

Index	Estimated Weights %	Total Return		
		QTD %	YTD %	Last 12 Months %
Ryan Labs Cash	5	0.05	0.10	0.13
Barclays Aggregate Index	30	1.45	3.85	5.78
S&P 500	60	3.25	11.84	15.39
MSCI EAFE Int'l	5	3.88	7.40	0.47
Asset Allocation Model	100	2.58	9.43	12.49
Ryan Labs Liability (PPA)	100	4.99	9.58	23.71
Assets – Liabilities (PPA)		-2.41	-0.15	-11.22
Ryan Labs Liability (FAS158)	100	2.24	13.07	22.70
Assets – Liabilities (FAS 158)		0.34	-3.64	-10.21
Ryan Labs Liability (TSY)	100	2.22	6.56	18.75
Assets – Liabilities (TSY)		0.36	2.87	-6.26

In Charles Dickens' classic novel, "A Tale of Two Cities," he famously wrote, "It was the best of times, it was the worst of times, it was the age of wisdom, it was the age of foolishness..." Rather than referencing France and London, assets and liabilities in 2012 are shaping up to similarly be the best and worst of times. If a survey was conducted at the beginning of the year asking the question to CFOs, Finance Directors, and members of Investment Committees, "Would you be pleased with a 9.58% YTD return on assets and a 12.49% return on assets for the trailing 12 months ending August 31, 2012?" it would be safe to bet the answer provided by the majority of those surveyed would be along of the lines of, "Yes, we would be ecstatic with returns over 9% and 12%." Likewise, if the same question were asked about liability returns of +9.58% YTD and +23.71% over the trailing twelve months, the answer would be completely dichotomous.

At the end of August 2012, RL pension funding is idling along at 65.59%, down from 65.68% year end 2011, down from 102% on 12/31/07, and down from 144.98% on 12/31/00. For the QTD, YTD, and trailing twelve months, the traditional asset allocation detailed above has returned -2.41%, -0.15%, and -11.22% versus RL PPA liabilities over the same time periods. The RL PPA yield-to-worst was 3.27% on August 31, 2012, down from 3.83% on December 31, 2011. In the "age of wisdom," asset/liability surplus volatility is still an issue for plan sponsors.

Making matters more difficult on the liability side for plan sponsors and further exacerbating the asset/liability return difference, the Fed announced on September 13, 2012 (added to Aug 31, 2012 AL Watch for timeliness), that the third round of Quantitative Easing has been authorized. In addition to purchasing \$40 billion of mortgages per month to help spur the real estate recovery on, the Fed is continuing with Operation Twist and keeping the Fed Funds Rate at or near zero through mid-2015. The Fed wants rates to remain low, which if successful, will not provide much relief for mark-to-market pension liability valuations. In a year when the third round of QE goes into effect, funding relief is granted through the use of artificially high discount rates, the equity markets are rallying, and interest rates remain volatile, many plan sponsors are left with uncertainty when trying to rebalance their fixed income portfolio.

While there is no one size fits all solution for ERISA, multi-employer/Taft-Hartley, and public pension funds, the steps that can be taken to answer those questions can be similar. If strong asset returns alone are not enough to keep up with liability returns, and as we've seen in the past 12 months (and further back) if strong asset returns cannot come close to bridging the funding gap, plan sponsors of all types should look to understand and review their capacity to take on tail risk. If underperforming liabilities by a significant margin will jeopardize long term strategic plans and/or long term sustainability of the pension fund, steps should be taken to use the fixed income portfolio in a manner that minimizes volatility. When risk management is combined with a deficit reduction strategy, the sequel to "A Tale of Two Returns" can perhaps be a story about sustainability and pension success as opposed to a story about not being able to keep up with liability returns. Where consistently being at or close to fully funded is the norm, not the anomaly. Where the best of times is sustainable. Structuring the bond portfolio relative to the liabilities is the first step that may help fulfill that goal.

REGISTERED INVESTMENT ADVISOR

Ryan Labs Pension Protection Act Equal Weighted Index					
(RL PPA Corp A to AAA Index)					
	Estimated Weights%	YTW¹ %	MDuration (Years)	YTD Returns %	Last 12 Month Returns %
2 Year Corporate	25	0.70	1.90	2.67	2.69
5 Year Corporate	25	1.69	4.61	6.33	5.99
10 Year Corporate	25	2.84	7.76	7.03	8.64
30 Year Corporate	25	4.05	14.15	9.82	17.51
RL PPA Index ²	100	3.27	15.81	9.58	23.71

Ryan Labs FAS 158 Pension Protection Expense Equal Weighted Index					
(RL FAS 158 Corp AA to AAA Index)					
	Estimated Weights%	YTW¹ %	MDuration (Years)	YTD Returns %	Last 12 Month Returns %
2 Year Corporate	25	0.52	1.90	1.42	1.87
5 Year Corporate	25	1.31	4.69	4.22	5.21
10 Year Corporate	25	2.42	8.09	5.62	9.18
30 Year Corporate	25	3.71	14.54	9.54	18.49
RL FAS158 Index ²	100	2.83	16.75	21.90	35.75

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

Index	Weights	'00	'01	'02	'03	'04	'05	'06	'07	'08	'09	'10	'11	08/'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	0.10
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	3.85
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	11.84
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	7.40
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	9.43
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	9.58
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	-0.15
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	65.59
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	6.56
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	2.87
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	54.38

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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REGISTERED INVESTMENT ADVISOR

500 Fifth Avenue, Suite 2520
New York, NY 10110
www.ryanlabs.com

MAIN: 212.635.2300
TOLL FREE: 800.321.2301
FAX: 212.635.2309