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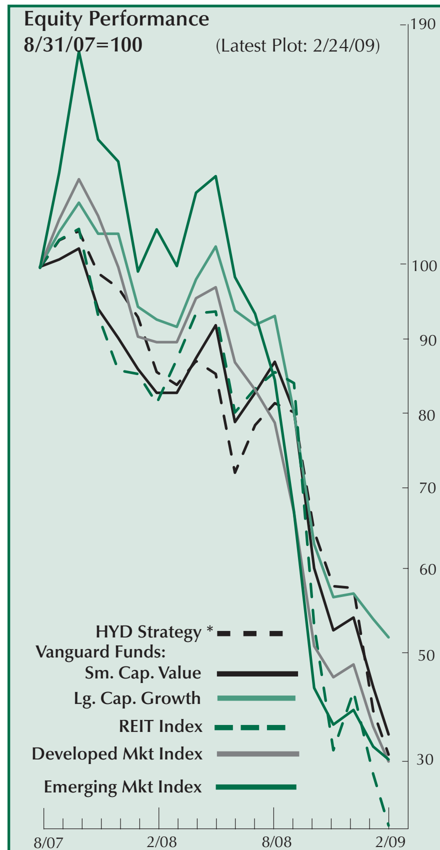

* HYD is a hypothetical model based on back-tested results. See p.14 for full explanation

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The Cost of "Wait and See"

During periods of distress in the capital markets we often hear from investors who, rather than hold a portion of their portfolios in common stocks, tell us they plan to hold cash, in order to "wait to see what will happen" and later "get back in when things are more certain." We understand their apprehension in light of world news, but the fact is such a day will never arrive. We hasten to add that uncertainty is hardly a bad thing; without it, after all, we would expect no additional return.

It is our job to address these arguments head on. The fact is, despite media hype, not all investors are panicked and markets are continuing to function by pricing securities according to their perceived risk. For every pessimistic seller there is an optimistic buyer, and market prices simply reflect a consensus opinion regarding future earnings and prosperity. But that consensus changes quickly and dramatically, and this tendency exacts a steep price from those who hope to prosper by sitting on the sidelines waiting for a better day.

Consider the early 1970s. Then, as now, the news was bleak: oil prices had quadrupled, price controls were imposed on food, 46 percent of adults feared a Great Depression akin to that of the 1930s and the Watergate scandal had forced a presidential resignation. A hypothetical all-global equity portfolio[1] would have fallen 18.0 percent in 1973 and another 24.1 percent in 1974. But an investor who at that point abandoned the fully invested strategy by fleeing to the safety of cash would have missed out on a 48.3 percent return during 1975. More accurately, *had he invested in Treasury bills in 1975 but then gone back into the all-equity strategy beginning in 1976, "after things had settled down", his ending portfolio value five years later (through 1979) would have been 40.2 percent lower than it would have been had he simply maintained the fully invested strategy*.

A similar story plays out in more recent bear markets. During 1990 the all-equity portfolio would have lost 16.2 percent, but would have rebounded 30.1 percent in 1991. During the infamous three-year "tech-stock meltdown" between 2000 and 2002, the portfolio would have lost 6.2 percent per year, but would have rebounded by 50.1 percent in 2003.

This is not to say that a very bad year, or years, will necessarily be followed by periods of extraordinary gains. Indeed it may take several years before the S&P 500 returns to its previous peak. The point is, no one knows how long it will take. That will be determined by events yet to unfold. We are confident, however, that investors who continually alter their portfolio based on current developments are playing with fire; it is an arbitrary approach that needlessly risks enormous opportunity costs. Fear is infectious in hard times, but the antidote is to maintain a balanced portfolio of stocks, bonds, cash and gold that methodically and deliberately pursues the risks and potential rewards that are inherent, but quantifiable, among these asset classes.

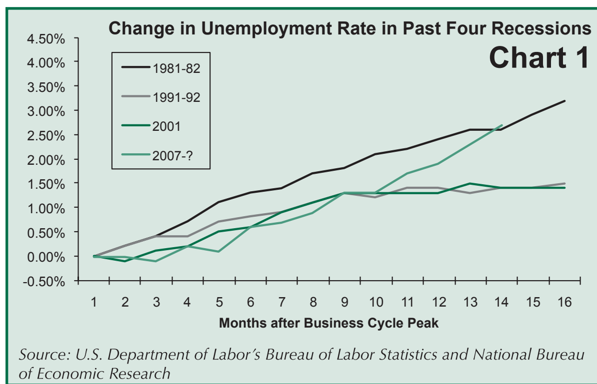
[1] 70% U.S. Stocks (25% Large Cap, 25% Large Cap Value, 18% Small Cap 2% REITs) 25% Non-U.S. Developed Stocks (5% International Large Cap, 10% International Value, 10% International Small Cap) 5% Emerging Markets (2% Emerging Markets, 2% Emerging Markets Value, 1% Emerging Markets Small Cap)

MODERN MEDIA HYPERBOLE VERSUS SOCIAL SCIENCE

Investors should not succumb to the tales of woe that are so pervasive in the media regarding the current state of capital markets and the general economy. Here our focus is on labor markets. Our discussion is based on findings published in "The Current Recession in Historical Perspective" *by L. Jacobo Rodriguez*[1] *as well as* "The Worst Job Market Since World War II?" *by Kerry Lynch of AIER.*[2]

Paul Krugman, 2008 Nobel laureate, recently wrote "Let's not mince words: This looks an awful lot like the beginning of a second Great Depression."

OK, let's not mince words: Paul Krugman is also a columnist for the New York Times, and sensational proclamations sell newspapers. The magnitude of the Great Depression in fact far exceeds anything we have experienced in the current recession thus far. An unbiased review of statistical indicators reveals no evidence to support Krugman's contention or for similar claims made by other "talking heads" clamoring for attention.



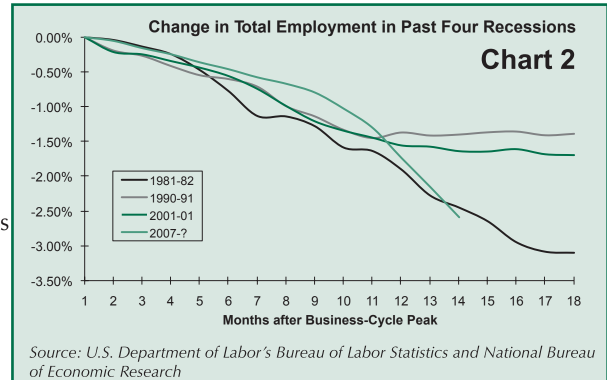
Source: U.S. Department of Labor's Bureau of Labor Statistics and National Bureau of Economic Research

Relative to the ten recessions since World War II, the current contraction is certainly severe, but many reports, especially those relating to employment statistics, are exaggerated. Prior to the recent election, then-President elect Obama declared that 2008 was "the single worst year of job losses since World War II," and subsequent news reports followed with similar themes.

Unfortunately, these claims cannot be dismissed as harmless hyperbole; as our parent organization the American Institute for Economic Research recently pointed out, such exaggerations undermine the confidence of consumers, businesses and investors.

Employment conditions are critical to individual investors, many of whom are currently employed or are employers themselves, and who have formed financial plans predicated on continued employment and assumed levels of compensation.

Statistical indicators provide two basic means to rationally assess how business cycles affect the labor market. Changes in both the employment rate, as well as the change in the level of *employment* since the onset of recession are both useful barometers, but should be interpreted with care.



Source: U.S. Department of Labor's Bureau of Labor Statistics and National Bureau of Economic Research

The Rate of Unemployment…

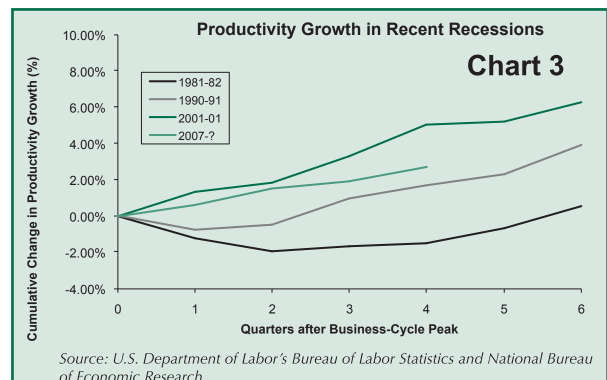
According to the National Bureau of Economic Research, December 2007 marks the most recent business cycle peak, when the current recession began. Over the next 12 months the unemployment rate increased by 2.3 percent; Chart 1 suggests that compared with the last four recessions, this increase is not alarming. The current change, moreover, appears to be average when a longer time frame is considered. During the 10 recessions since World War II the median increase in the unemployment rate twelve months after the onset of the recessions (not depicted) was 2.2 percent.

The unemployment rate, however, which measures the number of employed workers as a percent of the labor force, should not be viewed in isolation. This measure can be distorted when idle workers exit the workforce, so it can understate the true reduction in employment. It also fails to distinguish between full and part-time workers seeking full-time work so it is also be deficient as a gauge of underemployment.

The Job Count

To address these shortcomings, economists turn to the level of employment, measured by the total *number of jobs lost* relative to total employment. During the first twelve months of the current recession (through December 2008), the total number of jobs fell from 138.1 million to 135.5 million, a 1.9 percent drop. This matches the 1.9 percent median 12-month decline for the past 10 post-war recessions. Chart 2 reveals that so far this trend is also in line with those of the most recent four recessions.

Unfortunately the media has largely failed to report a bright spot. Despite sharply rising unemployment during 2008, real gross domestic product (GDP) and real personal income by year-end have both risen from their 2007 ending levels. This is attributable to increased productivity, which may bode well for the speed of an eventual recovery once the business cycle reaches its trough. Chart 3 reveals that worker productivity increased by 2.7 percent during the year, when compared with the fourth quarter of 2007. This is consistent with the trend



Source: U.S. Department of Labor's Bureau of Labor Statistics and National Bureau of Economic Research

[1] L. Jacobo Rodriguez *The Current Recession In Historical Perspective*, Quarterly Institutional Review, Fourth Quarter 2008, Dimensional Fund Advisors,

[2] Kerry Lynch, *The Worst Job Market Since World War II?* Research Reports, Vol. LXXVI, No. 2, Feb. 2, 2009, American Institute for Economic Research

[3] See our *Investment Guide*, December 2008: Gambling on the Business Cycle.

of the two most recent recessions (2001 and 1990-1991), but unlike the severe recessions of 1981-1982 and 1973-1975 (not depicted), when productivity turned negative.

The Limits of Data

There is no compelling evidence to date that the current recession will be a repeat of the Great Depression, when investors saw stock prices fell by nearly 90 percent between September 1929 and July 1932. But more generally, current business cycle conditions and data, like other publicly available information, are simply not useful in predicting financial market fluctuations. As we have explained in earlier issues[3], financial asset values are leading indicators of economic activity. Because they look forward and discount information in security prices as it becomes available, capital markets tend to anticipate turning points in the business cycle before they occur. Macroeconomic indicators are simply one more set of data points that are quickly disseminated and reflected in security prices.

Wise investors will avoid the temptation to time their portfolios' risk exposure based on statistical measures pertaining to the general economy. It is far more prudent to maintain a steady allocation based on an assessment of one's short and long-term needs and ability to withstand alternating periods of rising and falling valuations.These cycles are as unpredictable as they are inevitable.

ARE YOU READY TO RETIRE?

The swift collapse of the financial markets last year that has stretched into 2009 has slashed the value of even well-diversified investment portfolios, prompting many of those contemplating retirement within the next few years to reconsider whether they are still in a position to do so. In this tenuous economic environment it is especially important to take stock of savings, pensions, and other financial resources and determine whether they will be sufficient to last over the next 20 to 30 years. The questions below provide a planning checklist for those weighing a retirement decision.

Do I Have Enough Money?

According to a study by Aon Consulting and Georgia State University, retirees typically need to generate from 74 percent to 89 percent of pre-retirement income to maintain their pre-retirement standard of living. While statistical averages are informative and provide a useful guideline, actual expenditures in retirement can vary significantly, depending on health, debt levels, and the availability of regular sources of income such a pension.

For many, savings is an important piece of the retirement planning puzzle. Based on historical returns in a balanced portfolio of stocks and bonds, a number of studies have concluded that a retiree beginning with an annual withdrawal rate of about 4 percent of portfolio assets and increasing withdrawals by the rate of inflation every year would be unlikely to outlive his or her assets. With a $1 million portfolio, that would mean taking out $40,000 in the first year. Depending on interest and dividend payments, asset mix, and market performance, much of that could come from account earnings.

Of course, the 4 percent withdrawal rate is only a general rule of thumb. This withdrawal rate can vary greatly depending on the investor; more sophisticated analyses can be conducted using probabilistic forecasting[1]. The need to draw on personal savings will decrease with the availability of other sources of income, such as a pension or Social Security. It is wise to allow for a withdrawal target within a specified range to avoid the need for large "forced" liquidations of holdings during a down market.

Slower withdrawal rates can be combined with money-saving measures, such as cutting back on non-essentials like travel, cable television services, or charitable contributions. Downsizing from a large home to a smaller one or move to a less expensive area are also potential money savers that can help people get through tough times.

Is My Asset Mix Appropriate?

The massive downturn in virtually every corner of the financial markets last year caught most people by surprise. Many investors who thought they had adequately diversified portfolios saw their holdings shrink in value in 2008. Even our hypothetical conservative portfolio (see January 2009 Investment Guide "AIS Model Portfolios") fell by nearly 13 percent last year.

If there is one lesson investors should take away from the crash, it is to invest in line with tolerance for risk. If you can't stomach market downturns like last year's, you need to take this into account when allocating assets. The bottom line is you need to fine-tune them to match your emotional well-being. Any such adjustments should be rare and based only on careful introspection regarding your risk tolerance. Investors that change their allocations impetuously, based on recent market conditions, invariably fail.

It's important to remember that last year's perfect financial storm was highly unusual, and that the time-tested benefits of diversification still apply. Except for unusual periods like last year, investing across different asset classes is an effective way to spread risk and control volatility. Keeping some money in stocks is advisable even when you retire, since they tend to produce higher returns than cash or bonds and can help investment accounts keep pace with inflation. Generally it is wise to keep one or two years of readily available cash on hand when you retire can help avoid the need to liquidate investments during down markets. Our recommended portfolio allocations, published ever quarter, reflect these observations.

What about Social Security?

Social Security replaces one-third of pre-retirement income for the highest earning fifth of the population, says the Center for Retirement Research at Boston College, so deciding when to take it is an important piece of the retirement planning puzzle. The question for many is whether individuals who begin taking payments at full retirement age or older will live long enough to make up for the lower benefits they would have received for a longer period of time by starting early. Those born between 1943 and 1954 must now wait until age 66 to receive full benefits. If they start collecting earlier, benefits are permanently reduced based on the number of months they receive them prior to full retirement

[1]For a thorough discussion regarding this technique, see the May 2008 *Investment Guide*. To discuss our approach to portfolio allocation and retirement in our Professional Asset Management service, please contact us at (413) 528-1216.

age. This year, the maximum reduction for those who begin collecting at age 62 is 25 percent. Those who begin payments between full retirement age and age 70 earn additional delayed benefit credits.

Deciding whether to delay taking retirement benefits is a highly personal decision that depends on a number of factors. Someone who is in good health with a family history of longevity may feel comfortable putting off payments, while an individual with a poor health history may not. Also consider other sources of income. For those with those with adequate sources of outside income at retirement, pushing back Social Security in exchange for higher payments years down the road provides a form of longevity insurance that can kick in later as other assets diminish. On the other hand, taking Social Security benefits at age 62 rather than later may be a better alternative than liquidating depressed positions in a down market. But if you are working and under full retirement age, keep in mind that $1 in benefits is deducted for each $2 you earn above this year's annual limit of $14,160.

Will I Have Adequate Insurance?

With rising unemployment many people, including those facing retirement, must figure out how to replace employer-provided health insurance. As employers continue to cut insurance benefits, filling the health insurance gap between early retirement and Medicare coverage at age 65 is now a pivotal part of the retirement decision.

One option has been maintaining coverage under the Consolidated Omnibus Budget Reconciliation Act (COBRA), which mandates that individuals who have group health insurance through an employer with 20 or more employees must be permitted to continue purchasing that insurance at group rates for 18 months after leaving a job. Since the average cost of coverage through employer group plans is $4,704 for single individuals and $12,680 for families, according to The Kaiser Family Foundation, many people find COBRA coverage out of reach.

The stimulus package signed into law in mid-February requires employers and other plan sponsors to subsidize 65 percent of the COBRA monthly premium for up to nine months. The subsidy applies to layoffs between September 1, 2008 and December 31, 2009 and kicks in on or after March 1, 2009. The termination must be involuntary, and the subsidy is not available to those who lose coverage because of reduced work hours, or to employees with adjusted gross incomes of over $125,000 ($250,000 if married filing jointly).

While the premium subsidy may offer relief for some eyeing retirement, it does little for those who are years away from Medicare eligibility. Individual insurance plans may be another option, but premiums for people in their 50s or 60s tend to be quite high. Coverage may be unavailable, or prohibitively expensive, for those with pre-existing conditions. Those able to obtain insurance might consider using a high-deductible insurance plan in conjunction with a Health Savings Account, or HSA, to reduce premiums[2]. Regardless of which insurance option you choose, the important thing is to get premium quotes and make sure you can obtain coverage before you retire.

Can I Tighten My Belt?

One of the best things you can do is retire with a minimal amount of debt. Start with credit card balances and revolving lines of credit, since these usually have the highest interest rates. Next, move to auto loans, another big budget buster. Mortgages are another consideration, and there are two schools of thought on paying them off before retirement. The first says it's a good idea because it will free up extra cash for other fixed or discretionary expenses and provide emotional security that comes with being debt-free. Owning a home free-and-clear will also add to home equity, which can be tapped later through a home equity line of credit or reverse mortgage should the need arise. On the other hand paying off a mortgage might concentrate your net worth in a single asset, your home, which as we have been recently reminded is hardly without risk. You also forego valuable tax breaks, particularly if monthly payments consist mostly of interest and you are in a high tax bracket. If you have a low interest rate on your mortgage, you may be able to generate better returns through investing in financial assets rather than paying down the balance.

Can I Continue Working?

Those with the option to continue working should seriously consider doing so since this will give investments more for earnings to accrue and for accounts to recover from market losses. Working, even for another year or two, will also provide more time to beef up retirement plans. This year, individuals age 50 and older can contribute up to $22,000 into a tax-deferred 401(k). If working is not an option because your job is being eliminated, consider taking another job to earn extra income and to obtain group insurance coverage so that a catastrophic illness or accident does not drain or even wipe out savings.

[2] For more information on HSAs see the February and March 2008 issues of *Investment Guide*.

THE INS AND OUTS OF COLLEGE FINANCIAL AID

As many students and parents know, the college financial aid system can be a confusing labyrinth of frustrating and esoteric rules, paperwork, and delays. At the same time, it is often necessary to understand and navigate the system in order to meet the rising cost of a college education.

Financial aid is based on either financial need or merit and students often use a combination of both. With need-based aid, the federal government or the school determines what it calls the expected family contribution, or EFC, based on parent or student income, assets, number of children attending school, and other factors. As the name implies, this is the amount the family is expected to contribute toward college costs, and it is usually determined based on information provided in the Free Application for Federal Student Aid, or FAFSA, a lengthy form that uses the federal methodology to assess income and assets.

Some schools also require one or more additional forms that contain information not included in FAFSA. This may include the school's own form or the College Board's CSS PROFILE form. Financial aid, in the form of loans or grants, may be awarded by the federal government or the school for any amount that is not covered by the expected family contribution. Colleges and universities may employ their own formulas, or

"institutional methodology" for financial aid disbursement that differ from the federal guidelines. These formulas may assess home equity and other assets that the federal government does not count.

Merit aid is financial aid based on academic achievement, community involvement, or any other factors the school wishes to consider. It is generally disbursed in the form of a grant and therefore does not need to be repaid. Students may also obtain scholarships from outside sources such as community organizations. These scholarships may be based on financial need, merit, or a combination of both. The federal government and the schools may consider such scholarships in calculating their financial aid packages. As part of a financial aid package, schools may also offer students work-study arrangements.

The most appropriate college financial aid planning strategies depend largely on whether families plan to seek financial aid based on need or merit, or a combination of both.

Need-based Aid

The strategies for obtaining need-based aid involve lowering the expected family contribution through a number of possible methods.

Decrease student assets. Federal financial aid formulas count 20 percent of student assets, including savings accounts and investments, as being available to pay college expenses. By contrast, the formulas only count 2.6 percent to 5.6 percent of parental assets. This means that any investments put in a child's name for tax purposes during the accumulation period will be counted much more heavily and could therefore decrease the potential financial aid award. Parents who have saved in this manner who believe they may be eligible for need-based aid may wish to shift assets into their own names or spend down UTMA or other student accounts before applying for financial aid.

Minimize income growth. While putting a lid on your earning potential may seem counter-intuitive, financial aid formulas give people ample incentive to do so. Parental income is usually the most important determinant of whether or not a family receives financial aid, or how much they receive. Income is counted as eligible to pay school expenses on a sliding scale, with the assessment ranging from 22 percent to 47 percent.

The expected family contribution rises rapidly with income. According to the EFC calculator at the web site finaid.org that uses the federal formula, a family of four with one child in college and no substantial savings or assets and household income of $100,000 per year has an expected family contribution of $17,375. At $150,000 of household income the EFC shoots to $33,485 a year and at $200,000 it rises to $48,928.

Having two children in college at the same time cuts the EFC to $17,362 and $25,084, for the families with household income of $150,000 and $200,000, respectively--something to keep in mind for parents who earn too much to qualify for need-based aid with one child in college but who may qualify when two children attend.

Parents seeking to minimize income may take a number of steps, including shifting income or bonuses to a later year, increasing retirement plan contributions, avoiding the realization of capital gains, or taking capital losses to offset capital gains and income.

Decrease parental assets. Although parental assets count much less in financial aid formulas than parental income or student income and assets they can still impact financial aid awards, so it makes sense to pare them down to the extent possible. Common ways of doing this include paying down or paying off a mortgage (since home equity does not count in federal financial aid formulas), accelerating expenditures such as significant home improvement projects to before the year the FAFSA is submitted, or putting savings into non-assessable assets such as IRAs.

Reduce student income. To reduce student income, which is counted as much as 50 percent in financial aid formulas, parents might consider taking capital losses on investments in a student's name to reduce student income in the year before filing, or simply limiting student income.

Merit-based Aid

Strategies for obtaining merit-based aid are very different than those for need-based aid, and may include the following:

Choose schools that are likely to be generous. Families who do not qualify for need-based aid because their incomes or assets are too high might still be able to obtain financial aid based on academic accomplishment, as well as other criteria such as state of residence, intended major, or even gender. While some of the most elite private colleges do not hand out merit aid, many well-known and highly-respected colleges do.

Generally, applicants whose academic profile exceeds that of the average attendant's have a reasonable shot at merit aid at many schools. As a basis for comparison, consult the school's web site or college guidebooks for GPAs, SAT score ranges, and other relevant information. Despite heightened competition for spots at top colleges, there is still plenty of pressure to recruit the best students possible, particularly at higher-priced private schools a step or two down the prestige ladder.

Your child does not need to be a genius to receive merit aid. According to the web site meritaid.com, one in four students going to college receives some form of merit aid. While there is usually a minimum grade requirement, students with a 2.0 GPA often qualify, and the average reward is $5,000. Unlike most private scholarships, which are one-time payments, many merit aid awards are renewable.

Look at schools that tend to hand out merit aid. Some schools regularly hand out merit aid, while others are typically less generous. Schools with merit scholarships or tuition reduction programs often outline qualifications and other details on their websites. All accepted applicants are usually considered for merit aid and automatically notified of any award, although some colleges may require completion of FAFSA or a separate application.

Investigate scholarships. Scholarships are another good source of financial aid available both to those who receive need-based awards and those who do not. Those who expect to receive need-based awards, however, should be aware that the availability of a scholarship could reduce school or federal aid on a dollar-for-dollar basis. If this is a concern, you should contact the financial aid office at the school you are considering and ask about how it handles outside scholarships.

There are literally thousands of private scholarships available, with a typical value of between $1,000 and $2,000. The online scholarship search tool at collegeboard.com is a good place for students to start investigating this resource.

THE HIGH-YIELD DOW INVESTMENT STRATEGY

Our HYD model follows a passive approach to stock selection, so we rarely comment on news pertaining to the individual stocks. However the current financial sector crisis has placed the model's large bank holding companies in a situation that has rarely, if ever, been encountered by stocks within the model. Specifically, the government is playing an ever-enlarging role in determining their fate.

The Obama administration has modified the government's approach to the continuing capital crunch at Citigroup, Bank of America and other troubled banks. Treasury Secretary Geithner has endorsed plans to implement "stress tests". He proposes to assess their risk of insolvency should economic conditions continue to deteriorate. Presumably those banks deemed to be too weak to survive will no longer receive taxpayer support.

Meanwhile, Fed Chairman Bernanke has indicated that the government is prepared to take a larger ownership stake in banks as it deems necessary, but has dismissed suggestions of outright nationalizations. As of this writing there is news that the $45 billion in capital already committed to Citigroup in the form of preferred stock may be converted to common stock. This would raise the government's stake to forty percent and greatly dilute the value of existing common shares.

Shares of Citigroup and Bank of America are likely to be extremely volatile in coming months, but to date we have no reason to recommend that investors depart from the model. We will continue to sell these shares consistent with the model's 18 month holding period.

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 investment service. Contact us at (413) 528-1216.

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.

None of the four stocks eligible for purchase this month were eligible for purchase 18 months ago. HYD investors should find that the indicated purchases of **General Electric**, **Alcoa**, **DuPont**, and **AT&T** and sales of **Verizon**, **Citigroup**, **Altria Group** and **Philip Morris International** are sufficiently large to warrant trading. In larger accounts, rebalancing positions in **Pfizer** and **Bank of America** may be warranted.

Recommended HYD Portfolio

As of February 13, 2009

	Rank	Yield	Price	Status	Percent of Portfolio: Value	Percent of Portfolio: No. Shares[1]
General Electric	1	10.84%	11.44	Buying	6.85	7.92
Alcoa	2	9.09%	7.48	Buying	4.29	7.59
DuPont	3	7.32%	22.40	Buying	3.08	1.82
AT&T Corp.	4	6.78%	24.19	Buying	10.88	5.95
Verizon	5	6.22%	29.56	Selling	23.09	10.34
JP Morgan	6	6.16%	24.69			
Caterpiller	7	5.43%	30.94			
Merck & Co.	8	5.29%	28.75			
Kraft	9	4.60%	25.20			
American Express	10	4.57%	15.74			
Pfizer	11		14.58	Holding	30.74	27.92
Citigroup	27		3.49	Selling	5.76	21.85
Bank of America	29		5.57	Holding	5.09	12.11
Altria Group	NA		15.92	Selling	2.65	2.20
Philip Morris Int'l	NA		35.99	Selling	5.98	2.20
Fairpoint	NA		2.44	Selling	0.02	0.10
					98.43	100.00
Cash	NA				1.57	
					100.00	

[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 January 31, 2009)*

	1 mo.	1 yr.	5 yrs.	10 yrs.	20 yrs.	Since 1/79	Std. Dev.
HYD Strategy	-21.39	-46.06	-3.00	3.08	11.73	14.96	17.84
Russell 1000 Value Index	-11.50	-41.78	-3.53	0.05	8.06	11.34	14.55
Dow	-8.65	-34.97	-3.00	0.54	8.94	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 ($)

	2/13/09	*Mo. Earlier*	*Yr. Earlier*
Gold, London p.m. fixing	**935.50**	810.00	912.50
Silver, London Spot Price	**13.37**	10.51	17.38
Copper, COMEX Spot Price	**1.54**	1.44	3.53
Crude Oil, W. Texas Int. Spot	**37.50**	35.39	95.50
Dow Jones Spot Index	**249.82**	246.26	398.82
Dow Jones-AIG Futures Index	**108.16**	111.40	199.57
Reuters-Jefferies CRB Index	**213.14**	218.91	384.22

Interest Rates (%)

U.S. Treasury bills - 91 day	**0.29**	0.11	2.16
182 day	**0.45**	0.29	2.02
52 week	**0.60**	0.41	2.02
U.S. Treasury bonds - 10 year	**2.89**	2.23	3.76
Corporates:			
High Quality - 10+ year	**5.32**	4.82	5.61
Medium Quality - 10+ year	**8.13**	7.91	6.90
Federal Reserve Discount Rate	**0.50**	0.50	3.50
New York Prime Rate	**3.25**	3.25	6.00
Euro Rates 3 month	**2.00**	2.65	4.34
Government bonds - 10 year	**3.34**	2.94	3.95
Swiss Rates - 3 month	**0.50**	0.57	2.75
Government bonds - 10 year	**2.02**	2.02	2.83

Exchange Rates ($)

British Pound	**1.442200**	1.460200	1.961300
Canadian Dollar	**0.804182**	0.792205	0.998200
Euro	**1.287900**	1.309400	1.467400
Japanese Yen	**0.010889**	0.011162	0.009288
South African Rand	**0.100659**	0.098756	0.130548
Swiss Franc	**0.863483**	0.890313	0.916338

Securities Markets

	2/13/09	*Mo. Earlier*	*Yr. Earlier*
S & P 500 Stock Composite	**826.84**	843.74	1,349.99
Dow Jones Industrial Average	**7,850.41**	8,212.49	12,348.21
Dow Jones Bond Average	**212.23**	213.60	207.66
Nasdaq Composite	**1,534.36**	1,511.84	2,321.80
Financial Times Gold Mines Index	**2,489.64**	2,048.40	3,090.70
FT EMEA (African) Gold Mines	**2,219.62**	1,663.86	2,460.07
FT Asia Pacific Gold Mines	**9,865.68**	7,859.00	14,643.24
FT Americas Gold Mines	**2,201.82**	1,873.06	2,716.95

Coin Prices ($)

	2/13/08	*Mo. Earlier*	*Yr. Earlier*	*Prem (%)*
American Eagle (1.00)	**954.97**	872.88	947.03	2.08
Austrian 100-Corona (0.9803)	**888.03**	797.53	896.92	-3.17
British Sovereign (0.2354)	**219.25**	197.15	221.45	-0.44
Canadian Maple Leaf (1.00)	**947.28**	854.40	943.80	1.26
Mexican 50-Peso (1.2057)	**1,094.50**	983.00	1,105.50	-2.96
Mexican Ounce (1.00)	**927.90**	835.40	917.00	-0.81
S. African Krugerrand (1.00)	**945.95**	852.80	933.15	1.12
U.S. Double Eagle-$20 (0.9675)				
St. Gaudens (MS-60)	**1,145.00**	1,100.00	972.50	26.51
Liberty (Type I-AU50)	**1,170.00**	1,150.00	1,000.00	29.27
Liberty (Type II-AU50)	**1,142.50**	1,100.00	965.00	26.23
Liberty (Type III-AU50)	**1,115.00**	1,050.00	940.00	23.19
U.S. Silver Coins ($1,000 face value, circulated)				
90% Silver Circ. (715 oz.)	**10,400.00**	9,200.00	12,150.00	8.79
40% Silver Circ. (292 oz.)	**3,975.00**	3,200.00	4,987.50	1.82
Silver Dollars Circ.	**12,575.00**	12,675.00	13,425.00	21.58

Note: Premium reflects percentage difference between coin price and value of metal in a coin, with gold at $935.5 per ounce and silver at $13.37 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 Symbol	*Market Prices ($) 2/13/09*	*1/15/09*	*2/15/08*	*12-Month ($) High*	*Low*	*Latest Dividend Amount ($)*	*Record Date*	*Paid*	*Indicated Annual Dividend ($)*	*Yield† (%)*
General Electric	GE	**11.44**	13.77	34.37	38.52	10.66 *L*	0.310	2/23/09	4/27/09	1.240	10.84
Alcoa	AA	**7.48**	9.37	35.72	44.77	6.80	0.170	2/06/09	2/25/09	0.680	9.09
Dupont	DD	**22.40**	24.65	45.49	52.49	21.32	0.410	2/13/09	3/13/09	1.640	7.32
AT&T (New)	T	**24.19**	25.12	37.88	40.70	20.90	0.410	1/09/09	2/2/09	1.640	6.78
Verizon	VZ	**29.56**	29.90	37.83	39.94	23.07	0.460	1/9/09	2/2/09	1.840	6.22
J P Morgan	JPM	**24.69**	24.34	43.25	50.63	17.70 *L*	0.380	1/06/09	1/31/09	1.520	6.16
Caterpillar	CAT	**30.94**	39.39	69.95	85.96	29.60 *L*	0.420	1/20/09	2/20/09	1.680	5.43
Merck	MRK	**28.75**	28.12	47.53	48.23	22.82	0.380	12/05/08	1/2/09	1.520	5.29
Kraft	KFT	**25.20**	28.07	31.33	34.97	24.61 *L*	0.290	12/26/08	1/13/09	1.160	4.60
American Express	AXP	**15.74**	17.32	45.11	52.63	14.72 *L*	0.180	1/09/09	2/10/09	0.720	4.57
Pfizer***	PFE	**14.58**	17.39	22.33	22.92	13.74 *L*	0.160			0.640	4.39
Home Depot, Inc.	HD	**21.22**	22.81	27.52	30.74	17.05	0.225	12/04/08	12/18/08	0.900	4.24
Boeing	BA	**40.48**	40.96	85.18	88.29	36.17	0.420	2/06/09	3/6/09	1.680	4.15
3M Company	MMM	**49.42**	55.17	79.95	83.22	48.64 *L*	0.510	2/20/09	3/12/09	2.040	4.13
Intel Corp	INTC	**13.88**	13.29	20.11	25.29	12.06	0.140	2/07/09	3/1/09	0.560	4.03
Chevron	CVX	**69.73**	70.77	83.40	104.63	55.50	0.650	2/17/09	3/10/09	2.600	3.73
McDonald's	MCD	**56.81**	57.98	55.30	67.00	45.79	0.500	3/02/09	3/16/09	2.000	3.52
Coca-Cola	KO	**43.85**	43.36	58.76	61.90	40.28 *L*	0.380	12/01/08	12/15/08	1.520	3.47
United Tech.	UTX	**47.09**	49.69	71.53	75.86	41.76	0.385	2/20/09	3/10/09	1.540	3.27
Johnson & Johnson	JNJ	**57.10**	57.62	62.90	72.76	52.06	0.460	2/24/09	3/10/09	1.840	3.22
Procter and Gamble	PG	**51.09**	57.46	66.30	73.57	49.95 *L*	0.400	1/23/09	2/17/09	1.600	3.13
Microsoft Corp.	MSFT	**19.09**	19.24	28.42	32.10	16.75 *L*	0.130	2/19/09	3/12/09	0.520	2.72
Exxon Mobil	XOM	**74.59**	76.28	85.37	96.12	56.51	0.400	2/10/09	3/10/09	1.600	2.15
IBM	IBM	**93.84**	84.12	106.16	130.93	69.50	0.500	2/10/09	3/10/09	2.000	2.13
Wal-Mart Stores	WMT	**46.53**	51.35	49.44	63.85	46.25	0.238	12/15/08	1/2/09	0.950	2.04
Walt Disney	DIS	**18.52**	21.36	32.49	35.02	18.03 *L*	0.350	12/15/08	1/20/09	0.350	1.89
Citigroup	C	**3.49**	3.83	25.48	27.35	2.80 *L*	0.010	2/02/09	2/27/09	0.040	1.15
Hewlett-Packard	HPQ	**35.87**	35.75	43.87	49.97	28.23	0.080	3/11/09	4/1/09	0.320	0.89
Bank of America**	BAC	**5.57**	8.32	42.70	43.50	3.77 *L*	0.010	3/06/09	3/27/09	0.040	0.72
General Motors	GM	**2.50**	3.92	26.13	26.75	1.70	0.000	7/15/08	7/15/08	0.000	0.00

* See the Recommended HYD Portfolio table on page 6 for current recommendations. † Based on indicated dividends and market price as of 2/15/09.
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 2/16/08.
**Bank of America agreed with the U.S. Treasury on 1/16/2009 to limit its dividend payment to $0.01 per shares per quarter for next three years.
*** Pfizer announced on 01/26/09 that it will reduce its quarterly dividend payment to $0.16/share.

RECOMMENDED INVESTMENT VEHICLES

	Ticker Symbol	Avg. Market Cap. / Avg. Maturity	Descriptive Quarterly Statistics, as of 12/31/08: No. of Holdings	Expense (%)	Ratios: Sharpe	Turnover (%)	P/B	12 Mo. Yield (%)	Annualized Returns (%), as of 1/31/09: Total 1 yr.	Total 3 yr.	Total 5 yr.	After Tax* 1 yr.	After Tax* 3 yr.	After Tax* 5 yr.
Short/Intermediate Fixed Income														
Vanguard Short-Term Bond Index	BSV[2]	2.8 Yrs.	966	0.11	--	79	--	3.69	3.62	--	--	2.28	--	--
Vanguard Short-Term Bond Index	VBISX	2.8 Yrs.	966	0.18	0.69	79	--	3.78	3.50	5.59	3.89	2.16	4.05	2.50
iShares Barclays 1-3 Yr. Credit Bond	CSJ[1]	2.1 Yrs.	120	0.20	na	64	--	4.10	0.04	--	--	-1.35	--	--
iShares Barclays 1-3 Year Treasury	SHY[1]	1.8 Yrs.	41	0.15	1.07	76	--	3.41	4.41	5.72	3.86	3.16	4.27	2.64
Vanguard Limited-Term Tax-Exempt	VMLTX	2.6 Yrs.	805	0.15	-0.10	32	--	3.35	3.35	4.15	3.01	3.35	4.15	3.01
Real Estate														
Vanguard REIT Index	VNQ[2]	4.9 B.	98	0.10	-0.33	13	2.1	8.22	-47.77	-18.21	--	-48.86	-19.38	--
Vanguard REIT Index	VGSIX[3]	4.9 B.	98	0.20	-0.33	13	2.1	8.06	-47.82	-18.28	-3.82	-48.89	-19.42	-5.25
U.S. Large Cap Value														
Vanguard Value Index	VTV[2]	43.6 B.	411	0.10	-0.72	20	1.7	4.23	-40.83	-12.34	-3.25	-41.13	-12.71	-3.67
Vanguard Value Index	VIVAX	43.6 B.	411	0.20	-0.72	20	1.7	4.09	-40.88	-12.43	-3.37	-41.16	-12.79	-3.74
U.S. Small Cap Value														
iShares Russell Microcap Index	IWC[1]	0.2 B.	1336	0.60	-0.82	21	1.0	1.31	-41.59	-19.81	--	-41.70	-19.91	--
Vanguard Small-Cap Value Index	VBR[2]	1.3 B.	986	0.11	-0.58	34	1.3	3.08	-38.63	-15.03	-3.44	-39.03	-15.47	-3.88
Vanguard Small-Cap Value Index	VISVX	1.3 B.	986	0.22	-0.58	34	1.3	2.90	-38.69	-15.12	-3.53	-39.07	-15.53	-3.95
U.S. Large Cap Growth														
iShares Russell 1000 Growth Index	IWF[1]	26.6 B.	644	0.20	-0.72	16	2.6	1.67	-36.50	-11.24	-4.91	-36.62	-11.38	-5.06
Vanguard Growth Index	VIGRX	34.8 B.	399	0.22	-0.70	23	3.1	1.29	-36.07	-11.01	-4.47	-36.17	-11.13	-4.60
U.S. Marketwide														
Vanguard Total Stock Market Index	VTI[2]	25.4 B.	3502	0.07	-0.70	4	2.1	3.50	-38.45	-11.98	-3.78	-38.65	-12.23	-4.04
Fidelity Spartan Total Market Index	FSTMX[4]	22.0 B.	3241	0.10	-0.71	4	1.6	2.55	-38.65	-12.07	-3.84	na	na	na
Foreign- Developed Markets														
iShares MSCI Growth Index	EFG[1]	22.9 B.	494	0.40	-0.39	37	2.4	3.00	-42.10	-11.15	--	-42.17	-11.24	--
iShares MSCI Value Index	EFV[1]	21.3 B.	568	0.40	-0.49	28	1.1	4.86	-45.12	-13.55	--	-45.22	-13.82	--
Vanguard Europe Pacific Index	VEA[2]	28.3 B.	996	0.12	--	6	1.9	3.42	-44.48	--	--	-44.66	--	--
Vanguard Tax-Managed International	VTMGX[5]	28.3 B.	996	0.15	-0.43	6	1.9	3.31	-45.01	-12.47	-0.64	-45.18	-12.69	-0.86
Vanguard Developed Markets Index	VDMIX[6]	35.0 B.	1011	0.22	-0.44	7	2.3	5.29	-44.71	-12.42	-0.84	-45.25	-13.01	-1.42
Foreign- Emerging Markets														
Vanguard Emerging Market Index	VWO[2]	14.1 B.	837	0.25	-0.18	9	2.1	5.00	-51.23	-11.18	--	-51.59	-11.56	--
Vanguard Emerging Market Index	VEIEX[7]	14.1 B.	838	0.37	-0.17	9	2.1	4.70	-51.52	-11.42	4.59	-51.86	-11.78	4.24
Gold-Related Funds														
iShares COMEX Gold Trust	IAU[2]	--	1	0.40	--	--	--	0.00	0.10	17.09	--	0.10	17.09	--
streetTRACKS Gold Shares	GLD[1]	--	1	0.40	--	--	--	0.00	-0.81	16.90	--	-0.81	16.90	--

Recommended Gold-Mining Companies ($)

	Ticker Symbol	**2/13/09**	Month Earlier	Year Earlier	52-Week High	52-Week Low	Distributions: Last 12 Months	Frequency	Yield (%)
Anglogold Ltd., ADR †	AU	**29.64**	24.17	33.75	40.91	13.37	0.0991	Semiannual	0.3344
Barrick Gold Corp.	ABX	**37.94**	33.48	47.59	54.74	17.27	0.4000	Semiannual	1.0543
Gold Fileds Ltd.	GFI	**11.17**	7.94	13.22	16.85	4.64	0.1836	Semiannual	1.6437
Goldcorp, Inc.	GG	**31.75**	24.95	36.86	52.65	13.84	0.1530	Monthly	0.4819
Newmont Mining	NEM	**41.58**	37.12	47.89	55.15	21.17	0.4000	Quarterly	0.9620

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.

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