NIEMANN
CAPITAL MANAGEMENT

Don Niemann
President

With 20 years in the financial sector, Don Niemann has a compelling background that demonstrates his excellence in market analysis, designing methodologies and managing the complexities of buying and selling securities in a diverse marketplace. In 1991, Don founded Niemann Capital Management with the idea that a systematic and disciplined approach to risk management will provide superior returns over the long run and positively affect client retention.

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Minimum Initial Investment
$100,000

Maximum Management Fee
2.30%

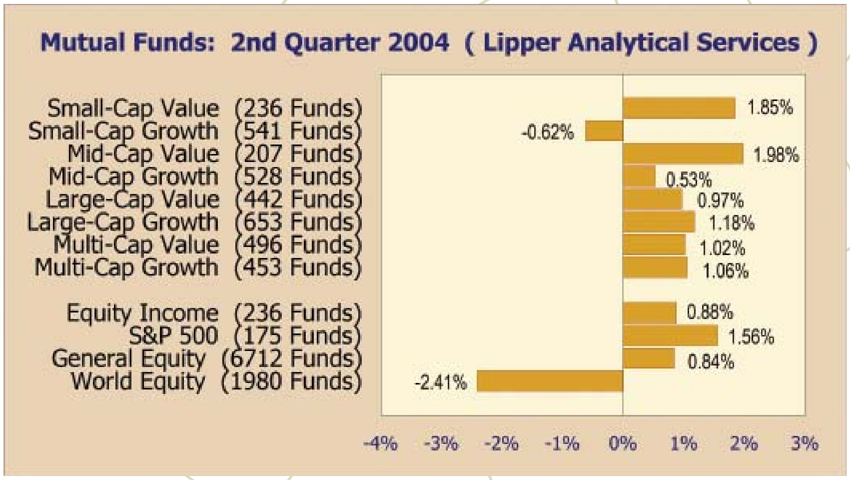
Advisor Location
Capitola, CA

Number of Staff
18

Assets Under Management
$388 million

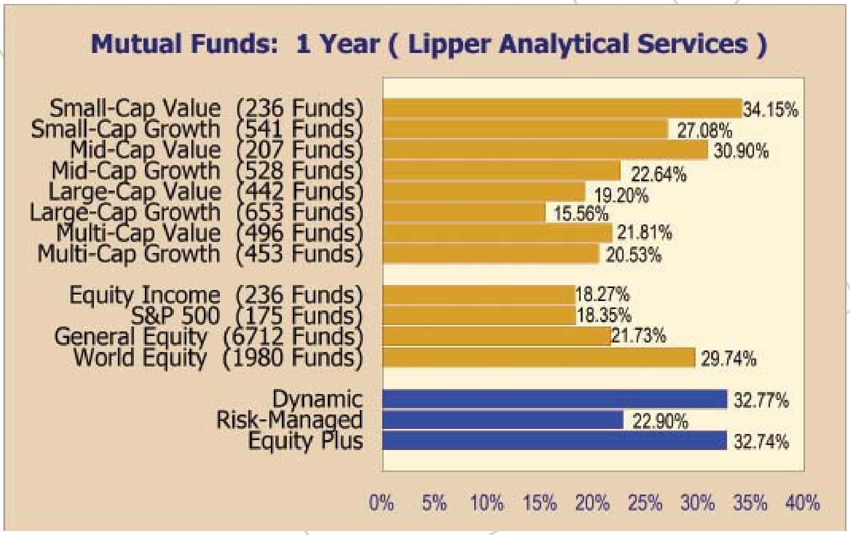
For the second time in as many quarters a nice rally in the final few weeks boosted most measures of U.S. share prices into the black. The tally, according to Lipper, placed more than 6700 diversified U.S. equity funds up an average 0.84% for the second quarter of 2004 (labeled General Equity in the chart "Mutual Funds: 2nd Quarter 2004" nearby). The big winner was natural resources, up 4.65%. Small and Mid Cap Value led the style boxes as they have for most of the last 4+ years.

The losers in Q2 could make a "Who's Who" list of some of our best positions over the past eighteen months. Gold was hammered down 18.35%, Emerging Markets dropped 9.52%, while China and the Pacific Region were down 9.29% and 6.01% respectively. Even Real Estate gave back 5.62%. Managing these changes in fortune was frustrating because despite the chaos, U.S. equities extended their streak of range-bound trading to 120+ sessions – which is quite rare. Yet even as markets remain decisively choppy, year over year returns through June 30 (see "Mutual Funds: 1 Year") remind us why it's all worth the effort.



Markets in Conflict

After six months of sideways, the bull run of last year is a fading memory. Inquiring minds want to know what it's going to take to get share prices

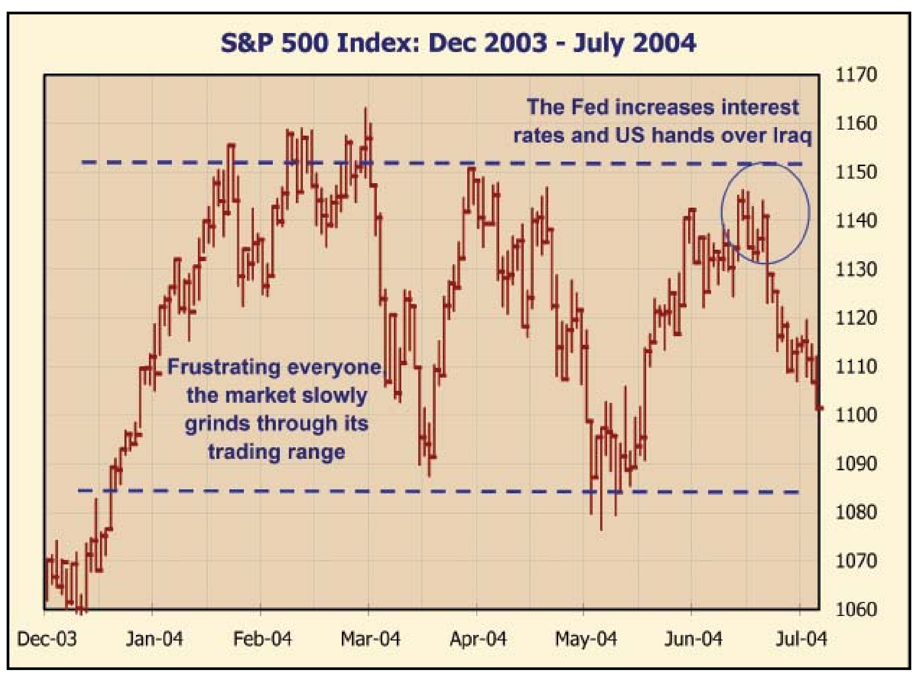


moving up again. In our last letter, we suggested one possible scenario that might play out as a turning point for stocks.

Our thought was that the turnover of sovereignty in Iraq AND the first Fed interest rate hike in years would remove enough uncertainty to make room for a rally. Reality played out quite the contrary as markets rallied into the rate hike / handover but have been straight down since. The worst performing index is NASDAQ which is down 8% this month! This price action flies in the face of a strong economy and some great individual earnings reports. Q2 will be the fourth consecutive quarter of 20%+ earnings gains – another rare event. No matter, markets look ahead, and one ignores their message at ones peril. So what is the problem here?

One reason the NASDAQ is having such a hard time are the new FASB rules requiring companies to expense option grants to employees. It's no secret these changes will hit technology earnings where they live. Smith Barney estimates the full implementation of current proposals will shave about 17% off overall tech earnings. Some companies will get an 80% haircut. This doesn't mean there won't be room for great rallies in the NASDAQ from time to time, and there is even a chance politicians might pull off some last ditch effort to ease the pain. Just keep this headwind in mind and manage positions accordingly until conversion to the new rules plays out. Overall though, I think what's really weighing on the markets are increasing odds of a Kerry victory this fall.

One need only consider how Bush's tax policy has affected small companies to understand the potential negative. Take our company for example. The last 3 jobs created at Niemann were the direct result of lower marginal rates for our partners combined with the impact of accelerated depreciation. Over the past couple of years we were able to replace aging equipment, invest for growth, AND create jobs because those two incentives made the risk of doing so reasonable. Without these advantages we would have almost certainly chosen a more conservative path.



Add to our "accelerated" investments the fact that the equipment we bought and the wages paid to our expanded staff rippled into the possible creation of other jobs. Multiply our company by tens of thousands of others, and you begin to see the impact of positive tax strategy.

Now switch your view 180 degrees. Kerry advocates rolling back business incentives and increasing marginal tax rates. These policies will cause small business owners to be more cautious, reign in spending, and put in place more conservative plans. Multiply these actions by thousands of companies and it's understandable why the markets turned sloppy last spring as the race tightened up.

Looking for the Next Big Thing

In our business the real money is made by uncovering and getting in front of secular trends as they unfold in the markets over time (\Sec'u'lar\ 1. Coming or observed once in an age). That's why the superior investor is always refining his big picture view of market trends. Tactical mistakes like buying or selling at the wrong time or price are often mitigated by the correct strategic posture - unless one does everything wrong.

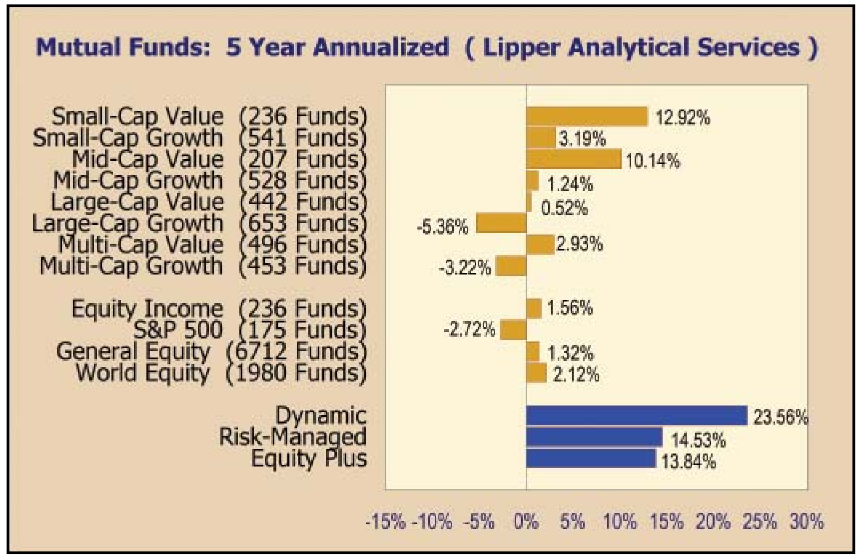
One obvious example of a secular trend (perhaps just ended?) is that of interest rates over the past 20 years. Kicked off by the Reagan revolution in the early 80s, investors around the world have enjoyed a powerful bull market in U.S. Government Bond prices as yields dropped from 15%+ when the phenomenon began to sub 5% in recent years. The direct beneficiaries on the equity side were Brokers and Financials, whose combined market value has risen to over 25% of the S&P 500. In March of 1980, Merrill Lynch shares sold for a split adjusted $1. Now they trade at $50. Such is the power of a macro trend. Over this same time span we can point to another trend: falling energy prices, that were not nearly as heralded, but still of great consequence.

During the heyday of the energy boom in 1980, the market value of US energy companies peaked at over 27% of the S&P 500. I remember energy shares trading in those days like the tech stocks of 1999. Many were over $100 per share and would fluctuate multiples of dollars per day. Sound familiar? After 20 years of sub-par performance the combined value of the energy sector had fallen to less than 5% of the S&P 500 by 2002. According to Art Smith of John S. Herold Inc. (an energy research outfit), the market value of this group languishes around 7% currently - and that's if you include the energy services companies. But with their underlying commodity prices near all-time highs, it's hard to see how energy shares have much to go on the upside. Or do they?

Energy is certainly in the news with $2.00+ a gallon gasoline prices and $40 per barrel oil prices making headlines every week. But just how expensive is energy today? Art Smith estimates that a $40 barrel of oil in 1980 translates into roughly $80 to $90 today. On a cents-per-mile-traveled basis, he says gasoline is as cheap as it has ever been at about 10 cents a mile. Dan Rice at State Street points out there hasn't been a big new discovery in the past 10 years, and demand is growing. The 2 to 3 million barrels of excess capacity the world has currently pales in the face of demand from China and India. At its current growth rate, China will swallow available supply by the middle of next year.

Add to this the fact that soaring energy prices haven't had the impact on the U.S. economy many analysts expected. The cost of energy has dropped to about 3.5% of GDP in recent years, so even sharp increases are more tolerable. There is a productivity story buried here as well; we get about 40% more output per barrel with about one half the employees than we did 30 years ago.

Are energy shares near a cyclical peak, or could this be the first leg of a bigger trend? It's hard to find another macro supply/demand story as compelling as energy. It's doubtful global expansion will drive the market value of energy back to its previous levels. But should the sector regain half its previous glory, simple math suggests we'll see some 5 and 10 baggers in the stocks. That's the kind of trend that helps create great long-term numbers - like those in our 5-Year comparisons nearby.



A New Strategy: Aggressive Growth

Soon you will see the new category "Stock" listed along with Niemann's Mutual Fund, Variable Annuity, and Variable Life offerings on the web. We are launching "Aggressive Growth" as the first of several new equity-based strategies over the next several quarters. Aggressive Growth will have much in common with our well-known mutual fund objectives (FIAG Dynamic, et al). It is:

- founded on our proprietary risk-adjusted analytics
- the product of extensive research, development and testing
- designed to take advantage of specific trends and imbalances within the markets
- actively managed and monitored daily
- published on Niemann's web

All of our new equity objectives will surpass our mutual fund products in several important ways. Since we will own the shares of individual companies directly there will be no limitations on how and when we can buy or sell shares. Redemption fees, penalties, and forced holding periods will be non-existent. Pressure from the fund companies will disappear. We can add value to our positions during the execution phase of the process rather than being stuck with the 4pm market closing price as we are with funds. We will be able to take direct advantage of changing fundamentals within industry groups, rather than getting stuck with the dogs as well. We can employ ETFs (exchange traded funds) to enhance and hedge our positions.

The Aggressive Growth strategy will be on the Fidelity platform like the rest of our separately managed accounts. A typical account will hold about 20 positions in companies we think have the best potential for growth over the next 12 to 18 months. That's right, we're going for long-term capital gains with this strategy! We'll use the Russell 2000 ETFs among others as a hedging vehicle to help protect the downside. More aggressive than FIAG Dynamic, you can expect an account to be more volatile, particularly since it will be focused in a handful of individual securities instead of the hundreds owned through our fund strategies. We think the potential upside is absolutely worth it.

Thank you for your continued confidence,

Don Niemann
President, CIO
Niemann Capital Management, Inc

Call your investment advisor today for more information describing how Niemann Capital Management helps add value to clients' investments. And, please refer to our website for additional performance information, www.ncm.net.

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To request Part 2 of Niemann's current ADV please contact Talia Wise at 800-622-1626 or talia@ncm.net.

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