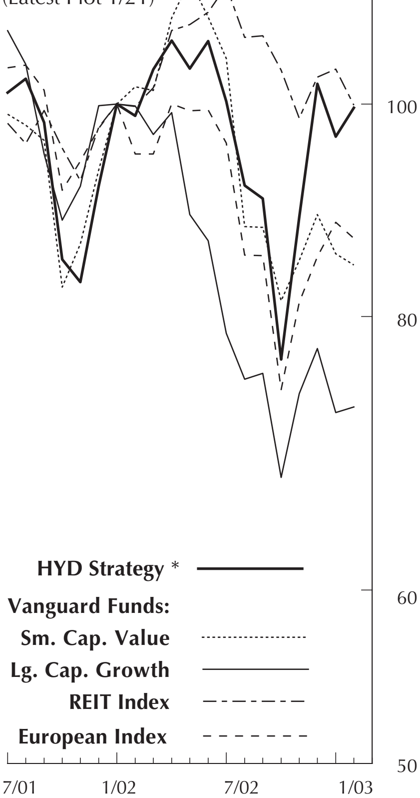
INVESTMENT GUIDE

Published Monthly by

American Investment Services, Inc.

Vol. XXV, No. 1 | Great Barrington, Massachusetts 01230 | January 31, 2003

Equity Performance
12/31/01=100
(Latest Plot 1/21)



*** HYD is a hypothetical model based on back-tested results. See p. 6 for a full explanation.**

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.

Online: www.americaninvestment.com

Dividends and Taxes

President Bush has proposed legislation that would eliminate the taxation of dividend income for individual owners of common stocks. We do not recommend that investors take any action at this point in anticipation what Congress might approve. Many aspects of the proposal have already been altered. Whatever new law survives the legislative process will very likely look much different from what has been proposed.

While the simple elimination of taxes on dividends sounds simple, what has been proposed is in fact complex. Dividends are taxed first as income to corporations; the remainder that is passed on to individual shareholders is currently taxed again at ordinary income tax rates if held in a taxable account. The proposal would eliminate double taxation at the individual level. However, dividends would be tax exempt only to the extent that the company had paid corporate taxes. This information would have to be provided to shareholders, creating another reporting burden. In addition, because the goal is to ensure that all corporate earnings are taxed only once, the plan also includes a capital gains tax break for shareholders of companies that pay the corporate levy on income but retain their earnings in lieu of paying a dividend. Thus with every dividend declared the taxpayer would have to track a new cost basis adjustment that would reduce the capital gain tax bite when the shares were eventually sold.

Dividend Data

	1999	***2000***	***% Increase***
All Returns	127,075,000	129,373,500	1.8%
Number of returns claiming dividends	32,226,000	34,140,605	5.6%
Amount of dividends claimed ($ Thous.)	$132,466,000	$146,987,679	9.9%

Source: Tax Foundation, IRS, SOI Bulletin, Dec. 2002.

Investors would confront additional implications. Dividend income from Real Estate Investment Trusts (REITs), for example would not be exempt from taxation, since REITs do not pay corporate income taxes if they meet minimum distribution and other requirements. The jury is out as to whether REITs would suffer as a result, however some REIT managers we have spoken to suggested they would consider "deREITing" by converting to C corporation status in this environment. In addition, investors holding high yielding common stocks, such as those in our HYD plan, might be better off holding these shares in a taxable account in order to escape the dividend tax. Presently, dividends held in tax-deferred accounts such as IRAs grow tax-deferred but eventually are taxed as ordinary income upon withdrawal.

Although we favor the notion of eliminating the double taxation of dividends, any attempt to do so will be fraught with complexity until the real problem—the existence of both a corporate and individual income tax—is eliminated.

QUARTERLY REVIEW OF INVESTMENT POLICY

Following a brutal third quarter, the stock market rebounded sharply in the final three months of 2002, as depicted in the Total Returns table on page 4. The growing probability of war in Iraq however, looms large, and is complicated by heightened tensions with North Korea. Consumer spending, which has sustained growth, could be tested. Despite these concerns, we have not altered our recommended portfolio allocations for investors with different tolerances for risk. These appear in the table below.

The U.S. Economy

According to the statistical indicators of our parent, the American Institute for Economic Research, 75 percent (six out of eight) of the leading indicators with an apparent cyclical trend were expanding at the end of December, unchanged from last month but down from 90 percent at the end of the third quarter. The cyclical score, AIER's purely mathematical assessment of the leading indicators, increased from 73 to 78. Both the percent of leaders expanding and the cyclical score indicate that further expansion over coming months is more likely than contraction.

For the past three years the housing market has been robust despite significant slowdowns in other sectors. Most recently new housing permits increased 8.2 percent to a seasonally adjusted annual rate of 1,880,000, with the fastest growth occurring in the Midwest. Permits issued in the West *decreased* 7.4 percent. Housing starts, the next stage in the building process, increased 5.0 percent.

Despite widely publicized fears of a "double dip" recession, and generalized pronouncements about the dismal condition of the economy (based, we suspect, more on the commentator's stock portfolio rather than any understanding of the economy), we expect the leaders to weaken further prior to another business-cycle downturn.

Among the six roughly coincident indicators, only *Gross Domestic Product*, which reached a new high, is clearly expanding. For the third quarter of 2002, GDP increased at an annual rate of 4.0 percent, with almost three quarters of the increase attributable to consumer spending.

Despite apparent growth overall, employment continues to shrink. Nonagricultural employment fell by 101,000 jobs in December, following a decrease of 88,000 in November. Most of December's job losses were in retail trade. The figures reflect seasonal adjustments, and as a result January's job gains might get an artificial boost. Nevertheless, employment's cyclical status remains indeterminate. The seasonally adjusted employment rate increased to 6.0 percent in December, equaling its cyclical high of last April. This 6 percent rate was the highest level since 1994, and its increase from 5.7 percent in September has been cited as evidence of a faltering economy. However, the recent increase should not be considered unusual; the total unemployment rate typically does not peak until well after a business-cycle trough.

Money-Market Funds

Cash-equivalent assets continue to provide very low nominal returns, and with inflation running at 2.7% throughout 2002, investors saw their cash equivalent holdings lose value in real terms. As of early January, taxable money-market funds were yielding roughly 0.90% on average, in nominal terms. Money-market funds, however, are issued and redeemed at Net Asset Value (NAV) of $1.00 per share, which can provide valuable stability to your portfolio. Cash equivalent assets are not included in the accompanying Total Returns table, but the value of their stability becomes apparent in light of the total returns provided by other asset classes during the past 11 quarters.

We have long emphasized the importance of minimizing costs, and now, with money market funds paying under 1%, expense ratios are critically important. We recommend low-cost funds such as those offered by the Vanguard Group. Currently, the Vanguard Prime Money Market fund carries a 0.33% expense ratio, and is yielding 1.19%, net of expenses.

Municipal money market funds might prove attractive to a broader class of investors than has been the case in recent years. Their appeal could extend beyond those in the highest marginal income-tax brackets. The pre-tax yield spread between muni funds and taxable funds has fallen. For example, the Vanguard Tax-Exempt Money Market fund provides income that is free of federal income taxes, and is currently yielding 0.98% on a pre-tax basis, so after taxes are considered many investors might come out ahead versus holding a taxable fund such as the Vanguard Prime fund (yielding 1.19%) cited above.

Yields on U.S. Treasury Securities

	9/30/02	12/31/02
3-month	1.56 %	1.19%
6-month	1.50 %	1.22%
1-year	1.43 %	1.21%
10-year	3.61 %	2.21%
30-year	4.66 %	4.78%

Intermediate-Term Bonds

The bond market outperformed the stock market for the third consecutive year. During the fourth quarter the bond market once again experienced a "downward shift" in the yield curve, as seen in the table above. The Federal Reserve's Board of Governors cut the federal fund rate by 0.50%, to 1.75% in early November.

The purpose of holding fixed-income securities is to enhance the stability of a portfolio. However, bond prices can change in response to a variety of factors. The expected returns from bonds with maturities of more than five years is more

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.

than offset by the volatility they would add to a portfolio, so investors should generally not hold securities with maturities that exceed that time frame. With interest rates at 40-year lows and government fiscal policy showing no signs of reversing its long-term trend of monetary inflating, we continue to believe that long-term interest rates will eventually rise in response to anticipated price inflation. Monetary expansion is at full throttle; a Fed Funds rate of 0.75% and inflation at over 2.0% implies a negative real Fed funds rate, an extraordinary occurrence. Investors should continue to avoid long-term bonds, despite the meager income currently provided by shorter-term instruments.

For many investors, any of the four fixed-income mutual funds on p. 8 will provide a suitable means of holding bonds. While not all these funds follow an investment approach that is strictly passive, they meet our investment parameters for cost and diversification, and have adopted a sound investment approach.

Investors with more substantial investment portfolios might consider building a bond ladder. Equal amounts should be invested in bonds with maturities ranging from six months to five years, in six to twelve month intervals. As these bonds mature, the proceeds can simply be reinvested in new five-year bonds. This will provide constant exposure to the "short end" of the yield curve. This approach can be taken with high quality corporate bonds, U.S. government securities (direct obligations of the U.S. Treasury or agency issues), or with high-quality municipal bonds.

Our preferred approach to fixed-income investing follows a "variable maturity" strategy. This amounts to holding a portfolio of bonds with an aggregate yield-to-maturity that is at the steepest portion of the yield curve. This provides the highest expected return per unit of volatility assumed. The strategy, however, is not simple to implement, and though it is passive in that it requires no forecast of interest rates, it does require active implementation because the yield curve changes over time. The only cost-effective means of implementing this approach is offered through the mutual funds of Dimensional Fund Advisors (DFA). DFA offers domestic, global and municipal bond funds that adopt this variable maturity strategy. The DFA funds are not available to "retail" investors, but may be purchased through our Professional Asset Management (PAM) program.

Total Returns: Duff and Phelps Select Income Fund, through 12/31/02

4Q '02	*1 Year*	*3 Years*	*5 Years*	*10 Years*
2.0%	-1.4%	15.7%	8.4%	8.4%

Income Equities

We recommend Real Estate Investment Trusts (REITs) and the Duff and Phelps Select Income fund for investors seeking to add investment income and enhance the stability to their holdings.

Utility stocks fell by 26.8% for the year, as measured by the Dow Jones Utilities index. We continue to recommend the Duff and Phelps Select Income fund (symbol DNP) as a means of capturing an attractive yield from utilities. The fund's share price has not fallen in line with the underlying utility securities it holds, and is currently trading at a premium of over 30%, well above it's historical average. The fund pays a monthly dividend and is currently yielding 7.5%. This is well above the yield of most utilities, which form the bulk of its holdings. The fund is able to maintain this high payout because, in addition to its common shares, management issues relatively low-cost remarketed preferred stock, which leverages the earnings available for common shareholders. We suspect the fund's exceptional premium to net asset value is a reflection of strong demand for its yield, which is currently well above that of fixed-income alternatives. The fund's share price will fall should interest rates rise; nevertheless, devoting 0-5% of a portfolio to this fund is warranted, depending on your circumstances.

REITs have been the big winners among asset classes for several months, as indicated in the Total Returns chart. REITs, however, did not share in the stock market rebound during the fourth quarter, instead remaining essentially flat. REITs have been negatively impacted by concern regarding the new proposal to cut dividend taxes. REITs currently avoid federal income taxes at the corporate level, but shareholders are taxed on dividends at ordinary income tax rates. The proposal to eliminate taxes for shareholders of other common stocks would not apply to REITs, so their advantage relative to common stocks would be diminished. However, a substantial portion of the total REIT capitalization is held by non-taxable institutions, such as pension funds, so this concern could be overstated.

The Vanguard REIT Index fund (symbol VGSIX) is currently yielding 5.8%. In addition to providing an attractive yield, REITs are not strongly correlated with those of other income-producing securities such as bonds, so they deserve inclusion in many portfolios.

Common Stocks

The fourth quarter brought a sharp turnaround in the stock market, but it was not enough to avoid a third consecutive year of negative performance for equities. The S&P 500 rose 8.4%, the NASDAQ

Total Returns (%)*

	2000			*2001*				*2002*				*Total Return Entire Period*
	2q	*3q*	*4q*	*1q*	*2q*	*3q*	*4q*	*1q*	*2q*	*3q*	*4q*	*2q 2000-4q 2002*
Vanguard Short-Term Corporate	1.22	2.78	2.50	**3.18**	1.25	3.34	0.17	0.26	1.25	**2.27**	1.34	21.32
Vanguard REIT Index	**10.51**	7.49	3.71	-0.50	10.66	-2.56	4.72	8.08	4.79	-8.48	0.10	**43.62**
Vanguard Value Index	-4.28	**8.80**	1.70	-6.58	4.41	-16.26	7.89	1.32	-10.69	-20.45	9.88	-26.19
High-Yield Dow 4/18	-6.91	6.26	**12.70**	-2.89	10.42	-16.09	9.19	6.90	-6.21	-23.56	**26.42**	5.67
Vanguard Small Cap Value Index	2.01	7.76	7.58	-0.78	**13.25**	-16.63	**21.22**	**9.59**	-4.15	-22.50	4.62	14.37
Vanguard Growth Index	-1.39	-8.77	-16.88	-17.50	7.70	-13.26	12.97	-0.87	-16.30	-14.07	7.04	-50.31
Vanguard European Stock Index	-2.74	-7.46	1.85	-15.62	-1.87	-12.09	9.48	0.05	-4.05	-22.85	10.77	-40.05
Gold (London PM Fix)	4.12	-5.03	0.20	-6.10	5.01	**8.31**	-5.66	9.01	**7.33**	1.63	7.75	26.03

* In each period, the highest returns provided are in **Bold Face Type**.

13% and the Dow climbed just under 10% during the final three months. For the year, however, corporate scandals, war and terrorism, and a slow growth economy delivered a loss of 22.1% for the broad market, as measured by the S&P 500, its worst performance since 1974.

We have provided recent returns for several useful indexes (see table below). The S&P 500 is intended to be representative of the entire large cap equity asset class, so it includes growth as well as value stocks. The S&P 500/BARRA Value Index includes only those large cap stocks in the S&P 500 index deemed to be value stocks, as measured by their price/earnings ratio, and is therefore useful for assessing the relative returns from our HYD model, which falls into the large cap value class. The Lipper Large Cap Value index is an alternative measuring stick for large cap value stocks as it provides the average returns for all of the actual large cap value mutual funds in the Lipper universe.

The Russell 2000 (small-cap) index gained 6.6%, while the Vanguard Small-Cap Value Index returned 4.6%. The Vanguard Value Index fund (large cap) gained 9.9%. Large-cap growth stocks rebounded more modestly, as the Vanguard Growth Index rose 7.0%. Foreign stocks had a strong quarter the Vanguard European Stock Index fund was the second-best performing among the asset classes in the table, gaining 10.8%. The Euro rose roughly 6.0% against the dollar, closing the year at $1.04, increasing the value of euro holdings in dollar terms. The trend continued into mid-January with the Euro at $1.07.

*Total Returns**	*1Q*	*2Q*	*3Q*	*4Q*	*2002*
HYD 4/18 Model	+6.92%	-6.21%	-23.79%	+26.42%	-3.36%
S&P 500 Index	+0.23%	-17.28%	-17.28%	+8.43%	-22.10%
S&P 500/BARRA Value Index	+1.32%	-10.64%	-20.46%	+9.90%	-20.85%
Lipper Large Cap Value Index	—	—	—	—	-19.68%

*HYD is a hypothetical model based on back-tested results. See p. 6 for a full explanation.

Mutual fund investors fled common stocks during 2002. According to the Investment Company Institute, through November stock funds had a net outflow of $18.87 billion, or 0.7% of average assets. October had a net outflow of $7.50 billion, while November had a nearly offsetting inflow of $6.46 billion. The last calendar year in which stock funds had a net outflow was in 1988, when 8.0% of assets fled the market.

Gold-Related Investments

The gold price surged during the fourth quarter, climbing from $323.70 to finish the year at $347.20. The gold price surged in response to fear of war, and perhaps in anticipation of a resurgence of price inflation. Significant forward selling in the past had served to dampen a resurgent gold price in recent years, but in the face of rising prices, several mining companies have reduced their hedge books. We do not recommend that investors "load up" on gold (or any other asset class) in anticipation of future events, such as war in the Middle East. Indeed, gold should be held as a form of insurance against price inflation or calamitous, unforeseeable events. Gold has historically been an extremely volatile asset class, and should only be held as a small proportion of an investment portfolio (see our recommended portfolio allocation table).

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.

Alternatively, 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.

INFLATION LINKED TREASURIES: ANOTHER LOOK

When the U.S. Treasury issued the first inflation indexed treasury bonds in 1997 we mused: "This may simply be an attempt to generate capital quickly while inflation indexed bonds are in the news. Or these issues may signal potential for fundamental changes in the bond markets; buyers could eventually come to regard conventional fixed-income debt instruments as inflexible relics." (See IG March 31, 1997). At that time we cautioned readers to be wary of several potential hazards; namely, real interest rate risk, the reliability of the Consumer Price Index (CPI) as a measure of inflation and a thin secondary market.

Nearly six years later, many other institutions have issued their own bonds linked to price inflation, conventional fixed income debt is still alive and well, and inflation as measured by the CPI has been relatively stable. We revisit inflation linked treasury bonds, or "TIPS" (Treasury Inflation-Protected Securities) as they are commonly known, and their appropriateness as part of a well diversified portfolio.

Demand for inflation indexed bonds in general has been strong. According to Lipper Inc., inflation indexed bond funds had combined assets of $5.1 Billion as of March 31, 2002 compared with $918 Million at the end of 2000. All issues since 1997 have been fully subscribed and a secondary market for TIPS has been established, though trading is thin.

How they Work

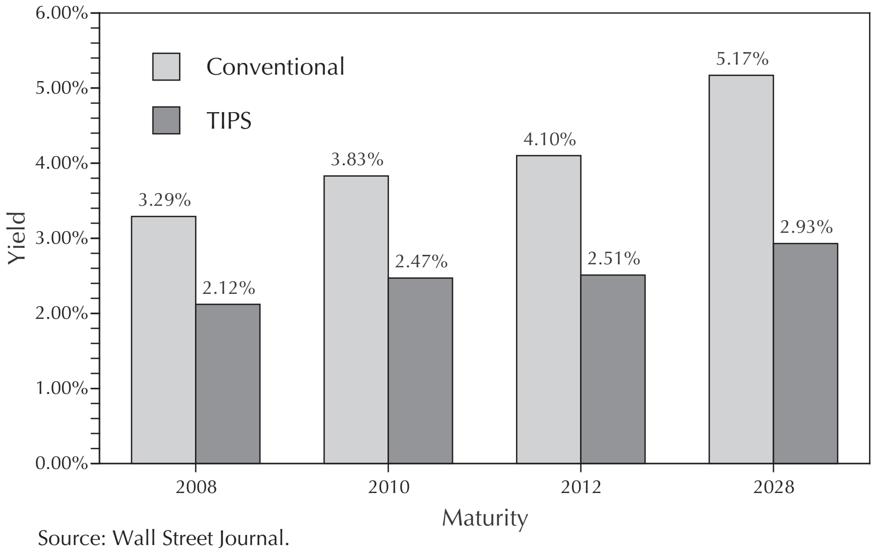
The July 2002 10-year notes were issued at 99% of par value and pay semi-annual interest payments at 3%. This is designed to be a "real" interest rate. The nominal dollar value of these payments is variable because the fixed rate is applied to a variable face value that is indexed to the Consumer Price Index for All Urban Areas (CPI-U). These issues are currently priced to yield 2.53%.

In January 2003 the CPI-U indicated that price inflation had risen slightly by 1.81%, and the principal value of a $10,000 par value bond rose to $10,180 (1.018 x $10,000), and the semi-annual interest payment was:

$10,180 X (.03/2) = 152.70
Total Taxable Income [Interest + Inflation Adjustment] = $332.70

At the end of the first year, the new

Yields on Conventional and Inflation-Adjusted Treasuries (TIPS) for Various Maturitites



Source: Wall Street Journal.

face value, assuming the rate of price inflation remains constant, would rise to \$10,180 X 1.018 = \$10,363, and the second coupon would be:

\$10,363 X (.03/2) = 155.45
Total Taxable Income [Interest + Inflation Adjustment] = \$338.45*

(Note that taxes are paid both on the coupon amount and the increase in the face value of the underlying asset.)

The yield on TIPS, when compared to yields on conventional treasuries, gives an implicit measure of inflationary expectations of the market. This is can be helpful for investors and policy makers.

It is important to understand that the present yields do not reflect future adjustments to the face value of the TIPS. Conventional treasuries and TIPS bear the same credit risk; the only significant difference between the two is the fact that TIPS' coupon payments and their value at maturity will be adjusted for price inflation. Therefore the difference in current yield to maturity on a TIPS issue and a conventional treasury issue of similar maturity indicates the market's best guess as to the rate of future price inflation through that date.

The chart above shows the yields on conventional and inflation adjusted treasury securities. For example, conventional bonds maturing in February 2012, are currently priced to yield 4.10%, while TIPS of roughly the same maturity are yielding 2.51%. The difference, 1.59% is the implied rate of annual price inflation projected by the market between now and February 2012. Similarly, the chart indicates that price inflation over the next 25 years will average 2.24%.

These projections of price inflation are well below the long-term rates of inflation suggested by the CPI. Since December 1925 price inflation has averaged 3.1% annually, and 4.1% since the end of World War II.

Can TIPS Enhance Your Investments?

While inflation is lower now than at any time since the 1960s, the prolonged recession has increased the likelihood that government will have to increase deficit spending which raises the specter of inflation on the horizon. TIPS offer investors the full faith and credit of the United States government and a guaranteed real rate of return that will keep pace with inflation.

Investors must be wary of certain potential hazards inherent in these securities, however. Some are common to all bonds, but other pitfalls are unique to these securities.

TIPS, if held to maturity, guarantee a predetermined real rate of return indicated by their yield, and are thereby immunized against price inflation as measured by the CPI. But they remain subject to interest rate risk because *real* interest rates change over time, in response to the supply and demand for capital. All bonds, indexed or not, remain exposed to the risk of rising real interest rates.

TIPS are tied to the CPI, a measure which could go through restructuring which would in turn affect the returns of bonds indexed to it. The Senate appointed Boskin Committee found that the CPI overestimates the rate of increase in the cost of living by about 1.1% annually and there have been calls from many quarters to revise the CPI to more accurately reflect fluctuations in the cost of living.

The market for conventional treasuries is very active and offers a high degree of liquidity. Despite a growing interest in TIPS, the secondary market is still in its infancy, so this should be a consideration for investors.

Finally, investors are liable for income taxes each year, not just on the income provided by TIPS, but also on the increase in face value resulting from the inflation adjustment, so TIPS are best suited for tax-deferred accounts such as IRAs or retirement plans.

TIPS: Are They Right for You?

Non-indexed treasuries will outperform inflation-indexed treasuries in periods when inflation is lower than expected. Conversely the opposite is true during periods of higher than anticipated inflation.

The brief analysis above suggests that, if history is a reliable guide, the market expects negligible monetary inflating over the next 25 years. If you are on a fixed income, or are otherwise extremely risk averse with regard to the erosion of your purchasing power, TIPS appear to be attractively priced, and could serve as a valuable component of that portion of your portfolio devoted to fixed income securities. However, these are best suited for investors with relatively long-term horizon because those investors are most vulnerable to a loss of purchasing power, and need not be especially concerned about the lack of a deep secondary market, since they will not be trading frequently. If TIPS appeal to you, they should be held in a tax-deferred investment account if possible.

You can purchase TIPS through your broker. We recommend that you purchase TIPS at auction. This can be accomplished through your broker or directly, through Treasury Direct via the internet at http://www.treasurydirect.gov/ or by phone at 1-800-722-2678. Mutual funds have also emerged that invest exclusively in inflation protected securities. You should only consider funds that are passively managed and have low expense ratios.

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 low risk (volatility) was obtained by purchasing the four 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", $12.)

The model portfolio of HYD holdings set forth in the accompanying table reflects the systematic and gradual accumulation the four 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 eight 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. Of the four stocks eligible for purchase this month, only **SBC Communications** was not eligible for purchase 18 months earlier (in July 2001), and one issue that was eligible for purchase then, **Caterpillar** is not eligible this month. Investors following the model should find that the indicated purchase of SBC and sales of Caterpillar are sufficiently large to warrant trading. In larger accounts, rebalancing may warrant additional purchases of **JP Morgan Chase** as the model calls for adding to positions that have lagged the entire portfolio. Investors with sizable holdings may be able to track the exact percentages month to month, but smaller accounts should trade less often to avoid excessive transactions costs, only adjusting their holdings toward the percentages in the table if prospective commissions will be less than, say, one percent of the value of a trade. By making such adjustments from time to time, investors should achieve results roughly equal to the fu-

As of January 15, 2003

	Rank	Yield	Price	Status	Percent of Portfolio* Value	Percent of Portfolio* No. Shares†
Philip Morris	1	6.23%	41.12	*		
JP Morgan Chase	2	5.02%	27.08	Holding**	22.1	28.6
General Motors	3	4.98%	40.20	*		
Eastman Kodak	4	4.60%	39.14	Holding**	29.4	26.3
SBC Comm.	5	3.78%	28.54	Buying	14.9	18.3
DuPont	6	3.29%	42.50	Holding**	23.1	19.1
General Electric	7	3.02%	25.19			
Honeywell Int'l	8	2.97%	25.27		—	—
Caterpillar	9	2.97%	47.18	Selling	10.3	7.7
					100.0	100.0

Change in Portfolio Value‡

	1 mo.	1 yr.	5 yrs.	10 yrs.	15 yrs.	From 12/63	Std. Dev.
Strategy	7.5%	5.9%	6.5%	14.2%	16.6%	15.8%	19.1
Dow	3.6%	-11.1%	4.1%	12.2%	13.1%	10.3%	17.0

* The strategy excludes Philip Morris and General Motors. ** Currently indicated purchases approximately equal to indicated purchases 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.

ture 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., buying 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 four 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 complement of the currently eligible stocks without delay. (This month, the four eligible issues—SBC Communications, Eastman Kodak, and J.P. Morgan Chase—account for a more than 90 percent of the total portfolio value). Any remaining cash will be held in a money-market fund pending subsequent purchases, which will be made whenever the client's holdings of each month's eligible stocks are below the percentages indicated by the strategy by an amount sufficient to warrant a trade.

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

THE DOW JONES INDUSTRIALS RANKED BY YIELD

	Ticker Symbol	Market Prices 1/15/03	Market Prices 12/13/02	Market Prices 1/15/02	12-Month High	12-Month Low	Latest Dividend Amount	Latest Dividend Record Date	Latest Dividend Paid	Indicated Annual Dividend	Indicated Yield† (%)
Philip Morris	MO	**$41.12**	40.98	49.00	57.79	35.40	0.640	12/23/02	1/10/03	2.560	6.23
★ J. P. Morgan Chase	JPM	**$27.08**	23.62	37.87	38.75	15.26	0.340	1/06/03	1/31/03	1.360	5.02
General Motors	GM	**$40.20**	36.52	49.96	68.17	30.80	0.500	11/14/02	12/10/02	2.000	4.98
★ Eastman Kodak	EK	**$39.14**	36.81	26.84	41.08 *H*	25.58	0.900	11/01/02	12/13/02	1.800	4.60
★ SBC Comm.	SBC	**$28.54**	25.75	37.79	39.56	19.57	0.270	1/10/03	2/03/03	1.080	3.78
★ DuPont	DD	**$42.50**	42.56	42.27	49.80	35.02	0.350	11/15/02	12/14/02	1.400	3.29
General Electric	GE	**$25.19**	25.50	38.71	41.84	21.40	0.190	12/31/02	1/27/03	0.760	3.02
Honeywell Intl.	HON	**$25.27**	23.71	30.75	40.95	18.77	0.188	11/20/02	12/10/02	0.750	2.97
Caterpillar	CAT	**$47.18**	44.60	49.75	59.99	33.75	0.350	1/21/03	2/20/03	1.400	2.97
Alcoa	AA	**$22.20**	23.03	34.52	39.75	17.62	0.150	2/07/03	2/25/03	0.600	2.70
International Paper	IP	**$37.91**	34.23	39.00	46.20	31.35	0.250	11/22/02	12/16/02	1.000	2.64
Exxon Mobil	XOM	**$34.93**	35.04	39.30	44.58	29.75	0.230	11/12/02	12/10/02	0.920	2.63
Merck	MRK	**$59.29**	57.34	58.65	64.50	38.50	0.360	12/06/02	1/02/03	1.440	2.43
Boeing	BA	**$33.35**	31.40	39.35	51.07	28.53	0.170	2/07/03	3/07/03	0.680	2.04
3M Company	MMM	**$127.02**	121.77	109.50	131.55	100.00	0.620	11/22/02	12/12/02	2.480	1.95
Citigroup	C	**$37.45**	36.00	49.72	50.56	24.42	0.180	11/04/02	11/22/02	0.720	1.92
Procter & Gamble	PG	**$85.90**	87.41	79.65	94.75	74.08	0.410	10/18/02	11/15/02	1.640	1.91
Coca-Cola	KO	**$44.90**	45.85	44.35	57.91	42.90 *L*	0.200	12/01/02	12/15/02	0.800	1.78
Hewlett-Packard	HPQ	**$20.25**	18.58	23.08	23.60	10.75	0.080	12/18/02	1/08/03	0.320	1.58
United Tech.	UTX	**$64.40**	60.10	61.12	77.75	48.83	0.245	11/15/02	12/10/02	0.980	1.52
Johnson & Johnson	JNJ	**$55.00**	54.91	59.17	65.89	41.40	0.205	2/18/03	3/11/03	0.820	1.49
McDonald's	MCD	**$16.69**	17.34	26.20	30.72	15.17 *L*	0.235	11/15/02	12/02/02	0.235	1.35
Walt Disney	DIS	**$17.99**	16.52	21.48	25.17	13.48	0.210	12/13/02	1/09/03	0.210	1.17
Home Depot, Inc.	HD	**$21.87**	26.39	49.70	52.60	21.06 *L*	0.060	12/05/02	12/19/02	0.240	1.10
American Express	AXP	**$37.67**	35.94	37.75	44.91	26.55	0.080	1/03/03	2/10/03	0.320	0.85
IBM	IBM	**$87.59**	80.00	118.85	120.55	54.01	0.150	11/08/02	12/10/02	0.600	0.69
Wal-Mart Stores	WMT	**$50.59**	50.54	56.87	63.94	43.72	0.075	12/20/02	1/06/03	0.300	0.59
AT&T (r)	T	**$27.46**	27.56	18.82	19.13	5.02 *L*	0.038	12/31/02	2/03/03	0.150	0.55
Intel Corp.	INTC	**$17.35**	17.58	34.68	35.19	12.95	0.020	11/07/02	12/01/02	0.080	0.46
Microsoft Corp.	MSFT	**$56.27**	52.50	69.55	70.00	41.41	0.000	-	-	0.000	0.00

★ BUY. ☆ HOLD. † Based on indicated dividends and market price as of 1/15/03 *H* New 52-week high. *L* New 52-week low. (s) All data adjusted for splits. (r) All data adjusted for reverse splits.

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

	1/15/03	Mo. Earlier	Yr. Earlier
Gold, London p.m. fixing	**351.00**	332.20	284.20
Silver, London Spot Price	**4.73**	4.74	4.55
Copper, COMEX Spot Price	**0.76**	0.72	0.70
Crude Oil, W. Texas Int. Spot	**33.21**	28.44	18.90
Dow Jones Spot Index	**150.85**	143.56	100.48
Dow Jones-AIG Futures Index	**114.49**	109.30	90.26
CRB-Bridge Futures Index	**239.74**	234.78	193.00

Interest Rates (%)

		1/15/03	Mo. Earlier	Yr. Earlier
U.S. Treasury bills -	91 day	**1.18**	1.20	1.58
	182 day	**1.22**	1.26	1.63
	52 week	**1.30**	1.39	1.91
U.S. Treasury bonds -	15 year	**4.78**	4.73	5.45
Corporates:				
High Quality -	10+ year	**5.91**	6.08	6.60
Medium Quality -	10+ year	**6.75**	6.97	7.32
Federal Reserve Discount Rate		**0.75**	0.75	1.25
New York Prime Rate		**4.25**	4.25	4.75
Euro Rates	3 month	**2.85**	2.99	3.33
Government bonds -	10 year	**4.19**	4.48	4.82
Swiss Rates -	3 month	**0.63**	0.74	1.71
Government bonds -	10 year	**2.28**	2.45	3.29

Exchange Rates

	1/15/03	Mo. Earlier	Yr. Earlier
British Pound	**$1.606700**	1.589900	1.436800
Canadian Dollar	**$0.651600**	0.640400	0.629000
Euro	**$1.056700**	1.020800	0.881300
Japanese Yen	**$0.008473**	0.008267	0.007612
South African Rand	**$0.113000**	0.114300	0.084200
Swiss Franc	**$0.723400**	0.692100	0.599700

Securities Markets

	1/15/03	Mo. Earlier	Yr. Earlier
S & P 500 Stock Composite	**918.22**	889.48	1,146.19
Dow Jones Industrial Average	**8,723.18**	8,433.71	9,924.15
Dow Jones Transportation Average	**2,360.51**	2,318.47	2,686.08
Dow Jones Utilities Average	**221.36**	209.10	294.83
Dow Jones Bond Average	**159.34**	155.30	103.15
Nasdaq Composite	**1,438.80**	1,362.42	2,000.91
Financial Times Gold Mines Index	**1,233.62**	1,278.44	928.65
FT African Gold Mines	**2,310.99**	2,372.18	1,099.00
FT Australasian Gold Mines	**1,776.21**	1,697.05	1,251.57
FT North American Gold Mines	**929.99**	973.39	831.10

Coin Prices

	1/15/03	Mo. Earlier	Yr. Earlier	Premium
American Eagle (1.00)	**$360.55**	334.15	286.05	2.72
Austrian 100-Corona (0.9803)	**$343.43**	318.33	272.63	-0.19
British Sovereign (0.2354)	**$86.35**	80.25	69.15	4.51
Canadian Maple Leaf (1.00)	**$360.80**	334.40	286.30	2.79
Mexican 50-Peso (1.2057)	**$423.80**	392.80	336.50	0.14
Mexican Ounce (1.00)	**$351.30**	325.70	278.90	0.09
S. African Krugerrand (1.00)	**$356.95**	331.05	283.85	1.70
U.S. Double Eagle-$20 (0.9675)				
St. Gaudens (MS-60)	**$410.00**	395.00	335.00	20.73
Liberty (Type I-AU)	**$675.00**	675.00	675.00	98.77
Liberty (Type II-AU)	**$410.00**	385.00	385.00	20.73
Liberty (Type III-AU)	**$390.00**	362.50	322.50	14.84
U.S. Silver Coins ($1,000 face value)				
90% Silver (715 oz.)	**$4,550.00**	4,550.00	4,500.00	34.54
40% Silver (292 oz.)	**$1,587.50**	1,587.50	1,525.00	14.94
Silver Dollars	**$6,112.50**	6,075.00	5,850.00	67.05

Note: Premium reflects percentage difference between coin price and value of metal in a coin, with gold at $351.00 per ounce and silver at $4.73 per ounce. The weight in troy ounces of the precious metal in coins is indicated in parentheses.

Recommended Mutual Funds

	Ticker Symbol	1/15/03	Month Earlier	Year Earlier	— 52-Week — High	Low	Distributions Latest 12 Months Income	Capital Gains	Yield (%)
Short-Term Bond Funds									
★ iShares Lehman 1-3 Yr Treasury	SHY	**$82.06**	81.90	NA	82.42	81.00	0.6400	0.0000	1.87
★ Fidelity Target Time Line 2003	FTARX	**$9.55**	9.54	9.57	9.57	9.41	0.3630	0.0000	3.80
★ USAA Short Term Bond	USSBX	**$9.03**	8.98	9.61	9.62	8.89	0.4867	0.0000	5.39
★ Vanguard Short-term Corporate	VFSTX	**$10.77**	10.73	10.89	10.89	10.58	0.5772	0.0000	5.36
Income Equity Funds									
★ DNP Select Income[1, 2]	DNP	**$10.54**	9.87	11.16	11.62	7.85	0.7800	0.0000	7.40
★ Vanguard REIT Index	VGSIX	**$11.67**	11.98	12.18	13.69	10.94	0.7600	0.0000	6.51
Large Cap. Value Equity Funds									
★ iShares S&P 500 Value Index[3]	IVE	**$45.06**	43.20	54.88	56.94	35.91	0.7824	0.1472	1.74
★ Vanguard Value Index	VIVAX	**$15.35**	14.77	18.75	19.46	12.38	0.3150	0.0000	2.05
Small Cap. Value Equity Funds									
★ iShares Sm. Cap. 600 Value Index[3]	IJS	**$73.81**	73.50	85.86	99.67	62.50	0.6224	0.3430	0.84
★ Vanguard Sm. Cap Value Index	VISVX	**$8.67**	8.72	10.33	11.66	7.43	0.0900	0.2760	1.04
Growth Equity Funds									
★ iShares S&P 500 Growth Index[3]	IVW	**$46.76**	45.75	59.69	60.68	40.02	0.4389	0.1124	0.94
★ Vanguard Growth Index	VIGRX	**$20.76**	20.38	26.57	26.81	18.25	0.2270	0.0000	1.09
Foreign Equity Funds									
★ iShares S&P Europe 350 Index[3]	IEV	**$48.16**	47.46	57.48	60.78	41.40	0.9307	0.0000	1.93
T Rowe Price European Stock	PRESX	**$13.07**	12.86	15.69	16.22	11.34	0.1400	0.0000	1.07
★ Vanguard European Stock Index	VEURX	**$16.57**	15.97	19.74	20.55	14.55	0.4000	0.0000	2.41

Recommended Gold-Mining Companies

	Ticker Symbol	1/15/03	Month Earlier	Year Earlier	— 52-Week — High	Low	Distributions Latest 12 Months	Frequency	Yield (%)
Anglo American PLC, ADR	AAUK	**$14.81**	13.94	16.40	19.61	10.84	0.460	Semiannual	3.11
★ Anglogold Ltd., ADR	AU	**$34.01**	33.99	20.01	36.98	18.75	1.129	Semiannual	3.32
ASA Ltd.[1]	ASA	**$38.80**	39.30	21.63	42.85	20.55	0.600	Quarterly	1.55
★ Barrick Gold Corp.†	ABX	**$15.15**	16.00	17.41	23.49	13.46	0.220	Semiannual	1.45
★ Gold Fields Ltd.	GFI	**$13.25**	14.68	5.88	17.15	5.60	0.273	Semiannual	2.06
★ Newmont Mining	NEM	**$27.50**	29.00	20.60	32.75	19.65	0.120	Quarterly	0.44
★ Placer Dome†	PDG	**$11.00**	11.36	12.16	14.74	7.91	0.100	Semiannual	0.91
★ Rio Tinto PLC‡	RTP	**$79.56**	77.60	76.81	86.00	61.10	3.359	Semiannual	4.22

★ 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.