.353 %	200,000	(3,059)
9/23/2014	1.312 %	500,000	(7,115)
10/6/2014	1.173 %	240,000	(2,520)
2/14/2015	2.145 %	500,000	(20,274)
6/2/2016	1.940 %	300,000	(11,027)
(g)12/19/2016	1.426 %	250,000	(724)
Interest Rate Swap Contracts (Cost, $0)		$4,740,000	$(79,476)

LEGEND

* Derived from audited financial statements.
(a) Securities or a portion of the securities are pledged as collateral for repurchase agreements or interest rate swap contracts.
(b) The coupon rate shown on floating or adjustable rate securities represents the rate at December 31, 2011.
(c) Percentage of net assets.
(d) Zero coupon bond, rate shown represents purchase yield.
(e) Comprised of investments that were individually less than 1% of net assets.
(f) The Company’s interest rate swap contracts receive a floating rate set quarterly to three month LIBOR.
(g) The interest rate swap effective date is December 19, 2012 and does not accrue any income or expense until that date.

See notes to condensed financial statements.

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CYS INVESTMENTS, INC.
CONDENSED STATEMENTS OF OPERATIONS (UNAUDITED)

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands, except per share numbers)	2012	2011	2012	2011
INVESTMENT INCOME:				
Interest income from Agency RMBS	$ 75,609	$ 63,548	$ 210,108	$ 168,263
Other income	1,022	1,018	3,639	3,003
Total investment income	76,631	64,566	213,747	171,266
EXPENSES:				
Interest	11,893	4,778	27,739	12,352
Management fees	—	2,291	—	8,442
Compensation and benefits	3,068	4,338	9,578	5,472
General, administrative and other	2,272	3,203	6,160	5,202
Total expenses	17,233	14,610	43,477	31,468
Net investment income	59,398	49,956	170,270	139,798
GAINS AND (LOSSES) FROM INVESTMENTS:				
Net realized gain (loss) on investments	27,049	13,267	93,335	28,613
Net unrealized appreciation (depreciation) on investments	194,078	107,692	229,528	241,390
Net gain (loss) from investments	221,127	120,959	322,863	270,003
GAINS AND (LOSSES) FROM SWAP AND CAP CONTRACTS:				
Net swap and cap interest income (expense)	(17,255)	(15,469)	(41,448)	(42,202)
Net gain (loss) on termination of swap contracts	—	—	—	(3,492)
Net unrealized appreciation (depreciation) on swap and cap contracts	(21,363)	(59,125)	(38,955)	(116,267)
Net gain (loss) from swap and cap contracts	(38,618)	(74,594)	(80,403)	(161,961)
NET INCOME	$ 241,907	$ 96,321	$ 412,730	$ 247,840
DIVIDEND ON PREFERRED STOCK	(953)	—	(953)	—
NET INCOME AVAILABLE TO COMMON SHARES	$ 240,954	$ 96,321	$ 411,777	$ 247,840
NET INCOME PER COMMON SHARE BASIC & DILUTED	$ 1.46	$ 1.16	$ 3.19	$ 3.15

See notes to condensed financial statements.

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CYS INVESTMENTS, INC.
CONDENSED STATEMENT OF CHANGES IN NET ASSETS (UNAUDITED)

(In thousands)	Three Months Ended September 30, 2012	Nine Months Ended September 30, 2012
Net income:		
Net investment income	$59,398	$170,270
Net realized gain (loss) on investments	27,049	93,335
Net unrealized appreciation (depreciation) on investments	194,078	229,528
Net gain (loss) on swap and cap contracts	(38,618)	(80,403)
Net income	241,907	412,730
Dividend on preferred stock	(953)	(953)
Net income available to common shares	240,954	411,777
Capital transactions:		
Net proceeds from issuance of common shares	739,443	1,237,152
Net proceeds from issuance of preferred shares	72,488	72,488
Distributions to common stockholders	(78,724)	(196,258)
Amortization of share based compensation	721	2,119
Increase in net assets from capital transactions	733,928	1,115,501
Total increase in net assets	974,882	1,527,278
Net assets:		
Beginning of period	1,629,854	1,077,458
End of period	$2,604,736	$2,604,736

See notes to condensed financial statements.

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CYS INVESTMENTS, INC.
CONDENSED STATEMENTS OF CASH FLOWS (UNAUDITED)

	Nine Months Ended September 30,	
(In thousands)	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 412,730	$ 247,840
Adjustments to reconcile net income to net cash used in operating activities:		
Purchase of investment securities	(26,295,320)	(6,104,138)
Premium paid on interest rate caps	(133,483)	—
Proceeds from disposition of investment securities	11,428,649	2,355,791
Proceeds from paydowns of investment securities	1,940,265	828,994
Amortization of share based compensation	2,119	4,691
Amortization of premiums and discounts on investment securities	69,092	27,289
Amortization of premiums on interest rate cap contracts	7,412	2,879
Net realized (gain) loss on investments	(93,335)	(28,613)
Net unrealized (appreciation) depreciation on investments	(229,528)	(241,390)
Net unrealized (appreciation) depreciation on swap and cap contracts	38,955	116,267
Change in assets and liabilities:		
Receivable for securities sold and principal repayments	(14,873)	(3,486)
Interest receivable	(22,618)	(11,410)
Other assets	(39)	(950)
Payable for securities purchased	5,620,745	(1,472,279)
Accrued interest payable	3,772	8,782
Related party management fee payable	—	(800)
Accrued expenses and other liabilities	3,216	2,532
Payable for cash received as collateral	47,960	—
Net cash used in operating activities	(7,214,281)	(4,268,001)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from repurchase agreements	59,689,598	31,273,293
Repayments of repurchase agreements	(53,658,435)	(27,176,468)
Net proceeds from issuance of common shares	1,235,842	275,936
Net proceeds from issuance of preferred shares	72,488	—
Distributions paid	(116,224)	(99,090)
Net cash provided by financing activities	7,223,269	4,273,671
Net increase (decrease) in cash and cash equivalents	8,988	5,670
CASH AND CASH EQUIVALENTS - Beginning of period	11,508	1,510
CASH AND CASH EQUIVALENTS - End of period	$ 20,496	$ 7,180
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Interest paid	$ 67,128	$ 47,975
SUPPLEMENTAL DISCLOSURES OF NONCASH FLOW INFORMATION:		
Distributions declared, not yet paid	$ 79,677	$ 45,509
Reinvestment of common share distributions	$ 1,310	$ —

See notes to condensed financial statements.

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CYS INVESTMENTS, INC.
CONDENSED NOTES TO FINANCIAL STATEMENTS (UNAUDITED)

1. ORGANIZATION

CYS Investments, Inc. (the “Company”) was formed as a Maryland corporation on January 3, 2006, and commenced operations on February 10, 2006. The Company has elected to be taxed and intends to continue to qualify as a real estate investment trust (“REIT”) and is required to comply with the provisions of the Internal Revenue Code of 1986, as amended (the “Code”), with respect thereto. Since March 2008, the Company has exclusively purchased residential mortgage-backed securities that are issued and the principal and interest of which are guaranteed by a federally chartered corporation (“Agency RMBS”), such as the Federal National Mortgage Association (“Fannie Mae”) or the Federal Home Loan Mortgage Corporation (“Freddie Mac”), or an agency of the U.S. government such as the Government National Mortgage Association (“Ginnie Mae”), or U.S. Treasuries securities. The Company’s common stock and Series A Cumulative Redeemable Preferred Stock, $25.00 liquidation preference (the "Series A Preferred Stock") trade on the New York Stock Exchange under the symbols “CYS” and "CYS PrA," respectively.

On September 1, 2011, the Company acquired certain assets and entered into agreements to internalize the Company’s management (the “Internalization”). The Company previously had been managed by Cypress Sharpridge Advisors LLC (the “Manager”) pursuant to a management agreement (the “Management Agreement”). The Manager had entered into sub-advisory agreements with Sharpridge Capital Management, L.P. (“Sharpridge”) and an affiliate of The Cypress Group, pursuant to which the Manager was provided with all of the resources and assets (the “Assets”) used to operate the Company’s business and manage the Company’s assets. In connection with the completion of the Internalization, the Management Agreement, sub-advisory agreements and other ancillary agreements related thereto were terminated. No termination fee was incurred or paid as a result of terminating those agreements.

2. SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying interim unaudited condensed financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (“GAAP”) and the instructions to Form 10-Q and Article 10, Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. The interim unaudited condensed financial statements should be read in conjunction with the Company’s audited financial statements as of and for the year ended December 31, 2011, included in the annual report on Form 10-K. The results for interim periods are not necessarily indicative of the results to be expected for the fiscal year.

The Company adopted Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) 946, Clarification of the Scope of Audit and Accounting Guide Investment Companies (“ASC 946”), prior to its deferral in February 2008. Under ASC 946, the Company uses financial reporting for investment companies.

Segment Reporting

The Company operates as a single segment reporting to the Chief Executive Officer, who manages the entire investment portfolio.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those management estimates.

Cash and Cash Equivalents

Cash and cash equivalents include cash on hand, cash held in banks and highly liquid investments with original maturities of three months or less. Interest income earned on cash and cash equivalents is recorded in other income.

Interest Rate Swap and Cap Contracts

The Company utilizes interest rate swaps and caps to hedge the interest rate risk associated with the financing of its portfolio. Specifically, the Company seeks to hedge the exposure to potential interest rate mismatches between the interest earned on investments and the borrowing costs caused by fluctuations in short term interest rates. In a simple interest rate swap, one investor pays a floating rate of interest on a notional principal amount and receives a fixed rate of interest on the same notional principal amount for a specified period of time. Alternatively, an investor may pay a fixed rate and receive a floating rate. In a simple interest rate cap, one investor pays a premium for a notional principal amount based on a capped interest rate (the “cap rate”). If the floating interest rate (the “floating rate”) exceeds the cap rate, the investor receives a payment from the cap counterparty equal to the difference between the floating rate and the cap rate on the same notional principal amount for a specified period of time. Alternatively, an investor may receive a premium and pay the difference in cap rate and floating rate.

During the term of the interest rate swap or cap, the Company makes or receives periodic payments and unrealized gains or losses are recorded as a result of marking the swap and cap to their fair value. When the swap or cap is terminated, the Company records a realized gain or loss equal to the difference between the proceeds from (or cost of) the closing transaction and the Company’s cost basis in the contract, if any. The periodic payments, amortization of premiums on cap contracts and any realized or unrealized gains or losses are reported under gains and losses from swap and cap contracts in the statements of operations. Swaps involve a risk that interest rates will move contrary to the Company’s expectations, thereby increasing the Company’s payment obligation.

Because the Company uses financial reporting for investment companies, its investments, including its interest rate swap and cap contracts, are carried at fair value with changes in fair value included in earnings. Consequently, there would be no impact to designating interest rate swaps and caps as cash flow or fair value hedges under GAAP.

The Company is exposed to credit loss in the event of nonperformance by the counterparty to the swap or cap limited to the amount of collateral posted that exceeds the fair value of the contract. However, as of September 30, 2012 and December 31, 2011, the Company did not anticipate nonperformance by any counterparty. Should interest rates move unexpectedly, the Company may not achieve the anticipated benefits of the interest rate swap or cap and may realize a loss.

Investment Valuation

The Company has established a pricing committee responsible for establishing valuation policies and procedures as well as approving valuations on a monthly basis at a pricing meeting. The pricing committee is made up of individuals from the accounting team, the investment team and senior management.

Agency RMBS and U.S. Treasury securities are generally valued on the basis of valuations provided by third party pricing services, as derived from such services’ pricing models. Inputs to the models may include, but are not limited to, reported trades, executable bid and asked prices, broker quotations, prices or yields of securities with similar characteristics, benchmark curves or information pertaining to the issuer, as well as industry and economic events. The pricing services may use a matrix approach, which considers information regarding securities with similar characteristics to determine the valuation for a security.

Interest rate swaps and caps are generally valued using valuations provided by broker quotations. Such broker quotations are based on the present value of fixed and projected floating rate cash flows over the term of the swap contract. Future cash flows are discounted to their present value using swap rates provided by electronic data services or by broker.

Collateralized loan obligations ("CLOs") are generally valued using valuations provided by broker quotations, as derived from such brokers’ pricing models. Inputs to the models may include, but are not limited to, reported trades, executable bid and asked prices, prices or yields of securities with similar characteristics, default rates, recovery rates, prepayment rates, reinvestment rates, and information pertaining to the issuer, as well as industry and economic events.

Fair values of long-lived assets, including real estate, are primarily derived internally and are based on observed sales transactions for similar assets. For real estate, fair values are based on discounted cash flow estimates which reflect current and projected lease profiles and available industry information about capitalization rates and expected trends in rents and occupancy.

All valuations received from third party pricing services or broker quotes are non-binding. The Company does not adjust any of the prices received from third party pricing services or brokers, and all prices are reviewed by the Company. This review includes comparisons of similar market transactions, alternative third party pricing services and broker quotes, or comparisons to a pricing model. To ensure the proper fair value hierarchy, the Company reviews the third party pricing service’s methodology to understand whether observable or unobservable inputs are being used.

Agency RMBS

The Company’s investments in Agency RMBS consist of whole-pool pass-through certificates backed by fixed rate, monthly reset adjustable-rate loans (“ARMs”) and hybrid ARMs, the principal and interest of which are guaranteed by Fannie Mae, Freddie Mac or Ginnie Mae. Hybrid ARMs have interest rates that have an initial fixed period (typically three, five, seven or ten years) and thereafter reset at regular intervals in a manner similar to ARMs.

Forward Settling Transactions

The Company may engage in forward settling transactions. The Company records forward settling transactions on the trade date and maintains security positions such that sufficient liquid assets will be available to make payment on the settlement date for the securities purchased. Securities purchased on a forward settling basis are carried at fair value and begin earning interest on the settlement date. Losses may occur on these transactions due to changes in market conditions or the failure of counterparties to perform under the contract. Among other forward settling transactions, the Company may transact in to-be-announced securities ("TBAs"). As with other forward settling transactions, a seller agrees to issue TBAs at a future date. However, the seller does not specify the particular securities to be delivered. Instead, the Company agrees to accept any security that meets specified terms such as issuer, interest rate and terms of underlying mortgages. The Company records TBAs on the trade date utilizing information associated with the specified terms of the transaction as opposed to the specific mortgages. TBAs are carried at fair value and begin earning interest on the settlement date. Losses may occur due to the fact that the actual underlying mortgages received may be less favorable than those anticipated by the Company.

As of September 30, 2012, the Company had pledged Agency RMBS with a fair value of $6.5 million on its open forward settling transactions. In addition, as of September 30, 2012 the Company had $10.0 million in cash pledged to it under its forward settling sales transactions. The Company did not have any pledged Agency RMBS on its open forward settling transactions as of December 31, 2011.

Repurchase Agreements

Repurchase agreements are borrowings that are collateralized by the Company's Agency RMBS and are carried at their amortized cost, which approximates their fair value due to their short term nature, generally 30-90 days. The Company's repurchase agreement counterparties are large institutional dealers in fixed income securities. Collateral is valued daily and counterparties may require additional collateral when appropriate. Counterparties have the right to sell or repledge collateral pledged for repurchase agreements.

Investment Transactions and Income

The Company records its transactions in securities on a trade date basis. Realized gains and losses on securities transactions are recorded on an identified cost basis. Interest income and expense are recorded on the accrual basis. Interest income on Agency RMBS is accrued based on outstanding principal amount of the securities and their contractual terms. Interest on CLOs is accrued at a rate determined based on estimated future cash flows and adjusted prospectively as future cash flow amounts are recast. For CLOs placed on nonaccrual status or when the Company cannot reliably estimate cash flows, the cost recovery method is used. Amortization of premium and accretion of discount are recorded using the yield to maturity method, and are included in investment income in the statements of operations. The Company does not estimate prepayments when calculating the yield to maturity. The amount of premium or discount associated with a prepayment is recorded through investment income on the statements of operations as they occur.

Reclassification and Presentation

The condensed statements of operations for the three and nine months ended September 30, 2011 had previously provided combined disclosure of investment income - interest income which was expanded as interest income from Agency RMBS and other income in the presentation herein.

Compensation and Benefits

Included in the Company's compensation and benefits are salaries, incentive compensation, benefits, share based compensation and the expense relating to restricted stock granted to non-employees (prior to the Internalization). The Company accounts for share based compensation using the fair value based methodology prescribed by ASC 718, Share-Based Payment ("ASC 718"). Compensation cost related to restricted common stock issued is measured at its estimated fair value at the grant date and recognized as expense over the vesting period. Prior to the Internalization, which became effective on September 1, 2011, compensation cost related to restricted common stock and common stock options issued to the Company's executive officers, certain employees of its Manager and its sub-advisors and other individuals who provide services to the Company was initially measured at estimated fair value at the grant date and was remeasured on subsequent dates to the extent the awards were unvested.

Income Taxes

The Company has elected to be taxed as a REIT and intends to continue to comply with provisions of the Code with respect thereto. As a REIT, the Company generally will not be subject to federal or state income tax on income that it currently distributes to its stockholders. To maintain its qualification as a REIT, the Company must distribute at least 90% of its REIT taxable income to its stockholders and meet certain other tests relating to assets and income.

Earnings Per Share ("EPS")

Basic EPS is computed using the two class method by dividing net income (loss), after adjusting for the impact of unvested stock awards deemed to be participating securities, by the weighted average number of common shares outstanding

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calculated excluding unvested stock awards. Diluted EPS is computed by dividing net income (loss), after adjusting for the impact of unvested stock awards deemed to be participating securities, by the weighted average number of common shares outstanding calculated excluding unvested stock awards, giving effect to common stock options and warrants, if they are not anti-dilutive. See note 3 for EPS computations.

Recent Accounting Pronouncements

In December 2011, the FASB issued ASU 2011-11, Disclosures about Offsetting Assets and Liabilities (Topic 210), Balance Sheet. The update requires new disclosures about balance sheet offsetting and related arrangements. For derivatives and financial assets and liabilities, the amendments require disclosure of gross asset and liability amounts, amounts offset on the balance sheet, and amounts subject to the offsetting requirements but not offset on the balance sheet. The guidance is effective December 1, 2013 and is to be applied retrospectively. This guidance does not amend the existing guidance on when it is appropriate to offset. As a result, we do not expect this guidance to have a material effect on the Company's financial statements.

3. EARNINGS PER SHARE

Components of the computation of basic and diluted EPS were as follows (in thousands, except per share numbers):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Net income	$241,907	$96,321	$412,730	$247,840
Less preferred stock dividends	(953)	—	(953)	—
Net income available to common shares	240,954	96,321	411,777	247,840
Less dividends paid:				
Common shares	(78,397)	(45,138)	(195,175)	(143,293)
Unvested shares	(327)	(371)	(1,083)	(1,306)
Undistributed earnings	162,230	50,812	215,519	103,241
Basic weighted average shares outstanding:				
Common shares	164,269	81,898	128,116	77,950
Basic earnings per common share:				
Distributed earnings	$0.48	$0.55	$1.52	$1.84
Undistributed earnings	0.98	0.61	1.67	1.31
Basic earnings per common share	$1.46	$1.16	$3.19	$3.15
Diluted weighted average shares outstanding:				
Common shares	164,269	81,898	128,116	77,950
Net effect of dilutive warrants (1)	—	—	—	1
	164,269	81,898	128,116	77,951
Diluted earnings per common share:				
Distributed earnings	$0.48	$0.55	$1.52	$1.84
Undistributed earnings	0.98	0.61	1.67	1.31
Diluted earnings per common share	$1.46	$1.16	$3.19	$3.15

(1) The impact of equity instruments is not included in the computation of EPS for periods in which their inclusion would be anti-dilutive. For the three and nine months ended September 30, 2012 and 2011, the Company had an aggregate of 131,088 stock options outstanding with a weighted average exercise price of $30.00 that were not included in the calculation of EPS, as their inclusion would have been anti-dilutive. These equity instruments may have a dilutive impact on future EPS.

4. INVESTMENTS IN SECURITIES AND INTEREST RATE SWAP AND CAP CONTRACTS AND OTHER ASSETS

The Company's valuation techniques are based on observable and unobservable inputs. Observable inputs reflect readily obtainable data from independent sources, while unobservable inputs reflect the Company's market

assumptions. ASC 820, Fair Value Measurements, classifies these inputs into the following hierarchy:
Level 1 Inputs—Quoted prices for identical instruments in active markets.
Level 2 Inputs—Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations whose inputs are observable or whose significant

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value drivers are observable.

Level 3 Inputs—Instruments with primarily unobservable value drivers.

Excluded from the tables below are financial instruments carried on the accompanying financial statements at cost basis, which is deemed to approximate fair value, primarily due to the short duration of these instruments, including cash and cash equivalents, receivables, payables and borrowings under repurchase arrangements with initial terms of 120 days or less. The fair value of these instruments is determined using level two inputs. The following tables provide a summary of the Company's assets and liabilities that are measured at fair value on a recurring basis as of September 30, 2012 and December 31, 2011:

September 30, 2012	Fair Value Measurements Using			
	Level 1	Level 2	Level 3	Total
	(in thousands)			
Assets				
Agency RMBS	$—	$22,596,939	$—	$22,596,939
U.S. Treasury Bills	29,989	—	—	29,989
CLOs	—	—	12,449	12,449
Real estate assets	—	—	6,928	6,928
Interest rate cap contracts	—	125,331	—	125,331
Total	$29,989	$22,722,270	$19,377	$22,771,636
Liabilities				
Interest rate swap contracts	$—	$111,725	$—	$111,725

December 31, 2011	Fair Value Measurements Using			
	Level 1	Level 2	Level 3	Total
	(in thousands)			
Assets				
Agency RMBS	$—	$9,372,454	$—	$9,372,454
U.S. Treasury Bills	74,999	—	—	74,999
CLOs	—	—	18,675	18,675
Interest rate cap contracts	—	5,966	—	5,966
Total	$74,999	$9,378,420	$18,675	$9,472,094
Liabilities				
Interest rate swap contracts	$—	$79,476	$—	$79,476

The table below presents a reconciliation of changes in assets classified as Level 3 in the Company's financial statements for the three and nine months ended September 30, 2012 and 2011. A discussion of the method of fair valuing these assets is included above in "Investment Valuation." CLOs are generally valued using valuations provided by broker quotations. The Company validates the broker quotations using internal discounted cash flow models. The significant unobservable inputs used in the fair value measurement of the Company's CLOs are prepayment rates, probability of default, and recovery rate in the event of default. Significant increases (decreases) in any of those inputs in isolation would result in a significantly lower (higher) fair value measurement. Generally, a change in the assumption used for the probability of default is accompanied by a directionally similar change in the assumption used for the loss severity and a directionally opposite change in the assumption used for prepayment rates. The weighted average inputs to the models were:

	Constant Prepayment Rate	Default Rate	Recovery Rate	Recovery Lag
Weighted Average	20 %	2 %	60 %	6 Months

Fair Value Reconciliation, Level 3
(in thousands)

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	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
CLOs				
Beginning balance Level 3 assets	$ 17,874	$ 24,141	$ 18,675	$ 20,478
Cash payments recorded as a reduction of cost basis	(964)	(1,236)	(3,081)	(3,664)
Change in net unrealized appreciation (depreciation)	1,483	(1,816)	2,799	4,275
Sales, at cost	(5,944)	(995)	(5,944)	(995)
Transfers into (out of) Level 3	—	—	—	—
Ending balance Level 3 assets	$ 12,449	$ 20,094	$ 12,449	$ 20,094

Fair values of real estate assets are valued based on discounted cash flow models. The significant unobservable input used in the fair value measurement is capitalization rates, which the Company estimated to be between 4% and 5% at September 30, 2012.

	Three Months Ended September 30,		Nine Months Ended September 30,	
Real Estate Assets	2012	2011	2012	2011
Beginning balance Level 3 assets	$6,928	$—	$—	$—
Purchase of real estate assets	—	—	6,928	—
Change in net unrealized appreciation (depreciation)	—	—	—	—
Transfers into (out of) Level 3	—	—	—	—
Ending balance Level 3 assets	$6,928	$—	$6,928	$—

The Agency RMBS portfolio consisted of Agency RMBS as follows:

September 30, 2012	Par Value	Fair Value	Weighted Average				
Asset Type	(in thousands)		Cost/Par	Fair Value/Par	MTR(1)	Coupon	CPR(2)
10 Year Fixed Rate	$224,154	$238,674	$103.69	$106.48	N/A	3.50 %	16.0 %
15 Year Fixed Rate	11,142,835	11,854,179	104.04	106.38	N/A	3.26 %	16.1 %
20 Year Fixed Rate	910,489	967,434	104.87	106.25	N/A	3.22 %	11.2 %
30 Year Fixed Rate	5,293,159	5,685,772	105.83	107.42	N/A	3.79 %	16.5 %
Hybrid ARMs	3,652,347	3,850,880	103.07	105.44	69.3	2.92 %	21.8 %
Total/Weighted Average	$21,222,984	$22,596,939	$104.35	$106.47	69.3 (3)	3.33 %	17.4 %

December 31, 2011	Par Value	Fair Value	Weighted Average				
Asset Type	(in thousands)		Cost/Par	Fair Value/Par	MTR(1)	Coupon	CPR(2)
10 Year Fixed Rate	$272,115	$284,948	$103.96	$104.72	N/A	3.50 %	13.6 %
15 Year Fixed Rate	4,763,965	5,010,121	102.53	105.17	N/A	3.79 %	17.8 %
20 Year Fixed Rate	551,766	585,103	102.32	106.04	N/A	4.14 %	28.1 %
30 Year Fixed Rate	239,747	259,123	103.09	108.08	N/A	5.00 %	26.3 %
Hybrid ARMs	3,098,024	3,233,159	102.31	104.36	64.0	3.29 %	20.3 %
Total/Weighted Average	$8,925,617	$9,372,454	$102.50	$105.01	64.0 (3)	3.66 %	19.5 %

(1) MTR, or "Months to Reset" is the number of months remaining before the fixed rate on a hybrid ARM becomes a variable rate. At the end of the fixed period, the variable rate will be determined by the margin and the

pre-specified caps of the ARM. After the fixed period, 100% of the hybrid ARMS in the portfolio reset annually.

(2) CPR, or “Constant Prepayment Rate,” is a method of expressing the prepayment rate for a mortgage pool that assumes that a constant fraction of the remaining principal is prepaid each month or year. Specifically, the constant prepayment rate is an annualized version of the prior three month prepayment rate. Securities with no prepayment history are

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excluded from this calculation.

(3) Weighted average months to reset of our Hybrid ARM portfolio.

As of September 30, 2012 and December 31, 2011, the Company's Agency RMBS were purchased at a net premium to their par value with approximately $923.8 million and $223.5 million, respectively, of unamortized premium included in their cost basis. This is due to the average interest rates on these investments being higher than prevailing market rates.

Actual maturities of Agency RMBS are generally shorter than stated contractual maturities (which range up to 30 years), as they are affected by the contractual lives of the underlying mortgages, periodic payments and prepayments of principal. As of September 30, 2012 and December 31, 2011, the average final contractual maturity of the Company's Agency RMBS portfolio is in year 2033 and 2031, respectively.

In order to mitigate its interest rate exposure, the Company enters into interest rate swap and cap contracts. The Company had the following activity in interest rate swap and cap transactions during the three and nine months ended September 30, 2012 and 2011 (in thousands):

Three and Nine Months Ended September 30, 2012			Three and Nine Months Ended September 30, 2011		
Trade Date	Transaction	Notional	Trade Date	Transaction	Notional
April 2012	Opened	$500,000	February 2011	Opened	$500,000
May 2012	Opened	600,000	March 2011	Opened	250,000
June 2012	Opened	600,000	May 2011	Terminated	(300,000)
July 2012	Opened	2,250,000	May 2011	Opened	300,000
September 2012	Opened	1,000,000	June 2011	Opened	300,000
Net Increase		$4,950,000	Net Increase		$1,050,000

As of September 30, 2012 and December 31, 2011, the Company had pledged Agency RMBS and U.S Treasury securities with a fair value of $131.5 million and $127.9 million, respectively, as collateral on interest rate swap and cap contracts. In addition, the Company had Agency RMBS and U.S. Treasuries of $21.4 million and cash of $38.0 million pledged to it as collateral for its interest rate cap contracts as of September 30, 2012. The Company did not have any collateral pledged to it as of December 31, 2011. Below is a summary of our interest rate swap and cap contracts open as of September 30, 2012 and December 31, 2011 and for the three and nine months ended September 30, 2012 and 2011 (in thousands):

Derivatives not designated as hedging instruments under ASC 815[(a)]

Interest Rate Swap Contracts	Notional Amount	Fair Value	Statement of Assets and Liabilities Location
September 30, 2012	$6,990,000	$(111,725)	Liabilities
December 31, 2011	4,740,000	(79,476)	Liabilities

Interest Rate Cap Contracts	Notional Amount	Fair Value	Statement of Assets and Liabilities Location
September 30, 2012	$3,400,000	$125,331	Assets
December 31, 2011	700,000	5,966	Assets

Derivatives Not Designated as Hedging Instruments Under ASC 815[(a)]	Location of Gain or (Loss) Recognized in Income on Derivative	Amount of Gain or (Loss) Recognized in Income on Derivative: Three Months Ended September 30, 2012	2011	Nine Months Ended September 30, 2012	2011
Interest rate swap and cap contracts	Net gain (loss) from swap and cap contracts	$(38,618)	$(74,594)	$ (80,403)	$ (161,961)

(a) See note 2 for additional information on the Company's purpose for entering into interest rate swaps and caps and the decision not to designate them as hedging instruments.

Credit Risk

At September 30, 2012 and December 31, 2011, the Company continued to have minimal exposure to credit losses on its mortgage assets by owning principally Agency RMBS. The payment of principal and interest on Agency RMBS is guaranteed by Freddie Mac, Fannie Mae or Ginnie Mae. In September 2008, both Freddie Mac and Fannie Mae were placed in the

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conservatorship of the United States government. While it is hoped that the conservatorship will help stabilize Freddie Mac's and Fannie Mae's losses and overall financial position, there can be no assurance that it will succeed or that, if necessary, Freddie Mac or Fannie Mae will be able to satisfy their guarantees of Agency RMBS.

On August 5, 2011, Standard & Poor's downgraded the U.S.'s credit rating to AA+ for the first time. Because Fannie Mae and Freddie Mac are in conservatorship of the U.S. Government, the implied credit ratings of Agency RMBS guaranteed by Freddie Mac, Fannie Mae or Ginnie Mae were also downgraded to AA+. While this downgrade did not have a significant impact on the fair value of the Agency RMBS in the Company's portfolio, it has increased the uncertainty regarding the credit risk of Agency RMBS.

The Company's CLOs and real estate assets do not have the backing of Fannie Mae, Freddie Mac or Ginnie Mae. Payment of principal and interest is dependent on the performance of the underlying loans, which are subject to borrower default and possible losses.

5. BORROWINGS

The Company leverages its Agency RMBS portfolio through the use of repurchase agreements. Each of the borrowing vehicles used by the Company bears interest at floating rates based on a spread above or below the LIBOR. The fair value of borrowings under repurchase agreements approximates their carrying amount due to the short term nature of these financial instruments.

Certain information with respect to the Company's borrowings is summarized in the following tables. Each of the borrowings listed is contractually due in one year or less (dollars in thousands).

September 30, 2012		
Outstanding repurchase agreements	$13,911,977	
Interest accrued thereon	$5,086	
Weighted average borrowing rate	0.42	%
Weighted average remaining maturity (in days)	29.2	
Fair value of the collateral(1)	$14,614,440	
December 31, 2011		
Outstanding repurchase agreements	$7,880,814	
Interest accrued thereon	$3,747	
Weighted average borrowing rate	0.36	%
Weighted average remaining maturity (in days)	27.6	
Fair value of the collateral(1)	$8,284,423	

(1) Collateral for repurchase agreements consists of Agency RMBS.

At September 30, 2012 and December 31, 2011, the Company did not have any borrowings under repurchase agreements where the amount at risk exceeded 10% of net assets.

6. COMMITMENTS AND CONTINGENCIES

The Company enters into certain contracts that contain a variety of indemnifications, principally with brokers. The maximum potential amount of future payment the Company could be required to make under these indemnification provisions is unknown. The Company has not had any asserted claims nor incurred any costs to defend lawsuits or settle claims related to these indemnification agreements. As a result, the estimated fair value of these agreements is minimal. Accordingly, the Company has no liabilities recorded for these agreements as of September 30, 2012 and December 31, 2011.

7. SHARE CAPITAL

The Company has authorized 500,000,000 shares of common stock having par value of $0.01 per share. As of September 30, 2012 and December 31, 2011, the Company had issued and outstanding 174,942,130 and 82,753,036 shares of common stock, respectively. The Company's common stock transactions during the nine months ended September 30, 2012 and 2011 are as follows (in thousands):

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	Nine Months Ended September 30, 2012		Nine Months Ended September 30, 2011	
	Shares	Amount	Shares	Amount
Shares sold in public offerings or issued as restricted stock	92,104	$1,238,141	23,192	$280,614
Shares issued in reinvestment of distributions	98	1,310	1	13
Shares canceled	(13)	(180)	—	—
Net increase	92,189	$1,239,271	23,193	$280,627

The Company has authorized 50,000,000 shares of preferred stock having a par value of $0.01 per share. As of September 30, 2012, 3,000,000 shares of 7.75% Series A Preferred Stock ($25.00 liquidation preference) were issued and outstanding. The Series A Preferred Stock will not be redeemable before August 3, 2017, except under circumstances where it is necessary to preserve our qualification as a REIT, for federal income tax purposes and the occurrence of certain change of control. On or after August 3, 2017, the Company may, at its option, redeem any or all of the shares of the Series A Preferred Stock at $25.00 per share plus any accumulated and unpaid dividends to, but not including, the redemption date. The Series A Preferred Stock has no stated maturity, is not subject to any sinking fund or mandatory redemption. As of December 31, 2011, no such shares were issued or outstanding.

Equity Offerings

On February 1, 2012, the Company closed a public offering of 28,750,000 shares of its common stock at a public offering price of $13.28 per share for total net proceeds of approximately $377.3 million, after the underwriting discount and commissions and expenses.

On July 16, 2012, the Company closed a public offering of 46,000,000 shares of its common stock at a public offering price of $13.70 per share for total net proceeds of approximately $622.2 million, after the underwriting discount and commissions and expenses.

On August 3, 2012, the Company closed a public offering of 3,000,000 shares of its Series A Preferred Stock, liquidation preference of $25.00 per share, for total net proceeds of approximately $72.5 million, after the underwriting discount and commissions and expenses.

Dividend Reinvestment and Direct Stock Purchase Plan (“DSPP”)

The Company sponsors a dividend reinvestment and direct stock purchase plan through which stockholders may purchase additional shares of common stock by reinvesting some or all of the cash dividends received on shares of common stock.

Stockholders may also make optional cash purchases of shares of common stock subject to certain limitations detailed in the plan prospectus. For the nine months ended September 30, 2012 and 2011, the Company issued 5,327,661 and 9,192 shares under the plan, respectively, raising approximately $74.0 million and $116,064 of net proceeds, respectively. As of September 30, 2012 and December 31, 2011, there were approximately 4.1 million and 9.4 million shares, respectively, available for issuance under this plan.

Restricted Stock Awards

For the nine months ended September 30, 2012 and 2011, the Company granted 205,390 and 171,132 shares of restricted stock, respectively, to certain of its directors, officers and employees.

Equity Placement Program (“EPP”)

On June 7, 2011, the Company entered into a sales agreement with JMP Securities LLC whereby the Company may, from time to time, publicly offer and sell up to 15.0 million shares of the Company’s common stock through at-the-market transactions and/or privately negotiated transactions. For the nine months ended September 30, 2012, the Company issued 11,918,553 shares under the plan raising approximately $164.3 million. As of September 30, 2012 and December 31, 2011, approximately 3.1 million and 15.0 million shares of common stock, respectively, remained available for issuance and sale under the sales agreement.

8. FINANCIAL HIGHLIGHTS

In accordance with financial reporting requirements applicable to investment companies, the Company has included below certain financial highlight information for the three and nine months ended September 30, 2012 and 2011:

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	Per Common Share			
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Net asset value, beginning of period	$13.52	$12.35	$ 13.02	$ 11.59
Net income:				
Net investment income	0.36 (a)	0.60 (a)	1.32 (a)	1.78 (a)
Net gain from investments and swap and cap contracts	1.11 (a)	0.56 (a)	1.88 (a)	1.37 (a)
Net income	1.47	1.16	3.20	3.15
Dividend on preferred stock	(0.01) (a)	— (a)	(0.01) (a)	— (a)
Net income available to common shares	1.46	1.16	3.19	3.15
Capital transactions:				
Distributions to common stockholders	(0.45)	(0.55)	(1.45)	(1.75)
Issuance of common and preferred shares and amortization of share based compensation	(0.07) (a)	0.02 (a)	(0.30) (a)	(0.01) (a)
Net decrease in net asset value from capital transactions	(0.52)	(0.53)	(1.75)	(1.76)
Net asset value, end of period	$14.46	$12.98	$ 14.46	$ 12.98
Net asset value total return (%)	10.28 % (b)	9.55 % (b)	22.20 % (b)	27.09 % (b)
Market value total return (%)	5.59 % (b)	(1.33)% (b)	18.88 % (b)	7.66 % (b)
Ratios to Average Net Assets				
Expenses before interest expense	0.93 % (c)	2.33 % (c)(d)	1.16 % (c)	2.47 % (c)(d)
Total expenses	3.00 % (c)	4.13 % (c)(d)	3.21 % (c)	4.17 % (c)(d)
Net investment income	10.33 % (c)	20.20 % (c)(d)	12.59 % (c)	19.45 % (c)(d)

(a) Calculated based on average shares outstanding during the period. Average shares outstanding include vested and unvested restricted shares and differs from weighted average shares outstanding used in calculating EPS (see note 3).
(b) Not computed on an annualized basis.
(c) Computed on an annualized basis.
(d) Includes $4.9 million of non-recurring expenses relating to the accelerated vesting of shares of restricted stock and other expenses associated with the Internalization. These non-recurring expenses represented 0.46% and 0.50% of average net assets for the three and nine months ended September 30, 2011, respectively.

9. SUBSEQUENT EVENTS

On October 1, 2012, an aggregate of 7,896 shares of restricted common stock were granted to certain directors as a portion of their compensation for serving on the Company's board of directors.

The CPR of the Company's Agency RMBS portfolio was approximately 15.4% for the month of October 2012.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

In this Quarterly Report on Form 10-Q, we refer to CYS Investments, Inc. as "we," "us," "our company," or "our," unless we specifically state otherwise or the context indicates otherwise. The following defines certain of the commonly used terms in this quarterly report on Form 10-Q: RMBS refers to residential mortgage-backed securities; agency securities or Agency RMBS refers to our RMBS that are issued or whose principal and interest payments are guaranteed by a federally chartered corporation, such as the Federal National Mortgage Association ("Fannie Mae") or the Federal Home Loan Mortgage Corporation ("Freddie Mac"), or an agency of the U.S. government, such as the Government National Mortgage Association ("Ginnie Mae"); ARMs refers to adjustable-rate mortgage loans that typically have interest rates that adjust annually to an increment over a specified interest rate index; and hybrids refers to ARMs that have interest rates that are fixed for a specified period of time and, thereafter, generally adjust annually to an increment over a specified interest rate index.

The following discussion should be read in conjunction with our financial statements and accompanying notes included in Item 1 of this Quarterly Report on Form 10-Q as well as our Annual Report on Form 10-K for the fiscal year ended December 31, 2011, filed on February 13, 2012.

Forward Looking Statements

When used in this Quarterly Report on Form 10-Q, in future filings with the Securities and Exchange Commission ("SEC") or in press releases or other written or oral communications, statements which are not historical in nature, including those containing words such as "believe," "expect," "anticipate," "estimate," "plan," "continue," "intend," "should," similar expressions, are intended to identify "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, and, as such, may involve known and unknown risks, uncertainties and assumptions. The forward-looking statements we make in this Quarterly Report on Form 10-Q include, but are not limited to, statements about the following:

- the effect of movements in interest rates on our assets and liabilities (including our hedging instruments) and our net income;
- our investment, financing and hedging strategy and the success of these strategies;
- the effect of increased prepayment rates on our portfolio;
- our ability to convert our assets into cash or extend the financing terms related to our assets;
- the effect of widening credit spreads on the value of our assets and investment strategy;
- the types of indebtedness we may incur;
- our ability to quantify risks based on historical experience;
- our ability to be taxed as a real estate investment trust ("REIT") and to maintain an exemption from registration under the Investment Company Act of 1940, as amended (the "Investment Company Act");
- our assessment of counterparty risk;
- our ability to meet short term liquidity requirements with our cash flow from operations and borrowings;
- our liquidity;
- our asset valuation policies;
- our distribution policy; and
- the effect of recent U.S. Government actions on interest rates and the housing and credit markets.

Forward-looking statements are based on our beliefs, assumptions and expectations of our future performance, taking into account all information currently available to us. These beliefs, assumptions and expectations are subject to risks and uncertainties and can change as a result of many possible events or factors, not all of which are known to us. If a change occurs, our business, financial condition, liquidity and results of operations may vary materially from those expressed in our forward-looking statements. The following factors could cause actual results to vary from our forward-looking statements:

- the factors referenced in this Quarterly Report on Form 10-Q;
- changes in our investment, financing and hedging strategy;
- the adequacy of our cash flow from operations and borrowings to meet our short term liquidity requirements;
- the liquidity of our portfolio;

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- unanticipated changes in our industry, interest rates, the credit markets, the general economy or the real estate market;
- changes in interest rates and the market value of our Agency RMBS;
- changes in the prepayment rates on the mortgage loans underlying our Agency RMBS;
- our ability to borrow to finance our assets;
- changes in government regulations affecting our business;
- our ability to maintain our qualification as a REIT for federal income tax purposes;
- our ability to maintain our exemption from registration under the Investment Company Act and the availability of such exemption in the future; and
- risks associated with investing in real estate assets, including changes in business conditions and the general economy.

These and other risks, uncertainties and factors, including those described elsewhere in this report, could cause our actual results to differ materially from those projected in any forward-looking statements we make. All forward-looking statements speak only as of the date on which they are made. New risks and uncertainties arise over time and it is not possible to predict those events or how they may affect us. Except as required by law, we are not obligated to, and do not intend to, update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Overview

We are a specialty finance company created with the objective of achieving consistent risk-adjusted investment income. We seek to achieve this objective by investing, on a leveraged basis, in Agency RMBS. In addition, our investment guidelines permit investments in collateralized mortgage obligations issued by a government agency or government sponsored entity that are collateralized by Agency RMBS (“CMOs”), although we had not invested in any CMOs as of September 30, 2012. We commenced operations in February 2006, and completed our initial public offering in June 2009. Our common stock and our Series A Cumulative Redeemable Preferred Stock, $25.00 liquidation preference (the "Series A Preferred Stock") trade on the New York Stock Exchange under the symbols “CYS” and "CYS PrA," respectively.

We earn investment income from our investment portfolio, and we use leverage to seek to enhance our returns. Our net investment income is generated primarily from the difference, or net spread, between the interest income we earn on our investment portfolio and the cost of our borrowings and hedging activities. The amount of net investment income we earn on our investments depends in part on our ability to control our financing costs, which comprise a significant portion of our operating expenses. Although we leverage our portfolio investments in Agency RMBS to seek to enhance our potential returns, leverage also may exacerbate losses.

While we use hedging to mitigate some of our interest rate risk, we do not hedge all of our exposure to changes in interest rates. This is because there are practical limitations on our ability to insulate our portfolio from all potential negative consequences associated with changes in short term interest rates in a manner that will allow us to achieve attractive spreads on our portfolio.

In addition to investing in issued pools of Agency RMBS, we regularly utilize forward settling transactions, including forward-settling purchases of Agency RMBS where the pool is “to-be-announced” (“TBAs”). Pursuant to these TBAs, we agree to purchase, for future delivery, Agency RMBS with certain principal and interest terms and certain types of underlying collateral, but the particular Agency RMBS to be delivered is not identified until shortly before the TBA settlement date. For our other forward settling transactions, we agree to purchase, for future delivery, Agency RMBS. However, unlike our TBAs, these forward settling transactions reference an identified Agency RMBS.

We have elected to be taxed as a REIT and have complied, and intend to continue to comply, with the provisions of the Internal Revenue Code of 1986, as amended (the “Internal Revenue Code”), with respect thereto. Accordingly, we generally do not expect to be subject to federal income tax on our REIT taxable income that we currently distribute to our stockholders if certain asset, income and ownership tests and recordkeeping requirements are fulfilled. Even if we maintain our qualification as a REIT, we may be subject to some federal, state and local taxes on our income.

Factors that Affect our Results of Operations and Financial Condition

A variety of industry and economic factors may impact our results of operations and financial condition. These factors include:

- interest rate trends;

• prepayment rates on mortgages underlying our Agency RMBS, and credit trends insofar as they affect prepayment

rates;
- competition for investments in Agency RMBS;
- actions taken by the U.S. Government, including the U.S. Federal Reserve (the "Federal Reserve") and the U.S. Treasury;
- credit rating downgrades of the United States' and certain European countries' sovereign debt; and
- other market developments.

In addition, a variety of factors relating to our business may also impact our results of operations and financial condition. These factors include:
- our degree of leverage;
- our access to funding and borrowing capacity;
- our borrowing costs;
- our hedging activities;
- the market value of our investments; and
- the REIT requirements and the requirements to qualify for a registration exemption under the Investment Company Act.

We anticipate that, for any period during which changes in the interest rates earned on our assets do not coincide with interest rate changes on the corresponding liabilities, such assets will likely change in value more slowly than the corresponding liabilities. Consequently, changes in interest rates, particularly short term interest rates, may significantly influence our net investment income.

Our net investment income may be affected by a difference between actual prepayment rates and our projections. Prepayments on loans and securities may be influenced by changes in market interest rates and homeowners' ability and desire to refinance their mortgages. To the extent we have acquired assets at a premium or discount to par value, changes in prepayment rates may impact our anticipated yield.

Trends and Recent Market Impacts

The volatility in the U.S. interest rate markets in 2011 and 2012 has produced opportunities in our markets. While the performance of the U.S. economy in 2011 was disappointing primarily due to a lack of significant job growth, the first quarter of 2012 appeared to show some improvement in job growth and U.S. real gross domestic product ("GDP") growth. However, this trend has not been sustained and GDP growth expectations have declined in the third quarter of 2012. The Federal Reserve's September 2012 release had their 2012 GDP projection in the range of 1.6% to 2.0%, which is down from their June projection of 1.6% to 2.5%. The Federal Reserve's core personal consumption expenditures inflation projection is low through 2015, at rates ranging from 1.6% to 2.3%.

In September 2012, the U.S. Federal Reserve Open Market Committee announced an open-ended program to purchase an additional $40 billion of Agency RMBS per month until the unemployment rate, among other economic indicators, show signs of improvement. This program, when combined with the Federal Reserve's existing programs to extend its holdings' average maturity, and reinvest principal payments from its holdings of agency debt and Agency RMBS into Agency RMBS, is expected to increase the Federal Reserve's holdings of long-term securities by approximately $85 billion per month through the end of 2012. The Federal Reserve also announced that it will keep the target range for the Federal Funds Rate between zero and 0.25% through at least mid-2015, which is six months longer than the Federal Reserve had previously announced.

The Federal Reserve expects these measures to put downward pressure on long-term interest rates. In the short term, these actions have driven Agency RMBS prices to all-time highs, which has further compressed interest spreads, and removed the historical correlation between mortgage rates and U.S. Treasury or interest rate swaps. These factors have contributed to a challenging interest rate hedging environment.

The U.S. unemployment rate declined in recent months from 8.5% in December 2011 to 7.8% in September 2012. However, this downward trend is partly explained by the decrease in the participation rate, which went from 64.0% in December 2011 to 63.6% in September 2012. Uncertainty in the marketplace surrounding the longer-term pace of job creation continues to be a concern for the U.S. economy and likely will remain a primary focus in the upcoming presidential election. While existing home sales have increased recently, with some regions showing a small increase in average home prices, the residential construction sector remains depressed. According to the U.S. Department of

Commerce, privately-owned housing units authorized by building permits in August 2012 were at a seasonally adjusted annual rate of 801,000. To put this figure in perspective, the September 2004 annual rate was 2,041,000.

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In addition, the over hang of the European debt crisis and the recent downgrading of a significant number of U.S. banks by Moody's also adds pressure to the U.S. economy and consumer confidence.
Overall inflation and wage pressures have remained relatively muted in recent months despite prices of crude oil and gasoline increasing in the first nine months of 2012.
The following trends and recent market impacts may also affect our business:
Interest Rates
As described above, the actions by the Federal Reserve have decoupled U.S. Treasury rates from mortgage rates. During the nine months ended September 30, 2012, the 10 Year U.S. Treasury rate decreased 24 basis points to 1.64%. This compares with a decrease of 104 basis points in the yield on par-priced Fannie Mae Agency RMBS backed by 30 year fixed rate mortgage loans to 1.84% at September 30, 2012. This demand has come primarily from the Federal Reserve. Based on Agency RMBS issuance data from Fannie Mae, Freddie Mac and Ginnie Mae between July and September 2012, it is estimated that the Federal Reserve could purchase as much as 58% of monthly new issuance through the end of 2012.
During the three months ended September 30, 2012 the average yield on the Company's purchases of Agency RMBS was 1.86%. The following table illustrates this market environment by comparing market levels for three benchmark securities or rates, the yield on five year U.S. Treasury Notes, the three year interest rate swap rate and the yield of par-priced Fannie Mae Agency RMBS backed by 15 year fixed rate mortgage loans:

Date	Five Year U.S. Treasury Note		Three Year Interest Rate Swap Rates		Par-priced Fannie Mae 15 year RMBS Yield	
September 30, 2012	0.625	%	0.439	%	0.820	%
June 30, 2012	0.718	%	0.624	%	1.706	%
March 31, 2012	1.039	%	0.758	%	1.997	%
December 31, 2011	0.832	%	0.820	%	2.102	%
September 30, 2011	0.952	%	0.736	%	2.124	%
June 30, 2011	1.761	%	1.147	%	3.143	%
March 31, 2011	2.277	%	1.571	%	3.494	%
December 31, 2010	2.006	%	1.279	%	3.401	%

Source: Bloomberg
Short-term rates have remained low, the table below presents 30-Day LIBOR, 3-Month LIBOR and the U.S. Federal Funds Target Rate at the end of each respective fiscal quarter. The availability of repurchase agreement financing is stable with interest rates between 0.34% and 0.53% for 30-90 day repurchase agreements at September 30, 2012. Several of our repurchase agreement counterparties were downgraded by Moody's in the second quarter of 2012. We believe that these downgrades resulted in slightly higher financing costs, and this modestly-incremental cost is likely to remain in place for the foreseeable future.

Date	30-Day LIBOR		3-Month LIBOR		Federal Funds Target Rate	
September 30, 2012	0.214	%	0.359	%	0.25	%
June 30, 2012	0.246	%	0.461	%	0.25	%
March 31, 2012	0.241	%	0.468	%	0.25	%
December 31, 2011	0.295	%	0.581	%	0.25	%
September 30, 2011	0.239	%	0.374	%	0.25	%
June 30, 2011	0.186	%	0.246	%	0.25	%
March 31, 2011	0.243	%	0.303	%	0.25	%
December 31, 2010	0.261	%	0.303	%	0.25	%

Source: Bloomberg

In 2012, the yield curve has flattened slightly. This has primarily been the result of various Federal Reserve actions since September 2011 designed to maintain the recent low level of the U.S. Federal Funds Target Rate and lower yields on longer term U.S. Treasury securities, which the Federal Reserve expects to consequently lower interest rates that are tied to such

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yields, such as mortgage rates and interest rates on commercial loans. Such programs are described in more detail below under the heading "—Government Activity." Below is a graph of the yield curve at September 30, 2012 and December 31, 2011.

Prepayment Rates and Loan Buy-back Programs

Prepayment rates were very low in the summer of 2011 but have increased since then as mortgages rates continue to push against historical lows. According to data provided by Freddie Mac, the weighted average commitment rate on a 30 year fixed rate mortgage was 3.36% in September 2012, compared to 3.95% in December 2011. However, the continued weak U.S. housing market and high unemployment have reduced many U.S. homeowners' ability to refinance their mortgages. The following table presents the prepayment rates for the population of Fannie Mae Agency RMBS backed by 15 year and 30 year fixed rate mortgages:

	Jan-11	Feb-11	Mar-11	Apr-11	May-11	Jun-11	Jul-11	Aug-11	Sep-11	Oct-11	Nov-11	Dec-11
15 Year	17.8 %	13.6 %	13.7 %	12.2 %	12.2 %	14.7 %	15.6 %	18.4 %	23.0 %	25.2 %	23.2 %	20.8 %
30 Year	19.5 %	15.5 %	15.4 %	13.4 %	13.0 %	14.9 %	14.9 %	16.8 %	21.4 %	24.4 %	25.2 %	23.6 %

	Jan-12	Feb-12	Mar-12	Apr-12	May-12	Jun-12	Jul-12	Aug-12	Sep-12
15 Year	18.8 %	20.9 %	21.6 %	18.7 %	18.5 %	19.2 %	21.0 %	23.6 %	21.0 %
30 Year	21.6 %	25.0 %	25.8 %	23.7 %	24.8 %	25.8 %	28.0 %	31.2 %	28.0 %

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Source: eMBS
Government Activity

On October 4, 2012, the Federal Housing Finance Authority (the “FHFA”) released its white paper entitled "Building a New Infrastructure for the Secondary Mortgage Market" (the “FHFA White Paper”). This release follows up on the FHFA's February 21, 2012 Strategic Plan for Enterprise Conservatorships, which set forth three goals for the next phase of the Fannie Mae and Freddie Mac conservatorships. These three goals are to (i) build a new infrastructure for the secondary mortgage market, (ii) gradually contract Fannie Mae and Freddie Mac's presence in the marketplace while simplifying and shrinking their operations, and (iii) maintain foreclosure prevention activities and credit availability for new and refinanced mortgages.

The FHFA White Paper proposes a new infrastructure for Fannie Mae and Freddie Mac that has two basic goals. The first goal is to replace the current, outdated infrastructures of Fannie Mae and Freddie Mac with a common, more efficient infrastructure that aligns the standards and practices of the two entities, beginning with core functions performed by both entities such as issuance, master servicing, bond administration, collateral management and data integration. The second goal is to establish an operating framework for Fannie Mae and Freddie Mac that is consistent with the progress of housing finance reform and encourages and accommodates the increased participation of private capital in assuming credit risk associated with the secondary mortgage market. The FHFA recognizes that there are a number of impediments to their goals which may or may not be surmountable, such as the absence of any significant secondary mortgage market mechanisms beyond Fannie Mae, Freddie Mac and Ginnie Mae, and that their proposals are in the formative stages. As a result, it is unclear if the proposals will be enacted. If such proposals are enacted, it is unclear how closely what is enacted will resemble the proposals from the FHFA White Paper or what the effects of the enactment will be.

In September 2012, the U.S. Federal Reserve Open Market Committee announced an open-ended program to purchase an additional $40 billion of Agency RMBS per month until the unemployment rate, among other economic indicators, show signs of improvement. This program, when combined with the Federal Reserve's existing programs to extend its holdings' average maturity, and reinvest principal payments from its holdings of agency debt and Agency RMBS into Agency RMBS, is expected to increase the Federal Reserve's holdings of long-term securities by approximately $85 billion per month through the end of 2012. The Federal Reserve also announced that it will keep the target range for the Federal Funds Rate between zero and 0.25% through at least mid-2015, which is six months longer than the Federal Reserve had previously announced.

The Federal Reserve expects these measures to put downward pressure on long-term interest rates. In the short term, these actions have driven Agency RMBS prices to new highs, which has further compressed interest spreads, and caused the historical correlation between mortgage rates and U.S. Treasury or interest rate swaps to no longer exist. On January 4, 2012, the Federal Reserve released a report titled “The U.S. Housing Market: Current Conditions and

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Policy Considerations" to Congress, which provided a framework for thinking about certain issues and tradeoffs that policy makers might consider. It is unclear how future legislation may impact the housing finance market and the investing environment for Agency RMBS as the method of reform is undecided and has not yet been defined by the regulators.

On September 21, 2011, the Federal Reserve announced its maturity extension program whereby it intended to sell $400 billion of shorter-term U.S. Treasury securities by the end of June 2012 and use the proceeds to buy longer-term U.S. Treasury securities. This program is intended to extend the average maturity of the securities in the Federal Reserve's portfolio. By reducing the supply of longer-term U.S. Treasury securities in the market, this action should put downward pressure on longer-term interest rates, including rates on financial assets that investors consider to be close substitutes for longer-term U.S. Treasury securities, like certain types of Agency RMBS. The reduction in longer-term interest rates, in turn, may contribute to a broad easing in financial market conditions that the Federal Reserve hopes will provide additional stimulus to support the economic recovery. In response to lagging economic growth, in June 2012, the Federal Reserve announced it was adding another $267 billion and extending the duration of the program aimed at lengthening the maturity of its portfolio through the end of 2012 in an effort to put additional downward pressure on long-term interest rates. The Federal Reserve also reaffirmed its policy to reinvest payments of principal and interest from its holdings of Agency RMBS.

In September 2011, the White House announced it is working on a major plan to allow some of the 11 million homeowners who owe more on their mortgages than their homes are worth to refinance. Consequently, in October 2011 the FHFA announced changes to the Home Affordable Refinance Program ("HARP") to expand access to refinancing for qualified individuals and families whose homes have lost value. One such change is to increase the HARP loan-to-value ceiling above 125%. However, this would only apply to mortgages guaranteed by Fannie Mae, Freddie Mac or Ginnie Mae. There are many challenging issues to this proposal, notably the question as to whether a loan with a 125% or greater loan-to-value ratio qualifies as a mortgage or an unsecured consumer loan. The chances of this initiative's success and other ideas proposed by the Federal Reserve's white paper, have created additional uncertainty in the RMBS market, particularly with respect to possible increases in prepayment rates. According to information published by the U.S. Department of Housing and Urban Development, 519,500 distressed homeowners were refinanced in the period from January through July of 2012.

In February 2011, the U.S. Department of the Treasury along with the U.S. Department of Housing and Urban Development released a report titled "Reforming America's Housing Finance Market" to Congress outlining recommendations for reforming the U.S. housing system, specifically Fannie Mae and Freddie Mac, and transforming government involvement in the housing market. It is unclear how future legislation may impact the housing finance market and the investing environment for Agency RMBS as the method of reform is undecided and has not yet been defined by the regulators.

On July 21, 2010, President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") into law. The Dodd-Frank Act is extensive, complicated and comprehensive legislation that impacts practically all aspects of banking and represents a significant overhaul of many aspects of the regulation of the financial services industry. Although many provisions remain subject to further rulemaking, the Dodd-Frank Act implements numerous and far-reaching regulatory changes that affect financial companies, including our Company, and other banks and institutions which are important to our business model. Certain notable rules are, among other things:

- Requiring regulation and oversight of large, systemically important financial institutions ("SIFI") by establishing an interagency council on systemic risk and implementation of heightened prudential standards and regulation by the Board of Governors of the Federal Reserve for SIFI (including nonbank financial companies), as well as the implementation of the Federal Deposit Insurance Corporation ("FDIC") resolution procedures for liquidation of large financial companies to avoid market disruption;
- applying the same leverage and risk-based capital requirements that apply to insured depository institutions to most bank holding companies, savings and loan holding companies and systemically important nonbank financial companies;
-

limiting the Federal Reserve's emergency authority to lend to nondepository institutions to facilities with broad-based eligibility, and authorizing the FDIC to establish an emergency financial stabilization fund for solvent depository institutions and their holding companies, subject to the approval of Congress, the Secretary of the U.S. Treasury and the Federal Reserve;

- creating regimes for regulation of over-the-counter derivatives and non-admitted property and casualty insurers and reinsurers;
- implementing regulation of hedge fund and private equity advisers by requiring such advisers to register with the SEC;
- providing for the implementation of corporate governance provisions for all public companies concerning proxy access and executive compensation; and

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- reforming regulation of credit rating agencies.

Many of the provisions of the Dodd-Frank Act, including certain provisions described above are subject to further study, rulemaking, and the discretion of regulatory bodies. As the hundreds of regulations called for by the Dodd-Frank Act are promulgated, we will continue to evaluate the impact of any such regulations. It is unclear how this legislation may impact the borrowing environment, investing environment for Agency RMBS and interest rate swaps as much of the bill's implementation has not yet been defined by the regulators.

Certain programs initiated by the U.S. Government, through the Federal Housing Administration ("FHA") and the FDIC, to provide homeowners with assistance in avoiding residential mortgage loan foreclosures are currently in effect. The programs may involve, among other things, the modification of mortgage loans to reduce the principal amount of the loans or the rate of interest payable on the loans, or to extend the payment terms of the loans. While the effect of these programs has not been as extensive as originally expected, the effect of such programs for holders of Agency RMBS could be that such holders would experience changes in the anticipated yields of their Agency RMBS due to (i) increased prepayment rates on their Agency RMBS and (ii) lower interest and principal payments on their Agency RMBS.

Credit Spreads

Over the past few years, the credit markets generally experienced tightening credit spreads (specifically, spreads between U.S. Treasury securities and other securities that are identical in all respects except for ratings) mainly due to the strong demand for lending opportunities. Generally, when credit spreads tighten, the value of Agency RMBS increases, which results in an increase in our book value. Due to these tightening credit spreads our book value has increased. If credit spreads were to widen, we expect the market value of Agency RMBS would decrease, which could reduce our book value, but also create an attractive opportunity to reinvest principal and interest from our existing portfolio as well as deploy new capital into higher-yielding Agency RMBS.

For a discussion of additional risks relating to our business see "Risk Factors" beginning on page 45 of this quarterly report on Form 10-Q and in our Annual Report on Form 10-K for the fiscal year ended December 31, 2011, filed on February 13, 2012.

Financial Condition

As of September 30, 2012 and December 31, 2011, the Agency RMBS in our portfolio were purchased at a net premium to their par value due to the average interest rates on these investments being higher than the prevailing market rates at the time of purchase. As of September 30, 2012 and December 31, 2011, we had approximately $923.8 million and $223.5 million, respectively, of unamortized premium included in the cost basis of our investments.

As of September 30, 2012 and December 31, 2011, our Agency RMBS portfolio consisted of the following assets:

September 30, 2012

	Par Value	Fair Value	Weighted Average							
Asset Type	(in thousands)		Cost/Par	Fair Value/Par	MTR[(1)]		Coupon		CPR[(2)]	
10 Year Fixed Rate	$224,154	$238,674	$103.69	$106.48	N/A		3.50	%	16.0	%
15 Year Fixed Rate	11,142,835	11,854,179	104.04	106.38	N/A		3.26	%	16.1	%
20 Year Fixed Rate	910,489	967,434	104.87	106.25	N/A		3.22	%	11.2	%
30 Year Fixed Rate	5,293,159	5,685,772	105.83	107.42	N/A		3.79	%	16.5	%
Hybrid ARMs	3,652,347	3,850,880	103.07	105.44	69.3		2.92	%	21.8	%
Total/Weighted Average	$21,222,984	$22,596,939	$104.35	$106.47	69.3	(3)	3.33	%	17.4	%

December 31, 2011

	Par Value	Fair Value	Weighted Average							
Asset Type	(in thousands)		Cost/Par	Fair Value/Par	MTR[1]		Coupon		CPR[2]	
10 Year Fixed Rate	$272,115	$284,948	$103.96	$104.72	N/A		3.50	%	13.6	%
15 Year Fixed Rate	4,763,965	5,010,121	102.53	105.17	N/A		3.79	%	17.8	%
20 Year Fixed Rate	551,766	585,103	102.32	106.04	N/A		4.14	%	28.1	%
30 Year Fixed Rate	239,747	259,123	103.09	108.08	N/A		5.00	%	26.3	%
Hybrid ARMs	3,098,024	3,233,159	102.31	104.36	64.0		3.29	%	20.3	%
Total/Weighted Average	$8,925,617	$9,372,454	$102.50	$105.01	64.0	(3)	3.66	%	19.5	%

(1) MTR, or "Months to Reset" is the number of months remaining before the fixed rate on a hybrid ARM becomes a variable rate. At the end of the fixed period, the variable rate will be determined by the margin and the pre-specified caps of the ARM. After the fixed period, 100% of the hybrid ARMS in the portfolio reset annually.

(2) CPR, or "Constant Prepayment Rate" is a method of expressing the prepayment rate for a mortgage pool that assumes that a constant fraction of the remaining principal is prepaid each month or year. Specifically, the constant prepayment rate is an annualized version of the prior three month prepayment rate. Securities with no prepayment history are excluded from this calculation.

(3) Weighted average months to reset of our ARM portfolio.

The CPR of the Company's Agency RMBS portfolio was approximately 15.4% for the month of October 2012. Actual maturities of Agency RMBS are generally shorter than stated contractual maturities (which range up to 30 years), as they are affected by the contractual lives of the underlying mortgages, periodic payments and prepayments of principal. As of September 30, 2012 and December 31, 2011, the average final contractual maturity of the mortgage portfolio is in year 2033 and 2031, respectively. The average expected life of our Agency RMBS reflects the estimated average period of time the securities in the portfolio will remain outstanding. The average expected lives of our Agency RMBS do not exceed five years, based upon the prepayment model obtained through subscription-based financial information service providers. The prepayment model considers current yield, forward yield, the steepness of the yield curve, current mortgage rates, the mortgage rate of the outstanding loan, loan age, margin and volatility. The actual lives of the Agency RMBS in our investment portfolio could be longer or shorter than those estimates depending on the actual prepayment rates experienced over the lives of the applicable securities.

Hedging Instruments

We seek to hedge as much of the interest rate risk we determine is in the best interests of our stockholders. Our policies do not contain specific requirements as to the percentages or amount of interest rate risk we are required to hedge. No assurance can be given that our hedging activities will have the desired beneficial impact on our results of operations or financial condition.

Interest rate hedging may fail to protect or could adversely affect us because, among other things:

- interest rate hedging can be expensive, particularly during periods of rising and volatile interest rates;
- available interest rate hedging may not correspond directly with the interest rate risk for which protection is sought;
- due to prepayments on assets and repayments of debt securing such assets, the duration of the hedge may not match the duration of the related liability or asset;
- the credit quality of the hedging counterparty may be downgraded to such an extent that it impairs our ability to sell or assign our side of the hedging transaction; and
- the hedging counterparty may default on its obligation to pay.

We engage in interest rate swaps and caps as a means of mitigating our interest rate risk on forecasted interest expense associated with repurchase agreements for the term of the swap contract. An interest rate swap is a contractual agreement entered into by two counterparties under which each agrees to make periodic payments to the other for an agreed period of time based upon a notional amount of principal. Under the most common form of interest rate swap, commonly known as a fixed-floating interest rate swap, a series of fixed interest rate payments on a notional amount of principal is exchanged for a series of floating interest rate payments on such notional amount. In a simple interest rate cap, one investor pays a premium for a notional principal amount based on a capped interest rate (the “cap rate”). When the floating interest rate (the “floating rate”)

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exceeds the cap rate, the investor receives a payment from the cap counterparty equal to the difference between the floating rate and the cap rate on the same notional principal amount for a specified period of time. Alternatively, an investor may receive a premium and pay the difference in cap rate and floating rate. Below is a summary of our interest rate swaps and caps as of September 30, 2012 and December 31, 2011:

September 30, 2012			Weighted Average		
	Number of Contracts	Notional (000's)	Rate	Maturity	Fair Value (000's)
Interest Rate Swaps	20	$6,990,000	1.298 %	June 2015	$(111,725)
Interest Rate Caps	10	3,400,000	1.622 %	July 2019	125,331

December 31, 2011			Weighted Average		
	Number of Contracts	Notional (000's)	Rate	Maturity	Fair Value (000's)
Interest Rate Swaps	15	4,740,000	1.478 %	July 2014	(79,476)
Interest Rate Caps	3	700,000	1.593 %	July 2015	5,966

The current fair value of interest rate swaps and caps is heavily dependent on the prevailing market fixed rate, the corresponding term structure of floating rates (known as the yield curve) as well as the expectation of changes in future floating rates.

Liabilities

We have entered into repurchase agreements to finance some of our purchases of Agency RMBS. Borrowings under these agreements are secured by our Agency RMBS and bear interest at rates that have historically moved in close relationship to LIBOR. At September 30, 2012, we had approximately $13,912.0 million of liabilities pursuant to repurchase agreements with 25 counterparties that had weighted average interest rates of approximately 0.42%, and a weighted average maturity of 29.2 days. In addition, as of September 30, 2012, we had approximately $6,084.0 million in payable for securities purchased, a portion of which will be financed through repurchase agreements. At December 31, 2011, we had approximately $7,880.8 million of liabilities pursuant to repurchase agreements with 24 counterparties that had weighted average interest rates of approximately 0.36%, and a weighted average maturity of 27.6 days. In addition, as of December 31, 2011 we had approximately $463.3 million in payable for securities purchased, a portion of which was financed through repurchase agreements. Below is a summary of our payable for securities purchased as of September 30, 2012 and December 31, 2011 (in thousands).

September 30, 2012			
Forward Settling Purchases	Settle Date	Par Value	Payable
FNMA - 20 Year 3.0% Fixed	10/11/2012	$203,502	$213,153
FNMA - 15 Year 3.0% Fixed	10/16/2012	150,000	157,750
FNMA - 30 Year 2.21% Hybrid ARM	10/23/2012	52,000	54,927
FNMA - 30 Year 5.0% Fixed	11/14/2012	800,000	873,773
FNMA - 30 Year 3.5% Fixed	11/14/2012	1,900,000	1,989,494
FNMA - 20 Year 3.0% Fixed	11/14/2012	75,000	79,382
FNMA - 15 Year 3.0% Fixed	11/19/2012	275,000	289,717
FNMA - 30 Year 2.29% Hybrid ARM	11/26/2012	100,000	104,057
FNMA - 30 Year 3.5% Fixed	12/12/2012	1,350,000	1,425,328
FNMA - 20 Year 3.0% Fixed	12/12/2012	350,000	368,644
FNMA - 15 Year 3.0% Fixed	12/18/2012	400,000	423,786
FNMA - 30 Year 2.35% Hybrid ARM	12/28/2012	100,000	104,036
		$5,755,502	$6,084,047

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December 31, 2011			
Forward Settling Purchases	Settle Date	Par Value	Payable
FNMA - 15 Year 3.5% Fixed	1/18/2012	$225,000	$232,977
FNMA - 30 Year 2.84% Hybrid ARM	1/24/2012	21,000	21,478
FNMA - 30 Year 2.85% Hybrid ARM	1/24/2012	16,000	16,579
FNMA - 30 Year 2.94% Hybrid ARM	1/24/2012	15,000	15,499
FNMA - 30 Year 3.12% Hybrid ARM	1/24/2012	50,000	51,807
FNMA - 30 Year 2.84% Hybrid ARM	1/24/2012	15,000	15,452
FNMA - 30 Year 3.17% Hybrid ARM	1/27/2012	36,000	37,389
FNMA - 30 Year 2.90% Hybrid ARM	2/23/2012	50,000	51,479
FNMA - 30 Year 2.82% Hybrid ARM	3/22/2012	20,000	20,642
		$448,000	$463,302

Summary Financial Data

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(In thousands, except per share numbers)	Three Months Ended September 30, 2012	2011	Nine Months Ended September 30, 2012	2011
INVESTMENT INCOME:				
Interest income from Agency RMBS	$ 75,609	$ 63,548	$ 210,108	$ 168,263
Other income	1,022	1,018	3,639	3,003
Total investment income	76,631	64,566	213,747	171,266
EXPENSES:				
Interest	11,893	4,778	27,739	12,352
Operating expenses	5,340	9,832	15,738	19,116
Total expenses	17,233	14,610	43,477	31,468
Net investment income	59,398	49,956	170,270	139,798
Net gain (loss) from investments	221,127	120,959	322,863	270,003
GAINS AND (LOSSES) FROM SWAP AND CAP CONTRACTS:				
Net swap and cap interest income (expense)	(17,255)	(15,469)	(41,448)	(42,202)
Net gain (loss) on termination of swap contracts	—	—	—	(3,492)
Net unrealized appreciation (depreciation) on swap and cap contracts	(21,363)	(59,125)	(38,955)	(116,267)
Net gain (loss) from swap and cap contracts	(38,618)	(74,594)	(80,403)	(161,961)
NET INCOME	$ 241,907	$ 96,321	$ 412,730	$ 247,840
DIVIDEND ON PREFERRED STOCK	(953)	—	(953)	—
NET INCOME AVAILABLE TO COMMON SHARES	$ 240,954	$ 96,321	$ 411,777	$ 247,840
Net income per common share (diluted)	$ 1.46	$ 1.16	$ 3.19	$ 3.15
Distributions per common share	$ 0.45	$ 0.55	$ 1.45	$ 1.75
Key Metrics*				
Average Agency RMBS(1)	$ 13,442,454	$ 8,350,710	$ 11,301,195	$ 6,948,539
Average repurchase agreements (2)	$ 11,571,371	$ 7,474,253	$ 9,905,284	$ 6,114,159
Average net assets (3)	$ 2,300,096	$ 1,061,373	$ 1,803,466	$ 966,675
Average common shares outstanding (4)	165,017	82,641	128,839	78,717
Average yield on Agency RMBS (5)	2.25 %	3.02 %	2.48 %	3.24 %
Average cost of funds and hedge (6)	1.01 %	1.07 %	0.93 %	1.19 %
Interest rate spread net of hedge (7)	1.24 %	1.95 %	1.55 %	2.05 %
Operating expense ratio (8)	0.93 %	2.33 %	1.16 %	2.47 %
Leverage ratio (at period end) (9)	7.7:1	7.7:1	7.7:1	7.7:1

(1) Our average Agency RMBS for the period was calculated by averaging the month end cost basis of our settled Agency RMBS during the period.

(2) Our average repurchase agreements for the period were calculated by averaging the month end repurchase agreement balance during the period.

(3) Our average net assets for the period were calculated by averaging the month end net assets during the period.

(4) Our average common shares outstanding was calculated by averaging the daily common shares outstanding during the period.

(5) Our average yield on Agency RMBS for the period was calculated by dividing our interest income from Agency RMBS by our average Agency RMBS.

(6) Our average cost of funds and hedge for the period was calculated by dividing our total interest expense, including our net swap and cap interest income (expense), by our average repurchase agreements.

(7)

Our interest rate spread net of hedge for the period was calculated by subtracting our average cost of funds and hedge from our average yield on Agency RMBS.

(8) Our operating expense ratio is calculated by dividing operating expenses by average net assets.

(9) Our leverage ratio was calculated by dividing (i) our repurchase agreements plus payable for securities purchased minus receivable for securities sold by (ii) net assets.

* All percentages are annualized.

Adjusted Interest Rate Spread net of hedge

The Company’s interest rate spread net of hedge is low due to the hedging of investments when purchased rather than when settled which is when they begin earning interest income. To better reflect the interest rate spread net of hedge on our

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interest earning assets we adjust it by applying total net swap and cap interest expense pro rata over average settled Agency RMBS positions relative to average total Agency RMBS positions. We believe this spread is generally more reflective of what we expect our interest rate spread net of hedge to be once the forward purchases settle.

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands, except per share numbers)	2012	2011	2012	2011
Average settled Agency RMBS[1]	$ 13,442,454	$ 8,350,710	$ 11,301,195	$ 6,948,539
Average total Agency RMBS[2]	18,751,053	9,136,306	14,955,424	8,369,672
Net swap and cap interest income (expense)	(17,255)	(15,469)	(41,448)	(42,202)
Net swap and cap interest income (expense) applied to settled Agency RMBS[3]	(12,370)	(14,139)	(31,321)	(35,036)
Adjusted average cost of funds and hedge [4]	0.84 %	1.00 %	0.79 %	1.04 %
Adjusted interest rate spread net of hedge [5]	1.41 %	2.02 %	1.69 %	2.20 %

(1) Our average settled Agency RMBS for the period is calculated by averaging the month end cost basis of our settled Agency RMBS during the period.

(2) Our average total Agency RMBS for the period is calculated by averaging the month end cost basis of our total Agency RMBS during the period.

(3) Our net swap and cap interest income (expense) applied to settled Agency RMBS is calculated by dividing average settled Agency RMBS by average total Agency RMBS multiplied by net swap and cap interest income (expense).

(4) Our adjusted average cost of funds and hedge for the period is calculated by dividing our total interest expense, including our net swap and cap interest income (expense) applied to settled Agency RMBS, by our average repurchase agreements.

(5) Our adjusted interest rate spread net of hedge for the period is calculated by subtracting our adjusted average cost of funds and hedge from our average yield on Agency RMBS.

Core Earnings

Core Earnings represents a non-GAAP financial measure and is defined as net income (loss) available to common shares excluding net gain (loss) from investments, net gain (loss) on termination of swap contracts and net unrealized appreciation (depreciation) on swap and cap contracts. In order to evaluate the effective yield of the portfolio, management uses Core Earnings to reflect the net investment income of our portfolio as adjusted to reflect the net swap and cap interest income (expense). Core Earnings allows management to isolate the interest income (expense) associated with our swaps and caps in order to monitor and project our borrowing costs and interest rate spread. In addition, management utilizes Core Earnings as a key metric in conjunction with other portfolio and market factors to determine the appropriate leverage and hedging ratios, as well as the overall structure of the portfolio.

We adopted Accounting Standards Codification (“ASC”) 946, Clarification of the Scope of Audit and Accounting Guide Investment Companies (“ASC 946”), prior to its deferral in February 2008, while most, if not all, other public companies that invest only in Agency RMBS have not adopted ASC 946. Under ASC 946, we use the financial reporting specified for investment companies, and accordingly, our investments are carried at fair value with changes in fair value included in earnings. Most other public companies that invest only in Agency RMBS include most changes in the fair value of their investments within shareholders’ equity, not in earnings. As a result, investors are not able to readily compare our results of operations to those of most of our competitors. We believe that the presentation of our Core Earnings is useful to investors because it provides a means to compare our Core Earnings to those of our peers. In addition, because Core Earnings isolates the net swap and cap interest income (expense), it provides investors with an additional metric to identify trends in our portfolio as they relate to the interest rate environment. The primary limitation associated with Core Earnings as a measure of our financial performance over any period is that it excludes the effects of net realized gain (loss) from investments. In addition, our presentation of Core Earnings may not be comparable to similarly-titled measures of other companies, which may use different calculations. As a result, Core Earnings should not be considered as a substitute for our GAAP net income (loss) as a measure of our financial performance or any measure of our liquidity under GAAP.

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(In thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
Non-GAAP Reconciliation:	2012	2011	2012	2011
NET INCOME AVAILABLE TO COMMON SHARES	$ 240,954	$ 96,321	$ 411,777	$ 247,840
Net (gain) loss from investments	(221,127)	(120,959)	(322,863)	(270,003)
Net (gain) loss on termination of swap contracts	—	—	—	3,492
Net unrealized (appreciation) depreciation on swap and cap contracts	21,363	59,125	38,955	116,267
Core Earnings	$ 41,190	$ 34,487	$ 127,869	$ 97,596

Results of Operations

Three Months Ended September 30, 2012 Compared to the Three Months Ended September 30, 2011

Net Income. Net income increased $145.6 million to $241.9 million for the three months ended September 30, 2012, compared to net income of $96.3 million for the three months ended September 30, 2011. The major components of this increase are detailed below.

Investment Income. Investment income, which primarily consists of interest income on Agency RMBS, increased by $12.0 million to $76.6 million for the three months ended September 30, 2012, as compared to $64.6 million for the three months ended September 30, 2011. The change in investment income was primarily due to the increased size of our portfolio. During the three months ended September 30, 2012, our average Agency RMBS portfolio was $13,442.5 million, compared to $8,350.7 million during the three months ended September 30, 2011. However, the increased income due to the size of our portfolio was partially offset by the decrease in the average yield on Agency RMBS. During the three months ended September 30, 2012 and 2011, our average yield on Agency RMBS was 2.25% and 3.02%, respectively.

Interest Expense. Interest expense increased $7.1 million to $11.9 million for the three months ended September 30, 2012, as compared to $4.8 million for the three months ended September 30, 2011. The increase was due to the increase in our average amounts outstanding under our repurchase agreements and higher interest rates. During the three months ended September 30, 2012 and 2011, our average repurchase agreements were $11,571.4 million and $7,474.3 million, respectively. In addition, we had an average rate on our repurchase agreements of 0.41% and 0.26% during the three months ended September 30, 2012 and 2011, respectively.

Operating Expenses. For the three months ended September 30, 2012, operating expenses decreased by $4.5 million to $5.3 million compared to $9.8 million for the three months ended September 30, 2011. Expenses also decreased as a percentage of net assets during the three months ended September 30, 2012 to 0.93% compared to 2.33% during the three months ended September 30, 2011. The primary reason for the decrease in our operating expenses was the non-recurring expenses of $4.9 million, associated with the Internalization during the three months ended September 30, 2011. The decrease in expenses as a percentage of net assets was mainly attributable to our larger asset base. Our average net assets were $2,300.1 million and $1,061.4 million during the three months ended September 30, 2012 and 2011, respectively. In addition, we are experiencing the benefit of the Internalization of management which took effect in September 2011.

Net Gain (Loss) From Investments. Net gain from investments increased by $100.1 million to $221.1 million for the three months ended September 30, 2012, compared to $121.0 million for the three months ended September 30, 2011. In both the three months ended September 30, 2012 and 2011, prices of Agency RMBS rose. However, during the three months ended September 30, 2012, the size of our Agency RMBS book was significantly larger at an average of $13,442.5 million compared to $8,350.7 million during the three months ended September 30, 2011.

During the three months ended September 30, 2012 we sold CLOs with a par value of $14.4 million for a net gain of $2.6 million compared to $2.0 million par value for a net gain of $0.7 million for the three months ended September 30, 2011.

Net Gain (Loss) from Swap and Cap Contracts. Net loss from swap and cap contracts decreased by $36.0 million to a loss of $38.6 million for the three months ended September 30, 2012, compared to a loss of $74.6 million for the three months ended September 30, 2011. The decrease in net loss on swap and cap contracts was primarily due to the change in swap rates combined with the change in the size of our interest rate swap and cap portfolio. During the three months ended September 30, 2012 and 2011, our average interest rate swap and cap notional amount was $9,077.5 million and $5,440.0 million, respectively. During the three months ended September 30, 2012 and 2011, three year swap rates decreased by 19 and 41 basis points, respectively.

Nine Months Ended September 30, 2012 Compared to the Nine Months Ended September 30, 2011

Net Income. Net income increased $164.9 million to $412.7 million for the nine months ended September 30, 2012, compared to net income of $247.8 million for the nine months ended September 30, 2011. The major components of this

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increase are detailed below.

Investment Income. Investment income, which primarily consists of interest income on Agency RMBS, increased by $42.4 million to $213.7 million for the nine months ended September 30, 2012, as compared to $171.3 million for the nine months ended September 30, 2011. The change in investment income was primarily due to the increased size of our portfolio. During the nine months ended September 30, 2012, our average Agency RMBS portfolio was $11,301.2 million, compared to $6,948.5 million during the nine months ended September 30, 2011. However, the increased income due to the size of our portfolio was partially offset by the decrease in the average yield on Agency RMBS. During the nine months ended September 30, 2012 and 2011, our average yield on Agency RMBS was 2.48% and 3.24%, respectively.

Interest Expense. Interest expense increased $15.3 million to $27.7 million for the nine months ended September 30, 2012, as compared to $12.4 million for the nine months ended September 30, 2011. The increase was due to the increase in our average amounts outstanding under our repurchase agreements and higher rates. During the nine months ended September 30, 2012 and 2011, our average repurchase agreements were $9,905.3 million and $6,114.2 million, respectively. In addition, we had an average rate on our repurchase agreements of 0.37% and 0.27% during the nine months ended September 30, 2012 and 2011, respectively.

Operating Expenses. For the nine months ended September 30, 2012, operating expenses decreased by $3.4 million to $15.7 million compared to $19.1 million for the nine months ended September 30, 2011. Expenses as a percentage of net assets also decreased during the nine months ended September 30, 2012 to 1.16% compared to 2.47% during the nine months ended September 30, 2011. The primary reason for the decrease in expenses as a percentage of net assets was that we had a larger asset base. Our average net assets were $1,803.5 million and $966.7 million during the nine months ended September 30, 2012 and 2011, respectively. In addition, we are experiencing the benefit of the Internalization of management which took effect in September 2011.

Net Gain (Loss) From Investments. Net gain from investments increased by $52.9 million to $322.9 million for the nine months ended September 30, 2012, compared to $270.0 million for the nine months ended September 30, 2011. In both the nine months ended September 30, 2012 and September 30, 2011, prices of Agency RMBS rose. However, during the nine months ended September 30, 2012, the size of our Agency RMBS book was significantly larger at an average of $11,301.2 million and compared to $6,948.5 million during the months ended September 30, 2011. During the nine months ended September 30, 2012 we sold CLOs with a par value of $14.4 million for a net gain of $2.6 million compared to $2.0 million par value for a net gain of $0.7 million for the nine months ended September 30, 2011.

Net Gain (Loss) from Swap and Cap Contracts. Net loss from swap and cap contracts decreased by $81.6 million to a loss of $80.4 million for the nine months ended September 30, 2012, compared to a loss of $162.0 million for the nine months ended September 30, 2011. The decrease in net loss on swap contracts was primarily due to the change in swap rates combined with the change in the size of our interest rate swap and cap portfolio. During the nine months ended September 30, 2012 and 2011, our average interest rate swap and cap notional amount was $7,055.0 million and $5,115.0 million, respectively. During the nine months ended September 30, 2012 and 2011, three year swap rates decreased by 38 and 54 basis points, respectively.

Contractual Obligations and Commitments

The following table summarizes our contractual obligations for repurchase agreements, interest expense on repurchase agreements and the office lease at September 30, 2012 and December 31, 2011 (dollars in thousands).

September 30, 2012	Within One Year	One to Three Years	Three to Five Years	Total
Repurchase agreements	$13,911,977	$—	$—	$13,911,977
Interest expense on repurchase agreements, based on rates at September 30, 2012	9,904	—	—	9,904
Long term operating lease obligation	319	243	—	562
Total	$13,922,200	$243	$—	$13,922,443
December 31, 2011	Within One Year	One to three Years	Three to Five Years	Total

Repurchase agreements	$7,880,814	$—	$—	$7,880,814
Interest expense on repurchase agreements, based on rates at December 31, 2011	5,852	—	—	5,852
Long term operating lease obligation	313	482	—	795
Total	$7,886,979	$482	$—	$7,887,461

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We enter into interest rate swap and cap contracts as a means of mitigating our interest rate risk on forecasted interest expense associated with repurchase agreements for the term of the swap or cap contract. At September 30, 2012 and December 31, 2011, we had interest rate swap and cap contracts with the following counterparties (dollars in thousands):

As of September 30, 2012

Counterparty	Total Notional	Fair Value	Amount At Risk [(1)]	Weighted Average Maturity in Years
BNP Paribas	$250,000	$(124)	$1,095	4.9
Credit Suisse International	2,050,000	27,208	13,198	6.2
Deutsche Bank	1,340,000	(12,745)	15,161	2.8
Goldman Sachs	1,800,000	(39,288)	21,619	1.7
ING Capital Markets, LLC	300,000	9,057	(443)	6.7
Morgan Stanley Capital Markets	750,000	28,649	9,309	7.9
Nomura Global Financial Products, Inc.	550,000	(21,608)	4,993	2.8
The Bank of Nova Scotia	250,000	(64)	566	4.9
The Royal Bank of Scotland plc	2,500,000	5,134	6,033	2.7
UBS AG	300,000	9,389	269	6.8
Wells Fargo Bank, N.A.	300,000	7,998	(51)	6.7
Total	$10,390,000	$13,606	$71,749	

As of December 31, 2011

Counterparty	Total Notional	Fair Value	Amount At Risk[(1)]	Weighted Average Maturity in Years
Deutsche Bank	$840,000	$(10,275)	$11,846	2.4
Goldman Sachs	1,800,000	(36,205)	18,025	2.5
Morgan Stanley Capital Markets	250,000	(723)	1,236	5.0
Nomura Global Financial Products, Inc.	550,000	(17,176)	4,679	3.6
The Royal Bank of Scotland plc	2,000,000	(9,131)	6,965	2.4
Total	$5,440,000	$(73,510)	$42,751	

(1) Equal to the fair value of pledged securities plus accrued interest income, minus the fair value of the interest rate swap and cap and accrued interest income and expense.

We enter into certain contracts that contain a variety of indemnification obligations, principally with our brokers and counterparties to interest rate swap contracts and repurchase agreements. The maximum potential future payment amount we could be required to pay under these indemnification obligations is unlimited. We have not incurred any costs to defend lawsuits or settle claims related to these indemnification obligations. As a result, the estimated fair value of these agreements is minimal. Accordingly, we recorded no liabilities for these agreements as of September 30, 2012 and December 31, 2011. In addition, as of September 30, 2012 and December 31, 2011, we had a $6,084.0 million and $463.3 million payable for securities purchased, respectively, a portion of which either was or will be financed through repurchase agreements. A summary of our payable for securities purchased as of September 30, 2012 and December 31, 2011 is included in the “Financial Condition—Liabilities” section.

Off-Balance Sheet Arrangements

As of September 30, 2012 and December 31, 2011, we did not maintain any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance, special purpose or variable interest entities, established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. Further, as of September 30, 2012 and December 31, 2011, we had not guaranteed any obligations

of unconsolidated entities or entered into any commitment or had any intent to provide funding to any such entities.
Liquidity and Capital Resources
Our primary sources of funds are borrowings under repurchase arrangements and monthly principal repayments and

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interest payments on our investments. Other sources of funds may include proceeds from debt and equity offerings and asset sales. As of September 30, 2012 and December 31, 2011, we had repurchase agreements totaling $13,912.0 million and $7,880.8 million, respectively, with a weighted average borrowing rate of 0.42% and 0.36%, respectively. In addition, during the nine months ended September 30, 2012 and 2011, we received $1,940.3 million and $829.0 million of principal repayments and $191.1 million and $159.9 million of interest payments, respectively. We held cash and cash equivalents of $20.5 million and $11.5 million at September 30, 2012 and December 31, 2011, respectively.

During the nine months ended September 30, 2012 and 2011, our operations used net cash of $7,214.3 million and $4,268.0 million, respectively. During the nine months ended September 30, 2012 and 2011, we had net purchases of securities (net of purchases, sales and principal repayments) of $12,926.4 million and $2,919.4 million, respectively. The increase in net purchases of securities was the result of investing the total net proceeds from the (i) February 1, 2012 and July 16, 2012 public offerings of common stock which raised approximately $377.3 million and $622.2 million of net proceeds, respectively, (ii) the August 3, 2012 public offering of Series A Preferred Stock which raised approximately $72.5 million of net proceeds and (iii) the issuance and sale of shares under the dividend reinvestment and direct stock purchase plan (“DSPP”) and Equity Placement Program (“EPP”), while maintaining our leverage ratio. Through the DSPP, stockholders may purchase additional shares of common stock by reinvesting some or all of the cash dividends received on shares of common stock. Stockholders may also make optional cash purchases of shares of common stock subject to certain limitations detailed in the plan prospectus. For the nine months ended September 30, 2012 and 2011 we issued 5,327,661 and 9,192 shares under the plan, respectively, raising approximately $74.0 million and $0.1 million of net proceeds, respectively. As of September 30, 2012 and December 31, 2011, there were approximately 4.1 million and 9.4 million shares, respectively available for issuance under the DSPP.

On June 7, 2011 we established the EPP whereby, from time to time, we may publicly offer and sell up to 15.0 million shares of our common stock in at-the-market transactions and/or privately negotiated transactions with JMP Securities LLC acting as sales agent. For the nine months ended September 30, 2012 the Company issued 11,918,553 shares under the plan raising approximately $164.3 million. The Company did not issue any shares under the plan during the nine months ended September 30, 2011. As of September 30, 2012 and December 31, 2011, there were approximately 3.1 million and 15.0 million shares of common stock, respectively, remained available for issuance to be sold under the EPP.

The following tables present certain information regarding our risk exposure on our repurchase agreements as of September 30, 2012 and December 31, 2011 (dollars in thousands):

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September 30, 2012

Counterparty	Total Outstanding Borrowings	% of Total		% of Net Assets At Risk (1)		Weighted Average Maturity in Days
Bank of America Securities LLC	$1,153,279	8.3	%	2.5	%	47
Bank of Nova Scotia	651,503	4.7		0.8		43
Barclays Capital, Inc.	1,145,405	8.2		2.3		53
BNP Paribas Securities Corp	660,121	4.7		1.4		16
Cantor Fitzgerald & Co.	210,581	1.5		0.5		11
Citigroup Global Markets, Inc.	475,957	3.4		1.0		21
Credit Suisse Securities (USA) LLC	647,308	4.7		1.1		18
Daiwa Securities America, Inc.	293,674	2.1		0.6		42
Deutsche Bank Securities Inc.	537,262	3.9		1.2		21
Goldman Sachs & Co.	788,524	5.7		1.6		18
Guggenheim Liquidity Services, LLC	245,567	1.8		0.5		21
Industrial and Commercial Bank of China Financial Services LLC	825,251	5.9		1.6		18
ING Financial Markets LLC	394,666	2.8		0.9		14
Jefferies & Company, Inc.	82,559	0.6		0.2		17
KGS Alpha Capital Markets	94,653	0.7		0.2		23
LBBW Securities LLC	188,240	1.4		0.4		51
Mitsubishi UFJ Securities (USA), Inc.	498,179	3.6		1.0		45
Mizuho Securities USA, Inc.	556,893	4.0		1.3		13
Morgan Stanley & Co. Inc.	659,175	4.7		1.4		30
Nomura Securities International, Inc.	628,791	4.5		1.5		21
RBC Capital Markets, LLC	698,620	5.0		1.5		18
South Street Securities LLC	377,416	2.7		1.1		18
The Royal Bank of Scotland PLC	158,729	1.1		0.3		10
UBS Securities LLC	942,641	6.8		2.1		54
Wells Fargo Securities, LLC	996,983	7.2		1.4		18
	$13,911,977	100.0	%	28.4	%	

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December 31, 2011

Counterparty	Total Outstanding Borrowings	% of Total		% of Net Assets At Risk [(1)]		Weighted Average Maturity in Days
Bank of America Securities LLC	$242,641	3.1	%	1.3	%	19
Bank of Nova Scotia	416,381	5.3		1.3		33
Barclays Capital, Inc.	414,103	5.3		2.1		52
BNP Paribas Securities Corp	282,544	3.6		1.4		13
Cantor Fitzgerald & Co.	411,499	5.2		2.1		36
Citigroup Global Markets, Inc.	244,284	3.1		1.3		20
Credit Suisse Securities (USA) LLC	414,021	5.2		1.9		47
Daiwa Securities America, Inc.	288,960	3.6		1.5		30
Deutsche Bank Securities, Inc.	557,902	7.1		3.0		11
Goldman Sachs & Co.	543,768	6.9		2.8		22
Guggenheim Liquidity Services, LLC	151,530	1.9		0.8		23
Industrial and Commercial Bank of China Financial Services LLC	415,863	5.3		2.3		30
ING Financial Markets LLC	419,837	5.3		2.2		19
Jefferies & Company, Inc.	101,235	1.3		0.5		17
LBBW Securities LLC	206,734	2.6		1.0		45
Mitsubishi UFJ Securities (USA), Inc.	482,404	6.1		2.4		35
Mizuho Securities USA, Inc.	297,917	3.8		1.5		20
Morgan Stanley & Co. Inc.	172,063	2.2		1.0		45
Nomura Securities International, Inc.	281,998	3.6		1.4		41
RBC Capital Markets, LLC	223,831	2.8		1.3		12
South Street Securities LLC	336,394	4.3		2.1		18
The Royal Bank of Scotland PLC	143,628	1.8		0.7		10
UBS Securities LLC	328,368	4.2		1.7		47
Wells Fargo Securities, LLC	502,909	6.4		1.7		10
Total	$7,880,814	100.0	%	39.3	%	

(1) Equal to the fair value of pledged securities plus accrued interest income, minus the sum of repurchase agreement liabilities and accrued interest expense divided by net assets.

Our repurchase agreements contain typical provisions and covenants as set forth in the standard master repurchase agreement published by the Securities Industry and Financial Markets Association. Our repurchase agreements generally require us to transfer additional securities to the counterparty in the event the value of the securities then held by the counterparty in the margin account falls below specified levels and contain events of default in cases where we or the counterparty breaches our respective obligations under the agreement.

We receive margin calls from our repurchase agreement counterparties from time to time in the ordinary course of business similar to other entities in the specialty finance business. We receive two types of margin calls under our repurchase agreements. The first type, which are known as “factor calls,” are margin calls that occur each month and relate to the timing difference between the reduction of principal balances of our Agency RMBS, due to monthly principal payments on the underlying mortgages, and the receipt of the corresponding cash. The second type of margin call we may receive is a “valuation call”, which occurs due to market and interest rate movements. Both factor and valuation margin calls occur if the total value of our assets pledged as collateral to a counterparty drops beyond a threshold level, typically between $100,000 and $500,000. Both types of margin calls require a dollar for dollar restoration of the margin shortfall. Conversely, we may initiate margin calls to our counterparties when the value of our assets pledged as collateral with a counterparty increases above the threshold level, thereby increasing our liquidity. All unrestricted cash and cash equivalents, plus any unpledged securities, are available to satisfy margin calls

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As of September 30, 2012 and December 31, 2011, we had approximately $1,769.2 million and $580.0 million, respectively, in Agency RMBS, U.S. Treasury securities and cash and cash equivalents available to satisfy future margin calls. To date, we have maintained sufficient liquidity to meet margin calls, and we have never been unable to satisfy a margin call, although no assurance can be given that we will be able to satisfy requests from our lenders to post additional collateral in the future.

An event of default or termination event under the standard master repurchase agreement would give our counterparty the option to terminate all repurchase transactions existing with us and make any amount due by us to the counterparty to be payable immediately.

We have made and intend to continue to make regular quarterly distributions of all or substantially all of our REIT taxable income to holders of our common stock. In order to qualify as a REIT and to avoid federal corporate income tax on the income that we distribute to our stockholders, we are required to distribute at least 90% of our REIT taxable income, determined without regard to the deduction for dividends paid and excluding net capital gain, on an annual basis. This requirement can impact our liquidity and capital resources.

For our short term (one year or less) and long term liquidity and capital resource requirements, we also rely on the cash flow from operations, primarily monthly principal and interest payments to be received on our Agency RMBS, as well as any securities offerings authorized by our board of directors.

Based on our current portfolio, leverage rate and available borrowing arrangements, we believe that our cash flow from operations and the utilization of borrowings will be sufficient to enable us to meet anticipated short term (one year or less) liquidity requirements such as funding our investment activities, funding our distributions to stockholders and for general corporate expenses. However, an increase in prepayment rates substantially above our expectations could cause a temporary liquidity shortfall due to the timing of the necessary margin calls on the financing arrangements and the actual receipt of the cash related to principal paydowns. If our cash resources are at any time insufficient to satisfy our liquidity requirements, we may have to issue debt or additional equity securities or sell Agency RMBS in our portfolio. If required, the sale of Agency RMBS at prices lower than their amortized cost would result in realized losses. We believe that we have additional capacity through repurchase agreements to leverage our equity further should the need for additional short term (one year or less) liquidity arise.

We may increase our capital resources by obtaining long term credit facilities or making public or private offerings of equity or debt securities. Such financing will depend on market conditions for capital raises and for the investment of any proceeds. If we are unable to renew, replace or expand our sources of financing on substantially similar terms, it may have an adverse effect on our business and results of operations.

Qualitative and Quantitative Disclosures about Short Term Borrowings

The following table discloses quantitative data about our short term borrowings under repurchase agreements during the three and nine months ended September 30, 2012 and 2011.

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In millions)	2012	2011	2012	2011
Outstanding at period end	$ 13,912	$ 7,541	$ 13,912	$ 7,541
Weighted average rate at period end	0.42 %	0.28 %	0.42 %	0.28 %
Average outstanding during period [1]	$ 11,571	$ 7,474	$ 9,905	$ 6,114
Weighted average rate during period	0.41 %	0.26 %	0.37 %	0.27 %
Largest month end balance during period	$ 13,912	$ 7,548	$ 13,912	$ 7,548

(1) Calculated based on the average month end balance during the period.

During the three months ended September 30, 2012, our repurchase agreement balance increased due to our July 16, 2012 public offering of our common stock and our August 3, 2012 offering of our Series A Preferred Stock, which allowed us to finance additional asset purchases. During the three months ended September 30, 2011, our repurchase agreement balance remained stable. The rate on repurchase agreements was relatively unchanged during the three months ended September 30, 2012 and 2011. During the nine months ended September 30, 2012 our repurchase agreement balance increased due to our February 1, 2012 and July 16, 2012 public offerings and our August 3, 2012 offering of our Series A Preferred Stock, which allowed us to finance additional asset purchases. During the three and nine months ended September 30, 2011, our repurchase agreement balance increased during the end of the period due to forward settling purchases made with the net proceeds from our February 2011 equity offering settling and being financed through repurchase agreements. During the nine months ended

September 30, 2011, the weighted average rate on our repurchase agreements remained relatively stable. However, during the nine months ended September 30, 2012, the rate was higher by five basis points at the end of the period compared to the average. This increase is partly explained by the European debt crisis and the downgrading of a significant number of U.S. banks by Moody's during the nine months ended September 30, 2012.

Inflation

Virtually all of our assets and liabilities are interest rate sensitive in nature. As a result, interest rates and other factors influence our performance far more than inflation. Changes in interest rates do not necessarily correlate with inflation rates or changes in inflation rates. Our financial statements are prepared in accordance with GAAP and our distributions are determined by our board of directors based in part on our REIT taxable income as calculated according to the requirements of the Internal Revenue Code. In each case, our activities and balance sheet are measured with reference to fair value without considering inflation.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

As of September 30, 2012 and December 31, 2011, the primary component of our market risk was interest rate risk, as described below. While we do not seek to avoid risk completely, we do believe that risk can be quantified from historical experience and seek to actively manage risk, to earn sufficient compensation to justify taking risks and to maintain capital levels consistent with the risks we undertake. Our board of directors exercises oversight of risk management in many ways, including overseeing our senior management's risk-related responsibilities and reviewing management and investment policies and performance against these policies and related benchmarks. See "Business—Risk Management" in our annual report on Form 10-K for the fiscal year ended December 31, 2011 for a further discussion of our risk mitigation practices.

Interest Rate Risk

We are subject to interest rate risk in connection with our investments in Agency RMBS collateralized by ARMs, hybrid ARMs and fixed rate mortgage loans and our related debt obligations, which are generally repurchase agreements of limited duration that are periodically refinanced at current market rates. We seek to mitigate this risk through utilization of derivative contracts, primarily interest rate swap and cap agreements.

Effect on Net Investment Income. We fund our investments in long term Agency RMBS collateralized by ARMs, hybrid ARMs and fixed rate mortgage loans with short term borrowings under repurchase agreements. During periods of rising interest rates, the borrowing costs associated with those Agency RMBS tend to increase while the income earned on such Agency RMBS (during the fixed rate component of such securities) may remain substantially unchanged. This results in a narrowing of the net interest spread between the related assets and borrowings and may even result in losses.

We are a party to the interest rate swap and contracts as of September 30, 2012 and December 31, 2011 described in detail under Item 2. "Management's Discussion and Analysis of Financial Condition and Results of Operations—Contractual Obligations and Commitments" in this quarterly report on Form 10-Q.

Hedging techniques are partly based on assumed levels of prepayments of our Agency RMBS. If prepayments are slower or faster than assumed, the life of the Agency RMBS will be longer or shorter, which would reduce the effectiveness of any hedging strategies we may use and may cause losses on such transactions.

Effect on Fair Value. Another component of interest rate risk is the effect changes in interest rates will have on the fair value of our assets. We face the risk that the fair value of our assets will increase or decrease at different rates than that of our liabilities, including our hedging instruments.

We primarily assess our interest rate risk by estimating the duration of our assets and the duration of our liabilities. Duration essentially measures the market price volatility of financial instruments as interest rates change. We generally calculate duration using various third-party financial models and empirical data. Different models and methodologies can produce different duration numbers for the same securities.

Extension Risk. We invest in Agency RMBS collateralized by hybrid ARMs, which have interest rates that are fixed for the first few years of the loan (typically three, five, seven or 10 years) and thereafter reset periodically on the same basis as Agency RMBS collateralized by ARMs. We compute the projected weighted average life of our Agency RMBS collateralized by hybrid ARMs based on assumptions regarding the rate at which the borrowers will prepay the underlying mortgages. In general, when Agency RMBS collateralized by fixed rate or hybrid ARMs is acquired with borrowings, we may, but are not required to, enter into an interest rate swap agreement or other hedging instrument that effectively fixes our borrowing costs for a period close to the anticipated weighted average life of the fixed rate portion of the related Agency RMBS. This strategy is designed to protect us from rising interest rates by fixing our borrowing costs for the duration of the fixed rate period of the collateral underlying the related Agency RMBS.

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We have structured our swaps to expire in conjunction with the estimated weighted average life of the fixed period of the mortgages underlying our Agency RMBS portfolio. However, in a rising interest rate environment, the weighted average life of the fixed rate mortgages underlying our Agency RMBS could extend beyond the term of the swap agreement or other hedging instrument. This could have a negative impact on our results from operations, as borrowing costs would no longer be fixed after the term of the hedging instrument while the income earned on the remaining Agency RMBS would remain fixed for a period of time. This situation may also cause the market value of our Agency RMBS to decline with little or no offsetting gain from the related hedging transactions. In extreme situations, we may be forced to sell assets to maintain adequate liquidity, which could cause us to incur losses.

Interest Rate Cap Risk. Both the ARMs and hybrid ARMs that collateralize our Agency RMBS are typically subject to periodic and lifetime interest rate caps and floors, which limit the amount by which the security's interest yield may change during any given period. However, our borrowing costs will not be subject to similar restrictions. Therefore, in a period of increasing interest rates, the interest costs on our borrowings could increase without limitation by caps while the interest rate yields on our Agency RMBS would effectively be limited by caps. This problem will be magnified to the extent that we acquire Agency RMBS that are collateralized by hybrid ARMs that are not fully indexed. In addition, the underlying mortgages may be subject to periodic payment caps that result in some portion of the interest being deferred and added to the principal outstanding. This could result in our receipt of less cash income on our Agency RMBS than we need in order to pay the interest cost on our related borrowings. These factors could lower our net investment income or cause a net loss during periods of rising interest rates, which would harm our financial condition, cash flows and results of operations.

Interest Rate Mismatch Risk. We intend to fund a substantial portion of our acquisitions of Agency RMBS with borrowings that, after the effect of hedging, have interest rates based on indices and repricing terms similar to, but of somewhat shorter maturities than, the interest rate indices and repricing terms of the Agency RMBS. Thus, we anticipate that in most cases the interest rate indices and repricing terms of our Agency RMBS and our funding sources will not be identical, thereby creating an interest rate mismatch between assets and liabilities. Therefore, our cost of funds would likely rise or fall more quickly than would our earnings rate on assets. During periods of changing interest rates, such interest rate mismatches could negatively impact our financial condition, cash flows and results of operations. To mitigate interest rate mismatches, we may utilize the hedging strategies discussed above.

Our analysis of risks is based on management's experience, estimates, models and assumptions. These analyses rely on models which utilize estimates of fair value and interest rate sensitivity. Actual economic conditions or implementation of investment decisions by our management may produce results that differ significantly from the estimates and assumptions used in our models and the projected results reflected herein.

Prepayment Risk

Prepayments are the full or partial repayment of principal prior to the original contractual maturity of a mortgage loan and typically occur due to refinancing of mortgage loans. Prepayment rates for existing Agency RMBS generally increase when prevailing mortgage interest rates fall. In addition, prepayment rates on Agency RMBS collateralized by ARMs and hybrid ARMs generally increase when the difference between long term and short term interest rates declines or becomes negative. Additionally, we currently own Agency RMBS that were purchased at a premium. The prepayment of such Agency RMBS at a rate faster than anticipated would result in a write-off of any remaining capitalized premium amount.

We seek to mitigate our prepayment risk by investing in Agency RMBS with (i) a variety of prepayment characteristics, (ii) prepayment prohibitions and penalties and (iii) prepayment protections, as well as by balancing Agency RMBS purchased at a premium with Agency RMBS purchased at a discount.

Effect on Fair Value and Net Income

Another component of interest rate risk is the effect changes in interest rates will have on the fair value of our assets and our net income exclusive of the effect on fair value. We face the risk that the fair value of our assets and net investment income will increase or decrease at different rates than that of our liabilities, including our hedging instruments.

We primarily assess our interest rate risk by estimating the duration of our assets and the duration of our liabilities. Duration essentially measures the market price volatility of financial instruments as interest rates change. We

generally calculate duration using various financial models and empirical data. Different models and methodologies can produce different duration numbers for the same securities.
The following sensitivity analysis table shows the estimated impact of our interest rate-sensitive investments and repurchase agreement liabilities on the fair value of our assets and our net income, exclusive of the effect of changes in fair value on our net income, at September 30, 2012 and December 31, 2011, assuming a static portfolio and that rates instantaneously fall 25, 50 and 75 basis points and rise 25, 50 and 75 basis points.

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September 30, 2012

Change in Interest Rates	Projected Change in the Fair Value of Our Assets*		Projected Change in Our Net Income	
- 75 basis points	1.37	%	9.15	%
- 50 basis points	0.92	%	7.32	%
- 25 basis points	0.47	%	3.66	%
No Change	—	%	—	%
+ 25 basis points	(0.44	)%	(9.15	)%
+ 50 basis points	(1.03	)%	(18.31	)%
+ 75 basis points	(1.78	)%	(27.46	)%

December 31, 2011

Change in Interest Rates	Projected Change in the Fair Value of Our Assets*		Projected Change in Our Net Income	
- 75 basis points	0.42	%	5.52	%
- 50 basis points	0.34	%	4.41	%
- 25 basis points	0.20	%	2.18	%
No Change	—	%	—	%
+ 25 basis points	(0.39	)%	(5.61	)%
+ 50 basis points	(0.93	)%	(11.17	)%
+ 75 basis points	(1.59	)%	(16.74	)%

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* Analytics provided by The Yield Book® Software

While the charts above reflect the estimated immediate impact of interest rate increases and decreases on a static portfolio, we rebalance our portfolio from time to time either to take advantage or minimize the impact of changes in interest rates. Additionally, the effects of interest rate changes on our portfolio illustrated in the above chart do not take into account the effect that our hedging instruments, mainly interest rate swaps and caps, would have on the fair value of our portfolio, but do take into account the effect that our hedging instruments, would have on our net income exclusive of the effect on fair value. Generally, our interest rate swaps reset in the quarter following changes in interest rates. It is important to note that the impact of changing interest rates on fair value and net income can change significantly when interest rates change beyond 75 basis points from current levels. Therefore, the volatility in the fair value of our assets could increase significantly when interest rates change beyond 75 basis points. In addition, other factors impact the fair value of and net income from our interest rate-sensitive investments and hedging instruments, such as the shape of the yield curve, market expectations as to future interest rate changes and other market conditions. Accordingly, in the event of changes in actual interest rates, the change in the fair value of our assets and our net income would likely differ from that shown above, and such difference might be material and adverse to our stockholders.

Risk Management

Our board of directors exercises its oversight of risk management in many ways, including overseeing our senior management's risk-related responsibilities, including reviewing management policies and performance against these policies and related benchmarks.

As part of our risk management process, we actively manage the interest rate, liquidity, prepayment and counterparty risks associated with our Agency RMBS portfolio. We seek to mitigate our interest rate risk exposure by entering into various hedging instruments in order to minimize our exposure to potential interest rate mismatches between the interest we earn on our investments and our borrowing costs.

We seek to mitigate our liquidity risks by monitoring our liquidity position on a daily basis and maintaining a prudent level of leverage, which we currently consider to be between six and 10 times the amount of net assets in our overall portfolio, based on current market conditions and various other factors, including the health of the financial institutions that lend to us under our repurchase agreements and the presence of special liquidity programs provided by domestic and foreign central banks.

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We seek to mitigate our prepayment risk by investing in Agency RMBS with (i) a variety of prepayment characteristics, (ii) prepayment prohibitions and penalties and (iii) prepayment protections, as well as by balancing Agency RMBS purchased at a premium with Agency RMBS purchased at a discount.
We seek to mitigate our counterparty risk by (i) diversifying our exposure across a broad number of counterparties, (ii) limiting our exposure to any one counterparty and (iii) monitoring the financial stability of our counterparties.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and our Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of September 30, 2012. The term “disclosure controls and procedures,” as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”), means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC’s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company’s management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on the evaluation of our disclosure controls and procedures as of September 30, 2012, our Chief Executive Officer and Chief Financial Officer concluded that, as of such date, our disclosure controls and procedures were effective.
There have been no changes in our internal controls over financial reporting that occurred during the last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

PART II. Other Information

Item 1. Legal Proceedings

The Company is not currently subject to any material legal proceedings.

Item 1A. Risk Factors

We cannot predict the impact of “QE3” on the prices and liquidity of Agency RMBS or other securities in which we invest, although the Federal Reserve action could increase the prices of our target assets and reduce the spread on our investments.

On November 25, 2008, the Federal Reserve announced a program to purchase Agency RMBS in the open market. The stated goal of this program was to provide support to mortgage and housing markets and to foster improved conditions in financial markets more generally. On March 18, 2009, this program was expanded to a target size of $1.25 trillion. The Federal Reserve completed this purchase program in March 2010. The Federal Reserve announced on November 3, 2010 that it intended to purchase an additional $600 billion of long-term securities by the end of the second quarter of 2011, at a pace of about $75 billion per month. On September 13, 2012, the Federal Reserve announced an open-ended program to expand its holdings of long-term securities by purchasing an additional $40 billion of Agency RMBS per month until key economic indicators, such as the unemployment rate, showed signs of improvement. This program, which we refer to as QE3, when combined with existing programs to extend the average maturity of the Fed's holdings of securities and reinvest principal payments from the Federal Reserve's holdings of agency debt and Agency RMBS into Agency RMBS, is expected to increase the Federal Reserve's holdings of long-term securities by approximately $85 billion each month through the end of 2012.

The Federal Reserve also announced that it will keep the target range for the federal funds rate between zero and 0.25% through at least mid-2015, which is six months longer than previously expected. The Federal Reserve expects these measures to put downward pressure on long-term interest rates. While the Federal Reserve hopes that QE3 will expedite an economic recovery, stabilize prices, reduce unemployment and restart business and household spending, we cannot predict the impact of these programs or any future actions by the Federal Reserve on the prices and liquidity of Agency RMBS or other securities in which we invest, although the Federal Reserve action could increase the prices of our target assets and reduce the spread on our investments.

Failure to obtain and maintain an exemption from being regulated as a commodity pool operator could subject us to additional regulation and compliance requirements and may result in fines and other penalties which could materially adversely affect our business and financial condition.

Recently adopted rules under the Dodd-Frank Act establish a comprehensive new regulatory framework for derivative contracts commonly referred to as “swaps.” Under these recently adopted rules, any investment fund that trades in swaps may be considered a “commodity pool,” which would cause its directors to be regulated as “commodity pool operators” ("CPOs"). Under the new rules, which become effective on October 12, 2012 for those who become CPOs solely because of their use of swaps, CPOs must register with the National Futures Association (the "NFA"), which requires compliance with NFA's rules, and are subject to regulation by the U.S. Commodity Futures Trading Commission (the “CFTC”) including with respect to disclosure, reporting, recordkeeping and business conduct.

We use hedging instruments in conjunction with our investment portfolio and related borrowings to reduce or mitigate risks associated with changes in interest rates, mortgage spreads, yield curve shapes and market volatility. These hedging instruments include interest rate swaps, interest rate futures and options on interest rate futures. We do not currently engage in any speculative derivatives activities or other non-hedging transactions using swaps, futures or options on futures. We do not use these instruments for the purpose of trading in commodity interests, and we do not consider our company or its operations to be a commodity pool as to which CPO regulation or compliance is required. We, along with numerous other mortgage REITs, have submitted a no-action letter request to the CFTC seeking exemptive relief for our directors from CPO registration under these new rules. However, at this time, our directors do not intend to register as CPOs with the NFA. While we have reason to believe that the CFTC may provide us with exemptive relief prior to December 31, 2012, there can be no assurance that any such relief will be granted. If exemptive relief is granted, we may be restricted to operating within certain parameters discussed in the no-action letter we submitted to the CFTC. For example, exemptive relief might limit our ability to enter into interest rate hedging transactions if the amount of income we receive from such hedges will exceed five percent of our gross income or the initial margin and premiums for such hedges will exceed one percent of the fair market value of our total assets.

The CFTC has substantial enforcement power with respect to violations of the laws over which it has jurisdiction, including their anti-fraud and anti-manipulation provisions. Among other things, CFTC may suspend or revoke the registration of a person who fails to comply, prohibit such a person from trading or doing business with registered entities, impose civil money penalties, require restitution and seek fines or imprisonment for criminal violations. Additionally, a private right of action exists against those who violate the laws over which CFTC has jurisdiction or who willfully aid, abet, counsel, induce or procure a violation of those laws. In the event we fail to receive exemptive relief from the CFTC on this matter and our directors fail to comply with the regulatory requirements of these new rules, we may be subject to significant fines, penalties and other civil or governmental actions or proceedings, any of which could have a materially adverse effect on our business, financial condition and results of operations.

We cannot predict the impact, if any, on our earnings or cash available for distribution to our stockholders of the FHFA's proposed revisions to Fannie Mae's, Freddie Mac's and Ginnie Mae's existing infrastructures to align the standards and practices of the three entities.

On February 21, 2012, the FHFA released its Strategic Plan for Enterprise Conservatorships, which set forth three goals for the next phase of the Fannie Mae and Freddie Mac conservatorships. These three goals are to (i) build a new infrastructure for the secondary mortgage market, (ii) gradually contract Fannie Mae and Freddie Mac's presence in the marketplace while simplifying and shrinking their operations, and (iii) maintain foreclosure prevention activities and credit availability for new and refinanced mortgages. On October 4, 2012, the FHFA released its white paper entitled Building a New Infrastructure for the Secondary Mortgage Market, which proposes a new infrastructure for Fannie Mae and Freddie Mac that has two basic goals.

The first such goal is to replace the current, outdated infrastructures of Fannie Mae and Freddie Mac with a common, more efficient infrastructure that aligns the standards and practices of the two entities, beginning with core functions performed by both entities such as issuance, master servicing, bond administration, collateral management and data integration. The second goal is to establish an operating framework for Fannie Mae and Freddie Mac that is consistent with the progress of housing finance reform and encourages and accommodates the increased participation of private capital in assuming credit risk associated with the secondary mortgage market.

The FHFA recognizes that there are a number of impediments to their goals which may or may not be surmountable, such as the absence of any significant secondary mortgage market mechanisms beyond Fannie Mae, Freddie Mac and Ginnie Mae, and that their proposals are in the formative stages. As a result, it is unclear if the proposals will be enacted. If such proposals are enacted, it is unclear how closely what is enacted will resemble the proposals from the FHFA White Paper or what the effects of the enactment will be in terms of our net asset value, earnings or cash available for distribution to our stockholders.

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Item 2. Unregistered Sales of Equity Securities and Use of Proceeds
None.
Item 3. Defaults Upon Senior Securities
None.
Item 4. Mine Safety Disclosures
None.
Item 5. Other Information
None.
Item 6. Exhibits
(a) Exhibits.

Exhibit Number	Description of Exhibit
31.1*	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes – Oxley Act of 2002
31.2*	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes – Oxley Act of 2002
32.1**	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes – Oxley Act of 2002
32.2**	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes – Oxley Act of 2002
Exhibit 101.INS XBRL	Instance Document (1)
Exhibit 101.SCH XBRL	Taxonomy Extension Schema Document (1)
Exhibit 101.CAL XBRL	Taxonomy Extension Calculation Linkbase Document (1)
Exhibit 101.DEF XBRL	Additional Taxonomy Extension Definition Linkbase Document Created (1)
Exhibit 101.LAB XBRL	Taxonomy Extension Label Linkbase Document (1)
Exhibit 101.PRE XBRL	Taxonomy Extension Presentation Linkbase Document (1)

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* Filed herewith.
** Furnished herewith.
(1) Submitted electronically herewith. Attached as Exhibit 101 to this report are the following documents formatted in XBRL (Extensible Business Reporting Language): (i) Statements of Assets and Liabilities at September 30, 2012(Unaudited) and December 31, 2011 (Derived from the audited balance sheet at December 31, 2011); (ii) Condensed Statements of Operations (Unaudited) for the three and nine months ended September 30, 2012 and 2011; (iii) Condensed Statement of Changes in Net Assets (Unaudited) for the three and nine months ended September 30, 2012; (iv) Condensed Statements of Cash Flows (Unaudited) for the nine months ended September 30, 2012 and 2011; and (v) Condensed Notes to Financial Statements (Unaudited) for the three and nine months

ended September 30, 2012. Users of this data are advised pursuant to Rule 406T of Regulation S-T that this interactive data file is deemed not filed or part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of section 18 of the Securities and Exchange Act of 1934, and otherwise is not subject to liability under these sections.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

	CYS INVESTMENTS, INC.
Dated: October 19, 2012	BY: /s/ FRANCES R. SPARK Frances R. Spark Chief Financial Officer and Treasurer (Principal Financial Officer and Principal Accounting Officer)

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