



Ryan ALM, inc.

Asset/Liability Management

The Solutions Company



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The Ryan Letter

February 2006

Index	Returns YTD 2005	Estimated Weights
Liabilities :		
Market (Treasury STRIPS)	0.00 %	100 %
IRS (30 yr Treasury)	1.05	
ROA (8% constant rate)	1.33	
Assets :		
Ryan Cash	0.65 %	5 %
Lehman Aggregate	0.34	30
S&P 500	2.93	60
MSCI EAFE Int'l	5.93	5
Asset Allocation Model	2.19 %	100 %
Assets – Liabilities		
Market	2.19 %	
IRS	1.14	
ROA	1.86	

February witnessed a decrease in rates thereby washing out the negative growth in Liabilities for January (Jan. = **-1.21%**, Feb. = 1.22%). Liabilities currently have no growth for 2006. This no growth Liability trend allowed Assets to outperform Liabilities for the year by about **2.19%** using market valuations (i.e. STRIPS); by **1.14%** under the IRS Contribution rules; and by **1.86%** 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 -48% since 1999** (see table below).

	Total Returns						
	2000	2001	2002	2003	2004	2005	2006
Assets	- 2.50	- 5.40	-11.41	20.04	8.92	4.43	2.19
Liabilities	25.96	3.08	19.47	1.96	9.35	8.87	- 0.00
Difference	-28.46	- 8.48	-30.89	18.08	-0.43	-4.44	2.19
Cumulative		-34.53	-54.75	- 46.57	-46.80	-49.16	-48.05

God Bless Pension America !

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www.ryanalm.com

Bush Administration Budget Proposal for Fiscal 2007

The new 2007 Budget Proposal projects spending of \$2.77 trillion up 2.3% from the \$2.71 trillion of fiscal 2006. Here are some of the key items under this budget proposal:

1. **Minimum Tax Relief for individuals** would be extended at the higher alternative minimum tax (AMT) exemption of \$40,250 for singles and \$58,000 for married couples filing together.
2. **Make Permanent Certain Tax Cuts** enacted in 2001 and 2003 for capital gains and dividends. The current tax rate is 15% scheduled to sunset on 12/31/08.
3. **Expand Tax-Free Savings.** This proposal would replace IRAs with two new tax-preferred savings accounts: Lifetime Savings Accounts (LSAs) and Retirement Savings Accounts (RSAs). Individuals would be able to contribute up to \$5,000 annually. Such contributions are non-deductible and exempt from federal income taxation. This proposal permits the rollover of existing IRAs and RSAs. Sounds good except \$5,000 doesn't buy much retirement... need another zero in that number.

Pension Reform

The Bush Administration proposal here would abandon the 30-year Treasury rate as a discount rate for determining funded status (and minimum contribution) in favor of a zero-coupon corporate yield curve based on a 90-day average of interest rates. As I have preached for years (since 1991) the only discount rate yield curve that works here is the Treasury STRIPS yield curve. The facts are clear: ***Corporate zero-coupon bonds do not exist*** causing an undervaluation of pension liabilities due to a higher discount rate. Moreover, **you can not defease liabilities with these imaginary securities**. Also using **any moving average of rates distorts the true economic value (present value/market value) of liabilities**. Although a 90-day average is far superior to the 4-year moving average traditionally used, it is still not accurate. For a review of our critique on this proposal, please go to www.ryanalm.com/research and read first the **Treasury White Paper on Pension Discounting** (dated 2/07/05) and then read **Critique of Treasury White Paper** (dated 03/04/05).

Welcome Back 30-year Treasury !

The bellwether 30-year Treasury issue was reissued on Thursday, Feb. 9 after being removed from the auction schedule on Halloween, October 31, 2001 ... **Trick or Treat America!**

The best way to monitor the success of the new 30-year Treasury auction and all Treasury auctions is to go to:

www.RyanIndex.com

The Ryan Index is the ONLY Treasury index that starts from auction date instead of settlement date. Legally, ownership of a bond takes place on trade date not settlement date. In order to be an accurate total return measurement of a Treasury auction issue you must start from birth (auction date). The Ryan Index also has the **most complete data history** from the start of each continuous auction maturity series. The Ryan Index is the **first daily bond index** created March 1983.

Quality of EPS Watch

Pension fund accounting can generate *phantom earnings* by forecasting a high return on pension assets versus pension expense thereby creating pension income. Lucent Technologies reported that 82% of 2005 earnings were generated by its pension funds. Lucent reported profits of \$1.185 billion of which \$973 million consisted of pension income. Lucent has \$34 billion in pension assets.

Pension Monitor

In order to closely watch the ever evolving tragedy of the Pension Crisis, we have designed the **Pension Monitor**. This web based site is a chronology of press clippings and research reports on what's happening with pensions throughout the world. Currently, there are over 1,300 press articles going back to 2002. We believe that this is the most comprehensive site for pension articles in the world today. To view, please go to :

www.RyanALM.com/PensionMonitor

www.PensionMonitor.com



Pension Watch – Delta

In February, Delta offered its pilots a \$300 million pay package in exchange for the right to terminate its pension plan. The \$300 million would be in the form of an interest-bearing note. The pilot pension plan is currently 47% funded. If the pilots accept the deal, the PBGC would be saddled with the unfunded obligations of a pension estimated at \$8.4 billion. The governing body of the Delta pilots' council will meet in Amsterdam, Netherlands on March 9 to seek a Mutual Assistance Agreement with members of the SkyTeam Pilots Association (SPA). SPA consists of pilots from nine member airlines around the world. This panel has 45 days within which to render a decision on Delta management's motion to reject the pilot contract. If the panel decides to uphold the motion, Delta will be free to impose pay rates and other terms and conditions of employment. If the motion is denied, the contract as it existed prior to the recent interim agreement will remain in effect.

The metal content of a penny (copper + zinc) is worth 66% more than the penny's value
FACT

Pension Ideas

I. Pension Problems :

Key pension problems itemized in www.RyanAlm.com/Research/The PENSION CRISIS :

1. **Discount Rate** = Wrong rate(s) creates wrong present values
2. **Smoothing** = Distorts / Overstates market values by about 29%
3. **ROA** = Dictates Asset Allocation and Discount Rate for Public Funds.

II. Pension Solutions !

Ryan ALM has a series of Pension Solutions research papers :

- | | |
|-----------------------------|---|
| Pension Solution # 1 | Custom Liability Index (CLI) |
| Pension Solution # 2 | Portable Alpha Liability System (PALS) |
| Pension Solution # 3 | Liability Index Fund (LIF) |

III. Custom Liability Index (CLI)

Ryan ALM provides the Benchmark for ALM with accurate daily pricing **that best represents the present value of the projected benefit payment schedule.** Ryan ALM builds Custom Liability Indexes based on market rates or any discount the client wants.

IV. Beta + Alpha Portfolio

For pensions, **Beta is the portfolio that matches liabilities** not some generic market index. Without a CLI it would be difficult to match liabilities. **Beta is best as a Liability Index Fund.** This is where investment grade bonds should go since they have little or no Alpha vs. liabilities. **Alpha is the excess return above liability growth.** It is certainly not excess returns above a **generic** market index. If you outperform a market index but lose to liabilities, **...you LOST ! Alpha is best as non-bonds portfolios that do not correlate to liabilities.**

V. Portable Alpha

Portable Alpha strategies should be liability driven since that is their true objective. Instead, most Alpha portfolios are given benchmarks different than liabilities and most Beta portfolios have poor correlation to pension liabilities (not matched). Ryan ALM designed our CORE product **“PALS”** as a Portable Alpha Liability Strategy where the Alpha portfolio is non-bonds (i.e. Equity, Real Estate, etc.) and the Beta portfolio is 100% bonds matched to liabilities. **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. When our Alpha portfolio achieves the client goal (i.e. full funding) we **port over to the Beta portfolio to match liabilities and secure the victory !**

*Given the Wrong Index ... you will get the Wrong Risk/Reward
Confucius*