Third Quarter 2012
Investment Review

THE METROPOLITAN WATER DISTRICT *of* SOUTHERN CALIFORNIA

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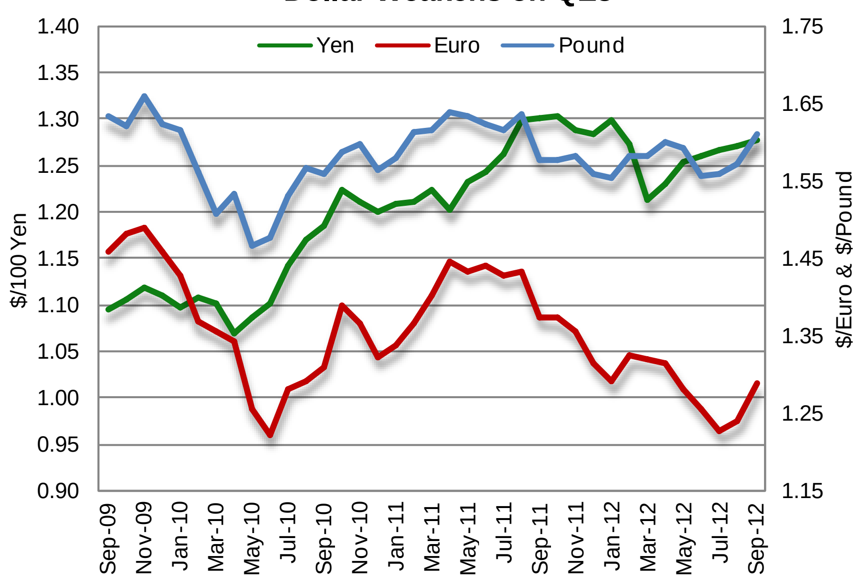
MARKET SNAPSHOT
SEPTEMBER 30, 2012

Index	Qtr	One Year	Three Year	Five Year
S&P 500	6.4%	30.2%	13.2%	1.1%
Dow Jones Industrial	5.0%	26.5%	14.5%	2.2%
Wilshire 5000	6.1%	29.6%	13.3%	1.5%
MSCI EAFE Index	6.9%	13.8%	2.1%	-5.2%
Barclays Aggregate	1.6%	5.2%	6.2%	6.5%
ML G/C 1-5 Yr A+	**0.8%**	**2.2%**	**3.0%**	**4.1%**
ML 3 Month T-Bill	**0.0%**	**0.1%**	**0.1%**	**0.7%**



Source: US Federal Reserve

- Global stock markets posted another strong quarter lifting returns well above investors' pessimistic expectations. The Fed helped by announcing an ongoing $40 billion per month program of MBS purchases "until employment improves".
- Growth has performed better than value, but active managers are still struggling to keep up with the strong market. Economically sensitive (cyclical) sectors such as energy (+10%) and consumer discretionary (+7%) outperformed.
- Small and mid-cap stocks have not been performing as well as large stocks, especially the mega-caps, due to risk concerns and higher valuations (PEs).
- The international markets outperformed the US, but there is still concern about the slowdown in China and the deepening recession in Europe. Stronger EAFE and EM currencies added about 2% to this performance.
- Commodities rebounded in the quarter, driven primarily by higher energy prices. The return on other real assets were constrained by low growth and low inflation, except for commercial real estate, which has an attractive 6% yield.
- Hedge funds have struggled in this environment along with other active management styles.
- A small back-up in treasury yields was offset by very strong demand for corporate bonds, especially high yield corporate debt.
- The CPI index picked-up in the third quarter, with the rise in energy prices, but inflation does not seem to be a concern. Cash yields are also expected to remain close to zero until 2015.

US Economy Still Weak, But Improving

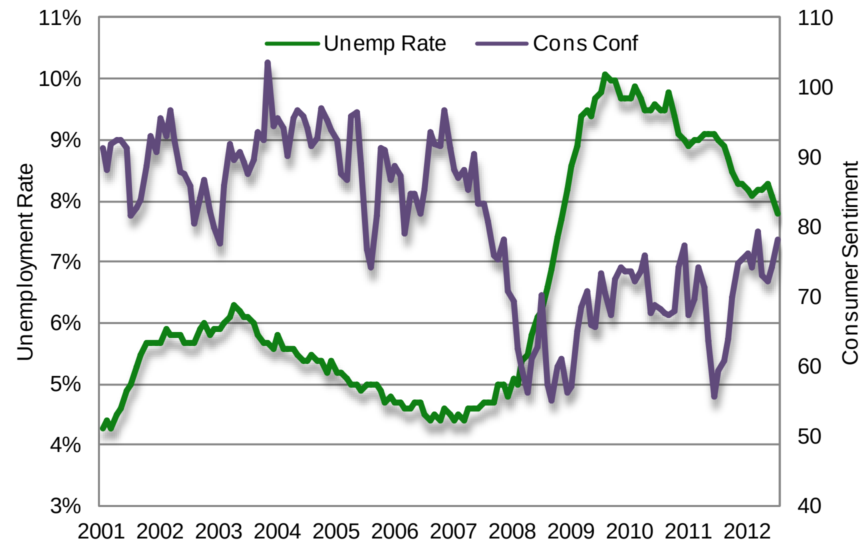
- The US economy has not gained any significant momentum, but there were several positive developments in the third quarter. For the first time in 43 months, the unemployment rate fell below 8% and settled at 7.8% for September as 114,000 new jobs were created.

- The ISM Manufacturing Index came out of an apparent summer slowdown in September with a reading of 51.5, signaling the first period of expansion since May.

- The housing market finally appears to be turning a corner with the help of record-low mortgage rates. The S&P Case-Shiller index of property values in 20 cities increased 1.2% in the 12 months ending July 2012, which was the biggest increase since August 2010.

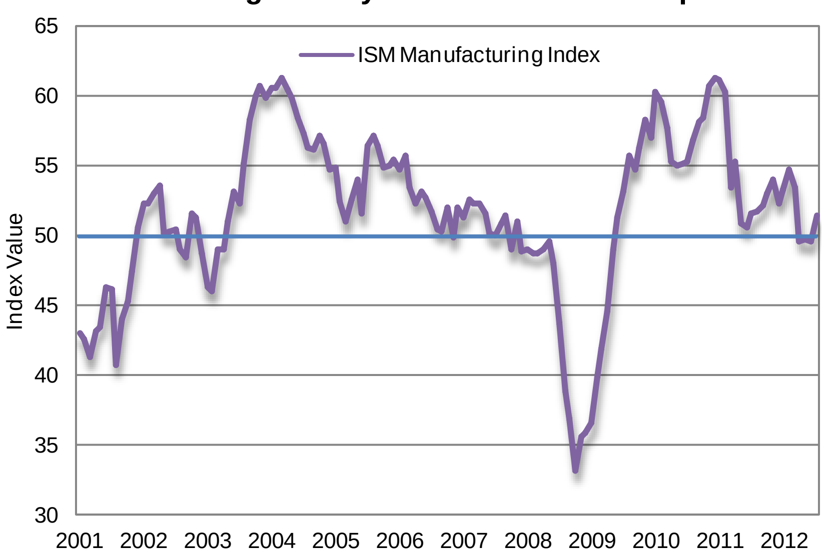
- Construction spending fell slightly in August (-0.6%), but was up 9% year-over-year for the first eight months of 2012.

Employment and Confidence Are Slowly Improving



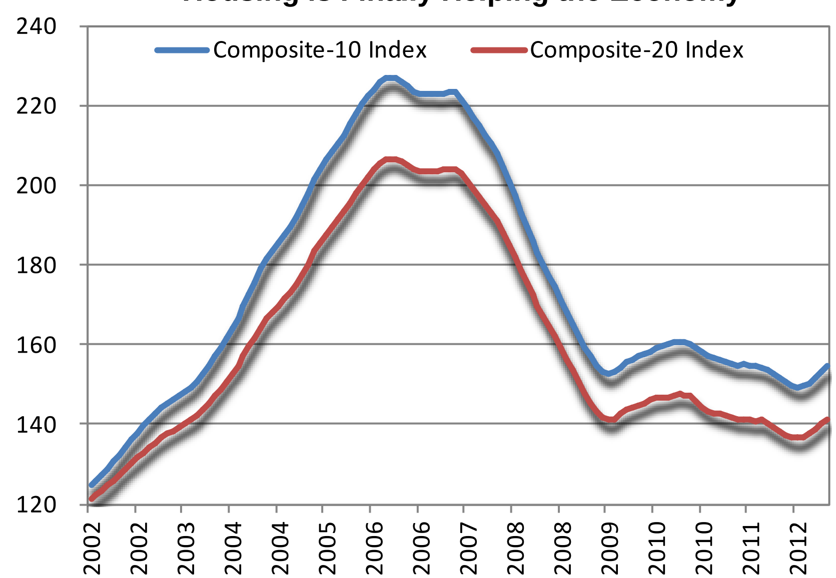
Source: Bureau of Labor Statistics, University of Michigan

Manufacturing Activity Rebounds a Bit in September



Source: ISM

Housing is Finally Helping the Economy

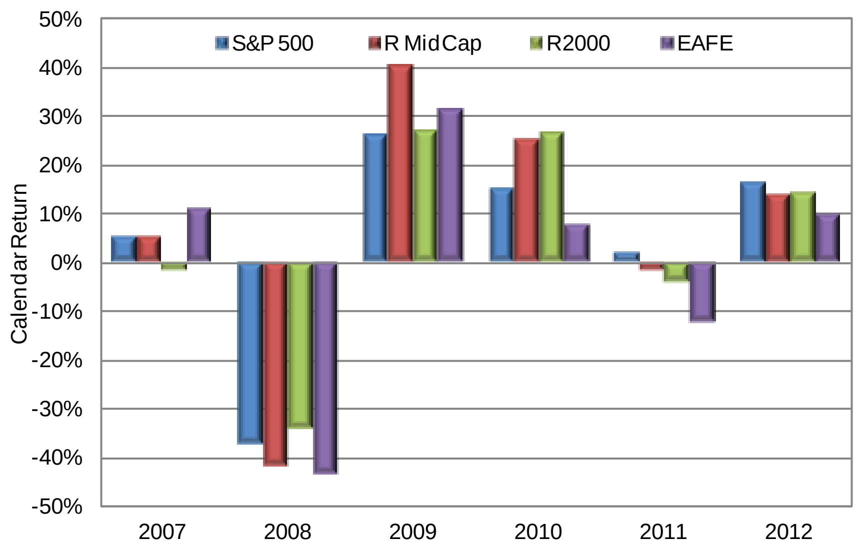


Source: S&P/Case-Shiller

Strong Quarter for US Equities

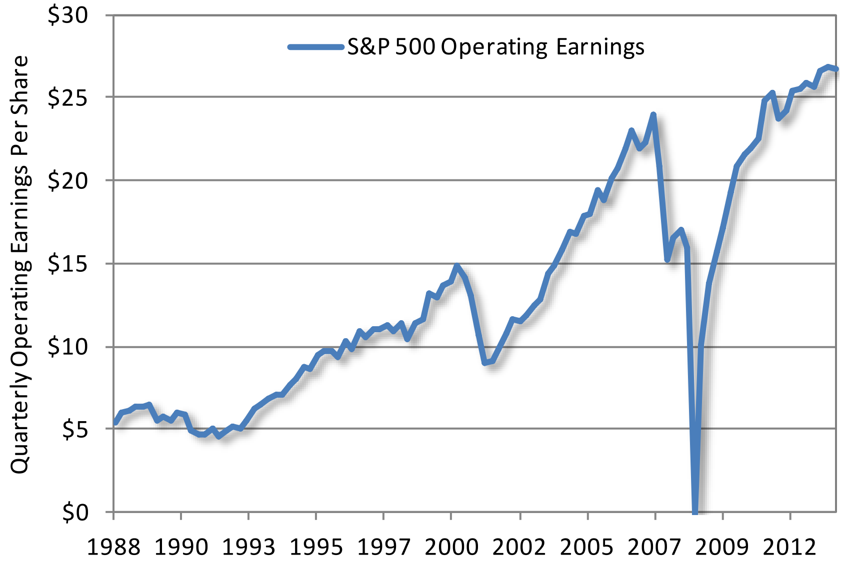
- It was another "risk on" quarter for the US stock market as investors' fears once again temporarily subsided. The S&P 500 gained +6.4% and the economically cyclical sectors were in favor as energy (+10.1%), consumer discretionary (7.5%), and information technology (7.5%) led the way. Utilities was the only sector to post a negative return at -0.5%.
- Unlike the last few quarters, value outperformed growth in the third quarter, but small caps still underperformed large caps due to risk and valuation concerns.
- Many active equity managers have struggled to beat the indexes recently; however core managers posted better results this quarter. More than 69% of small, mid, and large core managers beat their indexes in the third quarter. Large growth managers fared the worst, with only 17% exceeding the index.

US Outperforms Other Developed Markets



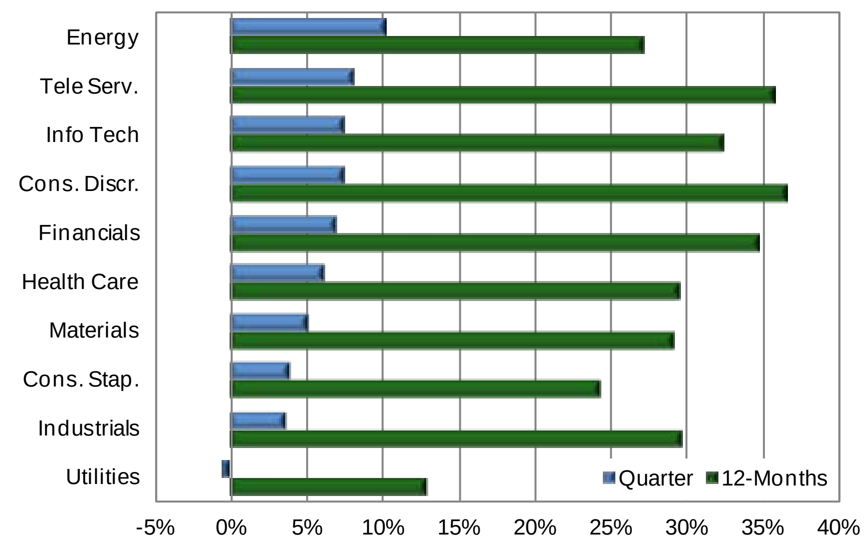
Source: Standard & Poor's, Russell, and MSCI Barra

Earnings Growth Has Stopped



Source: Standard & Poor's

Solid Performance Across Sectors



Source: Standard & Poor's

Fed Actions Support the Bond Market

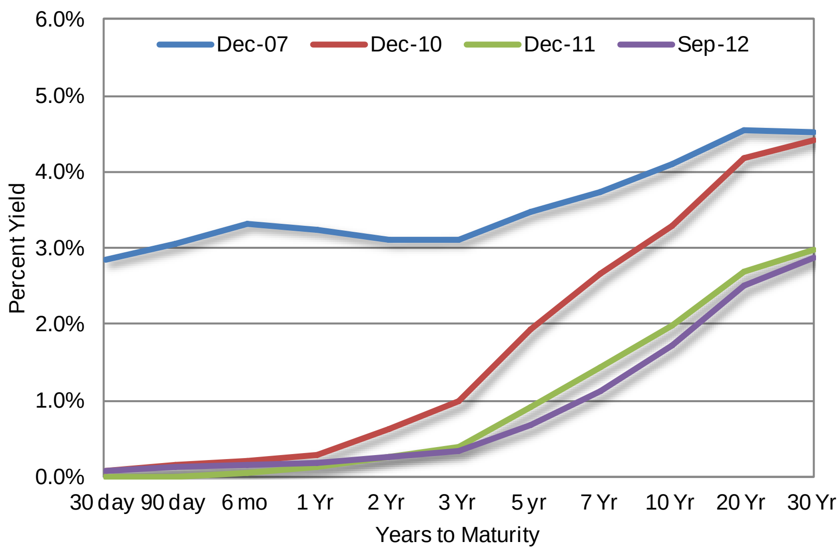
- The Fed announced a widely anticipated third round of quantitative easing in September where they committed to purchasing $40 billion of mortgage-backed securities each month. Unlike the first two rounds which had definitive dollar amounts, the Fed has stated that they will continue these monthly purchases until unemployment improves.

- Treasury yields ended the quarter slightly lower, except for the 30 year which increased by +7 bps to 2.82%. The 10 year treasury experienced a volatile quarter with yields ranging from 1.39% to 1.87%, but ended the quarter at 1.63%.

- The demand for yield continues as investors again flocked to high yield corporate debt in the third quarter. High yield was the best performing sector with a +4.5% gain, followed by corporate bonds with a gain of +3.5%. High yield remains the best performing fixed income sector on a year to date basis with a gain of +12.1%.

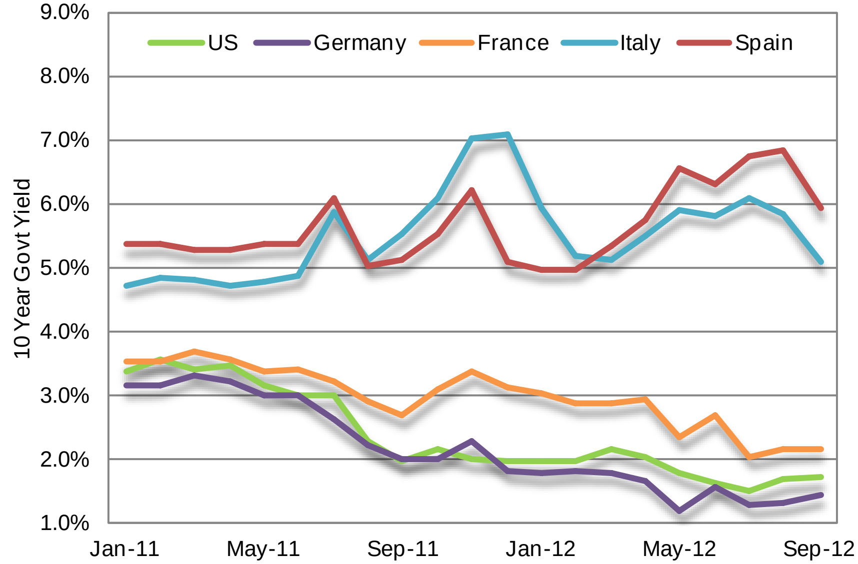
- Yields on Italian and Spanish debt dropped sharply after the ECB announced its bond buying program. The Italian 10 year yield fell 73 bps and the Spanish 10 year yield fell 39 bps.

Treasury Yields Remain Low



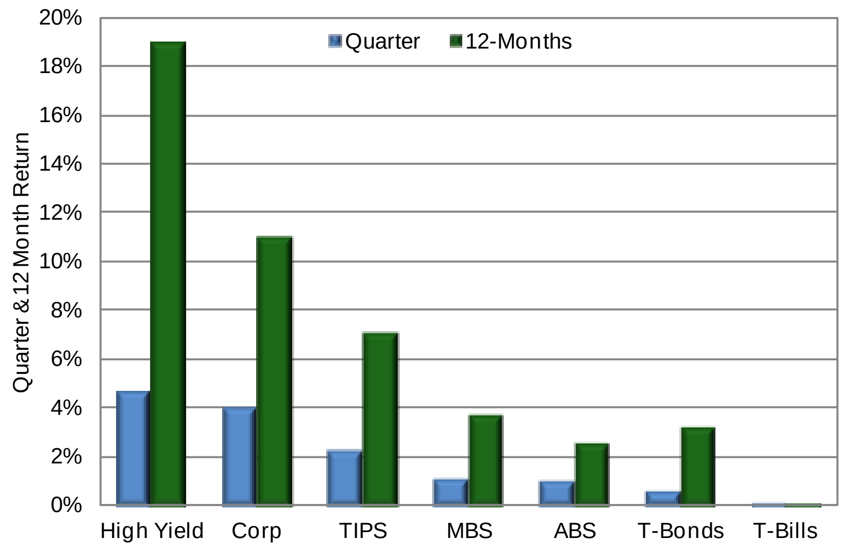
Source: Federal Reserve

European Debt Improves



Source: Federal Reserve, Bloomberg

Another Strong Quarter for Credit



Source: Merrill Lynch

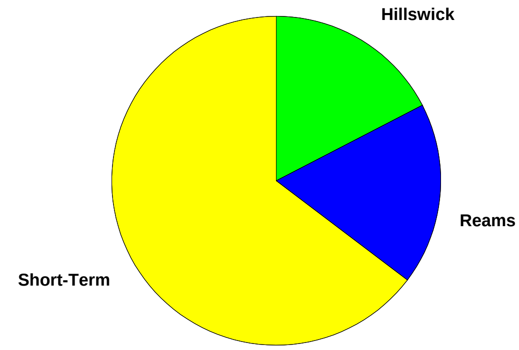
PORTFOLIO SUMMARY
SEPTEMBER 30, 2012

	Assets	Weight
Managed Accounts		
Hillswick Asset Mgmt	$161,799,100	17%
Reams Asset Mgmt	$166,577,500	18%
Total External Managed	$328,376,600	35%
Short-Term Account	$601,378,300	65%
Grand Total	**$929,754,900**	100%

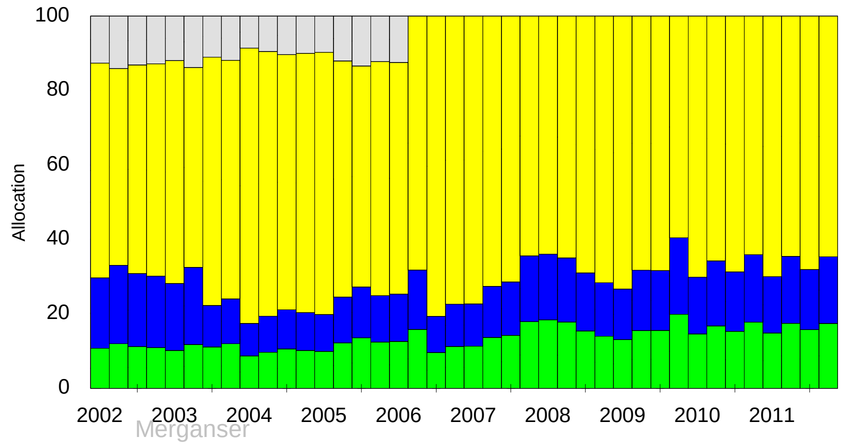
- The value of the Total Fund decreased by $91.0 million in the third quarter, due to net cash outflow of $94.6 million and earnings of $3.7 million.
- Net investment earnings for the quarter were:

Hillswick	$0.9 million
Reams	$1.9 million
Short-Term	$0.9 million
Total	$3.7 million

CURRENT ALLOCATION



HISTORICAL ALLOCATION



PERFORMANCE SUMMARY - TOTAL RETURN

SEPTEMBER 30, 2012

Manager	Quarter	Fiscal YTD	1 Year	3 Years	5 Years
Total Fund	0.4%	0.4%	1.5%	2.0%	2.8%
Benchmark[1]	0.3%	0.3%	0.8%	1.0%	1.8%
Hillswick Asset Mgmt	0.6%	0.6%	2.5%	3.8%	4.7%
ML G/C 1-5 yr. A & above	0.8%	0.8%	2.2%	3.0%	4.1%
Reams Asset Mgmt	1.1%	1.1%	3.5%	3.8%	5.1%
ML G/C 1-5 yr. A & above	0.8%	0.8%	2.2%	3.0%	4.1%
Total External Managers	0.9%	0.9%	3.0%	3.8%	4.9%
ML G/C 1-5 yr. A & above	0.8%	0.8%	2.2%	3.0%	4.1%
Short-Term Account	0.2%	0.2%	0.6%	1.0%	1.7%
ML 90-day T-Bill	0.0%	0.0%	0.1%	0.1%	0.7%

[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 continues to perform well with returns that are nearly twice the benchmark index and volatility (as measured by annualized standard deviation) that is only 1.2%.
- The two externally managed portfolios provided both income and capital gains in the last 12 months, and even though the portfolios are managed very differently, they both ended the last three years with the same 3.8% return, which is 80 bps net of fees above the benchmark index.
- Hillswick underperformed in the quarter, but out-performed by 30 bps in the last year, even though their portfolio is dominated by government bonds, with a lower yield. In the last year the account benefitted from good duration management and excess returns in their ~10% agency mortgage allocation.
- In the next quarter, Hillswick plans to reduce risk in both the treasuries and Agency MBS sectors.
- Reams exceeded the benchmark due to ~20% over-weights in both mortgage and corporate securities, and reasonably good bond selection over the last year.
- Reams expects to remain underweight to government debt and maintain a duration short of the benchmark, as long as real rates remain negative.
- The challenges in cash management continue with the benchmark yielding nearly 0%. In contrast, the staff-managed Short-Term Account has performed very well with a more flexible approach to security selection, while maintaining a longer duration and a quality focus.

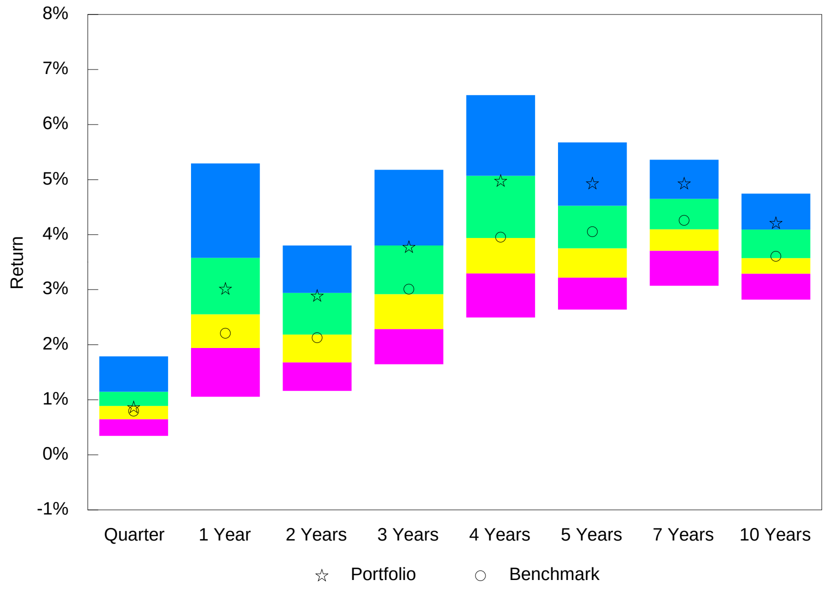
CONSOLIDATED BALANCE SHEET and CASH FLOW SUMMARY FOR THE FISCAL YEAR

JULY 1, 2012 TO SEPTEMBER 30, 2012

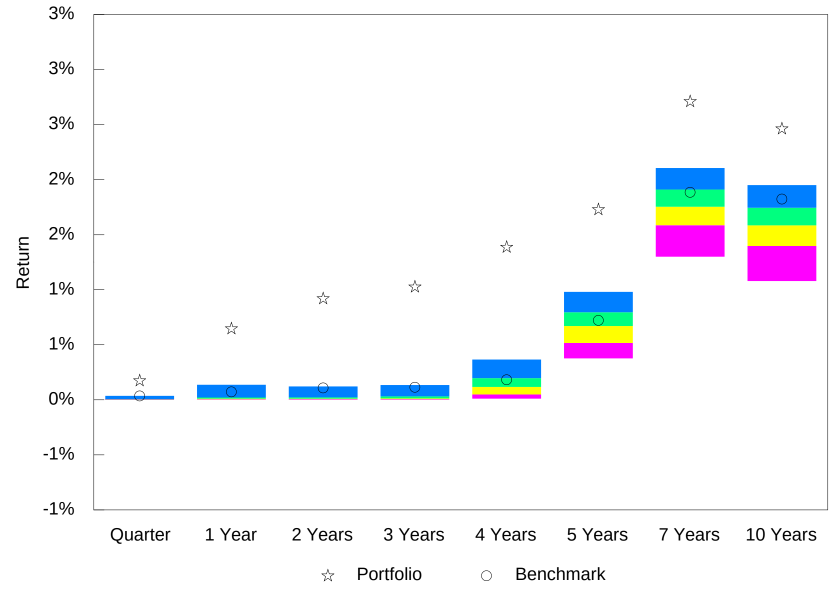
Manager	Beginning Balance	Net Cash Flows	Income	Gain/(Loss)	Ending Balance
Total Fund	**$1,020,739,100**	**($94,631,200)**	**$3,063,700**	**$583,400**	**$929,755,000**
Externally Managed					
Hillswick Asset Mgmt	$160,883,700	$0	$673,600	$241,800	$161,799,100
Reams Asset Mgmt	$164,700,800	$0	$752,700	$1,124,000	$166,577,500
Total Externally Managed	$325,584,500	$0	$1,426,300	$1,365,800	$328,376,600
Short-Term Account	$695,154,500	($94,631,200)	$1,637,500	($782,500)	$601,378,300

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

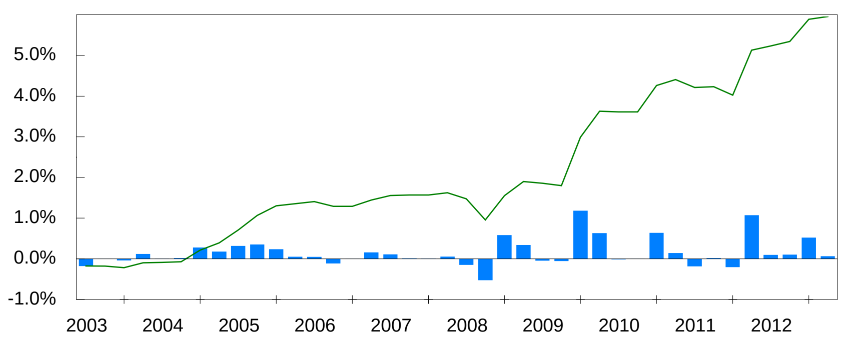
TOTAL EXTERNAL MGRS VS. PEER GROUP



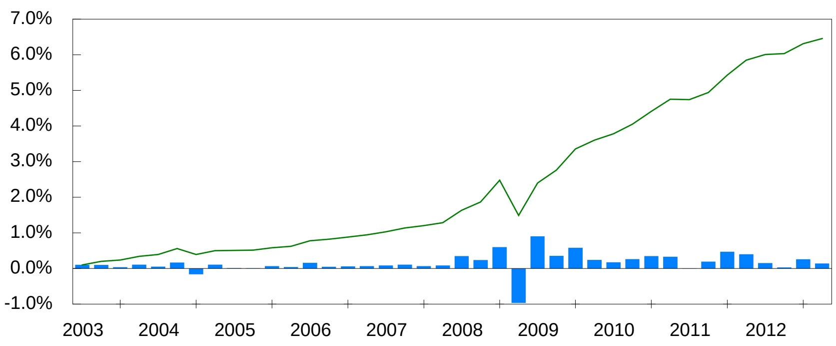
SHORT-TERM VS. PEER GROUP



TOTAL EXTERNAL MGRS VALUE ADDED



SHORT-TERM VALUE ADDED



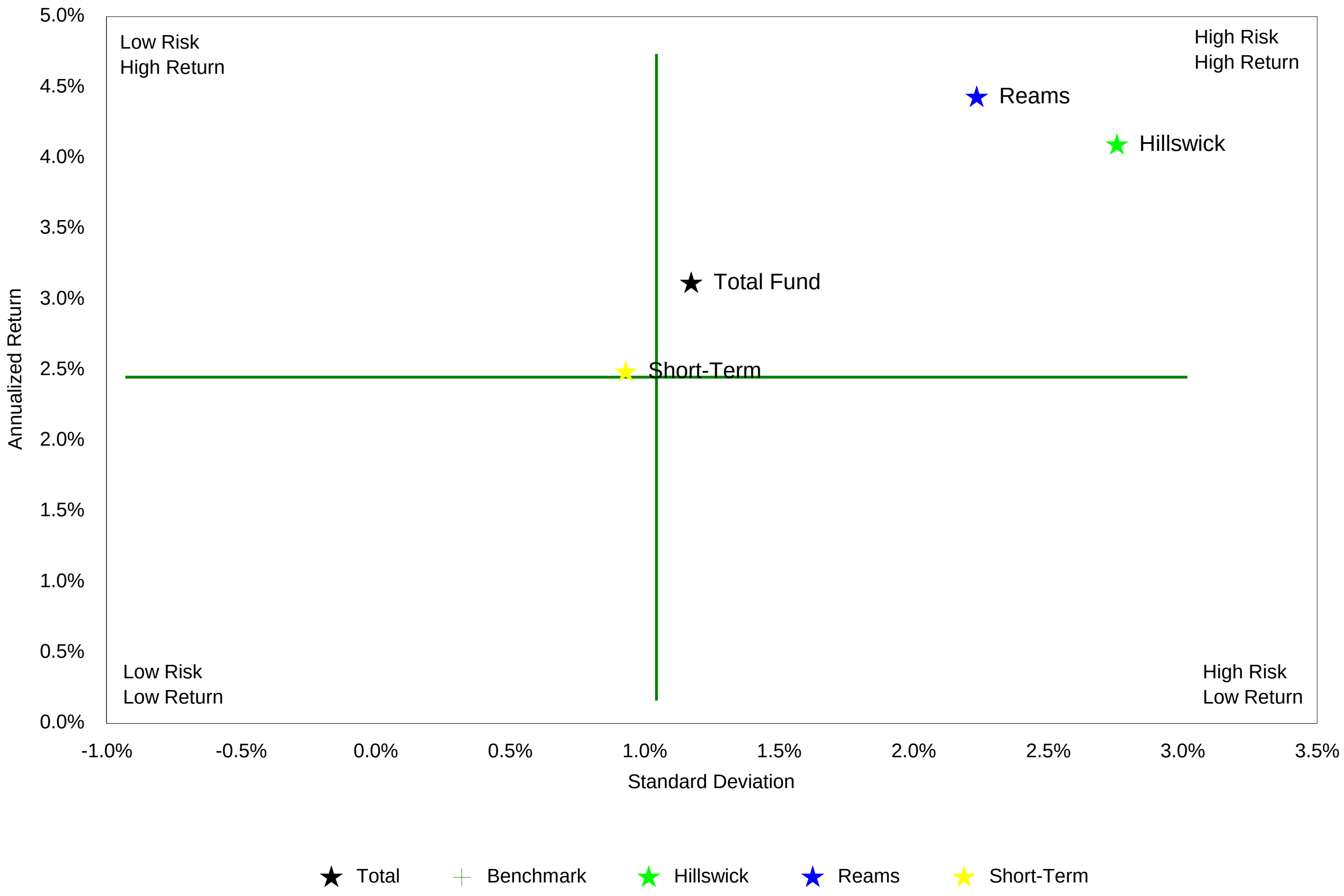
MANAGER SCORECARD
TEN-YEAR RESULTS

Manager	Return	Index Return	Std Dev	Alpha	Beta	Batting Average	Incept
Total Fund	3.11	2.45	1.17	0.45	1.26	825	4Q02
Hillswick Asset Mgmt.	4.09	3.64	2.76	0.22	1.12	450	4Q02
Reams Asset Mgmt.	4.43	3.64	2.23	1.07	0.84	700	4Q02
Short-Term Account	2.48	1.84	0.93	0.77	0.27	925	4Q02

INVESTMENTS PORTFOLIOS 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	Under	Exceed	Under	Positive	High
Hillswick Asset Mgmt	Exceed	Under	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.