Fourth Quarter 2011
Investment Review

THE METROPOLITAN WATER DISTRICT
of SOUTHERN CALIFORNIA

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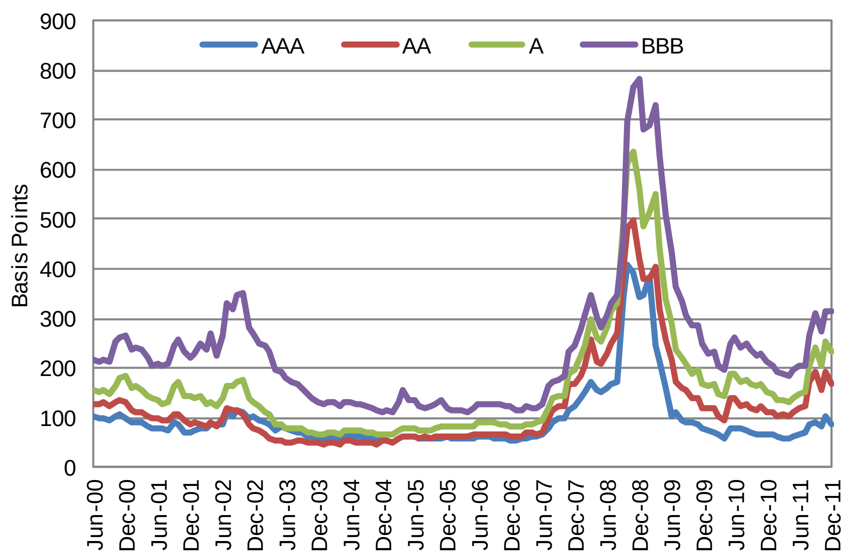
MARKET SNAPSHOT

DECEMBER 31, 2011

Index	Qtr	One Year	Three Year	Five Year
S&P 500	11.8%	2.1%	14.1%	-0.2%
Dow Jones Industrial	12.8%	8.4%	14.9%	2.4%
Wilshire 5000	12.0%	0.6%	15.3%	0.3%
MSCI EAFE Index	3.3%	-12.1%	7.6%	-4.7%
Barclays Aggregate	1.1%	7.8%	6.8%	6.5%
ML G/C 1-5 Yr A+	**0.4%**	**3.1%**	**3.4%**	**4.7%**
ML 3 Month T-Bill	**0.0%**	**0.1%**	**0.1%**	**1.5%**

Credit Securities Rebound



Source: Merrill Lynch Global Indices

- The global stock markets registered disappointing returns in 2011, as investors struggled with the European debt crisis, natural disasters, and low economic growth. The S&P 500 index declined by -0.2% for the year, offset by +2.3% in dividends. The return of the DJIA was larger due to the impact of high (share) priced stocks, like IBM, which gained more than 25%.
- 2011 was a roller coaster ride, with several moves of ±20% in the major indexes. The small cap market (Russell 2000) was even more volatile, as weak economic data and the debate over the debt ceiling in late summer brought back memories of 2008.
- As investors regained confidence in October, they moved back into economically sensitive cyclical stocks, but for the full year the defensive sectors led the market; large cap growth was the best style.
- The international markets underperformed the US by more than -14% in 2011. The problems in Europe and Japan had the biggest impact on the EAFE index, while concerns over growth in China, combined with EM currency losses of -5.7%, held back the emerging markets.
- Commercial real estate remained strong through-out the year, especially in the apartment sector. The 6%+ yield on the National Property Index was helped by even larger capital gains.
- Hedge funds were unable to gain traction in this volatile year, and commodity prices declined due to low growth and a reversal in speculation. Even gold declined as investors became accustomed to the macro concerns that fueled previous gains.
- The strong returns in the US bond market in 2011 were all about the flight to safety in US treasury bonds. High yield corporate debt followed the volatility of the stock market, but ended the year with average yields of more than 7% vs. 2.3% on the Barclays US Aggregate Bond Index.

Slow, But Positive Signs of Growth

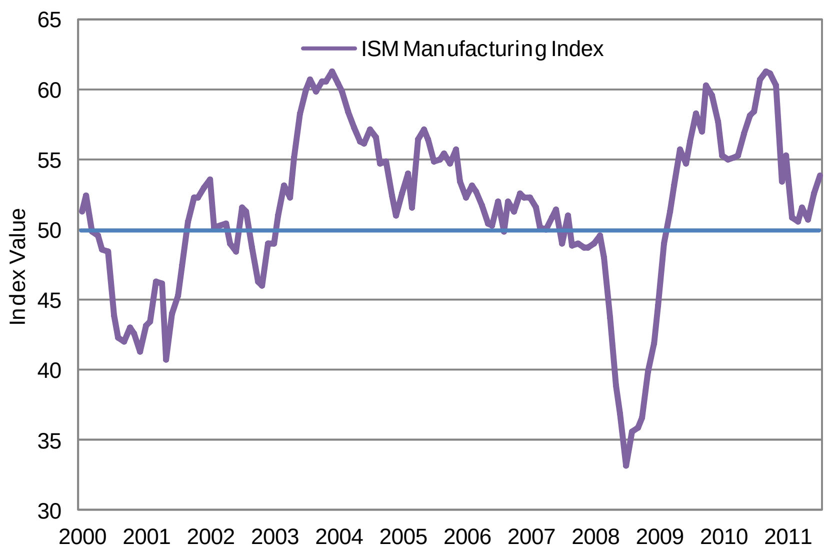
- The US economy grew at 2.8% in 4Q11, its fastest pace in more than a year, as manufacturers rebuilt inventory and retail sales improved. Consumer spending grew at 2%, compared to 1.7% in 3Q11, but unfortunately it was driven by a decline in the savings rate to 3.5%.

- Underlying demand remains weak, with persistent slack in the economy, so slower growth is expected in the coming year. The 3.0% y/y increase in the CPI should be interpreted as evidence of both the low rate of growth and the slack in output.

- The economic picture does have some positives; the unemployment rate declined in December to 8.5%, and the ISM manufacturing index is showing strength. But nothing in the data suggests that the slow growth of the last several years will end soon.

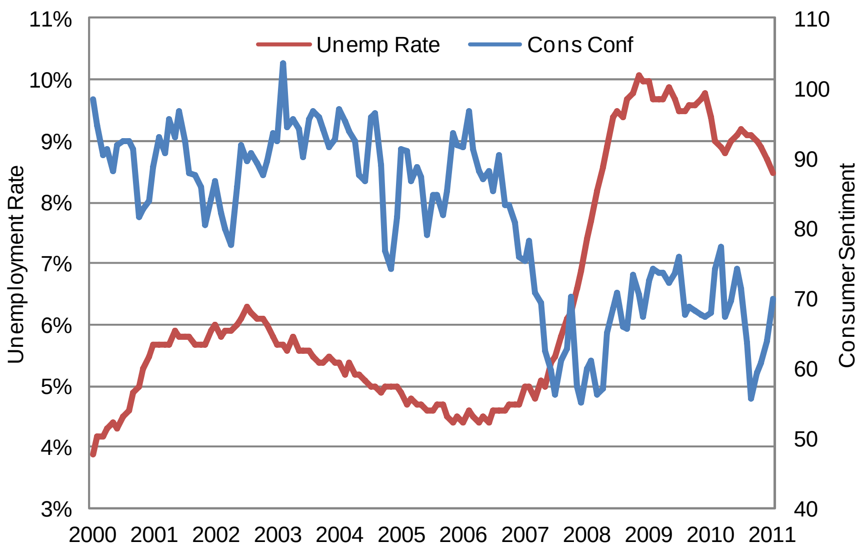
- The Joint Select Committee on Deficit Reduction (the Super Committee) failed to reach an agreement in November and the Europeans are still trying to solve their debt problems. Our guess is that these issues don't get resolved until a significant (future) crisis forces a political solution.

Improving Manufacturing Activity



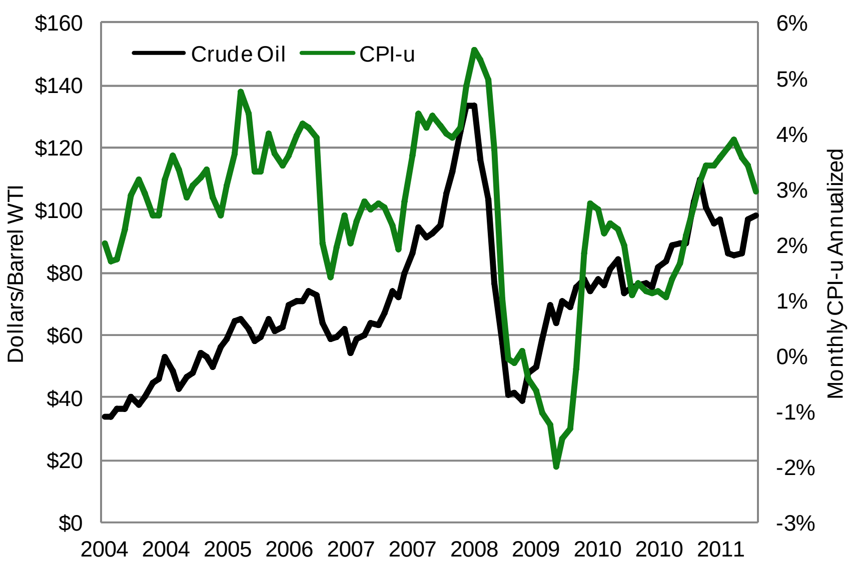
Source: ISM

Falling Unemployment Rate



Source: Bureau of Labor Statistics, University of Michigan

Inflation is not an Immediate Concern



Source: Bureau of Labor Statistics

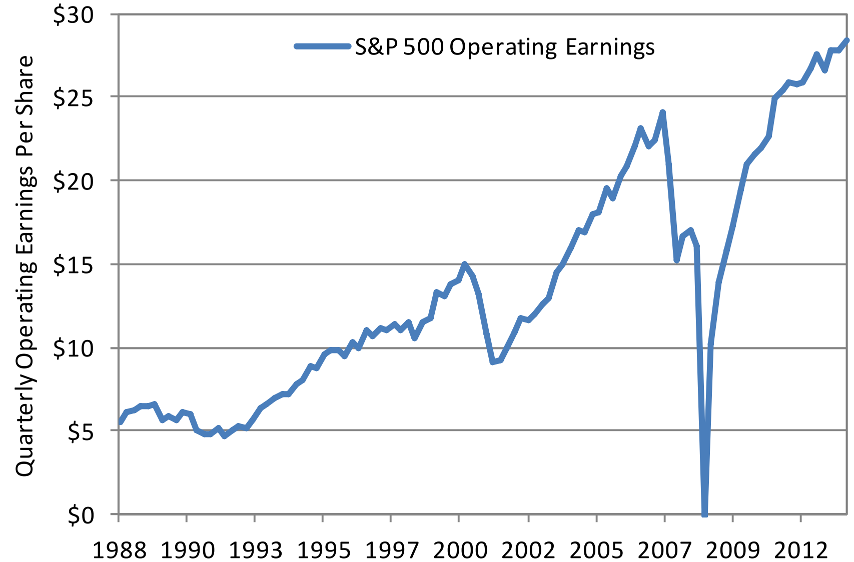
US Equity Managers Struggle in 2011

- Large US stocks rebounded in the fourth quarter, but nearly 80% of the active managers underperformed the benchmark indexes in 2011; growth managers were particularly challenged, with only 11% beating the Russell 1000 Growth Index, due to a combination of high volatility and high correlation among individual stocks.

- Defensive sectors led the US market, with utilities (+19.9%), consumer staples (+13.9%), and healthcare (+12.7%) outperforming the cyclical sectors like financials (-17.1%) and materials (-9.8%). Even though defensive sectors are often held by value managers, growth portfolios outperformed due to low weightings in the cyclical sectors.

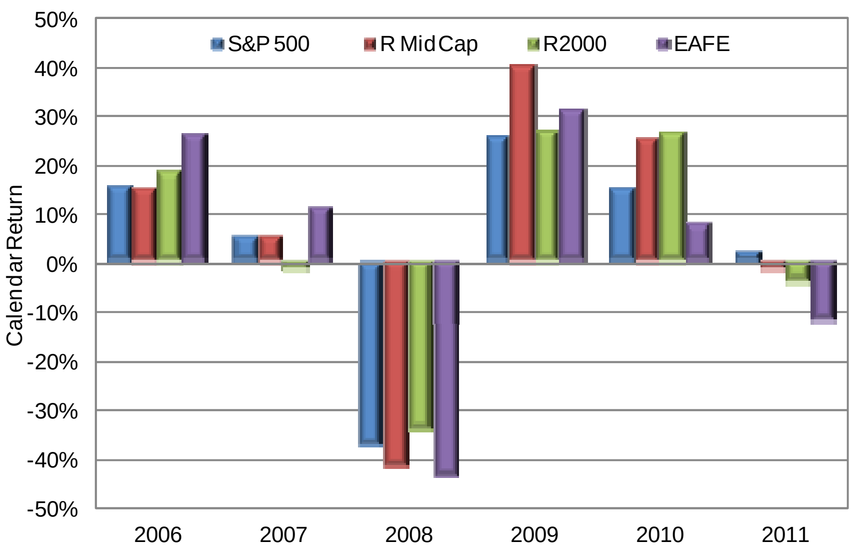
- The good news is that S&P 500 earnings per share and cash flow per share are hitting new highs; combining that with an average PE ratio below 13 and an increase in dividends and stock buy backs, it looks like an attractive time to buy US stocks. The best strategies for 2011 focused on yield (dividend strategies gained +18%); however, many other value strategies, like low P/E and low P/B, underperformed.

Earnings Reach New Highs



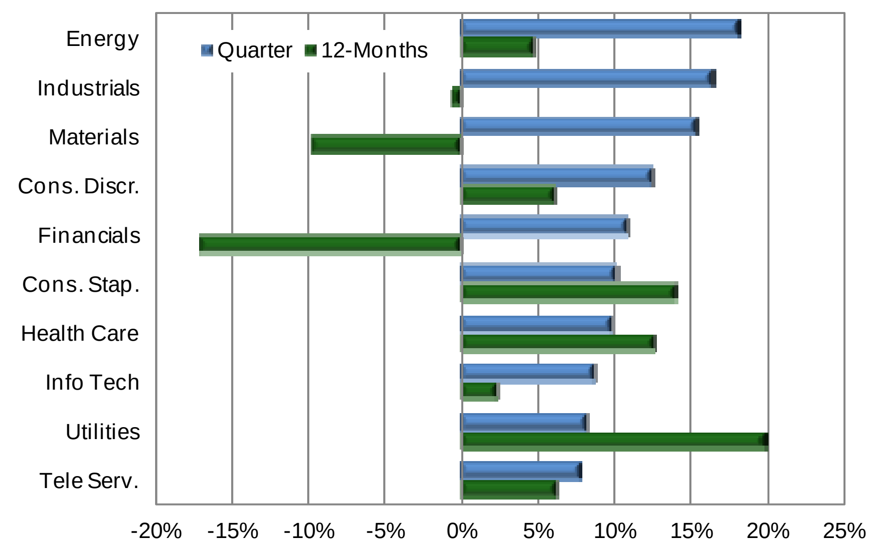
Source: Standard & Poor's

A Volatile Year Ends where It Began



Source: Standard & Poor's, Russell, and MSCI Barra

Cyclical Stocks Rebound



Source: Standard & Poor's

Big Year for Long Bonds

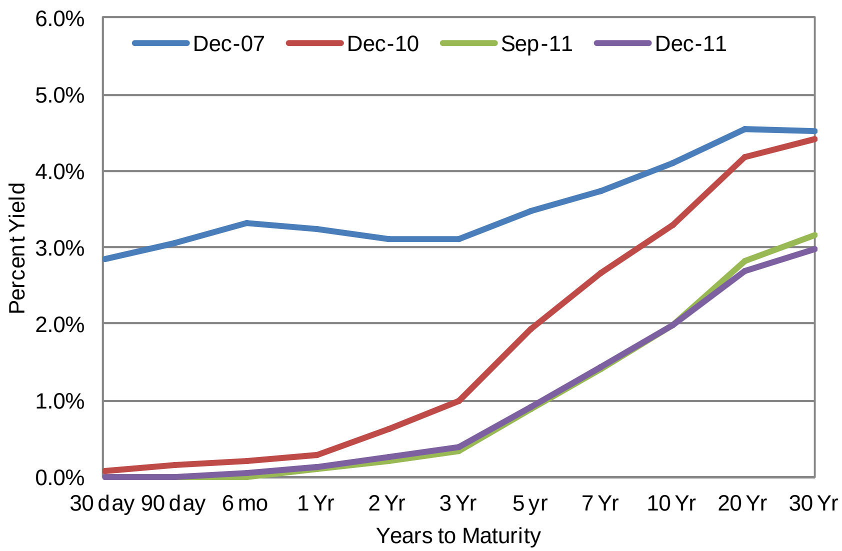
- The Barclays US Aggregate Bond Index gained +7.8% in 2011, and ended the year with a yield of 2.3%. Most of the gains came from US treasuries (+9.8%). Long treasuries gained +29.9%, TIPS gained +13.6%, and the whole market benefitted from the flight to quality and the Fed's promise to keep rates low, perhaps until 2014.

- 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.

- Credit securities (such as corporate bonds) returned an average of 8.4% in 2011, but underperformed duration-matched treasuries by 322 bps; mortgages also underperformed treasuries by 106 bps.

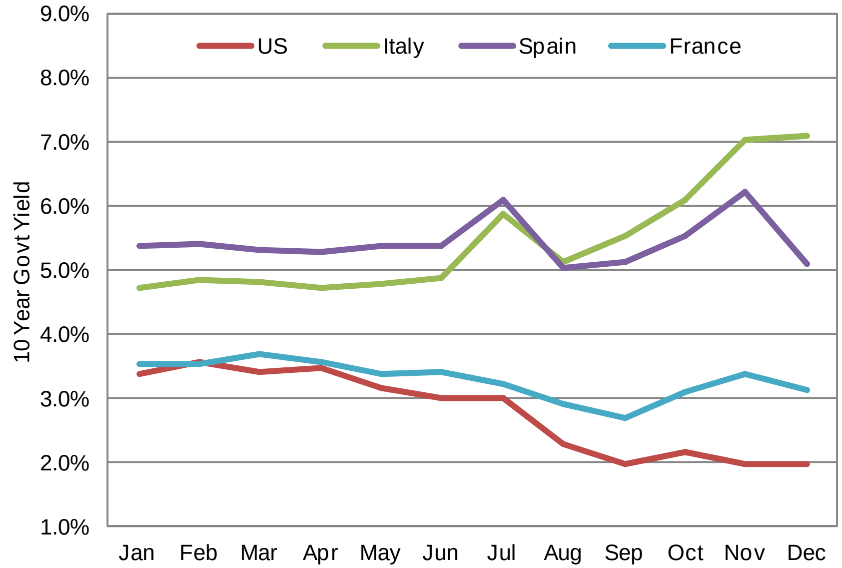
- Against the backdrop of mixed economic data, the credit sector ended the year at a spread of more than 2% (71 bps wider than last year), with junk bonds yielding nearly 8%. Corporate bonds look cheap given the strong balance sheets and cash flow in many US corporations.

Treasury Yields Remain Low



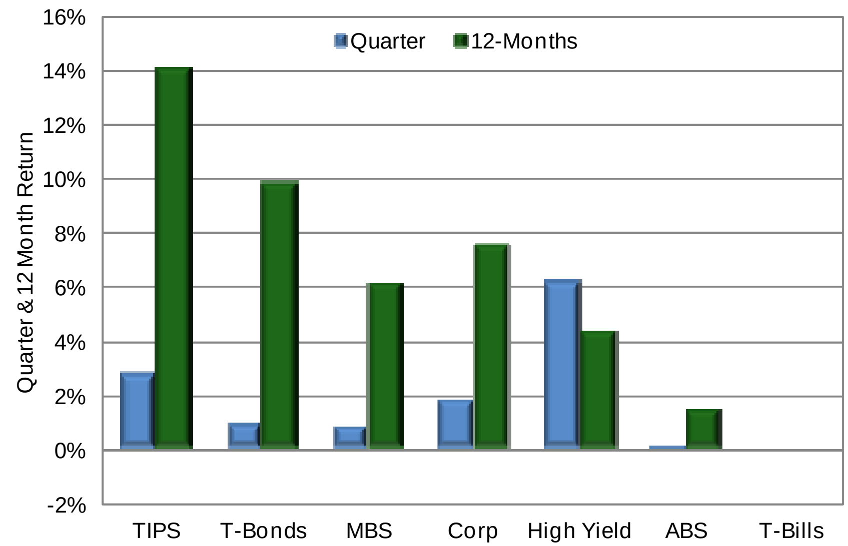
Source: Federal Reserve

Debt Crisis is Reflected in Higher Yields



Source: Federal Reserve, Bloomberg

High Yield Bonds Outperform



Source: Merrill Lynch

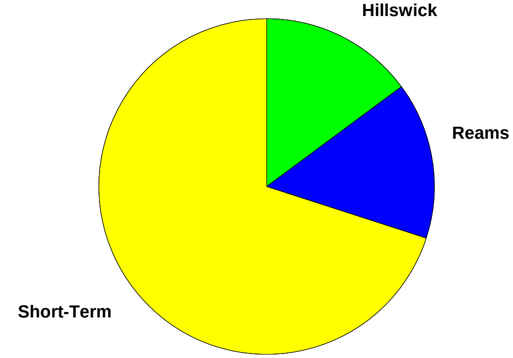
PORTFOLIO SUMMARY
DECEMBER 31, 2011

	Assets	Weight
Managed Accounts		
Hillswick Asset Mgmt	$158,657,000	15%
Reams Asset Mgmt	$161,670,100	15%
Total External Managed	$320,327,100	30%
Short-Term Account	$747,961,800	70%
Grand Total	**$1,068,288,900**	100%

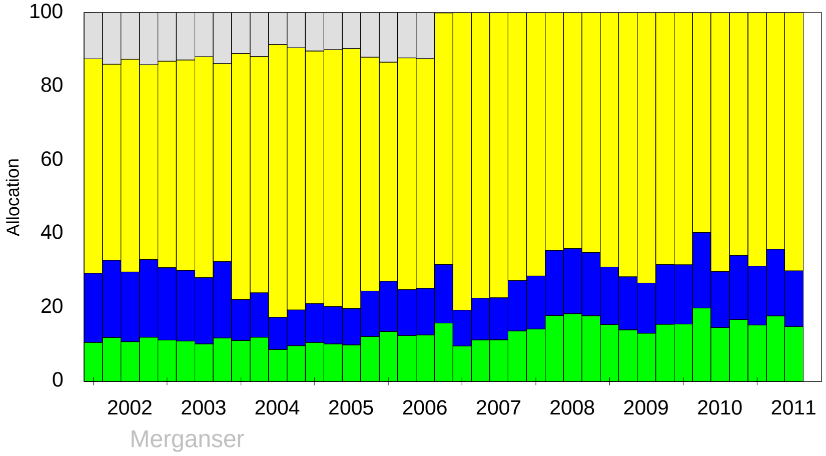
- The value of the Total Fund increased by $180.1 million in the fourth quarter, due to net cash inflow of $177.7 million and earnings of $2.4 million.
- Net investment earnings for the quarter were:

Hillswick	$0.8 million
Reams	$0.7 million
Short-Term	$0.9 million
Total	$2.4 million

CURRENT ALLOCATION



HISTORICAL ALLOCATION



PERFORMANCE SUMMARY - TOTAL RETURN

DECEMBER 31, 2011

Manager	Quarter	Fiscal YTD	1 Year	3 Years	5 Years
Total Fund	0.3%	1.3%	2.4%	2.5%	3.5%
Benchmark[1]	0.1%	0.5%	1.0%	1.2%	2.4%
Hillswick Asset Mgmt	0.5%	3.7%	5.2%	3.5%	5.2%
ML G/C 1-5 yr. A & above	0.4%	1.3%	3.1%	3.4%	4.7%
Reams Asset Mgmt	0.5%	1.4%	2.9%	5.6%	5.5%
ML G/C 1-5 yr. A & above	0.4%	1.3%	3.1%	3.4%	4.7%
Total External Managers	0.5%	2.5%	4.1%	4.5%	5.4%
ML G/C 1-5 yr. A & above	0.4%	1.3%	3.1%	3.4%	4.7%
Short-Term Account	0.1%	0.6%	1.3%	1.3%	2.5%
ML 90-day T-Bill	0.0%	0.0%	0.1%	0.1%	1.5%

[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 continues to exceed the benchmark index due to strong performance by Hillswick and the Staff-Managed Short-Term Account, as treasury yields fell to new lows in the quarter.
- The returns for the Externally-Managed and Staff-Managed portfolios continue to rank above the top 10% of their respective universes (see page 8). Even the Total Fund, with its large cash position, is above median in the limited duration fixed income universe.
- More than eighty percent (80%) of the active stock and bond managers underperformed in 2011. But Hillswick outperformed with good duration management and Reams came close with good security selection.
- Hillswick has added volatility to the portfolio, but our hats are off to the firm for their correct and contrarian call that low growth would lead to further declines in long treasury yields.
- Reams maintains a more conventional portfolio, with 33% in corporate bonds and 22% in mortgage bonds. Their allocation to investment grade credit added to performance in the fourth quarter, but mortgage bond selection added most to the full year.
- Cash management hit the headlines in January with a cover story in Barron's declaring "Broken Forever". The headline referred to the Fed actions that have caused cash management portfolios, especially money market funds, to provide zero returns.
- In light of the difficult cash management environment, the Short-Term Account continues to outperform. Most of this outperformance is due to strong and diversified security selection. The universe comparison on page 8 shows the extent of the strong relative performance.

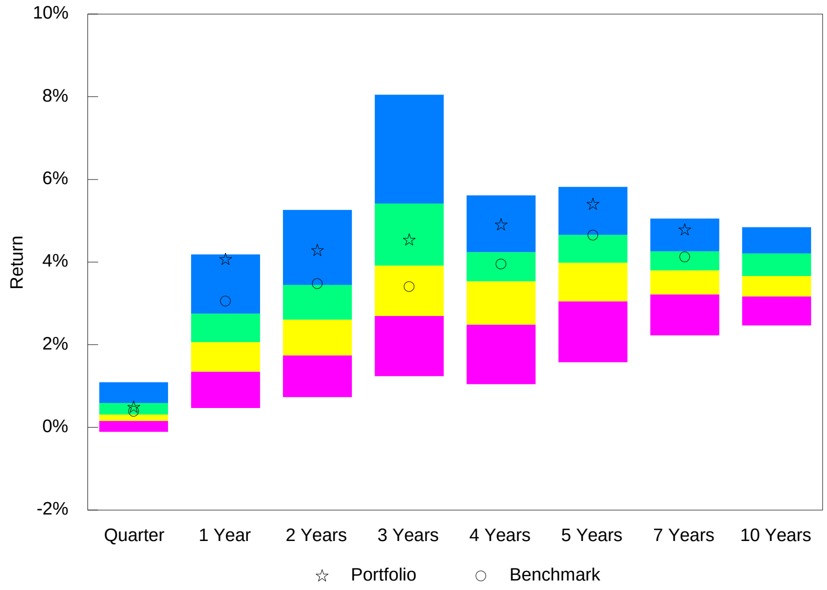
CONSOLIDATED BALANCE SHEET and CASH FLOW SUMMARY FOR THE FISCAL YEAR

JULY 1, 2011 TO DECEMBER 31, 2011

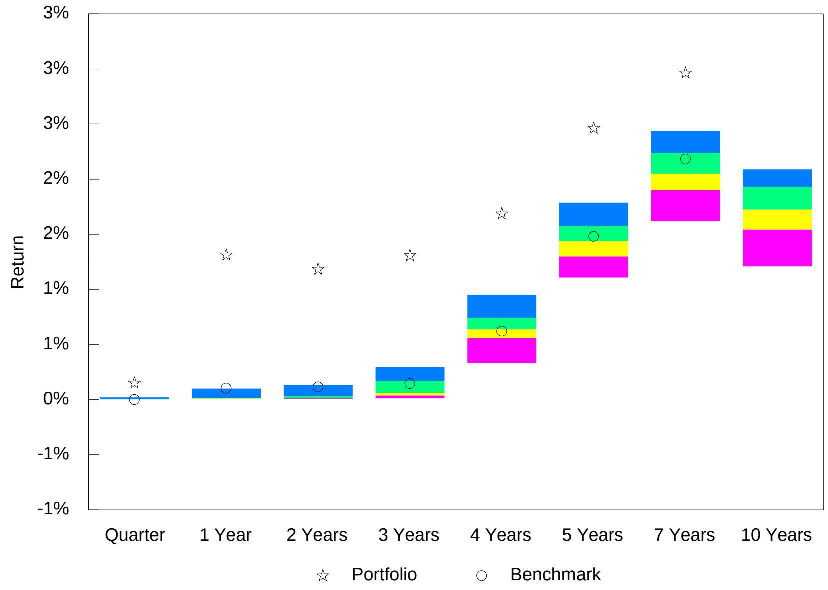
Manager	Beginning Balance	Net Cash Flows	Income	Gain/(Loss)	Ending Balance
Total Fund	**$998,822,600**	**$58,664,100**	**$7,759,700**	**$3,042,700**	**$1,068,289,100**
Externally Managed					
Hillswick Asset Mgmt	$152,934,600	$0	$1,349,100	$4,373,400	$158,657,100
Reams Asset Mgmt	$159,512,400	$0	$1,717,400	$440,400	$161,670,200
Total Externally Managed	$312,447,000	$0	$3,066,500	$4,813,800	$320,327,300
Short-Term Account	$686,375,600	$58,664,100	$4,693,200	($1,771,100)	$747,961,800

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

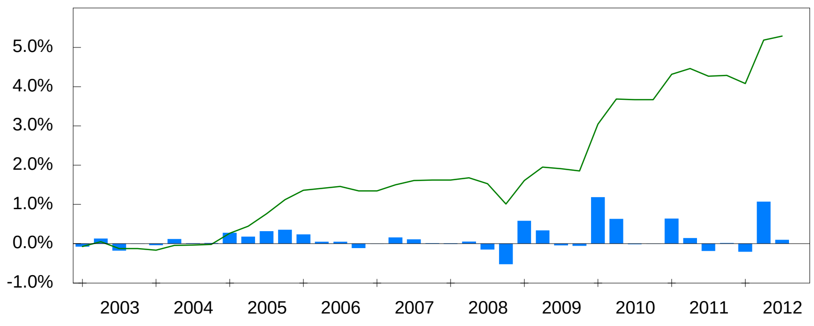
TOTAL EXTERNAL MGRS VS. PEER GROUP



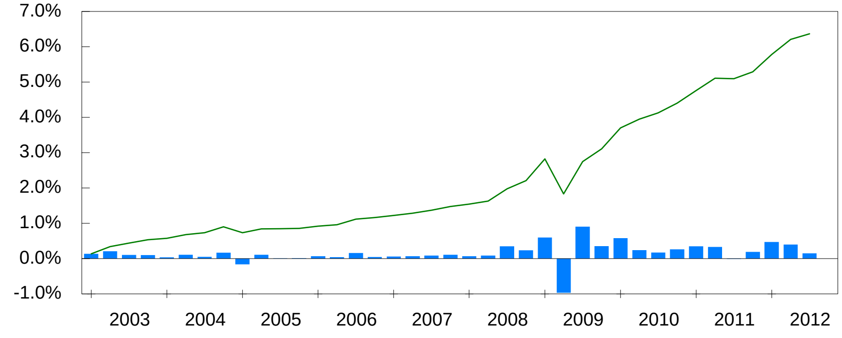
SHORT-TERM VS. PEER GROUP



TOTAL EXTERNAL MGRS VALUE ADDED



SHORT-TERM VALUE ADDED



MANAGER SCORECARD

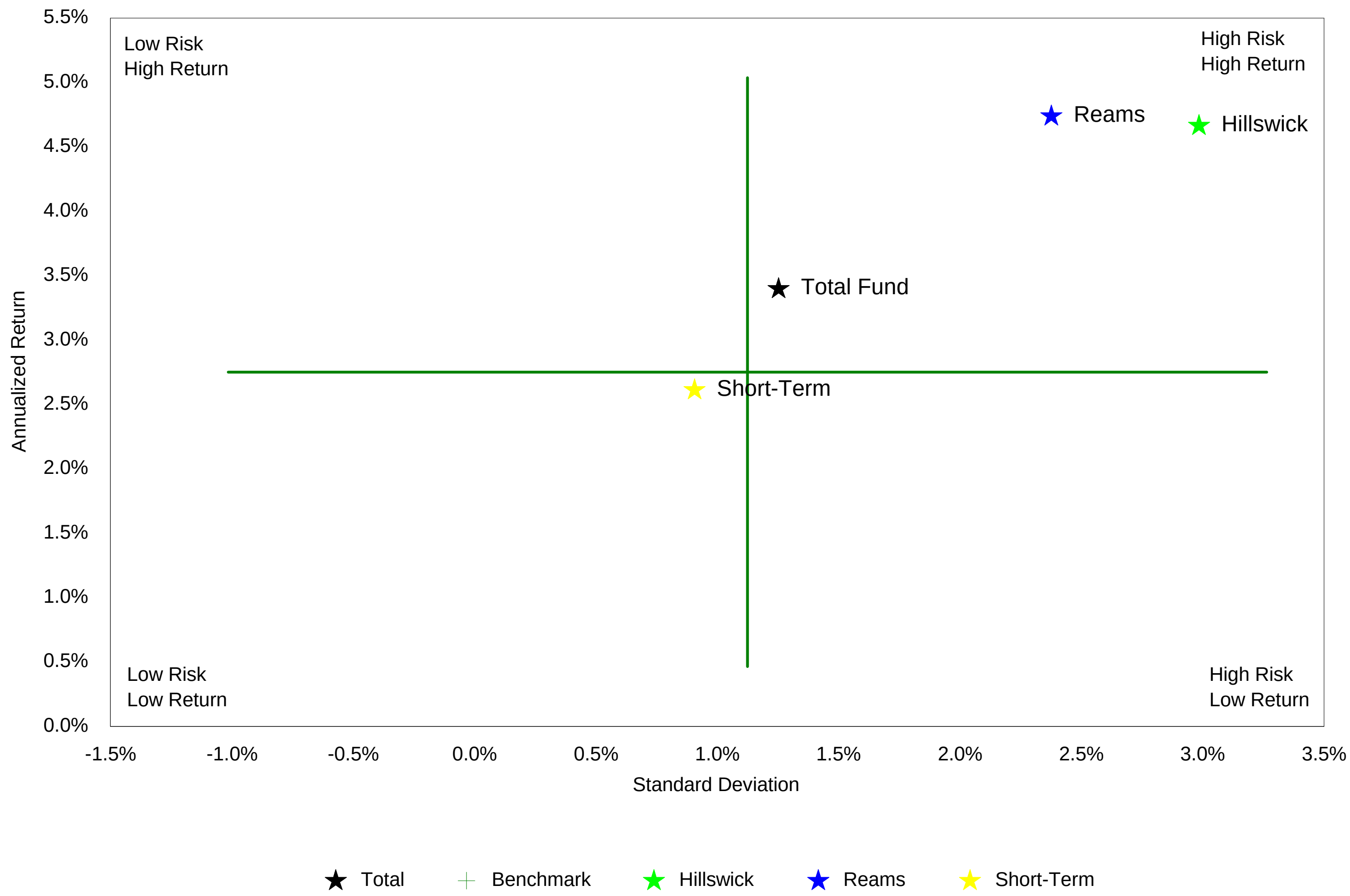
FROM INCEPTION

Manager	Return	Index Return	Std Dev	Alpha	Beta	Batting Average	Incept
Total Fund	3.40	2.75	1.25	0.44	1.20	821	2Q02
Hillswick Asset Mgmt.	4.67	4.10	2.99	0.24	1.14	487	2Q02
Reams Asset Mgmt.	4.74	4.10	2.38	0.98	0.84	641	2Q02
Short-Term Account	2.61	1.96	0.91	0.75	0.36	923	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	Under	Positive	High
Reams Asset Mgmt	Under	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.