RYAN LABS ASSET MANAGEMENT

ASSET/LIABILITY WATCH

MARCH 31, 2013

Index	Estimated Weights %	Total Return		
		QTD %	YTD %	Last 12 Months %
Ryan Labs Cash	5	0.05	0.05	0.22
Barclays Aggregate Index	30	-0.25	-0.25	3.64
S&P 500	60	10.03	10.03	11.41
MSCI EAFE Int'l	5	5.24	5.24	11.81
Asset Allocation Model	100	6.15	6.15	9.09
Ryan Labs Liability (PPA)	100	-2.77	-2.77	9.57
Assets – Liabilities (PPA)		8.92	8.92	-0.48
Ryan Labs Liability (FAS158)	100	-2.27	-2.27	13.67
Assets – Liabilities (FAS 158)		8.42	8.42	-4.58
Ryan Labs Liability (TSY)	100	-3.31	-3.31	6.99
Assets – Liabilities (TSY)		9.45	9.45	2.10

The first Quarter of 2013 has concluded with performance assets rallying and liability returns falling. This is the combination of returns that plan sponsors have been waiting for. This combination of strong asset returns and higher yields led to two of the three potential positive funding events occurring in the first quarter. If plan sponsors made contributions higher than their normal cost in the first quarter, the funding trifecta was hit. All in all, the year is off to a strong start. Now, how should a plan sponsor react to the strong quarter? If a plan sponsor is still in a shorter duration (intermediate, core) benchmark, is it time to begin to extend duration even though we're in the proverbial "low rate" environment?

With performance asset up, YTD funding has improved by 6%. Outperformance of assets versus liabilities by 8.92% has led the way for such a strong quarter. At the end of March RL PPA funding improved to 73%. The model asset allocation continued its performance, finishing up +6.15% for the 1st Quarter/YTD. Core fixed income returns were down –.25%, and the RL PPA liability was down –2.77%. The RL PPA Index, with a liability duration of 14.68 and priced on an equal weighted basis, saw its yields widen by 3 basis points, from 3.31% up 3.34%.

A pension's asset allocation can be constructed in many different ways. Overall total return/achieving ROA assumptions could be the foundation of your asset allocation. Risk management/LDI can act as the foundation as well. At the end of the day, the fixed income portfolio is the safe haven. It is supposed to act as the non-correlating asset class so that in times of stress, the entire portfolio isn't exposed to equity volatility. In this "low rate" environment, how could a fixed income portfolio be invested? The oversimplified answer is one of two ways, a shorter/core duration benchmark or a longer duration benchmark (LDI/credit long).

While a core duration benchmark may be appealing for those that believe rates are going up and going up soon, there is a cost that comes along with a core duration strategy relative to a long duration.LDI strategy. What is this cost? It's the carry cost. There are three scenarios that can play out for interest rates. They can go up. They can go down. They can stay the same. Depending on whether the fixed income portfolio is core duration or long duration, a plan sponsor will either win in all three of these scenarios or one out of three scenarios. This is the impact of the carry cost.

If rates stay the same, the higher yield of the long duration strategy will provide a higher total return and higher funded status or the long duration strategy, If rates go down, the longer duration strategy will outperform the core strategy, and hedge a portion of the liability interest rate risk, also providing a higher funded status. A core duration strategy will provide a higher total return versus a long duration strategy if rates rise above the breakeven level (approximately 35 to 45 bps, depending upon the portfolio's yield). However, if rates rise, liabilities will fall more than the fixed income portfolio (core and long duration), improving funding status. The core fixed income portfolio's lower yield, potential lower total return, and lower risk management versus the longer duration strategy is the carry cost. Over the next two months, ALW will further quantify what this risk and cost means to a plan sponsor in various interest rate environments.

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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	0.80	2.01	0.36	2.00
5 Year Corporate	25	1.75	4.67	0.45	5.78
10 Year Corporate	25	2.87	7.83	-0.49	7.67
30 Year Corporate	25	4.37	14.18	-2.38	7.89
RL PPA Index[2]	100	3.34	14.68	-2.77	9.57

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	0.55	2.02	0.27	1.22
5 Year Corporate	25	1.42	4.68	0.48	4.34
10 Year Corporate	25	2.67	8.05	-0.49	5.63
30 Year Corporate	25	3.99	14.86	-2.03	5.99
RL FAS158 Index[2]	100	3.05	15.43	-2.27	13.67

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	'12	3/'13
Ryan Labs Cash	**5%**	7	5	2	1	1	3	5	5	3	1	0	0	0	0
Barclays Aggregate	**30%**	12	8	10	4	4	2	4	7	5	6	7	8	4	0
S&P 500	**60%**	-9	-12	-25	29	11	5	16	5	-37	26	15	2	13	10
MSCI EAFE Int'l	**5%**	-14	-21	-16	39	21	14	27	12	-43	32	8	-12	18	5
Asset Allocation Model	**100%**	-2	-5	-13	20	9	5	12	6	-24	19	12	3	11	5
RL PPA Liability		8	15	24	7	11	6	2	2	10	6	14	21	9	-3
Return Difference		-10	-21	-38	13	-2	-1	10	4	-35	13	-2	-18	2	9
Funding Ratio (RL PPA)		**145**	**119**	**83**	**93**	**91**	**90**	**98**	**102**	**70**	**78**	**77**	**66**	**67**	**73**
Liabilities (TSY)	**100%**	24	4	17	2	10	10	1	11	42	-26	9	31	3	-2
Return Difference		-26	-9	-30	18	-1	-5	11	-4	-67	45	2	-28	8	8
Funding Ratio (Economic)		**96**	**88**	**65**	**77**	**76**	**72**	**80**	**77**	**41**	**66**	**67**	**53**	**57**	**62**

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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