

Independent *thinking*

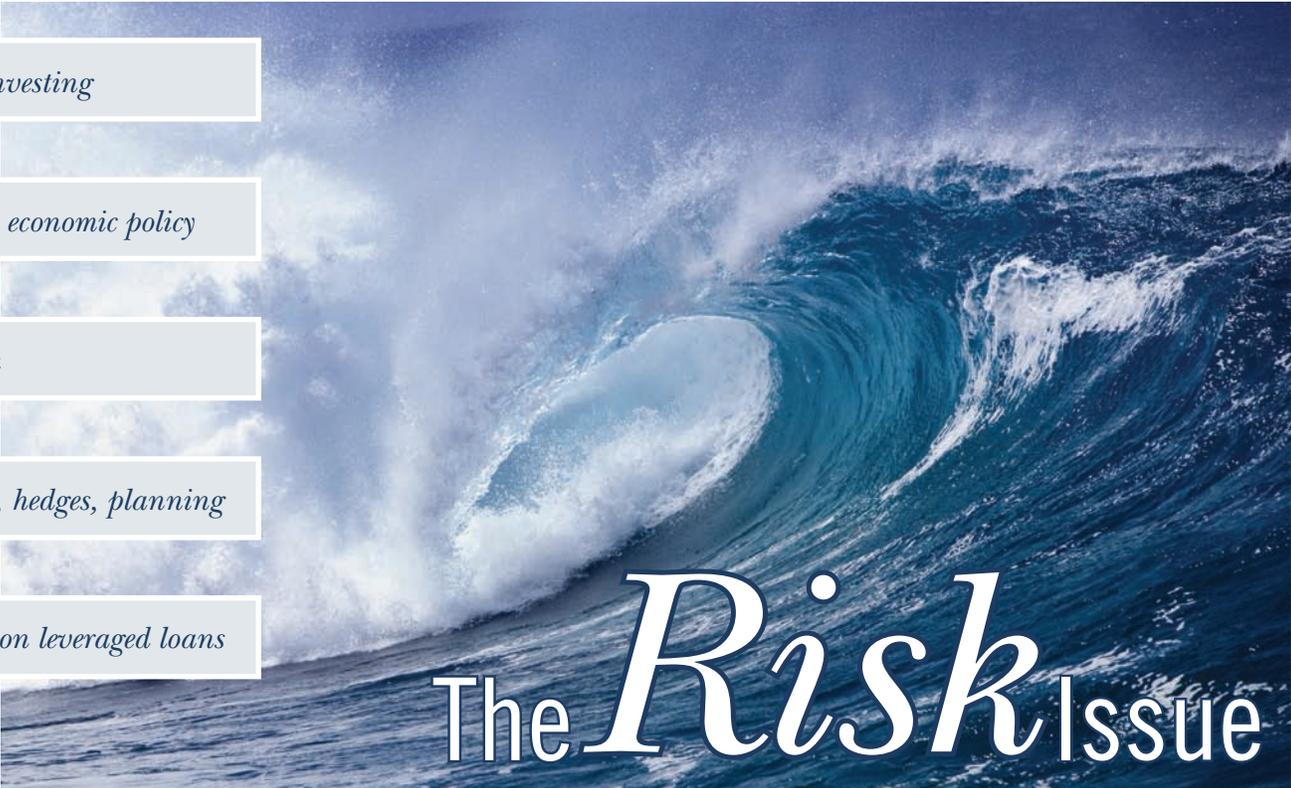
Goals-based investing

Pedro Aspe on economic policy

Dollar outlook

Stocks, munis, hedges, planning

Seix Advisors on leveraged loans



The *Risk* Issue

Navigating Risk with Goals-Based Investing

Like the sinking of the Titanic, the volatility of the U.S. markets over the past two years was perceived by contemporary experts as virtually impossible. And yet it was the second such event in a decade and the third in most baby boomers' experience. As most advisors continue to tout complex statistical models – and the firms that design them rearrange their respective deck chairs – some private clients and their advisors are charting a different course.

Individuals and related institutions are increasingly disenchanted with the performance of their total assets within the expected ranges of generic investment models. After all, the models most widely used by banks and brokerages severely underestimated the fat-tail risk of the most recent crisis, wiping out a substantial proportion of their private clients' portfolios. Investors who lost 25%-40% of their capital in the 18 months to March 2009 (the typical experience of those with a 60/40 stocks-to-bonds weighting) no longer want to be told how they did against volatility benchmarks.

Instead, as they survey the damage to their lifestyle, business, family and philanthropic interests, investors are demanding to know how, exactly, they will fulfill their financial obligations and meet their specific goals, particularly given the constraints of what, for most, is a considerably reduced appetite for risk and diminished return expectations.

Goals-based investing aligns an individual investor's specific needs and aspirations with his or her capabilities and financial and personal constraints. This approach enables advisors to focus on the lifestyle impact of changes in a client's portfolio values, his or her ability to weather severe storms and the likely impact of deflation and, more likely, inflation on assets. In other words, goals-based investing enables investors and their advisors to better understand the individual's true risk tolerance – and the tradeoffs involved.

For many, it's a steep learning curve. From 2003 through the summer of 2007, for example, *(continued on page 3)*

A message from the CEO

Welcome

to the inaugural issue of Independent Thinking, the quarterly journal of Evercore Wealth Management.

Independent Thinking is designed to share with our clients our perspectives and those of the outside managers we recommend. Each edition will also draw on the expertise of our parent, Evercore Partners: Pedro Aspe, Co-Chairman of Evercore Partners, the founder of the investment management group Protego and a former Minister of Finance and Public Credit for Mexico, brings his broad experience of fiscal and monetary policy to bear on this issue's topic of managing investment risk.

As it is a subject very much on the minds of our clients these days, all contributors to this issue address risk from their respective vantage points. Partners Iain Silverthorne, Tim Evnin, Chris Zander and Wendy Barasch have collaborated to discuss goals-based investing, an investment discipline that is a cornerstone of our firm and, we believe, rarely practiced elsewhere; John Apruzzese takes a hard look at the U.S. dollar while John McDermott discusses the relative merits of diversified hedging strategies and Judy McDonald Moses and Howard Cure weigh in on, respectively, the outlook for the equity and municipal bond markets.

These partners represent, along with their colleagues in New York and San Francisco, our core capabilities in fixed-income, equities and diversified hedges. As part of our commitment to our clients, we supplement our strengths with carefully selected access to external managers across multiple asset classes and investment styles. In that capacity, George Goudelias, Managing Director at Seix Advisors and Portfolio Manager of

the Seix Floating Rate High Income Fund, discusses the fund's strategy and his expectations for its performance.

Of course, space allows us to showcase just the tip of our collective thinking on all of these subjects; please feel free to contact any of the partners at Evercore Wealth Management for further information and



Jeffrey Maurer
Partner and CEO

with any questions or comments you may have.

We are committed to working directly with our clients and with each other. As a team of specialists with deep insight into the components of effective wealth management.

Risk was also very much in evidence when Evercore Wealth Management was founded 21 months ago. Moving their assets to an untested firm at the depth of a global recession might have been perceived by some investors as one risk too many. But for others, the appeal of a vibrant new firm built on investment expertise and an established partnership culture was even greater.

Our clients' choice – made at such a tumultuous time – imposes a special and lasting responsibility on all of us at Evercore Wealth Management. It is something we think about every day. We are extremely grateful to our clients and our colleagues for their faith in our firm, we are encouraged by our success to date and we are excited about our future.

A handwritten signature in black ink that reads "Jeff".

Jeff Maurer
Chief Executive Officer

Disclosures

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COVER STORY:

Navigating Risk with Goals-Based Investing

(continued from page 1) investors had a seemingly high risk tolerance for a market that didn't exhibit much risk until, of course, it did. There has since been a massive flight among individual investors to perceived safety, reflecting extremely low tolerance for any kind of risk (\$185 billion flowed into bond funds in the first seven months of this year, while domestic equity funds recorded outflows of \$29.6 billion) even at the expense of funding important long-term objectives.

Based on the same 60/40 split, an investor who had \$10 million now has \$7.5 million with which to sustain the same spending rate and meet his or her other goals. As a spending rate of, say, \$250,000 a year, or 2.5% of the original portfolio, now consumes 3.3%, or 32% more, the investor is forced to slash spending, reconsider his or her goals or take on yet more risk. For most clients, including the very high net worth, the primary objective now is to maintain income.

For some investors, that response is entirely appropriate. For example, an Evercore Wealth Management client in his late 40s with approximately \$50 million in assets was more risk averse than his age and total worth first indicated, as he feels that his business generates more than enough volatility. Through in-depth discussions with his advisor, it became apparent that he cannot personally tolerate the prospect of a large drawdown in his \$20 million of liquid assets but, with that sum conservatively invested in fixed-income strategies, he is comfortable with making relatively aggressive investments with the remainder, an approach that he told his advisor enables him to both sleep at night and to look forward to developing his business.

For others, a flight to safety jeopardizes cherished goals. A client in his mid 60s who has accumulated a similar amount at first believed that he could not tolerate

a drawdown of more than 20% because he does not have the time to earn it back. But in discussions with his advisor, his wife and children, it emerged that he is actually comfortable with preserving \$15 million for spending and enthusiastic about bucketing the remainder in relatively illiquid and aggressive investments to help fund the long-term interests of his family's shared charitable foundation.

Helping clients balance their behavioral tendencies to get greedy at tops and to panic at bottoms – to stick to their guns – is part of the advisor's job. Most financial advisors speak to goals-based investing, in one form or another. But conversations that can start with the best of intentions are translated

the client's individual needs, aspirations and constraints are not reflected in the allocation and management of their assets.

In other words, it's personal. At Evercore Wealth Management, the portfolio manager works directly with the client to define and prioritize their investment goals in the context of their risk tolerance and, critically, to allocate and manage their assets accordingly, reevaluating and adjusting to accommodate changing individual circumstances and opportunities in the markets. Asset classes are defined by their risk, return and, increasingly, their liquidity characteristics, an approach which in turn helps clients to better understand diversification and its benefits.



repeatedly as the relationship winds its way through the wealth management process in sales-driven institutions and, often, the substance is lost. The greater the separation between the client and the portfolio manager, the greater the risk that

Wendy Barasch, Tim Evin, Iain Silverthorne and Chris Zander contributed to this article. For further information on goals-based investing and related case studies, please contact any of these partners at Evercore Wealth Management.

Global Opportunity and Risk

by
PEDRO ASPE

Pedro Aspe is Co-Chairman of Evercore Partners, the founder and CEO of independent investment banking advisory firm Protego and a former Minister of Finance and Public Credit for Mexico. He holds positions at the Carnegie Foundation, Stanford University and the Massachusetts Institute of Technology.

Aggressive moves in both fiscal and monetary policy were required last year to avoid a deeper financial crisis. The decrease in private demand was exceptionally large and in the early stages of the crisis a temporary fiscal expansion was necessary. Countries with low debt and a track record of discipline policies have a better chance to be successful.

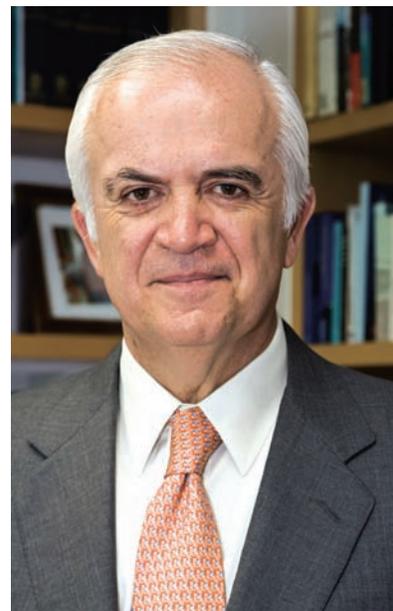
Some governments had to issue bonds, beyond their typical fiscal needs, which in turn required them to buy risky assets, absorbing a large share of the systemic risk. Their central banks became, in practice, the providers of insurance of last resort. But there was excessive concentration of aggregate risk in highly leveraged financial institutions, a much interconnected sector of the economy.

Fiscal deficits needed to increase demand in the short run will result in higher debts and the fiscal position of several governments will be significantly leveraged. The policy of paying for added public spending with debt issue works if the extra spending is temporary. If the expansion of the public sector is permanent, taxes must be raised even more in the future to pay for the added government expenditure and the extra debt. Ideally, the fiscal stimulus is temporary and government expenditure is reduced without increasing taxes, once the economic recovery is underway,

To the extent that monetary policy, including credit and quantitative easing, had largely reached limits, policy makers had little choice but to rely on fiscal policies. But some advanced economies entered the crisis with high levels of debt and therefore have limited ability to use fiscal policy. Going forward, the required degree of fiscal adjustment will be

huge, in light of the need to reduce debt against the background of aging-related challenges in pension and health care.

Recent studies* show that the relationship between debt and real GDP growth in advanced economies is weak



Pedro Aspe
*Co-Chairman
Evercore Partners*

for debt/GDP ratios below 90%. Above the threshold of 90% medium growth rates fall by 1%, and average growth rates fall considerably more (almost 4%), dampening growth.

For emerging markets the results are stronger. For the period considered, medium and average GDP grows 4% to 4.5% with debt below 90% of GDP and 2.9% for high debt (above 90% of GDP). As debt levels rise towards historical limits country risk premium rises sharply.

To the extent to which private debt becomes public debt after the crises, taxes eventually need to be raised or spending has to be reduced. Any government that attempts to inflate away the real value of debt will soon find itself paying higher interest rates.

At the end government debt policy redistributes the tax burden among generations. It is not possible to commit to permanent reductions in tax rates and any future tax cuts have to be combined

Government Debt/GDP

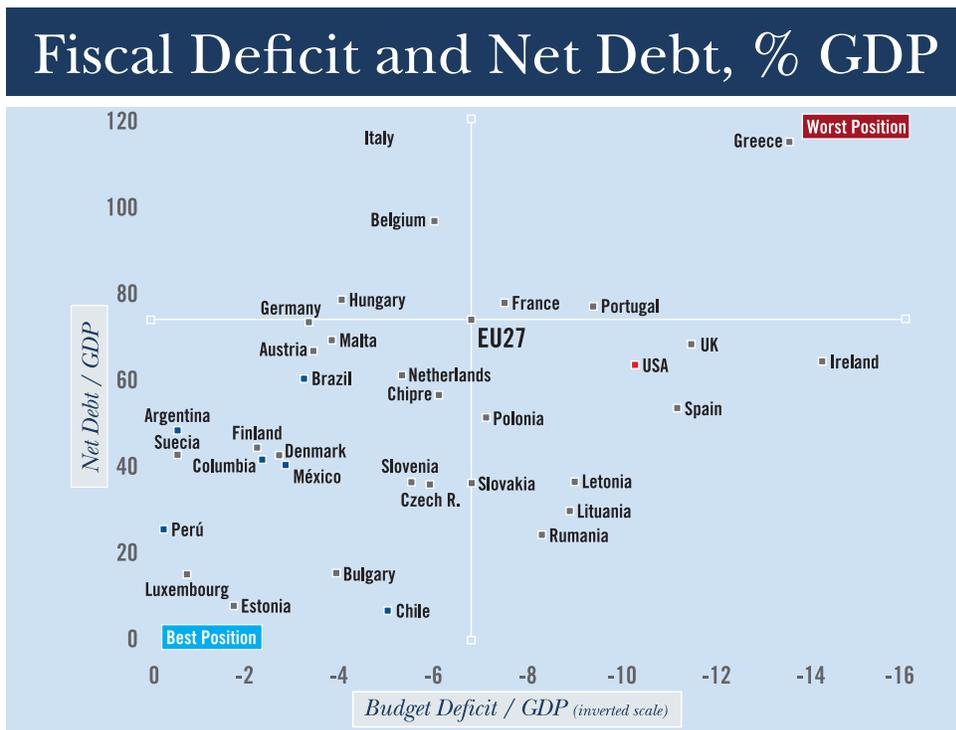
Measure	Period	Below 30 percent	30 to 60 percent	60 to 90 percent	90 percent and above
<i>GDP Growth</i>					
ADVANCED ECONOMIES					
Average	1946-2009	4.1	2.8	2.8	-0.1
Median	1946-2009	4.2	3.0	2.9	1.6
EMERGING MARKETS					
Average	1946-2009	4.3	4.8	4.1	1.3
Median	1946-2009	5.0	4.7	4.6	2.9

with policies to slow the growth of spending. Eventually the expansionary effect of higher deficits is offset by higher interest rates that crowd out private investment.

As governments come under greater pressure to display improved deficit and debt data they have to ensure that all public sector operations are transparently reflected in fiscal data and that well-designed budget processes reduce policy makers incentives to postpone needed adjustments. A reduction of public expenditure will avoid tax increases, reducing the probability of a double dip recession. When cyclical conditions permit, major fiscal adjustments are necessary – and they should start while the monetary stimulus is still in place, to benefit from an environment of low interest rates.

* Reinhart C. & Rogoff K. "Growth in the Time of Debt". *American Economic Review* (May, 2010)

Source: El Pais, IMF, Eurostats, BIM



Risk and the U.S. Dollar

by JOHN APRUZZESE



With gold at a new all-time high and the U.S. dollar down 8.7% against other major currencies at the end of the third quarter, investors are asking whether there is a risk of a dollar crisis – and what they should do about it.

The United States is, as the chart accompanying Pedro Aspe's article indicates, starting to hang with the wrong crowd in terms of both government debt and deficits. But it is still the issuer of the world's reserve currency, the legacy of the country's dominant economic and military power since World War II and its relatively stable political system. There is a large reserve of good will and confidence among central banks in the dollar as the reserve currency and international unit of exchange. This gives the country both tremendous leeway and great responsibility.

As important but rarely mentioned, the dollar is also the primary international unit

of exchange; 80% of all foreign exchange transactions involve the dollar and almost all international commodity trades are priced and transacted in dollars. The global economy and financial system need a standard unit of exchange to operate efficiently and to date there is no obvious alternative. A weak and volatile dollar is therefore a drag on international trade and the global economy.

But the value of the dollar is completely dependent on continued confidence because it is a fiat currency with nothing else backing it up but the good credit of the Federal Reserve and by extension the U.S. government. The question at hand is whether the extraordinary measures taken by the government and the Fed to avert a depression as a result of the financial crisis will destroy the world's confidence in the dollar.

The government's 2010 fiscal year just ended and here are the latest estimates:

- Total federal government revenues will come in at about \$2.14 trillion and total spending at about \$3.5 trillion leaving a deficit of \$1.36 trillion.
- Revenues are down \$430 billion from the all time high of \$2.57 trillion in 2007 while spending has since expanded by \$770 billion.

In an attempt to put the deficit in perspective, commentators invariably mention that the deficit is about 10% of GDP. This gives listeners pause. But a more telling statistic is that the deficit represents 39% of spending. The U.S. federal government currently does not have the revenues to support almost 40% of current spending, which means it will have to borrow more. That is a shocking percentage and yet almost never mentioned.

Further compounding the concern is the nature of the spending. For fiscal 2010 the government (continued on next page)

spent \$2.125 trillion, on transfer payments to individuals. The 65 and older crowd received \$1.42 trillion (\$700 billion for social security, \$200 billion from civil service and military retirement plans and \$520 billion for Medicare). That works out to about \$36,000 per each and every one of the 39 million people over 65. The poor and/or unemployed received \$700 billion (\$430 billion for unemployment and various welfare programs and \$270 billion for Medicaid). These transfer payments add up to 60% of total spending and exactly equals total revenues. Effectively, all other government spending had to be borrowed.

As the previous fiscal year was no different, the U.S. Treasury has in two years borrowed \$3 trillion which increased total debt outstanding by 50% to \$9 trillion. The

market was able to absorb the Treasury issuance and interest rates actually fell because: private debt in the U.S. contracted by over \$3 trillion; investors were attracted to Treasuries during the financial crisis for their perceived safety; and the Federal Reserve expanded its balance sheet by almost \$1.4 trillion.

This latter point causes the most concern for the dollar. The Fed has pumped \$1.4 trillion new dollars into the financial

United States means that the reaction of many other countries will be, as the Brazilian finance minister put it, an aggressive attempt to devalue their currencies to keep up with the dollar. If there was a “currency war” the winner would be gold.

For these reasons, and as signaled by the high price of gold, the market is very concerned about the soundness of the dollar. A dollar crisis is not a foregone conclusion, as the United States may yet be able to grow

“*The U.S. government does not have the revenues to support almost 40% of current spending.*”

system. Normally, such a move would create runaway inflation because the banks would turn around and lend out up to 10 times that amount in new loans which would flood the market with excess dollars. But that has not happened – at least not yet. One trillion of the new dollars actually remain on deposit at the Fed because banks are continuing to repair their balance sheets and there is little demand for additional credit from credit worthy borrowers. The cause of the crisis was excessive debt – the market’s cure is less debt.

At the same time, the deficit projection for next year is at least \$1 trillion, which means that the Treasury needs to borrow another \$1 trillion. But some of the largest lenders have lost their appetite. (The biggest lender of all, China, has reduced its holdings of U.S. Treasuries by 10% over the last year.) Instead, and for the first time since the 1960s, the world’s central banks have been net buyers of gold.

Dollar weakness accelerated when the Fed put the market on notice that it will consider further expansion of the balance sheet (quantitative easing) if the economy softens. Just about any other country in a similar situation would be punished by the market – the currency would be immediately devalued and the government put on a strict austerity plan. But the unique status of the

its way out of its current predicament. But prudent investors will want to be prepared, broadly diversifying among a number of dollar devaluation hedges including other currencies chosen carefully to consider the risk of competitive devaluation, hard assets (real estate and commodities), the stocks of companies with hard assets and pricing power, foreign stocks, TIPS and gold.

Potentially the worst assets to own are long-term dollar denominated bonds because the investor will get paid back in devalued dollars. In other words, what are normally considered the safest, most conservative investments – Treasuries and other high quality bonds – join the ranks of risky investments. Stocks in general are tricky because their value will fall at first as interest rates rise and future earnings are discounted at a higher rate but over time most companies will be able to re-price their products and the real value of the business will recover

At Evercore Wealth Management we carefully construct a portfolio to include a number of the dollar devaluation hedges and we carefully monitor the factors that affect confidence in the dollar.

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Core Capabilities

Equity:

Managing Stock Market Risks

by JUDY MCDONALD MOSES

Stocks will continue to generate attractive rates of return over the long term, if both individual stock and general market risks are properly managed.

The most generally accepted method for reducing individual stock risk is diversification. When properly applied, diversification limits extreme fluctuations in portfolio value and allows for more consistent performance over a wide range of economic conditions. In general, a portfolio of 30 to 35 well-chosen stocks provides over 90% of the protection afforded by more extreme diversification. This size portfolio also permits us to add excess return by carefully selecting stocks that sell for a discount to their intrinsic value.

The advantages of diversification are enhanced by adding exposure to international stock markets, especially stock from emerging market countries. Historically, the correlation between U.S. market returns and emerging market returns has been lower than it is presently. Correlations have risen as the global economy has become more interconnected. However, we believe the emerging markets continue to offer attractive investment opportunities as many of these countries have well-balanced public finances and rapid economic growth. An allocation of 30% of a portfolio to international markets, split evenly between developed and emerging markets, will provide added diversification and exposure to higher growth opportunities.

The most obvious and effective, yet often overlooked, method to manage stock market risk is limiting the proportion of stocks owned in an investment portfolio.

Stocks have higher volatility, and therefore higher expected returns, than other asset classes, such as cash and bonds. The larger the proportion of stocks in an investment portfolio relative to assets with lower volatility, the greater will be the variance of the portfolio's value.

We recognize that our clients vary in their ability and willingness to tolerate higher portfolio variance in the short term. Consequently, we work closely with our clients to thoroughly understand their financial needs and personal circumstances. This forms the basis of our goals-based approach to investing and enables us to best determine the appropriate level of stock market exposure for each individual client. While we will change the allocation to stocks in clients' portfolios based on our view of the markets, our opinion is that market timing should not be the primary method for reducing stock market risk.

Hedging strategies that use derivatives and short selling are yet another tool that we may utilize to manage risk (*see Diversified Hedges Portfolio on page 8*). The most direct way to hedge stock market exposure is to buy either put options on a broad market index or put options on individual stocks owned. The cost of put options varies, but typically reduces annual rates of return by 5% or more. For example, assuming the long-term expected rate of return on stocks is 10%, full protection would cost at least half of the expected return.

The short selling of selected stocks is also a common form of stock market hedging and is the basis of the original and most popular type of hedge funds – equity long/short hedge funds. The cost associated with short selling are higher, as the short seller must pay to borrow the stock plus any dividend payable during the relevant period.

Additionally, there may be interest expense if the short seller uses leverage. The benefit of investing with skilled managers

who sell short is that those managers have a larger investment opportunity set with which to generate excess returns for investors. For a long-only manager who believes a company's stock is overvalued, the only investment decision is to not own the stock. A long/short manager who comes to the same conclusion can sell the stock short and benefit from a decline in the stock's value. In addition, long/short equity strategies often have lower correlation to the stock market, and therefore add diversification benefits.

Traditionally, long/short hedge funds were structured as limited partnerships with limited liquidity as such funds required investors to lock-up their investments for a specified period of time. After the financial crisis, many investors rejected the lock-ups associated with hedge fund investing. As a result, several hedge fund managers now offer their long/short equity strategies in a mutual fund format, which is an attractive option for our clients who prefer liquid investment vehicles. We only select hedge funds managers, whether through a limited partnership or a mutual fund structure, who have demonstrated the ability to generate attractive returns after all fees and with low market correlation.

In summary, the most powerful ways to manage stock market risks are to determine the appropriate proportion of the portfolio that should be dedicated to stocks; to vary the proportion according to our view of market conditions; and to invest in select hedge funds. Furthermore, we use diversification and a fundamental value approach to stock selection within a client's designated allocation to stocks. The end result is an actively managed, well-constructed investment portfolio that meets each client's individual goals.

Judy McDonald Moses is a Partner and Portfolio Manager at the San Francisco office of Evercore Wealth Management. She can be contacted at moses@evercore.com.

Core Capabilities *(continued)*

Fixed Income: *The Changing Muni Landscape*

by **HOWARD CURE**

There will be more municipal bond defaults in this downturn than in any since the Great Depression. Such calamities, when they occur, while still rare, will be unique and possess one or more of the following characteristics:

- Narrow economies, notably rustbelt cities dependent upon uncompetitive manufacturing businesses
- Boom towns gone bust, notably sunbelt areas reliant on growth
- Entities with poor labor relations and high legacy costs
- Dependence on state aid with large cuts in the offing
- Local governments with public enterprises that have failed to be self-supporting
- Extraordinary financial hits, such as investment losses from swaps.

That said, there are still a number of sectors within the municipal bond market that offer more attractive yields than generic general obligation debt. Taxpayers are increasingly aware of the generous benefits public employees enjoy and we are therefore very careful when we invest in labor-intensive entities such as school districts and states. The following sectors attempt to avoid related labor issues and are therefore worth buying:

- Essential purpose enterprises such as water, sewer and electric systems with entities that have a monopolistic control over their customers and independent rate setting abilities
- Federally insured programs such as Federal Housing Administration loans to regionally important hospitals

- Dedicated tax structures such as sales and personal income tax bonds with strong additional bonds test or “poison pill” mechanisms
- State sponsored programs such as student loans, preferably with strong state oversight such as garnishment of wages in case of failure to pay and an obligation to replenish reserves
- Collateralized structures such as state housing agencies with areas that didn’t suffer housing booms then busts and have a long track record of monitoring a seasoned portfolio of loans that required down payments or federal mortgage insurance
- Airports that are not dependent upon a limited number of carriers or subject to hubbing risks and have a strong underlying regional economy with limited competition from other airports.

Howard Cure is the Director of Municipal Bond Research at Evercore Wealth Management. He can be contacted at cure@evercore.com

Diversified Hedges

by **JOHN MCDERMOTT**

The U.S. government expanded domestic deficits to record levels and more than doubled the quantity of dollars since 2008 but yields on cash and bonds are near all-time lows, an inversion of the traditional risk-return framework. Investors have reason to worry about the security of their money.

The Evercore Wealth Management Diversified Market Hedges portfolio seeks to safe harbor assets from unprecedented monetary and fiscal policy, tilting the balance of risk and reward back in favor of the investor. The portfolio makes liquid, easily understandable investments in currencies,

bonds, stocks and commodities without using leverage and it embraces sound fiscal and monetary policy.

Bonds issued in Australia, for example, which eschewed the money printing of other economies and raised interest rates multiple times in the last year, offer yields double the rate of equivalent U.S. dollar bonds. The Japanese government resisted the printing press – perhaps more than it should have – and the value of the yen soared against the U.S. dollar. Gold’s relative scarcity makes it the ultimate hedge against money printing in the United States, the United Kingdom and the European Union.

The appeal of these hedges will remain as long as developed economies compensate for prior fiscal mistakes with easy money.

To date, we have taken a contrary view of short-term fiscal fixes to the economy. Temporary homebuyer tax credits, as a case in point, impressed the market until they expired – when shares in homebuilder companies plunged 40% in two months. Our portfolio took the other side of this prescription, shorting the homebuilders ahead of expiration. Now, the portfolio is investing on the long side in foreign companies in local currencies and in U.S. companies expected to benefit from an improvement in fiscal policy.

As the portfolio’s name suggests, investments are diversified with multiple avenues for success. The Diversified Market Hedges portfolio has generated higher returns with lower risk than traditional liquid investments since the portfolio’s inception in January 2009 and so far this year.

Until both fiscal and monetary policy change, we expect to have opportunities for investment in the portfolio that will outperform the broader market as well as reduce risk for our clients.

John McDermott is a Partner and Portfolio Manager at Evercore Wealth Management. He can be contacted at mcdermott@evercore.com

Opportunities in Wealth Planning

by **CHRIS ZANDER**

Many individuals feel almost paralyzed by current market conditions and the continued uncertainty over pending legislation on estate tax reform. But low interest rates, relatively low federal gift tax rates and a slowly recovering economy indicate a significant opportunity cost risk in postponing wealth transfers.

THESE THREE TRANSFER STRATEGIES ARE PARTICULARLY ATTRACTIVE AT PRESENT:

GRANTOR RETAINED ANNUITY TRUSTS

The GRAT is an irrevocable trust that allows the grantor to transfer assets to the trust and receive an annuity over the trust's term. To avoid a taxable gift under current law, the present value of the annuity must equal the amount contributed when the trust is first established. This is calculated by taking the amount contributed and discounting it back over the trust term, using a monthly rate set by the Treasury (the Section 7520 rate). When the rate of return on assets over the term of the GRAT exceeds the Section 7520 rate, the excess return above the annuity payments may be transferred to the beneficiary tax-free. Grantors must survive the term of the GRAT for it to be successful; if they do not, then all or part of the trust assets will be included in their estates for estate tax purposes.

For GRATs created in October 2010, the Section 7520 rate has dropped to 2% annualized, an extremely low hurdle rate by historical standards. Many high-quality stocks and opportunistic bond strategies can yield a healthy spread above this 2%, with the opportunity for additional upside appreciation to generate a meaningful wealth transfer benefit. Multiple GRATs for different asset classes or investment strategies should be considered as well. The minimum term for a GRAT is two years, although there is proposed legislation that could increase that minimum term to 10 years.

INTRA-FAMILY LOANS AND INSTALLMENT SALES

Given the low interest rate environment, it may be beneficial for individuals to lend funds to a child or grandchild – or to a trust for their benefit – to make an opportunistic investment. In doing so, grantors create an “estate freeze” where they receive fixed principal and interest payments while the loan recipient benefits from any appreciation from the transaction. If the transaction is done with an intentionally defective grantor trust, there is no income tax impact as the grantor is the deemed taxpayer on the trust. Existing intentionally defective grantor trusts may also purchase assets from the grantor in return for an installment note. Both of these strategies involve freezing the asset value in the client's estate while transferring upside to the next generations. It's also worth noting that a loan and/or installment sale to a defective grantor trust is an effective way to make a transfer to grandchildren, from a transfer tax perspective.

To avoid creating a taxable gift, interest rates on the installment note or intra-family loan must be no less than the current month's IRS Applicable Federal Rate (governed under IRC Sec. 1274) for that time period. In October 2010, for loans of three years or less, the annual interest rate is 0.41%. For loans of more than three years but not more than nine years, the annual interest rate is 1.73%. For loans longer than nine years, the annual interest rate is 3.32%. These are attractive financing terms for families to consider when structuring investments to minimize estate taxes.

It is important to note, however, that these transactions use leverage and are similar to investing on margin. Individual investors must realize that a significant decline in the investments after the transaction is made could cause the transaction to fail for the intended beneficiary. As a result, it may be appropriate for the advisor to construct a diversified portfolio that includes an allocation to less risky assets.

CHARITABLE LEAD ANNUITY TRUSTS

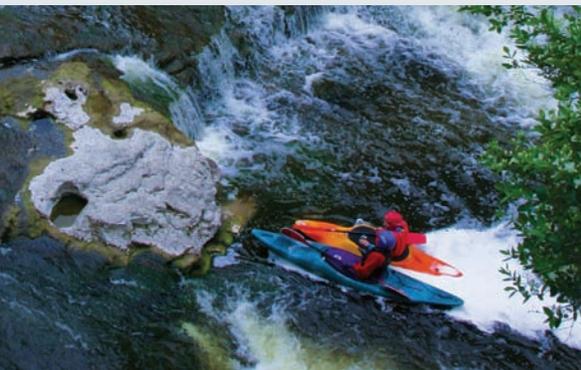
Individuals who want to incorporate a charitable intent with the leverage of a wealth transfer strategy should consider a charitable lead annuity trust (CLAT).

A charitable lead trust is an irrevocable trust (either with a fixed term or for the life of the grantor) that allows an individual to provide a stream of payments to a charitable organization while providing a longer-term benefit to family members. Given the low rate environment, we assess the value of a zeroed-out charitable lead annuity trust, where the annuity stream payment is structured to have a present value equal to the initial funding amount resulting in little to no taxable gift. In contrast to the GRAT, the CLAT benefits charity in the intervening period in lieu of returning annuity payments to the grantor.

Depending on the situation, a CLAT can be structured as a Grantor CLAT or a Non-Grantor CLAT. The Grantor CLAT allows the grantor to take an immediate charitable income tax deduction for the present value of the charitable income stream, and the grantor is subsequently taxed on the taxable income of the CLAT over the term of the trust. The Non-Grantor CLAT is a taxable trust where the income generated by the trust is taxable to the trust but the trust also receives (subject to certain limitations) a charitable income tax deduction to offset that income stream.

The decision to implement any or all of these strategies needs to be evaluated in the context of a comprehensive, goals-based strategic wealth plan that takes transfer taxes, income taxes, liquidity needs, investment goals and desire for administrative complexity into account. It is important to note that Evercore Wealth Management can work with an individual's other advisors to provide a comprehensive and coordinated wealth planning solution.

Chris Zander is a Partner and Wealth Advisor at Evercore Wealth Management. He can be contacted at zander@evercore.com.



Seix Advisors on Leveraged Loans

An interview with George Goudelias at Seix Advisors

Editor's note: The Seix Floating Rate High Income Fund (ticker: SAMBX) generates an attractive yield while providing investors with an opportunity to hedge against the risk of a significant upward move in interest rates, a likely long-term consequence of the recent and unprecedented changes to U.S. fiscal and monetary policy. The fund invests primarily in floating rate, leveraged loans, also known as bank loans. These securities are generally issued by corporate borrowers with credit profiles below investment grade. They also typically rate in the senior secured part of a company's capital structure and are pegged to 90-day LIBOR. This strategy takes on credit risk but limits interest rate risk, a mix that appeals to many investors at this stage of the credit and interest rate cycle. Seix Advisors, which employs 20 credit research analysts and describes its investment style as bottom-up and research-oriented, manages over \$25 billion in total fixed income assets, including approximately \$11 billion in the high yield credit and \$3.5 billion in leveraged loans.

Here we interview George Goudelias, the Manager of the Seix Floating Rate High Income Fund.



Q: Please explain the difference between a floating rate bond and a fixed rate bond?

A: The coupon on a floating rate security moves with changes in short-term interest rates, while a fixed rate bond pays the same coupon regardless of the level of current rates.

Q: When is it better to invest in floating rate securities relative to fixed rate?

A: When interest rates are rising. For example, the coupon of a floating rate security may start at 6.00% – a short-term rate of 2.00% plus a 4.00% spread at the same time a fixed rate security's coupon is 7.00%. If short-term rates rise to 4.00%, the fixed coupon remains at 7.00%, but the floating coupon jumps to 8.00% (4% plus the 2% spread). Conversely, if short-term rates fall 1.00%, the floating coupon drops to 5.00% while the fixed coupon remains at 7.00%.

Q: How do LIBOR floors work?

A: The LIBOR floor on a loan establishes the lowest possible coupon on a security. For example, if the LIBOR floor associated with a loan is 2.00% and the spread is 4.00%, the lowest possible coupon on the loan would be 6.00%. If LIBOR falls 0.50%, the coupon paid on the loan would remain at 6.00%. However, if LIBOR increases to 3.00%, the coupon would rise to 7.00%.

Q: What percentage of the fund has a floor? What is the current rate of the average floor?

A: Currently, 23% of the loans in the Fund have a LIBOR floor with an average of 2.22%.

Q: What is the difference between senior unsecured bonds and senior secured loans?

A: Senior secured loans are backed by collateral (assets such as property, plant and equipment, receivables, cash) and have structural seniority over senior unsecured bonds. In the event of a default, priority is

given to bank loans. This helps to mitigate losses and investors are, therefore, more likely to experience a higher recovery than bondholders.

Q: What are the historical differences in recovery rates for unsecured bonds and secured loans?

A: From 1982 to 2009, Moody's reports that the average recovery rate for first lien bank loans was 59.1% compared to 32.6% for senior unsecured bonds.

Q: What percentage of the fund is secured?

A: As of July 31, 2010, 90.3% of the Fund is invested in senior secured loans; 9.7% is invested in senior unsecured loans.

Q: What is the performance and volatility history of leveraged loans as an asset class?

A: Since inception (June 30, 2006), the annualized return of the CSFB Institutional Leveraged Loan Index was 0.5% and the standard deviation was 7.9%, while the broader CSFB Leveraged Loan Index return was 3.0% with a standard deviation of 17.4%. This compares with the 3.9% return and 13.5% standard deviation for the fund.

Q: How does the risk/return profile of leveraged loans compare with other risky asset classes over this period?

A: Over the same period, the return of the S&P 500 Index was -3.0% and the standard deviation was 20.6%. The Merrill Lynch High Yield Bond Index produced an annualized return of 7.4% with a standard deviation of 18.0%.

Q: 2008 was the worst year in history for leveraged loans. How did your fund do in relation to the market in that year?

A: The fund returned -21.8% vs. -15.8% for the CSFB Institutional Leverage Loan Index and -28.8% for the CSFB Leveraged Loan

Index. Since 2008, the fund has experienced only one default, a 0.2% position in Big West Oil. That compares with an average cumulative default rate of 7.6% over the same period.

Q: *How does the current spread environment in leveraged loans compare to the historical spread environment?*

A: Leveraged Loan spreads are near their historic average.

Q: *What is your expectation of default rates and recovery rates going forward in speculative grade debt?*

A: Default rates continue to fall as issuers strengthen balance sheets by paying down debt and extending maturities. Defaults fell from over 14% in late 2009 to 5% at the end of July of this year. Moody's is forecasting that the rate will fall to 2% over the next 12 months.

Q: *What is the average current yield in your fund? How does that compare to the broader leveraged loan market?*

A: The average current yield on the Fund is 5.62%. This is higher than the broader leveraged loan market and reflects both the 23% weighting in loans with LIBOR floors and the 11% high yield bond weighting.

Q: *What is the average credit quality of the fund? How does that compare to the broader leveraged loan market?*

A: The BB average credit quality of the Fund is higher than the broader leveraged loan market.

Q: *Finally, what are your expectations for performance in both up and down periods versus the market as a result of your fund's average credit quality?*

A: Compared to the broad market, as measured by the CSFB Leveraged Loan Index, I would expect the Fund to outperform in down markets and participate in up periods, but lag when the lowest quality loans outperform.

Evercore Wealth Management Rated among Top U.S. Firms; Barron's

Evercore Wealth Management was ranked among the leading 40 U.S. wealth management firms by assets under management for individuals with \$5 million or more, according to the annual survey published by *Barron's*. The survey, which is featured in the Penta section of the September 20th issue of the magazine, is the principal industry ranking of wealth management firms.

Evercore Partners is the New Force on Wall Street; Fortune

Fortune Magazine profiled Evercore Partners in its August issue, describing the firm as the "new force on Wall Street" and the only investment bank to substantially grow its advisory business in the recent markets. The feature attributed Evercore's growth to its advice model, concluding that clients are turning to firms that eschew the proprietary trading and lending to their clients that the giant banks emphasize. **To view the article, please visit:**

<http://evercorewealthmanagement.com/perspectives-and-news/market-update-2010-08-16.asp>.

Evercore Wealth Management Featured in Financial Advisor

The August cover issue, "Breakaway Trust Officers," profiles Evercore Wealth Management and interviews CEO Jeff Maurer and several partners in the firm. **To view the article, please visit:**

<http://evercorewealthmanagement.com/perspectives-and-news/market-update-2010-08-05.asp>.

Event: Ethical Dilemmas Facing the Trusts and Estates Practitioner

Evercore Wealth Management will host a seminar on October 20th in New York, featuring both partners and guest speakers. **For further information, please contact:**

Nancy Shavel Gabel Esq. at gabel@evercore.com.

Welcome Wendy Barasch

Wendy Barasch joined Evercore Wealth Management from Alliance Bernstein, as Partner and Head of Business Development. Wendy worked at Bernstein for 20 years, most recently as a managing director in the private client business.

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