INVESTMENT GUIDE

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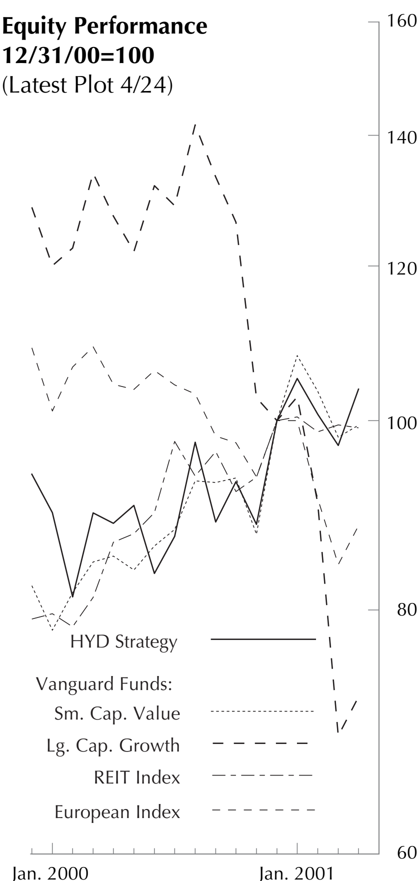

We offer two discretionary management services: Our Professional Asset Management (PAM) service covers all of our recommended assets and allows us to place trades in stocks, bonds, and mutual funds directly in our clients' accounts. (The accounts remain the property of our clients at all times—we are only authorized to trade on their behalf.) Our High-Yield Dow (HYD) service operates similarly, except it invests only in the highest-yielding Dow stocks, using the 4-for-18 model on a fully invested basis. Investors interested in these low-cost services should contact us at 413-528-1216 or Fax 413-528-0103.

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The Perils of Stock Picking

It is said that there are three remaining groups of people in the world who still believe that markets do not work: the North Koreans, the Cubans, and the stock pickers. We are inclined to agree.

However, too many investors still spend their time pondering the next hot stocks or wondering whether they should hire the latest stock picking "guru" instead of focusing on factors within their control.

These attempts invariably end in failure. The reason is simple: markets work. Stock prices efficiently reflect new information, and at any given time provide the best estimate of a firm's economic prospects. Nevertheless, high-priced "professionals" do their best to convince us that the market has "mispriced" assets, and furthermore that *they* know the "correct" price. Alas, despite our instincts to believe otherwise, there is no Tiger Woods of stock picking, because there cannot be. Anyone who claims to be smarter than the market bears a huge burden of proof.

That conclusion is supported by reams of empirical evidence. But one need not rely on sophisticated econometric models to see the truth. The tables below display the subsequent performance of the "hot" actively managed mutual funds from the most recent, and the earliest 5-year spans examined in a recent study. All 5-year intervals in between also yielded dismal results, as did going "deeper" into the list (i.e. the hottest 30 funds).

Subsequent Performance of Top 30 Mutual Funds

Five Year Period: January 1970-December 1974

	January 1970 - December 1974			*Subsequent Period January1975 - December 1999*		
	Rank	*Percentile Rank*	*Annualized Return*	*Rank*	*Percentile Rank*	*Annualized Return*
Dreyfus Founders:MdCpGr/F	1	99%	5.92	121	41%	15.75
Wade Fund	2	99%	3.67	200	2%	10.83
Lepercq-Istel Fund	3	98%	2.74	196	4%	11.64
Lindner Large Cap/Inv	4	98%	2.53	44	78%	18.37
Mutual Shares Fund/Z	5	97%	2.22	30	85%	19.39
Fidelity Contrafund	6	96%	1.61	38	81%	18.86
Security Growth & Inc/A	7	96%	1.38	191	6%	12.63
DLJ Winthrop Grth & Inc/A	8	95%	1.34	170	17%	14.38
Putnam Investors/A	9	95%	1.06	78	62%	17.07
American Mutual	10	94%	0.70	99	51%	16.34

Five Year Period: January 1990-December 1994

	January 1990 - December 1994			*Subsequent Period January1995 - December 1999*		
	Rank	*Percentile Rank*	*Annualized Return*	*Rank*	*Percentile Rank*	*Annualized Return*
AIM Aggressive Growth/A	1	100%	23.53	727	52%	22.55
Oppenheimer Main St G&I/A	2	100%	22.25	680	55%	22.94
Amer Cnt:Giftrust/Inv	3	99%	22.00	1056	31%	18.66
PBHG Growth	4	99%	21.98	504	67%	25.31
MFS Emerging Growth/B	5	99%	21.38	255	83%	28.57
PIMCO:Opportunity/C	6	99%	21.01	931	39%	20.07
United New Concepts/A	7	99%	19.85	181	88%	29.95
Crabbe Husan Special	8	99%	19.50	1520	0%	-4.20
Amer Cnt:Ultra/Inv	9	98%	19.38	193	87%	29.72
Kaufmann Fund	10	98%	19.28	1041	32%	18.78

Source: Dinmensional Fund Advisors and Micropal™ (excludes international, balanced, and specialty funds).

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QUARTERLY REVIEW OF INVESTMENT POLICY

Our recommended portfolio allocations are provided in the table below. These recommendations are based on our research, which attempts to identify appropriate asset classes for investors seeking to capture the highest returns possible, consistent with their tolerance for risk.

Money Market Funds

Money market funds are mutual funds that invest in short-term securities such as Treasury bills, bankers' acceptances, commercial paper, or negotiable certificates of deposit of major commercial banks. The shares of money market funds are issued and redeemed at a Net Asset Value (NAV) of $1.00 per share. They should not be confused with money market deposit accounts offered by banks, which are essentially interest bearing checking accounts, insured by the Federal Deposit Insurance Corporation (FDIC) and subject to minimum balance requirements and limited check writing privileges (typically no more than 3 per month).

Most brokers offer their customers a money market fund for a "sweep" account. Dividends, interest, and deposits are used to purchase additional shares in this fund, which may be redeemed to pay for purchases and withdrawals from the account. Similarly, mutual funds in "families"—which have the same sponsors and management companies, such as Vanguard—will include several money market funds among their offerings.

Intermediate-Term Bonds

Short- and intermediate-term bonds should serve not only to stabilize the income from the fixed-dollar portion of one's portfolio, but also to increase it (see the March *INVESTMENT GUIDE* for a detailed discussion of fixed-income securities).

Buying short-term bonds directly means the future stream of income and principal payments can be exactly ascertained, which could be especially useful when one expects that the funds will be needed (e.g. for tuition payments) during the next few years.

Individuals wishing to purchase bonds directly should work closely with their brokers, pay close attention to the bond ratings of what the broker has to offer, and fully understand the amount of the broker's commission.

However, many investors may find it more convenient to invest in short-to-intermediate-term bonds via mutual funds. These may be purchased and sold at any time and in relatively convenient amounts (although most funds do have a minimum purchase). Second, because they have a diversified portfolio of bonds, they can include some of the lowest investment grade, but higher-yielding issues (Baa or BBB) that we do not recommend for direct purchase.

Among the many bond funds available we recommend three that have low expense ratios, low turnover, and good ratings. These are indicated with an ★ on the back page. [Note: for our investment management clients, in addition to purchasing bonds directly, we will be using the DFA Five Year Global Fixed Income Fund, which invests in fixed-income securities of industrialized countries of less than five-year maturity. Its foreign currency holdings are hedged to the dollar. DFA funds are available only to institutions and the clients of registered investment advisors.]

Income Equities

We currently have only two recommendations in this category.

The first is Duff & Phelps Utilities Income Inc., a closed-end diversified investment company traded on the New York Stocks exchange (symbol DNP). The primary investment objective of the fund is current income and long-term growth of income. Dividends are paid monthly and its current yield is about 7.3%. The company invests mainly in the securities of public utilities and its returns benefit from modest leverage.

The second is the Vanguard REIT Index Fund (symbol VGSIX) that invests in the equity Real Estate Investment Trusts that comprise the Morgan Stanley REIT index. Its current yield is about 7%. The advantages of REITs are discussed in detail in the accompanying article.

Large Capitalization Value Stocks

Our Top 4-for-18-Months High-Yield Dow stock selection strategy model portfolio has again outperformed the Dow Jones Industrial Average (DJIA) over the most recent 12-month span, as well as over the longer periods reported in the box on p. 30. This may or may not continue, but all of our studies indicate that it will do well over the long-term. Indeed, from 1963 to the present (the period for which we have data), its long-term record has the best combination of risk (volatility) and return of the various asset classes and indexes we have surveyed.

Where the size of one's account permits, we recommend using our Top 4-for-18-months High-Yield Dow stock selection strategy. Smaller accounts may substitute the iShares S&P 500 BARRA Value Index Fund (IVE) or the Vanguard S&P 500 BARRA Value Index Fund (VIVAX). Both of these are based on the same index, which is composed of the companies with the lowest price-to-book value ratios that are included in the S&P 500 index.

Small Capitalization Value Stocks

As we discussed in the October *INVESTMENT GUIDE*, small capitalization stock prices often fluctuate differently from large capitalization stock prices. For this component we recommend two vehicles, both based on the S&P 600 BARRA Small Cap Index, which consists of 600 domestic stocks chosen for market size, liquidity, and industry group representation. It is a market value weighted index.

The funds we recommend here hold the issues in the index with the lowest price-to-book value ratios whose aggregate market capitalization equals half of the

RECOMMENDED PORTFOLIO ALLOCATION PERCENTAGES

	Conservative	*Moderate*	*Aggressive*
Money Market Funds	30	20	10
Intermediate Bonds	35	25	15
Income Equities	10	5	0
Large Cap Value Stocks	20	30	35
Small Cap Value Stocks	0	5	10
Growth Stocks	5	5	10
Foreign Equities	0	5	10
Gold Related	0	5	10
	100	100	100

Note: Most investors should adopt values in between the extreme conservative and aggressive percentages shown above. What is best for an individual investor will depend on individual circumstances, and one's tolerance for risk.

entire index. They are the exchange-traded iShares S&P 600 BARRA Small Cap Value Index Fund (symbol IJS) and the Vanguard S&P 600 BARRA Small Cap Value Index Fund (VSIIX). [Note: these funds hold companies with market capitalizations that are somewhat larger than the companies held by the DFA funds, which we use for our investment management clients and in our research, but we believe these funds are reasonable substitutes.]

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Large Cap Growth Stocks

Over the long-term, large cap growth stocks have lagged behind value stocks. But growth stocks have outperformed value investments by a wide margin during some periods. Large-capitalization growth stocks also tend not to move in tandem with large capitalization value stocks, so holding large growth stocks is suitable for investors with low tolerance for "tracking risk," or the risk of one's watching the portfolio returns deviate too far from those of the overall market.

For this component we also recommend two vehicles, both based on the S&P 500 BARRA Growth index. This index is composed of the companies with the highest price-to-book ratios that are included in the S&P 500 index. This index has consistently outperformed most self-proclaimed growth stock funds under active management.

Our recommendations include the exchange-traded iShares S&P 500 BARRA Growth Index Fund (IVW) and the Vanguard S&P 500 BARRA Growth Index Fund (VIGRX). Readers might well ask if they should instead purchase the index fund for the entire S&P 500, especially if the value index fund (the other half of the S&P 500) is used for the large capitalization value component. The answer is no: we are recommending a larger commitment to the value stocks than to the growth stocks, and rebalancing one's holdings among the components is an important aspect of our approach.

Foreign Equities

At present we only recommend exposure to the equities of Western Europe. Again we have two recommendations: the exchange-traded iShares S&P Europe 350 (IEV), which is based on the index of that name, and the Vanguard European Stock Index Fund (VEURX), which is based on the Morgan Stanley Capital International (MSCI) Europe Index. In addition to reflecting the fluctuations of European markets, which often diverge from the U.S. market, the dollar value of these funds will reflect the fluctuations of European currencies, notably the euro, against the dollar.

Gold-Related Investments

We have long recommended direct ownership of gold coins for individuals. This is not so much to make money as to have money in all circumstances. Unlike other financial assets that depend on explicit or implicit contracts and can be voided "with the stroke of a pen," gold coins have no obligor. Gold ownership provides some insurance against the day when general price inflation accelerates once again. Readers should be aware that coin dealers' margins are very high on numismatic and newly minted fractional ounce coins, which should be avoided.

Investors can receive the benefits of indirect ownership of gold "in the ground" via shares of precious metals mining companies. Our recommended shares include only well established, producing, dividend-paying companies (also listed on p. 32). For these companies, any increase in the price of gold flows almost entirely to the bottom line.

REITS: A VALUABLE PORTFOLIO COMPONENT

We recommend Real Estate Investment Trusts (REITs) for many investors. These fall into the "income equities" category in our table of recommended allocations on page 26. REITs have several features, including an income stream competitive with those of bonds and utilities. They provide a risk/return profile that is unique and can therefore play a valid role for investors seeking an optimal portfolio in terms of risk and return.

What is a REIT?

A REIT is a tax-advantaged operating company that specializes in owning and managing commercial property. Congress authorized REITs in 1960 to allow investors to participate in the commercial real estate market. REITs must distribute 95% of their net income to shareholders, who in turn must pay income taxes on these dividends, but the REIT itself avoids corporate income taxes. REITs thus benefit vis-a-vis common stocks by avoiding "double taxation."

There are other significant statutory requirements pertaining to REITs, including a stipulation that 75% of a REIT's assets must be invested in real estate, mortgage loans, cash, or government securities, and that 75% of gross income be derived from rents, mortgage interest, or gains from the sale of real property. Significantly, in 1986 a new tax law permitted REITs to go beyond mere ownership by allowing them to operate all aspects of the real estate business, from finding tenants and undertaking improvements to developing new properties.

Many investors have bitter recollections of the commercial real estate market. The REIT market of the 1970s, for example, was dominated by "mortgage REITs." These REITs, which originated, held and marketed real estate mortgage loans, were crushed by skyrocketing interest rates and left investors with significant losses. Real estate limited partnerships bring even darker memories; these structures were touted more for their tax advantages than their economic advantages. When the tax laws changed, these highly illiquid instruments crashed and burned.

Equity REITs, however, are distinct from both of these ill-fated predecessors. Unlike mortgage REITs, equity REITs directly own and manage commercial properties. They also bear very little resemblance to limited partnerships, which were frequently assembled by brokerage firms and promoters who claimed exaggerated appreciation potential. They charged high fees, typically held only a

few properties, and were highly illiquid. Raising new capital proved very difficult. Equity REITs, by contrast, trade in a highly liquid market where they are valued based on their ability to grow their earnings and dividends. Capital can be quickly and efficiently accessed by issuing new debt or shares, by reinvesting undistributed dividends, or by selling appreciated properties. Finally, unlike limited partnerships whose general partners frequently had conflicts of interest with the limited partners, the managers of most successful equity REITs hold a significant stake in the business themselves.

By a recent count, there are presently 189 REITs in existence of which 158 are equity REITs (the remainder are either mortgage or "hybrid" REITs). Equity REITs invest in shopping centers, malls, apartments, hospitals, nursing homes, office buildings, malls, manufactured home developments, industrial properties, and hotels. Some specialize within these areas, or within a geographic region, while others are diversified. According to the National Association of Real Estate Investment Trusts, (NAREIT) the market capitalization of all equity REITs stood at $134 billion at the end of 2000, up from only $49 billion five years earlier. NAREIT also lists 49 mutual funds that specialize in REITs.

Real Promise

REITs are a highly liquid form of holding real estate and are likely to continue to be so in the future as more private owners of real estate turn to the public markets.

In the aftermath of the saving- and-loan debacle, in the early 1990s, a traditional source of real estate financing disappeared, providing an opening for the public equity market. As real estate prices plunged in the face of this liquidity crisis, REITs emerged to fill the void by buying up properties at depressed prices.

The shift from private to public ownership has been facilitated by the emergence of "umbrella partnership" REITs or UPREITs. Under these plans, private developers can exchange existing properties for "units" of a limited partnership in which a REIT holds a controlling interest. These units receive the same dividends and voting rights available to REIT shareholders and may be converted into shares of the REIT. In exchanging their properties for the ownership units, the developers defer capital gains taxes until they convert their units to REIT shares. They also gain significant diversification and easy access to new capital through public equity markets. These features should provide continued growth for REITs in the future.

The real estate market has proven notoriously susceptible to boom and bust cycles, but the trend toward REIT ownership could mitigate these swings. In past real estate meltdowns, mismanaged firms were often said to be "overlooked" and managed to hang on until the entire industry was in crisis. Publicly traded REITs, on the other hand, operate in a highly efficient market and are subject to the close scrutiny of public disclosure. They are quickly punished if poorly managed. Pleasing the capital markets is essential to raising new funds; because they must distribute 95% of their earnings as dividends. REITs rely heavily on external financing for growth.

Excessive leverage was a major factor contributing to past real estate crashes, but today's REITs appear more conservatively financed. Debt rarely exceeds 40% of total market capitalization. The quality of debt has improved as well. REITs use leverage to minimize their cost of capital, but rely less on short-term and variable-rate debt than in the past. As their capitalization has grown, REITs have been able to develop more flexible capital structures that include preferred stock, convertible debt and unsecured debt.

The growing supply of REITs is likely to be matched by increasing demand for these securities. As more investors see the wisdom of passive investing, REITs are likely to appear in more portfolios for their unique risk/return characteristics.

REITs are also increasingly attractive to institutional investors. In the past, pension funds and insurance companies shunned REITs in favor of direct real estate investment run by an "in house" staff. REITs' small capitalizations and limited property types proved unpopular with large investors who required greater liquidity and diversification. But the market capitalizations and diversity of holdings among REITs has grown dramatically.

REITs, Risk, and Return

Equity REITs can provide a dependable source of investment income. In mid-April, the Vanguard Special REIT Index Portfolio, which mimics the broad-based Morgan Stanley REIT Index, was yielding 6.7%. In comparison, the 30-year Treasury bond was yielding 5.64%.

An asset class is perhaps best defined as a subset of capital markets with unique forms of "priced" risk. Priced risk is any risk the market compensated with expected returns. Anything that qualifies as an asset class has meaningful diversification properties and, therefore, a meaningful role in plan structure.

Most industry sectors do not qualify as asset classes. Oil stocks, for instance, are prone to "price shocks," but there is no expected return to compensate for these fluctuations, so holding oil stocks as an industry component within a portfolio is not justified based on risk and return. (This does not preclude holding oil stocks as part of a genuine asset class such as "large cap value stocks.") Oil shocks are an unpriced risk. Most industries have no independent risk-and-return characteristics.

Fama and French find that three risk factors—the market, the size effect and the book-to-market effect—describe the variation in returns of virtually every industry group. "Industry effects" do not exist, in the sense of explaining differences in expected returns. They found that what appear to be independent movements in the returns of industry groups are actually due to market, size and book-to-market effects in returns. The three factors explain the returns of all industry categories except one: REITs. 67% of the variation in returns of 49 industries are explained by the factors, compared to only 22% of the variation of REIT returns.

Because the model describes all industries except real estate, we cannot reject that real estate is a separate asset class. No other combination of investments can approximate their risk-and-return characteristics. REITs behave differently. They deserve a place in a diversified portfolio. The correlations in Table 1 reinforce this conclusion (a correlation of one represents perfect correlation). REITs, in spite of their reputation as interest-rate

Table 1
Monthly Correlations
Five Years: July1992-June 1997

	NAREIT	*S&P 500*	*LTGB*	*TBill*
NAREIT	1.00			
S&P 500 Index	0.22	1.00		
Long-Term Govt Bond	**0.23**	**0.47**	1.00	
Treasury Bill	0.07	0.28	0.11	1.00

Table 2

	Annualized Total Return	Annualized Standard Deviation
NAREIT Index 5 Yr.	9.05%	14.60
NAREIT Index 10 Yr.	12.74%	13.60
NAREIT Index 15 Yr.	8.05%	12.90

sensitive stocks, have a lower correlation with the bond market than does the S&P 500. This illustrates their diversification benefits.

REITs are attractive for their low risk level *in a diversified portfolio*, and for their frequent strong returns. Table 2 shows returns and standard deviations over the last 5, 10, and 15 years. Real estate securities have done well for their low risk, with the additional benefit of a high yield.

Liquid Properties

Professors Joseph Gyourko and Donald Keim of the Wharton School did seminal research into the behavior of real estate equity. They found that real estate stocks have a strong "lagged" correlation with appraised values of actual real estate. Because stocks are more liquid and more actively traded than buildings (and land), they tend to reflect real estate values more quickly than appraisals (as represented by the Russell NCREIT Index). Real estate stock prices are correlated with appraised values in the following year.

REITs do not behave like a stock, a bond, or a hybrid of both. We know, however, from Gyourko and Keim's research that real estate stocks deliver the returns of real estate. They're much easier to buy and sell than real estate property, and they anticipate the returns of the property market.

The lack of actual buildings is a benefit. Plans with properties in their portfolios have management problems REIT holders do not have—problems that require time, money, and personnel. It is also much easier to diversify with REITs. It's difficult to diversify a portfolio of actual properties across geographical regions and operator-types.

To summarize, REITs are listed as stocks, but they are not well explained by the current models of what a stock (or a bond) is. This is a reason to hold them: they are different and they enhance diversification. While they don't behave like stocks and they don't behave like bonds, they behave like actual property, with the added benefit that they trade like stocks.

Which REITs are Right?

Our passive approach to portfolio management leads us to recommend passively managed mutual funds as the most effective means of holding REITs.

We continue to recommend the Vanguard Special REIT Index Portfolio (VGSIX), an open-end, no-load mutual fund that invests in those REITs that comprise the Morgan Stanley REIT Index. This index tracks equity REITs in every major sector except health care REITs (these comprise about 12% of the overall REIT market). The index excludes REITs that have a market capitalization of less than $100 million, or fewer than 7 million shares outstanding, and has further restrictions with regard to trading volumes and minimum purchase price. This passive investment strategy seeks to capture the returns of the overall REIT market rather than trying to seek out pockets of value within particular real estate sectors. The fund therefore provides excellent geographic and sector diversification.

Dimensional Fund Advisors started their Real Estate Securities Fund (DFREX) in January 1993, following the Gyourko-Keim research. The strategy, designed by Gyourko and Keim, was among the first REIT portfolios available. While we believe that Dimensional provides the optimal method of adding REITs to a portfolio, these funds are only available through registered investment advisors. We offer this fund through our Professional Asset Management (PAM) service.

The portfolio holds all publicly-traded equity and hybrid REITs in market cap weights. Like the Vanguard fund, it excludes health care REITs. Gyourko-Keim concluded these REITs are more correlated with the healthcare industry and are not purely representative of the real estate asset class.

Dimensional's fund is similar to the Vanguard fund in that it is passive with respect to its management, but it is "active", and we think superior, with respect to trading. Traditional index funds strive to perfectly weight their portfolio to the index weights because they place the highest priority on tracking their index. Dimensional's equity strategies are mostly composed of higher cost-of-capital and higher expected return stocks, which are often illiquid stocks. Research shows that tracking an index of illiquid stocks is costly, and close tracking often indicates poor performance of the objective. This deserves some explanation.

To replicate huge indexes of small-cap stocks, traditional index strategies are forced to buy shares at the market close, often at the "asking" price. The selling brokers anticipate these purchases and raise prices. The inflated closing price paid by the index fund is the same price used to value the index. As a result, the fund closely tracks its index while paying excessive trading costs. Because many plan sponsors measure the success of an index fund by how closely it tracks its index, the poor performance often goes unnoticed. In small-cap stocks, close tracking comes at the cost of lower returns.

Dimensional uses its size and influence in the "upstairs market" of block trades to purchase blocks of the stocks in its portfolio at discounts. Dimensional often receives the trading costs paid by index funds that sell under pressure in order to track their benchmarks. As a result, the firm's small-cap strategies typically incur negative transaction costs, which translates directly into increased portfolio returns.

As is the case with our other passively managed recommended assets, the Vanguard fund and the DFA Real Estate fund both have superior track records among mutual funds in their respective asset classes.

Portions of this article were taken directly from Real Estate Securities Fund *by Eugene F. Fama, Jr., Dimensional Fund Advisors. For a full, annotated version of the text, please contact A.I.S.*

NEWLY RECOMMENDED FUNDS

	Ticker Symbol	4/12/01	Month Earlier	Year Earlier	52-Week High	52-Week Low	Distributions Latest 12 Months Income	Distributions Latest 12 Months Capital Gains	Yield (%)
iShares Index Funds:									
S&P SmallCap 600/BARRA Value	IJS	**76.24**	**76.65**	na	85.62	66.63	0.4800	0.3400	0.63
S&P 500/BARRA Value	IVE	**60.38**	**59.90**	na	67.00	55.00	0.6300	0.1500	1.04
S&P 500/BARRA Growth	IVW	**56.39**	**57.25**	na	94.25	52.88	0.3600	0.1100	0.64
S&P Europe 350	IEV	**66.80**	**65.00**	na	80.75	59.02	0.3500	0.0000	0.52
Vanguard Value Index	VIVAX	**20.79**	**21.63**	21.35	23.89	19.55	0.2800	0.8700	1.35
Vanguard Sm. Cap. Value Index	VISVX	**9.16**	**9.75**	7.96	10.70	7.93	0.3200	0.3300	3.49

THE HIGH-YIELD DOW INVESTMENT STRATEGY

We are convinced that long-term common stock investors will receive superior returns on the "large capitalization value stocks" component of their holdings if they consistently hold the highest-yielding Dow stocks. The fact that a given company's stock is included in the Dow Jones Industrial Average is evidence that the company is a mature and well-established going concern. When a Dow stock comes on to the list of the highest-yielding issues in the Average, it will be because its price is depressed—it is out of favor with the investing public for one reason or another (disappointing earnings, unfavorable news developments, etc.). A High-Yield Dow (HYD) strategy derives much of its effectiveness because it "forces" the investor to purchase sound companies when they are out of favor and to sell them when they return to relative popularity.

Selecting from the list will not be "cut and dried" if the timing of purchases and sales reflects individual prejudices or other *ad hoc* considerations. These usually come down to "I'm not going to buy *that*" or "goody goody, this fine company has finally come on the list and I'm going to load up". Our experience with investing in the highest-yielding Dow stocks has shown that attempts to "pick and choose" usually do not work as well as a disciplined approach.

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.)

The model portfolio of HYD holdings set forth in the accompanying table reflects the systematic and gradual accumulation of the 4 highest-yielding Dow issues that are neither General Motors nor Philip Morris. 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 seems unlikely that there will be sufficient "good news" for it to be sold out of the portfolio. For nearly 8 years, Philip Morris has never ranked lower than no. 4 on the list and whatever its ups and downs, unless it is specifically excluded—using Philip Morris in the strategy currently amounts to a "buy and hold" approach. The HYD strategy, to repeat, derives much of its superior performance from "buying cheap and selling dear."

In the construction of the model, shares purchased 18 months earlier that are no longer eligible for purchase are sold. 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 calls for selling the remaining holdings of **Chevron**, **Goodyear**, and **Sears Roebuck** (all three of these were dropped from the Dow 18 months ago, in October 1999) and for buying **Caterpillar**, **Dupont**, and **Eastman Kodak**. Investors with sizable portfolios should be able to track the exact percentages month-to-month, but 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.

The process of *starting* to use the strategy is not as straightforward. The two most extreme approaches are: buy all the indicated positions at once or spread purchases out over 18 months. Either choice could be said to represent an attempt at

As of April 12, 2001

	Rank	Yield	Price	Status	—Percent of Portfolio*— Value	No. Shares‡‡
Philip Morris	1	4.62%	$45.89	*	-0-	-0-
Eastman Kodak	2	4.14%	42.48	Buying	18.0	18.4
General Motors	3	3.77%	53.10	*	-0-	-0-
Dupont	4	3.07%	45.65	Buying	15.4	14.6
JP Morgan Chase	5	3.00%	45.37	Holding**	16.6	15.8
Caterpillar	6	2.89%	47.01	Buying	27.4	25.3
Int'l Paper	7	2.74%	36.48	Holding	10.6	12.7
SBC Comm.	8	2.49%	41.18	Holding	1.2	1.3
Proctor and Gamble	9	2.38%	58.80	—	—	—
Minn.Mng.& Mfg.	10	2.23%	107.73	Holding	6.0	2.4
A.T.&T.	25	0.69%	21.78	Holding	4.8	9.5
Chevron	-	2.83%	91.80	Selling	0.0	0.0
Goodyear Tire	-	4.95%	24.24	Selling	0.0	0.0
Sears, Roebuck	-	2.65%	34.75	Selling	0.0	0.0
					100.0	100.0

Change in Portfolio Value‡

	1 mo.	1 yr.	5 yrs.	10 yrs.	15 yrs.	From 12/63	Std. Dev.
Strategy	1.7%	12.5%	17.1%	19.1%	18.8%	16.6%	19.0
Dow	1.0%	0.5%	14.2%	15.5	15.0%	11.0%	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.

"market timing," i.e., "all at once" could be construed as prediction that—and will look good in retrospect only if—the prices of the shares go up after the purchases are made. On the other hand, if purchases are stretched out and stock prices increase, the value of the investor's holdings will lag behind the strategy's performance. We believe that most attempts to time the market are futile, and the best course lies somewhere inbetween the extremes.

Some portion of the shares now held in the strategy will be sold within a few months. The shares most likely to be sold are those whose indicated yields are too low to make them currently eligible for purchase. This usually means that their prices have risen (and their yields have fallen) in relative if not absolute terms, since they were purchased. If such stocks are purchased now and are sold within a few months, the investor will receive only a portion of the profit, or sustain a greater loss, than the strategy. On the other hand, if they are purchased and the strategy does not call for selling them, it will usually be because their prices have decreased so that their indicated yields render them again eligible for purchase. In short, buying stocks that are not currently among the top four, means either that they will be quickly sold (perhaps at a gain, perhaps not, but with payment of two commissions either way), *or*, that they will be held in the portfolio at a loss for some period of time. In the latter situation, the investor would have been better off to have waited.

Accordingly, for new HYD clients , we usually purchase the full complement of the currently eligible stocks immediately. (This month, the four eligible issues—Caterpillar, DuPont, Kodak, and JP Morgan Chase—account for about two-thirds of the total portfolio value.) Any remaining cash will be held in a money market fund pending subsequent purchases, which will be made whenever the client's holdings of each month's eligible stocks are below the percentages indicated by the strategy by an amount sufficient to warrant a trade.

AT&T is something of a special situation here. The current holdings in the strategy were acquired last fall, before the company slashed its dividend. The company's problems (see the December *INVESTMENT GUIDE*), continue to be reflected in its stock price. Yet, when the time comes to sell the strategy's holdings in the spring of 2002, it is quite possible that the shares (including prospective spin-offs) will be worth more than they are now. We have been buying AT&T for new clients but, because it is not now eligible for purchase, a case could be made that it should be left out of an initial commitment at this time.

Our **HYD Investment Management Program** provides professional and disciplined application of this 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.

THE DOW JONES INDUSTRIALS RANKED BY YIELD

	Ticker	Market Prices			12-Month		Latest Dividend			Indicated	
	Symbol	*4/12/01*	*3/15/01*	*4/14/00*	*High*	*Low*	*Amount*	*Record Date*	*Paid*	*Annual Dividend*	*Yield† (%)*
Philip Morris	MO	**$45.89**	47.26	21.13	52.04	20.38	0.530	3/15/01	4/10/01	2.120	4.62
★ Eastman Kodak	EK	**$42.48**	43.21	61.50	65.69	35.31	0.440	3/01/01	4/02/01	1.760	4.14
‡ General Motors	GM	**$53.10**	54.60	82.06	94.63	48.44	0.500	2/16/01	3/10/01	2.000	3.77
★ DuPont	DD	**$45.65**	43.00	56.55	63.63	38.19	0.350	2/15/01	3/14/01	1.400	3.07
★ J. P. Morgan Chase	JPM	**$45.37**	45.26	33.60	60.63	32.38	0.340	4/06/01	4/30/01	1.360	3.00
★ Caterpillar	CAT	**$47.01**	45.00	40.50	49.63	29.00	0.340	4/23/01	5/19/01	1.360	2.89
☆ International Paper	IP	**$36.48**	34.92	40.13	45.94	26.31	0.250	2/23/01	3/15/01	1.000	2.74
☆ SBC Comm.	SBC	**$41.18**	42.82	42.63	59.00	38.44	0.256	4/10/01	5/01/01	1.025	2.49
Procter & Gamble	PG	**$58.80**	64.94	63.00	79.31	53.25	0.350	4/20/01	5/15/01	1.400	2.38
☆ Minn. Min. & Mfg.	MMM	**$107.73**	109.24	90.81	122.94	80.44	0.600	2/23/01	3/12/01	2.400	2.23
‡ Exxon Mobil	XOM	**$82.00**	82.95	78.75	95.44	75.00	0.440	2/09/01	3/09/01	1.760	2.15
Honeywell Intl.	HON	**$43.45**	40.51	54.13	59.13	32.13	0.188	2/20/01	3/09/01	0.750	1.73
Merck	MRK	**$79.50**	74.05	63.56	96.69	61.88	0.340	3/09/01	4/02/01	1.360	1.71
Coca-Cola	KO	**$44.57**	47.65	47.00	64.00	42.37 *L*	0.180	6/15/01	7/01/01	0.720	1.62
Alcoa (s)	AA	**$38.99**	35.77	33.16	39.98 *H*	23.13	0.150•	5/04/01	5/25/01	0.600•	1.54
General Electric (s)	GE	**$44.70**	41.08	48.58	60.50	36.42 *L*	0.160	3/07/01	4/25/01	0.640	1.43
Johnson & Johnson	JNJ	**$90.95**	93.35	73.63	105.94	72.56	0.320	2/20/01	3/13/01	1.280	1.41
United Tech.	UTX	**$75.38**	75.75	56.63	82.50	54.00	0.225	2/16/01	3/10/01	0.900	1.19
Citigroup (s)	C	**$47.30**	46.40	59.88	59.13	39.00	0.140	5/07/01	5/25/01	0.560	1.18
Boeing	BA	**$60.50**	56.10	35.38	70.94	34.06	0.170	2/09/01	3/02/01	0.680	1.12
Hewlett-Packard (s)	HWP	**$30.62**	30.70	61.50	68.09	26.18 *L*	0.080	3/21/01	4/11/01	0.320	1.05
American Express (s)	AXP	**$39.19**	39.80	44.67	63.00	34.00 *L*	0.080	4/06/01	5/10/01	0.320	0.82
McDonald's	MCD	**$26.89**	27.24	33.56	39.94	24.75 *L*	0.215	11/15/00	12/01/00	0.215	0.80
Walt Disney	DIS	**$29.09**	28.00	38.88	43.88	26.00	0.210	12/08/00	12/22/00	0.210	0.72
☆ AT&T	T	**$21.78**	23.35	50.00	55.13	16.50	0.038	3/30/01	5/01/01	0.150	0.69
Wal-Mart Stores	WMT	**$49.70**	47.85	55.13	64.94	41.44	0.070	3/23/01	4/09/01	0.280	0.56
IBM	IBM	**$96.20**	95.56	106.00	134.94	80.06	0.130	2/09/01	3/10/01	0.520	0.54
Home Depot, Inc.	HD	**$41.65**	43.20	57.88	70.00	34.69	0.040	3/08/01	3/22/01	0.160	0.38
Intel Corp. (s)	INTC	**$28.12**	28.50	65.97	75.81	22.25 *L*	0.020	5/07/01	6/01/01	0.080	0.28
Microsoft Corp.	MSFT	**$62.18**	53.69	74.13	82.88	40.25	0.000	-	-	0.000	0.00
☆ Chevron	CHV	**$91.80**	88.70	85.69	94.88	76.88	0.650	2/16/01	3/12/01	2.600	2.83
☆ Goodyear	GT	**$24.24**	24.73	27.56	31.63	15.60	0.300	5/15/01	6/15/01	1.200	4.95
☆ Sears, Roebuck	S	**$34.75**	37.05	36.56	43.50	27.75	0.230	3/02/01	4/02/01	0.920	2.65

★ BUY. ☆ HOLD. † Based on indicated dividends and market price as of 4/12/01. *H* New 52-week high. *L* New 52-week low. (s) All data adjusted for splits. • Excludes extras. ‡ These issues had been recommended for purchase under our original HYD stock selection strategy because they had ranked among the 10 highest yielding issues for more then 12 months. They should be retained by readers who currently hold them.

Note: The issues indicated for purchase (★) are the 4 highest yielding issues (other than Philip Morris and General Motors) qualifying for purchase in the top 4-for-18 months model portfolio. The issues indicated for retention (☆) have similarly qualified for purchase during one or more of the preceding 17 months, but do not qualify for purchase this month.

RECENT MARKET STATISTICS

Precious Metals & Commodity Prices

	4/12/01	Mo. Earlier	Yr. Earlier
Gold, London p.m. fixing	**259.25**	262.05	282.00
Silver, London Spot Price	**4.37**	4.42	5.13
Copper, COMEX Spot Price	**0.76**	0.80	0.75
Crude Oil, W. Texas Int. Spot	**28.25**	26.55	25.58
Dow Jones Spot Index	**106.15**	109.02	120.92
Dow Jones-AIG Futures Index	**109.20**	107.49	95.87
CRB-Bridge Futures Index	**214.35**	215.76	211.11

Interest Rates (%)

		4/12/01	Mo. Earlier	Yr. Earlier
U.S. Treasury bills -	91 day	**3.98**	4.50	5.79
	182 day	**4.09**	4.40	6.03
	52 week	**4.11**	4.18	6.06
U.S. Treasury bonds -	15 year	**5.66**	5.28	6.15
Corporates:				
High Quality -	10+ year	**7.11**	6.82	7.68
Medium Quality -	10+ year	**7.89**	7.61	8.12
Federal Reserve Discount Rate		**4.50**	5.00	5.50
New York Prime Rate		**8.00**	8.50	9.00
Euro Rates	3 month	**4.56**	4.70	4.00
Government bonds -	10 year	**4.70**	4.69	5.05
Swiss Rates -	3 month	**3.24**	3.45	2.82
Government bonds -	10 year	**3.21**	3.35	na

Exchange Rates

	4/12/01	Mo. Earlier	Yr. Earlier
British Pound	**$1.438600**	1.431600	1.587000
Canadian Dollar	**$0.641500**	0.638300	0.677300
Euro	**$0.890800**	0.895000	0.961200
Japanese Yen	**$0.008083**	0.008136	0.009500
South African Rand	**$0.124500**	0.126600	0.151600
Swiss Franc	**$0.585800**	0.582300	0.612200

Securities Markets

	4/12/01	Mo. Earlier	Yr. Earlier
S & P 500 Stock Composite	**1,183.50**	1,173.56	1,356.56
Dow Jones Industrial Average	**10,126.94**	10,031.28	10,305.77
Dow Jones Transportation Average	**2,766.59**	2,703.01	2,727.04
Dow Jones Utilities Average	**383.53**	375.50	303.86
Dow Jones Bond Average	**101.15**	101.49	94.82
Nasdaq Composite	**1,961.43**	1,940.71	3,321.29
Financial Times Gold Mines Index	**696.39**	694.88	797.27
FT African Gold Mines	**813.67**	797.16	962.15
FT Australasian Gold Mines	**713.32**	740.83	776.52
FT North American Gold Mines	**653.37**	652.55	743.07

Coin Prices

	4/12/01	Mo. Earlier	Yr. Earlier	Premium
American Eagle (1.00)	**$265.35**	269.65	289.75	2.35
Austrian 100-Corona (0.9803)	**$252.93**	257.03	275.33	-0.48
British Sovereign (0.2354)	**$64.35**	65.35	69.75	5.44
Canadian Maple Leaf (1.00)	**$265.60**	269.90	289.10	2.45
Mexican 50-Peso (1.2057)	**$312.30**	317.30	339.90	-0.09
Mexican Ounce (1.00)	**$258.80**	263.00	281.70	-0.17
S. African Krugerrand (1.00)	**$263.55**	267.75	286.65	1.66
U.S. Double Eagle-$20 (0.9675)				
St. Gaudens (MS-60)	**$345.00**	342.50	387.50	37.55
Liberty (Type I-AU)	**$675.00**	675.00	675.00	169.11
Liberty (Type II-AU)	**$425.00**	425.00	435.00	69.44
Liberty (Type III-AU)	**$312.50**	312.50	350.00	24.59
U.S. Silver Coins ($1,000 face value)				
90% Silver (715 oz.)	**$4,200.00**	4,100.00	4,222.50	34.42
40% Silver (292 oz.)	**$1,550.00**	1,550.00	1,610.00	21.47
Silver Dollars	**$5,675.00**	5,700.00	6,250.00	67.87

Note: Premium reflects percentage difference between coin price and value of metal in a coin, with gold at $259.25 per ounce and silver at $4.37 per ounce. The weight in troy ounces of the precious metal in coins is indicated in parentheses.

Selected Mutual Funds

	Ticker Symbol	4/12/01	Month Earlier	Year Earlier	— 52-Week — High	Low	Distributions Latest 12 Months Income	Capital Gains	Yield (%)
★ Duff & Phelps Utilities Income[1]	DNP	**$10.77**	10.66	9.06	10.98	8.88	0.7800	0.0000	7.24
★ T Rowe Price European Stock	PRESX	**$17.84**	17.72	22.64	24.22	16.09	0.1600	1.4200	0.90
★ Vanguard European Stk Index	VEURX	**$22.78**	22.64	27.45	29.00	20.46	0.4330	0.0000	1.90
★ Vanguard REIT Index	VGSIX	**$11.16**	11.41	10.38	11.98	10.35	0.8000	0.0000	7.17
★ Vanguard Growth Index	VIGRX	**$25.78**	25.48	35.57	41.81	23.76	0.1250	0.0000	0.48
★ Fidelity Target Timeline 2003	FTARX	**$9.41**	9.44	9.10	9.47	8.88	0.6399	0.0000	6.80
★ USAA Short Term Bond	USSBX	**$9.80**	9.83	9.72	9.86	9.53	0.6528	0.0003	6.66
★ Vanguard Short Term Corp	VFSTX	**$10.72**	10.82	10.51	10.83	10.33	0.7135	0.0000	6.66

North American and Diversified Mining Companies

	Ticker Symbol	4/12/01	Month Earlier	Year Earlier	— 52-Week — High	Low	Indicated Annual Net Dividends	Payment Schedule	Yield (%)
Agnico-Eagle†	AEM	**$7.12**	6.97	5.94	7.99	4.88	0.020	Annual	0.28
★ Barrick Gold Corp.†	ABX	**$15.45**	15.36	17.25	20.00	12.31	0.220	Semiannual	1.42
Freeport-McMoran C&G, Cl.A	FCXA	**$12.35**	11.55	14.25	13.20	6.75	0.000	-	0.00
★ Homestake Mining	HM	**$6.00**	5.58	6.06	7.63	3.50	0.050	Semiannual	0.83
★ Newmont Mining	NEM	**$16.55**	16.71	22.31	28.38	12.75	0.120	Quarterly	0.73
★ Placer Dome†	PDG	**$9.60**	9.38	8.75	10.81	7.25	0.100	Semiannual	1.04
★ Rio Tinto PLC‡	RTP	**$76.20**	69.95	61.88	82.00	55.13	2.300	Semiannual	3.02

South African Mining Companies, Finance Houses and Investment Trusts

	Ticker Symbol	4/12/01	Month Earlier	Year Earlier	— 52-Week — High	Low	ADR Net Dividends• and Ex-Dividend Dates				Yield (%)
ASA Ltd.	ASA	**$16.70**	17.80	17.31	20.50	14.06	-	-	-	0.600°	3.59
Anglo American PLC[2]	AAUK	**$61.80**	61.25	46.00	68.88	38.63	9/20/00	0.580	6/05/01	1.280	3.01
★ Anglogold Ltd.[3]	AU	**$16.38**	15.26	22.94	22.06	12.25	8/09/00	0.511	2/21/01	0.399	5.55
Avgold Ltd.	AVGLY	**$5.10**	4.75	5.70	5.36	3.11	No Dividends Declared				
De Beers Consolidated Mines	DBRSY	**$40.05**	40.56	26.50	43.88	19.88	9/13/00	0.345	3/21/01	0.928	3.18
Gencor Ltd.	GNCRY	**$3.55**	3.45	3.65	4.47	2.27	9/13/00	0.164	3/07/01	0.461	17.61
★ Gold Fields Ltd.[4]	GOLD	**$4.21**	3.88	3.53	5.06	2.56	2/16/00	0.026	2/16/01	0.119	3.44

★ 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.

The information herein is derived from generally reliable sources, but cannot be guaranteed. American Investment Services, the American Institute for Economic Research, and the officers, employees, or other persons affiliated with either organization may from time to time have positions in the investments referred to herein.