NIEMANN
CAPITAL MANAGEMENT

THIRD QUARTER 2004 - 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%

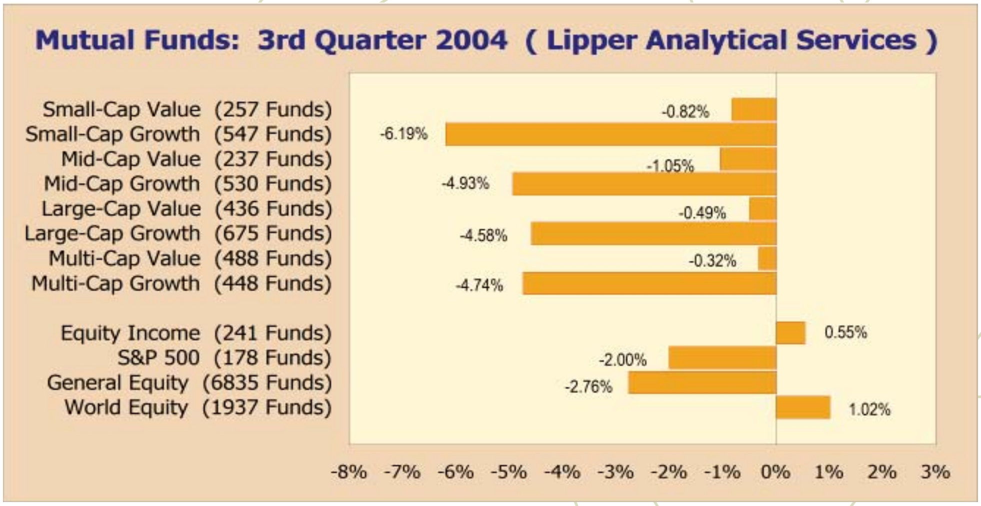
Advisor Location
Capitola, CA

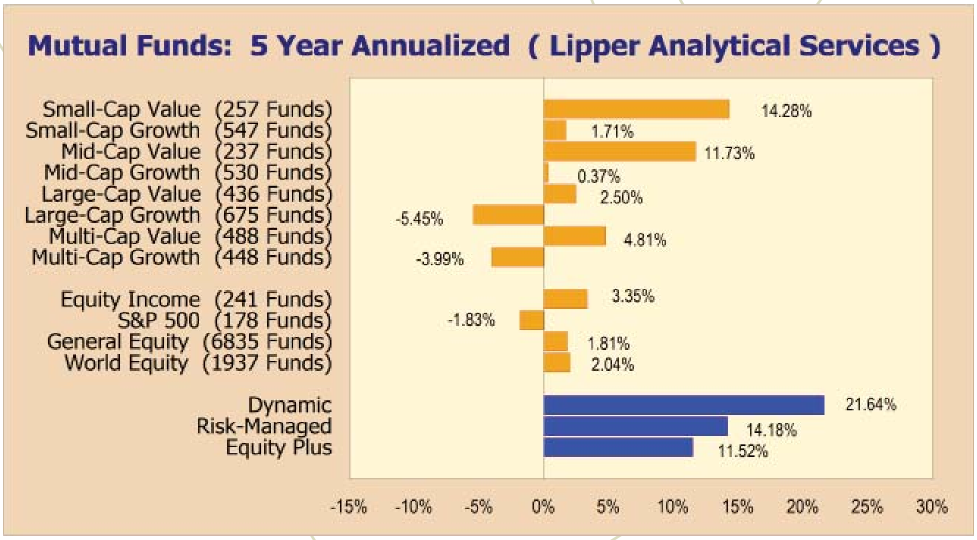
Number of Staff
18

Assets Under Management
$433 million

A rising tide of uncertainty took its toll on equity markets over the third quarter 2004. An extremely negative, hard fought election season buttressed by skyrocketing oil prices proved too much for US stocks, pushing most measures into the red for Q3. Lipper analyzed 6835 U.S. diversified equity funds last quarter and found them giving up 2.76% on average (see General Equity in the chart "Mutual Funds: 3rd Quarter 2004" nearby). Also evident in last quarter's performance snapshot is that the selling was focused in "growth stocks" with small-cap growth leading the decline, down 6.19%. The obstacle for growth managers continues to be technology. Lipper's Science and Technology group lost 10.97% over the period.

Niemann strategies remain largely invested with the small and mid cap value managers who continue to lead our market. These trends of value out-performing growth and small besting large are now 4½ years old. In the accompanying chart "Mutual Funds: 5 Year Annualized," one can see how truly dominant value managers have been through this decade! You might wonder when these trends will come to an end. But that would be the wrong question. The right question is, "How do you lay the groundwork to capitalize on change when it finally occurs?"





Active Vs. Passive

The character of the market is always changing. One year it's a raging bear (like 2002), and just after you've thrown in the towel a bull market gets underway. More often than not the market grinds away in sideways chop as it has for the past 9 months. Whatever the markets current phase, active managers like Niemann are best suited to capture the benefit of its changing fortunes. Niemann's five year annualized returns are a case in point. Contrast this active approach with that of a passive investor since 2000.

One of the most renowned advocates of passive investing is John Bogel (of Vanguard). You used to see him on CNBC every other week. His basic premise is that no one can out-perform the market over time. So naturally he promotes "buying the market" in the form of an index fund and holding it as the best chance for success. Passive investing is low cost, he says, adding to overall return. Millions of investors buy these arguments along with his Vanguard 500 Index, this country's largest mutual fund with $76 billion of investor assets. Plenty of professional investors agree since over $1.1 trillion dollars are indexed to the S&P 500.
Low cost or not, large-cap growth strategies like the S&P 500 have been dead money for the past 5 years. Consider the difference between the 14.28% annualized return achieved by active Small-Cap Value managers (on average) and a passive investment in an S&P 500 Index strategy according to Lipper. It's staggering. $1000 invested in the former is worth $1949 today, while an investor sticking with the S&P 500 Index has $913 of his money left. Niemann's Dynamic Growth delivered an impressive $2662 and that's net of fees!

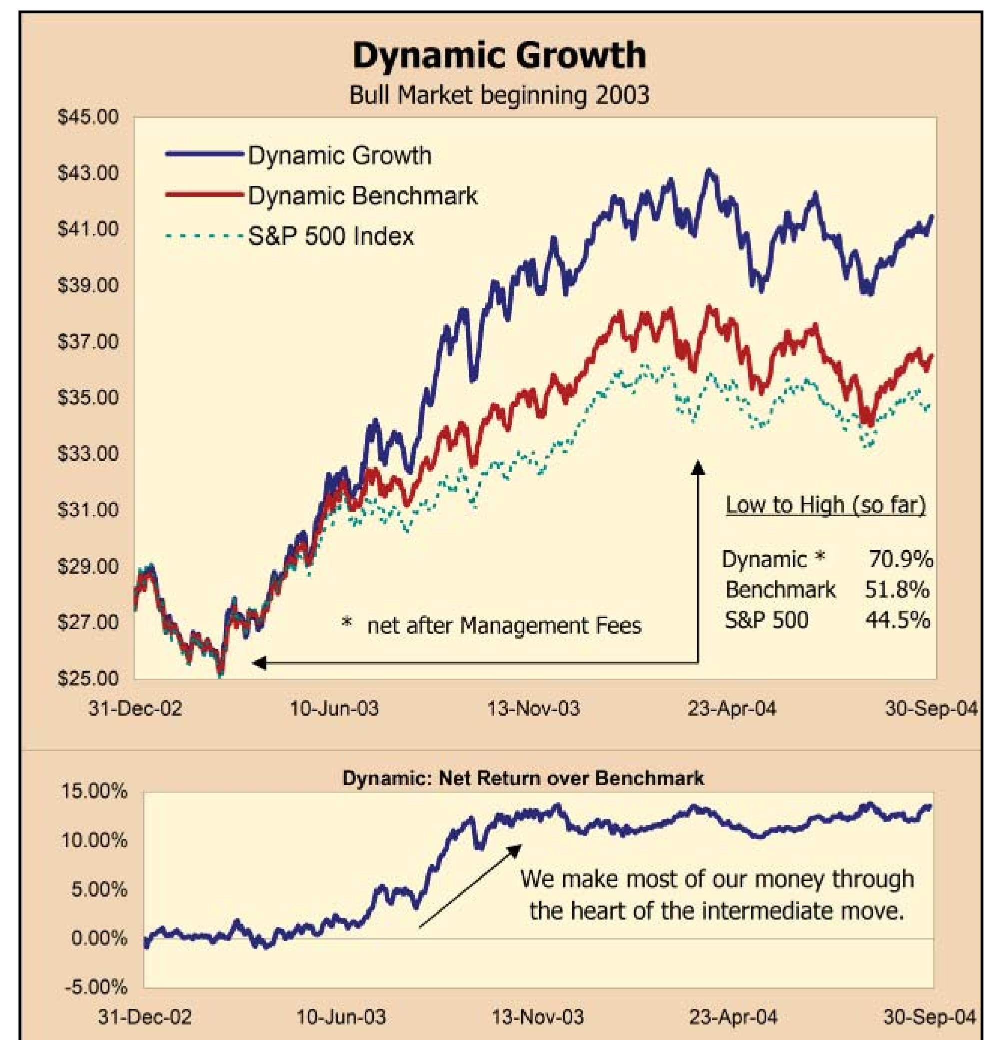
S&P 500 Index: The S&P 500 Index is a capitalization weighted, unmanaged group of 500 stocks as selected by the Standard & Poor's Publishing Company. They are usually the 500 largest companies in terms of market capitalization and are chosen to represent the entire market's value. The S&P 500 is used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

The true measure of success is net return as a function of the risk one takes. Active managers analyze this proposition (we do it every day) and adjust their portfolios accordingly. Large cap growth had a great five or six years in the mid to late 90's, just as the small value managers reigned supreme over the past five. Winners make money by finding and exploiting these trends. Winners keep money by not getting left holding the bag. The only guaranteed thing about a trend is that it will end. Passive investors who still hold their S&P 500 index investments from the last bull have little to show for their effort. The same will be said at some point about passive investors in small-cap value.

Quest for Growth

U.S. stock markets have been locked in a trading range all year and believe me everyone is getting restless. The pros haven't made money either. While we see our strategies performing as expected, after spending so many months in a range bound market some of our newer clients may be wondering why they're paying our fee. No worries, we don't take this personally. We know from our own experience how easy it is to imagine your Dynamic account growing at the 20% annualized clip it has over the past. But we also know how very hard it can be to live through the choppy markets that come with the program, not to mention bear trends! It's easy to lose comfort and become impatient when markets are in conflict and the press is negative.

Experience dictates that the best way for us to help you stay comfortable with our strategies is to deepen understanding of how they actually work. To this end, lets review our Dynamic strategy since the beginning of the current bull market in stocks. In the chart "Dynamic Growth: Trading Range Conflict," (located on the left) we set the unit value of Dynamic and its benchmark equal to the S&P 500 Index on Dec 31, 2003. The graph immediately below it measures the difference (or value added) between Dynamic and its benchmark after fees.



It's revealing how all three measures in the top chart are tracking each other so closely. Remember that Dynamic is invested with the same top-performing small and mid cap value managers that have driven its superior returns through much of the current bull. At the same time in the bottom chart you can see that we're not gaining much on our benchmark in 2004. After nine months of trading and four distinct 8% moves (each in an opposite direction), we're just about back to where we started the year. It may seem like nothing much has happened, but that is far from the truth. The fact is we work hardest during these corrective phases! And while it may be frustrating not seeing the returns building up in our accounts recently, this is typical of how Niemann strategies work. Lets look closer to see why.

As you know, the buy sides of our strategies are driven by bottom-up, quantitative analytics that emphasize risk-adjusted performance. Our idea is to focus managed accounts in those securities that offer the best potential return based on the risk we're willing to assume. Time horizon plays the key role. We anticipate owning a position for 9 to 15 months – the intermediate trend. Not only does this timeframe put us into position to acquire long-term capital gains, over the years our research has shown it continues to be the most profitable for our style of investing. What you may not realize is that organizing our methodology in this fashion predetermines how our strategies will work under different market conditions.

We expect our managed accounts to bounce around with the market during a bull correction phase, and that's just what they've done this year. Further, we expect our accounts to make the best gains against their benchmarks in the heart of an intermediate bull move. That is what we'll see next.

The Trend Is Our Friend

Now look at the big picture view in the chart sub-titled “Bull Market beginning 2003.” Here you see Dynamic getting traction once the intermediate trend is underway. Note how from the end of 2002 through May of ’03 Dynamic Growth was simply following the market up and down. During this bottoming phase, the overall market changed its character from bear to bull. As in most consolidation phases, “net return over benchmark” chopped up and down in a sideways fashion.

When the new bull broke out in June, 2003 net return over benchmark exploded. This is what we expected based on our methodology. All the effort poured into uncovering market leadership and building account positions during the consolidation phase payed off with a ten-month burst of out-performance. From the ’03 lows to the highs in ’04, Dynamic Growth surged 71% after fees compared to 52% for its benchmark and 45% for the S&P 500 Index.

You can see from these charts that your experience at Niemann would be vastly different if you joined Dynamic Growth in March of 2004, rather than March 2003: about 70% different. At the same time the strategy is working as well as it ever has. The point is while you have control over when you invest, you have none over how the market will treat you after your money goes to work. Unless your timing is impeccable, like those who did join Dynamic in March ’03, the most important element required from you to achieve your goal is the patience to allow your strategy to do its work. Understanding how your investment strategies should perform under different market conditions is key to cashing in on their success. Through this knowledge, the superior investor develops the patience and discipline to see strategies through to their successful completion.

End to Some Uncertainty

The re-election of President Bush resolves some of the open questions that have been weighing on U.S. markets: uncertainty over who would be elected, over whether a terror attack would be launched against us to influence the outcome, even whether we could get our election process to work as it should. Thankfully, the outcomes were good and our markets are responding. The president’s speech the day after his election renewed the markets anticipation of positive change. The next few years offer the best chance my generation will probably ever have to reform a tortured tax code and initiate real change in Social Security and Medicare. Success or failure in any of these areas will have a powerful impact on our financial markets. For the foreseeable future, it seems we will continue to live in interesting times!

Thank you for your 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.

To request Part 2 of Niemann’s current ADV Part II Section F and/or the Annual Full Disclosure Presentation, 2003 please contact Talia Wise @ 800-622-1626 or email her at talia@ncm.net.