ANWORTH MORTGAGE ASSET CORP
Form 10-Q
May 03, 2011
Table of Contents

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, 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 001-13709

ANWORTH MORTGAGE ASSET CORPORATION

(Exact name of registrant as specified in its charter)

MARYLAND	**52-2059785**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
1299 Ocean Avenue, Second Floor, Santa Monica, California	**90401**
(Address of principal executive offices)	**(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 such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

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

Large Accelerated Filer	x	Accelerated Filer	¨
Non-Accelerated Filer	¨ (Do not check if a smaller reporting company)	Smaller Reporting Company	¨

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

At May 2, 2011, the registrant had 126,533,060 shares of common stock issued and outstanding.

Table of Contents

ANWORTH MORTGAGE ASSET CORPORATION

FORM 10-Q

INDEX

Table of Contents

ANWORTH MORTGAGE ASSET CORPORATION AND SUBSIDIARIES

Part I. FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements

ANWORTH MORTGAGE ASSET CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(in thousands, except per share amounts)

	March 31, 2011 (unaudited)	December 31, 2010
ASSETS		
Agency MBS:		
Agency MBS pledged to counterparties at fair value	$ 7,323,431	$ 6,762,763
Agency MBS at fair value	803,822	957,316
Paydowns receivable	15,469	14,579
	8,142,722	7,734,658
Non-Agency MBS:		
Non-Agency MBS at fair value	3,990	4,394
Cash and cash equivalents	4,307	10,621
Interest and dividends receivable	28,254	27,097
Derivative instruments at fair value	13,462	8,828
Prepaid expenses and other	3,712	4,617
Total Assets:	$ 8,196,447	$ 7,790,215
LIABILITIES AND STOCKHOLDERS EQUITY		
Liabilities:		
Accrued interest payable	$ 19,659	$ 20,585
Repurchase agreements	6,920,000	6,375,000
Junior subordinated notes	37,380	37,380
Derivative instruments at fair value	55,334	70,557
Dividends payable on Series A Preferred Stock	1,011	1,011
Dividends payable on Series B Preferred Stock	492	430
Dividends payable on common stock	31,308	26,574
Payable for securities purchased	192,059	363,820
Accrued expenses and other	2,282	947
Total Liabilities:	$ 7,259,525	$ 6,896,304
Series B Cumulative Convertible Preferred Stock: par value $0.01 per share; liquidating preference $25.00 per share ($31,462 and $27,525, respectively); 1,258 and 1,101 shares issued and outstanding at March 31, 2011 and December 31, 2010, respectively	$ 29,395	$ 25,630
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 at March 31, 2011 and	$ 45,397	$ 45,397

December 31, 2010, respectively		
Common Stock: par value $0.01 per share; authorized 200,000 shares, 124,089 and 120,901 issued and outstanding at March 31, 2011 and December 31, 2010, respectively	1,241	1,209
Additional paid-in capital	1,075,898	1,053,959
Accumulated other comprehensive income consisting of unrealized losses and gains	41,371	22,444
Accumulated deficit	(256,380)	(254,728)
Total Stockholders Equity:	$ 907,527	$ 868,281
Total Liabilities and Stockholders Equity:	$ 8,196,447	$ 7,790,215

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, 2011	Three Months Ended March 31, 2010
Interest income:		
Interest on Agency MBS	$ 56,901	$ 61,151
Interest on Non-Agency MBS	45	48
Other income	11	9
	56,957	61,208
Interest expense:		
Interest expense on repurchase agreements	22,112	23,699
Interest expense on junior subordinated notes	319	305
	22,431	24,004
Net interest income	34,526	37,204
Recovery on Non-Agency MBS	218	0
Expenses:		
Compensation, incentive compensation and benefits	(2,861)	(3,198)
Other expenses	(723)	(757)
Total expenses	(3,584)	(3,955)
Net income	31,160	33,249
Dividend on Series A Cumulative Preferred Stock	(1,011)	(1,011)
Dividend on Series B Cumulative Convertible Preferred Stock	(492)	(430)
Net income to common stockholders	$ 29,657	$ 31,808
Basic earnings per common share	$ 0.24	$ 0.27
Diluted earnings per common share	$ 0.24	$ 0.27
Basic weighted average number of shares outstanding	121,914	116,755
Diluted weighted average number of shares outstanding	126,205	120,316

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 Par Value	Common Stock Par Value	Additional Paid-In Capital	Accum. Other Comp. Income Agency MBS	Accum. Other Comp. Income Non-Agency MBS	Accum. Other Comp. (Loss) Derivatives	Accum. (Deficit)	Comp. Income (Loss)	Total
Balance, December 31, 2010	1,876	120,901	$ 45,397	$ 1,209	$ 1,053,959	$ 80,945	$ 3,705	$ (62,206)	$ (254,728)		$ 868,281
Issuance of common stock		3,188		32	21,869						21,901
Other comprehensive income (loss), fair value adjustments and reclassifications						(1,074)	79	19,921		18,926	18,926
Net income									31,160	31,160	31,160
Comprehensive loss										$ 50,086	
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									(492)		(492)
Dividend declared - $0.25 per common share									(31,308)		(31,308)
Balance, March 31, 2011	1,876	124,089	$ 45,397	$ 1,241	$ 1,075,898	$ 79,871	$ 3,784	$ (42,285)	$ (256,379)		$ 907,527

See accompanying notes to unaudited consolidated financial statements.

ANWORTH MORTGAGE ASSET CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

	Three Months Ended March 31, 2011	Three Months Ended March 31, 2010
Operating Activities:		
Net income	$ 31,160	$ 33,249
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Amortization of premium and discounts (Agency MBS)	12,213	12,340
Amortization of restricted stock	70	70
Changes in assets and liabilities:		
(Increase) decrease in interest receivable	(1,157)	1,689
Decrease (increase) in prepaid expenses and other	905	(593)
(Decrease) in accrued interest payable	(863)	(1,330)
(Decrease) increase in accrued expenses and payables for securities purchased	(170,425)	98,779
Net cash (used in) provided by operating activities	$ (128,097)	$ 144,204
Investing Activities:		
Available-for-sale Agency MBS:		
Purchases	$ (862,433)	(530,195)
Principal payments	441,082	449,311
Available-for-sale Non-Agency MBS:		
Principal payments	483	869
Net cash (used in) investing activities	$ (420,868)	$ (80,015)
Financing Activities:		
Borrowings from repurchase agreements	$ 8,749,000	7,194,350
Repayments on repurchase agreements	(8,204,000)	(7,241,350)
Proceeds from common stock issued, net	21,901	19,100
Proceeds from Series B Preferred stock issued, net	3,765	0
Series A Preferred stock dividends paid	(1,011)	(1,011)
Series B Preferred stock dividends paid	(430)	(433)
Common stock dividends paid	(26,574)	(32,305)
Treasury stock	0	(3,517)
Net cash provided by (used in) financing activities	$ 542,651	$ (65,166)
Net decrease in cash and cash equivalents	$ (6,314)	$ (977)
Cash and cash equivalents at beginning of period	10,621	1,812
Cash and cash equivalents at end of period	$ 4,307	$ 835
Supplemental Disclosure of Cash Flow Information:		
Cash paid for interest	$ 23,294	$ 25,335

See accompanying notes to unaudited consolidated financial statements.

4

Table of Contents

ANWORTH MORTGAGE ASSET CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands)

(unaudited)

	Three Months Ended March 31, 2011	Three Months Ended March 31, 2010
Net income	$ 31,160	$ 33,249
Available-for-sale Agency MBS, fair value adjustment	(1,074)	(23,751)
Available-for-sale Non-Agency MBS, fair value adjustment	79	1,451
Unrealized gains (losses) on cash flow hedges	2,484	(20,484)
Reclassification adjustment for interest expense included in net income	17,437	20,673
	18,926	(22,111)
Comprehensive income	$ 50,086	$ 11,138

See accompanying notes to unaudited consolidated financial statements.

ANWORTH MORTGAGE ASSET CORPORATION AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

As used in this Quarterly Report on Form 10-Q, company, we, us, our, and Anworth refer to Anworth Mortgage Asset Corporation.

NOTE 1. ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

Anworth Mortgage Asset Corporation 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, or U.S., agency mortgage-backed securities, or Agency MBS. Agency MBS are securities representing obligations guaranteed by the U.S. government, such as Ginnie Mae, or guaranteed by federally sponsored enterprises, such as Fannie Mae or Freddie Mac. 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 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 taxable 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 taxable 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. Material estimates that are susceptible to change relate to the determination of the fair value of securities, amortization of security premiums and accretion of security discounts, accounting for derivatives and hedging activities and accounting for impaired securities. Actual results could materially differ from these estimates. 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, 2011 and 2010 are not necessarily indicative of the results that may be expected for the calendar year. The interim financial information in the accompanying unaudited consolidated financial statements and the notes thereto should be read in conjunction with the audited consolidated financial statements included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2010.

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.

Reverse Repurchase Agreements

We use securities purchased under agreements to resell, or reverse repurchase agreements, as a means of investing excess cash. Although legally structured as a purchase and subsequent resale, reverse repurchase agreements are treated as financing transactions under which the counterparty pledges securities (principally U.S. treasury securities) and accrued interest as collateral to secure a loan. The difference between the purchase price that we pay and the resale price that we receive represents interest paid to us and is included in Other income on our unaudited consolidated statements of income. It is our policy to generally take possession of securities purchased under reverse repurchase agreements at the time such agreements are made.

Mortgage-Backed Securities (MBS)

Agency MBS are securities that are obligations (including principal and interest) which are guaranteed by the U.S. government, such as Ginnie Mae, or guaranteed by federally sponsored enterprises, such as Fannie Mae or Freddie Mac. Our investment grade Agency MBS portfolio is 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

6

a certain period, usually three to five years, and then adjusts 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 securities issued by other companies that are not government-sponsored enterprises and 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 generally included in Other comprehensive income (loss) as a component of stockholders equity. Losses that are credit-related 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 (loss).

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 lives of the securities using the effective interest yield method, adjusted for the effects of actual prepayments based on the Financial Accounting Standards Board, or FASB, Accounting Standards Codification, or ASC, 320-10. 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, which could be material and adverse.

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, 2011 and December 31, 2010, aggregated by investment category and length of time (dollar amounts in thousands):

March 31, 2011

	Less Than 12 Months			12 Months or More			Total		
Description 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	116	$ 3,383,580	$ (40,871)	314	$ 255,572	$ (6,346)	430	$ 3,639,152	$ (47,217)

December 31, 2010

	Less Than 12 Months			12 Months or More			Total		
Description 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	115	$ 2,818,632	$ (37,912)	313	$ 250,040	$ (6,498)	428	$ 3,068,672	$ (44,410)

We do not consider those 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. 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 U.S. government or government-sponsored agencies. Since September 2008, the government-sponsored agencies have been in the conservatorship of the U.S. government. We do not expect to sell the Agency MBS at a price less than the amortized cost basis of our investments. Because the decline in market value of the Agency MBS is attributable to changes in interest rates and not the credit quality of the Agency MBS in our portfolio, and because we do not have the intent to sell these investments nor is it more likely than not that we will be required to sell these

Table of Contents

investments before recovery of their amortized cost basis, which may be at maturity, we do not consider these investments to be other-than-temporarily impaired at March 31, 2011.

Repurchase Agreements

We finance the acquisition of our MBS primarily 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 and accrued interest 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. Upon 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 convert 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 LIBOR. The notional amounts are not exchanged. We account for these swap agreements as cash flow hedges in accordance with ASC 815-10. 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. In order to limit credit risk associated with swap agreements, our current practice is to only enter into swap agreements with large financial institution counterparties who are market makers for these types of instruments, 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 ASC 815-10, 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 ASC 815-10.

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 sheets at their fair value, based on values obtained from large financial institutions who are market makers for these types of instruments. 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 our 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.

For more details on the amounts and other qualitative information on our swap agreements, see Note 12. For more information on the fair value of our swap agreements, see Note 6.

Credit Risk

At March 31, 2011, we have attempted to limit our exposure to credit losses on our MBS by purchasing securities primarily through 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. In September 2008, both Freddie Mac and Fannie Mae were placed in the conservatorship of the U.S. government. While it is hoped that the conservatorship will help stabilize Freddie Mac s and Fannie Mae s losses and overall financial position, there can be no assurance that it will succeed or that, if necessary, Freddie Mac or Fannie Mae will be able to satisfy its guarantees of Agency MBS.

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. Some adjustable-rate MBS subject to periodic payment caps may result in a portion of the interest being deferred and added to the principal outstanding.

Other-than-temporary losses on our available-for-sale MBS, as measured by the amount of decline in estimated fair value attributable to credit losses that are considered to be other-than-temporary, are charged against income, resulting in an adjustment of the cost basis of such securities. Based on the criteria in ASC-320-10, the determination of whether a security is other-than-temporarily impaired (OTTI) involves judgments and assumptions based on both subjective and objective factors. When a security is impaired, an OTTI is considered to have occurred if (i) we intend to sell the security, (ii) it is more likely than not that we will be required to sell the security before recovery of its amortized cost basis, or (iii) we do not expect to recover its amortized cost basis (i.e., there is a credit-related loss). The following are among, but not all of, the factors considered in determining whether and to what extent an OTTI exists and the portion that is related to credit loss: (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.

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 our stockholders satisfy the REIT requirements and that certain asset, income and stock ownership tests are met.

We have no unrecognized tax benefits and do not anticipate any increase in unrecognized benefits during 2011 relative to any tax positions taken prior to January 1, 2011. 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 existed at March 31, 2011. We file both REIT and taxable REIT subsidiary U.S. federal and California income tax returns. These returns are generally open to examination by the IRS and the California Franchise Tax Board for all years after 2006 and 2005, respectively.

Cumulative Convertible Preferred Stock

We classify our Series B Cumulative Convertible Preferred Stock, or Series B Preferred Stock, on our consolidated balance sheets using the guidance in ASC 480-10-S99. The Series B Preferred Stock contains certain fundamental change provisions that allow the holder to redeem the preferred stock for cash only if certain events occur, such as a change in control. As redemption under these circumstances is not solely within our control, we have classified the Series B Preferred Stock as temporary equity.

We have analyzed whether the conversion features in the Series B Preferred Stock should be bifurcated under the guidance in ASC 815-10 and have determined that bifurcation is not necessary.

9

Table of Contents

Stock-Based Compensation

In accordance with ASC 718-10, any compensation cost relating to share-based payment transactions is recognized in the unaudited consolidated financial statements.

Restricted stock is expensed over the vesting period (see Note 11).

Earnings Per Share

Basic earnings per share, or EPS, is computed by dividing net income 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 for the three months ended March 31, 2011 and March 31, 2010 are as follows (amounts in thousands, except per share data):

	Net Income Available to Common Stockholders	Average Shares	Earnings per Share
For the three months ended March 31, 2011			
Basic EPS	$ 29,657	121,914	$ 0.24
Effect of dilutive securities(1)	492	4,291	0.00
Diluted EPS	$ 30,149	126,205	$ 0.24
For the three months ended March 31, 2010			
Basic EPS	$ 31,808	116,755	$ 0.27
Effect of dilutive securities(2)	430	3,561	0.00
Diluted EPS	$ 32,238	120,316	$ 0.27

(1) During the three months ended March 31, 2011, diluted earnings per common share included the assumed conversion of 1.258 million shares of Series B Preferred Stock at the then-current conversion rate of 3.4094 shares of common stock and adding back the Series B Preferred Stock dividend.

(2) During the three months ended March 31, 2010, diluted earnings per common share included the assumed conversion of 1.1 million shares of Series B Preferred Stock at the then-current conversion rate of 3.1505 shares of common stock and adding back the Series B Preferred Stock dividend.

Accumulated Other Comprehensive Income

In accordance with ASC 220-10-55-2, comprehensive income is divided into net income and other comprehensive income, 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 ASC 815-10.

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

None.

NOTE 2. REVERSE REPURCHASE AGREEMENTS

At March 31, 2011, we did not have any reverse repurchase agreements outstanding. During the three months ended March 31, 2011, the maximum amount of reverse repurchase agreements outstanding was $27 million and the average amount outstanding was $1.3 million. These investments are used as a means of investing excess cash. The collateral for

Table of Contents

these loans was U.S. Treasury securities with an aggregate fair value equal to the amount of the loans. At December 31, 2010, there were no reverse repurchase agreements outstanding.

NOTE 3. MORTGAGE-BACKED SECURITIES (MBS)

The following tables summarize our Agency MBS and Non-Agency MBS, classified as available-for-sale, at March 31, 2011 and December 31, 2010, which are carried at their fair value (amounts in thousands):

March 31, 2011

Agency MBS (By Agency)	Ginnie Mae	Freddie Mac	Fannie Mae	Total Agency MBS
Amortized cost	$ 18,892	$ 2,378,075	$ 5,650,416	$ 8,047,383
Paydowns receivable	0	15,469	0	15,469
Unrealized gains	3	39,910	87,174	127,087
Unrealized losses	(306)	(23,342)	(23,569)	(47,217)
Fair value	$ 18,589	$ 2,410,112	$ 5,714,021	$ 8,142,722

Agency MBS (By Security Type)	ARMs	Hybrids	15-Year Fixed-Rate	30-Year Fixed-Rate	Floating-Rate CMOs	Total Agency MBS
Amortized cost	$ 1,794,676	$ 4,765,361	$ 917,261	$ 566,303	$ 3,782	$ 8,047,383
Paydowns receivable	5,852	9,617	0	0	0	15,469
Unrealized gains	35,599	53,009	0	38,467	12	127,087
Unrealized losses	(6,386)	(21,231)	(16,976)	(2,621)	(3)	(47,217)
Fair value	$ 1,829,741	$ 4,806,756	$ 900,285	$ 602,149	$ 3,791	$ 8,142,722

Non-Agency MBS	Total Non-Agency MBS
Amortized cost	$ 205
Unrealized gains	3,785
Fair value	$ 3,990

At March 31, 2011, our Non-Agency MBS portfolio consisted of floating-rate CMOs (option-adjusted ARMs based on one-month LIBOR) with an average coupon of 0.50%, which were acquired at par value.

The fair value of our Non-Agency MBS portfolio declined to approximately $4 million at March 31, 2011 from a fair value of approximately $4.4 million at December 31, 2010. The detail of this decline is shown on page 15.

At March 31, 2011, two securities representing the principal balance of our Non-Agency MBS portfolio were rated C by Moody s Investor Service. At March 31, 2011, a security representing approximately 67% of the principal balance of our Non-Agency MBS portfolio was rated D (which was downgraded during the quarter from CC) by Standard & Poor s and a security representing approximately 33% of the principal balance of our Non-Agency MBS portfolio continued to be rated CC by Standard & Poor s.

Table of Contents

December 31, 2010

Agency MBS (By Agency)	Ginnie Mae	Freddie Mac	Fannie Mae	Total Agency MBS
Amortized cost	$ 19,451	$ 2,129,836	$ 5,489,848	$ 7,639,135
Paydowns receivable	0	14,579	0	14,579
Unrealized gains	0	40,455	84,899	125,354
Unrealized losses	(286)	(21,401)	(22,723)	(44,410)
Fair value	$ 19,165	$ 2,163,469	$ 5,552,024	$ 7,734,658

Agency MBS (By Security Type)	ARMs	Hybrids	15-Year Fixed-Rate	30-Year Fixed-Rate	Floating-Rate CMOs	Total Agency MBS
Amortized cost	$ 1,685,741	$ 4,523,628	$ 811,687	$ 613,912	$ 4,167	$ 7,639,135
Paydowns receivable	6,069	8,510	0	0	0	14,579
Unrealized gains	26,501	59,149	162	39,519	23	125,354
Unrealized losses	(6,895)	(19,009)	(16,162)	(2,341)	(3)	(44,410)
Fair value	$ 1,711,416	$ 4,572,278	$ 795,687	$ 651,090	$ 4,187	$ 7,734,658

Non-Agency MBS	Total Non-Agency MBS
Amortized cost	$ 689
Unrealized gains	3,705
Fair value	$ 4,394

At December 31, 2010, our Non-Agency MBS portfolio consisted of floating-rate CMOs (option-adjusted ARMs based on one-month LIBOR) with an average coupon of 0.51%, which were acquired at par value.

At December 31, 2010, two securities representing the principal balance of our Non-Agency MBS portfolio were rated CC by Standard & Poor s and C by Moody s Investor Service.

NOTE 4. REPURCHASE AGREEMENTS

We have entered into repurchase agreements with large 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 MBS and bear fixed interest rates that have historically been based upon LIBOR.

Table of Contents

At March 31, 2011 and December 31, 2010, the repurchase agreements had the following balances (in thousands), weighted average interest rates and remaining weighted average maturities:

	March 31, 2011		December 31, 2010	
	Balance	Weighted Average Interest Rate	Balance	Weighted Average Interest Rate
Overnight	$ 0	0.00%	$ 0	0.00%
Less than 30 days	3,485,000	0.28	3,730,000	0.30
30 days to 90 days	3,435,000	0.28	2,645,000	0.30
Over 90 days to less than 1 year	0	0.00	0	0.00
1 year to 2 years	0	0.00	0	0.00
Demand	0	0.00	0	0.00
	$ 6,920,000	0.28%	$ 6,375,000	0.30%
Weighted average maturity	36 days		31 days	
Weighted average term to maturity (after accounting for swap agreements)	441 days		418 days	
Weighted average borrowing rate (after accounting for swap agreements)	1.32%		1.43%	
Agency MBS pledged as collateral under the repurchase agreements and swap agreements	$ 7,323,431		$ 6,762,763	

NOTE 5. 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, at our option, in whole or in part, without penalty, after March 30, 2010 and April 30, 2010, respectively. We used the net proceeds of this private placement to invest in Agency MBS. We have reviewed the structure of the transaction under ASC 810-10 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. As of the date of this filing, we have not redeemed any of the notes or securities.

NOTE 6. FAIR VALUES OF FINANCIAL INSTRUMENTS

As defined in ASC 820-10, 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. ASC 820-10 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.

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 the inputs utilized to fair value our Agency MBS to be Level 2. Management bases the fair value for these investments primarily on third party bid price indications provided by dealers who make markets in these instruments. The Agency MBS market is primarily an over-the-counter market. As such, there are no standard, public market quotations or published trading data for individual MBS securities. As our portfolio consists of hundreds of similar, but distinct, securities that have each been traded with only one broker counterparty, we generally seek to have each Agency MBS security priced by one broker. The prices received are non-binding offers to trade, but are indicative quotations of the market value of our securities as of the market close on the last day of each quarter. The brokers receive trading data from several traders that participate in the active markets for these securities and directly observe numerous trades of securities similar to the securities owned by us. Given the volume of market activity for Agency MBS, it is our belief that the broker pricing accurately reflects market information for actual, contemporaneous transactions. We do not adjust quotes or prices we obtain from brokers and pricing services. In the limited instances where valuations are received on a security from multiple brokers, we use the median value of the prices received to determine fair value. To validate the prices we obtain, to ensure our fair value determinations are consistent with ASC 820, and to ensure that we properly classify these securities in the fair value hierarchy, we evaluate the pricing information we receive taking into account factors such as coupon, prepayment experience, fixed/adjustable rate, coupon index, time to reset and issuing agency, among other factors. Based on these factors, broker prices are compared to prices of similar securities provided by other brokers. If we determine (based on such a comparison and our market knowledge and expertise) that a security is priced significantly differently than similar securities, the broker is contacted and requested to revisit their valuation of the security. If a broker refuses to reconsider its valuation, we will request pricing from another broker and use the median value of the prices received to determine fair value. If we are unable to receive a valuation from another broker, the price received from an independent third party pricing service will be used, if it is determined (based on our market knowledge and expertise) to be more reliable than the broker pricing. However, the fair value reported may not be indicative of the amounts that could be realized in an actual market exchange.

Our derivative assets and derivative liabilities are comprised of swap agreements, in which we pay a fixed rate of interest and receive a variable rate of interest that is based on LIBOR. The fair value of these instruments is reported to us independently from dealers who are large financial institutions and are market makers for these types of instruments. The LIBOR swap rate is observable at commonly quoted intervals over the full term of the swap agreements and therefore is considered a Level 2 item. The fair value of the derivative instruments assets and liabilities are the estimated amounts the Company would either receive or pay to terminate these agreements at the reporting date, taking into account current interest rates and the Company s credit worthiness. For more information on our swap agreements, see Note 1 and Note 12.

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. At March 31, 2011 and December 31, 2010, we considered the inputs utilized to fair value the Non-Agency MBS to be Level 3. Historically (prior to December 31, 2008), we had received non-binding indications of value from brokers who make markets in Non-Agency MBS and we also observed market activity in our Non-Agency MBS as well as other similar securities. As the market for Non-Agency MBS became more volatile and less liquid, we received fewer indications of value on these securities. At March 31, 2011 and December 31, 2010, we were unable to get any brokers who made markets in these securities to provide valuation information on our Non-Agency MBS. Instead, we obtained valuations at March 31, 2011 and December 31, 2010 for our Non-Agency MBS from an experienced independent third party pricing service, whose methodologies are based on broker provided pricing information, as well as indirect observation of market activity. Although we continue to monitor market activity for the Non-Agency MBS in our portfolio, as well as for other similar securities, given the lack of trading activity that we are able to observe, we place more weight on the third party pricing service valuations, as they are both independent and specifically determined. As a result of the lack of valuation information from brokers and our own observation of market activity, we determined that the market for our Non-Agency MBS was inactive. We also believe that the valuations obtained from the independent third party pricing service already take into account the illiquidity of the market for Non-Agency MBS and therefore we do not apply our own liquidity discount when determining their fair value. Based on this information, we consider the fair value measurement of the Non-Agency MBS a Level 3 input at March 31, 2011 and December 31, 2010.

In determining the appropriate levels, we perform a detailed analysis of the assets and liabilities that are subject to ASC 820-10. At each reporting period, all assets and liabilities for which the fair value measurement is based on significant unobservable inputs are classified as Level 3.

At March 31, 2011, fair value measurements were as follows (in thousands):

	Level 1	Level 2	Level 3	Total
Assets:				
Agency MBS(1)	$	$ 8,142,722	$	$ 8,142,722
Non-Agency MBS(2)	$	$	$ 3,990	$ 3,990
Derivative instruments(3)	$	$ 13,462	$	$ 13,462
Liabilities:				
Derivative instruments(3)	$	$ 55,334	$	$ 55,334

Table of Contents

(1) For more detail about the fair value of our Agency MBS by agency and type of security, see Note 3.
(2) For more detail about the fair value of our Non-Agency MBS, see Note 3.
(3) Derivative instruments are hedging instruments under ASC 815-10. For more detail about our derivative instruments, see Notes 1 and 12.

Cash and cash equivalents, restricted cash, interest receivable, repurchase agreements and interest payable are reflected in our 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 we believe the spread would be consistent with the expectations of market participants as of March 31, 2011 and December 31, 2010, the carrying value approximates fair value.

A reconciliation of the Level 3 Non-Agency MBS fair value measurements is as follows (in thousands):

	Amount
Balance at December 31, 2010	$ 4,394
Principal paydowns	(483)
Unrealized gains	79
Balance at March 31, 2011	$ 3,990

NOTE 7. 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, gross income and stock ownership tests are met. We believe we currently meet all REIT requirements regarding the ownership of our common stock and the distribution of our taxable net income. Therefore, we believe that we continue to qualify as a REIT under the provisions of the Code.

NOTE 8. SERIES B CUMULATIVE CONVERTIBLE 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 our common stock is entitled to receive any dividends. The Series B Preferred Stock is senior to the common stock and on parity with our 8.625% 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. So long as any shares of the Series B Preferred Stock remain outstanding, we will not, without the affirmative vote or consent of the holders of at least two-thirds of the shares of the Series B Preferred Stock outstanding at the time, authorize or create, or increase the authorized or issued amount of, any class or series of capital stock ranking prior to the Series B Preferred Stock with respect to payment of dividends or the distribution of assets upon liquidation, dissolution or winding up.

The Series B Preferred Stock has no maturity date and is not redeemable. Through March 31, 2011, the Series B Preferred Stock was convertible at the then-current conversion rate of 3.4094 shares of our common stock per $25.00 liquidation preference. The conversion rate is adjusted in any fiscal quarter in which the cash dividends paid to common stockholders results in an annualized common stock dividend yield that is greater than 6.25%. The conversion ratio is also 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 holder(s) of Series B Preferred Stock 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. We may exercise this conversion option only if our common stock price equals or exceeds 130% of the then-prevailing conversion price of the Series B Preferred Stock for at least twenty (20) trading days in a period of thirty (30) consecutive trading days (including the last trading day of such period) ending on the trading day immediately prior to our issuance of a press release announcing the exercise of the conversion option. The Series B Preferred Stock contains certain fundamental change provisions that allow the holder to redeem the Series B Preferred Stock for cash if certain events occur, such as a change in control. 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, the holder(s) of Series B Preferred Stock, together with the holders of Series A Preferred Stock, will be entitled to elect two additional directors to our board of directors to serve until all unpaid dividends have been paid or declared and set aside 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, 2011, we have declared and set aside for payment the required dividends for the Series B Preferred Stock.

During the three months ended March 31, 2011, there was one transaction to convert 1,000 shares of Series B Preferred Stock into 3,409 shares of our common stock (at the then-current conversion rate of 3.4094). During the three months ended March 31, 2011, we issued an aggregate of 158,500 shares of Series B Preferred Stock, which provided net proceeds to us of approximately $3.8 million.

NOTE 9. PUBLIC OFFERINGS AND CAPITAL STOCK

At March 31, 2011, our authorized capital included 200 million shares of common stock, of which 124,088,947 shares were issued and outstanding.

At March 31, 2011, 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 undesignated shares of 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. At March 31, 2011, there were 1,875,500 shares of Series A Preferred Stock issued and outstanding and 1,258,498 shares of Series B Preferred Stock issued and outstanding, respectively.

On February 1, 2010, we announced that our board of directors had authorized a share repurchase program, permitting us to acquire 5,850,000 shares of our common stock, or approximately 5% of our then outstanding common stock. The shares were acquired at prevailing prices through open market transactions. The manner, price, number and timing of these share repurchases were subject to market conditions and applicable SEC rules. During the three months ended March 31, 2011, we did not repurchase any shares under this program. As the share repurchase program had a one-year term only, it expired on January 27, 2011. From February 1, 2010 through January 27, 2011, we had repurchased an aggregate of 3,724,121 shares at a weighted average price of $6.57 per share under this program.

On May 14, 2008, we entered into a Controlled Equity Offering Sales Agreement, or the 2008 Sales Agreement, with Cantor Fitzgerald & Co., or Cantor, which was amended by Amendment No. 1 to Sales Agreement on February 8, 2011. During the three months ended March 31, 2011, we sold an aggregate of 2,076,900 shares of our common stock at a weighted average price of $7.07 per share under the amended 2008 Sales Agreement, which provided net proceeds to us of approximately $14.5 million, net of sales commissions less reimbursement of fees. The sales agent received an aggregate of approximately $255 thousand, which represents an average commission of approximately 2.0% on the gross sales price per share. During the three months ended March 31, 2011, we sold an aggregate of 158,500 shares of our Series B Preferred Stock at a weighted average price of $24.39 per share under the amended 2008 Sales Agreement, which provided net proceeds to us of approximately $3.8 million, net of sales commissions less reimbursement of fees. The sales agent received an aggregate of approximately $77 thousand, which represents an average commission of approximately 2.0% on the gross sales price per share. During the three months ended March 31, 2011, we did not sell any shares of our Series A Preferred Stock under the amended 2008 Sales Agreement. At March 31, 2011, there were 3,025,000 shares of common stock, 1,250,000 shares of Series A Preferred Stock and 1,744,300 shares of Series B Preferred Stock, respectively, available under the amended 2008 Sales Agreement.

Table of Contents

Our Dividend Reinvestment and Stock Purchase Plan allows stockholders and non-stockholders to purchase shares of our common stock and to reinvest dividends therefrom to acquire additional shares of our common stock. On December 28, 2009, we filed a shelf registration statement on Form S-3ASR with the SEC, offering up to 20 million shares of common stock for our 2009 Dividend Reinvestment and Stock Purchase Plan, or the 2009 Plan. During the three months ended March 31, 2011, we issued 1,107,940 shares of common stock at a weighted average price of $6.74 per share under the 2009 Plan, resulting in proceeds to us of approximately $7.47 million. At March 31, 2011, there were approximately 9.962 million shares remaining under the 2009 Plan.

On December 28, 2009, we filed a shelf registration statement on Form S-3 with the SEC, and on February 26, 2010 we filed a pre-effective amendment thereto with the SEC, offering up to $600 million of our capital stock. The registration statement was declared effective on March 26, 2010. At March 31, 2011, approximately $580.8 million was available for issuance under the registration statement.

On November 7, 2005, we filed a registration statement on Form S-8 with the SEC 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. To date, we have issued 2.68 million shares under the plan. This amount includes 1.02 million shares of unexercised stock options and restricted stock.

NOTE 10. TRANSACTIONS WITH AFFILIATES

Anworth 2002 Incentive Compensation Plan

Under our 2002 Incentive Compensation Plan, or the 2002 Incentive Plan, Lloyd McAdams, our Chief Executive Officer, Joseph E. McAdams, our Chief Investment Officer, Heather U. Baines, our Executive Vice President, and other executives are eligible to earn incentive compensation during each fiscal quarter. 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. Pursuant to their employment agreements, Lloyd McAdams, Joseph E. McAdams and Heather U. Baines are entitled to minimum percentages of all amounts paid under the 2002 Incentive Plan. Those percentages are 45%, 25% and 5%, respectively. The 2002 Incentive Plan is tied directly to our performance and is designed to incentivize key employees to maximize return on equity. The total aggregate amount of compensation that may be earned quarterly by all participants under the 2002 Incentive Plan 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. At March 31, 2011, the Threshold Return was 4.46%.

Average net worth, as defined in the 2002 Incentive Plan, for any period is (i) the daily average of the cumulative net proceeds to date from all offerings of the Company s equity securities, after deducting any underwriting discounts and commissions and other expenses and costs related to such offerings, plus (ii) the Company s retained earnings computed by taking the average of such values at the end of each month during such period.

The 2002 Incentive Plan contains a high water-mark provision requiring that in any fiscal quarter in which net income is an amount less than the amount necessary to earn the Threshold Return, the Company 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 with respect to participants who were participants during the fiscal quarter(s) in which negative incentive compensation was generated. At March 31, 2011, the incentive compensation accrual carry forward was a negative $4.7 million, which was reduced from a negative $6.4 million at December 31, 2010. This negative carry forward may provide an incentive to management to make higher risk investments in an attempt to generate returns to overcome the negative carry forward.

The percentage of taxable 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.

17

Table of Contents

During the three months ended March 31, 2011 and 2010, eligible employees under the 2002 Incentive Plan did not earn any incentive compensation due to the negative incentive carry forward under the Plan.

Employment Agreements

Salary, Incentive and Termination Provisions

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 Chief Investment Officer, and Heather U. Baines serves as our Executive Vice President. Lloyd McAdams receives a $925 thousand annual base salary, Joseph E. McAdams receives a $700 thousand annual base salary and Heather U. Baines receives a $60 thousand annual base salary.

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 2002 Incentive Plan may not be amended without the consent of Lloyd McAdams and Joseph E. McAdams;

- 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 their 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 under the 2002 Incentive Plan 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 2002 Incentive 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 2002 Incentive 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 if such termination is in connection with a change in control;

- 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; and

- each agreement contains an evergreen provision that permits automatic renewal for one year at the end of each term unless written notice of termination is provided by either party six months prior to the end of the current term.

Performance-Based Bonus Pool Provisions

Under the terms of their employment agreements, a long-term equity incentive structure was established for Messrs. Lloyd McAdams and Joseph E. McAdams. As a result, they are eligible to participate in a performance-based bonus pool that is funded based on our return on average equity, or ROAE. ROAE is calculated as the twelve-month net income available to common stockholders, excluding the effect of 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 of our board of directors, or 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.

Table of Contents

As structured by the Compensation Committee, the aggregate amount of this performance-based bonus pool available for distribution can range annually based upon our ROAE in accordance with the following:

- if our ROAE is 0% or less, no performance-based bonus is paid.
- if our ROAE is greater than 0% but less than 8%, a bonus pool of up to $500 thousand is available in the aggregate.
- if our ROAE is 8% or greater, then the bonus pool available to be paid to both executives in the aggregate equals $500 thousand plus 10% of the first $5 million of excess 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 bonus pool by as much as 10% in any given year, based upon its assessment of factors including our leverage, stability of the book value of our common stock and price per share of our common stock relative to other industry participants. Of the aggregate amount available for distribution from the bonus pool, the Compensation Committee bases annual bonus allocation to each of Messrs. Lloyd McAdams and Joseph E. McAdams on its assessment of the performance of each executive.

In order to further align the performance of Messrs. Lloyd McAdams and Joseph E. McAdams with our long-term financial success and the creation of stockholder value, the Compensation Committee also determined that with respect to 2008 and each year thereafter, 25% of the annual performance-based bonus amount allocated to be distributed to an executive over $100 thousand would be paid in restricted shares of common stock (the Restricted Shares). In addition, neither executive will be permitted to sell or otherwise transfer any Restricted Shares during the executive s employment with us until the value of his respective stock holdings in the company exceeds a seven and one-half times multiple of his base compensation and, once this threshold is met, only to the extent that the value of such 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.

The Compensation Committee, in its discretion, may provide additional 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 compensation may be provided in consideration of the execution of our business and strategic plans. During the three months ended March 31, 2011, no additional compensation was paid to Messrs. Lloyd McAdams and Joseph E. McAdams.

Change in Control and Arbitration Agreements

On June 27, 2006, we entered into Change in Control and Arbitration Agreements with each of Thad M. Brown, our Chief Financial Officer, Charles J. Siegel, our Senior Vice President-Finance, Bistra Pashamova, our Senior Vice President and Portfolio Manager, and Evangelos Karagiannis, 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 (as defined therein), 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 in 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 trusts controlled by certain of our officers. Under the sublease, as amended on July 8, 2003, we lease, on a pass-through basis, 5,500 square feet of office space from PIA and pay rent at an annual rate equal to PIA s obligation, currently $55.78 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, 2011, we paid approximately $83 thousand in rent and other operating expenses to PIA under the sublease, which is included in Other expenses on the unaudited consolidated statements of income. During the three months ended March 31, 2010, we paid $81 thousand in rent and related expenses to PIA under this sublease.

19

Table of Contents

At March 31, 2011, the future minimum lease commitment was as follows (in whole dollars):

Year	2011	2012	Total Commitment
Commitment	$ 234,713	$ 158,012	$ 392,725

On October 14, 2002, we entered into an administrative services agreement with PIA. On July 25, 2008, we entered into a new administrative services agreement with PIA which was amended and restated on August 20, 2010. Under this agreement, PIA provides administrative services and equipment to us including human resources, operational support and information technology, and we pay an annual fee of 5 basis points on the first $225 million of stockholders equity and 1.25 basis points thereafter (paid quarterly in arrears) for those services. The administrative services agreement had an initial term of one year and renews 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 unaudited consolidated statements of income are fees of $48 thousand paid to PIA in connection with this agreement during the three months ended March 31, 2011. During the three months ended March 31, 2010, we paid fees of $82 thousand 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. 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 Chief 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 Chief Executive Officer and our other four highest paid officers. To date, the board has designated all of the executive officers as those 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. At March 31, 2011, the aggregate balance of the amounts previously deferred for Lloyd McAdams was $415,823.

NOTE 11. EQUITY COMPENSATION PLAN

2004 Equity Compensation Plan

At our May 27, 2004 annual stockholders meeting, our stockholders adopted the Anworth Mortgage Asset Corporation 2004 Equity Compensation Plan, or the Plan, which amended and restated our 1997 Stock Option and Awards Plan. The Plan authorized the grant of stock options and other stock-based awards, as of December 31, 2005, 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, options not so qualified, 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, 2011, 824,034 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.

20

In October 2005, our board of directors approved the grant of 200,780 shares of restricted stock to various of our employees under the Plan. The stock price 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 stock price on the effective date of the grant was $9.12. The shares will vest in equal annual installments over a three-year period provided that the annually compounded rate of return on our common stock, including dividends, exceeds 12% measured on an annual basis as of the anniversary date of the grant. 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, transferred or pledged until after termination of employment with us or upon the tenth anniversary of the effective date.

We recognize the compensation expense related to restricted stock over the ten-year vesting period. During the three months ended March 31, 2011, we expensed approximately $51 thousand related to these 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 2007 Dividend Equivalent Rights Plan. A dividend equivalent right, or DER, is a right to receive amounts equal in value to the dividend distributions paid on a share of our common stock. DERs are paid in either cash or shares of our common stock, whichever is specified by our Compensation Committee at the time of grant, at such times as dividends are paid on shares of our common stock during the period between the date a DER is issued and the date the DER expires or earlier terminates. The committee may impose such other conditions to the grant of DERs as it may deem appropriate. The maximum term for DERs under the 2007 Dividend Equivalent Rights Plan is ten years from the date of grant. Prior to January 1, 2011, an aggregate of 582 thousand DERs were issued to our officers and employees under the 2007 Dividend Equivalent Rights Plan. These DERs are not attached to any stock and only have the right to receive the same cash distribution per common share 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. During the three months ended March 31, 2011 we paid or accrued $140 thousand as compensation related to DERs granted. During the three months ended March 31, 2010, we paid or accrued approximately $135 thousand as compensation related to DERs granted.

NOTE 12. HEDGING INSTRUMENTS

At March 31, 2011, we were a counterparty to interest rate swap agreements, which are derivative instruments as defined by ASC 815-10, with an aggregate notional amount of $2.735 billion and a weighted average maturity of 2.96 years. During the three months ended March 31, 2011, three swap agreements with an aggregate notional amount of $225 million matured. During the three months ended March 31, 2011, we entered into four new swap agreements with a notional amount of $300 million and terms of up to five years. We utilize swap agreements to manage interest rate risk relating to our repurchase agreements (the hedged item) and do not anticipate entering into derivative transactions for speculative or trading purposes. In accordance with the swap agreements, we will pay a fixed-rate of interest during the term of the swap agreements (ranging from 1.11% to 5.7375%) and receive a payment that varies with the three-month LIBOR rate.

Table of Contents

At March 31, 2011 and December 31, 2010, our swap agreements had the following notional amounts (in thousands), weighted average interest rates and remaining term (in months):

	March 31, 2011			December 31, 2010		
	Notional Amount	Weighted Average Interest Rate	Remaining Term in Months	Notional Amount	Weighted Average Interest Rate	Remaining Term in Months
Less than 12 months	$ 400,000	5.09%	6	$ 475,000	4.36%	4
1 year to 2 years	695,000	3.41	19	520,000	3.92	17
2 years to 3 years	200,000	2.85	32	375,000	3.32	26
3 years to 4 years	410,000	2.00	42	410,000	2.07	40
Over 4 years	1,030,000	2.14	56	880,000	2.07	56
	$ 2,735,000	2.93%	35	$ 2,660,000	3.02%	33

Swap Agreements by Counterparty

	March 31, 2011	December 31, 2010
	(in thousands)	
Deutsche Bank Securities	$ 700,000	$ 725,000
Credit Suisse	445,000	545,000
Nomura Securities International	400,000	400,000
RBS Greenwich Capital	390,000	390,000
Citigroup	300,000	300,000
JP Morgan Securities	200,000	50,000
Morgan Stanley	150,000	150,000
Bank of New York	100,000	100,000
LBBW Securities, LLC	50,000	0
	$ 2,735,000	$ 2,660,000

During the three months ended March 31, 2011, there was a decrease in unrealized losses of $19.9 million from $62.2 million in unrealized losses at December 31, 2010 to $42.3 million in unrealized losses, on our swap agreements included in Other comprehensive income (this decrease in unrealized losses consisted of unrealized gains on cash flow hedges of $2.5 million and a reclassification adjustment for interest expense included in net income of $17.4 million).

At March 31, 2011, we had asset derivatives of $13.5 million and liability derivatives of $55.3 million (both shown on our unaudited consolidated balance sheets).

During the three months ended March 31, 2011, there was no gain or loss recognized in earnings 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. On September 18, 2008, we terminated all of our interest rate swap agreements with Lehman Brothers Special Finance, or LBSF, as the counterparty. The notional balance of these swap agreements was $240 million. The fair value of these swap agreements at termination was approximately $(1.5) million, reflecting a realized loss. This loss is being amortized into interest expense over the remaining term of the related hedged borrowings. During the three months ended March 31, 2011, the amount amortized into interest expense was approximately $64 thousand and the remaining amount at March 31, 2011 to be amortized was approximately $444 thousand. For the three months ended March 31, 2010, the amount amortized into interest expense was approximately $60 thousand.

22

Table of Contents

For more information on our accounting policies, the objectives and risk exposures relating to derivatives and hedging agreements, see the section on Derivative Financial Instruments in Note 1. For more information on the fair value of our swap agreements, see Note 6.

NOTE 13. COMMITMENTS AND CONTINGENCIES

(a) Lease Commitment and Administrative Services Commitment We sublease office space and use administrative services from PIA, as more fully described in Note 10.

NOTE 14. OTHER EXPENSES

	Three Months Ended March 31, 2011	2010
	(in thousands)	
Legal and accounting fees	$ 125	$ 104
Printing and stockholder communications	22	12
Directors and Officers insurance	110	109
Software and implementation	65	64
Administrative service fees	48	82
Rent and related expenses	83	81
Stock exchange and filing fees	59	59
Custodian fees	33	32
Sarbanes-Oxley consulting fees	0	36
Board of directors fees and expenses	80	73
Securities data services	27	27
Other	71	78
Total of other expenses:	$ 723	$ 757

NOTE 15. SUBSEQUENT EVENTS

On April 13, 2011, 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 was payable on April 15, 2011 to our holders of record of Series A Preferred Stock and Series B Preferred Stock, respectively, as of the close of business on March 31, 2011.

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 that 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. This conversion rate increased on April 12, 2011 from 3.4094 shares of our common stock to 3.4778 shares of our common stock using the following information: (1) the average of the closing price of our common stock for the ten (10) consecutive trading day period was $7.12 and (2) the annualized common stock dividend yield was 14.0449%.

From April 1, 2011 through May 2, 2011, we sold an aggregate of 875,100 shares of common stock at a weighted average price of $7.27 per share pursuant to our amended Controlled Equity Offering Sales Agreement with Cantor, which provided net proceeds to us of approximately $6.2 million, net of sales commissions less reimbursement of fees. Cantor, as the sales agent, received an aggregate commission of approximately $127 thousand, which represents an average commission of approximately 2.0% on the gross sales price per share. From April 1, 2011 through May 2, 2011, we sold 10,346 shares of Series B Preferred Stock at a weighted average price of $24.75 per share pursuant to our amended Controlled Equity Offering Sales Agreement with Cantor, which provided net proceeds to us of approximately $251 thousand, net of sales commissions less reimbursement of fees. Cantor, as the sales agent, received a commission of approximately $5 thousand, which represents an average commission of approximately 2.0% on the gross sales price per share.

From April 1, 2011 through May 2, 2011, there were four transactions to convert an aggregate of 79,100 shares of Series B Preferred Stock into an aggregate of 269,681 shares of our common stock (at the then-current conversion rate of 3.4094).

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

As used in this Quarterly Report on Form 10-Q, company, we, us, our, and Anworth refer to Anworth Mortgage Asset Corporation.

You should read the following discussion and analysis in conjunction with the unaudited consolidated financial statements and related notes thereto contained in Item 1 of Part I of this Quarterly Report on Form 10-Q. The information contained in this Quarterly Report on Form 10-Q 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 Quarterly Report on Form 10-Q and in our other reports filed with the United States Securities and Exchange Commission, or the SEC, including our Annual Report on Form 10-K for the fiscal year ended December 31, 2010.

Forward Looking Statements

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the 1933 Act 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 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, assu other similar expressions. You should not rely on our forward-looking statements because the matters they describe are subject to assumptions, known and unknown risks, uncertainties and other unpredictable factors, many of which are beyond our control. 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 the section Risk Factors, Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2010.

Statements regarding the following subjects, among others, may be forward-looking: changes in interest rates and the market value of our mortgage-backed securities (MBS); changes in the yield curve; the availability of MBS for purchase; changes in the prepayment rates on the mortgage loans securing our MBS; our ability to borrow to finance our assets; our ability to use borrowings to finance our assets and, if available, the terms of any financing; implementation of or changes in government regulations or programs affecting our business; our ability to maintain our qualification as a real estate investment trust (REIT) for federal income tax purposes; our ability to maintain our exemption from registration under the Investment Company Act of 1940, as amended; risks associated with investing in real estate assets, including changes in business conditions and the general economy; and management s ability to manage our growth. All forward-looking statements speak only as of the date 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 do not intend to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

General

Our Company

We were formed in October 1997 and commenced operations on March 17, 1998. We are in the business of investing primarily in United States, or U.S., agency mortgage-backed securities, or agency MBS, which are obligations guaranteed by the U.S. government, such as Ginnie Mae, or federally sponsored enterprises, such as Fannie Mae or Freddie Mac. 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 taxable earnings to stockholders without paying federal or state income tax at the corporate level on the distributed earnings. At March 31, 2011, our qualified REIT assets (real estate assets, as defined under the Code, cash and cash items and government securities) were greater than 99% 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 2010 revenue qualified for both the 75% source of income test and the 95% source of income test under the REIT rules. At March 31, 2011, we believe we met all REIT requirements regarding the ownership of our common stock and the distributions of our taxable net income. Therefore, we believe that we continue to qualify as a REIT under the provisions of the Code.

24

Table of Contents

Although the U.S. government and other governments have taken various actions (including placing Fannie Mae and Freddie Mac in conservatorship) intended to protect financial institutions, their respective economies and their respective housing and mortgage markets, we continue to operate under very difficult market conditions. There can be no assurance that these various actions will have a beneficial impact on the global financial markets and, more specifically, the market for the securities we currently own in our portfolio. We cannot predict what, if any, impact these actions or future actions by either the U.S. government or foreign governments could have on our business, results of operations and financial condition. These events may impact the availability of financing generally in the marketplace and also may impact the market value of MBS generally, including the securities we currently own in our portfolio.

Our Portfolio

Our operations consist of the following portfolios: agency mortgage-backed securities, or Agency MBS, and non-agency mortgage-backed securities, or Non-Agency MBS. Approximately 99.9% of our total portfolio is Agency MBS.

At March 31, 2011, we had total assets of $8.2 billion. Our Agency MBS portfolio, consisting of $8.1 billion, was distributed as follows: 22% adjustable-rate Agency MBS, 59% hybrid adjustable-rate Agency MBS, 11% 15-year fixed-rate Agency MBS, 8% 30-year fixed-rate Agency MBS and less than 1% agency floating-rate collateralized mortgage obligations, or CMOs. Our Non-Agency MBS portfolio consisted of approximately $4 million of floating-rate CMOs. Stockholders equity available to common stockholders at March 31, 2011 was approximately $858.6 million, or $6.92 per share. The $858.6 million equals total stockholders equity of $907.5 million less the Series A Preferred Stock liquidating value of approximately $46.9 million and less the difference between the Series B Preferred Stock liquidating value of $31.5 million and the proceeds from its sale of $29.4 million. For the three months ended March 31, 2011, we reported net income of $31.2 million. Net income to common stockholders was $29.7 million, or net income of $0.24 per diluted share, based on a weighted average of 126.2 million fully diluted shares outstanding, which consisted of net income of $31.2 million minus payment of preferred dividends of $1.5 million.

Results of Operations

Three Months Ended March 31, 2011 Compared to March 31, 2010

For the three months ended March 31, 2011, our net income was $31.2 million. Our net income available to common stockholders was $29.7 million, or $0.24 per diluted share, based on a weighted average of 126.2 million fully diluted shares outstanding. This includes net income of $31.2 million minus the payment of preferred dividends of $1.5 million. For the three months ended March 31, 2010, our net income was $33.2 million. Our net income available to common stockholders was $31.8 million, or $0.27 per diluted share, based on a weighted average of 120.3 million fully diluted shares outstanding. This included net income of $33.2 million minus the payment of preferred dividends of $1.4 million.

Net interest income for the three months ended March 31, 2011 totaled $34.5 million, or 50% of gross income, compared to $37.2 million, or 50.6% of gross income, for the three months ended March 31, 2010. Net interest income is comprised of the interest income earned on mortgage investments (net of premium amortization expense) less interest expense from borrowings. Interest income (net of premium amortization expense) for the three months ended March 31, 2011 was $57 million, compared to $61.2 million for the three months ended March 31, 2010, a decrease of 7% due primarily to a decrease in the weighted average coupons on Agency MBS (from 4.06% at March 31, 2010 to 3.11% at March 31, 2011), partially offset by an increase in the weighted average portfolio outstanding of approximately $7.3 billion at March 31, 2011 from approximately $6.03 billion at March 31, 2010. Interest expense for the three months ended March 31, 2011 was $22.4 million, compared to $24.0 million for the three months ended March 31, 2010, a decrease of 7%, which resulted primarily from a decline in short-term interest rates after the effect of the swap agreements (from 1.82% at March 31, 2010 to 1.38% at March 31, 2011) and partially offset by an increase in the average borrowings outstanding, from $5.27 billion at March 31, 2010 to $6.50 billion at March 31, 2011.

Table of Contents

The results of our operations are affected by a number of factors, many of which are beyond our control, and primarily depend on, among other things, the level of our net interest income, the market value of our MBS, the supply of, and demand for, MBS in the marketplace, and the terms and availability of financing. Our net interest income varies primarily as a result of changes in interest rates, the slope of the yield curve (the differential between long-term and short-term interest rates), borrowing costs (our interest expense) and prepayment speeds on our MBS portfolios, the behavior of which involves various risks and uncertainties. Interest rates and prepayment speeds, as measured by the constant prepayment rate, or CPR, vary according to the type of investment, conditions in the financial markets, competition and other factors, none of which can be predicted with any certainty. With respect to our business operations, increases in interest rates, in general, may, over time, cause: (i) the interest expense associated with our borrowings, which are primarily comprised of repurchase agreements, to increase; (ii) the value of our MBS portfolios and, correspondingly, our stockholders equity to decline; (iii) coupons on our MBS to reset, although on a delayed basis, to higher interest rates; (iv) prepayments on our MBS portfolios to slow, thereby slowing the amortization of our MBS purchase premiums; and (v) the value of our interest rate swap agreements and, correspondingly, our stockholders equity to increase. Conversely, decreases in interest rates, in general, may, over time, cause: (i) prepayments on our MBS portfolios to increase, thereby accelerating the amortization of our MBS purchase premiums; (ii) the interest expense associated with our borrowings to decrease; (iii) the value of our MBS portfolios and, correspondingly, our stockholders equity to increase; (iv) the value of our interest rate swap agreements and, correspondingly, our stockholders equity to decrease; and (v) coupons on our MBS to reset, although on a delayed basis, to lower interest rates. In addition, our borrowing costs and credit lines are further affected by the type of collateral pledged and general conditions in the credit markets.

During the three months ended March 31, 2011, premium amortization expense decreased $0.1 million, or 1%, from $12.3 million during the three months ended March 31, 2010 to $12.2 million.

The following table shows the approximate CPR of our Agency MBS and Non-Agency MBS for each of the following quarters:

Portfolio	First Quarter 2011	First Quarter 2010
Agency MBS and Non-Agency MBS	21%	30%

During the three months ended March 31, 2011 and 2010, there was no gain or loss recognized in earnings 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.

Total expenses were $3.6 million for the three months ended March 31, 2011, compared to $4.0 million for the three months ended March 31, 2010. Compensation costs decreased $337 thousand (due to a decrease in the accrual for bonus and incentive compensation). Other expenses (as detailed in Note 14 to the accompanying unaudited consolidated financial statements) decreased $34 thousand.

Financial Condition

Agency MBS Portfolio

At March 31, 2011, we held agency mortgage assets whose amortized cost was approximately $8.05 billion, consisting primarily of $6.56 billion of adjustable-rate Agency MBS, $1.48 billion of fixed-rate Agency MBS and $4 million of floating-rate CMOs. This amount represents an approximately 5% increase from the $7.64 billion held at December 31, 2010. Of the adjustable-rate Agency MBS owned by us, 27% were adjustable-rate pass-through certificates whose coupons reset within one year. The remaining 73% consisted of hybrid adjustable-rate Agency MBS whose coupons will reset between one year and five years. Hybrid adjustable-rate Agency 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.

Table of Contents

The following table presents a schedule of the fair value of our Agency MBS owned at March 31, 2011 and December 31, 2010, classified by type of issuer (dollar amounts in thousands):

	March 31, 2011		December 31, 2010	
Agency	Fair Value	Portfolio Percentage	Fair Value	Portfolio Percentage
Fannie Mae (FNM)	$ 5,714,021	70.2%	$ 5,552,024	71.8%
Freddie Mac (FHLMC)	2,410,112	29.6	2,163,469	28.0
Ginnie Mae (GNMA)	18,589	0.2	19,165	0.2
Total Agency MBS:	$ 8,142,722	100.0%	$ 7,734,658	100.0%

The following table classifies the fair value of our Agency MBS owned at March 31, 2011 and December 31, 2010 by type of interest rate index (dollar amounts in thousands):

	March 31, 2011		December 31, 2010	
Index	Fair Value	Portfolio Percentage	Fair Value	Portfolio Percentage
One-month LIBOR	$ 3,791	0.0%	$ 4,187	0.0%
Six-month LIBOR	82,653	1.0	87,894	1.1
One-year LIBOR	6,154,122	75.6	5,778,465	74.8
Six-month certificate of deposit	1,314	0.0	1,339	0.0
Six-month constant maturity treasury	481	0.0	497	0.0
One-year constant maturity treasury	369,608	4.5	386,332	5.0
Cost of Funds Index	28,319	0.4	29,167	0.4
15-year fixed-rate	900,285	11.1	795,687	10.3
30-year fixed-rate	602,149	7.4	651,090	8.4
Total Agency MBS:	$ 8,142,722	100.0	$ 7,734,658	100.0%

The fair values indicated do not include interest earned but not yet paid. With respect to our hybrid adjustable-rate Agency 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. The fair value of our Agency MBS is reported to us independently from dealers who are major financial institutions and are considered to be market makers for these types of instruments. For more detail on the fair value of our Agency MBS, see Note 6 to the accompanying unaudited consolidated financial statements.

The weighted average coupons and average amortized costs of our Agency MBS at March 31, 2011 and December 31, 2010 were as follows:

	March 31, 2011	December 31, 2010
Weighted Average Coupon:		
Adjustable-rate	3.74%	3.77%
Hybrid adjustable-rate	3.66	3.83
15-year fixed-rate	3.72	3.68
30-year fixed-rate	5.56	5.56
CMOs	1.06	1.07
Total Agency MBS:	3.82%	3.94%
Average Amortized Cost:		

Adjustable-rate and hybrid adjustable-rate	102.62%	102.62%
15-year fixed-rate	103.21	103.27
30-year fixed-rate	100.73	100.72
Total Agency MBS:	102.55%	102.53%
Current yield (weighted average coupon divided by average amortized cost)	3.72%	3.84%

Table of Contents

Relative to our Agency MBS portfolio at March 31, 2011, the average interest rate on outstanding repurchase agreements was 0.28% and the average days to maturity was 36 days. After adjusting for interest rate swap transactions, the average interest rate on outstanding repurchase agreements was 1.32% and the weighted average term to next rate adjustment was 441 days. Relative to our Agency MBS portfolio at December 31, 2010, the average interest rate on outstanding repurchase agreements was 0.30% and the average days to maturity was 31 days. After adjusting for interest rate swap transactions, the average interest rate on outstanding repurchase agreements was 1.43% and the weighted average term to next rate adjustment was 418 days.

At March 31, 2011 and December 31, 2010, the unamortized net premium paid for our Agency MBS was $200 million and $189 million, respectively.

One of the factors that impacts the reported yield on our MBS portfolio is the actual prepayment rate on the underlying mortgages. We analyze our MBS and the extent to which prepayments impact the yield. 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 CPR, the premium would be amortized over a longer time period, resulting in a higher yield to maturity.

Non-Agency MBS Portfolio

Non-Agency MBS are securities not issued by the government or government-sponsored enterprises and are secured primarily by first-lien residential mortgage loans. At March 31, 2011, our Non-Agency MBS portfolio consisted of a fair value of $4 million of floating-rate CMOs with an average coupon of 0.50% which were acquired at par value. At December 31, 2010, our Non-Agency MBS portfolio consisted of a fair value of $4.4 million of floating-rate CMOs with an average coupon of 0.51% which were acquired at par value.

At March 31, 2011, the fair value of our Non-Agency MBS portfolio decreased to approximately $4 million from a fair value of approximately $4.4 million at December 31, 2010. The decrease was due primarily to principal paydowns of approximately $0.5 million offset by an increase in an unrealized gain of approximately $0.1 million.

At March 31, 2011, the amortized cost of our Non-Agency MBS was $205 thousand. At December 31, 2010, the amortized cost of our Non-Agency MBS was $689 thousand.

At March 31, 2011, two securities representing the principal balance of our Non-Agency MBS portfolio were rated C by Moody s Investor Service. At March 31, 2011, a security representing approximately 67% of the principal balance of our Non-Agency MBS portfolio was rated D (which was downgraded during the quarter from CC) by Standard & Poor s and a security representing approximately 33% of the principal balance of our Non-Agency MBS portfolio continued to be rated CC by Standard & Poor s

We received valuations at March 31, 2011 and December 31, 2010 for the Non-Agency MBS from an independent third party pricing service whose methodologies are based on broker-provided pricing as well as indirect observation of market activity and we consider the fair value measurement a Level 3 input at March 31, 2011 and December 31, 2010. For more detail on the fair value of our Non-Agency MBS, see Note 6 to the accompanying unaudited consolidated financial statements.

Table of Contents

The table below provides additional details regarding our Non-Agency MBS portfolio at March 31, 2011 and December 31, 2010:

	March 31, 2011	December 31, 2010
Non-Agency MBS at fair value	$ 4.0 million	$ 4.4 million
Principal balance of Non-Agency MBS	$ 35.28 million	$ 38.23 million
Original principal balance on Non-Agency MBS	$ 60 million	$ 60 million
Original FICO (credit score)	730	730
Information on Loan Collateral of Non-Agency MBS Securitizations:		
Loan principal as percentage of original loan principal	58.7%	62.8%
Weighted average original loan-to-value (LTV)	69%	69%
Weighted average original LTV adjusted for negative loan amortization	72%	72%
California loans(1)	70%	70%
Pay-option ARM loans(1)	100%	100%
2006 loan originations(1)	99%	99%
3-month CPR	10.6%	12.2%
Loans in foreclosure(1)	19.2%	17.2%
Real estate owned (REO)(1)(2)	3.4%	2.9%
Total seriously delinquent(1)(3)	34.5%	31.4%
Realized losses (as percentage of original collateral balance)	8.1%	7.4%
Information on Subordination Levels of Non-Agency MBS Securitizations(4):		
Average securitization principal subordinate to Anworth-owned tranches	0.4%	0.8%
Average securitization principal of Anworth-owned tranches	16.0%	16.8%
Average securitization principal senior to Anworth-owned tranches	83.6%	82.4%

(1) As a percentage of collateral loan principal.
(2) Represents the amount of collateral loan principal where the properties are now REO.
(3) Includes 90+ days delinquent plus foreclosures plus bankruptcy plus REO.
(4) Weighted average as percentage of collateral loan principal at March 31, 2011 and December 31, 2010.

Hedging

We periodically enter into derivative transactions, in the form of forward purchase commitments and interest rate swap agreements, which are intended to hedge our exposure to rising interest 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 those hedging transactions should be qualifying income under the REIT rules for purposes of the 95% gross income test and 75% gross income test. To qualify for this exclusion, the hedging transaction must be clearly identified as such before the close of the day on which it was acquired, originated or entered into. The transaction also must hedge indebtedness incurred or to be incurred by us to acquire or carry real estate assets.

As part of our asset/liability management policy, we may enter into hedging agreements such as interest rate caps, floors or swaps. These agreements are entered into to try to reduce interest rate risk and are 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, 2011, we were a counter-party to swap agreements, which are derivative instruments as defined by ASC 815-10, with an aggregate notional amount of $2.735 billion and an average maturity of 2.96 years. We 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

29

agreements and receive a payment that varies with the three-month LIBOR rate. At March 31, 2011, there were unrealized losses of approximately $42.3 million on our swap agreements.

For more information on the amounts, policies, objectives and other qualitative data on our hedge agreements, see Notes 1, 6 and 12 to the accompanying unaudited consolidated financial statements.

Liquidity and Capital Resources

Agency MBS and Non-Agency MBS Portfolios

Our primary source of funds consists of repurchase agreements which totaled $6.92 billion at March 31, 2011. As collateral for these repurchase agreements, we pledged approximately $7.32 billion in Agency MBS. Our other significant source of funds for the three months ended March 31, 2011 consisted of payments of principal from our Agency MBS portfolio in the amount of $441 million.

For the three months ended March 31, 2011, there was a net decrease in cash and cash equivalents of approximately $6.3 million. This consisted of the following components:

- Net cash used in operating activities for the three months ended March 31, 2011 was approximately $128.1 million. This is comprised of net income of $31.2 million, adding back the following non-cash items: the amortization of premiums and discounts of approximately $12.2 million and the amortization of restricted stock of $70 thousand. Net cash used in operating activities also included a decrease in accrued expenses of approximately $170.4 million (due primarily to a decrease in payables for securities purchased), an increase in interest receivable of approximately $1.2 million, a decrease in accrued interest payable of approximately $0.9 million, partially offset by a decrease in prepaid expenses and other assets of approximately $0.9 million,; and

- Net cash used in investing activities for the three months ended March 31, 2011 was approximately $420.9 million which consisted of purchases of Agency MBS of approximately $862.4 million, partially offset by $441.1 million from principal payments on Agency MBS and payments on Non-Agency MBS of approximately $483 thousand; and

- Net cash provided by financing activities for the three months ended March 31, 2011 was approximately $542.7 million. This consisted of borrowings on repurchase agreements of approximately $8.75 billion, partially offset by repayments on repurchase agreements of approximately $8.20 billion. This also included net proceeds from common stock issued of approximately $21.9 million and net proceeds from Series B Preferred Stock issued of $3.8 million less dividends paid of $26.6 million on common stock and dividends paid of approximately $1.4 million on preferred stock.

Relative to our Agency MBS portfolio at March 31, 2011, all of our repurchase agreements were fixed-rate term repurchase agreements with original maturities ranging from 27 days to three months. At March 31, 2011, we had borrowed funds under repurchase agreements with 17 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 or increasing market concern about the liquidity or value of our MBS 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, 2011 but there can be no assurance we will have adequate cash flow, liquid assets and unpledged collateral with which to meet our margin requirements in the future.

Our leverage on capital (including all preferred stock and junior subordinated notes) increased from 6.8x at December 31, 2010 to 7.1x at March 31, 2011.

In the future, we expect that our primary sources of funds will continue to consist of borrowed funds under repurchase agreement transactions and monthly payments of principal and interest on our MBS portfolio. Our liquid assets generally consist of unpledged MBS, cash and cash equivalents. A large negative change in the market value of our MBS might reduce our liquidity, requiring us to sell assets with the likely result of realized losses upon sale.

During the three months ended March 31, 2011, we raised approximately $7.5 million in capital under our Dividend Reinvestment and Stock Purchase Plan.

Table of Contents

At March 31, 2011, our authorized capital included 20 million shares of $0.01 par value preferred stock, which we have classified as Series A Preferred Stock and Series B Preferred Stock. During the three months ended March 31, 2011, we did not issue any shares of Series A Preferred Stock. During the three months ended March 31, 2011, we issued an aggregate of 158,500 shares of Series B Preferred Stock

During the three months ended March 31, 2011, we issued an aggregate of 2,076,900 shares of common stock at a weighted average price of $7.07 per share under 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 $14.5 million, net of sales commissions and less reimbursement of fees. Cantor, as sales agent, received an aggregate commission of approximately $255 thousand, which represents an average commission of approximately 2.0% on the gross sales price per share. During the three months ended March 31, 2011, we issued an aggregate of 158,500 shares of Series B Preferred Stock at a weighted average price of $24.39 per share under our amended Controlled Equity Offering Sales Agreement with Cantor, which provided net proceeds to us of approximately $3.8 million, net of sales commissions and less reimbursement of fees. Cantor, as sales agent, received an aggregate commission of approximately $77 thousand, which represents an average commission of approximately 2.0% on the gross sales price per share. During the three months ended March 31, 2011, we did not issue any shares of Series A Preferred Stock under our amended Controlled Equity Offering Sales Agreement with Cantor. At March 31, 2011, there were 3,025,000 shares of common stock, 1,250,000 shares of Series A Preferred Stock and 1,744,300 shares of Series B Preferred Stock, respectively, available for future issuance under the amended Controlled Equity Offering Sales Agreement.

On February 1, 2010, we announced that our board of directors had authorized a share repurchase program, permitting us to acquire 5,850,000 shares of our common stock, or approximately 5% of our then outstanding common stock. The shares were acquired at prevailing prices through open market transactions. The manner, price, number and timing of these share repurchases were subject to market conditions and applicable SEC rules. During the three months ended March 31, 2011, we did not repurchase any shares under this program. As the share repurchase program had a one-year term only, it expired on January 27, 2011. From February 1, 2010 through January 27, 2011, we had repurchased an aggregate of 3,724,121 shares at a weighted average price of $6.57 per share under this program.

Disclosure of Contractual Obligations

There were no material changes outside the normal course of business during the three months ended March 31, 2011 to the contractual obligations identified in our Form 10-K for the fiscal year ended December 31, 2010.

Stockholders Equity

We use available-for-sale treatment for our Agency MBS and Non-Agency MBS, which are carried on our consolidated balance sheets at fair value rather than historical cost. Based upon this treatment, our total equity base at March 31, 2011 was $907.5 million. Common stockholders equity was approximately $858.6 million or a book value of $6.92 per share.

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 temporary, they do not impact GAAP 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 available-for-sale securities.

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 sheets 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 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. Accumulative other comprehensive income, unrealized gain on available-for-sale Agency MBS was approximately $79.9 million or 1.0% of the amortized cost of our Agency MBS at March 31, 2011. This, along with Accumulative other comprehensive loss, derivatives of approximately $42.3 million and Accumulated other comprehensive gain, Non-Agency MBS of $3.8 million, constitutes the total Accumulative other comprehensive income of approximately $41.4 million.

Table of Contents

Critical Accounting Policies

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

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 on the basis of information then readily available to it of certain amounts included in the unaudited consolidated financial statements, giving due consideration to materiality. 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 and adversely from these estimates.

Our accounting policies are described in Note 1 to the accompanying unaudited consolidated financial statements. Management believes the more significant of our accounting policies are the following:

Revenue Recognition

The most significant source of our revenue is derived from our investments in MBS. 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 MBS 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 and estimated prepayments based on ASC 320-10. 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, 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 balance sheet at fair value. The fair values of our Agency MBS are generally based on third party bid price indications provided by certain dealers who make markets in such securities. The fair value of our Non-Agency MBS are obtained from an independent third party pricing service whose methodologies are based on broker-provided pricing as well as indirect observation of market activity. If, in the opinion of management, one or more securities prices reported to us are not reliable or unavailable, management reviews 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 (i.e., 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 are attributable to changes in interest rates and not credit quality, and because we do not have the intent to sell these investments nor is it not more likely than not that we will be required to sell these investments before recovery of their amortized cost bases, which may be at maturity, we do not consider these investments to be other-than-temporarily impaired. Losses (that are related to credit quality) 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 (loss) to current-period income (loss). For more detail on the fair value of our securities, see Note 6 to the accompanying unaudited consolidated financial statements.

Accounting for Derivatives and Hedging Activities

In accordance with ASC 815-10, 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 ASC 815-10.

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 sheets at their fair value based on values obtained from large financial institutions, who are market makers for these types of instruments. 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 (loss) 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. For more detail on our derivative instruments, see Notes 1, 6 and 12 to the accompanying unaudited consolidated financial statements.

Income Taxes

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 allow us to be taxed as a REIT and, as a result, management does not expect to pay substantial, if any, 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.

Recent Accounting Pronouncements

A description of recent accounting pronouncements, the date adoption is required and the impact on our unaudited consolidated financial statements is contained in Note 1 to the accompanying unaudited consolidated financial statements.

Subsequent Events

On April 13, 2011, 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 was payable on April 15, 2011 to our holders of record of Series A Preferred Stock and Series B Preferred Stock, respectively, as of the close of business on March 31, 2011.

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 that 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. This conversion rate increased on April 12, 2011 from 3.4094 shares of our common stock to 3.4778 shares of our common stock using the following information: (1) the average of the closing price of our common stock for the ten (10) consecutive trading day period was $7.12 and (2) the annualized common stock dividend yield was 14.0449%.

From April 1, 2011 through May 2, 2011, we sold an aggregate of 875,100 shares of common stock at a weighted average price of $7.27 per share pursuant to our amended Controlled Equity Offering Sales Agreement with Cantor, which provided net proceeds to us of approximately $6.2 million, net of sales commissions less reimbursement of fees. Cantor, as the sales agent, received an aggregate commission of approximately $127 thousand, which represents an average commission of approximately 2.0% on the gross sales price per share. From April 1, 2011 through May 2, 2011, we sold 10,346 shares of Series B Preferred Stock at a weighted average price of $24.75 per share pursuant to our amended Controlled Equity Offering Sales Agreement with Cantor, which provided net proceeds to us of approximately $251 thousand, net of sales commissions less reimbursement of fees. Cantor, as the sales agent, received a commission of approximately $5 thousand, which represents an average commission of approximately 2.0% on the gross sales price per share.

From April 1, 2011 through May 2, 2011, there were four transactions to convert an aggregate of 79,100 shares of Series B Preferred Stock into an aggregate of 269,681 shares of our common stock (at the then-current conversion rate of 3.4094).

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 instruments 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 returns 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 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 varies.

Table of Contents

At March 31, 2011, our Agency MBS and Non-Agency MBS and the related borrowings will prospectively reprice based on the following time frames (dollar amounts in thousands):

	Investments(1)(2)		Borrowings	
	Amount	Percentage of Total Investments	Amount	Percentage of Total Borrowings
Investment Type/Rate Reset Dates:				
15-year fixed-rate investments	$ 900,285	11.1%	$ 0	0.0%
30-year fixed-rate investments	602,149	7.4	0	0.0
Adjustable-Rate Investments/Obligations:				
Less than 3 months	491,245	6.0	6,920,000	100.0
Greater than 3 months and less than 1 year	1,346,276	16.5	0	0.0
Greater than 1 year and less than 2 years	710,375	8.7	0	0.0
Greater than 2 years and less than 3 years	342,158	4.2	0	0.0
Greater than 3 years and less than 5 years	3,754,224	46.1	0	0.0
Total:	$ 8,146,712	100.0%	$ 6,920,000	100.0%

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

(2) We assume that if the repricing of the investment is just beyond 3 months but less than 4 months, it is included in the Less than 3 months category.

At December 31, 2010, our Agency MBS and Non-Agency MBS and the related borrowings will prospectively reprice based on the following time frames (dollar amounts in thousands):

	Investments(1)(2)		Borrowings	
	Amount	Percentage of Total Investments	Amount	Percentage of Total Borrowings
Investment Type/Rate Reset Dates:				
15-year fixed-rate investments	$ 795,687	10.3%	$ 0	0.0%
30-year fixed-rate investments	651,090	8.4	0	0.0
Adjustable-Rate Investments/Obligations:				
Less than 3 months	441,146	5.7	6,375,000	100.0
Greater than 3 months and less than 1 year	1,278,847	16.5	0	0.0
Greater than 1 year and less than 2 years	880,765	11.4	0	0.0
Greater than 2 years and less than 3 years	503,878	6.5	0	0.0
Greater than 3 years and less than 5 years	3,187,639	41.2	0	0.0
Total:	$ 7,739,052	100.0%	$ 6,375,000	100.0%

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

(2) We assume that if the repricing of the investment is just beyond 3 months but less than 4 months, it is included in the Less than 3 months category.

Market Value Risk

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 (that is not considered to be an other-than-temporary impairment) reflected as part of Accumulated other comprehensive income that is included in the equity section of our balance sheet. The market value of our assets can fluctuate due to changes in interest rates and other factors.

Liquidity Risk

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, 2011, our Agency MBS and Non-Agency adjustable-rate MBS had a weighted average term to next rate adjustment of approximately 35 months while our borrowings had a weighted average term to next rate adjustment of 36 days. After adjusting for interest rate swap transactions, the weighted average term to next rate adjustment was 441 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. Our assets that are pledged to secure short-term borrowings are high-quality liquid assets. As a result, we have been able to roll over our short-term borrowings as they mature. There can be no assurance that we will always be able to roll over our short-term debt.

During the past year, there were continuing liquidity and credit concerns surrounding the mortgage markets and the general economy. While the U.S. government and other governments have taken various actions to address these concerns, there continue to be severe restrictions on the availability of financing in general and concerns about the potential impact on product availability, liquidity, interest rates and changes in the yield curve. While we have been able to meet all of our liquidity needs to date, there are still concerns in the mortgage sector about the availability of financing generally.

At March 31, 2011, we had unrestricted cash of $4.3 million and $808 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. In addition, 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 MBS. As we receive repayments of mortgage principal, we amortize the premium balances as a reduction to our income. If the mortgage loans underlying MBS were prepaid at a faster rate than we anticipate, we would amortize the premium at a faster rate. This would reduce our income.

General

Many assumptions are made to present the information in the tables below 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 tables below 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 shock rate 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.

Tabular Presentation

The information presented in the tables below projects the impact of sudden changes in interest rates on Anworth s annual Projected Net Interest Income and Projected Portfolio Value, as more fully discussed below, based on our investments in place at March 31, 2011 and includes all of our interest rate-sensitive assets, liabilities and hedges, such as interest rate swap agreements.

36

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 the value of our assets that we carry at fair value and any change in the value of any derivative instruments or hedges, such 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%	52.5%	0.1%
1%	12.6%	0.9%
0%	0%	0%
1%	17.7%	2.6%
2%	35.4%	5.7%

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 instantaneous decline in interest rates from the 0% change scenario is estimated to result in an approximate 72% increase in the prepayment rate of our Agency MBS and Non-Agency MBS portfolios. The base interest rate scenario assumes interest rates at March 31, 2011. Actual results could differ significantly from those estimated in the tables. The above table includes the effect of interest rate swap agreements. At March 31, 2011, the aggregate notional amount of the interest rate swap agreements was $2.735 billion and the weighted average maturity was 2.96 years.

The information presented in the table below projects the impact of sudden changes in interest rates on Anworth s annual Projected Net Income and Projected Portfolio Value compared to the base case used in the table above and <u>excludes</u> 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%	6.2%	2.0%
1%	33.7%	1.9%
0%	0%	0%
1%	8.1%	3.5%
2%	25.9%	7.6%

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) that are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC s rules, regulations and forms and that such information is accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow for timely decisions regarding required disclosure. 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 Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness in design and operation of our disclosure controls and procedures as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on such evaluation, our Chief Executive Officer and Chief 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 information required to be disclosed by us in our reports filed or submitted under the Exchange Act within the time periods specified in the SEC s rules, regulations and forms. Our management, with the participation of our Chief Executive Officer and Chief 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

Table of Contents

file or submit under the Exchange Act is accumulated and communicated to management, including our Chief Executive Officer and Chief 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.

Table of Contents

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 factors in our Annual Report on Form 10-K for the year ended December 31, 2010 have been modified as follows. The materialization of any risks and uncertainties identified in our Forward Looking Statements contained in this report together with those previously disclosed in the Form 10-K or those that are presently unforeseen could result in material and adverse effects on our financial condition, results of operations and cash flows. See Item 2, Management s Discussion and Analysis of Financial Condition and Results of Operations Forward Looking Statements in this Quarterly Report on Form 10-Q.

Risks Related to our Business

New laws may be passed affecting the relationship between Fannie Mae and Freddie Mac, on the one hand, and the federal government, on the other, which could adversely affect the price of agency MBS.

The interest and principal payments we expect to receive on the Agency 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 MBS in which we invest depend on a steady stream of payments on the mortgages underlying the securities.

Since September 2008, there have been increased market concerns about Fannie Mae s and Freddie Mac s ability to withstand future credit losses associated with securities held in their investment portfolios, and on which they provide guarantees, without the direct support of the federal government. Fannie Mae and Freddie Mac were placed into the conservatorship of the Federal Housing Finance Agency, or FHFA, their federal regulator, pursuant to its powers under The Federal Housing Finance Regulatory Reform Act of 2008, a part of the Housing and Economic Recovery Act of 2008.

In addition to FHFA becoming the conservator of Fannie Mae and Freddie Mac, the U.S. Department of the Treasury has taken various actions intended to provide Fannie Mae and Freddie Mac with additional liquidity and ensure their financial stability. The U.S. Treasury can hold its portfolio of Agency MBS to maturity and, based on mortgage market conditions, may make adjustments to the portfolio. This flexibility may adversely affect the pricing and availability for our target assets. It is also possible that if and when the U.S. Treasury commits to purchase Agency MBS in the future, it could create additional demand that would increase the pricing of Agency MBS that we seek to acquire.

Shortly after Fannie Mae and Freddie Mac were placed in federal conservatorship, the Secretary of the U.S. Treasury suggested that the guarantee payment structure of Fannie Mae and Freddie Mac should be re-examined. The future roles of Fannie Mae and Freddie Mac could be significantly reduced and the nature of their guarantees could be eliminated or considerably limited relative to historical measurements. The U.S. Treasury could also stop providing credit support to Fannie Mae and Freddie Mac in the future. Any changes to the nature of the guarantees provided by Fannie Mae and Freddie Mac could redefine what constitutes an Agency MBS and could have broad adverse market implications. In addition, if Fannie Mae or Freddie Mac were eliminated, or their structures were to change radically, we would not be able to acquire Agency MBS from these companies, which would eliminate the major component of our business model. In February 2011, the U.S. Department of the Treasury and the U.S. Department of Housing and Urban Development released a report to Congress titled Reforming America s Housing Finance Market (the 2011 Report). The Report includes general proposals to wind down Fannie Mae and Freddie Mac by requiring them to increase guarantee fees, reducing conforming loan limits and reducing their investment portfolios.March 31, 2011 The Report also recommends increased government regulation of the Agency MBS market and MBS markets generally.

Our income could be negatively affected in a number of ways depending on the implementation of one or more of the proposals in the Report and the manner in which related events unfold. For example, the current credit support provided by the U.S. Treasury to Fannie Mae and Freddie Mac, and any additional credit support it may provide in the future, could have the effect of lowering the interest rate we expect to receive from Agency MBS that we seek to acquire, thereby tightening the spread between the interest we earn on our portfolio of targeted assets and our cost of financing that portfolio. A reduction in the supply of Agency MBS could also negatively affect the pricing of Agency MBS we seek to acquire by reducing the spread between the interest we earn on our portfolio of targeted assets and our cost of financing that portfolio.

39

Table of Contents

Any law affecting these government-sponsored enterprises may create market uncertainty and have the effect of reducing the actual or perceived credit quality of securities issued or guaranteed by Fannie Mae or Freddie Mac. As a result, such laws could increase the risk of loss on investments in Fannie Mae and/or Freddie Mac Agency MBS. It also is possible that such laws could adversely impact the market for such securities and spreads at which they trade. All of the foregoing could materially adversely affect our business, operations and financial condition.

Continued adverse developments in the residential mortgage market may adversely affect the value of the Agency MBS in which we intend to invest.

During the past several years, the residential mortgage market in the U.S. has experienced a variety of difficulties and changing 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 MBS. As a result, values for MBS assets, including some agency MBS, have been negatively impacted. Future inflation, or a perceived increase in inflation risk, could also increase volatility and deterioration in the broader residential mortgage and MBS markets. Further increased volatility and deterioration in the broader residential mortgage and MBS markets may adversely affect the performance and market value of the Agency MBS 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. Inflation, or a perceived increase in inflation risk, could cause a decline in the value of our Agency MBS. If market conditions result in a decline in the value of our Agency MBS, our financial position and results of operations could be adversely affected.

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

None.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. Reserved.

Item 5. Other Information.

(a) Additional Disclosures. None.

(b) Stockholder Nominations. There have been no material changes to the procedures by which stockholders may recommend nominees to our board of directors during the quarter ended March 31, 2011. Please see the discussion of our procedures in our most recent proxy statement filed with the SEC on March 29, 2011 on Form DEF 14A.

Item 6. Exhibits.

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

Exhibit	**Description**

Number	
1.1	Controlled Equity Offering Sales Agreement dated May 14, 2008 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 May 15, 2008)
1.2	Amendment No. 1 to Sales Agreement dated February 8, 2011 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 February 8, 2011)
3.1	Amended Articles of Incorporation of Anworth (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	Amended Bylaws of the Company (incorporated by reference from our Current Report on Form 8-K filed with the SEC on March 13, 2009)
3.3	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)

Exhibit Number	Description
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 November 3, 2004)
3.5	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)
3.6	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)
3.7	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 May 21, 2007)
3.8	Articles of Amendment to Amended Articles of Incorporation (incorporated by reference from our Current Report on Form 8-K filed with the SEC on May 28, 2008)
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, 2005)
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, 2005)
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, 2005)
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, 2005)
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 SEC on May 17, 2002), as amended by Amendment No. 1 to 2002 Incentive Compensation Plan (incorporated by reference from our Current Report on Form 8-K filed with the SEC on October 15, 2009)
10.2*	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)
10.3*	2007 Dividend Equivalent Rights 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, 2007)
10.4	2009 Dividend Reinvestment and Stock Purchase Plan (incorporated by reference from our Registration Statement on Form S-3ASR, Registration No. 333-164047, which became effective under the Act on December 28, 2009)

Table of Contents

Exhibit Number	Description
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), February 22, 2008 (incorporated by reference from our Current Report on Form 8-K filed with the SEC on February 27, 2008) , December 30, 2008 (incorporated by reference from our Current Report on Form 8-K filed with the SEC on January 2, 2009) and October 14, 2009 (incorporated by reference from our Current Report on Form 8-K, filed with the SEC on October 15, 2009).
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) and October 14, 2009 (incorporated by reference from our Current Report on Form 8-K, filed with the SEC on October 15, 2009).
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), February 22, 2008 (incorporated by reference from our Current Report on Form 8-K filed with the SEC on February 27, 2008) , December 30, 2008 (incorporated by reference from our Current Report on Form 8-K filed with the SEC on January 2, 2009) and October 14, 2009 (incorporated by reference from our Current Report on Form 8-K, filed with the SEC on October 15, 2009).
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*	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)
10.10	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)

Table of Contents

Exhibit Number	Description
10.11	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 McAdams, Thad Brown and the several Holders, as defined therein. (incorporated by reference from our Annual Report on Form 10-K for the fiscal year ended December 31, 2005, as filed with the SEC on March 16, 2006)
10.12*	Change in Control and Arbitration Agreement dated June 27, 2006, between Anworth and Thad M. Brown (incorporated by reference from our Current Report on Form 8-K filed with the SEC on June 28, 2006)
10.13*	Change in Control and Arbitration Agreement dated June 27, 2006, between Anworth and Charles J. Siegel (incorporated by reference from our Current Report on Form 8-K filed with the SEC on June 28, 2006)
10.14*	Change in Control and Arbitration Agreement dated June 27, 2006, between Anworth and Evangelos Karagiannis (incorporated by reference from our Current Report on Form 8-K filed with the SEC on June 28, 2006)
10.15*	Change in Control and Arbitration Agreement dated June 27, 2006, between Anworth and Bistra Pashamova (incorporated by reference from our Current Report on Form 8-K filed with the SEC on June 28, 2006)
10.16	Amended and Restated Administrative Services Agreement dated August 20, 2010, between Anworth and PIA (incorporated by reference from our Current Report on Form 8-K filed with the SEC on August 20, 2010)
31.1	Certification of the Principal Executive Officer, as required by Rule 13a-14(a) of the Securities Exchange Act of 1934
31.2	Certification of the Principal Financial Officer, as required by Rule 13a-14(a) of the Securities Exchange Act of 1934
32.1	Certifications of the Principal 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 Principal Financial Officer provided pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
99.1	Risk Factors Incorporated by Reference to our Definitive Proxy Statement
101**	XBRL Instance Document
101**	XBRL Taxonomy Extension Schema Document
101**	XBRL Taxonomy Extension Calculation Linkbase Document
101**	XBRL Taxonomy Definition Linkbase Document
101**	XBRL Taxonomy Extension Labels Linkbase Document
101**	XBRL Taxonomy Extension Presentation Linkbase Document

* Represents a management contract or compensatory plan, contract or arrangement in which any director or any of the named executives participates.

** XBRL (Extensible Business Reporting Language) information is furnished and not filed or a part of a registration statement or prospectus for purposes of Section 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, and otherwise is not subject to liability under these sections.

Table of Contents

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 3, 2011

/s/ JOSEPH LLOYD MCADAMS

Joseph Lloyd McAdams

Chairman of the Board, President and Chief Executive Officer

(Chief Executive Officer)

Dated: May 3, 2011

/s/ THAD M. BROWN

Thad M. Brown

Chief Financial Officer

(Chief Financial Officer and Principal Accounting Officer)

44