

ANWORTH MORTGAGE ASSET CORP
Form 10-Q
May 09, 2008
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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 MARCH 31, 2008

OR

.. **TRANSACTION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from _____ to _____

Commission File Number 001-13709

ANWORTH MORTGAGE ASSET CORPORATION

(Exact name of registrant as specified in its charter)

| | |
|--|--|
| MARYLAND (State or other jurisdiction of incorporation or organization) | 52-2059785 (I.R.S. Employer Identification No.) |
| 1299 Ocean Avenue, 2nd Floor, Santa Monica, California (Address of principal executive offices) | 90401 (Zip Code) |
| Registrant's telephone number, including area code: (310) 255-4493 | |

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 filing requirements for the past 90 days. Yes 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 definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (check one):

Large Accelerated Filer Accelerated Filer Non-Accelerated Filer Smaller Reporting Company

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

At May 2, 2008, the registrant had 82,472,537 shares of common stock issued and outstanding.

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| | March 31, 2008 | December 31, 2007 (unaudited) |
|--|-------------------|-------------------------------------|
| ASSETS | | |
| Agency MBS: | | |
| Agency MBS pledged to counterparties at fair value | \$ 5,451,270 | \$ 4,478,983 |
| Agency MBS at fair value | 276,980 | 183,564 |
| | 5,728,250 | 4,662,547 |
| Non-Agency MBS: | | |
| Non-Agency MBS at fair value | 26,424 | 42,714 |
| Cash and cash equivalents | 14,343 | 12,440 |
| Interest and dividends receivable | 29,337 | 25,618 |
| Derivative instruments at fair value | | 1,791 |
| Prepaid expenses and other assets | 9,028 | 52,371 |
| Cash and cash equivalents of discontinued operations | 33 | |
| Assets of discontinued operations | 13 | 38 |
| | \$ 5,807,428 | \$ 4,797,519 |
| LIABILITIES AND STOCKHOLDERS EQUITY | | |
| Liabilities: | | |
| Accrued interest payable | \$ 38,380 | \$ 40,892 |
| Repurchase agreements | 5,077,400 | 4,227,100 |
| Junior subordinated notes | 37,380 | 37,380 |
| Derivative instruments at fair value | 104,296 | 45,193 |
| Dividends payable on Series A Cumulative Preferred Stock | 1,011 | 1,011 |
| Dividends payable on Series B Cumulative Convertible Preferred Stock | 471 | 471 |
| Dividends payable on common stock | | 6,765 |
| Accrued expenses and other liabilities | 1,784 | 1,317 |
| Liabilities of discontinued operations | 7,762 | 7,834 |
| | \$ 5,268,484 | \$ 4,367,963 |
| Series B Cumulative Convertible Preferred Stock: par value \$0.01 per share; liquidating preference \$25.00 per share (\$30,150 and \$30,150, respectively); 1,206 and 1,206 shares issued and outstanding, respectively | \$ 28,108 | \$ 28,108 |
| Stockholders' Equity: | | |
| Series A Cumulative Preferred Stock: par value \$0.01 per share; liquidating preference \$25.00 per share (\$46,888 and \$46,888, respectively); 1,876 and 1,876 shares issued and outstanding, respectively | \$ 45,397 | \$ 45,397 |
| | 766 | 573 |

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Common Stock: par value \$0.01 per share; authorized 100,000 shares, 76,606 and 57,289 issued and outstanding, respectively

| | | |
|--|--------------|--------------|
| Additional paid-in capital | 761,582 | 601,462 |
| Accumulated other comprehensive loss consisting of unrealized losses and gains | (102,149) | (36,129) |
| Accumulated deficit | (194,760) | (209,855) |
| | \$ 510,836 | \$ 401,448 |
| | \$ 5,807,428 | \$ 4,797,519 |

See accompanying notes to unaudited consolidated financial statements.

Table of Contents**ANWORTH MORTGAGE ASSET CORPORATION AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF INCOME****(in thousands, except per share amounts)****(unaudited)**

| | Three Months Ended March 31, | |
|--|---|-------------|
| | 2008 | 2007 |
| Interest income net of amortization of premium and discount: | | |
| Interest on Agency MBS | \$ 67,579 | \$ 62,128 |
| Interest on Non-Agency MBS | 420 | 1,682 |
| Other income | 402 | 39 |
| | 68,401 | 63,849 |
| Interest expense: | | |
| Interest expense on repurchase agreements | 48,395 | 59,016 |
| Interest expense on junior subordinated notes | 695 | 794 |
| | 49,090 | 59,810 |
| Net interest income | 19,311 | 4,039 |
| Net loss on derivative instruments | (280) | |
| Expenses: | | |
| Compensation and benefits | (1,640) | (657) |
| Compensation amortization of restricted stock | (51) | (207) |
| Other expenses | (775) | (714) |
| Total expenses | (2,466) | (1,578) |
| Income from continuing operations | 16,565 | 2,461 |
| Income from discontinued operations | 12 | 303 |
| Net income | \$ 16,577 | \$ 2,764 |
| Dividend on Series A Cumulative Preferred Stock | (1,011) | |
| Dividend on Series B Cumulative Convertible Preferred Stock | (471) | (325) |
| Net income to common stockholders | \$ 15,095 | \$ 2,439 |
| Basic earnings per common share: | | |
| Continuing operations | \$ 0.22 | \$ 0.04 |
| Discontinued operations | | 0.01 |
| Total basic earnings per common share | \$ 0.22 | \$ 0.05 |
| Diluted earnings per common share: | | |
| Continuing operations | \$ 0.21 | \$ 0.04 |
| Discontinued operations | | 0.01 |

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| | | |
|---|---------|---------|
| Total diluted earnings per common share | \$ 0.21 | \$ 0.05 |
| Basic weighted average number of shares outstanding | 69,708 | 45,614 |
| Diluted weighted average number of shares outstanding | 72,581 | 45,639 |

See accompanying notes to unaudited consolidated financial statements.

Table of Contents**ANWORTH MORTGAGE ASSET CORPORATION AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY**

(in thousands, except per share amounts)

(unaudited)

| | Series A Preferred Stock Shares | Common Stock Shares | Series A Preferred Stock | Common Stock Value | Additional Paid-In Capital | Accum. Other Comp. Income (Loss) | | Accum. Other Comp. (Loss) Derivatives | Accumulated (Deficit) | Comp. Income (Loss) | Total |
|--|---------------------------------------|---------------------------|--------------------------------|--------------------------|----------------------------------|-------------------------------------|-------------------|---|--------------------------|---------------------------|------------|
| | | | | | | Agency MBS | Non-Agency MBS | | | | |
| Balance, December 31, 2007 | 1,876 | 57,289 | \$ 45,397 | \$ 573 | \$ 601,462 | \$ 14,251 | \$ (7,003) | \$ (43,377) | \$ (209,855) | | \$ 401,448 |
| Issuance of common stock | | 19,317 | | 193 | 160,041 | | | | | | 160,234 |
| Other comprehensive income (loss), fair value adjustments | | | | | | 8,690 | (14,096) | (60,614) | | (66,020) | (66,020) |
| Net income | | | | | | | | | 16,577 | 16,577 | 16,577 |
| Total comprehensive income | | | | | | | | | | \$ (49,443) | |
| DERs exercise | | | | | 9 | | | | | | 9 |
| Amortization of restricted stock | | | | | 70 | | | | | | 70 |
| Dividend declared \$0.539063 per Series A preferred share | | | | | | | | | (1,011) | | (1,011) |
| Dividend declared \$0.390625 per Series B preferred share | | | | | | | | | (471) | | (471) |
| Balance, March 31, 2008 | 1,876 | 76,606 | \$ 45,397 | \$ 766 | \$ 761,582 | \$ 22,941 | \$ (21,099) | \$ (103,991) | \$ (194,760) | | \$ 510,836 |

See accompanying notes to unaudited consolidated financial statements.

Table of Contents**ANWORTH MORTGAGE ASSET CORPORATION AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS****(in thousands)****(unaudited)**

| | Three Months Ended March 31, | |
|---|---|---------------------|
| | 2008 | 2007 |
| Operating Activities: | | |
| Income from continuing operations | \$ 16,565 | \$ 2,461 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Amortization of premium and discounts (Agency MBS) | 3,454 | 5,921 |
| Amortization of restricted stock | 70 | 227 |
| Loss on derivative instruments | 280 | |
| Changes in assets and liabilities: | | |
| (Increase) in interest receivable | (3,719) | (1,276) |
| Decrease (increase) in prepaid expenses and other | 43,386 | (10,609) |
| (Decrease) increase in accrued interest payable | (2,512) | 8,126 |
| Increase in accrued expenses and other | 477 | 1,188 |
| Net cash (used in) provided by operating activities of discontinued operations | (34) | 4,358 |
| Net cash provided by operating activities | \$ 57,967 | \$ 10,396 |
| Investing Activities: | | |
| Available-for-sale Agency MBS: | | |
| Purchases | \$ (1,317,427) | \$ (644,345) |
| Principal payments | 256,916 | 339,814 |
| Available-for-sale Non-Agency MBS: | | |
| Purchases | | (20,000) |
| Principal payments | 2,193 | 8,594 |
| Net cash provided by investing activities of discontinued operations | | 96,040 |
| Net cash used in investing activities | \$ (1,058,318) | \$ (219,897) |
| Financing Activities: | | |
| Borrowings from repurchase agreements | \$ 6,473,513 | \$ 6,781,122 |
| Repayments on repurchase agreements | (5,623,213) | (6,496,872) |
| Proceeds from common stock issued, net | 160,234 | 62 |
| Proceeds from Series B Preferred Stock issued, net | | 26,866 |
| Series A Preferred stock dividends paid | (1,011) | (1,011) |
| Series B Preferred stock dividends paid | (471) | |
| Common stock dividends paid | (6,765) | (912) |
| Net cash used in financing activities of discontinued operations | | (99,575) |
| Net cash provided by financing activities | \$ 1,002,287 | \$ 209,680 |
| Net increase in cash and cash equivalents | \$ 1,936 | \$ 179 |
| Cash and cash equivalents at beginning of period | 12,440 | 34 |
| Add: net (increase) in cash of discontinued operations | (33) | (201) |
| Cash and cash equivalents at end of period | \$ 14,343 | \$ 12 |

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Supplemental Disclosure of Cash Flow Information:

| | | | |
|------------------------|--|-----------|-----------|
| Cash paid for interest | | \$ 51,603 | \$ 74,078 |
| | See accompanying notes to unaudited consolidated financial statements. | | |

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ANWORTH MORTGAGE ASSET CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(in thousands)

(unaudited)

| | Three Months Ended | |
|--|---------------------------|-------------|
| | March 31, | |
| | 2008 | 2007 |
| Net income | \$ 16,577 | \$ 2,764 |
| Available-for-sale Agency MBS, fair value adjustment | 8,690 | 16,367 |
| Available-for-sale Non-Agency MBS, fair value adjustment | (14,096) | (165) |
| Unrealized losses on cash flow hedges | (61,910) | (4,708) |
| Reclassification adjustment for interest income included in net income | 1,296 | (1,888) |
| BT Other MBS, reclassification adjustment into earnings | | (9,415) |
| Reclassification adjustment for gains on sales included in net income | | (185) |
| | (66,020) | 6 |
| Comprehensive (loss) income | \$ (49,443) | \$ 2,770 |

See accompanying notes to unaudited consolidated financial statements.

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ANWORTH MORTGAGE ASSET CORPORATION AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

Anworth Mortgage Asset Corporation, or Anworth, was incorporated in Maryland on October 20, 1997 and commenced operations on March 17, 1998. We are in the business of investing primarily in United States agency mortgage-backed securities, referred to as Agency MBS. United States agency securities are securities that are obligations guaranteed by the United States government or guaranteed by federally sponsored enterprises such as Fannie Mae, Freddie Mac or Ginnie Mae. We seek attractive long-term investment returns by investing our equity capital and borrowed funds in such securities and other mortgage-related assets.

We have elected to be taxed as a real estate investment trust, or REIT, under the Internal Revenue Code of 1986, or the Code. As a REIT, we routinely distribute substantially all of the income generated from our operations to our stockholders. As long as we retain our REIT status, we generally will not be subject to federal or state taxes on our income to the extent that we distribute our net income to our stockholders.

BASIS OF PRESENTATION AND CONSOLIDATION

The accompanying unaudited consolidated financial statements are prepared on the accrual basis of accounting in accordance with generally accepted accounting principles utilized in the United States of America, or GAAP. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could materially differ from these estimates. Our unaudited consolidated financial statements include the accounts of all subsidiaries including BT Management Company, L.L.C., or BT Management, over which we maintain substantial control. Significant intercompany accounts and transactions have been eliminated. In the opinion of management, all material adjustments, consisting of normal recurring adjustments, considered necessary for a fair presentation have been included. The operating results for the three months ended March 31, 2008 and 2007 are not necessarily indicative of the results that may be expected for the calendar year. The interim financial information should be read in conjunction with the audited consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2007.

Change in Basis of Presentation

Since September 2007, we have presented both Belvedere Trust Mortgage Corporation, or Belvedere Trust, and BT Management as discontinued operations. All prior period information is presented in the same manner for conformity.

The following is a summary of our significant accounting policies:

Cash and Cash Equivalents

Cash and cash equivalents include cash on hand and highly liquid investments with original maturities of three months or less. The carrying amount of cash equivalents approximates their fair value.

Mortgage-Backed Securities (MBS)

Agency MBS are securities that are obligations which are guaranteed by the United States government or its sponsored enterprises such as Fannie Mae, Freddie Mac and Ginnie Mae. The payment of principal and interest on the Fannie Mae and Freddie Mac MBS are guaranteed by those respective agencies. The payment of principal

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and interest on the Ginnie Mae MBS are backed by the full faith and credit of the United States government. Relative to our investment grade Agency MBS portfolio, we have invested primarily in fixed-rate and adjustable-rate mortgage-backed pass-through certificates and hybrid adjustable-rate MBS. Hybrid adjustable-rate MBS have an initial interest rate that is fixed for a certain period, usually three to five years, and then adjust annually for the remainder of the term of the loan. We structure our investment portfolio to be diversified with a variety of prepayment characteristics, investing in mortgage-related assets with prepayment penalties, investing in certain mortgage security structures that have prepayment protections and purchasing mortgage-related assets at a premium and at a discount.

Non-Agency MBS are AAA rated investment grade securities not issued by government-sponsored enterprises which are secured primarily by first-lien residential mortgage loans.

We classify our MBS as either trading investments, available-for-sale investments or held-to-maturity investments. Our management determines the appropriate classification of the securities at the time they are acquired and evaluates the appropriateness of such classifications at each balance sheet date. We currently classify all of our MBS as available-for-sale. All assets that are classified as available-for-sale are carried at fair value and unrealized gains or losses are included in Other comprehensive income or loss as a component of stockholders' equity. Losses on securities classified as available-for-sale which are determined by management to be other-than-temporary in nature are reclassified from other comprehensive income to income.

The most significant source of our revenue is derived from our investments in MBS. Interest income on our Agency MBS and Non-Agency MBS is accrued based on the actual coupon rate and the outstanding principal amount of the underlying mortgages. Premiums and discounts are amortized or accreted into interest income over the estimated lives of the securities using the effective interest yield method, adjusted for the effects of actual prepayments. Our policy for estimating prepayment speeds for calculating the effective yield is to evaluate historical performance, street consensus prepayment speeds and current market conditions. If our estimate of prepayments is incorrect, as compared to the aforementioned references, we may be required to make an adjustment to the amortization or accretion of premiums and discounts that would have an impact on future income.

Securities are recorded on the date the securities are purchased or sold. Realized gains or losses from securities transactions are determined based on the specific identified cost of the securities.

The following table shows our investments' gross unrealized losses and fair value of those individual securities that have been in a continuous unrealized loss position at March 31, 2008, aggregated by investment category and length of time:

| Description of Securities | Less Than 12 Months | | | 12 Months or More | | | Total | | |
|---------------------------|---|--------------|-------------------|----------------------|------------|-------------------|----------------------|--------------|-------------------|
| | (dollar amounts in thousands except for number of securities) | | | | | | | | |
| | Number of Securities | Fair Value | Unrealized Losses | Number of Securities | Fair Value | Unrealized Losses | Number of Securities | Fair Value | Unrealized Losses |
| Agency MBS | 76 | \$ 1,307,965 | \$ (8,322) | 389 | \$ 752,775 | \$ (14,143) | 465 | \$ 2,060,740 | \$ (22,465) |
| Non-Agency MBS | | \$ | \$ | 2 | \$ 26,424 | \$ (21,099) | 2 | \$ 26,424 | \$ (21,099) |

We do not consider those Agency MBS and Non-Agency MBS that have been in a continuous loss position for 12 months or more to be other-than-temporarily impaired. The unrealized losses on our investments in Agency MBS were caused by fluctuations in interest rates and recent pricing that is reflective of the liquidity and credit problems surrounding the mortgage markets generally. We purchased the Agency MBS primarily at a premium relative to their face value and the contractual cash flows of those investments are guaranteed by United States government-sponsored enterprises and agencies. The Non-Agency MBS are currently AAA rated. The unrealized losses on our investments in Non-Agency MBS were caused by recent pricing reflective of the liquidity and credit problems surrounding the mortgage markets generally. We currently do not believe that it is

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probable that we will be unable to collect all amounts due on the Non-Agency MBS. As we have the ability and intent to hold both the Agency MBS and Non-Agency MBS investments until a recovery of fair value up to (or beyond) its cost, which may be maturity, we do not consider these investments to be other-than-temporarily impaired at March 31, 2008.

Repurchase Agreements

We finance the acquisition of our MBS through the use of repurchase agreements. Under these repurchase agreements, we sell securities to a lender and agree to repurchase the same securities in the future for a price that is higher than the original sales price. The difference between the sale price that we receive and the repurchase price that we pay represents interest paid to the lender. Although structured as a sale and repurchase obligation, a repurchase agreement operates as a financing under which we pledge our securities as collateral to secure a loan which is equal in value to a specified percentage of the estimated fair value of the pledged collateral. We retain beneficial ownership of the pledged collateral. At the maturity of a repurchase agreement, we are required to repay the loan and concurrently receive back our pledged collateral from the lender or, with the consent of the lender, we may renew such agreement at the then prevailing financing rate. These repurchase agreements may require us to pledge additional assets to the lender in the event the estimated fair value of the existing pledged collateral declines.

Derivative Financial Instruments

Interest Rate Risk Management

We use primarily short-term (less than or equal to 12 months) repurchase agreements to finance the purchase of our MBS. These obligations expose us to variability in interest payments due to changes in interest rates. We continuously monitor changes in interest rate exposures and evaluate hedging opportunities.

Our objective is to limit the impact of interest rate changes on earnings and cash flows. We achieve this by entering into interest rate swap agreements which effectively converts a percentage of our repurchase agreements to fixed-rate obligations over a period of up to five years. Under interest rate swap contracts, we agree to pay an amount equal to a specified fixed rate of interest times a notional principal amount and to receive in return an amount equal to a specified variable-rate of interest times a notional amount, generally based on the London Interbank Offered Rate, or LIBOR. The notional amounts are not exchanged. We account for these swap agreements as cash flow hedges in accordance with Statement of Financial Accounting Standards Statement No. 133, Accounting for Derivative Instruments and Hedging Activities, or SFAS No. 133. We do not issue or hold derivative contracts for speculative purposes.

We are exposed to credit losses in the event of non-performance by counterparties to these interest rate swap agreements, but we do not expect any of the counterparties to fail to meet their obligations. In order to limit credit risk associated with swap agreements, our current policy is to only purchase swap agreements from financial institution counterparties rated A or better by at least one of the rating agencies, limit our exposure on each swap agreement to a single counterparty under our defined guidelines and either pay or receive collateral to or from each counterparty on a periodic basis to cover the net fair market value position of the swap agreements held with that counterparty.

Accounting for Derivatives and Hedging Activities

In accordance with SFAS No. 133, as amended by Statement of Financial Accounting Standards Statement No. 138, Accounting for Certain Derivative Instruments and Certain Hedging Activities, or SFAS No. 138, a derivative that is designated as a hedge is recognized as an asset/liability and measured at estimated fair value. In order for our interest rate swap agreements to qualify for hedge accounting, upon entering into the swap agreement, we must anticipate that the hedge will be highly effective, as defined by SFAS No. 133.

On the date we enter into a derivative contract, we designate the derivative as a hedge of the variability of cash flows that are to be received or paid in connection with a recognized asset or liability (a cash flow hedge). Changes in the fair value of a derivative that are highly effective and that are designated and qualify as a cash

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flow hedge, to the extent that the hedge is effective, are recorded in Other comprehensive income and reclassified to income when the forecasted transaction affects income (e.g., when periodic settlement interest payments are due on repurchase agreements). The swap agreements are carried on our Consolidated Balance Sheets at their fair value based on values obtained from major financial institutions. Hedge ineffectiveness, if any, is recorded in current-period income.

We formally assess, both at the hedge's inception and on an ongoing basis, whether the derivatives that are used in hedging transactions have been highly effective in offsetting changes in the cash flows of hedged items and whether those derivatives may be expected to remain highly effective in future periods. If it is determined that a derivative is not (or has ceased to be) highly effective as a hedge, we discontinue hedge accounting.

When we discontinue hedge accounting, the gain or loss on the derivative remains in Accumulated other comprehensive income and is reclassified into income when the forecasted transaction affects income. In all situations in which hedge accounting is discontinued and the derivative remains outstanding, we will carry the derivative at its fair value on the balance sheet, recognizing changes in the fair value in current-period income.

For purposes of the cash flow statement, cash flows from derivative instruments are classified with the cash flows from the hedged item.

Credit Risk

At March 31, 2008, we had limited our exposure to credit losses on our portfolio of fixed-rate and adjustable-rate Agency MBS by purchasing securities primarily from Freddie Mac and Fannie Mae. The payment of principal and interest on the Freddie Mac and Fannie Mae MBS are guaranteed by those respective enterprises but are not guaranteed by the United States government. At March 31, 2008, because of the guarantee of these government-sponsored enterprises, all of these Agency MBS have an implied AAA rating.

Our adjustable-rate MBS are subject to periodic and lifetime interest rate caps. Periodic caps can limit the amount an interest rate can increase during any given period.

Our Non-Agency MBS portfolio is currently rated AAA. These securities do not have the backing of Fannie Mae or Freddie Mac. Payment of principal and interest is dependent on the performance of the underlying loans which are subject to borrower default and possible losses. The underlying loans on our Non-Agency MBS portfolio currently have a weighted average loan-to-value of 73% and a FICO of 731. The current weighted average 90 days + delinquency (including bankruptcy, foreclosures and real estate owned) is 4.18%.

Other-than-temporary losses on our available-for-sale MBS, as measured by the amount of decline in estimated fair value attributable to factors that are considered to be other-than-temporary, are charged against income, resulting in an adjustment of the cost basis of such securities. The following are among, but not all of, the factors considered in determining whether and to what extent an other-than-temporary impairment exists: (i) the expected cash flow from the investment; (ii) whether there has been an other-than-temporary deterioration of the credit quality of the underlying mortgages; (iii) the credit protection available to the related mortgage pool for MBS; (iv) any other market information available, including analysts' assessments and statements, public statements and filings made by the debtor or counterparty; (v) management's internal analysis of the security, considering all known relevant information at the time of assessment; and (vi) the magnitude and duration of historical decline in market prices. Because management's assessments are based on factual information as well as subjective information available at the time of assessment, the determination as to whether an other-than-temporary decline exists and, if so, the amount considered impaired is also subjective and, therefore, constitutes material estimates that are susceptible to significant change.

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Income Taxes

We have elected to be taxed as a REIT and to comply with the provisions of the Code with respect thereto. Accordingly, we will not be subject to federal income tax to the extent that our distributions to stockholders satisfy the REIT requirements and certain asset, income and stock ownership tests are met.

Belvedere Trust Finance Corporation, or BT Finance, and BT Finance's wholly-owned subsidiaries, BT Residential Funding Corporation and BellaVista Funding Corporation, are taxable REIT subsidiaries, or TRS, of our company. These companies are in the process of being dissolved and are included in discontinued operations. In general, a TRS may hold assets that we cannot hold directly and may engage in any real estate or non-real estate related business. A TRS is subject to corporate federal and state income tax and will be taxed as a regular C corporation. Securities of a TRS will constitute non-real estate assets for purposes of determining whether at least 75% of a REIT's assets consist of real estate. Under current law, no more than 20% of a REIT's total assets can consist of securities of one or more TRS. At March 31, 2008, the amount of our assets attributable to our TRS was less than 1%. A more detailed description of federal income tax considerations regarding our qualifications and taxation as a REIT appears in our 2007 Annual Report on Form 10-K on page 8.

The possible tax offset of the net operating losses and the net capital losses for Belvedere Trust and for the sales of securities appears in Note 6 to the accompanying unaudited consolidated financial statements.

On January 1, 2007, we adopted the provisions of Financial Accounting Standards Board, or FASB, Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, or FIN 48. The adoption of FIN 48 had no effect on our financial statements. We have no unrecognized tax benefits and do not anticipate any increase in unrecognized benefits during 2008 relative to any tax positions taken prior to January 1, 2008. Should the accrual of any interest or penalties relative to unrecognized tax benefits be necessary, it is our policy to record such accruals in our income taxes accounts; and no such accruals exist as of March 31, 2008. We file both REIT and taxable REIT subsidiary U.S. federal and California income tax returns. These returns are open to examination by taxing authorities for all years after 2002. Although the Internal Revenue Service, or the IRS, has closed their 2004 and 2005 exams in January 2007 for our taxable REIT subsidiary, those two years technically remain open under the statute of limitations.

Cumulative Convertible Preferred Stock

We classify our Series B Cumulative Convertible Preferred Stock, or Series B Preferred Stock, on the Consolidated Balance Sheets using the guidance in Emerging Issues Task Force (EITF) Topic D-98, *Classification and Measurement of Redeemable Securities*. The Series B Preferred Stock contains certain fundamental change provisions that allow the holder to redeem the preferred stock for cash if certain events occur. As redemption under these circumstances is not solely within our control, we have classified the Series B Preferred Stock as temporary equity in the accompanying unaudited consolidated financial statements.

We have analyzed whether the conversion features in the Series B Preferred Stock should be bifurcated under the guidance in SFAS No. 133 and EITF Issue No. 00-19, *Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock* and have determined that bifurcation is not necessary.

Stock-Based Compensation

In December 2005, our board of directors authorized the immediate vesting of all of our then-outstanding common stock options. We intend to utilize restricted stock grants instead of stock option grants in future employee compensation (see Note 10).

Restricted stock is expensed over the vesting period (see Note 10).

Table of Contents**Earnings Per Share**

Basic earnings per share, or EPS, is computed by dividing net income (loss) available to common stockholders by the weighted average number of common shares outstanding during the period. Diluted EPS assumes the conversion, exercise or issuance of all potential common stock equivalents unless the effect is to reduce a loss or increase the income per share.

The computation of EPS is as follows (amounts in thousands, except per share data):

| | Three Months Ended March 31, | |
|--|---|-----------------|
| | 2008 | 2007 |
| Income from continuing operations | \$ 16,565 | \$ 2,461 |
| Income from discontinued operations | 12 | 303 |
| Net income | \$ 16,577 | \$ 2,764 |
| Dividend on Series A Cumulative Preferred Stock | (1,011) | |
| Dividend on Series B Cumulative Convertible Preferred Stock(1) | (471) | (325) |
| Net income to common stockholders | \$ 15,095 | \$ 2,439 |
| Basic earnings per common share: | | |
| Continuing operations | \$ 0.22 | \$ 0.04 |
| Discontinued operations | | 0.01 |
| Total basic earnings per common share | \$ 0.22 | \$ 0.05 |
| Diluted earnings per common share: | | |
| Continuing operations | \$ 0.21 | \$ 0.04 |
| Discontinued operations | | 0.01 |
| Total diluted earnings per common share(2) | \$ 0.21 | \$ 0.05 |
| Basic weighted average number of shares outstanding | 69,708 | 45,614 |
| Diluted weighted average number of shares outstanding | 72,581 | 45,639 |

- (1) During the quarterly period ended March 31, 2007, the number of weighted average shares not included in Diluted EPS because of anti-dilution was 2.7 million.
- (2) During the quarterly period ended March 31, 2008, diluted earnings per common share include the assumed conversion of 1.206 million shares of Series B Preferred Stock at the conversion rate of 2.3809 shares of common stock and adding back the Series B Preferred Stock dividend.

Accumulated Other Comprehensive Income (Loss)

SFAS No. 130, Reporting Comprehensive Income, divides comprehensive income into net income and other comprehensive income (loss), which includes unrealized gains and losses on marketable securities classified as available-for-sale, and unrealized gains and losses on derivative financial instruments that qualify for cash flow hedge accounting under SFAS No. 133.

USE OF ESTIMATES

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could materially differ from those estimates.

RECENT ACCOUNTING PRONOUNCEMENTS

In February 2008, the FASB issued a Staff Position No. 140-3, Accounting for Transfers of Financial Assets and Repurchase Financing Transactions, or FSP No. 140-3. Its objective is to provide guidance on the

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accounting for a transfer of a financial asset and repurchase financing. Unless the initial transaction meets certain criteria that are defined in this Staff Position, it must be evaluated to determine whether it meets the requirements for sale accounting under SFAS 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities. If it does not meet the requirements for sales accounting under SFAS 140, it must be accounted for based on the economics of the combined transaction, which generally represents a forward contract. SFAS 133, Accounting for Derivative Instruments and Hedging Activities should be used to evaluate whether the linked transaction must be accounted for as a derivative. FSP No. 140-3 is effective for our financial statements for the fiscal year beginning January 1, 2009 and thereafter. We are in the process of studying the effects of FSP No. 140-3 but do not believe it will have a material impact on our financial statements.

In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities an Amendment of SFAS No. 133, or SFAS 161. SFAS 161 will require entities to provide enhanced disclosures about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under SFAS 133 and its related interpretations, and (c) how derivative instruments and related hedged items affect an entity's financial position, financial performance and cash flows. SFAS 161 requires that objectives for using derivative instruments be disclosed in terms of underlying risk and accounting designation and to better convey the purpose of derivative use in terms of the risks that the entity is intending to manage. SFAS 161 will be effective for our financial statements for all fiscal years and interim periods beginning January 1, 2009. We do not believe that SFAS 161 will have a material impact on our financial statements.

NOTE 2. MORTGAGE-BACKED SECURITIES (MBS)

The following tables summarize our Agency MBS and Non-Agency MBS classified as available-for-sale as of March 31, 2008 and December 31, 2007, which are carried at their fair value (amounts in thousands):

March 31, 2008

| Agency MBS (By Agency) | Ginnie Mae | Freddie Mac | Fannie Mae | Total Agency MBS |
|------------------------|------------|--------------|--------------|------------------|
| Amortized cost | \$ 32,875 | \$ 1,351,244 | \$ 4,308,723 | \$ 5,692,842 |
| Paydowns receivable | | 12,467 | | 12,467 |
| Unrealized gains | 30 | 15,402 | 29,974 | 45,406 |
| Unrealized losses | (303) | (3,632) | (18,530) | (22,465) |
| Fair value | \$ 32,602 | \$ 1,375,481 | \$ 4,320,167 | \$ 5,728,250 |

| Agency MBS (By Security Type) | ARMs | Hybrids | Fixed-Rate | Floating-Rate CMOs | Total Agency MBS |
|-------------------------------|--------------|--------------|--------------|--------------------|------------------|
| Amortized cost | \$ 1,002,300 | \$ 3,676,411 | \$ 1,005,161 | \$ 8,970 | \$ 5,692,842 |
| Paydowns receivable | 8,999 | 3,468 | | | 12,467 |
| Unrealized gains | 1,439 | 31,793 | 12,169 | 5 | 45,406 |
| Unrealized losses | (14,959) | (3,844) | (3,548) | (114) | (22,465) |
| Fair value | \$ 997,779 | \$ 3,707,828 | \$ 1,013,782 | \$ 8,861 | \$ 5,728,250 |

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| | Total Non-Agency MBS |
|-----------------------|-------------------------------------|
| Non-Agency MBS | |
| Amortized cost | \$ 47,523 |
| Paydowns receivable | |
| Unrealized gains | |
| Unrealized losses | (21,099) |
| Fair value | \$ 26,424 |

At March 31, 2008, our Non-Agency MBS consisted of CMO floaters (option-adjusted ARMs based on one-month LIBOR) with an average coupon of 2.85% which were acquired at par value.

December 31, 2007

| Agency MBS (By Agency) | Ginnie Mae | Freddie Mac | Fannie Mae | Total Agency MBS |
|-------------------------------|-------------------|------------------------|---------------------|-----------------------------|
| Amortized cost | \$ 35,854 | \$ 1,193,972 | \$ 3,403,050 | \$ 4,632,876 |
| Paydowns receivable | | 15,420 | | 15,420 |
| Unrealized gains | | 10,389 | 21,240 | 31,629 |
| Unrealized losses | (628) | (4,490) | (12,260) | (17,378) |
| Fair value | \$ 35,226 | \$ 1,215,291 | \$ 3,412,030 | \$ 4,662,547 |

| Agency MBS (By Security Type) | ARMs | Hybrids | Fixed-Rate | Floating-Rate CMOs | Total Agency MBS |
|--------------------------------------|-------------------|---------------------|-------------------|-------------------------------|-----------------------------|
| Amortized cost | \$ 917,566 | \$ 2,887,833 | \$ 818,160 | \$ 9,317 | \$ 4,632,876 |
| Paydowns receivable | 9,984 | 5,436 | | | 15,420 |
| Unrealized gains | 706 | 22,944 | 7,927 | 52 | 31,629 |
| Unrealized losses | (10,075) | (623) | (6,680) | | (17,378) |
| Fair value | \$ 918,181 | \$ 2,915,590 | \$ 819,407 | \$ 9,369 | \$ 4,662,547 |

| | Total Non-Agency MBS |
|-----------------------|-------------------------------------|
| Non-Agency MBS | |
| Amortized cost | \$ 49,717 |
| Paydowns receivable | |
| Unrealized gains | |
| Unrealized losses | (7,003) |
| Fair value | \$ 42,714 |

At December 31, 2007, our Non-Agency MBS consisted of CMO floaters with an average coupon of 5.11% which were acquired at par value.

NOTE 3. REPURCHASE AGREEMENTS

We have entered into repurchase agreements with major financial institutions to finance most of our Agency MBS. The repurchase agreements are short-term borrowings that are secured by the market value of our Agency MBS and bear fixed interest rates that have historically had their basis on LIBOR. Relative to our Agency MBS portfolio, at March 31, 2008, our repurchase agreements had a weighted average term to maturity of 53 days and a weighted average borrowing rate of 3.30%. After adjusting for swap transactions, the weighted average term to

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the next rate adjustment was 529 days with a weighted average borrowing rate of 4.04%. At March 31, 2008, Agency MBS with a fair value of approximately \$5.4 billion have been pledged as collateral under the repurchase agreements.

Relative to our Agency MBS portfolio, at December 31, 2007, our repurchase agreements had a weighted average term to maturity of 49 days and a weighted average borrowing rate of 4.91%. After adjusting for swap transactions, the weighted average term to the next rate adjustment was 418 days with a weighted average borrowing rate of 4.77%. At December 31, 2007, Agency MBS with a fair value of approximately \$4.48 billion had been pledged as collateral under the repurchase agreements.

At March 31, 2008 and December 31, 2007, the repurchase agreements had the following remaining maturities:

| | March 31, 2008 | December 31, 2007 |
|------------------------------|-------------------|----------------------|
| Less than 3 months | 96.1% | 95.4% |
| 3 months to less than 1 year | 1.5 | 1.8 |
| 1 year to 2 years | 2.4 | 2.8 |
| Total | 100.0% | 100.0% |

At March 31, 2008, we had one counterparty, Cantor Fitzgerald & Co., where the amount at risk (\$52.4 million) exceeded 10% of our stockholders' equity. The amount at risk represents the fair value of the securities less the amount of the repurchase agreement liabilities. The weighted average maturity for the repurchase agreements with this counterparty was 118 days.

NOTE 4. JUNIOR SUBORDINATED NOTES

On March 15, 2005, we issued \$37,380,000 of junior subordinated notes to a newly-formed statutory trust, Anworth Capital Trust I, organized by us under Delaware law. The trust issued \$36,250,000 in trust preferred securities to unrelated third party investors. Both the notes and the trust preferred securities require quarterly payments and bear interest at the prevailing three-month LIBOR rate plus 3.10%, reset quarterly. The first interest payment was made on June 30, 2005. Both the notes and the securities will mature in 2035 and may be redeemable, in whole or in part, without penalty, at our option after March 30, 2010 and April 30, 2010. We used the net proceeds of this private placement to invest in Agency MBS. We have reviewed the structure of the transaction under FIN 46 and concluded that Anworth Capital Trust I does not meet the requirements for consolidation. On September 26, 2005, the notes, the trust preferred securities and the related agreements were amended. The only material change was that one of the class holders requested that interest payments be made quarterly on January 30, April 30, July 30 and October 30 instead of at the end of each calendar quarter. This became effective with the quarterly payment after September 30, 2005.

NOTE 5. FAIR VALUES OF FINANCIAL INSTRUMENTS

On January 1, 2008, we adopted Statement of Financial Accounting Standards No. 157, Fair Value Measurements, or SFAS 157. As defined in SFAS 157, fair value is the price that would be received from the sale of an asset or paid to transfer or settle a liability in an orderly transaction between market participants in the principal (or most advantageous) market for the asset or liability. SFAS 157 establishes a fair value hierarchy that ranks the quality and reliability of the information used to determine fair values. Financial assets and liabilities carried at fair value are classified and disclosed in one of the three following categories:

Level 1: Quoted market prices in active markets for identical assets or liabilities. We consider our Agency MBS and Non-Agency MBS to be Level 1 inputs. Management bases the fair value for these investments primarily on third party bid price indications provided by dealers who make markets in these instruments.

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However, the fair value reported reflects estimates and may not be indicative of the amounts that could be realized in an actual market exchange.

Level 2: Observable market based inputs or unobservable inputs that are corroborated by market data. This includes those financial instruments that are valued using models or other valuation methodologies where substantially all of the assumptions are observable in the marketplace, can be derived from observable market data or are supported by observable levels at which transactions are executed in the marketplace. We consider our liability derivatives to be Level 2 inputs. The fair value of these instruments is reported to us independently from dealers who are major financial institutions and are considered to be the market makers for these types of instruments.

Level 3: Unobservable inputs that are not corroborated by market data. This is comprised of financial instruments whose fair value is estimated based on internally developed models or methodologies utilizing significant inputs that are generally less readily observable from objective sources. We do not have any assets or liabilities at Level 3 inputs.

At March 31, 2008, fair value measurements were as follows (in thousands):

| | Level 1 | Level 2 | Level 3 | Total |
|------------------------|--------------|------------|---------|--------------|
| Assets: | | | | |
| Agency MBS | \$ 5,728,250 | \$ | \$ | \$ 5,728,250 |
| Non-Agency MBS | 26,424 | | | 26,424 |
| Liabilities: | | | | |
| Derivative instruments | \$ | \$ 104,296 | \$ | \$ 104,296 |

Cash and cash equivalents, restricted cash, interest receivable, repurchase agreements and interest payable are reflected in the unaudited consolidated financial statements at their costs, which approximate their fair value because of the nature and short term of these instruments.

Junior subordinated notes are variable-rate debt and, as such, the carrying value approximates fair value.

NOTE 6. INCOME TAXES

We have elected to be taxed as a REIT and to comply with the provisions of the Code with respect thereto. Accordingly, we will not be subject to federal or state income taxes to the extent that our distributions to stockholders satisfy the REIT requirements and certain asset, income and stock ownership tests are met. We believe we met all REIT requirements regarding these tests and the distribution of our net income. Therefore, we believe that we continue to qualify as a REIT under the provisions of the Code.

BT Finance and its wholly-owned subsidiaries, BT Residential Funding Corporation and BellaVista Funding Corporation, are TRS of Anworth. These companies are in the process of being dissolved and are included in the results of discontinued operations. A TRS is subject to corporate federal and state income tax and will be taxed as a regular C Corporation. At December 31, 2007, BT Finance's net operating loss carry forwards (NOLs) were approximately \$1.33 million for both federal and state purposes. These begin to expire in 2024 and 2014, respectively. We do not expect that these NOLs are likely to be utilized and, as such, have fully reserved them.

The loss from the sales of our MBS in 2007 are capital losses and can only be offset against capital gains or future capital gains within five years. The loss from the sales and impairments on sales of Belvedere Trust's assets are capital losses and can only be offset against capital gains or future capital gains within five years.

On January 1, 2007, we adopted the provisions of FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, or FIN 48. The adoption of FIN 48 had no effect on our financial statements. We have no

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unrecognized tax benefits and do not anticipate any increase in unrecognized benefits during 2008 relative to any tax positions taken prior to January 1, 2008. Should the accrual of any interest or penalties relative to unrecognized tax benefits be necessary, it is our policy to record such accruals in our income taxes accounts; no such accruals exist as of January 1, 2008. We file both REIT and taxable REIT subsidiary U.S. federal and California income tax returns. These returns are open to examination by taxing authorities for all years after 2002. Although the IRS closed its 2004 and 2005 exams in January 2007 for our taxable REIT subsidiary, those two years technically remain open under the statute of limitations.

NOTE 7. SERIES B CUMULATIVE CONVERTIBLE PREFERRED STOCK

We have issued an aggregate of 1.206 million shares of Series B Preferred Stock. The Series B Preferred Stock has a par value of \$0.01 per share and a liquidation preference of \$25.00 per share plus accrued and unpaid dividends (whether or not declared). The Series B Preferred Stock must be paid a dividend at a rate of 6.25% per year on the \$25.00 liquidation preference before the common stock is entitled to receive any dividends. The Series B Preferred Stock is senior to the common stock and on parity with our Series A Cumulative Preferred Stock, or Series A Preferred Stock, with respect to the payment of distributions and amounts, upon liquidation, dissolution or winding up.

The Series B Preferred Stock has no maturity date and is not redeemable. The Series B Preferred Stock is convertible at an initial conversion rate of 2.3809 shares of our common stock per \$25.00 liquidation preference. The conversion rate will be adjusted in any fiscal quarter in which the cash dividends paid to common stockholders results in an annualized common stock dividend yield which is greater than 6.25%. The conversion ratio will also be subject to adjustment upon the occurrence of certain specific events such as a change of control. The Series B Preferred Stock is convertible into shares of our common stock at the option of the Series B preferred stockholder at any time at the then prevailing conversion rate. On or after January 25, 2012, we may, at our option, convert, under certain circumstances, each share of Series B Preferred Stock into a number of common shares at the then prevailing conversion rate. The Series B Preferred Stock contains certain fundamental change provisions that allow the holder to redeem the preferred stock for cash if certain events occur. The Series B Preferred Stock generally does not have voting rights, except if dividends on the Series B Preferred Stock are in arrears for six or more quarterly periods (whether or not consecutive). Under such circumstances, Series B preferred stockholders, together with our Series A preferred stockholders, will be entitled to vote to elect two additional directors to our board of directors to serve until all unpaid dividends have been paid or declared and set apart for payment. In addition, certain material and adverse changes to the terms of the Series B Preferred Stock may not be taken without the affirmative vote of at least two-thirds of the outstanding shares of Series B Preferred Stock and Series A Preferred Stock voting together as a single class. Through March 31, 2008, we have declared and set aside for payment the required dividend for the Series B Preferred Stock.

NOTE 8. PUBLIC OFFERINGS AND CAPITAL STOCK

Our Dividend Reinvestment and Stock Purchase Plan allows stockholders and non-stockholders to purchase shares of our common stock and to reinvest dividends in additional shares of our common stock. During the three months ended March 31, 2008, we issued approximately 492,000 shares of common stock under the plan, resulting in proceeds to us of approximately \$4.0 million.

On June 29, 2007, we entered into a Controlled Equity Offering Sales Agreement, or the Sales Agreement, with Cantor Fitzgerald & Co., or Cantor, to reinstate and modify a controlled equity offering program, or the Program, under which Cantor will act as sales agent. Under the Program we may sell from time to time in our sole discretion up to 10 million shares of common stock, 1.225 million shares of Series A Preferred Stock and 2 million shares of Series B Preferred Stock. During the three months ended March 31, 2008, we sold 2.36 million shares of our common stock under the Program which provided net proceeds to us of approximately \$19.9 million. The sales agent received an aggregate of approximately \$483,000, which represents an average commission of approximately 2.32% on the gross sales price per share.

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On May 23, 2007, we filed a shelf registration statement on Form S-3 with the SEC, offering up to \$500 million of our capital stock. The registration statement was declared effective on June 8, 2007. As of March 31, 2008, approximately \$266.6 million of this amount remained available for issuance under the registration statement.

On November 7, 2005, we filed a registration statement on Form S-8 to register an aggregate of up to 3.5 million shares of our common stock to be issued pursuant to the Anworth Mortgage Asset Corporation 2004 Equity Compensation Plan, or the 2004 Equity Plan.

On January 30, 2008, we issued an aggregate of 16.445 million shares of common stock and recognized net proceeds of approximately \$136.3 million (net of underwriting fees, commissions and other costs). We used all of the net proceeds from this offering to acquire Agency MBS.

At March 31, 2008, our authorized capital included 20 million shares of \$0.01 par value preferred stock, of which 5.15 million shares had been designated 8.625% Series A Cumulative Preferred Stock (liquidation preference \$25.00 per share) and 3.15 million shares had been designated 6.25% Series B Cumulative Convertible Preferred Stock (liquidation preference \$25.00 per share). The remaining preferred stock may be issued in one or more classes or series, with such distinctive designations, rights and preferences as determined by our board of directors.

NOTE 9. TRANSACTIONS WITH AFFILIATES

Anworth 2002 Incentive Compensation Plan

Under our 2002 Incentive Compensation Plan, or the 2002 Incentive Plan, eligible employees have the opportunity to earn incentive compensation for each fiscal quarter. The total aggregate amount of compensation that may be earned by all employees equals a percentage of net income, before incentive compensation, in excess of the amount that would produce an annualized return on average net worth equal to the ten-year U.S. Treasury Rate plus 1%, or the Threshold Return.

The 2002 Incentive Plan contains a high water mark provision requiring that in any fiscal quarter in which our net income is an amount less than the amount necessary to earn the Threshold Return, we will calculate negative incentive compensation for that fiscal quarter which will be carried forward and will offset future incentive compensation earned under the 2002 Incentive Plan, but only with respect to those participants who were participants during the fiscal quarter(s) in which negative incentive compensation was generated.

The percentage of net income in excess of the Threshold Return earned under the 2002 Incentive Plan by all employees is calculated based on our quarterly average net worth as defined in the 2002 Incentive Plan. The percentage rate used in this calculation is based on a blended average of the following tiered percentage rates:

25% for the first \$50 million of average net worth;

15% for the average net worth between \$50 million and \$100 million;

10% for the average net worth between \$100 million and \$200 million; and

5% for the average net worth in excess of \$200 million.

The 2002 Incentive Plan requires that we pay all amounts earned thereunder each quarter (subject to offset for accrued negative incentive compensation) and we will be required to pay a percentage of such amounts to certain of our executives pursuant to the terms of their employment agreements. During the three months ended March 31, 2008, eligible employees under the 2002 Incentive Plan did not earn any incentive compensation. At March 31, 2008, there was a negative incentive compensation accrual carried forward of \$20.6 million.

Employment Agreements

Pursuant to the terms of their employment agreements with us, Lloyd McAdams serves as our President, Chairman and Chief Executive Officer, Joseph E. McAdams serves as our Executive Vice President and

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Heather U. Baines serves as our Executive Vice President. Lloyd McAdams receives a \$925,000 annual base salary, Joseph E. McAdams receives a \$700,000 annual base salary and Heather U. Baines receives a \$60,000 annual base salary. These agreements automatically renew each year unless written notice is provided by either party six months prior to the end of the current term.

These employment agreements also have the following provisions:

the three executives are entitled to participate in the 2002 Incentive Plan and each of these individuals are provided a minimum percentage of the amounts earned under such plan. Lloyd McAdams is entitled to 45% of all amounts paid under the plan, Joseph E. McAdams is entitled to 25% of all amounts paid under the plan and Heather U. Baines is entitled to 5% of all amounts paid under the plan. The three executives may be paid up to 50% of their respective incentive compensation earned under such plan in the form of common stock;

the 2002 Incentive Plan may not be amended without the consent of the three executives;

in the event any of the three executives is terminated without cause or if they terminate for good reason, or in the case of Lloyd McAdams or Joseph E. McAdams, their employment agreements are not renewed, then the executives would be entitled to: (1) all base salary due under the employment agreements, (2) all discretionary bonus due under the employment agreements, (3) a lump sum payment of an amount equal to three years of the executive's then-current base salary, (4) payment of COBRA medical coverage for 18 months, (5) immediate vesting of all pension benefits, (6) all incentive compensation to which the executives would have been entitled to under the employment agreements prorated through the termination date, and (7) all expense reimbursements and benefits due and owing the executives through the termination. In addition, under these circumstances Lloyd McAdams and Joseph E. McAdams would each be entitled to a lump sum payment equal to 150% of the greater of (i) the highest amount paid or that could be payable (in the aggregate) under the 2002 Incentive Plan during any one of the three fiscal years prior to their termination, and (ii) the highest amount paid, or that could be payable (in the aggregate), under the plan during any of the three fiscal years following their termination. Ms. Baines would also be entitled to a lump sum payment equal to all incentive compensation that Ms. Baines would have been entitled to under the plan during the three-year period following her termination;

the equity awards granted to each of the three executives will immediately vest upon the termination of the executive's employment upon a change in control; and

Lloyd McAdams and Joseph E. McAdams are each subject to a one-year non-competition provision following termination of their employment except in the event of a change in control.

Under the terms of their employment agreements, a long-term equity incentive structure was established for Messrs. Lloyd McAdams and Joseph E. McAdams (the Executives). As a result, the Executives are eligible to participate in a performance-based bonus pool that is funded based on the company's return on average equity (ROAE). ROAE is calculated as the twelve-month GAAP net income available to common stockholders minus depreciation, preferred stock dividends, gains/losses on asset sales and impairment charges, divided by the average stockholder equity less goodwill and preferred stockholder equity. The Compensation Committee evaluated various measures and factors of performance in developing this structure and, in its view, ROAE was determined to be the single best indicator of our overall performance and therefore of value creation for our stockholders. This is in part due to the fact that ROAE is a metric of our performance that has been calculated and reported on a consistent basis since our inception in 1998.

As designed by the Compensation Committee, the aggregate amount of this performance-based bonus pool available for distribution to the Executives can range annually based upon our ROAE. If the ROAE is 0% or less, no performance-based bonus is paid. If the ROAE is greater than 0% but less than 8%, a pool of up to \$500,000 is available. If the ROAE is 8% or greater, then the pool is \$500,000 plus 10% of the first \$5 million of excess

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return and 6% of the amount of the excess return greater than \$5 million. The Compensation Committee has the discretionary right to adjust downward the amount available for distribution from the Executives' bonus pool by as much as 10.0% in any given year, based upon its assessment of factors including our leverage, stability of book value of the common stock and price per share of our common stock relative to other industry participants. Of the aggregate amount available for distribution from the Executives' bonus pool, the Compensation Committee bases annual bonus allocation to each of the Executives on its assessment of the performance of each Executive.

In order to further align the performance of the Executives with our long-term financial success and the creation of stockholder value, the Compensation Committee also determined that (1) with respect to 2008, at least 50.0% of the annual performance-based bonus amount to be distributed to an Executive over \$100,000 would be paid in restricted shares of common stock (the Restricted Shares) and (2) with respect to each year thereafter, at least 50.0% of any annual performance-based bonus amount over \$100,000 will be paid in Restricted Shares. In addition, neither Executive will be permitted to sell or otherwise transfer any Restricted Shares during the Executive's employment with the company until the value of the Executive's stock holdings in the company exceeds a seven and one-half times multiple of the Executive's base compensation and, once this threshold is met, only to the extent that the value of the Executive's holdings exceeds that multiple.

Prior to the end of any year, the Compensation Committee, at its discretion, may notify an Executive that the Executive will not participate in the pool during the following year. If this occurs, the sale or transfer restrictions on previously issued pool shares will be eliminated at that time.

Our Principal Executive Officer (Lloyd McAdams) and Chief Investment Officer (Joseph E. McAdams) may receive incentive compensation pursuant to the terms of their employment agreements. The Compensation Committee, in its discretion, may provide additional incentive compensation to each of Messrs. Lloyd McAdams and Joseph E. McAdams beyond the annual performance-based bonus awards earned under the incentive compensation structure in their employment agreements. This additional incentive compensation may be provided in consideration of the company's execution of our business and strategic plan. During the three months ended March 31, 2008, we did not pay any additional incentive compensation to Messrs. Lloyd McAdams and Joseph E. McAdams.

On June 27, 2006, we entered into Change in Control and Arbitration Agreements with each of Thad M. Brown, our Principal Financial Officer, Charles J. Siegel, our Senior Vice President-Finance, Evangelos Karagiannis, our Vice President and Portfolio Manager, and Bistra Pashamova, our Vice President and Portfolio Manager, as well as certain of our other employees. The Change in Control and Arbitration Agreements grant these officers and employees, in the event that a change in control occurs, a lump sum payment equal to (i) 12 months annual base salary in effect on the date of the change in control, plus (ii) the average annual incentive compensation received for the two complete fiscal years prior to the date of the change on control, and plus (iii) the average annual bonus received for the two complete fiscal years prior to the date of the change in control, as well as other benefits. The Change in Control and Arbitration Agreements also provide for accelerated vesting of equity awards granted to these officers and employees upon a change in control.

Agreements with Pacific Income Advisers, Inc.

On June 13, 2002, we entered into a sublease with Pacific Income Advisers, Inc., or PIA, a company owned by a trust controlled by certain of our officers. Under the sublease, we lease, on a pass-through basis, 5,500 square feet of office space from PIA and pay rent at a rate equal to PIA's obligation, currently \$51.05 per square foot. The sublease runs through June 30, 2012 unless earlier terminated pursuant to the master lease. During the three months ended March 31, 2008, we paid \$70,000 in rent to PIA under the sublease which is included in Other expenses on the Consolidated Statements of Income. During the three months ended March 31, 2007, we paid \$68,000 in rent to PIA under this sublease.

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The future minimum lease commitment is as follows (in whole dollars):

| Year | 2008 | 2009 | 2010 | 2011 | 2012 | Total Commitment |
|------------|------------|------------|------------|------------|------------|---------------------|
| Commitment | \$ 214,775 | \$ 293,515 | \$ 302,332 | \$ 311,414 | \$ 158,012 | \$ 1,280,048 |

On October 14, 2002, we entered into an administrative services agreement with PIA. Under the administrative services agreement, PIA provides administrative services and equipment to us including human resources, operational support and information technology, and we pay an annual fee of 7 basis points on the first \$225 million of stockholders' equity and 3.5 basis points thereafter (paid quarterly in advance) for those services. The administrative services agreement is for an initial term of one year and will renew for successive one-year terms thereafter unless either party gives notice of termination no less than 30 days before the expiration of the then-current annual term. We may also terminate the administrative services agreement upon 30 days prior written notice for any reason and immediately if there is a material breach by PIA. Included in Other expenses on the Consolidated Statements of Income are fees of \$70,000 paid to PIA in connection with this agreement during the three months ended March 31, 2008. During the three months ended March 31, 2007, we paid fees of \$55,000 to PIA in connection with this agreement.

Deferred Compensation Plan

On January 15, 2003, we adopted the Anworth Mortgage Asset Corporation Deferred Compensation Plan, or the Deferred Compensation Plan. We amended the plan effective January 1, 2005 to comply with Section 409A of the Code enacted as part of the American Jobs Creation Act of 2004. The Deferred Compensation Plan permits our eligible officers to defer the payment of all or a portion of their cash compensation that otherwise would be in excess of the \$1 million annual limitation on deductible compensation imposed by Section 162(m) of the Code (based on the officers' compensation and benefit elections made prior to January 1 of the calendar year in which the compensation will be deferred). Under this limitation, compensation paid to our Principal Executive Officer and our four other highest paid officers is not deductible by us for income tax purposes to the extent the amount paid to any such officer exceeds \$1 million in any calendar year, unless such compensation qualifies as performance-based compensation under Section 162(m). Our board of directors designates the eligible officers who may participate in the Deferred Compensation Plan from among the group consisting of our Principal Executive Officer and our other four highest paid officers. To date, the board has designated Lloyd McAdams, our Chairman, President and Principal Executive Officer, and Joseph E. McAdams, our Chief Investment Officer and Executive Vice President, as the only officers who may participate in the Deferred Compensation Plan. Each eligible officer becomes a participant in the Deferred Compensation Plan by making a written election to defer the payment of cash compensation. With certain limited exceptions, the election must be filed with us before January 1 of the calendar year in which the compensation will be deferred. The election is effective for the entire calendar year and may not be terminated or modified for that calendar year. If a participant wishes to defer compensation in a subsequent calendar year, a new deferral election must be made before January 1 of that subsequent year.

Amounts deferred under the Deferred Compensation Plan are not paid to the participant as earned, but are credited to a bookkeeping account maintained by us in the name of the participant. The balance in the participant's account is credited with earnings at a rate of return equal to the annual dividend yield on our common stock. The balance in the participant's account is paid to the participant six months after termination of employment or upon the death of the participant or a change in control of our company. Each participant is a general unsecured creditor of our company with respect to all amounts deferred under the Deferred Compensation Plan.

NOTE 10. EQUITY COMPENSATION PLAN

At our May 27, 2004 annual meeting of stockholders, our stockholders adopted the Anworth Mortgage Asset Corporation 2004 Equity Compensation Plan, or the Plan, which amended and restated our 1997 Stock

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Option and Awards Plan. The Plan authorized the grant of stock options and other stock-based awards for an aggregate of up to 3,500,000 of the outstanding shares of our common stock. The Plan authorizes our board of directors, or a committee of our board, to grant incentive stock options, as defined under section 422 of the Code, non-qualified stock options, restricted stock, dividend equivalent rights (DERs), phantom shares, stock-based awards that qualify as performance-based awards under Section 162(m) of the Code and other stock-based awards. The exercise price for any option granted under the Plan may not be less than 100% of the fair market value of the shares of common stock at the time the option is granted. At March 31, 2008, 1,212, 402 shares remained available for future issuance under the Plan through any combination of stock options or other awards. The Plan does not provide for automatic annual increases in the aggregate share reserve or the number of shares remaining available for grant. We filed a registration statement on Form S-8 on November 7, 2005 to register an aggregate of up to 3,500,000 shares of our common stock to be issued pursuant to the Plan.

In October 2005, our board of directors approved a grant of an aggregate of 200,780 shares of restricted stock to various of our officers and employees under the Plan. Such grant was made effective on October 27, 2005. The closing price of our common stock on the grant date was \$7.72. The restricted stock vests 10% per year on each anniversary date for a ten-year period and shall also vest immediately upon the death of the grantee or upon the grantee reaching age 65. Each grantee shall have the right to sell 40% of the restricted stock anytime after such shares have vested. The remaining 60% of such vested restricted stock may not be sold until after termination of employment with us. We amortize the restricted stock over the vesting period, which is the lesser of ten years or the remaining number of years to age 65.

In October 2006, our board of directors approved a grant of an aggregate of 197,362 shares of performance-based restricted stock to various of our officers and employees under the Plan. Such grant was made effective on October 18, 2006. The closing price of our common stock on the effective date of the grant was \$9.12. The shares will vest in equal annual installments over the next three years provided that the annually compounded rate of return on our common stock, including dividends, exceeds 12% measured from the effective date of the grant to each of the next three anniversary dates. If the annually compounded rate of return does not exceed 12%, then the shares will vest on the anniversary date thereafter when the annually compounded rate of return exceeds 12%. If the annually compounded rate of return does not exceed 12% within ten years after the effective date of the grant, then the shares will be forfeited. The shares will fully vest within the ten-year period upon the death of a grantee. Upon vesting, each grantee shall have the right to sell 40% of the restricted stock anytime after such shares have vested. The remaining 60% of such vested restricted stock may not be sold until after termination of employment with us or upon the tenth anniversary of the effective date.

During the three months ended March 31, 2008, we expensed \$51,000 relating to these two restricted stock grants.

At our May 24, 2007 annual meeting of stockholders, our stockholders adopted the Anworth Mortgage Asset Corporation 2007 Dividend Equivalent Rights Plan, or the DER Plan. On February 22, 2008, a grant of an aggregate of 300,000 DERs under the DER Plan was issued to our employees and officers. These DERs are not attached to any stock and only have the right to receive the same cash distribution distributed to our common stockholders during the term of the grant. All of these grants have a five-year term from the date of the grant.

NOTE 11. HEDGING INSTRUMENTS

At March 31, 2008, we were a counter-party to swap agreements, which are derivative instruments as defined by SFAS No. 133 and SFAS No. 138, with an aggregate notional amount of \$2.68 billion and a weighted average maturity of 2.7 years. During the three months ended March 31, 2008, we entered into 12 new swap agreements with an aggregate notional amount of \$740 million with terms of up to five years. We utilize swap agreements to manage interest rate risk relating to our repurchase agreements and do not anticipate entering into derivative transactions for speculative or trading purposes. In accordance with the swap agreements, we will pay

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a fixed-rate of interest during the term of the swap agreements and receive a payment that varies with the three-month LIBOR rate. During the three months ended March 31, 2008, one swap agreement with a notional amount of \$100 million matured.

At March 31, 2008, there was an increase in unrealized losses of \$60.6 million, from \$43.4 million of unrealized losses at December 31, 2007 to unrealized losses of \$104.0 million, on our swap agreements included in Other comprehensive income (this decrease consisted of unrealized losses on cash flow hedges of \$61.9 million and a reclassification adjustment for interest income included in net income of \$1.3 million) and are presented as Derivative instruments at fair value on the Consolidated Balance Sheets as a liability of \$104.3 million.

During the three months ended March 31, 2008, there was a loss recognized in earnings of \$280,000 due to hedge ineffectiveness. We have determined that our hedges are still considered highly effective. There were no components of the derivative instruments gain or loss excluded from the assessment of hedge effectiveness. The maximum length of our swap agreements is five years. We do not anticipate any discontinuance of the swap agreements and thus do not expect to recognize any gain or loss into earnings because of this.

NOTE 12. COMMITMENTS AND CONTINGENCIES

Lease Commitment and Administrative Services Commitment We sublease office space and use administrative services from PIA as more fully described in Note 9.

NOTE 13. OTHER EXPENSES

| | Three Months Ended March 31, | |
|---|---|---------------|
| | 2008 | 2007 |
| | (in thousands) | |
| Legal and accounting fees | \$ 184 | \$ 154 |
| Printing and stockholder communications | | 11 |
| Directors and Officers insurance | 121 | 97 |
| Software and implementation | 57 | 56 |
| Administrative service fees | 70 | 55 |
| Rent | 70 | 68 |
| Stock exchange and filing fees | 65 | 23 |
| Custodian fees | 34 | 24 |
| Sarbanes-Oxley consulting fees | 12 | 50 |
| Board of directors fees and expenses | 67 | 74 |
| Securities data services | 26 | 39 |
| Other | 69 | 63 |
| Total of Other Expenses | \$ 775 | \$ 714 |

NOTE 14. DISCONTINUED OPERATIONS

The assets of Belvedere Trust and BT Management have either been sold or written off. Belvedere Trust and BT Management are neither acquiring any new assets nor transacting any new business and are in the process of dissolving their operations.

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The major assets and liabilities of the discontinued operations at March 31, 2008 and December 31, 2007 are as follows (in thousands):

| | March 31, 2008 | December 31, 2007 |
|--|-------------------|----------------------|
| Assets of Discontinued Operations: | | |
| Cash and cash equivalents | \$ 33 | \$ |
| Other assets | 13 | 38 |
| | \$ 46 | \$ 38 |
| Liabilities of Discontinued Operations: | | |
| Claims outstanding | \$ 7,713 | \$ 7,713 |
| Accrued expenses and other liabilities | 49 | 121 |
| | \$ 7,762 | \$ 7,834 |

The major components of income and expense for the discontinued operations for the three months ended March 31, 2008 and 2007 are as follows (in thousands):

| | Three Months Ended March 31, 2008 | 2007 |
|---|---|-----------|
| Interest income: | | |
| Interest on BT Other MBS | \$ | \$ 3,610 |
| Interest on BT Residential Loans | | 19,080 |
| | \$ | \$ 22,690 |
| Interest expense: | | |
| Interest expense on repurchase agreements | \$ | \$ 3,746 |
| Interest expense on MBS issued | | 17,930 |
| | \$ | \$ 21,676 |
| Net interest income (expense) | \$ | \$ 1,014 |
| Gain on sale of Belvedere Trust's assets | | 185 |
| Other income | 62 | |
| Expenses | (50) | (896) |
| Income from discontinued operations | \$ 12 | \$ 303 |

Accounting Policies and Footnotes for Discontinued Operations*BT Other MBS Portfolio*

At March 31, 2008 and December 31, 2007, there were no assets remaining in Belvedere Trust's BT Other MBS portfolio.

Interest income on Belvedere Trust's BT Other MBS was determined in accordance with FASB Emerging Issues Task Force (EITF) 99-20. The excess of estimated future cash flows over the initial investment was the accretable yield to be recognized as interest income over the life of the investment using the effective yield method. If the current fair value of any individual security was lower than its current amortized cost, we determined whether an impairment charge was required to be taken through current income. If there was a continued adverse change in

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estimated cash flows (considering both the timing and the amount of the cash flows, and taking into consideration receipt of cash flows to date), then the security was written down to fair value, which then became the new amortized cost basis for future amortization.

Securities were recorded on the date the securities were purchased or sold. Realized gains or losses from securities transactions were determined based on the specific identified cost of the securities.

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BT Residential Loans Portfolio

At September 30, 2007, we determined that Belvedere Trust is no longer the primary beneficiary of the Variable Interest Entities and Belvedere Trust is no longer consolidating these interests. Prior to September 30, 2007, these interests had been shown in the consolidated financial statements as BT Residential Loans.

Belvedere Trust's BT Residential Loans had been previously classified as held-for-investment and were carried at their unpaid principal balance, adjusted for unamortized premiums or discounts. Interest income was accrued based upon the actual interest rates and the outstanding principal amounts on the loans. Premiums or discounts had been amortized into income using the effective interest yield method, adjusted for actual prepayments.

Belvedere Trust's Repurchase Agreements

Belvedere Trust entered into repurchase agreements with major financial institutions to finance most of its BT Other MBS portfolio and to finance most of the retained portion of the residential real estate loans which it had securitized. The repurchase agreements were primarily short-term borrowings that were secured by the market value of the pledged assets and bear interest rates that have historically had their basis on LIBOR. At March 31, 2008, Belvedere Trust had no outstanding repurchase agreements. At March 31, 2008, Belvedere Trust has three claims against it totaling approximately \$8 million, which have been contested, related to repurchase agreement transactions. Anworth is neither a co-party to nor a guarantor of Belvedere Trust's repurchase agreements or any claims against Belvedere Trust.

NOTE 15. SUBSEQUENT EVENTS

From April 1, 2008 through May 2, 2008, we sold 5.5 million shares of common stock pursuant to our amended Controlled Equity Offering Sales Agreement with Cantor Fitzgerald & Co. (as described in Note 9 to the accompanying unaudited consolidated financial statements), which provided net proceeds to us of approximately \$36.2 million. Cantor Fitzgerald & Co., as the sales agent, received an aggregate commission of approximately \$740,000, which represents an average commission of approximately 2.0% on the gross sales price per share.

On April 11, 2008, we declared a common stock dividend of \$0.20 per share which is payable to our holders of record of common stock on May 19, 2008 as of the close of business on April 30, 2008. When we pay any cash dividend during any quarterly fiscal period to all or substantially all of our common stockholders in an amount that results in an annualized common stock dividend yield which is greater than 6.25% (the dividend yield on our Series B Preferred Stock), the conversion rate on our Series B Preferred Stock is adjusted based on a formula specified in the Series B Preferred Stock prospectus supplement. The conversion rate increased from 2.3809 shares of our common stock to 2.4318 shares of our common stock using the following information: (1) the average of the closing common stock price for the 10-day trading period was \$6.79 and (2) annualized common stock dividend yield was 11.7838%.

On April 11, 2008, we declared a Series A Preferred Stock dividend of \$0.539063 per share and a Series B Preferred Stock dividend of \$0.390625 per share, each of which is payable on July 15, 2008 to our holders of record of Series A Preferred Stock and Series B Preferred Stock, respectively, as of the close of business on April 30, 2008.

On April 11, 2008, our board of directors approved an amendment to our Amended Articles of Incorporation to increase our authorized shares of common stock from 100 million to 200 million shares. This amendment is subject to approval by our stockholders at our annual meeting scheduled for May 22, 2008.

On April 11, 2008 we filed a shelf registration statement on Form S-3 with the SEC to register 15 million shares of common stock for our 2008 Dividend Reinvestment and Stock Purchase Plan, or the 2008 Plan. The 2008 Plan is in addition to our 2003 Dividend Reinvestment and Stock Purchase Plan.

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ANWORTH MORTGAGE ASSET CORPORATION

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

Cautionary Statement

You should read the following discussion and analysis in conjunction with the unaudited consolidated financial statements and related notes thereto contained elsewhere in this Quarterly Report on Form 10-Q, or Report. The information contained in this Report is not a complete description of our business or the risks associated with an investment in our stock. We urge you to carefully review and consider the various disclosures made by us in this Report and in our other reports filed with the United States Securities and Exchange Commission, or SEC, including our Annual Report on Form 10-K for the year ended December 31, 2007, that discuss our business in greater detail.

This Report contains forward-looking statements. Forward-looking statements are those that predict or describe future events or trends and that do not relate solely to historical matters. You can generally identify forward-looking statements as statements containing the words will, believe, expect, anticipate, intend, estimate, assume or other similar expressions. You should not rely on our forward-looking statements because the matters they describe are subject to known and unknown risks, uncertainties and other unpredictable factors, many of which are beyond our control. These forward-looking statements are subject to assumptions and to various risks and uncertainties. Therefore, our actual results could differ materially and adversely from those expressed in any forward-looking statements as a result of various factors, some of which are listed under Item 1A, Risk Factors, in our 2007 Annual Report on Form 10-K. We undertake no obligation to revise or update publicly any forward-looking statements for any reason.

As used in this Report, company, we, us, our, and Anworth refer to Anworth Mortgage Asset Corporation.

General

We were formed in October 1997 and commenced operations on March 17, 1998. We are in the business of investing primarily in United States agency mortgage-backed securities, or MBS, which are obligations guaranteed by the United States government or guaranteed by federally sponsored enterprises such as Fannie Mae, Freddie Mac or Ginnie Mae. Our principal business objective is to generate net income for distribution to stockholders based upon the spread between the interest income on our mortgage-related assets and the costs of borrowing to finance our acquisition of these assets.

We are organized for tax purposes as a real estate investment trust, or REIT. Accordingly, we generally distribute substantially all of our earnings to stockholders without paying federal or state income tax at the corporate level on the distributed earnings. At March 31, 2008, our qualified REIT assets (real estate assets, as defined in the Internal Revenue Code, or Code, cash and cash items and government securities) were greater than 90% of our total assets, as compared to the Code requirement that at least 75% of our total assets must be qualified REIT assets. Greater than 99% of our 2007 revenue qualifies for both the 75% source of income test and the 95% source of income test under the REIT rules. We believe we currently meet all REIT requirements regarding the ownership of our common stock and the distributions of our net income. Therefore, we believe that we continue to qualify as a REIT under the provisions of the Code.

Our continuing operations consist of the following portfolios: Agency mortgage-backed securities, or Agency MBS, and Non-Agency mortgage-backed securities, or Non-Agency MBS. Our discontinued operations previously consisted of the following portfolios: Belvedere Trust's residential real estate loans, or BT Residential Loans, and Belvedere Trust's other mortgage-backed securities, or BT Other MBS.

At March 31, 2008, we had total assets of \$5.8 billion. Our Agency MBS portfolio, consisting of \$5.73 billion, was distributed as follows: 17% agency adjustable-rate MBS, 65% agency hybrid adjustable-rate MBS, 18% agency

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fixed-rate MBS and less than 1% agency floating-rate collateralized mortgage obligations, or CMOs. Our Non-Agency MBS portfolio consisted of \$26 million of floating-rate CMOs. Stockholders' equity available to common stockholders at the fiscal quarter ended March 31, 2008 was approximately \$461.9 million, or \$6.03 per share. The \$461.9 million equals total stockholders' equity of \$510.8 million less the Series A Preferred Stock liquidating value of \$46.9 million and less the difference between the Series B Preferred Stock liquidating value of \$30.1 million and the proceeds from its sale of \$28.1 million. For the three months ended March 31, 2008, we reported net income of \$16.6 million. Our net income to common stockholders was \$15.1 million, or \$0.21 per diluted share.

Results of Operations*Three Months Ended March 31, 2008 Compared to March 31, 2007*

For the three months ended March 31, 2008, our net income was \$16.6 million. Our net income to common stockholders was \$15.1 million, or \$0.21 per diluted share, based on an average of 72.6 million shares outstanding. For the three months ended March 31, 2007, our net income was \$2.8 million and our net income to common stockholders was \$2.4 million, or \$0.05 per diluted share, based on an average of 45.6 million shares outstanding.

Net interest income for the three months ended March 31, 2008 was \$19.3 million, or 26.8% of gross income from continuing operations, compared to \$4.0 million, or 5.8% of gross income from continuing operations, for the three months ended March 31, 2007. Net interest income is comprised of the interest income earned on mortgage investments less interest expense from borrowings. Interest income net of premium amortization expense for the three months ended March 31, 2008 was \$68.4 million, compared to \$63.8 million for the three months ended March 31, 2007, an increase of 7.1%. The increase in interest income is due primarily to the increase in our investments in Agency MBS (based on the leverage on \$160 million in capital raised during the three months ended March 31, 2008). Interest expense for the three months ended March 31, 2008 was \$49.1 million, compared to \$59.8 million for the three months ended March 31, 2007, a decrease of 17.9%. This decrease was due primarily to the decrease in short-term interest rates.

During the three months ended March 31, 2008, premium amortization expense decreased \$2.4 million, or 41%, from \$5.9 million during the three months ended March 31, 2007 to \$3.5 million, which was due primarily to the decrease in the constant prepayment rate of our MBS investments.

The table below shows the approximate constant prepayment rate of our MBS for each of the following quarters:

| Portfolio | First Quarter 2008 | First Quarter 2007 |
|-------------------------------|-----------------------------------|-----------------------------------|
| Agency MBS and Non-Agency MBS | 18% | 24% |

During the three months ended March 31, 2008, we recognized a loss of \$280,000 due to hedge ineffectiveness.

Total expenses were \$2.5 million for the three months ended March 31, 2008, compared to \$1.6 million for the three months ended March 31, 2007. The increase of \$888,000 in total expenses was due to an increase in compensation and benefits of \$983,000 (due primarily to increases in executives' and other employees' salaries of \$183,000 and year-end 2008 additional compensation of \$800,000) and an increase in Other expenses of \$61,000, partially offset by a decrease in amortization of restricted stock of \$156,000.

Financial Condition*Agency MBS Portfolio*

At March 31, 2008, we held agency mortgage assets whose amortized cost was approximately \$5.69 billion, consisting primarily of \$4.68 billion of adjustable-rate MBS, \$1.0 billion of fixed-rate MBS and \$9 million of

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floating-rate CMOs. This amount represents an approximate 22% increase from the \$4.66 billion held at December 31, 2007. Of the adjustable-rate Agency MBS owned by us, 21% were adjustable-rate pass-through certificates whose coupons reset within one year. The remaining 79% consisted of hybrid adjustable-rate MBS whose coupons will reset between one year and five years. Hybrid adjustable-rate MBS have an initial interest rate that is fixed for a certain period, usually three to five years, and thereafter adjust annually for the remainder of the term of the loan.

The following table presents a schedule of our Agency MBS at fair value owned at March 31, 2008 and December 31, 2007, classified by type of issuer (dollar amounts in thousands):

| Agency | March 31, 2008 | | December 31, 2007 | |
|---------------------|----------------|----------------------|-------------------|----------------------|
| | Fair Value | Portfolio Percentage | Fair Value | Portfolio Percentage |
| Fannie Mae (FNM) | \$ 4,320,167 | 75.4% | \$ 3,412,030 | 73.2% |
| Freddie Mac (FHLMC) | 1,375,481 | 24.0 | 1,215,291 | 26.1 |
| Ginnie Mae (GNMA) | 32,602 | 0.6 | 35,226 | 0.7 |
| Total Agency MBS | \$ 5,728,250 | 100.0% | \$ 4,662,547 | 100.0% |

The following table classifies our portfolio of Agency MBS owned at March 31, 2008 and December 31, 2007, by type of interest rate index (dollar amounts in thousands):

| Index | March 31, 2008 | | December 31, 2007 | |
|--------------------------------------|----------------|----------------------|-------------------|----------------------|
| | Fair Value | Portfolio Percentage | Fair Value | Portfolio Percentage |
| One-month LIBOR | \$ 8,860 | 0.1% | \$ 9,369 | 0.2% |
| Six-month LIBOR | 50,557 | 0.9 | 52,366 | 1.1 |
| One-year LIBOR | 4,091,359 | 71.4 | 3,203,408 | 68.7 |
| Six-month Certificate of Deposit | 1,897 | | 2,101 | 0.1 |
| Six-month Constant Maturity Treasury | 716 | | 766 | |
| One-year Constant Maturity Treasury | 518,242 | 9.1 | 530,614 | 11.4 |
| Cost of Funds Index | 42,837 | 0.8 | 44,516 | 0.9 |
| Fixed-rate | 1,013,782 | 17.7 | 819,407 | 17.6 |
| Total Agency MBS | \$ 5,728,250 | 100.0% | \$ 4,662,547 | 100.0% |

The fair values indicated above do not include interest earned but not yet paid. With respect to our hybrid adjustable-rate MBS, the fair value of these securities appears on the line associated with the index based on which the security will eventually reset once the initial fixed interest rate period has expired.

At March 31, 2008, our total agency portfolio had a weighted average coupon of 5.68%. The average coupon of the adjustable-rate securities was 5.94%, the hybrid securities average coupon was 5.60%, the fixed-rate securities average coupon was 5.76% and the CMO floaters average coupon was 3.63%. At December 31, 2007, our total agency portfolio had a weighted average coupon of 5.91%. The average coupon of the adjustable-rate securities was 6.10%, the hybrid average coupon was 5.85%, the fixed-rate securities average coupon was 5.92% and the CMO floaters average coupon was 5.84%.

At March 31, 2008, the average amortized cost of our agency mortgage-related assets was 101.23%, the average amortized cost of our adjustable-rate securities was 101.34% and the average amortized cost of our fixed-rate securities was 100.71%. Relative to our Agency MBS portfolio at March 31, 2008, the average interest rate on outstanding repurchase agreements was 3.30% and the average days to maturity was 53 days. After adjusting for interest rate swap transactions, the average interest rate on outstanding repurchase agreements was 4.04% and the weighted average term to next rate adjustment was 529 days.

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At December 31, 2007, the average amortized cost of our agency mortgage-related assets was 101.23%, the average amortized cost of our adjustable-rate securities was 101.34% and the average amortized cost of our fixed-rate securities was 100.88%. Relative to our Agency MBS portfolio at December 31, 2007, the average interest rate on outstanding repurchase agreements was 4.91% and the average days to maturity was 49 days. After adjusting for interest rate swap transactions, the average interest rate on outstanding repurchase agreements was 4.77% and the weighted average term to next rate adjustment was 418 days.

At March 31, 2008 and December 31, 2007, the unamortized net premium paid for our Agency MBS was \$69 million and \$56 million, respectively.

At March 31, 2008, the current yield on our Agency MBS portfolio was 5.61% based on a weighted average coupon of 5.68% divided by the average amortized cost of 101.23%. At December 31, 2007, the current yield on our Agency MBS portfolio was 5.84% based on a weighted average coupon of 5.91% divided by the average amortized cost of 101.23%.

We analyze our MBS and the extent to which prepayments impact the yield of the securities. When the rate of prepayments exceeds expectations, we amortize the premiums paid on mortgage assets over a shorter time period, resulting in a reduced yield to maturity on our mortgage assets. Conversely, if actual prepayments are less than the assumed constant prepayment rate, the premium would be amortized over a longer time period, resulting in a higher yield to maturity.

Non-Agency MBS Portfolio

At March 31, 2008, our Non-Agency MBS portfolio consisted of \$26 million of CMO floaters with an average coupon of 2.85% which were acquired at par value. At December 31, 2007, our Non-Agency MBS portfolio consisted of \$43 million of CMO floaters with an average coupon of 5.11%, which were acquired at par value.

Hedging

We periodically enter into derivative transactions, in the form of forward purchase commitments and interest rate swaps, which are intended to hedge our exposure to rising rates on funds borrowed to finance our investments in securities. We designate interest rate swap transactions as cash flow hedges. We also periodically enter into derivative transactions, in the form of forward purchase commitments, which are not designated as hedges. To the extent that we enter into hedging transactions to reduce our interest rate risk on indebtedness incurred to acquire or carry real estate assets, any income or gain from the disposition of hedging transactions should be qualifying income for purposes of the REIT rules 95% gross income test, but not the 75% gross income test.

As part of our asset/liability management policy, we may enter into hedging agreements such as interest rate caps, floors or swaps. These agreements would be entered into to try to reduce interest rate risk and would be designed to provide us with income and capital appreciation in the event of certain changes in interest rates. We review the need for hedging agreements on a regular basis consistent with our capital investment policy. At March 31, 2008, we were a counter-party to swap agreements, which are derivative instruments as defined by SFAS No. 133 and SFAS No. 138, with an aggregate notional amount of \$2.68 billion and a weighted average maturity of 2.7 years. We utilize swap agreements to manage interest rate risk and do not anticipate entering into derivative transactions for speculative or trading purposes. In accordance with the swap agreements, we pay a fixed rate of interest during the term of the swap agreements and receive a payment that varies with the three-month LIBOR rate. At March 31, 2008, there were unrealized losses of approximately \$104.0 million on our swap agreements.

Table of Contents**Liquidity and Capital Resources***Agency MBS and Non-Agency MBS Portfolios*

Our primary source of funds consists of repurchase agreements, relative to our Agency MBS portfolio, which totaled \$5.1 billion at March 31, 2008. As collateral for these repurchase agreements, we have pledged approximately \$5.4 billion in Agency MBS. Our other significant source of funds for the three months ended March 31, 2008 consisted of payments of principal from our Agency MBS portfolio, which were \$257 million

Relative to our Agency MBS portfolio at March 31, 2008, all of our repurchase agreements were fixed-rate term repurchase agreements with original maturities ranging from 30 days to 24 months. At March 31, 2008, we had borrowed funds under repurchase agreements with 13 different financial institutions. As the repurchase agreements mature, we enter into new repurchase agreements to take their place. Because we borrow money based on the fair value of our MBS and because increases in short-term interest rates can negatively impact the valuation of MBS, our borrowing ability could be reduced and lenders may initiate margin calls in the event short-term interest rates increase or the value of our MBS declines for other reasons. We had adequate cash flow, liquid assets and unpledged collateral with which to meet our margin requirements during the three months ended March 31, 2008.

In the future, we expect that our primary sources of funds will continue to consist of borrowed funds under repurchase agreement transactions and of monthly payments of principal and interest on our MBS portfolio. Our liquid assets generally consist of unpledged MBS, cash and cash equivalents.

During the three months ended March 31, 2008, we raised approximately \$4.0 million in capital under our Dividend Reinvestment and Stock Purchase Plan.

At March 31, 2008, our authorized capital included 20 million shares of \$0.01 par value preferred stock, which we have classified as Series A Cumulative Preferred Stock, or Series A Preferred Stock, and Series B Cumulative Convertible Preferred Stock, or Series B Preferred Stock. During the three months ended March 31, 2008, we did not issue any shares of Series A or Series B Preferred Stock. During the three months ended March 31, 2008 we issued 2.36 million shares of common stock under our amended our Controlled Equity Offering Sales Agreement with Cantor Fitzgerald & Co. (as described in Note 9 to the accompanying unaudited consolidated financial statements), which provided net proceeds to us of approximately \$19.9 million. Cantor Fitzgerald & Co., as sales agent, received an aggregate commission of approximately \$483,000, which represents an average commission of approximately 2.32% on the gross sales price per share.

On January 30, 2008, we issued an aggregate of 16.445 million shares of common stock in a secondary public offering and recognized net proceeds of approximately \$136.3 million (net of underwriting fees, commissions and other costs). We used all of the net proceeds from this offering to acquire Agency MBS.

Off-Balance Sheet and Contractual Arrangements

The following table represents our contractual obligations at March 31, 2008 (in thousands):

| | Less Than 1 Year | 1-3 Years | 3-5 Years | More Than 5 Years | Total |
|------------------------------|---------------------|------------|-----------|----------------------|--------------|
| Repurchase agreements(1) | \$ 4,957,400 | \$ 120,000 | \$ | \$ | \$ 5,077,400 |
| Junior subordinated notes(2) | | | | 37,380 | 37,380 |
| Lease commitment | 287 | 600 | 393 | | 1,280 |
| Total(3) | \$ 4,957,687 | \$ 120,600 | \$ 393 | \$ 37,380 | \$ 5,116,060 |

(1) These represent amounts due by maturity.

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- (2) These represent amounts due by contractual maturity. However, we have the option to redeem these after March 30, 2010 and April 30, 2010 as more fully described in Note 4 to the accompanying unaudited consolidated financial statements.
- (3) This does not include annual compensation agreements and incentive compensation agreements, which are more fully described in Note 9 to the accompanying unaudited consolidated financial statements.

Stockholders' Equity

We use available-for-sale treatment for our Agency MBS and Non-Agency MBS portfolios, which are carried on our balance sheet at fair value rather than historical cost. Based upon this treatment, stockholders' equity available to common stockholders at March 31, 2008 was approximately \$461.9 million, or \$6.03 per share. The \$461.9 million equals total stockholders' equity of \$510.8 million less the Series A Preferred Stock liquidating value of \$46.9 million and less the difference between the Series B Preferred Stock liquidating value of \$30.1 million and the proceeds from its sale of \$28.1 million.

Under our available-for-sale accounting treatment, unrealized fluctuations in fair values of assets are assessed to determine whether they are other-than-temporary. To the extent we determine that these unrealized fluctuations are not other-than-temporary, they do not impact net income or taxable income but rather are reflected on our Consolidated Balance Sheets by changing the carrying value of the assets and reflecting the change in stockholders' equity under Accumulated other comprehensive income, unrealized gain (loss) on Agency MBS or Non-Agency MBS.

As a result of this mark-to-market accounting treatment, our book value and book value per share are likely to fluctuate far more than if we used historical amortized cost accounting on all of our assets. As a result, comparisons with some companies that use historical cost accounting for all of their balance sheet may not be meaningful.

Unrealized changes in the fair value of MBS have one significant and direct effect on our potential earnings and dividends: positive mark-to-market changes will increase our equity base and allow us to increase our borrowing capacity, while negative changes will tend to reduce our borrowing capacity under our capital investment policy. A very large negative change in the net market value of our MBS might reduce our liquidity, requiring us to sell assets with the likely result of realized losses upon sale. Accumulated other comprehensive income, unrealized gains on our available-for-sale Agency MBS portfolio was \$22.9 million, or 0.4% of the amortized cost of our Agency MBS, at March 31, 2008. This, along with Accumulated other comprehensive loss, Non-Agency MBS of \$21.1 million and Accumulated other comprehensive loss, derivatives of \$104.0 million, constitute the total Accumulated other comprehensive loss of \$102.2 million.

Critical Accounting Policies

Management has the obligation to ensure that its accounting policies and methodologies are in accordance with GAAP. Management has reviewed and evaluated its critical accounting policies and believes them to be appropriate and in accordance with GAAP.

The preparation of financial statements in accordance with GAAP requires management to make estimates and assumptions in certain circumstances that affect amounts reported in the accompanying unaudited consolidated financial statements. In preparing these unaudited consolidated financial statements, management has made its best estimates and judgments of certain amounts included in the unaudited consolidated financial statements, giving due consideration to materiality. We do not believe that there is a great likelihood that materially different amounts would be reported related to accounting policies described below. Nevertheless, application of these accounting policies involves the exercise of judgment and use of assumptions as to future uncertainties and, as a result, actual results could differ materially from these estimates.

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Our accounting policies are described in Note 1 to the accompanying unaudited consolidated financial statements. Management believes the more significant of these for continuing operations to be as follows:

Revenue Recognition

The most significant source of our revenue is derived from our investments in mortgage-related assets. We reflect income using the effective yield method which, through amortization of premiums and accretion of discounts at an effective yield, recognizes periodic income over the estimated life of the investment on a constant yield basis, as adjusted for actual prepayment activity. Management believes our revenue recognition policies are appropriate to reflect the substance of the underlying transactions.

Interest income on our mortgage-related assets is accrued based on the actual coupon rate and the outstanding principal amounts of the underlying mortgages. Premiums and discounts are amortized or accreted into interest income over the expected lives of the securities using the effective interest yield method, adjusted for the effects of actual prepayments. Our policy for estimating prepayment speeds for calculating the effective yield is to evaluate historical performance, street consensus prepayment speeds and current market conditions. If our estimate of prepayments is incorrect, as compared to the aforementioned references, we may be required to make an adjustment to the amortization or accretion of premiums and discounts that would have an impact on future income.

Valuation and Classification of Investment Securities

We carry our investment securities on our Consolidated Balance Sheets at fair value. The fair values of our MBS (as disclosed in Note 5 to the accompanying unaudited consolidated financial statements) are generally based on market prices provided by certain dealers who make markets in such securities. The fair values of other marketable securities are obtained from the last reported sale of such securities on its principal exchange or, if no representative sale is reported, the mean between the closing bid and ask prices. If, in the opinion of management, one or more securities prices reported to us are not reliable or are unavailable, management estimates the fair value based on characteristics of the security it receives from the issuer and available market information. The fair values reported reflect estimates and may not necessarily be indicative of the amounts we could realize in a current market exchange. We review various factors (e.g., expected cash flows, changes in interest rates, credit protection, etc.) in determining whether and to what extent an other-than-temporary impairment exists. To the extent that unrealized losses on our Agency MBS and Non-Agency MBS portfolios are not attributable to credit quality, and we have the ability and intent to hold these investments until a recovery of fair value up to (or beyond) its cost, which may be maturity, we do not consider these investments to be other-than-temporarily impaired. Losses on securities classified as available-for-sale, which are determined by management to be other-than-temporary in nature, are reclassified from Accumulated other comprehensive income to current-period income.

Accounting for Derivatives and Hedging Activities

In accordance with SFAS No. 133, as amended by SFAS No. 138, a derivative that is designated as a hedge is recognized as an asset/liability and measured at estimated fair value. In order for our interest rate swap agreements to qualify for hedge accounting, upon entering into the swap agreement, we must anticipate that the hedge will be highly effective, as defined by SFAS No. 133.

On the date we enter into a derivative contract, we designate the derivative as a hedge of the variability of cash flows that are to be received or paid in connection with a recognized asset or liability (a cash flow hedge). Changes in the fair value of a derivative that are highly effective and that are designated and qualify as a cash flow hedge, to the extent that the hedge is effective, are recorded in Other comprehensive income and reclassified to income when the forecasted transaction affects income (e.g., when periodic settlement interest payments are due on repurchase agreements). The swap agreements are carried on our Consolidated Balance

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Sheets at their fair value based on values obtained from major financial institutions (as disclosed in Note 5 to the accompanying unaudited consolidated financial statements). Hedge ineffectiveness, if any, is recorded in current-period income.

We formally assess both at the hedge's inception and on an ongoing basis, whether the derivatives that are used in hedging transactions have been highly effective in offsetting changes in the cash flows of hedged items and whether those derivatives may be expected to remain highly effective in future periods. If it is determined that a derivative is not (or has ceased to be) highly effective as a hedge, we discontinue hedge accounting.

When we discontinue hedge accounting, the gain or loss on the derivative remains in Accumulated other comprehensive income and is reclassified into income when the forecasted transaction affects income. In all situations in which hedge accounting is discontinued and the derivative remains outstanding, we will carry the derivative at its fair value on the balance sheet, recognizing changes in the fair value in current-period income.

For purposes of the cash flow statement, cash flows from derivative instruments are classified with the cash flows from the hedged item.

Income Taxes

Other than BT Finance, as noted below, our financial results do not reflect provisions for current or deferred income taxes. Management believes that we have and intend to continue to operate in a manner that will continue to allow us to be taxed as a REIT and, as a result, management does not expect to pay substantial corporate level taxes. Many of these requirements, however, are highly technical and complex. If we were to fail to meet these requirements, we would be subject to federal income tax.

BT Finance, our indirect wholly-owned subsidiary, is a taxable REIT subsidiary and may be liable for corporate income tax expenses. BT Finance, as a subsidiary of Belvedere Trust, is reported within Discontinued Operations and is also in the process of being dissolved.

Subsequent Events

From April 1, 2008 through May 2, 2008, we sold 5.5 million shares of common stock pursuant to our amended Controlled Equity Offering Sales Agreement with Cantor Fitzgerald & Co. (as described in Note 9 to the accompanying unaudited consolidated financial statements), which provided net proceeds to us of approximately \$36.2 million. Cantor Fitzgerald & Co., as the sales agent, received an aggregate commission of approximately \$740,000, which represents an average commission of approximately 2.0% on the gross sales price per share.

On April 11, 2008, we declared a common stock dividend of \$0.20 per share which is payable to our holders of record of common stock on May 19, 2008 as of the close of business on April 30, 2008. When we pay any cash dividend during any quarterly fiscal period to all or substantially all of our common stockholders in an amount that results in an annualized common stock dividend yield which is greater than 6.25% (the dividend yield on our Series B Preferred Stock), the conversion rate on our Series B Preferred Stock is adjusted based on a formula specified in the Series B Preferred Stock prospectus supplement. The conversion rate increased from 2.3809 shares of our common stock to 2.4318 shares of our common stock using the following information: (1) the average of the closing common stock price for the 10-day trading period was \$6.79 and (2) annualized common stock dividend yield was 11.7838%.

On April 11, 2008, we declared a Series A Preferred Stock dividend of \$0.539063 per share and a Series B Preferred Stock dividend of \$0.390625 per share, each of which is payable on July 15, 2008 to our holders of record of Series A Preferred Stock and Series B Preferred Stock, respectively, as of the close of business on April 30, 2008.

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On April 11, 2008, our board of directors approved an amendment to our Amended Articles of Incorporation to increase our authorized shares of common stock from 100 million to 200 million shares. This amendment is subject to approval by our stockholders at our annual meeting scheduled for May 22, 2008.

On April 11, 2008 we filed a shelf registration statement on Form S-3 with the SEC to register 15 million shares of common stock for our 2008 Dividend Reinvestment and Stock Purchase Plan, or the 2008 Plan. The 2008 Plan is in addition to our 2003 Dividend Reinvestment and Stock Purchase Plan.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

We seek to manage the interest rate, market value, liquidity, prepayment and credit risks inherent in all financial institutions in a prudent manner designed to insure our longevity while, at the same time, seeking to provide an opportunity for stockholders to realize attractive total rates of return through ownership of our common stock. While we do not seek to avoid risk completely, we do seek, to the best of our ability, to assume risk that can be quantified from historical experience, to actively manage that risk, to earn sufficient compensation to justify taking those risks and to maintain capital levels consistent with the risks we undertake.

Interest Rate Risk

We primarily invest in adjustable-rate, hybrid and fixed-rate mortgage-related assets. Hybrid mortgages are ARMs that have a fixed interest rate for an initial period of time (typically three years or greater) and then convert to an adjustable-rate for the remaining loan term. Our debt obligations are generally repurchase agreements of limited duration that are periodically refinanced at current market rates.

ARM-related assets are typically subject to periodic and lifetime interest rate caps that limit the amount an ARM-related asset's interest rate can change during any given period. ARM securities are also typically subject to a minimum interest rate payable. Our borrowings are not subject to similar restrictions. Hence, in a period of increasing interest rates, interest rates on our borrowings could increase without limitation, while the interest rates on our mortgage-related assets could be limited. This problem would be magnified to the extent we acquire mortgage-related assets that are not fully indexed. Further, some ARM-related assets may be subject to periodic payment caps that result in some portion of the interest being deferred and added to the principal outstanding. These factors could lower our net interest income or cause a net loss during periods of rising interest rates, which would negatively impact our liquidity, net income and our ability to make distributions to stockholders.

We fund the purchase of a substantial portion of our ARM-related assets with borrowings that 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 our mortgage assets. Thus, we anticipate that in most cases the interest rate indices and repricing terms of our mortgage assets and our funding sources will not be identical, thereby creating an interest rate mismatch between assets and liabilities. During periods of changing interest rates, such interest rate mismatches could negatively impact our net interest income, dividend yield and the market price of our common stock.

Most of our adjustable-rate assets are based on the one-year constant maturity treasury rate and the one-year LIBOR rate and our debt obligations are generally based on LIBOR. These indices generally move in the same direction, but there can be no assurance that this will continue to occur.

Our ARM-related assets and borrowings reset at various different dates for the specific asset or obligation. In general, the repricing of our debt obligations occurs more quickly than on our assets. Therefore, on average, our cost of funds may rise or fall more quickly than does our earnings rate on the assets.

Further, our net income may vary somewhat as the spread between one-month interest rates and six- and twelve-month interest rates vary.

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At March 31, 2008, our Agency MBS and Non-Agency MBS portfolios and related borrowings would have prospectively repriced based on the following time frames (dollar amounts in thousands):

| | Investments(1) | | Borrowings | |
|---|---------------------|---------------------------------|---------------------|--------------------------------|
| | Amount | Percentage of Total Investments | Amount | Percentage of Total Borrowings |
| Investment Type/Rate Reset Dates: | | | | |
| Fixed-rate investments | \$ 1,013,782 | 17.6% | \$ | |
| Adjustable-Rate Investments/Obligations: | | | | |
| Less than 3 months | 246,385 | 4.3 | 4,882,400 | 96.1% |
| Greater than 3 months and less than 1 year | 786,679 | 13.7 | 75,000 | 1.5 |
| Greater than 1 year and less than 2 years | 30,528 | 0.5 | 120,000 | 2.4 |
| Greater than 2 years and less than 3 years | 444,223 | 7.7 | | |
| Greater than 3 years and less than 5 years | 3,233,077 | 56.2 | | |
| Total | \$ 5,754,674 | 100.0% | \$ 5,077,400 | 100.0% |

(1) Based on when they contractually reprice and do not consider the effect of any prepayments.

At December 31, 2007, our Agency MBS and Non-Agency MBS portfolios and related borrowings would have prospectively repriced based on the following time frames (dollar amounts in thousands):

| | Investments(1) | | Borrowings | |
|---|---------------------|---------------------------------|---------------------|--------------------------------|
| | Amount | Percentage of Total Investments | Amount | Percentage of Total Borrowings |
| Investment Type/Rate Reset Dates: | | | | |
| Fixed-rate investments | \$ 819,407 | 17.4% | \$ | |
| Adjustable-Rate Investments/Obligations: | | | | |
| Less than 3 months | 260,948 | 5.5 | 4,032,100 | 95.4% |
| Greater than 3 months and less than 1 year | 709,315 | 15.1 | 75,000 | 1.8 |
| Greater than 1 year and less than 2 years | 214,649 | 4.6 | 120,000 | 2.8 |
| Greater than 2 years and less than 3 years | 62,893 | 1.3 | | |
| Greater than 3 years and less than 5 years | 2,638,049 | 56.1 | | |
| Total | \$ 4,705,261 | 100.0% | \$ 4,227,100 | 100.0% |

(1) Based on when they contractually reprice and do not consider the effect of any prepayments.

Market Value Risk

Substantially all of our MBS are classified as available-for-sale assets. As such, they are reflected at fair value (i.e., market value) with the periodic adjustment to fair value reflected as part of Accumulated other comprehensive income that is included in the Stockholders Equity section of our Consolidated Balance Sheets. The market value of our assets can fluctuate due to changes in interest rates and other factors.

Liquidity Risk

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Our primary liquidity risk arises from financing long-maturity MBS with short-term debt. The interest rates on our borrowings generally adjust more frequently than the interest rates on our adjustable-rate MBS. For example, at March 31, 2008, our Agency MBS and Non-Agency adjustable-rate MBS had a weighted average term to next rate adjustment of approximately 38 months while our borrowings had a weighted average term to next rate adjustment of 53 days. After adjusting for interest rate swap transactions, the weighted average term to

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next rate adjustment was 529 days. Accordingly, in a period of rising interest rates, our borrowing costs will usually increase faster than our interest earnings from MBS. As a result, we could experience a decrease in net income or a net loss during these periods (this occurred in 2006). Our assets that are pledged to secure short-term borrowings are high-quality liquid assets. During the three months ended March 31, 2008, there were continuing liquidity and credit concerns surrounding the mortgage markets generally, which we believe resulted in banks and other lenders becoming more cautious in providing repurchase agreement lending relative to both Agency MBS and AAA-rated MBS. While the effect on the availability of financing for AAA-rated MBS has been more pronounced than for Agency MBS, we have seen more limited liquidity in terms of the length of borrowing terms, margin requirements and the amount of financing available.

At March 31, 2008, we had unrestricted cash of \$14.3 million and \$303 million in unpledged Agency MBS and Non-Agency MBS available to meet margin calls on short-term borrowings that could be caused by asset value declines or changes in lender collateralization requirements.

Prepayment Risk

Prepayments are the full or partial repayment of principal prior to the original term to maturity of a mortgage loan and typically occur due to refinancing of mortgage loans. Prepayment rates on mortgage-related securities and mortgage loans vary from time to time and may cause changes in the amount of our net interest income. Prepayments of ARM loans usually can be expected to increase when mortgage interest rates fall below the then-current interest rates on such loans and decrease when mortgage interest rates exceed the then-current interest rate on such loans, although such effects are not entirely predictable. Prepayment rates may also be affected by the conditions in the housing and financial markets, general economic conditions and the relative interest rates on fixed-rate loans and ARM loans underlying MBS. The purchase prices of MBS are generally based upon assumptions regarding the expected amounts and rates of prepayments. Where slow prepayment assumptions are made, we may pay a premium for MBS. To the extent such assumptions differ from the actual amounts of prepayments, we could experience reduced earnings or losses. The total prepayment of any MBS purchased at a premium by us would result in the immediate write-off of any remaining capitalized premium amount and a reduction of our net interest income by such amount. Finally, in the event that we are unable to acquire new MBS to replace the prepaid MBS, our financial condition, cash flows and results of operations could be harmed.

We often purchase mortgage-related assets that have a higher interest rate than the market interest rate at the time. In exchange for this higher interest rate, we must pay a premium over par value to acquire these assets. In accordance with accounting rules, we amortize this premium over the term of the mortgage-backed security. As we receive repayments of mortgage principal, we amortize the premium balances as a reduction to our income. If the mortgage loans underlying a mortgage-backed security were prepaid at a faster rate than we anticipate, we would amortize the premium at a faster rate. This would reduce our income.

Tabular Presentation

The information presented in the table below projects the impact of sudden changes in interest rates on our annual Projected Net Interest Income and Projected Portfolio Value, as more fully discussed below, based on investments in place at March 31, 2008, and includes all of our interest rate-sensitive assets, liabilities and hedges, such as interest rate swap agreements.

Changes in Projected Net Interest Income equals the change that would occur in the calculated Projected Net Interest Income for the next twelve months relative to the 0% change scenario if interest rates were to instantaneously parallel shift to and remain at the stated level for the next twelve months.

Changes in Projected Portfolio Value equals the change in value of our assets that we carry at fair value rather than at historical amortized cost and any change in the value of any derivative instruments or hedges, such

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as interest rate swap agreements. We acquire interest rate-sensitive assets and fund them with interest rate-sensitive liabilities. We generally plan to retain such assets and the associated interest rate risk to maturity.

| Change in Interest Rates | Percentage Change in Projected Net Interest Income | Percentage Change In Projected Portfolio Value |
|--------------------------|--|--|
| 2.0% | 39% | 0.9% |
| 1.0% | 17% | 0.2% |
| 0% | | |
| 1.0% | 12% | 1.8% |
| 2.0% | 28% | 4.3% |

When interest rates are shocked, prepayment assumptions are adjusted based on management's best estimate of the effects of changes in interest rates on prepayment speeds. For example, under current market conditions, a 100 basis point decline in interest rates is estimated to result in a 149% increase in the prepayment rate of our Agency MBS portfolio. The base interest rate scenario assumes interest rates at March 31, 2008. Actual results could differ significantly from those estimated in the table. The above table includes the effect of interest rate swap agreements. At March 31, 2008, the aggregate notional amount of the interest rate swap agreements was \$2.68 billion and the weighted average maturity was 2.7 years.

The information presented in the table below projects the impact of sudden changes in interest rates on our annual Projected Net Income and Projected Portfolio Value compared to the base case used in the table above and excludes the effect of the interest rate swap agreements.

| Change in Interest Rates | Percentage Change in Projected Net Interest Income | Percentage Change In Projected Portfolio Value |
|--------------------------|--|--|
| 2.0% | 56% | 1.4% |
| 1.0% | 55% | 1.3% |
| 0% | | |
| 1.0% | 12% | 2.9% |
| 2.0% | 27% | 6.5% |

General

Many assumptions are made to present the information in the above tables and, as such, there can be no assurance that assumed events will occur, or that other events will not occur, that would affect the outcomes; therefore, the above tables and all related disclosures constitute forward-looking statements. The analyses presented utilize assumptions and estimates based on management's judgment and experience. Furthermore, future sales, acquisitions and restructuring could materially change the interest rate risk profile for us. The tables quantify the potential changes in net income and net asset value should interest rates immediately change (are shocked). The results of interest rate shocks of plus and minus 100 and 200 basis points are presented. The cash flows associated with the portfolio of mortgage-related assets for each rate shock are calculated based on a variety of assumptions including prepayment speeds, time until coupon reset, yield on future acquisitions, slope of the yield curve and size of the portfolio. Assumptions made on the interest rate-sensitive liabilities, which are repurchase agreements, include anticipated interest rates (no negative rates are utilized), collateral requirements as a percent of the repurchase agreement and amount of borrowing. Assumptions made in calculating the impact on net asset value of interest rate shocks include interest rates, prepayment rates and the yield spread of mortgage-related assets relative to prevailing interest rates.

Item 4. Controls and Procedures*Disclosure Controls and Procedures*

We maintain disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) designed to ensure that information required to be disclosed by us in the reports that we

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file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

Our management, with the participation of our Principal Executive Officer and Principal Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. Based on such evaluation, our Principal Executive Officer and Principal Financial Officer have concluded that, as of the end of such period, our disclosure controls and procedures are effective in the timely and accurate recording, processing, summarizing and reporting of material financial and non-financial information within the time periods specified in the SEC's rules and forms. Our management, with the participation of our Principal Executive Officer and Principal Financial Officer, has concluded that our disclosure controls and procedures are also effective to ensure that information required to be disclosed in the reports that we file or submit under the Exchange Act is accumulated and communicated to management, including our Principal Executive Officer and Principal Financial Officer, to allow timely decisions regarding required disclosure.

Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting that occurred during our last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings.

We are not a party to any material pending legal proceedings.

Item 1A. Risk Factors.

The following risk factor in our 2007 Annual Report on Form 10-K has been modified as follows:

Our incentive compensation arrangements may create incentives to increase the risk of our mortgage portfolio in an attempt to increase compensation.

In addition to their base salaries, some management and key employees are eligible to earn incentive compensation for each fiscal year pursuant to our 2002 Incentive Plan and certain executive officers are eligible to earn incentive compensation pursuant to the terms of their Employment Agreements. Under the 2002 Incentive Plan, the aggregate amount of compensation that may be earned by these employees equals a percentage of net income, before incentive compensation, in excess of the amount that would produce an annualized return on average net worth equal to the ten-year U.S. Treasury Rate plus 1%. In any fiscal quarter in which our net income is an amount less than the amount necessary to earn this threshold return, we calculate negative incentive compensation for that fiscal quarter which will be carried forward and will offset future incentive compensation earned under the 2002 Incentive Plan, but only with respect to those participants who were participants during the fiscal quarter(s) in which negative incentive compensation was generated. Although negative incentive compensation is used to offset future incentive compensation, as our management evaluates different mortgage-related assets for our investment, there is a risk that management will cause us to assume more risk than is prudent. Under the Employment Agreements, the executive officers are eligible to participate in a performance-based bonus pool that is funded based on the company's return on average equity (ROAE). ROAE is calculated as the twelve-month GAAP net income minus depreciation, preferred stock dividends, gains/losses on asset sales and impairment charges, divided by the average stockholder equity less goodwill and preferred stockholder equity. The aggregate amount of this performance-based bonus pool available for distribution to the executive officers can range annually based upon our ROAE. If the ROAE is 0% or less, no performance-based bonus is paid. If the ROAE is greater than 0% but less than 8%, a pool of up to \$500,000 is available. If the ROAE is 8% or greater, then the pool is \$500,000 plus 10% of the first \$5 million of excess return and 6% of the amount of the excess return greater than \$5 million. Of the aggregate amount available for distribution from the bonus pool, the Compensation Committee bases annual bonus allocation to each of the participating executive officers on its assessment of the performance of each executive officer. At least 50.0% of any annual performance-based bonus amount over \$100,000 will be paid in restricted shares (as opposed to cash). In an effort to earn greater amounts of incentive compensation under their Employment Agreement, as our executive officers evaluate different mortgage-related assets for our investment, there is a risk that they will cause us to assume more risk than is prudent. Prior to the end of any year, the Compensation Committee, at its discretion, may notify an Executive that the Executive will not participate in the pool during the following year. If this occurs, the sale or transfer restrictions on previously issued pool shares will be eliminated at that time.

The following additional risk factors have been added since the filing of our 2007 Annual Report on Form 10-K:

Adverse developments in the global capital market, including recent defaults, credit losses and liquidity concerns, could make it difficult for us to borrow money from financial institutions to acquire MBS on a leveraged basis, which could adversely affect our profitability.

We rely on the availability of financing to acquire MBS on a leveraged basis. Institutions from which we obtain financing may have owned or financed MBS and other assets which have declined in value and caused them to suffer losses as a result of the recent downturn in the residential mortgage market. If these conditions persist, these institutions may be forced to exit the repurchase market, become insolvent or further tighten their lending standards or increase the amount of equity capital or haircut required to obtain financing and, in such event, could make it more difficult for us to obtain financing on favorable terms or at all. Our profitability may be adversely affected if we were unable to obtain cost-effective financing for our investments.

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Adverse developments in the broader residential mortgage market may adversely affect the value of the agency securities in which we intend to invest.

Recently, the residential mortgage market in the United States has experienced a variety of difficulties and changed economic conditions including recent defaults, credit losses and liquidity concerns. News of actual and potential security liquidations has increased the volatility of many financial assets including agency securities and other high-quality MBS assets. As a result, values for MBS assets, including some agency securities and other AAA-rated MBS assets, have been negatively impacted. Further increased volatility and deterioration in the broader residential mortgage and MBS markets may adversely affect the performance and market value of the agency securities in which we invest.

Our investments serve as collateral for our financings. Any decline in their value, or perceived market uncertainty about their value, would likely make it difficult for us to obtain financing on favorable terms or at all, or maintain our compliance with terms of any financing arrangements already in place. If market conditions result in a decline in the value of our agency securities, our financial position and results of operations could be adversely affected.

We are subject to the risk that Fannie Mae and Freddie Mac may not be able to fully satisfy their guarantee obligations, which may adversely affect the value of our investment portfolio and our ability to sell or finance these securities.

The interest and principal payments we expect to receive on the MBS in which we invest will be guaranteed by Fannie Mae, Freddie Mac or Ginnie Mae. Unlike the Ginnie Mae certificates in which we invest, the principal and interest on securities issued by Fannie Mae and Freddie Mac are not guaranteed by the U.S. government. All the agency securities in which we invest depend on a steady stream of payments on the mortgages underlying the securities.

For 2007, both Fannie Mae and Freddie Mac reported substantial losses. Fannie Mae has publicly stated that it expects losses on guarantees of MBS to continue and expects significant increases in credit-related expenses and credit losses through 2008. Freddie Mac has publicly stated that it expects total credit losses to increase in 2008. If Fannie Mae and Freddie Mac continue to suffer significant losses, their ability to honor their respective MBS guarantees may be adversely affected. Further, any actual or perceived financial challenges at either Fannie Mae or Freddie Mac could cause the rating agencies to downgrade secured and unsecured securities issued by Fannie Mae and Freddie Mac. On January 9, 2008, Moody's Investors Service, or Moody's, placed Freddie Mac's A- bank financial strength rating, which measures the likelihood it will require financial assistance from third parties, on review for possible downgrade. On February 28, 2008, Moody's also placed Fannie Mae's B+ bank financial strength rating on review for possible downgrade. Any failure to honor guarantees on MBS by Fannie Mae or Freddie Mac or any downgrade of securities issued by Fannie Mae or Freddie Mac by the rating agencies could cause a significant decline in the cash flow from, and the value of, any MBS we may own and we may then be unable to sell or finance agency securities on favorable terms or at all.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

None.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. Submission of Matters to a Vote of Security Holders.

None.

Item 5. Other Information.

None.

Table of Contents**Item 6. Exhibits.**

The following exhibits are either filed herewith or incorporated herein by reference:

| Exhibit Number | Description |
|-----------------------|---|
| 1.1 | Controlled Equity Offering Sales Agreement dated June 29, 2007 between Anworth Mortgage Asset Corporation and Cantor Fitzgerald & Co. (incorporated by reference from our Current Report on Form 8-K filed with the SEC on July 2, 2007) |
| 3.1 | Amended Articles of Incorporation (incorporated by reference from our Registration Statement on Form S-11, Registration No. 333-38641, which became effective under the Securities Act of 1933 on March 12, 1998) |
| 3.2 | Articles of Amendment to Amended Articles of Incorporation (incorporated by reference from our Definitive Proxy Statement filed pursuant to Section 14(a) of the Securities Exchange Act of 1934, as filed with the SEC on May 14, 2003) |
| 3.3 | Articles Supplementary for Series A Cumulative Preferred Stock (incorporated by reference from our Current Report on Form 8-K filed with the SEC on November 3, 2004) |
| 3.4 | Articles Supplementary for Series A Cumulative Preferred Stock (incorporated by reference from our Current Report on Form 8-K filed with the SEC on January 21, 2005) |
| 3.5 | Articles Supplementary for Series B Cumulative Convertible Preferred Stock (incorporated by reference from our Current Report on Form 8-K filed with the SEC on January 30, 2007) |
| 3.6 | Bylaws (incorporated by reference from our Registration Statement on Form S-11, Registration No. 333-38641, which became effective under the Securities Act of 1933 on March 12, 1998) |
| 4.1 | Specimen Common Stock Certificate (incorporated by reference from our Registration Statement on Form S-11, Registration No. 333-38641, which became effective under the Securities Act of 1933 on March 12, 1998) |
| 4.2 | Specimen Series A Cumulative Preferred Stock Certificate (incorporated by reference from our Current Report on Form 8-K filed with the SEC on November 3, 2004) |
| 4.3 | Specimen Series B Cumulative Convertible Preferred Stock Certificate (incorporated by reference from our Current Report on Form 8-K filed with the SEC on January 30, 2007) |
| 4.4 | Specimen Anworth Capital Trust I Floating Rate Preferred Stock Certificate (liquidation amount \$1,000 per Preferred Security) (incorporated by reference from our Current Report on Form 8-K filed with the SEC on March 16, 2006) |
| 4.5 | Specimen Anworth Capital Trust I Floating Rate Common Stock Certificate (liquidation amount \$1,000 per Common Security) (incorporated by reference from our Current Report on Form 8-K filed with the SEC on March 16, 2006) |
| 4.6 | Specimen Anworth Floating Rate Junior Subordinated Note Due 2035 (incorporated by reference from our Current Report on Form 8-K filed with the SEC on March 16, 2006) |
| 4.7 | Junior Subordinated Indenture dated as of March 15, 2005, between Anworth and JPMorgan Chase Bank (incorporated by reference from our Current Report on Form 8-K filed with the SEC on March 16, 2006) |
| 10.1 | 2002 Incentive Compensation Plan (incorporated by reference from our Definitive Proxy Statement filed pursuant to Section 14(a) of the Securities Exchange Act of 1934, as filed with the Securities Exchange Commission on May 17, 2002) |
| 10.2 | 2003 Dividend Reinvestment and Stock Purchase Plan (incorporated by reference from our Registration Statement on Form S-3, Registration No. 333-110744, which became effective under the Act on February 20, 2004) |

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| Exhibit Number | Description |
|-----------------------|--|
| 10.3 | 2004 Equity Compensation Plan (incorporated by reference from our Definitive Proxy Statement filed pursuant to Section 14(a) of the Securities Exchange Act of 1934, as filed with the SEC on April 26, 2004) |
| 10.4 | 2008 Dividend Reinvestment and Stock Purchase Plan (incorporated by reference from our Registration Statement on Form S-3, Registration No. 333-, which became effective under the Act on April 11, 2008) |
| 10.5 | Employment Agreement dated January 1, 2002, between the Manager and Lloyd McAdams (incorporated by reference from our Quarterly Report on Form 10-Q for the quarter ended June 30, 2002, as filed with the SEC on August 14, 2002) as amended by Addenda dated April 18, 2002 (incorporated by reference from our Quarterly Report on Form 10-Q for the quarter ended June 30, 2002, as filed with the SEC on August 14, 2002), May 28, 2004 (incorporated by reference from our Quarterly Report on Form 10-Q for the quarter ended June 30, 2004, as filed with the SEC on August 9, 2004), June 27, 2006 (incorporated by reference from our Current Report on Form 8-K filed with the SEC on June 28, 2006) and February 22, 2008 (incorporated by reference from our Current Report on Form 8-K filed with the SEC on February 27, 2008) |
| 10.6 | Employment Agreement dated January 1, 2002, between the Manager and Heather U. Baines (incorporated by reference from our Quarterly Report on Form 10-Q for the quarter ended June 30, 2002, as filed with the SEC on August 14, 2002) as amended by Addenda dated April 18, 2002 (incorporated by reference from our Quarterly Report on Form 10-Q for the quarter ended June 30, 2002, as filed with the SEC on August 14, 2002), June 27, 2006 (incorporated by reference from our Current Report on Form 8-K filed with the SEC on June 28, 2006) and February 13, 2008 (incorporated by reference from our Current Report on Form 8-K filed with the SEC on February 15, 2008) |
| 10.7 | Employment Agreement dated January 1, 2002, between the Manager and Joseph E. McAdams (incorporated by reference from our Quarterly Report on Form 10-Q for the quarter ended June 30, 2002, as filed with the SEC on August 14, 2002) as amended by Addenda dated April 18, 2002 (incorporated by reference from our Quarterly Report on Form 10-Q for the quarter ended June 30, 2002, as filed with the SEC on August 14, 2002), June 13, 2002 (incorporated by reference from our Quarterly Report on Form 10-Q for the quarter ended June 30, 2002, as filed with the SEC on August 14, 2002), May 28, 2004 (incorporated by reference from our Quarterly Report on Form 10-Q for the quarter ended June 30, 2004, as filed with the SEC on August 9, 2004), June 27, 2006 (incorporated by reference from our Current Report on Form 8-K filed with the SEC on June 28, 2006), February 13, 2008 (incorporated by reference from our Current Report on Form 8-K filed with the SEC on February 15, 2008) and February 22, 2008 (incorporated by reference from our Current Report on Form 8-K filed with the SEC on February 27, 2008) |
| 10.8 | Sublease dated June 13, 2002, between Anworth and PIA (incorporated by reference from our Quarterly Report on Form 10-Q for the quarter ended June 30, 2002, as filed with the SEC on August 14, 2002) as amended by Amendment to Sublease dated July 8, 2003 (incorporated by reference from our Quarterly Report on Form 10-Q for the quarter ended June 30, 2003, as filed with the SEC on August 8, 2003) |
| 10.9 | Administrative Agreement dated October 14, 2002, between Anworth and PIA (incorporated by reference from our Quarterly Report on Form 10-Q for the quarter ended September 30, 2002, as filed with the SEC on November 14, 2002) |
| 10.10 | Deferred Compensation Plan (incorporated by reference from our Annual Report on Form 10-K for the year ended December 31, 2002, as filed with the SEC on March 26, 2003) |
| 10.11 | BT Management Operating Agreement dated November 3, 2003 (incorporated by reference from our Quarterly Report on Form 10-Q for the quarter ended September 30, 2003, as filed with the SEC on November 13, 2003) |

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| Exhibit Number | Description |
|---------------------------|---|
| 10.12 | Management Agreement dated November 3, 2003 between BT Management and Belvedere Trust Mortgage Corporation (incorporated by reference from our Quarterly Report on Form 10-Q for the quarter ended September 30, 2003, as filed with the SEC on November 13, 2003) |
| 10.13 | Purchase Agreement dated as of March 15, 2005, by and among Anworth, Anworth Capital Trust I, TABERNA Preferred Funding I, Ltd., and Merrill Lynch International (incorporated by reference from our Current Report on Form 8-K filed with the SEC on March 16, 2005) |
| 10.14 | Assignment and Assumption of Sublease and Consent of Sublessor dated May 16, 2005 among Belvedere Trust, BT Management Holding Corporation and Keefe, Bruyette & Woods, Inc. (incorporated by reference from our Quarterly Report on Form 10-Q for the quarter ended June 30, 2005, as filed with the Securities and Exchange Commission on August 9, 2005) |
| 10.15 | Guaranty of Sublease dated May 16, 2005 between Anworth and Keefe, Bruyette & Woods, Inc. (incorporated by reference from our Quarterly Report on Form 10-Q for the quarter ended June 30, 2005, as filed with the Securities and Exchange Commission on August 9, 2005) |
| 10.16 | Second Amended and Restated Trust Agreement dated as of September 26, 2005 by and among Anworth, JPMorgan Chase Bank, National Association, Chase Bank USA, National Association, Lloyd McAdams, Joseph E. McAdams, Thad Brown and the several Holders, as defined therein (incorporated by reference to our Annual Report on Form 10-K for the year ended December 31, 2005, as filed with the Securities and Exchange Commission on March 16, 2006) |
| 10.17 | Change in Control and Arbitration Agreement effective June 27, 2006 by and between Anworth Mortgage Asset Corporation and Thad M. Brown (incorporated by reference from our Current Report on Form 8-K filed with the SEC on June 28, 2006) |
| 10.18 | Change in Control and Arbitration Agreement effective June 27, 2006 by and between Anworth Mortgage Asset Corporation and Charles J. Siegel (incorporated by reference from our Current Report on Form 8-K filed with the SEC on June 28, 2006) |
| 10.19 | Change in Control and Arbitration Agreement effective June 27, 2006 by and between Anworth Mortgage Asset Corporation and Evangelos Karagiannis (incorporated by reference from our Current Report on Form 8-K filed with the SEC on June 28, 2006) |
| 10.20 | Change in Control and Arbitration Agreement effective June 27, 2006 by and between Anworth Mortgage Asset Corporation and Bistra Pashamova (incorporated by reference from our Current Report on Form 8-K filed with the SEC on June 28, 2006) |
| 31.1 | Certification of the Chief Executive Officer, as required by Rule 13a-14(a) of the Securities Exchange Act of 1934 |
| 31.2 | Certification of the Chief Financial Officer, as required by Rule 13a-14(a) of the Securities Exchange Act of 1934 |
| 32.1 | Certifications of the Chief Executive Officer provided pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| 32.2 | Certifications of the Chief Financial Officer provided pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

ANWORTH MORTGAGE ASSET CORPORATION

Dated: May 9, 2008

/s/ JOSEPH LLOYD McADAMS
Joseph Lloyd McAdams
Chairman of the Board, President and Chief Executive Officer
(Principal Executive Officer)

Dated: May 9, 2008

/s/ THAD M. BROWN
Thad M. Brown
Chief Financial Officer
(Principal Financial Officer and Principal Accounting Officer)