Fourth Quarter 2012
Investment Review

THE METROPOLITAN WATER DISTRICT
of SOUTHERN CALIFORNIA

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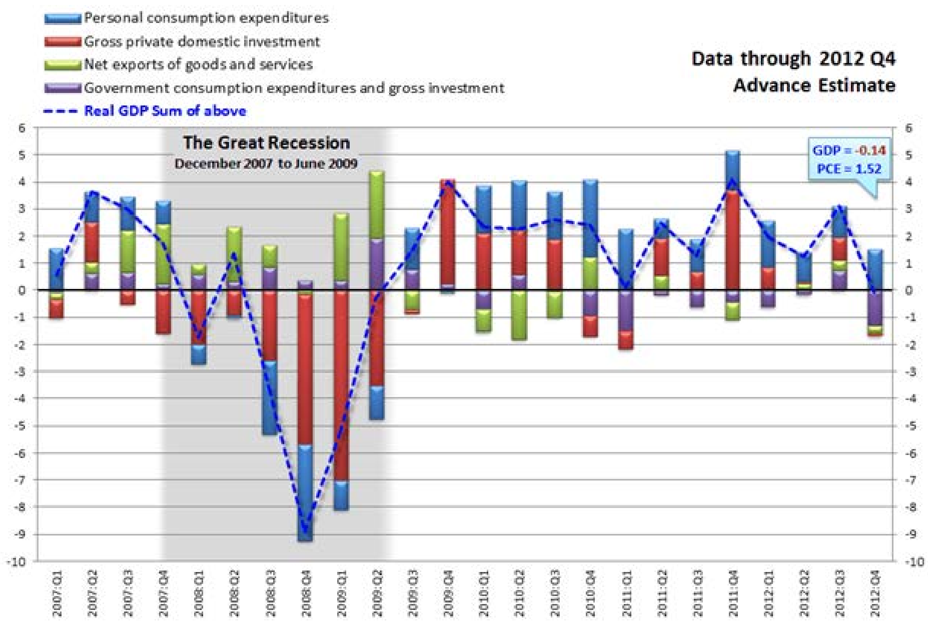
MARKET SNAPSHOT
DECEMBER 31, 2012

Index	Qtr	One Year	Three Year	Five Year
S&P 500	-0.4%	16.0%	10.9%	1.7%
Dow Jones Industrial	-1.7%	10.2%	10.9%	2.6%
Wilshire 5000	0.3%	16.1%	11.2%	2.2%
MSCI EAFE Index	6.6%	17.3%	3.6%	-3.7%
Barclays Aggregate	0.2%	4.2%	6.2%	5.9%
ML G/C 1-5 Yr A+	**0.2%**	**2.0%**	**3.0%**	**3.6%**
ML 3 Month T-Bill	**0.0%**	**0.1%**	**0.1%**	**0.5%**

Slow Growth Continues to Dominate the Markets



Source: dshort and Advanced Equity

- The global stock markets posted strong returns in 2012 as investors shrugged off all of the macro concerns that dominated the news early in the year.
- Value outperformed growth for most of 2012, with small growth lagging by 150 bps. Cyclical sectors generally had a strong year, led by the +29% return in the financial sector.
- Small and mid-cap US stocks gained traction in the fourth quarter, but remain modestly over-valued versus their long term averages. Active managers struggled for the entire year, with more than 70% behind the benchmarks.
- The international equity markets surprised investors with strong returns in the fourth quarter despite the debt crisis in Europe and slowing growth in the emerging markets. Currencies provided a small boost to these returns.
- Core commercial real estate outpaced the gains in net operating income, with cap rates falling and prices approaching the highs of 2007.
- Commodities ended 2012 with a small loss, as the energy complex fell by -9%, offset by an 18% drought-influenced gain in grain prices.
- Most hedge fund strategies trailed the equity markets by a wide margin, blaming high correlations and volatile markets.
- High yield bonds gained momentum throughout the year, ending 2012 with massive inflows. The Federal Reserve now appears to be in full control and investors are willing to accept their vision of fixed income relative values.

Global Economy Improves Despite the Headwinds

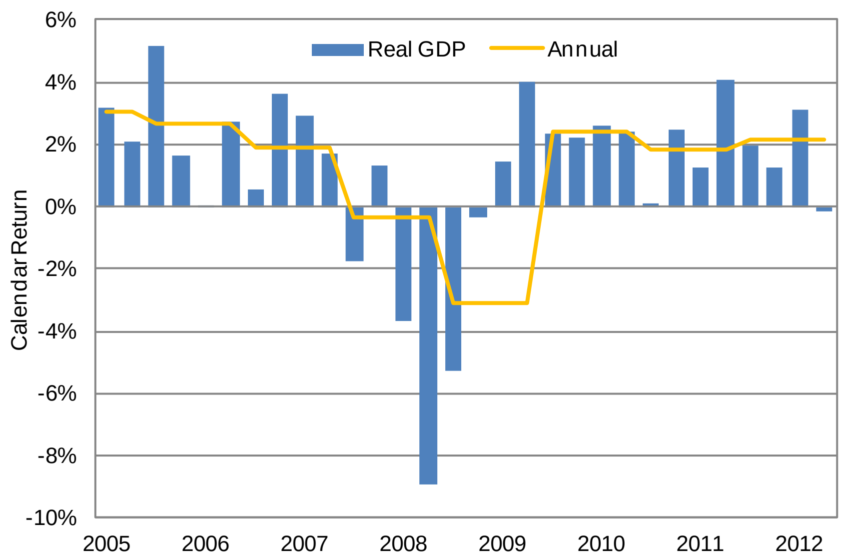
- The US economy improved slowly in the fourth quarter, with many economic indicators pointing up at year-end; however, initial 4Q GDP was -0.1%, versus +3.1% in 3Q, and +1.3% in 2Q. The slowdown in the US, although troubling, is still better than the contraction in Europe.

- On a positive note, housing starts are on the rise, with permits for new construction up +3.6% in November to an annual rate of 899,000, the highest reading since July 2008; even though sales of existing homes fell by -4.3% in December.

- The unemployment rate continues to hover around 7.8%; although new jobs continue to be created, it will take a lot more than the current average of about 125,000 per month to make a significant impact.

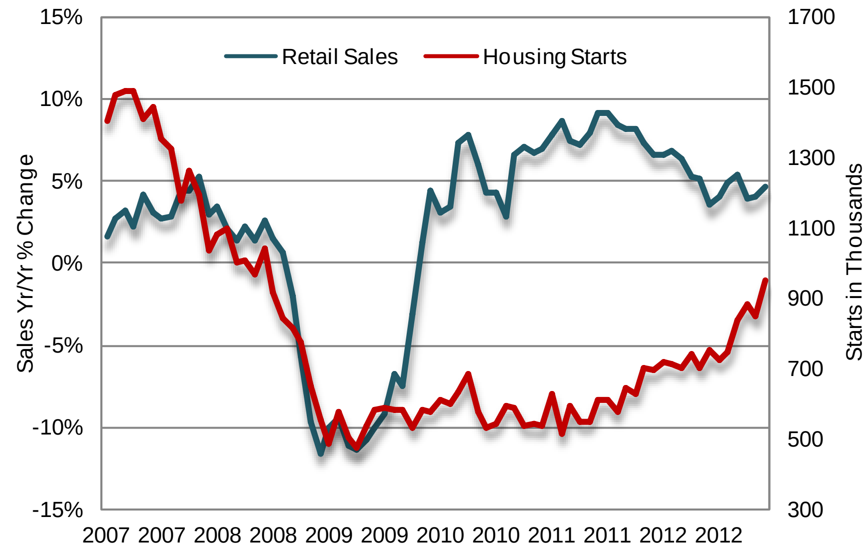
- The US economy temporarily avoided the "fiscal cliff" when legislation was approved on January 2 to maintain lower income tax rates for individuals earning less than $400,000. However, new deadlines for resolving spending cuts and the debt ceiling will arrive in Mar and May.

Personal Consumption Offset Weak Business Spending



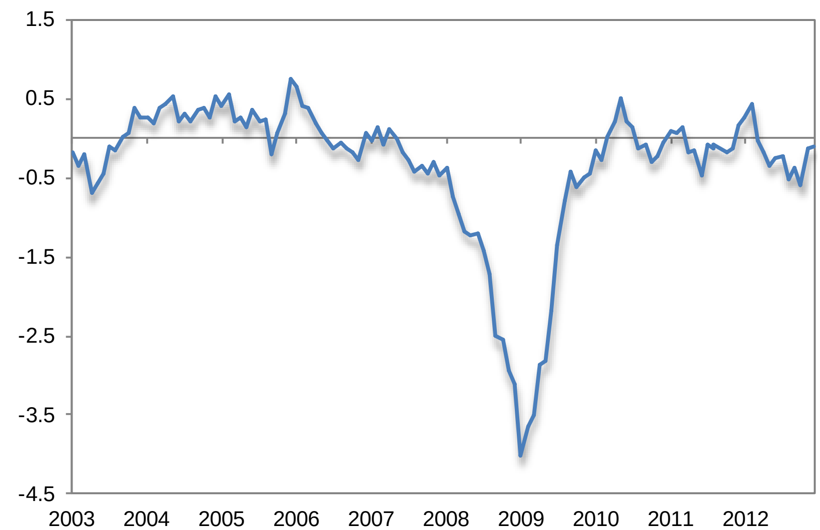
Source: US Bureau of Economic Analysis

Housing is Beginning to Help



Source: US Census Bureau

But National Economic Activity Remains Low



Source: Federal Reserve Bank of Chicago

Stock Returns Defy the Skeptics

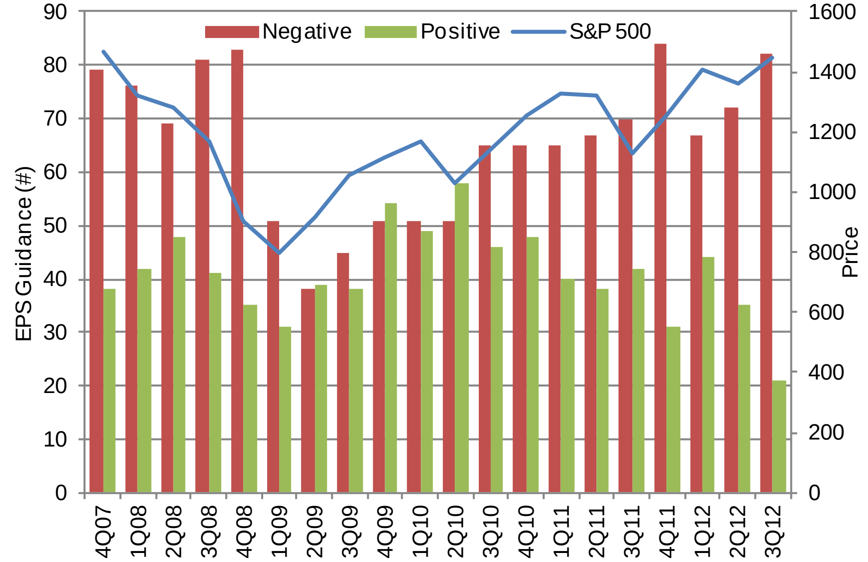
- Although fourth quarter returns for the US stock market were subdued, the S&P 500 finished 2012 with a +16% gain, much to the surprise of investors who started the year with concerns over the elections and the crisis in Europe.

- A rebound in the financial sector (+29%), especially among big banks, led the market, followed by consumer discretionary (+24%) and telecom (+18%). The more stable sectors like utilities (+1%) and energy (+5%) declined in the fourth quarter and lagged for most of the year.

- Although US stocks performed well in 2012, earnings estimates fell across most sectors, so the expansion in PE ratios played an important role in gains this year. Nonetheless, the S&P 500 finished 2012 with a PE ratio of about 14, which is below the long term average.

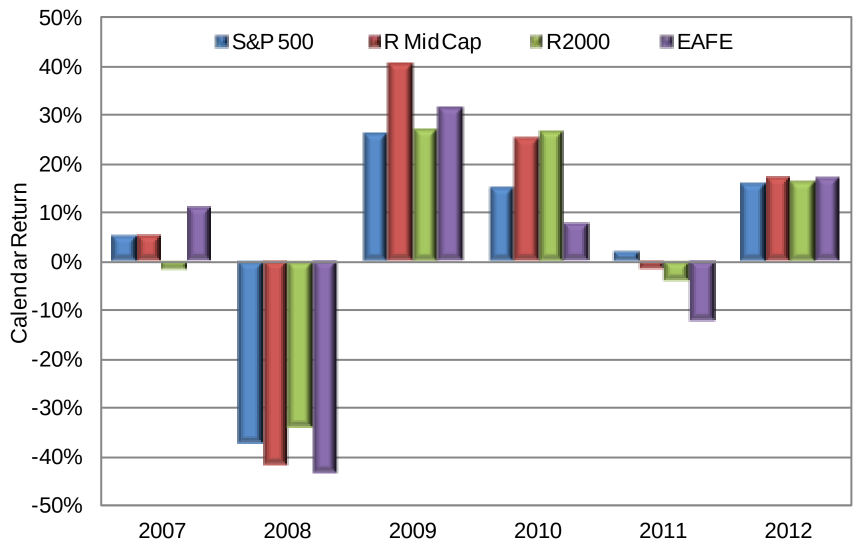
- Although active managers struggled all year to beat their respective benchmarks, the tide turned a bit for large growth managers, with more than 90% beating the Russell 1000 Growth Index, which suffered from the 20% decline in Apple.

Earnings Revisions Continue to Slide



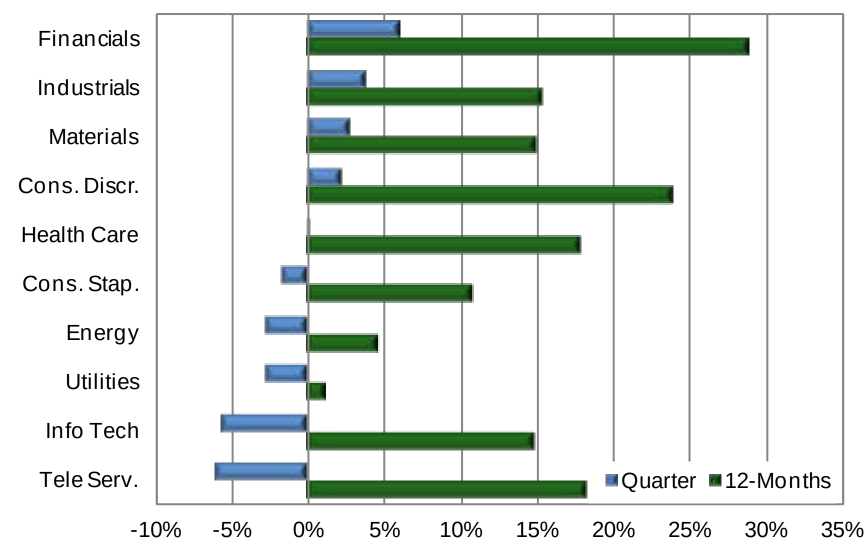
Source: Factset

International Rallies Back in the Fourth Quarter



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

Financials Post the Strongest Returns

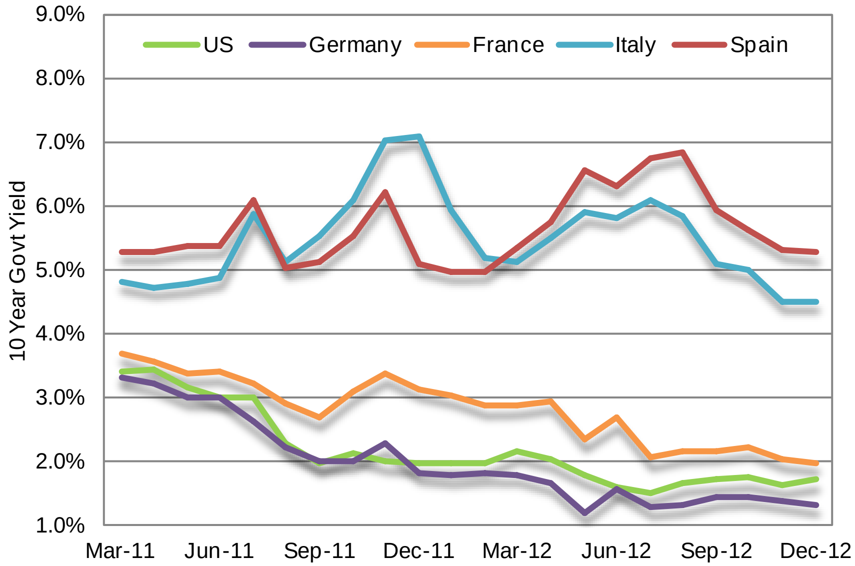


Source: Standard & Poor's

Bond Returns Also Defy the Skeptics

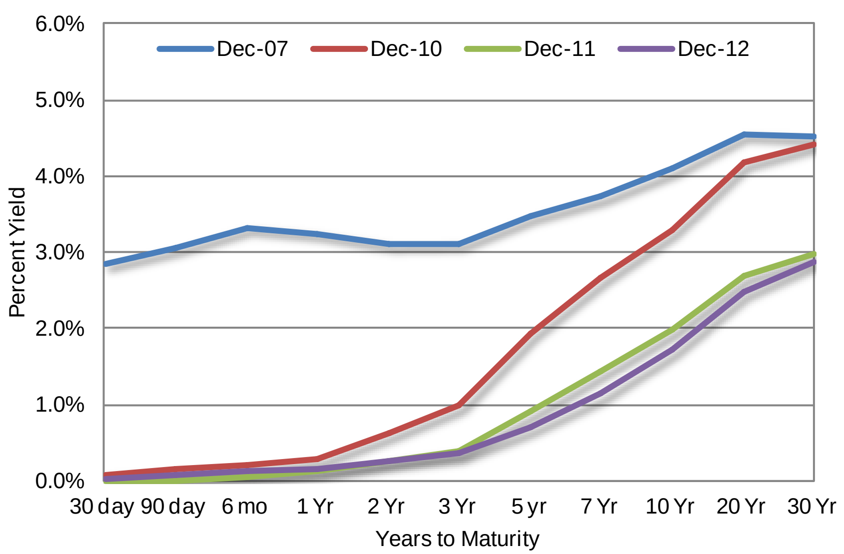
- The Fed continued their significant program of support and stimulus by announcing in December the additional purchase of $45 billion per month of mortgages and treasury securities on top of the $40 billion per month announced earlier in the year.
- Investors frustrated with lower yields, embraced riskier sectors, such as high yield (+16%) and corporates (+10%), while treasury bonds and mortgages returned around +2%. The positive return for treasuries was a bit of a victory given the potential for losses from higher rates.
- Spanish and Italian yields continued to fall in the fourth quarter despite the debt crisis, driven by the power of the ECB. Although the Italian 10-year fell -59 bps and the Spanish 10-year fell -67 bps, heavy issuance in 1Q13 may prevent these yields from falling further.
- Although 2012 was generally a good year for most bond funds, it will be impossible for managers to match that performance in 2013, since spreads are relatively tight and interest rates near historic lows.

Yields Fall Across the Globe



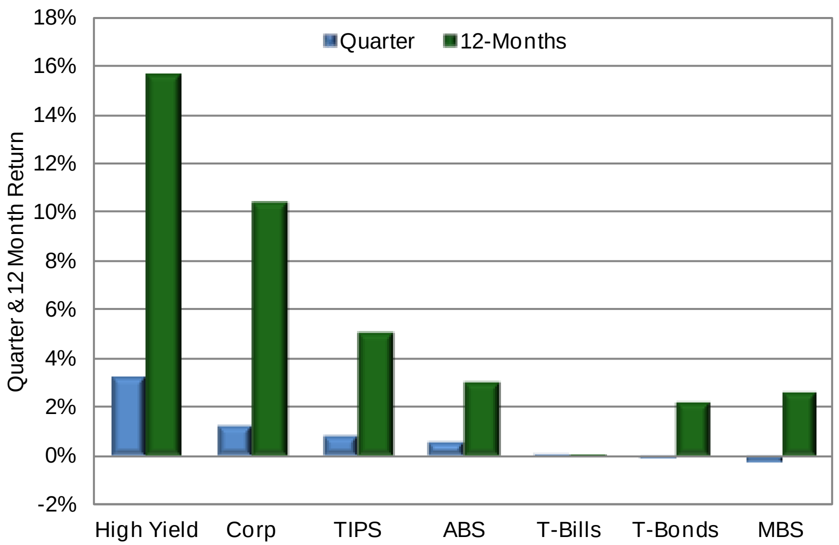
Source: Federal Reserve, Bloomberg

No Pain Yet for US Treasuries



Source: Federal Reserve

Strong Gains for Corporate Bonds



Source: Merrill Lynch

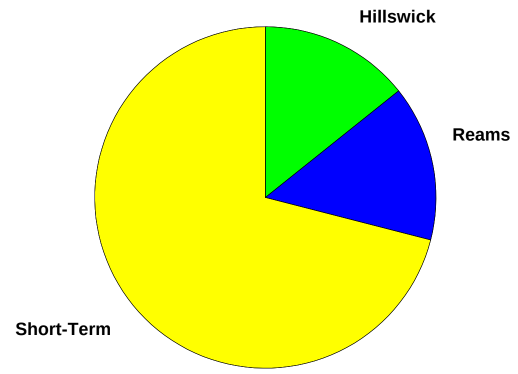
PORTFOLIO SUMMARY
DECEMBER 31, 2012

	Assets	Weight
Managed Accounts		
Hillswick Asset Mgmt	$161,757,400	14%
Reams Asset Mgmt	$167,233,200	15%
Total External Managed	$328,990,600	29%
Short-Term Account	$805,052,700	71%
Grand Total	**$1,134,043,300**	100%

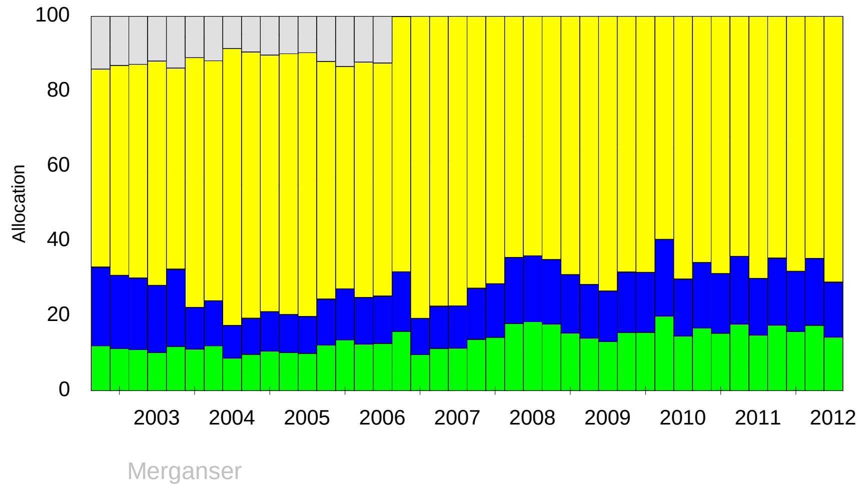
- The value of the Total Fund increased by $204.3 million in the fourth quarter, due to net cash inflow of $203.1 million and earnings of $1.2 million.
- Net investment earnings for the quarter were:

Hillswick	- $0.04 million
Reams	$0.66 million
Short-Term	$0.57 million
Total	$1.19 million

CURRENT ALLOCATION



HISTORICAL ALLOCATION



PERFORMANCE SUMMARY - TOTAL RETURN

DECEMBER 31, 2012

Manager	QTR	Fiscal YTD	1 Year	3 Yrs	5 Yrs
Total Fund	0.1%	0.6%	1.4%	2.0%	2.5%
Benchmark[1]	0.1%	0.4%	0.7%	1.0%	1.5%
Hillswick Asset Mgmt	-0.0%	0.5%	2.0%	3.9%	4.2%
ML G/C 1-5 yr. A & above	0.2%	0.9%	2.0%	3.0%	3.6%
Reams Asset Mgmt	0.4%	1.5%	3.4%	3.6%	4.7%
ML G/C 1-5 yr. A & above	0.2%	0.9%	2.0%	3.0%	3.6%
Total External Managers	0.2%	1.0%	2.7%	3.8%	4.5%
ML G/C 1-5 yr. A & above	0.2%	0.9%	2.0%	3.0%	3.6%
Short-Term Account	0.1%	0.3%	0.6%	1.0%	1.5%
ML 90-day T-Bill	0.0%	0.1%	0.1%	0.1%	0.5%

[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 by a wide margin. But the low return on intermediate and short-term fixed income securities has reduced the overall yield to less than 2%.
- The two externally managed portfolios provided both income and capital gains in the last 12 months, but the lower risk Hillswick portfolio once again returned less than Reams due to lower credit exposure.
- Hillswick underperformed for the last two quarters, but matched the benchmark index over the last 12 months. Their portfolio continues to be dominated by government bonds, with a yield on their account that is slightly above the benchmark.
- Since June, Hillswick has increased the defensive nature of their account because they viewed actions by the Fed and the fiscal cliff "agreements" with great skepticism. With a yield and duration close to the benchmark, they will not outperform unless their avoidance of credit risk turns out to be well founded.
- Reams exceeded the benchmark due primarily to a 21% overweight to corporate securities and reasonably good bond selection. They agree with Hillswick in one area, the need to be conservative in the management of duration.
- Reams expects to maintain a 20%+ overweight to corporate and mortgages, and a duration short of the benchmark. Unlike Hillswick, they view corporate bonds as the most attractive risk-adjusted sector.
- The staff-managed Short-Term Account continues to execute an opportunistic security selection strategy, while maintaining a longer duration and a quality focus. The performance results have been excellent.

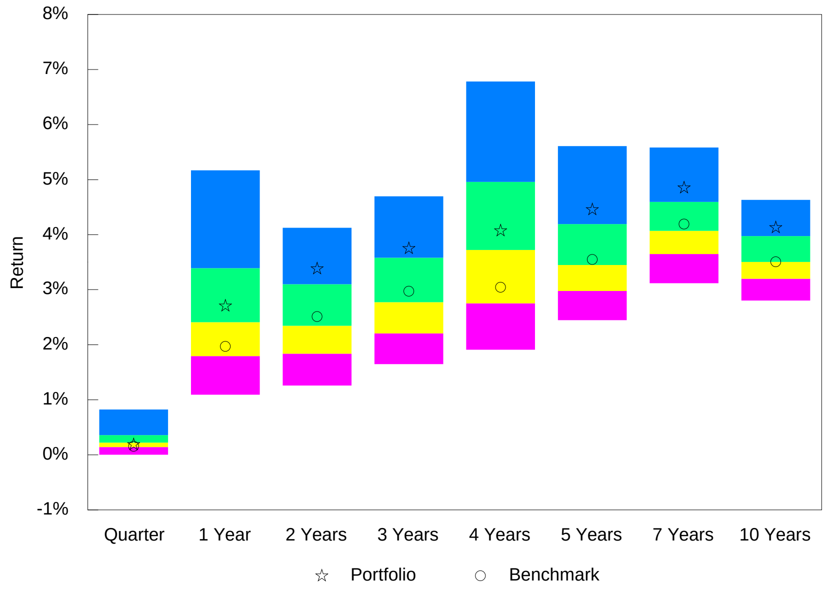
CONSOLIDATED BALANCE SHEET and CASH FLOW SUMMARY FOR THE FISCAL YEAR

JULY 1, 2012 TO DECEMBER 31, 2012

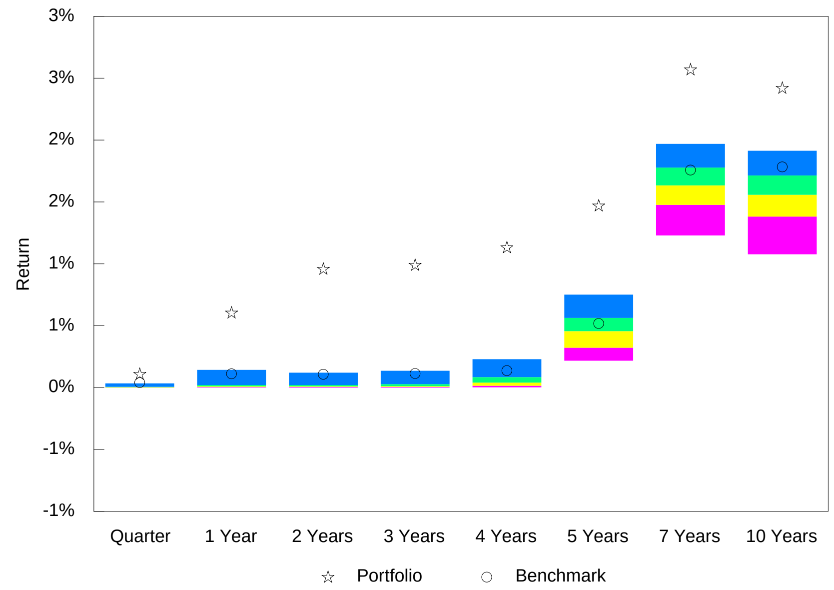
Manager	Beginning Balance	Net Cash Flows	Income	Gain/(Loss)	Ending Balance
Total Fund	**$1,020,739,100**	**$108,474,300**	**$6,397,800**	**($1,567,800)**	**$1,134,043,400**
Externally Managed					
Hillswick Asset Mgmt	$160,883,700	$0	$1,354,500	($480,800)	$161,757,400
Reams Asset Mgmt	$164,700,800	$0	$1,431,400	$1,101,000	$167,233,200
Total Externally Managed	$325,584,500	$0	$2,785,900	$620,200	$328,990,600
Short-Term Account	$695,154,500	$108,474,300	$3,611,900	($2,188,000)	$805,052,700

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

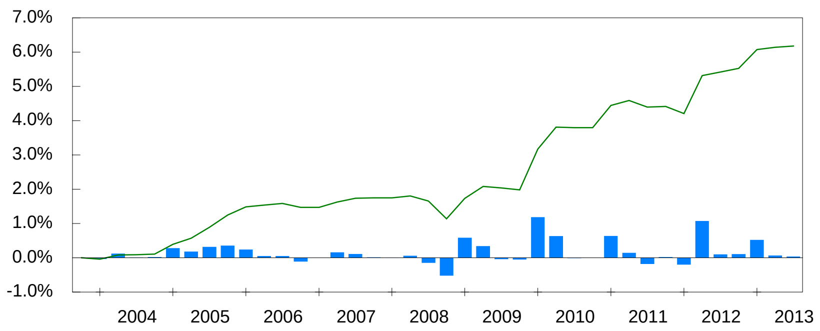
TOTAL EXTERNAL MGRS VS. PEER GROUP



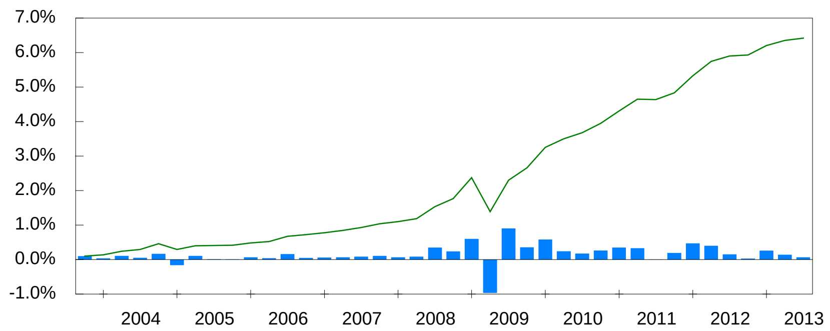
SHORT-TERM VS. PEER GROUP



TOTAL EXTERNAL MGRS VALUE ADDED



SHORT-TERM VALUE ADDED



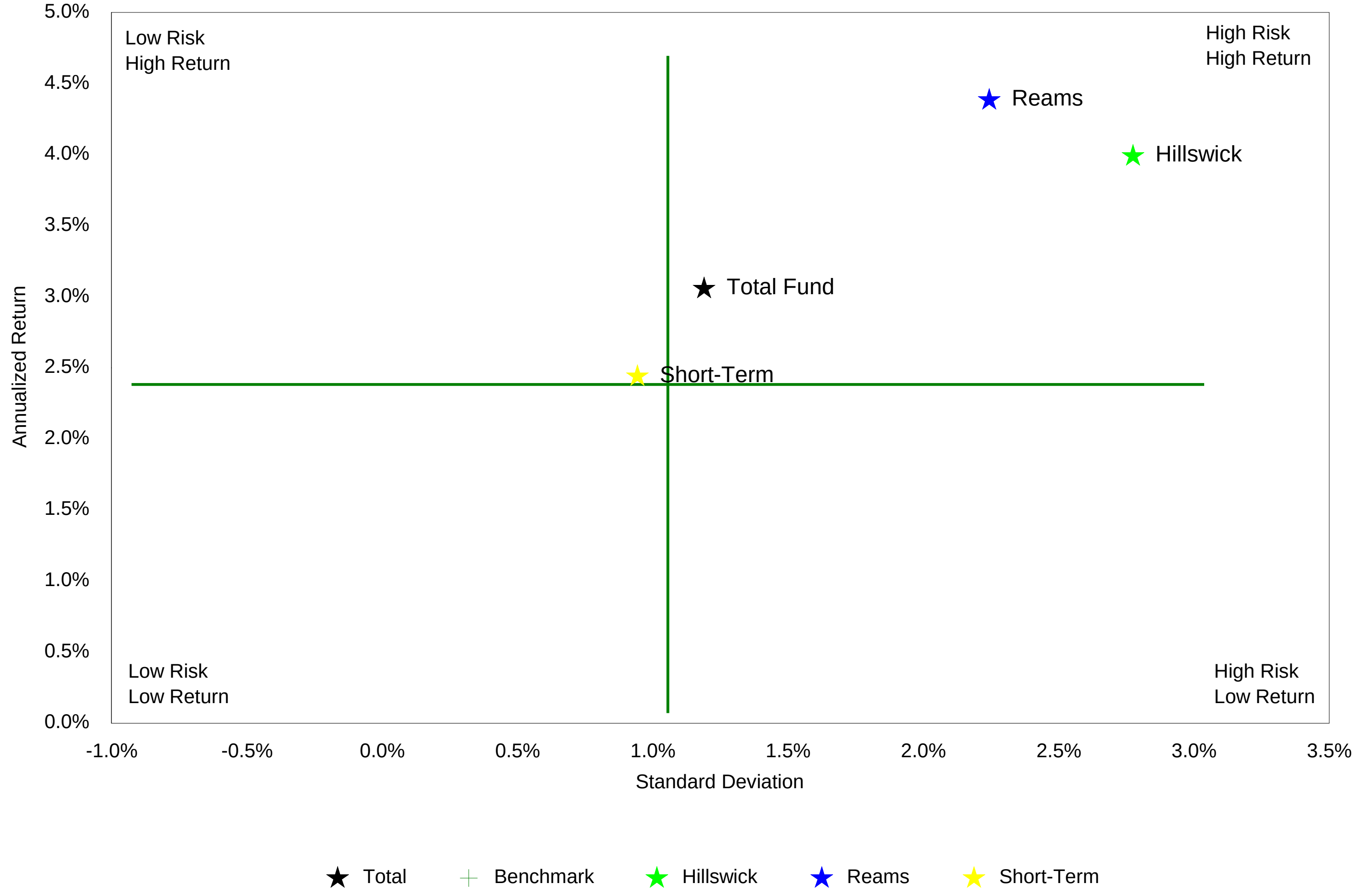
MANAGER SCORECARD
TEN-YEAR RESULTS

Manager	Return	Index Return	Std Dev	Alpha	Beta	Batting Average	Incept
Total Fund	3.06	2.38	1.19	0.46	1.27	850	1Q03
Hillswick Asset Mgmt.	3.99	3.54	2.78	0.22	1.12	450	1Q03
Reams Asset Mgmt.	4.38	3.54	2.24	1.11	0.85	725	1Q03
Short-Term Account	2.44	1.80	0.94	0.76	0.29	925	1Q03

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	NA	Exceed	NA	Positive	High
Hillswick Asset Mgmt	OK	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.