

# QUARTERLY UPDATE January 2011

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

## A Look in the Rear View Mirror

It would be quite understandable if you viewed the progress of the U.S. economy and the stock market in 2010 with some ambivalence. With so much focus by the media on home foreclosures and unemployment levels it was difficult to believe that we were in the midst of a recovery. However, the reality was that both the stock market and the economy gained strength as the year came to an end. After beginning the year at 1,115 the S&P 500 index crisscrossed that line no fewer than 165 times during the first seven months of the year. However, since late August the S&P 500 index climbed 20%, resulting in a total return of 15% for the year. The more volatile small-cap sector, as represented by the Russell 2000, produced a total return of nearly 27%. Economic growth, as represented by Gross Domestic Product (GDP), is expected to be 2.8% for the year. Corporate profits accelerated in 2010 with operating earnings for S&P 500 companies likely having increased 47% versus 2009.

## A Look at the Road Ahead

This is the time of year when prognosticators and market pundits produce large volumes of hot air attempting to predict where the markets will end in the New Year. Since the Trust Company of Vermont does not wish to contribute to the problem of global warming, it has been our practice to try and avoid such activities. However, since one of the primary purposes of this edition of the newsletter is to provide you with an outlook on the economy and the stock market, let's take a look at what the prognosticators are predicting and offer our take on these views.

The current consensus is that the U.S. economy will grow at a slightly faster rate in 2011 versus 2010 and that stocks will produce higher returns than bonds. Economists recently surveyed by Bloomberg estimate that the economy will grow at a 3.3% rate. Ten prominent market strategists surveyed by Barrons collectively predicted that the S&P 500 Index will finish 2011 10% higher, with the range running from 7 to 17%. While we are prone to being skeptical of consensus thinking we do not find ourselves in stark disagreement. Why the optimism you ask? For me personally it is primarily

a matter of human behavior repeating itself. Let's start with the basis for economic growth in 2011 being an increase in consumer and business spending. Consumer demand tends to be self-reinforcing, with companies responding to increasing demand by increasing production, requiring more workers and equipment, thereby spurring greater demand. During the second half of 2010 the seeds of greater demand were in

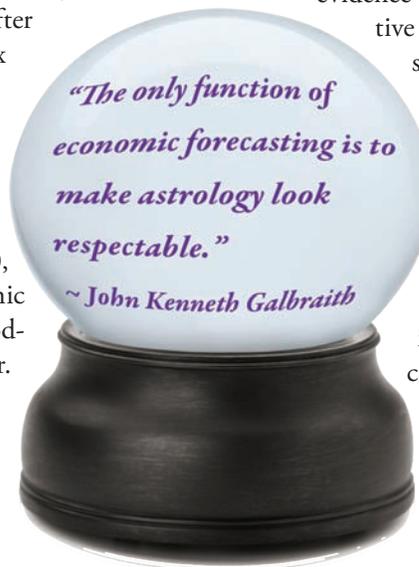
evidence as retail sales increased for five consecutive months likely ending in a Christmas sales season that exceeded analyst expectations.

Looking at 2011 we believe that this trend will continue, fueled by the increase in worker's paychecks resulting from the reduction in the payroll tax. After two years of frugality as consumers reduced their debt levels it is likely that 2011 will benefit from pent up demand. Our culture is, after all, one that is built on inspiring consumption.

Whether the bull market continues in 2011 will be dependent upon one of the oldest of human emotions, the desire to make money. Stock market returns are a byproduct of the struggle between fear and the desire to make money. Over the long-term fear has only won this battle for short periods of time. Since the current bull market began on March 9, 2009 the S&P 500 has risen 86% yet individual investors have pulled \$111 billion from U.S. stock mutual funds and plowed more than \$609 billion into bond funds. If intermediate and long-term bond funds produce negative returns, as they did in the latest quarter, it is likely that the allure of higher returns for the stock market will overcome fear, especially as memories of the last bear market dissipates. Evidence of this shift began to appear in December with retail equity mutual funds showing a net inflow of funds and bond mutual funds experiencing a net outflow. The potential shift out of bond funds combined with substantial levels of cash sitting in low yielding bank deposits provides plenty of fuel to keep the stock market rising in 2011.

*In closing, my wish for all of you in the New Year is that of Peace and Plenty.*

*~ Todd Gray, Trust Investment Committee*



# PROCRASTINATION PERILS

Jack Davidson



It happened again this year. The December panic. Why did I wait so long to shop for presents? Why did I wait until the last week of December to do the charitable gifts? Why did I almost allow my Consumer Reports subscription to expire?

I plan on doing better next year. For one, I have decided to study why people procrastinate. A simple New Year's Resolution won't suffice. For one, I have just learned that 70 percent of all New Year's resolutions are abandoned by February.

I take comfort in that I am not alone. A local store owner informed me that the last minute holiday shoppers are predominantly men.

Is procrastination more of a problem for one gender than another? I don't think so, but it's hard to know what our hardwiring is like. I know that many times when presented with a need to do something, my first instinct is to think "Can I put this off?" and my wife's is "How can I fit this in?" When I go to bed with an agenda in my head, the most amazing thing happens: it's gone when I wake. Not so Judy. Her agenda organizes itself overnight.

I don't think procrastination afflicts one gender more than the other. There might be differences in what tasks might attract procrastination. I know it is much easier for me to buy a digital camera than it is for my wife, and it is easier for her to deal with health insurance options than it is for me.

So, I have embarked on my study of procrastination. I told that to my neighbor, and he said "Didn't you say that last year?" Peter's quick. Well, after one day of Googling "procrastination", I have changed my plan. Instead, I will figure out how to overcome

procrastination for important things. I don't want to know the cause. It's disturbing. Do I fear failure? Do I fear success? Am I a "laid-back" procrastinator? Am I an anxiety-obsessed procrastinator? Do I hate authority? I will look into the causes later.

For now, I am studying techniques to avoid procrastinating with a certain degree of urgency. Why? It's really not about me. I am a functioning procrastinator. It's Congress! Those of us who do estate planning were hoping that Congress would remove the uncertainty regarding the federal estate tax. They did not! More on the changes they did make later. Nonetheless, there is no reason to procrastinate in having your estate plan reviewed.

When we do an estate plan, there are probably two universal barriers to completion and one variable. First, there is the lack of urgency unless the client is seriously ill, and the second is the natural tendency to avoid dealing with our mortality. The variable is "Who is driving the estate plan?"

Most of us are afflicted with procrastination with varying degrees of dysfunction. Some of us are blessed with partners who can help us overcome procrastinating when it is important not to procrastinate. Fortunately, I am one of those.

My first estate plan was executed on a neighbor's porch. My wife informed me that we were not getting on the plane, with our two young sons in the care of her parents, without one in place. We were about to leave. Fortunately, I was able to round up enough witnesses. The barriers had been removed, and my wife was driving the estate plan.

There are many clients who feel that they need a perfect plan. There are few perfect plans, although that is our goal. Many planners feel that it's better to achieve 90 percent the way you want it than to have no plan at all. Although there is some strength to the argument that if you execute the plan now, the urgency for the remaining 10% will now diminish to the point where the plan does not achieve the perfection it deserves.

In my opinion there are four important parts to an estate plan:



- THE PLAN
- THE DOCUMENTS
- TITLING
- THE DRIVER OF THE PLAN

**THE PLAN** is usually not an easy project. It involves thinking through contingencies as well as, perhaps, dovetailing it with the complexities of tax rules.

**THE DOCUMENTS:** Will, Trusts, Durable Powers of Attorney, and Medical Directives such as Living Wills.

**TITLING** is the process of making sure that your property ends up where it is supposed to end up - for example, in a living trust - if that is intended. This may involve removing property from joint name and changing beneficiary designations of Life Insurance policies and IRAs. I have seen perfectly good plans ruined by the lack of attention to titling.

**THE DRIVER OF THE PLAN** is essential. This person needs to make sure that the documents are completed and property is titled properly. In most cases, do not expect your attorney to play this role. Some will drive the documents. Some even drive the titling. Many don't. I have observed a fair number of attorneys from small firms practicing triage. They first respond to the urgent needs of their clients and then to the less urgent ones. Most estate plans are in the category of less urgent. I have seen far too many instances

of a client who has taken months - even years - to complete a plan, and then the attorney takes months to complete the documents. It is ideal if you, or your spouse or another family member, drives the estate plan. There are other drivers as well, but they may drive faster than the speed limit appropriate for you. I have seen many Life Insurance Trusts driven at breakneck speed by the agent.

Sometimes we encounter teams of professionals involved in an estate plan. The client, the attorney, the accountant, the life insurance agent, and the trust officer. Teams can procrastinate as well. If you have a team, you need a project manager. Otherwise, you run the risk of a very high annual maintenance bill without closing open items. The project manager simply holds everyone to the fire until closure. Every estate planning team needs one and, ideally, it should be a member of the team or a family member. You just need to select the right personality and spell out the responsibility. It is rare that the client makes the best project manager when it comes to a team of planners.

Congress recently passed a tax bill that provides some attractive benefits. Among them is "portability", whereby a spouse can use the other spouse's exemption to the extent it was not used on the first spouse's death. We have many trusts designed to capture the first exemption. Will they no longer be necessary? What happens if the changes "sunset" in 2013 as planned? The chart below illustrates some of the key changes:

	2009		2010	
Tax	Exemption	Rate	Exemption	Rate
Gifts	\$1M	45%	\$1M	0.35
Estates	\$3.5M	45%	\$5M	0.35
GST	\$3.5M	45%	\$5M*	0
	2011-2012		2013	
Tax	Exemption	Rate	Exemption	Rate
Gifts	\$5M	35%	\$1M	55%
Estates	\$5M	35%	\$1M	55%
GST	\$5M	35%	\$1M**	55%

It is also interesting to note that Vermont has no gift tax

nor does it have a gift-tax exemption. Vermont does have a GST (Generation Skipping Tax) tax with a much smaller exemption and an Estate Tax with the exemption rising to \$2,750,000 in 2011.

Dovetailing the new Federal rules with the Vermont rules requires thoughtful planning. Do we have enough certainty now to create the perfect plan? Not in all cases! We have enough certainty to reward good planning.

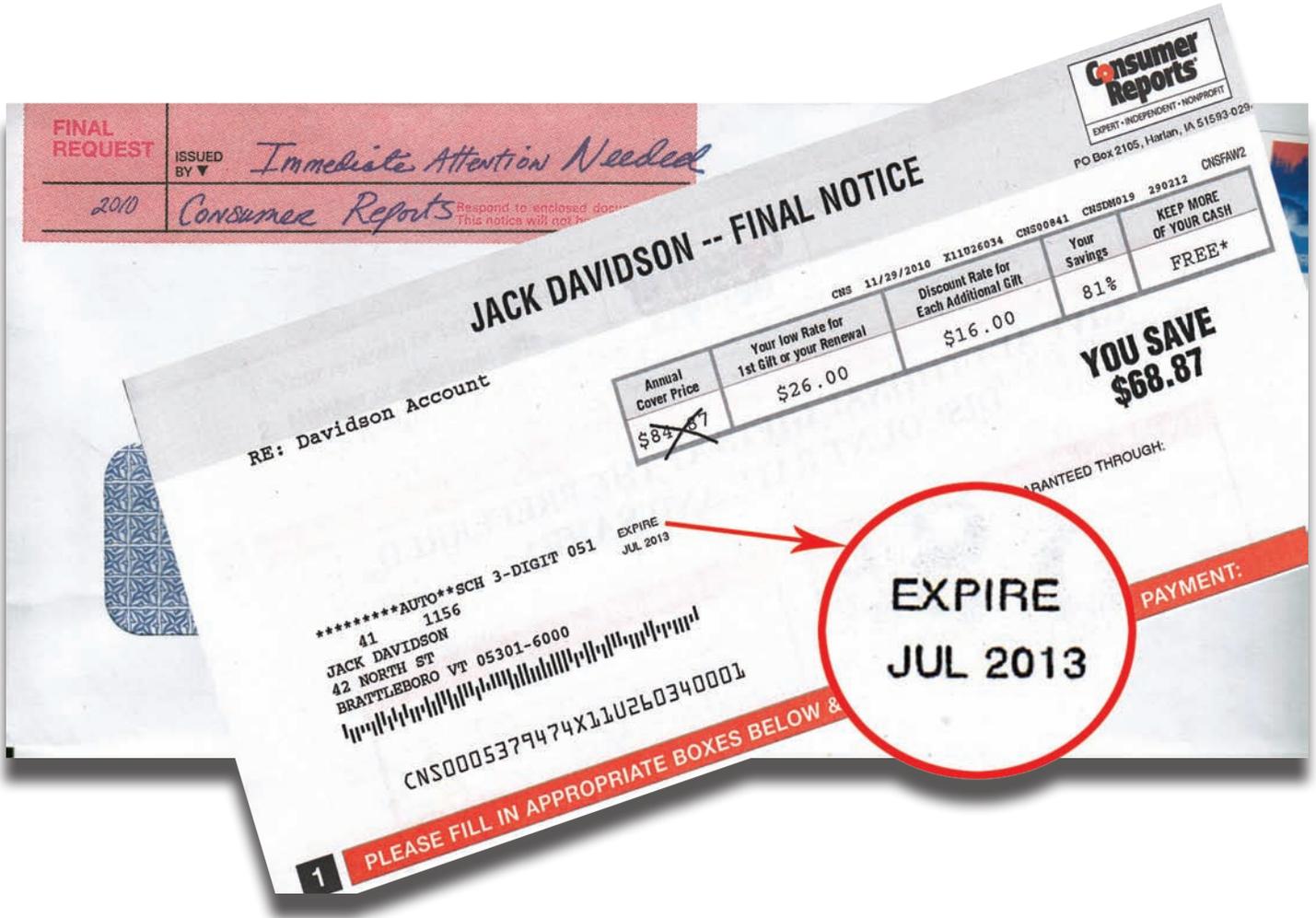
What do you do? You see your attorney. You see your trust officer. More than ever, good advice is very specific to the size of the family assets and family needs. In addition, the legal profession has had some time to adjust to this uncertain world. Disclaimer Trusts and Fractional QTIPs Trusts adjust well to the ups and downs of the tax code, and they are now more familiar to the lawyers. Familiarity leads to less procrastination.

So, we at the Trust Company of Vermont want to create a

sense of urgency. Short of this newsletter, we are at a loss at how to do this. That said, I see a light at the end of the tunnel. I think we can learn from Consumer Reports. I feel indebted to them. They know how to create a sense of urgency so necessary for recovering procrastinators. Allowing my subscription to lapse would have been traumatic for me. How would I be able to pick the best digital camera or talk knowledgeably with my son about the best Flat-Panel TV? So I was able to save my subscription in time. Then someone pointed out that I had already renewed through the year 2013. Just further evidence that Consumer Reports knows the business of urgency.

*\* Executors of 2010 decedents can elect the "no estate tax/modified carryover basis" \*\* Indexed for inflation.*

Editor's Note: This is the first time Jack has submitted his article on time.



# Vermont's Trust Code Tools

*Christopher Chapman, Vice President, Trust Administration  
& Estate Planning*

Vermont's new Trust Code gave trustees a shiny new toolkit when it was signed into law in 2009. In a word, it is comprehensive. As such, the new code is a handy source of guidance, especially for individuals who serve as trustees. It replaces a patchwork of rules that were largely based on case law, most of it from other states and often dated.



It is a truly modernizing statute as well. The Trust Code acknowledges the need to solve problems economically and recognizes that

trusts are long-term arrangements in a dynamic society. In another word, it helps trustees adapt to changing circumstances.

In this first of a series, we point out several key areas where new rules help trustees administer trusts more effectively. Here, we highlight the expanded role of probate courts, a solution to the old income-only trust problem and enabling trusts to move around.

## The Probate Courts

A huge benefit of the Vermont Trust Code is its enlargement of the probate court's jurisdiction to encompass all kinds of personal trusts. Although the probate court has long had jurisdiction over trusts created under wills, previously only the Superior Court had jurisdiction over standalone trusts, which we know as "living trusts."

Probate jurisdiction over personal trusts has a distinct advantage – procedures there are much less formal, potentially resulting in much more cost-effective and efficient proceedings. Of course, difficult issues and parties can lengthen any proceeding, but the potential is there for speedy resolution.

In the event a trust needs some sort of change – whether to correct an error or adapt to new circumstances – the probate court is now available. All an interested party needs to do is petition the court with a letter to hear a matter.

The court's powers include the authority to:

- Settle disputes;
- Reform or terminate a trust to conform with the terms of the settlor's intentions;
- Modify a charitable trust whose terms have become obsolete;
- Remove and replace a trustee;
- Combine trusts with similar provisions or divide them when appropriate;
- Terminate or modify a trust that is no longer economical to administer or in the case of unanticipated circumstances.

The list of powers is longer than this, but the gist is clear: no longer must trust-related issues needing court involvement undergo the expensive and time-consuming formalities of Superior Court procedure. However, it is important to note that, in the event any party to a probate trust proceeding is dissatisfied with the result, the matter can still be taken up in Superior Court.

## Unitrust Provisions

The Trust Code rights an old, inadvertent wrong by making it possible to make larger distributions from an income-only trust than the often meager income itself.

As nearly everyone is aware, interest and dividend rates have steadily fallen over the past twenty or so years. Before this long-term decline, a grantor could take good care of someone such as a surviving spouse by simply providing that the net income be paid out to the beneficiary. Many such trusts were enacted. Income rates were high enough that grantors did not believe it would be necessary to provide for principal distributions.

However, many beneficiaries have found themselves squeezed by falling amounts of income as a result of those diminished interest and dividend rates. Where in-

come may have been in the neighborhood of four percent of the portfolio value, a beneficiary might find himself or herself currently receiving one percent or so. For years, there was no solution to this problem of an outside, unanticipated circumstance.

Under the expanded rules of trust administration, a trustee may now remit between three and five percent of a trust's value – a so-called “unitrust” amount – and dip into principal to accomplish the distribution. Of course, there are some ground rules to be followed in making this change. Among them is that the trustee must notify all qualified beneficiaries of the change. The change can be made without court involvement provided none of the qualified beneficiaries objects and the trustee adopts a written policy on the new arrangement.

A distinct, related advantage of a unitrust arrangement follows for management of the trust investments. In a unitrust arrangement, the trustee is essentially released from its previously hidebound obligation to manage the trust assets with a distinct emphasis on income. Current income rates frustrate such an approach, as income distributions have fallen for reasons out of the manager's control. The unitrust arrangement allows the trustee to invest for the total return of the portfolio without having to worry whether that return is coming from income or growth of principal. It essentially lets the manager do what is best to achieve a reasonable total return. The Trust Code's unitrust provision in turn lets the trustee take care of the income beneficiary's interests. The unitrust is an excellent example of the Trust Code enabling a trustee to adapt to changing circumstances. Without such flexibility, beneficiaries simply would not be served as effectively as grantors had intended when times were different.

There are fewer and fewer income-only trusts to worry about these days, but for those beneficiaries who have long been disappointed by income rates, the unitrust is a saving grace.

## Moving a Trust From Out of State

Among the Trust Code's modernizing features is its recognition that Americans move around a great deal. The statute permits a change of place of administration from state to state, essentially following beneficiaries as they move. A trustee has a continuing duty to administer the trust where appropriate to the trust's purposes and the

interests of the beneficiaries, and the statute permits a change when it makes sense. This means the trust can move out from under one state's trust laws to another's, which can be very helpful to the parties to the trust, especially the beneficiaries. One significant limitation is that tax jurisdiction does not change even when administration moves to another state. However, we have not found this fact to be an impediment to effective trust administration.

The Trust Code permits the trustee to establish a new principal place of administration simply by way of notification to the beneficiaries. Beneficiaries have a right to object within 60 days of being informed, but in the case of a dispute, the probate court can of course be involved to resolve the issue.

More on the Trust Code – In future issues of our newsletter, we will explore other aspects of the Vermont Trust Code. In the meantime, if this article raises questions, please contact your administrator or portfolio manager.

### We are pleased to introduce the latest addition to our staff, Todd E. Gray.



Todd hails originally from Maine and is a graduate of the University of Maine, as well as Husson College in Bangor where he acquired his MBA. He started his career at the Bangor office of the Merrill Trust Company

in 1983. For the past ten years he served as Senior Vice President & Senior Investment Officer with the People's United Bank (formerly Chittenden Bank) Wealth Management, in Brattleboro. Todd and his wife, Karen, reside in Keene. Welcome, Todd.

Conversion Update: The statements this month reflect transactions from our old accounting system through 10/31/2010 and our new accounting system for the balance of the year. We hope the transition is seamless for our clients. That said, if you have any questions do not hesitate to call.