INVESTMENT GUIDE

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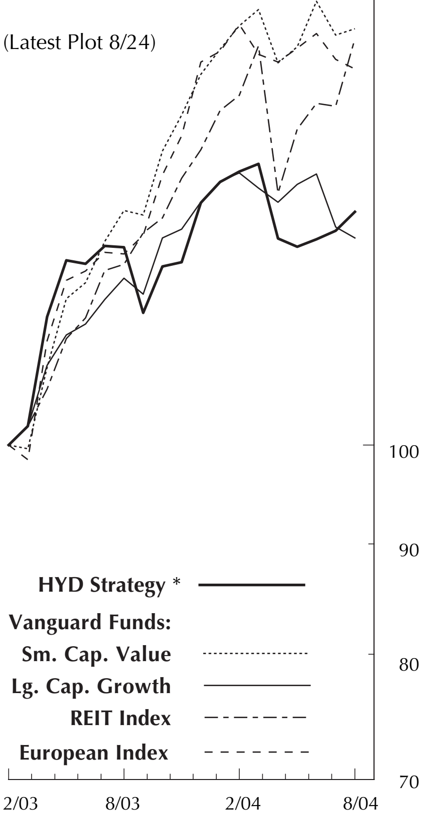
Equity Performance
2/1/03=100

(Latest Plot 8/24)



*** HYD is a hypothetical model based on back-tested results. See p. 62 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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The Market "Pros": Often in Error but Never in Doubt

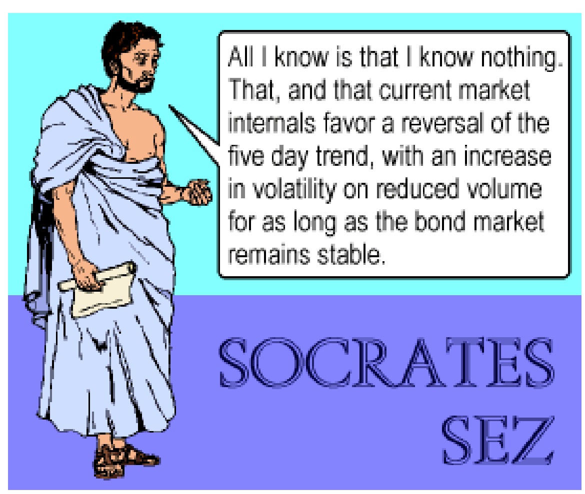
The *Wall Street Journal* warned in early May that "Nearly everyone agrees the bond market will take a hit when the Federal Reserve starts raising interest rates, perhaps as early as next month."

The Fed did in fact raise the target federal funds rate from 1.00 percent to 1.25 percent on June 30, but the bond market did not take a hit, instead it rose that day, sending the yield on the ten year Treasury note (which moves in the opposite direction of bond prices) down to 4.59 percent, roughly 0.20 percent lower than its level when the *Wall Street Journal* article appeared. As of August 20th bonds had risen further, dropping the yield to 4.23 percent.

If the Fed's move was a virtual certainty, why should market participants have been expected to wait until June 30th to take action as the article implied? That widely anticipated move was reflected in prices before the article appeared, and long before the Fed meeting. The subsequent rise in bond prices on June 30th was a reflection of whatever *new* developments were coming to light on that day; the Fed's increase was a foregone conclusion to the market.

Unfortunately there is no shortage of brokers and other money managers with a knack for telling compelling tales about what the market, or a security, is about to do. Their claims are cleverly pitched and sound credible. The typical "talking head" is an entertainer, whose talent lies not in prognosticating but in making old, usually factual, news appear to be revelatory. These pundits invariably fail to explain why that information should not already have impacted the market.

We do not claim to compete with these showmen. We admit that our approach to investing is about as riveting as watching paint dry. For example, with regard to our approach to selecting large-cap value stocks, we do our very best to *ignore* all the news affecting the stocks in our high-yield Dow model, unless it pertains to a change in the dividend or the composition in the 30 stocks that comprise the Dow. Our mission is simple: to provide sound, low-cost investment education and advice to our readers and our advisory clients.



WHAT TO KNOW ABOUT MUNICIPAL BONDS

Municipal bonds remain a favorite among tax-averse investors. Fixed income investments merit a place in almost every portfolio, and this tax-advantaged variety is warranted for many investors. Readers should be aware of their various features before investing.

General Characteristics

Municipal bonds ("munis") fall into the fixed-income category of investments. They are debt obligations issued by states, cities, and other government entities to raise money for work to be performed for the "public good." When purchasing muni bonds, investors are essentially loaning money to the issuer who promises to pay a specified amount of interest and return the principal at the maturity date.

There are two general categories of municipal bonds; general-obligation bonds and revenue bonds. General-obligation bonds are secured by the general funds of the issuing entity (i.e., tax revenues); revenue bonds are tied to the receipts produced from a specific project (i.e., toll receipts or airport receipts). One of the first such projects financed in this manner was the Erie Canal in 1817. There are various hybrid bonds as well, such as the "double barrel," which is both a general obligation and a revenue bond, and the limited-tax obligation bond.

According to bond specialist Fixed Income Securities, there are approximately 1.5 million individual bonds outstanding, issued by 50,000 issuers. This includes all 50 states, the District of Columbia, and several U.S. protectorates. In addition certain types of authorities, such as water districts, housing and industrial development authorities may also issue municipal bonds called "private activity bonds." Private corporations access municipal bond funding through participation in these entities.

According to Federal Reserve estimates outstanding municipal debt obligations totaled $1.87 trillion as of September 30, 2003, making it one of the world's largest securities markets. Munis are sold in the secondary market via banks and dealers registered to trade in municipal securities. Roughly one-third of the total outstanding muni bonds are held by private households and the rest are held by institutional investors.

In July 1983 an act of Congress mandated that all new muni bonds be issued as registered bonds rather than bearer bonds. In this form each bondholder is registered with the issuer rather than actually holding title to the security. This act was intended to facilitate the reporting of bond holdings to tax authorities.

Tax Treatment

The key advantage to investing in municipal bonds is that the interest earned is free of regular Federal income tax and is usually free of any regular state or local income tax if the bond was issued in the state where the taxpayer lives (some states tax their own municipal bonds). However, if you buy municipal bonds issued in another state, you'll pay income tax on that interest if your own state has an income tax.

If you sell a muni for more than you paid for it, you will have a capital gain. That gain is taxable under the Federal capital-gains tax rates (15 percent maximum now if you held the bond for at least 12 months or at your marginal tax rate if you held it less than 12 months).

The right of states to issue municipal bonds free from Federal taxation has been tested and upheld by the Federal courts. There are taxable municipal bonds as well. Certain projects that do not qualify may issue taxable obligations. Over $75 billion in taxable municipals have been issued in the past five years.

Like conventional bonds, munis are issued with a variety of features. They may have a fixed semi-annual coupon, floating rate, variable rate, zero coupon or compound interest. Measuring the profitability of muni investments is also similar to conventional bonds.

To compare a muni bond to a conventional bond, consider the muni bond's *Tax Equivalent Yield (TEY)* as follows:

TEY = Tax-Free Yield / (1-Marginal Tax Rate)

Example:

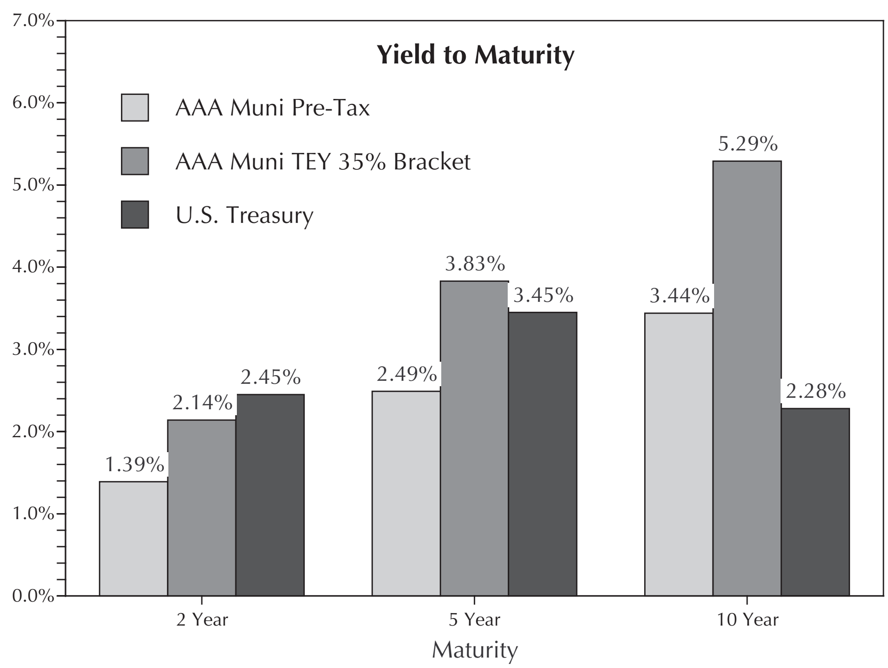
For an investor in a combined 35% tax bracket contemplating the purchase of a municipal bond quoted at a 3.55% yield to maturity, the after-tax TEY would be:

$$3.55 / (1-0.35) = 5.46$$

Thus the investor would find this after-tax yield to be attractive compared with taxable bonds of comparable maturity and credit risk yielding less than 5.46%.

The table on page 59 illustrates the tax benefit of munis vs. corporate as well as the fact that the market perceives them to be risky investments over longer periods. The TEY is for an investor in a combined 35% Federal and state marginal tax bracket.

It may be tempting to focus simply on the higher yield paid by long-term shares. However, historical evidence shows that longer-term, fixed-income securities are more volatile than shorter term bonds and are more sensitive to



changes in interest rates. As a rule of thumb we recommend that investors avoid bonds that mature in more than five years. *Duration* can be a very useful measure when considering specific muni issues. The duration of a bond is the time required to fully recover the purchase price of a bond given the present values of its cash flows. For any given bond, it shows its price sensitivity to interest rates.

Relative Risk Factors

Muni-Bonds are generally considered a very stable and safe class of investment and default is very rare. Prior to New York City's near default on its municipal bonds during the fiscal crisis of 1975, investors relied exclusively on private rating agencies' assessment of the quality of municipal bonds. That event showed that these ratings were not infallible and that municipal bonds are not without risk.

It is important to carefully review the specific terms of the bond offered. Call provisions should be carefully scrutinized as they entail significant opportunity cost. A call provision gives the issuer the right to repurchase a bond according to predetermined guidelines as described in the official statement. It allows the issuer to call the bond if interest rates fall below the rate the issuer is currently paying. Calls are designed to ensure the timely and orderly retirement of debt. A bond may be subject to a random call by arbitrary selection or some predetermined call specified in the *official statement*, such as early payment of mortgages on real estate construction that the bond financed.

While call provisions generally favor the issuer, there are intangible benefits to investors such as the reduction of default risk. Because they expose the purchaser to the risk of being called, issuers typically must pay a higher initial coupon rate versus comparable non-callable bonds. It also affords some level of price support as the issuer becomes a buyer at times when interest rates are lower than at the time of issuance. Call-protection features very often require the issuer to repurchase the bonds at a premium to their par value. Brokers and dealers of muni bonds are required to disclose the call impact on the yield of a bond. Munis are generally quoted in the *yield to call* rather than the yield to maturity.

Variations on Municipal Bonds

AMT Bonds All municipal bonds are not equal in the eyes of the Federal government. Some are not exempt from the alternative minimum tax (AMT). An increasing number of individual tax payers are finding themselves subject to the AMT, which they must pay if their liability under the AMT exceeds their regular income tax. Interest on "private activity" municipal bonds is included in calculating the AMT income. Investors subject to the AMT should take this into account when purchasing these bonds. Conversely, investors not subject to the AMT might benefit from AMT bonds because AMT bonds must offer a higher return versus non-AMT bonds, in order to attract AMT taxpayers.

Pre-Refunded Bonds Pre-refunded municipal bonds generally carry a rating of "AAA" because of they have lower credit risk. The income and principal from pre-refunded municipal bonds is secured by an irrevocable trust that holds U.S. Treasury securities. The payments from pre-refunded municipal bonds are therefore in effect backed by the full faith and credit of the U.S. government and are no longer dependent upon the revenue stream or tax collections of the original issuing municipality.

Territorial Bonds issued by Puerto Rico, Guam, the U.S. Virgin Islands and other U.S. Territories enjoy full tax-exemption in all 50 states. These bonds can therefore provide a broader selection of bonds that extends beyond an investor's home state for investors seeking to escape taxes at both the Federal and state levels. The basis for these territories' special tax treatment emerged from a 1914 court ruling.

Insured Bonds Insured municipal bonds are municipal securities that are enhanced by financial guaranty insurers. Municipal-bond insurance guarantees the timely payment of all principal and interest on a municipal bond should the issuer default. This gives these bonds increased marketability and lower credit risk, though this feature also enables issuers to pay a lower interest rate versus similar non-insured bonds.

Pre-Tax Return on Tax-Exempt Investment

	1%	*3%*	*4%*	*5%*	*6%*	*7%*	*8%*
				After-Tax Equivalent Return			
Tax Rate							
10	1.111	3.33	4.44	5.56	6.67	7.78	8.89
15	1.176	3.53	4.71	5.88	7.06	8.24	9.41
27	1.370	4.11	5.48	6.85	8.22	9.59	10.96
30	1.429	4.29	5.71	7.14	8.57	10.00	11.43
35	1.538	4.62	6.15	7.69	9.23	10.77	12.31
38.6	1.629	4.89	6.51	8.14	9.77	11.4	13.03

Source: CCH Incorporated.

Markets for Munis

You can purchase munis from a registered bond broker-dealer. Transaction costs range from 0.5% to 3% of the bond's value. There is no explicit commission; instead the markup is included in the yield and price quoted at the time of purchase. The Bond Market Association website http://www.investinginbonds.com gives daily price and yield information for many munis as well as transaction prices to make sure that you are paying a fair-market rate. More information on munis is available from the Fixed Income Securities, LLC, a bond brokerage, at http://www.fisbond.com.

Morningstar offers analysis of 1,800 muni bond funds. Funds are categorized by state and length of holding (i.e., short, medium or long term). The advantages of a fund versus purchasing bonds directly might include lower transaction costs for the underlying bonds, and liquidity. A fund can be sold any day at the fund's closing net-asset value, while an offer to sell muni bonds, especially small lots, might not generate many interested buyers. The downside of a fund is it may not meet your specific tax needs and it will limit your ability to employ techniques such as laddering of maturities to minimize interest-rate risk. Many fund managers in fact attempt to predict interest rates, often to the detriment of their shareholders. Simply put, bond funds offer a "one size" approach that is appropriate for some but not for all. Many funds are quite costly. According to Morningstar, the average municipal bond fund has a 1.07% expense ratio, and many impose front-end or deferred loads.

DFA offers a Short-Term Municipal Bond Portfolio that employs a variable-maturity strategy that seeks to minimize volatility while maximizing total return. The fund is quite inexpensive but is available only through registered investment advisors. We offer the fund through our Professional Asset Management program.

INDEXED ANNUITIES: TOO GOOD TO BE TRUE

Since the stock market meltdown of 2000, traumatized investors have proven to be an easy target for sharp salesman. In this environment, the insurance industry has been aggressively marketing equity-indexed annuities, which claim to offer precisely what jaded investors long for: participation in any "upside" in the stock market, with "guaranteed downside protection." This claim alone should arouse suspicion, and indeed, we recommend that investors avoid them in favor of a well-allocated portfolio of more conventional investment vehicles.

Equity indexed annuities (EIAs) are a hybrid type of deferred annuity; they share characteristics of fixed and variable annuities. EIAs offer a guaranteed minimum interest rate, touted as a "floor," as well as an interest rate tied to a market index. Very often the S&P 500 is the index of choice, though others are available. Thus, their returns are more volatile than those of fixed annuities, but are less volatile than variable annuities. Of course risk and return go hand in hand; other factors equal (e.g., fees), EIAs' expected returns lie above those of fixed annuities and below those of variable annuities.

It is important to understand that an EIA is an investment contract. It is not an investment in stocks or an equity fund. As investment vehicles, variable annuities are securities registered with the Securities and Exchange Commission, but EIAs are not. They therefore are not subject to the disclosure or sales-practice requirements that apply to more traditional variable annuities.

Downside "Protection"

The downside-protection feature of an EIA is a guaranteed value (the minimum available for withdrawal) often calculated as 90 percent of your premium plus 3 percent annually. In light of current interest rates, a 3 percent rate might sound attractive, but it is important to note that since the end of World War II price inflation has averaged over 4 percent annually. So, considering that you begin with a 90 percent base, if the equity index does poorly and this minimum floor applies in any given year, you could lose money in nominal terms, and even more in inflation-adjusted dollars.

Suppose you pay a $50,000 premium for an EIA with this feature, and that a bear market prevails for two years, while inflation averages 3.5 percent annually over the period. Your guaranteed value will be $47,740 after 2 years, representing only $44,551 in purchasing power. In addition, the guarantee is only as strong as the solvency of the insurance company providing the guarantee. Moreover, all deferred annuities are appropriate only as a long-term investment, thus the guarantee is valuable only in the unlikely event that you would have to turn to your EIA to meet some unforeseen event, but this withdrawal could be quite costly. Most EIAs impose surrender charges for withdrawals taken over the first five to seven years of the contract, some as high as 9 percent in the first year. In addition, any gains will be taxed as ordinary income, and if taken before age 59 1/2, a 10 percent income tax penalty would apply.

The Downside of the Upside

Our greatest concern with EIAs, however, is not with the downside protection but with the so called "upside potential" they are said to provide. Because these are unregulated contracts, the methods for computing and crediting index-linked interest vary considerably among EIAs, and even the most diligent investor must read the contract very carefully. The contract's "fine print" can dramatically impact the growth of the investment.

The index-related interest rate is impacted by a host of parameters, the most significant of which are *participation rates, fees*, and *interest-rate caps*. The participation rate is that percentage of the gain in the index that gets credited to the annuity, and it can vary between 50 percent and 100 percent . Thus you could buy a contract that will only participate at half the rate of growth of the market. Your returns can also be limited by fees. These are spread, margin, or asset-based fees that are subtracted from any gain in the index, and can be in lieu of or in addition to participation rates. Interest-rate caps might also be imposed, which simply place a ceiling, sometimes as low as 8 percent , on the rate of interest that can be earned. This could essentially render the notion of "market-linked growth" meaningless. The S&P 500 returned 13.1 percent annually between January 1974 and December 2001; in 17 of those years the index returned more than 8 percent , during which a contract with a simple 8 percent cap would have missed out on 69 percent of the market's gains, on average.

	12/1974-6/2004	12/1926-6/2004
	Annualized Returns	
S&P 500 Total Return	13.61	10.40
S&P 500 Income Return (dividends)	3.40	4.26
S&P 500 Capital Appreciation Return	9.90	5.89

Even if these parameters appear reasonable, investors must be on guard, since participation rates, fees, and rate caps can all potentially be changed at the end of a contract term, which could be as short as one year.

In addition there is no standardized method for calculating the amount of interest credited for a given change in the index. EIAs even differ with matters as fundamental as compounding. Some pay only simple interest, based on the premium paid, but not on prior interest earned during the term, while others will compound interest earned during the term.

Common interest-crediting methods include *annual reset, high-water mark,* and *point-to-point* calculations. Under the annual reset method the index-based interest is calculated each year by comparing the index value at the beginning and end of each contract year, ignoring declines. On its face this method would appear to be more generous than others during periods of market volatility, but this feature is typically coupled with restrictive caps or frequently changing participation rates.

The high-water mark calculates interest using the highest index value at certain points during the term of the contract, often on the contract anniversary. This method therefore might generate a higher rate of interest than other methods, and protects against subsequent declines in the market during the period after the peak has been reached. But this technique is often combined with restrictive participation rates or caps, and interest is not credited until the end of the term, so early surrender could result in loss of any index-based interest earned during the period.

The point-to-point method compares the index values at the beginning and end of the entire term. The downside here is that only two data points are used, so a sudden decline in the market at the end of the period can quickly eradicate any gains. In addition, interest cannot be added until the end of the term, which could be seven years, so a premature withdrawal will result in forfeiture of any interest. These negatives are often mitigated by higher participation rates or higher rate caps.

Almost all EIAs exclude any dividends when computing interest based on an index; the S&P 500, which is most frequently used, is a price index only. The table below demonstrates that dividend exclusion can have a significant impact when comparing EIAs with the alternative of holding common stocks or mutual funds directly.

The complex nature of these calculations makes it very difficult to shop around and compare EIAs, and this is further complicated by the structure of the insurance industry. Typically a salesman will present only the product sold by his firm, for which he receives a commission. He therefore will not offer competing products, and is likely to discourage you from looking elsewhere.

Equity indexed annuities sound very appealing, but should be avoided. You are better off maintaining your own portfolio, designed to accommodate your tolerance for risk, using the investment vehicles we recommend. If you seek help from a financial services professional, we strongly recommend that you avoid anyone compensated for selling a particular product. Instead you should seek a fee-only, registered investment advisor who is free to recommend any investment from the universe of financial assets available, and whose only interest is recommending well-diversified, low-cost investment vehicles representing those asset classes best suited to meet your needs.

INTEREST RATES AND THE HOUSING BOOM

The following was derived from the American Institute for Economic Research's August 23, 2004 Research Reports: "Interest Rates and the Housing Boom."

The housing boom of the past few years has been an extraordinary one by any measure. Sales of both new and existing homes increased to record highs in May. The number of new housing units authorized by building permits—the first step in the building process—rose to a 30-year high in May. Even so, the supply of unsold homes available for purchase is exceptionally low, which suggests that residential construction may remain strong for some time. And, of course, house prices have surged. In May the national average price of a new home was $292,000, up from $240,000 three years ago. In some parts of the country, prices have increased much more.

As long ago as 2001, analysts worried that this boom was becoming an unsustainable bubble. Yet, much like the stock market that continued to soar long after Alan Greenspan warned of "irrational exuberance" among investors, the housing boom has continued, confounding those who expected it to slow before now. However, if the housing market is in some sense "overvalued," the Federal Reserve's decision in June to begin raising interest rates—and the increase in mortgage rates that began even earlier, in April—could finally signal the beginning of the end for the boom.

This could pose a major risk to the economy, because the strong housing market has been crucial to its recent performance. It helped make the 2001 recession one of the mildest on record. It also helped sustain the spotty recovery that began in November 2001; without it, the economy might well have sunk back into recession.

Perhaps equally important, the increase in house prices softened the blow to household balance sheets from losses in the stock market. Despite last year's rebound, the value of stocks held by American households is, at $13 trillion, still $4 trillion below its 1999 peak. But in that same period, the value of the real estate owned by households increased by $6 trillion. The net worth of Americans now stands at an all-time high, thanks largely to the increased value of their homes.

In some areas, the increase in prices has been astonishing. Between 1998 and 2003, according to the National Association of Realtors, the median price of a single-family house in San Diego increased from $207,000 to $425,000. (The median is the halfway point; half of the homes sold for less, half sold for more.) In the San Francisco Bay area, it increased from $322,000 to $558,000. In the New York City metropolitan area, the median price rose from $188,000 to $353,000, in Washington, D.C. from $172,000 to $286,000, and in Boston from $213,000 to $355,000.

Homeowners who also own well designed portfolios of financial assets should not be overly concerned with whether the housing market is experiencing a "bubble." Your allocation plan with regard to your financial assets should not be adjusted to assume a more aggressive posture simply because your net worth, through a rising equity stake in your primary residence, might have grown dramatically; this unexpected "windfall" could evaporate quickly. Similarly, the prospect of a reversal in home prices from current levels should not prompt flight to cash or short-term bonds. If your financial plan was originally formulated under the assumption that your home was to serve as your primary residence and not as a speculative investment, staying the course is very likely your best option.

Whether you are a current or prospective homeowner, there are myriad considerations to weigh, including renting versus buying, financing and refinancing, income taxes, real estate agents and more. For a comprehensive assessment of these topics, we recommend, *Homeowner or Tenant? How to Make a Wise Choice* published by the American Institute for Economic Research, $6.00. www.AIER.org or (413) 528-1216.

CHANGES IN THE VANGUARD SHORT-TERM CORPORATE FUND

The Vanguard Short-Term Corporate Fund has changed its name and its mandate, but we continue to recommend it. The fund will be known as the Vanguard Short-Term Investment-Grade Fund. While the fund's investment policy previously restricted management to investing at least 80 percent of the fund's assets in investment-grade corporate fixed income securities, they will be now allowed greater flexibility; the 80 percent cap will be broadened to include U.S. Treasury, agency and mortgage-backed securities. The fund's credit rating may improve, and as a result its expected return may fall slightly, but in our estimation the trade-off is worthwhile.

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 then a Dow component, were not eligible for purchase 18 months earlier. Investors following the model should find that the indicated purchases of **Citigroup** and **Verizon** and sales of **Eastman Kodak** and **AT&T** (no longer Dow components) 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 ac-

As of August 13, 2004

					——Percent of Portfolio*——	
	Rank	*Yield*	*Price*	*Status*	*Value*	*No. Shares*[1]
Altria Group	1	5.78%	47.06	*		
SBC Comm.	2	4.99%	25.06	Holding**	26.87	29.30
General Motors	3	4.92%	40.69	*		
Verizon	4	3.94%	39.07	Buying	8.06	5.64
JP Morgan Chase	5	3.69%	36.87	Holding**	27.29	20.23
CitiGroup	6	3.64%	44.01	Buying	8.65	5.37
DuPont	7	3.48%	40.21	Holding	4.30	2.92
Merck	8	3.41%	44.59	Holding	3.01	1.84
General Electric	9	2.51%	31.89			
Exxon Mobil	10	2.40%	44.92			
AT&T	NA	6.93%	13.70	Sellling	13.02	25.97
Eastman Kodak	NA	1.82%	27.47	Selling	8.78	8.73
					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	3.13%	1.38%	0.34%	12.17%	13.97%	15.17%	19.30%
Dow	-3.09%	7.42%	-0.28%	12.04%	11.42%	10.36%	16.89%

* 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.

ERRATA

Last month's HYD Table incorrectly indicated the status of DD as "Hold". Dupont, which was eligible for purchase in January 2003, should have been labeled a "sale." We regret this error and any confusion it may have caused.

counts should trade less often to avoid excessive transactions costs, only adjusting their holdings toward the percentages in the table if prospective commissions will be less than, say, one percent of the value of a trade. By making such adjustments from time to time, investors should achieve results roughly equal to the 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 70 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	Market Prices			12-Month		Latest Dividend			Indicated	
	Symbol	8/13/04	7/15/04	8/15/03	High	Low	Amount	Record Date	Paid	Annual Dividend	Yield† (%)
Altria Group	MO	**$47.06**	48.20	39.85	58.96	38.72	0.680	6/15/04	7/09/04	2.720	5.78
★ SBC Comm.	SBC	**$25.06**	23.00	23.23	27.73	21.16	0.313	7/10/04	8/02/04	1.250	4.99
General Motors	GM	**$40.69**	43.94	37.10	55.55	37.41	0.500	8/13/04	9/10/04	2.000	4.92
★ Verizon	VZ	**$39.07**	34.81	35.82	39.80 *H*	31.10	0.385	7/09/04	8/02/04	1.540	3.94
★ J. P. Morgan Chase	JPM	**$36.87**	36.00	33.66	43.84	33.00	0.340	7/06/04	7/31/04	1.360	3.69
★ Citigroup	C	**$44.01**	44.21	44.90	52.88	42.55	0.400	8/02/04	8/27/04	1.600	3.64
☆ DuPont	DD	**$40.21**	42.62	43.63	46.25	38.60	0.350	8/13/04	9/11/04	1.400	3.48
☆ Merck	MRK	**$44.59**	44.71	53.48	54.30	40.57	0.380	9/03/04	10/01/04	1.520	3.41
General Electric	GE	**$31.89**	33.37	28.78	34.57	27.37	0.200	6/28/04	7/26/04	0.800	2.51
Exxon Mobil	XOM	**$44.92**	45.32	36.83	46.94 *H*	35.05	0.270	8/13/04	9/10/04	1.080	2.40
Caterpillar	CAT	**$71.75**	79.40	70.96	85.70	66.86	0.410	7/20/04	8/20/04	1.640	2.29
Coca-Cola	KO	**$44.37**	50.84	45.01	53.50	42.53	0.250	9/15/04	10/01/04	1.000	2.25
Pfizer	PFE	**$31.15**	32.58	31.42	38.89	29.43	0.170	8/13/04	9/03/04	0.680	2.18
Honeywell Intl.	HON	**$34.80**	35.70	28.55	38.46 *H*	25.94	0.188	8/20/04	9/10/04	0.750	2.16
Johnson & Johnson	JNJ	**$55.54**	55.35	51.05	58.14 *H*	48.05	0.280	8/17/04	9/07/04	1.140	2.05
Alcoa	AA	**$29.63**	32.88	27.70	39.44	26.16	0.150	8/06/04	8/25/04	0.600	2.02
Hewlett-Packard	HPQ	**$16.50**	19.65	21.40	26.28	16.08 *L*	0.080	9/15/04	10/06/04	0.320	1.94
3M Company (s)	MMM	**$77.66**	88.62	71.33	90.29	68.16	0.360	8/20/04	9/12/04	1.440	1.85
Procter & Gamble (s)	PG	**$54.46**	55.01	44.56	56.34	43.28	0.250	7/23/04	8/16/04	1.000	1.84
Boeing	BA	**$49.72**	49.14	32.94	51.49	33.00	0.200	8/13/04	9/03/04	0.800	1.61
McDonald's	MCD	**$25.81**	27.91	22.98	29.98	21.65	0.400	11/14/03	12/01/03	0.400	1.55
United Tech.	UTX	**$90.92**	91.00	76.48	97.84	76.76	0.350	8/20/04	9/10/04	1.400	1.54
Microsoft Corp.	MSFT	**$27.02**	27.87	25.54	30.00	24.01	0.080	8/25/04	9/14/04	0.320	1.18
Home Depot, Inc.	HD	**$33.14**	34.33	33.54	37.89	31.11	0.850	9/02/04	9/16/04	0.340	1.03
Walt Disney	DIS	**$20.89**	23.87	22.45	28.41	19.78	0.210	12/12/03	1/06/04	0.210	1.01
Wal-Mart Stores	WMT	**$53.40**	52.33	58.10	61.31	50.50	0.130	8/20/04	9/07/04	0.520	0.97
IBM	IBM	**$83.91**	84.02	81.79	100.43	81.27	0.180	8/10/04	9/10/04	0.720	0.86
American Express	AXP	**$49.35**	48.90	45.50	53.98	43.53	0.100	7/02/04	8/10/04	0.400	0.81
Intel Corp.	INTC	**$21.56**	23.15	25.05	34.60	21.03 *L*	0.040	8/07/04	9/01/04	0.160	0.74
AIG	AIG	**$66.48**	69.53	62.40	77.36	56.16	0.075	9/03/04	9/17/04	0.300	0.45
☆ AT&T	T	**$13.70**	14.60	21.03	23.18	13.59	0.240	6/30/04	8/02/04	0.950	6.93
☆ Eastman Kodak	EK	**$27.47**	25.82	27.13	31.55	20.39	0.250	6/01/04	7/15/04	0.500	1.82

† Based on indicated dividends and market price as of 8/13/04. *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

	8/13/04	Mo. Earlier	Yr. Earlier
Gold, London p.m. fixing	**396.75**	**403.15**	364.50
Silver, London Spot Price	**6.48**	**6.54**	5.02
Copper, COMEX Spot Price	**1.32**	**1.29**	0.79
Crude Oil, W. Texas Int. Spot	**46.58**	**40.97**	31.05
Dow Jones Spot Index	**146.87**	**146.47**	149.41
Dow Jones-AIG Futures Index	**187.84**	**185.02**	117.96
CRB-Bridge Futures Index	**269.19**	**273.38**	235.67

Interest Rates (%)

		8/13/04	Mo. Earlier	Yr. Earlier
U.S. Treasury bills -	91 day	**1.42**	**1.33**	0.95
	182 day	**1.71**	**1.67**	1.03
	52 week	**1.92**	**1.95**	1.20
U.S. Treasury bonds -	10 year	**4.23**	**3.71**	4.53
Corporates:				
High Quality -	10+ year	**5.70**	**5.91**	6.18
Medium Quality -	10+ year	**6.11**	**6.37**	6.80
Federal Reserve Discount Rate		**2.50**	**2.25**	2.00
New York Prime Rate		**4.50**	**4.25**	4.00
Euro Rates	3 month	**2.11**	**2.11**	2.14
Government bonds -	10 year	**4.05**	**4.19**	4.13
Swiss Rates -	3 month	**0.52**	**0.48**	0.25
Government bonds -	10 year	**2.62**	**2.84**	2.58

Exchange Rates

	8/13/04	Mo. Earlier	Yr. Earlier
British Pound	**$1.840900**	**$1.859000**	1.591000
Canadian Dollar	**$0.762600**	**$0.756500**	0.719700
Euro	**$1.233600**	**$1.235300**	1.118900
Japanese Yen	**$0.902800**	**$0.912600**	0.008370
South African Rand	**$0.153500**	**$0.166100**	0.136800
Swiss Franc	**$0.805000**	**$0.808800**	0.724300

Securities Markets

	8/13/04	Mo. Earlier	Yr. Earlier
S & P 500 Stock Composite	**1,064.80**	**1,106.69**	990.67
Dow Jones Industrial Average	**9,825.35**	**10,163.16**	9,321.69
Dow Jones Transportation Average	**2,966.92**	**3,125.39**	2,623.66
Dow Jones Utilities Average	**283.17**	**279.99**	237.47
Dow Jones Bond Average	**179.41**	**175.90**	165.63
Nasdaq Composite	**1,757.22**	**1,912.71**	1,702.01
Financial Times Gold Mines Index	**1,481.21**	**1,522.58**	1,454.63
FT African Gold Mines	**2,030.25**	**1,915.58**	2,326.98
FT Australasian Gold Mines	**3,353.05**	**3,584.43**	2,367.53
FT North American Gold Mines	**1,217.08**	**1,281.87**	1,161.25

Coin Prices

	8/13/04	Mo. Earlier	Yr. Earlier	Premium
American Eagle (1.00)	**$410.45**	**$402.25**	370.75	3.45
Austrian 100-Corona (0.9803)	**$390.93**	**$383.03**	353.13	0.51
British Sovereign (0.2354)	**$97.95**	**$96.05**	88.75	4.88
Canadian Maple Leaf (1.00)	**$410.70**	**$402.50**	371.00	3.52
Mexican 50-Peso (1.2057)	**$482.20**	**$472.60**	435.70	0.80
Mexican Ounce (1.00)	**$399.90**	**$391.80**	361.20	0.79
S. African Krugerrand (1.00)	**$405.95**	**$397.85**	366.95	2.32
U.S. Double Eagle-$20 (0.9675)				
St. Gaudens (MS-60)	**$460.00**	**$460.00**	415.00	19.84
Liberty (Type I-AU)	**$675.00**	**$675.00**	675.00	75.85
Liberty (Type II-AU)	**$487.50**	**$487.50**	440.00	27.00
Liberty (Type III-AU)	**$425.00**	**$425.00**	405.00	10.72
U.S. Silver Coins ($1,000 face value, circulated, year earlier uncirculated)				
90% Silver (715 oz.)	**$4,700.00**	**$4,230.00**	4,450.00	1.44
40% Silver (292 oz.)	**$1,910.00**	**$1,730.00**	1,587.50	0.94
Silver Dollars	**$6,500.00**	**$6,500.00**	6,300.00	29.66

Note: Premium reflects percentage difference between coin price and value of metal in a coin, with gold at $396.75 per ounce and silver at $6.48 per ounce. The weight in troy ounces of the precious metal in coins is indicated in parentheses.

Recommended Mutual Funds

	Ticker Symbol	8/13/04	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	**$82.08**	**$81.76**	82.08	83.08	81.14	1.4134	0.0000	1.72
★ USAA Short Term Bond	USSBX	**$9.01**	**$8.99**	9.04	9.15	8.95	0.2995	0.0000	3.32
★ Vanguard Short-Term Inv. Grade	VFSTX	**$10.70**	**$10.67**	10.75	10.89	10.59	0.3800	0.0000	3.55
Income Equity Funds									
★ DNP Select Income[1, 2]	DNP	**$10.90**	**$10.90**	10.50	11.42	9.60	0.7800	0.0000	7.16
★ Vanguard REIT Index	VGSIX	**$15.74**	**$15.83**	13.63	16.98	13.58	0.8200	0.0000	5.21
Large Cap. Value Equity Funds									
★ iShares S&P 500 Value Index[3]	IVE	**$54.55**	**$55.76**	49.09	58.88	48.35	0.9564	0.0000	1.75
★ Vanguard Value Index	VIVAX	**$18.72**	**$19.14**	16.78	19.91	16.65	0.4420	0.0000	2.36
Small Cap. Value Equity Funds									
★ iShares Sm. Cap. 600 Value Index[3]	IJS	**$99.54**	**$105.99**	86.20	109.90	85.06	0.9237	0.0000	0.93
★ Vanguard Sm. Cap Value Index	VISVX	**$11.55**	**$12.10**	9.72	12.48	9.64	0.1980	0.0000	1.71
Growth Equity Funds									
★ iShares S&P 500 Growth Index[3]	IVW	**$52.25**	**$54.75**	50.14	58.01	48.72	0.6288	0.0000	1.20
★ Vanguard Growth Index	VIGRX	**$23.15**	**$24.76**	22.39	26.09	22.25	0.1360	0.0000	0.59
Foreign Equity Funds									
★ iShares S&P Europe 350 Index[3]	IEV	**$62.86**	**$64.73**	54.55	69.20	52.70	1.1110	0.0000	1.77
T Rowe Price European Stock	PRESX	**$16.67**	**$17.63**	14.67	18.68	14.33	0.2200	0.0200	1.32
★ Vanguard European Stock Index	VEURX	**$21.73**	**$22.77**	18.62	23.57	18.10	0.4600	0.0000	2.12

Recommended Gold-Mining Companies

	Ticker Symbol	8/13/04	Month Earlier	Year Earlier	— 52-Week — High	Low	Distributions Latest 12 Months	Frequency	Yield (%)
Anglo American PLC, ADR[4]	AAUK	**$22.02**	**$21.25**	18.34	26.69	18.00	0.543	Semiannual	2.47
★ Anglogold Ashanti Ltd., ADR	AU	**$33.75**	**$33.57**	37.30	49.95	29.91	0.768	Semiannual	2.28
ASA Ltd.[1]	ASA	**$36.48**	**$36.61**	41.73	48.00	33.15	0.600	Quarterly	1.64
★ Barrick Gold Corp.†	ABX	**$18.72**	**$20.55**	18.30	24.16	18.04	0.188	Semiannual	1.00
★ Gold Fields Ltd.	GFI	**$11.72**	**$10.09**	13.01	15.52	9.13	0.123	Semiannual	1.05
★ Newmont Mining	NEM	**$40.92**	**$41.90**	38.50	50.28	34.70	0.300	Quarterly	0.73
★ Placer Dome†	PDG	**$15.95**	**$17.06**	13.16	19.23	12.78	0.085	Semiannual	0.53
★ Rio Tinto PLC‡	RTP	**$100.45**	**$103.46**	84.56	116.33	84.53	2.560	Semiannual	2.55

★ 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. [4] Preliminary estimate of semi-annual dividend.