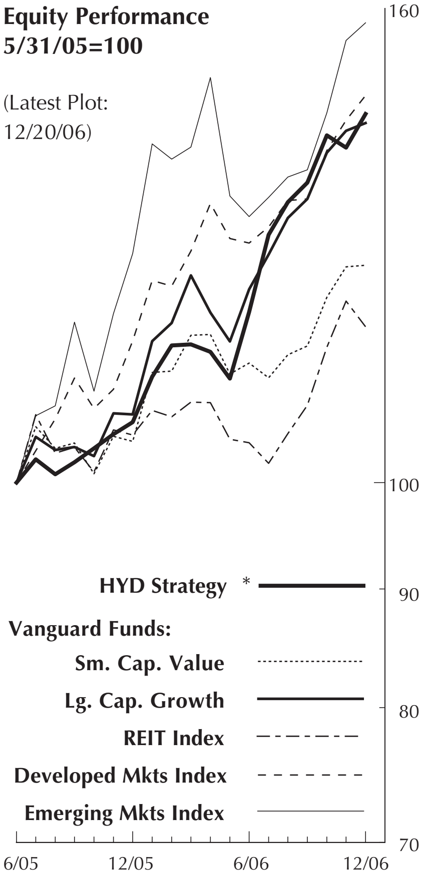
INVESTMENT GUIDE
Published Monthly by

American Investment Services, Inc.

Vol. XXVIII, No. 12 Great Barrington, Massachusetts 01230 December 29, 2006

Equity Performance
5/31/05=100

(Latest Plot: 12/20/06)



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

Lessons from Thailand

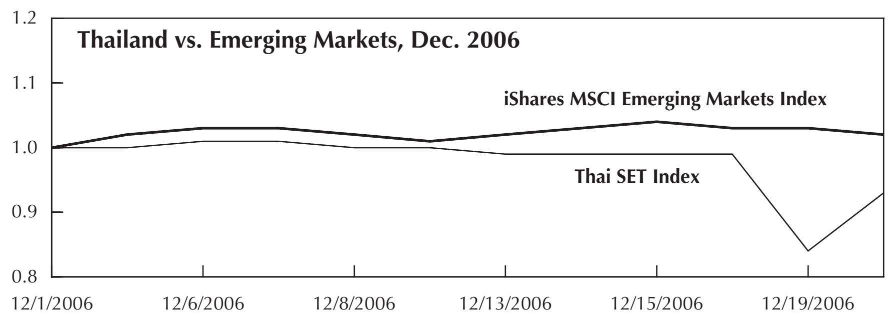
Thailand's new government, installed via military coup in September, blundered badly when, on December 19th, it imposed new restrictions on foreign investors. The result was bad for Thailand and bad for emerging market investors who were diversified inadequately. We suspect, however, that the lessons conveyed will ultimately prove to be a boon to capital markets, global prosperity, and perhaps freedom in general.

The government had apparently decided that too much foreign investment was a bad thing. An inflow of capital that had sent the Thai stock market skyrocketing had also sent the Thai currency (the Baht) to new highs. This in turn hampered export growth. The new rules were harsh: foreign investors were required to lock up 30 percent of their funds with the Thai central bank and investors who decided to pull out of Thailand before one year would lose one third of their "deposit."

This was not a great day for emerging-market investors, but neither was it disastrous. The restrictions were revised quickly and Thai stocks partially rebounded in response. The damage to the government's credibility however, had been done. The Thai stock market plunged 15 percent, but the Vanguard Emerging Markets Index, which tracks the MSCI Emerging Markets Index, lost only 1 percent.

It is encouraging that, unlike the Asian crisis ten years ago, the market's rebuke was confined largely to Thailand. The message to interventionists is clear: capital markets will discriminate brutally between governments that respect property rights and those that do not. The goal of an *emerging* nation is, presumably, to one day *emerge*, and join the ranks of developed nations. This distinction will be made not by declaration of the United Nations, the World Bank, or by inclusion in any politically determined assemblage of nations. These countries will know they have "arrived" when, among other things, they appear among developed market indexes.

Investors should maintain their exposure to emerging markets by adhering to the recommended portfolio allocations we publish quarterly. This asset class will continue to be highly volatile. These nascent, often narrowly based economies are inherently more vulnerable than developed economies, and political risks will not disappear. Patient investors will be rewarded commensurately.



ESTATE PLANNING FOR CONCENTRATED STOCK POSITIONS*

The following article appeared in Estate Planning*, a journal written for investment advisors. It provides an excellent summary of options available to investors: what to do with large holdings of an individual security that has substantial unrealized capital gains.*

The author explains how life insurance can be used as one alternative. Our only caution is that investors ensure that life insurance is appropriate for their particular situation, and that fees are held to a minimum. Charitable Remainder Trusts (CRTs) are also described as a viable alternative for those with charitable intentions. For more information on how AIS can manage a CRT on behalf of a charity you name contact us at (413) 528-1216.

It is not uncommon for a financial adviser's wealthiest clients to hold concentrated stock positions. After all, it is likely that this concentrated position is what created the wealth for the client. Whether the stock was from an initial public offering (IPO), stock options, the sale of a closely held business, or a distribution from an ESOP or 401(k) plan that held employer stock, the bottom line is that the client currently holds a substantial amount of their net worth in a single stock position. Now that the wealth has been created, client concerns may shift to reducing the risk of holding a nondiversified portfolio, preserving the estate for heirs, or looking for ways to create income with a reduced tax burden. Aside from the diversification and income tax issues, holding a concentrated stock position also poses unique estate disposition problems.

Estate Disposition Issues

When looking at a concentrated stock position from a wealth transfer perspective, the following issues typically need to be addressed:

- Is it better to hold the stock in the estate until death in order to get a stepped-up basis and avoid capital-gains tax, or is it preferable to transfer the stock (and remove any potential future appreciation) from the estate to avoid estate taxation at death?
- If estate taxes will be due, is there sufficient liquidity in the estate so a large block of concentrated stock does not need to be liquidated in a down market?
- If the stock needs to be liquidated to pay estate taxes, will selling a large block in a single transaction negatively impact the price?
- Are there strategies available that can diversify the portfolio while accomplishing the client's tax management, risk management, charitable planning, and asset protection objectives?

In general, for clients who are expected to have taxable estates, avoiding the more onerous estate tax will probably be more cost effective than holding the stock until death in order to avoid capital-gains tax. In today's environment, capital-gains rates are a relatively low 15 percent[1] compared to current estate tax rates of 46 percent.[2] Therefore, strategies that can remove the stock position from the taxable estate can provide liquidity so the stock does not need to be liquidated to pay estate tax at death, or can dispose of the stock in order to diversify in a tax efficient manner may be attractive to the client.

Removing the Asset from the Estate

One option for the client is to simply gift some or all of the shares to an irrevocable trust. This freezes the value of the stock for transfer tax purposes and also removes any future appreciation from the taxable estate. The irrevocable trust can also provide creditor protection and serve as an instrument to promote family values and pass wealth down through multiple generations. Assuming the stock is expected to continue appreciating, this simple strategy may be appropriate. While estate taxes are saved, the grantor's cost basis is carried over and there will be income tax consequences once the stock is ultimately disposed of.

If diversification or liquidity is an issue, or the stock is not expected to continue appreciating as rapidly, strategies for selling the stock might be considered.

Tax Efficient Diversification

There are several options for a client looking to diversify a concentrated stock position in a tax efficient manner. These would include:

Selling the stock at the currently low capital-gains rate. As previously mentioned, today's 15 percent capital-gains rates are close to historic lows. While the client and adviser will need to analyze the decision to sell by making educated guesses as to the future of capital-gains rates, the growth rate of the stock, and other investment options, selling at today's low rate may be a very attractive alternative. If desired, the sale proceeds can then be gifted in order to reduce future estate taxes.

Monetizing the stock position. Monetization is the process of borrowing or forward selling against the stock position. This can provide immediate cash flow without immediate income tax consequences. The cash created by the monetization strategy can be reinvested in a diversified portfolio or other assets like life insurance or real estate. The reinvested proceeds can also be gifted outside the estate into an irrevocable trust.

By margining the stock and making gifts, the client is reducing the taxable estate to the extent of the margin loan. Margining the stock does carry the risk of a potential margin call in the event of a substantial decline in the stock price and also carries an interest cost.

With a variable forward sale, the client can receive tax free upfront cash payments that can be used for gifting or diversification. The client agrees to deliver stock or cash to the buyer of the forward sale at a future date. Unlike a margin loan, the forward sale provides a hedge against stock price decline and does not have a loan interest charge.

Selling the stock inside a charitable remainder trust (CRT). The charitable remainder trust can be an effective vehicle for repositioning a concentrated stock portfolio for a client who might be charitably inclined or already making charitable gifts. The CRT is a tax-exempt entity, which would permit the transferred stock to be sold without immediate tax

---

* This article, written by James Allen, originally appeared in the August 2006 issue of *Estate Planning*, published by the Society of FSP. For more information, please visit www.financialpro.org. Mr. Allen, CFP, CLU, ChFC, CAP, is vice president of advanced markets for MetLife Investors in Irvine, Calif. His articles have been previously featured in the Journal of *Financial Service Professionals*, and he is also a coauthor of the National Underwriter publication *The Tools & Techniques of Charitable Giving*. James has been a member of the Society of FSP since 1991.

[1] The current long term capital gain rate of 15 percent is scheduled to expire in 2011.

[2] Under EGTRRA, the top estate tax rate changes to 45 percent for 2007–2009, the estate tax is repealed in 2010, and becomes 55 percent in 2011.

consequences, thus allowing the entire sale proceeds to be reinvested. The client would create a charitable remainder trust and would have an income interest in the trust with the remainder value passing to charity when the trust ends. The client can choose some of the trust terms such as the duration of the trust and the payout percentage.[3] The client (donor) then transfers the stock position to the trust and will receive a charitable income tax deduction which is based generally on the present value of what the charity is calculated to receive when the trust terminates. The trustee of the CRT can sell the stock position and reinvest the proceeds into other income-producing assets, and will pay the stated payout percentage or annuity amount to the donor at least annually. While the sale of the stock inside the CRT does not generate immediate taxation because the CRT is a tax-exempt entity, the CRT payments to the donor are taxable based on a four-tiered system. Consequently, the use of a CRT does not eliminate taxes; it simply defers them until payments are received by the donor. The CRT also has the added benefit of removing the stock position from the client's taxable estate as the remainder value of the trust passes to charity.

A common strategy for diversifying a concentrated stock position using a CRT would be to contribute some of the stock position to the CRT and then sell some of the stock outright. The tax deduction created by the contribution to the CRT can be used to offset the capital gains tax on the outright sale thus reducing or eliminating tax on the sale. The client would have an income stream from the CRT as a well as cash to reinvest or gift. A portion of the sale proceeds can also be used to purchase life insurance to replace for the heirs what they are losing as the trust remainder will pass to charity not to heirs.

The Role of Life Insurance

Life insurance can be used in a variety of ways when planning with a concentrated stock portfolio. Life insurance can provide liquidity at death so the portfolio does not have to be liquidated during a bear market. It can also eliminate the need to sell a large block of stock that may cause a decrease in market value. Additionally, life insurance can be a potential asset to include in the newly diversified portfolio. Secondary guarantee universal life, current assumption universal life, or whole life products can provide attractive internal rates of return on cash value or death benefit and can serve as part of the fixed income portion of the client's newly diversified portfolio. Finally, life insurance can be used as a tax efficient investment alternative inside an irrevocable trust that has been established using gifted proceeds from the sale or monetization of the stock position.

Conclusion

Planning for concentrated stock positions presents the adviser with unique asset management, risk management, tax management, and wealth preservation issues. By employing the appropriate strategies, a client can diversify with minimized tax consequences and more readily accomplish his or her wealth management objectives.

[3] There are limitations on the duration and payout percentages allowed in a CRT.

HOW SAFE IS YOUR BANK ACCOUNT?

Innovations in the banking industry have made it easier than ever to use your bank account to pay bills and make deposits. Instead of using paper checks or paper deposits slips, you can make automatic payments or receive deposits electronically. You can even authorize transactions with just a phone call (and no prior written consent). While the shift toward electronic payments has made banking more efficient, it has created new potential for fraudsters to exploit the system. Your account is vulnerable even if you do all your banking "the old-fashioned way."

In the 1970s the banking industry, seeking to reduce the cost of processing the growing volume of paper checks, developed an electronic payments network that enabled banks to send payment information back and forth to each other electronically. The network grew and by 1978 spanned the entire nation—and with that the Automated Clearing House (ACH) network was born. Use of the ACH network has grown rapidly, and in the fourth quarter of 2005 over 2.8 billion transactions worth over $6 trillion were processed through it.

Processing a payment through the ACH network costs banks about one fifth what they spend to process a paper check. The network also makes it easier for banks to avoid phony, forged, or doctored paper checks. However, as the ACH network has grown in scope and popularity, traditional check fraud is increasingly being replaced by a new problem— electronic ACH fraud.

How the System Works

Through the ACH network all the information necessary to conduct a transaction can travel electronically from bank to bank: the account number, the bank's routing number, and the amount of the transaction. A central ACH operator, currently either the Federal Reserve or the

Credit: Steve Breen & Copley News Service private Electronic Payments Network, coordinates the settlement between the two banks, with an account at one bank getting debited and an account at the other bank getting credited.

The process begins when one party, the "originator," submits an entry through its bank to either debit or credit a recipient's account. The originator's bank batches all the ACH entries, nets out any transactions for which they hold the recipient's account as well, and then submits the remaining entries to the ACH operator. An ACH entry can be used to withdraw money or to deposit it. For example, the ACH network is used when your employer deposits your pay directly into your bank account or the government directly deposits your Social Security check or tax refund. It is also used to make checkless withdrawals. If your mortgage or cable bill is deducted automatically each month from your bank account, the payment travels through the ACH network.

Even if you do not pay your bills electronically or use direct deposit, your banking information has probably traveled over the network. Companies that accept checks can now take the information off a check and finish processing the payment through the ACH network. If you pay a check in person and the merchant scans the check and hands it back to you, that payment is going to clear through the ACH network. If you mail a check, it may be converted into electronic form. When this happens, the paper check is destroyed and replaced with an electronic image.

A key difference between checks and electronic payments is that when funds are electronically debited through the ACH network, *the transaction is initiated by the business that is going to receive the funds, not by the person paying the bill*. If you pay your phone bill automatically, each month the phone company, not you, instructs the bank to have money withdrawn from your account and deposited into its account.

When recurring automatic payments are involved, the originating party (say, the phone company) must, by law, get written permission from you before it can access your bank account. Often it requires a voided check as proof of authorization, proof that the account exists, and to provide the necessary routing information off the check. However, businesses are increasingly using the ACH network in other ways that do not require your written permission.

Phoning It In

One such transaction is a "Telephone Initiated Entry," which the ACH network has accepted since 2001. This is similar to paying for something over the phone with a credit card, but instead of providing your credit card number you provide your banking account information off the bottom of your check. This can be convenient if, say, you are rushing to make a mortgage payment on time. However, unlike other types of ACH transactions, *no written approval is required*—and the potential for fraud is thus greatly increased.

The company initiating the telephone transfer through the ACH network is required to use "commercially reasonable procedures" to verify the identity of the customer. But the definition of commercially reasonable procedures is weak. Businesses are only required to record your verbal authorization *or* hold off on making the transfer until they send you written confirmation that you verbally authorized it. They seldom use written confirmations (these take too long, thereby defeating one of the main attractions of phone transfers). So usually they just record your phone authorization.

The problem is that it is difficult to verify a person's identity over the phone. (There's no way to show your driver's license to anyone.) Some companies ask for key information, such as your mother's maiden name. Others ask for nothing more than the account information printed on your checks.

This means that the only thing a fraudster needs to try to access your bank account is the string of numbers on the bottom of your check. Armed with your account information, he can pick up the phone, pretend to be you, and "authorize" a debit from your account. Because it is so easy to make a Telephone Initiated Entry, the information on any one of your checks is potentially just as sensitive as the information on your credit card and needs the same level of protection.

The rules governing these transactions do offer some protection. Set by the National Automated Clearing House Association (NACHA) and based on the Federal Reserve's "Regulation E," they treat phone-initiated transfers as "single entry" payments. This means that each payment requires a separate phone authorization. Second, if you do not have an existing relationship with a company they can not call you to initiate a transfer.

However, ACH fraud often occurs when an unscrupulous company or person violates this rule and calls you to obtain your banking information and authorization to debit your account. They may even record your conversation so they can replay your "authorization" to other companies. Never give your bank routing number, your account number, or even the name of your bank to a telemarketer.

Standard Entry Class codes you may see on your bank statement:

ARC – Accounts Receivable Truncated Check
: You send a paper check by U.S. mail to a merchant; the merchant converts it into an electronic ACH entry. The paper check is destroyed.

POP – Point-of-Purchase (Electronic Check Conversion)
: You pay a check in person; the merchant immediately takes payment information from the check and processes it through the ACH network. Typically the processed check is handed right back to you.

PPD – Prearranged Payment and Deposit
: You give written authorization for a business to deposit funds directly into your account or to debit your account for a bill payment. You can authorize one-time or periodic transfers.

TEL – Telephone Initiated Entry
: You give oral authorization by phone for a single-entry debit to your account. Can be used only when there is no standing authorization for ACH entries, and either there is an existing relationship between the originator and you *or* you initiated the phone call.

WEB – Internet Initiated Entry
: You give authorization via the internet for a merchant to debit your account. The anonymous nature of the internet makes WEB entries susceptible to new types of fraud similar to TEL entries.

Companies are allowed to call you to initiate phone transfers if you already have a "business relationship" with them—that is, if you purchased goods or services from them within the past two years. There is less potential for fraud here, because such companies are likely to have prior information that they can use to help verify your identity (a password, a birth date, etc.).

Because no one is required to notify you in writing that a Telephone Initiated Entry has been made in your name, the first place you will see information about it is typically your bank statement. Remember, even if you do not use a bank debit card, make Telephone Initiated Entries, or pay any bills electronically, your account is still at risk for ACH fraud. Thus, you should carefully review each item on your statement. Even if you recognize the company, make sure that the amount and type of debit is valid.

On your bank statement you will likely see the name of the company that initiated the ACH debit, as well as a three-character code. That code, called a Standard Entry Class (SEC) code, indicates what type of ACH entry it is. The box below shows the five most common types of SEC codes.

Protecting Yourself

It is up to you to object to a questionable ACH withdrawal on your account. Your bank has nothing to do with authorizing these payments and has no way of knowing whether they are legitimate or not, until you complain. Moreover, your bank is not liable for any fraudulent ACH activity. Here again, ACH payments are different from other account activity. Typically your bank is responsible for obtaining proper authorization to access your account—your ID if you visit the bank in person or your signature on a check. But ACH entries are different—by law, it is the *merchant's bank* (which originated the payment), and not your bank, that bears the final responsibility for any fraudulent entries.

Under Regulation E, you have 60 days from the time your bank statement is sent to you to contest an ACH debit on your account. In some situations you may have even longer, but generally once the 60-day window closes, getting your money back become much more difficult. Under NACHA's rules and Regulation E, you cannot be held responsible for fraudulent charges if you report them in time, and the originating bank (the merchant's bank) must redeposit the money.

One way to avoid problems is to put a "debit block" on your bank accounts, so they can not be debited in any way through the ACH network. Businesses often do this with the accounts they use to pay payroll, because unscrupulous employees have been known to use the account information from their paychecks to fraudulently charge personal expenses to their employer. However, because the ACH network is so ubiquitous, blocking yourself off from it can cause unforeseen problems. You will likely have trouble making payments in stores or getting your checks processed. Alternatively, your bank may allow you to block certain companies or certain banks from accessing your account on a case-by-case basis.

When you buy something from a company you are not familiar with, you may be better off using your credit card rather than writing a check. Often you have better consumer protection with a credit card.

Your best defense is to review your bank statements regularly, and to protect your checking account information and checkbook as carefully as you protect your credit cards and other personal financial information. If you spot a questionable transaction, report it to your bank immediately. Even if you have never paid a bill by phone or through automatic deduction, your bank account is vulnerable. Given the relative ease with which a fraudster can access your account through the ACH network, you must be vigilant.

ARE WE HAVING FUN YET?

This following article, by Weston Wellington, Vice President, Dimensional Fund Advisors (November 27, 2006), provides further evidence that investors are best served by seeking investment vehicles designed to simply deliver the returns of the capital markets. Most investors will find that the funds we recommend on page 96 are the most cost-effective means of doing so.

Advocates of active management often concede that past performance of money managers is an unreliable guide to future results, but claim that careful assessment of qualitative factors such as organizational strength, investment philosophy, decision-making process, etc., can be useful in identifying those most likely to exhibit persistence in performance. An interesting test of this assertion has now accumulated five years of evidence and the results are not encouraging for fans of stock pickers or those who select them.

Morningstar FundInvestor, a monthly print publication seeking to deliver "research and recommendations for the serious investor," introduced two model mutual fund portfolios in November 2001, and a third portfolio was added the following May. In an article announcing the new models, Morningstar suggested that identifying superior funds was a straightforward exercise for capable analysts: "picking great funds," they observed, was "the fun part of the investment process."

For each portfolio, Morningstar selects seven to ten mutual funds diversified across the large/small cap and growth/value style map, and fund holdings are adjusted when deemed appropriate. Each month, Morningstar reports the performance of the portfolios and their components and explains their thinking regarding additions or deletions.

To provide an achievable investment alternative for comparison, Morningstar constructed blended benchmarks composed of three Vanguard index funds: Total Stock Market, Total International Stock Market, and Total Bond Market.

Summary: Morningstar vs. Benchmark

Portfolio	*Inception*	*Equity/Fixed*	*Total Return*
Aggressive Wealth Maker	Nov. 1, 2001	85%/15%	51.8%
Benchmark			56.4%
Wealth Maker	Nov. 1, 2001	65%/35%	41.8%
Benchmark			48.1%
Wealth Keeper	May 1, 2002	35%/65%	32.8%
Benchmark			34.3%

Each benchmark replicates the model's target asset class exposure.

Turnover at the portfolio level has been low: six of the eight funds in the Wealth Maker Portfolio as of October 31, 2006, for example, were also in the portfolio two years earlier. Over this period, one fund was replaced (Fidelity Capital Appreciation, FDCAX) and two funds were added (Harbor International Growth Institutional, HAIGX; and T. Rowe Price New America Growth, PRWAX).

The model portfolios are designed to "let fund selection shine through" and have maintained a consistent asset allocation policy since inception, so results reflect the ability of Morningstar analysts to identify fund managers with superior stock selection skill. Two of the portfolios have five-year performance records for the period ending October 31, 2006, while the third has a record of four-and-a-half years. None of the portfolios have outperformed their benchmarks since inception, and two have underperformed over the most recent twelve-month period as well.

Morningstar analysts have access to detailed information on thousands of funds and are among the most knowledgeable and thoughtful researchers in the mutual fund industry. If they find outperforming a straightforward index fund strategy so challenging, what extra information do other investors (or their advisors) claim to have that Morningstar has overlooked?

Sources: Carlson, Greg. "A Big Year for Our Foreign Funds." *Morningstar FundInvestor*, November 2006. Benz, Christine, and Russell Kinnel. "Introducing Model Portfolios." *Morningstar FundInvestor*, October 2001.

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 80. 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.

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, **Pfizer** and **Altria** were not eligible for purchase 18 months earlier. HYD investors should find that the indicated purchases of Pfizer and Altria, and sales of **Merck** and **JP Morgan 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 December 15, 2006

	Rank	*Yield*	*Price*	*Status*	*Percent of Portfolio* Value	*Percent of Portfolio* No. Shares[1]
Verizon	1	4.44%	36.48	Holding**	22.66	24.97
Altria Group	2	4.04%	85.21	Buying	7.36	3.47
AT&T Corp (New)	3	3.98%	35.66	Holding**	26.93	30.36
Pfizer	4	3.74%	25.64	Buying	6.37	9.98
CitiGroup	5	3.62%	54.07	Holding	14.67	10.90
Merck	6	3.45%	44.04	Selling	18.61	16.99
General Motors	7	3.42%	29.26	*		
DuPont	8	3.04%	48.75			
General Electric	9	3.00%	37.36			
JP Morgan Chase	10	2.82%	48.30	Selling	2.60	2.16
IAR	NA		27.56	Selling	0.80	1.16
					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.

Verizon Spins off Idearc

A spin-off of Idearc to shareholders of Verizon Communications Inc. (NYSE:VZ) was completed November 20th. Idearc was Verizon's domestic operation that published print and internet yellow pages. Verizon distributed a dividend of one share of Idearc for every 20 shares of Verizon common stock held as of November 1.

On Monday, Nov. 20, Idearc Inc. common stock began trading under the symbol "IAR."

The HYD model will incrementally sell off IAR over the 18 months, since it is not, and never has been, a Dow component. The "Recommended HYD Portfolio" table on the opposite page shows the model's allocation to IAR as of December 15th. Each month we will continue to display the number of shares held by the model.

Investors with relatively small holdings of IAR may not find it cost effective to sell their shares in the very small increments called for by the model. In that case we recommend that investors sell all of their shares immediately. If your IAR shares are held in a taxable account, you may wish to ensure that 12 months have passed before selling the shares to ensure that any appreciation realized is treated as a long-term gain for tax purposes.

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, through Oct. 31, 2006.)**	*1 mo.*	*1 yr.*	*5 yrs.*	*10 yrs.*	*15 yrs.*	*Since 1/79*	*Std. Dev.*
HYD Strategy	-1.23	32.85	11.67	13.02	16.53	18.47	17.11
Russell 1000 Value Index	2.28	20.28	10.88	10.61	13.49	14.55	13.95
Dow	1.55	15.78	6.76	8.57	12.51	N/A	N/A

*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 12/15/06*	*Market Prices 11/15/06*	*Market Prices 12/15/05*	*12-Month High*	*12-Month Low*	*Latest Dividend Amount*	*Latest Dividend Record Date*	*Latest Dividend Paid*	*Indicated Annual Dividend*	*Indicated Yield† (%)*
Verizon	VZ	**36.48**	**36.09**	30.61	38.95	30.00	0.405	1/10/07	2/01/07	1.620	4.44
Altria Group	MO	**85.21**	**82.25**	76.62	85.55 *H*	68.36	0.860	12/27/06	1/10/06	3.440	4.04
AT&T (new)	T	**35.66**	**32.46**	24.85	36.00 *H*	24.24	0.355	1/10/07	2/1/07	1.420	3.98
Pfizer	PFE	**25.64**	**26.53**	22.79	28.60	22.16	0.240	11/10/06	12/05/06	0.960	3.74
Citigroup	C	**54.07**	**50.47**	49.10	54.08 *H*	44.81	0.490	11/06/06	11/22/06	1.960	3.62
Merck	MRK	**44.04**	**44.15**	29.77	46.37	29.50	0.380	12/08/06	1/02/07	1.520	3.45
General Motors	GM	**29.26**	**35.35**	22.13	36.56	18.33	0.250	11/17/06	12/09/06	1.000	3.42
DuPont	DD	**48.75**	**47.35**	42.91	49.29 *H*	38.52	0.370	11/15/06	12/14/06	1.480	3.04
General Electric	GE	**37.36**	**35.79**	36.00	37.51 *H*	32.06	0.280	12/26/06	1/25/07	1.120	3.00
J. P. Morgan Chase	JPM	**48.30**	**47.45**	39.58	48.65 *H*	37.88	0.340	1/05/06	1/31/06	1.360	2.82
Coca-Cola	KO	**48.93**	**46.65**	41.16	49.35 *H*	39.36	0.310	12/01/06	12/15/06	1.240	2.53
3M Company	MMM	**78.31**	**80.71**	77.49	88.35	67.05	0.460	11/24/06	12/12/06	1.840	2.35
McDonald's	MCD	**43.41**	**41.10**	34.98	43.95 *H*	31.73	1.000	11/15/06	12/01/06	1.000	2.30
Johnson & Johnson	JNJ	**66.29**	**66.54**	60.16	69.41	56.70	0.375	11/28/06	12/12/06	1.500	2.26
Home Depot, Inc.	HD	**39.88**	**37.62**	42.58	43.95	32.85	0.225	11/30/06	12/14/06	0.900	2.26
Honeywell Intl.	HON	**43.62**	**43.35**	37.96	44.48	35.24	0.228	11/20/06	12/08/06	0.910	2.09
Caterpillar	CAT	**61.82**	**61.45**	58.71	82.03	56.36	0.300	1/22/07	2/20/07	1.200	1.94
Procter & Gamble	PG	**64.11**	**63.12**	58.99	64.38	52.75	0.310	10/20/06	11/15/06	1.240	1.93
Alcoa	AA	**31.04**	**28.55**	28.23	36.96	26.39	0.150	11/03/06	11/25/06	0.600	1.93
Intel Corp.	INTC	**20.96**	**22.32**	26.58	26.68	16.75	0.100	11/07/06	12/01/06	0.400	1.91
United Tech.	UTX	**62.45**	**65.60**	57.60	67.47	54.20	0.265	11/17/06	12/10/06	1.060	1.70
Exxon Mobil	XOM	**77.30**	**74.80**	59.49	79.00 *H*	55.60	0.320	11/13/06	12/11/06	1.280	1.66
Boeing	BA	**90.70**	**87.08**	70.79	92.05 *H*	65.90	0.350	2/09/07	3/02/07	1.400	1.54
Wal-Mart Stores	WMT	**46.45**	**47.68**	49.26	52.15	42.31	0.168	12/15/06	1/02/06	0.670	1.44
Microsoft Corp.	MSFT	**30.19**	**29.12**	26.92	30.23 *H*	21.46	0.100	11/14/06	12/14/06	0.400	1.32
IBM	IBM	**95.26**	**93.11**	83.53	95.80 *H*	72.73	0.300	11/10/06	12/09/06	1.200	1.26
American Express	AXP	**61.64**	**59.48**	51.43	62.30 *H*	49.73	0.150	1/05/06	2/09/07	0.600	0.97
AIG	AIG	**72.13**	**71.99**	65.30	72.55 *H*	57.52	0.165	3/02/07	3/16/07	0.660	0.92
Walt Disney	DIS	**34.30**	**32.69**	24.74	34.84 *H*	23.77	0.310	12/15/06	1/12/07	0.310	0.90
Hewlett-Packard	HPQ	**39.95**	**39.79**	29.20	40.85 *H*	28.35	0.080	12/13/06	1/03/07	0.320	0.80

* See the Recommended HYD Portfolio table on page 94 for current recommendations.

† Based on indicated dividends and market price as of 12/15/06. Extra dividends are not included in annual yields. *H* New 52-week high. *L* New 52-week low. (s) All data adjusted for splits.

RECENT MARKET STATISTICS

Precious Metals & Commodity Prices

	12/15/06	Mo. Earlier	Yr. Earlier
Gold, London p.m. fixing	**623.75**	**617.25**	506.25
Silver, London Spot Price	**13.73**	**12.69**	8.39
Copper, COMEX Spot Price	**3.04**	**3.09**	2.14
Crude Oil, W. Texas Int. Spot	**63.43**	**58.76**	59.99
Dow Jones Spot Index	**292.76**	**291.27**	256.56
CRB-Bridge Futures Index	**313.34**	**310.85**	328.66

Interest Rates (%)

U.S. Treasury bills -	91 day	**4.90**	**5.08**	3.92
	182 day	**5.06**	**5.14**	4.30
	52 week	**4.91**	**4.98**	4.36
U.S. Treasury bonds -	10 year	**4.60**	**4.62**	4.47
Corporates:				
High Quality -	10+ year	**5.75**	**5.73**	5.73
Medium Quality -	10+ year	**6.14**	**6.10**	6.04
Federal Reserve Discount Rate		**6.25**	**6.25**	5.25
New York Prime Rate		**8.25**	**8.25**	7.25
Euro Rates	3 month	**3.67**	**3.60**	2.46
Government bonds -	10 year	**3.70**	**3.73**	3.37
Swiss Rates -	3 month	**1.99**	**1.90**	1.04
Government bonds -	10 year	**2.41**	**2.17**	2.04

Exchange Rates

British Pound	**$1.951800**	**$1.889100**	1.764700
Canadian Dollar	**$0.864100**	**$0.878200**	0.862300
Euro	**$1.308300**	**$1.282600**	1.197100
Japanese Yen	**$0.008470**	**$0.008472**	0.008597
South African Rand	**$0.143500**	**$0.139500**	0.155000
Swiss Franc	**$0.818700**	**$0.802600**	0.775300

Securities Markets

	12/15/06	Mo. Earlier	Yr. Earlier
S & P 500 Stock Composite	**1,427.09**	**1,396.57**	1,270.94
Dow Jones Industrial Average	**12,445.52**	**12,251.71**	10,881.67
Dow Jones Bond Average	**196.34**	**196.18**	186.68
Nasdaq Composite	**2,457.20**	**2,442.75**	2,260.63
Financial Times Gold Mines Index	**2,422.94**	**2,345.82**	2,041.08
FT EMEA Gold Mines	**2,998.03**	**2,878.34**	2,689.79
FT Asia Pacific Gold Mines	**8,981.24**	**8,003.27**	5,753.12
FT Americas Gold Mines	**1,929.26**	**1,897.63**	1,661.82

Coin Prices

	12/15/06	*Mo. Earlier*	*Yr. Earlier*	*Premium*
American Eagle (1.00)	**$644.15**	**$639.85**	520.75	3.27
Austrian 100-Corona (0.9803)	**$613.13**	**$609.03**	495.73	0.27
British Sovereign (0.2354)	**$152.15**	**$151.15**	123.55	3.62
Canadian Maple Leaf (1.00)	**$644.40**	**$640.10**	521.55	3.31
Mexican 50-Peso (1.2057)	**$755.90**	**$750.90**	611.40	0.51
Mexican Ounce (1.00)	**$627.00**	**$622.80**	507.00	0.52
S. African Krugerrand (1.00)	**$635.25**	**$631.05**	514.15	1.84
U.S. Double Eagle-$20 (0.9675)				
St. Gaudens (MS-60)	**$670.00**	**$650.00**	565.00	11.02
Liberty (Type I-AU50)	**$762.50**	**$762.50**	675.00	26.35
Liberty (Type II-AU50)	**$660.00**	**$655.00**	542.50	9.37
Liberty (Type III-AU50)	**$640.00**	**$630.00**	530.00	6.05
U.S. Silver Coins ($1,000 face value, circulated)				
90% Silver Circ. (715 oz.)	**$9,600.00**	**$8,800.00**	6,037.50	-2.21
40% Silver Circ. (292 oz.)	**$3,922.50**	**$3,575.00**	2,407.50	-2.16
Silver Dollars Circ.	**$10,100.00**	**$9,475.00**	7,100.00	-4.91

Note: Premium reflects percentage difference between coin price and value of metal in a coin, with gold at $623.75 per ounce and silver at $13.73 per ounce. The weight in troy ounces of the precious metal in coins is indicated in parentheses.

Recommended Mutual Funds

Short/Intermediate Fixed Income	*Ticker Symbol*	***12/15/06***	*Month Earlier*	*Year Earlier*	*52-Week High*	*52-Week Low*	*Distributions Latest 12 Months Income*	*Capital Gains*	*Yield (%)*
iShares Lehman 1-3 Yr Treasury[3]	SHY	**$80.17**	**$80.08**	80.34	80.51	79.26	3.5384	0.0000	4.41
Vanguard Short-term Inv. Grade	VFSTX	**$10.57**	**$10.55**	10.51	10.61	10.41	0.4549	0.0000	4.30
Real Estate/Utilities									
DNP Select Income[1, 2]	DNP	**$10.87**	**$10.93**	10.44	11.13	9.74	0.7850	0.0000	7.22
Vanguard REIT Index	VGSIX	**$26.06**	**$24.97**	20.45	26.84	19.80	1.5950	0.3616	6.12
U.S. Large Cap. Value Equity									
iShares S&P 500 Value Index[3]	IVE	**$77.33**	**$75.34**	66.45	77.45	64.80	2.9987	0.0000	3.88
Vanguard Value Index	VIVAX	**$26.78**	**$25.95**	22.72	26.78	22.29	0.5750	0.0000	2.15
U.S. Small Cap. Value									
iShares Sm. Cap. 600 Value Index[3]	IJS	**$76.03**	**$75.89**	65.29	76.82	63.23	0.8026	0.0000	1.06
Vanguard Sm. Cap Value Index	VISVX	**$17.42**	**$17.22**	15.03	17.49	14.56	0.2690	0.0000	1.54
iShares Russell Microcap Index[5]	IWC	**$58.62**	**$58.33**	51.92	59.26	49.86	0.2475	0.0000	0.42
U.S. Large Cap Growth									
iShares S&P 500 Growth Index[3]	IVW	**$65.95**	**$64.78**	60.70	66.10	56.25	0.7176	0.0000	1.09
Vanguard Growth Index	VIGRX	**$30.19**	**$29.72**	28.20	30.19	25.91	0.2350	0.0000	0.78
Foreign - Developed Markets									
iShares MSCI EAFE Index[4]	EFA	**$74.03**	**$71.53**	58.84	74.37	58.78	1.1097	0.0000	1.50
iShares MSCI EAFE Value Index[4]	EFV	**$72.01**	**$69.92**	56.00	72.63	56.00	0.2542	0.0000	0.35
Vanguard Developed Markets Index[4]	VDMIX	**$12.82**	**$12.33**	10.12	12.85	10.11	0.2190	0.0000	1.71
Foreign - Emerging Markets									
iShares Emerging Markets Index[3]	EEM	**$113.60**	**$108.20**	87.80	113.64	81.35	0.9875	0.0000	0.87
Vanguard Emerging Market Index	VEIEX	**$24.17**	**$23.03**	18.90	24.17	17.95	0.3150	0.0000	1.30
Gold-Related Funds									
iShares COMEX Gold Trust[3]	IAU	**$61.11**	**$61.89**	50.23	72.32	48.82	0.0000	0.0000	0.00
streetTRACKS Gold shares	GLD	**$61.00**	**$61.84**	50.24	72.26	48.80	0.0000	0.0000	0.00

Recommended Gold-Mining Companies

	Ticker Symbol	***12/15/06***	*Month Earlier*	*Year Earlier*	*52-Week High*	*52-Week Low*	*Distributions Latest 12 Months*	*Frequency*	*Yield (%)*
Anglogold Ltd., ADR	AU	**$46.31**	**$44.39**	46.67	62.20	35.58	0.393	Semiannual	0.85
Barrick Gold Corp.†§	ABX	**$30.45**	**$29.31**	26.90	36.03	25.10	0.187	Semiannual	0.61
Gold Fields Ltd.	GFI	**$18.27**	**$17.51**	16.38	26.95	16.12	0.218	Semiannual	1.19
Goldcorp, Inc.[6]†	GG	**$28.01**	**$27.78**	19.82	41.66	19.10	0.153	Monthly	0.55
Newmont Mining	NEM	**$47.49**	**$45.57**	49.99	62.72	39.84	0.400	Quarterly	0.84
Rio Tinto PLC‡ *	RTP	**$220.36**	**$209.54**	174.06	253.33	172.76	3.260	Semiannual	1.48

[1] Closed End Fund, traded on NYSE. [2] Dividends Paid Monthly. [3] Exchange traded Funds, traded on NYSE. [4] New listing as of July 2006, replacing IEV and VEURX. [5] New listing as of July 2006. [6] New listing as of September 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.