Trust Company *of* Vermont Quarterly Update

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Brattleboro ◆ Burlington ◆ Rutland ◆ Manchester

Employee-owned & Vermont-based

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Chris Cassidy, CEO

I started at Trust Company of Vermont as a full-time employee in 2006. At the time, corporate earnings were strong, the economy was doing well, and the housing market was booming. S&P 500 returns were positive in both 2006 and 2007, and everything was going along smoothly. Then 2008 happened.

2008 marked the second worst year of the last one hundred years for the S&P 500 with the index falling almost 40% in one year. Only in 1931, during the Great Depression, did the stock market perform worse than 2008.

As stressful and difficult as 2008 was, the S&P 500 recorded double-digit gains in 2009, 2010, 2012, 2013 and 2014. In fact, a common theme with equity markets over the past one hundred years is that periods of the biggest gains generally follow periods of the biggest losses.

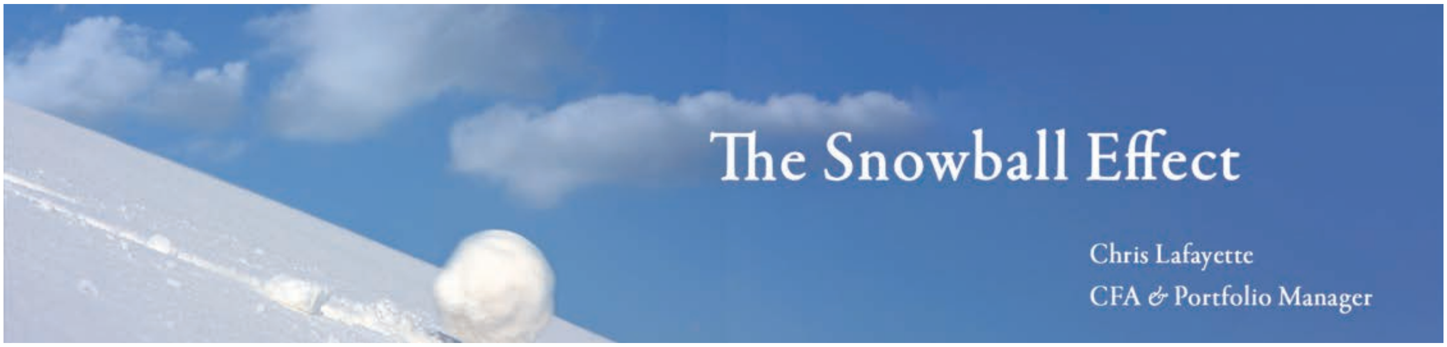
Recently, Dreman Value Management analyzed the major geopolitical events the world has faced since World War II, such as the Cuban Missile Crisis, the Persian Gulf War and the 1998 Russian Bond Default, and their impact on equity markets. It concluded that while markets struggle initially in the face of geopolitical turmoil, on average the Dow Jones Industrial Average was over 16% higher twelve months later.

That theme holds true in recent times as well. A recent Barron's article noted that the average S&P 500 gain for the 12 months following a close in correction territory is 9.3% dating back to 1998. We saw this phenomenon play out in 2020 when the S&P lost one third of its value in a matter of weeks, only to post a double-digit gain for the calendar year.

Geopolitical conflicts and volatile financial markets are never easy to experience. The nightly images of the humanitarian crisis occurring right now in the Ukraine are heart breaking and sad. Our thoughts and prayers go out to all the people that are displaced and suffering because of this unfortunate conflict.

As previously mentioned, geopolitical conflicts almost always result in market volatility and downward pressure on equity prices. We have certainly seen that in 2022 with the S&P 500 and Dow Jones Industrial Average reaching correction territory. Thankfully, we have a highly experienced group of portfolio managers that are accustomed to market volatility.

Trust Company of Vermont was fortunate to hire Chris Lafayette as a Portfolio Manager in our Burlington Office at the beginning of this year. Chris resides in South Burlington with his wife, Rachel, and their three children. Like me, Chris managed assets during the 2008 Financial Crisis and is no stranger to volatile price swings. His article provides some insights into investing in turbulent financial markets.



It was an 11th grade Investing class at Burlington High School where I was first introduced to the magic of compounding returns. Our teacher, Mr. McGrath, demonstrated how modest savings early in life, growing at historical rates of stock market returns, would make us all millionaires with the benefit of time. This was naturally fascinating and many of us immediately started buying stocks, but as luck would have it, my junior year of high school coincided with the end of the go-go 1990s. The subsequent Dotcom bust saw a 49% peak to trough decline in United States equity markets and left few of us as stock market enthusiasts.

However, because of a love of statistics, and an innate curiosity around all things business, I endeavored to better understand what drove these mysterious markets. Flash forward to today and I've spent the past fourteen years managing assets, but I am still constantly reminded that the practice of compounding money is more difficult than the theory.

Stocks are a risk asset. At almost any given time, I like to assume there is the risk that stocks could go down 50% from where they are. But for taking this risk, investors have historically been compensated with higher returns. The S&P 500 has compounded at 10.5% annually since inception. Double digit returns sound great when compared to "risk-free" assets, like a 10-year United States Treasury, yielding just under 2% today. However, no one can tell you what a stock portfolio will be worth tomorrow, and an investor must be willing to sustain significant short term volatility, to achieve long term gains.

The person most often quoted when looking to decipher the stock market's gyrations is Warren Buffett. Appealing to my contrarian nature, my personal favorite is, ***"Be fearful when others are greedy and greedy when others are fearful."*** If you read Buffett's biography by Alice Schroeder, ***The Snowball***, it details how his acceptance of stock market volatility, and the ability to take advantage of it, took him from humble beginnings to one of the world's wealthiest individuals.

Another thing that Buffett is quick to point out is that you can reduce the likelihood of experiencing losses the longer you stay invested in the market. Looking at the S&P 500 average annual returns for trailing 10-year periods starting in 1935, only 4 of 86 times would an individual have lost money if able to stay invested for the full 10 years. Furthermore, those losses were very modest.

10 Year Periods	Average Annual Returns
1929 -1938	-0.90%
1930 - 1939	-0.10%
1999- 2008	-1.40%
2000 - 2009	-1.00%
All Period 10 Year Average	10.50%

As we well know, this history encompasses numerous international conflicts, periods of incredibly high inflation, countless political and policy transitions, numerous interest rate environments, and even a world war.

Needless to say, the stock market has shown a tremendous ability to endure substantial turmoil in its long-term march higher.

Still, news headlines suggest investing is a timing game, and we are led to believe that there are times of greater risk in the market and times of less risk. It is natural for investors to want to avoid risk, so it would seem logical to sell when the risk is greater. There is no question that the market dislikes uncertainty, but if we can use history as an example, and assume that the problem de jour will eventually find a resolution, then market pull backs are actually an opportunity to buy assets at lower prices to benefit from long-term results.

The tragic events unfolding today in Ukraine have been portrayed as introducing a higher element of risk to the stock market. International indexes with the most direct exposure to Russia and the Ukraine have less than 2% and 0.1% respectively, but there are real impacts on commodities. Russia is a significant exporter of fossil fuels and wheat, and price increases could impact the Federal Reserve's decision to raise interest rates, introducing second order risk.

While these risks are real, periods of high inflation, or escalating tensions between global superpowers, are not unprecedented and it doesn't take a long walk through history to find parallel situations. Then, like today, the manifestation of these risks resulted in large swings in stock markets. But as the chart below shows, large daily stock market declines have often preceded the largest daily percentage gains in history.

Largest Daily Losses			Subsequent Gain	
Rank	**Date**	**%**		**%**
1.	10/19/1987	-22.61	10/21/1987	10.15
2.	03/16/2020	-12.93	03/24/2020	11.37
3.	10/28/1929	-12.82	10/30/1929	12.34
6.	11/06/1929	- 9.92	11/14/1929	9.36
11.	10/15/2008	- 7.87	10/28/2008	10.88

If a strategy of de-risking a portfolio meant exiting stocks after prices declined sharply, we can see that historically you are apt to miss out on days of rapid recovery. The data on missing the biggest increases in the market is devastating to compounding gains.

Analysis by Bank of America suggests that missing the 10 biggest daily gains in the stock market each decade, reduced cumulative returns over 10 years from 105% to just 36% since 1930.

How do we sleep at night knowing that we must sustain periods of significant loss to reap the compounding benefits that stocks provide? On this, my personal approach mirrors that of the investment team at Trust Company of Vermont, which is why I am so excited to have joined forces. Our philosophy is to own high quality, cash producing companies, that are in good financial condition such that they can navigate negative events and live to reap the rewards of an eventual recovery.

Again, this sounds simple, but no one likes looking at the value of their portfolio declining. The practice of drowning out headlines and having a long-term mindset is more often spoken of, than it is adhered to. Despite the compelling proposition Mr. McGrath offered more than twenty years ago about compounding your way to financial freedom, not everyone will be able to withstand the temptation to "avoid losses." But for those that can accept the volatility, and view it not as a risk, but rather the reason you will be rewarded, the benefits of compounding returns are just as available today as they were when first explained to me many years ago.

Helpful Planning Reminders for 2022

2022 brought some changes to estate and gift tax exemptions, as well as retirement account contribution limits. Understanding these various exemptions and limits can be helpful for estate planning, gifting, and saving. Below is a quick summary:

Estate Tax Exemption

The federal estate tax exemption has an annual adjustment for inflation. That annual adjustment brings the estate tax exemption up to $12,060,000 per person for 2022. This number represents the amount of assets that a decedent can pass to his or her heirs, or other beneficiaries, free of federal estate tax.

Per current law, this historically high federal estate tax exemption is scheduled to sunset at the end of 2025. If no action is taken by Congress before then, the federal estate tax exemption will revert to $5,000,000 as indexed for inflation on January 1, 2026.

It is important to note that various states have their own state tax exemption. Vermont's is currently $5,000,000 in 2022.

Gift Tax Annual Exclusion

The gift tax annual exclusion allows an individual to make gifts without impacting their lifetime gift tax exemption, which is currently equal to the federal estate tax exemption of $12,060,000. The annual gift tax exclusion for 2022 has been increased by $1,000 to $16,000 per person, with no limitation on the number of people that you can make gifts to.

Retirement Account Contribution Limits

If you have a 401(k) or 403(b) retirement account, you can contribute up to $20,500 to your plan in 2022. Furthermore, if you are 50 or older, you may contribute an additional $6,500 in 2022 per the "catch-up" provision.

The annual contribution limit for IRAs remains unchanged from 2021. An individual can contribute up to $6,000 to an IRA in 2022. If an individual is 50 or older, they can contribute an additional $1,000 per the "catch up" provision in 2022.

The combined annual contribution limit for Roth and traditional IRAs is $6,000, or $7,000 if you're age 50 or older for the 2021 and 2022 tax years. You can contribute to an IRA if you or your spouse have earned income. Contributions and deductibility are subject to modified adjusted income limits. Consult your tax preparer for eligibility.