INVESTMENT GUIDE

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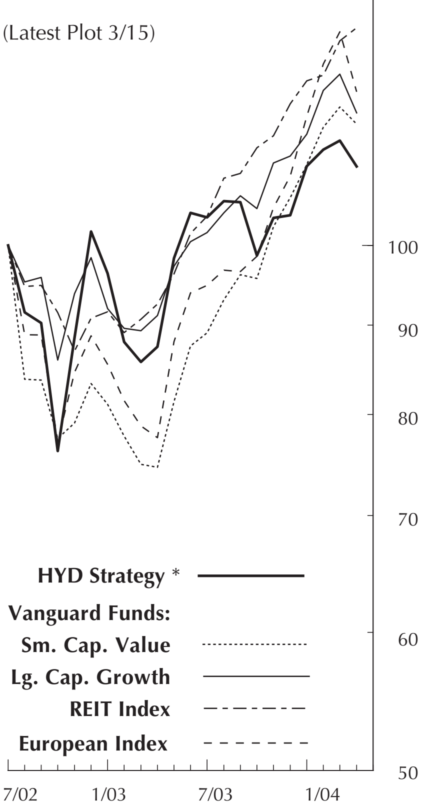
Equity Performance
7/1/02=100

(Latest Plot 3/15)



*** HYD is a hypothetical model based on back-tested results.** **See p. 22 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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Martha, et al.

The highly publicized case against Martha Stewart has focused attention on the notion of insider trading. These events, as well as the trend described by the Wall Street journal article reprinted herein, serve as a reminder that individual investors are not well served by stock picking.

The capital markets assimilate information with stunning efficiency. This phenomenon is lethal to gamblers and market prognosticators who bet against it, but enormously generous to true investors, who recognize the market's brutal efficiency as an engine of economic growth, and patiently accept the returns of well-diversified asset classes.

There is a mystery, however, in the functioning of markets. If, after all we were all to accept the wisdom of passive investing and accept prices as given, who would be left to set those prices? It is our view that there are in fact buyers and sellers who, at the margin, have an edge. There are no doubt individuals who, in the parlance of the economist, have a lower marginal cost of gathering and interpreting information concerning specific companies. But don't look for them in your local stock broker's office. They typically work exclusively in obscure fields, devoting all of their efforts to pursuing minute bits of information that might provide an advantage. Several are described in the Wall Street journal article. But superior knowledge does not necessarily result in great profits, for even these experts live in a competitive world, and we doubt that the prices they receive for their services greatly exceed their costs. In any event the article makes it clear that immediate access to this type of information is all but impossible for individual investors.

If well functioning markets depend on individuals with a relative advantage in information gathering, the notion of "insider trading" becomes a very grey area. Who is, after all, an insider? If it is any buyer or seller directing capital among assets based on their presumably superior knowledge, then attempts to prohibit the practice arguably interfere with the efficient flow of capital. Most efforts are impractical in any event. Insider trading, for example (buying and selling), is closely scrutinized, but what about insider holding? Is it inconceivable that an investor privy to unreleased "good news" has held his shares during a market rout?

The bottom line is you should not lose sleep worrying about insider trading, for there is a readily available antidote known as portfolio diversification. Our recommendations provide exposure to the desirable risk of our recommended asset classes, which have historically been rewarded with commensurate returns, and dispense with these firm-specific and industry-specific risks that are not systematically rewarded.

INCREASINGLY, STOCK RESEARCH SERVES THE PROS, NOT 'LITTLE GUY'*

In the wake of the Spitzer Pact, Wall Street and upstarts are catering to the elite few. Ordering 'Bespoke' Reports.

By Ann Davis

In early September, CarMax Inc. told investors it had met used-car sales targets for a just-ended quarter. But a small number of investment pros would soon learn there might be a catch.

A stock-analysis boutique, Majestic Research LLC, had dissected car-registration data that it regularly gets an inside look at. It discovered that CarMax's sales for the second quarter apparently hadn't grown evenly across all dealerships, but had spiked at a single California outlet. The research firm sent out a flash alert. Some big investment funds quickly sold or changed their bets on the shares. Several weeks later, CarMax lowered its earnings "guidance" for the next quarter, although it plays down the significance of the data Majestic used.

"Clients pay us a premium to do something just for them," says the research firm's chief executive, Seth Goldstein. Unlike Wall Street analysts who publish widely, he explains, "we don't market what we do and we don't advertise."

This is the changing face of stock research. When New York Attorney General Eliot Spitzer succeeded last year in separating investment- banking divisions from stock analysts to eliminate conflicts of interest, the historic settlement was supposed to herald a new era of securities analysis — one benefiting little-guy stock pickers. But now more than ever, the most pioneering, market-moving research is going exclusively to big mutual funds and the private investment pools known as hedge funds, not to the small investor for whom regulators waged their campaign.

At the same time, Wall Street research available to individual investors is being produced under sharply curtailed budgets. The regulatory accord, in the interest of ending conflicts of interest, stopped firms from tying research budgets to investment-banking revenue. That left much more of the budgets to be funded by trading commissions, which are under heavy pressure.

The 10 largest research departments on Wall Street are following nearly 20% fewer stocks than at the height of the boom in 2000, according to Reuters Research. Smith Barney, for example, no longer covers U.S. auto makers or airlines. It says it hopes to resume coverage of autos but hasn't tracked the industry since 2002.

Research budgets are so spare the brokers have even dabbled in outsourcing. J.P. Morgan Chase & Co. has hired 50 junior analysts in Bombay, India. The move has helped cut the yearly cost of covering a stock to $117,000 from $185,000 in 2001, a spokesman says.

Meanwhile, cumbersome new processes imposed as a check on biased research have combined with the tight budgets to make the field less attractive to some seasoned analysts. Many, such as former Bear Stearns Cos. gambling analyst Jason Ader, have left the field lately. Mr. Ader started his own hedge fund.

In this environment, luxe-research boutiques are prospering. A growing number tout "bespoke research," or custom projects for a single client, named after the British term for made-to-measure gentlemen's suits.

For Nick Zaharias, managing director of Field Check Group LLC in Menlo Park, Calif., a typical project would be a request to check whether a software firm was losing salespeople to its competitors. A former software executive himself, Mr. Zaharias taps his headhunter and sales-manager sources for scoops. "My day-to-day life is more like an investigative journalist," he says.

Annual fees for exclusive research can run to six figures. One former Wall Street analyst lives in a Western ski town and gets $750,000 a year from a large money manager, according to a firm that has handled arrangements between the analyst and the money manager.

In fact, the fewer clients the better. Retail analyst Jennifer Black, formerly at the broker-dealer arm of Wells Fargo & Co., struck out on her own six months ago in Lake Oswego, Ore. "I decided I would be expensive and have limited distribution," she says. She has seven clients and intends to stop at 15.

Donald Luskin has "exactly 29" clients for his Trend Macrolytics LLC consultancy. Some like to discuss economic news with him by instant messaging and "are constantly tapping back and forth one-sentence fragments," he says. He works at home at the top of a remote canyon road near Palo Alto, Calif.

Customers of Assay Research LLC, a one-year-old forensic-accounting shop that dissects financial statements for clues to a deteriorating business, offered to pay premium fees if the stock analysis was sharply limited. "Clients really want to feel that they're getting something that nobody else is," says Brad Rexroad, an Assay principal.

Meanwhile, at the big Wall Street firms, the focus increasingly is on white-glove service for investment institutions. At Credit Suisse First Boston last week, analyst Ivy Zelman played host to 20 trading clients at a private event at the Detroit-area offices of Masco Corp., a maker of building products. Portfolio managers from clients such as Alliance Capital Management Holding LP and TIAA-CREF got to question executives of Masco and one of its customers over dinner. The next day, they drilled down into operations with division chiefs.

Overall, small investors may still be better off than when they risked pouring their savings into a stock an analyst was recommending just to please an investment-banking client. There are several provisions to root out such conflicts of interest in the settlement, which involved the Securities and Exchange Commission and other regulators in addition to Mr. Spitzer's office. The accord also requires the 10 firms that settled to supply investors with second opinions: millions of dollars worth of analysis purchased from outside research firms.

In addition, efforts to cater to investment pros don't always leave the little guy out altogether. Smith Barney, a unit of Citigroup Inc., has long had a team that distills research aimed at institutions for a small-investor clientele, and Merrill Lynch & Co. recently set up one. Researchers' emphasis on serving institutional investors also benefits small investors who invest with mutual funds. Still, more than 21% of U.S. families own individual stocks, a Federal Reserve survey shows, and thus are affected by a steady erosion in stock research and a migration of the best information to elite investors.

Trading commissions earned by the securities firms historically funded their stock analysis. But commissions have been shrinking for years, thanks to low-cost electronic alternatives and trading in pennies instead of fractions of a dollar. Commissions ran as much as 15 cents a

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share on institutional trading desks in the early 1990s, leaving plenty of cash to pay analysts. Today they average a nickel a share, and money managers have ways of pushing them far lower.

This trend mattered less to analysts during the late-1990s underwriting boom, because investment-banking divisions were happily subsidizing analysts' pay. Now analyst pay must again be funded largely out of commission income. The eight biggest securities firms have sharply cut their U.S. stock-research budgets. Their combined spending peaked at $2.7 billion in 2000 but is just $1.7 billion today, estimates Brad Hintz of the Sanford C. Bernstein unit of Alliance Capital.

This puts the pros with big trading dollars to spend in the catbird seat. Brokerage firms especially seek the trading business of today's proliferating hedge funds, because they tend to trade frequently and also to multiply their buy and sell orders with leverage. These big traders, in an age when earnings-report analysis hits the Web in minutes, want insights the whole world isn't getting.

"You hear it from hedge funds over and over again: They have no cap on what they will pay you if you make them money" with exclusive insights, says Majestic Research's Mr. Goldstein.

Wall Street firms sometimes foot the bill for elite investors' use of research boutiques, in exchange for the big investors' trading business. Such "soft dollar" arrangements — in which the client usually pays above-market commissions — are being examined by regulators but have long enjoyed a legal safe harbor.

For their money, institutional investors also gain the right to phone the Wall Street firms' analysts whenever they like, grilling them or asking them to do special analyses of a stock or an industry sector. By contrast, the best an individual investor could typically hope for would be to get a copy of an analyst's standard report through a stockbroker.

In a step that further limits access, some small research shops dispense with written reports. Two New York firms, Gerson Lehrman Group and Vista Research Inc., have Rolodexes of thousands of industry experts they can put on the phone with a money manager. They include doctors involved in drug trials and former bank regulators, who earn from a few hundred to a few thousand dollars to take a big investor's call on short notice.

One client of Gerson Lehrman is Bessemer Venture Partners, which takes stakes in private companies. Recently, it was evaluating a business that made medical devices for sleep disorders. To get a feel for doctors' willingness to use it, Gerson Lehrman helped Bessemer talk to about eight medical specialists who have dealt with sleep disorders.

"When you read somebody else's research, you read something based on the questions that they posed. When you can get somebody on the phone yourself, you can pose the question," says Rob Stavis, a Bessemer partner. The small stock-research boutiques themselves are drawing investment interest. Bessemer has just purchased a stake in Gerson Lehrman.

Mutual-fund companies also have access to this exclusive research. In late December, Victory Capital Management was trying to decide whether to invest in memory-chip maker Micron Technology Inc. Vista set up a call with an executive who buys and sells dynamic random access memory chips, or DRAMs, in Asia. For an hour and a half, Victory portfolio managers crouched around a speakerphone and grilled the executive, trying to determine whether sliding chip prices had finally bottomed out.

Two days later, with much of Wall Street still bearish on Micron, Victory invested in the stock. It is up about 18%, amid talk that DRAM prices have started to stabilize. Victory wants insights that aren't widely broadcast, says Richard Turgeon, an executive of the fund family, a unit of KeyCorp. He says Victory is "using Wall Street less and less."

But Wall Street, too, is catering to the biggest investors. Goldman Sachs Group Inc. formed a unit that suggests trades in more exotic instruments such as derivatives and stock options. Surveys show the largest investors want "deep dives on sectors, companies and themes, as opposed to quarterly updates," says Morgan Stanley's research director, Dennis Shea.

Eighteen CSFB analysts scrutinize data from an extensive new company database CSFB has acquired, and will run customized analyses of investment ideas for big clients. CSFB's Ms. Zelman sometimes brings them together with private homebuilders and building-supply companies she has spent years cultivating. Private-company sources can discuss sales trends that a public company wouldn't be allowed to relay to a select audience.

Wall Street analysts have no doubt who it is they need to please: the firms' largest trading clients. Many big mutual funds and hedge funds let a securities firm know exactly how much value, or how little, they put on the stock analysis they're getting from the firm. In a private report to a brokerage firm, a fund will quantify how much its research had to do with winning the fund's trading business — say, 40%. These report cards, called "commission votes," then break it down analyst by analyst, singling individuals out for accolades or criticism.

Dwindling Coverage: Number of Stocks Followed by Some Wall Street Firms at the End of 2000 and 2003

Firm	*2000*	*2003*
Merrill Lynch	3,500	2,469
CSFB	3,077	2,373
Smith Barney	3,000	2,300
J.P. Morgan Chase	2,400*	2,260
Goldman Sachs	2,315	1,950
Morgan Stanley	2,150	1,925
Lehman Brothers	1,650	1,605

*For 2001; figure for 2000 not available. Note: Includes operations both in U.S. and abroad. Source: WSJ research research.

For analysts, commission votes loom large now that their pay can't be tied to how much investment-banking business they bring in. "It's the largest factor that I use in evaluating an analyst," says Morgan Stanley's Mr. Shea.

However, some analysts say this practice is already becoming a potential new source of pressure on them: to mold research calls to please powerful trading clients.

As research gets more exclusive, areas once considered core are falling off. Wall Street is doing less of what it calls "maintenance research" — routine recommendations after earnings news. This has only about "one hour of shelf life," says CSFB's research director, Stefano Natella.

Two firms are going even further. In the past two weeks, HSBC Holdings PLC of Britain and the SG Cowen unit of France's Societe Generale SA said they will stop issuing buy, sell and hold ratings on stocks and focus on analyzing industry trends. Buy or hold ratings are more important to the small investor than to sophisticated pros.

As research budgets tighten, hundreds of midsize companies have lost analyst coverage entirely, and coverage of large companies has fallen off. Merrill Lynch hasn't followed major U.S. restaurant stocks such as McDonald's Corp. since it laid off its restaurant analyst last May, and hasn't covered big retailers such as Home Depot Inc. since laying off another analyst in September. Merrill says it will reinstate coverage of the sectors later this year.

Some big-firm analysts are stretched

as their workload grows. Goldman Sachs's top airline analyst, Glenn Engel, added the huge aerospace industry to his plate last year after a colleague left and wasn't replaced. He hired a former engineer to help penetrate the industry and gave increasing responsibility for airlines to a junior analyst. "I get less sleep and less time at home," says Mr. Engel, who says he's asking his family for their patience.

As if all this didn't have enough impact on the stock analysis available to small investors, add in delays growing out of committee reviews mandated by the regulatory settlement. To guard against conflicted recommendations, firms now require analysts who want to change a stock's rating to write supporting memos, then apply to present their views to in-house review panels, which may include lawyers, economists, bond experts and brokerage-firm officials.

Leaner Times for Wall Street Research: Estimated Budgets for U.S. Stock Research, in Millions

Firm	*2000*	*2003*
Merrill Lynch	$494.6	$292.4
CSFB	$468.1	$284.8
Smith Barney	$478.2	$269.9
Morgan Stanley	$386.7	$249.3
J.P. Morgan Chase	$149.2	$185.0
Goldman Sachs	$376.8	$177.7
Lehman Brothers	$211.6	$160.1
Bear Stearns	$121.9	$79.7

Source: Sanford C. Bernstein calculations, based on data from selected firms, executive recruiters and other sources and excluding legal and compliance costs and overhead.

"Because stocks are always moving, the lengthy committee procedure carries the risk that you will miss the optimal point to change a rating," says Alice Schroeder, a former senior insurance analyst at Morgan Stanley, who stepped down last spring to write a book.

For analysts, the reviews add to more-mundane hassles they've faced since the probe of ties to investment banking. At Citigroup and Morgan Stanley, for instance, analysts have to use someone else's pass to get into areas where bankers work; theirs don't open the doors. Legal "chaperones" must monitor analysts' discussions with investment bankers. One ex-analyst complains it's like being constantly told, "You have all been bad children."

Mr. Spitzer says that while there might be less research today for individual investors, "I'd rather have less but honest than more but fraudulent." He notes that the settlement requires analysts to certify that opinions in their reports are honestly theirs.

As for exclusivity, Wall Street securities firms are "free to tailor research to institutional investors," Mr. Spitzer says. "Not only are they free to do that, but the market will shape what happens."

MUTUAL FUND RANKINGS: APPROACH WITH CAUTION

It is tempting to invest according to the convenient assessments of mutual funds offered by independent mutual fund ranking services. These often seduce investors by reducing a fund's qualities to a single number or symbol. Perhaps the best known is Morningstar, which rates funds much like hotels, with funds assessed highest receiving a five-star rating. Investors should not rely on these gauges of performance alone, for what appears to be simple is often simplistic.

The science of economics is predicated on empirical analysis—and, in the case of optimal portfolio construction, should begin with an objective review of asset returns over a statistically valid (i.e. very long) time period. The desirability of adding an asset to a portfolio should be based on its contribution to the total risk of the portfolio; therefore at AIS we seek to identify assets that provide unique patterns of risk and return. Once these *asset classes* have been defined, we design portfolios in which each asset class is weighted according to the risk tolerance of our client. Only then do we turn our attention to selecting a particular investment vehicle, where our primary concern is finding the most economical means of holding those desired asset classes.

Many actively managed fund companies turn the investment selection process on its head. They use Morningstar and similar rating services to tempt investors to proceed the other way around by focusing exclusively on "stellar" funds. Even a quick scan of advertisements aimed at individual investors will turn up numerous instances of prominently displayed fund ratings are, but obscured meaningful information. Indeed, some very large mutual fund families offer mutual funds in virtually every imaginable sector, and then aggressively market those funds that have suddenly been thrust into a four or five-star ranking by spectacular near-term performance. Unwary investors often do not realize that rankings can be heavily influenced by near term performance, and that leadership among investment categories rotates, so a large fund family can almost certainly boast of at least one fund that looks like a surefire winner at any given time, even though there is no reason to believe that the fund will continue to outperform.

The Morningstar approach measures a fund's risk-adjusted returns (including expenses) for as many as three time spans

THE GOLD STANDARD

Our parent organization, the American Institute for Economic Research, will host a conference entitled "The Way To Resume is to Resume, An Exploration of the Process of the Resumption of the Gold Standard." The conference will be held on the AIER campus in Great Barrington, Massachusetts on Wednesday May 12 through Friday May 14. Participants will include several speakers from the investment industry and academia. As part of the conference AIS will present "Gold and Asset Class Investing." There is no conference fee for AIS subscribers. Additional information can be found at www.AIER.org.

This conference presents a unique opportunity to review a subject that should be addressed at least once every 20 years or so: Does society gain advantages from adopting a gold monetary standard, and if so, how does it go about resumption from a practical standpoint?

The operations and benefits of the classical gold standard have been studied extensively. Government-managed resumption also has been examined. But the practical problems of resumption have received little consideration. For example, what should be the gold contents of currencies? A solution might begin with the realization that the original gold standard was privately produced and that its successful reestablishment depends on the desires and capabilities of modern financial players. What monetary standard would emerge if private banks and money markets were allowed to function freely? Recent deregulations and bank consolidations give hope that we are moving in the direction of free financial markets. The conference will consider the results of studies of these and related issues.

(three, five and ten years). These numbers are combined to form an overall rating; for example, those that fall in the top 10 percent earn the coveted five-star ranking. Funds with less than three years history are not rated. Morningstar arrives at these rankings by adjusting each fund's total return by a risk penalty since fund managers who assume more risk should be expected to earn a higher return over time. The rating is also constructed to recognize that investors are typically risk averse—that is, they are willing to sacrifice some level of expected return in exchange for a more certain outcome.

So far so good; but Morningstar's approach lacks meaning because its groupings appear to be based on factors other than risk and reward. True asset classes are defined by their exposure to unique forms of risk—for example, small cap value stocks are far more risky than short term bonds, and are not strongly correlated with our other recommended asset classes. Therefore is it only reasonable to compare small cap value funds with other funds of that asset class.

Until recently Morningstar assigned all funds to only one of four groupings: domestic equities, international equities, taxable bonds and municipal bonds. These groups were clearly far too broad to provide a useful measure; e.g. small cap value stocks were properly separated from bonds, but were still measured against large cap growth stocks. In June 2002 Morningstar revised its star ranking calculation. The changes included a significant narrowing of categories in an attempt to address this shortcoming. However, while the firm has defined 50 new categories, these appear to have very little relevance to modern portfolio theory. For example, our research indicates that domestic equities should be assigned to one of four asset classes—large cap growth, large cap value, small cap growth and small cap value—but the nomenclature adopted by Morningstar includes "mid cap" and "blend" stocks. We have found no risk/return attributes that justify a delineation of stocks in this manner.

Morningstar's labeling therefore unfortunately continues to provide misleading results. For example, we often recommend the Dimensional U.S. Large Cap Value fund (DFLVX) for investors in our Professional Asset Management program. The fund invests in companies whose size (market capitalization) falls within the largest 90 percent of the market universe, and makes an additional "cut" by including only those firms that carry a high book value in relation to their market value. This provides desirable exposure to the two dimensions of risk (size and value) that, in addition to market risk, are systematically rewarded with return over time. These criteria are based on a review of historical data, and suggest that U.S. commons stocks should be considered either "large" or "small." Yet Morningstar considers many of the fund's holdings to be "mid-cap" stocks and has therefore assigned the fund to that peer group. As a result the fund is inappropriately compared with funds that are far more heavily weighted toward smaller stocks. So the star rating is meaningless.

Morningstar and other rating services are also deficient in that they only measure a fund against a peer group. This skips what is perhaps the most important step in portfolio construction: determining *which* peer groups should be included in a portfolio. In our view, only discrete asset classes should qualify as peer groups, and this determination requires looking not only at risk adjusted returns, but also at the degree to which returns among candidate peer groups are correlated.

Perhaps the greatest indictment of these rating services as a predictive tool, however, is their inability to predict with any consistency what funds will provide the best performance. Professor Morey of Pace University examined stock funds rated by Morningstar and Value Line at the end of 1994. Over the next six years he compared the actual performance of funds that received high rankings with those that had received average rankings. Highly-rated funds did not, on average, perform any better than the funds with a lower rating. These findings do not surprise us in the least. There is no evidence to suggest that stock pickers have ever added value, and in our view these rating services and the fund companies that misuse them only serve to encourage performance-chasing, or as we call it, "skating to where the puck was".

Rating the Raters

	Fund A	*Fund B*	*Fund C*	*Fund D*
Morningstar[1] (12/00)	★★★★★	★★	★★★	★★★★
Forbes (12/00)	C	A	A+	D
U.S. News & World Report[2] (12/00)	34	50	10	93
Wall Street Journal (1/01)	E	C	A	B
Business Week (1/01)	A	No Ranking	B+	C

Note: Funds A, B, C and D are actual funds. They are not identified because the purpose of this illustration is not to sell a particular security. It is to emphasize that ratings, in and of themselves, do not provide enough information for making an investment decision.

[1] Five stars is highest rating, one star is lowest rating. [2] 100 is highest rating. 1 is lowest rating.

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 **AT&T** was not eligible for purchase 18 months earlier (in September 2002). Investors following the model should find that the indicated purchases of **AT&T** and **Dupont** and sales of **Eastman Kodak** are sufficiently large to warrant trading. In larger accounts, rebalancing positions in **JP Morgan Chase** and **SBC** may be warranted as the model calls for adding to positions that have lagged the entire portfolio and selling positions that have done better. 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

As of March 15, 2004

	Rank	Yield	Price	Status	—Percent of Portfolio*— Value	No. Shares[1]
SBC Comm.	1	5.17%	24.18	Holding**	23.32	27.48
Altria Group	2	5.06%	53.77	*		
AT&T	3	5.03%	18.87	Buying	18.56	28.03
General Motors	4	4.45%	44.97	*		
DuPont	5	3.41%	41.01	Holding**	7.73	5.37
JP Morgan Chase	6	3.32%	40.93	Holding**	31.63	22.01
Merck	7	3.30%	44.85	Holding	2.94	1.87
CitiGroup	8	3.26%	49.12	Holding	1.55	0.90
Caterpillar	13	2.00%	73.98	Holding	1.97	0.76
Eastman Kodak	16	1.94%	25.72	Selling	12.26	13.58
					100.0	100.0

Change in Portfolio Value[2]

	1 mo.	1 yr.	5 yrs.	10 yrs.	15 yrs.	From 12/63	Std. Dev.
HYD Strategy	-3.81%	31.75%	4.21%	12.49%	14.92%	15.48%	19.39
Dow	-4.75%	31.26%	2.17%	12.08%	12.77%	10.52%	16.96

* 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.

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, Dupont and J.P. Morgan Chase— account for roughly 80 percent of the total portfolio value). Any remaining cash will be held in a money-market fund pending subsequent purchases, which will be made whenever the client's holdings of each month's eligible stocks are below the percentages indicated by the strategy by an amount sufficient to warrant a trade.

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

THE DOW JONES INDUSTRIALS RANKED BY YIELD

	Ticker Symbol	*Market Prices 3/15/04*	*2/13/04*	*3/14/03*	*12-Month High*	*Low*	*Latest Dividend Amount*	*Record Date*	*Paid*	*Indicated Annual Dividend*	*Yield† (%)*
★ SBC Comm.	SBC	**$24.18**	25.05	20.85	27.73	19.65	0.313	1/10/04	2/02/04	1.250	5.17
Altria Group	MO	**$53.77**	54.66	34.93	58.96 *H*	27.70	0.680	3/15/04	4/12/04	2.720	5.06
★ AT&T (r)	T	**$18.87**	20.00	16.18	23.18	13.45	0.238	12/31/03	2/02/04	0.950	5.03
General Motors	GM	**$44.97**	48.88	32.00	55.55	31.10	0.500	2/13/04	3/10/04	2.000	4.45
★ DuPont	DD	**$41.01**	44.46	37.82	46.25 *H*	37.47	0.350	2/13/04	3/13/04	1.400	3.41
★ J. P. Morgan Chase	JPM	**$40.93**	40.16	21.26	43.84 *H*	21.01	0.340	1/06/04	1/31/04	1.360	3.32
☆ Merck	MRK	**$44.85**	48.88	50.80	63.50	40.57	0.370	3/05/04	4/01/04	1.480	3.30
☆ Citigroup	C	**$49.12**	49.49	33.75	51.11	33.26	0.400	2/02/04	2/27/04	1.600	3.26
General Electric	GE	**$30.30**	32.72	25.65	34.57	24.75	0.200	3/01/04	4/26/04	0.800	2.64
International Paper	IP	**$40.54**	43.40	35.64	45.01	33.17	0.250	2/20/04	3/15/04	1.000	2.47
Exxon Mobil	XOM	**$41.78**	41.91	34.39	43.40 *H*	34.20	0.250	2/11/04	3/10/04	1.000	2.39
Honeywell Intl.	HON	**$32.59**	36.41	22.47	37.65	21.16	0.188	2/20/04	3/10/04	0.750	2.30
Coca-Cola	KO	**$47.71**	51.14	39.90	52.78	39.00	0.250	3/15/04	4/01/04	1.000	2.10
☆ Caterpillar	CAT	**$73.98**	77.42	47.02	85.70	46.78	0.370	1/20/04	2/20/04	1.480	2.00
Procter & Gamble	PG	**$102.52**	102.05	83.40	107.21 *H*	82.83	0.455	1/23/04	2/17/04	2.000	1.95
☆ Eastman Kodak	EK	**$25.72**	29.03	28.72	32.46	20.39	0.250	11/03/03	12/12/03	0.500	1.94
3M Company (s)	MMM	**$74.87**	79.68	62.78	86.20	60.26	0.330	2/20/04	3/12/04	1.440	1.92
Johnson & Johnson	JNJ	**$50.57**	54.23	55.19	59.08	48.05	0.240	2/17/04	3/09/04	0.960	1.90
Alcoa	AA	**$34.11**	37.01	19.94	39.44	18.86	0.150	2/06/04	2/25/04	0.600	1.76
Boeing	BA	**$39.78**	44.45	25.55	45.10 *H*	24.85	0.170	2/13/04	3/05/04	0.680	1.71
United Tech.	UTX	**$87.90**	94.63	58.87	97.84 *H*	57.00	0.350	2/20/04	3/10/04	1.400	1.59
Hewlett-Packard	HPQ	**$21.71**	23.01	15.66	26.28	15.20	0.080	3/17/04	4/07/04	0.320	1.47
McDonald's	MCD	**$28.45**	26.63	13.54	29.98 *H*	13.24	0.400	11/14/03	12/01/03	0.400	1.41
Wal-Mart Stores	WMT	**$57.90**	56.32	49.36	61.31 *H*	49.36	0.130	3/19/04	4/05/04	0.520	0.90
Walt Disney	DIS	**$25.33**	26.92	16.42	28.41	16.03	0.210	12/12/03	1/06/04	0.210	0.83
Home Depot, Inc.	HD	**$35.41**	36.17	22.99	37.89	22.59	0.070	3/11/04	3/22/04	0.280	0.79
American Express	AXP	**$50.95**	53.65	33.48	53.98	32.86	0.100	1/02/04	2/10/04	0.400	0.79
IBM	IBM	**$91.82**	99.71	79.00	100.43	77.84	0.160	2/10/04	3/10/04	0.640	0.70
Microsoft Corp. (s)	MSFT	**$25.19**	26.59	24.86	30.00	23.60	0.160	10/17/03	11/07/03	0.160	0.64
Intel Corp.	INTC	**$27.09**	30.14	17.17	34.60	16.26	0.040	2/07/04	3/01/04	0.160	0.59

† Based on indicated dividends and market price as of 3/15/04. *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 .10 on 11/3/03 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

	3/15/04	Mo. Earlier	Yr. Earlier
Gold, London p.m. fixing	**398.10**	416.00	335.20
Silver, London Spot Price	**7.11**	6.54	4.54
Copper, COMEX Spot Price	**1.35**	1.24	0.75
Crude Oil, W. Texas Int. Spot	**37.44**	34.56	35.38
Dow Jones Spot Index	**189.48**	179.37	152.52
Dow Jones-AIG Futures Index	**148.29**	140.50	117.92
CRB-Bridge Futures Index	**278.36**	264.85	240.00

Interest Rates (%)

U.S. Treasury bills -	91 day	**0.95**	0.90	1.12
	182 day	**1.00**	0.97	1.12
	52 week	**1.11**	1.12	1.17
U.S. Treasury bonds -	15 year	**4.34**	4.60	4.38
Corporates:				
High Quality -	10+ year	**5.29**	5.55	5.61
Medium Quality -	10+ year	**5.67**	5.91	6.37
Federal Reserve Discount Rate		**2.00**	2.00	2.25
New York Prime Rate		**4.00**	4.00	4.25
Euro Rates	3 month	**2.07**	2.09	2.54
Government bonds -	10 year	**4.03**	4.14	3.80
Swiss Rates -	3 month	**0.26**	0.24	0.32
Government bonds -	10 year	**2.46**	2.52	2.07

Exchange Rates

British Pound	**$1.818800**	1.905600	1.582000
Canadian Dollar	**$0.751900**	0.762400	0.679800
Euro	**$1.235100**	1.285800	1.079200
Japanese Yen	**$0.009144**	0.009475	0.008493
South African Rand	**$0.149300**	0.150300	0.122900
Swiss Franc	**$0.787800**	0.816500	0.736300

Securities Markets

	3/15/04	Mo. Earlier	Yr. Earlier
S & P 500 Stock Composite	**1,104.49**	1,145.81	833.27
Dow Jones Industrial Average	**10,102.89**	10,627.85	7,859.71
Dow Jones Transportation Average	**2,790.44**	2,916.56	2,027.09
Dow Jones Utilities Average	**274.68**	270.68	199.15
Dow Jones Bond Average	**180.69**	178.50	163.52
Nasdaq Composite	**1,939.20**	2,053.56	1,340.33
Financial Times Gold Mines Index	**1,592.70**	1,705.28	1,072.96
FT African Gold Mines	**2,335.57**	2,566.97	1,860.39
FT Australasian Gold Mines	**3,077.85**	3,566.79	1,584.28
FT North American Gold Mines	**1,296.22**	1,365.64	835.78

Coin Prices

	3/15/04	Mo. Earlier	Yr. Earlier	Premium
American Eagle (1.00)	**$410.35**	416.65	363.55	3.08
Austrian 100-Corona (0.9803)	**$390.83**	396.83	346.33	0.15
British Sovereign (0.2354)	**$97.95**	99.45	87.15	4.52
Canadian Maple Leaf (1.00)	**$410.60**	416.90	363.80	3.14
Mexican 50-Peso (1.2057)	**$482.10**	489.50	427.30	0.44
Mexican Ounce (1.00)	**$399.80**	405.90	354.30	0.43
S. African Krugerrand (1.00)	**$405.85**	412.05	359.95	1.95
U.S. Double Eagle-$20 (0.9675)				
St. Gaudens (MS-60)	**$480.00**	492.50	455.00	24.62
Liberty (Type I-AU)	**$675.00**	675.00	675.00	75.25
Liberty (Type II-AU)	**$505.00**	505.00	440.00	31.11
Liberty (Type III-AU)	**$455.00**	450.00	420.00	18.13
U.S. Silver Coins ($1,000 face value, Circulated, year earlier uncirculated)				
90% Silver (715 oz.)	**$4,870.00**	4,492.50	4,550.00	-4.20
40% Silver (292 oz.)	**$1,955.00**	1,780.00	1,587.50	-5.83
Silver Dollars	**$6,500.00**	6,550.00	6,112.50	18.18

Note: Premium reflects percentage difference between coin price and value of metal in a coin, with gold at $398.10 per ounce and silver at $7.11 per ounce. The weight in troy ounces of the precious metal in coins is indicated in parentheses.

Recommended Mutual Funds

	Ticker Symbol	3/15/04	Month Earlier	Year Earlier	52-Week High	52-Week Low	Distributions Latest 12 Months Income	Distributions Latest 12 Months Capital Gains	Yield (%)
Short-Term Bond Funds									
★ iShares Lehman 1-3 Yr Treasury	SHY	**$82.92**	82.78	82.32	83.04	81.82	1.3116	0.0000	1.58
★ USAA Short Term Bond	USSBX	**$9.14**	9.11	9.06	9.23	9.00	0.3264	0.0000	3.57
★ Vanguard Short-term Corporate	VFSTX	**$10.88**	10.84	10.81	10.96	10.72	0.4202	0.0000	3.86
Income Equity Funds									
★ DNP Select Income[1, 2]	DNP	**$11.11**	11.23	9.89	11.32	9.70	0.7800	0.0000	7.02
★ Vanguard REIT Index	VGSIX	**$16.40**	15.96	11.55	16.63	11.48	0.7800	0.0000	4.76
Large Cap. Value Equity Funds									
★ iShares S&P 500 Value Index[3]	IVE	**$56.09**	57.51	39.78	58.88	39.40	0.8873	0.1472	1.58
★ Vanguard Value Index	VIVAX	**$19.26**	19.55	13.59	19.91	13.09	0.3720	0.0000	1.93
Small Cap. Value Equity Funds									
★ iShares Sm. Cap. 600 Value Index[3]	IJS	**$103.48**	104.25	64.25	108.70	45.57	0.6187	0.3430	0.60
★ Vanguard Sm. Cap Value Index	VISVX	**$12.11**	12.00	7.57	12.38	7.39	0.1980	0.0000	1.64
Growth Equity Funds									
★ iShares S&P 500 Growth Index[3]	IVW	**$54.72**	57.23	43.60	58.01	43.34	0.6069	0.1124	1.11
★ Vanguard Growth Index	VIGRX	**$25.15**	25.79	19.42	26.09	18.78	0.1760	0.0000	0.70
Foreign Equity Funds									
★ iShares S&P Europe 350 Index[3]	IEV	**$63.20**	67.58	42.59	69.20	42.04	2.5127	0.0000	3.98
T Rowe Price European Stock	PRESX	**$17.55**	18.28	11.68	18.68	10.81	0.2200	0.0200	1.25
★ Vanguard European Stock Index	VEURX	**$22.08**	23.19	14.66	23.57	13.64	0.4600	0.0000	2.08

Recommended Gold-Mining Companies

	Ticker Symbol	3/15/04	Month Earlier	Year Earlier	52-Week High	52-Week Low	Distributions Latest 12 Months	Distributions Frequency	Yield (%)
Anglo American PLC, ADR	AAUK	**$23.22**	24.38	14.65	26.69	13.46	0.638	Semiannual	2.75
★ Anglogold Ltd., ADR	AU	**$40.40**	43.20	30.19	49.95	27.10	0.982	Semiannual	2.43
ASA Ltd.[1]	ASA	**$40.07**	43.88	34.20	48.00	31.76	0.600	Quarterly	1.50
★ Barrick Gold Corp.†	ABX	**$20.87**	20.98	14.65	23.70	14.30	0.220	Semiannual	1.05
★ Gold Fields Ltd.	GFI	**$11.65**	13.06	10.80	15.52	9.52	0.192	Semiannual	1.65
★ Newmont Mining	NEM	**$41.99**	44.26	25.09	50.28	24.23	0.200	Quarterly	0.48
★ Placer Dome†	PDG	**$16.06**	17.09	9.23	19.23	8.76	0.100	Semiannual	0.62
★ Rio Tinto PLC‡	RTP	**$98.35**	111.20	79.55	116.33	72.30	3.160	Semiannual	3.21

★ Buy. ☆ Hold. (s) All data adjusted for splits. † Dividend shown is after 15% Canadian tax withholding. ‡ Not subject to U.K. withholding tax. na Not applicable.
[1] Closed-end fund, traded on the NYSE. [2] Dividends paid monthly. [3] Exchange traded fund, traded on ASE.