INVESTMENT GUIDE

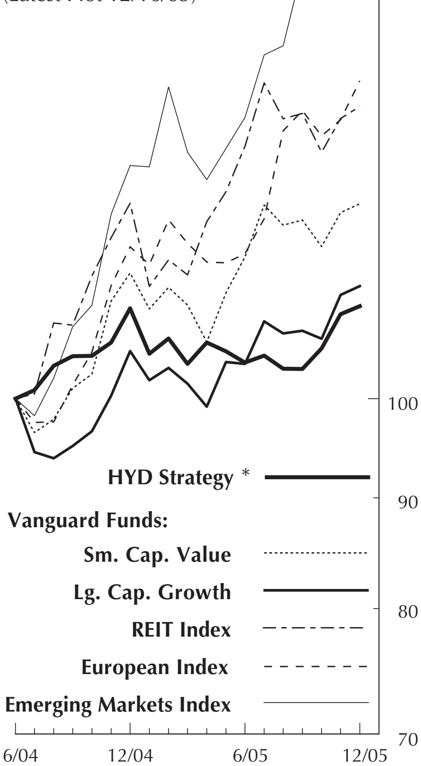
Published Monthly by

American Investment Services, Inc.

Vol. XXVII, No. 12 Great Barrington, Massachusetts 01230 December 30, 2005

Equity Performance
5/30/04=100

(Latest Plot 12/16/05)



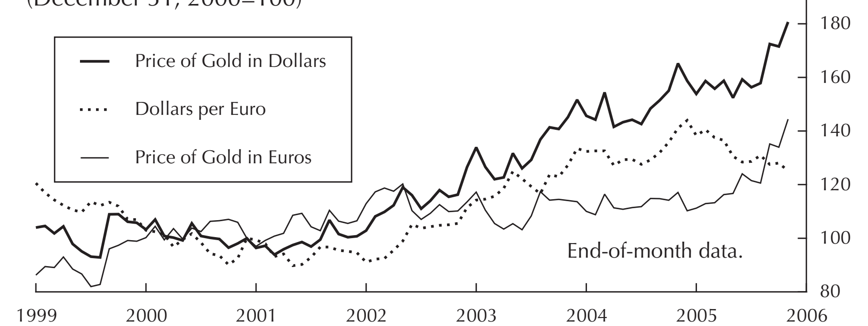
*** HYD is a hypothetical model based on back-tested results. See p. 94 for a full explanation.**

Gold at $500

Gold bullion closed in London at $502.50 per ounce on December 2. The P.M. fix had not been above $500 since 1987. Even though, as shown in the chart below, the dollar price of gold had been steadily increasing for five years or so, it was the $500 "milestone" that put gold back in the headlines of the financial press. Many attributed the strengthening of the gold price to the weakening dollar. Indeed, the trend of the dollar price of gold and the price of euros in dollars closely paralleled each other during 2002, 2003, and 2004. The price of gold in euros was essentially flat during those years. Its monthly average did not exceed its level in the spring of 2002 until last June. The dollar price increased more than one third during the same period.

If the increasing price of gold was merely a reflection of the foreign exchange value of the dollar, then a strengthening of the dollar could have been expected to be accompanied by a decrease in the dollar price of gold. But this is not what happened. Since the end of last year, the dollar price of gold has *increased* by nearly 14 percent, while the dollar price of euros has *decreased* by roughly the same amount (note how the two curves have diverged during recent months).

Indexes of the Price of Gold and the Euro
(December 31, 2000=100)



That the price of gold has increased in dollars and euros (as well as other major currencies) has been seen by many observers as an indication that investors have been providing against an acceleration of the loss of purchasing power of paper money, *i.e.*, that they have come to expect higher rates of general price inflation here and abroad. However, much of the recent sharp run-up in the gold price has apparently reflected speculative buying on the basis of its "price momentum."

Those who are buying gold simply because its price has been going up will probably tire of it if the price levels off (even temporarily). Nevertheless, it appears likely that overall demand will remain strong as the increasing prosperity of China and India (as well as the current high oil price) means increased demand among groups in Asia and the Middle East with long-standing

(continued next page)

traditions of holding gold as a store of value.

As for supply, it will be several years before mining projects that were "mothballed" when the price of gold was low can be brought on stream. However, if the price of gold continues to increase markedly, it can be expected that the world's central banks, which still hold approximately half of all gold that is in "good delivery" form, will at some point become tempted to become sellers. In other words, we have no way of determining how long the "bull market" in gold will last, and neither does anyone else. As we have often stated, the reason to own gold is not to *make* money, but to *have* money in any and all circumstances.

SECTION 529 PLANS: CLEARING UP THE CONFUSION*

Since their introduction a few years ago, Section 529 savings plans have become a popular way to help meet the escalating cost of a college education. However, the plans are confusing, the fees can be high, and tax treatment varies from state to state. Their advantages and disadvantages are discussed below.

According to the College Savings Plans Network, between 2002 and 2004 the total assets in 529 plans increased from $27 billion to $65 billion and the number of 529 accounts surged from 4.4 million to 7.2 million. More liberal tax treatment included in the Tax Relief Act of 2001, coupled with sharply rising tuition costs, has fueled this increase.

Named for Section 529 of the Internal Revenue Code, these tax-favored investment and savings plans are set up and operated by each state to help families save for college costs. While different states have different rules and investment options, they all offer powerful savings and tax incentives. Although contributions are not eligible for a federal tax deduction, investment earnings in the plan grow tax-free and withdrawals used to pay for a beneficiary's qualified educational expenses are exempt from federal taxes (although, in some states, they may be subject to state taxes). Individual states may offer other incentives, such as an up-front deduction for contributions.

Another attractive feature is that the donor maintains control of the account so the beneficiary cannot access the funds. This offers a big advantage over custodial accounts set up under the Uniform Transfers to Minors Act (UTMA), where the child takes control once he or she reaches the age of majority. Everyone can use a Section 529 savings plan, without income limits on participation, and the amounts you can contribute are substantial (well over $100,000 in most states). As there is often no residency requirement, you can set up plans in more than one state.

Despite these attractive features, recent investigations by industry and government regulators also point to the plans as a source of scrutiny, controversy, and confusion. Because they are issued by states, Section 529 Plans are not regulated by the Securities and Exchange Commission and are not required to include a standardized fee schedule and historical return disclosure, as mutual funds are. Without this key information, determining the true cost of a 529 Plan and comparing it to other plans has proven to be extraordinarily difficult for many people.

Regulators have become concerned that some brokers and financial advisors, who account for most plan sales, take advantage of this lack of clarity by selling high-cost plans that may not be suitable for their clients. The National Association of Securities Dealers (NASD) is currently investigating 20 brokerage firms and their sales practices to determine whether financial advisors steered too many clients toward high-commission 529 plans outside their home states without explaining the tax advantages of in-state plans. In October, it ordered one of these firms, Ameriprise Financial Services, to pay $1.25 million in fines and restitution for inadequately supervising brokers who sold such plans.

Moreover, a study by Drs. Raquel Meyer Alexander and LeAnn Luna of the University of North Carolina last year drew the disturbing conclusion that the states providing the *largest* state income tax deduction for residents' contributions are likely to have the *smallest* number of accounts, while 529 plans with *higher* fees have more accounts and more assets than plans with *lower fees*. Meanwhile, a Securities and Exchange Commission task force is investigating 529 plan fee structures and investor disclosures.

Some help for investors came last year when the College Savings Plans Network, an affiliate of the National Association of State Treasurers, approved voluntary guidelines for 529 disclosures. The Municipal Securities Rulemaking Board, a self-regulatory agency created by Congress, is working to create standardized 529 disclosure documents. At this point, however, the quality and clarity of disclosure varies widely from plan to plan.

As states and regulators hash out the details, families facing ever-mounting college expenses are left to sort through Section 529 plans largely on their own. The differing investments, expenses, and tax treatment of each state's plan make comparison and evaluation extremely difficult, so it is critical to do research and ask questions before buying. Below are some key issues and plan features that should help guide your search.

Prepaid vs. Savings Plans

Section 529 plans fall into two broad categories. Participants in "prepaid tuition plans" purchase tuition "certificates" or "credits" that go toward future payment of tuition and required fees for the beneficiary. Program trust funds, funded by participant contributions, are managed to generate an investment return sufficient to cover a specified level of future tuition payments. Under a 529 "savings program," the newer and more common version, participants contribute to an account that invests in mutual funds and other investments. Most of these are sold through financial advisors, although there are a number of direct investment plans as well. You can use the money from savings plans to cover tuition and fees, as well as books, supplies, and in many cases, room and board.

Prepaid plans can provide some level of assurance for risk-averse investors because they offer a defined benefit or specified return in the form of a specified number of tuition units or credits, which are unaffected by increases in tuition. By contrast, the money a savings plan investor has available to pay for college depends on both the amount of contributions and the investment results of the account. However, prepaid plans have a number of restrictions. Usually, the beneficiary must meet state residency requirements and the programs are geared toward meeting costs at a pre-selected roster of in-state public or private schools. Most savings plan programs are open to residents of

* This article is by Marla Brill, AIER Research Fellow.

any state and the money in the account can be used to pay tuition and other expenses at any college.

In 2003, TIAA-CREF became the first (and still only) firm to introduce a non-state sponsored prepaid contract plan called Independent 529 Plan. Unlike traditional state-run prepaid plans, it has no residency restrictions and participants can choose from among approximately 250 participating private colleges around the country. A list of those colleges and more information on the plan is available at www.independent529plan.org.

State Tax Treatment

State tax treatment of college savings plan contributions and withdrawals vary widely from state to state. In Colorado, contributions (excluding rollovers) are fully deductible from taxable income for state residents. In Rhode Island, residents filing jointly may only deduct a maximum of $1,000. Twenty-five states and the District of Columbia offer a tax deduction or credit for contributions, and no state provides a deduction or credit to its residents for an out-of-state plan. Many states permit tax-free withdrawals for residents who use them to pay qualified educational expenses, even for out-of-state plans. Others allow tax-free withdrawals for their own plans, but tax distributed earnings from other state plans.

The issue that the NASD is examining—whether brokers push out-of-state plans because they offer the highest commissions, yet neglect to tell investors about the tax advantages of in-state plans—should be high on your list of questions. Although an out-of-state plan can sometimes offer a better deal than one offered by your home state if it has lower expenses or better investment options, it is important to understand why someone is recommending it. Ask why your financial advisor does not recommend your home state's plan if that is the case, and obtain and information on that plan and the tax treatment of contributions, earnings, and withdrawals before making any decisions. An excellent source of information on 529 Plans offered in all 50 states can be found at the web site of the College Savings Plans Network (www.collegesavings.org).

Keep in mind that if you move, you may lose any state tax deduction on future contributions and state tax exemptions on withdrawals. Most states require a "recapture" of prior deductions on non-qualified withdrawals, and some states require them for rollovers into out-of-state plans.

Expenses

A number of plans have drawn criticism because the high fees they charge, while others are relatively reasonable. Some have a one-time enrollment fee, which usually ranges from $25 to $100. Many charge an account maintenance fee of as much as $50 a year, which may be waived for larger accounts. All 529 Plans have a program management fee that covers the costs associated with the outside program manager or state agency that administers the plan. This expense can often exceed one percent a year, although many plans have program fees of 0.5 percent or less. Another fee covers the expenses of the underlying mutual funds. These can be less than 0.4 percent for low-cost index funds to over two percent for higher-cost funds. Some programs lump the program management fee mutual fund expense together into one figure.

If you work with a financial advisor who charges commissions, you will also incur a sales charge, which can run as high as 5.75 percent of your contribution. If you work with a fee-only advisor or do your own research, you can buy a direct-sold plan that does not have a sales charge. In a number of states, residents may purchase direct-sold programs, but non-residents must buy them though a financial advisor or pay the higher costs associated with shares sold through advisors. For those interested in comparing costs, the NASD offers a useful cost analyzer at www.nasd.com/529analyzer.

Control of Investment Options

Most states offer age-based and static investment options. Under a static arrangement, investors choose from among several "funds of funds" consisting of stocks, bonds, or a combination of both, and the allocation remains fixed. An aged-based portfolio is a fund of funds where the asset mix becomes more conservative as the beneficiary approaches college age. Account owners can change investments once every calendar year. Switching to another state's plan is generally permitted once a year.

Researching the investment performance of various state plans is difficult, since most state programs are relatively new and have only a short track record. As a rule of thumb, it is best to go with an investment management firm you have used before and feel comfortable with, preferably one that offers low-cost index funds.

Financial Aid

Assets in a 529 savings plan are considered an asset of the account owner. As such, they usually reduce a student's eligibility for financial aid, but the negative effect is often less than it is for other types of college savings. Tax-free withdrawals from 529 savings accounts owned by a parent or student are not included in financial aid income calculations, and do not reduce financial aid eligibility.

Note that financial aid rules vary, depending on the type of aid and the school. Loans or scholarships awarded by individual schools, which can be a significant component of a financial aid package, may or may not conform to the rules for federal financial aid. Also keep in mind that prepaid tuition plans are treated differently in calculating federal financial aid than 529 savings plans. Because payments from tuition contracts are considered an additional "resource," they reduce financial aid on a dollar-for-dollar basis. If you think your family may be eligible for financial aid from either government or private sources, it is important to thoroughly investigate the impact that a 529 plan may have on any awards.

Other Considerations

Congress authorized the tax-free treatment of distributions from 529 savings plans used for qualified higher education expenses as part of the Economic Growth and Tax Reconciliation Act of 2001. However, under the Act, that treatment is now scheduled to "sunset" on December 31, 2010, unless renewed by Congress. This means that anyone with a child who does not finish college by then may not be able to take tax-free withdrawals when they are needed.

Another consideration, critics say, is that because some 529 plans are loaded with fees, consumers may be better off saving for college in a taxable account stocked with low-cost, tax-efficient investments, such as index funds. The approach is more flexible because account owners can choose the investments they want, switch investments as often as they like, and claim a capital loss deduction if an investment loses value. In other situations, a Coverdell education savings account, or a traditional or Roth IRA, make the most sense.

INFLATION-ADJUSTED U.S. SAVINGS BONDS

The recent surge in price inflation has reduced the real interest rate on traditional Treasury bonds, close to, and at times, even below zero. While the nominal return on these bonds is fixed, their real return will always be uncertain because the real return depends on the future rate of price inflation. In contrast, inflation-adjusted I bonds provide a way for investors to obtain a steady, positive real return.

The inflation-adjusted return on long-term bonds has fallen apparently because the rate of price inflation has been higher than investors expected. The Consumer Price Index increased by 4.3 percent in the 12 months ended in October, from a rate of 1.7 percent just 18 months ago. Long-term interest rates, however, have not increased as much: the rate on 10-year Treasury notes is currently about 4.5 percent, compared with 4.0 percent in early 2004.

Consequently, the inflation-adjusted rate on 10-year Treasuries has decreased from about two percent in early 2004 to nearly zero today. In other words, at their current yields, Treasuries provide an interest income that is barely sufficient to compensate for the erosion of the dollar's purchasing power during the past year. At various times in the past year, their real yield has been negative.

Real interest rates rarely remain zero or negative for long. If the rate of price inflation remains elevated, investors' inflationary expectations will change and they will likely demand higher nominal interest on Treasuries. However, if they think the recent spike in price inflation will be short-lived, nominal rates on long-term bonds may not increase much.

Either way, the real returns on standard Treasury securities will remain unpredictable because there is no guarantee that inflationary expectations will match the actual rate of price inflation. Investors may win (if the future rate of price inflation over the life of their bonds is less than expected) or lose (if it is more than expected), but the bottom line is that their real return cannot be known.

Two alternatives to standard Treasuries do provide a guaranteed, fixed real return: Treasury Inflation-Protected Securities (TIPS) and, our focus here, I bonds.

The Treasury began offering I bonds, a type of savings bond, in 1998. The nominal interest rate on I bonds is variable and is pegged to changes in the CPI. If price inflation increases, the I bond rate increases, thereby compensating the bondholder for the dollar's loss of purchasing power. I bonds thus work differently from standard Treasuries. With the latter, your nominal interest rate is fixed but your real rate varies; with inflation-adjusted I bonds, your nominal interest rate varies but your real rate is fixed.

The nominal interest rate on an I bond is a combination of a fixed rate plus an adjustment for price inflation. The fixed rate is selected by the Treasury and remains the same for the 30-year life of the bond. The inflation adjustment changes every six months and is based on the latest six-month change in the CPI. Each year on November 1, the Treasury announces an inflation adjustment based on the change in the CPI from the previous September through March; on May 1, it announces a new inflation adjustment based on price inflation from March through September.

Last month, the Treasury announced the latest rates. I bonds purchased between November 1, 2005 and April 30, 2006 will earn an annual rate of 6.73 percent for the first six months after purchase. This rate includes a 1.0 percent fixed rate, which will remain in effect for the life of the bond, and an annualized inflation adjustment of roughly 5.7 percent (the annual rate of increase in the CPI between March and September 2005). Next May, the Treasury will announce a new inflation adjustment based on what happens to the CPI between now and then.

Although the Treasury announces new rates in May and November, the rates on individual I bonds are adjusted on the six-month anniversary of their purchase. Thus, if you buy a bond in January, its rate will change at the beginning of every January and July. For example, between January and July 2006 it will earn the 6.73 percent rate announced earlier this month. From July through January 2007, it will earn the rate announced next May.

How Have They Done?

The fixed real rate that an I bond earns depends on the date it was issued. For bonds purchased between now and next May it will be 1.0 percent, but for bonds that were purchased between May 1 and November 1 of this year, it is 1.2 percent. The Treasury has periodically changed the real rate to reflect the downward trend in the real rates available on standard Treasury securities. The highest real rate ever offered was 3.6 percent, payable for the lifetime of I bonds purchased in 2000. Adding in the current adjustment for inflation, these bonds will pay an annual nominal interest rate of 9.4 between now and next May.

With the inflation-adjusted yield on standard Treasuries at its lowest level in over 20 years, it is not surprising that the Treasury is offering a low real rate on I bonds. When the general level of real rates increases, the Treasury probably will raise the guaranteed real rate on future issues of I bonds. In the meantime, even at the current low rate, I bonds are providing a slightly higher real return than the zero-to-negative real rate that standard Treasuries have recently provided.

Moreover, when the real rates on alternative investments do rebound, you can cash in an I bond with minimal penalty. You must hold them for at least a year, and if you redeem them within the first five years, you forfeit the three most recent months of interest.

Unlike conventional Treasury securities, the price of an I bond does not vary inversely with its yield. If you buy a stan-

PLACER DOME OFFER

Placer Dome shareholders who have not responded to Barrick Gold's unsolicited takeover offer should take no action at this time. Barrick has not adjusted the terms of its offer despite the rising gold price, which reached a new 24-year high in early December. The company has, however extended its initial offer through January 16, 2006.

On October 31, shareholders were offered the right to elect to receive $20.50 in cash **or** 0.7518 of a Barrick common share plus $0.05 in cash for each Placer Dome common share, subject to pro ration. Based on current share prices for ABX and PDG, shareholders would be better off holding their PDG shares versus accepting either option.

Our recommendation is based purely on the value of the offer in light of current market prices. Both firms are among the world's premier gold mining companies, and a properly structured merger could ultimately bring significant advantages to shareholders of both firms.

dard bond today and interest rates subsequently increase, the market value of the bond will fall. In contrast, the redemption value of an I bond will simply be its purchase price plus any accrued interest.

An important caveat for investors seeking current income from bonds: I bonds, like EE savings bonds, do not pay cash income. Interest accrues monthly, and is paid when you cash in the bond.

I bonds offer other advantages. Interest is exempt from state and local income tax, and bondholders have the option of deferring federal income tax until the bonds are redeemed or until they stop earning interest after 30 years, whichever comes first. If the bonds are used to pay for college expenses the interest may be exempt from federal tax. For more information on this education-related tax break see IRS Publication 970, "Tax Benefits for Education."

Paper I bonds are available in denominations ranging from $50 to $10,000 and can be purchased at most banks. You can also buy electronic I bonds online for as little as $25, using a TreasuryDirect account at the U.S. Treasury. For more information, visit www.treasurydirect.gov or www.savingsbond.gov.

DOW STALWARTS?

Two venerable Dow stocks, General Motors and Coca Cola, have recently fallen from grace. We mention these only to point out that eventually all companies, no matter how invulnerable they might seem, encounter difficult times. We exclude GM from our 4-for-18 high-yield Dow strategy because the firm has never had a consistent dividend policy; all too often the model would have sold GM, not because of an appreciated share price, but because of a reduced dividend. We mention Coca Cola only because not long ago the firm could seemingly do no wrong, yet the share price has fallen enough so that KO is the eleventh highest yielding stock among the Dow thirty.

The following was provided by Dimensional Fund Advisors.

GM's Slippery Slope

Standard & Poor's Corp. downgraded its credit rating on General Motors' senior unsecured debt for the third time this year, reducing its rating from BB- to B. GM's financial difficulties are a harsh reminder that even the largest and strongest firms are vulnerable to competitive pressures. Measured by sales volume, GM ranked #1 as recently as 1999 in *Fortune's* annual survey of US corporations; and based on 2004 data, it still ranked #3 behind Wal-Mart and ExxonMobil.

GM debt securities were rated AAA by Standard & Poor's until 1981, and A as recently as 2001. GM first lost its investment grade credit rating (defined as BBB- or higher) in May 2005. Highlighting the importance of diversification, GM shares have slumped over 40% this year, closing at $23.05 on December 12, while NYSE shares of rival Toyota (TM) have jumped 18.6%. Parts suppliers TRW Automotive (TRW) and Johnson Controls (JCI) rose 27.3% and 13.6% respectively.

Not Much Fizz

The *Wall Street Journal* reported recently that Pepsico could soon overtake Coca-Cola as measured by stock market capitalization for the first time since Coke shares were offered to the public in 1919. The article observed "the stellar profit gains that Coke generated in the 1990s from global expansion and bottling deals began fizzling under Mr. Isdell's predecessors, Douglas Daft and M. Douglas Ivester."

Competitive forces make it difficult for even the strongest firms to fend off competitors indefinitely. We recall a cover story announcing the results of *Fortune* magazine's annual "Most Admired Company" survey in 1997: Coca-Cola ranked #1, and indeed ranked among the top ten in each *Fortune* survey from 1990 through 1999. Coke shares at that time carried Standard & Poor's highest earnings and dividends rating (A+), and total return through March 31, 1997 was 24.1% per year for the previous five-year period. Coke shares have since fallen 13.2%. Over this period, the S&P 500 Index (price-only) has appreciated 66.9%.

"Smoke and mirrors maybe, but, no, I don't think they have a chimney."

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 **Pfizer** were not eligible for purchase 18 months earlier. Investors following the model should find that the indicated purchases of **Merck** and **Pfizer** and sales of **Citigroup** and **JP Morgan Chase** are sufficiently large to warrant trading. In larger accounts, rebalancing positions in **AT&T Corp (Formerly SBC Communications)** and **Verizon** 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.

As of December 15, 2005

					Percent of Portfolio*	
	Rank	*Yield*	*Price*	*Status*	*Value*	*No. Shares*[1]
General Motors	1	9.04%	22.13	*		
AT&T Corp (New)	2	5.35%	24.85	Holding**	25.71	32.08
Verizon	3	5.29%	30.61	Holding**	21.93	22.22
Merck	4	5.11%	29.77	Buying	20.87	21.74
Pfizer	5	4.21%	22.79	Buying	1.52	2.07
Altria Group	6	4.18%	76.62	*		
CitiGroup	7	3.58%	49.10	Selling	10.42	6.58
DuPont	8	3.45%	42.91			
JP Morgan Chase	9	3.44%	39.58	Selling	19.53	15.31
General Electric	10	2.78%	36.00			
					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	2.29%	-1.67%	3.39%	9.81%	14.32%	14.94%	19.10%
Dow	2.02%	3.61%	2.54%	9.24%	12.04%	10.26%	16.74%

* 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.

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—AT&T Corp, Verizon, Merck and Pfizer—account for roughly 70 percent of the total portfolio value). Any remaining cash will be held in a money-market fund pending subsequent purchases, which will be made whenever the client's holdings of each month's eligible stocks are below the percentages indicated by the strategy by an amount sufficient to warrant a trade.

Our **HYD Investment Management Program** provides professional and disciplined application of this strategy for individual accounts. For accounts of $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 12/15/05*	*Market Prices 11/15/05*	*Market Prices 12/15/04*	*12-Month High*	*12-Month Low*	*Latest Dividend Amount*	*Latest Dividend Record Date*	*Latest Dividend Paid*	*Indicated Annual Dividend*	*Indicated Yield† (%)*
General Motors	GM	**$22.13**	**$22.61**	38.96	40.82	20.60 *L*	0.500	11/10/05	12/10/05	2.000	9.04
★ AT&T (new)	T	**$24.85**	**$23.89**	25.68	26.17	21.79	0.333	10/10/05	11/1/05	1.330	5.35
★ Verizon	VZ	**$30.61**	**$30.82**	40.70	41.44	29.13	0.405	1/10/06	2/01/06	1.620	5.29
★ Merck	MRK	**$29.77**	**$30.02**	30.48	36.26	25.50	0.380	12/02/05	1/03/06	1.520	5.11
★ Pfizer	PFE	**$22.79**	**$21.89**	28.32	29.21	20.27 *L*	0.240	2/10/05	3/07/05	0.960	4.21
Altria Group	MO	**$76.62**	**$74.39**	60.80	78.68 *H*	59.85	0.800	12/28/05	1/10/06	3.200	4.18
☆ Citigroup	C	**$49.10**	**$47.66**	47.31	49.99	42.91	0.440	11/07/05	11/23/05	1.760	3.58
DuPont	DD	**$42.91**	**$42.35**	48.39	54.90	37.60	0.370	11/15/05	12/14/05	1.480	3.45
☆ J. P. Morgan Chase	JPM	**$39.58**	**$37.73**	39.03	39.75 *H*	32.92	0.340	1/06/06	1/31/06	1.360	3.44
General Electric	GE	**$36.00**	**$34.40**	37.39	37.49	32.67	0.250	12/27/05	1/25/06	1.000	2.78
Coca-Cola	KO	**$41.16**	**$42.46**	41.47	45.26	40.55	0.280	12/01/05	12/15/05	1.120	2.72
Johnson & Johnson	JNJ	**$60.16**	**$62.83**	60.90	69.99	59.76	0.330	11/22/05	12/13/05	1.320	2.19
Honeywell Intl.	HON	**$37.96**	**$36.34**	36.01	39.50	32.68	0.206	11/18/05	12/09/05	0.825	2.17
3M Company	MMM	**$77.49**	**$78.06**	79.09	87.45	69.71	0.420	11/25/05	12/12/05	1.680	2.17
Alcoa	AA	**$28.23**	**$26.26**	31.30	32.29	22.28	0.150	11/04/05	11/25/05	0.600	2.13
Exxon Mobil	XOM	**$59.49**	**$56.43**	50.51	65.96	49.25	0.290	11/10/05	12/09/05	1.160	1.95
McDonald's	MCD	**$34.98**	**$33.31**	32.44	35.69 *H*	27.36	0.670	11/15/05	12/01/05	0.670	1.92
Procter & Gamble	PG	**$58.99**	**$56.00**	56.12	59.70 *H*	51.16	0.280	10/21/05	11/15/05	1.120	1.90
Caterpillar (s)	CAT	**$58.71**	**$55.90**	47.44	59.88	41.31	0.250	1/20/06	2/18/06	1.000	1.70
Boeing	BA	**$70.79**	**$67.00**	52.40	71.98 *H*	49.52	0.300	2/10/06	3/03/06	1.200	1.70
United Tech. (s)	UTX	**$57.60**	**$53.19**	51.20	58.13 *H*	48.43	0.220	11/18/05	12/10/05	0.880	1.53
Microsoft Corp.	MSFT	**$26.92**	**$27.50**	27.11	28.25 *H*	23.82	0.090	2/17/06	3/09/06	0.360	1.34
Wal-Mart Stores	WMT	**$49.26**	**$48.78**	53.03	54.60	42.31	0.150	12/16/05	1/03/06	0.600	1.22
Intel Corp.	INTC	**$26.58**	**$25.08**	23.14	28.84	21.89	0.080	11/07/05	12/01/05	0.320	1.20
Hewlett-Packard	HPQ	**$29.20**	**$28.12**	20.71	30.25 *H*	18.89	0.080	12/14/05	1/04/06	0.320	1.10
Walt Disney	DIS	**$24.74**	**$26.06**	27.60	29.99	22.89	0.270	12/12/05	1/06/06	0.270	1.09
IBM	IBM	**$83.53**	**$85.53**	97.33	99.10	71.85	0.200	11/10/05	12/10/05	0.800	0.96
Home Depot, Inc.	HD	**$42.58**	**$42.40**	42.49	43.98	34.56	0.100	12/01/05	12/15/05	0.400	0.94
American Express ††	AXP	**$51.43**	**$50.93**	56.14	59.50	46.59	0.120	1/06/06	2/10/06	0.480	0.93
AIG	AIG	**$65.30**	**$66.68**	64.72	73.46	49.91	0.150	3/03/05	3/17/05	0.600	0.92

† Based on indicated dividends and market price as of 12/15/05. 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

	12/15/05	Mo. Earlier	Yr. Earlier
Gold, London p.m. fixing	**506.25**	**468.25**	439.00
Silver, London Spot Price	**8.39**	**7.77**	6.78
Copper, COMEX Spot Price	**2.14**	**2.03**	1.46
Crude Oil, W. Texas Int. Spot	**59.99**	**56.98**	44.19
Dow Jones Spot Index	**256.56**	**241.38**	195.33
Dow Jones-AIG Futures Index	**174.13**	**165.13**	146.89
CRB-Bridge Futures Index	**328.66**	**312.73**	284.52

Interest Rates (%)

		12/15/05	Mo. Earlier	Yr. Earlier
U.S. Treasury bills -	91 day	**3.92**	**3.99**	2.20
	182 day	**4.30**	**4.33**	2.46
	52 week	**4.36**	**4.44**	2.66
U.S. Treasury bonds -	10 year	**4.47**	**4.57**	4.07
Corporates:				
High Quality -	10+ year	**5.73**	**5.77**	5.42
Medium Quality -	10+ year	**6.04**	**6.09**	5.70
Federal Reserve Discount Rate		**5.25**	**5.00**	3.25
New York Prime Rate		**7.25**	**7.00**	5.25
Euro Rates	3 month	**2.45**	**2.31**	2.18
Government bonds -	10 year	**3.37**	**3.49**	3.50
Swiss Rates -	3 month	**1.04**	**0.94**	0.76
Government bonds -	10 year	**2.11**	**2.20**	2.19

Exchange Rates

	12/15/05	Mo. Earlier	Yr. Earlier
British Pound	**$1.764700**	**$1.736000**	1.946200
Canadian Dollar	**$0.862300**	**$0.838800**	0.809900
Euro	**$1.197100**	**$1.172700**	1.330600
Japanese Yen	**$0.008597**	**$0.008415**	0.009600
South African Rand	**$0.155000**	**$0.147500**	0.173200
Swiss Franc	**$0.775300**	**$0.759800**	0.870500

Securities Markets

	12/15/05	Mo. Earlier	Yr. Earlier
S & P 500 Stock Composite	**1,270.94**	**1,229.01**	1,203.54
Dow Jones Industrial Average	**10,881.67**	**10,686.44**	10,681.62
Dow Jones Transportation Average	**4,145.77**	**4,006.16**	3,759.61
Dow Jones Utilities Average	**417.89**	**388.18**	327.97
Dow Jones Bond Average	**186.68**	**185.01**	186.77
Nasdaq Composite	**2,260.63**	**2,186.74**	2,162.55
Financial Times Gold Mines Index	**2,041.08**	**1,830.00**	1,711.02
FT African Gold Mines	**2,689.79**	**2,381.40**	2,103.50
FT Australasian Gold Mines	**5,753.12**	**5,105.42**	4,259.84
FT North American Gold Mines	**1,661.82**	**1,498.33**	1,440.44

Coin Prices

	12/15/05	Mo. Earlier	Yr. Earlier	Premium
American Eagle (1.00)	**$520.75**	**$469.85**	464.95	2.86
Austrian 100-Corona (0.9803)	**$495.73**	**$447.43**	442.73	-0.11
British Sovereign (0.2354)	**$123.55**	**$111.75**	110.65	3.67
Canadian Maple Leaf (1.00)	**$521.55**	**$470.10**	465.20	-2.11
Mexican 50-Peso (1.2057)	**$611.40**	**$551.80**	546.10	0.17
Mexican Ounce (1.00)	**$507.00**	**$457.60**	452.80	0.15
S. African Krugerrand (1.00)	**$514.15**	**$464.25**	459.45	1.56
U.S. Double Eagle-$20 (0.9675)				
St. Gaudens (MS-60)	**$565.00**	**$525.00**	520.00	15.35
Liberty (Type I-AU)	**$675.00**	**$675.00**	675.00	37.81
Liberty (Type II-AU)	**$542.50**	**$515.00**	497.50	10.76
Liberty (Type III-AU)	**$530.00**	**$495.00**	472.00	8.21
U.S. Silver Coins ($1,000 face value, circulated)				
90% Silver (715 oz.)	**$6,037.50**	**$5,335.00**	5,480.00	0.64
40% Silver (292 oz.)	**$2,407.50**	**$2,150.00**	2,230.00	-1.73
Silver Dollars	**$7,100.00**	**$6,900.00**	6,612.50	9.39

Note: Premium reflects percentage difference between coin price and value of metal in a coin, with gold at $506.25 per ounce and silver at $8.39 per ounce. The weight in troy ounces of the precious metal in coins is indicated in parentheses.

Recommended Mutual Funds

	Ticker Symbol	12/15/05	Month Earlier	Year Earlier	— 52-Week — High	Low	Distributions Latest 12 Months Income	Capital Gains	Yield (%)
Short-Term Bond Funds									
iShares Lehman 1-3 Yr Treasury[3]	SHY	**$80.34**	**$80.14**	81.68	81.68	80.03	2.3502	0.0000	2.93
Vanguard Short-term Inv. Grade	VFSTX	**$10.51**	**$10.49**	10.67	10.67	9.88	0.3759	0.0000	3.58
Income Equity Funds									
DNP Select Income[1, 2]	DNP	**$10.44**	**$10.66**	11.54	11.95	10.18	0.7800	0.0000	8.14
Vanguard REIT Index	VGSIX	**$20.45**	**$19.79**	18.98	21.06	17.00	0.7850	0.2596	3.84
Large Cap. Value Equity Funds									
iShares S&P 500 Value Index[3]	IVE	**$66.45**	**$64.14**	62.66	66.84	58.37	1.2828	0.0000	1.93
Vanguard Value Index	VIVAX	**$22.72**	**$21.89**	21.32	22.78	20.45	0.5290	0.0000	2.33
Small Cap. Value Equity Funds									
iShares Sm. Cap. 600 Value Index[3]	IJS	**$65.29**	**$62.99**	61.07	66.35	55.04	1.7405	0.0000	1.90
Vanguard Sm. Cap Value Index	VISVX	**$15.03**	**$14.47**	14.07	15.18	12.87	0.2270	0.0000	1.51
Growth Equity Funds									
iShares S&P 500 Growth Index[3]	IVW	**$60.70**	**$58.74**	58.35	60.94	54.60	1.1005	0.0000	1.81
Vanguard Growth Index	VIGRX	**$28.20**	**$27.24**	26.44	28.22	24.48	0.3250	0.0000	1.15
Foreign Equity Funds									
iShares S&P Europe 350 Index[3]	IEV	**$82.45**	**$78.55**	75.79	83.41	72.20	1.3481	0.0000	1.64
Vanguard European Stock Index	VEURX	**$28.39**	**$27.01**	26.15	28.67	25.02	0.5800	0.0000	2.04
iShares Emerging Markets Index[3]	EEM	**$87.80**	**$82.20**	64.82	88.83	63.38	0.8043	0.0000	0.92
Vanguard Emerging Market Index	VEIEX	**$18.90**	**$17.65**	14.04	19.00	13.97	0.2590	0.0000	1.37
Gold-Related Funds									
iShares COMEX Gold Trust[3]	IAU	**$50.23**	**$46.64**	N/A	53.78	41.04	0.0000	0.0000	0.00
streetTRACKS Gold shares	GLD	**$50.24**	**$46.66**	43.99	53.76	41.02	0.0000	0.0000	0.00

Recommended Gold-Mining Companies

	Ticker Symbol	12/15/05	Month Earlier	Year Earlier	— 52-Week — High	Low	Distributions Latest 12 Months	Frequency	Yield (%)
Anglogold Ltd., ADR	AU	**$46.67**	**$41.00**	36.75	48.64	30.50	0.565	Semiannual	1.21
Barrick Gold Corp.†	ABX	**$26.90**	**$25.27**	23.45	29.96	21.07	0.187	Semiannual	0.70
Gold Fields Ltd.	GFI	**$16.38**	**$13.48**	13.10	17.66	9.40	0.112	Semiannual	0.68
Newmont Mining	NEM	**$49.99**	**$43.04**	45.75	52.49	34.90	0.400	Quarterly	0.80
Placer Dome†	PDG	**$22.09**	**$20.07**	19.05	23.54	12.10	0.085	Semiannual	0.38
Rio Tinto PLC‡	RTP	**$174.06**	**$161.41**	112.75	177.81	110.56	3.340	Semiannual	1.92

[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.