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

May 2005

Asset / Liability Scoreboard

Index	Returns YTD 2005	Estimated Weights
Liabilities :		
Market (Treasury STRIPS)	8.80 %	100 %
Pension Act (Corporates)	4.51	
ROA (8% constant rate)	3.33	
Assets :		
Ryan Cash	1.07 %	5 %
Lehman Aggregate	1.96	30
S&P 500	-0.96	60
MSCI EAFE Int'l	-2.18	5
Asset Allocation Model	-0.01 %	100 %
Assets – Liabilities		
Market	-8.81 %	
Pension Bill	-4.52	
ROA	-3.34	

Pension liabilities outgrew pension assets by about 0.91% in May (3.16% vs. 2.25%) widening the Asset/Liability deficit for the year 2005 to **-8.81%** using market valuations (i.e. STRIPS); by **-4.52%** using the new Pension Act valuation (moving average of three corporate indexes with a duration of 12 years); and by **-3.34%** 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	-0.01
Pension Liabilities	25.96	3.08	19.47	1.96	9.35	8.80
Difference	-28.46	- 8.48	-30.89	18.08	-0.43	-8.81
Cumulative		-34.53	-54.75	- 46.57	-46.80	-51.55

God Bless Pension America !

Treasury to Reissue 30-year ! or ?

On May 4, 2005 the Department of Treasury issued their quarterly refunding statement proclaiming they are considering whether or not to reintroduce regular issuance of a 30-year nominal Treasury bond. Such a decision will be announced at the August refunding on August 3, 2005. There are two possible outcomes :

1. No change in current policy
2. Semi-annual auctions beginning February 2006

With long interest rates at the lowest yields in 45 years and our country facing the largest federal deficit in our history, I don't understand the hesitation. Add in the current Pension Crisis and Secretary Chao's remarks on urging pensions to better match assets to liabilities with long bonds, how can the Treasury Department watch this opportunity and crisis go bye. Then throw in France and their reaction to their pension dilemma by issuing 50-year Government bonds. Voila !

My personal comment to the Treasury is… LET'S GO ! **Not only issue 30-year bonds as a regular auction series but increase its size and frequency**. Over time the country should save huge interest expense. Moreover, zero-coupon bonds (STRIPS) are the best match of assets to liabilities. Long Treasuries create a whole yield curve of zeroes. **I further urge a large increase in long TIPS issuance**. Why not reissue 30-year TIPS too. In time, zero-coupon TIPS could be the best hedge or match to pension liabilities. By the way, ever thought of a **Public Shelf Registration of STRIPS** so pensions can get any duration and size they want at any time. Agencies are required to invest this way with non-marketables Treasuries. My last comment to the Treasury is … please be responsive … now!

UAL Pension Crash Lands

Tuesday, May 10 the U.S. Bankruptcy Court ruled (Judge Eugene Wedoff) to terminate the Defined Benefit Plan of United Airlines. **With a deficit of -$9.8 billion, UAL is the largest pension default in U.S. corporate history !** Bethlehem Steel was the previous largest default at -$3.6 billion in 2002. However, the PBGC will only guarantee $5 billion of the UAL fiasco. At its current pace of pension acquisitions, the PBGC will be the largest pension entity in America before the end of this decade. By the way, Northwest Airlines is circling the pension landing area too as Fischer Newman, Senior VP of Government affairs, is seeking a 25-year curing period instead of the current 5 years to repair a **-$3.8 billion pension deficit**.

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.

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.

Finance is the art of passing money from hand to hand until it finally disappears… ***Robert Sarnoff***