

Index	Estimated Weights %	Total Return		
		QTD %	YTD %	Last 12 Months %
Ryan Labs Cash	5	0.06	0.15	0.43
Lehman Aggregate	30	1.89	3.71	9.03
S&P 500	60	-6.54	-1.51	20.97
MSCI EAFE Int'l	5	-12.90	-12.08	6.84
Asset Allocation Model	100	-3.99	-0.27	15.79
Ryan Labs Liability (PPA)	100	4.84	6.44	22.36
Assets – Liabilities (PPA)		-8.83	-6.72	-6.57
Ryan Labs Liability (FAS158)	100	6.00	7.61	20.48
Assets – Liabilities (FAS 158)		-9.99	-7.88	-4.69
Ryan Labs Liability (TSY)	100	10.78	10.17	7.93
Assets – Liabilities (TSY)		-14.77	-10.45	7.86

The 2010 story shows no end as PPA liability returns continue to rally, gaining another 1.30% in the month of May to finish with a YTD return of 6.44%. May proved to be a disastrous month in the equity markets, as fear and dislocation have returned. The European debt crisis, coupled with the BP oil leak, have brought with it volatility reminiscent of late 2008 and early 2009. The S&P gave back 856 basis points of YTD returns in a month, and the asset allocation model declined a further 578 basis points versus liabilities in May to finish down versus liabilities by over 13% YTD.

The average U.S. pension portfolio in America, estimated at 65% equities and 35% fixed income, has returned -0.27% through May 31, 2010. The average pension asset portfolio returned 15.79% over the last 12 months. However, trailing 12 month returns have declined by 10.05% from their month end close in April of 25.84%. Domestic equities have returned 20.97% over the last 12 months while international equities have returned 6.84% over the same time period. Funding on a PPA basis ended May at 72.95%, down from last month end funding level of 77.18%. Funding levels are now at levels below year end 2008.

In times of volatility, it becomes important for a plan sponsor to understand their specific risk capacity. Fat tail events have gone from a once in a lifetime scenario to what seems like an annual experience. From an Enterprise Risk Management (ERM) perspective, it becomes important to understand what an appropriate asset allocation is, based on the plan sponsor's capacity to take risk. Rather than accepting the standard 60/40 allocation as the de facto, plan sponsors have begun to use their pension surplus volatility to identify the ideal asset allocation for their given risk capacity. Surplus volatility is defined as the instantaneous volatility of the difference of assets and liabilities resulting from market movements.

To begin to look at asset allocation from an ERM standpoint that is designed to minimize surplus volatility, plan sponsors should ask their consultants these two questions:

- 1) Based on our balance sheet's capacity to take risk, how much of the portfolio should be in fixed income?
- 2) Based on our risk budget (surplus volatility), what duration should the fixed income portfolio have?

By asking these questions, a plan sponsor can begin to look at asset allocation from an ERM perspective. The past two "once in a lifetime events" in the last decade have shown that the asset only framework of mean variance optimization as the foundation for asset allocation has not been an effective strategy to decrease funding volatility. In the PPA/FAS 158 era, tying asset allocation back to balance sheet capacity is a great start to risk management.

REGISTERED INVESTMENT ADVISOR

**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	2.04	1.89	1.42	6.51
5 Year Corporate	25	3.61	4.39	3.20	12.16
10 Year Corporate	25	4.82	6.93	3.92	15.62
30 Year Corporate	25	5.77	12.77	4.92	19.16
RL PPA Index ²	100	4.32	16.57	6.44	22.36

**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	1.89	2.00	1.63	6.34
5 Year Corporate	25	3.10	4.29	4.04	11.98
10 Year Corporate	25	4.25	7.43	6.17	14.69
30 Year Corporate	25	5.86	12.81	5.12	20.15
RL FAS158 Index ²	100	4.03	16.56	7.61	20.48

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

Index	Weights	'00	'01	'02	'03	'04	'05	'06	'07	'08	'09	05/'10
Ryan Labs Cash	5%	6.57	5.01	1.92	1.19	1.27	3.17	4.89	5.22	3.01	0.51	0.15
Lehman Aggregate	30%	11.63	8.44	10.25	4.10	4.34	2.43	4.33	6.96	5.24	5.94	3.71
S&P 500	60%	-9.10	-11.89	-25.15	28.68	10.88	4.91	15.79	5.50	-37.01	26.45	-1.51
MSCI EAFE Int'l	5%	-13.87	-21.11	-15.64	39.17	20.70	14.02	26.87	11.62	-43.06	32.45	-12.08
Asset Allocation Model	100%	-2.50	-5.42	-13.49	20.04	8.93	4.61	12.25	6.35	-24.49	19.43	-0.27
RL PPA Liability		11.79	14.39	27.91	6.59	10.06	4.77	1.18	2.32	3.97	19.21	6.44
Return Difference		-14.29	-19.81	-41.40	13.45	-1.13	0.17	11.07	4.03	-28.46	0.22	-6.72
Funding Ratio (RL PPA)		149.13	123.31	83.40	93.92	92.95	92.80	102.96	107.01	77.72	77.87	72.95
Liabilities (TSY)	100%	26.56	3.63	17.36	1.04	11.40	12.23	0.17	11.53	59.13	-34.30	10.17
Return Difference		-28.79	-9.04	-30.86	19.01	-2.47	-7.62	12.08	-5.17	-83.62	53.74	-10.45
Funding Ratio (Economic)		100.20	91.46	67.41	80.09	78.32	73.00	81.80	78.01	37.02	67.29	60.91

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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