INVESTMENT GUIDE

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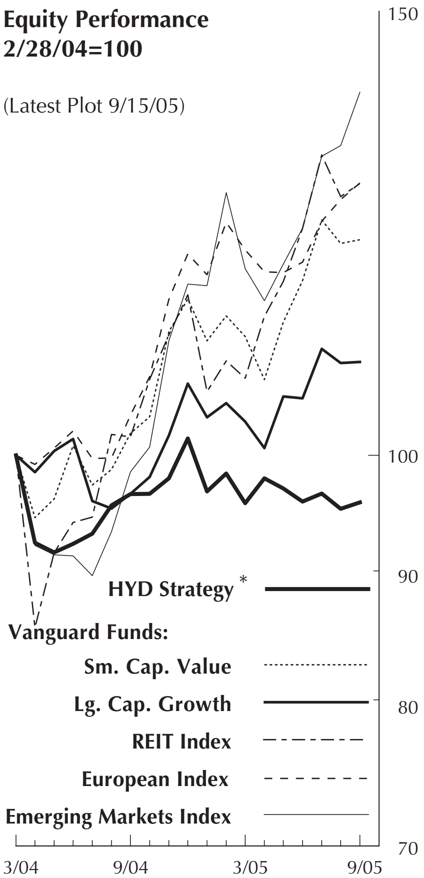
Equity Performance
2/28/04=100

(Latest Plot 9/15/05)



*** HYD is a hypothetical model based on back-tested results. See p. 70 for a full explanation.**

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

Online: www.americaninvestment.com

Heeding Our Own Advice

"You make more money selling advice than following it. It's one of the things we count on in the magazine business—along with the short memory of our readers."

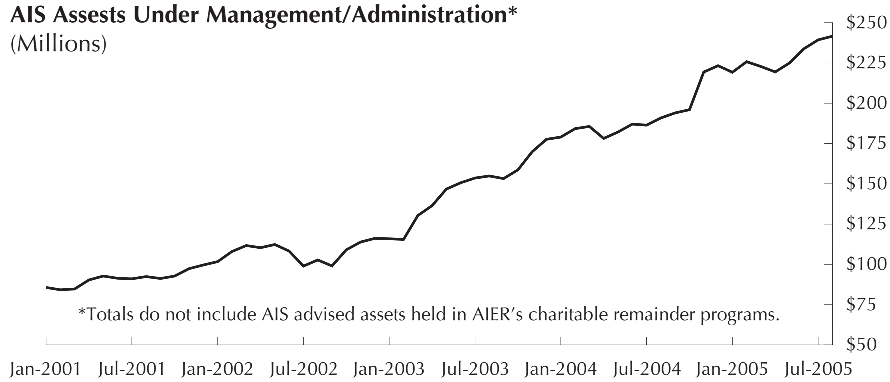
—Steve Forbes, *Forbes* Magazine, The Anderson School,
University of California at Los Angeles, April 19, 2003.

We appreciate Mr. Forbes' candor. He is correct; it is easy to make money by peddling advice and hopping from one hot investment notion to the next.

We, too, are in business to earn money, though our approach is decidedly different from that of most financial publishers. Asset class investing, though not terribly exciting, is tried and true, and there is a growing awareness among the investing public that a structured, passive approach is by far the most rational approach to building wealth. We are content to prosper patiently in this environment, by gradually building our subscriber and client base. We do not lose sleep over those who part ways in order to seek the wisdom of the latest market guru.

The chart below depicts the growth of the assets we manage or administer for individuals and institutions:

AIS Assests Under Management/Administration*
(Millions)



Contrary to Mr. Forbes' suggestion, we *do* follow our own investment advice, and we have no regrets. The chart above does not include the $127 million in assets we advise that are held in trust in the charitable remainder programs of our parent, the American Institute for Economic Research (AIER). For these programs, we utilize the same eight asset classes that we recommend for our readers.

Donors and AIER alike have benefited from our approach. A donor can name beneficiaries who receive payments of income for life. No capital gains taxes are due when donated assets are sold and reinvested and the donor can take a charitable deduction for the actuarially calculated present value of the eventual remainder. AIER has been able to fund its educational mission in part through the receipt of assets upon the death of the last beneficiary named.

(continued next page)

Many other charitable and educational institutions raise funds by offering programs with the same tax advantages, but we are not aware of any others that follow the investment strategy recommended by AIS.

There are few restrictions on the type of appreciated asset that may be donated. In fact, these programs might be well suited to investors with appreciated real estate, who find they are "land rich" but "income deprived." For more information regarding AIER's programs, contact Mr. Shaun Buckler, CFO, (413) 528-1216 ext. 3146, sbuckler@aier.org.

REITS: A VALUABLE PORTFOLIO COMPONENT

Congress created Real Estate Investment Trusts (REITs) in 1960 in order to provide the investing public with a way to invest in large-scale commercial properties. By mid-year 2005, REITs firms owned more than 24,000 properties throughout the U.S. across all property classes. The National Association of Real Estate Investment Trusts (NAREIT) estimates that REIT-structured entities currently control roughly 15 percent to 20 percent of all investment-grade property on U.S. soil, worth approximately $475 billion.

While eye-popping residential real estate prices have captured the lion's share of headlines, commercial property values have also provided hefty returns. The NAREIT equity index provided total annualized returns of 14.08 percent between January 2000 and July 2005, versus 13.32 percent for the S&P 500 common stock index.

Though they have provided extraordinary returns in recent years, we are confident that commercial real estate will not grow to the sky. Like all of our recommended asset classes, real estate should comprise but one component of a well-structured portfolio. Currently we recommend that investors confine their REIT exposure to no more than 10 percent of their portfolio's total value.

REITs have several attractive features, including an income stream competitive with those of bonds and utilities. They provide a risk/return profile that is unique and can therefore play a valid role for investors seeking an optimal portfolio in terms of risk and return.

What is a REIT?

A REIT is a tax-advantaged operating company that specializes in owning and managing commercial property. REITs avoid taxation at the corporate level if they distribute 90 percent of their net income to shareholders annually. REITs thus typically provide a much higher dividend yield relative to most common stocks.

REIT dividends received by individuals are taxed as ordinary income, where federal rates top out at 35 percent. The Jobs and Growth Tax Relief Reconciliation Act of 2003 cut the tax rate on dividends for most common stocks to 15 percent, but REIT dividends, because they avoid taxes at the corporate level, were excluded from this break.

There are other significant statutory requirements pertaining to REITs, including a stipulation that 75 percent of a REIT's assets must be invested in real estate, mortgage loans, cash, or government securities, and that 75 percent of gross income be derived from rents, mortgage interest, or gains from the sale of real property. In 1986, the tax law was broadened, permitting REITs to go beyond mere ownership by allowing them to operate all aspects of the real estate business, from finding tenants and undertaking improvements to developing new properties.

Many investors have bitter recollections of the commercial real estate market. The REIT market of the 1970s, for example, was dominated by "mortgage REITs." These REITs, which originated, held and marketed real estate mortgage loans, were crushed by skyrocketing interest rates and left investors with significant losses. Real estate limited partnerships bring even darker memories; these structures were touted more for their tax advantages than their economic advantages. When the tax laws changed, these highly illiquid instruments crashed and burned.

Equity REITs, however, are distinct from both of these ill-fated predecessors. Unlike mortgage REITs, equity REITs directly own and manage commercial properties. They also bear very little resemblance to limited partnerships, which were frequently assembled by brokerage firms and promoters who claimed exaggerated appreciation potential. They charged high fees, typically held only a few properties, and were highly illiquid.

Table 1: **Monthly Correlations**

Five Years: January 1972-July 2005

	NAREIT	*S&P 500*	*LTGB*	*TBill*
NAREIT	1.00			
S&P 500 Index	0.52	1.00		
Long-Term Gov't Bond	0.17	0.23	1.00	
Treasury Bill	-0.08	-0.03	0.06	1.00

Raising new capital proved very difficult. Equity REITs, by contrast, trade in a highly liquid market where they are valued based on their ability to grow their earnings and dividends. Capital can be quickly and efficiently accessed by issuing new debt or shares, by reinvesting undistributed dividends, or by selling appreciated properties. Finally, unlike limited partnerships whose general partners frequently had conflicts of interest with the limited partners, the managers of most successful equity REITs hold a significant stake in the business themselves.

By a recent count, there are presently 198 REITs in existence of which 161 are equity REITs (the remainder are either mortgage or "hybrid" REITs). Equity REITs invest in shopping centers, malls, apartments, hospitals, nursing homes, office buildings, malls, manufactured home developments, industrial properties, and hotels. Some specialize within these areas, or within a geographic region, while others are diversified. According to the National Association of Real Estate Investment Trusts (NAREIT), the market capitalization of all equity REITs stood at $307 billion at the end of 2004, up from only $138 billion five years earlier. NAREIT also lists 83 mutual funds that specialize in REITs.

Real Promise

REITs are a highly liquid form of holding real estate and are likely to continue to be so in the future as more private owners of real estate turn to the public markets.

In the aftermath of the saving-and-loan debacle in the early 1990s, a traditional source of real estate financing disappeared, providing an opening for the public equity market. As real estate prices plunged in the face of this liquidity crisis, REITs emerged to fill the void by buying up properties at depressed prices.

The shift from private to public ownership has been facilitated by the emergence of "umbrella partnership" REITs or UPREITs. Under these plans, private developers can exchange existing properties for "units" of a limited partnership in which a REIT holds a controlling interest. These units receive the same dividends and voting rights available to REIT shareholders and may be converted into shares of the REIT. In exchanging their properties for the ownership units, the developers defer capital gains taxes until they convert their units to REIT shares. They also gain significant diversification and easy access to new capital through public equity markets.

The real estate market has proven notoriously susceptible to boom and bust cycles, but the trend toward REIT ownership could mitigate these swings. In past real estate meltdowns, mismanaged firms were often said to be "overlooked" and managed to hang on until the entire industry was in crisis. Publicly traded REITs, on the other hand, operate in a highly efficient market and are subject to the close scrutiny of public disclosure. They are quickly punished if poorly managed. REITs rely heavily on external financing for growth because they must distribute 90 percent of their earnings as dividends.

Excessive leverage was a major factor contributing to past real estate crashes, but today's REITs appear more conservatively financed. Debt rarely exceeds 40 percent of total market capitalization. The quality of debt has improved as well. REITs use leverage to minimize their cost of capital, but rely less on short-term and variable-rate debt than in the past. As their capitalization has grown, REITs have been able to develop more flexible capital structures that include preferred stock, convertible debt and unsecured debt.

The growing supply of REITs is likely to be matched by increasing demand for these securities. As more investors see the wisdom of passive investing, REITs are likely to appear in more portfolios for their unique risk/return characteristics.

REITs are also increasingly attractive to institutional investors. In the past, pension funds and insurance companies shunned REITs in favor of direct real estate investment run by an "in house" staff. REITs' small capitalizations and limited property types proved unpopular with large investors who required greater liquidity and diversification. Today, however, the market capitalizations and diversity of holdings among REITs has grown dramatically.

REITs, Risk, and Return

Equity REITs can provide a dependable source of investment income. In mid-September, the Vanguard REIT Index Portfolio, which mimics the broad-based Morgan Stanley REIT Index, was yielding 4.4 percent. By comparison, the 10-year Treasury bond was yielding 4.18 percent.

An asset class is perhaps best defined as a subset of capital markets with unique forms of "priced" risk. Priced risk is any risk the market compensated with expected returns. Anything that qualifies as an asset class has meaningful diversification properties and, therefore, a meaningful role in plan structure.

Most industry sectors do not qualify as asset classes. Oil stocks, for instance, are prone to "price shocks," but there is no expected return to compensate for these fluctuations, so holding oil stocks as an industry component within a portfolio is not justified based on risk and return. (This does not preclude holding oil stocks as part of a genuine asset class such as "large cap value stocks.") Oil price shocks are an unpriced risk. Most industries have no independent risk-and-return characteristics.

Fama and French find that three risk factors—the market, the size effect and the book-to-market effect—describe the variation in returns of virtually every industry group. "Industry effects" do not exist, in the sense of explaining differences in expected returns. They found that what appear to be independent movements in the returns of industry groups are actually due to market, size and book-to-market effects in returns. The three factors explain the returns of all industry categories except one: REITs. 67 percent of the variation in the returns of 49 industries are explained by the factors, compared to only 22 percent of the variation of REIT returns.

Because the model describes all industries except real estate, we cannot reject that real estate is a separate asset class. No other combination of investments can approximate their risk-and-return characteristics. REITs behave differently. They deserve a place in a diversified portfolio. The correlations in Table 1 reinforce this conclusion (a correlation of one represents perfect correlation). REITs, in spite of their reputation as interest-rate sensitive stocks, have a lower correlation with the bond market than does the S&P 500. This illustrates their diversification benefits.

REITs are attractive for their low risk level in a diversified portfolio, and for their frequent strong returns. Table 2 shows yearly returns by component since 1999. Real estate securities have done well for their low risk, with the additional benefit of a high level of dividend income.

Table 2: **NAREIT Equity Index**

	Return Components		
Year	*Total*	*Price*	*Income*
1999	-4.62	-12.21	7.59
2000	26.37	16.51	9.86
2001	13.93	5.85	8.08
2002	3.82	-3.12	6.94
2003	37.13	28.48	8.66
2004	31.58	24.35	7.23
2005*	9.80	6.48	3.32

* Year to date. Source: NAREIT.

Liquid Properties

Professors Joseph Gyourko and Donald Keim of the Wharton School did seminal research into the behavior of real estate equity. They found that real estate stocks have a strong "lagged" correlation with appraised values of actual real estate. Because stocks are more liquid and more actively traded than buildings (and land), they tend to reflect real estate values more quickly than appraisals (as represented by the Russell NCREIT Index). Real estate stock prices are correlated with appraised values in the following year.

REITs do not behave like a stock, a bond, or a hybrid of both. We know, however, from Gyourko and Keim's research that real estate stocks deliver the returns of real estate. They're much easier to buy and sell than real estate property, and they anticipate the returns of the property market.

The lack of actual buildings is a benefit. Plans with properties in their portfolios have management problems REIT holders do not have—problems that require time, money, and personnel. It is also much easier to diversify with REITs. It's difficult to diversify a portfolio of actual properties across geographical regions and operator-types.

To summarize, REITs are listed as stocks, but they are not well explained by the current models of what a stock (or a bond) is. This is a reason to hold them: they are different and they enhance diversification. While they don't behave like stocks and they don't behave like bonds, they behave like actual property, with the added benefit that they trade like stocks.

Which REITs are Right?

Our passive approach to portfolio management leads us to recommend passively managed mutual funds as the most effective means of holding REITs.

We continue to recommend the Vanguard REIT Index fund (VGSIX), an open-end, no-load mutual fund that invests in those REITs that comprise the MSCI US REIT Index. This index tracks 121 equity REITs, and excludes REITs with market capitalizations of less than $100 million. This passive investment strategy seeks to capture the returns of the overall REIT market rather than trying to seek out pockets of value within particular real estate sectors. The fund provides excellent geographic and sector diversification.

Dimensional Fund Advisors started their Real Estate Securities Fund (DFREX) in January 1993, following the Gyourko-Keim research. The strategy, designed by Gyourko and Keim, was among the first REIT portfolios available. While we believe that Dimensional provides the optimal method of adding REITs to a portfolio, these funds are only available through registered investment advisors. We offer this fund through our Professional Asset Management (PAM) service.

DFREX holds all publicly-traded equity and hybrid REITs in market cap weights. It excludes health care REITs. Gyourko-Keim concluded these REITs are more correlated with the healthcare industry and are not purely representative of the real estate asset class.

Dimensional's fund is similar to the Vanguard fund in that it is passive with respect to its management, but it is "active", and we think superior, with respect to trading. Traditional index funds strive to perfectly weight their portfolio to the index weights because they place the highest priority on tracking their index. Dimensional's equity strategies are mostly composed of higher cost-of-capital and higher expected return stocks, which are often illiquid stocks. Research shows that tracking an index of illiquid stocks is costly, and close tracking often indicates poor performance of the objective. This deserves some explanation.

To replicate huge indexes of small-cap stocks, traditional index strategies are forced to buy shares at the market close, often at the "asking" price. The selling brokers anticipate these purchases and raise prices. The inflated closing price paid by the index fund is the same price used to value the index. As a result, the fund closely tracks its index while paying excessive trading costs. Because many plan sponsors measure the success of an index fund by how closely it tracks its index, the poor performance often goes unnoticed. In small-cap stocks, close tracking comes at the cost of lower returns.

Dimensional uses its size and influence in the "upstairs market" of block trades to purchase blocks of the stocks in its portfolio at discounts. Dimensional often receives the trading costs paid by index funds that sell under pressure in order to track their benchmarks. As a result, the firm's small-cap strategies typically incur negative transaction costs which translate directly into increased portfolio returns.

As is the case with our other passively managed recommended assets, the Vanguard fund and the DFA Real Estate fund both have superior track records among mutual funds in their respective asset classes.

Portions of this article were taken directly from Real Estate Securities Fund by Eugene F. Fama, Jr., Dimensional Fund Advisors. For a full, annotated version of the text, please contact A.I.S.

A NEW WAY TO ACCESS MICRO CAP STOCKS: EXCHANGE TRADED FUNDS

In our June 2005 issue we revisited the size premia that investors can expect from small and micro capitalization stocks. We continue to recommend that investors include micro-cap stocks as a component of a well diversified asset class based portfolio. The higher expected return for micro-cap stocks is fundamentally a "cost of capital" story; investors demand a premium for investing in these small and relatively risky companies.

The U.S. equity micro cap asset class includes those stocks that comprise the smallest 4 percent of the total market capitalization of the U.S. stock market. There are significant barriers to entry in this market for individual investors. These include lack of liquidity, the relatively high cost of managing a micro-cap portfolio and the difficulty in finding a pooled investment vehicle, such as a mutual fund, that captures the desired market capitalization effectively. Faced with these constraints, we have been recommending two small cap funds, the iShares Small Cap 600 Value Index and the Vanguard Small Cap Value Index fund. Both funds are passive, low-cost investment vehicles, but these are in fact "next best" solutions because they have very little exposure to the tiniest (micro cap) stocks that our research suggests provide the greatest "bang for the buck" in terms of expected return.

The Morningstar Principia database currently lists 45 mutual funds with the "micro-cap" moniker. Over half of these funds have been launched since the year 2000, and all but three have been started since 1990. The group has an average expense ratio of 1.83% and only one fund, the Dimensional Fund Advisors US Micro Cap with an expense ratio of 0.56%, is below 1.0%. This highlights both the exorbitant fees charged by most fund companies and the relatively high cost of running a micro-cap fund. Most of these funds are also actively managed, so they also suffer from all of the additional disadvantages inherent to "stock picking" which we have addressed at length in previous articles. We have been using the DFA funds successfully on behalf of our clients, but these are not available directly to investors who choose not to use an investment advisor.

An ETF product would seem the ideal way for individuals to overcome the obstacles to accessing the micro-cap market. The introduction of exchange traded fund (ETF) products has leveled the playing field in many respects for individual investors. They offer many benefits over traditional mutual fund products. These include diversification, efficient tracking of underlying indexes, intraday pricing, liquidity, a minimal tax bite and low expenses. The rapid growth of this breed of investment products has been quite impressive. At the close of 2004, more than $226 billion was invested in exchange-traded funds (ETFs) worldwide, up from $151 billion at the close of 2003 (see chart below).

Don't Judge an Index (or ETF) by its Cover

The rapid investor acceptance of ETF investing has prompted Wall Street to pump out new products at an alarming rate. It would seem that analytical firms are prepared to create an index to fit almost any product. However, not all ETF products are based on sound index methodology, and some "indexes" are defined so esoterically that they instead should be considered actively managed funds.

The newly launched Powershares Zacks Micro Cap Portfolio (PZI), for example, is based on a benchmark designed by Zacks Investment Research.

Powershares products are self-described "semi-active" funds and use terms such as "Intellidex" or "Dynamic Portfolio" for their indexes, which are actively adjusted based on qualitative assessments in hopes of beating a broad market index. Don't be fooled by these gimmicky names, they are active trading strategies that will guarantee investors higher expenses. The Zacks Micro Cap Index screens micro cap stocks based on vague criteria such as "undesirable characteristics" and "poor fundamentals."

Similarly, the Dow Jones Select Micro Cap Index is designed to capture what it terms the "investable" portion of U.S. micro-cap companies. It ostensibly measures the performance of micro-capitalization stocks traded on the major U.S. exchanges, but the screens that are applied in order to narrow the list to stocks deemed investable would appear to eliminate the very stocks that provide the greatest potential returns. By screening for market capitalization and for "poor fundamentals" (low operating profit margins, low price-to-earnings ratios, low price-to-sales ratios, low earnings momentum and trailing stock-market returns) the index eliminates very small firms that typically have low price-to-book ratios, a measure of risk which has historically compensated investors with additional return.

The result of the screens is a relatively small number of companies; as of August 31, 2005, the Dow version listed only 280 stocks with an average market capitalization of $400 million. This relatively small list of firms can be expected to result in greater volatility relative to the micro cap universe.

The Russell Microcap Index—The Real Thing?

The Frank Russell Company has recently introduced its own bogey, the Russell Microcap Index. In addition, Barclays Global Investors (BGI) recently launched the iShares Russell Microcap Index Fund (IWC), which tracks a customized version of the Russell Microcap index called the "Russell MicrocapX Index," which includes over 90% of the market value of the broader Russell index. It is designed to screen out shares with very low trading volume. The fund only began trading in August 2005 and we are not recommending these shares until they have had a longer trading history. However, this investment vehicle holds promise as a means of allowing retail investors better access to the micro cap asset class.

Comparative Data: Small/Micro Cap Investment Vehicles

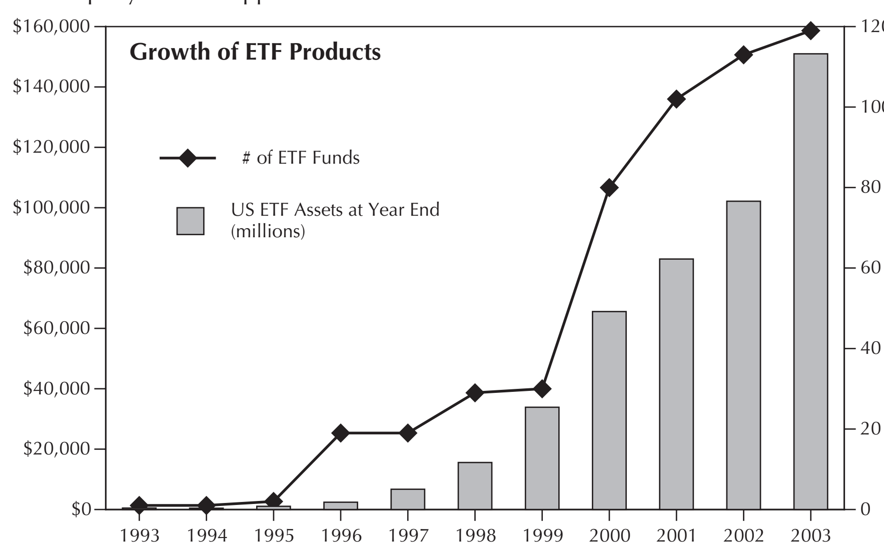
	Ticker	*(Geometric) Weighted Avg. Market Cap. ($ millions)*	*Number of Holdings*
DFA Micro Cap Portfolio*	DFSCX	$289	2,487
DFA U.S. Small Cap Value Portfolio*	DFSVX	$522	1,313
Vanguard Small Cap Value Index	VISVX	$1,301	948
iShares S&P Small Cap 600/Barra Value	IJS	$902	354
iShares Russell Micro-Cap Index Fund	IWC	$242	1,250

*DFA funds available only through DFA approved registered investment advisors.
Source: Morningstar, Frank Russell Company (Russell.com).

Russell has several indexes designed to represent different market cap segments of the U.S. Stock Market. The Russell 3000 Index measures the performance of the 3,000 largest U.S. companies based on total market capitalization. These firms represent roughly 98% of the investable U.S. equity market. The Russell 2000 Index measures the performance of the 2,000 smallest companies in the Russell 3000 Index, which represents approximately 8% of the total market capitalization of the Russell 3000 Index (until recently the Russell 2000 Value Index served as the underlying index for our recommended Vanguard Small Cap Value Index fund—the fund now tracks the MSCI U.S. Small Cap Value Index).

The Russell Microcap Index represents less than 3% of the U.S. equity market. It includes the smallest 1,000 securities in the small-cap Russell 2000 Index plus the next 1,000 smallest securities ranked by market cap. As of the latest reconstitution, the average market capitalization was approximately $217.0 million, and the median market capitalization was approximately $182.6 million. The largest company in the index had an approximate market capitalization of $539.5 million while the smallest company had an approximate market capitalization of $54.8 million.

Though we are we optimistic about the IWC, we are withholding our recommendation at this time. The shares have only been trading since mid-August. In the absence of a longer trading history, we are not convinced that these shares will adequately capture the risk/return profile of the micro cap sector. The Russell indexes are reconstituted only annually on June 30 based on market capitalization information as of May 31 and the fund's customized benchmark, the Russell MicrocapX Index, holds only 1,250 stocks selected from the Russell Microcap Index. There could be substantial "drift" in the average market cap of the index throughout the year, as the component shares rise and fall in market price. Another source of concern is the ability of the fund to efficiently track the actual Microcap Index. For this to occur in any ETF, it is essential that a fund's underlying assets provide adequate liquidity for arbitrageurs to quickly move in an exploit any price differential between an ETF's net asset value and its current market value. Micro caps are the most illiquid portion of the U.S. equity market. The limited data so far indicates that the fund will closely track its NAV.



Source: Investment Company Institute.

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 rarely 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**, **Verizon** and and sales of **AT&T** (no longer a Dow component) and **Dupont** 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 results

As of Septmeber 15, 2005

	Rank	Yield	Price	Status	Percent of Portfolio* Value	No. Shares[1]
General Motors	1	6.14%	32.55	*		
SBC Comm.	2	5.40%	23.90	Holding**	25.97	32.96
Merck	3	5.29%	28.76	Buying	17.09	18.04
Verizon	4	5.00%	32.39	Buying	23.70	22.21
Altria Group	5	4.43%	72.25	*		
JP Morgan Chase	7	3.98%	34.13	Holding**	20.49	18.22
CitiGroup	6	3.91%	43.05	Holding	12.72	8.57
DuPont	8	3.69%	40.10	Selling	0.00	0.00
Pfizer	9	2.96%	25.70			
Coca Cola	10	2.57%	43.63			
AT&T***	NA	4.84%	19.65	Selling	0.00	0.00
					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	-1.85%	-3.35%	1.22%	10.25%	13.57%	14.88%	19.09%
Dow	-0.46%	5.57%	0.95%	9.77%	11.98%	10.25%	16.77%

* 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.

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 JP Morgan Chase— account for roughly 87.25 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 9/15/05	Market Prices 8/15/05	Market Prices 9/15/04	12-Month High	12-Month Low	Latest Dividend Amount	Latest Dividend Record Date	Latest Dividend Paid	Indicated Annual Dividend	Indicated Yield† (%)
General Motors	GM	**$32.55**	**$34.54**	42.11	43.29	24.67	0.500	8/12/05	9/10/05	2.000	6.14
★ SBC Comm.	SBC	**$23.91**	**$24.46**	26.06	27.29	22.78	0.323	7/08/05	8/01/05	1.290	5.40
★ Merck	MRK	**$28.76**	**$30.66**	45.40	45.87	25.60	0.380	9/02/05	10/03/05	1.520	5.29
★ Verizon	VZ	**$32.39**	**$32.99**	39.95	42.27	32.15 *L*	0.405	10/07/05	11/01/05	1.620	5.00
Altria Group	MO	**$72.25**	**$67.02**	48.95	73.36 *H*	44.50	0.800	9/15/05	10/11/05	3.200	4.43
★ J. P. Morgan Chase	JPM	**$34.13**	**$34.65**	39.08	40.45	33.31 *L*	0.340	7/06/05	7/31/05	1.360	3.98
☆ Citigroup	C	**$45.03**	**$43.79**	46.98	49.99	42.10	0.440	8/01/05	8/26/05	1.760	3.91
DuPont	DD	**$40.10**	**$41.51**	43.02	54.90	38.66 *L*	0.370	8/15/05	9/12/05	1.480	3.69
Pfizer	PFE	**$25.70**	**$26.20**	31.85	32.63	21.99	0.190	8/12/05	9/06/05	0.760	2.96
Coca-Cola	KO	**$43.63**	**$43.54**	41.16	45.26	38.30	0.280	9/15/05	10/01/05	1.120	2.57
General Electric	GE	**$34.38**	**$34.21**	33.53	37.75	32.65	0.220	6/27/05	7/25/05	0.880	2.56
3M Company	MMM	**$73.31**	**$72.18**	82.00	87.45	70.41 *L*	0.420	8/19/05	9/12/05	1.680	2.29
Alcoa	AA	**$26.38**	**$29.24**	30.41	34.99	25.55	0.150	8/05/05	8/25/05	0.600	2.27
Honeywell Intl.	HON	**$38.60**	**$38.87**	36.38	39.50	31.85	0.206	8/19/05	9/09/05	0.825	2.14
Johnson & Johnson	JNJ	**$64.37**	**$63.35**	58.18	69.99	54.81	0.330	8/23/05	9/13/05	1.320	2.05
Procter & Gamble	PG	**$55.50**	**$54.18**	56.30	57.40	50.53	0.280	7/22/05	8/15/05	1.120	2.02
Exxon Mobil	XOM	**$62.46**	**$60.42**	47.43	64.37	47.30	0.290	8/12/05	9/09/05	1.160	1.86
United Tech. (s)	UTX	**$50.68**	**$51.75**	47.09	54.07	48.43	0.220	8/19/05	9/10/05	0.880	1.74
Caterpillar (s)	CAT	**$57.74**	**$55.26**	37.33	59.88 *H*	37.01	0.250	7/22/05	8/19/05	1.000	1.73
McDonald's	MCD	**$33.45**	**$33.60**	27.53	34.70	26.95	0.550	11/15/04	12/01/04	0.550	1.64
Boeing	BA	**$65.08**	**$67.46**	53.66	68.38 *H*	48.10	0.250	8/12/05	9/02/05	1.000	1.54
Wal-Mart Stores	WMT	**$44.32**	**$49.10**	52.91	57.89	44.53 *L*	0.150	8/19/05	9/06/05	0.600	1.35
Intel Corp.	INTC	**$24.55**	**$26.53**	20.42	28.84	19.64	0.080	11/07/05	12/01/05	0.320	1.30
Microsoft Corp.	MSFT	**$26.27**	**$27.13**	27.19	30.20	23.82	0.080	8/17/05	9/08/05	0.320	1.22
Hewlett-Packard	HPQ	**$27.87**	**$24.09**	18.28	27.98 *H*	17.59	0.080	9/14/05	10/05/05	0.320	1.15
Walt Disney	DIS	**$24.00**	**$26.17**	23.01	29.99	22.00	0.240	12/10/04	1/06/05	0.240	1.00
IBM	IBM	**$80.01**	**$82.50**	86.37	99.10	71.85	0.200	8/10/05	9/10/05	0.800	1.00
Home Depot, Inc.	HD	**$40.34**	**$41.61**	38.39	44.30	34.56	0.100	9/01/05	9/15/05	0.400	0.99
AIG	AIG	**$60.95**	**$62.16**	71.22	73.46	49.91	0.150	9/02/05	9/16/05	0.600	0.98
American Express	AXP	**$57.56**	**$56.53**	50.90	59.26 *H*	49.51	0.120	7/01/05	8/10/05	0.480	0.83

† Based on indicated dividends and market price as of 9/15/05. *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

	9/15/05	Mo. Earlier	Yr. Earlier
Gold, London p.m. fixing	**454.80**	**442.20**	404.45
Silver, London Spot Price	**7.03**	**7.07**	6.19
Copper, COMEX Spot Price	**1.68**	**1.77**	1.27
Crude Oil, W. Texas Int. Spot	**64.75**	**66.27**	43.58
Dow Jones Spot Index	**238.36**	**233.45**	183.80
Dow Jones-AIG Futures Index	**167.69**	**164.53**	143.01
CRB-Bridge Futures Index	**319.71**	**318.91**	273.09

Interest Rates (%)

		9/15/05	Mo. Earlier	Yr. Earlier
U.S. Treasury bills -	91 day	**3.44**	**3.50**	1.66
	182 day	**3.76**	**3.80**	1.87
	52 week	**3.82**	**3.92**	2.02
U.S. Treasury bonds -	10 year	**4.22**	**4.28**	4.48
Corporates:				
High Quality -	10+ year	**5.46**	**5.42**	5.60
Medium Quality -	10+ year	**5.75**	**5.79**	5.99
Federal Reserve Discount Rate		**4.50**	**4.50**	2.50
New York Prime Rate		**6.50**	**6.50**	4.50
Euro Rates	3 month	**2.14**	**2.13**	2.12
Government bonds -	10 year	**3.06**	**3.29**	4.10
Swiss Rates -	3 month	**0.76**	**0.76**	0.65
Government bonds -	10 year	**1.80**	**2.02**	2.66

Exchange Rates

	9/15/05	Mo. Earlier	Yr. Earlier
British Pound	**$1.804900**	**$1.811800**	1.788500
Canadian Dollar	**$0.844200**	**$0.833800**	0.773400
Euro	**$1.222400**	**$1.236800**	1.215800
Japanese Yen	**$0.009036**	**$0.009155**	0.009126
South African Rand	**$0.156800**	**$0.155300**	0.152300
Swiss Franc	**$0.789200**	**$0.797000**	0.786700

Securities Markets

	9/15/05	Mo. Earlier	Yr. Earlier
S & P 500 Stock Composite	**1,227.73**	**1,233.87**	1,120.37
Dow Jones Industrial Average	**10,558.75**	**10,634.38**	10,231.36
Dow Jones Transportation Average	**3,596.99**	**3,761.59**	3,215.75
Dow Jones Utilities Average	**424.01**	**397.14**	291.63
Dow Jones Bond Average	**189.28**	**188.78**	181.70
Nasdaq Composite	**2,146.15**	**2,167.04**	1,896.52
Financial Times Gold Mines Index	**1,822.53**	**1,690.16**	1,560.73
FT African Gold Mines	**2,113.80**	**1,969.67**	2,167.56
FT Australasian Gold Mines	**4,928.69**	**4,671.19**	3,346.51
FT North American Gold Mines	**1,546.34**	**1,428.51**	1,283.10

Coin Prices

	9/15/05	Mo. Earlier	Yr. Earlier	Premium
American Eagle (1.00)	**$460.35**	**$445.15**	407.15	1.22
Austrian 100-Corona (0.9803)	**$438.43**	**$423.83**	387.73	-1.66
British Sovereign (0.2354)	**$109.55**	**$106.05**	97.15	2.33
Canadian Maple Leaf (1.00)	**$460.60**	**$445.40**	407.40	1.28
Mexican 50-Peso (1.2057)	**$540.70**	**$522.80**	478.30	-1.40
Mexican Ounce (1.00)	**$448.40**	**$433.50**	396.60	-1.41
S. African Krugerrand (1.00)	**$454.95**	**$439.95**	402.65	0.03
U.S. Double Eagle-$20 (0.9675)				
St. Gaudens (MS-60)	**$500.00**	**$500.00**	470.00	13.63
Liberty (Type I-AU)	**$675.00**	**$675.00**	675.00	53.40
Liberty (Type II-AU)	**$497.50**	**$497.50**	487.50	13.06
Liberty (Type III-AU)	**$470.00**	**$460.00**	425.00	6.81
U.S. Silver Coins ($1,000 face value, circulated)				
90% Silver (715 oz.)	**$4,970.00**	**$4,917.50**	4,335.00	-1.12
40% Silver (292 oz.)	**$1,992.50**	**$2,000.00**	1,760.00	-2.94
Silver Dollars	**$6,912.50**	**$6,700.00**	6,500.00	27.11

Note: Premium reflects percentage difference between coin price and value of metal in a coin, with gold at $454.80 per ounce and silver at $7.03 per ounce. The weight in troy ounces of the precious metal in coins is indicated in parentheses.

Recommended Mutual Funds

	Ticker Symbol	9/15/05	Month Earlier	Year Earlier	52-Week High	52-Week Low	Distributions Latest 12 Months Income	Distributions Latest 12 Months Capital Gains	Yield (%)
Short-Term Bond Funds									
iShares Lehman 1-3 Yr Treasury[3]	SHY	**$80.85**	**$80.62**	82.03	82.28	80.39	2.0700	0.0000	2.56
Vanguard Short-term Inv. Grade	VFSTX	**$10.39**	**$10.54**	10.71	10.47	10.33	0.3674	0.0000	3.54
Income Equity Funds									
DNP Select Income[1, 2]	DNP	**$11.47**	**$11.49**	11.15	11.95	10.24	0.8500	0.0000	7.41
Vanguard REIT Index	VGSIX	**$20.34**	**$19.80**	16.93	21.06	17.00	0.9033	0.3277	4.44
Large Cap. Value Equity Funds									
iShares S&P 500 Value Index[3]	IVE	**$64.22**	**$64.31**	57.61	65.00	56.20	1.2549	0.0000	1.95
Vanguard Value Index	VIVAX	**$22.22**	**$22.09**	19.74	22.44	20.45	0.4890	0.0000	2.20
Small Cap. Value Equity Funds									
iShares Sm. Cap. 600 Value Index[3]	IJS	**$64.01**	**$63.92**	53.92	66.30	53.30	1.3743	0.0000	2.15
Vanguard Sm. Cap Value Index	VISVX	**$14.75**	**$14.69**	12.44	15.18	12.28	0.2270	0.0000	1.54
Growth Equity Funds									
iShares S&P 500 Growth Index[3]	IVW	**$58.50**	**$58.94**	54.90	59.53	52.81	1.0726	0.0000	1.83
Vanguard Growth Index	VIGRX	**$26.80**	**$27.05**	24.87	27.36	23.87	0.3200	0.0000	1.19
Foreign Equity Funds									
iShares S&P Europe 350 Index[3]	IEV	**$79.99**	**$80.10**	65.39	81.68	65.20	1.3481	0.0000	1.69
Vanguard European Stock Index	VEURX	**$27.73**	**$27.72**	22.03	28.28	25.02	0.5800	0.0000	2.09
iShares Emerging Markets Index[3]	EEM	**$81.20**	**$79.60**	54.92	81.20	54.25	0.8043	0.0000	0.99
Vanguard Emerging Market Index	VEIEX	**$17.49**	**$17.11**	12.14	17.49	13.97	0.2590	0.0000	1.48
Gold-Related Funds									
iShares COMEX Gold Trust[3]	IAU	**$45.49**	**$44.16**	N/A	45.49	41.04	0.0000	0.0000	0.00
streetTRACKS Gold shares	GLD	**$45.42**	**$44.13**	N/A	46.00	41.02	0.0000	0.0000	0.00

Recommended Gold-Mining Companies

	Ticker Symbol	9/15/05	Month Earlier	Year Earlier	52-Week High	52-Week Low	Distributions Latest 12 Months	Distributions Frequency	Yield (%)
Anglogold Ltd., ADR	AU	**$40.49**	**$36.23**	36.53	42.40	30.50	0.565	Semiannual	1.40
Barrick Gold Corp.†	ABX	**$28.07**	**$27.08**	19.59	28.07	19.21	0.187	Semiannual	0.67
Gold Fields Ltd.	GFI	**$12.70**	**$11.64**	12.16	15.25	9.40	0.112	Semiannual	0.88
Newmont Mining	NEM	**$44.99**	**$41.06**	43.29	49.98	34.90	0.400	Quarterly	0.89
Placer Dome†	PDG	**$16.19**	**$15.45**	16.92	23.67	12.10	0.085	Semiannual	0.53
Rio Tinto PLC‡	RTP	**$151.21**	**$150.05**	100.10	151.21	100.63	3.340	Semiannual	2.21

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

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.