Trust Company *of* Vermont Quarterly Update

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Brattleboro ♦ Burlington ♦ Rutland ♦ Manchester ♦ St. Albans

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Lions and Tigers and Bears, Oh My!

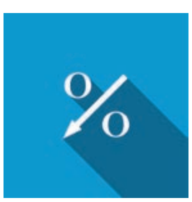
TODD GRAY, PORTFOLIO MANAGER

"Toto, I've a feeling we're not in Kansas anymore."
~ Dorothy in The Wizard of Oz

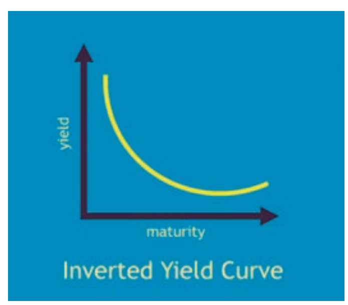
Departing from our normal approach of addressing one particular investment theme in each newsletter, I instead

would like to briefly address several issues which have dominated the financial news of late and have caused investors to have their own "Oh My" moment, like Dorothy and her companions on the yellow brick road.

Paying no interest on a mortgage? Paying interest to own a bond as opposed to receiving it? We are certainly not in Kansas, Toto! We are in Denmark, where Jyske Bank recently offered a 10-year fixed-rate mortgage



at negative 0.5% and Finland-based Nordea Bank announced that it will offer a 20-year fixed-rate mortgage in Denmark that charges no interest. There are currently more than $16 trillion in negative-yielding sovereign debt instruments around the world, as central banks try to ease monetary conditions to sustain the global economy. The 10-year sovereign bonds in Belgium, Germany, France and Japan, among others, are trading with a negative interest rate. Suddenly, the current 1.5% yield on the 10-year U.S. Treasury doesn't look so bad! Could negative yields happen here in the U.S.? The question investors may eventually have to ask themselves is how much would they be willing to pay (***pay,*** not receive) for the safety of investing in a non-risk investment such as a Certificate of Deposit or a Treasury Bond? From an investor standpoint this type of interest rate environment is a big positive for risk assets, especially stocks.



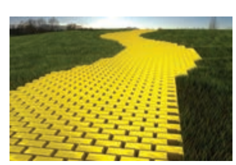
I have heard the term "yield curve inversion" more in the past two months than I have in my thirty-two years in the investment business. What is an "inverted yield curve"? It is when the yield on long-term bonds falls below that of short-term bonds. What does this mean to you as an investor? The yield curve has inverted before each of the last six recessions. In and of itself, inversion does not cause a recession, but can help to diagnose one. The problem from the viewpoint of an investor, is that inversion does not pinpoint exact timing of recessions or how fast economic conditions will decline. It also has not been a timely signal of when investors should reduce portfolio risk as the stock market can continue to perform quite well after a yield-curve inversion occurs. The most accurate and timely indicator of a recession has been when the ten-year U.S. Treasury bond yield has fallen 25 basis points (¼ of 1%) or more below the yield of the two-year Treasury, or when an inversion has lasted for at least four consecutive weeks.

The question I am most often asked these days is are we going to have a recession? The answer is unequivocally yes! A surprisingly straightforward answer coming from someone in the investment business! The catch is that I don't know when it will occur or how long it might last and neither does anyone else. In a recent survey of economists, 40% believe the United States will fall into a recession before the end of next year, while 60% believe it will occur in 2021 or later. What is a recession? It is generally defined as two consecutive quarters of negative economic growth. Are recessions a rare occurrence? No. Since 1950 there have been ten recessions. Does the stock market always decline during a recession? The answer is no, as the S&P 500 Index has had positive returns during five of the ten recessions since 1950. The returns for these periods of recession have ranged from being up 16% to down 37%.

The implementation of tariffs on certain types of goods imported from China (and in China on U.S. goods) has dominated the financial news and has had an impact on the stock market. How do tariffs impact consumers and investors? In simplest terms, a tariff is a tax. It is important to recognize that the tariffs owed on imports are paid by the importer, not by the foreign country, in this case China. Thus, tariffs increase the cost of the goods paid by the importer. Businesses importing goods must either eat the additional costs, thereby reducing their profits, or pass part, or all, of the tariff on to their customers. Thus, as a consumer you are impacted by having to pay higher prices and as investor you are potentially impacted by owning companies facing declining profits resulting from either not being able to pass along all the additional cost of the tariff, or from declining sales growth as customers reduce their purchases due to higher prices. If the current tariff war with China were to accelerate or expand from here, then that would certainly be a drag on corporate profits, economic growth and stock returns. However, if China and the U.S. were to come to a trade agreement then this would likely be a great boost to the stock market.

A couple random facts to ponder: A 65-year old currently spending $100,000 per year for living expenses today will need $128,008 per year by age 75 and $163,862 at age 85 to pay those same expenses, based on an inflation rate of 2.5% per year. Therefore, we strongly encourage clients of all ages to maintain some degree of exposure to stocks throughout their lives to maintain buying power.

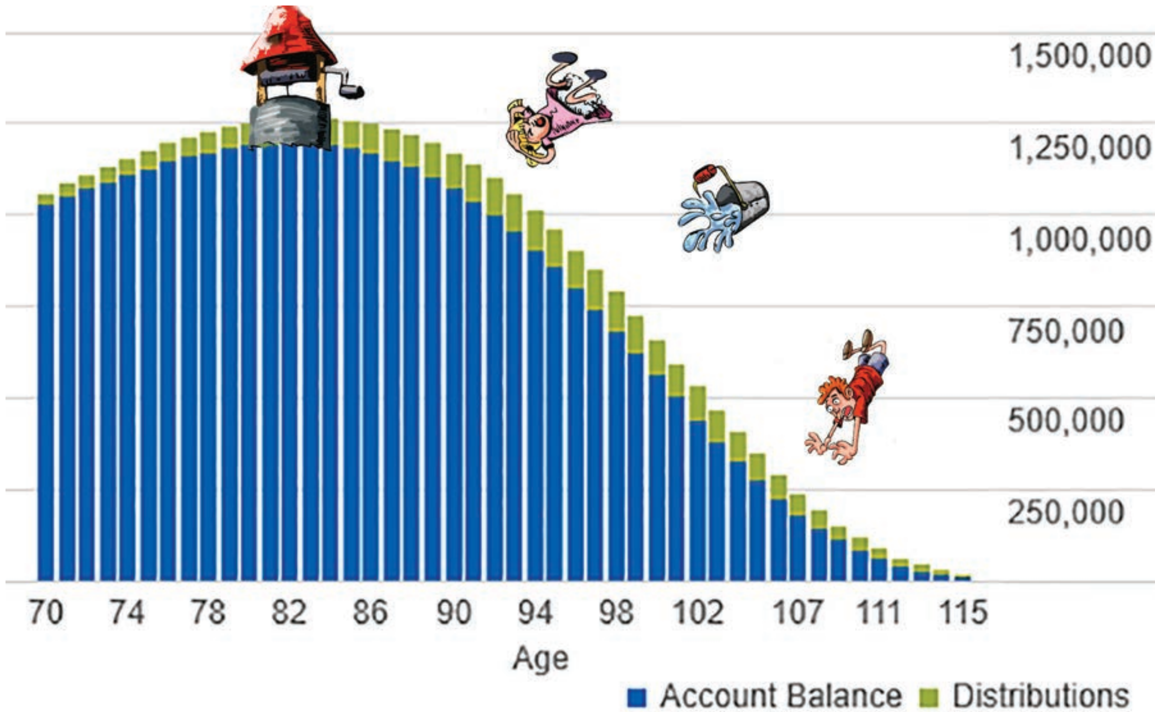
Speaking of stocks, you have often heard us say that we are "long-term" investors. This is not just some old overused phrase to us but a belief that is derived from a study of the history of stock market returns that have shown a significant portion of stock market returns has been generated in a small number of trading days. The total "cumulative" return of the S&P 500 Index for the ten-year period from 2009 through 2018 was 243%. The 25 best trading days during this time period (out of 2,520 trading days) produced a gain of 162.9%, or 67%, of the total return for this ten-year period.



The yellow brick road of investing does not always travel in a straight line and from time to time investors may experience sudden unseen dips in the road. However, by keeping events in the economy and the markets in proper perspective, we can avoid taking financial actions resulting from the cries of "Lions and Tigers and Bears, Oh My" by the financial news media that could have harmful long-term consequences for you.

The Hill and Your IRA and the 50% Penalty

Jack Davidson



JACK AND JILL WENT UP THE HILL TO FETCH A PAIL OF WATER;

JACK FELL DOWN AND BROKE HIS CROWN, AND JILL CAME TUMBLING AFTER.

I am a tax advisor to my twin sister, Jill. Thus, I worry about the metaphorical hill, the powers to be that might punish me when I fetch our water, and the impact on both of us.

I am now personally climbing the hill more often once we reached 70 ½. We both need to climb the hill and get our RMDs, also known as the Required Minimum Distribution, from our IRAs. But what would happen if we did not fill the pail in the required amounts? We will tumble down, and the question that haunts me is, why should I have to break my crown? It seems patently unfair. If I don't take out enough, the penalty is 50%. But what about my sister? Will the IRS break her crown if she is 5 days late? It will be a 50% penalty of the water left in the pail.

At the Trust Company of Vermont, you will find many editions of Natalie Choate's *Life and Death Planning for Retirement Benefits: The Essential Handbook for Estate Planners*. Natalie is a member of the law firm Nutter, McClennen & Fish LLP, and she is widely known in this field of expertise as "the" expert. In 2016, Natalie was featured in an article in the Wall Street Journal when she was about to turn 70 ½ . The main thesis of the article is that Natalie had several different types of IRA accounts and the RMD is based on the value of all the accounts. As an estate planner, she pointed out how complex it was for her because she has the option of withdrawing all the RMD from just one account. In 2018, Natalie reported that she did not withdraw all of the required RMD for 2017 and faced the 50% penalty.

In the estate planning world, complex plans to save estate taxes are now infrequent simply because the exemption is so high. But IRA planning is growing by leaps and bounds, in part because the pension world started to disappear beginning in the early 70s. So the leaps and bounds are all going up the hill and the hills keep getting bigger. Now we are seeing million dollar IRAs. So let's take a look at a hypothetical Jill (not my sister...another Jill) and the approximate required RMD, assuming a 6% rate of growth on a million dollar IRA:

Age	RMD	Penalty
70 ½	$36,000	$18,000
80	$60,000	$30,000
90	$93,000	$46,500

Who will be watching Jill when she turns 90, if she needs watching? What happens if I am watching her? Why do the IRS and our federal legislators break our crowns? The penalties for late filing personal income and estate tax returns are much less. But at TCV we don't go political. That said, we can give you the phone numbers to call your federal legislators.

At the Trust Company of Vermont we constantly monitor the RMDs. Recently we introduced a program to allow IRA owners who have reached 70½ to make charitable contributions from their IRA, and receive a charitable deduction even if they take the standard deduction. Each check to a qualified non-profit is counted towards the RMD. We produce the checks, which allows us to monitor the amounts paid to avoid the penalty, and then we send them to the owner to forward to the charities.

How did Natalie break her crown in 2017 when she did not withdraw enough of her RMD? She started using a program similar to ours where the IRA trustee sent her the checks to forward to the charity. One $500 check to a charity had never been cashed, and the Trustee had stopped payment on the check and restored the $500 to her IRA. Our program does not restore the check to the account, although we will replace the check. Fortunately, Natalie paid 9 different charities so she only had to pay a $250 penalty.

Monitoring RMDs is stressful. Our client may have one or two IRAs elsewhere that need to be factored into the withdrawal plan. So, we are looking at the Hill once again, and considering options to facilitate procedures for those interested in charitable giving directly from their IRAs. We are at the stage of monitoring, and avoiding tumbling, if too little is withdrawn before year end.

"Let's just say you both went up this hill to fetch a pail of water, then Jack fell down and broke his crown, and you, Jill, came tumbling after. With this policy, you'd be covered for that."