NIEMANN CAPITAL MANAGEMENT
Don't just allocate. Rotate.®

Portfolio Manager Commentary:
Third Quarter 2010

THE NIEMANN APPROACH TO MONEY MANAGEMENT

When Don Niemann and Travis Silberman came together in 1991 to create Niemann Capital Management, they did so based on a shared vision and a similar philosophical approach to investing. As they developed the investment methodology we still use today, Don and Travis did so with certain objectives in mind. The thought process behind our daily process was and still is:

- First, keep losses recoverable: Avoid catastrophic loss of principal. Bear markets occur on average every 4-6 years. The average bear market loss is approximately 35%. Our goal is to avoid losses of this magnitude.
- Second, capitalize on opportunity when it presents itself. During a sustained uptrend, our goal is to capture a majority of the upside move.
- In combination, these two overarching principles provide us with the best opportunity to add value over a complete market cycle—as history shows we've accomplished.

We also committed ourselves to managing clients' expectations at the start of every relationship by describing the market conditions where our management style would be challenged (See Setting Expectations). There are three such environments:

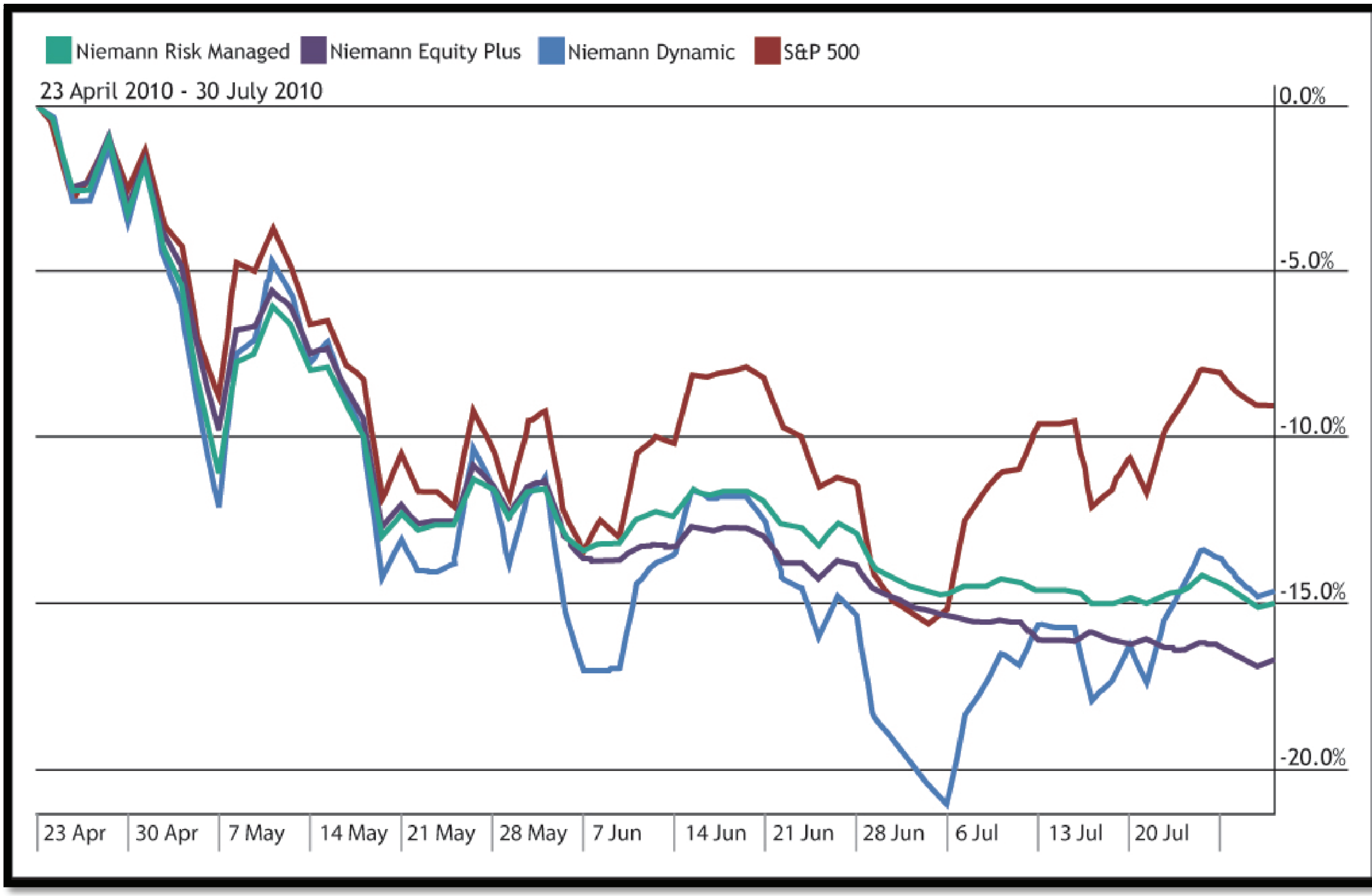
- First, when the market deteriorates and experiences a sustained downturn, our conservative and moderate strategies will grow increasingly defensive as conditions worsen. When the market quickly reverses its downtrend and surges upward (what is sometimes referred to as a "V-bottom") Risk Managed strategies and Equity Plus will lag the rebound initially as they rotate out of cash, toward leadership.
- Second, when a prolonged trend ends abruptly, our focus on leadership may hurt us. As a trend grows stronger we incrementally increase our exposure to it. The one thing you can count on with a trend is that it will end eventually and when it ends abruptly, often times the leaders suffer the worst losses. For that reason, we oftentimes fall with the market when a trend initially unravels, until we rotate to stronger options on a risk-adjusted basis.
- Third, as trend followers, when the market is devoid of any clear trend, our methodology will suffer. In other words, a market that grinds sideways, with extremely high levels of correlation will be challenging for us.

The third scenario is exactly what we've faced this summer—quick, short-lived ups and downs further complicated by unusually strong correlation among market sectors and styles. When we say "highly correlated," we mean that all major areas of the market move up and down together, in lockstep. With this type of movement, the value created through investment selection is diminished. When leadership rotates very swiftly, it's tough for us (or anyone) to capitalize on trends that deteriorate suddenly. In short, we were penalized by the market's quick up and down moves through the beginning of August. Recently, our strategies have gotten back into sync and added value as we fell less than the market overall in August and quickly jumped on September's advance.

Let's look at how this year's market environment has affected performance. We'll pay particular attention to July, as that's where the majority of the gap between Niemann's performance and the major indices occurred.

The Breakdown

April 23, 2010 through July 30, 2010



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As the chart above illustrates, in late April a significant breakdown started to occur. In May and June, market health deteriorated rapidly. As mentioned above, exceptionally high correlation among the various sectors of the market became increasingly apparent. In fact, we witnessed more 9 to 1 days than we've seen in literally decades, i.e., 90% of stocks trading up and down in tandem, which was extremely abnormal. During that 60-day window, the S&P 500 retreated over 16%. Clearly, the correction in May and June was the most severe we'd seen since the current rally began in March of 2009.

By late June, the market had plunged down through the lows set in early February, establishing new lows for the year. The number of stocks trading above their 50-day moving averages began to shrink substantially while the number of stocks making new lows increased dramatically. All of these data points indicated to us that the market was growing increasingly unhealthy and looked at the time to be fraught with both uncertainty and risk. By early July, the market looked poised to fall further. But, it didn't.

At that point, we were confronted with a market demonstrating serious signs of distress, in combination with a complete lack of leadership. For those reasons, we began to increase our cash positions in the Risk Managed and Equity Plus strategies because our objective is to keep losses recoverable. Through mid-June, Niemann's strategies were trailing the market by approximately 3% net of fees, in what could be considered one of the most challenging environments our conservative and moderate strategies have ever faced. But, as the selling pressure continued into early summer, around mid-June we started adding inverse funds in an effort to hedge off our long positions in Risk Managed. In Equity Plus, we looked for the best inverse or short options available in order to take advantage of areas of the market under stress. The first week in July, the market surged upward 5-7% and for the month, ended very strongly. The market's push upward forced us to cover our shorts and the performance gap between Niemann and the indices can largely be attributed to what occurred during that July spike.

Typical of this summer's range-bound market, August saw a reversal of July's good fortune. In two weeks the market fell 7% then turned upward once again, posting the best results for the month of September in 70 years. Niemann's strategies weathered August and September nicely with smaller losses than the market overall in August and a quick rotation toward strength in September, resulting a majority of the upside being captured.

As we've oftentimes discussed, one of the steps of our investment process is to look at market health each day by analyzing key technical indicators. The information we glean from the data we study daily drives the decisions of how much cash to carry or how much equity exposure to assume. This step in our process is important because it assists us in managing absolute losses versus relative ones, which is what risk management is all about.

Specifically, when Don and Travis developed our investment process, certain levels of loss within any given Niemann strategy were deemed acceptable—because they were recoverable. Beyond the point of "recoverability", our methodology was designed to signal a move to a more defensive posture. The ability to rotate to cash is a valuable mechanism we employ specifically to guard against catastrophic loss within our client portfolios. As a general rule of thumb, by the time the market declines by 10-12%, our conservative and moderate strategies will be approximately 50% cash.

Given the wide trading range we've seen since mid-May, and the repeated 10-12% fluctuations in the market, our recent performance is a real-life example of our aversion to suffering absolute losses within our client accounts. At certain points in time this summer, the market has fallen past our point of acceptability and we've been forced to become defensive on multiple occasions. Further exacerbating the problem, the market has advanced enough in particular instances to warrant increased exposure to the market, forcing us back in.

While the summer's fits and starts posed a challenge to most market participants, we are beginning to see some rays of light. The market has always prized certainty, and the ups and downs of 2010 amply illustrate that it equally dislikes long periods of uncertainty—whether the cause of doubt is economic or political. This year's market action has been heavily influenced by looming policy decisions and implications. One source of focus is the mid-term elections. November 2nd will provide a much-needed dose of certainty, irrespective of the outcome. In addition, the recent, abnormally high correlation levels among asset styles and classes have finally begun to subside. This will make it much easier for us to identify and rotate toward strengthening trends when and as they occur. And the market has finally broken through the upward limit of its recent trading range (See chart below). While no one knows where the market will go from here, the fact that we broke out above the range and have remained there is a positive sign.

S&P 500: The Last Six Months

April 1, 2010 through September 30, 2010

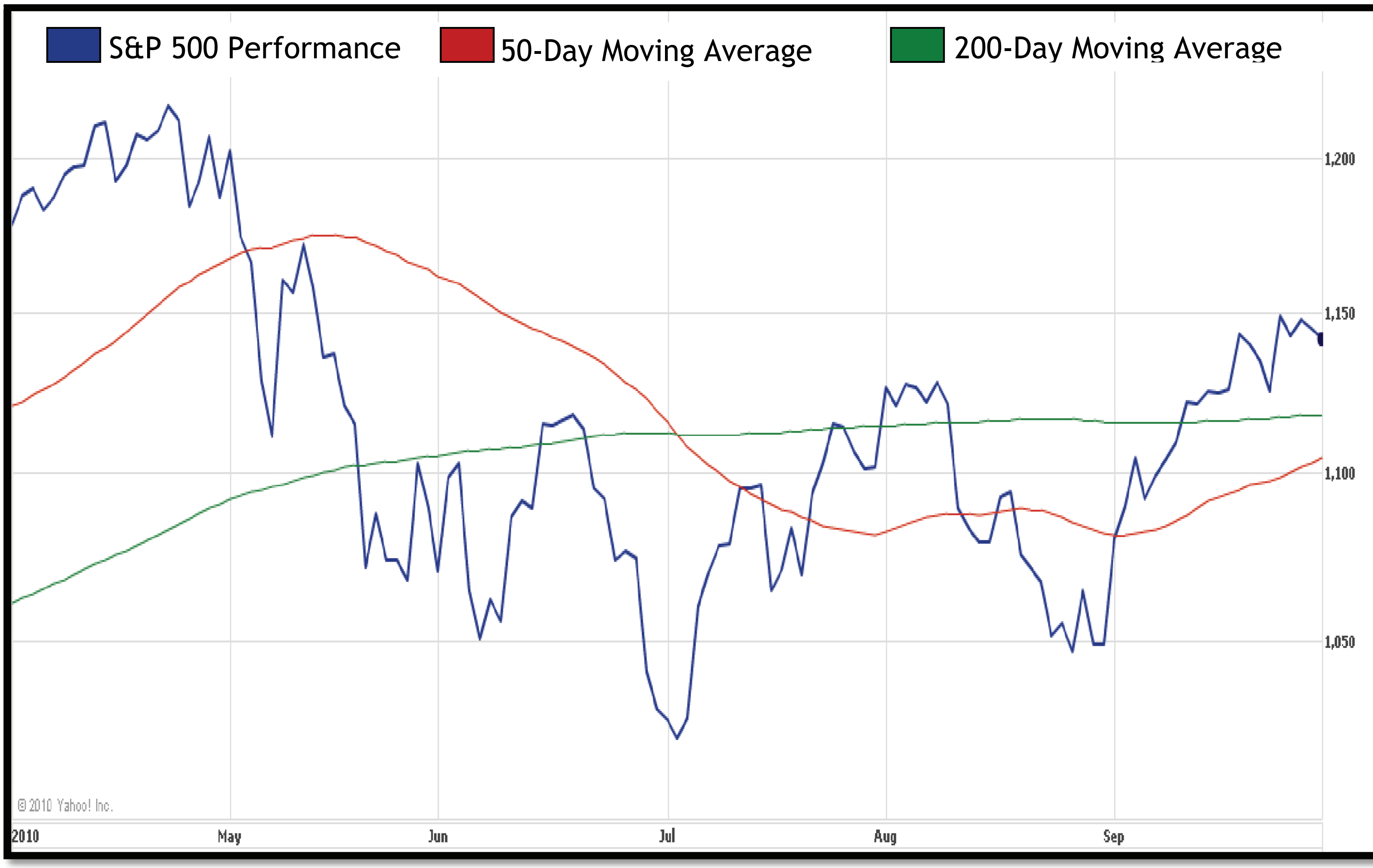

Chart Source: Yahoo Finance. This information was obtained from sources we believe to be reliable, but its accuracy and completeness are not guaranteed.

The chart above shows the S&P 500's performance from April through the end of September. Its 50-day moving average over this time period was 1106, while the 200-day moving average was slightly higher at 1118. In mid-September, the S&P 500 broke through these trading ranges, ending the quarter at 1141.

As we've often maintained, any systematic approach to investing is constructed with series of compromises in mind. In other words, no methodology can out-perform the market in all environments; it's just not possible. Niemann is no exception. It's also important to note that regardless of which approach to the market an advisor and investor choose, periodic losses are an inescapable part of the bargain. As we've proven though, underperformance over a complete market cycle doesn't have to be part of the same bargain. Remaining committed and disciplined are the keys to ultimate success.

Our method of responding to market volatility is an outgrowth of our philosophical commitment to avoid catastrophic loss. While 2010 has proven to be vexing, our analytics team is adhering to the same disciplines today that Don and Travis established when our firm started—managing risk and keeping losses recoverable to the best of our ability.

S&P 500 Index- Assumes reinvested dividends: 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.

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