

The dramatic market moves of the last twelve months – up as well as down – have shifted many investors' perceptions of risk. High volatility shows that markets have not shaken off the shock of the global financial crisis. Given the concern over the aftershocks from the crisis, it is hard to explain the stock market's recovery to average valuation levels – even assuming that equity prices tend to predict an economic recovery well in advance.

Is this just a false dawn? Household debt will contract, and job growth will stay sluggish for years to come as small companies struggle with limited credit, potentially higher taxes, and rising healthcare costs. The woeful state of federal as well as state and local finances only adds to the headwinds facing the US economy. The sheer scale of government intervention around the globe could distort incentives and affect the prices of many financial assets, from commodities to government bonds.

On the other hand, investors should not overlook the profound changes at work in the global economy. At least 35% of the revenues by S&P 500 firms come from outside the US – and those revenues are shifting from Europe and other developed countries to the emerging markets. Measured on a purchase-power-parity basis, the GDP of emerging markets is now larger than that of developed markets and growing at a much faster pace. Large companies around the world have trimmed their cost structures to be able to profit once growth resumes, and many have reoriented their businesses to the greatest opportunity of all time: Hundreds of millions of people in emerging markets are now starting to earn enough money to join the middle class, the engine of the US economy for the past 50 years. While Americans try to figure out how to recover from excessive consumer spending and leverage, emerging market consumers are just getting started. They can't wait to buy all the things we have been buying for decades. As just one example, more cars are now being sold in China than in the US – and more than 90% of the cars in China are being purchased with cash. US investors must reduce their perceptions of the significance of the US economy and understand the emergence of many millions of new customers around the world when analyzing the business prospects of most companies.

On balance, therefore, we remain cautiously optimistic. For investors whose portfolios may now be overweighting equity, we advise a close look at rebalancing. We recently reduced our allocation to bonds from overweight to neutral. We increased to overweight our allocation to inflation and dollar hedging assets, because the increase in public debt is likely to put great pressure on the authorities in the US and elsewhere to give in to inflationary devaluations.

Defensive assets

Among defensive assets, despite the media concern about municipal finances, we have found selective, attractively priced issues, primarily in the new issue market – many in the 7- to 12-year range. To pick up yield over cash and money market funds, we remain focused on research-driven, short-duration securities, plus high-coupon issues priced to short calls. We emphasize essential-purpose revenue and dedicated tax bonds; we continue to avoid the GO and appropriation debt of most states and major cities. We are still pursuing geographic diversification while increasing yields after factoring in state income taxes. A recent purchase has been New Hampshire Health & Educational Facilities Authority for Lakes Regional, which we bought in a number of maturities and which is secured by reserve funds as well as FHA mortgage insurance (which itself is backstopped by open-ended access to US Treasury loans).

Evercore Wealth Management's Approach to Asset Allocation

Asset Class	Portfolio Objective		
	Income	Income with Appreciation	Appreciation
CASH Money Market Funds Treasury Bills Municipal Paper/Floaters	0-20%	0-20%	0-10%
DEFENSIVE ASSETS High Quality Fixed-Income <i>Municipal Bonds</i> <i>High Quality Corporate Bonds</i> <i>Agency & Government Securities</i> <i>Government Insured Mortgages</i>	40-60%	20-40%	0-20%
INFLATION AND DOLLAR HEDGING ASSETS TIPS Foreign Bonds Gold Commodities	0-10%	0-10%	0-10%
GROWTH ASSETS Global Equity <i>Domestic Equity</i> <i>Developed Foreign and Emerging Markets</i> Opportunistic Fixed Income <i>Corporate Bonds with equity-like returns</i> <i>Convertible and High-Yield Bonds</i> REITs	20-40%	40-60%	60-80%
ILLIQUID GROWTH ASSETS, SPECIAL SITUATIONS Distressed Debt Private Equity and Venture Capital Opportunistic Hedge Funds Real Estate	0-10%	0-10%	0-10%

Inflation and dollar hedging assets

Our investment committee has identified a range of investments that are not just hedges but also well-diversified income producers with appreciation potential, although turnover is likely to be higher than with traditional assets. These include investing in the strong currencies of countries with rapid economic growth and positive trade balances. The exposure to these foreign currencies could come in the form of government bonds, corporate bonds, or short-term currency instruments. Industrial metals and commodities highly sensitive to fiscal stimulus, such as copper, also fall into this category, as do precious metals that act as substitutes for paper currency, like gold. (The two metals may even hedge each other, with copper performing if growth resumes, and gold if it doesn't.) We like inflation-protected bonds issued by the US Treasury, as well as other countries.

Our recommended allocation for this asset class is 35% to precious metals, 10% to commodities, 25% to foreign currency and foreign bonds, and 30% to interest-rate hedges. In dedicated accounts, equities in countries with favorable, growth-oriented fiscal policies or in US companies in globally-traded businesses also have some hedge characteristics, as do tax-advantaged, higher-yielding oil and gas pipeline partnerships with growth opportunities and contractual price adjustments.

Liquid growth assets

Our equity portfolio has had defensive characteristics since inception last March, with above-average balance sheet quality among most of its holdings. It also includes some higher yielding corporate bonds as equity substitutes. The portfolio is directly exposed to the two best positioned emerging economies through China and Brazil ETF's. We are also seeding the portfolio with US-based

companies that have significant exposure to emerging markets, some of which get the majority of their revenues from outside the US in emerging markets. Over time and as opportunities arise, we expect an increasing portion of the equity portfolio to be directly exposed to emerging market growth.

Illiquid growth assets and special situations

We selected a top-tier manager to help our clients who were interested in participating in potentially attractive investment opportunities in distressed debt. We prefer this strategy, which tends to perform better following periods of economic stress, over other illiquid growth assets and special situations at this time.

Wealth management

Wealth planning has seldom been more important. The changing income tax and estate tax outlook and volatile markets have complicated decisions that may have been on auto-pilot in recent years. Given the likelihood of higher income tax rates, it is imperative to review personal income tax plans with advisors. Depending on each individual situation, it may be worth accelerating taxable income items into 2009 (e.g., realizing long-term capital gains) and deferring deductions to 2010 (e.g., charitable gifts). The expanded opportunity to convert traditional IRAs to Roth IRAs in 2010 also requires careful, case-by-case analysis. Although the outcome of estate and gift tax legislation is still in flux, opportunistic wealth transfer still looks prudent to consider as interest rates are relatively low and valuations for both marketable and non-marketable assets are still depressed. We are happy to work with our clients and their advisors in formulating and executing the right strategy for their specific goals.

Our business

It now has been a year since we opened our doors at EWM. We now have 16 partners and a total staff of 36, managing \$1.4 billion in client assets nationwide from our offices in New York and San Francisco. We are also taking on new fiduciary appointments for our clients at Evercore Trust Company. We founded the firm on three principles:

- **Unconflicted advice.** We are focused on our clients' goals and are free from the conflicts inherent in most large institutions;
- **Undiluted investment expertise.** We believe that clients benefit from a direct relationship with the investment and fiduciary professionals who manage their wealth;
- **The value of partnership.** Our culture is founded on institutional and individual integrity. We work as a team, and our interests are aligned with those of our clients.

In a nutshell, we hold to a new standard in wealth management. Our client-first approach, our individual and collective investment expertise, and our partnership structure enable us to deliver our best thinking directly to our clients. We welcome your comments and questions.

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