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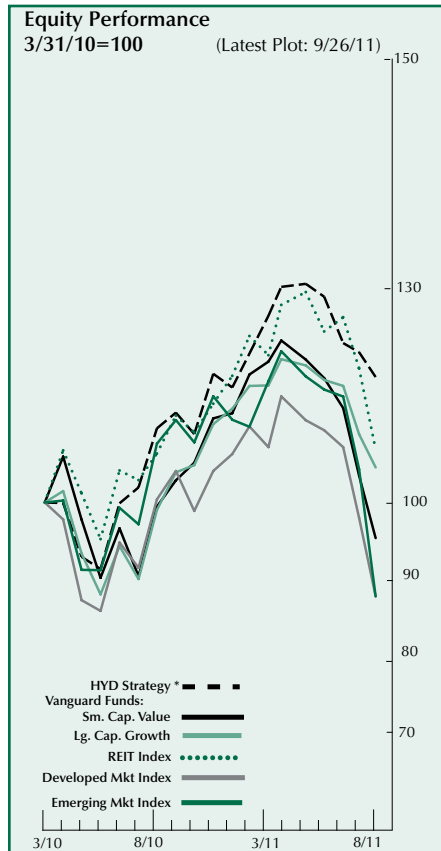
INVESTMENT GUIDE

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The Best Alternative

Capital markets are reflecting bad news throughout the global economy. In the U.S. aggressive monetary and fiscal policy has served to stimulate fears of inflation and growth of the national debt, but little else. European policymakers face a debt crisis that threatens the viability of the European Union, and now growth in China appears to be slowing as well.

Dramatic market volatility can leave many investors to ponder: "What should I do now?" We take this opportunity to remind you of the advantages you have gained by subscribing to a newsletter published by an advisory firm that is wholly owned by an economic think tank dedicated to providing citizens with useful, objective analysis. Current events have not changed our philosophy or strategy, and we remain highly confident in our research and our approach to investing.

Economists are trained to view the world the way it is, rather than the way we would like it to be. Consumers, firms, and investors must choose among available alternatives, all of which entail trade-offs. Though economists disagree on many topics, few if any dispute the fundamental notion that investors live in a world in which the pursuit of greater returns is impossible without the assumption of greater risk.

Your best alternative remains a well-diversified portfolio based on sound empirical research.

It might be tempting to sell your financial assets and go to cash. This is always a gamble as it requires guessing correctly twice, by selling when securities are about to fall in price and eventually buying in again, but not too late so as to have missed the rebound. This strategy is even more dubious now, considering that short-term interest rates are so low that after accounting for price inflation, negative returns on cash-equivalent assets are virtually certain.

As for stocks, most companies have solid balance sheets. Management has taken prudent action to pare expenses and limit debt. Cash balances are high, though few firms are currently willing to put that cash to work given the uncertainty hanging over the economy. These same firms are well-poised to prosper when

* HYD is a hypothetical model based on back-tested results. See p.70 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

(continued next page)

economic activity accelerates. The stock market itself serves as one of the early indicators of an upswing in economic growth, so investors are best served by maintaining exposure to stocks. In the meantime, some of these individual firms will fail, but since it is very difficult to identify them ahead of time, diversification remains essential.

Our bond portfolio quiver has all the arrows needed to address the various risks and opportunities inherent in fixed income assets. Interest rates are at historic lows, and many investors are worried about rising rates that could quickly send bond prices tumbling. We manage this risk by keeping bond durations short. The Fed's monetary expansion has many worried about the risk of future price inflation. We have inflation-adjusted bond (TIPS) funds to protect against this threat. As for credit (solvency) risk, we recommend only in globally diversified funds that include investment-grade securities and sovereign debt in developed economies. To manage tax risk, the risk of rising marginal income tax rates, we

recommend concentrating bonds in tax-deferred accounts when possible. In taxable accounts we recommend high-quality and well-diversified municipal bond portfolios.

Our approach, in a nutshell, is to identify various forms of risk through empirical analysis and to isolate those risks within selected low-cost investment vehicles. This allows you to assemble a portfolio designed to optimize your investment returns consistent with the level of risk you are willing to accept and the types of risk to which you are most sensitive.

This approach stands in contrast to the countless money managers who claim to understand the risk-return trade-off, but deny it implicitly in their sales pitches and in practice. While we encourage investors to acknowledge their fear, others seek to exploit investors' anxieties. Some offer too-good-to-be-true products with supposed limits on the downside but no corresponding limit on gains. Others sell advice. Currently some are telling investors to invest heavily in gold simply because the gold price has increased, (and therefore should

continue to increase) while others are proclaiming a top in the gold price, and that it is time to sell. This contradiction should itself speak volumes. More importantly, an objective historical analysis of the gold price reveals an extremely volatile asset that can be of great value if held at all times, but in moderation and only within a well-diversified portfolio.

With regard to the health of the overall economy, AIER's business-cycle analysis points toward continued, albeit slow, recovery. Growth has been hampered by a confluence of events throughout the globe, but do not be distracted by the dire, sensational commentary that seems to amplify every instance of bad news. There is no substitute for dispassionate, rational analysis of data.

We understand the anxiety you might be feeling. However, by adhering to the approach we recommend, you have wisely chosen the most prudent course of action among the many alternatives available to you.

COUNTERPARTY RISK: WHAT INDIVIDUAL INVESTORS NEED TO KNOW

Investing involves risks. The fundamentals of academic finance are based on the idea of receiving returns relative to a certain level of risk. Mutual fund and ETF prospectuses are loaded with page after page describing it. Here, at AIS, we're constantly looking to make sure we take the right amount — in short, risk isn't always a bad word.

But investors are most used to evaluating *market* risks. When you buy a stock, you know equities as a whole might decline, or the company in which you're invested could, in a worst-case scenario, go bankrupt quickly, leaving you with pennies on the dollar. Most investors temper these downside risks through diversification. By holding not just one stock, but a whole portfolio, the odds of an event wiping out the entire portfolio become vanishingly small. Further, most investors diversify into other asset classes such as bonds, real estate, or gold. Indeed, the entire investment management industry, from financial advisors to hedge funds, spends nearly all of its energy analyzing and managing market risk.

However, there is another kind of risk present in some — but not all — investments, that goes virtually undisclosed, and for the most part, un-discussed: counterparty risk.

Counterparty risk is the risk that the person on the other side of your investment will renege on their side

of the transaction. Investors deal with this risk every day in the world's largest auction market, eBay. When you agree to buy a mint-condition issue of Amazing Spider-Man #1 from a comic book collector across the country, you send him your cash (\$10,000 at recent prices), and you trust that he will ship you your comic. But what if he doesn't? What if he declares bankruptcy and the IRS comes and seizes all of his assets, and you're out both the \$10,000 and the comic?

That's counterparty risk.

Modern financial markets are built on the idea of minimizing counterparty risk wherever possible. As soon as a market — whether it's for stocks, bonds, grain or gold — gets big enough, if the thing being traded is fungible (meaning easily exchangeable and common in description), there is generally some sort of exchange that steps in to, in effect, become everyone's counterparty. When you as an investor buy 100 shares of IBM, you don't need to worry about whether the person selling you the 100 shares fails to deliver, because both your broker and his have agreed to use the Depository Trust and Clearing Corporation (DTCC) as the clearing agency for your trade. Should he go bankrupt, the DTCC will make you whole. It works because it consolidates all of the counterparty risks in the market into a single pool of securities, and everyone agrees to play by the same

rules. Because these clearing systems work so well and invisibly, investors simply aren't used to thinking about counterparty risk.

Modern Counterparty Risk

Exchange-Traded Funds have changed the way many investors approach the market. As generally low cost, indexed vehicles, they've opened up a tremendous range of asset classes for investors, and provided unparalleled transparency, efficiency and flexibility. But with this new range of asset class comes a new set of risks.

Most ETFs are actually mutual funds in disguise. Funds holding traditional assets like stocks, bonds and cash are overwhelmingly organized as Registered Investment Companies under the 1940 act, just like a mutual fund. One of the benefits of that structure is that each fund is its own legal entity — a trust — complete with a board of directors, independent books, and a rigorous set of regulations that govern how it's managed. Short of some kind of conspiracy among the independent board and all of the various auditors, lawyers, custodians and brokers for the fund, there is effectively zero risk that a mutual fund itself simply disappears, any more than there's a risk that the coins in your safe-deposit vault at your local bank simply vanish over night.

Errata

We regret an error in the August 2011 issue of *Investment Guide*. Chart 2 on page 60 incorrectly states the ending value of one dollar invested in hypothetical AIS moderate risk portfolios with and without gold, between January 1990 and December 1999. The portfolio without gold would have had an ending value of \$2.20, not \$2.12 as presented, while the portfolio with gold would have had an ending value of \$2.12, not \$2.20 as presented. These figures are stated correctly in the text of the article on page 59, but do not correspond to the misstated information on the chart.

any investor paying attention had ample opportunity to sell their ETN shares ahead of bankruptcy, in the end, a few million dollars of investor assets were indeed wiped off the books when no bailout was forthcoming for Lehman.

While ETNs provide an interesting alternative for investors, they do come with this additional risk. There are currently no ETNs among our recommended

are familiar with the two most common types of derivatives: Futures (which commit the investor to buy or sell something at a point in the future), and Options (which give the investor the right to buy or sell something at a point in the future). Futures and Options are common in many mutual funds and ETFs, usually as small positions that help the fund put excess cash to work quickly and easily. But these derivatives, while they may have market or even leveraged market risk, hold essentially no counterparty risk. Like stocks, they're bought and sold on an exchange and backed up by an independent third party clearing process that guarantees the trades.

However, this isn't true for all derivatives. Swaps, in particular, are problematic.

At its core, a swap is the simplest and most flexible form of derivative. It is simply an agreement between two people to take different sides of a particular bet. A swap on the S&P 500 for example, would obligate the two swap counterparties to pay each other based on which way the S&P 500 moved on any particular day. On a day when the S&P is up 1 percent, the person on the short side of the swap would owe the person on the long side of the swap 1 percent of whatever the notional value of the swap is. On a day when the market was down 1 percent, the opposite would

A Note on Notes

But not everything labeled as an "ETF" is like that. First, and easiest to identify, is the peculiar animal known as the exchange-traded *note*, or ETN. Like an ETF, an ETN trades on an exchange throughout the day, giving you exposure to the performance of some underlying index. But where an ETF is actually the listed shares of a trust, an ETN is simply a slice of debt — a bond — with a unique pattern of payouts.

Let's use as an example the largest ETN in the market, the JPMorgan Alerian MLP ETN (AMJ), with over \$2.5 billion in assets. AMJ tracks the Alerian index of Master Limited Partnerships, which invest primarily in natural gas pipelines. But the ETN, being a note, doesn't actually invest in anything. Rather, JPMorgan Chase promises to pay note-holders a pattern of returns equal to the performance of that index, minus fees. Because investors can return a block of shares for cash at any time (just as they can with an ETF), the shares of AMJ on the open market tend to track the actual intraday and long-term performance of the index extremely well. Indeed, from the perspective of an investor trying to track a difficult-to-access market like MLPs, AMJ is extraordinary, as there's actually zero fund management risk. There's no room for tracking error — there's simply a promise to pay the exact return of the index.

But what happens to holders of AMJ should JPMorgan Chase go bankrupt? Exactly the same that would happen to any bondholder of JPMorgan Chase — you could theoretically lose your entire investment with the stroke of a pen.

To be fair, the ETNs currently on the market come from some of the largest and best capitalized banks in the world: Barclays & JP Morgan. But in 2008, Lehman Brothers had their own series of ETNs on the market, and while

securities.

Swaps and Other Derivatives

While it's relatively easy to make a rational decision to accept or reject ETNs for their counterparty risk — the word "ETN" is generally in the name of the security — it can be far trickier to discover hidden counterparty risk in a traditional 1940 Act mutual fund or ETF.

Derivatives — securities that derive their value from the movement of other securities — have become an increasingly large and important part of the financial markets. Most investors

Securities Lending

In equity mutual fund portfolios, it's common for the portfolio manager to make some portion of the portfolio available for lending to short sellers. Short sellers are banking on a price decline — they borrow shares, sell them immediately and later repurchase the shares — at a lower price, they hope, and return those shares to the lender. While there is some small counterparty risk associated with these transactions, the risks are vanishingly small, and are rewarded with an income stream for investors.

We covered the securities lending process in detail in the May 31, 2007 *Investment Guide* (Vol. XXIX, No.5 Mutual Fund Securities Lending: Hidden Risk and Return). In brief however, when a fund loans out 100 shares of IBM to a short seller, they take in return collateral (cash or short term securities) in excess of the value of those 100 shares. The borrower is responsible for returning the 100 shares of IBM, along with any dividends it might have paid, in addition to some small fee (called a rebate). The fund, therefore, receives not only the return of the 100 share IBM investment, but the additional income from investing the collateral and the rebate. This additional income is generally split with the investment manager, at rates ranging from 50/50 to 100 percent for the shareholders. Our recommended funds return 100 percent.

The risk of the short-seller failing to deliver the 100 shares back is quite small, as the value of the collateral is constantly trued up to exceed the value of the 100 shares. Should the counterparty fail to deliver, the fund can simply re-buy the shares in the open market — this presents an inconvenience, with some transaction costs, but not a capital risk.

A well run securities lending program can actually offset the entire expense ratio of an ETF or mutual fund in certain hard-to-borrow markets, such as small caps and emerging markets, producing predictable — if small — excess returns for investors with minimal risk. For this reason, we do not consider an active securities lending program to be a black mark when evaluating potential investments.

The European ETF Market

While swap-ETFs in the U.S. are limited to leveraged and inverse products and a handful of commodities funds, they are predominant in the European ETF market. Recent headlines from Europe, particularly in the wake of the discovery of \$2 billion in rogue trading losses at UBS, have highlighted this risk. ETFs in Europe are more commonly used by institutions than by individuals — institutions have long been comfortable with swaps and their embedded counterparty risk. The concern in Europe, however, is that a lack of disclosure of both ETF trading and swap counterparties could cause a situation of cascading defaults, where one bank was backing up their own swap obligations by purchasing swaps from another, and so on. Much of the discussion in the European ETF market is now about how to clean up, regulate, or increase the transparency of counterparty risk.

be true.

The beauty of swaps is that they can quite literally be based on anything two parties agree on. For that reason, portfolio managers often use them when seeking exposure that would otherwise be difficult to manage in the context of a mutual fund or ETF. Leveraged and Inverse ETFs and Mutual Funds, for example, are almost entirely based on swaps. Indeed, if you go to the website of any leveraged ETF, you're likely to see a single line item as that fund's holdings: one total return swap for the stated objective of the fund. Even otherwise traditional funds often hold small swap positions, commonly credit-default swaps (CDS), which serve as a form of insurance on the debt obligations of bond issuers. Portfolio managers use small CDS positions to help offset the risk of fixed income investing.

The problem is that this is a tremendously undiversified investment. While the counterparty in the S&P 500 swap example might be providing the returns of a diversified equity portfolio, should that counterparty go bankrupt, there's nobody on the other side of the swap to make good on that performance promise. While that sounds scary, it's important to understand that swaps used within ETFs and Mutual Funds are fully collateralized. No money actually

changes hands when a fund "buys" a swap: they simply sign an agreement with a counterparty. On a regular basis — as often as daily — the agreement is settled and trued up, with whichever party owes money paying the other. The true counterparty risk, therefore, is limited to the amount that the swap has drifted since the last settlement true-up. In a highly volatile market, this could amount to a significant sum, but would be very unlikely to actually wipe out an entire position.

Evaluating Counterparty Risk

It is relatively simple to evaluate counterparty risk in ETNs. Exchange traded notes are issued by a handful of very large banks, all of which have active credit default swap markets that can be used as a gauge for measuring the risk that the issuing bank might default. Using CDS quotes from a source like Bloomberg, you can discover, for example, that to "insure" the debt of JP Morgan costs 0.73 percent per year, while to "insure" the debt of Barclays Bank costs 1.84 percent. This does not imply that Barclays Bank is 1.84 percent likely to go bankrupt in the next 12 months, rather, that's just the premium the market will demand to guarantee against such an event. As a rule of

thumb, CDS rates over 3-4 percent are cause for alarm. Lehman, for instance, had a CDS rate of 7 percent prior to its default.

Assessing the counterparty risk of more traditional ETFs and Mutual Funds however requires a bit more detective work. Investors should not only read the prospectus, which will highlight counterparty risks and the potential use of derivatives, they should also examine the fund's portfolio. Any swaps in use will be obvious, but it is extremely unlikely the counterparties on those swaps will be disclosed. In such a case, a prudent investor would assume the worst possible large bank in the market is on the other side of that agreement, and that some portion of the portfolio is at risk. Keep in mind, the more volatile the underlying investment, the greater the portion of the portfolio that might be at risk (as the daily or weekly move will be larger in more volatile securities). Investors may choose to simply avoid funds that make substantial use of over-the-counter swaps, or at a minimum, monitor such portfolios extremely carefully.

Conclusion

The good news for investors is that in the realm of ETFs and Mutual Funds, counterparty risk is easy to see, either through portfolio holdings or through the structure of the product. We currently do not recommend any ETNs, and we monitor the holdings of our recommended funds to avoid swap counterparty risk. But the vast majority of ETFs in existence are devoid of any significant counterparty risk, and retain many features that will appeal to rational investors, such as tax efficiency, economy, and flexibility.

STOCKS, INFLATION AND DIVIDENDS

In the September 19 issue of Research Reports¹ AIER presented the price performance of the Dow Jones Industrial Average (DJIA, or "the Dow") over several decades. The article illuminated the corrosive effect of price inflation on stock price returns over time, and also pointed out the importance of dividends. Our high-yield Dow investment strategy acknowledges explicitly the importance of dividends in an inflationary environment.

Common stocks are a poor hedge against price inflation – from month-

to-month or over other short term periods their total returns are not strongly correlated with changes in consumer prices. However, investors

can generally rely on stocks to provide positive real (inflation-adjusted) returns over time because stock prices represent the present value of a future earnings

Hypothetical Annual Returns During High Inflation January 15, 1965 – December 15, 1981			
	DJIA Price Only (Dividends excluded)	DJIA (Total Return)	AIS HYD Strategy Total Return
Nominal	-0.10 %	+4.46 %	+11.48 %
Real (Inflation Adjusted)	-6.79 %	-2.23 %	+ 4.79 %

Planned Giving: Is it Right for You?

- Do you have a need for investment income?
- Do you own real estate, common stocks, or other assets with large unrealized capital gains that pose a potentially large tax liability?
- Do you have charitable intentions?

If you answered yes to these questions, a charitable remainder program might be well suited to your circumstances. For more information, contact David Michaels, Chief Financial Officer for AIER, at (413) 528-1216 ext. 3146.

stream generated by the sale of goods and services at prices that are subject to inflation.

The 1970s were extremely challenging for investors, but also instructive regarding common stocks, inflation and dividends. Rapidly rising consumer prices eroded the purchasing power of virtually every asset class; it was a rare instance of a long-term time span when even common stocks failed to keep pace with inflation. Using mid-month prices, between January 1965 and December 1981, a hypothetical portfolio tracking the Dow would have provided a total real return of -2.23 percent per year. Had dividends been excluded, the results would have been far worse: the portfolio would have lost nearly seven percent (-6.79%) per year.

During this same period, a hypothetical portfolio tracking our high-yield Dow (HYD) investment strategy

would have provided a *positive* total return of 4.79 percent per year after accounting for price inflation, thus exceeding the real total return on the Dow itself by 7.02 percent per year.

We developed the HYD model with AIER's Reserve Life Income (RLI) fund in mind. The RLI fund, which is held in trust, is a pooled income fund with a dual mandate: it must distribute a steady stream of investment income (dividends and interest) to trust beneficiaries, but the purchasing power of the underlying assets must also be preserved on behalf of the trust fund's charitable remainderman, AIER. AIER's staff economists reasoned that a portfolio of stocks with an above-average dividend yield would serve both purposes. We now employ the strategy that emerged² within the RLI fund and also on behalf of many of our clients in our Professional Asset Management Program.

Our research is supported by a wide body of academic research. So-called value stocks have provided stronger returns than growth stocks over time. There are several ways to classify a stock as growth or value. Common measures include dividend yield (indicated dividend divided by market price), book-to-market ratio (book value divided by

its market price) or earnings-to-price ratio (earnings divided by market price). The key is that some measure of a firm's economic well-being is being measured relative to the stock's market price. Value stocks have higher yields, book-to-market and earnings-to-price ratios relative to growth stocks.

Over the long term (since 1927) large cap value stocks have generated higher annualized returns than the overall stock market, as measured by the S&P 500 Index. We believe this is explained by the inherent trade-off between risk and return. Value companies, being in a distressed state, carry high economic risk and have higher costs of capital than financially healthier firms with strong prospects for growth. Riskier companies that borrow money must pay (and investors receive) higher interest rates; similarly, when they issue stock they receive (and investors pay) lower prices. A higher cost of capital for a firm means a higher expected return for investors.

Because of their inherently higher level of risk, distressed companies have higher expected returns than companies that are healthier. Research and historical results show that long-term increases in expected returns can be achieved with value exposure. Such premiums cannot be gained by subjective stock selection or market timing, nor can it be gained through various other segmenting schemes promoted by active managers, such as "bets" on industrial sectors.

In addition to our high-yield Dow approach, we recommend value-oriented mutual funds and ETFs that employ a book-to-market approach. These can be found on page 72.

1 Steven R. Cunningham, PhD, Director of Research and Education "Stock Prices and Inflation" Research Reports, Vol. LXXVIII, No. 16, September 19, 2011, p. 4.

2 (see page 70 and our website for more detail)

SOVEREIGN DEBT RATINGS AND STOCK RETURNS¹

In early August, Standard & Poor's downgraded US government debt from a top-rated AAA to AA+. In the weeks preceding the event, some market observers expected a downgrade to result in higher interest rates and lower stock returns.

After the downgrade, yields on US government securities fell across the term spectrum as investors around the world fled to the safe haven of US bonds. US stocks experienced negative returns in the following weeks but logged positive performance from the day of the downgrade to month end.²

These events raise questions about whether changes in sovereign debt ratings impact the financial markets. The short answer is that results are mixed, and that many other factors affect a

country's cost of capital and stock market returns.

Regarding bond markets, history offers examples of major developed countries that experienced a credit downgrade without a significant rise in interest rates.³ Examples include Australia, Canada, and Japan, which lost their top ratings in 1986, 1992, and 1998, respectively.

Other research suggests that countries with high credit ratings may withstand a downgrade better than countries with lower ratings. One study looked at sovereign credit rating downgrades since 1990 and found that bond yields changed little among countries downgraded from the highest triple-A rating. However, countries with lower credit ratings (single A or below) experienced significant interest rate

increases following their downgrade.⁴

Stock Market Impact

Another question is whether the US downgrade has played a role in the US market downturn—and research does not provide convincing evidence.

The accompanying table summarizes stock market performance of respective countries before and after a ratings change. It is based upon a study of ratings changes made by Moody's from 1983 to 2009. During the twenty-seven-year period, the ratings agency made seventy-one upgrades and twenty-five downgrades to governments in the developed and emerging markets tracked by MSCI.

The study identified the date of each change and logged each country's market

performance in the twelve months before and twelve months after the event. Each country's market returns were compared to the respective market index and the excess return averaged for all events. (Excess return refers to performance above or below the respective market index, either MSCI EAFE or MSCI Emerging Markets, as appropriate.)

The aggregate results show that stock markets of upgraded countries outperformed their respective market index in the twelve months before the rating change (13.83%), while stocks in downgraded countries aggregately underperformed the market index before the event. However, cumulative returns in the twelve months following a ratings change were almost the same for the upgraded and downgraded countries (3.87% vs. 3.73%).⁵

These results suggest that market prices reflect all available information and expectations about a country's economic prospects—including the

possibility of a ratings change. By the time a country's debt rating is upgraded or downgraded, the market has already integrated the news into prices. Stock markets reflected positive economic

developments prior to a ratings upgrade and negative developments before a ratings downgrade. After the event, markets did not appear to perform much differently, in aggregate.

This research underscores the importance of looking to market prices for signals about the fiscal health and prospects of a country or a company.

Equity Market Performance Before and After Moody's Ratings Changes 1983–2009		
	Cumulative Return in Excess of Market	
Sovereign Bond Rating Change	12 Months Before	12 Months After
Upgrade	13.83%	3.87%
Downgrade	-6.56%	3.73%

Analysis conducted by Dimensional Fund Advisors using sovereign bond rating data from Moody's Investors Services, "Sovereign Default and Recovery Rates, 1983–2009." Returns are in US dollars and represent performance in excess of MSCI EAFE Index for developed markets and MSCI Emerging Markets Index for emerging markets. A positive excess return indicates market outperformance; a negative excess return indicates underperformance. The table reports the return of an equal-weighted, event-time portfolio. Past performance is no guarantee of future results.

Based on the foregoing analysis, markets appear to work faster and more accurately than ratings firms to assess a country's financial condition and evaluate the potential impact on its cost of capital and equity market.

1. Adapted from: Bryan Harris "Sovereign Debt Ratings and Stock Returns" Advisor Byline, https://my.dimensional.com/insight/advisor_by-line/76050/
2. Two weeks following the downgrade, the US market, as measured by the Russell 3000 Index, logged a negative 6.82% return (August 5–19). However, from the day of the announcement to month end, the market returned a positive 1.6%. Russell data copyright © Russell Investment Group 1995–2011, all rights reserved.
3. Tom Lauricella, "Lessons of Lower Ratings," Wall Street Journal, July 30, 2011.
4. Ivan Rudolph-Shabinsky and Dennis Shen, "When 'Risk-Free' Isn't Risk Free: The Impact of a US Treasury Downgrade" (white paper, Alliance Bernstein, June 2011), www.alliancebernstein.com/CmsObjectABD/PDF/Research_WhitePaper/Treasury-Downgrade_110706.pdf.
5. The twelve-month aggregate excess performance prior to the ratings change was statistically significant, while the twelve-month returns after the ratings change were not.

THE HIGH-YIELD DOW INVESTMENT STRATEGY

Recommended HYD Portfolio

As of September 15, 2011

	Rank	Yield (%)	Price (\$)	Status	—Percent of Portfolio—	
					Value (%)	No. Shares (%) ¹
AT&T	1	6.03	28.54	Holding**	24.65	23.49
Verizon	2	5.53	36.19	Holding**	26.48	19.90
Merck	3	4.68	32.49	Buying	20.92	17.51
Pfizer	4	4.33	18.49	Holding**	24.99	36.76
DuPont	8	3.53	46.48	Selling	2.73	1.60
Frontier Communications	N/A	N/A	7.03	Selling	0.19	0.75
Cash (6-mo. T-Bill)	--	--	--		0.04	--
Totals	--	--	--		100.00	100.00

**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.

Subscribers can find a full description of the strategy and methodology in the "Subscribers Only" (Log in required) section of our website: www.americaninvestment.com.

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) through August 31, 2011*.

	1 mo.	1 yr.	5 yrs.	10 yrs.	20 yrs.	Since 1/79	Std. Dev.
HYD Strategy	-1.01	17.86	1.30	5.20	11.89	15.62	18.04
Russell 1000 Value Index	-6.24	14.37	-1.61	3.41	8.86	11.78	14.96
Dow	-3.96	19.03	3.17	4.08	9.44	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 (\$)

	9/15/11	Mo. Earlier	Yr. Earlier
Gold, London p.m. fixing	1782.00	1739.00	1053.50
Silver, London Spot Price	40.34	39.18	17.54
Copper, COMEX Spot Price	3.95	4.03	2.85
Crude Oil, W. Texas Int. Spot	89.39	87.87	77.57
Dow Jones Spot Index		465.92	467.39
Dow Jones-UBS Futures Index	158.28	158.39	133.32
Reuters-Jefferies CRB Index	332.60	330.52	273.72

Securities Markets

	9/15/11	Mo. Earlier	Yr. Earlier
S & P 500 Stock Composite	1,209.11	1,204.49	1,125.07
Dow Jones Industrial Average	11,433.18	11,482.90	10,572.73
Dow Jones Bond Average	283.74	283.21	268.38
Nasdaq Composite	2,607.07	2,555.20	2,301.32
341.35 Financial Times Gold Mines Index	3,977.39	3,815.05	
FT EMEA (African) Gold Mines	3,515.55	3,419.37	3,306.67
FT Asia Pacific Gold Mines	17,466.27	18,789.65	16,842.79
FT Americas Gold Mines	3,437.21	3,220.76	3,046.02

Interest Rates (%)

U.S. Treasury bills - 91 day	0.01	0.02	0.15
182 day	0.03	0.08	0.20
52 week	0.09	0.11	0.24
U.S. Treasury bonds - 10 year	2.09	2.29	2.74
Corporates:			
High Quality - 10+ year	4.19	4.40	4.59
Medium Quality - 10+ year	5.40	5.44	5.74
Federal Reserve Discount Rate	0.75	0.75	0.75
New York Prime Rate	3.25	3.25	3.25
Euro Rates			
3 month	1.53	1.55	0.88
Government bonds - 10 year	1.74	2.34	2.40
Swiss Rates - 3 month	0.01	0.08	0.18
Government bonds - 10 year	0.98	1.25	1.45

Coin Prices (\$)

	9/15/11	Mo. Earlier	Yr. Earlier	Prem (%)
American Eagle (1.00)	1,877.88	1,833.47	1,308.82	5.38
Austrian 100-Corona (0.9803)	1,772.82	1,729.72	1,232.93	1.48
British Sovereign (0.2354)	442.90	432.40	311.20	5.58
Canadian Maple Leaf (1.00)	1,856.60	1,812.10	1,307.40	4.19
Mexican 50-Peso (1.2057)	2,184.30	2,131.30	1,519.40	1.66
Mexican Ounce (1.00)	1,832.30	1,788.30	1,280.50	2.82
S. African Krugerrand (1.00)	1,854.28	1,809.88	1,301.07	4.06
U.S. Double Eagle-\$20 (0.9675)				
St. Gaudens (MS-60)	1,842.50	1,940.00	1,475.00	6.87
Liberty (Type I-AU50)	1,982.50	1,977.50	1,600.00	14.99
Liberty (Type II-AU50)	1,960.00	1,947.50	1,487.50	13.68
Liberty (Type III-AU50)	1,827.50	1,910.00	1,427.50	6.00
U.S. Silver Coins (\$1,000 face value, circulated)				
90% Silver Circ. (715 oz.)	28,725.00	27,925.00	14,387.50	-0.41
40% Silver Circ. (292 oz.)	11,637.50	11,325.00	5,862.50	-1.20
Silver Dollars Circ.	31,275.00	30,375.00	16,025.00	0.22

Note: Premium reflects percentage difference between coin price and value of metal in a coin, with gold at \$1782 per ounce and silver at \$40.34 per ounce. The weight in troy ounces of the precious metal in coins is indicated in parentheses.

Exchange Rates (\$)

British Pound	1.580800	1.638700	1.564100
Canadian Dollar	1.013500	1.016467	0.972668
Euro	1.385800	1.445200	1.300800
Japanese Yen	0.013000	0.013033	0.011678
South African Rand	0.135400	0.140485	0.141183
Swiss Franc	1.148770	1.281723	0.996810

THE DOW JONES INDUSTRIALS RANKED BY YIELD*

Ticker	Symbol	Market Prices (\$)			12-Month (\$)		Latest Dividend Record		Indicated Annual Yield†		
		9/15/11	8/15/11	9/15/10	High	Low	Amount (\$)	Date	Paid	Dividend (\$)	(%)
AT&T	T	28.54	28.81	28.01	31.94	27.20	0.430	7/08/11	8/1/11	1.720	6.03
Verizon	VZ	36.19	35.05	31.19	38.95	30.94	0.500	10/07/11	11/1/11	2.000	5.53
Merck	MRK	32.49	32.13	36.51	37.68	29.47	0.380	9/15/11	10/7/11	1.520	4.68
Pfizer	PFE	18.49	18.34	17.27	21.45	16.25	0.200	8/05/11	9/6/11	0.800	4.33
Intel Corp	INTC	21.54	20.89	18.72	23.96	18.58	0.210	8/07/11	9/1/11	0.840	3.90
General Electric	GE	16.08	16.39	16.34	21.65	14.72	0.150	9/15/11	10/25/11	0.600	3.73
Johnson & Johnson	JNJ	64.40	64.59	61.05	68.05	57.50	0.570	8/30/11	9/13/11	2.280	3.54
Dupont	DD	46.48	47.72	42.93	57.00	42.83	0.410	8/15/11	9/12/11	1.640	3.53
Procter and Gamble	PG	62.78	61.88	61.11	67.72	57.56	0.525	7/22/11	8/15/11	2.100	3.35
Kraft	KFT	34.95	34.68	31.59	36.30	29.80	0.290	9/30/11	10/14/11	1.160	3.32
Travelers	TRV	49.84	52.27	52.49	64.17	46.62 L	0.410	9/09/11	9/30/11	1.640	3.29
Chevron	CVX	99.26	99.10	79.21	109.94	78.16	0.780	8/19/11	9/12/11	3.120	3.14
J P Morgan	JPM	33.81	36.88	40.98	48.36	31.21 L	0.250	7/06/11	7/31/11	1.000	2.96
Home Depot, Inc.	HD	34.28	31.46	29.94	39.38	28.13	0.250	9/01/11	9/15/11	1.000	2.92
Wal-Mart Stores	WMT	52.51	49.98	52.86	57.90	48.31	0.365	3/11/11	4/4/11	1.460	2.78
McDonald's	MCD	88.07	86.82	74.71	91.22 H	72.14	0.610	9/01/11	9/16/11	2.440	2.77
3M Company	MMM	80.63	83.31	84.58	98.19	76.00 L	0.550	8/19/11	9/12/11	2.200	2.73
Coca-Cola	KO	71.02	68.20	57.42	71.77 H	57.25	0.470	9/15/11	10/1/11	1.880	2.65
Boeing	BA	64.32	62.70	62.73	80.65	56.01	0.420	8/12/11	9/2/11	1.680	2.61
Exxon Mobil	XOM	74.01	74.29	61.00	88.23	60.45	0.470	8/12/11	9/9/11	1.880	2.54
United Tech.	UTX	75.61	73.54	68.27	91.83	67.12	0.480	8/19/11	9/10/11	1.920	2.54
Microsoft Corp.	MSFT	26.99	25.51	25.12	29.46	23.65	0.160	8/18/11	9/8/11	0.640	2.37
Caterpillar	CAT	86.60	91.37	72.13	116.55	71.09	0.460	7/20/11	8/20/11	1.840	2.12
Hewlett-Packard	HPQ	23.27	32.43	39.62	49.39	22.13 L	0.120	9/14/11	10/5/11	0.480	2.06
IBM	IBM	170.09	172.99	129.43	185.63	128.80	0.750	8/10/11	9/10/11	3.000	1.76
American Express	AXP	49.36	45.82	40.85	53.80	37.33	0.180	7/01/11	8/10/11	0.720	1.46
Cisco	CSCO	16.67	16.03	21.59	24.60	13.30	0.060	7/07/11	7/27/11	0.240	1.44
Walt Disney	DIS	32.94	33.65	34.21	44.34	29.60	0.400	12/13/10	1/18/11	0.400	1.21
Alcoa	AA	11.98	12.56	11.43	18.47	10.99	0.030	8/05/11	8/25/11	0.120	1.00
Bank of America	BAC	7.33	7.76	13.71	15.31	6.01 L	0.010	9/02/11	9/23/11	0.040	0.55

* See the Recommended HYD Portfolio table on page 70 for current recommendations. † Based on indicated dividends and market price as of 9/15/11.

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 9/16/10.

RECOMMENDED INVESTMENT VEHICLES

Security Symbol	Avg. Market Cap. / Avg. Maturity	No. of Holdings	Descriptive Quarterly Statistics, as of 6/30/11		Ratios		Annualized Returns ⁸ (%), as of 8/31/11						
			Expense ⁷ (%)	Sharpe	Turnover (%)	P/B	12 Mo. Yield (%)	1 yr.	3 yr.	5 yr.	1 yr.	3 yr.	5 yr.
Short/Intermediate Fixed Income													
Vanguard Short-Term Bond Index	BSV/VBISX	1307	0.22	1.76	60	--	1.98	2.41	4.54	5.05	1.63	3.60	3.85
iShares Barclays 1-3 Yr. Credit Bond	CSIJ	713	0.20	0.98	12	--	2.17	2.09	4.40	--	1.33	3.28	--
iShares Barclays 1-3 Year Treasury	SHY ¹	36	0.15	1.70	85	--	0.95	1.41	2.57	3.86	1.07	1.93	2.91
Vanguard Limited-Term Tax-Exempt	VMLTX	1442	0.20	1.52	14	--	2.29	2.17	4.81	4.66	1.05	3.45	3.15
SPDR Short-Term Municipal Bond	SHM ¹	339	0.20	1.27	14	--	1.49	1.96	3.81	--	1.38	3.50	--
Inflation-Protected Fixed Income													
iShares Barclays TIPS Bond	TIP ¹	32	0.20	0.57	13	--	3.61	10.59	6.69	7.05	8.90	5.31	5.45
Vanguard Inflation-Protected Securities	VIPSX	32	0.22	0.53	29	--	3.51	10.29	6.24	6.82	8.93	5.27	5.50
Real Estate													
Vanguard REIT Index	VNOQ/VGSIX ²	106	0.26	0.35	12	2.2	3.14	18.58	2.79	0.55	17.18	1.39	-0.71
SPDR Dow Jones REIT	RWR ¹	83	0.25	0.32	10	2.3	2.89	19.45	1.72	-0.49	18.17	0.28	-1.78
U.S. Large Cap Value													
Vanguard Value Index	VTV ¹ /VIVAX	416	0.26	0.23	27	1.7	2.20	14.52	-0.75	-1.40	14.12	-1.16	-1.81
iShares Russell 1000 Value Index	IWD ¹	657	0.20	0.20	24	1.5	1.94	14.15	-1.53	-1.71	13.56	-1.97	-2.12
U.S. Small Cap Value													
iShares Russell Microcap Index	IWC ¹	1420	0.60	0.33	35	1.5	0.80	19.36	-1.51	-2.75	19.09	-1.69	-2.90
Vanguard Small-Cap Value Index	VBR ¹ /VISX	983	0.26	0.43	25	1.5	1.71	17.12	1.93	0.92	16.70	1.47	0.48
U.S. Large Cap Growth													
iShares Russell 1000 Growth Index	IWF ¹	594	0.20	0.31	24	4.1	1.24	23.68	2.91	3.58	23.28	2.64	3.35
Vanguard Growth Index	VUG ¹ /VIGRX	434	0.26	0.28	26	3.4	1.04	23.15	2.18	3.64	22.94	2.00	3.48
U.S. Marketwide													
Vanguard Total Stock Market Index	VTI ¹ /VTSMX	3383	0.17	0.29	5	2.2	1.67	19.37	1.05	1.36	19.05	0.75	1.08
Fidelity Spartan Total Market Index	FSTMX ³	3096	0.10	0.28	4	2.2	1.57	19.32	1.01	1.35	na	na	na
Foreign-Developed Markets													
iShares MSCI Growth Index	EFG ¹	557	0.40	0.06	28	2.2	1.95	12.86	-2.25	-0.12	12.30	-2.52	-0.33
iShares MSCI Value Index	EFV ¹	526	0.40	0.08	30	1.1	3.66	6.67	-3.82	-3.08	5.70	-4.27	-3.53
Vanguard Europe Pacific Index	VEA ¹ /VTMGX ⁴	947	0.18	0.08	6	1.5	2.32	10.38	-2.45	-1.23	10.13	-2.69	-1.46
Vanguard Developed Markets Index	VDMIX ⁵	985	0.22	0.07	13	1.5	2.65	10.41	-2.59	-1.36	9.88	-3.14	-1.90
SPDR S&P International Small Cap	GWX ¹	689	0.60	0.25	17	1.2	2.00	17.80	3.47	--	17.25	3.08	--
Foreign-Emerging Markets													
Vanguard Emerging Market Index	VWO ¹ /VEIEX ⁶	889	0.35	0.28	12	2.2	1.42	9.26	4.96	8.15	8.18	4.31	7.64
Gold-Related Funds													
iShares COMEX Gold Trust	IAU ¹	1	0.25	0.84	0	--	0.00	44.96	29.37	23.27	44.96	29.37	23.27
SPDR Gold Shares	GLD ¹	1	0.40	0.84	0	--	0.00	44.98	29.10	23.32	44.98	29.10	23.32

Recommended Gold-Mining Companies (\$)

Ticker Symbol	Month 9/15/11	Year Earlier	--- 52-Week ---		Dividends Paid Last 12 Months	Payment Schedule (%)	Yield (%)
			High	Low			
Anglogold Ltd., ADR	AU	46.22	45.47	44.50	0.2334	Semiannual 0.5050	
Barrick Gold Corp. +	ABX	52.87	50.68	44.99	0.4080	Semiannual 0.7717	
Gold Fields Ltd.	GGI	16.84	16.87	15.29	0.2381	Semiannual 1.4139	
Goldcorp, Inc. +	GG	50.59	51.13	42.76	0.3171	Monthly 0.6268	
Newmont Mining	NEM	64.29	59.02	62.90	0.8000	Quarterly 1.2444	

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. withholding.

Data provided by the funds and Morningstar. ¹Exchange Traded Fund, traded on NYSE. ²1% fee for redemption in 1 yr. ³0.5% fee for redemption in 90 days. ⁴1% fee for redemption in 5 yrs. ⁵2% fee for redemption in 60 days. ⁶0.5% fee for purchase and 0.25% fee for redemption. ⁷For Vanguard funds, Expense Ratios shown are for Mutual Funds. ETFs have lower expenses. ⁸For Vanguard Funds, returns shown are for Mutual Funds; ETFs' returns may deviate *Pre-liquidation. 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.