RYAN LABS
ASSET MANAGEMENT

BOND MARKET WATCH
JUNE 30, 2012

Equity markets and other risk assets rallied into the close of the quarter largely off of optimistic language coming out of the June Eurozone summit, yet Treasury yields have continued to move lower as growth continues to look weak. Just days before the summit, German finance minister Wolfgang Schauble alluded to the possibility of future jointly issued Eurozone debt. The result fell short of the level of fiscal and monetary integration that markets may have idealistically envisioned yet there were steps taken. The "EU Fiscal Treaty", which essentially converts the temporary EFSF into the $500 billion permanent European Stability Mechanism (ESM), will require more adherence to common budget goals across troubled EU countries and will be able to fund troubled banks directly, but still pales in comparison to the size of the $4+ trillion ECB balance sheet, as well as the several trillion dollar debt problem plaguing the Eurozone. Germany's Constitutional Court still has to ratify the ESM. Spanish 10-year yields have come back under 7% to 6.73% as we write this, but remain very volatile. With the Euro Summit temporarily behind us as we write this in mid-July, investors have shifted their attention to domestic economic headlines, and are focused on earnings. Domestic economic headlines have continued to disappoint and have pushed bond yields down when paired with so much global uncertainty. Despite sounding redundant, Treasury yields across the curve continue to grab headlines with record low yields. In the US Treasury market, the yield on the Ryan Labs 10-year Treasury Index finished 2011 at 1.87%, and finished the first quarter up at 2.22%, but ended the quarter at 1.66%. The Ryan Labs 30-year Treasury Index yielded 3.34% at the end of March and closed the quarter at 2.77%, as the yield curve flattened on the quarter. As we write this, the 5-year, 10-year and 30-year Treasuries have all made record lows recently. The 10-year sits at 1.47% for example up on our screens while the 5-year is at 59 bps.

The quarter came to a close with spreads slightly tighter than the wides of the quarter in May but still wider than first quarter levels. 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. Spreads in credit were tighter at the end of June compared with the end of May by 11 bps. After spreads in financials tightened the most in the first quarter, financials widened in the second quarter but also have rallied substantially from the wides. After ending December at 337 bps and tightening to 227 bps to close out the first quarter, financials ended the quarter at 253 bps. However, financials have rallied 19 bps since the end of May and continue to perform. Better-than-expected earnings (albeit low hurdles) out of JPMorgan, Wells Fargo, Goldman and Citi, as well as some sense of hope regarding reduced probability of credit contagion coming from Eurozone banks has helped ease financial spreads. US macroeconomic statistics continue to underwhelm investors, especially in the domestic labor market. The monthly change in nonfarm payrolls again missed expectations; with a net change of +80K jobs compared with expectations of 100K jobs. To put that into perspective, the combined number of net new jobs for May and June (+157K) was lower than the May expected number alone (164k). Unemployment remains at 8.2% while underemployment (U6) is at 14.9%. The most recently printed ISM came in below 50 at 49.7, which signals contraction. On a positive note, the ECRI Weekly Leading Index of leading economic indicators has turned positive since its local lows of mid-June. The lack of an outright QE3 announcement at the last FOMC meeting and the looming tax increases due to the "fiscal cliff" also are wild-cards.

Within the securitized sector, ABS continued to 2nd quarter, breaking away from any macro led widening and continuing to tighten throughout the quarter. The excess return of the Barclays ABS index 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 outperformed compared with the widening of 4Q 2011. CMBS widened in May, as it suffered from macro correlation, but has performed well over the last month and a half. CMBS is up 365 bps versus duration-neutral Treasuries for the year after a strong June which saw the index outperform by 81 bps. ABS was up 147 bps versus duration-neutral Treasuries for the year. Agency MBS outperformed by 30 bps for the month and is up 43 bps versus Treasuries for the year. U.S. core fixed income has returned 2.37% YTD after returning 2.33% for 2011.

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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	-0.75	-0.79	0.74	0.85	TIPS	-0.25	5.06	5.67	18.15
Treasury	0.31	0.12	0.04	0.65	Treasury	1.66	5.84	3.44	17.34
Agency	0.43	0.18	0.38	0.78	Agency	1.17	2.68	2.03	10.13
AAA Corporate	0.60	0.18	1.06	1.71	AAA Corporate	2.30	3.38	5.32	15.23
AA Corporate	1.08	0.54	1.83	2.27	AA Corporate	2.93	3.40	6.06	13.83
A Corporate	1.74	0.70	3.28	2.84	A Corporate	3.53	3.93	7.84	13.75
BBB Corporate	2.26	0.91	3.21	3.84	BBB Corporate	3.98	3.11	7.01	12.12
Financials	2.36	0.91	3.87	3.21	Financials	4.31	4.27	9.72	11.60
Industrials	1.08	0.63	2.07	3.01	Industrials	3.41	3.78	6.98	15.32
Utilities	1.23	0.26	1.46	2.59	Utilities	3.43	3.25	6.00	14.04
RL 5 Year Indexes					**RL 30 Year Indexes**				
TIPS	-0.93	0.58	2.09	5.55	TIPS	0.49	9.18	7.57	29.38
Treasury	0.73	1.93	1.45	7.40	Treasury	2.77	12.83	4.22	38.98
Agency	0.69	1.37	1.88	6.55	Agency	2.98	8.22	5.16	27.23
AAA Corporate	1.49	1.54	3.17	6.57	AAA Corporate	3.68	6.63	8.35	33.36
AA Corporate	1.90	1.70	4.44	6.44	AA Corporate	4.19	5.68	10.17	27.89
A Corporate	2.68	2.03	6.27	7.17	A Corporate	4.48	5.75	11.29	24.57
BBB Corporate	3.20	1.78	5.65	7.92	BBB Corporate	5.24	4.35	9.78	21.63
Financials	3.44	2.03	7.64	6.99	Financials	5.34	6.24	16.96	22.45
Industrials	2.22	1.97	4.83	8.68	Industrials	4.55	5.21	9.28	26.22
Utilities	2.45	1.26	3.80	7.82	Utilities	4.38	4.42	8.02	24.76
Barclays Indexes					**Barclays Indexes**				
BC Aggregate	1.98	2.06	2.37	7.47	BC ABS	1.16	1.33	2.17	4.88
BC CMBS	2.88	0.86	4.35	6.67	BC MBS	2.49	1.10	1.67	5.04

The material presented and calculated here is based on information considered reliable. Ryan Labs does not represent that it is accurate or complete.

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Ryan Labs TIPS				
	Yield To Worst (%)	MDuration (Years)	Year To Date Returns (%)	Last 12 Month Returns (%)
2 Year TIPS	-0.75	2.25	0.74	0.85
5 Year TIPS	-0.93	4.64	2.09	5.55
10 Year TIPS	-0.25	10.72	5.67	18.15
30 Year TIPS	0.49	22.48	7.57	29.38
RL TIPS Index	-0.43	8.78	3.86	11.97

Market Implied Breakeven Inflation Expectation				
	Yield To Worst (%)		Inflation (%)	
	Nominals [1]	TIPS	BEI [2]	Current [3]
CPI (1 Month Lag)				1.7
2 Year	0.31	-0.75	1.06	
5 Year	0.73	-0.93	1.66	
10 Year	1.66	-0.25	1.91	
30 Year	2.77	0.49	2.28	

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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