INVESTMENT GUIDE

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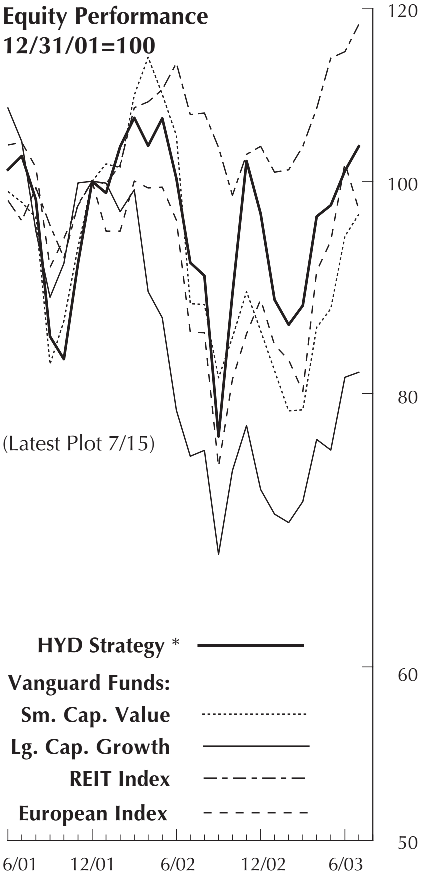

*** HYD is a hypothetical model based on back-tested results. See p. 54 for a full explanation.**

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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Mutual Fund Costs: As Important as Ever

In the aftermath of the great reversal in the equity market that began in the spring of 2000, advocates of "stock picking" put forth a peculiar argument. In a bear market, it was claimed, the ability to pick winners from among the rubble would be all the more important. Passive strategies, especially indexing strategies that attempt to garner the gains of the general market, were said to be doomed. Not surprisingly, brokers and active mutual funds were the most vocal in proclaiming that they possessed the ability to identify the few stocks that would defy the odds. Most notably, they asserted that investors should not be afraid to pay up for this ability, in the form of higher expenses necessary for compensating fund managers blessed with this unique power to divine the winners.

Our view is quite different. Active managers have not put a scratch in the overwhelming empirical evidence that cites their failure to add value, whether in bull or bear markets. Moreover, in a bear market, where nominal returns can be negative or at best no better than the current annual rate of price inflation (2.2 percent), expense ratios of over one percent are simply exorbitant.

Our mantra remains unchanged. You should ignore overtures to find "winners" or to anticipate the market, and instead concentrate on factors within your control. Central among these is your ability to choose the most cost-effective means of capturing the returns associated with the asset class you seek. This month's feature on mutual-fund expenses was adapted from an article published by our parent, the American Institute for Economic Research. Wise investors will read and heed:

During the 1990s, when an ebullient stock market provided a tailwind, most equity mutual funds delivered double-digit returns and few investors paid much attention to fund expenses.

After a long bear market, and with the prospect of a more subdued investment environment, mutual funds can no longer depend on phenomenal market returns to mask high expenses. Not surprisingly, fund expenses are receiving attention from both regulatory agencies and industry observers as a major factor in overall fund performance.

In testimony in March 2003 before the U.S. House of Representatives, John Bogle, founder and retired Chief Executive of The Vanguard Group, noted a clear and dramatic link between fund costs and investment returns. Among other things his testimony noted that:

- During the decade ended June 30, 2001, the lowest-cost quartile of funds earned an average net return of 14.5 percent a year, while the average high-cost fund earned an average 12.3 percent a year. The low-cost advantage prevailed regardless of the fund's investment strategy or focus.
- The average equity mutual fund's performance lagged the returns of the Standard & Poor's 500 Stock Index by an average of 3.1 percent a year between 1982 and 2002. This lag corresponds almost exactly to the actual total costs fund investors incur annually.

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QUARTERLY REVIEW OF INVESTMENT POLICY

The second quarter was rewarding for investors. Stocks and bonds both provided strong results during the period, thanks to good news on several fronts, including the fall of Baghdad and passage of the new tax law, which reduced the Federal levy on income as well as capital gains. The quarter brought no significant signs of accelerating price inflation and at quarter-end the Federal Reserve again cut its target for short-term rates to 1.0 percent, its lowest level in 45 years. The 0.25 percent reduction marks the Feds 13th cut since the beginning of 2001. In July the National Bureau of Economic Research announced that the U.S. economy had emerged from recession in November 2001.

The U.S. Economy

As of mid-July, 50 percent of the primary leading indicators followed by our parent, the American Institute for Economic Research (AIER), are pointing to continued expansion. The cyclical score, AIER's purely mathematical assessment of the leading indicators stands at 69; a score of 50 or more suggests that continued expansion is more likely than contraction. Notably, new housing remains strong with construction increasing 3.7 percent in June.

Among the primary roughly coincident indicators, two of five series (40 percent) are pointing to continued expansion. Gross Domestic Product grew at an annual rate of 1.9 percent in the first quarter, up from 1.4 percent in the previous quarter. Nonagricultural employment fell to another new low, a clear indication that this series is contracting.

We have maintained our recommended allocations unchanged in the accompanying table. However, in light of the current interest rate environment, investors should carefully assess their current commitments to money-market funds. The Consumer Price Index suggests an annual rate of price inflation of 2.2 percent, well above the yield on short-term cash equivalent assets such as money-market funds. As we explain below, liquidity remains an important concern. However, it would be reasonable for investors to boost their income by moving a portion of their cash holdings into short-term bonds and bond funds, as the spread between these holdings and money-market funds is wide enough to warrant such a change. Each investor's liquidity needs are different, so this decision depends largely on your particular circumstances.

Money-Market Funds

We have found that many investors fail to realize that money-market funds and other cash-equivalent assets are in fact investments in their own right that perform important roles in maintaining a portfolio's value. Short-term cash-equivalent assets are providing paltry returns, especially after adjusting for the effects of price inflation. Nevertheless, liquidity remains extremely important. Uncertainty, after all, applies not only to how your investments are valued in the market, but also to your personal circumstances. Unforeseen events causing unnecessary losses could force you to liquidate securities during a downturn in the market if your cash position is inadequate. Investors should not be tempted to reduce cash allocations in order to seek a higher yield.

Money-market funds are mutual funds that invest in short-term securities such as Treasury bills, bankers' acceptances, commercial paper, or negotiable certificates of deposit of major commercial banks. The shares of money-market funds are issued and redeemed at a Net Asset Value (NAV) of $1.00 per share. They should not be confused with money-market deposit accounts offered by banks, which essentially are interest-bearing checking accounts insured by the Federal Deposit Insurance Corporation (FDIC) and subject to minimum-balance requirements and limited check-writing privileges.

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

Investors may also consider certificates of deposit (CDs) or Treasury bills. While these do not offer the convenience of money-market funds, they are considered to provide the ultimate safety in terms of credit risk, since treasury securities are direct obligations of the U.S. Treasury, while CDs are insured for up to $100,000 by the FDIC.

We have long emphasized the importance of minimizing costs, and now, with money market funds paying well under one percent, expense ratios are more important than ever. Our recommended vehicles are low-cost funds such as those offered by the Vanguard Group. Currently, the Vanguard Prime Money Market Fund carries a 0.33 percent expense ratio, and has an annual yield of 0.81 percent.

The thin yield spread between municipal money-market funds and taxable funds continues to make muni funds an attractive alternative. For example, the Vanguard Tax-Exempt Money Market Fund provides income that is free of Federal income taxes and has a current annual yield of 0.69 percent on a pretax basis. On an after-tax basis investors should consider whether they would come out ahead with this fund versus holding a taxable fund such as the Vanguard Prime Money Market Fund, which is currently yielding 0.81 percent. The following formula can be used to deter-

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 one's circumstances and tolerance for risk.

mine the after-tax equivalent yield (TEY) on a muni fund:

$$TEY = \frac{\text{Tax Free Yield}}{(1\text{-Marginal Tax Rate})}$$

Example:

For an investor in a combined 15% tax bracket contemplating the purchase of the Vanguard Tax-Exempt Money Market Fund, its TEY would be:

0.69 / (1-0.15) = 0.81

Thus, purely on a return basis the investor would be indifferent between the return on this fund and the Vanguard Prime Money Market Fund; as it happens the after-tax returns are identical. Investors in higher tax brackets would be better off with the tax-free exempt fund.

Intermediate-Term Bonds

Although common stocks grabbed the headlines during the first quarter, bonds more than held their own. The U.S. 10-year Treasury returned 3.5 percent, as throughout the quarter the Fed continued to signal its intention to maintain low rates as long as the economy remained in slow-growth mode. During the last week of June the Fed cut rates by 0.25 percent and appeared to leave the door open for further cuts. Credit spreads fell, as investors bought high-yielding junk bonds and bond funds; the Lehman Brothers high-yield corporate bond index returned 10.1 percent for the quarter.

Mortgage-backed securities took a turn for the worse. Homeowners continued to retire older high-interest mortgages through refinancing, and news of questionable accounting at Freddie Mac shook that segment of the bond market, boosting the spreads of these securities over Treasuries.

Despite historically low interest rates, we do not recommend that investors "reach for yield." Investors should not be tempted to either assume greater credit risk through junk bonds, nor should you assume greater interest rate risk by extending maturities. The bond allocation in the accompanying table should be confined to U.S. Government securities or high-grade corporate or municipal bonds with five years or fewer remaining until maturity. The expected returns from bonds with maturities of more than five years is more 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 price inflation.

For many investors, any of the three fixed-income mutual funds on p. 56 will provide a suitable means of holding bonds. While not all of 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 be reinvested in new five-year bonds. This will provide constant exposure to the "short end" of the yield curve and generate a relatively steady flow of income. 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.

Ideally, investors would follow 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.

Income Equities

Real Estate Investment Trusts (REITs) and the Duff and Phelps Select Income Fund should be of interest to most investors. In addition to enhancing the stability of your portfolio's value, these investment vehicles provide a steady level of income. The accompanying table reveals that since the beginning of the last quarter of 2000, REITs have provided at total return of over 37 percent. That was the strongest return of any of our recommended asset classes during that period, despite the fact that REITs did not provide the highest return during any particular quarter.

With yields on fixed income investments so meager, REITs continue to draw strong interest from investors. At the end of June, the dividend yield on the NAREIT equity index was 6.42 percent, while the U.S. 10-year Treasury note was yielding only 3.53 percent. While this spread of 2.89 percent has fallen since the end of the first quarter, it remains well above the historical spread, which has averaged 1.13 percent since 1990.

Our investment vehicle of choice is the Vanguard REIT Index fund (symbol VGSIX). It is currently yielding 5.67 percent. 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.

Utility stocks rose 21.9 percent for the quarter, as measured by the Dow Jones Utilities Index. We continue to recommend the DNP Select Income Fund, which is dominated by bonds and stocks of public utilities. The fund pays a monthly dividend and is currently yielding 7.1 percent on an annual basis. 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.

DNP is trading at a steep 38 percent premium to its net-asset value, well above its historical average. 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. Although the fund's value can be expected to fall should interest rates rise to their historical average, holding this fund as a relatively small portion of your portfolio (see our recommended allocation table) is warranted in light of its strong yield and overall historical performance.

Common Stocks

The HYD model outperformed the Lipper Large-Cap Value Index and the overall market with a return of 18.59 percent during the first quarter. The resolution of the war in Iraq boosted stock prices and the passage of the *Jobs and Growth Tax Relief Reconciliation Act of 2003* provided further momentum for HYD stocks.

For the quarter, the Dow Jones Industrial Average gained 13.02 percent and the NASD Composite gained an even more robust 21.3 percent. The S&P 500, which returned 13.39 percent, 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, which returned 18.84 percent, 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, which returned 16.78 percent, is an alternative measure of large-cap value stocks as it provides the average returns for all of the large-cap-value mutual funds in the Lipper universe.

The Russell 2000 (small-cap) Index gained 17.88 percent, while the Vanguard Small-Cap Value Index returned 19.39 percent. The Vanguard Value Index Fund (large cap) gained 20.27 percent. Large-cap growth stocks were up more sharply, as the Vanguard Growth Index gained 11.57 percent.

International stocks had strong quarterly returns. The MSCI EAFE Index finished the second quarter up 19.27 percent. Japan and Singapore surged 7.37 percent and 5.79 percent, respectively. European markets were up 10.13 percent and the Vanguard European Stock Index fund rose 22.30 percent. The euro rose roughly 4.9 percent against the dollar, closing the quarter at $1.14, increasing the value of euro holdings in dollar terms.

Emerging markets were another bright spot, with the MSCI Emerging Markets Free Index returning 22.19 percent for the quarter.

The strong returns attracted investors to mutual funds. According to the Investment Company Institute, stock funds had inflows of $28.22 billion in April and May. During the period, domestic equity funds had inflows of $25.15 billion and international funds inflows of $3.07 billion. Bond funds had an inflow of $8.97 billion in May, and an inflow of $10.54 billion in April.

Gold-Related Investments

The gold price was volatile, reaching a high of $375.65 on a weaker dollar, before finishing the quarter at $346. 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.

Total Returns (%)*

	2000	*2001*				*2002*				*2003*		*Total Return Entire Period*
	4Q	*1Q*	*2Q*	*3Q*	*4Q*	*1Q*	*2Q*	*3Q*	*4Q*	*1Q*	*2Q*	*4Q 2000-2Q 2003*
Vanguard Short-Term Corporate	2.50	**3.18**	1.25	3.34	0.17	0.26	1.25	**2.27**	1.34	**1.39**	0.02	20.48
Vanguard REIT Index	3.71	-0.50	10.66	-2.56	4.72	8.08	4.79	-8.48	0.10	1.01	12.27	**37.10**
Vanguard Value Index	1.70	-6.58	4.41	-16.26	7.89	1.32	-10.69	-20.45	9.88	-5.57	20.27	-19.53
High-Yield Dow 4/18	**12.70**	-2.89	10.42	-16.09	9.19	6.90	-6.21	-23.56	**26.42**	-9.21	18.59	15.01
Vanguard Small Cap Value Index	7.58	-0.78	**13.25**	-16.63	**21.22**	**9.59**	-4.15	-22.50	4.62	-7.98	19.39	15.30
Vanguard Growth Index	-16.88	-17.50	7.70	-13.26	12.97	-0.87	-16.30	-14.07	7.04	-0.91	11.57	-38.93
Vanguard European Stock Index	1.85	-15.62	-1.87	-12.09	9.48	0.05	-4.05	-22.85	10.77	-9.25	**22.30**	-26.09
Gold (London PM Fix)	0.20	-6.10	5.01	**8.31**	-5.66	9.01	**7.33**	1.63	7.75	-3.56	3.33	27.02

* The highest returns provided in each period are in **Bold Face Type**.

MUTUAL FUND COSTS: AS IMPORTANT AS EVER

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- The impact of expenses on capital accumulation is enormous. An investment of $10,000 in the Standard & Poor's 500 Stock Index would have produced $105,250 over the decade studied, compared to $56,765 if it were invested in the average equity fund. This means the average stock fund captured just 54 percent of cumulative market profits over the period, largely because of the impact of fees.

Statistics from the Investment Company Institute (ICI), a trade organization for the mutual fund industry, suggest that investors have obtained some relief in the form of lower expenses in recent years. The organization found that between 1980 and 2001, the average annual cost of purchasing and holding equity mutual funds decreased 43 percent, from 2.26 percent to 1.28 percent. The cost of owning bond and money-market funds decreased by 41 percent and 35 percent, respectively.

But ICI's figures provide only a partial and somewhat misleading picture of trends in fund expenses. Costs have decreased mainly because more people are buying lower-cost funds, either on their own or through 401(k) and other retirement plans, not because the majority of funds have lowered their fees. The ICI study also excluded many costs of fund ownership, such as redemption fees, and it amortized up-front sales charges over a ten-year period, which is several times longer than the average holding period for fund investors today.

Other evidence suggests that while front-end sales charges have fallen, mutual fund fees that are more difficult to detect have gone up. In March, the General Accounting Office reported that, "since 1998, the majority of stock and bond funds we analyzed had higher expense ratios in 2001 that they did in 1998." This finding was confirmed by data from Lipper Inc., indicating that the median expense ratio for equity funds increased from 0.91 percent in 1984 to 1.36 percent in 2002.

Avoiding the Fee Trap

While the average mutual fund fee may seem high, some mutual fund sponsors keep their fees relatively low. The best way to avoid getting socked by excessive fund fees, and to find reasonably-priced funds, is to understand how fees work and determine as precisely as possible how much they cost. Much of this information can be gleaned from the *fee table* in the prospectus, a document that is often available both in hard copy form and on the Internet.

The fee table separates "shareholder fees," or fees borne directly by shareholders for buying, selling, or exchanging a fund, from "annual fund operating expenses," which cover the ongoing expenses of running the fund and servicing shareholders. It also includes an illustration of the dollar amount an investor would pay in expenses on a $10,000 investment over one, three, five, and ten years, assuming a five percent return each year.

Shareholder fees may be charged in the form of an up-front sales charge, or front-end load. A 4.5 percent sales charge on a $10,000 investment, for example, would cut the value of the initial investment to $9,550. Fund shares may also have a back-end load, or deferred sales charge, which applies if you sell fund shares before a specified period of time.

While no-load funds do not have either front- or back-end sales charges, all funds have annual operating expenses. Annual fund operating expenses may include a management fee, an ongoing fee the investment advisor charges to manage the fund. They may also include a distribution (12b-1) fee, an ongoing fee that fund companies use to compensate the financial professionals who sell their funds. This fee may not exceed one percent of assets, and may include a service fee of up to 0.25 percent a year. The fact that a fund does not have a front- or back-end sales charge does not make it a true no-load, as some brokers may imply. The sales commission just comes from the assets of the fund in the form of a 12b-1 charge, rather than directly from the shareholder.

The share class will usually indicate which form the sales charge takes. Class A shares usually have a front-end sales charge, and no, or a low, 12b-1 fee. Class B shares usually have no up-front charges, but instead have a back-end load if the shares are sold before a certain number of years. They may also have a 12b-1 fee. Class C shares typically have the highest 12b-1 fee of any share class, but no initial or deferred sales charges. Class I shares, available only to financial advisors and institutional investors, usually have no sales charges or 12b-1 fees, and very low annual expenses. These lower costs are offset by the fact that individuals who purchase these shares on behalf of clients usually charge their own, separate management fees.

The total amount of annual fund operating expenses is listed in the prospectus as the expense ratio. It includes investment management fees, 12b-1 fees if applicable, administrative expenses, and the cost of shareholder mailings. This standardized figure allows investors to compare annual expenses among different funds.

According to data from Lipper Inc., funds that invest in U.S. stocks have an average annual expense ratio of 1.54 percent of assets, while the average investment-grade bond fund has an expense ratio of 0.97 percent. But expense ratios among mutual funds, even those with similar investment strategies, can vary enormously. Some stock funds charge less than 0.20 percent of assets a year, while others sport double-digit expense ratios.

Look for Low-Cost Funds

To help compare fund costs, the U.S. Securities and Exchange Commission has a Mutual Fund Cost Calculator, located at www.sec.gov/investor/tools/mfcc/get-started.htm. The SEC's calculator does not take into account brokerage commissions or other trading costs that the fund incurs when its managers buy or sell securities. According to the General Accounting Office, estimates of the size of brokerage commissions mutual funds pay range from 0.15 percent of assets to as much as 0.50 percent.

Also, be sure to check whether a fund that has a low expense ratio will continue to do so. Some fund managers agree to absorb a portion of a fund's costs until its total assets reach a certain size. These temporary fee-waivers have the most visible impact in bond and money-market funds because they provide an immediate and visible boost to yields, but can also appear in equity funds as well. The prospectus will indicate whether the fund is waiving fees, and how long the fee waiver is in effect.

Claim Your Volume Discounts

Many mutual funds sold with sales charges offer volume discounts to investors. The amount of these discounts, which can be found in the prospectuses of mutual funds offering them, depends on the size of the investment. The investment amounts at which investors qualify for these discounts are called breakpoints. Typical breakpoint discounts apply to purchases at $50,000, $100,000, $250,000, $500,000 and $1 million, although some funds provide a breakpoint at $25,000.

Last March, the Securities and Exchange Commission reported that many investors who were eligible for breakpoint discounts did not receive them. They reported that of 5,515 transactions that appeared eligible for such a discount, 1,757 did not receive it. In many instances, investors forfeited the discount because their broker did not link fund shares held by all family members, or did not consider their ownership in related funds within the same fund "family."

Cost is certainly not the only consideration when buying a mutual fund, but it is an important one. As a general rule, certain types of mutual funds have lower costs than others. Larger funds tend to have lower expense ratios than small ones because they can spread costs over a larger asset base. Funds with low portfolio turnover typically incur lower commission costs. While the typical equity fund has a 100 percent turnover rate, implying a complete turnover of securities in the portfolio each year, the turnover rate can fall well above or below that figure. Index funds, which mirror the performance of a particular stock index, usually cost less to own than actively-managed funds because of their low turnover and low management fees. Funds with higher expense ratios, on average, include those that invest in small-company or foreign stocks, and smaller or newer funds.

This article was written by Marla Brill, the author of Windfall-How to Manage Sudden Money Before It Manages You and publisher of Brill's Mutual Fund Interactive *(brill.com)*.

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 January 2002), 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. 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

As of July 15, 2003

					Percent of Portfolio*	
	Rank	*Yield*	*Price*	*Status*	*Value*	*No. Shares*[1]
Eastman Kodak	1	6.78%	26.56	Holding**	20.31	22.93
Altria Group	2	6.32%	40.50	*		
General Motors	3	5.52%	36.25	*		
SBC Comm.	4	4.56%	24.80	Buying	21.00	25.39
AT&T	5	3.83%	19.60	Buying	9.22	14.10
JP Morgan Chase	6	3.65%	37.29	Holding**	32.24	25.93
DuPont	7	3.33%	42.08	Selling	13.99	9.96
CitiGroup	8	2.99%	46.83			
Exxon Mobil	9	2.84%	35.19			
General Electric	10	2.75%	27.67			
Caterpillar	14	2.41%	58.07	Selling	3.22	1.66
					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	-1.70%	11.80%	3.90%	13.15%	15.72%	15.64%	19.45
Dow	0.21%	8.11%	1.49%	11.90%	12.78%	10.39%	17.02

* 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.

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 four-fifths 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 7/15/03	6/13/03	7/15/02	12-Month High	Low	Latest Dividend Amount	Record Date	Paid	Indicated Annual Dividend	Yield† (%)
★ Eastman Kodak	EK	**$26.56**	30.83	29.46	41.08	25.59	0.900	6/02/03	7/16/03	1.800	6.78
Altria Group	MO	**$40.50**	42.18	42.40	52.00	27.70	0.640	6/13/03	7/08/03	2.560	6.32
General Motors	GM	**$36.25**	36.20	47.92	50.05	29.75	0.500	5/16/03	6/10/03	2.000	5.52
★ SBC Comm.	SBC	**$24.80**	25.32	29.51	31.65	18.85	0.283	7/10/03	8/01/03	1.130	4.56
★ AT&T (r)	T	**$19.60**	20.86	10.55	29.52	13.45	0.188	6/30/03	8/01/03	0.750	3.83
★ J. P. Morgan Chase	JPM	**$37.29**	34.70	30.08	37.88 *H*	15.26	0.340	7/03/03	7/31/03	1.360	3.65
☆ DuPont	DD	**$42.08**	43.58	42.05	45.30	34.71	0.350	5/15/03	6/12/03	1.400	3.33
Citigroup	C	**$46.83**	44.10	36.94	48.15 *H*	24.42	0.350	8/04/03	8/22/03	1.400	2.99
Exxon Mobil	XOM	**$35.19**	37.93	35.75	38.45	29.75	0.250	5/13/03	6/10/03	1.000	2.84
General Electric	GE	**$27.67**	30.65	28.25	32.98	21.30	0.190	6/30/03	7/25/03	0.760	2.75
International Paper	IP	**$36.74**	37.87	39.87	40.90	31.35	0.250	5/23/03	6/16/03	1.000	2.72
Honeywell Intl.	HON	**$27.88**	27.86	32.25	33.87	18.77	0.188	5/20/03	6/10/03	0.750	2.69
Alcoa	AA	**$24.75**	25.58	29.20	29.94	17.62	0.150	8/08/03	8/25/03	0.600	2.42
☆ Caterpillar	CAT	**$58.07**	56.05	45.19	58.73 *H*	33.75	0.350	7/21/03	8/20/03	1.400	2.41
Merck	MRK	**$61.87**	59.23	45.70	63.50 *H*	38.50	0.360	6/06/03	7/01/03	1.440	2.33
3M Company	MMM	**$128.09**	127.80	118.89	136.75	108.20	0.660	5/23/03	6/12/03	2.640	2.06
Procter & Gamble	PG	**$88.75**	91.17	82.30	93.50	74.08	0.455	7/18/03	8/15/03	1.820	2.05
Boeing	BA	**$33.44**	35.34	39.76	43.19	24.73	0.170	8/15/03	9/05/03	0.680	2.03
Coca-Cola	KO	**$43.99**	47.35	52.00	53.40	37.01	0.220	6/15/03	7/01/03	0.880	2.00
Johnson & Johnson	JNJ	**$52.55**	52.56	49.00	61.30	41.40	0.240	5/20/03	6/10/03	0.960	1.83
United Tech.	UTX	**$71.92**	72.11	62.35	74.25 *H*	48.83	0.270	8/22/03	9/10/03	1.080	1.50
Hewlett-Packard	HPQ	**$22.90**	20.99	15.00	23.70 *H*	10.75	0.080	6/18/03	7/09/03	0.320	1.40
McDonald's	MCD	**$21.08**	21.46	26.55	27.08	12.12	0.235	11/15/02	12/02/02	0.235	1.11
Walt Disney	DIS	**$21.35**	20.35	17.98	21.62	13.48	0.210	12/13/02	1/09/03	0.210	0.98
American Express	AXP	**$45.14**	43.43	33.64	46.35 *H*	26.55	0.100	7/03/03	8/08/03	0.400	0.89
IBM	IBM	**$86.44**	82.75	71.00	90.40	54.01	0.160	5/09/03	6/10/03	0.640	0.74
Home Depot, Inc.	HD	**$33.17**	33.56	30.00	34.90	20.10	0.060	6/12/03	6/26/03	0.240	0.72
Wal-Mart Stores	WMT	**$57.32**	54.08	53.44	58.03	43.72	0.090	6/20/03	7/07/03	0.360	0.63
Intel Corp.	INTC	**$24.10**	21.36	19.12	24.77 *H*	12.95	0.020	5/07/03	6/01/03	0.080	0.33
Microsoft Corp. (s)	MSFT	**$27.27**	24.65	51.80	29.48	20.71	0.080	2/21/03	3/07/03	0.080	0.29

★ BUY. ☆ HOLD. † Based on indicated dividends and market price as of 7/15/03. *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 .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

	7/15/03	Mo. Earlier	Yr. Earlier
Gold, London p.m. fixing	**348.25**	353.05	319.00
Silver, London Spot Price	**4.78**	4.51	5.05
Copper, COMEX Spot Price	**0.79**	0.76	0.73
Crude Oil, W. Texas Int. Spot	**31.62**	30.65	27.07
Dow Jones Spot Index	**146.49**	148.16	127.29
Dow Jones-AIG Futures Index	**116.11**	116.98	99.63
CRB-Bridge Futures Index	**233.12**	234.11	212.09

Interest Rates (%)

U.S. Treasury bills -	91 day	**0.89**	0.84	1.70
	182 day	**0.96**	0.83	1.72
	52 week	**1.05**	0.89	1.80
U.S. Treasury bonds -	15 year	**4.55**	3.71	5.37
Corporates:				
High Quality -	10+ year	**5.50**	4.79	6.52
Medium Quality -	10+ year	**6.03**	5.36	7.53
Federal Reserve Discount Rate		**2.00**	2.25	1.25
New York Prime Rate		**4.00**	4.25	4.75
Euro Rates	3 month	**2.13**	2.12	3.42
Government bonds -	10 year	**3.87**	3.48	4.87
Swiss Rates -	3 month	**0.27**	0.27	1.18
Government bonds -	10 year	**2.33**	2.08	3.08

Exchange Rates

British Pound	**$1.591200**	1.685000	1.572600
Canadian Dollar	**$0.716100**	0.749600	0.650300
Euro	**$1.113500**	1.187300	1.012900
Japanese Yen	**$0.008447**	0.008503	0.008645
South African Rand	**$0.127900**	0.128400	0.098900
Swiss Franc	**$0.719200**	0.769000	0.690700

Securities Markets

	7/15/03	Mo. Earlier	Yr. Earlier
S & P 500 Stock Composite	**1,000.42**	988.61	917.93
Dow Jones Industrial Average	**9,128.97**	9,117.12	8,639.19
Dow Jones Transportation Average	**2,573.97**	2,455.56	2,433.81
Dow Jones Utilities Average	**238.63**	249.01	241.76
Dow Jones Bond Average	**171.40**	178.44	143.65
Nasdaq Composite	**1,753.21**	1,626.49	1,382.62
Financial Times Gold Mines Index	**1,262.89**	1,298.88	1,242.75
FT African Gold Mines	**2,037.14**	2,069.20	2,246.69
FT Australasian Gold Mines	**2,181.40**	2,181.79	1,701.34
FT North American Gold Mines	**1,000.75**	1,036.13	953.33

Coin Prices

	7/15/03	Mo. Earlier	Yr. Earlier	Premium
American Eagle (1.00)	**$356.85**	370.85	320.15	2.47
Austrian 100-Corona (0.9803)	**$339.93**	353.23	305.03	-0.43
British Sovereign (0.2354)	**$85.55**	88.75	77.05	4.36
Canadian Maple Leaf (1.00)	**$357.10**	371.10	320.40	2.54
Mexican 50-Peso (1.2057)	**$419.50**	435.80	376.50	-0.09
Mexican Ounce (1.00)	**$347.80**	361.30	312.10	-0.13
S. African Krugerrand (1.00)	**$353.35**	367.05	317.35	1.46
U.S. Double Eagle-$20 (0.9675)				
St. Gaudens (MS-60)	**$410.00**	415.00	370.00	21.69
Liberty (Type I-AU)	**$675.00**	675.00	675.00	100.34
Liberty (Type II-AU)	**$440.00**	440.00	385.00	30.59
Liberty (Type III-AU)	**$390.00**	395.00	350.00	15.75
U.S. Silver Coins ($1,000 face value)				
90% Silver (715 oz.)	**$4,450.00**	4,500.00	4,600.00	30.20
40% Silver (292 oz.)	**$1,587.50**	1,587.50	1,550.00	13.74
Silver Dollars	**$6,137.50**	6,137.50	6,000.00	65.98

Note: Premium reflects percentage difference between coin price and value of metal in a coin, with gold at $348.25 per ounce and silver at $4.78 per ounce. The weight in troy ounces of the precious metal in coins is indicated in parentheses.

Recommended Mutual Funds

	Ticker Symbol	7/15/03	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	**$82.46**	82.95	NA	83.04	81.00	1.3260	0.0000	1.46
★ USAA Short Term Bond	USSBX	**$9.13**	9.23	9.27	9.27	8.89	0.4026	0.0000	4.41
★ Vanguard Short-term Corporate	VFSTX	**$10.87**	10.96	10.70	10.96	10.58	0.5087	0.0000	4.68
Income Equity Funds									
★ DNP Select Income[1, 2]	DNP	**$11.04**	10.95	9.35	11.20	7.85	0.7800	0.0000	7.07
★ Vanguard REIT Index	VGSIX	**$13.57**	13.22	12.33	13.62	10.94	0.7700	0.0000	5.67
Large Cap. Value Equity Funds									
★ iShares S&P 500 Value Index[3]	IVE	**$49.23**	49.14	45.72	50.01	35.91	0.8400	0.1472	1.71
★ Vanguard Value Index	VIVAX	**$16.72**	16.85	15.60	17.17	12.38	0.3050	0.0000	1.82
Small Cap. Value Equity Funds									
★ iShares Sm. Cap. 600 Value Index[3]	IJS	**$85.81**	81.49	79.50	86.75	62.50	0.7315	0.3430	0.85
★ Vanguard Sm. Cap Value Index	VISVX	**$9.76**	9.39	9.39	9.81	7.39	0.0900	0.0000	0.92
Growth Equity Funds									
★ iShares S&P 500 Growth Index[3]	IVW	**$50.96**	50.09	45.87	51.83	40.02	0.5390	0.1124	1.06
★ Vanguard Growth Index	VIGRX	**$22.86**	22.15	20.45	22.92	18.25	0.2370	0.0000	1.04
Foreign Equity Funds									
★ iShares S&P Europe 350 Index[3]	IEV	**$52.31**	54.70	51.84	55.94	39.52	1.9044	0.0000	3.64
T Rowe Price European Stock	PRESX	**$14.25**	14.78	13.55	15.08	10.81	0.1400	0.0000	0.98
★ Vanguard European Stock Index	VEURX	**$18.09**	18.57	17.68	19.10	13.64	0.4000	0.0000	2.21

Recommended Gold-Mining Companies

	Ticker Symbol	7/15/03	Month Earlier	Year Earlier	— 52-Week — High	Low	Distributions Latest 12 Months	Frequency	Yield (%)
Anglo American PLC, ADR	AAUK	**$15.91**	15.84	15.56	16.99	10.84	0.480	Semiannual	3.02
★ Anglogold Ltd., ADR	AU	**$30.77**	31.34	27.60	38.69	19.75	1.459	Semiannual	4.74
ASA Ltd.[1]	ASA	**$36.02**	37.60	34.55	42.85	24.72	0.600	Quarterly	1.67
★ Barrick Gold Corp.†	ABX	**$16.98**	18.19	17.45	18.97	13.46	0.220	Semiannual	1.30
★ Gold Fields Ltd.	GFI	**$11.00**	12.44	12.50	15.44	8.96	0.389	Semiannual	3.54
★ Newmont Mining	NEM	**$31.84**	32.07	27.75	34.40	20.80	0.160	Quarterly	0.50
★ Placer Dome†	PDG	**$11.48**	11.97	10.50	12.70	7.91	0.100	Semiannual	0.87
★ Rio Tinto PLC‡	RTP	**$81.76**	81.65	70.32	85.26	61.10	2.399	Semiannual	2.93

★ 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.