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Equity Performance
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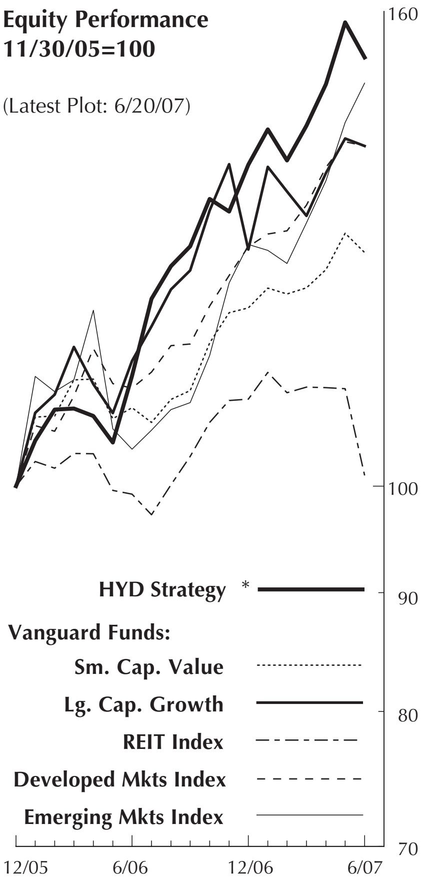
(Latest Plot: 6/20/07)



*** HYD is a hypothetical model based on back-tested results. See p. 46 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

SEC Oversight: Helpful, But Do Your Own Homework

The regulation of mutual funds is very much in the news. Not surprisingly, shareholders, fund managers, regulators, and, of course, politicians, are all weighing in with regard to the adequacy of current regulations. We contend that when it comes to reigning in abuses, no regulator can match the power of consumer sovereignty. Enforcement, ultimately, must come from millions of educated investors making rational decisions on their own behalf. To that end, this month's issue is largely devoted to scrutinizing the hidden fees and questionable practices that pervade the mutual fund and the retirement plan industries.

We generally approach regulation with a healthy dose of skepticism. Mutual fund rules currently on the books, after all, were designed to address perceived problems that existed (ostensibly) some three decades ago. These rules (described in the following pages) have failed to keep pace with change in the capital markets. For example, as SEC Chairman Cox has pointed out, regulations that allowed for "12b-1" (marketing) fees were justified on the grounds that they would foster the growth of a then-nascent mutual fund industry. That argument is now defunct; mutual funds now outnumber common stocks and hold more than $10 trillion in assets. Similarly, "soft dollar" payments from brokers to fund managers were permitted largely as a compromise at a time when an antiquated system of fixed commissions was being abolished. As we document herein, both of these loopholes have since been grossly abused.

The SEC's current appeal for greater transparency with respect to fees, however, appears sensible. We have often pointed out that while the past returns of a fund are generally a poor indication of future returns, the expenses they charge are an excellent indicator of the levies they will assess going forward. In other words, the returns of a security are beyond the control of investors and money managers alike. However, the fees that an investor opts to pay are completely within his control; it is imperative, therefore, that these levies are measured consistently and stated clearly. The SEC will always be "playing catch-up" to capital markets that are constantly innovating, but their quest to ensure that mutual funds make all of their costs explicit is quite reasonable.

We are always concerned that regulatory agencies, (the SEC, or the Department of Labor in the case of retirement plans) can create a false sense of security for investors who can become complacent simply because these entities exist. For individual investors, there is no substitute for conducting thorough due diligence before investing. Readers should take full advantage of the information that fund companies are required to publish (e.g. expense ratios). There are vast fee disparities among fees assessed by different mutual funds. The *Investment Guide* is designed to help confine your selections to include only those investment vehicles with cost-conscious managers who put the shareholder first.

American Investment Services, Inc. is wholly owned by the American Institute for Economic Research.

NEW RETIREMENT PLAN RULES—PERILS AND OPPORTUNITIES[1]

In recent years individual investors have enjoyed increased opportunity to lower their investment related costs. This is the result of a confluence of factors including technological and financial innovation, increased regulatory scrutiny of industry practices and a more sophisticated investing public. However, the qualified retirement plan industry, particularly defined contribution plans, remain one of the last bastions for the financial service industry's opaque and highly profitable fee structure. A host of new rules aim to increase transparency for plan participants (employees) and responsibilities for plan sponsors (employers).

This article focuses primarily on changes affecting 403(b) plans, which are sponsored by many non profit organizations. However, the trend is clear: all defined contribution plans, including 401(k) plans, will soon have to adopt more employee-friendly practices. Plan fees in particular will be under review. It behooves anyone with a defined contribution plan, including 401(k) participants and sponsors, to pay close attention to these developments as they are indicative of sweeping changes that are sure to follow.

Changes Afoot for Non Profits

Employers who sponsor 403(b) plans are facing a variety of new regulations; though these regulations have technically only been proposed, employers must demonstrate good faith compliance with these requirements pending the issuance of final regulations. In a nutshell, the new rules are calling for employers to play a greater role as a plan fiduciary.

For those organizations that intentionally adopted 403(b) plans in order that they be considered "non-ERISA (Employee Retirement Income Security Act) plans," or "non-employer sponsored plans," these changes will be drastic. For employers already operating with an ERISA plan (an "employer sponsored 403(b) plan") these changes make it clear that they will be held to the higher standards that currently apply to most other defined contribution plans.

Several new requirements have already been proposed by the IRS; final regulations are due out at any time. These fall into five broad categories.

Adopt a Written Plan Document

By year-end 2008, 403(b) plans must have a written plan document that outlines the rules of the plan. This includes all the material terms and conditions for eligibility, benefits, applicable limitations, distribution options and the contracts available under the plan.

In effect, this means the employer will have to manage and operate the plan. If the plan currently permits multiple vendors to offer benefits under the plan, those contracts will either have to be included in the written document or attached as an appendix to the written document. This will no longer be "open-ended." It is not clear whether plans of the "non-employer sponsored" variety will become ERISA plans as a result of this requirement. The Department of Labor (DOL) will provide guidance clarifying the full extent of the responsibilities associated with adopting a written plan document.

Review Vendors and Disclose Costs

Under the new rules, the employer will be responsible for the selection of all investment alternatives available under the plan. While this selection must still be broad and well-diversified, in some cases the employer will be required to limit the number of vendors and options. Because these choices will now fall entirely on the employer (employees will not choose from various vendors and products), it will become more important than ever for the employer to be able to communicate both the reasons for selecting a particular vendor and the costs associated with the product selected.

Drafting an investment policy statement (IPS) and a request for proposal (RFP) will help employers to both define their objectives and also provide a clear explanation of benefits and costs. This is not just a good idea; it is an employer's re-

AIS: Breaking New Ground in Retirement Plans

The times are a changin' in the retirement plan industry. The traditional high-priced, limited-selection service model is beginning to crumble, and we are poised to provide a better alternative.

These traditional packaged products are marketed, typically, by insurance companies and other large financial institutions. They are notorious for restricting investment options to their own high-priced products and they frequently fail to take advantage of practical and beneficial plan design features that can be utilized to suit an employer's unique objectives. The failure to seize opportunities is rampant; a few changes to a plan's structure and selections can save employers and employees thousands of dollars over time.

The services we provide are ahead of the curve:

- Our program is completely independent with regard to the investment vehicles used. For each of our recommended asset classes, we recommend only those investment vehicles that offer the best "bang for the buck" in terms of risk-adjusted returns after expenses.
- We keep overall plan costs low and completely transparent, through an "unbundled" approach in which we team with only the most cost competitive service providers (administrators and record keepers) who provide practical and proactive plan administration services.
- We also provide a feature that most other "unbundled plans" do not offer at the advisory level: We will analyze your plan and develop specific recommendation that address *all aspects* of your retirement program. All too often, "turn-key" providers rely on a "one-size fits all" approach using pre-designed boilerplate documents that are often inappropriate for many firms or organizations.

To arrange for a review of your 401(k), 403(b), or any other qualified retirement plan, at no cost, please contact Karen Miller, Director of Retirement Plan Services, at (413) 528-1216 ext 3155.

[1] Legal Disclaimer: This document should not be construed as formal legal advice. This outline is intended only to summarize our understanding of accepted law and proposed regulations.

sponsibility as a plan fiduciary. Even if current providers/vendors are retained, they should be reviewed as part of the RFP process. Since many 403(b) plans have been funded with high-fee, insurance based investment products, it may be difficult to discern and compare all of the fees. For example, many annuity products have a surrender charge that can be stretched out over seven years; the true cost of the plan will include any surrender costs paid by participants.

There is a strong tendency for employers to stick with existing vendors. Many vendors/service providers have already contacted clients who sponsor 403(b) plans to let them know they are prepared for the new rules and promise a painless transition to compliance with the regulations. Although the convenience of this approach might be tempting, this may well fall short of the new responsibilities associated with sponsoring a 403(b) plan under the new regulations. It is very likely that the 401(k) industry will similarly face new regulations regarding the prudent selection and monitoring of plan investment advisors and companies.

Many plan sponsors are unaware that there are investment alternatives that can save employees a great deal of money over their lifetime. This could amount to several thousands of dollars when compounded. Though 401(k) participant fees are often much lower than participant 403(b) fees, the range of fees assessed by various 401(k) plan structures is quite wide.

Employers who have not already done so should consider setting up a committee to monitor and document their vendor/service provider selection process. Vendors can include benefit consultants, but employers should also consider including employee representative(s) in addition to any in-house, human resource employees. The committee can produce an RFP and begin interviewing prospective vendors and service providers.

Implement a Monitoring Process

Since the plan sponsor must now play a greater role as plan fiduciary, oversight of plan operations will ultimately fall on the employer/plan sponsor. Processes for monitoring individual plan limits and benefits must be established and reviewed on a regular basis and although many of the tasks may be assigned to outside vendors/service providers, the responsibility for the selection will rest with the employer. Careful monitoring and documentation of the process will allow sponsors to minimize the time spent in the future addressing questions or concerns from plan participants, the IRS or the DOL.

Ensure Employee Communications

Employees must be notified of the new regulations since many of the changes affect them directly. In addition to any change, elimination or addition of plan vendors, employees must be notified of new distribution and transfer restrictions that take effect on January 1, 2008. In addition, employers will be required to notify eligible employees on a regular basis of their option to participate in the plan and when they can make and/or change their elections. (This is the "universal availability rule.")

If a committee or advisory board is established to review vendors, the same committee or board could be asked to develop or approve employee communication materials.

Other Changes

There are many other changes included in the proposed regulations, such as an end to 90-24 transfers (employees can no longer transfer to an investment not offered under the employer's plan) and the option to permit an employer to terminate a 403(b) plan. Many of these changes are highlighted in the thousands of pieces of correspondence that employers have been receiving from service providers and/or regulators.

The final regulations are due to be released at any time. The effective date of the regulations is January 1, 2008. We will keep our readers apprised of significant developments.

THE HIDDEN COSTS OF FUND INVESTING

Buying a mutual fund is a lot like renting a car: The price that's advertised can be *very* different from the price you actually pay.

The ad says you can rent a mid-size car for $19.99/day, but that's before the collision waver, the airport facility charge, the fuel surcharge, the car rental tax, the…well, you get the point. By the time you give your credit card to the man at the counter, that $19.99 fee has morphed into a $100 bill.

Unfortunately, the same thing is true of mutual funds. We all know that costs matter in investing, and ***INVESTMENT GUIDE*** readers know that it is critical to keep a close eye on expense ratios. But expense ratios are just one part of the equation. Commissions, soft dollar arrangements, trading costs, taxes…all of these are quite explicitly *not* on your side, and they are not always disclosed in the expense ratio. Understanding how these fees operate…and how they impact your mutual funds…is critical to making smart decisions about your portfolio.

The Myth of the Expense Ratio

The challenge in writing about hidden fees is that they are, well, hidden. Are they a big problem or a little problem? No one really knew, because there was no way to gather data on the hidden costs.

But earlier this year, a group of professors from Maastricht University in The Netherlands released a clever study[1] that put things in perspective. The professors compared the performance of large pension funds and their mutual fund counterparts. This is a valid comparison, as both types of funds are managed by the same companies, often by the same managers using the same portfolio strategies.

The comparison showed that the mutual funds underperformed their corresponding pension plans. That was no surprise: pension plans can be huge, and size matters in the money management industry. The California Public Employee's Retirement System (CalPERS) has $240 billion in buying power; the individual investor has effectively none. It's not difficult to determine who gets a better rate on their money market account. Plus, individual investor assets cost more to manage, because there are real costs associated with maintaining accounts, mailing statements and handling distributions, not to mention regulatory compliance.

Despite these differences, the *size* of the under-performance in the study was shocking. The Maastricht study found that mutual funds under-perform their pension plan counterparts by 150 to 250 basis points (1.5 to 2.5 percent) per year. To

[1] Frehen, Rik G.P., Bauer, Rob, Otten, Roger and Lum, Hubert, "The Performance of US Pension Funds" (February 26, 2007). Available at SSRN: http://ssrn.com/abstract=965388

put that in perspective, if your $100,000 fund investment sits for 20 years, 250 basis points in underperformance is going to cost you $65,000. That's real money.

What happened? The costs piled up. Let's walk through each component of those costs, and try to understand how we can find and avoid them.

The Costs We Know: Expense Ratios

The first place investors look for costs is in the fund's expense ratio. Expense ratios capture four core components of cost, are disclosed by prospectus and are reported periodically.

Management Fee: This is what the advisor charges to run the portfolio. Management fees range from a pittance (fewer than 10 basis points for certain index funds) to the more common one percent for most actively managed equity funds (and even more for unique, narrow asset classes).

12b-1 Fee: This arcane sounding line item would better be called a "marketing fee," because that's what it is. 12b-1 fees allow a fund company to push the costs of selling their products back onto the investor. They were designed with a noble intent: to allow funds to grow quickly so costs could be lowered due to economies of scale. But in practice, 12b-1 fees have become a catch-all bucket for all manner of marketing-related activities: advertising, trips to Hawaii for high-performing brokers and new websites are all fair game. The only real restriction on 12b-1 fees is that, if they exceed 25 basis points, the fund can't be marketed as "no-load."

Shareholder Services Fee: This line item, a recent contrivance, is perhaps most neatly summed up in the Dreyfus funds prospectuses, which define it as "the fee paid to the fund's distributor for shareholder services." Translation: "We want to be able to charge you for delivering your statements and accounting for your assets."

Other Expenses: This exceptionally vague category has the sole benefit of being reported, but that's about it. Other expenses can be nearly anything: fees paid to custodians, accountants, lawyers, and for all we know, loan-sharks and bookies.

Those four line items, when combined, comprise what most funds show as their "total expense ratio." This is typically between one percent and 1.5 percent for an actively managed fund, and less than 50 basis points for a no-load index fund.

Nearly Hidden Cost: Sales Expenses

Outside the published expense ratio, there are dozens of other documented-but-tricky ways to lose money on a mutual fund, including many that are disclosed. The most egregious of these costs is the straight-up sales charge, or load.

Mutual fund loads come in all shapes and sizes, but they all fund the same thing: They compensate full-service brokers. Perhaps the most offensive sales load is the "level load," in which a fund investor is charged a flat amount (usually one percent) each and every year that they own the fund, solely to compensate the broker who may have made the sale with one phone call to an unsuspecting retiree. Slightly less onerous is the "front-end load," where the fund company lops up to 6 percent of the initial investment right off the top, and hands it to the broker. Finally, the "Contingent Deferred Sales Charge" is a fee paid by investors who sell their fund shares within a certain time frame, usually five years.

The alternative to load fees is no-load funds, but even most no-load funds face cost pressures that ultimately come back to the investor. No-load funds, by definition, avoid sales loads, and thus are the only type of funds we would ever recommend in the pages of the *INVESTMENT GUIDE*. But if a fund company wants to have its shares featured in a "marketplace" such as Schwab's OneSource program, which makes funds available in its retail brokerage accounts, the fund itself will have to pay a marketplace fee. Historically, the cost of doing business with Schwab was 25 basis points—conveniently the same amount a no-load fund could charge as a 12b-1 fee. But times have changed, and Schwab[2] now charges up to 40 basis points. This means that a fund manager must not only fork over their 25 basis point 12b-1 fee, but an additional 15 basis points as well. While this isn't charged explicitly to the fund investor, that's who ultimately pays, typically through increased expense ratios.

Hidden Costs: Turnover and Trading

For most investors, indexing is an optimal way of capturing the returns of an asset class. Asset allocation and discipline are far more beneficial than day trading.

But if you look at what the average non-index fund manager is doing with your money, you'll see that we're in the minority. According to Morningstar, actively managed funds consistently average more than 100 percent turnover.[3] And all of that turnover costs money, sometimes in ways you cannot imagine.

First, there are the trading costs: Funds often pay upwards of two cents a share to make trades—this levy can exceed what an individual would pay to some discount brokers. Over the course of a year, these trading costs can easily add an extra 30-50 basis points in hidden fees—hidden because the investor will

[2] We do not utilize mutual funds that assess marketplace fees in our PAM advisory service. Our custodians (Schwab, TD Ameritrade and Fidelity) assess transaction fees when these funds are purchased or sold, but once accounts are established, trading is limited to occasional portfolio rebalancing, so these fees are not substantial.

[3] Turnover is a measurement of how frequently assets within a fund are bought and sold by the managers. It is calculated by taking either the total amount of new securities purchased or the amount of securities sold - whichever is less - over a particular period and dividing that by the total net asset value (NAV) of the fund. The measurement is usually reported for a 12-month time period.

Errata

In last month's article "Investing and the Business Cycle," we mistakenly stated that our parent organization, AIER, had "concluded that recession has begun." AIER in fact stated in its April 23 issue of *Research Reports* that "a recession now appears imminent." In Table 1 of that article we also incorrectly indicated that AIER had indicated recession had begun in March 2000. It was in fact not until May 2001 when AIER stated that contraction was more likely than continued expansion.

For a complete description of AIER's use of statistical indicators in their business cycle analysis, we recommend their book *Forecasting Business Trends* ($5.00).

never see a comprehensive disclosure of these charges.

For those two-plus cents, the fund is supposed to get "good execution." Good execution means getting the best possible price in the timeliest manner, minimizing yet another hidden cost: spreads. Unlike mutual funds, stocks and bonds don't trade at a single end-of-day price. It always costs more to buy something than to sell it, with the difference going to intermediaries who enable the trade. Over time, this difference eats away at an actively managed portfolio. Total spread costs for an actively managed fund can approach 50 basis points per year.

Beyond "good execution," commissions also go to pay soft dollars, the most hidden fee of all. Brokerage firms are in the business of getting transactions, so they woo large investors (such as mutual funds). Part of that courtship is purely value based: good execution for a good price. But many firms sweeten the deal by providing services, most commonly research, but they might also dispense "favors" such as allocations of hot initial public offerings (IPOs). A fund might pay three cents per share instead of two if that extra penny means a steady flow of analysis from the trading desk of a well-respected and in-the-know brokerage analyst. As chairman Cox has pointed out, this loophole has been grossly abused, to pay for items such as membership dues, carpeting, entertainment, interior decorators and even beach front villas.[4]

Ultimately, a fund's trustees are charged with overseeing these soft dollar arrangements in a way that benefits shareholders. But short of an SEC audit, these sign-offs are largely perfunctory, and discussions take place behind closed doors.

Finally, there is the most insidious hidden cost of all, and it hits each investor uniquely: taxes. An investor buying actively managed funds with their after-tax dollars can lose a substantial portion of their annual returns to the IRS. With 100 percent turnover in a hot market segment, shareholders can receive large capital gains distributions, even when they don't sell a fund. These distributions have to be paid with cash out-of-pocket, and can easily eat up 20-40 percent of gains in a fund. A 15 percent gain in a high-turnover, actively managed mutual fund is worth much less after taxes than the same return in a passive, low-turnover index product.

Once you add all these fees together—expense ratios, sales loads, hidden fees (including soft dollar costs) and taxes—it's easy to see why the average investor in an actively managed fund trails the market, and why the average mutual fund lagged its pension plan counterpart in the Maastricht study.

A Note about Index Funds

While index funds are the best defense against high fees, they are not immune to the problem, and they come with unique challenges all their own. For instance, all index funds have some amount of tracking error. Tracking error is the difference between the return of the index and the return of the fund, and it can vary from a few basis points to a few percent per year.

Index investors expect to miss their benchmarks by the explicit costs of their funds—the non-hidden costs. But indexing is as much art as science; other variables such as cash flows, portfolio optimization and securities lending conspire to make perfect tracking unrealistic.

Exchange-traded funds (ETFs) add new layers of uncertainty. ETFs are bought and sold like stocks, and like stocks, investors pay a spread and commission costs when they trade the funds. ETFs can also trade at premiums or discounts to the actual value of their assets, although in practice, most funds have traded close to the underlying assets.

The 401(k) Plan Trap

Investors might consider themselves better off in their employer's 401(k) plan, or some similar vehicle in which someone else (supposedly wiser) has taken on the burden of selecting investment vehicles. Unfortunately, in many (if not most) 401(k) plans, nothing could be further from the truth. Some of the most egregious abuses of the mutual fund fee structure occur within 401(k) plans and other defined contribution plans.

This happens because under the traditional 401(k) model, most 401(k) plan sponsors (employers) outsource their asset management decisions to the firm running the plan. This creates an instant conflict of interest. If a firm hires Fidelity, for instance, then Fidelity will most likely recommend a bucket of Fidelity funds. And while plan managers may include other funds from so-called fund marketplaces, there are no rigorous checks and balances to ensure that the funds are actually the highest performing, lowest cost, most appropriate investment choices for plan participants. In many plans a portion of the fund's fees are paid directly back to plan salesmen, creating a clear incentive for the plan manager to sell high-cost funds, other things equal.

In fairness, the reason investors end up paying more in a 401(k) plan than they do when managing assets themselves is that there *are* genuine costs that must be born. Someone has to manage the payroll deductions, the recordkeeping, the educational materials and the plan documents. These functions are generally delegated to a third party record keeper and administrator, who are often captive to the mutual fund company. In order to make their services appear "free" to the company sponsoring the plan, however, the fees for these additional activities are simply rolled up inside other costs whether they are called shareholder servicing fees, account fees, charges for loans, transactions, or other easily overlooked line items.

Thus, the incentives in many 401(k) plans are grossly misaligned. The fund company wants to garner the largest possible pool of assets with the highest margin (read: most expensive) funds. The plan sponsor wants to provide a perceived benefit to employees at the lowest possible direct cost. The participant simply wants to maximize returns. Guess who loses?

All of these perverse incentives can be avoided if employers instead adopt an "unbundled" plan utilizing independent service providers, with each providing fully disclosed fees for specific services. Ideally this team would be "quarterbacked" by an independent investment advisor who receives no remuneration from the funds they recommend. (See accompanying box to learn more about the services we provide.)

Quis custodiet ipsos custodes?

The good news is that the issue of hidden fees in mutual funds is being brought out into the daylight. It's nothing new: The Securities and Exchange Commission (SEC) has been hemming and hawing about fund expenses, hidden and not, for decades. But recently, more scrutiny has been given to soft dollar arrangements, with SEC Chairman Cox commenting recently:

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[4] Speech by SEC Chairman: Address to the Mutual Fund Directors Forum Seventh Annual Policy Conference www.sec.gov/news/speech/2007/spch041207/cc.htm

This witch's brew of hidden fees, conflicts of interest, and complexity in application is at odds with investors' best interests. We all know we can do better. That's why I've asked Congress to consider legislation to repeal or at least substantially revise the 1975 law that provides a 'safe harbor' for soft dollars.

Though we generally regard regulation with skepticism, this attention from Washington is not unfounded: the watchmen need watching. Every mutual fund has trustees, who have a fiduciary duty to make decisions solely in the best interest of fund shareholders. Things like trading practices, soft-dollar arrangements, tracking error, 12b-1 fees and loads are all the purview of fund trustees. In a perfect world, trustees would be true watchmen, questioning, challenging, and demanding evidence that these expenses were justified and fully disclosed. Only then would investors truly have the tools they need to make informed decisions.

In our view, the average fund trustee isn't doing enough, and it is apparent that Chairman Cox, along with the NASD and perhaps even Congress, will be paying more attention to the problem of hidden and semi-hidden fees.

At the end of the day, each investor must take responsibility for his own portfolio. After all, it's your money. Among the myriad of mutual funds available, many are excellent, but the line-up is constantly changing. We can help by monitoring these options and keeping you abreast of the best funds available.

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 40. 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 **AT&T Corp** and **Merck** are sufficiently large to warrant trading. In larger accounts, rebalancing positions in **Verizon** and **Citigroup** may be warranted.

Recommended HYD Portfolio
As of June 15, 2007

	Rank	Yield	Price	Status	*——Percent of Portfolio——* Value	No. Shares[1]
Pfizer	1	4.38%	26.47	Buying	12.96	21.01
CitiGroup	2	4.00%	53.98	Holding**	16.75	13.32
Altria Group	3	3.91%	70.67	Buying	12.88	7.82
Verizon	4	3.77%	42.99	Holding**	25.17	25.13
AT&T Corp	5	3.53%	40.28	Selling	18.96	20.21
JP Morgan Chase	6	3.01%	50.56			
Merck	7	3.00%	50.73	Selling	9.78	8.28
General Electric	8	2.94%	38.12			
General Motors	9	2.89%	34.66	*		
DuPont	10	2.88%	51.47			
KFT	NA		35.31	Selling	2.90	3.52
IAR	NA		36.07	Selling	0.60	0.72
					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.

HYD: A Passive Approach

The model's focus on current yields ignores most sources of stock market advice and information. The strategy, in effect, relies on the conclusions and findings (as evidenced by their actions rather than words) of only three groups of people: the editors of *The Wall Street Journal*, who pick major well-established corporations for inclusion in the DJIA; the directors and managements of the companies themselves who set the dividend payout; and the investing public, who determine the price of the stock. The first two must be considered as more knowledgeable than the third. The editors do not select flash-in-the-pan enterprises for their index, and directors and managers generally do not declare dividends that their companies cannot afford or sustain.

In our view the superior performance of the higher yielding issues in the DJIA is simply another manifestation of the market at work. If the distressed companies that typically offer higher dividend yields are in fact riskier than the high-flying growth stocks that dominate the other end of the list, then it should not be a surprise that the high-yielders, as a group, provide higher total returns. Greater risk *should* provide greater returns.

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 May 31, 2007)**

	1 mo.	*1 yr.*	*5 yrs.*	*10 yrs.*	*15 yrs.*	*Since 1/79*	*Std. Dev.*
HYD Strategy	6.31	51.63	13.43	13.16	15.60	18.90	17.03
Russell 1000 Value Index	3.61	25.58	12.51	10.59	13.24	14.71	13.85
Dow	4.62	24.85	8.98	8.50	12.09	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 Symbol	Market Prices ($) 6/15/07	5/15/07	6/15/06	12-Month ($) High	Low	Latest Dividend Amount ($)	Record Date	Paid	Indicated Annual Dividend ($)	Yield† (%)
Pfizer	PFE	**26.47**	27.10	23.53	28.60	22.16	0.290	5/11/07	6/05/07	1.160	4.38
Citigroup	C	**53.98**	52.79	48.68	57.00	46.22	0.540	5/07/07	5/25/07	2.160	4.00
Altria Group (s)	MO	**70.67**	69.41	70.58	72.20 *H*	47.00	0.690	6/15/07	7/10/07	2.760	3.91
Verizon	VZ	**42.99**	42.54	32.19	43.99 *H*	30.10	0.405	7/10/07	8/01/07	1.620	3.77
AT&T (New)	T	**40.28**	40.39	27.73	41.50 *H*	24.72	0.355	4/10/07	5/1/07	1.420	3.53
J P Morgan	JPM	**50.56**	52.03	40.60	53.25	39.33	0.380	7/06/07	7/31/07	1.520	3.01
Merck	MRK	**50.73**	52.62	34.33	55.14 *H*	32.75	0.380	6/08/07	7/02/07	1.520	3.00
General Electric	GE	**38.12**	36.64	34.11	38.49	32.06	0.280	6/25/07	7/25/07	1.120	2.94
General Motors	GM	**34.66**	31.97	25.59	37.24	23.71	0.250	5/11/07	6/09/07	1.000	2.89
Dupont	DD	**51.47**	50.90	40.93	53.67	38.82	0.370	5/15/07	6/12/07	1.480	2.88
Johnson & Johnson	JNJ	**62.77**	61.82	61.47	69.41	58.97	0.415	5/29/07	6/12/07	1.660	2.64
Coca-Cola	KO	**51.58**	52.46	43.04	53.65	42.27	0.340	6/15/07	7/01/07	1.360	2.64
Home Depot, Inc.	HD	**37.95**	38.30	37.37	42.01	32.85	0.225	6/07/07	6/21/07	0.900	2.37
Procter and Gamble	PG	**62.57**	62.07	54.88	66.30	52.75	0.350	4/27/07	5/15/07	1.400	2.24
3M Company	MMM	**87.67**	86.17	80.90	89.03 *H*	67.05	0.480	5/18/07	6/12/07	1.920	2.19
McDonald's	MCD	**52.17**	51.27	33.35	52.60 *H*	31.73	1.000	11/15/06	12/01/06	1.000	1.92
Intel Corp	INTC	**24.24**	22.01	18.12	24.25 *H*	16.75	0.113	5/07/07	6/01/07	0.450	1.86
Wal-Mart Stores	WMT	**49.34**	47.62	48.66	52.15	42.31	0.220	12/14/07	1/02/08	0.880	1.78
United Tech.	UTX	**72.01**	68.50	60.81	72.30 *H*	57.45	0.320	8/17/07	9/10/07	1.280	1.78
Caterpillar	CAT	**81.11**	76.01	70.85	81.60 *H*	57.98	0.360	7/20/07	8/20/07	1.440	1.78
Honeywell Int'l.	HON	**58.87**	58.01	38.93	59.37	35.53	0.250	5/18/07	6/08/07	1.000	1.70
Alcoa	AA	**41.60**	39.29	30.26	41.69 *H*	26.39	0.170	5/04/07	5/25/07	0.680	1.63
Exxon Mobil	XOM	**85.94**	81.13	59.12	86.45 *H*	56.64	0.350	5/14/07	6/11/07	1.400	1.63
IBM	IBM	**105.09**	104.83	78.56	108.05 *H*	72.73	0.400	5/10/07	6/09/07	1.600	1.52
Boeing	BA	**98.15**	94.34	84.81	101.45 *H*	72.13	0.350	5/11/07	6/01/07	1.400	1.43
Microsoft Corp.	MSFT	**30.49**	30.90	22.07	31.48	21.46	0.100	5/17/07	6/14/07	0.400	1.31
Amer. Int. Group	AIG	**72.54**	72.07	60.03	72.97	57.52	0.200	9/07/07	9/21/07	0.800	1.10
American Express	AXP	**63.77**	63.02	53.57	65.24 *H*	49.73	0.150	7/06/07	8/10/07	0.600	0.94
Walt Disney	DIS	**34.40**	35.94	29.19	36.79 *H*	27.95	0.310	12/15/06	1/12/07	0.310	0.90
Hewlett-Packard	HPQ	**45.71**	44.75	31.88	46.29 *H*	29.00	0.080	6/13/07	7/05/07	0.320	0.70

* See the Recommended HYD Portfolio table on page 46 for current recommendations. † Based on indicated dividends and market price as of 6/15/07. 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 ($)

	6/15/07	Mo. Earlier	Yr. Earlier
Gold, London p.m. fixing	**653.10**	668.25	569.50
Silver, London Spot Price	**13.06**	13.02	10.15
Copper, COMEX Spot Price	**3.42**	3.53	3.31
Crude Oil, W. Texas Int. Spot	**67.99**	63.17	69.50
Dow Jones Spot Index	**324.15**	312.59	270.36
Dow Jones-AIG Futures Index	**176.48**	173.23	169.35

Interest Rates (%)

		6/15/07	Mo. Earlier	Yr. Earlier
U.S. Treasury bills -	91 day	**4.43**	4.70	4.83
	182 day	**4.68**	4.71	5.15
	52 week	**4.93**	4.85	5.19
U.S. Treasury bonds -	10 year	**5.16**	4.71	5.10
Corporates:				
High Quality -	10+ year	**5.87**	5.44	6.24
Medium Quality -	10+ year	**6.76**	6.34	6.63
Federal Reserve Discount Rate		**6.25**	6.25	6.00
New York Prime Rate		**8.25**	8.25	8.00
Euro Rates	3 month	**4.15**	4.07	2.97
Government bonds -	10 year	**4.63**	na	3.96
Swiss Rates -	3 month	**2.49**	2.41	1.46
Government bonds -	10 year	**3.22**	2.90	2.69

Exchange Rates ($)

	6/15/07	Mo. Earlier	Yr. Earlier
British Pound	**1.976500**	1.986200	1.847900
Canadian Dollar	**0.936505**	0.911079	0.898600
Euro	**1.336500**	1.360300	1.261500
Japanese Yen	**0.008094**	0.008318	0.008706
South African Rand	**0.140499**	0.144718	0.145700
Swiss Franc	**0.804635**	0.824063	0.811500

Securities Markets

	6/15/07	Mo. Earlier	Yr. Earlier
S & P 500 Stock Composite	**1,532.91**	1,501.19	1,256.16
Dow Jones Industrial Average	**13,639.48**	13,383.84	11,015.19
Dow Jones Bond Average	**195.29**	200.18	185.05
Nasdaq Composite	**2,626.71**	2,525.29	2,144.15
Financial Times Gold Mines Index	**2,270.13**	2,287.19	2,190.65
FT EMEA (African) Gold Mines	**2,667.62**	2,844.87	2,634.57
FT Asia Pacific Gold Mines	**9,104.13**	8,806.41	6,446.96
FT Americas Gold Mines	**1,817.14**	1,804.37	1,822.10

Coin Prices ($)

	6/15/07	*Mo. Earlier*	*Yr. Earlier*	*(%) Prem*
American Eagle (1.00)	**668.85**	703.25	657.55	2.41
Austrian 100-Corona (0.9803)	**636.63**	669.33	625.92	-0.56
British Sovereign (0.2354)	**157.95**	165.85	155.35	2.74
Canadian Maple Leaf (1.00)	**669.10**	703.50	657.80	2.45
Mexican 50-Peso (1.2057)	**784.90**	825.10	771.70	-0.32
Mexican Ounce (1.00)	**651.00**	684.40	640.00	-0.32
S. African Krugerrand (1.00)	**659.55**	693.25	648.45	0.99
U.S. Double Eagle-$20 (0.9675)				
St. Gaudens (MS-60)	**690.00**	710.00	690.00	9.20
Liberty (Type I-AU50)	**762.50**	762.50	720.00	20.67
Liberty (Type II-AU50)	**712.50**	712.50	692.50	12.76
Liberty (Type III-AU50)	**655.00**	690.00	655.00	3.66
U.S. Silver Coins ($1,000 face value, circulated)				
90% Silver Circ. (715 oz.)	**9,200.00**	9,390.00	8,460.00	-1.48
40% Silver Circ. (292 oz.)	**3,775.00**	3,822.50	3,362.50	-1.01
Silver Dollars Circ.	**9,950.00**	10,075.00	10,150.00	-1.52

Note: Premium reflects percentage difference between coin price and value of metal in a coin, with gold at $653.10 per ounce and silver at $13.06 per ounce. The weight in troy ounces of the precious metal in coins is indicated in parentheses.

Recommended Investment Vehicles ($)

Short/Intermediate Fixed Income	*Ticker Symbol*	*6/15/07*	*Month Earlier*	*Year Earlier*	*52-Week High*	*52-Week Low*	*Distributions Latest 12 Months Income*	*Capital Gains*	*Yield (%)*
iShares Lehman 1-3 Yr Treasury[4]	SHY	**79.81**	80.09	79.58	80.60	79.26	3.4203	0.0000	4.29
Vanguard Short-term Inv. Grade	VFSTX	**10.49**	10.58	10.43	10.63	10.41	0.4948	0.0000	4.72
Real Estate/Utilities									
DNP Select Income[1, 2]	DNP	**11.02**	11.33	10.34	11.43	9.96	0.7800	0.0000	7.08
Vanguard REIT Index	VGSIX	**25.00**	25.73	21.66	28.93	21.12	0.6107	0.3723	2.44
U.S. Large Cap. Value Equity									
iShares S&P 500 Value Index[3]	IVE	**83.78**	82.35	67.86	84.32	66.26	1.5423	0.0000	1.84
Vanguard Value Index	VIVAX	**28.81**	28.28	23.15	28.81	22.83	0.6110	0.0000	2.12
U.S. Small Cap. Value									
iShares Sm. Cap 600 Value Index[3]	IJS	**81.87**	78.88	67.80	82.89	64.35	0.5998	0.0000	0.73
Vanguard Sm. Cap Value Index	VISVX	**18.25**	17.85	15.31	18.25	14.96	0.3130	0.0000	1.72
iShares Russell Microcap Index[6]	IWC	**61.57**	58.93	52.89	61.92	49.86	0.3396	0.0000	0.55
U.S. Large Cap Growth									
iShares S&P 500 Growth Index[3]	IVW	**70.09**	68.22	58.15	70.36	56.25	0.8147	0.0000	1.16
Vanguard Growth Index	VIGRX	**32.56**	31.64	26.99	32.56	25.91	0.2290	0.0000	0.70
Foreign - Developed Markets									
iShares MSCI EAFE Index[3,5]	EFA	**80.79**	80.02	61.11	81.79	59.67	1.5335	0.0000	1.90
iShares MSCI EAFE Value Index[3,5]	EFV	**78.92**	77.63	59.98	79.57	58.38	1.1925	0.0000	1.51
Vanguard Developed Markets Index[5]	VDMIX	**14.00**	13.78	10.78	14.00	10.62	0.2990	0.0050	2.14
Foreign - Emerging Markets									
iShares Emerging Markets Index[3]	EEM	**132.42**	124.88	89.21	132.42	85.40	1.5725	0.0000	1.19
Vanguard Emerging Market Index	VEIEX	**28.51**	26.69	18.90	28.51	18.76	0.3960	0.0000	1.39
Gold-Related Funds									
iShares COMEX Gold Trust[4]	IAU	**64.93**	66.66	57.15	68.76	55.60	0.0000	0.0000	0.00
streetTRACKS Gold shares[3]	GLD	**64.85**	66.54	57.32	68.73	55.55	0.0000	0.0000	0.00

Recommended Gold-Mining Companies ($)

	Ticker Symbol	*6/15/07*	*Month Earlier*	*Year Earlier*	*52-Week High*	*52-Week Low*	*Distributions Latest 12 Months*	*Frequency*	*Yield (%)*
Anglogold Ltd., ADR	AU	**40.89**	42.59	42.17	50.86	36.19	0.6100	Semiannual	1.49
Barrick Gold Corp.†	ABX	**29.14**	30.00	28.04	34.04	27.22	0.2210	Semiannual	0.76
Gold Fields Ltd.	GFI	**16.40**	17.12	17.94	24.10	15.81	0.2768	Semiannual	1.69
Goldcorp, Inc.[7]†	GG	**24.83**	23.68	26.99	31.30	21.13	0.1530	Monthly	0.62
Newmont Mining	NEM	**40.43**	40.21	50.51	55.52	38.77	0.4000	Quarterly	0.99
Rio Tinto PLC‡	RTP	**308.41**	276.25	204.94	308.41	179.07	4.1600	Semiannual	1.35

[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.

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