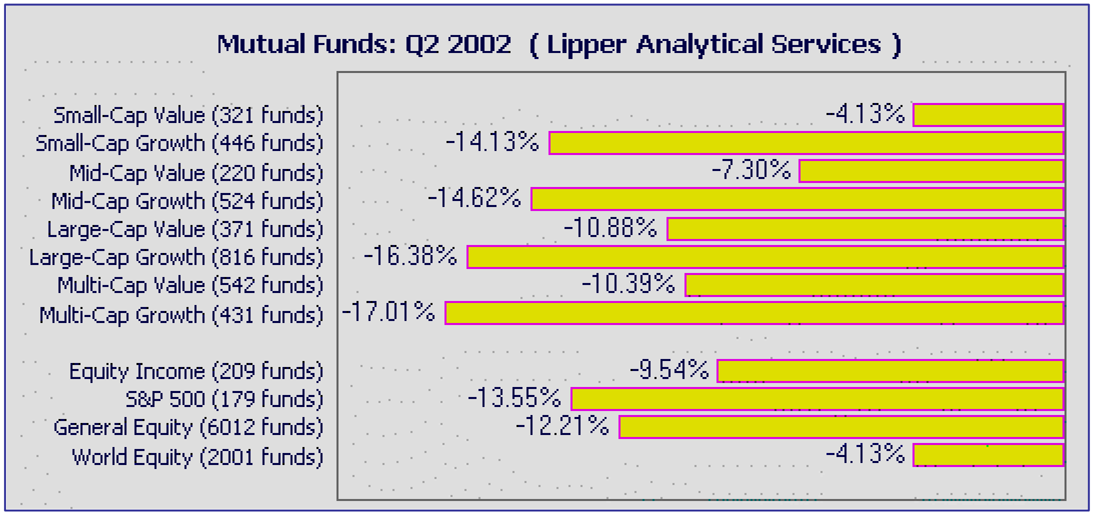
Niemann Capital Management, Inc.

Second Quarter 2002 Review

No Rest for the Weary.

After seven months of solid gains following the post-attack lows, a pullback in stocks was inevitable. We even looked forward to the decline as an important and necessary part of the base building process, which routinely terminates a bear market. It is within this ebb and flow, this tug-of-war between bulls and bears that new leadership emerges, setting the stage for a bull market. Yet as the downturn unfolded in June, selling turned out to be fiercer, and deeper, than one would expect within the context of a growing economy. World equity markets turned what could have been a building block for a new up trend, into another beating for the hapless bulls.



Sellers hammered growth shares, as you can see in the breakdown of returns by style and asset class in the chart nearby. Every growth category suffered double-digit declines with virtually no stone left unturned. In fact, 37 of Lipper's 41 stock-fund sectors were down on the quarter. Of the four winners, two were extending their Q1 gains: Real Estate added 4.98% and Gold was up 11.11%. International funds bucked the decline, but were lower as a group by –2.91%.

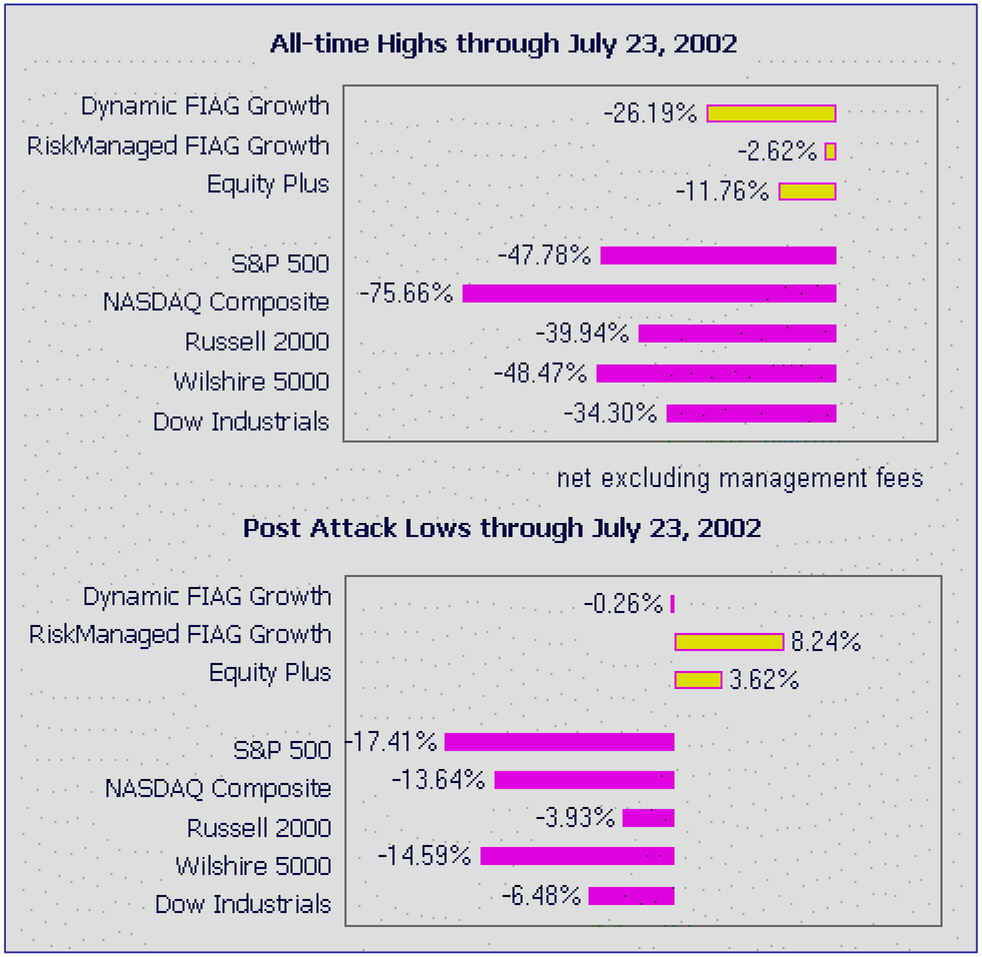
The two themes we've taken advantage of since the market highs in 2000 continued through the second quarter of 2002: 1) shares of small companies bettered larger ones, and 2) value out-performed growth. This good *relative performance* certainly helped our client accounts resist the decline, but by the end of the quarter, this fact turned out to be about as much consolation as finding out one only needs a small filling, instead of a root canal.

It's a Process, not an Event.

A psychology of fear and uncertainty dominates the business world – and investors can only wonder how many more Enrons and WorldComms are out there. Having major world markets breaking to new lows is painful and demoralizing. But finding a bear market low is a process, not an event. As one trader put it, "it's only in the rinse cycle you find out how dirty the laundry was." Important to remember is that Mr. Market has an uncanny way of forcing investors to do just the wrong thing at turning points. Heavy mutual fund redemptions over the past several weeks suggest many market participants may be doing just that, by finally "throwing in the towel" after 2 1/2 years of bear market. The four-week average of money coming OUT of stock funds is approaching $8 billion as of July 29. The wholesale selling of shares over the past several weeks has been as aggravated as I can remember since 1987.

Looking at the Big Picture.

All of which is pretty good news from a bigger picture point of view. When the going gets tough, if you can't sell what you want, you sell what you can. Disorderly, wholesale selling creates opportunity as good stocks get thrown out with the bad. Where is all the money going? Well, Mr. Market is not without a sense of irony. One of our clients, a real estate broker specializing in investment properties tells us, "apartment buildings are going like hot cakes". Of course we must inquire as to what might be driving the demand, since "aren't rents falling some now?" "They are." he says. "But people are funding with big checks from their mutual funds. It makes no sense the prices they're paying, but I guess the money has to go somewhere."



Does this sound familiar? Three years ago, $15 billion *uninformed* dollars a week were pouring into stock funds at what turned out to be the end of a 5 year bull trend. Now, what's left of that money is pouring out of stocks and into bonds and real estate, both of which are well into extended bull markets of their own. The more things change, the more they stay the same.

Winning the War of Attrition?

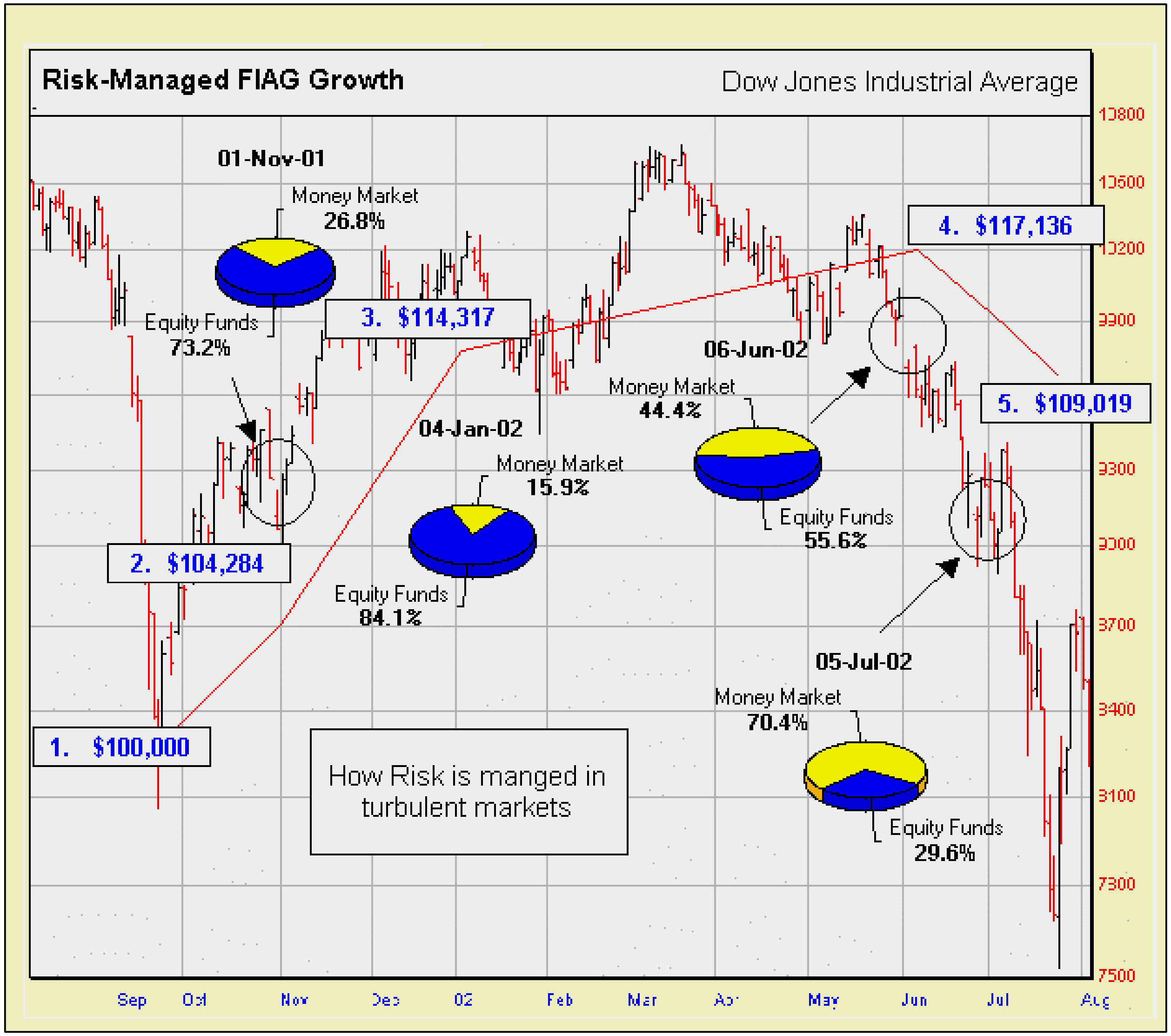
With the market putting in a potential new low on July 23rd, it's time to check the scorecards again. This is a very effective means of evaluating HOW your strategy is working through the market turbulence, which is critical to building and maintaining the confidence to become a successful investor over the long run.

First you should grade how your strategy has performed from its closing value the day of the market high to the lowest low of the bear trend. The top chart nearby uncovers the cumulative return for each of our Mutual Fund portfolios and the popular market measures from the day of their all-time highs through the day of the lowest close, July 23, 2002.

Another useful measure is to compare performance from the previous low to the new low – is any headway being made? The bottom chart reveals the cumulative returns from the post attack low, Sept 21, 2001 through the recent low on July 23rd. I'd say we're more than holding our own, but in the final analysis, you are the only judge who counts. Risk-Managed FIAG has performed so well one wonders how this strategy has been able to sidestep so much chaos in the markets.

Navigating a Turbulent Market

The S&P 500 index was down –17.41% from the post attack low, Sept 21, 2001 to the recent low on July 23, 2002. How did Niemann's Risk-Managed portfolios manage to hang onto the gains made after the September attacks, even as the broader markets could not? Lets review an actual Risk-Managed FIAG client account invested over this time period to find out. All Niemann Risk-Managed strategies work the same way – the main difference is the list of securities from which we can choose the investments for each of the different portfolios.



1. We set the starting value of this Risk-Managed FIAG account at $100k on the day of the post attack low, Sept 21, 2001, for easy comparison.

2. By November, accounts were 73.2% invested in equity mutual funds. Note the market had already moved up fairly well from the lows. <u>We need markets to show strength before we put money to work</u>.

3. Consistent market strength into January 2002 propelled these accounts to an 85% equity allocation. Note that account values had moved up so that returns were in the mid teens.

4. Markets fell into a trading range over the first five months of the year, and as stocks began to break down in June, we began raising cash in risk-managed accounts.

5. Responding to continued market weakness; risk-managed accounts became very defensive by the end of June, with allocations in money market/fixed income pushed up to over 70%.

As of this writing, accounts in this portfolio average an 83% money-market/fixed income allocation. Results:

1. $100,000 invested in Risk-Managed FIAG Growth appreciated to $107,000+ (after mgmt. fees) over this tough 10-month period.
2. $100,000 invested in an S&P 500 index fund would have been worth approx $82,600 on July 23, 2002.
3. $100,000 invested in the Wilshire 5000 Total Market Index fell to approx $85,400.

The Bottom Line.

Remember all those "Thousand Specials" – the 3-hour parties on CNBC celebrating how much money everyone was making each time the NASDAQ broke up through another thousand mark? How about those pictures of snorting bulls on the cover of Business Week, or that hot new book of yesteryear "Dow 36,000"? When was the last time your mechanic was trading stocks on line, or your gardener was touting an IPO?

Today we see pictures of bears on the cover of major business magazines instead of "CEO of the Year" (unless they're in cuffs). The hot new financial book is "Conquer the Crash". CNBC is touting the virtues of investing in real estate and bonds. The world these days looks as negative as the end of the bull seemed positive – and investors are running out of stocks like lemmings over a cliff!

<u>Times have changed, but human nature hasn't</u>. Step back, take a deep breath, and see these symptoms for what they really are! The fact is no one knows what the markets have in store, least of all the talking heads on TV and in the press. What we do know is that, *in the overall scheme of things*, when everyone wanted stocks in 1999/2000 – it was a great time to sell them. And now that owning any stock is like having a disease – it's a very good time to start picking through the rubble.

We've done a lot of the heavy lifting already: *enduring a vicious bear market with the vast majority of our assets intact*. The big payoff for all this hard work is lies ahead. Remember, <u>very low interest rates</u>, <u>low inflation</u>, and <u>stimulative fiscal policies</u> are an extremely potent driving force for economic growth, and an inevitable bull market in stocks.

Our task is to remain systematic, disciplined, and ready to take advantage of that new market theme when it unfolds.

Thanks for your continued confidence,

Don Niemann
President, CIO
Niemann Capital Management, Inc

P.S. Don't email me on the mechanic/gardener quip - our "used to be" window-washer probably made more money in the last bull market than any of us.