

INVESTMENT GUIDE

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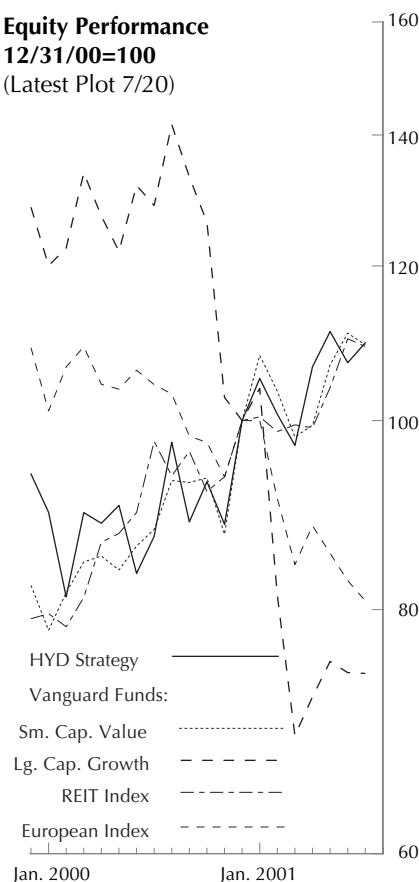
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We offer two discretionary management services: Our Professional Asset Management (PAM) service covers all of our recommended assets and allows us to place trades in stocks, bonds, and mutual funds directly in our clients' accounts. (The accounts remain 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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Wall Street Analysts: Caveat Emptor

Suppose you were in the market for a new automobile, and further suppose that, because you had very little time, you wanted to hire an agent to find the best car for your circumstances at the best price. Would you hire someone who was also being paid a commission by Ford to sell their cars?

This is precisely the situation many investors, perhaps unknowingly, are often in. The fact is, many Wall Street "full service" brokerage firms regularly publish research and directly advise their clients to buy certain securities while at the same time the firm's investment banking branch is competing to sell new stock issued by corporations. Firms claim to have a "Chinese wall" which separates research departments from their investment-banking unit, but in fact analysts' compensation is often related to the firm's ability to woo corporate clients.

Evidence of this conflict is obvious. "Sell" recommendations by analysts are virtually unheard of, we suspect partly because of concern for offending potential investment banking clients, and down grades of a company often appear as euphemisms, such as a change from "strong buy" to "buy", or "market outperformer" to "market performer." We have seen evidence in our role as investment advisors as well. From time to time we encounter a wave of prospective clients who have been using a full service broker, whose holdings include the same obscure security, often inappropriate for the investor's circumstances, that, sure enough, had been underwritten by the broker's affiliated banking firm.

This issue has gained a great deal of attention recently. In the aftermath of the Nasdaq's fall from grace, politicians and regulators have increased their scrutiny of financial firms. The Securities Industry Association (SIA), the trade association for these Wall Street firms, responded by endorsing certain "best practices" that SIA's member firms should follow. These included guidance for corporate governance (reporting among business units), adoption of consistent and transparent recommendations, prohibition of direct ties between analysts' compensation and investment banking revenues, and full disclosure of personal interests.

Several of SIA's member firms agreed, generally, but explained that no real changes were needed because these practices were already being followed.

Is regulation the answer? We do not think so. Instead investors should consider the many alternatives provided by the market place. We recommend that investors pay only for objective investment advice, provided by an entity whose compensation is derived solely from the investors they serve. The same would apply to individuals seeking financial or estate planning. As a reader of the *INVESTMENT GUIDE*, you receive one of the lowest-cost independent investment newsletters available. Clients of our advisory services similarly benefit from unbiased supervision of their accounts, held with well-established discount brokers at a cost that is among the very lowest in the industry.

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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.

Unlike many investment advisors, we do not claim the ability to identify “undervalued” assets. We have access to the same public information available to all market participants, and our research supports the notion that asset prices at any given time fully reflect that information. While there is no doubt that asset price changes provide evidence of over- and under-reaction to news, there is equally compelling evidence that these episodes are offsetting and unpredictable, and efforts to exploit these fluctuations are bound to fail. Those who claim otherwise are implicitly arguing that markets do not work (i.e., assets are “mispriced”) and that they possess the unique ability, among thousands of market participants, to determine the correct prices.

We do not attempt to “time” the overall market. Our parent, AIER, has studied business cycles for over 70 years, and their efforts are limited to identifying turning points in the economy in the very near term. While AIER’s approach provides a reasonable means of assessing the strength of the economy, it is far from infallible, and the link between these indicators and the capital markets is very tenuous. Adjustments to our recommended asset allocations based on the near-term business cycle outlook will be very rare, and modest.

Our approach to portfolio management is based on asset allocation, which is a passive approach as opposed to active management (stock picking and market

timing). While history suggests that certain asset classes, such as large- and small cap-value stocks, have the potential to “outperform” the overall market, there is no “free lunch;” investors are necessarily assuming greater risk by purchasing these assets. This risk can be minimized by adequate diversification within each asset class, and by holding asset classes whose returns have had strong long-term appreciation historically, but that fluctuate independently of one another (their returns are not strongly correlated). By holding these assets in proper proportion, investors can adopt a plan with the goal of minimizing the overall volatility of their portfolio without sacrificing the potential for long-term growth. The table on p. 52 provides a summary of the

historical correlation coefficients among our recommended assets, or asset classes similar to those we recommend. Assets with returns that have a perfect, positive linear correlation have a correlation coefficient of 1 (the returns on both assets would increase or decrease in identical fashion). Conversely, assets with a perfect, negative linear correlation would have a correlation coefficient of -1 (the returns on one asset would perfectly offset the returns on the other asset). A correlation coefficient of zero means that there is no linear relationship between the stocks.

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 three 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

Short-Term Interest Rates

	July 13, 2001	July 14, 2000
3-Month Treasury Bills	3.56%	6.14%
6-Month Treasury Bills	3.57%	6.27%

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.

Investors have seen a sharp drop in short-term interest rates in recent months, as seen in the table above. Conservative investors, who rely more on investment income than capital appreciation, have particularly felt the pinch. We do not recommend that investors reduce their money market holdings by extending maturities in search of higher yields. Price inflation and greater volatility outweigh the benefit of higher income. Instead investors should maintain adequate exposure to short-term bonds and income generating equities.

Intermediate-Term Bonds

Short- and intermediate-term bonds serve not only to stabilize the overall returns of one’s portfolio, but also to increase the investment income generated. Investors with both taxable and tax-deferred accounts, such as IRAs, can optimize the after-tax returns of their total portfolio by emphasizing income-producing assets, such as bonds and income-generating equities (see below) in their tax-deferred accounts. Assets that tend to appreciate through capital gains, such as common stocks, are more suitable for taxable accounts. This is because investment income is taxed as ordinary income (at rates exceeding 40% when state taxes are included), while long-term capital gains are taxed at a maximum of 20%. Our research

RECOMMENDED PORTFOLIO ALLOCATION PERCENTAGES

	Conservative	Moderate	Aggressive
Money Market Funds	30	20	10
Intermediate-Term 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.

indicates that investors have little to gain, in terms of risk-adjusted returns, by extending maturities beyond five years.

We also recommend that investors adopt a passive approach when selecting fixed-income investments (see the March 2001 *INVESTMENT GUIDE* for a detailed explanation). Ideally, investors should utilize a variable maturity approach. This amounts to “riding the yield” curve by being invested at the steepest part of the yield curve at any given moment. This strategy makes no attempt to predict rates, but instead assumes that the present yield curve is the best estimate of the future yield curve. The strategy provides the greatest potential for maximizing risk-adjusted returns. This approach requires a great deal of diligence, so a mutual fund is the best method of utilizing this strategy. The only fund family that we are aware of that employs such an approach at a low cost is the Dimensional Fund Advisors group (DFA). However, these funds are only available to institutional clients or to individuals through investment advisors (we offer these funds through our Professional Asset Management program).

We have identified three bond mutual funds that investors can buy directly from Fidelity, Vanguard, and USAA. These are indicated with a ★ on the back page. While we find these inferior to the DFA funds, these funds all have low expense ratios, low turnover, and good ratings. These funds either follow a passive approach, or have consistently provided strong returns with modest volatility.

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 (Baa or BBB), but higher-yielding issues that we do not recommend for direct purchase.

An alternative, though somewhat less effective approach, would be for investors to maintain their own “laddered” portfolio of bonds, with maturities between one and five 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.

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 Stock 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 7.10%. 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 6.3%. The April *INVESTMENT GUIDE* discussed REITs in detail. In addition to providing a strong source of investment income, the total returns of REITs are not strongly correlated with those of other income-producing securities such as bonds. The correlation table on p. 52 shows that the correlation between REITs and intermediate-term bonds is only 0.14.

Both assets have delivered solid total returns during the quarter and so far this year. The Duff and Phelps fund provided total returns of 4.52% for the second quarter, and was up 6.48% for the first six months. The Vanguard REIT fund was up 10.66% during the second quarter, and 10.11% for the first half.

Large-Capitalization Value Stocks

During the past 12 months, our Top 4-for-18-Months High-Yield Dow stock selection strategy model portfolio has performed well.

Short-Term Results: Total Returns, 4-for-18 HYD Model

Third Quarter 2000	6.26%
Fourth Quarter 2000	12.71%
First Quarter 2001	-2.89%
Second Quarter 2001	10.24%
12 months through June 30, 2001	28.20%

While these figures might appear tantalizing, investors should realize that these are only short-term results, and that future short-term spans will certainly bring lower, and sometimes negative returns. Investors should be drawn to this approach for its strong *long-term* returns and low volatility, which is demonstrated on page 54, as well as the fact that the approach has provided returns that are not strongly correlated with our other assets (see correlation table) including our other common stock categories. 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.

Although we are selecting stocks directly, the approach is passive. We essentially ignore all considerations except a stock’s relative dividend yield, the fact that it is in the Dow Jones Industrial Average, and an appropriate holding period. We do not allow any other factors (projected earnings, new product development, analysts’ sentiments, etc.) to affect our buy and sell decisions.

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 use the iShares S&P 500 BARRA Value Index Fund (IVE) or the Vanguard S&P 500 BARRA Value Index Fund (VIVAX) instead. Both of these are based on the same index, which is composed of the companies with the lowest price-to-book value ratios included in the S&P 500 index.

Small-Capitalization Value Stocks

As we discussed in the October 2000 *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 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 (VISVX).

These funds have provided investors with strong returns very recently. During the second quarter the Vanguard Small Cap Value fund provided total returns of 13.03%, and has delivered year-to-date a total return of 12.15%. Throughout the long bull market in equities that began in 1982, small-cap stocks have generally lagged well behind the performance of the broader market, particularly as large-caps surged over the past decade. It remains to be seen whether this very brief resurgence marks the beginning of a sustained period of small-cap out-performance, but historical evidence indicates that this group has had several periods of

Correlation Matrix AIS Recommended Asset Classes January 1986-June 2001

	<i>U.S. 30-Day Treasury Bill</i>	<i>U.S. Int.-Term Govt. Bond</i>	<i>Gold (London PM Fix)</i>	<i>Wilshire Real Estate Sec. Index</i>	<i>High-Yield Dow Strategy</i>	<i>U.S. Small Stocks</i>	<i>S&P/BARRA 500 Growth Index</i>	<i>MSCI Europe Index</i>
U.S. 30-Day Treasury Bill	1.00							
U.S. Int.-Term Govt. Bond	0.19	1.00						
Gold (London PM Fix)	-0.04	-0.08	1.00					
Wilshire Real Estate Sec. Index	-0.13	0.14	-0.16	1.00				
High-Yield Dow Strategy	0.02	0.15	-0.08	0.47	1.00			
U.S. Small Stocks	-0.14	-0.01	-0.08	0.55	0.42	1.00		
S&P/BARRA 500 Growth Index	0.01	0.20	-0.18	0.42	0.59	0.66	1.00	
MSCI Europe Index	0.03	0.19	-0.05	0.39	0.55	0.47	0.64	1.00

dominance in the past.

These funds do not provide exposure to the very smallest stocks, which in our view are the most desirable because they provide the greatest “bang for the buck” in terms of risk and return. These so-called “micro-caps” are also the least correlated with our other assets (the correlation table above uses the returns of the smallest two deciles, true “micro-caps,” in calculating the correlation figures). Again, the only cost-effective means of holding this class that we are aware of are the DFA funds, offered only through investment advisors.

Large-Capitalization 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-cap growth stocks also tend not to move closely in tandem with small- or large-capitalization value stocks, as demonstrated in the correlation table, so holding large-growth stocks is suitable for investors with low tolerance for having their portfolio's returns stray 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 large growth stock funds under active management. Over the past 5, 10, and 15 years at least two-thirds of large-cap growth funds have failed to better the index.

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-capitaliza-

tion value component. The answer is no: we are recommending a larger commitment to the value stocks than to the growth stocks, and re-balancing 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.

These shares have fared poorly so far this year, as the euro fell back against the dollar after a short rally early in the year. The Vanguard fund fell by 17.20% year-to-date through the end of June, and lost 1.87% during the second quarter, while the iShares lost 17.58% and 2.10%, respectively. European economic growth has been slow as well. We continue to recommend these shares as they provide unique risk/return characteristics and therefore merit a place in most investors' portfolios.

Once again, the DFA group provides passive low-cost “index type” mutual funds that invest in foreign equities. DFA is unique in that their funds invest not only in Europe but also in developed economies elsewhere throughout the world, and these are offered on a small-cap and large-cap value basis. Our search of the entire universe of mutual funds revealed no similar funds offered directly to investors; the DFA funds

can only be purchased by institutions or through investment advisors.

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. As we described in detail in the May 2001 *INVESTMENT GUIDE*, holding gold as a form of insurance for times of extreme distress is entirely consistent with portfolio theory. 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. 55). For these companies, any increase in the price of gold flows almost entirely to the bottom line.

The past eighteen years have largely been a period of economic growth and the U.S. financial markets have provided extraordinary returns. Not surprising, gold has languished. Very recently, however, our recommended gold-related shares have done well, as indicated in the table below.

Total Returns 2001, AIS Recommended Mining Shares

	<i>Year to date (through June 30)</i>	<i>Second Quarter 2001</i>
Anglogold ADR	23.46%	23.94%
Barrick Gold	-6.92%	6.69%
Gold Fields ADR	31.14%	18.45%
Homestake Mining	85.05%	47.34%
Newmont Mining	9.42%	14.61%
Rio Tinto ADR	0.81%	3.58%
Placer Dome	2.36%	13.29%

HATE TO SAY WE TOLD YOU SO...

By the spring of 2000, the “tech mania” had driven the prices of growth stocks, especially those related to information technology, to unprecedented levels. We do not typically second-guess the market with regard to “appropriate” prices and valuations, but at that time we sensed that many investors’ portfolios were overly exposed to large-cap growth stocks. At the time the financial media, as well as the investing public, were in a swoon over “new economy” stocks, of which the undisputed star was Cisco Systems. For example, *Fortune’s* May 15 cover story about Cisco included the following:

- “Of the 33 analysts covering the firm, 12 have ‘buys’ and 21 have ‘strong buys’.”
- “A Cisco executive: ‘Backlog is as good as we’ve ever seen it.’”
- “The deepest management team in the valley.”
- “Making a science of acquisitions is just one of the best practices that makes Cisco a star.”
- “A legendary grasp of its numbers...it can guide analysts down to the last penny as to what it will report for the quarter.”
- “A venture capitalist’s assessment of [Cisco CEO] Chambers: ‘the most customer-focused human being you will ever meet. He is relentless.’”
- “General Electric CEO Jack Welch: ‘We’ve had teams from all different parts of GE go study Cisco, and our people are really impressed.’”

Somewhat earlier, in *INVESTMENT GUIDE*, March 31, 2000, we published our own analysis of Cisco Systems:

“...How much are investors willing to pay for this [growth]? At this writing, the answer is about 130 times current earnings, something like 10 times the multiple of our selected Dow companies. At this lofty multiple, Cisco’s ‘earnings yield’ is less than 0.8%. The company has never paid a dividend. A p/e of 130 is usually only applicable to a ‘start up’ company that is emerging into profitability or to a well-established company whose earnings are depressed temporarily. Can a multiple this high be justified for a company with substantial and consistently growing earnings? The answer *might* be yes, if future growth is sufficiently large.

“How much growth would justify such

an astonishingly high multiple of growing earnings on a stock that pays no dividends? In attempting to answer this question, we will [assume that]...by the year 2025 Cisco will be indistinguishable from the mature companies that we have selected from the Dow currently [i.e., that Cisco’s growth will gradually decrease to an assumed long-term growth rate for nominal GDP (6%), and that it will eventually carry a p/e (13) and offer a dividend yield (3.3%) comparable to the Dow stocks we recommend.]

“Using these assumptions, how much must Cisco grow for its total return over the next 25 years to equal the 9.3% [growth plus income] return on our slower-moving 10 Dow stocks? Assuming that the company maintains its profit margin, our projection would be for its sales and earnings to grow together as follows (in billions of dollars):

	Revenues	Earnings	5-yr Growth Rate
2000	\$17	3.5	50%*
2005	90	18.6	40%
2010	284	58.7	26%
2015	618	128.0	17%
2020	1,042	215.7	11%
2025	1,441	304.9	7%

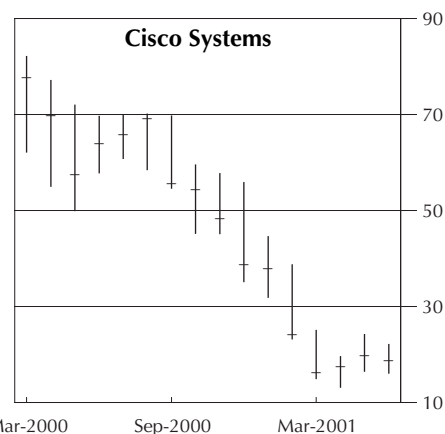
* 1995-2000 actual.

“This may happen, but we do not think it is likely. For one, if nominal GDP grows by 6%, then \$1.4 trillion in sales would be nearly 4% of GDP in 2025 — that’s a lot of internet routers. In addition, even if the company reached that level of revenues, its profit margins would be likely to erode in the face of increased competition as its markets matured, which would mean that even higher revenue growth

would be needed to reach the projected level of earnings.

Perhaps even more significantly, Cisco’s growth rate is already well below 50%. In fact, the consensus of analysts is that its earnings for fiscal 2001 will be 30% more than in fiscal 2000.”

The Results Since March 2000



We are not averse to holding large-cap growth stocks, nor Cisco systems. In fact, in the accompanying quarterly review article, we discuss the merits of holdings large-cap growth stocks as a component of an appropriately allocated and well-diversified portfolio. Our recommended vehicle for large-cap growth stocks is the Vanguard Large Cap Growth Index fund. Currently Cisco is included in the fund, but it is one of 126 stocks, and it comprises only 2.36% of the fund’s net asset value.

Our point is that investors must be extremely disciplined in order to avoid getting caught up in the hype that is so successful at selling magazines and investment “advice.” Perhaps it is human nature to chase short-term phenomenon. We hope the *INVESTMENT GUIDE* serves as a reminder to “stay the course.”

BARRICK TO ACQUIRE HOMESTAKE

Consolidation within the gold mining industry took a giant step forward with the June 25 announcement by Toronto-based Barrick Gold Corp (NYSE:ABX) of its acquisition of California-based Homestake Mining Co (NYSE:HM). This merger makes Barrick the world’s second largest gold producer, up from fourth position, and ahead of Newmont Mining and GoldFields Ltd. AngloGold remains the world’s largest producer.

The merger agreement, which has been approved by Barrick and Home-

stake, calls for Barrick to exchange 0.53 of a share of Barrick for each share of Homestake. Based on closing prices immediately prior to the announced merger (June 22, 2001), this represents a premium of 31% and a total value of \$2.3 billion. Barrick has indicated that they intend the transaction to be tax-free for U.S. taxpayers. The transaction is to be treated as a pooling of interests under U.S. GAAP; Barrick has indicated that it will adopt GAAP principals upon the merger completion.

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 when 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 the list of the highest-yielding issues in the Average, it will be because the company is out of favor with the investing public for one reason or another (disappointing earnings, unfavorable news developments, etc.) and its stock price is depressed. 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, they 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 exclude Philip Morris 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 fourth on the list, whatever its ups and downs, and using Philip Morris in the strategy now 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 month 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 on 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 remain-

ing holdings of **SBC Communications** to add to holdings of **Dupont**. The three other issues eligible for purchase this month, **Caterpillar**, **Eastman Kodak** and **JP Morgan Chase**, were also eligible for purchase 18 months ago. Those positions have been retained in the strategy with some minor purchases and sales to ensure that this month's commitment to each of the four eligible issues is of equal value.

The model portfolio received shares in **AT&T Wireless** that were spun-off from **AT&T** this month. The model treats spin-offs as remaining a part of the commitment to the stock from which they came. The current positions in AT&T date from July, September, October and November, 2000. This means that they, as well as the AT&T Wireless shares (and any additional spin-offs from AT&T in the meantime), will be held in the model until, January, March, April and May 2002.

Investors with sizable portfolios

As of July 13, 2001

				—Percent of Portfolio*—		
	Rank	Yield	Price	Status	Value	No. Shares##
Philip Morris	1	4.71%	44.99	*	-0-	-0-
Eastman Kodak	2	3.85%	45.73	Holding**	19.7	18.6
JP Morgan Chase	3	3.20%	42.55	Holding**	14.2	14.5
Dupont	4	3.08%	45.47	Buying	18.5	17.7
General Motors	5	3.02%	66.19	*	-0-	-0-
Caterpillar	6	2.67%	52.48	Holding**	25.8	21.4
Int'l Paper	7	2.59%	38.65	Holding	13.5	15.1
SBC Comm.	8	2.44%	41.95	Sold	-0-	-0-
Merck	9	2.28%	61.50	—	—	—
Proctor & Gamble	10	2.23%	68.14	—	—	—
Minn.Mng. & Mfg.	11	2.14%	112.23	Selling	3.0	1.2
AT&T	24	0.72%	20.87	Holding	4.2	8.7
AT&T Wireless	—	0.00%	16.95	Holding	<u>1.1</u>	<u>2.8</u>
					100.0	100.0

Change in Portfolio Value\$

	1 mo.	1 yr.	5 yrs.	10 yrs.	15 yrs.	From 12/63	Std. Dev.
Strategy	-0.5%	20.7%	18.0%	18.3%	19.5%	16.7%	19.0
Dow	-0.8%	0.5%	16.2%	15.7%	15.5%	11.4%	17.1

* 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.

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 in the table 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: 1) buy all the indicated positions at once or 2) spread purchases out over 18 months. Either choice could be said to represent an attempt at "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 in between 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 the stocks not currently eligible for purchase are bought and the strategy does not call for selling them soon, it will usually be because their prices have decreased so that their indicated yields render them again eligible for purchase. In other words, buying a stock that is not currently among the top 4 means that it will very likely be sold during the months ahead (perhaps at a gain, perhaps not, but with payment of two commissions either way). Alternatively, if the price decreases so that the issue again becomes eligible for purchase, then the investor's initial purchase would be

likely to be held in the portfolio at a loss for some period of time. In the latter situation, the investor would have been better off waiting.

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, Eastman Kodak, and JP Morgan Chase—account for more than 75% 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.

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's discretionary portfolio management programs are comparable to those of many index mutual funds. Contact us for information on this and our other discretionary investment management services.

THE DOW JONES INDUSTRIALS RANKED BY YIELD

	Ticker Symbol	Market Prices			— 12-Month —		Latest Dividend			— Indicated —		
		7/13/01	6/15/01	7/14/00	High	Low	Amount	Record Date	Paid	Annual Dividend	Yield† (%)	
	Philip Morris	MO	\$44.99	46.32	24.50	53.88	23.00	0.530	6/15/01	7/10/01	2.120	4.71
★	Eastman Kodak	EK	\$45.73	46.74	61.13	65.69	35.31	0.440	6/01/01	7/02/01	1.760	3.85
★	J. P. Morgan Chase	JPM	\$42.55	44.90	34.78	58.38	32.38	0.340	7/06/01	7/31/01	1.360	3.20
★	DuPont	DD	\$45.47	45.76	45.44	50.69	38.19	0.350	5/15/01	6/12/01	1.400	3.08
	General Motors	GM	\$66.19	59.35	61.81	76.63	48.44	0.500	5/11/01	6/09/01	2.000	3.02
★	Caterpillar	CAT	\$52.48	54.15	35.75	56.83	29.00	0.350	7/20/01	8/20/01	1.400	2.67
☆	International Paper	IP	\$38.65	37.00	35.81	43.31	26.31	0.250	5/18/01	6/15/01	1.000	2.59
	SBC Comm.	SBC	\$41.95	40.31	45.38	59.00	38.20 L	0.256	7/10/01	8/01/01	1.025	2.44
	Merck	MRK	\$61.50	73.75	67.25	96.69	60.35 L	0.350	9/04/01	10/01/01	1.400	2.28
	Procter & Gamble	PG	\$68.14	62.60	56.00	79.31	54.31	0.380	7/20/01	8/15/01	1.520	2.23
☆	Minn. Min. & Mfg.	MMM	\$112.23	120.88	87.88	127.00	80.50	0.600	5/180/1	6/12/01	2.400	2.14
	Honeywell Intl.	HON	\$36.50	38.70	36.13	55.69	33.00	0.188	7/09/01	7/25/01	0.750	2.05
	Exxon Mobil	XOM	\$85.98	88.90	77.56	95.44	75.13	0.440	5/14/01	6/11/01	1.760	2.05
	Coca-Cola	KO	\$46.01	44.26	57.63	64.00	42.37	0.180	9/15/01	10/01/01	0.720	1.56
	Alcoa (s)	AA	\$41.46	38.97	32.94	45.71	23.13	0.150●	8/01/01	8/25/01	0.600●	1.45
	Johnson & Johnson (s)	JNJ	\$53.05	52.04	45.91	54.20 H	40.25	0.180	8/21/01	9/11/01	0.720	1.36
	General Electric	GE	\$47.45	48.81	51.50	60.50	36.42	0.160	7/09/01	7/25/01	0.640	1.35
	Citigroup (s)	C	\$48.86	49.30	68.00	59.13	39.00	0.160	8/06/01	8/24/01	0.640	1.31
	Boeing	BA	\$55.07	64.25	44.44	70.94	43.31	0.170	8/17/01	9/07/01	0.680	1.23
	United Tech.	UTX	\$75.15	74.75	61.13	87.50	56.31	0.225	5/18/01	6/10/01	0.900	1.20
	Hewlett-Packard (s)	HWP	\$27.98	27.00	66.91	68.09	25.00	0.080	9/19/01	10/10/01	0.320	1.14
	American Express	AXP	\$39.36	38.94	56.56	63.00	34.00	0.080	7/06/01	8/10/01	0.320	0.81
	McDonald's	MCD	\$27.65	28.67	31.38	35.06	24.75	0.215	11/15/00	12/01/00	0.215	0.78
	Walt Disney	DIS	\$28.19	29.70	37.44	43.00	26.00	0.210	12/08/00	12/22/00	0.210	0.74
☆	AT&T	T	\$20.87	21.00	33.00	26.46	12.41 L	0.038	6/29/01	8/01/01	0.150	0.72
	Wal-Mart Stores	WMT	\$52.90	48.15	59.50	61.25	41.44	0.070	6/22/01	7/09/01	0.280	0.53
	IBM	IBM	\$108.53	113.60	103.94	134.94	80.06	0.140	5/10/01	6/09/01	0.560	0.52
	Home Depot, Inc.	HD	\$48.70	48.90	56.44	60.00	34.69	0.040	6/14/01	6/28/01	0.160	0.33
	Intel Corp. (s)	INTC	\$30.19	27.68	73.35	75.81	22.25	0.020	8/07/01	9/01/01	0.080	0.26
	Microsoft Corp.	MSFT	\$71.39	68.02	78.94	80.00	40.25	0.000	-	-	0.000	0.00
☆	AT&T Wireless	AWE	\$16.95	15.67	27.00	29.56	15.29	0.000	-	-	0.000	0.00

★ Buy. ☆ Hold. † Based on indicated dividends and market price as of 7/13/01. H New 52-week high. L New 52-week low. (s) All data adjusted for splits. • Excludes extras.

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

	7/13/01	Mo. Earlier	Yr. Earlier
Gold, London p.m. fixing	266.35	272.20	280.25
Silver, London Spot Price	4.25	4.45	4.97
Copper, COMEX Spot Price	0.70	0.72	0.82
Crude Oil, W. Texas Int. Spot	26.59	28.51	31.40
Dow Jones Spot Index	104.80	109.48	113.22
Dow Jones-AIG Futures Index	103.64	105.43	102.07
CRB-Bridge Futures Index	207.31	209.06	220.60

Interest Rates (%)

U.S. Treasury bills -	91 day	3.57	3.41	6.14
	182 day	3.53	3.37	6.27
	52 week	3.46	3.41	6.07
U.S. Treasury bonds -	15 year	5.72	5.71	6.25
Corporates:				
High Quality -	10+ year	7.03	7.03	7.84
Medium Quality -	10+ year	7.67	7.64	8.32
Federal Reserve Discount Rate		3.25	3.50	6.00
New York Prime Rate		6.75	7.00	9.50
Euro Rates	3 month	4.46	4.45	4.72
Government bonds -	10 year	4.97	4.97	5.20
Swiss Rates -	3 month	3.23	3.15	3.41
Government bonds -	10 year	3.36	3.43	na

Exchange Rates

British Pound	\$1.403900	1.402700	1.495300
Canadian Dollar	\$0.650800	0.654200	0.673900
Euro	\$0.854700	0.858900	0.937200
Japanese Yen	\$0.008004	0.008110	0.009202
South African Rand	\$0.121000	0.124300	0.145100
Swiss Franc	\$0.564700	0.561600	0.605700

Securities Markets

	7/13/01	Mo. Earlier	Yr. Earlier
S & P 500 Stock Composite	1,215.68	1,214.36	1,509.98
Dow Jones Industrial Average	10,539.06	10,623.64	10,812.75
Dow Jones Transportation Average	2,940.35	2,693.62	2,919.04
Dow Jones Utilities Average	361.24	363.73	325.64
Dow Jones Bond Average	102.49	102.36	95.66
Nasdaq Composite	2,084.79	2,028.43	4,246.18
Financial Times Gold Mines Index	777.74	835.15	771.74
FT African Gold Mines	877.20	936.86	878.28
FT Australasian Gold Mines	908.32	946.79	828.04
FT North American Gold Mines	724.51	782.94	726.75

Coin Prices

	7/13/01	Mo. Earlier	Yr. Earlier	Premium
American Eagle (1.00)	\$273.75	275.15	291.15	2.78
Austrian 100-Corona (0.9803)	\$260.83	262.23	277.43	-0.11
British Sovereign (0.2354)	\$66.25	66.55	70.25	5.66
Canadian Maple Leaf (1.00)	\$274.00	275.40	291.40	2.87
Mexican 50-Peso (1.2057)	\$322.10	323.70	342.50	0.30
Mexican Ounce (1.00)	\$266.90	268.30	283.90	0.21
S. African Krugerrand (1.00)	\$271.75	273.15	288.85	2.03
U.S. Double Eagle-\$20 (0.9675)				
St. Gaudens (MS-60)	\$342.50	350.00	360.00	32.91
Liberty (Type I-AU)	\$675.00	675.00	675.00	161.94
Liberty (Type II-AU)	\$425.00	425.00	435.00	64.92
Liberty (Type III-AU)	\$307.50	310.00	335.00	19.33
U.S. Silver Coins (\$1,000 face value)				
90% Silver (715 oz.)	\$4,200.00	4,200.00	4,200.00	38.13
40% Silver (292 oz.)	\$1,550.00	1,550.00	1,610.00	24.83
Silver Dollars	\$6,075.00	6,075.00	5,750.00	84.67

Note: Premium reflects percentage difference between coin price and value of metal in a coin, with gold at \$266.35 per ounce and silver at \$4.25 per ounce. The weight in troy ounces of the precious metal in coins is indicated in parentheses.

Recommended Mutual Funds

	Ticker Symbol	7/13/01	Month Earlier	Year Earlier	— 52-Week — High Low	Distributions Latest 12 Months Income Capital Gains	Yield (%)
Short-Term Bond Funds							
★ Fidelity Target Time Line 2003	FTARX	9.42	9.45	9.03	9.47 9.02	0.6117	6.49
★ USAA Short Term Bond	USSBS	9.87	9.88	9.69	9.90 9.55	0.6512	6.60
★ Vanguard Short-term Corporate	VFSTX	10.80	10.81	10.47	10.83 10.45	0.7114	6.59
Income Equity Funds							
★ Duff & Phelps Utilities Income ^{1,2}	DNP	10.90	11.04	9.63	11.20 9.50	0.7800	7.16
★ Vanguard REIT Index	VGSIX	12.22	12.29	11.30	12.30 10.67	0.8100	6.63
Large Cap. Value Equity Funds							
★ iShares S&P 500 Value Index ³	IVE	61.15	61.22	61.16	67.00 55.00	0.7618	1.25
★ Vanguard Value Index	VIVAX	21.04	21.16	22.58	23.95 19.55	0.3380	1.61
Small Cap. Value Equity Funds							
★ iShares Sm. Cap. Value Index ³	IJS	83.81	82.55	na	86.58 66.63	0.5054	0.60
★ Vanguard Sm. Cap Value Index	VISVX	10.10	9.93	9.11	10.70 8.59	0.0820	0.81
Growth Equity Funds							
★ iShares S&P 500 Growth Index ³	IVW	60.71	60.22	92.83	92.84 52.88	0.2786	0.46
★ Vanguard Growth Index	VIGRX	26.99	26.82	40.82	41.81 23.76	0.1250	0.46
Foreign Equity Funds							
★ iShares S&P Europe 350 Index ³	IEV	61.00	63.48	na	80.75 59.02	0.7756	1.27
★ T Rowe Price European Stock	PRESX	16.44	17.13	23.98	24.17 16.09	0.1600	0.97
★ Vanguard European Stock Index	VEURX	20.92	21.81	28.54	28.64 20.46	0.4330	2.07

Recommended Gold-Mining Companies

	Ticker Symbol	7/13/01	Month Earlier	Year Earlier	— 52-Week — High Low	Distributions Latest 12 Months Income Capital Gains	Yield (%)
Anglo American PLC, ADR	AAUK	\$14.80	14.36	12.88	18.25 11.56	0.460	3.11
★ AngloGold Ltd., ADR	AU	\$18.14	18.62	19.81	22.34 12.25	0.909	5.01
ASA Ltd. ¹	ASA	\$18.75	19.90	15.75	22.90 14.06	0.600	3.20
★ Barrick Gold Corp.†	ABX	\$15.29	16.80	17.56	19.38 12.31	0.220	1.44
★ Gold Fields Ltd.ADR	GOLD	\$4.09	4.51	3.66	5.25 2.56	0.119	2.91
★ Homestake Mining	HM	\$7.82	7.30	6.31	8.25 3.50	0.050	0.64
★ Newmont Mining	NEM	\$18.86	21.89	19.38	24.60 12.75	0.120	0.64
★ Placer Dome†	PDG	\$10.20	11.12	9.19	12.48 7.25	0.100	0.98
★ Rio Tinto PLC‡	RTP	\$72.70	69.92	68.88	85.00 55.13	2.300	3.16

★ 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. ¹ Closed-end fund, traded on the NYSE. ² Dividends paid monthly. ³ Exchange traded fund, traded on ASE.

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.