NIEMANN CAPITAL MANAGEMENT
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Portfolio Manager Commentary:
Second Quarter 2009

THE CONTINUING WISDOM OF A MEASURED APPROACH

The second quarter of 2009 started strongly—hinged on hopes of an economic rebound—with the extension of the March rally fueling investor optimism. Upward momentum built through the beginning of June, galvanized by the anticipation of a positive impact on the markets from Washington's economic stimulus package and spearheaded by gains in commodities, basic materials and gold. Those investors brave enough to begin the process of recouping their losses welcomed the buoying effect of the upturn (while everyone's secret hope was that the worst was over).

But by early June the market began to cool and has essentially slid sideways through quarter end. Mixed economic data indicated that the recovery isn't occurring as quickly or smoothly as anticipated. However, this interim dip is typical of a bottoming process, where prices have been deeply discounted in anticipation of a worst-case scenario. The initial rebound we experienced of roughly 40% on the S&P 500 stimulated investor confidence, despite the fact that outright optimism may have been somewhat premature.

The economy has continued to intimate damage—decreased consumer demand along with a glut of supply has forced many companies to attack their bottom line, working hard to trim expenses (often including staff, as the unemployment figures illustrate) in an effort to become leaner, more efficient and ultimately, more productive. This makes sense as focusing on expenses affords companies direct influence on their bottom line. And, it's exactly these steps which lay the foundation for significantly enhancing long-term profitability and earnings growth. An example of this can be seen in technology's recent strength: Technology is a productivity tool. Thus, it stands to reason that companies will invest in technology as a key facet of their cost cutting to achieve greater efficiencies.

But investors and advisors alike are also looking for top-line improvement as well, in the form of increased sales and greater demand. Unfortunately, that facet of returning financial health has yet to appear. Subsequent to the run up at the start of the quarter, the leadership we saw emerging initially has failed to maintain its momentum and the metrics we track are currently not as healthy. It appears that the market has lost steam.

After four straight weeks of market decline, the current period of softening generates several logical questions in the minds of both advisors and investors:

- Is this just a temporary stall?
- Will we test market lows once again?
- Will the market regain its previous upward momentum and once regained, move steadily upward toward a recapturing of previous milestones?

No one knows, and from our perspective it's pointless to prognosticate. With that being said, we can draw similar parallels to the bear to bull transition of 2002 to 2003. During that period, the market retested its lows two times. The low was established in July of 2002—we retested it in October of that same year and again in March of 2003. Following each low the market rallied sharply, stalled, then churned sideways before finally taking off for good in the summer of 2003 as shown in the chart below.

Bear to Bull Transition
October 2001 – September 2003

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

In the chart above, we can see that the last bear market actually tested the low two times. Also note that the rallies occurred with a falling 200 day average and a falling to flat 50 day moving average. The bull market got underway well before these averages moved up.

Applying this bit of history to the present demonstrates why investors are on tender hooks: Following this current period of adjustment and the lack of a discernable trend, one cannot be sure in which direction the market will go from here. Careful analysis of key metrics and time will indicate if the recent softening is a temporary stall, whether we retest previously established lows (which would be normal, albeit painful), or if the market will again begin its upward ascent.

The Current Bear Market
April 2008 – June 2009

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

In the chart above, it appears that the low of the current bear market was set in March, although only time will tell. But if history is any guide (and it usually is), one would expect a retest of the March lows, and the next bull market will be underway before most investors take note. We do not know how painful the correction or "retest" will be, thus we will perform our analysis every day and continue to manage risk accordingly.

Given the uncertainty that remains and the deterioration seen in overall leadership and market health, we've increased our defensive posture. Our daily, bottom up analysis has uncovered relative strength in consumer staples, utilities and health care as of late—in other words, those areas of the market considered defensive (and that tend to perform better during stagnant conditions). We believe this is the appropriate response based on prevailing conditions, our market analytics and review of market history. It's also important to note that earnings season is just underway at the time of this writing. The market will be scrutinizing the forward view (more than current earnings) for signs that companies anticipate business may be picking up—and if so, where.

So in response to the current conditions and the three questions posed above, investors have three alternatives available to choose from (Remember the Cycle of Market Emotions?):

- **OPTIMISM**— Investors who have suffered through the worst downturn since the 1930s are loathe to consider that the pain may continue. They are anxious to recoup their losses. They've swallowed enough negative emotion to last a lifetime. Perhaps as a function of hope or courage, those who have moved substantially back into the market appear to be engaging in a variation of the power of positive thinking: they're trying to will the market higher.

- **PESSIMISM**—Having been badly burned, these investors are loathe to leave the sidelines, even though some of them may be engaged enough to realize that their only option for regaining previous losses is to re-enter the market. They just can't overcome the power of their negative emotions sufficiently to place their hand back on the stove. And that's why the sidelines are still loaded with uncommitted cash.

- **THE NIEMANN APPROACH**—We continue to believe in and recommend the unemotional, fact-based methodology that has historically worked to the advantage of our investors. We will continue to perform the unglamorous, day-to-day, quantitative hard work of assessing the market: Both from the bottom up and the top down. We will respond appropriately to the movements of the market based on our proven analytics.

In closing, it's important to stress that the Niemann methodology was designed to manage risk based on current market conditions, not unknown future events. Our investment philosophy is one of uncovering potential for "risk adjusted return." Our process was engineered specifically to eliminate the emotion from our decision making—so that we move in direct response to the behavior of the market—based on the facts. The downside of a responsive methodology is the possibility that the market rebounds after a shift to a more defensive posture (sound familiar?) or trends downward after a rotation out of cash back in to equities.

We've often said, "Give us the time and we'll prove the process." By teaming up to resist the seductive (and erroneous) influence of emotion-based investment decisions, our investors and their advisors buy us the time we need to demonstrate the long-term effect of staying engaged in the market.

Looking forward, the market will do what it does. We will continue to perform our proprietary analysis, every day—and respond accordingly. And, over the long term, the numbers will speak for themselves.

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