SECOND QUARTER 2005 - REVIEW

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
20

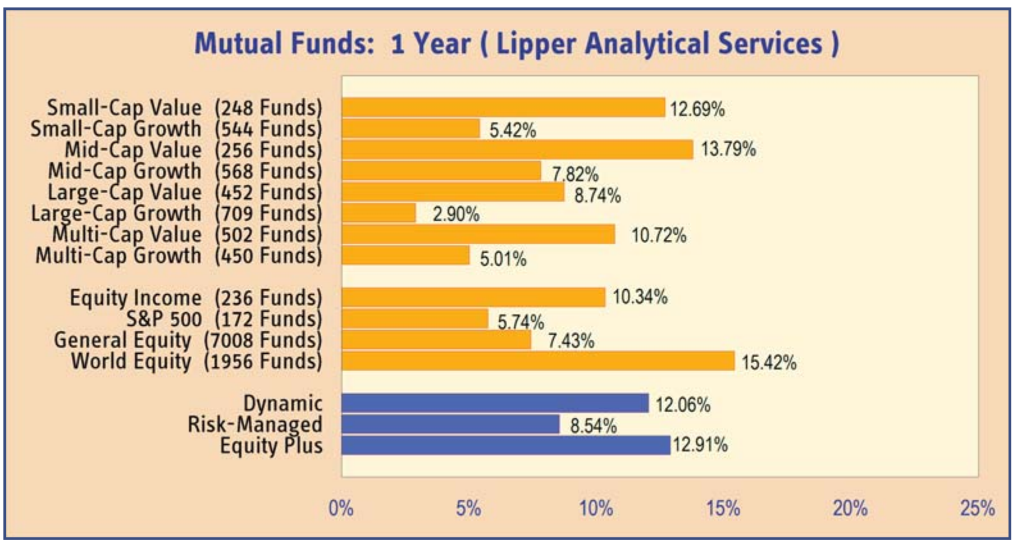
Assets Under Management
$560 million

Alan Greenspan once said, “The fact that our economical models at The Fed, the best in the world, have been wrong for fourteen straight quarters, does not mean they will not be right in the fifteenth quarter.” That pretty much sums up our experience with the fine art of economic prognostication. How would you bet on that fifteenth quarter? We’d have to put our money on “not right,” and that should tell you something about our management style. Stock and bond markets have been just as confused while grinding out a six month trading range this year. Was Q404 the last gasp of a dying bull, or is there more to come?

Sometimes, when markets are in conflict and don’t seem to have much conviction, the best way to guage their strength is by what doesn’t happen. Take this past April for example. The Dow was down over 7% on the year and the Russell 2000 (smaller companies) off more than 10%. Rumors of a hedge fund meltdown became fact when General Motors debt was downgraded to junk. Oil vaulted over $50 a barrel. By April 20th the fear in the air was palpable as the Dow sat poised to break below 10,000. We had been raising cash for weeks and were ready to batten down the hatches. It seemed certain the market would crack. Suddenly, buyers appeared out of nowhere like calvary riding over the hill and rallied stocks broadly into June. What seemed certain to happen didn’t.

Fast forward to July 7th. On the heals of the first London bombings, markets were sharply lower around the world. Down more than 400 points over the previous 10 days, the Dow was called 200+ lower on the news. Once more buyers emerged, not only stemming the decline but actually driving stocks to a higher close that very day! Again what seemed most likely to happen didn’t. These two examples of perverse market behavior are instructive. Pundits continue to wax on about the health of an old bull market, but the fact is stocks are still climbing that proverbial wall of worry.

One thing is true, the easy money is gone. Even though General Equity funds (of which there are now 7,008!) ended the first half down a slight 0.26%, it was Mr. Toad’s Wild Ride all the way. It’s only July and our risk strategies have “round-tripped,” ranging from close-to-fully invested in January to halfway out



S&P 500 Index: The S&P 500 Index is a capitalization weighted, unmanaged group of 500 stocks as selected by the Standard & Poor’s Publishing Company. They are usually the 500 largest companies in terms of market capitalization and are chosen to represent the entire market’s value. The S&P 500 is used by many institutional investors as a performance benchmark representing the “stock market” return.

of the market in April to almost fully invested today. The fact is we work hardest when markets are range bound. Where to next? We think higher still, but what we know for sure is that those who depend on crystal balls better learn how to eat glass.

In recent Reviews we set out to describe how each of our strategies worked in the past under different market conditions. The purpose was to help you understand what is likely to happen when things go wrong. Why focus on the bad stuff? When pushed hard enough, even seasoned investors can fall into an emotional trap and make the wrong move at the wrong time. So rather than glossing over adversity, or silently suffering through it, the superior investor seeks to embrace adversity, understand it, and manage it. I am certain this trait has added a good bit to our performance over the years. This quarter we're going to shift gears and focus on the why/when we buy or sell a security. We'll look into what all Niemann strategies have in common: our bottom-up selection process.

When we talk to clients about this aspect of their managed account, the questions most often asked are:

Why does Niemann choose one investment over another?

How can Niemann possibly evaluate every position, every day?

What motivates Niemann to buy or sell?

Even though we answer these questions freely, people sometimes come away thinking there is some "secret sauce" in there somewhere. My reply is if patience, discipline, and systematic application of investment strategy day in and day out are secrets, well then maybe there is.

The Challenge

Considering the ever growing number of companies to choose from and the variety of strategies managers employ, it's no wonder mutual fund returns vary. Still it's amazing how wide the disparity can be. The table nearby shows the six-month percentage returns of several Mid-Cap Value funds through Dec. 31, 2004. Same asset class: Mid-Cap and same basic strategy: Value. Yet over this six-month period the difference in return between first and last is 15%! It's clear in hindsight which ones we should own, but that doesn't do us much good. Achieving superior returns over the long run requires that we find and own top-performing funds during their heyday. Niemann's bottom-up investment selection process is designed to do just that.

It's a Daily Process

The process begins around 5pm PST every market day when tens of thousands of mutual funds, stocks and market indices are reported for that day's trading. Our systems download, scrub, and queue up a wide spectrum of information on that day's trading for processing. Securities are grouped into their predefined collections where Niemann's custom benchmarks are calculated. Then each security in turn is analyzed against its benchmark, itself, and its peers.

1. First we analyze the risk-return profile. The security is marshaled through regression analysis to break down its trading patterns against its respective benchmark. This is done in multiple timeframes, from 21 to 144 trading days. The security is broken down into many components (or "stats") which we can use to help evaluate it. Telling stats are; **volatility**, **beta** and **alpha**. **Alpha** reflects the part of a security's return not explained by the market. You can think of **beta** as the tendency of a security's returns to respond to swings in the market.

Let's say we are evaluating five Mid-Cap Value funds. Over the

Even Funds with the same Objective are not Created Equal	6-Month % through 12.31.04
Artisan INV:MidCap Value	10.86%
JPMorgan Diversified MidCap	6.79%
Goldman MidCap Value-A	5.96%
JPMorgan MidCap Value-A	4.94%
Hotchkis MidCap Value-A	4.49%
Pioneer MidCap Value-A	4.10%
Allianz CCM MidCap-A	3.73%
Columbia MidCap Value-A	3.59%
BlackRoc INV:MidCap Value-A	3.47%
Janus INV:MidCap Value	2.90%
Putnam MidCap Value-A	2.85%
Security MidCap Value-A	2.54%
Phoenix MidCap Value-A	1.50%
Hartford MidCap Value-A	1.30%
MFS MidCap Value-A	0.95%
Excelsio MidCap Value	-0.06%
Dreyfus MidCap Value	-0.37%
Quaker MidCap Value-A	-0.95%
VanEck MidCap Value-A	-1.06%
ING MidCap Value Fund-A	-5.08%

past month one of them was down 4%; three were exactly even, while the remaining fund was up 2%. During the same time the market was also flat. Niemann's analysis will assign positive **alpha** to the fund that was up 2%, and penalize the fund that was down 4%. The three unchanged funds are neither helped nor hurt since the market was also flat. **Volatility** is a stat which describes how much a fund's price moves up & down over time. Using the same five securities as before, their average change in price was exactly 2%. The fund down 4% is dinged again because its **volatility** is greater than average (not to mention negative). Monitoring these stats is how we analyze the security's risk-return profile. Think of baseball. In every game the players are rated on offense and defense. Sure, a home run is great, but a high batting average is more important. How many errors does the player make? There are many stats to analyze the overall value of a baseball player. Niemann rates a security by looking at its many statistics and assess its overall investment value.

2. Once the risk-return profile is complete, trend analysis and scoring of the security begins. Consider this: suppose the Mid-Cap Fund that was down 4% still managed to finish the month above the 50-day mean of its closing prices. At the same time the other four funds finished below their respective 50-day averages. Our process rewards the fund that is down 4% and penalizes the rest. If that 4% fund persists in its trend (meaning it sticks to its trading pattern over time) its score will increase.

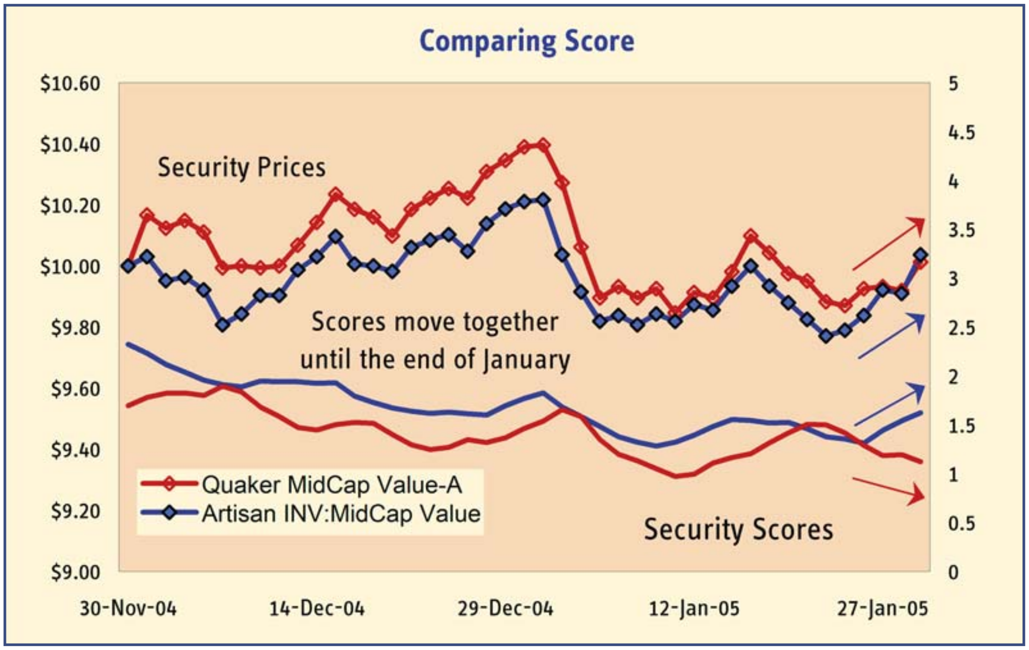
Trending components come in many shapes and sizes and we use about a dozen of them, again in many time frames. "Overbought/oversold" ideas (a fancy way of describing how far a stock usually goes up or down before reversing to its mean) fall into this category as well. Finally, work begins on a grab-bag of security specific analytics. Among these are **relative strength** and **volume analysis**. **Relative strength** is how a security measures up against its peers and its own trading footprint. **Volume analysis** helps us track how many shares are bought or sold and at what price.

At the end of the daily process we have created what we call a vector for each security, which contains all its stats for the trading day.

Building a Score

Relative importance of a security's attributes change depending on market conditions. Higher volatility may add to the security's return in a rising market but can really penalize a security's return when markets decline. How can we possibly keep track of all the moving parts of thousands of securities, let alone consider the relative merits of each when buying and selling? It's all in the score. Once all of the stats of a vector are calculated, they are combined into a single score. The score exists as a result of every time horizon analyzed. Securities are ranked according to score and these numbers are meticulously tracked to uncover change. Niemann's analytics is committed to the daily maintenance of these procedures.

In the chart *Comparing Score,* daily prices and intermediate trend scores of two similar funds are compared. Throughout this two-month time frame, these securities trade in lock step. Returns over the period are virtually identical. Yet by the end of the series in January, even as prices continue to track, scores begin to diverge. What is happening here? Perhaps the manager of the blue fund has adjusted the portfolio and it is beginning to work better. Or some of the stocks in the competing fund may be starting to lag. Or the



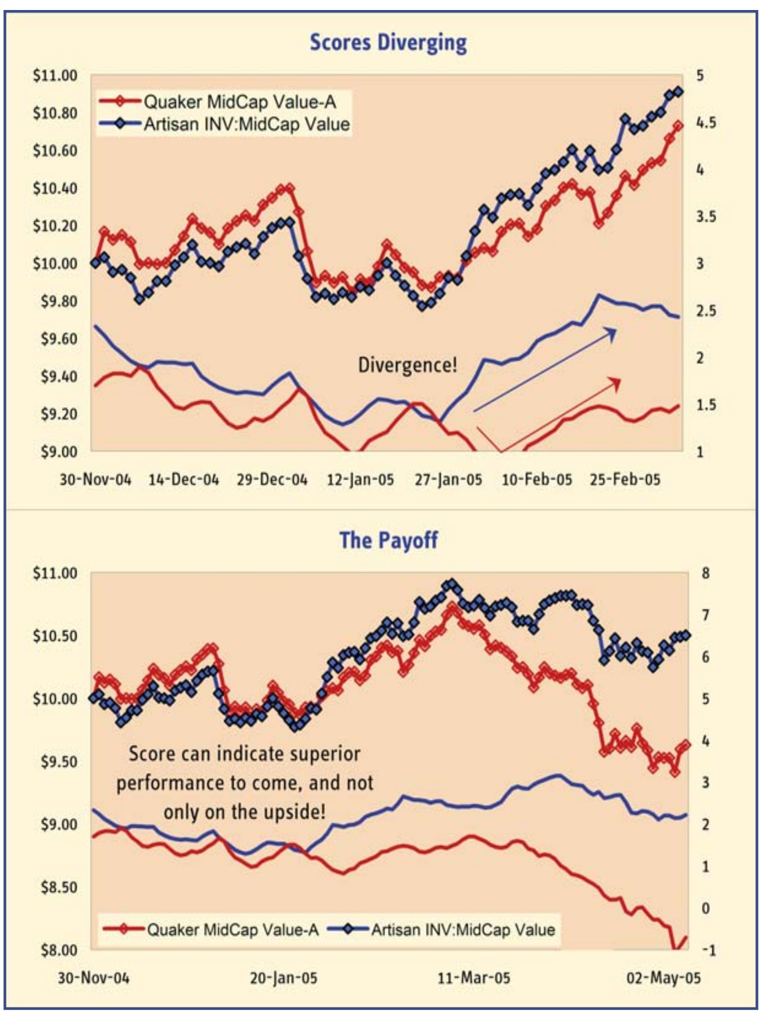
other manager could be changing the sector focus of the fund. Frankly we don't know the why, just that something is changing.

The next chart *Scores Diverging,* continues the series a few more weeks. By now the divergence in score is clear even though prices and therefore returns are still very similar. Remember score is not just about return – it includes risk, predictability and relationship to markets as well. Note how the score of the blue fund achieved new highs while its competitor has not. How will this play out in the following weeks?

Finally we see *The Payoff.* Diverging scores in the previous two charts now prove prescient. As the market changes trend and heads lower it becomes clear the blue manager has made superior adjustments. In a scant few weeks the difference in return widens to over ten percentage points.

Find and Own the Best of Breed

Mutual fund and variable sub-account performance, both up and down, depend on the choices made by their management teams. Are they making the right ones for us? How do we find out?



The long and the short of it is that we do the work. We break down every security we follow into its core components, and then construct its scoring from the bottom up based on our findings. We evaluate the results relative to all the other choices we might have. We do this every day. Our objective is to own the best investments we can find and keep them until they are no longer best of breed. This process may seem onerous, but to us it's the essence of effective portfolio management.

Like most of the complexities in life, the management of money is best approached by first breaking it down into understandable pieces. But lest you start thinking it's too easy, there's one caveat to mention here; who could say it better than Alan Greenspan, "I guess I should warn you, if I turn out to be particularly clear, you've probably misunderstood what I've said."

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. Please refer to our website for additional performance information, www.ncm.net.

To request Part 2 of Niemann's current ADV Part II Section F and/or the Annual Full Disclosure Presentation, 2004 please contact Talia Wise @ 800-622-1626 or email her at talia@ncm.net.