Third Quarter 2011
Investment Review

THE METROPOLITAN WATER DISTRICT
of SOUTHERN CALIFORNIA

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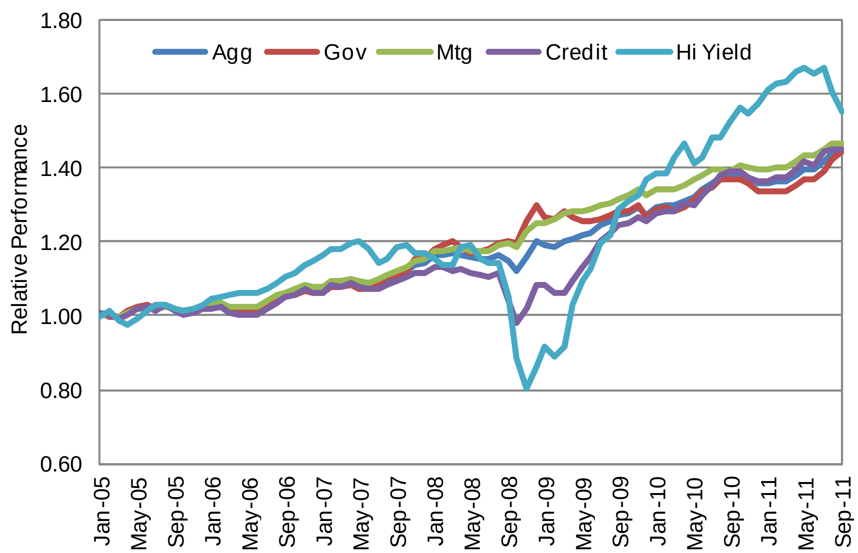
MARKET SNAPSHOT
SEPTEMBER 30, 2011

Index	Qtr	One Year	Three Year	Five Year
S&P 500	-13.9%	1.1%	1.2%	-1.2%
Dow Jones Industrial	-11.5%	3.8%	3.1%	1.4%
Wilshire 5000	-15.1%	0.4%	1.9%	-0.5%
MSCI EAFE Index	-19.0%	-9.4%	-1.1%	-3.5%
Barclays Aggregate	3.8%	5.3%	8.0%	6.5%
ML G/C 1-5 Yr A+	**1.0%**	**2.0%**	**4.5%**	**4.8%**
ML 3 Month T-Bill	**0.0%**	**0.1%**	**0.2%**	**1.7%**

Treasuries Rally and Credit Declines



Source: Merrill Lynch Global Indices

- The global stock markets suffered from the steepest decline since the financial crisis began in 2008. The decline was caused by concerns over the political stalemate in the US, European sovereign debt, and low global growth.
- The rotation away from the economically cyclical sectors like materials, into defensive sectors like consumer staples has continued, with only the utility sector posting positive returns in 3Q.
- Investors tend to favor growth companies in a “low growth” environment, so growth generally outperformed value in the third quarter; except in small caps where growth is associated with risk.
- Emerging markets underperformed developed international markets by -3.6%, driven primarily by currencies and concerns over growth in China. The stronger US dollar reduced the return on the EAFE index by -3% and on the EM index by -7.5%.
- The commodity markets continued to decline due to low global growth and a reversal in speculation, driven in part by changes in margin requirements. Even gold lost some of its luster after the close of the quarter, dropping more than -15%.
- Commercial real estate prices have remained strong, especially in the apartment sector. But cap rates are falling again because net operating income has not kept pace with price increases.
- The -6.2% quarterly decline in hedge fund index was among the worst ever for the HFRI; most strategies except short bias declined.
- The strong rally in the US bond market was all about the flight to treasury bonds. The yield in the 10-year bond dropped by 102 bps and the yield on the 30-year bond dropped by 105 bps.

Slow Growth in the Global Economy

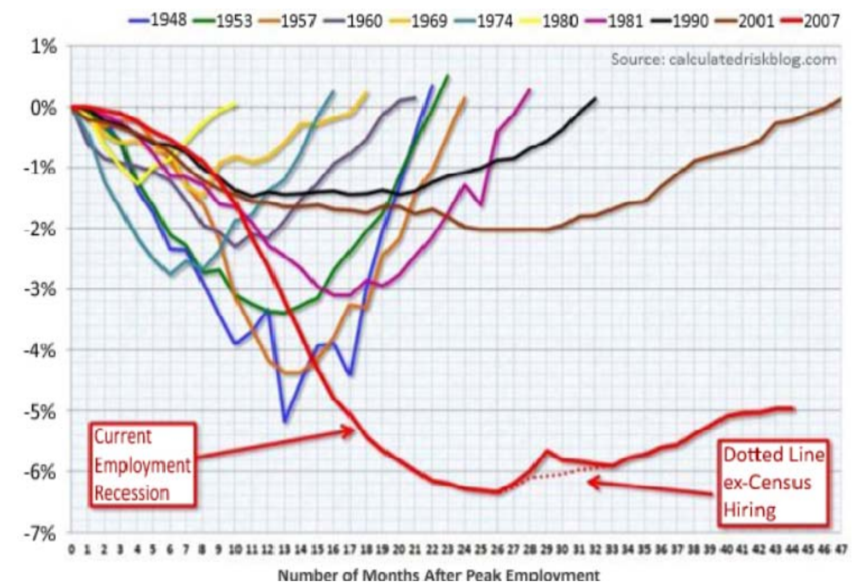
- Economic growth appears to be improving slowly, with third quarter GDP now estimated at +2.5%, versus +1.3% in 3Q, and 0.4% in 1Q. Job growth was revised upward in July and August, but the 287,000 gain for the quarter was too little to change the 9.1% unemployment rate, so consumer sentiment has fallen back to the levels of 2008.

- Incomes have also stagnated in the US; personal income actually declined by -0.1% in August. Low growth has also constrained the rate of inflation, although the CPI-u y/y increased from +1.1% in 2010 to +3.9% in 2011, most of the gain was due to the recovery in real estate.

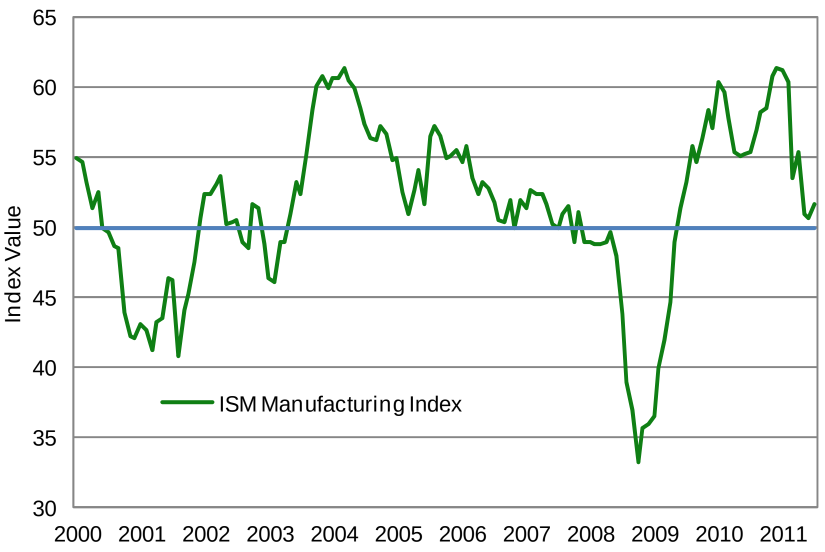
- Global growth is also slowing, as consumer dependant economies suffer from high unemployment, stagnant wages, and a commitment by corporations to maintain lean inventories and payrolls.

- Oil prices were well off their highs in 3Q, with WTI at $86/barrel, driven by the lack of global demand. However, energy prices remain volatile and this will be an important factor heading into the important holiday shopping season.

Job Growth is Stagnant

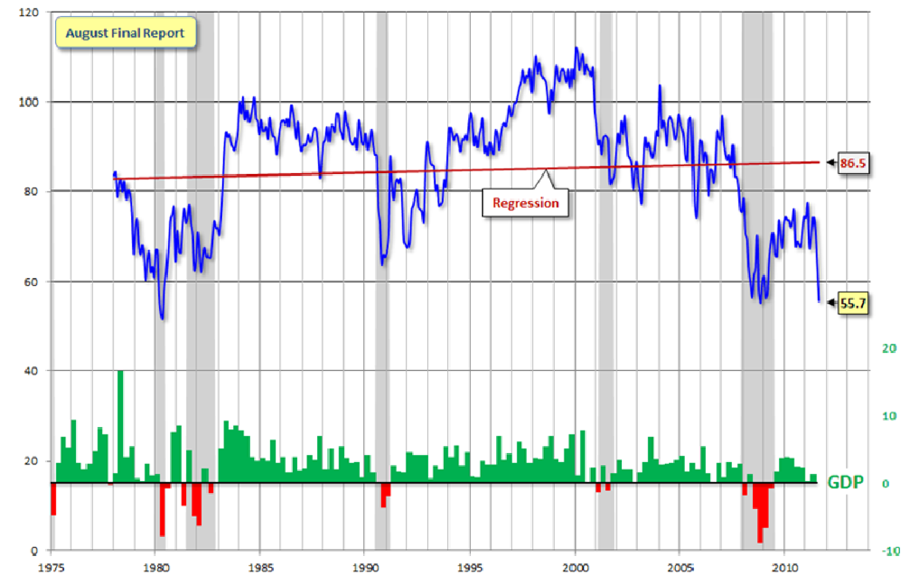


Manufacturing Activity is Weak



Source: ISM

Consumer Confidence is at 2008 Levels



Source: University of Michigan

US Stocks React to the Economic Slowdown

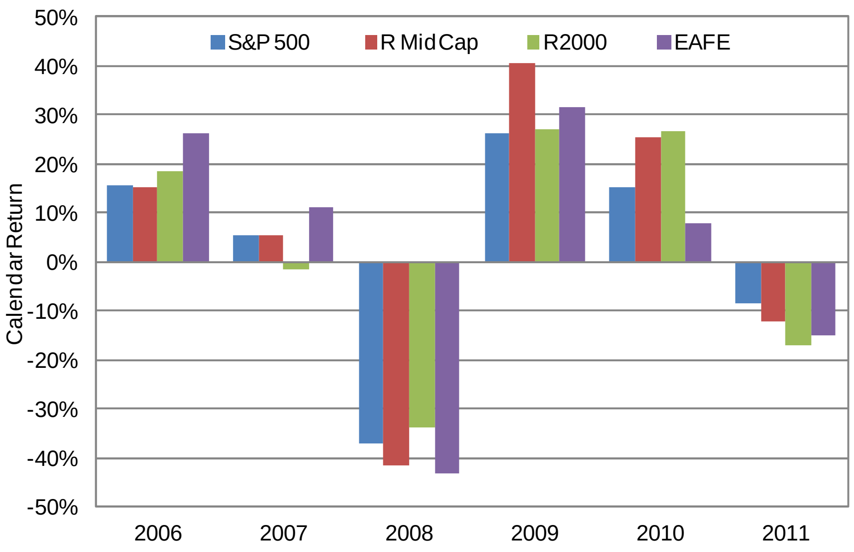
- Large US stocks, as measured by the S&P 500, lost nearly 14% in the third quarter, and small cap stocks were down more than -20%. Defensive sectors like utilities (+0.3%) and staples (-4%) outperformed, while materials (-24%) and financials (-23%) fell significantly.

- One bright spot is the fact that earnings have remained strong given the current economic conditions. But all eyes will be on third quarter earnings as investors look for evidence of another recession.

- The S&P 500 is now selling at a P/E ratio below 14, with an earnings yield that is at the highest level in more than 20 years and a spread above treasuries of nearly 5%. Historically this has been an attractive place to buy stocks.

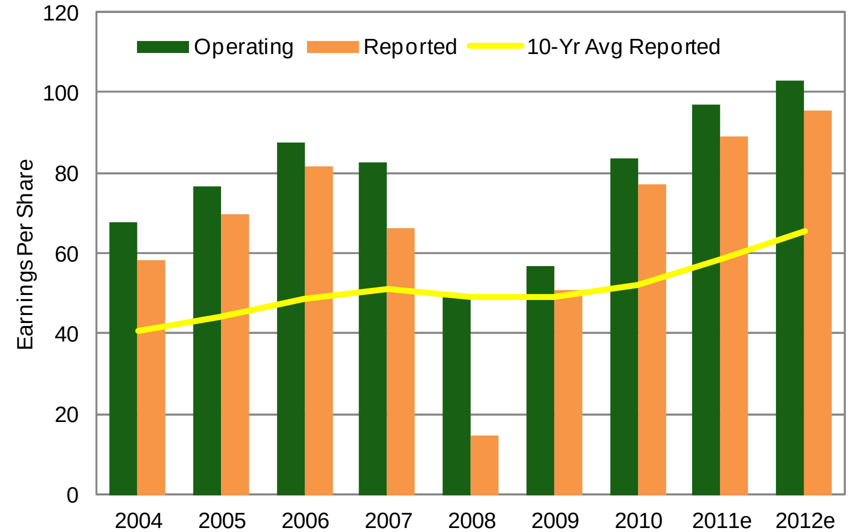
- But active managers have found this to be a difficult investment environment; just 13% of large cap core managers beat their benchmark in the third quarter. Overall only 28% of the 2,100 mutual funds tracked by Morningstar beat their benchmarks in the third quarter.

A Volatile Quarter Ends with a Large Decline



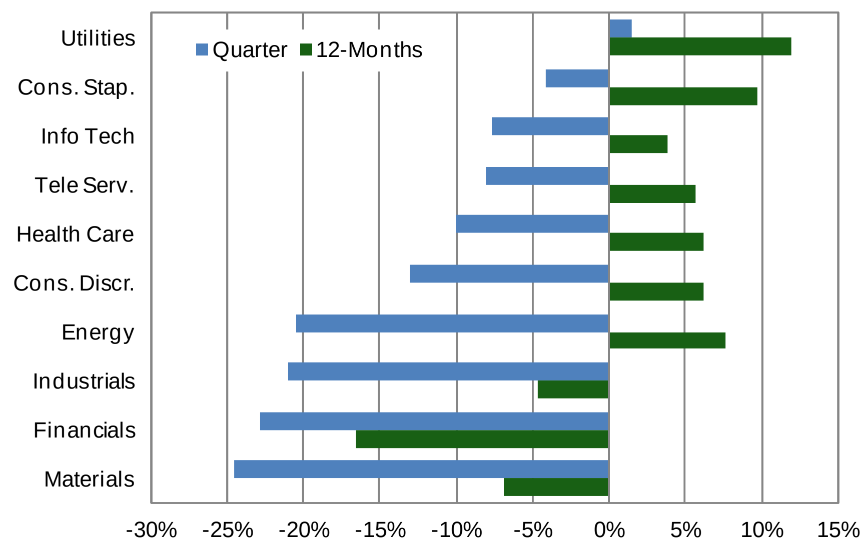
Source: Standard & Poor's and Russell

S&P 500 Earnings are Still Strong



Source: Standard & Poor's

Cyclical Stocks Continue to Underperform



Source: Standard & Poor's

The Bond Market Surprises Again

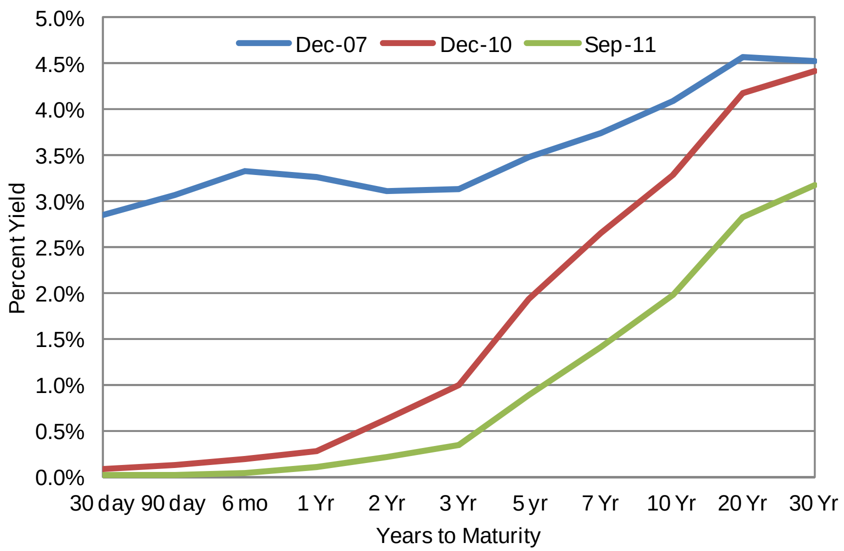
- In August, S&P lowered the rating on US treasury bonds to AA+, but the bigger problem appeared to be the political stalemate that raised the chance of a US default. Instead of treasury bonds declining, the news ignited a strong rally with gains of more than +24% on long treasuries.

- To add fuel to that fire, the Fed announced “Operation Twist” in late September, in which they will sell $400 billion in short-term securities by June 2012 and buy an equal amount of longer-term bonds, with the objective of lowering the cost of mortgages and other loans.

- Most bond managers made the mistake of underweighting the treasury sector which gained more than +6%, as the10-year yield hit a record low of 1.7%. The investment grade Barclays Credit Index posted a gain of +3.0%, but the High Yield Index suffered a -6.1% loss, as investors became more concerned about the risk of a recession.

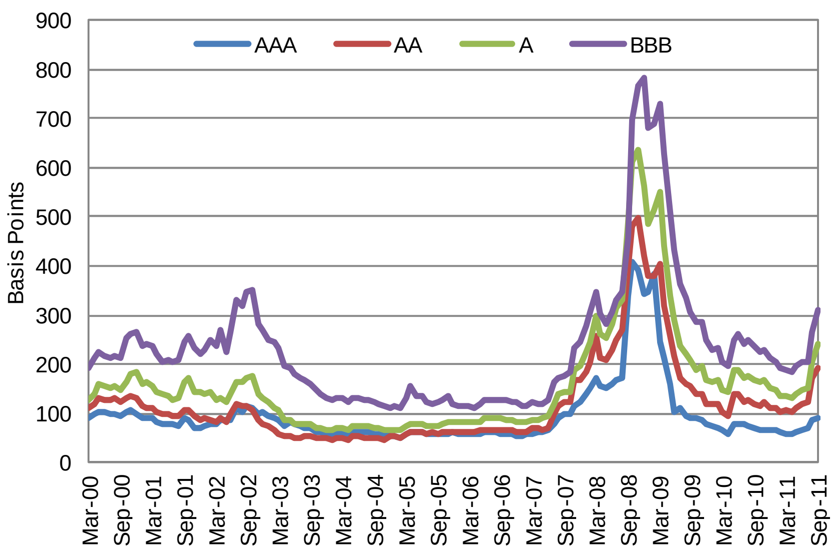
- Fannie Mae announced that 30-year mortgages hit an all-time low yield of 3.94%, but MBS gained even less than corporate bonds, with a 3Q return of +2.4%, on concerns over a rise in the rate of refinancing.

Treasury Yields are at All-Time Low



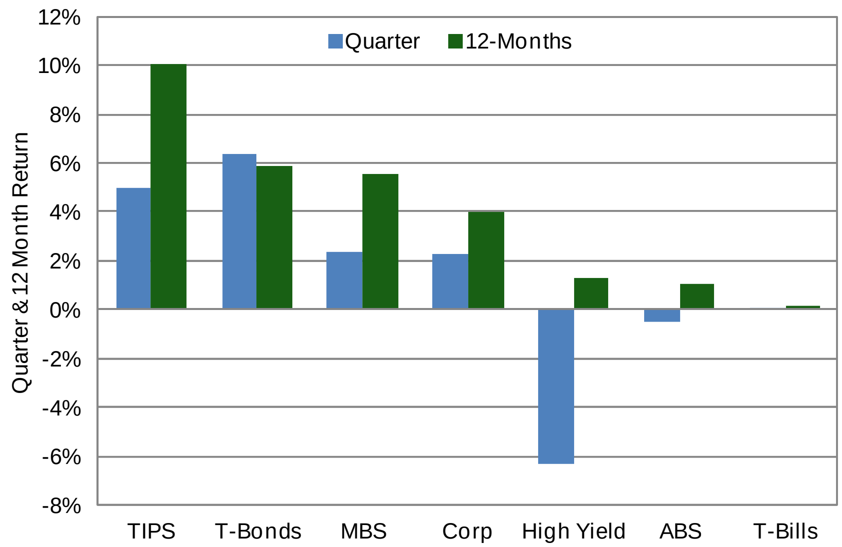
Source: Federal Reserve

Spreads Widen with Economic Concerns



Source: Merrill Lynch

Another Good Quarter for Treasuries



Source: Merrill Lynch

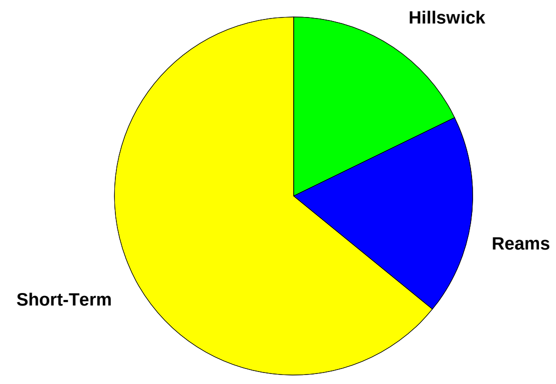
PORTFOLIO SUMMARY
SEPTEMBER 30, 2011

	Assets	Weight
Managed Accounts		
Hillswick Asset Mgmt	$157,849,100	18%
Reams Asset Mgmt	$160,933,800	18%
Total External Managed	$318,782,900	36%
Short-Term Account	$569,363,400	64%
Grand Total	**$888,146,300**	100%

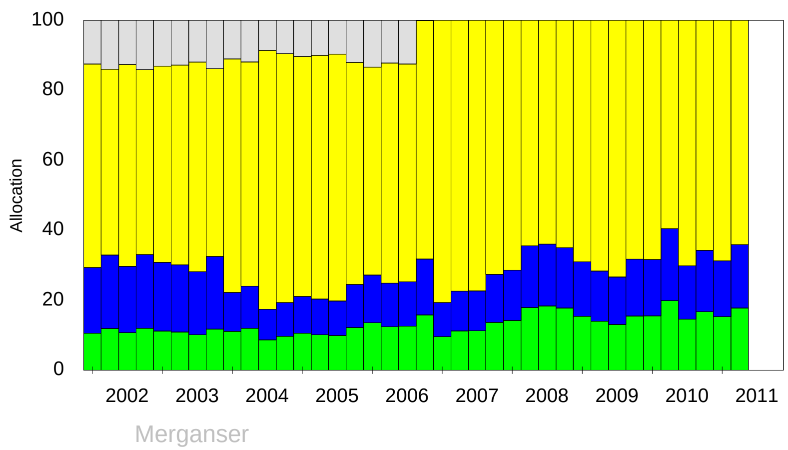
- The value of the Total Fund decreased by $110.7 million in the third quarter, due to net cash outflow of $119 million, offset by earnings of $8.3 million.
- Net investment earnings for the quarter were:

Hillswick	$4.9 million
Reams	$1.4 million
Short-Term	$2.0 million
Total	$8.3 million

CURRENT ALLOCATION



HISTORICAL ALLOCATION



PERFORMANCE SUMMARY - TOTAL RETURN

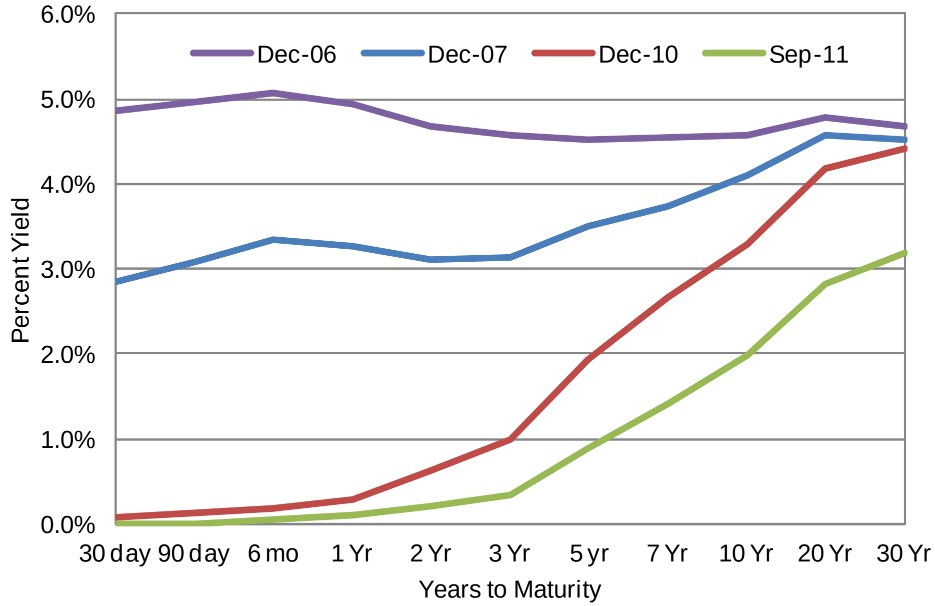
SEPTEMBER 30, 2011

Manager	Quarter	Fiscal YTD	1 Year	3 Years	5 Years
Total Fund	1.1%	1.1%	1.8%	3.1%	3.7%
Benchmark[1]	0.3%	0.3%	0.7%	1.6%	2.7%
Hillswick Asset Mgmt	3.2%	3.2%	3.5%	5.0%	5.3%
ML G/C 1-5 yr. A & above	1.0%	1.0%	2.0%	4.5%	4.8%
Reams Asset Mgmt	0.9%	0.9%	2.1%	6.2%	5.7%
ML G/C 1-5 yr. A & above	1.0%	1.0%	2.0%	4.5%	4.8%
Total External Managers	2.0%	2.0%	2.8%	5.6%	5.5%
ML G/C 1-5 yr. A & above	1.0%	1.0%	2.0%	4.5%	4.8%
Short-Term Account	0.4%	0.4%	1.2%	1.6%	2.7%
ML 90-day T-Bill	0.0%	0.0%	0.1%	0.2%	1.7%

[1] The benchmark for the Total Fund is based on the average asset allocation between the Externally Managed and Short-term Accounts, incorporating the Merrill Lynch Government/Corporate 1-5 yr A+ and the Merrill Lynch 3 Month T-Bill.

- The Total Fund significantly exceeded the benchmark index due to strong performance by Hillswick and the Staff-Managed Short-Term Account as treasury yields fell to the lowest level since the Eisenhower administration.
- Hillswick correctly anticipated that low growth and a decline in risk appetites would cause investors to seek the safety of treasury bonds, so they opened the quarter with longer duration and an underweight to both mortgages and corporate bonds.
- Most bond managers have been underweight US treasury bonds, but Hillswick has been consistent in their expectation that treasuries will outperform, and they have been adept in managing the duration exposure of the portfolio.
- Reams maintains a more conventional or balanced approach to their portfolio, with 33% in corporate bonds and 22% in mortgage bonds. Most of the underperformance in the quarter was due to the overweight to corporate bonds, but this was largely offset by good security selection in mortgages.
- The diversification provided by the different approaches of Hillswick and Reams once again benefited the performance of the Total Fund. At the end of 2010 Reams was outperforming and now it is Hillswick.
- The internally-managed Short-Term Account continues to outperform in a very challenging environment for cash management. The portfolio once again benefited from both security selection and maturity management. The universe comparison, shown on page 9, is also very compelling versus other short-term portfolios.

LOW YIELDS INCREASE THE CHANCE OF BOND LOSSES



NEGATIVE IMPACT OF HIGHER RATES ON BOND INDEX RETURNS, AS OF SEPTEMBER 30

	Down -100 bps	Flat	Up +100 bps	Up +200 bps	Up +300 bps
Barclays US Aggregate	+6.0%	+2.3%	-2.3%	-7.1%	-12.0%
Barclays US Intermediate Aggregate	+4.4%	+2.0%	-1.3%	-4.9%	-8.4%
Barclays US Intermediate Gov't Credit	+4.8%	+1.7%	-1.8%	-5.4%	-9.0%
Barclays US 1-3 Yr Gov't Credit	+0.5%	+0.8%	-0.9%	-2.6%	-4.2%

The table above shows the performance impact on the total return of bond indexes over a one year period upon a parallel shift in interest rate across the yield curve.

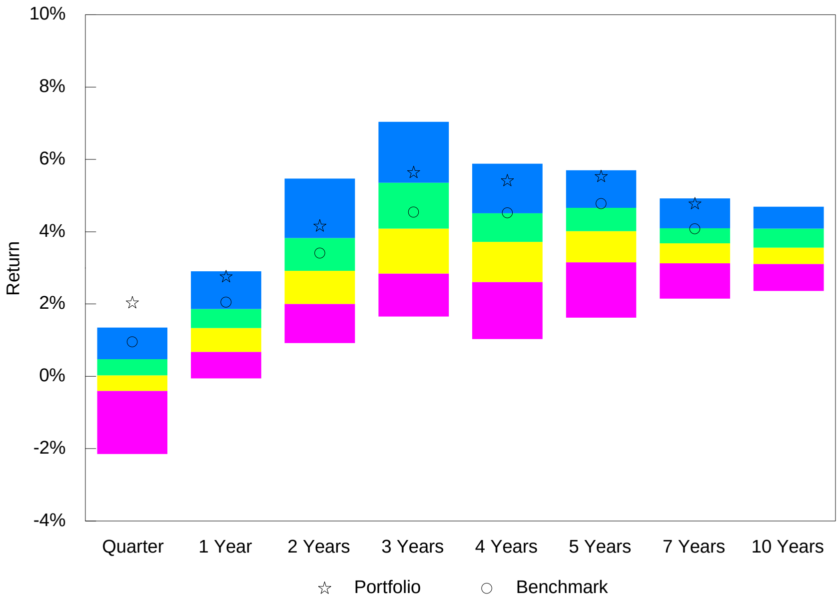
CONSOLIDATED BALANCE SHEET and CASH FLOW SUMMARY FOR THE FISCAL YEAR

JULY 1, 2011 TO SEPTEMBER 30, 2011

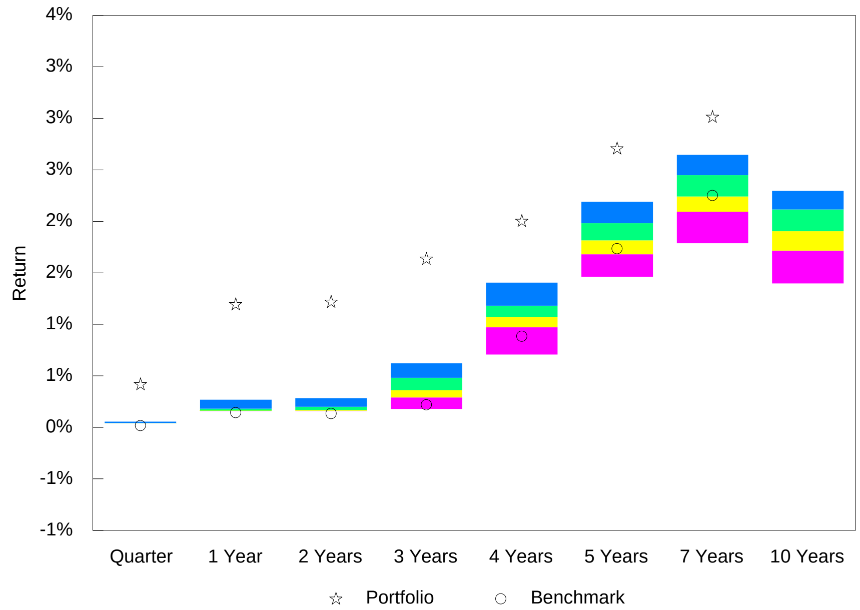
Manager	Beginning Balance	Net Cash Flows	Income	Gain/(Loss)	Ending Balance
Total Fund	**$998,822,600**	**($118,992,900)**	**$3,855,900**	**$4,460,700**	**$888,146,300**
Externally Managed					
Hillswick Asset Mgmt	$152,934,600	$0	$698,900	$4,215,600	$157,849,100
Reams Asset Mgmt	$159,512,400	$0	$944,500	$476,900	$160,933,800
Total Externally Managed	$312,447,000	$0	$1,643,400	$4,692,500	$318,782,900
Short-Term Account	$686,375,600	($118,992,900)	$2,212,500	($231,800)	$569,363,400

Note: The totals may differ slightly from the actual sums due to rounding.

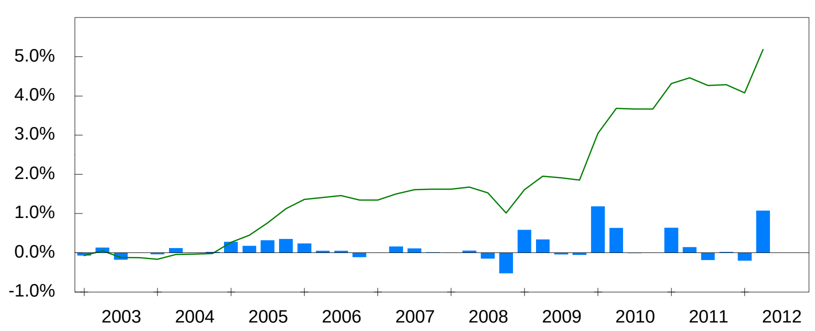
TOTAL EXTERNAL MGRS VS. PEER GROUP



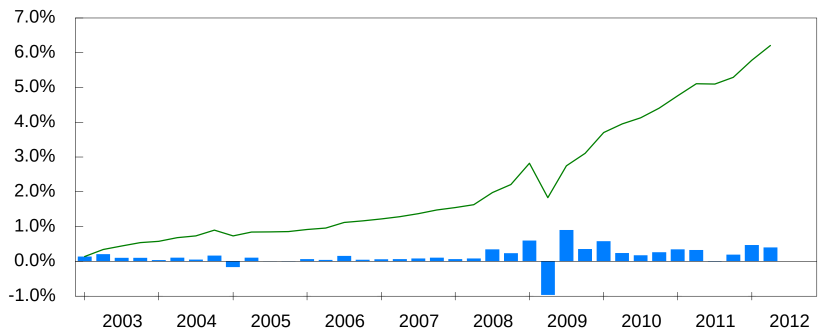
SHORT-TERM VS. PEER GROUP



TOTAL EXTERNAL MGRS VALUE ADDED



SHORT-TERM VALUE ADDED



MANAGER SCORECARD

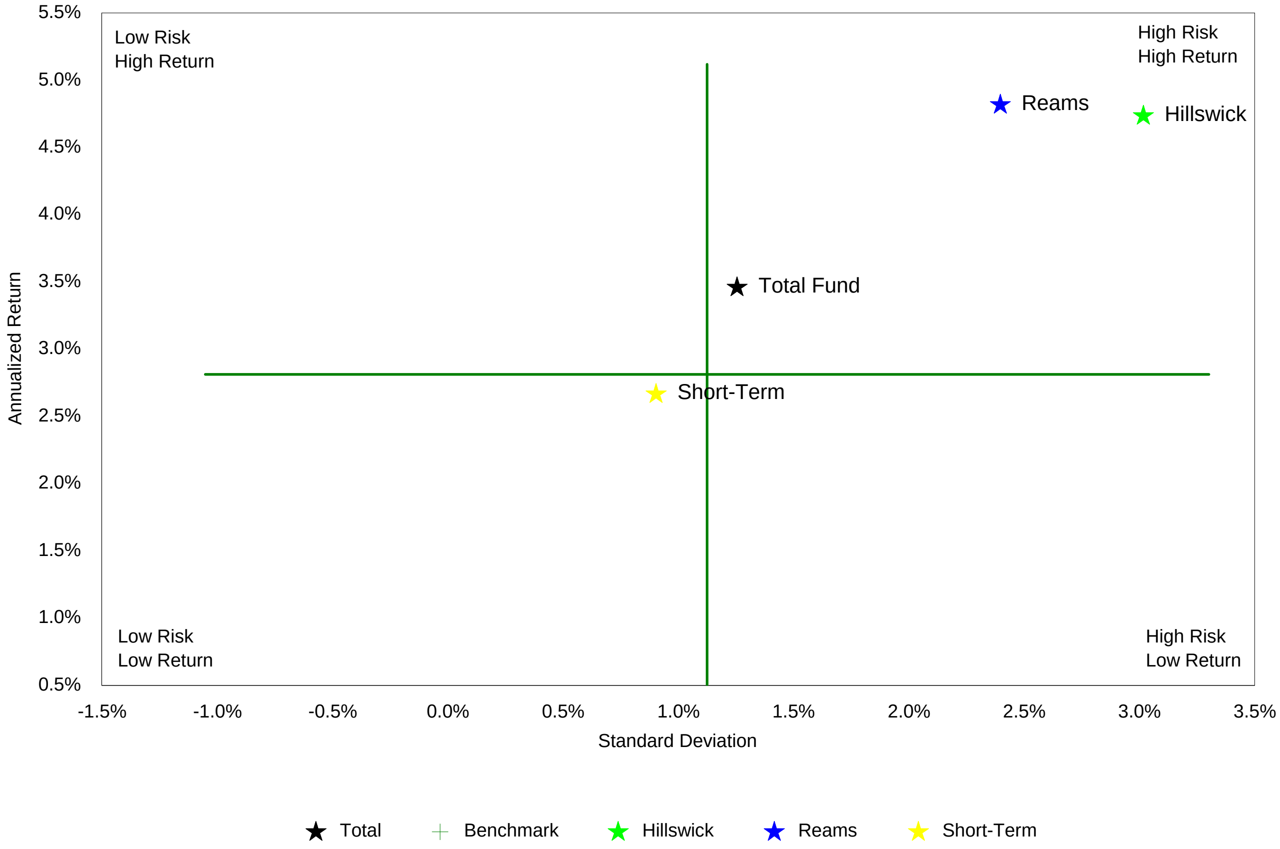
FROM INCEPTION

Manager	Return	Index Return	Std Dev	Alpha	Beta	Batting Average	Incept
Total Fund	3.46	2.81	1.26	0.44	1.20	816	2Q02
Hillswick Asset Mgmt.	4.74	4.17	3.02	0.24	1.14	474	2Q02
Reams Asset Mgmt.	4.82	4.17	2.40	0.99	0.84	632	2Q02
Short-Term Account	2.67	2.01	0.90	0.76	0.35	921	2Q02

INVESTMENTS VS. POLICY BENCHMARKS

Manager	1 Year Benchmark	1 Year Univ Med	3 Year Benchmark	3 Year Univ Med	Alpha	Beta <1.10
Total Fund	Exceed	Exceed	Exceed	Under	Positive	High
Hillswick Asset Mgmt	Exceed	Exceed	Exceed	Exceed	Positive	High
Reams Asset Mgmt	Exceed	Exceed	Exceed	Exceed	Positive	Low
Short-Term Account	Exceed	Exceed	Exceed	Exceed	Positive	Low

RISK / RETURN ANALYSIS
(FROM INCEPTION)



Alpha

Alpha is a measure of the value added (or the excess return of a portfolio versus the benchmark - adjusted for risk) for an actively managed portfolio. It is generally interpreted as a measure of a manager's skill as the result of security selection and asset allocation - the higher the number the better.

Batting Average

Batting Average is a measure of how often the manager has beaten the benchmark. A batting average of 600 indicates that the manager has beaten the portfolio benchmark (or comparable market index) six out of every ten quarters, or 60% of the time.

Beta

Beta is a measure of a manager's risk vs the benchmark. A beta of 1.0 indicates that a portfolio has roughly the same volatility as the benchmark. A beta greater than 1.0 indicates that the portfolio is more volatile or sensitive to changes in the market.

Duration

Duration is a measure of the sensitivity in the price of a bond to changes in interest rates, so it is a measure of risk in a fixed income portfolio. As a rule of thumb, a fixed income portfolio with a duration of 5 (years) will decline 5% in value for every 1% upward movement in comparable interest rates.

Standard Deviation

Standard deviation is a measure of the dispersion of a portfolio's return around its expected return. A higher standard deviation indicates greater dispersion and, therefore, lower predictability of future returns.