RYAN LABS ASSET MANAGEMENT

ASSET/LIABILITY WATCH

JULY 31, 2013

Index	Estimated Weights %	Total Return		
		QTD %	YTD %	Last 12 Months %
Ryan Labs Cash	5	0.03	0.13	0.23
Barclays Aggregate Index	30	0.14	-2.31	-1.90
S&P 500	60	4.95	18.20	22.21
MSCI EAFE Int'l	5	5.28	9.98	24.01
Asset Allocation Model	100	3.27	10.54	13.71
Ryan Labs Liability (PPA)	100	1.81	-7.64	-9.63
Assets – Liabilities (PPA)		1.46	18.18	23.34
Ryan Labs Liability (FAS158)	100	1.11	-9.10	-13.52
Assets – Liabilities (FAS 158)		2.16	19.64	27.23
Ryan Labs Liability (TSY)	100	-2.24	-11.27	-15.66
Assets – Liabilities (TSY)		5.51	21.81	29.37

The summer slow down, interest rate uncertainty, nor any other market dynamic has been capable of slowing down momentum for pension funding. Across the board, performance assets have been continuing their rally, interest rates have been creeping up, and pension plans that have unhedged interest rate risk have seen their funding ratios improve meaningfully. Overall, pension plans across America are feeling pretty good right now. But, trees do not grow to the sky and capital markets do not move linearly. At summer's midpoint, what can a pension plan do?

The traditional asset allocation has outperformed RL PPA liabilities by 18.18% YTD. The S&P 500 has led the way with an 18.20% YTD return, while PPA liabilities have declined in value by –7.64%. The asset allocation model return of 10.54% has led to such a meaningful outperformance of assets versus liabilities. The RL model asset allocation returns over the past 12 months have outperformed liabilities by 23.34%, a staggering amount over this time period.. The RL PPA Index, with a liability duration of 14.27 years and priced on an equal weighted basis, widened by 53 basis points YTD, going from 3.22% to 3.75%. Funding has improved over the past 12 months from 63.5% to 80%, an increase of 16.5%, far surpassing most glide path triggers.

The majority of pension plans have one of four fixed income strategies being implemented. First, there's an intermediate/core strategy that is significantly shorter in duration, with a 5% to 10% interest rate hedge. Second is a light version of liability driven investing, whereby a plan is either shorter in duration or has less money allocated to a long duration strategy and are hedged between 20 to 30%. The third strategy is a more meaningful hedge, whereby either through an overweight to fixed income and/or a long duration strategy matching the plan's liabilities, a plan is hedging 30 to 50% of their interest rate risk On a much smaller scale, the fourth are plans that hedge 75%+ of their interest rate risk, fully matched to their liabilities. For the sake of A/L Watch, we will focus on the first three allocations.

Those plans that fall within the first strategy, similar to the RL Model Asset Allocation, have seen their funding ratio improve by approximately 16.5% over the past twelve months. Plans in the second and third hedging category have seen their funding ratios increase from approximately 5% to 15%. With such a meaningful right tail scenario having played out in the past 12 months, how should a plan adjust their asset allocation?

Rather than rely on the vagaries of the capital markets, a pension plan has an opportunity to be proactive and reduce further funding volatility. To what degree a plan should do this is fully dependant on their risk capacity and risk budget. If stocks pull back and the Fed drives rates down going forward, how much of the funding improvement can a plan tolerate losing? There is no one size fits all answer, but if there is one thing that can be learned from Page 3 of A/L Watch, it's that the market giveth, and the market taketh away, if you let it. However, those plans that put a glide path plan in place have an opportunity to move forward with it. Whether it's a 5% or 10% increase to fixed, or extending duration, being proactive in the face of a three standard deviation move to the upside should yield better long term funding results.

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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	0.94	1.99	0.43	1.16
5 Year Corporate	25	2.38	4.56	-1.63	0.10
10 Year Corporate	25	3.65	7.78	-4.85	-3.61
30 Year Corporate	25	4.84	13.77	-7.48	-8.99
RL PPA Index[2]	100	3.75	14.27	-7.64	-9.63

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	0.68	2.01	0.33	0.62
5 Year Corporate	25	2.10	4.62	-1.96	-1.30
10 Year Corporate	25	3.38	8.09	-5.43	-5.56
30 Year Corporate	25	4.58	14.26	-7.98	-11.40
RL FAS158 Index[2]	100	3.46	14.56	-9.10	-13.52

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	7/'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	-2
S&P 500	**60%**	-9	-12	-25	29	11	5	16	5	-37	26	15	2	13	18
MSCI EAFE Int'l	**5%**	-14	-21	-16	39	21	14	27	12	-43	32	8	-12	18	10
Asset Allocation Model	**100%**	-2	-5	-13	20	9	5	12	6	-24	19	12	3	11	11
RL PPA Liability		8	15	24	7	11	6	2	2	10	6	14	21	9	-8
Return Difference		-10	-21	-38	13	-2	-1	10	4	-35	13	-2	-18	2	18
Funding Ratio (RL PPA)		**145**	**119**	**83**	**93**	**91**	**90**	**98**	**102**	**70**	**78**	**77**	**66**	**67**	**80**
Liabilities (TSY)	**100%**	24	4	17	2	10	10	1	11	42	-26	9	31	3	-11
Return Difference		-26	-9	-30	18	-1	-5	11	-4	-67	45	2	-28	8	22
Funding Ratio (Economic)		**96**	**88**	**65**	**77**	**76**	**72**	**80**	**77**	**41**	**66**	**67**	**53**	**57**	**71**

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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