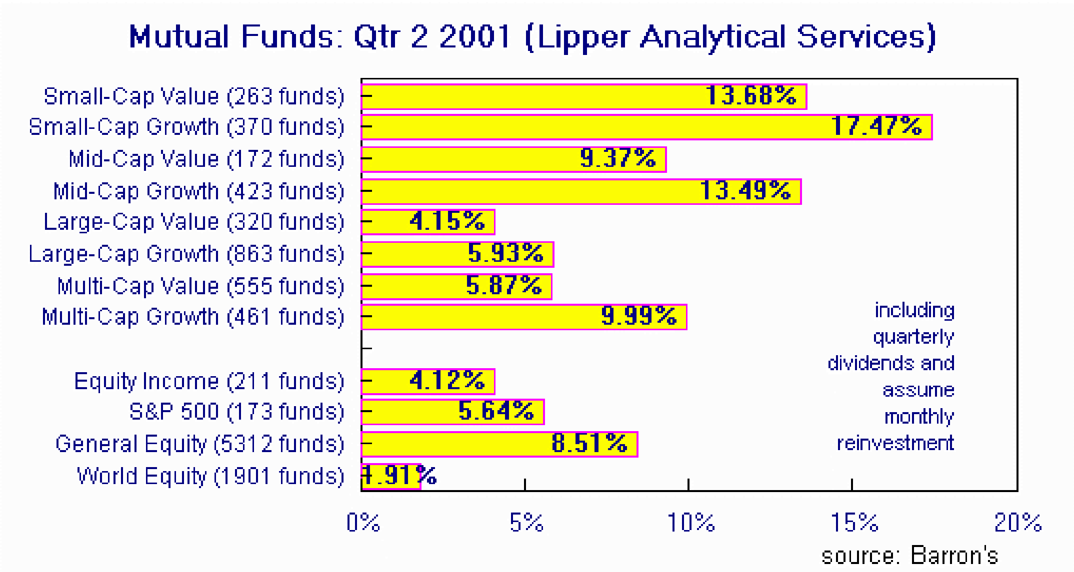
Niemann Capital Management, Inc.

Second Quarter 2001 Review

Value Dog is having its day.

Stock mutual funds bounced back in the second quarter, a welcome relief, though most remain lower year to date. Small-cap classes led the way with all three components (“value”, “core” and “growth”) posting solid double-digit returns. As usual, those stocks and sectors declining the most in the previous downtrend (from January through the first of April) enjoyed the sharpest rebounds. Technology funds rallied 13.12% on average in Q2, cutting year over year losses to –52.8% (wow). And just as typically, sectors holding up the best during the sell-off were mediocre performers in the rally. Natural Resource funds, previous market leaders with a 7.42% 1-year return, scraped out a meager 0.14% over Q2.



Growth funds out-performed their value counterparts over a quarter for the first time since Q1 2000, printing an average 11.72% return versus 8.26% for value according to *Barron’s*. Is the value style running out of steam, and is it time to start re-positioning towards growth? We think not.

Remember, so depressed were value shares early last year that the huge losses suffered by Julian Robertson’s Tiger Management (one of the great value investors) forced the closing of one of the largest hedge fund operations in the world (over $20 billion in 1998). At that time, value had never been cheaper relative to growth. Looking back, the closest comparison would be the end of the Nifty Fifty bubble in 1974. (“Nifty fifty” was the moniker for the so-called “one-decision growth stocks” you should buy and hold for life. Polaroid was one of those, so was Xerox.) Over the following several years value *outperformed* growth by over a hundred percentage points. Even after a tremendous run in the category over the past year, value remains cheaper than normal.

At the same time growth is still expensive, despite catastrophically lower share prices over the same period. The tech bellwether Cisco is a case in point. Expected to report 3 cents for the July quarter this week, Cisco’s shares are currently trading around $20, or more than 30 times 2003 estimated profits. Not exactly a bargain. Another example is Intel, at $30 trading for about 60 times expected 2001 profits. Even the broad market is rich at about 26 times earnings, higher than either of the previous bull market peaks of 21 times in 1929 and 1965.

Bottom Line

Value still offers the best chance for success over the intermediate term, though any good news in the tech sector should ignite a rally there. But keep perspective on the bigger picture; US stocks are 18 months into arguably the most vicious bear market in 25 years. Like a storm with high wind, this bear is ripping up everything not firmly attached to the ground. Bear markets wear out investor enthusiasm through a succession of brief sharp rallies followed by protracted disheartening declines. The best offense is good defense, staying systematic and disciplined. The objective is to be there at the start of the next bull trend with most of our money intact

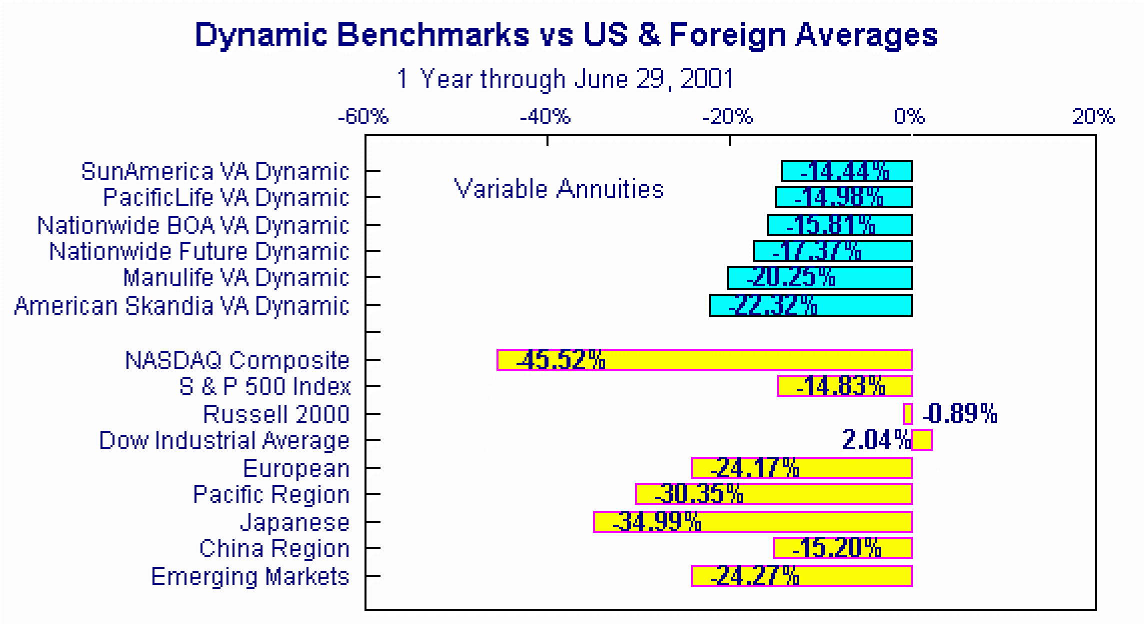
Thanks for your continued confidence,

Don Niemann
President
Niemann Capital Management, Inc.

Benchmark Reality Check

As you know, Niemann reports your managed account performance against a custom benchmark, based solely on the investment choices available to your particular strategy. If we are managing your *Nationwide Best of America* variable annuity contract, we must allocate your portfolio among the 40+ different investment choices available within that universe. Evaluating your managed account against a benchmark made from those same choices is the most direct way to expose the value Niemann adds to your portfolio (or not!), both in the context of risk and return.

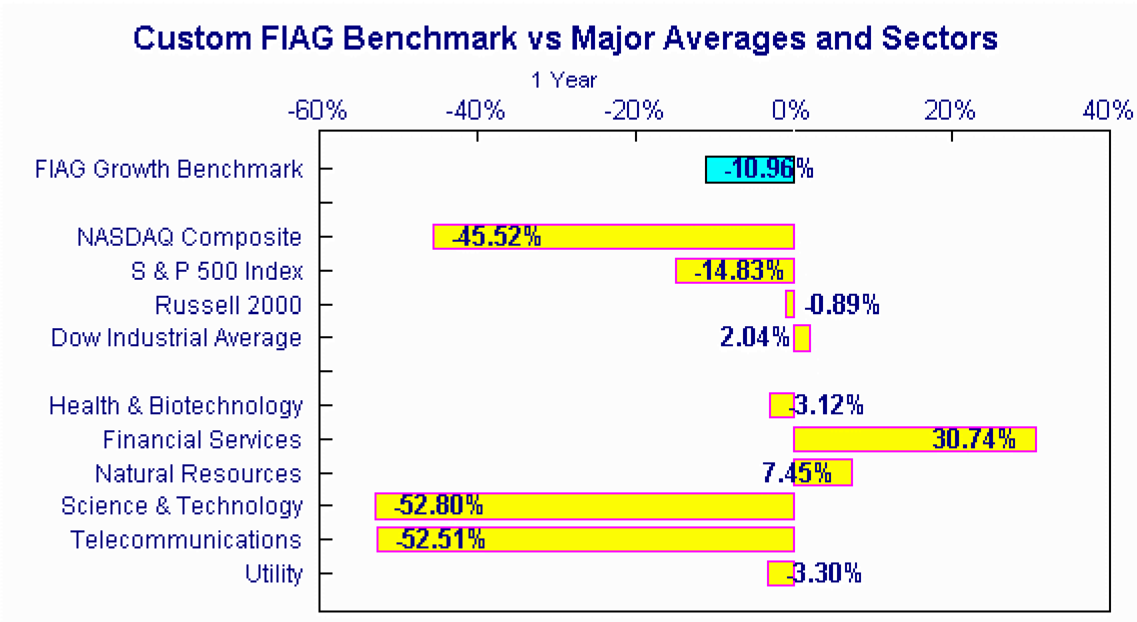
This being said, one question that arises form time to time is "How do Niemann's custom benchmarks compare to the major averages?"



Lets tackle this question by comparing Niemann's custom Dynamic Variable Annuity benchmarks against major US and foreign equity markets. Why include non-US mutual fund averages? Because all of these variable contracts contain from a few to several international sub-account investment choices, so a valid benchmark must include them. Over the one-year period ending June 29, the Sun America dynamic benchmark tops the list while American Skandia trails the pack almost 8 percentage points behind the leader. What accounts for this huge difference in benchmark performance?

Well to begin with, American Skandia contains several more international sub-account choices compared to Sun America, which worked against it judging by the returns in foreign market equity funds over the period. Also, Skandia has more investment choices targeting technology and the Nasdaq than does Sun America. You can almost visually see how the Nasdaq and foreign markets pulled Skandia's benchmark performance lower (in the chart nearby). If you set out to compare your Skandia annuity (assuming you were invested like the benchmark – equally among all the choices) to the S&P 500, you would be disappointed in the performance. But is this a valid comparison? Frankly, the comparison would have no more merit than arbitrarily saying the Nasdaq is your benchmark and you beat it by 20 percentage points. It should be apples to apples, as the old saying goes.

Very important to remember is that the very characteristics working against Skandia over this time frame may work for it in another. Skandia with its International Small Cap sub-account was our best performing universe by far in 1998.



These same principles hold true with our "FIAG Growth Benchmark". Compared against the major US stock market averages over the past year, its -10.96% performance reflects the average return of the 1100+ domestic mutual funds of which it is made.

The fact that it performed better than the S&P 500 or Nasdaq is no more important than it lagging the Russell 2000. It is important that when you consider your FIAG managed account, you are evaluating investment performance against a benchmark that makes sense, and accurately describes the risk and return potential awaiting you.