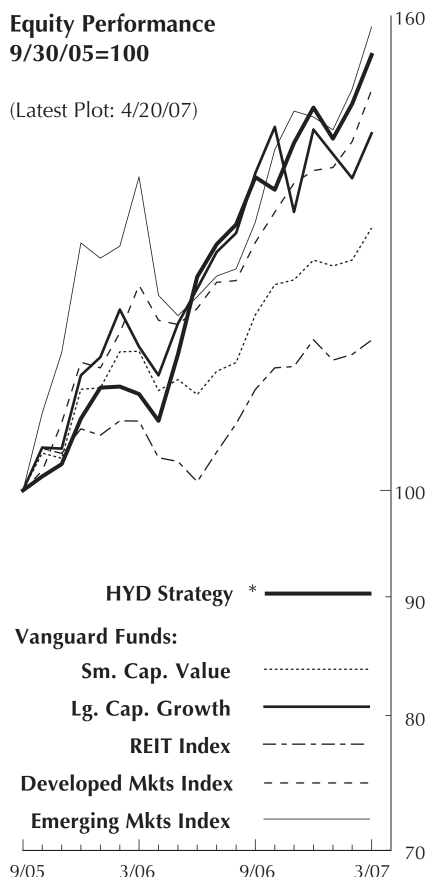
INVESTMENT GUIDE

Published Monthly by

American Investment Services, Inc.

Vol. XXIX, No. 4 | Great Barrington, Massachusetts 01230 | April 30, 2007



*** HYD is a hypothetical model based on back-tested results. See p. 30 for a full explanation.**

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

Online: www.americaninvestment.com

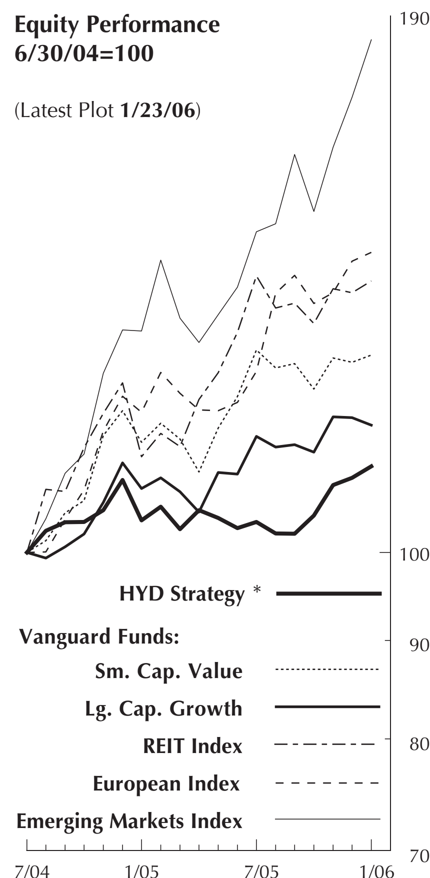
Recession? Fear Not

The statistical indicators of our parent organization, the American Institute for Economic Research, suggest that while economic contraction is more probable than continued expansion, the timing of the next recession cannot be determined. Investors should assume that the capital markets are "aware" of this situation, and simply maintain their current portfolio allocations. Our model portfolios (see table on page 26) are designed to withstand a variety of economic conditions.

Please Ignore the Chart

We have received many inquiries recently regarding our discretionary high-yield Dow investment service (HYD). We cannot help but think this surge in interest has something to do with the chart to the left, which shows that investors who have been invested in the model have experienced very strong absolute and relative returns over the past 18 months.

If we had a marketing department, as do many money managers, we would probably be shouting our figures from the highest hilltops. However, that would be a disservice to our readers and clients. Our recommendations are based on long-term considerations. As recently as 15 months ago, the HYD portfolio lagged our other recommended investment vehicles, as seen in the chart at right. We regret that a handful of impatient investors left our program then.



The fact is the HYD approach is highly effective for investors with a long-term outlook. This is the case with all of our recommended investments. We display these charts to remind readers that while our asset classes usually provide positive returns over the short term, it is anyone's guess as to which among them will shine brightest. The table on page 27 provides further evidence of this.

We have no idea what the next twelve months will bring; now is as good a time as any to start with an HYD portfolio if you truly have a long-term outlook and are prepared to stick with the model through thick-and-thin. We encourage readers with interest in our programs to call us, but don't expect a sales pitch. In fact we will discourage investors who do not demonstrate that they hold a genuine long-term view.

QUARTERLY REVIEW OF INVESTMENT POLICY

The first quarter brought the largest one-day decline (3.5 percent) in the U.S. stock market since March 2003. Nevertheless, by quarter-end all of our recommended asset classes registered positive returns. For the second time in the past three calendar quarters our hypothetical high-yield Dow approach provided the highest returns of all. The HYD model ended a long hiatus; up until the third quarter of 2006 it failed to earn the "best" ranking asset class for 14 consecutive quarters. Foreign markets finally cooled off, as developed and emerging markets both provided returns of less than 5 percent.

Our recommended allocation table, below, includes no changes this quarter. Investors should design a portfolio tailored to their individual needs. The three model portfolios are only guidelines. It is also important to understand that the data presented in the table are purely hypothetical results of representative indexes. The model portfolios in the bottom portion of the table are backward-looking. They include risk and return measures that would have resulted had we been recommending these newly adopted allocation plans at the beginning of the time periods we list.

The Economy

As noted recently in *Research Reports*, AIER's bi-weekly newsletter, the Fed's monetary policy contributed to the housing boom that began in early 2001. The Fed's short-term rate-cutting began that year, and rates eventually reached a 45-year low. Rates on adjustable-rate mortgages (ARMs), which are indexed to short-term rates, fell accordingly. Home prices rose rapidly, and as housing eventually became less affordable, borrowers turned to riskier "subprime" mortgages.

Now faced with higher short-term rates, borrowers are confronted with higher payments on their ARMs. Foreclosures have surged, and suddenly there is a large supply of homes for sale (see accompanying article "A Buyer's Market?"). While it is clear to us that the Fed failed to take away the punch bowl before the party got too interesting, it is as yet uncertain how far the subprime mortgage woes will carry over to the broader economy.

Cash Equivalent Assets

The Federal Reserve Open Market Committee (FOMC) met at the end of December and again on March 21st, and each time left the Fed funds target rate unchanged. The rate remains at 5.25 percent. The minutes of the March meeting confirmed that the Fed remains wary of price inflation and that "further policy firming might prove necessary."

At the end of March the 13-week Treasury bill was yielding 4.89 percent, and had changed little since mid-January. Taxable money-market funds were yielding 4.75, while tax-free money funds were yielding 3.06. Through the three months ending in March, the Consumer Price Index was running at an annualized rate of 4.7 percent. However, excluding food and energy, the CPI advanced at an annualized rate of 2.3 percent, down from 2.6 percent for all of 2006. The current

AIS Model Portfolios(1)
For the Period Ending March 31, 2006

Asset Class	*Index*	*Recommended Percentage Allocations* **(2)**			*Asset Class Statistics: Risk and Return*			
					Total Return (annualized)			*Std. Dev. (annualized)*
		Conservative	*Moderate*	*Aggressive*	*1 Year*	*5 Year*	*15 Year*	*15 Year*
Cash & Equivalent Assets **(3)**	3 Month CD Index	20	10	0	5.30	2.78	4.17	0.48
Short/Int. Fixed Income	Lehman Brothers 1-5 Yr Govt/Cred	40	30	0	5.70	4.10	5.71	2.31
Real Estate	DJ Wilshire Real Estate Securities TR Index	10	10	10	21.85	22.76	15.46	13.63
U.S. Large Cap Growth	Russell 1000 Growth Index (USD)	5	5	10	7.06	3.48	8.48	16.73
U.S. Large Cap Value	Russell 1000 Value Index (USD)	15	20	30	16.83	10.24	13.06	12.65
U.S. Small Cap Value	Russell 2000 Value Index (USD)	5	7	13	10.38	13.61	14.43	13.88
	DFA US Micro Cap Portfolio (USD)	0	3	7	3.24	13.99	14.60	19.38
Foreign Developed Markets	MSCI EAFE Index (USD) Gross Div	5	7	13	20.69	16.24	9.41	14.39
Foreign Emerging Markets	MSCI Emg. Mkts. Index (USD) Gross Div	0	3	7	21.03	24.84	9.28	22.02
Gold Related	Gold EOM gold (London PM Fix)	0	5	10	14.38	17.17	4.54	13.23
	Total	100	100	100				

Model Portfolio Statistics: Risk, Return and Growth

	Conservative	*Moderate*	*Aggressive*
Portfolio Return 1 Year	10.16	11.94	15.09
Portfolio Return 5 Year (annualized)	8.05	10.57	14.31
Portfolio Return 15 Year (annualized)	8.63	9.92	12.32
Portfolio Standard Deviation 15 Year (annualized)	4.47	6.39	10.95
Growth of $100 over 15 Years	$346	$413	$571

(1) Past performance may not be indicative of future results. Therefore, no current or prospective investor should assume that the future performance of any specific investment, investment strategy (including the investments and/or investment strategies recommended by AIS), or product made reference to directly or indirectly, will be profitable or equal to past performance levels. 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 results portrayed in this portfolio reflect the reinvestment of dividends and capital gains. Model Portfolio Statistics are hypothetical and do not reflect historical recommendations of AIS. Annual portfolio rebalancing is assumed.
(2) For our recommended investment vehicles for each asset class, see page 32.
(3) Investors should maintain cash balances adequate to cover living expenses for up to 6 months in addition to the cash levels indicated.

yield spread of U.S. Treasuries over inflation-adjusted U.S. Treasuries across all maturities suggests that while the market is not anticipating dramatic price inflation, even over the long term, inflationary expectations have moved up in recent months.

Investors should maintain cash or equivalent reserves over and above those specified in the model portfolio table. As a general guideline, this reserve should approach a level high enough to maintain your living standard for up to six months to provide liquidity in the event of unforeseen circumstances. The appropriate level of cash to hold depends a great deal on your particular circumstances.

Short/Intermediate-Term Bonds

The yield curve remained inverted during the quarter; mid-range maturities fell while short term and longer rates changed little.

Fixed-income securities are recommended for portfolio stability. As long as investors hold fixed income securities with maturities that do not exceed 5 years, they will have the ability to reduce the volatility of their portfolio's value without significantly reducing their expected returns. We recommend high-credit quality bonds. Securities issued by the U.S. Government or its agencies are generally acceptable, as well as high-quality U.S. corporate and municipal bonds.

Over long periods equities typically outperform bonds, but there have been sustained periods, such as the mid-1970s when short-term Treasuries provided higher returns than U.S. stocks. During such periods investors can expect to rebalance their portfolios by selling bonds and buying stocks, so it is important to maintain reasonable exposure to bonds.

There are three strategies for holding bonds while maintaining a "passive" approach to bonds (i.e. not attempting to predict interest rates). Investors with larger accounts might consider investing directly in bonds through a bond "ladder." This entails investing roughly equal dollar amounts in bonds maturing at regular intervals (e.g. every three months). As bonds mature the proceeds can be used to invest at the "long end" in order to maintain equal exposure to the yield curve over five years. Alternatively investors can invest in one of the fixed income bond funds list on page 32, or, investors who seek the assistance of an investment advisor can adopt a "variable maturity" strategy by utilizing mutual funds managed by Dimensional Fund Advisors. (See our August 2005 *INVESTMENT GUIDE* for a full explanation of this approach.)

Real Estate

In terms of total return, REITs have been a dominant asset class in recent years. As REIT prices climbed higher in early 2006, the dividend yield on the FTSE NAREIT equity index fell below the yield on 10-year U.S. Treasuries. Their falling yield led many forecasters to predict a sharp reversion in REIT prices; however, while REIT returns have fallen, they have remained positive, and during the first quarter managed a respectable 3.39 percent.

REITs are a distinct asset class and belong in almost every portfolio. They are a creature of the tax code; as long as a REIT distributes 90 percent of its income, it pays no corporate income tax. REIT returns are not strongly correlated to either bonds or stocks.

Utility stocks may be appropriate for investors who have an explicit interest in maximizing investment income. The Duff and Phelps Select Income Fund (DNP) is ideal for this purpose. It pays a convenient and substantial monthly dividend (current annual yield 6.9 percent). DNP is heavily concentrated in public utility stocks. The fund's yield, however, is well above that of most utilities by virtue of financial leverage. Management has issued remarketed preferred shares at short-term interest rates and invests the proceeds in higher-yielding equities and longer-term bonds.

Common Stocks

U.S. stocks had a wild ride in the first quarter. A confluence of events led to a sharp decline across developed markets on February 27, and in early March increasing concern over mortgage default rates appeared to lead the market lower over concerns that the economy as a whole might suffer. Investors, however, did not panic; by the end of the quarter, the S&P 500 had recovered and managed a positive return of 0.64 percent. Small cap value stocks provided investors with just over 2 percent return for the quarter, while large cap growth stocks earned 1.21 percent. Among large cap value stocks, the high-yield Dow model provided an astounding 10.56 percent return, well above other large cap value stocks, which as a group managed only 0.90 percent for the quarter as measured by the Vanguard Value Index fund.

The accompanying Total Returns table indicates that emerging markets have provided the strongest returns of any asset class since June 2004. Though it has cooled off during the first quarter, the Vanguard Emerging Markets Index fund still provided investors with a respectable 2.18 total return as markets quickly recovered

Total Returns (%)

	—2004—		—2005—				—2006—				2007	*Entire Period*
	3Q	*4Q*	*1Q*	*2Q*	*3Q*	*4Q*	*1Q*	*2Q*	*3Q*	*4Q*	*1Q*	*3Q 2004-1Q 2007*
Vanguard Short-Term Inv Grade	1.50	0.39	-0.38	1.55	0.24	0.77	0.52	0.79	2.31	1.28	1.57	11.03
Vanguard REIT Index	**8.13**	15.06	-7.34	**14.65**	3.56	1.70	**14.79**	-1.37	9.39	9.07	3.39	94.41
Vanguard Value Index	1.24	9.80	-0.42	1.70	4.08	1.60	5.29	0.91	6.63	7.82	0.90	46.72
High-Yield Dow 4/18*	3.64	6.22	-5.73	0.13	-0.69	7.29	9.81	2.56	**13.70**	8.42	**10.56**	69.94
Vanguard Small Cap Value	1.13	13.03	-3.35	5.26	4.01	0.24	11.05	-2.72	1.72	8.52	2.01	47.49
Vanguard Growth Index	-4.88	9.40	-3.56	2.12	3.59	3.00	3.30	-3.94	3.79	5.85	1.21	20.65
Vanguard Developed Markets†	-0.49	15.23	-0.22	-1.31	10.93	3.75	9.30	0.81	4.00	10.11	4.21	70.88
Vanguard Emerging Markets‡	7.98	**18.71**	**1.43**	3.69	**17.23**	7.10	11.22	-4.57	4.00	**17.22**	2.18	**123.78**
Gold (London PM Fix)	6.02	4.8	-1.86	2.24	8.27	**8.40**	13.45	**5.41**	-2.32	5.47	4.71	68.80

The highest returns provided in each period are in **Bold Face Type**. * HYD is a hypothetical model based on back tested results. See p. 30 for a full explanation. † Vanguard Developed Markets Index Fund: First recommended in *INVESTMENT GUIDE* 3Q 2006. ‡ Vanguard Emerging Markets Index Fund: First recommended in *INVESTMENT GUIDE* 2Q 2005.

from Thailand's meltdown at the end of December. Global markets were roiled in late February when China's government hinted it might intervene to slow the economy. China's trade surplus for the first quarter reached $46.6 billion, double its level from 2006.

The dollar fell against most major currencies during the quarter, ranging from 0.3 percent against the Swiss franc to 2.5 percent against the Australian dollar. The Euro ended roughly where it began, at $1.33, but ranged between $1.34 and $1.29 throughout the quarter. The Vanguard Developed Markets Index Fund returned 4.21 percent. The European Central Bank raised short-term interest rates to 3.75 percent as GDP in the Euro area registered an annualized 3.6 percent for the quarter. In Japan, GDP reached an annualized 5.5 percent; the Japanese Yen rose roughly 1 percent ranging between $0.00818 and $0.00868.

Gold-Related Investments

Gold once again had a volatile quarter, ranging between $608.40 and $685.75, but by the time the quarter closed it had settled at $661.75, a gain of 4.71 percent for the three months.

Gold has provided very meager total returns since the gold began to trade freely in 1968, and the gold price has been notoriously volatile ever since. However, its returns have very low correlation (and in some cases even negative correlation) with our other recommended asset classes. This means that gold can reduce a portfolio's overall volatility without sacrificing expected return. Gold can be viewed as a form of portfolio insurance; it has been shown to hold up well during periods of financial distress.

We recommend that investors hold gold through either of our recommended exchange-traded funds (ETFs) or through a portfolio of our six recommended gold stocks. All of these securities are listed on page 32. Because gold ETFs represent an investment in a precious metal, realized long-term capital gains are taxed as collectibles at a rate of 28 percent. ETFs are therefore better suited for tax-deferred accounts such as IRAs.

A BUYERS' MARKET?

Our articles are typically confined to issues surrounding financial assets. However, in recent years for many investors, home equity has become an unexpectedly large part of their net worth. The past several months, however, have brought a reversal in that trend. Wise investors should pay close attention to developments in residential real estate markets and the impact they might have on their overall wealth.

The housing market experienced an unprecedented boom from 2002 to 2005. Whether this was a "bubble" is debatable, but the boom is clearly over. Prices have declined in some areas and virtually all measures of activity in the housing sector have decreased sharply.

That hissing sound you hear is the deflation of the housing boom. Since peaking in the summer of 2005, conditions in the housing market have deteriorated significantly. Sales have plummeted and prices are falling.

Many analysts have referred to the boom of 2002-2005 as a "bubble," claiming that it replaced the dotcom-driven stock market bubble of the late 1990s. This assertion is debatable. Nevertheless, in many respects the boom had the characteristics of a bubble, especially in 2005.

Before the boom, home prices experienced a long period of moderate increase. As shown in Chart 1, from the early 1980s through the late 1990s, the median purchase price of an existing single-family house increased at rates that averaged about four percent per year. Adjusted for price inflation, purchase prices increased by only one percent each year.

Sales were also moderate by historical standards. As shown in Chart 2, sales of existing homes peaked in 1978 and remained below that peak for the next 19 years. A similar story played out in new home construction. The housing market experienced cyclical and regional swings in activity in the 80s and much of the 90s, but there was nothing extraordinary about these cycles.

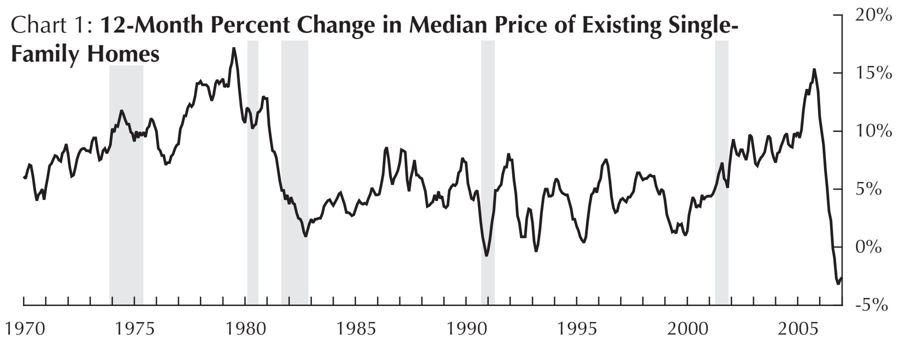
An Unprecedented Boom

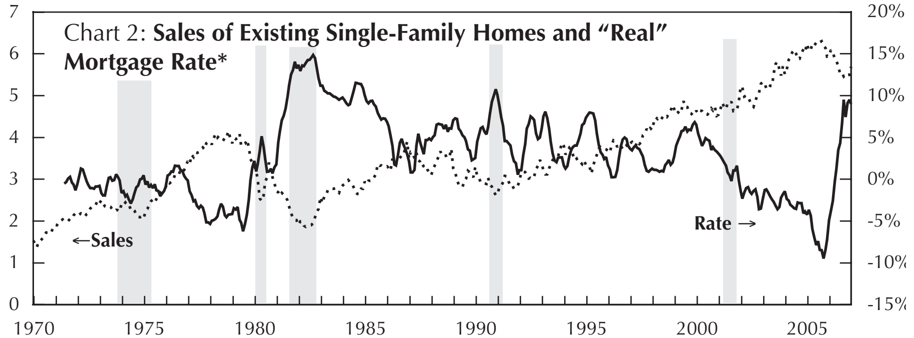
Then came the boom. The rate of increase in home prices began to accelerate in 2002. By 2005, the year-over-year increase topped 15 percent.

Sales rates set new records. At the peak in June 2005, sales of existing homes reached an annual rate of more than six million—50 percent higher than the previous record set in 1978.

Construction of new homes likewise boomed. Sales of new homes, which rarely exceeded 850,000 per year prior to 2000, reached 1.4 million in mid-2005. Simultaneously, the prices of new homes soared, increasing at double-digit rates (year-over-year) in some months.

In the hottest markets, homes sold within hours of being put on the market;





Series are 3-month moving averages of monthly data. Latest base data, January 2007. Sales are in millions of units at a seasonally-adjusted annual rate. * Real mortgage rate is nominal rate on 30-year fixed mortgages minus 12-month percentage change in median home price.

often multiple offers were received and bidding wars erupted. The inventory of unsold homes decreased to a historically low level. As shown in Chart 3, at the height of the boom in 2005, the supply of unsold existing homes dropped to just 3.7 months (*i.e.*, it would have taken only that long to sell the existing stock at the prevailing sales rate).

Speculators and investors entered the market. According to the Federal Reserve, 17 percent of home mortgages taken out in 2005 were for investment purposes—double the amount in 2000. "Flipping" a home—buying it and quickly selling it for a profit—became increasingly common. According to one industry estimate, at the peak up to 20 percent of new home purchases were made with the intent to flip.

It is debatable whether or not this boom was a bubble; there is no generally accepted definition of a "bubble." But the main characteristic of a bubble is a rapid rate of increase in prices to a level that becomes unsustainable—and the exceptionally rapid rate of home price appreciation during this period is indisputable.

Historically low mortgage rates helped to keep these higher prices affordable. So, too, did the proliferation of creative mortgage products—which also expanded the pool of buyers.

Additionally, the combination of rapid price increases and very low interest rates encouraged speculation. In effect, it reduced the "real" cost of borrowing to zero.

The standard way to calculate a real interest rate is to adjust the nominal rate for inflation by using a broad price index such as the Consumer Price Index. But arguably it makes more sense to adjust mortgage rates by using the rate of increase in home prices.

This "real" mortgage rate—the nominal mortgage rate minus the 12-month change in the median home price—is shown in Chart 2. It was positive from the early 1980s through 2001. But beginning in early 2002, it decreased to less than zero. By 2005, the peak year of the boom, the "real" mortgage rate was a remarkable -10 percent. This so called "free" money created a significant incentive to speculate on housing.

The Bust Arrives

Since peaking in the summer of 2005, housing activity has decreased sharply. Sales of existing single-family homes are off 10 percent, while sales of new homes have plummeted by 32 percent. Prices are also falling. Since July 2006, the median purchase price of an existing home has fallen, year-over-year, for an unprecedented six consecutive months. It is now nine percent off its peak.

The prices of new homes have also decreased, falling by seven percent from their spring 2006 peak. Moreover, this understates their effective price decline, because builders have been giving away extras and upgrades (such as better cabinetry, sprinkler systems and even helping with closing costs) to sweeten deals; these giveaways amount to a hidden price cut.

Lenar Corporation, the nation's fourth largest builder, says that in the fall of 2005 it gave an average of $10,000 in incentives per home; one year later, that had risen to $47,000. According to the National Association of Home Builders, 80 percent of builders are offering incentives.

Not surprisingly, inventories of unsold homes have increased. At current rates of sale, there is a 6.6 months' supply of existing homes for sale (see Chart 3) and a 6.8 months' supply of new homes. Moreover, there are still more than 1.2 million homes under construction. Excluding the past few years, this level of activity has not been seen since the late 1970s, and as these homes are completed they will put upward pressure on inventories unless sales pick up.

New homes are also taking longer to sell—the median number of months they are on the market is the highest since 2001. And the number of completed new homes for sale has soared. As shown in Chart 4, it reached a record 175,000 in January, far more than the peaks reached in earlier housing cycles.

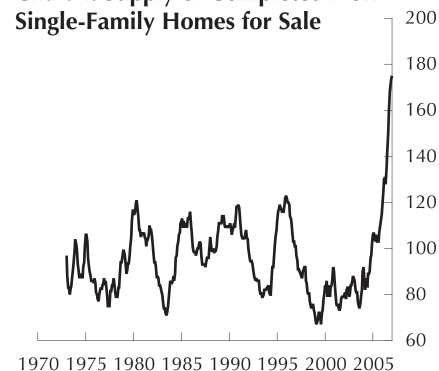
It is unusual for home prices to decrease. Unlike the prices of other assets, such as commodities and stocks, home prices tend to be "sticky" on the downside. That's because homeowners usually live in their homes, and if market prices weaken, they usually take the home off the market rather than sell at a loss. Thus, rather than prices decreasing, more typically the number of existing homes for sale usually shrinks. And indeed that is now happening. It has decreased by more than eight percent since last summer.

The Impact on Construction

At the peak of the boom, the number of housing starts hit a 34-year high. It has since fallen by 38 percent. The number of building permits issued, a leading indicator of future new home construction,

Chart 3: **Months' Supply of Existing Single-Family Homes for Sale**

Chart 4**: Supply of Completed New Single-Family Homes for Sale**



Note: Completed homes are in thousands of units.

has fallen by 30 percent from its peak, the largest decrease since the housing recession of the early 1990s. Many builders have issued profit warnings during the past nine months, citing low buyer traffic and high cancellation rates for orders.

The National Association of Realtors says this is now "a buyers' market." Clearly the market favors buyers more than it did a year ago, but whether the downturn has hit bottom remains unclear. (Realtors understandably would like everyone to think so.) Prospective buyers are reported to be "sitting on the fence" waiting for prices to stabilize before making an offer. In the fourth quarter of last year, home sales decreased from year-ago rates in 43 states and the District of Columbia.

Price decreases have been likewise broad-based. A record 73 of the 149 metropolitan areas surveyed experienced year-over-year price decreases during last year's fourth quarter, up from 45 in the third quarter.

Why the Sudden Bust?

The sharp reversal in the housing market can probably be attributed to decreasing affordability. Through the 1990s and as recently as 2004, housing remained

affordable by historical standards, according to various indexes that take into account such factors as income, mortgage rates, loan terms, and home prices. However, beginning in early 2005, these indexes began to decrease sharply, reflecting the large run-up in home prices in 2005 and a moderate increase in mortgage rates. As affordability decreased, the pool of buyers shrank. Problems with subprime loans have also reduced demand.

The "real" mortgage interest rate (again, as shown in Chart 2) likewise began to increase sharply, rising to more than 8 percent in late 2006. This was the highest rate since the early 1990s—a time when home sales decreased sharply.

Outlook

The housing market is undergoing a major correction after a spectacular multiyear boom. If recent data and comments by large home builders, building material retailers, and real estate professionals are to be believed, it would appear that the housing market correction is far from over. The recovery, whenever it begins, is unlikely to bring activity back to the peak rates of the boom.

By some measures, activity remains fairly high by historical standards. Although sales and construction are well off their remarkable boom rates, they have yet to approach the lows experienced during earlier housing downturns. Even so, the magnitude and breadth of the past year's decline are the type that, in the past, almost always have been associated with an economy-wide recession. Whether "things are different" this time remains to be seen.

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 24. 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.

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, Altria** and **Citigroup** were not eligible for purchase 18 months earlier. HYD investors should find that the indicated purchases of Pfizer, Altria and Citigroup, and sales of **AT&T Corp** and **Merck** are sufficiently large to warrant trading. In larger accounts, rebalancing positions in **Verizon**, and may be warranted.

Recommended HYD Portfolio
As of April 13, 2007

	Rank	*Yield*	*Price*	*Status*	*Percent of Portfolio* Value	*Percent of Portfolio* No. Shares[1]
Altria Group	1	4.95%	69.56	Buying	10.43	6.09
Pfizer	2	4.35%	26.67	Buying	11.90	18.13
Verizon	3	4.33%	37.39	Holding**	22.94	24.93
CitiGroup	4	4.19%	51.60	Buying	15.06	11.87
AT&T Corp (New)	5	3.66%	38.84	Selling	22.58	23.63
General Electric	6	3.17%	35.38			
General Motors	7	3.12%	32.02	*		
Merck	8	3.03%	50.21	Selling	13.46	10.89
DuPont	9	3.00%	49.31			
JP Morgan Chase	10	2.77%	49.09			
Kraft Foods	NA		32.80	Selling	2.90	3.60
Idearc	NA		34.74	Selling	0.73	0.85
					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.

Contact us at (413) 528-1216 or email: aisinfo@americaninvestment.com.

Kraft Spun Off

On March 30, 2007, Altria (ticker MO) spun off its remaining shares of Kraft Foods Inc. (KFT) to shareholders. For every share of MO owned, shareholders received 0.692024 shares of KFT. For shares held in taxable accounts, the original cost of MO shares should be allocated between KFT (23.84%) and MO (76.16%); any cash received in lieu of fractional shares of KFT was valued at 31.2527 per share.

We reintroduced MO as part of our HYD model in August 2006. Readers who have invested in accordance with the model on page 30 have therefore received shares of KFT. The model will begin to sell these off in accordance with our model beginning in March 2008, 18 months after MO was first recommended for purchase (assuming KFT remains excluded from those stocks that comprise the Dow Jones Industrial Average).

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 to transitioning from a model portfolio that had excluded Altria to one that had never excluded it.

*Hypothetical Total Returns (percent, through Mar. 31, 2007)**	*1 mo.*	*1 yr.*	*5 yrs.*	*10 yrs.*	*15 yrs.*	*Since 1/79*	*Std. Dev.*
HYD Strategy	3.55	32.38	11.75	12.93	15.38	18.59	17.05
Russell 1000 Value Index	1.55	16.83	10.24	10.85	13.06	14.51	13.87
Dow	0.84	13.83	5.86	8.60	11.74	NA	NA

*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	Market Prices ($)			12-Month ($)		Latest Dividend			Indicated	
	Symbol	*4/13/07*	*3/15/07*	*4/13/06*	*High*	*Low*	*Amount ($)*	*Record Date*	*Paid*	*Annual Dividend ($)*	*Yield† (%)*
Altria Group	MO	**69.56**	84.75	69.00	71.10	51.30 *L*	0.860	3/15/07	4/10/07	3.440	4.95
Pfizer	PFE	**26.67**	24.99	24.50	28.60	22.16 *L*	0.290	2/09/07	3/06/07	1.160	4.35
Verizon	VZ	**37.39**	36.36	32.81	38.95	30.10 *L*	0.405	4/10/07	5/01/07	1.620	4.33
Citigroup	C	**51.60**	50.13	48.05	57.00	46.22 *L*	0.540	2/05/07	2/23/07	2.160	4.19
AT&T (New)	T	**38.84**	36.94	25.58	39.90	24.72 *L*	0.355	4/10/07	5/1/07	1.420	3.66
General Electric	GE	**35.38**	34.52	33.89	38.49 *H*	32.06	0.280	2/26/07	4/25/07	1.120	3.17
General Motors	GM	**32.02**	29.38	20.40	37.24	20.01 *L*	0.250	2/16/07	3/10/07	1.000	3.12
Merck	MRK	**50.21**	43.19	33.94	50.80	32.75 *L*	0.380	3/09/07	4/02/07	1.520	3.03
Dupont	DD	**49.31**	50.43	43.30	53.67 *H*	38.82	0.370	2/15/07	3/14/07	1.480	3.00
J P Morgan	JPM	**49.09**	47.70	42.19	51.95 *H*	39.33	0.340	4/05/07	4/30/07	1.360	2.77
Coca-Cola	KO	**49.88**	47.08	41.26	50.31 *H*	40.86	0.340	3/15/07	4/01/07	1.360	2.73
3M Company	MMM	**76.72**	75.99	80.97	88.35 *H*	67.05	0.480	2/23/07	3/12/07	1.920	2.50
Johnson & Johnson	JNJ	**62.35**	60.53	57.91	69.41 *H*	57.46	0.375	2/27/07	3/13/07	1.500	2.41
Home Depot, Inc.	HD	**37.89**	37.49	41.12	42.01	32.85 *L*	0.225	3/08/07	3/22/07	0.900	2.38
Intel Corp	INTC	**20.46**	19.14	19.45	22.50	16.75	0.113	5/07/07	6/01/07	0.450	2.20
Honeywell Int'l.	HON	**47.03**	46.98	43.41	48.50	35.53 *L*	0.250	2/27/07	3/09/07	1.000	2.13
McDonald's	MCD	**47.64**	43.47	34.85	47.92	31.73 *L*	1.000	11/15/06	12/01/06	1.000	2.10
Procter and Gamble	PG	**63.38**	61.91	56.60	66.30 *H*	52.75	0.310	1/19/07	2/15/07	1.240	1.96
Alcoa	AA	**35.12**	33.88	33.71	36.96	26.39 *L*	0.170	2/02/07	2/25/07	0.680	1.94
Wal-Mart Stores	WMT	**47.41**	46.00	45.77	52.15	42.31 *L*	0.220	12/14/07	1/02/08	0.880	1.86
Caterpillar	CAT	**66.79**	63.46	76.94	82.03	57.98 *L*	0.300	4/23/07	5/19/07	1.200	1.80
Exxon Mobil	XOM	**77.41**	70.69	61.56	79.00 *H*	56.64	0.320	2/09/07	3/09/07	1.280	1.65
United Tech.	UTX	**65.05**	64.40	57.14	69.49 *H*	56.87	0.265	5/18/07	6/10/07	1.060	1.63
Boeing	BA	**91.03**	91.04	82.93	92.24 *H*	72.13	0.350	2/09/07	3/02/07	1.400	1.54
Microsoft Corp.	MSFT	**28.61**	27.28	27.07	31.48	21.46 *L*	0.100	5/17/07	6/14/07	0.400	1.40
IBM	IBM	**94.93**	93.45	81.98	100.90 *H*	72.73	0.300	2/09/07	3/10/07	1.200	1.26
American Express	AXP	**57.36**	56.11	51.21	62.50	49.73 *L*	0.150	4/05/07	5/10/07	0.600	1.05
Amer. Int. Group	AIG	**66.91**	67.05	63.40	72.97 *H*	57.52	0.165	6/01/07	6/15/07	0.660	0.99
Walt Disney	DIS	**34.72**	33.79	27.88	36.09	26.75 *L*	0.310	12/15/06	1/12/07	0.310	0.89
Hewlett-Packard	HPQ	**41.18**	39.70	32.62	43.72	29.00 *L*	0.080	3/14/07	4/04/07	0.320	0.78

* See the Recommended HYD Portfolio table on page 30 for current recommendations. † Based on indicated dividends and market price as of 4/13/07. 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 ($)

	4/13/07	Mo. Earlier	Yr. Earlier
Gold, London p.m. fixing	**681.75**	648.50	593.00
Silver, London Spot Price	**13.88**	12.90	12.61
Copper, COMEX Spot Price	**3.53**	2.99	2.87
Crude Oil, W. Texas Int. Spot	**63.63**	57.55	69.32
Dow Jones Spot Index	**313.39**	294.70	265.22
Reuters-Jefferies CRB Index	**317.93**	304.11	342.32

Interest Rates (%)

		4/13/07	Mo. Earlier	Yr. Earlier
U.S. Treasury bills -	91 day	**4.88**	4.91	4.69
	182 day	**4.89**	4.91	4.92
	52 week	**4.98**	4.93	4.97
U.S. Treasury bonds -	10 year	**4.76**	4.54	5.05
Corporates:				
High Quality -	10+ year	**5.55**	5.28	6.19
Medium Quality -	10+ year	**6.46**	6.24	6.54
Federal Reserve Discount Rate		**6.25**	6.25	5.75
New York Prime Rate		**8.25**	8.25	7.75
Euro Rates	3 month	**3.96**	3.90	2.82
Government bonds -	10 year	**na**	na	3.81
Swiss Rates -	3 month	**2.31**	2.28	1.26
Government bonds -	10 year	**2.75**	2.62	2.55

Exchange Rates ($)

	4/13/07	Mo. Earlier	Yr. Earlier
British Pound	**1.982900**	1.928800	1.752200
Canadian Dollar	**0.878812**	0.851400	0.869000
Euro	**1.351800**	1.320200	1.211300
Japanese Yen	**0.008384**	0.008601	0.008441
South African Rand	**0.138985**	0.133600	0.163300
Swiss Franc	**0.822774**	0.822200	0.770700

Securities Markets

	4/13/07	Mo. Earlier	Yr. Earlier
S & P 500 Stock Composite	**1452.85**	1392.98	1,289.12
Dow Jones Industrial Average	**12612.13**	12159.68	11,137.65
Dow Jones Bond Average	**198.1515**	200.5266	184.34
Nasdaq Composite	**2491.94**	2378.7	2,326.11
Financial Times Gold Mines Index	**2450.21**	2230.16	2,414.28
FT EMEA (African) Gold Mines	**3152.95**	2797.73	3,333.98
FT Asia Pacific Gold Mines	**9269.61**	7944.8	7,151.77
FT Americas Gold Mines	**1910.96**	1775.4	1,924.06

Coin Prices ($)

	4/13/07	Mo. Earlier	Yr. Earlier	(%) Premium
American Eagle (1.00)	**686.85**	662.95	611.15	0.75
Austrian 100-Corona (0.9803)	**653.72**	631.03	581.72	-2.18
British Sovereign (0.2354)	**162.05**	156.55	144.55	0.98
Canadian Maple Leaf (1.00)	**687.10**	663.20	611.40	0.78
Mexican 50-Peso (1.2057)	**805.90**	778.00	717.20	-1.96
Mexican Ounce (1.00)	**668.40**	645.30	594.90	-1.96
S. African Krugerrand (1.00)	**677.15**	653.75	602.85	-0.67
U.S. Double Eagle-$20 (0.9675)				
St. Gaudens (MS-60)	**690.00**	690.00	622.50	4.61
Liberty (Type I-AU50)	**762.50**	762.50	675.00	15.60
Liberty (Type II-AU50)	**690.00**	675.00	622.50	4.61
Liberty (Type III-AU50)	**670.00**	655.00	602.50	1.58
U.S. Silver Coins ($1,000 face value, circulated)				
90% Silver Circ. (715 oz.)	**9,567.50**	8,937.50	8,662.50	-3.59
40% Silver Circ. (292 oz.)	**3,937.50**	3,617.50	3,525.00	-2.85
Silver Dollars Circ.	**10,012.50**	9,925.00	9,225.00	-6.75

Note: Premium reflects percentage difference between coin price and value of metal in a coin, with gold at $681.75 per ounce and silver at $13.88 per ounce. The weight in troy ounces of the precious metal in coins is indicated in parentheses.

Recommended Mutual Funds ($)

	Ticker Symbol	4/13/07	Month Earlier	Year Earlier	— 52-Week — High	Low	Distributions Latest 12 Months Income	Capital Gains	Yield (%)
Short/Intermediate Fixed Income									
iShares Lehman 1-3 Yr Treasury[4]	SHY	**80.07**	80.38	79.72	80.60	79.26	3.3787	0.0000	4.22
Vanguard Short-term Inv. Grade	VFSTX	**10.57**	10.62	10.44	10.63	10.41	0.4824	0.0000	4.56
Real Estate/Utilities									
DNP Select Income[1, 2]	DNP	**11.34**	11.13	10.10	11.43	9.74	0.7800	0.0000	6.88
Vanguard REIT Index	VGSIX	**26.45**	26.52	21.18	28.93	20.67	0.6107	0.3723	2.31
U.S. Large Cap. Value Equity									
iShares S&P 500 Value Index[3]	IVE	**79.05**	76.17	68.64	79.87	65.64	1.5423	0.0000	1.95
Vanguard Value Index	VIVAX	**27.19**	26.14	23.25	27.32	22.63	0.6110	0.0000	2.25
U.S. Small Cap. Value									
iShares Sm. Cap 600 Value Index[3]	IJS	**78.34**	75.34	71.59	79.53	64.35	0.5998	0.0531	0.77
Vanguard Sm. Cap Value Index	VISVX	**17.68**	17.07	15.81	17.96	14.87	0.3130	0.0000	1.77
iShares Russell Microcap Index[6]	IWC	**60.27**	57.40	57.14	61.64	49.86	0.3396	0.0000	0.56
U.S. Large Cap Growth									
iShares S&P 500 Growth Index[3]	IVW	**66.34**	63.63	60.17	66.75	56.25	0.8147	0.0000	1.23
Vanguard Growth Index	VIGRX	**30.87**	29.65	28.25	31.07	25.91	0.2290	0.0000	0.74
Foreign - Developed Markets									
iShares MSCI EAFE Index[5]	EFA	**78.66**	73.16	63.85	78.69	58.17	1.5335	0.0000	1.95
iShares MSCI EAFE Value Index[5]	EFV	**76.51**	71.40	61.88	76.54	57.05	1.1925	0.0000	1.56
Vanguard Developed Markets Index[5]	VDMIX	**13.54**	12.63	11.22	13.54	10.32	0.2990	0.0050	2.21
Foreign - Emerging Markets									
iShares Emerging Markets Index[3]	EEM	**122.97**	111.27	101.20	122.97	81.35	1.5725	0.0000	1.28
Vanguard Emerging Market Index	VEIEX	**26.05**	23.63	21.65	26.05	17.95	0.3960	0.0000	1.52
Gold-Related Funds									
iShares COMEX Gold Trust[4]	IAU	**67.91**	64.12	59.68	72.32	55.06	0.0000	0.0000	0.00
streetTRACKS Gold shares	GLD	**67.84**	63.98	59.50	72.26	55.05	0.0000	0.0000	0.00

Recommended Gold-Mining Companies ($)

	Ticker Symbol	4/13/07	Month Earlier	Year Earlier	— 52-Week — High	Low	Distributions Latest 12 Months	Frequency	Yield (%)
Anglogold Ltd., ADR	AU	**48.65**	43.41	50.69	57.34	36.19	0.6100	Semiannual	1.41
Barrick Gold Corp.†	ABX	**29.34**	28.08	28.83	35.23	26.89	0.1870	Semiannual	0.67
Gold Fields Ltd.	GFI	**19.95**	17.07	23.18	26.33	16.22	0.2768	Semiannual	1.62
Goldcorp, Inc.[7]†	GG	**26.54**	24.10	29.99	40.67	21.13	0.1530	Monthly	0.63
Newmont Mining	NEM	**44.61**	42.14	52.87	58.43	40.83	0.4000	Quarterly	0.95
Rio Tinto PLC‡	RTP	**247.02**	210.81	216.97	247.02	179.07	4.1600	Semiannual	1.97

[1] Closed End Fund, traded on NYSE. [2] Dividends Paid Monthly. [3] Exchange traded Funds, traded on NYSE. [4] Exchange traded Funds, traded on AMEX. [5] New listing as of July 2006, replacing IEV and VEURX. [6] New listing as of July 2006. [7] 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.

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.