Fourth Quarter 2016

Investment Review

THE METROPOLITAN WATER DISTRICT *of* SOUTHERN CALIFORNIA

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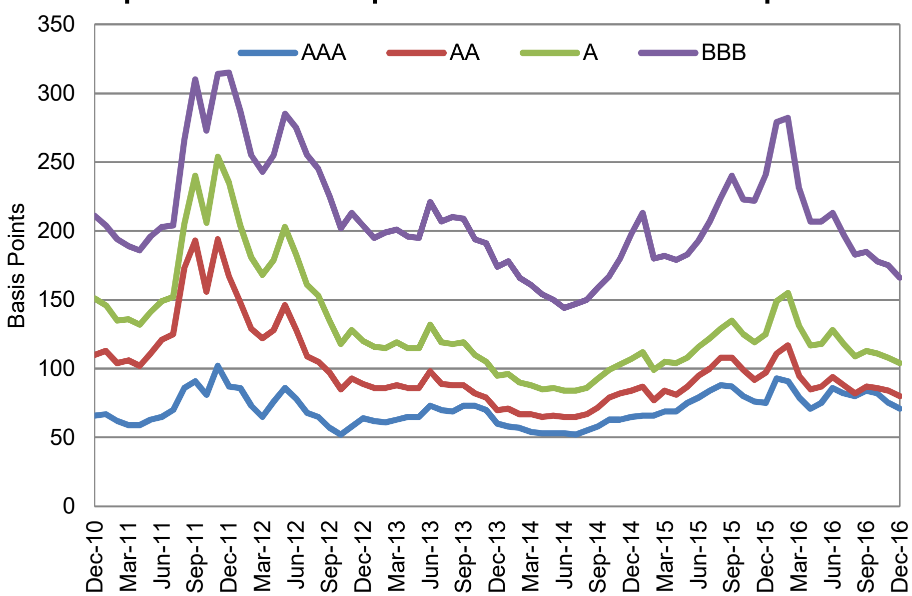
MARKET SNAPSHOT
DECEMBER 31, 2016

Index	Qtr	One Year	Three Year	Five Year
S&P 500	3.8%	12.0%	8.9%	14.7%
Dow Jones Industrial	8.7%	16.5%	8.7%	12.9%
Wilshire 5000	4.3%	13.0%	8.1%	14.5%
MSCI EAFE Index	-0.7%	1.0%	-1.6%	6.5%
Barclays Aggregate	-3.0%	2.7%	3.0%	2.2%
BofA ML G/C 1-5 Yr A+	**-1.1%**	**1.3%**	**1.3%**	**1.2%**
BofA ML 3 Month T-Bill	**0.1%**	**0.3%**	**0.1%**	**0.1%**

Corporate Bonds Outperform with Lower Credit Spreads



- Source: Merrill Lynch

- The US stock market rewarded investors with better than expected returns. President Trump's pledge to increase government spending on defense and infrastructure, while cutting taxes, is expected to create powerful fiscal stimulus that will offset the Fed's cut in monetary stimulus.

- The tax cut could increase earnings by more than 10%, with further gains from the stimulus program. But with current valuations at 19 PE, S&P earnings will need to rise to more than $130/sh to offset the PE compression from higher interest rates.

- US equity performance was dominated by the surge in financial stocks (+21%) and the decline in health care stocks (-4%), both driven by expected change in regulations. Small and mid-cap stocks surged even more, since they have higher average tax rates and lower exposure to foreign trade.

- International returns were negatively impacted by the strength of the dollar; the gain in the EAFE index was offset by a -7.8% increase in the dollar and the EM index was similarly affected by a -2.7% increase in the dollar against EM currencies.

- The yield on commercial real estate has now fallen below 5% and future returns will be limited by valuations that are 25% above the prior peak.

- Hedge funds had a disappointing year, but the strong energy market has lifted commodity prices across the entire complex. Supply and demand fundamentals are improving in agriculture and industrial metals (from growth in China).

- The December rate increase of 25 bps by the Fed was widely anticipated, but it still caused the largest quarterly decline in the bond averages in 35 years. Corp bonds and high yield, in particular, surged with the oil prices and the rebound in the stock market..

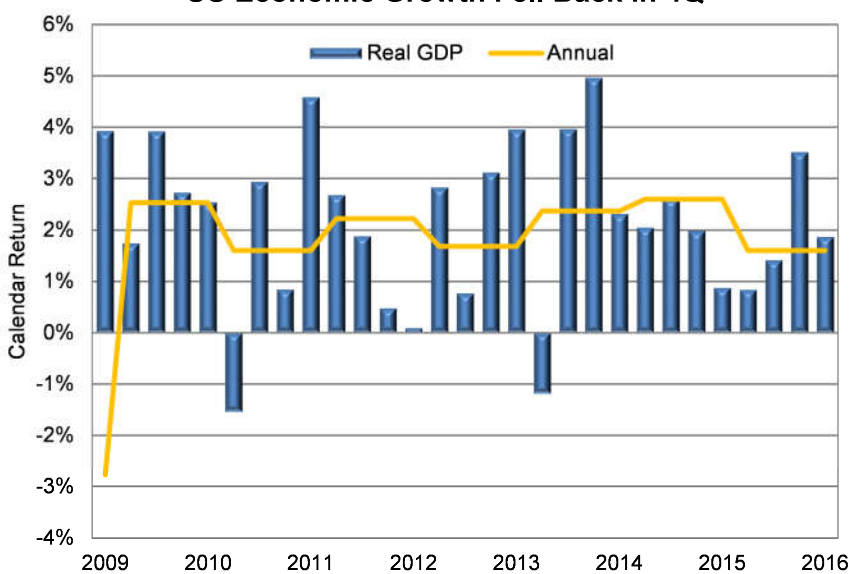
Economic Growth and Inflation Expected to Rise in 2017

- US economic growth slowed more than expected to +1.9% (est.) in 4Q (down from +3.5% in 3Q), as consumer spending and rising business investment was offset by a decline in exports. The trend line of sub 3% annual growth rates has remained in place since 2005, but investors are anticipating that the tax cuts and fiscal spending proposed by President Trump will reset this growth rate by the second half of 2017.

- Major international economies, unlike the US, continue to rely on expansionary monetary policies; but despite some initial success, they are struggling to maintain growth, and that is not expected to change due to: 1) low population growth, 2) debt added in the previous decade, and 3) globalization that dispersed high margin manufacturing jobs.

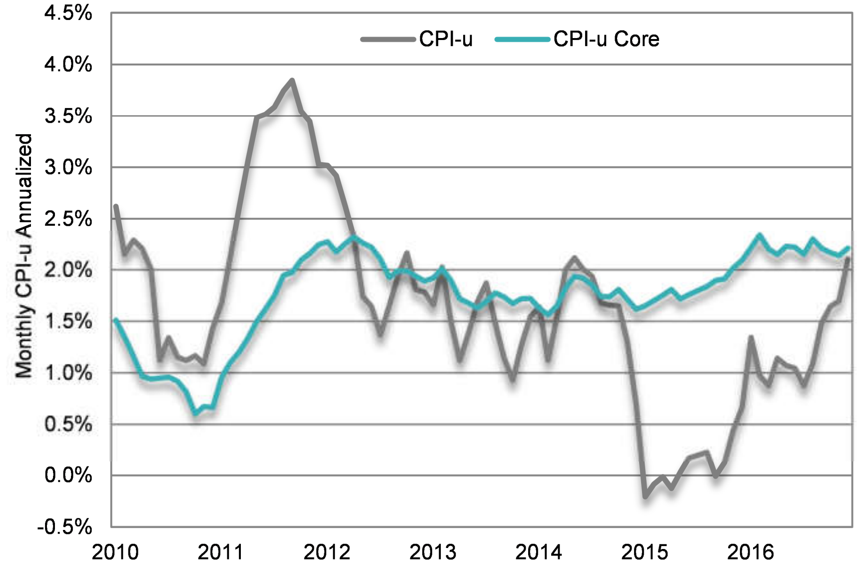
- The trend to higher inflation began in early 2016, and better growth and the decision by OPEC to cut oil production by 1.2M b/d will likely push inflation higher. Overall we expect the US economy to benefit from modest improvement in wages, better consumer confidence, and additional business investment (a factor missing in recent years), which will offset the headwinds of higher rates and a stronger dollar.

US Economic Growth Fell Back in 4Q



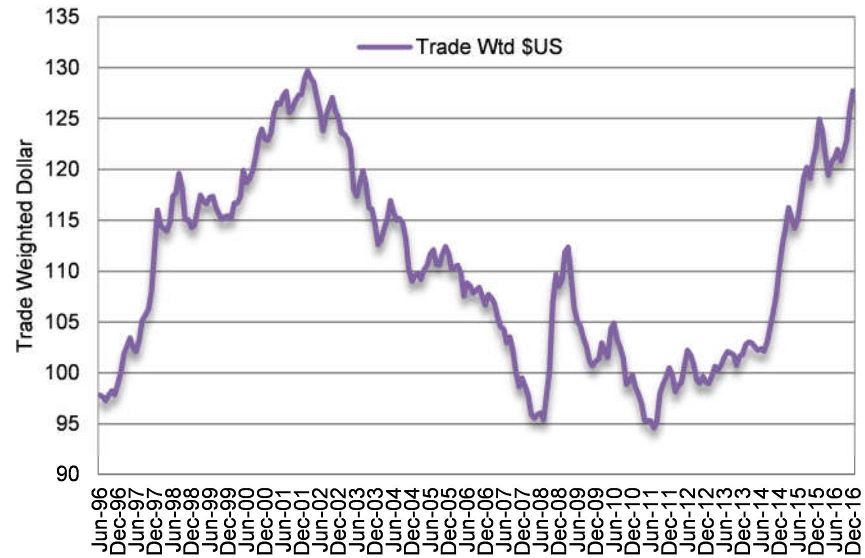
Source: US Bureau of Economic Analysis

Headline Inflation Rebounds with Energy Prices



Source: Bureau of Labor Statistics

US Dollar Driven Back to Tech Bubble Peak



Source: US Federal Reserve

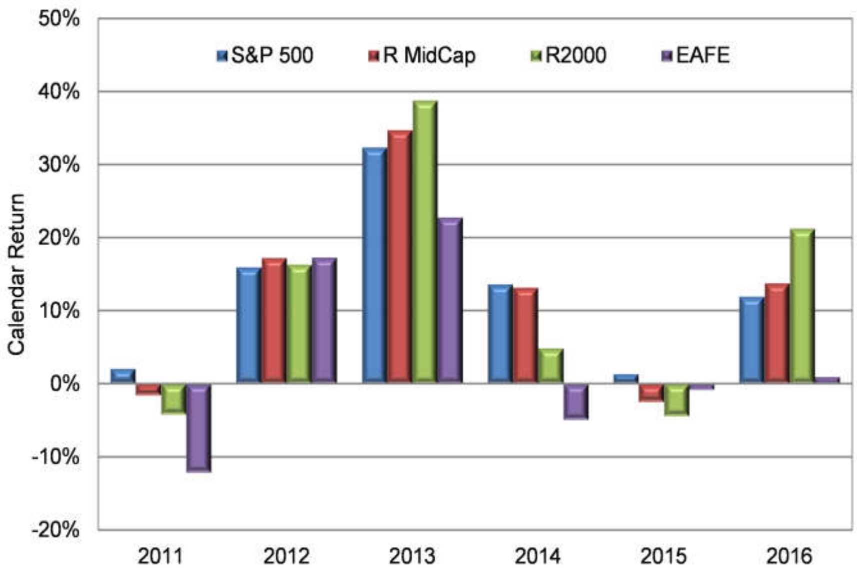
A Surprising Year Has a Surprising End

- US stock market posted solid gains in 4Q, offsetting the decline in October, in response to President Trump's pledge to increase government spending on defense and infrastructure, while cutting taxes and regulations. Small and mid-cap stocks responded positively, since they generally pay higher tax rates and are less exposed to foreign trade.

- Higher oil prices and the rotation to economically sensitive stocks lifted returns in energy (+7%), industrials (+7%) and materials (+5%), but the big winner was financials (+21%) driven by anticipated deregulation and higher int income. But high current valuations, rising interest rates, and strength in the dollar will be significant headwinds, which can be offset if earnings reach the expected target of $140+/sh by the end of 2017.

- Small cap stock valuations are 10% above historical averages, so reality will have to meet expectations, or the gains will evaporate. On the positive side, growth is improving (ISM Mfg 54.7%), recession risk is low (LEI +0.5%), consumer confidence is strong (a 13-year high), and business investment is rising; all of these factors should allow interest rates to rise without another taper tantrum.

Trump Rally Lifted Stocks to Solid Gains in 2016

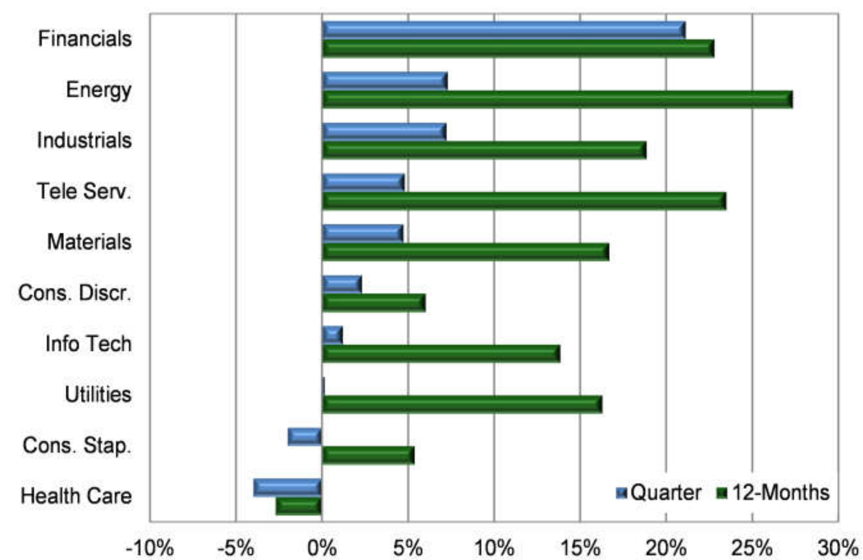


Source: Standard & Poor's, Russell, MSCI

Earnings Expected to Grow in 2017

Source: Standard & Poor's

Financials Surge on Deregulation, Gains in Interest Income



Source: Standard & Poor's

Strong Gains in Credit

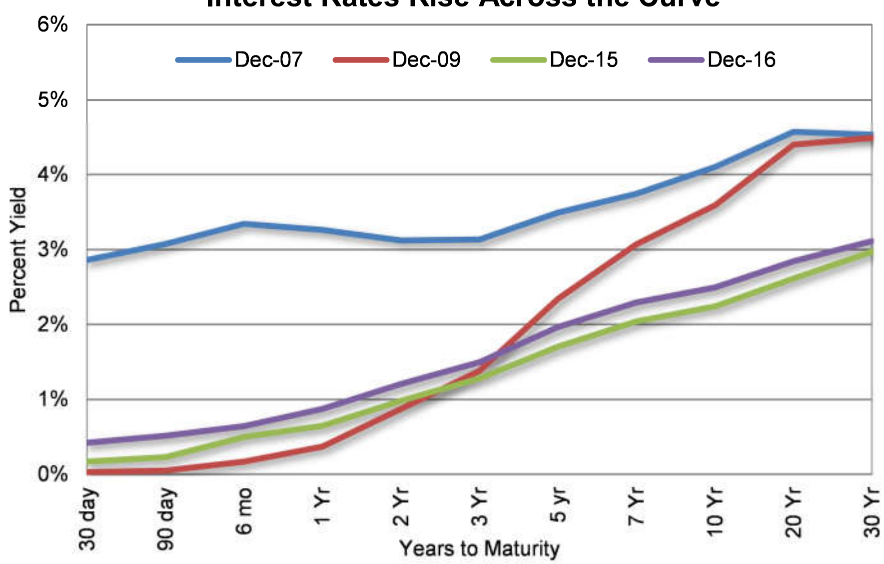
- The core US bond market (Bloom Barc US Aggregate) fell by -3.0% in 4Q, the worst quarter for the index in 35 years. US treasuries, with little yield cushion, fell even more by -3.8%, as the yield on the 10-year rose from 1.59% to 2.44%. All of this is reaction to the anticipated rise in Fed funds by 25 bps in December to a range of 0.50% to 0.75%, and the Fed is telegraphing three more 25 bps moves in 2017.

- Corporate and mortgage bonds also declined in the quarter, but outperformed duration matched treasuries by 156 bps and 39 bps respectively. The real winner was high yield corporate bonds which outperformed treasuries by more than 400 bps in the quarter, and gained 17.1% in 2016. Long treasuries declined by -11.7% in 4Q.

- Inflation expectations have increased since the election and TIPS outperformed treasuries with a gain of 4.7% in 2016.

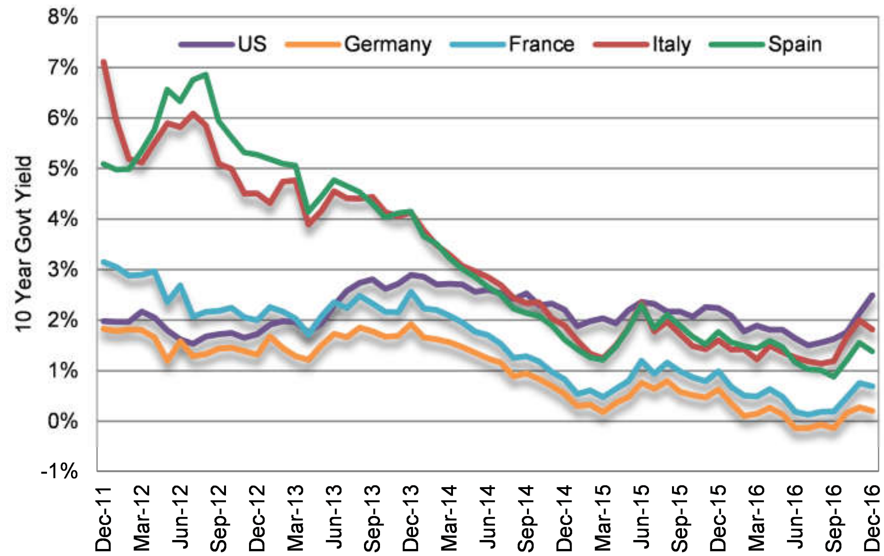
- Higher growth, higher inflation, and the rising rates have lifted the dollar, in particular to a 13-year high vs. the euro. In December the ECB announced an extension to its quant easing program, but currency was the biggest impact in the -11% decline for the JPM Global Bond Index.

Interest Rates Rise Across the Curve



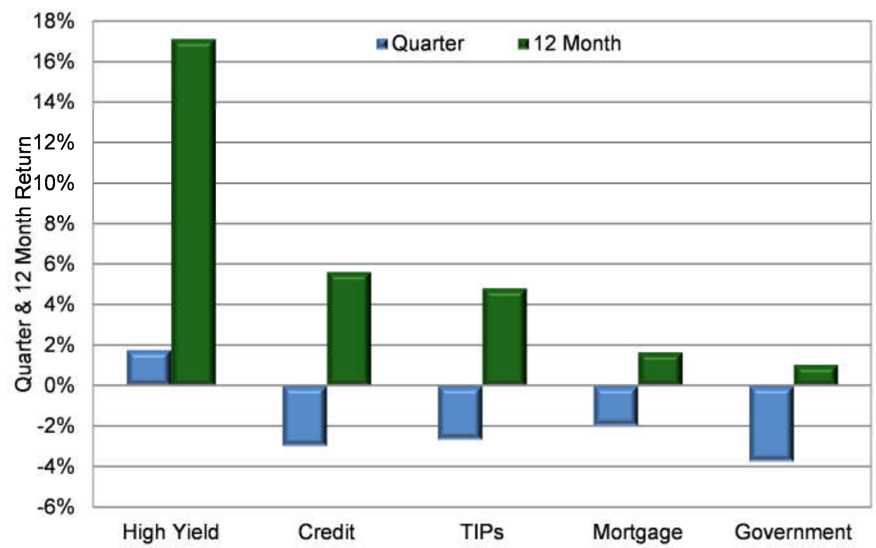
Source: Federal Reserve

Global Interest Rates Start to Rise



Source: Merrill Lynch

High Yield Bonds Lead the Rebound



Source: Barclays

PORTFOLIO SUMMARY
DECEMBER 31, 2016

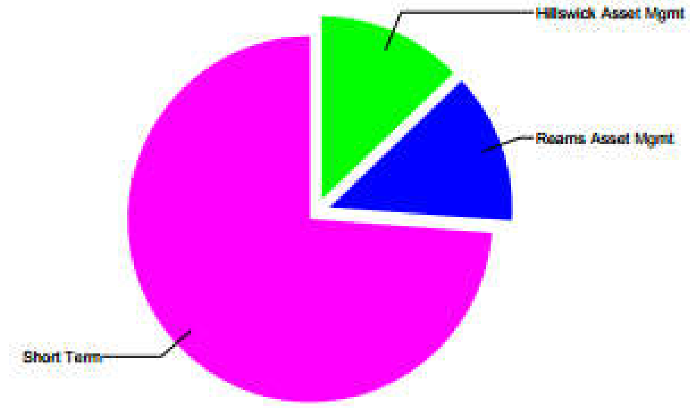
	Assets	Weight
Managed Accounts		
Hillswick Asset Mgmt	$168,863,108	13%
Reams Asset Mgmt	$175,034,560	13%
Total External Managed	$343,897,668	26%
Short-Term Account	$970,490,208	74%
Grand Total	$1,314,387,875	100%

- The value of the Total Fund increased by $339.5 million in the fourth quarter, due to net cash inflow of $342.3 million offset by an investment loss of $2.7 million.
- Net investment gain/loss for the quarter were:

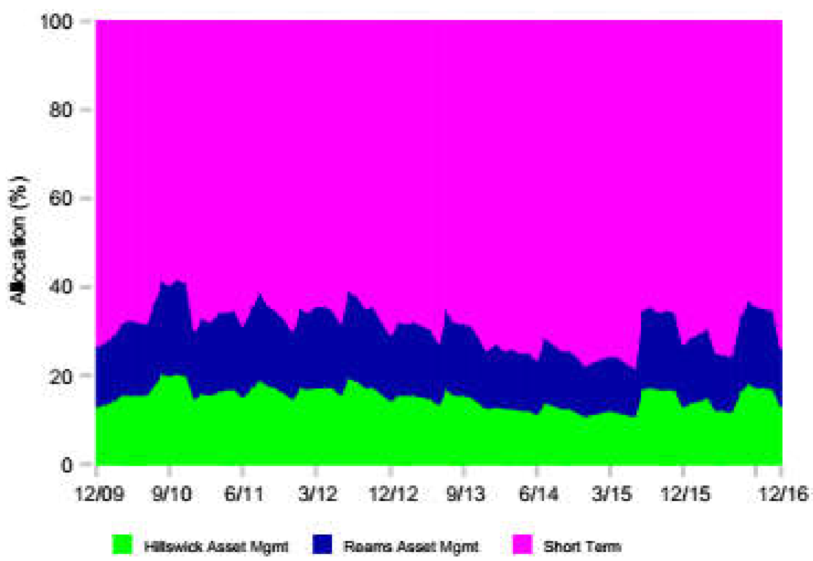
Hillswick	-$2.0 million
Reams	-$1.5 million
Short-Term	$0.8 million
Total	-$2.7 million

Note: Totals may differ slightly due to rounding.

CURRENT ALLOCATION



HISTORICAL ALLOCATION



PERFORMANCE SUMMARY - TOTAL RETURN
DECEMBER 31, 2016

Manager	QTR	Fiscal YTD	1 Year	3 Yrs	5 Yrs
Total Fund	-0.3%	-0.2%	0.7%	1.0%	0.8%
Benchmark[1]	-0.2%	-0.2%	0.6%	0.4%	0.4%
Hillswick Asset Mgmt	-1.2%	-1.3%	1.5%	1.9%	1.3%
BofA ML G/C 1-5 yr. A	-1.1%	-1.1%	1.3%	1.3%	1.2%
Reams Asset Mgmt	-0.9%	-0.9%	1.2%	1.3%	1.6%
BofA ML G/C 1-5 yr. A	-1.1%	-1.1%	1.3%	1.3%	1.2%
Total External Managers	-1.0%	-1.1%	1.3%	1.6%	1.4%
BofA ML G/C 1-5 yr. A	-1.1%	-1.1%	1.3%	1.3%	1.2%
Short-Term Account	0.1%	0.3%	0.7%	0.9%	0.5%
BofA ML 90-day T-Bill	0.1%	0.2%	0.3%	0.1%	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 fell just short of the benchmark due to rounding and a small drag from Hillswick, which was largely offset by Reams. The rise in interest rates in the fourth quarter was the reason for the -0.2% loss in the benchmark.

- Ten-year treasury yields rose from 1.59% to 2.44% in the quarter in anticipation of and reaction to the 25 bps increase in the Fed funds rate on December 14. US government bonds under-performed corporate and mortgage bonds, since they have little yield cushion to offset higher rates.

- The Hillswick portfolio holds primarily government bonds, with a corresponding underweight to corporate bonds versus the index. Although Hillswick moved to a slightly shorter duration in September, it was not enough to offset the 20 bps lower yield from holding primarily gov. bonds.

- Hillswick believes that the Fed is distorting the risk premiums (spreads) in the market and the yield pick-up from mortgage and corporate bonds is not enough to offset the risk in these sectors.

- Reams outperformed the benchmark for the quarter. An overweight to mortgages and a shorter duration position helped performance. Reams believes that the bond market is late in the credit cycle, so they will continue to conservatively position the portfolio and seek to add value through security selection in both corporate and mortgage bonds.

- The staff-managed Short-Term Account matched the benchmark for the quarter and maintains a strong yield premium versus the benchmark; the comparison to other cash portfolios is on page 8. The Short Term Account will benefit from higher yields in 2017.

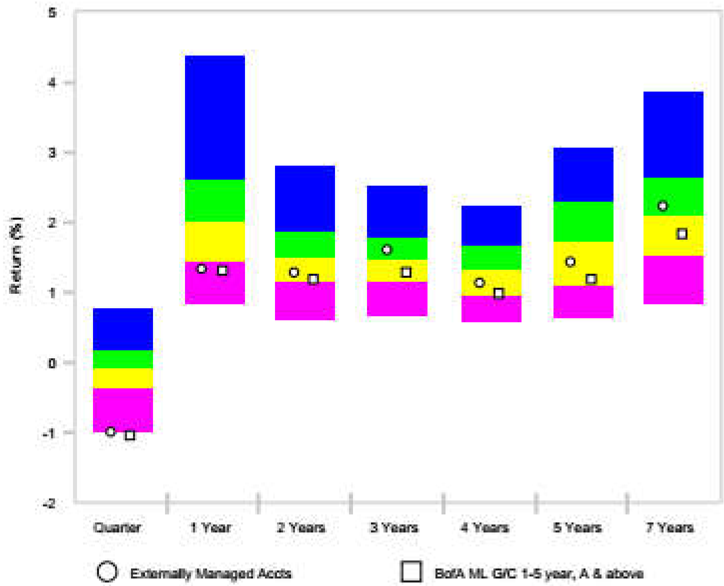
CONSOLIDATED BALANCE SHEET and CASH FLOW SUMMARY FOR THE FISCAL YEAR

JULY 1, 2016 TO DECEMBER 31, 2016

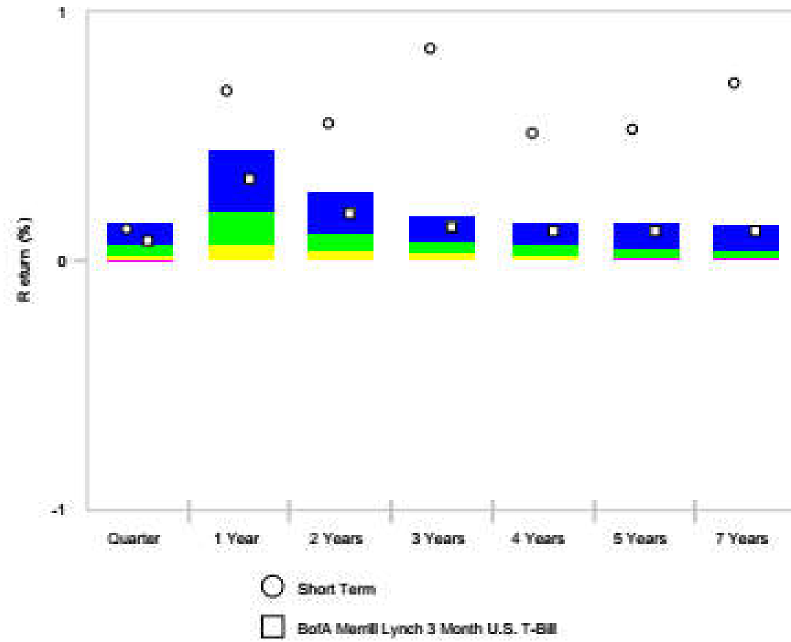
Manager	Beginning Balance	Net Cash Flows	Income	Gain/(Loss)	Ending Balance
Total Fund	**$1,435,462,976**	**($119,165,239)**	**$6,495,487**	**($8,405,349)**	**$1,314,387,875**
Externally Managed					
Hillswick Asset Mgmt	$171,009,214	$0	$1,684,348	($3,830,454)	$168,863,108
Reams Asset Mgmt	$176,624,830	$0	$1,696,122	($3,286,392)	$175,034,560
Total Externally Managed	$347,634,044	$0	$3,380,470	($7,116,846)	$343,897,668
Short-Term Account	$1,087,828,932	($119,165,239)	$3,115,017	($1,288,503)	$970,490,208

Note: Totals may differ slightly due to rounding.

TOTAL EXTERNAL MGRS VS. PEER GROUP

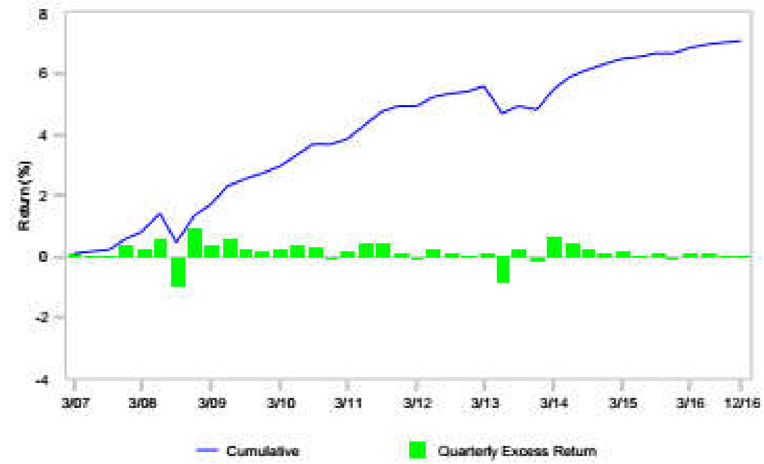


SHORT-TERM VS. PEER GROUP



TOTAL EXTERNAL MGRS VALUE ADDED

SHORT-TERM VALUE ADDED



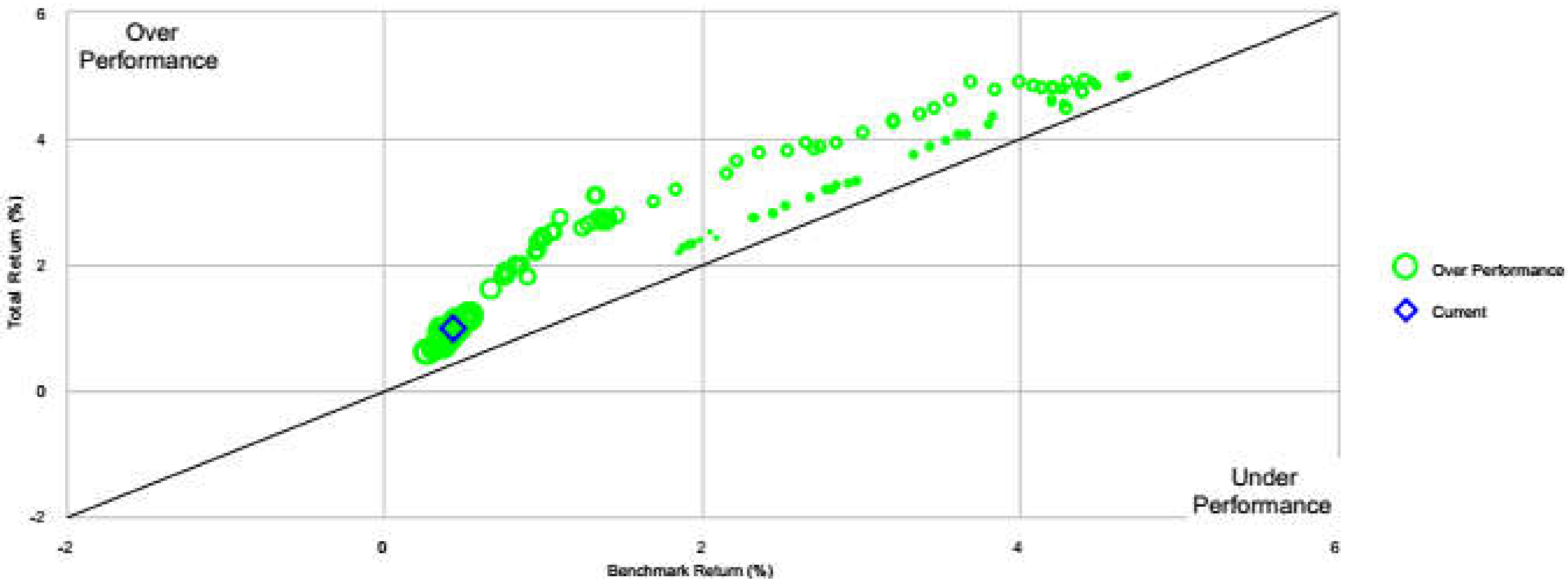
MANAGER SCORECARD
SINCE INCEPTION OF MANAGER

Manager	Return	Index Return	Std Dev	Alpha	Beta	Batting Average	Incept
Total Fund	2.50	1.86	1.03	0.52	1.06	73.30	5/02
Hillswick Asset Mgmt.	3.49	3.10	2.41	0.07	1.10	53.98	5/02
Reams Asset Mgmt.	3.66	3.10	2.65	1.00	0.86	56.82	5/02
Short-Term Account	1.90	1.34	0.67	0.77	0.85	77.84	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	OK	NA	Exceed	NA	Positive	OK
Hillswick Asset Mgmt	Exceed	Under	Exceed	Exceed	Positive	High
Reams Asset Mgmt	OK	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.