INVESTMENT GUIDE

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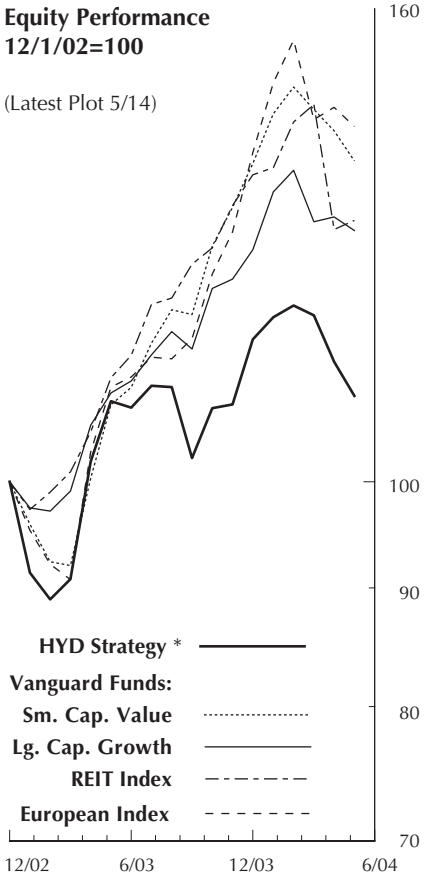


*** HYD is a hypothetical model based on back-tested results. See p. 38 for a full explanation.**

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

Online: www.americaninvestment.com

Rising Rates

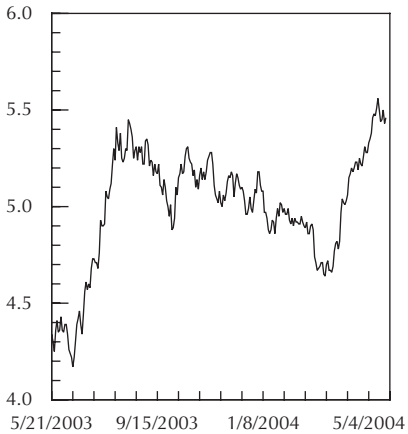
The month of April ushered in news signaling very solid economic growth, and the bond market responded by sending interest rates to their highest level in a year, as shown in the first chart below.

Conservative investors who have structured their portfolios in accordance with our recommendations might be anxious about the decline in their portfolio values, as bond prices have been pummeled in this environment. After all, we recommend that conservative investors have as much as 65 percent of their holdings in money market funds or fixed income investments. A shift in interest rates, however, is no reason to alter your investment strategy. We recommend only fixed income securities with maturities up to 5 years, which are far less interest rate sensitive than longer-term holdings. Moreover, while these interest rate spikes occur on occasion, cash and short-term bonds have proven to be far less volatile than equities over the longer term.

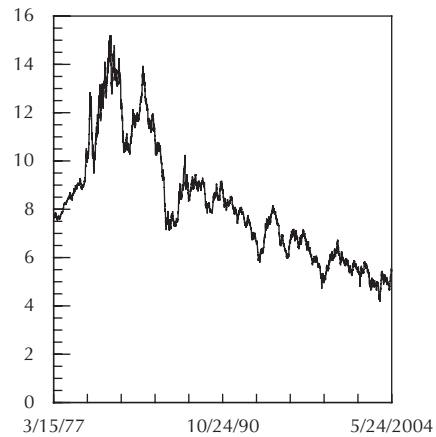
The fact is short-term interest rates simply cannot be forecast with any consistency. Rates are affected by a myriad of factors, not the least of which is the release of economic statistics. In April the market seized upon every bit of evidence that might have affected the Federal Reserve Board of Governors' decision to alter the target fed funds rate; several reports regarding economic growth "exceeded the market's expectations" and these were met by an immediate and sharp drop in bond prices. For months pundits have been warning that "rates have nowhere to go but up", but when and by how much was anyone's guess. It was *new information* that caused the latest spike; news by definition comes randomly, so security prices and interest rates move in a pattern that is inherently random.

Long-term interest rates remain below their long-term levels, as shown in the second chart below, but it does not follow that higher interest rates are imminent. *The best estimate of tomorrow's interest rates, in light of currently available information, is today's rates.* The best fixed income strategy to follow is one that ignores interest rate forecasts, either by holding a bond ladder or by following a variable maturity strategy (or "riding the yield curve"). Both were last described in detail in the March 2001 ***Investment Guide***.

30 Year Treasury Yield
May 21, 2003-May 21, 2004



30 Year Treasury Yield
March 15, 1977-May 21, 2004



IS AN ADJUSTABLE RATE MORTGAGE FOR YOU?

For many people a sound investment strategy, quite literally, begins at home. Although most individuals view choosing a new mortgage or refinancing as an isolated decision, monthly loan payments have a direct and often significant impact on how much they will have left over to save for college, retirement, or other financial goals.

With so many options available today, it is now possible to tailor a mortgage to suit a particular savings plan. A young couple, for example, might select a traditional 30-year fixed rate mortgage to lock in a predictable monthly payment. This would help assure their ability to set aside enough each month to keep a long-term retirement savings plan on track, without having to worry about fluctuating mortgage payments. Alternatively, someone approaching retirement might refinance with a lower-rate adjustable rate mortgage and use the interest savings to beef up retirement plan contributions.

One of the fundamental decisions homebuyers or those refinancing face is whether to choose a fixed or adjustable rate mortgage. Borrowers should base this decision on their personal circumstances and avoid any temptation to predict interest rates in making this choice. When mortgage rates were scraping bottom at the beginning of the year, the traditional fixed rate version would appear to have been the logical alternative for those who preferred the assurance of set monthly payments over the uncertainty of the potential for escalating costs down the road with an adjustable rate mortgage. But this is obvious only in retrospect. More recently rising interest rates might have helped spark a revival in the popularity of adjustable rate mortgages. In mid-May, ARMs accounted for nearly one-third of loan applications, up from about one-quarter of applications in February, according to the Mortgage Bankers Association. Borrowers appear to be betting that rates will not necessarily continue their climb. During that period, the average national rate on a 30-year fixed-rate mortgage rose from 5.76 to 6.37 percent. But it is important to keep these rates in perspective; there have been several periods when 30-year fixed rates have exceeded 10 percent.

Yet many people choose adjustable rate mortgages, even in times of rising rates, because they have lower initial rates than fixed-rate mortgages. That break allows homebuyers to qualify for larger mortgages than lenders would approve under a fixed-rate mortgage. With home values soaring over the last several years, many buyers might not be able to buy the "home of their dreams," or even a suitable abode, without turning to adjustable rate mortgages.

When mortgage rates climb, the allure of a lower rate, even if it is only temporary, becomes more powerful. Recently, the national average rate on a one-year adjustable rate mortgage was 4.03 percent, compared with 6.37 percent for a 30-year fixed rate mortgage. In the first year of a $200,000 mortgage, the rate difference translates into a monthly payment of $958 for the ARM and $1,247 for the fixed-rate mortgage.

Of course, the picture in the second year and beyond could be quite different in a rising rate environment. Under a scenario in which interest rates rose two percent each year, the ARM holder would be paying $1,721 a month by year four.

Still, the fact that an adjustable rate mortgage is designed to fulfill the "adjustable" part of its name does not necessarily make it a bad choice. Many people, particularly those with transient lifestyles, can save thousands of dollars in interest costs by using them. Holders of adjustable rate mortgages came out ahead for much of the last decade, a period marked by generally declining interest rates.

Is an Adjustable Rate Mortgage for You?

It could be if:

- You plan to move within a few years. If you are fairly certain that you won't be putting down roots for too long, you can tailor an adjustable rate mortgage to your time frame. For example, a transient executive who anticipates moving in the near future might opt for a 5/1 hybrid ARM that has a fixed rate for five years, followed by annual rate adjustments. Or, a young married couple might choose a similar product if they are buying an entry-level home that they will probably outgrow as their family expands. Assuming recent interest rates, individuals in these situations would save $12,496 in interest costs over five years by using a 5/1 hybrid ARM rather than a 30-year fixed-rate mortgage.
- The lender will not approve a fixed-rate mortgage. If you have trouble qualifying for a fixed-rate mortgage, an ARM may be your only option. Just be sure to carefully consider whether or not you could afford any increase in monthly payments.
- Your income appears secure, and likely to increase.
- You do not anticipate any sizable debts in the near future. Your ability to shoulder any payment increases could hinge on whether or not you anticipate other large expenses, such as college tuition or long-term care for an elderly parent.

Anyone considering an ARM should look beyond the initial lower monthly payment to examine the terms of the mortgage, and to determine whether or not they can afford an environment of rapidly rising interest rates. Such an increase could have an enormous impact on monthly payments and result in "payment shock." To calculate the possible long-term costs of an adjustable rate mortgage, consider three figures: the monthly payment based on the initial mortgage rate, the monthly payment that would be due after the first periodic adjustment if the rate (or payment) rises by the maximum periodic increase allowed, and the payment due if it increases to the highest allowable lifetime cap. The lender should be able to provide these figures, as well as answers to these key questions:

How long will the interest rate last? ARM interest rates and monthly payments change periodically. The time between one rate change and another is called the adjustment period, and it typically occurs every year, every three years, or every five years. Some ARMs change rates more frequently. The longer the rate stays the same, the higher the interest rate will be. Recently, for example, the average national rate for an ARM with an initial three-year adjustment period was 4.53 percent, compared to 5.54 percent for a mortgage with an initial rate that lasted seven years.

How is the rate determined? Lenders usually peg an ARM's initial rate and any subsequent changes to an index that fluctuates with interest rates. They then tack on a markup, called a margin. The total of the index, plus the margin, equals the interest rate you will pay. The most common indices lenders use are the London InterBank Offered Rate (LIBOR), 11th District Cost-of-Funds (COFI), Treasury Bills,

and Treasury Constant Maturities (TCM).

Some lenders offer initial mortgage rates that are lower than the rate indicated by the index rate plus the specified adjustment. However, these teaser or discounted rates last only a year or so, after which the rate will increase even if the general level of interest rates has not. If the rate on an ARM is initially set at a low teaser rate you should take higher future payments into account when evaluating your ability to carry the loan.

Are there any interest rate or payment caps? Most ARMs limit the amount of interest rate increase that occurs from one adjustment to another. Almost all ARMs must also have an overall cap that limits interest rate increases over the life of the loan. The most common caps limit each adjustment rate increase to two percentage points, with a six percentage point total increase permitted over the life of the loan. A drop in interest rates will not always result in lower monthly payments, however. This might happen when the interest rate cap has limited the rate increase to less than the sum of the index and margin. If rates later fall, the lender can apply any increases it forfeited because of the cap to future rate adjustments.

Some ARMs limit monthly payment increases rather than the mortgage rate. If an ARM has a payment cap of 10 percent, for example, a monthly payment of $1,000 cannot increase to more than $1,100 at the next adjustment.

During times of rapidly rising interest rates, the increased payments on an ARM with a payment cap may not be sufficient to cover the interest due on the loan. If that happens, the resulting unpaid interest is added to the outstanding principal and the amount of the loan increases. The result is called "negative amortization." If this continues for an extended period of time, the borrower could end up owing more to the lender than the initial loan amount. Some loans require that if the amount owed increases to a specified level, such as 125 percent of the original loan amount, the monthly payments must increase to an amount sufficient to amortize the higher balance. Borrowers can avoid negative amortization by increasing their monthly payments to fully cover interest costs.

What are the prepayment or conversion terms? Many ARMs allow you to pay off the mortgage early when the rate is adjusted, while others impose special fees or penalties for doing so. Still others include terms that allow you to convert to a fixed-rate mortgage at prevailing rates, at specified times. These mortgages may have a higher interest rate or higher upfront fees, or impose a special fee at conversion.

Common types of ARMs

Adjustable rate mortgages come in a variety of forms, some of which may be more suitable for your financial situation than others. *Traditional* ARMs have interest rates that adjust at regular intervals. The most popular of these, the one-year ARM, adjusts its interest rate annually.

Monthly ARMs typically have the lowest rates, but they adjust more frequently. Typically, they start with a fixed rate for a short initial period, usually three or six months. After that, the rate changes monthly. Although monthly adjustments are usually not subject to rate caps, these mortgages often have a lifetime rate cap of around 5 percent. Payment increases on monthly ARMs are often limited by a payment cap.

Recent Mortgage Rates

30-year fixed:	6.37%
15-year fixed:	5.61%
One-year ARM:	4.03%
3/1 ARM:	4.53%
5/1 ARM:	5.12%
7/1 ARM:	5.54%
10/1 ARM:	5.83%

National average rates as of May 7, 2004.
Source: HSH Associates, Butler, N.J.

A relatively new breed, the *hybrid* ARM, carries a fixed rate for anywhere from three to ten years, then adjusts its rate annually. Hybrids have become popular among mobile executives or others who have a relatively good idea of how long they plan to stay in a home, and who wish to tailor their mortgages accordingly.

These ARMs have a variety of cap structures, some of which offer little protection at the initial adjustment in a rising rate environment. First adjustment caps on hybrid ARMs can range anywhere from two to six percent. For a 7/1 ARM that means an initial 5.5 percent rate can jump to as much as 11.5 percent in the eighth year! Because cap arrangements can vary widely from lender to lender, be sure to ask about them when shopping for a hybrid. Although mortgages that protect against sharp first adjustment rate increases may have slightly higher initial rates, they may be worthwhile if you value the added protection.

GOLD REVISITED

We have long recommended gold-related investments for our readers and clients. This recommendation has always been based on an analysis of data, as has been the case with all of our recommended asset classes. In our most recent revision of our book "How to Invest Wisely" we re-examined gold; here we provide an overview of our findings, and our rationale for including it in our recommended portfolios.

Over the very long term gold has maintained its purchasing power far better than every major fiat currency issued. Unlike paper currencies gold cannot be instantly debased at the stroke of a pen. In many parts of the world, gold, even in the form of jewelry, is accepted as a medium of exchange. In this light gold appears worth holding as a dependable form of money.

Inflating and Investing

Investing was a relatively simple matter when the British pound, the U.S. dollar, and other currencies were redeemable on demand in specific amounts of gold. Such currencies were generally believed to be as good as gold. High-grade bonds and similar instruments thus were even better than gold—they paid interest. The cost of living might go up or down with cycles of trade or of war and peace, but the long-term stability of prices seemed assured. Under a fully functional gold standard, long-term interest rates were quite stable through business cycles, and high-grade bond prices fluctuated in a relatively narrow range. In this environment, all an investor needed to do was save up some money and lend it out at interest to borrowers who were likely to pay it back.

This has changed completely during the past half century. Chart 1 shows that $1 invested in long-term government bonds in 1926 would have grown to $64 in nominal dollars by the end of March 2004. But these are fixed dollar claims, and investors who held them would have found that their coupon payments and the eventual redemption value of these bonds would not have kept pace with the rising prices of goods and services. In real terms, that is, after adjusting for increases in the

Chart 1
Stocks Versus Bonds
Growth of $1 Since 1926

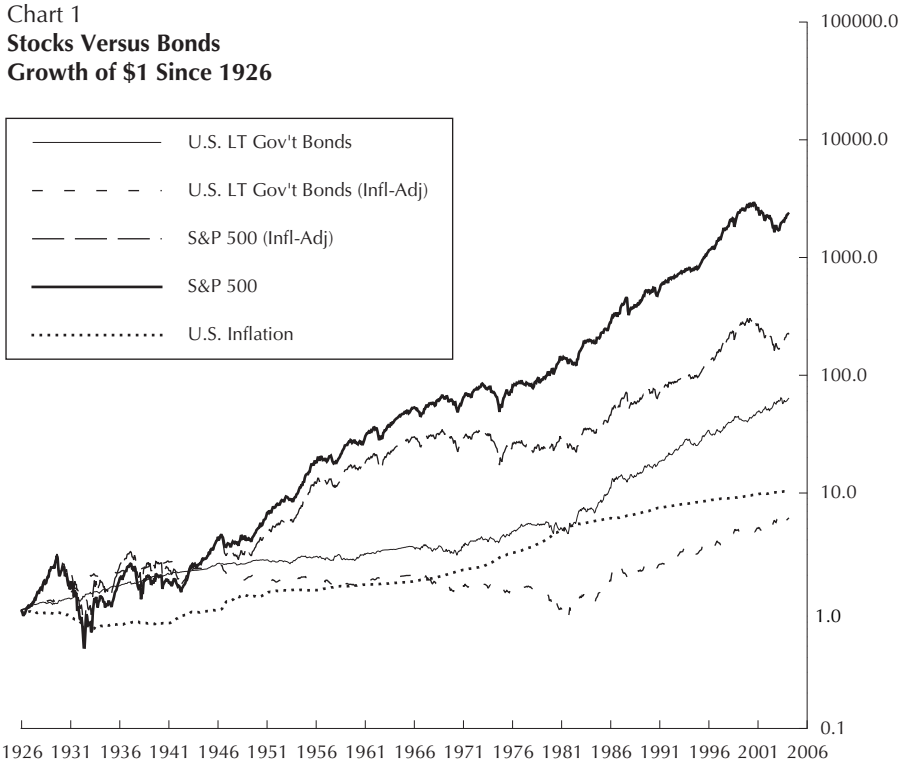
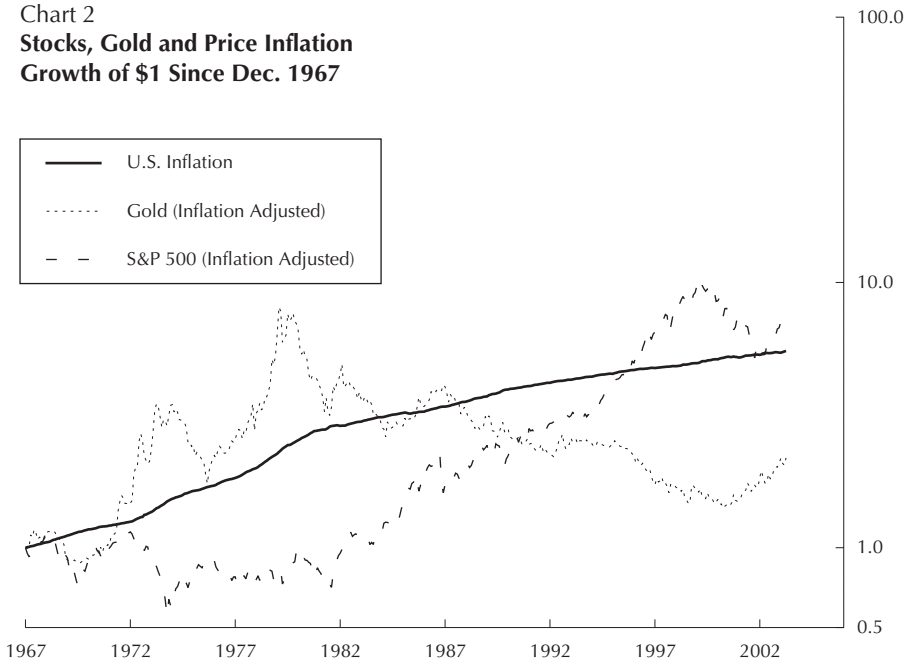


Chart 2
Stocks, Gold and Price Inflation
Growth of $1 Since Dec. 1967



consumer price index, $1 dollar invested in 1926 would only have grown to $6. *In other words, over the entire period price inflation would have obliterated 91 percent of the investor's nominal return.*

In this environment investors have naturally sought refuge from the ravages of price inflation. Notably, common stocks, which previously had been regarded as highly speculative holdings, are now typically recommended for even the portfolios of conservative investors. Chart 1 demonstrates that common stocks (as measured by the S&P 500) would have done a far superior job of offsetting price inflation.

The downside to stocks is their volatility. Stocks are a residual claim on the assets of a firm, so in the event of bankruptcy, shareholders' claims are subordinate to those of bondholders. Common stock dividends furthermore are not contractual like coupon payments on a bond; they are declared at the discretion of a board of directors who base their decision on the firm's profitability. These uncertainties are manifested in the highly volatile nature of stock prices.

Our challenge in forming our portfolio recommendations is to acknowledge both the certainty of price inflation as well as the risk inherent in holding alternative assets. We attempt to form portfolios that will provide positive real returns by selecting asset classes that provide growth over time, but that are not strongly correlated with one another.

Is Gold an Inflation Hedge?

It is often claimed that gold deserves inclusion in portfolios because it is a "hedge against inflation." Indeed to some the notion is almost a tautology. That proposition deserves closer scrutiny.

Chart 2 depicts the growth of gold versus price inflation since January 1968, when the gold price first began to "float"; in fact over the entire 36 year period gold has proven to be a relatively ineffective inflation hedge. In the late 1970s when price inflation was exorbitant and virtually every other conventional financial asset performed miserably, gold proved to be extraordinarily effective. But since the mid 1980s, while inflation has been persistent, its rate has moderated considerably, and in this environment the gold price has languished and has proven to be a poor hedge.

Over the entire period the correlation coefficient between gold and inflation was -0.02; this very slight negative correlation suggests that in terms of direction and magnitude, the returns to gold, on average, were actually falling when prices were rising, and vice versa (a correlation coefficient of 1.0 indicates a perfect positive linear relationship between two variables, -1.0 indicates a perfect negative linear relationship, while a correlation coefficient of zero means that there is no linear relationship).

Is Gold a Conservative Investment?

Many investors regard gold as a form of money that should form a "cornerstone" of one's portfolio. It is regarded by some to be a "conservative" investment that has withstood the test of time. This notion should also be examined.

Table 1 indicates that between January 1968 and December 2004, gold bullion provided a total annualized return of 7.1 percent, matching the returns of 6-month Treasury bills. Gold, however, was

far more volatile. Standard deviation measures the *dispersion* of returns about the mean, and this measure of volatility shows that gold was essentially 17 times riskier than Treasury bills. In addition, gold provided negative total returns during 16 of the 36 calendar years examined, while Treasuries provided positive returns every year. For the investor concerned with volatility, Treasuries would appear to win hands down.

So—Why Hold Gold?

If gold fails to live up to its reputation as an inflation-proof, conservative investment, why should an investor hold it? The answer lies in the fact that gold behaves quite differently from virtually every other asset in our recommended mix.

Table 2 presents the results from three hypothetical portfolios. An all-equity portfolio invested equally between the S&P 500, U.S. large-cap value stocks and U.S. small-cap value stocks would have provided a total annualized return of 13.52 percent between 1968 and December 2003. If each of these allocations had been reduced by 3.33 percent and a 10 percent gold allocation added, the total return on the portfolio would have fallen by only 0.07 percentage point, but the risk, as measured by standard deviation, would have dropped by a full 1.6 percentage points per year. If on the other hand that 10 percent had been allocated to Treasury bills instead of gold, the risk would fall to roughly the same level as that of the gold portfolio, but the total return would be a full 0.43 percentage point lower. Over 36 years the gold premium of 0.43 percentage point would have added roughly $1,670 to an original investment of $10,000.

This "diversification return" is a result of the fact that gold is highly uncorrelated with these other asset classes. When a portfolio is periodically rebalanced among asset classes whose prices move asynchronously, one is mechanically "selling high and buying low." To the extent that an investor can add assets that are not strongly correlated, he can potentially enhance his returns. Table 3 demonstrates that gold is negatively correlated with all four of these alternative asset classes.

How to Hold Gold

Holding gold directly, in the form of bullion or bullion coins, can be problematic. Many investors hold gold for its monetary attributes; however, in the U.S. physical gold is not readily acceptable as a medium of exchange. Selling bullion or coins for dollars is also difficult as dealers are few and far between, and prices can vary widely from dealer to dealer. It has been widely reported in the financial press that a gold-backed exchange-traded fund may soon emerge. This would provide easy access to an asset tied directly to the gold price, since exchange-traded funds trade on major stock exchanges throughout the day. However, these shares are in the approval process, so they are not yet available.

In this environment we favor holding shares of "blue chip" gold mining companies. The firms recommend on page 40 are among the world's largest producers. All of these firms pay a dividend and have long-lived reserves and low cash operating costs. These firms offer growth potential independent of the gold price as well, through exploration and new mine development.

Table 1: **Gold versus Treasury Bills (Jan 1968 - Dec 2003)**

	Gold (PM Fix)	*U.S. T- Bills (6 month)*
Total annualized return (%)	7.1	7.1
Standard Deviation (annualized)	20.5	1.2
Number of calendar years with negative returns	16	0

Table 2: **Hypothetical Portfolio Results (Jan 1968 - Dec 2003)**
(Annual Rebalancing)

	100% Equity Portfolio	*10% Bullion Portfolio*	*10% T-bill Portfolio*
		Allocations (%)	
S&P 500 Index	33.33	30	30
US Large Cap Value*	33.34	30	30
US Small Cap Value**	33.33	30	30
Gold Bullion (PM fix)		10	
6-Month Treasury Bills			10
Total	100	100	100
		Risk and Return (Annualized, %)	
Portfolio Return	13.52	13.45	13.02
Standard Deviation	16.28	14.68	14.66

*Fama/French US Large Value (inc. Utilities) Sim. Port.
**Fama/French US Small Value (inc. Utilities) Sim. Port.

Table 3: **Correlations Between Asset Classes**
Jan 1968 - Dec 2003
Annual

	S&P 500 Index	*US Large Cap Value*	*US Small Cap Value*	*Gold Bullion (PM fix)*	*6-Month U.S. T-Bill*
S&P 500 Index	1				
US Large Cap Value	0.827	1			
US Small Cap Value	0.61	0.808	1		
Gold Bullion (PM fix)	**-0.247**	**-0.281**	**-0.212**	1	
6 Month Treasury Bills	0.028	0.102	-0.064	**-0.096**	1

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 **Citigroup** and **Verizon**, which was not in the Dow, were not eligible for purchase 18 months earlier (in December 2002). Investors following the model should find that the indicated purchases of **Verizon** and **Citigroup** 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.

As of May 14, 2004

					——*Percent of Portfolio**——	
	Rank	*Yield*	*Price*	*Status*	*Value*	*No. Shares*[1]
Altria Group	1	5.45%	49.88	*		
SBC Comm.	2	5.10%	24.50	Holding**	25.77	28.19
General Motors	3	4.51%	44.35	*		
Verizon	4	4.24%	36.36	Buying	3.09	2.28
JP Morgan Chase	5	3.81%	35.66	Holding**	28.07	21.09
CitiGroup	6	3.50%	45.65	Buying	4.51	2.65
DuPont	7	3.36%	41.69	Holding	7.11	4.57
Merck	8	3.19%	46.45	Holding	3.21	1.85
General Electric	9	2.65%	30.16			
Exxon Mobil	10	2.50%	43.27			
AT&T	NA	5.70%	16.72	Holding	17.33	27.78
Eastman Kodak	NA	2.00%	25.13	Selling	10.88	11.60
					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	-4.93%	3.86%	0.34%	12.11%	14.54%	15.26%	19.35
Dow	-3.50%	17.09%	0.10%	12.53%	12.23%	10.46%	16.93

* The strategy excludes Altria and General Motors. ** Currently indicated purchases approximately equal to indicated purchases 18 months ago. [1] Because the percentage of each issue in the portfolio by value reflects the prices shown in the table, we are also showing the number of *shares* of each stock as a percentage of the total number of shares in the entire portfolio. [2] Assuming all purchases and sales at mid-month prices (+/–$0.125 per share commissions), reinvestment of all dividends and interest, and no taxes. The 5-, 10- and 15-year total returns are annualized as are the total returns and the standard deviations of those returns since December 1963.

Note: These calculations are based on hypothetical trades following a very exacting stock-selection strategy, and are gross of any management fees. They do not reflect returns on actual investments or previous recommendations of AIS. Past performance may differ from future results.

By making such adjustments from time to time, investors should achieve results roughly equal to the future performance of the model.

The process of *starting* to use the strategy is not as straightforward. The two most extreme approaches are: 1) buy all the indicated positions at once or 2) spread purchases out over 18 months. Either choice could be said to represent an attempt at market timing, i.e., buying all at once could be construed as a prediction that (and will look good in retrospect only if) the prices of the shares go up after the purchases are made. On the other hand, if purchases are stretched out and stock prices increase, the value of the investor's holdings will lag behind the strategy's performance. We believe that most attempts to time the market are futile, and the best course lies somewhere in between the extremes.

Some portion of the shares now held in the strategy will be sold within a few months. The shares most likely to be sold are those whose indicated yields are too low to make them currently eligible for purchase. This usually means that their prices have risen (and their yields have fallen), in relative if not absolute terms, since they were purchased. If such stocks are purchased now and are sold within a few months, the investor will receive only a portion of the profit, or sustain a greater loss, than the strategy. On the other hand, if the stocks not currently eligible for purchase are bought and the strategy does not call for selling them soon, it will usually be because their prices have decreased so that their indicated yields render them again eligible for purchase. In other words, buying a stock that is not currently among the top four means that it will very likely be sold during the months ahead (perhaps at a gain, perhaps not, but with payment of two commissions either way). Alternatively, if the price decreases so that the issue again becomes eligible for purchase, then the investor's initial purchase would be likely to be held in the portfolio at a loss for some period of time. In the latter situation, the investor would have been better off waiting.

Accordingly, for new HYD clients, we usually purchase the complement of the currently eligible stocks without delay. (This month, the four eligible issues—SBC Communications, Verizon, J.P. Morgan Chase, and Citigroup — account for roughly 60 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 5/14/04	Market Prices 4/15/04	Market Prices 5/15/03	12-Month High	12-Month Low	Latest Dividend Amount	Latest Dividend Record Date	Latest Dividend Paid	Indicated Annual Dividend	Indicated Yield† (%)
Altria Group	MO	**$49.88**	55.59	33.74	58.96	33.25	0.680	3/15/04	4/12/04	2.720	5.45
★ SBC Comm.	SBC	**$24.50**	24.36	24.76	27.73	21.16	0.313	4/10/04	5/03/04	1.250	5.10
General Motors	GM	**$44.35**	45.39	34.88	55.55	32.84	0.500	5/14/04	6/10/04	2.000	4.51
★ Verizon	VZ	**$36.36**	37.06	37.10	41.35	31.10	0.385	4/09/04	5/03/04	1.540	4.24
★ J. P. Morgan Chase	JPM	**$35.66**	38.77	31.04	43.84	29.93	0.340	7/06/04	7/31/04	1.360	3.81
★ Citigroup	C	**$45.65**	49.92	39.45	52.88	38.09	0.400	5/03/04	5/28/04	1.600	3.50
☆ DuPont	DD	**$41.69**	45.07	42.60	46.25	38.60	0.350	5/14/04	6/12/04	1.400	3.36
☆ Merck	MRK	**$46.45**	46.98	59.53	63.50	40.57	0.370	3/05/04	4/01/04	1.480	3.19
General Electric	GE	**$30.16**	30.76	28.48	34.57	26.90	0.200	3/01/04	4/26/04	0.800	2.65
Exxon Mobil	XOM	**$43.27**	43.68	35.29	44.24 *H*	34.90	0.270	5/13/04	6/10/04	1.080	2.50
Honeywell Intl.	HON	**$33.48**	34.50	25.15	37.65	23.27	0.188	5/20/04	6/10/04	0.750	2.24
Johnson & Johnson	JNJ	**$54.52**	54.52	55.44	56.39	48.05	0.285	5/18/04	6/08/04	1.140	2.09
Alcoa	AA	**$29.78**	33.00	22.75	39.44	21.83	0.150	5/10/04	5/25/04	0.600	2.01
Coca-Cola	KO	**$50.00**	51.20	44.64	53.50 *H*	42.28	0.250	6/15/04	7/01/04	1.000	2.00
Caterpillar	CAT	**$75.69**	80.80	53.40	85.70	50.19	0.370	4/26/04	5/20/04	1.480	1.96
Pfizer	PFE	**$35.60**	37.34	33.53	38.89	29.43	0.170	5/15/04	6/04/04	0.680	1.91
Procter & Gamble	PG	**$106.41**	106.12	89.90	108.85 *H*	86.51	0.500	4/23/04	5/14/04	2.000	1.88
Boeing	BA	**$43.44**	41.53	30.16	45.10	28.55	0.200	5/21/04	6/11/04	0.800	1.84
3M Company (s)	MMM	**$83.81**	82.85	62.92	88.70 *H*	61.25	0.360	5/21/04	6/12/04	1.440	1.72
United Tech.	UTX	**$83.25**	88.14	67.77	97.84	64.93	0.350	5/21/04	6/10/04	1.400	1.68
Hewlett-Packard	HPQ	**$19.61**	21.89	17.63	26.28	16.73	0.080	3/17/04	4/07/04	0.320	1.63
McDonald's	MCD	**$26.17**	26.93	18.60	29.98	16.58	0.400	11/14/03	12/01/03	0.400	1.53
Wal-Mart Stores	WMT	**$55.06**	57.79	53.76	61.31	50.50	0.130	5/21/04	6/07/04	0.520	0.94
Walt Disney	DIS	**$23.24**	24.70	18.46	28.41	17.45	0.210	12/12/03	1/06/04	0.210	0.90
IBM	IBM	**$86.41**	93.97	89.90	100.43	78.73	0.180	5/10/04	6/10/04	0.720	0.83
Home Depot, Inc.	HD	**$33.80**	35.86	29.37	37.89	27.85	0.070	3/11/04	3/22/04	0.280	0.83
American Express	AXP	**$48.86**	49.75	40.99	53.98	39.15	0.100	4/02/04	5/10/04	0.400	0.82
Microsoft Corp.	MSFT	**$25.86**	25.22	25.79	30.00	23.60	0.160	10/15/03	11/07/03	0.160	0.62
Intel Corp.	INTC	**$27.04**	26.66	20.00	34.60	18.51	0.040	5/07/04	6/01/04	0.160	0.59
AIG	AIG	**$70.80**	74.68	57.31	77.36	54.20	0.650	6/04/04	6/18/04	0.260	0.37
☆ AT&T	T	**$16.72**	18.64	17.44	23.18	16.46	0.237	3/31/04	5/03/04	0.950	5.70
☆ Eastman Kodak	EK	**$25.13**	24.95	30.02	32.46	20.39	0.250	11/03/03	12/12/03	0.500	2.00

† Based on indicated dividends and market price as of 5/14/04. *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

	5/14/04	*Mo. Earlier*	*Yr. Earlier*
Gold, London p.m. fixing	**376.50**	**398.25**	354.25
Silver, London Spot Price	**5.56**	**6.86**	4.87
Copper, COMEX Spot Price	**1.18**	**1.29**	0.76
Crude Oil, W. Texas Int. Spot	**41.38**	**37.57**	28.74
Dow Jones Spot Index	**191.60**	**190.42**	152.96
Dow Jones-AIG Futures Index	**149.08**	**148.49**	119.21
CRB-Bridge Futures Index	**269.19**	**276.87**	240.63

Interest Rates (%)

U.S. Treasury bills -	91 day	**0.98**	**0.93**	1.05
	182 day	**1.33**	**1.11**	1.09
	52 week	**1.77**	**1.41**	1.12
U.S. Treasury bonds -	15 year	**5.32**	**4.96**	4.03
Corporates:				
High Quality -	10+ year	**6.21**	**5.84**	5.17
Medium Quality -	10+ year	**6.70**	**6.25**	5.79
Federal Reserve Discount Rate		**2.00**	**2.00**	2.25
New York Prime Rate		**4.00**	**4.00**	4.25
Euro Rates	3 month	**2.08**	**2.05**	2.43
Government bonds -	10 year	**4.27**	**3.88**	3.86
Swiss Rates -	3 month	**0.27**	**0.27**	0.30
Government bonds -	10 year	**2.76**	**2.62**	2.27

Exchange Rates

British Pound	**$1.767400**	**$1.785100**	1.625600
Canadian Dollar	**$0.722300**	**$0.742500**	0.727300
Euro	**$1.200700**	**$1.192900**	1.148400
Japanese Yen	**$0.008794**	**$0.009217**	0.008621
South African Rand	**$0.147500**	**$0.152400**	0.128200
Swiss Franc	**$0.782300**	**$0.767900**	0.763500

Securities Markets

	5/14/04	*Mo. Earlier*	*Yr. Earlier*
S & P 500 Stock Composite	**1,095.70**	**1,128.84**	946.67
Dow Jones Industrial Average	**10,012.87**	**10,397.46**	8,713.14
Dow Jones Transportation Average	**2,848.89**	**2,913.94**	2,436.79
Dow Jones Utilities Average	**265.02**	**271.98**	230.65
Dow Jones Bond Average	**171.13**	**175.54**	172.20
Nasdaq Composite	**1,904.25**	**2,002.17**	1,551.38
Financial Times Gold Mines Index	**1,361.45**	**1,588.20**	1,217.83
FT African Gold Mines	**1,870.71**	**2,195.74**	2,000.91
FT Australasian Gold Mines	**2,655.47**	**3,193.67**	2,004.19
FT North American Gold Mines	**1,132.14**	**1,314.78**	961.72

Coin Prices

	5/14/04	*Mo. Earlier*	*Yr. Earlier*	*Premium*
American Eagle (1.00)	**$396.55**	**$430.25**	360.45	5.33
Austrian 100-Corona (0.9803)	**$377.63**	**$409.72**	343.33	2.31
British Sovereign (0.2354)	**$94.75**	**$102.55**	86.35	6.91
Canadian Maple Leaf (1.00)	**$396.80**	**$430.50**	360.70	5.39
Mexican 50-Peso (1.2057)	**$465.90**	**$505.40**	423.60	2.63
Mexican Ounce (1.00)	**$386.30**	**$419.10**	351.20	2.60
S. African Krugerrand (1.00)	**$392.25**	**$425.35**	356.85	4.18
U.S. Double Eagle-$20 (0.9675)				
St. Gaudens (MS-60)	**$475.00**	**$480.00**	410.00	30.40
Liberty (Type I-AU)	**$675.00**	**$675.00**	675.00	85.31
Liberty (Type II-AU)	**$487.50**	**$492.50**	440.00	33.83
Liberty (Type III-AU)	**$440.00**	**$455.00**	385.00	20.79
U.S. Silver Coins ($1,000 face value, circulated, year earlier uncirculated)				
90% Silver (715 oz.)	**$4,302.50**	**$5,530.00**	4,500.00	8.23
40% Silver (292 oz.)	**$1,730.00**	**$2,180.00**	1,587.50	6.56
Silver Dollars	**$6,500.00**	**$6,675.00**	6,112.50	51.12

Note: Premium reflects percentage difference between coin price and value of metal in a coin, with gold at $376.50 per ounce and silver at $5.56 per ounce. The weight in troy ounces of the precious metal in coins is indicated in parentheses.

Recommended Mutual Funds

	Ticker Symbol	*5/14/04*	*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	**$81.64**	**$82.22**	82.49	83.08	81.32	1.3107	0.0000	1.61
★ USAA Short Term Bond	USSBX	**$8.99**	**$9.06**	9.16	9.23	8.98	0.3138	0.0000	3.49
★ Vanguard Short-term Corporate	VFSTX	**$10.64**	**$10.76**	10.88	10.96	10.63	0.4020	0.0000	3.78
Income Equity Funds									
★ DNP Select Income[1, 2]	DNP	**$10.07**	**$10.57**	10.31	11.42	9.60	0.7800	0.0000	7.75
★ Vanguard REIT Index	VGSIX	**$14.18**	**$14.75**	12.90	16.98	12.76	0.7900	0.0000	5.57
Large Cap. Value Equity Funds									
★ iShares S&P 500 Value Index[3]	IVE	**$54.83**	**$56.66**	46.06	58.88	44.65	0.9246	0.0000	1.69
★ Vanguard Value Index	VIVAX	**$18.62**	**$19.12**	15.70	19.91	15.46	0.4020	0.0000	2.16
Small Cap. Value Equity Funds									
★ iShares Sm. Cap. 600 Value Index[3]	IJS	**$99.76**	**$104.79**	76.55	109.15	45.57	0.8487	0.0000	0.85
★ Vanguard Sm. Cap Value Index	VISVX	**$11.30**	**$11.91**	9.00	12.48	8.68	0.1980	0.0000	1.75
Growth Equity Funds									
★ iShares S&P 500 Growth Index[3]	IVW	**$54.80**	**$56.25**	48.76	58.01	46.59	0.6160	0.0000	1.12
★ Vanguard Growth Index	VIGRX	**$24.66**	**$25.50**	21.65	26.09	20.80	0.1460	0.0000	0.59
Foreign Equity Funds									
★ iShares S&P Europe 350 Index[3]	IEV	**$62.18**	**$64.58**	51.05	69.20	49.68	2.5127	0.0000	4.04
T Rowe Price European Stock	PRESX	**$16.67**	**$17.41**	13.78	18.68	13.59	0.2200	0.0200	1.32
★ Vanguard European Stock Index	VEURX	**$21.37**	**$22.14**	17.39	23.57	17.16	0.4600	0.0000	2.15

Recommended Gold-Mining Companies

	Ticker Symbol	*5/14/04*	*Month Earlier*	*Year Earlier*	*— 52-Week — High*	*Low*	*Distributions Latest 12 Months*	*Frequency*	*Yield (%)*
Anglo American PLC, ADR	AAUK	**$19.21**	**$23.74**	14.86	26.69	14.50	0.780	Semiannual	4.06
★ Anglogold Ltd., ADR	AU	**$31.75**	**$36.77**	30.63	49.95	28.15	0.996	Semiannual	3.14
ASA Ltd.[1]	ASA	**$35.27**	**$39.46**	36.38	48.00	33.47	0.600	Quarterly	1.70
★ Barrick Gold Corp.†	ABX	**$18.79**	**$21.77**	17.53	24.16	16.63	0.220	Semiannual	1.17
★ Gold Fields Ltd.	GFI	**$10.42**	**$12.18**	11.34	15.52	9.75	0.118	Semiannual	1.13
★ Newmont Mining	NEM	**$36.95**	**$43.05**	28.56	50.28	28.50	0.300	Quarterly	0.81
★ Placer Dome†	PDG	**$14.12**	**$16.41**	10.73	19.23	10.50	0.100	Semiannual	0.71
★ Rio Tinto PLC‡	RTP	**$86.42**	**$96.55**	74.75	116.33	74.47	2.560	Semiannual	2.96

★ 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.