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Ancient advice for a college graduate

David DeBellis, Portfolio Manager & Chartered Financial Analyst

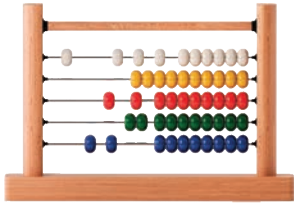
On May 17th of this year, I will have the joy of watching my son walk across the stage at his college graduation. Sure, some of that joy will be in knowing that I will no longer be sending money to Roger Williams University, but I am excited (and nervous) for my son as he starts a new chapter in his life. And while I know that his college professors have prepared him for life in the business world, I don't think any of his lessons involved how to manage his own finances. And since I never had anyone sit me down and explain how I should deal with the paychecks I would soon be receiving, I plan on doing just that with my son.

Much of the advice that I plan on sharing with him comes from a book written over 90 years ago. The title of the book is "The Richest Man in Babylon" and was written by George Clason in 1926. The book is a collection of parables, based in the ancient city of Babylon. It is the story of Arkad – the son of a humble merchant – who grows to become the richest man in Babylon, thanks to wisdom he sought out from a rich money lender named Algamish. The parables are lessons that he teaches to others in the city, and calls the lessons the **"Seven Cures for a Lean Purse."**

The first of Arkad's lessons is the most important one in my opinion: **"Start thy purse to fattening."** Translated into words that my son will understand: pay yourself first! In this lesson, he explains "I found the road to wealth when I decided that a part of all I earned was mine to keep." We cannot accumulate wealth if we do not save what we earn. By paying ourselves first, we guarantee that this will happen. The book recommends that 10% be set aside before any other money is spent. The IRS takes our taxes off the top, why shouldn't we?

His next lesson can be one of the most difficult: **"Control thy expenses."** Essentially this means learning to live within your means. This is going to be tough for my son. Our consumer-driven society makes it incredibly easy to overspend. As a young man, I loved cars and was always looking to "trade up." I now drive a vehicle with over 100,000 miles and have challenged myself to get at least 200,000 before considering a new vehicle. Arkad explains to his students not to confuse necessary expenses with their desires. I try to explain to my son that his iPhone is just as good at making calls and sending text messages as the new ones that Apple introduces each year, and while he may want the new one, he needs to ask himself "do I ***need*** it?"

In order to control expenses, you have to become a conscious spender and know where your money is going. Making a budget and tracking your spending is a great way to start. Tony Robbins, the self-help guru, wrote in one of his many books; "At the end of the day, the question to ask yourself is this: Do my expenses, big and small, bring me the thrill they once did?" Because even a small reduction in spending can make a big difference in long-term savings. Tony has a great example of this that I plan to show my son. If he can save just $5 a day and invest that in stocks, the $5 per day savings would grow to $30,727 in 10 years, $113,905 in 20 years and $948,612 in 40 years! If he increases the amount he can save, the results are even more dramatic. This ties in really well with the next lesson from the "Richest Man in Babylon".



"Make thy gold multiply." This is one of my favorite explanations of compounding that I've ever read. Arkad explains to his students: "The gold we may retain from our earnings is but the start. The earnings it will make shall build our fortunes. Learn to make your treasure work for you. Make it your slave. Make its children and its children's children work for you." Simply put, invest your savings and make it work for you.

My caveat to this lesson is to make sure that you set aside an emergency fund of approximately 6 to 9 months' worth of living expenses. This is his security blanket in case an economic down-turn affects his job status. After he's accomplished this, my advice to him is to invest his savings in a portfolio of stocks. In doing this, he will see his savings grow by leaps and bounds over time. He should also take advantage of any employer-sponsored savings plans, especially if the company matches any of his contributions. A company match is free money...and who doesn't want some free money? He should also take advantage of the tax-free compounding that an investment in a Traditional IRA or ROTH IRA provides. I prefer the ROTH IRA for him since he probably won't be in a very high tax bracket. He can put up to $6,000 a year into this and when he reaches his retirement, he'll have a tax-free source of money to draw from.

Arkad's next lesson, **"Guard thy treasures from loss"** can be interpreted a couple of ways. From an investment standpoint, I interpret this as "know what you are investing in." If someone is trying to sell you an investment that is too good to be true, it probably is. Make sure that your investments are diversified and don't be afraid to ask for help if you're not sure you know exactly what you are doing.

The other way that I interpret this is to make sure that you purchase insurance for your valuable assets. Car insurance, renter's insurance and health insurance are all very important for a young person just starting out.

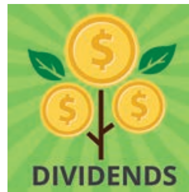
Another of the lessons from the book that I will pass along is to **"Increase thy ability to earn."** Many employers offer reimbursement for employees who want to further their education, and this can lead to more lucrative job opportunities. Technology has also made it much easier to find work on the side. My son recently became qualified to be a driver for the ride-sharing company known as Lyft. This is a way for him to make some extra cash during his free time.

These are just a few of my favorite lessons from the book, which I plan on giving to him after his graduation. Of course, there are some lessons that our children need to learn on their own, but I hope that I can at least start him off on the right path.

Dividends vs Total Return

Steve Singiser, Portfolio Manager

Restaurant server to a breakfast customer: "Would you like a dividend in your coffee cup?" Friend returning from vacation: "We had a wonderful time and the sunny weather was a real dividend." These are pleasant little bonuses that provide us with momentary pleasures. The dividends this article will discuss are those paid by companies whose stock you own in your investment account. These dividends are tangible and real. They will pay for your restaurant coffee and expensive vacation.



When purchasing shares of stock there are two distinct ways you may be rewarded: capital appreciation and cash dividends. Combined, they add up to what is called "total return". Capital appreciation is the increase in value of the shares. This will, of course, vary as the price goes up or down and is called an "unrealized capital gain". The gain is only yours to keep when the shares are sold. There is no guarantee you will realize a gain on your purchase. Cash dividends, on the other hand, are paid directly to you by the company and are a fixed amount regardless of the price of the stock. Once paid, dividends are yours to keep, spend, or reinvest.

It may be argued that dividend income is the primary reason to invest in stocks. Yet, investing for high current income is often a fool's errand and short-term thinking. For the longer term, investing for total return will reap greater rewards for the investor. Total return is the most reliable measure for how your investments are doing.

The text and selective stock charts that follow will show how dividends play a meaningful role in successful stock selection, not for their high current yield, but as a reflection of earnings growth that support yearly dividend increases. The charts contain a wealth of information for the twelve-year period ending December 31, 2018.

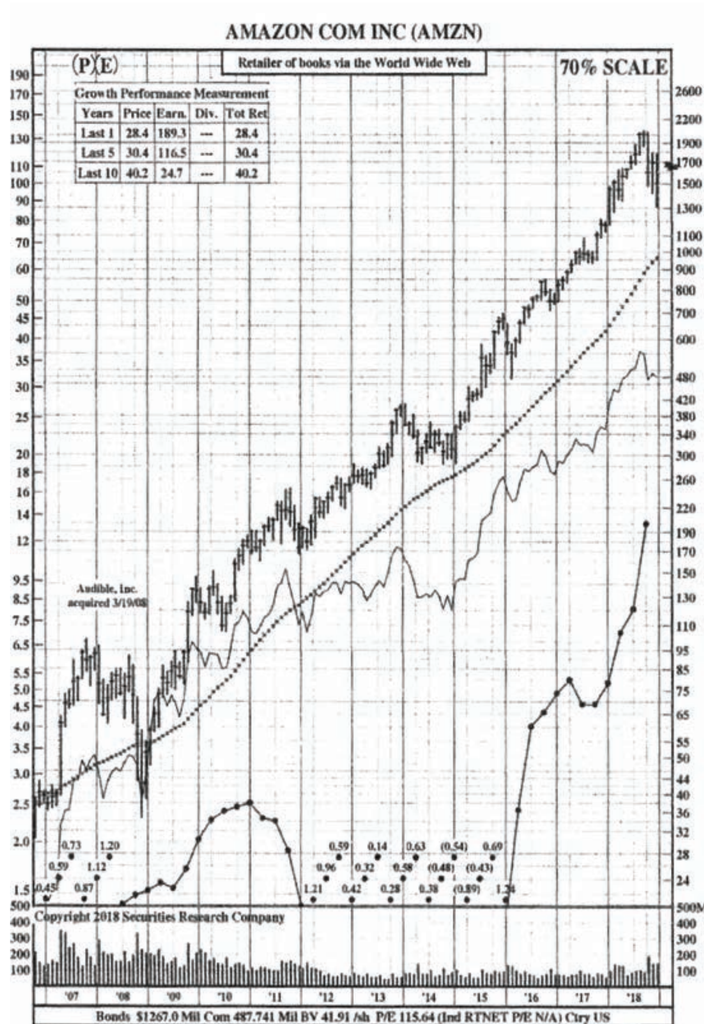
What to look for on the charts:

- The monthly price range looks like a crazy picket fence.
- Earnings per share are shown as a black line connecting black dots.
- Yearly dividends per share is shown as a line of white dots that look like rising steps.
- The rectangular box in the upper left corner shows growth rates for the past 1, 5, and 10 years of the stock prices, earnings, dividends, and resulting total return.

The genesis and life cycle of a corporate cash dividend parallels the success of the corporation itself. A company is successful when revenues increase, leading to increased profits, providing cash to pay a dividend to its shareholders. These are the stocks we want you to own. They are your best hedge against inflation.

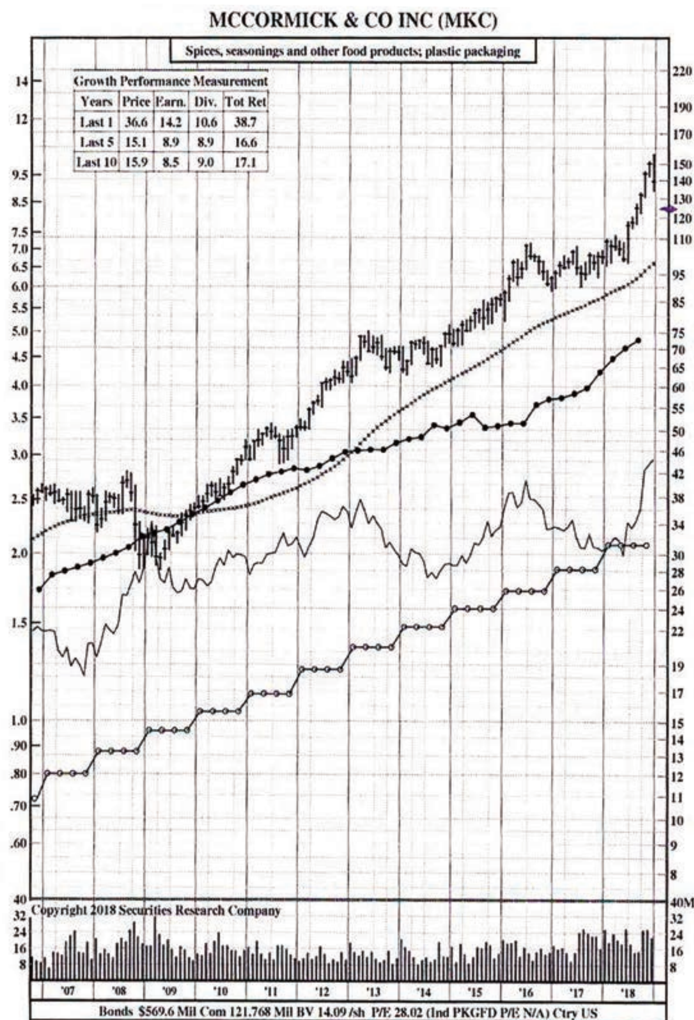
The Genesis and Life of a Corporate Cash Dividend in Three Phases

Phase One: A hypothetical company opens for business, with limited capital, some revenues, but no income. It cannot afford paying a dividend. With time, revenues grow, profits follow but are reinvested in the business to provide future growth. Amazon is an extreme example of a company that invests its income for future growth and pays no dividend. Will they ever pay a cash dividend? Probably, but not in the foreseeable future. So far, their strategy has worked unbelievably well. When earnings started declining in 2011, the company was able to move aggressively into many new areas. By 2015 earnings started recovering at an extremely high rate. Since 2009, even taking into account four years of poor earnings, Amazon's stock price increased annually at a compound rate of 40.2%. Because the company pays no dividend, 40.2% is also the annual total return. A $1,000 purchase on 1/1/09 has increased in value over the next ten years to about $27,270.00. What a rewarding investment this has been! However, Amazon does not meet everyone's comfort level or income requirements due to the lack of a cash dividend.



Phase Two: For our hypothetical example, revenues continue to grow, the company shows higher profits, the balance sheet is stable, and there is cash left over after paying taxes and all other expenses. It is time to share the profits with shareholders by paying an initial cash dividend. Some of the profit is held back to invest in the company for future growth. This is called retained earnings and is an important way of planning for the future. In this way, successful businesses may enjoy many years of revenue/income/dividend growth. Phase Two is the "sweet spot" phase of stock investing, as both price appreciation and cash dividends contribute to the total return. Many excellent companies qualify for inclusion. I have selected one of my favorites, McCormick & Co. Inc., the spice company whose products are well known to everyone.

Notice how dividend growth of 9% is comparable to earnings growth of 8.5% for the past ten years. (The two plotted lines run parallel to each other and are rising at the same consistent rate.) The dividend paid each year is about one half the company's earnings, indicating a well-managed company.

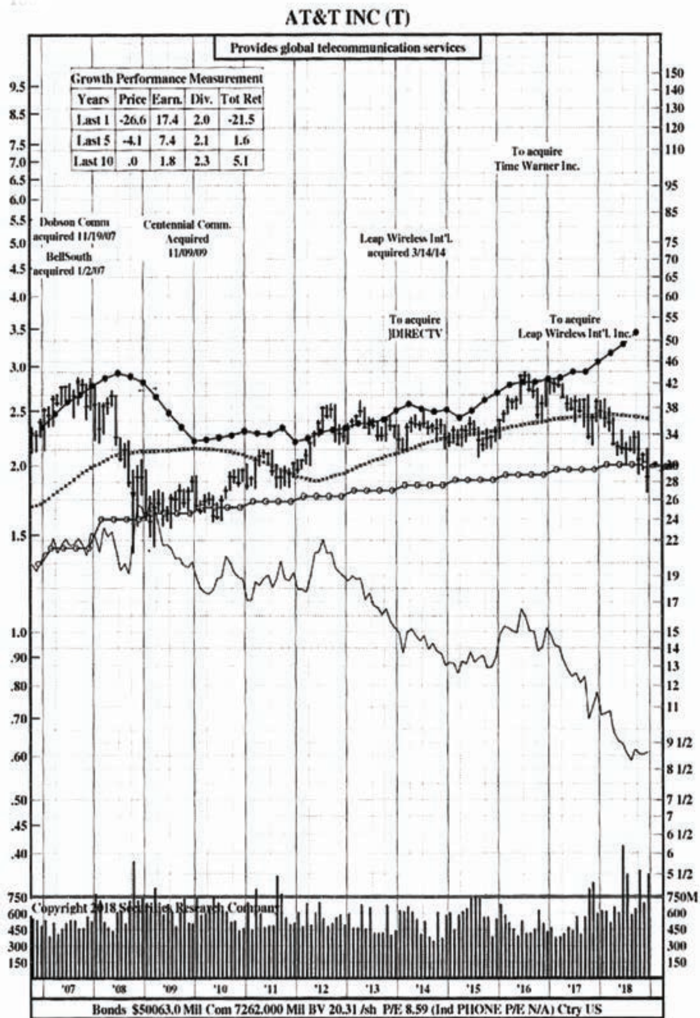


Annual dividend increases provide a source of spendable income to their shareholders, and the balance of retained earnings is reinvested for the future. Note: A $1,000 purchase on 1/1/09 increased in market value over ten years to $4,375. In 2009 the company paid a cash dividend of $0.96; in 2018 they paid $2.12. Annualized total return for the past ten years was 17%. This is well above average. McCormick has been an outstanding investment opportunity over many years.

Phase Three: Success does not last forever. Companies and industries mature. Bad business decisions and competition take a toll on products that are no longer valued. When growth in revenues slows or is eliminated, income growth follows. Annual dividend increases are no longer supportable. The buggy whip industry, when the automobile was invented, is a silly but classic example. Eastman Kodak is a better example of product obsolescence and General Electric of poor management decisions. AT&T is a good example of several converging negatives. Size, competition, new technologies have all held back continuing growth.

Beginning in the late 19th Century AT&T was the leading telecommunications company capitalizing early on the invention of the telephone. By the late 20th Century their dominance led the Government to force the divestiture of many of their regional telephone companies. That was the beginning of ongoing challenges that had a negative effect on AT&T's ability to increase profits. The advent and popularity of wireless communication resulted in a rapid change from the traditional telephone to Smart Phones and a significant reduction in profitable land line revenues.

The AT&T chart shows very little growth during the past 10 years in price (0%), earnings (1.8%), or dividends (2.3%). The total return for this period was only 5%, primarily because of a generously large cash dividend. During this same period, by comparison, Apple's annual growth in earnings was 31% and total return 30%. A modest cash dividend was initiated in 2012 that has increased each year from $1.52 to $2.92 a share.



If you are a fan of Starbucks coffee, you may be curious as to how their stock has done. It has done very well. If you really like their product, you may not regret buying their coffee, instead of their stock. Since 2009 Starbucks' stock price has increased annually 30%. A $1,000 investment in their stock ten years ago is worth about $14,000 currently. This year you would receive at least $288 in cash dividends. If Peter Lynch drinks coffee, he probably owns shares of their stock. Who is Peter Lynch and why should we care if he is invested in Starbucks? Some of you may know the answer. For the those who don't know, I will answer the question in our July Newsletter.

Hibernation in Vermont

Jack Davidson

I find that trying to do my tax return in the winter makes sense. Why do a tax return in the summer when hibernation is not in fashion? But in the winter, sitting at home on a snowy, cold day lets me focus on assembling data to finish my return, although my preference is a cozy couch using my iPad and iPhone.

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Last year, I discovered that I no longer needed to balance my check book and gather receipts. The federal tax law increased the standard deduction for married couples to $24,000, with an additional $1,300 for those over 65. So, I will take the standard deduction rather than itemize.

Vermont's tax return recently arrived and I settled in to finish my return. That is when I discovered that our legislators passed a law that allows a charitable contribution credit against the Vermont taxpayer's tax liability. This credit is 5 percent of the first $20,000 in eligible charitable contributions made during the taxable year, regardless of whether the taxpayer itemizes on their federal tax return or takes the standard deduction. Back to assembling data and, alas, forget the couch.

SELF-PROVING WILLS & SPENCER TRACY

Jack Davidson

My father may have made a mistake. We may have been the first family in our neighborhood to own a television. Although unintended, he turned a day dreaming, disorganized son into an addict. I fell in love with the Million Dollar Movie. WOR-TV Channel 9 played the same movie every day for a week… Monday through Friday. This meant that I could watch a movie when I could sneak into the TV room at 5 p.m., mindful of my sport schedules. The price I paid was that it was one of the reasons I rarely did homework. Most of them were old movies and many, like ***Inherit the Wind*** [1], helped my education more deeply than daydreaming in a class.

I was profoundly impacted by actors like Spencer Tracy, Errol Flynn, and James Cagney. I also fell in love with Olivia de Havilland in ***Strawberry Blonde***, who, coincidently, looked and behaved like my wife when I met her for the first time.

As I matured into the world of trust administration, the characters were not far away. When legally challenged, I might say "What would Spencer Tracy do?"

After reading about a will that was disallowed by a probate court in another state because the "soon-to-be decedent" (the testator) was in an L-shaped hospital room where all the witnesses could see the testator sign, but one witness could not see the other witness sign, I was stunned. This occurred many years ago but Vermont's law in this regard, then and now, is as follows: "Each witness signed at the request of the testator, in the testator's presence, and in the presence of the other witnesses".

As a youth, one of my favorite Million Dollar Movies was ***Men of Boys Town***. It featured Spencer Tracy as Father Flanagan and Mickey Rooney as an orphan. The movie was about the founding of Boys Town and featured the classic line, "He ain't heavy, he's my brother", that was the motto of Boys Town. I was so impressed by this movie, that, had I possessed valuable assets, I would have voluntarily liquidated my estate and sent the proceeds to Father Flanagan.

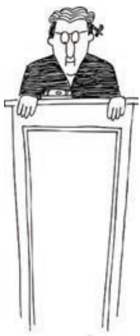
One day in my early time as a trust officer at the Vermont National Bank, I walked into the lobby and was asked to witness a will just signed by a customer of the Bank. Two bankers had just witnessed her signature and signed the document. Vermont law in those days required three witnesses, and I had not seen either the testator or the witnesses sign. What to do?

The customer was very upset when I suggested we might have a problem. Her will left all of her estate to a charity located in…of all places…Nebraska. It was Boys Town! I asked her if she had a family. "No", she said. I thought, well, who is going to object to

her will? Only relatives would stand to gain. Will anyone remember the details many years later when the will is admitted to probate upon her death? No one, perhaps. Certainly not me. I have a hard time finding the right parking lot at the end of the day.

A Vermont case allowed the testator to acknowledge his or her signature in front of the witnesses, so I had her acknowledge her signature. Now, what to do about the witnesses? No case in Vermont covered this problem. They could have signed again, but double signatures might have raised other issues such as the witnesses' sobriety. So I asked each witness to acknowledge their signature, signed the will as a witness and returned the executed will to a happy customer.

She died six months later. We learned of her death when her ***husband*** brought in the will. Although she shared the same house, she had not talked to him in twenty years and, evidently, refused to acknowledge his existence.



Under Vermont law, it is necessary for at least one witness to testify at the probate hearing to allow the will. The Judge looked very puzzled when I testified about the unusual circumstances concerning the signing of this will. Fortunately for him, he did not have to render an opinion as to the validity of the will. In Vermont, a spouse has the right to take all or part of the probate estate when adequate provisions are not made for them in the will. Due to the size of the estate, her husband was able to elect against the will and take the entire estate.

So it really didn't matter whether the will was valid. But the point of this story is that we should leave the drafting and execution of wills to the lawyer? Yes! But........

Witnessing a will can be challenging. What happens if all the witnesses simply retired and went to unknown places? Fortunately, Vermont in 2018 passed a law that allows for "self-proved wills". If the will is notarized and no one objects to the filing of the will, the Court will approve without requiring a witness. So the point of this story is to make sure your will is notarized so you don't have a witness like me testify in front of the Judge. Yes! But......

What about Boys Town? Had I known that the spouse would take her estate instead of Boys Town, and its orphans and Father Flanagan, I would have suggested a living trust. The last time I checked, Vermont is one of only 16 states that allow a spouse to disinherit a spouse using a living trust. Vermont statutory law is clear, but litigation may change the law. But it has not happened and, in some states, the Court has not sided with the spouse left out.

By the way, Vermont does not require a witness for a trust. That said, always have the trust notarized.

Footnote: [1] *Inherit the Wind* tells the story of the famous 1925 Scopes "Monkey Trial". John T. Scopes was a schoolteacher in Dayton, Tennessee who was arrested for teaching Charles Darwin to elementary school students.

"My Goodness! Your dear old uncle appears to have left everything to me."

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