INVESTMENT GUIDE

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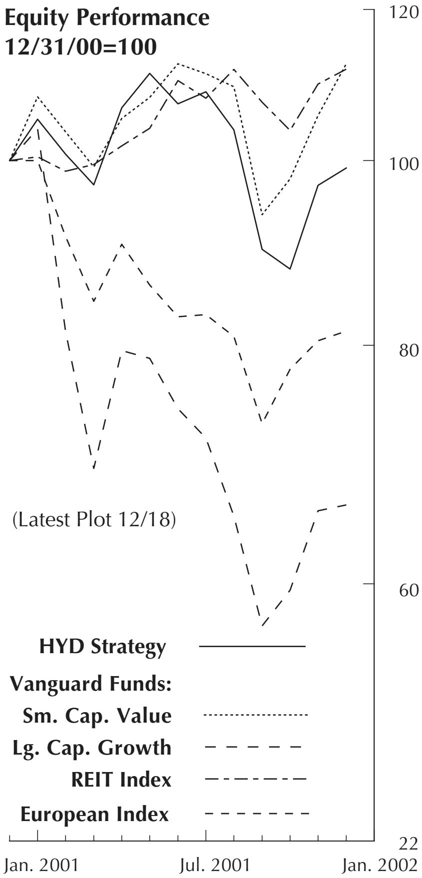

Coping With Recession

During the sustained boom times of the 1980s, many people may have come to believe that there was no need to prepare for "tough times." The 1990-91 recession was a harsh reminder that prosperity is not guaranteed, and that it is prudent to save for the proverbial rainy day. More recently, the belief that technology and the globalization of markets have ushered in a "new economy" has fostered the notion that business-cycles were a relic of the "old economy." The stark fact is that if you lose your job during a recession and have no savings on which to draw, you probably will have difficulty making ends meet, even if you qualify for various Government unemployment and welfare benefits.

Personal Implications of Recessions

The personal effects of recessions are potentially devastating. Layoffs and firings can cut or wipe out earned income, deplete family savings, force the "distress sale" of assets, lead to default on debt, and, in extreme cases, to bankruptcy or even homelessness. Even under less severe circumstances, recessions often force families to alter their lifestyles to some degree. Discretionary spending may be cut. Or plans for college, travel, or retirement may have to be abandoned or adjusted.

In this respect, the advice given in the popular press to help the victims of a recession cope tends to be "too little too late." Most personal financial affairs columns dispense generic advice that probably is painfully obvious to those who have lost their jobs. Readers are encouraged to work hard at their jobs to reduce the chance of being fired. They are told to build their savings with the aim of accumulating funds to finance household needs for between three and nine months. And they are advised to "get control" of their debt by paying off credit cards and budgeting family expenses. While this is good advice that ought to be followed at all times, it scarcely helps those who have not practiced it before the need arises.

On the other hand, you can take a number of steps to get by should your income drop markedly. For one, you should separate your expenses into necessary and nonessential items. Anything that does not contribute directly to your daily maintenance or family protection—mortgage or rent, utilities, car loan, gas, food, clothing, life and health insurance—should be considered an extra that can be postponed until your income is restored. The latter includes payments on credit card and other consumer debt. If you do not pay those bills, you will damage your credit rating. But that is better than going without shelter and food.

Home Equity Loans and Home Equity Lines of Credit

Home equity is one of the largest components of U.S. household wealth. However, it is illiquid and cannot be used in its current form to purchase goods and services or service debt. It can, however, be used as collateral to obtain credit, which is spendable. As of the second quarter 2001, loans made

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COPING WITH RECESSION (CONT.)

under home equity lines of credit and home equity loans secured by junior liens reached $643 billion, slightly more than 40 percent of consumer debt. (Consumer debt includes automobile debt, credit card and department store card debt, educational loans, boat loans, and the like. Loans secured by homes and other real estate are not included.) Although many types of financial institutions extend home equity loans, commercial banks have become the primary source for such funds. Lenders continue to promote home equity debt by waiving closing costs and other fees, offering low introductory interest rates, and increasing loan-to-value ratios.

Home equity loans and home equity lines of credit are both secured by a mortgage on your house. However, there are clear differences. A home equity loan is a closed-end loan that works like a conventional mortgage. The borrower gets the entire loan up front and then repays interest and principal in equal monthly payments. Such loans are more difficult and expensive to obtain than a line of credit. With a home equity line of credit, a borrower is preapproved for a specific loan amount. The money is accessible at any time. You might think of a line of credit as a credit card with a checkbook—interest is only charged on what is borrowed. Borrowers use home equity lines of credit mostly for home improvement, but also for repayment of other debts, vehicle purchases, education, business expenses, vacations, and medical expenses. Home equity loans are used primarily for repayment of other debts and home improvement.

In many cases you can reduce the immediate burden of debt without defaulting. If you are a homeowner and have an established home equity line of credit, consider taking out a loan against your home equity line to pay off high-interest credit card debt. Not only are the interest payments substantially lower with a home equity line, but they may be deductible for individual income tax purposes. In replacing unsecured debt with home-secured debt, however, you become exposed to the risk of more severe consequences should you lose your ability to service your debt. Of course, if you do not already have a home equity credit line, you probably will not be able to get one after you have lost your job.

The Federal Reserve has prepared a free brochure on home equity lines of credit titled "When Your Home is on the Line," that is available without charge. To order a copy, phone (202) 452-3244, fax (202) 728-5886, or write Publication Services, MS-127, Board of Governors of the Federal Reserve System, Washington, DC 20551. The publication is also available online at www.federalreserve.gov/pubs/HomeLine/.

Credit Problems and Credit Repair

If paying bills becomes a problem, you should call all creditors to inform them of the change in your financial status and work out, if possible, a revised payment schedule. Some creditors may accept interest-only payments until you are in a position to begin paying back the principal. If you need further help, call the National Foundation for Consumer Credit at 1-800-388-2227 or visit their website at www.nfcc.org. This nonprofit organization is funded by banks and other creditors. By calling it you will demonstrate your commitment to paying back what you owe, even though that may take some time.

Beware of businesses that promise to repair your credit. For anywhere between $100 to $1500 these firms guarantee that they can make damaging entries on your credit report disappear and help you reestablish good credit. Some operate by urging you to use a phony Social Security number to establish a new credit identity (which is illegal). Others bombard the credit reporting agencies with letters disputing everything on the consumer's credit report. Credit reporting bureaus must respond within 30 days to all disputes in a credit report. The investigation must be completed in 30 days, or the item in question must be removed. However, any negative information that is accurate—late payments, delinquencies, etc.—remains on credit reports for seven years. Borrowers can dispute errors in their credit records for themselves at no cost.

The Federal Trade Commission's Bureau of Consumer Protection offers free information on such topics as credit repair, fair debt collection, choosing a credit counselor, and more. For a complete list of titles, call toll-free 1-877-382-4357, write Consumer Response Center, Federal Trade Commission, 600 Pennsylvania Ave. NW Room H-130, Washington, DC 20580-0001, or visit www.ftc.gov/bcp/menu-credit.htm.

Retirement Accounts

Many employees have accumulated substantial balances in deferred income retirement accounts, such as 401(k) plans, that become available to them on termination of employment. If you have a 401(k) account through your former employer, the funds in it should be rolled over into a separate Individual Retirement Account (IRA) to which you have immediate access (say, a money-market IRA) should the need arise. (To avoid having taxes withheld on this rollover, have the funds transferred directly from your employer-sponsored account to your new IRA rather than paid to you first.) You will be penalized 10 percent if you withdraw funds from this IRA before you are 59 1/2 years of age, as well as have to pay income taxes on any such withdrawals. However, the funds will be available if needed, whereas they might not be if left with the former employer.

The Bankruptcy Decision

In very difficult times, when all other avenues have failed and bankruptcy is the only remaining alternative, debtors still must decide which type of bankruptcy to file—Chapter 7 or Chapter 13. Chapter 7 is straight bankruptcy, and is referred to simply as "bankruptcy" in the following discussion. Under the provisions of the Bankruptcy Code, many (but perhaps not all) of a bankrupt's debts will be forgiven. Most of the bankrupt's assets will be sold to pay off creditors. Secured creditors have first claim to the proceeds while unsecured lenders divide whatever remains.

Chapter 13 is known as a wage-earner plan, and is intended for the person with a steady income who can repay debts but needs court protection from creditor harassment. Under this option, the borrower is permitted to keep all assets over an extended time period while a sustained effort is made to repay most, if not all, outstanding obligations. Since it involves a rehabilitation or reorganization of the consumer's indebtedness, Chapter 13 is not technically regarded as a bankruptcy.

As in most decision-making situations, the most useful way to proceed is to compare bankruptcy (that is, Chapter 7) with all available alternatives. However, this may not be easy if a creditor has already obtained a court order to garnishee the debtor's wages and a decision must be made immediately. Moreover, determining the market value of assets that might be sold to satisfy debt obligations can be a time-consuming process. And projecting future income, expenses, debt obligations, and asset acquisitions over the next six years (under each alternative and under bankruptcy) in order to determine a reasonable after-bankruptcy budget is next to impossible.

However, several considerations ought to be taken into account before a decision to file bankruptcy is made. Of primary importance is the matter of which debts are dischargeable or nondischargeable under bankruptcy. A dischargeable debt is one that a bankrupt is no longer legally bound to pay after a bankruptcy filing. Examples are credit card debts, medical bills, utility bills, and rent. Most unsecured debt is dischargeable. A nondischargeable debt is one that remains even after a bankruptcy filing. Traffic tickets, alimony and child support, state and Federal income taxes (with some exemptions) and most student loans are examples of this type of debt. Some secured debts are also nondischargeable. If a large proportion of debt is nondischargeable, then bankruptcy would provide relatively little relief and might best be forgone.

Also important is to determine what personal belongings are exempt and nonexempt under bankruptcy. Bankrupts are permitted to retain possession of a property that is on the exempt list of the state or Federal Government. Bankruptcy statutes hold that the bankrupt individual should be able to keep some basic items needed to make a "fresh start." But creditors (or, more precisely, the bankruptcy trustee) can take nonexempt property as part of the bankruptcy proceedings and liquidate it to pay off debts. Note that the classification of a bankrupt's property depends on the bankrupt's election of either a state or Federal exemption, but not both or some mix thereof. State and Federal exemption schedules differ significantly, and which one may be most advantageous depends on what exemption schedule provides a particular bankrupt the most exemptions under a Chapter 7 filing.

Which is a better option, Chapter 7 or Chapter 13? The answer is, "It depends." Chapter 13 is generally considered a better strategy than straight bankruptcy if a debtor's income is regularly forthcoming, if the debtor has substantial nondischargeable debts, and most of the debtor's assets are nonexempt.

Distressed borrowers who think that a Chapter 7 filing may be the best (or only) way out of financial trouble are well-advised to consult a competent attorney who regularly accepts bankruptcy cases.

PASSIVE INVESTING: AN OVERVIEW

The history of stock prices has been extensively studied for many years (the most extensive database is maintained by the Center for Research in Securities Prices at the University of Chicago). A major finding of this work is that there is a relationship between firm size (measured by market capitalization) and return. As second major finding is that there is also a relationship between returns and "investment style," *i.e.*, stocks that are richly priced (presumably because their prospects are better than most) vs. those that are "cheap." This distinction is usually expressed as "growth vs. value."

Ibbotson Associates defines large stocks as those with market capitalizations large enough to place them in the top half of all companies traded on the New York Stock Exchange ranked by market capitalization and small companies are defined as all the rest. Ibbotson further defines growth stocks as the 30 percent of issue with the highest ratio of price to book value and value stocks as the 30 percent with the lowest ratio of price to book value (the middle 40 percent is excluded).

Using these definitions of categories of domestic common stocks, Ibbotson calculated the returns in the table below for the years 1927-1999.

These categories comprise the major domestic common stock building blocks of a passive investment portfolio.

A third finding of the studies of historic stock prices is that the classifications of large vs. small and growth vs. value generally "explain" most of the performance differences of nearly all industry groups. In other words, the returns from investing in a specific industry tend to reflect the characteristics of the companies in that industry (whether they have large or small capitalization and whether they are priced as growth or value stocks) rather than any unique characteristics of that industry.

There are three exceptions to this. Real Estate Investment Trusts (REITs), foreign stocks, and gold mining shares tend to fluctuate differently from common stocks. These equity categories can provide additional "building blocks," in a passive investment portfolio. Their returns are less correlated to the domestic common stock categories shown below than those categories are to each other.

Why Not the Best?

The reader may well wonder why, given the historical performance of various categories of stocks, a long-term investor shouldn't simply buy the one that has performed the best? If, over the 1927-1999 period of 72 years, small capitalization value stocks outperformed the other three major categories of domestic common stocks by a wide margin, why not put my money there and be done with it?

The answer to this question goes to the very heart of the passive approach to investing. First, as we have noted several times, annual rates of return can differ greatly depending on the period over which they are calculated. Moreover, the relative performance of the small and large, value and growth categories can vary greatly year-to-year. During the 1927-1999 period, small capitalization value stocks were the *best* performing category in just 24 of the 72 years. On the other hand small capitalization growth stocks were the best performing category in 16 of those 72 years, even though they returned more than 5 percentage points less per year on average than the small capitalization value stocks.

Thus, the reason not to purchase only small capitalization value stocks (or any other single category) is that future returns in a portfolio will be calculated from present levels. Even if one is thoroughly convinced that small capitalization value stocks will, if held long enough, emerge as the sector providing the highest returns, it could take many years to do so. Anyone deciding where to invest right now simply has no way of

	Annual Returns	*Standard Deviation*
Large Stocks	11.3%	20.1
Small Stocks	12.6%	33.6
Growth Stocks	10.2%	20.1
Value stocks	13.4%	28.1
Large Growth	10.3%	20.0
Large Value	12.7%	27.6
Small Growth	9.6%	33.1
Small Value	14.7%	32.3

telling which category will do the best, not only during the next year, but for much longer periods.

By placing funds in several categories, the investor stands to "beat the averages" in two ways. First, by rebalancing holdings, some of the categories that that have done better than the others will be sold to add to the holdings that have not done as well. Not every rebalancing trade will be made at peaks and troughs of divergences (*i.e.,* recent trends of the categories may persist, so that delaying a given trade could enable the investor to sell higher and/or buy lower), but over the long-term the returns on the various categories tend to be much closer to each other, than in the short-term. Secondly, and especially when the returns on the selected categories are not highly correlated, holding several and re-balancing them in a disciplined way will serve to reduce the variability of the total returns on the entire portfolio.

Similarly, even though it is likely that stocks will provide better long-term returns than fixed dollar claims, investors would be well-advised to keep a portion of their holdings in fixed claims. By doing so, the volatility of one's holding will be reduced to acceptable levels, and a reserve will be available to purchase more equities if their prices decrease.

What's Right for You?

How an individual investor builds a portfolio will, to repeat, depend on the resources and opportunities available. Although we have indicated that a passive investment portfolio should hold several of the "building blocks" mentioned above there is no need to hold them all or to give them equal weights. When building your own portfolio, you will have to select from the index funds that are available to you.

When U.S. common stocks are classified according to the size of market capitalization, the usual breakdown is for "large cap", "mid-cap" and "small-cap" stocks, but there is little consistency in the sizes of the companies such breakdowns include. With the companies ranked according to their market capitalizations, a comparison of the "universes" of U.S. common stocks put together by the major indexers is presented in the table below.

These categories are by no means an equal division of U.S. common stock, either by the numbers of companies or by the total values of their market capitalizations. In the table below, "large caps" account for between roughly 70 and 85 percent of the market value of all publicly traded stocks, "mid caps" for about 5 to 20 percent, "small caps" for another 3 to 5 percent. All of the indexes ignore 3,000 to 5,000 other U.S. "micro cap" companies with a total capitalization equal to about 2 to 5 percent of the total market.

For each of the published indexes, there are also indexes for value and growth stocks. These are compiled using various methodologies, and not all of these are "tracked" by mutual funds as yet, but many are. Currently there are many low-cost mutual funds and exchange-traded funds as well as mutual funds from Dimensional Fund Advisors that we utilize for our clients. The latter deem "large stocks" as the 1,800 or so stocks that account for 90 percent of the market's value, and the remaining 10 percent (nearly 4,000 stocks) as "small stocks." They also offer a unique "micro-cap" fund that holds more than 3,000 stocks in the bottom 4 percent of the total market. When putting together one's own portfolio, the following considerations appear pertinent:

Large capitalization value stocks tend to have above-average returns with a below average standard deviation. This category includes "blue chips" that are currently out of favor as well as companies in unglamorous industries or that are in some way "distressed." The High Yield Dow stock selection strategy may be employed here, if resources permit. (The HYD strategy involves relatively frequent incremental trades, attempting to follow it with less than roughly $100,000 can lead to unacceptably high trading costs and or increased volatility). Otherwise, funds that track the Dow Jones Large Cap. Value, the S&P 500/Barra Value, or the Russell 1000 Value indexes should be used.

Large Capitalization Growth Stocks include the current "darlings" of the investment professionals. Their price-earnings ratios tend to be high and their dividend yields tend to be low. Most passive investors will probably wish to given them less weight than large capitalization value stocks. They should not be omitted entirely, however, because there are times when they do very well. If you are using the HYD strategy for your large value stocks, then an S&P 500 index fund might well be used as your growth component here as that index is much more tilted toward growth stocks than the indexes that include stocks that do not have market capitalization large enough to qualify for the S&P 500. Otherwise funds that track the Dow Jones Large Cap. Growth, S&P 500/Barra Growth or the Russell 1000 Growth indexes should be used.

Small capitalization stocks tend to be more volatile that the large stocks. *Small growth stocks* include the legions of "story stocks" that are heavily picked over by active managers in search of the next Xerox or Cisco Systems. Although their high volatility can sometimes make them shine, their overall performance tends to lag the other categories considerably. Passive investors should only include small cap growth stocks if they are held through a "small cap" fund that does not specifically focus on either growth or value stocks, *i.e.,* funds that hold only small cap growth stocks are probably best avoided. On the other hand, as noted above, *small value stocks* have been the best long-term performers and, despite their relatively volatility, they belong in any passive investment portfolio.

Given that the correlation of returns is lowest between the largest stocks and the smallest stocks, and that returns (and volatility) are higher for smaller stocks, investors should select those small capitalization value stock funds available that holds the smallest stocks.

The reason to include funds holding *Real Estate Investment Trusts* (REITs) and foreign stock funds is to further reduce your portfolio's volatility, while maintaining the ability to participate in these sectors' returns, which can be expected to exceed those of fixed-dollar claims over the long term.

The returns on gold mining shares have been even less correlated to those on domestic common stocks. There are funds specializing in precious metals, but none track any of the precious metals indexes (i.e., they are all "actively" managed), and

		Dow Jones	*Russell*	*Standard & Poor's*	*Wilshire*
Large Cap	top	191	200	500	500
Mid Cap	next	543	800	400	750
Small Cap	next	987	2,000	600	1,250
Total Companies		1,721	3,500	1,500	2,500

a large portion of their holdings are in speculative or "junior" gold mines as well as silver and platinum mines (metals whose uses are mainly industrial rather than as a store of value) whose profits tend to fluctuate with business conditions.

Accordingly, those wanting to participate in this sector should purchase shares in the few gold mining companies meeting the criteria that we believe make them suitable for investors as opposed to speculators. The first, and most important, criterion is that a company actually be producing. Secondly, the company must have adequate reserves to support production for a prolonged period. Thirdly, the company must not be overly leveraged, either financially through insupportable debt on its balance sheet or operationally via high production costs. Fourthly, a company must be large enough so that its shares are highly liquid and its operation adequately diversified to protect investors from political and other risks to company assets. Lastly, the company should pay a dividend so that investors can gain some current income from this portion of their portfolios.

The low and even negative investment returns of "gold bugs" during the past 20 years and the fact that gold mining share prices are volatile are not reasons to rule out participation in this sector. The very low correlations of the returns on gold mining shares with those of other sectors, means that rebalancing transactions will tend to sell some gold shares when they have increased in price and *vice versa*.

However, the decision to include gold stocks will also depend on the investor's outlook, specifically on how much longer central banks, who still hold a very large proportion of the world's stock of tradable gold, will continue to be heavy net sellers whenever the price of gold firms up. At some point the central bankers are likely to decide that their gold holdings, which are their only liquid monetary asset that cannot default, are no longer excessive. We would guess that level to be significantly more than zero, but we can only guess. Meanwhile, the world's stock of tradable gold is increasing by no more than 1 or 2 percent per year, which is far less that the rates at which fiat currencies are being created. This will lead to a much higher gold price at some future date, but again we can only guess how much higher or when.

Which brings us to the question of how "passive" the approach we are recommending really is.

The Active Part of Passive Investing

Selecting the components, and their proportions, in your portfolio will reflect the opportunities open to you, your appraisal of your situation and tolerance for risk, *and* your appraisal of the economic and financial outlook. This begins with the most basic decision of all—how to divide your holdings between equities and fixed dollar claims.

The notion that common stocks will generate higher returns in the long-term, while supported by the historical record, may take quite a lot of time to be validated. There was a 20 year period 1929 through 1948, when the total returns on 5-year treasury notes was higher than that on domestic common stocks, and there was a similar 16 year period between 1966 and 1982. Given that by all historical measures, U.S. common stock valuations remain close to record levels, we believe that relative caution is in order and that fixed-dollar claims should be a larger proportion of most portfolios than they would be if common stock prices were lower. These observations are reflected in our current recommended allocations, which we publish every quarter.

By the same token, if you believe that the widening acceptance of free markets around the world will continue, then your commitments to foreign equities should probably include an emerging markets index fund. But more cautious investors should probably stick with funds that concentrated only on Europe, or somewhat more adventurously, Europe, Australia, and the Far East (EAFE).

Similarly, it you truly believe in the "new economy" and expect that high tech stocks will resume their winning ways before long, then you probably will want more large capitalization growth stocks that we would deem prudent.

In short, how an individual sets up his or her own passive portfolio will inescapably reflect personal opinions and biases. It cannot be emphasized too strongly that, as long as the holdings are well diversified, whether these opinions prove to be correct will be much less important to one's results than sticking with the program you set out for yourself. Changes in your allocations by sector should be made only because you have developed new opinions regarding the long-term outlook. In turn, these opinions should reflect some very fundamental change and most emphatically *not* simply that one sector has gone up and you don't want to sell any of it or another has gone done and you do not want to buy any more.

The power of "passive" investing is that it can help you overcome the emotions that appear to govern the decisions of most investors: fear and greed.

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 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 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 more than 8 years, Philip Morris has never ranked lower than fourth on the list, whatever its ups and downs, and, given the circumstances, using Philip Morris in the strategy 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 on the full list of 30 Dow stocks) are based on mid-month closing prices, plus or minus $0.125 per share. This month, 3 of the stocks eligible for purchase were also eligible for purchase 18 months earlier. These were **Dupont, J.P. Morgan Chase,** and **Caterpillar.** The strategy calls for rebalancing, to ensure that this month's commitment to each of these three and **Eastman Kodak,** which is also eligible for purchase, is of equal value. In addition to purchases of Kodak and sale of the portion of holdings of **International Paper** purchased in June, 2000, rebalancing called for small sales of Caterpillar and small purchases of Dupont and J.P. Morgan. Most investors following the model should find that only the International Paper sale and the purchases of Kodak will be sufficiently large to warrant trading.

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. These positions, as well as the shares in **AT&T Wireless** that were spun-off from AT&T last month (and any additional spin-offs from AT&T in the meantime), will be held in the model until, January, March, April and May 2002.

As of December 14, 2001

	Rank	Yield	Price	Status	Percent of Portfolio*: Value	Percent of Portfolio*: No. Shares‡
Eastman Kodak	1	5.89%	30.58	Buying	18.2	22.0
Philip Morris	2	5.06%	45.81	*	-0-	-0-
General Motors	3	4.21%	47.48	*	-0-	-0-
JP Morgan Chase	4	3.77%	36.04	Holding**	13.8	14.1
Dupont	5	3.37%	41.49	Holding**	23.9	21.3
Caterpillar	6	2.80%	50.07	Holding**	26.5	19.6
SBC Comm.	7	2.63%	38.95		-	-
Int'l Paper	8	2.54%	39.40	Selling	13.2	12.4
AT&T	24	0.93%	16.13	Holding	3.5	8.0
AT&T Wireless	—	0.00%	13.45	Holding	0.9	2.6
					100.0	100.0

Change in Portfolio Value†

	1 mo.	1 yr.	5 yrs.	10 yrs.	15 yrs.	From 12/63	Std. Dev.
Strategy	-0.7%	2.2%	12.3%	16.8%	17.8%	16.1%	19.0
Dow	-0.4%	-2.6%	11.1%	15.1%	14.2%	11.0%	16.8

* 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.

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 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 a 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 without delay. (This month, the four eligible issues—Caterpillar, Dupont, Eastman Kodak, and J.P. Morgan Chase—account for more than 80% 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	Market Prices			12-Month		Latest Dividend			Indicated	
	Symbol	12/14/01	11/15/01	12/15/00	High	Low	Amount	Record Date	Paid	Annual Dividend	Yield† (%)
★ Eastman Kodak	EK	**$30.58**	28.62	38.19	49.95	24.40	0.450	12/03/01	12/20/01	1.800	5.89
Philip Morris	MO	**$45.81**	47.99	40.06	53.88	38.75	0.580	12/24/01	1/10/02	2.320	5.06
General Motors	GM	**$47.48**	46.85	53.81	67.80	39.17	0.500	11/15/01	12/10/01	2.000	4.21
★ J. P. Morgan Chase	JPM	**$36.04**	39.55	43.24	57.33	29.04	0.340	10/05/01	10/31/01	1.360	3.77
★ DuPont	DD	**$41.49**	44.11	43.75	49.88	32.64	0.350	11/15/01	12/14/01	1.400	3.37
★ Caterpillar	CAT	**$50.07**	47.97	40.81	56.83	39.75	0.350	1/22/02	2/20/02	1.400	2.80
SBC Comm.	SBC	**$38.95**	39.00	53.69	54.38	36.50	0.256	1/10/02	2/01/02	1.025	2.63
☆ International Paper	IP	**$39.40**	39.66	37.38	43.31	30.70	0.250	11/23/01	12/14/01	1.000	2.54
Exxon Mobil (s)	XOM	**$36.86**	37.19	42.07	45.84	35.01	0.230	11/09/01	12/10/01	0.920	2.50
Merck	MRK	**$58.09**	64.66	90.38	95.94	57.49 *L*	0.350	12/07/01	1/02/02	1.400	2.41
Honeywell Intl.	HON	**$31.69**	30.87	47.88	53.90	22.15	0.188	11/20/01	12/10/01	0.750	2.37
Minn. Min. & Mfg.	MMM	**$115.80**	114.62	112.19	127.00	85.86	0.600	11/23/01	12/12/01	2.400	2.07
Procter & Gamble	PG	**$79.90**	78.29	71.38	81.10 *H*	55.96	0.380	10/19/01	11/15/01	1.520	1.90
Boeing	BA	**$37.55**	34.24	64.88	69.94	27.60	0.170	2/08/02	3/01/02	0.680	1.81
General Electric	GE	**$37.65**	41.55	49.81	53.55	28.50	0.160	9/28/01	10/25/01	0.640	1.70
Alcoa	AA	**$37.02**	37.50	30.94	45.71	27.36	0.150•	11/02/01	11/25/01	0.600•	1.62
Coca-Cola	KO	**$46.25**	50.00	53.50	62.19	42.37	0.180	12/01/01	12/15/01	0.720	1.56
Hewlett-Packard	HWP	**$21.00**	22.09	31.63	37.95	12.50	0.080	12/19/01	1/09/02	0.320	1.52
United Tech.	UTX	**$61.46**	57.75	71.19	87.50	40.10	0.225	11/16/01	12/10/01	0.900	1.46
Citigroup	C	**$46.69**	50.09	48.06	57.38	34.51	0.160	11/05/01	11/21/01	0.640	1.37
Johnson & Johnson (s)	JNJ	**$56.30**	60.00	49.28	60.97 *H*	40.25	0.180	11/20/01	12/11/01	0.720	1.28
Walt Disney	DIS	**$20.97**	20.30	29.38	34.80	15.50	0.210	12/07/01	12/21/01	0.210	1.00
☆ AT&T	T	**$16.13**	16.98	21.00	25.15 *H*	14.75	0.038	9/28/01	11/01/01	0.150	0.93
American Express	AXP	**$32.26**	34.39	54.63	57.94	24.20	0.080	1/04/02	2/08/02	0.320	0.91
McDonald's	MCD	**$26.80**	28.36	31.50	35.06	24.75	0.225	11/15/01	12/03/01	0.225	0.84
Wal-Mart Stores	WMT	**$54.06**	56.00	49.88	58.75	42.00	0.070	12/21/01	1/07/02	0.280	0.52
IBM	IBM	**$121.10**	114.75	87.81	123.21 *H*	80.06	0.140	11/09/01	12/10/01	0.560	0.46
Home Depot, Inc.	HD	**$49.81**	46.49	41.94	53.73	30.30	0.050	11/30/01	12/13/01	0.200	0.40
Intel Corp.	INTC	**$33.27**	30.78	32.44	38.59	18.96	0.020	11/07/01	12/01/01	0.080	0.24
Microsoft Corp.	MSFT	**$67.44**	66.12	49.19	76.15	40.25	0.000	-	-	0.000	0.00
☆ AT&T Wireless	AWE	**$13.45**	15.44	21.81	27.30	12.27	0.000	-	-	0.000	0.00

★ BUY. ☆ HOLD. † Based on indicated dividends and market price as of 12/14/01. *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

	12/14/01	Mo. Earlier	Yr. Earlier
Gold, London p.m. fixing	**277.05**	275.45	270.35
Silver, London Spot Price	**4.36**	4.11	4.61
Copper, COMEX Spot Price	**0.67**	0.67	0.87
Crude Oil, W. Texas Int. Spot	**19.23**	17.45	28.87
Dow Jones Spot Index	**97.30**	95.21	112.68
Dow Jones-AIG Futures Index	**88.97**	88.28	112.06
CRB-Bridge Futures Index	**191.07**	186.37	227.41

Interest Rates (%)

		12/14/01	Mo. Earlier	Yr. Earlier
U.S. Treasury bills -	91 day	**1.72**	1.89	6.00
	182 day	**1.82**	1.99	5.97
	52 week	**2.20**	2.29	5.64
U.S. Treasury bonds -	15 year	**5.81**	5.29	5.56
Corporates:				
High Quality -	10+ year	**6.90**	6.67	7.27
Medium Quality -	10+ year	**7.71**	7.47	8.02
Federal Reserve Discount Rate		**1.25**	1.50	6.00
New York Prime Rate		**4.75**	5.00	9.50
Euro Rates	3 month	**3.35**	3.34	4.95
Government bonds -	10 year	**4.62**	4.41	4.86
Swiss Rates -	3 month	**1.88**	2.05	3.50
Government bonds -	10 year	**3.21**	3.04	3.69

Exchange Rates

	12/14/01	Mo. Earlier	Yr. Earlier
British Pound	**$1.456100**	1.432200	1.471000
Canadian Dollar	**$0.640700**	0.628800	0.655800
Euro	**$0.904900**	0.884400	0.894100
Japanese Yen	**$0.007826**	0.008156	0.008892
South African Rand	**$0.083800**	0.104900	0.130400
Swiss Franc	**$0.612700**	0.602700	0.594900

Securities Markets

	12/14/01	Mo. Earlier	Yr. Earlier
S & P 500 Stock Composite	**1,123.09**	1,142.24	1,312.15
Dow Jones Industrial Average	**9,811.15**	9,872.39	10,434.96
Dow Jones Transportation Average	**2,577.10**	2,454.00	2,698.68
Dow Jones Utilities Average	**278.15**	289.76	386.52
Dow Jones Bond Average	**102.71**	104.26	96.57
Nasdaq Composite	**1,953.17**	1,900.57	2,653.27
Financial Times Gold Mines Index	**854.97**	808.49	664.06
FT African Gold Mines	**985.48**	894.22	676.56
FT Australasian Gold Mines	**1,119.10**	1,001.68	802.38
FT North American Gold Mines	**775.46**	749.30	637.83

Coin Prices

	12/14/01	Mo. Earlier	Yr. Earlier	Premium
American Eagle (1.00)	**$284.35**	285.95	277.45	2.63
Austrian 100-Corona (0.9803)	**$270.93**	272.53	264.43	-0.25
British Sovereign (0.2354)	**$68.75**	69.05	67.15	5.42
Canadian Maple Leaf (1.00)	**$284.60**	286.20	277.70	2.73
Mexican 50-Peso (1.2057)	**$334.50**	336.40	326.50	0.14
Mexican Ounce (1.00)	**$277.20**	278.80	270.60	0.05
S. African Krugerrand (1.00)	**$282.15**	283.75	275.45	1.84
U.S. Double Eagle-$20 (0.9675)				
St. Gaudens (MS-60)	**$335.00**	335.00	347.50	24.98
Liberty (Type I-AU)	**$675.00**	675.00	675.00	151.82
Liberty (Type II-AU)	**$385.00**	400.00	425.00	43.63
Liberty (Type III-AU)	**$312.50**	312.50	314.00	16.58
U.S. Silver Coins ($1,000 face value)				
90% Silver (715 oz.)	**$4,500.00**	4,500.00	4,000.00	44.35
40% Silver (292 oz.)	**$1,525.00**	1,537.50	1,550.00	19.78
Silver Dollars	**$5,850.00**	5,850.00	5,700.00	73.44

Note: Premium reflects percentage difference between coin price and value of metal in a coin, with gold at $277.05 per ounce and silver at $4.36 per ounce. The weight in troy ounces of the precious metal in coins is indicated in parentheses.

Recommended Mutual Funds

	Ticker Symbol	12/14/01	Month Earlier	Year Earlier	52-Week High	52-Week Low	Distributions Latest 12 Months Income	Distributions Latest 12 Months Capital Gains	Yield (%)
Short-Term Bond Funds									
★ Fidelity Target Time Line 2003	FTARX	**$9.49**	9.58	9.25	9.68	9.24	0.5326	0.0000	5.61
★ USAA Short Term Bond	USSBX	**$9.48**	9.87	9.65	10.04	9.48	0.6344	0.0000	6.69
★ Vanguard Short-term Corporate	VFSTX	**$10.78**	10.92	10.62	11.03	10.62	0.6885	0.0000	6.39
Income Equity Funds									
★ Duff & Phelps Utilities Income[1, 2]	DNP	**$11.02**	11.12	10.50	11.25	9.56	0.7800	0.0000	7.08
★ Vanguard REIT Index	VGSIX	**$12.24**	12.02	11.63	12.93	11.13	0.8300	0.0000	6.78
Large Cap. Value Equity Funds									
★ iShares S&P 500 Value Index[3]	IVE	**$53.77**	54.78	60.88	67.00	46.30	0.8132	0.1472	1.51
★ Vanguard Value Index	VIVAX	**$18.54**	18.90	22.55	23.95	16.41	0.3280	1.4400	1.77
Small Cap. Value Equity Funds									
★ iShares Sm. Cap. 600 Value Index[3]	IJS	**$82.68**	77.95	69.98	86.58	66.35	0.5723	0.3430	0.69
★ Vanguard Sm. Cap Value Index	VISVX	**$10.08**	9.45	9.18	10.70	8.14	0.0820	0.6900	0.81
Growth Equity Funds									
★ iShares S&P 500 Growth Index[3]	IVW	**$58.62**	59.34	71.25	72.84	48.00	0.3571	0.1124	0.61
★ Vanguard Growth Index	VIGRX	**$26.11**	26.45	31.72	32.78	21.75	0.1500	0.0000	0.57
Foreign Equity Funds									
★ iShares S&P Europe 350 Index[3]	IEV	**$57.65**	58.05	73.94	80.50	45.52	0.7993	0.0000	1.39
★ T Rowe Price European Stock	PRESX	**$15.43**	16.05	19.78	20.65	13.07	0.3600	0.0000	2.33
★ Vanguard European Stock Index	VEURX	**$19.96**	20.26	25.36	27.29	16.85	0.4330	0.0000	2.17

Recommended Gold-Mining Companies

	Ticker Symbol	12/14/01	Month Earlier	Year Earlier	52-Week High	52-Week Low	Distributions Latest 12 Months Income	Distributions Latest 12 Months Capital Gains	Yield (%)
Anglo American PLC, ADR (s)	AAUK	**$15.50**	15.04	13.06	18.25	9.46	0.460	Semiannual	2.97
★ Anglogold Ltd., ADR	AU	**$18.73**	17.67	14.13	22.34	13.15	0.781	Semiannual	4.17
ASA Ltd.[1]	ASA	**$20.50**	18.75	14.56	22.90	14.38	0.600	Quarterly	2.93
★ Barrick Gold Corp.†	ABX	**$16.37**	14.82	15.99	19.38	13.69	0.220	Semiannual	1.34
★ Gold Fields Ltd.ADR	GOLD	**$5.20**	4.59	3.28	5.25	3.19	0.162	Semiannual	3.12
★ Homestake Mining	HM	**$8.62**	7.73	4.31	9.49	3.94	0.025	Annual	0.29
★ Newmont Mining	NEM	**$19.72**	20.18	16.19	25.23	14.00	0.120	Quarterly	0.61
★ Placer Dome†	PDG	**$11.27**	10.60	9.44	13.49	7.88	0.100	Semiannual	0.89
★ Rio Tinto PLC ‡	RTP	**$74.00**	74.66	66.00	85.00	53.70	2.350	Semiannual	3.18

★ 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.