Ryan ALM, inc.

Asset/Liability Management

The Solutions Company


Ronald Ryan, CEO, CFA

The Ryan Letter

April 2009

Index	Returns YTD 2009	Estimated Weights
Liabilities :		
Market (Tsy STRIPS)	-15.85 %	100 %
FAS 158 (AA Corporates)	- 2.02	
PPA (AA Corporates)	-0.23	
GASB / ASOP (8% ROA)	2.63	
Assets :		
Ryan Cash	0.17 %	5 %
Lehman Aggregate	0.59	30
S&P 500	-2.49	60
MSCI EAFE Int'l	-2.69	5
Asset Allocation Model	-1.10 %	100 %
Assets – Liabilities		
Market	14.75%	
FAS 158	0.92	
PPA	-0.87	
GASB / ASOP	-3.73	

Using Asset Allocation above, 2009 pension assets **outperformed** liabilities by **14.75%** using market valuations (STRIPS); won by **0.92%** under FAS 158; lost by **-0.87%** under the PPA rules (AA Corporate rates); and lost by **-3.73%** using the GASB and ASOP 27 methodology of a constant ROA (8.00%). Such valuations show the significant difference in not using proper *market* valuations. Most pension funds enjoyed a funded ratio surplus in 1999. However, **assets have underperformed liabilities by about -137.97% since 1999** on a compounded index basis starting at 100 on 12/31/99! (see **Pension Scoreboard** section)

Total Returns

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Assets	-2.50	-5.40	-11.41	20.04	8.92	4.43	12.25	6.82	-24.47	-1.10
Liabilities	25.96	3.08	19.47	1.96	9.35	8.87	0.81	11.76	33.93	-15.85
Difference:										
Annual	-28.46	-8.48	-30.89	18.08	-0.43	-4.44	11.44	-4.94	-58.40	14.75
Cumulative		-37.60	-73.40	-60.08	-66.13	-76.75	-64.60	-78.38	-181.57	-137.97

God Bless Pension America !

Chrysler Secured Bond Swap … Illegal? Equity Equalization?

Chrysler will use $10.5 billion from the U.S. and Canadian governments to merge into Fiat SpA. Fiat will eventually own 35% of Chrysler, a health care trust fund for the UAW will own 55% and secured bond holders around 10%. Secured bond holders will swap their bonds for common stock and get about 30 cents per dollar valuation while the UAW will get about 50 cents per dollar. According to the legal firm White & Case, who represents the non-TARP secured lenders, this is a violation of bankruptcy laws which says that secured lenders get paid off before unsecured lenders (UAW) get anything much less an inequitable distribution. On Sunday, May 3 a debtor group represented by White & Case filed a Sale Motion objecting to the 363 asset sale. Some very harsh language aimed at Uncle Sam was filed. The highlights from the filing include:

"Separate and apart from the lack of due process and any infirmities in the bidding procedures themselves, the Sale Motion should be denied because it seeks approval of a sale that cannot be approved under the Bankruptcy Code. In short, the Court should not permit a patently illegal sales process to go forward. Among other things, the sale proposed by the Debtors constitutes an impermissible sub rosa **plan of reorganization that strips the Chrysler Senior Lenders of the protections of section 1129(a) of title 11 of the United States (the ""Bankruptcy Code") and improperly attempts to extinguish their property rights without their consent.** Further, the sale does not comply with section 363(f) of the Bankruptcy Code and **was not proposed in good faith. Indeed, the sale is far from an arm's length transaction, but rather, is the result of a tainted sales process dominated by the United States government.** Under these circumstances, the Sale Motion should be denied."

New Accounting Rule … Boon for Banks

Banks that are trading at a fraction of their tangible book value have the opportunity of boosting equity when they engage in "bargain purchase" business combinations according to Moody's. A bargain purchase business combination occurs when an entity is acquired for less than the fair value assigned to its net assets. Under the new accounting rules for business combinations (FAS 141 Revised), which went into effect for deals closing on or after January 1st of this year, the excess of the fair value of net assets acquired over the purchase price is immediately recognized as a gain in the acquirer's income statement. Accordingly, the reported equity is immediately increased by the net of the tax gain from the bargain purchase. Previously, the bargain purchase was allocated as a reduction of certain non-current assets on the balance sheet.

Pension Deficit Watch: Private

According to a recent Merrill Lynch pension database dated October 22, 2008, companies with reported pension underfunding below 80% include:

General Dynamics = 68%
Chevron = 69%
Exxon = 69%
Johnson & Johnson = 70%
Kimberly- Clark = 72%
PepsiCo = 72%

Keep in mind this data is based on the Pension Protection Act (PPA) basis of valuation which smoothes liabilities over two years and uses a hypothetical corporate zero-coupon yield curve. As of 12/31/08 our analysis suggests the PPA methodology would undervalue liabilities by about 35% versus the market using real Treasury STRIPS yield curve.

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Treasury "I Bond" Earn 0%

The Treasury Department announced that the Series I Savings Bonds purchased between May and October will earn 0% for their first six months. Such bonds have 30-year maturities and have two parts: a fixed rate set by the Treasury at 0.10% for new issues and the inflation adjustment, which reflects the change in the Consumer Price Index (CPI) over a six-month period. Since that inflation adjustment calculated a negative -5.56% annualized rate for the September – March period, the fixed-rate portion will be wiped out during its next six-month rate period. Since I-bonds can't have a negative rate the principal is protected. Moreover, the CPI has never been a good indicator of the true economic inflation rates.

Microsoft Files 1st Bond Offering

Microsoft filed its first bond offering in early May as a three-tier financing of 5-year, 10-year and 30-year maturities. The purpose is to fund a large share buyback plus acquisition of a software giant. Such financing totaled a $3.75 billion issuance. Given its AAA rating and sacred image, Microsoft may find institutional buyers of this museum offering that should come quite rich at maybe half the yield spread (@ 95 bps) of the few AAA bonds available today. Microsoft has $25.3 billion in cash and short-term investments so this offering is not needed for operational purposes but only for investment purposes.

FASB – IASB Update

On May 1, the Financial Accounting Standards Board (FASB) released its proposed FASB Staff Position (FSP) 157-f measuring liabilities under FASB 157 entitled Fair Value Measurement. The proposed FSP discusses permissible valuation techniques for determining the fair value of liabilities, and would require disclosure of "any change in valuation technique resulting from the application of this FSP. Revisions resulting from a change in this valuation technique or its application shall be included in changes in fair value in the period of adoption." The comment period ends June 1.

Economic Recovery Watch …Unemployment

The unemployment rate jumped to 8.9% in April for the highest rate in 26 years. Some 5.7 million jobs have been lost or 4.1% of payroll since the recession began in December 2007. This is the largest decline since 1958.

In God We Trust ! … (Not in our Financial Institutions)
U.S. Currency

Public Pension Watch

There seems to be an avalanche of Public Pension announcements concerning Pension + OPEB deficits and the mismanagement of such funds. **Potential municipal bankruptcies are waiting to erupt across America due to budget crises stemming mainly from unaffordable pension and OPEB contributions!** As I have preached since 1991, the accounting and actuarial rules (GASB and ASOP 27) governing Public Pension plans are the start of the pension crisis since they do not *mark to market* assets and liabilities. Assets are valued using a five-year *smoothing* technique that can undervalue or overvalue assets. Currently, this method *overvalues assets by @ 25%*. Liabilities are valued at a Discount Rate = ROA rate (@ 8.00% vs. market rates @ 4.00%). Using the ROA as the discount rate has *undervalued public pension liabilities by 30% to 55%* this decade. As a result, reported F**unded Ratios are greatly overstated**. These inappropriate rules have led to inappropriate benefit decisions, contribution decisions and asset allocation decisions. It all links! Here is an update on some municipalities:

Moody's – Issued a *negative outlook* to the creditworthiness of *all* local governments in the U.S.. This is the first time Moody's ever issued a blanket report on municipalities.

Worst Funded Cities – Based on actuarial reports (which *overvalue* Funded Ratios) the cities with Funded Ratios below 50% are: Atlanta, Jersey City, Little Rock, Philadelphia, Pittsburgh, Providence and Wilmington.

Nat'l Bureau of Economic Research – Predicts that pension obligations for U.S. state governments will grow to approximately $7.9 trillion in just 15 years. They conservatively estimate that state pensions are 50% underfunded ($750 billion deficit) with a good chance that they are $1.75 trillion underfunded today.

Atlanta – The city's annual contribution to its three pension plans has nearly tripled from $36.6 million in 2003 to its current level of $100.3 million. City Council President Lisa Borders said "we are fighting for our survival".

California – State auditor Elaine Howle projected in 2007 that OPEB benefits will cost the state $48 billion as an unfunded liabilitity. This gap she predicts will rise another $4.71 billion for fiscal 2008-09.

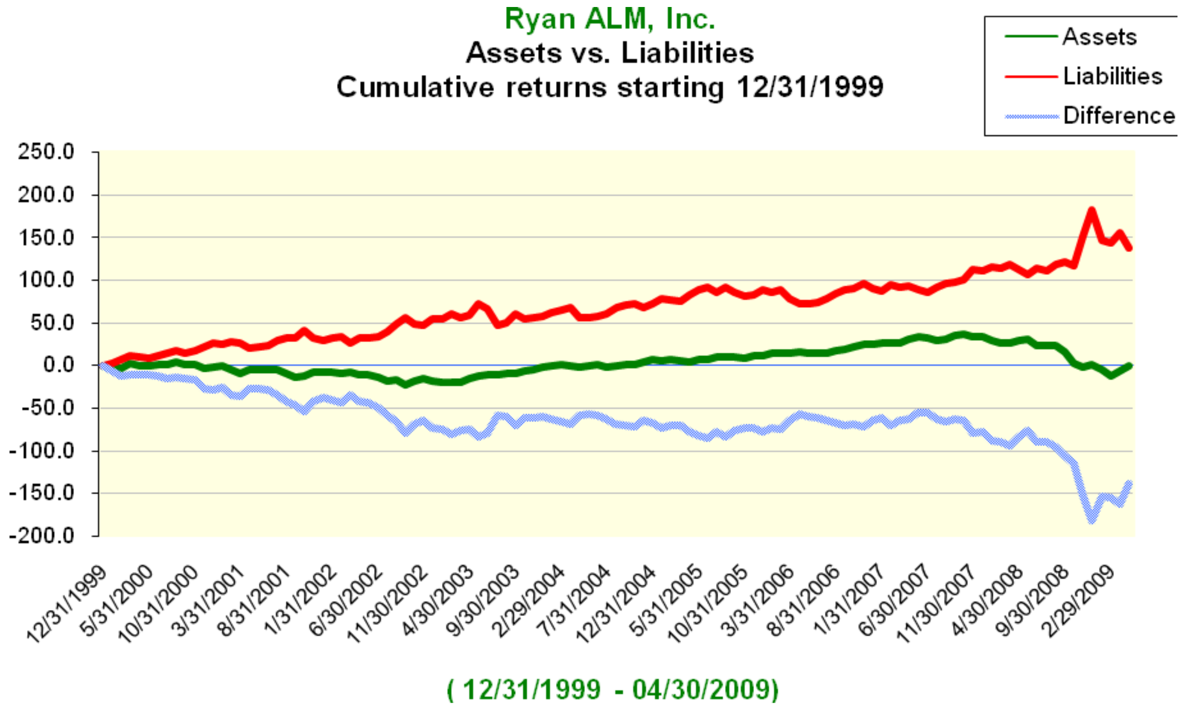
Massachusets – The city of Worcester Retirement System was 85.6% funded at the start of 2007. After 2008, it fell to 57% funded. As a result, pension contributions could increase by 57% starting in two years. Most other local pensions lost 26% in asset values in 2008.

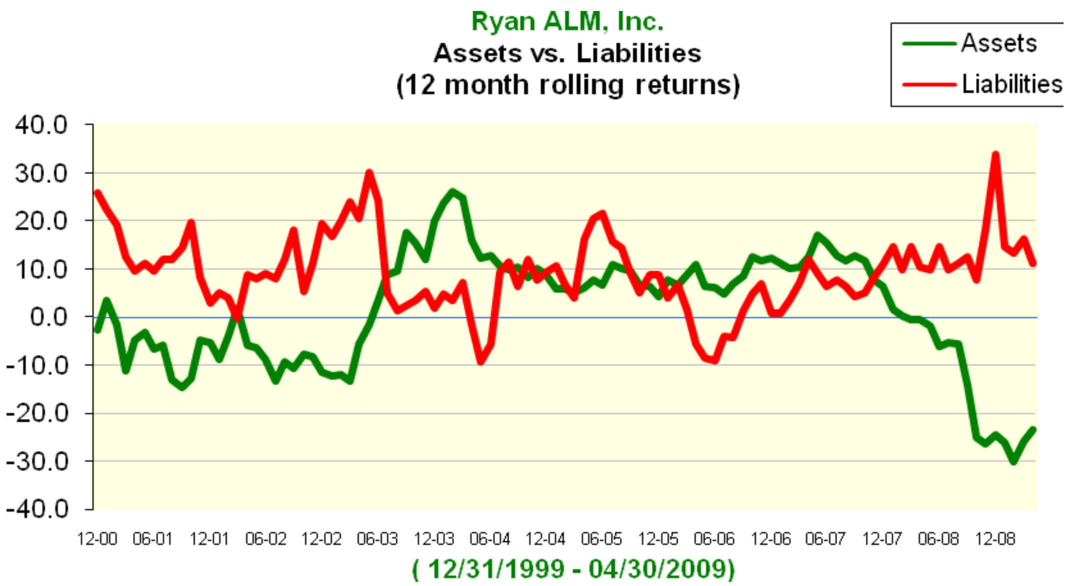
Pittsburgh – City Controller Michael Lamb cites concern over the city pension fund which is 29% funded. Pension assets fell from $385 to $262 million with liabilities around $899 million.

"Investors should be skeptical of history-based models. Beware of geeks bearing formulas."
Warren Buffett

Pension Scoreboard

The graphs below show asset vs. liability rolling 12 month and cumulative growth since 1999. The cumulative growth difference is **– 137.97% suggesting any pension Funded Ratio below 238.65 in 1999 has a deficit today!** As the Pension Crisis watchdog, we designed the **Pension Monitor** to capture world pension news … go to: **http://www.pensionmonitor.com**





Ryan Indexes

Custom Liability Indexes

The best way to price (discount rate) and understand the interest rate sensitivity of liabilities is the **Ryan Treasury STRIPS yield curve indexes** as a **LIABILITY INDEX BENCHMARK.** In March 1985, when STRIPS were born, my team and I at the Ryan Financial Strategy Group (RFSG) created the **1st STRIPS Index.** Based upon these Ryan STRIPS indexes we created the **1st Liability Index in 1991** as the proper liability Benchmark for liability driven objectives. Since 1991, the Ryan team has developed hundreds of Custom Liability Indexes (CLI). Similar to snowflakes, no two pension funds are alike in that they each have unique benefit payment schedules due to different labor forces, mortality and plan amendments. Without a CLI it would be difficult, for assets to be managed vs. this liability objective. Until a CLI is installed as the benchmark, the asset side is in jeopardy of managing vs. the wrong objective (generic market indexes). **If you outperform generic market indexes, but lose to the CLI … the plan loses !**

Ryan Treasury Indexes

In March 1983, my index team and I at the Ryan Financial Strategy Group (RFSG) created the **1st Daily bond Index … the Ryan Index** as a *Treasury Yield Curve* index series for each auction maturity series (from Bills to Bonds). The best way to understand the interest rate behavior of bonds is to use the Ryan Treasury constant maturity series for each Treasury *auction* series with two composite indexes … **Ryan Cash and Ryan Index.**

Ryan/Mergent 1-30 year Treasury Maturity Ladder Index (PowerShares ETF)

On October 11, 2007 PowerShares launched a fixed income ETF based upon the Ryan/Mergent 1-30 year Treasury Maturity Ladder index. This index is an equal-weighted diversified portfolio of 30 distinct maturities. For more info on this ETF and index, please go to :

www. Powershares.com (click on fixed income portfolios)

To view all Ryan Indexes data go to : www.RyanIndex.com

Note: In October 2005, Ron Ryan terminated his license agreement with Ryan Labs to distribute and calculate the Ryan Indexes and Ryan STRIPS Indexes. Ron Ryan and Ryan ALM have no affiliation with Ryan Labs. Any use of the formulas, methodologies and data of any of the Ryan Indexes without Ron Ryan's written permission is prohibited.

Index Funds

<u>Liability Index Funds (Liability Beta Portfolio)</u>

The best way to match assets to liabilities and reduce the volatility of the Funded Ratio is through a Liability Index Fund or Liability Beta Portfolio. Immunization is a popular strategy to match liabilities but has a mathematical problem in that it matches the *average duration* of liabilities instead of the entire *term structure* of liabilities. Only a Liability Index Fund correctly matches and fully funds each liability payment. This requires a Custom Liability Index. Ron Ryan was the inventor of both the Custom Liability Index and Liability Index Fund (Liability Beta Portfolio) concept.

Given the Wrong Index … you will get the Wrong Risk/Reward
Confucius