



# QUARTERLY UPDATE

April  
2011

Brattleboro ♦ Burlington ♦ Rutland ♦ Manchester ♦ St. Albans ♦ Stowe

## Taking Good Care

**Stewardship:** careful and responsible management of something entrusted to one's care

**Prudence:** the habit of acting with deliberation and discretion; wisdom applied to practice

*(Source: Merriam-Webster Dictionary)*

The number of high profile cases of corporate malfeasance over the last decade has made it increasingly clear that there are some CEO's and corporate Board of Directors who do not emphasize stewardship and prudence in making business decisions. Common to each of these cases of malfeasance were companies with insufficient governance practices resulting in actions that were not in the long-term interest of company shareholders.

In our role as an investment manager and a fiduciary, we believe that we have a responsibility to try and avoid investing in such companies when and wherever possible. To assist us with this task we are utilizing research from Morningstar which provides a "Stewardship" rating. In arriving at this rating Morningstar evaluates "the commitment to shareholders demonstrated by each firm's board and management team by assessing transparency, shareholder friendliness, financial incentives and stock ownership." The focus of this research is to try and identify those companies that may provide misleading financial information, seek to limit the power of minority

shareholders, or have management incentives that are not aligned with shareholder interests. The grades are assigned on an absolute scale, not relative to peers, and can be interpreted as follows: A means "Excellent," B means "Good," C means "Fair," D means "Poor," and F means "Very Poor."

In selecting investments for clients' accounts, our portfolio managers review each company's Stewardship rating as well as the comments of Morningstar's analysts concerning management's strengths and weaknesses in this area. While no rating system can screen out all companies that fail to exercise good stewardship and prudence, we believe that utilizing this particular rating helps us to identify those companies with corporate cultures that create fertile soil for such practices. Monitoring corporate stewardship is just one of many things that we at Trust Company of Vermont do to protect your investments.

~ Todd E. Gray, Portfolio Manager



# Happy Second Anniversary, Bull Market

Todd E. Gray, Vice President & Portfolio Manager

March 9, 2011 represented the second anniversary of the birth of the current bull market in U.S. stocks. With the S&P 500 Index having increased during this time period by almost 100%, measuring from the lowest to the highest point, it is reasonable to have some concerns about the health of the bull. Is the bull market getting long in the tooth? Have stock prices gone up too much and too fast? Such concerns are best addressed by examining previous bull markets.

Over the past eighty years there have been sixteen bull markets. Out of the sixteen, eleven have lasted for longer than two years with the longest lasting nine years. Measuring from the market bottom to the peak, the average bull market duration has been 3.8 years. So, from the standpoint of duration, the current bull market is still below average in its length.

At 100% gains, this bull market has run further and faster than any previous rally since 1932. Indeed, it has outpaced every other rally's 24 month return by a substantial margin, with the average return over this time period being 56%. Based on this information, concerns that the stock market has bounced back too much and too fast would appear valid. However, it is important to keep in mind that the last stock market decline was far more severe than the typical bear market, making this sharp rise a little less extraordinary.

In order to get an accurate perspective on the health of the current bull market, investors need to examine

what is driving this rise and how these drivers may be different from previous bull markets. Earnings growth, a critical measure of corporate health, has been strong and that trend is expected to continue in 2011. Therefore,

despite the rise in stock prices, the price-to-earnings (P/E) ratio, which measures how much investors are willing to pay for each dollar of company earnings, indicates that the market is still inexpensive. The "forward" P/E ratio for the S&P 500 index is 13.6, which is below the historical average of 15. That means there's still room for P/E expansion before the market can be considered "fairly valued".



Low interest rates and cost cutting have driven corporations to retool their balance sheets. They are currently sitting on almost \$2 trillion of cash. Some of the money that's been saved and raised by companies is being earmarked for dividend increases and stock repurchases, which should help extend the bull market. The current dividend payout ratio for the S&P 500 of 26% leaves considerable upside if the payout ratio moves toward its 54% historic average.

*"The four most dangerous words in investing are: it's different this time."*

*- Legendary Investor Sir John Templeton*

At the risk of violating the wisdom of Sir John Templeton, we would suggest that there are external dynamics that are different this time. The biggest change is that the U.S. stock market is no

longer reliant on the U.S. economy. We now live within a truly global economy. The companies with global reach,



those that sell their products worldwide and source raw materials, components, manufacturing and labor globally, are the companies leading the market higher.

What's different is that

the external forces that can

drive up, or derail, the U.S. stock market are forces which are beyond our borders and our control. Events such as global stock markets correcting or crashing, emerging markets' economic growth and inflation, government debt held by overseas investors, sovereign wealth funds and central banks can all have a significant impact on our markets. While we are not dismissing the lessons of history, we believe that we are operating within a new global environment that may very well make historical statistics less accurate predictors of current and future market movements.

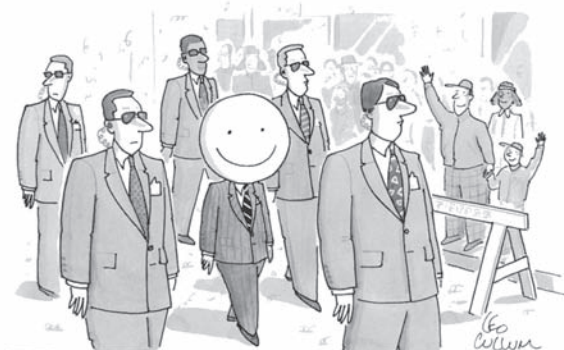
## What do we do now?

As we celebrate the second anniversary of the bull market, the lessons of history would suggest that we need to be preparing for a shift to sectors that will be leading the bull market in its third year of life. That shift would be away from the small-cap and growth sectors of the stock market toward large-cap and value. While it is entirely normal for the small-cap and growth sectors to lead the stock market during the earlier phases of this bull market, it is increasingly surprising that they have continued to do so. The typical pattern during prior bull markets is for the shift toward the large-cap and value ends of the spectrum to have occurred before the two-year mark. With each passing month, the odds in favor

of large-cap and value taking the lead become that much stronger. Eventually, this shift in market leadership will take place and when it does the advantage that large-cap has over small-cap and value over growth could be quite significant. According to calculations made by Jeremy Grantham, the chief investment strategist at Boston-based GMO, the large-cap value sector has never been more undervalued than it is today, relative to small-cap growth stocks. We also believe that the superior economic growth levels of emerging market countries make their stocks attractive investments, as well as U.S. companies who derive significant amounts of revenue from these countries.

A common question currently being asked by investors is should they be reducing their stock holdings and buying bonds. With interest rates, especially short-term rates, being either at or near the lowest levels of the past 50 years, our opinion is that bonds, especially government bonds, are not particularly attractive at this point. However, it is important that investors do not allow their stock allocation to grow above the maximum level that is warranted for their circumstances and tolerance for risk.

We welcome the opportunity to meet with you to review your portfolio and discuss how our outlook can fit into your specific goals and objectives.



THE RETURN OF GUARDED OPTIMISM



face to



face with

facebook



~ Jack Davidson

It started innocently enough. I went to a family wedding and my niece posted pictures to her Facebook account. I had heard about Facebook and passing references to “social media”. Her Facebook page looked harmless enough. My niece maintained a place on the internet where she could store pictures and post news. Her “mini web page” also included a Wall where viewers could post messages.

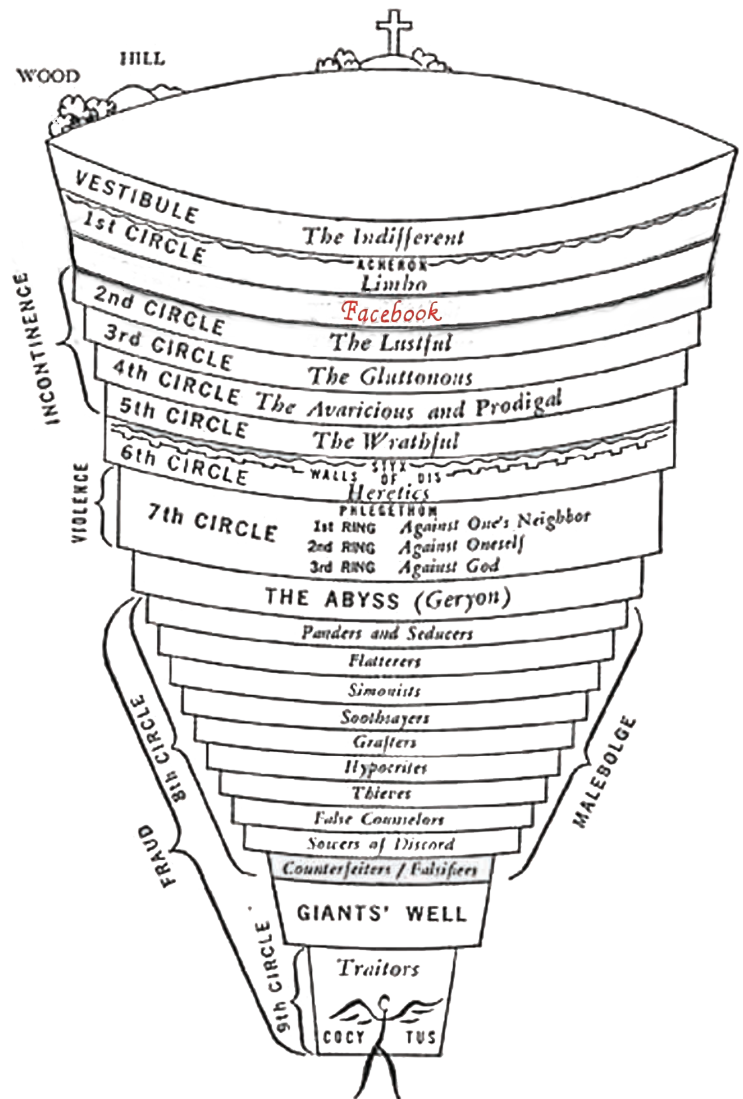
So, in order to see her pictures, I discovered that I needed to create my own Facebook account. Such was my first, innocent step into an unfamiliar universe.

Now, I am no stranger to technology. Nor are many of my colleagues at TCV. In the mid-eighties, a group of us started using e-mail for our work. We also scrapped the typewriters and bought PCs for everyone at the Vermont National Bank Trust Department. We even created our own network. In 1985, we used e-mail almost exclusively to communicate with each other while everyone else played telephone tag.

At the time, we also thought that retirees would eventually embrace the internet, although that was not the conventional wisdom. We knew the transition to home computers for seniors would be slow, but we were confident that it would eventually happen. We foresaw the attraction of e-mailing to children and grandchildren, and we felt that the desire to connect in this new way was strong enough to overcome the significant obstacles that seniors faced. The technology was new and intimidating. I recall spending weeks learning to control the cursor using the unfamiliar mouse. The Microsoft software was also fraught with problems and many of us, the early users, are still

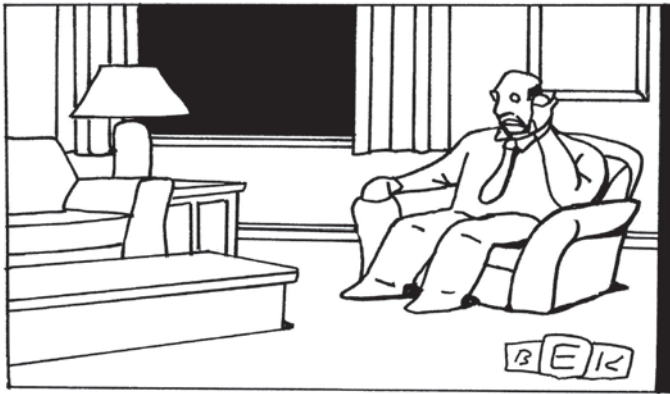
traumatized whenever we see a blue screen.

I recall the day my mother in-law spotted me at work on my first home PC. She proclaimed that the internet was “evil”. A few years later, she was emailing my wife on a regular basis, having presumably reconciled with the spiritual issues. Now I am starting to have the same thoughts about Facebook. I sometimes wonder which circle in hell would Dante place Facebook?



Hell

I suspect that many seniors have ~ or will be ~ drawn into Facebook for similar reasons: to stay connected with the younger generations and to retrieve photos of family outings held hostage by Facebook.

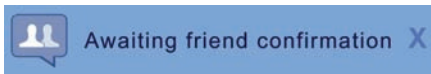


*"Just sitting here waiting for Facebook to go away."*

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It is hard for me to explain how Facebook works. I know that it is widely embraced. Facebook has more than 600 million active users, and a recent estimate placed 41.6% of the U.S. population with a Facebook account.

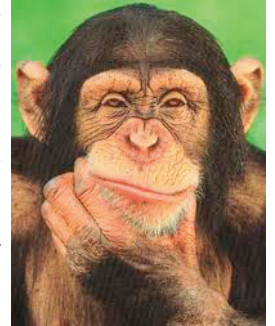
After reading that Ivy Bean of Bradford, England, had a Facebook account until her recent passing at age 104, I concluded that I was way behind a mainstream community activity. Certainly, my colleagues were as well. No one ever talked about Facebook or invited me to be their "Friend." Now, if you do not have a Facebook Account, let me explain that last sentence. Shortly after I set up my account, which included completing a brief profile with facts such as where I went to school and my marital status, I started receiving requests from people from high school and college asking to be "My Friend." I thought that was odd, since a few of these people didn't want to be my friend when I was in school -- so why start now?



I did consent to be friends with my family members but, in so doing, I felt that I had entered a new world that lacked privacy. I now had access to all the private

details of their Facebook accounts, including their friends.

I decided to post a picture to my profile, so I whimsically selected a studious looking Chimpanzee. The next thing I know I am receiving posts on my Wall all saying pretty much the same thing ~ "Nice to see you haven't changed." After I realized that I had not checked off the box for marital status, I made the correction and then I started to see variants of a new message "About time you married Judy after all these years". People were lurking.



I decided to pull the blinds down and stopped using Facebook. Periodically, I received requests to be "My Friend," and I would ignore them. I feel badly about this. If you were a rejected friend, please accept my apologies ~ nothing personal.

I couldn't imagine my colleagues were using Facebook. Otherwise, I would expect that at least a few would want to be "My Friend." So I polled them. Here are the results for the Trust Company of Vermont:

70% have Facebook accounts

30% do not plan on having a Facebook account

17% hate Facebook

57% are reluctant Facebook users

40% use Facebook only to stay close to family

On further reflection, the results do not surprise me. We are a company steeped in the need to maintain confidentiality. We also want to stay close to our extended families. So it seems to make sense that we are, on the whole, reluctant users.

Over the years, I have observed that the willingness to share financial information

depends primarily on your generation rather than any other factor, although socio-economic status has some influence. If you are older than 75, you tend not to want to share information regarding your net worth. If you are between 30 and 75, your willingness increases, sometimes significantly. If you are younger than 30, there is a real possibility that you are quite willing to share personal information at a level that many of your elders cannot comprehend.

Another niece invited me to join her Facebook. Her parents were noticeably absent in the Friends list; for good reason. She posted what I consider to be a highly personal diary that an earlier generation would have hidden under the floorboards. Then there were her pictures. My first thought was, “How old is my niece?” and my second was, “What is the drinking age in Massachusetts?”

### Estate Planning and Confidentiality

One of the first questions I ask when I do estate planning is whether family members have shared their estate plan. This is critically important information. How can I adequately plan an estate of a son or daughter if I do not know what the parents will be leaving them, and in what form? Do they provide for the spouse? Do they provide for the grandchildren? What are the values of the assets, and could they subject an estate to taxation that could be avoided with proper planning?

Often, I encounter children who will not ask their parents the questions that need to be asked. I also find parents who would be willing to share the information, if asked, but do not volunteer the information.

So, parents, if your children have reached an age where they need to plan, consider volunteering the information. And to the children, we urge you to ask

for the information.

I make these suggestions mindful of the new world of confidentiality, the world of social media, and the possibility that if our clients share this information with someone under 30 it may end up on Facebook.

### Confidentiality & the Trust Company of Vermont

E-mail is not confidential unless it is encrypted. That is why at TCV we constantly remind ourselves not to send or reply to e-mails with information that needs to remain confidential. Frequently, our clients send us e-mail that should be encrypted. Merely responding with the text of the client's e-mail can expose this information to a second round of interception as it travels back to the client. In this context, we have recently installed ZixMail, which automatically encrypts our e-mail to our clients. So, when you first encounter our ZixMail response, it may be unsettling ~ but in this odd new world where we need stringent rules to protect data on the internet while data is widely shared through social media, we need to be increasingly vigilant.

We also intend to post on our web page “how-to” instructions showing the highest privacy settings for Facebook.

Facebook may not be evil. It may be a wonderful way to stay connected to friends and family. That said, I wonder what Blaise Pascal, the 17th century French mathematician, inventor, and philosopher, would think of Facebook were he alive today. Here is a man so noteworthy that a programming language has been named after him. Quoting Pascal: “I have discovered that all human evil comes from this, man's being unable to sit still in a room.” My mother-in-law understood this. I wasn't just sitting at my desk in front of a screen. I was traveling the world.



### Travel with caution.