

Independent *thinking*

Policy and Investing

Stephen Worth on the Global Automotive Industry

Equities, Fixed Income, Diversified Hedges and Wealth Planning

Harding Loevner on Frontier Markets



The *Policy* Issue

Shifting Gears, Staying on Track

Government policy, always a determining factor in capital market pricing, is now a significant variable. The unprecedented actions taken by governments across the globe since 2008 have altered the classic relationship between risk and return, creating opportunities to grow and protect portfolios for investors who do not exclusively rely on old frameworks for security valuation and asset allocation.

Overleveraged sovereign nations in Europe, bulging fiscal deficits in developed nations, extraordinary monetary policy, competitive currency devaluation, fiscal austerity programs and long-term entitlements; these issues used to be the stuff of think tank debates. Today, they are the hot topics around water coolers and at suburban dinner parties – and key factors in market pricing.

Interest rates on U.S. and major European government bonds have fallen to historic lows, as of this writing, and equity markets

are swinging wildly, subjecting investors to near-record volatility. Confidence among investors and consumers in the United States has plunged, as incomes deteriorate and unemployment remains high. And confidence in our elected officials is two rungs below rock bottom, thanks in part to the unprecedented nature of our current predicament.

In Europe, it's even worse. Slow growth in many EU member states, currency dislocations and the ability of weaker members to borrow at yields similar to their much stronger brethren have created a system in which far too much debt is piled up in the countries that can least afford it, as illustrated on page 3. France and Germany, where banks purchased fistfuls of bonds issued by their profligate counterparts, are exposed to the same problems of their over-indebted neighbors.

Consider the plight of a pension fund manager in Spain or Italy looking to fill his or her bond portfolio *(continued on page 3)*

A message from the CEO



Jeffrey Maurer
Partner and CEO

Crisp days generate a sense of urgency, a feeling that is only reinforced by the current political and economic outlook. As we consider the associated risks, we are reminded that change is certain and that only careful planning across a wide range of probable and possible outcomes will serve our clients well in the coming months and years.

Government policy, once the preserve of Beltway discussions, now influences the markets on a daily basis. In this issue of Independent Thinking, we expand on our distinctive approach to diversification in the context of changing monetary and fiscal policy, both in the United States and in Europe, and consider the related opportunities. All of our major asset classes, which are defined by their risk, return and liquidity characteristics, are positioned to protect and grow individual portfolios by factoring in policy considerations. This is a significant differentiator for our firm and a discipline that has benefited our clients.

For individual investors, changes in policy and volatile markets can complicate

planning, spending and investment decisions. Here, Chris Zander outlines the issues that should be at the forefront of discussions between individuals and their advisors. On the equity and fixed income fronts, Tim Evnin discusses several attractive

the beginning will recall that we launched Evercore Wealth Management at the depths of the financial crisis, in November 2008. So it was with confidence, even in these market conditions, that we announced in September the expansion of the firm to the

“Government policy now influences the markets on a daily basis.”

stocks, noting that growth can be achieved even in difficult environments, and Howard Cure reviews the relative strengths and vulnerabilities of individual states as the Federal government pulls back on spending.

Also in this issue, Stephen Worth, an automotive and industrial specialist at Evercore's corporate advisory business, makes a strong case for the Detroit Three, arguably among the greatest beneficiaries of government policy over the past few years. And one of our selected external managers, Don Elefson at Harding & Loevner, takes a look at the prospects for some of the most attractive frontier markets.

Clients who have been with us since

Midwest. We welcome our six new partners who will contribute significantly to our national capabilities as they bring with them considerable talent and experience.

As always, please feel free to contact any of us at Evercore Wealth Management, in our New York, San Francisco and, now, Minneapolis offices. We remain extremely grateful to our clients and our colleagues for their support and are delighted by the continued success of our firm.



Jeff Maurer
Chief Executive Officer

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COVER STORY: Shifting Gears, Staying on Track

(continued from page 1) with stable assets. Should this manager invest in Spanish or Italian government bonds, once perceived as fail-safe holdings, when the rest of the world is trying to sell?

The obviousness of the answer is one of the reasons that the U.S. Treasury market recorded such a significant rally over the last two months, up close to 30% on the 30-year Treasury bond, and why the price of U.S. equities fell more than 10% over the same period. Despite the recent S&P downgrade of U.S. debt, the global market still believes that the full faith and credit of the United States government is as good as it gets today. Investors are backing that belief with their assets while attempting to de-risk portfolios by fleeing stocks and peripheral debt.

In other words, stocks in the United States went down in price – and Treasury bonds went up in price – at least in part because Italian and Spanish pension fund managers, along with those in other vulnerable markets, worried about the safety of assets they had once assumed were stable.

At Evercore Wealth Management, we see that the challenges in the United States are not structural in nature. The U.S. system of government, while wildly partisan and at times dysfunctional, generally works over the long term. We believe that our politicians will eventually adopt policies that allow for the efficient allocation of capital and that our economy will grow out of its current burden of liabilities. But this process is likely to be messy and is certain to be slow. In the interim, we see opportunities to profit from shifts in fiscal and monetary policy.

Recent monetary policy changes in the United States and the market's subsequent moves are cases in point. When, via Quantitative Easing I, the Federal Reserve

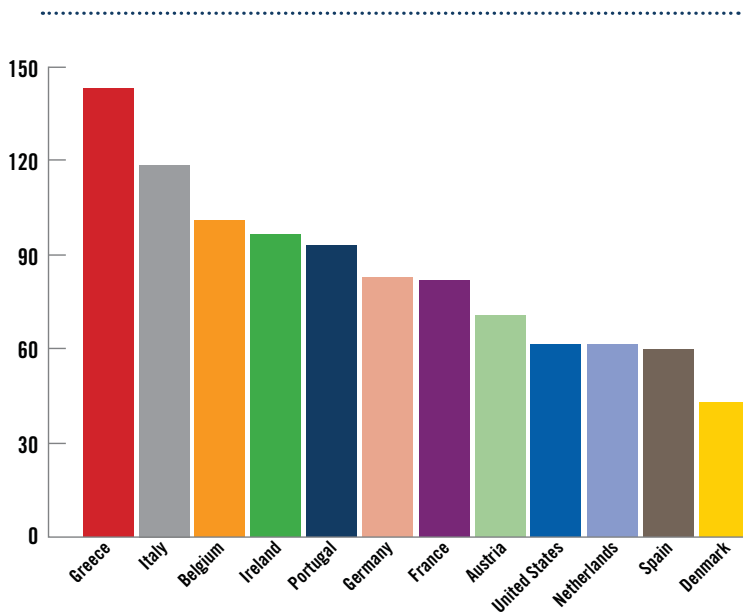
expanded its balance sheet by over a trillion dollars in 2009, the S&P 500 Index rose about 80%, as demonstrated in the chart below. At the conclusion of the program the S&P declined by nearly 20%. Whispers of QE II soon drove the market up again, this time by approximately 30%. From the end of this program in June 30, 2011, to late September, prices declined by around 10%.

Why does the market not immediately account for expected or even announced policy changes? After all, Federal Reserve Chairman Ben Bernanke himself has said that there is a direct linkage between the Fed's QE policies and the equity market. We believe it is because many capital markets participants are uneasy factoring in government policy as a significant variable. (continued on page 5)



Source: Strategas Research Partners, EWM Research

SELECT EUROZONE COUNTRIES & THE UNITED STATES DEBT TO GDP RATIOS



Source: CIA Fact Book, EWM Research

New Players on the Field

by
STEPHEN WORTH

Stephen Worth is a Senior Managing Director at Evercore's corporate advisory business, focusing on the global automotive and general industrial sectors. He advised General Motors throughout its restructuring in 2008-2009 and on its record-breaking \$23 billion IPO in 2010. He also advised the finance committee of the board of directors of Chrysler on the company's recapitalization in 2011. Evercore is the parent company of Evercore Wealth Management.

Labor negotiations in Detroit are making headlines again. But this time, the Detroit Three have an edge, both at home and abroad.

More jobs and higher profit sharing are the main themes for the United Auto Workers this year, reflecting a completely different reality. Five years ago, General Motors, Ford and Chrysler were in a battle for survival – striving for wage and work rules that were competitive with the transplants and re-cutting the entitlements that had become towering liabilities overshadowing razor-thin equity values. Many investors felt that bankruptcy was a forgone conclusion and the business model was broken.

The 2007 UAW negotiations were a meaningful step in the campaign to reshape these companies into viable long-term businesses. But the progress, as significant as it was, was soon eclipsed

by the events brought about by the credit crisis – spiking oil prices, a marked shift away from the light trucks that were the lifeblood of the Detroit Three and, then, an epic collapse in volumes. By the end of 2009, two of the three U.S. automakers had been through an accelerated Chapter 11 and the U.S. auto sector as a whole had received the equivalent of a \$180 billion equity injection.

Excess manufacturing capacity has been shuttered, uncompetitive brands and dealers were eliminated, liabilities were restructured and reduced, and both suppliers and automakers are now profitable and well-capitalized. Operating margins of the Detroit Three today are 400-600 basis points higher than at any point in the past 10 years at volumes that are 25% below the average of the five years preceding the downturn. These are new companies. As GM pointed out to investors after its record-breaking IPO in November, they are finally in a position to play offense.

In contrast, little to no excess capacity has been eliminated in Japan or Europe during the downturn.

Toyota has yet to recover from its 2010 product recalls, which badly dented the company's sterling reputation for quality and eroded the price premium that its products had commanded from consumers. Pricing, after all, is a combination of both real and perceived value. The giant automaker, which at \$110 billion is still nearly twice the size by market capitalization of its nearest competitors, is also struggling with the impact of the continued economic malaise in Japan, a strong yen and the ongoing repercussions of the March earthquake. If that were not enough, there is the stunning growth of Hyundai to consider. Toyota remains a superb manufacturing company and a formidable competitor, but the road ahead appears far more challenging than two short years ago.

The strengthening of the euro and yen has reminded automakers yet again of the virtue of manufacturing in the

markets in which they sell. Toyota, VW, Hyundai, Mercedes and BMW have all announced capacity increases or new plants in the United States in the past few years. While on-shoring production is the right long-term move, the cost arbitrage



Stephen Worth
*Senior Managing Director
Evercore Partners*

of establishing low-cost, non-union manufacturing to compete against Detroit is essentially gone.

One of the key competitive levers for the global automakers is scale. That hasn't always been true. "Big" has sometimes translated into bureaucracy, complexity and waste. What's changed is the progress automakers have made in the use of global architectures – the use of a common vehicle platform to produce multiple variants around the world. The concept is easy: if you can save on the development costs, purchase components in larger volumes and set up your manufacturing to swing between products from the same architecture, then costs come down and flexibility goes up.

China will play a key role in this strategy as almost two-thirds of the current vehicle volumes are off of the same vehicle architectures that are used in developed markets. As those volumes grow, it will provide automakers a cost

advantage around the world. Already, vehicle sales in China have topped those in the United States. It is perfectly possible that within 20 years one out of every three vehicles in the world will be sold in China. While the United States will continue to be a coveted market, thanks to its size and relative sophistication, China is likely to be the most important market for global automakers and suppliers.

The Chinese automakers that currently make up the remaining third of the market base their products off of lower-cost architectures that match their demographic. This portion of the market will grow disproportionately in the next 20 years as lower price-point products penetrate the domestic market.

Over time, and after some considerable consolidation, the local brands will gain in sophistication and scale and begin to compete in the mature markets, but their first application will be in other emerging markets. The ability of Chinese manufacturers to compete in mature markets will depend on their own learning curve and cost structure, but just as important will be the extent to which the current global leaders use their scale advantage in global architectures over the next few decades.

The other game-changer that lies ahead is in power train technology. Technology moves slowly in the auto industry. It is reasonable to expect some reticence towards rapid deployment of

untested technology if your product's purpose is to propel human cargo 75 MPH down a highway. Someday, a widespread alternative to the internal combustion engine will emerge. For the moment, there is no clear winner. Most large automakers are hedging their bets by exploring multiple emerging technologies. But the bets are so large that better capitalized companies will have an edge.

The Detroit Three (or Two, depending on how you view the Fiat-Chrysler alliance) have seemingly regained their footing at a crucial moment. Competition going forward will be different. Scale matters. Emerging markets will play a critical role. For investors in the U.S. automotive industry, these are interesting times.

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(continued from page 3) In the current volatile environment, relying exclusively on traditional valuation methods and capital market assumptions to determine asset allocation and security selection subjects portfolios to new risks.

Thinking about government policy and how it relates to capital markets is an important facet of our asset allocation. This view is expressed most directly via our allocation to our Diversified Market Hedges, or DMH, strategy, which focuses on identifying and hedging the largest risks to stock and bond portfolios, specifically by looking for instances where government policy has created inefficiently priced securities. This tactical approach allows us to invest with full confidence in our fundamentally driven equity and municipal bond portfolios.

But DMH is not the only area where federal government policy is now a factor in our security selection. Our core stock portfolios contain a considerable focus on companies with solid balance sheets and

we are significantly underweight Europe in relation to a global index. In fixed income, we are combating historically low interest rates by investing in mortgage-backed securities, leveraged loans and the middle market lending space, which all provide excellent current yields, good long-term risk-adjusted returns and limited interest rate risk.

While federal government policy has always been a significant aspect of quality municipal bond credit analysis, the recent enormous fiscal policy initiatives have made paying attention to federal policy even more important than usual. Today, the potential changes to Medicaid, the discussion of the elimination of municipal issuers tax-exempt status, and diminishing government funding for states post the implementation of the American Recovery and Reinvestment Act of 2009, which provided temporary fiscal relief, are just a few of the many issues facing the municipal market which stem from federal fiscal policy. Any one of these could have

broad repercussions for the market. Policy is a more important input into our analysis of individual municipal issuers than it ever has been in the past.

Abraham Lincoln claimed to have never had a policy but instead just tried his best, every day. Today, however, policy is a critical variable, for investors as well as for politicians and think tank debaters. At Evercore Wealth Management our fundamental analysis of stocks and bonds will always be our core focus and competency, but the interaction between government policy and capital markets has also become an integral part of our investment decision-making process.

Brian Pollak and Iain Silverthorne contributed to this article. Brian is a Fixed Income Portfolio Manager and a co-manager of the Diversified Market Hedges Strategy; he can be contacted at brian.pollak@evercore.com. Iain is a Partner and Wealth Advisor at the San Francisco office; he can be contacted at silverthorne@evercore.com.

Core Capabilities

Equities: *Growth in Different Guises*

by **TIM EVNIN**

The allocation to growth in our goal-based asset portfolios remains most heavily weighted towards equities. Even in this market, which is dominated by political and economic uncertainty, there are industries and companies that we find compelling.

Gaming, for instance, continues to grow, notably in Asian markets. We have

for growth abroad, in this case Latin America. DirecTV's businesses in Brazil and Mexico have been growing at a combined rate of over 30% a year, along with local incomes and availability of service. The company as a whole has excellent profitability characteristics and was able to grow revenues even through 2008-2009.

A purchase from earlier in the year, AutoZone, has proven its ability to grow even in a slow-growth industry. This Memphis-based national chain of auto parts stores sells to a relatively stable market, which is growing between 2% and 4% a year. Consolidation of smaller operators adds to that growth. Against this

and around the world. We do not expect that to slow: Steve Jobs has built a company that is positioned for continued success.

Whether by tapping into nascent demand, like Las Vegas Sands and DirecTV, or by shrinking to grow, as AutoZone is effectively managing to do through its share buyback program, or by creating entirely new markets, as Apple continues to do, some companies are managing to prosper, even in this economy.

At Evercore Wealth Management, our goal in equity allocation is to identify companies that prosper even in a difficult economic environment, evaluate their long-term prospects, and pay the right price for the shares of those businesses.

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Fixed Income: *States' Fights*

by **HOWARD CURE**

The effects on credit quality from the Budget Control Act of 2011 will be felt unevenly across state and local lines, depending on the strengths of their respective economies and their reliance on federal funding.

As noted in the previous issue of Independent Thinking, many states are balancing their budgets on the back of local governments. Here, we take a look at the potential impact on states as the federal government engages in its own budget balancing exercise. For some, declines in federal appropriations

recently added Las Vegas Sands Corp. to our holdings. Las Vegas Sands generates over 75% of its revenues outside the United States and has doubled revenues in just the past two years, thanks to continued high growth rates for the industry in Macau and the recent debut of the company's Marina Bay Sands resort, one of only two casinos in Singapore.

DirecTV is another U.S.-domiciled mature business with excellent prospects

modest backdrop, AutoZone has managed to grow earnings per share significantly for the last five years. By honing execution and directing all excess cash to repurchasing shares, the company has turned 5% sales growth into 15% average annual earnings per share growth. This looks likely to continue.

We also remain enthusiastic about Apple, which continues to enlarge its share of consumer spending in the United States



could undermine the already fragile economic recovery and complicate aspects of state and local government fiscal management.

The map below depicts the percentage of federal spending by state compared to

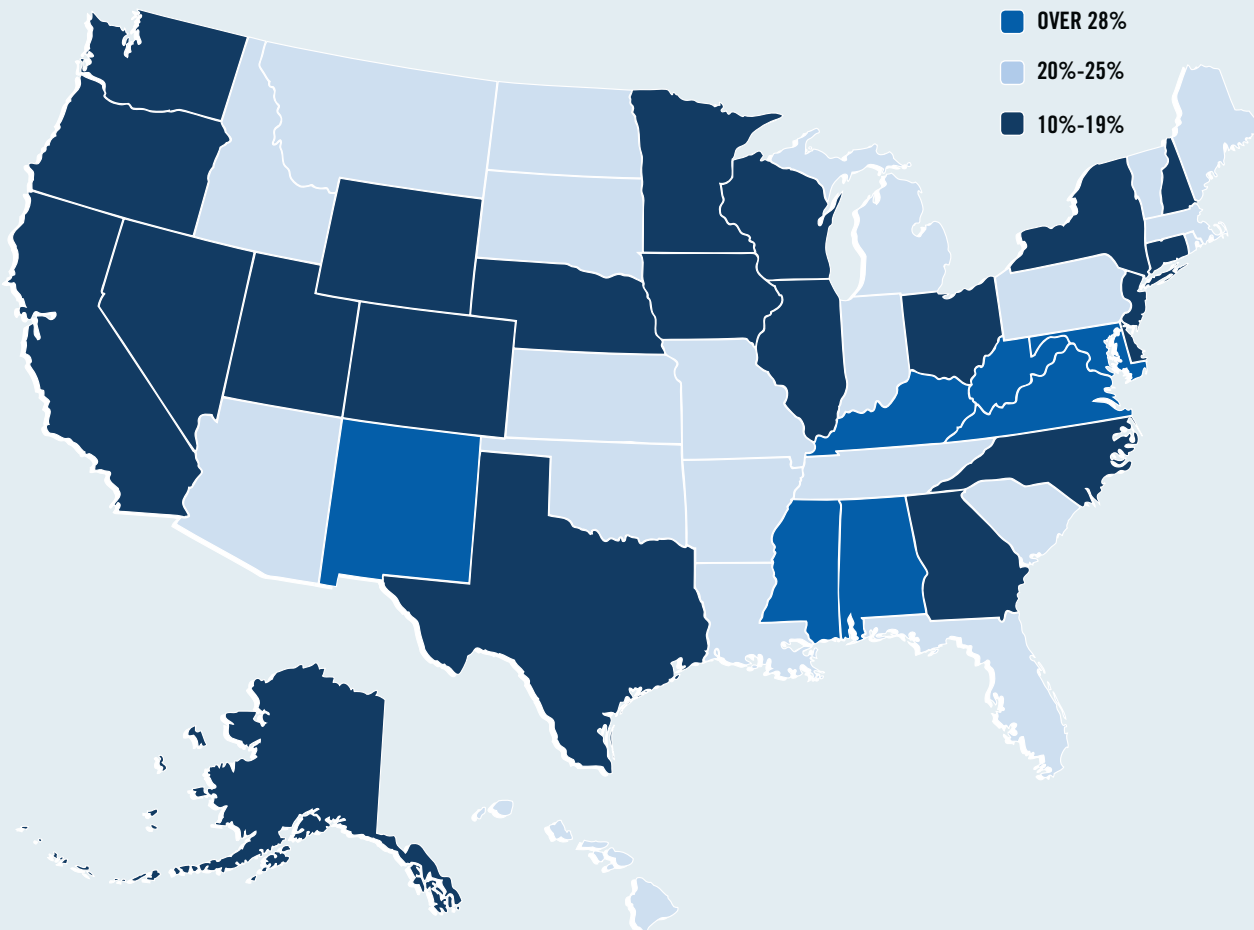
In the direct payments category, health and entitlement programs are largely driven by state income levels, which is why the relatively poor states of Alabama, Arkansas, Mississippi, West Virginia and Kentucky are marked in bright blue. Under

able to adapt to changes due to federal procurement contracts.

Virginia is also the largest recipient, on a percentage basis, of federal military spending, with cuts in defense a key component of the debt reduction deal

FEDERAL SPENDING BY STATE COMPARED TO GROSS DOMESTIC PRODUCT

FY 2008



that state's gross domestic product.* The average ratio of federal spending per state to the state's gross domestic product was 19.7%; Mississippi, Kentucky, Virginia, New Mexico, West Virginia, Maryland and Alabama all recorded rates over 28%. While there is a particular reliance on federal spending within each of these states, the source of the funding varies.

The major sub-categories within federal spending by state are: direct payments including healthcare assistance and food stamps; procurement contracts; and defense spending. Each is subject to different degrees of cuts.

the Budget Control Act, Medicaid and the Children's Health Insurance Program, or CHIP, are among the programs likely to be exempt from cuts.

In the procurement category, owing to its research facilities in both defense and healthcare and the large number of federal employees, Virginia and Maryland are very vulnerable to cuts. Both federal agency headcount reductions and cutbacks in contract spending could adversely affect these states' economies. It should be noted, however, that both Virginia and Maryland have a highly skilled, well-educated workforce that should be

approved this year. Other states that stand to lose significant funds in this category are Alaska, Hawaii, Maryland, Alabama and Mississippi. Doubtless, officials in each of these states will be fighting to retain their local military facilities. However, based on funding formulas for states to maintain their proportion of defense spending, there would have to be entitlement cuts or reductions in state aid to compensate – and these revenue sources have their own supporters.

To date, states have fared fairly well in the Budget Control Act with key state-specific programs, including Medicaid,

CHIPS and other entitlement programs, specifically exempted. Even the currently exempt entitlement programs could reappear for restructuring, leading to cuts. It is then up to the individual states to consider absorbing and funding services that currently receive federal support.

At Evercore Wealth Management, we will continue to monitor this very fluid situation and the potential impact on state and local finances.

**These findings are based on 2008 data which was selected over 2009 data, which was distorted by stimulus to state and local government, including enhanced Medicaid matching funds and additional educational funding, by the American Recovery and Reinvestment Act of 2009.*

Howard Cure is the Director of Municipal Bond Research at Evercore Wealth Management. He can be contacted at cure@evercore.com.

Diversified Market Hedges:

Between the Lines

The Diversified Market Hedges, or DMH, strategy places government economic policy at the forefront of investment decision-making, thereby removing policy complications from other investment activities at Evercore Wealth Management. Our objective is preserving and growing portfolios. We are neutral about policy per se, but care deeply about the continued potential impact of policy on our clients' capital.

This approach strives to hedge the asset class or asset classes most at risk from policy intervention and seeks to do it as inexpensively as possible. While policymakers can support any asset class they choose, support must come at the expense of another asset class and this cost is often unnoticed and unannounced.

The DMH strategy seeks to profit from this cost to offset any losses in the asset class sacrificed by policymakers.

For example, quantitative easing in the United States clearly aided stock prices in 2009 and again in its second iteration in 2010 but it simultaneously devalued the dollar by 20% and reduced the income-producing potential of fixed-income portfolios. We owned high-yielding foreign bonds and gold to counter this intervention and protect our investment-grade, fixed-income asset class. As a result, the strategy produced strongly positive returns in 2009 and again in 2010, offsetting the decline in client purchasing power and income generation.

Today, we see the perpetuation of misperceptions in investors' belief that European policymakers will find a solution to Greek debt risk. Debt bail-outs in Europe prop up bonds of over-levered economies but hinder economic growth in the process which reduces stock prices.

Many equities in Europe are down 30% or more and the S&P 500 is well into

correction mode as of this writing. We are attempting to protect the growth equity positions of our clients by purchasing investments designed to benefit from falling, global growth expectations this year and particularly from lower European stock prices. As a result of this growth hedge, our DMH strategy continues to serve our clients well – this year by offsetting equity risk, instead of cash and fixed-income risk.

Government intervention is likely to be both an ongoing risk and opportunity for investment. We believe that the DMH strategy, when included in broader investment mandates, can increase the likelihood of capital preservation, preserve purchasing power and yield asset appreciation, and may also reduce volatility along the way.

The Evercore Wealth Management Diversified Market Hedges strategy is managed by three partners in New York and one in San Francisco. For further information, please contact Greg Nicolls at greg.nicolls@evercore.com.

Wealth Planning: *Sustainable Spending* by CHRIS ZANDER

An important part of any goals-based investment process for both institutions and individuals is to understand the projected annual cash flow requirements that may impact portfolio sustainability over longer periods of time. Institutions typically have relatively stable balance sheets, built on operating business plans with long-term time horizons. Individuals, however, generally face greater variability in the factors affecting their wealth management plans.

Individual financial planning analysis as practiced at most institutions will attempt to determine the sustainable withdrawal rate for a portfolio using standard long-term assumptions based on an advisor's investment market views and inputs from clients on related factors, such as their typical spending rate. Advisors will then overlay a Monte Carlo analysis to incorporate volatility and randomness – an approach which can appear rigorous but has significant drawbacks in its assumptions regarding normal distribution outcomes. These advisors do their clients a disservice.

In our experience, the ever-changing circumstances that individuals and families face make it very difficult to develop a set investment plan without further investigation. Among the factors that the discovery process at Evercore Wealth Management aims to identify are:

ACTUAL ANNUAL EXPENSES

While many individuals believe that they are spending at a predictable rate, they are actually funding a host of one-time expenses, including quite a few that seem to reoccur. These need to be accounted for.

AN APPROPRIATE INFLATION RATE

Costs for affluent individuals tend to increase at a higher rate than CPI-based measures, something that most advisors don't plan for. Private school tuition, vacations and multiple home ownership expenses are just a few examples.

INVESTMENT EXPENSES

The fully loaded expenses associated in managing portfolios, including investment fees and reporting costs, need to be accounted for in the planning process to anticipate and reflect a true net return.

TAXES

All taxes impacting individual investment portfolios must be assessed in full and on an ongoing basis.

CHANGING PERSONAL CIRCUMSTANCES

People change, even well into retirement. Individual investors may become more – or less – risk averse, philanthropic or interested in transferring wealth to fund children's businesses or grandchildren's educations. These changes can significantly affect investment portfolios.

The recent volatility in investment returns and low income yields on portfolio assets make proper planning even more critical. With net income yields on some portfolios at 2% or below, some individuals are consuming a portion of the portfolio principal and prospective growth to maintain their current all-in spending levels. That exposes them to greater risk in times of market declines. These market conditions also make them more vulnerable to changing course at exactly the wrong time.

Advisors must verify that their assumptions are accurate and reflect actual data and realistic forecasts, prepare for

a range of spending scenarios, anticipate changing circumstances, and identify the appropriate solutions. Most importantly, we need to communicate this process – and the results – to the individual investor. At the end of the day, this should be the real focus of any wealth management relationship.

Chris Zander is a Partner and Head of Wealth Planning at Evercore Wealth Management. He can be contacted at zander@evercore.com.



Editor's note: *Beyond emerging markets lies the frontier: small and developing economies that have the investment potential of Brazil, Russia, India and China 10 years ago – and the risks. Here we interview Don Elefson, co-manager of the Harding Loevner Frontier Emerging Markets Fund.*



Q: *How do you define frontier markets?*

A: The most accurate definition is based on the development of the local stock markets, which we assess across three elements: liquidity of the underlying companies; breadth of investment opportunities; and the settlement and trading process. This is a better measure than GDP per capita, which index providers use. Our core model includes both true frontier markets and small emerging markets that represent less than 4% of the MSCI Emerging Market Index.

Q: *What is your investment approach to such a diverse and challenging sector?*

A: We screen individual companies for four criteria: competitive positions; sustainability of growth; financial strength; and quality

of management, just as we would in emerging and developed markets. At the same time, we monitor the respective country's financial conditions, including its inflationary trends and the value of its currency, and its political risk. Change in the frontier markets tends to occur at the macro-economic and political levels.

Q: *How do liquidity flows from developed countries impact your investment decisions?*

A: A slowdown of equity flows may inhibit stock market price appreciation but most frontier markets do not really need foreign money; foreign borrowing requirements are low. Unlike their counterparts in western Europe or the United States, frontier-based companies have strong balance sheets. Slowing growth leading to lower risk appetites and slowing liquidity should not hit frontier economies as hard as investors might think.

Longer term, once the current uncertainties in the developed world subside, money should flow from developed countries into frontier equity markets. These markets have low correlations with both developed and many emerging markets and offer sustainable growth potential as they encompass a lot of new consumers.

Fixed investment flows are strong and should continue that way. Large emerging markets, including China and India, are huge investors in frontier fixed assets; they are exploiting new market growth opportunities for their own products and lowering their own manufacturing costs.

Q: *What opportunities do you see for the frontier markets as a whole?*

A: Frontier markets are in the same position of emerging markets 10 years ago but with a compressed timeline for growth, thanks to the greater impact now of

telecommunications and the Internet. People living in these countries now can see, assess and act upon ideas faster. In Africa, for example, the rate of cellular penetration was just 15% three years ago; today it is 45%.

Large frontier markets in particular could develop in investment terms along the same lines as the BRIC countries. For example:

- Nigeria, like Brazil 10 years ago, is a large oil producer that is plagued by high levels of corruption and inflation, as well as power shortages. Brazil worked through these challenges, and Nigeria can too;
- Saudi Arabia, like Russia, is a leading oil producer with internal issues that make the country unappealing to many investors. But Saudi Arabia, like Russia, can build on its strong financial position to become a significant emerging market;
- Bangladesh is following the same evolutionary path as India by making its name as a low-cost producer. To take a specific example, one of India's first internationally prominent companies was a generic pharmaceutical producer called Renbaxy. In Bangladesh, companies like Square Pharma may be the next generic producer to gain market share in developed markets;
- Vietnam's model is similar to that of China, shipping low-cost manufactured goods by sea and around the world. Not surprisingly, Chinese companies are now investing in Vietnamese manufacturing to lower their own costs and remain competitive in the global economy.

Q: *What do you see as the most attractive sectors in these markets?*

A: Consumers are the main driver. Rising demand for consumer goods, both staples and discretionary, will benefit local companies. Consumer companies in Saudi Arabia and

low-cost manufacturers in Bangladesh are particularly attractive now.

Banks are another area of opportunity, notably those in Nigeria. Throughout the frontier markets, banks are in better financial shape than those in developed markets, thanks to their relatively traditional models. Many have loan-to-deposits ratios under 100% and high margins but remain undervalued.

Q: *How about risks? Are you avoiding any frontier countries or sectors?*

A: The biggest risk for investors in frontier markets is political, followed by inflation and slowing economic growth, in that order. The Arab Spring has showcased developing risks and the impact of modern communications in propelling changes that can also create new opportunities. In addition to the obvious political risks in Egypt, Tunisia and elsewhere in the Middle East, there are religious risks affecting investments in Africa, notably in Nigeria, Uganda and Tanzania.

Inflation is also a significant risk for frontier markets, where food costs can comprise more than 50% of consumers' expenditure. Lower global food supplies have led to higher food prices, which in turn create inflationary pressures. If inflation is not brought down, both political and economic risk will increase. But we do see price levels starting to decline this year, thanks in part to declining oil prices.

As for economic growth, the long-term outlook seems to us positive, if political and inflation risks remain under control. Again, consider the Arab Spring. Living conditions in North Africa and along the Arabian Gulf were stagnant and young people in particular had few prospects. But now, as the result of sudden, sweeping changes including reactive government investments in education and other services, there is a real prospect of lasting progress, for the citizens – and for the markets.

EVERCORE | Wealth Management *News*

Evercore Wealth Management Expands to Midwest; Names Six New Partners

The firm welcomed six new partners in September to establish the Evercore Wealth Management's Midwest headquarters in Minneapolis. All six join from Lowry Hill and bring with them substantial investment advisory and portfolio management experience. They are:

Martha Pomerantz is a portfolio manager and a member of the Evercore Wealth Management Investment Policy Committee, as well as co-manager of the Minneapolis office. She can be contacted at martha.pomerantz@evercore.com.

Julie Krieger is a co-manager of the Evercore Wealth Management Minneapolis office and a wealth advisor, responsible for delivering comprehensive multi-generational wealth management and planning advice to Midwest clients. She can be contacted at julie.krieger@evercore.com.

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