Trust Company *of* Vermont Quarterly Update

January 2015

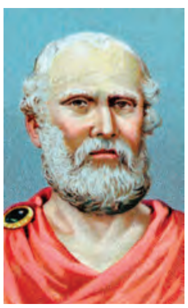
Brattleboro ◆ Burlington ◆ Rutland ◆ Manchester ◆ St. Albans

Employee-owned & Vermont-based www.tcvermont.com

I Don't Know & I Don't Care

(from "Beach House on the Moon" by Jimmy Buffett)

Todd Gray, Portfolio Manager



"Wise men speak because they have something to say; Fools because they have to say something." ~ Plato

Well, it is that time of the year once again. No, I am not referring to Black Friday or holiday parties. I am referring to that time of the year when Wall Street strategists fill the airwaves with predictions concerning where the stock market will end up next year. Television and radio programs are filled with investment guru's confidently making such predictions. Each year I eagerly await for that brave soul who, in front of a national audience, responds to the question of where the market will end the following year with these three simple words, "I don't know."

Why is it that these well-educated people are so eager each year to publicly share their market prophecies when they are so frequently proven to be wrong? Well, for some it is undoubtedly a matter of self-promotion and ego. However, for most of the investment profession it is a matter of not being able to say those three difficult words, "I don't know", especially when it is the client who is asking the question. As paid professionals we feel compelled to act as if we have some secret foresight that allows us to know where the market will move in the short run. While such predictions may make for an interesting topic of discussion over a morning cup of coffee, I question their value in making successful investment decisions. If you listen to, or read, enough of these predictions you will find convincing arguments put forth for the market going both up and down over the next year. There is always evidence that can be found to support both cases. However, the stock market often enjoys being a contrarian and doing the opposite of what these so called "experts" believe will happen.

We believe it is important to keep in mind that bull markets begin and end with little warning and often when least expected.

Not only do I not know with any certainty where the stock market will end 2015, I actually don't care and would urge you to not care either. Why? Because you should not be focusing on where the stock market will be trading in one year but where it will be trading five and ten years from now. Stocks should be purchased with long-term money, not with money that you are likely to need in the next year or two.

Successful investing is more a byproduct of time than timing.

Although I would be uncomfortable telling you whether the stock market will be up or down in 2015, I do feel comfortable telling you that I believe the market will be higher five years from now and would be highly confident predicting that the stock market will be higher ten years from today. This is not wishful thinking but a statement supported by history. Over consecutive five and ten year periods of time the stock market has produced positive results during the vast majority of these periods.

The portfolio managers here at the trust company manage portfolios based on the belief that while the stock market is one of the great vehicles for building wealth over the long-term, a bear market could begin tomorrow. So when and how do we prepare for down markets? We are constantly preparing for a downturn in the market starting with the moment we initially develop your portfolio. There are a number of strategies that can help reduce the impact of stock market declines. In the brief space this newsletter allows, I want to touch on three that I think have the biggest impact being:

- **Diversification**
- **Investing in companies with substantial competitive advantages**
- **Rebalancing**

Diversifying your stock portfolio amongst different companies representing a wide variety of industries significantly reduces the impact of declines affecting an entire sector of the economy or specific industry groups. For instance, in recent weeks the price of stocks within the Energy sector has fallen as the price of oil dropped dramatically. If energy related stocks represented a major portion of your portfolio then you would have suffered a significant decline in value. By also owning stocks within the Consumer sector of the economy that are benefitting from falling oil prices, the impact on your stock portfolio of declining oil stock prices would be substantially reduced.

"I try to buy stocks in businesses that are so wonderful that an idiot can run them because sooner or later, one will." - Warren Buffett

Investing in companies with substantial competitive advantages, or what Warren Buffett refers to as wide "economic moats," can significantly reduce the impact resulting from economic downturns. Stocks with substantial economic moat generally are less volatile than stocks with little or no-moat over the course of an economic cycle because their competitive advantages result in more predictable and consistent earnings growth, higher returns on investment capital and higher cash flows. When economic conditions are weakening, stock investors tend to move their money into wide moat companies because of their ability to make money through both good times and bad. Now this does not mean that such companies are immune from declines in their stock price but they typically decline in value substantially less and the possibility of these companies going out of business is far less than companies with little or no competitive advantages.

"In finance, everything that is agreeable is unsound and everything that is sound is disagreeable." - Winston Churchill

"Rebalancing" is based on the old recipe for successful investing being "Buy Low and Sell High." It is a principle that most investors readily accept but have difficulty putting into practice. It involves reducing exposure to stocks when they reach a level within your portfolio that exceeds your long-term target allocation, and increasing your exposure to stocks when they fall below the target allocation. Why is this so hard for investors to implement? Because it requires selling when the stock market is moving up and buying when stock prices are falling, which likely runs counter to what your instincts are telling you. Allowing your stock allocation to substantially exceed your long-term target will magnify your potential losses when the market inevitably falls. On the other hand, letting stock allocations fall well below your target allocation will result in diminished returns over time, threatening the achievement of your long-term financial goals.

In our last quarterly newsletter Jack Davidson wrote about the time tested business model of the Brooks Brothers with their focus on providing quality clothing at reasonable prices. Like Brooks Brothers, the portfolio managers of the Trust Company of Vermont seek to buy the stocks of companies with great business practices that we believe can stand the test of time. We want the stocks we buy to wear well and provide you with great value over time.

We wish all of you a New Year full of joy, good health and, hopefully, a rising stock market (disclaimer: this is not a prediction).

The Year-End Bonus

Bond Amortization

As a result of tax law changes, most bonds purchased on or after January 1, 2014, will be subject to mandatory rules affecting bond amortizations and accretions. Bonds purchased before January 1, 2014 may also enjoy optional benefits of the changes. The principal beneficiary of the changes are accounts where managers purchase bonds above par (amortization). Buying bonds below par (accretion) may have an inverse impact. Fortunately most of our portfolios consist of bonds purchased at par or above.

An Example:

Let's say we purchase a $25,000 Boeing Company Debenture at 7.25%, maturing on June 15, 2025. The current price would amount to approximately $33,250 resulting in a yield to maturity of approximately 3.43%. Every year we would report taxable interest income of $1,812 and, upon maturity in 2025, a capital loss of $8,250. Amortizing would reduce the taxable income by $8,250 at the expense of losing the capital loss. That is a small price to pay for a significant tax benefit; interest income is taxed higher than the impact of offsetting capital gains.

So when you see amortizations on your statements, see past the new complexities. Rather, see it as a continuation of a Year-End Bonus.

Year	Interest	Reduction	Net	Balance
2015	$1,812	$664	$1,149	$32,586
2016	$1,812	$686	$1,126	$31,900
2017	$1,812	$710	$1,102	$31,189
2018	$1,812	$736	$1,077	$30,453
2019	$1,812	$761	$1,051	$29,691
2020	$1,812	$789	$1,025	$28,903
2021	$1,812	$815	$997	$28,087
2022	$1,812	$845	$968	$27,243
2023	$1,812	$874	$938	$26,369
2024	$1,812	$904	$908	$25,464
2025	$906	$464	$442	$25,000

Communications

It was not that long ago that small towns in Vermont had the experience of a party line. For new arrivals to Vermont, it is hard for some to believe that several of our neighbors could, and sometimes did, listen to our conversations. Now we don't have to worry about our neighbors.

Now we need to worry about the ***world.*** Many of us now communicate through email. Email can be an unauthorized party line with a lot of uninvited neighbors who, for the most part, are unfriendly.

Although we continue to use email systems to secure information that we send to our clients, a response email may be vulnerable. When we set up an account, critical information is secure. If additional information is added later, a letter or phone call is our preferred method of communication. Better yet, a personal visit is the most secure. That said, we are in Vermont, and a phone call often is the safest route at this time of the year.

We have recently upgraded our phone system which allows for direct phone lines to all staff. The system is designed for direct contact. Staff members can re-route their desk phones to cell phones, or home phones or email. The new systems increase direct contact but may still be vulnerable if messages are left with too much detail. When in doubt, we suggest "call me".

Direct Lines to Our Staff

Brattleboro

John Abel	802.231.2764
Angela Bowman	802.231.2765
Chris Chapman	802.231.2766
Jack Davidson	802.231.2767
Bobi Flynn	802.231.2768
Angie Freeman	802.231.2780
Todd Gray	802.231.2781
Lisa Johnson	802.231.2782
Ellen Lowery	802.231.2783
Kurt Merrill	802.231.2784
Lori Miller	802.231.2785
Kathy Patenaude	802.231.2786
Jane Waysville	802.231.2788

Manchester

Deb Brown	802.230.4132
Sharry Rutken	802.230.4223

Burlington

Chris Cassidy	802.227.0049
David DeBellis	802.227.0053
Ashley Ferrone	802.227.0068
Sandy Kidwell	802.227.0162
Maryann McDermott	802.227.0163
Rich Pearce	802.227.0421
Jill Ravey	802.227.0724
Nanette Stevens	802.227.0725
George von Trapp	802.227.0726

Rutland

Jeanne Gilbert	802.230.4660
Bonnie McLellan	802.230.4662
Steve Singiser	802.230.4663

St. Albans

Butch Hebert	802.524.6200

THE BOYS IN THE BOAT

JACK DAVIDSON

I have an uncertain relationship with water. For the most part, I don't like water in its many guises. Often each morning I encounter: "Honey, did you drink enough water today?" and I respond with a slight prevarication.

I don't like to swim in it. When I first encountered a pool I was so skinny that I sank to the bottom and my thrashing was not helpful. Today, I no longer have the sinking problem but memories linger nonetheless.

I grew up on Long Island near the North Shore. Jones Beach on the South Shore simply disgorged me half drowned whenever I tried to swim past the waves. On the placid North Shore, horseshoe crabs, jelly fish, and sand sharks waited for me. The memories were debilitating. If I swim in a lake, I add to the list snakes and piranhas.

As an adult, I acquiesced to a family trip to Martha's Vineyard. On arrival I saw the movie "Jaws".

One day I decided that I would learn to swim so I could enter triathlons. I could do breast strokes because I could remain vigilant but the Australian Crawl was essential. I spent six months in training, resulting in two noteworthy accomplishments. At the Spofford Lake Triathlon it was announced over the loudspeaker that I broke the course record for the slowest speed in the history of the event (my only competitor was disqualified because he started to drown). At the Elm City Triathlon, it was a very foggy day. The marking boats would follow the last swimmer. They did not see me. When I finally got to shore, everyone had left.

Water can be threatening. It reminds me of the stock market. I am not an investment manager. I am an estate planner. Metaphorically speaking, an investment manager is trying to sail through bouts of turbulent water. An estate planner, on the other hand, is on firm ground. If we see the turbulence of a tax change, we head to the bunkers and try to figure out what to do next.

I often use the sailing metaphor of tacking to finish the investment race ahead of our competitors. It felt hollow. I only entered one race. I must have tacked in the wrong direction. The wind stopped and I was the only one still out in the middle of Spofford Lake and I had to hand paddle my sunfish to the shore.

I needed a better metaphor and I found it! It resonated as if I had just won a race on the water. It was beyond improbability.

I read "The Boys in the Boat", which celebrates the 1936 U.S. Men's Olympic eight-oar rowing team from the University of Washington - nine working class boys who, against all odds, won the Olympics. It is an inspiring tale.

To be honest, the purpose of this article is to focus on the Trust Company of Vermont and what follows will attempt to do just that...describe us. To be truthful it might be better to read the book and go no further. Any attempt to use the story as a metaphor may simply distract you from the achievements of the men in the boat.

Our Metaphor

The key to winning an eight-oar race is twofold: the ability of nine people to perform as one, and the stroke. Stroke control is essential. A low stroke and the boat does not go as fast. A fast stroke and the crew may, as they say, burn out.

Our strategy is to have a full roster of rowers and a coxswain, and all are essential. We have 9 investment managers at the Trust Company of Vermont. They are designed to row as one. We chose this model instead of a captain with a crew. Thanks to our new Clearsea video system, they meet once a week for about an hour to share ideas.

We are designed for 2000 meters and 4000 meters. Our definition is to achieve the investment objectives in 10 years (2000 meters) or 20 years (4000). Stroke control is essential.

Often when the University of Washington crew raced, they were behind the leaders until the very end. Often when markets are up, we have no problems staying with our stroke. Our goal is not to be in the lead in five years if our goal is ten years.

Disclosure

While reading the book, I started to encounter suppressed memories of my brief rowing career. A new teacher, Al Lawn, showed up at my public high school. He started the first rowing program for public high schools on Long Island and recruited reluctant high school students without experience. We rowed in a Pocock boat. We rowed in the rain. My suspicion is that I consented because Al and 8 others could retrieve me from the water if I "caught a crab".

Managing Institutional Accounts