TRUST COMPANY of VERMONT

Quarterly Update

January 2009

Brattleboro ◆ Burlington ◆ Rutland ◆ Manchester ◆ St. Albans ◆ Stowe

Financial Markets Commentary

Steve Singiser, Founder & Trust Investment Officer

Well, 2008 is not a year many of us will soon forget. The post World War II credit expansion appears to have finally hit a wall. So much has been written about the events that led to the severe collapse in stock prices, a recession that has finally been acknowledged, and the variety of problems that seem to have no immediate solution, we hesitate to add our own comments. With this in mind the remainder of this article will attempt to justify the statement that "Things are not as bad as they seem."

There are three positive signs of a turnaround. First, the very fact that many problems previously ignored have surfaced is a positive. An illness cannot be treated until you at least know you are sick. Now both public and private resources are being utilized to mitigate the worst of these problems. Under today's circumstances we do not subscribe to Ronald Reagan's witty quote that "The most terrifying words in the English language are: I'm from the Government and I am here to help." We are fortunate to have a government that is willing and able to help, at least until certain private sectors can be stabilized and take responsibility for their own actions.

Secondly, it is a positive that many companies have strong balance sheets and a large amount of cash liquidity. This is not only indicative of a given company's financial strength, but also it's ability to acquire less strong companies at an attractive price and thus augment future growth prospects.

Thirdly, inflation is at a very low level and higher inflation does not appear to be an immediate concern, as most commodity prices have declined significantly in recent months. Nowhere is this more evident than what you are paying for gasoline compared with a couple of months ago. While much of the decline in commodity prices is recession related, its longer term effect is a positive for a future economic recovery.

Paradoxically, the very rapid and sometimes scary decline in stock prices during October and November may be the most compelling reason for optimism, at least for anyone who wants to own stocks. With many dividend yields higher than bond yields and most recognized measures of per share value near historic lows, it is hard to ignore this apparent buying opportunity: an opportunity born out of crisis.

Finally, in January there will be new leadership in Washington. New leadership should bring new approaches to resolving current economic and financial issues. Some will be successful and others not. If we are going to move forward, we should be prepared to give the new approaches time to work.

While we can not see the future, our individual actions can affect it. At Trust Company of Vermont we believe every new year gives each of us an opportunity to do a better job at what we do, act with great integrity always, and seek out ways to help those less fortunate than ourselves. We are committed to do these things for the future benefit of our clients and friends, as well as our communities at large. We hope you will join us in this endeavor for the benefit of all.

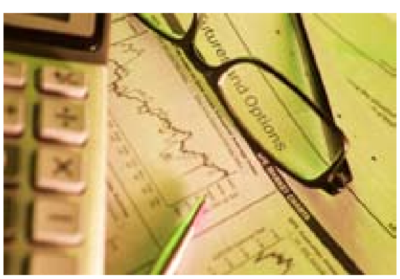
It is our sincere wish that we will all share in a prosperous new year.

Wall Street, Main Street, and the Vermont Community Loan Fund

Jack Davidson, Founder & Principal

Banking has changed. This should not be a surprise to anyone. Perhaps more telling is that the history of U.S. banking since its birth has been a dance between three competing philosophies: liberalism, (now, neoliberalism), populism, and progressivism.

In the 70's banks made mortgages and they kept them. They also made character loans. In small towns like Brattleboro, the bankers knew the customer, knew the collateral and knew they had to live with the loan for the duration. Sometime in the late 70's banks started to sell their mortgages, thus shortening their exposure to bad credit decisions. The transformation of the credit market had begun.



The Federal regulators made it very difficult to make character loans. Formulas and collateral became the primary focus. We were losing transparency at a rapid rate. Mortgages were broken up and packaged in complicated arrangements. Tranches and algorithms started to replace judgment and it became necessary to rely on a growing list of other safeguards such as credit rating companies, credits swaps and complex collateral arrangements.

Hedge funds seemed to thrive in this new environment. Although they are typically open only to a limited range of professional or wealthy investors and thus exempt in many jurisdictions from regulations governing retail investments, it has become evident that they have a profound influence on Main Street. School endowments have dropped precipitously, foundations are closing, and the damage is starting to move from Wall Street to Main Street.

Fortunately, at Trust Company of Vermont we tend to like transparency. Neither our managers nor our state regulators would be comfortable with many of the investment vehicles in the news today. We have not invested in hedge funds, thus avoiding not only Mr. Madoff, but also the significant recent declines experienced by legitimate hedge funds, which have leveraged and lost, all in pursuit of higher yields.

We believe that we have sheltered to some degree our Main Street, which we define as our clients, employees, shareholders and vendors. As an employee owned company, we are part of Main Street and one of our goals is to protect our clients from the toxic elements of Wall Street. Sure, our portfolios have declined, but not to the degree experienced by many other investors. Yes, we have sheltered our Main Street. But have we helped Main Street? Not as much as we could. Not since many of us left Vermont National Bank.

As a single purpose trust company we do not loan money. We simply invest it. This means that when you walk into the Trust Company of Vermont we will ordinarily invest your assets in stocks and bonds and your capital will flow mostly out-of-state. Many of us come from banks with trust departments, principally Vermont National Bank, before its merger in 1999. It is telling that had you walked into Vermont National Bank with some money to invest you had a fighting chance that your money would help Main Street, unless you ended up in the Trust Department.

At Vermont National you could not only invest your money locally, you could even have some control over where the Bank loaned your money. The Bank's Socially Responsible Banking Fund was, and is today through its successor by merger with the Chittenden Bank, a wonderful way to help community groups, educational institutions, small family farms, conservation groups and downtown revitalization projects.The Socially Responsible Banking Fund was created in the mid-eighties. Although it was facilitated by the President of the Bank, who was principally responsible for its introduction, many of the commercial loan officers were reluctant to loan out the deposits that flowed into the fund. It seemed that the orthodox view prevailing at the time was that the non-profit world was uniformly not as financially sophisticated as your standard profit-making, hard-nosed businessperson. Then in the late eighties a recession hit hard and the number of bad loans soared ***except*** in the Socially Responsible Banking Fund, where the write-offs continued to be negligible.

There are many advantages to investing locally. For some, it's a reflection of their progressive philosophy and for others its populism. For us, it seems much less complex. Investing locally allows us to provide capital to our neighbors in familiar, old fashioned ways where the principal safeguards are transparency and character. We can see who is borrowing; the collateral and their character. So it is in this context that I would like to introduce you to the Vermont Community Loan Fund.

The Vermont Community Loan Fund

Founded in 1987, the Vermont Community Loan Fund (VCLF) provides loans for small businesses, affordable housing, community facilities, and child care facilities in Vermont. Currently the Loan Fund manages approximately $24 million and since inception they have lent over $51 million and leveraged hundreds of millions more, creating opportunities for thousands of lower-income Vermont families.

Investments in the VCLF can have variable rates and terms, decided by the investor. Your investment can also provide tax benefits for you if you designate that it is to be used for affordable housing, and qualifies for the Vermont State Charitable Housing Tax Credit. This credit has the potential of giving an investor a higher-than-market-return, while providing the borrower with a lower-than-market-interest rate.

Of course "higher" or "lower" than-market-return tends toward the subjective if you factor in risk. So what is the risk? While the VCLF is Community Development Financial Institution (CDFI) certified and monitored by the U.S. Department of the Treasury, with 21 years of fiscal responsibility and successful growth, investments in the Vermont Community Loan Fund are not FDIC-insured.

However, this does not mean that investors' funds are unsecured**.** VCLF has implemented internal safeguards to mitigate the risk in their lending portfolio and to self-insure investors' money. They include:

- **Security** - VCLF secures every loan that they make with real property and/or personal assets. Even in the case of a higher-risk project, the collateral limits or eliminates any potential loss to the Fund.

- **Equity** - They have just over $6 million in endowed equity, money that has been permanently granted to VCLF to lend out as capital and provide a safeguard for invested money. Currently, their equity represents 26% of total assets, much higher in comparison to commercial banks at 4% and even credit unions at up to 10%. This equity acts like the foundation of the Loan Fund and would be the first money impacted in the event of any loss. In their twenty years of successful lending, the Loan Fund has only experienced losses totaling 0.5% of total dollars loaned, a loss rate much lower than any bank.

- **Cash Reserve** - They currently keep just under $2 million available in cash reserves to cover loan losses and/or liquidity needs. Representing almost 10% of total assets, this cash reserve provides investors with a buffer against negative external impacts, such as the current downturn in the economy. The Loan Fund finished 2008 in the black, with steady gains in both operating support and invested dollars. They have always been able to repay every investor at the end of their investment's term.

They also provide what they describe as "Active Lending" – that is, they provide extensive technical assistance and support to the borrowers from intake to the final payoff, ensuring that their borrowers have all the tools and resources they need to succeed. VCLF has former bankers on their staff; they know what a healthy borrower looks like, and they can help them with any challenges along the way.

Currently VCLF has approximately 250 outstanding loans spread as follows: 25% for affordable housing, 20% to community facilities, 15% for child care, and the balance to small businesses. A total of 260 individual investors, mainly Vermonters and their families, provide 25% of the loan capital with the balance coming from institutions such as the U.S. Department of Agriculture, the Calvert Foundation, the Episcopal Diocese of Vermont, St. Michael's College, and the Chittenden Bank Socially Responsible Banking Fund.

If you are interested in investing in the Community Loan Fund through your account with the Trust Company of Vermont, contact us. If you keep your investment under 5% of your total portfolio, so we both don't lose sleep since the loan is not FDIC insured, we will exempt the investment from our management fee. If the investment is appropriate for you, we can act as an intermediary for you with the VCLF in setting the rate and term. If you would like more information, you can contact us, or the Vermont Community Loan Fund, 15 State Street, P.O. Box 827, Montpelier, VT 05602 (www.investinvermont.org).

IRA RMD's Suspended for 2009

Thanks to a new federal law, our IRA account holders, age 70½ or older, will not have to take a required minimum distribution (RMD) from their IRA accounts in 2009. Congress made the change motivated by the impact of the market decline and the unfairness of having retirees sell securities in order to make the distribution. The 2009 RMD suspension applies to IRAs, 401(k)s, 403(b)s, and other defined contribution plans. The suspension also applies to investors under age 70½ with inherited IRAs or inherited retirement plan accounts that would otherwise be subject to RMDs.

As of the new year:

~ the estate tax exemption is $3.5 million,

~ the estate gift tax exemption is $1 million,

~ and the annual gift exclusion is $13,000.

Joint Trust Alert

When we concluded our series of articles on joint trusts we inserted the following bullet point:

> **"For larger estates, select separate trusts when in doubt. The IRS has provided guidelines, but at this time they are not absolute. Until Congress stabilizes the exemption, our rule of thumb is any plan where the combined estate is over two million should favor separate trusts."**

The three part series tended to favor the joint trusts as a tax savings device based on a series of IRS Private Letter Rulings. Unfortunately, a recently issued opinion of the Tax Court in the Estate of Lee strongly suggests otherwise. Stay tuned. The current exemption is $3,500,000 and if Congress allows it to stay at this level, which seems to be the prevailing opinion, joint trusts of combined estates that will stay under this amount will work just fine.