



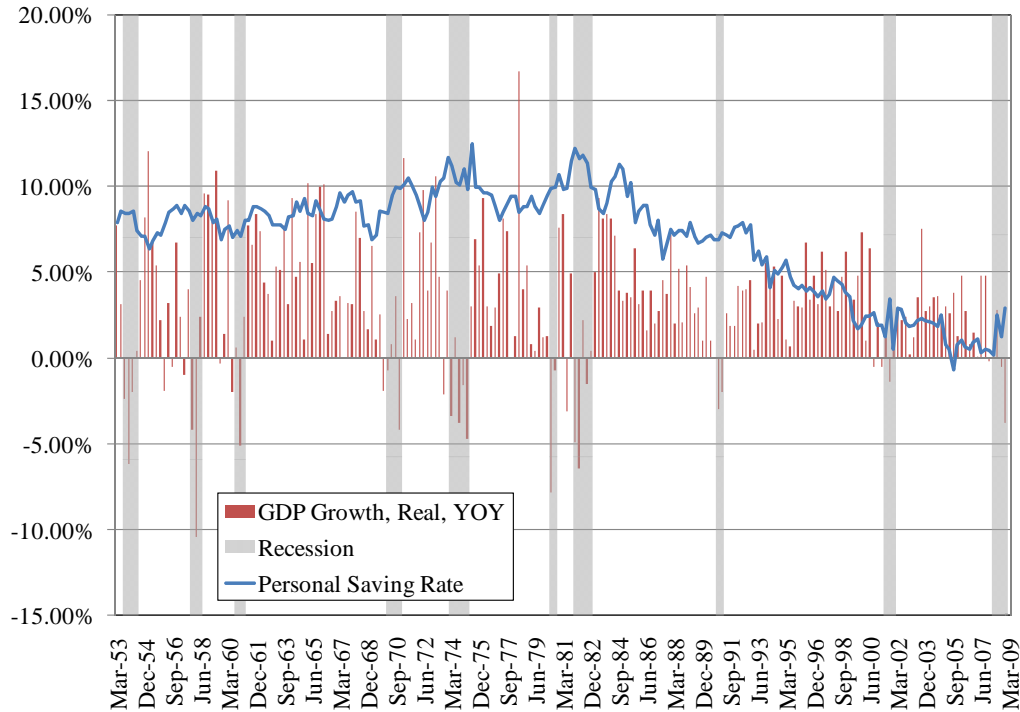
Michael Farrell, Chairman of Annaly, delivered opening remarks to the Company's 2008 fourth quarter earnings call. We reprint those remarks below:

Just Save, Baby, Just Save

As we sit on the precipice of the greatest fiscal stimulus package in our nation's history, the question we are asked most often during our discussions with market participants is "When will it end?" Well, we can't tell you the exact date, but I believe that a precursor will be the stabilization of mortgage cash flows. I can say that with certainty because from where we sit the current instability in the economy began showing its teeth in the mortgage market in 2002 and it will ultimately end once those cash flows stabilize again. When this occurs—at some uncertain future date—property valuations will have found a bottom and new run rates in GDP will have been established.

The sooner this happens, the better; but in the interim, we as a nation will be faced with policies designed to maintain the consumption-driven force of our domestic economy. My view is that this is what got us into this problem in the first place, and it runs counter to what Americans are now doing as rational economic beings—we are reducing consumption and increasing savings. The following is a construct of Newton's principles. For every action, there is an equal and opposite reaction. We are witnessing the reaction of America's primary Gross Domestic Product component, its consumers, as they retrench and repair their own balance sheets.

As the title of these remarks infers, I believe that consumers are embarking on a reversion to the mean of national personal savings as a percentage of disposable personal income, or the savings rate. The average since 1953 has been almost 7%, but with a very sharp downward trend at the end of the subsequent half-century. The average savings rate from 1953 to 1989 was 8%, with peaks over 12% in 1975 and 1982. In the ten years ended December 2008, however, the average has been less than 2%, with a low of minus 2.7% in 2005. In the closing months of 2008, terrified consumers have pushed this rate positive again: The just-released data for December show a savings rate of 3.6%. The average for the 4th quarter is the highest quarterly average since the second quarter of 1999. A rising savings rate is consistent with slower economic growth; according to Merrill Lynch's David Rosenberg, because of multiplier effects every 1% rise in savings takes away about 1.3% in consumer spending. In the mid-1970s and early 1980s, the savings retrenchment led to negative GDP prints as consumers acted to preserve their balance sheets.



Source: Federal Reserve, Bureau of Economic Analysis, Haver Analytics

Encouraging savings to preserve the nation’s fiscal house is exactly what is needed to right the capsized ship of capitalism and truly secure the national interests. As a citizen, one would hope that in its noble rush to save the economy the Obama Administration would also be considering the long term solution of the nation funding its own debt by jump-starting the savings rate instead of the consumption rate. At the same time, I recognize that it would very painful to initiate such a program, as there is clearly no corporate or political constituency for a remedy that virtually guarantees a recession. It would be recognition that the thriftiness of Aesop’s ant is purposeful. It also means fewer cars in the driveway; fewer travel vacations; fewer dollars allocated to private education choices; fewer dinners out; difficult choices about healthcare; smaller homes that are colder in winter and warmer in summer; fewer ‘must have’ electronic toys; delayed retirements and, in general, tougher choices about personal disposable incomes to the detriment of consumption-based and export-based economies.

Tough as it may be to sell this policy agenda, I submit that it is what the country needs to do to secure its future. Our policy makers, given the information that they now have about the mess that has been created should include a savings incentive in order to accelerate the long term healing process for the United States. History has shown us that the people will choose this route of their own accord when faced with the uncertainty of job losses, stagnant income and declining values in financial assets. The generation that lived through the Great Depression had, as economists at JP Morgan called it, “a precautionary saving motive.” For the past decade Americans haven’t had that motive, and accordingly have reduced their savings rate for a number of reasons—the rising value of financial assets, easy access to credit and the economic stability of “The Great Moderation.” Today, these reasons are gone. We are increasing our savings so we can repair the hole in our personal balance sheets which, through the third quarter of 2008, is a cumulative \$7 trillion decline from the peak. My argument is the faster that we get there the faster the repair process will begin. Perhaps tax incentives can be added to accelerate the process. To



strategically direct the increased savings, the tax benefit can be structured to target investment in the public or private sector.

We should set a national target personal savings rate of 15% to provide the balance required to properly value and control our domestic economy. The increase to 15% amounts to a diversion of about \$1.2 trillion in personal savings away from consumption, or a little more than the size of the proposed stimulus package. Our national security interests are at stake here, not simply the price of our standard of living. We all sense that higher taxes are coming at the Federal and municipal levels. Entitlements are going to be renegotiated. Social Security will be reformatted to reflect the fact that we are living longer and the pool of payers is shrinking. Medicare/Medicaid and healthcare will be restructured to a socialist model. But, we still need to pay for it. At this point in the economic cycle, savers are the key to survival, not consumers. With this in place, the America of the immediate future will look, at best, a lot like the America of the 1950's. If we truly think that there is a short term solution via consumption then we deserve our fate. The long term view and solutions are much harder to take in the short run, but if Americans are incentivized to save their stimulus checks rather than spend them, it would help provide structurally sustainable fiscal health in the long run. This would position the country to win the economic war rather than the current battle.

The answer is that we need to swallow the full tablespoon of medicine or, to paraphrase Al Davis, the legendary owner of the Oakland Raiders, "Just save, baby."

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