Defensive investing, like defensive driving, sometimes means gunning the engine. Even the most conservative investors need to take on some exposure to equity risk now to enhance or even retain the purchasing power of their capital.

Cash has lost over 11% of its purchasing power in the past five years, as investors have failed to earn even a nominal return. Inflation is running at an annual rate of about 1.5% at present, and the expectation is that short-term interest rates will be pretty much at zero for at least the next two years.

The outlook for other traditional defensive assets isn’t much brighter. Investment-grade bonds of intermediate duration, after earning 5% plus returns for most of that five-year time frame, have demonstrated over the past 12 months that they too can generate negative returns in periods of rising long-term interest rates. While we think long-term interest rates should stabilize soon at these higher levels, it seems likely that they will rise further in the not-so-distant future.

(continued on page 3)
As the nights draw in and thoughts of Thanksgiving approach, we find ourselves taking stock and planning for our families’ futures. Today, this means looking to our financial assets and investment income, rather than the contents of our cellars, to see us through the coming seasons. However, the instinct to accumulate, preserve and account – and to share our stories and values with our children and grandchildren to further their own prospects – is unchanged.

In this issue of Independent Thinking, we consider both financial and emotional preparedness. They are inextricably linked. The goals – and constraints – of our clients shape our approach to strategic wealth planning, asset allocation and investment management. We are committed to measuring our performance not only by traditional industry benchmarks but also by our success in meeting each client’s individual and family goals in the context of his or her attitudes to risk.

Financial risk, a subject always on our minds, is the focus here in the articles that address our outlook for the markets in which we invest on behalf of our clients. Our Evercore colleague Tim Carlson addresses the risks – and opportunities – in the dramatically changed oil and gas industry in the United States, an area ripe for mergers and acquisitions. Also in this issue, we interview the co-managers of the Matthews Pacific Tiger Fund, one of our carefully selected outside investment funds.

Risk is also a key consideration in sharing our values and our wealth with future generations. In my 40 years in wealth management, I have found a near universal desire among successful parents to use their wealth to help their children. I have witnessed a very mixed record of success, however. With this in mind, I write here from the perspective of my generation, the aging Baby Boomers in the autumn of our own lives, on the possibility of a middle way that provides support without breeding entitlement.

I am also delighted to welcome our newest partner to the firm. Jewelle Bickford joined us in late August to build on our existing Wise Women, family governance and impact investing programs. She’s off to a strong start, with a very successful recent gathering in New York that featured Gloria Steinem, the recipient of the Presidential Medal of Freedom this year, in discussing the emotional and financial aspects of a woman’s life. Other events are in the works, in each of our offices.

Look for information on events to celebrate the upcoming fifth anniversary of Evercore Wealth Management. By the standards of the firms in which many of us worked for decades, this is young indeed. It is a significant milestone, nonetheless. I’ll write more about my thoughts on our growth to date and our future in the next issue, but in the interim, I would like to take every opportunity I can to thank our clients and colleagues for their confidence in the firm.

As always, please feel free to contact any of the partners at Evercore Wealth Management for further information and with any questions or comments you may have. And look too for news on our upcoming events. As the nights draw in, the lights indoors brighten, and we are looking forward to a busy season.

Jeff Maurer
Chief Executive Officer
As for gold, it peaked two years ago and has declined considerably since – and with marked volatility, even though monetary policy remains expansive in the extreme. Gold’s lack of appreciation during the recent deficit ceiling showdown in Washington, D.C. also brings into question its safe haven status.

Investments in non-investment-grade credit strategies that have little or no interest rate risk earned respectable returns in excess of 5% over much of that same five-year period. But the spreads on these instruments have lately started to narrow, making them less attractive, especially as they are inherently tax inefficient. Most hedge fund strategies have generated on average disappointingly low single-digit performance over the last five years and there is no evidence yet of a turnaround.

Exposure to equities is difficult for many conservative investors, especially after experiencing two horrific crashes in a little over a decade. Indeed, the actual volatility of the U.S. market was widely calculated by financial services industry analysts’ models at the time as close to statistically impossible. Now that the pendulum has swung so far in the opposite direction, with U.S. stocks by far and away the best performing asset class in recent years, investors also have reason to fear buying high, as well as taking on what has been traditionally perceived as increased risk.

However, with cash and short-term bonds failing to generate returns above inflation, even very conservative investors should maintain some equity exposure. As Jawaharlal Nehru put it, the policy of being too cautious is the greatest risk of all.

The fundamental value of the market now at about 14 times expected earnings seems to us reasonable; the supply/demand balance is favorable with a continuation of corporate stock buybacks and the beginnings of positive flows into equity mutual funds; and the outlook for the economy and corporate profits is continued growth. As our Evercore colleague Tim Carlson at the firm’s Houston office writes on page 4, developments in North American natural gas production are contributing to a resurgence in domestic manufacturing, with repercussions being felt throughout the economy. The real benefits of cheap energy, including its positive effect on our balance of trade, will be years in the making, but the drivers are already in place.

Federal Reserve policy is also helping to support the economy, as it has been designed to increase the value of long-term assets. It seems to us likely that this policy will continue for the foreseeable future under the leadership of Janet Yellen. Damaging inflation could follow if the Fed overplays its monetary hand, but it looks like deflationary forces have many more years to run. These include continued high unemployment, excess manufacturing capacity worldwide, contraction of private credit demand (most evident now in Europe), and productivity-enhancing technology. The technologies creating dramatic leaps in productivity include robotics, mobile communication devices, cloud computing and big data applications. There will be winners and losers in this sector, of course, which puts a premium now on stock picking. Bill Vaughn writes about the outlook for Google on page 12.

While we do advise diversifying into other asset classes to protect against a significant change in the current trends, we continue to favor long-only equity exposure as the largest component of a balanced account. That view has served us well, as we have maintained a 50% weighting in equities for balanced portfolios since the bottom of the market over four years ago. We remain mindful of our goals-based approach to wealth management. While a market multiple of 14 times seems to us unlikely to lead to a repeat of prior market drawdowns, uncertainty is the only constant. We work with our clients to make sure potential drawdowns can be withstood without changing asset allocations.

We encourage even our most conservative investors to allocate at least 20% percent of their portfolio to equities. In addition to equities, we are handpicking compelling illiquid investments, such as non-performing residential mortgages, that have an expected return in excess of 10% due to unique circumstances and manager expertise.

John Apruzzese is the Chief Investment Officer at Evercore Wealth Management. He can be contacted at apruzzese@evercore.com.
By the late 1990s, many well-informed and influential oil and gas experts were talking about the real possibility of so-called peak oil - the theory that global oil production had peaked and was in decline based on a lack of new discoveries and the prohibitive cost to develop smaller fields economically. Production in the United States was certainly in decline, as large fields in the Permian Basin of Texas and the offshore Gulf of Mexico had already reached their peaks, and international major oil companies like Exxon, BP, Shell and Chevron had set their sights on exploration elsewhere. At the time, U.S. independent oil and gas producers focused their efforts on acquiring assets from the major companies and other independents and/or finding and developing natural gas reserves in areas such as the Gulf Coast region of Texas and Louisiana and in the Rocky Mountain region.

In 2003, horizontal well drilling technology was introduced in the Barnett Shale, an unconventional resource play in north central Texas that was characterized by rock that is very difficult to produce from, and drilling accelerated with the new prospect of economic development. Horizontal drilling, the development of new hydraulic fracking technologies, an increase in oil and natural gas prices, and the exploration efforts of a large number of independent oil and gas companies have since opened up a tremendous amount of oil and natural gas resources in the United States to economic development. Oil production grew at the fastest pace in history in 2012. At the same time, the tremendous growth in the supply of natural gas has made this cleaner energy source a viable option for American homes and businesses, and raised the welcome, albeit long-term, prospect of an energy-independent North America.

With the increase in natural gas supply and the corresponding decline in natural gas prices, strategies that made sense for independent oil and gas producers when gas prices were at or in excess of $8 per million British thermal units (mmBtu) are no longer economically viable at $3-4 per mmBtu.

Tim Carlson is a Senior Managing Director at Evercore's Houston office, advising companies across North America on oil and gas transactions. Since joining the firm in 2011, he has advised on numerous transactions, including the merger of McMoRan Exploration, Inc. with Freeport-McMoRan Copper & Gold, and the pending merger of Pioneer Southwest Energy Partners with Pioneer Natural Resources. Here he considers the outlook for U.S. oil and gas production in an operating environment that has changed almost beyond recognition over the past ten years.
After the land grab of the past few years, where companies rushed to add to their drilling inventory through the acquisitions of assets and undeveloped acreage, the focus has now shifted from growth in the number of drilling locations and resource potential to a more fundamental manufacturing model focused on efficient field development and economic production growth.

Independents have also shifted their focus to oil and natural gas liquids weighted production and growth opportunities in areas such as the Eagle Ford shale of South Texas, the Bakken shale of North Dakota and Montana, the Utica shale in Ohio and unconventional plays in the Permian Basin. The capital markets have followed this shift in strategy and currently reward companies with core positions in the most economically viable areas (Eagle Ford, Bakken, Utica and Marcellus shales) and the operating capabilities to drive costs lower and returns higher through time.

Given that all production declines, the exploration and production industry has always been a capital-intensive business where all of the producer’s cash flow (and sometimes more) has been used to replace and grow production from year to year. This capital intensity has accelerated, as unconventional reserves generally decline at a higher rate than conventional resources, horizontal wells and modern well completions cost significantly more than conventional vertical wells of the past, and the independent oil and gas companies try to hold all of the acreage and opportunities that they have accumulated over the past few years.

To fund this capital deficit, companies have looked to the capital markets, to the sale of their mature, lower-growth conventional assets and have entered into joint venture arrangements with international oil companies and private equity partners to accelerate their higher-growth unconventional drilling. International majors have also shifted their focus back to the U.S. and have purchased companies and assets to stake their claim on a portion of the significant resource potential.

**Source:** Historical Spot Prices per Bloomberg.
With the dramatic paradigm shift in the oil and gas industry that we’ve seen in the past 10 years, U.S. investors and businesses should be excited by the prospects of long-term, low-cost energy and eventual energy independence.

Of course, wildcatters built this industry, and their spirit endures in both the small and very large companies. The lure of exploration is as strong as ever, and companies will continue to make discoveries and find ways to produce known hydrocarbons cheaper and in greater quantities. This will only make the prospects for a bright future for the U.S. oil and gas industry even brighter.

For information on Evercore’s oil & gas advisory business and industry investments at Evercore Wealth Management, please contact Iain Silverthorne at silverthorne@evercore.com.

---

**North American M&A Transaction Volumes – Buyers Broken Down by Country**

![Graph showing M&A transaction volumes by country](image)

*Source: North American Upstream Transactions >$50mm per IHS Herold.*

**North American M&A Transaction Volumes – The Unconventional/Shale Boom**

![Graph showing M&A transaction volumes by type](image)

*Source: North American Upstream Transactions >$50mm per IHS Herold.*

---

6 • FALL 2013 • INDEPENDENT THINKING
Wealth Planning
Aging Baby Boomers: Helping the Young Help Themselves
by Jeff Maurer

A few weeks ago, one of my children sent me a blog from The Huffington Post titled Why Generation Y Yuppies Are Unhappy. The gist was that these young adults, embodied by the fictional Lucy, had expected more out of life by now because they are, well, special. But success for many has been slow in coming.

I tried to deliver the same message to my children regarding hard work that my Depression Era parents had instilled in me: Work hard and, over time, you will be successful. Inevitably, they heard it differently. That’s partly because the experiences they share with most of their generation are very different than mine. For every Silicon Valley millionaire under 30, there are millions of young people who are finding life harder than it was for their own parents.

When we purchased our first home, I was a young trust officer and my wife was a teacher preparing for maternity leave. Our combined annual income represented nearly 40% of the value of that house. Comparable salaries today would cover just 15% of the very same house – and that’s for those lucky enough to have two salaries. Back then a college degree was almost a guarantee of a good job: Now almost 9% of college graduates are out of work; double that number are underemployed; and far more are underpaid.

My children also heard that message differently because they were raised by affluent parents, while I was not (although I did grow up in a wonderful New York neighborhood and enjoyed all the benefits of a close family life). Like many successful Baby Boomers, I am left wondering: How does our wealth really affect our children?

My wife and I years ago developed a philosophy involving assistance, but not entitlement. As long as our children and, later, their spouses too were leading what we perceived as productive lives, we would help. We did it at least as much for us as for them: Covering rent on a doorman building when they started working in New York allowed us to sleep at night. But should this help extend to down payments, subsidized mortgages, private school tuitions for grandchildren, vacations and substantial cash gifts? And whose standards should define productivity in the first place? How can those of us raised on our parents’ American Dream nurture children who may have a very different take on their own opportunities and goals?

For the record, my children and their spouses seem to me very unlike Lucy. They are, by both my reckoning and theirs, leading happy, productive lives. Nor do the wonderful young people I see every day at Evercore Wealth Management seem to suffer from any generational malaise. However, I have no doubt that Lucy exists – and that my generation raised her. The question is, what can we do to help her now?

For us, these conversations are an integral part of wealth management. Our clients’ hopes and fears for their children and grandchildren are key in shaping and managing investment portfolios. It is our job and our privilege to engage families in these conversations and to safeguard their assets accordingly.

Jeff Maurer is the CEO of Evercore Wealth Management. He can be contacted at maurer@evercore.com.
For Richer or Poorer
by Jennifer Tse

Same-sex spouses should revisit their gift and estate plan as soon as possible. The June 23, 2013 decision by the U.S. Supreme Court on the unconstitutionality of the Defense of Marriage Act and the subsequent decision by the U.S. Department of Treasury and the Internal Revenue Service to recognize legal same-sex marriages in all jurisdictions have significant wealth planning implications.

Impacted couples need to make sure they are taking advantage of their lifetime gift and estate tax exemptions and unlimited marital deduction, review their beneficiary designations, and understand their Social Security and employee benefits.

As of this year, all same-sex spouses will be required to file Federal income tax returns with a “married filing jointly” or “married filing separately” filing status. Income tax filing will be more complex in states that do not recognize same-sex marriage and could result in a need to complete additional Federal income tax forms.

Same-sex spouses who were married in prior years may also amend prior tax returns up to three years or two years from the date the tax was paid, whichever is later, and possibly obtain a refund of any overpayment of taxes. Spouses should consult with their tax advisor.

Please contact any of the Wealth Advisors at Evercore Wealth Management to discuss coordinating financial and estate plans in light of these changes.

Jennifer Tse is a Vice President and Wealth Advisor. She can be contacted at tse@evercore.com.
Defensive Assets
Brighter Days in California

by Howard Cure

Editor’s Note:
This article was extracted from “California in Context,” published by Evercore Wealth Management on October 10, 2013. To view the full article, please visit http://www.evercorewealthmanagement.com/news/perspectives.php.

California has made significant progress over the past three years on its path to fiscal stability, including balancing its budget while projecting to reduce its backlog of obligations to local governments and agencies by 84.5%. The state is not entirely out of the woods, as its history of undisciplined spending has undermined many a prudent fiscal plan, and its local municipalities remain at risk. However, investors in California debt have many viable bond choices. Of these, the coastal cities and their essential service enterprise systems are far more attractive bets than those inland.

In stark contrast to states reliant on a few dominant economic sectors, California boasts a deep and diverse economy, capable of above-average growth rates. Its prominent higher-education institutions and businesses in innovative sectors position California as a leading venture capital recipient state. Indeed, California has over two times more venture capital investments than the other top four venture capital states combined.

Of course, wealth brings its own burdens. California’s volatile revenue base and its increasingly highly progressive income tax structure make budgetary projections difficult to forecast. For instance, taxing capital gains as ordinary income can result in huge fluctuations in revenues that need to be addressed quickly. But the Golden State is better living up to its promise these days with a new and, from an investor’s point of view, very welcome commitment to aligning recurring revenues and expenses while paying down budgetary debts. The “Wall of Debt” as described by Governor Brown and estimated at $27.8 billion at the end of fiscal year 2013 is now expected to be reduced to $4.3 billion by fiscal year 2017.

We believe many California cities have hit a low point in the municipal economic cycle and that a turnaround may be coming for those that are beginning to see revenue improvement. Given the recent recession’s impact on economies and local government finances, as well as some constitutional limitations on tax-raising flexibility for California local governments, it is not surprising that many local governments’ budgets have been hit hard, notably in the interior. There has been a widening gap in credit quality in the local government sector, with a bifurcation in credit quality between governments that had permanently transformed their budgets with long-term solutions and those that made short-term adjustments and one-time fixes. This corresponds with changes in California’s property tax base that highlight the state’s uneven recovery.

As noted in “A Brighter Bond Outlook in California,” published by Evercore Wealth Management on April 8, 2013, many sectors that were dependent upon the state for funding, particularly public education, should see a stabilization in their credit outlook as a result of Proposition 30, as additional revenues will be dedicated to reverse appropriation cuts endured over the last several years. As a result of this change, we are more favorably disposed toward this sector for the time being. Cities in California, for better or worse, are not nearly as dependent upon the state as educational entities and counties for its revenue base,
and have not directly benefited by the statewide tax increase. There are, however, opportunities to invest in cities that have proven resilient in the face of cyclical economic events. In particular, we look for entities that did not suffer from fluctuations in the property tax base and dramatic declines in revenues. Most of these are in the coastal areas.

Given the cash shortages the state was facing just a few years ago, California has made significant progress on the path to fiscal stability. We are increasingly optimistic about the state’s credit as a whole and hope there is now a will to maintain its structural balance without inflicting undue pain on underlying local entities.

We continue to favor bonds supported by essential service enterprise systems. There are many to choose from in California, given the number of water, wastewater and public power issuers. These entities do not face the same revenue-raising restrictions that confront cities as a result of Proposition 13 limitations. Further, they are more capital intensive and do not have the same proportion of labor costs. Careful research at the grassroots level enables us to identify what we believe are the best of these.

While there is reason for hope that California’s economic, fiscal and political improvements will become entrenched, history would suggest a more cautious optimism on the local level, where we remain very careful buyers. Many cities are still grappling with events both in and out of their control in a state that provides little guidance to local governments.

Howard Cure is the Director of Municipal Bond Research at Evercore Wealth Management. He can be contacted at cure@evercore.com.
Diversified Market Strategies
The Diversification Paradox
by Brian Pollak and Rachel Epstein

Apart from large cap domestic equities, nearly every major asset class has disappointed so far this year. While the S&P 500 index has returned over 20%, emerging markets stocks, many bonds strategies, and commodity indices have all generated much smaller gains or losses. International developed stocks, which are up significantly, were also well behind U.S. benchmarks. At this juncture, the question on many investors’ minds has to be: “Are we paying too much for diversification?” The answer has to be “Yes,” if we are thinking only about this year or much of the previous four years, one of the strongest bull markets for big cap equities in history. There has indeed been an opportunity cost. After all, the benefit of diversification, which strives to smooth out unsystematic risk events in a portfolio so that the positive performance of some investments will neutralize the negative performance of others, can only be fully realized if the securities in the portfolio are uncorrelated. These benefits become much more apparent over the full course of a market cycle, which is typically seven years in duration. Over this longer time period, different asset classes alternate roles as winners and losers. Ultimately, the best argument now for diversification may be that we haven’t needed it lately. The overwhelming evidence is that it is still necessary.

On an annualized basis, the S&P 500 has returned 7.6% and 8.8% over the past 10 and 20 years, respectively. During this time, an investor would have experienced a 45.6% decline from March 2000 through September 2002, and a larger drawdown of 47.7% between September 2007 and March 2009. Despite the recent big move up, the market has gained very little ground as a whole since March 2000, returning only 2.8% annualized through the end of September 2013.

Conversely, since March 2000, and over the past 10 and 20 years, the bond market returned 5.74%, 4.59% and 5.75%, respectively. Gold over those same time periods returned 12.25%, 13.18% and 6.82%, respectively. In addition, both bonds and gold have historically provided protection in bad markets. In the drawdown in 2000-2002, bonds returned 28.6% and gold returned 15.9%. Over the more recent financial crisis in 2007-2009, bonds returned 8.5% and gold returned 23.6%. The bond and gold components of a diversified portfolio substantially cushioned the dramatic equity declines. While both bonds and gold may not provide the same level of diversification in the future, it is our view that portfolios will continue to benefit over the long-term from diversification.

To offset risk in the equity portion of client portfolios at Evercore Wealth Management (see the article by Evercore Wealth Management Chief Investment Officer John Apruzzese on the cover), we will manage our allocation to defensive assets, credit strategies and diversified market strategies, or DMS, accordingly. DMS is designed to provide stability to investor portfolios when stocks or bonds, or even both, are struggling. Investments are liquid and ideally uncorrelated with both stock and bond markets, but have both volatility and return characteristics commensurate with a blended portfolio of stocks and bonds over the course of a cycle. The role of DMS in a portfolio should afford investors more confidence in the broader asset allocation and in holding onto more volatile investments in market downturns.

At present, DMS is focused on two areas: absolute return strategies designed to generate a risk-adjusted return above and beyond their benchmarks; and investments that have a long history of generating a different return stream than equities or bonds. The hope is that this DMS portion of a portfolio, which we currently recommend to be about 12% of clients’ balanced accounts, will provide ballast, stabilizing the whole in troubled times while not diminishing returns over an investment cycle. It requires patience to own diversifying assets when nothing in the world is beating U.S. equities, but they are necessary, perhaps more now than ever.

Brian Pollak is a Portfolio Manager at Evercore Wealth Management. He can be contacted at pollak@evercore.com.

Rachel Epstein is an Analyst at the firm. She can be contacted at rachel.epstein@evercore.com.
The S&P 500 index is up more than 30% since we noted in the Summer 2012 edition of Independent Thinking that the United States was home to some of the most attractive companies in the world. We see further growth ahead, as the market shifts gears from recovery to expansion.

While recovering from the financial crisis, growth investors only needed the world to not end. We got more than that, as compelling valuations and an accommodative Federal Reserve policy drove company share prices to double in value over the four-and-a-half years since the worst had passed. Now that valuations have returned to more historically normal levels, we will look for increased economic growth to drive stocks higher – and we will focus on the interaction of our equity holdings within each client’s portfolio.

We see some very powerful drivers for a number of industry sectors, as well as the economy as a whole. The housing market is recovering in fits and starts. Nationwide, home prices are up 12%. Automakers are also recovering: Next year’s sales of new cars and trucks are forecast by industry analysts to reach the highest level since 2006. In addition, the United States is experiencing an energy boom, with surging production and associated regional investment and hiring. (See Tim Carlson’s article on page 4.)

While our outlook is optimistic and we continue to remain bullish on equities, we must also continue to manage the associated risks, as John Apruzzese discusses in the lead article of this issue. The single best way to reduce risk is through diversification, not only by asset class but also within each class. For the growth portion of each portfolio, we are careful to diversify into stocks that are not highly correlated with each other.

Consider Google, which has become almost synonymous with technological innovation and the Internet. The company has the leading Web search engine with a 67% market share and its Android system powers 51% of the smartphone market. Google’s revenues are widely expected to grow 20% in 2013. Instead of paying a dividend, the company reinvests all of its profits back into its business, compounding its prospects for future growth.

Google has a place in many of our investors’ portfolios. But so does Diageo – the world’s largest distiller and distributor of premium spirits, including Johnny Walker and Smirnoff – a business that tends to weather bad times as well as good. Diageo is expanding in the United States, where it generates higher margins than in its faster-growing emerging market operations. All told, it generates considerably more cash than it needs, with an annual dividend yield of 2.4%.

Both companies present attractive opportunities in this expanding market. However, they are different enough in product, market and economic sensitivities that they provide diversification as well. As we position our investments for further growth in the United States, we continue to believe that an equity portfolio should include assets that represent a diversified range of industries and geographies.

Bill Vaughn is a Partner and Portfolio Manager at Evercore Wealth Management in San Francisco. He can be contacted at vaughn@evercore.com.
Evercore Wealth Management supplements its core capabilities with a range of non-proprietary investments, including international growth assets. Here we interview the managers of the Matthews Pacific Tiger Fund, Richard Goa and Sharat Shroff, who seek to generate long-term capital appreciation by investing in companies based in Asia, outside Japan.

Q: The correlation between U.S. equity markets and international equity markets, both developed and emerging, is now very high. Does investing in emerging markets still provide diversification benefits to a portfolio?

A: When investing in Asia, investors need a specific strategy and need to invest with a longtime horizon. Over the past several years, the region has become more intertwined with the rest of the globe. Healthier economic fundamentals now underpin a deep and diverse set of markets in Asia, which provides investors with a much broader range of opportunities. While trade will remain an important feature of Asian economies, it is worth noting that domestic demand is becoming more significant in China and other countries. In our view, it is best to invest with domestically oriented businesses to derive the most benefit from growth and diversification.

Q: Why should investors consider investing specifically in Asia, rather than a broader emerging markets strategy?

A: In comparing the region with other emerging markets, it is worth noting that Asia’s rise has been predicated on a virtuous cycle of savings and investment, shaping a more diversified and broad-based economy. For instance, the development of a manufacturing sector creates deeper and more sustainable competitive advantages relative to, say, commodities since there is no room for complacency. Japan and South Korea are two notable examples of economies that have managed to deliver decent growth over the past several decades despite the absence of basic commodities like oil and gas.

Q: What do you think about the distinction between developed and emerging countries within Asia? For example, South Korea is classified as an emerging market country by the MSCI Emerging Market Index but not by the FTSE Emerging Market Index.

A: We believe that these distinctions of developed and emerging can be artificial, particularly in how they relate to companies. Consider the large information
technology service providers in India, which derive a substantial amount of their revenues from overseas. They have offices spread across the globe, are listed in international exchanges, and have a high proportion of overseas investors. How should these companies be characterized?

Our investment process is anchored by a long-term investment approach, fundamental research-based security selection and a benchmark-agnostic portfolio construction, so the relevance of these classifications is minimal. In our view, other factors may be much more significant in assessing progress within an economy. For example, we pay close attention to the development of governance standards within the corporate sector. There are instances in which these standards may be tighter and more evolved in some of the smaller, so-called emerging countries in the region.

Q: There are widespread concerns about China’s rate of economic growth slowing while India continues to be challenged by structural problems. Where are you finding good investment opportunities in these two countries?

A: China is in the beginning stages of developing a more balanced outlook for its economy – one that is not simply predicated on growing at any cost but also considers how the growth is achieved. There is greater emphasis now by the policymakers on building a service economy that provides a better quality of life to its citizens. The kinds of businesses that might participate in this next leg of growth include financial services (outside of traditional banking), health care, e-commerce and consumption. Due to the challenges of overcapacity and a general slowdown in the economy, valuations for some of these stocks have become more acceptable in recent months, providing an opportunity to build to our existing positions.

The lackluster pace of reforms in India has constrained a strong pickup in investment spending, although robust demand continues for infrastructure-oriented services. While we recognize the difficulty in accurately predicting the next phase of economic reforms, it remains our view that there are capable management teams that are well-suited to cope with the vagaries of policymaking. We look at the current weakness as an opportunity to accumulate businesses in the utilities and industrial sectors.

Q: You view the growing middle class and consumer spending in Asia as an important theme in the fund. What are some related investments?

A: Our belief in the growing middle class is predicated on the trend of increasing productivity eventually translating into higher wages and growing consumption by the middle class. By some estimates, Asia may account for nearly half of global middle class consumption by the end of the next two decades, and the majority of global middle class spending by 2050.

That said, Asian countries are under different development stages with different culture and characteristics. We use an approach of bottom-up fundamental analysis
to evaluate companies and usually find different investment opportunities within the region to benefit from the general trend of a consumption boom.

We are witnessing particularly strong growth in Internet-related areas, for example. In addition to traditional online search, gaming and advertising, e-commerce and new formats of social communications are increasingly gaining traction with Chinese consumers. Various retail formats like convenience stores, shopping malls and hypermarkets are also represented in the portfolio across several parts of Asia. It is more difficult to identify quality businesses in the consumer discretionary sector where domestic companies increasingly compete with multinational brands. We do, however, have some exposure to luxury products through a couple of holdings in India and South Korea.

Q: Asian equities historically have a higher volatility than U.S. domestic equities. How do you manage risk in the fund as a result of the higher relative volatility of the underlying asset class?

A: We need to distinguish between the volatility in the equity prices, and the volatility in the underlying fundamentals. Our research suggests that the volatility in earnings has actually been lower in many parts of Asia compared to the S&P 500 Index. That said, we are mindful that investing in Asia is akin to traveling down a fast-moving river: We don’t feel the need to have the fastest boat but rather the steadier boat to overcome choppiness. We seek to invest with companies that have straightforward business models, with a return of capital that easily exceeds the cost of capital. This precludes us from carrying significant allocation to commodity-like businesses.

In terms of risk, our first objective is to avoid permanent loss of capital. We pay significant attention to the corporate structure, board of directors and management incentives. Having identified a well-run company, we try not to time the entry and exit points of our investment, instead believing in a buy-and-hold approach. Our risk mitigation is very much embedded in security selection instead of going to cash.

Q: All of Matthews’ Asia research analysts and portfolio managers are located in San Francisco. Why?

A: Most of our portfolio managers and research analysts have lived, studied or traveled extensively in Asia. Our Pacific Coast location allows us to follow the region closely while maintaining objectivity and a global perspective. Since our investment team is located in one destination, it also allows for cross-fertilization of ideas that is helpful to the overall research process.

For further information on the Evercore Wealth Management Efficient Architecture® Investment platform and the Matthews Pacific Tiger Fund, please contact Evercore Wealth Management Partner and Portfolio Manager Judy Moses at moses@evercore.com.
The Evercore Wealth Management standard is rooted in client relationships, shaped by our investment expertise and secured by the backing of a powerful, like-minded institution.

Disclosures

Evercore Wealth Management, LLC is registered with the Securities and Exchange Commission under the Investment Advisers Act of 1940. This material was prepared for informational purposes only and should not be viewed as advice or recommendations with respect to asset allocation or any particular investment. It does not constitute an offer to sell or a solicitation of an offer to buy any particular security, nor does it constitute a recommendation to buy, sell or hold such security. Specific needs of a client must be reviewed and as a result determine the proper allocation for a client and must be adjusted to market circumstances. The securities discussed herein were holdings during the quarter. They will not always be the highest performing securities in the portfolio, but rather will have some characteristic of significance relevant to the article (e.g., reported news or event, a new contract, acquisition/divestiture, financing/refinancing, revenue or earnings, changes to management, change in relative valuation, plant strike, product recall, court ruling, etc.). They do not represent all of the securities purchased, sold, or recommended, and the reader should not assume that investments in the securities identified and discussed were or will be profitable. The information here was obtained from multiple sources believed to be reliable as of the date of publication, but we make no representations as to the accuracy or completeness of such third-party information and have no obligation to update, modify or amend this information or otherwise notify a reader thereof in the event that any such information becomes outdated, inaccurate or incomplete. Any opinions herein reflect our judgment at this date and are subject to change. This material does not purport to be a complete description of our investment services. Upon request, we will furnish a list of all securities recommended to clients during the past year. It is not our intention to state or imply in any manner that past results are an indication of future performance, which may vary. Future results cannot be guaranteed and a loss of principal may occur.

Past performance is no guarantee of future results. Inherent in any investment is the potential for loss. The performance results discussed for the EWM Balanced composite are based upon the returns of fully discretionary managed accounts with a designated investment objective of Balanced and no investment restrictions. The performance results portrayed are gross of actual management fees and net of transaction costs. The performance results do not reflect the deduction of investment advisory fees. The return of the accounts will be reduced by the advisory fees and any other expenses incurred in the management of the investment advisory accounts. As of the date of the report, the maximum investment advisory fee is 1% of assets under management. The performance results reflect the reinvestment of dividends and other earnings to the extent they are actually reinvested. A complete description of EWM’s advisory fees is available in Part 2 of Form ADV and is available upon request. EWM manages its client portfolios according to each client’s specific investment needs and goals. The returns of each account participating in the Balanced strategy will vary due to a variety of factors, including the timing of trades by EWM, market conditions, cash availability, and the timing of client deposits and withdrawals. Therefore, prospective clients should not assume that similar performance results to those shown would have been achieved for their accounts had they been invested in the strategy during the period.

The EWM Balanced Composite’s benchmark is 50% MSCI ACWI Index, 30% BarCap Short-Intermediate Managed Money Index, 10% Citigroup 3-Month Treasury Bill Index, and 10% HFR Hedge Fund of Fund Composite Index.

The &P 500 is a market-capitalization weighted index that includes the 500 most widely held companies chosen with respect to market size, liquidity, and industry. The Barclays Capital Short-Intermediate Managed Money Index includes municipal bonds that have a nominal maturity of 1 to 10 years, have an amount outstanding of at least $7 million, are issued as part of a deal of at least $75 million, with a minimum credit rating of Aa3, are not subject to Alternative Minimum Tax, and have been issued in the past five years. The Citigroup 3-Month Treasury Bill Index tracks the performance of U.S. Treasury Bills with a remaining maturity of three months. The MSCI EAFE Index (Europe, Australasia, Far East) is a free float-adjusted market capitalization index that is designed to measure the equity market performance of developed and emerging markets. The MSCI ACWI consists of 45 country indices comprising 24 developed and 21 emerging market country indices. The Barclays Capital Short-Intermediate Managed Money index includes municipal bonds that have a nominal maturity of 1 to 10 years, have an amount outstanding of at least $7 million, are issued as part of a deal of at least $75 million, with a minimum credit rating of Aa3, are not subject to Alternative Minimum Tax, and have been issued in the past five years. The Citigroup 3-Month Treasury Bill Index tracks the performance of U.S. Treasury Bills with a remaining maturity of three months. The HFR Hedge Fund of Fund Composite Index is a free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets and consists of the following 21 emerging market country indices: Brazil, Chile, China, Colombia, Czech Republic, Egypt, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Morocco, Peru, Philippines, Poland, Russia, South Africa, Taiwan, Thailand, and Turkey.

You cannot invest directly in indices. Index results assume the reinvestment of all dividends and capital gains. In addition, the accounts’ holdings will differ from the securities that comprise the indices.