CALDWELL TRUST COMPANY

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Investment letter

Tax rates for 2011: what happens if current tax cuts sunset?

In our last letter we discussed the transformation of America's economy into a new paradigm unprecedented in our fiscal past. Now we'll consider a priority item that investors need to ponder regarding the ways federal fiscal policy could affect tax rates and deficits: What happens on January 1 if Congress allows taxes to revert to the higher rates that were in place before stimulus legislation lowered them in 2001? Let's take a look at what happened in the past under similar economic conditions when tax rates changed.

Historical results of tinkering with taxes

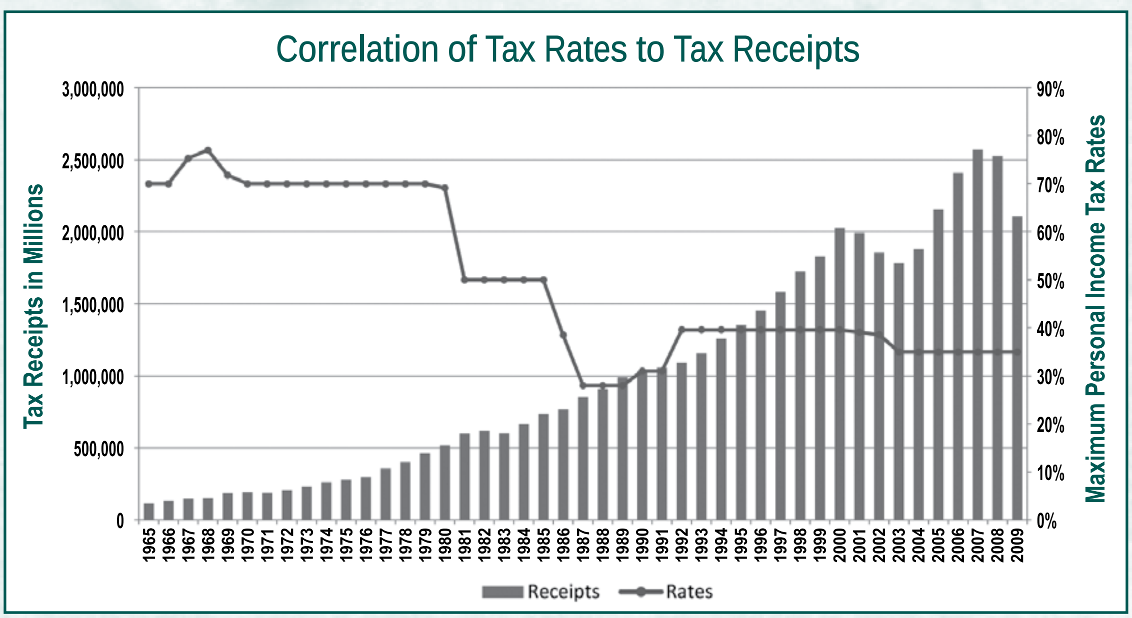
Going back to WWII, the top individual income tax rate was set high to pay for the war, and the 90 percent range was widely acceptable. After the war, high tax rates continued as pent-up demands from returning service personnel drove the economy upward despite the burdensome tax rates. When those rates finally became economically penalizing, however, President John F. Kennedy followed the advice of his economic advisor, Walter Heller. He asked for and got a drop in the highest rate to 70 percent.

That change jump-started the economy, which emboldened President Lyndon B. Johnson to get many "Great Society" economic and civil rights legislations passed into law, even through America had to pay for these programs and the war in Vietnam at the same time. The spending burden gnawed away at the economy. Fiscal deficits caused more federal borrowing, leading in turn to double-digit inflation and interest rates under the following Nixon, Ford and Carter administrations. The word "stagflation" was coined to describe an economy that stagnated while simultaneously incurring high inflation rates.

Removing the gold standard

During those tumultuous years, President Richard M. Nixon issued a Presidential Order to unilaterally discontinue backing the U.S. dollar with gold. That alone resulted in the dual reaction of a record-breaking spike in gold prices and a sharp drop in the purchasing power of the dollar. High tax and interest rates, inflation and government spending increases continued. This period of social unrest and economic stagnation resulted in the Dow hitting 969 at the end of 1965 and not closing above that level for 17 years until finally closing at 1,046 at the end of 1982, ending one of America's worst economic recessions on record.

Paul Volcker, Chairman of the Federal Reserve under Presidents Jimmy Carter and Ronald Reagan, was a key policy maker at the time (*and he advises President Obama today*). Many blamed his hawkish monetary controls at the Fed for causing that sharp economic contraction. However, the result was an almost immediate drop in gold prices, a strengthening dollar and falling inflation and interest rates that decreased from nearly 20 percent down to around 4 percent. The contraction was brutal until it was finally halted by a combination of Volker's monetary discipline and Congress's agreement to cut the top tax rate from 70% to 35%. These two policy



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On January 1, taxes may increase overnight from current low

changes alone were widely credited for laying the groundwork for the record-breaking economic expansion that saw declining inflation and interest rates lasting to the end of the 20th century.

Most classical economic theorists opposed Reagan's move to cut tax rates in the early '80s, and Congress passed the cuts only with considerable political opposition. The result, however, was that lower rates actually produced all-time record tax receipts from an expanding economy. Stock prices confirmed the wisdom of that move by rising from a Dow close of 1,046 on December 31, 1982, to more than 11,700 before the "tech bubble" burst in 2000 and the Dow retreated to around 10,000, where it remains today.

Greatest creation of wealth in history

That 18-year period of economic growth resulted in the greatest era of household wealth creation in the history of the world—from about $5 trillion to over $65 trillion—before falling back to the $50 trillion level today. The wealth created during that time continues to this day to sustain America's position of world economic and military leadership to the benefit of all nations. Today, that same strength alone enables America to embark upon yet another economic experiment into the treacherous realm of record deficit spending in an attempt to avoid another painful economic correction.

The federal government isn't trying to tax our way out of the recession yet. Instead, it is spending our way out and putting the dollar's acceptability at risk once again. The Fed is facilitating this approach by holding interest rates at record low levels, which it is able do because inflation also remains low. In the last letter, we discussed America's highly risky policy of expanding debt and creating money to pump trillions back into the hands of its unemployed people and troubled banks and businesses. Our debt issuance is now massively greater relative to that of the earlier 17- year period of economic stagflation. Political leaders are being forced to decide what to do next as America, and indeed the whole industrialized world, faces the daunting task of encouraging the resumption of economic growth to support burgeoning debt levels everywhere. This puts tax rates front and center as the logical, and perhaps only, place for policy makers to tinker.

The consequences and results of those earlier trial-and-error actions in the old economy should provide policy makers and economic advisors with sufficient ammunition to do what they must with tax policies this time around. Today's political leaders have the advantage of actual experience rather than only economic theory as they try to devise incentive-based policies to reach their desired objective of increased tax receipts. Perhaps in this new economy though, political leaders are taking a different approach, seeking selected tax changes that are less likely to adversely impact the economy at this critical time. If so, maybe this time around America will end up increasing rather than reducing federal tax receipts.

A troubling sunset

And so, we return to the issue we began with: tax increases that may occur on January 1, 2011. The top individual income bracket is in the 35 percent range through the end of this year. A key economic question is what will Congress do? Will it do nothing and allow the 2001 tax legislation to sunset, resetting rates and rules back to the higher level that had been in place? Or will it vote to extend that law, keeping some or all of the present rates in place? The complexities of the 2001 legislation are beyond the scope of this letter. However, more issues are involved than individual tax rates. If estate tax relief is allowed to sunset, massive numbers of Americans will face a complete revision of their estate plans. Capital gains and many other tax rules and rates are likewise at stake.

Tax fairness, primarily a political and not an economic issue, is also now in play. This is so notwithstanding that around 25 percent of low-income individuals currently pay no tax, while higher-income individuals pay approximately 95 percent of all taxes. If politics is allowed to determine economic policies, the consequences, whether good or bad, will likely influence future political outcomes.

CONCLUSION

Investors should not rely on politics for help, but should instead carefully monitor economic issues. Historical experiences are far and away the most useful indicators toward that end, but it is hard to comprehend what experiences the new economic paradigm will bring. So long as federal fiscal policies continue to navigate these new and uncharted waters, we anticipate that the markets will remain volatile. The possibility of impending tax increases and myriad other uncertainties will impede recovery from the recession. So, our outlook at Caldwell Trust Company and our advice to investors remain unchanged: stay conservative in exposure to stocks, concentrate on deriving income from dividends and interest rather than capital gains and stick with short maturities in fixed-income investments.

Future Caldwell leader starts kindergarten

Brooks Caldwell, 5, confidently heads off to his first day at Garden Elementary School, Venice. Brooks and his brothers Zach, 3, and Chase, nearly 2, represent the next generation of Caldwells. They are the sons of Melissa and R. G. "Kelly" Caldwell, Jr., CEO and president of Caldwell Trust Company.

Staff Profile

Trust officer Bill Cunningham always finds time to help area kids

Bill Cunningham's career is as a trust officer. Judging by his record, he does that very well. His passion is a deep concern for children. He does that very well too.

William A. Cunningham joined Caldwell Trust Company in August 2009 as a vice president and trust officer. He brought 45 years of trust experience, beginning with 12 years in trust operations at Riggs National Bank in Washington, D.C.

During his time in suburban Washington, the father of two then-small boys observed the unintentional pain inflicted on children when they didn't make the "big teams" in county-sponsored Little Leagues. Despite a strong desire to play, kids who didn't make the cut had no way to follow their dreams. Working through his church in Landover, Maryland, Bill founded an athletic association that offered football, baseball, basketball and other sports. The league warmly welcomed interested young boys and girls. It was a place where nobody was left out, Bill says.

Although his career was time-consuming, finding time to start a youth-oriented athletic association was entirely in character for Bill. "My favorite causes involve children," he says. In Sarasota, TideWell Hospice of Sarasota is a close second.

Bill, his wife Antonette and their two sons moved to this area in 1977. He worked in trust/estate administration as a vice president at Southeast Bank, N.A. In 1991, he joined Northern Trust Bank of Florida, N.A., as vice president of trust administration. In 2009, he retired.

Bill's retirement was short-lived. Accustomed to being busy, he accepted a longstanding invitation from R. G. "Kelly" Caldwell, Jr., Caldwell's president and CEO. Bill was already familiar with the company: He had worked at Riggs National Bank and Southeast Bank with Lloyd "Leo" O'Meara, who would later became a co-founder of Caldwell Trust Company. At Southeast, he also worked with Jan Miller, now a Caldwell vice president and trust officer. "I chose Caldwell because it shares my philosophy about customer relations, that the client is of utmost importance," Bill says.

He never retired from community involvement either. Bill has been active with Children First since 1998 and was on its Board of Directors until September 2009. Over the years he served as president, vice president, president emeritus and treasurer. He also worked in development/fundraising, helping to retire the debt for Children First's Newtown campus, according to Philip Tavill, Children First president and CEO. In addition, Bill assisted with revising bylaws, served on many committees and chaired the finance and golf tournament committees.

Cunningham has served on the boards of 17 area organizations, most recently joining that of TideWell Hospice. He has worked with them for 29 years and even ran for King of their Mardi Gras one year, raising almost $19,000.

Despite a busy schedule, Bill always has time for his family, which now includes a 16-year-old granddaughter—and he even manages to fit in an occasional round of golf.

Bill is based in Caldwell's Sarasota office. To contact him, email bill@ctrust.com or call 941.926.9336.

Caldwell in the Community

Children First is in top 1 percent of all Head Start programs in U.S.

With kindergarten readiness as its ultimate goal, Sarasota's Children First celebrates a half-century of service with recognition by the National Head Start Association as a "Program of Excellence," placing it among the top 22 of 2,700 Head Start programs in the country.

Founded by the Junior League of Sarasota as a day nursery, the not-for-profit organization serves more than 600 children and their families through a comprehensive approach that includes development, education, health, well-being and even two meals a day plus snacks.

Based at 1723 North Orange Avenue, Children First delivers services from 12 locations in Sarasota, Nokomis, Venice and North Port. Their assistance begins even before birth, with classes that extend from prenatal care through kindergarten preparation. Their services encompass entire families with parenting and family stabilization programs.

Photo by Alex Stafford Photography

As a long-time volunteer for Children First, Bill Cunningham of Caldwell Trust Company is gratified by the performance of this agency, which in turn appreciates his help. Philip Tavill, president and CEO, says, "Simply put, Bill Cunningham is driven by mission and results. During his tenure on the board, thousands of our community's most vulnerable very young children and their families benefited from Bill's dedication to their well-being."

Farley Funeral Homes and Crematory and Venice Memorial Gardens choose Caldwell Trust Company to manage employer retirement plans

Farley Funeral Homes and Crematory and its affiliate, Venice Memorial Gardens, are the most recent businesses to select Caldwell Trust Company as trustee and administrator for their employer-sponsored 401(k) retirement plans, says John Tufaro, Caldwell's retirement plan specialist. The plans became effective on September 1.

Michelle and John A. Williams

"We would have done this sooner if I hadn't been so busy as president of the Florida Funeral Directors Association," says John A. Williams, CPA, LFD. "We needed time to get it going." He and his wife Michelle Farley Williams run Farley Funeral Homes and Crematory along with three other family members.

John has been with the business, which dates back to 1932, for 13 years while "Michelle has been with the company for life," he says. Farley's president since 2006, John is also vice-president of Venice Memorial Gardens, which is owned by Michelle's parents, David and Joanne Farley. Their other daughter, Mary, is the fifth family member in the businesses, which have 27 collective employees.

"We have been Caldwell clients as individual investors for many years so we knew them well," Williams says. "The objective nature with which they do their work is very important to us—probably the most important reason we asked them to manage our retirement plans."

Williams also drew on his knowledge as a Certified Public Accountant in evaluating the move to Caldwell. "We consider them trustworthy and knowledgeable," he says, "and they're just down the street. We especially appreciate that they operate as a trust company. They do what their client needs. They have no other motive than that."

"Too many companies start a 401(k) plan and forget it," John Tufaro says. "They don't realize they're legally liable for the plan's costs and performance. When Caldwell becomes trustee and investment manager, we assist with legal obligations and fiduciary duties. We become the primary relationship entity for both the firm and its employees.

"Unlike non-fiduciary brokerage firms and insurance companies, we are allowed to give investment advice," Tufaro says. "Many employees find that very helpful."

Caldwell has been managing retirement plans for employers since 2004. The services are offered to for-profit businesses and not-for-profit organizations. To learn more about this program, contact John Tufaro at john@ctrust.com or 941.493.3600.