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Bitcoin: What Is It and Should You Own Some?

David DeBellis, CFA & Portfolio Manager

To say that the markets have become 'frothy' is an understatement. We are seeing daily swings in market prices and share volume that have not been seen in quite a while. And I don't want to say that the market is reaching its peak, but there are some signs that I think could indicate the best returns have been earned in this market cycle. One sign of this could be the rise in popularity of some very non-traditional investment vehicles. You may have heard or read about things like **Cryptocurrencies, Special Purpose Acquisition Companies (SPACs)** or, most recently, **Non Fungible Tokens**. And while I have not been asked about the latter two, I have had several clients and even nieces and nephews ask me about whether or not they should be buying bitcoin, the most popular of the cryptocurrencies.

Before I can answer this, I think it is important for everyone to know exactly what bitcoin is. To start, let's first define what a cryptocurrency is. At their core, cryptocurrencies provide an electronic payment system that enables paperless transactions from one party to another through blockchain technology (a digital ledger). The transactions are secured with cryptography and are entirely anonymous. They also bypass middlemen such as banks and credit card companies. There are hundreds of digital currencies, but as mentioned earlier, bitcoin is the first and largest of them. How big you might ask? The current market capitalization of bitcoin is near $1.1 trillion dollars, that's up from just $110 billion a year ago and bigger than the three largest US banks combined (JP Morgan, Bank of America and Wells Fargo). It's also more than five times larger than the next biggest cryptocurrency, Ethereum.

There's a couple more things that I think anyone considering buying bitcoin should know. First, bitcoins are not minted like the dollars and coins that we use on a daily basis. Instead, they are produced by people and businesses running computers to solve a very complex mathematical problem (known as mining). The formula is freely available, but the computing power needed to solve it is very high and costly. Next is perhaps the most important thing that a potential investor needs to know.

How is the value of bitcoin determined? Simply put, the price of a bitcoin is determined by the supply and demand on the exchanges where it trades. In other words, it's worth what someone else is willing to pay for it.

This is very different from traditional currencies, where the value is influenced by factors such as central bank monetary policy, inflation and foreign currency exchange rates.

Bank of America recently published a research piece titled "Bitcoin's Dirty Little Secrets". In the piece, BofA did not pull any punches at bitcoin prices, saying that they are not backed by hard fundamentals but by fund flows, big-name buyers and miner rewards cuts that will result in decreased supply. The author of the article said that there is no good reason to own bitcoin, unless you think that prices will continue to rise. They went on to explain how much of the 1,000 percent rise in the price was thanks to increased institutional and corporate interest along with speculative demand.

They pointed out that much of the increase was due largely to thin liquidity, arguing that gold needs around $1.86 billion worth of transactions to increase by 1% while bitcoin only needs $93 million worth to move a similar amount. Adding to this liquidity issue is the fact that bitcoin output is capped at 21 million coins.

Here are a few more facts about bitcoin that I think make it a poor choice as an investment vehicle. According to the analyst at Bank of America, bitcoin's ownership is very concentrated with just 2.4 percent of addresses owning approximately 95% of total bitcoin in circulation. This makes the use of bitcoin as a payment mechanism very impractical.

As more and more institutions adopt the use of bitcoin, it is likely that we'll see regulations created around it. Christine Legarde, the president of the European Central Bank, recently called for regulation to address "the funny business associated with cryptocurrencies". Regulations are unlikely to enhance the value of the asset. Along with this, a number of central banks have begun discussing the idea of launching their own digital currencies that might use mainstream technology and operate on mainstream payment systems. If this were to happen, it is highly likely that bitcoin would lose it spark and fizzle out.

And lastly, there is an environmental reason not to invest in bitcoin. The mining of bitcoins takes an incredible amount of computing power and energy. It is estimated that the bitcoin network emits about 60 million tons of carbon dioxide, or about the same amount as the entire country of Greece.

Bitcoin's 498% one-year increase was bound to draw the attention of all investors, especially those who read articles about people becoming wealthy through investments in it. But there were 100 stocks with market capitalizations of $1 billion or more that had returns equal to or greater than bitcoin. Most of these companies have earnings and can be more easily valued than cryptocurrency. And it is with this fact in mind, along with the points above, that we do not recommend a strategic holding in bitcoin, but instead view it as a speculative, high risk investment.

Customer information security is our top priority. Beginning on April 7, 2021, we will add an extra layer of security to your Trust Reporter Client Access log-in. This added layer of security is called Two-Factor Authentication (2FA) and gives you extra protection against fraud and identity theft. Going forward, accessing your account will require entering a code sent via text. We realize additional log-in requirements can be cumbersome at first, but in the current cybersecurity environment, we do this with the utmost care for the security of your information.

Consistency in Chaos

Chris Cassidy, CEO

Every year in March and April, millions of sports fans turn their attention to the Men's and Women's NCAA Basketball Tournaments. These exciting tournaments feature college teams from all over the country in a thrilling single elimination format. It is expected that a whopping 35 million Americans will fill out a bracket this year.

In fact, so many people spend part of their workday streaming games and checking their brackets that recent estimates suggest that this year's tournament could cost employers over $13 billion in lost employee productivity. In addition, the American Gaming Association expects 47 million Americans to place bets on NCAA Tournament games.

The NCAA Tournament is often referred to as "March Madness" because of all the upsets (underdogs beating favored teams) and bracket chaos that ensues in the early rounds. Despite these fun early round upsets, the Men's and Women's Tournament Champion is almost always a well-known team, from a well-known conference with a high seed (teams are seeded from 1 to 16 with 1 being the highest and 16 being the lowest). In other words, despite the short-term chaos, the ultimate result is much more consistent.

The Men's NCAA Tournament expanded to its current format of 64 teams in 1985, while the Women's NCAA Tournament expanded to 64 team in 1994. Since that time, a top 3 seed won the Men's National Championship about 90% of the time. Furthermore, almost 80% of the Men's National Champions since 1985 are currently in just three conferences: the Atlantic Coast Conference, the Big East Conference and the Southeastern Conference.

There is even more long-term consistency with the Women's NCAA Tournament Champion. Since the Women's NCAA Tournament expanded to 64 teams, a top 3 seed won the National Championship 100% of the time. In fact, a number one seed has won more than 75% of the time. Furthermore, two teams, UConn and Tennessee, have combined to win the national championship approximately 60% of the time.

The stock market is somewhat similar to an NCAA Tournament Bracket. In the short-term, stock market returns can be very inconsistent and large selloffs are not uncommon. In 2008, the S&P 500 plunged more than 35% and during the dot.com collapse of 2000-2002, the market posted negative returns for three straight years, including a more than 20% decline in 2002. More recently, in February/March of 2020, the S&P 500 lost one third of its value in just 4 weeks.

Despite this shorter-term chaos, long-term equity market returns have been surprisingly consistent. Over the past twenty years, ending 2020, geometric average annual returns for the S&P 500 have been roughly 7.5%. Over the last 50 years S&P 500 annual returns have been roughly 10.5%. Going all the way back to 1928, S&P 500 annual returns have been approximately 10%. While it is not uncommon for equity markets to decline 10-20% in value in a given year, long-term returns have historically been remarkably consistent.

Although upsets are fun to pick when filling out a bracket, my advice is to stick with the top seeds when picking a national champion. Although financial markets can be very chaotic and unpredictable in the short-term, my advice is the focus on long-term returns.

What if You Leave Your IRA in Trust?

Jennifer Rowe, Esq., Trust Administrator

If you plan to leave your retirement account in trust for your children or other beneficiaries, the SECURE Act presents some new wrinkles. Just as if you left the plan to individuals, in most cases the ten-year distribution rule now applies (there are exceptions for disabled or chronically ill beneficiaries, minor children, your surviving spouse, and beneficiaries less than ten years younger than you). **But what if you don't want your children to receive the entire IRA amount in ten years?** Your trust can provide that the trustee should take out the IRA distributions over ten years as required, pay the tax, and continue to hold the distributed amount in trust for your children and the beneficiaries who follow them, for their lifetimes or until the age you select. Just as you planned, the trust can provide protection from your beneficiaries' creditors, possible divorce, and unchecked spending, and continue to carry out whatever estate tax measures you may have chosen to include.

However . . . the income tax impact of the ten-year rule is more severe if the IRA's income is trapped in a trust instead of passing into the hands of an individual beneficiary. That's because a trust pays income tax at the top rate, currently 37%, on virtually all its income, while an individual pays that top rate only on income exceeding a bit more than $500,000. So unless your children have income sufficient to put them in the top tax bracket, holding the IRA distributions in trust is going to cost even more in income tax than giving them the entire IRA within ten years. What to do? We have some ideas. There are provisions you can add to your trust that will shift the responsibility to pay income tax from the trust to the individual beneficiaries, without actually paying out all the income.

"How is this a good thing?" your children are now asking as they read over your shoulder. ***"I have to pay the tax on income I didn't even receive?"*** Keep in mind that the trust will be able to distribute to those tax-paying children sufficient funds to cover the additional tax they'll owe, and most important, remember that as long as the children are paying tax at the 12%, 22%, or 24% rate, they're paying less than the trust would pay on the same amount of income. That's an overall savings that preserves more in trust for the future benefit of your children, and perhaps their children also.

"OK, I'm in," your child may now be saying. ***"I'll work together with the trustee to minimize the joint tax burden paid by the trust and me, which will leave more for me later on."***

If this is your situation, talk with us and with your attorney about including language in your trust that lets your trustee choose to give a beneficiary the power to withdraw the taxable income from the trust each year. Under this provision, whether or not your child withdraws the income, the income will be taxed to the child at the child's rate. Any portion of the taxable income that your child does not withdraw remains in trust after the power to withdraw lapses, which will happen on a predetermined schedule or at the end of the year. Of course, if your child repeatedly uses the withdrawal power to take all the year's taxable income out of the trust, no trust protection is gained, and in that case the trustee can decide in any given year not to offer the withdrawal power. Giving the trustee that discretion means you can add some flexibility to your trust and use the withdrawal power to limit taxes . . . whenever it makes sense.

More Strategies for Dealing with the Secure Act's 10-Year Rule

Chris Chapman, CTFA & Trust Administrator

With appreciation to colleagues Jeanne Gilbert and Deb Brown for their assistance

My colleague Jenny Rowe explains how to deal with IRA money that will be held in trust for your beneficiaries. There is a second, complementing set of planning techniques available that can be brought to bear ***during lifetime*** to minimize the size of the IRA itself without much loss of benefit.

Spend down from the IRA during your lifetime while keeping an eye on your tax bracket. The idea may scrape against your saving and financial discipline, but by using some of that money instead of your trust's tax-free principal, you will proportionately reduce the impact of the eventual tax issues associated with the Secure Act's ten-year-termination rule. That tactic will also leave more of your principal available for the support of your trust's beneficiaries – with corresponding tax savings to them.

Convert a portion of your IRA to a Roth IRA. You may already be aware that in most cases, money accumulated in a Roth IRA is not subject to income tax upon distributions.

A caveat, however, is that rolling over IRA money to a Roth IRA is a taxable event, so you would lose some money to taxes in the transaction. Also, this technique is best used when you have plenty of time to make up the loss to taxes with growth and income from the IRA, the Roth IRA, or other investments. For that reason, it may not be good for a person in retirement. For a younger person, though, it may be an excellent strategy.

Make a "QCD" – If you are age 70½ or older, you may want to conduct some, or all, of your charitable giving from your IRA. Tax rules allow such an account holder to distribute up to $100,000 per year to charities. This kind of gift is known as a Qualified Charitable Distribution, or QCD for short. It is important to note that charitable giving strategies are recommended only for those who are charitably inclined in the first place. It should go without saying that there is actually no money saved for the family when it is given away. But charitable use of IRA funds can indeed simplify your income tax situation.

Involve a certain kind of charitable trust. A more sophisticated way to simplify administration of your trust and reduce – or even eliminate – the matter of ten-year-rule complexity is to make distributions from your IRA to a trust known as a ***charitable remainder unitrust*** during your lifetime, or to make such a trust your IRA's designated beneficiary – or do both.

Space limitation prevents an in-depth discussion here, but suffice it to say that this vehicle can be handy for the charitably inclined. Upon funding, which is partially deductible, this trust makes distributions each year at a rate you determine to one or more individuals whom you name up front, for life, and then distributes to any one or more 501(c)(3) organizations you also name. The IRA's accumulated tax-deferred income is thus distributed over the individual beneficiaries' lifetimes. These distributions completely skirt the Secure Act's ten-year rule potential tax problem.

Please call us with any questions you may have about these strategies.

What I Learned Hiking in Europe: Shawshank Redemption

Jack Davidson

My spousal responsibility of hiking in foreign countries is a gift that I would often like to avoid. Why not look at the Alps on my 50-inch TV, in glorious color, with the beauty of the flaming logs in my fireplace, versus trying to keep up with hikers at 9,000 feet with the wrong gloves and ear and neck coverings? When hiking in reality rather than my TV den, to create

friendly distractions of the aching body, I would ask others in our hiking groups, what movies do you like? The most frequent response, especially hikers from Great Britain, would be "The Shawshank Redemption".

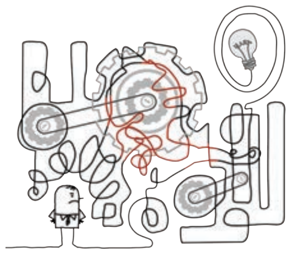
The 1994 film, one of my favorite movies, is based on the 1982 Stephen King novella about a trust officer in a bank who is wrongly sentenced to life in Shawshank State Penitentiary and eventually outsmarts the corrupt Warden. Based on hearsay, it is my understanding that when Stephen King, who was living in Portland, Maine, at the time, went into the trust department of a local bank for assistance in setting up his estate plan, he based his character on a trust officer in this bank.

A bank trust officer works for a "corporate trustee". A corporate trustee is either a bank with a trust department or an independent trust company, such as the Trust Company of Vermont. Corporate trustees are regulated by state or federal agencies and courts of law. They are considered experts who are required to meet higher standards than non professional trustees. Often corporate trustees are considered the "voice of reason" when a person's estate plan includes a trustee, but are they worth the price? Most corporate trustees base their primary fee on the value of the assets, rather than time spent, so the byproduct in many cases is that they will not offer trust services for smaller trusts.

Estate planning lawyers will often recommend revocable living trusts to avoid the probate court for two reasons: privacy and costs. Probate assets, whether passing through an estate or housed in testamentary trusts, are open to public inspection. Most probate court personnel will tell you about those who come into the court to target those with assets who might like their investment products. Costs, on the other hand, may be the primary reason to avoid the probate court. Why account to the probate court, with the associated costs?

One can simply bypass the court with a simple "living" trust where the donor is the trustee, and change the name of the investment management account to

the donor as trustee. When the donor passes on, the property may then pass swiftly to the beneficiaries and avoid the probate process. But if, for example, some of the beneficiaries need a trust because of age, health, behavior and/or their financial management acumen, the trust may become irrevocable and continue on for their benefit. Or, if the trust needs to be designed to save taxes, the trust may become irrevocable. When a trust becomes irrevocable for a short period of time, simplicity may be a safe and sensible solution when the trustee is not trained in highly complex tax and fiduciary laws. If for longer periods of time, the non-corporate trustee may become a problem. They are not monitored by those that know the rules of being a fiduciary. Most unsupervised trustees are well-meaning, but they may make costly mistakes because of unintentional violation of complex tax and fiduciary laws and the risk may cost a lot more than simply avoiding the probate court. In Vermont, unlike some other jurisdictions, probate court supervision of the estate and the trust (which we refer to as a testamentary trust because it is included in the will), is efficient and should be considered for those trustees who may not fully understand their fiduciary duties.



Estate planning in Vermont is once again experiencing the ebbs and flows of complexities. As the estate tax exemptions increased, the need for sophisticated irrevocable trusts declined in numbers although larger estates may have a greater need based on the future projections of tax law changes. On the other hand, medicaid planning and special needs trusts are growing in numbers and complexity.

Selecting a trustee may be the most complex issue for those that want to take care of others. The key questions are: Do I need a trust? How much will it cost year-by-year, including the accountant's fee for doing the fiduciary tax return, and the cost of those needed to advise the trustee of the "legal" obligations of being a fiduciary?

When a corporate trustee is selected, you may have unintentionally created a legacy of imprisoning your assets for your beneficiaries. Changing corporate trustees may be a very important addition to the trust. Your trust document can include a clause that allows the beneficiary or beneficiaries to change the corporate trustee to another corporate trustee. Fortunately, in 2005 Vermont started to change the rules which at the time made it very difficult to remove a corporate trustee. Now the probate court can easily and quickly remove and replace a corporate trustee for both living and testamentary trusts for a number of very sensible reasons, such as the relationship between the trustee and the beneficiaries and the responsiveness of the trustee to the beneficiaries. The probate court can even have the corporate trustee reimburse the trust for attorney's fees and court costs paid by the trust relating to their efforts to avoid removal.

Vermont also approved a "Trust Protector". That is a person or persons, other than a trustee, who can monitor the actions of the trustee based on the provisions inserted into the trust and/or allow for future modifications of the document without needing to involve the court. As your lawyer may tell you, you can specify how much authority a trust protector will have. The list of powers you might give to this person might be very helpful, or might become unsettling for the beneficiaries of the trust depending on what you select. Often the trust protector's "authority list" is short and simply used to change the provisions to stay up-to-date regarding tax law changes after the trust becomes irrevocable. A trust protector might be a simple and cost-effective way of monitoring the behavior of a non-corporate trustee, for instance by reviewing and approving a trustee's reports or accountings.

Estate Planning can be like trekking in the mountains when you think you are near the top and then discover you still need to hike 3 more hours. Planning your legacy is often more complex and time-consuming than one might expect.

Sometimes when I hike, I think of the Shawshank Redemption. I have been a "Trust Officer" for my entire career. I first worked in a bank trust department and now in a trust company. The movie describes the main character, Andy Dufresne, as a "banker". My banking friends sometimes bask in the light of the character, Andy. I take issue. In the movie Andy does estate and trust planning as well as tax returns and investments. This is not what bankers do. So, "bankers" take pride if you would like, but we trust officers have just endured the tax season, and we continually face estate plans derailed by tax law changes, and, perhaps most importantly, the pain if the stock market goes down.

All of us at TCV hope you and your family are remaining safe and well during the pandemic. We look forward to the days ahead where we can meet again in person. In the meantime, for TCV's most recent office policies and service accommodations, please see our website:

www.tcvermont.com

Peter Sherlock Appointed Chairman of the TCV Board

Peter Sherlock, long-time TCV board member, has been elected Chairman of the Board. Complementing our new CEO, Chris Cassidy, the employee-owners of TCV are grateful for his stewardship.

"I was fortunate enough to be asked by Jack (Davidson) at the inception of the Trust Company of Vermont to become involved as a Director. It has been a great pleasure to witness the numerous successes of the organization over the last twenty-plus years, and I look forward to helping in the stewardship of the company in any way I can into the future"

Mr. Sherlock, a Chartered Financial Analyst (CFA), was formerly the principal behind Sherlock Investment Management, Inc., a SEC-Registered Investment Advisor that had been located and operated in Brattleboro, VT for over 20 years. In addition to volunteering on various investment committees for local not-for-profits, Mr. Sherlock currently serves on the board of the Brattleboro Savings and Loan and was previously board chair of the New Hampshire Trust Company and both Southern Vermont Healthcare (Brattleboro Memorial Hospital) and the Brattleboro Retreat. He is a graduate of both the University of Vermont and the University of Massachusetts and when he's not either planning or on new travels, he lives in Arizona and Vermont with his wife, Susan.