Gardeners know that the best yields over time come from plots that are thoughtfully planned, with plants selected to complement each other and nurtured accordingly. Wealth managers make similar decisions on behalf of high net worth investors, allocating to diverse asset classes with a view to meeting the long-term goals of the investor.

Equities are flourishing as of this writing, with the S&P 500 index up 10.2% for the year to date, fueled by the effects of an accommodating Federal Reserve policy and increased monetary stimulus around the globe, while returns on investment-grade bonds wither, barely keeping pace with inflation and increasingly risky by historic standards. Not surprisingly, many investors are starting to ask why they should even own bonds.

There remains, however, a strong case for investing in both equities and fixed income investments, including credit strategies, and we take a look at these and other asset classes throughout this issue of Independent Thinking. Let’s start here with the bigger question: How should investors allocate to each asset class? The textbook answer is to broadly diversify the portfolio across asset classes structured toward meeting a return goal at an acceptable level of risk. But what is an acceptable level of risk? How do we define the return goal?

(continued on page 3)
Welcome to the Spring issue of Independent Thinking. Those of us on the East Coast are particularly delighted to welcome spring this year, after a winter that was heralded by Hurricane Sandy, capped by Nemo the blizzard – and has dragged on since. Our clients and colleagues on the West Coast have had a better time of it, of course, and those in our Minneapolis offices were perhaps more philosophical to begin with.

A yearning to feel the sun on our faces is not the only reason that several colleagues and I will be heading to California this month. We are delighted to mark the union of our two San Francisco offices and our continued growth in the region with a special event in the Evercore Wealth Management Independent Thinking series at the de Young Museum.

Roger Altman, Chairman and Founder of Evercore Partners, will address our clients, as will Keith McWilliams, John Apruzzese, Chris Zander, Howard Cure and Evercore Consumer Internet analyst Ken Sena. It promises to be a wonderful evening, not least because we are hosting clients to an exclusive presentation of Vermeer’s “Girl with a Pearl Earring” and other Dutch masterpieces from the Mauritshuis at the Hague.

Looking further ahead, we have other reasons to be cheerful as the days grow longer. Many of the risks that loomed so large just months ago continue to recede and inflation remains at bay. The recent banking crisis in Cyprus reminds us how vulnerable and interconnected the world’s markets are. But the bigger picture continues to brighten, thanks in part to developing emerging resources here in North America. We take a look in this issue of Independent Thinking at some of the related opportunities, notably in the energy, manufacturing, and Internet sectors.

Finally, and as promised in the last issue, my column on the challenges and the privileges facing aging boomers debuts this month. Please do let me or any of my colleagues know your thoughts on the issues raised in this and future columns. I hope to share my and others’ experiences in planning for the events that confront us all, sooner or later, and would very much welcome your engagement.

Jeff Maurer
Chief Executive Officer
The first part of that answer depends on the investor. Regardless of their asset size, individuals – and families – are different from institutions. The goals of the former are more varied and can even be in conflict: Do the long-term health care requirements of older members trump the housing, business and educational interests of the younger, for example? Individual and even family spending budgets are shorter term and more volatile than those of institutions, and they are less able to tap alternative funding solutions.

Consider the example of an executive retiring at age 65 after 40-plus years in the workforce. While Mary and her spouse may want to provide a lasting legacy for their children or favorite charities, their primary objective is likely to be to fund their lifestyle goals for the next 15-20 years at a high level of confidence. Failing to meet that objective would be stressful at best and devastating at worse, as any executive’s ability to earn back any shortfall diminishes with each day in retirement. In contrast, failing to leave a legacy for capable children or for charities would be a much smaller pill to swallow.

For Mary, the acceptable level of risk is not high. She needs to generate $300,000 a year after taxes from her $10 million portfolio to maintain her lifestyle. That’s three percent of the starting principal. If our inflation expectation is 2.5%, taxes are another 1.5% and investment fees total 1%, the target return needs to be 8% to meet the spending requirement and grow the principal with inflation to preserve purchasing power. This is how we define the return goal.

So, back to our original question: How much should investors allocate to each asset class, in the context of their appetite for risks and their goals? To properly address this, we should focus on the next 15 years, which are the most critical in terms of minimizing volatility of assets used for lifestyle spending. When the lifestyle annual rate of $300,000 is adjusted for inflation, one way to fund the objective is to set aside $4.4 million in municipal bonds, assuming an annual investment return of 2.5% per year (to reflect a conservative view of yields on municipal bonds and a full drawdown over the time period). This will allow the investor to fund the spending objective for that period of time and gain a higher level of certainty as the maturities of the bond portfolio align with the requirements.

The remaining $5.6 million balance of the portfolio should then be diversified across other asset classes, including public global equities, private equity, opportunistic credit, and diversified market strategies to offer a portfolio of lower correlated return streams targeted to meet the overall return objective. If Mary comes to believe that the portfolio, as constructed to meet the 8% hurdle, carries too much risk, she can lower the risk/return expectation for the portfolio and simultaneously reduce expectations for the legacy remainder for children and charity, assuming the near-term spending objective remains the fixed determinant.

Like many individual and family investors, Mary could also discover that her priorities change with time. She could choose to alter the portfolio structure accordingly, to better secure deepening or new passions, if she is willing to make the related tradeoffs and adjust expectations in other areas. The key point is that she is structuring her portfolio to not only meet her objectives, but to prioritize those objectives to ensure that the most important ones are served first. In this case, investment grade bonds are part of the solution.

Chris Zander is a Partner at Evercore Wealth Management and the National Head of Wealth Planning. He can be contacted at zander@evercore.com.

Spring 2013 • Independent Thinking • 3
We are often asked how we define the Internet industry. It’s a good question, given that the companies most thought of as Internet, such as Google, Amazon, eBay and LinkedIn, to name just a few, increasingly seem to be competing in industries that have little to do with their competitive set.

Google and Amazon, for example, are pushing into hardware and software. eBay’s PayPal division is helping revolutionize traditional banking practices, not just online but in physical locations as well. LinkedIn, as opposed to generating the majority of its revenues from consumers or advertisers, sells software-based subscriptions to small and medium businesses, and to enterprises related to hiring solutions and sales practices. In defining the industry as a whole, we focus on what these companies have in common.

There are two main attributes, at least among the more successful examples: a strong audience or consumer-facing component; and an ability to use this audience component to rethink established supply chains. It is this latter element that often gets overlooked when considering Internet companies, as investors often focus instead on audience scale. Potentially worse, investors can become perplexed by or even dismissive of Internet companies that seem to stray from their core competency of building audience to tackle seemingly unrelated industries.

Google’s decision to compete directly with Apple and Microsoft through creating operating systems, such as Android and Chrome, is a great example. Another example is Amazon’s decision to offer infrastructure storage, networking and computation to enterprise clients through their Web services division, which similarly would seem to have nothing to do with its core retailing and marketplace businesses.

The common thread here is that all of these companies are using data more efficiently, to put buyers together with sellers. I would even argue that payment data via PayPal or business referrals through LinkedIn stand to do something similar. However, this creates a source of tension. As so-called data layers deepen and multiply through advances in mobile applications and social
platforms, better Web tracking, and more sophisticated operating systems, the number of competitors who stand to help buyers and sellers leverage this data for profit increases, leading to newer sets of competitors and sources of disruption.

In this vein, we recently looked at how an emergent set of software provider companies, including Pro Services, Sabre and TravelClick, use advances in data and analytics to create a new software data layer between current online travel sites and their travel suppliers. We found that the ability to provide customer relationship and revenue management expertise across hundreds of channels is giving these emergent software companies strong traction among travel suppliers.

Moreover, this traction is gaining the notice of large Internet competitors, such as Google. Google’s Hotel Finder search engine is now contracted with Sabre, effectively bypassing the online travel agent model for a small portion of total travel supply. The risk here is that these companies will share the experience of the advertising technology industry, where yield managers ultimately served to rationalize traditional ad networks, leading to industry consolidation, with Google developing an upper hand.

To be clear, we do not see the same disruptive outcome for the online travel industry, thanks in part to the diversification of their supplier base, where Priceline has an advantage with 300,000 hotel suppliers (compared with Sabre’s 14,000), and the strength of their consumer brands, where Expedia, Priceline, and TripAdvisor all have an advantage.

The best defense that most Internet companies have is their large consumer-facing audience. The ability to use that audience scale to deliver continuous supply-chain disruptions will separate the winners from the rest. It is only through such efforts that scale ultimately equals defensibility.
The Aging Baby Boomer
MANAGING ON YOUR OWN TERMS

by Jeff Maurer

EDITOR’S NOTE:
As previewed in the last edition of Independent Thinking, this is the first in a regular column that considers the wealth planning issues confronting the vanguard of the Baby Boom generation.

Andy Rooney nailed the aging paradox when he said that the idea of living a long life appeals to everyone, but the idea of getting old doesn’t appeal to anyone. Still, the better we plan, the more we can enjoy both the idea and the reality.

It seems like only yesterday that my wife and I executed our first wills. The challenge was not how we would dispose of our assets – for there were very few assets then to dispose of – but who would be the guardian of our soon-to-be-born child. As that child is now 37 years old, the provision has long since been removed. But the discussion continues as, in one of the ironies of life, we look ahead into the hopefully still distant future to identify our own guardians.

Several years and a few dollars after that first guardianship discussion, my wife and I added a health care proxy and a durable power of attorney to our provisions. Everyone needs a health care proxy; the choices here are very personal and we would all want to make them for ourselves or on our behalf by our loved ones, rather than have the choices made for us by strangers.

All of us also need a form of durable power of attorney, to designate or appoint one or more agents to make all financial related decisions on our behalf. It is durable because it will survive any future incapacity. Living or revocable trusts, which can better protect assets and streamline dealings with financial institutions when time may be tight, may also be an attractive option. I added a revocable trust to my own estate planning documents a few years ago, retitling most of my assets in the name of my trust. I currently serve as the trustee and the beneficiary but have designated successor trustees to serve in the event of my death or disability.

Direct and personal relationships with advisors, as well as with one’s spouse, children, and perhaps siblings, in which you share your desires regarding health care and related issues are key in getting this right. I don’t have to go far to check in with my wealth advisors and portfolio managers at Evercore Wealth Management, but I also work closely with my own personal attorney on these and related issues. He is well known to my wife, who has matching documents, and to other members of our family.

Like many of my contemporaries in their 60s, I am enjoying a career and lifestyle that would have astonished our forebears, both in its fullness and its continuing promise. I enjoy it all the more knowing that I have done as much as I can to protect my family and myself. Proper estate planning eases the worry and allows us to remember that getting older, while not exactly fun, is a darn sight better than the alternative.

Jeff Maurer is a Partner and the CEO of Evercore Wealth Management. He can be contacted at maurer@evercore.com.
When the fourth quarter of 2012 GDP figure came in as a decline of 0.1%, it was disappointing icing on an already rather disappointing growth cake. But “the private economy is actually growing at a more acceptable rate of recovery,” claims John Apruzzese, a portfolio manager at Evercore Wealth Management.

Real GDP, or inflation-adjusted gross domestic product, grew 2.2% last year, but excluding government, he says, growth was closer to 3%.

Good news, for instance, came from auto sales, which have returned to their long-term average of over 15 million per year, compared to a low point of about 9 million during the crisis. Housing starts are on the same positive trajectory, climbing 36.9% last year to 954,000. Eight million jobs were lost during the crisis; so far in the recovery, about 5 million jobs have been created. The government, meanwhile, has lost about half a million jobs in that time. More evidence, says Apruzzese, that the “private economy is doing better than what [the economy] looks like when you include the government.”

According to the firm’s 2013 outlook, presented at their New York office last week, even after fiscal cliff uncertainty was put behind investors, still they’re “worried about fiscal drag after recent tax increases and more Washington budget negotiations.” But “we think the private economy has momentum,” he said, “and should be able to withstand some more fiscal drag.”

When the private economy is strong, corporate profits are strong, and investor confidence follows. Keeping in mind the distinction between government growth and private growth may help investors to take risks, which Apruzzese says are becoming more necessary in order to earn income. “You have to go out over 7 years in municipal bonds to earn 2%, or the rate of inflation,” he notes. That pushes investors to take on more risk to earn a return, and the private economy’s growing strength is starting to encourage them to do so.
The Best Defense is A Good Defense

by Brian Pollak and Gary Gildersleeve

“I used to think if there was reincarnation, I wanted to come back as the President or the Pope or a .400 baseball hitter. But now I want to come back as the bond market. You can intimidate everyone.”

— James Carville, Clinton campaign strategist

Investors are still intimidated by the bond market, but now by its potential downward price weakness instead of its ability to bully. Long considered the core defensive class in almost every asset allocation, bonds are trading at historic lows and investors are increasingly worried that they will lose purchasing power if interest rates rise, a real possibility as the Federal Reserve keeps monetary policy loose. Indeed, many investors are starting to ask why they should own bonds at all.

We believe that bonds should remain a key part of a balanced asset allocation, but that investors should change the way they think about the asset class and its associated risks. It’s worth striving for a little more yield, while positioning portfolios to withstand some of the worst outcomes. In today’s low interest rate environment, identifying ways to reduce interest rate risk and increase yield to levels above current inflation is a challenge.

Investment grade bonds used to be the anchor against the wind in most investors’ overall portfolios. They typically provided more attractive yields than U.S. Treasuries and a relatively assured return of principal, while offsetting the impact of equity market declines in balanced portfolios. Many investment advisors, encouraged by the Federal Reserve’s interest rate policy and the anemic yields available, are recommending that clients forsake bonds and take on greater risk.

But what if the wind turns? Investment advisors as a whole have been expecting higher rates for the past three years, but yields have continued to trend lower. Further, and despite rallying equity prices worldwide and improving domestic economic news, many of the issues that have preoccupied investors over the past few years continue to loom. The European Union and the U.S. Congress, to take two obvious examples, have not reached real resolutions on any front.

If a sudden, negative event occurred, a portfolio of relatively short-term investment-grade bonds, which still provide relatively attractive yields, would fill the void, providing stability and possible price appreciation in the face of a large equity downturn.

We complement that with a portfolio of higher yielding, more credit-sensitive bonds that are exposed to less interest rate risk. Accepting more credit risk
seems to us preferable now to taking on greater
duration risk. Yes, credit risk, especially in the housing
sector, was a big culprit in the market mayhem of
2008 – but corporate, municipal, and individual
balance sheets are in much better shape today than
they were in then. In addition, credit spreads in the
mortgage, corporate, and municipal markets are near
or above historical norms, and still far from their
record low levels, relative to risk-free securities,
achieved in the early part of 2007. Credit strategies
can be employed with relatively low levels of duration,
or interest rate risk, meaning that the portfolio
would mature in a fairly short time frame, allowing
reinvestment in a higher-yield environment and limiting
the effect of higher inflation.

We believe a basket of these strategies makes the
most sense, allowing for diversification of credit risk,
manager risk and interest rate risk. The current asset
allocation at Evercore Wealth Management to our
credit strategies allocation consists of a residential
mortgage-backed securities strategy that mixes
both government-guaranteed and non-guaranteed
mortgages, a leveraged loan portfolio that specializes
in LIBOR-based floating rate loans issued by
corporations rated below investment grade, and a
short duration, high-yield bond strategy, such as that
currently employed by the Osterweis Strategic
Income Fund and discussed on page 11 by manager
Carl Kaufman.

In aggregate, these strategies have a below two-
year interest rate duration and approximately a 5%
yield, compared with a five-year duration and around a
2% yield for most taxable broad-based bond funds.
We are taking more credit risk to get those yields, but
we believe it is prudent in the current environment to
diversify between credit and interest rate risk.

The combination of core bonds with these other
supplemental strategies produces a reformulated
defensive portfolio, but not one that’s just defensive
against deflation and equity declines. This portfolio
also serves to provide a more diversified return stream
during periods of inflation or rising interest rates.

Brian Pollak is a Managing Director and Portfolio Manager
at Evercore Wealth Management. He can be contacted at
brian.pollak@evercore.com.
Gary Gildersleeve is a Partner and Portfolio Manager. He can be
contacted at gildersleeve@evercore.com.
A Fresh Start for California

by Howard Cure

California relies on its richest residents. Even before the passage of Proposition 30 on November 5, 2012, 15% of the population was accountable for 80% of the state’s tax revenues. Now they are subject to the highest income taxes in the country. But for high net worth investors, an improved bond outlook may be something of a silver lining.

Proposition 30, which allows the state to increase personal income tax of high income taxpayers for seven years and increase sales tax for all consumers for four years, is projected by the California Department of Finance to boost the state’s revenue base by more than $6 billion annually through fiscal year 2017 and by smaller amounts for the following two years.

The additional revenues will be available for a wide range of purposes, including funding existing state programs, schools and community colleges, and paying state debts. Future actions by the state legislature and the governor will determine the exact allocation of the funds. While the tax changes are temporary, the state now has some time to institute real fiscal reform.

The increase in the state income tax rate for high-income earners will make it increasingly difficult to diversify a municipal portfolio into out-of-state credits for California residents, due to the high hurdle to compensate in yield for the loss of tax benefits from buying out-of-state bonds. But the state is large and economically diverse with varied regions and a multitude of medium and large-size issuers that can provide a real range of in-state choices for investors. In addition, the higher tax rates will potentially increase demand for California paper, which will reduce yields for new bond issues.

At the same time, the state’s economy is improving. The unemployment rate, while still higher than that of the United States as a whole, has been declining for more than a year, thanks to moderate growth in private sector employment. The housing market has made a comeback in many, though not all, parts of the state.

The bond market has recognized the improving financial condition of the state, as demonstrated by the precipitous decline in spreads on Californian general obligation bonds over the past three years. The most recent catalyst to lower yields was the upgrade by S&P to A from A- on January 31, 2013, and consistently strong fund flows.

10-Year California General Obligation Bond Spreads Against Significant Rating Events

Collectively, the state’s prior budget cuts, temporary tax bump, and improving economy will cut the budget deficit to $1.9 billion, according to the nonpartisan Legislative Analyst’s Office, a big drop from its estimate of $25 billion made a just two years ago. Of course, this now seemingly manageable deficit is also dependent upon lawmakers restraining program growth and not reversing existing cuts.

Howard Cure is head of municipal bond research at Evercore Wealth Management. He can be contacted at cure@evercore.com. To view his full report on the California outlook, visit http://www.evercorewealthmanagement.com/news/perspectives.php.
**Editor’s Note:**

The Osterweis Strategic Income Fund invests primarily in income-bearing securities, which can include a wide range of debt and dividend-paying equity securities but emphasizes what it perceives as the most attractive sectors at the time. The goal is to deliver a fixed income fund that can provide attractive long-term returns by strategically managing both interest rate risk and credit risk throughout market cycles. Here we interview Carl Kaufman, manager of the fund and the lead manager for fixed income strategy at the firm.

**Q:** Your fund is more concentrated than those of many of your peers. How do you select the bonds in your portfolio?

**A:** First, we look at the market as a whole and determine what sectors of the market offer the most attractive return relative to risk. We then take an equity-like approach to selecting individual issues. We look at bonds issued by companies that we feel comfortable with in terms of cash flow, leverage, management and price. We buy issues one at a time, so we know the companies very well. We are also very price sensitive and very patient in waiting to buy at the right price.

**Q:** Your focus now is on shorter-duration, high-yield bonds. How do you view the associated risks?

**A:** Many people get concerned when they hear the term high yield. People think that high yield equates to high likelihood of default. We think that with good credit work, we can find companies that may have lower quality ratings, but actually have good company fundamentals and offer attractive yields on their bonds. We have also had great success with a number of companies that many investors overlook just because they are not rated by either S&P or Moody’s. A company that is not rated is not necessarily a bad company. To sum it up, we believe that if we buy issues from companies with good businesses and cash flow, we should do pretty well over the course of a cycle.

**Q:** What do you see as the outlook for these assets in this continued low-yield environment?

**A:** Due to the fact that we are in a long-term deleveraging cycle, we may have very slow economic growth and possibly low interest rates for a long period of time,
barring a major war or other exogenous event that could spur faster growth. In this slow growth environment, it is important to invest in strong companies that produce free cash flow and have improving credit fundamentals. If we do stay in a low interest rate environment, the higher yields in non-investment grade bonds will continue to be attractive.

Q: You have had a sizable allocation of cash in the portfolio for some time. Is cash a core holding or a tactical investment?

A: It is relatively high now (approximately 14%); a three- to five-percent allocation is what we would consider normal. That said, the cash holding can be tactical and is dependent on flows coming in and out of the fund. Right now, we want to have cash on hand should we see a spring market correction, as we have seen in the past. The cash allows us to act quickly should buying opportunities present themselves.

Q: Other than high-yield bonds and cash, what else does the fund invest in now?

A: We also like convertibles, including both equity sensitive and busted convertibles. We particularly like attractively priced equity sensitive convertibles when we can find them. Occasionally we will buy asset-backed paper. We may buy floating-rate bonds when they are out of favor and yield much more than fixed rate bonds, thereby giving us a cheap floating-rate option.

Q: What is your long-term view of the broader bond market? What would you say to investors who are concerned about beating inflation when yields remain so low?

A: Generally speaking, individual investors should ideally try to keep up with inflation and get a return on top of that. Just trying to keep up with real inflation can be a challenge at this point because the official inflation numbers may not reflect what an individual is actually experiencing. We don’t think you will see a rise in official inflation numbers anytime soon and that could result in low investment-grade returns for quite a while.

For now, I think investors should temper their return outlook lower and not stretch for yield by investing in low-quality companies or going out longer on the yield curve. Investors should, however, be ready to act if there are market corrections and opportunities to buy some higher yielding issues as they present themselves.
The Quest for Growth

by Keith McWilliams

Some high net worth investors start and end goal-setting conversations with a clear order: “Make me money.” While the wealth manager’s job is to balance the search for return with the exposure to risk, this is still a reasonable demand. Designing a long-term investment strategy, assessing risk, and properly minimizing the impact of taxes significantly contribute to asset accumulation. Identifying opportunity, especially challenging in an era of tepid GDP growth and major consumer deleveraging, is important too.

Many private investors are still in a defensive crouch, four years into a bull run in the equity markets. They are fearful for the United States and developed economies in general, and additionally alarmed by the aftermarket dramas in social media IPOs. At the same time, they are becoming worried that they have missed the moment. A great rotation back into equities may now still be in its infancy, however. Net investor outflows from equity mutual funds persisted from mid-2011 through December 2012 and have just started to reverse in January. Inflows into bond funds have continued throughout that period and still have not reversed.

The places to look for growth may not be readily apparent. The focus to date by equity investors has been on the relative safety of dividend-paying companies. But many of these dividend-paying stocks may now be overpriced. Growth sectors are more likely to benefit when economic growth accelerates.

The industrials and information technology sectors are trading at a 5%-10% discount to the price/earnings ratio of the S&P 500, while sectors generally perceived as safer, including utilities, telecom and consumer staples, are trading at 10%-30% premiums to the S&P 500. This anomaly should eventually reverse. Industrials and tech are likely to be beneficiaries of deferred corporate spending loosening up and the U.S. manufacturing renaissance, with new plants opening and jobs being repatriated onshore. Bill Vaughn discusses this in detail on page 15.

From a West-Coast standpoint, the dot.com boom and bust of the last decade taught us that great early stage spaces and companies don’t necessarily make great investments for the long-term oriented investor in the public markets. The more lasting returns come from the commercialization phase of corporate growth, when companies start to show that they can build a sustainable profitable business model. Technology commercialization themes for more mature spaces include software-as-a-service, storage, network security, business intelligence, so-called big data companies, and, of course, mobile computing. Ken Sena takes a look at the intersection of online travel sites and electronic channels on page 4.

Energy constitutes another promising sector as shale oil and natural gas cheaply fuel our manufacturing renaissance. And with the housing sector clearly turning, further gains to consumer discretionary sectors seem likely.

From an asset class standpoint, small cap stocks have merely matched large caps in the recovery, making them an interesting bet. Post recessions, they usually lead the market, thanks to their ability to borrow inexpensively to
fund very targeted growth. Small business bank lending restrictions are still holding these stocks back, but signs in recent months suggest that this may be easing. When interest rates begin to climb, banks will be further induced to lend, which could in part fuel a small cap advance. They are also less affected by a strengthening U.S. dollar than are multinationals with their export exposure.

In emerging markets, where we invest half of our international allocation, a theme of note is the rise of the new middle class. The growth areas in these economies, which one could argue have emerged already, are consumer discretion and information technology. This is in contrast to the traditional value approach, which concentrates on the largest, most liquid dividend payers involved in the infrastructure of the emerging country, such as the state-run oil company, telephone company, railroad and brewery. It’s worth noting that emerging market valuation ratios are generally lower than those in the developed economies, while their growth rates are higher, and that many of the individual countries are now creditors of the United States and other developed countries.

At Evercore Wealth Management, we seek growth for clients with moderate risk tolerance in 50% of our asset allocation, while diversifying risk by allocating the balance among defensive assets, credit strategies, diversified market strategies with lower correlation to stocks, and illiquid alternatives, as individual and family client circumstances warrant. For clients who want and can afford to take on more risk, we seek growth in 70% of the portfolio and will also suggest more illiquid investments. We are confident that, with this approach, we are able to serve the best interests of our clients, in the context of their individual goals and attitudes to risk – including those who charge us first and foremost with making them money.

Keith McWilliams is a Partner at Evercore Wealth Management and head of the West Coast region. He can be contacted at keith.mcwilliams@evercore.com.
**Beneath the Soil**

by Bill Vaughn

The resurgence in the U.S. energy industry is gathering strength. Companies like Schlumberger Limited are leaders in technological developments, including new techniques such as fracking, which are boosting domestic energy production. Crude oil production increased by 790,000 barrels per day last year, the largest increase in annual output since the beginning of U.S. commercial crude oil production in 1859.

This boom has led to a recovery in jobs in the energy sector and in regions with greater energy activity. Job creation from Texas to Wyoming has been strong. The unemployment rate in North Dakota, for instance, is just 3.3%, or less than half the 7.7% national rate. Companies like Oil States International are providing workforce accommodations and logistics for new workers flocking to these regions.

Increased energy supply keeps energy costs down. Many manufacturers incur significant energy costs, so the savings can be meaningful. Natural gas prices are two to three times higher in Europe and Japan. This gives U.S. manufacturers a global competitive advantage.

As a result, manufacturers are moving back to the United States. For example, Nucor Corporation, a North Carolina-based specialty steel maker that shut down a plant in Louisiana and moved its operations to Trinidad in 2004, recently announced that it would build a $750 million plant in Louisiana, citing affordable domestic natural gas as the driver.

The impact is even stronger for other industries. Natural gas is used as a raw input to make chemicals, fertilizers and plastics. The rail industry is another case, with record levels of energy transportation demand; Union Pacific reported a 69% increase in crude oil volumes last quarter alone.

These factors have spurred increased manufacturing activity. Manufacturing as a percent of U.S. GDP, which has been falling for decades, has now risen for the second straight year. U.S. labor productivity, adjusted for inflation, is now significantly above the global average. This, as Keith McWilliams describes on page 13, is the American manufacturing renaissance.

Accordingly, there is an increase in skilled blue-collar jobs, after the losses incurred in the financial crisis of 2008. Workers who have borne the brunt of the worst of the weak job market the past several years are at least seeing a brighter future.

The International Energy Agency now projects that the U.S. will surpass Saudi Arabia in oil production within 7 years and achieve energy independence within 10 years. We currently import 37% of our oil, down from 60% four years ago. This will help lower our trade deficit and help protect us from geopolitical events that may interrupt global oil production or transportation.

There are concerns, however. Many people worry that fracking can contaminate groundwater. In addition, President Obama has said that climate change will be a higher priority in his second term. It may be that carbon-based energy projects, like the Keystone pipeline, will receive higher scrutiny from regulators, but we doubt that this trend will be reversed. The advantages are just too significant.

The longer-term impact of robust U.S. energy and manufacturing industries is positive for the economy as a whole. Jobs are created; consumer and housing demand recovers, giving the economy positive momentum. Public sector finances are also repaired with higher tax receipts. Already, some states, including Texas, are seeing much bigger than expected budget surpluses and are enacting tax rebates and increased infrastructure spending.

For investors, this powerful trend does not mean that every company in these areas will make a successful investment. It is important to thoroughly examine the investment fundamentals, valuation and outlook for each company individually. Now there are a greater number of investment candidates worthy of further examination.

---

*Bill Vaughn* is a Partner and Portfolio Manager at Evercore Wealth Management. He can be contacted at vaughn@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.

Contacts:

**NEW YORK**
Evercore Wealth Management
55 East 52nd Street
New York, NY 10055
212.822.7620

**MINNEAPOLIS**
Evercore Wealth Management
150 S. Fifth Street, Suite 1330
Minneapolis, MN 55402
612.656.2827

**MARTHA POMERantz**
Partner
612.656.2821
martha.pomerantz@evercore.com

**SAN FRANCISCO**
Evercore Wealth Management
425 California Street, Suite 1500
San Francisco, CA 94104
415.288.3000

**KEITH MCWILLIAMS**
Partner
415.288.3010
keith.mcwilliams@evercore.com

**LOS ANGELES**
Evercore Wealth Management
601 S. Figueroa Street, 44th Floor
Los Angeles, CA 90017
213.443.2620

**MICHAEL O'BRIEN**
Partner
213.443.2622
michael.obrien@evercore.com

**ALINE SULLIVAN**
Editor
203.918.3389
aline@kensingtonprivate.com

**EDITORIAL AND MEDIA**
info@kensingtonprivate.com

Our firm is founded on four core principles
Independent Advice | Direct Relationships | Planning & Investment Expertise | Partnership Values

For more information, please visit
www.evercorewealthmanagement.com

**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 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 assessed before determining 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. Past performance does not indicate future results. Evercore Wealth Management is compensated for the investment advisory services it provides, generally based on a percentage of assets under management. In addition to the investment management fees charged, clients may be responsible for additional expenses, such as brokerage fees, custody fees, and fees and expenses charged by third-party mutual funds, pooled investment vehicles, and third-party managers that may be recommended to clients. For more information on advisory fees, please refer to Evercore Wealth Management’s Part 2 of Form ADV, which is available upon request. 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 to 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. Trust, estate and custodial services are provided by Evercore Trust Company, N.A., an affiliate of Evercore Wealth Management.

IRS Circular 230 Disclosure: Pursuant to IRS Regulations, we inform you that any U.S. Federal tax advice contained in this communication (including any attachments) is not intended or written to be used, and cannot be used, for the purpose of avoiding IRS imposed penalties.