Second Quarter 2015
Investment Review

THE METROPOLITAN WATER DISTRICT
of SOUTHERN CALIFORNIA

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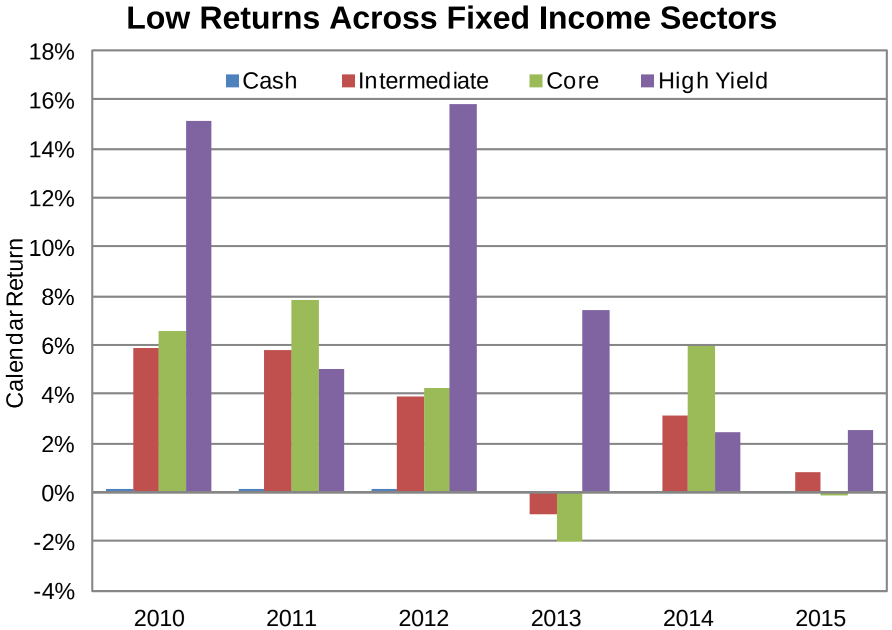
MARKET SNAPSHOT
JUNE 30, 2015

Index	Qtr	One Year	Three Year	Five Year
S&P 500	0.3%	7.4%	17.3%	17.3%
Dow Jones Industrial	-0.3%	7.2%	13.8%	15.4%
Wilshire 5000	0.0%	6.7%	17.6%	17.4%
MSCI EAFE Index	0.6%	-4.2%	12.0%	9.5%
Barclays Aggregate	-1.7%	1.9%	1.8%	3.4%
BofA ML G/C 1-5 Yr A+	**0.0%**	**1.4%**	**1.1%**	**1.7%**
BofA ML 3 Month T-Bill	**0.0%**	**0.0%**	**0.1%**	**0.1%**



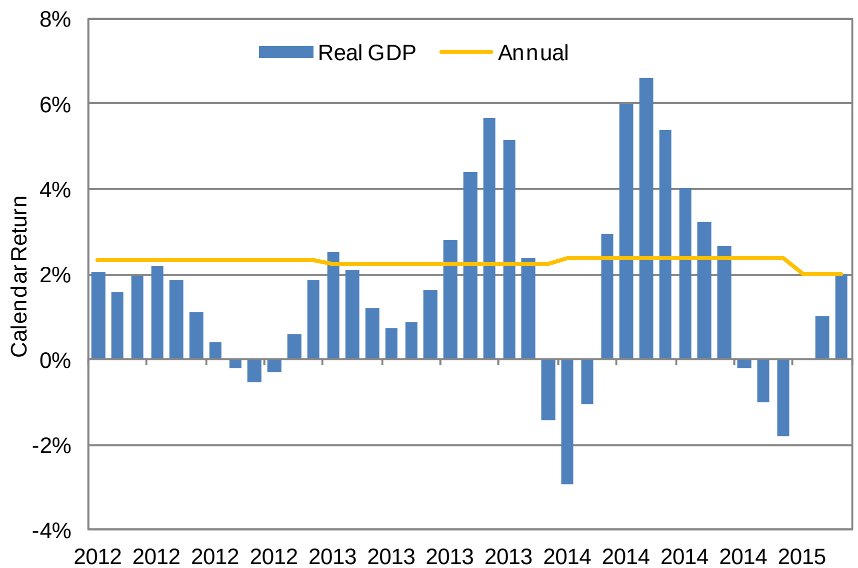
Source: Barclays Capital

- The US stock market ended the second quarter with a small gain, But the NASDAQ market was driven to new highs by enthusiasm for healthcare and technology. Analysts are pointing to the surge in small cap growth stocks as an indication of "irrational exuberance" in the stock market.
- Health care was once again the best performing sector in the S&P with a gain of +2.9%; utilities fell by -5.8% over concerns about growth and rates. The cap weighted indexes in the US are doing better than the average stock; many of which are trading below their 200-day moving averages.
- The EAFE Index declined by -1.8% in local currency terms, but gained +0.6% in USD with a rebound in the euro and pound sterling. The EM index also posed a small gain, but was battered in June and July by a -30% crash in mainland China.
- Prices increases in commercial real estate were so strong that even the Fed has expressed concern. Commodity prices were also strong in the quarter, but quickly reversed again in July.
- Hedge funds have struggled with narrow and volatile markets, but investors continue to focus on these strategies to offset low equity returns.
- Fixed income declined in the quarter, as the 10-year treasury yield rose by +40 bps to 2.3%. Corporate bonds sank by -2.7% during the quarter amid heavy supply and increasing rates. The yield curve steepened on improving economic data and the expectation of a Fed rate hike by 4Q.
- International yields bounced off record lows as reflected in the rebound in 10-yr German bonds, which rose from just 0.05% to 0.8%; yet €1 trillion in bonds are still trading at negative yields.

A Rebound, But Low Growth Expected in 2015

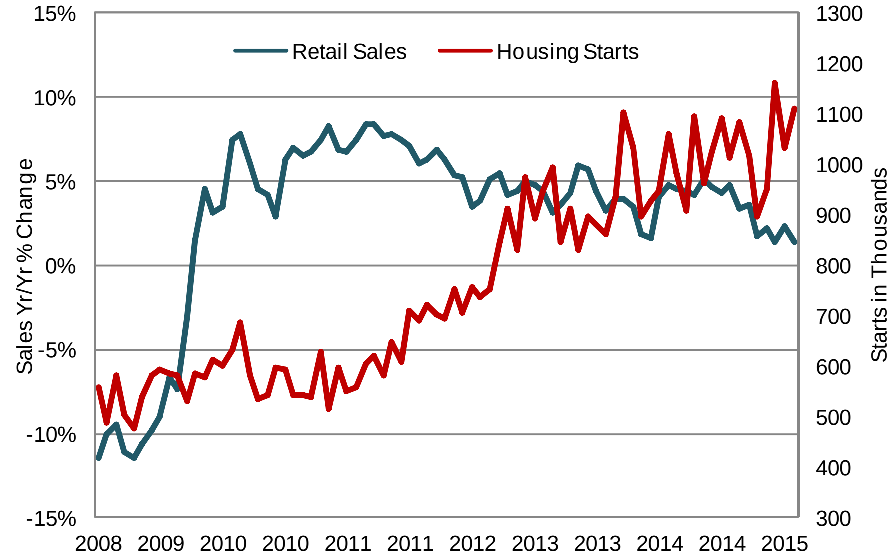
- The US economy grew at an estimated rate of +2.5% (annualized GDP) in the second quarter, following a decline of -0.2% in the first quarter. Cold weather was blamed for the weakness in early 2015, but aggregate demand remains weaker than expected.
- Retail sales declined by -0.3% in June, indicating that consumers are still hesitant to spend freely, despite lower gasoline prices. Some of the weakness in demand is due to the fact that average hourly earnings remain flat, even though the unemployment rate fell to 5.3%.
- Housing remains a bright spot; contracts to buy existing homes increased by 10.4% compared to May 2014; the highest level since April 2006. But home prices in key markets have been increasing faster than wages, so demand is likely to soften.
- Despite the turmoil in Greece, economic growth is improving in Europe and Japan; both regions have been helped by aggressive central bank intervention.

GDP Growth Recovers After Winter Slowdown



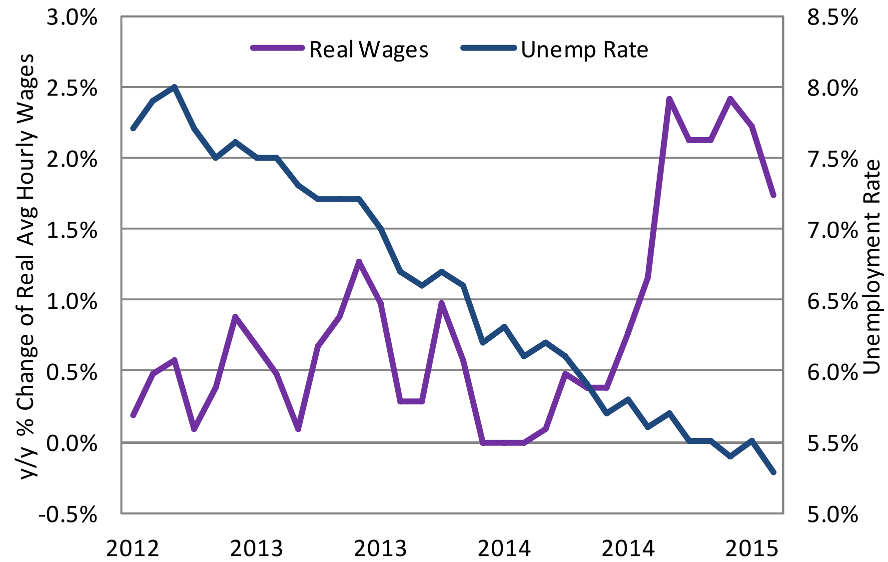
Source: Bureau of Labor Statistics

Retail Sales Disappoint in June



Source: US Census Bureau

Lower Unemployment is not Helping Real Wages



Source: Bureau of Labor Statistics

Low Returns for US Stocks

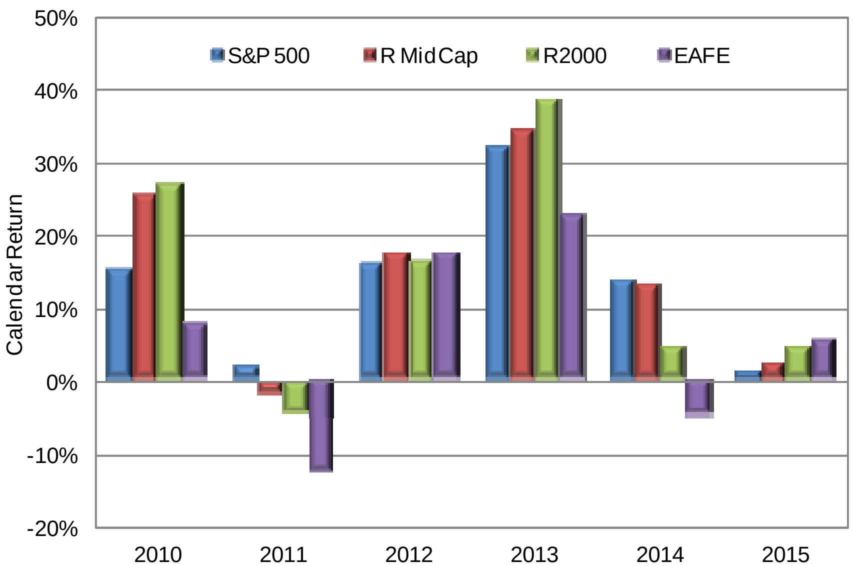
- The S&P 500 posted a gain of just +0.3% in the second quarter and +1.2% YTD. The price of the DJIA actually dropped -1.1% YTD; the first 6 mo. loss since 2010. S&P estimates that earnings will decline by -4.5% in 2Q, but most of the decline is in the energy sector; ex-energy earnings are expected to rise by +3.3%.

- Health care was again the best performing sector aided by vigorous M&A activity. Utilities were the worst performer, losing -5.8%; the sector has been under pressure, along with REITs, in 2015 due to concerns about the impact of a Fed rate increase.

- Active large cap managers outperformed by a small margin in the quarter; 59% of active managers beat the Russell 1000 index, but the average excess return was just 20 bps.

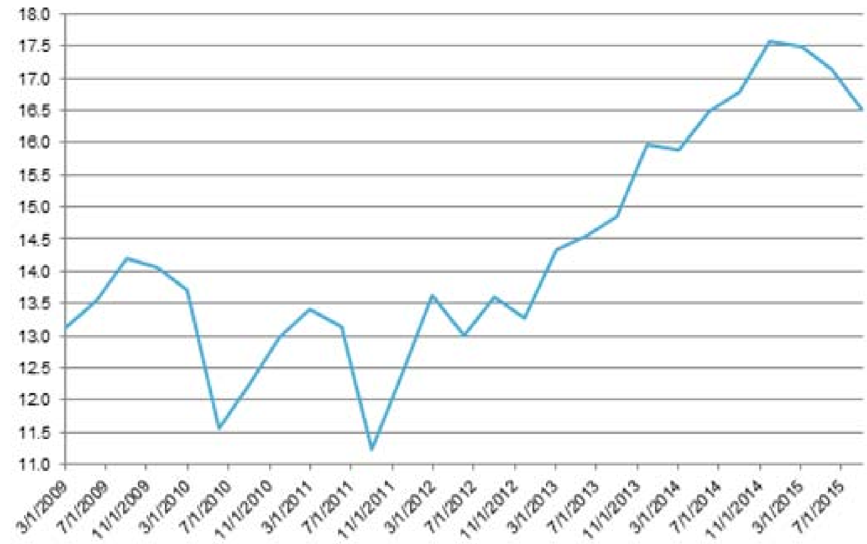
- Growth stocks, especially small cap growth, outperformed value, as investors rewarded companies that could grow in this difficult environment; however, valuations are stretched.

Large Cap Stocks Lag YTD



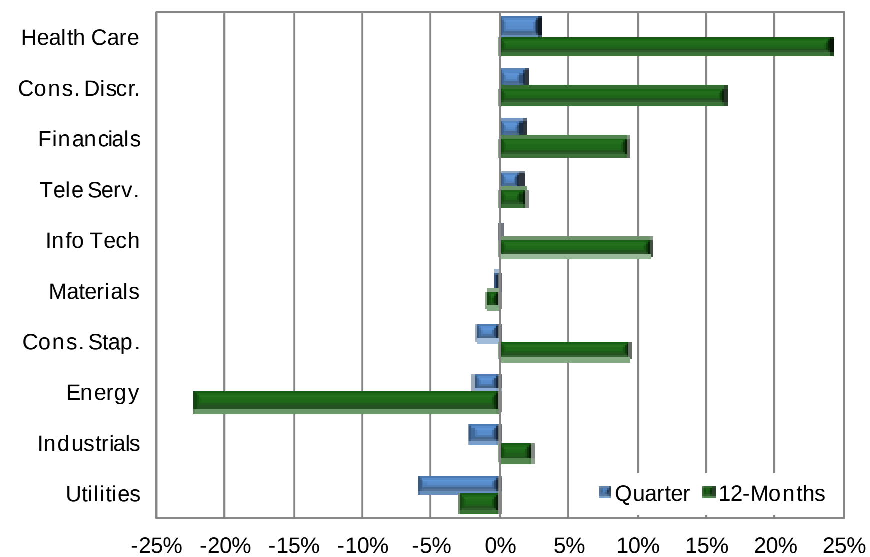
Source: Standard & Poor's, Russell, MSCI

S&P 500 Forward PEs Will Limit Future Gains



Source: S&P Capital IQ

Health Care On Top; Energy and Utilities Decline



Source: Standard & Poor's

Yields Rise on Fed, Economic Data

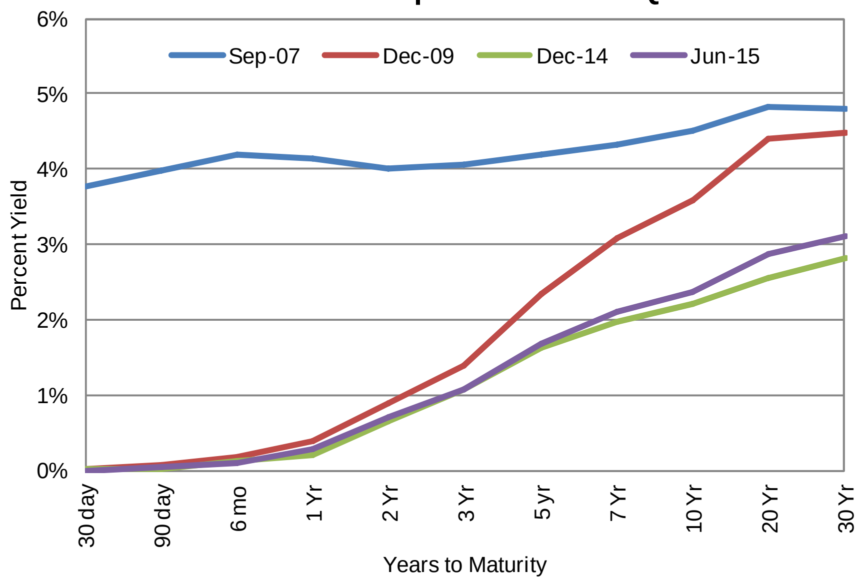
- Anticipation of an interest rate hike by the Fed resulted in a steepening of the yield curve and wider spreads in the second quarter. The 10-yr treasury yield rose +40 bps to 2.3%, and the Barclays US Aggregate is now at a small loss of -0.1% for 2015.

- Corporate bonds underperformed the broad bond market with a loss of -2.7%, amid $365 billion of new issuance (up 18% YoY). High yield spreads also widened in June, but the sector has been able to stay significantly positive (up +2.5% YTD) due to higher coupons.

- European yields surged in the second quarter as investors realized yields had fallen to irrational levels, even with ECB intervention. The yield on the German 10-year bond rose from an all-time low of 0.05% in mid April to over 1% in June, settling at 0.8% on June 30.

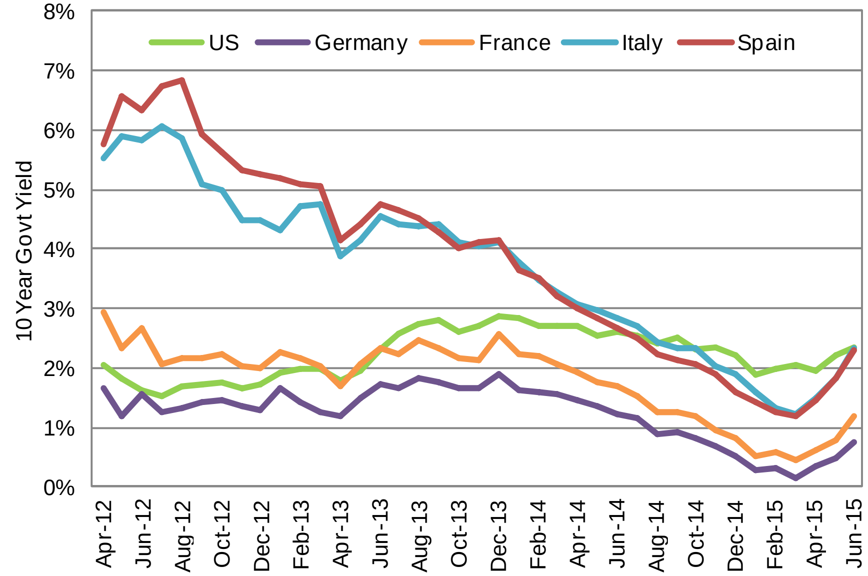
- The Fed has indicated they are still on track to raise rates later this year with continued progress in the labor market. If the decision is "data dependent," a rate hike may still be a year away, but our best guess is that the Fed will begin the process with 25 bps sometime in 4Q.

Yield Curve Steepens in Second Quarter



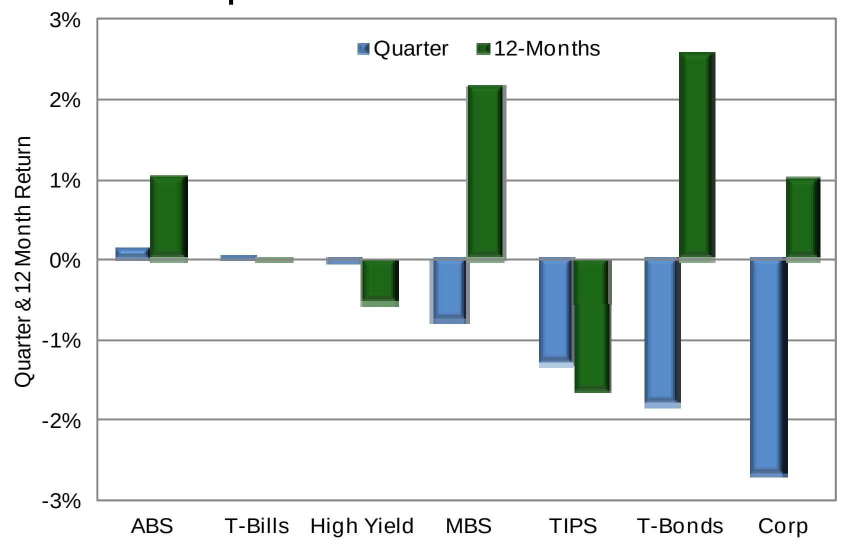
Source: Federal Reserve

Sharp Rise in European Yields



Source: Federal Reserve, Bloomberg

Corporate Bonds Suffer as Yields Rise



Source: Merrill Lynch

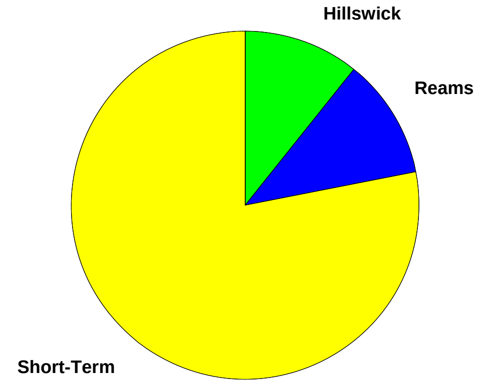
PORTFOLIO SUMMARY
JUNE 30, 2015

	Assets	Weight
Managed Accounts		
Hillswick Asset Mgmt	$165,968,600	11%
Reams Asset Mgmt	$172,581,300	11%
Total External Managed	$338,549,900	22%
Short-Term Account	$1,205,924,200	78%
Grand Total	**$1,544,474,100**	100%

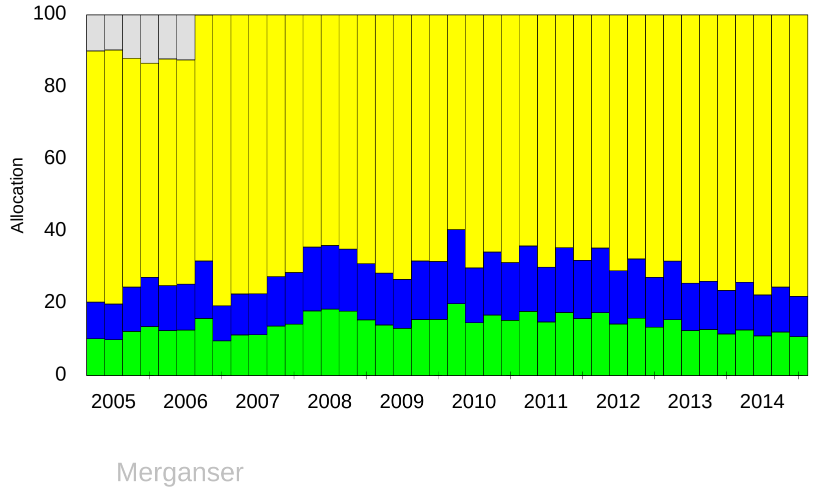
- The value of the Total Fund increased by $160.9 million in the second quarter, due to net cash inflow of $160.4 million and investment gains of $0.5 million.
- Net investment gain/loss for the quarter were:

Hillswick	-$0.4 million
Reams	$0.2 million
Short-Term	$0.7 million
Total	$0.5 million

CURRENT ALLOCATION



HISTORICAL ALLOCATION



PERFORMANCE SUMMARY - TOTAL RETURN

JUNE 30, 2015

Manager	QTR	Fiscal YTD	1 Year	3 Yrs	5 Yrs
Total Fund	0.0%	0.9%	0.9%	0.7%	1.2%
Benchmark[1]	0.0%	0.3%	0.3%	0.4%	0.6%
Hillswick Asset Mgmt	-0.2%	2.2%	2.2%	1.0%	2.1%
BofA ML G/C 1-5 yr. A	0.0%	1.4%	1.4%	1.1%	1.7%
Reams Asset Mgmt	0.1%	1.4%	1.4%	1.6%	2.1%
BofA ML G/C 1-5 yr. A	0.0%	1.4%	1.4%	1.1%	1.7%
Total External Managers	0.0%	1.8%	1.8%	1.3%	2.1%
BofA ML G/C 1-5 yr. A	0.0%	1.4%	1.4%	1.1%	1.7%
Short-Term Account	0.1%	0.6%	0.6%	0.5%	0.7%
BofA ML 90-day T-Bill	0.0%	0.0%	0.0%	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.

- Interest rates increased during the second quarter, which caused a decline in bond prices that fully offset the interest earned by the Fund and caused a small loss of about -4 bps (rounded to 0.0%).
- Despite the commonly held belief that the Fed will begin raising interest rates in the fourth quarter; Hillswick believes that 10-year treasury rates will fall back to the 1.9% level last seen in March, so they are maintaining a duration about 10% longer than the benchmark. The longer duration resulted in a 20 bps loss in 2Q.
- Hillswick also maintains higher-than-benchmark credit quality (i.e. low corporate and mortgage bond exposure), believing that corporate and mortgage bond spreads will widen further and current levels don't justify the added risk.
- Hillswick and Reams have portfolio yields close to the benchmark of 1.1%; the low YTM is just one indication of how far yields have fallen.
- Reams remains underweight government bonds, with a duration of about 2.3 years, 15% short of the benchmark. They expect a modest rise in interest rates and believe that real rates are unattractive in low duration bonds.
- Both external managers remain cautious. Reams is concerned that yields will rise due to a change in monetary policy, and Hillswick believes that spreads will rise due to bond market instability.
- The staff-managed Short-Term Account continues to take advantage of market opportunities in off-the-run and higher coupon cash securities. The success of this approach is shown in the peer group comparison on page 8.

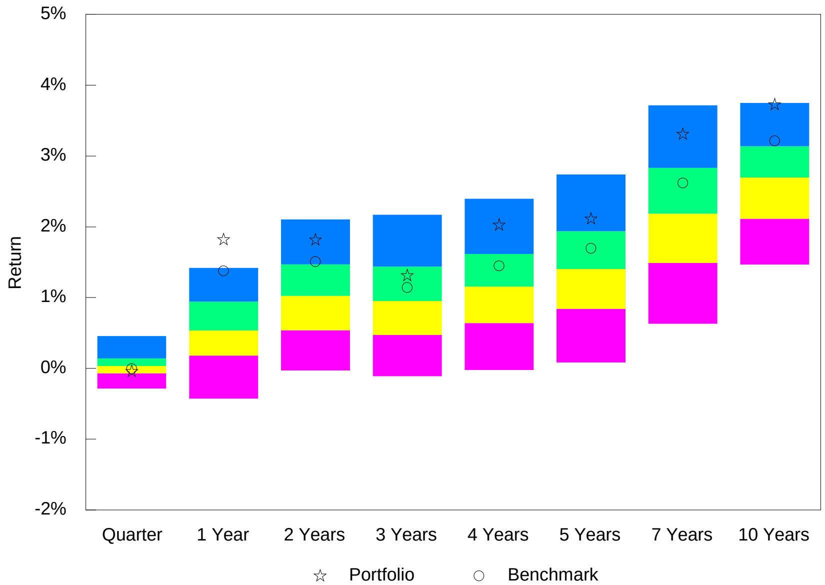
CONSOLIDATED BALANCE SHEET and CASH FLOW SUMMARY FOR THE FISCAL YEAR

JULY 1, 2014 TO JUNE 30, 2015

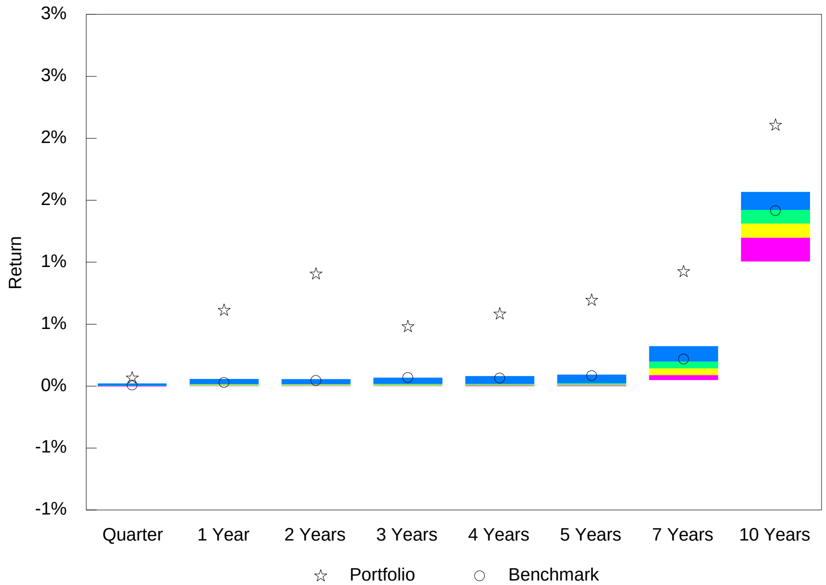
Manager	Beginning Balance	Net Cash Flows	Income	Gain/(Loss)	Ending Balance
Total Fund	**$1,412,053,200**	**$120,790,900**	**$14,838,700**	**($3,208,700)**	**$1,544,474,100**
Externally Managed					
Hillswick Asset Mgmt	$162,331,600	$0	$3,929,900	($292,900)	$165,968,600
Reams Asset Mgmt	$170,169,600	$0	$2,663,000	($251,300)	$172,581,300
Total Externally Managed	$332,501,200	$0	$6,592,900	($544,200)	$338,549,900
Short-Term Account	$1,079,551,900	$120,790,900	$8,245,900	($2,664,500)	$1,205,924,200

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

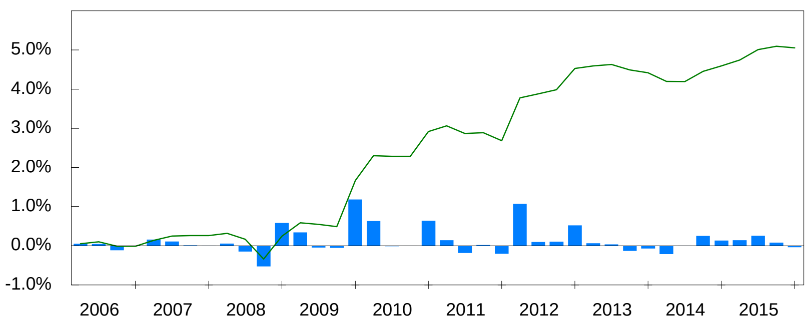
TOTAL EXTERNAL MGRS VS. PEER GROUP



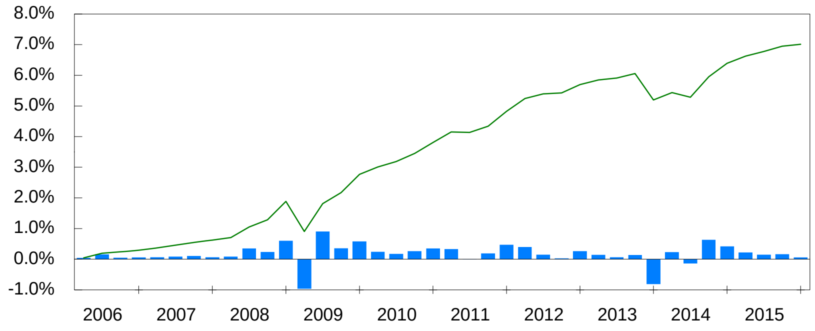
SHORT-TERM VS. PEER GROUP



TOTAL EXTERNAL MGRS VALUE ADDED



SHORT-TERM VALUE ADDED



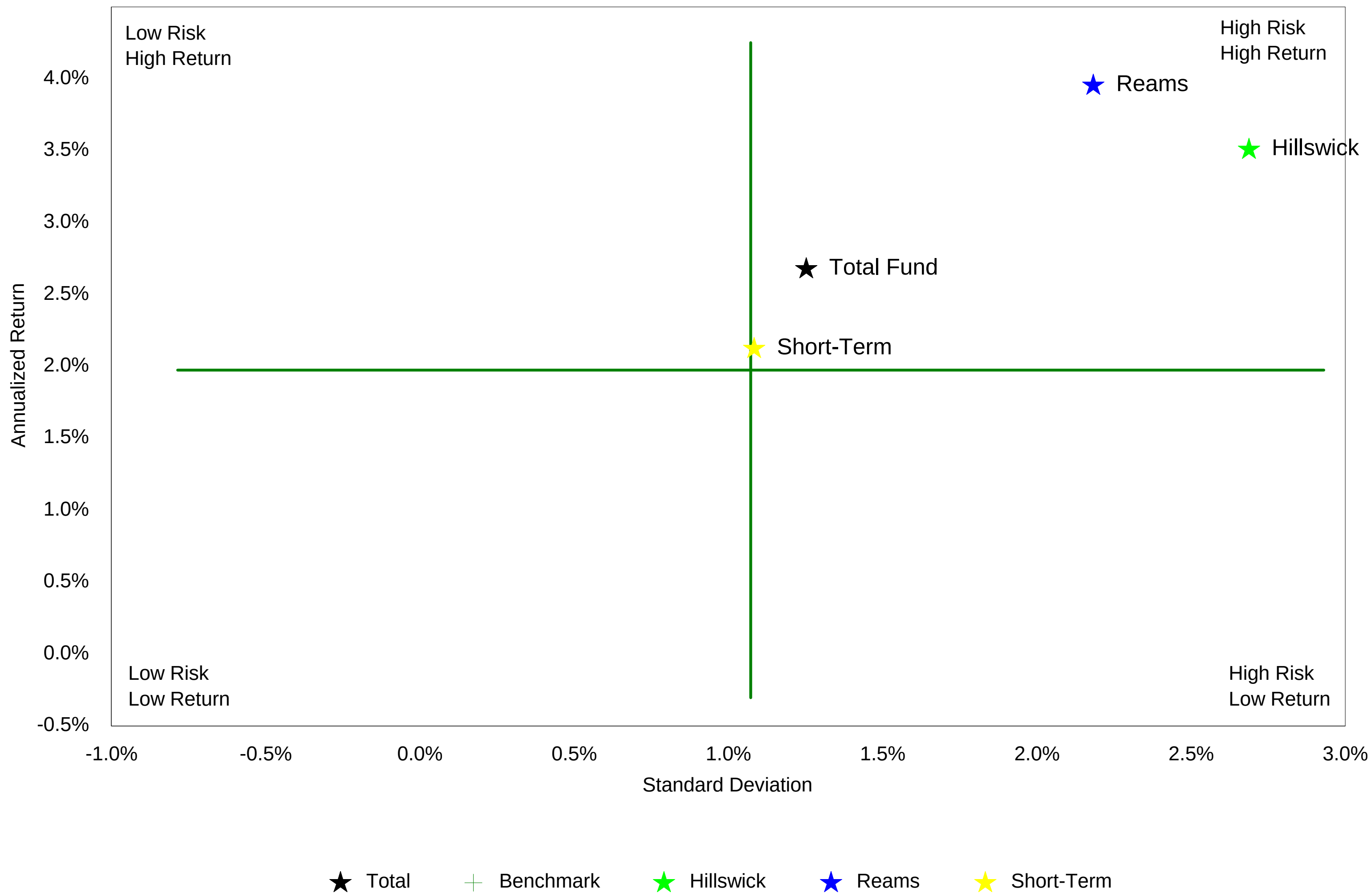
MANAGER SCORECARD
TEN-YEAR RESULTS

Manager	Return	Index Return	Std Dev	Alpha	Beta	Batting Average	Incept
Total Fund	2.68	1.97	1.25	0.44	1.36	850	3Q05
Hillswick Asset Mgmt.	3.51	3.24	2.69	-0.06	1.17	425	3Q05
Reams Asset Mgmt.	3.95	3.24	2.18	0.97	0.86	700	3Q05
Short-Term Account	2.12	1.43	1.08	0.79	0.34	900	3Q05

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	Exceed	Exceed	OK	Exceed	OK	High
Reams Asset Mgmt	OK	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.