

INDEPENDENT THINKING

THE NEW STANDARD IN WEALTH MANAGEMENT

EVERCORE
Volume 45

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Low-Resource World

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Gifting and Letting Go:
Emotional and
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THE NEW STANDARD IN WEALTH MANAGEMENT

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A Message from the CEO



It's summertime, and the living is a little uneasy. We entered a bear market on June 13 and are experiencing the highest inflation in three decades, the biggest rate hike by the Federal Reserve since 1994, and continuing geopolitical instability. Still, this season is always welcome, and we are mindful that there are opportunities – as well as risks – in all market conditions.

The important thing, as many of the articles in this issue of *Independent Thinking* stress, is to remain focused on long-term goals. We've enjoyed a long period of extraordinary market gains, but the real test of wealth management is in helping clients manage through the inevitable downturns. That's an art and a science, and you'll find both aspects addressed here through different lenses in articles by John Apruzzese, Jeff Maurer and others. If this sounds familiar, that's because we have written about this subject many times in *Independent Thinking* and broach it often in client conversations. We feel strongly about modeling market drawdowns, as we believe that families and institutions need to be made aware of the potential impact, to plan and invest accordingly. Partners at our firm and other senior professionals at Evercore have experienced similar market conditions, including the 2007-2009 recession that forged our firm, and I believe that our teams – and clients – benefit greatly from this collective wisdom.

Down markets can also provide an opportunity to efficiently accelerate long-term wealth transfer plans. Justin Miller touches on that in his article on gifting, along with the importance of fully preparing beneficiaries, while Tom Olchon

considers the challenges associated with gifting digital assets. Also in this issue is a very thoughtful article by Brian Pollak on socially responsible investing. We have dedicated considerable time and effort in refining our advice and solutions in this area, to serve interested clients. We remain convinced that ESG, impact and socially responsible investing mean different things to different people and that creating truly customized portfolios, managed and measured according to solid investing principles and tailored to each client's specific views and goals, is the best approach.

On another note, I hope that you've been able to join our recent webinars. I may be biased, but I think they are getting better and better. They are not a substitute for in-person gatherings, which we hope to safely resume soon, but I expect that they will remain an important part of our educational programming, as we've had terrific client engagement. We had near-record attendance for our latest investment outlook, and again for our discussion on the practical and emotional aspects of giving to children and grandchildren. You will see recaps of each here; if you would like to watch the webinars in full, please visit our client site or contact your advisors. As always, please let us know your thoughts.

COVID is still with us, of course, but life generally, and the workplace in particular, feels a lot more like it used to, but even better as we've adopted more flexibility. Our own teams are fully in gear and our offices are humming. Indeed, the lobby and elevators here at our New York headquarters are packed at present with the new cadre of Evercore (and our own Evercore Wealth Management) interns, all bristling with nerves and excitement. They are a welcome sign of the season and a reminder that even after so much change, life goes on.

In short, we are prepared for continued volatility in the markets against unsettled – and sometimes unsettling – economic conditions. But we are grateful for a return to more normal working conditions, for the companionship of our colleagues, and, always, for our clients.

I hope you and your family have a wonderful summer.

A handwritten signature in black ink that reads "Chris". The signature is fluid and cursive.

Chris Zander
President & Chief Executive Officer

Investing in a Low-Resource World

By John Apruzzese

It took just three months for COVID-19 to spread around the world, followed by supply chain shocks and now persistent inflation, a reminder of just how interconnected we all still are. But globalization, in spirit and in practice, is in retreat and cracks are appearing throughout the U.S.-centric trade and finance system. In an increasingly resource-constrained world, risks and opportunities for investors may need to be recalibrated.



*Globalization, in spirit
and in practice, is in retreat*

Take a look at the chart below. Global trade took off in 1991, with the end of the Cold War. And it really got going after 2001, with China’s participation in the World Trade Organization, sparking years of growth that lifted millions of people throughout the developing world out of poverty. Global access to the natural resources previously locked behind the Iron Curtain – and to the huge labor and growing consumer markets in China – paid significant dividends, notably to multinational corporations. U.S. investors and Americans generally benefited from the world’s willingness to retain trade gains in U.S. dollar-based assets, allowing the United States to finance its ongoing trade deficit.

The United States and China effectively pressed rewind on globalization about five years ago, when the United States implemented stiff trade tariffs on Chinese goods and China became more autocratic and less capital-friendly.

And Russia has critically compounded fears of a new Cold War with the invasion of Ukraine. As of March 2022, global trade volumes are down 0.9% from the end of 2021, and growth projections continue to decline for 2022 estimates.

Now, U.S. companies are scrambling to onshore manufacturing or to at least diversify their sources away from China but are finding the effort neither easy nor inexpensive. Many tech companies, such as Google and Amazon, have pulled some of their businesses out of China, but at present, the United States remains dependent on both Chinese consumer goods and on semiconductors produced in Taiwan and South Korea.

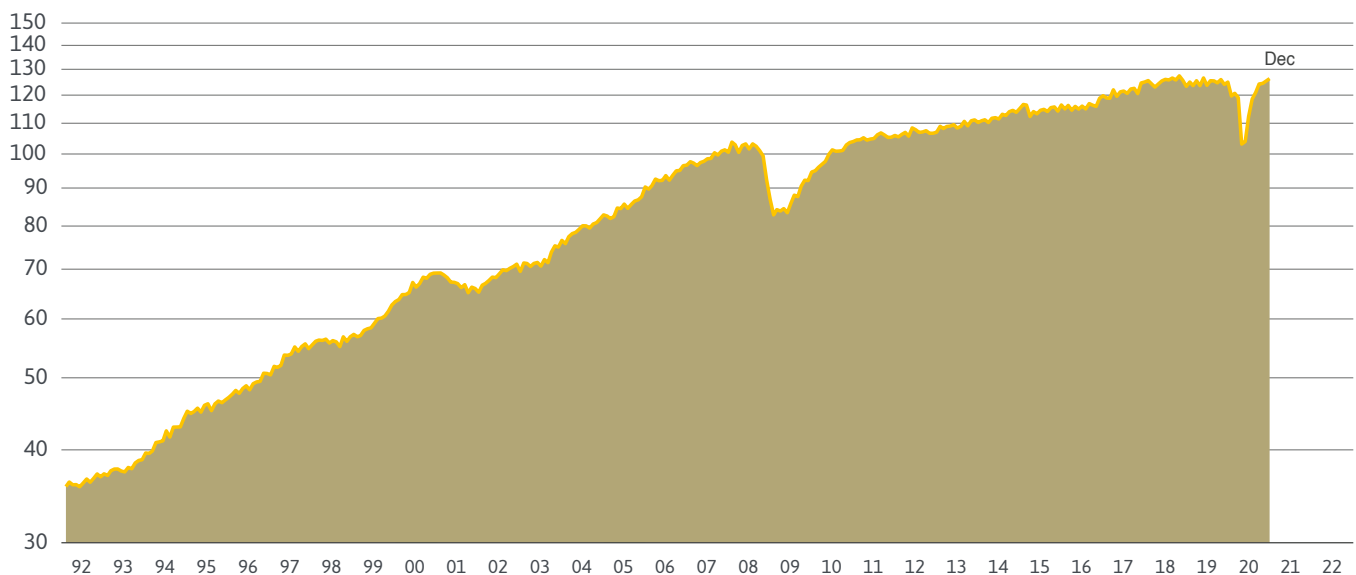
China has stopped buying U.S. Treasuries. That’s been okay so far. As illustrated on page 5, alternatives for global investors are limited and total demand for U.S. dollars is still high.

U.S. energy independence is good news, of course, but it does mean that the United States has less incentive to guarantee the security of international trade routes and stabilize the Middle East. Consider the trade disruption underway as Europe scrambles to reduce its dependence on Russian oil and gas, a difficult transition in the long term and almost impossible in the short term. The Persian Gulf countries produce 30% of the world’s oil, compared with Russia’s 10%, so the potential for trouble is that much greater.

Russia and Ukraine are also major exporters of wheat, vegetable oils and fertilizer, and the resulting shortages are exposing vulnerabilities around the world. Consumers everywhere are being hit with high prices for essential foods and, as always, the poorest are being hurt the most. Geopolitical alliances could shift in favor of China and Russia as governments in developing countries try to ward off starvation.

World Exports (Volume)

(trillions dollars, seasonally adjusted, 12-month sum, ratio scale)



Source: Yardeni Research, June 13, 2022



Investment Outlook Webinar

Maintaining Equilibrium: The Evercore Wealth Management Investment Outlook

Recession, if it comes, could impact portfolios.

The *Independent Thinking* webinar “Maintaining Equilibrium: The Evercore Wealth Management Investment Outlook” assessed the likelihood of a recession and our positioning across our asset classes, as well as potential opportunities for wealth transfer.

For further information or to view the replay, please contact **Michael Beck** at michael.beck@evercore.com or 212.822.7634.

The high inflation rates that we and the rest of the world are now experiencing are a negative for almost all investment asset classes. Investors force values down as inflation mounts, not because the underlying assets are necessarily deteriorating, but to increase the future nominal expected return to make up for the higher inflation rates. Eventually, stocks should be an inflation hedge as well-managed companies adjust to the new reality, but that takes time.

It’s tempting to consider hedges. But attempting to invest in short-term inflation hedges can be a dangerous game. Commodity prices move up rapidly during an inflation shock, as they have recently, but the long-term returns from investing directly in commodities is very poor. Commodity producers present an opportunity, but timing is critical; most commodity producers are not good long-term investments because they tend to lack a competitive advantage. And Treasury inflation protection bonds,

or TIPs, are not as helpful in combating inflation as one might think. They have generated a negative return this year through May 31 because real interest rates have moved up along with inflation, causing TIPs prices to fall. Only when real interest rates reach an acceptable level do they become a good inflation hedge. The real yield on the 10-year TIPs has only just turned positive, so we will be watching this market closely.

For investors, there’s a lot to think about. This is a good time to revisit both long-term goals and attitudes to risk, as Jeff Maurer discusses on page 14, and to review capital market assumptions. Our balanced composite has experienced about an 11% drawdown so far this year.¹ If we have a recession in the next 12 months, on which we are at present assigning a 40% probability, balanced accounts could drop another 10% or so as the stock market prices in falling earnings, in addition to the valuation reduction that we have already experienced. (See the

article on page 9 addressing our focus on investing in high-quality companies.) The yields on longer-term bonds out 3-10 years are starting to get interesting but could go higher if inflation is not contained, so caution is warranted in this asset class as well.

Our primary focus at present is on wealth preservation, and we remain confident long-term investors. We continue to rebalance portfolios and reexamine risk tolerance, in the context of individual client goals and tax considerations. We are maintaining sizable allocations to defensive assets, as well as to illiquid investments, again as appropriate for each client. Finally, we continue to overweight the United States, as we have done for years, a position that has served many of our clients well. In this resource-challenged environment, the United States is not immune, but we are relatively self-sufficient, in food and many other commodities, as well as in energy.

¹ The performance results of the balanced composite are based upon the returns of fully discretionary managed accounts with a designated investment objective of Balanced and no investment restrictions. The performance results mentioned are net of fees reflecting the deduction of actual fees of the accounts included in the composite and are through 5/31/22.

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

Betting on the Greenback

By Jake Stoiber

China’s pullback in new purchases of U.S. Treasuries is only the latest challenge to the U.S. dollar’s 60-year supremacy; others have included the formation of the European Monetary Union, the rise of Japan and China as global economic powers, and other changes to the international monetary system.

But the size of the U.S. economy, its importance in international trade, and the depth and openness of its financial markets have so far preserved the dollar’s status. It continues to serve as the world’s primary reserve currency, meaning countries around the world, as illustrated below, choose to hold large amounts of U.S. dollars for transactions, trade and monetary value preservation.

As John Apruzzese discusses on page 2, this long-term global preference for U.S. dollars has benefited the United States in major ways, lowering the cost of capital for its government and corporations, and strengthening the purchasing power of its citizens. From Wall Street to Main Street, this is a big advantage and one of the reasons we remain overweight to the United States in our portfolios.

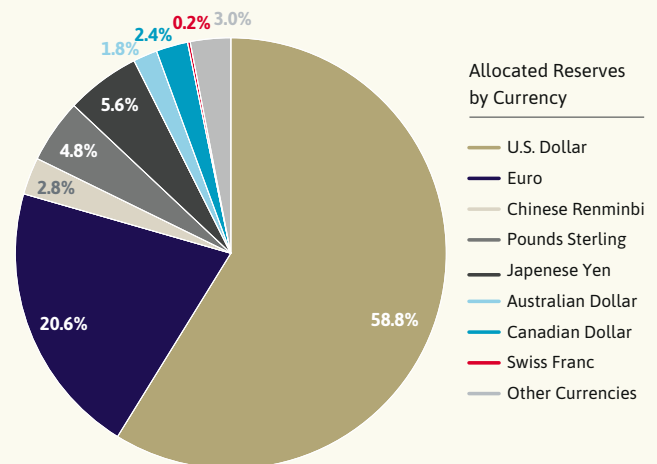
Jake Stoiber is a Vice President at Evercore Wealth Management. He can be contacted at jake.stoiber@evercore.com.

Top 10 Official Foreign Holders of U.S. Treasuries (\$billions)

	Total	Percent
Japan	1,232	16%
China	1,040	14%
United Kingdom	635	8%
Ireland	316	4%
Luxembourg	301	4%
Cayman Islands	293	4%
Switzerland	274	4%
Belgium	265	3%
France	247	3%
Taiwan	238	3%
Total for all Foreign Holders	7,614	

Source: United States Department of the Treasury, March 2022

World Allocated Reserves by Currency



Source: International Monetary Fund – December 31, 2021

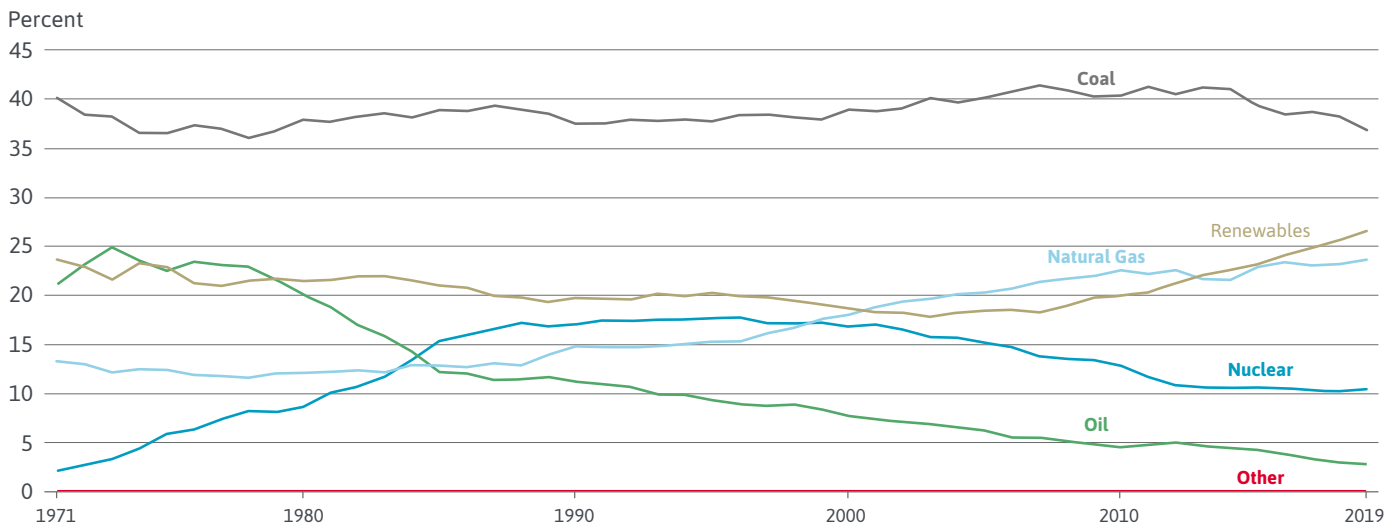
ESG: Tough Love in a Changing Environment

By Brian Pollak

It still isn't easy being green. Some environmental and, for that matter, social and governance investing practices are under attack, as regulators and the financial press question the aggressive marketing of ethical principles to attract trillions of dollars in global capital. This scrutiny is long overdue and should ultimately benefit investors who hope to help create a better world. In the interim, current events are refining how individuals and institutions feel about ESG investing.

World electricity generation mix by fuel

1971–2019



Source: International Energy Agency, August 9, 2021

For example, inquiries regarding how ESG scoring integrates gun control skyrocketed after mass shootings, as one might expect, so much so that some large ESG investment solutions changed their methodology. More recently, however, many investors are reconsidering technology company exposures, hitherto the darlings of many ESG portfolios, over concerns about the risks associated with social media and the companies' own governance issues.

*Many investors
are reconsidering
technology company
exposures*

The most dramatic changes in sentiment apply to U.S. domestic energy and defense contractors, two sectors that have traditionally scored very poorly on the screens of ESG data providers. But now the thinking goes something like this: Should a domestic natural gas producer sending liquefied natural gas to Europe now be considered socially responsible? What about a defense contractor that sells weapons to a country fending off an invasion? And should ESG scores for companies with high levels of exposure in revenues to countries run by autocratic or totalitarian dictators begin to negatively impact scoring?

There are many lenses by which to view ESG. With high inflation, driven by a combination of monetary and fiscal stimulus and myriad supply chain disruptions, as described by John Apruzzese in the cover article of this issue, underlying changes are even – and controversially – taking place to the area historically

*There are many lenses by
which to view ESG.*



viewed as the least ESG-friendly: the global fossil fuel and energy sector. Proponents note that some of the companies in this sector are leaders in building out renewable infrastructure, looking for and finding new and more sustainable forms of energy, and adding technology components to traditional energy production to improve the carbon footprint.

27%

the proportion of global electricity represented by renewables.

All of the energy markets have been significantly disrupted by the war in Ukraine, and as a result, much of the globe is reconfiguring its energy infrastructure. It has become clear that access to natural resources that are either domestically produced or produced by a trustworthy geopolitical partner is important. As a result, this reconfiguration is likely to take years, not months or quarters, as countries work to ensure a stable energy supply through a combination of fossil fuel and renewable power. This means tighter supplies, more energy scarcity, and likely higher prices for the foreseeable future. Renewable power sources are responsible for just 27% of the global electricity generation at the International Energy Agency's last count in 2019, significant progress from 2011 when it represented only 20 percent. But even this tremendous

growth has only served to keep fossil fuel usage stable, not shrink it at a global level. This may require continued investment in methods to transition to a cleaner economy alongside, not just at the expense of, the fossil fuel industry.

In the interim, the focus of governments everywhere is on getting reasonably priced energy to those that need it to heat their homes and offices, fuel their cars, plows, trains and planes, and power their factories and hospitals. This is likely to involve the use of traditional fossil fuels, natural gas, oil and perhaps even coal, which, while losing energy market share, unfortunately still remains the dominant fuel input in many countries and represents over 35% of global electricity generation.¹

None of this is to say that fossil fuel or renewables are inherently bad or good investments. The fundamental quality of any investment is a function of both its future cash flows and the price paid for those cash flows. Many fossil fuels-focused investments did relatively poorly over the past decade, the result of investors' expectations that cash flows would soon diminish. That's changed, at least in the short term, with the realization that the horizon for change is receding.

Clearly, investors must use their judgment in determining if and how to balance the desire to participate in the eventual transition to a more sustainable global carbon footprint with the realities of the current energy needs of the global economy. ESG means very different things to different people, and that decision

ESG means very different things to different people.

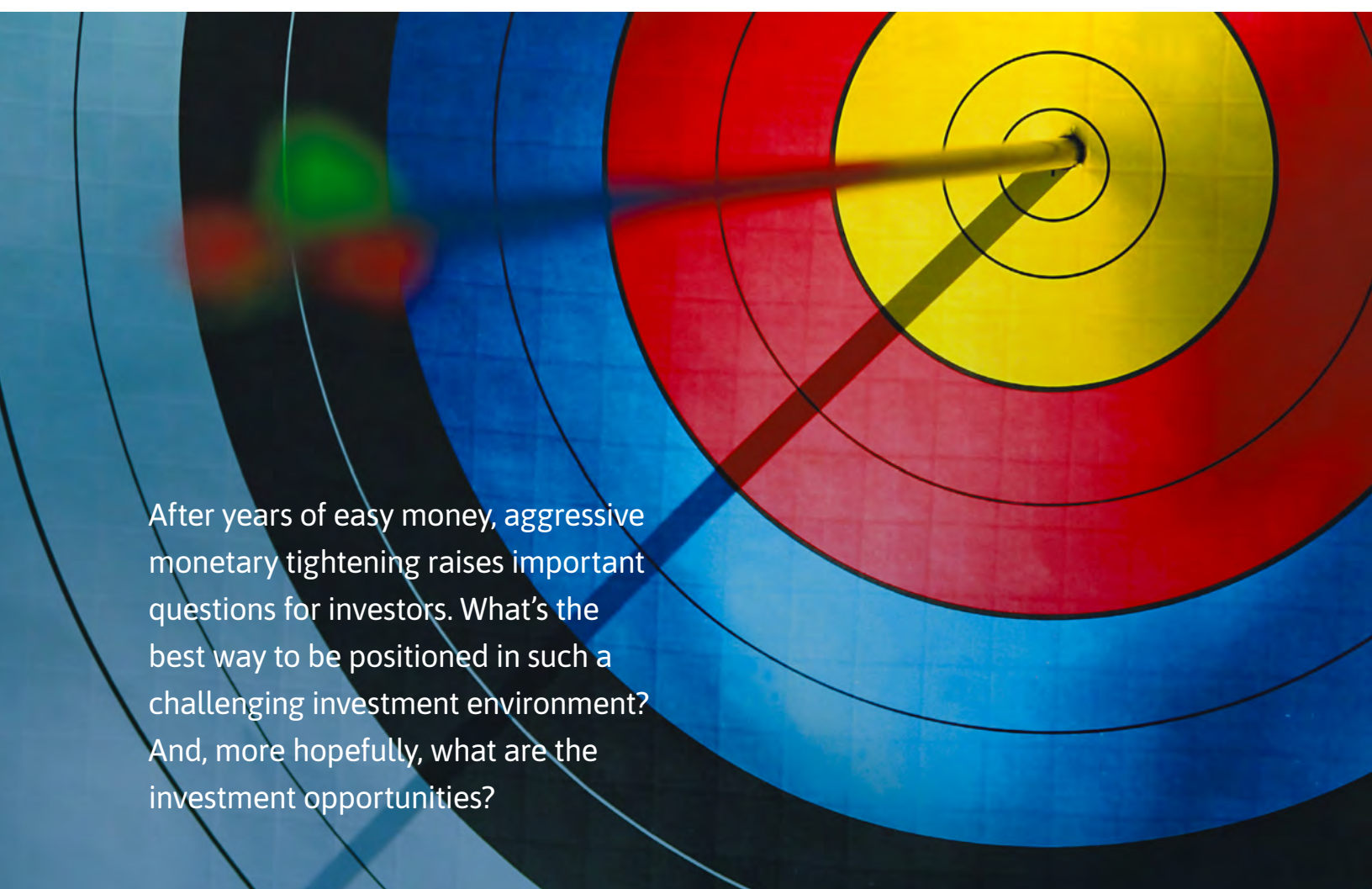
will be very personal. We remain focused on viewing ESG portfolios as investments first, building individual, fully customized portfolios to meet each client's unique long-term financial and ESG goals.

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¹ <https://www.iea.org/reports/world-energy-balances-overview/world>

Concentrating on High-Quality Businesses

By Aldo Palles



After years of easy money, aggressive monetary tightening raises important questions for investors. What's the best way to be positioned in such a challenging investment environment? And, more hopefully, what are the investment opportunities?

A focus on quality seems to us a reasonable response in these circumstances. Although high-quality companies also decline in turbulent markets, these companies generally have withstood the test of time by successfully enduring economic downturns and rebounding strongly once the economy and stock market eventually recover.

While there is no universally accepted definition of quality, we find that high-quality businesses can be identified in terms of five key attributes: high profitability, a sustainable competitive advantage, attractive long-term growth prospects, capable management teams, and strong balance sheets. In our view, these characteristics should enable such companies to achieve sustained investment performance over a full market cycle.

Let's take a look at each of these components:

High Profitability: A defining characteristic of high-quality businesses is their ability to earn sustainably high returns on invested capital over time. (Return on invested capital measures the after-tax operating income of a business relative to the total capital employed in the business.) High-profit businesses, such as Apple, MasterCard, and Home Depot, can consistently earn strong returns on invested capital, exceeding the cost of capital demanded by shareholders and creditors. These rare businesses often possess pricing power or, alternatively, utilize their resources more efficiently to generate strong returns and strong, predictable cash flows.

Sustainable Competitive Advantage: A sustainable competitive advantage enables a business to earn higher compounded rates of return over time than its competitors. Primary sources of competitive advantage often include intangible assets such as brand names

like Nike, intellectual property protected by patents or copyrights such as Walt Disney, or licensing and franchising agreements like McDonald's. Other sources of competitive advantage include economies of scale or cost leadership (e.g., Amazon), products or services with high switching costs (such as Microsoft), industries with high barriers to entry (e.g., FedEx), and network effects where the business becomes increasingly valuable as the number of participants in the network increases.

Attractive Long-Term Growth Prospects: High-quality businesses also have significant opportunities to grow by increasing market share, expanding into new markets, or by introducing new products and services (as Alphabet has done with cloud computing services, artificial intelligence, and autonomous driving). In their widely acclaimed book on corporate valuation, McKinsey & Co. consultants found strong empirical

evidence that long-term revenue growth – particularly organic revenue growth – is the most important driver of shareholder returns for companies with high returns on invested capital.¹ Furthermore, they found that investments in research and development correspond powerfully with long-term shareholder returns.² In other words, it is the ability to grow the business by reinvesting capital at high rates of return that drives the strong long-term compounding effects of high-quality companies.

Capable Management Teams: A business that exhibits several quality characteristics could nonetheless underperform if it is led by an ineffective management team. Ineffective management teams often destroy, rather than create, shareholder value through imprudent use of company resources or by diminishing the company's

competitive advantage through poor decision-making. Indications of strong management teams include candor in communicating business results, a clearly articulated business strategy, a demonstrated track record of success, a history of deploying capital effectively, and a strong commitment to shareholder interests, as evidenced by JP Morgan Chase, for example.

Strong Balance Sheets: Companies with strong balance sheets (i.e., low-to-moderate debt levels) have greater financial flexibility and can withstand economic downturns or external shocks better than firms with weaker balance sheets. Strong balance sheets are particularly important during periods of heightened market volatility. Companies with this attribute like Morgan Stanley can use their financial resources to increase dividends, repurchase shares at depressed prices or take advantage of attractive business opportunities.

What about valuations? One practical challenge of investing in high-quality businesses is that, as a group, they are often more expensive relative to lower-quality peers and the overall market because of their superior characteristics. Interestingly, financial economists have found that returns from quality stocks may be abnormally high on a risk-adjusted basis even after accounting for their more expensive valuations. A plausible explanation for this anomaly is that analysts and investors systematically underestimate the future returns of high-quality businesses relative to lower-quality firms.³

Although high-quality businesses can outperform despite higher valuations, investors should hesitate to overpay at the cost of reducing long-term compounding benefits. We believe a market downturn provides long-term investors with an opportunity to add

to existing high-quality businesses at more attractive valuations. Furthermore, businesses with extended valuations or deteriorating fundamentals should be sold and replaced with higher-quality businesses with more compelling valuations and longer-term prospects.

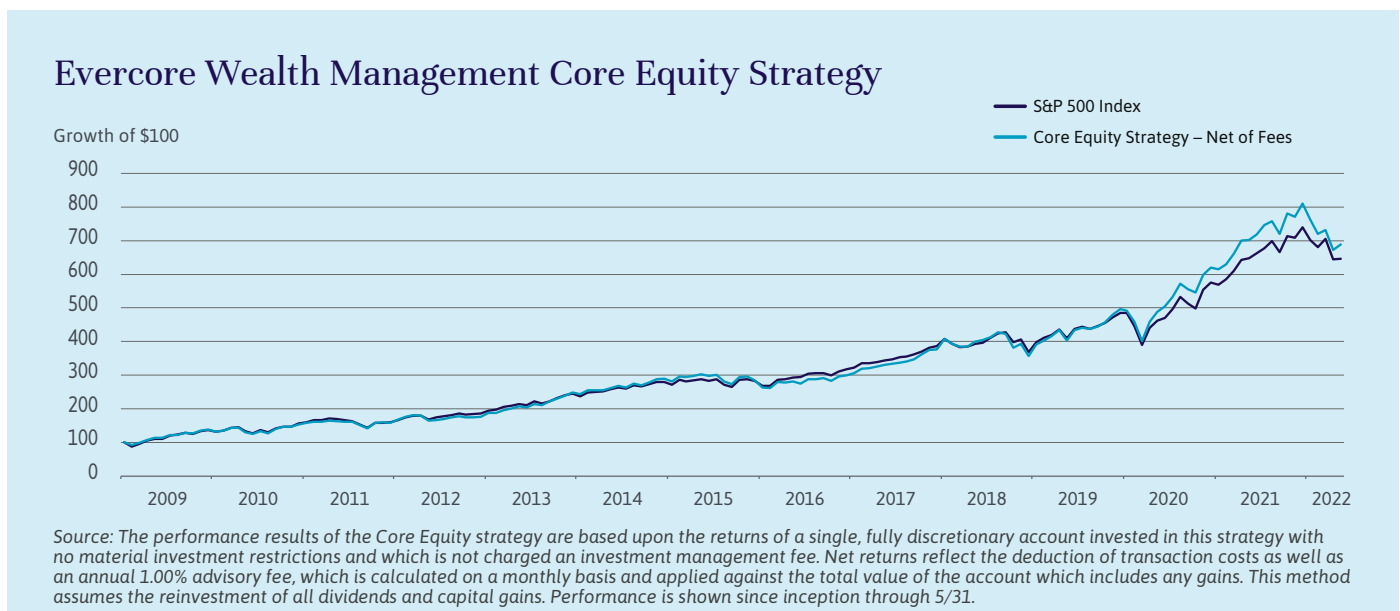
Evercore Wealth Management strives to purchase shares of high-quality businesses at attractive valuations and hold them for the long term. As illustrated below, this approach has enabled our clients to benefit from the economic advantages of these stable businesses and capture their long-term compounding effects.

Aldo Palles is a Managing Director and Portfolio Manager at the Evercore Wealth Management office in Palm Beach, Florida. He can be contacted at aldo.palles@evercore.com.

¹ B. Jiang and T. Koller, "How to Choose Between Growth and ROIC," *McKinsey on Finance*, no. 25 (Autumn 2007): 19-22, www.mckinsey.com.

² Tim Koller, Marc Goedhart, and David Wessels, *Valuation: Measuring and Managing the Value of Companies*, 7th ed., (Hoboken, NJ: John Wiley, 2020).

³ Jean-Philippe Bouchaud, Stefano Ciliberti, Augustin Landier, Guillaume Simon, and David Thesmar, "The Excess Returns of 'Quality' Stocks: A Behavioral Anomaly," 2016.



Q&A

with Accolade Partners
and Jennison Associates



Judy Moses

Evercore Wealth Management



Debra Netschert

Jennison Associates



Joelle Kayden

Accolade Partners

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 recap part of the April 7, 2022, webinar discussion with Joelle Kayden, the founder and managing member of Accolade Partners; Debra Netschert, a health sciences equity portfolio manager at Jennison Associates; and Evercore Wealth Management Partner and Portfolio Manager Judy Moses. Please note that the views of the external managers are their own and not necessarily those of Evercore Wealth Management.

Judy: Over the last two years, we have become much more focused on our personal and our families' healthcare and the ways in which we interact with the healthcare system. How transformational a period is this?

Debra: There are two big issues happening in healthcare. First, the baby boomers are aging, which will increase the number of seniors needing healthcare. Second, we will have a huge demand for primary care physicians because the number of physicians coming out of medical school is diminishing. The estimates suggest that we will be short 50,000 primary care physicians in 5-10 years. The only practical way to solve that is to find ways to be able to provide care in a more efficient virtual setting.

We are already seeing changes. For example, telemedicine wasn't really embraced by physicians and patients pre-COVID. People were hesitant to use it. Even if you had the telemedicine option through your insurance, people believed they wouldn't get the best possible care that way. Now, it's easy to understand the areas in which you can use telemedicine and the areas in which you can't, and how this tool can improve the efficiency of the system. Telemedicine is here to stay.

Judy: The United States is often criticized for spending so much per capita on healthcare, and yet we don't have the healthiest population. Why do you think that is?

Joelle: As the saying goes, "There is a trillion dollars of waste, we just don't know where it is in the healthcare system." I think it's in a couple of places. The biggest is in administrative overhead. There are whole industries dealing with reimbursements – making sure that the right person gets paid the right amount of money, and the document is coded correctly and so on. This is nuts! It's a multibillion-dollar industry. There is fraud, abuse, and waste in this system. There are also huge variations in practice patterns among physicians in different parts of the country.

We didn't really have the data before to be able to do this, but instead of reimbursing on a fee-for-service basis, physicians are now being reimbursed for episodes of care. In other words, physicians are being held accountable for the whole treatment, not just delivering that one service. And they're able to take risks, which means they can share in the savings against a rate that is largely established by the government, because commercial payers tend to follow whatever the government sets as the appropriate reimbursement.

You must have the data in the first place, to convince people that they can take risk and that they could achieve efficiencies in the system. This is a concept called value-based care, and it's increasingly being adopted by more forward-leaning physician groups and companies that are venture backed. Hopefully it will reduce the utilization of the healthcare system and be used as needed, instead of generating a lot of unnecessary costs.

Judy: What are the areas within healthcare where innovation can be most impactful in improving efficiency, reducing costs and/or or improving health outcomes?

Debra: If you can provide nutrition and health coach services to someone who is prediabetic to bring their blood sugar down so that they never get diabetes, you will save the healthcare system a whole lot of money down the road. I think eventually we will get to the point to lower the cost curve further down the line.

Joelle: A lot of the costs in the healthcare system are consumed in a person's last period of life, whether it's six months or a year. These are incredibly expensive inpatient procedures, and none of us want to deny care to a dying or elderly family member.

The drugs we are delivering today, such as the immunotherapy treatments that are targeted to treat cancer, are very expensive. You must ask, who is going to get the care, how many people are going to get the care, and who will pay for it? Fundamentally, the United States is a society that prides itself on innovation, but these procedures and drugs are still very expensive. I think there will be a shift if we can achieve some efficiencies to start to deliver this next-generation technology of care.

Judy: We saw this big run up in the stock prices of biotech companies initially during the pandemic, but recently it's been a challenging area to be an investor. Can you talk about the impact of these companies coming to market earlier in their life cycle, and what that really means for the industry and investors?

Debra: There's been a tremendous amount of innovation in biotech, and I still believe that we are in a technological super-cycle when it comes to biotech. We have more information about biological systems than we've ever had, which gives us the ability to really understand biology at a much deeper level. A tremendous amount of money was put into the venture capital firms, which in turn invested in

a lot of biotechnology companies. As more biotechnology companies were created, they were entering the public markets at an incredibly early stage.

For example, 10 years ago, investors would have needed a greater proof of concept. Then, a company that was moving to an IPO would have had solid Phase Two clinical data in 60 to 120 patients so we would be able to understand what that molecule was capable of. But over the past two years, companies coming to the market didn't expect to have their first drug in a human clinical trial for four to five years. There was an oversupply in the public markets of very early-stage companies that investors wouldn't know for 10 years if they really had a great technology.

Science and drug development is a series of tests. If you fall and skin your knee, you clean it up, you figure out what went wrong, and then you try the treatment again. And that process is just not something that the public markets are good at. As private investors, we expect it will take maybe two or three years to see the fruits of those labors.

Judy: We have seen a big mental health challenge in relation to the pandemic, specifically in young people. Can you talk about what you are seeing in those trends?

Debra: There has been a huge shift in perception of mental health, where it's okay to say you have depression or anxiety and it's okay for your child to have ADHD. People are now realizing that physical health is just as important as mental health. Sometimes one could argue that mental health is even more important. I think we are going to see people be more demanding that whole health is reimbursed. When you think of the average cost per person, it may not go down in the median term because we will start to reimburse for mental health, preventive health coaches, and physical therapy.

For further information or if you would like to watch the full video recording, please contact **Michael Beck** at michael.beck@evercore.com.

Bear Markets: Inevitable but Manageable

By Jeff Maurer



25%

Evercore Wealth Management's
assumption of the current greatest
potential risk to a balanced portfolio

Bear markets are inevitable, painful and, with proper planning, manageable.

This is my eighth bear market in my 52 years as a wealth manager. The prior ones averaged a peak-to-trough drawdown of 41% in stocks and 25% in balanced portfolios (60% in stocks, 40% in bonds), well in excess of the 20% drawdown that defines a bear market. Each experience was unique: The 2020 pandemic bear market lasted just 33 days, compared with the 32-month average; others dragged on for years.

By our current assumptions, as described by Jake Stoiber on page 15, we believe the greatest potential risk to a traditional balanced portfolio is a 25% drawdown. Most bear markets come nowhere near that, but the short dramatic plunge in March 2020 took us right to the edge of our expectations, with a record 33% drop for stocks from peak to trough and an estimated 22% for our balanced composite.

So how do we manage assets through bear markets? We start by revisiting our clients' risk tolerance levels. For those in or approaching retirement or who rely on their portfolios for spending, we believe a

Estimating Drawdowns: How Low Can the Markets Go?

By Jake Stoiber

In the spirit of transparency, and because we believe it's the best estimate of portfolio risk, Evercore Wealth Management attempts to show clients an estimated maximum drawdown for their portfolios, from market peak to trough.

We start with basic assumptions, based on historical data, for each of our asset classes: Cash, Defensive Assets, Credit Strategies, Diversified Market Strategies, and Growth Assets. And we test those assumptions, effectively shocking them by modeling across a range of market scenarios. For example, how much could yields rise? What if they rise across the entire curve? How much do credit spreads widen? What is the potential relationship between U.S. and international stock performance?

We then multiply these adjusted assumptions for each asset class by the weights we allocate to them in our sample portfolios or investment objective guidance. The result is our maximum drawdown estimate, currently 25% for a balanced portfolio. It's worth noting that we calculate the drawdown in our sample balanced account as though we do not own illiquid alternative assets. We do this because there is a lag in illiquid manager performance reporting, and excluding these assets seems to us to be the more conservative approach. We believe investors with illiquid growth assets should, over time, expect a similar drawdown.

We review and, if necessary, revise, these assumptions at the same time we update our long-term capital market assumptions, and as circumstances warrant. This review also gives us a chance to compare our estimates to previous market selloffs at both the sample portfolio level and the individual asset class level to make sure our assumptions are reasonable in practice.

In the 13 years since our firm's inception, we have never breached our maximum drawdown estimate. Even the Great Recession downturn of 2007-2009, which forged our approach, remained within our expectations. The 2020 post-COVID shutdown market plunge came close, but in the end it held. We believe our estimated drawdown analysis is a good tool that allows us to advise our clients to ride out down markets and allows us to plan and invest with confidence in all market conditions.

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properly diversified account should aim to have at least 20%-25% in defensive assets or cash. That allocation, along with normal portfolio income, should allow families to cover four to six years of spending including capital calls. (It's also worth noting that while no one can control bear markets, we can all control, at least to some degree, our spending.)

If that sounds like a lot, consider that it should enable investors to ride out market drawdowns, avoiding permanent loss of capital through forced sales at depressed prices. An investor who sold a million dollars' worth of shares in the S&P 500 index in March 2020 not only had to pay taxes on the embedded gains, but also lost out on the subsequent appreciation. The same position would be worth \$1.75 million today.¹

Once we determine the appropriate asset allocation, we are generally slow to make

strategic changes to the portfolio unless our view of long-term asset class returns or volatility changes. Of course, as John Apruzzese describes in these pages, we are always looking at relative valuations and economic conditions and questioning our own capital market assumptions. And we do react tactically to market conditions by rebalancing portfolios.

For example, as the equity market cumulatively doubled over the three years ending 2021, we worked with clients to trim equity positions to maintain the agreed-upon asset allocation. In the current bear market, we are taking the same approach, this time considering in consultation with clients if – and when – it's appropriate to rebalance into equities.

We know it is unlikely that we or just about anyone else will make the correct decision to sell an asset class right before it goes down and to purchase it

right before it goes up, so we proceed very carefully. Additionally, we must consider the tax consequences of sales for most of our clients.

Please review Jake's article and let us know if you have any questions. It can make for uncomfortable reading, which is why not many wealth managers show what drawdowns can really do to a portfolio. We do. Most of our partners have already experienced three statistically "once-in-a-lifetime" financial events (in 2000, 2008, and 2020), so we know the value of planning and preparation.

Our goal is for every one of our clients to be well-positioned to ride out this and future bear markets, and to be able to look forward to the better days that will inevitably follow.

Jeff Maurer is the Chairman of Evercore Wealth Management and Evercore Trust Company. He can be reached at maurer@evercore.com.

¹ As of June 15, 2022

What's in Your (Digital) Wallet? Estate Planning for Crypto and NFT Assets

By Tom Olchon

Some early investors in cryptocurrency and non-fungible tokens, or NFTs, have accumulated significant wealth. But the extreme volatility and evolving tax treatment of these assets are good reasons to think long and hard about managing them in the context of estate planning. Generational gifting strategies and charitable planning may save on estate taxes and allow for further appreciation of these assets outside of the estate.



But first, how can such volatile and often illiquid assets even be valued for estate planning purposes? It's an essential step in proper planning, as the inclusion of crypto and NFTs may potentially cause an otherwise non-taxable estate to become taxable. Even with a step-up in basis, there may be income tax considerations. Only a qualified appraiser should make that call, and IRS guidance is still a bit murky as it relates to a qualified appraisal, so please take extra care when dealing with this issue.

It's worth stressing here that getting tax planning right is critical, and failure to comply even as regulations evolve can have extremely serious

Got Crypto? An Estate Planning Checklist

Many investors in digital assets are passionate about their prospects. It is important to keep a cool head in planning for their eventual transfer.

- Inventory and catalog all digital assets for current as well as future fiduciaries. This includes keeping a list of important passwords, passkeys (such as the new passkeys by Apple), account numbers, keys, and access points. The information must be stored safely, perhaps in a safe deposit box. The safe deposit box might not contain passwords, but rather instructions to access passwords that have already been stored on a reliable password management app such as LastPass.
 - Obtain valuations for all digital assets from a qualified appraiser in compliance with current IRS guidance. While not all digital assets are traded on an exchange or are readily marketable, valuations are necessary for tax planning, and it's important to track the cost basis for each asset.
 - Secure private blockchain keys and other access points while still providing enough information for a third-party fiduciary to be able to fulfill their roles.
 - Consider appointing a corporate executor and/or administrative trustee. While appointing a corporate fiduciary may feel less personal, the fiduciary may have the ability to dedicate more resources and experience to the administration of the estate than an individual, which may lead to a more efficient process.
 - Revisit the estate plan frequently, as the legal and jurisdictional issues surrounding digital assets continue to evolve.
- T.O.

consequences, including forcing the use of an additional and unintended gift tax exemption, or even causing there to be tax owed if the IRS determines that the value of the gift exceeds the available exemption.

The custody and security of cryptocurrencies and NFTs present another planning challenge. Striking the right balance between preserving the security of private blockchain keys and other access points now, and providing access for a third-party fiduciary later, isn't easy. But at the very least, the executor of an estate that includes crypto and/or NFTs will need a road map to help identify, locate, and eventually access these digital assets.

Making gifts during the grantor's lifetime can generate significant benefits, including the appreciation of the gifts outside of the grantor's estate. For example, a grantor could gift the assets into an LLC. The manager of the LLC would then have general management and investment

responsibilities over the underlying assets. The issue of custody and security cannot be emphasized enough, and the grantor or a very close and trusted third party could serve in that LLC manager role.

The interests in the LLC can in turn be gifted into one or more trusts for the benefit of future generations and/or possibly charities. These trusts can be created as directed trusts in Delaware (or another jurisdiction that allows for directed trusts), utilizing a corporate administrative trustee. In this scenario, the manager of the LLC can also serve as the investment direction advisor to the administrative trustee, directing the administrative trustee to hold the shares of the LLC. While the grantor could be the LLC manager and the investment advisor with responsibility for managing the cryptocurrency or NFTs, the estate tax rules would prevent the grantor from retaining full control as trustee over distributions to trust beneficiaries. In that case, an independent trustee – such as a corporate trustee – could

be responsible for following the terms of the trust agreement to determine when and how much to distribute to the ultimate trust beneficiaries.

In essence, in this scenario, the underlying assets have now been transferred to future generations and/or charities, appreciation of those assets will occur outside of the grantor's estate, and the manager of the LLC and investment direction advisor to the trust retain general management responsibilities and investment control over the underlying assets in the LLC.

The laws and rules governing crypto and NFTs are still evolving, unevenly, across jurisdictions, but as more people hold these assets, it is important that they are considered in estate plans.

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Gifts and Letting Go: Emotional and Practical Perspectives

By Justin Miller

Making significant gifts to loved ones is arguably one of the most fraught wealth management decisions. Emotionally, we need to balance the joy of giving during our lifetimes with a potential loss of control and the prospect of unintended consequences. Practically, we need to weigh how much we can afford to give, with the realization that every dollar not transferred could be subject to a 40% federal estate tax (or more, if rates return to previous levels), as well as potential state estate taxes.



40%

The federal estate tax imposed on
every dollar not transferred

Gifts Webinar

Gifts and Letting Go: The Emotional and Practical Aspects of Wealth Transfer

Deciding when – and how much – to give children and grandchildren is arguably the most fraught wealth management decision many of us will make.

Evercore Wealth Management Partner Justin Miller and guest Dr. Denise Federer discussed the emotional and technical considerations in gifting. Wealth and Fiduciary Advisor Dan Stolfa moderated the discussion.

For further information or to view the replay, please contact **Michael Beck** at michael.beck@evercore.com or 212.822.7634.



CAN I GIVE? WILL I HAVE ENOUGH?

The last thing anyone wants is to have to borrow from their kids or grandkids later in life because they gave too much away. Whether you have \$10 million or \$100 million, a long-term cash-flow analysis – also called a lifestyle analysis – is a necessity. No one wants to be forced into significant drawdowns at the wrong time, which means that inflation and market volatility must be considered. In addition, wealthier people tend to live longer than average, and a longer life could bring unexpected and uninsurable medical expenses down the road.¹

Sometimes, even those with more wealth than they would ever spend in multiple lifetimes might be afraid to give. In that case, it is important to address any anxiety from a psychological and emotional perspective, as well as from a practical one.

HOW MUCH SHOULD I GIVE?

Some people want to know how much is enough. Other people want to learn how much is too much. Warren Buffett once said that the perfect amount to give children is “enough money so that they

would feel they could do anything, but not so much that they could do nothing.”² Unfortunately, there is no magic number.

Instead, the answer is to give loved ones no more than they are prepared for. An unprepared individual could receive a few hundred thousand dollars, and it could ruin their life – they might drop out of school, abuse drugs and alcohol, or develop a gambling addiction. On the other hand, a prepared person could be gifted millions of dollars and could still turn out well – continue to study hard, build a career, raise a family, and become a pillar of the community.

The key is to focus on preparing the family for the money. A team of good attorneys, accountants, and wealth managers should be able to help implement a successful long-term plan to invest the family’s assets and transfer the funds over multiple generations in a tax-efficient manner. The team should also focus on the work in preparing future generations for that financial wealth. This could involve financial education, communication and values exercises, and a focus on healthy family governance.

WHEN SHOULD I GIVE?

From a gift, estate, and generation-skipping transfer, or GST, tax perspective, giving sooner rather than later could provide substantial tax benefits. Not only can a married couple transfer up to \$24.12 million completely free of taxes in 2022, but all the future growth of those assets could be free of any future gift, estate, and GST taxes. Moreover, the \$24.12 million lifetime exemption amount per couple is set to be cut roughly in half after 2025, so families only have a relatively limited time to take advantage of the substantial potential tax savings from the larger use-it-or-lose-it exemption amount.

On the emotional front, not only do we want to see loved ones enjoy gifts while we are still alive, but studies have shown that giving to others can boost the giver’s happiness and satisfaction, increase life expectancy, reduce stress, and ease depression.³ Moreover, avoiding the topic of wealth transfer, to family members and to charity, could create more problems down the road. Even if family members currently get along, they might all end up fighting with each other over assets if they are not prepared for the wealth.

Before making any gift, it is important to prepare family members for that gift from a financial, psychological, and emotional perspective. There is not one perfect age at which to directly give money to a child or grandchild. Some young adults are perfectly equipped to manage millions of dollars in their 20s, while older adults might blow it all within a few years. The answer to when to give is only when they are ready. By starting with gifts of smaller amounts at younger ages, you can help the next generation learn to manage the wealth in an effective and healthy manner, develop greater responsibility, and become good stewards of the wealth in the future.

HOW SHOULD I GIVE?

An individual can give to as many people as they want up to \$16,000 per year – the annual exclusion amount as of 2022 – without any need to report the gift for tax purposes on a Form 709, United States Gift (and Generation-Skipping Transfer) Tax Return. In addition, individuals can pay anyone’s education or health care expenses directly without it counting toward their annual exclusion amount or lifetime exemption amount.

Making gifts to loved ones does not necessarily mean handing them cash. Instead of giving assets directly outright, gifts can be set up during the beneficiary’s lifetime for tax purposes by using trusts. In addition to tax benefits, those trusts can also be used to preserve assets as a safety net for the beneficiary’s lifetime – in other words, moderate how much is available to beneficiaries based on personal

circumstances, such as supplemental income for education or consumption. Furthermore, trusts, along with the guidance and protection of a corporate trustee, could also provide beneficiaries with additional asset protection from potential creditors or even possible divorce in the future.

Setting aside gifts in trust now does not have to mean telling beneficiaries about the gift or handing them copies of account statements or balance sheets. While most states require that trust beneficiaries receive certain notices about a trust and the trust’s assets, there are some states – such as Delaware – that have special “silent trust” rules, which allow the grantor to keep information private.

TO WHOM SHOULD I GIVE?

Balancing equal with equitable can be a major planning challenge while trying to preserve family harmony. Differences in means and needs require each family to determine what fair means to them and what the future might hold. For example, family members with special needs may require additional financial assistance. At the same time, individuals who are financially successful now might need more support down the road due to a potential health condition or financial hardship in the future.

For many families, charity is often part of the overall wealth plan. From an income, gift, estate, and GST tax perspective, it is important to work with good advisors to structure charitable gifts in the most efficient

manner for tax purposes. While a common approach is to set aside a portion of income for charity, a more recent approach among some families is to treat charity like a child when determining overall giving. For instance, a family with three children could set aside 25% for charity and the remaining 75% for the children. As discussed in the previous issue of *Independent Thinking*, a family philanthropy program also could be created so that generations can work together to support the family’s legacy.

WHERE DO I GO FROM HERE?

Providing wealth to loved ones should truly be a gift, not simply a mechanical transfer of assets. If done correctly after preparing those loved ones for the wealth, it could provide a better quality of life, save on taxes, and prevent the negative impacts on those who are unprepared for the wealth. Consider working with your wealth advisor who can provide a financial analysis and help prepare future generations as part of an ongoing process. As Nathan Mayer Rothschild, son of the founder of the Rothschild banking dynasty, once said, “It requires a great deal of boldness and a great deal of caution to make a great fortune; and when you have got it, it requires ten times as much wit to keep it.”

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¹ Gleib DA, Lee C, Weinstein M, “Assessment of Mortality Disparities by Wealth Relative to Other Measures of Socioeconomic Status Among US Adults,” *JAMA Network Open*, 5(4):e226547. doi: 10.1001/jamanetworkopen.2022.6547 (Apr. 8, 2022); Finegood ED, Briley DA, Turiano NA, et al., “Association of Wealth with Longevity in US Adults at Midlife,” *JAMA Health Forum*, 2(7):e211652. doi: 10.1001/jamahealthforum.2021.1652 (Jul. 23, 2021).

² Kirkland R, “Should You Leave It All to the Children?” *Fortune* (Sep. 29, 1986). George Clooney, as Matt King in the movie *The Descendants* (2011), said something similar, “you give your children enough money to do something but not enough to do nothing.”

³ Dunn EW, Aknin LB, Norton MI, “Spending money on others promotes happiness,” *Science*, Vol. 319, Issue 5870, pp. 1687-1688 (Mar 21 2008); Harbaugh W, Mayr U, Burghart D, “Neural Responses to Taxation and Voluntary Giving Reveal Motives for Charitable Donations,” *Science*, Vol. 316, Issue 5831, pp. 1622-1625 (Jun. 15, 2007).

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