Trust Company *of* Vermont Quarterly Update

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Brattleboro ◆ Burlington ◆ Rutland ◆ Manchester ◆ St. Albans

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Down Memory Lane with Portfolio Manager Steve Singiser

In this article, the first of two parts, I plan to write a brief history of the stock market starting in 1962 and ending in the present year. This time span represents about a half century and, coincidentally, it is the span of my working career. Beginning in 1962, this article will be divided into four approximate ten year time periods, each with distinctive investment characteristics and watershed events. The final fifteen year time period begins with the new millennium.

When World War II ended in 1945, the United States was the dominant power in the free world both politically and economically. To wage a successful war against the Axis countries we constructed a massive and efficient industrial complex that at war's end was converted from producing wartime armaments to peacetime consumer products. The demand for these consumer products came from returning veterans looking to complete their educations, start a new business, get a good job, get married and start a family, and buy or build a home, all with an urgency to make up for time lost. Thus the table was set for a period of economic growth and a strong stock market that lasted nearly thirty years from 1945 until 1972. Our history starts at the beginning of the final decade of that period, or 1962, to be precise.

John Kennedy was President of the United States in 1962. The Cold War with Russia was anything but "cold" with ongoing crises in Berlin and Cuba. The President was given authorization to activate Army Reserve units. The Deep South was in turmoil as increasing pressure to move toward actual integration was met in several states with open rebellion. The President called out the National Guard in both Alabama and Mississippi to restore order.

Cigarettes cost about 20 cents a pack and you could purchase a brand new VW Beetle for just under $2,000. A ride on the New York City Subway cost 15 cents. Better yet, you could enjoy a draft beer for a dime. They were the good old days and a salary of $100 a week was considered high pay.

I started working in the Trust Department of the Chemical Corn Exchange Bank in 1962 at exactly that pay. I may have been overpaid.

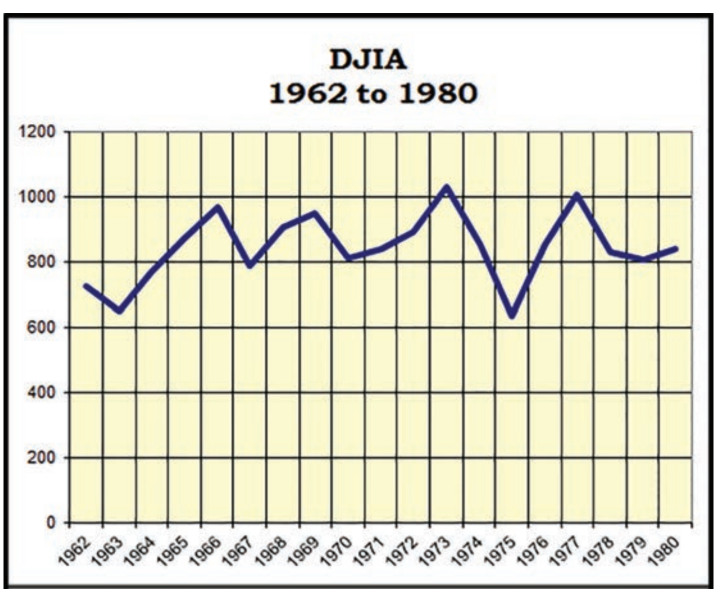
I remember overhearing a conversation among my coworkers discussing Xerox. I thought they were talking about a new antifreeze from DuPont or Union Carbide. I knew very little about investing in the stock market then. I don't want to know how wealthy I might have become had I bought 100 shares of Xerox at that time.

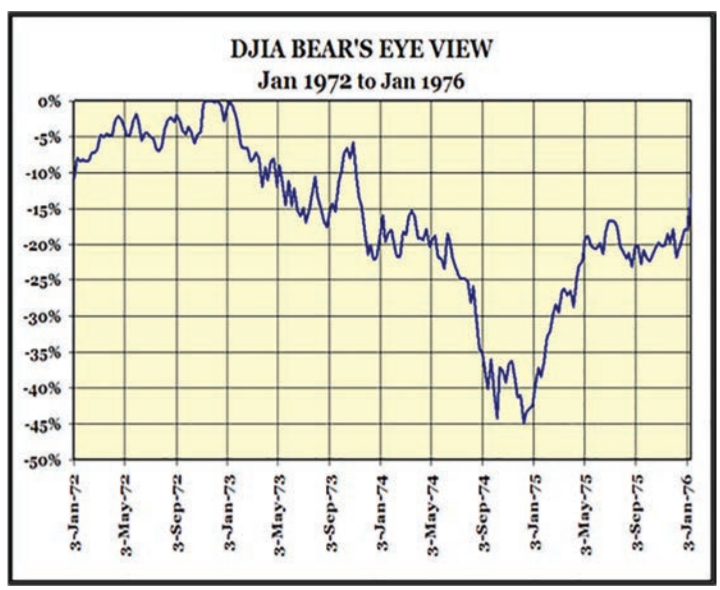
In 1962 the Dow Jones Industrial Average, DJIA, was the most widely recognized benchmark for how 'The Market' was doing. Of the 30 stocks listed in the 1962 DJIA only AT&T, Chevron, DuPont, General Electric, Proctor & Gamble, Exxon Mobil, and United Technologies remain. Many of the present Dow Jones companies were not even in business in 1962. In fact, this March Apple replaced AT&T. Apple was founded in 1977.

During most of this twenty year period the stock market traded mostly between 750 and 1000, actually reaching 1000 several times. In spite of this overall lackluster performance, there were several opportunities to make a lot of money in stocks or lose even more. It was rarely dull.

In retrospect, the 60s up until the December 1972 high of 1050 was a very favorable period to own almost any stock. The economy was strong in terms of disposable personal income, retail sales, and industrial production. Although interest rates trended upward, the stock market was driven by rising corporate profits and consumer spending. The 'Nifty Fifty' became a popular name for a group of widely held stocks with consistent earnings growth of 15% or more. There were many more than fifty. IBM, Xerox, Polaroid, Baxter Labs, Avon Products were just a few of the favored investments.

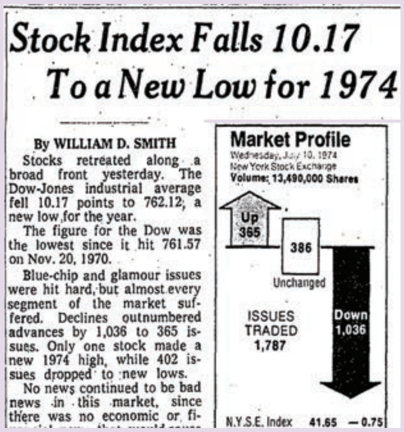
The backdrop of this period was less appealing. There was much civil and social unrest as the 'baby boomers' came of age. Notable events such as the Bay of Pigs invasion, Cuban Missile Crisis, and John Kennedy's assassination impacted our lives. And the unpopular war in Vietnam was front page and TV evening news every day. One very positive diversion was the successful space program and ultimately landing men on the moon.





The 1970s

Bull markets, however, do not last forever and this one ended in January, 1973 – not that anyone knew it at the time. By June 1974, only a year and a half later, the DJIA had lost nearly one half its value. Many of the Nifty Fifty stocks declined much more than that, as they had risen to irrational heights. Avon Products, for example, rose in price from $55 a share in March, 1965 to $140 a share, its all-time high in March, 1973. By September, 1974 it had collapsed to $19 a share. It was a very scary time to own stocks. Even worse was managing other people's investments. It took years for many stocks to recover to their previous highs; some, for example Polaroid, never did. The more conservative DJIA, as you can see on the chart, recovered to 1000 in 1976 and again in 1982. President Nixon was elected in 1968 and re-elected in 1972. He was forced out of office in 1974. He has been blamed for many things, but so far not for the 1973-74 stock market collapse. I believe good old-fashioned greed played a role.



Stock Index Falls 10.17 To a New Low for 1974

By WILLIAM D. SMITH

Stocks retreated along a broad front yesterday. The Dow-Jones industrial average fell 10.17 points to 762.12, a new low for the year.

The figure for the Dow was the lowest since it hit 761.57 on Nov. 20, 1970.

Blue-chip and glamour issues were hit hard, but almost every segment of the market suffered. Declines outnumbered advances by 1,036 to 365 issues. Only one stock made a new 1974 high, while 402 issues dropped to new lows.

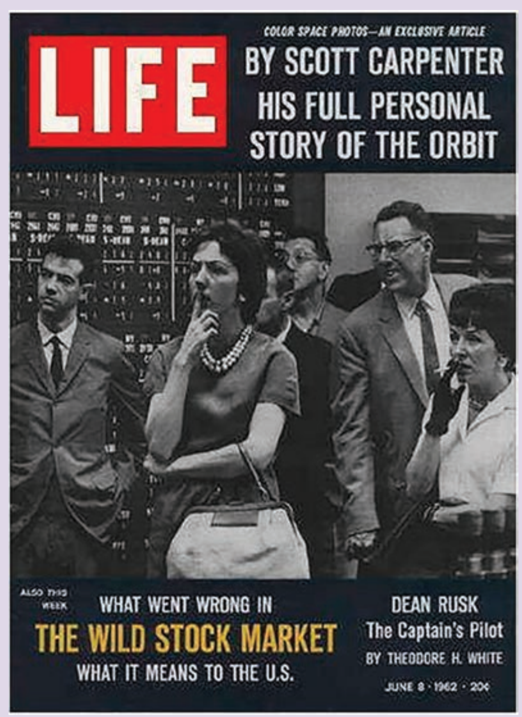
No news continued to be bad news in this market, since there was no economic or fi-

Other notable events during the 1970s were the end of the Vietnam War in 1973 and the Arab embargo on shipments of oil to the United States. As the decade wore on there was a dramatic increase in the rate of inflation and a commensurate increase in interest rates/bond yields. Much of this was the result of higher energy costs. The 10 year US Treasury Bond yield rose from approximately 8% in 1970 to 16% in 1981. Double digit mortgage rates hammered real estate values, as financing became unaffordable.

Before closing this installment I will cite one more event, the full impact of which is far from over. Within a few days of taking office in January, 1969, President Nixon began planning the establishment of a relationship with China. Almost exactly three years later, February 27, 1972, President Nixon visited China and met with Mao Zedong. Who could have possibly predicted where this would lead? It would be only a matter of time before the most frequently printed three word phrase in the English language would be:

Look for Part II: The 1980s, 1990s & The New Millennium, in our July newsletter.

Congratulations, Steve, on making it through challenging markets.



ZENO'S PARADOX

JACK DAVIDSON

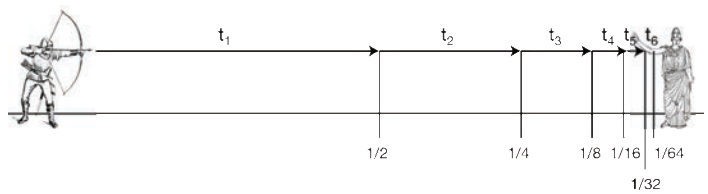
When I was a youth, my parents monitored me for both my safety and hints of my future potential. Their surveillance for safety was a great idea, history shows. Potential, on the other hand, was problematic. One day, Dad brought home a neighbor to show my "promise" as an artist. "Look at Jackie's selection of color," he beamed, but I remained focused on my painting of a German Shepherd. I did not want to tell my proud father that it was paint-by-number.

Then one day, potential may have arrived. My grade in the New York State Regents Exam in arithmetic showed up, and I had a perfect score. The verdict at home: I would become a mathematician. Unfortunately, I enrolled in Algebra the next year, and my math-whiz career ended quickly. It became evident that my brain needed to adjust, and whether that was true or not, I blamed the ancient philosopher Zeno's best-known paradox.

Zeno's Paradox

You will never reach point B from point A as you must always get half-way there, and half of the half, and half of that half, and so on. . . .

My algebra teacher explained with the image of an archer. He drew a line on his blackboard representing the flight of an arrow toward a target. In describing Zeno's paradox, he then stated that a line can be divided in half infinitely. So I pictured an infinite number of dots and concluded that I had to touch each one before I got to the target. I knew the arrow got to the target, but my mathematics did not arrive there.



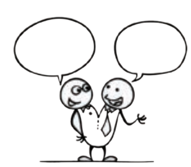
I think I have been cursed by the specter of Zeno's paradox. Zeno simply shows up unannounced in so many different places. In college, I went to the men's room of a local tavern and encountered this on the wall:

The statement below this line is true

The statement above this line is false

My brain went into a loop – up, down, up, down. Everyone waiting for me probably thought I was sick.

I suspect Zeno had offspring:

 **Oxymoron** *Glib & Flippant Contradictory Language*	 **Conundrum** *Somber, confusing & unsolvable*
 **Enigma** *Studious & Complex*	 **Catch-22** *Inclined to work in a regulatory environment*

And so, the curse continues.

Sometimes in estate planning I will hear accurate statements that take me back to Zeno and his offspring reminiscent of a scene in the movie "Absence of Malice," when Sally Field says at the end of the movie in response to a reporter's question: "That's true, isn't it?" The reply: " No. But it's accurate."

Is the top Vermont Estate tax rate 16 percent? No. But it's accurate. The Vermont website says Vermont has no gift taxes. Is that correct? No. But it is accurate.

Truth and accuracy are all about perception. In defense of our legislators, an estate planner's perception is focused on the client. In Vermont, a taxable estate of 3 million would be assessed $100,000. That translates to 3.33%. That said, an estate planner would see a savings of $100,000 by addressing the amount above the exemption of $2,750,000 and that translates to 40%.

The top Vermont rate is 16% after the taxable estate passes the threshold of $10,040,000. If a Vermonter changes residence to "tax-free" states such as Florida, with a taxable estate of $10,040,000, how much would they actually save? 6.42%. If 100 million? 9.28%. Fortunately for the taxpayer, the arrow never reaches the target of 16%. Fortunately for Vermont, the arrow often does (15.47% on 100 million) as a result of the shift of a portion of the federal tax. Alas, a Florida resident can't deduct a state estate tax and we can.

The complexities of our law also mask a gift tax for some estates. That said, the gift tax will be paid on death and not at the time of the gift.

The most important player in an estate plan is the attorney. Lawyers have been trained to be accurate, and they have been trained to give you the right answers. Sometimes I think my answers to estate planning questions are close to, if not 100 percent accurate; I think I am in the A to A+ territory. I also know that I am probably struggling to move from C+ to a B- because sometimes I answered the question correctly but it is the wrong question.

I know lawyers contribute to legislation. I know lawyers will studiously avoid a paradox. When I came upon the following paradox, I knew that it was devised by a disgruntled law student who did not graduate because he or she could not endure three years under the scrutiny of lawyer teachers:

Paradox of the Court

A law student agrees he will pay his teacher after he wins his first case. The teacher then sues the student (who has not yet won a case) for payment.[1]

I reject the Paradox of the Court, and I am sympathetic with our readers' own attorneys. They, like me, have to deal with Zeno's offspring. Unlike me, however, they may have avoided the curse.

Estate planning is very important. It affects the lives of others. The focus is not just on saving taxes; it is the importance of each of our legacies. And for many of us, procrastination is just so easy. We face mortality, decisions, and complexity. We need to ask the right questions and understand the right answers.

As a result of recent changes in the federal estate tax, fewer people now need complex tax savings trusts – or so we thought on first inspection. Then we noticed

[1] Paraphrasing Aulus Gellius, *Attic Nights,* Book 5, Chapter 10

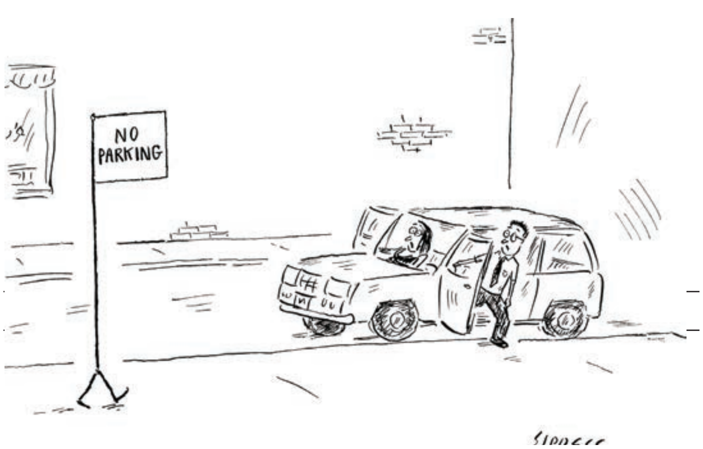
that the generation of those in need of planning often have large IRAs – not enough to cause estate taxation but substantial enough to need planning to avoid the possibility of an income tax at a rate as high as the highest estate tax rate.

What follows is an effort to assist those who would like to complete their estate plans.

Often, complexity and legalese are showstoppers. So, I have boxed in areas that you don't have to read if the questions are not relevant to you. If relevant, you may want to ask your lawyer or trust officer the question without having to suffer through my efforts to explain the reason for the question.

Some, and perhaps many, lawyers are dealing with recent changes in Vermont law regarding trusts. So, we are still struggling with clarity while also now rooting out the offspring of Zeno in fiduciary law, as well as tax law. Here are a few of the challenges that may be relevant in reviewing your estate plan —and the estate plans of others, such as those of your own parents. We live longer; and paradoxically, assets can grow in value and the need for longer-term planning also grows, all while we are preoccupied by the prospective challenges of living in a nursing home.

Sometimes newly enacted laws need time for clarification



Estates above or approaching $2,750,000

The Question: Have you called your attorney or trust officer to review your estate plan recently?

Sophisticated trust plans designed to save federal estate taxes may no longer be necessary for federal tax reasons, but ironically, they can generate state estate taxes that can easily be avoided by way of simple amendments.

Larger estates may not be subject to the Vermont gift tax. Gifts may help avoid the approximately 10 percent rate of Vermont estate tax at the high end, but gifts of appreciated assets could ultimately be subject to a greater tax to the recipients (on capital gains). Selection of assets to give is important. Under current law, most property we own will have the cost basis change upon death, so that capital gains on a subsequent sale may disappear. If we give assets before death, the basis does not change.

Second marriage and the objective to take care of both the new spouse and the children of a first marriage.

The Question: What is the impact of my IRA on my estate plan? What will be the impact on both my spouse and my children?

If an IRA is a significant asset in your estate, your lawyer knows that if you set up a trust for your spouse, the taxes on the required minimum distributions (RMD) to the trust may be subject to a very high rate if taxed in the trust (income above $12,300 will face federal and state income taxes totaling approximately 46 percent in Vermont). If the trustee pays out all of the RMD to the spouse, the tax may – and often is – significantly less. So, lawyers concerned about the income tax consequences sometimes insert a clause that tells the trustee to pay out all of the RMD to the surviving spouse. What gets lost in the strategizing is that the RMD is designed to have an IRA pay out over the beneficiary's life expectancy. If the surviving spouse lives to his or her life expectancy, there will thus be nothing left in the IRA for the children.

The New 10 Percent Rule and your IRA

The Question: If you are naming your trust as the beneficiary of your IRA: Does the 10 percent rule apply to my IRA?

Vermont recently changed its laws to define trust income in greater detail. Regarding IRAs, some lawyers and trust officers now define 10 percent of the RMD as the income, with the rest going to principal. However, I have never met a conventional IRA that is subject to this rule. If you have an IRA in the form of an annuity account, then, yes, it may apply.

Here is an example of the impact of misunderstanding a rule. The income beneficiary of the trust is age 33. The IRA generates approximately $30,000 in income. The RMD is $30,953. The 10 percent rule is invoked in error. Instead of receiving the $30,000, the beneficiary is destined to receive only ten percent of it: $3,095. The balance of the RMD, $27,857, is trapped in the trust, in which the income tax is significantly greater. This same formula would continue during the life of the beneficiary.

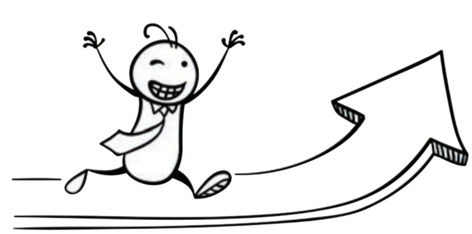
If your lawyer or your trust officer disagrees, you can amend your trust to reflect your desired definition of income. If the trust is already irrevocable, call me, and I will give you a list of agreeable lawyers who will disagree with the first-look interpretation of the rule (unless, of course we are talking about an annuity).

The new rule of notification: sharing the privacy of your assets with those you do not want in the room.

The Question: After I die, who will have the right to see the transactions of my trustee?

When a trust is revocable, the client controls the trust and determines who is privy to the transactions. When the trust becomes irrevocable, the rules change. The new default rules, unless the trust provides otherwise, include those whom you might not want to be privy to the transactions. You might not want the spouse of a divorced child to have access to all transactions as a result of an interest of a grandchild. If there is a non-profit in the wings, do you want them in an oversight role? In short, oversight can be important if necessary, but having too many people in the room can ruin an otherwise nice relationship. Your lawyer can override the default rules.

Zeno is alive and well, and we need to be mindful. That said, I have personally resolved the paradox. I now picture my finger running over an infinite number of dots, and -- voila! – I bump into the target while en route to infinity.



To Our Clients:

We are getting younger, not older.

The Trust Company of Vermont employs the young and the not-so-young, mindful that the definition of young is seen through the eyes of many of us who have been in the business of providing trust and investment management services for some length of time. As employee-owners we are committed to long-term sustainability. We are also mindful that some of our clients are concerned about a change of relationship when one of us retires whether by choice, by chance, or by chills (Florida seasonally beckons).

An ageless quest has been our focus as we look forward to the future, but it is in the past that we have unearthed our continual spring. Collectively, we are not afraid to say as a Trust Company, we are old-fashioned. As they say, what goes around comes around, and we have latched on to a business model of family ownership for successive generations as it fleetingly passed by. Today, more often than not, companies are created and then companies are sold. This is not our path.

Our family business model is dominated by seasoned professionals who want successive generations to maintain the business, and we have begun the process of bringing in and training the next generation of employee-owners.

For many of us, the plan is not to retire, nor fade away, but to scale down and make room for the next generation. Our goal is that 30 years from now our Company will still be employee-owned and Vermont-based. We will still be here. We said that 15 years ago and it is still the same mantra "30 years from today" and we plan accordingly. When we hire, we seek a commitment to stay until retirement and our definition of retirement is to continue to work until you are ready to retire. We also encourage part-time employment past traditional retirement, which we define as age 70. Scaling down facilitates a mentor relationship with new family members. Our goal is to have several Warren Buffets still at their desks.

We prize both wisdom and creativity, stubbornness and a desire to change, and a large squabbling family. We are a family business!

The Employee-Owners