

An aerial photograph of a long, narrow wooden bridge spanning a river with white-water rapids. The bridge is made of dark wood and has a person in a red shirt walking across it. The surrounding area is a dense, lush green forest with many trees and rocks visible in the water.

# INDEPENDENT THINKING

THE NEW STANDARD IN WEALTH MANAGEMENT

EVERCORE  
Volume 39

[evercorewealthandtrust.com](http://evercorewealthandtrust.com)

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The Markets and  
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# A Message from the CEO



It is astonishing how quickly people can adapt to change. We are just halfway into this extraordinary year and we have become accustomed to entirely new ways of working, learning and socializing. And we are thinking in new ways, too.

Some of these changes, notably the technological advances and the drivers of disinflation addressed in a number of articles in this issue of *Independent Thinking*, were already underway and have since accelerated. Others are long overdue. The protests in cities across the United States and around the world after the killing of George Floyd in Minneapolis remind us just how much work there is still to do in building a just and equitable society. In this regard, the interest and good will of our colleagues and clients encourages us to do our best, in upholding the Evercore values of integrity and respect – and in making every effort to consider how others might be feeling in these challenging times and treating each person accordingly.

Investors everywhere are also adapting to change, albeit nervously. At the time of this writing, the S&P 500 index has recovered three-quarters of the dramatic losses suffered in March. As our Chief Investment Officer John Apruzzese writes in these pages, we believe that current valuation levels, while by no means cheap, are not unreasonable, given the heavy weighting of the index to the technology giants and other companies managing to thrive in these economic conditions.

You'll also see my interview with law professors Max Schanzenbach and Robert Sitkoff on the potential pitfalls confronting

trustees of trusts investing in ESG and socially responsible strategies. These are significant but not insurmountable challenges. Our ability to help customize and manage these portfolios and serve as a professional trustee makes us a valued partner to an increasing number of families, foundations and endowments seeking to drive and support change through investing. We will be discussing this and related topics in future issues of this publication.

We will continue to adapt on all fronts, as we focus on the future, including our eventual return to the Evercore offices from the many virtual offices we also call home. I could not be more proud of our team's unwavering focus on our clients through this challenging time and of our continued success.

We will also continue to help our new and existing clients adapt, as individual and family circumstances evolve, along with the markets and the political, cultural and economic environment. Our webinars have certainly been popular among clients, with subjects ranging from our investment outlook to deciphering misinformation and disinformation in the media, to a primer led by our tech-savvy Chairman on home technology. The last is described by Wealth & Fiduciary Advisor Ashley Ferriello on page 14, who observes that while we are

looking forward to reconnecting in person, many of us – clients and advisors alike – have found our virtual meetings timely, enjoyable and surprisingly effective.

Speaking of technology, please let us know how you are enjoying the new Evercore Wealth & Trust App. The client response since its debut a couple of weeks ago has been very positive and we are eager to hear your feedback, ahead of future updates.

Please contact us to discuss any of these topics addressed in this issue of *Independent Thinking* and with anything else you have on your mind. In this new normal of rapid, important change, our commitment to our clients remains steadfast, and we welcome your engagement.

I hope you and your family are well and enjoying the summer.

A handwritten signature in dark ink, appearing to read "Chris". The signature is fluid and cursive.

**Chris Zander**  
President & Chief Executive Officer

# Bridging the Disconnect: The Markets and the Economy

By John Apruzzese

How is it possible that the stock market is so resilient? Approximately 20-30 million Americans are out of work, and both COVID-19 and social unrest continue, but the S&P 500 recovered from a historic shock within a month.

## A winners-take-all market

Market Cap: Big 5 Performance Relative to S&P 500 With & Without Big 5\* (indexed to 0 on 12/28/2012)



\* Big 5 stocks include Alphabet (Google), Amazon, Apple, Facebook, and Microsoft. Both classes of Alphabet are included. Source: Standard & Poor's and Yardeni Research Inc.

As remarkable as it may seem, we believe that the index is still reasonably priced. The aggregate valuation of the five most highly capitalized companies – Microsoft, Apple, Amazon, Alphabet (the parent of Google), and Facebook – is \$5.6 trillion, or about 20% of the S&P 500. They are major beneficiaries of powerful and, with the COVID-19 response, now rapidly accelerating trends: internet and mobile device usage; online shopping; virtual communications; cloud computing; online advertising; and work-from-home technology. As a result, the expected growth rate of their combined revenues is 12% for this year and accelerating to 15% for 2021.

Four of the five tech giants are among the most profitable companies that have ever existed (Amazon, which is the only employee-intensive company, has a low profit margin in its core online retail business, so it effectively trades profits for growth). All have robust balance sheets with no net debt, and a combined cache of \$464 billion in cash. They are continuing to fund future growth, spending a collective \$116 billion in research and development in just the past year. That's in addition to the billions of dollars spent on acquisitions that allow them to capture the latest innovations around the globe and, in some cases, eliminate competition. They also benefit from the network effect – gaining market power exponentially as they grow.

In short, the five are the winners in their respective winners-take-all markets. Take a look at the chart (opposite), which shows the rise of these companies relative to the broader S&P 500 index – and what the index would look like without them. Behind the big five are similar technology companies, including Netflix, that as a group make up another 10% of the S&P 500 index. The sector, together with the healthcare companies and other large companies that provide

\$5.6 TRILLION

The aggregate value of the five most highly capitalized companies in the S&P 500

essential goods and services that have not been adversely affected by the COVID-19

crisis, represents about 50% of the S&P 500. (About 58% of Evercore Wealth Management core equity portfolio is made up of companies that currently have been either unaffected by the crisis or have benefited from the response.)

It's another picture entirely for travel and entertainment, sports, sit-down restaurants, personal care/service and



elective healthcare businesses. These companies employed over 30 million people in the United States before the pandemic, but the large public companies among them represent less than 10% of the S&P 500 by market capitalization. Those that are doing well can attribute at least part of that success to technology, such as the ability to receive online orders and serve customers stuck in their homes.

20%

The total S&P 500 weighting of the big five tech companies

In contrast, Alphabet, Apple, Facebook and Microsoft together employ just about 400,000 people; of the big five tech companies, only Amazon is a significant employer, with more than one million people.

It's clear to us that the stock market weighted by market cap does not reflect the broad economy. Less clear is whether the technology giants are now too expensive. At 5.5 times aggregate revenues of \$1 trillion this year, they certainly are not cheap. In the past year they collectively generated about \$186 billion in free cash flow, of which \$28 billion was paid out in dividends and \$124 billion spent on stock buybacks. So the free cash flow yield is about 3.3%, and the yield on cash returned to shareholders from the dividends and stock buybacks is about 2.7%, with a reasonable probability that these numbers will grow at an annual rate in excess of 10% for the foreseeable future.

The five now have a higher valuation than before the crisis because their business fundamentals have actually improved as a result of the crisis, with accelerating revenue growth and steady or improving margins. The crisis has also resulted in significantly lower long-term interest rates – the yield on the 10-year Treasury has dropped from a range of 1.5%-2% before the crisis to 0.6%-0.9% now. Long-term inflation expectations have also fallen to well below 2%. Low inflation and low interest rates put a higher value on future cash flow, which pushes up equity valuations.

No company will be immune to the consequence of a long-term shutdown, of course. If current restrictions were to extend for multiple quarters or be reinstated, the resulting economic damage would begin to affect even the big five technology companies through, for example, reduced advertising revenue for Google and Facebook and fewer iPhone purchases. At present, however, the market is betting that the economy is going to reopen fast enough for most of the currently unemployed to get back to work before the more than \$2 trillion of fiscal stimulus runs out. Certainly, that is the hope.

*Of the big five tech companies, only Amazon is a significant employer.*

We continue to own Apple, Alphabet, Amazon and Microsoft, with our total portfolio weighting for the four companies about equal to the 20% weighting of all five stocks in the S&P 500 index, although the composition of individual portfolios varies. We do not own Facebook because we

believe it has the most regulatory risk, and we are not comfortable with its governance structure.

There is still plenty of uncertainty in the markets, given the unprecedented nature of the response to the health crisis and the other issues roiling the country. Our core equity portfolio is part of our total asset allocation, which has been adjusted to reflect changes in the economy, and tailored within individual portfolios to meet each client's long-term goals and risk tolerance.

**John Apruzzese** is the Chief Investment Officer of Evercore Wealth Management. He can be contacted at [apruzzese@evercore.com](mailto:apruzzese@evercore.com).

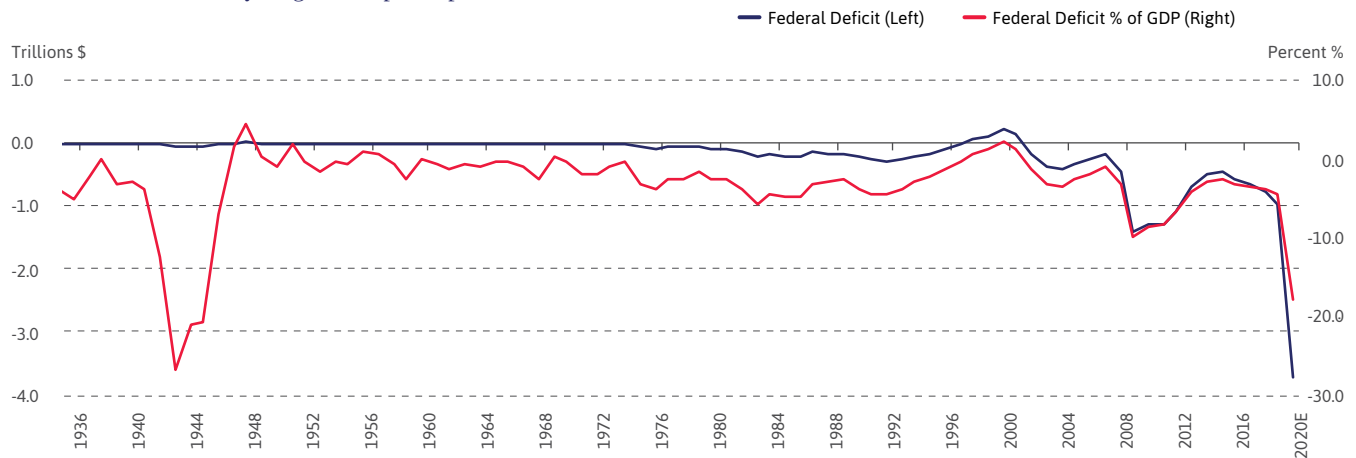
# COVID-19 Response Diagnosis: Inflation or Deflation?

By Brian Pollak

The United States is on course to amass a \$3.7 trillion additional net debt for 2020, the equivalent of 17.9% of the national GDP, the largest on both accounts since WWII. The aggregate gross domestic government debt-to-GDP ratio has tripled since 2000. And the Federal Reserve is expanding its balance sheet at a record clip. But inflation, the natural consequence of fiscal and monetary easing, according to some schools of economics, is nowhere to be seen. Instead, deflation appears to be the bigger risk, at least for now.

## The largest national debt since World War II

The U.S deficit, already large, has spiked post COVID-19



Source: Federal Reserve Economic Data

COVID-19 fiscal relief in the United States has to date focused on providing temporary support to the employees and employers most susceptible to layoffs and closures. It has also served to stabilize the markets. Much of that support is scheduled to roll off as the economy improves. Economists are in broad agreement that this fiscal spending will address already lost production but just partially offset the expected decline in GDP since mid-March. In other words, the relief so far has been just that; relief, not a lasting stimulus.

At the same time, consumer demand and prices have plunged. While there have been some supply shocks among essentials (milk, eggs and so on), the most recent CPI year-over-year reading was 0.2%. Clearly, the capital markets are not expecting much in the way of inflation anytime soon; the five-year, five-year forward breakeven inflation rate, which measures expected average inflation over a five-year period that

begins five years from today, is now just around 1.5% – and 10-year inflation, as measured by yields on Treasury inflation-protected securities, or TIPs, is lower still, at around 1.3%.

Of course, this deficit spending by the federal government does add significant debt to the U.S. balance sheet. However, large fiscal deficits and government debt are generally not viewed by economists as inflationary. Instead, high debt loads relative to GDP often result in disinflation or deflation, as has already happened in Japan and much of Europe. Empirical studies show that the higher the sovereign debt load becomes, the more the returns on that spending diminish. In other words, at these levels each debt-funded dollar spent creates less than a dollar of growth, which is why high debt loads relative to GDP often result in disinflation or deflation.

Moving to monetary policy, the Fed expanded its balance sheet considerably

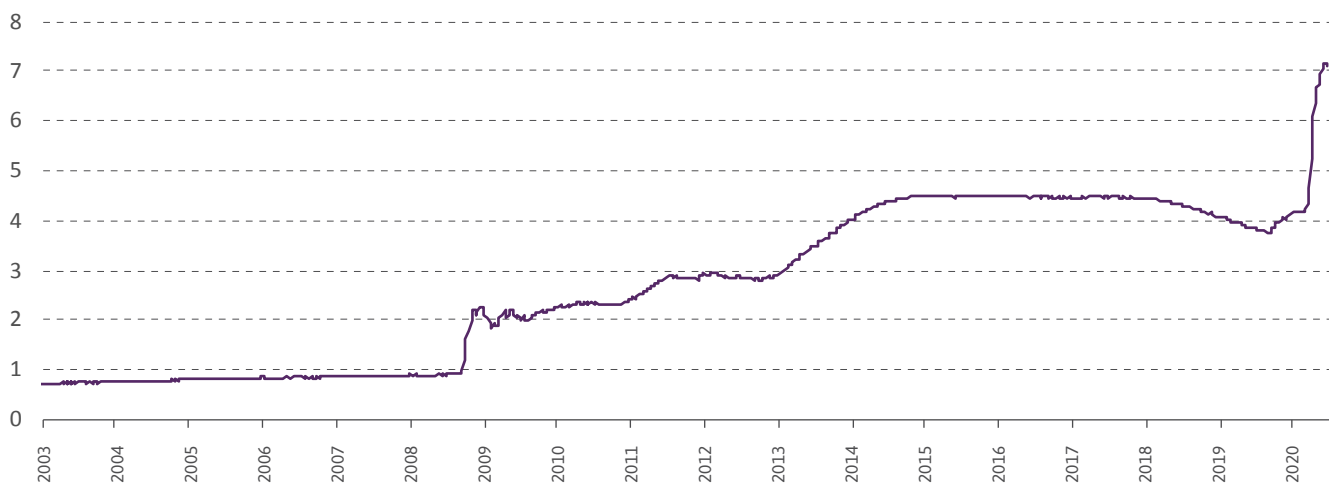
post the 2008-2009 financial crisis, as did other central banks, without sparking inflation. But this year's monetary expansion has been bigger and more rapid than previous efforts to jump-start the economy. Does it therefore follow that it will be inflationary?

Perhaps it might be, if the Federal Reserve were to not just expand its balance sheet by purchasing securities temporarily – as it did with quantitative easing, or QE, post the financial crisis of 2008-2009 – but were to also extend credit to the private sector on a permanent basis, delivering this so-called helicopter money directly and permanently to the consumers and small businesses most likely to spend it. Importantly, this would involve the government and the Federal Reserve working in concert, with the Treasury issuing debts to finance the permanently elevated government deficit, and the Federal Reserve then purchasing the new debt with newly printed money.

## A ballooning balance sheet

### Federal Reserve Assets

Trillions \$



Source: Federal Reserve Economic Data



This policy could be considered a version of the highly controversial Modern Monetary Theory, as described [here](#), which would create the potential for high inflation. Indeed, some argue that a temporary version of this policy is in effect now, as the Fed will buy nearly all of the massive net debt issued by the Treasury in 2020. But there is not yet a broad expectation in the markets – or an explicit promise by the Fed – that this will be perpetual. That’s an important distinction, and it’s not yet evident.

We are also watching to see if other experimental monetary policies, such as negative interest rates or more permanently purchasing credit or equity assets on the central bank’s

balance sheet, are deployed here in the United States – and if so, how those programs might impact inflation.

Another argument for rising inflation is the prospect of continuing deglobalization. If individual countries, concerned about the safety and controllability of their supply chains, look inward for goods production, a drop in global trade would be expected, making it more expensive for each country to produce goods, thus leading to some inflation. Sino-American relations, already problematic, could certainly deteriorate at the expense of international trade, as indeed was already the case pre-COVID-19. However, any cost or efficiency loss resulting from the altering of global supply chains

would likely be temporary. We would expect that companies in the United States and other large developed markets would eventually adjust, aided by advances in technology such as 3-D printing and robotics.

In any case, these arguments for inflation remain largely speculative. As discussed in previous issues of *Independent Thinking*, three deflationary secular forces – high debt loads, aging demographics and technological disruption – continue to keep inflation in check. In fact, one could easily argue that all three have accelerated as a result of the current crisis. The potential for higher debt burdens on consumers, businesses and municipalities could create a cycle of private sector debt deleveraging, which in itself will be disinflationary. And the broad acceptance of and accelerated use of technology, such as teleconferencing and e-commerce, is also hastening disinflationary trends.

Low inflation was an important component of the decade-long bull market in equities and the key driver of the 30-plus year bull market in bonds. We do not view high inflation as an immediate, or even a likely, medium-term threat. Whether monetary and fiscal policies result in significant long-term inflation depends on the magnitude of deficit spending, the permanence of that spending, how much of that spending is monetized by the Fed, tax and regulatory policy, and other inflationary or deflationary forces occurring alongside those policies.

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**Brian Pollak** is a Partner and Portfolio Manager at Evercore Wealth Management. He can be contacted at [pollak@evercore.com](mailto:pollak@evercore.com).

## Deconstructing Deflation

By Jake Stoiber

The term *deflation* often has negative connotations, evoking images of a Depression-era economy. But deflation can be good or bad, depending on the drivers. At present, we see a mix of both.

Good deflation can occur as a result of improving aggregate supply from factors such as globalization and technological disruption. Resulting higher productivity and cheaper inputs shape an environment in which both consumers and producers can mutually thrive as prices, as well as costs, decline. Incomes rise and output increases. This type of deflation can coexist with real economic growth.

Bad deflation often occurs as a result of declining aggregate demand from trends such as aging demographics and high debt burdens. Declining consumption coupled with less investment produces a challenging cycle in which consumers further delay purchases and already high debt levels become even harder to pay back for companies. Unemployment rises and output detracts. This type of deflation pushes real growth lower, creating a downward spiral.

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**Jake Stoiber** is an Associate at Evercore Wealth Management. He can be contacted at [jake.stoiber@evercore.com](mailto:jake.stoiber@evercore.com).

# Q&A

with the Voya Securitized Credit Fund



Dave Goodson

*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 speak with Dave Goodson, head of securitized fixed income at Voya Investment Management and a senior portfolio manager at the Voya Securitized Credit Fund.

**Q:** Let's start with the basics. Please explain securitized credit.

**A:** Securitized credit refers to a fixed income capital market and has its roots in the agency markets, which finances our housing market and dates back to the 1970s. It is material in its size and scope, with over \$2 trillion in bonds outstanding and spanning a diverse mix of sectors, secured by pools of assets that tie to consumers and real estate markets. The key risk is credit risk, but in a different form than that taken in corporate credit markets.

Securitization is a financing technique that refers to the process by which pools of assets (consumer loans, residential and commercial mortgage loans) are repackaged into interest-bearing fixed income securities that can be efficiently distributed into the capital markets. Investors in securitized bonds rely on principal and interest payments from the asset pool for repayment, not the creditworthiness of the entity that originated the underlying assets.

From a risk perspective, securitized credit offers a diverse set of opportunities. These include residential mortgage credit, consumer loan products, and the commercial real estate mortgage market. Securitized credit utilizes a structural dimension that allows varying degrees of risk-taking relative to those underlying sources of collateral, encompassing bonds with investment grade, below investment grade and non-rated securities, as well as fixed and floating rate coupons.

**Q:** How would you describe the Voya approach?

**A:** At the highest level, Voya takes a "through-the-cycle" approach to investing in securitized credit. We have a long-term perspective when we invest and position the asset class as a strategic allocation in investors' portfolios. Until recently, many investors viewed securitized credit as a niche asset class and a tactical trade that was more tied to the housing recovery. (Some investors still hold this view.) In our opinion, this view is far too narrow and sets up fixed income portfolios to find themselves less diversified and overly reliant on non-securitized markets over time.

We have set up our team so that we have expertise across the full spectrum of securitized credit, so we can optimize the diversification offered by this asset class and deliver our clients the best opportunities consistently over a cycle. We have a saying among our team that in the securitized market, "Every CUSIP has a story."<sup>1</sup> This is reflective of our rigorous bottom-up research and our commitment to understanding all of the complex and idiosyncratic factors that make up each securitized bond's risk and return profile.

**Q:** The fund is focused on specific credit areas, notably commercial mortgage-backed securities, or CMBSs, and credit risk transfers, or CRTs. Why?

**A:** The fund is actually diversified across key dimensions, with allocations to each of the major sectors. The fund also invests across the underlying sub-sectors of these major groups and across a curated mix of CUSIPs issued by particular issuers that we know.

However, I understand the basis for the question, given that when we attribute the negative performance from March and early April, the key, most punished holdings were found in CMBS and within the CRT portion of residential mortgage-backed

<sup>1</sup> Editor's note. A CUSIP number is a unique identification number assigned by the Committee on Uniform Securities Identification Procedures to all stocks for use by most computerized trading recordkeeping systems. It comprises nine letters and includes letters and numbers.

securities, or RMBS. These positions each provide a higher degree of structural leverage. By structural leverage, we mean that the collateral securing the investment has a magnified impact on the outcome of the investment, relative to other investments where structural protections are more significant, or less structurally leveraged. Ultimately, we are comfortable taking structural leverage in certain cases – like particular CMBS and within CRT – if warranted by collateral that is less leveraged and likely to retain its value across a wide range of scenarios. And for both CMBS and RMBS investing, we had and have a macro premise that real estate markets in the United States, both residential and commercial, are reasonably early in their respective cycles and have characteristics that support continued growth in values through the medium term, with exceptions that can be efficiently navigated. The exceptionally low rate environment also informs the view, providing a powerful tailwind that favors real estate fundamentals via several feedback loops.

When we overlay our approach to security selection, the investment case becomes clearer and warrants taking structural leverage in pursuit of our objective in the fund. We do so in precise, measured exposures, recognizing the disproportionate impact it can have in extreme scenarios.

In the case of CMBS, where idiosyncratic risk necessitates loan level underwriting, we utilize, among other inputs, micro inputs from our real estate finance lending team, which gives us a real advantage in identifying the right commercial real estate to invest in. We can be exacting in our loss underwriting and track exposures with a high degree of precision over time, which enables us to reposition more efficiently ahead of market repricings and changes in consensus views around key variables that impact particular loans.

In the case of CRT, the analysis is different, given the inherently lower idiosyncratic risk driven by the magnitude of loans collateralizing transactions in the asset class. The primary focus is also assessing credit risk, but the analysis focuses on testing for combinations of risk involving the underlying borrowers, rather than analyzing individual loans. Testing for loans with combinations of risks (higher loan-to-value, lower FICO, higher debt-to-income, for example) and structural resilience against identified mortgage loans with layered risks that may produce defaults over time informs our security selection in CRT.

Over time, investments in more structurally leveraged parts of the securitized credit universe may not make sense. For example, some parts of the U.S. economy have seen consumption patterns completely reshaped by the pandemic, with potentially longstanding implications for commercial real

estate valuations. This challenges the investment outlook for certain parts of the CMBS universe structurally leveraged to the retail universe, necessitating some repositioning there.

Rest assured, other top-down and bottom-up signals are constantly moving to shape a dynamic relative value assessment that we implement in pursuit of our total return-oriented objective in the fund. Today, despite the increased risk presented by unprecedented unemployment and stunningly low Q2 economic growth, our assessment of the opportunity in these segments is as compelling as we have seen in the post-crisis universe. As the recovery continues to unfold, we expect price appreciation to follow outsized yields to drive total returns higher in these parts of the fund.

**Q: How do you view other areas of securitized credit, such as auto loans and student loans?**

**A:** Our current strategy within asset-backed securities, or ABS, has been focused on taking risk that ties most closely to the U.S. consumer, as we view the underpinnings of consumer creditworthiness as superior to the inherently more cyclical commercial (container leases, railcar leases, aircraft) forms of taking credit risk in ABS. Their performance and prospects are superior when compared to the outlook in commercial ABS sectors.

**Q: What is your long-term outlook for U.S. securitized credit?**

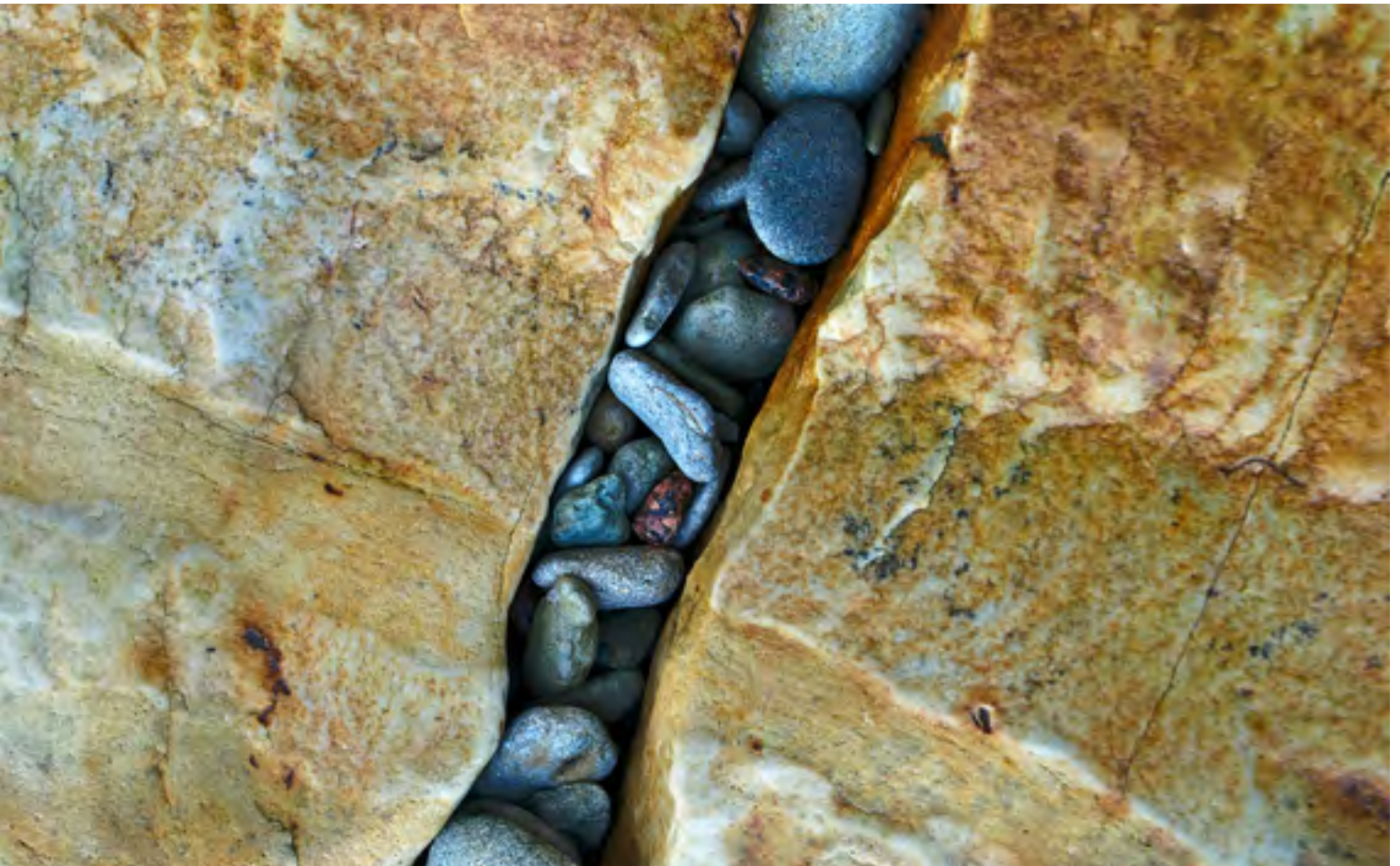
**A:** The key risks that drive performance in securitized credit markets – the U.S. consumer and U.S. real estate – are well positioned. Consumer balance sheets are clean, and income statements have been bridged with fiscal support to the reopening of the economy. The real estate markets, housing in particular, are undersupplied after years of new construction lagging the growth in the preceding 10-year expansion in our economy. This fosters compelling risk-adjusted opportunities in one of the few spaces in fixed income to earn measurable income, an attribute in incredibly short supply.

Near term, the challenges are obvious, but surmountable, and will be done absent the releveraging that has occurred in corporate credit. This will leave securitized credit markets inherently earlier in their market cycle and better positioned to continue to support growth and higher valuations for a long time to come.

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For further information about the Voya Securitized Credit Fund and other funds on the Evercore Wealth Management investment platform, please contact **Stephanie Hackett** at [stephanie.hackett@evercore.com](mailto:stephanie.hackett@evercore.com).

# Mind the Gap: Fiduciary Risk in ESG Investing



*Editor's note:* Evercore Wealth Management provides customized environmental, social and governance, or ESG, investment services to families, family trusts, foundations and endowments. Additionally, Evercore Trust Company can serve as a sole trustee or as co-trustee, or can provide comprehensive fiduciary support as an agent to individual trustees. Here, Chris Zander, CEO of Evercore Wealth Management and Evercore Trust Company, interviews two leading authorities on trust law about the risks faced by trustees of ESG portfolios. We will address managing the issues raised here and related topics in future issues of *Independent Thinking*.

**Max Schanzenbach** is the Seigle Family Professor of Law at Northwestern University School of Law. His research uses economic theory and statistical methods to assess the real-world effects of law and legal institutions in a variety of fields, including trust and fiduciary law. A widely published scholar, he is also a former editor of the *American Law and Economics Review*.

**Robert Sitkoff** is the John L. Gray Professor of Law at Harvard Law School. His research and teaching focuses on economic and empirical analysis of trusts, estates, and fiduciary administration. He is the surviving author of *Wills, Trusts, and Estates*, the most popular American coursebook on trusts and estates, and a coeditor of *The Oxford Handbook of Fiduciary Law*.

Together, they recently published *Reconciling Fiduciary Duty and Social Conscience: The Law and Economics of ESG Investing by a Trustee* in the *Stanford Law Review*.

**Q: High net worth investors, foundations and endowments are increasingly interested in and indeed often passionate about ESG investing. We work with clients to meet their ESG goals, without sacrificing returns or taking on too much investment or fiduciary risk. What do you see as the risks for fiduciaries?**

ESG investing resists precise definition, but roughly speaking, it is an umbrella term that refers to an investment strategy that emphasizes a firm's governance structure or the environmental or social impacts of the firm's products or practices.

The original motives for ESG investing were moral or ethical, based on third-party effects rather than investment returns. In the late 1990s and early 2000s, proponents of socially responsible investment, or SRI, rebranded the concept as ESG by adding corporate governance factors (the G in ESG). Moreover, some asserted that ESG investing could improve risk-adjusted

returns, thereby providing a direct benefit to investors.

For example, instead of avoiding the fossil fuel industry to achieve collateral benefits from reduced pollution, ESG proponents argued that the fossil fuel industry should be avoided because financial markets underestimate its litigation and regulatory risks, and therefore divestment would improve risk-adjusted return. On this view, ESG investing can be a kind of profit-seeking, active investing strategy. ESG investing may also be implemented via shareholder voting or other engagement with management (we call this active shareholding or stewardship, in contrast to active investing by picking and choosing securities).

We clarify ESG investing by differentiating it into two categories. We refer to ESG investing for moral or ethical reasons or to benefit a third party – what had been called SRI – as *collateral benefits* ESG.

We refer to ESG investing for risk and return benefits – that is, to improve risk-adjusted returns – as *risk-return* ESG.

For a trustee or other fiduciary investor, the motive or purpose for using ESG factors is of critical legal significance. You asked about the risks for fiduciaries. The answer turns on the fiduciary's motive; that is, whether the fiduciary is undertaking collateral benefits ESG or risk-return ESG.

**Q: All trustees, individual and corporate, must act with a duty of loyalty and a duty of care or prudence. Do ESG investing strategies that seek to advance specific causes – what you are calling collateral benefits ESG – fall outside those responsibilities?**

The trust fiduciary law duty of loyalty, which is applicable not only to trustees of private trusts but also to ERISA fiduciaries, imposes a “sole interest” or “exclusive benefit” rule.<sup>1</sup> The trustee or other

<sup>1</sup> Editor's note: The Employee Retirement Income Security Act of 1974, or ERISA, requires fiduciaries to act with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims. On June 23, 2020, the U.S. Department of Labor proposed amendments to the investment duties regulations that would make it clear that retirement plans fiduciaries must not consider non-financial factors (such as ESG) in making investment decisions for ERISA-covered retirement plans.

fiduciary must act in the sole interest and for the exclusive benefit of the beneficiary. Accordingly, ESG investing to benefit a third party or advance a specific cause – what had been called SRI and what we call collateral benefits ESG – ordinarily violates the trust fiduciary duty of loyalty.

*The relevant sole interest is limited to the financial interests of the participants.*

ERISA makes the sole interest rule mandatory as a matter of federal law. Neither a plan sponsor nor a plan participant can authorize deviation from the sole interest rule under ERISA. Under current Supreme Court precedent, moreover, the relevant sole interest is limited to the financial interests of the participants.

Under state trust law, by contrast, the sole interest rule is a default that in theory can be overcome by authorization in the terms of the trust or by the beneficiaries. In practice, however, authorization is complicated, and much will turn on the circumstances. There is variation across the states on how much leeway a grantor can give a trustee in the terms of a trust, and authorization by a beneficiary is fraught because it must be fully informed – and there are also questions of temporal scope.

A charitable endowment will typically have a little more flexibility. If a specific cause falls within the organization's charitable purpose, then pursuit of that cause via endowment investment is a substitute for expenditure (what is sometimes called mission- or program-related investment), and so not a loyalty breach. Furthermore, charities are often organized as corporate or other entities

rather than as a trust, in which case the application of duty of loyalty may be less strict.

**Q: Are some ESG strategies riskier than others from a legal point of view? For example, how does using ESG factors as a component of the underlying decision-making compare with more focused, less diversified strategies (public or private) that advance particular interests?**

Collateral benefits ESG ordinarily violates the sole interest rule of the trust law fiduciary duty of loyalty. Risk-return ESG, by contrast, is consistent with the sole interest rule, because by definition the purpose is pursuit of improved risk-adjusted returns.

Instead, the question for a given risk-return ESG strategy is whether it satisfies the duty of care or prudence, and in particular, the prudent investor rule. That rule neither favors nor disfavors any particular type or kind of investment strategy. Instead, as set forth in the Uniform Prudent Investor Act, the prudent investor rule requires “an overall investment strategy having risk and return objectives reasonably suited to the trust” and, other than in exceptional circumstances, requires a fiduciary to “diversify the investments of the trust.” The rule is explicit in not adopting a specific investment strategy or prohibiting specific types of investments.

*A program of risk-return ESG could well satisfy the prudent investor rule.*

So a risk-return ESG strategy will be judged under the prudent investor rule on the same terms as any other

investment strategy. In light of the current theory and evidence on ESG investing, we believe a program of risk-return ESG could well satisfy the prudent investor rule. As with any strategy, the individual fiduciary must support his or her choices, and the corporate fiduciary its choices, with a reasonable analysis concluding that the risk-return benefits of the strategy offset any associated costs, and that the risk and return objectives of the strategy are suited to the trust. In accordance with the duty to keep adequate records, the fiduciary's analysis of these considerations must be documented in the fiduciary's files.

**Q: If the performance of an ESG strategy is lagging that of a more traditional strategy – or taking on more risks – does that force a rethink from a fiduciary point of view?**

The fiduciary duty of prudence also requires ongoing monitoring. After implementing a prudent investment program, whether based on ESG factors or otherwise, a fiduciary must continue to monitor costs and returns, and adjust the program in light of actual performance and changing circumstances. In the words of the Supreme Court, “a trustee has a continuing duty to monitor trust investments and remove imprudent ones,” and “[t]his continuing duty exists separate and apart from the trustee's duty to exercise prudence in selecting investments at the outset.”

**Q: Some proponents of ESG investing, including the U.N.-backed Principles of Responsible Investing, or PRI, have argued that a fiduciary not only can but must use ESG factors. What is your view?**

The claim that ESG investing is or should be mandatory under American trust fiduciary law is wrong. Under the prudent investor rule, there are no categorical rules of permissible or impermissible investments. Instead, as under the

Uniform Prudent Investor Act, “[a] trustee may invest in any kind of property or type of investment,” as long as the investment is “part of an overall investment strategy having risk and return objectives reasonably suited to the trust.”

*There are hundreds of ESG ratings services and they often disagree.*

A simple way to see the folly of the PRI’s position is that it would make a passive market index without an ESG wrapper illegal for a trustee or other fiduciary investor. That is not the law. To the contrary, in the words of the Supreme Court, a trustee “could reasonably see ‘little hope of outperforming the market,’” and therefore “prudently rely on the market price.” To put the point more directly, a total market index is not a per se illegal investment for a trustee or other fiduciary.

There is also the difficulty that the ESG rubric is too fluid, and the application of ESG factors too subjective, to lend itself to a mandate. There are hundreds of ESG ratings services, for example, and they often disagree. The subjectivity inherent to ESG investing, and the fluidity of the ESG rubric, casts a pall over the practical feasibility of a mandate.

**Q: Nevertheless, industry proponents of ESG, who grow in numbers every day and now include some very well-known investors, Larry Fink of BlackRock among them, are encouraged by evidence that ESG strategies can improve risk-adjusted returns. Do you believe that the evidence is now sufficient to merit a change in trust law?**

In light of the current theory and evidence on ESG investing, a program of risk-return ESG could well satisfy

the prudent investor rule. But so could a contrarian investing strategy or a passive market index fund. Whether a given investment strategy is prudent will depend on the particular circumstances. There is no need for a change in trust fiduciary law to accommodate prudent ESG investing. And there is no guarantee that risk-return ESG investing, even if an effective strategy now, will continue to be effective in the long run. In particular, active trading based on ESG factors relies on those factors being mispriced

in the market today. If ESG grows more popular among investors, those factors should no longer be mispriced, making the strategy less effective.

For more information on the investment and fiduciary issues related to ESG strategies at Evercore Wealth Management and Evercore Trust Company, please contact **Chris Zander** at [zander@evercore.com](mailto:zander@evercore.com).



# Planning and Thriving in a Digital Age

*By Ashley Ferriello*





We will be reflecting on the events of 2020 for years to come. But one outcome is already clear; digital interaction is here to stay. While virtual wealth planning will never fully replace in-person interaction, it does have some advantages.

The most striking gain is the immediacy of conversations with clients, their other trusted advisors, and colleagues across the country – and the related decision-making. As Evercore Wealth Management CEO Chris Zander wrote two years ago, even the best wealth plan doesn't accomplish much sitting in a drawer (or a computer folder), while the family it is supposed to serve and the world at large moves on.<sup>1</sup> That's even more true this year, as events are developing so fast. Changing circumstances require consistent and flexible interaction.

Healthcare proxies and other important documents, a change in employment, a new domicile or residence, a

<sup>1</sup> <https://www.evercorewealthandtrust.com/the-value-of-integrated-wealth-management/>

developing interest in philanthropy or socially responsible investing, or a desire to accelerate wealth transfer plans – these are among the many factors that families and their advisors are considering in this period.

*Before 2020 it would have been hard to imagine having such a deep and important conversation on video.*

A New York-based couple serves as a case in point; although each client situation is unique, the challenges they are facing now are fairly common. They had been planning to retire in a year or two but are now having a rethink, concerned about

the uncertainty in the markets and in their respective businesses. This has prompted a series of video calls with their wealth management team (a Wealth & Fiduciary Advisor and a Portfolio Manager) to discuss their options.

There's a lot to talk about. The main areas of focus are the exact timing of the retirement, ranging from this year to five years from now, changing their domicile for tax and other purposes to Florida, and revisiting their appetite for risk, to ensure that both their financial plan and their portfolio reflect their current circumstances and goals. Other topics include future wealth transfer provisions to their children and a couple of charities; insurance; and the management of a large single stock position in one company after retirement (which, by the way, now looks like it will be in two years' time).

Before 2020 it would have been hard to imagine having such a deep and important conversation on video, instead of in person. Integrated wealth management starts with planning that informs asset allocation, portfolio management, financial and legacy planning, and customized trust and fiduciary services. And it considers the impact of taxes, so families know what to expect and are able to plan their lives accordingly.

*Technology allows for real-time modeling of different options and screen sharing.*

But technology allows for real-time modeling of different options and screen sharing, making this strategic wealth planning process remarkably efficient. On a related note, video calls and webinars can simplify the meeting logistics themselves, making it easier to securely gather families across geographies

## Moving Your Financial Life Online



The shift to digitized personal finance is rapidly accelerating, leaving many with urgent questions on how to make the best of the new digital normal. Addressing those questions was the focus of a recent Evercore Wealth Management webinar, *Thriving in a Digital Age: A Primer (and More) on Moving Your Financial Life Online*.

Chairman **Jeff Maurer**, Portfolio Manager **Jonathan Bergner**, and Wealth & Fiduciary Advisor **Ashley Ferriello** discussed best practices on transitioning financial lives online. The full replay can be accessed on our client site or [here](#).

## A checklist for moving your financial life online:

- Schedule regular meetings with your advisors: Video is preferable so we can see each other and look at any relevant materials together; audio is the next best communication channel.
- Review meeting materials in advance by email and/or during a video call. Financial planning scenarios can be updated in real time using our planning software eMoney.
- Leverage our remote administrative capabilities to conduct business as usual, including electronic signing, remote notary (depending on your state), paying important bills, and asset transfers.
- Invite outside advisors (accountant, attorney, art advisor, insurance advisor and others) to the meeting, as needed.
- Go paperless with electronic statements and tax information. Our client portal can also serve as a secure electronic vault for important documents like a healthcare proxy, for example, so that you can have instant access to that information.
- Use the Evercore Wealth & Trust mobile App between meetings to retrieve information about your accounts, such as balances, asset allocation, activity and performance.

*The events of 2020 so far have caused many people to pause and reflect on long-term goals.*

and generations, and to engage, as appropriate, other trusted advisors, such as lawyers and accountants – and plug the whole team into a video call. Virtual meeting formats also seem to encourage more active participation, notably from previously less engaged spouses.

Absolutely, video calls can feel awkward and confusing, at least the first few times.

But the “weirdness factor” quickly fades, and even the most initially reluctant participants then feel like themselves online, able to engage with their families and advisors. At Evercore Wealth Management, we are determined to help all of our clients, regardless of technical sophistication, get the most out of their new digital lives. (See page 15 for details on our recent client webinar.)

The events of 2020 so far (and there’s another six months to go!) have caused many people to pause and reflect on long-term goals. At Evercore Wealth Management, our technology has enabled us to continue and even to enhance these

conversations without losing the human connection we all value so much. Time will tell how our clients choose to gather in the future – perhaps it will be a mix of virtual and in-person meetings – but we are grateful to feel so connected through this period.

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**Ashley Ferriello** is a Managing Director and Wealth & Fiduciary Advisor at Evercore Wealth Management. She can be contacted at [ferriello@evercore.com](mailto:ferriello@evercore.com).

# Prepared for Anything with Good Technology and Good Advice

By Jeff Maurer

Fifty years ago, I was attending business school and marching up and down Wall Street – but not the way you might think, at least not at first.

Back then, I was marching as an organizer of a group called Business Students for Peace. It was just a few weeks after the Ohio National

Guard fired on protesters at Kent State University, a time that felt much like this. A few weeks later I was marching the street again,

seeking employment. I stumbled into a position at U.S. Trust, then located at 45 Wall Street, and entered the wealth management business.



I've learned at least two things since. The first is to hold on to our ideals, as they will be repeatedly tested in our personal and business lives. I like to think I've done my best, but I know that there is much more that I (and all of us, as a society) can do, a subject I hope to revisit in subsequent editions of *Independent Thinking*. The second is to be prepared for change, because none of us know what's coming next.

Enter COVID-19. I haven't been to a restaurant, bumped into a friend or colleague or, worse still, hugged

a grandchild without a mask since mid-March. And like many among my generational cohort, I'm sad to say that I have no plans to rush back to the old normal. But if I didn't expect a pandemic, I was at least prepared, thanks to good technology and good advice.

I love technology. I find it incredibly interesting, and it informs my work and other passions. So when I realized my home offices in Florida and New York would in fact be my only offices – and video my only way of catching

*It is my hope that all Evercore Wealth Management clients will benefit from technology.*

up with those grandchildren – I was already set up with the appropriate equipment (as were my colleagues, thanks to years of robust business continuity planning). And I was equipped to play, as well as to work. My spouse of 47 years and I had subscriptions to multiple entertainment sources – daily online



newspapers, magazines, music and films, as well as video technologies that enabled us to socialize, order online, and settle \$5 wagers on golf games through Zelle.

*I've experienced seven bear markets, all very different but none pleasant.*

On a related note, our financial accounts were online, our documents stored on the cloud (as are our photographs), and we were enrolled in contactless payment systems.

It is my hope that all Evercore Wealth Management clients, irrespective of age or technological sophistication, will similarly benefit from technology.

Please see Ashley Ferriello's article on virtual wealth planning on page 14 and, if you were unable to join our recent webinar *Thriving in a Digital Age: A Primer (and More)*, you can access the replay on our client site or [here](#).

Additionally, I (along with other Evercore Wealth Management clients) was ready on the financial front. In the 50 years since those marches on Wall Street, I've experienced seven bear markets, all very different but none pleasant. The important thing is to ride them out, which means staying close to trusted advisors who have their clients' best interest at heart and are objectively focused on those clients' long-term goals.

As illustrated below, each of those bear markets had a maximum drawdown of between 20% and 56%, and lasted between three and

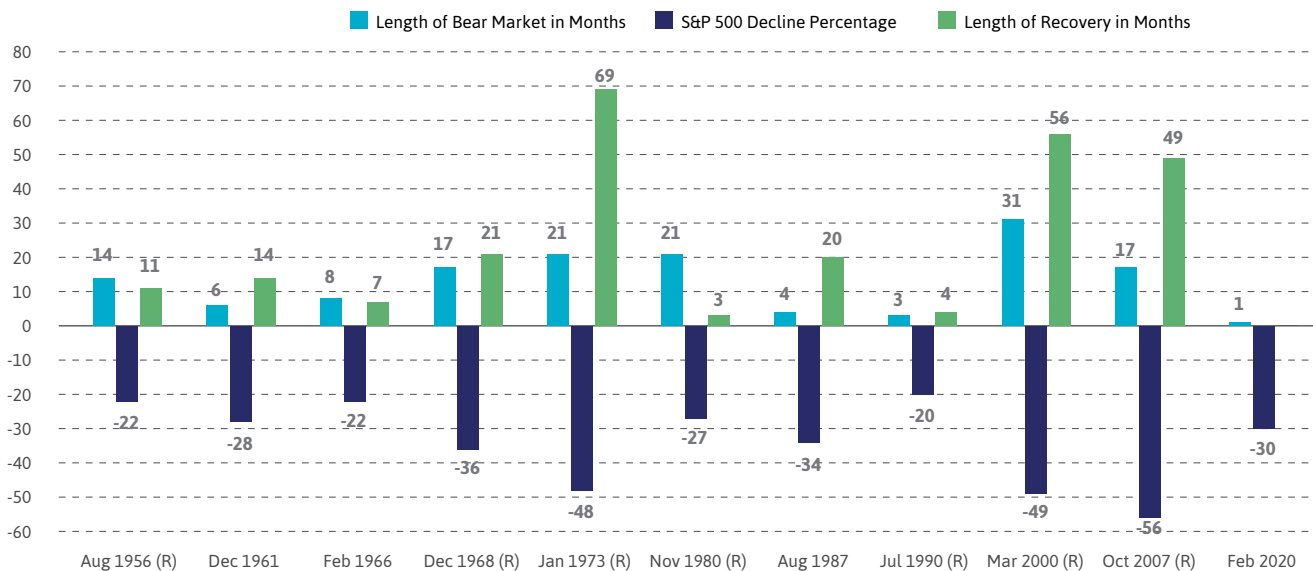
31 months, with recovery times longer still. The COVID-19 bear market, which started in February and resulted in a 30% drawdown, appears to have lasted less than one month, although we won't be sure of that for some time. But we'll be prepared, in any case.

None of us know what's coming next. I'm sure that all of us hope for an increasingly equitable society, an effective COVID-19 vaccine, and to gather in peace in a new and better normal.

**Jeff Maurer** is the Chairman of Evercore Wealth Management and Evercore Trust Company. He can be contacted at [maurer@evercore.com](mailto:maurer@evercore.com).

## Hang on Tight and Wait for Recovery

Seven bear markets in 50 years



(R)=Bear market coincides with a recession  
Source: LPL Research, CFRA FactSet.

## Independent Thinking Panel Series

### Stranger Than Fiction: A Conversation with Steven Brill and Paul Steiger



Many of us recognize fake news when we see it. But we may not realize the true extent of the problem, and the potential impact on our health, our political process, and our society.

The rise – and consequences – of misinformation and disinformation was the focus of this Evercore Wealth Management webinar on June 9, 2020. Steven Brill, the co-founder of NewsGuard, which rates the legitimacy of online news sites, and the author of several books, including *America's Bitter Pill: Money, Politics, Backroom Deals, and the Fight to Fix Our Broken Healthcare System*, and Paul Steiger, the founder of ProPublica, the independent nonprofit newsroom supporting investigative reporting, and former long-term Managing Editor of *The Wall Street Journal*, were the speakers. Aline Sullivan, the editor of Evercore's *Independent Thinking*, moderated.

The replay can be accessed on our client site or [here](#).

### Now and Next: Recovering from the Pandemic and Preparing for the Future

*"We will look back on this period as a turning point, in our economy, in our society, in our relationship with nature and technology – and in our own lives."* – Andrew Zolli



That was the view expressed in the Evercore Wealth Management client event *Now and Next: A Webinar Series with Futurist Andrew Zolli on Resilience and Recovery*. Andrew is the global impact lead of a high-frequency imaging organization called Planet and the author of *Resilience: Why Things Bounce Back*. Evercore Wealth Management Partner and Financial Advisor Jewelle Bickford presented the two-part event.

"The developed world is suffering from pessimism and loss of faith in social institutions," Andrew said. "A comprehensive recovery will mean addressing the balance between individual and collective risk, universal basic income, healthcare, family leave and childcare, labor rights and housing."

He added: "Questions about the long-term role of the state, environmental protections, automation, and our attitudes to privacy will also have to be discussed, as we seek to recover from this virus and better prepare for future challenges."

The full replay can be accessed on our client site.

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

Jay Springer  
Partner  
212.822.7621  
springer@evercore.com

**TAMPA**  
4030 Boy Scout Boulevard, Suite 475  
Tampa, FL 33607  
813.313.1190

Julio Castro  
Partner  
813.313.1192  
julio.castro@evercore.com

**MINNEAPOLIS**  
150 S. Fifth Street, Suite 1330  
Minneapolis, MN 55402  
612.656.2820

Martha Pomerantz  
Partner  
612.656.2821  
martha.pomerantz@evercore.com

**WILMINGTON**  
Evercore Trust Company, N.A.  
300 Delaware Avenue, Suite 1225  
Wilmington, DE 19801  
302.304.7362

Darlene Marchesani  
Managing Director and Trust Counsel  
302.304.7361  
darlene.marchesani@evercore.com

**PALM BEACH**  
515 North Flagler Drive, Suite 702  
West Palm Beach, FL 33401  
561.812.1010

Michael Cozene  
Partner  
561.812.1010  
michael.cozene@evercore.com

**EDITORIAL AND MEDIA**  
Aline Sullivan  
Editor  
203.918.3389  
aline.sullivan@evercore.com

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

Keith McWilliams  
Partner  
415.288.3010  
keith.mcwilliams@evercore.com

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