Trust Company *of* Vermont Quarterly Update

JULY 2023

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Stick to what you know… or seek help

Chris Cassidy
CEO

I initially enrolled in college planning to be an English major. I took several English courses my first year ranging from Evolving Canon, where I studied classics such as Shakespeare and Chaucer, to Creative Writing, where I read Cather and Carver and wrote my own stories. Thankfully for my ego, no copies exist of anything that I wrote in that class!

In Creative Writing class, my professor would advise me to "write what you know." Although I was never able to write a novel, and I ended up double majoring in economics and business, I apply the concept of "write what you know" to investments. Whenever I tried to write about emotions I'd never felt, or concepts I had no personal experience with, my stories were terrible. Similarly, any time I have strayed out of my investment comfort zone, I have regretted it.

In college, I started an Ameritrade account with the money I earned working summer and winter breaks. I invested in three companies, whose financial statements I had analyzed in a financial accounting class. These were profitable companies, with strong balance sheets, and I was able to read and understand their annual reports. After making these three investments, I had about $100 left over and decided I was going to invest in a promising fitness penny stock trading at $0.05/share. I thought, "if this stock goes to just $1, I will have made 20 times my investment." Before the semester ended, the stock went to zero. Lesson learned.

When I did my MBA Program, I took a class in Options Trading. The Professor used a computer simulator to give all of us $1 million dollars of fake money, so that we could place large trades using options and derivatives. Within a few weeks, most of the class, including me, had lost all the fake money we were given. Lesson learned.

For me, my comfort zone is investing in individual stocks of profitable companies whose financial statements I can analyze and whose annual reports I can study. I also feel comfortable analyzing high-quality bonds and exchange traded funds (ETFs). Having a comfort level with the assets that you own allows you not to panic when financial markets are volatile.

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A list for long term capital management

Paul Copeland

AUGUST 1998 WAS the 3rd worst month for stocks in the last 50 years, with the market down almost 14.5%. This was an even bigger drop than in March 2020, when Covid sank the S&P 500 12.5%.

Many people don't remember the summer/fall of 98, but I certainly do. I had just moved to Boston after spending a few years in Japan and thought I would have a job with MFS Investment Management (this is the firm that created America's first mutual fund). The crisis that dropped the market put them and several other financial firms in a hiring freeze. So, I had to re-start my job search and on August 31st had an interview with traders at Bear Stearns. As we met that afternoon, the TV news reports were blaring that the Dow was down over 500 points (down 6.4% or about 2,100 points in today's figures). Their upper floor of a Boston skyscraper was crazy and both I and the guys interviewing me knew it wasn't a fit for me.

The big news was that Russia had defaulted on its' debt. Behind the scenes though, it was much more complicated. The largest, most powerful hedge fund that everyone on Wall Street had been hustling for years to maximize business with, was imploding. In the good years, Bear Stearns had been "lucky" enough to beat out Merrill Lynch and others to be the clearing broker, taking responsibility for the trades of the now sinking hedge fund.

Long-Term Capital Management (LTCM) was this hedge fund, started by John Meriwether, the legendary head of Solomon Brothers' bond arbitrage desk. The bond traders who joined Meriwether were the smartest in the industry, earning the nickname "Young Professors." They included two Nobel Prize winning economists, Robert Merton & Myron Scholes, who wrote the textbook formula to price options. This formula was an important part of the Chartered Financial Analyst derivatives curriculum that I studied, and my lecturers considered it a masterpiece. LTCM's specialty was finding pairs of bonds that had a predictable range between their prices. When bonds were trading outside of that range, they bet that the prices would converge (or return to normal).

Their returns were over 20% in the first year and over 40% in each of the following 2 years. But to make more money they had to take big bets, using leverage. In other words, most of their investments were made with borrowed funds. Just before their fall they had $5 billion of equity and $125 billion of debt. Fortune Magazine wrote "At LTCM the best minds were destroyed by the oldest and most famously addictive drug in finance, leverage." They also chased returns into areas where they didn't have a competitive advantage or even much expertise, including currencies, equities, and emerging market sovereign debt, such as the Russian bonds that defaulted.

Ironically, the stock market finished up 27% for the year 1998 as seen in the first chart, but LTCM was wiped out that fall. On September 10th, Bear Stearns threatened to stop clearing LTCM trades because they feared being on the hook if LTCM went bankrupt. Less than a month after my job interview, the CEO of Bear Stearns declined to participate with 14 of the largest financial institutions in a Federal Reserve bailout of Long-Term Capital Management. 10 years later, in the Great Recession of 2008, Bear Stearns collapsed, brought down by collateralized debt obligations (CDOs), an asset with risks they didn't understand. The Federal Reserve brokered a fire sale of their assets to JP Morgan.

LTCM and Bear Stearns were led by some of the best and brightest. They had connections, capital, degrees and expertise but they failed partly by going away from what they knew. It's easy to do as there are so many investment opportunities out there. Mutual funds alone number over 100,000 worldwide. There is a finite number of investments that any one firm can follow, so an approved list of investments is a helpful tool to keep us from getting lost in unknown areas.

We choose to focus on what we know

Unless otherwise directed by the account owner, we only purchase stocks or funds that are on our approved list. Our Trust Investment Committee, consisting of 10 investment professionals, currently follows about eighty Mutual Funds and Exchange Traded Funds (ETFs), along with 215 individual stocks. Since we customize portfolios for our clients, we keep this larger list to have options in each of the 11 major industry sectors that we use toward certain goals of some clients, such as income or ESG (Environmental, Social, Governance) investing. But we are generally buying a more focused group of these stocks with fewer than 60 companies making up over three-quarters of the stocks owned in all accounts where we have full authority to make investment decisions. Individual stocks are selected based on factors including sustainable competitive advantages, superior financial strength, high quality management and potential for future growth.

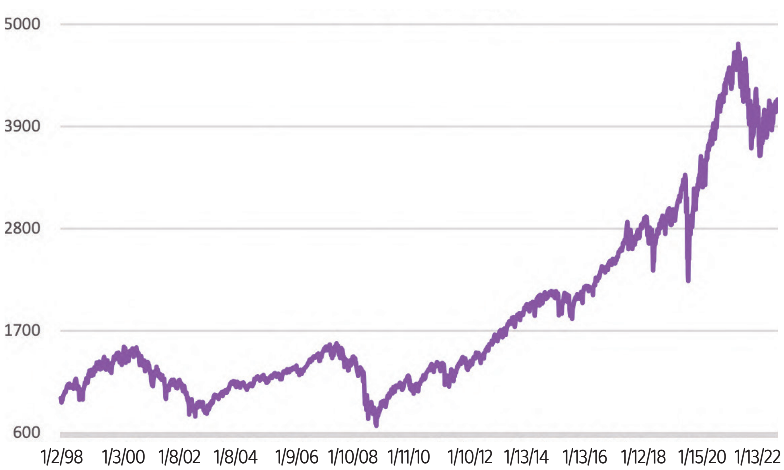
Because bonds typically represent the low-risk segment of a portfolio, we want to minimize the potential for permanent loss of capital. Thus, our bond investments consist primarily of U.S. Treasury, U.S. Government Agency, and municipal bonds. When we buy a corporate bond, a credit rating of at least "A" is required.

We avoid what we don't know

This presently includes investments in commodities, collectibles, currency, (including cryptocurrency), derivatives, private equity, and hedge funds. It also includes some stocks of smaller or foreign companies or stocks that trade more on speculation than fundamentals.

Trust Company of Vermont was chartered on September 16, 1999, a year after LTCM faltered. We can't avoid the volatility that goes along with investing in marketable securities of high-quality companies, or even the volatility that exists in U.S. Treasuries and municipal bonds. We can, however, focus our portfolios on what we know and understand, while avoiding what we don't! We believe this is the best way to manage capital through the next August of 1998, whenever that may be. ■

1998 - 2022 S&P 500



1998 S&P 500

Price data from Yahoo Finance

Do you really need an estate plan?

Jeanne Blackmore

THERE ARE SOME QUESTIONS that you should ask only if you are prepared to accept the answer, and this is one of them! Estate planning may not be fun or exciting, but it certainly is necessary. As the old Ben Franklin adage goes, the only things certain in life are death and taxes... estate planning makes managing both easier, for us and for our families. Let's look at the basics of a good estate plan, and how Trust Company of Vermont can help you implement and maintain your estate plan.

A good estate plan should achieve two primary goals: (1) provide for your end-of-life care needs; and (2) provide for the disposition of your assets on your death. The first goal is easy to explain: every estate plan should include an advanced directive for health care and a power of attorney. These documents allow you to designate an agent to advocate for your health care wishes and your day-to-day business affairs should you become unable to do so yourself. It is important to put these documents in place while you are healthy and of sound mind because an incapacitated person without a valid advanced directive or power of attorney often must be put under court-supervised guardianship. This could be very stressful for your family and caregivers. That said, it can be difficult to settle on who to designate as agent or what authority to give to an agent. We are happy to help clients work through these issues, which are often quite complicated, and can in some limited circumstances fill an agency role.

The second goal is more complicated to explain, but worth understanding. There are any number of ways you can arrange for your assets to pass on death. You can use a Will or a Trust or transfer-on-death or beneficiary designations or a combination thereof. The precise structure of an estate plan depends largely on your personal financial profile. A good estate plan uses a combination of these tools to achieve the goal of disposing of your assets on your death: (1) in the manner you wish; (2) without incurring unnecessary estate tax; and (3) without requiring probate administration.

The most common structure for an estate plan is a so-called pour-over Will and a Trust. The purpose of a pour-over Will is to authorize your executor to transfer to your Trust (via the probate process) any asset you forgot to title in your Trust during your lifetime. The goal, however, is to title all your assets in the name of your Trust during your lifetime so that it is not necessary for your executor to use your Will on your death. Your Trust then provides for the disposition of your assets on your death (except for those assets that you choose to pass by transfer-on-death or beneficiary designation outside of your Trust). Because Trusts are not subject to probate administration, but rather are administered privately in keeping with the applicable state trust code, they are a very efficient way to attend to the disposition of assets on death. Do not worry that your Trust will interfere in your life during your lifetime. While you are alive, you will be the Trustee of your Trust, your Trust assets are fully within your control, the Trust agreement may be revoked or amended at any time, and the Trust does not require a separate tax identification number or tax filing. Upon your death, the Trust snaps into existence as a separate legal entity and can no longer be revoked or amended. Rather, the terms of the Trust agreement become fixed. The person or organization you designate to succeed you as Trustee is then obligated to administer the Trust assets according to the terms you set forth in the Trust agreement during your lifetime. Common Trust terms following your death might say something along the lines of: *please pay my final bills and expenses, and then divide remaining Trust assets equally between my children and hold them in continuing trust for the benefit of each until each turns 35 years old, at which time Trust assets shall be distributed outright to each child.*

The most difficult (and important) things to decide when drafting your Trust are: (1) how do you want to pass your assets to your spouse and/or heirs; and (2) whom do you wish to designate as your successor Trustee(s)? The answers to these questions are very personal and can vary depending on personal financial profile, whether the surviving spouse is from a first or second marriage, whether you have concerns about creditors or divorce for your heirs, whether your heirs will wish to protect assets inherited from you for their own heirs, and whether you would like to provide for charitable distributions. There is no single correct way to construct the dispositive and Trustee provisions of your Trust and, fortunately, there is significant flexibility in how a Trust agreement can be drafted.

Trust administration is one of the cornerstone services that Trust Company of Vermont provides to clients. Our trust administrators and relationship managers have reviewed and administered literally thousands of Trust agreements. We are happy to provide support and suggestions to clients regarding what types of dispositive provisions and Trustee structures work in various scenarios, and to provide feedback to your estate planning counsel.

In many instances, we streamline the estate planning process for clients and their counsel and, as a result, reduce legal fees to implement an estate plan. For clients with taxable estates, we often identify tax savings strategies that can be incorporated into your estate plan by your estate planning counsel.

The final step to estate planning is to make sure that all your assets are properly titled in your Trust and/or have a proper transfer-on-death or beneficiary designation so that everything dovetails properly. An improper title or beneficiary designation can result in an asset passing in a manner you did not wish, an unnecessary probate administration, or in the worst case, conflict among your heirs. For clients with retirement assets, life insurance, or taxable estates, this step of estate planning can be complicated and must be done with care. In addition, as your asset composition may change over time, you must periodically review your asset titling and designations. For those clients to whom we provide support and assistance with their estate planning, we consider this to be a critical part of that service.

To circle back to where we started, estate planning may not be fun or exciting, but it certainly is necessary. Here at Trust Company of Vermont we are here to help you get it done, and to keep it done. ■

Stick to what you know… or seek help

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Why would I sell a wonderful company that I've analyzed for years just because markets are stressed?

Unfortunately, sticking to what you know is very limiting. It is very hard for anyone to be an expert in multiple fields, and if you only tend to the areas where you are an expert, many important areas will be neglected. Consequently, it is important to know when to ask for help.

I am not an estate planning attorney, and despite working at a Trust Company, I never had an estate plan until two years ago. At the end of 2021, with my daughter's birth a few months away, I decided it was time to get a plan in place. For me, the motivating factors were having a Will that named a guardian of my child in the event my wife and I passed away prematurely, having a Power of Attorney that gives my spouse the ability to manage my affairs in the event of incapacity and having an advanced health care directive in the event I need emergency medical care.

Although I was not an expert in estate planning, I was able to utilize my colleagues at Trust Company of Vermont for advice, and a local attorney for drafting documents. I now sleep better at night, at least when my daughter isn't teething, knowing that I have an estate plan in place. I hope I won't need to utilize it for quite some time!

In this Newsletter, Jeanne Blackmore has written an article about the importance of estate planning. In addition, Paul Copeland has written an article on the importance of sticking to your core competencies in investing. Both have a very high level of expertise in their fields. ■

529 Plans

are getting more flexibility

Beginning in 2024, the SECURE Act 2.0 will allow the beneficiaries of 529 plans to roll over up to $35,000 during their lifetime to their own ROTH IRA without paying taxes or penalties. This is exciting news for those who have overfunded their 529 plan, have not gone to college, or would like more flexibility on what to do with the funds. We will be discussing this more with clients next year, but for now, below are the details:

- The 529 plan must have been open for at least 15 years.
- The owner of the Roth IRA and beneficiary of the 529 plan must be the same person.
- Contributions made to the 529 plan in the last five years, including the earnings of these funds, are not eligible.
- Transfers are still subject to annual Roth IRA contribution caps, which are currently at $6,500.
- You must have earned income up to the amount you are rolling over.

Parents and grandparents may now feel increased confidence in opening a 529 plan for a young child, knowing that unused college funds can become a jump-start on retirement savings or an emergency fund when the child becomes a young adult.