

INVESTMENT GUIDE

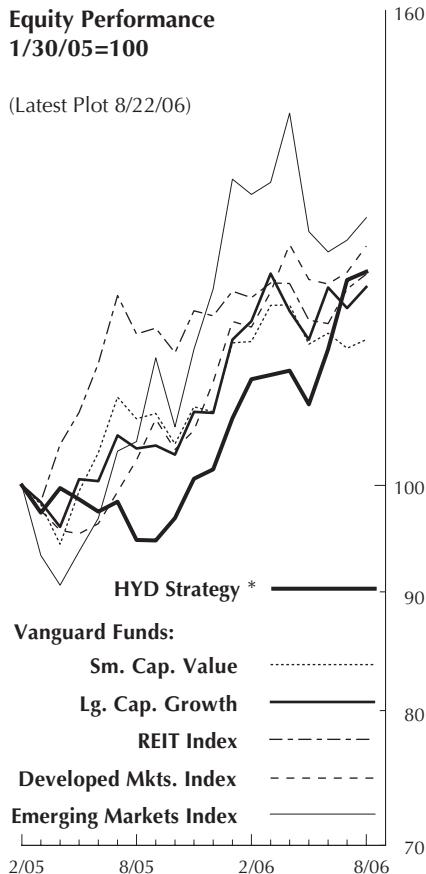
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* HYD is a hypothetical model based on back-tested results. See p. 62 for a full explanation.

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Mea Culpa Altria

Over six years ago we deviated from our disciplined approach to investing when we removed Philip Morris (now Altria, ticker: MO) from our high-yield Dow investment model. We have come to regret that decision, and it is one we intend never to repeat. MO subsequently provided a total return of about 30 percent per year.

This month we are reintroducing Altria as a component of our model. Our decision to do so at this time is unrelated to anyone's opinion regarding the firm's fate. Though its share price has rebounded sharply since we removed MO from the model, its dividend yield has remained strong relative to the other stocks in the Dow 30. It therefore would have remained in the model; had we not abandoned MO the shares would currently account for 22 percent of the model's total market value. Our recommended procedure for "getting back in" is found in the discussion on page 62.

It is painful but instructive to review our rationale for abandoning MO. Our model began accumulating shares in April of 1993. Over the next seven years the firm came under assault from trial lawyers and state attorneys general for health claims related to tobacco. MO subsequently suffered a series of potentially devastating decisions. Though it had yet to pay a penny in claims, the share price fell steadily, and its yield rose. Though this pattern was not untypical of firms in the model (high-yielding shares are typically distressed), MO was an extreme case. The media frenzy over big tobacco's imminent demise was in full swing. The market, moreover, was not favoring value stocks in general; dividends were considered passé and tech stocks were the darlings of Wall Street.

We threw in the towel in March 2000, following a 15 month period when MO's share fell from \$52.25 to \$20.13, and its yield rose to 9.5 percent. We reasoned that MO was different from other stocks in the model; the firm's fate was in the hands of attorneys and juries rather than management. Given that its dividend yield was nearly three times that of the next highest yielding stock, we asserted that the only way MO would ever be sold out of the model would be "feet first" following bankruptcy or via its deletion from the Dow.

We did consider sticking with the model. We realized that with a 9.5 percent yield, if the share price were to climb by just \$2 over the next twelve months, investors would enjoy a total return of nearly 20 percent. Alas, amidst the clamor from the media and "experts" predicting the demise of big tobacco this argument fell upon deaf ears and MO was jettisoned.

One year later the firm's legal fortunes had reversed. The share price had more than doubled, to \$47.26. Investors would have enjoyed a total return of over 150 percent.

In retrospect we did precisely what we tell our readers not to do. We allowed ourselves to be swept up in the emotion of the times. After months of constantly defending our holdings of MO we were all too glad to be rid of it. Instead of lashing ourselves to the mast we jumped overboard. It is a mistake we do not intend to repeat.

INDEXES, INDEX FUNDS, AND ASSET ALLOCATION

Our investment recommendations must be consistent with, and flow naturally from, the research methodology employed by our parent organization, the American Institute for Economic Research. Below we have reprinted an article that appeared in AIER's Research Reports in April. It provides an excellent review of the rationale for our general approach to portfolio management.

Thousands of times a day investors ask "how's the market doing?" The usual answer is that the market is up (or down) a number of points, which the questioner will understand as a reference to the change in the "Dow" (the Dow Jones Industrial Average, or DJIA) from the close of the previous trading session.

When the average was first calculated in 1896, it was simply the total of the prices of 12 different issues traded on the New York Stock Exchange (almost all of them railroads) divided by 12. This divisor was changed whenever there were

changes on the list (additions, substitutions, stock splits, spin-offs, etc.). Recalculating the divisor ensured that the level of the average before and after a change would be equal. In 1928 the number of issues in the DJIA was increased to 30 (where it has remained ever since), but even then, the divisor was much less than 30 (16.7, in fact). The divisor is now 0.135.

The 30 issues included in the DJIA are selected by the editors of *The Wall Street Journal*, apparently on an *ad hoc* basis. The 30 issues are very large companies; together they account for about 20 percent of the total value of all 5,000 or so publicly traded stocks.

The way in which the DJIA is calculated reflects its beginnings in an era when there were no calculators or computers (and maybe not even adding machines). Its construction means that it is *price weighted*, which means that a percentage change in the highest price stock on the list will have a much larger impact on the average than the same percentage change

in the lowest price stock on the list. Statistically, this is indefensible.

Nevertheless, the DJIA has tracked very closely with the Standard and Poor's index of 500 common stock prices (S&P 500), which is the series usually employed by serious students of financial and economic trends (and which is increasingly reported as a short answer to "how's the market doing?"). The S&P 500 is calculated from the total market capitalization (the market price of a stock times the number of shares outstanding) of domestic companies with the 500 largest market capitalizations. It is an index, rather than an average, and changes in the S&P 500 reflect changes in the total market value of the 500 largest stocks. Those 500 issues account for more than three-quarters of the total value of all domestic common stocks.

Other Indexes

Today, with nearly instantaneous communications and computers, more organizations than just Dow Jones and Standard and Poor's publish indexes of common stock prices, and even those two companies offer more indexes than they did just a few years ago. Many of these newer series are listed in the accompanying table. What they have in common is that they are all calculated from the ranked market capitalizations of individual stocks.

Thus, it is possible to find an index for several ranges beginning with the very largest market capitalization issue (currently Exxon Mobil, valued at nearly \$400 billion) and continuing down the list to some stopping point. This point may be no. 300, 500, 1,000, 3,000 or even all the way down to the very smallest companies ranked at nearly no. 5,000 or so, which have market values of a little over \$1 million.

These organizations also publish indexes for intermediate ranges (variously named "mid" "small" or "micro" capitalization stocks). It is important to understand that these categorizations are completely arbitrary and vary from organization to organization. For example, what Morgan Stanley International deems to be "Mid Cap" (nos. 301 to 750) falls entirely within the range that the Frank Russell Co. considers Large Cap (the Russell 1000).

In addition, most of the indexes shown in the table are further broken down between "growth" and "value." Again, there

Selected Common Stock Price Indexes

Index	Includes Stocks with Market Caps Ranked		Percent of Total Mkt. Cap
Standard and Poor's			
500 (Large-Cap)	1	to 500	76.4%
400 (Mid-Cap)	501	to 900	11.1%
1000	501	to 1,500	16.0%
600 (Small-Cap)	901	to 1,500	4.9%
Composite	1	to 1,500	92.4%
Dow Jones			
Large-Cap	1	to 307	67.1%
Mid-Cap	308	to 855	17.8%
Small-Cap	856	to 1,623	8.4%
Total Market	1	to 1,623	93.3%
Frank Russell Co.			
Russell 1000	1	to 1,000	87.2%
Russell 2000	1,001	to 3,000	11.3%
Russell 3000	1	to 3,000	98.5%
Russell Microcap	3,001	to 4,000	1.2%
Small Cap Completeness	501	to 4,000	23.3%
Morgan Stanley Capital International			
Large-Cap	1	to 300	66.7%
Mid-Cap	301	to 750	16.3%
Prime	1	to 750	83.0%
Small-Cap	751	to 2,500	14.4%
Investable Market	1	to 2,500	97.4%
Micro	2,501	to 5,000	2.6%
Broad	1	to 5,000	100.0%
Wilshire			
5,000	1	to 5,000	100.0%
4,500	501	to 5,000	23.6%
Dimensional Fund Advisors			
Large (CRSP 1-5)	1	to 1,279	90.5%
Small (CRSP 6-10)	1,280	to 4,310	9.4%
Micro (CRSP 9-10)	1,806	to 4,310	4.0%

is no commonly employed approach to this division. In general, the issues in a given index are ranked according to one or more financial ratios (such as market price to book value, or cash flow). The stocks with the highest ratios are deemed to be "growth stocks" while those with the lowest ratios are "value stocks."

The proliferation of indexes has led to a rapid increase in the number of index funds. Each such fund is designed to track a given index and may be either a traditional open-ended investment company or one of the newer exchange-traded funds. There are two rationales behind these investment vehicles.

First, it is empirically demonstrable that roughly two-thirds to three-quarters of investors (professional or otherwise) fail to achieve the returns that indexes suggest they should. Moreover, there is no reason to believe that a fund or manager that "beats the index" in one period is likely to do so in a future period. One reason for this is, of course, that indexes do not pay management fees or incur trading costs—managers who charge high fees and indulge in heavy trading are even less likely to beat the indexes than managers who minimize their investors' costs.

Index funds have minimal costs and expenses. Their stock selections have been made for them, which means that they do not have to employ analysts and "stock pickers." And they trade far less than actively managed funds.

A second, more theoretical, rationale for index funds is the notion that common stock prices reflect all available information at any given time and that new information will come to light in a random fashion. In other words, on the assumption that markets work to price financial assets with accuracy, then efforts at stock picking are futile, and investors should concentrate on what they can control: expenses and risk. As we have noted, index funds are an excellent way to limit expenses when investing in equities. But how to control risk?

Diversify to Control Risk

The way to control risk is to diversify one's holdings. As experienced and successful investors, such as John Bogle or Warren Buffett, often state, most investors would do better holding a mutual fund that tracks the S&P 500, than trying to pick stocks or actively managed mutual funds. The reason is that such funds have very low expenses and they hold many more issues (500) than an actively

managed portfolio.

Empirical studies also demonstrate that risk and return are related over the long term. The volatility of returns is the usual measure of risk and, in general (but not always), higher long-term returns are associated with larger short-term volatility of those returns.

The proliferations of funds that track additional indexes has created opportunities for further diversification—what some have called "asset class investing." Some segments of the market have had higher long-term returns than the S&P 500—small cap stocks and value stocks in particular. The short-term volatility of the returns on those segments is larger than it is for the S&P 500; but when they are included in an investment portfolio, the volatility of that portfolio's returns will be less than the average of its individual components.

In other words, this approach takes advantage of the fact that various segments of the market have dissimilar price movements.

However, it should be understood that an index fund can serve as an asset class only within the context of a specific portfolio. A portfolio of six different actively-managed mutual funds would not, in fact, be diversified, if all six funds were focused on large capitalization growth stocks. Similarly, an S&P 500 fund and a fund that tracked the Russell 1000 should not be considered as two different asset classes within a portfolio—the coefficient of correlation of the returns on the two indexes during the past 27 years was 0.996!

Brokerage firms and mutual fund management companies often create funds simply to have "new products." But many of these are not suitable for an asset class investor. In general, industry-specific funds (those that hold, for example, only consumer product companies or only energy companies) are not useful asset classes. Exhaustive research has shown

that the size and valuation (growth or value) of the companies within such funds account for most of the variation in their returns. The two exceptions to this finding are real estate investment trusts and gold mining companies.

Similarly, commodity futures contracts cannot be considered as an asset class, because there is no economic return to be gained—the gains of the longs are matched by the losses of the shorts, and vice versa.

The Useless Middle?

As the foregoing discussion of the composition of various indexes indicated, what constitutes a "mid-cap" stock is in the eye of the beholder. Using extensive records of common stock prices developed by the University of Chicago's Center for Securities Price Research, we examined the returns on the middle three quintiles of U.S. common stocks ranked by market capitalization.

During the years 1926-2005, the median difference between the returns on the largest quintile and the smallest quintile was more than 13 percentage points. During eight out of ten 12-month spans during those years, the returns on the middle quintiles were somewhere between those on the largest and smallest quintiles. The other 20 percent of the time (when the returns on the middle three quintiles were outside the range between the first and fifth quintiles) the median difference from the closer of the two remaining quintiles was about 2 percentage points.

This suggests that there is little point in holding a "mid-cap" fund, especially when the portfolio contains funds holding companies further down the list of companies ranked by size. To repeat, asset class investing takes advantage of dissimilar price movements. Of course, to limit risk a "mid-cap" fund could replace a fund that held smaller, but more volatile, companies.

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HYD AND MULTI-FACTOR INVESTING

It has become increasingly accepted among financial economists that equity investors are compensated with returns for assuming three specific forms of risk. These include market risk, size risk, and distress risk. An investor can test an investment vehicle such as a mutual fund or an investment approach against this “three-factor” model to determine its exposure to these forms of risk, and to weigh whether it qualifies as an appropriate vehicle for capturing returns attributable to a particular asset class.

Market risk is the risk an investor bears for investing in the stock market instead of Treasury bills. Between January 1927 and December 2005, investors received on average an 8.25 percent return per year

for investing in stocks versus Treasury bills; this is the market’s historical equity premium. An investor who owns a portfolio of stocks, such as an all-equity mutual fund, can measure his exposure to market risk through analyzing the portfolio’s historical returns via single-factor regression analysis. A resulting measure called *beta* represents the portfolio’s percent sensitivity to this market factor. For example, if your portfolio ranged on average within 80 percent of the fluctuations of the market’s premium, you would have beta of 0.80 and your expected return would be 80 percent of the market’s average premium over Treasury bills. The market portfolio has a beta of 1.0. *Alpha* accounts for the difference, positive or

negative between the portfolio’s returns and this expectation.

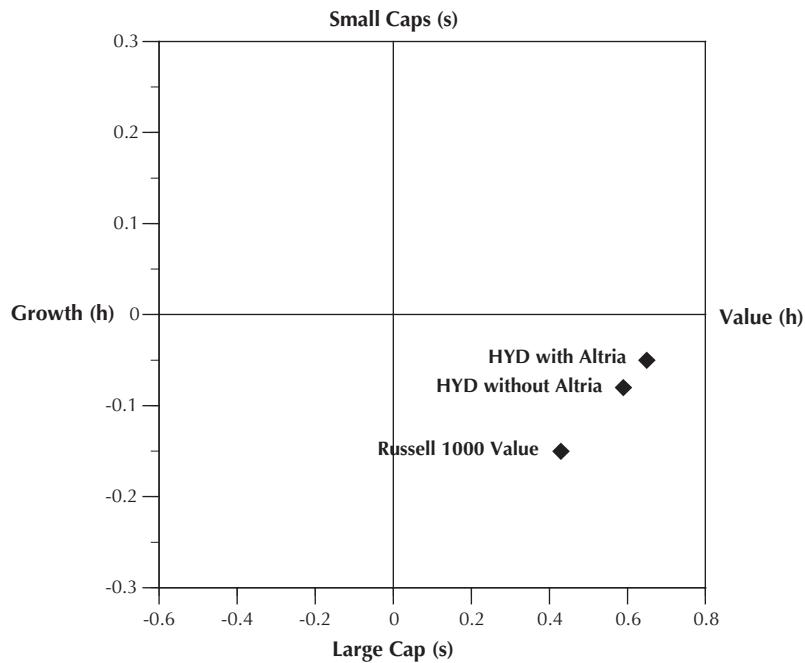
For many years this single factor (market risk) Capital Asset Pricing Model (CAPM) was the standard for assessing a portfolio’s expected returns. Fama and French extended CAPM to account for two additional forms of compensated risk, namely size and distress, and developed what has come to be known as the three-factor model.

Size risk is the risk investors assume by investing in small firms (measured by market cap) versus large firms. Consider whether you would be as willing to loan money to General Electric as you would a small unknown firm with \$1 million in sales; the only way most investors would be indifferent to these two options would be if the small firm were to offer a higher rate of interest on the loan. Issuing stocks is just an alternative way for firms to raise capital, so one would also expect small firms to provide a return premium over large caps. Indeed they do; between 1927 and 2005 investors were rewarded, on average, with an additional 3.73 percent per year for investing in small stocks versus large cap stocks.

Distress risk is the risk investors assume for investing in firms that are recognized to be in some type of financial difficulty. Distressed companies are often financed with “junk bonds,” or bonds priced to provide a higher yield to maturity than bonds of similar maturity issued by financially sound firms. Similarly, the common stocks of distressed firms must be priced low enough to provide expected returns that can compete with those of sound companies. Brokers and other stock pickers perhaps frustrated trying to sell “distressed stocks” succeeded in promoting these instead as “value stocks” and labeled safer stocks “growth” stocks; the labels, though misleading, have stuck.

Just as there is a beta for gauging a portfolio’s market risk, a portfolio’s size and distress exposure can be similarly quantified. To calculate these additional “betas,” the three-factor model simply adds a size factor (the excess returns of small cap over large cap stocks) and a distress factor (the excess returns of distressed stocks over low risk stocks). Fama and French identify distressed firms by dividing a stock’s book value by its market value; a firm with a high book value per share relative to its market price per share is a lower-priced stock. However,

Risk Exposure Profiles



Expected Premiums

Average Historical Excess Return (%)	HYD with Altria: Regression Results		
	Column A	Column B	(Col. A) X (Col. B) (%)
Market	8.25	Market Beta	0.98 8.09
Size	3.73	Size “Beta”	-0.05 -0.19
Book-to-Mkt	5.01	Book-to-Mkt “Beta”	0.65 3.26
Total			11.16
Minus Market Excess Return			8.25
Expected Premium over Market, HYD with Altria			2.91
Expected Premium over Market, HYD without Altria			2.16
Expected Premium over Market, Russell 1000 Value			1.76

the numerator could just as easily be a firm's earnings or its dividend per share; the key is to use the market price in the denominator and to "scale" it consistently by using a reliably ascertainable numerator. In our high-yield Dow approach we prefer dividends for the numerator, which represent cash payments versus accounting measures such as book value or earnings.

We ran the returns for our high-yield Dow models (with and without Altria) between January 1979 and June 2006 in the three-factor model to determine their

exposures to each of these compensated forms of risk. The results are plotted in the accompanying chart. Size is measured along the vertical axis, and book-to-market (growth versus value) along the horizontal axis. Each axis represents a spectrum of exposure to these two factors; portfolios that assume high size risk (those dominated by small-caps) plot high on the size axis, while portfolios that assume a lot of distress risk (dominated by value oriented stocks) plot farther to the right on the book-to-market axis.

The analysis reveals that the portfolio

that includes Altria has more book-to-market (value) exposure than the model that excludes it. The higher book-to-market ratio reflects the extra risks to which the portfolio is exposed when Altria is included. The table below the chart calculates the expected return premium for the model that includes Altria, and provides a comparison with the model that excludes Altria as well as the Russell 1000 Value Index. The slightly higher expected return premium garnered by including Altria bolsters our rationale for reintroducing the shares at this time.

THE PENSION PROTECTION ACT OF 2006

Faced with increasingly anxious pensioners and the upcoming mid-term elections, Congress passed a long-awaited comprehensive pension reform bill. The mammoth, 900-page Pension Protection Act (PPA) contains modest measures to address potential failures of traditional defined benefit plans which currently cover some 44 million participants, (see "The Decline of the Defined Benefit Plan" in the February 2006 *Investment Guide*).

More importantly, the Act accelerates the shift, underway for many years, from defined benefit to defined contribution retirement programs and places more of the responsibility for retirement planning on individuals. It includes more incentives for individuals to save and increases the flexibility and portability of retirement accounts. These are by and large positive developments that recognize major changes in the economy and the nature of the workforce.

Traditional Pension Plans

The "pension reform" part of the bill addresses funding, reporting and disclosure, plan termination, benefit rules and participant education. The new law greatly strengthens the Pension Benefit Guaranty Corporation (PBGC) which has been widely criticized as an inadequate fund of "last resort" to protect private pension plans.

The Act alters the actuarial methods of determining the present value of plan liabilities by introducing a new interest rate and mortality table. This will require sponsors to meet more realistic funding projections. The Labor Department estimates that 30,000 pension plans are currently under-funded by some \$450 billion. Under the new legislation "at-risk" plans have seven years to close the gap in pension liability shortfalls. Airlines re-

ceived special treatment and have between 10 and 17 years. Companies will be allowed a higher limit on the deductibility of contributions to pension plans.

Starting with the post-2007 plan years the variable rate premium for PBGC insurance will be based on a plan's unfunded vested benefits using a new calculation. Limits will also be imposed upon the extent to which PBGC will guarantee benefits due to certain contingent events. These measures should shore up PBGC to some extent.

Defined Contribution and Other "Cash" Savings Plans

In recent years defined contribution plans have come to dominate the retirement landscape. The PPA includes many

incentives to encourage increased savings in these plans. It makes automatic enrollment in 401(k) plans easier; going forward, employees must affirmatively "opt-out" in order to not participate. Additionally the safe-harbor provisions for participant education now allow for "personalized" investment advice from fiduciary advisers, with certain limitations.

Many retirement related provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA") were slated to sunset in 2010. Under PPA higher retirement savings contribution limits become permanent. These include:

- Permanent higher dollar amount for IRA contributions—these max-out at \$5,000 in 2008 and are inflation ad-

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"The employees have to assume a share of the blame for allowing the pension fund to become so big and tempting."

justed thereafter.

- Permanent higher dollar limits on defined contribution plans.
- Permanent "catch-up" contributions for older works for IRAs, SIMPLE IRAs and 401(k) plans.
- Permanent portability for 403(b) and 457 plans—which are eligible for expanded rollover options.
- Permanent higher deductible amounts for employer contributions.

New Rules Affect Charitable Giving

A Provision of the bill will make it

easier to donate IRA savings to charity. In 2006 and 2007, individuals who are 70 1/2 or older can take tax-free withdrawals from their IRAs as long as that money goes directly to charity.

This may provide a major tax advantage for retirees who no longer pay a lot of mortgage interest and don't have large enough deductions to itemize. Filers who do still itemize will be able to reduce their income and avoid some of the unintended consequences of itemized deductions (e.g., a phase-out of the personal exemption).

The law removes the ever popular deduction for donations of used clothing and household items unless the items are in "good" condition, though it leaves the definition of "good condition" to the imagination. According to the IRS, individuals reported \$36.9 billion in such "non-cash" contributions in 2003. Additionally, no deduction will be allowed for contributions unless the donor can provide a written record. This will add to the administrative burdens on charities. Make sure a receipt book accompanies the donation plate at your local congregation.

THE HIGH-YIELD DOW INVESTMENT STRATEGY

For most investors seeking exposure to U.S. large capitalization value stocks, we recommend either of the two large cap value funds listed on page 64. However, investors who have more than \$100,000 to dedicate to this asset class might instead consider our high-yield Dow (HYD) investment strategy (\$100,000 is the minimum we estimate that is necessary to ensure that trading costs are reasonable relative to the value of the portfolio). The strategy is especially well suited for certain trusts or other accounts that have an explicit interest in generating investment income, but which also seek capital appreciation. Unlike several popular but simplistic "Dogs of the Dow" methods, our HYD model is based on an exhaustive review of monthly prices, dividends and capital changes pertaining to each of the stocks that have comprised the Dow Jones Industrial Average beginning in July 1962.

Though the model follows an exacting stock-selection strategy (see accompanying box), investors can easily establish and maintain a high-yield Dow portfolio; all that is required is discipline applied on a monthly basis. **INVESTMENT GUIDE subscribers can establish and maintain a portfolio simply by ensuring that their portfolios are allocated to reflect the percentage valuations listed in the table to the right. Each month this table will reflect the results of any purchases or sales called for by the model.**

For investors who do not wish to manage their own accounts, we can manage an HYD portfolio on your behalf through our low-cost HYD investment service. Contact us at (413) 528-1216 or email: aisinfo@americaninvestment.com.

Getting Into Altria

As discussed in this month's lead article, we are reintroducing Altria (formerly Philip Morris, ticker MO) into our high-yield Dow (HYD) investment strategy.

HYD: The Nuts and Bolts

Our HYD model began by incrementally "investing" a hypothetical sum of \$1 million over 18 months. Specifically, one eighteenth of \$1 million (\$55,000) was invested equally in each of the 4 highest-yielding issues in the Dow Jones Industrial Average each month, beginning in July 1962. Once fully invested (January 1964) the model began a regular monthly process of considering for sale only those shares purchased 18 months earlier, and replacing them with the shares of the four highest-yielding shares at that time. The model each month thus mechanically purchases shares that are relatively low in price (with a high dividend yield) and sells shares that are relatively high in price (with a low dividend yield), all the while garnering a relatively high level of dividend income. The model also makes monthly "rebalancing" trades, as required, in order to add to positions that have lagged the entire portfolio and sell positions that have done better.

For a thorough discussion of the strategy, we recommend AIER's booklet, "How to Invest Wisely," \$12).

Of the four stocks eligible for purchase this month, **Citigroup** and **Altria** were not eligible for purchase 18 months earlier. HYD investors should find that the indicated purchases of Citigroup and Altria, and sales of **Merck** and **JPMorgan Chase** are sufficiently large to warrant trading. In larger accounts, rebalancing positions in **Verizon** and **AT&T Corp** (formerly SBC Communications) may be warranted.

Recommended HYD Portfolio

As of August 15, 2006

	Rank	Yield	Price	Status	Value	No. Shares ¹	Percent of Portfolio*
Verizon	1	4.71%	34.39	Holding**	22.63	23.76	
AT&T Corp	2	4.38%	30.36	Holding**	25.99	30.91	
CitiGroup	3	4.05%	48.41	Buying	10.41	7.76	
Altria Group	4	3.95%	80.96	Buying	1.53	0.68	
Merck	5	3.71%	40.95	Selling	25.34	22.34	
DuPont	6	3.70%	39.97				
Pfizer	7	3.64%	26.40	Holding	5.76	7.88	
General Motors	8	3.27%	30.54	*			
JPMorgan Chase	9	3.02%	45.04	Selling	8.33	6.68	
General Electric	10	3.01%	33.20				
					100.0	100.0	

* The strategy excludes 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.

Our decision reflects a desire to reverse our entirely subjective decision to exclude MO in March 2000, and return to a stock selection strategy that is based purely on empirical analysis. We have no idea what MO's short-term outlook is, and our decision to adjust the model at this time does not in any way constitute an attempt to "time" the market. While Altria's fate is unknown, we are confident that its relative yield is a reliable indicator of whether it is appropriate for inclusion in a well-constructed large-cap value portfolio.

Readers who have been following our model will have to adjust their holdings accordingly. In order to avoid dramatic portfolio alterations, we will reintroduce MO incrementally. Specifically, over the next 18 months our model portfolio (reflected in the accompanying Recommended HYD Portfolio table) will add shares of MO when and only when it ranks it among the four highest yielding shares among the Dow 30 when ranked by their dividend yield. At the end of 18 months (February 2008) the model's composition will be identical to a model portfolio that, from its inception in July 1962, had never excluded MO from consideration.

Hypothetical Returns: HYD and Relevant Indices

The total returns presented in the table below represent changes in the value of a hypothetical HYD portfolio with a beginning date of January 1979 (the longest period for which data was available for the HYD model and relevant indexes). See the accompanying box for a description of the model's construction. The data in the table (as well as on the front-page chart) reflect the returns of the model had Philip Morris (now Altria) been purchased whenever warranted by our 4-for-18 methodology. The data do *not* reflect the returns of the model depicted in the accompanying Recommended HYD Portfolio table, which takes a "phased in" approach (described herein) to transitioning from a model portfolio that had excluded Altria to one that had never excluded it.

	Hypothetical Total Returns (percent)*						Since	Std.
	1 mo.	1 yr.	5 yrs.	10 yrs.	15 yrs.	1/79	Dev.	
Dow	0.45	7.60	3.47	9.39	11.55	N.A.	N.A.	
Russell 1000								
Value Index	2.43	11.58	7.45	11.54	12.61	14.36	14.02	
HYD Strategy	7.96	24.81	8.08	13.32	15.47	18.34	17.19	

*Data assume 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 is the standard deviation of those returns since January 1979, where available. Model HYD 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. Historical performance results for investment indexes and/or categories generally do not reflect the deduction of transaction and/or custodial charges or the deduction of an investment-management fee, the incurrence of which would have the effect of decreasing historical performance results.

THE DOW JONES INDUSTRIALS RANKED BY YIELD*

Ticker Symbol	Market Prices			12-Month			Latest Dividend			Indicated	
	8/15/06	7/14/06	8/15/05	High	Low	Amount	Date	Paid	Annual Dividend	Yield† (%)	
Verizon	VZ	34.39	31.62	32.99	35.17	29.13	0.405	7/10/06	8/01/06	1.620	4.71
AT&T	T	30.36	26.58	23.23	31.16 H	21.79	0.333	7/10/06	8/1/06	1.330	4.38
Citigroup	C	48.41	47.58	43.79	50.72	42.91	0.490	8/07/06	8/25/06	1.960	4.05
Altria Group	MO	80.96	77.39	67.02	81.69 H	66.95	0.800	6/15/06	7/10/06	3.200	3.95
Merck	MRK	40.95	36.15	30.66	41.78 H	25.50	0.380	9/01/06	10/02/06	1.520	3.71
DuPont	DD	39.97	39.67	41.51	45.75	37.60	0.370	8/15/06	9/12/06	1.480	3.70
Pfizer	PFE	26.40	22.42	26.20	26.84	20.27	0.240	8/11/06	9/05/06	0.960	3.64
General Motors	GM	30.54	27.47	34.54	35.02	18.33	0.250	8/11/06	9/09/06	1.000	3.27
J. P. Morgan Chase	JPM	45.04	40.89	34.65	46.80	32.92	0.340	7/06/06	7/31/06	1.360	3.02
General Electric	GE	33.20	32.11	34.21	36.34	32.06	0.250	6/26/06	7/25/06	1.000	3.01
Coca-Cola	KO	44.32	42.65	43.54	44.79 H	39.36	0.310	9/15/06	10/01/06	1.240	2.80
3M Company	MMM	69.78	71.22	72.18	88.35	67.05 L	0.460	8/25/06	9/12/06	1.840	2.64
Honeywell Intl.	HON	38.27	37.01	38.87	44.48	32.68	0.228	8/18/06	9/08/06	0.910	2.38
Johnson & Johnson	JNJ	64.41	60.46	63.35	65.33	56.70	0.375	8/29/06	9/12/06	1.500	2.33
Intel Corp.	INTC	18.13	17.88	26.53	27.49	16.75	0.100	8/07/06	9/01/06	0.400	2.21
Alcoa	AA	28.49	30.79	29.24	36.96	22.28	0.150	8/04/06	8/25/06	0.600	2.11
Procter & Gamble	PG	60.44	55.66	54.18	62.50	52.75	0.310	7/21/06	8/15/06	1.240	2.05
McDonald's	MCD	35.50	33.04	33.60	36.75	31.31	0.670	11/15/05	12/01/05	0.670	1.89
Exxon Mobil	XOM	68.69	64.90	60.42	70.42 H	54.50	0.320	8/14/06	9/11/06	1.280	1.86
Caterpillar (s)	CAT	67.41	69.19	55.26	82.03	48.25	0.300	7/20/06	8/19/06	1.200	1.78
Home Depot, Inc.	HD	34.44	33.84	41.61	43.95	32.85 L	0.150	6/08/06	6/22/06	0.600	1.74
United Tech. (s)	UTX	61.03	58.81	51.75	66.39	49.29	0.265	8/18/06	9/10/06	1.060	1.74
Boeing	BA	76.58	77.25	67.46	89.58	62.01	0.300	8/11/06	9/01/06	1.200	1.57
IBM	IBM	77.08	73.57	82.50	89.94	72.73 L	0.300	8/10/06	9/09/06	1.200	1.56
Wal-Mart Stores	WMT	44.55	43.05	49.10	50.87	42.31	0.168	8/18/06	9/05/06	0.670	1.50
Microsoft Corp.	MSFT	24.62	22.29	27.13	28.38	21.46	0.090	8/17/06	9/14/06	0.360	1.46
American Express ++	AXP	52.81	51.27	56.53	59.50	46.59	0.150	7/07/06	8/10/06	0.600	1.14
AIG	AIG	62.59	57.76	62.16	71.09	57.52 L	0.165	9/01/06	9/15/06	0.660	1.05
Hewlett-Packard	HPQ	33.99	30.76	24.09	34.52	23.66	0.080	9/13/06	10/04/06	0.320	0.94
Walt Disney	DIS	29.64	28.49	26.17	31.03	22.89	0.270	12/12/05	1/06/06	0.270	0.91

* See the Recommended HYD Portfolio table on page 62 for current recommendations.

† Based on indicated dividends and market price as of 8/15/06. 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.

RECENT MARKET STATISTICS

Precious Metals & Commodity Prices				Securities Markets					
	8/15/06	Mo. Earlier	Yr. Earlier		8/15/06	Mo. Earlier	Yr. Earlier		
Gold, London p.m. fixing	625.50	663.25	442.20	S & P 500 Stock Composite	1,285.57	1,236.20	1,233.87		
Silver, London Spot Price	11.99	11.63	7.07	Dow Jones Industrial Average	11,230.26	10,739.35	10,634.83		
Copper, COMEX Spot Price	3.56	3.83	1.77	Dow Jones Transportation Average	4,282.82	4,590.60	3,761.59		
Crude Oil, W. Texas Int. Spot	73.05	77.03	66.27	Dow Jones Utilities Average	438.20	418.12	397.14		
Dow Jones Spot Index	283.10	287.03	233.45	Dow Jones Bond Average	188.01	185.06	188.78		
Dow Jones-AIG Futures Index	172.09	179.96	164.53	Nasdaq Composite	2,115.01	2,037.35	2,167.04		
CRB-Bridge Futures Index	338.76	357.21	318.91	Financial Times Gold Mines Index	2,393.78	2,469.24	1,690.16		
				FT African Gold Mines	3,020.90	3,236.94	1,969.67		
				FT Australasian Gold Mines	6,986.40	7,175.88	4,671.19		
				FT North American Gold Mines	1,956.98	1,989.20	1,428.51		
Interest Rates (%)				Coin Prices					
U.S. Treasury bills -	91 day	5.08	5.04	3.50					
	182 day	5.18	5.25	3.80					
	52 week	5.08	5.19	3.92					
U.S. Treasury bonds -	10 year		5.07	4.28	American Eagle (1.00)	\$662.25	\$638.15	445.15	
Corporates:					Austrian 100-Corona (0.9803)	\$630.33	\$607.43	423.83	
High Quality -	10+ year	6.08	6.22	5.42	British Sovereign (0.2354)	\$156.35	\$150.75	106.05	
Medium Quality -	10+ year	6.48	6.62	5.79	Canadian Maple Leaf (1.00)	\$662.50	\$638.40	445.40	
Federal Reserve Discount Rate		6.25	6.25	4.50	Mexican 50-Peso (1.2057)	\$777.10	\$748.90	522.80	
New York Prime Rate		8.25	8.25	6.50	Mexican Ounce (1.00)	\$644.60	\$621.10	433.50	
Euro Rates	3 month	3.21	3.06	2.13	S. African Krugerrand (1.00)	\$653.05	\$629.05	439.95	
Government bonds -	10 year	3.89	4.09	3.29	U.S. Double Eagle-\$20 (0.9675)			4.40	
Swiss Rates -	3 month	1.58	1.53	0.76	St. Gaudens (MS-60)	\$655.00	\$675.00	500.00	
Government bonds -	10 year	2.68	2.87	2.02	Liberty (Type I-AU50)	\$762.50	\$695.00	675.00	
				Liberty (Type II-AU50)	\$660.00	\$655.00	497.50		
				Liberty (Type III-AU50)	\$640.00	\$630.00	460.00		
Exchange Rates				U.S. Silver Coins (\$1,000 face value, circulated)					
British Pound		\$1.393200	\$1.837700	1.811800	90% Silver Circ. (.715 oz.)	\$8,575.00	\$7,700.00	4,917.50	
Canadian Dollar		\$0.890100	\$0.886000	0.833800	40% Silver Circ. (.292 oz.)	\$3,405.00	\$3,020.00	2,000.00	
Euro		\$1.278500	\$1.264900	1.236800	Silver Dollars Circ.	\$9,775.00	\$9,700.00	5,39	
Japanese Yen		\$0.008613	\$0.008604	0.009155					
South African Rand		\$0.145800	\$0.138700	0.155300					
Swiss Franc		\$0.808400	\$0.810100	0.797000					
Recommended Mutual Funds									
Short-Term Bond Funds	Ticker Symbol	8/15/06	Month Earlier	Year Earlier	— 52-Week —	Distributions Income	Latest 12 Months Capital Gains	Yield (%)	
iShares Lehman 1-3 Yr Treasury ³	SHY	\$79.84	\$79.59	80.62	81.10	79.26	3.2449	0.0000	4.06
Vanguard Short-term Inv. Grade	VFSTX	\$10.48	\$9.79	10.54	10.60	9.75	0.4223	0.0000	4.03
Income Equity Funds									
DNP Select Income ^{1,2}	DNP	\$10.51	\$10.41	11.49	11.75	9.74	0.7850	0.0000	7.47
Vanguard REIT Index	VGSIX	\$22.93	\$22.04	19.80	23.31	18.47	0.7605	0.3023	3.32
Large Cap. Value Equity Funds									
iShares S&P 500 Value Index ³	IVE	\$69.60	\$66.75	64.31	71.81	60.40	2.5476	0.0000	3.66
Vanguard Value Index	VIVAX	\$24.18	\$23.11	22.09	24.29	20.88	0.5850	0.0000	2.42
Small Cap. Value Equity Funds									
iShares Sm. Cap. 600 Value Index ³	IJS	\$67.55	\$65.80	63.92	75.42	59.28	0.7495	0.0000	1.11
Vanguard Sm. Cap Value Index	VISVX	\$15.51	\$15.09	14.69	16.49	13.76	0.2690	0.0000	1.73
iShares Russell Microcap Index ⁵	IWC	\$51.22	\$50.74	N/A	56.26	47.06	0.1747	0.0000	0.34
Growth Equity Funds									
iShares S&P 500 Growth Index ³	IVW	\$59.19	\$56.80	58.94	61.76	56.05	0.7171	0.0000	1.21
Vanguard Growth Index	VIGRX	\$29.90	\$26.06	27.05	28.69	25.79	0.2350	0.0000	0.79
Foreign Equity Funds									
iShares MSCI EAFE Index ⁴	EFA	\$67.02	\$62.68	55.47	70.65	54.55	1.1097	0.0000	1.66
iShares MSCI EAFE Value Index ⁴	EFV	\$64.92	\$60.08	52.70	67.28	51.15	0.2542	0.0000	0.39
Vanguard Developed Mkts Index ⁴	VDMIX	\$11.57	\$10.81	9.54	12.17	9.46	0.2190	0.0000	1.89
iShares Emerging Markets Index ³	EEM	\$98.20	\$89.00	79.60	111.25	74.85	0.9875	0.0000	1.01
Vanguard Emerging Market Index	VEIEX	\$20.91	\$19.49	17.11	23.85	16.41	0.3150	0.0000	1.51
Gold-Related Funds									
iShares COMEX Gold Trust ³	IAU	\$62.00	\$66.08	44.16	72.32	42.86	0.0000	0.0000	0.00
streetTRACKS Gold shares	GLD	\$62.01	\$65.85	44.13	72.26	42.81	0.0000	0.0000	0.00
Recommended Gold-Mining Companies									
	Ticker Symbol	8/15/06	Month Earlier	Year Earlier	— 52-Week —	Distributions			
					High	Low	Latest Frequency	Yield (%)	
Anglogold Ltd., ADR	AU	\$48.58	\$47.58	36.23	62.20	34.58	0.410	Semiannual	0.84
Barrick Gold Corp. ^{†\$}	ABX	\$31.02	\$30.34	27.08	36.03	24.58	0.187	Semiannual	0.60
Gold Fields Ltd.	GFI	\$20.12	\$23.14	11.64	26.95	10.69	0.230	Semiannual	1.14
Newmont Mining	NEM	\$50.69	\$54.96	41.06	62.72	38.40	0.400	Quarterly	0.79
Rio Tinto PLC ^{‡ *}	RTP	\$206.38	\$204.45	150.05	253.33	139.30	3.260	Semiannual	1.58

¹ Closed End Fund, traded on NYSE. ² Dividends Paid Monthly. ³ Exchange traded Funds, traded on NYSE. ⁴ New listing this month, replacing IEV and VEURX. ⁵ New listing as of July 2006. [†] Dividend shown is after 15% Canadian tax withholding. [‡] Not subject to U.K. withholding tax. [§] Barrick Gold Corp. took over Placer Dome (PDG) on 2/28/06. * Dividends reported do not include a special dividend of \$4.40 payable April 7, 2006.

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