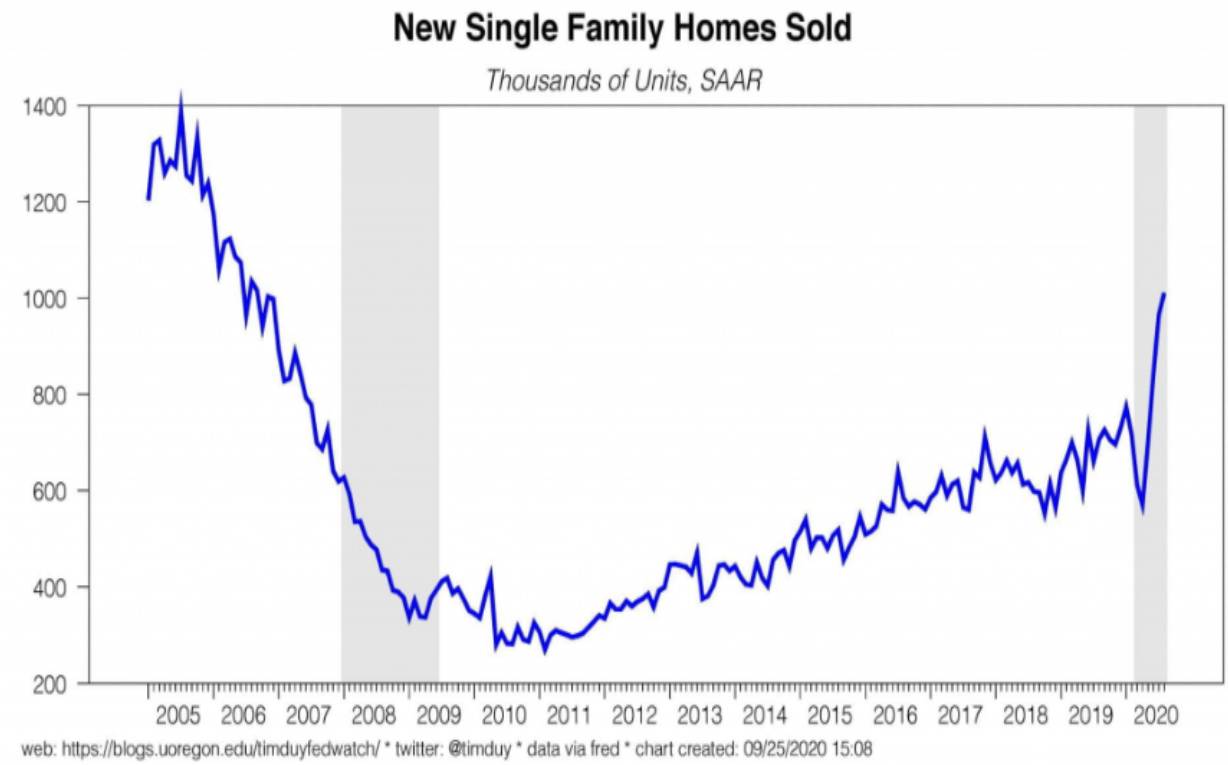
SCHNIEDERS
CAPITAL MANAGEMENT, LLC

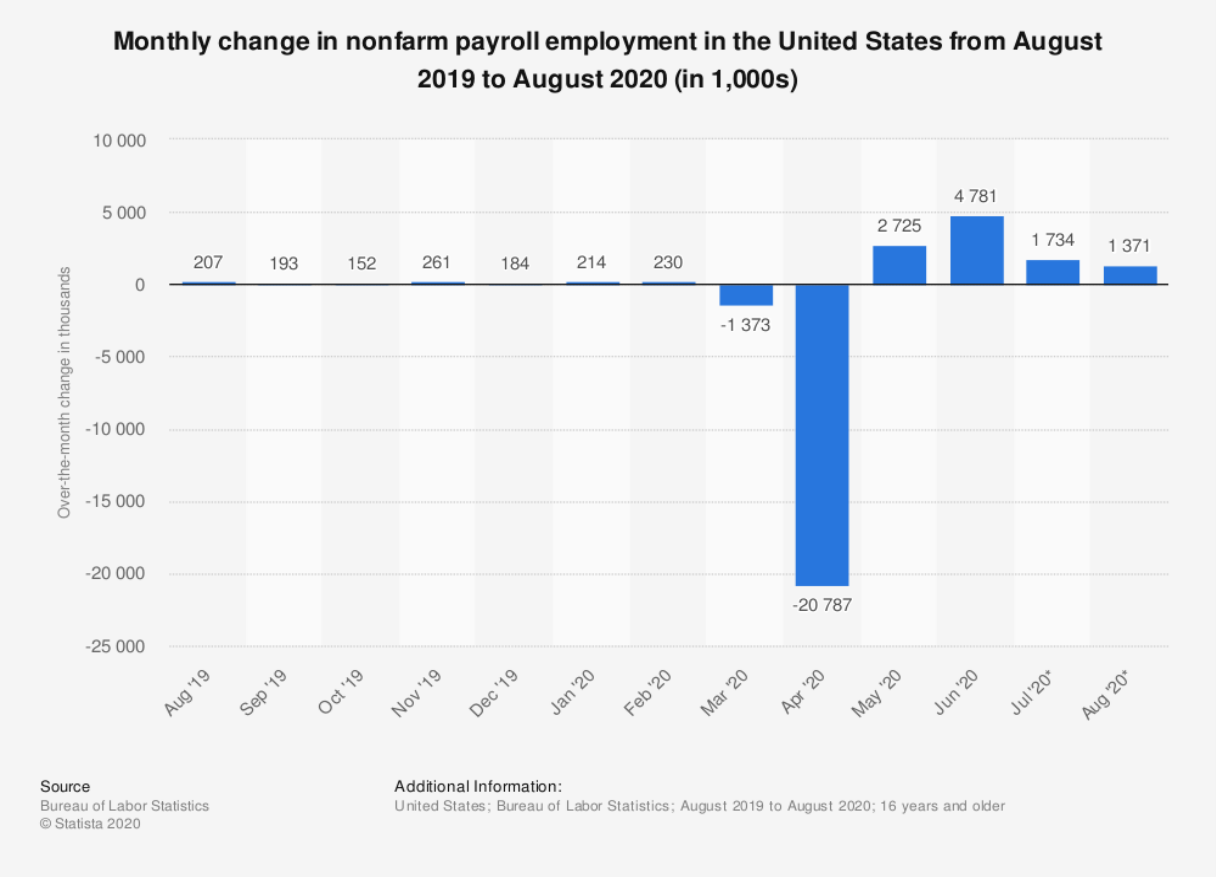
Fourth Quarter 2020 Market Commentary

In February of this year the unemployment rate stood at a fifty-year low of 3.5% and stocks were standing at an all-time high. Then the true extent of the Coronavirus hit. In a matter of four weeks, the market went from an all-time high to close to a 40% drop, the fastest drop on record, while unemployment rates spiked to levels not seen since the Great Depression. The Federal Reserve and U.S. government responded with massive fiscal and monetary stimulus, the likes of which have never been seen before in this country. In a matter of weeks, the Federal Reserve pumped more money into the economy than during the entire Financial Crisis of 2008-2009. The Federal government also issued large scale stimulus programs to help those affected by the health crisis. These actions caused the stock market, and to a lesser extent the actual economy, to improve significantly since those early days in March. Now the stimulus measures are beginning to wear off. In this commentary, we will update the current conditions of the economy, why we believe the economy will struggle to continue to rebound until businesses are fully allowed to open back up, why we believe future growth will most likely be slower due to the large accumulated debt load fueled by the crises, and why equities still remain attractive.

According to the labor department, the economy has now recovered 11.4 million of the 22 million jobs lost in March and in April at the beginning of the pandemic. The Federal Reserve's policy of zero interest rates is spurring a rebound in auto sales, a 12-year new high in new home sales, and new home construction, as big-ticket items become more affordable with low rates. Commercial real estate is still weak as many businesses remain partially closed and struggle to pay their rent.



Low rates have also caused money to move into the stock market as there are few options that are available to earn a return on savings other than real estate or stocks. This has also caused the market to recover much of its losses faster than normal with technology stocks doing best, as shopping and work have moved online, while more traditionally safer industries like utilities and commercial real estate are still suffering from partial lock downs. Unfortunately, the low interest rates cannot fully make up for the parts of the economy that are still partially or fully closed. Job growth is cooling, and September marked the first month since April that net hiring was below 1 million. Unemployment is now in line with previous recessions and remains well above levels seen before the pandemic.



Unfortunately, the financial bridge which the government has provided to those most affected by the pandemic is beginning to run out just as new hiring is starting to sputter. Many households received up to $1,200 in one-time payments under the Cares Act, along with an enhanced weekly unemployment benefit that shrank in August and expired at the end of September. From late March through July, unemployed Americans received $600 a week—or $2,400 a month—on top of their normal jobless benefits, under federal stimulus in the Cares Act. Moreover, under an executive action by President Trump, unemployed workers received an additional $300 a week for no more than six weeks which also ended in September.

The large stimulus efforts helped bring back 40% of the jobs lost in April and May. However, job growth in July, August, and September showed improvements, but they have been

sequentially less strong each month, leaving us with a roughly 7.5% unemployment rate. According to Barron's, that leaves 11.7 million fewer people working than before the crisis. Of the people who are still out of work, roughly 3.8 million say they are "on a temporary layoff" and are expected to be recalled.

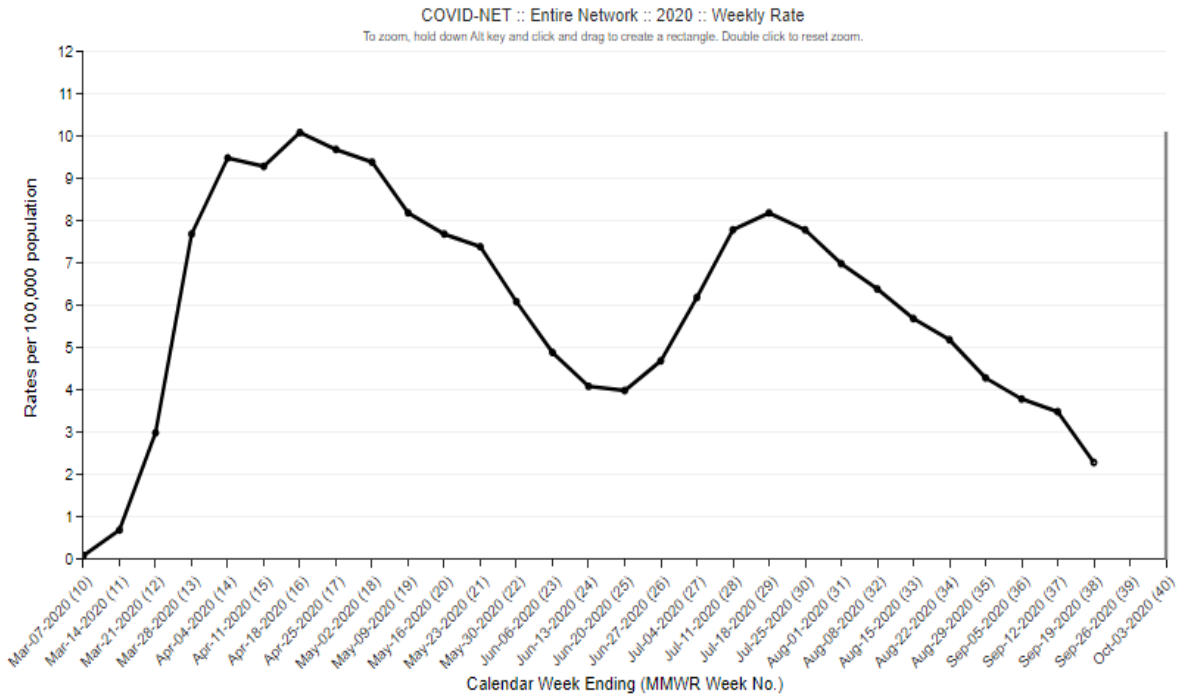
The problem is that the longer the pandemic drags on, the more permanent those layoffs become. The hardest hit sector of the economy: retail, restaurants, hotels, airlines, live entertainment, bars, personal services, dentist, and temporary help accounted for two thirds of the jobs lost. For example, in the first week of October, airlines announced 30,000 layoffs while Disney disclosed, that they were also letting go 28,000 theme park workers. Making matters worse, the large drop in local tax revenue is forcing cities to cut back. Nationwide, public schools and universities have let go 8% of their staffs, while municipalities have cut 5% of their workers since the pandemic began.

We do not believe these hardest hit sectors of the economy will recover until all states are allowed to open back up. Moreover, of the states that have partially opened back up, not all have gone well. Most likely, we feel that the U.S. will not truly get back to normal until there is a vaccine or a cure to COVID-19. Despite heroic efforts by the pharmaceutical and bio-tech industries, who will almost certainly develop a vaccine faster than anyone thought possible, we could still be several months before a vaccine will be ready. This translates into higher unemployment rates for at least the near term.

Although a vaccine is not quite ready, the good news is that the treatments on COVID-19 treatments are getting better. The hospitalization rate is now below the summer lows and it appears that Wall Street analysts' (See SCM Market Commentary for June 2020) estimates of the death rate dropping by up to 70% appear to be correct, as the number of new deaths dropped to between 500-1000, from an average of 2,000 a day. This has happened even though the number

of new cases has doubled on a daily basis. This is still tragic, but the numbers are improving. The number of new cases has increased in part due to more testing, but the percentage of tests that report COVID-19 has returned to about 5%, which matches the Summer lows according to Calculatedrisk.com.

Hospitalization Rates of COVID-19 Patients

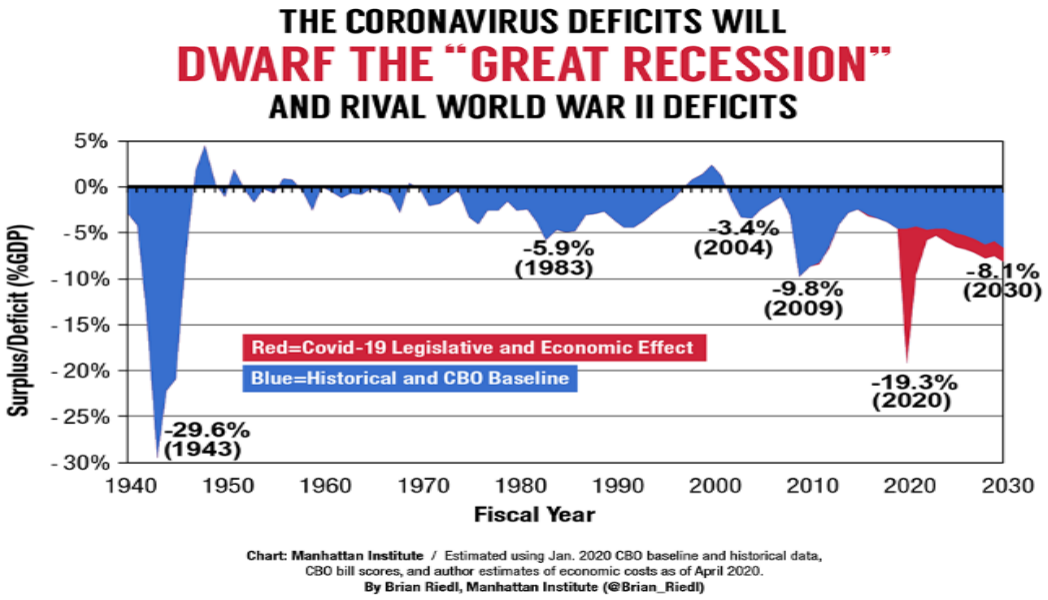


Source: CDC

As we mentioned in out last commentary, Gilead's drug Remdesivir, which prevents COVID-19 from replicating, the steroid Dexamethasone, which English researchers found helps the body to not attack itself for those severely affected with COVID-19, and blood plasma therapy are among the leading causes for the reduction in death rates. In other good news, since our last commentary, Pfizer, Moderna, Johnson & Johnson and AstraZenca have all found vaccines that work against COVID-19, and these companies are now in testing to see if the vaccines are safe. The earliest in which we might see a vaccine available for use will be the end

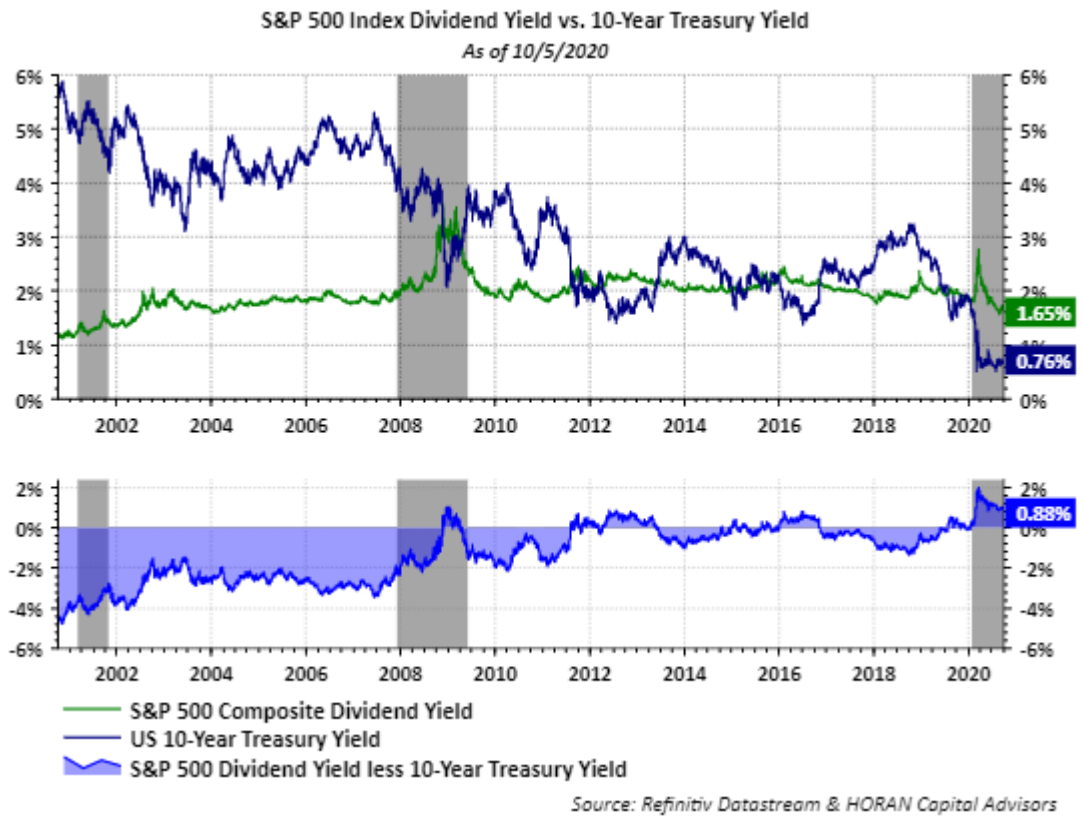
of November as the FDA has just changed its guidelines for approval until after the election. There was hope that a vaccine might be released earlier and life might return to normal quicker, but the FDA is in a tough spot. If the FDA approves a vaccine too early, people might not trust the results, if they approve too late it could be considered political. A group of researchers affiliated with the Center for Global Development estimate that there is a 50% probability a vaccine safe and effective enough to be approved by a stringent regulator will be available by April 2021, with an 85% probability of that happening by the end of the year 2021.

Meanwhile, the Federal Reserve balance sheet and national debt were already stretched before the crisis. They are even more so now. Goldman Sachs reports that our country currently has $65 trillion in business, consumer, and government debt, three times U.S. GDP. This is bad because high current debt loads lead to lower future economic growth because money that could have been used to grow the economy will have to be used to pay down debt. CBO economists have long noted several macroeconomic channels through which debt can adversely impact medium- and long-run economic growth. More recent observations suggest that large increases in the debt-to-GDP ratio could lead to much higher taxes, and lower future incomes.



In addition to higher taxes needed to repay large deficits during the coronavirus, interest rates will most likely stay lower for longer. In fact, in September, Federal Reserve chairman Jerome Powell said, "Interest rates are likely to stay low for years as the economy fights its way back from the coronavirus pandemic." This makes sense because with a public debt load of over $25 trillion, even a 1% rise in interest rates leads to a $250 billion increase in additional cost to service that debt. The office of Budget and Management projects current FY 2021 budget at $4.829 trillion, two-thirds of which must go to mandatory programs such as social security and healthcare. Defense spending ($636 billion) and departments that support defense ($228 billion-Veterans Affairs, Homeland Security, FBI, and National Nuclear Security Administration) make up another 17.8% of the budget. Therefore, just a handful of programs account for over 83% U.S. national spending. Thus, rising interest rates would quickly crowd out any additional discretionary spending.

Despite this, equities will most likely still remain attractive. Simply put, there are 10,000 Americans turning 65 every day and they all need retirement income. Historically, most of these retirees would buy bonds to support themselves in retirement. However, with the ten-year U.S. government bond yielding only 0.7%, a one-million-dollar investment in a ten-year treasury will only produce $7,000 in yearly income. This is not enough income for most investors. This will most likely force more investors into equities as the dividend yield on stocks is more than double the yield of ten U.S. government bonds (see chart below). Moreover, companies tend to raise their dividend over time while interest rates on bonds are locked in.



In conclusion, the stock market and the economy have both recovered significantly since the pandemic induced lows of March. Moreover, we believe it is only a matter of time before our country defeats the virus. Treatments have gotten much better and a vaccine is not far off. However, the cost of battling the Coronavirus has caused the national debt to explode at a time when the country was still recovering the financial cost of the Great Recession of 2008-2009. Most likely, the aftermath of the Coronavirus will usher in a period of higher taxes, lower interest rates and lower growth. Given this backdrop, we continue to like companies which are providing goods and services that people need to use on a daily basis and who are returning cash back to investors through dividends and/or stock repurchases at rates greater than the ten-year U.S. government bond yield.

We thank you for your continued support.

Sincerely,

James F. Schnieders, CFA
Principal

John C. Schnieders, CFA, CFP®
Principal

William H. Schnieders, M.B.A
Principal