First Quarter 2017
Investment Review

THE METROPOLITAN WATER DISTRICT
of SOUTHERN CALIFORNIA

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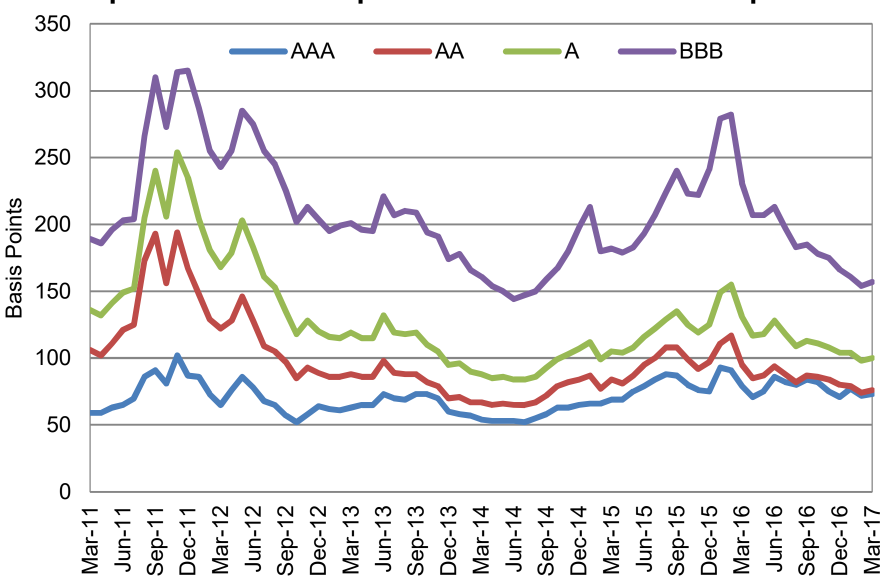
MARKET SNAPSHOT
MARCH 31, 2017

Index	Qtr	One Year	Three Year	Five Year
S&P 500	6.1%	17.2%	10.4%	13.3%
Dow Jones Industrial	5.2%	19.9%	10.6%	12.2%
Wilshire 5000	5.7%	18.5%	9.4%	13.0%
MSCI EAFE Index	7.2%	11.7%	0.5%	5.8%
Barclays Aggregate	0.8%	0.4%	2.7%	2.3%
BofA ML G/C 1-5 Yr A+	**0.5%**	**0.2%**	**1.3%**	**1.2%**
BofA ML 3 Month T-Bill	**0.1%**	**0.4%**	**0.2%**	**0.1%**

Corporate Bonds Outperform with Lower Credit Spreads



- Source: Merrill Lynch

- The surge in consumer and business confidence has been a boost to risk assets in the stock and bond markets. President Trump's pledge to cut taxes and regulations, while increasing government spending on defense and infrastructure, is expected to create powerful fiscal stimulus.

- Most of the hard economic data has yet to turn, but corporate earnings seem to be one area that is meeting expectations. But with current PEs at 19, S&P earnings will need to rise to offset the PE compression from higher interest rates.

- Growth stocks rebounded across capitalizations, reflecting the risk-on attitude of investors. The cyclical sectors of financials (+19%), materials (+12%), and industrials (+11%) led in 1Q17.

- International returns were helped by currency gains against the dollar: +2.5% for EAFE and +3.7% for EM. India (+17%) and China (+13%) led the emerging markets, but returns were good across the globe, with the exception of a -5% in Russia.

- Commercial real estate is still producing capital gains above its 4.5% yield, but future returns will be limited by valuations that are 25% above the prior peak. Other real assets and commodity prices have been constrained by lower growth, lower oil prices, and a softer than expected CPI.

- Hedge fund returns have improved across sectors along with strength in the equity and credit markets. Pairwise correlations in the equity markets have declined, which have helped arbitrage strategies.

- The Fed rate increase of 25 bps in March was widely anticipated, and was accepted with calm by the stock and bond markets. Corporate and high yield bonds continue to perform well, and overall the bond market has responded better than many feared.

Economic Data Out of Sync with Investor Expectations

- The recent surge in consumer and business confidence appears to be out of sync with hard data, especially GDP growth, which fell to 0.7% in 1Q17. The US economy is entering its eighth year of economic expansion, a length nearly twice the average, and pent-up demand may be exhausted. The US bond market, where interest rates have slipped back, may be reflecting this data more than the stock market.

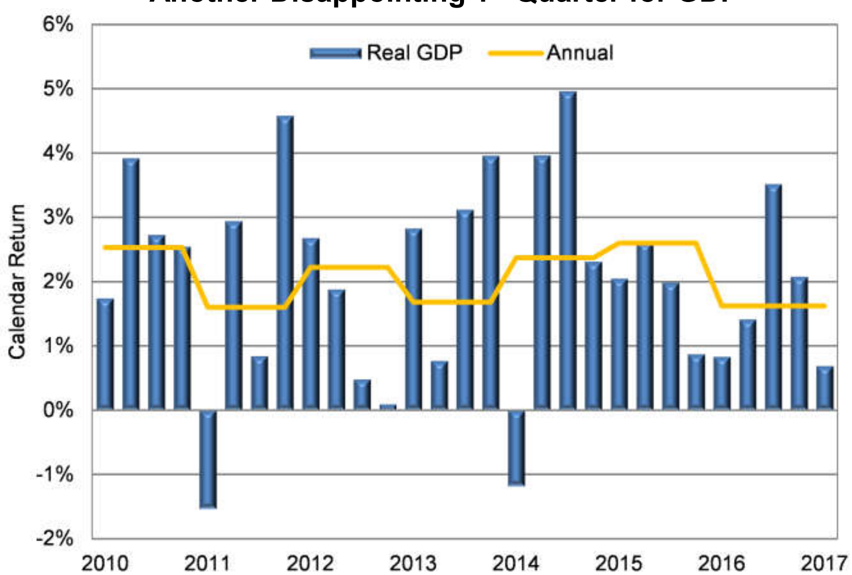
- European and Asian economies are showing signs of recovery, despite the political turmoil. But many developed economies (including the US) have similar problems: 1) low population growth, 2) debt added in the previous decade, and 3) globalization that has dispersed high margin manufacturing jobs.

- The Federal Reserve has undertaken the fifteenth tightening cycle since WWII. Most of the prior cycles have led to economic slowdowns and ten of the tightening cycles led to disruptions in financial markets. Consumers, business, and governments are carrying record levels of debt and over-leverage is a problem when the Fed raises interest rates.

A Surge in Consumer (and Business) Confidence

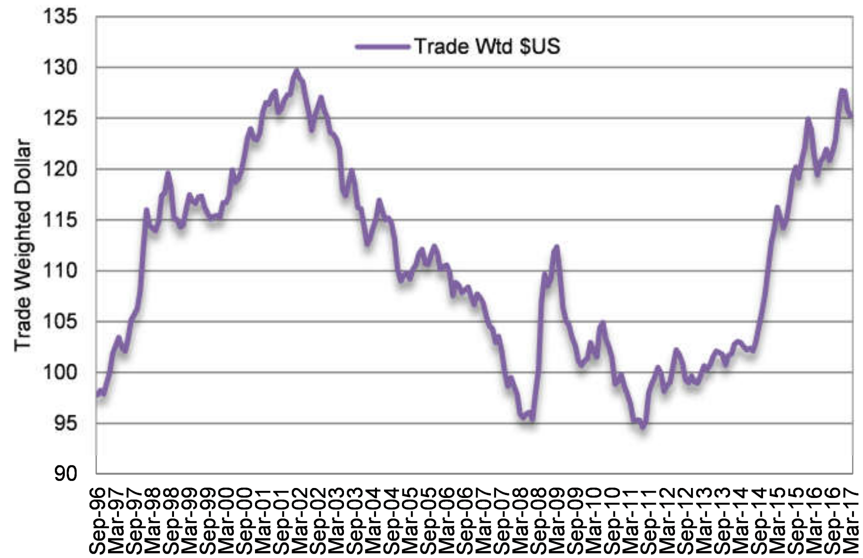
Source: dshort.com

Another Disappointing 1st Quarter for GDP



Source: US Bureau of Economic Analysis

Strong US Dollar a Headwind for Growth?



Source: US Federal Reserve

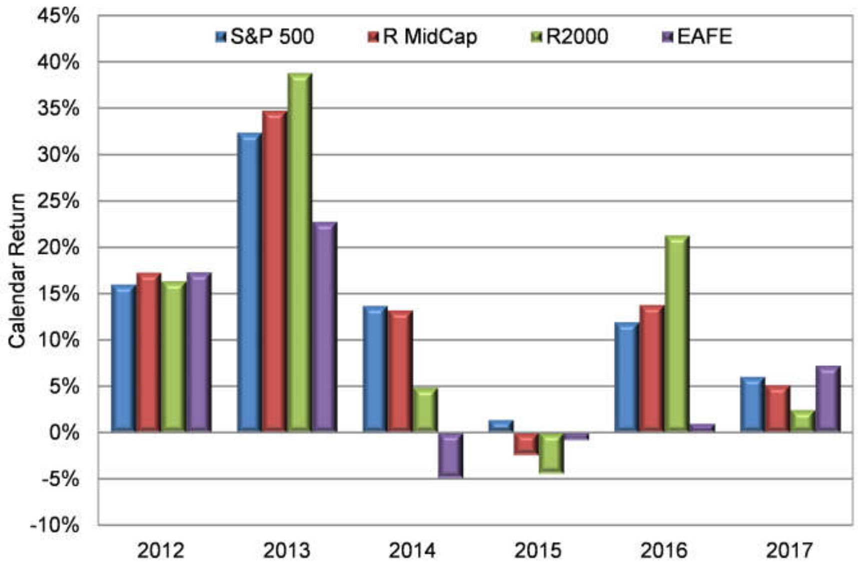
Strong Returns in US Stock Market

- US stock market posted the best 1Q returns since 2013 in response to President Trump's pledge to cut taxes and regulations, while increasing government spending on defense and infrastructure. Small and mid-cap stocks also responded positively, but overall returns are expected to be limited by high valuations.
- The economically sensitive (cyclical) sectors led the market in 1Q17, with financials (+19%), materials (+12%), and industrials (+11%). High current valuations, rising interest rates, and strength in the dollar will remain headwinds, but they can be offset if earnings reach the expected target of $140+/share by the end of 2017.
- Small cap stock valuations remain above historical averages relative to already expensive large cap stocks. Growth stocks outperformed in the quarter, but the single best factor in 1Q17 was high foreign exposure, which led to gains of +9.5% for international companies.
- Market leadership has not been clearly cyclical or defensive, but in many areas the Trump reflation trade is beginning to weaken.

Earnings Expected to Grow in 2017

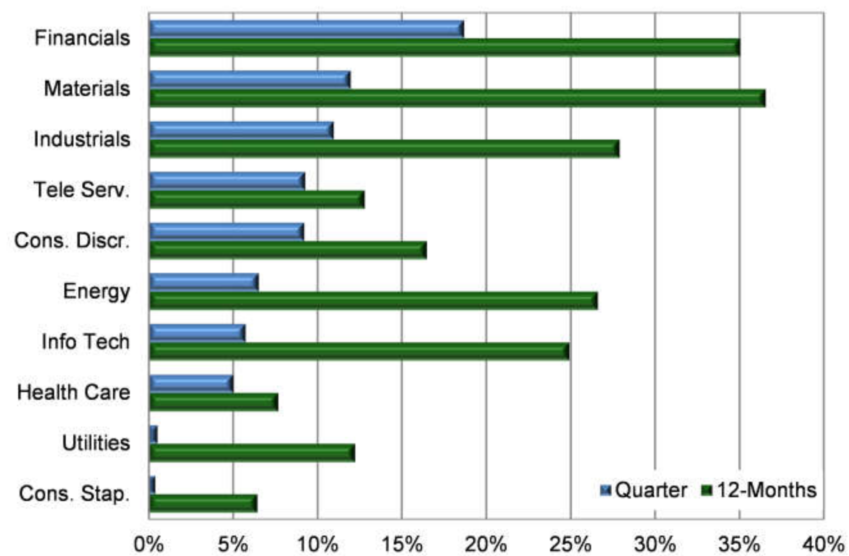
Source: Standard & Poor's

Trump Rally Lifted Stocks to Solid Gains



Source: Standard & Poor's, Russell, MSCI

Financials Surge on Deregulation, Gains in Interest Income

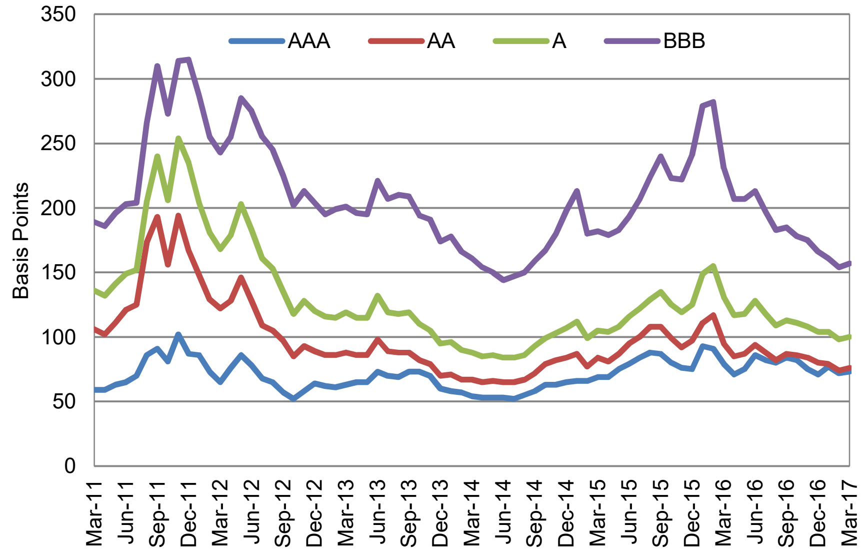


Source: Standard & Poor's

Strong Gains in Credit

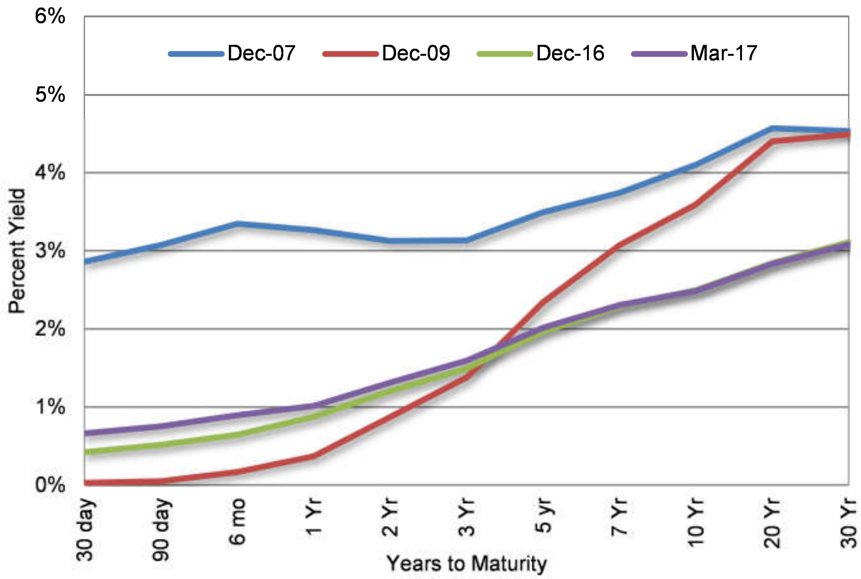
- The core US bond market performed better than expected in 1Q17 after falling by 3% in 4Q16. The Barclays US Aggregate Index was helped to a positive return of +0.8%, by continuing good performance in corporate bonds and limited impact from Fed rate increases. In a broad sense, the riskiest bonds outperformed, with emerging market bonds posting some of the best returns.
- The Federal Reserve lifted the target for Fed funds by 25 bps in March to a range of 0.75% to 1.00%. In response to this change, the treasury yield curve flattened as the 2-year yield rose, and the 5, 10, and 30-year yields declined. Corporate credit continued its outperformance and mortgage bonds slipped a bit compared to treasury bonds.
- There is little evidence of factors that could lead to higher inflation; perhaps that is why the US bond market is quieter than expected. The environment seems neither as negative for bonds, nor as positive for the stocks, as assumed after the election. In comparison, we see improving trends in the global bond markets, especially EM.

Global Interest Rates Start to Rise



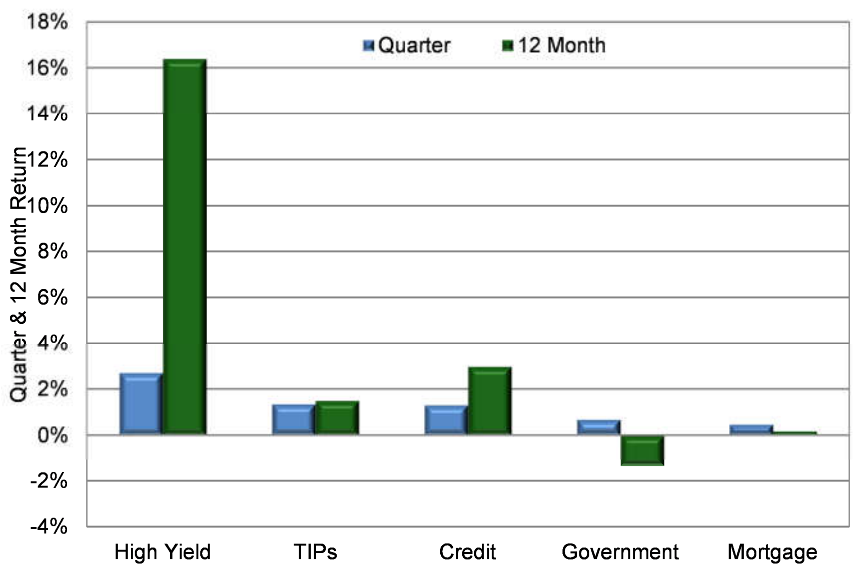
Source: Merrill Lynch

Interest Rates Rise Across the Curve



Source: Federal Reserve

High Yield Bonds Lead the Rebound



Source: Barclays

PORTFOLIO SUMMARY
MARCH 31, 2017

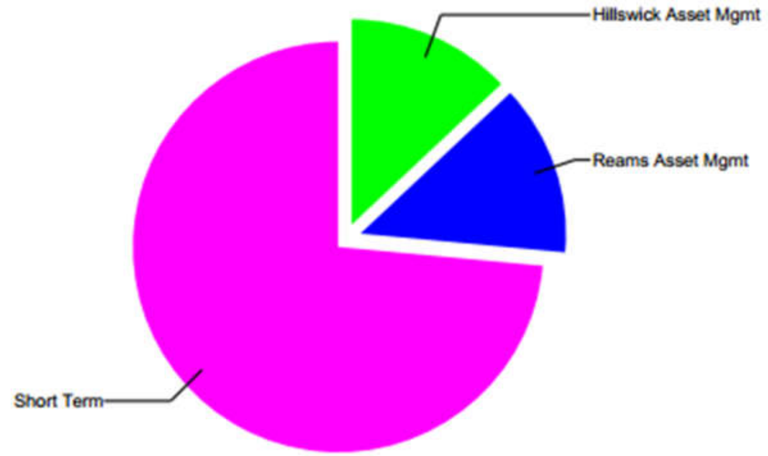
	Assets	Weight
Managed Accounts		
Hillswick Asset Mgmt	$169,420,879	13%
Reams Asset Mgmt	$175,758,309	13%
Total External Managed	$345,179,188	26%
Short-Term Account	$959,291,939	74%
Grand Total	$1,304,471,127	100%

- The value of the Total Fund decreased by $9.9 million in the first quarter, due to net cash outflow of $13.3 million offset by an investment gain of $3.4 million.
- Net investment gain/loss for the quarter were:

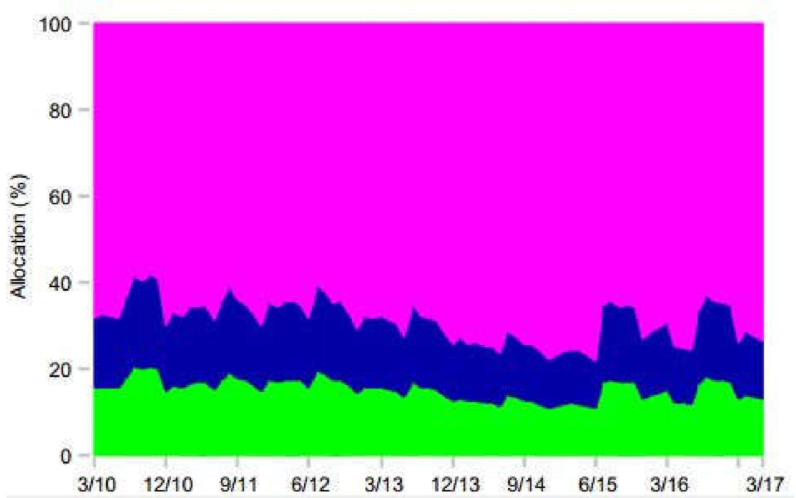
Hillswick	$0.6 million
Reams	$0.7 million
Short-Term	$2.1 million
Total	$3.4 million

Note: Totals may differ slightly due to rounding.

CURRENT ALLOCATION



HISTORICAL ALLOCATION



PERFORMANCE SUMMARY - TOTAL RETURN

MARCH 31, 2017

Manager	QTR	Fiscal YTD	1 Year	3 Yrs	5 Yrs
Total Fund	0.3%	0.1%	0.4%	0.9%	0.8%
Benchmark[1]	0.2%	0.0%	0.3%	0.5%	0.4%
Hillswick Asset Mgmt	0.3%	-0.9%	0.0%	1.7%	1.3%
BofA ML G/C 1-5 yr. A	0.5%	-0.7%	0.2%	1.3%	1.2%
Reams Asset Mgmt	0.4%	-0.5%	0.4%	1.3%	1.5%
BofA ML G/C 1-5 yr. A	0.5%	-0.7%	0.2%	1.3%	1.2%
Total External Managers	0.4%	-0.7%	0.2%	1.5%	1.4%
BofA ML G/C 1-5 yr. A	0.5%	-0.7%	0.2%	1.3%	1.2%
Short-Term Account	0.2%	0.5%	0.7%	0.7%	0.6%
BofA ML 90-day T-Bill	0.1%	0.3%	0.4%	0.2%	0.1%

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

- The Total Fund exceeded the benchmark in the quarter due to good performance in the staff-managed Short-Term Account and gains in the externally-managed accounts. The rise in short rates should continue to help returns in the Short-Term Account.

- The Fed kept pace with the planned rate increases by raising Fed funds by 25 bps in March. The treasury yield curve flattened as the 2-year yield rose, while the 5, 10, and 30-year yields declined. Spread sectors were positive; corporate credit continued its outperformance, but treasury bonds outperformed mortgages.

- Hillswick underperformed the benchmark, since they holds primarily government bonds, with little yield advantage. They also moved from short to flat duration relative to the benchmark to take advantage of the large short position among traders, anticipating that yields may fall in the near term.

- In the long run, Hillswick believes that the trend is toward higher treasury yields and will again shorten duration. Hillswick remains convinced that risk premiums (spreads) are not attractive enough to offset the risk in mortgage or corp bonds.

- Reams underperformed the benchmark due to an overweight in mortgages and underweight to gov't bonds. Reams believes that the credit cycle in near the end, so they will continue to move conservatively and seek to add value through security selection in higher quality corporate and mortgage bonds.

- The staff-managed Short-Term Account continued its strong performance and will benefit from higher yields in 2017. The comparison to other cash portfolios is on page 8.

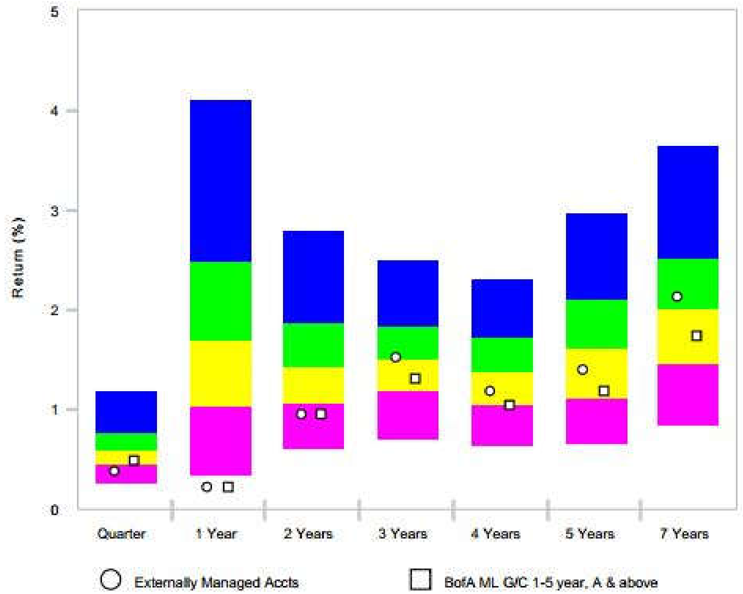
CONSOLIDATED BALANCE SHEET and CASH FLOW SUMMARY FOR THE FISCAL YEAR

JULY 1, 2016 TO MARCH 31, 2017

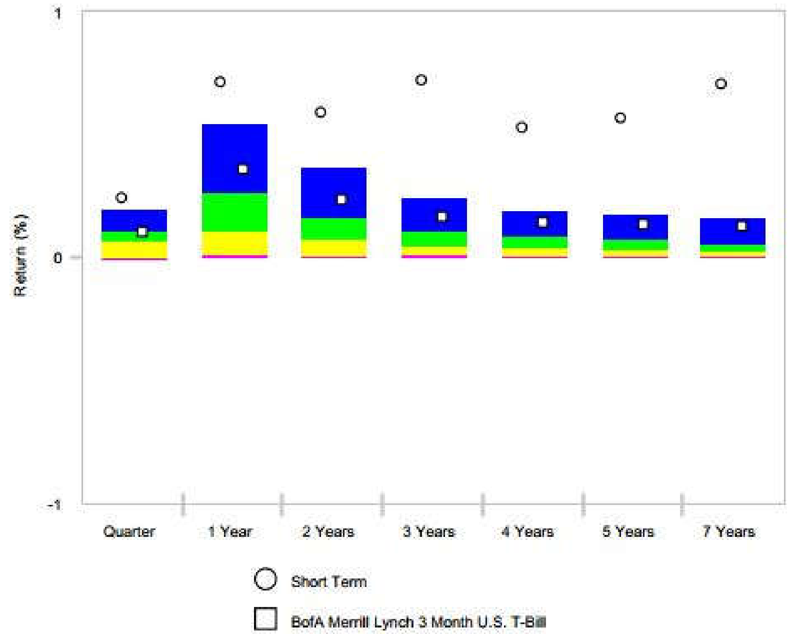
Manager	Beginning Balance	Net Cash Flows	Income	Gain/(Loss)	Ending Balance
Total Fund	**$1,435,462,976**	**($132,454,502)**	**$10,142,490**	**($8,679,837)**	**$1,304,471,127**
Externally Managed					
Hillswick Asset Mgmt	$171,009,214	$0	$2,558,110	($4,146,445)	$169,420,879
Reams Asset Mgmt	$176,624,830	$0	$2,613,523	($3,480,044)	$175,758,309
Total Externally Managed	$347,634,044	$0	$5,171,633	($7,626,489)	$345,179,188
Short-Term Account	$1,087,828,932	($132,454,502)	$4,970,856	($1,053,348)	$959,291,939

Note: Totals may differ slightly due to rounding.

TOTAL EXTERNAL MGRS VS. PEER GROUP

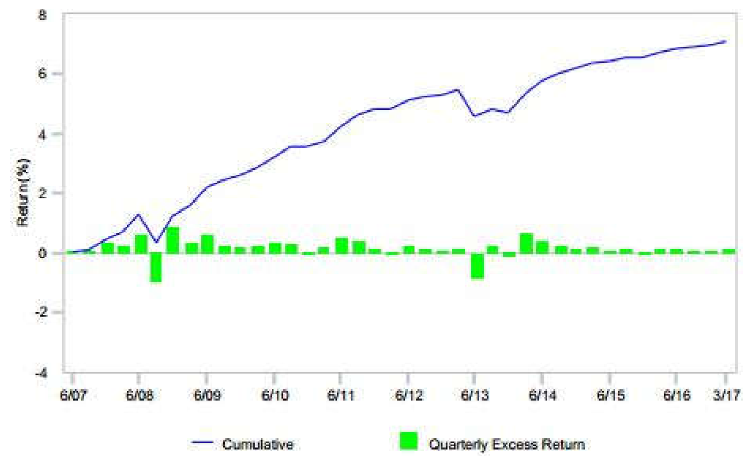


SHORT-TERM VS. PEER GROUP



TOTAL EXTERNAL MGRS VALUE ADDED

SHORT-TERM VALUE ADDED



MANAGER SCORECARD

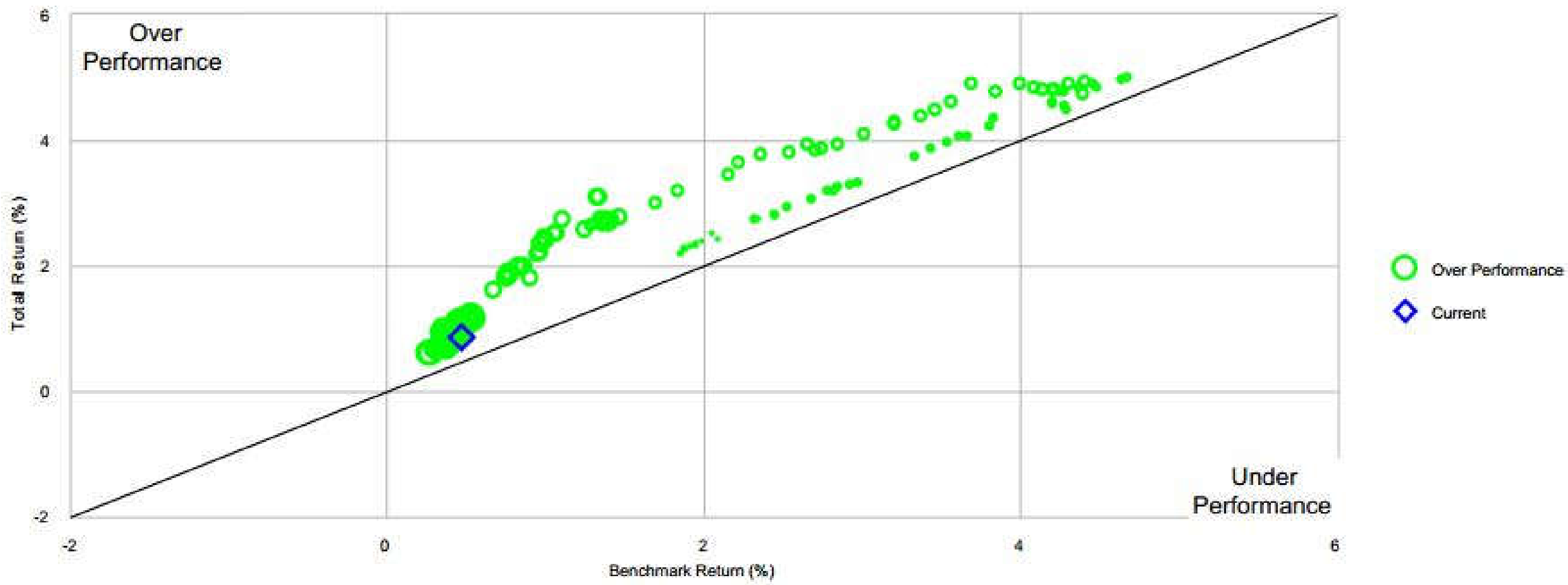
SINCE INCEPTION OF MANAGER

Manager	Return	Index Return	Std Dev	Alpha	Beta	Batting Average	Incept
Total Fund	2.48	1.85	1.03	0.52	1.06	73.74	5/02
Hillswick Asset Mgmt.	3.45	3.08	2.39	0.06	1.11	53.07	5/02
Reams Asset Mgmt.	3.63	3.08	2.63	0.98	0.86	55.87	5/02
Short-Term Account	1.88	1.32	0.66	0.77	0.85	78.21	5/02

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	OK
Hillswick Asset Mgmt	Under	Under	Exceed	Exceed	Positive	High
Reams Asset Mgmt	Exceed	Under	OK	Under	Positive	Low
Short-Term Account	Exceed	Exceed	Exceed	Exceed	Positive	Low

3-YEAR ROLLING VALUE ADDED FOR TOTAL FUND
(FROM INCEPTION)



Each green circle above the line represents a 3-year period above the benchmark, larger circles = more recent periods

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.