Fourth Quarter 2015
Investment Review

THE METROPOLITAN WATER DISTRICT *of* SOUTHERN CALIFORNIA

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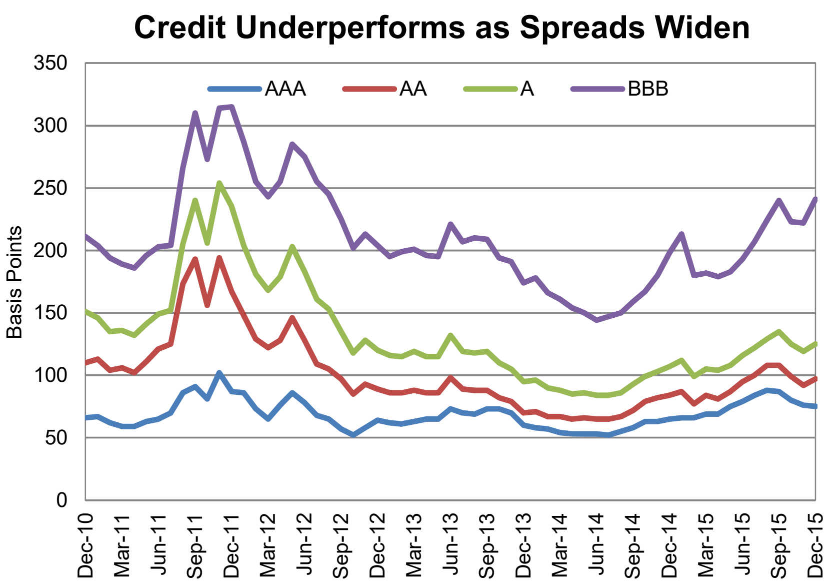
MARKET SNAPSHOT
DECEMBER 31, 2015

Index	Qtr	One Year	Three Year	Five Year
S&P 500	7.0%	1.4%	15.1%	12.6%
Dow Jones Industrial	7.7%	0.2%	12.7%	11.3%
Wilshire 5000	5.9%	-0.2%	14.4%	11.8%
MSCI EAFE Index	4.7%	-0.8%	5.0%	3.6%
Barclays Aggregate	-0.6%	0.5%	1.4%	3.2%
BofA ML G/C 1-5 Yr A+	**-0.6%**	**1.1%**	**0.9%**	**1.5%**
BofA ML 3 Month T-Bill	**0.0%**	**0.0%**	**0.0%**	**0.1%**



Source: Merrill Lynch

- The global stock markets (except EM) staged a recovery in the fourth quarter to end 2015 with either a small positive or negative return. But the rebound was quickly overshadowed by one of the worst starts on record for equities in early 2016.
- US equity performance was very narrow in 2015; the top 10 stocks in the S&P 500 Index were up +26% in 2015, while the remaining 490 stocks lost -1.1%. Big declines in the energy (-21%) and materials (-8.4%) sectors caused disruptions in both the stock and bond markets.
- Large US stocks was still one of the best places to be in 2015, beating cash (+0.1%), government bonds (+0.9%), IG corporate bonds (-0.8%), and gold (-11.6%). Growth stocks also beat value stocks by the widest margin (950 bps) since 2008.
- International developed market equities, as measured by the MSCI EAFE index, actually beat the US stock market for a year, but declines in foreign currency sliced -6.1% from EAFE and -9.2% from the EM index.
- Commodity prices fell again in 4Q, led by a -23% decline in petroleum. But nearly every commodity fell in 2015; lower growth, especially from China, was a major factor across the commodity markets.
- Commercial real estate is the one asset class that seems immune to lower growth and increased risk. With cap rates at historic lows, RE income will need to catch up to stretched valuations.
- US treasury bonds fell by nearly -1% in 4Q as the yield on the 10-year rose from 2.04% to 2.27%. The aggregate bond index returned just 0.5% in 2015, with a decline in corporate bonds (the worst sector), offset by a +1.5% return in the mortgage bond index.

Weak Economic Growth

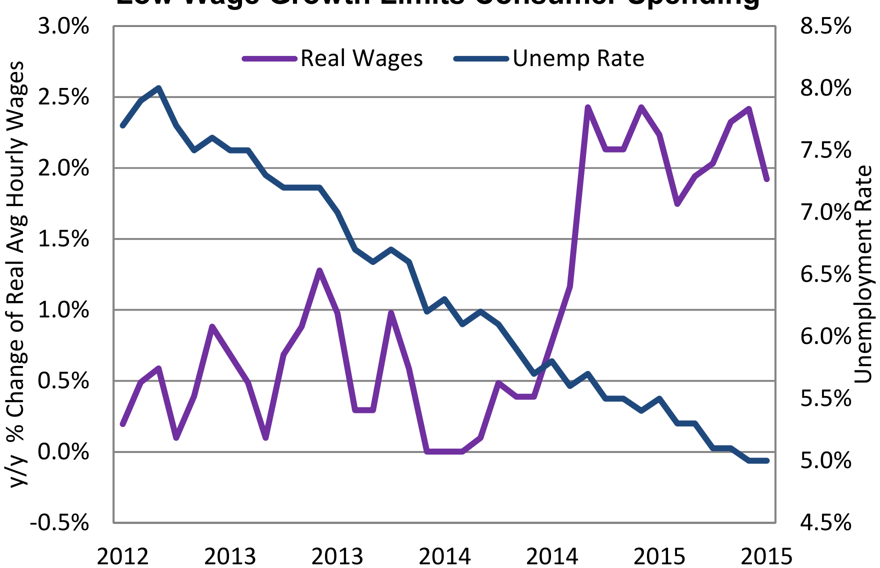
- Autos and housing are the only bright spots in an otherwise weak US economy. History seems to indicate (see Reinhart and Rogoff) that the recovery from a credit crisis extends over 10 years, so we may have to wait until 2018 for better growth.

- Positive factors for the US include solid employment growth and low inflation. The US remains a net importer of oil, so the decline in petroleum prices will ultimately be good. Low energy prices are also helping to offset persistent low wage growth.

- The European Central Bank was forced into another round of monetary easing in the fourth quarter to combat low growth and disruptions in Europe. The crisis in Syria spilled into the EU causing emigration problems that affected travel and trade.

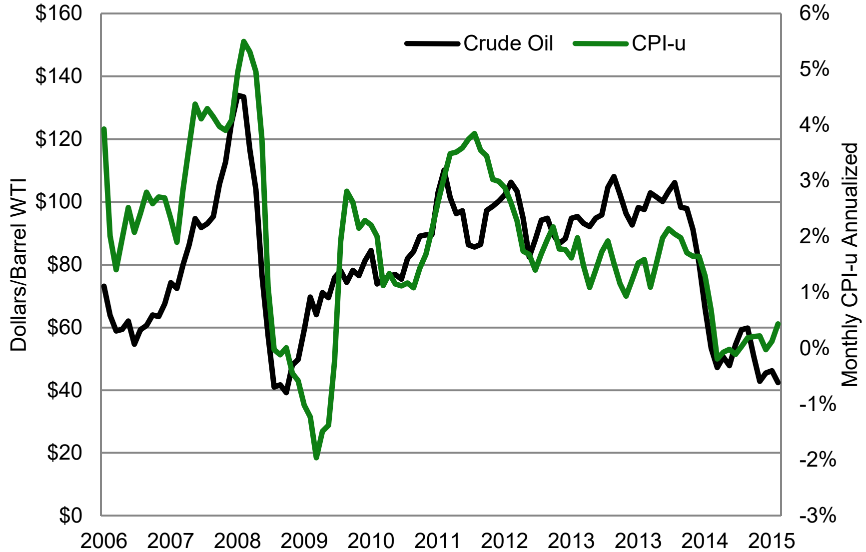
- The biggest economic news was the slowdown in China. The published growth rate of 6.5%, the lowest in 25 years, would still be the envy of most countries, but many were counting on stronger growth and the revised data reinforced the suspicion that recent results were inflated.

Low Wage Growth Limits Consumer Spending



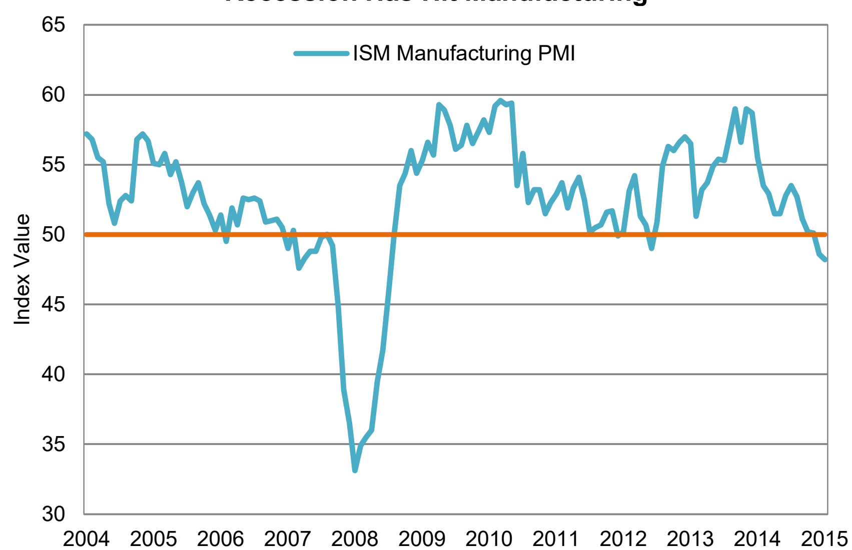
Source: Bureau of Labor Statistics

Steep Drop in Energy Caused by Supply and Demand



Source: Bureau of Labor Statistics

Recession Has Hit Manufacturing



Source: ISM

Low Growth and Credit Scare US Stock Investors

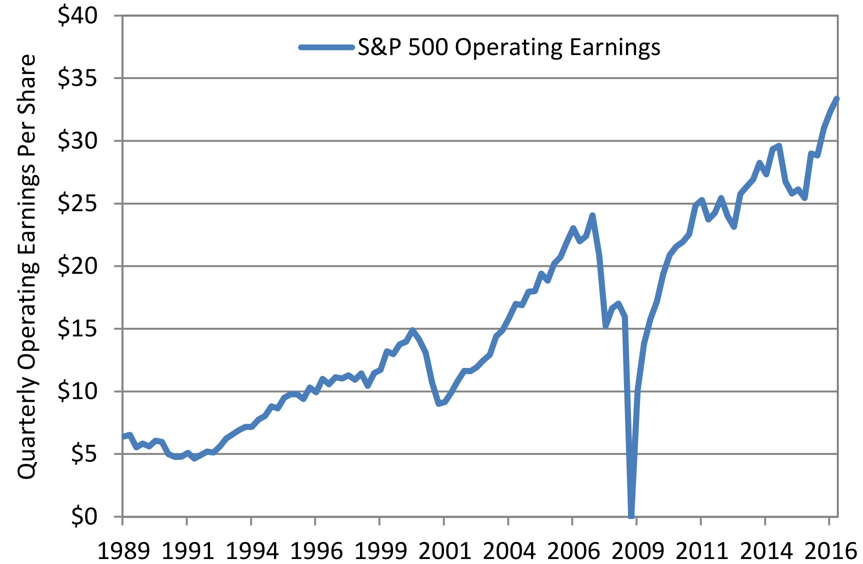
- Volatility returned to the US stock market as investors were forced to deal with lower global growth and the first Fed interest rate rise in the last 10 years. Investor attitudes changed due to the four "Cs:" China, credit, commodities, and currency.

- Active managers performed a little better in 2015. But the bar has been set low, with only 40% of large cap managers beating the Russell 1000 and 35% beating the S&P 500. One problem was the narrow market; the top 30 stocks in the Russell 3000 (just 1%) accounted for the gain, while the combined value of the remaining stocks declined in price.

- Consumer discretionary was the best performing sector in 2015 (+10%), but three-quarters of that return came from Amazon (the best stock in the S&P 500). Healthcare finished second (+6.9%), and has outperformed the market for the last five consecutive years.

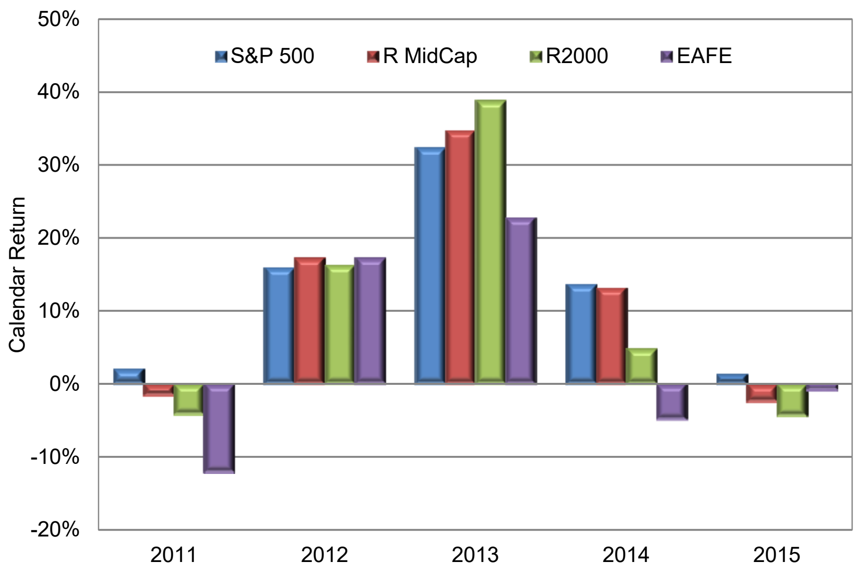
- Growth stocks beat value stocks by one of the widest margins ever (950 bps). Large tech stocks were particularly strong and drove the NASDAQ to a 7% gain in 2015.

Earnings Growth is Expected to Slow



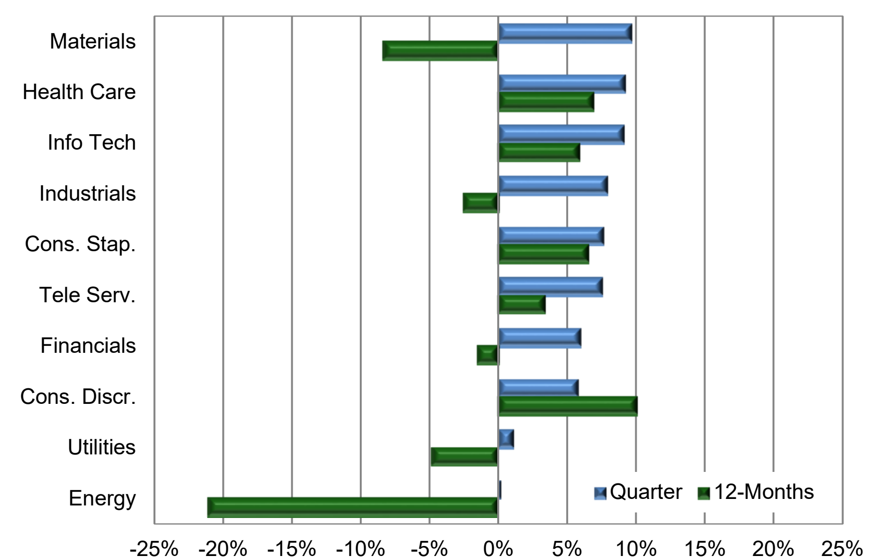
Source: Standard & Poor's

Low Returns Across Equity Markets



Source: Standard & Poor's, Russell, MSCI

Energy and Materials Drag Market Lower



Source: Standard & Poor's

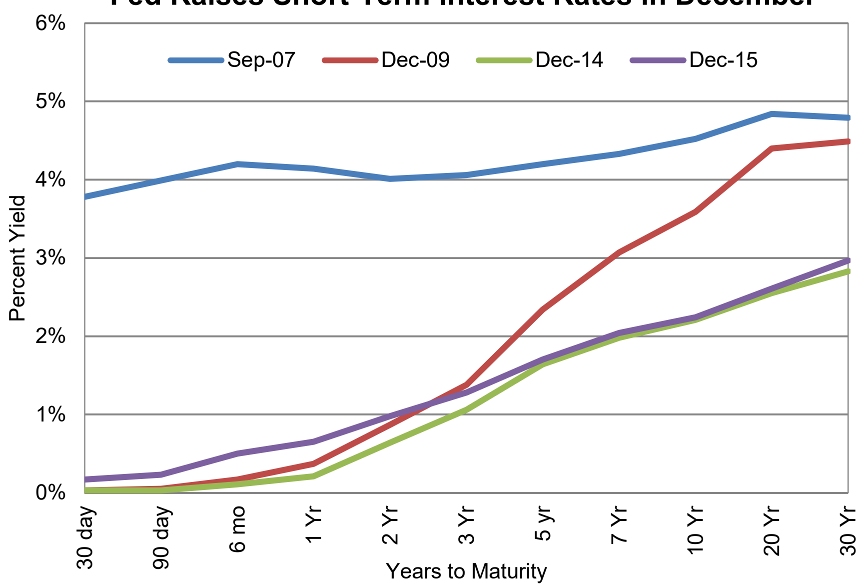
High Yield Bond Market is Hit Hard

- The aggregate bond market fell by -0.6% in 4Q and gained just +0.5% in 2015, as the Fed finally moved the target Fed funds rate on December 16 from 0.25% to 0.50%. At first, longer term yields rose (23 bps for the 10yr) and the yield curve steepened, but by mid January yields had fallen back to the levels prior to the rate hike.

- Mortgage bonds were the best performing sector (1.5%) followed by the other structured credit sectors, ABS (1.3%) and CMBS (1%). Corporate bonds fell across the board, but the biggest impact of the Fed tightening has been on high yield bonds, with a loss of -4.5% in 2015 and further declines in early 2016.

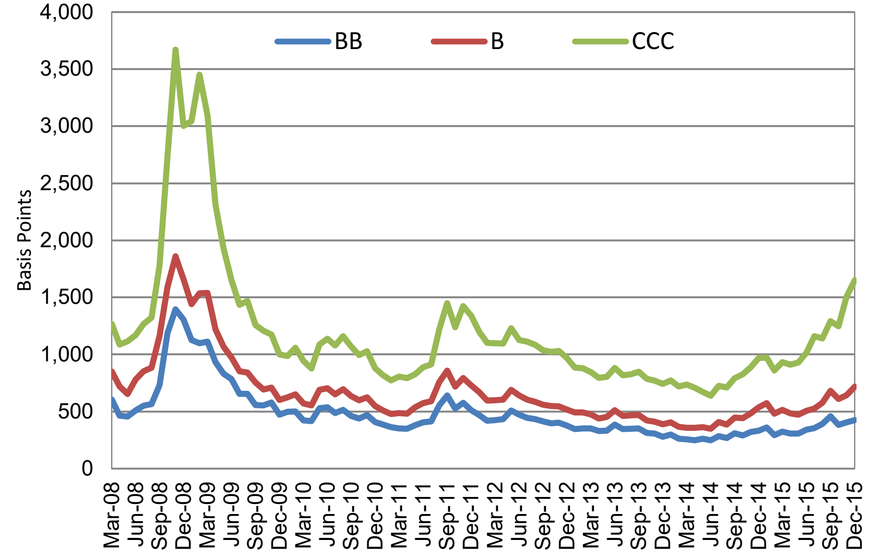
- The significant increase in high yield bond spreads is remarkable since it normally occurs only when a recession is eminent. Even more than the increase in stock market volatility (which is normal), the high yield bond market is signaling bigger problems in 2016.

Fed Raises Short-Term Interest Rates in December



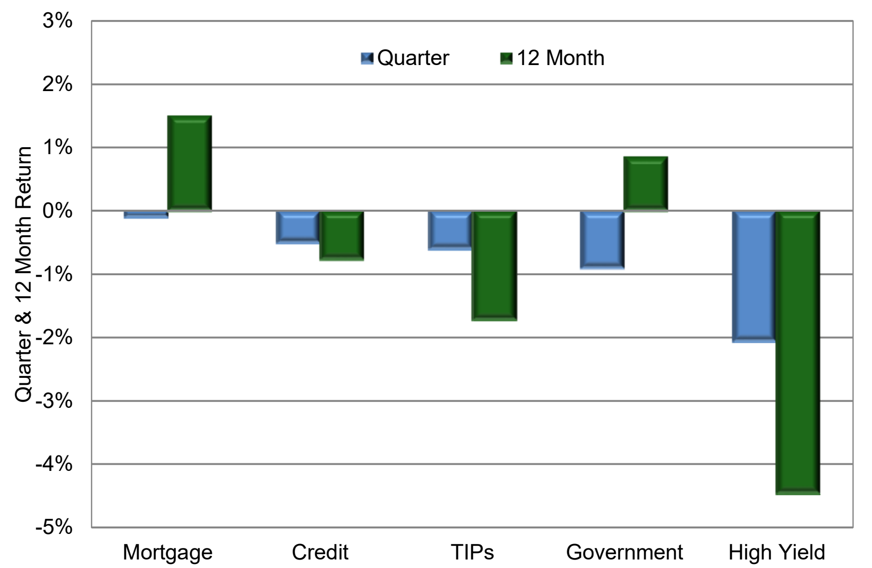
Source: Federal Reserve

Credit Spreads Increase Significantly



Source: Merrill Lynch

IG and HY Credit Underperformed



Source: Barclays

PORTFOLIO SUMMARY
DECEMBER 31, 2015

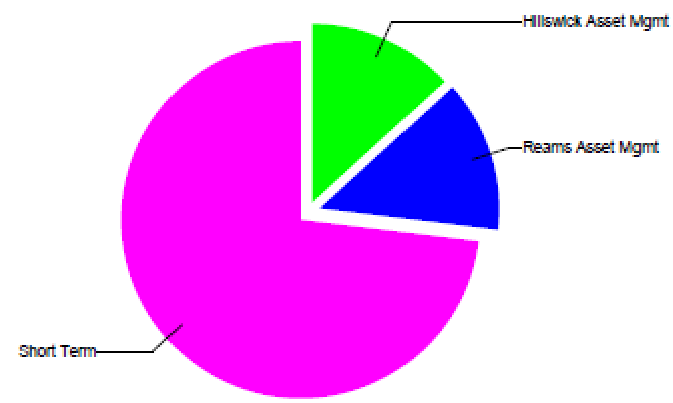
	Assets	Weight
Managed Accounts		
Hillswick Asset Mgmt	$166,429,788	13%
Reams Asset Mgmt	$172,948,169	14%
Total External Managed	$339,377,957	27%
Short-Term Account	$921,558,158	73%
Grand Total	**$1,260,936,114**	100%

- The value of the Total Fund increased by $270.7 million in the fourth quarter, due to net cash inflow of $272 million offset by an investment loss of $1.3 million.

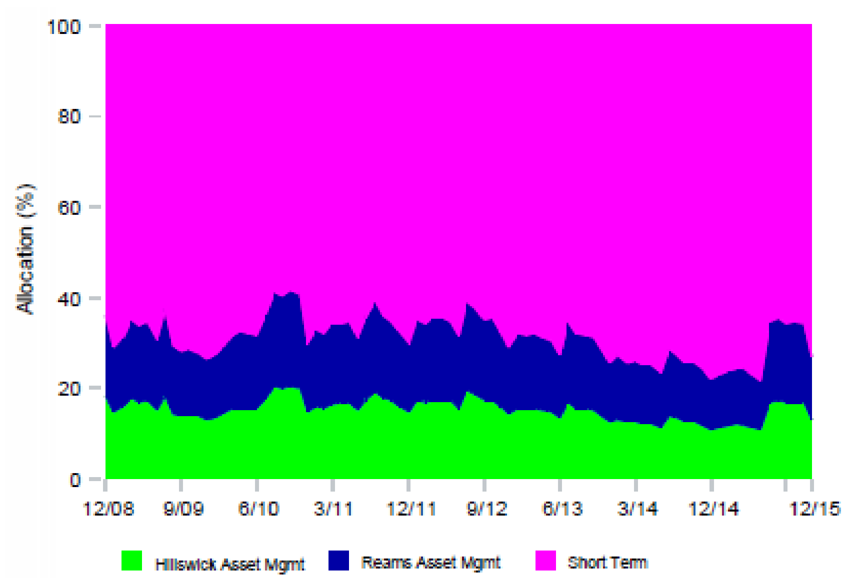
- Net investment gain/loss for the quarter were:

Hillswick	-$1.0 million
Reams	-$0.6 million
Short-Term	$0.3 million
Total	-$1.3 million

CURRENT ALLOCATION



HISTORICAL ALLOCATION



PERFORMANCE SUMMARY - TOTAL RETURN

DECEMBER 31, 2015

Manager	QTR	Fiscal YTD	1 Year	3 Yrs	5 Yrs
Total Fund	-0.1%	0.2%	0.6%	0.6%	1.1%
Benchmark[1]	-0.1%	0.0%	0.3%	0.3%	0.4%
Hillswick Asset Mgmt	-0.6%	0.3%	1.2%	1.0%	2.0%
BofA ML G/C 1-5 yr. A	-0.6%	0.1%	1.1%	0.9%	1.5%
Reams Asset Mgmt	-0.3%	0.2%	1.3%	1.1%	1.9%
BofA ML G/C 1-5 yr. A	-0.6%	0.1%	1.1%	0.9%	1.5%
Total External Managers	-0.5%	0.2%	1.2%	1.0%	2.0%
BofA ML G/C 1-5 yr. A	-0.6%	0.1%	1.1%	0.9%	1.5%
Short-Term Account	0.0%	0.2%	0.4%	0.5%	0.7%
BofA ML 90-day T-Bill	0.0%	0.0%	0.0%	0.0%	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 Fed's decision to raise the target rate for Fed funds from 0.25% to 0.5%, along with an increase in global equity risk, was enough to convince investors that the era of easy money was over and they dumped assets like high yield bonds.
- A small increase in Fed funds may not seem like much, but it changed investor psychology, so the selling of risk assets spilled over from high yield bonds to stocks and to investment grade bonds, producing negative returns in the benchmark index.
- Hillswick was right about the direction of yields and credit spreads, but with a portfolio of primarily government bonds they had few tools to avoid declining bond prices in the fourth quarter.
- Hillswick is expected to add value via duration management, and they generally met that goal in 2015. They still believe that spreads will widen further and current levels don't justify the added risk.
- Reams starts with a higher yielding portfolio by maintaining an underweight to government bonds. They expect a modest rise in interest rates but believe that the low duration portion of corporate bonds is attractive.
- Hillswick and Reams continue to work well in producing a diversified external bond portfolio.
- The staff-managed Short-Term Account was able to take advantage of higher spreads, after the Fed rate hike. The results are not evident in 4Q, but the higher yields will produce better income in 2016. The success of this approach is shown in the peer group comparison on page 8.

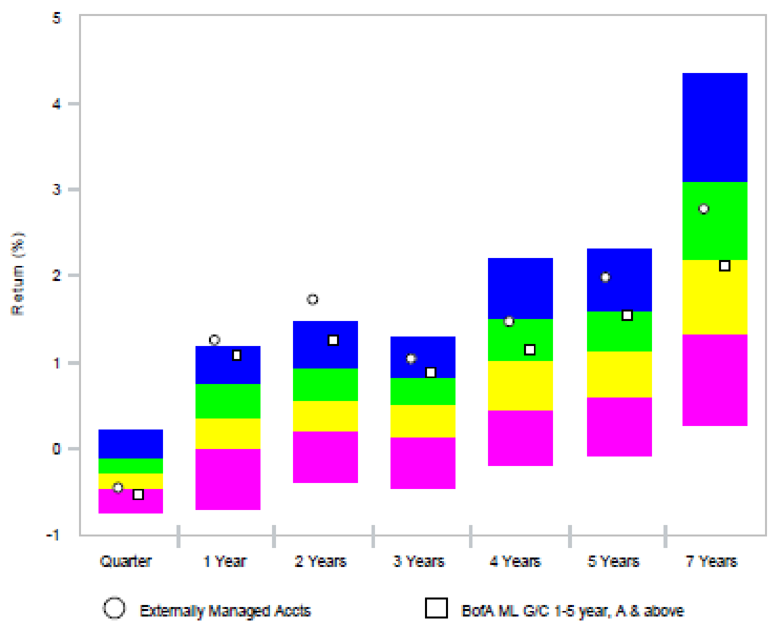
CONSOLIDATED BALANCE SHEET and CASH FLOW SUMMARY FOR THE FISCAL YEAR

JULY 1, 2015 TO DECEMBER 31, 2015

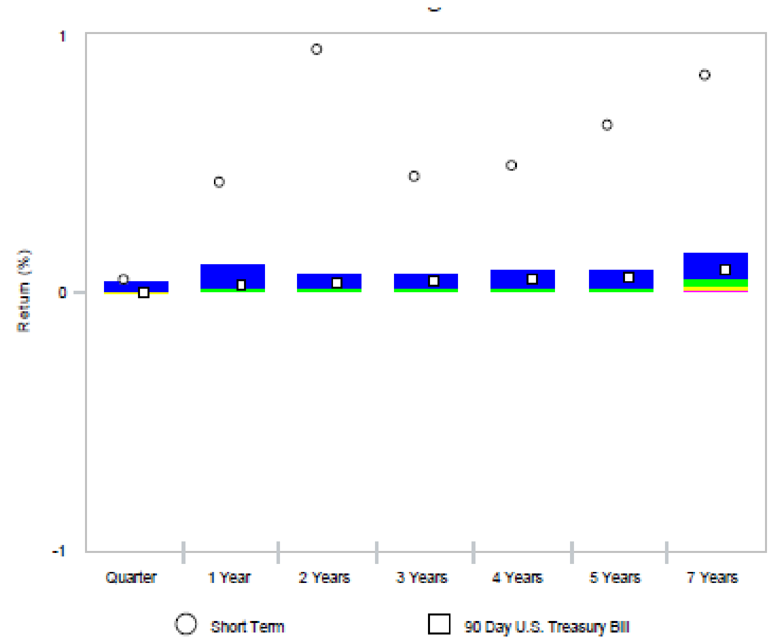
Manager	Beginning Balance	Net Cash Flows	Income	Gain/(Loss)	Ending Balance
Total Fund	$1,544,474,095	($285,655,596)	$6,105,801	($3,988,186)	$1,260,936,114
Externally Managed					
Hillswick Asset Mgmt	$165,968,580		$1,709,082	($1,247,874)	$166,429,788
Reams Asset Mgmt	$172,581,353		$1,557,907	($1,191,090)	$172,948,169
Total Externally Managed	$338,549,932		$3,266,989	($2,438,964)	$339,377,957
Short-Term Account	$1,205,924,163	($285,655,596)	$2,838,812	($1,549,221)	$921,558,158

Note: Totals may differ slightly due to rounding.

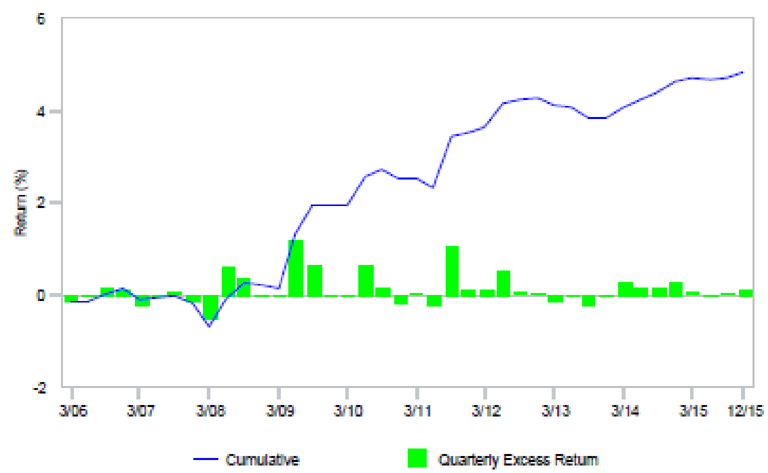
TOTAL EXTERNAL MGRS VS. PEER GROUP



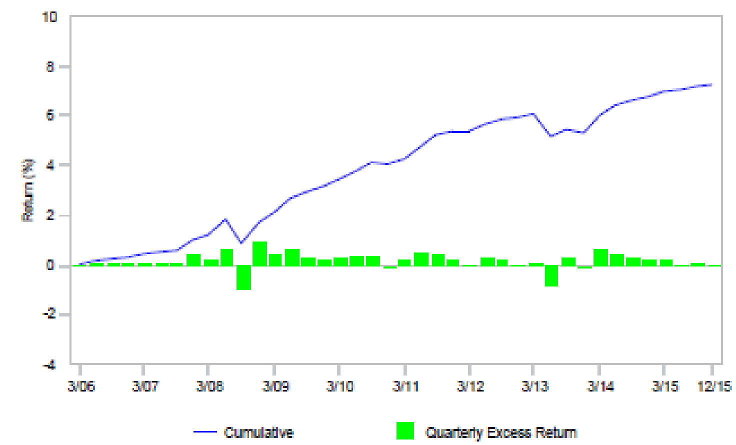
SHORT-TERM VS. PEER GROUP



TOTAL EXTERNAL MGRS VALUE ADDED



SHORT-TERM VALUE ADDED



MANAGER SCORECARD

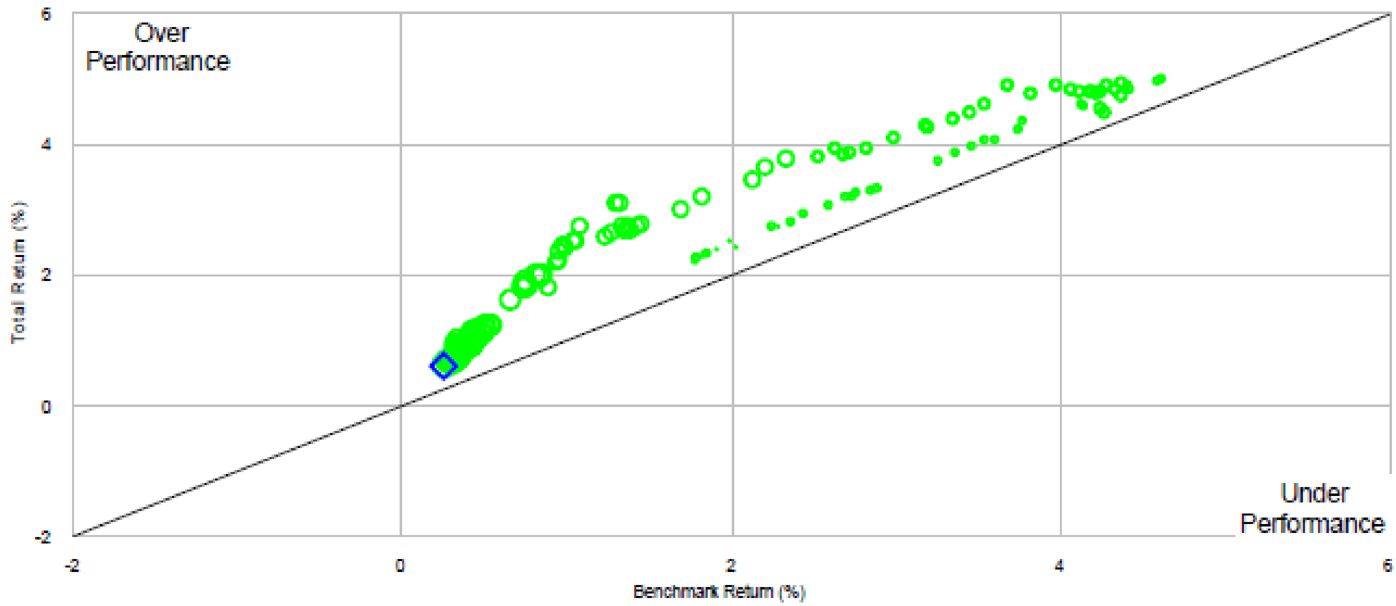
SINCE INCEPTION OF MANAGER

Manager	Return	Index Return	Std Dev	Alpha	Beta	Batting Average	Incept
Total Fund	2.63	1.93	1.05	0.60	1.06	744	5/02
Hillswick Asset Mgmt.	3.64	3.23	2.44	0.07	1.11	537	5/02
Reams Asset Mgmt.	3.84	3.23	2.71	1.07	0.86	567	5/02
Short-Term Account	1.99	1.36	0.68	0.83	0.85	787	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	Exceed	Exceed	Exceed	Exceed	OK	High
Reams Asset Mgmt	Exceed	Exceed	Exceed	Exceed	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.