What Next? Investing in Turbulent Markets

Making an Impact: SRI & ESG Investing

Shh: Considering a Delaware Silent Trust

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The Case for U.S. Bonds

It’s Complicated: Private Equity Fees

Sustainable Investing: A Q&A with Dimensional Fund Advisors
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A Message from the CEO

So much for the summer lull. Investors pulled out of global equity markets in the two trading days post Brexit, resulting in a $3 trillion decline in market capitalization. But one week later the markets had largely recovered. Another week on and the S&P 500 index set a record high.

What next? That’s the question we pose in this edition of Independent Thinking. As professional investors, we have views – often very strong views – on the likely direction of the markets and on the prospects for specific securities. You’ll see some of those here. As the stewards of our clients’ wealth, however, we know that the very best counsel we can give is to stay focused on long-term goals. In other words, to borrow a British wartime saying: Keep calm and carry on.

That sounds easier than it is (the British struggled to take their own advice in the immediate aftermath of Brexit). Dramatic economic and political events can shake investor confidence to the core – it’s human nature to want to flee an environment that feels unsafe, in search of security. But the evidence overwhelmingly supports staying put, to preserve holdings and participate in subsequent market rebounds.

In short, periods of upheaval are simply not the time to change an investment strategy. They can, however, serve as a reminder of individual attitudes to risk or as a realization that, with age or for other reasons, those attitudes have changed.

Several articles in this issue address our approach to assessing risk tolerance, as we determine how to maximize each client’s chance of success in meeting their goals, on their terms. This is especially topical now, as many investors are choosing to take on more risk in search of yield. John Apruzzese, Sandy Panetta, and Stephanie Hackett each address aspects of our asset allocation process, while I focus in my regular column on the very real needs of aging Baby Boomers to make decisions in this low-growth environment around funding lifestyle and legacy goals. (Spoiler alert: Something has to give.)

Also in this issue are articles on private equity fees and an interview with Joseph Chi at Dimensional Fund Advisors, one of our carefully selected external managers, about the firm’s two sustainability funds. On a related note, Iain Silverthorne takes a deeper dive into socially responsible investing, something you’ll be hearing more about from us in coming issues. We also consider the pros and cons of a Delaware silent trust. They aren’t for everyone, but some families may benefit from the flexibility that they afford.

These are interesting times. And they are only going to get more interesting as we approach the U.S. presidential election. But we are going to hang on to our hats and help clients stay focused on what really matters, across the spectrum of their family, business, and legacy goals.

As always, please feel free to contact any of us at Evercore Wealth Management to discuss the topics in this issue or with any other questions or comments you may have.

We hope that this is a happy, healthy summer for you and your family.

Jeff Maurer
Chief Executive Officer
Globalization has lifted millions of people in the emerging world out of poverty and has reduced inequality at the global level.

Creative destruction, which the economist Joseph Schumpeter said is the essence of capitalism, is all around us – and it continues to accelerate. Technological changes are displacing old industries and creating opportunities that are magnified by globalization. Investors benefit from both corporate growth and low inflation, a byproduct of global competition.

Why then is economic growth now slowing? If creative destruction fosters innovation and growth, why have yields on sovereign debt declined to record lows? As the chart on page 8 shows, over $10 trillion worth of government bonds across 10 countries are now trading at
negative interest rates. Stocks have held up remarkably well, but volatility has increased and should remain at elevated levels.

Some of the reasons are clear: Productivity, labor force growth and inflation are the well-known components of nominal economic growth, and the growth rates for all three are in decline. Of these, productivity is by far the most important because it is the sole driver of real per capita economic growth and improving standards of living. The jury is still out on what is causing the recent deterioration in the productivity growth rate. Most likely, it relates to the growing dominance of the service sector over manufacturing. Either it is inherently harder to increase productivity in the service sector than it is in manufacturing, or productivity is not being accurately measured in the service sector. We believe the real answer contains elements of both – and that productivity growth is actually better than the official estimates.

Less clear is the relationship between economic growth and populism. Globalization, sparked by the fall of the Berlin Wall in 1989 and ignited in 2001 when China joined the World Trade Organization, has lifted millions of people in the emerging world out of poverty and has reduced inequality at the global level. But it has done little for the industrial working classes in the developed world, who have seen their livelihoods migrate to emerging markets or disappear altogether.

Indeed, the technological advances of the past few decades have cut far more jobs than they have created. Stagnant wages and, for white middle-age Americans, recent evidence of declining life expectancy caused by suicides and drug addiction, are among the grim consequences of growing inequality. (This same demographic was also hardest hit by the subprime credit bubble, in which many became grossly overextended.)

The recent rise of populist movements on both sides of the Atlantic is a wake-up call to investors. Just about all of us were surprised by the Brexit vote. Many seem equally surprised by the rise of Donald Trump and the enthusiasm for Bernie Sanders. Populist movements are also surging in France, India and Brazil.

Managing Innovation

If productivity is the driver of real economic growth, regulation is the brake. Uber and Airbnb are currently waging battles around the world as they disrupt vested interests in the traditional taxi and hotel businesses. Amazon and the big U.S. technology companies, including Facebook, Google and Microsoft, face government-sponsored opposition to their hegemonies in Europe and China.

Of course, some regulation is necessary to protect the public interest. There are, for example, many unsettled questions around security and privacy that will need to be fought over among regulators and lawmakers around the world, even at the expense of slowing the dissemination of some innovative products and services.

The challenge is to strike the right balance, so that we can capitalize on innovations while keeping the negative potential consequences to a minimum. It is not yet clear that governments are striking that balance.

A disproportionate amount of major technological innovation and commercialization happens in the United States because we have a relatively friendly small-business regime. However, impediments have been growing, notably on small businesses. That’s unfortunate, as startups and small businesses do the heavy lifting in figuring out business models that exploit new technologies and create opportunity. Indeed, most of the new jobs and productivity improvements in recent years have come from businesses with fewer than 50 employees.

There’s a great deal at stake, as extremely exciting innovations on the horizon hold the promise of boosting productivity and jump-starting the economy. Driverless cars, drones, robots, new disease therapies, and high-quality voice recognition are all tantalizingly close to broad-based implementation.

Investors in innovation must be careful not to be swept up in market enthusiasms, which can push valuations to unreasonable levels. We prefer to invest in companies in, for example, the semiconductor industry, which are creating the underlying building blocks for many of the new technologies.

In this low-growth economic environment, innovation and its applications offer investors some of the brightest chances of generating healthy returns.

– J.A.
Populism is not something that monetary policy can fix to inequality, as the wealthy owners of assets benefit from inflated asset prices and small savers are stymied by record low interest rates.

We will be watching developments closely. The United States is in relatively good shape, and we do not expect a recession anytime soon. We remain underweight in international equities in general and significantly underweight in international developed markets, including Europe. We see opportunity now in the U.S. stock market, especially in the technology sector. (See the related article on managing innovation and regulation on page 3.) We have no exposure to foreign currency-denominated bonds. Our defensive assets are generating positive returns and adding stability to portfolios in these volatile market conditions.

We lowered our capital market return assumptions one year ago and remain confident that our expectations are reasonable in light of current market conditions. If, however, the populist trend does gain majorities in the United States and other developed countries, we will need to further reduce our global growth expectations, expect interest rates to stay lower for longer, and further reduce nominal expected returns from most of the major asset classes.

John Apruzzese is the Chief Investment Officer at Evercore Wealth Management. He can be contacted at apruzzese@evercore.com.
Lessons from Florence: Preparing for Medical Emergencies Abroad

By Karen Francois

It’s difficult to make the best decisions or think clearly when faced with a stressful situation. Managing a medical emergency abroad, especially in a country where you don’t speak the language, is about as stressful as it gets. And it’s a critical time to make the right decisions.

The key is to be prepared, so before your trip consider some of these suggestions:

• See your doctor before you go. Make sure you are in sound shape, obtain vaccinations, and request scripts for any prescriptions. Keep a copy of your medical history with your passport.

• Create a list, in order of priority, of whom to contact in the event of an emergency. Speak with your advisors, and with your credit card companies about their global assist programs.

• Research area hospitals and clinics. Create a contact list of English-speaking physicians and their practices. The International Association for Medical Assistance to travelers, International SOS, and the Travelers Emergency Network can aid your search.

• Review your insurance coverage to determine if coverage is available outside the United States. Understand the resources your health plan provides. Can they make a medical interpreter available to you? Can they speak to the hospital and doctor on your behalf?

• Consider purchasing a short-term medical policy that includes evacuation if your current policy does not provide coverage. Also purchase additional travel insurance for cancellation, interruption, and 24/7 travel assistance.

• Contact your hotel and ask if they provide concierge services such as a local guide or interpreter to help navigate the local country’s health care system.

• Consider registering your trip with the U.S. State Department. Registration enables the nearest American embassy to relay urgent messages or tell you about a looming crisis at your destination. Embassy staff can also provide a list of doctors, hospitals, and specialists at your destination.

• Know how to call for emergency services. Visit https://travel.state.gov/content/dam/students-abroad/pdfs/911_ABROAD.pdf.

The extent to which you prepare will, of course, depend on your circumstances and destination. But everyone should at least be aware of the resources available – and spend some time thinking about their options – well before something goes wrong. Knowing that you are well prepared will make your vacation all the more enjoyable.

Editor’s note: The author learned these lessons the hard way, after her husband had a medical emergency in Italy on the third day of their summer vacation. His diagnosis, treatment, transport home (on the Queen Mary, because he couldn’t fly), and recovery have taught her firsthand how important it is to make medical care a component of travel planning.

Karen Francois is a Partner and Wealth & Fiduciary Advisor at Evercore Wealth Management. She can be contacted at francois@evercore.com.
Risk and Asset Allocation

By Stephanie Hackett

Risk matters. A portfolio that holds risky assets has a greater likelihood of more extreme movements. If these movements are outside an investor’s comfort range, there’s another risk at play: that he or she will abandon an investment plan, with potentially unfortunate consequences.

Look at what happens when investors try to time the markets. As the chart below shows, the average mutual fund investor underperforms most major asset classes. That’s because they are more likely to sell after bad news is already priced into the market or buy after the market has rebounded. It’s far better to stay invested through the full market cycle, usually five to 10 years from economic boom to

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**Disciplined Diversification vs. the Average Investor**

10-year annualized returns by asset class, 2006–2015

![Graph showing 10-year annualized returns by asset class, 2006–2015.]

Sources: J.P. Morgan Asset Management; Dalbar Inc.
Indexes used are as follows: REITS: NAREIT Equity REIT Index, EAFE: MSCI EAFE, Oil: WTI Index, Bonds: Barclays U.S. Aggregate Index, Homes: median sale price of existing single-family homes, Gold: USD/troy oz, Inflation: CPI, 60/40: A balanced portfolio with 60% invested in S&P 500 Index and 40% invested in high-quality U.S. fixed income, represented by the Barclays U.S. Aggregate Index. The portfolio is rebalanced annually. Average asset allocation investor return is based on an analysis by Dalbar Inc., which utilizes the net of aggregate mutual fund sales, redemptions and exchanges each month as a measure of investor behavior. Returns are annualized (and total return where applicable) and represent the 10-year period ending 12/31/15 to match Dalbar’s most recent analysis.

recession and back to boom again, than to dip in and out. A truly goals-based approach to investing first tries to limit the level of portfolio risk within a comfortable range and then focuses on maximizing risk-adjusted returns.

**RISK ASSESSMENTS**

Portfolio risk should be evaluated against prospective benefits. Growth assets, such as stocks, have greater potential for higher returns, but also have more risk, or volatility. Bonds should be considered defensive assets, as they lower a portfolio’s overall risk and provide a more stable return stream.

Finance professionals often describe risk in terms of volatility, which is a measure of the dispersion (or range) of returns for an asset. Higher volatility means higher risk, because there is more uncertainty around where the price will be at any particular point in time. However, volatility is not the best measure of an investor’s comfort level. Volatility focuses investors on how much a stock price can lose in a day or a month, but it’s the total cumulative loss in a down market over a prolonged period of time – the maximum potential drawdown – that truly impacts an individual investor’s risk tolerance.

In a severe market downturn, the drawdowns can be painful; in the global financial crisis of 2008-2009, the total drawdown in equities was 55%. Investors who couldn’t stomach the pain of these sustained losses sold out of their stocks near the low point and missed much of the rebound. In contrast, a balanced portfolio invested in 60% equities and 40% fixed income had a maximum drawdown of 30% over that same period. Not only do bonds have lower volatility than stocks, but the two generally have a low correlation to each other, meaning that they usually do not move in the same direction or at the same time. During most periods that stocks are down, bonds will be flat or slightly positive, thereby reducing the maximum potential drawdown in a balanced portfolio.

For an investor to remain engaged through a full market cycle, the maximum potential drawdown based on worst-case expected market assumptions needs to be within a range that’s perceived as acceptable. If it’s not, that’s a signal to limit risk by increasing the amount of defensive assets, such as bonds, in the portfolio mix. For those with a longer time horizon and higher tolerance for potential drawdowns, a higher exposure to growth assets may be appropriate. Either way, it can be helpful to set aside a separate fund with the equivalent of several years’ worth of spending. The investor is able to fund his or her lifestyle through the worst of the market cycle and remain invested in the markets.

As appropriate to each client, we incorporate other asset classes into the portfolio mix, based on their potential to maximize returns for each unit of risk. Additions to our asset allocation framework must either reduce the overall risk in the portfolio without lowering expected return, or have the potential to increase overall return without increasing risk. Our asset categories are based on their risk, return, and liquidity characteristics.

It’s important to strike the right note for each portfolio, preserving and growing assets in the context of current market conditions. That’s the best way we can help our clients invest with confidence and stay on track to meet their long-term goals.

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**A Goals-based Approach**

Asset classes are based on risk, return, and liquidity characteristics.

<table>
<thead>
<tr>
<th>Asset Class</th>
<th>Allocation</th>
<th>Sample Assets</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Cash</strong></td>
<td>• Managed for anticipated spending needs and future investments</td>
<td>• Cash Management</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Money Market Funds</td>
</tr>
<tr>
<td><strong>Defensive Assets</strong></td>
<td>• Designed to preserve capital and provide current income</td>
<td>• Taxable Bonds</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Municipal Bonds</td>
</tr>
<tr>
<td><strong>Credit Strategies</strong></td>
<td>• Developed to enhance total returns through credit risk exposure while minimizing interest rate risk</td>
<td>• Floating Rate Bonds</td>
</tr>
<tr>
<td></td>
<td>• We retain selected outside managers of liquid alternative fund strategies that invest in a range of non-investment grade credit instruments</td>
<td>• High Yield Bonds</td>
</tr>
<tr>
<td><strong>Diversified Market Strategies</strong></td>
<td>• Designed to offset risks to which traditional allocations of bonds and diversified stock portfolios are vulnerable</td>
<td>• TIPS</td>
</tr>
<tr>
<td></td>
<td>• We retain outside managers and select securities that we expect will have low correlations to traditional equities and fixed income investments</td>
<td>• Gold and Commodities (ETFs)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Foreign Bonds</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Liquid Alternatives</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Multi-Strategy Hedge Funds</td>
</tr>
<tr>
<td><strong>Growth Assets</strong></td>
<td>• Incorporates all growth-oriented assets</td>
<td>• Core U.S. Equity</td>
</tr>
<tr>
<td></td>
<td>• We manage a core mid-large cap portfolio of predominantly U.S. stocks</td>
<td>• Small Cap U.S. Equity</td>
</tr>
<tr>
<td></td>
<td>• We additionally retain outside passive and active managers for large cap, small cap, international developed and emerging markets</td>
<td>• International Equity</td>
</tr>
<tr>
<td><strong>Illiquid Assets</strong></td>
<td>• Allocated to investments with potential for high growth returns that are evaluated in the context of risk, tax consequences, liquidity needs and time horizon</td>
<td>• Emerging Markets Equity</td>
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<tr>
<td></td>
<td></td>
<td>• Long/Short Hedge Funds</td>
</tr>
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<td></td>
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<td>• Private Equity</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Venture Capital</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Illiquid Real Estate Investments</td>
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</table>
Almost 60% of the Bank of America Merrill Lynch Global Government Bond Index, excluding U.S. bonds, trades at a negative yield, and about one-third trades at a yield that is less than 1%. Japan’s 20-year yield briefly dropped past zero for the first time, and as of writing, the U.S. Treasury 10-year yield is currently 1.58%, near record lows.

Investors around the world have flocked to U.S. bond markets in search of yield and, since Britain’s referendum vote to quit the European Union, safety. Certainly, the U.S. fixed income sector stands out against the very low, or even negative, yields in other developed nations.

### Negative Yield Monitor

<table>
<thead>
<tr>
<th>Country</th>
<th>1-Year</th>
<th>2-Year</th>
<th>3-Year</th>
<th>4-Year</th>
<th>5-Year</th>
<th>6-Year</th>
<th>7-Year</th>
<th>8-Year</th>
<th>9-Year</th>
<th>10-Year</th>
<th>15-Year</th>
<th>20-Year</th>
<th>30-Year</th>
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<td>-1.211</td>
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<td>-0.952</td>
<td>-0.843</td>
<td>-0.75</td>
<td>-0.693</td>
<td>-0.447</td>
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<td>Japan</td>
<td>-0.352</td>
<td>-0.341</td>
<td>-0.333</td>
<td>-0.355</td>
<td>-0.369</td>
<td>-0.376</td>
<td>-0.374</td>
<td>-0.36</td>
<td>-0.333</td>
<td>-0.279</td>
<td>-0.156</td>
<td>0.014</td>
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<td>-0.69</td>
<td>-0.714</td>
<td>-0.683</td>
<td>-0.617</td>
<td>-0.588</td>
<td>-0.511</td>
<td>-0.442</td>
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<td>-0.189</td>
<td>-0.134</td>
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<td>-0.629</td>
<td>-0.493</td>
<td>-0.466</td>
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<td>0.062</td>
<td>0.299</td>
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<td>-0.435</td>
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<td>—</td>
<td>-0.25</td>
<td>—</td>
<td>-0.009</td>
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<td>—</td>
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<td>-0.16</td>
<td>0.025</td>
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<td>0.371</td>
<td>0.439</td>
<td>0.712</td>
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<td>-0.015</td>
<td>0.076</td>
<td>0.285</td>
<td>0.48</td>
<td>0.66</td>
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<td>1.044</td>
<td>1.217</td>
<td>1.506</td>
<td>1.855</td>
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<td>0.254</td>
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<tr>
<td>United States</td>
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<td>—</td>
<td>1.326</td>
<td>1.461</td>
<td>1.638</td>
<td>2.102</td>
</tr>
</tbody>
</table>

Source: Fidelity and Bloomberg, BAML Indices, FCM as of July 6, 2016.
Investors have embraced municipal bonds in an otherwise unsettled time for financial markets, as evidenced by substantial retail inflows into the asset class this year. Municipal bonds currently offer some of the highest yields for U.S. residents, when adjusted for taxes. In fact, yields on municipal securities are sometimes higher than yields on similarly rated taxable debt even before taxes are considered. A carefully selected portfolio of high-grade municipal bonds can include tax exemption, high credit quality, liquidity and relatively low volatility.

Other than a handful of issuers in the headlines, notably Puerto Rico, municipal bonds have fared well. The Barclay’s Managed Money Short/Intermediate Index has returned 2.88% year-to-date through June 30. While this partly reflects recent declines in U.S. Treasury yields, it also reflects the strong supply and demand characteristics of municipal bonds, along with steady credit quality for the overall market. That’s likely to remain the case: Maturing bonds and bonds that are expected to be called by issuers are projected to outweigh the anticipated volume of the new supply of municipal bonds in the coming months. We expect that municipal bonds will remain an attractive fixed income alternative for U.S. taxpayers. However, investors should be aware that the income they will earn in this low interest rate environment will be significantly less than the income they may have enjoyed just a few short years ago.

At some point, short-term interest rates are likely to rise, an eventuality that worries investors in bonds. After all, the Federal Reserve’s stated intention is still to raise its target range for the federal funds rate over time, and it seems to us that economic conditions will eventually warrant this tightening of policy. However, the Fed’s stated intention is for the pace of rate hikes to be gradual. It’s also worth noting that bond markets fared well during the Fed’s last tightening cycle, which began in June 2004 and concluded in June 2006.

That cycle was characterized by slow, well-telegraphed increases in the federal funds rate, features that could also prevail in this cycle. During the 2004-2006 cycle, yields at the short end of the municipals curve rose, as one would expect. Investors in short maturity bonds would have been able to reinvest the proceeds in higher-yielding securities as their bonds matured over time. However, yields further out the curve, beyond ten years, actually were lower by the end of the cycle, reflecting the market’s expectation that tighter monetary policy would contain inflation and eventually slow the pace of economic growth. If a bondholder stayed the course during this cycle and remained invested in the longer bonds, yields on their bonds would have declined and the price would have improved.

While the result of this analysis is encouraging for bond investors, not all tightening cycles are the same with respect to the timing, duration, and magnitude of the increases. And not all tightening cycles affect the shape of the curve in the same way. But the yield curve typically flattens during tightening cycles, with short-term rates rising much more than long-term ones. Often the coupon payments of longer dated bonds will offset, or go a long way to offset, the price decline.

History suggests that investing in bonds during a tightening cycle does not necessarily end in disaster, as long as a portfolio is positioned properly for the change. As interest rates are difficult to predict, a diversified approach would help investors through the uncertainty. A barbell strategy, for example, with exposure to both the short and the long ends of the yield curve, can be effective. In this case, the shorter maturity securities earn ever-higher yields as the Fed tightens, but the longer dated bonds generate more income and provide a hedge against the possibility that rate increases turn out to be anemic.

Sandy Panetta is a Partner and Portfolio Manager at Evercore Wealth Management. She can be contacted at panetta@evercore.com.

### AAA Municipal Yields

**Last Fed Tightening Cycle June 2004–July 2006**

<table>
<thead>
<tr>
<th>Year</th>
<th>AAA GO 6/15/2004</th>
<th>AAA GO 6/30/2006</th>
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<tr>
<td>0</td>
<td>1.5</td>
<td>1.5</td>
</tr>
<tr>
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</tr>
<tr>
<td>20</td>
<td>6.0</td>
<td>6.0</td>
</tr>
</tbody>
</table>

*Sources: U.S. Treasury, MMD.*
It’s Complicated: A Guide to Private Equity Fees

By Brian Pollak

Three words are commonly associated with fees related to private funds: onerous, opaque, and complicated. For some prospective investors, the management fees and carried interest charged by the general partnerships that manage these funds can be a turnoff. So too can the investment time frame; assets can be tied up for seven years or more. For many qualified investors, however, private funds can be worth the trouble.

Private funds can include any illiquid limited partnership structure, such as private equity, real estate, and/or credit. They typically have an investment period of between two to six years, during which time the fund makes investments and draws down capital. This is followed by a harvesting period of two to six years, when the fund liquidates its investments and returns the proceeds to the limited partners.

So, what’s the attraction? Investors who can tolerate the illiquidity and the relatively high fees can be rewarded with relatively high net returns. The private equity market over the past three decades outperformed the S&P 500 Index net of fees by at least 300 basis points annually over 10-, 15-, 20-, and 25-year periods, as illustrated by the chart on page 11. For top quartile funds, the premium was even higher, around 500 basis points annually. In addition, many private fund returns, particularly from private equity and real estate, are relatively tax-efficient, as most are treated as long-term capital gains. In the current low-return environment, there is a compelling case for owning tax-efficient assets with a demonstrated return premium.

Let’s focus on the different components of private funds, highlighting what we believe are the industry’s best practices. The interests of the general partners, or the fund management company, should align to the interests of the limited partners, or the investors.

Investors who can tolerate the illiquidity and high fees can be rewarded

MANAGEMENT FEES

Typically, general partners charge management fees that range from 1.25% to 2.00% to their limited partners for primary funds. Management fees are generally charged on committed capital. In other words, after the investor makes a commitment to a fund, management fees are charged on the entire commitment amount, regardless of whether the capital is actually drawn or invested. Some funds charge only on invested capital, which lowers the management fees charged to the limited partners, but may incentivize the managers to chase potentially bad deals for the sake of investing capital.

There are two other ways that the general partners can generate money from fund fees, neither of which is well...
disclosed. Almost all private funds charge an additional administrative fee that transfers selected fund expenses and shared services (including fixed costs such as audit, accounting, and legal) to the limited partners. In contrast to mutual funds (in which these fees are transparent and capped), they tend to be buried in the fund’s private placement memorandums or even undisclosed.

Best practices here are for capped administrative fees in either a hard dollar amount or in basis points of assets under management. They should amount to no more than 0.10% to 0.15% of fund assets.

In addition, private funds often receive other fees from third parties related to the activities of the fund. These can include placement fees, directors’ fees, and transaction fees. Ideally, these additional fees are credited 100% back to the limited partners, reducing the net management fee paid.

It’s generally preferable to invest in funds that charge on invested capital, instead of on committed capital. Investors are right to be wary of funds with multiple entries in their administrative fund expense columns. Certainly, firms that keep all or most of the fees they generate from third parties for the general partners should raise a red flag.

CARRIED INTEREST

All these management and administrative fees often don’t cover much more than the general partners’ operating expenses. The real moneymaker for the owners of the most successful private funds is carried interest, also known as the incentive fee. Carried interest is also how general partners align their interest with the limited partners, as they only make significant money on their funds if their investors do well.

Typically, general partners take between 15% and 20% of the fund’s net profit (after management fee), but in some cases the incentive fee can be as high as 30%. Carried interest taxation has been under extreme criticism from all political fronts, as the money made by general partners on carried interest is currently treated as a long-term capital gain.

In almost all cases, the general partners can’t charge any incentive fees until the fund achieves a certain preferred return, or hurdle rate. These rates typically range from 5% to 8% of the fund’s net profit and are compounded annually. A higher preferred return means a better alignment of incentives, which is friendlier to the limited partners. In other words, preferred returns ensure that the limited partners don’t start paying incentive fees until they have received a reasonable return for the risk they are taking.

DO THE GENERAL PARTNERS INVEST IN THEIR OWN FUND?

One of the best ways a general partner and, ideally, all the other investment professionals at the fund, can demonstrate proper alignment of incentives is to invest significant amounts of their own assets into their funds alongside their limited partners (1% to 5% of the total fund’s assets is typical; a minimum of 2% is preferable). There is no better way to demonstrate confidence in one’s abilities than to eat one’s own cooking.

WORTH THE TROUBLE

It’s important to approach investing in private funds with a selection framework, to properly analyze and evaluate the associated fees. Yes, the fees are complicated. But there is real value in the sector, and careful investment can reward patient investors. A portfolio of private funds with reasonable fee structures and, as we will discuss in future issues of Independent Thinking, different vintage years (inception dates) and manager diversification can enhance a portfolio’s overall risk-adjusted return without dramatically increasing risk.

Brian Pollak is a Partner and Portfolio Manager at Evercore Wealth Management. He can be contacted at brian.pollak@evercore.com.
Impact Investing
By Iain Silverthorne

Among the many misperceptions around socially responsible investing, arguably the biggest is that investors in this sphere are any less focused on returns than their more traditional counterparts. This $21.4 trillion global discipline is increasingly effective, transparent, and measurable.

As socially responsible investing, or SRI, and its more proactive twin, environmental, social and governance, or ESG investing, mature, it is becoming evident to even the most skeptical investors that focusing on companies with these factors in their mandates can have a positive impact on performance. As we discussed in the last issue of Independent Thinking, increasing interest in socially responsible companies and improving returns in the SRI/ESG sector have together created something of a virtuous circle. Good sustainability practices positively impact a company’s stock price.¹

Today, returns from almost two-thirds of the investment managers focused on SRI/ESG strategies meet or exceed the median returns of the managers of traditional funds.² The MSCI KLD 400 index of socially responsible companies continues to outperform the more traditional MSCI USA Investable Market Index, averaging a 9.53% annualized return over the past five years against the 9.37% return of its benchmark.³

¹ Smith School of Enterprise and the Environment at the University of Oxford.
² As of June 30, 2016.
³ As of June 30, 2016.
At the same time, SRI/ESG is becoming easier to understand. Access to public information related to companies’ best practices, especially for domestic and international developed markets, has increased dramatically. Some company disclosures, including compensation practices, board structure and diversity, are now mandatory in most developed markets. Financial metrics, such as how much revenue is derived from a business line that produces a lot of CO₂, are also increasingly easy to access.

Additional information related to companies’ SRI/ESG practices are now voluntarily disclosed, although many companies remain selective in publishing their metrics. An expanding range of third-party information sources, such as Bloomberg, MSCI and EIRIS, a leading global provider of ESG research, are making this data more transparent, which helps investors craft a thoughtful approach to impact investing.

Improved transparency enables better measurement, a key component of effective SRI/ESG investing, especially as many investors see themselves as voting with their wallet. Careful analysis of all underlying holdings and voting, either directly or by proxy through an investment adviser, in shareholder resolutions is a powerful way to drive market change and encourage government intervention.

Despite – or perhaps because of – all these recent advances, investors still aren’t sure how to actually describe impact investing. Since its origins in the abolitionist movement, SRI/ESG investing has come to mean very different things to different people. Not long ago, most strategies avoided the so-called sin stocks such as tobacco, alcohol, and gambling. These days, SRI/ESG strategies often include a focus on investing in companies that are good stewards of the environment, with relatively low carbon footprints, while avoiding certain sectors entirely, such as coal. Others focus on encouraging board diversity, Catholic values, and/or steering clear of animal testing, factory farming, child labor, and arms manufacturing. The universe of SRI/ESG factors, both negative and positive, is large and still expanding.

Global Impact Investing Network, or GIIN, a New York City-based trade group, recently tackled this nomenclature challenge, proposing that impact investments be defined as “investments made into companies, organizations, and funds with the intention to generate social and environmental impact alongside a financial return.” The group notes that impact investments can be made in both emerging and developed markets, and can target a range of returns from below market to market rate, depending upon the circumstances.

This seems reasonable. However, what is meaningful to one investor in terms of social or environmental goals may not be for another. Solutions must be customized to specific individual and family goals. It’s important to assess an SRI/ESG mandate in the same way as other, more traditional opportunities are evaluated, by measuring returns against industry benchmarks, and determining fee-effective, risk-adjusted, tax-efficient and, preferably, liquid investments in a particular asset class.

At Evercore Wealth Management, we work with Aperio to provide detailed customization for clients willing and able to invest $1 million or more in an SRI/ESG strategy. And we follow up, to access and score investment data that can continually inform and support each investor’s goals. We also allocate funds to external managers for clients interested in making smaller commitments. (See the interview with Dimensional Fund Advisors’ Joseph Chi on page 14.)

For an increasing number of investors, SRI/ESG strategies are an increasingly effective, transparent and impactful solution.

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**Strategies & Integration**

<table>
<thead>
<tr>
<th>Examples of SRI Strategies</th>
<th>Integration Options</th>
</tr>
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<tbody>
<tr>
<td>• Carbon-Free</td>
<td>• Negative Screening</td>
</tr>
<tr>
<td>• Humane Equity (Animal Rights)</td>
<td>• Positive Screening (Scoring, Best in Class)</td>
</tr>
<tr>
<td>• Global Environmental Impact</td>
<td>• Impact</td>
</tr>
<tr>
<td>• Faith-Based Values</td>
<td>• Proxy Voting</td>
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<tr>
<td>• Labor-Friendly</td>
<td>• Shareholder Engagement</td>
</tr>
<tr>
<td>• Domestic &amp; Global ESG</td>
<td>• Any Combination for Complete Customization</td>
</tr>
<tr>
<td>• Women’s Inclusion</td>
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Source: Aperio Group.
Q&A with Dimensional Fund Advisors

Q: Dimensional is a pioneer in what is now widely known as factor investing, in which securities are chosen based on attributes that are associated with higher returns. Please tell us about your approach to your sustainability-based investment strategies.

A: We use a systematic process to efficiently provide low-cost, broadly diversified portfolios that focus on securities with higher expected returns, as identified by rigorous academic research. Differences in expected returns among securities are observed along the dimensions of expected returns. In equity markets, these dimensions define: (i) the small cap premium, with smaller capitalization companies having higher expected returns than larger capitalization companies, (ii) the value premium, with companies trading at a low price relative to their book equity having higher expected returns than companies with high prices relative to their equity, and (iii) the profitability premium, with companies with higher profitability having higher expected returns than companies with lower profitability trading at a similar relative price.

The Dimensional sustainability funds provide well-diversified investment solutions focused on higher expected return securities in U.S. and international developed markets, respectively, while taking into account sustainability considerations.

Q: How have investors’ views of sustainable investing evolved? How about the investors themselves?

A: In recent years, we have found that investors are increasingly concerned about the potential environmental effects of certain business practices, and many individuals and institutions are asking how they can align their environmental views and personal values with their investment decisions. Scientists, industries, governments, and society in general are now looking for ways to manage the tradeoffs between improving people’s standard of living in the short and medium term and, in the long term, avoiding environmental damage that may inhibit humanity’s standard of living.

With investors increasingly concerned about the potential environmental effects of certain business practices, institutions and individuals can embrace these concerns through their behavior and consumption decisions and can become effective agents of change. Investors are also choosing to express their preferences through their participation in global capital markets.

Editor’s note: Evercore Wealth Management supplements its core investment capabilities with carefully selected outside funds across the range of the firm’s asset classes. The firm has invested in Dimensional Fund Advisors’ DFA International Core Equity Portfolio since September 2014, during which time the fund has outperformed its benchmark. Here, we interview Joseph Chi, Co-Head of Portfolio Management at Dimensional Fund Advisors and the chairman of the firm’s investment committee, about two of the firm’s newer funds, the U.S. Sustainability Core 1 Portfolio and the International Sustainability Core 1 Portfolio.
Q: How are pensions and endowments engaging in sustainable investing?

A: Industry stakeholders appear to be increasingly interested in ESG, or environmental, social, governance investing. In particular, a number of institutional investors, including pensions, endowments, and foundations, have recently considered the outright divestment of companies involved or associated with fossil fuels. Concerns over land use/biodiversity, toxic spills/releases, operational waste, water management, cluster munitions, factory farming, child labor, tobacco, and other topics have also been included in conversations around ESG investing.

Q: How have DFA’s strategies changed?

A: The investment strategy of the U.S. Sustainability Core 1 Portfolio and the International Sustainability Core 1 Portfolio is to add value over conventional benchmarks by providing low-cost, well-diversified portfolios that focus on securities with higher expected returns. This investment strategy has not changed; however, the sustainability considerations that we use have evolved with the increasing availability of reliable data about the impact of companies on our planet and our society, and with evolutions in science and technology.

We recently implemented enhancements in the portfolios to more directly reduce exposure to companies that have substantial greenhouse gas emissions or potential emissions from reserves.

Q: How does your sustainability-scoring framework operate?

A: Dimensional’s approach emphasizes environmental sustainability at both the portfolio and industry level. We believe this dual approach to be more comprehensive, as some industries do not produce emissions but are consumers to industries that produce emissions and have the option to select what to consume. The best example is the financial industry, which consumes, say, electricity, and has a choice to purchase from green sources. Our approach attempts to focus on both demand and supply, not just on utilities. At the industry level, we have a patented process that emphasizes companies operating with more environmental responsibility relative to their peers while preserving diversification among industries.

All companies in our investment universe receive a sustainability score based on five industry-level variables: greenhouse gas emissions intensity, land use/biodiversity, toxic spills/releases, operational waste, and water management. Within each industry, weightings are adjusted to emphasize investment in companies with higher scores and minimize or exclude investment in companies with lower scores relative to their peers.

In addition to addressing greenhouse gas emissions as a primary component of the industry-based scoring system, we focus on greenhouse gas emissions at the strategy portfolio level by excluding or underweighting the top contributors to greenhouse gas emissions as well as potential emissions from reserves.

The approach also limits investment in companies that use particularly intensive factory farming methods, companies identified as manufacturers of cluster munitions and mines that indiscriminately affect humans and the productive use of land, companies cited for child labor practices, and those linked to the production of tobacco.

The sustainability portfolios also vote proxies in a manner that we believe to be consistent with the underlying sustainability goals of investors in the portfolios.

For further information on Dimensional Fund Advisors’ sustainability funds and on the Evercore Wealth Management approach to sustainable investing, please contact Iain Silverthorne at silverthorne@evercore.com.

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1 The DFA International Core Equity Portfolio returned -3.91 from 9/30/2014 to 6/30/2016. The MSCI World ex-US returned -5.54 over the same period.
2 Dimensional’s approach to sustainability investing is protected by U.S. Patent Nos. 7,596,525 B1, 7,599,874 B1 and 8,438,092 B2.
Buying Time with a Delaware Silent Trust

By Darlene Marchesani

Becoming a parent has been likened to deciding forever to have your heart go walking around outside your body. While parents of all backgrounds share many of the same anxieties, affluent parents often worry that their wealth could harm their children, affecting their drive, their sense of accomplishment, and their relationships.

Thoughtful discussions, between parents, among families, and with wealth and fiduciary advisors, form the starting point in preparing children for inheritance. For some parents, the first question is: Do my children have to know that they have a trust? The answer in most cases is yes, and generally for good reason. In most states, trustees are required to provide trust beneficiaries or their guardians with information about the trust, including its nature and amount, on the beneficiary’s request.

In Delaware, however, families have the option of a silent trust, which allows for a period of time in which the beneficiary of the trust is not informed of its existence. For some parents and grandparents, this time, known as the quiet period, can provide peace of mind. The child can develop independence and self-reliance, unencumbered by the temptations and responsibilities of wealth. Silent trusts can also buy time for the older generations to prepare themselves and the child for discussions around wealth. Educating a new generation about income streams, asset allocations, and management of risk can serve to increase awareness, so that the news of the trust does not come as a shock.

Recent Delaware legislation provides families with options to tie the silent period to any one (or a combination of) specific milestones. These include: the age of the beneficiary; the lifetime of the trustor or his or her spouse; a term

News from Delaware

In July 2016, the Delaware legislature made it easier for trustors and beneficiaries to amend irrevocable trusts, provided that the modification does not violate a material purpose of the trust.

S.B. 248 provides that trust modifications made by non-judicial settlement agreement are no longer required to be of the type that would be approved by the Chancery Court, if they were brought before the court. This is a significant move that expands opportunities to modify trusts beyond decanting and merger. The proposed law also allows an irrevocable trust to be modified while the trustor is still living.

We’ll be writing more about this decision and the implications for families and their advisors in future issues of Independent Thinking. In the interim, please contact Darlene Marchesani for further information.

– D.M.
of years or a specific date; or an event that is certain to occur, such as the tenth anniversary of the trustor’s death. (Tying a trust to a child’s marriage makes for amusing Hollywood plot lines but isn’t actually a staple of estate planning.)

**Silent trusts can buy time for discussions around wealth**

The interests of the beneficiary during the quiet period can be managed by a designated representative, named in the trust document by the trustor. He or she receives account statements and can sign consent, release, and indemnification agreements that are binding upon the represented beneficiary. This representative can also initiate a court or administrative proceeding on behalf of the beneficiary.

It’s important to note that the statute does require that the event be certain to occur. There’s no case law on this yet (it was only enacted in August 2015), but the quiet period does have to be perceived by a court as reasonable.

Silent trusts are just one of the many advantages of having a trust in Delaware. Other advantages include the absence of income tax on trusts (without Delaware-domiciled beneficiaries), asset protection, and flexibility in modifying certain types of trusts through decanting, merger, or non-judicial settlement agreements.

Every family is different, and circumstances can change. Your wealth advisors are able to help you determine if establishing a silent trust, modifying the conditions of an existing trust to tie a quiet period to one or more events, or establishing another type of Delaware trust is the right choice for your family.

**Darlene Marchesani** is the Chief Trust Officer and Trust Counsel of Evercore Trust Company of Delaware. She can be contacted at darlene.marchesani@evercore.com. For information on Evercore Wealth Management’s family wealth services and our September 20 event, *Shaping the Financial Conversation with Your Family*, with nonprofit consultant Sharna Goldseker in New York, please contact your wealth advisor.
Flourishing in a Low-Growth World

By Jeff Maurer

Optimism, an American strength in so many ways, is a dangerous weakness in planning for our financial futures. As wealth managers, we worry when we see our clients’ inherent optimism reflected in their long-term views of the markets and their spending habits, even as capital market returns stagnate. Thriving in challenging markets starts with an acknowledgement – and an adjustment to – the prevailing climate.

Inflation, which we project at 2% a year, remains low by historic standards. But the cost of living well, as most of our clients understandably choose to do, continues to increase, often at astonishing rates. Whether you are trying to buy Hamilton tickets, sending a child or grandchild to college, traveling at peak seasons, or purchasing private health care, you’ll find that prices for many desirable goods and services are rising at a much faster clip than the broad Consumer Price Index suggests.

Even if we cut down on the fun (and there isn’t much evidence of our clients doing that), we have to consider that we are, as a group, living longer and, in many cases, better, more energetic lives than earlier generations could have ever imagined. Baby Boomers are, for example, traveling more and spending more on each trip, according to a recent Visa study – and indications are that this trend will only accelerate as the next generation ages. By 2025, travelers age 65 and up will...
en>more than double their international travel to 180 million trips, accounting for one in eight international trips globally.¹

When we do slow down and need help to carry out our activities of daily living, it’s likely that most of us want to stay in our own residences and will require costly aides and medical treatment from physicians who don’t take Medicare. That won’t be cheap either. The latest study by the Centers for Medicare and Medicaid estimates that health care costs overall are likely to rise by an average of nearly 6% per year for the coming decade.²

Sustaining our existing lifestyles, let alone funding more expensive ones, will prove a challenge. Readers will recall that one year ago we reduced our expected rate of return for our balanced account to 6%, or 2.6% after inflation, taxes, and fees. That was a good call. Today, our expectations remain broadly the same, even as we look 10 years forward.

My advice is unchanged too: We have to set priorities in this low-return environment. If you are concerned about your spending and about your lifestyle and legacy goals, let us prepare a lifestyle analysis for you and track the likely outcome of our market assumptions and your spending over the next decade or longer. (Jen Tse explains this approach on page 20.) You may be surprised by the results.

Your decisions thereafter will depend on the level of your assets and your own personal and family circumstances. Many of us may choose to rein in our spending, at least until the markets improve. (I count myself among this group, as my own parents – and three of my four grandparents – lived well into their 90s, and I need to prepare for a similarly long run.) Others will bet on a shorter time frame or choose to spend more than they earn in returns, in effect annuitizing assets and leaving a smaller legacy. Your wealth advisors will help you evaluate your options and advise which works best for you.

Our concern is that you will be able to make an informed choice, one that is based on sensible capital market assumptions net of inflation, taxes and fees – and that your assets will last at least through your lifetime.


Jeff Maurer is the Chief Executive Officer of Evercore Wealth Management. He can be contacted at maurer@evercore.com.
Facing Facts: A Lifestyle Analysis

By Jen Tse

The Evercore Wealth Management lifestyle analysis is tailored to each client’s income and commitments. Inputs include income from all sources, such as salary, pension and Social Security income, if applicable, and all investment returns. Outflows cover measurable fixed and variable expenses.

The lifestyle analysis will gauge whether you will have enough assets to maintain your lifestyle and, if you wish, to provide a legacy. It can also be used to determine whether or not your current asset allocation is appropriate to meet those goals. The analysis, which is both quantitative and qualitative in its approach and is based on a range of assumptions, will also help guide your answers to questions such as: When can I retire? What happens if there is another market correction? Do I have enough capital to purchase another residence, start a business venture, or make more gifts to family members and charity?

A sensitivity analysis such as a Monte Carlo simulation that can vary the investment return assumptions could also be created to complement the lifestyle analysis. The Monte Carlo simulation provides an array of possible outcomes based upon the underlying lifestyle analysis assumptions and assesses the impact of risk, allowing for better decision-making.

In this example, we assumed a starting asset base of $20 million and a 6% total pre-tax annual return on those assets. The first couple, the Blues, spends 3% annually of their initial portfolios, or $600,000 a year. The second, the Greens, spends 4.5% a year or $900,000 a year. We inflate spending by 3% a year, as the total spending rate of both couples will likely outstrip our basic assumption of 2%.

(See Jeff Maurer’s article on page 18, which references inflation rates for discretionary consumption.) All four people are currently age 65 and are living in Florida, free from state income tax.

In 30 years, at age 95, the Blues will be left with $38.6 million (dotted blue line in the chart to the left), or $15.9 million in today’s dollars (solid blue line). The Greens will have seen their assets deteriorate, with just $5.1 million (dotted green line), or $2.1 million in today’s dollars (solid green line), to live for the remainder of their lives and leave to their heirs.

Please contact your wealth advisor for further information and to discuss your own lifestyle analysis. Jen Tse is a Vice President and Wealth & Fiduciary Advisor at Evercore Wealth Management. She can be contacted at tse@evercore.com.

(Important Notice Regarding Analysis: The primary objective of this financial plan is to prepare an analysis of your current financial situation and evaluate alternative strategies in meeting your articulated planning goals and objectives. In compiling financial information, we have relied upon your representations and have not attempted to independently verify the accuracy or completeness of the information provided. Certain assumptions have been made in the planning process. Although we believe such assumptions are reasonable within their context, actual results will vary. If you have a material change in your life that could affect your financial plan, it is imperative that you keep us informed. The analysis, statements and projections may be incomplete or contain other departures from generally accepted accounting principles and should not be relied upon by third parties for any purposes other than the development of your financial plan. This analysis is not intended to provide complete accounting, insurance, investment, legal or tax advice. Past performance is not indicative of future results.)

Private Wealth Education at Evercore:

- Sharna Goldseker: Shaping the Financial Conversation with Your Family
- Roger Altman: The Economic and Political Outlook
- What You Don’t Know About Health Care Coverage Can Hurt You: An Educational Seminar
- The 7th Annual CLE Event – Anthony E. Davis: Confronting Cyber Risks

Wise Women Seminars:

- Women, Wealth & Wisdom
- Wise Investing: How to Build a Realistic, Tax-Efficient & Sustainable Portfolio
- Thoughtful Giving to Your Children

Please contact your advisor or Jewelle Bickford at jewelle.bickford@evercore.com for further details on upcoming Evercore Wealth Management events in your region.
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