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*Wholly Owned by the
American Institute for Economic Research*

The High Yield Dow Investment Service

Research Results and Answers to Common Questions

*The Best Way to Invest in the Dow Stocks with
the Highest Dividend Yield*

Our discretionary High Yield Dow (HYD) service is an investment program for individuals who want management of the “large cap value stocks” segment of their portfolio. With this service, AIS implements the HYD strategy, also called the “4-for-18 model,” on your behalf. HYD has been available to individuals since 1997.

This pamphlet describes the initial research study conducted by the American Institute for Economic Research (AIER) that resulted in the 4-for-18 model and creation of the HYD service. It also answers some common questions about the research and the service.

American Investment Services (AIS)

AIS is a registered Investment Advisor with the Securities and Exchange Commission. Founded in 1978 to provide low cost independent investment management and advice to individuals, estates, trusts, pension and profit sharing plans and charitable organizations, AIS has been working hard to meet client needs for over two decades during alternating periods of economic boom, recession, and inflation. AIS provides investment services on a fee only basis and does not receive any commission or other compensation, either directly or indirectly, from any party other than clients, including brokers and investment companies.

AIS also publishes a monthly newsletter, Investment Guide.

AIS is wholly owned by the American Institute for Economic Research (AIER) and regularly meets with AIER's staff of economists and researchers to review economic trends, investment policy, and AIER's decades of research.

American Institute for Economic Research (AIER)

AIER, founded in 1933, is an independent scientific and educational organization. The Institute's research is planned to help individuals protect their personal interests and those of the Nation. By publishing the results of scientific inquiry, carried on with diligence, independence, and integrity, AIER hopes to help citizens preserve the best of the Nation's heritage and choose wisely the policies that will determine the Nation's future.

AIER represents no fund, concentration of wealth, or other special interests. Advertising is not accepted in its publications. Financial support for the Institute is provided primarily by the small annual fees from thousands of sustaining members, by receipts from sales of its helpful publications, by tax-deductible contributions, and by earnings of AIS. Experience suggests that information and advice on economic subjects are most useful when they come from a source that is independent of special interests, either commercial or political.

AIER's Charter and Bylaws ensure that neither the Institute itself nor members of its staff may derive profit from organizations or businesses that happen to benefit from the results of Institute research. AIER's financial accounts are available for public inspection during the normal working hours of the Institute.

Introduction

Which of the 30 Dow Jones Industrial Average (DJIA) stocks will perform the best? Over the long term, studies have shown that the issues with the highest dividend yields do much better than the Average. Most analysts have focused on the returns to the 10 highest-yielding issues over a 12-month span, typically year-end to year-end. They generally have found that the top 10 issues have outperformed the Dow by 2 to 3 percentage points per year. A few have found that just the top 5 issues, or some other selection of the highest-yielding issues, performed even better.

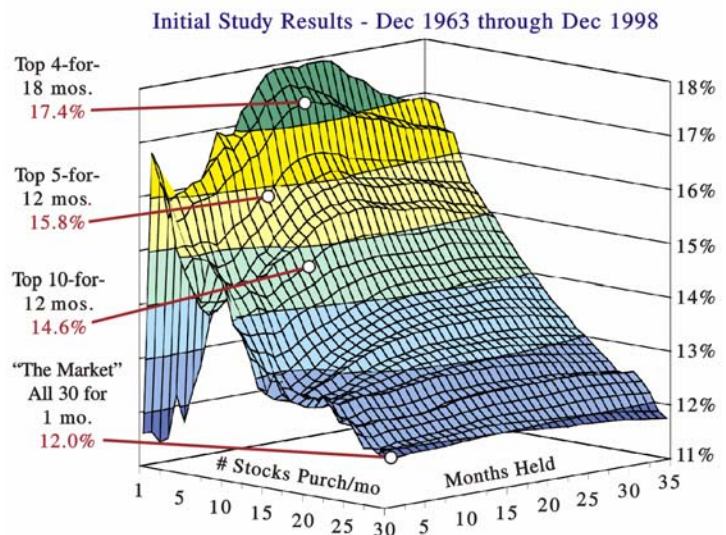
However, the selection of the top 5 or 10 issues and a 12-month span seems to offer little more than convenience in computation. We find no reason to believe that the top 5 or 10 yielding issues or that a 12-month holding period will produce the best results.

To find the optimum combination of issues and holding period, AIER conducted a study by looking at historical returns of the Dow Jones stocks. They discovered that a portfolio based on holding the four highest yielding stocks for 18 months at a time would have yielded the best returns.

The Dow Jones Study

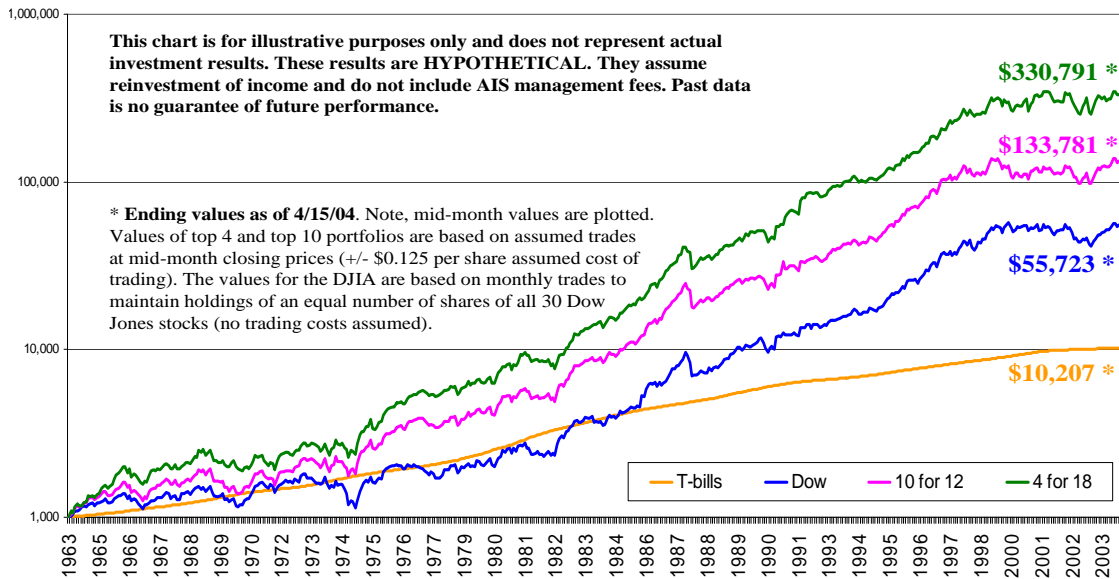
AIER calculated the returns for 1,080 hypothetical portfolios (ranging from buying only the single highest-yielding issue and holding it for just one month, to buying all 30 Dow issues and holding for three years) from 1963 to 1998. The backtested results, shown in the chart, have the appearance of a topographical map of a mountain ridge.

The top 10 and the top 5 held for one year do indeed “beat the Dow.” However, they appear like “base camps” on the way to scaling the heights above—the best returns were for portfolios buying fewer than 5 issues and holding them for about a year and a half. *Given that a majority of investment managers and mutual funds fail to beat the averages in a given year, and that*



only a handful have done so over periods of 10 or 20 years, these findings should be of great interest to conservative, long term investors.

Updated results through April 2004 *
Hypothetical Value of \$1,000 Invested on December 15, 1963



As shown in the chart above, what may appear to be relatively small differences in annual returns can accumulate to very large differences. After 35 years, a portfolio composed of the 4 highest-yielding issues in the DJIA, held for 18 months, would be worth more than five times a portfolio that matched the Dow Jones Industrial Average. The 4-for-18 portfolio would be more than double a portfolio based on holding the 10 highest-yielding issues in the Dow for 1 year.

U.S. equities have outperformed fixed-dollar claims by a wide margin during recent years. This has not always been the situation, however. The Dow first reached the 1,000 level in early 1966, yet it did not decisively surpass that benchmark until 1983, nearly 17 years later. During those difficult stock market years, the cumulative return on the DJIA was about equal to that on 91-day Treasury Bills, but the High-Yield strategies did better than either. Compounding of reinvested dividends is only one reason that the High-Yield strategies have outperformed the Average. Such strategies also force investors to “buy low and sell dear.” This is because, in general, the Dow issues with the highest yields are the ones least favored by the investment community at any given time. Such issues are sold when they no longer rank among the highest dividend yielders. Sometimes this may be because the company has passed or cut its dividend, but most of the time it is because the issue has returned to favor with investors and has been bid up in price.

Of course, past performance is not a guarantee of future success. In particular, what would have been the best high-yield strategy during the past 35 years would not have been the best during most shorter periods within those 35 years, and almost assuredly will not prove to be the very best during the next 2, 5, or even 10 years. Nevertheless, we believe that the superior performance of the top 4-for-18 month strategy reflects more than pure chance, and that it is likely to be among the best in the future.

Frequently Asked Questions

Q: Some strategies appear to have higher returns, why focus on the top 4-for-18?

A: As indicated in the “climbing the mountain” chart, several 2- and 3-stock strategies had higher total returns than the 4-for-18 strategy, but the standard deviations of their returns were higher too—they were also riskier. The 4-for-18 strategy had the best combination of risk and return. Presumably, this reflected the greater diversification of the 4 stock strategy in comparison to the 2- or 3-stock programs.

Q: Do 4 stocks provide enough diversification?

A: The purpose of diversification is to reduce risk. The 4-for-18 strategy had a total return of 5.4 percentage points more per year than the Dow during the 35 years we studied, yet the increase in the annualized standard deviation of the return was only 2.4 percentage points, to 19.5 from 17.1 for the entire Dow.

Also, with regard to diversification, the top 4-for-18 strategy does not hold just 4 stocks at any given time, but rather some amount of all issues that have ranked in the top 4 during the preceding 18 months. In our study, the top 4-for-18 portfolio held between 8 and 9 of the 30 DJIA issues, on average, at any one time. If prices did not fluctuate, or dividends accumulate, an issue that had ranked in the top 4 during all 18 of the previous months would comprise 25% (18/72) of the portfolio. An issue that had ranked among the top 4 during only 1 month would comprise 1.4% (1/72) of the holdings.

Q: Does monthly trading result in high transaction costs?

A: No. With an 18-month holding period, one-third of a top 4-for-18 portfolio is “off the table” during a 12-month span. In addition, 2 or even 3 of the top 4 in a given month will usually have been in the top 4 18 months earlier and thus be retained. During the period we studied, an average of between one-quarter and one-fifth of the holdings in the top 4-for-18 portfolio had been held for less than one year at any given time, i.e. annual turnover averaged between 20% and 25%, a rate that is below that of most managed funds.

Q: You have shown that it did work, can you explain why it worked?

A: A High-Yield Dow stock selection strategy relies on only 3 pieces of information. Is the stock in the Dow? What is its indicated annual dividend? And how does the investing public value that dividend? Although they are far from infallible, we believe that the editors of The Wall Street Journal (who compile the DJIA) and the corporate insiders (managers and directors who set the dividend) are more knowledgeable, and are less subject to passing fads and emotions, than the general public.

Q: What if “everybody did it?”

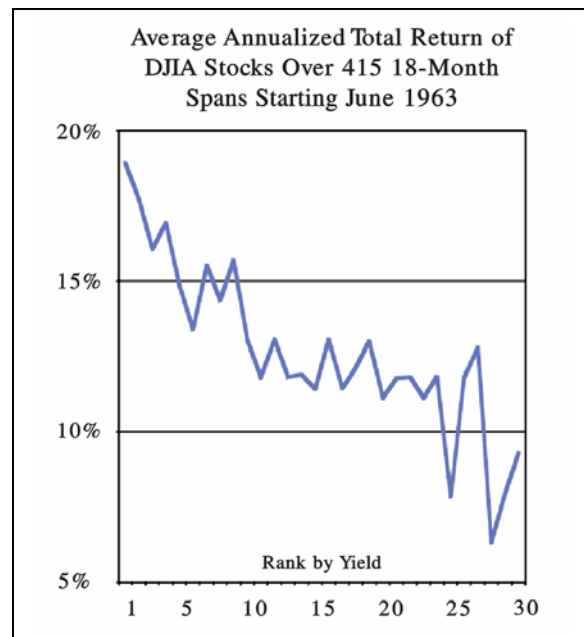
A: We do not believe that a disciplined High-Yield Dow approach will ever become extremely popular because it goes against the very powerful emotions of fear and greed that drive most investors’ decisions. The prices of stocks in the top 4 usually reflect some adverse development, bad publicity, or “tale of woe” that has caused investors to drive their prices down. When their yields decrease and they leave the top 4, it is usually because they have returned to favor with investors.

The 30 Dow stocks account for more than one-fifth of the market value of all 5,000 or so U.S. common stocks. It would take prodigious buying and selling to alter the dividend yield rankings of the Dow stocks. Even then we could expect that prospective dividend yields would remain correlated with total return.

Q: Isn't what you have done called “data mining?”

A: By that you must mean that what we have identified as the best strategy was simply a random occurrence among the more than 1,080 possibilities we examined.

We have not “mined” the data to find a unique occurrence. There is no reason to believe that the top 4-for-18 strategy will provide the very best combination of risk and return in the future as it would have over the past 35 years. However, as the chart on the right indicates, there is a strong correlation between a Dow issue's rank by dividend yield and its subsequent performance. The 4-for-18 approach is only one of hundreds of high-yield approaches that could have significantly out-performed the market.



On the other hand, we believe that more complex approaches are far more likely to constitute data mining, especially when, as most are, they are based on limited data sets such as annual year-end prices.

Q: Do you always buy whichever stocks are in the top 4?

A: No. Our model (and all the charts above) excludes General Motors. Stable dividends are one of the keys to High-Yield strategies. GM's dividend history is erratic, and trading GM on the basis of its dividend yield would not have worked well. For example, when GM ranked no. 1, which it did 20% of the time between June 1963 and December 1997, its average annualized total return was only 5.1% vs. the 18.9% for other no. 1 ranked issues plotted in the chart above.

Another key to the success of the plan is the ability of management to respond to crises, allowing investors to “buy low” and “sell high” when shares rebound.

Q: Why not use a larger list?

A: The returns on the Dow Jones Industrial Average seldom differ much from those on more statistically sophisticated and broader indexes, such as the S&P 500. The top 4-for-18 strategy is likely to do as well against the S&P as against the Dow. Paradoxically, selecting from a larger list could increase the volatility of one's holdings by rendering them less diversified by sector. All the major oil companies, financial services companies, pharmaceutical companies, retailers, etc. are included in the S&P. Thus, the sector that is most out of favor at any given time would be likely to dominate, say, a selection of the 10 highest yielders of the S&P 100. In contrast, the 30 DJIA issues are carefully selected to include no more than 1 or 2 companies from a given industry.

The High Yield Dow Investment Service

Our discretionary High Yield Dow Investment Service (HYD) implements the AIER 4-for-18 model. We trade on your behalf each month so that the holdings of each stock in your HYD account match the proportions indicated by the model as closely as possible.

Our minimum account size is \$100,000 and we believe that investors with long term funds to invest will find this service most attractive. Due to its relative simplicity, our management fee for the program is among the lowest in the industry for a discretionary investment service. It is calculated and billed quarterly in arrears based on a tiered, cumulative structure:

AIS High Yield Dow Fee Tiers		
Minimum Annual Fee is \$1,350		
Tier	Applies to AUM	Annual Fee
1	\$100,000 - \$250,000	0.70% of account or \$1,350, whichever is greater
2	\$250,001 - \$500,000	Tier 1 maximum fee plus 0.40% of AUM in Tier 2
3	\$500,001 - \$1,000,000	Tier 2 maximum fee plus 0.25% of AUM in Tier 3
4	\$1,000,001 - \$1,500,000	Tier 3 maximum fee plus 0.10% of AUM in Tier 4
5	Over \$1,500,000	Flat 0.30% of total AUM

Based on these tiers, the actual fee for various account sizes is (to the nearest dollar):

Quarterly Fee Calculation for Various AUM		
AUM	Quarterly Fee	Annual Equivalent
\$100,000	\$338	1.35%
200,000	350	0.70%
300,000	488	0.65%
400,000	588	0.59%
500,000	688	0.55%
750,000	844	0.45%
800,000	875	0.44%
1,000,000	1,000	0.40%
1,250,000	1,063	0.34%
1,500,000	1,125	0.30%

To participate in HYD, you must maintain a brokerage account at Charles Schwab, TD Ameritrade, or Fidelity Investments. AIS is given limited power of attorney to place trades on your behalf. Monthly transaction confirmations and reports will be sent directly from the broker in addition to quarterly reports from AIS.

Commissions are paid directly to the broker. AIS does not earn any commission or other form of compensation on trades. Our only incentive to trade is to stay in line with the 4-for-18 model. Through our institutional arrangements with these brokers, you will pay low commissions according to the attached schedule.