ASSET/LIABILITY WATCH

OCTOBER 30, 2012

Index	Estimated Weights %	Total Return		
		QTD %	YTD %	Last 12 Months %
Ryan Labs Cash	5	0.02	0.13	0.15
Barclays Aggregate Index	30	0.20	4.20	5.25
S&P 500	60	-1.98	12.28	12.66
MSCI EAFE Int'l	5	0.84	11.54	5.15
Asset Allocation Model	100	-1.09	10.02	10.56
Ryan Labs Liability (PPA)	100	1.08	11.66	14.20
Assets – Liabilities (PPA)		-2.16	-1.64	-3.63
Ryan Labs Liability (FAS158)	100	0.06	14.34	16.44
Assets – Liabilities (FAS 158)		-1.15	-4.31	-5.87
Ryan Labs Liability (TSY)	100	-0.14	3.80	10.95
Assets – Liabilities (TSY)		-0.94	6.22	-0.38

October has now come to a close, and the month of November brings with it the Election, Thanksgiving, the start of the Holiday Season, and a sense of optimism that comes with a new year approaching and year-end projects being wrapped up. At press time, we can report on a few things. First, President Obama won reelection. Second, the "fiscal cliff" is a term that any person with access to a newspaper or the internet has now become familiar with. Third, plan sponsors received an early Holiday gift in the form of significantly lower contributions based on the twenty-five year corporate bond average as a result of MAP-21.

To start off the Fourth Quarter of 2012, RL pension funding declined from the end of the last quarter, down to 64.72%. From 66.22%. At the end of 2011, RL pension funding was 65.68% year, significantly down from pre crash levels of 102% on 12/31/07. For the QTD, YTD, and trailing twelve months, the traditional asset allocation detailed above has returned a negative –2.16%, -1.64%, and +-3.63% versus RL PPA liabilities over the same time periods. The RL PPA yield-to-worst was 3.15% on October 31, 2012, down from 3.83% on December 31, 2011.

Now that the election is over, the first agenda item sitting on the desks of members of Congress is to address the fiscal cliff, represented by the Bush era tax cuts expiring, automatic spending cuts going into effect, and the beginning of deficit reductions occurring. Simply stated, assets (in the form of taxes) increase, liabilities decrease. The unanswered question leading into negotiations is how much of an impact of these automatic spending cuts and higher taxes will have on the fragile economic recovery that has been taking place since the official end to the Great Recession in June of 2009.

With the uncertainty surrounding the outcome of fiscal cliff negotiations comes a new source of market volatility. The affect that this could have on tail risk for pension plan assets over the short term could be meaningful. However, for PPA liabilities, the disconnect between MAP-21 liability calculations and market realities will significantly smooth yield changes. As updated AFTAP's arrive, this disconnect between market yields and the twenty-five year corporate average with the 10% corridor become apparent. When the first segment prices liabilities at approximately 5.5%, the second at approximately 6.5%, and the third segment at approximately 7.5%, and intermediate corporate yields are 2.02% and long corporate yields are 4.27% as of October 31, 2012, it is clear that market bond yields are being ignored by MAP-21.

For practitioners of risk management, the MAP-21 funding distortion should not be ignored. Over time, market rates will cross over the corridor rates, and while plan sponsors can currently choose to take advantage of the lower contribution requirements allowed under MAP-21, a bond portfolio does not have the same luxury of being able to be priced at twenty-five year average yields. As pension plan investment committees formulate their own deficit reduction or surplus optimization strategies heading into 2013, a market framework of assessing and understanding asset/liability tracking error, duration hedge, and surplus volatility will assist in providing tighter risk management over the years to come.

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Ryan Labs Pension Protection Act Equal Weighted Index (RL PPA Corp A to AAA Index)					
	Estimated Weights%	YTW[1] %	MDuration (Years)	YTD Returns %	Last 12 Month Returns %
2 Year Corporate	25	0.78	1.95	3.03	2.90
5 Year Corporate	25	1.61	4.71	7.85	7.58
10 Year Corporate	25	2.72	7.83	8.75	8.89
30 Year Corporate	25	3.98	14.17	11.80	11.65
RL PPA Index[2]	100	3.15	15.81	11.66	14.20

Ryan Labs FAS 158 Pension Protection Expense Equal Weighted Index (RL FAS 158 Corp AA to AAA Index)					
	Estimated Weights%	YTW[1] %	MDuration (Years)	YTD Returns %	Last 12 Month Returns %
2 Year Corporate	25	0.73	1.96	1.18	1.37
5 Year Corporate	25	1.27	4.76	4.90	5.47
10 Year Corporate	25	2.40	8.20	6.36	7.77
30 Year Corporate	25	3.62	14.88	10.13	11.38
RL FAS158 Index[2]	100	2.87	16.25	19.28	20.72

1. *Effective Annualized Yield to Worst*
2. *Equal Weighted Index*

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Index	Weights	'00	'01	'02	'03	'04	'05	'06	'07	'08	'09	'10	'11	10/'12
Ryan Labs Cash	**5%**	6.57	5.01	1.92	1.19	1.27	3.17	4.89	5.22	3.01	0.51	0.35	0.39	0.13
Barclays Aggregate	**30%**	11.63	8.44	10.25	4.10	4.34	2.43	4.33	6.96	5.24	5.94	6.54	7.84	4.20
S&P 500	**60%**	-9.10	-11.89	-25.15	28.68	10.88	4.91	15.79	5.50	-37.01	26.45	15.06	2.12	12.28
MSCI EAFE Int'l	**5%**	-13.87	-21.11	-15.64	39.17	20.70	14.02	26.87	11.62	-43.06	32.45	8.14	-12.19	11.54
Asset Allocation Model	**100%**	-2.50	-5.42	-13.49	20.04	8.93	4.61	12.25	6.35	-24.49	19.43	11.87	3.26	10.02
RL PPA Liability		7.72	15.40	24.17	7.30	11.22	5.95	2.36	2.39	10.44	6.34	13.73	21.13	11.66
Return Difference		-10.22	-20.82	-37.66	12.74	-2.29	-1.34	9.89	3.96	-34.93	13.10	-1.86	-17.87	-1.64
Funding Ratio (RL PPA)		**144.98**	**118.83**	**82.78**	**92.61**	**90.70**	**89.55**	**98.20**	**102.00**	**69.74**	**78.33**	**77.05**	**65.68**	**64.72**
Liabilities (TSY)	**100%**	23.91	3.91	16.73	1.57	9.96	10.08	0.85	10.81	42.48	-25.71	9.41	31.08	3.80
Return Difference		-26.41	-9.33	-30.22	18.47	-1.03	-5.47	11.40	-4.46	-66.97	45.14	2.46	-27.82	6.22
Funding Ratio (Economic)		**96.23**	**87.60**	**64.92**	**76.72**	**76.00**	**72.23**	**80.39**	**77.16**	**40.89**	**65.74**	**67.22**	**52.95**	**56.13**

Notes: RL PPA liability curve is the spot curve of the replication of IRS PPA curve (US credit A to AAA).
RL Treasury liability curve is the proxy for economic liabilities.

Assumptions :Normal costs = annual contributions
No benefit enhancements
Assets portfolio rebalanced monthly

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