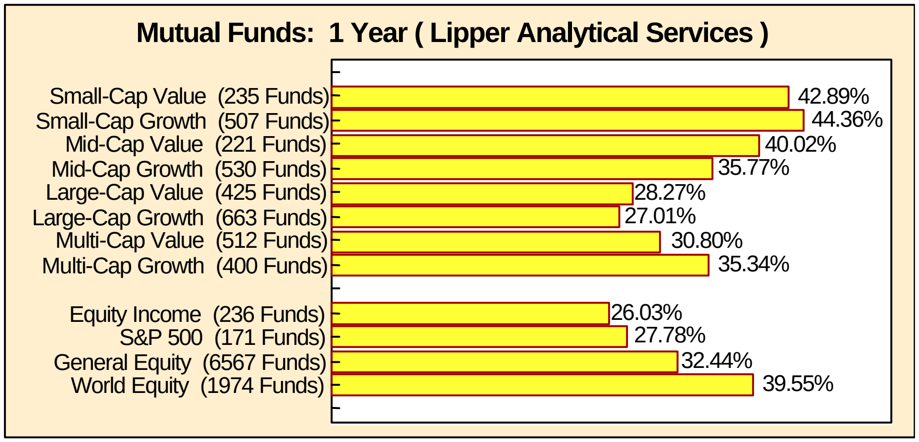
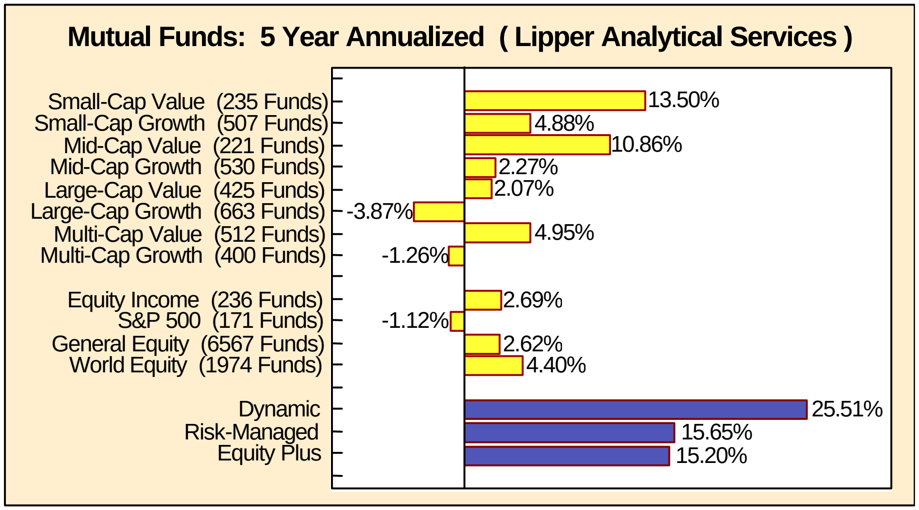
Niemann Capital Management, Inc.

Fourth Quarter 2003 Review

A Year to Remember

Stocks finished 2003 with a bang. The average equity fund advanced 12.03% over Q4 according to Lipper, bringing year over year gains to a healthy 32.44%. As seen in the chart "Mutual Funds: 1 Year" nearby, strong double-digit returns in virtually all categories of U.S equity funds are testament to the depth and breadth of a raging bull market in US shares. The solid Q4 finish comes as no surprise to anyone watching the flow of money. Despite ongoing scandals in the industry (more about this later), investors sunk $235 billion into stock funds in 2003 ($80 billion in Q4 alone!), an amount eclipsed only by the $307 billion wagered at the height of the bubble in 2000 (money flow estimates by Strategic Insight).





The good news wasn't limited to U.S. shares: European funds surged 37.58%, Japanese 37.84%, and Pacific Region 38.02%. Funds focused on Latin American soared 61.95%, and China 63.16%. Real Estate funds were up 36.75%, and Gold 58.33%. It wasn't just about stocks. Funds investing in Emerging Market debt enjoyed a 30.07% gain, while High Current Yield funds advanced 24.3% (all fund numbers according to Lipper Analytical Services). Mainstream investments weren't the only winners. Commodities ranging from copper and zinc to soybeans and crude had a very good 2003.

Why wax on about such good fortune? Well, we haven't had a lot of good news over recent years, but that's not the point. The unmistakable picture that should emerge in your mind when you take it all in is one of a broad, global bull market advance - a rising tide that truly is *lifting all boats*. Take full advantage of windows like these; they are fundamental to building and protecting wealth! The returns on this page are payment for time served in the trenches over the previous two years.

Full Circle

While Niemann accounts were sailing along pretty well anyway, the Q4 advance helped us ring the bell on one of our more important mileposts. Once again we have come "full circle": navigating boom to bust to boom again. It is our pleasure to announce that all Niemann managed account strategies have achieved all-time new highs, and that's net of everything, except taxes. We're particularly pleased with the 5-Year numbers of our mutual fund strategies (see: "Mutual Funds: 5-Year Annualized" nearby). Remember, 2½ years, or roughly half of this period was a crushing bear market, which is why the S&P 500 lost an annualized –1.12% over this timeframe. So net of everything numbers starting at 15%+/yr and ranging to 25%+/yr are stellar. Frankly, you all are going to be pretty happy with the returns inside this *review*. Enjoy them because the easy money - for this cycle - is most likely *behind us*.

Not trying to rain on the parade you understand, just staying focused on what got us here – or as my dad put it: "always dance with the girl that brung ya". Our dance partner happens to be *risk-management*, and sometimes she gets forgotten when the market starts to rock as it has in recent weeks. A friend and mentor drilled into me early in my career: "learn to love losses". He meant taking small losses is the key to big returns over the longer run. We must always be ready for a reversal of fortune, and never buy into the prevailing wisdom. That said, let's step back and try to see where we are in the scheme of things.

Reality Check

Stock prices correctly anticipated the explosive 3rd quarter GDP growth of 8.2% beginning with their spring rally in '03. Economists were way behind the curve. Is this a jobless recovery that will peter out later this year as some of them suggest? Based on solid Q4 market action extending into '04, my bet is we are still growing faster than expected *right now*. What if our economy has morphed to the point that the traditional measures economists use to forecast growth aren't working so well anymore? Take the employment survey for example. Many were surprised when payrolls grew by only 1,000 in the last report (consensus was +150k). The fact is these "headline numbers" focus on establishment jobs (jobs at big companies). There is another employment report called the "household survey" which suggests 2 million new jobs have been created since employment hit its nadir in 2002. Why the big difference? The household survey includes job growth at small companies as well as folks starting their own business, and that's where the action is.

> Corporate earnings drive stock prices, and earnings are created by economic growth. Markets have not priced in the potential of growing faster than is generally anticipated.

Consider the years 1990, '94, '98, and 2002. Each marked an important market bottom. Each was four years apart. Lets see, four years - election cycle. Coincidence? The third year of an election cycle is typically the best for the market. Remember what happened in the "third years" 1991, '95, '99, and 2003? Many of you don't go back far enough with our company to know we achieved all-time new high profits in each of those years. Another election tidbit: studying presidential races back to 1860, Chip Dickson (chief U.S. strategist for Lehman Brothers) found that in the fourth year of a new political party occupying the White House, stock returns average 13.1% versus 4.0% otherwise.

> The fourth year of the election cycle (as in this year) is the second best for the market. (And yes, we also made new high profits in the "fourth years" of 1992, '96, and 2000.)

Another trend we're thinking more about these days is small stocks versus large. Those of you actually reading these quarterly missives know we've been heavy in small caps since mid 2000. Catching this segue is the main reason Niemann accounts have far outperformed the broad market averages over the past few years. Now it's going on four strong years in the small-cap space, and these stocks are looking much more fully valued. We're expecting rotation to *something new* this year; indeed, it may have already started.

You'll notice more mid and large cap names dotting your accounts in recent weeks.

Finally, it's always instructive to keep an eye on the relative P/Es (price to earnings ratio) of markets. Looking at the world, Emerging Markets still seem like the place to be. Foreign developed markets (i.e. Western Europe) sport a P/E of about 24. This is not particularly cheap. The U.S. markets look to be about 21 times, not egregious, but not cheap either. Emerging markets look relatively better at about 15 times earnings (all according to Acadian Capital Management). Emerging markets were basically wiped out with the Asian currency crisis in 1998. You might remember Long Term Capital Management. This hedge fund, famously staffed by Nobel laureates, imploded so quickly Mr. Greenspan (Chair of the Fed) actually bailed them out lest they suck down their counter-parties with them. Asian stocks collapsed and we got a bubble, driven by the money printed in the process.

The Asian currency crisis in 1998 drove emerging equities down to bargain prices, and despite a great 2003, they still have catching up to do.

To sum it up, market internals are stronger *right now* than we have ever seen them. About the most bearish evidence we can come up with is there is nothing particularly negative near term to be worried about. All of which makes us *very uncomfortable*. Yet, regardless of what we or anyone else thinks, our job is to remain systematic and disciplined, focused on our strategies. We'll leave the predictions to the economists, Nobel laureates, and talking heads on CNBC.

Scandal Redux

In our last *review*, we included a piece on breaking scandals in the Mutual Fund industry called "Falling off the Pedestal" (still posted on the web site). We wrote that comment just as news of so-called "late-day trading" and "time-zone arbitrage" pointed to fraud on a massive scale. One can only imagine the suits scrambling all over each other to point their finger at someone else. In the financial industry, the knee jerk response to scandals like these is to "protect the public"; so new fees, charges and rules are being implemented pell-mell by an industry caught with its hand in the cookie jar. In this way they can argue they kept "investors in mind" when the SEC gets around to knocking on their particular door. Where it ends we can only guess. But more importantly, how will this chaos affect us?

Needless to say, we continue to proactively address change as it arises to minimize any impact on our investment process. Fortunately there has been little material effect thus far. At the same time some custodians, like Nationwide and Manulife (on the variable life side), are proposing policies that may restrict access and/or our ability to adjust investments to market conditions. We are carefully analyzing such policies, and may soon be recommending alternatives to the offending products/parties. At the end of the day, we simply will not deal with companies that implement policies affecting our ability to effectively manage risk. These companies don't understand investor needs, and there are way too many alternatives.

All of us at Niemann wish you a healthy and prosperous New Year!

Thank you for your continued confidence,

Don Niemann
President, CIO
Niemann Capital Management, Inc