INVESTMENT GUIDE

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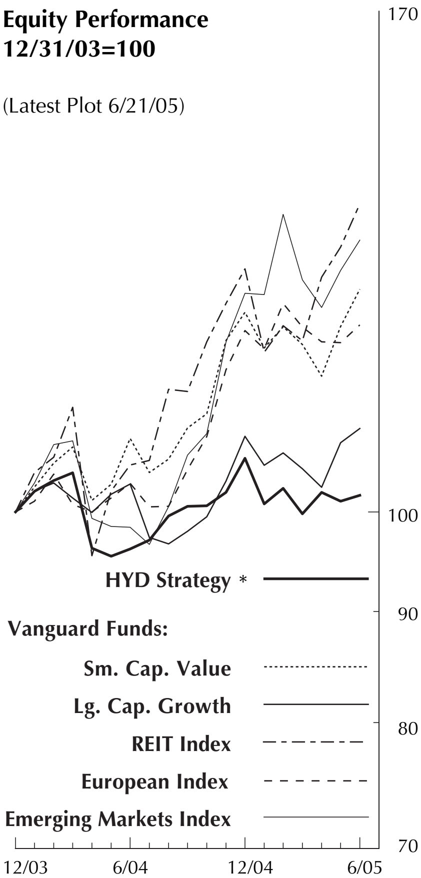
Equity Performance 12/31/03=100

(Latest Plot 6/21/05)



*** HYD is a hypothetical model based on back-tested results. See p. 46 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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Safe at Home?

Tech stocks are no longer the subject of polite conversation. To some, stocks and bonds in general are passé. The hot topic today is real estate, residential that is. Over the past decade many home buyers who plunked down a modest down payment, seeking only a place of residence, have watched as their equity has grown exponentially to become the largest component of their net worth.

Some investor/homeowners might need a sobriety check. The table below demonstrates that the real run-up in home prices has been most pronounced during the past five years; however, relative to alternative investments, median (national) home-prices did not keep pace with either stocks or bonds over the past decade. Notably, even T-bills outperformed the median home price during the 1994–1999 period, and even after the tech-stock "melt-down" after 1999, stocks earned more than double the returns of the median home price in the ten years from 1994 to 2004.

Cumulative Total Returns for Benchmarks*

	Latest five years (12/31/1999 to 12/31/2004)	*Prior five years (12/31/1994 to 12/31/1999)*	*Ten years (12/31/1994 to 12/31/2004)*
Median existing home prices	40%	25%	75%
Standard & Poor's 500 Index	–11%	251%	212%
Lehman Aggregate Bond Index	45%	45%	110%
Citigroup 3-month T-Bill	15%	29%	48%
Consumer Price Index	13%	12%	27%

* Past performance is not a guarantee of future results. Unlike stocks and bonds, U.S. Treasury bills are guaranteed as to the timely payment of principal and interest. The performance of an index is not an exact representation of any particular investment, as you cannot invest directly in an index. Source: The Vanguard Group.

A fair comparison between residential real estate and highly liquid financial assets is difficult. Median home prices exclude transaction costs, taxes, and operating costs such as insurance and maintenance, of which every homeowner is painfully aware. A homeowner with no financial assets but a fully paid-off mortgage might take comfort in "having a roof over his head," but all of his eggs are in one basket. It is easy and inexpensive to diversify among a portfolio of stocks or bonds, but it is impractical to invest among several residential real estate markets (Real Estate Investment Trusts are highly liquid and a viable asset class, but these provide a stake in commercial properties, which differ distinctly from residential properties).

The point is investors should not look to their home equity as a substitute for a well-structured portfolio of financial assets. Especially dangerous is the practice known as "equity stripping," or borrowing against ones home equity in order to invest in financial markets. A sharp downturn in the stock market coupled with an increase in interest rates could result in enormous losses for investors who go out on this limb.

THE RENT OR BUY DECISION

Residential real estate prices are continuing to climb at an astonishing rate. In this environment, many homeowners and potential homeowners are pondering whether, or how, to respond. The trend is especially challenging for potential first-time homeowners who may be fearful of buying into a market that could quickly reverse course. Below we have reprinted the second chapter of Homeowner or Tenant? How to Make a Wise Choice. *published by our parent, the American Institute for Economic Research* ***($8.00. To order call 413- 528-1216)****. While we recommend this book to all of our readers, first-time home buyers in particular will find that it provides invaluable perspective regarding all facets of this decision.*

Your personal preference regarding housing presumably will be one of the most important aspects in your decision to rent or buy, but your ability to follow your personal preference will be influenced by financial considerations.

Financial Aspects Summarized

The amount you are able or willing to spend on housing will depend on the resources available to you and your desire for housing in relation to your desire for other goods and services. In addition, the amount of housing you can obtain for a given outlay will vary if you rent or buy according to the extent to which the various factors described later apply to you or to a specific residence. Your decision will be affected by the following:

1. The significance to you of the homeowner's ability to pay property taxes and mortgage interest with pre-tax dollars. This will depend not only on your tax rate but also on the extent to which your homeowner's deductions can be used. Your total itemized deductions for tax purposes must exceed your standard deduction if the deductions are to have any tax-saving value to you. For example, a married couple not having annual itemized deductions unrelated to housing of $9,500 or more in 2003 would not have ended up paying all of their property taxes and mortgage interest with pre-tax income. (The amount of this standard deduction is increased each year to account for price inflation.)

2. Your ability and willingness to perform maintenance and repair work yourself and to meet other obligations (property taxes, insurance, interest) at a tax-adjusted cost less than that of a landlord. Remember, although you may be more conscientious (and work cheaper) than a landlord's employee, rented accommodations may be cheaper to maintain because of the type of construction typical of rental units. Also, even though a lender will offer you more favorable terms than would a landlord, the rent charged by a particular landlord may be determined in large part by the debt service on a mortgage loan taken out many years ago; that is, in a particular situation a rental charge might reflect historical rather than current interest rates and property values.

3. The length of your intended stay in a given residence. Transaction costs (averaging about 10-12 percent on a sale and purchase) may outweigh any financial advantages to you from homeownership if you plan to move soon.

4. Your eligibility to receive special government assistance as a home buyer. Presumably all mortgage borrowers benefit from government efforts designed to foster mortgage lending, such as Congress' chartering of so-called government-sponsored enterprises (*e.g.*, Fannie Mae and Freddie Mac) that create a secondary mortgage market. However, some individuals, such as veterans, may be eligible for special government financial assistance for purchasing a house.

5. Your desire to acquire or accumulate equity in a house. This can be either a desire to create sweat equity by adding to its value through your own labor, or simply a desire to put your savings into a tangible store of value. Gains from the former seem reasonably well assured and they are taxed lightly (if at all) relative to other productive activities you might undertake. Residences can serve as a store of value for one's savings and the forced savings aspect of regular mortgage payments may be especially attractive to you. However, investment returns on housing relative to other assets have fluctuated over time, and within a given period they have fluctuated widely from one region to another.

Personal Preferences And Other Nonfinancial Considerations

The rights and responsibilities of tenants differ in many respects from those of owner-occupants. Your personal preferences and attitudes toward these responsibilities can be determined by only you, and the most we can do is to call your attention to some of the aspects involved.

For a tenant, financial obligations end after payment of rent and of the cost of the utilities for which the tenant is responsible. Not only is the number of bills paid by homeowners much larger than that paid by tenants (even though their total amounts may be equivalent) but also the outlays of homeowners usually are more irregular.

Some stability in the monthly outlays of homeowners can be accomplished through level payment plans with utility companies or fuel dealers, and lending institutions may offer or require the establishment of escrow accounts in which funds to pay insurance and property taxes are accumulated monthly. Such arrangements, while serving to stabilize the month-to-month outlays of homeowners, usually involve extra cost in the form of fees and lost opportunity income. In any event, homeowners must be prepared to spend time and money on minor or major repairs that can arise at unpredictable intervals.

Moreover, the financial demands of homeownership are open-ended, in effect, as no residence is ever perfect. In other words, the range of possible expenditures related to housing is much larger than it is for tenants. Redecorating, remodeling, building in appliances, adding on, etc., are all outlets for self-expression. However, they can absorb large amounts of time and money, and there is no guarantee that the latter always can be recovered upon the sale of the house. Tenants have fewer options of this sort available to them. Most alterations or renovations of their quarters require the permission of the landlord, and any lasting improvements become the landlord's property and not that of the tenant.

Clearly, one's nest-building urges are more likely to be fulfilled as a homeowner than as a tenant, but the costs of such can present unexpected demands on your resources that you would not face as a tenant. However, these costs are a function of your personal discipline. With respect to your personal savings, such costs may be the other side of the forced savings coin imposed on homeowners through periodic mortgage repayments. If you believe that you are not disciplined enough to save systematically without the spur of a monthly mortgage bill, how can you be confident that you will not waste funds on fanciful household expenses if you are a homeowner?

Although the foregoing aspects of the rent or buy decision involve your personal finances, their effects on your decision depends on your personal preference for such things as predictability of outlays and outside constraints on your spending. Other aspects of homeownership and tenancy that may be important to you involve nonfinancial considerations, such as the freedom of tenants to move on short notice and to rely on someone else to deal with maintenance and repairs, or the pride of house ownership and the greater freedom to decorate a house the way one pleases. Some individuals might prefer the relative anonymity of an urban apartment, while others might want the feeling of putting down roots as a homeowner. No one but you can assign relative importance to such things.

A Digression: The American Way of Life

Americans devote a much larger proportion of their incomes to shelter than do citizens of other nations. Although this may reflect general affluence (food is the largest outlay for most people in the world and also for lower-income Americans), it also reflects the apparent American ideal of a single-family house with a lawn, a swing set for the kids, a family room, facilities for entertaining guests, a kitchen equipped like a small restaurant, etc. Many such amenities are greatly underutilized by their owners. An alternative might be to resist the pressure to keep up with the Joneses and to choose relatively modest accommodations, whether owned or rented, and to devote both the time and money saved to dining out, clubs, travel, etc.

We mention this alternative only because it is so often overlooked. There are armies of salesmen selling you items relating to housing, but few who are urging you to take your kids to the zoo. There are no doubt many individuals who genuinely enjoy housework and home maintenance, and you may be among them. However, if you are not, consider seriously that your choice of housing has a direct bearing on the resources of time and money that you can devote to other aspects of your life.

Evaluating Alternatives

Estimates of various financial aspects (such as your personal tax situation) and summaries of the general pros and cons of buying or renting may be helpful in a general consideration of renting or buying. However, *actual decisions* must involve *actual residences*. No two residences are ever exactly alike, and few are equivalent even in living space and amenities. Thus, any decision to rent or to buy must rest in large part on criteria that cannot be measured or quantified in financial terms.

It should be noted that throughout this publication "buying a house" simply refers to acquiring equity ownership in a personal residence. There are certain types of housing (condominiums and cooperatives) that offer their owner-occupants some of the advantages (and disadvantages) of renting. A condominium or a cooperative often physically resembles an apartment building; occasionally, either type may be a freestanding structure. Residents in such units enjoy the tax advantages of and the investment returns associated with homeownership. They also have the freedom to decorate and remodel their individual quarters as they wish. Moreover, many expenses are not the responsibility of an individual resident only, and some expenses may be relatively low, particularly for features or amenities held in common.

However, condominiums and cooperatives may lack privacy, and the joint responsibility of the occupants for some costs may be a cause of dissension. Joint responsibility also involves risk insofar as any failure of some occupants to meet their share of the common charges would increase the burden on the other occupants. This risk is far greater for cooperatives that may involve a large mortgage on the entire premise than it is for condominiums. Liens on the latter apply to separate, individual units.

The financial aspects of buying or selling a single-family house, a cooperative apartment, or a condominium are identical in their effects. In other words, ownership in any form enables the occupant to pay mortgage interest and property taxes out of pre-tax income and to receive any increase in the value of his residence. Similarly, the financial aspects of renting are broadly identical whether the rental accommodation is a single-family house, an apartment, or even a hotel suite.

Later in this book you will find worksheets prepared to help you organize financial information in a way that you may find helpful in deciding whether to rent or buy, or perhaps whether to sell and buy another house. These worksheets have been designed to be as flexible as possible, *i.e.*, to be useful for nearly every alternative available to you. As a result, some readers may find the worksheets and the instructions to be overly complex. That, unfortunately, is a reflection of the housing transaction. If a reader believed that buying or renting a house is a simple matter, presumably he would not be interested in this book. Moreover, even if one does not gain the full advantage of this book by completing the worksheets, one may find it useful simply for its descriptions of the many aspects pertinent to the housing decision. At least some thought, even if not qualified by formal estimates, should be given to the financial aspects of the housing decision.

SMALL-CAP STOCKS

Small-cap stocks have continued to perform well since we first recommended them in October 2000. Our recommendation then, as now, was based on a review of historical asset-class performance rather than an attempt to identify an asset class that we thought was about to become "hot." The data suggests that long-term investors can benefit from holding small-cap stocks as part of a well diversified portfolio strategy.

Our assessment of asset-class performance is derived from a monthly returns database maintained by the Center for Research in Securities Prices (CRSP). For data through 1981, the CRSP database ranks all issues listed on the New York Stock Exchange (NYSE) by market capitalization in descending order and then breaks that list down by decile (e.g., decile one includes those stocks that comprise the largest 10 percent of NYSE listed stocks). After 1981, non-NYSE issues were added by including them in the decile that they would belong in if they were listed on the NYSE. The non-NYSE stocks (i.e., stocks listed on the American Stock Exchange, other organized exchanges or over-the-counter) tend to have smaller market capitalizations than "Big Board" listed issues. Therefore, the deciles did not contain either an equal number of stocks or equal amounts of market capitalization, but rather something in between. Beginning in July 2001, the CRSP was again adjusted to include all NYSE and non-NYSE stocks, and ranked by market capitalization in descending order and separated into deciles.

The historical returns and volatility of these deciles have been thoroughly studied. As indicated in Chart 1, small-cap stocks have provided significantly greater returns than the Standard & Poor's 500 Index (large-cap stocks), although investors would have had to accept increased volatility in the process. Small-cap stocks are represented as the fifth capitalization quintile (bottom 20 percent) of stocks in the CRSP database. After 1981, that figure reflects the results for the DFA U.S. Micro-Cap Portfolio, a passively managed mutual fund that concentrates on issues (including ASE and NASDAQ stocks) with capitalizations that would place them in the fifth capitalization quintile of the CRSP database. Because they are so small, these "micro-cap" stocks account for the lowest four percent of the market's entire capitalization.

What should make micro-cap stocks especially attractive to investors, however, is not just their relatively small potential-return premium, but also the fact that the returns to micro-capitalization issues are not strongly correlated with those of large stocks. In Table 1, we show market returns by quintiles. Large stocks (quintile one) and micro-cap stocks (quintile five) provided the greatest "swings" in terms of gains and losses over three-year rolling periods, but most importantly, these swings were not correlated. For example, between 1966 and 1968, micro-caps averaged over 40.6 percent annually, while large-caps managed only 7.9 percent. Conversely, between 1987 and 1989, micro-caps returned only 4.3 percent while large-caps gained 16.7 percent. No one can predict these patterns of relative performance in advance, but investors can maximize their potential returns while minimizing volatility by holding both groups. Despite their inherent volatility, micro-caps have demonstrated resiliency during bear markets. Between 1966 and December 1982, a very difficult period for most equity investors, the bottom quintile of the NYSE by market capitalization provided annualized total returns of 13.9 percent, while the S&P 500 returned only 5.8 percent annually.

What is CRSP?

CRSP ("crisp") is an acronym for the Center for Research in Security Prices at the University of Chicago. Established in 1960 with a grant from Merrill Lynch & Co., the center undertook a massive data-gathering project to answer the question "how have stocks performed over the long term?" Under the direction of James Lorie, Ph.D., a professor of business administration, and Lawrence Fisher, associate professor of finance, a database of both price and dividend information was compiled for all common stocks listed on the NYSE beginning in 1926. Over two million bits of information were entered onto magnetic tape, and the commercial computers then becoming available calculated total returns. The results were published in a landmark article in the Journal of Business in January 1964. The center continues to add data on a regular basis, and with a $180,000 grant from Dimensional Fund Advisors in 1984, added data from NASDAQ markets starting in January 1972. The CRSP data files have been an essential tool in the study of capital markets by an entire generation of financial economists.

No Free Lunch Redux

We must emphasize that micro-cap stocks are extremely volatile. In capital markets there is an inevitable trade off between risk and return. Micro-cap stocks are often new issues of unproven, "concept" companies with an intriguing product, technology or business plan or older companies in distress. These stocks are usually unattractive to investors or lenders unless the potential returns are very high. Just as lenders would demand a high rate of interest for lending to these companies, equity investors require a high expected rate of return (from the firm's perspective, this represents a high cost of capital).

Only investors who have a relatively long-term investment horizon and can weather the ups and downs depicted in Table 1 should consider this group. In terms of portfolio allocation, these micro-caps should comprise no more than 10 percent of a portfolio. We have grouped the micro-cap approach as part of the value-stock category since, by construction, candidates are purchased when they qualify for the smallest 4th percentile of the market-capitalization universe and sold after their shares have appreciated above the 5th percentile of the market universe.

Why Not Pick the Best Small Stocks?

According to Morningstar, Inc., some 1,570 small-cap mutual funds exist (small-cap growth, blend and value combined). Innumerable money managers claim to be adept stock pickers, but, as with large-cap stocks, the evidence suggests that no one can consistently outperform the small-cap market average.

It is important to note that the average median capitalization of Morningstar's small-cap category is $1,076 million, while the DFA Micro-Cap Portfolio median market capitalization is only $156 million.

It is a virtual statistical certainty that when enough money managers attempt to pick stocks, some will outperform a passive benchmark simply due to chance, even over extensive time periods. However, evidence suggests that the number of stock pickers outperforming benchmarks or indexes has been below what would be expected by chance. Moreover,

Chart 1: **Growth of a Dollar, Cumulative Returns**
(Monthly Data: Jan 1926 - Dec 2004)

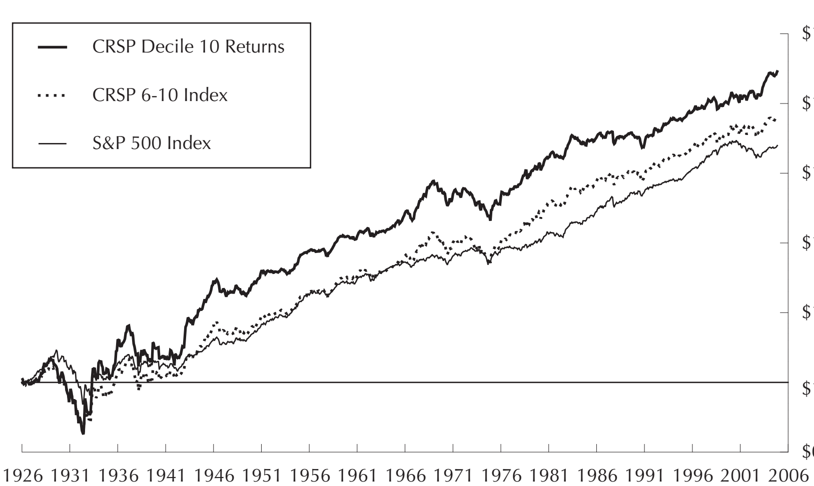

Table 1: Annual Stock Market Returns (NYSE, AMEX, NASDAQ)

Lowest returns are in italic, **highest are in bold**

Size Quintile	*1*	*2*	*3*	*4*	*5*
1927-29	**18.3**	10.2	6.5	1.3	*-1.0*
1930-32	**-29.8**	-31.1	-32.6	*-35.5*	-31.4
1933-35	*35.6*	47.7	54.6	68.0	**86.7**
1936-38	**4.2**	2.7	4.1	1.2	*0.8*
1939-41	-5.5	-5.2	**-4.2**	-4.7	*-9.8*
1942-44	*23.0*	28.3	36.4	47.3	**77.5**
1945-47	*10.9*	12.7	13.1	11.3	**15.6**
1948-50	17.0	16.7	16.9	*16.2*	**19.4**
1951-53	**12.0**	9.8	7.5	6.5	*2.3*
1954-56	26.2	25.8	27.1	*25.5*	**27.8**
1957-59	*13.7*	16.2	15.4	17.8	**19.2**
1960-62	**5.8**	5.3	1.6	2.0	*1.2*
1963-65	*16.9*	19.8	22.1	**22.2**	**22.2**
1966-68	*7.9*	15.9	22.5	28.0	**40.6**
1969-71	**1.9**	0.9	-2.6	*-7.7*	0.6
1972-74	**2.2**	-15.3	-18.8	-21.3	*-25.4*
1975-77	*17.8*	31.5	37.3	44.9	**47.2**
1978-80	*19.3*	24.9	28.2	31.4	**33.2**
1981-83	*10.6*	17.4	20.4	19.2	**22.7**
1984-86	**19.6**	15.1	13.5	10.9	*4.4*
1987-89	**16.7**	16.1	12.8	10.9	*4.3*
1990-92	*11.6*	12.9	**15.5**	11.8	11.7
1993-95	*14.8*	*14.8*	*14.8*	*14.8*	**15.9**
1996-98	**25.9**	16.6	12.6	14.8	*10.6*
1999-01	*0.2*	6.0	6.9	11.0	**15.2**
2002-04	*6.3*	11.5	11.4	13.3	**22.6**

those who "out-perform" over a given time period are rarely the same individuals who do so over subsequent periods, so investors who select managers on this basis will invariably be disappointed. We believe this is the case with small-cap stocks as well. Over three, five, 10 and 15 year spans, the DFA Micro-Cap Portfolio has outperformed 86 percent, 74.3 percent, 94.66 percent and 87.88 percent of small-blend funds, respectively.

Investing in Micro-caps

Individual investors have very few avenues for purchasing micro-caps in an adequately diversified, cost-effective manner. Most of these companies are so small and illiquid that bid-ask spreads and commission costs make direct investments impractical.

The DFA U.S. Micro-Cap Portfolio capitalizes on these apparent barriers. The fund is often the effective market maker for micro-cap stocks, giving it significant buying leverage. When selling shares, the fund managers patiently sell off small portions of holdings, even if the delay risks missing the goal of holding only stocks among the smallest four percent of the market's total capitalization. This trading advantage is significant; between January 1982 and December 2004 the fund outperformed its bogey, the CRSP 9-10 Index, despite charging for the costs associated with running the fund.

The DFA U.S. Micro-Cap Portfolio fund does not purchase master limited partnerships, investment companies, ADRs, REITs, initial public offerings, companies in bankruptcy, or stocks with fewer than four market makers. The annual expense ratio is 0.56 percent (versus 1.67 percent for all small-cap value funds), and annual turnover is only 27 percent (versus 62 percent for all small-cap value funds). As of March 31, 2005 the fund held 2,455 issues and its 10 largest holdings accounted for roughly 1.6 percent of its assets. This is extraordinarily low relative to the universe of small cap portfolios which average approximately 20 percent.

The DFA funds can only be purchased through a qualified investment advisor, however, the DFA funds have very low expense ratios (comparable to those of Vanguard), so that even when combined with advisory fees, many readers might find the DFA funds to be a valuable addition to their portfolios. The DFA group carefully screens advisors, partly to avoid the funds of "hot money" investors and money managers attempting to chase the latest returns. This works to the benefit of investors by reducing costs. We can purchase these funds through our Professional Asset Management (**PAM**) program. Please contact us at (413)528-1216 to learn more.

We have searched for a reasonable alternative to recommend to our readers. A number of small-cap index funds are available that track an established small-cap index. However, these indexes largely exclude micro-cap stocks and focus on much larger stocks. For example the S&P600 Small-Cap Index has a median market capitalization of $1,090 million, versus $156 million for the DFA U.S. Micro-Cap Portfolio. Nevertheless, these indexes can provide a reasonable means of adding stocks that are far smaller than the high-yield Dow stocks. For this purpose, we currently recommend the Vanguard Small- Cap Value Index fund, which targets the MSCI US Small-Cap Value Index and the iShares Small-Cap 600 Value Index. These are listed on page 49.

Small-Cap Controversy?

Several market theorists have questioned the validity of the "size effect." Studies contend that the data for what constitutes a "small-capitalization" stock is not consistent throughout market history. For example the smallest decile of stocks traded on the NYSE in the 1920's and 1930's would likely be considered large-cap stocks in today's parlance, simply because so few issues were publicly traded. Others have noted the fact that the "size premium" can be discounted if a few stellar periods of return are removed from the data series. We conclude that the debate is superfluous. Capital markets have undergone dramatic transformation over the last century and comparing the capitalizations of stock exchanges of earlier periods to those of today is irrelevant. Furthermore, the dramatic volatility of small-cap stocks over certain periods is exactly why investors should hold them. Where there is risk, reward inevitably follows for the patient and disciplined investor.

Annualized Percent Returns
(Monthly Data: Jan 1926 - Feb 2005)

	Annualized Return	*Annualized Std Dev*
CRSP Decile 10 Index	13.86	37.41
CRSP Deciles 6-10 Index	11.79	27.54
S&P 500 Index	*10.40*	*19.36*

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 **Verizon**, which was not then a Dow component, was not eligible for purchase 18 months earlier. Investors following the model should find that the indicated purchases of **Verizon** and sales of **AT&T** (no longer a Dow component) are sufficiently large to warrant trading. In larger accounts, rebalancing positions in **Merck**, **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 results roughly equal to the future perfor-

As of June 15, 2005

					Percent of Portfolio*	
	Rank	*Yield*	*Price*	*Status*	*Value*	*No. Shares*[1]
General Motors	1	5.50%	36.34	*		
SBC Comm.	2	5.37%	24.01	Holding**	24.94	32.40
Merck	3	4.76%	31.90	Holding**	14.73	14.40
Verizon	4	4.61%	35.16	Buying	20.34	18.04
Altria Group	5	4.39%	66.48	*		
JP Morgan Chase	6	3.81%	35.71	Holding**	23.12	20.19
CitiGroup	7	3.71%	47.40	Holding	11.22	7.38
DuPont	8	3.16%	46.83	Holding	1.58	1.05
Pfizer	9	2.67%	28.43			
Coca Cola	10	2.57%	43.64			
AT&T***	NA	4.92%	19.30	Selling	4.04	6.53
					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	2.46%	5.88%	3.83%	11.06%	13.55%	15.03%	19.14%
Dow	4.46%	4.15%	1.36%	10.48%	11.01%	10.30%	16.83%

* The strategy excludes Altria and General Motors. ** Currently indicated purchases approximately equal to indicated purchases 18 months ago. *** No longer a Dow Component. [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.

mance 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 83 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 Symbol	*Market Prices 6/15/05*	*Market Prices 5/13/05*	*Market Prices 6/15/04*	*12-Month High*	*12-Month Low*	*Latest Dividend Amount*	*Latest Dividend Record Date*	*Latest Dividend Paid*	*Indicated Annual Dividend*	*Indicated Yield† (%)*
General Motors	GM	**$36.34**	**$30.98**	47.64	48.27	24.67	0.500	5/19/05	6/10/05	2.000	5.50
★ SBC Comm.	SBC	**$24.01**	**$23.08**	24.47	27.29	22.78	0.323	4/08/05	5/02/05	1.290	5.37
★ Merck	MRK	**$31.90**	**$33.46**	47.95	48.78	25.60	0.380	6/03/05	7/01/05	1.520	4.76
★ Verizon	VZ	**$35.16**	**$34.09**	35.94	42.27	33.71	0.405	4/08/05	5/02/05	1.620	4.61
Altria Group	MO	**$66.48**	**$64.95**	47.55	69.68 *H*	44.50	0.730	6/15/05	7/11/05	2.920	4.39
★ J. P. Morgan Chase	JPM	**$35.71**	**$34.46**	37.25	40.45	33.35	0.340	7/06/05	7/31/05	1.360	3.81
☆ Citigroup	C	**$47.40**	**$45.91**	47.02	49.99	42.10	0.440	4/25/05	5/20/05	1.760	3.71
☆ DuPont	DD	**$46.83**	**$46.24**	43.57	54.90	39.88	0.370	5/13/05	6/11/05	1.480	3.16
Pfizer	PFE	**$28.43**	**$27.86**	35.09	35.31	21.99	0.190	5/13/05	6/07/05	0.760	2.67
Coca-Cola	KO	**$43.64**	**$44.11**	51.23	51.68	38.30	0.280	6/15/05	7/01/05	1.120	2.57
General Electric	GE	**$36.32**	**$35.70**	31.81	37.75	31.42	0.220	2/28/05	4/25/05	0.880	2.42
Honeywell Intl.	HON	**$37.30**	**$35.93**	35.97	39.50	31.85	0.206	5/20/05	6/10/05	0.825	2.21
3M Company	MMM	**$76.13**	**$75.61**	85.55	90.29	73.31	0.420	5/20/05	6/12/05	1.680	2.21
Alcoa	AA	**$27.56**	**$26.70**	31.14	34.99	26.03 *L*	0.150	5/06/05	5/25/05	0.600	2.18
Procter & Gamble (s)	PG	**$54.40**	**$54.75**	55.52	57.40	50.53	0.280	4/22/05	5/16/05	1.120	2.06
Johnson & Johnson	JNJ	**$66.35**	**$67.10**	56.21	69.99	54.37	0.330	5/17/05	6/07/05	1.320	1.99
Exxon Mobil	XOM	**$59.25**	**$53.70**	44.08	64.37	44.00	0.290	5/13/05	6/10/05	1.160	1.96
McDonald's	MCD	**$28.95**	**$29.65**	26.68	34.56	25.64	0.550	11/15/04	12/01/04	0.550	1.90
United Tech.	UTX	**$52.36**	**$50.17**	44.64	54.07	43.52 *L*	0.220	5/20/05	6/10/05	0.880	1.68
Caterpillar	CAT	**$98.58**	**$89.00**	75.39	99.96	68.50	0.410	4/25/05	5/20/05	1.640	1.66
Boeing	BA	**$64.41**	**$59.50**	49.25	66.09 *H*	46.40	0.250	5/13/05	6/03/05	1.000	1.55
Hewlett-Packard	HPQ	**$23.88**	**$20.62**	21.70	24.01 *H*	16.08	0.080	6/15/05	7/06/05	0.320	1.34
Microsoft Corp.	MSFT	**$25.26**	**$25.30**	27.41	30.20	23.82	0.080	5/18/05	6/09/05	0.320	1.27
Wal-Mart Stores	WMT	**$49.85**	**$47.13**	56.71	57.89	46.20	0.150	8/19/05	9/06/05	0.600	1.20
Intel Corp.	INTC	**$26.94**	**$25.12**	28.43	28.60	19.64	0.080	5/07/05	6/01/05	0.320	1.19
IBM	IBM	**$76.30**	**$73.16**	90.54	99.10	71.85	0.200	5/10/05	6/10/05	0.800	1.05
Home Depot, Inc.	HD	**$40.03**	**$36.29**	35.77	44.30	32.39	0.100	6/09/05	6/23/05	0.400	1.00
AIG	AIG	**$55.41**	**$52.05**	72.15	73.46	49.91	0.125	9/02/05	9/16/05	0.500	0.90
Walt Disney	DIS	**$27.04**	**$27.00**	24.70	29.99	20.88	0.240	12/10/04	1/06/05	0.240	0.89
American Express	AXP	**$54.99**	**$51.75**	51.22	58.03	47.70	0.120	7/01/05	8/10/05	0.480	0.87
☆ AT&T	T	**$19.30**	18.54	16.18	20.01	13.59	0.238	3/31/05	5/02/05	0.950	4.92

† Based on indicated dividends and market price as of 6/15/05. *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

	6/15/05	Mo. Earlier	Yr. Earlier
Gold, London p.m. fixing	**428.70**	**420.00**	386.50
Silver, London Spot Price	**7.26**	**6.88**	5.63
Copper, COMEX Spot Price	**1.61**	**1.42**	1.20
Crude Oil, W. Texas Int. Spot	**55.57**	**48.67**	37.19
Dow Jones Spot Index	**218.09**	**202.72**	182.86
Dow Jones-AIG Futures Index	**156.05**	**147.33**	144.14
CRB-Bridge Futures Index	**306.98**	**293.85**	266.62

Interest Rates (%)

		6/15/05	Mo. Earlier	Yr. Earlier
U.S. Treasury bills -	91 day	**2.99**	**2.81**	1.33
	182 day	**3.21**	**3.12**	1.67
	52 week	**3.52**	**3.35**	2.10
U.S. Treasury bonds -	10 year	**4.12**	**4.13**	4.68
Corporates:				
High Quality -	10+ year	**5.34**	**5.37**	6.06
Medium Quality -	10+ year	**5.74**	**5.91**	6.52
Federal Reserve Discount Rate		**4.00**	**4.00**	2.00
New York Prime Rate		**6.00**	**6.00**	4.00
Euro Rates	3 month	**2.11**	**2.13**	2.10
Government bonds -	10 year	**3.09**	**3.33**	4.33
Swiss Rates -	3 month	**0.75**	**0.76**	0.34
Government bonds -	10 year	**1.89**	**2.01**	2.92

Exchange Rates

	6/15/05	Mo. Earlier	Yr. Earlier
British Pound	**$1.821400**	**$1.850600**	1.828100
Canadian Dollar	**$0.806200**	**$0.790300**	0.728100
Euro	**$1.211100**	**$1.262300**	1.205700
Japanese Yen	**$0.915500**	**$0.931300**	0.908000
South African Rand	**$0.147700**	**$0.157900**	0.152900
Swiss Franc	**$0.786400**	**$0.816800**	0.791200

Securities Markets

	6/15/05	Mo. Earlier	Yr. Earlier
S & P 500 Stock Composite	**1,206.58**	**1,154.06**	1,132.01
Dow Jones Industrial Average	**10,566.37**	**10,140.12**	10,380.43
Dow Jones Transportation Average	**3,527.22**	**3,402.20**	3,039.84
Dow Jones Utilities Average	**373.94**	**355.42**	272.27
Dow Jones Bond Average	**188.49**	**185.67**	173.29
Nasdaq Composite	**2,074.92**	**1,976.78**	1,995.60
Financial Times Gold Mines Index	**1,525.38**	**1,354.47**	1,387.71
FT African Gold Mines	**1,789.63**	**1,568.02**	1,801.15
FT Australasian Gold Mines	**4,033.77**	**3,658.90**	2,967.13
FT North American Gold Mines	**1,293.55**	**1,149.10**	1,167.30

Coin Prices

	6/15/05	Mo. Earlier	Yr. Earlier	Premium
American Eagle (1.00)	**$436.75**	**$429.05**	403.35	1.88
Austrian 100-Corona (0.9803)	**$415.93**	**$408.53**	384.13	-1.03
British Sovereign (0.2354)	**$102.40**	**$100.60**	96.35	1.47
Canadian Maple Leaf (1.00)	**$437.00**	**$429.30**	403.60	1.94
Mexican 50-Peso (1.2057)	**$363.00**	**$504.00**	473.90	-29.77
Mexican Ounce (1.00)	**$425.40**	**$417.90**	392.90	-0.77
S. African Krugerrand (1.00)	**$431.75**	**$424.15**	398.95	0.71
U.S. Double Eagle-$20 (0.9675)				
St. Gaudens (MS-60)	**$500.00**	**$510.00**	470.00	20.55
Liberty (Type I-AU)	**$675.00**	**$675.00**	675.00	62.74
Liberty (Type II-AU)	**$497.50**	**$497.50**	487.50	19.95
Liberty (Type III-AU)	**$460.00**	**$460.00**	425.00	10.91
U.S. Silver Coins ($1,000 face value, circulated, year earlier uncirculated)				
90% Silver (715 oz.)	**$5,275.00**	**$4,880.00**	4,182.50	1.62
40% Silver (292 oz.)	**$2,130.00**	**$1,970.00**	1,725.00	0.48
Silver Dollars	**$6,700.00**	**$6,675.00**	6,500.00	19.29

Note: Premium reflects percentage difference between coin price and value of metal in a coin, with gold at $428.70 per ounce and silver at $7.26 per ounce. The weight in troy ounces of the precious metal in coins is indicated in parentheses.

Recommended Mutual Funds

	Ticker Symbol	6/15/05	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[3]	SHY	**$80.99**	**$81.10**	81.45	82.28	80.62	1.8942	0.0000	2.34
Vanguard Short-term Corporate	VFSTX	**$10.58**	**$10.58**	10.62	10.25	9.96	0.3622	0.0000	3.42
Income Equity Funds									
DNP Select Income[1, 2]	DNP	**$11.45**	**$11.28**	10.75	11.95	10.24	0.8500	0.0000	7.42
Vanguard REIT Index	VGSIX	**$19.66**	**$18.28**	15.36	19.91	15.43	0.8800	0.1400	4.48
Large Cap. Value Equity Funds									
iShares S&P 500 Value Index[3]	IVE	**$62.82**	**$59.45**	56.86	63.97	54.17	1.0245	0.0000	1.63
Vanguard Value Index	VIVAX	**$21.69**	**$20.60**	19.24	21.98	18.65	0.3690	0.0000	1.70
Small Cap. Value Equity Funds									
iShares Sm. Cap. 600 Value Index[3]	IJS	**$62.07**	**$56.97**	52.60	62.37	49.53	1.5536	0.0000	2.50
Vanguard Sm. Cap Value Index	VISVX	**$14.17**	**$12.98**	11.91	27.26	21.61	0.2270	0.0000	1.60
Growth Equity Funds									
iShares S&P 500 Growth Index[3]	IVW	**$57.70**	**$55.80**	56.83	58.99	51.98	1.0956	0.0000	1.90
Vanguard Growth Index	VIGRX	**$26.29**	**$25.11**	25.55	26.45	23.11	0.3050	0.0000	1.16
Foreign Equity Funds									
iShares S&P Europe 350 Index[3]	IEV	**$74.57**	**$73.20**	65.73	78.75	62.21	1.3481	0.0000	1.81
Vanguard European Stock Index	VEURX	**$25.76**	**$25.30**	22.42	27.11	21.59	0.5800	0.0000	2.25
iShares Emerging Markets Index[3]	EEM	**$71.60**	**$65.10**	49.60	74.18	50.33	0.8043	0.0000	1.12
Vanguard Emerging Market Index	VEIEX	**$15.40**	**$14.83**	11.17	15.99	11.16	0.2590	0.0000	1.68
Gold-Related Funds									
iShares COMEX Gold Trust[3]	IAU	**$42.79**	**$41.94**	N/A	44.69	41.04	0.0000	0.0000	0.00
streetTRACKS Gold shares	GLD	**$42.74**	**$41.95**	N/A	46.00	41.02	0.0000	0.0000	0.00

Recommended Gold-Mining Companies

	Ticker Symbol	6/15/05	Month Earlier	Year Earlier	— 52-Week — High	Low	Distributions Latest 12 Months	Frequency	Yield (%)
Anglogold Ltd., ADR	AU	**$34.80**	**$31.00**	31.79	42.40	29.91	0.599	Semiannual	1.72
Barrick Gold Corp.†	ABX	**$23.61**	**$21.55**	19.26	26.32	18.14	0.220	Semiannual	0.93
Gold Fields Ltd.	GFI	**$10.60**	**$9.57**	10.27	15.25	9.13	0.150	Semiannual	1.42
Newmont Mining	NEM	**$38.39**	**$35.31**	37.97	49.98	35.83	0.280	Quarterly	0.73
Placer Dome†	PDG	**$15.03**	**$12.30**	15.31	23.67	12.32	0.100	Semiannual	0.67
Rio Tinto PLC‡	RTP	**$123.99**	**$115.80**	94.95	143.95	84.53	0.770	Semiannual	0.62

[1] Closed-end fund, traded on the NYSE. [2] Dividends paid monthly. [3] Exchange -traded fund, traded on ASE. † Dividend shown is after 15% Canadian tax withholding. ‡ Not subject to U.K. withholding tax. na Not applicable.