Ryan ALM, inc.
Asset / Liability Management
The Solutions Company

April 2005

Asset / Liability Scoreboard

Index	Returns YTD 2005	Estimated Weights
Liabilities :		
Market (Treasury STRIPS)	5.47 %	100 %
Pension Act (Corporates)	3.63	
ROA (8% constant rate)	2.67	
Assets :		
Ryan Cash	0.79 %	5 %
Lehman Aggregate	0.87	30
S&P 500	-4.01	60
MSCI EAFE Int'l	-2.33	5
Asset Allocation Model	-2.22 %	100 %
Assets – Liabilities		
Market	-7.69 %	
Pension Bill	-5.85	
ROA	-4.89	

Pension liabilities outgrew pension assets by about 5.02% for April widening the Asset/Liability deficit for the year 2005 to **-7.69%** using market valuations (i.e. STRIPS); by **-5.85%** using the new Pension Act valuation (moving average of three corporate indexes with a duration of 12 years); and by **-4.89%** using the ASOP 27 methodology of a constant ROA (i.e. 8.00%). Most pension funds enjoyed a funded ratio surplus in 1999. However, this funded ratio has been reduced by about **-50%** since then (see table below).

Total Returns	2000	2001	2002	2003	2004	2005
Pension Assets	- 2.50	- 5.40	-11.41	20.04	8.92	-2.22
Pension Liabilities	25.96	3.08	19.47	1.96	9.35	5.47
Difference	-28.46	- 8.48	-30.89	18.08	-0.43	-7.69
Cumulative		-34.53	-54.75	- 46.57	-46.80	-49.11

Congrats to P&I and Michael Clowes

The April 18 edition of Pensions & Investments is must reading. The lead story "**The looming retirement DISATER**" is an extensive 11 page review of what they call the three legged stool (Social Security, Employer-Provided Retirement Plans and Personal Savings). Each leg has deteriorated to a crisis point such that it can not support the retirement needs of future demographics. Numerous contributors, including yours truly (pages 24 and 25), present a detailed view of what went wrong and how do we fix it.

I (Ron Ryan) want to personally congratulate Michael Clowes, editorial director of P&I, for receiving the prestigious 2005 Lillywhite Award from EBRI. Mike has been a crusader for a long time and has always presented his views with clarity and integrity. Good job, Mike !

Smoothing

A rather overlooked accounting issue is the smoothing of asset market values over the last five years. This attempt to reduce funded ratio volatility creates major distortions and quite often leads to increased benefits as a result of overstated asset values. Currently, we calculate the last five years as **29% overstated** thereby reducing the funded ratio accordingly. Until assets and liabilities are marked to market accurately and frequently, it is hard to understand the true economic value of the pension.

The Quest for Alpha

There seems to be much ado about Alpha, especially Portable Alpha. As I read research papers and listen at the many seminars I speak at, I keep asking the same question… What is Alpha for a Pension Fund?
It is certainly not excess returns above a generic market index benchmark which I hear consistently.
As we have witnessed too often, if you outperform a market index but lose to liabilities, did you win or lose?…**you LOST !** Did you earn Alpha? …of course not ! The best equity managers in 2000-2002 lost big time to the spectacular growth of pension liabilities for those three years :

	2000	2001	2002	Cumulative
S&P 500	**- 9.09**	**- 11.86**	**- 22.08**	**- 37.51%**
Pension Liabilities	**25.96**	**3.08**	**19.47**	**55.12**
Difference	**- 35.05**	**- 14.94**	**- 41.55**	**- 92.63**

Moreover, as I speak at seminars, I usually ask the audience a key question: would you buy equities to fund short Liabilities? They always tell me NO, it is too risky. So the ALM quest is not to find the highest returns but to fit the risk/reward behavior of an asset class to the behavior of the liabilities it is funding.

Portable Alpha strategies should fit in the same mold. They should be liability driven and focused since that is their true objective. Instead, most Alpha portfolios are given benchmarks different than liabilities as well as most Beta portfolios have poor correlation to the liabilities the Portable Alpha should be focused on. Ryan ALM designed our CORE product **"PALS"** as a Portable Alpha Liability Strategy with a heavy allocation to non-bond assets (i.e. Equity, Real Estate, etc.). Our Alpha portfolio mission is to cure the pension deficit by outperforming target liabilities (**Alpha**) over a time horizon equal to the liability payment dates. Based on a Custom Liability Index we build for each client, we know the total return of the target liabilities we are managing to and ultimately funding. When we have achieved the client goal (i.e. full funding) we port over to the Beta portfolio to match liabilities and secure the victory.

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Custom Liability Index

Ryan ALM provides accurate daily pricing and valuation of pension liabilities through the creation of a Custom Liability Index that best represents the present value of the projected benefit payment schedule. Ryan ALM builds Custom Liability Indexes based on any rate structure the client and their consultants and actuaries feel is appropriate. Currently, Ryan ALM prices liabilities using :

1. **Market Rates (STRIPs)**
2. **Single Discount Rates (ROA, New Pension Bill, Moody's AA rate, etc.)**
3. **Annuity Rates**

Pension Solutions !

Ryan ALM has a series of Pension Solutions research papers.
Please refer to our RESEARCH section on our web site for our latest releases :

Pension Solution # 1… Custom Liability Index
Pension Solution # 2… Portable Alpha Liability System (PALS)

Press

Ryan ALM is a vigilant **watchdog** on pension trends, news and events. We created a **PRESS** section on our web site to isolate those stories we feel are the most newsworthy for our readers. Please browse for any important story and give us your thoughts.

God Bless Pension America !