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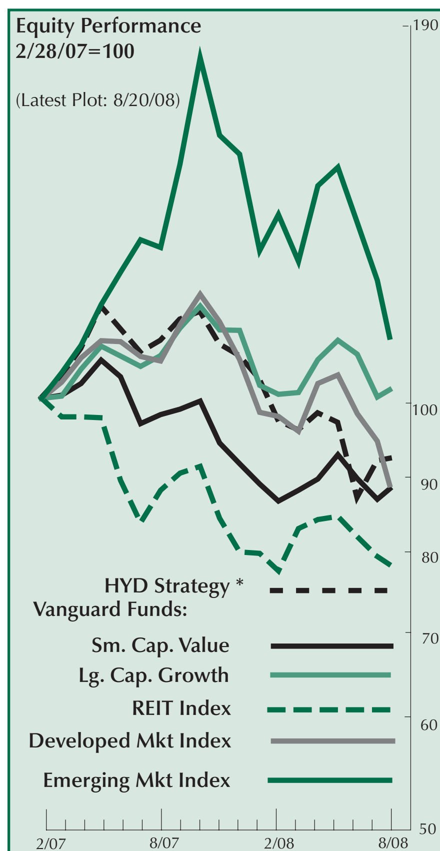

*** HYD is a hypothetical model based on back-tested results. See p.62 for full explanation**

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

Yes, You Can Beat the Market…Just Stop Trying

Our long-time readers are well aware of our skepticism toward "active" money managers; those who seek to outperform the overall stock market by picking "mispriced" stocks or by attempting to time the market's gyrations. Our recommendations are instead based on the tenets of Modern Portfolio Theory (MPT) and the notion of market efficiency. Active managers who have managed to outperform the market have done so only by chance, or by assuming greater risk than that posed by the market.

But there is a way to "beat the market." Simple logic dictates that an investor who chooses to hold a passively managed, market-cap weighted index of the entire U.S. stock market will earn *net* returns that, in fact, *exceed* those of the rest of the market. After all, if an investor holds such a portfolio, the aggregate of all other investors' portfolios must also comprise the market portfolio. The returns, before fees and expenses, earned by the passive portfolio will equal those of the market-cap weighted average of all other portfolios, since both provide market returns. Therefore, when the fees and transaction costs of active management are accounted for, the (net) returns of the passive investor must be higher.

John Bogle, founder of the Vanguard Group, put it most succinctly:

> "Whether markets are efficient or inefficient, investors as a group must fall short of the market return by the amount of the costs they incur…Even for investors who incur more modest costs (say, 1% per year), the odds are that 95% of them will fail - often by huge amounts - to earn the stock market's return over an investment lifetime."[1]

Ken French of Dartmouth's Tuck School of Business recently quantified the cost of active management[2]. In his study French found that an average investor pays 0.67 percent per year by choosing active management rather than simply embracing the market's returns. This is the cost the typical active investor can expect to pay for the privilege of being able to earn, on average, the market's rate of return. Over short periods some will of course outperform the average (just as some will underperform), but none can do so consistently.

Yet hope springs eternal. At the end of 2007 only 12.7 percent of mutual fund assets were held in passive funds. Apparently the remaining 87.3 percent remains in the hands of active investors, each of whom is convinced that everyone else is foolish, and that they possess a special ability to exceed the generous returns of the capital markets that are there for the taking.

Errata: The U.S. Treasury Yield Curve chart on page 53 of the July issue of *Investment Guide* was incorrectly labeled. Current subscribers can request a revised version by emailing us at aissubscriptions@americaninvestment.com. We apologize for the error.

[1] November-December 2003 issue of CFA Magazine
[2] French, Kenneth R.,The Cost of Active Investing(April 9, 2008). Available at SSRN: http://ssrn.com/abstract=1105775

WHAT MEDICARE DOES AND DOESN'T COVER -- AND HOW TO FILL THE GAPS

While many individuals approaching age 65 know that they will soon be eligible for Medicare, they may not know that even with this health care cushion they can still end up incurring large, unexpected medical bills if they do not know about the program's coverage gaps and how to fill them. Because plan costs and benefits change periodically, it's important for those who are already enrolled to review benefits each year and determine if their insurance coverage still meets their needs.

The Basics

Medicare pays for many hospital, physician, and health care expenses. The original Medicare plan, managed by the Federal government, consists of Part A (hospital insurance) and Part B (medical insurance). Part A helps cover inpatient hospital care and some skilled nursing facility, hospice, and home health care costs if you meet certain conditions. Part B helps cover services such as doctors' services and outpatient care, as well as some preventive services.

Out-of-pocket costs for original Medicare depend on a number of factors, including whether your doctor accepts the program's assigned charges, whether you have Medigap insurance, and how often you use health care services. Below is a partial list of the major items that are *not covered* by Medicare Parts A and B.

- Most chiropractic services
- Cosmetic surgery
- Custodial care (such as help with bathing or using the bathroom), except when you also get skilled nursing care in a skilled nursing facility, at home, or in a hospice.
- Deductibles, coinsurance or co-payments for certain health care-services. See accompanying box.
- Dental care and dentures
- Routine eye care and most eye-glasses
- Foot care
- Hearing aids and exams
- Long-term care
- Prescription drugs
- Shots to prevent illness.
- Routine physical exams
- Foreign travel emergencies
- Premiums. If you or a spouse paid Medicare taxes while working, you usually don't pay Part A premiums. The Part B standard premium of $96.40 is paid each month. However, your monthly premium is higher if you are single and your annual income is over $82,000, or if you are married filing jointly and your annual in come exceeds $164,000. The maximum Part B monthly premium is $238.40.

Doctor's Assignments

One of the biggest coverage gaps occurs when doctors charge more than Medicare allowable charges. Be sure to ask physicians if they accept Medicare assignments. Doctors who accept assignments agree to be paid by Medicare and to accept only the amount Medicare approves for their services. They can only charge you or your Medigap insurance company the Medicare deductible or co-insurance amount.

Doctors or health care providers who do not agree to accept assignment are required to submit a claim to Medicare directly and can bill you for more than the Medicare-approved amount. For some services a "limiting charge" of 15 percent over the Medicare-approved amount applies, and you will pay the difference between the assignment and the additional charge. Other physicians will not work with Medicare at all, and require a private fee-for-service contract. If you sign one of these contracts it means that neither Medicare nor Medigap insurance will pay for services and you are responsible for the bill. To find doctors who accept assignment, visit www.medicare.gov and click on "Search Tools."

Amounts You Must Pay Under Medicare Parts A & B: Deductibles, coinsurance or co-payments

Hospital stays: $1,024 deductible and no-coinsurance for days 1-60 per benefit period, $256 per day for days 61-90, and $512 per "lifetime reserve day" after day 90 each benefit period (up to 60 days)

Skilled nursing facility: $0 for the first 20 days of each benefit period; $128 per day for days 21-100 each benefit period. All costs after day 100.
Home health care: 20 percent of Medicare-approved amount for durable medical equipment.

Blood: 20 percent of Medicare-approved amount for more than three pints.

Medical and other services: 20 percent of Medicare-approved amount for most doctor services, outpatient therapy, most preventive services, and durable medical equipment.

Mental health: Fifty percent of most outpatient mental health care.

Part C--Medicare Advantage

Another way to get Medicare coverage is through Part C Medicare Advantage Plans, which are Medicare-approved health care options such as HMOs and PPOs that are managed by private companies. They typically combine Part A and Part B coverage, and may also include prescription drug coverage provided in Medicare Part D. Some of them offer extra benefits, such as coverage for vision, hearing, dental, or health and wellness programs. These plans can charge different co-payments, co-insurance and deductibles. You generally pay the monthly Part B premium to participate in a Medicare Advantage plan, and perhaps an additional premium for benefits not included in Parts A and B.

Part D--Prescription Drug Coverage

If you do not participate in a Medicare Advantage Plan that has prescription drug coverage, you can obtain Part D coverage for prescription drugs through a Medicare drug plan run by private companies. Although these plans are required to cover many drugs, they may exclude certain drugs from coverage and charge different co-payments or co-insurance.

Medigap

Medigap insurance is designed to pay for many of the expenses listed previously that Medicare does not cover. A Medigap policy covers only one person. If you and your spouse both want Medigap coverage you each must buy separate Medigap policies. Medigap policies only work with the original Medicare plan. If you participate in a Medicare Advantage Plan you should not buy a Medigap policy.

Medigap policies are standardized and each one offers the same basic benefits, regardless of the insurance company that is selling it. The only difference between them is cost, and there can be

big differences in the premiums insurance companies charge for exactly the same coverage. According to TheStreet.com Ratings (formerly Weiss Ratings) the price last year for the most popular Medigap coverage, Plan F, ranged from $788 a year to nearly $12,000 for a 65-year old male. The median policy price was $1,880. Some companies may offer discounts such as those available to non-smokers or married individuals. The best way to get information on prices of Medigap policies in your area is to contact your State Health Insurance Assistance Program (www.shiptalk.org).

There are a dozen standard Medigap plans, labeled A-L, each offering different levels of coverage. (If you live in Massachusetts, Minnesota, or Wisconsin you have different standard Medigap plans.) Plans A and B are the most basic and include Medicare Part A co-insurance amounts for hospital stays over 60 days and Medigap coverage for hospital benefits, Part B co-insurance or co-payments for outpatient services, and blood. The more comprehensive plans may also cover the Part B deductible and excess charges, foreign travel emergency, and skilled nursing facility co-insurance. Plans F and J offer a lower cost, high deductible option where you pay the first $1,900 in Medigap-covered costs before the Medigap policy kicks in. Plans K and L, also high deductible plans, have out-of-pocket limits of $4,440 and $2,220, respectively. These high-deductible plans are best suited for healthier individuals. Some low-income individuals may qualify for Medigap coverage through Medicaid, or through a Medicare savings program. The Medicare website has more detailed information on the standardized Medigap plans and what they cover.

Long-term Care Insurance

Long-term care in a nursing home or home setting is not covered by Medicare or Medigap, and it is typically covered by Medicaid only if you have exhausted your savings and are near impoverishment. With the average cost of a private room in a nursing home running $74,806 a year, many people are left with a large funding gap if they need long-term care.

Long-term care insurance is designed to alleviate the burden of long-term care expenses. Policy coverage may include costs associated with a nursing home, assisted living facility, adult day care, or nursing care in a home setting. This form of insurance can be quite expensive. According to the U.S. Department of Health and Human Services, the average cost of a comprehensive long-term care policy in 2005 was about $2,000 for an individual between the ages of 65-69. Not everyone can afford both Medigap and long-term care insurance and may need to choose between the two. When weighing the options it's important to keep in mind that a relatively small percentage of individuals require long-term care in an expensive nursing home setting for an extended period, and about half of those who do enter a nursing home remain there for less than one year. Most people are more likely to use Medigap policy benefits for co-payments, extended hospital stays, and other costs not covered by Medicare.

If you are considering long-term care insurance, stick with an insurance company that has experience in the long-term care insurance market. Ten of the largest insurers accounted for 87 percent of all individual long-term care policy sales in 2007, according to the Life Insurance Marketing Research Institute: Allianz Life, Bankers Life and Casualty, Genworth Financial, John Hancock, Massachusetts Mutual, MetLife, Mutual of Omaha, New York Life, Northwestern, and Prudential. Make sure the carrier has top financial strength ratings from at least two insurance rating companies such as A.M. Best, Moody's, Weiss, or Standard & Poor's.

Health Savings Accounts

If your employer offers a Health Savings Account (HSA), you can consider contributing to this tax-deferred account in order to establish a "nest egg", from which you can make tax-free withdrawals at any time to pay for out-of-pocket medical expenses, including those not covered by Medicare. For a detailed discussion of these accounts, see the February and March 2008 issues of *Investment Guide*.

INDEXED ANNUITIES: DON'T BE A VICTIM

Investors beware: sharp salesmen are on the prowl and are pushing new products more aggressively than ever. Equity Indexed Annuities (EIAs) in particular are being touted as the ultimate free lunch, but in most cases the fare is in fact quite poor, and very costly.

Sales efforts have become so brazen that the Securities and Exchange Commission (SEC) is now weighing whether to consider these products to be securities, which would effectively put them under the SEC's purview (see accompanying box).

The sales push is fueled by demographics. Increasing life expectancies and price inflation, especially rising health care costs, are contributing to rising anxiety over living standards in retirement. Baby boomers, especially those seeking a "sure thing" retirement-income savings vehicle, are especially vulnerable.

A Short Review of Annuities

Annuities are of two basic types, immediate and deferred. *Immediate annuities* allow investors to make a lump-sum purchase of an income stream that will continue for a certain period, often the remainder of the annuitant's life. It is an insurance product that essentially guarantees the annuitant will never outlive his income. Insurance companies offer many payout variations, such as joint and survivor annuities, that ensure payments will continue after the death of the primary annuitant.

Deferred annuities on the other hand, do not provide income for at least a year, and usually many years, after the investment is made. During this accumulation phase, investors make a lump-sum purchase or periodic payments to an investment subaccount, which grows tax-deferred[1]. When the payout phase begins, the annuitant may choose to annuitize the account, or withdraw funds as needed. If annuitized, part of each payment will be tax-free depending on the annuitant's life expectancy and the size of his after-tax purchase payments. Withdrawals, on the other hand, are fully taxable at the owner's marginal tax rate until all the earnings have been paid out. Subsequent withdrawals of principal are tax-free.

Deferred annuities are of two general types, fixed and variable. During the accumulation phase fixed annuities earn interest at a rate that is adjusted periodically by the insurance company, while the returns on variable annuities depend on the investment performance of the underlying subaccounts. In this respect variable annuities are very similar to mutual funds.

Equity indexed annuities (EIAs) are a hybrid type of deferred annuity and they share characteristics of fixed and variable annuities. EIAs offer a guaranteed minimum interest rate, touted as a "floor," as well as an interest rate that is linked to an

external equity reference. Very often the S&P 500 is the index of choice, though others are available. Thus, their returns are more volatile than those of fixed annuities, but are less volatile than variable annuities. Of course risk and return go hand in hand; other factors equal (e.g., fees), EIAs' expected returns lie above those of fixed annuities and below those of variable annuities.

Downside "Protection"

The downside-protection feature of an EIA is a guaranteed value (the minimum available for withdrawal) often calculated as 90 percent of your premium plus 3 percent annually. Notably, price inflation has averaged over 4 percent annually. So, considering that you begin with a 90 percent base, if the equity index performs poorly and this minimum floor applies in any given year, you could lose money in nominal terms, and even more in inflation-adjusted dollars.

Suppose you pay a $50,000 premium for an EIA with this feature, and that a bear market prevails for two years, while inflation averages 3.5 percent annually over the period. Your guaranteed value will be $47,740 after 2 years, representing only $44,551 in purchasing power.

Deferred annuities are appropriate only as a long-term investment, so the guarantee is valuable only in the unlikely event that you would have to turn to your EIA to meet some unforeseen event, but this withdrawal could be costly. Most EIAs impose surrender charges for withdrawals taken over the first five to seven years of the contract, some as high as 9 percent in the first year. Some allow a limited number of withdrawals each year, but penalties typically apply for withdrawals that exceed a specified level. In addition, any gains will be taxed as ordinary income, and if taken before age 59 1/2, a 10 percent income tax penalty would apply.

The EIA's guarantee, moreover, is only as strong as the solvency of the insurance company backing the contract. Rating agencies such as A.M. Best and Standard and Poor's can help screen out weak companies. However, insurance companies are offering ever more aggressive promises in their expanding array of annuity products. So due diligence regarding an insurer's claims paying ability is extremely important.

The Downside of the Upside

Our greatest concern with EIAs, however, is not with the downside protection but with the so called "upside potential" they are said to provide. Because these are unregulated contracts, the methods for computing and crediting index-linked interest vary considerably among EIAs, and even the most diligent investor must read the contract very carefully. The contract's "fine print" can dramatically impact the growth of the investment.

The index-related interest rate is impacted by a host of parameters, the most significant of which are *participation rates, fees,* and *interest-rate caps*. The participation rate is that percentage of the gain in the index that gets credited to the annuity, and it can vary between 50 percent and 100 percent. Thus you could buy a contract that will only participate at half the rate of growth of the market. Your returns can also be limited by fees. These are spread, margin, or asset-based fees that are subtracted from any gain in the index, and can be in lieu of or in addition to participation rates. Interest-rate caps might also be imposed, which simply place a ceiling, sometimes as low as 8 percent, on the rate of interest that can be earned. This could essentially render the notion of "market-linked growth" meaningless. The S&P 500 returned 12.74 percent annually between January 1974 and December 2007. In 20 of those years the index returned more than 8 percent, during which a contract with a simple 8 percent cap would have missed out on 63 percent of the market's gains, on average.

Even if these parameters appear reasonable, investors must be on guard, since participation rates, fees, and rate caps can all potentially be changed at the end of a contract term, which could be as short as one year.

In addition there is no standardized method for calculating the amount of interest credited for a given change in the index. EIAs even differ with matters as fundamental as compounding. Some pay only simple interest, based on the premium paid, but not on prior interest earned during the term, while others will compound interest earned during the term.

Common interest-crediting methods include *annual reset, high-water mark*, and *point-to-point* calculations. Under the annual reset method the index-based interest is calculated each year by comparing the index value at the beginning and end of each contract year, ignoring declines. On its face this method would appear to be more generous than others during periods of market volatility, but this feature is typically coupled with restrictive caps or frequently changing participation rates.

Equity Indexed Annuities: The Cost of Excluding Dividends

Annualized Returns, S&P 500 December 1974 - July 2008

Total Return	12.47
Capital Appreciation Return	8.99
Income Return (dividends)	3.22

The high-water mark calculates interest using the highest index value at certain points during the term of the contract, often on the contract anniversary. This method therefore might generate a higher rate of interest than other methods, and protects against subsequent declines in the market during the period after the peak has been reached. But this technique is often combined with restrictive participation rates or caps, and interest is not credited until the end of the term, so early surrender could result in loss of any index-based interest earned during the period.

The point-to-point method compares the index values at the beginning and end of the entire term. The downside here is that only two data points are used, so a sudden decline in the market at the end of the period can quickly eradicate any gains. In addition, interest cannot be added until the end of the term, which could be seven years, so a premature withdrawal will result in forfeiture of any interest. These negatives are often mitigated by higher participation rates or higher rate caps.

Almost all EIAs exclude any dividends when computing interest based on an index; the S&P 500, which is most frequently used, is a price index only. The table above demonstrates that dividend exclusion can have a significant impact when comparing EIAs with the alternative of holding common stocks or mutual funds directly.

The complex nature of these calculations makes it very difficult to shop around and compare EIAs, and this is further complicated by the structure of the insurance industry. Typically a salesman will present only the product sold by his

[1]This favorable tax treatment is granted because these products provide an element of insurance known as the guaranteed death benefit, which provides downside protection of the owner's investment. Typically the owner's heirs receive the greater of the current market value of the annuity subaccount or the owner's original investment.

firm, for which he receives a commission. He therefore will not offer competing products, and is likely to discourage you from looking elsewhere.

Equity indexed annuities sound very appealing, but should be avoided. You are better off maintaining your own portfolio, designed to accommodate your tolerance for risk, using the investment vehicles we recommend. If you seek help from a financial services professional, we strongly recommend that you avoid anyone compensated for selling a particular product. Instead you should seek a fee-only, registered investment advisor who is free to recommend any investment from the universe of financial assets available, and whose only interest is recommending well-diversified, low-cost investment vehicles representing those asset classes best suited to meet your needs.

Annuity Sales Practices Drawing Regulatory Scrutiny

It is important for buyers of variable annuities to understand that in addition to being insurance products, they are investment securities and are subject to SEC regulation and registration. An equity indexed annuity (EIA), on the other hand, is a type of insurance product that is exempt from the regulation and registration requirements, including the disclosure, anti-fraud and sales practice protections that apply to investment securities.

While the transfer of investment risk from the insured to the insurance carrier is a key distinguishing characteristic of an insurance contract, EIAs involve an element of market risk that is borne by the insured. The SEC is therefore questioning whether EIAs should continue to qualify for exemption, and therefore whether EIAs should be subject to the same oversight of sales practices protections that apply to securities.

Although the SEC inquiry is ostensibly driven by concern for the welfare of investors, it is not at all clear that this question will be resolved to the benefit of investors. A special interest battle lurks behind the scenes. EIAs have traditionally been considered insurance products and sold by insurance agents, who are subject to oversight by state insurance regulators. Many agents do not hold securities licenses, so if EIAs are deemed to be securities, sales of these lucrative, high-commission products would merely be transferred from insurance agents into the hands of SEC registered broker-dealers.

Neither insurance agents nor broker-dealers hold a *fiduciary duty* to customers and are therefore not required to meet the standard of care threshold that is required of registered investment advisors (RIAs). An RIA has a specific affirmative duty to put the client's interests ahead of his or her own, and to provide advice and recommendations that are best for the client. An RIA is also required to provide clients with several up-front disclosures, including any potential conflicts of interest. Neither agents nor broker-dealers are subject to the stringent, in-advance disclosure rules with which RIA's must comply.

Investors seeking the advice of investment professionals should seek the services of a qualified RIA rather than insurance representatives or securities brokers, and any RIA's SEC registration should be carefully reviewed. Investors should avoid anyone selling financial products limited to those created by a particular firm, or who receives compensation from firms for selling a particular product.

IMMEDIATE ANNUITIES: RETIREES BEWARE

In the preceding article we caution investors who might be considering the purchase of a *deferred annuity* amidst the confusing array of indexed products that are being marketed aggressively. But many *immediate annuities*, which begin making periodic payments shortly after they are purchased, are equally suspect. A traditional, low-cost immediate annuity might deserve a place alongside a well allocated investment portfolio. However, far too many inferior products are being aggressively foisted upon retirees fearful of outliving their income.

Immediate annuities provide a stream of income as long as the annuitant lives. An insurance company can guarantee that income because the mortality experience of large groups is predictable. Firms can offer contracts that will provide payments to those who exceed their life expectancies because they are funded in part by premiums paid by other annuitants who die prematurely relative to their life expectancies.

These simple "lifetime only" contracts, however, have numerous variations, such as installment refunds, stepped-up payments, and joint-and-life survivorship features. All of these provide a reduced income stream, higher fees, or both, compared to lifetime only annuities. Faced with the reality of price inflation, annuitants have come to demand contracts with payments that can increase over time. The industry has responded with products that provide payments indexed to inflation. Perhaps the most significant innovation, however, is the variable-rate immediate annuity. Under these contracts, premiums are invested in subaccounts similar to mutual funds in which the annuitant, rather than the insurance company, bears the market risk, since the periodic payments will vary with the experience of the underlying investment.

Many firms are now offering an array of "living benefit" policy riders that seek to limit the downside of these variable payments by guaranteeing a "floor" below which payments cannot fall, but also promising annuitants that they will enjoy higher payments when the market does well. Ever more creative riders with new promises and fees are emerging regularly. The industry racked up $41.644 billion in premium flows in the first quarter of 2008 bringing total VA assets to $1.396 trillion according to NAVA, the Association for Insured Retirement Solutions.

It is beyond the scope of this article to catalogue these various schemes. However, high-pressure salesmen have approached many of our clients. In many cases fees are exorbitant (sub-account expense ratios average about 1.8 percent higher than mutual fund alternatives), payment limits are glossed over, and risks, if stated, are underemphasized. When we (painstakingly) dissect these contracts we invariably recommend that investors "just say no."

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 the back page. 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.

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

Recommended HYD Portfolio

As of August 15, 2008

	Rank	Yield	Price	Status	Value	No. Shares[1]
					Percent of Portfolio	
Bank of America	1	8.34%	30.70	Buying	10.34	8.69
Citigroup	2	6.90%	18.55	Holding**	17.77	24.72
Pfizer	3	6.41%	19.97	Holding**	25.61	33.09
AT&T Corp.	4	5.05%	31.66	Buying	5.60	4.56
Verizon	5	4.92%	34.96	Selling	21.72	16.03
Merck & Co.	6	4.20%	36.16			
General Electric	7	4.16%	29.80			
Morgan (JP)	8	3.99%	38.07			
AIG	9	3.83%	22.99			
DuPont	10	3.59%	45.70			
Altria Group	NA		21.60	Selling	5.17	6.17
Philip Morris Int'l	NA		55.57	Selling	13.29	6.17
Kraft	NA		32.96	Selling	0.41	0.32
Fairpoint	NA		8.71	Selling	0.08	0.24
					100.00	100.00

* 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.

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 text for a description of the model's construction.

Hypothetical Total Returns (percent, through July 31, 2008)*

	1 mo.	1 yr.	5 yrs.	10 yrs.	20 yrs.	Since 1/79	Std. Dev.
HYD Strategy	7.00	-16.16	10.17	7.87	15.17	17.13	17.12
Russell 1000 Value Index	-0.36	-15.15	8.51	5.06	10.98	13.19	13.92
Dow	0.43	-11.71	6.67	4.62	11.44	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 20-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.

RECENT MARKET STATISTICS

Precious Metals & Commodity Prices ($)

	8/15/08	Mo. Earlier	Yr. Earlier
Gold, London p.m. fixing	**786.50**	986.00	667.25
Silver, London Spot Price	**12.82**	19.30	12.51
Copper, COMEX Spot Price	**3.34**	3.72	3.37
Crude Oil, W. Texas Int. Spot	**113.76**	138.73	73.33
Dow Jones Spot Index	**390.67**	462.45	314.92
Dow Jones-AIG Futures Index	**187.15**	224.21	167.33
Reuters-Jefferies CRB Index	**382.30**	449.49	311.89

Interest Rates (%)

	8/15/08	Mo. Earlier	Yr. Earlier
U.S. Treasury bills - 91 day	**1.81**	1.37	4.10
182 day	**1.94**	1.86	4.31
52 week	**2.05**	2.08	4.41
U.S. Treasury bonds - 10 year	**3.84**	3.87	4.69
Corporates:			
High Quality - 10+ year	**5.61**	5.58	5.82
Medium Quality - 10+ year	**7.11**	7.09	6.69
Federal Reserve Discount Rate	**2.25**	2.25	6.25
New York Prime Rate	**5.00**	5.00	8.25
Euro Rates 3 month	**4.97**	4.96	4.53
Government bonds - 10 year	**4.20**	4.38	4.33
Swiss Rates - 3 month	**2.75**	2.80	2.75
Government bonds - 10 year	**2.92**	3.08	3.00

Exchange Rates ($)

	8/15/08	Mo. Earlier	Yr. Earlier
British Pound	**1.865100**	2.003600	1.992300
Canadian Dollar	**0.942596**	0.998502	0.930579
Euro	**1.469500**	1.592300	1.347900
Japanese Yen	**0.009051**	0.009544	0.008533
South African Rand	**0.126902**	0.130888	0.135639
Swiss Franc	**0.912409**	0.991179	0.820951

Securities Markets

	8/15/08	Mo. Earlier	Yr. Earlier
S & P 500 Stock Composite	**1,298.20**	1,214.91	1,406.70
Dow Jones Industrial Average	**11,659.90**	10,962.54	12,861.47
Dow Jones Bond Average	**206.50**	205.74	198.49
Nasdaq Composite	**2,452.52**	2,215.71	2,458.83
Financial Times Gold Mines Index	**2,203.66**	3,298.96	2,203.26
FT EMEA (African) Gold Mines	**1,861.42**	2,665.26	2,335.65
FT Asia Pacific Gold Mines	**9,011.66**	13,887.48	9,582.12
FT Americas Gold Mines	**1,968.46**	2,967.44	1,801.56

Coin Prices ($)

	8/15/08	Mo. Earlier	Yr. Earlier	Prem (%)
American Eagle (1.00)	**850.22**	951.53	686.45	8.10
Austrian 100-Corona (0.9803)	**798.63**	901.22	653.33	3.58
British Sovereign (0.2354)	**197.45**	222.45	161.95	6.65
Canadian Maple Leaf (1.00)	**840.50**	948.30	686.70	6.87
Mexican 50-Peso (1.2057)	**984.50**	1,110.70	805.40	3.82
Mexican Ounce (1.00)	**816.60**	921.40	668.10	3.83
S. African Krugerrand (1.00)	**833.88**	929.67	676.75	6.02
U.S. Double Eagle-$20 (0.9675)				
St. Gaudens (MS-60)	**947.50**	977.50	700.00	24.50
Liberty (Type I-AU50)	**1,070.00**	1,050.00	762.50	40.62
Liberty (Type II-AU50)	**1,020.00**	1,012.50	712.50	34.04
Liberty (Type III-AU50)	**907.50**	962.50	675.00	19.26
U.S. Silver Coins ($1,000 face value, circulated)				
90% Silver Circ. (715 oz.)	**10,250.00**	12,450.00	9,012.50	11.82
40% Silver Circ. (292 oz.)	**4,100.00**	4,975.00	3,730.00	9.52
Silver Dollars Circ.	**13,425.00**	14,275.00	10,250.00	35.37

Note: Premium reflects percentage difference between coin price and value of metal in a coin, with gold at $786.50 per ounce and silver at $12.82 per ounce. The weight in troy ounces of the precious metal in coins is indicated in parentheses.

THE DOW JONES INDUSTRIALS RANKED BY YIELD*

	Ticker	Market Prices ($)			12-Month ($)		Latest Dividend	Record		Indicated Annual	Yield†
	Symbol	8/15/08	7/15/08	8/15/07	High	Low	Amount ($)	Date	Paid	Dividend ($)	(%)
Bank of America	BAC	30.70	18.52	48.23	52.96	18.44	0.640	9/05/08	9/26/08	2.560	8.34
Citigroup	C	18.55	14.56	45.61	49.90	14.01	0.320	8/04/08	8/22/08	1.280	6.90
Pfizer	PFE	19.97	17.58	23.53	25.71	17.12	0.320	8/08/08	9/3/08	1.280	6.41
AT&T (New)	T	31.66	31.95	37.99	42.97	29.72 *L*	0.400	7/10/08	8/1/08	1.600	5.05
Verizon	VZ	34.96	35.04	40.50	46.24	33.15	0.430	7/10/08	8/1/08	1.720	4.92
Merck	MRK	36.16	36.58	49.78	61.62	31.15 *L*	0.380	9/05/08	10/1/08	1.520	4.20
General Electric	GE	29.80	26.65	36.90	42.15	25.60	0.310	6/23/08	7/25/08	1.240	4.16
J P Morgan	JPM	38.07	31.02	43.00	49.95	29.24	0.380	7/03/08	7/31/08	1.520	3.99
Amer. Int. Group	AIG	22.99	20.64	63.22	70.13	19.73	0.220	9/05/08	9/19/08	0.880	3.83
Dupont	DD	45.70	41.16	46.92	52.49	40.43	0.410	8/15/08	9/12/08	1.640	3.59
Home Depot, Inc.	HD	27.53	21.46	33.36	38.54	20.76	0.225	6/05/08	6/19/08	0.900	3.27
Chevron	CVX	84.25	89.42	80.76	104.63	76.40	0.650	8/19/08	9/10/08	2.600	3.09
Coca-Cola	KO	55.06	51.79	53.83	65.59	49.44 *L*	0.380	9/15/08	10/1/08	1.520	2.76
3M Company	MMM	73.49	67.69	85.06	97.00	67.26	0.500	8/22/08	9/12/08	2.000	2.72
Johnson & Johnson	JNJ	71.33	67.70	61.30	71.90 *H*	60.73	0.460	8/26/08	9/9/08	1.840	2.58
Boeing	BA	64.45	63.88	95.51	107.15	60.77 *L*	0.400	8/08/08	9/5/08	1.600	2.48
Caterpillar	CAT	70.35	67.04	74.95	85.96	59.60	0.420	7/21/08	8/20/08	1.680	2.39
McDonald's	MCD	63.63	58.56	47.56	67.00 *H*	46.64	0.375	9/02/08	9/16/08	1.500	2.36
Intel Corp	INTC	24.26	20.71	23.22	27.99	18.05	0.140	8/07/08	9/1/08	0.560	2.31
Procter and Gamble	PG	71.60	64.35	63.48	75.18	60.05	0.400	7/18/08	8/15/08	1.600	2.23
Alcoa	AA	31.81	34.51	33.70	44.77	26.69	0.170	8/08/08	8/25/08	0.680	2.14
Exxon Mobil	XOM	77.07	82.19	81.69	96.12	76.14 *L*	0.400	8/13/08	9/10/08	1.600	2.08
United Tech.	UTX	66.80	60.08	71.63	82.50	58.87	0.320	8/15/08	9/10/08	1.280	1.92
American Express	AXP	39.07	37.02	56.74	63.63	35.10 *L*	0.180	7/11/08	8/8/08	0.720	1.84
Wal-Mart Stores	WMT	59.37	56.24	43.28	61.00 *H*	42.09	0.238	12/15/08	1/2/09	0.950	1.60
IBM	IBM	126.36	123.20	111.23	130.93 *H*	97.04	0.500	8/08/08	9/10/08	2.000	1.58
Microsoft Corp.	MSFT	27.81	26.15	28.10	37.50	24.87	0.110	8/21/08	9/11/08	0.440	1.58
Walt Disney	DIS	32.50	29.43	31.71	35.69	26.30	0.350	12/07/07	1/11/08	0.350	1.08
Hewlett-Packard	HPQ	45.59	41.65	46.15	53.48	39.99	0.080	9/10/08	10/1/08	0.320	0.70
General Motors**	GM	11.18	9.84	31.54	43.20	8.81	0.000	7/15/08	7/15/08	0.000	0.00

* See the Recommended HYD Portfolio table on page 62 for current recommendations. † Based on indicated dividends and market price as of 7/15/08.
Extra dividends are not included in annual yields. *H* New 52-week high. *L* New 52-week low. (s) All data adjusted for splits and spin-offs. 12-month data begins 7/16/07.
**General Motors announced on 7/15/08 that it had suspended dividend payments.

RECOMMENDED INVESTMENT VEHICLES

	Ticker Symbol	Avg. Market Cap. / Avg. Maturity	No. of Holdings	Expense (%)	Sharpe Ratio	Turnover (%)	P/B Ratio	12 Mo. Yield (%)	Total 1 yr.	Total 3 yr.	Total 5 yr.	After Tax* 1 yr.	After Tax* 3 yr.	After Tax* 5 yr.
			Descriptive Quarterly Statistics, as of 6/30/08						Annualized Returns (%), as of 7/31/08					
Short/Intermediate Fixed Income														
Vanguard Short-Term Bond Index	BSV[2]	2.7 Yrs.	867	0.11	--	79	--	4.11	6.63	--	--	5.12	--	--
Vanguard Short-Term Bond Index	VBISX	2.7 Yrs.	867	0.18	0.14	79	--	4.30	6.52	4.76	3.64	4.96	3.21	2.25
Vanguard Short-Term Inv. Grade	VFSTX	3.3 Yrs.	913	0.21	0.04	48	--	4.85	4.00	4.35	3.54	2.28	2.72	2.07
iShares Lehman 1-3 Year Treasury	SHY[1]	1.7 Yrs.	37	0.15	0.22	76	--	3.63	6.81	4.89	3.39	5.48	3.48	2.27
Vanguard Limited-Term Tax-Exempt	VMLTX	2.8 Yrs.	714	0.15	-0.62	32	--	3.46	4.94	3.55	2.87	4.94	3.55	2.87
Real Estate														
Vanguard REIT Index	VNQ[2]	5.0 B.	99	0.10	0.12	36	2.2	5.23	-3.57	3.54	--	-4.89	2.21	--
Vanguard REIT Index	VGSIX[3]	5.0 B.	99	0.20	0.11	36	2.2	5.11	-3.62	3.46	13.35	-4.92	2.16	11.74
U.S. Large Cap Value														
Vanguard Value Index	VTV[2]	51.5 B.	388	0.10	-0.02	20	1.9	3.34	-16.33	2.32	--	-16.69	1.90	--
Vanguard Value Index	VIVAX	51.5 B.	388	0.20	-0.03	20	1.9	3.22	-16.39	2.22	8.18	-16.74	1.82	7.78
U.S. Small Cap Value														
iShares Russell Microcap Index	IWC[1]	0.3 B.	1387	0.60	--	21	1.3	0.68	-16.35	--	--	-16.52	--	--
Vanguard Small-Cap Value Index	VBR[2]	1.4 B.	989	0.11	-0.15	34	1.4	2.68	-10.67	0.86	--	-11.09	0.42	--
Vanguard Small-Cap Value Index	VISVX	1.4 B.	989	0.22	-0.15	34	1.4	2.51	-10.78	0.74	10.18	-11.18	0.33	9.75
U.S. Large Cap Growth														
iShares Russell 1000 Growth Index	IWF[1]	33.8 B.	647	0.20	0.18	16	4.0	0.76	-6.44	3.39	6.19	-6.69	3.20	6.01
Vanguard Growth Index	VIGRX	35.2 B.	426	0.22	0.25	23	3.5	0.86	-4.17	4.20	6.76	-4.29	4.07	6.63
U.S. Marketwide														
Vanguard Total Stock Market Index	VTI[2]	27.7 B.	3554	0.07	0.11	4	2.3	1.83	-10.11	3.31	7.98	-10.36	3.03	7.70
Fidelity Spartan Total Market Index	FSTMX[4]	28.6 B.	3327	0.10	0.12	4	2.5	1.75	-10.19	3.30	7.92	na	na	na
Foreign- Developed Markets														
iShares MSCI Growth Index	EFG[1]	32.7 B.	555	0.40	--	28	3.5	2.27	-7.11	11.73	--	-7.59	11.48	--
iShares MSCI Value Index	EFV[1]	37.0 B.	542	0.40	--	21	1.7	6.19	-17.21	8.35	--	-18.42	7.75	--
Vanguard Europe Pacific Index	VEA[2]	34.4 B.	1174	0.12	--	6	2.3	--	-11.59	--	--	-11.76	--	--
Vanguard Tax-Managed International	VTMGX[5]	34.4 B.	1174	0.15	0.74	6	2.3	2.44	-12.50	10.25	15.32	-12.67	10.02	15.11
Vanguard Developed Markets Index	VDMIX[6]	34.8 B.	3	0.22	0.73	7	2.3	3.19	-11.74	10.43	15.18	-12.23	9.90	14.65
Foreign- Emerging Markets														
Vanguard Emerging Market Index	VWO[2]	18.0 B.	951	0.25	1.01	9	2.8	2.12	-4.28	21.51	--	-4.57	21.19	--
Vanguard Emerging Market Index	VEIEX[7]	18.0 B.	951	0.37	1.01	9	2.8	2.01	-4.86	21.17	26.30	-5.14	20.87	26.00
Gold-Related Funds														
iShares COMEX Gold Trust	IAU[2]	--	1	0.40	--	--	--	0.00	36.49	28.07	--	36.49	28.07	--
streetTRACKS Gold Shares	GLD[1]	--	1	0.40	--	--	--	0.00	37.35	28.10	--	37.35	28.10	--

Recommended Gold-Mining Companies ($)

	Ticker Symbol	8/15/08	Month Earlier	Year Earlier	52-Week High	52-Week Low	Distributions Last 12 Months	Distributions Frequency	Yield (%)
Anglogold Ltd., ADR	AU	**26.67**	35.11	35.86	51.35	25.55	0.1350	Semiannual	0.5062
Barrick Gold Corp.	ABX	**32.16**	49.67	31.67	54.74	28.89	0.2975	Semiannual	0.9251
Gold Fileds Ltd.	GFI	**8.66**	13.11	14.52	19.92	8.58	0.2489	Semiannual	2.8741
Goldcorp, Inc.	GG	**29.56**	47.99	23.47	52.65	21.00	0.1530	Monthly	0.5176
Newmont Mining	NEM	**41.51**	50.83	40.11	57.55	38.01	0.4000	Quarterly	0.9636

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.

Data provided by the funds and Morningstar. [1]Exchange Traded Fund, traded on NYSE. [2]Exchange Traded Fund, traded on AMEX. [3]1% fee for redemption in 1 yr. [4]0.5% fee for redemption in 90 days. [5]1% fee for redemption in 5 yrs. [6]2% fee for redemption in 60 days. [7]0.5% fee for purchase and 0.5% fee for redemption. * Calculated using the highest individual federal income tax rates in effect at the time of each distribution and do not reflect the impact of state and local taxes and individual tax situations. † Dividend shown is after 15% Canadian tax withholding. ‡ Not subject to U.K. withholding tax.