
# Trust Company *of* Vermont
## Quarterly Update January 2020

Brattleboro ◆ Burlington ◆ Rutland ◆ Manchester ◆ St. Albans

Employee-owned & Vermont-based www.tcvermont.com

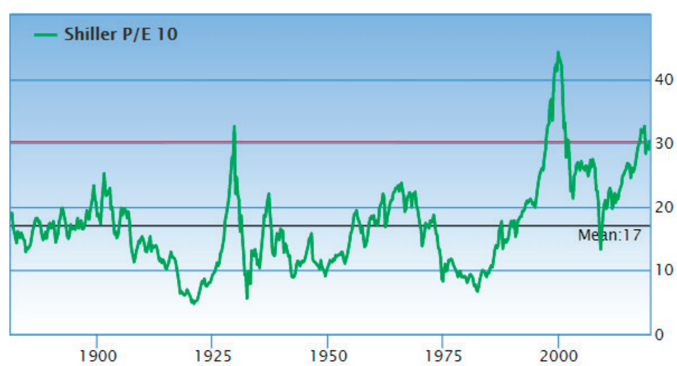

## Current Views on the Market

Ben Ferris, Portfolio Manager

"If you spend more than 13 minutes analyzing economic and market forecasts, you've wasted 10 minutes." – Peter Lynch

I believe it is fruitless to spend much time worrying or forecasting macroeconomic factors. Gaining an informational edge in this arena would be essentially impossible even if there were only a handful of daily datapoints to analyze, let alone thousands. However, I think it is important to have a bird's-eye view of where the markets are in the economic cycle. I think it is especially helpful when markets hit extreme valuation levels. Hopefully this only takes three minutes to analyze and review. If it takes you longer, I owe you some minutes back and please let me know your hourly rate – I'll make sure Jack reimburses you with a personal check!

One high-level valuation metric that I always like to keep an eye on is the Shiller CAPE P/E 10 ratio (where CAPE stands for cyclically-adjusted price to earnings), named after the Nobel Prize-winning economist Robert Shiller. This ratio is calculated by taking the price level of the S&P 500 (about 3,100 at the time of this writing) and dividing it by the average earnings of the companies in the index over the last ten years, adjusted for inflation. The idea is to value companies based on their earnings power over the course of an economic cycle, which typically lasts about ten years. The higher the ratio, the more expensive the market is. As you can see in the chart below, we are currently at a very high level (30), almost double the long-term average.




While there are some flaws with this metric, it has proven to be extremely useful at predicting long-term returns for stocks. In fact, since 1970, there has been a 0.75 correlation between the ratio and the future 10-year gain on the S&P 500, with high CAPE ratios correlating to low 10-year returns. It is informative to see how US equities have performed in subsequent periods when the CAPE ratio is at high and low levels. The chart below shows the three lowest and highest CAPE ratios going back to 1881 and the subsequent one, three, five, and ten year returns for the S&P 500.

**Table 2: Historical Highs and Lows in CAPE and *Subsequent* U.S. Equity Returns**

| Date | CAPE | 1 Year | 3 Year | 5 Year | 10 Year |
|---|---|---|---|---|---|
| Dec. 1920 | 4.78 | 7.3% | 7.9% | 12.8% | 8.6% |
| June 1932 | 5.57 | 117.8% | 28.5% | 26.8% | 5.7% |
| July 1982 | 6.64 | 52.7% | 20.7% | 23.2% | 14.3% |
| June 2018 | 32.12 | ? | ? | ? | ? |
| Sept. 1929 | 32.56 | -33.6% | -35.9% | -22.3% | -8.6% |
| Dec. 1999 | 44.20 | -6.8% | -14.3% | -3.4% | -2.5% |

This valuation metric has not been a good predictor of one or five-year returns, and there is nothing to say that it will continue to be a good predictor of ten-year returns going forward. However, I do believe there are some important takeaways.

In the short-run, it is anyone's guess where the market will go, but when thinking about long-run potential returns, starting-point valuations matter. With the current Shiller 10 ratio currently at 30.5, we are much closer to historical highs than to the lows, and the Shiller regression would predict a negative 2% compound annual return on the S&P over the next ten years. This model could certainly prove to be way off the mark, but it does serve as a helpful guidepost.

Another bird's-eye view indicator that Warren Buffett often references is the ratio of the market value of all US stocks to US GDP. The higher the ratio, the more expensive stocks are relative to underlying economic activity. We are near all-time highs on this ratio.


All of this can be summarized by saying the market as a whole is expensive. Fortunately, we do not "buy the market" at Trust Company of Vermont. We select investments in high-quality businesses we understand, that have durable competitive advantages that can outperform regardless of the macroeconomic environment.

We cherish the privilege our clients bestow on us to select individual stocks. This allows us to make purchases based on the merits of the business and the price at which we can pay to become an owner. We believe this process allows us to reduce risk and increase potential returns for our clients.

As always, should you have any questions about your portfolio, please do not hesitate to contact your Investment Manager.

***Wishing you and yours a happy, healthy and prosperous New Year***

# Bigger May Not Be Better

Ben Ferris Portfolio Manager

The S&P 500 has returned roughly 15% per year over the past decade. Two thirds of this return, or 10% per annum, has come from the likes of just five companies: Amazon, Apple, Facebook, Google and Microsoft.

As a result, these five companies now comprise over 15% of the entire S&P 500 index, or a whopping $4.6 trillion of value. The Information Technology sector today represents about 22% of the S&P 500. While still a decent shout from the historically high 30% reached at the height of the Internet Bubble, peeling back the layers reveals a different story. As it stands, Amazon, Google, Facebook, and Netflix are not included in this sector of the index despite the fact these companies greatly benefit from the rise of internet usage and information technology. A cynic might argue that it is harder to sell an indexed product on Wall Street if it appears less diversified. If we include these companies and other natural beneficiaries of the internet, we'd find that the percentage grows to just over 30%.

Although it is interesting to study, sector weightings are sometimes subjective and perhaps speak more to the changing nature of an economy over time than to any latent risks to specific companies or markets. If comparing the historical sector breakdown falls into the "nice to know" category, a historical comparison of the size of these companies fits more into the "need to know" category.

One can argue that given the incredible returns over the past decade, the five companies previously mentioned (Amazon, Apple, Facebook, Google and Microsoft) are priced as if their future success is inevitable. Innovation is a hallmark of American capitalism. New technology replaces old, industries are flipped on their heads, and companies face ruthless upheaval to adapt and remain competitive less they fall to the wayside. A quick look at history reveals an ominous sign for the potential future of these current-day behemoths.

Here is a look at the ten largest US companies by assets in 1917 presented by Forbes (Market Capitalization was not available):

| Rank | Company | Assets $mm |
|---|---|---|
| 1 | U.S. Steel | 2,500 |
| 2 | AT&T | 762 |
| 3 | Standard Oil | 574 |
| 4 | Bethlehem Steel | 382 |
| 5 | Armour & Co. | 314 |
| 6 | Swift & Co. | 306 |
| 7 | International Harvester | 265 |
| 8 | E.I. du Pont de Nemours | 263 |
| 9 | Midvale Steel & Ordnance | 256 |
| 10 | U. S. Rubber | 250 |

The list looks quite different in 1967:

| Rank | Company | Assets $mm |
|---|---|---|
| 1 | IBM | 35,200 |
| 2 | AT&T | 27,300 |
| 3 | Eastman Kodak | 24,100 |
| 4 | General Motors | 23,400 |
| 5 | Standard Oil (merged into Exxon/Mobil in 2001) | 14,500 |
| 6 | Texaco (merged into Chevron in 2001) | 11,200 |
| 7 | Sears & Roebuck | 8,800 |
| 8 | General Electric | 8,700 |
| 9 | Polaroid | 7,900 |
| 10 | Gulf Oil | 7,900 |

As you can see, only two of the companies (AT&T and Standard Oil) remained in the top ten fifty years later.

Forty years later, on the eve of the financial crisis in 2007, the list looked like this (market cap instead of assets):

| Rank | Company | Market Cap* ($mm) |
|---|---|---|
| 1 | Exxon Mobil | 512,000 |
| 2 | General Electric | 393,000 |
| 3 | Microsoft | 281,000 |
| 4 | AT&T | 255,000 |
| 5 | Citigroup | 253,000 |
| 6 | Bank of America | 216,000 |
| 7 | WalMart | 197,000 |
| 8 | Proctor & Gamble | 192,000 |
| 9 | American International Group | 181,000 |
| 10 | Chevron | 181,000 |

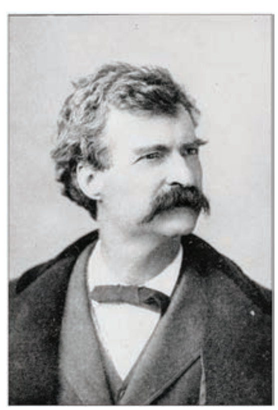
* Market cap = total value of a company's outstanding stock

There were more survivors this round with Exxon, General Electric, and AT&T remaining on the list. However, the next twelve years up to today were not kind to many of these companies, and only one (Microsoft) ended up outpacing the S&P 500 over that timeframe. In fact, four of the ten above have had negative total returns in one of the longest bull markets in history.

Consequently, today's list looks remarkably different than just twelve years ago. Only Microsoft and Exxon Mobil remain on the top ten list:

| Rank | Company | Market Cap ($mm) |
|---|---|---|
| 1 | Apple | 1,145,000 |
| 2 | Microsoft | 1,102,000 |
| 3 | Amazon | 895,000 |
| 4 | Alphabet (Google) | 894,000 |
| 5 | Facebook | 554,000 |
| 6 | Berkshire Hathaway | 539,000 |
| 7 | Johnson & Johnson | 345,000 |
| 8 | JP Morgan Chase & Co. | 408,000 |
| 9 | Visa | 392,000 |
| 10 | Exxon Mobil | 308,000 |

Perhaps the pace of technological innovation has sped up over time and incumbents are doomed to a shorter tenure on the throne. Competition is very real and as investors, we must remember that even what seem like the most enduring businesses can see their market share and competitive advantages erode over time. Mark Twain maybe said it best: "The past does not repeat itself, but it rhymes."



# Ashes to Ashes & Dust to Dust is Complex

Jack Davidson

The primary focus of most estate plans is what happens when we leave? How do we save taxes? How do we provide for others? How to plan if our journey might include a nursing home? And our final journey when we transition from ashes to ashes and dust to dust.

As a youth, I encountered caskets and graveyards. Today the transition has changed. In 1960, only 3.6% of Americans chose cremation. The current rate is projected at 55.8%. According to the National Funeral Directors Association, the projected cremation rate will continue to rise in the coming years to 70.6% in 2030. There are several reasons why cremation has become popular, such as economic and demographic factors, but I suspect that the speed of decomposition is probably not a significant factor. Depending on the type of the casket...wood composition such as oak versus cherry would be one of the factors...the journey to ashes would take no more than 100 years (teeth being the exception). The graves, and what is left of us, for those who choose the grave and the casket, may be attractive simply because we will be enshrined in perpetuity. Our grave site is permanent, and our stone will name us, and perhaps nearby, our ancestors and our descendants.

Legally, can we embrace the concept of perpetuity? When I first came upon the common law Rule Against Perpetuity (the "Rule"), I simply focused on trusts. The Rule prevents a trust from holding property that would vest beyond 21 years after the "measuring lives" living at the time of creation of the interest. Most states still embrace this rule but many of them have adjusted the rule. At least 27 states allow the rule to be violated if the trust terminates in 90 years.

At the time when I first focused on the rule and the popularity of Generation Skipping Trusts designed to go for several generations, I encountered creative lawyers who would add the following clause: "In no event shall the trust continue beyond the expiration of 21 years from the death of the last survivor of the descendants of Joseph P. Kennedy Sr., the late Ambassador to the Court of St. James." The Kennedy family of 9 children had many descendants at the time the clause was inserted in many documents. Although not beneficiaries, they were the measuring lives.

Vermont has embraced the rule in its earliest version with one exception. Vermont allows trusts in perpetuity for the benefit of cemeteries. Gravesites need attention, and managing the costs over multiple generations is embraced in Vermont. Under Vermont law, a town becomes responsible for a cemetery if a church or volunteers, with time or money, are unable to maintain the property.

The headstone may be our effort not to be forgotten so the next generations know those who went before. Vermont headstones may enshrine a few, in perpetuity, that may enlighten us on the behavior of others. For example, James Fisk's headstone in the Prospect Hill Cemetery in Brattleboro may reveal to us his chosen lifestyle and his preferred relationships.

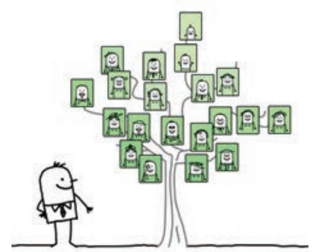
*"James Fisk, Jr. (April 1, 1835 – January 7, 1872) – known variously as "Big Jim", "Diamond Jim", and "Jubilee Jim" – was an American stockbroker and corporate executive who has been referred to as one of the "robber barons" of the Gilded Age. Though Fisk was admired by the working class of New York and the Erie Railroad, he achieved much ill-fame for his role in Black Friday in 1869, where he and his partner Jay Gould befriended the unsuspecting President Ulysses S. Grant in an attempt to use the President's good name in a scheme to corner the gold market in New York City. Several years later Fisk was murdered by a disgruntled business associate."*[1]

Ellsworth Bunker's headstone in the Dummerston Center Cemetery suggested a less complex world view.


Ellsworth F. Bunker (May 11, 1894 – September 27, 1984) was an American businessman and diplomat (including being the ambassador to Argentina, Italy, India, Nepal and South Vietnam). As of 2018, Bunker is one of two people to receive the Presidential Medal of Freedom twice.

In 1977, I moved to a home in front of the Dummerston Center Cemetery. Oddly, I found it comforting. I had great affection for the movie *Our Town* based on Thornton Wilder's 1938 metatheatrical three-act play about an American small town, Grover's Corners, portraying the everyday lives of its citizens between 1901 - 1913. One theater production used the back drop of the Dummerston Center Cemetery. So, now I have headstones and a gravesite and conflict with my spouse. She wants cremation for herself and I want to stay intact in a cherry casket. She has threatened that if I go first, she will decide whether to accelerate the process of ashes to ashes by being housed in a very small container. At least I will have a stone, perhaps in perpetuity.


Estate planning for the final stages may be difficult, and may often involve family members. Graves and headstones versus cremation may be less of a challenge than selecting funeral homes and/or ceremonial sites. For many, it is important for family stories to invigorate a ceremony so that family members are not lost and forgotten. Fortunately, we can now write our history where it can be found many generations later, if we pay attention to where it is stored, either in paper form or digital storage.



Ceremonies often inspire us and inspirations sometimes come from well-written scripts about our lost ones. Sometimes the happenstance of talking with friends and relatives can unexpectedly inspire us as well.

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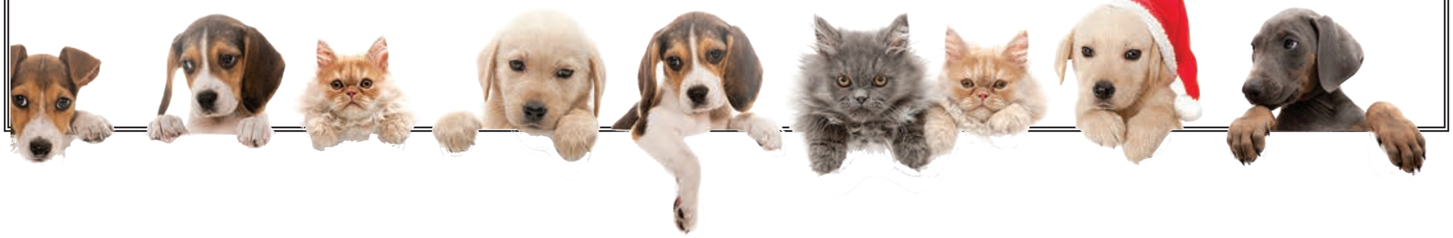
1 Extracted from Wikipedia

# Estate Planning & Pet Ownership

Jack Davidson



Vermont has the highest ownership of pets in the country. More than two-thirds of Vermonters (70.8 percent) own at least one pet, according to a 2012 study by the American Veterinary Medical Association.

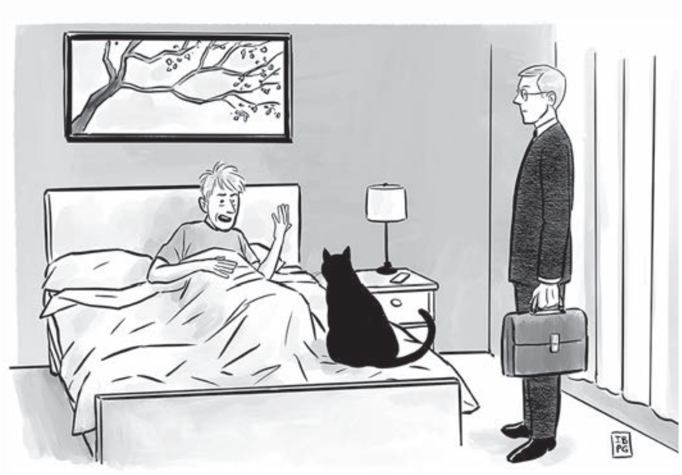
For many of us, our animals may be an important part of our estate plan. However, lawyer-driven estate plans often focus on legal and tax issues, and support of family members. Your estate planning lawyer may not mention pets unless you raise the issue.

In the legal world, pets cannot own property. However, you can plan to take care of your pet if you find the right person or organization, and suitable resources for their care. However, if you choose the wrong caregiver, your pet may suffer and your resources may only take care of the caregiver. A simple bequest of money, with an understanding of care, may be very vulnerable if you choose the wrong person. The alternative is a Pet Trust.

Pet Trusts create a legal obligation to care for your pet in the manner that your lawyer specifies in the document, and provides accountability for the money that you leave to the caregiver. You can also create the trust now in case you become incapacitated. Pet Trusts are expensive and structured for "what ifs" which may be too restrictive in unintended ways. Legal terms are often not up to the task. In contrast, if you discuss the issues with your proposed caregiver now, and a person you can trust, the best route may simply be a gift or bequest to your friend of both the pet, and the money to take care of the pet.

In some cases, the legal world of Pet Trusts may create unforeseen consequences such as end-of-life decisions. In one case, the trustee benefited from the income flow and evidently kept a suffering pet alive well after the point that the deceased owner would have approved, if living. It is comforting for those of us who use individuals in Vermont, rather than paid trustees, that there is a high probability that you will find one of the 70% owners who are probably very consistent in how they love their animals, much like you do.

If you decide that a Pet Trust is the best alternative, the Trust Company of Vermont may be willing to act as trustee. Our overall client relationships may be a factor for acceptance. Based on our recent poll (next page) of personal pet ownership by our employee-owners, it is highly likely that we would love your pet, regardless of shape, size and temperament.



*"Fine, I'll get up and feed you! No need to get the lawyers involved."*

# Our TCV Pets

Our recent poll of employees' pet companions