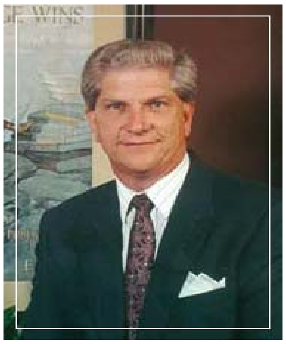
Ryan ALM, inc.

Asset/Liability Management

The Solutions Company

The Ryan Letter

May 2009



Ronald Ryan, CEO, CFA

Index	Returns YTD 2009	Estimated Weights
Liabilities :		
Market (Tsy STRIPS)	-18.68 %	100 %
FAS 158 (AA Corporates)	- 6.73	
PPA (AA Corporates)	-0.22	
GASB / ASOP (8 % ROA)	3.33	
Assets :		
Ryan Cash	0.23 %	5 %
Lehman Aggregate	1.32	30
S&P 500	2.96	60
MSCI EAFE Int'l	9.00	5
Asset Allocation Model	3.04 %	100 %
Assets – Liabilities		
Market	21.72%	
FAS 158	9.77	
PPA	3.26	
GASB / ASOP	-0.29	

Using Asset Allocation above, 2009 pension assets **outperformed** liabilities by **21.72%** using market valuations (STRIPS); won by **9.77%** under FAS 158; won by **3.26%** under the PPA rules (AA Corporate rates); and lost by **-0.29%** 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 -125.80% 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	3.04
Liabilities	25.96	3.08	19.47	1.96	9.35	8.87	0.81	11.76	33.93	-18.68
Difference:										
Annual	-28.46	-8.48	-30.89	18.08	-0.43	-4.44	11.44	-4.94	-58.40	21.72
Cumulative		-37.60	-73.40	-60.08	-66.13	-76.75	-64.60	-78.38	-181.57	-125.80

God Bless Pension America !

2009 … A Great Year for Pensions !

So far 2009 has started out as a great year for pensions not because of great asset returns but because of negative growth in liabilities. Based on the Ryan Liability Index (registered trademark of Ryan ALM, Inc.) we calculate a growth of **-18.68%** in the present value of our generic Ryan Liability Index (average duration = 15 years) for the first five months of May. This is due to a spike up in interest rates on the Treasury yield curve:

	----- Year to date 2009 -----	
	Yield Move	**Total Return**
10-year Ryan Treasury STRIPS Index	**100 bps**	**- 7.70 %**
15-year Ryan Treasury STRIPS Index	**136**	**- 16.87**
20-year Ryan Treasury STRIPS Index	**147**	**- 23.54**

As I have presented often at seminars and through my research reports, it is the liability side that will most likely allow pensions to recover and improve their Funded Ratios. Instead of chasing golden rings and risky asset strategies, the best way to pension recovery is through higher interest rates. This will raise the economic discount rates and lower the economic present values of liabilities. Current accounting rules (especially GASB) distort the economic value and reality of pension liabilities. As the Society of Actuaries cited, pension assets cannot be managed to current accounting books! They recommended that pensions create a set of ***economic books*** that mark to market assets and liabilities accurately and frequently. **Ryan ALM provides a Custom Liability Index (CLI) that prices liabilities *daily* and calculates the true economic value of liabilities.** With a CLI as the proper benchmark, the pension asset side can now function effectively on Asset Allocation (since it now knows the true economic Funded Ratio), on Asset Management (which requires an index benchmark to understand the risk/reward behavior it is to match or outperform) and Performance Measurement (which should be the comparison of assets vs. the true client objective …liabilities). With a CLI as the asset benchmark and client objective index, all asset functions can now be in harmony with the true client objective.

Pension Funds File Court Papers to Block Sale of Chrysler's Assets

A group of Indiana pension funds that own senior first lien debt of Chrysler LLC objected to the auctioning of the company assets and filed court papers asking U.S. Bankruptcy Judge Arthur Gonzalez in New York to block the sale., claiming the plan is illegal and damages their rights. The pension funds are also asking for appointment of a trustee to run Chrysler citing that Chrysler has "ceded control over their business and their restructuring efforts to the United States Treasury Department" which is using the bankruptcy to reward certain creditors that "the government deems politically important" according to the filings. "The Treasury Department has taken constructive possession of Chrysler and is requiring it to adopt a sale plan in bankruptcy that violates the most fundamental of creditor rights" lawyers for the pension plan have pleaded. White & Case LLP is representing these pension funds as well as the group known as Chrysler's Non-TARP lenders. Such pension funds included Indiana State Teachers Retirement Fund, Indiana State Police and Indiana Major Move Construction. President Barack Obama criticized the Non-TARP lenders for refusing to accept an offer that would have paid them about 30 cents on the dollar saying they forced the automaker's bankruptcy. The Non-TARP group abandoned its fight to block Chrysler's sale plan earlier this month citing political pressure.

What Happens to the GM Pensions in Bankruptcy?

GM officially filed for bankruptcy bringing up the big question …what happens to the pensions? The bankruptcy process has been a corporate strategy to reduce the costs of pension and OPEB benefits significantly by restructuring the corporation subject to the bankruptcy judge approval. The approximate size of the GM pension liability is around $100 billion with about a $20 billion deficit based on FASB accounting rules. Such benefits could be transferred over to the PBGC in bankruptcy. Since the PBGC has a cap on the maximum benefits paid ($4,500 a month at age 65) many GM workers could receive a dramatic reduction in pension benefits. However, it appears that the UAW and the Government want to avoid this scenario and can block a GM pension termination. Another reason that the GM pensions won't be terminated is the Employee Retirement Income Security Act (ERISA) which governs defined benefit pensions. ERISA forbids a pension termination in bankruptcy unless continuation of the plan would make it too difficult to reorganize. This is not the case with GM since it has the Federal Government to finance its reorganization.

PBGC Deficit Doubles in Last Six Months

The PBGC guarantees corporate pension defined benefit plans for 44 million Americans when companies go bankrupt up to $51,750 annually per employee. In October, the PBGC faced a shortfall of $11 billion. However, due to lower interest rates, losses on its equity portfolio and the increase in companies filing bankruptcy protection swelled the PBGC deficit to a record high of $22.5 billion. With assets of $56 billion the PBGC Funded Ratio is around 71%. In a statement from the PBGC, they itemized the $22.5 billion deficit was a result of $11 billion in plan terminations, $7 billion from a decrease in the discount rate used to value liabilities and about $3 billion in investment losses. An asset allocation shift from bonds to stocks, private equities and real estate last year was the reason for the PBGC $3 billion in investment losses.

Bankruptcy Watch …California

Since August 2006, I have reported that the spiking contribution costs to pay pension and OPEB benefits are too much to bear for many cities and states and could lead to bankruptcy. In bankruptcy such costs could be renegotiated and even renaged on. California is struggling to keep its fiscal head above water with a $24.3 billion shortfall in its $92 billion general operating budget adopted just three months ago. The governor has proposed $16 billion in budget cuts plus borrowings and accelerating the collection of taxes. Controller John Chiang said the State would essentially be out of cash by the end of July. Treasurer Bill Lockyer concluded that given the current economic conditions it would be difficult for California to borrow significant sums, that the main way to resolve this huge budget shortfall is through spending cuts.

Illinois Faced with Pension Proposal Controversy

Governor Pat Quinn's plan to overhaul the state's pension system would cost Illinois taxpayers $95 billion extra over the next 30 years according to the Center for Tax and Budget Accountability. Faced with a $11.6 billion deficit, Quinn wants to cut pension contributions in half over the next five years. Such short-term savings would be followed by huge long-term costs according to experts. The total cost would be $532 billion through 2045 versus $437 under the current plan. Quinn spokeswoman Katie Ridgway countered that Illinois would wind up owing less because benefits would be scaled back as the governor proposes reducing pension benefits to future state workers. Quinn contends those changes justify the state not making its required pension contributions now.

GM's Pension Battle Reaches Out to Canada

Both the U.S. and Canadian governments will indirectly pump billions of taxpayer dollars into repairing the huge hole in the GM pension funded ratio according to the company's union. The Canadian Auto Workers union revealed on May 22 that it will soon dramatically increase payments to shore up a $6.5 billion pension shortfall. Industry minister Tony Clement said that Ottawa was not in the business of bailing out pension plans or legacy costs at GM. Ontario Premier Dalton McGuinty acknowledged that the province bears some responsibility for the massive shortfall because it allowed GM to reduce its pension contributions to its plan under a legislative loophole that eventually led to the massive shortfall. Opposing politicians said it is unfair that taxpayers don't know how much they will specifically spend on GM pensions.

Credit Card Act …Friend or Foe?

The President signed into law. The new legislation would require 45 days notice before a credit card company can raise its interest rates. It would stop rate hikes on existing balances unless the borrower is 60 days late on its payment. The original rate would have to be restored in six months when the borrower is caught up on payments. Some expect credit card firms to revive annual fees and curtail reward programs. They may also impose interest rates on purchases immediately eliminating the grace period. Critics say the Act will restrict credit to those it allegedly protects and may hurt consumer spending. Card companies may decide they will never accept shaky borrowers again and simply deny them credit. U.S. households hold about $950 billion in revolving debt, most from credit cards. Credit card firms face record defaults. Balances they don't expect to get repaid rose to 9% in April up from 5.2% last year.

Economic Recovery Watch …Housing Starts

New construction of single-family homes and apartments fell 12.8% in April to a record low annualized rate of 458,000. This drop was mainly due to a 46.1% decline in multifamily housing which fell to a record low of 78,000 annualized. Single-family housing actually rose 2.8% to an annual rate of 368,000. Housing starts are down 54.2% in the past year with single-family starts down 45.6%. The government cautions that housing data is volatile and subject to large sampling and statistical errors. In most months, the government can't be sure whether starts increased or decreased. Large revisions of reported figures are common …Caveat Emptor!

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.

California – Judges Retirement System has projected liabilities of $2.9 billion with current assets of only $19.3 million. Contributions are at 8% of payroll matched by the judges 8% but total only $13 million annually with $205 in benefit payments in 2010.

New York – Governor Paterson shocked legislators by vetoing a routine extension of a law that lets newly hired police and firefighters join an old pension plan. The vetoed plan would allow retirement after 20 years of service at half salary. Governor Paterson made it clear that New York cannot continue the present, unaffordable pension system.

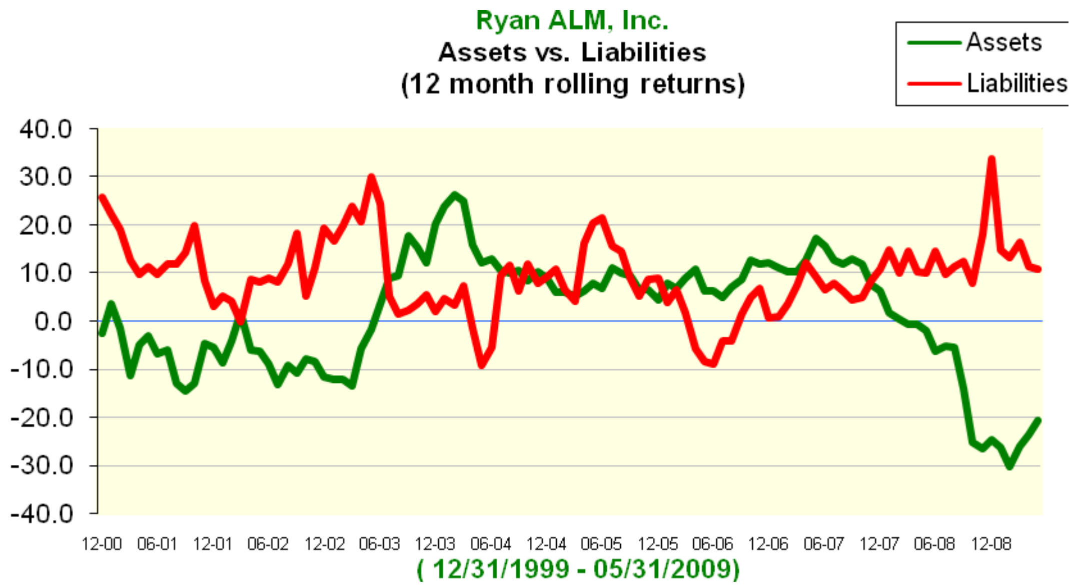
Oregon – According to the recent actuarial report pension contributions are projected to go from the current 12% of payroll to 18% in 2011 and then 25% by July 2013 based on a 71% funded ratio.

West Virginia – Health care costs are projected at $7 billion with no assets currently to fund it. This amounts to twice the state's general fund budget for the coming year.

"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 **– 125.80% suggesting any pension Funded Ratio below 221.35 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 …(Patent Pending)
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

Ryan Index is a Registered Trademark of Ryan ALM, Inc.
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.

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

Index Funds

<u>Liability Index Funds = Liability Beta Portfolio …(Patent Pending)</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.

The Lowest Risk Portfolio is always …the Objective as an Objective Index Fund
Ronald J. Ryan, CFA