

Ellington Financial LLC
Form 10-K
March 14, 2012
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2011

OR

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

For the transition period from to .
Commission file number 001-34569

Ellington Financial LLC

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(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	26-0489289 (IRS Employer Identification No.)
53 Forest Avenue Old Greenwich, CT (Address of principal executive offices)	06870 (Zip Code)
(203) 698-1200 (Registrant's telephone number, including area code)	

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common shares representing limited liability company interests, no par value	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☐ No ☒

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes ☐ No ☒

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☐

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

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Large accelerated filer ☐ Accelerated filer ☒
Non-accelerated filer ☐ (Do not check if a smaller reporting company) Smaller reporting company ☐
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

As of June 30, 2011, the last business day of the Registrant's most recently completed second fiscal quarter, the aggregate market value of the registrant's common shares held by non-affiliates was \$281,802,665 based on the closing price as reported on the New York Stock Exchange on that date.

Number of the registrant's common shares outstanding as of March 9, 2012: 16,447,651

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive Proxy Statement with respect to its 2012 Annual Meeting of Shareholders to be filed not later than 120 days after the end of the registrant's fiscal year are incorporated by reference into Part III hereof as noted therein.

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ELLINGTON FINANCIAL LLC

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PART I

Item 1. Business

Except where the context suggests otherwise, EFC, we, us and our refer to Ellington Financial LLC and its subsidiaries, our Manager refers to Ellington Financial Management LLC, our external manager, and Ellington refers to Ellington Management Group, L.L.C. and its affiliated investment advisory firms, including our Manager, and Manager Group refers collectively to Ellington and its principals (including family trusts established by the foregoing) and entities in which 100% of the interests are beneficially owned by the foregoing. In certain instances, references to our Manager and services to be provided to us by our Manager may also include services provided by Ellington and its other affiliates from time to time.

Special Note Regarding Forward-Looking Statements

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

Forward-looking statements are based on our beliefs, assumptions and expectations of our future performance, taking into account all information currently available to us. These beliefs, assumptions and expectations are subject to risks and uncertainties and can change as a result of many possible events or factors, not all of which are known to us. If a change occurs, our business, financial condition, liquidity and results of operations may vary materially from those expressed or implied in our forward-looking statements. The following factors are examples of those that could cause actual results to vary from our forward-looking statements: changes in interest rates and the market value of our securities; changes in the prepayment rates on the mortgage loans underlying our agency securities; our ability to borrow to finance our assets; changes in government regulations affecting our business; our ability to maintain our exemption from registration under the Investment Company Act of 1940, as amended (the Investment Company Act); and risks associated with investing in real estate assets, including changes in business conditions and the general economy. These and other risks, uncertainties and factors, including the risk factors described under Item 1A of this Annual Report on Form 10-K, could cause our actual results to differ materially from those projected or implied in any forward-looking statements we make. All forward-looking statements speak only as of the date on which they are made. New risks and uncertainties arise over time and it is not possible to predict those events or how they may affect us. Except as required by law, we are not obligated to, and do not intend to, update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Our Company

Ellington Financial LLC is a specialty finance company formed in August 2007 that specializes in acquiring and managing mortgage-related assets. Our primary objective is to generate attractive, risk-adjusted total returns for our shareholders by making investments that we believe compensate us appropriately for the risks associated with them. We seek to attain this objective by utilizing an opportunistic strategy. Our targeted assets currently include:

residential mortgage-backed securities, or RMBS, backed by prime jumbo, Alternative A-paper, or Alt-A, manufactured housing and subprime residential mortgage loans, or non-Agency RMBS ;

RMBS for which the principal and interest payments are guaranteed by a U.S. Government agency or a U.S. Government-sponsored entity, or Agency RMBS ;

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mortgage-related derivatives;

commercial mortgage-backed securities, or CMBS, commercial mortgage loans and other commercial real estate debt; and

corporate debt and equity securities and derivatives.

We also may opportunistically acquire and manage other types of mortgage-related assets and financial assets, such as residential whole mortgage loans, asset-backed securities, or ABS, backed by consumer and commercial assets, non-mortgage-related derivatives and real property.

We believe that we have been organized and have operated so that we have qualified, and will continue to qualify, to be treated for U.S. federal income tax purposes as a partnership and not as an association or a publicly traded partnership taxable as a corporation.

Our Manager and Ellington

We are externally managed and advised by our Manager, an affiliate of Ellington, pursuant to a management agreement. Our Manager was formed solely to serve as our manager and does not have any other clients. In addition, our Manager currently does not have any employees and instead relies on the employees of Ellington to perform its obligations to us. Ellington is an investment management firm and registered investment advisor with a 17-year history of investing in a broad spectrum of mortgage-backed securities, or MBS, and related derivatives.

The members of our management team include Michael Vranos, founder and Chief Executive Officer of Ellington, who serves as our Co-Chief Investment Officer and a member of our Board of Directors, Laurence Penn, Vice Chairman of Ellington, who serves as our Chief Executive Officer and President and a member of our Board of Directors, Mark Tecotzky, a Managing Director of Ellington, who serves as our Co-Chief Investment Officer, Lisa Mumford, who serves as our dedicated Chief Financial Officer, and Daniel Margolis, General Counsel of Ellington, who serves as our Secretary. Each of these individuals is an officer of our Manager. We currently do not have any employees.

Our Manager is responsible for administering our business activities and day-to-day operations and, pursuant to a services agreement between our Manager and Ellington, relies on the resources of Ellington to support our operations. Ellington has established portfolio management resources for each of our targeted asset classes and an established infrastructure supporting those resources. Through our relationship with our Manager, we benefit from Ellington's highly analytical investment processes, broad-based deal flow, extensive relationships in the financial community, financial and capital structuring skills, investment surveillance database and operational expertise. Ellington's analytic approach to the investment process involves collection of substantial amounts of data regarding historical performance of MBS collateral and MBS market transactions. Ellington analyzes this data to identify possible trends and develops financial models used to support the investment and risk management process. In addition, throughout Ellington's 17-year history of investing in MBS and related derivatives, it has developed strong relationships with a wide range of dealers and other market participants that provide Ellington access to a broad range of trading opportunities and market information. In addition, our Manager provides us with access to a wide variety of asset acquisition and disposition opportunities and information that assist us in making asset management decisions across our targeted asset classes, which we believe provides us with a significant competitive advantage. We also benefit from Ellington's finance, accounting, operational, legal, compliance and administrative functions.

As of December 31, 2011, Ellington employed over 100 employees and had assets under management of approximately \$3.7 billion, of which approximately \$2.8 billion comprised our company and various alternative investment vehicles, including hedge funds and various private accounts, and of which approximately \$0.9 billion comprised accounts with more traditional mandates.

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Our Strategy

We utilize an opportunistic strategy to seek to provide investors with attractive, risk-adjusted total returns by:

taking advantage of opportunities in the residential mortgage market by purchasing investment grade and non-investment grade non-Agency RMBS, including senior and subordinated securities;

acquiring Agency RMBS on a more leveraged basis in order to take advantage of opportunities in that market sector and assist us in maintaining our exclusion from regulation as an investment company under the Investment Company Act;

acquiring CMBS, commercial mortgage loans and other commercial real estate debt instruments;

opportunistically entering into and managing a portfolio of mortgage-related derivatives;

opportunistically acquiring and managing other mortgage-related and financial assets, such as residential whole mortgage loans, ABS backed by consumer and commercial assets and non-mortgage-related derivatives;

opportunistically acquiring real estate such as single and multi-family residential properties; and

opportunistically mitigating our credit and interest rate risk by using a variety of hedging instruments.

Our strategy is adaptable to changing market environments, subject to compliance with the income and other tests that will allow us to continue to be treated as a partnership for U.S. federal income tax purposes and to maintain our exclusion from regulation as an investment company under the Investment Company Act. As a result, although we focus on the assets described above, our acquisition and management decisions depend on prevailing market conditions and our targeted asset classes may vary over time in response to market conditions. We may engage in a high degree of trading volume as we implement our strategy. Our Manager is authorized to follow very broad investment guidelines and, as a result, we cannot predict our portfolio composition. We may change our strategy and policies without a vote of our shareholders. Moreover, although our independent directors periodically review our investment guidelines and our portfolio, they generally do not review our proposed asset acquisitions or asset management decisions.

Ellington's investment philosophy revolves around the pursuit of value across various types of MBS and related assets. Ellington seeks investments across a wide range of MBS sectors without any restriction as to ratings, structure or position in the capital structure. Over time and through market cycles, opportunities will present themselves in varying sectors and in varying forms. For example, in the wake of the financial crisis, the liquidations of MBS from structured vehicles, distressed and or capital-constrained financial institutions as well as from U.S. Government portfolios have been significant sources of asset acquisition opportunities. By rotating between and allocating among various sectors of the MBS markets and adjusting the extent to which it hedges, Ellington believes that it is able to capitalize on the disparities between these sectors as well as on overall trends in the marketplace, and therefore provide better and more consistent returns for its investors. Disparities between MBS sectors vary from time to time and are driven by a combination of factors. For example, as various MBS sectors fall in and out of favor, the relative yields that the market demands for those sectors may vary. In addition, Ellington's performance projections for certain sectors may differ from those of other market participants and such disparities will naturally cause us, from time to time, to gravitate towards certain sectors and away from others. Disparities between MBS sectors may also be driven by differences in collateral performance (for example, subprime loans originated before 2005 have generally performed better than subprime loans originated between 2005 and 2007) and in the structure of particular investments (for example, in the timing of cash flow or the level of credit enhancement), and our Manager may believe that other market participants are overestimating or underestimating the value of these differences. Furthermore, we believe that risk management, including opportunistic portfolio hedging and prudent financing and liquidity management, is essential for consistent generation of attractive, risk-adjusted total returns across market cycles.

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Ellington's continued emphasis on and development of proprietary MBS credit, interest rate and prepayment models, as well as other proprietary research and analytics, underscores the importance it places on a disciplined

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and analytical approach to fixed income investing, especially in MBS. Our Manager uses Ellington's proprietary models to identify attractive assets, value these assets, monitor and forecast the performance of these assets, and opportunistically hedge our credit and interest rate risk. We leverage these skills and resources to seek to meet our objectives.

We believe that our Manager is uniquely qualified to implement our strategy. Our strategy is consistent with Ellington's investment approach, which is based on its distinctive strengths in sourcing, analyzing, trading and hedging complex MBS. Furthermore, we believe that Ellington's extensive experience in buying, selling, analyzing and structuring fixed income securities, coupled with its broad access to market information and trading flows, provides us with a steady flow of opportunities to acquire assets with favorable trade executions.

We also employ a wide variety of hedging instruments and derivative contracts. See Risk Management.

Our Targeted Asset Classes

Our targeted asset classes currently include:

Asset Class	Principal Assets
Non-Agency RMBS	<p>RMBS backed by prime jumbo, Alt-A, manufactured housing and subprime mortgages;</p> <p>RMBS backed by fixed rate mortgages, ARMs, Option-ARMs and Hybrid ARMs;</p> <p>RMBS backed by first lien and second lien mortgages;</p> <p>Investment grade and non-investment grade securities;</p> <p>Senior and subordinated securities; and</p> <p>Interest only securities, or IOs, principal only securities, or POs, inverse interest only securities, or IIOs, and inverse floaters.</p>
Agency RMBS	<p>Whole pool pass-through certificates;</p> <p>Agency collateralized mortgage obligations, or CMOs, including IOs; and</p> <p>To-Be-Announced mortgage pass-through certificates, or TBAs.</p>
Mortgage-Related Derivatives	<p>Credit default swaps on individual RMBS, on the ABX, CMBX and PrimeX indices and on other mortgage-related indices; and</p> <p>Other mortgage-related derivatives.</p>
CMBS and Commercial Mortgage Loans	<p>CMBS; and</p> <p>Commercial mortgages and other commercial real estate debt.</p>
Corporate Debt and Equity Securities and Derivatives	<p>Credit default swaps on corporations or on corporate indices;</p> <p>Corporate debt or equity securities; and</p> <p>Options or total return swaps on corporate equity or on corporate equity indices.</p>
Other	<p>Residential whole mortgage loans;</p> <p>ABS, including CDOs;</p> <p>Other non-mortgage-related derivatives; and</p> <p>Real estate including single and multi-family residential properties.</p>

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The following briefly discusses the principal types of assets we purchase.

Non-Agency RMBS

We acquire non-Agency RMBS backed by prime jumbo, Alt-A, manufactured housing and subprime residential mortgage loans. Our non-Agency RMBS holdings can include investment-grade and non-investment grade classes, including the BB-rated, B-rated and non-rated classes.

Non-Agency RMBS are debt obligations issued by private originators of or investors in residential mortgage loans. Non-Agency RMBS generally are issued as CMOs and are backed by pools of whole mortgage loans or by mortgage pass-through certificates. Non-Agency RMBS generally are securitized in senior/subordinated structures, or in excess spread/over-collateralization structures. In senior/subordinated structures, the subordinated tranches generally absorb all losses on the underlying mortgage loans before any losses are borne by the senior tranches. In excess spread/over-collateralization structures, losses are first absorbed by any existing over-collateralization, then borne by subordinated tranches and excess spread, which represents the difference between the interest payments received on the mortgage loans backing the RMBS and the interest due on the RMBS debt tranches, and finally by senior tranches and any remaining excess spread.

Agency RMBS

Our assets in this asset class consist primarily of whole pool pass-through certificates, the principal and interest of which are guaranteed by Fannie Mae, Freddie Mac, or Ginnie Mae, and which are backed by ARMs, hybrid ARMs or fixed-rate mortgages. Mortgage pass-through certificates are securities representing undivided interests in pools of mortgage loans secured by real property where payments of both interest and principal, plus pre-paid principal, on the securities are made monthly to holders of the security, in effect passing through monthly payments made by the individual borrowers on the mortgage loans that underlie the securities, net of fees paid to the issuer/guarantor and servicers of the securities. Whole pool pass-through certificates are mortgage pass-through certificates that represent the entire ownership of (as opposed to merely a partial undivided interest in) a pool of mortgage loans.

TBAs

In addition to investing in specific pools of Agency RMBS, we utilize forward-settling purchases and sales of Agency RMBS where the underlying pools of mortgage loans are TBAs. Pursuant to these TBA transactions, we agree to purchase or sell, for future delivery, Agency RMBS with certain principal and interest terms and certain types of underlying collateral, but the particular Agency RMBS to be delivered is not identified until shortly before the TBA settlement date. TBAs are liquid and have quoted market prices and represent the most actively traded class of MBS. We use TBAs primarily for hedging purposes. TBA trading is based on the assumption that mortgage pools that are eligible to be delivered at TBA settlement are fungible and thus the specific mortgage pools to be delivered do not need to be explicitly identified at the time a trade is initiated.

We primarily engage in TBA transactions for purposes of managing certain risks associated with our long Agency RMBS and, to a lesser extent, our non-Agency RMBS. The principal risks that we use TBAs to mitigate are interest rate and yield spread risks. For example, we may hedge the interest rate and/or yield spread risk inherent in our long Agency RMBS by taking short positions in TBAs that are similar in character. Alternatively, we may engage in TBA transactions because we find them attractive on their own, from a relative value perspective or otherwise.

Mortgage-Related Derivatives

We take long and short positions in various mortgage-related derivative instruments, including credit default swaps. A credit default swap is a credit derivative contract in which one party (the protection buyer) pays an ongoing periodic premium (and often an upfront payment as well) to another party (the protection seller) in

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return for compensation for default (or similar credit event) by a reference entity. In this case, the reference entity can be an individual MBS or an index of several MBS, such as an ABX Index, PrimeX or a CMBX Index. Payments from the protection seller to the protection buyer typically occur if a credit event takes place; a credit event may be triggered by, among other things, the reference entity's failure to pay its principal obligations or a severe ratings downgrade of the reference entity.

CMBS

CMBS are mortgage-backed securities collateralized by loans on commercial properties. The majority of CMBS issued are fixed rate securities backed by fixed rate loans made to multiple borrowers on a variety of property types, though single-borrower CMBS and floating-rate CMBS have also been issued.

The majority of CMBS utilize senior/subordinate structures, similar to those found in non-Agency RMBS. Subordination levels vary so as to provide for one or more AAA credit ratings on the most senior classes, with less senior securities rated investment grade and non-investment grade, including a first loss component which is typically unrated.

Commercial Mortgage Loans and Other Commercial Real Estate Debt

Commercial mortgage loans are loans secured by liens on commercial properties, including retail, office, industrial, hotel and multifamily properties. Loans may be fixed or floating rate and will generally range from two to ten years. Commercial real estate debt typically limits the borrower's right to freely prepay for a period of time through provisions such as prepayment fees, lockout, yield maintenance or defeasance provisions.

First lien loans may be structured as whole loans, or alternatively bifurcated into a senior participation interest (A-Note) and a subordinated participation interest (B-Note). The rights of an A-Note or B-Note holder are typically governed by an intercreditor agreement which sets forth the respective rights and obligations of the holders, with the B-Note's entitlement to principal and interest subordinated to that of the A-Note.

A subordinate loan may be structured simply as a second mortgage, or alternatively as a mezzanine loan, which is a loan secured by the pledge of the borrower's ownership interests in the property, and therefore subordinate to any mortgage loan but senior to the borrower's equity in the property. An intercreditor agreement typically governs the rights of a second mortgage or mezzanine loan relative to a first mortgage loan, with the second mortgage loan's or mezzanine loan's entitlement to interest and principal subordinated to that of the first mortgage loan.

Commercial real estate loans may also be structured into more complicated senior/subordinate structures, including those providing for multiple B-Note or multiple mezzanine loan senior/subordinate components. A loan or a component of a loan may have only one lender, or pari passu participation interests may be issued to multiple lenders. Loans are generally privately negotiated, and so structures can vary based on the specific facts and circumstances relating to the loan, property and borrower, among other things.

Commercial mortgage loans are sometimes made for the acquisition, renovation or redevelopment of a property. These loans are typically shorter term loans, or bridge loans.

Corporate Debt and Equity Securities and Derivatives

For hedging purposes, we take short positions in corporate debt and equity (including indices on corporate debt and equity) by entering into derivative contracts such as credit default swaps, total return swaps and options. These are generally not hedges against risks that are directly related to specific corporate entities. Rather, these hedges reference corporations (such as financial institutions that have substantial mortgage-related exposure) or indices whose performance we believe may have a reasonable degree of correlation with the performance of our portfolio. Given this correlation, a short position with respect to such corporations or indices provides a hedge to our portfolio of MBS as a whole.

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A credit default swap is a derivative contract in which one party (the protection buyer) pays an ongoing periodic premium (and often an upfront payment as well) to another party (the protection seller) in return for compensation upon the occurrence of a credit event with respect to the corporation or index referenced by such derivative contract. A credit event relating to a credit default swap on an individual corporation or an index of corporate names would typically be triggered by a corporation's bankruptcy or failure to make scheduled payments in respect of debt obligations. A total return swap is a derivative whereby one party makes payments to the other representing the total return on a reference debt or equity security (or index of debt or equity securities) in exchange for an agreed upon ongoing periodic premium. An equity option is a derivative that gives the holder the option to buy or sell an equity security or index of securities at a predetermined price within a certain time period. The option may reference the equity of a publicly traded company or an equity index. In addition to general market risk, our derivatives on corporate debt and equity securities are subject to risks related to the underlying corporate entities.

Other Assets

We also may from time to time opportunistically acquire other mortgage-related and financial assets that may include, among others: residential whole mortgage loans, ABS backed by consumer and commercial assets and real property. In the first quarter of 2012, our independent directors approved a change to our investment guidelines in order to allow us to opportunistically acquire real property interests such as single family and multifamily residential properties. As of the date of this Annual Report on Form 10-K, we have not acquired any such properties but we are exploring the possibility of doing so in the future, particularly with respect to foreclosure properties that we would acquire and hold for appreciation and/or rental income.

Our Portfolio

As of December 31, 2011, our investment portfolio consisted of the following:

(In thousands)

Asset Class	Cost / (Proceeds)	Fair Value	Fair Value as a Percentage of Shareholders Equity
Non-Agency MBS and Commercial Mortgage Loans:			
Non-Agency RMBS	\$ 444,585	\$ 417,533	112.58%
Non-Agency CMBS and Commercial Mortgage Loans	23,856	20,493	5.52%
Agency RMBS:			
Agency RMBS-other than TBAs	723,926	732,311	197.43%
Agency RMBS-TBAs	31,845	32,033	8.64%
Agency RMBS-TBAs Sold Short	(443,893)	(446,707)	(120.43)%
Repurchase Agreements	15,750	15,750	4.24%
U.S. Treasury Securities	9,991	10,113	2.72%
U.S. Treasury Securities Sold Short	(15,120)	(15,687)	(4.23)%
Total	\$ 790,940	\$ 765,839	206.47%

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As of December 31, 2011, our derivatives portfolio consisted of the following:

(In thousands)

Asset Class	Notional Value	Fair Value	Fair Value as a Percentage of Shareholders Equity
Long Positions:			
Credit Default Swaps on Asset Backed Indices ⁽¹⁾	\$ 22,615	\$ (9,548)	(2.58)%
Interest Rate Swaps ⁽²⁾	4,500	68	0.02%
Short Positions:			
Credit Default Swaps on Asset Backed Securities ⁽³⁾	(74,787)	61,498	16.58%
Credit Default Swaps on Asset Backed Indices ⁽³⁾	(82,642)	40,303	10.87%
Credit Default Swaps on Corporate Bond Indices ⁽³⁾	(106,500)	963	0.26%
Interest Rate Swaps ⁽⁴⁾	(305,400)	(17,191)	(4.64)%
Total Return Swaps ⁽⁵⁾	(20,571)	(274)	(0.07)%
Eurodollar Futures ⁽⁶⁾	(147,000)	12	0.00%
Total	\$ (709,785)	\$ 75,831	20.44%

(1) Long positions using credit default swaps represent transactions where we sold protection to the counterparty.

(2) For long positions in interest rate swaps, a floating rate is being paid and a fixed rate is being received.

(3) Short positions using credit default swaps represent transactions where we purchased protection from a counterparty.

(4) For short positions in interest rate swaps, a fixed rate is being paid and a floating rate is being received.

(5) Notional value represents the number of underlying shares or par value times the closing price of the underlying security.

(6) Every \$1,000,000 in notional value represents one contract.

The table below shows the credit rating categories from Moody's, Standard and Poor's or Fitch Rating Ltd., for our long investment portfolio as of December 31, 2011, excluding IOs and other similar securities with a fair value of \$12.8 million, but including our long investments that were unrated but affiliated with Fannie Mae, Freddie Mac, or Ginnie Mae, including TBAs. Ratings tend to be a lagging credit indicator; as a result, the credit quality of our long investment holdings may be lower than the credit quality implied based on the ratings listed below. In situations where an investment has a split rating, the lowest provided rating is used.

(In thousands)

Ratings Description	Current Principal	Fair Value	Average Price	Fair Value as a Percentage of Shareholders Equity
U.S. Treasury Securities	\$ 10,000	\$ 10,113	\$ 101.13	2.72%
Unrated but Agency-Guaranteed	709,703	759,007	106.95	204.63%
Aaa/AAA/AAA	6,022	4,646	77.16	1.25%
Aa/AA/AA	10,344	6,978		