Investing in the Changing Economy

Integrating Pre-Transaction Planning

Baby Boomers: A New Perspective on Home

Roger Altman: New Drivers of the Changing Economy

Q&A with Tim Evnin & Charlie Ryan

Blending Families through Communication, Trusts
Committed to meeting our clients’ financial goals, and to earning and sustaining their trust

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A Message from the CEO

Change is in the air, as will be immediately apparent to regular readers of Independent Thinking. This new design captures and reflects our latest thinking as we expand our capabilities across the breadth of wealth management. Dig a little deeper into these pages here and at our rebranded website, www.evercorewealthmanagement.com, and you’ll get a sense of our organizing principles. I’d like to share with you some of my thoughts on each:

GLOBAL INVESTMENT MANAGEMENT

We are an investment management firm, first and foremost. We are proud of our performance and I am pleased to say that it has benefited our clients.

In addition to regular articles by our Chief Investment Officer, John Apruzzese, starting with this cover story, you’ll see a number of features on global investing in every issue of Independent Thinking – ranging from our outlook for our proprietary strategies, to the perspectives of our Evercore colleagues, to those of our carefully selected external managers.

In this issue, Roger Altman, the Founder and Executive Chairman of Evercore, shares his thoughts on the outlook for the U.S. economy. We also interview two of our own partners, Tim Evnin and Charlie Ryan, who co-manage our robust core equity portfolio and The Wall Street Fund, a publicly traded mutual fund.

STRATEGIC WEALTH PLANNING

Every investment decision we make is on behalf of people – individuals and families – with whom we have real relationships. You entrust us to help maintain your lifestyle, secure your retirement, protect your family, and establish your legacies. That’s an honor and a responsibility that we take very seriously. We make sure you know what to expect – after the real impact of taxes, fees, and inflation – and how to plan accordingly, now and as circumstances change.

You’ll see articles in every issue by Chris Zander, our Chief Wealth Advisory Officer, and by other members of our multidisciplinary teams, including experts in investment management, tax, financial and estate planning, and in philanthropic strategy.

TRUST AND FAMILY WEALTH SERVICES

Protecting your family and your business and philanthropic interests often involves creating and managing the right trust structures. Through Evercore Trust Company, N.A., we are able to offer our clients a range of trust and fiduciary services, including some, such as special needs/special purpose trusts, that can be difficult to find elsewhere. We will consider some of these in depth in futures issues of Independent Thinking, as well as the unique needs of large, multigenerational families, a growing area of focus at our firm.

PERSPECTIVES ON WEALTH

We are also investing in expanding our educational programs and seminars at Evercore Wealth Management, to engage our clients, share our latest thinking, and learn from each other. You’ll read here in these pages two complementary perspectives on blended families, and one – mine – on the challenges and opportunities facing aging Baby Boomers.

All of these efforts are underpinned by our shared values at Evercore and our commitment to serve the best interests of our clients, always. I can’t stress enough that wealth management, as it should be practiced, fully integrates investment management and financial planning. It remains as simple, and as complicated, as that.

I am delighted with Independent Thinking and our public website. We are also making progress in the rollout of our new client site, albeit not at the pace that we had originally anticipated. We now expect to launch the site by the end of this year and will communicate our progress regularly to our clients.

All told, it looks like an exciting fall. There is a lot happening here these days, so please do visit our website frequently to check on upcoming events and our latest thinking. As always, do not hesitate to contact me, or any of my partners at Evercore Wealth Management, with any comments or questions you may have. We very much welcome your engagement.

Jeff Maurer
Chief Executive Officer
Strong corporate profits, fueled in large part by surging technological advances, suggest that the economy is healthy and the economic future is bright. But the Federal Reserve is preoccupied by the plight of the millions of Americans left on the side of the road in the recovery. This dramatic divergence between strong businesses and weak employment is rapidly altering the investment landscape.

It is our job to find and invest in the winners and avoid the losers that will result from the dynamic structural changes that are coursing through the economy. In addition to analyzing and forecasting aggregate U.S. economic activity, we like to dig into the data and its impact on industry sectors and individual companies.

S&P 500 index aggregate profits now total just over $1 trillion, up from a pre-recession high in 2007 of $725 billion. This 50% increase in profits has been the fundamental driving force behind the bull market. The rate of growth is, of course, not evenly spread across the economy. Instead, the information technology and consumer discretionary sectors are the two main drivers of this recovery. Profits from both have more than doubled since 2007, to collectively account for almost a third of total corporate profits (with technology contributing almost double, at 20% of the total).

Employment, in contrast, has languished. As Roger Altman writes on page 8, this represents a long-term threat to the economy. Even in technology, jobs are shrinking. That’s surprising, even after taking into account the loss of domestic tech jobs as companies move in-house computer operations to the Cloud and the millions of jobs created in China and elsewhere to manufacture the billions of smart phones and tablets sold in recent years. Total technology employment is actually down 2% since 2007.

Growth since 2004, Indexed to 100

*Tech Industry Payrolls represents the aggregate of the following payroll sectors: Computer and Electronic Product Manufacturing, Electronics and Appliance Stores, Telecommunications, Data Processing, Hosting and Related Services, & Computer Systems Design and Related Services

Source: Bloomberg and capital IQ
The divisions today are as stark as they were in the Industrial Revolution, arguably even more so. Google, Facebook and other social media companies are simply generating profits relative to the numbers of their employees on a scale that has never been seen before. Google is currently generating $250,000 of profits per employee and Facebook is generating over $500,000 in profits per employee. And that’s just the beginning. The truly transformative power of technology is not so much the direct economic growth of the tech businesses themselves but the effect that they have on other industries, as innovations are disseminated and implemented throughout the economy.

As investors, we are constantly on the lookout for companies that are early adopters of technology or stand to benefit from technological innovation. American Tower, for example, is growing rapidly and reporting high profitability as it supplies consumer demand for bandwidth from ever-increasing smart phone usage. United Healthcare is a leader in a laggard’s race, as the healthcare industry finally joins the modern world. (The medical profession is the last to get rid of its paper files.) Very useful innovation does appear to be accelerating. The progress toward a driverless car, for example, is moving far faster than could have been imagined a few years ago and the ripple effects of that development are likely to be enormous. NXP Semiconductor is a leading supplier of specialized chips for many automobile applications including a future automobile direct communications network.

While innovation advances, jobs have not followed. The Federal Reserve remains preoccupied, as it generally has been, with employment. Investors are left a new landscape characterized by strong corporate earnings and very accommodative monetary policy. The recently confirmed Vice Chairman of the Fed, Stanley Fischer, who we expect will have significant influence over policy, observed that supply-side developments, notably the decline in the rate of long-term investment in capital stock by U.S. corporations, has been troubling, especially in the context of very low real and nominal interest rates. CEOs have been slow to commit to long-term investments and have preferred to spend free cash flow on stock buyback. This is helpful when prices are low, but counterproductive when share prices move above long-term averages, as is currently the case.

For us, the primary focus will be on future productivity growth, both in the United States and globally. An uptick in the long-term growth rate of productivity would justify the current valuation of the equity market and allow our economy to grow out of the debt overhang. Productivity will continue to generate increasing profits, even as it destroys more jobs than it creates, and the short and medium-term outlook is positive.

Although this imbalance would be dangerous, to our economy and our society, if it were to continue over the long term, history would suggest patience. The modern equivalent of the factory jobs that replaced the farm jobs in the Industrial Revolution will come. As Mr. Fischer says, it is unwise to underestimate human ingenuity.

John Apruzzese is the Chief Investment Officer at Evercore Wealth Management. He can be contacted at apruzzese@evercore.com.
The sale or transfer of a business requires months or even years of detailed business planning. It is the culmination of so much work, and represents so much sweat and sacrifice: Why would anyone leave a single manageable detail to chance? However, by failing to create a corresponding wealth plan, business owners of all types can leave considerable sums on the table. It’s understandable, of course. The owner – whether an entrepreneur, an executive with a significant shareholding, a private equity or venture capital investor, or a family office director – is so wrapped up in the business itself that the treatment of the eventual sale proceeds can be the furthest thing from his or her mind. But that deal won’t be a true success if it isn’t structured to meet the needs of the individuals and families involved.

For anyone even contemplating the sale of a business, the time to plan is now. As remote as they might seem in the run up to a transaction, the seller’s goals for lifestyle spending, investment, family wealth transfer, charitable giving, and all the related tax issues, need to be considered – and integrated – well in advance. Ideally, the corporate and wealth management advisors will work together. In the heat of the deal, there will be little time for thoughtful planning, but there will be all the time in the world for regret.

Consider the experience of an entrepreneur in her late 40s who sold her small biotechnology company for mostly stock, in the expectation that the value of the acquiring company would continue to rise. Unfortunately, she did not fully grasp the ramifications of the relevant securities laws nor assess her post-deal objectives. First, she accepted a deal comprised mostly of stock and a small cash component that together was higher than some all-cash offers. Worse still, the shares were subject to very onerous resale restrictions over the course of the next few years.

By the time she consulted a wealth advisor, she had not fully appreciated the relatively low liquidity in the stock, which made direct hedging almost impossible. Before the restricted period had elapsed, the acquiring company fell on hard times and decreased almost 90% in value. Had her needs been more thoroughly analyzed from her personal financial perspective and the deal been structured to weigh more heavily to cash, she could have funded her lifestyle and new business requirements for long enough to get her next company off the ground. Instead, she was left with no choice but to abandon her entrepreneurial plans and take a job with a big company.

Advance planning can make an enormous impact, to the seller and his or her family and philanthropic interests. The happier experience of a serial venture investor evaluating a late-stage start-up serves as a case in point. He knew, thanks to time already spent with his advisors, that his current financial position was sufficient to meet his long-term lifestyle objectives and was looking for opportunities to transfer wealth to his heirs. Upon identifying the
next promising investment opportunity, he directed 50% of the initial $2 million investment in the start-up to a grantor-retained annuity trust, or GRAT, for three years, which he believed was a reasonable time frame for the firm to realize its potential.

He was right. The company went public through an initial public offering, or IPO, and substantially increased in value during that time. At the termination of the GRAT, $15 million in stock was successfully distributed to three grantor trusts for his adult children, free of gift tax. When a portion of stock was sold, he, as grantor, was required to pay the full income taxes due on the sale (which is essentially making an additional tax-free gift to the trust) and the trust retained the full principal. The investor then, with the help of his advisors, decided to fully diversify the trust (and step-up its tax basis) by substituting current high-basis cash and fixed income assets into the trust in return for the highly appreciated shares. This swap provided the trustee and investment advisor with the flexibility to create a long-term portfolio allocation free of concentration and tax restrictions for each beneficiary.

Now in possession of the highly appreciated shares, the investor contributed them to a private family foundation to seed the family’s philanthropic mission, as determined by him, his wife and his three adult children. The foundation’s trustees sold the shares without recognition of a capital gains tax, and the investor received a charitable income tax deduction based on the fair market value of the gift.

Obviously, he was fortunate in the share price performance of the company, while the biotechnology entrepreneur was not. Without proper wealth planning to complement his investment decision, however, the $15 million effectively passed to the trusts would have been subject to a combined federal and state estate tax of more than 50 percent.

Each transaction is different, as are the goals and constraints of individuals involved. The decision around the actual proceeds of a transaction should include an assessment of the differences in value and associated risk, deal terms, and the potential impact of securities law restrictions, which can significantly affect the ultimate value.

While utilizing the proper trust vehicles is important to ensure success of the plan, including a long-term governance and asset protection structure for the assets, the selection of an undervalued asset with long-term potential and the timing of the gift of that asset are likely to be the most critical factors in the success of any wealth transfer strategy. Examples of these assets include: early stage direct venture capital or private equity investments (with potential for an IPO or sale), private business interests and the general partner’s capital and carried interest in alternative investment organizations, which are similar to a call option on the future success of the fund.

While the solutions and techniques available vary by the individual’s circumstances and the immediacy of the transaction situation, careful advance wealth planning will provide a thoughtful foundation from which to make sound decisions during the anxious times prior to a transaction.

Chris Zander is the Chief Wealth Advisory Officer at Evercore Wealth Management. He can be contacted at zander@evercore.com.
A New Perspective on Home:
Jeff Maurer on Baby Boomers Changing Domiciles

By Jeff Maurer
One of the pleasures in getting older can be expanding our horizons, to include a new life in a new place, while retaining our ties to our family, communities and even work. We may even be able to save our heirs and ourselves considerable sums in the process.

Although many affluent Baby Boomers will, like earlier generations, pick up sticks entirely and move south on retirement, increasing numbers of us seem to be mixing it up, renting and then buying vacation homes to enjoy an active lifestyle with our family and friends while remaining engaged with our communities and our work. Expanding travel options, ranging from JetBlue to NetJets and including all sorts of residence clubs, are helping to blur the lines between work and retirement, and keep families together across the generations.

If we choose our destination carefully, we can consider converting the vacation home to a permanent residence for tax purposes, enjoying significant opportunity to save money on income taxes and on gift and estate taxes, while still spending time in both places and continuing to explore new horizons.

The lifestyle advantages of a winter in Florida or Nevada, or for still passionate skiers, Wyoming, over, say, New York or Minneapolis, are obvious. The tax advantages can be equally compelling. For example, a New York couple in their 60s with an estate of $25 million and adjusted gross income of $1 million is charged an effective tax rate of 40.2%, paying $65,894 a year in state income tax alone by our calculations (in addition to the $355,726 that they owe the Federal government each year). If the same couple established their domicile in Florida, they would cut their annual tax rate to 33.6%. More significant, they would reduce the tax on their estate by almost $2.085 million (assuming the Federal estate tax exemption of $5.34 million per person or $10.68 million for a married couple); leaving their heirs with considerably more than if they had stayed in New York.

Lower or no state income taxes can translate into higher real estate prices and property taxes in many locations but, for many of our clients in New York, New Jersey, Connecticut, Minnesota, California and other high-tax jurisdictions, the trade-off can be well worth the move, at least on the financial front. Our clients already domiciled in Florida want to preserve their tax status and are careful that their summer vacation homes do not turn into permanent residences.

Less appealing for most is the prospect of leaving family, and friends, especially as many affluent Baby Boomers tend to be very engaged members of their communities. But again, expanding transportation options can make these choices less absolute than they once were, both for retirees and for those still engaged in the workforce. When adult children realize the extent of the savings on the estate, they are usually more than willing to keep houseplants watered over the winter (and are generally happy to visit then too).

State tax laws can be complicated and states like New York do not let their taxpayers go without a fight. For me and my wife, work and young grandchildren in New York will continue to trump retirement for the foreseeable future. But we would rather read to those children about the weather described by Dr. Seuss in The Cat in the Hat (“The sun did not shine. It was too wet to play. So we sat in the house. All that cold, cold, wet day”) than experience it on a daily basis again this winter, so a vacation home just might be in our plans.

Jeff Maurer is the CEO of Evercore Wealth Management. He writes regularly on the opportunities and challenges facing Baby Boomers. He can be contacted at maurer@evercore.com.
New Drivers of the Changing Economy

By Roger Altman

Total household wealth in the United States has surpassed the peak recorded in 2007, job creation has surged, and GDP has regained the 5%, or $1 trillion, lost to the financial crisis and subsequent recession. Our economic outlook is improving, more so than many Americans yet realize.

The biggest driver of this growth is consumer spending, typically 70% of U.S. GDP, and on track to gain about 3% this year. Consumer confidence is on the rise as well, fueled by the best job creation rate in 15 years and the lowest household debt-to-income ratios in more than 30 years.

Domestic energy production has also been a major contributor to these gains. After four decades of decline, the United States looks set to become the world’s largest producer of oil and gas by next year and should be a net exporter within four years. New technologies are allowing us to access huge, new supplies of natural gas which is, at about $4.70 per 1,000 cu. ft., now cheaper here than anywhere else in the world. This newfound energy self-reliance is a boon for our political security, as well as for our economy, as we eradicate our dependency on foreign oil.

The surge in natural gas production has enabled us to reduce our use of coal, the dirtiest fuel, to produce electricity. At the same time, tightened regulation has encouraged car makers to improve their technologies and boost their mileage. All told, carbon emissions in the United States are down almost 10% in 10 years and further reductions look likely. After decades of degrading our environment, it seems that we are at last making strides in defending it.

U.S. manufacturing is also looking up, thanks to the increased use of technology in American factories and to rising wages in Asia, which have narrowed the cost-to-product difference, making our domestic production relatively more competitive.
The same technological advances mean that the manufacturing sector is unlikely to become a major source of new employment – only 668,000 of the six million manufacturing jobs between 2000 and 2010 have been recovered – but it does seem that U.S. manufacturing is again a stable part of our economy.

Many important social trends are showing signs of improvement, too. More than 80% of students complete high school now, an all-time high. Johns Hopkins University predicts that the rate will rise to 90% by 2020, reflecting the efforts of grassroots organizations to reform public schools. College completion rates are also improving, to almost 60%. We have a long way to go to significantly improve our international standing in education, but it seems that we are now heading in the right direction.

Other important trends, including violent crime rates and teen pregnancy rates (both down), and overall birthrates (up, including for children born to women with a college education), are all showing substantial progress. The consequences are a higher quality of life, reduced government costs, and a stronger economy.

Investors are right to welcome these developments: Our short- and medium-term economic prospects are bright, and many of us are realizing significant benefits. The banking system has been recapitalized and the housing market is on the mend, after being stripped of many of its excesses.

It is hardly surprising, however, that many Americans don’t yet feel that the economy has turned the corner. Apart from the continued gridlock in Washington, D.C., which is reason enough to despair, it is clear to everyone that lower-income citizens remain under severe pressure. While it appears income growth will improve soon, median household income is still about 8% lower than before the crisis, and the prospects for those without the education to compete in the new economy are relatively bleak.

We will all suffer if this state of affairs continues. If one-third of our society remains unable to fully participate in our economic life, our long-term outlook is shakier than any of us would wish, while the human cost is incalculable. We need to strengthen the social security net and improve the skills of our people.

Roger Altman, former Deputy Secretary of the U.S. Treasury, is the Executive Chairman and Founder of Evercore.
Editor’s note: Tim Evnin and Charlie Ryan are co-managers of Evercore Wealth Management Partners Account, the firm’s representative core equity portfolio. The portfolio, which currently holds 41 securities, has since its inception in February 2009 outperformed the S&P 500 and returned 30.37% net of fees in the past 12 months through August 31, 2014 (compared with 25.25% for the S&P 500). Tim and Charlie are also the co-managers of The Wall Street Fund, an equity mutual fund advised by the firm.

Q&A

Q: How do you manage the firm’s core equity portfolio?
TE: The selection process is rigorous, with each new idea championed by one of Evercore Wealth Management’s portfolio managers. We are fundamental investors, so it is critical that we understand the key drivers of each company presented and its management’s views on capital allocation. We are also long-term investors. If we are doing our job correctly, we should have low turnover and be tax efficient.

Q: How would you characterize your investment style?
TE: We use the fundamental process to analyze a business and think about what it is worth. This is as much an art as a science, and an approximation rather than an exact number. We then use this work to look at how the business is priced by the market. This gives us a sense if it’s right for our clients’ portfolios. Just because it is a good business does not mean it is a good stock to own. We are trying to find that gap between what we think a business might be worth and how the market is pricing it, absolutely and relatively to similar businesses.

Q: Does market capitalization matter?
CR: It does to some extent, but we will look at companies as small as $1 billion and up to the largest. At present we own both Apple, the biggest company by market capitalization, and AMC Networks, our smallest holding at about $4.5 billion. We do not believe that size is necessarily a determining factor in how a company should be analyzed or how it will perform in the market. It could be, but it is not always an important driver. There are simple big companies and very complicated small companies.

Q: Are client portfolios at Evercore Wealth Management customized?
TE: We customize, but there is a high degree of commonality among the portfolios. We have developed a priority list of companies, which totals about 55 at present. These all represent ideas that have been championed by one of our portfolio managers. It is their responsibility to keep their partners up to date on developments.

CR: It is from this list that all securities are generally selected for client portfolios. Client portfolios usually have 35-45 holdings. The flexibility to pick within the list allows for customization depending on a client’s other holdings, exposure through closely held businesses, biases, and the attractiveness of a company at a point in time.
Q: The investment performance of the portfolio has been strong. Why do you think that is?

TE: While it may sound a bit like an oxymoron, our portfolio is concentrated but also diversified. This, combined with the low turnover and the willingness to have very different industry exposure than the benchmark, is what we believe led us to outperform.

Q: Could you expand on that?

TE: Our view is that if you own too many companies or have industry weightings that hug the benchmark, it is very hard to have performance that is different from the market. We are willing to rely on our fundamental analysis and own the companies that are attractive to us, irrespective of industry or size. We are also happy to own companies that are not in any of the benchmarks. In our portfolios, with about 40 companies approximately equally weighted at cost, each holding is large enough to impact the portfolio as a whole if we are correct, but not so large as to undermine it if we are wrong.

We are careful in our portfolio construction and experienced enough to know that there are things we don’t know. So we will seek to make sure that we own companies at different stages in their life cycle and across different end markets and different industries. To us, this is intelligent diversification rather than diversification driven by a benchmark.

CR: Last, we mentioned low turnover. We try to be very patient. It seems that there is still a lot of money that sloshes in and out of stocks based on short-term events, whether market- or company-specific. For us, this volatility gives us an opportunity to buy into companies we like at prices that are reasonable if we maintain our long-term view.

Q: Can you give an example of this volatility at work?

CR: Just recently the tower stocks – the companies that own cellular towers and lease the space to carriers – were downgraded by an analyst who extrapolated a few data points into the future. The stocks fell. But if you have a long-term view and thesis about rising demand – and the incredible quality and franchise that these businesses have – a few data points about last month’s trends are just not persuasive.

Q: Is there anything else you would like to add?

TE: The equity markets have been strong these last few years, and we are very grateful that we have been able to outperform for our clients. We are encouraged that we continue to find good investments in this market.

Tim Evnin and Charlie Ryan are both Partners at Evercore Wealth Management. They can be contacted at, respectively, evnin@evercore.com and ryan@evercore.com.

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**Cumulative Return vs. Benchmark**

![Graph showing cumulative return vs. benchmark over time]

- Core Equity
- S&P 500 Partial 02/03/09–02/28/09

Portfolio Inception: 02/01/09
Source: SEI Performance Station
Time to Act in New York

Richard Ravitch

Editor’s note: Richard Ravitch, the court-appointed advisor to the bankruptcy judge in Detroit and former New York Lieutenant Governor, addressed Evercore Wealth Management clients in New York on September 8, 2014. Here are some excerpts from that discussion and his recent book: So Much to Do: A Full Life of Business, Politics and Confronting Fiscal Crises.

NEW YORK CITY

It’s been almost four decades since the New York City fiscal crisis. The city was on the verge of ruin following years of fiscal mismanagement when President Ford endorsed legislation, including federal loan guarantees. That was then. Today, it is nearly impossible to get federal legislation passed to address an individual city’s financial problems. Cities must rely on their own resources, along with accurate and realistic forecasts, to confront their challenges.

It’s important to note that the Ford legislation followed a number of lifesaving moves by the city itself, including the creation of the Municipal Assistance Corporation and the Emergency Financial Control Board; the appointment of a new deputy mayor for finance; new city and state taxes; layoffs, wage deferrals, employee contributions to their pension funds, and increased commitments by the pension funds to invest in city debt; an independent audit of the funds’ actuarial soundness; and a reduction in subsidies like the city’s support for its
higher education system. Together, these actions relieved the city’s finances until it could transform from its reliance on manufacturing to a more prosperous and diverse economy supported by finance, tourism, trade, media, arts, education and medical research, as well as a push into the technology sector.

The good news, for investors and residents, is that its experiences taught New York City to adhere to strict governmental accrual accounting. This much more accurately reflects the current financial situation than the approach used by most cities and states. In addition, there are a number of public and private fiscal watchdogs that regularly monitor the fiscal condition, both in terms of current operations as well as forecasting operating and capital budget needs. These watchdogs include the city’s Independent Budget Office, the City and State Comptroller, the New York State Financial Control Board, the Citizens Budget Committee and the Empire Center for Public Policy. It is unlikely, albeit not impossible, that New York will again get itself into the kind of trouble that it did in the 1970s.

THE METROPOLITAN TRANSPORTATION AUTHORITY

Editor’s note: Richard Ravitch was appointed chairman of the then distressed Metropolitan Transportation Authority, or MTA, in 1979.

Public transportation is governed by some stubborn facts. First, it costs more than private markets can provide through passenger fares. The rest of the system’s operating and capital funds come directly from local, state and federal governments.

Second, “public” means politics. Part of operating revenues come from rider fares, but every fare increase occasions a political ritual of posturing and protest, although funds are needed to keep the system running safely. Further complicating the situation is the power of the unions.

Today, the MTA is also grappling with its aging infrastructure during a continued period of diminishing federal assistance. It also must contend with infrastructure upgrades after the system was exposed to further damage from Hurricane Sandy and the need for storm preparedness. No one can question the importance of the public transportation system to the efficient functioning of the city’s economy. The multilevel government involvement in the financial and capital planning adds to management’s challenges. Finding the necessary combination of revenue streams from fares, tolls and various taxes is the key to providing stability to the MTA’s operations.

STATE BUDGET CRISIS TASKFORCE

Editor’s note: Richard Ravitch and Former Federal Reserve Board Chair Paul Volcker created the State Budget Crisis Task Force in April 2011 to address growing concerns about the long-term fiscal sustainability of the states and the persistent structural imbalance in state budgets, which was accelerated by the financial collapse of 2008.

To address the declining fiscal condition of states, the Task Force hosted national dialogues focusing on the most urgent areas of concern, including infrastructure, underfunded retirement promises, Medicaid and managing the impact of federal deficit reduction. Its conclusion in January 2014 was unambiguous: The existing trajectory of state spending, taxation and administrative practice cannot be sustained. The basic problem is not cyclical, it is structural – and the costs of inaction are high. To get people to engage in self-inflicted pain requires either extraordinary leaders or, more likely, extraordinary leaders and exigent circumstances.

The nation and its states have made social commitments that are admirable but exceed their current financial resources. The media focus is on national budget issues, but it is the states and their local governments that bear most of the responsibility for delivering essential services to our citizens. The time to act is now.

For information on future events and related topics, including the firm’s approach to municipal bond research, please contact Howard Cure at cure@evercore.com.
Blending Families Through Communication, Trusts

By Jewelle Bickford
My father was married three times, and my mother, twice. With six kids from different spouses, we were the epitome of what has become known as a blended family, although mixed-up would have been a better description for us. In 1960, few people were divorced and remarried. Today, however, approximately one-third of all weddings in America form stepfamilies. Although children of divorced parents are no longer unusual, successfully blending families can be enormously challenging, in both emotional and practical terms – and money can complicate that challenge further. But there is a great deal that couples and their advisors can do to foster harmony, minimize fears and sustain wealth.

At the heart of the planning effort is the couple that is driving the creation and, ultimately, the culture of the new family. They are the ones who will decide how and when to communicate their shared intent with the rest of the family, and how and when to engage children – both adult and minor – in the process.

Most people entering a second marriage understand the advisability of a prenuptial agreement and the need to change their will after marriage...

Most people entering a second marriage understand the advisability of a prenuptial agreement and the need to change their will after marriage, to provide for their new spouse. More complicated but still relatively straightforward is the need for careful estate planning for the couple. If, for example, one person has all the assets, making use of the other spouse’s gift tax exclusions and transfer tax exemptions is an important part of the planning process. Planning for LGBT couples can require additional considerations, depending upon the laws of the state where the couple resides.

Blended families are generally defined by the presence of children, whether those from prior unions or born into the new family or, as is often the case, a mix of both. Many parents begin the wealth-planning process with the presumption that equal inheritance is best and desired by all. But that may not be the case, depending upon who made the money, whether family trusts are involved, the amounts in question, and the age of the parents when they marry.

Consider the very different needs of adult children who have already been educated and those of young children just starting school. Others may have special needs or be supported in part, or in full, by their other parent. Children, like adults, often equate money with love, and all but the youngest children will know more about the parents’ relationships and the amount of the wealth involved than the parents might realize.

When parents communicate their intentions, it becomes the foundation for family interaction. Facilitated family meetings can help because no matter how much care and planning the parents give to structuring a family meeting, all too often issues arise – highly emotional issues that have been buried for years – which parents may not be prepared to address. Trained facilitators know how to deal with these events when they occur and can guide a family through them.

In my own case, if my father had used skilled facilitated communications with his newly acquired stepchildren, the family might have avoided costly litigation that served no one’s best interest after he died.

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Providing for a spouse’s needs while ensuring that assets eventually transfer to children is the usual goal in family estate planning. For blended families in which the spouse is not the parent of all or any of those children, trusts can provide effective planning structures.

For many blended families, the need to provide for a surviving spouse has to be balanced with the desire to protect children born outside that relationship. If, for example, a woman brings substantial assets, as well as children, to a new relationship and then dies, she would want to ensure that her husband can live out his life in comfort but that the remaining assets are then passed on to her children and grandchildren.

A Qualified Terminable Interest Property Trust, or QTIP Trust, enables her to do just that. Property passing to a QTIP trust is eligible for the marital deduction, so the property is not taxed at the death of the first spouse, leaving the entire amount available to support the surviving spouse. A QTIP trust provides income and discretionary principal to the spouse during his life and then distributes the remaining principal, after taxes, to her beneficiaries, namely the children from her previous marriage. At the death of the surviving spouse, the balance remaining in the trust can, after payment of estate taxes, be distributed to her children.

For some families, notably those with a significant age gap between the spouses, the QTIP doesn’t provide adequate protection. If, as we see often, an older man marries a much younger woman, their new life can eclipse his commitments to his children from his earlier marriage (particularly if they are close in age to his new spouse). Even if there is a prenuptial agreement in place, the outcome can prove markedly different than the intent.

Say, as is often the case, that prenup provides his second wife with their home and its furnishing after his death and provides his children, currently young adults, with all the other assets comprising his estate. Sounds reasonable, right? But several years go by and the couple buys a larger house and some valuable art. Now his liquid estate is worth a fraction of what it was and his wife stands to inherit significantly more than his children.

For this man, as for so many people in a similar position, an Irrevocable Life Insurance Trust, or ILIT, is an efficient wealth-planning solution. By establishing this type of trust and naming his children as trustees, the investor removes the trust and its value from his taxable estate. He then makes annual gifts to the trust, which the trustees use to purchase life insurance on his life. As the grantor of the trust, he dictates the terms of the trust and how distributions are made to the beneficiaries – in this case, his children. The use of the trust is particularly attractive, because trust property is generally excluded from the grantor-insured’s estate.

On his death, his wife will inherit their remaining shared assets, and his children will receive the life insurance. He and his entire family are more likely to enjoy a peaceful life in the interim, as well, knowing that these decisions have already been made and funded.

Each situation is unique, and a solid estate plan designed to accommodate individual and family circumstances is essential. In a blended family, consideration needs to be given to each spouse’s diverging interests and the impact those interests have on the overall estate plan. As Jewelle Bickford notes in the article on page 14, it’s important to take the time to identify and discuss individual objectives and plan how to communicate them with the extended family.

It’s also important to inventory assets and review both the beneficiary designations in retirement plans and insurance policies and any existing powers of attorney, healthcare proxies or living wills to determine whether changes need to be made. What will happen to your assets on your death? Is that what you want? What if your spouse or a child predeceased you? Would that change the disposition of your assets? These are just some of the challenging questions that need to be resolved.

At Evercore Wealth Management, we help clients be as specific as possible in their planning and avoid ambiguity. With open and honest communication, estate planning for the blended family can provide orderly, equitable, compassionate distribution of assets and hopefully strengthen the relationship between the surviving beneficiaries.

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