The Total Summary: Fannie & Freddie

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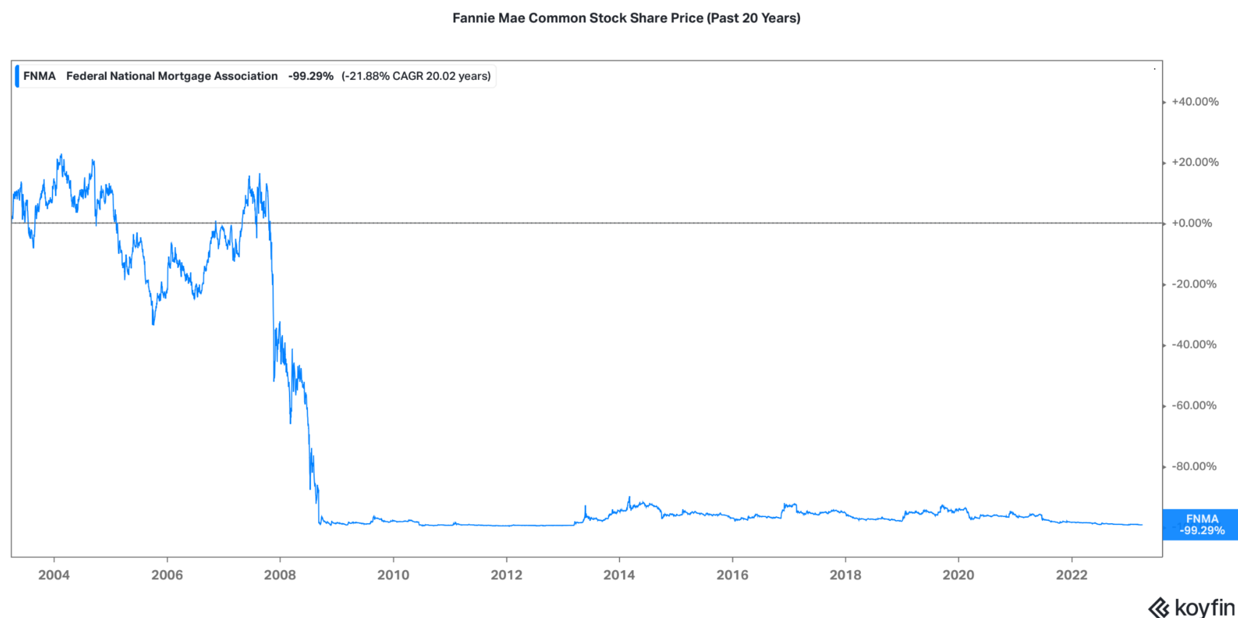
Introduction

Fannie Mae's Current Valuation
Share Price: $0.41
Market Cap: $474m
Average Volume: ~2,000,000 shares per day ($1m value)



Business Explanation:
Buys mortgages from originators like consumer banks, securitizes them into mortgage backed securities, and then sells the final product to investors, while taking a small fee. All while earning interest income as a "middle man." It enables American banks to originate 30y mortgages, which they would otherwise not want to keep on their books.

2022 Year-end Financials:
Net Income: $12.9b
Shareholder's Equity: $60.2b

Key People:
CEO: Priscilla Almodovar
Founder: Franklin Delano Roosevelt
President of the United States: Joe Biden
Secretary of Treasury: Janet Yellen
Director of the FHFA: Sandra Thompson

Investment Thesis:
Despite currently being in conservatorship, whether by executive action or the result of a legal case, I believe it's likely that Fannie Mae & Freddie Mac will be released from conservatorship in the next 2 years, and should that happen the preferred shares would receive par value (from 6.88% of par currently) and there exist various opportunities for very high upside with the common shares. Even if the release does not happen in the next 2 years, should the stocks re-price to what I believe the realistic probabilities are, it could lead to high performance for both common and preferred shares.

Why focus on Fannie, not Freddie?
As you will learn, Fannie and Freddie's fates are inextricably linked, and so is their history. However, for this writeup I focused on Fannie Mae because it's the larger, more established of the two. As well, while the specific financial numbers are different for Freddie Mac, the general thesis, catalysis, and outcomes remain extremely similar. Focusing on purely Fannie Mae allowed me to dive deeper into the specifics.

Key Risks:
- The timeline takes longer than expected for release
- The most important legal cases fail, even if the smaller ones succeed
- Share price suffers considerably between now and release due to a lack of catalysts
- For common shares there is NO security, endless dilution is a serious risk
- While we view receivership as an unrealistic option, it could wipe out the preferred stock

The History of the Mortgage GSE's

The Early Years

Fannie Mae or the Federal National Mortgage Association (FNMA) was created in 1938 by US President Franklin Delano Roosevelt as part of helping the American mortgage market recover from the Great Depression. The New Deal was an integral part of FDR's platform for escaping the Great Depression, and a large part of that was housing reform and mortgage affordability. Of course, World War II coming soon after changed the world and America's place in it. Fannie Mae was established by an amendment to the National Housing Act, a bill passed by Congress at the time. Creating a secondary market for mortgages, enabled banks to issue more mortgages and sell them, getting the proceeds so that they could issue even more.

Fannie Mae helped provide much-needed stability in the market, as well as credit for those who needed it to buy a home. In 1968 Fannie Mae transitioned to a privately owned but publicly traded corporation, no longer on the government's budget, but instead using stocks and bonds to fund itself. As well in 1968, the then Fannie Mae was split into Ginnie Mae (GNMA) which would guarantee Federal Housing Administration, Veterans Administration, and Farmers Home Administration loans. Ginnie Mae was backed explicitly, versus the implicit (implied) guarantee for Fannie Mae. In 1970 the Federal Government created Freddie Mac to have a competitor to Fannie Mae and Ginnie Mae

In the 1980s, Fannie Mae began to securitize mortgage loans and guarantee payments to investors. This was a massive boost to the business and its financials, which public investors now benefitted from. In 1981 Fannie created a product called mortgage-backed securities with primarily bundled private loans.

In 1992, George H.W. Bush signed the Housing and Community Development Act of 1992, which required Fannie and Freddie to lend to low and moderate-income families. We see this affordable housing trend continue into the early 2000s as well. For the history of Fannie Mae during the 2008 Financial Crisis, I will continue on the next page, as there is much more to cover.

The Financial Crisis & FHFA

The Sparks of a Crisis

From 2007-2008 a Financial Crisis began due to subprime lending in the United States, and the ripples were felt around the world. By 2004, home ownership had peaked in the United States, and later in 2006, home prices began to fall for the first time. This decline was further aided by the Fed's raising of interest rates up to 5.25%. The American homeowner was highly leveraged, in part due to the banks continuing to issue subprime mortgages, packaging them into mortgage-backed securities pretending as if they were safer than they were, and selling them for massive profits. However, there are many great books, articles, essays, movies, and documentaries to learn about the 2008 Financial Crisis, including but not limited to *The Big Short* by Michael Lewis, *Too Big to Fail* by Andrew Ross Sorkin, *On the Brink* by Hank Paulson, *The Courage to Act* by Ben Bernanke, and *Another Big Lie* by Tim Pagliara.

Fannie Mae during The Crisis

While Fannie Mae & Freddie Mac may not have been complicit in creating the financial crisis, the default rate skyrocketing to 29% for adjustable-rate mortgages, and 9% for fixed-rate mortgages had a bleak outlook for the portfolio of mortgages that Fannie Mae held. However, Fannie and Freddie had large capital reserves, even during the financial crisis and these required reserves have only risen since then! However, the Federal Government & US Treasury used the crisis as a pretense to bring FnF under conservatorship, and raise the "expected credit losses" to justify the conservatorship. The expected credit losses counted as losses on the income statement, and as a contra account on the balance sheet. However, $234b was set aside by Fannie & Freddie, despite only $125b being realized. That $109b gap was used as an excuse to bring FnF into conservatorship because of them being "distressed." When conservatorship was imposed in September 2008, Fannie Mae had excess core capital of $9.4b, and Freddie Mac had $2.7b in excess core capital.

The takeover orchestrated by the Treasury Department was not working with Fannie and Freddie, but instead against them. Then Secretary of Treasury Hank Paulson was quoted saying "We're going to move quickly and take them by surprise. The first sound they hear will be their heads hitting the floor." to President Bush. As well, Paulson stated that "we'd basically killed the shareholders" when speaking about Fannie and Freddie. Even before September, Paulson stated "his plan to mount the equivalent of a financial invasion of Fannie and Freddie." I believe that both with hindsight, and as was clear at the time, Fannie and Freddie would have survived the crisis without government conservatorship, and the US Government acted to take over the two GSEs because of the profits it could bring the Federal Government.

The Creation of the Federal Housing Finance Agency

The FHFA was created as part of the Housing and Economic Recovery Act (HERA), which was a bill passed by Congress in the midst of the Great Financial Crisis to help the

country's recovery while limiting any further downside for the economy. Funnily enough, a future Director of the FHFA, Mark Calabria, was part of the team to draft the bill, but this is not for many years to come… The predecessor to the FHFA was the Office of the Federal Housing Enterprise Oversight (OFHEO), but through HERA it was transformed into the Federal Housing Finance Agency. The first director of the agency was previously the director of OFHEO, and transitioned to his new role as the agency transformed. However, on August 25th, 2009 James Lockhart resigned and Edward DeMarco was appointed as the new Director for a 5-year term. DeMarco served as an acting director until December 10th, 2013 when he was replaced by Mel Watt, a then congressman in the House of Representatives. He served as an "acting director" for 1,538 days despite the vacancies act prohibiting it to only 210 days.

After DeMarco's term, President Obama nominated former congressman Mel Watt to lead the agency. Under Watt's term, Fannie and Freddie made tens of billions of dollars more in profit, all of which went to the US Treasury as part of the newly enacted Net Worth Sweep amendment.

The FHFA under President Trump

Despite President Trump starting his one term as President in January 2017, Mel Watt's term as Director did not end until January 2019. As far as Trump, the FHFA, Mel Watt, and everyone involved was aware Trump could not fire Mel Watt unless it was "for cause." As the Supreme Court soon clarified this in June 2021, through the Collins v. Yellen decision, this precedent was changed. Once Mel Watt's term had finished Trump nominated Mark Calabria, who as noted earlier worked on the original drafting of HERA. Calabria switched the Net Worth Sweep from a cash payment to the US Treasury to now enabling it to be paid via an increase in Treasury's liquidation preference for Fannie and Freddie respectively, but by the same amount as the Net Worth Sweep. He and the Trump administration had spoken clearly and publicly about their goal to free Fannie and Freddie from government conservatorship. Despite his term being 5 years he was removed once the Supreme Court decided that a Director of the FHFA could be fired by the President for any reason, and "for cause" was not needed.

The FHFA under President Biden

Following Mark Calabria's dismissal, President Biden announced in June 2021 that Sandra Thompson would be the White House's appointee for the director position. She had previously worked as Director of Risk Management at the FDIC. Her term has not been focused on the removal of Fannie and Freddie from conservatorship, but she has continued the net worth sweep via liquidation preference and not cash payments, which is a positive sign. Both common and preferred shares have fallen significantly since Biden was elected President, a sign that investors do not believe the Biden administration would release Fannie & Freddie, and that any solution would not benefit any of the share classes.

US Treasury's Financial Stakes

Liquidation Preference: The liquidation preference was instituted when Director Calabria switched the Net Worth Sweep from cash payments to more of an "IOU."

- As of Fannie Mae's Q4 2022 earnings report, the liquidation preference is $180.3 billion. This means that if there were to be a liquidation of Fannie Mae, $180.3b would have to first go to the US Treasury before other preferred stock, or common stock were to get any value. This liquidation preference increases by Fannie's net income each quarter. If Fannie were to post a net income of $2b for Q1 2023, then the new liquidation preference (LP) would be $182.3b.

Senior Preferred Stock: This was the original stake that the US Treasury had, where for every $1b that Fannie Mae lost, they would borrow $1b from the US Treasury at a 10% interest rate. While there is no longer any additional Senior Preferred stock, the original stake remains.

- The current Senior Preferred Stock par value is $1280.8b. While the 10% interest was disposed of for the Net Worth Sweep in 2012, it is imperative that the senior preferred stock be converted, paid down, or eliminated for the common stock, legacy or otherwise, to have value

Common Stock Warrants: These warrants were added as part of the 2012 PSPA amendments, and still remain. It does enable the US Government to prioritize common stock valuations, dilute the legacy common shareholders, and then make $100-200b in an Initial Public Offering of Fannie & Freddie.

- The US Treasury still has a warrant for 79.9% of Fannie and Freddie's respective common stock. The cost of the warrant is decreed to be a "nominal amount" so it would be 80% dilution for next to no benefit for the underlying companies and legacy common shareholders.

The Current Legal Battles

Consolidated v. FHFA/Fannie & Freddie

The idea being debated here is whether or not Fannie Mae & Freddie Mac broke the implied contract with shareholders. This case primarily focuses on the preferred shares, as the primary plaintiff, Fairholme Funds, is a large holder of the preferred stock. Fannie Mae common stock is not involved in the case. Even in a victory Freddie Mac common stock would only get a few pennies.

This is the case that is currently in Royce Lamberth's court. It originally went to a jury trial with the $1.6b damage model, but ended in a hung jury. It will be having a retrial in July 2023 as a jury trial again, but now it would be possible for the plaintiffs to bring higher damage models to the trial, if Lamberth allows it. With the $1.6b damage model and pre judgment interest, the different preferred shares would get different amounts. It is estimated that they will ask for approximately $2 a share for the $25 par shares, or $4 for the $50 par.

Collins v. Yellen

This case originally went to the Supreme Court and led to the decision that the President of the United States can fire an Independent Director "for cause" as opposed to the requirement that there be a reason previous to this case. Because President Trump did not know about this new clarification, it led to Mel Watt (Obama's nominee) serving many years into Trump's 2016 term, at which point Trump nominated Mark Calabria in his stead. Mark Calabria's term was cut short however because of this new clarification.

Collins has been remanded to the lower courts to hold a trial on what relief may be granted to shareholders, and if so, how much relief.

Rop v. FHFA

This case focuses on the principle that a director of an agency is allowed to serve for 120 days after the vacancy as an acting Director, even if they are unconfirmed by the Senate. However, Ed Demarco was the director of the FHFA while the Net Worth Sweep was implemented, and he was not confirmed until the end of 2013, many years after the 150-day limit had expired, and after he had already implemented serious policies like the NWS.

Bhatti v. FHFA

The essence of the Bhatti case is whether the plaintiffs (Fannie Mae shareholders) were harmed by the fact that Trump wanted to remove Obama's director of the FHFA, Mel Watt, and replace him with a director like Calabria, but was unable to because of the belief that it could only be "for cause." However, with the landmark Collins v. Yellen Supreme Court decision, Biden was able to remove Calabria at will, and the question is whether if Trump had been able to remove Watt at will, would he have, and if he did, would it have resulted in financial gain for shareholders?

Kelly v. US

This case comes from private investor Michael Kelly, who owned FBOP, a holding company for a series of banks that invested in hundreds of millions of dollars worth of preferred shares, which are now worth a fraction of that due to conservatorship. Kelly is arguing that preferred shareholders are due because of the direct & derivative taking, breach of the implied covenant, and a few other related arguments. Because Kelly only owned the preferred shares, that is the class of shares that he is targeting relief for in his lawsuit. If the case goes smoothly, we expect a decision in the 3rd Quarter of 2023, so before November 2023 begins.

Wazee St v. US

For the Wazee case, it alleges that the Fannie scenario justifies invoking the Takings clause of the 5th amendment and that the US Government "unjustly enriched" itself. It is being tried in the Court of Federal Claim, with The Honorable Margaret M. Sweeney presiding as the judge. The shareholders (Wazee) allege that the Federal Government took their property without just compensation, and are due financial compensation because of the Bill of Rights 5th amendment's takings clause. It's currently in the "en banc" phase of a trial.

Community Financials Services Association of America v. CFPB

The CFPB case primarily boils down to appropriations, the process where Congress provides a budget for something. For an agency that is controlled by the President of the United States (POTUS) and has large implications for the American public and economy, it would require appropriations for its budget. However, the Consumer Financial Protection Bureau (CFPB) did not go through this process, so the 5th circuit court ruled it unconstitutional. Its appeal (writ) to the Supreme Court was successful so the Supreme Court will review the case and its application of Constitutional Appropriations.

It will be argued in the Supreme Court's 2nd term, i.e. the second half of 2023, with a decision coming ~90 days after it's argued, so in Q1 of 2023. However, this timeline could change. With SCOTUS, an affirmation of the previous ruling by the 5th circuit and declaring the FHFA illegal as well would be a massive win for Fannie & Freddie shareholders.

The Constitution and Appropriations

Separation of Powers

Ever since the beginning of the United States of America, the founders sought a way to have a functioning government that would serve the people while also not providing too much power to any one person or branch of government. Hence, they created the 3 main branches of government, legislative, executive, and judicial. By splitting the powers among the 3 branches, and each deriving their power from different sources and elections, it would in theory ensure that the United States never becomes a monarchy. A large part of this separation of powers was ensuring that even though the President had various powers, only congress could allocate or "appropriate" the funds.

Application to the CFPB & FHFA

With the Consumer Finance Protection Bureau, the 5th Circuit court ruled that its structure was unconstitutional because it allowed a POTUS controlled independent agency (which it became after the Collins v Yellen SCOTUS ruling) to bypass appropriations with the fees the CFPB assessed. Because the President of the United States is able to fire the director, that led to it becoming POTUS controlled, which then affected the legality of the funding mechanism.

Void Ab Initio

If the Supreme Court affirms the 5th court's ruling, then it's quite possible that the CFPB (and FHFA by extension) would be ruled unconstitutional. It then becomes a logistical nightmare to determine how to "reverse" any challenged transactions. This could then lead to many of the transactions like conservatorship, treasury's warrants for 79.9%, and the net worth sweep being reversed. As I will mention in the valuation section, this leads to an extraordinary result for the private Fannie & Freddie investors.

However, the more realistic outcome is that the Supreme Court's ruling would limit the impact to just the CFPB, and congress would put together a bill so that the CFPB could continue to function.

Seila Law (v. CFPB)

This was a case that went to the Supreme Court, and the justices clarified that a government agency cannot retroactively give itself a power. In essence, if the director can be removed at will, then the President cannot fund their own agency that serves at their pleasure. This translates to the recent CFPB SCOTUS case, as well as the parallels with the FHFA.

Timeline & Upcoming Catalysts

Q2 2023

- *Fairholme Funds v. FHFA et al* jury trial in the court of Royce Lamberth will take place in July 2023 at a DC Courthouse. It's expected that plaintiffs will ask for approximately 10% of par as damages for the preferred shares.
- *Kelly v. US* oral arguments are expected to be during the 2nd quarter of 2023.

Q3 2023

- The *Kelly v. US* decision is expected to be sometime during the 3rd quarter, especially if the oral arguments take place in the 2nd quarter.
- *Bhatti v. FHFA* oral arguments should be taking place during this 3rd quarter.

Q4 2023

- *CFPB v. Community Financial Services Association* oral arguments are expected to be in the 4th quarter. This is an essential ruling for the Supreme Court to affirm after the trial.

2024

- From January to March 2024, both parties will hold their primary elections. It is expected for current President Joe Biden to run unopposed.
- November 5th General Election

2028

- Treasury's warrants for 79.9% of Fannie Mae and Freddie Mac's common shares for a nominal amount will expire in September 2028.

Comments

Because the Trump administration has shown they have a path for leaving conservatorship, versus the Biden admin's lack of action, if a Republican were to win the general election, it could be positive for the thesis and market price. As well, Ron DeSantis is much more of an unknown, so when it comes to Fannie Mae & Freddie Mac's release, investors may prefer former President Donald Trump. However, I believe that there is a large risk here because while Trump and his "MAGA" supporters may win in the primary election, Trump related candidates suffered by a few percentage points during the midterm elections, which may seem small, but has a quite large effect.

Personally, I believe that Trump is likely to win the primary election, but unlikely to win the general election if he is the nominee vs. the incumbent President Biden. While many criticize Biden for the high inflation, possible recession, and more, the negatives that many voters give Trump related candidates are even larger in my opinion.

Valuations

FHFA is "Void ab Initio"
Common Shares: \$163-\$290
Preferred Shares: 100% of par

In a scenario where due to separation of powers, the FHFA is considered invalid, it would leave significant upside in both the common and preferred shares. In this scenario, any challenged transaction could be struck down and reversed. Currently, only the Net Worth Sweep is being challenged, but others like Treasury's 79.9% warrants, the Senior Preferred Stock, and other actions from the FHFA since its 2008 creation could be challenged.

Assuming that \$150b is paid back from Treasury to Fannie Mae, this extreme scenario leads to a valuation of \$290 per share for Fannie Mae's Common Shares. Of course, preferred shares would also get 100% of par. Without the \$150b return payment, I have Fannie Mae common shares benign worth \$163 per share. This values the shares without government warrants, liquidation preference, or senior preferred stock.

Administrative Reform + Warrant Exercise (79.9%)
Common Shares: \$9-\$36
Preferred Shares: 100% of par

This would be a scenario where the Senior Preferred Stock and liquidation preference are removed by the government, and they simply exercise their 79.9% warrants. I believe this would lead to less than just 20% of the valuation from the scenario above because of the increased fear of government nationalization that would continue to exist. Thus, I personally estimate it could be a further 20% discount from the valuation above. Ie. if it was a 10x multiple for the scenario above, instead it would be an 8x multiple. Much of the common stock valuation comes down to whether or not there is much of a liquidation preference left at release, and/or whether the senior preferred stock is converted, or remains.

With purely 79.9%% dilution due to Treasury's warrants, I see a price target of \$36, 20% of the \$180 price target, but with a further 20% discount due to the uncertainty that would be brought by the government abusing its warrants, and taking 80% of Fannie and Freddie.

Release + Dilution
Common Shares: \$0.01
Preferred Shares: 100% of par

The US Government could release Fannie & Freddie, but convert their Senior Preferred Stock to common stock as part of a theorized restructuring process. This would lead to common

shares being worth a fraction of a penny each, while preferred shares continue to get 100% of par, because the equity dilution would only benefit the pref shares. However, former Chief Financial Officer of Fanie Mae, Tim Howard, has responded negatively to those who call the situation a restructuring.

Receivership
Common Shares: $0
Preferred Shares: 0% of par

One of the few scenarios in which the preferred shares can be easily written off is if Fannie Mae & Freddie Mac entire receivership, instead of regular conservatorship. Receivership is intended for insolvency, so it would be hard to imagine that the fundamental businesses of Fannie and Freddie would get to that point. However, the past decade and a half has shown the Federal Government can do anything that they want, so it's quite possible they could force the twins into this position. For example, due to the liquidation preference, senior preferred stock, and the various ways that they calculate regulatory capital and "equity" the companies can be positioned in a way that makes them appear insolvent. In receivership, it could mean $0 for both commons and prefs.

Decay of Time..
Common Shares: *unknown*
Preferred Shares: *unknown*

More so than other investments, truly anything can happen for Fannie and Freddie, and it could be another 13 years before any real action is taken on paying back the preferred shares, releasing them from conservatorship, or any related actions. Because this thesis relies on *something* happening, whether it's from the courts, various presidential administrations, congress, or the FHFA, if there were to be another decade without action it would be disastrous for the thesis. However, the government's warrants would expire after September 2028, so there is somewhat of a clock. They do not need the warrants to take over the companies though, as they could do so via conversion of their senior preferred stock or liquidation preference. Even if something were to happen in 2028, that is still 5 years away, which would not be great.

The Stocks and Their Current Valuations

Preferred Shares: 6.88% of par

- Because there are not many (if any?) probable valuations where preferred shares end up with exactly 6.88% of par, I believe that the best way to value it would be via a probability valuation. However, it's important to account for discounting a scenario that might happen in 2027 and beyond.
- If one wanted to discount the probability of **getting par value in 3 years** (2026) at a 16% discount rate, it would have a present value of $16.44. Assuming a **11% chance** of this scenario, and an **89% chance of getting $0**, it leads to the market's current valuation, 6.88% of par.
- However, I personally believe that the odds of getting $0 for the preferred shares is much less likely, even if it may take longer. If the probability was raised to 40%, and the number of years raised to 5 (2028), it leads to a valuation of 15.6% of par value for the preferred shares.
- One's thoughts on the current valuation could also be impacted by the Fairholme contract jury case taking place in July 2023, as if they were to get 10% of par as damages in the next 6 months for shareholders, that changes the valuation dramatically.

Common Shares: $0.41

- There are many more outcomes for the common shares, which makes trying to work backward to the current market valuation that much harder. However, I believe the market summarizes it right now into 4 possible outcomes, $0, $0.10, $5, and $35 per share.
- Assuming a 1% chance of $35 a share, 5% chance of $5, 5% chance of $0.10 and 89% chance of $0, it leads to a valuation of $0.61, which if you discounted by 2 years @ 15%, you arrive at the current share price of $0.41.
- Like the preferred shares, a lot of the valuation comes down to whether or not you believe a probability valuation like that is too high, or low. For example, for the common shares if you added even just 1% at a $180 valuation, and lowered the $0 outcome from 89 to 88%, even after discounting it by 2 years @ 15% again, you achieve a valuation of $1.82 a share.

Risks

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1. The timeline takes longer than expected for release
    a. This is one of the clearest risks, and why many investment managers decline to invest in the thesis. While we have seen accelerated legal cases, they can drag on for years between remands, appeals, and months between each filing. Plus, court decisions are notoriously hard to predict.
    b. When it comes to government reform related to Fannie & Freddie, they benefit from the status quo, so have even less of a reason to act.
2. The most important legal cases fail, even if the smaller ones succeed
    a. The American court system tries to find the "right" answer but there's nothing to confirm that the Supreme Court would apply the constitution to the FHFA & CFPB as one might think. If many of the largest legal battles are lost, even with minimal monetary relief it could be a disaster for any shareholders.
3. Share price suffers considerably between now and release due to a lack of catalysts
    a. Because of the lack of catalysts, it's quite possible that the share price could continue to fall like it has since conservatorship began. In the last 5 years the common stock is down 75%, versus a 40% gain for the S&P 500 stock index.
4. For common shares there is NO security, endless dilution is a serious risk
    a. If the senior preferred stock is converted to common stock, with a current $120b par value for the pref stock, and $488m $FNMA market cap, it would lead to common shareholders having only a 0.4% stake in the proforma company. Especially because many of the largest & most vocal stockholders are preferred shareholders, the government could be convinced to follow a plan like this.
5. While we view receivership as an unrealistic option, it could wipe out the preferred stock
    a. In receivership the main goals are recovering funds for creditors and avoiding bankruptcy. Many of the usual "shareholder rights" are ignored. I do not foresee this as a likely outcome, but due to the government's bi-partisan animosity towards Fannie & Freddie, it should be considered by all investors.

Conclusion & My Thoughts

Mispriced tail risk- to the upside

- Particularly for the common shares, I believe that there is a very real possibility of $35/share, and up to $290/share depending on the legal successes, especially with the CFPB & appropriations. While it may be extremely hard to put an exact probability on the upper echelon of outcomes, and at the same time one would be unwise to claim that any of these are certain, there is a strong precedent and path for the shares to get to that >$180 level. With just a 10% chance of $180 a share, that would be an $18 price target assuming the other 90% is $0. $18 would be 38x from the current price.

There is more of a timeline than what the consensus believes

- One of the largest and most legitimate risks is that there is no timeline, and it would just lead to the GSEs remaining in conservatorship for another 14+ years. However, as noted in the timeline, the warrants would expire after 2028. As well, as Fannie and Freddie continue to build capital, show their resiliency in economic downturns, and as all of the legal cases are finished, I believe the probability of the thesis completing becomes more and more likely each year. However, the friendlier the FHFA and the executive branch are to Fannie Mae, like letting them keep the cash with the company, and just owing the "liquidation preference", makes a release that much more likely.

Crucial Diversification between Preferred and Commons

- As has hopefully been made clear in the previous sections, there is a large spread of outcomes for the common shares, and the pref shares offer much more of a binary result between 100% of par, or 0%. There are multiple scenarios where preferred shares still get 100% of par, while common shares get diluted into oblivion, so it's important for one to still get "rewarded" by their position in that scenario.
- In addition, there are potential scenarios where common shares get $180 a share, and preferred shares get 100% of par still, but it would not be anywhere near the return common shareholders get. By having a similar exposure to the common shares, it enables one to take part in the mispriced tail risk for the common stock's upside. Of course, the balance between preferred and common stock also depends on one's investment mandate and goals.

It is important for every investor to form their own opinions on the securities mentioned above, and invest according to their own research, goals, beliefs, and experience.