Trust Company *of* Vermont
Quarterly Update January 2019

Brattleboro ◆ Burlington ◆ Rutland ◆ Manchester ◆ St. Albans

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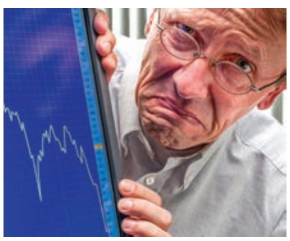
Fear and Being "Normal"

David DeBellis, Portfolio Manager & Chartered Financial Analyst



Investor fears today are higher than they have been in quite a while. We have been spoiled by extremely low levels of stock market volatility over the last several years. Financial markets have seen a pickup in volatility, with broader equity indexes down 10% or more from their September highs. Add to this the constant barrage of news stories about the trade war with China and how it might affect growth in the economy, or Presidential tweets or troubles overseas, and many are left wondering if there is more pain to come for the markets.

Most individuals tend to be reactive and risk averse when it comes to investing in stocks. And for good reason – when it's your money on the line, you appropriately feel like it's a direct hit when the stock market doesn't perform in your favor. There is no question that demand for investments is driven by both reason and emotion. It's emotion that allows us to accept higher levels of risk when markets are rising and less when they are falling. In other words, we're human!

Try as we might to curb our emotions, behavioral economists argue that biases are hard-wired into our brains and personalities: Some of us are overconfident, taking excessive risks; others too meek, seeking to avoid losses at the first sign of trouble. We're also programmed to look for patterns in unrelated information – seeing Elvis in a piece of bacon, or a cloud shaped like a fish. We cannot ignore or suppress them, but by recognizing them they can be managed. One strategy is to take a slower, more systematic approach to making decisions. Seek contrary opinions and go on a media blackout for a little while.

> "The investor's chief problem - and even his worst enemy - is likely to be himself."
> - Benjamin Graham

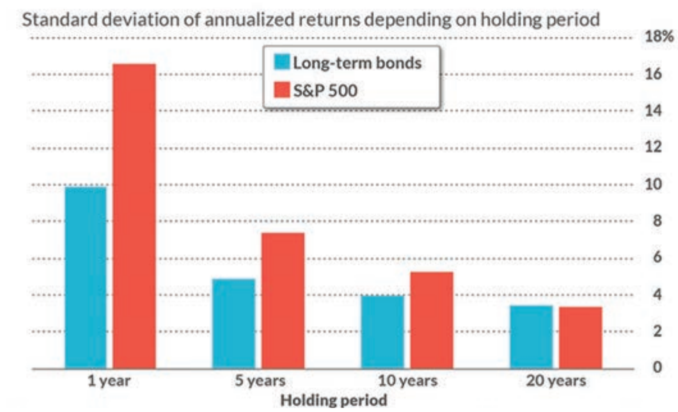
We commonly equate risk to volatility, which can reinforce the behavioral bias of loss aversion. Volatility should not be what matters most to investors, especially those with a long-term time horizon. Instead, the most significant risk is that of a permanent loss of capital. Most causes of permanent loss of capital are self-inflicted. Failing to maintain enough liquidity to meet unexpected expenses increases the chance that you will need to sell at an inopportune time. Panic is another trigger of permanent loss of capital and provides another argument in favor of moderating the intake of financial news.

To mitigate risk of permanent loss of capital, portfolios should be constructed in terms of "buckets." There should be a short-term bucket that provides liquidity for immediate income needs and unexpected expenses.



This would be invested in a money market fund or other short-term fixed income investment. The intermediate bucket would be invested in slightly longer-term investments that can be easily liquidated in an emergency. These investments would consist of high-quality bonds or fixed income mutual funds. They would earn a slightly better return than cash, but without a large increase in short-term volatility.

The last piece of the portfolio puzzle is the long-term bucket. This is the part of your portfolio that increases the amount of capital that you have to spend in the future. At a bare minimum, this is your hedge against inflation. This bucket is invested in equity securities; common stocks or stock mutual funds. This is the part of the portfolio that is going to be prone to great fluctuations in value over the short-term. But, if you can put your emotions aside and only look at this in longer-term increments, you will find that it really isn't much riskier than owning bonds. But some people may look at the chart below



and question their ability to not look at their portfolio and not worry about daily ups and downs of the stock market. And that's OK, since we are all "just human." We all deserve a good night's sleep, and if the stock market is keeping that from happening, then you should have a conversation with your portfolio manager. Now might be an opportune time to trim some of the equity risk in your portfolio. We are in the late stages of the longest economic recovery in our country's history and had the longest running bull market as well.

However, remember that most of the signals that the media throws at us on a daily basis are just statistical noise. What you think may be a pattern in the market just might be as random as seeing Elvis on your breakfast plate.

"It's only fair that I warn you, Margaret. I'm very subject to market fluctuations."

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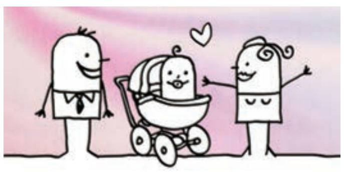
Wrestling & the Fiduciary

Jack Davidson

My first job after graduation from law school was as a tax writer at Prentiss Hall. The acceptance process was a forgone conclusion. The salary for a lawyer was “extraordinarily” low and anyone with a law degree was pre-accepted. Once installed in a cubicle, I discovered that this was not the best choice to avoid working in a law firm. My cubicle incarceration became a temporary plan when newly married. My wife informed me that I was going to have a family and her occupation and compensation would be on hold. My income projections suggested financial stress, so I turned to her brother, who was a rising star as an investment manager at Chase Manhattan Bank. I asked if he could get me a job. His response was “How about the Trust Department?” and mine was “What is a Trust Department?” I said yes, and fortunately Chase said yes as well.



Chase was still considering lawyers in the Trust Department if it became clear that the lawyer would not use Chase as a stepping stone to a prestigious law firm specializing in estate planning. My plan of not going to a law firm was patently evident. What I did not know at the time was that leaving New York City was my career plan if I wanted to raise children. A year and a half later I left for the Trust Department at the Vermont National Bank.

Understanding cultures takes time. Understanding the complex world of Wall Street was beyond my limited level of comprehension. Not so in Vermont, or so I thought. I was wrong.

In retrospect, I often think about my behavior and the impact of surviving in the “banking culture” as a trust officer governed by fiduciary rules. Having wrestled in high school, I was drawn to John Irving’s *The World According to Garp*, followed by the movie. The main character became a wrestling coach. Little did I know that both the book and the banking culture were far more complex than simply becoming a wrestler or a respectable trust officer in Vermont.

Wrestling and Fiduciary Law

I did not understand banking. I did not understand the lawyer’s world. I had some understanding of the trust world and I was also familiar with wrestling. Wrestling is not a team sport, and my combat training may have saved me.

It did not take long for me to discover that I was not a banker. I often think of banks as housing three cultures. The loan officer and the teller (the banker), the trust officer (the fiduciary), and securities sales staff (brokers). All have a few things in common. Sometimes it’s a branch which houses all of us or the Christmas party. The banker and the broker have one thing in common that stands out. They sell products. The fiduciary sells services. Were it only that simple. It is not. "Fiduciary" means more than service, and my career took an unusual turn. One that involved trust donors and beneficiaries who come first, even at the expense of the Bank.....whether its reputation, or its bottom line, or both. Judge Benjamin Cardoza, who served as an Associate Justice of the Supreme Court of the United States, eloquently described the duties of the fiduciary in Meinhard v. Salmon:

> "Many forms of conduct permissible in a workday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the marketplace. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior....."

I became head of the Trust Department in 1975. I was too young, but so was the Trust Department. Just a few staff, no computers, stocks and bonds housed in the vault, and electronic calculators that cost the equivalent of 10% of my annual salary. In those days banks simply looked at trust services as a loss-leader to their more profitable business lines. My world of slowly moving towards a more sustainable and profitable department gave me some comfort. Then the wrestling began.

We were sued!

If your local broker gets sued, you never hear about it. Check their agreements. The industry promotes private arbitration agreements. Not so in the trust world that is governed by fiduciary rules where trust beneficiaries are not part of the agreement. The higher standard of a fiduciary may be vulnerable to reputation risk, as well as the bottom line.

I spent most of an entire year defending a law suit.

Vermont National Bank, as part of a plan to become a state-wide bank, purchased another bank. This bank had a trust department and my job was to consolidate the two departments.

The Bank's Trust Officer helped to set up a trust account primarily for tax reasons, and the Trust Officer agreed to a 50% reduction of the standard fee, with the understanding that he would not manage the assets, but simply advise the individual donor when asked. Shortly after the donor's death, his widow decided to move the trust to the bank that managed her assets. It appeared that both the competing bank's trust officer, and the attorney on its board, were actively involved in a lawsuit against us.

The market had recently experienced a drop in certain types of securities prior to our merger. The widow sued us, although the account had moved to the competing bank before the merger. I spent an entire year responding to the plaintiff's requests, such as my trust committee meetings and the minutes concerning the purchase of the merged bank. Most requests were denied by the court. Finally, we reached the stage of discovery through depositions, when all parties, under oath, present the facts. This stage of the wrestling match allows all parties to avoid going to court when the facts, under oath, may reveal who will win the wrestling match. The trust officer of the competing bank, under oath, testified to facts that did not match the paper trail, but the written version redacted this part of his testimony. During the deposition of the widow, she was asked why she decided to sue. She mentioned the security that plummeted the most. Well, it turns out that the competing bank held that

security and not the bank we had purchased. Case closed. We won the match. Or did we?

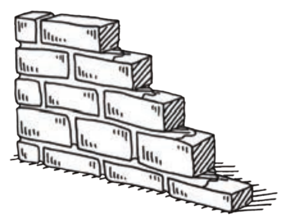
Wasting my first year as head of the Trust Department, consumed by a law suit, was unsettling. Unfamiliar with the practice of law in Vermont, I thought in retrospect that John Irving was writing the script. Before the deposition, the lawyer who served on the board of the competing bank, either by design or happenstance, facilitated a newspaper article about the pending lawsuit that stated Vermont National Bank was grossly negligent in managing the assets and charged excessive fees. The article did not disclose that

we were not the trustee, nor did the lawyer inform the publisher. He won the match. Our ability to attract trust clients in this section of northern Vermont simply disappeared. In the broker's world, both the good and the bad and the ugly are not in the news. Not so with fiduciaries.

Wrestling Once Again

Sharing information between the Bank and the Trust Department was initially viewed as being a positive influence for both sides at the table. If the Bank loans money to GE, well, that makes it easier for the Trust Department to invest in GE. But the regulatory environment started to change and the world became more complicated. The regulatory examiners of Vermont National Bank referred to the "Chinese Wall" to prevent the sharing of information between the Bank and the Trust Department. Fortunately, and appropriately, the name has now changed to simply the "Wall" or the "Ethics Wall".

The definition of Walls can be complex. Of late, I have been thinking of Hadrian's Wall that marked



the boundary of the Roman empire in Britain. The question is, which side of the Wall am I on?

All hell broke loose once again. I sued.

Windham College closed in 1978. Vermont National Bank had loaned money to the college, secured by liens on the personal property. The Department of Housing and Urban Development (*HUD*) and the United States Department of Health, Education, and Welfare (HEW) had loaned money to

the college using a Trustee. Vermont National Bank was the trustee (the fiduciary) for both HUD and HEW. As the trust officer, I enabled a law suit against Vermont National Bank to stop the auction of the personal property as part of the strategy of trying to sell the College intact rather than in bits and pieces.

The focus of the banker is on the bottom line. In Vermont, bankers focused on the investors much like Wall Street? Well, no! Those who owned stock in the local banks were most often neighbors and friends. The depositors, neighbors as well, need to be protected if a bank fails. So the banker felt the need to exit with their loan repaid, and let HUD and HEW deal with the poor decision of allowing an expansion unsuited for Putney, Vermont.

Windham was founded in 1951. Student enrollment grew from 160 to a peak of 935, and then started to decline. The enrollment in 1978 was 248, bolstered by 75 international students invited from Middle Eastern countries. The closing occurred in a cold Vermont winter, and the international students were forced to leave the school premises by the order of the local sheriff, and the dormitories were closed and locked.

Both HUD and HEW were unable to provide the funds to allow me to retain the President, and the security staff, until I submitted an accounting. They said it would take a year. I found another bank to facilitate about 3 months of expenses. I struggled just to find money for the security staff after the 3 month period.

The court allowed Vermont National to start the auction. I asked the banker "Would you stop the auction once your loan of approximately $250,000 has been repaid?" The answer was "no". Once the auction started, Vermont National Bank sold personal property in the library, which was secured by lien with HEW. So I threatened a $30,000 law suit if they did not stop at $250,000. They agreed. On the third day of the auction, one of my trust officers[1] kept tabs on the amount auctioned, and when the tab exceeded $250,000, she gestured to the auctioneer and he stopped the auction. Many in the large auditorium were very upset.

There are many other stories about what transpired over the years until Landmark College bought the campus. But the person[2] who both edits and designs this newsletter has restricted my storytelling space. She graduated in 1976 from Windham College.

So the purpose of this article was to reflect, and to enlighten others who may not understand the complicated role when an institution becomes a fiduciary.

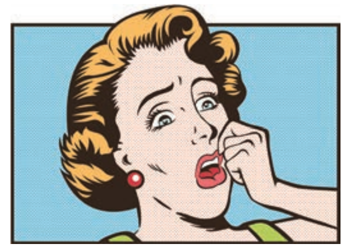
And there may be another reason, perhaps stirred by the actress Glenn Close who recently received the Museum of the Moving Image's annual salute at a gala in New York City. From my perspective, Glenn started and defined her career in the movie *The World According to Garp.* Trying to understand the banking culture is one thing. Trying to understand the world according to Garp is more complex. On the second day of the Windham College auction, the person bidding on the wrestling mats was a Windham College professor, and coach who started the wrestling program at Windham College. It was John Irving.

[1] Jane Waysville, Employee-owner of TCV

[2] Ellen Lowery, Employee-owner of TCV

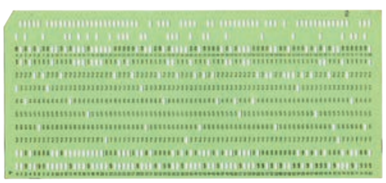
Cybersecurity

Ellen Lowery, TCV Auditor



My first day as a bank auditor, in 1982, I was handed a wooden ruler, ushered into a large bank vault lined with safe deposit boxes and instructed to measure the boxes and compare to the size and rental rates noted on dog-eared index cards in a battered metal box. It took a long time and was deadly dull. These days, computers can simply correlate rental rates and sizes. It's an ideal task for a computer.

As time went by I graduated to ATM PIN duty. Once a week a pair of auditors would be ushered into the Bank's



mainframe computer room with our deck of punched cards that was used to generate PIN numbers for new customers' ATM cards. At the time, it was cutting edge and had a vague James-Bond-like quality. The room was kept cold, with a raised floor and halon gas fire suppression system, quiet as a church save for the discreet whirring of row upon row of blinking tape drives. We had to enter the locked room under dual control and sign a logbook in and out. It was all about security.

Today, I carry around more processing power and memory storage in the cell phone peeking out of my purse. I simply glance in its direction and its facial recognition software knows it's me and unlocks the phone. When connected to the internet, it can access vast amounts of data in the "cloud".

Computers offer us so many useful tools. But some of their best attributes, such as speed, accuracy, and access to vast volumes of data, can unfortunately be put to bad use by those up to no good, and the results are also magnified and multiplied at sobering speed. And so, we have the topic of cybersecurity, a term none of us knew in the 1980s.

What TCV Does

TCV employs an Information Technology support company with an expertise in cybersecurity. They manage the maintenance of our individual computers, proactively manage our firewalls, and have advanced forensic software installed in the event of an incident. They continually test our staff via training emails that entice employees to click, to ingrain proper habits, and illustrate current techniques. Our staff takes ongoing cybersecurity courses and is trained in identity theft scenarios.

Our in-house Technology Committee meets regularly with our technology consultant to monitor our systems and determine the best IT policies for our company and our staff. One of the group's responsibilities is ongoing, in-depth reviews of our various software vendors to ensure they have appropriate provisions in place as well.

What You Can Do

Think of your email Inbox as your front door....... some of the people knocking want to scam you, break into your house, or hold all the files on your computer subject to ransom. Don't open the door to everybody. Develop a 5 second delay before you click on hyperlinks. Gently hover your cursor over a link and a pop-up will show you where it would go if you click. You will find surprises! Beware attached files, especially those you were not expecting. Be especially wary of any file with a .exe file extension. Never respond to an email asking you to confirm your user name and password. Be aware of "spoofed" email that appears to come from someone you know, or regularly do business with, where their email account has been compromised and you are then sent a malicious email from their account.

Maintain a clean machine. Keep your devices, apps, browsers, and anti-virus/anti-malware software patched and up to date.

Know that "free" wi-fi at hotels, airports or cafes can wind up having a big price tag. Your activity on such networks is easily hacked. Use a Virtual Private Network (VPN) software to connect to public wi-fis. Here at TCV we use EncryptMe® apps and software.

Have reasonably complex passwords, change them now and again and don't use the same password for every site. Consider a password manager program. Frustrated by Dq7$v96Q? Try a mnemonic approach based on the first letters of a song or quote that is easy to remember. *To Kill a Mockingbird* becomes 2kll@mbird. Or, where space allows, create a passphrase, linking unrelated words with a memorable image, such as *turkey parachute tiaras.*

Back up your files with some regularity. Remember that anyone with access to your computer may obtain private information about you or initiate activity that appears to come from you. For mobile devices, such as laptops, tablets or smartphones, enable encryption and remote wipe capability in the event your device is lost or stolen.

With good regular habits you can enjoy the many benefits our devices and the internet offer, along with more peace of mind. Here at TCV, this enables us to work remotely, connect with each other or clients whenever the need arises and to pursue our heated contests of Words with Friends!

Statement Notes

Tax Statements

You will now be able to upload your annual 1099 tax statements to TurboTax and H&R Block software. Look for the Tracking ID on the bottom of your tax documents and follow the import rules in the program.

Tracking ID: M2DLEFCKHJFNLMNWPSTVKPU3
Important Tax Return Documents Enclosed

We do our best to get these statements to you in a timely manner and hope to have them out by the second week in February.

E-Statements

Would you rather receive only electronic statements? Please ask your Relationship Manager how to switch to E-statements.

WISHING YOU A HAPPY & HEALTHY NEW YEAR!

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