INVESTMENT GUIDE

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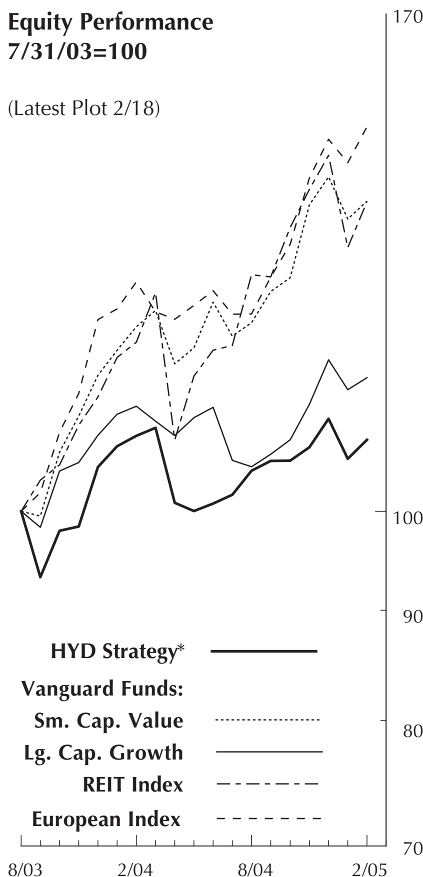

*** HYD is a hypothetical model based on back-tested results. See p. 14 for a full explanation.**

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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Independent Advice

Individual investors face a variety of hurdles, but for many, especially those getting started, the greatest challenge is often sorting through the hodgepodge of entities offering investment related services. Even to categorize the various service providers is a daunting task. The choices can be bewildering; brokers, investment advisors, insurance agents, trust departments, financial planners and various "money mangers" abound.

The Securities and Exchange Commission is currently weighing action that some claim would help clarify matters for investors. Until now, the SEC has considered stock brokers to be salespeople rather than advisors, so brokers have not been subject to the strict disclosure rules required of registered investment advisors. Thus brokers are claiming that any advice they provide is "solely incidental" to making a sale. Yet at the same time the industry's marketing efforts are clearly aimed at blurring the distinction between brokers and advisors, by referring to their brokers as "financial consultants" or "wealth managers." In April the SEC will decide if and under what circumstances brokers should be subject to the same rules as advisors.

Brokers are trying to have it both ways, but we will not weigh in on how regulators should do their job. Our own view is that informed consumers can make rationale choices on their own behalf. The challenge for investors is to be informed in order to avoid being "sold", and to that end the *Investment Guide* is designed to provide our readers with sound recommendations at minimal cost; our advisory services follow the same formula.

Among the myriad firms offering investment services, AIS is unique. Our objectivity stems from the fact that we are wholly owned by the American Institute for Economic Research (AIER), a nonprofit "think tank." AIS embraces the notion stated succinctly in AIER's mission statement:

> "Experience suggests that information and advice on economic subjects are most useful when they come from a source that is independent of special interests, either commercial or political."

Our revenues are derived only from our subscriptions and our advisory fee, which is based on the value of the portfolios we manage. We do not accept remuneration from any "third parties" including brokers or mutual funds. Our success or failure therefore hinges solely on the efficacy of our recommendations, rather than our ability to sell a product or service. Those recommendations are formed from the findings of AIER's staff economists. In addition to their own empirical research that dates back to 1933, they are free to weigh the results of inquiries conducted by financial economists employed by colleges and universities, and by firms in the financial sector, such as Dimensional Fund Advisors. DFA is at the "cutting edge" of modern portfolio theory and their findings are based upon the most comprehensive publicly traded securities data base in existence, the Center for Research in Securities Prices.

2004: THE YEAR IN REVIEW

The following is an excerpt from "2004: The Year in Review" by Weston Wellington, Vice President, Dimensional Fund Advisors. Once again he demonstrates the dangers of betting on the glib prognostications of the many "experts" eager to have their voices heard.

2004: Strong Returns Abound

Buy-and-hold equity investors had plenty to smile about in 2004. Total return for the S&P 500 Index® was 10.87%, while most other asset classes posted even stronger results. US large-cap growth stocks were once again the weakest relative performers among major asset classes:

Table 1: One-Year Total Return 31-Dec-04

S&P 500 Index®	10.87%
Russell 1000 Growth Index®	6.30%
Russell 1000 Value Index®	16.49%
Russell 2000 Index®	18.32%
Russell 2000 Value Index®	22.45%
Wilshire REIT Index	33.17%
MSCI EAFE Index*	20.25%
MSCI EAFE Growth Index*	16.11%
MSCI EAFE Value Index*	24.31%
MSCI EAFE Small Cap Index*	30.80%
MSCI Emerging Markets Free Index*	25.56%

* Net dividends. Source: The S&P Data are provided by Standard & Poor's Index Services Group. Russell data courtesy of Russell Analytic Services. Wilshire data courtesy of Wilshire Associates Incorporated. MSCI data courtesy of Morgan Stanley Capital International.

Returns on international stocks for dollar-based investors were generally enhanced by local currency appreciation relative to the US dollar in both developed and emerging stock markets (see Table 2.)

The positive returns, however, were generally compressed into the final four months of the year. The S&P 500®, NASDAQ Composite, and Russell 2000® indices all reached their lows for the year on August 12 amid considerable pessimism regarding the outlook for stocks. At that time, year-to-date results were negative for all three benchmarks.

Almost every year brings its share of surprises, and 2004 was no exception.

- Small company stocks surprised many observers by outperforming large cap stocks by a significant margin. After outperforming large cap stocks every year for the previous five years, many observers believed large cap stocks would win the relative performance race.
- REIT securities in the US also surprised many observers by bouncing back from the worst one-month loss since October 1987 (the Wilshire REIT Index was down 14.64% in April) and going on to outperform the broad stock market by a large margin, the fifth consecutive year of superior performance.
- Perhaps the biggest surprise was the behavior of interest rates. Fifty-two out of fifty-four economists surveyed by the *Wall Street Journal* in early 2004 expected yields on ten-year US Treasury notes to rise from their year-end 2003 level of 4.25%. News events throughout the year appeared to support this prediction. Sales of new homes, autos, and consumer goods remained healthy, the Federal Reserve raised the target rate for federal funds five times, and prices for oil and key industrial commodity prices rose sharply. In addition, the federal budget deficit swelled to a record high and the US dollar exchange rate fell relative to most major currencies. In such an environment, most investment professionals were confident that interest rates could only go up. They didn't. Although short-term rates rose, yields on ten-year Treasury notes ended the year at 4.22%, slightly below where they began.

News Headlines from 2004

Many investors place great emphasis on assessing the outlook for business conditions in developing their investment strategy. The observations and predictions collected below are not meant to suggest that all forecasts are inaccurate or that ignoring troublesome news events will always represent a profitable investment strategy. But it illustrates why earning capital market rates of return that are there for the taking often proves so difficult for many investors.

"Bond prices, especially those of Treasuries, will be driven lower, analysts say, as interest rates rise, first in response to growth and then as traders react to the growing federal budget deficit, which some analysts now predict will reach $500 billion this year."

Table 2: Dow Jones Global Indexes One-Year Price Change 31-Dec-04

	Local Currency	*US Dollars*
Developed Markets		
Australia	23.38%	28.69%
Canada	12.61%	21.98%
France	8.47%	17.07%
Germany	5.89%	14.29%
Hong Kong	18.13%	17.99%
Italy	18.21%	27.59%
Japan	11.27%	16.62%
Netherlands	3.62%	11.84%
Switzerland	4.78%	14.18%
United Kingdom	8.92%	16.93%
Emerging Markets		
Brazil	25.12%	36.22%
Mexico	45.45%	46.53%
Chile	17.68%	25.59%
Indonesia	45.30%	31.84%
Malaysia	11.12%	11.11%
Philippines	31.46%	30.09%
So. Africa	28.12%	52.17%
So. Korea	7.63%	23.99%
Taiwan	2.68%	10.03%
Thailand	-10.55%	-8.77%

Source: Wall Street Journal, "Year End Review," January 3, 2005, p. R6.

—Jonathan Fuerbringer, "After Rout, Bond Traders Are 'Playing Defense,'" *New York Times*, January 2, 2004, Special Business Section.

"Nearly everyone agrees the bond market will take a hit when the Federal Reserve starts raising short-term interest rates, perhaps as early as next month. . . . Some worry the next few months will look like a repeat of the bloody bond market of 1994, when a relentless Fed rate-hike campaign sent bond prices sharply lower and triggered massive losses for pension funds and trading firms."

—Aaron Lucchetti, "Some Investors Fear a Repeat of 1994 Market," *Wall Street Journal*, May 11, 2004, p. C1.

Table 3: Yields on 10-Year U.S. Treasury Bonds

15-Jan-05	*14-Jan-04*
4.22%	4.55%

"The only interesting market is Germany. It is the only European market where companies have taken the needed steps to

restructure by cutting costs, laying off workers and reducing debt. Big companies in France and Italy are struggling to reduce high labor costs and debts."

—Ken Belson, "Global Investors Expect Still More Gains," *New York Times*, January 2, 2004, Special Business Section.

Table 4: One-Year Total Returns (USD) 31-Dec-04

MSCI Italy Index*	32.51%
MSCI Europe Index*	20.88%
MSCI France Index*	18.48%
MSCI Germany Index *	16.16%

* Net dividends.

"The rally in small stocks came to a screeching halt in April. . . . Small stocks, because of their strong run over the past couple of years, have also become more expensive relative to large caps."

—Karen Talley, "Small Stocks' Strong Run Ends Amid Sustainability Questions," *Wall Street Journal*, May 3, 2004, p. C3.

"There is no asset class that looks attractive now. Mainstream stocks, small-cap stocks, Treasurys [sic], corporate bonds, junk bonds, real estate, cash, emerging-market assets, commodities all are either expensive or yield little."

—Jesse Eisinger, "Low Returns in High-Risk World," *Wall Street Journal*, June 9, 2004, p. C1.

"Cash remains the safest place to endure what many see as a dearth of investment opportunities. . . . "

—Jeff D. Opdyke, "Holding Pattern: Fund Managers Flock to Cash," *Wall Street Journal*, July 15, 2004, p. D1.

"The long-term bear market that commenced in 2000 is still in force, and the 2003 rally was simply a big bounce in a bigger downtrend. Be as defensive as possible."

—Michael Belkin of Belkin Ltd., quoted in Michael R. Sesit, "Strategists Turn Glum in Hurry," *Wall Street Journal,* July 15, 2004, p. C14.

"It could be last call at the European small-stock party. . . . After a huge small-stock climb in 2003, the gap between large- and small-cap valuations has narrowed in the U.S. and Europe."

—Sara Callan, "Small Caps Rally May Fizzle," *Wall Street Journal*, March 8, 2004, p. C18.

"London-based Smithers & Co., an independent economic consultancy, estimates the U.S. stock market is 60% overvalued, based on the firm's replacement-cost analysis, meaning that U.S. companies' net assets are worth just 40% of their market capitalization."

—Alen Mattich, "High P/Es Could Crimp Returns," *Wall Street Journal*, April 29, 2004, p. C3.

"Fund managers around the world are as bearish on U.S. stocks as they were in 2002, a Merrill Lynch & Co. survey suggests—and instead are gravitating toward the Japanese market."

—Sarah Spikes, "Funds get Bearish on U.S.," *Wall Street Journal*, August 18, 2004, p. C16.

EMERGING MARKETS INVESTING

The term *"emerging market"* evokes images of rogue currency traders, banana republics and Russian oil tycoons. Speculators have enriched themselves from the meteoric rises, while others have suffered large losses in the face of spectacular crashes in these markets. Indeed, the equity markets of developing countries are subject to the same boom-and-bust cycles that plague their economies. However, a growing body of empirical research suggests that emerging market equities deserve a place in the portfolio of the average investor.

Why Invest?

We stress that emerging market investing should not be considered for speculative gains, but rather to gain exposure to a distinct and dynamic asset class and to increase overall portfolio diversification. The key benefit to be gained from adding an emerging market component to a well-diversified portfolio is a lack of correlation with US equities. This is important because of the increasingly positive correlation of other "developed" foreign equity markets with US equity markets.

The correlation matrix in Table 1 displays the correlations[1] of the S&P 500, the MSCI EAFE (Europe, Australia and the Far East) Index and the S&P IFCI Emerging Market Composite Index.

Table 1

	S&P 500	*MSCI EAFE*	*S&P/IFCI Emerging Market Composite*
S&P 500	1		
MSCI EAFE	0.637324	1	
S&P/IFCI Emerging Market Composite	0.594733	0.579908	1

Source: Ibbotson Associates.

The positive correlation of US, European and Japanese equity markets is a natural outgrowth of the "global economy", and a testament to the efficiency of market forces—both the capital markets and the markets for goods and services. The major U.S. large-cap indices are dominated, in terms of capitalization, by multinational corporations whose revenues are global in nature, and whose stock is often traded on different exchanges throughout the "developed" world. In this context it is intuitive that the return characteristics of US equities and those of other "developed" economies would show an increasingly positive correlation.

One of the most striking aspects of globalization has been the rapid development of organized equity exchanges in the developing world. Research conducted by McKinsey Global Institute shows that 20 percent of the world's $200 trillion total stock of securitized assets originates outside of the US, Japan, the UK and the "Eurozone". Still, according to State Street Global Advisors, issues of these emerging markets represent only 5 percent of the world's total equity markets, suggesting that there is room to grow.

Developing economies have growth rates that are much higher than developed economies, and therefore offer the potential for higher investment returns (see Table 2). Further, the populations of the

[1] The Correlation Matrix is based on the correlation coefficient, a number between -1.0 and 1.0. If there is a perfect linear relationship between two holdings, the correlation is 1.0. If there is a perfect negative linear relationship the correlation coefficient is -1.0. A correlation coefficient of zero means that there is no linear relationship.

Table 2

	15 year period ending 12/04 Total Return	Standard Deviation
S&P 500	13.29	16.37
MSCI EAFE	6.40	17.86
S&P/IFCI Emerging Market Composite	14.01	25.90

Source: Ibbotson Associates.

emerging market countries, as defined by the MSCI Emerging Markets Index, represents some 60 percent of the total world population.

What is an "Emerging Market"?

But what constitutes an "emerging market" and which emerging markets are appropriate for investment? Emerging markets are defined by a variety of economic metrics. It can be said generally that they are countries with less developed legal and economic systems than the countries included in the MSCI EAFE index, and for this reason they are considered to be riskier. They are also countries that are experiencing rapid economic growth and financial and economic liberalization, usually prompted by policy reforms.

The World Bank Group classifies countries into four income categories. Most of the countries represented in the MSCI Emerging Markets Index, the most commonly used benchmark, fall into the lower three quartiles by per capita income and have a gross national income per capita below $9,075.

The MSCI Emerging Markets countries are listed in Table 3.

It is readily apparent that these countries are not a monolithic group. Each has a unique set of demographic, economic and resource characteristics that drives its path toward development. Some have competitive advantage in natural resources, some in human capital, some in technology. China, for example, with its huge and increasingly skilled labor force, is an export juggernaut and is now one of the largest holders of foreign reserves. India's technology sector has made it a hub for international outsourcing. Russia and Venezuela are rich in natural resources. While export led growth has been a mainstay of developing economies, the burgeoning middle classes in emerging market economies has fueled demand for consumer goods internally, providing additional opportunities for long-term economic growth and stability. In fact 33 percent of the fifteen largest economies in the world are represented in the MSCI emerging markets group.

Table 3: MSCI Emerging Markets Index Member Nations (as of 3-31-04)

Argentina	Indonesia	Philippines
Brazil	Israel	Poland
Chile	Jordan	Russia
China	Korea	South Africa
Colombia	Malaysia	Taiwan
Czech Republic	Mexico	Thailand
Egypt	Morocco	Turkey
Hungary	Pakistan	Venezuela
India	Peru	

Source: MSCI.

Risk and Reward

In addition to the volatility of returns, investors face additional risk when investing in foreign markets. These include liquidity risk, policy risk, political risk and currency risk. Companies or even entire economic sectors may be subject to arbitrary expropriation or nationalization, often following a change in regime. Currencies can be devalued or become inconvertible as a result of change in government policy. These risks can cause asset values to evaporate overnight.

The so-called "tequila effect" that followed the Mexican devaluation in 1992 caused hot money to flow out of emerging markets in a flight to quality. The Asian currency crisis later in the decade similarly panicked foreign investors. While the emerging markets crises of the 1990s are sobering reminders of the risks entailed in foreign investing, they were also catalysts for positive change. Developing nations have made considerable progress in currency and trade liberalization, and taken steps towards greater transparency in accounting and government regulation in order to win back the confidence of foreign investors.

We recommend that investors exclude countries with poorly structured legal systems, a disregard for individual property, poor treatment of foreign investors, and inadequate market structures. Annual gains and losses in emerging market investments can be dramatic and must, therefore be realized in measured proportion, commensurate with an investor's risk tolerance. It is equally important that these investments must be adequately diversified.

How to Invest

There are a several ways that an investor can gain exposure to emerging market equities.

Transactional issues and costs associated with emerging markets are substantial and make direct investment impractical for most investors. One must consider the complexities involved in managing multiple currencies, engaging custodians to hold securities and the monitoring of corporate actions. Additionally, many countries place restrictions on foreign investment that make direct investment possible only for institutional investors.

Table 4

	Avg. one-way transaction cost (bps)	*Avg. external movement and custody charges (bps)**
Emerging Markets	55	17
Developed Markets	26	5
U.S.	14	0

Source: *Barclays Global Investors.* *Repatriation of funds after sales, and payment of dividends.

Table 4 illustrates the costs associated with buying individual shares of emerging markets equities.

Indirect investments include exchange traded funds (ETF's), open-end mutual funds, and closed-end funds. Investors should carefully scrutinize the costs, investment methodology, risk, liquidity and diversification when considering emerging market funds.

ETFs combine the advantages of stocks with those of index funds. Like stocks, they are liquid, easy to use, and can be traded throughout the day. Like index funds, they provide diversification, asset class tracking, and low expenses.

Trading activity by mutual fund man-

Table 5: Correlations of 120 Monthly Returns, 01/95-12/04

MSCI Index	*1*	*2*	*3*	*4*	*5*	*6*	*7*	*8*
1 Argentina	1							
2 Brazil	0.49	1						
3 Chile	0.49	0.68	1					
4 Indonesia	0.23	0.32	0.48	1				
5 Korea	0.18	0.26	0.35	0.35	1			
6 Malyasia	0.28	0.27	0.45	0.57	0.30	1		
7 Mexico	0.53	0.67	0.56	0.31	0.28	0.28	1	
8 Philippines	0.36	0.35	0.49	0.61	0.35	0.54	0.40	1

Source: Morningstar Principia.

agers creates tax consequences (such as short- and long-term capital gains distributions at year-end) that are passed through to shareholders. Whenever a mutual fund realizes capital gains, it is obligated to distribute those gains to investors on an annual basis – this is a taxable event. Generally, ETFs realize capital gains only when changes are made to the underlying benchmark index that they track and investors aren't typically penalized with tax consequences when other shareholders sell their shares. Index portfolio turnover is typically much lower than that of actively managed funds.

The tax-efficiency of a mutual fund is constrained by diversification requirements, and liquidity management (i.e., shareholder redemptions and deposits). An ETF's liquidity is less constrained because shareholders find buyers and sellers through the facilities of the exchanges.

We recommend the iShares products from Barclays Global Investors Services, which offers the most extensive family of ETFs. In addition to the iShares MSCI Emerging Markets Index Fund (Ticker symbol EEM), Barclays offers several country specific funds, based on MSCI indexes that cover Brazil, Malaysia, Mexico, South Africa, South Korea and Taiwan. However, it is advisable that most investors invest in the larger index rather than the constituent indexes in order to ensure adequate diversification. Correlations among emerging markets are very low, which significantly reduces the volatility of an investment based on a broad emerging markets index (see Table 5).

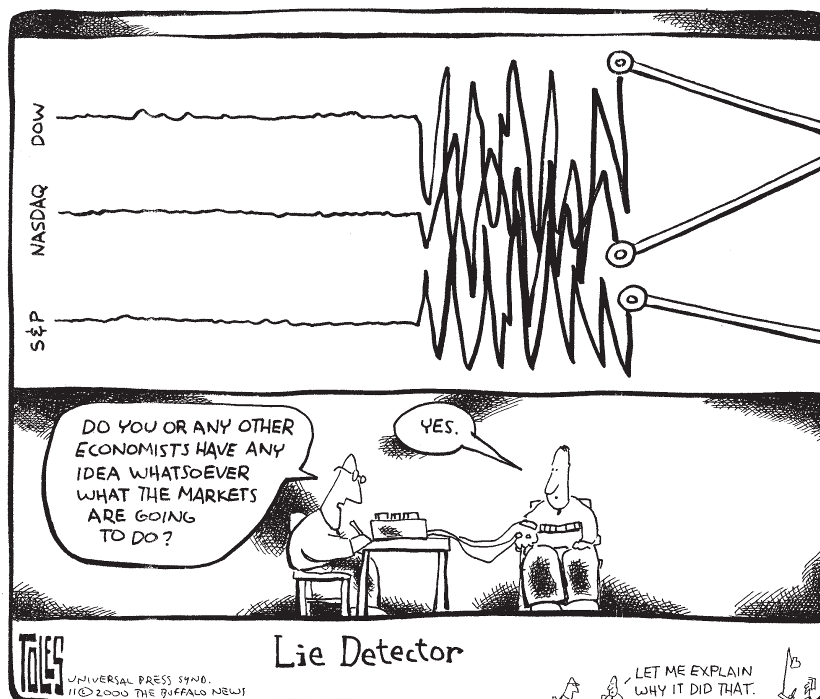
State Street Global Advisors, also offers an ETF Emerging Markets Fund and Bank of New York offers the BLDRS Emerging Markets 50 ADR Index Fund (ADRE), a capitalization-weighted index designed to track the performance of a basket of emerging market depositary receipts.

There are 192 mutual funds in the Morningstar database under the category heading "Diversified Emerging Markets". It has been suggested that emerging markets are inefficient which would provide active managers with a potential performance edge. While the availability of data is more limited compared with developed markets, research suggests that emerging markets are in fact efficient and that an index strategy is optimal. The high transactional costs of active trading are particularly pronounced. Research conducted by Lipper Inc., MSCI and The Vanguard Group shows that the MSCI emerging markets index outperformed 56% of actively managed funds during the three-year and five-year periods ending December 31, 2003. The index did not fair quite as well over ten years, as a result of exposure to the Asian crisis, which should prove to be a statistical anomaly.

We recommend the emerging markets funds offered by Dimensional Fund Advisors (DFA) and the Vanguard Group. DFA provides a "building-block approach" to emerging market investing, with opportunities to gain exposure to value and small cap stocks. The size and value effects have been demonstrated in foreign equity markets and exposure to these segments should provide higher expected return for long-term, disciplined investors. The Vanguard Select Emerging Markets Index (VEIEX) is managed by MSCI for Vanguard and includes a subset of the countries in the MSCI Emerging Markets Index. DFA funds are only available through approved investment advisors. Contact us for more information.

What is right for you?

Returns on emerging market equities have low correlation to those of the developed world and therefore provide diversification benefits for traditional portfolios. While they are very volatile in the short term, they offer excellent potential for long-term results. It is not possible to predict which emerging market economies will succeed over the long-term and therefore investors should diversify exposure to the full compliment of emerging market economies at the lowest cost possible. While there is a lack of historical data, the application of financial market theory implies that the higher risk of emerging market investment should be compensated with higher returns over the long-term. We recommend that investors with high risk tolerance for short-term fluctuations and long-term investment horizons allocate up to 50 percent of their foreign investments to emerging markets.



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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 **Merck** 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 **Merck** and **Verizon** and sales of **Eastman Kodak, 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 accounts should trade less often to avoid excessive transactions costs, only adjusting their holdings toward the percentages in the table if prospective commissions will be less than, say, one percent of the value of a trade. By making such adjustments from time to time, investors should achieve

As of February 15, 2005

					——Percent of Portfolio*——	
	Rank	*Yield*	*Price*	*Status*	*Value*	*No. Shares*[1]
General Motors	1	5.37%	37.22	*		
SBC Comm.	2	5.26%	24.52	Holding**	24.81	31.53
Merck	3	5.18%	29.35	Buying	9.25	9.82
Altria Group	4	4.42%	66.06	*		
Verizon	5	4.25%	36.26	Buying	14.98	12.89
JP Morgan Chase	6	3.62%	37.55	Holding**	23.54	19.53
CitiGroup	7	3.56%	49.40	Holding	11.86	7.48
Pfizer	8	3.01%	25.22			
DuPont	9	2.71%	51.75	Holding	4.94	2.97
General Electric	10	2.42%	36.39			
AT&T	NA	4.85%	19.55	Selling	9.01	14.37
Eastman Kodak	NA	1.45%	34.48	Selling	1.56	1.41
					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	1.06%	-0.48%	5.59%	12.41%	13.81%	15.20%	19.22%
Dow	2.89%	0.88%	1.82%	12.10%	11.97%	10.43%	16.86%

* 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.

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, Merck, Verizon, and JPMorgan Chase — account for roughly 72.5 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 $150,000 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	*2/15/05*	*1/14/05*	*2/15/04*	*High*	*Low*	*Amount*	*Record Date*	*Paid*	*Annual Dividend*	*Yield† (%)*
General Motors	GM	**$37.22**	**$37.13**	48.88	50.04	35.85 *L*	0.500	2/11/05	3/10/05	2.000	5.37
★ SBC Comm.	SBC	**$24.52**	**$24.41**	25.05	27.29	22.98	0.323	1/10/05	2/01/05	1.290	5.26
★ Merck	MRK	**$29.35**	**$30.87**	48.88	49.19	25.60	0.380	12/03/04	1/03/05	1.520	5.18
Altria Group	MO	**$66.06**	**$63.35**	54.66	63.09	44.50	0.730	12/27/04	1/10/04	2.920	4.42
★ Verizon	VZ	**$36.26**	**$36.84**	37.65	42.27	34.13	0.385	1/10/05	2/01/05	1.540	4.25
★ J. P. Morgan Chase	JPM	**$37.55**	**$37.81**	40.16	43.84	34.62	0.340	1/06/05	1/31/05	1.360	3.62
☆ Citigroup	C	**$49.40**	**$47.51**	49.49	52.88	42.10	0.440	2/07/05	2/25/05	1.760	3.56
Pfizer	PFE	**$25.22**	**$25.25**	37.38	37.97	21.99	0.190	2/11/05	3/08/05	0.760	3.01
☆ DuPont	DD	**$51.75**	**$47.07**	51.14	53.50 *H*	38.30 *L*	0.250	2/15/05	3/14/05	1.400	2.71
General Electric	GE	**$36.39**	**$35.52**	32.72	37.75	28.88	0.220	2/28/05	4/25/05	0.880	2.42
Coca-Cola	KO	**$42.65**	**$40.97**	49.73	53.50	38.30	0.250	12/01/04	12/15/04	1.000	2.34
Honeywell Intl.	HON	**$39.05**	**$35.34**	36.41	39.80 *H*	31.23	0.206	2/18/05	3/10/05	0.825	2.11
Alcoa	AA	**$29.81**	**$29.90**	37.01	38.58	28.01 *L*	0.150	2/04/05	2/25/05	0.600	2.01
3M Company	MMM	**$85.90**	**$83.97**	79.68	90.29	73.31	0.360	2/25/05	3/12/05	1.680	1.96
Exxon Mobil	XOM	**$56.92**	**$51.07**	41.91	56.87 *H*	39.91	0.270	2/10/05	3/10/05	1.080	1.90
Procter & Gamble (s)	PG	**$53.48**	**$55.88**	51.03	57.40	50.53	0.250	1/21/05	2/15/05	1.000	1.87
Boeing	BA	**$54.43**	**$50.91**	44.45	55.48	38.04	0.250	2/11/05	3/04/05	1.000	1.84
Caterpillar	CAT	**$91.50**	**$93.69**	77.42	98.72	68.50	0.410	1/20/05	2/19/05	1.640	1.79
Johnson & Johnson	JNJ	**$65.91**	**$62.70**	54.23	66.89 *H*	49.25	0.285	2/15/05	3/08/05	1.140	1.73
McDonald's	MCD	**$33.16**	**$31.31**	26.63	32.96	25.05	0.550	11/15/04	12/01/04	0.550	1.66
Hewlett-Packard	HPQ	**$21.12**	**$20.07**	23.01	24.29	16.08	0.080	3/16/05	4/07/05	0.320	1.52
United Tech.	UTX	**$102.77**	**$100.94**	95.40	106.28	80.67	0.440	2/18/05	3/10/05	1.400	1.36
Intel Corp.	INTC	**$24.47**	**$23.02**	30.14	31.10	19.64	0.080	2/07/05	3/01/05	0.320	1.31
Microsoft Corp.	MSFT	**$25.93**	**$26.12**	26.59	27.50	21.61 *L*	0.080	2/17/05	3/10/05	0.320	1.23
Wal-Mart Stores	WMT	**$52.70**	**$53.99**	56.32	61.31	51.08	0.130	12/17/04	1/03/05	0.520	0.99
American Express	AXP	**$54.50**	**$52.72**	53.65	58.03 *H*	47.32	0.120	1/07/05	2/10/05	0.480	0.88
Walt Disney	DIS	**$29.58**	**$28.30**	26.92	29.99 *H*	20.88	0.240	12/08/04	1/06/05	0.240	0.81
Home Depot, Inc.	HD	**$42.73**	**$41.90**	36.17	44.30	32.34	0.085	12/02/04	12/16/04	0.340	0.80
IBM	IBM	**$94.33**	**$94.10**	99.71	100.00	81.90	0.180	2/10/05	2/10/05	0.720	0.76
AIG	AIG	**$71.85**	**$66.14**	74.72	77.36	54.28	0.125	3/04/05	3/18/05	0.500	0.70
☆ AT&T	T	**$19.55**	18.67	20.00	20.60	13.59	0.238	12/31/04	2/01/05	0.950	4.86
☆ Eastman Kodak	EK	**$34.52**	31.89	29.03	35.19	24.25	0.250	11/01/04	12/14/04	0.500	1.45

† Based on indicated dividends and market price as of 2/15/05. *H* New 52-week high. *L* New 52-week low. (s) All data adjusted for splits. (r) All data adjusted for reverse splits. Extra dividends are not included in annual yields.

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

	2/15/05	*Mo. Earlier*	*Yr. Earlier*
Gold, London p.m. fixing	**424.40**	**422.50**	**416.00**
Silver, London Spot Price	**7.25**	**6.63**	**6.54**
Copper, COMEX Spot Price	**1.49**	**1.44**	**1.24**
Crude Oil, W. Texas Int. Spot	**47.27**	**48.38**	**34.56**
Dow Jones Spot Index	**198.72**	**195.32**	**179.37**
Dow Jones-AIG Futures Index	**147.38**	**146.79**	**140.50**
CRB-Bridge Futures Index	**289.33**	**283.22**	**264.85**

Interest Rates (%)

U.S. Treasury bills -	91 day	**2.59**	**2.36**	**0.90**
	182 day	**2.76**	**2.66**	**0.97**
	52 week	**3.00**	**2.91**	**1.12**
U.S. Treasury bonds -	10 year	**4.41**	**4.22**	**4.60**
Corporates:				
High Quality -	10+ year	**5.27**	**5.43**	**5.55**
Medium Quality -	10+ year	**5.63**	**5.82**	**5.91**
Federal Reserve Discount Rate		**3.50**	**3.25**	**2.00**
New York Prime Rate		**5.50**	**5.25**	**4.00**
Euro Rates	3 month	**2.14**	**2.15**	**2.09**
Government bonds -	10 year	**3.41**	**3.56**	**4.14**
Swiss Rates -	3 month	**0.75**	**0.74**	**0.24**
Government bonds -	10 year	**1.96**	**2.19**	**2.52**

Exchange Rates

British Pound	**$1.896700**	**$1.869300**	**$1.905600**
Canadian Dollar	**$0.812600**	**$0.822600**	**$0.762400**
Euro	**$1.301800**	**$1.310400**	**$1.285800**
Japanese Yen	**$0.009576**	**$0.009800**	**$0.094750**
South African Rand	**$0.168000**	**$0.165800**	**$0.150300**
Swiss Franc	**$0.840000**	**$0.846600**	**$0.009429**

Securities Markets

	2/15/05	*Mo. Earlier*	*Yr. Earlier*
S & P 500 Stock Composite	**1,210.12**	**1,184.52**	**1,145.81**
Dow Jones Industrial Average	**10,837.32**	**10,558.00**	**10,627.85**
Dow Jones Transportation Average	**3,615.16**	**3,569.16**	**2,916.56**
Dow Jones Utilities Average	**353.88**	**332.29**	**270.68**
Dow Jones Bond Average	**188.80**	**186.07**	**178.50**
Nasdaq Composite	**2,089.21**	**2,087.91**	**2,053.56**
Financial Times Gold Mines Index	**1,617.00**	**1,600.08**	**1,705.28**
FT African Gold Mines	**1,906.13**	**1,948.86**	**2,566.97**
FT Australasian Gold Mines	**4,344.23**	**4,297.50**	**3,566.79**
FT North American Gold Mines	**1,365.84**	**1,339.20**	**1,365.64**

Coin Prices

	2/15/05	*Mo. Earlier*	*Yr. Earlier*	*Premium*
American Eagle (1.00)	**$436.05**	**$429.25**	416.65	2.75
Austrian 100-Corona (0.9803)	**$415.23**	**$408.73**	396.83	-0.19
British Sovereign (0.2354)	**$103.95**	**$102.35**	99.45	4.05
Canadian Maple Leaf (1.00)	**$436.30**	**$429.50**	416.90	2.80
Mexican 50-Peso (1.2057)	**$512.20**	**$504.20**	489.50	0.10
Mexican Ounce (1.00)	**$424.70**	**$418.10**	405.90	0.07
S. African Krugerrand (1.00)	**$431.05**	**$424.35**	412.05	1.57
U.S. Double Eagle-$20 (0.9675)				
St. Gaudens (MS-60)	**$515.00**	**$520.00**	492.50	25.42
Liberty (Type I-AU)	**$675.00**	**$675.00**	675.00	64.39
Liberty (Type II-AU)	**$497.50**	**$497.50**	505.00	21.16
Liberty (Type III-AU)	**$460.00**	**$465.00**	450.00	12.03
U.S. Silver Coins ($1,000 face value, circulated, year earlier uncirculated)				
90% Silver (715 oz.)	**$5,140.00**	**$4,540.00**	4,492.50	-0.84
40% Silver (292 oz.)	**$2,065.00**	**$1,840.00**	1,780.00	-2.46
Silver Dollars	**$6,725.00**	**$6,600.00**	6,550.00	19.91

Note: Premium reflects percentage difference between coin price and value of metal in a coin, with gold at $425.80 per ounce and silver at $7.245 per ounce. The weight in troy ounces of the precious metal in coins is indicated in parentheses.

Recommended Mutual Funds

	Ticker Symbol	*2/15/05*	*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	**$81.22**	**$81.37**	**$82.78**	83.08	81.14	1.5826	0.0000	1.95
★ USAA Short Term Bond	USSBX	**$8.94**	**$8.95**	**$9.11**	9.15	8.94	0.2892	0.0000	3.23
★ Vanguard Short-term Inv. Grade	VFSTX	**$10.63**	**$10.63**	**$10.84**	10.89	10.59	0.3620	0.0000	3.41
Income Equity Funds									
★ DNP Select Income[1, 2]	DNP	**$11.85**	**$11.41**	**$11.23**	11.95	9.60	0.7800	0.0000	6.58
★ Vanguard REIT Index	VGSIX	**$16.07**	**$17.65**	**$15.96**	18.98	13.88	0.8810	0.0710	5.48
Large Cap. Value Equity Funds									
★ iShares S&P 500 Value Index[3]	IVE	**$63.07**	**$61.34**	**$57.51**	63.26	53.44	1.0179	0.0000	1.61
★ Vanguard Value Index	VIVAX	**$21.51**	**$20.88**	**$19.55**	21.51	18.37	0.4590	0.0000	2.13
Small Cap. Value Equity Funds									
★ iShares Sm. Cap. 600 Value Index[3]	IJS	**$120.63**	**$115.74**	**$104.25**	122.93	97.57	1.3525	0.0000	1.12
★ Vanguard Sm. Cap Value Index	VISVX	**$13.77**	**$13.33**	**$12.00**	14.13	11.15	0.2250	0.0000	1.63
Growth Equity Funds									
★ iShares S&P 500 Growth Index[3]	IVW	**$57.93**	**$56.88**	**$57.23**	58.65	51.98	0.9764	0.0000	1.69
★ Vanguard Growth Index	VIGRX	**$26.02**	**$25.79**	**$25.79**	26.45	23.11	0.2950	0.0000	1.13
Foreign Equity Funds									
★ iShares S&P Europe 350 Index[3]	IEV	**$76.80**	**$73.29**	**$67.58**	76.50	61.60	1.3481	0.0000	1.76
T Rowe Price European Stock	PRESX	**$19.96**	**$19.30**	**$18.28**	20.00	16.46	0.2700	0.0100	1.35
★ Vanguard European Stock Index	VEURX	**$26.06**	**$25.23**	**$23.19**	26.15	21.25	0.5800	0.0000	2.23

Recommended Gold-Mining Companies

	Ticker Symbol	*2/15/05*	*Month Earlier*	*Year Earlier*	*— 52-Week — High*	*Low*	*Distributions Latest 12 Months*	*Frequency*	*Yield (%)*
Anglo American PLC, ADR[4]	AAUK	**$25.07**	**$23.31**	**$24.38**	26.86	18.94	0.580	Semiannual	2.31
★ Anglogold Ashanti Ltd., ADR	AU	**$35.32**	**$33.41**	**$43.20**	44.86	29.91	0.754	Semiannual	2.13
★ Barrick Gold Corp.†	ABX	**$23.09**	**$22.15**	**$20.98**	25.52	18.04	0.187	Semiannual	0.81
★ Gold Fields Ltd.	GFI	**$11.66**	**$12.18**	**$13.06**	15.25	9.13	0.123	Semiannual	1.05
★ Newmont Mining	NEM	**$42.34**	**$41.87**	**$44.26**	49.98	34.70	0.400	Quarterly	0.94
★ Placer Dome†	PDG	**$17.75**	**$17.71**	**$17.09**	23.67	12.89	0.085	Semiannual	0.48
★ Rio Tinto PLC‡	RTP	**$129.92**	**$116.87**	**$111.20**	130.20	84.53	2.640	Semiannual	2.03

★ 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.

The information herein is derived from generally reliable sources, but cannot be guaranteed. American Investment Services, the American Institute for Economic Research, and the officers, employees, or other persons affiliated with either organization may from time to time have positions in the investments referred to herein.