INDEPENDENT THINKING

THE NEW STANDARD IN WEALTH MANAGEMENT

EVERCORE
Volume 41

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A Message from the CEO

One year and counting. As the pandemic morphs into a still present but manageable virus – and the dust from the election continues to settle – it's interesting to reflect on the role of planning in our lives. On the one hand, anyone who thinks they know what is going to happen next had clearly better think again. On the other hand, good planning keeps us focused and resilient.

As wealth managers, we need to build and preserve portfolios with both hands. While none of us expected anything like COVID-19, we knew enough to expect the unexpected. After all, we had already experienced three "once-in-a-lifetime" financial events in just 20 years.

One year ago, our hypothetical model balanced portfolio (which analyzes 50 years of data) assumed a drawdown potential of 24% – meaning that we modeled that the market could fall 24% from its peak value to its trough value and remain positioned to participate in the subsequent economic recovery. In late February 2020, those assumptions were tested to the extreme with arguably the most dramatic correction in market history – and our assumptions held. Clients who stayed invested were able to ride out the storm and benefit from the subsequent gains in asset values.

Today, our hypothetical model portfolio retains roughly the same drawdown potential assumptions, meaning that we haven't let down our guard, even – or especially – as the markets record new highs. We have some thoughts, of course, especially around the relationships between market valuations and inflation, as discussed by John Apruzzese and Brian Pollak in this issue of *Independent Thinking*. And we remain firm believers in diversification, including to illiquid investments as well as to equities, and to a still sizable, albeit reduced, position in fixed income.

And we continue to plan, on behalf of clients facing life's transitions, such as selling a business, addressed in these pages by Evercore's Jason Sobol, or preserving family properties in trust, addressed by Tom Olchon. And of course, we plan to help our clients support organizations that continue to suffer from the shutdown, including the theater, the subject of Jeff Maurer's column in this issue.

The country itself is in a period of transition, with a new Administration and a new agenda. As Pam Lundell discusses, this is a good time to revisit wealth plans to ensure that they accurately reflect income needs, risk tolerance, and estate and philanthropic objectives in a tax-efficient manner. After $3.9 trillion of fiscal stimulus and the prospect of more to come, taxes will remain one of life's inevitabilities.

I know this past year has been incredibly stressful for many people, of all ages. Feelings of isolation, loneliness, frustration at missed milestones – we've stayed close to our clients and heard the stories and shared the experiences. But we are also hearing some sense of reprieve, of hope, as the vaccines continue to roll out and a new normal starts to take shape. Amid all the losses may be some real gains, if we make progress on a path to a more inclusive and equitable society, balance work and other life responsibilities, and recognize the power and perils of virtual communications. While we've all been reminded that life can change on a dime, it may be that we – families, businesses and society – are more resilient than we knew.

On a related note, you'll see more information shortly on our events series, including investment and wealth planning topics and those of more general interest. So please check our client site regularly and look for invitations from your advisors.

We are always mindful of the confidence you have placed in our firm. It's an important responsibility and we will do our best for you and your family.

Chris

Chris Zander
President & Chief Executive Officer

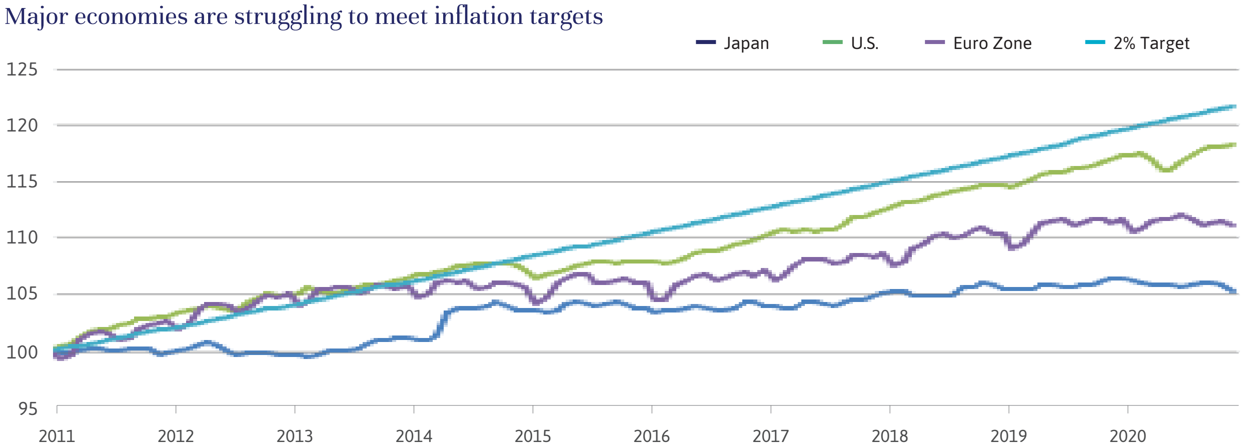
What Next? Investing in a Changed World

By John Apruzzese

Sky-high asset prices and record-low yields make for a dramatic investment landscape, a far cry from the one that global central bankers set out to shape years ago when they embarked on sweeping stimulus efforts, first to recover from the ravages of 2008-2009 and more recently to manage the economic fallout of the pandemic. Instead, the contrasts have become only more extreme, with stocks trading at 22.3 times forward earnings and all investment-grade fixed income securities, from 30-year Treasuries to investment-grade corporate bonds and municipals, now generating yields below the expected rate of inflation.

A Low Inflation World

Major economies are struggling to meet inflation targets



Note: Indexed to 100 at 12/1/2010
Source: Federal Reserve Economic Data – November 30, 2020

Other factors are at play, of course. But there is one main reason why the stock market, and for that matter, all asset classes, are so high and interest rates are so low – massive government deficit spending financed by central banks. The U.S. Federal Reserve, the European Central Bank and the Bank of Japan have pumped a combined $7 trillion of liquidity into the global financial system since mid-2020. While much of this deficit financing was necessary, it may have already gone too far. Indeed, contrary to perceived wisdom that stimulus is inflationary, the empirical evidence of recent years suggests that the more a country's debt represents of its GDP, and the more that debt is assumed by its government, the lower the country's prevailing inflation rate.

Japan's government debt is now 238% of GDP, and the Bank of Japan, holding much of that debt, has assets of 126% of GDP; the compound annual inflation rate in Japan over the last ten years is 0.5%. The Eurozone has the next highest level of government debt financed by the central bank, with government debt at 97% of GDP and European Central Bank assets at 55% of GDP; the compound annual rate of inflation in the Eurozone over the last 10 years is 1.2%. Here in the United States, we appear to be heading down a similar path, with 99% of government debt to GDP and Federal Reserve assets at 34% of GDP. Our consumer price index rate of inflation is a relatively healthy 1.7%, healthier relative to those of Japan and Europe, but a far cry from the Fed's stated goal of 2%.

In other words, all this monetary inflation has produced only asset inflation, not an increase in consumer inflation. Brian Pollak addresses this subject on page 5.

Potential Productivity Peaks

One trend could fully justify the high valuation of the stock market and generate attractive future returns: increasing productivity growth. Indeed, the rapid deployment of technological innovations into the economy might allow for the kind of rapid productivity growth last witnessed in the 1990s with the deployment of the personal computer.

Of course, we all knew that it was possible to do more with the technology at our disposal. But it took the urgency of the pandemic response for us to take advantage of it. This new openness and the associated potential productivity advances could very well accelerate economic growth and increase our standards of living fast enough to keep inflation under control and allow the economy to grow into the current high debt levels. We believe that the elevated valuation levels of the stock market would then be more than justified by the earning growth of the innovators.

At the same time, we are also close to an inflection point in energy when the cost of sustainable alternatives falls below that of fossil fuels. This will likely create attractive returns on large capital investments in electronic vehicles and in the solar and wind capacity to generate the power.

– JA

Of course, an investor would receive a solidly positive real return over the next year or two in long-dated investment grade fixed income if long-term interest rates in the United States collapse to zero or go negative, as has happened in Europe and Japan. This seems to us possible but not likely: Federal Reserve officials have made it clear that they want to avoid negative nominal interest rates. If long-term interest rates do instead grind higher, the returns of long-dated fixed income in the short-term will be negative even before adjusting for inflation.

Up on the peaks of this investment landscape, the S&P 500 now sells for close to a record-high valuation at 22.3 times expected earnings over the next 12 months, or slightly more than in 2019 before the pandemic. Earnings are expected to grow an additional 15% in 2022, which would bring next year's forward price-to earnings ratio down to a multiple of 19.5, but still well above the long-term average of 16 times. At the same time, some areas of the equity markets are experiencing levels of speculation – and related valuations – reminiscent of previous market peaks. However, as we've discussed a number of times in *Independent Thinking*, it seems to us reasonable for the market as a whole to sell considerably above long-term historical average valuation levels in this low inflation and interest rate environment.

Talk of another stimulus package in the United States – this time to the tune of $1.9 trillion, although that is likely to be watered down by the nearly balanced Senate – has given rise to more talk of inflation. Again, recent evidence suggests that the reverse will hold true and inflation will remain suppressed. But this dynamic could change if there is a reversal in one or more of the global deflationary forces, including population growth, innovation, high debt loads and globalization, or if the

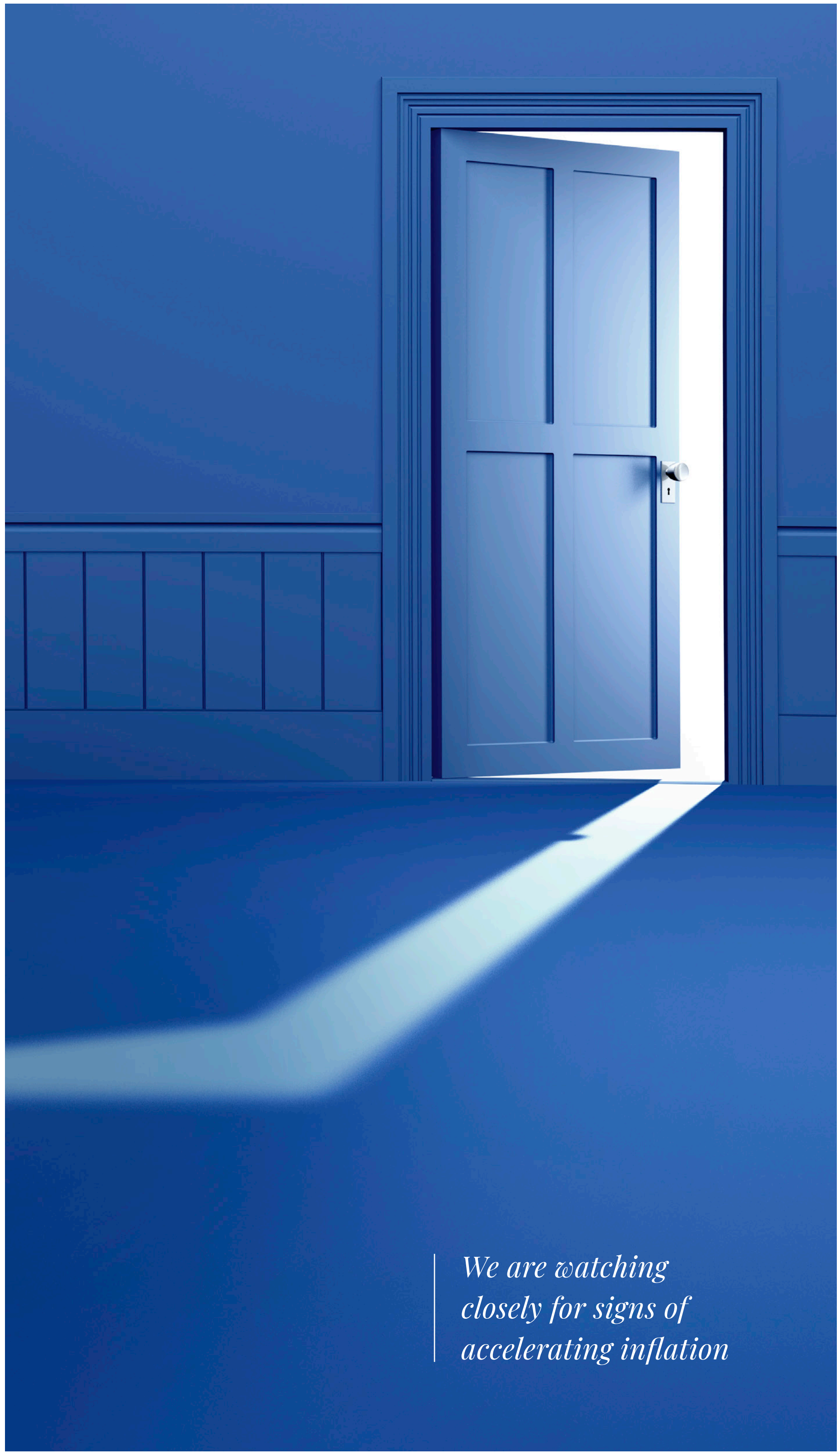
Fed simply throws all caution to the wind in its determination to increase consumer inflation by bypassing the banking system and sending newly created dollars directly to consumers.

Appreciable gains in inflation and interest rates could drag down stock market valuations closer to the historic average even if earnings continue to grow at an above-average rate for the next two years. The valuation levels on all financial asset classes, from fixed income to leveraged real estate, would come under pressure from rising inflation. We will be watching closely for the early warning signs of accelerating inflation, hoping to distinguish the real signals from the noise. Reports of a rise to about 3% year-on-year inflation in April and May should be understood in the context of the global shutdown last year; the early signs of sustainably higher inflation are likely to include rising oil prices, accelerating wages and significant deterioration in global trade.

We will also be watching for further evidence of improving productivity, as described on page 3. Increased productivity growth could fully justify the high valuation of the stock market and allow for attractive returns in the future.

We remain confident in our asset allocation in current market conditions. We will continue to adjust individual portfolios to meet each client's long-term goals and risk tolerance.

John Apruzzese is the Chief Investment Officer at Evercore Wealth Management. He can be contacted at apruzzese@evercore.com.



Inflation, But Not As We Usually Know It

By Brian Pollak

Inflation, said the late economist Milton Friedman, is taxation without legislation. In that context, it's not surprising that the strikingly low consumer price inflation of the past 20 years continues to support outperformance in both stocks and bonds. But other forms of inflation are on the rise, threatening future returns.

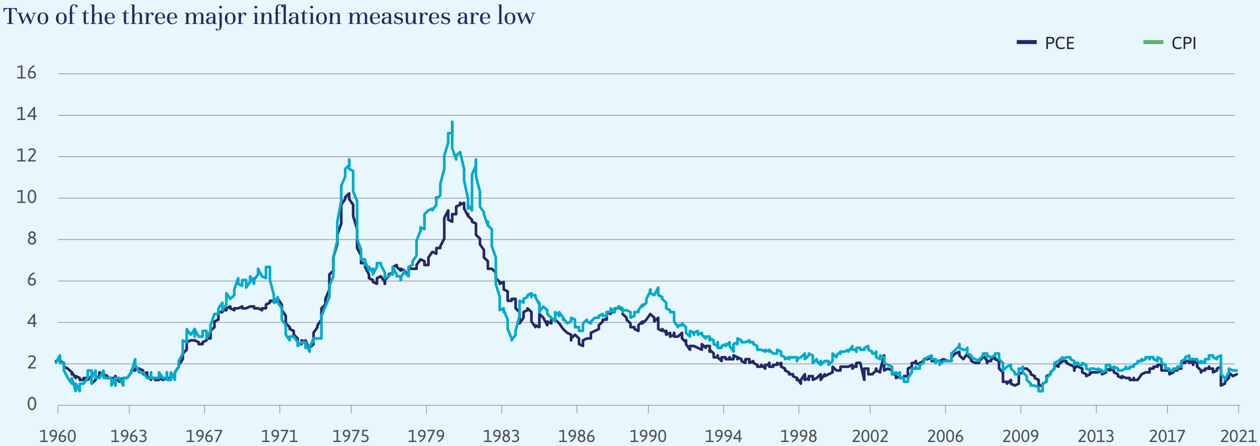
Let's take a look at the three main types of inflation: consumer price, monetary and asset price. The interaction among them will be a significant driver in the markets and bears close watching.

CONSUMER PRICE INFLATION

Price inflation is the price of goods and services experienced by both consumers and producers. The primary metrics used to measure consumer inflation are the

U.S. Inflation Rates Year-on-Year Change

Two of the three major inflation measures are low



Source: Federal Reserve Economic Data – December 31, 2020

Consumer Price Index, or CPI, and the Personal Consumption Expenditure Index (PCE). Both measure a market basket of consumer goods and services, but use different formulas and basket constructions. Both are important, but the PCE is the measure on which the Federal Reserve focuses most of its attention. While the Fed has a stated inflation target of 2%, both indexes have largely fallen short of the market over the past 10 years and appear to remain in decline.

The secular forces holding back consumer price inflation have included high debt levels, technological change, aging demographics and increasing globalization, and collectively they remain a considerable force. But the rising tide of monetary inflation might change that equation.

MONETARY INFLATION

Monetary inflation generally refers to increases in the supply of money, and is most commonly measured by the monetary base or "MB", which includes currency in circulation and money held in the reserve accounts of Federal Reserve member banks. MB represents the liability side of the central bank's balance sheet, while government debt (e.g., U.S. Treasuries) or other securities purchased by the central bank represent the asset side. As with any balance sheet, assets must match liabilities, so increases in central bank bond purchases simultaneously increase the monetary base. MB is tightly tied to"M2", a broader definition and a calculation that includes cash, checking and savings deposits, money market securities and funds, as well as other easily convertible "near money" deposits. M2 is closely watched as an indicator of money supply and inflation. A rise in MB drives M2 higher, as illustrated in the chart below. The significant increases in both Treasury purchases by the Fed and Treasury issuance in 2020 by the government have led to a corresponding spike in M2 not seen in over half a century.

Recent events have undermined the conventional wisdom that there is a direct correlation between M2 growth and consumer price inflation. The Federal Reserve, along with all developed central banks, has increased the size of its balance sheets to historic levels.

> *The inflation rate has remained under the Fed's target.*

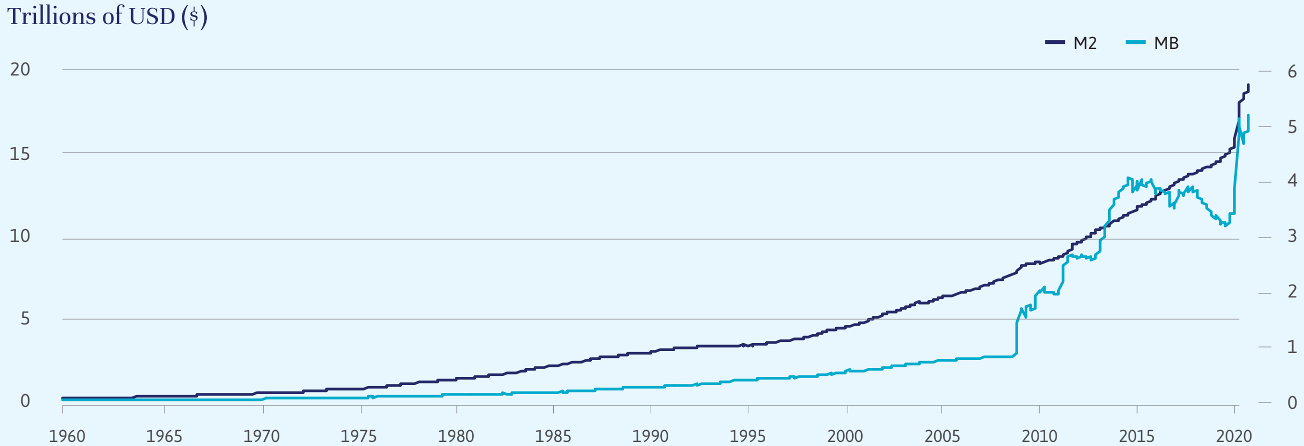
This began post the financial crisis of 2008-2009, slowed briefly late in the last decade, and accelerated to historic records since the COVID-19 crisis began. Yet the inflation experienced by consumers has remained under the Fed's target rate through this period of epic balance sheet expansion. Consumer inflation is even lower in Japan and the European Union, despite even more aggressive monetary policy actions.

ASSET PRICE INFLATION

It is clear that the money supply has leaked into the economy, but primarily in the form of asset price inflation. Monetary inflation impacts asset price inflation by creating excess liquidity and a lower discount rate, both of which allow for higher valuations. Fed treasury purchases push bond yields lower, encouraging savers to take on more equity and (lower quality) bond risk, to earn more return.

MB and M2 – Two Measures of Inflation

Trillions of USD ($)



Source: Federal Reserve Economic Data – January 31, 2021

The central bank balance sheet (MB) expansion and M2 stock increase have inflated financial assets, most obviously stocks and bonds, but also real estate, gold, Bitcoin, and collectibles like fine art. Again, the conventional wisdom has been challenged, as we still have not seen evidence of consumer price inflation in the economy – but asset inflation, along with M2 growth, has moved higher faster and more fiercely than in 2009.

Household net worth, probably the best metric to understand broad-based asset inflation, hit a U.S. record in absolute terms in the third quarter of 2020 at $123.5 trillion, according to Federal Reserve data. Much of the value of U.S. household net worth derives from ownership of equities, bonds and real estate. On a relative basis to disposable income and to GDP, it is near the post-WWII high and at the post-WWII high, respectively.

It's worth noting that asset inflation has primarily accrued to the wealthier part of society. Only slightly over half of U.S. households have a stake in the stock market, according to a Gallup poll conducted in 2020, but a separate Federal Reserve report shows that the wealthiest 10% own over 87% of the equities. Real estate is slightly more egalitarian, with 67% home ownership rates, but again, by dollar value, much of this is concentrated at the top. As wage inflation is a prerequisite for sustained consumer inflation, wage inflation that is equal to or especially in excess of consumer inflation would be one way to help alleviate this wealth disparity. It would mean less fiscal spending would be required for transfer payments, reducing the need for fiscal deficits and for aggressive monetary policies.

As discussed in the cover article of this issue, the potential for monetary and fiscal policy expansion to push consumer prices higher is far from a given. But it may be the single biggest risk to a traditional portfolio of stocks and bonds, as significantly higher consumer price inflation would likely take significant steam out of asset prices. While our base case remains a continued period of low inflation, we will continue to diligently monitor the factors that drive longer-term inflation and consider investments that could offer protection. As always, diversification of risk and appropriate asset allocation is our best defense against any long-term risk, inflation included.

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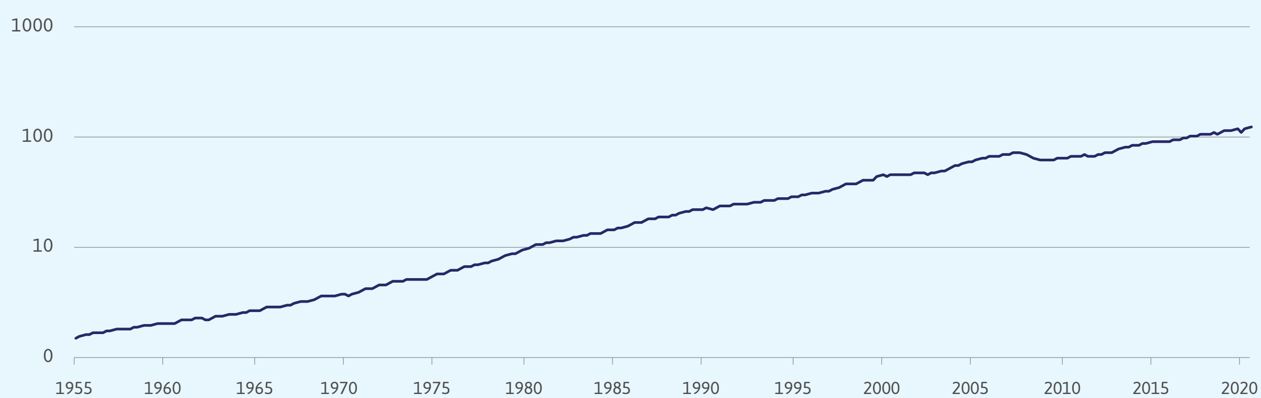
U.S. Household Net Worth

Trillions of USD ($)



Source: Federal Reserve Economic Data – December 31, 2020

Q&A
with Atul Rustgi of Accolade Partners

Atul Rustgi

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. Here we discuss opportunities in venture capital with Atul Rustgi, a Partner at Accolade Partners. Accolade is a venture capital and growth equity fund of funds, concentrating on the technology and health sectors. Please note that this represents the views of Accolade and not necessarily the views of Evercore Wealth Management.

Q: Venture capital investing is a long-term commitment, with investors sacrificing the liquidity of the public markets for the prospect of higher returns. What are the advantages of this approach to investing in the technology and healthcare sectors?

A: Given venture capital is a high-risk, long lock-up investment strategy, investors should be compensated with higher returns versus the public markets. We believe that software companies inherently have superior business models with high growth, high gross margins, high recurring revenue, low fixed costs, and the potential for significant profitability. As a result of these characteristics, public software companies are at all-time high valuations. What venture capital can provide is scale arbitrage, allowing investors exposure to these companies at both lower absolute valuations and lower multiples. Venture capital investors can benefit as these companies compound for 10-plus years in the private markets before entering the public markets at exponentially higher valuations.

Q: Your funds are focused on investing at the early stages and in growth rounds of financing. What do you think about valuation in the context of risk at these early stages?

A: Early- versus late-stage venture capital offer different risk returns. In early-stage venture, valuations are more compelling at sub $10-$50 million, where venture investors can achieve 10%-20% ownership of companies. Loss ratios for any early-stage fund can go as high as 60% of the portfolio, but if any one of these companies eventually achieves a multi-billion-dollar outcome, usually between five and 10 years from investment, they can return multiples of a manager's fund. In late-stage venture capital, given that the product-market fit has been established, loss ratios are much lower but valuations are much higher.

Q: You have also been active in healthcare IT and biotech. What trends do you see there?

A: Biotech continues to be very exciting, with significant levels of innovation. Areas of focus for our managers include oncology and neurology. Diagnostics also continues to be an area of focus. Recent advancements are enabling the use of liquid biopsy in cancer screening, therapeutic selection and drug trial optimization.

Healthcare information technology is an emerging investment area. The 2009 Recovery Act was the catalyst for the adoption of electronic health records, or EHRs. About $30 billion in incentives were given to hospitals and providers to implement the use of EHRs and reporting of clinical quality measures, which in turn enabled the submission of claims electronically and has catapulted the volume of healthcare data. As a result, we have seen an explosion of new companies that aim to synthesize and analyze data to provide insights that lead to better outcomes, from value-based care to new care-delivery models.

Q: You've been investing in blockchain technology for several years, an area that has the potential to disrupt many industries. How do you think about the risks in investing here and what opportunities are you finding? *Editor's note: For a primer on blockchain, please see page 9.*

A: We have spent years researching and landscaping in blockchain technology. We have gained significant conviction in the space and have launched a dedicated fund of funds vehicle to invest in the leading blockchain managers.

Several years ago when we started performing due diligence on the blockchain space, there were a number of concerns that gave us pause. First, regulatory: Would the SEC shut it down? Second, there was not a deep bench of institutional managers. Third, the best engineers were focused on traditional tech. And fourth, there was not enough product market fit outside of Bitcoin, nor any commercial traction.

Today, all of those concerns have been alleviated. On the regulatory front, the SEC is not shutting it down, but instead creating guiderails. From a manager perspective, there are now over 100 firms with a VC approach, and 10-15 stand out as leaders in the space. Talent-wise, all the top universities have highly sought-after programs across cryptography and distributed systems, and we consistently hear that the best engineering talent is now focused on blockchain. Finally, we have seen real commercial traction and product-market fit both within and beyond Bitcoin.

In addition to hedge funds and companies buying Bitcoin, financial service companies such as Square, PayPal and Visa are incorporating digital assets into their offerings. Furthermore, we are seeing growth in areas beyond Bitcoin, such as decentralized finance (commonly called DeFi), consumer applications and emerging areas such as non-fungible tokens.

We believe the decentralized business model is as disruptive to centralized business models as online was to offline and SaaS to perpetual license software. Consequently, we believe blockchain has return potential similar to venture in the early 1990s.

For further information on Accolade and the other externally managed funds on the Evercore platform, please contact Evercore Wealth Management Partner and Portfolio Manager **Stephanie Hackett** at stephanie.hackett@evercore.com.

Connecting the Blocks: A Blockchain Primer

By Jake Stoiber

Blockchain is well named. At its core a specific type of database, a blockchain collects data together into groups, or “blocks,” which store digital information, such as financial transactions or asset ownership records.

Imagine a series of these blocks. Each block has a specified storage capacity and, once full, is placed by a network computer next to the previously filled block by updating the openly viewable and editable record; it is only allowed to make this placement through network consensus. Now imagine those blocks linked together through cryptography, a computer-generated scrambling set to prevent alteration from outside parties. The result is an unbreakable (as far as we know) and irreversible list, or “chain,” crossing hitherto established silos and borders.

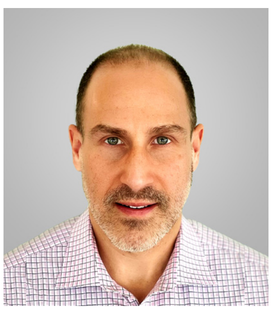
Bitcoin is the best-known application of blockchain technology: moving value online without the need for a trusted third party, such as a bank or payment network. But there is no end to other existing and potential applications. These include:

- Smart contracts, which execute objectively based on the piece of computer code written, for use in financial, government, legal or real estate transactions.
- Decentralized finance, or DeFI, transactions, replacing traditional banking and finance processes. Peer-to-peer lending and borrowing, and trading on cryptographic exchanges are good examples.
- Decentralized file storage networks, whether general, legal, medical or business-related.
- Advertising models in which users are paid (via tokens) for viewing ads and can elect to keep their own data (as opposed to those of Google, Facebook and the like that monetize user data).
- Stable value digital payment networks operating within existing social media platforms.
- Decentralized ride-sharing platforms.
- Supply chain information, for example in organic food and wine production.

We are all just beginning to appreciate the scale of potential blockchain application. It clearly can disrupt significant technology platforms and traditional business models in ways similar to the revolutionary changes brought by the internet. As with any new disruptive technology, some efforts will fail and others will reap outsized rewards. We expect blockchain to be an area of increasing investor focus.

Jake Stoiber is a Vice President at Evercore Wealth Management. He can be contacted at jake.stoiber@evercore.com.

Jason Sobol on Business Transaction Planning



Editor's note: Jason Sobol is a Senior Managing Director of Media and Information Investment Banking at Evercore and the Co-Head of U.S. Advisory. He focuses on advising companies in the information and media sectors, and in the past year he has advised Clarivate on its merger with CPA Global, IXL Learning on its acquisition of Rosetta Stone, Red Ventures on its acquisition of CNET, RetailMeNot on its sale to J2 Global, and Comscore on its equity raise from Charter Communications, Qurate Retail and Cerberus.

Q: Jason, many of our readers have built businesses of their own, not dissimilar from the many founder-owned businesses in your industry sector. How would you suggest that they think about an eventual exit?

A: The right time to sell a business to maximize value is when the stars align around four primary factors: market conditions, industry dynamics, buyer strength, and business momentum. Obviously, we spend a lot of time discussing the first three with our clients, but those are out of our clients' control. The business trajectory is in a company's control and is a key determinant to optimizing when a business enters a potential sale transaction process.

The design of that process should be customized to the particular objectives of the founder-owner. Typically, most owners want to maximize value, speed of process and certainty of transaction closing. With family founder-owned businesses, we also appreciate the importance of legacy as an additional objective, which can have its own intrinsic value to a family-founder, and can influence both the optimal timing of a transaction and the process structure itself.

Q: What do you mean by legacy in this context?

A: For founder-owned businesses, legacy can include estate planning, employee protections, political, succession objectives or other considerations (the founder may have preferred buyers in mind, for example); a whole set of objectives beyond the dollars. For example, let's take succession: Many founders wait until they feel done – ready to sell and completely retire. If that founder is also an active CEO, any buyer paying a premium value for the business is probably going to expect the founder to have some "roll and role" – reinvesting equity into the transaction and also sticking around in some capacity for a period of time for an orderly succession transition. Founders should take such considerations into account when optimizing the timing of a sale process.

Founders may have a bias to certain strategic acquirers as the perfect home for their business, customers and employees. This criteria may warrant a customized process that engages with certain strategic buyers sequentially versus simultaneously with other financial and strategic acquirers.

As a result, legacy and founder-specific objectives have profound implications on both the timing and structure of a transaction process.

Q: Does that mean founders often leave business transaction planning too late?

A: Correct. It takes planning well in advance to optimize the outcome. That's why we are always talking to founder-owners about where they are in their succession curve, as well as helping them understand the market dynamics and sensitivities of potential buyers. If a founder-CEO wants to completely exit the business, such a business owner should either execute the succession plans well in advance of a transaction or prepare to do so for some period of time after a transaction. Leaving that risk to a buyer could have profound implications on the achievable value for the business.

These can be hard conversations, but the interplay between process timing and valuation is important. We really get to know our clients very well to advise on such personal dynamics, and wealth management has an important role to play in that process as well. That's another workstream that should be started well in advance of a sale, to include the seller's estate and tax structure as part of the overall plan.

Q: It sounds like you have a lot of experience in these transactions in your industry sectors.

A: The information and media industries are remarkably fragmented and full of family-founded businesses. There are a lot of data or media companies out there, many with less than $50 million in revenue. At the core of these businesses is content or data – information that engages consumers or informs professionals to make decisions. That content or data is scalable, created once and provided to many. With inherent fixed costs to media and information businesses, such companies have intrinsic operating leverage and compelling financial profiles with stable cash flows. Not surprisingly, such businesses are coveted by both private equity firms and strategic buyers. Our advisory work and the transaction processes we design for these types of businesses have to align with the specific objectives of founder-led businesses – often a combination of maximizing value, deal certainty, speed of transaction and legacy factors.

With the world today increasingly driven by information and disruption from technologies that facilitate real-time decision-making based on data, this is one of the most exciting times in this space. So yes, we have seen a lot of deals, and we expect to see a lot more.

Evercore Wealth Management and Evercore Trust Company, N.A. are part of Evercore. For further information on transaction planning at the firm, please contact Evercore Wealth Management and Evercore Trust Company CEO **Chris Zander** at zander@evercore.com.

Great Business Transitions Take a Team

By Ashley Ferriello

Business founder-owners are often so focused on managing their businesses that they struggle to prepare for the eventual transition, both on the business front, as described here and on page 10 by Evercore Senior Managing Director Jason Sobol, and on the personal level. Assembling the right team can ease that burden, ensuring the best possible deal and opening up vistas in the next stage of life.

Key members include:

- **Investment Banker or Business Broker:** Depending on the size and complexity of the company, either an investment banker or business broker can help value the company, identify suitable prospective buyers, structure the deal, and negotiate and advocate on behalf of the business founder-owner.

- **Wealth Advisory Team:** A holistic approach to a business transaction includes a team of wealth advisors who will work closely with the founder-owner's other trusted advisors and will, as appropriate, engage and educate the entire family, advocating for and representing their personal planning goals and objectives. This team leads financial and estate planning strategies to meet long-term lifestyle, family, philanthropic and future business goals, supported by an asset allocation and investment plan tailored to the long-term objectives. Personal planning should be considered as early as possible in advance of a transaction.

- **Specialized Attorneys:** A well-managed transaction is likely to include both a corporate attorney and an estate attorney. The corporate attorney represents the business being sold and will review information disclosures to investors, opine on the various potential structures of a transaction, negotiate and draft confidentiality, employment, and purchase and sale agreements, and orchestrate the closing of the deal. An estate attorney represents the founder-owner and his or her family, to ensure a properly positioned estate plan, as well as tax-efficient wealth transfer strategies pre- and post-transaction, as appropriate.

It's All in the Details: A Checklist for Founder-Owners

Pre-transaction

- [ ] Engage in a comprehensive family wealth and business assessment to clarify and develop a goals-based wealth plan.
- [ ] Identify and implement tax-efficient wealth transfer strategies to transition assets with potential for growth to future generations.
- [ ] Review current and future liquidity needs to ensure lifestyle sustainability, including replacing income previously derived from the business and offsetting expenses previously charged to the business.
- [ ] Structure and minimize income, gift and estate taxes related to the transaction, factoring in domicile, residency and trust situs considerations.
- [ ] Consider individual and family philanthropic goals while taking advantage of charitable planning strategies and available tax deductions.
- [ ] Consider asset location with respect to investment strategies across family entities (i.e., trusts).

Post-transaction

- [ ] Develop post-transaction equity diversification strategies while remaining mindful of securities laws relating to restrictions on selling, hedging and borrowing of restricted stock.
- [ ] Engage in the management of more diversified liquid and illiquid assets, as well as any retained concentrated holdings.
- [ ] Review cash flow, to ensure that income from the business and ongoing expenses previously charged to the business are sufficiently replaced.
- [ ] Supplement existing knowledge with family governance and private wealth education.

- **Accountants or Tax Advisors:** At least one and possibly multiple accountants or tax specialists, depending on the complexity of the deal, will play an important role on the team. Simultaneously, a founder-owner could have his or her personal CPA help coordinate advanced planning strategies for wealth transfer, charitable giving, or other tax-efficient planning pre- and post-deal.

- **ExtendedTeam:** A business valuation specialist, life insurance professional, or an exit-planning specialist may also have valuable roles to play in managing a successful business transition.

Evercore Wealth Management works closely with business founder-owners and their other advisors, providing comprehensive pre- and post-transaction planning.

Ashley Ferriello is a Partner and Wealth & Fiduciary Advisor at Evercore Wealth Management and Evercore Trust Company. She can be contacted at ferriello@evercore.com.

Time to Plan for Progressive Tax Changes

By Pam Lundell

The Biden Administration's majority in both the House and the Senate, while slim, could result in tax legislation aimed at high net worth individuals and at corporations. Negotiations will require compromise and perhaps budget reconciliation, which allows passage with just a simple majority. Other priorities, such as managing the COVID-19 response and Cabinet appointments, will probably take time. But President Biden's message is clear, and planning now for a progressive tax code is prudent. President Biden's proposals, as illustrated on page 16, include raising taxes on taxpayers making more than $400,000 and expanding Social Security tax on earned income over $400,000. For individuals, the highest marginal tax rate would rise to 39.6% from 37% at present.

And for taxpayers with over $1 million in income, capital gains and qualified dividends could be subject to ordinary income tax rates, in addition to the current 3.8% net investment income tax. This would equate to a federal tax rate of 40.8% as compared to 23.8% currently.

The Administration has also proposed doing away with the popular 1031 like-kind exchange, which for almost 100 years has allowed taxpayers to defer capital gains tax on the sale of property held in a trade or business or held for investment if the proceeds were reinvested in a similar property. Examples include land, residential, commercial and rental properties.

Other proposals include capping itemized deductions at 28% and restoring the Pease limitation, which applies a 3% reduction of some deductions based on excess income over certain income thresholds. Repeal of the $10,000 SALT cap (deduction for state and local tax) has also been proposed, which could be beneficial for some taxpayers, if they are not also subject to the alternative minimum tax.

$400,000

Current proposals include raising taxes on those making more than $400,000

Tax

> *Tax-deferral strategies continue to make sense in this environment.*

Income tax planning in a time of flux can be tricky. Acceleration of income to avoid potential future higher rates can backfire, and we believe investments in securities as well as a business or real estate should only be sold in the context of broader investment considerations. Tax-deferral strategies such as maximizing retirement plan funding and deferred compensation continue to make sense in this environment. For property sales, accelerating a 1031 like-kind exchange could be prudent, and using the installment sale method would allow for tax deferral. Further, if charitably inclined, charitable remainder trusts, or CRTs, provide stock diversification with gain recognition over a term of years while providing a stream of income for the duration of the trust as well as an upfront charitable deduction. Finally, a disciplined tax loss harvesting approach could offset gains.

Estate plans should also be reviewed now. President Biden has indicated his support for returning the estate, gift and generation-skipping transfer, or GST, exemptions to the levels in place before the Tax Cuts and Jobs Act of 2017, or TCJA. The top tax rate could increase to 45% from 40%; the gift exemption could be limited to $1 million; and the estate and GST exemptions could be reduced to either $3.5 or $5 million, adjusted for inflation, down significantly from the current exemption of $11.7 million per person. The Biden plan would also eliminate the step-up in basis at death, although it's not yet clear whether the tax on the unrealized gain would be due at death or when an heir later sells the asset. However, previous attempts to eliminate the basis step-up have been ultimately unsuccessful.

> **2025**
>
> The current estate, gift and GST exemptions are scheduled to sunset in 2025.

Anyone who wishes to utilize their remaining estate, gift and GST exemptions before the TCJA sunsets at the end of 2025, or new legislation reduces the levels, should consider accelerating planning now, focusing on certain strategies in particular. Spousal Limited Access Trusts, or SLATs, can utilize exemptions while providing support to a spouse if needed. Grantor Retained Annuity Trusts, or GRATs, are also attractive, especially in this low interest rate environment, as are strategies that freeze gift values or take advantage of discounts. And, as always, we believe that taking advantage of the $15,000 annual exclusion gift and the gift exclusion for payment of qualified medical and education expenses makes good sense. If appropriate, consider using the larger generation-skipping transfer tax exemption amount to fund Dynasty or "Perpetual" Trusts in favorable jurisdictions like Delaware.

So plan now, and thoughtfully consider implementation. Of course, any aggressive gifting plans should never come at the expense of lifestyle funds, a healthy sense of control over your own affairs and/or family legacy objectives. Your Evercore team will be pleased to help you model likely outcomes and incorporate proper governance preparing for change.

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Potential Tax Law Changes

	Current Law (2021)	Proposed
Individual Rates	• 10%, 12%, 22%, 24%, 32%, 35% and 37%	• Increase top rate to 40.8%, or more if income tax rates rise. Taxpayers with income over $400,000 could see tax increases.
Capital Gains Rates and Investments	• 0% for 0-12% bracket, 15% for 22% -35% bracket, 20% for 37% bracket • 3.8% Medicare tax applied to lower of NII or Modified Adjusted Gross Income over income thresholds	• Tax at ordinary income rates for taxpayers with income over $1 million • Retain 3.8% Medicare tax • Reform QOZ to make qualification more restrictive • End 1031 exchange for real estate
Credits and Deductions	• SALT cap of $10,000 limit on deduction for state and local taxes • Standard deductions higher	• Cap itemized deductions at 28%. Restore Pease limitations for incomes above $400,000. • End or modify SALT cap
Qualified Business Deduction	• Up to 20% deduction of income for eligible taxpayers	• End special qualifying rules, including those for real estate investors. Phase out the deduction for taxpayers with income above $400,000.
Corporate Tax Rates	• 21% tax rate • 10.5% on foreign sourced profit	• 28% with 15% minimum book tax on companies reporting more than $100 million in the United States but that paid zero or negative federal income taxes • Surtax on U.S .companies making products overseas and selling in the United States • 10% credit for certain domestic production • 21% tax on foreign sourced profit
Employment/ Social Security Taxes	• 6.2% Social Security tax on wages up to $142,800; 1.45% Medicare tax on all wages • 0.9% Additional Medicare Tax on income above certain thresholds	• Lift Social Security taxable wage base cap on high earners, imposing 6.2% tax on wages >$400,000 for both employer and employee
Estate Taxes	• Federal exemption $11,700,000 per person • 40% tax rate	• Eliminate step-up basis at death. Not yet clear if capital gains tax will be paid at death or later when heirs sell. • Reduce estate tax exemption to $3,500,000 or $5,000,000 adjusted for inflation • 45% estate tax rate • Reduce gift tax exemption to $1,000,000 • Modify GRAT rules and valuation discounts

Source: Trump, Biden Tax Plan Comparison, Bloomberg Tax & Accounting

Home Is Where the Tax Exemption Is: Placing Property in Trust Now

By Tom Olchon

More than ever, home is where our hearts are. Home may also be a cornerstone in our wealth transfer planning, allowing families to utilize the still high lifetime estate tax exemption, without sacrificing liquidity.

Let's back up. The estate tax exemption, as discussed on page 14, is scheduled to sunset in 2025, with talk of cuts to previous levels indexed for inflation or even less from the current $11.7 million per individual. There has also been some discussion about eliminating the step-up in basis at death. Not surprisingly, many families are exploring wealth transfer options now. But tapping liquid assets can mean compromising lifestyle and other considerations, as well as the risk of generating significant taxes. Placing primary and secondary (or other) residences in trust could provide a tidy solution.

Consider two recent residents of New York who are making some big and potentially very tax-efficient changes in their lives. Their Florida vacation home will soon be their main residence, and their home in Long Island, where they raised their children and still have many friends, will become their summer place. (As discussed in *Florida Bound: Moving to a Warmer [Tax] Climate* by Helena Jonassen (click here), changing domicile can be tricky; we recommend working very closely with advisors.)

This approach could work at least as well for other illiquid assets.

In this couple's case, changing domicile has been well worth the effort; their income tax and estate tax situation is obviously improving (as Florida imposes neither) and they are flexing new muscles at work and play, exploring their new neighborhood by bike and photographing local birdlife. To utilize their exemption, the couple created two trusts: one a Spousal Limited Access Trust, or SLAT, for the lifetime benefit of the other and then on to their children, grandchildren, and future lineal descendants; and the other a Generation-Skipping Tax-Exempt Trust, or GST trust, also for the benefit of their children, grandchildren, and future lineal descendants.

More to our point here, the couple also retitled their New York property to tenants in common from joint name. This allows one partner to use half of the property to fund the SLAT, while the other can fund the GST-exempt trust. Like many of those implementing similar strategies, the couple and their advisors created an LLC structure to own the property before gifting it. This makes transferring the property easier and provides some efficiencies related to its ongoing management. A subsequent valuation took into account a 25% discount for their relative lack of control over the property, minimizing the amount of exemption used in each transaction while funding both trusts.

The two trusts are now paying the insurance, taxes, and maintenance on the New York (and now vacation) property, amounts that are offset by the couple's payment of a fair market value rent to use the property as they like. (These grantor trusts do not have to pay income taxes on the rental income.) The couple is aware that the fair market value of the rent may be in excess of the cost of carrying the property, but the potential hit to their liquidity is marginal compared with the one they would have incurred had they transferred other assets. There is an additional benefit to rent above expenses in that it serves as another tax-free transfer to heirs and can put a real yield on the property.

It's worth noting that if the residence gains significantly in value, the couple could swap inclusion in the trust for other assets of equal value but with a higher cost basis. The house would then be included in the estate and the heirs would benefit from the step-up in cost basis (a readjustment of the value of an appreciated asset for tax purposes upon inheritance). This assumes that the step-up remains in effect.

0%

Florida income and estate tax

It's also worth noting that this couple's entire approach could work at least as well for other types of illiquid assets with appreciation potential. These and other related issues, including family governance, are matters for discussions with family members and advisors, including corporate fiduciaries. (In this case, the couple works with Evercore Trust Company.)

Ironically, this couple remains relatively liquid, thanks to what many of us consider our most illiquid asset – the family home. It sounds like a lot of planning – and it was – but they are pleased to be wrapping it up and are looking forward to the next stage of their lives.

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Waiting for Another Brief and Shining Moment: Preserving the Arts

By Jeff Maurer

It's been more than a year since I – and I'm guessing you – enjoyed a live performance. I've been hooked on the theater since 1961 when my parents took me to see *Camelot*, the Lerner and Loewe musical starring Richard Burton, Julie Andrews and Robert Goulet, at the Majestic in New York City. And I was so looking forward to seeing *The Lehman Trilogy* last spring along with some of our clients. But … well, you know this particular plot twist: Stages, along with concert halls and comedy clubs, went dark, with millions of performers, stagehands, ushers and back office personnel left bereft of livelihood and passion.

Their virtual efforts, however admirable and entertaining, don't seem to me a satisfying substitute for the real thing (although a recent production of *Meet Me in St. Louis* by the Irish Repertory Theater of New York came close). I miss the intimacy of the venue, of being part of the audience as we are transported to a new place, swept up in the drama, the mystery, the music and the laughter. I miss rising together, with one voice, to thank the cast for sharing their talents with us.

That talent is still out there: More than five million Americans make their livelihood in the broader arts, at the National Endowment for the Arts' last count, with more in New York alone than in finance, tech or education. They are waiting in the wings, working at other jobs, hoping for better days. I like to think that they miss us too.

Arts and culture represent 4.5% of U.S. gross domestic product, or GDP, a proportion larger than that contributed by industries as diverse as construction, agriculture, and transportation. The $75 million appropriated back in March by Congress through the CARES Act to preserve jobs and help support organizations forced to close wasn't nearly enough.

In the interim, we can help. One of the great privileges of a career in wealth management has been to work with clients who integrate the arts into their lives, sharing their enthusiasm with their families and, often, with their communities. Many of our clients are

continuing to support the arts by keeping subscriptions and memberships current and by donating to favorite institutions.

We can help, whether your interests are in the arts or in the many other areas affected by the duration of this pandemic. It's worth noting that this may be an opportune time to diversify appreciated stock positions in anticipation of higher income and capital gains taxes, if that makes sense in the context of broader retirement, family gifting and philanthropy goals. (See Pam Lundell's article on page 14.) It's also a good time to consider strategies such as charitable split interest trusts.

4.5%

Arts and culture represents 4.5% of the GDP

It's been 60 years since I first sat in that theater, enthralled by the trials of Arthur, Guinevere and Lancelot. I will be at least as thrilled to see the lights switch back on and to wait with the rest of the (inoculated) audience for the curtains to rise again.

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