Quarterly Update

April 2006

Brattleboro ◆ Burlington ◆ Rutland ◆ St. Albans ◆ Stowe

Our Investment Process

Rich Pearce, Portfolio Manager

Departing a bit from the traditional investment theme, I thought it might be useful, and I hope, interesting, to step back a bit to provide a glimpse, if just partially, of how we go about managing assets for our clients. I'm not going to attempt to describe our process in total, but rather, I am going to highlight just one aspect as a representative of the whole.

Our investment management system is driven by the Trust Investment Committee (TIC). This committee is made up of all seven investment managers and we get together monthly to chat about all things investment related. The Investment Committee is responsible for determining economic projections, assigning sector weightings, maintaining our stock buy list and monitoring our performance, along with some routine operational issues. The members of TIC average 27 years experience in the investment management business with a nice balance between seasoned and younger managers. Harold "Butch" Hebert, profiled in this issue, is our most "seasoned" manager while our youngest manager still has over 14 years experience managing assets. This blend of personality and experience leads to an effective collaboration of differing opinions and perspectives forcing each of us to contemplate ideas we might not normally consider. We value this team approach and believe it in turn leads to accounts managed in a more thoughtful and effective manner.

We use economic sectors as our core tool in managing assets. There are ten broad economic sectors and each one is simply a group of stocks that are, more or less, related. All Finance related stocks go in one, Energy stocks in another, Health Care related stocks in yet another and so on. As I said, we delegate, so each manager is given responsibility for one or two of these sectors, which means they must find and recommend to the committee the addition or deletion of stocks in their sector, understand, and communicate to the rest of us, how their sector relates to economic activity and suggest how much emphasis should be placed on their sector.

Personally, for example, I was assigned the Consumer Staples sector. Consumer Staples include those companies that, in general, make or sell products that are not affected by economic activity, those things we need to purchase regardless of our personal financial health; think soap, toothpaste, deodorant and beer, not necessarily in that order. As you might guess, these stocks tend to perform pretty well during economic uncertainty and they remain an important part of our portfolios so this sector is always pretty well represented.

At each meeting we discuss how much emphasis should be placed on each of our sectors, relative to our benchmark, the S&P 500 Index. Currently, my sector, the Consumer Staples area, is weighted about average. This is to say, our accounts tend to own about the same percentage of Consumer Staples stocks as our benchmark. In addition we have agreed to "over-weight" the Health Care and Industrial sectors. So, in the judgment of the Investment Committee, these areas should be over-emphasized and our accounts will begin to have more invested in these areas than our benchmark, the S&P 500.

Our Thirty Year "Plan B" for Investment Management

Our decision to use the team approach in managing assets was made with the recognition that for it to work, we needed to encourage diversity. One factor that seems to have a significant impact on the variety of opinions is the number of market cycles a manager has experienced. A good manager needs to survive at least one market crash. Whether it's the crash of 2000-2002 when the Dow dropped 37.8%, October 1987 when the Dow dropped 23% in one day, the experience seasons a manager. We have a special place of honor in our company for the survivors of the 1973-1974 market crash, which lasted almost ten years. Some investment managers who started their careers in the late sixties and early seventies never recovered from the trauma of this crash. Others maintained a healthy long term outlook and the lesson learned or reinforced was not to commit short term money to the stock market.

Rich Pearce's article in this issue focuses on our Investment Committee. The vibrancy of this Committee is important to our long term plans for the company and is the critical piece of our thirty year plan.

Far too often we let valuable experience retire. Our goal is not to do this. In this context, we have designed our company so that our managers will be encouraged to work into their retirement years. In order to do this, we need to facilitate working part-time. We also want to make sure that our investment culture is not over-weighted towards those, who in the natural process of aging, become too risk averse. So we are mindful of building a bench of younger managers to allow our "seasoned" managers to remain with us.

In this context, we are pleased to announce that Christopher Cassidy will be joining our Company in June.

Chris, who has interned with us for two years, is about to graduate from Skidmore College. He will assist us in stock research and portfolio analysis.

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New Burlington Location Update

We're in the process of relocating to our new home in Burlington. We will be moving into temporary quarters on the third floor of 286 College Street on Thursday, April 13th. In June, our plans are to move down to the first and second floors. So we will be available, but probably not fully presentable for several months, in our new location. After we're fully settled in, we'll look forward to welcoming clients to this historic and gracious building. Please note that our phone, fax and email contacts remain the same.

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Colleague Profile
St. Albans' Own
Butch Hebert

There is something about driving into St. Albans, which is located about 25 miles north of Burlington,

that suggests this town (technically a city) is unique. Quoting the Virtual Vermont web page (www.virtualvermont.com), "Because of its importance as a rail terminus and car shop, it has long been known as "Railroad City."'

In puritan New England, it is rare to find towns and cities with the names of saints. Again the Virtual Vermonter in theorizing why Benning Wentworth, in naming St. Albans, departed from the norm: "One would like to credit Wentworth with remembering its significance as the birthplace of the rights of the common man. The Assembly of St. Albans, convened in 1213 to organize opposition to the unpopular King John, formed the groundwork for the Magna Carta and was a basis for the House of Commons. Patriots of English descent look to it as the wellspring of civic and political liberties."

If you spend anytime at all with Harold "Butch" Hebert you will find him a "wellspring of civic and political liberties". Born and raised in St. Albans, he is as committed today to the community as he was 25 years ago as one of the founders of the Franklin County Home Health Agency, or more recently the Collins Perley Sports & Fitness Center, clearly visible as you enter the town. Active in many organizations over the years, he currently serves as Treasurer for the Northwestern Medical Center.

Butch was born in St. Albans. His father, not surprisingly, worked for the railroad. After graduating from Bellows Falls Free Academy, Butch had an opportunity to sign as a catcher for the Red Sox, but as fate would have it, ended up as a machinist apprentice for, not surprisingly, the railroad. Military service followed, and he spent two years in Germany, and a year in the cadre at West Point. Upon returning to Vermont, he went to Champlain College, majoring in accounting, and upon graduation worked for the F.G. Grassett Accounting firm. In 1970, he was recruited by the Franklin County Bank to work in the Trust Department doing taxes.

Butch quickly moved into investment management, and eventually became head of the Trust Department. After his Bank was bought out, he joined the Vermont National Bank Trust Department and continued to work in investments after the merger with Chittenden. In 2001, Butch and Mary Ann McDermott-Reynolds, a long time co-worker, set up our St. Alban's office.

Butch, through his membership in the St. Alban's Rotary, has spent several weeks over the last few years in Honduras to help rebuild schools originally damaged by Hurricane Mitch. He plans on going back next year as part of an ongoing program called "Hands to Honduras."

Butch emerged from the market crash of 1973-1974 essentially unscathed and with the belief that the stock market is a safe place to be for many investors if you invest long-term. He's a natural "stock picker" and carries this view into the Trust Investment Committee. Butch is one of our "seasoned" managers whose experience and skills are valued by the rest of us. So, when he started talking about working less, we hired David DeBellis, a mere youth at the time by comparison, to absorb some of his workload so he could be the first in our group to go to "Plan B" (see our article "The 30 Year Plan").

Butch recently built a house on Lake Champlain in Georgia just south of St. Albans where he lives with his wife Sally, a high school sweetheart whom he married in Basel, Switzerland in 1965. He has two sons and two granddaughters. His life has a balance to it that some of us envy: garden, dote on the granddaughters, review portfolios, engage in violent physical activity such as racquetball (it was just a few years ago that he ran the Marine Corp marathon), meet with local business-people and argue politics, study the stock market, meet with long time clients, engage in somnolent activity such as golf, and lastly, stay involved in the community.

Don't Be Immobilized by Current Events

Greg McConahey, Portfolio Manager

Today's investors are bombarded with so much information it can be easy to lose sight of what is truly important when it comes to achieving financial success. Where will energy prices be in six months and what impact will they have on consumer spending? How long will the U.S. continue to run current account and trade deficits and what impact will this have on the value of the U.S. dollar? Will these deficits force Congress to end the 15% tax on dividends and capital gains? As a result of rising mortgage interest rates will investors move money out of real estate into stocks? How will the health care payment system be impacted by the aging of the baby boomers? How will the increasing significance of China's economic cycles influence the global economy? While these current issues and many others have a bearing on the level and direction of various asset class prices, investors must not react like a 'deer in a headlight' and fail to take action.

The first step in taking action is to determine how much of one's assets can be invested for at least three to five years without a need for these funds to meet current living expenses. In conjunction with this quantification of assets to invest, an investor must determine the goal and length of time to achieve the goal for these funds. Having some understanding of the rate of return necessary to achieve the goal is important as well.

Most individuals we work with are either investing to fund a future retirement or are retired but still have a lengthy life expectancy and need to protect the purchasing power of the accumulated funds.

The second step in taking action is determining an asset allocation that takes into account the time frame to meet the goal. Making the right call on asset allocation and sticking to that allocation will have the most influence on achieving one's goal. Understanding historical rates of return for various asset classes is important as well as appreciating the volatility inherent in each asset class. Our objective is to build a portfolio that is diversified across and within each asset class. Our equity holdings are primarily represented by larger market capitalization companies. These companies by and large pay a dividend and in most cases have increased that dividend on an annual basis for some time. These companies are diversified across ten different sectors. We further supplement the equity allocation with exposure to mid and small capitalization companies.

The third step in taking action is to rebalance your portfolio on a regular basis back to the target asset allocation. This probably doesn't need to be done more often than annually. This rebalancing should be done both with regard to stocks and bonds but also within stocks across market cap and industry sector. This year's winners can be next year's laggards so it is important to harvest a portion of the gain and reinvest it. Rebalancing further reinforces the intended diversification by making sure that the asset weightings are in line with the original plan.

In closing, no matter where you are in the cycle of investing, don't let the onslaught of current events prevent you from executing your investment plan. We feel the backdrop for investors is still constructive given continued expected economic growth in 2006, strong corporate profit growth, low inflation and relatively low interest rates. Please feel free to give us a call to discuss your portfolio and our outlook in greater detail.