Ryan ALM, inc.

Asset/Liability Management

The Solutions Company

Ronald Ryan, CEO, CFA

The Ryan Letter

April 2008

Index	Returns YTD 2008	Estimated Weights
Liabilities :		
Market (Tsy STRIPS)	1.20 %	100 %
IRS (Corporates)	0.81	
ROA (8% constant rate)	2.64	
Assets :		
Ryan Cash	1.19 %	5 %
Lehman Aggregate	1.95	30
S&P 500	-5.03	60
MSCI EAFE Int'l	-3.76	5
Asset Allocation Model	-2.50 %	100 %
Assets – Liabilities		
Market	-3.70%	
IRS	-3.31	
ROA	-5.14	

Based on the Asset Allocation above, year to date 2008 pension assets **underperformed** liabilities by **-3.70%** using market valuations (i.e. STRIPS); lost by **-3.31%** under the IRS Contribution rules (PPA Corporate rates); and lost by **-5.14%** 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, assets have underperformed liabilities **by about -83% since 1999** on a compounded index basis starting at 100 on 12/31/99!

(see Graphs and Index disclosures on pages 7 and 8)

Total Returns

	2000	2001	2002	2003	2004	2005	2006	2007	2008
Assets	-2.50	-5.40	-11.41	20.04	8.92	4.43	12.25	6.82	- 2.50
Liabilities	25.96	3.08	19.47	1.96	9.35	8.87	0.81	11.76	1.20
Difference:									
Annual	-28.46	-8.48	-30.89	18.08	-0.43	-4.44	11.44	-4.94	-3.70
Cumulative		-37.60	-73.40	-60.08	-66.13	-76.75	-64.60	-78.38	-83.34

God Bless Pension America !

Sub-Prime Crisis Overview

According to Federal Reserve data, the home mortgage market is approximately $11 trillion with the sub-prime market around $1.1 trillion. Sub-prime mortgages are loosely defined as loans to borrowers with credit scores below 620 and with a history of credit problems and also without the income verification standards required by the FHA. According to First American CoreLogic mortgage data, approximately $400 billion of sub-prime mortgages reset in 2007, $389 billion in 2008 and another $137 billion in 2009. There is usually a 12 to 15 month lag between the reset date and event of default ("E.O.D."). A key factor in deciding on foreclosure is the amount of equity in the home. Most sub-prime mortgages were made with little, if any, equity in a market with inflated housing prices. The default rate on sub-prime mortgages stands at 26.6% up from 11.6% in 2007. This rate is expected to rise significantly. A very conservative estimate is that **a third of the $925 billion sub-prime problem loans will default (@ $308 billion)**. For 100 years, home prices have tracked inflation. The recent housing bubble led to overvalued homes 30% above the inflation trend line. A 20% correction is necessary to bring home prices in line with historical inflation data. A 20% housing prices decline would put virtually all sub-prime mortgages underwater and the risk of defaults would increase by double or even triple their current rate. Beyond sub-prime mortgages there are also adjustable rate mortgages scheduled to rest. According to Credit Suisse data **over $2 trillion in ARMs will reset in the next 3 years**. The current default rate on ARMs is 9.3% up from 2.1% just a year ago.

SEC Files Civil Complaint vs. Five San Diego City Officials

The SEC filed a civil complaint on April 7 against five former San Diego city officials alleging they committed fraud by concealing a ballooning shortfall in the city pension fund to bond-rating agencies and to the investors who bought city bonds in 2002 and 2003. The SEC complaint claimed the officials knew the city's unfunded liability was expected to soar to about $2 billion in 2009 from $284 million in 2002. The SEC complaint also said the officials failed to tell investors that the city carried a $1.1 billion liability for retiree health care. The SEC complaint also noted that the city had been using above-average returns on pension investments to give bonus checks to retirees since 1980. Typically the prudent investor would set aside (escrow) investment gains to cushion against downturns in the market. Five former pension fund officials were indicted by a federal grand jury in 2006 on charges of concealing information from fellow pension board members about a crucial 2002 vote that caused pension liabilities to rise sharply. San Diego's pension liabilities soared after the City Council decided in 1996 and again in 2002 to skip contribution payments but at the same time increase retirement benefits. Last year, the SEC filed a civil complaint against the city's former outside auditor indicating he committed fraud by signing off on false and misleading financial statements.

Vallejo, CA Votes to File for Bankruptcy

On May 7, the city council voted unanimously to go into bankruptcy. This decision was made after talks with labor unions failed to win contract concessions through 2012. Once the city files its petition, a federal bankruptcy judge must decide whether the city is actually insolvent. If proven so, the case can proceed. Police and firefighters salaries, pensions and overtime cost @ 80% of the city's $89 million general fund budget. This is the largest city in California to ever file for bankruptcy (population = 117,000). Vallejo is a suburb of San Francisco. Orange

County filed the largest municipal bankruptcy in the 1990s after losing $1.64 billion in reverse repos. Desert Hot Springs also filed for bankruptcy in 2001 due to a legal judgment of almost $6 million.

Milliman Study Suggests Corporate DB Plans in Surplus

According to a year end 2007 study by actuarial firm Milliman Associates, the 100 largest corporate plan sponsors improved their funded status from a $15 billion deficit in 2006 to a $70 billion surplus in 2007. If true, one would think that pension funds should behave accordingly by changing their asset allocation to a matching liability strategy (immunization) to secure their surplus. This would eliminate the volatility in their funded ratio and contributions as well as eliminate interest rate risk (i.e. matching liabilities behavior). This would require a significant move into bonds. Most companies are reluctant to match assets vs. liabilities since such a move could lower the ROA forecast. The forecasted ROA on pension assets minus pension expenses equals pension income (creates earnings) or pension expense (hurts earnings). Naturally, there is a bias towards making the ROA as high as possible (requires validation by the auditors). So any reduction in the ROA could cause some pain on EPS by lowering pension income (or increasing net pension expense). Until FASB removes this dangerous ability of allowing corporations to forecast annually their pension ROA and replaces it with accurate actual market returns, the manipulation of EPS will continue (i.e. phantom earnings). Once you attach a P/E multiple to these phantom earnings we may have a significant overvaluation of a company's market valuation. As a result, DB plans continue to have low bond allocations which puts them on a funded ratio roller coaster which tends to go from high surpluses to deep deficits repeatedly. They need to get off this roller coaster and match assets vs. liabilities as a goal if not a requirement. By not matching assets to liabilities, companies risk damaging their long-term EPS, credit rating and even solvency as the 2000-02 equity correction period is too vivid an example. The S&L crisis of the 1970s, the Insurance fiasco of the 1980s and the pension crisis of the 2000s are all vivid examples of the financial damage of not managing assets vs. liabilities correctly. Let's pray that OPEB (healthcare) is not the next financial tsunami coming.

Tiburon CEO Conference

I was honored recently to be chosen as one of nine speakers before the Tiburon CEO conference. Tiburon is a leader in seminars and strategic consulting for senior executives in the financial industry. Over 100 CEOs were present. My presentation was "the Pension Crisis and Solutions". Check out **www.TiburonAdvisors.com** for more info on Tiburon.

If Elected President …

Given that we are now in the stretch run of an election, I thought I would offer some ideas for the candidates. Hopefully, you find them entertaining and even useful. I would appreciate any critiques sent to **rryan@ryanalm.com** :

1. Increase IRA Allowance – As we prepare for a Social Security crisis, American taxpayers should be allowed to provide for their retirement. The IRA has been a great invention but limited. We need to allow our citizens to provide for their own retirement. We need to raise the limits on what taxpayers can allocate to their IRA plan. At current IRA allowances plus Social Security benefits, most Americans would be hard pressed to meet retirement costs. Why not allow a 20% allocation to an IRA. The government still gets paid in taxes. The only question becomes is it upfront (Roth IRA) or deferred.

2. Make Healthcare Assets Tax-Exempt - We are currently facing the largest financial disaster in America's history … how to pay for Healthcare benefits (OPEB). Pensions were given an incentive to prefund pension liabilities by making them tax-exempt. However, healthcare assets do not have the same tax treatment. As a result, there has been a reluctance to prefund. Instead of funding these future liabilities at 50 to 60% cost thereby saving 40 to 50% most institutions (corporate and Public) have chosen a pay-as-you-go strategy which funds such liabilities at 100% cost.

3. Reduce Taxes – If our Declaration of Independence is correct that all men are created equal then perhaps we should treat our citizens the same way. Robbing the rich to give to the poor may be a Robin Hood value but does not work in a capitalist system. We need to motivate the rich to live and work in America. A FLAT INCOME TAX would be a fair system which would eliminate much cost of preparing those arduous tax forms and generate as much revenue as the government gets today. We also need to reduce the Corporate income tax which is the second highest in the world to attract and keep corporations in America. We need to create an environment that motivates the most productive people and companies to live, build and work here. In this way, they will in turn hire more people, spend more in our economy. We should also make permanent the lower capital gains tax rates and eliminate double taxation of dividends to motivate economy activity.

4. Find and Buy Low Cost Manufacturing - America has steadily lost its manufacturing to the rest of the world due to our higher labor costs and taxes. We need to find a way to produce our goods cheaper where the production facilities are on our soil. It's time we become more self dependent, especially on any critical goods and services. As we see with oil, any dependence on foreign goods here can be harmful to our economy. Why not buy a less developed country to be a low cost provider where we send our intellectual property to teach a low cost labor force. We do not want them to come to America where they would have to be paid at least our minimum wage, move away from family and live a life style they are not used to or perhaps want. Remember, most of America's land mass was purchased! Our key cities and environmental resources were founded mainly by purchasing the land (i.e. Manhattan, Louisiana Purchase, Alaska, etc.). I would think that Haiti is an ideal candidate. It is close to our shores with the third largest land mass in the Caribbean. I would think that we could buy this undeveloped country for a lot less than the Iraq war costs. I am sure that the Haitians would welcome to become a U.S. possession that would upgrade their way of life. I am sure that the politicians would also welcome it for a price that would be less costly than any war.

5. Bring back Investment Tax Credit - We are losing our manufacturing steadily to the rest of the world for many years now. We need incentives for corporations to do the right thing for America. Build plant and equipment here in America, hire more Americans! It worked before in the 1960s and 1970s … we need a strong corporate America.

6. Legalize National Lottery - There are about 38 states that have a state lottery. For many states, this is the second or third largest revenue for that state. We need to find ways to finance and support Social Security and Medicare without taxing our citizens. A National Lottery with revenue dedicated to SS and Medicare would be a big help.

7. Sell our Gold – Since we left the Gold standard many decades ago, there is no economic reason to hold this commodity. Given the fact that Gold is now at an all time high price ($821.50 per troy ounce as of 11/30/07) and our economy needs a stimulus (other than raising taxes) this might be a proper strategy and certainly good timing. As of September 2007, the U.S. owned 8,133.5 tonnes of Gold (Germany has 3,417.5, China = 600 and the UK = 310.3) . There are 32,551 troy ounces in each tonne. This would value our Gold reserves at $214,822,380,207. Such a new found wealth could shore up the Social Security and Medicare trust fund which is the next big financial crisis that all Americans will pay for in higher FICA taxes. Put the sale proceeds in a lock box and only use the interest income when you start to run SS deficits in future years. This way we would have an interest earning asset rather than the reverse situation which we have today (a cost center not a profit center).

8. Get rid of Electoral College - This antiquated system is in defiance of our Declaration of Independence which states that all men are created equal. Each American should get an equal vote in our elections. Anything less or more contradicts our heritage.

Public Pension and OPEB Watch

There seems to be an avalanche of recent Public Pension announcements concerning the growth of pension + OPEB deficits and the mismanagement of such funds. 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* the liabilities (market rates @ 5.00%). Instead, they value the liabilities at the ROA rate (discount rate @ 8.00%). Such a discount rate methodology has *undervalued* public pension liabilities by 30 to 45% in the last 7 years. As a result, reported funded ratios are not accurate and need to be reduced accordingly. 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:

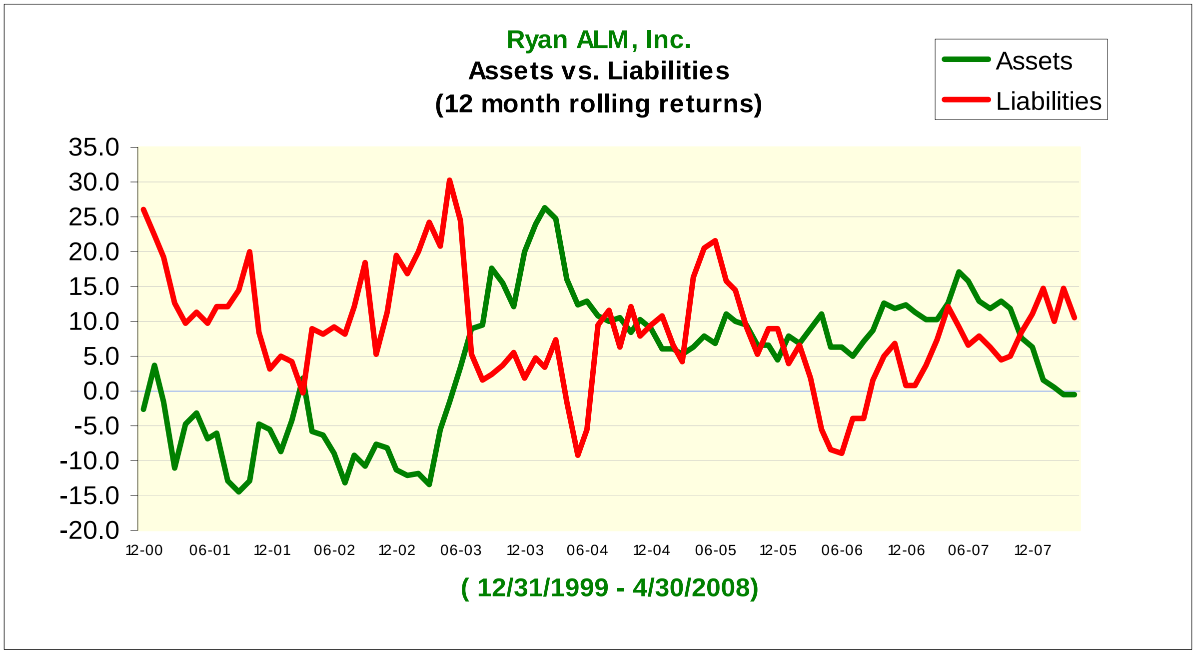
Ten Worst State Pensions – According to a recent S&P study here are the 10 worst state pension plans based on their reported Funded Ratio:

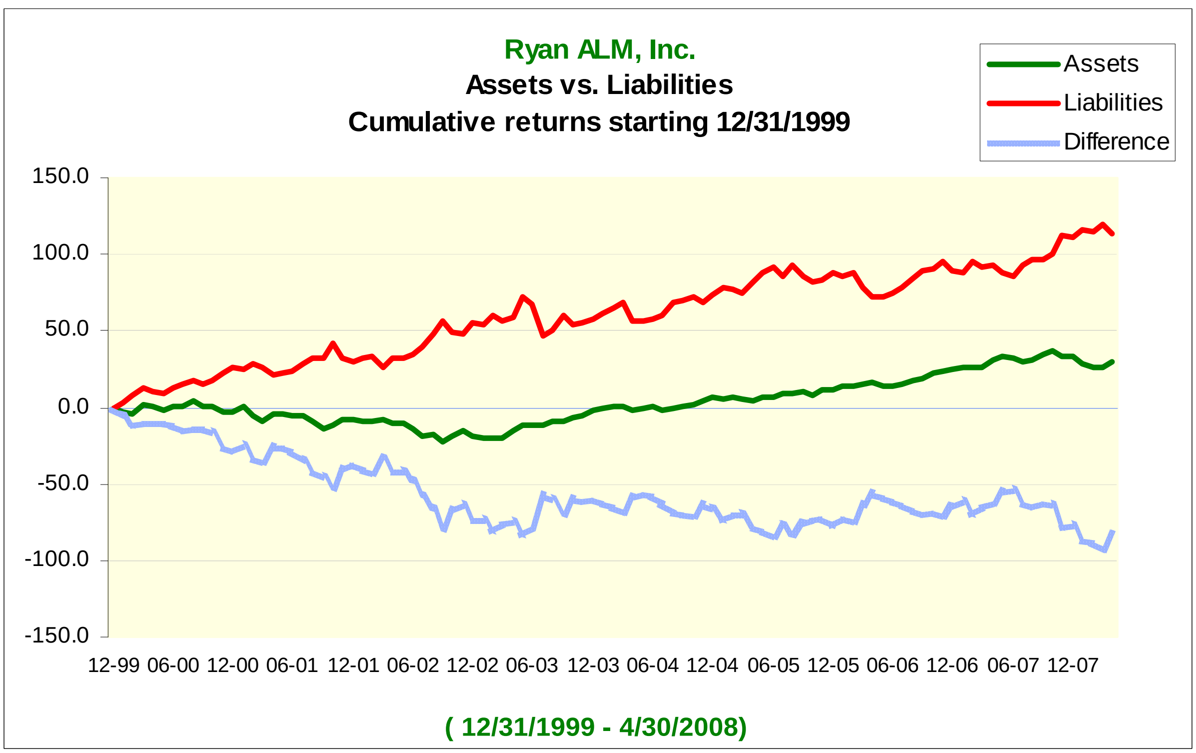
($ billions)

State Pension	Pension Size ($)	Deficit (%)	Deficit ($)
West Virginia	11.1	47.3 %	5.3
Rhode Island	10.6	46.6	4.9
Connecticut	33.9	43.6	14.8
Illinois	79.9	40.5	32.4
Oklahoma	24.4	40.5	9.9
Alaska	21.6	39.0	8.4
New Hampshire	6.4	38.6	2.5
Indiana	28.2	35.7	10.1
Hawaii	14.7	35.0	5.1
Louisiana	30.9	33.7	10.4

Pension Scoreboard

Based on the Ryan generic Liability Index and a static Asset Allocation 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 **-83.34% suggesting any pension with a Funded Ratio below 164.18 in 1999 has a deficit today !**. As a Pension Crisis watchdog, we have also designed the **Pension Monitor** as the most comprehensive site for pension articles in the world today: **http://www.pensionmonitor.com**





Indexes

Custom Liability Indexes

The best way to price (discount rate) and understand the interest rate sensitivity of liabilities is the **Ryan Treasury STRIPS yield curve indexes** 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.).

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 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 100 daily pages + many pages of research and methodology including :

Returns
Yield History
Yield Spreads
Percentage Spreads

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

Index Funds

Liability Index Funds

The best way to match assets to liabilities and reduce the volatility of the Funded Ratio is through a Liability Index Fund. Immunization was a common strategy to match liabilities but had a mathematical problem in that it matched 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) concept.

Ameristock / Ryan Launch Five (5) New Bond ETFs

On Monday, July 2nd Ameristock and Ryan ALM launched five new bond ETFs based upon the Ryan Indexes. Here is the list of these innovative ETFs and ticker names:

Ameristock / Ryan 1 year Treasury (GKA)
Ameristock / Ryan 2 year Treasury (GKB)
Ameristock / Ryan 5 year Treasury (GKC)
Ameristock / Ryan 10 year Treasury (GKD)
Ameristock / Ryan 20 year Treasury (GKE)

These new ETFs are **constant maturity** index funds. They are the first such bond funds in the ETF market place today. The other bond ETFs are based on maturity range indexes (i.e. 7-10 years) rather than a precise spot on the Treasury yield curve. These maturity range indexes tend to have significant drifts in average coupon and duration as old issues pass thru this index composition. Such drifts can distort the implied or expected risk/reward behavior. Moreover, these indexes allow for callable bonds which trade to a call date and not a maturity date which create more skewness. Such drifts and skewness are corrected with a constant maturity index methodology.

For more info on these ETFs and the Ryan Indexes, please go to :

Ryan Indexes = www.RyanIndex.com
and
www.RyanALM.com
Ameristock / Ryan ETFs = www.Ameristock.com

Powershares Launches ETF based on Ryan/Mergent 1-30 year Maturity Ladder Indexes

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)