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THE BIG SECRET ON WALL STREET

"It's Like Treasuries On Steroids"

FROM THE DESK OF PORTER STANSBERRY

SPECIAL REPORT

Note: This issue of ***The Big Secret on Wall Street*** was originally published on February 3, 2023. Information in this report reflects the time of publication. For the latest updates on our open positions, please visit our live portfolio link **here**.

"It's Like Treasuries On Steroids"

Poor People Have Welfare, Social Security and Medicare: This Is The Dole for Rich People

Everyone *thinks* they know the story about the Dutch tulip mania.

You know, everyone in Europe from prime ministers to chimney sweeps sold everything to lay hands on prized "broken" flowers, striped by a mosaic virus. At the height of the madness, buyers traded mansions for a single bulb. Once, a hapless sailor mistook a tulip bulb for an onion, sliced it up and ate it on a sandwich, and went to jail… for destroying a million dollars' worth of property.

When the bubble burst – as all bubbles must – ruined speculators committed suicide and Holland's economy sank into depression.

There's just one problem with the narrative: none of it is true.

Most of the legends about tulip mania – which was actually a fad confined to a few wealthy merchants, and in reality didn't disrupt Holland's economy in any meaningful way – sprang from the fertile imagination of a Scottish poet and journalist named Charles Mackay.

Mackay is most famous for the 1840s investment psychology classic *Memoirs of Extraordinary Popular Delusions and the Madness of Crowds*, where he fabricated most of the details of "Tulipomania" as a warning to traders. The fable has since burrowed so deeply into our investment and cultural zeitgeist that we accept it as fact.

Mackay was a master storyteller. He was also deeply steeped in denial.

At the same time that he was spinning cautionary tales about the non-existent tulip bubble, Mackay was in the thick of a real-life bubble of his own: the British railway mania.

On September 15, 1830, the launch of the Liverpool and Manchester railway gave birth to the modern railroad industry. For the first time in history, cheap and fast movement of goods and people between distant cities became possible.

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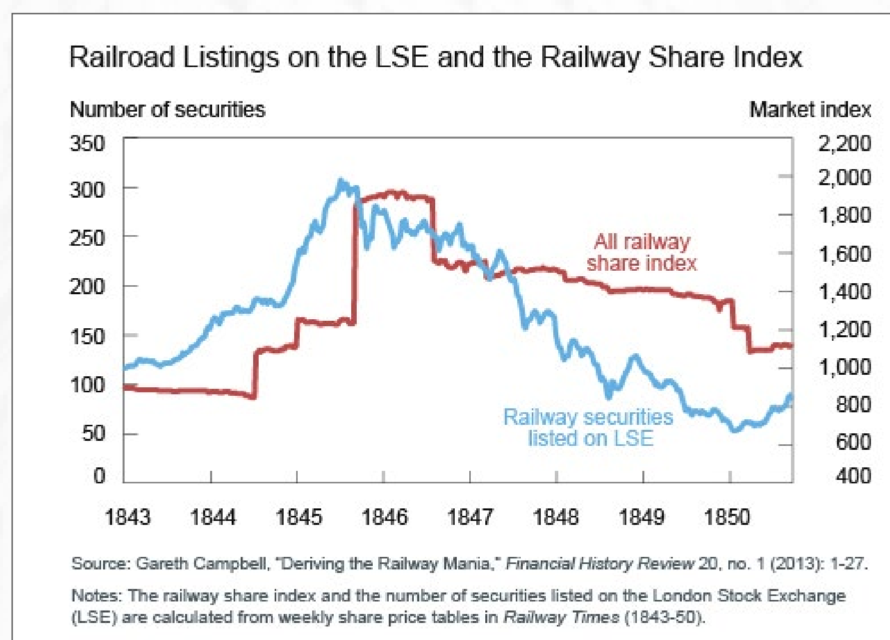
As rail transport exploded across Britain, the public became swept up by the promises of this revolutionary new technology. Speculators and promoters seized on the frenzy to raise capital and peddle increasingly dubious investment prospects to the unsuspecting public (and to many household names, like Charles Darwin and the Brontë sisters). Share prices of publicly traded railway companies surged across the board, regardless of the viability of their underlying businesses… with all of the predictable consequences.

The boom reached its zenith in 1846, with the British parliament approving a record 236 listings of new railway corporations, which together promised to lay 9,500 miles of track.

The bust followed shortly thereafter, as a broad index of railway share prices was cut in half during the "Panic of 1847." Many shareholders were wiped out completely as bankruptcies swept across the industry. Roughly two-thirds of the publicly listed stocks were delisted from the exchange or bought out at pennies on the dollar.



Source: Gareth Campbell, "Deriving the Railway Mania," *Financial History Review* 20, no. 1 (2013): 1-27.

Notes: The railway share index and the number of securities listed on the London Stock Exchange (LSE) are calculated from weekly share price tables in *Railway Times* (1843-50).

Charles Mackay somehow didn't see this pattern. Or he outright ignored it.

During the peak years of railway mania, 1844 through 1846, Mackay served as editor of a paper called the *Glasgow Argus* – where he wrote puff pieces encouraging railway speculation and soothing the fears of investors.

"We think that those who sound the alarm of an approaching railway crisis have somewhat exaggerated the danger," he wrote in 1845. "We think the alarmists are in error and that there is no reason whatever to fear for any legitimate railway speculation."

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At the same time, he resolutely refuted the suggestion that earlier bubbles – like the ones he himself examined in *Extraordinary Popular Delusions* – had anything in common with the railway craze:

> *It may appear wise to the careless or to the ignorant to trace resemblances. Those, however, who look more deeply into the matter and think for themselves cannot discover sufficient resemblance of cause to anticipate a similarity of effect.”*

After the disastrous Panic of 1847, though, Mackay’s silence spoke volumes.

Although *Delusions* became a perennial bestseller, with many updated editions… at no time did he ever mention the railway bubble, except once in an oblique footnote.

Why did Charles Mackay, the bubble expert, have such a blind spot?

Simply put, the tale of speculative mania going bust is as old as time itself. And denial prior to the bust is equally time-honored. It is historically hard for speculators to accept the end of a bull market.

Take October 29, 1929, “Black Tuesday” – the stock market crash that started the Great Depression. Plunging stock prices decimated customer positions, leaving brokerage firms on the hook for the unpayable margin debts of millions of speculators.

The next day, denial hit the front page of the *New York Times* in full force.

"All the News That's Fit to Print."

The New York Times.

THE WEATHER

GRUNDY FOR CURBING 'BACKWARD STATES' ON THE TARIFF BILL

KAHN REFUSES POST IN SENATE CAMPAIGN; CALLS CHOICE UNWISE

STOCKS COLLAPSE IN 16,410,030-SHARE DAY, BUT RALLY AT CLOSE CHEERS BROKERS; BANKERS OPTIMISTIC, TO CONTINUE AID

LEADERS SEE FEAR WANING

Point to 'Lifting Spells' in Trading as Sign of Buying Activity.

CLOSING RALLY VIGOROUS

Leading Issues Regain From 4 to 14 Points in 15 Minutes.

COALITION FIGHTING MOVE TO KILL TARIFF

MISSING AIRLINER BROUGHT IN SAFELY

U. S. STEEL TO PAY $1 EXTRA DIVIDEND

RESERVE BOARD FINDS ACTION UNNECESSARY

There’s no mention of real estate investor C. Fred Stewart, who gassed himself to death in his kitchen… or Wellington Lytle, who died with just four cents to his name… or John Schwitzgebel, who shot himself and was found lying under the stock pages of the newspaper.

Ah, no. In this upbeat world, “Rally at close cheers brokers.” And optimistic bankers stand by to “aid” the

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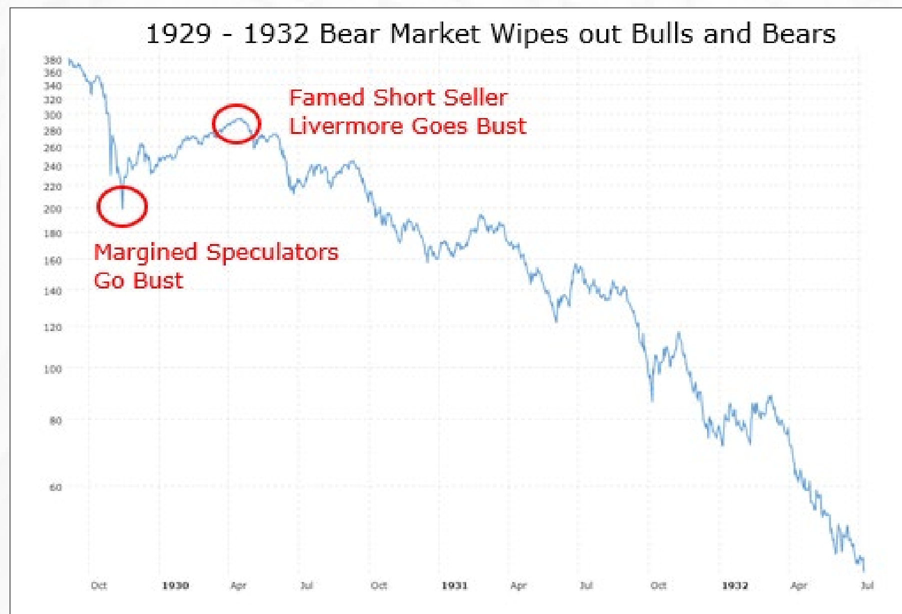
market with buying orders.

Throughout the article, the author cited numerous high-profile industrialists and market leaders of the day, assuring the panicked public that the worst was over:

> *The market has now passed through three days of collapse, and so violent has it been that most authorities believe that the end is not far away… The smashing decline has brought stocks down to a level where, in the opinion of leading bankers and industrialists, they are a buy on their merits and prospects, and brokers have so advised their customers."*

In the short term, the "experts" were right. The market found a bottom in November 1929, and surged by nearly 50% over the next months. But it was a short-lived reprieve…By April 1930, the U.S. stock market had recovered to 80% of its prior 1929 peak. Many believed the worst had passed…but when the selling resumed, the market plunged by another 85%.

The whiplash roller coaster wiped out scores more traders, including **legendary speculator Jesse Livermore**, who cleared a $100 million windfall from shorting stocks in the initial 1929 crash. But he ultimately ended up penniless, as he doubled down on his massive short position in the face of the powerful bear market rally through April 1930. (Livermore also eventually committed suicide.)



Source: Dow Jones - 1929 Crash and Bear Market

The moral of the story is really the same as the moral of *Extraordinary Popular Delusions*: Don't be seduced by speculative mania. And don't assume that you'll be the one happy exception to the rule.

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Today's market is no different. After a devastating 2022 that rewarded bears, the market consensus has flipped in favor of the bulls to start the year, punishing short sellers with $81 billion in losses in January alone:

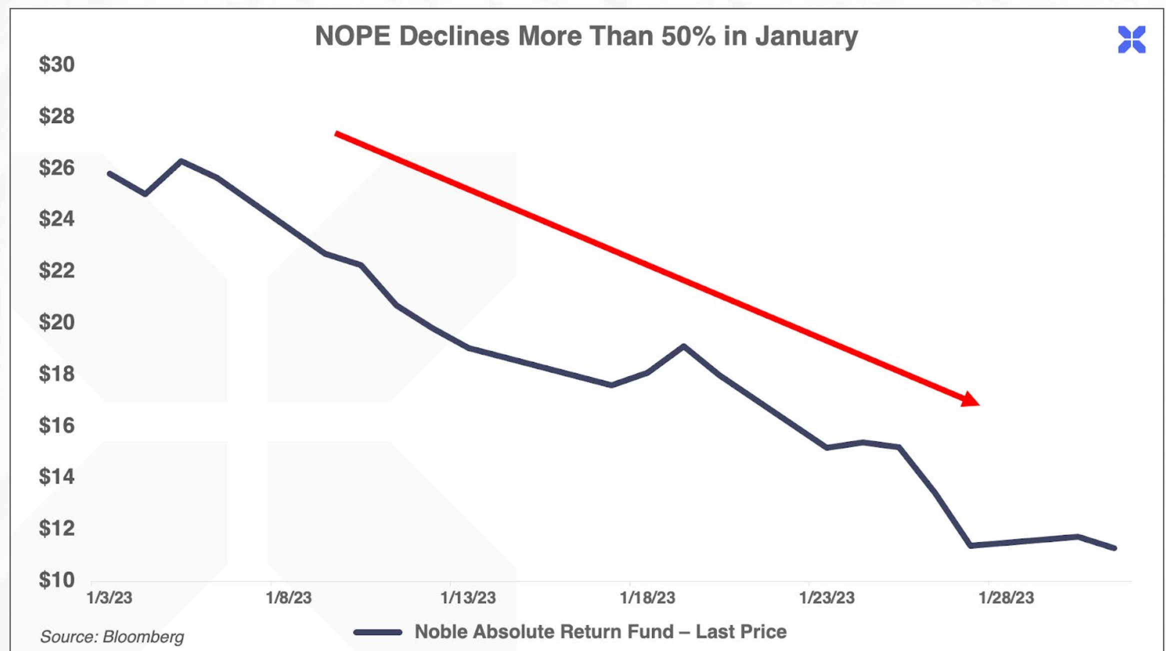
Short Sellers Feel the Pain in Stock Market's 2023 Rally

Highly shorted shares are beating the S&P 500 this year, and short sellers are down by $81 billion

Source

Consider the case of the Noble Absolute Return Fund (NOPE), launched in September of last year under the guise of "**raging against the Everything Bubble**". The fund had a stellar run out of the gate as stocks plummeted in the final months of 2022, including a 54% return in December alone. These returns were driven primarily by a massive short position in the shares of electric vehicle maker Tesla (TSLA), which paid off big as shares plunged.

NOPE's fortunes have since faded, as 2022's beaten-down stocks enjoyed a massive surge in 2023. (Tesla rallied 80%, and "meme stocks" like BBBY rose sharply in hopes of a short squeeze.) Over the past month, NOPE is down more than 50%.



Not surprisingly, the bulls are out in full force. High-profile social media influencer Jason DeBolt, who broadcasts his Tesla investing journey on Twitter, **announced**

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last week that he had sold his $2.8 million house, and used the proceeds to double down on his all-in Tesla gamble:

Jason DeBolt
@jasondebolt

Sold my house and bought around 10,000 $TSLA shares. Own 48,000 shares now.

Purchased all shares slowly over last few weeks before earnings on margin in $128-139 range. Up $250k on these shares already. Closed out margin today with house proceeds. Have cash. Feeling good.

$TSLA

Jan 26, 2023	
Sold (MLS) (Sold)	$2,825,000
TheMLS #	
Jan 16, 2023	
Pending (Pending)	–
TheMLS #	
Dec 30, 2022	
Contingent (Backup Offers Accepted)	–
TheMLS	
Dec 13, 2022	
Listed (Active)	$2,175,000
TheMLS	
Dec 07, 2020	
Sold (MLS) (Sold)	$2,069,420
TheMLS #	

4:04 PM · Jan 26, 2023 · 1.1M Views

304 Retweets 159 Quote Tweets 5,303 Likes

We won't venture a prediction about the future of Tesla (or Jason DeBolt), but one thing is clear: Speculative excess does not mean the end of a bear market. It just means speculators are likely to get caught with their pants down in the inevitable vicious reversal.

Latest Recession Red Flag: Negative PMI

Despite last year's decline in share prices, valuations in U.S. markets today are still close to all-time highs. The following chart from hedge fund manager John Hussman gauges whether markets are closer to a top or bottom. This ratio divides the total market capitalization of U.S. businesses by their "gross value-added," a measure of profitability. When this ratio is high, it means U.S. businesses are expensive relative to their earnings, and vice versa.

The chart below shows that this valuation metric remains near all-time highs, despite a modest decline from the record levels. So if the lows are in for the U.S. stock market, it would be the most expensive bear market bottom of all time:

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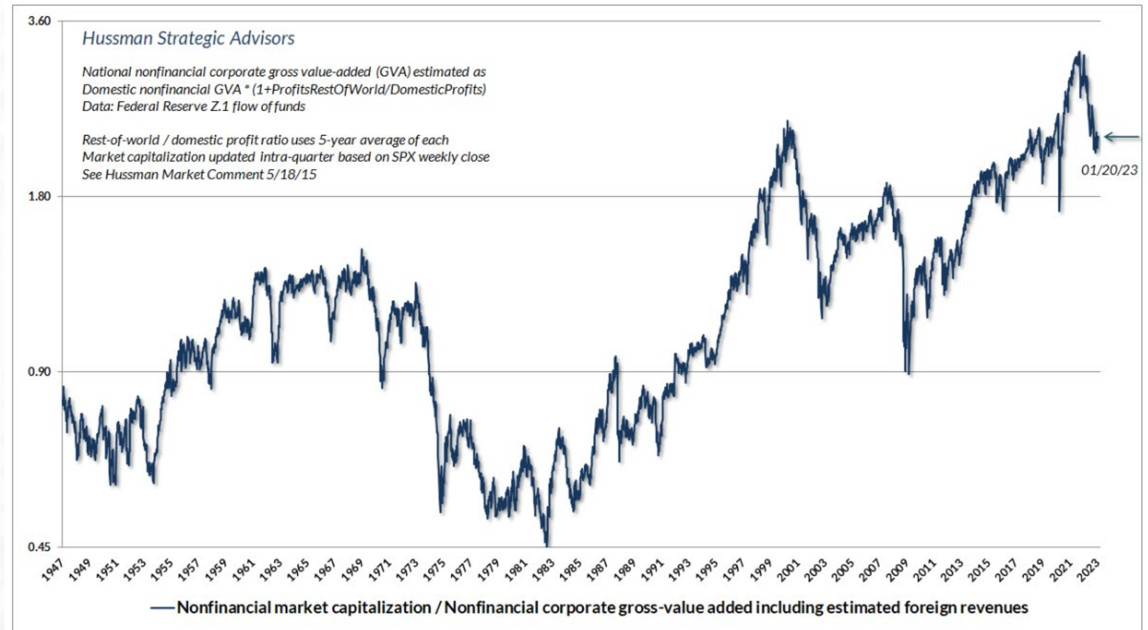

Source

Meanwhile, the consensus narrative also tells us that the worst of the economic slowdown is now behind us, and we can expect a "soft landing" – a mild contraction that avoids a recession.

But the history of bear markets is littered with similarly false "all clear" signals, from 1929 to 2007. (*The New York Times* is responsible for a great deal of misinformation, it seems.)

AL BUSINESS The New York Times

Fed chairman projects 'soft landing' for U.S. economy - Business - International Herald Tribune

Give this article

By Edmund L. Andrews

Feb. 15, 2007

WASHINGTON — The chairman of the Federal Reserve Board, Ben Bernanke, has given Congress an upbeat view of the U.S. economy, predicting that unemployment was likely to remain low over the next two years even as inflation declined slightly.

We prefer to take a data-informed view. Prior to every sharp recession of the past many decades, the yield curve has inverted – that is, long duration Treasury yields fall below those of short duration yields. And that's what happening now, with a record yield curve inversion pointing towards serious economic trouble ahead,

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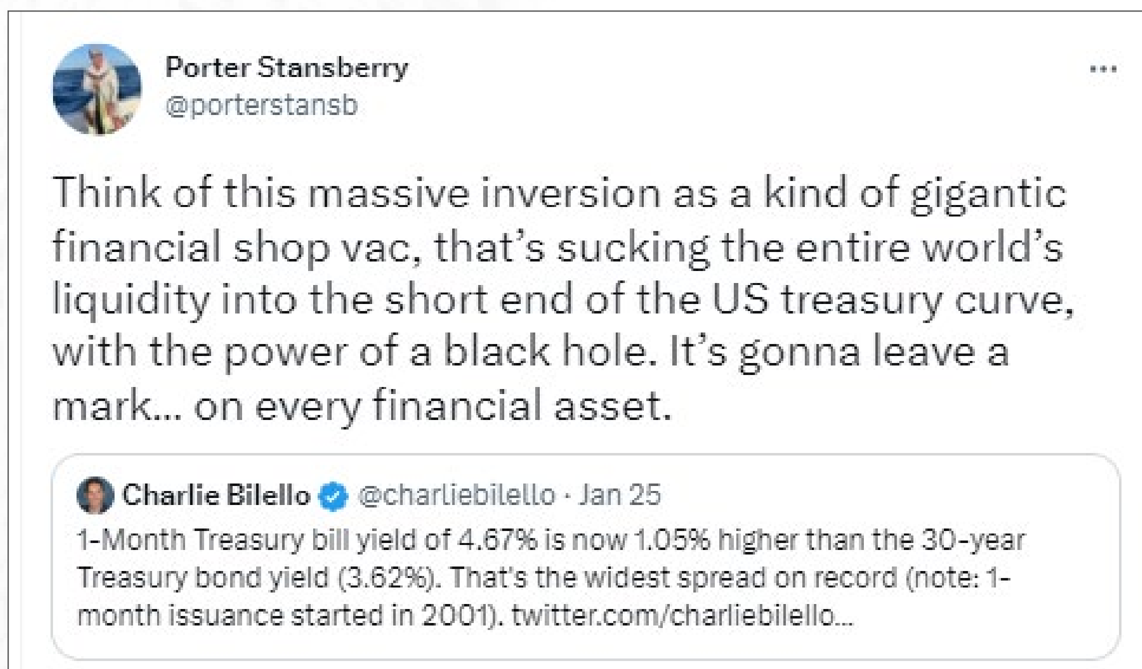
as Porter recently explained on Twitter:



We've also spotted another major **recession red flag**: persistent declines in a key leading indicator for economic activity, the S&P Global Purchasing Managers Index (PMI).

Every month, the PMI surveys supply chain managers across the U.S. to determine whether their business is expanding, contracting, or staying flat – then sums up the results. When that total falls below 50, it indicates a broad economic contraction.

The **latest data released in January** showed the U.S. manufacturing sector has now contracted for seven consecutive months, while the services sector has contracted for the last three months. (Giving the lie to another popular bullish narrative, consumer spending hasn't "moved from goods to services" – it's just evaporated altogether.)

A one- or two-month blip below 50 can happen at any time. But when PMIs register a series of consecutive negative numbers in goods *and* services – that's a giant red warning flag. These readings telegraph a persistent, broad-based decline in activity across the entire economy.

As the chart below shows, sharp and persistent contractions in PMI readings provided a warning signal leading into the 2008 Great Financial Crisis. And the latest PMI data is eroding in a similar fashion today:

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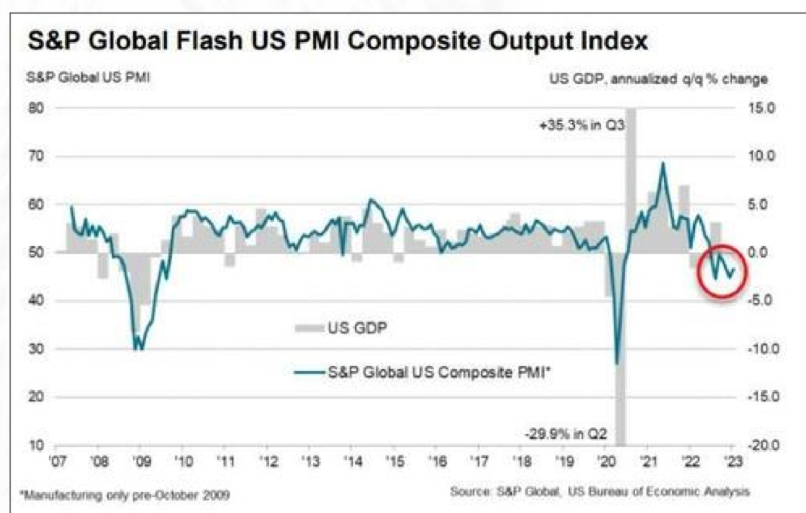

And this time, the pace of the deterioration is *quick*. According to S&P Global, **"the rate of [PMI] decline is among the steepest seen since the global financial crisis."**

Deceptive whipsaw rallies aside, we remain firmly in Camp Recession (and, we'd like to think, Camp Common Sense) at Porter & Co. And that means adding defensive names to the portfolio.

Better Than Treasuries – Believe It Or Not

Today's "safety" play (which we've added to our "Battleship" portfolio section) is a real estate investment trust (REIT). These mutual-fund-style vehicles pool capital and invest it across a diversified portfolio of real estate assets. They're required by law to pay out 90% of their profits to investors, which means they offer exceptionally high dividend yields.

And because of the recent spike in mortgage rates (more on this later), there's rarely been a better time to invest in REITs than right now.

The REIT we'll introduce today offers an extra degree of safety. It avoids physical real estate properties entirely, and instead invests primarily in mortgage securities that are effectively backed by the government. These securities have zero default risk – they're as good as Treasury bonds, since they're backed by the full faith and credit of Uncle Sam.

And they're a better buy than government bonds. Today, Treasuries will generate a yield of around 4%, while this REIT's government-backed mortgage portfolio offers a staggering 15% yield.

Here's how it works...

Uncle Sam Backs YOU

Founded in 1997, Annaly Capital Management (**NYSE: NLY**) is one of the

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largest real estate investment trusts (REITs). Over the last 25 years, Annaly has successfully navigated the ups and downs of the economic and housing cycle, including the 2008 Great Financial Crisis.

Over the past year, REITs like Annaly came under pressure from rising interest rates. But that trend is now reversing, creating an incredible buying opportunity.

Before we dig into the buy case, let's first examine Annaly's returns and risks.

Like most REITs, Annaly has a straightforward business model – it borrows money at low interest rates and invests in higher-yielding real estate assets, capturing the difference between the two.

Annaly is on the third rung of a kind of mortgage "food chain." At the top, a bank like Wells Fargo issues a mortgage loan. Next, another party purchases that mortgage and pools it with other mortgages into a package called a mortgage-backed security (MBS).

On the third rung of the ladder, a company like Annaly buys the MBS and uses it for investment income. So, even though Annaly itself doesn't directly issue mortgage loans to consumers, they are a critical cog in the mortgage financing machine, by creating secondary demand for mortgages through the MBS market.

By buying MBS products, Annaly provides an outlet for the banks that issue mortgages to offload risk of holding mortgage loans on their balance sheet. This in turn frees up capital for banks to issue more loans.

The MBS market used to be a Wild West free-for-all... back in the days of the mid-2000's housing bubble, it was poorly regulated and flooded with low-quality subprime loans. (Those badly packaged bundles of dynamite exploded and nearly took the global financial system with them.)

But today, the post-Crisis crackdown on subprime lending has resulted in much tighter underwriting standards. Today's MBS products contain higher-quality mortgages – and Annaly buys only the best.

Annaly has survived through every mortgage cycle over the last 25 years – including the 2008 Crisis – because of their risk management and conservative underwriting standards. As of the end of Q3, the average-weighted credit rating across Annaly's MBS portfolio is a pristine 762 FICO score.

Perhaps most importantly, roughly 75% of Annaly's MBS holdings contain "agency-backed" mortgages, meaning these mortgages are guaranteed against default by Fannie Mae and Freddie Mac. These government-sponsored entities (GSEs) are financially supported by the U.S. government, providing a financial backstop that ensures they won't go bust (more on this below). They are the foundation upon which the MBS market operates.

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Remember that three-step food chain? Fannie Mae and Freddie Mac are on the second rung. They buy mortgages from banks and repackage them into MBS products. Without middlemen like F & F, banks would be limited in how much capital they could extend to homeowners... which, in turn, would drive up mortgage costs and make it too expensive for people to buy houses.

In other words, Fannie and Freddie play a critical role in the financial machinery that allows Americans to access low-cost mortgages... and Uncle Sam can't afford to let them go bust.

Fannie and Freddie nearly went bankrupt during the 2008 mortgage meltdown. Uncle Sam bailed them out and then placed F & F under conservatorship, officially making them GSEs (government-sponsored entities). Unlike Britney Spears, Fannie and Freddie won't be free of their conservatorship anytime soon. It's now been going strong for 14 years, with **no end in sight**.

That means MBS products guaranteed by Fannie and Freddie are effectively backed by the U.S. government. And that's great news for Annaly...because the majority of its mortgage portfolio comes with zero default risk. As we learned in 2008, if the MBS market unravels, the U.S. government will extend financial support to Freddie and Fannie, ensuring that their MBS products don't go bust.

Because Annaly owns the MBS products guaranteed by Fannie and Freddie, it can safely boost its returns with low-cost leverage.

The company targets a leverage ratio of less than 10x, meaning for every $1 million in assets it will borrow no more than $10 million. In the wake of the 2008 Financial Crisis, Annaly has maintained a more conservative target of generally staying below 8x leverage. The company further cut back its leverage to around 7x in the wake of the COVID-19 pandemic.

As of the end of Q3, Annaly's net leverage ratio was 7.1x, or roughly in line with its peer average of 6.7x.

Why Annaly Is At A Buy Point

Annaly is one of our favorite "when" stocks – a high-quality business we'd like to own forever, and one we keep on our radar to buy when it trades at the right price.

Occasionally, a disruption in the MBS market causes NLY shares to dip to a buy point, offering tremendous value. That's only happened a handful of times over the past 25 years...and now is one of those times.

NLY's share price hasn't dropped due to a problem with the business – it's because of a temporary bookkeeping anomaly that we'll explain in a moment. (In a way, we're reminded of **our distressed debt strategy** – we find solid underlying businesses suffering from unfounded market fear.)

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Recall from our earlier discussion that Annaly doesn't incur default risk for the majority of its portfolio holdings. Instead, the company's key risk stems from fluctuating interest rates. That's because the value of fixed income securities trade inversely with interest rates.

Consider the case of a 30-year Treasury bond issued with a coupon (i.e., annual interest payment) of 3%. When the prevailing market interest rate for 30-year Treasuries is 3%, the bond will trade at par value (that is,100 cents on the dollar). But if the market rate for 30-year Treasuries moves up to 4%, the existing 3% coupon becomes less valuable, and the price goes down.

After all, there's no incentive to own a 3% Treasury bond at par, when a higher-yielding 4% bond at par value is available in the open market. The market adjusts for this by bidding down the price of the 3% Treasury, until the effective yield matches that of the existing 4% interest rate available at par value.

The same dynamics apply to Annaly's MBS holdings, where rising mortgage rates cause the existing lower-yielding MBS to fall in price. Annaly hedges this interest rate risk by pairing their long exposure in MBS against short positions in Treasuries. The spread between Annaly's 30-year MBS long positions and short 10-year Treasuries is known as the "mortgage basis".

As of Q3 2022, this mortgage basis was 1.85%, up nearly 4-fold from 0.48% from the same period last year:

30-Year Mortgage vs 10-Year Treasury Basis Spikes

	Q3 2022	Q3 2021
Annaly's 30-Year mortgage current coupon	5.68%	1.97%
10-Year U.S. Treasury rate	3.83%	1.49%
Annaly's Mortgage basis	1.85%	0.48%

This growing mortgage basis is good news for the new capital Annaly puts to work, because it means Annaly captures a higher interest rate spread against its hedging

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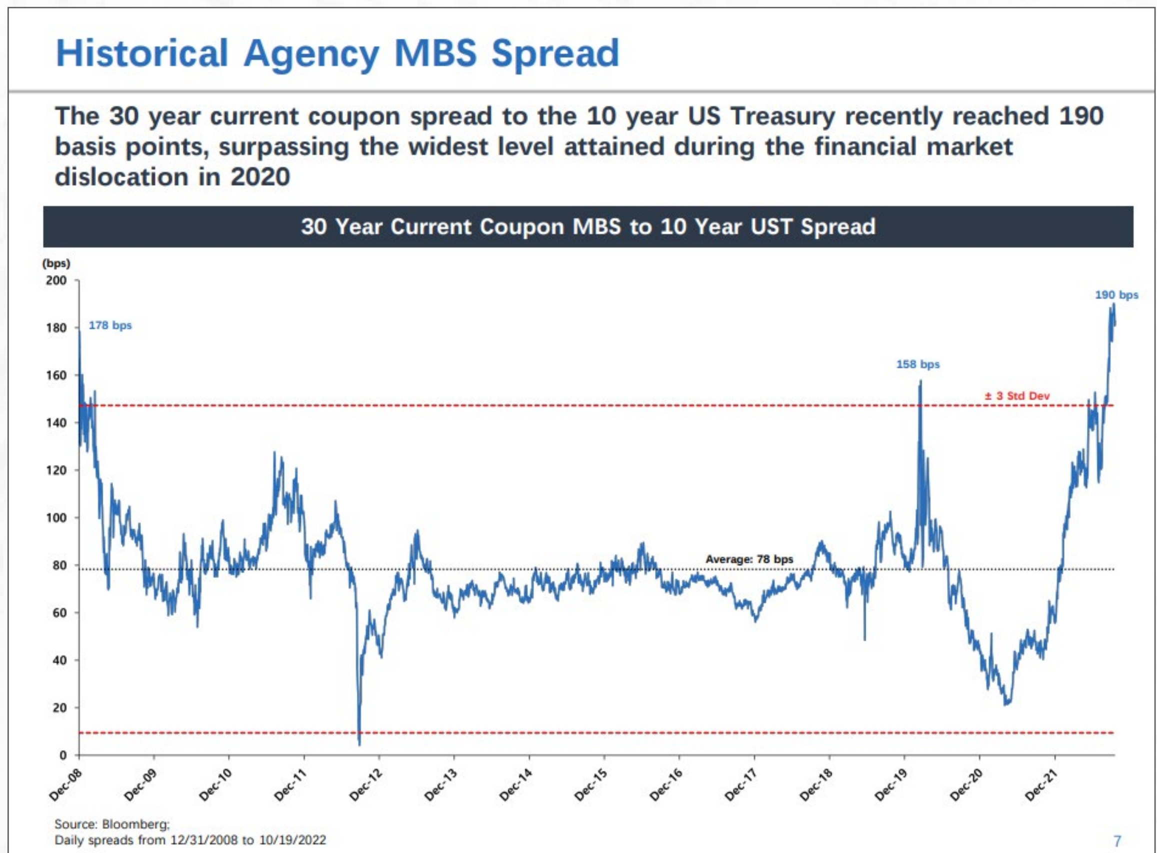
positions. But it creates pressure on Annaly's existing loan book in the shorter-term.

Therein lies the key challenge and risk in Annaly's business model – pairing mortgage securities against Treasuries is not a perfect hedge.

When mortgage rates rise faster than Treasuries, this causes the value of Annaly's existing MBS to fall more than the value of the Treasuries used as a hedge. As a result, a widening in the mortgage basis causes a drop in Annaly's book value – the value of its existing asset holdings, net of the value of its offsetting hedge positions.

In 2022, the mortgage basis between 30-year MBS versus 10-year Treasuries widened to the highest levels since the 2008 Financial Crisis:



This rapid widening in mortgage basis caused Annaly's book value to fall by roughly 44% from a high of $36 in Q1 2021 to a low of $20 by Q3 2022:

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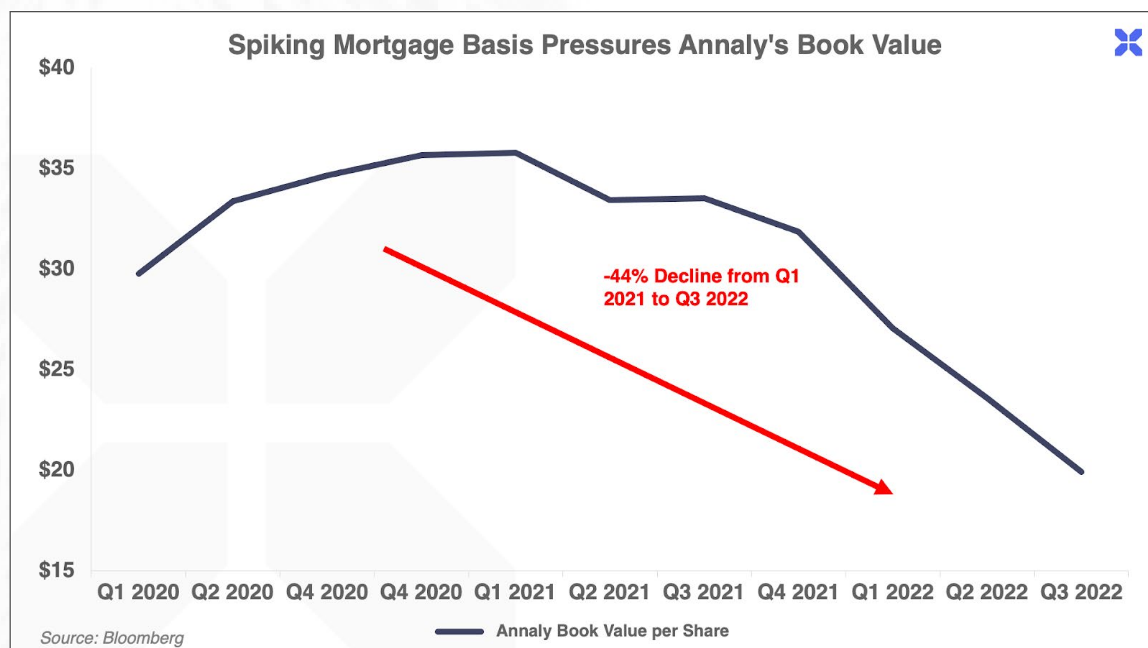

Since Annaly's shares typically track changes in book value, the rapid decline in book value pushed Annaly's share price towards record lows of $15 in late 2022. The share price has since rebounded to around $23 today, and we believe the rebound has only just begun.

History shows that when the spread between mortgage rates and Treasuries increases, especially by the magnitude seen in 2022, these dislocations don't last long. This time should not be different.

Here's why we expect the mortgage basis to narrow further from here, thereby boosting Annaly's book value and share price.

Consumers Revolt Against Rising Mortgage Rate

No matter how complicated the package, or how many brokers and products are involved, real estate is about one thing: People buying property.

And thanks to rising mortgage rates, people are buying far, far less property right now compared to just months ago.

Last year, mortgage rates spiked at their fastest pace in a generation, reversing from the record lows of sub-3% in 2020 - 2021 to a peak of more than 7% by October 2022 – the highest level of the last 20 years.

This surge in borrowing costs crushed the purchasing power of home buyers across the board last year.

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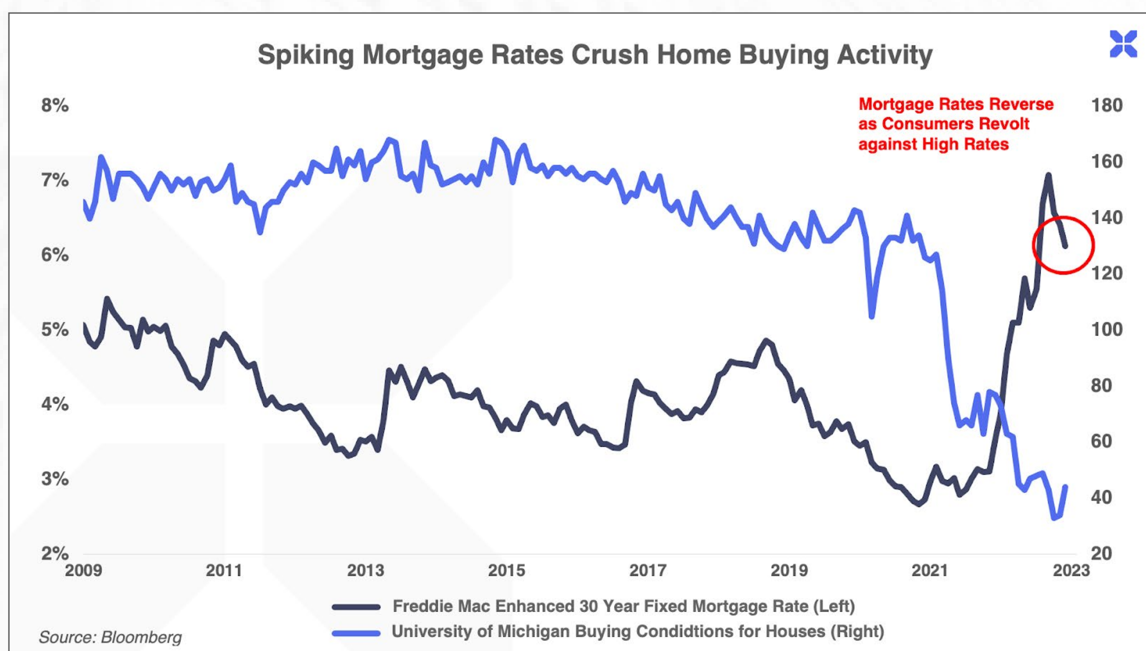
Consider the case of a $500k home purchased with a 20% cash down payment of $100k, and the remaining $400k financed with a mortgage loan. Using the 3% mortgage rate in 2021, that loan results in a monthly payment of $1,686. But that same loan issued at a 7% mortgage rate boosts the monthly payment by nearly $1,000 per month, to $2,661.

Consumers revolted against these higher borrowing costs by pulling back on home sales at the **fastest pace on record** – with a 34% annual decline in home sales in December 2022. Meanwhile, the University of Michigan consumer sentiment index among home buyers plunged to its lowest levels in over 40 years.

Collapsing demand for home purchases translated into a similar drop in demand for mortgage loans. The mortgage rate plunged from a high of 7.35% in November 2022 to 6.45% today:



The market has spoken: the record collapse in home sales shows that consumers cannot afford the sky-high mortgage rates reached in 2022. The market is now attempting to restore the supply and demand balance for homes by sending mortgage rates lower – down to just over 6% today, or a full percentage point decline from the peak of last year.

This, in turn, is causing the spread between 30-year mortgage rates and 10-year Treasury bonds to narrow:

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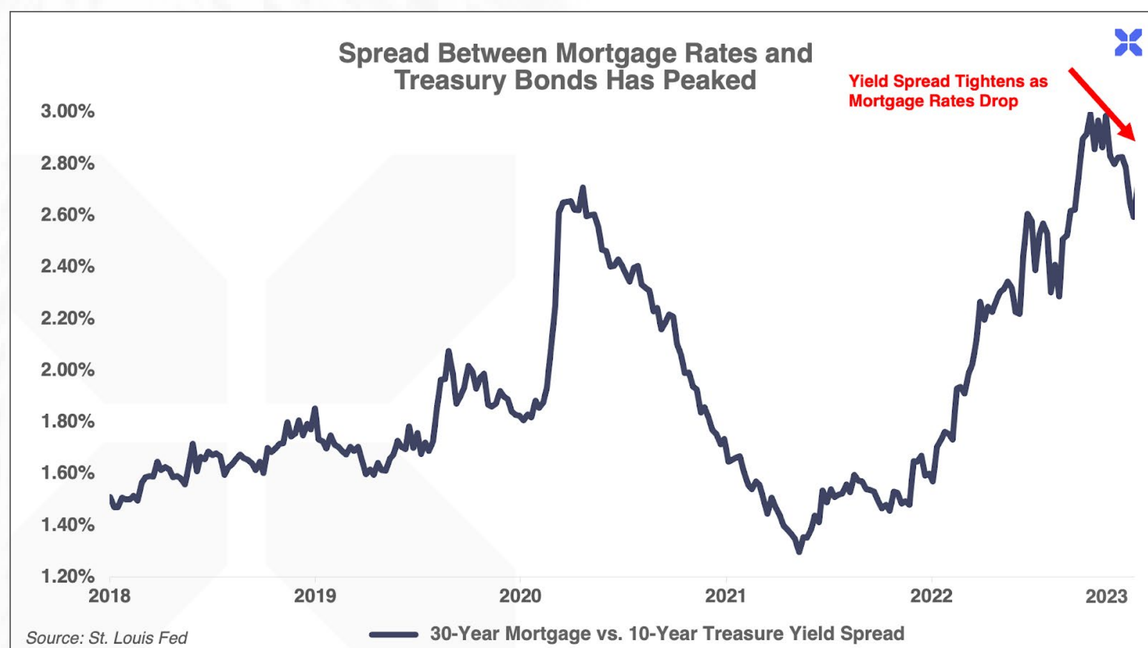

We expect history will repeat here, and that the market will find balance at some level below today's near-record wide mortgage basis. And that's all Annaly needs for its book value to stabilize, and then begin increasing further from here.

If we can rule out the scenario of a further widening in mortgage basis, then Annaly will thrive in either of the two remaining scenarios of a flat or falling mortgage basis going forward.

As we mentioned previously, a rising mortgage basis pressures the value of Annaly's existing portfolio. The flip side of this coin is that a falling mortgage basis *improves*Annaly's book value, by causing its long positions in MBS holdings to appreciate faster than the offsetting losses from its Treasury hedges.

If the mortgage basis remains flat at today's elevated values, Annaly can also win by earning a higher spread on the new capital it puts to work. Over time, this would result in greater earnings power, and thus an increase in dividend payments (remember: Annaly, like all REITs, must pay out 90% of its earnings to shareholders).

But even if we're wrong, and mortgage rates continue to rise, Annaly can cash in on a hidden benefit: *lower mortgage prepayments*.

Heads or Tails, Annaly Wins

Most standard mortgages come with a "prepayment" option for borrowers. This allows the borrower to pay more than their minimum monthly payment, up to the

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full outstanding mortgage value, at any time.

During periods of falling interest rates, consumers will use a refinancing transaction to pre-pay their existing mortgage. This involves taking out a new mortgage at a lower interest rate, and using the proceeds to repay their existing, higher-rate mortgage loan.

It's easy to see why, in a falling interest rate environment, lots of customers are eager to prepay!

But what's good for the homebuyer – pre-paying their existing mortgage and taking on a new mortgage at a lower rate – isn't good for the lender. The mortgage lender gets an upfront cash infusion, but at the cost of reducing further interest income.

That's what's been happening for much of the past 25 years, during a low-interest-rate era where customers were eager to prepay and lock in lower rates. REITs like Annaly took a hit – and added in a substantial line item expense from prepayments, known as "premium amortization expense" (PAA)."

But these dynamics reverse in a rising interest rate environment. As mortgage rates jumped in 2022, far fewer home buyers opted for prepayment. Annaly benefited from this trend, as its PAA expense fell from $60.7 million in Q3 of 2021 to a net benefit of $45.4 million in Q3 2022.

That, in turn, helped boost the key metric for Annaly shareholders, known as "earnings available for distribution" – the key metric Annaly uses to determine its dividend payment for investors.

The table below shows the key drivers of Annaly's income, including the net economic interest income (defined as interest income net of interest and PAA expense), over the last year:

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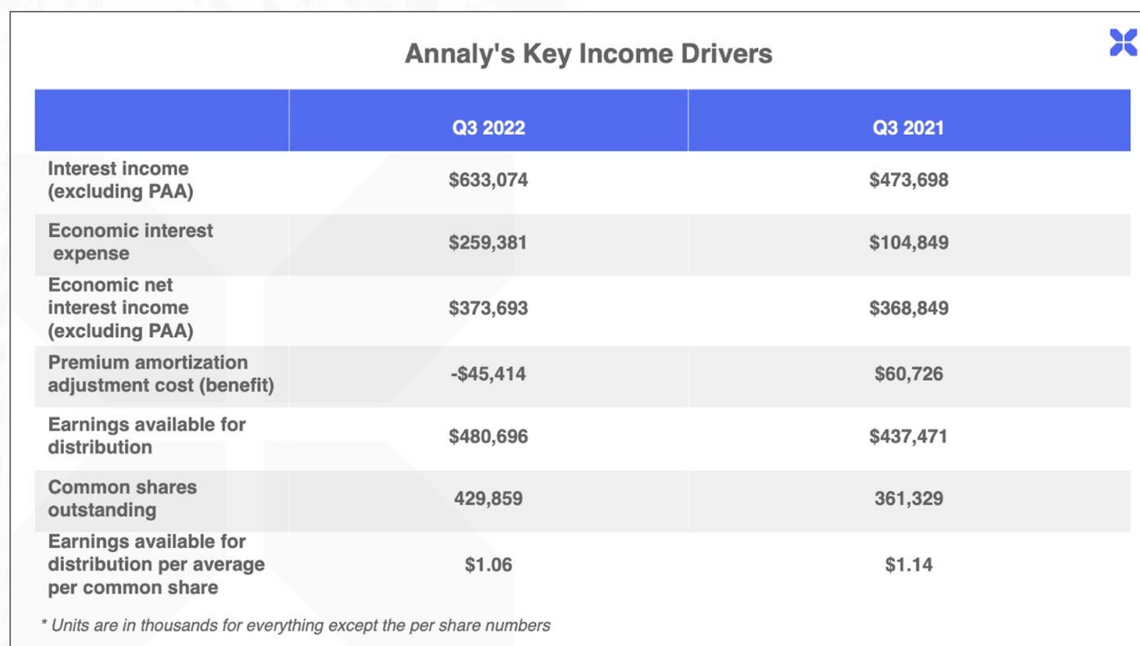

Annaly's Key Income Drivers

	Q3 2022	Q3 2021
Interest income (excluding PAA)	$633,074	$473,698
Economic interest expense	$259,381	$104,849
Economic net interest income (excluding PAA)	$373,693	$368,849
Premium amortization adjustment cost (benefit)	-$45,414	$60,726
Earnings available for distribution	$480,696	$437,471
Common shares outstanding	429,859	361,329
Earnings available for distribution per average per common share	$1.06	$1.14

** Units are in thousands for everything except the per share numbers*

The table shows that the net impact from the widening mortgage basis from Q3 2021 to Q3 2022 was a roughly 10% increase in earnings available for distribution, from $437 million to $480 million. Over the same period, Annaly's share count grew by roughly 18% from 361 million to 430 million, as a result of two equity offerings last year. Annaly raised this capital in order to shore up its liquidity, and to provide the funds needed to capitalize on today's more attractive mortgage rates.

The bottom line is that even in a high-interest-rate environment that discouraged homebuyers, Annaly's earnings held up thanks to a significant drop in PAA expense. And it was *still* able to generate enough earnings for distribution to cover its $0.88 quarterly dividend payment.

Unless we see a substantial widening in mortgage basis, Annaly's book value and share price should stabilize from here. Meanwhile, the company is well positioned to continue improving its earnings profile by capitalizing on today's still-elevated mortgage basis. That means the company will likely continue paying out its $0.88 quarterly dividend.

At today's share price of around $23, that translates into an annual dividend payment of $3.52, or a 15.3% annual yield.

Annaly management also reiterated its expectations for stable earnings on the company's latest earnings call from October 27. On the call, management noted that it expects the upcoming Q4 earnings available for distribution to be roughly in line with the Q3 dividend payment.

Plus, if the peak in mortgage basis is behind us, there's further upside potential

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from Annaly's share price rising, as its book value increases from here.

We recommend that you buy and hold shares of Annaly. It offers one of the few safe havens in today's high-risk market, with a relatively safe 15% dividend yield, plus the potential for further gains from an appreciating share price.

Action to take: Annaly **(NLY)** is no longer an active recommendation.

Porter Stansberry

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Stevenson, MD

P.S. If you'd like to learn more about the Porter & Co. team – all of whom are real humans, and many of whom have Twitter accounts – you can get acquainted with us **here**. You can reach me (Porter) personally via:

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