A Conversation with Don Niemann

July 22, 2008: Mid-Year Portfolio Manager Update

NIEMANN CAPITAL MANAGEMENT

American investors are fearful:

On the Dow, volatility continues. The price of oil continues to pressure the economy. Public perception is that we're in a recession. The supply of houses on the market keeps climbing while the pool of potential buyers keeps shrinking, as lending standards toughen and credit gets increasingly harder to find. No firm solution to the mortgage crisis has been identified, as demonstrated by the failure of the seventh largest S&L in the country—IndyMac Bank. A trip to the grocery store costs more by the week. Inflation's on the rise, with the Consumer Price Index jumping over 1% in June—its fastest rate of increase in 17 years. A relatively tight race for president marked by clear policy differences has injected uncertainty into the markets as well.

As so often happens during times like these, the pundits tend to extrapolate near-term challenges into a long-term disaster. But didn't we hear similar portents of doom after Sept 11th? (It's constructive to recall this date because the current market is similarly positioned for an intermediate upswing but the final low may yet be in.) Or, exactly the same lamentations when the tech bubble burst? Many of the fears, reactions and questions posed to advisors by fretful investors today are strikingly similar to those expressed during the downturn of mid-2000 through 2002.

Obviously, there's plenty to discuss in our Mid-Year conversation with Don Niemann.

Q: The start of the year was dismal; April was strong; May was okay and as has been variously reported, this was the worst June since the Great Depression. How would you characterize what we saw in the first half of '08?

Don Niemann: I would characterize the past several months in the markets as a tug of war between the rapid deceleration of our domestic economy and the robust growth abroad. By now almost everyone has at least heard the proposition that on a global scale we're experiencing more demand for many goods than there is supply. Rapidly expanding middle classes in China, India and emerging economies around the world are resulting in significantly higher demand for energy, food, commodities, materials, etc. And whenever there are secular changes between supply and demand the inevitable side effects are dislocations – both positive and negative. That's what I think our markets are going through now—the fear of uncertainty being priced into the markets.

Q: Market downturns and the increasing volatility that typically accompanies them serve to fuel emotion-based (i.e., ill-advised or irrational) investment decisions. Any thoughts on this to share with our advisors and investors?

DN: The challenge is to keep one's head while everyone else is losing theirs. Our frenzied media coverage spawns emotion which leads to the irrationality of fear and greed. This is a natural part of the process and frankly, creates the very opportunities we'll take advantage of through the next bull trend. The antidote to emotion is a solid game plan: a systematic approach to investing and the discipline to see it through.

The last bear market ended in 2003 so the current downturn isn't unexpected. Actually, the abundant fear and loathing we're seeing now are signs of a maturing bear trend. It's interesting to note that currently several of our metrics (measurements of market conditions) are roughly equivalent to July 2002, the internal low of the last bear market.

Q: When investors see shrinking balances in their portfolios, they often question or challenge the process used to manage their money. How is the game plan working?

DN: In our present circumstances, I think it's vitally important to make a strong comment on our process—to shift our readers' focus onto what we're doing within Niemann, and why: Specifically our job is to shield clients' portfolios as best we can during times like these. Our process doesn't vary, because we've proven, time and time again, that it works—if you stick with us through an entire market cycle.

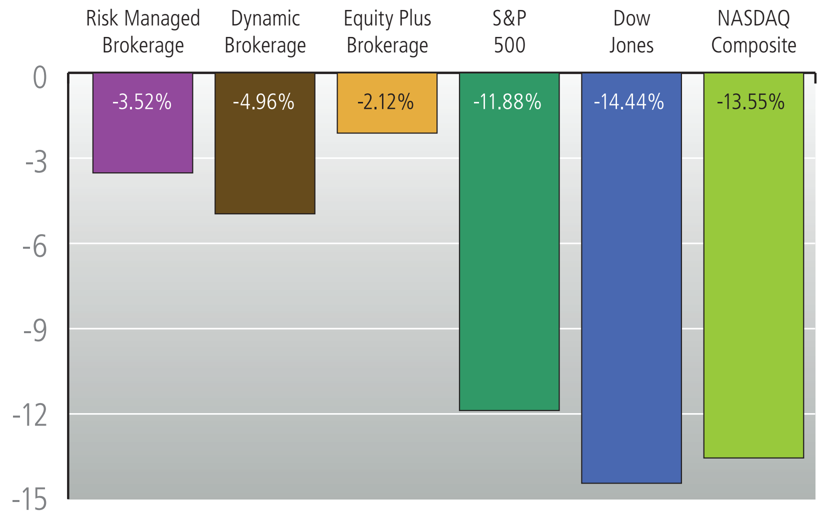
As I've always said, our primary objective during a downturn is to keep losses recoverable. So, when things get bad, we try to "get smaller," by limiting our investors' exposure to the market. To accomplish that we can A) become increasingly defensive—by moving more heavily to cash; B) hedge the portfolio by employing short positions—which move in the opposite direction to the market; or C) rotate into positions that are less volatile or are working best within the current market.

But whatever response we employ to current market conditions, we strive to keep clients involved, keep them from hitting the panic button, and keep them invested. Because no matter how bad it gets, there will be a point in the future when the market turns around and begins its next bull run.

Here's the key: The experienced investor stays in the market, to be positioned for the recovery, when it comes.

Niemann Core Strategies vs. Indices

December 31, 2007 – June 30, 2008



The above chart shows our core strategies vs. the indices year to date through the end of the second quarter. While the indices approach -15%, our methodology has kept losses to a minimum, even in our most aggressive strategy. This ability to preserve capital and keep losses recoverable is essential in a bear market. When the inevitable recovery begins, investors assets need to be intact in order to take advantage of that opportunity.

Source: www.fasttrack.net. This information has been obtained from sources we believe to be reliable, but its accuracy and completeness are not guaranteed. Results are net of actual advisory fee and assumes all dividends and capital gains are reinvested.

Q: Do you see any bright spots in the current market?

DN: In addition to the natural resources, commodities, energy and materials sectors we've been invested in for awhile, there are some rays of light in technology, medical/health services and biotech.

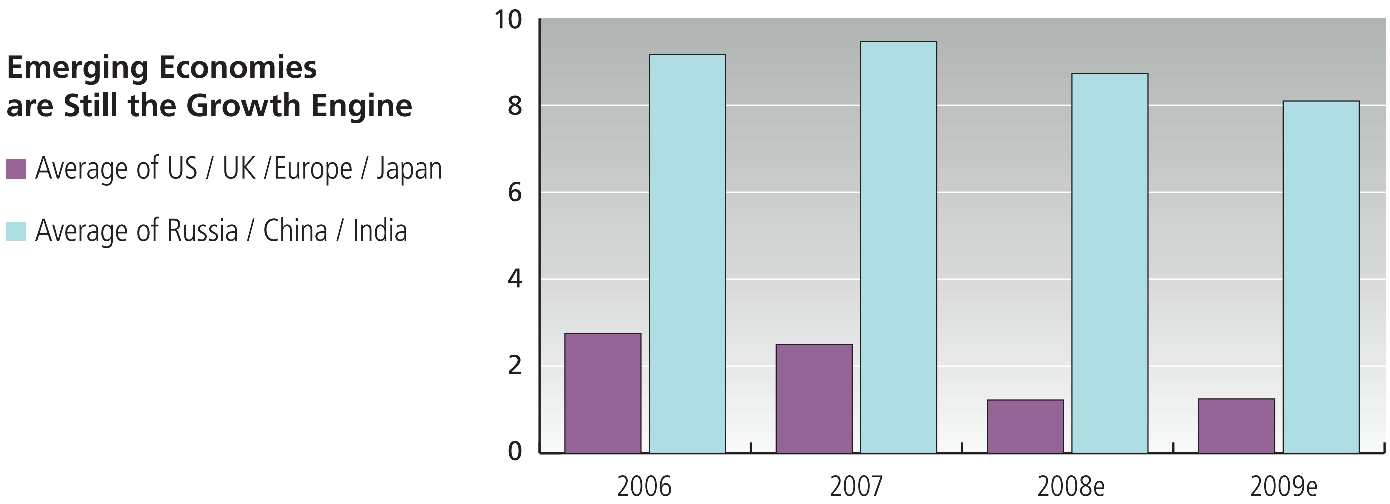
The goal of our process is to find those pockets of strength, to uncover those little gems in the market that will add value to client accounts. But it's still a bit early for the leadership of the next cycle to emerge.

Another area we've been in for awhile is Latin America, with a concentration in Brazil. Brazil is an interesting contrast to the United States. Brazil's willingness to develop their natural resources over the past few years has in turn led to vast new discoveries of oil and natural gas. Having made the commitment to alternative energy some time ago, they are now practically self-sufficient in automotive fuel. Brazil was just upgraded to "investment grade" which will drive international investment for years to come. All this from a socialist country that defaulted on its sovereign debt 20 years ago.

While the fundamentals are very positive for investing in Brazil, like most markets around the world a pullback has been underway following the last bull run. Like the major U.S. indices, Brazil is back to its March levels.

Bottom line, growth continues in China, India, Brazil and the emerging markets albeit at a more measured pace—but the existence of growth in and of itself doesn't mean everybody's a winner.

Emerging Economies are Still the Growth Engine



Source: International Monetary Fund, World Economic Outlook Update, January 2008. This information has been obtained from sources we believe to be reliable, but its accuracy and completeness are not guaranteed.

Q: How is the current political situation, i.e. how is the presidential race affecting the market?

DN: We don't view elections in terms of the people running for office—Democrat, Republican or whatever. Rather it's the policies they represent, and the potential market impact of those policies that is critical. With the election still months away, the markets continue to handicap what those policies might be. Candidates are known to adjust their pitch to be more in tune with the choir, so an abundance of uncertainty remains. *(cont.)*

The market doesn't like uncertainty. In and of itself, uncertainty breeds negativity and we're seeing that priced into the market now. Considering the tightness of the race and the divergence of policy, we're likely to see swings both up and down as the election nears.

Q: Any specific thoughts on oil?

DN: Oil—and commodities in general—had a very sharp move upward. As we entered 2008, oil was just under $90/barrel, hit $145 and dropped below $135 in mid-July. Typically, such big upswings are followed by sharp corrections—and significant volatility prior to establishing a new price level. We may be in the midst of just such a correction now.

The other observation I would share with everyone about a significantly higher price for oil is that it will likely foster—perhaps even galvanize—innovation. More expensive oil elevates the threshold of what constitutes "economical" alternative solutions.

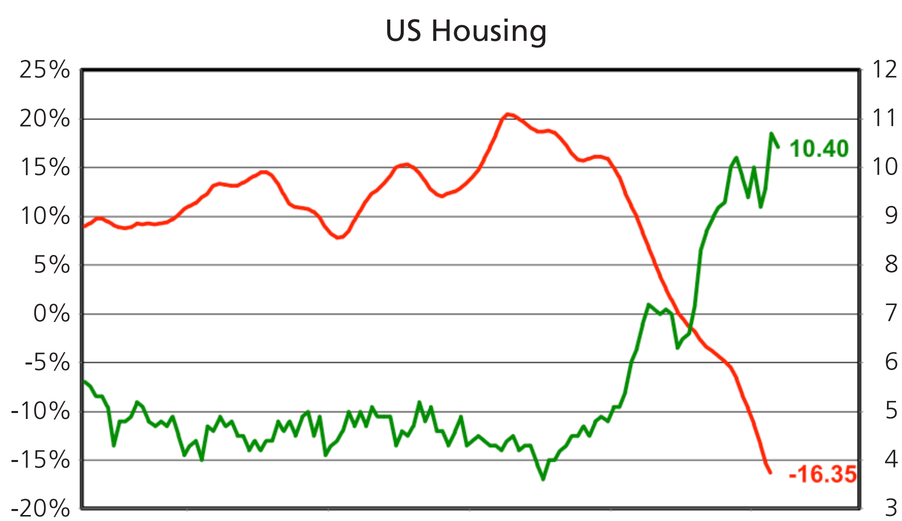
High prices and the pain they cause are "setting the table" for a very positive change. Citizens are recognizing that importing 70% of our oil is a significant problem. The typical response of American ingenuity is, "Oil is a problem. Let's fix it." In the long run that could be a very good thing and spur the growth of new industries. If the country mobilizes along those lines, that could create a bull market, in and of itself.

Q: Any new thoughts on the mortgage crisis since last we spoke with you?

DN: We talked earlier about a global shift in supply and demand, and that's clearly at work within the U.S. real estate market, independent of the cause. The supply of available houses is still growing and at present, demand is reduced. Eventually sales will pick up as prices decrease. But until we begin to see the supply getting smaller, there's really no way that prices are going to start going up.

US Housing: The Long Road Back

- Change in home prices, year over year (left axis) 4/30/08
- Months supply of home on the market (right axis) 5/30/08



Source: Factset. This information has been obtained from sources we believe to be reliable, but its accuracy and completeness are not guaranteed.

Q: As you look ahead, are you pessimistic or optimistic?

DN: Probably one of the most optimistic things one can say about where we are now is that people are really pessimistic (laughs). Toward the end of a bear market, everyone comes to understand and believe the mess they're in. The media fuels a vicious cycle of negativity, which flushes out the market and creates new buying opportunities.

So we can postulate that the more pessimistic the mood becomes, in reality, the closer we are to the start of the next bull run—and that always makes me optimistic.

Our goal is to remove the emotion from investing. For those of us who have been around for a few decades, we've learned through hard experience that the market really does move in cycles. The tides flow in and out; the market cycles up and down. As it does, the world is going to be full of opportunities. It always is. We just never know exactly when those opportunities will reveal themselves.

Here's what I do know: Every day, we're getting closer to the next upswing. And as I said earlier, there's nothing like the first part of a bull market—if you stay invested to take full advantage of the opportunity.

So hang in there, it's coming.

Dow Jones Industrial Average: *The Dow Jones Industrial Average is an index of 30 "blue-chip" U.S. stocks. At 100-plus years, it is the oldest continuing U.S. market index and the best-known market indicator in the world. It is called an "average" because it originally was computed by adding up stock prices and dividing by the number of stocks.*

NASDAQ Composite: *The Nasdaq Composite Index is a market capitalization price only index that tracks the performance of domestic common stocks traded on the regular Nasdaq market as well as foreign common stocks and ADRs traded on the National Market System.*

S&P 500 Index fund: *The S&P 500 Index Fund is a mutual fund that keeps a portfolio of 500 stocks designed to match the S&P 500.*

All other funds shown are provided courtesy of Lipper Analytical Services and Niemann Analytics, Inc.