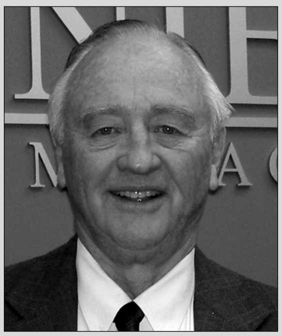
REPRINTED FROM MARCH 26, 2007

THE WALL STREET TRANSCRIPT

Questioning Market Leaders For Long Term Investors

High Quality, Blue Chip Portfolio Investment



WILLIAM H. SCHNIEDERS, Principal, is the Founder of Schnieders Capital Management, LLC, along with his son Jim. He has spent 40 years in the investment industry as a broker, Analyst and a Portfolio Manager. He graduated from UC Berkeley, where he majored in Finance. He received his MBA from New York University's graduate school at night, after two years of service in the military. Mr. Schnieders began his investment career with Dean Witter in New York, and later became a partner with BWA Associates in Los Angeles. After BWA was purchased in the early 1970s, he joined Smith Barney as Vice President of their portfolio advisory group. During this time, he was also involved as an Adjunct Professor of Finance at the Pepperdine graduate school of business administration. In 1984, he joined Paine Webber as a Senior Vice President of Investments and a Senior Portfolio Manager for their portfolio management group, where he was employed until the founding of SCM.

JAMES F. SCHNIEDERS is a Principal with Schnieders Capital Management, LLC. Prior to helping found SCM, he worked at William O'Neil & Co Inc. for nine years. William O'Neil is a highly regarded institutional investment firm and owners of one of the world's largest equity research databases. While at O'Neil, he specialized in providing investment research, ideas and advice to some of the top financial institutions in the United States and Asia. He graduated with honors from UCLA and has also earned a Chartered Financial Analyst designation. Also, he is a member of the Association for Investment Management and Research as well as a member of the Los Angeles Society of Financial Analysts.

JOHN C. SCHNIEDERS joined Schnieders Capital Management, LLC, in a Principal capacity on July 1, 2006. Before joining SCM, he worked for 12 years at William O'Neil & Company, which is an institutional investment advisor, as well as the parent company of the Investor's Business Daily newspaper. While At William O'Neil & Company, he worked for over two years as an Analyst directly with the company's Founder, Bill O'Neil, and for eight years advising institutional clients in the United States and Canada on the composition and allocation of investment portfolios. He holds a Chartered Financial Analyst designation. Furthermore, he is also a Certified Financial Planner and helps SCM clients in their personal financial goals. He completed his undergraduate course work at UCLA where he earned magna cum laude honors.

TWST: Would you start by giving us a brief overview of Schnieders Capital Management?

Bill Schnieders: Schnieders Capital Management was formed in 2002. We deal with high net worth clients. Our clients are primarily family groups, but we also manage some institutional money, both corporations and foundations. As an investment philosophy, we tailor portfolios to individual client needs. We first try to satisfy income requirements and then put in as much growth as possible (within the parameters of each client's growth objectives and risk tolerance) using the major investment themes that we see. So while there are a lot of similarities in our portfolios, each one is custom designed.

TWST: Would you take us through the steps for potential clients, from your first meeting to asset allocation to the actual construction of their portfolio?

Jim Schnieders: Typically, when a client comes in, we start by analyzing their overall financial position. So essentially, we look at an individual, whether it is a high net worth individual, a corporation or a foundation, as its own separate entity. We go through, develop and look at them as a company. We look at their assets, their liabilities and their cash flows. We determine what their goals are.

Sometimes there is a cash flow need included in their goals. So we basically take that cash flow need and say, "Okay, when is this cash flow going to be needed?" For a high net worth individual facing retirement, it's going to be x number of years in the future. We take that need, put an inflation rate on it, and then make a discount to the present and say, "Here's the rate of return. We are going to need to meet those objectives." From there, we begin to build a diversified, high quality blue chip portfolio that we think will meet those needs.

TWST: What is the investment process? What characteristics are you looking for? Tell us about your equity strategies.

John Schnieders: We run several proprietary screen models, looking for companies that have earnings growth, sales growth and margin growth. We try to invest in certain themes. We see several things that are driving the worldwide markets, one of which is the aging of the US population, which is affecting various industries such as leisure, health care and financial services. We foresee the rise of a global middle class. We see the rest of the world as trying to emulate the American lifestyle.

Bill Schnieders: As a part of that, we see a tremendous growth of globalization. One of our strategies is to utilize large cap multinational companies that are leaders in their industry and, in many and most cases, are also the low cost providers of these services. We also see energy as a major theme that we have used over the last three years. There is a tremendous demand/supply imbalance of energy. There were originally fears of running out of oil, which has pretty much been resolved by the oil find that **Chevron** (CVX) made off the coast of Louisiana not long ago.

Bill Schnieders: We see a tremendous growth of globalization. One of our strategies is to utilize large cap multinational companies that are leaders in their industry and, in many and most cases, are also the low cost providers of these services.

Jim Schnieders: We run computer screens to find companies with attractive valuations that have consistent earnings streams with defendable product positions that we believe can turn excess free cash flows into rising dividend streams. From there, we build the portfolio and try to overweight companies that are playing on these major worldwide themes.

TWST: Would you tell us about the stocks that you are looking for as potential holdings?

Jim Schnieders: One of the first things that we do is run an earnings stability model. This indicates the standard deviation of the variability around an earnings trend. We are trying to find companies that are growing faster than the S&P 500 but are doing so with less earnings volatility. As we mentioned, one of the major themes that we see is that the biggest demographic in US history is going to retire. These people are looking at their portfolios. They are going to need more money for retirement. We think that they are going to want companies that can generate excess dividends to help them in their retirement years. So in our opinion, it is going to be very important to find companies that can produce rising income streams in a consistent manner. Once we have those companies, then we begin to diversify it from there.

Bill Schnieders: We see the baby boomers as being in the demographic sweet spot of the population. They are all nearing retirement age and they are all in need of income. This has led us to the dividend theme, among other things. We have utilized utilities in specific companies. We have positions in **Exelon** (EXC), **Dominion Resources** (D), **Southern Company** (SO), **Duke Energy** (DUK) and **FPL Group** (FPL). We also have used a couple of the exchange-traded funds within utilities, like **iShares DJ US Utilities** (IDU) and **Utilities Select SPDR** (XLU).

Jim Schnieders: In addition, we are buying very consistent stocks that play into the themes that we talked about. **Procter & Gamble** (PG) fits in multiple areas that we see. One, it plays on the rise of the global middle class. The people in India or China want the same lifestyle that Americans enjoy. They are going to be using these types of products. The company pays a high dividend. It is a very consistent earnings company. It is diversified internationally. We think that it will be the same as we go forward.

Another name is **General Electric** (GE). As you look at different asset classes out there, large cap Dow Jones type stocks have really gone sideways for the last seven years. That intrigues us. **General Electric** is a very high quality blue chip name. It trades at attractive valuations. It pays a 3.2% dividend. What we find attractive about this is that the earnings stream on **GE** continues to rise. Even after 9/11 when the country went into recession, **GE** still made more money in 2001 than they did in 2000. They are very consistent with their earnings. Now we have reached a point, in our opinion, where the company trades at attractive valuations.

But just as important, they keep growing that dividend. Right now, **GE** is paying $1.12 per share in dividends, which, by the way, is actually more than they earned per share in earnings back in 1999. Now, if you are a long-term investor, and if **GE** can continue to turn that consistent earnings stream into dividends, then we think that this makes more sense than locking in bonds. If they can pay a dividend of 3.2% and continue to grow that dividend at 10%, that means every seven years, that dividend is going to double. In our opinion, that is why you buy stocks in the first place. You are buying companies that can generate consistent earnings and can convert those earnings into rising dividend streams.

Jim Schnieders: General Electric is a very sound, high quality company. We are trying to find value. This company is essentially still half-priced from where it was at the turn of the decade. Even though earnings have gone up substantially too, the dividend has gone up substantially, and now they are buying back stocks.

1-Year Daily Chart of General Electric

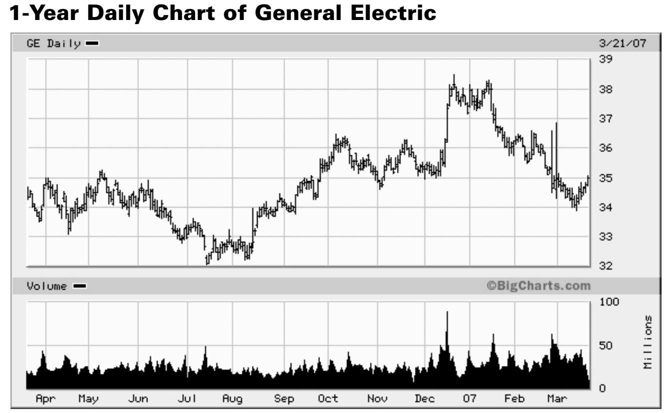


Chart provided by www.BigCharts.com

TWST: How has the portfolio changed in composition over the last 12-18 months as a result of your thematic approach?

Jim Schnieders: We run a balanced portfolio. We typically run about 50 positions, at 2% each. Sometimes when stocks make big runs, we will start cutting back on them. So, for example, we have been taking some profits on the real estate investment trusts. That is another way we have been playing to the aging of America to generate excess income. We still have investments in some REITs, but REITs have been a very successful group, and one of the reasons you buy real estate investment trusts is for the yield. What we are seeing now on a lot of these REIT yields is that they have become quite low. Some of even the higher quality REITs are only paying 3%-4% right now. At those kinds of yields, we think that other asset classes have become more attractive.

Likewise, if a stock is not working, we will also cut it. We could cut it for tax purposes or because we were wrong. We understand that even though we do a lot of fundamental work on all of the stocks that we buy, there are going to be a certain number of stocks that we were just plain wrong on, so we are going to cut them. We try to limit losses to around 10%.

Bill Schnieders: One of the things that plays into this aging of America theme and dividend growth is the fact that dividends are tax advantaged investments for the first time in many years. There is an 85% tax exclusion with qualified dividends. So with **General Electric**, which Jim just outlined, you have a company that is growing its dividend. In fact, this is another theme — most of the companies that we own have rising dividend growth and they are also buying back some of their own stocks. This 85% tax exclusion is important because if you are getting a 4% dividend on utilities and you only have a 15% tax on those dividends, it is equivalent to getting approximately 7% on a fully taxable piece of paper or interest on a corporate bond.

However, it is really a bottom-up portfolio, and we are really utilizing themes. So we are building the portfolio with companies that meet our fundamental criteria and that have a theme and story that we believe are going to continue to drive earnings, and it turns out that certain sectors get overweight at certain times.

TWST: What are some of the companies that you feel are representative of your investment approach?

Jim Schnieders: We did mention **General Electric**. We believe that that is a very sound, high quality company. We are trying to find value. This company is essentially still half-priced from where it was at the turn of the decade. Even though earnings have gone up substantially too, the dividend has gone up substantially, and now they are buying back stocks. We mentioned **Procter & Gamble**, which is a very consistent earnings company. Earnings continue to rise. We think that they will play on the rise of the global middle class. We have mentioned utilities. We have a broad range of utilities, which we think are good income substitutes for investors. Those are a couple of ideas that we like, and we think that they are going to be sound investments going forward.

Jim Schnieders: Colgate is very consistent. In terms of an earnings stability model, they are about as high as you can get. They also have about 75% of their business overseas. We are seeing weakness in the dollar. We think that companies that are diversified internationally, that can play the rise of the global middle class, and that can grow their earnings consistently will do well.

TWST: How many stocks would you generally have in a client's portfolio?

Jim Schnieders: Typically, we have about 50 stocks, and that implies about a 2% weighting in each stock. If any one company becomes over 5% of the account, we start trimming back and taking profits, which leads back to why we were taking profits in some of these real estate investment trusts.

TWST: Do you allocate to sectors at all or is it strictly bottom-up as a result of your themes?

John Schnieders: We are looking at themes. We have representations in every sector, but some sectors are going to be more attractive at certain points than other sectors at other times. Right now, we are currently overweight in utilities. We are still overweight in energy. We are overweight in some areas within the healthcare sector.

TWST: You mentioned Procter & Gamble as part of the globalization theme. Are there any other multinational companies that appeal to you?

Jim Schnieders: We have positions in **Colgate** (CL) as well, and the reasons there are severalfold. They are also very consistent. In terms of an earnings stability model, they are about as high as you can get. They also have about 75% of their business overseas. We are seeing weakness in the dollar. We think that companies that are diversified internationally, that can play the rise of the global middle class, and that can grow their earnings consistently will do well. **Colgate** is another example of that.

John Schnieders: Another name is **United Technologies** (UTX). They are worldwide in scope. They are the world's largest elevator manufacturer. They are capitalizing on a building boom in Asia and in India. They are also benefiting from an aerospace resurgence in the United States with their aerospace division. They are very well run. No one division predominates their earnings. They are participating in the global rise of the middle class. Those are the types of companies that we are looking for — ones that are very consistent, that have dependable earnings and that have a defendable market position.

TWST: Are you interested in any areas of technology from your thematic approach?

Jim Schnieders: We definitely like technology as one of the areas going forward. But two themes that we are very keen on are valuation and dividend growth. Many technology companies don't pay a dividend, and it is also harder to defend their technology. Having said that, we do have technology positions, but they tend to be in the bigger companies. The reason why is because after the whole dotcom fiasco, we felt that the biggest driver in technology was the enterprise users. Many enterprise users went with these small startups only to find that two years later, they were out of business. So we think that from a technology standpoint, it is going to be the big companies that benefit from that.

One of the companies that we happen to like in the technology space is **IBM** (IBM). **IBM** is now doing 50% of their business in hardware and 50% in services. They are very well managed. As far as technology companies go, they are very consistent. They trade at attractive valuations. They have been raising their software presence. They are global in scope. People forget that **IBM** is a big company — it is a $91 billion company now. It was trading at much higher levels seven years ago. Though the stock was over $120 several years ago, now we are seeing it in the low $90s, and yet the earnings continue to rise. They are buying back stock, and they are also increasing their dividends now.

John Schnieders: One of the themes that we are seeing is companies buying back stock. **IBM** has started to buy back stock, and we are starting to see this with a lot of the large cap stocks. One of the things that we have seen that has really helped the market in the last couple of years is that the supply of public stock has been declining. Right now, the S&P 500 companies are sitting on $600 billion of cash. Last year, they repurchased $400 billion of their own stock. One of the reasons why you had so many quarters of double-digit earnings increases is because the supply of outstanding stock is going down as the earnings rise. We are seeing that this tremendous buyback spree — not only with what **IBM** is doing, but with other companies as well — is really helping earnings.

One thing that Jim was also mentioning is that we are seeing margin increases at **IBM**. **IBM** has sold off their money-losing PC division to the Chinese, and at the same time, they have made over 20 software acquisitions, most recently of FileNet and MRO. They are increasing the top-line revenue growth, expanding the margins, and expanding the earnings as they go into higher margin software businesses. We see that as a defendable position. They are a company in technology that has a low p/e, a good dividend and good earnings visibility going forward.

John Schnieders: We are seeing margin increases at IBM. IBM has sold off their money-losing PC division to the Chinese, and at the same time, they have made over 20 software acquisitions, most recently of FileNet and MRO. They are increasing the top-line revenue growth, expanding the margins, and expanding the earnings as they go into higher margin software businesses. We see that as a defendable position.

1-Year Daily Chart of IBM

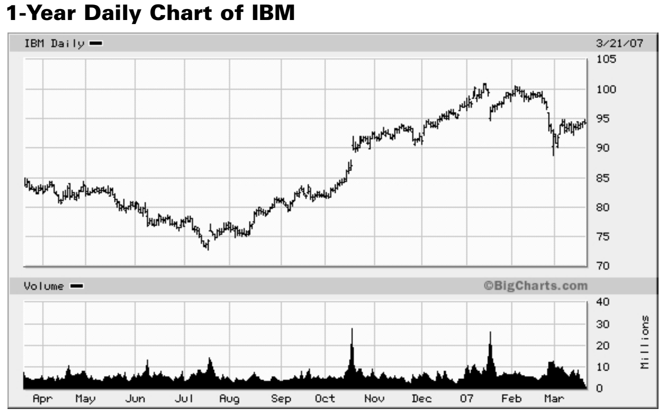


Chart provided by www.BigCharts.com

Bill Schnieders: IBM happens to be our largest technology position. We have also bought **Hewlett-Packard** (HPQ) and **Cisco** (CSCO). **Cisco** is a company that is way off its high from back in the 1999-2000 era, and it has been consistently growing its earning during this period of time. It fits our value parameters.

Jim Schnieders: When you asked about what we saw new in technology, I think that Bill just hit the nail on the head. What we see new in technology on the Internet is the proliferation of video over the Web and on wireless networks. As more and more people start going to YouTube, as more and more video gets put on the Web, and as you start seeing IPTV and WebTV emerge, the existing Internet infrastructure will be unable to handle it. We think that this is going to play well for companies like **Cisco** that make the router hubs and networking equipment necessary to handle these increased bandwidth loads, and it gives them good earnings visibility going forward.

TWST: What about the healthcare sector? Does that have an attraction for you at this time?

Jim Schnieders: In terms of the healthcare sector, we tend to be more overweight in the medical product companies. We think that there is a lot going on in the pharma space, and that is a whole discussion in and of itself. On the healthcare side, our two biggest weights there are **Johnson & Johnson** (JNJ) and **Abbott Labs** (ABT). **Johnson & Johnson** is an attractively priced company with very consistent earnings. It gets back to a very strong earnings stability reading. We see consistent earnings growth. You can look back at **Johnson & Johnson** for 20 years and it's basically a ruler in terms of projecting where their earnings are going to come in. They pay an attractive dividend and they are international in scope.

In terms of **Abbott Labs**, you see much of the same thing. They are a very long-term consistent earnings company. It is a $22 billion company now and continues to grow. Their earnings stability ranking is about as good as it gets; it is about a 1 ranking. They are also paying a 2.5% dividend. The pharmaceutical part of their business is only 37% of revenues now, so they have done a good job of moving into more of the medical products, which we think is going to be stronger going forward.

Bill Schnieders: The aging of America is one of our themes, and one of the more obvious beneficiaries of that would appear to be health care. And yet, as Jim just mentioned, we see medical products companies as being superior to what I think most investors would look at, which would be the big pharmaceutical companies such as **Pfizer** (PFE), **Lilly** (LLY), **Merck** (MRK) and so forth. We think that there is going to be government interference in this market. There are problems with generic drugs coming on. So while the demographics fit for health care, we have been very selective in our choices for that sector.

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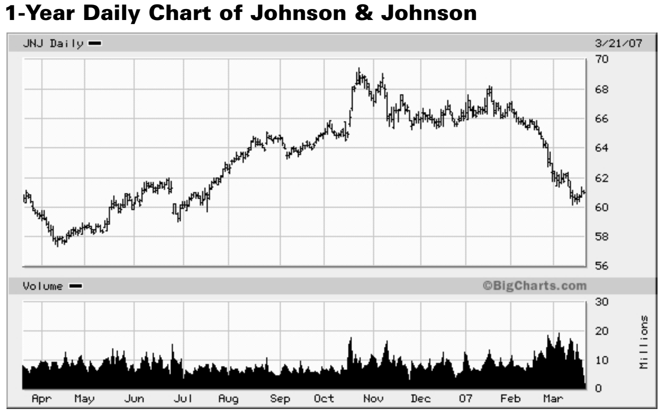
1-Year Daily Chart of Johnson & Johnson



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TWST: What triggers an exit from your portfolio? What is the sell process?

John Schnieders: We actually have a rigorous sell discipline. We have several determinants. The most obvious is that if we are wrong, we are going to get rid of the stock. The second is if we see deteriorating fundamentals or the story is changing and the driver in the stock is changing. That will cause us to sell a stock. The third and probably the most difficult is on valuations. We subscribe to various databases and look at different market studies. A study done by William O'Neil & Company, just as an example, has stated that once a stock starts its initial move and once you have p/e expansion of 150% above the initial breakout point, the stock is usually near the end of its move.

Jim Schnieders: The breakout point John refers to is a fundamental inflection point in terms of earnings.

John Schnieders: So that is one thing that we are looking at. But if we start to see margins deteriorating, revenues slowing down, earnings slowing down, or if we think that the stock is fully valued, we will sell. Also, if it gets to be too big of a percentage of the portfolio, we will start cutting back as well. So we are looking to cut positions back on several different factors.

Jim Schnieders: An example of that would be some of these real estate investment trusts. These have been really strong performers for us. Many stocks had big moves. One of the reasons we were driving these themes was for the income growth, and as the prices have gone up, the yields have gone down. We reached a point and said, "Hey, it no longer makes sense and it is probably time to start taking gains here." So that is what we have done.

Bill Schnieders: As an example of that, our biggest REIT holding has been **EastGroup Properties** (EGP). When we first started buying that, it had yields of pretty close to 5%, and now it is about half of that. The REITs that we have owned have been predominantly industrial and commercial properties, not apartment buildings or residential.

Jim Schnieders: We are actually a little bit negative right now on the residential space, and we have no residential exposure in any of our portfolios to the residential market.

TWST: What is the average turnover?

Jim Schnieders: The average turnover is going to depend upon the client and their objective, but we try to keep turnover between 40% and 60%.

Bill Schnieders: They will vary with the different clients and so forth, but that number would be right in the middle. It is about 50%.

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TWST: Tell us about your risk management techniques. How do you attempt to control risk at the portfolio level and also at the security level?

Jim Schnieders: We have several ways of controlling risk. One is obviously just through standard portfolio techniques, such as diversification and position size. The second is to make sure that we stay on top of the companies with our fundamental research. Investing is a process, and you have to stay in the process. As things change, we have to change with it. As our clients change, the portfolios change. We try to avoid concentration risk. We try to avoid buying overvalued companies, and we try to adhere to our rigorous sell discipline. We know that a certain number of our stocks are going to be wrong. If you can control your losses, you can let your winners ride.

Bill Schnieders: Jim gave an analysis of what we use on a bottom-up individual stock basis. From a top-down basis, we also tend to look at interest rates and macroeconomic factors. Over the past year and a half, we have had roughly a 70% equity and 30% fixed income component to our portfolios for our average client. That is about what we need in order to meet the income needs that we talked about earlier. As you know, we are in a world right now where interest rates are flat. They are actually higher in the three-month and six-month area at around 5%. Ten-year Treasuries are now about 4.5%, and 30-year Treasuries are just slightly above that in terms of yield. So the 30% that we have in fixed income is largely confined in the high quality corporate and Treasury markets, with an average maturity of no more than 18 months or so.

So one of the things that we see from a risk management point of view is that as a result of globalization (as we have mentioned previously, we have taken advantage of that with both large and multi-cap companies on the manufacturing and the consumer sides), we have become encumbered with deficits, leading to the United States actually needing over $2 billion a day to finance the deficits. We do have some structural imbalances, which are serious.

One thing that has kept this imbalance is that fact that we basically have four primary sources of liquidity in our economy. We have the government, households, corporate profits and foreign lending. The first two, the government and the households, are at negative numbers. In other words, they spend more than they take in, at least on the official figures on households. Corporate profits make up some of this slack, but they are not on the hook to pay the balance of payments deficit. Foreign lending has met most of our liquidity needs, and it is foreign lending that has kept interest rates down in the longer end of the bond market.

We see this as a serious concern going forward, because at some point in time, we see the probability that the countries that are making the products that we buy — such as China and India — are accumulating vast reserves of US dollars. China itself, if you include US Treasury federal agency paper and so forth, is pushing $1 trillion of foreign reserves right now, largely in US dollars. We think that there is a high probability that the time will come in the near future where they are going to want to own euros, yen or some basket of securities. If and as that happens, we think that the Fed will have to respond by raising interest rates. If and as they do that (it may two or three years out), we are going to want to extend maturities and probably expand the percentage mix of portfolios more toward the fixed income side.

TWST: What is your tax management philosophy for your high net worth individuals?

Jim Schnieders: Tax is obviously an important part of the overall return. That is why when we are selling, we always sell the high-cost loss first. When managing our accounts, if we have a large gain of stock and we can wait a month and pay the tax of the prior year, we will. So it is definitely a consideration. These are custom-built portfolios for people, so it is going to depend on individual clients and individual tax needs, but it is definitely a consideration that goes into our model.

TWST: What differentiates your investment approach at Schnieders Capital Management from that of other firms? What do you bring to the table that others might not?

Jim Schnieders: The biggest thing is that we do a lot of work upfront before we even bring on a client. We think that it is very important to make sure that we are all on the same page. So before we even start billing a client or bringing them on, we already have a pretty good idea because we have spent a lot of time with them. We try to figure out what their goals are, what their entire financial situation looks like, whether it be an individual or a foundation, and we try to build a customized portfolio.

So before that starts, we have already built models on that entity. We have an idea of what their assets look like. We have an idea of what their liabilities look like. We have an idea of what their cash flow looks like. By the time we have built a portfolio, we are not just taking a pre-canned product or a pre-canned list of stocks and throwing it at them. We are actually customizing. Even though we may use a lot of the same stocks in various portfolios, the actual product per person is going to be customized to their individual needs.

John Schnieders: Our ideas are our own. We come up with our own thematic and sector research. We are not reliant on Wall Street research. Sometimes we are very contrarian to what the Street is thinking. And to just reiterate what Jim was saying, we do some financial planning right upfront with people so that we can build better portfolios. That is one differentiator. We are looking at someone's complete financial picture when we build this portfolio and are offering them financial advice as we build that portfolio. It is not just a stock portfolio; rather, it is a complete financial picture.

TWST: Since you are generating your own ideas, do you ever visit or contact managements of companies you want in your portfolio?

Jim Schnieders: We use pretty sophisticated quantitative models here. We have gone back in time and researched the top performing stocks of all time, going back to the early 1900s. We have written programs to find those types of stocks today. Both John and I were Wall Street analysts for a long period of time, and what we have found is that most companies out there are still doing things in traditional ways. They are looking at 10-Ks and 10-Qs. They are going through the reports and trying to find good companies.

What we found though when we were working on Wall Street is that with the rise of technology, a lot of this could be automated. You could take your relational database and put quantitative variables on individual items on the balance sheet, income statement and cash flow statement. We can even write programs to say, "Okay, is this item good or bad?" We have a quantitative model that allows us to screen for companies with the parameters that we are looking for, based on parameters that have worked in the past. This brings us back full circle. It allows us to bring companies to the forefront that have consistent earnings, that have above average earnings growth, that trade at attractive valuations, that are paying dividends, that have solid dividend growth and that have defendable market positions.

Once we have this list, it allows us to start the research process at a much higher level. At that point, we can start talking to companies. We do use sellside research. We don't rely on it, but we like to see what other people are saying. We like to talk to the companies ourselves. When you combine the work that we are doing upfront in terms of trying to figure out what a client needs, and then combining it with our proprietary system of what has worked in the past, we bring to the table a unique product offering that we can customize for individuals.

TWST: You mentioned the REITs. Are your clients asking you more about alternative investments these days?

John Schnieders: Some clients have asked about that, and some have not. We believe that, going forward, alternative investments are going to be a bigger and bigger component in most people's portfolios. As people begin to enter retirement age, they can't afford to take as much risk, and yet they still have a long-term time horizon, so they need to have a vehicle that can afford them equity-like returns without equity-like exposure. Some alternative investments, such as long/short hedge funds, meet that criterion. We have some contacts in that industry, and we outsource most of that to a Fund called the Decathlon Fund, which we have a relationship with.

John Schnieders: We come up with our own thematic and sector research. We are not reliant on Wall Street research. Sometimes we are very contrarian to what the Street is thinking. And we do some financial planning right upfront with people so that we can build better portfolios. We are looking at someone's complete financial picture when we build this portfolio and are offering them financial advice as we build that portfolio. It is not just a stock portfolio; rather, it is a complete financial picture.

TWST: What about the performance of the portfolio? Since they are all customized, do you have benchmarks? How do you measure the performance?

Jim Schnieders: The overall performance is based on what the client's needs are. That is the first and foremost benchmark — determining their specific needs and making sure that we are meeting those needs. The second benchmark we are using to see how we are doing relative to the overall market is the S&P 500.

TWST: Do you do a performance aggregate of the different components of the portfolios?

Jim Schnieders: Our performance has generally been quite good. We do use performance aggregates, although because each one is independent, we do not use AIMR-compliant numbers. Therefore, we use a benchmark performance. Since we have started, we have been outperforming the S&P, but we don't publish our numbers because they are not AIMR-compliant.

TWST: What about the energy theme? How have you been playing that?

Bill Schnieders: When we talked about our major themes, we talked about globalization, the aging of America and the baby boomers, and energy, but we haven't really expanded on that, and we think this is significant. We have had an energy overweighting for the last two or three years. Essentially, what we have here is a situation where the United States produces about 10% of the world production with a little over 8 million barrels a day, but we consume almost 25% of the world consumption. There is a major problem looming in energy in that they are no longer finding any oil fields of any significance onshore domestically. Prudhoe Bay was the last major onshore development.

We are seeing an increasing demand for energy in general, and oil in particular, by the emerging nations of the world at an increasing rate, while at the same time, the supply side is coming on at a lesser degree and at higher prices. For example, the oil that we are finding is primarily offshore. These rigs can cost several hundred million dollars. They can drill hundreds of miles offshore with pipes going down several thousand feet. This **Chevron** announcement that was made some months ago is 29,000 feet under the surface of the ocean. It is very expensive to drill this.

If you take the consumption of about 20 million barrels a day in the United States, multiply that by 365 days and then divide by our population, we arrive at a quotient of somewhere around 24 barrels of oil per person per year in the United States. That takes into account everything containing oil, such as gasoline, diesel fuel, heating oil, even PVC pipe and many common household items. To cut to the chase, there are similar numbers for Europe that run in the high teens, and the developed nations of Asia such as Japan and South Korea average about 15 barrels of oil per person per year.

Where the problem arises is that India uses about 1 barrel of oil per person per year, and China uses slightly more. But in India, we have close to 1 billion people, and in China, closer to 1.4 billion people, so those two countries alone are 2.4 billion people, about 8 times the population of the United States, which is around 300 million. So two countries specifically have a significantly larger population base and are growing their energy usage roughly consistent with their factory growth, which would be about 7% and 8% respectively.

Jim Schnieders: If you look at those companies fundamentally, they all trade at very low valuations and are big dividend payers, and those dividends are growing. They are also returning a lot of cash back to investors through large share repurchases. When we do our bottom-up and our top-down, we try to meet in the middle and say, “Okay, these are companies that meet multiple objectives.”

TWST: Would you like to make any summary statement?

Jim Schnieders: Our general stance is that America is the best growth story of all time, and we are very bullish long term on America. However, there have been times in America’s history where it has been prudent to be defensive, and we think that we may be entering one of those times right now. Bill mentioned the structural imbalances. You have also seen the slowing corporate earnings growth and heard Greenspan’s remarks.

Bill Schnieders: We have major positions in Chevron, Exxon and Conoco at much lower prices, and also in Apache as a domestic producer. We are holding on to those positions. We have taken a little bit of money off the table and put it into cash reserves, but we are still maintaining an overweight position in oil.

So we have a situation where China was a net exporter four or five years ago, and now they have become the world’s second biggest importer. There hasn’t been much slack between production and consumption anyway. It has only run between 1 and 2 million barrels of oil a day going back over the last few years. There has been some inventory slack that has caused prices to slow down over the last few months, but we see this as a continuing problem.

In addition to that, we import over half of our oil. While Canada is our major supplier of imports, the next four countries in line are Mexico, Saudi Arabia, Venezuela and Nigeria. We see some geopolitical components in each of those countries that could become problematic in the future, particularly with the latter two countries, Venezuela and Nigeria.

TWST: Are you keeping energy as an overweight?

Bill Schnieders: We have major positions in **Chevron**, **Exxon** (XOM) and **Conoco** (COP) at much lower prices, and also in **Apache** (APA) as a domestic producer. We are holding on to those positions. We have taken a little bit of money off the table and put it into cash reserves, but we are still maintaining an overweight position in oil.

We see a problem that is beginning to brew in the subprime mortgage area. We have had such a huge increase in the real estate market over the last six years and it is impacting increasing numbers of people, especially on the coasts, making it harder for them to buy homes. To afford homes, many of these people have taken out riskier mortgages and mortgages they really don’t understand. Our fear is that, especially in the subprime market, these people will be unable to meet these financial obligations that they have signed, as their loans reset at higher prices.

What concerns us the most in here is the use of no doc, interest-only and adjustable rate mortgages. No doc loans are essentially stated income loans. The temptation is there for people to state that they make more than they really do so they can afford to get the home they want and get the mortgage they want — to live the American dream. The problem that we see is that in 1998, 24% of all mortgages in this nation were no doc loans. In 2006, 50% of homes were no-doc loans, so that is a little concerning. Then if you look at these interest-only loans, that is where no principal is paid on the mortgage. An adjustable rate loan is a loan where loans actually float as rates go higher.

Most of these loans start off with very low teaser rates and then reset. We have had 17 rate hikes. So now you have a situation where most of these loans are going to reset at much higher rates. They are going to reset at LIBOR, plus a percentage. We think that it is going to be harder for people to pay these new loans.

To quantify this, industry analysts estimate that between $800 billion and $1.2 trillion in adjustable rate mortgages were reset this year. In fact, the Mortgage Bankers Association states that mortgages on one in 11 homes is both adjustable and subprime. There was the recent announcement of **HSBC** — these are high quality companies, by the way — that they increased their bad debt charges to $10.6 billion to cover mortgage losses, while **Countrywide** stated that 20% of their subprime loans are behind payment.

While we don't have any investments in this space, our cause of concern is that this problem in the subprime mortgage area could spread, causing mortgage players in the industry to raise their credit standards, and it would be very hard for people with existing loans to refinance. This is important for us as investors because we think that real estate has really been the primary driver in the economy for the last five years. In fact, *Forbes* did a study showing that Americans pulled $500 billion out of their homes last year. That is up from $100 billion in 2001. In our opinion, equity appreciation extraction in real estate has been a big driver behind consumer spending. Consumer spending is two-thirds of the economy.

If you have a situation where the biggest driver of consumer spending is beginning to show signs of weakness and slowing, that means that consumer spending could drop. We are bullish long term, but near term, we would be defensive. This goes back to our main thesis: you want to be in high quality, blue chip, dividend-paying companies that can produce consistent earnings, that have defendable product positions, and that can generate excess cash flows and turn those cash flows into rising dividend streams for investors.

TWST: Thank you.

Note: Opinions and recommendations are as of 3/14/07.

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