BOND MARKET WATCH
JUNE 30, 2013

With the 2nd quarter of the year in the books, risk generally ended the quarter wider, as credit markets limped into the end of June despite equities posting a very strong first half. The S&P500 gained 10.03% in 1Q 2013 and finished the first half of the year up 12.63% and up 13.83% if you include dividends reinvested in the index. However, stocks sold off materially from their highs in mid-May, as the Fed's talk of potential tapering in their $85 billion a month in Agency MBS and U.S. Treasury asset purchases put a damper strong first half sentiment. Stocks corrected about 6% at one point during June. Volatility was muted for much of the first quarter but picked up with the correction in stocks and the reaction to the Fed. The VIX made new trailing 12-month lows at 11.41 in mid-March but approached 22 during the later part of June. Treasuries had remained range-bound for a large portion of 2012, but bonds experienced heavy selling during the second quarter and especially in June, as the 10-year yield reached as high as 2.66% during the month. The Ryan Labs 10-year Treasury Index finished 2Q 2013 yielding 2.48% after yielding 1.86% at the end of 1Q 2013, and ending 2012 at 1.75%. Throughout most of the second half of 2012, the 10-year remained in a range between the mid 1.5% area and 1.9%, yet we are settling into potentially a new range as we see the 10-year in the mid-2% area as we write this. On a positive note, the impetus for the Fed's tapering discussion was their more positive macroeconomic outlook. We saw +178k net jobs added in May in the Non-Farm Payroll report compared with expectations of +175K, and unemployment rate came down to 7.6%. Home prices continue to see double digit annual increases with the S&P/CS Composite-20 year-over-year index coming in at 12.05% compared with expectations of 10.6%. Some of the regional Manufacturing indexes have also been strong with both the Richmond, Dallas and Philly Fed indexes surprising to the upside. The recent US Manufacturing ISM came in at 50.9 compared with expectations of 50.5 and consumer confidence on the University of Michigan survey came in at 84.1 compared to last month of 82.7. US Advance retail sales came in at 0.6% month-over-month compared with expectations of 0.4%. However, GDP was revised to 1.8% for the first quarter after initially coming in at 2.4% for the first quarter and inflation has been benign with a CPI at 1.4% year-over-year and a Core CPI ex-food and energy coming in at 1.7%.

We have continued to discuss the strength of large cap U.S. corporations, and that will be put to the test as we approach 2nd quarter earnings season. Earnings were generally positive last quarter with 73% of the S&P500 surprising to the upside. But top line revenue growth was actually slightly negative at -0.83% and earnings only grew at 2.14%. With positive, but generally weak GDP forecasts in the high 1% to mid-2% area, the recovery still appears weaker than stocks' recent performance portends. Weak GDP growth, commodity price declines, and macroeconomic and credit concerns out of China continue to be on investors' radar. However, the Fed's language has been the most important topic for US fixed income investors. Chairman Bernanke's discussion on tapering their asset purchases later this year sent rates and credit bond prices lower and markets have tried to find a new equilibrium. Bond traders from the hedge fund community all the way to traditional money managers seemed reluctant to take on additional duration risk, driving credit spreads wider alongside rate steepening. Unlike recent Treasury sell-offs or rallies over the past couple of years, spread widening was correlated with Treasury yield increases. As government bonds sold-off, corporate bonds and other credit such as high yield, securitized credit, and agency MBS underperformed, leading to poor returns across investment grade fixed income sectors. Recently, treasuries and credit has rallied a bit off the lows, suggesting Within high-grade fixed income, after credit spreads in the Barclays Aggregate Index ended 2011 at 217 bps, and ended 2012 at 133 bps, spreads widened to 144 bps off Treasuries at the end of June from 130 bps at the end of the first quarter of 2013. After ending December 2011 at 337 bps and tightening to 155 bps off Treasuries to end 2012, financials widened to 155 bps at the end of 2Q 2013. Industrials closed out 2012 at 133 bps, and ended the 2nd quarter wider at 149 bps from 137 bps at the end of 1Q 2013.

Following a strong 2012, ABS and CMBS had a good 1Q 2013. However, CMBS underperformed in the recent quarter while ABS performed well compared to other securitized sectors. Most of the positive technicals in ABS and CMBS have remained a strength, as comparative relative value remains in place. Fundamentals in CMBS have continued to perform with rising commercial real estate prices however underlying commercial loan rates have started to rise in line with other mortgages and rates. In ABS, many consumer sub sectors have continued to perform well fundamentally such as auto ABS on the back of record auto sales. Agency MBS underperformed duration neutral Treasuries as the 30 year fixed mortgage rate exceeded 4.5% near the end of June from 3.4% in the early part of May. Agency MBS was one of the hardest hit sectors after the Fed's comments regarding tapering MBS purchases.

RYAN LABS
ASSET MANAGEMENT

BOND MARKET WATCH

JUNE 30, 2013

Yield and Total Returns

Ryan Labs Indexes	YTW	QTD	YTD	12M[1]	Ryan Labs Indexes	YTW	QTD	YTD	12M[1]
RL 2 Year Indexes					**RL 10 Year Indexes**				
TIPS	-0.88	-2.08	-1.56	-0.38	TIPS	0.57	-9.48	-10.05	-6.78
Treasury	0.34	-0.03	0.04	0.29	Treasury	2.48	-4.15	-4.74	-4.04
Agency	-0.05	0.03	0.06	0.25	Agency	1.59	-2.63	-1.13	0.12
AAA Corporate	0.64	-0.04	0.34	1.65	AAA Corporate	3.09	-0.86	0.30	2.53
AA Corporate	0.87	-0.10	0.39	2.18	AA Corporate	3.48	-3.71	-3.43	0.55
A Corporate	1.38	-0.51	0.19	3.25	A Corporate	3.73	-3.55	-3.15	2.51
BBB Corporate	1.87	-0.25	0.73	4.48	BBB Corporate	4.47	-3.33	-2.31	6.03
Financials	1.62	-0.58	0.30	3.90	Financials	4.11	-3.97	-2.90	5.85
Industrials	1.28	-0.32	0.31	2.74	Industrials	3.93	-3.33	-2.93	1.53
Utilities	1.25	-0.66	0.00	2.54	Utilities	3.89	-4.02	-3.48	1.18
RL 5 Year Indexes					**RL 30 Year Indexes**				
TIPS	-0.34	-5.46	-4.98	-2.73	TIPS	1.18	-12.89	-16.38	-12.42
Treasury	1.36	-2.22	-2.20	-1.44	Treasury	3.50	-6.13	-9.54	-10.89
Agency	1.01	-0.09	-1.22	-0.41	Agency	3.80	-7.77	-8.64	-7.87
AAA Corporate	1.93	-1.85	-0.87	1.77	AAA Corporate	4.37	-4.02	-5.30	-1.33
AA Corporate	2.30	-1.95	-1.33	2.19	AA Corporate	4.83	-5.30	-5.18	0.28
A Corporate	2.64	-2.16	-1.30	4.56	A Corporate	4.93	-4.87	-6.12	0.17
BBB Corporate	3.28	-2.10	-1.16	4.08	BBB Corporate	5.55	-5.16	-5.70	2.70
Financials	3.00	-2.47	-1.11	6.31	Financials	5.32	-5.23	-4.36	5.48
Industrials	2.70	-2.00	-1.26	2.70	Industrials	5.11	-4.97	-6.45	-0.31
Utilities	2.56	-2.04	-1.07	4.31	Utilities	4.90	-4.87	-5.49	0.08
Barclays Indexes					**Barclays Indexes**				
BC Aggregate	2.35	-2.33	-2.44	-0.69	BC ABS	1.28	-0.80	-0.82	0.69
BC CMBS	2.34	-1.44	-1.31	3.72	BC MBS	3.16	-1.99	-2.04	-1.14

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Ryan Labs TIPS	Yield To Worst (%)	MDuration (Years)	Year To Date Returns (%)	Last 12 Month Returns (%)
2 Year TIPS	-0.88	2.33	-1.56	-0.38
5 Year TIPS	-0.34	4.89	-4.98	-2.73
10 Year TIPS	0.57	10.12	-10.05	-6.78
30 Year TIPS	1.18	21.25	-16.38	-12.42
RL TIPS Index	0.08	8.05	-7.68	-4.95

Market Implied Breakeven Inflation Expectation	Yield To Worst (%)		Inflation (%)	
	Nominals [1]	TIPS	BEI [2]	Current [3]
CPI (1 Month Lag)				1.4
2 Year	0.34	-0.88	1.22	
5 Year	1.36	-0.34	1.70	
10 Year	2.48	0.57	1.91	
30 Year	3.50	1.18	2.32	

1) Nominals represent conventional U.S. Treasury Bonds and Notes.

2) BEI = Breakeven Inflation Rate (Nominal yields minus TIPS yields). Widening BEI indicates that TIPS are outperforming nominal bonds. When realized inflation is greater than implied inflation, TIPS also outperform.

3) Current Inflation = Bureau of Labor Statistics, Year over Year Consumer Price Index (non-seasonally adjusted, all items, 1 month lag)

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