

April 20, 1999

When the evening news reports the Dow is up, does that mean you are any wealthier than yesterday? Not necessarily. The Dow completed the quarter with a 6.6% return and beat its domestic equity index partner, the Standard & Poor's 500, with its 4.8% return for the quarter. Both indices consist of very large capitalized stocks. (Capitalization refers to the total number of outstanding shares multiplied by the price of the stock – a measure not necessarily reflective of the assets of the company.) In addition, both indices are “market capitalization weighted” which means the highest capitalized stocks dominate the performance of the indices. The highest capitalized stocks have done very well lately.

1999 First Quarter Market News

Before we discuss why market capitalized weightings essentially distorted the meaningfulness these two well-quoted indices, here is a brief report of stock mutual fund groups that had particularly good or bad returns for the first quarter of 1999.

<u>The Good:</u>		<u>The Bad:</u>	
Telecommunications	+18%	Small-cap	-6%
Science and technology	+16%	Real estate	-4%
Japanese	+16%	Gold-oriented	-4%
Latin America	+11%	Utility	-3%

Source: Lipper & The Wall Street Journal

Actually, the advances in the US stock markets in 1998 were “thin” meaning that most stocks didn't enjoy the returns of the largest cap stocks. For example, just 10 of the 500 stocks in the S&P accounted for 43% of its return, and only 33 stocks represented over 75% of its return. This phenomenon continued during the first half of the most recent quarter. Large cap Internet-related technology and telecommunications were very “in,” and virtually all small caps were very “out.”

We find the trends disconcerting because they coerce many investors to pile onto the “winners.” The market has priced many of the stocks with the expectation earnings will increase 20% or more each year for many years to come. We don't think this is realistic for many of these companies. The enclosed column by Jeremy Siegel from the *Wall Street Journal* states the case well.

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Our Approach for Your Portfolio

In any case, your portfolio returns for 1998 did not reflect the exceptional performance of the Dow and the S&P (which returned 28% of 1998) unless you were highly concentrated in the very thin group of stocks which drove these indices. Such an approach would have required a great degree of gamble and speculation. Our investment recommendations are based on two essential assumptions which run contrary to the concentrated speculative approach:

1. **Diversification** Over the long run, market timing and asset concentration does not add value but it increases volatility. We recommend a range of investment exposures to a number of asset classes depending upon your risk tolerance and investment needs (“asset allocation”). We review asset managers who stick to their chosen investment style, and then recommend managers we believe are very good at their particular investment style for each asset class chosen in our asset allocation analysis. This investment method effectively reduces the overall risk of a portfolio while increasing the chance for superior returns over time.
2. **Reversion to the Mean** There is a large body of academic evidence that leads us to believe prices of securities tend to “revert to the mean” over time. The price of stocks in under-performing asset classes will increase and high priced stocks in over-performing asset classes will decrease toward their long-range “normal” price. By periodically adjusting where funds are invested, we generally move more money towards under-performing asset classes and out of the higher-performing asset classes. And although your portfolio continues to be diversified, it is exposed to asset classes that are more likely to experience superior returns over the long-run.

Growth and Value. Are the Ugly Ducklings Blossoming?

One example of an over-performing asset class is US growth stocks. For the past five years, growth stocks have sky rocketed, and we’ve increasingly believed that value stocks would outperform growth stocks in the relatively near future. We haven’t careened from one style to another, and we’ve kept a healthy component of growth stocks in your portfolio. Although we may have been early in tilting toward value stocks, they appear to be returning to favor this quarter.

Some of the worst performers of 1998 have been the best performers since mid-February of this year. For example emerging market stocks are up over 20% and value stocks are up almost 10%. Real estate has advanced as well . . . especially in the last week or so.

As we have discussed before, the performance of your account is largely driven by your portfolio's asset allocation. At the same time, a degree of tactical asset allocation (small shifts toward certain asset classes) will result in portfolio returns that meet your investment objectives over the long-run.

A New Member of Our Team

Please join us in welcoming Scott Rhodes to our firm. Scott comes to us with over 13 years of experience in the securities industry. He began his career as a manager in a consulting firm providing analysis and opinion to attorneys and stock brokerage firms regarding securities fraud cases. After three years of primarily defense work, Scott spent the next ten years at the National Association of Securities Dealers. During his tenure at the NASD, Scott evaluated client portfolios, inspected securities broker dealers, and participated in many high visibility enforcement actions against brokers and brokerage firms. Scott is an honor graduate of Gonzaga University, and has earned the prestigious professional designation of Chartered Financial Analyst. We're sure you will be meeting Scott in the months ahead as he becomes an important member of our investment management and planning team.

Tick Tock Tick 2000

Lastly, as we creep closer to the beginning of year 2000, our thoughts move toward New Years Eve celebrations (held deep in the woods of Montana with electric generators by our side). All kidding aside, year 2000 is a serious concern for the securities and banking industry, as well as for other businesses. The investment industry has committed enormous resources to ensure that its computers will not lose important information and will be able to function when year 2000 rolls around, Regulatory agencies have been visiting and sending questionnaires to determine whether we are taking appropriate action to address this serious concern.

Schwab Institutional's representatives inform us they have been engaged in reprogramming for Y2K for at least the last four years and currently have approximately 225 information system personnel working on their systems. Schwab anticipates spending \$60 to \$75 million to upgrade its system. All brokerage firms have already run through mandatory system-wide Y2K scenarios with stock exchanges and their vendors and will again before year-end.

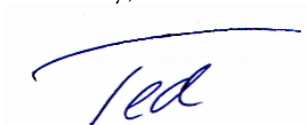
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Here in our office with the assistance of our technology providers, we have upgraded all of our computer programs to be Y2K compliant. So, we are guardedly optimistic that 2000 will arrive without any serious consequences to our financial system.

We invite you to call if you have any questions about Y2K, the markets or any matters respecting your finances.

Sincerely,

A handwritten signature in blue ink, appearing to read "Ted", with a long, sweeping horizontal line above it.

FREDERIC T. KUTSCHER