

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

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Spending Down

This month we continue our series on income in retirement. In the following pages we assess reverse mortgages and preferred stocks, and we will assess other sources of income coming months. However, readers should keep in mind that ideally their savings will constitute their primary source of cash flow.

Spending from savings, however, requires discipline. To avoid the risk of depleting their savings prematurely, retirees should formulate spending guidelines to accompany their portfolio allocation plan.

Recent research conducted by The Vanguard Group reassessed the "4 percent spending rule", a widely accepted rule-of-thumb for spending in retirement.¹ Since 1926 the annual investment income (interest and dividends) from a 50 percent stock/50 percent bond portfolio would have exceeded 4 percent in most years. However, yields have been steadily decreasing over the past 30 years, falling from a peak of 10.2 percent in 1982 to only 2.8 percent in 2011.

Investors willing to spend from capital, however, should take heart. Vanguard assessed a variety of inflation-adjusted spending rates and portfolio allocation plans² for investors with differing planning horizons and desired levels of "certainty" regarding portfolio success rates (success being defined as not running out of money prematurely). The table below provides a synopsis.

Portfolio Withdrawal Rates Assuming 85% Success Rate							
Portfolio	Planning Horizon (years)						
	10	15	20	25	30	35	40
Conservative	9.3%	6.3%	4.8%	4.0%	3.5%	3.1%	2.9%
Moderate	9.6	6.6	5.2	4.4	3.9	3.5	3.3
Aggressive	9.6	6.7	5.3	4.5	4	3.7	3.4

For example, for a retiree with a 25 year planning horizon and assuming an 85 percent success rate (an 85 percent probability of not depleting the account before 25 years), an aggressively allocated portfolio would support a 4.5 percent withdrawal rate³. A conservative portfolio on the other hand would only support a 4.0 percent withdrawal rate.

This model is useful as a point of reference because it can accommodate different assumptions regarding an investor's time horizon, portfolio allocation, and chosen success rate. It suggests that the traditional 4 percent rule-of-thumb falls within a range of withdrawal rates that would be reasonable for many retirees.

1 Maria A. Bruno, CFP Colleen M. Jaconetti, CPA, CFP, Yan Zilbering "Revisiting the '4% spending rule'". The Vanguard Group, Inc.

2 Aggressive portfolio: 80% stocks, 20% bonds, moderate portfolio: 50% stocks, 50% bonds, conservative portfolio: 20% stocks, 80% bonds. Projections based on Vanguard Capital Markets Model a proprietary financial simulation tool.

3 Spending 4.5 percent of the initial balance in the first year of retirement and adjusting the dollar amount for inflation in subsequent years.

REVERSE MORTGAGES: TAPPING YOUR HOME FOR INCOME

This month we describe reverse mortgages as the third segment in our series addressing income in retirement. It would be understandable if you dismissed reverse mortgages out of hand. After all, they're often hawked by B-list celebrities on late night TV. But if you're nearing, or in retirement and have a substantial portion of your net worth tied up in real estate, it pays to understand how a reverse mortgage works, and how it can give you flexibility in managing your retirement finances.

The Basics

The easiest way to think about a reverse mortgage is to start with a traditional mortgage. We all know how those work – in a traditional mortgage, you take a loan from a bank for the purposes of financing property. The starting point of any mortgage is cash you already have (a down payment), and cash you intend to pay over time (your payments to the bank). At the end of your traditional mortgage, your loan is entirely paid off, and you own the property outright.

A reverse mortgage starts from a position in which you own your property already (or at least substantially). In a reverse mortgage, a bank loans you money and in exchange gets a lien on your property. The bank doesn't expect that money back, however, until you no longer need the home (usually through death or relocation), or unless you default on your obligations under that loan. It is important to note that you retain ownership of the home; as long as the requirements of the loan are met, borrowers cannot lose their home, and do not have to pay the money back until the home is sold.

If this sounds familiar, it should. A far more common instrument lets people tap into their home equity – the home equity line of credit. In a line of credit, borrowers take out a mini-mortgage, in which they typically make monthly interest payments to the bank, and eventually pay back the full value of the line of credit.

But reverse mortgages are different. No payments are made to the bank during the life of the loan. That means that the borrower need not have any income stream whatsoever in order to qualify for a reverse mortgage (although the bank will still verify the borrower's financial information.) Instead of paying the bank, the bank will actually be paying the borrower, either in a single lump sum, or in a stream of payments, or on demand, through a line of credit.

Why might you do this? Imagine you're 70 years old, and you own –

tap into this equity should your other sources of retirement income prove inadequate. The only alternative, for many retirees, could be to sell the house and “downsizing”, which might require selling when the housing market has fallen.

Getting Into The Details

Unlike a traditional mortgage, interest on a reverse mortgage is simply added to the amount of the loan as it accrues. In a traditional mortgage, borrowers make monthly payments that cover the interest and a portion of the principal, thereby decreasing the amount of the loan over time while increasing the equity in their homes. With a reverse mortgage, the monthly interest is added to the initial loan amount, so that over time, the amount of the loan grows. That means that if the value of the house falls, the loan can end up close to or larger than the value of the home. On the other hand, if real estate prices rise faster than interest accrues, the borrower's notional equity in the house can increase.

For loans backed by the FHA, the amount that can be borrowed is based on the age of the youngest borrower, the current interest rate, the initial mortgage insurance premium and the lesser of the home's appraised value or the FHA mortgage limit of \$625,000. For homes appraised at greater than \$625,000¹ a reverse mortgage is still possible, but only \$625,000 of the appraisal price will be used to calculate your maximum loan amount. For example, at a 5 percent interest rate a borrower aged 72 could qualify for a maximum loan amount somewhere between 55.4-67.1 percent² of the appraised home value or \$625,000, whichever is lower. Those percentages drop to 52.3-61.9 percent if the borrower is 62, and rise to 58.3-73.0 percent if the borrower is 82. The corresponding dollar limits are presented in the accompanying table.

The reason for the age variable here should be obvious – the bank is counting on there being some sort of

Reverse Mortgage Qualifications

- » The borrower must be 62 or older — if applying jointly, the age of the youngest borrower is used
- » The borrowers cannot be delinquent on any federal debt
- » The borrowers must live in the property as their principal residence and cannot rent the home to others
- » The borrowers must participate in reverse mortgage counseling by a HUD approved entity
- » The home must be owned outright, or have a mortgage amount low enough to be paid off in full by the reverse mortgage
- » The property must be a single family home, a 2-4 unit home with one unit occupied by owner, a HUD approved condo project or a manufactured home that meets the Federal Housing Authority requirements

outright – a house worth \$500,000 at current real estate prices. You paid that house off years ago. Your income from traditional retirement sources is enough to live off of, but you are finding it difficult to maintain the house, and pay the taxes on it. Your children are doing fine, so you're not concerned about leaving the house to them. A reverse mortgage would allow you to pay for upkeep and taxes on the house, potentially living in it for the remainder of your life. It can also allow you to

liquidity event so they'll get their money back. The event is generally the death of the borrower, when the house will be sold within the estate. Loans made to older borrowers will, on average be paid back more quickly than loans made to younger borrowers.

There are no restrictions on how the funds from reverse mortgages can be used, though typically they go towards home repairs or improvements, medical expenses and/or as a supplement to social security payments. It is also possible to use reverse mortgages to help purchase a new home (see below).

Both borrowers and properties must meet certain conditions in order to qualify for a reverse mortgage (see box).

In order to keep the loan, borrowers must maintain the property and pay all real estate taxes and homeowners insurance (hazard and flood, if required). Failure to do so will result in default, and the loan must be paid in full at that time.

Under the Hood: Types of Reverse Mortgages

In order to fully appreciate the benefits of reverse mortgages, there are certain complexities that must be understood.

As with regular mortgages, the key distinction between core types of loans is that some carry federal guarantees while others do not. Since 2008, only guaranteed loans have been available.

The Home Equity Conversion Mortgage (HECM) is the backbone of the industry. It's a loan from an approved private lender that is backed by the Federal Housing Authority, under the US Department of Housing and Urban Development (HUD). This guarantee goes two ways. First, borrowers are guaranteed they will receive any payments they are owed, whether that's a lump sum, a series of payments or a line of credit. They also guarantee to the lender that they will be repaid in full, subject to certain conditions. These guarantees have a cost -- borrowers are charged the Mortgage Insurance Premium (MIP). HECM loans are also nonrecourse - meaning that the lenders cannot come after the borrowers if the sale of the home does not cover the amount of the loan.

These guaranteed loans come in three flavors: HECM Standard, HECM SAVER and HECM-for-Purchase. All three share the same requirements above; the

difference is in their costs and how much you can borrow.

A Standard HECM reverse mortgage has a substantial up front initial insurance

premium paid to the FHA – 2 percent of the value of the home or \$12,500 whichever is lower. In the "SAVER" version that initial premium is just 0.01 percent. SAVER's are available for a smaller percentage of your equity, however, so they make sense only if you're not maximizing the amount you can borrow, or plan to hold the reverse mortgage for only a short period of time. In either case, borrowers pay subsequent annual premiums of 1.25 percent of the value of the home at the time the reverse mortgage is signed. Those "payments" of course, like all the other expenses of a reverse mortgage, don't come out of the borrower's wallet – they accrue to the value of the loan.

Beyond that, shopping for a reverse mortgage can look a lot like shopping for a mortgage – you can get either fixed or adjustable rates (with SAVERs generally charging slightly higher interest rates). If you choose a fixed rate, you'll have to take the full value of the loan in a lump sum. If you choose a variable rate, you have other payment options, outlined below. There are also other traditional mortgage fees – service charges, origination fees, appraisals, title search and title insurance, surveys, inspections, recording fees, mortgage taxes, credit checks — the list can seem just as endless as closing costs when purchasing a home. Again, most if not all of these fees and charges are just added to the value of the loan.

HECM to Purchase a Home

Though our focus is on the reverse mortgage as a source of income, an aspiring homeowner can also use a reverse mortgage to finance the purchase of a new home, instead of using a traditional mortgage, provided the borrower has enough cash to cover what can be a significant down payment plus closing costs. For example, consider a 72 year old who decides to move closer to family and wants to buy a new home worth \$200,000. With interest rates at 5

Loan Limits: \$200,000 Home, 5 Percent Interest Rate		
Age at loan origination	Range of maximum loan amount	
62	\$104,600	\$123,800
72	\$110,800	\$134,200
82	\$116,600	\$146,000
* Depending on loan type		

percent, she would qualify for a HECM worth 67.7 percent of the new home purchase price. At closing, the borrower would need a down payment of \$64,600 plus any closing costs, including the initial mortgage insurance premium of \$4,000. The rest of the purchase price (\$135,400) would be financed by the HECM. In essence, this is like a traditional mortgage, except that the borrower will never make a mortgage payment. Just as with other reverse mortgages, monthly interest payments, MIP and service fees would be rolled into the loan amount so the loan balance would grow for as long as the borrowers held the loan. When the borrower passes away, the home would be sold, and the loan repaid.

Cold Hard Cash: Payout Options

Unlike a traditional mortgage, reverse mortgage borrowers have some hard choices to make about how they want to get paid. The most basic and common payment structure is a simple lump sum. In fact, if you decide you want a fixed interest rate, this is your only payout option. Once the loan closes, the entire loan amount is paid out to the borrower and the loan begins to accrue interest. Depending on the interest rate, and how long you hold the loan, compounding interest could soon mean that the loan amount could grow to be greater than the value of the home, especially during a period of decreasing home prices, with the bank receiving all proceeds of the sale of the home upon the death of the home owner.

If you do not want a fixed rate loan, there are plenty of alternatives:

- » line of credit
- » tenure payment plan
- » term payment plan
- » modified tenure payment plan
- » modified term payment plan

A line of credit payout allows you to withdraw money at specific intervals or as needed. The other payment plan options differ only in their length of time

— a tenure payment plan guarantees a fixed payment amount each month for as long as you live in the house and your loan is in good standing. A term plan gives you monthly payments for a specific length of time. Term plans tend to pay out higher monthly amounts than tenure plans. With both term and tenured plans, the monthly amount is fixed, so your purchasing power will decrease with price inflation. Modified plans are a combination of scheduled payouts with an amount reserved to use as a line of credit.

Borrowers with available funds in a line-of-credit plan benefit from an interesting by-product of compounding. Since the unused portion of the credit line compounds at the same rate as the loan balance, the credit line actually gets larger over time and is available to the borrower.

As long as there is unused money in a reverse mortgage, a borrower can change their payment plan for a fee of \$20 — for example, if the a line of credit borrower decides they want to get a tenure payment for the rest of their life after a few years, the remaining money in the line of credit would be used. The reverse is also true — a borrower with monthly payment plan who has not received their total loan amount can change to a line-of-credit payment plan.

In fiscal year 2011, around 70 percent of reverse mortgages were in the form of fixed rate mortgages which require lump sum payouts. Borrowers seem to be more interested in locking in a fixed interest rate than having flexibility accessing the money through various

payment plans.

But looking only at interest rates may not be the best way to approach reverse mortgages. The flexibility in accessing funds associated with the reverse mortgages with adjustable interest rates may be more appropriate to a borrower's needs. By delaying payouts, not only do you avoid large interest accruals against the value of the property, you end up with more available cash down the road. While it might be tempting to lock in a fixed rate and take a large lump sum up front, this would be ill-advised if you only end up squirreling it away in a savings account earning a (currently) meager interest rate while interest accrues on the loan at a much higher rate. You could invest the loan in riskier financial assets, but then you would be lending against the equity in your home only to subject yourself to the very real risk of not having the money when you need it down the line.

Any payments from a reverse mortgage are not counted as income and generally do not affect social security or Medicare benefits, but it is important to consult a tax advisor to determine if this holds true in each individual's case. Also note that the interest on reverse mortgages is not deductible from taxable income until the loan is paid off in part or completely.

Conclusion and Caveats

If this all still leaves you cautious, that's probably a good thing. There are a number of risks and issues that can vary a great deal, depending on the borrowers

particular circumstances.

It is important to have a very good understanding of what your current financial picture is, and how it may change in the years to come. How will you use the money? What expenses do you anticipate in the next few years, the next 5, the next 10? Will your house need a new roof or septic system? Do you have the money to make those types of repairs? How long do you expect to live in your current house? Will you be able to age in place, or is the house not suitable for you if certain medical conditions arise or worsen? What do your alternative cash flows look like?

Non-payment of homeowners insurance and or real estate taxes can trigger repayment of the loan, as can allowing the property to fall into disrepair, potentially leaving you both without a house, and without income. Borrowers need to make sure they have sufficient funds to keep the loan in good standing for the life of the loan.

When the loan does come due, usually because of the borrower's death or home sale, declining home values may mean that the amount of the loan is larger than what the house is worth. There may not be any equity left for the borrower, or the estate.

All that said, for many investors in retirement, a modest home may in fact be their biggest untapped asset. A reverse mortgage can be a valuable source of liquidity and, indeed, security.

1 The national loan limit was set at \$417,000 in 2008 and was raised to \$625,000 in 2009. Since that time, the increase has been extended many times as part of the American Recovery and Reinvestment Act, but is set to expire December 31, 2012 if no further extensions are made.

2 Principal Limit Factors, http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/sfh/hecm/hecmhomelenders

PREFERRED STOCK AND YOUR PORTFOLIO

Firms in need of capital can borrow funds, by issuing debt, or they can offer an ownership stake by issuing common stock. The line between these two alternatives, however, is not distinct. Firms can also issue securities that combine aspects of both bonds and common stocks. Preferred stocks are among these hybrid instruments.

In this article we summarize the pros and cons of these lesser-known securities. While preferred stocks offer appealing features, including yields that are very attractive in the current interest

rate environment, free markets prohibit free lunches. There are trade-offs that investors must accept, and any advantage acknowledged by the market must come at a price.

A Notch above Common

A preferred stock is an equity security with an intermediate claim (below bondholders and above common stockholders) on a firm's assets and cash flows. In other words, preferred stocks provide rights not conferred

by common stocks. Specifically, preferred shareholders have a right to dividends before any dividends are paid on common stocks¹ and a claim on liquidation proceeds that is senior to claims of common stock shareholders, who have only a residual claim.

As a form of equity, traditional preferred stock has an infinite life and pays dividends. The corporation has no obligation to redeem these shares. The dividend is either fixed or it may vary according to a specified rule. Because preferred stocks provide a structured

General Creditor Standings		
	Class	Seniority
Debt	Secured Debt	↓
	Unsecured Senior Debt	
	Unsecured Subordinate Debt	
Equity	Preferred Stocks	
	Common Stocks	

*Source: Preferred Stock Primer Preferred Stocks and the S&P U.S. Preferred Stock Index, Standard & Poor's. March 25, 2009

cash flow, most investors view them fixed-income securities that serve as an alternative to bonds.

Preferred shares have several other distinctive features, and variations, that can affect their pricing. They do not pay dividends above the stated payout, regardless of how much the company earns. Shareholders usually do not have voting rights, nor do they receive payments above par value in the event of an acquisition.² The dividend payout is not legally binding, but shareholders must meet each period to vote on the dividend. In the case of cumulative preferred shares, if the issuing firm omits the dividend in any period, any unpaid dividends must be paid before common stock dividends can be paid. Non-traditional preferred shares include those that are callable by the issuer, which have a potentially limited life, as well as issues that are convertible into the common stock of the issuer.

Preferred Issuers

Because preferred shares carry lower risk versus common stock from the investor's perspective, they provide a commensurately lower-cost of capital for corporate issuers. But preferred stocks are a more expensive form of capital compared with bonds. Firms cannot deduct dividend payments on preferred stock (or on common stock) from their taxable earnings, which can be taxed at rates that exceed 40 percent. Interest payments on bonds, however, are deductible. This helps explain the relatively small size of the market for preferred stocks relative to the corporate bond market.

Publicly traded preferred stocks are issued overwhelmingly by financial institutions. As of August 27, the iShares S&P Preferred Stock Index fund had 65 percent of its assets invested in the preferred shares of banks and diversified financial institutions. This dominance is attributable largely to regulation. Banks

must maintain sufficient capital to offset their liabilities, including minimum levels of Tier 1 capital, which includes equity and preferred securities. From a bank's perspective, preferred shares have clear advantages over stocks as a means of raising capital. They do not dilute the ownership stake of common shareholders and the hybrid bond-stock nature of preferred shares provides financial leverage while still qualifying for Tier 1 equity credit.

Preferred Buyers

Individual investors might be enticed by preferred stocks' recent returns and current yield. The accompanying chart shows that preferred shares have provided strong overall returns relative to the S&P 500 since the market hit bottom in March 2009. At the end of August preferred stocks in the U.S. were yielding just over six percent, a very attractive payout compared with current dividend yields on U.S. common stocks as well as current yields on short and intermediate bonds.

Investors, however, should consider that preferred stocks carry some of the disadvantages of both stocks and bonds, while failing to provide many of their advantages. A fixed dividend means investors have no prospect for participating in future earnings enjoyed by common shareholders. The growth in share price is similarly limited, because it represents the present value of the (fixed) dividend stream. In terms of safety, though preferred stocks have a senior claim on assets over common stocks, preferred shares have no maturity date as do bonds, so they fail to provide an investor with the security of redemption at par value.

Preferred shares can also default by failing to pay their stated dividend. Though this is rare, the recent credit crisis demonstrated that defaults (and forced conversions) can occur, and are more likely during times of stress in credit markets.

The preferred stock market is also small and relatively illiquid compared

with the overall stock market. The total market value of U.S. preferred stocks amounts to less than 2 percent of the overall U.S. stock market. A marked inflow of new capital from investors can therefore push prices up, and expected returns down, unless corporations issue new shares in significant quantity.

Some preferred stocks pay dividends that are considered qualified distributions and are therefore treated like common stock dividends and taxed at a maximum rate of 15 percent. This class of preferred stock, however, has more stringent holding period requirements than those that apply to common stocks. Dividend payments from other (non-qualified) preferred stocks are taxed like corporate bond interest payments, and are therefore subject to ordinary income tax rates as high as 35 percent.

Through an IRS provision known as the dividend received deduction, U.S. corporations that own preferred stock can exclude 70 percent of the dividend income they receive from their taxable income. For this reason a large portion of outstanding preferred stock in the U.S. is held by institutional investors.

Numbers Please

We evaluated preferred stocks to see whether they might qualify as an asset class and therefore merit inclusion within an investor's portfolio. Our analysis is limited by a relatively short sample period; our data set limited to less than nine years.³

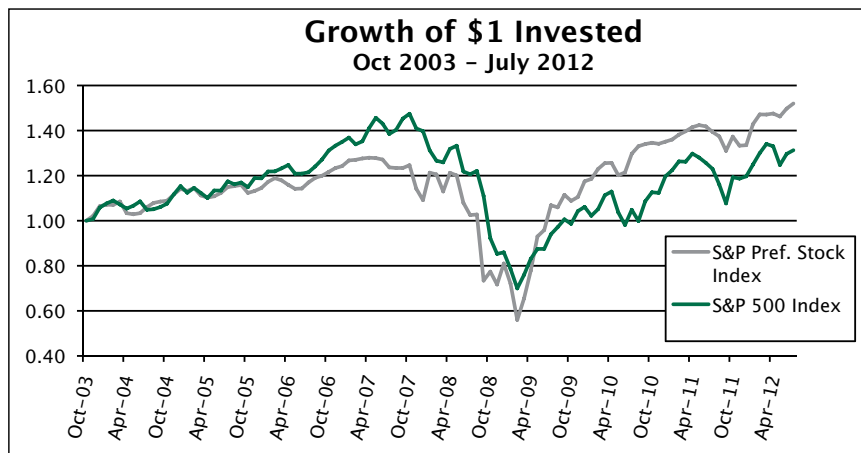
An asset class, generally speaking, is a set of securities that provide a distinct source of risk and return. In order to qualify as an asset class a group of securities must, at a minimum, have positive expected returns that are not strongly correlated with those of other asset classes. Furthermore, securities within an asset class must share similar liquidity characteristics and be assigned similar priorities with regard to claims on an issuer's assets.

Between October 2003 and August 2012 the monthly correlation between preferred stocks and common stocks was 0.58 percent, and the correlation between preferred stocks and bonds was 0.26 percent. This correlation statistic can range between -1.0 to +1.0, so these correlation figures are indeed low and therefore do not rule out preferred stocks as an asset class.

Correlation, however, does not tell

the whole story. Prior research (spanning data between October 2003 and February 2011) reveals that the returns of preferred stocks are reliably sensitive to the risk factors associated with the overall stock market (“beta”), as well as the risk factors associated with value stocks versus growth stocks, and the term and default risk associated with bonds. The returns were particularly sensitive to the default risk, which is consistent with expectations, since preferred stockholders claims on assets and cash flows are subordinate to the claims of bondholders.⁴

All of this suggests that while preferred stocks display low correlation with the returns of stocks and bonds, their returns can be explained by a combination of the risk factors associated with our recommended asset classes. This implies that the investment characteristics of preferred stocks can be replicated by holding some combination of our recommended assets. Therefore in light of other considerations, especially preferred stocks’ limited liquidity,



we find no compelling reason to recommend these securities as a distinct asset class worthy of inclusion in a well-diversified portfolio.

We recommend U.S. and foreign common stocks for growth, and bonds for portfolio stability. Exhaustive empirical research provides evidence of returns that are clearly distinct. These provide reliable building blocks for

constructing portfolios designed to get the most “bang for the buck” in terms of generating risk adjusted returns.

Preferred shares might nonetheless prove attractive for a certain class of investors in need of total return but who also have an explicit requirement for cash flow provided exclusively by investment income (interest or dividends) as opposed to realized gains. These might include individuals with certain trust accounts, as well charitable institutions, endowments and foundations.

1 Preferred dividends may be fixed or floating, and may be cumulative, or non-cumulative.

2 Exceptions exist in certain “participating” preferred shares.

3 The only well-diversified representative index available for preferred stocks is the S&P U.S. Preferred Stock Index, which provides monthly returns beginning October 2003.

4 James L. Davis, “Investment Characteristics of Preferred Stock” Dimensional Fund Advisors, June 2011.

THE HIGH-YIELD DOW INVESTMENT STRATEGY

Recommended HYD Portfolio

As of August 15, 2012

	Rank	Yield (%)	Price (\$)	Status	—Percent of Portfolio—	
					Value (%)	No. Shares (%) ¹
AT&T	1	4.74	37.10	Holding**	25.48	24.20
Verizon	2	4.53	44.19	Holding**	24.44	19.49
Merck	3	3.81	44.06	Holding**	25.60	20.48
Pfizer	4	3.66	24.04	Holding**	24.44	35.83
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.

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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 July 31, 2012*.

	1 mo.	1 yr.	5 yrs.	10 yrs.	20 yrs.	Since 1/79	Std. Dev.
HYD Strategy	5.17	36.56	4.32	9.94	12.32	16.28	17.89
Russell 1000 Value Index	1.03	7.64	-1.06	6.42	8.92	11.90	15.03
Dow Jones Industrial Average	1.15	10.12	2.52	6.73	9.46	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. They do not reflect returns on actual investments or previous recommendations of AIS. Past performance may differ from future results. Historical performance results for the Russell 1000 Value Index and the Dow Jones Industrial Index 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. HYD Strategy results reflect the deduction of 0.55% management fee, the annual rate assessed to a \$500,000 account managed through our High Yield Dow investment service.

RECENT MARKET STATISTICS

Precious Metals & Commodity Prices (\$)

	8/15/12	Mo. Earlier	Yr. Earlier
Gold, London p.m. fixing	1,601.75	1595.50	1739.00
Silver, London Spot Price	27.64	27.48	39.18
Copper, COMEX Spot Price	3.35	3.50	4.03
Crude Oil, W. Texas Int. Spot	94.32	87.09	87.87
Dow Jones Spot Index	438.46	428.83	467.39
Dow Jones-UBS Commodity Index	142.27	140.34	158.39
Reuters-Jefferies CRB Index	301.71	293.96	330.52

Interest Rates (%)

U.S. Treasury bills - 91 day	0.09	0.10	0.02
182 day	0.14	0.15	0.08
52 week	0.18	0.19	0.11
U.S. Treasury bonds - 10 year	1.80	1.52	2.29
Corporates:			
High Quality - 10+ year	3.64	3.43	4.40
Medium Quality - 10+ year	5.07	4.89	5.44
Federal Reserve Discount Rate	0.75	0.75	0.75
New York Prime Rate	3.25	3.25	3.25
Euro Rates			
3 month	0.34	0.51	1.55
Government bonds - 10 year	1.55	1.28	2.34
Swiss Rates - 3 month	0.05	0.08	0.08
Government bonds - 10 year	0.65	0.60	1.25

Exchange Rates (\$)

British Pound	1.569700	1.555000	1.638700
Canadian Dollar	1.012000	0.985000	1.016467
Euro	1.231500	1.223200	1.445200
Japanese Yen	0.012600	0.012600	0.013033
South African Rand	0.120000	0.120900	0.140485
Swiss Franc	1.025000	1.018600	1.281723

Securities Markets

	8/15/12	Mo. Earlier	Yr. Earlier
S & P 500 Stock Composite	1,405.53	1,356.78	1,204.49
Dow Jones Industrial Average	13,164.78	12,777.09	11,482.90
Dow Jones Bond Average	311.80	312.42	283.21
Nasdaq Composite	3,030.93	2,908.47	2,555.20
Financial Times Gold Mines Index	2,759.16	2,636.56	3,815.05
FT EMEA (African) Gold Mines	2,770.00	2,613.27	3,419.37
FT Asia Pacific Gold Mines	11,556.83	9,971.24	18,789.65
FT Americas Gold Mines	2,322.46	2,261.17	3,220.76

Coin Prices (\$)

	8/15/12	Mo. Earlier	Yr. Earlier	Prem (%)
American Eagle (1.00)	1,648.40	1,628.30	1,833.47	2.91
Austrian 100-Corona (0.9803)	1,552.43	1,532.93	1,729.72	-1.13
British Sovereign (0.2354)	386.10	381.30	432.40	2.40
Canadian Maple Leaf (1.00)	1,624.30	1,604.20	1,812.10	1.41
Mexican 50-Peso (1.2057)	1,912.90	1,888.90	2,131.30	-0.95
Mexican Ounce (1.00)	1,607.00	1,587.10	1,788.30	0.33
S. African Kruggerand (1.00)	1,621.97	1,601.88	1,809.88	1.26
U.S. Double Eagle-\$20 (0.9675)				
St. Gaudens (MS-60)	1,630.00	1,675.00	1,940.00	5.18
Liberty (Type I-AU50)	2,025.00	2,025.00	1,977.50	30.67
Liberty (Type II-AU50)	1,700.00	1,700.00	1,947.50	9.70
Liberty (Type III-AU50)	1,600.00	1,655.00	1,910.00	3.25
U.S. Silver Coins (\$1,000 face value, circulated)				
90% Silver Circ. (715 oz.)	20,150.00	19,412.50	27,925.00	1.96
40% Silver Circ. (292 oz.)	8,125.00	7,825.00	11,325.00	0.67
Silver Dollars Circ.	25,850.00	25,187.50	30,375.00	20.89

Note: Premium reflects percentage difference between coin price and value of metal in a coin, with gold at \$1,601.75 per ounce and silver at \$27.64 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 (\$)			12-Month (\$)		Latest Dividend Record		Indicated Annual Yield†			
	8/15/12	7/13/12	8/15/11	High	Low	Amount (\$)	Date	Paid	Dividend (\$)	(%)	
AT&T	T	37.10	35.35	28.81	38.28 H	27.29	0.440	7/10/12	8/1/12	1.760	4.74
Verizon	VZ	44.19	45.21	35.05	46.41 H	34.47	0.500	7/10/12	8/1/12	2.000	4.53
Merck	MRK	44.06	43.47	32.13	45.17 H	30.54	0.420	9/17/12	10/5/12	1.680	3.81
Pfizer	PFE	24.04	22.81	18.34	24.49 H	17.05	0.220	8/03/12	9/5/12	0.880	3.66
Johnson & Johnson	JNJ	68.35	68.61	64.59	69.75 H	60.83	0.610	8/28/12	9/11/12	2.440	3.57
Intel Corp	INTC	26.27	25.25	20.89	29.27	19.16	0.225	8/07/12	9/1/12	0.900	3.43
Dupont	DD	50.28	47.63	47.72	53.98	37.10	0.430	8/15/12	9/12/12	1.720	3.42
Procter and Gamble	PG	66.64	65.09	61.88	67.95	59.07	0.562	7/20/12	8/15/12	2.248	3.37
General Electric	GE	20.96	19.77	16.39	21.19 H	14.02	0.170	6/25/12	7/25/12	0.680	3.24
J P Morgan	JPM	37.07	36.07	36.88	46.49	27.85	0.300	7/06/12	7/31/12	1.200	3.24
Chevron	CVX	112.57	106.01	99.10	113.87 H	86.68	0.900	8/17/12	9/10/12	3.600	3.20
McDonald's	MCD	87.81	92.29	86.82	102.22	83.65	0.700	9/04/12	9/18/12	2.800	3.19
Travelers	TRV	63.75	63.13	52.27	65.27	45.97	0.460	9/10/12	9/28/12	1.840	2.89
Kraft	KFT	40.70	39.71	34.68	41.50 H	31.88	0.290	9/19/12	10/15/12	1.160	2.85
United Tech.	UTX	77.99	73.59	73.54	87.50	66.87	0.535	8/17/12	9/10/12	2.140	2.74
Hewlett-Packard	HPQ	19.29	18.98	32.43	34.00	17.41 L	0.132	9/12/12	10/3/12	0.528	2.74
Microsoft Corp.	MSFT	30.20	29.39	25.51	32.95	23.79	0.200	8/16/12	9/13/12	0.800	2.65
Coca-Cola	KO	39.35	77.28	68.20	79.36	38.05 L	0.255	9/14/12	10/1/12	1.020	2.59
Exxon Mobil	XOM	88.00	85.47	74.29	88.67 H	67.93	0.570	8/13/12	9/10/12	2.280	2.59
3M Company	MMM	92.54	87.59	83.31	92.74	68.63	0.590	8/24/12	9/12/12	2.360	2.55
Boeing	BA	73.07	73.51	62.70	77.83	56.90	0.440	8/17/12	9/7/12	1.760	2.41
Caterpillar	CAT	87.61	82.07	91.37	116.95	67.54	0.520	7/20/12	8/20/12	2.080	2.37
Wal-Mart Stores	WMT	74.45	73.18	49.98	75.24 H	49.94	0.398	12/07/12	1/2/13	1.590	2.14
Home Depot, Inc.	HD	55.00	52.09	31.46	55.34 H	31.03	0.290	5/31/12	6/14/12	1.160	2.11
Cisco	CSCO	17.35	16.31	16.03	21.30	14.90	0.080	7/05/12	7/25/12	0.320	1.84
IBM	IBM	198.40	186.01	172.99	210.69	157.13	0.850	8/10/12	9/10/12	3.400	1.71
American Express	AXP	56.66	57.93	45.82	61.42	41.30	0.200	7/06/12	8/10/12	0.800	1.41
Alcoa	AA	8.73	8.42	12.56	12.93	7.97 L	0.030	8/03/12	8/27/12	0.120	1.37
Walt Disney	DIS	49.89	48.19	33.65	50.65 H	28.19	0.600	12/16/11	1/18/12	0.600	1.20
Bank of America	BAC	7.87	7.82	7.76	10.10	4.92	0.010	9/07/12	9/28/12	0.040	0.51

* See the Recommended HYD Portfolio table on page 62 for current recommendations. † Based on indicated dividends and market price as of 8/15/12.

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 8/16/11.

/ Dividend increased since 7/15/12 D Dividend decreased since 7/15/12

RECOMMENDED INVESTMENT VEHICLES

Descriptive Quarterly Statistics, as of 6/30/12

Annualized Returns⁴ (%), as of 7/31/12

Security Symbol	Avg. Market Cap./Avg. Maturity	No. of Holdings	Expense ³ (%)	Sharpe Ratio	Turnover (%)	P/B	12 Mo. Yield (%)	Annualized Returns ⁴ (%)					
								1 yr.	3 yr.	5 yr.	1 yr. After Tax*	3 yr.	5 yr.
Short-/Intermediate Fixed Income													
Vanguard Short-Term Bond Index	2.80 Yrs.	1383	0.22	1.94	67	--	1.62	2.01	3.29	4.48	1.36	2.51	3.46
iShares Barclays 1-3 Yr. Credit Bond	1.95 Yrs.	680	0.20	1.78	8	--	1.72	1.83	3.42	4.11	1.23	2.59	2.99
iShares Barclays 1-3 Year Treasury	1.91 Yrs.	61	0.15	1.34	72	--	0.60	0.63	1.51	3.04	0.44	1.14	2.34
Vanguard Limited-Term Tax-Exempt	2.80 Yrs.	1718	0.20	1.95	14	--	2.01	2.65	2.92	3.65	2.65	2.92	3.65
SPDR Short-Term Municipal Bond	3.12 Yrs.	371	0.20	1.30	25	--	1.36	2.23	2.48	--	1.71	2.20	--
Inflation-Protected Fixed Income													
iShares Barclays TIPS Bond	9.31 Yrs.	36	0.20	1.89	15	--	3.08	9.36	10.09	8.22	8.31	8.79	6.70
Vanguard Inflation-Protected Securities	9.60 Yrs.	34	0.20	1.89	28	--	2.49	9.58	10.12	8.02	8.59	9.01	6.84
Real Estate													
VNQ ¹ /VGSIX	7.76 B	115	0.24	1.47	10	2.2	3.17	13.37	29.26	5.14	12.24	27.91	3.87
RWR ¹	8.79 B	82	0.25	1.47	10	2.2	2.88	13.14	29.70	4.01	11.88	28.23	2.65
U.S. Large Cap Value													
Vanguard Value Index	46.12 B	416	0.24	0.95	23	1.6	2.53	7.45	12.64	-1.07	7.02	12.21	-1.48
iShares Russell 1000 Value Index	35.47 B	657	0.20	0.94	21	1.4	2.77	7.44	12.98	-1.16	6.83	12.52	-1.58
U.S. Small Cap Value													
iShares Russell Microcap Index	0.28 B	1378	0.60	0.76	31	1.4	1.60	0.65	12.21	-1.58	0.27	11.96	-1.78
Vanguard Small-Cap Value Index	1.44 B	1008	0.24	0.92	30	1.4	1.90	2.30	14.54011	1.78	1.87	14.10	1.33
U.S. Large Cap Growth													
iShares Russell 1000 Growth Index	44.35 B	587	0.20	1.05	19	3.7	1.63	8.06	15.14	3.30	7.69	14.85	3.06
Vanguard Growth Index	45.99 B	401	0.24	1.03	23	3.8	1.05	8.43	15.32	3.51	8.25	15.13	3.34
U.S. Marketwide													
Vanguard Total Stock Market Index	31.1 B	3302	0.17	1.00	5	2.2	1.78	7.32	14.28	1.46	7.01	13.96	1.16
Fidelity Spartan Total Market Index	29.42 B	3295	0.10	1.01	17	2.0	1.69	7.37	14.32	1.43	na	na	na
Foreign-Developed Markets													
iShares MSCI Growth Index	23.36 B	571	0.40	0.45	27	1.8	2.60	-10.59	5.04	-4.20	-11.22	4.71	-4.44
iShares MSCI Value Index	28.45 B	497	0.40	0.29	29	0.9	4.65	-12.52	1.20	-7.19	-13.57	0.63	-7.68
Vanguard Europe Pacific Index	30.21 B	898	0.12	0.38	5	1.4	3.34	-11.85	2.96	-5.34	-12.13	2.70	-5.57
Vanguard Developed Markets Index	29.65 B	944	0.20	0.38	5	1.3	3.49	-11.65	3.07	-5.41	-12.16	2.63	-5.95
SPDR S&P International Small Cap	0.92 B	731	0.59	0.53	22	1.0	2.91	-15.83	6.69	-4.64	-16.37	6.21	-5.08
Foreign-Emerging Markets													
Vanguard Emerging Market Index	20.0 B	892	0.33	0.51	10	1.8	2.10	-14.67	6.02	-1.00	-14.93	5.76	-1.35
Gold-Related Funds													
iShares COMEX Gold Trust	--	1	0.25	0.98	--	--	0.00	-0.69	19.01	19.05	-0.69	19.01	19.05
SPDR Gold Shares	--	1	0.40	0.98	--	--	0.00	-0.80	19.52	19.03	-0.80	19.52	19.03

Data provided by the funds and Morningstar. ¹Exchange Traded Fund, traded on NYSE. ²0.5% fee for redemption in 90 days. ³For Vanguard funds, Expense Ratios shown are for Mutual Funds. ETFs have lower expenses. ⁴For 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.

Dividends Paid Last 12 Months
 Payment Schedule
 Yield (%)

Recommended Gold-Mining Companies (\$)

Ticker Symbol	Month Earlier	Year Earlier	52-Week	
			High	Low
AU	8/15/12	33.93	49.14	30.70
ABX	34.69	34.84	55.95	31.00
GFI	13.67	12.24	18.49	11.71
GG	36.71	33.99	56.31	31.54
NEM	46.63	46.16	72.42	42.95

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.