INDEPENDENT THINKING

THE NEW STANDARD IN WEALTH MANAGEMENT

EVERCORE

Spring 2017

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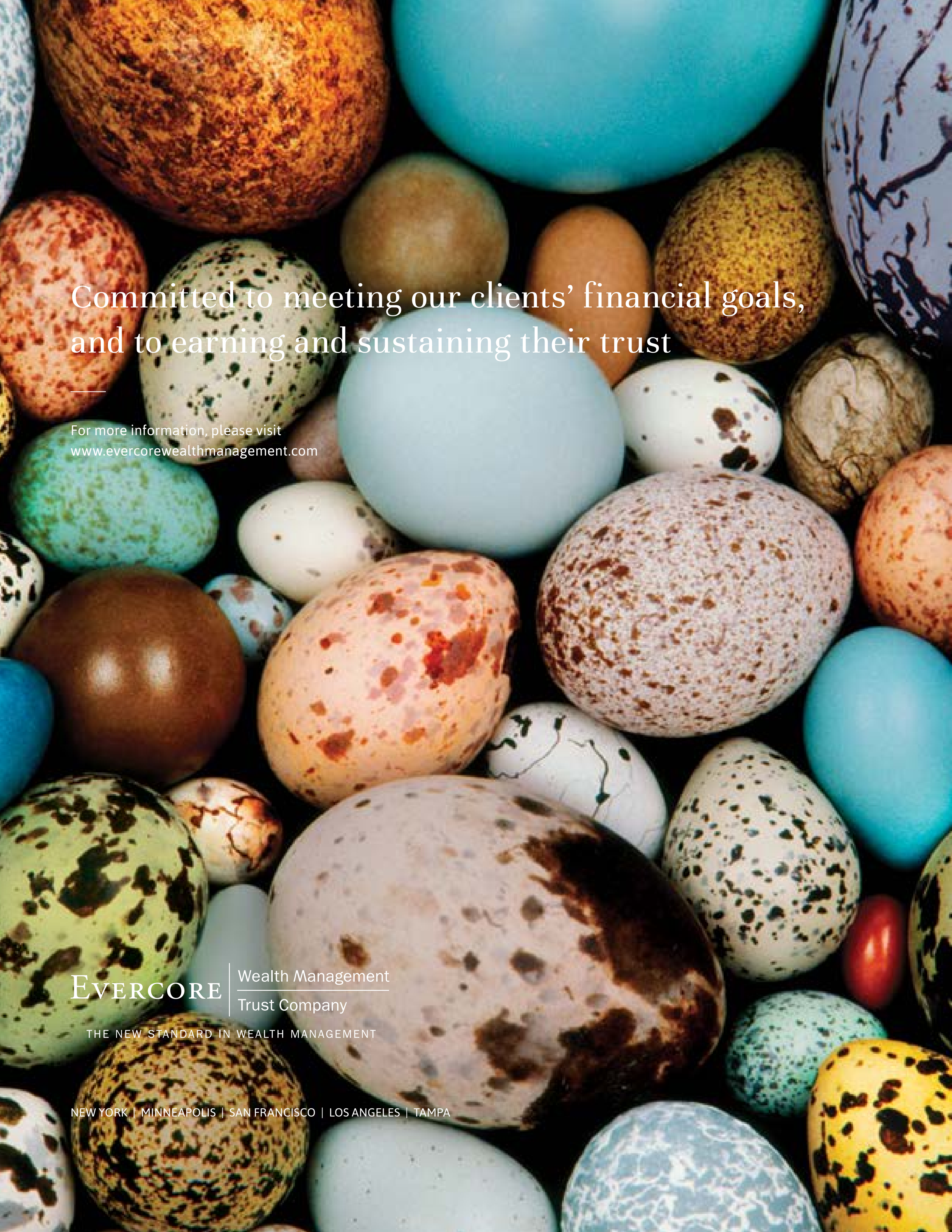
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A Message from the CEO

Every good photographer knows that conditions are always changing. The light, the movement, the angle – there are many considerations and no simple solutions. The “auto” setting on even the most advanced technological cameras rarely produces a memorable work.

Wealth managers confront some of the same challenges. How do we help our clients plan for their financial futures in an environment that is always changing? Technology has produced good passive strategies, algorithms to beat the markets, Roboadvisors, and the promise of other forms of artificial intelligence to supplement that of humans. These are great advances, and we have learned to use them to help us plan, as well as for constant information. But good wealth managers remain active too, in the markets and in communicating with clients.

As you’ll read in this issue of *Independent Thinking*, we invest actively for our clients in several of our asset classes, notably the domestic investment-grade bond market and the domestic equity market. We believe that we can add value to passively managed products and that we can do so in a manner that is both fee efficient and tax efficient for our clients. We also believe that by being active in these markets, we can better evaluate other active investors, including those in private equity and other alternative investments. Active investing informs our capital market assumptions and enables us to plan for our clients more effectively.

We also believe that direct and personal communication with our clients is the only way to stay abreast of their changing objectives and their tolerance for risk. Even the best plans created by artificial intelligence are not empathetically connected to the people involved. In my own conversations with our clients, I am struck by how many share my view: that we want to be able to count on the relationships we have developed with our advisors; we want them to be fully informed by technological advances, but driven by their active involvement with both the markets and our families.

A direct relationship with each client is a cornerstone of Evercore’s approach and, I believe, the aspect of our culture that most strongly sets us apart from other firms. John Weinberg shares that view and we are all delighted that he recently joined Evercore as Executive Chairman after 32 years – and a long family history – at Goldman Sachs. You’ll learn more about his plans here on page 5.

I hope you find this issue of *Independent Thinking* informative – and that you enjoy the photograph on page 14.

Jeff

Jeff Maurer
Chief Executive Officer

Better Together: Active & Passive Investing

By John Apruzzese

Crack open the most effective portfolios and you'll find both passive and active investments – and strategies that contain elements of both.

Passive equity investments, which track an index such as the S&P 500, have earned their place through low fees and, for the past eight years, strong performance relative to active managers with similar benchmarks. Like most good investment ideas, this shift – rightly described by Vanguard founder John Bogle as a tsunami – is in danger of being taken to extremes. At an annual growth rate of about one percentage point, capital flows into index funds are driving up the valuation of large cap stocks, which already have the highest weightings in the indices. Stocks with low representation in the indexes are being overlooked, creating a latent potential to eventually outperform, net of active management fees.

Investors need to consider the relative merits of both passive and active strategies for each asset class, along with the associated transparency, volatility, and risk characteristics, and after-fee returns, to ensure allocation to the optimal vehicle and the right measure of diversification. See page 4 for our current recommended allocations.

> *Stocks with low index representation are being overlooked*

Municipal bond and credit exposures are, in our view, best managed by hands-on investment managers. There are no universally accepted municipal bond indices, and those that exist are often not easily replicated. In a similar vein, the more interesting credit strategies, such as consumer lending and floating rate bank loans, do not have indices to replicate. For these reasons, we believe that the advantages of individually customized municipal bond and credit portfolios outweigh the (marginally) lower costs of passive strategies in these asset classes.

Equity opportunities are more complex, and we manage passive, active and blended portfolios in this asset class. Investors with single stock concentrations or significant exposure

to a particular sector through their other investments and business interests require an active approach to diversification, as do all investors looking for alpha, and we customize and manage our active core equity portfolio accordingly. We employ what we describe as enhanced passive strategies for both domestic equities and developed international markets. We use the term *enhanced* because, although the funds reference an index, they will adjust security weightings by basic fundamental factors other than simply market capitalization, such as dividends or value.

At the extreme end of active management are hedge funds, which have suffered as an asset class since the financial crisis. Too much capital – $3.2 trillion at the height in 2015 – was handed over to global hedge funds, and they have for the most part competed away their advantage. Attempts to outsmart the market using proprietary security selection or other investment calls, such as market timing or sector rotation, no longer justify their very high-fee, high-turnover structures.

We continue to evaluate intriguing hedge fund strategies but generally take an enhanced passive approach to the alternatives market by selecting funds that provide exposure to a basic investment strategy, such as risk arbitrage, but do not attempt to provide the equivalent of proprietary security selection and therefore can charge lower fees. For instance, the AQR Multi-Strategy Alternative Fund aims to replicate the nine basic hedge fund strategies without making proprietary judgments or charging excessive fees, or carrying costs. In other words, we are in effect taking a passive approach to most of our liquid alternative investments. This is an unconventional but, in our experience, very effective strategy for high net worth individual, foundation and endowment portfolios.

$3.2 Trillion

allocated to hedge funds globally at the peak

John Weinberg on Joining Evercore

I joined Evercore to build on this unique culture and to help the firm continue to grow in stature and respect. This is an extraordinary institution with real opportunities in investment banking advisory, research, and wealth management.

Editor's note: John Weinberg was recently named Executive Chairman and Chairman of the Board at Evercore. He previously worked for 32 years at Goldman Sachs, where he served most recently as Vice Chairman and Co-Head of the investment banking division – and as the third generation of his family in a leadership role at Goldman Sachs. In this interview with *Independent Thinking*, John considers the qualities and opportunities that drew him to Evercore and sets out his expectations for the firm.

One of our aspirations for Evercore is to be better known, for our capabilities and our commitment to our clients, and for our integrity.

We have an almost militant – perhaps unconditional would be a better word – commitment here to objectivity and to doing the right thing. Our people take intense pride in giving advice that is 100% focused on our clients' best interests. We aspire to listen well, understand trade-offs, and then deliver service that is the best in class in each of our businesses.

There is also a strong element of humility in the Evercore culture that is rare in this industry and is, to me, extremely attractive. Our people really listen to our clients; they take the time to know them and their businesses well, and to build lasting relationships.

Evercore has grown significantly in the past few years. I expect this growth to continue as we consistently hire professionals from outside and as we promote from within the firm. We have a deep and broad bench now in many of our sectors and geographies – and our people are among the very best in their businesses.

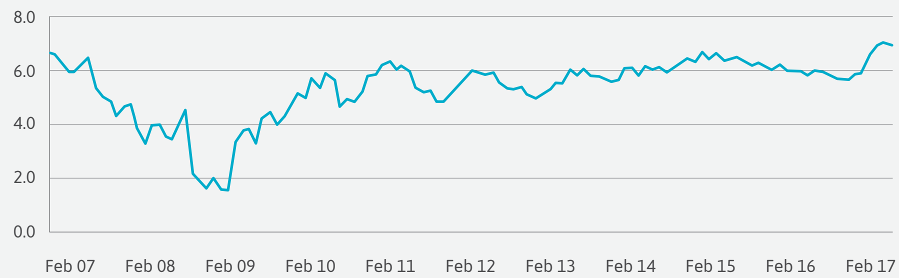
That's certainly true for our wealth management business, which has performed consistently well since its inception in 2008, providing our clients with unconflicted advice and efficiently managed portfolios that sustain them in living the lives they want to live. I expect Evercore Wealth Management to continue growing across the United States, never losing the independent spirit and the tight bonds that have set it apart from its competitors.

The direct relationship between senior advisors at Evercore and our clients across our businesses should stand us in good stead as we enter what I believe will be a much more volatile geopolitical landscape. All of us have to help our clients understand the potential impacts of that volatility and to manage accordingly, aligning their investments with their appetite for risk.

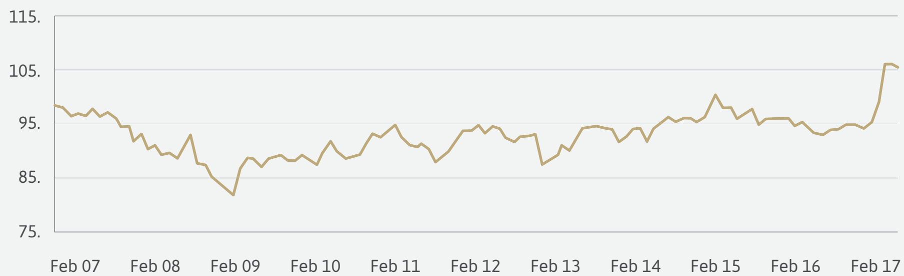
Our job is to understand and serve our clients, and to help them reach their objectives. It's as simple – and as complex – as it sounds, and I've been in this business long enough to know that it's rarely done as well as it is at Evercore.

After more than three decades at a rival firm, I am delighted to now be part of Evercore. Our goal is to be the most trusted and respected financial services firm in the world.

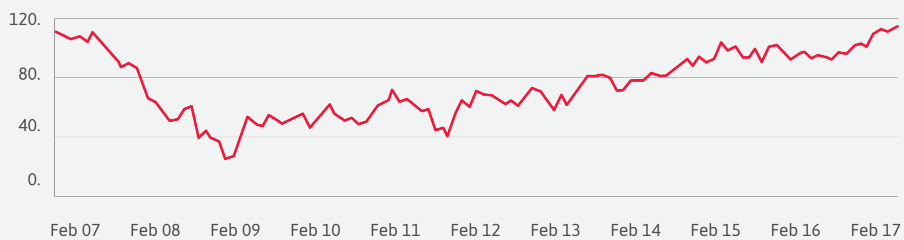
CEO Confidence Index



Small Business Optimism Index



Consumer Confidence



Source: Bloomberg. Data as of February 28, 2017.

U.S. Dollar

Source: Bloomberg. Data as of March 30, 2017.

So why hold bonds at all if expectations are for higher interest rates? In this example, each year that interest rates go higher, the hypothetical portfolio would throw off more income, as it can reinvest maturing securities in higher yielding bonds, providing more cushion as interest rates increase further. There is a chance that none of the policy prescriptions President Trump has proposed are implemented as expected, that they don't work as planned, or that President Trump focuses more on policies that are negative for growth, like trade protectionism, than the markets currently expect. There is also the risk that exogenous events, such as a further economic slowdown in China, eclipse the effects of good fiscal domestic policy. Finally, longer-term deflationary or disinflationary trends, including aging demographics, technological advancements, and unsustainable national debt levels, could happen faster than most investors expect, keeping the 35-year bull market in bonds charging for the foreseeable future.

In this era of radical uncertainty, the best portfolio defense is true diversification. A portfolio of well-researched, investment-grade municipal and corporate bonds continues to make sense as an important part of a balanced portfolio.

Brian Pollak is a Partner and Portfolio Manager at Evercore Wealth Management. He can be contacted at brian.pollak@evercore.com.
Howard Cure is the Director of Municipal Bond Research at Evercore Wealth Management. He can be contacted at cure@evercore.com.

Marital Agreements

By Kirsten Weisser

First marriages are occurring later in life; second (or subsequent) marriages are more common; and both partners are likely to be earning their own wealth. Not surprisingly, there seems to be an increasing recognition that good planning makes good sense.

Sure, a prenuptial agreement is as unromantic as it sounds. It determines the disposition of property in a marriage, as both partners disclose all the assets that they are bringing to the marriage and agree on how the property will be divided in the event of divorce or death. It doesn't rule out happily-ever-after, however – it just makes things easier, especially when one spouse brings considerably more assets to a marriage or other factors need to be considered, such as existing trusts, future inheritances and, of course, blended families.

For young couples with relatively simple financial lives, the consideration of a prenuptial agreement may not be necessary. If assets – whether received or earned – have been properly segregated and titled, that may be enough to protect the status of property. That's why many families establish trusts for their children; to prevent their assets from becoming subject to a prenuptial, as well as to provide for general creditor protection. Individuals can also establish a self-settled trust to maintain clear records for separate property assets and income. Early financial literacy can help young people make wise decisions in planning for their own financial futures.

(See page 20 for upcoming educational events at Evercore Wealth Management.)

For second (or subsequent) marriages and for blended families, the issues become more complex. New marital agreements and estate planning documents should be coordinated and reconciled with prior agreements, including any previous divorce settlements and existing family trusts, to ensure that the property will flow in the manner that the family intends, and to minimize the risk of future litigation.

Many questions have to be asked and answered. Should a new spouse be appointed as agent, power of attorney or fiduciary in estate planning documents? Should he or she be appointed as a future trustee, executor or conservator? Would this give the new spouse the authority to make decisions that impact pre-existing family trusts? And does the proposed division of wealth make sense in the first place? In the case of second and subsequent marriages, the spouse with the greater assets often chooses in the planning stage to leave the marital home to his or her new spouse, usually including the tangible personal property. This seemingly thoughtful and appropriate plan can backfire in a big way if, for example, subsequent decorations (which would be considered tangible personal property) include the couple's $5 million art collection. Careful planning with periodic reviews is essential.

These are sensitive subjects for couples – and their families – to address at a time when celebrations seem more in order. But the emotional aspects of wealth can strengthen or divide an expanding family. Expectations of preserving or spending wealth, different definitions of fairness, and perceptions of competition or favoritism are common challenges in even the happiest of families.

Consulting with a lawyer who specializes in marital agreements is a good starting point for all couples (and each partner), regardless of their ages or assets, to secure a full understanding of the relevant property laws, including separate property, joint property, and the features of income earned and property accumulated while married. California and a few other states recognize community property as well as quasi-community property.

Honest discussions, expert advice, and ongoing education can set appropriate expectations and minimize conflict during times of family transition – and enable everyone involved to enjoy the big day.

Kirsten Weisser is a Managing Director, Wealth & Fiduciary Advisor at Evercore Wealth Management. She can be contacted at kirsten.weisser@evercore.com.

Q&A
with Third Avenue Real Estate Value Fund

Ryan Dobratz

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. Marty Whitman, a pioneer in value investing, founded Third Avenue in 1986; the firm launched the Third Avenue Real Estate Value Fund in 1998 to achieve long-term capital appreciation by investing in both real estate and real estate-related securities worldwide. Here we interview Co-lead Portfolio Manager Ryan Dobratz. Please note that this interview represents the views of Ryan Dobratz and not necessarily the views of Evercore Wealth Management.

Q: Third Avenue is best known as a value investor. How does that approach apply to your real estate funds?

A: Third Avenue has always emphasized creditworthiness and investments in the common stocks of well-capitalized companies. For real estate businesses, this means that they must have high-quality assets such as class-A office and retail portfolios, valuable and productive tracts of timberlands, or well-located land holdings with development potential. In addition, these businesses must be conservatively financed with modest levels of debt, as well as off-balance sheet liabilities such as contractual obligations.

We will invest in securities only when the shares can be purchased at a substantial discount to the company's net asset value, or NAV. Our goal is to find companies where the NAV can increase by 10% or more per year.

Rarely does one find both good news and attractive prices. As a result, the Third Avenue Real Estate Value Fund typically buys companies, property types, and geographies that are out of favor, and holds on until conditions improve, which on average takes about five years. Since inception, the Third Avenue Real Estate Value Fund has earned an annualized return of about 11%, placing it among the top global real estate funds.

Q: Why should investors consider real estate now, in a rising interest rate environment?

A: If interest rates are going up for the right reasons, such as a rebound in economic activity and accelerated job growth, that's actually quite positive for real estate. But dividend-seeking investors have pushed up many real estate securities, including real estate investment trusts, or REITs, to valuations that might not prove to be sustainable in a higher rate world. As long-term value investors, we have positioned the Third Avenue Real Estate Value Fund as an alternative that would not only seek to protect capital in a rising rate environment but to potentially benefit from it.

To accomplish this, we started reducing the fund's exposure to yield-oriented real estate securities. Instead, we focused the fund's capital in companies with securities trading at discounts to more durable property values and in property types with shorter-term leases, such as retail, industrial, and multi-family properties (as opposed to property types such as healthcare and net-lease, where cash flows are largely locked in for terms of 20 years or more).

The fund also increased its exposure to real estate-related businesses with strong ties to the U.S. residential markets (in particular, the construction of single-family homes), as well as commercial real estate companies with well-located development projects that could potentially capitalize on demand recovery and earn outsized returns. In addition, the fund initiated modest investments in U.S. banks and other real estate-related businesses with depressed earnings that would likely prosper in a higher-rate environment.

Since 2013, there have been three periods where the yield on the 10-year U.S. Treasury has increased by more than 0.50% over two or more months. During those periods, the fund has provided an average return of +1.4%, while the fund's most relevant benchmark, the FTSE/EPRA NAREIT Developed Index, has generated an average loss of -8.0%. Using these three periods as a guide, we believe the fund is well-positioned if interest rates continue to increase further.

Q: What role do REITs play in the fund?

A: One of the key advantages of the Third Avenue Real Estate Value Fund is that it has a flexible mandate that allows it to not only invest in REITs but also in real estate operating companies, or REOCs, and real estate-related businesses such as home builders, timber companies, land development companies, and regional banks. We believe that our real estate universe is nearly three times larger than that of funds that closely follow the relevant benchmarks.

As a real estate strategy that seeks to maximize total returns while emphasizing capital appreciation, the fund has always been biased to investing more capital in REOCs than REITs for two primary reasons. One, unlike a REIT that is required to distribute 90% of its net income as dividends each year, a REOC is free to retain the cash flow generated in the business and reinvest in developments, redevelopments or opportunistic acquisitions. This approach tends to result in more attractive rates of growth over time and more tax-efficient capital appreciation. Two, having the ability to self-finance this expansion is a much more reliable business model in our view, as REITs are more dependent upon the somewhat fickle capital markets to finance their expansionary efforts. For these reasons, about two-thirds of the fund's capital is now in REOCs and real estate-related businesses, including some of the top holdings like Cheung Kong Property in Hong Kong and Lennar Corp in the United States.

We are not opposed to investing in REITs, however, provided they are well-capitalized. At the present time, we just aren't finding a ton of value in the more widely held U.S. REITs. However, there is one glaring opportunity in U.S. REITs today: timber. The fund currently has roughly 11% of its capital in these types of timber companies, most notably Weyerhaeuser and Rayonier. In our view, both of these businesses are incredibly well-capitalized and trade at large discounts to the private market value of their timberland holdings, but are poised to benefit as residential construction activity in the United States continues to approach more normalized levels (1.5 million homes built annually vs. 1.1 million currently). In such a scenario, both businesses have the potential to generate meaningfully higher cash flows and dividends by selling more logs at higher prices and closing the large discounts at which the shares currently trade relative to their NAVs.

Q: Geographic diversification seems to be a byproduct of the fund. Where are you finding the best opportunities now?

A: We have approximately half of the fund's capital allocated overseas. These investments are primarily concentrated in the securities of well-capitalized property companies that own irreplaceable portfolios of assets in outstanding markets but are currently out of favor due to near-term headwinds, such as London and Hong Kong.

In the United Kingdom, property companies are dealing with the uncertainty of the Brexit impact on occupier markets, particularly financial services. We have taken advantage of the resulting dislocations in the public markets by boosting the fund's exposure to Land Securities, Hammerson, Segro and similar companies that own office, malls, and industrial properties in and around London, which we view as one of the most attractive markets for long-term investors globally.

In Hong Kong, real estate businesses continue to trade at steep discounts to the private market, largely due to the lack of a takeover market and what investors believe are outdated corporate structures and capital allocation policies. We have established meaningful positions in blue-chip property companies such as Cheung Kong Property, Henderson Land, and Wheelock & Co. that control hard-to-replicate portfolios in Hong Kong (one of the most supply-constrained markets globally) at prices that are at 30%-60% discounts to conservative estimates of NAV.

Q: Third Avenue had a difficult time in the credit market. Please tell us what happened from your point of view and what impact it has had on the other funds.

A: In December 2015, Third Avenue made the decision to seek exemptive relief from the SEC and suspend redemptions in its credit fund to protect shareholders. Since then, the credit fund has made four liquidating distributions that account for approximately 40% of the total assets, and the adjusted NAV is above the NAV at the time the move was made. The Real Estate Value Fund did initially experience redemptions, but these materially tapered off in the following months. While significant redemptions can have serious implications for portfolios comprised of less-liquid securities, this was not the case for the fund. Fund management satisfied all redemptions from the fund's existing cash resources and by selectively reducing holdings, largely on a pro-rata basis, to keep the portfolio positions and weightings intact. The portfolio managers in the Third Avenue Real Estate Value Fund have a significant portion of their personal wealth invested alongside shareholders and have increased their investment in the fund since the announcement.

For more information about the Third Avenue Real Estate Value Fund and about other funds on the Evercore Wealth Management investment platform, please contact **Stephanie Hackett** at stephanie.hackett@evercore.com.

The Value of Integrated Wealth Management

By Chris Zander

It's tempting to try to deconstruct wealth management. Why not try to manage it all yourself? That's how many people tend to think about planning and investing, until that approach unravels.

A basic wealth plan seems serviceable, until family circumstances, concentrated holdings, and the real impact of taxes are considered – and found unaccounted for. And even the best stand-alone plan doesn't accomplish much sitting in a drawer, collecting dust, while the family it was meant to serve and the world at large moves on. Changing tax laws and constantly changing market conditions – along with changing family circumstances – require a hands-on approach and more regular interaction.

Active wealth management integrates financial planning and portfolio management, to meet specific investor and family goals. It's not easy: Every individual and every family (happy or not) is unique. Large single stock positions, a business to sell, an interest in philanthropy or socially responsible investing, a blended family, a child with special needs – there are at least as many considerations for wealth managers to factor in the planning as there are family members involved. It's important to employ advisors who can look across the disciplines of wealth management to not only advise on prudent actions, but to also implement the plans in an effective manner. As appropriate, the advisor should also be able to spot extenuating or extraordinary issues and identify the right external advisors and specialists to resolve them.

Consider a California couple in their early 60s embarking on the sale of their insurance brokerage business. They are so focused on the sale itself that they can overlook their own finances, except to wonder, albeit late in the game, how they should invest the proceeds of the sale. However, the correct way to approach strategic planning in this scenario is – and should be – far more complex.

- Have we first analyzed whether the proceeds from the sale of the company are sufficient, on an after-tax basis, to meet our ongoing retirement lifestyle goals?

- Have we determined the level of risk our portfolio needs to assume to meet those goals? For example, is it possible a very conservative portfolio should be structured because it meets our goals under most outcomes and we don't want to take on unnecessary risk beyond those objectives?

- Are there specific wealth transfer strategies that we should consider in advance of the sale to minimize the estate and gift tax consequences of the transaction and enhance our goal of transferring assets to the next generation?

- Have we considered utilizing a trust to receive the assets in an effective wealth transfer plan? Do we have the appropriate terms in those trusts that are aligned with the specific needs of the beneficiaries and our family values, and are flexible with regard to changing tax laws and circumstances?

- Have we selected the appropriate trustees, whether individual or corporate, to assist our family as long-term fiduciaries in the governance process?

- What are our options with respect to benefiting our philanthropic causes, and how do we evaluate the tax,

cash flow, investment and estate planning implications of a gift to a charitable foundation or long-term charitable trust?

Working with a professional advisor who can coordinate many aspects of the overall wealth management plan enables this couple and others to be involved in the key decision-making related to their financial affairs but also to rely on the expertise and service of an experienced team. The team can bring together all the elements of a strategic plan and engage as appropriate with other generations of the family, key specialists and the family's other advisors – all with sensitivity to the long-term financial goals and circumstances of each member of the family. Done right, this approach saves time and money.

It doesn't surprise us that many of our own clients are financial professionals, working and retired. They know the work involved; they value an objective assessment of their goals and the associated opportunities and risks; and they want that assessment to inform the management of their assets. They also prize the human relationships – and the sense that they and their families have a team that they can count on, in all market conditions.

Integrated wealth management starts with strategic planning that shapes – and continues to inform – asset allocation, portfolio management, financial and legacy planning, and customized trust and fiduciary services. It considers the impact of taxes, costs and complexity at every juncture, from plans that enable families to know what to expect, not just in broad strokes but also in practice, providing financial education as needed throughout the process. An integrated team that knows each investor's lifestyle, family, business, estate planning and tax circumstances should produce better results – through all market cycles – than those who work in silos.

Integrated, multi-disciplinary advice reflects the way most clients should be served and the way that practice should be evaluated: as a whole. The sum of wealth management, as it should be practiced, provides far more value than that of its parts.

Chris Zander is the Chief Wealth & Fiduciary Advisor at Evercore Wealth Management and the President of Evercore Trust Company of Delaware. He can be contacted at zander@evercore.com.

Readiness & Recovery

By Jeff Maurer

Resilience, or the grace and power to recover, is by many accounts the single most important quality in aging prosperously and well. As we get older, we start to see the core of resilience is what resilience gerontologists – these are the people that study resiliency in the elderly – and one of our recent speakers, futurist Andrew Zolli (see page 20), called narrative openness.

That means understanding that our story is not over; that we are still the protagonists of our own novel and that there still may be twists and turns in the plot. In short, it's a heck of a lot easier to land on our feet if we are prepared for a fall.

Investors able to bounce back from the Great Recession had generally maintained a balanced asset allocation that allowed them to maintain their lifestyle as they waited for the market to recover. Some fell harder, including those who had invested with Bernie Madoff. The appeal was all too obvious – who wouldn't want to see their money compound at 10% a year? – and many of his investors had allocated 50% or more of their assets to his investment program. Their lives were forever changed. So too were many of those who bet the farm on Internet stocks in the late 1990s or in collateralized mortgage obligations in the run up to the collapse of Lehman Brothers in 2008.

Time will tell how some of today's high-wire strategies pan out, including stretching for yield by extending credit qualities or maturities, and buying high dividend-paying stocks regardless of their fundamentals. We also have to wonder how much risk there is in purely passive portfolios, in the wake of massive asset flows to indexed funds that have inflated the biggest stocks. (See the article by our Chief Investment Officer John Apruzzese on page 2 of this issue.)

Not everyone shares this perspective. A client left us recently to move his assets to a 100% passive equity strategy: making a leap of faith in the continuing growth of the fastest rising major sector of the market since the Great Recession, without any corresponding diversification into other asset classes. He was attracted to the low fees and turned off by the prospects for bonds. (See the article by Brian Pollak and Howard Cure on page 6 that outlines our view of the bond market and makes the case for maintaining an allocation to the asset class.)

While a 100% allocation to passive equity might be a reasonable solution for some endowments, or for an institution with a perpetual investment time horizon, or, for that matter, Messrs. Buffett and Gates, we fear that it is not the right solution for most high net worth individuals and their families. Most of us will need to withdraw funds from our accounts to maintain our lifestyle at some juncture in the market cycles.

An index-only growth strategy presupposes that public equities have the highest return potential of all the asset classes. However, after a 7.5% annualized return for the S&P 500 over the past ten years, we believe that well-chosen private equity investments will produce returns that are between 30% and 50% higher than the S&P index going forward, more than compensating this and other qualified investors for the lack of liquidity in this one asset class.

7.5%

annualized return for the S&P 500 for the past ten years

We construct resilient portfolios intended to limit drawdowns and to produce reasonable risk-adjusted returns, in all market conditions. Each of us has only one life, and we had better be prepared to live it well, regardless of the market's next move.

Jeff Maurer is the CEO of Evercore Wealth Management and the Chairman of Evercore Trust Company, N.A. He can be contacted at maurer@evercore.com.

Charitable Giving & Tax Reform

By Keith McWilliams and Carly McKeeman

For charitably minded families, this may be the year to step up in a meaningful way to support nonprofits. While no one knows what tax reform will look like or, if it comes to pass, whether it will be retroactive or delayed to 2018, it's important to note that the current plans could significantly impact both donors and their causes. In addition, highly appreciated stock values make this an opportune time to maintain or accelerate giving.

Editor's note: This is the first in an occasional series on private philanthropy and its tools – the family foundation, donor-advised funds and charitable trusts, among other techniques. For further information on philanthropy, trusts and family wealth services at Evercore Wealth Management, Evercore Trust Company, N.A. and Evercore Trust Company of Delaware, please contact your advisor.

At the extreme end of the plans now on the table, the top individual income tax rate for married couples filing jointly will be reduced to 33% from 39.6%, and all itemized deductions, including those for charitable gifts, will be capped at $200,000 today. For those with mortgage interest, high state income taxes and property taxes, this could severely limit or even eliminate the ability to deduct charitable gifts. The chart below illustrates both the current Trump and Republican Party proposals.

These changes lead to uncertainty for nonprofits of all kinds that rely on charitable donations. In addition, some charities are facing political as well as fiscal pressure. While the challenges facing well-known organizations such as the National Endowment of the Arts and the American Civil Liberties Union get a lot of press – and have reported record donations since the election – the interdependencies of nonprofit funding and government policy are complex. For example, the American Lung Association receives grant funding through the Environmental Protection Agency.

All donors eager to bolster their favorite cause should first consider contributions of qualified appreciated stock. The current fair market value of shares held for more than one year before contribution can be deducted, subject to adjusted gross income, or AGI, limitations, in addition to avoiding the capital gains tax otherwise due on the appreciation in the event of a sale. That's a significant consideration after 10 years of an average 7.5% annual gain in the S&P 500.

33%

Top proposed tax rates for couples

Additionally, for IRA account holders age 70½ and older, donating a portion or all of the required minimum distributions (up to $100,000) directly from an IRA to charity remains an attractive option for avoiding income tax on the distribution (which is generally at ordinary federal and state income tax rates), especially if the charitable deduction is cut. There is no charitable income tax deduction in this scenario. If the charitable deduction is not limited, evaluating the double benefit with gifting low-basis stock and avoiding taxes on the gain and achieving an income tax deduction – versus solely avoiding income taxes with an IRA charitable contribution –

Plotting & Planning

Topic	Current Law	Trump Tax Plan	Republican Party Plan
Individual Income Tax Rates	Married filing jointly (For 2017): 10% (Taxable income not over $18,650) 15% (Over $18,650 but not over $75,900) 25% (Over $75,900 but not over $153,100) 28% (Over $153,100 but not over $233,350) 33% (Over $233,350 but not over $416,700) 35% (Over $416,700 but not over $470,700) 39.6% (Over $470,700)	Married Filing Jointly: 12% (Not over $75,000) 25% (Over $75,000 but not over $225,000) 33% (Over $225,000)	Married filing jointly: 0% 12% 25% 33%
Standard Deduction	2017: Married filing jointly: $12,700	Married filing jointly: $30,000	Married filing jointly: $24,000
Itemized Deductions, Including Charitable	Charitable contributions allowed with specific income percentage limitations.	Cap at $100,000 for single taxpayers; $200,000 for married filing jointly.	Eliminates all itemized deductions except mortgage interest deduction and the charitable contribution deduction.

Source: Bloomberg/BNA

Pros and considerations: A brief look at some popular charitable giving vehicles

Vehicle	Description	Benefits	Additional Considerations
Charitable Lead Trust (CLT)	• Pays out annually to a qualified charity with the remaining assets going to beneficiaries at the end of the trust term • Charity will either receive a variable annuity that is a percentage of the trust's value each year (unitrust) or a fixed amount based on the funding value of the trust (annuity) • May be created during the grantor's lifetime or upon death	Tax-efficient way to provide for charity and family: • Gift to beneficiaries is discounted by the income interest passing to charity, so less gift tax exemption is utilized • Any appreciation of trust assets is removed from the donor's estate • After the trust term ends, property remaining in the trust including appreciation, passes to remaindermen at no additional gift tax cost • Tremendous flexibility in choosing trust term, charitable payout percentage and beneficiaries • Annuity version can be structured so that the gift tax value of the asset transferred is zero (or close to zero) • If the unitrust version is chosen, grantor can allocate generation-skipping tax exemption at the trust's inception to name grandchildren as remainder beneficiaries	• Administration should be handled with care to ensure execution of trust terms and prudent investment management of trust assets • The family will not benefit from the trust during its charitable term. • Must outperform the payout to charity or nothing will remain in trust for heirs • Carryover basis for trust beneficiaries • Donor may choose to structure as a grantor trust and to claim a charitable deduction, but the trade-off is that donor must also be taxed on the trust income throughout the term of the trust. • For a grantor trust, the deduction may be subject to recapture if the donor does not survive the term or relinquishes the grantor power during life
Charitable Remainder Trust (CRT)	• Pays out annually to a non-charitable beneficiary with remaining assets going to a qualified charity at the end of the trust term • Income beneficiary will either receive a fixed amount based on the funding value of the trust (annuity) or a variable payment that is a percentage of the trust's value each year (unitrust) • Income payment may be made for the life of beneficiaries, for a term of years (not to exceed 20 years), or a combination • May be created during lifetime or upon death	• Donor may retain an income stream or give that income stream to beneficiaries • If income beneficiary is anyone other than the donor or spouse, the amount of a gift is discounted by the remainder interest passing to charity, so less gift tax exemption is utilized • Donor may retain a right to change the charitable beneficiary during the term of the trust • Trust is a tax-free entity, so sales proceeds are undiminished by taxes and reinvested by the trustee for growth and income • Tax liability is passed to the income beneficiary on a tiered tax system; a donor can potentially use the charitable tax deduction to offset taxable income • If the unitrust version is chosen, additional assets may be added to the trust	• Trust must meet certain requirements and administration should be handled with care • Present value of the remainder interest must be at least 10% of the net fair market value on the funding date • If the unitrust payout version is chosen, the trust assets need to be revalued once every year to determine the income payout • If the donor dies prior to the ending of the trust term and the successor income beneficiary is not the spouse, the present value of the remaining income stream is includible in the donor's gross estate
Donor-Advised Fund	• A charitable investment vehicle administered by an outside sponsoring organization, whose sole purpose is to distribute funds to other charities • Sponsoring organization maintains separate accounts for each donor's contributions • Donor advises the sponsoring organization on which causes to support • Can usually hold many types of assets	• Ability to "front-load" charitable giving and obtain immediate income tax deduction (up to 50% of adjusted gross income for cash, 30% of adjusted gross income for securities) • Avoid capital gains on donation of appreciated property • Easy to establish with minimal costs — considered a simpler, less expensive alternative to a private foundation, and appropriate for smaller donation amounts • Donor maintains some control over investment and makes recommendations to the sponsoring organization on grants • Separates the tax decision from the ultimate charitable gift decision • Simplifies tax reporting and gift administration	• Transfers are irrevocable • While rare, a sponsoring organization could conceivably alter the donor's intent by redirecting the payment • The sponsoring organization sets the terms, including type of assets they will receive and the minimum funding amount • An outright gift may suit the donor's needs better • A donor's IRA required minimum distribution cannot be used to fund a donor-advised fund • Donor-advised funds have investment management and administrative fees
Family Foundation	• An independent, legal, charitable entity that can be established during life or upon death • A foundation can exist in perpetuity, and is a long-term way to engage family members with a shared charitable vision • The focus of the foundation can be broad and encompass grants that support various charitable endeavors or be limited to a specific area of interest	• Ability to obtain immediate income tax deduction (up to 30% of adjusted gross income for cash, 20% of adjusted gross income for securities) • Avoid capital gains tax on donation of appreciated property • The donor retains complete control, in both grantmaking and investment strategy • Diverse types of assets can be contributed to the foundation (with some limitations) • Wide range of investment options, creating investment flexibility • Wide range of spending options, including grants to outside organizations, qualified administrative expenses, and sometimes individuals • Separates the tax decision from the ultimate charitable gift decision	• Required to distribute at least 5% of assets based on the previous year • Ongoing administration requirements are more extensive than other vehicles: The foundation must have a board of directors who document and approve of significant actions, and the foundation is required to file a Form 990-PF with the IRS annually • As a result of required annual reporting with the IRS, gifts from a foundation are considered public record • Net investment income is subject to ongoing federal excise tax of either 1% or 2% • Prohibits self-dealing between private foundations and their substantial contributors and other disqualified persons

Source: Evercore

merits analysis based on the specific circumstances.

For donors focused on making a long-term, sustainable impact and on engaging younger generations in the family's philanthropy, it may make good sense to make a large gift this year through a planned giving vehicle. Again, it's important to stress that we don't yet know if and when tax reform will materialize and whether it will be retroactive. These strategies should be considered in light of each family's full circumstances, including available deductions.

$200,000

cap on all itemized deductions for married joint filers

For families with considerably appreciated stock holdings that are looking for a tax-efficient way to diversify, create an income stream for life (or a term of years), and leave a charitable bequest at the end of the period, a charitable remainder unitrust is a potentially effective solution. The donor would obtain an upfront charitable deduction based on the present value of the projected remainder interest to charity. However, at today's low rates, that present value is smaller than if rates trended higher.

Families who would like to provide for their next generation over the longer term, but also benefit charitable organizations in the interim, may choose a charitable lead annuity trust (CLAT). This type of trust provides for fixed payments to a charity over a term of years, with the remainder passing to family members. In today's low interest rate environment, the relative value of the charitable deduction with a CLAT is high. Depending on the outcome of tax reform, these can be structured either with an upfront charitable income tax deduction for the grantor (a grantor CLAT), or an annual charitable deduction within the trust (a non-grantor CLAT).

The strategy that could be impacted significantly by limitations on charitable deductions is the large one-time gift (or series of gifts) to a donor-advised fund, or DAF, or a private family foundation. Typically, this option enables donors to give appreciated stock to the DAF or foundation, diversify immediately, and take advantage of a full charitable income tax deduction in years of relatively higher income, say the year of retirement or the sale of a business (subject to AGI limitations). Furthermore, it allows time for the donor to develop a multi-year giving plan from the DAF or foundation to the charities they (and their families) wish to benefit.

However, a limitation on the charitable deduction (or even just a lack of clarity) should prompt a rethink. Donors can deduct charitable contributions in the year of the gift and for five years thereafter if there is a carryover. Once the eventual tax reform plan is known, individuals should work with their advisors on a multi-year income tax projection to determine whether the deductions related to their charitable giving can be reasonably absorbed during the allowable time frame. (See the chart on page 18 for a brief synopsis on the pros and cons of each approach.) Combinations of these strategies may also make sense.

It is important to think ahead, because the planning and implementation of these entities requires time and work, with wealth advisors and the family's attorney and tax advisor. With changes anticipated in both income tax rates and the charitable deduction, now is a good time to be thinking about charitable giving, and how best to maximize a family's tax benefits and the charitable impact of a gift.

*It **may** make sense to make a large gift this year*

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Andrew Zolli on Resilience

The management of complexity has become an essential feature of our times. When everything is connected, and things bond together in ways that feel complicated and even subliminal, we see a challenge emerging to our collective resilience. How do we help ourselves, our families, and our organizations flourish amid this disruption?

Editor's note: Andrew Zolli is a futurist, an advisor to Facebook and other companies on the intersection of technology, society, and artificial intelligence, and the author of *Resilience: Why Things Bounce Back*. This is a brief extract from his presentation to Evercore clients in New York on March 8, 2017.

Many of us are profiting from technology and, at the same time, finding ourselves challenged by the resulting political volatility and social upheaval. We are experiencing a very high number of stress symptoms. Now, some stress trains us for life; some adversity is good. But when we've had enough stress, it would be nice to be able to say, well, thanks very much. Because too much stress diminishes our capacities. Consider this: It takes a full 67 seconds to cognitively recover from every email you receive. We are even exposed to a lot of stress that is happening around us, not just *to* us. It still activates the same circuits in our brains.

Obvious defenses are genetic, such as a healthy body and brain. Another is a strong social network and a spirituality. And one of the greatest is a sense of narrative openness, that we are still resilient, still living our story.

As the length and breadth of a human life has expanded dramatically, we have invented an entirely new act in the human experience. We have started to see the core of this resilience in our third act, in our 60s, 70s, 80s and 90s.

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- The Mind, Body & Brain Connection and the Impact on Longevity
  Moderator: Laura Landro; Panelists: Dr. Holly Andersen and Dr. Ana Krieger
- Emotional, Physical and Financial Cost of Alzheimer's
  Speaker: George Vradenburg

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

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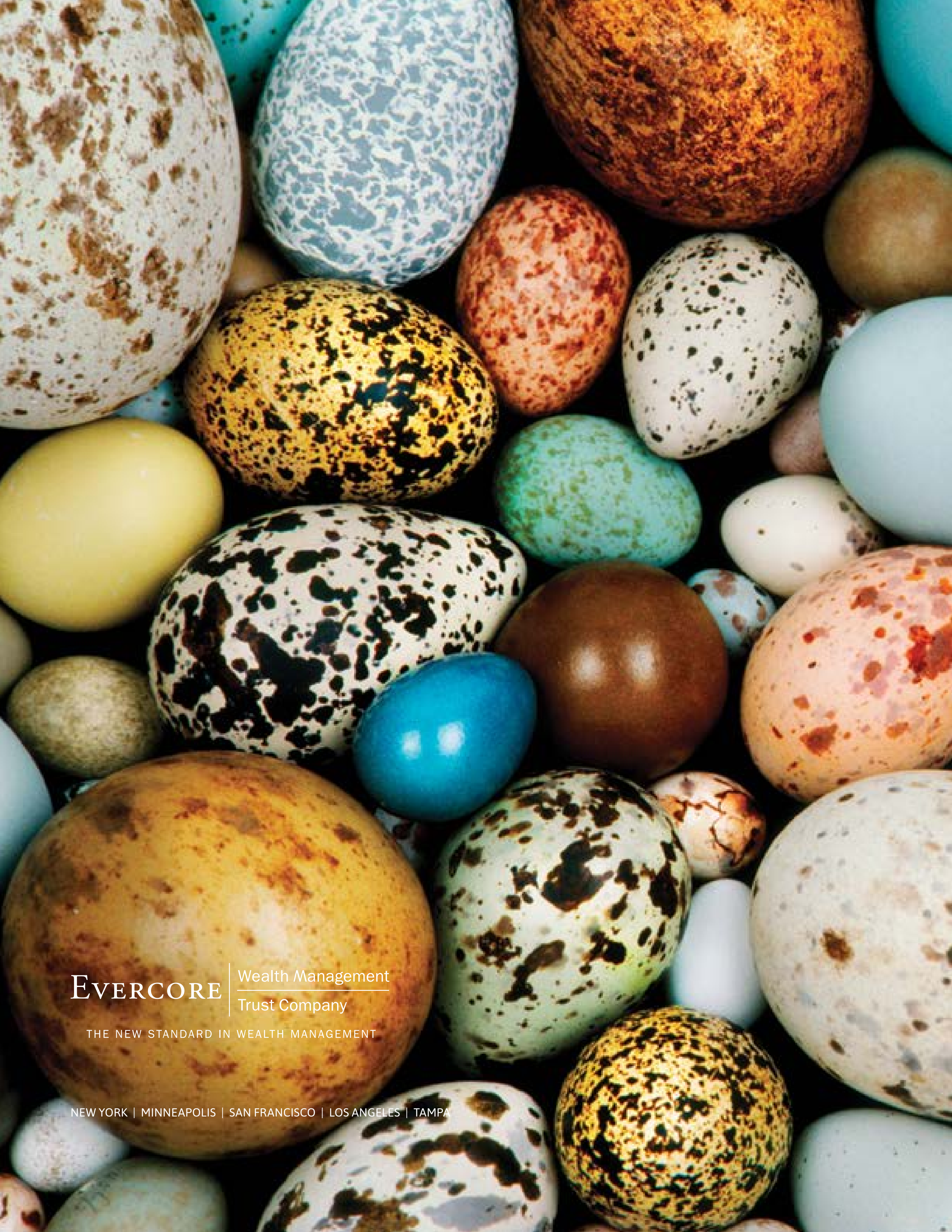
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