BOND MARKET WATCH
JULY 31, 2012

Equity markets and other risk assets continued the rally that began at the end of May of 2012. For the month of July, the S&P 500 index returned 1.38%, European equities returned 2.91% and the excess return of U.S. credit markets versus U.S. Treasuries was 1.23%. There were some interesting divergences: Spanish and Italian bonds dropped in price by about two points in July and U.S. Treasuries had positive returns for the period. European central bank president Mario Draghi's verbal commitment to peripheral European debt, optimistic language coming out of the June Eurozone summit and German finance minister Wolfgang Schauble comments on the possibility of future jointly issued Eurozone debt have underpinned the markets. It remains to be seen how strong the German commitment to peripheral bond purchases will be and this has kept market participants wary but for now risk assets continue to perform.

Recent U.S. economic statistics have been a mixed bag but at least for now do not appear to be getting worse. Purchasing managers surveys have stabilized above 50, jobless claims continue to fall and the housing market is beginning to show signs of improvement. The August jobs report was also much stronger than expected surprising the market after poor July numbers.

The majority of equity earnings announcements have beat analysts' estimates so far but interestingly many large or mega capitalization companies have missed on revenue estimates. Better margins have helped equity prices but revenue growth will need to be stronger in the coming quarters to sustain the rally in equities. As an example IBM reported earnings mid July and beat analysts' estimates by six cents per share but missed on revenue by approximately $500 million. The market has so far focused on the bottom line with IBM equity up 6% since the announcement but clearly margin improvement can only do so much looking forward.

Treasury yields fell somewhat in July although at this writing there has been a significant rise in Treasury rates from the July lows in yield. In the US Treasury market, the yield on the Ryan Labs 10-year Treasury Index finished 2011 at 1.87%, and finished the July at 1.47%. July witnessed historic lows on 10-year Treasury yields briefly dipping below 1.40%. The Ryan Labs 30-year Treasury Index yielded 2.90% at the end of 2011 and closed July at 2.54%, as the yield curve flattened for July. As we write this, the 5-year, 10-year and 30-year Treasuries have all gone up significantly in yield from the July low with the 10-year at 1.81%.

July was a strong month for all credit and structured securities. Spreads were tighter across the board as technical factors and stable fundamentals contributed to strong performance. Within high-grade fixed income, after credit spreads in the Barclays Aggregate Index tightened to 161 bps over Treasuries at the end of the first quarter from 217 bps at the end of 2011, spreads widened back out to 182 to close the second quarter. In July spreads were tighter by 20 bps versus quarter end closing at 162. Credit tightening was broad based with most sectors performing well. Financial credits had outperformed earlier in the year but in July Industrial and Utility credit outperformed as demand for high quality credit was strong. In investment grade, BBB-rated credit performed the best for July but A-rated credits were only a few basis points behind. High yield returns for the year and July are noteworthy. The high yield index returned 9.3% year-to-date through July and 1.9% for the month. Yield to worst is down to 6.89% for the index. High yield fundamentals have supported these returns as coverage, leverage and liquidity has generally improved. Also, credit defaults are running near 2%, a low and supportive number for the overall market. Supply has been heavy and well absorbed but it's worth noting that less bondholder friendly deals have been getting done (increased leverage, less covenant protection and financed dividends to private equity sponsors).

Within the securitized sector, ABS continued the trend from the second quarter tightening throughout the July. The excess return of the Barclays ABS index for July was 85 bps but does not tell the whole story, as the index is dominated by tighter triple AAA senior tranches backed by credit cards and auto loans. Many of the ABS subordinate bonds continue to perform well as collateral credit trends have stabilized and new levered money has entered the market. There are positives and negatives clearly – a better fundamental picture helps but more investor leverage against these assets may eventually bode poorly for future performance. CMBS widened in May, as it suffered from macro correlation, but has performed well since. CMBS is up 166bps versus duration-neutral Treasuries for July and a massive 600 bps for the year. ABS was up 295 bps versus duration-neutral Treasuries for the year. Agency MBS outperformed by 80 bps for the month and is up 247 bps versus Treasuries for the year.

U.S. core fixed income has returned 3.78% YTD after returning 2.33% for 2011. Looking forward the focus for market participants will be on Europe and the political pronouncements from European leadership, the global growth picture focused on the BRIC nations, the U.S fiscal cliff and the pending U.S. presidential election.

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	-1.20	0.64	1.39	0.35	TIPS	-0.46	2.40	8.21	14.51
Treasury	0.22	0.21	0.25	0.61	Treasury	1.49	1.68	5.17	15.54
Agency	0.38	0.06	0.44	0.77	Agency	0.97	1.14	3.19	8.72
AAA Corporate	0.47	0.39	1.46	1.49	AAA Corporate	2.23	1.68	7.08	13.48
AA Corporate	0.87	0.66	2.49	2.32	AA Corporate	2.58	2.39	8.59	12.98
A Corporate	1.42	1.01	4.32	3.33	A Corporate	3.12	2.74	10.80	13.63
BBB Corporate	2.12	1.13	4.38	4.47	BBB Corporate	3.78	2.40	9.58	11.50
Financials	2.00	1.24	5.15	3.97	Financials	3.92	3.01	13.02	12.09
Industrials	0.91	0.82	2.90	3.24	Industrials	3.16	2.37	9.52	14.08
Utilities	1.07	0.89	2.35	2.89	Utilities	3.16	2.14	8.28	12.80
RL 5 Year Indexes					RL 30 Year Indexes				
TIPS	-1.16	1.07	3.17	3.90	TIPS	0.25	5.59	13.58	26.47
Treasury	0.60	0.72	2.18	5.89	Treasury	2.58	4.08	8.47	38.27
Agency	0.53	0.63	2.52	5.35	Agency	2.77	2.93	8.25	25.89
AAA Corporate	1.33	1.19	4.40	5.91	AAA Corporate	3.34	6.23	15.10	34.78
AA Corporate	1.67	1.67	6.18	6.42	AA Corporate	3.83	5.51	16.25	28.96
A Corporate	2.31	2.12	8.52	7.55	A Corporate	4.10	4.85	16.69	25.26
BBB Corporate	2.89	1.68	7.43	7.55	BBB Corporate	4.86	4.84	15.10	22.26
Financials	3.05	2.29	10.10	7.51	Financials	4.93	4.69	22.45	24.45
Industrials	1.95	1.67	6.58	8.08	Industrials	4.19	5.03	14.78	26.44
Utilities	2.20	1.76	5.62	7.28	Utilities	4.07	4.86	13.27	24.70
Barclays Indexes					Barclays Indexes				
BC Aggregate	1.72	1.38	3.78	7.25	BC ABS	0.96	0.76	2.95	4.50
BC CMBS	2.48	1.66	6.09	7.49	BC MBS	2.12	0.82	2.50	4.91

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

Ryan Labs TIPS				
	Yield To Worst (%)	**MDuration (Years)**	**Year To Date Returns (%)**	**Last 12 Month Returns (%)**
2 Year TIPS	-1.20	2.53	1.39	0.35
5 Year TIPS	-1.16	4.99	3.17	3.90
10 Year TIPS	-0.46	10.90	8.21	14.51
30 Year TIPS	0.25	22.60	13.58	26.47
RL TIPS Index	-0.69	8.88	5.98	9.84

Market Implied Breakeven Inflation Expectation				
	Yield To Worst (%)		**Inflation (%)**	
	Nominals [1]	**TIPS**	**BEI [2]**	**Current [3]**
CPI (1 Month Lag)				1.7
2 Year	0.22	-1.20	1.42	
5 Year	0.60	-1.16	1.76	
10 Year	1.49	-0.46	1.95	
30 Year	2.58	0.25	2.33	

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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