The Shortest Distance Between A and B

Based on the market decline of the last few months—not to mention the very difficult road of the past two years—a growing percentage of investors have had more than enough. The pain and frustration of continuing to fight the market for little or no return, in combination with the cost of paying advisors and underperforming managers, has simply become too much. Some investors are once again ready to capitulate, some want to flee to bonds, and many are thinking, "I just don't want to be in the market anymore."

We understand. Everyone at Niemann shares your frustration, as literally all of us are invested in Niemann strategies, just like all of you. And the truth is, we're in a segment of the market cycle where our performance returns are lackluster. But we think it's important to understand why.

So in this edition of our Portfolio Manager Commentary for Q2 2010, let's address the key issues head on, by considering: A) why we're all in equities in the first place, B) why we also need risk management and C) the limitations of <u>any</u> systematic approach to the equity markets.

WHY EQUITIES—WHAT ARE YOUR OPTIONS FOR BUILDING WEALTH?

Retirement plans ultimately are pretty simple: Once you determine how big your portfolio needs to be for you to enjoy a comfortable retirement—and not outlive your money—the gist of any good plan is the "roadmap" built to get you from Point A (your starting point) to Point B (the dollar figure at a certain age) that enables you to smoothly transition out of your career and into retirement, free of any financial worries along the way.

But what's the best way to get there? Historically, (and currently) real estate as a means to build wealth is fraught with problems. Starting and building a successful business that can be sold to fund retirement is a viable option for only a very few true entrepreneurs. And the third option is investing in the equity markets. Based on historical data, equities are perhaps the most effective method of investing and for achieving a yield sufficient to fund retirement.* Equities do require adequate diversification, but they're still the best option for the vast majority of investors.

Investing over the long term requires compensating for the pernicious affects of inflation—yet another advantage to employing equities and also why simply focusing on cash and/or bonds won't provide the growth necessary to build your portfolio.

And from that perspective, the reality is that for almost all of us, we need <u>continuous exposure</u> to the equity markets to afford ourselves the opportunity to generate that retirement nest egg.

However, history has also shown that to effectively invest in the equity markets, it requires that you must also effectively manage risk.

MANAGING RISK

While the equity markets may indeed be necessary, they too present certain inescapable challenges. The equity markets are A) volatile, B) uncertain and C) subject to the effects of many outside forces (i.e., morphing governmental policies like the passage of new healthcare legislation, natural disasters like historically huge oil spills and unforeseen events like 9/11).

To negate the effects of the challenges inherent in the market, the successful investor has a plan to manage these risks. Just as you would not jump out of a plane without a parachute, investing in the equity markets requires a means of protecting yourself in negative market environments. That’s the function of risk management.

Our systematic approach to the equity markets (i.e., our analytical process) has been designed to do just that. Our methodology is also a function of our philosophy—to avoid catastrophic loss of principal. That’s why we always strive to take the least possible risk in any given market environment—while seeking the greatest potential return for the risk we take.

THE TRUE NATURE OF A SYSTEMATIC APPROACH

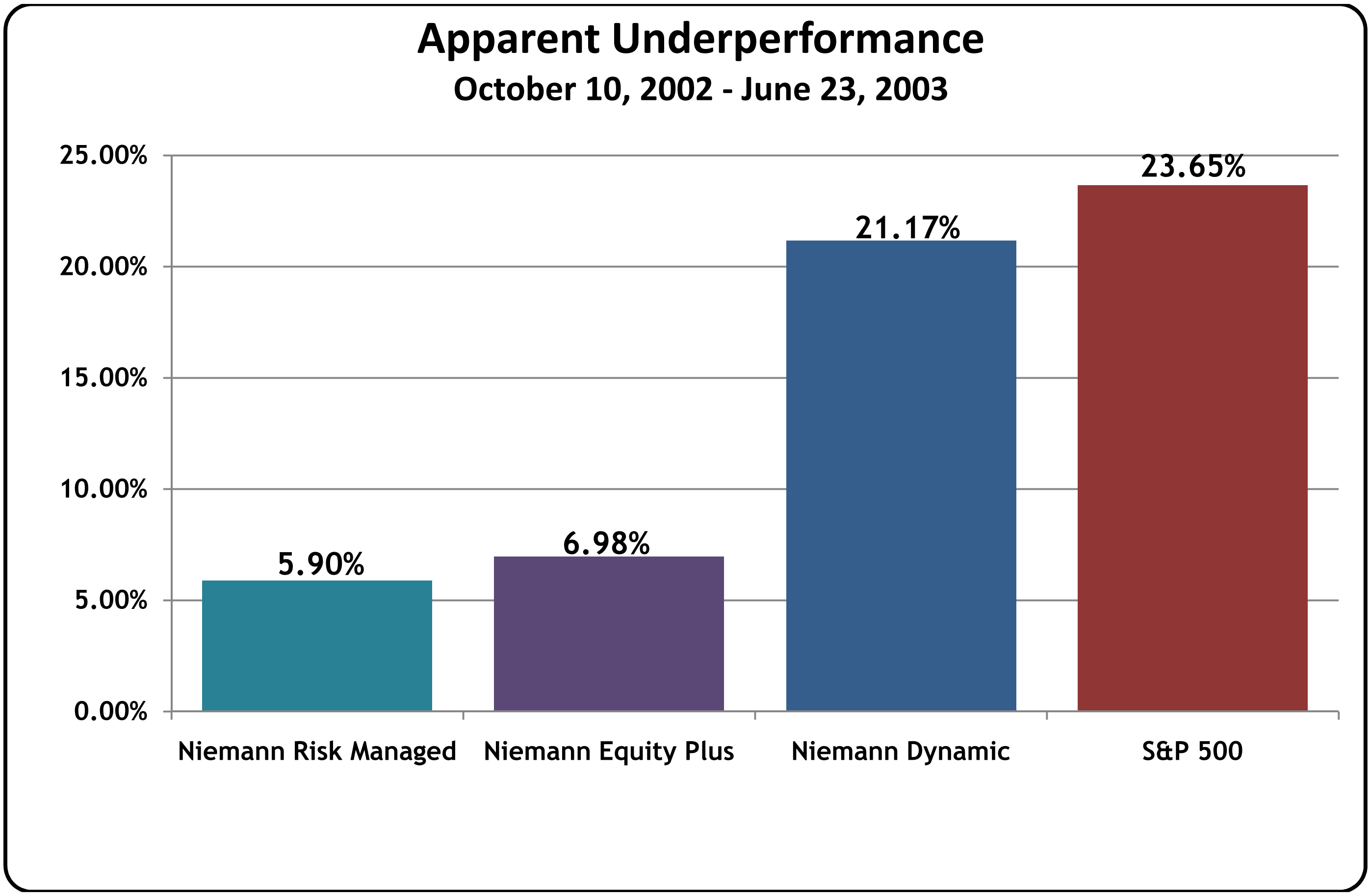
While we pride ourselves on our ability to manage risk, no process is infallible and all “systematic approaches” to the market’s ups and downs are a series of compromises. To achieve the stated objective, sacrifices must be made along the way.

The essential key to successful investing is discipline—doing the daily work and sticking to the methodology, even during the times it isn’t working perfectly. This is what drives Niemann’s long-term performance. Nearly two decades of our history has convinced us that we would be remiss to change our approach based on the current market environment, even if we are underperforming at a particular point in time.

In short, all methodologies have drawbacks and underperform under certain market conditions. In challenging markets like these, our process has uncovered much risk, with little potential reward. And as a result of managing risk to the best of our ability, there is a lack of reward across many of our strategies at this time.

This phenomenon is not unique to Niemann: In the current market environment, there’s a lack of reward everywhere. As stated, every investment strategy gives something up to achieve its objective. But the inescapable advantage of any such approach is that it forms a “roadmap” (which achieves the prerequisite of investment success). It enables the investor to stay in the market and stay the course within his or her long-term plan, and not fall victim to an emotional decision, based on a short-term view of the market.

Let’s take a look at a similar point in our history where we lagged the market over the short term.



No strategy works perfectly in all market environments. There have been other times in the past where our clients have been uncomfortable and have questioned performance. Yet, it’s the uncomfortable times (as shown above) that have actually laid the foundation for the next opportunity.

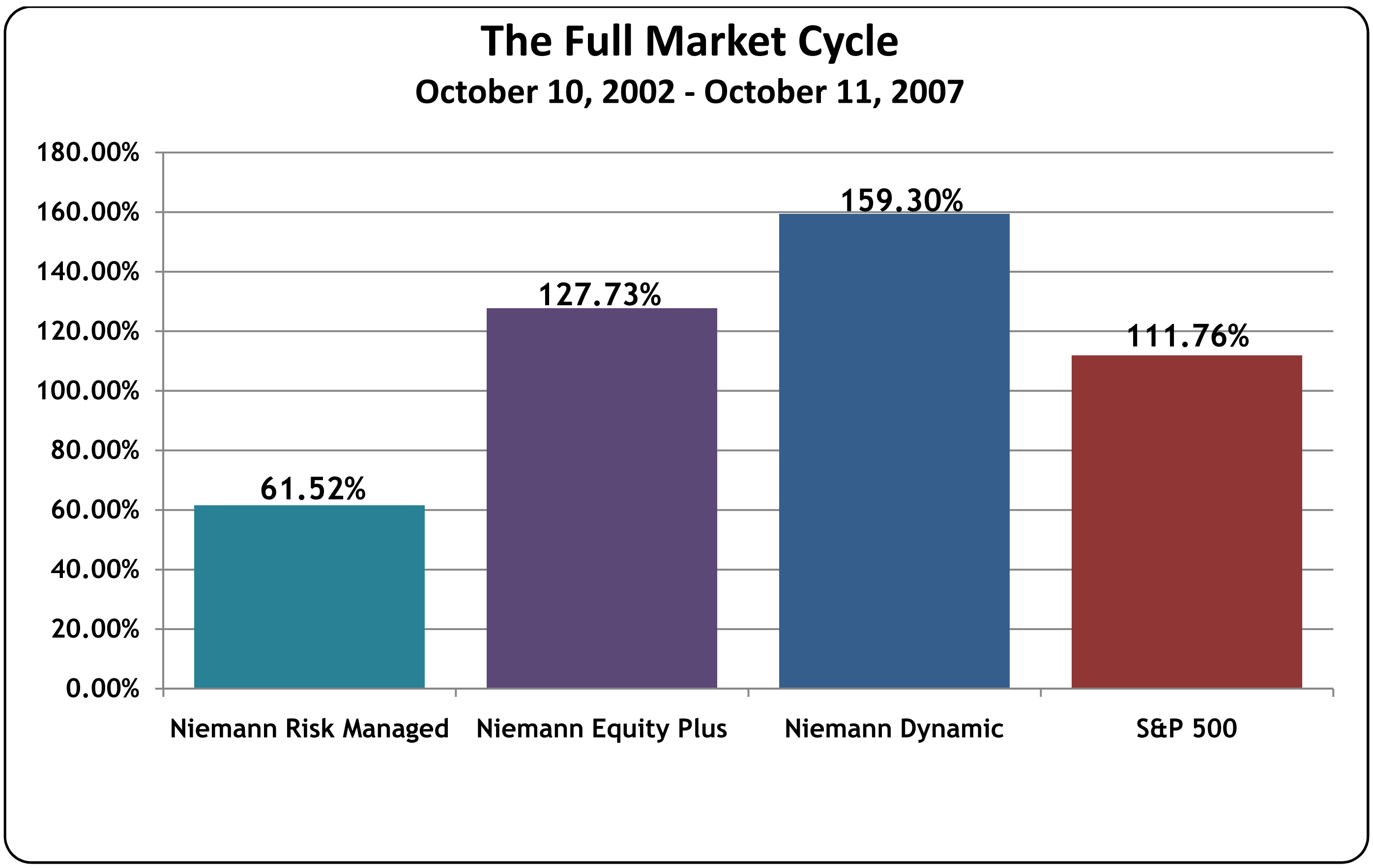
Consider this analogy of your “journey” to successful retirement: The equity market is essentially a freeway. Along with most other drivers, you merge on, taking the most expeditious route to reach your destination (i.e., a fully funded retirement portfolio). On your journey from point A to point B, there are various obstacles you may face: traffic, a flat tire, an accident.

And whenever these challenges arise, you’re faced with a choice of how best to respond. Do you muster the patience to endure the slowdown (i.e., stick to your investment plan) until the traffic clears and you resume full speed toward your goal? Or, do you abandon the freeway and “wait it out” until you feel as though it’s safe to resume your journey (i.e., exit the market, thereby abandoning your investment plan)?

But before you make your decision, remember these facts: A) Eventually, the traffic jam will pass and you will once again be on a clear path to your investment goal. B) If you surrender to your impatience and exit, there's no way to know when to get back on the freeway. C) The traffic flow will resume, but you won't be there to move forward with it. Sitting on a side street, you won't make any forward progress.

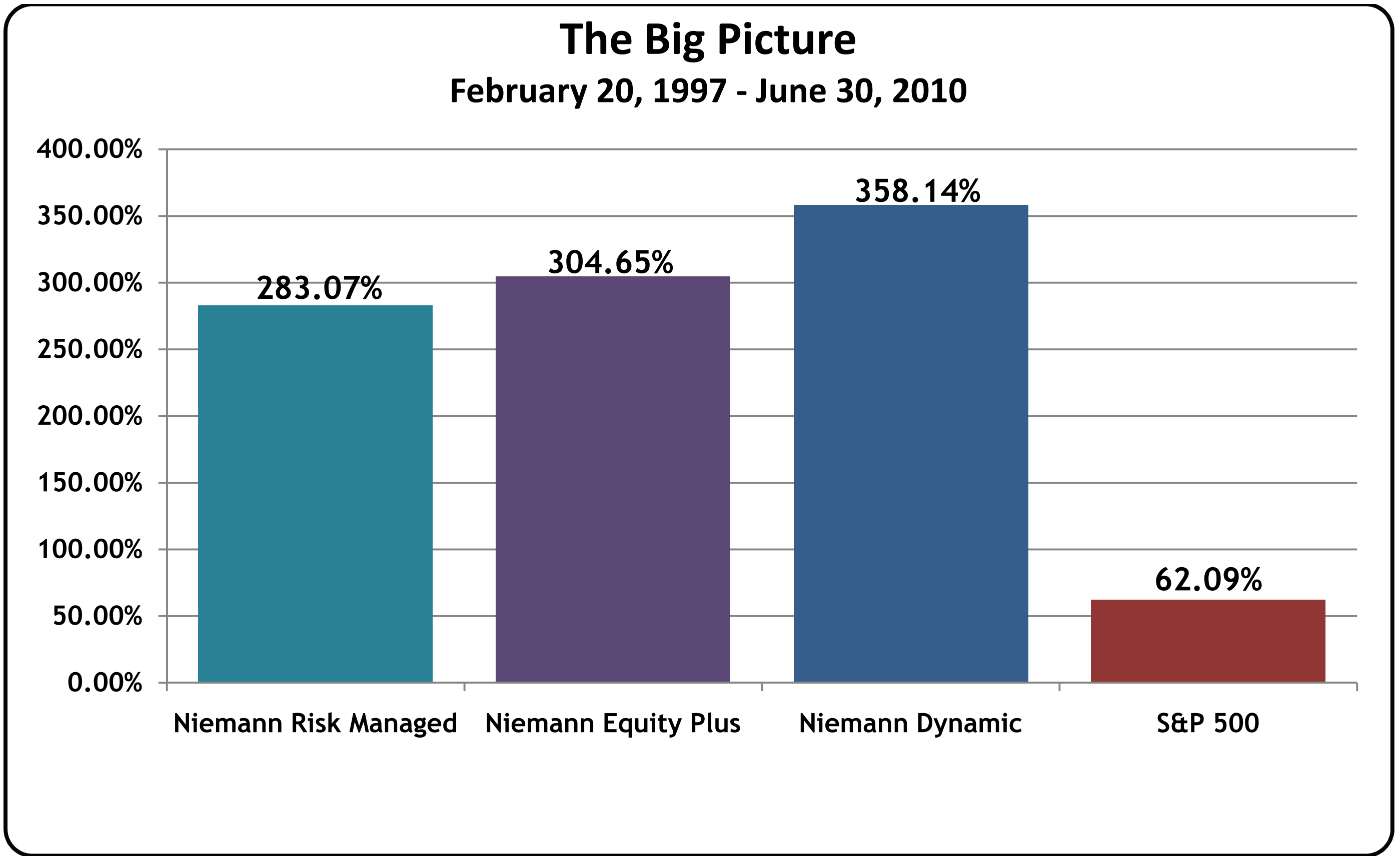
As most of us have learned the hard way, even though it's frustrating, if not maddening to endure the temporary delay, staying put ultimately results in reaching your destination as expeditiously and directly as possible.

Had investors chosen to abandon the market at the point shown in the chart above, they would have failed to take advantage of the eventual outcome of this particular market cycle, as shown in the next chart.



Investors were handsomely rewarded if they had the emotional intelligence to stay the course and let our methodology do its job. If our clients give us the time to let our process play out, they gain the opportunity to benefit over a full market cycle.

As we've always maintained, investing is a long-term proposition. Obviously, the longer an investor stays on plan, the more opportunities the market presents for investment success.



We believe our long-term track record speaks for itself. But for a client to achieve numbers like those shown above, they had to remain invested over the long term.

A FEW CLOSING THOUGHTS

We understand where investors are emotionally, based on the market's current behavior. We also recognize that everyone's feeling the pain of "staying the course" in this market environment. But as we've shown above, the sacrifices made along the way actually lay the groundwork for taking full advantage of the next opportunity, when it comes along. In fact, it is likely that we are much closer to the Point of Maximum Financial Opportunity than the Point of Maximum Financial Risk.

We fully believe that for all of us who work for a living, the equity markets are still the best method for building a portfolio that will afford each of us a comfortable retirement. But to achieve your investment objectives via equities also requires a systematic approach to managing risk in all market environments. And, an inescapable facet of that approach is maintaining the discipline necessary to avoid exiting the freeway (read: abandoning the market or violating your plan) before reaching your destination.

Stay on the freeway.

*Source: 2010 Dalbar Quantitive Analysis of Investor Behavior Report

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