INVESTMENT GUIDE

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In this issue:

WHAT RATE OF RETURN CAN AN INVESTOR EXPECT? *Despite the pronouncements of the talking heads, columnists, brokerage firm seers, and others, no one can tell what 2001 will bring for the financial markets.*

Our investment approach is based on an acknowledgment of that fact. Our goal is to select low-cost vehicles that have demonstrated attractive long-term returns in relation to their volatility (risk). These can be used as building blocks for our readers' and clients' portfolios. We tend to overweigh large capitalization value stocks because they have had the most favorable returns in relation to volatility, but we also recommend including some growth stocks and foreign issues. Index funds with low turnover and low expenses are the best way to go about this (pp. 90-92).

INVESTING IN SWITZERLAND IS GETTING MORE EXPENSIVE: *The latest tax convention between Switzerland and the United States means that U.S. persons have little or no reason left for holding assets in Switzerland (p. 91).*

WHITHER MA BELL? *Investors who have been long accustomed to thinking of AT&T as a giant paragon of stability were rudely shocked by its recent dividend cut (pp. 93-94).*

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THE DOW JONES INDUSTRIALS RANKED BY YIELD: *Caterpillar, International Paper and Goodyear have helped revive the "dogs of the Dow" (p. 95).*

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Is a "Soft Landing" Still Possible?

Despite the rapid deterioration of the leading indicators during recent months, the prevailing view on Wall Street and in Washington D.C. seems to be that economic growth will slow from the pace of recent years, but that there will be no recession. When President-elect Bush visited the White House on December 19, President Clinton noted that " I don't think we're going to have that [a recession] …But I think there are things to be managed. He [the President Elect] will have challenges and we ought to give him a chance to meet them …."

Just what might some of these challenges be?

The foremost is the possibility that consumers are in the process of a major retrenchment now that they are finding that stock market profits are not a realistic substitute for savings. During recent years, personal savings have decreased toward zero, even as stock market and real estate gains boosted households' net worth. U.S. common stocks have, by some estimates, shed more than $3 trillion of value from the lofty peaks reached earlier this year. Those peaks were short lived, yet it is clear that the value of households' equity holdings, direct and via mutual fund shares, will have decreased during the year 2000 for the first time since 1994, probably by the largest percentage drop since 1973.

At the same time, the dollar, which had been very strong during the 1990s despite a widening trade deficit, has begun to weaken in the foreign exchange markets. A continued slide of the dollar could prompt foreign investors to leave U.S. markets and, by raising the cost of imports, enable U.S. producers to raise prices. Attempting to defend the dollar and to restrain price inflation could make it more difficult for U.S. monetary authorities to cut interest rates. Indeed, at its most recent meeting, the Federal Reserve Board, although indicating that it now views the possibility of a recession as a greater threat than an acceleration of price inflation, decided to make no changes in its discount rate or its Federal Funds target rate. Even if, as is widely expected, the Fed does cut rates during the months ahead, monetary policy might not be very effective in shoring up either spending or the securities and foreign exchange markets. Reportedly, one-fifth of bank holdings of business loans are in various "troubled loan" categories. Commercial and industrial loans are at an all-time high in relation to business inventories, and faltering sales could quickly boost unsold inventories and non-performing loans alike. The resulting pressures on lending margins could make the banks reluctant to lower their rates for any but the most creditworthy borrowers.

In these circumstances, it might seem that the major across-the-board tax cut favored by President-elect Bush during the election campaign would be the most promising means of putting funds in the hands of consumers and businesses. Unfortunately, the delays and uncertainties of the legislative process render fiscal policy virtually useless for contra-cyclical purposes. In short, Alan Greenspan and the Federal Reserve are the ones on the spot; having brought on the long-awaited slowdown, it remains to be seen whether they can stop it from developing into a recession.

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WHAT RATE OF RETURN CAN AN INVESTOR REASONABLY EXPECT?

The year 2000 was not kind to equity investors. Nearly all the broad stock indexes were down for the 12 months, and those who plunged into the "new economy" (technology stocks) late probably have been badly burned.

As the *Bank Credit Analyst*[1] recently observed "The air is now thick with predictions for 2001. As might be expected, most Wall Street strategists are as bullish as ever—many have simply made their old end-2000 target their new target for the end-2001. The idea that the stock market could perform poorly for two years in a row seems inconceivable to an industry that grew prosperous feeding on five successive years of double-digit gains during the second half of the '90s."

What are our predictions? Where do we think, say, the Dow Jones Industrial Average will be a year from now? Our answer to such questions is that we have no idea. Our *hunch* is that the bear market has considerably more to run, and we are as certain as we can be of anything that the 20% or so annual returns that common stock investors have enjoyed since 1982 are unlikely to be realized over the next 18 years.

[1] BCA Publications Ltd., 102 Sherbrooke Street West, Montreal Quebec, Canada, H3A 3L6.

Risk and Return

That said, it is impossible to discuss returns, either historical or prospective, without mentioning risk. Returns are easy to quantify, as in the table below, which shows the annual returns for various types of investments for the 22 years 1979 through 2000 (the returns for 2000 are for the first 11 months only). Risk, on the other hand, is far less clearly appraised in the typical investor's mind.

Most simplistically, a holding that loses value is often deemed to have been risky. As indicated in the table, there was only one of the nine types of holdings, 6 mos. Treasury bills, that did not generate a loss in at least one of the past 22 years. It is no coincidence that T-bills also provided the lowest average return of the 9 possibilities in the table. Investors seeking higher returns than those offered by T-bills, or bank accounts and Certificates of Deposit, perforce have to recognize that disappointing returns and even losses are to be expected over relatively short periods.

A more rigorous way of evaluating risk is the *standard deviation* of the annual returns. This is a mathematical measure of variability—the higher the standard deviation, the less dependable, in this instance, the annual returns. As indicated in the table, the standard deviation of the returns on the fixed income possibilities is in line with expectations—it is higher for the higher-yielding intermediate and long-term bonds. The standard deviation is not so well behaved for the equity returns, where the possibilities with the most variable returns over the 22 years, small capitalization growth stocks and foreign stocks, did not provide the highest overall returns.

This may reflect the unusual categories we have selected. The division of domestic equities into large and small capitalization issues and again into growth and value stocks reflect the methodology of Professors Eugene Fama and Ken French, of the University of Chicago and Yale, respectively. They begin by determining the median capitalization of issues listed on the New York Stock Exchange (NYSE). They exclude certain issues such as regulated utilities, closed-end funds and unit trusts, companies in receivership, recent IPOs, etc. Issues traded on the Nasdaq or on the American Stock Exchange are classified as small unless their market capitalization is larger than the median on the NYSE.

Another reason why the standard deviation of the equity series returns is not always larger when the average annual

ANNUAL RETURNS FOR SELECTED ASSET CLASSES

	Equities						*Fixed Income*		
	Large Capitalization		*Small Capitalization*		*Russell*		*6 Month*	*Inter-*	*Long term*
	Growth	*Value*	*Growth*	*Value*	*Mid Cap.*	*Foreign*	*T-Bills*	*Mediate*	*Treasuries*
1979	20.7	23.8	**47.3**	38.0	32.5	6.2	9.7	6.0	-1.2
1980	33.9	16.5	**46.1**	29.1	32.5	24.4	11.7	6.4	-4.0
1981	-7.9	11.2	-4.1	10.5	2.4	-1.0	**17.6**	10.5	1.9
1982	17.6	27.4	26.0	37.7	23.3	-0.8	13.7	26.1	**40.4**
1983	16.2	26.8	26.9	**44.2**	23.8	24.6	9.3	8.6	0.7
1984	-1.1	14.1	-8.9	5.1	1.4	7.9	11.6	14.4	**15.5**
1985	31.5	29.5	28.5	34.7	32.0	**56.7**	9.2	18.1	31.0
1986	13.7	20.4	5.8	16.9	18.2	**70.0**	7.3	13.1	24.5
1987	6.4	2.3	-10.0	-6.3	0.2	**24.9**	6.6	3.7	-2.7
1988	12.8	24.6	20.5	**28.8**	19.8	28.6	6.9	6.7	9.7
1989	**31.5**	28.4	19.1	19.7	26.3	10.8	9.3	12.7	18.1
1990	1.4	-13.9	-18.1	-20.8	-11.5	-23.2	8.7	**9.2**	6.2
1991	41.1	29.8	**52.1**	39.4	41.5	12.5	7.2	14.6	19.3
1992	7.1	21.2	11.2	**29.9**	16.4	-11.8	4.3	7.2	9.4
1993	2.0	21.2	14.0	22.6	14.3	**32.9**	3.4	8.8	18.2
1994	1.5	-4.6	-2.9	-1.0	-2.1	**8.0**	3.9	-2.2	-7.8
1995	**37.9**	37.2	31.3	29.2	34.5	11.6	6.6	15.3	31.7
1996	21.2	15.7	12.9	**21.4**	19.0	6.2	5.3	4.1	-0.9
1997	30.3	31.7	16.3	**34.4**	29.0	2.0	5.6	7.9	15.9
1998	**33.6**	14.9	0.4	-7.0	10.1	20.3	5.6	8.4	13.1
1999	28.2	1.9	**47.7**	10.8	18.2	27.3	4.6	0.4	-9.0
2000	-13.7	2.7	-19.9	-4.1	0.6	-16.9	5.8	8.1	**18.6**
Avg. Return	16.4	17.5	14.3	18.3	17.4	13.3	8.2	9.8	11.1
Std. Deviation	19.5	16.6	26.5	18.8	19.3	19.5	1.4	5.3	11.1
No. Down yrs.	3	2	6	5	2	5	0	1	6

Note: The large and small capitalizations, value and growth series are the Fama French series described in the text. The foreign stock series includes Europe, Austrialia and Far East Asia. The Lehman Intermediate bond series includes both government and corporate bonds of 3.5 to 4 years maturity, and the long-term Treasury bond series is for a 20 year maturity. The results for 2000 are through November.

returns are larger could be that the standard deviation may not reflect everything that might be considered risk.

Growth vs. Value

Most investors have a general idea of what constitutes a growth stock and what constitutes a value stock, but there are many ways to define them. A value-oriented investor may hold a given issue because it meets his or her specific criteria, yet the same issue may be held by another investor in the belief and expectation that it offers superior growth prospects. Generally speaking, growth stocks will have relatively high returns on equity, high growth rates of sales and earnings, etc., as well as high price/earnings and price-to-book ratios, and low dividend yields. Value stocks will have low price-to-book value ratios, low price/earnings multiples, and above average dividend yields. Value stocks are often "turnaround" situations that value investors believe have been beaten down in price to unwarranted levels, so that the issue sells below some intrinsic value.

Within the large and small capitalization universes as defined in the series in the table and in the chart on p. 92, the growth issues are defined as the 30 percent of companies with the lowest ratios of book value to market capitalization, and the value issues are the 30 percent with the highest ratios of book value to market capitalization. (This means that the 40 percent of issues in the middle of each category are not included at all). These divisions are designed to highlight differences in investment strategies or "styles" among investment managers. The Fama-French series mimic the selections of, and serve as a "yardstick" for the results of, portfolio managers who follow a stated strategy of investing in growth or value stocks.

Active vs. Passive Management

Investment managers may be classified by their approach to investing. Two broad categories, reflecting different belief systems regarding the behavior of capital markets, are usually referred to as active and passive. Active management is the traditional way of building a securities portfolio, and may include a wide variety of strategies for identifying issues that appear to offer above-average returns. As discussed above, one manager might focus on companies with impressive growth in sales and profits, another on firms with promising new products, a third on turnaround situations.

Regardless of their individual approaches, all active managers purchase securities *selectively* based on some forecast of future events. Implicit in this idea is the belief that carefully selected securities will produce higher rates of return than those chosen at random. Active managers periodically reshuffle their portfolios in an effort to keep them stocked with only the most promising securities. The costs associated with generating and implementing these revisions make active management the most expensive investment approach. These expenses are passed along to the client. Studies of money managers' performance over the past fifty years offer powerful evidence that active managers as a group are unable to generate investment returns high enough to recoup these costs and extract excess profits.

Passive managers (sometimes called index managers) make no forecasts of the stock market or the economy, and no effort to distinguish "attractive" from "unattractive" securities. Passive managers often construct their portfolios to mirror the performance of well-recognized market benchmarks such as the Standard & Poor's 500 Composite Index (500 large U.S. companies), Russell 2000 Index (2000 small U.S. companies), or Morgan Stanley Capital International EAFE index (large international companies). A passive manager investing in large U.S. companies, for example, makes no determination if Ford is preferable to General Motors, Coca-Cola to Pepsi, or Campbell Soup to Kellogg. Instead he or she simply buys everything from Abbott Laboratories to Xerox, resulting in a portfolio with hundreds of stocks. Portfolio adjustments are made only in response to changes in the underlying universe or index, e.g., when Chrysler disappears in a merger with Daimler Benz, or a new company such as Microsoft joins the ranks of large company stocks. Passive investment products first appeared in 1973 and have become increasingly popular, with over $1 trillion worldwide dedicated to various indexed

INVESTING IN SWITZERLAND IS GETTING MORE EXPENSIVE

A new Tax Convention between the Swiss Confederation and the United States becomes effective January 1. The terms of the tax treaty provide that U.S. citizens who invest in U.S. domestic securities through a foreign bank or intermediary must declare such ownership with the U.S. Government by filing a completed Internal Revenue Service Form W-9 (Request for Taxpayer Identification Number and Certification). A Form W-9 or some other disclosure and reporting authorization must be submitted to a Swiss bank or other qualified intermediary to avoid the withholding of a nonrefundable tax of 31% on income and gains produced by U.S. securities. Foreign banks and qualified intermediaries are required to seek such information from U.S. investors holding U.S. investments in foreign accounts to assure that foreign banks will be able to claim a refund of U.S. taxes withheld from non-U.S. investors.

This Tax Convention is the latest effort to end the ability of U.S. persons to take advantage of privacy laws applicable in Switzerland and in other foreign jurisdictions. It would seem that U.S. investors who continue to hold investment in U.S. securities in foreign banks have three alternatives:

1. Complete IRS Form W-9, identifying themselves as a holder of U.S. securities in a foreign account,
2. Agree to the nonrefundable 31% withholding tax,
3. Liquidate U.S. investments held in a foreign account.

We recommend the liquidation of all U.S. investments held in foreign accounts and reinvestment, if appropriate, in the United States.

strategies in 1997.

As it has evolved over the years, our approach now leans toward the passive. Our High Yield Dow approach is a passive approach—we let the numbers do the picking for us, and the mutual funds we recommend are generally index funds, with low expense ratios and turnover. By now, many studies have concluded that simple selection methods consistently applied produce returns that are superior to actively managed funds, whether growth or value oriented. The much higher costs of active management are but one reason for this. In addition, there is no reason to believe that active managers who manage to do better than the indexes for some period will repeat their performance in a future period.

Where possible, we prefer what some call a "structured" approach, which recognizes that popular benchmarks for equity or fixed income securities were developed as simple signposts of financial performance and were not intended to serve as blueprints for actual investment strategies. Structured and passive investing strategies share a common belief that market prices are the best estimate of value. Hence, neither attempts to beat the market through superior security selection. There is reason to believe passive and structured investors are smart not to try to beat the market. Security prices reflect the collective judgment of investors regarding the appropriate price to pay when balancing prospective risk and reward. Academic research has focused on identifying the risk factors investors appear to care about in determining these prices. Bearing risk is what investors get paid for—the more clearly we can define risk, the better we can predict the expected returns that come with it. The structured approach takes insights about risk characteristics and designs investment products to isolate and capture them in a precise way. The resulting strategies may not necessarily match familiar equity or fixed income indexes, but often represent a more scientific approach to designing the asset class "building blocks" used to develop a total portfolio.

Index funds that slavishly follow a specific index face special problems of their own. For example, the annual reconstitution of the Russell 2000 index in June 1998 produced 523 new names. Index managers forced to buy these names may be negotiating from a difficult position. The poor liquidity and high trading costs associated with small firms creates an obstacle for investment managers seeking to capture their returns through simple indexing. Replicating a stock index entails purchasing the correct number of shares in a portfolio to match the securities' weights in the index. This approach has worked very well for strategies attempting to track a large company index such as the Standard & Poor's 500.

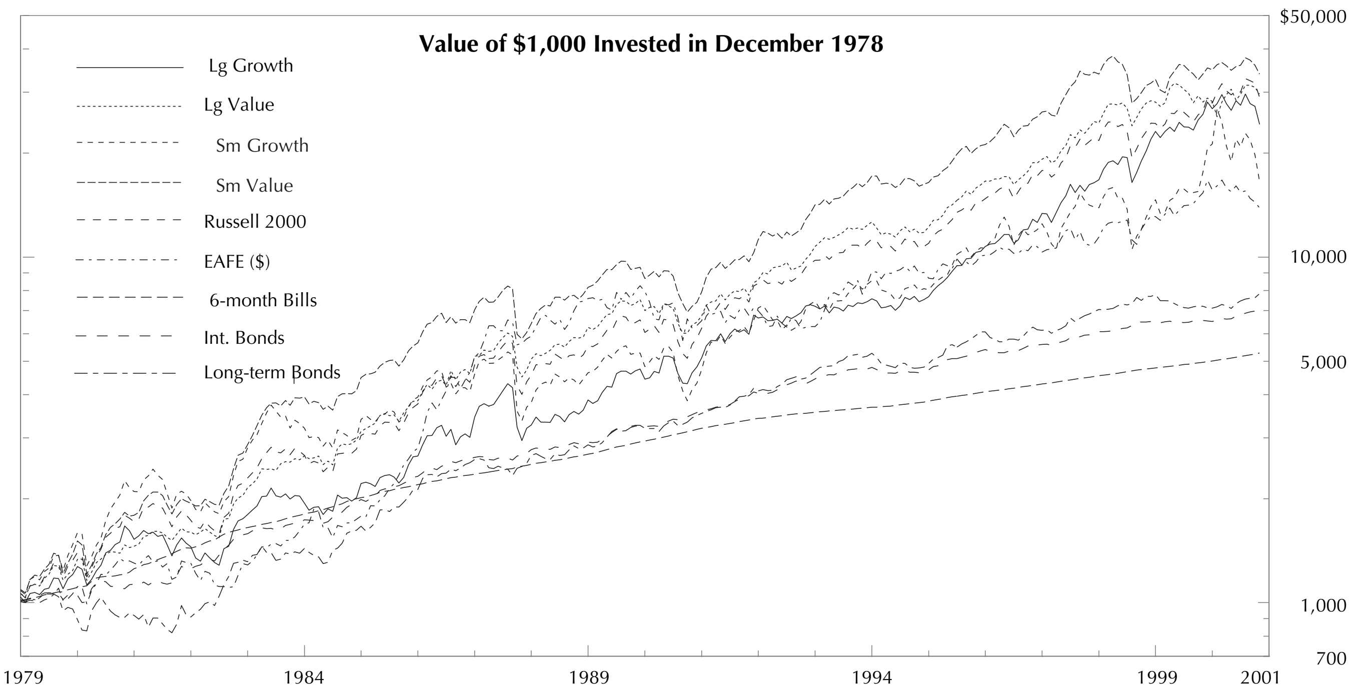
Low-cost passive investing has withstood a hailstorm of criticism since inception over 25 years ago, and delivered satisfying results for many of the world's largest investors. Active management continues to deliver performance that both delights or disappoints investors in an unpredictable fashion. Structured investing attempts to combine the best of both—the broad diversification, low cost, and low turnover of passive strategies with an active component that seeks to add value not through forecasting but through engineering and execution.

Conclusion

As an inspection of the table and the chart accompanying this article should make plain, equities can be expected to produce returns that are superior to fixed dollar claims *in the long run*. However, returns on common stock are highly variable, not only year-to-year, but also within categories of common stock, and there is a place for some fixed-income holdings in most portfolios. Such an inspection should also reveal that attempting to determine which types of investment will do best *in the short term* is a fool's errand.

That we tend to overweigh large-capitalization value stocks because they have had the most favorable returns in relation to volatility, does not mean that we recommend ignoring all growth stocks or foreign issues. To repeat, we believe that index funds with low turnover and low expenses are the best way to go about this.

Note: Much of this article was adapted from "Ways to Invest" by Weston Wellington of Dimensional Fund Advisors, Inc.



WHITHER MA BELL?

For many years, American Telephone & Telegraph was the largest, in terms of capitalization, and most widely held common stock. It was the first stock ever owned by many investors and most investors have held it at one time or another. AT&T was one of the few major corporations that maintained its dividends through the years of the Great Depression and its $9.00-per-share annual dividend (paid at a time when the minimum wage was $0.25 per hour) provided much-needed income for many families.

The historic basis of its success was its ability to convince regulators that it needed to function as a monopoly (so that service to rural and low-traffic residential customers could be subsidized by overcharging businesses and other high volume callers). Growth came from decreased costs from improved technology that was developed in the renowned Bell Labs. These advances facilitated rate decreases, especially for long-distance service, which, in turn, fostered much higher usage. The fact that its equipment, manufactured by wholly-owned Western Electric, was leased rather than sold to consumers, served to stabilize revenues.

This cozy situation began to unravel when competitors began to offer cheaper long-distance service by linking local telephones in different cities by microwave and fiber optic lines that bypassed the Bell systems monopoly and when regulators decided that customers could hook up their own equipment to the Bell system's lines. By the time the Justice Department's suit to "break up" the Bell system came along, telephone executives were actually looking forward to getting out of the fetters of the old monolithic structure of the telecommunications industry.

The local operating companies (baby bells) were spun-off to AT&T stockholders as 7 separate companies in early 1984. Subsequent spin-offs included Western Electric, which became Lucent, and the ill-fated NCR Corp., which had been acquired by AT&T in an effort to enter the personal computer business.

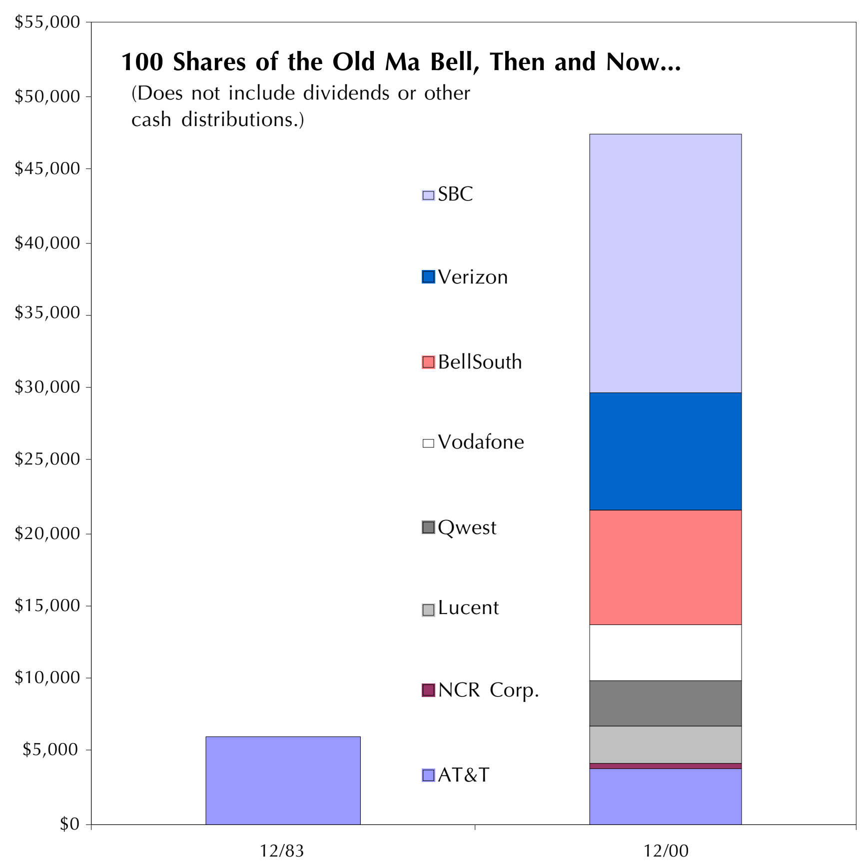
What's Left?

The right column of the accompanying chart shows the value of the various spin-offs from AT&T on the assumption that the holder of 100 shares prior to the 1984 breakup has held on to every spin-off stock he or she received (the chart does not reflect dividends or other cash distributions). As this clearly indicates, it has been the "baby bells" (recombined and renamed) that have accounted for most of the increase in the value of the investor's holdings since December 1983. In fact, since the spin-offs of Lucent and NCR, the value of the investor's AT&T stock is now worth less than it was at the end of 1983. This reflects the fact that most of what was in AT&T 17 years ago is now in other companies.

AT&T now has 4 component businesses: Business Services, Consumer Services, Wireless Services, and Broadband. The most troubled of these is Consumer Services, which is essentially residential long-distance service where competition and advancing technology are rapidly driving prices toward zero. Revenues in this division are steadily decreasing. The other three segments are experiencing growing revenues, but they face some severe problems. Business Services, which provides voice and data communications as well as networking services to business and governments, will require investment to replace and upgrade aging fiber optic and other transmission lines.

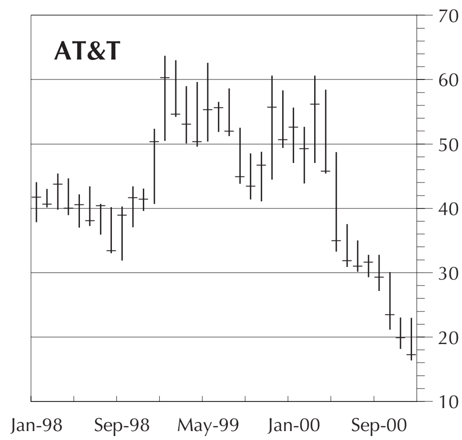
Wireless Services, although growing rapidly, apparently relies on the older TDMA (time division multiple access) rather than CDMA (code division multiple access) technology that is better suited to non-voice (internet) wireless communication, and which is used by its major competitors here and in the rest of the world. Broadband provides traditional video as well as digital video and high-speed data and telephone service over cable TV systems, most of which were recently purchased by AT&T. The company's plans to expand its services over cable have been set back by a variety of regulatory issues. In order to service the huge debt burden it has taken upon itself mainly to purchase cable systems and to conserve funds for needed capital expenditures, the Board of Directors recently cut its quarterly dividend to $0.0375 from $0.22.

In addition, the company has stated its intention to further restructure itself by creating 4 new tradable entities either as "asset-based" or "tracking" stocks, from its 4 component businesses. The details, other than the already completed sale of about 16% of its wireless services business as an IPO last summer, are unclear. Presumably there will be additional public offerings, exchange offers, and/or spin-offs. AT&T itself is expected to keep only the Business Services and the name. The apportionment of the company's debt among the 4 entities remains to be seen.



In short, AT&T has been attempting to reinvent itself and its attempts have been unsuccessful to date, as evidenced by the sharp decrease in its common stock price during the second half of the year. On the basis of its old $0.88 annual dividend, the decline in AT&T stock price brought it onto the list of the highest-yielding Dow stocks (it was no. 3 as of December 15) and it qualified for purchase in our mechanical "alternative" strategy (see below) during 4 months this fall. The December 20th dividend cut to an indicated $.015 annual rate will remove AT&T from both lists next month.

It is possible, of course, that the 4 en-



tities that AT&T stockholders can now expect to wind up owning will be worth more than the recent AT&T stock price. However, the uncertainties of competition and of the technologies of its services (which are a far cry from the company's traditional environment), its huge debt load, and the fact that its cable acquisitions were made at what now appear to have been highly inflated prices, mean that such a favorable outcome is far from assured. Those who are rigidly following the alternative model will continue to own AT&T (and any future spin-offs) for the next 14 to 18 months.

ALTERNATIVE HIGH-YIELD DOW INVESTMENT STRATEGY

We are convinced that long-term common stock investors will receive superior returns if they consistently purchase (and hold) higher-yielding Dow stocks from a listing such as that on the opposite page. Selecting from such lists is not a "cut and dried" process, however. Individual circumstances and a variety of *ad hoc* decisions will determine the timing of purchases and sales.

In our monthly listings, a given issue may retain a ★ or a ☆ for months, even years, at a time. As a result, investment (and reinvestment of sales proceeds) in particular stocks will vary with each individual investor. This means that, while it would be possible to calculate total returns (dividends and capital gains) for a specific investor, it is not possible to compute such returns on our recommendations *per se*.

Our parent has exhaustively researched many possible High-Yield Dow approaches, "backtesting" various possible selections from the DJIA ranked by yield for various holding periods. For the 35 years ended in December 1998, it was found that the best combination of total return and risk (volatility) was obtained by purchasing the 4 highest yielding issues and holding them for 18 months. (For a thorough discussion of the strategy for investing in the highest-yielding stocks in the DJIA, please read AIER's booklet, "How to Invest Wisely, with Toward an Optimal Stock Selection Strategy," 139 pp. $9.)

In our model described below, which is distinct from the table on the opposite page, about one-eighteenth of the portfolio is devoted to the 4 issues eligible each month. (We say "about" because various adjustments and rebalancings are needed to ensure that both the composition of the model portfolio and its returns are independent of when it is presumed to have been initiated.) Eligible issues include the 4 highest-yielding Dow issues that are neither General Motors nor Philip Morris. A HYD strategy derives much of its effectiveness because it "forces" the investor to purchase sound companies when they are out of favor and sell them when they return to relative popularity. We exclude GM because its erratic dividend history has usually rendered its relative yield ineffective as a means of signaling timely purchases, especially when it has ranked no. 4 or higher on the list. We have chosen to exclude Philip Morris also, because, in present circumstances, it seem unlikely that there will be sufficient "good news" for it to be sold out of the model portfolio, whatever its ups and downs, unless it is specifically excluded. The hypothetical trades used to compute the composition of the model (as well as the returns on the model and the full list of 30 Dow stocks) are based on mid-month closing prices, plus or minus $0.125 per share.

This month, the strategy sold some Chevron, which is no longer in the Dow, and some Minnesota Mining and J.P. Morgan to buy Caterpillar, A.T.& T., and Dupont. These transactions assume the investor has been following the model for at least 18 months. Investors following the model for less than 18 months would be buying all 4 eligible stocks, using one-eighteenth of their total portfolio each month. Investors can also accumulate portfolios that approximate the model in less than 18 months by "jumping in" and duplicating the model immediately. However, only investors with sizable portfolios should attempt to track the exact percentages month to month. To avoid excessive transaction costs, investors should adjust their holdings toward the percentages below only when commissions are less than 1% of the value of a trade. By making such adjustments from time to time, investors should achieve results roughly equal to the future performance of the model.

Our ***HYD Investment Management Program*** *provides professional and disciplined application of this alternative strategy for individual accounts. For accounts of $100,000 or more, the fees and expenses of AIS discretionary portfolio management programs are comparable to those of most mutual funds. Contact us for information on this and our other discretionary investment management services.*

As of December 15, 2000					*——Percent of Portfolio*——*	
	Rank	*Yield*	*Price*	*Status*	*Value*	*No. Shares‡‡*
Philip Morris	1	5.29%	40.0625	*	-0-	-0-
Eastman Kodak	2	4.61%	38.1875	Holding**	14.8	18.9
A.T.&T.	3	4.19%	21.0000	Buying	5.1	12.4
General Motors	4	3.72%	53.8125	*	-0-	-0-
Caterpillar	5	3.33%	40.8125	Buying	20.3	25.4
Dupont	6	3.20%	43.7500	Buying	9.7	11.3
Int'l Paper	7	2.68%	37.3750	Holding	7.0	9.5
Morgan, J.P.	8	2.50%	160.0000	Selling	23.1	7.3
Exxon Mobil	9	2.09%	84.1250			
Minn.Mng.& Mfg.	10	2.07%	113.6250	Selling	10.4	4.7
Proctor & Gamble	11	1.91%	71.3750			
SBC Communications	12	1.62%	53.6875	Holding	1.7	1.6
Chevron	-	3.32%	78.2500	Selling	4.6	3.0
Goodyear Tire	-	6.63%	18.0900	Holding	0.5	1.4
Sears, Roebuck	-	2.77%	33.2200	Holding	2.8	4.5
					100.0	100.0

Change in Portfolio Value‡

	1 mo.	*1 yr.*	*5 yrs.*	*10 yrs.*	*15 yrs.*	*From 12/63*	*Std. Dev.*
Alt. Strategy	2.1%	0.8	16.6%	20.2%	19.6	16.5%	18.7
Dow	-2.4%	-5.7%	16.8%	17.3%	16.6%	11.2%	16.9

* The strategy excludes Philip Morris and General Motors. ** Indicated purchases approximately offset by sales of shares purchased 18 months ago. ‡ Assuming all purchases and sales at mid-month prices (+/– $0.125 per share commissions) reinvestment of all dividends and interest, and no taxes. The 5, 10 and 15-year total returns are annualized as are the total returns and the standard deviations of those returns since December 1963. ‡‡ Because the percentage of each issue in the portfolio by value reflects the prices shown in the table, we are also showing the number of *shares* of each stock as a percentage of the total number of shares in the entire portfolio.

Note: These calculations are based on hypothetical trades following very exacting stock selection strategies. They do not reflect returns on actual investments or previous recommendations of AIS. Past performance may differ from future results.

THE DOW JONES INDUSTRIALS RANKED BY YIELD

High-Yield Dow investors' returns have been boosted by recoveries in three "old economy" giants during the fourth quarter.

Caterpillar made a number of positive announcements starting off with a very strong third quarter earnings performance of $0.62 per share, $0.04 higher than Wall Street estimates. The company announced anticipated earnings growth for the years 2000 and 2001. This optimism is based on the company's expectation of renewed world-wide demand for agricultural equipment and expected growth of its electric power generating equipment sales, which have become Caterpillar's fastest growing product line. The company recently entered into an agreement with DaimlerChrysler to jointly develop medium-duty engines, fuel systems, and other powertrain components. Daimler, like many other European car manufacturers, has historically used diesel engines in most of the vehicles it has produced.

International Paper recently rolled back its fourth quarter earnings estimate to $0.30 per share, far below Wall Street earlier consensus of $0.44 per share. However, after an initial decline on the announcement, the company's share price recovered to a new eight-month high. Analysts look positively on the company's quick action to reduce production at some of its wood and paper production facilities. The company is aggressively moving forward with the sale of milling and production facilities obtained in recent mergers that do not fit with the company's three core businesses, i.e., paper, packaging, and forest products. The integration of International Paper and Champion International is ahead of forecasts, and has produced cost savings of $500 million. The company anticipates a cut in capital spending of 20% from $1.5 billion in 2000 to $1.2 billion in 2001. The company also anticipates completing asset sales of $5 billion by the end of 2001.

Goodyear Tire remains a hold, despite its removal from the Dow. The company's original equipment sales are expected to decline with production cutbacks by major automobile producers. As a result of increased raw material, labor, and energy costs cited as the cause of loss announced for the third quarter, the company recently announced price increases in its growing replacement tire business. So far, this has not resulted in a loss of market share because the company seems to have been a major beneficiary of the Firestone recall. The company's world-wide tire sales in the third quarter were 8.7% more than the third quarter 1999. This includes a significant contribution from sales of Dunlop tires, purchased from Sumitomo Tire in the third quarter of 1999. Unit sales for the first nine months of 2000 were 15.8% higher than during the same period in 1999.

	Ticker Symbol	Months On/(Off) Top 10	Market Prices 12/15/00	Market Prices 11/15/00	Market Prices 12/15/99	12-Month High	12-Month Low	Latest Dividend Amount	Latest Dividend Record Date	Latest Dividend Paid	Indicated Annual Dividend	Indicated Yield† (%)
Philip Morris	MO	94	**$40.06**	35.75	23.56	41.75 *H*	18.69	0.530	12/15/00	1/10/01	2.120	5.29
★ Eastman Kodak	EK	27	**$38.19**	47.75	60.31	67.81	35.31	0.440	12/01/00	1/02/01	1.760	4.61
AT&T	T	7	**$21.00**	20.56	54.50	61.00	18.25 *L*	0.220	9/29/00	11/01/00	0.880	4.19
★ General Motors †	GM	59	**$53.81**	57.81	71.25	94.63	48.44 *L*	0.500	11/16/00	12/09/00	2.000	3.72
★ Caterpillar	CAT	20	**$40.81**	36.69	46.52	55.13	29.00	0.340	1/22/01	2/20/01	1.360	3.33
☆ DuPont	DD	14/(32)	**$43.75**	43.44	65.04	74.00	38.19	0.350	11/15/00	12/14/00	1.400	3.20
★ International Paper	IP	13	**$37.38**	36.00	55.82	60.00	26.31	0.250	11/24/00	12/15/00	1.000	2.68
★ J. P. Morgan	JPM	86	**$160.00**	150.63	130.38	187.63	104.88	1.000	9/25/00	10/13/00	4.000	2.50
☆ Exxon Mobil	XOM	2/(7)	**$84.13**	90.38	83.06	95.44	69.88	0.440	11/13/00	12/11/00	1.760	2.09
★ Minn. Min. & Mfg.	MMM	74	**$112.19**	95.38	95.25	119.00 *H*	78.19	0.580	11/24/00	12/12/00	2.320	2.07
Procter & Gamble	PG		**$71.38**	73.38	112.63	118.38	52.75	0.350	10/20/00	11/15/00	1.400	1.96
☆ SBC Comm.	SBC	(3)	**$53.69**	57.31	52.06	59.00	34.81	0.254	10/10/00	11/01/00	1.010	1.88
Alcoa (s)	AA		**$30.94**	29.25	39.50	43.63	23.13	0.125•	11/03/00	11/25/00	0.500•	1.62
Honeywell Intl.	HON		**$47.88**	51.63	60.79	63.88	32.13	0.188	11/20/00	12/08/00	0.750	1.57
Merck	MRK		**$90.38**	91.63	71.69	96.69 *H*	52.00	0.340	12/08/00	1/02/01	1.360	1.50
Johnson & Johnson	JNJ		**$98.56**	95.00	94.67	103.00	66.13	0.320	11/21/00	12/12/00	1.280	1.30
Coca-Cola	KO		**$53.50**	61.31	59.88	66.88	42.88	0.170	12/01/00	12/15/00	0.680	1.27
United Tech.	UTX		**$71.19**	67.06	58.13	77.19 *H*	46.50	0.225	11/17/00	12/10/00	0.900	1.26
Citigroup * (s)	C		**$48.06**	50.19	54.50	59.13	35.34	0.140	11/06/00	11/22/00	0.560	1.17
General Electric (s)	GE		**$49.81**	52.50	48.10	60.50	41.65	0.137	10/03/00	10/25/00	0.550	1.10
Boeing	BA		**$64.88**	63.56	38.75	70.94 *H*	32.00	0.170	2/09/01	3/02/01	0.680	1.05
Hewlett-Packard (s)	HWP		**$31.63**	35.31	50.57	68.09	30.50	0.080	12/20/00	1/10/01	0.320	1.01
Walt Disney	DIS		**$29.38**	31.81	28.88	43.88	27.75	0.210	12/08/00	12/22/00	0.210	0.71
McDonald's	MCD		**$31.50**	33.31	41.81	43.63	26.38	0.215	11/15/00	12/01/00	0.220	0.70
IBM	IBM		**$87.81**	99.38	107.00	134.94	86.94	0.130	11/10/00	12/09/00	0.520	0.59
American Express (s)	AXP		**$54.63**	57.69	52.73	63.00	39.83	0.080	1/05/01	2/09/01	0.320	0.59
Wal-Mart Stores	WMT		**$49.88**	49.00	66.01	70.25	41.44	0.060	12/22/00	1/08/01	0.240	0.48
Home Depot, Inc.(s)	HD		**$41.94**	39.63	62.33	70.00	34.69	0.040	11/30/00	12/14/00	0.160	0.38
Intel Corp. (s)	INTC		**$32.44**	41.50	39.47	75.81	31.25 *L*	0.020	11/07/00	12/01/00	0.080	0.25
Microsoft Corp.	MSFT		**$49.19**	70.06	108.44	119.94	48.44	0.000	-	-	0.000	0.00
☆ Chevron	CHV	(14)	**$78.25**	83.94	89.94	94.88	69.94	0.650	11/17/00	12/11/00	2.600	3.32
☆ Goodyear	GT	(14)	**$18.09**	18.10	28.13	31.63	15.60	0.300	11/16/00	12/15/00	1.200	6.63
Sears, Roebuck	S	(14)	**$33.22**	31.46	31.25	43.50	25.25	0.230	11/30/00	1/02/01	0.920	2.77

★ BUY. ☆ HOLD. † Based on indicated dividends and market price as of 12/15/00. *H* New 52-week high. *L* New 52-week low. (s) All data adjusted for splits. • Excludes extras. * Travelers Group merged with Citibank as of 10/8/98 to form Citigroup. ‡ Spinoff of 0.69893 shares of Delphi Automotive per share of GM on 5/29/99.

Note: The count in months for the Top 10 issues indicates how long they have ranked among the Top 10. Issues are recommended for purchase (★) after having been among the Top 10 for 12 or more consecutive months, but this period can be changed if conditions warrant. Issues recommended for retention (☆) had qualified for purchase, but subsequently ranked no. 11 or lower and the monthly count (in parentheses) indicates how long ago they left the Top 10. If an issue became a ☆, but subsequently returned to the Top 10, both monthly counts are shown.

RECENT MARKET STATISTICS

Precious Metals & Commodity Prices

	12/15/00	*Mo. Earlier*	*Yr. Earlier*
Gold, London p.m. fixing	**270.35**	264.60	280.05
Silver, London Spot Price	**4.61**	4.66	5.19
Copper, COMEX Spot Price	**0.87**	0.83	0.82
Crude Oil, W. Texas Int. Spot	**28.87**	35.58	26.38
Dow Jones Spot Index	**112.68**	111.02	116.14
Dow Jones-AIG Futures Index	**112.06**	110.94	91.66
CRB-Bridge Futures Index	**227.41**	226.83	203.69

Interest Rates (%)

U.S. Treasury bills -	91 day	**6.00**	6.35	5.32
	182 day	**5.97**	6.34	5.66
	52 week	**5.64**	6.14	5.82
U.S. Treasury bonds -	15 year	**5.56**	5.93	6.56
Corporates:				
High Quality -	10+ year	**7.27**	7.61	7.49
Medium Quality -	10+ year	**8.02**	8.25	7.97
Federal Reserve Discount Rate		**6.00**	6.00	5.00
New York Prime Rate		**9.50**	9.50	8.50
Euro Rates	3 month	**4.95**	5.17	3.46
Government bonds -	10 year	**4.86**	5.18	5.00
Swiss Rates -	3 month	**3.50**	3.50	1.99
Government bonds -	10 year	**3.69**	3.81	na

Exchange Rates

British Pound	**$1.471000**	1.424000	1.614800
Canadian Dollar	**$0.655800**	0.644200	0.674700
Euro	**$0.894100**	0.856700	1.014400
Japanese Yen	**$0.008892**	0.009186	0.009709
South African Rand	**$0.130400**	0.130100	0.162600
Swiss Franc	**$0.594900**	0.560900	0.633700

Securities Markets

	12/15/00	*Mo. Earlier*	*Yr. Earlier*
S & P 500 Stock Composite	**1,312.15**	1,389.81	1,413.32
Dow Jones Industrial Average	**10,434.96**	10,707.60	11,225.32
Dow Jones Transportation Average	**2,698.68**	2,841.01	2,919.54
Dow Jones Utilities Average	**386.52**	388.20	272.19
Dow Jones Bond Average	**96.57**	95.60	98.29
Nasdaq Composite	**2,653.27**	3,165.49	3,621.95
Financial Times Gold Mines Index	**664.06**	571.59	901.00
FT African Gold Mines	**676.56**	624.53	1,072.43
FT Australasian Gold Mines	**802.38**	711.28	1,072.48
FT North American Gold Mines	**637.83**	531.92	818.71

Coin Prices

	12/15/00	*Mo. Earlier*	*Yr. Earlier*	*Premium*
American Eagle (1.00)	**$277.45**	271.65	284.90	2.63
Austrian 100-Corona (0.9803)	**$264.43**	258.93	270.43	-0.23
British Sovereign (0.2354)	**$67.15**	65.75	68.55	5.51
Canadian Maple Leaf (1.00)	**$277.70**	271.90	284.10	2.72
Mexican 50-Peso (1.2057)	**$326.50**	319.70	333.90	0.17
Mexican Ounce (1.00)	**$270.60**	265.00	276.70	0.09
S. African Krugerrand (1.00)	**$275.45**	269.75	281.65	1.89
U.S. Double Eagle-$20 (0.9675)				
St. Gaudens (MS-60)	**$347.50**	345.00	390.00	32.85
Liberty (Type I-AU)	**$675.00**	675.00	675.00	158.06
Liberty (Type II-AU)	**$425.00**	435.00	435.00	62.48
Liberty (Type III-AU)	**$314.00**	312.50	370.00	20.05
U.S. Silver Coins ($1,000 face value)				
90% Silver (715 oz.)	**$4,000.00**	3,900.00	4,250.00	21.35
40% Silver (292 oz.)	**$1,550.00**	1,537.50	1,612.50	15.15
Silver Dollars	**$5,700.00**	5,700.00	6,825.00	59.83

Note: Premium reflects percentage difference between coin price and value of metal in a coin, with gold at $270.35 per ounce and silver at $4.61 per ounce. The weight in troy ounces of the precious metal in coins is indicated in parentheses.

Selected Mutual Funds

	Ticker Symbol	*12/15/00*	*Month Earlier*	*Year Earlier*	*— 52-Week — High*	*Low*	*Distributions Latest 12 Months Income*	*Capital Gains*	*Yield (%)*
★ Duff & Phelps Utilities Income[1]	DNP	**$10.50**	10.25	8.63	10.50	8.25	0.7800	0.0000	7.43
★ T Rowe Price European Stock	PRESX	**$19.78**	21.58	22.13	25.32	19.78	0.3000	3.3200	1.52
★ Vanguard European Stk Index	VEURX	**$25.36**	25.76	27.54	29.85	24.16	0.5000	0.2000	1.97
☆ Vanguard REIT Index	VGSIX	**$11.63**	10.94	9.38	11.98	9.38	0.8000	0.0000	6.88
★ Vanguard Growth Index	VIGRX	**$31.72**	34.78	38.90	42.38	31.72	0.1580	0.9050	0.50
★ Fidelity Target Timeline 2003	FTARX	**$9.25**	9.14	9.15	9.25	8.88	0.6522	0.0000	7.05
★ USAA Short Term Bond	USSBX	**$9.65**	9.59	9.67	9.74	9.53	0.6477	0.0003	6.71
★ Vanguard Short Term Corp	VFSTX	**$10.62**	10.54	10.56	10.62	10.33	0.7038	0.0000	6.63

North American and Diversified Mining Companies

	Ticker Symbol	*12/15/00*	*Month Earlier*	*Year Earlier*	*— 52-Week — High*	*Low*	*Indicated Annual Net Dividends*	*Payment Schedule*	*Yield (%)*
Agnico-Eagle†	AEM	**$6.06**	5.13	6.63	7.94	4.88	0.020	Annual	0.33
★ Barrick Gold Corp.†	ABX	**$15.99**	13.31	17.75	20.00	12.31	0.220	Semiannual	1.38
Battle Mountain Gold	BMG	**$1.69**	1.31	2.31	2.88	1.25	0.000	-	0.00
Freeport-McMoran C&G, Cl.A	FCXA	**$7.75**	6.88	14.31	18.75	6.75	0.000	-	0.00
★ Homestake Mining	HM	**$4.31**	3.69	8.06	8.50	3.50	0.050	Semiannual	1.16
★ Newmont Mining	NEM	**$16.19**	13.50	23.13	28.38	12.75	0.120	Quarterly	0.74
★ Placer Dome†	PDG	**$9.44**	7.75	10.75	12.19	7.25	0.100	Semiannual	1.06
★ Rio Tinto PLC‡	RTP	**$66.00**	61.56	86.00	97.25	55.13	2.300	Semiannual	3.48

South African Mining Companies, Finance Houses and Investment Trusts

	Ticker Symbol	*12/15/00*	*Month Earlier*	*Year Earlier*	*— 52-Week — High*	*Low*	*ADR Net Dividends• and Ex-Dividend Dates*				*Yield (%)*
ASA Ltd.	ASA	**$14.56**	14.44	19.00	20.88	14.06	-	-	-	0.600°	4.12
Anglo American PLC[2]	AAUK	**$52.25**	55.23	64.38	71.00	36.75	4/05/00	1.060	9/20/00	0.580	3.14
★ Anglogold Ltd.[3]	AU	**$14.13**	13.31	24.31	28.69	12.25	2/23/00	0.834	8/09/00	0.511	9.52
Avgold Ltd.	AVGLY	**$3.74**	3.32	6.54	7.50	3.11	No Dividends Declared				
De Beers Consolidated Mines	DBRSY	**$26.13**	29.19	29.13	31.75	18.19	3/29/00	0.675	9/13/00	0.345	3.90
Gencor Ltd.	GNCRY	**$3.68**	4.03	3.97	4.68	2.27	3/29/00	0.041	9/13/00	0.164	5.57
★ Gold Fields Ltd.[4]	GOLD	**$3.28**	2.72	4.78	5.69	2.56	9/15/99	0.045	2/16/00	0.026	2.16

★ Buy. ☆ Hold. (s) All data adjusted for splits. † Dividend shown is after 15% Canadian tax withholding. ‡ Dividend shown is after 15% U.K. tax withholding on a portion of the total. na Not applicable. • Paid or announced last 12 months. ° Total dividend paid in latest 12 months. [1] Closed-end fund—traded on the NYSE. Dividends paid monthly. [2] Anglo American Gold Inv. Co. merger in Anglo American plc. [3] Formerly Vaal Reefs plus interests in Free State, Western Deep, Ergo, Elandsrand and others. 2 ADRs = 1 ordinary share. [4] Gold Fields Ltd. and Driefontonein Consolidated merged to form Gold Fields, Ltd. e Estimated.