RYAN LABS
ASSET MANAGEMENT

BOND MARKET WATCH
SEPTEMBER 30, 2013

The third quarter in the bond market was marked by a host of macroeconomic, government, and policy uncertainty after intense selling across fixed income markets in the second quarter. Fixed income investors were happy to move on from the second quarter that saw one of the worst bond performances in the history of the Barclays Aggregate index, only to face the prospect of possible September tapering of the Fed's Quantitative Easing program in September, a government shutdown, and the prospect of the US Treasury not able to pay its bills due to breaching the debt ceiling. First, the Fed surprised many strategists, economists, and investors by not tapering their $85 billion in monthly asset purchases, with most expecting at least some tapering in Treasury purchases and perhaps a cut back in Agency MBS purchases as well. The Fed delivered neither in the face of mixed macroeconomic data in employment (Change in Non Farm Payrolls at +169k vs expectations of 180k and a 7.3% unemployment rate), inflation (CPI still well below the Fed's view of being a threat at 1.5% year-over-year and Core CPI at 1.8%), retail sales (up a tepid 0.2% month over month), and mortgage rates (The Bankrate.com 30-year fixed rate skyrocketed from the trailing 12 month low of 3.36% in December all the way to 4.67% in early September, creating worry about the knock-on effect on purchasers ability to finance new home purchases.) Equities sold off towards the end of September as the debt ceiling limit loomed and amidst the government shutdown, but have since rallied and are up over 22% for the year as we write this. Volatility, underlying Treasury yields and corporate bond yields were all at, or near, multiyear low levels at the end of the first quarter and volatility certainly picked up with the government ineptitude as the VIX eclipsed 20 for the first time since the increased macro concern of the Fed "tapering" their asset purchases in June. The VIX has collapsed since the government debt ceiling has been extended, albeit temporarily, and is currently is at 13.15 as we write this. Volatility, as measured by the VIX, has correlated closely with higher beta credit spreads and high yield spreads.

After the 10 year US Treasury averaged a 1.78% yield in 2012 and touched 1.62% as recently as May, the heavy selling of the 2nd quarter did not improve in July and August. However, after reaching close to 3% in the beginning of September, the 10 year index rallied, with the yield coming in to 2.58% as we write this. The Ryan Labs 10-year Treasury Index yielded 2.62% to finish out the third quarter on September 30th. Much of the reasons behind the bond sell-off earlier in the year due to a combination of fear regarding the eventual unwinding of the Fed's multiyear QE program remain and better macroeconomic indicators have been delayed however temporary this may be. 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 the average yield for 2013 is 2.23%, while the average 10 year yield over the past 3-months is 2.71%.

3Q earnings are beginning to come into focus after most of the market was focused on the government shutdown. Earnings were generally good in the first quarter with 73% of the S&P500 surprising to the upside, and followed that up with a decent second quarter, with 71% upside surprises. Top line revenue growth has still been weak, and came in last quarter at 1.45%, with earnings up 3.46%. Financial sector earnings were up 28.7% in the 2nd quarter over the same quarter a year ago, but are showing signs of weakness after a few recent report. For example, Wells Fargo showed difficulty in mortgage origination and has recently announced layoffs in that sector while Goldman Sachs and other large banks had a difficult quarter in fixed income trading. Within high-grade fixed income, after credit spreads in the Barclays Aggregate Index ended 2011 at 217 bps, and 2012 at 133 bps, spreads tightened to 135 bps at the end of the 3rd quarter from 144 bps off Treasuries at the end of the 2nd quarter. After tightening to 155 bps off Treasuries to end 2012, financials tightened to widened to 139 bps to end the third quarter from 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. Industrial spreads tightened in the third quarter to 142 bps. The agency MBS sector underperformed duration neutral Treasuries for much of the quarter on the fear of the Fed's taper, and the yield curve steepening, but rallied off of the Fed's announcement to delay and had a strong month of September, with a month-to-date excess return of 63 bps. The Barclays Aggregate Index has returned -1.89%.

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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	-0.98	0.53	-1.04	-0.70	TIPS	0.54	0.99	-9.14	-8.48
Treasury	0.33	0.24	0.24	0.28	Treasury	2.62	-0.61	-5.41	-5.65
Agency	0.41	0.02	0.04	0.19	Agency	1.43	0.35	-0.78	-1.11
AAA Corporate	0.66	0.45	0.41	1.05	AAA Corporate	3.44	-0.47	-4.41	-3.15
AA Corporate	0.86	0.56	0.78	1.37	AA Corporate	3.60	0.02	-4.76	-2.86
A Corporate	1.32	0.88	1.05	2.02	A Corporate	3.91	0.14	-4.14	-2.17
BBB Corporate	1.96	1.05	1.72	3.07	BBB Corporate	4.73	0.58	-3.14	1.20
Financials	1.55	1.10	1.47	2.45	Financials	4.28	0.99	-2.28	0.88
Industrials	1.35	0.77	0.97	2.00	Industrials	4.18	-0.13	-4.22	-2.43
Utilities	1.46	0.48	0.74	1.85	Utilities	4.18	-0.19	-3.88	-1.81
RL 5 Year Indexes					**RL 30 Year Indexes**				
TIPS	-0.40	1.22	-3.82	-3.45	TIPS	1.30	-1.62	-17.99	-16.65
Treasury	1.39	0.69	-1.57	-1.57	Treasury	3.69	-3.34	-11.97	-13.10
Agency	1.45	-2.62	-3.80	-3.79	Agency	3.93	-2.07	-10.53	-12.17
AAA Corporate	2.02	0.48	-1.40	-0.54	AAA Corporate	4.62	-2.03	-10.75	-10.55
AA Corporate	2.38	0.78	-0.82	0.63	AA Corporate	4.93	0.05	-6.81	-4.81
A Corporate	2.65	1.38	-0.45	1.16	A Corporate	5.03	-0.22	-6.66	-4.89
BBB Corporate	3.38	1.22	-0.24	1.64	BBB Corporate	5.73	-0.35	-7.03	-4.35
Financials	2.92	2.05	0.80	2.77	Financials	5.36	1.09	-2.77	0.30
Industrials	2.76	0.82	-1.00	0.44	Industrials	5.27	-0.71	-7.91	-5.93
Utilities	2.72	0.56	-0.55	1.62	Utilities	5.07	-0.98	-6.39	-4.77
Barclays Indexes					**Barclays Indexes**				
BC Aggregate	2.34	0.57	-1.89	-1.68	BC ABS	1.26	0.17	-0.66	-0.37
BC CMBS	2.24	1.02	-0.30	0.91	BC MBS	3.09	1.04	-1.02	-1.24

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Ryan Labs TIPS				
	Yield To Worst (%)	**MDuration (Years)**	**Year To Date Returns (%)**	**Last 12 Month Returns (%)**
2 Year TIPS	**-0.98**	**2.37**	**-1.04**	**-0.70**
5 Year TIPS	**-0.40**	**5.15**	**-3.82**	**-3.45**
10 Year TIPS	**0.54**	**10.20**	**-9.14**	**-8.48**
30 Year TIPS	**1.30**	**21.85**	**-17.99**	**-16.65**
RL TIPS Index	**0.04**	**8.26**	**-7.17**	**-6.56**

Market Implied Breakeven Inflation Expectation				
	Yield To Worst (%)		**Inflation (%)**	
	Nominals [1]	**TIPS**	**BEI [2]**	**Current [3]**
CPI (1 Month Lag)				1.5
2 Year	0.33	-0.98	1.31	
5 Year	1.39	-0.40	1.80	
10 Year	2.62	0.54	2.08	
30 Year	3.69	1.30	2.39	

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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