INVESTMENT GUIDE

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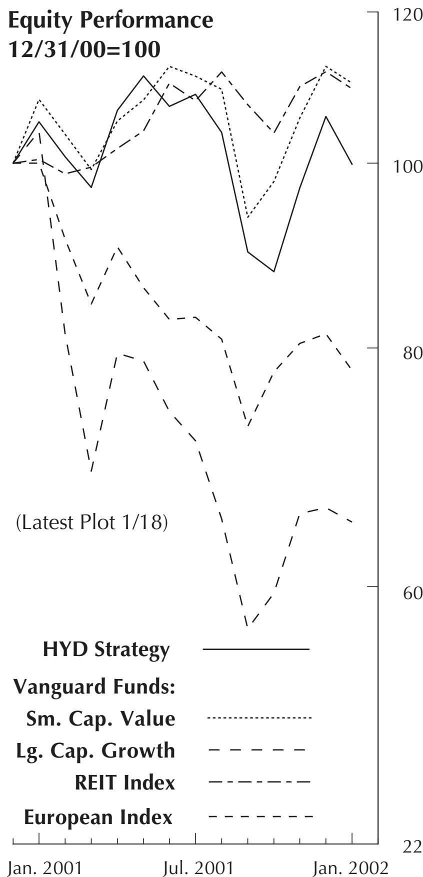

We offer two discretionary management services: Our Professional Asset Management (PAM) service covers all of our recommended assets and allows us to place trades in stocks, bonds, and mutual funds directly in our clients' accounts. (The accounts remain the property of our clients at all times—we are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

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Risky Retirement Plans

We know of a retirement program that has been very much in the news, in which investments were restricted to the securities issued by a single entity. Most participants appeared satisfied, until it was discovered that the accounting methods used to track the soundness of those securities, while apparently within recognized guidelines, completely obscured the fact that the entity was enormously in debt. While participants were blindly contributing to the plan, the principals with the responsibility for ensuring the solvency of the underlying investment were instead using the arrangement to pursue their personal agendas. Ultimately, the scheme collapsed, and the participants were left holding the bag.

No, we're not talking about Enron; we're talking about Social Security.

As our parent, AIER, has pointed out many times, the payroll tax receipts attributable to Social Security currently exceed disbursements, but the "trust fund" to which this excess is credited amounts to little more than an instrument of accounting chicanery. In fact, the proceeds are "invested" in the non-marketable securities (bonds) of a single entity (the U.S. Government). But why does the government borrow, if not to spend? Politicians devised this scheme to create the appearance of a sound retirement system, while in fact using the surplus to spend on everything from farm subsidies to space shuttles in order to enhance their chances for re-election.

In the wake of the Enron debacle, Senator Barbara Boxer (D California) and John Corzine (D New Jersey) have called for an amendment that would limit the amount of company stock permitted in participant-directed retirement plans to 20 percent. Politicians and pundits have expressed their incredulity that employers would restrict participants' investment options to employer stock. We note that only the employer's matching contribution was contractually restricted to holding Enron stock, and that the employees' contributory accounts were frozen for only a very brief period. Enron's employees had other investment options, but the media horror stories typically describe employees who held far more Enron stock than what was required by the plan. We have heard heart-rending stories of now worthless accounts that had once exceeded $1 million. But the stories fail to point out that had the 20% restriction applied, their accounts never would have approached $1 million to begin with. The notion that the "right" regulations would have preserved the millionaire status of countless Enron employees is nonsense.

But more importantly, even if company stock was in effect a mandatory form of compensation, no one forced anyone to work at Enron. We recognize that the fiasco involved a severe breach of fiduciary responsibility, that not all investors shared access to the same information, and that everything that could go wrong did go wrong. But this is what risk is all about, and ultimately the decision to hold Enron stock, and how much to hold, was in the hands of those who owned it. Did Enron employees learn nothing from the sudden evaporation of "dot com" millionaires?

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Relative to the working population, which with very few exceptions must participate in the great Ponzi scheme known as Social Security, Enron employees enjoyed a retirement program that was downright liberal with regard to the opportunity for diversification. U.S. citizens must dedicate 12.4% of their earnings to Social Security, which *has never been solvent* in an actuarial sense. Social Security simply transfers earnings from one generation to another. It is not an investment plan with individual accounts. Moreover, changing demographics will not allow these sleight-of-hand transfers to continue unless the scheme is altered. We are compelled by law to put all of our Social Sercurity eggs in an imaginary basket.

If the Senators were genuinely concerned with workers' retirement plans, it seems to us they would also require that no more than 20% of Social Security payroll taxes be invested in government securities. The remaining 80% could be designated personal savings accounts allowing individual discretion among investment options. Don't hold your breath.

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.

While 2001 was a difficult year for many equity investors, conventional wisdom suggests that all is well and that the reversal in the stock market over the past two years was merely an aberration. The recession will ebb, earnings will recover, and the indexes will again fly high. Bloomberg News recently surveyed 15 Wall Street strategists. Every analyst expected the Dow to be higher by year-end, and on average the analysts expected it to reach 11,200, roughly 10% higher than its current level.

A 10% annual increase is roughly consistent with long-term total annual returns from large cap stocks, but this rosy forecast may be little more about the wishful thinking from "the street." The sound bites we have heard typically reflect confidence regarding the economy—the fed has been aggressive and lower interest rates are sure to be stimulatory—or point out that after two years of decline the markets are sure to reverse course. Yet the pundits never pause to explain why we shouldn't expect these considerations to be reflected in current valuations.

According to Barron's, the S&P 500 stood at 1161.02 in early January, down 13.7% from a year earlier. Yet the price to (trailing) earnings ratio stood at 40.71, versus 24.57 a year ago. The market's valuation relative to earnings *increased* 65%; stock prices fell, but not as quickly as earnings, which fell 68%.

Our parent, AIER, recently examined the total market value of equity of all U.S. non-financial business corporations relative to their net worth. At the end of June 2001 stocks were trading at 178 percent of their book-value net worth. This followed a dramatic reduction from an unprecedented 263 percent reached in the first quarter of 2000. Over the five quarters over $4.3 trillion in equity valuation was wiped out, and we doubt that the peak will be revisited any time soon.

Our own take is that even the most careful analysis of empirical data can provide little more than a reasonable guess as to what might come over the next 10-15 years, and that forecasting where the market will be in one year amounts to little more than rolling the dice. Our recommended allocations below run contrary to popular opinion in that we favor cash, gold and short-term bonds more heavily than most other advisors. Investors should ignore the enticing rhetoric promoting market timing and instead maintain a portfolio appropriate to their circumstances.

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 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.

With regard to the economy in general, the statistical indicators followed by our parent, the American Institute for Economic Research, indicate that an end to the current recession is not yet in sight. Only 20 percent of the leading indicators with a discernable trend are currently expanding, and the cyclical score, a purely mathematical analysis of the leaders is at 38 (a score of 50 or below suggests that continued recession is more likely than recovery). None of the coincident indicators and 33 percent of the lagging indicators with identifiable trends are expanding cyclically.

Money Market Funds

Short-term cash equivalent assets are providing negative real returns. Nevertheless, liquidity remains extremely important, so we are not reducing our recommended allocations for cash and equivalent assets. Uncertainty applies not only to securities markets, but also to your personal circumstances. Unforeseen events, such as medical or other emergency, could force you to liquidate securities during a downturn in the market if your cash position is inadequate. Investors should not reduce their cash allocations in order to boost their holdings of higher yielding, longer-term fixed income securities. The added return from extending maturities is very modest, as indicated in the table below, yet the added price volatility is significant.

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.

Most brokers offer their customers a money market fund for a "sweep" account. Dividends, interest, and deposits are used to purchase additional shares in this fund, which may be redeemed to pay for purchases and withdrawals from the account. Similarly, mutual funds in "families," which have the same sponsors and management companies, such as Vanguard, will include several money market funds among their offerings. These typically include municipal money market funds, which earn income that is exempt from Federal, and sometimes state and local income taxes.

Yields on U.S. Treasury Securities

3-month	1.61%
6-month	1.71%
1-year	1.96%
5-year	4.21%
10-year	4.91%
30-year	5.39%

Intermediate-Term Bonds

Yields among short- and intermediate-term bonds have also fallen, but most investors should include these securities in their portfolios. In addition to providing an income stream that is reasonably reliable, these holdings can stabilize the overall returns of one's portfolio. Investors with tax-deferred accounts that offer these securities, such as IRAs and most 401(k) plans, are in an especially good position to take advantage of these features because investment income is taxed as ordinary income (at rates that can exceed 40% when state taxes are included). Income generating equities (below) are also well suited for tax-deferred accounts. Long-term capital gains are taxed at a maximum of 20%, so taxable accounts are generally better suited for those assets that tend to appreciate through capital gains, such as common stocks.

Our research indicates that investors have little to gain, in terms of risk-adjusted returns, by extending maturities beyond five years. Bond prices and interest rates are inversely related, and long-term bonds, because they are locked into a fixed rate for a longer period, are more interest-rate sensitive than shorter-term bonds.

We also recommend that investors adopt a passive approach when selecting fixed-income investments. 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, but it requires a great deal of diligence, so a mutual fund is the best method of utilizing this strategy. However, 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). Fidelity, Vanguard, and USAA offer reasonable alternatives. These mutual funds are indicated with a ★ on the back page. 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.

Income Equities

We currently have two recommendations in this category. The first is Duff & Phelps Utilities Income Inc., a closed-end, diversified investment company that is 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 6.99%. The company invests mainly in the securities of public utilities. The fund has a relatively high expense ratio, but this reflects interest paid on short-term remarketable securities that are issued in order to leverage its earnings and provide investors with a very attractive yield.

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. REITs are obligated to pay out 95% of their earnings as dividends. Its current yield is about 6.65%. 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.

Large-Capitalization Value Stocks

During the past 3 months, our Top 4-for-18-Months High-Yield Dow stock selection strategy provided a total return of 9.2%. For the year ending December 31, the model returned –0.71%. The model's long-term hypothetical risk/return profile is presented on page 6.

Although the strategy involves picking stocks from the 30 listed in the Dow Jones Industrial Average (the Dow), it is a passive investment approach. We select the stocks and number of shares to purchase or sell, based on two additional pieces of data: the company's dividend and price. Though from infallible, this technique often provides a mechanical means of "buying low" and "selling high." A relatively high yield indicates a stock that is perceived as carrying higher-than usual risk, and therefore higher than normal potential returns. Shares are sold when their relative yield has fallen, most often this occurs as a result of an appreciated share price.

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

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 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 (IJS) and the Vanguard S&P 600 BARRA Small Cap Value Index Fund (VISVX).

Our research suggests that the patterns of returns attributable to small-cap stocks are unique and valuable. Because their price changes tend to be weakly correlated with large-cap stocks, such as the Dow high-yield shares, investors can derive strong returns with relative stability by holding both asset classes in their portfolio.

In our view, the Vanguard fund and the iShares are a good way to invest in small-caps, but the most profound "small-cap effect" is found among the very small-

est stocks traded, the so-called "micro-caps." These provide the greatest "bang for the buck" in terms of risk and return and are the least correlated with our other assets. The only cost-effective means of holding this class that we are aware of are via the DFA funds, offered only through investment advisors.

Large-Capitalization Growth Stocks

Many investors will want to invest a portion of their portfolio to this asset class. History suggests that large cap value stocks have outperformed growth stocks over the very long term, but during certain periods (most recently during the end of the previous decade) large cap growth stocks have surged far ahead of value. Since these periods are not predictable, a modest commitment to this asset class is warranted for investors who have a low tolerance for watching their portfolio's returns stray to far from those of the overall market.

For this component we 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. If you want large-cap growth stocks in your portfolio, we recommend indexing as the most cost-effective means of gaining this exposure.

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).

Foreign Equities

For our readers we are currently recommending funds with exposure to the equities of Western Europe. Again we have two recommendations: the exchange-traded iShares S&P Europe 350 (IEV), which tracks 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.

As indicated in the accompanying table, foreign stocks have been out of favor. But investors should be patient. Our research reveals that during several periods foreign stocks outperformed the U.S. market, and that this asset class remains largely uncorrelated with returns from the U.S.

AIS Recommended Mutual Funds
Total Returns, Calendar Year 2001
(1/02/01-12/31/01)

Fund	Return
Vanguard REIT Index	12.4%
Vanguard Value Index	-11.9%
IShares S&P 500/BARRA Value Index	-11.8%
Vanguard Small Cap Value Index	13.6%
IShares S&P Small Cap 600/BARRA Value Index	12.6%
Vanguard Growth Index	-12.9%
IShares S&P 500/BARRA Growth Index	-12.9%
Vanguard European Index	-20.3%
IShares S&P Europe 350 Index	-20.0%

Gold-Related Investments

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

Investors can receive the benefits of indirect ownership of gold "in the ground" via shares of precious metals mining companies. Our recommended shares include only well established, producing, dividend-paying companies. For these companies, any increase in the price of gold flows almost entirely to the bottom line. Recently two of our recommended holdings, Newmont Mining and Barrick Gold, already among the world's largest producers, have taken advantage of the low gold price to buy out other large producers.

Though others have concluded that gold no longer provides the insurance it once did, we do not concur. The gold price did not rise significantly in response to the September 11 attack on the U.S., and in years gold has been subject to central bank selling and forward sales by producers. But our endorsement of gold as a hedge against accelerated inflating and periods of distress is based on empirical analysis. The fact that the gold price has not been tested against severe domestic inflating in the past 20 years is no reason to abandon it. During that last episode the gold price proved its worth, surging to over $800 per ounce, and the economy remains vulnerable to the weaknesses inherent in all fiat currencies.

Our review of a variety of asset classes continues to suggest that gold is a distinct and valuable asset class. It appears that the dollar, particularly in the form of U.S. Treasury securities, is now widely considered to be a "safe haven" asset, but we take little comfort in this. The dollar is a fiat currency with ever-declining purchasing power, even if the rate of decline is slower than that of alternative currencies. In the absence of any adequate substitute form of portfolio insurance, we recommend that investors maintain positions consistent with the percentage allocations on page 2.

FOREIGN STOCKS

When any particular asset class performs poorly, investors can quickly grow impatient. It seems against human nature to ride out these tough periods and stay the course. In the article below David G. Booth, Chairman and Chief Executive Officer of Dimensional Fund Advisors, provides an excellent summary of why international equities remain a valuable component for most investors' portfolios, despite several years of underperformance.

International Investment Allocation

International stocks have underperformed U.S. stock returns recently. For the five years ending December 31, the EAFE ("net") Index gained 4% while the Standard and Poor's 500 Stock Index had a 66% return. Given the disappointing results from international investing, many investors are reducing their commitments to international stocks even beyond the reduction due to their relative underperformance.

We believe that investors should maintain a relatively fixed percentage of their

assets invested internationally. In order to maintain fixed weights, investors have to shift from domestic to international stocks after a period of relative underperformance from international investing.

While it is often difficult to get excited about investing internationally after a period of poor relative performance, the longer term evidence about stock returns in developed markets supports the policy of maintaining relatively fixed country weights. The attached table displays long-term stock returns for the three principle stock markets. The time period covers 32 years.

Since 1970, the compound returns for large cap stocks in Japan and the United Kingdom are within 2 percentage points per year. The similarity of the returns is consistent with the notion that the long-term equity cost of capital for firms in developed markets is about the same as the cost of capital for U.S. firms, since an investor's return is a company's cost of capital.

Displayed are the returns for a combination of the three indices. The hypothetical Portfolio is rebalanced quarterly to maintain weights of 50% S&P 500, 25% Japan and 25% U.K. Since 1970, the Portfolio return is greater than the return for any of its three component indices. The "diversification return," the increase in compound return due to the variance-reducing benefit of diversification, is .85% per year.

Global Stock Returns, 32 Years ending December 31, 2001
(Annualized Dollar Returns, Percent)

	32 Years 1/70–12/01	*16 Years 1/70–12/85*	*16 Years 1/86–12/01*
Standard & Poor's 500 Stock Index	12.03	10.08	14.02
MSCI Japan Index (net)	10.79	18.20	3.84
U.K. Financial Times All-Shares Index	12.59	12.36	12.81
Portfolio, rebalanced quarterly	12.71	13.56	11.86
50% S&P 500			
25% MSCI Japan			
25% FT All-Shares			
Less: Weighted-Average Index Return	11.86	12.68	11.17
Diversification Return	.85	.88	.69
Correlations with S&P 500 (R2)			
MSCI Japan Index (net)	.10	.09	.11
U.K. Financial Times All-Shares Index	.26	.20	.42

S&P 500 Index courtesy of Ibbotson Associates.MSCI Japan Index courtesy of Morgan Stanley Capital International.U.K. All-Shares Index courtesy FTSE.

The diversification return is .88% per year in the first half of the period and .69% for the second half. The low correlation of domestic with international returns produces a reliable diversification return benefit.

The anxiety felt by some investors about investing internationally is the result of a prolonged period of relatively poor performance recently. Given the lower correlation of returns across countries, it is reasonable to expect that international stock returns can be quite different from U.S. stock returns. But, it is the low correlation that produces the large diversification benefit of investing internationally.

To argue that U.S. returns have higher expected returns is to argue that the cost of capital is higher for U.S. firms than it is for international firms. We do not believe that to be the case. We believe that the costs of equity capital are similar for comparable firms in all developed markets. The long-term evidence demonstrates that the returns for the U.S., Japan and the U.K. are amazingly close. The correct response to the inevitable differences in short-term returns is to readjust global portfolio weights back to relatively fixed policy targets.

NEWMONT MINING: THE RICH GET RICHER

Newmont Mining has won the right to merge with Australia's Normandy Mining and Canada's Franco Nevada, at a total cost of roughly $US 4.5 billion, after South Africa's AngloGold closed its competing offer to acquire Normandy. Despite the often-contentious battle between the two mining giants, which was also rumored to include Barrick Gold, Anglo Gold only managed to acquire 7.1percent of Normandy's outstanding shares.

In its proxy statement/prospectus to shareholders announcing the February 13, 2001 special meeting to vote on the proposed merger, Newmont outlined the "restructuring" of the company and the benefits that can be derived from it. The proposed mergers will create the world's largest gold producer with 2001 production of 8.2 million ounces and reserves of 97 million ounces. Newmont will operate a diversified portfolio of established mining properties focussing on major ore bodies located throughout the world. In addition to strengthening its position as one of the world's best capitalized gold mining companies, Newmont is expected to benefit significantly from the profitable royalty and investment business of Franco-Nevada which will greatly enhance cash flow.

The terms of the merger agreement call for every 100 shares of Normandy to be exchanged for 3.85 shares of Newmont Mining common stock plus A$50. Franco-Nevada shareholders will receive 0.8 of a share of Newmont Mining for each common share of Franco-Nevada. The bid for Franco-Nevada is conditioned on Newmont receiving at least 50.1percent of Normandy's shares. The bid for Normandy, however, is not linked to the successful completion of the Franco-Nevada merger.

Newmont shareholders have been asked to complete and sign the proxy statement forwarded to all Newmont shareholders. We recommend that Newmont shareholders vote **to approve** each of the proposals.

These approvals cover a number of areas. These include the general approval of the merger plan and agreement, as well as an increase in the number of authorized shares of Newmont. The approval of the issuance of common shares in a holding company for the restructuring of the shares of Newmont, and the approval of the unlikely adjournment of the meeting to give the company additional time to solicit additional proxies is also requested.

Franco Nevada is the world's largest public precious metals royalty company with interests in gold, platinum and diamonds. The firm has a 100% interest in six exploration properties and a 50% interest in two additional properties in Canada. Franco's mining properties were carried at C$537 million according to quarter-end statements as of September 30, 2001, and it carries no debt. Total revenues through the third quarter were C$85.4 million.

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", 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, the 4 stocks eligible for purchase were also eligible for purchase 18 months earlier. These were **Dupont, J.P. Morgan Chase, Caterpillar** and **Eastman Kodak.** The strategy calls for rebalancing, however, to ensure that this month's commitment to each of the four eligible issues is of equal value. This month rebalancing calls for purchases of Eastman Kodak and small purchases of Dupont and J.P. Morgan. Sales of Caterpillar and small sales of **International Paper** are also called for. Most investors following the model should find that only the Caterpillar sale and the purchases of Kodak are 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 August, October, November, and December 2000. These positions, as well as the shares in **AT&T Wireless** that were spun-off from AT&T, will be held in the model until, February, April, May and June 2002.

Investors with sizable portfolios should be able to track the exact percentages month to month, but to avoid excessive transaction costs, investors should adjust

As of January 15, 2002

					Percent of Portfolio*	
	Rank	*Yield*	*Price*	*Status*	*Value*	*No. Shares‡*
Eastman Kodak	1	6.71%	26.84	Holding**	16.9	22.8
Philip Morris	2	4.73%	49.00	*	-0-	-0-
General Motors	3	4.00%	49.96	*	-0-	-0-
JP Morgan Chase	4	3.59%	37.87	Holding**	14.6	13.9
Dupont	5	3.31%	42.27	Holding**	24.7	21.1
Caterpillar	6	2.81%	49.75	Holding**	26.0	18.9
SBC Comm.	7	2.71%	37.79		-0-	-0-
Int'l Paper	8	2.56%	39.00	Holding	13.0	12.0
AT&T	25	0.80%	18.82	Holding	4.0	7.7
AT&T Wireless	—	0.00%	11.79	Holding	0.8	2.5
					100.0	100.0

Change in Portfolio Value†

	1 mo.	*1 yr.*	*5 yrs.*	*10 yrs.*	*15 yrs.*	*From 12/63*	*Std. Dev.*
Strategy	-0.8%	-6.8%	10.0%	14.6%	16.2%	16.1%	18.9
Dow	1.3%	-4.2%	9.8%	13.9%	13.8%	10.7%	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 a very exacting stock selection strategy, and are gross of any management fees. They do not reflect returns on actual investments or previous recommendations of AIS. Past performance may differ from future results.

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. This service is designed for that portion of an investor's portfolio designated for large-cap value stocks. 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	*1/15/02*	*12/14/01*	*1/12/01*	*High*	*Low*	*Amount*	*Record Date*	*Paid*	*Annual Dividend*	*Yield† (%)*
★ Eastman Kodak	EK	**$26.84**	30.58	40.88	49.95	24.40	0.450	12/03/01	12/20/01	1.800	6.71
Philip Morris	MO	**$49.00**	45.81	42.25	53.88	41.44	0.580	12/24/01	1/10/02	2.320	4.73
General Motors	GM	**$49.96**	47.48	52.88	67.80	39.17	0.500	11/15/01	12/10/01	2.000	4.00
★ J. P. Morgan Chase	JPM	**$37.87**	36.04	53.31	57.33	29.04	0.340	1/04/02	1/31/02	1.360	3.59
★ DuPont	DD	**$42.27**	41.49	43.19	49.88	32.64	0.350	11/15/01	12/14/01	1.400	3.31
★ Caterpillar	CAT	**$49.75**	50.07	43.69	56.83	39.75	0.350	1/22/02	2/20/02	1.400	2.81
SBC Comm.	SBC	**$37.79**	38.95	50.94	51.24	36.50	0.256	1/10/02	2/01/02	1.025	2.71
☆ International Paper	IP	**$39.00**	39.40	36.94	42.50	30.70	0.250	11/23/01	12/14/01	1.000	2.56
Honeywell Intl.	HON	**$30.75**	31.69	46.50	53.90	22.15	0.188	11/20/01	12/10/01	0.750	2.44
Merck	MRK	**$58.65**	58.09	81.44	85.55	56.80 *L*	0.350	12/07/01	1/02/02	1.400	2.39
Exxon Mobil (s)	XOM	**$39.30**	36.86	41.41	45.84	35.01	0.230	11/09/01	12/10/01	0.920	2.34
Minn. Min. & Mfg.	MMM	**$109.50**	115.80	109.69	127.00	85.86	0.600	11/23/01	12/12/01	2.400	2.19
Procter & Gamble	PG	**$79.65**	79.90	70.31	81.72 *H*	55.96	0.380	1/18/02	2/15/02	1.520	1.91
General Electric	GE	**$38.71**	37.65	45.69	53.55	28.50	0.180	12/31/01	1/25/02	0.720	1.86
Alcoa	AA	**$34.52**	37.02	31.81	45.71	27.36	0.150•	2/08/02	2/25/02	0.600•	1.74
Boeing	BA	**$39.35**	37.55	60.63	69.85	27.60	0.170	2/08/02	3/01/02	0.680	1.73
Coca-Cola	KO	**$44.35**	46.25	56.63	60.99	42.37	0.180	12/01/01	12/15/01	0.720	1.62
United Tech.	UTX	**$61.12**	61.46	70.69	87.50	40.10	0.225	11/16/01	12/10/01	0.900	1.47
Hewlett-Packard	HWP	**$23.08**	21.00	30.69	37.95	12.50	0.080	3/06/02	4/10/02	0.320	1.39
Citigroup	C	**$49.72**	46.69	53.13	56.99	34.51	0.160	2/04/02	2/22/02	0.640	1.29
Johnson & Johnson (s)	JNJ	**$59.17**	56.30	47.28	60.97	40.25	0.180	2/19/02	3/12/02	0.720	1.22
Walt Disney	DIS	**$21.48**	20.97	31.56	34.80	15.50	0.210	12/07/01	12/21/01	0.210	0.98
McDonald's	MCD	**$26.20**	26.80	33.63	35.06	24.75	0.225	11/15/01	12/03/01	0.225	0.86
American Express	AXP	**$37.75**	32.26	47.94	50.69	24.20	0.080	1/04/02	2/08/02	0.320	0.85
☆ AT&T	T	**$18.82**	16.13	24.44	25.15	14.75	0.038	12/31/01	2/01/02	0.150	0.80
Wal-Mart Stores	WMT	**$56.87**	54.06	52.94	58.74	42.00	0.070	12/21/01	1/07/02	0.280	0.49
IBM	IBM	**$118.85**	121.10	93.81	126.39 *H*	87.49	0.140	11/09/01	12/10/01	0.560	0.47
Home Depot, Inc.	HD	**$49.70**	49.81	49.13	53.73	30.30	0.050	11/30/01	12/13/01	0.200	0.40
Intel Corp.	INTC	**$34.68**	33.27	32.13	38.59	18.96	0.020	11/07/01	12/01/01	0.080	0.23
Microsoft Corp.	MSFT	**$69.55**	67.44	53.50	76.15	47.50	0.000	-	-	0.000	0.00
☆ AT&T Wireless	AWE	**$11.79**	13.45	24.69	27.30	10.77 *L*	0.000	-	-	0.000	0.00

★ BUY. ☆ HOLD. † Based on indicated dividends and market price as of 1/15/02. *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

	1/15/02	Mo. Earlier	Yr. Earlier
Gold, London p.m. fixing	**284.20**	277.05	263.70
Silver, London Spot Price	**4.55**	4.36	4.60
Copper, COMEX Spot Price	**0.70**	0.67	0.84
Crude Oil, W. Texas Int. Spot	**18.90**	19.23	30.05
Dow Jones Spot Index	**100.48**	97.30	110.22
Dow Jones-AIG Futures Index	**90.26**	88.97	115.03
CRB-Bridge Futures Index	**193.00**	191.07	229.54

Interest Rates (%)

		1/15/02	Mo. Earlier	Yr. Earlier
U.S. Treasury bills -	91 day	**1.58**	1.72	5.30
	182 day	**1.63**	1.82	5.21
	52 week	**1.91**	2.20	4.94
U.S. Treasury bonds -	15 year	**5.45**	5.81	5.65
Corporates:				
High Quality -	10+ year	**6.60**	6.90	7.31
Medium Quality -	10+ year	**7.32**	7.71	8.08
Federal Reserve Discount Rate		**1.25**	1.25	5.50
New York Prime Rate		**4.75**	4.75	9.00
Euro Rates	3 month	**3.33**	3.35	4.78
Government bonds -	10 year	**4.82**	4.62	4.72
Swiss Rates -	3 month	**1.71**	1.88	3.40
Government bonds -	10 year	**3.29**	3.21	3.39

Exchange Rates

	1/15/02	Mo. Earlier	Yr. Earlier
British Pound	**$1.436800**	1.456100	1.479000
Canadian Dollar	**$0.629000**	0.640700	0.667700
Euro	**$0.881300**	0.904900	0.941400
Japanese Yen	**$0.007612**	0.007826	0.008454
South African Rand	**$0.084200**	0.083800	0.127700
Swiss Franc	**$0.599700**	0.612700	0.617800

Securities Markets

	1/15/02	Mo. Earlier	Yr. Earlier
S & P 500 Stock Composite	**1,146.19**	1,123.09	1,318.32
Dow Jones Industrial Average	**9,924.15**	9,811.15	10,525.38
Dow Jones Transportation Average	**2,686.08**	2,577.10	3,001.98
Dow Jones Utilities Average	**294.83**	278.15	345.64
Dow Jones Bond Average	**103.15**	102.71	99.50
Nasdaq Composite	**2,000.91**	1,953.17	2,626.50
Financial Times Gold Mines Index	**928.65**	854.97	659.31
FT African Gold Mines	**1,099.00**	985.48	685.47
FT Australasian Gold Mines	**1,251.57**	1,119.10	786.08
FT North American Gold Mines	**831.10**	775.46	630.28

Coin Prices

	1/15/02	Mo. Earlier	Yr. Earlier	Premium
American Eagle (1.00)	**$286.05**	284.35	291.15	0.65
Austrian 100-Corona (0.9803)	**$272.63**	270.93	277.43	-2.15
British Sovereign (0.2354)	**$69.15**	68.75	70.25	3.36
Canadian Maple Leaf (1.00)	**$286.30**	284.60	291.40	0.74
Mexican 50-Peso (1.2057)	**$336.50**	334.50	342.50	-1.80
Mexican Ounce (1.00)	**$278.90**	277.20	283.90	-1.86
S. African Krugerrand (1.00)	**$283.85**	282.15	288.85	-0.12
U.S. Double Eagle-$20 (0.9675)				
St. Gaudens (MS-60)	**$335.00**	335.00	360.00	21.83
Liberty (Type I-AU)	**$675.00**	675.00	675.00	145.49
Liberty (Type II-AU)	**$385.00**	385.00	435.00	40.02
Liberty (Type III-AU)	**$322.50**	312.50	335.00	17.29
U.S. Silver Coins ($1,000 face value)				
90% Silver (715 oz.)	**$4,500.00**	4,500.00	4,200.00	38.32
40% Silver (292 oz.)	**$1,525.00**	1,525.00	1,610.00	14.78
Silver Dollars	**$5,850.00**	5,850.00	5,750.00	66.20

Note: Premium reflects percentage difference between coin price and value of metal in a coin, with gold at $284.20 per ounce and silver at $4.55 per ounce. The weight in troy ounces of the precious metal in coins is indicated in parentheses.

Recommended Mutual Funds

	Ticker Symbol	1/15/02	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	**$9.57**	9.49	9.32	9.68	9.32	0.5160	0.0000	5.39
★ USAA Short Term Bond	USSBX	**$9.61**	9.48	9.71	10.04	9.47	0.6292	0.0000	6.55
★ Vanguard Short-term Corporate	VFSTX	**$10.89**	10.78	10.67	11.03	10.66	0.6785	0.0000	6.23
Income Equity Funds									
★ Duff & Phelps Utilities Income[1, 2]	DNP	**$11.16**	11.02	10.00	11.25	9.94	0.7800	0.0000	6.99
★ Vanguard REIT Index	VGSIX	**$12.18**	12.24	11.43	12.93	11.13	0.8100	0.0000	6.65
Large Cap. Value Equity Funds									
★ iShares S&P 500 Value Index[3]	IVE	**$54.88**	53.77	64.27	67.00	46.30	0.8132	0.1472	1.48
★ Vanguard Value Index	VIVAX	**$18.75**	18.54	23.14	23.95	16.41	0.3160	0.9770	1.69
Small Cap. Value Equity Funds									
★ iShares Sm. Cap. 600 Value Index[3]	IJS	**$85.86**	82.68	79.19	89.02	66.35	0.5723	0.3430	0.67
★ Vanguard Sm. Cap Value Index	VISVX	**$10.33**	10.08	9.95	10.70	8.14	0.0650	0.5450	0.63
Growth Equity Funds									
★ iShares S&P 500 Growth Index[3]	IVW	**$59.69**	58.62	67.69	71.75	48.00	0.3571	0.1124	0.60
★ Vanguard Growth Index	VIGRX	**$26.57**	26.11	30.14	31.72	21.75	0.1870	0.0000	0.70
Foreign Equity Funds									
★ iShares S&P Europe 350 Index[3]	IEV	**$57.48**	57.65	76.55	77.00	45.52	0.7993	0.0000	1.39
★ T Rowe Price European Stock	PRESX	**$15.69**	15.43	20.57	20.65	13.07	0.3600	0.0000	2.29
★ Vanguard European Stock Index	VEURX	**$19.74**	19.96	25.93	26.06	16.85	0.4500	0.0000	2.28

Recommended Gold-Mining Companies

	Ticker Symbol	1/15/02	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	**$16.40**	15.50	14.25	18.25	9.46	0.460	Semiannual	2.80
★ Anglogold Ltd., ADR	AU	**$20.01**	18.73	14.31	22.34	13.15	0.781	Semiannual	3.90
ASA Ltd.[1]	ASA	**$21.63**	20.50	15.50	22.90	15.38	0.600	Quarterly	2.77
★ Barrick Gold Corp.†	ABX	**$17.41**	16.37	15.71	19.38	13.69	0.220	Semiannual	1.26
★ Gold Fields Ltd., ADR	GOLD	**$5.88**	5.20	3.31	6.27	3.25	0.162	Semiannual	2.76
★ Newmont Mining	NEM	**$20.60**	19.72	16.88	25.23	14.00	0.120	Quarterly	0.58
★ Placer Dome†	PDG	**$12.16**	11.27	8.81	13.49	7.88	0.100	Semiannual	0.82
★ Rio Tinto PLC‡	RTP	**$76.81**	74.00	70.50	85.00	53.70	2.350	Semiannual	3.06

★ 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.