

Index	Estimated Weights %	Total Return		
		QTD %	YTD %	Last 12 Months %
Ryan Labs Cash	5	0.08	0.51	0.51
Lehman Aggregate	30	0.20	5.94	5.94
S&P 500	60	6.04	26.45	26.45
MSCI EAFE Int'l	5	2.23	32.45	32.45
Asset Allocation Model	100	3.81	19.43	19.43
Ryan Labs Liability (PPA)	100	-1.40	15.56	15.56
Assets – Liabilities (PPA)		5.21	3.87	3.87
Ryan Labs Liability (FAS158)	100	-0.66	11.68	11.68
Assets – Liabilities (FAS 158)		4.72	7.75	7.75
Ryan Labs Liability (TSY)	100	-6.96	-20.72	-20.72
Assets – Liabilities (TSY)		10.77	40.16	40.16

As we look back at 2009, there was a substantial rally in both assets and liabilities. PPA Liabilities have returned 15.56% year-to-date as of 12/31/2009, caused by a substantial tightening in corporate bond spreads, while the average asset portfolio was up 19.43%. The leading indicators are pointing to a recovery taking hold, but pension funds across the country remain underfunded due to the strong pace of liability increases.

The average U.S. pension portfolio in America, estimated at 65% equities and 35% fixed income, posted a 19.43% return for 2009. Domestic equities are up over 26.45% for the year, while international equity returns, as measured by the MSCI EAFE, are up 32.45%. Despite the rally in equities and credit, funding on a PPA basis remains low at 76.86%. Substantial contributions will likely be required of most plan sponsors. CFOs, who have undergone at least a year of vigorous cost cutting, would prefer to use excess cash for core business and capital expenditure but funding exposure will make a dent in cash on-hand.

Although pension funds have enjoyed the substantial recovery across asset classes, the PPA liability increase for 2009 has dampened the celebration. Furthering the asset-liability model's viability has been the difficulty in correlation assumptions with asset-only frameworks. When markets are stressed, correlations across risk asset classes increase substantially leaving little diversification. Furthermore, in times of stress, pension funds have also typically been in their most difficult funding situations: lower discount rates increase liability present values while asset values are distressed. While this may sound like an obvious situation to avoid, the typical asset-only portfolio management framework leaves the average plan sponsor ill-equipped for this scenario. As equity holdings of the pension fund correlate highly with the underlying equity of a plan sponsor, the sponsor ends up needing to contribute when they can least afford it.

Difficulties estimating the precise timing and extent of the recovery have proven that interest rate forecasting can be dangerous for a plan sponsor. With unemployment hovering around 10%, and little near-term threat from inflation, holding out for interest rate increases may take awhile. In the meantime, sponsors can do more to hedge interest rate risk in this uncertain economic environment with a liability-driven strategy. However, with exceptionally low short term rates, and a massive amount of liquidity injected into the market by the Fed, some institutional investors choose to be more tactical in their LDI strategy. This would involve holding a bond portfolio somewhat short of the liability duration while still managing the liability exposure.

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Ryan Labs Pension Protection Act Equal Weighted Index
(RL PPA Corp A to AAA Index)

	Estimated Weights%	YTW¹ %	MDuration (Years)	YTD Returns %	Last 12 Month Returns %
2 Year Corporate	25	2.13	1.96	9.70	9.70
5 Year Corporate	25	3.80	4.36	11.72	11.72
10 Year Corporate	25	5.07	6.94	8.96	8.96
30 Year Corporate	25	6.01	12.55	7.23	7.23
RL PPA Index ²	100	4.76	15.39	15.56	15.56

Ryan Labs FAS 158 Pension Protection Expense Equal Weighted Index
(RL FAS 158 Corp AA to AAA Index)

	Estimated Weights%	YTW¹ %	MDuration (Years)	YTD Returns %	Last 12 Month Returns %
2 Year Corporate	25	2.14	2.00	6.49	6.49
5 Year Corporate	25	3.57	4.23	8.84	8.84
10 Year Corporate	25	4.96	7.56	-0.15	-0.15
30 Year Corporate	25	6.09	12.60	2.10	2.10
RL FAS158 Index ²	100	4.58	15.21	11.68	11.68

1. *Effective Annualized Yield to Worst*
2. *Equal Weighted Index*

Index	Weights	'99	'00	'01	'02	'03	'04	'05	'06	'07	'08	Dec'09
Ryan Labs Cash	5%	4.74	6.57	5.01	1.92	1.19	1.27	3.17	4.89	5.22	3.01	0.51
Lehman Aggregate	30%	-0.82	11.63	8.44	10.25	4.10	4.34	2.43	4.33	6.96	5.24	5.94
S&P 500	60%	21.04	-9.10	-11.89	-25.15	28.68	10.88	4.91	15.79	5.50	-37.01	26.45
MSCI EAFE Int'l	5%	27.32	-13.87	-21.11	-15.64	39.17	20.70	14.02	26.87	11.62	-43.06	32.45
Asset Allocation Model	100%	13.72	-2.50	-5.42	-13.49	20.04	8.93	4.61	12.25	6.35	-24.49	19.43
RL PPA Liability		-14.21	11.80	14.39	27.91	6.56	10.06	4.32	1.23	3.54	5.03	15.56
Return Difference		27.93	-14.30	-19.81	-41.40	13.48	-1.13	0.29	11.02	2.82	-29.52	3.87
Funding Ratio (RL PPA)		166.57	145.26	120.11	81.23	91.50	90.56	90.81	100.69	103.44	74.37	76.86
Liabilities (TSY)	100%	-12.02	26.56	3.20	18.78	2.25	10.25	10.64	1.46	11.29	33.53	-20.72
Return Difference		25.74	-29.06	-8.61	-32.27	17.80	-1.32	-6.03	10.79	-4.93	-58.02	40.16
Funding Ratio (Economic)		119.86	92.34	84.64	61.64	72.37	71.51	67.61	74.80	71.48	40.42	60.90

Notes: RL PPA liability curve is the spot curve of the replication of IRS PPA curve (US credit A to AAA).

RL Treasury liability curve is the proxy for economic liabilities.

Assumptions :Normal costs = annual contributions

No benefit enhancements

Assets portfolio rebalanced monthly

The material presented and calculated here is based on information considered reliable. Ryan Labs does not represent that it is accurate or complete.

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