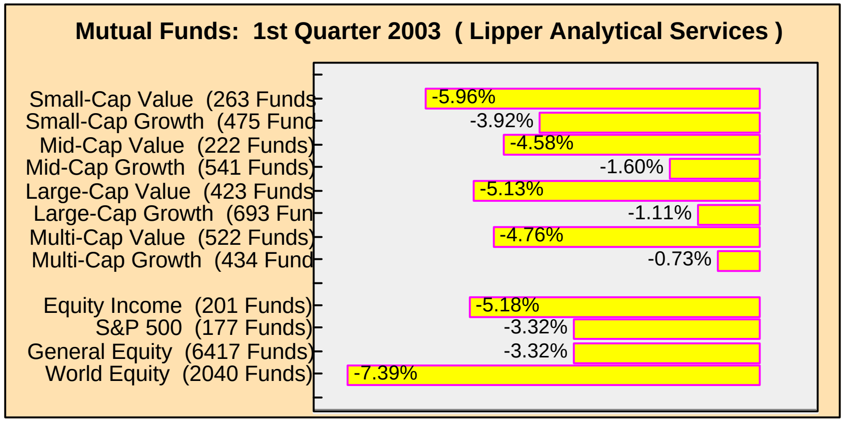
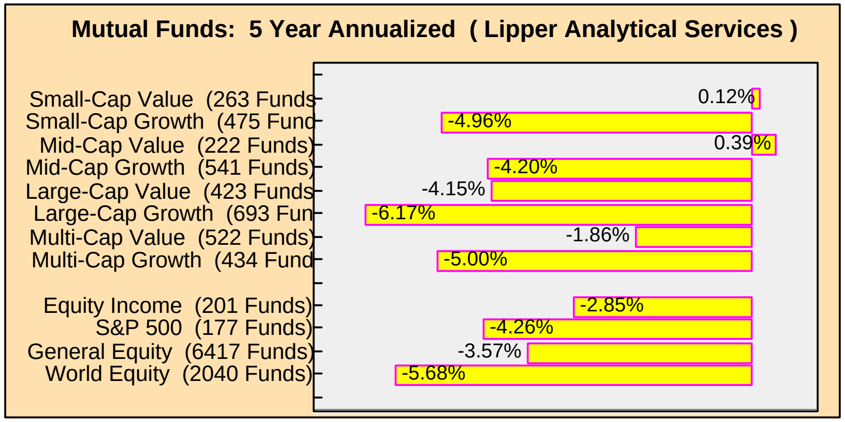
Niemann Capital Management, Inc.

First Quarter 2003 Review

First quarter numbers look strikingly similar to their five-year counterparts, and you probably don't want to dwell on any of them. But you should, particularly the five-year returns. Five years ago - lets see - where were you in April 1998? Do you remember what you thought stock returns might be over the next 5 years? I'll bet it wasn't losing an average -5% a year! Opinion polls taken in 1998 showed the majority of individual investors expected returns of 15% and even 20% per year as far as the eye could see. As is often the case when everyone is thinking the same way, reality bites. Take that very large crowd employing the famous "buy & hold the S&P 500 index" theory for example. They need a 25% gain from here just to get even. At least they own a "low cost" investment.





An infinitely smaller group of thoughtful individuals invested in Niemann's mutual fund strategies have enjoyed a different outcome. Risk-Managed, Equity Plus, and Dynamic have banked returns of 11.87%, 9.22%, and 16.9% respectively over the same period. That's per year, net of everything, except taxes (this would be one of those scenarios where you don't mind paying taxes).

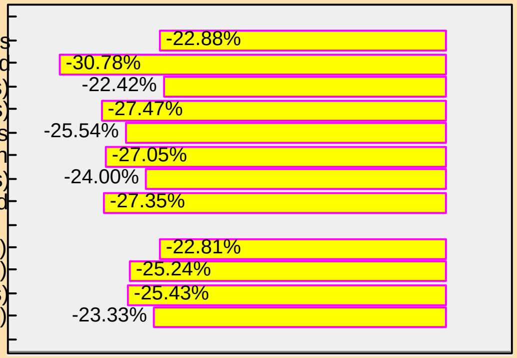
It's all Relative.

Clients opening their first accounts with us sometime within the past eighteen months are thinking – these numbers aren't right! That's not what happened in my account! I understand; it doesn't seem like what happened in my accounts either, since they're managed right along with yours. At the same time, my returns look just like the numbers above, as do all client accounts in these portfolios over that longer haul. The only difference is time, and timing.

If the timing of your investment turns out to be unfavorable (and who knows in advance if it will be?), then you are relying on us to lose less than the market as it's going down. We achieve this most of the time. Yet, while this sounds great in principle, I know that over time it tends to wear out in practice. The superior investor never allows emotion to get in the way of facts, but who among us can maintain that elevated state? We want to be financially secure, and if we don't happen to have several million lying around in T-bills (you'd need about $5 million to grind out $100k a year after taxes) we're forced to take on some risk. Should we face immediate adversity, it's not long before we become even more concerned about the future.

Lets say you placed money at Niemann about one year ago (using March 29, 2002 for comparison purposes), and now you've down 15%. This may not be what you expected - but it is what you could have hoped for. The S&P 500 was down 25% over this time frame, and a perusal of the one-year returns for all classes of mutual funds (nearby) tells the tale – there was nowhere to hide. In fact, this phase looks more and more like that "final purge" of a bear market, where investors give up and sell at any cost. Even so, we "beat the market" by about 1000 basis points or 10%. Should we continue to outperform the S&P 500 by this margin over the next 5 years, we'll all be way ahead of this game.

Mutual Funds: 1 Year (Lipper Analytical Services)



Question everything.

Long time clients must forgive me once again for ruminating on the markets being, first and foremost, discounting mechanisms. Investors buy and sell stocks based on what they think will happen in the future. When times are good and investors on the whole positive, stock prices reflect this optimism. Remember those halcyon days when stocks went up even on bad news? It is just as true that pessimism has the opposite effect. The art of investing lies in uncovering the shift between these emotional boundaries. Getting it right is where money can be made - and saved. Pessimism abounds these days, so let's challenge conventional wisdom on a few of the issues the bears are sure will hold back our economy and markets. We may not be right, but it's a good bet the crowd isn't either.

Another terrorist attack will sink the markets.

What if we were Safer Now than we have been in years? Not the false sense of security we had in the 90's. That distraction was a figment of our imagination. Call it: one part "Winning the Cold War", two parts "Ebullient Economy" (spiked by massive cuts in defense spending), and one part "We're Safe Here with Big Oceans on Both Sides". We mixed a cocktail strong enough to keep us blissfully oblivious. The first attack on the World Trade Center we took in stride. Following were years of continued attacks on our people and property around the world: embassy bombings, the USS Cole. Bin Laden declared war on us and we hardly noticed. Inspectors kicked out of Iraq? Korea reneged on their arms agreement? Good for only two or three days on cable news. Such is the power of optimism, and this country and its markets were on fire! So, finally, were our buildings, after those planes dove into them.

Rather, I'm thinking of real, tangible safety. The kind created by demonstrating that the U.S. will defend itself from real threats overtly made around the world. Thankfully, finally, our country is on offense. Like any well coached team, game experience is hardening our citizen soldiers. We are mentally stronger as well. Yes, we may be closer to the beginning than the end of these challenges, but it's no accident we've escaped further attacks within U.S. borders for going on two years. Add to this the revelation we can place 40 cruise missiles on a phone booth with about 12 minutes notice. These are facts not lost on the Kim Jung Ils of the world. While it may not be popular, finding the courage to back principle with the exercise of power has increased our security tenfold. It's this marriage of principle and action, not our missiles, that makes us safe. Reagan did it with Libya and the hijackings stopped. Logically, another terrorist attack should hit the markets short term. Fear of another attack is keeping investors out of stocks, and the markets are climbing that wall of worry. We are safer now than we have been in years.

Unemployment is Rising and the Capital Markets have Seized Up.

Almost six percent of our workers can't find a job, but unemployment is not the disaster the minority party is spinning it up as, going into an election cycle. Five years ago, getting down to this level of "un-employed" was not only celebrated, it was thought to be "full employment". There was hot debate on whether so few unemployed would set off another inflationary spiral. This idea turned out to be ridiculous, but one fact is undeniable: creating jobs is our greatest domestic challenge. Yes, bigger than social security, bigger than health care, maybe bigger than both put together. Without a growing economy nothing is possible. Growth is the only way to create enough wealth to solve other issues, <u>but we face stiff competition</u>.

Did you know that 20 million people a year migrate into the cities of China looking for jobs in manufacturing? We have 16 million manufacturing jobs TOTAL in this country. Say you're an employer. You pay $15/hour here or $20/month there, and you <u>must compete on price</u> or lose business! Consider this excerpt from a recent issue of Barron's. Alan Abelson is writing, and quotes Felix Zulauf, a well respected hedge fund manager speaking to his "big picture" economic view (parenthesis are mine):

> "(Felix laments) this country's leading export is jobs … and that's true of the developed economies generally. (He) sees the "convergence" between two different worlds – one, led by China, featuring low costs and low regulation, the other, high-cost and highly regulated, like ours (the U.S.) and Western Europe – as the major problem for all industrialized countries. As "more and more goods are produced in the low-cost world," he reflects, "the old world (ours) loses profits, jobs, and income." Which makes it "virtually impossible under these circumstances for (high-cost) economies to re-enter a normal business-cycle expansion as we know it … ""

Our "knowledge-based" economy is adding to this headwind. We lead the world in productivity, which also means our companies can grow without adding as many workers. This force is so potent economists believe our economy must grow at a 2½ to 3% annual rate not to <u>lose</u> jobs! We must grow faster still to create them.

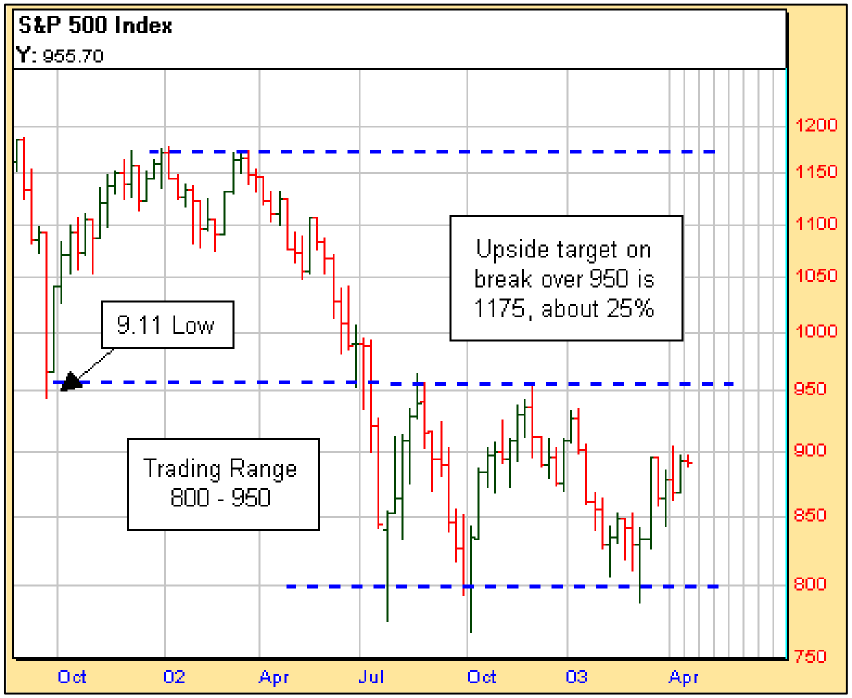
Leveraging creation, not consumption, is only way out. Bush is focused on the right question - How do we get our economy growing at 4 to 5% longer term? One could almost laugh at the knee-jerk political responses if they weren't so tragic. Hand each citizen a check for a few hundred bucks hoping we'll spend it? Then what? Most of what we'll buy is made in China. Raise taxes on producers and transfer the money to the "middle class". That's a great idea; pile even more luggage on the only horse that can run. Rely on worn-out consumption based stimulus and the emerging tigers of the "low-cost" world will run us down and have us for lunch. Creating incentives for faster long-term growth is far more important. Check out the economies of Germany and France if you wonder where the road to consumption will lead us.

What if such challenges led to Real Change? The silent majority in this country may be poised to deliver another jolt, just as we did in Iraq. I'm speaking to the elimination of taxes on dividends. This is the right direction - attacking the structural impediments to growth. It's not enough reform by half, and it should be much simpler, but it's a <u>step outside the box</u>! Cutting taxes on small business is the right direction. When politicians advocate taxing the rich – these are the people they're talking about. Small business owners carry the heaviest tax load, with higher rates than corporations – and taxes discourage growth. Small business entrepreneurs have always been the foundation of our economy. They take the risks. They create most of the jobs. They are saddled with the highest cost of capital in the industrialized world. Lighten the load and small business will create our way out of this mess.

If the markets sense we will accept the challenge to look at and do things differently, they will reward us! One step could lead to another – and we might find economic rebirth. Yes, we are hearing the same tired rhetoric, but understand that change scares politicians and they resist it, lest they find themselves on the wrong side and unemployed themselves. There is one other solution: we make politicians our country's leading export. We infect the tigers with the same virus killing us.

What if we were on the verge of Better Times?

Our economy is grudgingly expanding. Wages continue to rise. Inflation is at its lowest level since the mid 60's, as are interest rates. Very low mortgage rates have helped business and citizens alike clean up and rebuild their balance sheets. As you can see in this chart of the S&P 500, U.S. equity markets have been off their lows and trading within a 15% range for months. Each dip below 800 is met with solid buying (note how the index closes towards the high of the day, then moves up in each case). Every time we reach towards 950, the market stalls out. This is a trading range, and as of this writing we are smack in the middle of it. Mr. Market is looking for answers as well. Our first clue to what comes next lies in the direction in which this index leaves its range.



U.S. markets have held up amazingly well through several months of extreme uncertainty. Contrasted with the Europeans, most of which broke to solid new lows in March, or Japan which is at 20 year lows, one gets the impression we're doing OK - as huge bear markets go.

Thank you for your continued confidence,

Don Niemann
President, CIO
Niemann Capital Management, Inc

P.S. SARS could become an issue, but here's a thought. Our CDC solves SARS for China, and they solve North Korea for us.