April 14, 2008 **First Quarter 2008 Client Letter**

"Empirical on the Radio"

Two of our managing partners, Ken Smith and Jack Monteith recently began co-hosting a financial radio show titled "Successful Investing". The show can be heard in the following markets:

- Seattle on AM 880 KIXI (Sundays at 9:30am)
- Portland on AM 1360 KUIK (Saturdays at 9:00am)
- Anchorage on AM 650 KENI (Saturdays at 8:00am)

The purpose of "Successful Investing" is to educate the public on investment and financial planning topics. The format is to share the science of investing for the first half of the show. The second half of the show frequently includes guest experts who share their knowledge on issues related to wealth management. The first show aired in March and featured a national expert and published author on identify theft.

Jack and Ken created this show out of frustration with the mainstream financial media. They believe that shows like Jim Cramer's "Real Money" on CNBC do more harm than good. In discussing why they created this show Ken has stated, "Investors often find that it is difficult to differentiate between financial entertainment and solid financial advice." "Successful Investing" is our way of educating investors on the scientific way to invest; "it is our goal to have a positive impact on the communities we serve by sharing sound insights." We hope that you will tune in and listen if you have the opportunity. We would love your suggestions for topics and questions for the show.

"Update on Statements"

We are excited to share with you that starting March 31 Charles Schwab will be sending you enhanced monthly statements. We believe you will find these new statements more informative and useful compared with the old version. Our hope is that these new reports complement the information provided on the EWM statements. Specifically you will notice that the EWM reports are more performance based, whereas the monthly Schwab statements will be more transaction and tax based.

Furthermore, during tax time next year you will be receiving a Realized Gain & Loss Report directly from Schwab that will more closely match how it is reported on Schedule D of your tax return. It is our goal to make your investment tax reporting as simple and seamless as possible for you and your tax preparer.

Below we have highlighted a couple new features on your monthly Schwab statements that we believe you will find informative:

<u>Market Monitor (Page 1)</u>

Description: This shows the current yield of that account's MoneyMarket fund, which is any cash over $100 in that account.

Change in Account Value (Page 2)

Description: This section provides a clearer representation of the activity during the reporting period such variables as deposits/withdrawals, dividends, interest, and fees. The bar graph on the right of the page provides the account balance over the trailing twelve months.

Gain or (Loss) Summary (Page 2)

Description: This shows the Realized Gain or Loss (Short Term/Long Term) and Unrealized Gain or Loss accrued during that time period.

Asset Composition (Page 2)

Description: This section provides a categorical overview of your account based on investment type such as mutual funds and money markets.

Income Summary (Page 3)

Description: This section displays the monthly and YTD federally tax-exempt and federally taxable dividends that have paid in your account.

We are always looking at ways to improve our reports, so as always please feel free to contact us if you have any questions or suggestions.

"Empirical Fund Selection"

Introduction

Over the last year and a half we have documented our investment process in our quarterly letters. We have published our views on the following topics: market efficiency, structured asset class investing and developing capital market expectations (all of the previous letters are available on request and on our website). This quarter we continue documenting our investment approach with a discussion on our investment selection process. We highlight some of the investment companies (mutual funds) that we are using to construct your globally diversified portfolio. We also discuss the reason that Empirical pays little attention to traditional mutual fund rating agencies and other financial publication fund ranking systems.

Fund Diversification

One of the notions documented by academics is the idea that investors who hold a small number of securities instead of a large number of securities should not expect to receive better investment returns over the long run. An investor who buys one large American company takes on more risk than an investor who holds all five hundred companies present in the S&P 500 index. This is because one company has a greater possibility of failure than five hundred companies combined do. Because investors can easily avoid the risk of owning a single company, the market does not reward investors for taking on this kind of risk (referred to as *unsystematic risk*). Certainly there is risk in holding the S&P 500 index over short periods of time but the risk is not specific to one company's troubles (i.e. Enron and others that have faltered). The risk that large American companies face as a group is reflective of the macroeconomic environment and this is market risk (or *systematic risk*). We can reduce the risk facing large American companies by investing in other classes of companies like small American companies or international companies (both large and small). The same diversification rules apply in these other asset classes as well; we want to own enough of the companies in these other areas to eliminate the unsystematic risk (unrewarded risk) from those investments.

Eliminating the risk of holding too few securities can be done by investing in mutual funds that own hundreds if not thousands of securities. In Table 1 below we present a sample of mutual funds that have been in existence for at least ten years. The column titled "Number of Holdings" shows you how many securities each of these funds hold. The funds listed were selected because they have been around for at least ten years. The longer time frame gives us a better idea on how well they are tracking their target asset classes.

Table 1

Performance of Funds and Indices Ending 3/31/08

Fund returns are net of operating expenses, indices do not include expenses

		Number of Holdings	*5 Year Returns*	*10 Year Returns*
US Large Cap Stocks				
Benchmark Index	**S&P 500 Index**	**500**	**11.32%**	**3.50%**
EWM Security	S&P 500 SPDR ETF	500	11.24%	3.41%
Benchmark Index	**Russell 1000 Value Index**	**619**	**13.68%**	**5.53%**
EWM Security	DFA US Large Cap Value Portfolio	249	14.91%	6.39%
US Small Cap Stock				
Benchmark Index	**Russell 2000 Index**	**2,000**	**14.90%**	**4.96%**
EWM Security	DFA US Small Cap Portfolio	2,869	15.29%	6.84%
Benchmark Index	**Russell 2000 Value Index**	**1,284**	**15.45%**	**7.46%**
EWM Security	DFA US Small Cap Value Portfolio	1,366	18.95%	9.73%
Developed International Stock				
Benchmark Index	**MSCI EAFE Index (net)**	**813**	**21.40%**	**6.18%**
EWM Security	DFA Large Cap International Portfolio	1,470	21.00%	6.41%
Benchmark Index	**MSCI EAFE Small Cap Index (net)**	**603**	**25.93%**	**N/A**
EWM Security	DFA Intl. Small Co. Portfolio	4,522	26.01%	11.63%

It should not be assumed that any of the securities transactions or holdings discussed were or will prove to be profitable, or that the investment recommendations or decisions we make in the future will be profitable or will equal the investment performance of the securities discussed herein. The information in this report should not be considered a recommendation to purchase or sell any particular security. There is no assurance that any securities discussed herein will remain in an account's portfolio at the time you receive this report or that securities sold have not been repurchased. The securities discussed do not represent an account's entire portfolio and in the aggregate may represent only a small percentage of an account's portfolio holdings. Please see attached performance insert for full disclosure. A complete list of funds utilized currently and in the past is available on request.

Tracking an Asset Class

We select mutual funds that have done an excellent job of providing you with the returns of the specific asset class the fund was selected for. Some of the funds attempt to track a specific widely recognized index as closely as possible. Other funds we use track asset classes where a popular index has yet to be created. In these cases we look to the academics for indexes. We believe the lack of well known indexes in certain asset classes is a result of the fact that academic research is often times slow to be embraced by the investment industry. For example, one of the funds we use, the DFA Micro Cap fund has been around since 1981 yet only in recent years has an index provider (Russell in this case) created an index that tracks micro cap stocks. Research showing how to divide the market up into meaningful categories such as large, small, growth and value appeared long before it became commonplace in the financial media to do so. Some of this research was conducted by the founders of the mutual fund company DFA. Financial publications in the past were more inclined to divide funds among categories like aggressive growth, growth or income.

By examining Table 1 you will see that the funds shown have done a great job of capturing the returns of the asset classes they invest in (over the long term). This is why we own the funds we do, not because of a particular rating or ranking they receive from mutual fund publications. It is important to note that some funds do not have an appropriate well-known benchmark. For example, this is the case with the global bond funds we utilize.

Fund Company Profiles

The mutual fund companies we utilize are well established leaders in their industry. These companies have significant capital under management and are pioneers in the management of passively managed mutual funds. The fund companies listed below in Table 2 cover the vast majority of the funds being used in our client portfolios. Each company brings with it a unique opportunity to capture investment asset classes in a highly efficient way.

Table 2

Investment Company Information

Fund Company	*Year Founded*	*Assets Managed (Retail & Institutional)*	*Types Of Funds*	*Number Of Funds Offered*	*Number Of Funds Used By EWM*
Dimensional Fund Advisors	1981	$152 billion	Mutual Funds	54	22
Vanguard	1975	$1.3 trillion	Mutual Funds & Exchange Traded Funds	150	22
Barclays Global Investors	1971	$2 trillion	Exchange Traded Funds & Exchange Traded Notes	183	18
Northern Funds	1889	$400 billion	Mutual Funds & Exchange Traded Funds	39	1
State Street Global Advisors	1978	$2 trillion	Mutual Funds & Exchange Traded Funds	103	1

The fund company we use for most asset classes is DFA (Dimensional Fund Advisors). The reason why we use numerous DFA funds is that they have been among the best in the world at capturing the returns of unique asset classes. DFA was formed and is run by leaders from the academic community. For example, the author of the Efficient Market Hypothesis, Eugene Fama, is actively involved in the company. DFA's philosophy is a divergence from that of most mutual fund companies because they create mutual funds only when academic evidence supports doing so.

Unlike traditional actively managed funds where it is virtually impossible to be the best of breed in several asset classes, structured asset class funds and index funds do not face those same challenges. This is why we will hold several funds from the same company; not because we believe they are the best stock pickers in each asset class. DFA has been able to add several percentage points of return over traditional benchmarks in many of their asset class funds. They have accomplished this by eliminating weaknesses found in both actively managed mutual funds and traditional index funds. Using a passive approach, better portfolio engineering, and cost management has paid off for them. Also, the funds are only available through a select few advisors. This gives DFA another edge by not having to cater to the public. Please keep in mind that we are not beholden to any fund company or brokerage firm. As new diversified asset class funds become available, we examine them.

Flaws with Fund Rating Systems

The desire to rate or rank mutual funds is common among investors. Investors may want to know how their investments stack up in comparison to other mutual funds. The easiest way to do this is to look to one or more financial publication(s) that categorize and rank mutual funds. Table 3 below presents a list of some of the financial information providers who rank mutual funds.

Table 3

The Limits Of Fund Rating Services

	Fund A	*Fund B*	*Fund C*	*Fund D*
Morningstar **(Dec 2000)**	★★★★★	★★	★★★	★★★★
Forbes **(Dec 2000)**	**C**	**A**	**A+**	**D**
US News & World Report **(Dec 2000)**	**34**	**50**	**10**	**93**
Wall Street Journal **(Jan 2001)**	**E**	**C**	**A**	**B**
BusinessWeek **(Jan 2001)**	**A**	**No Rating**	**B+**	**C**

The funds listed in this table are real mutual funds with the names hidden to keep the focus off of specific mutual funds. The interesting insight here is that there are large disparities among agency ratings for a specific fund. A partial explanation for this is that some of the agencies are not attempting to rank funds in terms of their future prospects; they are simply ranking funds in order of performance over a specific period of time. Therefore, the same fund may have different rankings by the same agency for different time intervals. This is apparent in the Wall Street Journal's rankings; they provide one year, three year and five year rankings. The investor has to decide what time interval is meaningful. We ignore commercial rating systems because we believe the empirical data is clear that rating/ranking services add little value to a strategy employing passively managed funds. As mentioned earlier, we define success as a fund's ability to capture the returns of a specific asset class with the lowest amount of drag from expenses and taxes. The research is clear that over long periods of time the majority of actively managed mutual funds do not beat indexes, especially after taxes. Those that do are not only rare but very difficult to identify in advance as evidenced by the poor track record of the rating agencies in identifying future winners.

Another flaw inherent in rating systems is the failure to categorize mutual funds into appropriate asset classes. Only in recent years has Morningstar begun to account for investment styles when rating funds. Because many of the commercial agencies lag the academic world, the funds we utilize in your portfolio continue to get categorized incorrectly. This means that even if ranking systems were effective, you would not be able to make the appropriate apples-to-apples comparisons.

Sincerely,

Kenneth R. Smith

The Empirical Wealth Management Team
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