Price, said Warren Buffett, is what you pay; value is what you get. The Sage of Omaha, quoting his mentor Benjamin Graham, argues that this principle applies just as well to socks as to stocks. It also applies – or at least it should – to the practice of wealth management. Private investors should be able to understand exactly what they are paying their advisors and what they can reasonably expect in returns – but many struggle to understand either side of the equation. They have good reason.

Hidden fees and incentives can easily obscure the real price of investment advice and management. Advisors at many large financial institutions can be paid – and promoted – for pushing proprietary products or negotiating revenue-sharing contracts with outside managers, at the expense of their clients.

When we founded Evercore Wealth Management five years ago, just as the great recession hit its nadir, we committed to a culture of independent advice, direct relationships and partnership values that drives what one California partner describes as radical transparency in all our dealings. A recent New York Times profile of the firm, (continued on page 3)
Record heat and record highs in the stock market are shaping this into a memorable summer, rewarding investors who bought in May and only then went away, ideally to a breezy beach or the mountains.

At Evercore Wealth Management, we remain hard at work in our New York, Minneapolis and California offices, delivering to our clients across the United States the honest, independent advice and investing expertise that they have come to expect from this firm.

Transparency is so core to our business – and still so rare in the wealth management field – that a recent profile of the firm in The New York Times, reprinted here on page 4, was titled “Telling the Truth on Fees, Warts and All.” It’s somewhat disconcerting that this approach is news – but we are glad that we are the ones making it.

In this issue of Independent Thinking, Chris Zander, our Chief Wealth Advisory Officer, asserts that transparency in advice is at least as important as in fees and investing. Julie Krieger reviews strategies for leveraging charitable giving funds; Charlie Ryan discusses the growth investing team’s approach to time arbitrage; and Gary Gildersleeve and Brian Pollak make the case that this is an opportune time to purchase attractively priced bonds.

Also in this issue, one of our external managers, Patrick Geddes of Aperio Group, discusses his firm’s approach to socially responsible indexing. Values-based investing is a growing concern for a number of our clients, notably young entrepreneurs, and we are committed to accessing them the best possible strategies in the context of the overall performance of their portfolios and their appetite for risk.

As always, please contact any one of us at Evercore Wealth Management to discuss the topics in this issue or any other questions or comments you may have. For those of you still looking forward to the beach or the mountains, we wish you a wonderful vacation. And for all of our clients and colleagues, we hope that the rest of your summer is a happy and healthy time.
reprinted here on page 4, takes a look at this approach, focusing on returns.

Transparency of advice is arguably even more important. Private investors are entitled to fully understand the value of the advice they receive. However, many advisors project investment returns without fully factoring in tax, inflation, spending rates, fees and other variables. Client expectations are raised and, eventually, dashed.

It is not enough for advisors to simply take inputs on spending and attitudes to risk, highlight an investment return target and fund a portfolio with the hopes of reaching that objective. What happens, for instance, if the portfolio’s risk in a sharp downturn causes the client to reassess and ultimately sell at an inopportune time? How much more risk will that individual then have to take on to have a shot of reaching his or her goals?

To take another example, what happens if, over a 10-year period, a couple heading into retirement doesn’t take into account the impact of their real spending, income taxes and inflation on their portfolio returns, and finds themselves well short of their saving goal, just when they were ready to shift gears into a more relaxed lifestyle? The cost of opaque advice can ultimately be measured in more than financial terms.

And finally, what happens in the next recession? Translating a standard deviation measure into the actual dollar impact of a drawdown in advance suggests whether a portfolio is sustainable through a difficult period.

In our current balanced portfolio forecast, we predict an annual return of 7%, before taxes and fees. We determine this forecast using our capital market assumptions for the underlying indices in each asset class. But we don’t stop there, because that’s not what our clients – or those at any wealth management firm – are likely to experience in practice. We expect that the portfolio manager’s added value (above the forecasted index results) will – after offsetting income tax, a 2% inflation expectation and the firm’s fees – yield a real return of 3% a year. Built into this is an important assumption – that the portfolio could decline by 25% from peak to trough.

To bring some perspective to these forecasted returns, it’s worth considering several points of reference. First, we examined a traditional balanced portfolio invested 60% in the S&P 500 index and 40% in a municipal bond index. Taking into account the impact of inflation and taxes using today’s income tax rates (both annually, due to turnover and rebalancing, and assuming full liquidation at the end of the period), the real, after-tax annualized returns for the past 30-, 20- and 10-year periods ended December 31, 2012 were 5.67%, 4.17% and 3.10%, respectively, without accounting for fees.

It’s important to note that these results were achieved in a bull market for fixed income and, in the case of the 10-year period, over a very poor market for stocks. For investors who want a firm vantage point from which to plan their future, 3% seems to us a realistic – and reasonable – return expectation.

It’s also important to note that, while pre-tax returns on our composite of balanced accounts were 10.44% (gross of fees) and 9.58% (net of fees) annualized from February 1, 2009 to May 31, 2013, exceeding our own expectations, this outperformance occurred during a recovery phase in major global markets. It remains to be seen whether we were too conservative in our 10-year projections. In the interim, investors who are planning for major events must be able to sustain their lifestyles and the funding of their long-term goals, including retirement and legacy planning, should their portfolios revert to our annualized projection.

At Evercore Wealth Management, we are focused on selecting investment strategies that we hope will outperform relevant benchmarks, within proper asset allocation guidelines and risk tolerances. It is our fiduciary duty as trusted advisors to assist our clients with planning for realistic adverse scenarios and to seek to ensure that our clients can sustain their portfolios through those periods.

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Telling the Truth on Fees, Warts and All

By PAUL SULLIVAN

Here’s a sales pitch you don’t often hear: Let us invest your money. You can count on a return of 3 percent, though there is a chance it will be less. But we can guarantee this return for 10 years.

Sure, the 12 percent returns of Bernard L. Madoff proved ephemeral and the financial crisis lowered investors’ expectations. But 3 percent? Maybe less? That certainly seems to be a meager return, particularly given the stock market’s fast start this year.

Yet this was the pitch I heard when I met Jeff Maurer, chief executive of Evercore Wealth Management, and John Apruzzese, Evercore’s chief investment officer. They formed the firm four years ago with several former executives from U.S. Trust. I joked with them that offering such measly returns did not seem to be a good way to win new business.

“We don’t win every client we pitch,” Mr. Apruzzese said.

It turns out, though, that these low returns do not come from poorly performing investments. The firm is simply being honest. That 3 percent return includes projections on performance of many types of investments but also assumptions on tax rates, inflation and fees – both theirs and those of the outside managers they use.

“One of our key principles was transparency on fees, which has hurt us,” Mr. Maurer said. “Another was how we talked about what could happen in a downturn, which has also hurt us.”
Mr. Maurer said his firm preferred to say that there was a chance your portfolio could go down 25 percent, instead of trying to attach a probability to its happening. Saying there was a 1 percent chance, he said, was misleading because the chance of a market collapse like the one in 2008 was small. But it happened nonetheless.

Fees, of course, are a constant source of friction in investing. If you are the type of person who believes it is impossible to get better than the market rate of return, then you probably believe that the lowest-fee index fund or exchange-traded fund is the way to go. On the other hand, if you are the type of person who believes that managers can get returns higher than the market average, you may be willing to pay higher fees, calculating that the net return will be better or at least the swings in the investments’ value will be less volatile.

What piqued my interest was that Mr. Maurer and Mr. Apruzzese made a point of disclosing all the charges, even the ones investors would not see. With that knowledge, investors could understand what those fees were doing to their portfolios’ returns.

So I asked to come back and play a prospective client to see how they revealed the fees. For the record, I was not assessing the quality of their advice or their offerings but how they presented likely returns, warts and all.

Evercore manages $4.7 billion and has an average account size of $10 million, so the firm serves a refined niche. Most of its clients also have the bulk of their wealth in taxable accounts and not in tax-deferred retirement accounts, where the money is taxed only when it is taken out.

But regardless of their wealth, all investors would benefit from asking their advisers to subtract not just their management fees, as most already do, but the fees in the investments themselves. Investors would also benefit if their advisers factored in inflation and any probable taxes. At the very least, this would give a sense of the real return and help investors be more realistic.

For the purpose of the meeting, Mr. Maurer and Mr. Apruzzese created a fictional me who resembled a typical 40-year-old client of theirs. The fictional me began his career at a top-tier consulting firm and is now an executive at a financial firm. He earns $500,000 a year with a $500,000 bonus. He has company stock worth $1.5 million with a lot of embedded capital gains and he inherited $4 million in 2010. He has a $500,000 mortgage on a $2 million house. His goal is to retire at age 60.

Mr. Maurer said this typical client would probably arrive with over half of his $10 million portfolio in cash and municipal bonds and another 20 percent in retirement accounts. Only about 10 percent would be invested in equities other than the company stock.

Mr. Apruzzese walked me through the six baskets the firm uses for thinking about how money is invested: cash, defensive assets (municipal and taxable bonds), credit strategies (high-yield bonds, mortgage-backed securities), diversified market strategies (commodities, foreign bonds, liquid alternative investments), growth assets (stocks) and illiquid alternatives (private equity, venture capital).

This was a fairly standard approach. Advisers generally aim to divide up a portfolio in ways that investors can understand, regardless of their level of financial sophistication. Another popular way is to put money into fictional buckets for specific needs, like current expenses or charity.

For me, the firm presented three investment options – capital preservation, balanced and capital appreciation, which could be translated as conservative, moderate and aggressive portfolios. Mixing the six baskets together for each objective generated pretax, after-fee returns of 6.1 percent, 7 percent and 8.2 percent a year, with maximum losses of 15 percent, 25 percent and 35 percent, respectively. The projections were for the next decade.

I selected the balanced portfolio, and Mr. Apruzzese showed me how taxes reduced the solid 7 percent return to 5 percent, by factoring in long- and short-term capital gains at the highest federal rates. Inflation of 2 percent knocked it down to 3 percent. (The capital preservation portfolio fell to 2.3 percent, while the capital appreciation portfolio ended up at 3.9 percent.)

“When some people see that 3 percent return, we never hear from them again,” Mr. Maurer said. “We have clients come in and say I was at X competitor and they said there were no fees. I say, ‘O.K., but they’re selling you all their own products and the fees are embedded in them.’”

But what about Evercore’s fees? That came later, though Mr. Maurer said most clients did not focus on them the way I did. “It’s about explaining what the fees are,” he said. “We don’t get a placement fee or any revenue sharing. We try to get the lowest fees possible for that investment solution.”

Like most wealth management firms, Evercore has a sliding fee scale for its advice – the more money you have, the lower the fee. On $10 million, the management fee was 0.88 percent, though no fee was charged on the $1.5 million in company stock. The firm manages municipal bonds and core equity portfolios itself but does not charge a fee on top of the management fee. This equated to $76,250 a year to them.

On the $4.5 million of the portfolio invested with outside managers, the fees were 1.03 percent or $46,480. Many of those fees, though, would normally be deducted from the returns of the funds in a way that most investors would not notice. Mr. Apruzzese said calling attention to those fees was important.

In total, the fictional me paid 1.23 percent of the portfolio, or $122,730, in annual fees.

“By expressing it in dollars, that makes a real impact on clients,” Mr. Apruzzese said. “Most advisers talk in percentages or, worse, basis points, and no one knows what a basis point is.”

Still, what I would have liked to see was a pre-fee return along with the returns before taxes and inflation. I asked why it was not presented this way. Mr. Apruzzese said it was because the firm showed clients returns that it expected would be lower than the actual returns. Those higher gains would then cover the fees. But he added that most clients – the kind of people who actually have the $10 million I was pretending to have – preferred to talk about what they could do with their money and not be bogged down in the minutiae.

As a real-life example, he said that the $800 million that the firm manages as a balanced portfolio had returned an average of 10.75 percent annually from February 2009 to March 2013. With several caveats for taxes, Mr. Apruzzese said that became 9.89 percent after fees, 8.21 percent after taxes and 5.85 percent when the Consumer Price Index over that time was factored in.

Even though it was not my money, I felt disappointed. A solid double-digit return was whittled down to a decent single-digit one before my eyes. But with nearly half the gain consumed by fees, taxes and inflation, it was a reminder that all investors should be focused on the real return and forget about that dazzling headline number.
Prospective donors can get significantly more bang for their charitable buck by utilizing leveraging strategies. The choice of strategy will depend on each donor’s specific goals and tax circumstances, but it’s worth first considering some of the options.

Pre-funding charitable giving through the creation of a donor-advised fund or family foundation could reduce current federal and state income tax liabilities while deferring specific donation decisions, including the timing of the gift and the specific charitable recipient or recipients. This approach can be extremely valuable to investors who face an extraordinary gain in a single tax year, whether from the sale of a closely held business, real estate or very low basis stock.

An individual selling a company, for example, will be able to focus on the business at hand, knowing that his or her family’s future charitable giving can be funded with a portion of the sale proceeds. It’s important to note that the donor-advised fund or family foundation needs to be funded in the same tax year as the gains are recognized to receive the tax benefit.

A donor-advised fund is easy to implement and can provide family name recognition, while relieving the benefactor of ongoing administrative burdens. A donor-advised fund is considered a public charity and offers a relatively high charitable deduction limit of 50% of adjusted gross income for cash and 30% for stock and real estate. Another advantage here is the absence of strict annual distribution requirements. Many community foundations offer donor-advised funds with administrative support. The donor can recommend grants to charitable beneficiaries and designate gift amounts to be distributed in future years.

Some donors prefer to establish a private family foundation, which connotes a significant commitment to future charitable giving. The current generation may use the foundation as a means to educate and pass on their traditions to future generations. A private foundation is subject to a lower charitable deduction limit of 30% of adjusted gross income for cash and 20% for stock and other capital gain property, and an annual 5% distribution requirement.

Usually there will be higher initial and annual cost to establish and administer a private foundation, including annual filings of both a 990PF tax return to the IRS and the State Attorney General. We recommend this approach for clients who plan to donate at least $1 million or more in their lifetimes, and we are able to assist in the administration.

Other leveraging strategies are accessible to many investors, including those who choose to establish a donor-advised fund or a family foundation.

The gift of appreciated property can provide leverage through significant tax savings that can benefit both the donor and the recipient. Investors are able to fund charitable gifts with appreciated stock or other assets, including art or real estate, that have been held for longer than a year.
This strategy potentially allows donors at the top tax rate to gain a charitable deduction for the full fair market value of the gift and avoid the federal capital gains tax and Medicare surtax of 23.8% on that amount, along with any respective state tax that would have been due were the asset simply sold. (At Evercore Wealth Management, we assist clients with gifting stock in amounts as low as $1,000, a savings of $240 compared with writing a check.)

Employees of companies with matching gift programs are typically able to gain 100% leverage on the qualified amounts. Most companies cap the limit to be matched at modest amounts, and some choose a specific charitable focus, such as education. Nevertheless, this is an attractive strategy, from both the perspective of the donors and the beneficiaries. In addition to the leverage the charity receives from the match, there is also leverage for the donor from the tax savings from the direct charitable gift.

Donors of lead matching gifts offer a leadership gift to a specific cause that is a conditional commitment to match the contributions of other donors at a given rate. The lead donor can set the maximum amount he or she is willing to give or join forces with other lead donors to set a higher bar. Studies suggest that this is an effective fundraising approach, resulting in considerable increases in both the donation per solicitation and the probability that an individual donates. A typical lead gift would provide a 100% match/leverage, providing the donor with a tax savings and the charity with the increased donation. The lead donor can also offer a higher match ratio, which may generate more gifts.

Finally, investors over 70½ can request an IRA Qualified Charitable Distribution of up to $100,000 to a designated charity in 2013. This tax-free distribution can be used to satisfy all or a portion of the IRA required minimum distribution for the year. A charitable deduction is not allowed, but the benefit on the payments’ exclusion from income is higher, resulting in leverage of a 39.6% income tax savings for someone in the highest federal tax bracket, plus the respective state tax benefit, depending on domicile. This tax provision is scheduled to expire at the end of 2013 under current law, although it has been extended a few times in the past.

At Evercore Wealth Management, we work closely with prospective donors, their families and their other advisors to design and assist with the funding of effective charitable giving.

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The Aging Baby Boomer
Golden Years
by Jeff Maurer

Editor’s Note:
This is the second of a regular series on the opportunities and challenges facing aging Baby Boomers.

It promises, as of writing, to be another perfect hot summer day. Many of my contemporaries from my working career and from college will spend it on the golf course or on the water. They have paid their dues, invested wisely, and are now enjoying their time on their own terms.

This morning I walked to our headquarters in midtown Manhattan at the start of another workday. Don’t get me wrong: I like the water and golf course as much as any reasonably healthy man in his mid-60s – but I enjoy business and working with clients even more. The launch of Evercore Wealth Management at the age of 62, when I was already fortunate enough to be in a position where I could have opted instead for a comfortable retirement, was a more appropriate mulligan for me than one on the first tee.

Indeed, the challenge and rewards of reassembling a band of former colleagues to build something new with Evercore was irresistible. My partners and I were determined, even at such a difficult time in the markets, to establish a wealth management business that we would be proud of and that could serve our former clients, their families and friends, and our Evercore colleagues – and grow from there. Our success to date has been a source of great pride and satisfaction to us all and we are fired up for the challenges ahead.

If you are fortunate enough to have good health, traditional retirement ages are now nothing but mileposts in a world that is constantly changing. This morning I read about a study in France that concluded that workers who postpone retirement are less likely to develop Alzheimer’s disease and other forms of dementia. As I wrote in past issues of Independent Thinking and will address in future issues, I plan seriously for the contingencies of aging. But this active, fully engaged life suits me well.

Justice Oliver Wendell Holmes Jr., who served on the United States Supreme Court for 29 years before retiring at the age of 90, observed that: “Men do not quit playing because they grow old; they grow old because they quit playing.” My recommendation to all our readers is to help fate with your free will. Stay active, whether in business, philanthropy, education, family, sports or on the Supreme Court.

I just turned 66 and had to decide whether to take Social Security or wait until later. I decided to postpone Social Security for at least a few more years.

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It’s no wonder that the recent rise in interest rates has felt painful to fixed income investors. The nearly 1% gains in the 10-year Treasury and 10-year municipal bonds yields over May and June were some of the steepest in memory. After nearly two full years in an extraordinary environment, investors had become accustomed to the low rates in both taxable and tax-exempt markets. Now negative total returns are being recognized from the lower yield bases and recent buyers have been suffering losses, at least on paper.

The Barclays Capital Aggregate Bond Index lost 3.30% in May and June, while the Barclays 1-10 Year Managed Money Municipal Bond Index lost 2.96%. Even an investor in the Barclays High Yield Index, typically a relatively robust asset class when interest rates are rising, generated a total loss of 3.18% over the same time period. No fixed income sector was left unscathed.

This rise in interest rates may – or may not – presage a return to a relatively normal investing environment. Either way, we see opportunities to purchase attractively priced bonds. A portfolio with a shorter-than-normal duration and some well-researched, medium investment-grade rated municipal securities should enhance yield. Shorter maturities should also be less sensitive to interest rate moves until the Federal Reserve decides to raise the Federal Funds rate.

A portfolio with four-year duration, for example, would decline in price by nearly 4% after a 1% move higher in yields across the curve, while a portfolio with seven-year duration would decline in price by close to 6.5% with that same move in interest rates. Duration matters. (See graph on page 10.)

This remains an opportune time to increase yield without adding much duration risk through selected sub-investment grade credit strategies. Leveraged loans and low-duration high-yield strategies have both recently outperformed their more interest rate-sensitive counterparts.

(continued on page 10)
Economic data is likely to drive markets for the foreseeable future, as the Fed continues to scrutinize each incoming data point. A string of weak data or employment reports would settle the bond markets, at least for a while. But evidence that the economy is strong enough to sustain itself without the Fed’s support could spell the beginning of the end for the 30-year bond bull market.

These are challenging times for fixed income investors. However, our strategy of taking on less interest rate and more credit risk has enabled certain Evercore Wealth Management portfolios to outperform their benchmarks in the last few months. We believe our bond strategies continue to be well positioned across a range of interest rate environments.

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Diversified Market Strategies

by Brian Pollak

Investors aren’t used to losing money in the bond markets. Many have spent the better part of the last three decades watching stocks and bonds go up at the same time. There have been periods where one market performed well and the other performed poorly, but until this spring, there have been very few periods in recent memory in which both stock and bond performance was negative.

By mid-June, after Federal Reserve Chairman Ben Bernanke reminded us of something we already knew – that rates will not stay this low forever – it had became apparent that most investors are ill-prepared to face simultaneous losses in both major asset classes. Volatility spiked dramatically in both the bond and the equity markets before settling down a few weeks later.

As of writing, investors everywhere remain a little rattled; allocations to equities generally remain relatively low, even as the market records further gains, and bond mutual funds outflows are significant.

At Evercore Wealth Management, our diversified market strategies, or DMS, asset class is designed to provide stability to investor portfolios when stocks and bonds 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 hope is that this DMS portion of a portfolio, which we currently recommend to be about 10% of a clients’ balanced accounts, will provide ballast, stabilizing the whole in troubled times while not diminishing returns over an investment cycle.

At present, we are 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 latter includes an allocation to securities that invest in gold, which, despite its recent weak performance, remains a core investment. While gold may not perform well in markets in which real growth is rising and volatility is low, it remains one of the few assets with the ability to hold value in inflationary and deflationary periods. It also has a very low long-term correlation to both equities and bonds.

Global monetary policy over the past few years is unprecedented and investors should remain prepared for a range of outcomes. Central bankers have demonstrated great skill in shepherding the economy to date, but threading the needle of their exit strategy, while possible, is not a foregone conclusion.

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Growth Assets
Time On Our Side
by Charles Ryan

After a roller-coaster spring, the equity markets entered the summer on a high note, leaving many investors wondering where we go from here. What real opportunities exist after the stellar returns of markets over the past 12 months as a whole? No one knows for certain, of course, but we do believe that for patient long-term investors there are still plenty of opportunities to buy great businesses.

At Evercore Wealth Management, our approach to growth assets includes the concept generally known as time arbitrage. The term is usually defined as the opportunity created when a stock misses its earnings guidance mark and is sold below its long-term value. We take a broader view, which enables us to take a different perspective than investors focused on the current quarter.

This can be an advantage for us as fundamental investors, seeking to add value to clients’ portfolios in a market buffeted by short-term and flash-term trading. For example, fears of rising interest rates, as discussed in other articles in this issue of Independent Thinking, drove spooked investors from yield-oriented sectors, such as REITs. The Vanguard REIT index lost 15% from its peak on May 21 to June 24, not for any fundamental reason, but on what looked like forced redemptions by anxious institutional investors ahead of the end of the second quarter.

We were able to use this broad market sell-off to add to the American Tower position in our core portfolio. It seems to us that the recent rise in rates will have no impact on the company’s business or its capital structure. We continue to believe that the stock in this wireless communications infrastructure company is undervalued and the sell-off only made it more attractive.

Practicing time arbitrage also leads us to sell securities when short-term forces change their valuations. Acquisition rumors and the disclosure of new investors, respectively, drove the valuations of generic drug maker Activas Inc. and remote site accommodation company Oil States International to levels that we could not justify against the associated risks. We sold both positions in our core portfolio in mid-May, although we will continue to monitor the stocks.

Unlike short-term investors, we are not trying to predict the next takeover or 13D filing – or trying to outguess Wall Street on corporate earnings each quarter. We are focused instead in our efforts to generate value in client portfolios through a disciplined, repeatable process for buying and selling securities based on fundamentals.

An investment process that incorporates a disciplined time arbitrage strategy requires patience and nerve – but for those with a goals-based investment approach and a long-term view, it can be very rewarding.

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Aperio Group and SRI Investing
An Interview with Patrick Geddes, Chief Investment Officer

Editor’s Note:

Evercore Wealth Management supplements its core planning and investing strengths with carefully selected access to external managers across multiple asset classes and investment styles. Here we speak with Aperio Group Chief Investment Officer Patrick Geddes about his firm’s focuses on customized and after-tax indexing strategies that reflect investor values and perspectives. Aperio manages $4.5 billion in separately managed accounts.

Q: SRI is usually defined as socially responsible investing. But at Aperio, the term refers to indexing. What is the distinction?

A: Aperio Group delivers SRI based on an indexing philosophy, which means that portfolios are still created to track standard benchmarks like the Russell 3000 or the MSCI All Country World Index. We then use an optimizer to incorporate negative or positive screening for a wide range of environmental, social and governance issues that may be of concern to investors.

An indexing perspective brings greater flexibility in how strictly SRI screens are implemented. This approach allows investors to achieve two important goals: measuring the impact of screening on a portfolio’s risk (as measured by tracking error); and customizing a portfolio to reflect a client’s values.

Q: To date, SRI has seemed to many investors an approach that is more attractive in theory than in practice. Are results improving?

A: Research to date shows no performance penalty. And now we are seeing SRI choices growing to include significantly lower-cost strategies based on blending SRI screens with traditional indexing. If SRI equity strategies reflect the same data pattern as non-screened strategies, then lower fees should lead on average to improved performance. Investors are also benefiting from a far wider range of SRI choices across all asset classes, including both public and private equities.

Q: Many wealth management firms employ SRI only for client assets earmarked for philanthropy. Would you argue for a broader application?

A: Many advisors have begun emphasizing a holistic approach that can include incorporating a family’s values. A lot of the motivation for SRI investing comes...
from younger generations who strongly desire that their values be fully reflected in their portfolios. As investor awareness grows about relative performance, and the industry expands the range of SRI strategies, clients start to ask for broader applications.

Any investor, whether a philanthropic foundation or a high net worth individual, should understand the trade-offs involved in SRI screening. While it’s inaccurate to judge all screening as merely a tax on returns, it’s also naively optimistic to think that there is absolutely no impact or to expect with high confidence that screening will lead to superior performance. When the investment math is made clear, then the often trivial incremental risk can be understood and the best investment decision reached. SRI values can be implemented across a far wider range of assets than those earmarked for philanthropy, but SRI investors should do so as well-informed consumers.

Q: Aperio manages assets for family offices, endowments and foundations, as well as for taxable investors. How do the SRI investment needs of individuals differ from those of institutions?

A: For individuals, the process of identifying values and assessing the risk-reward trade-offs can be more straightforward. For institutions, the goal is usually to design a portfolio to reflect the values of the entity itself, and the process of identifying the particular values requires a more formal approach. Large families may make decisions in ways similar to institutions.

Q: How are client interests changing? What are the important issues for investors today?

A: Interest in incorporating values has been spreading to a far wider range of investors. Many advisors remain skeptical, but competitive pressure means that they risk alienating clients by trying to dissuade them from achieving their goals. At Aperio Group, we’ve seen how conversations about values, even when generations or couples don’t all agree, can bind families together.

As for specific screens, environmental issues have always been a major area of interest, but that emphasis continues to rise. For example, many high net worth investors express interest in the carbon divestment campaigns aimed at university endowments. Whether or not one views divestment as an effective tactic, the investment math around screening has gained prominence. In a similar vein, sustainability generates a lot of discussion, as do issues that relate to current events, such as a heightened focus on gun manufacturing after the school massacre in Connecticut. Social justice and faith-based screens remain in demand as well.
**Q:** How do you see SRI continuing to evolve?

**A:** As SRI becomes more mainstream, investors’ interest will continue to grow, as will the range of research and products. Research on individual companies has become much more sophisticated over the past ten years as investors and governments demand greater disclosure from companies and more data from SRI research firms.

Beyond screening, many investment analysts now incorporate traditional SRI or environmental, social and governance (ESG) factors to explain stock behavior. Exposure to governmental regulation, particularly regarding the environment, will also become increasingly important. For example, in the debate on carbon divestment, some investors prefer to exclude certain energy companies because of their perceived impact on the environment. Others might want to avoid or underweight the same companies, but because of perceived risk of regulatory changes.

In another push beyond screening, many investors focus not just on whether or not to own particular companies, but rather on how to effect change, either through proxy voting or direct engagement with resolutions or other forms of persuasion (or coercion, depending on your perspective).

For many investors, screening with values remains unappealing. For many others, the widening range of strategies and research data means the world of SRI will become even more diverse. After all, there are many different ways to define SRI and many ways to implement it. The debate around how to incorporate values will continue, especially as the means of implementation become more sophisticated. The days of SRI being viewed by investors as a sideshow are probably a thing of the past.

*For further information on SRI investing, contact Iain Silverthorne at Evercore Wealth Management in San Francisco at silverthorne@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.

For more information, please visit www.evercorewealthmanagement.com.

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With respect to EWM’s Balanced strategy, the expected performance is a target, and is not guaranteed. 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% HFRI Hedge Fund of Fund Composite Index.

The S&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 HFRI Hedge Fund of Fund Composite Index is an equal weighted index comprised of multiple managers with at least $50 million in assets under management and a 12-month track record. The MSCI ACWI Index is a free float-adjusted market capitalization weighted 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 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 markets, excluding the U.S. and Canada and is net of the foreign withholding tax on dividends. The index consists of the following 22 developed market country indices: Australia, Austria, Belgium, Denmark, Finland, France, Germany, Greece, Hong Kong, Ireland, Israel, Italy, Japan, the Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, and the United Kingdom. The MSCI Emerging Markets 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 may vary from the securities that comprise the indices.