



*Michael Farrell, Chairman of Annaly, delivered opening remarks to the Company's 2009 first quarter earnings call. We reprint those remarks below:*

### **You Can't Always Get What You Want Or How To Learn To Love The New Economy**



In the early years of my life, when someone got a new car it was a big event in our neighborhood. We heard about the visit to the dealer, the discussion about the picking of desired colors and features and the projected delivery date. The anticipation was almost as exciting as waiting for a new baby! On the scheduled delivery date, as the proud owner drove his car home, all the neighbors gathered by the curb, waiting to greet the new addition. It was customary, in some neighborhoods, to throw loose change onto the passenger side floor for good luck and make a wish for a long happy life together. Every family was linked to a manufacturer. We often heard at family gatherings that grandpa was a Buick man, Uncle Joe was a Ford acolyte and Aunt Betty loved her Dodge Dart more than she loved her late husband.

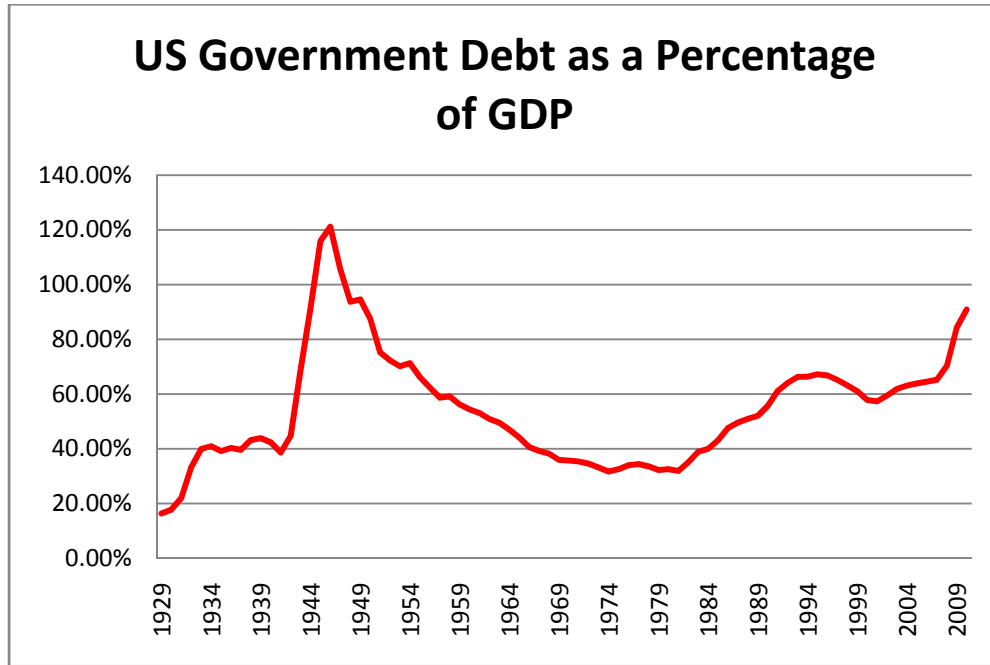
One home was enough for most families. Second mortgages were whispered scandals, best discussed in the corners of living rooms. "Oh my Gosh, Bill and Sue took out a second mortgage on their home!" This was a true early warning signal of financial ruin.

People never moved. Young adults lived at home longer, married earlier, rented and saved and only then began to acquire and build their nests. The mobility ascribed to America's workers didn't really take hold until the late 1960s, mostly, in my view, as a byproduct of the youthful rebellion against social, economic and political stagnancy. Exhausted by the uncertainties of the 1930s and 1940s, the older generation just felt lucky to be alive and they settled in to a time of saving, preservation of capital and lowered expectations as consumers. The Baby Boomers, on the other hand, were ready to move out and up. Not only were they eager to pursue the American Dream, but they were adapting to a much higher degree of comfort with the use of credit to attain it. And our country and its financial institutions were much more obliging, too, understanding the growth potential in the democratization of credit and the socialization of risk.

We know now how this story has turned out, but where do we go from here? During recent discussions with investors, we have suggested that one possible outcome is for the US economy to



look a lot like the 1950s. In the attached chart we show how the percentage of US debt to Gross Domestic Product has evolved over the past 60 years.



Sources: Haver Analytics/US Treasury Department, Bureau of Economic Analysis; 2009 and 2010 estimates from the Congressional Budget Office.

As the chart demonstrates, during the Eisenhower years, real progress was made in reducing the high relative debt levels of the war years, and also in planting the seeds for a new kind of consumption-based economy. So much so that in the Kennedy administration, tax codes were relaxed and the private economy began to supplant the public economy. The impact of this was so dramatic that up until the record-setting 120 month expansion of 1991 to 2001, the longest expansion on record was the 106-month trough to peak of February 1961 to December 1969. By the time LBJ became president, he was already prepared to spend the prosperity generated by this growth on his vision of the “Great Society”. Since those days, private sector debt growth—mortgages, credit cards, car loans, second liens, fueled by continuously dilutive underwriting standards—totally rebalanced the composition of private/public sector debt and created a new weighting of GDP where consumers represented 70% of domestic growth and 20% of global growth. We are now experiencing the transition back to a greater composition of government borrowings as a percentage of total outstanding debt. It isn’t over yet, and it will continue for the foreseeable future.

So what will the new America look like? The Rolling Stones summed it up in their 1970’s hit, “You can’t always get what you want”. Inventory on demand is a thing of the past. Operating margins will be defended by managing inventories on an order by order basis. The new car, when purchased, will take weeks to ship from wherever it is being assembled. Deflationary price discovery and distribution will dominate the economic landscape; it is no surprise to me that Amazon.com, the online shopping marvel, continues to outperform.



The US went through this in the post World War II/Korean War economy. Its framework may sound familiar to you. Low front end interest rates. Quantitative easing across the yield curve, especially in the longer maturities. Large drops in GDP while the wartime enterprises reengineered themselves for the coming consumer boom. Inflation was subdued, except for brief episodes of supply/demand shocks. Equity markets that were largely range bound for years exploded upwards in the mid-1950s as the transition to consumers took hold. The Dow Jones Industrials didn't break the 1929 high of 381 until the end of 1954, but almost doubled to 680 by the end of 1959. We may not be coming out of a guns-and-bombs war-time experience, but I doubt anyone will disagree that the resources of our government and the private sector are most definitely fighting a war.

For those of you reading this on our website, please note the "I Like Ike" button at the top of the page. The reason for the button is the determined hope by this observer that legislators, regulators and our political leaders see the reality and push down hard on the disciplines and policies needed to stabilize and emerge from this traumatic transition we are currently experiencing. The transition to the new era is always painful for those caught up and invested in old era business models. Stabilization at this point would be good, but not a sign that the worst is over. Like the older generation in the 1950s, the current generation is exhausted, spent out and settling into lowered expectations.

When will the new Woodstock generation emerge? We'll discuss that in the next quarter's earnings call, when we answer the question: "Who is John Galt?"

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