



Quarterly Update April 2008

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

Financial Markets ∞ The Road Ahead

Gregory M. McConahey, Trust Investment Committee

One of Yogi Berra's famous lines is "When you get to the fork in the road, take it."



The fork in the road the Federal Reserve has taken is to provide liquidity to the banking system and thereby help the weakening U.S. economy avoid a severe downturn. The Fed's historically aggressive 2.0% reduction in the federal funds rate since January and initiation of several unconventional borrowing arrangements for banks and non-bank primary dealers appears to have averted a liquidity panic but will take time to truly impact the economy.

In response to this action, the fork in the road global investors have taken is to increase their selling of the U.S. dollar and bid up commodities, most of which are dollar denominated, thereby accelerating already upwardly trending inflation

measurements. The commodity price increase is further exacerbated by increasing global demand for energy, corn, wheat and both precious and strategic metals. "Main Street" has been well aware of increasing prices for some time and now the Bureau of Labor Statistics' most recently released Producer Price Index for Finished Goods showed an increase of 7.4% for the 12 months ended January 2008. This level of increase has not been registered since the early 1980's.

Is the U.S. entering a period of sustained inflation similar to the 1970's or a prolonged period of no growth and stagnating stock market values like Japan since the late 1980's? No one knows the answer to these questions. To be sure, the U.S. faces a difficult period ahead but we remain confident in the resiliency of the U.S. economy and the enterprising nature of its workforce.



The fork in the road we will continue to take for our cli-

ents is one that is consistent with their objectives and risk tolerance. We continue to favor equities of multinational companies that benefit from international demand for goods and services, such as infrastructure, telecommunications or consumer products. The growth in revenue from international markets has partially offset the slowdown in the U.S. economy for the many of the multinational companies. Recent dislocations in the bond market have presented opportunities in municipal bonds. As an example, the 10 year U.S. Treasury Note (federally taxable) currently yields 3.50% while a 'AAA' tax free general market municipal bond yields 4.05%. Inflation protected securities may play a greater role in fixed income portfolios. In this dynamic environment we must constantly assess ways to preserve and grow our client's assets.



We welcome the opportunity to review our outlook, and your portfolio, in greater detail at your convenience.

JOINT TRUSTS - PART III

This article concludes our series on the use of joint trusts. Parts I and II explored the impact of recent IRS Private Letter Rulings that suggest how a joint trust could work in both taxable and nontaxable estates. Please see our July and December newsletters from 2007 at our website, www.tcvermont.com. We should point out that this series of articles has been written for our clients who live in separate property states, such as Vermont. If you live in a community property state, this series of commentary does not apply to your situation.

The Tax-Plan Joint Trust



The Tax Plan Joint Trust is for the husband and wife whose expected combined wealth will exceed the couple's likely estate-tax exemption amounts. It is also for a couple concerned about the impact of second marriage circumstances.

Unlike the Disclaimer Joint Trust, the Tax Plan Joint Trust automatically funds the "credit-shelter" and "marital-deduction" trusts. Consequently, it is a safer vessel for saving estate taxes from an administrative point of view. It does not depend on the surviving spouse to make any elections within nine months of the spouse's death, as a disclaimer trust would. Nor does it run the risk of an inadvertent loss of the right to make a disclaimer election in the event the surviving spouse were to receive benefits from the trust before attempting to make the election.

There are a number of factors to consider when deciding whether to use separate trusts, or joint trusts, and the type of joint trusts. As previously noted, an especially attractive feature of joint trusts is simplification of asset ownership. With a joint trust, a couple no longer needs to divide assets between them to create the two-trust tax benefits – or so we are led to believe by IRS Private Letter Rulings. The final arbiter on which trusts to use is your attorney.

If you are interested in a joint trust, we recommend that you consult with an attorney. The following checklist should assist you in your discussions.

- ❖ Consider joint trusts if you have trouble allocating assets between spouses.
- ❖ Consider joint trusts when a substantial portion of the combined assets consist of tax-deferred assets, such as IRA's and 401(k) accumulations. Those assets can throw off an otherwise well crafted plan because they cannot be encompassed easily by the conventional two-trust plan.
- ❖ Consider the Disclaimer Joint Trust when the need for estate-tax planning is remote. A disclaimer trust provides a safety net for the unexpected, and, if the disclaimer must be employed, electing to fund the Credit Shelter Trust can provide potential savings in estate taxes.
- ❖ 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.
- ❖ Discuss the impact of creditor protection, divorce, and subsequent marriages. If the possibility of a subsequent remarriage is a concern, favor separate trusts.
- ❖ Discuss the impact of funding a joint trust. Those who use a joint trust are well advised to document the portions that each spouse contributes to the joint trust.
- ❖ Customizing conventional joint trust language may inadvertently result in gifts. Consider this impact.
- ❖ Consider the impact of basis adjustments on death for determining capital gains. Joint trusts mimic joint tenancy with rights of survivorship in this regard. In other words, it is likely that only one-half of each jointly owned asset will be "stepped up" upon death.

~ Christopher G. Chapman