Ryan ALM, inc.

Asset/Liability Management

The Solutions Company

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The Ryan Letter

May 2007

Index	Returns YTD 2007	Estimated Weights
Liabilities :		
Market (Tsy STRIPS)	-0.78 %	100 %
IRS (Corporates)	1.99	
ROA (8% constant rate)	3.33	
Assets :		
Ryan Cash	2.18 %	5 %
Lehman Aggregate	1.27	30
S&P 500	8.77	60
MSCI EAFE Int'l	10.92	5
Asset Allocation Model	6.29 %	100 %
Assets – Liabilities		
Market	7.07 %	
IRS	4.30	
ROA	2.96	

Based on the Asset Allocation above, for the year 2007, pension assets outperformed liabilities by about **7.07%** using market valuations (i.e. STRIPS); **4.30%** under the IRS Contribution rules (PPA Corporate rates); and **2.96%** using the ASOP 27 methodology of a constant ROA (i.e. 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, this **funded ratio has been reduced by about -55% since 1999** (see Graphs and Index disclosures on pages 3 and 4).

Total Returns

	2000	2001	2002	2003	2004	2005	2006	2007
Assets	- 2.50	- 5.40	-11.41	20.04	8.92	4.43	12.25	6.29
Liabilities	25.96	3.08	19.47	1.96	9.35	8.87	0.81	-0.78
Difference : Annual	-28.46	- 8.48	-30.89	18.08	-0.43	-4.44	11.44	7.07
Cumulative		-37.60	-73.40	- 60.08	-66.13	-76.75	-64.60	-55.25

God Bless Pension America !

Daimler Dumps Chrysler to Cerberus Capital to get rid of Pension + OPEB Liabilities

Daimler-Benz bought Chrysler for $36 billion in 1998. Cerberus will purchase 80.1% of Chrysler for $7.4 billion. What's interesting is that Daimler will put $2.5 billion in cash back into Chrysler and also lend it $400 million. It is estimated that Daimler will save over $20 billion in pension and healthcare benefits. Will Cerberus force Chrysler into bankruptcy to restructure the pension and healthcare benefits? Cerberus is named for the three-headed dog that guarded the gates of hell. Stay tuned to this story.

Allied Pilots Association (APA) Cautions American Airlines on Pension Relief Bill

The APA reacted to the airline-specific pension relief in the Pension Protection Act (PPA) by cautioning American Airlines (AMR) against any reduction in pension contributions. Captain Ralph Hunter, APA President, said "Four years ago our pilots agreed to annual concessions of $600 million as part of American Airlines' consensual out-of-court restructuring.. One of our pilots' principal motivations for agreeing to such deep concessions was the preservation of our pension benefits which we recognized would be at risk in bankruptcy court. It would be ill advised for AMR to cease making ongoing cash contributions to our plans simply because the legislation may permit them to do so." The PPA allows airlines to use a discount rate of 8.25% on liabilities in calculating their funding obligation (contributions).

McKinsey Study Shows Major Shift in DB Plans

A recent study by the consulting firm McKinsey & Co. shows that up to 75% of all corporate defined benefit plans could be frozen or terminated in the next five years. In addition, McKinsey predicts looming regulatory and accounting changes will force plan sponsors to quickly adopt sharply different approaches to portfolio construction. At least 40% of the $2.3 trillion in private sector pension plans will be invested in entirely different products and solutions in the next five years according to the study. Allocations to active domestic equity are expected to plummet by 67% with long-duration fixed income, hedge funds and private equity picking up most of the shift in asset allocation.

Social Security Trustee Report Update

The 2007 Social Security Trustees Report was releases on April 23. It shows that SS owes $6.8 trillion. SS spending will exceed projected tax collections in 2017. After adjusting for inflation, annual deficits will reach $67.8 billion in 2020, $266.5 billion in 2030, and $330.9 billion in 2035. The Old-Age and Survivors Trust Fund took in $642.2 billion in 2006 and paid out $461.0 billion leaving a surplus of $181.2 billion. Unfortunately, the government spends this surplus as part of their operating budget. Currently, 38% of the Federal Government income is derived by borrowing from the SS Trust Fund.

Federal Deficit May Be $1.3 Trillion Not $248 Billion

According to a USA TODAY analysis, if corporate-style accounting standards are used, the federal government deficit would have been $1.3 trillion last fiscal year instead of the $248 billion reported. Modern accounting requires that an entity count expenses when occurred even if the payment will be made later. The federal government does not follow this rule so SS and Medicare promises don't show up in the government's financial reports. The bottom line is that taxpayers are on the hook for $59.1 trillion in future liabilities = $516,348 per household.

Taxes and Social Security

In 1983 a presidential commission recommended that Social Security be taxed. The recommendation became law in 1984. At the time, few retirees were affected because benefits were only to be taxed when other sources of income were quite high. With the initial income level set at $25,000 for a single return and $32,000 for a joint return, it was expected that only 1 % of beneficiaries would pay any taxes on their benefits. But there was a catch. The income levels were not adjusted for inflation. For a couple, the taxation of benefits begins when your other sources of income plus one-half of your SS benefits exceeds $32,000.

Public Pension and OPEB Watch

There seems to be an avalanche of recent Public Pension announcements concerning the growth of pension deficits and the mismanagement of such funds :

New Jersey - Federal authorities have launched civil and criminal investigations into a series of maneuvers New Jersey officials used over the past decade to shore up state budgets by skipping billions of dollars in contributions to the state's retirement accounts for teachers and public employees. The state has hired attorney Carmen Lawrence, a former chief of the SEC's largest regional office and head of Fried Frank Harris Shriver and Jacobsen securities regulation and enforcement practice, to defend them.

California - State Controller John Chiang unveiled the first actuarial analysis of California's OPEB liabilities. The current pay-as-you-go policy results in an actuarial liability of $47.88 billion, which represents the total present value of future retiree health benefits for current state retirees and employees. Based on this liability, California has an "annual required contribution" of $3.59 billion for 2007-2008. Incredibly, Chiang's estimate might be on the conservative side. His numbers assume that health care inflation will decline over the next 10 years to 4.5% per year. These amounts are exclusive of pension obligations.

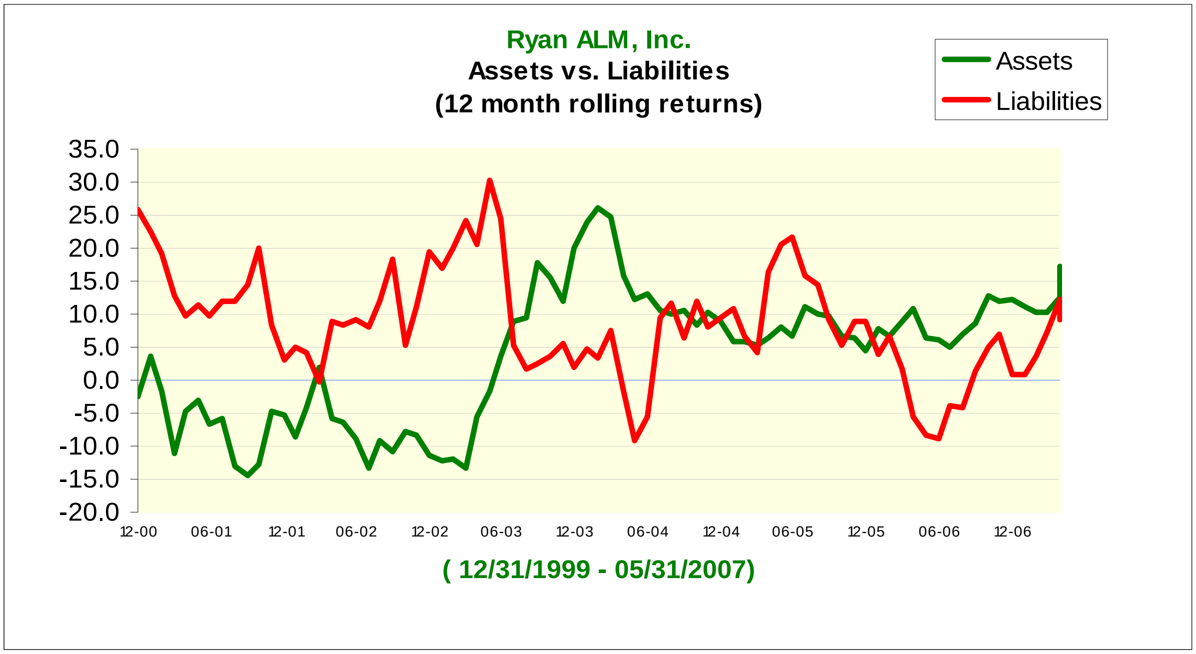
Houston - Mayor Bill White says that short of layoffs, the city won't meet its full obligation to the municipal pension fund in the next fiscal year citing rising health care costs that are expected to strain resources. In his new budget the mayor proposes paying only 66% of the statutorily required pension contribution (roughly equal to 24% of payroll). Such an arrangement would need approval from the pension fund board. White inherited a $1.9 billion unfunded liability in the pension fund when he took office in 2004. At that time the city got the pension board to agree to reduced annual contributions for three years. The contributions were to be increased in the 2007 budget.

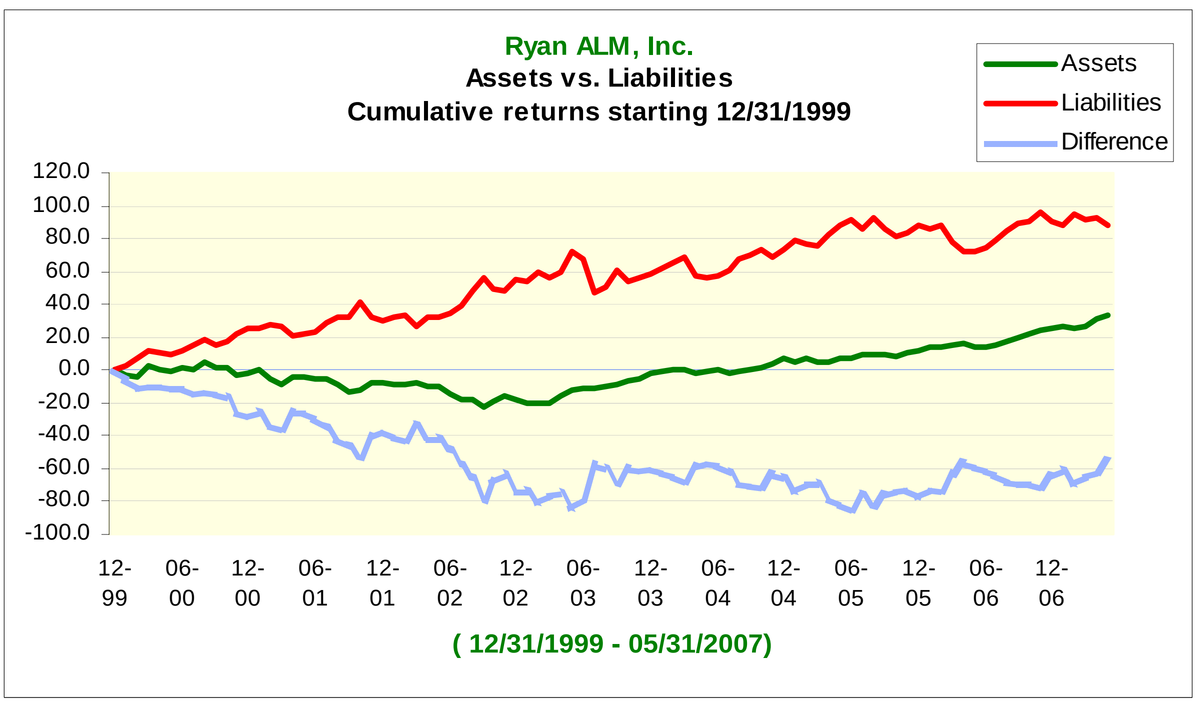
Chicago Transit Authority (CTA) - The CTA has the worst-funded public pension fund in Illinois. The CTA has enough money to cover only about 33% of its liabilities. Without a solution, the pension plan would be exhausted of assets by 2012 when taxpayers would have to pay those benefits. The CTA solution is to terminate the defined benefit plan and switch to a defined contribution plan. The CTA wants to borrow funds in the meantime. The five retirement plans that cover state employees and teachers are underfunded by more than $40 billion.

Pension Scoreboard

Based on the Ryan generic Liability Index and a static Asset Allocation, as shown on page 1, the following graphs show asset growth versus liability growth for rolling 12 month periods and cumulative growth since 1999. The cumulative growth difference is **-55.25% suggesting any plan with a Funding Ratio below 155.25% at the end of 1999 is in a deficit position today**.

In order to closely watch the Pension Crisis, we have designed the **Pension Monitor**. We believe that this is the most comprehensive site for pension articles in the world today. To view, please click on : **http://www.pensionmonitor.com/**





Custom Liability Indexes

In 1991, my current product development team and I designed the first Liability Index using the Ryan STRIPS Indexes. Since then we have developed hundreds of Custom Liability Indexes (CLI). Similar to snowflakes, no two pension funds are alike in that they have unique benefit payment schedules due to different labor forces, different mortality, different plan amendments. **The true objective of a pension is to fund liabilities at the lowest cost to the plan with prudent risk**. Without a Custom Liability Index it would be difficult, if not impossible, for assets to be managed vs. this liability objective. Until a CLI is installed as a set of economic books, the asset side is in jeopardy of managing vs. the wrong objective (i.e. generic market indexes) **If you outperform generic market indexes, but lose to the CLI … the plan loses !**

Ryan Indexes …Enhanced !

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.**

The daily reports on these indices have been greatly expanded and enhanced to over 130 daily pages + 10 pages of research and methodology including :

Returns
Yield History
Yield Spreads
Percentage Spreads

The best way to price (discount rate) and understand the interest rate sensitivity of **liabilities** is … the **Ryan Treasury STRIPS yield curve** known as the **LIABILITY BENCHMARK or LIABILITY INDEX**. 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 (Pensions, Lotteries, NDT, Insurance Cos., etc.).

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.

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