# INVESTMENT GUIDE

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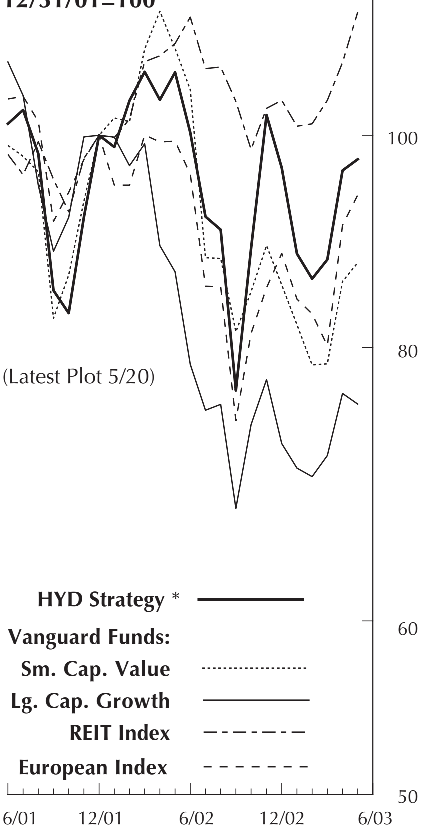
**Equity Performance**
**12/31/01=100**




*** HYD is a hypothetical model based on back-tested results. See p. 38 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.

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## Minding Wall Street

In late April regulators announced the final terms of a deal reached with ten Wall Street securities firms following a two-year investigation of analysts' practices. If the intention was to restore faith in Wall Street, count us among those who consider the deal a failure. The market showed no immediate reaction; the major indexes hardly reacted following the announcement.

The terms of the settlement include fines totaling $1.4 billion and disciplinary action against two well-known analysts. New rules were also established that will supposedly keep separate the work of analysts and that of their investment banking colleagues. The regulators found that analysts' compensation was directly related to their willingness to report "buy" ratings for high-risk stocks that the investment banking side was selling to the public. Internal documents were made public that revealed blatant efforts to exhort analysts to tout such stocks. In our view it is this shedding of daylight that will have the most impact by enabling the market to apply its own discipline.

The settlement also called for the ten firms to establish a $432-million fund to finance outside, stand-alone analysts who will generate reports to be published alongside those of the firms' own analysts—ostensibly to dissuade the latter from issuing biased research.

We believe that this arrangement will do little to improve the image of Wall Street analysts. It is questionable whether these stand-alone firms will remain any more objective than the "inside" analysts; after all, under the terms of the deal the independents still must contract with firms that derive the lion's share of their revenues from underwriting securities.

The settlement amounts to little more than an attempt to ensure that in the future worthless recommendations will be derived in an unbiased fashion. Even assuming objectivity is maintained, the sort of analysis propagated by Wall Street is simply not worth anything. Mountains of studies demonstrate the futility of attempting to pick "hot stocks." In our view there is a huge burden of proof upon anyone who asserts that he possesses a unique ability to consistently exploit publicly available information in order to trade stocks profitably. Investment research should instead be confined to an empirical review of asset-class behavior over the long term.

We suspect that the story is hardly over, and that as events unfold investors will increasingly turn to structured investing rather than rely on the whims of "professional" stock pickers. We have great faith that while individual investors cannot outsmart the market, most are smarter than Wall Street.

## GOLD MARKET SURVEY

We have long advocated maintaining gold investments as a form of insurance. It is a worthwhile exercise to periodically review the many good reasons for doing so. For thousands of years gold has been prized as a store of value. Nations may rise and fall, currencies come and go, but gold endures. It is a secure asset that can be liquidated at any time, under virtually any circumstances. During times of market panics gold can be the most effective, and often the only, means of raising cash. Holding a portion of your portfolio in gold can be invaluable. It is also a very useful tool in diversification. Gold prices are influenced by a unique set of factors and exhibit low correlation to other financial assets.

Gold had a strong year in 2002 and regained its position as a world reserve currency. The steady improvement in 1999 and 2000, a period of relative financial and political stability, provided a strong base for the 2002 run up in price. When the need for risk management arose amid weakening global fundamentals, professional money managers and investors rediscovered gold after post-Y2K selling. Gold prices averaged $309.68 in 2002, an increase of 14.3 percent. According to the World Gold Council, gold outperformed all the major world currencies by nine to 25 percent over the year. Gold also outperformed most major equity markets, beating the Dow by 47 percent, the FTSE by 52 percent, the Nikkei by 44 percent, and the European Index by 36 percent. Gold Fields Mineral Services Ltd., a London-based commodity research firm and the leading authority on the world gold market, released its annual Gold Survey on April 10th. The following is our review of their findings.

### Supply

Total worldwide mine production, the largest component of supply, was down marginally by 36 tons or 1.4 percent to 2,587 tons. Lower-grade ore production from older United States mines and the closure of the world's largest mine, Grasberg in Indonesia, were major factors in the decline. The weighted-average costs of production rose four percent in 2002, due in part to the impact of the depreciation of the Rand on South African producers. On the upside, South Africa increased production for the first time since 1993.

Central bank sales reached 556 tons, a rise of five percent over 2001. The heavy selling, concentrated in the fourth quarter, was triggered by the strong gold price. Official sector sales are limited by the Central Bank Gold Agreement (see box on p. 35). Lending fell by 226 tons because of low lease rates and concerns over counterparty credit risk.

Scrap gold amounted to 835 tons representing 21 percent of total supply in 2002. The higher gold price and currency concerns drove the volumes of scrap supplies worldwide with the steepest increases in the Middle East and India.

### Demand

The demand for gold was strong in 2002 with a 25 percent price increase over the prior year. Geopolitical concerns spurred the run-up in gold prices prior to the U.S.-led war on Iraq. While those uncertainties persist, poor economic news drives continuing demand as investors seek safe havens from the poor results of both equity and bond markets.

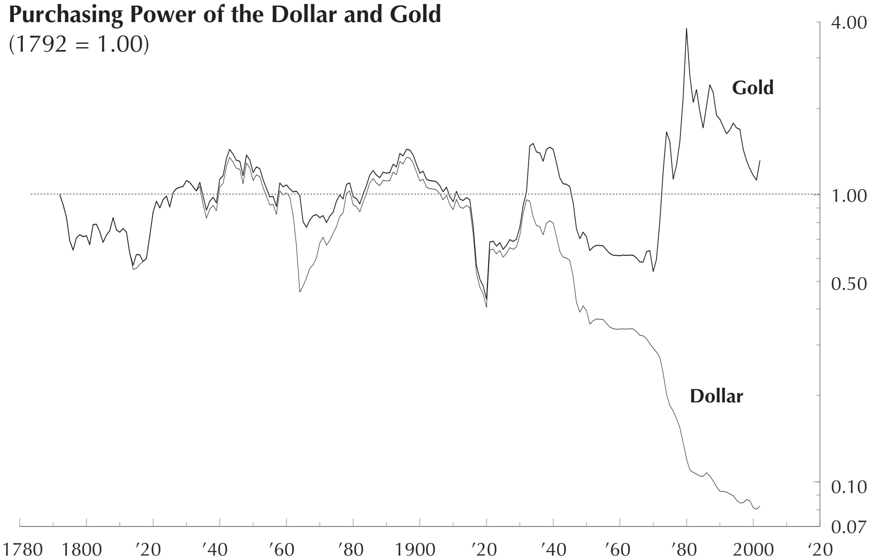
Total gold demand rose by just one percent as strong investment gains were offset by a slowdown in fabrication, which decreased sharply to 3,175 tons (down 10 percent). Jewelry demand suffered from a poor monsoon in India, the world's largest market. Total worldwide jewelry fabrication demand was off 11 percent to 2,689 tons, its lowest level since 1994. India saw a decline of over 19 percent or 120 tons, the Middle East declined by 10 percent, and East Asia declined by 12 percent. European fabrication was down 12 percent due to weak domestic demand and lower exports to the United States.

Industrial and decorative demand fell by 19 percent to 82 tons. Electronics demand rose slightly to 210 tons; lower usage in the suffering IT and telecom sectors has slowed growth over the last several years. The Gold Field's Survey notes that the inability of fabrication to withstand the price rise indicates weak fundamentals in the world economy.

Official coin fabrication rose by 22 percent to 69 tons and bar hoarding was up two percent to 252 tons. Implied net investment increased to 128 tons. The total value of net world investment in 2002 was just $4.5 billion, a small figure relative to total available investment. Investment has been limited to specialized "boutique" funds and private individuals. The pro-gold economic and political fundamentals suggest upside potential for investment, Gold Fields notes.

The largest component of demand was producer dehedging of 423 tons as the reversal in the gold price prompted many producers to unwind their positions. The narrow contango[1], shareholder pressure,

**Purchasing Power of the Dollar and Gold**
(1792 = 1.00)




Note: On April 2, 1792, Congress established the dollar (then legally equivalent to 24.75 grains of pure gold) as the Nation's monetary unit. The changes in purchasing power shown in the chart were calculated from annual averages of the wholesale price index (source: U.S. Department of Labor) and the annual averages of the exchange ratio of dollars for gold. The precision of these data may be questioned, particularly with respect to the absolute level of the purchasing power of gold over long periods.

[1] When the forward price exceeds the spot price, the difference is called the "contango." When the price condition is reversed it is called "backwardation."

and consolidation of mining companies also contributed.

This was the third consecutive year that producers have reduced their hedge positions. According to Gold Fields the scale-back was mostly attributable to scheduled delivery into outstanding contacts. The three biggest hedging companies, AngloGold, Barrick, and Placer Dome, accounted for 80 percent of the decline in forwards. The combination of investor interest and dehedging created a self-fulfilling momentum for the gold price as higher spot prices prompted mining companies to dehedge which, in turn, put upward pressure on the gold price.

### Price Outlook for 2003

Gold Fields projects a strong repeat performance for gold in 2003. After a postwar lull in demand, the underlying economic and political factors that prompted investor interest in 2002 will return. Continued producer dehedging and investment demand should compensate for weak fabrication demand. If, as projected, interest rates remain low, the gold-price contango will not provide an incentive to hedge.

The Iraq war diverted attention from the global economy but has done nothing to improve the outlook. Sluggish growth in Europe, deflation in Japan, and continued weakness in the United States pose challenges to corporate profits and stock prices. With interest rates at historic lows and recent indications from the U.S. Treasury that it will not take market action to support the dollar, investors may seek nondollar vehicles.

On the political front, it appears that the quick victory in Iraq has not eased international tensions. In fact the recent bombings in Riyad and the increased Isreali-Palistinian violence suggest that instability will increase. Disagreement between Washington and Western European allies has had a chilling effect on international relations and casts doubts on the credibility and future role of the United Nations. The potential for further unilateral U.S. action against rogue states and the ongoing war on terrorism create an environment of global uncertainty.

In Gold Field's estimation, these factors point to a positive outlook for gold.

### Hedging

The resurgence of the gold price over the past year has revived the long-standing debate about hedging by gold mining companies.

### The Washington Agreement on Gold (WAG)

Central banks hold nearly 25 percent of the above-ground world gold supply and their actions have tremendous impact on the world market. In 1999 15 European central banks signed the "Washington Agreement" (now known as the Central Bank Gold Agreement). The accord was aimed at stabilizing the world gold market by coordinating central-bank sales. A lack of clarity regarding the central banks' commitment to holding gold and their increasing use of derivatives was impeding the efficient workings of the world gold market.

The agreement affirms official-sector support to a transparent and functioning gold market. The "Statement on Gold" includes the following:

1. Gold will remain an important element of global monetary reserves.
2. The institutions will not enter the markets as sellers, with the exception of previously agreed upon sales.
3. Gold sales already scheduled will be achieved through a concerted program of sales over the period and will not exceed 2,000 tons.
4. The signatories agree not to expand gold leasing and their use of gold futures and options
5. The agreement will be reviewed after five years.

The signatories agreed to limit annual sales of gold to 400 tons over a five-year period. The U.S. Federal Reserve, the International Monetary Fund, the Bank for International Settlements, and the Central Banks of Australia and Japan later became non-signatory participants. The agreement has brought stability to the gold price by limiting sales of the largest holders. Of the 32,000 tons of gold held by the world's central banks, 46 percent is held by the 15 European signatories, 25 percent is held by the US Federal Reserve, and 10 percent by the International Monetary Fund. The Japanese central bank and smaller central banks hold the balance.

The Agreement expires in September 2004. No renewal announcement has been made.

The sudden increase in the gold price revealed marked differences in the hedging programs of various gold mining companies. In particular, it now appears that some of the major producers had a poor understanding of hedging and had adopted strategies designed to protect against further decreases in the gold price, but had left them exceptionally vulnerable when the gold price reversed its course.

### Hedging Techniques

Beginning in the late 1960s, when the price of newly mined gold began to float (*i.e.*, when central banks ceased buying and selling gold at fixed prices), futures contracts traded on exchanges that enabled producers and consumers to sell (or buy) gold for delivery at some future date. In addition, the markets soon offered "option" contracts providing for future sale or purchase of gold at a set price. These are similar to forward contracts except that they may be exercised at only one party's discretion. A "call" provides its holder the right to buy at the set price from the issuer or "writer," whereas a "put" enables its holder to sell.

Futures trading and options enabled gold producers to "lock in" prices at which future gold production could be sold profitably, and it enabled users of gold to "lock in" future costs. This was fairly straightforward and the basic functioning of the gold-futures markets is similar to that many other commodities.

In general, prices for future delivery are higher than the current or "spot" price for immediate delivery; how much higher reflects the cost of holding the item (interest or borrowings to finance immediate purchases and possibly the cost of storage). As mentioned earlier, when the spot price is less than the forward price, the difference is known as the contango. The opposite situation is known as backwardation, which typically reflects a sudden and severe supply disruption at a time when there are relatively low stocks on hand in relation to production and consumption. Backwardations have almost never been observed in the gold market, presumably because at any given time gold holdings in "good-delivery" form are many times annual production and use. Perhaps because of this unique aspect of the gold market, contracts especially tailored to the gold industry have been developed.

**Average Gold Leasing Rates**

| | *1-month* | *3-month* | *6-month* | *12-month* |
|---|---|---|---|---|
| 2000 | 0.6% | 0.8% | 1.0% | 1.5% |
| 2001 | 1.3% | 1.3% | 1.4% | 1.7% |
| 2002 | 0.3% | 0.4% | 0.6% | 0.9% |

One of the earliest of these was the **gold loan**. Large commercial banks would borrow gold from a central bank. Such "bullion banks" would then re-lend the gold to a mining company that would resell the gold in the spot market for cash and use the proceeds to develop and improve its gold mines and processing facilities. This benefited all the parties concerned: the mining company obtained financing at a favorable interest rate, the central bank earned some interest on what otherwise would have been a non-earning asset, and the bullion bank received fees and spreads in exchange for absorbing the risk of default. This arrangement is depicted in the accompanying diagram.

Later on this arrangement came to be used not to finance production facilities but as a way for producers to obtain more revenue than would be received by simply selling all current production at the spot price. If the gold producer placed the proceeds of the borrowed gold in an interest-bearing account rather than developing its facilities, the company effectively sold gold at the forward price in effect when the gold was borrowed. When the gold is returned to the bullion bank, the borrower will have received the spot price at the time the gold was borrowed plus the interest on the proceeds of the spot sale. Such **forward-sale contracts** offer several advantages over simply selling in the futures market on an exchange.

For one, unlike selling short in the futures market, when a gold producer enters into a forward-sales contract there are no concerns about meeting margin calls if the spot price should rise. When a forward-sales contract matures, and the spot price is higher than the price received by the company plus interest, the loss is an opportunity cost (*i.e.*, the company might have made more by simply selling at the spot price), but not a cash drain on the company's finances. More importantly, forward-sales contracts are negotiated individually and their terms may be varied to suit the needs of the parties concerned. For example, the duration of the contract may be much longer than what is available on exchange-traded futures.

A wide variety of forward-sales contracts exist, whose terms vary from the arrangement described above. The major variations include: **floating gold rate forward** where the interest rate on the borrowed gold is calculated in the light of market experience, **floating forward** where the interest rate on both the gold and the dollar deposit are variable, and **spot deferred** where the rates float and the maturity date can be postponed.

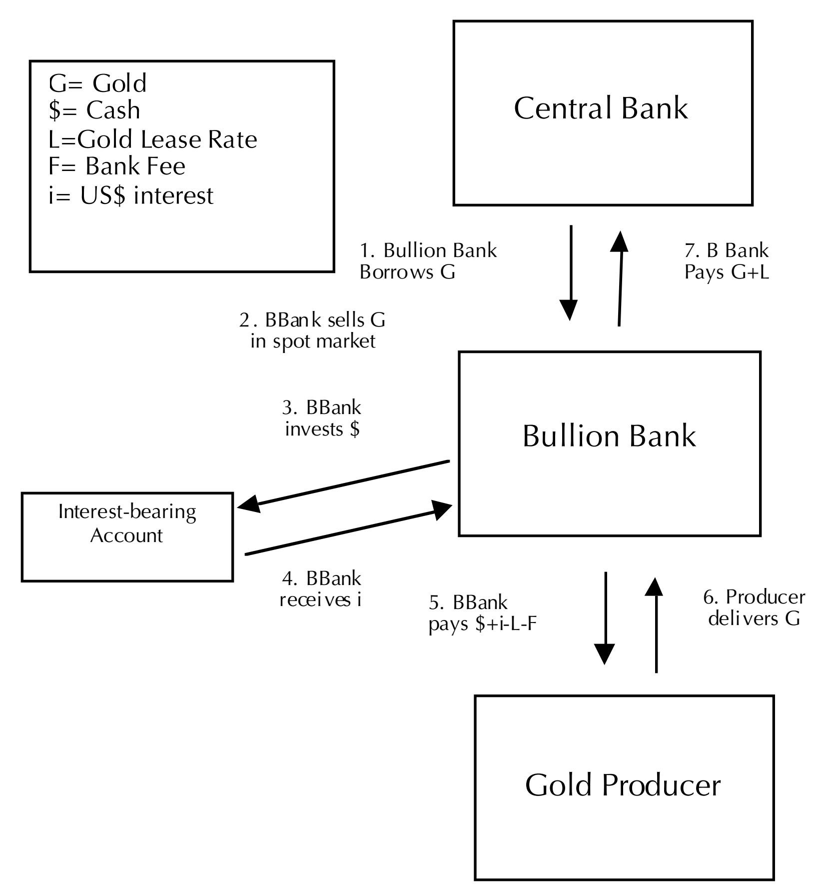
These types of contracts are usually available only to well-financed and established gold producers, with spot deferred contracts being available only to the very soundest companies. Options and futures are generally the mainstay of the "hedge books" of the weaker companies, though the major companies with large forward contracts can also employ these.

### The Controversies

Hedging has long been controversial in the gold mining industry. From the standpoint of an individual producer, critics note that when future output is committed to be sold at a fixed price via forward contracts, short sales in the futures market, or the writing of calls, the company stands to miss out on a portion of an increase in the price of gold. Similarly, if the company purchases puts to protect it against a decrease in the gold price, it will lose the premium paid if the puts expire "out of the money." For such reasons, some companies, such as Newmont Mining, have steadfastly refused to hedge at all, preferring to sell all the output in the spot market.

For the industry as a whole, critics have alleged that forward contracts have caused bullion to be brought to market before it has been produced and that this has depressed the price of gold. There is

**Mechanics of a Gold Loan**



**An example:**

| | | | |
|---|---|---|---|
| | Spot price of gold | $350 | |
| | Contract period | 3 years | |
| | Dollar interest rate | 5.5% | |
| | Gold lease rate | 2.0% | |
| | Contango | 3.5% | |
| *Year* | *Value of contract* | *Annual Contango* | *Value at Year end* |
| One | $350.00 | $12.25 | $362.25 |
| Two | $362.25 | $12.67 | $374.92 |
| Three | $374.92 | $13.12 | $388.04 |

some evidence that this has happened from time to time—rallies in the gold price may have been stunted by increases in forward selling by the mines—but it is hard to see how the timing of sales would increase or decrease the supply of gold over the long term.

As for the first charge, the events of this fall demonstrate that the effects of hedging are far more dependent on the way it is done, and on its extent in relation to a producer's resources, than whether it is done at all. Hedging has been of great benefit to companies that could, in effect, sell their production at prices in excess (sometimes well in excess) of the spot price of gold, when that price was falling. But when the price of gold soared as it did recently, the weakness of some companys' hedge books was astonishing.

In short, hedging serves to limit the effects of market-price swings both up and down, but it must be done properly and related to the resources involved. Hedging becomes speculation if it decreases the risk of only one possible price fluctuation (up or down) while increasing exposure to the other.

## QUALITY GOLD MINING COMPANIES

We advocate gold ownership via gold mining companies that have "gold in the ground." Of the many gold mining companies in the world, very few are suitable for investors instead of speculators. Our recommended gold-mining companies have long-lived reserves, are well financed, and pay dividends. We begin a series of articles on our recommended mining companies this month with Newmont Mining Corporation.

### Newmont Mining Corporation

Newmont Mining (ticker **NEM**) is one of the world's largest gold producers. The firm has 86.9 million equity ounces[1] in gold reserves and operates in ten countries. The bulk of the firm's production is derived from Nevada, Peru, Australia, and Indonesia. Last year the firm sold 7.6 million equity ounces of gold, the highest level in the firm's history, at an average realized price of $313 per ounce and a total cash cost of $189 per ounce.

Newmont does not hedge its gold sales, and last year shareholders benefited from this policy. Newmont's share price rose 52% for the year, while the gold price rose only 25%. Net income for the year was $154.3 million, versus a 2001 loss of $54 million. The solid results prompted management to boost the dividend from $0.03 to $0.04 in January.

The firm's finances are strong. At year-end Newmont's balance sheet revealed assets of $10.2 billion with a cash position of $402 million and long term debt of $1.86 billion.

Early in the year Newmont completed the acquisition of Normandy Mining, Australia's largest gold company, and Franco Nevada for roughly $4.3 billion, expanding its global presence and gaining several ongoing income streams as well as untapped properties. Management is confident the acquisitions will add value by reducing overhead and achieving operating synergies.

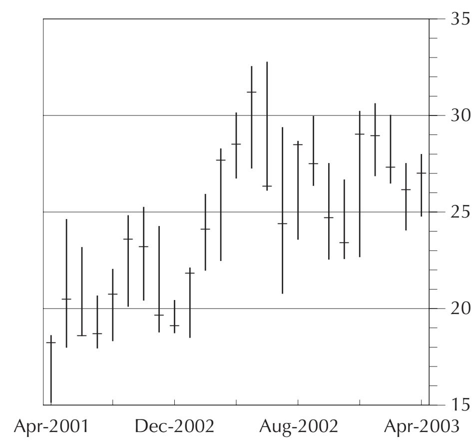
North American mines in Nevada account for the largest portion of Newmont's output, with over 2.7 million equity ounces sold during 2002, or 36% of total sales, at an average cost of $220 per ounce. New projects located near existing mines suggest that Nevada will continue to be a dependable source of cash in coming years. The firm is projecting continued sales from the region at roughly the same level for the next five years. Newmont holds additional properties in Canada, California, and Mexico. North American properties account for 40% of Newmont's gold reserves.

Newmont also owns 51.4% of Minera Yanacocha, an entity with properties located 370 miles north of Lima, where gold was discovered in 1986. Five open-pit mines there comprise the largest gold mining region in South America, whose sales totaled 1.4 million equity ounces or 18.6% of total sales produced at a cost of $131 per ounce.

Australia accounted for sales of 1.7 million equity ounces in 2002, or 22% of the firm's total, at an average cash cost of $191. Newmont has evolved as Australia's largest gold producer following the acquisitions of Battle Mountain Gold in 2001 and last year's purchase of Normandy Mining. Cash costs were negatively affected by unfavorable exchange rates, but output exceeded expectations for the year. The largest mine is Kalgoorlie in Western Australia, which accounted for 325,000 ounces, in which Newmont holds a 50% interest. The Pajingo underground mine in Queensland came to Newmont through the acquisition of Battle Mountain Gold and produced 296,000 ounces at a total cost of only $95 per ounce. Tanami, in the Northern Territory, and Yandal in the west, accounted for a combined 1.1 million equity ounces.

Newmont holds a 56% interest in the Batu Hijau mining operation in Indonesia. The facility produces gold as well as copper, and is one of the world's lowest net-cash-cost copper facilities. Batu Hijau produced 278,000 equity ounces of gold and 362 million equity pounds of copper during 2002.

**Newmont Mining**




[1] "Equity ounces" represent total production attributable to the firm, including output prorated to reflect the firm's stake in joint ventures.

## THE HIGH-YIELD DOW INVESTMENT STRATEGY

We are convinced that long-term, common-stock investors will receive superior returns on the "large-capitalization-value stock" 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 of the four highest-yielding Dow issues, excluding General Motors and Altria (formerly 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 Altria 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, Altria has never ranked lower than fourth on the list, whatever its ups and downs, and, given the circumstances, using Altria 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** and **AT&T** were not eligible for purchase 18 months earlier (in November 2001), and two issues that were eligible for purchase then, **Caterpillar** and **Dupont** are not eligible this month. Investors following the model should find that the indicated purchases of SBC and AT&T, and sales of Caterpillar and Dupont are sufficiently large to warrant trading. In larger accounts, rebalancing positions in **Eastman Kodak** and **JP Morgan Chase** may be warranted as the model calls for adding to positions that have lagged the entire portfolio and lightening up on positions that have done better than the portfolio as a whole. 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.

*As of May 15, 2003*

| | | | | | ——Percent of Portfolio*—— | |
|---|---|---|---|---|---|---|
| | *Rank* | *Yield* | *Price* | *Status* | *Value* | *No. Shares*[1] |
| Altria Group | 1 | 7.59% | 33.74 | * | | |
| Eastman Kodak | 2 | 6.00% | 30.02 | Holding** | 23.66 | 23.77 |
| General Motors | 3 | 5.73% | 34.88 | * | | |
| SBC Comm. | 4 | 4.56% | 24.76 | Buying | 18.98 | 23.12 |
| JP Morgan Chase | 5 | 4.38% | 31.04 | Holding** | 27.81 | 27.03 |
| AT&T | 6 | 4.30% | 17.44 | Buying | 5.88 | 10.18 |
| DuPont | 7 | 3.29% | 42.60 | Selling | 17.67 | 12.51 |
| Honeywell Int'l | 8 | 2.98% | 25.15 | | | |
| Exxon Mobil | 9 | 2.83% | 35.29 | | | |
| International Paper | 10 | 2.67% | 37.42 | | | |
| Caterpillar | 13 | 2.62% | 53.40 | Selling | 5.97 | 3.37 |
| | | | | | 100.0 | 100.0 |

*Change in Portfolio Value*[2]

| | *1 mo.* | *1 yr.* | *5 yrs.* | *10 yrs.* | *15 yrs.* | *From 12/63* | *Std. Dev.* |
|---|---|---|---|---|---|---|---|
| Strategy | 7.42% | -8.11% | 3.57% | 12.70% | 15.66% | 15.56% | 19.45 |
| Dow | 6.08% | -9.37% | 1.71% | 12.18% | 13.26% | 10.41% | 17.09 |

* The strategy excludes Altria and General Motors. ** Currently indicated purchases approximately equal to indicated purchases 18 months ago. [1] 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. [2] 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.

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.

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., 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, AT&T, Eastman Kodak, and J.P. Morgan Chase—account for roughly three-fourths 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 5/15/03* | *Market Prices 4/15/03* | *Market Prices 5/15/02* | *12-Month High* | *12-Month Low* | *Latest Dividend Amount* | *Latest Dividend Record Date* | *Latest Dividend Paid* | *Indicated Annual Dividend* | *Indicated Yield† (%)* |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Altria Group | MO | **$33.74** | 32.45 | 53.59 | 57.79 | 27.70 | 0.640 | 3/14/03 | 4/09/03 | 2.560 | 7.59 |
| ★ Eastman Kodak | EK | **$30.02** | 31.67 | 33.79 | 41.08 | 25.59 | 0.900 | 6/02/03 | 7/16/03 | 1.800 | 6.00 |
| General Motors | GM | **$34.88** | 35.17 | 67.30 | 68.17 | 29.75 | 0.500 | 5/16/03 | 6/10/03 | 2.000 | 5.73 |
| ★ SBC Comm. | SBC | **$24.76** | 21.25 | 33.41 | 44.75 *H* | 18.85 | 0.283 | 4/10/03 | 5/01/03 | 1.130 | 4.56 |
| ★ J. P. Morgan Chase | JPM | **$31.04** | 26.87 | 36.96 | 38.75 | 15.26 | 0.340 | 4/04/03 | 4/30/03 | 1.360 | 4.38 |
| ★ AT&T (r) | T | **$17.44** | 13.73 | 13.51 | 29.52 | 13.45 *L* | 0.188 | 3/31/03 | 5/01/03 | 0.750 | 4.30 |
| ☆ DuPont | DD | **$42.60** | 40.81 | 46.63 | 47.48 | 34.71 | 0.350 | 5/15/03 | 6/12/03 | 1.400 | 3.29 |
| Honeywell Intl. | HON | **$25.15** | 22.39 | 39.25 | 39.51 | 18.77 | 0.188 | 5/20/03 | 6/10/03 | 0.750 | 2.98 |
| Exxon Mobil | XOM | **$35.29** | 35.05 | 39.71 | 41.10 | 29.75 | 0.250 | 5/13/03 | 6/10/03 | 1.000 | 2.83 |
| International Paper | IP | **$37.42** | 34.06 | 44.99 | 45.20 | 31.35 | 0.250 | 5/23/03 | 6/16/03 | 1.000 | 2.67 |
| General Electric | GE | **$28.48** | 28.30 | 30.93 | 33.45 | 21.30 | 0.190 | 2/28/03 | 4/25/03 | 0.760 | 2.67 |
| Alcoa | AA | **$22.75** | 22.59 | 36.07 | 36.85 | 17.62 | 0.150 | 5/02/03 | 5/25/03 | 0.600 | 2.64 |
| ☆ Caterpillar | CAT | **$53.40** | 52.70 | 56.00 | 56.35 | 33.75 | 0.350 | 4/21/03 | 5/20/03 | 1.400 | 2.62 |
| Merck | MRK | **$59.53** | 56.93 | 56.90 | 60.48 | 38.50 | 0.360 | 3/07/03 | 4/01/03 | 1.440 | 2.42 |
| Boeing | BA | **$30.16** | 27.29 | 44.55 | 46.03 | 24.73 | 0.170 | 5/16/03 | 6/06/03 | 0.680 | 2.25 |
| 3M Company | MMM | **$125.85** | 133.64 | 129.50 | 136.75 | 108.20 | 0.660 | 5/23/03 | 6/12/03 | 2.640 | 2.10 |
| Citigroup | C | **$39.45** | 39.25 | 45.76 | 47.09 | 24.42 | 0.200 | 5/05/03 | 5/23/03 | 0.800 | 2.03 |
| Coca-Cola | KO | **$44.64** | 42.53 | 56.69 | 57.50 | 37.01 | 0.220 | 6/15/03 | 7/01/03 | 0.880 | 1.97 |
| Procter & Gamble | PG | **$89.90** | 89.88 | 92.15 | 94.75 | 74.08 | 0.410 | 4/17/03 | 5/15/03 | 1.640 | 1.82 |
| Hewlett-Packard | HPQ | **$17.63** | 15.57 | 19.35 | 21.20 | 10.75 | 0.080 | 3/19/03 | 4/09/03 | 0.320 | 1.82 |
| Johnson & Johnson | JNJ | **$55.44** | 55.98 | 60.24 | 62.60 | 41.40 | 0.240 | 5/20/03 | 6/10/03 | 0.960 | 1.73 |
| United Tech. | UTX | **$67.77** | 63.71 | 70.45 | 72.06 | 48.83 | 0.270 | 5/16/03 | 6/10/03 | 1.080 | 1.59 |
| McDonald's | MCD | **$18.60** | 15.85 | 30.06 | 30.72 | 12.12 | 0.235 | 11/15/02 | 12/02/02 | 0.235 | 1.26 |
| Walt Disney | DIS | **$18.46** | 18.31 | 24.50 | 24.98 | 13.48 | 0.210 | 12/13/02 | 1/09/03 | 0.210 | 1.14 |
| Home Depot, Inc. | HD | **$29.37** | 27.16 | 47.00 | 49.50 | 20.10 | 0.060 | 3/13/03 | 3/27/03 | 0.240 | 0.82 |
| American Express | AXP | **$40.99** | 36.90 | 44.87 | 44.91 | 26.55 | 0.080 | 4/04/03 | 5/09/03 | 0.320 | 0.78 |
| IBM | IBM | **$89.90** | 82.79 | 84.50 | 90.40 *H* | 54.01 | 0.160 | 5/09/03 | 6/10/03 | 0.640 | 0.71 |
| Wal-Mart Stores | WMT | **$53.76** | 55.29 | 56.77 | 59.30 | 43.72 | 0.090 | 3/21/03 | 4/07/03 | 0.360 | 0.67 |
| Intel Corp. | INTC | **$20.00** | 17.13 | 30.24 | 31.36 | 12.95 | 0.020 | 5/07/03 | 6/01/03 | 0.080 | 0.40 |
| Microsoft Corp. (s) | MSFT | **$25.79** | 24.61 | 27.38 | 29.48 | 20.71 | 0.080 | 2/21/03 | 3/07/03 | 0.080 | 0.31 |

★ BUY. ☆ HOLD. † Based on indicated dividends and market price as of 5/15/03 *H* New 52-week high. *L* New 52-week low. (s) All data adjusted for splits. (r) All data adjusted for reverse splits. * SBC paid an extra dividend of 0.05 on 5/1/03 that is not included in the annual yield.

Note: The issues indicated for purchase (★) are the 4 highest yielding issues (other than Altria Group 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

| | 5/15/03 | Mo. Earlier | Yr. Earlier |
|---|---|---|---|
| Gold, London p.m. fixing | **354.25** | 325.45 | 308.30 |
| Silver, London Spot Price | **4.87** | 4.52 | 4.60 |
| Copper, COMEX Spot Price | **0.76** | 0.73 | 0.74 |
| Crude Oil, W. Texas Int. Spot | **28.74** | 29.29 | 28.15 |
| Dow Jones Spot Index | **152.96** | 145.89 | 126.61 |
| Dow Jones-AIG Futures Index | **119.21** | 113.47 | 99.92 |
| CRB-Bridge Futures Index | **240.63** | 231.73 | 204.01 |

## Interest Rates (%)

| | | | | |
|---|---|---|---|---|
| U.S. Treasury bills - | 91 day | **1.05** | 1.17 | 1.75 |
| | 182 day | **1.09** | 1.18 | 1.90 |
| | 52 week | **1.12** | 1.24 | 2.36 |
| U.S. Treasury bonds - | 15 year | **4.03** | 4.60 | 5.78 |
| Corporates: | | | | |
| High Quality - | 10+ year | **5.17** | 5.84 | 7.03 |
| Medium Quality - | 10+ year | **5.79** | 6.44 | 7.88 |
| Federal Reserve Discount Rate | | **2.25** | 2.25 | 1.25 |
| New York Prime Rate | | **4.25** | 4.25 | 4.75 |
| Euro Rates | 3 month | **2.43** | 2.52 | 3.42 |
| Government bonds - | 10 year | **3.86** | 4.17 | 5.09 |
| Swiss Rates - | 3 month | **0.30** | 0.30 | 1.28 |
| Government bonds - | 10 year | **2.27** | 2.53 | 3.28 |

## Exchange Rates

| | | | |
|---|---|---|---|
| British Pound | **$1.625600** | 1.576600 | 1.459400 |
| Canadian Dollar | **$0.727300** | 0.690800 | 0.643200 |
| Euro | **$1.148400** | 1.084200 | 0.912400 |
| Japanese Yen | **$0.008621** | 0.008313 | 0.007848 |
| South African Rand | **$0.128200** | 0.130000 | 0.098600 |
| Swiss Franc | **$0.763500** | 0.722220 | 0.626900 |

## Securities Markets

| | 5/15/03 | Mo. Earlier | Yr. Earlier |
|---|---|---|---|
| S & P 500 Stock Composite | **946.67** | 890.81 | 1,091.00 |
| Dow Jones Industrial Average | **8,713.14** | 8,402.36 | 10,243.68 |
| Dow Jones Transportation Average | **2,436.79** | 2,316.62 | 2,797.98 |
| Dow Jones Utilities Average | **230.65** | 216.82 | 293.90 |
| Dow Jones Bond Average | **172.20** | 165.42 | 138.56 |
| Nasdaq Composite | **1,551.38** | 1,391.01 | 1,725.56 |
| *Financial Times* Gold Mines Index | **1,217.83** | 1,104.49 | 1,287.90 |
| *FT* African Gold Mines | **2,000.91** | 1,826.61 | 2,238.18 |
| *FT* Australasian Gold Mines | **2,004.19** | 1,715.65 | 1,574.46 |
| *FT* North American Gold Mines | **961.72** | 873.55 | 1,017.02 |

## Coin Prices

| | 5/15/03 | Mo. Earlier | Yr. Earlier | Premium |
|---|---|---|---|---|
| American Eagle (1.00) | **$360.45** | 329.75 | 319.25 | 1.75 |
| Austrian 100-Corona (0.9803) | **$343.33** | 314.13 | 304.23 | -1.14 |
| British Sovereign (0.2354) | **$86.35** | 79.25 | 76.85 | 3.55 |
| Canadian Maple Leaf (1.00) | **$360.70** | 330.00 | 319.50 | 1.82 |
| Mexican 50-Peso (1.2057) | **$423.60** | 387.70 | 375.40 | -0.82 |
| Mexican Ounce (1.00) | **$351.20** | 321.40 | 311.20 | -0.86 |
| S. African Krugerrand (1.00) | **$356.85** | 326.75 | 316.45 | 0.73 |
| U.S. Double Eagle-$20 (0.9675) | | | | |
| St. Gaudens (MS-60) | **$410.00** | 440.00 | 345.00 | 19.63 |
| Liberty (Type I-AU) | **$675.00** | 675.00 | 675.00 | 96.94 |
| Liberty (Type II-AU) | **$440.00** | 440.00 | 385.00 | 28.38 |
| Liberty (Type III-AU) | **$385.00** | 395.00 | 332.50 | 12.33 |
| U.S. Silver Coins ($1,000 face value) | | | | |
| 90% Silver (715 oz.) | **$4,500.00** | 4,500.00 | 4,600.00 | 29.23 |
| 40% Silver (292 oz.) | **$1,587.50** | 1,587.50 | 1,525.00 | 11.64 |
| Silver Dollars | **$6,112.50** | 6,112.50 | 6,000.00 | 62.25 |

Note: Premium reflects percentage difference between coin price and value of metal in a coin, with gold at $354.25 per ounce and silver at $4.87 per ounce. The weight in troy ounces of the precious metal in coins is indicated in parentheses.

## Recommended Mutual Funds

| | Ticker | | Month | Year | — 52-Week — | | Distributions Latest 12 Months | | Yield |
|---|---|---|---|---|---|---|---|---|---|
| ***Short-Term Bond Funds*** | Symbol | 5/15/03 | Earlier | Earlier | High | Low | Income | Capital Gains | (%) |
| ★ iShares Lehman 1-3 Yr Treasury | SHY | **$82.49** | 82.22 | NA | 82.63 | 81.00 | 1.1168 | 0.0000 | 1.48 |
| ★ USAA Short Term Bond | USSBX | **$9.16** | 9.04 | 9.34 | 9.39 | 8.89 | 0.4321 | 0.0000 | 4.72 |
| ★ Vanguard Short-term Corporate | VFSTX | **$10.88** | 10.79 | 10.71 | 10.89 | 10.58 | 0.5352 | 0.0000 | 4.92 |
| ***Income Equity Funds*** | | | | | | | | | |
| ★ DNP Select Income[1, 2] | DNP | **$10.31** | 10.05 | 11.24 | 11.34 | 7.85 | 0.7800 | 0.0000 | 7.57 |
| ★ Vanguard REIT Index | VGSIX | **$12.90** | 12.27 | 13.02 | 13.45 | 10.94 | 0.7700 | 0.0000 | 5.97 |
| ***Large Cap. Value Equity Funds*** | | | | | | | | | |
| ★ iShares S&P 500 Value Index[3] | IVE | **$46.06** | 42.89 | 54.10 | 54.63 | 35.91 | 0.8386 | 0.1472 | 1.82 |
| ★ Vanguard Value Index | VIVAX | **$15.70** | 14.61 | 18.47 | 18.65 | 12.38 | 0.3150 | 0.0000 | 2.01 |
| ***Small Cap. Value Equity Funds*** | | | | | | | | | |
| ★ iShares Sm. Cap. 600 Value Index[3] | IJS | **$76.55** | 69.49 | 99.20 | 99.40 | 62.50 | 0.6752 | 0.3430 | 0.88 |
| ★ Vanguard Sm. Cap Value Index | VISVX | **$9.00** | 8.17 | 11.62 | 11.46 | 7.39 | 0.0900 | 0.0000 | 1.00 |
| ***Growth Equity Funds*** | | | | | | | | | |
| ★ iShares S&P 500 Growth Index[3] | IVW | **$48.76** | 46.25 | 55.27 | 56.19 | 40.02 | 0.5055 | 0.1124 | 1.04 |
| ★ Vanguard Growth Index | VIGRX | **$21.65** | 20.53 | 24.47 | 24.95 | 18.25 | 0.2470 | 0.0000 | 1.14 |
| ***Foreign Equity Funds*** | | | | | | | | | |
| ★ iShares S&P Europe 350 Index[3] | IEV | **$51.05** | 47.43 | 59.98 | 60.78 | 39.52 | 1.9044 | 0.0000 | 3.73 |
| T Rowe Price European Stock | PRESX | **$13.78** | 12.80 | 16.11 | 16.17 | 10.81 | 0.1400 | 0.0000 | 1.02 |
| ★ Vanguard European Stock Index | VEURX | **$17.39** | 16.09 | 20.46 | 20.55 | 13.64 | 0.4000 | 0.0000 | 2.30 |

## Recommended Gold-Mining Companies

| | Ticker | | Month | Year | — 52-Week — | | Distributions | | Yield |
|---|---|---|---|---|---|---|---|---|---|
| | Symbol | 5/15/03 | Earlier | Earlier | High | Low | Latest 12 Months | Frequency | (%) |
| Anglo American PLC, ADR | AAUK | **$14.86** | 14.60 | 17.55 | 19.61 | 10.84 | 0.480 | Semiannual | 3.23 |
| ★ Anglogold Ltd., ADR | AU | **$30.63** | 28.55 | 28.30 | 38.69 | 19.75 | 1.459 | Semiannual | 4.76 |
| ASA Ltd.[1] | ASA | **$36.38** | 34.81 | 35.04 | 42.85 | 24.72 | 0.600 | Quarterly | 1.65 |
| ★ Barrick Gold Corp.† | ABX | **$17.53** | 15.42 | 20.76 | 23.49 | 13.46 | 0.220 | Semiannual | 1.25 |
| ★ Gold Fields Ltd. | GFI | **$11.34** | 10.73 | 14.13 | 17.15 | 8.96 | 0.389 | Semiannual | 3.43 |
| ★ Newmont Mining | NEM | **$28.56** | 26.38 | 27.67 | 32.75 | 20.80 | 0.160 | Quarterly | 0.56 |
| ★ Placer Dome† | PDG | **$10.73** | 9.97 | 12.17 | 14.74 | 7.91 | 0.100 | Semiannual | 0.93 |
| ★ Rio Tinto PLC‡ | RTP | **$74.75** | 78.37 | 80.12 | 84.15 | 61.10 | 2.399 | Semiannual | 3.21 |

★ 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.