INVESTMENT GUIDE

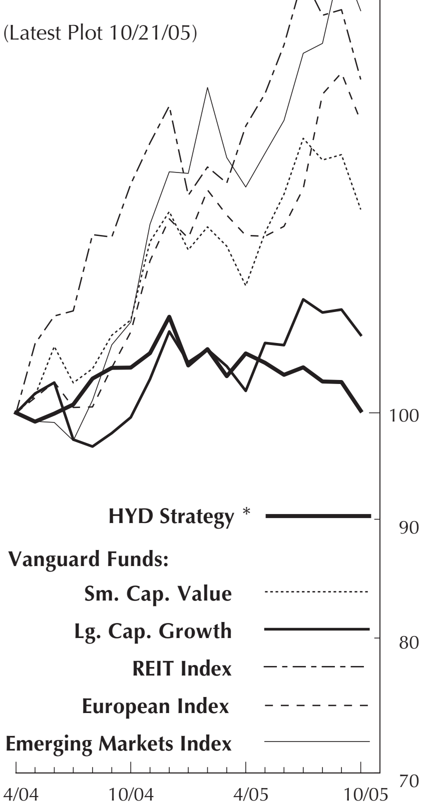
Published Monthly by

American Investment Services, Inc.

Vol. XXVII, No. 10 Great Barrington, Massachusetts 01230 October 31, 2005

Equity Performance 3/31/04=100

(Latest Plot 10/21/05)



*** HYD is a hypothetical model based on back-tested results. See p. 78 for a full explanation.**

Money Management Evolves (Gradually)

Who said it?

"Most investors, both institutional and individual, will find that the best way to own common stocks is through an index fund that charges minimal fees. Those following this path are sure to beat the net results (after fees and expenses) delivered by the great majority of investment professionals."[1]

A. Alan Greenspan, Chairman, Federal Reserve Board of Governors
B. John Bogle, Founder, The Vanguard Group
C. Eugene F. Fama, Professor of Finance, University of Chicago
D. Warren Buffett, Chairman, Berkshire Hathaway Corporation

The answer is D. Who'd a thunk? The sage of Omaha, that venerable value investor, the patron saint of stock pickers, Warren Buffett, is a devotee of index-fund investing.

The basic precepts of passive investing are being increasingly adopted, if more subtly, by the investing community. For example, Both Lipper and Morningstar, the biggest names among mutual fund ratings firms, for many years had categorized funds along a hodge-podge of labels that seemed to reflect marketing conventions (these included "growth and income" and "capital appreciation" among others). In recent years, however both have switched to categories more familiar to our readers, these include Small Cap Value, Small Cap Growth, Large Cap Value and Large Cap Growth. Investment consultants have steadily gravitated toward segmenting the market along size and value-growth dimensions, the very approach we advocate.

We applaud this approach to fund classification. We are, however, alarmed by another development; the widespread adoption of the term "index" to describe funds. Indexes have been launched to capture every conceivable market or industry "sector." An index in itself is nothing more than a measure of a market segment, while an asset class is defined by unique risk and return characteristics. "Sector picking" is no better than "stock-picking." Sector-based index funds may offer investors lower costs versus actively managed counterparts, but are not necessarily based on sound methodology.

The mutual fund industry remains largely dominated by prognosticators, that is, those who insist that investors can consistently reap market-beating returns without exposure to the systematic risk factors of size (small cap versus large cap) and value (high book to market versus low book to market). We on the other hand contend that markets efficiently and consistently evaluate and reflect all relevant risks, and that these risks are reflected in prices. Investors can only hope to earn larger gains through increased exposure to these quantifiable risk factors. Through the *Investment Guide* and our advisory services we help investors to achieve those returns through a structured and measured approach.

[1] Berkshire Hathaway Incorporated, 1996 annual report www.Berkshirehathaway.com

QUARTERLY REVIEW OF INVESTMENT POLICY

Hurricane Katrina dominated the news during the third quarter. When spectacular news is all but impossible to avoid, investors without an established plan are adrift. They invariably allow headlines to inform their decisions and are easily swayed by anecdotal stories and the wild conjecture of “talking heads”. During these stormy times the best shelter is a structured approach based on asset classes selected through impartial analysis of historical data. This empirical approach allows us to shut out the “noise” emanating from the media. Our data, which originate as early as 1926, make it clear that self-disciplined investors equipped with a simple asset allocation plan could have withstood a multitude of tumultuous periods.

Among our recommended asset classes, gold shined brightest during the quarter (see accompanying Total Returns table). Common stocks were up, with foreign issues outpacing U.S. stocks. Rising interest rates provided slightly negative returns for short-term bonds.

The Economy: Follow the Data

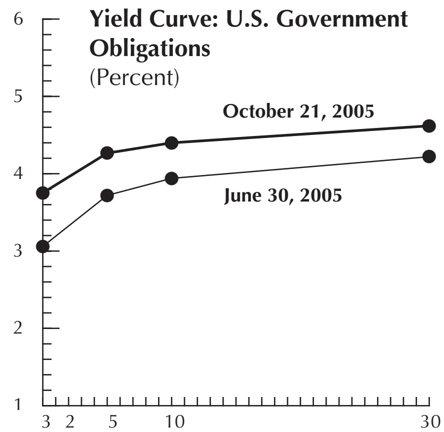
The statistical indicators of our parent, the American Institute for Economic Research (AIER) provide similar reassurance. Despite all the fretful headlines, there is no evidence to suggest that the broad economy is in danger of contraction.

Katrina’s effect is starting to show up in the leaders and coinciders, now that data for September has become available. Among AIER’s twelve primary leading indicators, four are expanding, two are contracting, and six are indeterminate. Three leaders, *new housing permits, new orders for non-defense capital goods, and ratio of manufacturing and trade sales to inventories* hit new highs. *Average weekly initial claims for state unemployment insurance* (inverted) was downgraded from expanding to probably expanding after new claims spiked in September due to Katrina. Additional claims have been reported since but the change has not been remarkable, and its effects are not likely to extend beyond the short-term. Overall, four of the six leaders with a clear trend point to continued economic expansion. The cyclical score, which encompasses all twelve indictors, suggests that the likelihood of economic contraction is small.

Among the coinciders, Gross Domestic Produce (GDP) grew at 3.3 percent during the third quarter. All of the coincident indicators are currently appraised as expanding, despite mixed data affecting two series. Again these two series were impacted by the hurricane, but these effects are not expected to be long-lasting. All six lagging indicators are appraised as currently expanding.

Cash Equivalent Assets

The Federal Reserve Open Market Committee (FOMC) bumped up the target Federal funds rate by 0.25 percent two times during the quarter, marking eleven consecutive increases. The moves were consistent with previous suggestions from the Fed regarding “measured” increases in the future, and came as no surprise to the financial markets. The Producer Price Index (PPI) for finished goods rose 1.9 percent in September, exceeding the expectations of many market analysts, as food and energy costs rose sharply following the twin hurricanes. The Consumer Price Index (CPI) followed suit, rising 1.2 percent, the sharpest increase in 25 years. However, the “core” measures of both the PPI and the CPI, which exclude food and energy prices, rose only 0.3 percent and 0.1 percent, respectively. The Fed nevertheless appears concerned, stating that “higher energy and other costs have the potential to add to inflation pressures.”



Interest rates rose throughout the quarter in response to the Fed’s moves, and perhaps in anticipation of rising price inflation. The accompanying yield curve chart shows that rates rose among fixed income securities of all maturities.

The 13-week Treasury bill yield, which stood at 3.06 percent in mid-July, had risen to 3.47 percent at the end of the third quarter and had climbed to 3.76 percent by mid-October. Taxable money-market funds are currently yielding 3.21 percent on average while tax-free money funds are averaging 2.12 percent.

There is no certainty that cash-equivalent assets will keep pace with the general rise in consumer prices. This does not suggest that investors should abandon cash as an asset class. While other assets are far more likely to outpace price inflation, they are also far more volatile. A stable and readily accessible source of cash is important in order to meet planned expenditures, as well as unexpected cash needs. The accompanying Recommended Portfolio Allocation table offers guidelines for the appropriate level of cash to maintain, but in the end this should be largely determined by your personal circumstances.

Money market funds are the most convenient means of providing this liquidity. These mutual funds invest in short-term securities such as Treasury bills, bankers’ acceptances, commercial paper, or negotiable certificates of deposit of major commercial banks. Most brokers now offer money market funds that are “sweep” vehicles; dividends and interest from

RECOMMENDED PORTFOLIO ALLOCATION PERCENTAGES

	Conservative	*Moderate*	*Aggressive*
Cash-Equivalent Assets	30	20	10
Short/Intermediate-Term Bonds	35	25	15
Income Equities	10	5	0
Large-Cap Value Stocks	20	30	35
Small-Cap Value Stocks	0	5	10
Large-Cap Growth Stocks	5	5	10
Foreign Stocks	0	5	10
Gold-Related	0	5	10
	100	100	100

Note: Most investors should adopt values between the extreme conservative and aggressive percentages shown above. What is best for an individual investor will depend on one’s circumstances and tolerance for risk.

other asset classes can be automatically deposited in these accounts at the owner's discretion. Most brokers also allow check-writing.

Investors who have established short/intermediate-term bond "ladders" (see short/intermediate-term bonds, below) should consider their bonds with less than one year until maturity to be cash-equivalent assets.

Short/Intermediate-Term Bonds

Though interest rates have crept higher, the yield curve has remained remarkably flat and long-term rates remain near a forty-four year low. The persistence of low long-term rates has confounded conventional wisdom; when short-term rates rise, long-term rates usually rise as well. Indeed the bond markets have barely flinched despite a confluence of events that would suggest higher price inflation, including China's currency revaluation, and the oil price, which has surged roughly 53 percent so far this year.

There are as many "explanations" as there are analysts. It has been argued that domestic bond markets continue to attract foreign capital, since U.S. interest rates, though low in historical terms, remain attractive relative to those in other developed nations. Others point out that the dollar's slide against the Euro has slowed. Some economists have maintained that the Fed for several years has tightened quickly and decisively in the face of any suggestion of price inflation, so the bond market has reflected increased confidence that long-term inflating can be held in check. Many pundits simply maintain that rates will inevitably rise.

Investors should realize that prognosticators who guess right gain notoriety, which can be lucrative for as long as their luck continues. We choose not to play the forecasting game. It is better instead to assume that all available information is factored into security prices.

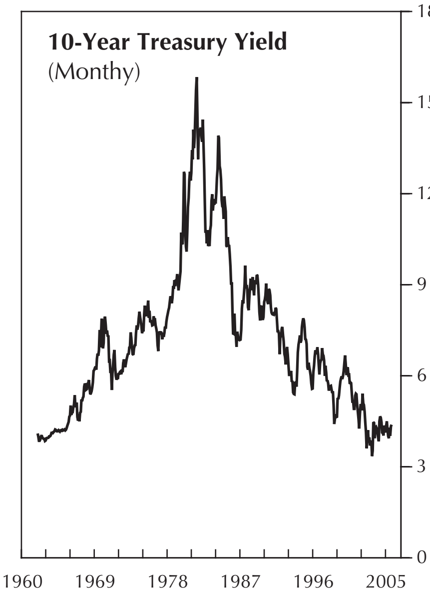
We realize it provides little comfort to simply observe that prices and interest rates are not predictable. But investors will find it reassuring that many factors that are necessary to succeed financially are well within their control. In the case of bonds, interest rates are not predictable, but investors have tremendous latitude to invest in bonds in an optimal manner; they can maximize the returns they can expect, while minimizing the volatility of their bond portfolio.

For many investors, either of the fixed-income mutual funds on page 80 will provide a suitable means of holding bonds. Investors with larger investment portfolios might consider a bond ladder. Equal amounts should be invested in bonds with maturities ranging from six months to five years, with six- to twelve-month intervals. Only government issued securities or high-grade corporate or municipal bonds should be considered. As these bonds mature, the proceeds can be invested in new five-year bonds. This will ensure roughly equal exposure to the entire "short end" of the yield curve. Alternatively, one could adopt a "variable maturity" strategy (see the August 2005 *INVESTMENT GUIDE* for a full discussion) an approach designed to provide highest expected return per unit of volatility assumed.

Income Equities

REITs once again landed in positive territory for the quarter, with the NAREIT Equity Index and the Vanguard REIT Index fund posting gains of 3.83 percent and 3.56 percent, respectively. The accompanying table shows that REITs were the top performing asset class overall for the past eleven quarters.

Year-to-date, the NAREIT Equity index has provided a total return of 10.46 percent. However, the returns varied considerably among property types. Self-



storage REITs, which comprise roughly 4.4 percent of the equity REIT total market capitalization, have surged 24.29 percent so far this year. Lodging and resorts, which comprise 5.84 percent, on the other hand, are up only 3.12 percent. Equity REITs are dominated by the industrial/office and retail sectors, which form a combined 56 percent of the total equity REIT market capitalization. These provided returns of 10.78 and 10.23 percent, respectively, through the third quarter. Investors should invest in an entire market-cap weighted index versus individual REITs or REIT sectors.

Utilities, which form one of the ten industries that comprise the S&P 500, provided a total return of 6.37 percent, second only to energy stocks. The Duff and Phelps Select Income Fund (DNP) is ideal for investors who wish to take a stake in the utility sector. The fund started the third quarter at $11.56 and ended at $11.59 and is currently yielding 6.2 percent. DNP is a closed-end fund. It is currently trading at a 32.6-percent premium

Total Returns (%)

	2003				2004				2005			Total Return Entire Period 1Q 2003-3Q 2005
	1Q	*2Q*	*3Q*	*4Q*	*1Q*	*2Q*	*Q3*	*Q4*	*1Q*	*2Q*	*3Q*	
Vanguard Short-Term Inv Grade	**1.39**	1.89	0.39	0.46	1.53	-1.30	1.50	0.39	-0.38	1.55	-0.20	7.41
Vanguard REIT Index	1.01	12.27	9.47	9.27	**11.75**	-5.95	**8.13**	15.06	-7.34	**14.65**	3.56	**95.15**
Vanguard Value Index	-5.57	20.27	2.24	13.93	2.12	1.56	1.24	9.80	-0.42	1.70	4.08	60.76
High-Yield Dow 4/18**	-9.94	18.92	-5.10	12.47	4.25	-7.76	3.64	6.22	-5.73	0.13	-0.69	13.45
Vanguard Small Cap Value Index	-7.98	19.39	7.48	16.19	7.14	0.89	1.13	13.03	-3.35	5.26	4.01	79.37
Vanguard Growth Index	-0.91	11.57	3.24	10.33	1.49	1.51	-4.88	9.40	-3.56	2.12	3.59	37.73
Vanguard European Stock Index	-9.25	**22.30**	3.89	**20.30**	0.82	**2.25**	1.19	**15.86**	**0.38**	1.11	8.14	84.00
Gold (London PM Fix)	-3.56	3.33	**12.14**	7.28	1.79	-6.58	6.02	4.8	-1.86	2.24	**8.27**	37.60

The highest returns provided in each period are in **Bold Face Type**. * HYD is a hypothetical model based on back tested results. See p. 78 for a full explanation.

to its net asset value. The fund's underlying holdings are concentrated in bonds and stocks of public utilities, the interest and dividends of which are distributed in a monthly dividend. In addition to its common shares, the fund issues relatively low-cost remarketed preferred stock, which leverages its earnings.

Common Stocks

Common stocks rallied early in the quarter, prior to the twin hurricanes and subsequent surge in energy prices that pushed valuations back down by quarter-end. The NASDAQ reached a four-year high in early August, but fell back, and ended up gaining 4.6 percent for the quarter. Large cap value and growth stocks performed roughly evenly; the S&P/Barra 500 Growth Index climbed 3.78 percent, while the S&P 500/Barra Value Index gained 3.44 percent. Small-cap value shares, as measured by the S&P SmallCap 600/Barra Value Index, provided a total return of 4.16 percent.

For the year-to-date, energy stocks have been largely responsible for the total returns of the overall stock market. Through the first three quarters, the S&P 500 returned 2.76 percent. Energy stocks provided a total return of roughly 45 percent, with all other sectors collectively providing roughly 0 percent.

Foreign markets, as measured by the MSCI World ex U.S. index, provided a 7.08 percent total return in the third quarter, with the Vanguard European Stock Index fund delivering a total return of 8.14 percent. The Euro started at $1.21 and rose to $1.25 in early September, before falling back to finish the quarter at $1.20. Emerging markets far outpaced developed markets, as the MSCI Emerging Markets Index provided a hefty 17.95 percent total return.

Gold-Related Investments

Among our recommended asset classes, gold provided a total return of 8.27 percent, beginning the period at $437.10 per ounce (London PM fix) and ending at $473.25. By October 11 the price had reached a 17-year high of $475.50. Gold benefited from a strong market in commodities in general, an increase in Asian demand, and qualms over rising energy prices.

Gold is valuable as a form of insurance. Investors should hold a small portion of gold in their overall portfolio. The accompanying Recommended Portfolio Allocation table provides reasonable guidelines. As 2005 draws to a close, investors may find that gold exceeds its target allocation, since the metal has outperformed several other asset classes. This should prompt investors to reduce their stake in gold and reinvest the proceeds as part of a complete portfolio rebalancing. The accompanying article provides guidance for minimizing capital gain taxes during the rebalancing process.

SMART TAX SWAPPING STRATEGIES

As 2005 draws to a close it appears likely that the stock market will post modest gains for the year despite the continued upward spikes in oil prices, a spate of natural disasters and signs of resurgent inflation. Indeed all of our recommended asset classes thus far have provided positive returns. Nevertheless, this year investors may have realized taxable gains or losses, considering that the market is still recovering from the steep decline that began in March 2000. Capital markets are, have been and will always be volatile. This presents investors with opportunities to benefit from any loss positions in taxable accounts.

It is important to understand the rules with regard to investment-related taxes.

The Investment Plan

Investors with tax-deferred accounts, including IRAs and qualified retirement plans, should carefully integrate these plans into an overall investment strategy. For maximum tax efficiency, you should take full advantage of your tax-deferred accounts by allocating to them those assets that are least tax-efficient, especially those that provide a high level of investment income.

The Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA) brought considerable tax relief for investors, but it also muddied the waters with regard to the optimal use of tax-deferred accounts. Here we consider how best to utilize those accounts for those investors that have them. For those investors who have only a taxable account, or only a tax-deferred account, none of our recommended assets should necessarily be excluded from your holdings. We merely describe the ideal use of taxable and tax-deferred accounts, if you have both available.

Most fixed-income securities (bonds) pay interest, so if held in a taxable account, interest payments will be taxed as ordinary income, at a combined Federal and state marginal income tax rate that could exceed 40 percent. Since withdrawals from tax-deferred accounts (IRAs and qualified retirement plans) are also fully taxable as ordinary income, it makes sense to take full advantage of the tax deferral feature and concentrate your fixed-income holdings in those accounts to the extent possible. The same applies to real estate investment trusts (REITs), since the income they generate is treated as ordinary income.

Both long-term capital gains and most dividends on common stock are taxed at a maximum rate of only 15 percent. Assets that can be expected to provide their returns through capital appreciation, such as small-cap stocks, large-cap growth stocks and gold mining shares, should be concentrated in taxable accounts. Our passive approach, which relies heavily on indexing strategies, generates minimal realized gains from year-to-year, so appreciation is effectively deferred for many years. When these shares are eventually liquidated and gains realized, they will be taxed at only 15 percent. On the other hand, if held in a tax-deferred *account*, the eventual effective levy on all withdrawals could exceed 40 percent.

Netting Gains and Losses

Generally, gains from the sale of long-term capital assets, such as the securities we recommend, are taxed at a maximum rate of 15 percent (five percent for individuals in the 15 percent bracket). A short-term holding period is one year or less, while long-term assets are those held for at least one year. Although the capital-gains tax rate has fallen, investors often become fixated on avoiding the tax altogether, to the detriment of their portfolio. You should instead focus on maximizing your after-tax returns.

In our work as investment advisors, it is not uncommon to encounter an investor with as much as 25 percent of his portfolio invested in a single stock. Typically the stock is held in a taxable account and has significant unrealized gains. Because they are loath to pay 15 percent to the government, these investors continue to hold the stock, leaving the portfolio highly susceptible to the fortunes of a single company. Our advice: "don't let the tail wag the dog." Very often investors will be better served in the long run by absorbing this tax cost in order to hold a more diversified portfolio.

There is no general rule for when to sell highly appreciated assets. One must quantify and evaluate the trade-off between the expected return from holding the stock and incurring no tax versus selling and reinvesting the proceeds after taxes are paid. This can only be done on an individual basis.

Although accountants and tax software alleviate much of the burden of calculating gains and losses, investors should understand the rules pertaining to taxable gains and losses in order to take full advantage of year-end moves that can provide considerable tax savings. In order to compute the amount of net short-term or long-term gain or loss for the year, investors should take the following steps:

1) Offset your total short-term capital losses against total short-term capital gains. (Short-term losses should include short-term losses carried over from prior years.) The result is your net short-term capital gain or loss.

2) Offset your total long-term capital losses against total long-term capital gains. (Long-term losses should include long-term losses carried over from prior years.) The result is your net long-term capital gain or loss.

3) Net out the results in 1) and 2), then apply the following rules:

i) Net short-term capital gains: Taxable as ordinary income.

ii) Net long-term capital gain: Generally taxable at a maximum rate of 15 percent.

iii) Net short-term capital loss or net long-term capital loss: Apply dollar for-dollar against ordinary income, up to $3,000 per year. Any excess may be carried forward to future years indefinitely until exhausted. The net loss carried forward retains its long-term or short-term character for the year to which it is carried.

iv) Combination of a net short-term capital gain and a net long-term capital gain: the net short-term gain is treated as in (i) above; the net long-term gain is treated as in (ii) above.

v) Combination of net short-term capital loss and a net long-term capital loss: both are treated as in (iii) above.

For married couples filing jointly, capital gains from one spouse may be offset by capital losses of the other spouse. However, only one maximum deduction of $3,000 against ordinary income may be applied.

Smart Tax Swapping Strategies
Fund Name & Target Index

Vanguard European Stock Index Fund (VEURX) MSCI European Index	**iShares S&P Europe 350 Fund (IEV)** S&P Europe 350 Index
Vanguard Value Index Fund (VIVAX) MSCI Prime Market Value Index	**iShares Russell 1000 Value Index Fund (IWD)** Russell 1000 Index (value subset)
Vanguard Small Cap Value Index Fund (VISVX) MSCI Small-Cap Value Index	**iShares Russell 2000 Value Index Fund (IWN)** Russell 2000 Index (value subset)
Vanguard Growth Index Fund (IWV) MSCI Prime Market Growth Index	**iShares Russell 1000 Growth Index Fund (IWF)** Russell 1000 Index (growth subset)

Swapping Securities

Investors can use these rules to increase their after-tax portfolio returns by making year-end adjustments in their holdings. For example, many investors might still have short- or long-term unrealized losses in the Vanguard Growth Index fund. By selling these shares for less than their cost basis, you can generate a loss that can offset gains generated elsewhere, or even reduce your ordinary income by applying the rules above. However, if you sold all of these large-cap growth shares, your portfolio suddenly would be out of balance relative to our recommended allocations. A seemingly obvious solution would be to simply buy back the shares immediately. Unfortunately, the IRS considers a quick sale and repurchase of the same security a "wash sale," and will disallow the loss. Losses on the sale of securities are disallowed if substantially identical securities or options to purchase such securities are purchased within a 61-day window beginning 30 days before the date of the sale and ending 30 days after the sale. One could wait the requisite 30 days and then repurchase the securities. However, markets can move a great deal in 30 days. Securities prices are inherently unpredictable, so you risk "selling at the bottom" and purchasing only after a substantial rebound in price.

There might be a better solution. Investors can "swap" securities they currently hold for assets whose prices are highly correlated with those that are to be sold. Several assets fit this description, without being considered "substantially identical" assets. By selling one of these assets and immediately purchasing its substitute, an investor can potentially generate a loss for tax purposes without changing his *economic* position, because his exposure to that asset class would be largely unaffected. The accompanying table suggests some reasonable substitutes. Any fund may be substituted for the corresponding fund in the same row. The returns on each of these investment vehicles are highly correlated with the returns of the substitute we suggest.

Exchange Traded Funds

Exchange Traded Funds (ETFs) are extremely useful tools for tax swapping. The number of ETF products has exploded in recent years, and there is an ETF to match virtually every available index. They offer diverse equity exposure, have low expense ratios and are highly liquid.

The Gold ETFs listed on page 80 are considered collectibles by the IRS and capital gains from the sale of these shares are taxed at a maximum rate of 28%. Gold ETF shares should therefore be purchased in tax-deferred accounts.

We recommend several ETFs from the iShares family sponsored by Barclays Global Investor Services.

Record Keeping

It is extremely important to keep accurate records and documentation of purchases and sales of securities. The "specific identification" method for identifying the sale of common stocks allows investors to earmark specific lots for sale. This technique can be used to minimize net short-term gains. The key is that the lot must be identified and conveyed to the transacting broker at the time of sale and properly documented.

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** was not eligible for purchase 18 months earlier. Investors following the model should find that the indicated purchases of **Merck** and sales of **Citigroup** are sufficiently large to warrant trading. In larger accounts, rebalancing positions in **SBC, Verizon** and **JP Morgan Chase** 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 performance of the model.

The process of *starting* to use the strategy is not as straightforward. The two most

As of October 15, 2005

				——Percent of Portfolio*——		
	Rank	*Yield*	*Price*	*Status*	*Value*	*No. Shares*[1]
General Motors	1	7.15%	27.98	*		
SBC Comm.	2	5.81%	22.20	Holding**	25.23	32.70
Merck	3	5.60%	27.16	Buying	18.29	19.37
Verizon	4	5.42%	29.90	Holding**	23.07	22.20
Altria Group	5	4.53%	70.66	*		
JP Morgan Chase	6	3.99%	34.08	Holding**	21.49	18.14
CitiGroup	7	3.91%	45.04	Selling	11.89	7.59
DuPont	8	3.89%	38.00			
Pfizer	9	3.13%	24.32			
Coca Cola	10	2.66%	42.07			
					100.0	100.0

Change in Portfolio Value[2]

	1 mo.	*1 yr.*	*5 yrs.*	*10 yrs.*	*15 yrs.*	*From 12/63*	*Std. Dev.*
HYD Strategy	-3.82%	-7.79%	3.85%	9.60%	14.11%	14.74%	19.07%
Dow	-2.99%	5.38%	1.76%	9.46%	12.19%	10.14%	16.75%

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

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

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 88 percent of the total portfolio value). Any remaining cash will be held in a money-market fund pending subsequent purchases, which will be made whenever the client's holdings of each month's eligible stocks are below the percentages indicated by the strategy by an amount sufficient to warrant a trade.

Our **HYD Investment Management Program** provides professional and disciplined application of this strategy for individual accounts. For accounts of $150,000 or more, the fees and expenses of AIS's discretionary portfolio management programs are comparable to those of many index mutual funds. Contact us for information on this and our other discretionary investment management services.

THE DOW JONES INDUSTRIALS RANKED BY YIELD

	Ticker	Market Prices			12-Month		Latest Dividend			Indicated	
	Symbol	10/14/05	9/15/05	10/15/04	High	Low	Amount	Record Date	Paid	Annual Dividend	Yield† (%)
General Motors	GM	**$27.98**	**$32.55**	38.95	40.82	24.67	0.500	8/12/05	9/10/05	2.000	7.15
★ SBC Comm.	SBC	**$22.20**	**$23.91**	26.68	26.97	21.75 *L*	0.323	10/10/05	11/01/05	1.290	5.81
★ Merck	MRK	**$27.16**	**$28.76**	30.50	36.36	25.50 *L*	0.380	9/02/05	10/03/05	1.520	5.60
★ Verizon	VZ	**$29.90**	**$32.39**	40.87	42.27	29.68 *L*	0.405	10/07/05	11/01/05	1.620	5.42
Altria Group	MO	**$70.66**	**$72.25**	47.36	74.60 *H*	45.88	0.800	9/15/05	10/11/05	3.200	4.53
★ J. P. Morgan Chase	JPM	**$34.08**	**$34.13**	38.74	39.91	32.92 *L*	0.340	10/06/05	10/31/05	1.360	3.99
☆ Citigroup	C	**$45.04**	**$45.03**	43.94	49.99	42.10	0.440	8/01/05	8/26/05	1.760	3.91
DuPont	DD	**$38.00**	**$40.10**	42.76	54.90	37.64 *L*	0.370	8/15/05	9/12/05	1.480	3.89
Pfizer	PFE	**$24.32**	**$25.70**	28.50	30.50	21.99	0.190	8/12/05	9/06/05	0.760	3.13
Coca-Cola	KO	**$42.07**	**$43.63**	39.20	45.26	38.30	0.280	9/15/05	10/01/05	1.120	2.66
Alcoa	AA	**$22.97**	**$26.38**	32.57	34.99	22.37 *L*	0.150	11/04/05	11/25/05	0.600	2.61
General Electric	GE	**$34.34**	**$34.38**	33.55	37.75	32.65	0.220	9/26/05	10/25/05	0.880	2.56
3M Company	MMM	**$70.72**	**$73.31**	77.98	87.45	69.71 *L*	0.420	8/19/05	9/12/05	1.680	2.38
Honeywell Intl.	HON	**$36.10**	**$38.60**	35.00	39.50	31.85	0.206	8/19/05	9/09/05	0.825	2.29
McDonald's	MCD	**$32.32**	**$33.45**	28.99	35.03 *H*	27.36	0.670	11/15/05	12/01/05	0.670	2.07
Johnson & Johnson	JNJ	**$63.70**	**$64.37**	56.58	69.99	56.20	0.330	8/23/05	9/13/05	1.320	2.07
Procter & Gamble	PG	**$56.11**	**$55.50**	53.69	59.56 *H*	50.53	0.280	10/21/05	11/15/05	1.120	2.00
Exxon Mobil	XOM	**$58.64**	**$62.46**	49.02	65.96 *H*	48.23	0.290	8/12/05	9/09/05	1.160	1.98
Caterpillar (s)	CAT	**$54.74**	**$57.74**	40.55	59.88	38.38	0.250	10/24/05	11/19/05	1.000	1.83
United Tech. (s)	UTX	**$51.63**	**$50.68**	45.84	54.07	44.24 *L*	0.220	11/18/05	12/10/05	0.880	1.70
Boeing	BA	**$67.50**	**$65.08**	50.19	68.48 *H*	48.10	0.250	8/12/05	9/02/05	1.000	1.48
Intel Corp.	INTC	**$23.23**	**$24.55**	20.61	28.84	20.35	0.080	11/07/05	12/01/05	0.320	1.38
Wal-Mart Stores	WMT	**$45.04**	**$44.32**	52.53	57.89	42.31 *L*	0.150	12/16/05	1/03/06	0.600	1.33
Microsoft Corp.	MSFT	**$24.67**	**$26.27**	27.99	27.94	23.82	0.080	11/17/05	12/08/05	0.320	1.30
Hewlett-Packard	HPQ	**$27.54**	**$27.87**	18.21	29.51 *H*	17.59	0.080	9/14/05	10/05/05	0.320	1.16
Home Depot, Inc.	HD	**$38.41**	**$40.34**	39.81	44.30	34.56	0.100	9/01/05	9/15/05	0.400	1.04
Walt Disney	DIS	**$23.39**	**$24.00**	24.91	29.99	22.90	0.240	12/10/04	1/06/05	0.240	1.03
American Express††	AXP	**$47.95**	**$50.26**	45.96	52.08 *H*	43.34 *L*	0.120	10/07/05	11/10/05	0.480	1.00
IBM	IBM	**$82.35**	**$80.01**	84.85	99.10	71.85	0.200	8/10/05	9/10/05	0.800	0.97
AIG	AIG	**$62.44**	**$60.95**	57.85	73.46	49.91	0.150	12/02/05	12/16/05	0.600	0.96

† Based on indicated dividends and market price as of 10/14/05. Extra dividends are not included in annual yields. *H* New 52-week high. *L* New 52-week low. (s) All data adjusted for splits. †† Ameriprise Financial, Inc. spun-off from American Express Company (AXP) on September 30, 2005. Prior historical prices of AXP adjusted to reflect the post-split cost basis allocation.

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

	10/14/05	Mo. Earlier	Yr. Earlier
Gold, London p.m. fixing	**469.20**	**454.80**	420.40
Silver, London Spot Price	**7.67**	**7.03**	7.06
Copper, COMEX Spot Price	**1.85**	**1.68**	1.32
Crude Oil, W. Texas Int. Spot	**62.63**	**64.75**	54.93
Dow Jones Spot Index	**251.96**	**238.36**	203.44
Dow Jones-AIG Futures Index	**174.09**	**167.69**	154.98
CRB-Bridge Futures Index	**327.64**	**319.71**	285.59

Interest Rates (%)

		10/14/05	Mo. Earlier	Yr. Earlier
U.S. Treasury bills -	91 day	**3.79**	**3.44**	1.74
	182 day	**4.10**	**3.76**	1.99
	52 week	**4.25**	**3.82**	2.12
U.S. Treasury bonds -	10 year	**4.49**	**4.22**	4.06
Corporates:				
High Quality -	10+ year	**5.71**	**5.46**	5.49
Medium Quality -	10+ year	**6.02**	**5.75**	5.88
Federal Reserve Discount Rate		**4.75**	**4.50**	2.75
New York Prime Rate		**6.75**	**6.50**	4.75
Euro Rates	3 month	**2.18**	**2.14**	2.15
Government bonds -	10 year	**3.14**	**3.06**	3.87
Swiss Rates -	3 month	**0.81**	**0.76**	0.72
Government bonds -	10 year	**1.91**	**1.80**	2.49

Exchange Rates

	10/14/05	Mo. Earlier	Yr. Earlier
British Pound	**$1.769900**	**$1.804900**	1.672100
Canadian Dollar	**$0.843600**	**$0.844200**	0.756000
Euro	**$1.208700**	**$1.222400**	1.162300
Japanese Yen	**$0.008771**	**$0.009036**	0.009118
South African Rand	**$0.152900**	**$0.156800**	0.142900
Swiss Franc	**$0.779200**	**$0.789200**	0.750900

Securities Markets

	10/14/05	Mo. Earlier	Yr. Earlier
S & P 500 Stock Composite	**1,186.57**	**1,227.73**	1,108.20
Dow Jones Industrial Average	**10,287.34**	**10,558.75**	9,933.38
Dow Jones Transportation Average	**3,638.61**	**3,596.99**	3,352.68
Dow Jones Utilities Average	**394.06**	**424.01**	301.63
Dow Jones Bond Average	**185.43**	**189.28**	183.80
Nasdaq Composite	**2,064.83**	**2,146.15**	1,911.50
Financial Times Gold Mines Index	**1,820.09**	**1,822.53**	1,703.22
FT African Gold Mines	**2,242.92**	**2,113.80**	2,380.06
FT Australasian Gold Mines	**5,370.06**	**4,928.69**	3,819.45
FT North American Gold Mines	**1,502.98**	**1,546.34**	1,391.11

Coin Prices

	10/14/05	Mo. Earlier	Yr. Earlier	Premium
American Eagle (1.00)	**$486.25**	**$460.35**	432.15	3.63
Austrian 100-Corona (0.9803)	**$463.03**	**$438.43**	411.53	0.67
British Sovereign (0.2354)	**$115.55**	**$109.55**	103.05	4.62
Canadian Maple Leaf (1.00)	**$486.50**	**$460.60**	432.40	3.69
Mexican 50-Peso (1.2057)	**$571.00**	**$540.70**	507.70	0.93
Mexican Ounce (1.00)	**$473.50**	**$448.40**	420.90	0.92
S. African Krugerrand (1.00)	**$480.35**	**$454.95**	427.25	2.38
U.S. Double Eagle-$20 (0.9675)				
St. Gaudens (MS-60)	**$525.00**	**$500.00**	470.00	15.65
Liberty (Type I-AU)	**$675.00**	**$675.00**	675.00	48.69
Liberty (Type II-AU)	**$515.00**	**$497.50**	477.50	13.45
Liberty (Type III-AU)	**$490.00**	**$470.00**	440.00	7.94
U.S. Silver Coins ($1,000 face value, circulated)				
90% Silver (715 oz.)	**$5,475.00**	**$4,970.00**	5,035.00	-0.17
40% Silver (292 oz.)	**$2,200.00**	**$1,992.50**	2,047.50	-1.77
Silver Dollars	**$6,912.50**	**$6,912.50**	6,400.00	16.50

Note: Premium reflects percentage difference between coin price and value of metal in a coin, with gold at $469.20 per ounce and silver at $7.67per ounce. The weight in troy ounces of the precious metal in coins is indicated in parentheses.

Recommended Mutual Funds

	Ticker Symbol	10/14/05	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	**$80.38**	**$80.85**	82.11	82.20	80.31	2.1700	0.0000	2.70
Vanguard Short-term Inv. Grade	VFSTX	**$10.51**	**$10.39**	10.72	10.25	9.93	0.4605	0.0000	4.38
Income Equity Funds									
DNP Select Income[1, 2]	DNP	**$11.22**	**$11.47**	11.14	11.95	10.24	0.8600	0.0000	7.66
Vanguard REIT Index	VGSIX	**$18.90**	**$20.34**	17.37	21.06	17.00	0.9110	0.1400	4.82
Large Cap. Value Equity Funds									
iShares S&P 500 Value Index[3]	IVE	**$61.52**	**$64.22**	57.42	65.00	56.20	1.2728	0.0000	2.07
Vanguard Value Index	VIVAX	**$21.18**	**$22.22**	19.57	22.44	19.29	0.5290	0.0000	2.50
Small Cap. Value Equity Funds									
iShares Sm. Cap. 600 Value Index[3]	IJS	**$60.86**	**$64.01**	54.25	66.30	53.31	0.7405	0.0000	1.22
Vanguard Sm. Cap Value Index	VISVX	**$13.98**	**$14.75**	12.52	15.18	12.42	0.2270	0.0000	1.62
Growth Equity Funds									
iShares S&P 500 Growth Index[3]	IVW	**$56.90**	**$58.50**	53.48	59.53	52.81	1.1005	0.0000	1.93
Vanguard Growth Index	VIGRX	**$26.06**	**$26.80**	24.05	27.36	23.87	0.3250	0.0000	1.25
Foreign Equity Funds									
iShares S&P Europe 350 Index[3]	IEV	**$78.73**	**$79.99**	67.60	81.68	67.00	1.3481	0.0000	1.71
Vanguard European Stock Index	VEURX	**$27.16**	**$27.73**	23.24	28.28	23.12	0.5800	0.0000	2.14
iShares Emerging Markets Index[3]	EEM	**$77.94**	**$81.20**	56.75	85.92	56.75	0.8043	0.0000	1.03
Vanguard Emerging Market Index	VEIEX	**$16.96**	**$17.49**	12.42	18.10	12.59	0.2590	0.0000	1.53
Gold-Related Funds									
iShares COMEX Gold Trust[3]	IAU	**$46.83**	**$45.49**	N/A	47.90	41.04	0.0000	0.0000	0.00
streetTRACKS Gold shares	GLD	**$46.80**	**$45.42**	N/A	47.72	41.02	0.0000	0.0000	0.00

Recommended Gold-Mining Companies

	Ticker Symbol	10/14/05	Month Earlier	Year Earlier	— 52-Week — High	Low	Distributions Latest 12 Months	Frequency	Yield (%)
Anglogold Ltd., ADR	AU	**$41.45**	**$40.49**	36.87	44.45	30.50	0.565	Semiannual	1.36
Barrick Gold Corp.†	ABX	**$26.88**	**$28.07**	20.57	29.96	20.25	0.187	Semiannual	0.70
Gold Fields Ltd.	GFI	**$13.62**	**$12.70**	14.94	15.25	9.40	0.112	Semiannual	0.82
Newmont Mining	NEM	**$44.98**	**$44.99**	44.78	49.98	34.90	0.400	Quarterly	0.89
Placer Dome†	PDG	**$16.20**	**$16.19**	20.11	23.67	12.10	0.085	Semiannual	0.52
Rio Tinto PLC‡	RTP	**$156.35**	**$151.21**	106.92	167.38	101.97	3.340	Semiannual	2.14

[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.