

INDEPENDENT THINKING

THE NEW STANDARD IN WEALTH MANAGEMENT

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Volume 43

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A Message from the CEO



Welcome to the latest issue of *Independent Thinking*. In approaching this column, one thought has really stuck with me – that trees don't grow to the sky. After 10 years of low taxes, low inflation, and an average annualized total return of 16.6% for the S&P, compared with a historical mean of 10%, we are prepared for tougher conditions.

This isn't a "Winter is Coming" message. We remain confident investors and expect further, albeit more subdued, growth in the markets. As John Apruzzese and Brian Pollak write in these pages, inflation has recently spiked, but diversification is a powerful hedge and, longer-term, powerful deflationary forces are still at play. Interest rates remain low. At the same time, U.S. corporate earnings remain strong, thanks in large part to remarkable productivity gains.

Taxes are going up, however. We don't yet know by how much or in what forms, exactly, but higher taxes look almost certain. Justin Miller, who joined us in July as a Partner and National Director of Wealth Planning, reviews the current proposals (still subject to horse trading in Congress) and several related wealth planning strategies on page 11.

But again, we feel confident. As Jeff Maurer writes in this issue on page 19, we've been discussing taxes with our clients for over a year, in anticipation of a changing environment, always in the context of overall wealth plans – and we are prepared to assist. One of our Partners, Helena Jonassen, recently observed in *The Wall Street Journal* that our clients are by and large resigned to higher rates. I think that's right; resigned – and ready.

So, this is more of an "Autumn Message," I guess, in that we should preserve our gains and prepare for at least somewhat leaner times. And that's okay. We have never bought into

new paradigms. Markets and economies move in cycles, and we have enjoyed a remarkable run. We are positioned to take advantage of the many opportunities this market still affords, while protecting portfolios to meet our clients' goals.

On a separate note, it appears to be another season altogether in our offices – one of renewal. Our teams are coming back together, increasingly working in person and meeting with clients in their homes, at our buildings, and in all sorts of places in between. We have thought-out protocols in place, of course, and continue to meet and host events virtually as well. But the pleasure of reuniting with lifelong friends and meeting new colleagues and clients in person is everything we expected – and more.

I am very proud of the culture we have built at Evercore Wealth Management and Evercore Trust Company, and grateful always for our clients' trust.

I hope that you and your family are happy and well.



Chris Zander
President & Chief Executive Officer

Inflation Hedges: What's in Your Portfolio?

By John Apruzzese and Brian Pollak

Properly diversified investment portfolios are naturally hedged against inflation. Short-term bonds, equities and real estate can be surprisingly strong defenses against rising inflation; assets commonly perceived as targeted inflation hedges, not so much. It's a distinction worth thinking about in asset allocation, even in periods of transitory inflation.



Let's start with fixed income. Bonds with long-term fixed interest rates, especially those with 10 years or more to final maturity, are no one's idea of strong performers when inflation is relatively high, as it is now at 5.3%, after averaging just 1.9% over the previous decade. While inflation doesn't present a risk to the principal value of bonds (assuming the issuers don't default on their obligations), it can certainly erode the purchasing power of their proceeds. At present, the 10-year Treasury note has a nominal yield of just 1.52%, well under the 2.38% inflation rate widely anticipated in the market over the same period.

In contrast, high-quality municipal and corporate fixed rate bonds with shorter-term maturities are relatively stable in periods of high inflation, at least relative to longer-term maturity bonds. Additionally, investors are able to reinvest proceeds more quickly, to take advantage of higher yields.

Floating rate securities, which carry variable coupons that change based on a benchmark rate, usually tied to short-term interest rates, are also relatively appealing when inflation and interest rates are rising. Many higher-yielding corporate securities, such as bank loans and middle market loans, are offered at floating rates, and provide attractive current cash flows that could rise if inflation persists. (See the chart below for current fixed income returns.)

Treasury Inflation Protected Securities, or TIPS, are commonly misunderstood as effective inflation hedges. TIPS were created by the U.S. Treasury Department in the 1990s in an effort to provide investors with a way to protect their Treasury investments from inflation. Principal and interest payments are indexed to the Consumer Price Index, or CPI, providing investors with some

2.38%

Current market expectations for annualized inflation over the next 10 years.

protection from a decline in the purchasing power of their money. But the prices of TIPS are also dependent on the prevailing market real interest rate (the yield less expected inflation over the life of the security).

Currently, the real interest rate for a 10-year TIPS is -0.89%, meaning that a TIPS investor effectively pays a premium to invest in a bond with no coupon. In an inflationary environment, investing in TIPS will provide a rate of return less than that of expected future inflation. If the real yield increases, the price of the TIPS declines, as bond yields move inversely to price, further diminishing

How low can fixed income go?

Fixed Income Sector	Nominal Yield	Real Yield	Duration (Years)
10-Year U.S. Treasury	1.52%	-0.86%	9.2
Investment Grade Muni Bonds	0.67%	-1.71%	4.5
Mortgage-Backed Securities	1.45%	-0.93%	7.6
Barclays AGG	1.56%	-0.82%	6.2
Investment Grade Corporate	2.05%	-0.33%	8.6
High-Yield Muni Bonds	3.11%	0.73%	7.3
High-Yield Corporate	4.04%	1.66%	3.6
Leveraged Loans	3.71%	1.33%	0.5

Source: FactSet – September 30, 2021

Equities have a good chance of performing well through periods of high inflation.

the TIPS' total return. Indeed, TIPS can generate negative returns even if inflation is rising.

What about commodities? Investors may still associate precious metals generally, and gold in particular, as beneficiaries of inflation. But gold now appears to be most correlated to changes in real interest rates, rising as real interest rates – and the returns of conventional investments such as cash equivalents and bonds – fall. Gold prices are therefore unlikely to perform well in an environment where the Federal Reserve starts to aggressively increase interest rates to fight accelerating inflation. There may be other reasons to own gold within an investment portfolio, but it's likely not an effective inflation hedge.

Commodities overall often perform well as an asset class during inflationary periods, as prices generally rise rapidly with demand. But they can fall just as fast when supply catches up and/or other inputs become a factor, such as rising costs, regulation and technologically driven productivity gains. There are interesting developments in some areas of the market (see the article by Michael Kirkbride on page 6 on the impact of ESG investing on the energy sector), but we believe that commodities in general do not constitute an attractive asset class for long-term investors.

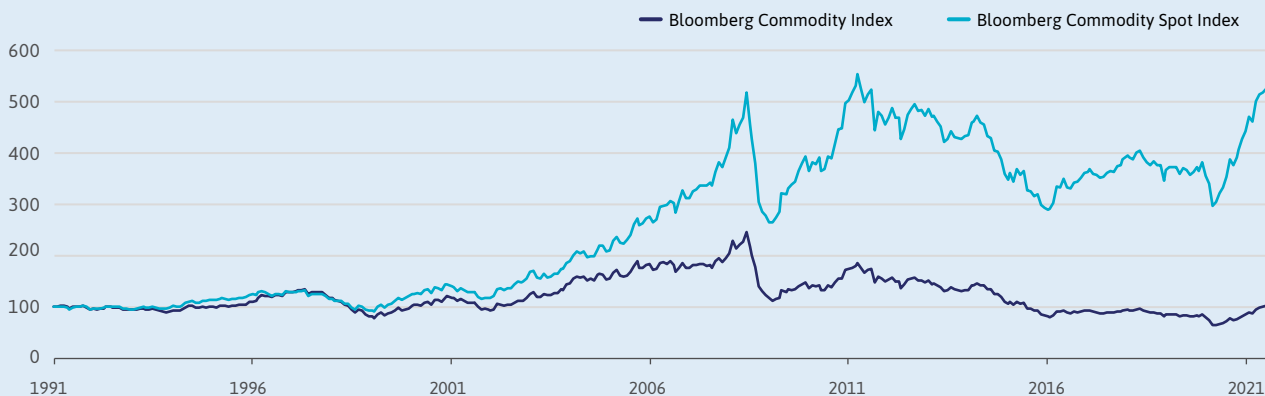
While spot commodity prices typically do well during periods of inflation, they generally do poorly in other environments, such as in low or stable inflation or deflation. In addition, the spot prices are not investible, forcing commodity investors into vehicles that purchase futures. The Commodity Futures Index has had a 0% cumulative return over the past 30 years (as illustrated by the dark blue line in the commodity chart below).

Equities, in contrast, have a good chance of performing well through periods of high inflation, although investors may need to be patient for a couple of reasons. The first reason is that companies may initially struggle to increase revenues at a rate high enough to offset input cost inflation while maintaining profit margins, creating temporary equity market volatility. We've seen this in the utility sector, for example, where regulatory constraints make quick repricing difficult. The second reason is that long-term investors tend to discount the value of future cash flows more steeply during periods of high inflation, forcing the multiple on future earnings down overall, and a shift to companies with relatively certain near-term cash flow and earnings power, and away from growth companies. But again, this move in the market is likely to prove temporary. Eventually, we expect companies with persistently high earnings growth to outgrow the rate of inflation.

It's important to note that price dispersion among companies during

Bloomberg Commodity Index

Commodities in general do not constitute an attractive asset class for long-term investors.



Source: FactSet – October 6, 2021
Note: Indexed to 100 on 1/31/1991

inflationary periods may increase, as those better or more quickly able to pass through costs to end consumers will be at an advantage, and shares in some could even be considered inflation hedges. Commodity producers, consumer staples companies and financial services companies should be able to raise prices quickly as inflation rises, offering inflation protection. Conversely, companies with fixed prices that are difficult to change or tied to inputs other than inflation will likely underperform. Companies with high dividend yields, but limited revenue growth, may also be susceptible to rising inflation, as the value of the dividend cash flow to investors diminishes.

We continue to expect private investments to outstrip their public counterparts.

Private equity and venture capital investments have similar characteristics to their public counterparts in an inflationary period. The underlying economics are the same, in that private companies with pricing power will be able to manage increasing input costs. However, private companies are not marked to market as quickly as public companies, so the initial drops in value due to reduced valuation metrics are not as obvious and may be overcome for private companies that are able to quickly adjust to the inflation of their input costs. Over the long term, we continue to expect private investment returns to outstrip their public counterparts, due to the illiquidity premium, which is driven by managements' longer-term outlook and higher levels of low-cost leverage.

Broad diversification can help protect portfolios for all manner of long-term risks.

Investors able and willing to accept illiquidity may find that prudently leveraged private real estate, with its solid current cash flows and the potential to grow cash flow through increasing net operating income, is one of the best hedges against inflation. In general, private real estate generates cash flows at a rate higher than traditional fixed income, and those cash flows can grow over time, in some cases at a rate tied to the Consumer Price Index. Real estate is a hard asset with intrinsic value that can also appreciate in value, protecting the purchasing power of the investment.

Yes, many real estate submarkets look expensive at present. But there is some natural land scarcity in many regions, and the value of any existing real estate in those locations will be tied to the cost to replace a similar structure, which should also be rising during periods of inflation. Private real estate is often purchased using leverage – and leverage, especially the fixed rate variety, can significantly enhance the investment performance of an asset during inflationary periods, as the value of the principal and fixed interest costs are diminished by broadly rising prices. Unlike commodities, real estate has the potential added benefit of having a positive expected return in a low inflation environment, if the cash flows provide a floor to expected returns.

Bitcoin and digital assets are uncorrelated to inflation, although they may provide an inflation hedge

to the extent that they provide diversification from assets that could be impacted by inflation. Our approach in this area is through venture capital investments focused on digital assets and related businesses, as appropriate for individual clients.

It may take time, but the market and the Federal Reserve appear to believe that inflation will moderate from its current high level, as supply chain issues ease and volatility in commodity prices abates. Jay Powell, the Fed Chair, had this to say during a recent speech at the annual Jackson Hole conference: “While the underlying global disinflationary factors are likely to evolve over time, there is little reason to think that they have suddenly reversed or abated. It seems more likely that they will continue to weigh on inflation as the pandemic passes into history.”

We agree. But as stewards of family and institutional capital, we remain alert. We believe broad diversification can help protect portfolios from all manner of long-term risks, including the potential for sustained high inflation, if and when it comes.

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ESG and Inflation: Short-Term Pain, Long-Term Gain

By Michael Kirkbride

Is ESG investing fueling inflation? As counterintuitive as it seems, the well-intentioned allocation of capital may come at a cost to investors. That's particularly true in the energy sector. Environmental, social and governance, or ESG, investing has grown very quickly into a mainstream and increasingly dominant force in portfolios, reflecting growing concerns among investors across a range of issues from boardroom diversity to carbon footprint.

Let's back up. This style of investing is designed to combine capital growth with long-term business and environmental sustainability. Estimates vary widely, but it seems fair to say that the 40%-plus growth over the last few years that has led to \$17 trillion¹ in sustainably invested assets is poised to continue apace.

Countries and corporations are paying attention. At present, 90% of S&P 500 corporations publish a sustainability report, up from 20% in 2011, indicative of both investor and management focus.² Among the topics addressed are direct impacts like

energy companies transitioning from reliance on fossil fuels, in response to investor and regulatory pressures, as well as corporate commitments to sustainability.

As a result, traditional energy production is becoming more difficult and more expensive. Oil production growth rates are falling and coal use is dwindling.

So far, so great for ESG investors. But energy transitions take time. Coal, oil and natural gas all took decades to move to peak usage. While some renewables, notably solar and wind,

\$17 TRILLION

Recent ESG growth has created a \$17 trillion market.

are now within striking distances of rivaling traditional energy sources in cost effectiveness at scale, there are still some big issues to be resolved, such as those around storage and transmission. Overall, the use of modern renewables is barely a decade along in its growth. At the same time, global demand for energy is rising. The International Energy Agency

^{1,2} <https://www.ga-institute.com/research/ga-research-collection/flash-reports/2020-russell-1000-flash-report.html>

projects global energy demand to increase by more than 2% per year for the coming decade and, in the recovery from the pandemic shutdowns, almost double that rate in 2021.

2%

Annual projected rise in global energy demand (International Energy Agency).

As Bill Gates describes in his book *How to Avoid a Climate Crisis*, the move to modern renewables is, at this time, based on environmental interests and often in the face of economic interests. A possible result is inflation and the economic pressures that go along with it.

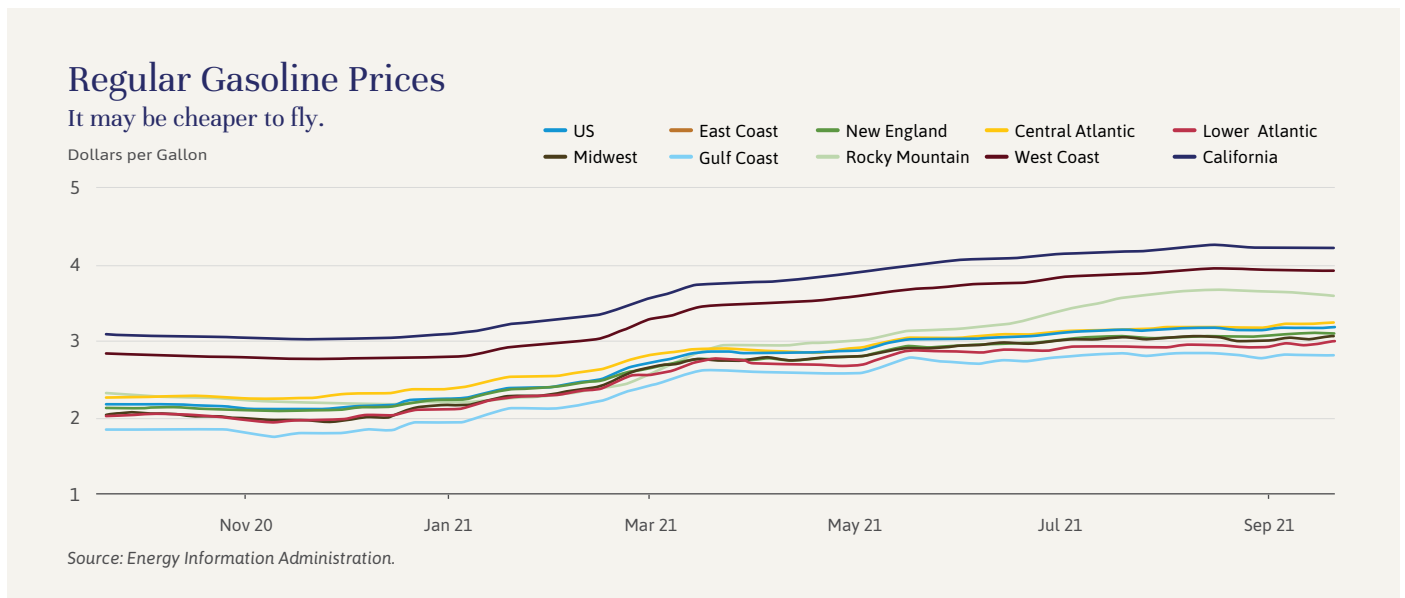
As a case in point, rising prices across most of the energy sector are contributing to increases in gasoline prices to multiyear highs, putting pressure on consumers, as illustrated by the chart below. While these price hikes may indeed prove transitory, they also serve as a reminder of the importance of considering longer-term supply-demand dynamics.

What would be the offset to this inflation? As with so many other aspects of the economy, we look to technology-driven productivity gains and the companies leading that charge. The 2020 pledge by Google parent Alphabet to carbon-free targets by 2030 was big news. Two other examples from the current Evercore Wealth Management core equity portfolio also serve as good examples of corporate change: BorgWarner, a traditional auto parts supplier, is evolving into an electric vehicle/

hybrid supplier; and Microsoft's Azure cloud segment has built a suite of software designed to drive efficiencies and safety throughout the energy industry.

Investors will be wise to monitor the extent of this green premium. Future inflationary trends and the transition to a greener future are important considerations in building portfolios meant to last.

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Q&A

on Global Health Sciences
with Jennison Associates



Debra Netschert

Editor's note: Evercore Wealth Management supplements its core investment capabilities with carefully selected outside funds across the range of the firm's asset classes. Here we discuss opportunities in public companies with Debra Netschert, a health sciences equity portfolio manager at Jennison Associates. Jennison employs a bottom-up, analyst-driven stock selection based on proprietary fundamental research and investment insight. Please note that this article represents the views of Jennison and not necessarily the views of Evercore Wealth Management.

Q: Debra, let's start with the pandemic. Is it as transformative to the global health sciences sector as many investors might suspect?

A: It does feel like all COVID, all the time. And it is clear that healthcare is going to change in a dramatic way as a result of this experience. We are going to see faster product rollouts, faster development times and far more user engagement. As a society, we've become so much more technology savvy and so much more health savvy. That's a powerful combination.

Q: So, you anticipate more consumer demand?

A: People everywhere are thinking much more about their healthcare and are conscious of the things that they can do to help themselves, including through the use of personal care devices. Sure, maybe some of the self-administrated blood oxygen measurements and thermometers that we've all been buying will get tossed into drawers. But it seems inevitable that people are going to increase their efforts to optimize their healthcare. And technology is going to play a big role there.

Q: What sorts of new products are you excited about?

A: Think about glucose monitors that provide a continuous glucose monitoring system (CGM). The daily management of diabetes is daunting, and achieving clinically acceptable outcomes requires significant engagement and modified behavior. The availability of actionable data – such as real-time accurate blood glucose readings – is the first and arguably most critical piece of diabetes treatment algorithms. We are excited about next-generation CGMs, which will have a smaller footprint and increased accuracy. A growing awareness of the direct correlation between the use of real-time glucose data to positive outcomes and fewer complications will drive increased penetration into the large Type 2 population. Ultimately, individuals will have the ability to use CGMs that are more accurate, super user-friendly and about the size of a large Band-Aid.™

Given that so much of disease control is about personal compliance, developments like this are going to be a game changer. Patients – and their doctors – will be able to look at their real-time data in a more qualitative fashion and make more immediate changes when needed. This will lead to much better outcomes and fewer complications.



Another innovation that has the potential to really accelerate the diagnosis of a disease and more accurately monitor disease progression is liquid biopsy. Using this technology, oncologists use a simple blood sample to figure out the driving mutation that is causing the cancer cells to multiply, instead of an invasive needle biopsy. This allows a patient to receive a more targeted therapy faster, which will hopefully lead to better outcomes.

Q: Does this surge in innovation create opportunities for skilled investment managers, especially given the relative lack of correlation of the biotech sector to the broader market?

A: Yes, because the healthcare market is very different in each geography. In the United States especially, it's quite fragmented. In addition, diseases are heterogeneous; everyone's body is different, and each technology being developed is slightly different from the next. These small changes are not evident on the surface; they require a skilled eye to decipher. There are countless ways to participate in this market, to find a niche, especially as the science is changing so rapidly. In the biotech sector alone, the number of public companies has more than quadrupled over the past 10 years.

As for correlation, certain companies may be correlated to the market at the factor or macro level, but it is their product cycle or clinical data that will really break that correlation. We are really focused at the innovation level, looking for companies that are raising the standard of medicine across specific areas. There is a lot of clinical data to analyze in our space, and it needs to be put into context

with the competing technologies, standard of care, and an ever-changing regulatory and reimbursement environment, so the bar is always moving. When the data for a clinical trial comes out, it's never entirely in line with expectations, so we are always learning something new. Importantly, the deep analysis that comes with analyzing thousands of clinical trials helps to develop a certain level of pattern recognition, which improves your hit rate over time. We are also engaged with our management teams trying to guide them and have a positive impact on these companies, from both a strategic and ESG perspective.

Q: You sound pretty passionate about this industry. You started your own career as biotechnology analyst after an education in health science and physical therapy. What drew you to the investing world?

A: I have always had an interest in healthcare, particularly in personalized medicine, and in advancing healthcare – and I never want to stop learning. Investing in this space is a great vantage point for seeing the innovation curve, which is just so striking now. Millennials are not going to endure the healthcare system that we have today – the lack of information and lack of transparency. There is likely going to be massive change. It's an incredibly exciting time.

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

Changes at the Top: the New York Muni Outlook

By Howard Cure

For bondholders, the transition of power in both New York State and New York City shouldn't be much cause for concern. Kathy Hochul, who replaced Andrew Cuomo as Governor, is the former Lieutenant Governor. Eric Adams, the presumptive next Mayor of New York City, has significant state and local government experience as well as serving, with distinction, as a NYC police officer.

Both face big challenges, however. Staffing, managing all the issues associated with the coronavirus pandemic, infrastructure spending, and running for office will likely be top of mind for Ms. Hochul. Mr. Adams hopes to improve relations between the city and state, and revive the city's economy while providing opportunities for all people to share in the growth.

The Metropolitan Transportation Authority, or MTA, is among the most pressing issues. The MTA has lost about half of its riders since the pandemic started; emergency federal aid has bolstered the authority against a huge operating deficit. However, budget gaps are on the horizon, as soon as 2025. Fortunately, the state is providing

increased financial resources for both operations and capital expenditures.

On a related note, implementing congestion pricing in New York City, which is expected to generate \$1 billion a year, is also a challenge. The revenue from congestion pricing – a charge on driving in certain traffic-prone areas – was meant to help fund the MTA's \$51 billion, five-year capital program. Congestion pricing needs to reasonably maximize revenues while determining possible exemptions to the fee. It remains to be seen if capital priorities will change under a new administration.

The relationship between Mr. Cuomo and outgoing New York City Mayor Bill DeBlasio always seemed particularly adversarial, even by New York standards. The city needs state approval for most tax reforms or implementing important programmatic changes, and a constructive relationship between Ms. Hochul and Mr. Adams could result in real benefits.

New York State and New York City have proven their resiliency time and again. A transition to a new leadership, while challenging, does not diminish our confidence in the state's or city's credits.


In New York, as with all of our state and local bonds, we continue to focus on credit issues that have a broad revenue base and strong legal pledge, such as New York State general obligation, personal income tax and sales tax bonds, as well as essential purpose revenue systems such as water, sewer and public power issues. At the same time, we are more cautious and selective when it comes to sectors more severely impeded by the pandemic, such as transportation bonds and the healthcare sector.

Editor's note: This article is extracted and updated from "Another Governor for New York: The Muni Outlook," also by Howard Cure, published by Evercore Wealth Management in August 2021.

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Estate Tax Planning: Act Now, Before It's Too Late

By Justin Miller



1,633%

The rise in the estate tax exemption
over the past 20 years.

When it comes to estate planning, the best advice is to plan early and often. Not only are the current estate and gift tax rules set to expire after 2025, but, depending on Congress, we could see some significant changes much sooner. Families looking to pass on intergenerational wealth in the most tax-efficient manner should consider taking action as soon as possible.

The proposed changes are significant. Following a 1,633% rise in the estate tax exemption over the past 20 years, President Biden earlier this year proposed multiple tax changes as part of the American Families Plan. More recently, the House Ways and Means Committee, the chief tax-writing committee of the House of Representatives, proposed to cut the estate tax exemption roughly in half, subject grantor trusts to estate taxes, and eliminate tax-free sales to intentionally defective grantor trusts.

Each individual currently has an \$11.7 million exemption amount, which means a married couple can give \$23.4 million to loved ones during life or after death without owing any gift, estate or generation-skipping transfer, or GST, tax. That exemption amount is a use-it-or-lose-it benefit, so if the exemption amount goes down in the future, any prior gifts will receive grandfathered protection. The Treasury Department issued final regulations in 2019 confirming that there will be no so-called clawback for tax purposes if an individual makes a tax-free gift under the current law and the government reduces the exemption amount in a future year.

The other change that could occur is an increase in the gift, estate and GST tax rate, which currently is 40 percent. From a historical perspective, the highest rates ranged from 55% to 77% for almost 70 years before 2002. Therefore, not only could the exemption amount be reduced, but the gift, estate and GST tax rate also could be significantly increased in the future.

Given the potential reduction in the exemption amount and possible increase in tax rates, there is a narrow window of opportunity remaining in 2021 for families to transfer substantial wealth to future generations permanently free of gift, estate and GST tax. Let's look here at three planning strategies that can effect this transfer, keeping in mind that any big decision should be made in the context of each family's long-term wealth plan and in close consultation with advisors.

DYNASTY TRUSTS

One of the most popular wealth transfer strategies is to create a Dynasty Trust in Delaware or in other states with strong asset protection laws, for children, grandchildren and future generations. A Dynasty Trust could not only prevent future gift, estate and GST tax, but could also help protect assets for family members from future creditors in the

wake of any number of potential events, such as a car accident or divorce. For instance, a married couple could transfer \$23.4 million tax-free into a Dynasty Trust. Those assets and all the future growth would be permanently set aside for family members without ever being subject to gift, estate or GST tax. As an example of the potential future benefit provided by Dynasty Trusts, a \$23.4 million Dynasty Trust growing at 7% per year would set aside potentially \$176 million in 30 years for future generations free of gift, estate and GST tax. Moreover, Delaware eliminated the common-law rule against perpetuities in 1995, which means the Dynasty Trust can support multiple generations of a family for hundreds of years.

There is a narrow window of opportunity for families to transfer substantial wealth to future generations.

Dynasty Trusts are often set up as grantor trusts, allowing the grantor to pay all the income tax for the trust without any gift tax consequences. In other words, the Dynasty Trust's assets grow free of income tax, and the payment of income tax by the grantor further reduces the grantor's taxable estate.¹ On the other hand, wealthy families in high income tax states may want to consider creating a non-grantor trust, where the trust pays its own tax, in a jurisdiction where the Dynasty Trust would not be subject to any state income tax. As a non-grantor trust in a state without a state income tax, the Dynasty Trust could continue to grow free of estate, gift and GST tax, as well as state income tax for generations – subject to potential state sourcing rules and throwback tax, for example, in California and New York.

\$11.7 MILLION

The current individual lifetime gift, estate and generation-skipping tax exemption.

SPOUSAL LIFETIME ACCESS TRUSTS

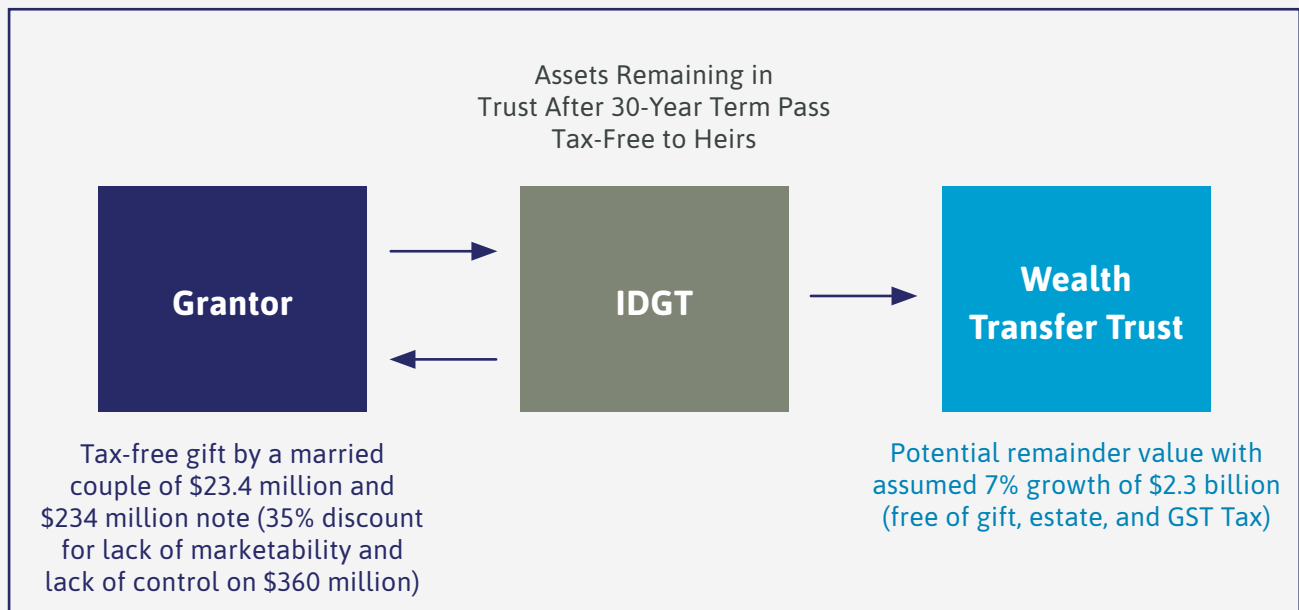
Not all wealthy parents are comfortable permanently setting aside millions of dollars for children and future generations, especially if they might need or want the assets back in the future. In that case, a spousal lifetime access trust, or SLAT, could be the

optimal solution to maximize the gift, estate and GST tax savings while still protecting assets for the spouses for the rest of their lifetimes. With a SLAT, one spouse would create an \$11.7 million irrevocable trust with their separate property to benefit the second spouse. After the second spouse dies, the SLAT protects future generations, free of gift, estate and GST tax. It is important to remember that SLATs are irrevocable trusts, which could be a big issue if spouses get divorced in the future.

It may also be possible for the second spouse to create a similar \$11.7 million SLAT for the first spouse. However, the two SLATs would need

to be independent and different enough to avoid what is known as the “reciprocal trust doctrine” and “step transaction doctrine.” Accordingly, the first spouse is taking a real risk that the second spouse might not necessarily fund a second SLAT for the first spouse. Suppose there is concern about the reciprocal trust or step transaction doctrine. In that case, instead of the second spouse creating a similar SLAT for the first spouse, another option could be for the second spouse to utilize their individual \$11.7 million exemption by creating an entirely different type of trust, such as a Dynasty Trust, for future generations.

Hypothetical: Sale To Intentionally Defective Grantor Trust (IDGT)



Assumes September 2021 Applicable Federal Rates. IRS Rev. Rul. 2021-16. Also assumes 7% net growth and parent pays income taxes for grantor trust, which is not treated as a gift for gift tax purposes. See IRS Rev. Rul. 2008-22, 2004-64, and 85-13.

Typically, SLATs are grantor trusts, similar to Dynasty Trusts. As an alternative, careful drafting may make it possible to create a spousal lifetime access non-grantor trust, or SLANT. As a non-grantor trust, the SLANT would grow free of state income tax in a jurisdiction such as Delaware, subject to potential state sourcing rules and throwback tax, for example, in California and New York.

SALE TO INTENTIONALLY DEFECTIVE GRANTOR TRUSTS

Families looking to maximize the amount they can leave to future generations free of gift, estate and GST tax can consider several strategies that maximize use of the current high exemption amounts. A sale to an intentionally defective grantor trust, or IDGT, which could be a Dynasty Trust or SLAT, is one of the most powerful strategies to set aside substantial amounts of assets for future generations. Typically, the first step is to fund the IDGT with an amount equal to 10% of the assets that the IDGT will be acquiring. The initial gift is often referred to as seeding the trust, although some practitioners are comfortable eliminating this step if there are adequate beneficiary guarantees.

For example, a married couple who are parents could gift \$23.4 million to an IDGT, and the IDGT would then buy \$234 million worth of assets from the parents for a promissory note. The IRS publishes applicable federal rates monthly; the minimum interest-only payment that the parents would need to charge on a promissory note for 30 years would be 1.73%.² To make the sale to IDGT strategy even more effective,

wealthy families often sell assets, such as closely held business interests, to the IDGT at a discount due to their lack of marketability and control.³ For example, families could create a family limited partnership, or FLP, or a family LLC to manage the family's investments. It is essential that the entity has a legitimate business purpose and that the family respects both the form and substance of the structure.⁴

Of course, the government could eliminate discounts for family-controlled entities in the near future – which has been proposed by the House Ways and Means Committee – so there might be limited time to transfer discounted interests in a family-controlled entity before the rules change. The Treasury Department issued proposed regulations under section 2704(b) in 2016, which would have limited the ability of families to claim valuation discounts for gifts and bequests of interests in family-controlled entities to family members. However, in response to President Trump's Executive Order 13789 in 2017, the Treasury withdrew those proposed regulations. With the change in presidency and political shift in Congress, intrafamily discounts once again could be a target for change.

As an example of the substantial amount of assets that parents can transfer to future generations with a sale to IDGT strategy, let's assume two wealthy parents create an FLP. The parents could then seed an IDGT with \$23.4 million and sell a \$234 million discounted limited partnership interest to the IDGT. Assuming a 35% aggregate

Any plan should reflect the counsel of advisors.

discount for lack of marketability and control, that \$234 million discounted limited partnership could have an undiscounted value of \$360 million. The IDGT could purchase the interests from the parents with a \$234 million interest-only promissory note using, for example, the September 2021 IRS section 7520 interest rate of 1.73% for 30 years. The IDGT is a grantor trust, so the parents would not owe any income tax on the sale, as the tax rules do not treat it as a sale for income tax purposes.⁵ If the assets grow at an illustrative 7% rate for the next 30 years, the partnership liquidates, and then the note is paid off, there will be potentially approximately \$2.3 billion in the IDGT for future generations that could be permanently free of gift, estate and GST tax. If future estate tax rates eventually go back to the historical norm of 55%, planning in 2021 would save the family almost \$1.3 billion in tax.

Every family has unique characteristics and dynamics, and again, any plan should reflect the collaborative counsel of advisors, including a wealth manager, attorney and accountant. A professional appraiser also should be included to value assets other than cash or publicly traded securities. And don't forget to file Form 709, United States Gift (and Generation-Skipping Transfer) Tax Return, to report any gifts that take advantage of the exemption amount.

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¹ See Rev. Rul. 2008-22, 2004-64 and 85-13.

² As of September 2021. Rev. Rul. 2021-16.

³ See International Glossary of Business Valuation Terms, as adopted in 2001 by the American Institute of Certified Public Accountants, American Society of Appraisers, Canadian Institute of Chartered Business Valuators, National Association of Certified Valuation Analysts, and The Institute of Business Appraisers.

⁴ For two recent examples, see *Nelson v. Commissioner*, T.C. Memo 2020-81 (June 2020), and *Estate of Moore v. Commissioner*, T.C. Memo. 2020-40 (April 2020).

⁵ See Rev. Rul. 85-13.

Planning With Purpose: Non-Charitable Purpose Trusts

By Alex Lyden-Horn

If we can't take a treasured possession with us, we might want to ensure that it's taken care of. That's true for all sorts of assets, whether a beloved family vacation home, an art collection, a pet, or even our own cryogenically frozen remains or other genetic material. (The verdict is still out on whether we can, in fact, take the last with us.)

A non-charitable purpose trust can serve as a steward of certain valued assets, protecting them for years to come or even in perpetuity. Once the sole province of offshore jurisdictions, the non-charitable purpose trust is now permitted in some form in almost every state.

Unlike other trusts, a non-charitable purpose trust is designed to carry out a specific purpose, rather than benefit certain named beneficiaries. As illustrated by the charts on pages 17 and 18, non-charitable purpose trusts have a wide range of potential applications.*

A non-charitable purpose trust is designed to carry out a specific purpose.

There have historically been two primary uses for non-charitable purpose trusts (which were sometimes referred to as "honorary" trusts). The first use is the care and maintenance of a burial plot. This structure could theoretically be applied to the maintenance of cryogenically frozen remains or other genetic material, but that is still up

for debate. The second is the care of pets or other animals after the death of the owner. Depending on the maximum term under state law, such trusts may be structured to continue in perpetuity for the benefit of both the named animals and their future offspring.

An increasingly popular and evolving use of non-charitable purpose trusts is to hold an asset that has particular meaning or importance to the settlor. The advantage of this structure over a traditional trust is that the focus will be on the best interests of the asset itself, rather than investment performance or the wishes of individual beneficiaries. These are often described as stewardship trusts, as the primary purpose is the preservation of the asset in accordance with the settlor's wishes and values.

All of these trusts can also be structured to distribute out to named beneficiaries, whether individuals or charities, or be held in further trust for their benefit, upon the completion of the purpose.

* Another broad category of uses for non-charitable purpose trusts is the furtherance of specific public policies or quasi-charitable purposes that would not otherwise meet the requirements for a traditional charitable trust, which offers a management vehicle for philanthropic gifting without the restrictions that accompany a purely charitable trust, but forgoes the usual charitable deductions associated with creating a charitable trust. A full discussion of this structure is beyond the scope of this article.

So, who ensures that the settlor's wishes are carried out when there are no beneficiaries? For trusts with a traditional charitable purpose, the State Attorney General in each jurisdiction is empowered to step in; that's not the case with non-charitable purpose trusts. Enter the "Enforcer," who, as the title suggests, is named in the trust agreement to enforce its terms and hold the trustee accountable.

The flexibility of a non-charitable purpose trust depends largely on the state where the trust is established, meaning that choice of situs is critical. States with more traditional laws may permit non-charitable purpose trusts only in very specific circumstances; for example, the care of animals or the maintenance of gravesites as discussed on page 18. Such states may also limit the maximum term to as little as 21 years. However, some states, including Delaware, permit trusts for any lawful purpose that is reasonable, attainable, and does not violate public policy, and these states have statutes expressly permitting such trusts to exist in perpetuity.

The longer the term of the trust, the more likely it is that there will be a material change in circumstances affecting the fulfillment of the purpose. Therefore, for a long-term or perpetual trust, it may be advisable to appoint a trust protector with broad powers to, for example, modify the purpose, add beneficiaries or terminate the trust. This strategy can be combined with directed trust statutes to further customize and allocate the powers under the trust, which is particularly beneficial if the trust holds unique assets that require specific skills to manage.

Given the specialized nature and near-limitless options for non-charitable purpose trusts, the choice of fiduciary



*The choice of fiduciary
is a critical consideration.*

Non-Charitable Purpose Trusts: A Snapshot

	The Trustee holds assets for:	The Trustee must answer to:
Traditional Trusts	Named beneficiaries	Named beneficiaries
Charitable Purpose Trusts	Unnamed charitable beneficiaries	State Attorney General
Non-Charitable Purpose Trusts	Non-human beneficiaries or stated non-charitable purpose	“Enforcer” named in trust agreement

is also a critical decision. In some instances, the best option may be to have a trusted individual serve as the decision maker with respect to the purpose, with a corporate trustee in place to handle the administrative functions (and also grant access to the preferred jurisdiction). On the other hand, the trust will likely need to hold sufficient investable assets (in addition to any “special” assets) to ensure that the purpose can be maintained for the expected term of the trust. Responsibility for such assets may be better allocated to a corporate fiduciary or professional investment manager. Fortunately, the states that permit long-term non-charitable purpose trusts also tend to have robust directed trust statutes that permit this level of customization.

As to tax, non-charitable purpose trusts are generally subject to the same tax systems as traditional trusts. However, it is important to note that, from a tax perspective, non-charitable purpose trusts have more in common with traditional irrevocable trusts than charitable trusts.

A non-charitable purpose trust is a unique estate planning structure that may not be appropriate for everyone.

For income tax purposes, like traditional trusts, non-charitable purpose trusts can be structured as grantor trusts (income is taxed to the grantor/settlor) or non-grantor trusts (income is taxed to the trust). The grantor trust structure is the most straightforward, at least while the settlor is living, as all income simply passes through the trust and is reported on the settlor’s income tax return.

Similarly, for gift tax purposes, despite the absence of identifiable recipients, contributions to a non-charitable purpose trust are considered gifts to the same extent as contributions to a traditional trust. Thus, like traditional trusts,

a non-charitable purpose trust can be structured as a completed gift or an incomplete gift. However, gifts to a non-charitable purpose trust typically will not qualify for the annual exclusion from gift tax, because there are no individual beneficiaries to possess withdrawal rights (often referred to as “Crummey Powers”). Also, unlike a charitable trust, the initial funding of the trust would not qualify for the charitable deduction.

Finally, while it may seem unlikely that a trust without beneficiaries would create any generation-skipping transfer (“GST”) tax concerns, it is important that a full GST review be performed. For example, there may be a need to allocate GST exemption to the trust if there is a possibility that the assets will pass to grandchildren or to more remote descendants once the purpose has been completed.

A non-charitable purpose trust is a unique estate planning structure that may not be appropriate for everyone. However, for those with a need to

Reasons to consider a non-charitable purpose trust:

What?	How?	Why?
The trust holds sufficient assets to maintain a burial plot in perpetuity.	Trust income and principal can be used for expenses and upkeep, including payments to a caretaker.	The trust structure gives greater security that funds will be used appropriately and available long into the future.
The trust takes possession of an animal (like a racehorse) or simply holds assets to be used for their care (like a household pet).	Trust income and principal can be used for care of the animal, including payments to a caretaker.	While assets could simply be gifted to the caretaker, the trust structure ensures that the assets are used for their intended purpose.
The trust holds an important piece of family real estate (like a shared vacation home).	The trust's purpose is to maintain the property as a family asset for as long as possible.	The family members, while permitted to use the property, are not able to pressure the trustee to sell.
The trust holds valuable cars, artwork or other collectibles.	A specialized trustee is appointed to preserve the assets and manage their use.	The trustee is immune from pressure to diversify assets or provide a return on investment.
The trust holds voting or controlling shares in a family business.	The trust's purpose is to ensure that the business is not sold or liquidated, either in perpetuity or for a set period.	This structure separates the long-term business decision making from the day-to-day economic considerations.
The trust holds intellectual property, like copyrights or name and likeness rights.	The trust's purpose is to preserve the settlor's legacy by only permitting uses that are in line with settlor's wishes (e.g., no use in advertising or posthumous publishing of new works).	Compliance with the settlor's wishes takes precedence over the potential financial returns.

care for animals or to preserve unique assets, or to further causes that do not fit into the traditional charitable trust mold, they present a powerful and flexible tool. While the focus of traditional estate planning tends to be on tax savings, asset growth, and efficient transfers of wealth, the non-charitable purpose trust is focused on ensuring that one's wishes are carried out, taking into account one's values and priorities, without diminution by economic or beneficiary concerns. In this regard, they should be considered a valuable complement to the more traditional estate planning structures.

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Wealth Planning in Markets Too Good to Last

By Jeff Maurer

This is not “That ‘70s Show”. I know that not because I’m familiar with the popular television show of that name, but because I started my career in 1970. It was a decade of poor economic growth and poor equity performance, accompanied by runaway inflation of as much as 13 percent. Interest rates also rose over the decade as the Federal Reserve attempted to fight inflation; by September 30, 1981, 40 years ago, the Treasury 10-year note yielded 15.82%, a record high.

*This is a crucial time to
review lifestyle, family,
business and other goals.*



10%

The annualized growth mean of the S&P 500 index.

The focus of wealth managers then was to keep investors from losing too much ground while remaining positioned to benefit from future growth. So the recent, and we believe temporary, run-up in inflation to around 5% certainly bears watching, but it doesn't keep me up at night.

This is not "That 2010s Show" either. That decade was marked by extraordinary returns in several asset classes, notably equities, which enabled

balanced investors to stay on track to meet their financial goals, despite historically low dividend and fixed income yields. The S&P 500 index rose 14.5% on an annualized basis from the beginning of that decade to this year to date. (From fashion to social mores to investing, most decades seem to end a year or two into the next. Our balanced account strategy compounded annually at 9.0% net of fees, outperforming its benchmark, which itself returned 7.7% over the same period.¹

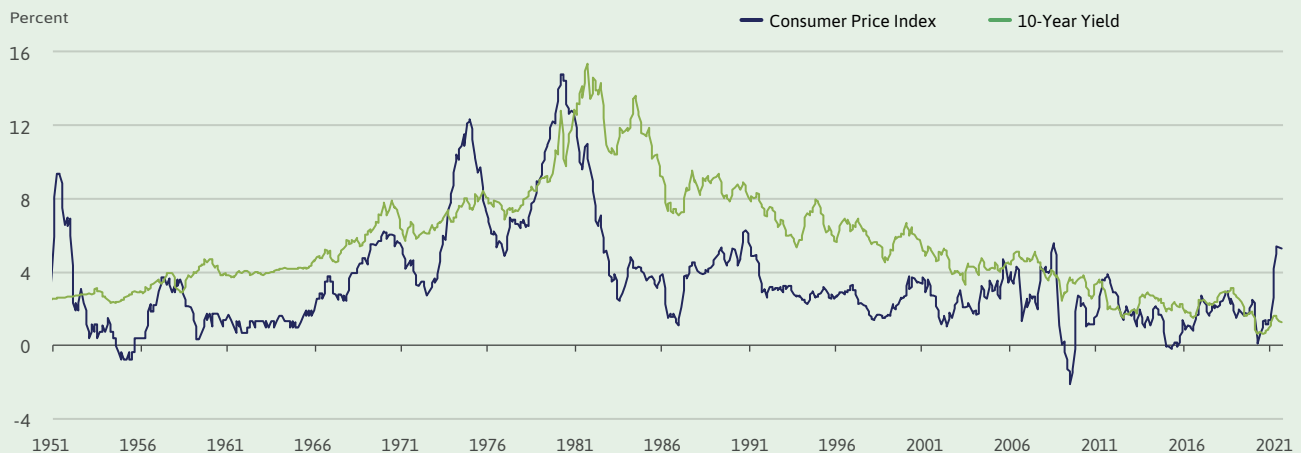
These returns have been just too easy to get used to. But at some point, the S&P 500 is likely to revert to its 10% annualized growth mean, illustrated by the chart below, and balanced accounts will move accordingly. In addition to rising inflation risk, income and capital gains taxes look set to rise. Domestic policies seem to swing in

long arcs based on election cycles; the pandemic and related global supply chain issues only add to the uncertainty now. While we certainly hope to continue generating strong investment returns, we are under no illusions that it's going to be easy.

From my vantage point, as Chairman, and as the Partner at our firm with the longest memory, this seems like a crucial time to review lifestyle, family, business and other goals in anticipation of a changing environment. That means revisiting lifestyle needs, circumstances and risk appetites. It's our job to help our clients manage through personal change, as well as change in the markets. A close review of each client's circumstances and perspectives will, along with our capital market assumptions, inform financial plans and direct investment recommendations.

Not that (late) 70's Show

Inflation and 10-Year Treasury yields are low



Source: Federal Reserve Economic Data – September 2021

We may be at the beginning of inflection point, so now is the time to make or review plans.

For some, a close review may result in putting off retirement for a few years or viewing philanthropy differently. Others may elect to increase their portfolio's return potential by investing in more illiquid assets, trading liquidity for potentially higher returns. Some will consider a change in domicile to a more tax-friendly state. Many should review estate plans in light of proposed estate and gift taxes, as Justin Miller observes on page 11. Investors who rely on their portfolios to fund all or part of

their lifestyles and have been trimming equity positions to cover spending requirements, as well as to rebalance portfolios and reduce risk, may need to reduce their spending.

We may be at the beginning of an inflection point, so now is the time to make or review wealth plans. There's no substitute for a conversation. Please make time to sit down, virtually or in person, with your Evercore team, to plan for this decade – and the years to come.

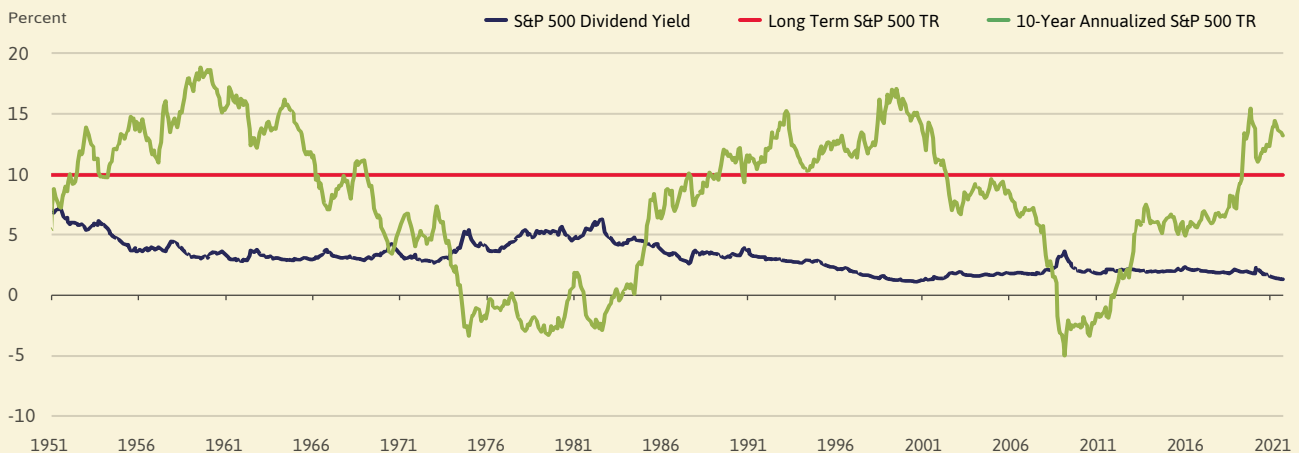
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¹ The EWM Blended Global Benchmark consists of 50% MSCI All Country World Index, 30% Bar Cap Municipal Short-Intermediate 1-10 Year Index, 10% BofA Merrill Lynch 3-month Treasury Bill Index, and 10 Wilshire Liquid Alternative Index. The current benchmark has been used for reporting since July 1, 2017. You cannot invest directly in the benchmark.



Equity total returns tend to revert to the mean

Dividend yields remain low



Source: Robert Shiller online data – September 2021

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