

The global economy

Despite some recent hopeful signs, it appears that the global economy is not yet out of the woods and the current recession will likely continue through at least the end of the year. Policy responses have been aggressive but only partially effective and deflationary forces dominate. The solvency of large banks no longer appears to be in question but consumers remain reluctant to open their wallets amidst continuing uncertainty. And, while the United States was the first into this recession and should be the first out, we are concerned about a protracted bottoming process and economic recovery, the recent stock market rally notwithstanding. The rise was fueled by some evidence that the rate of economic decline is slowing and that first quarter earnings estimates were too negative, as a result of the extremely bearish sentiment that prevailed in February and March.

Comprehensive asset allocation

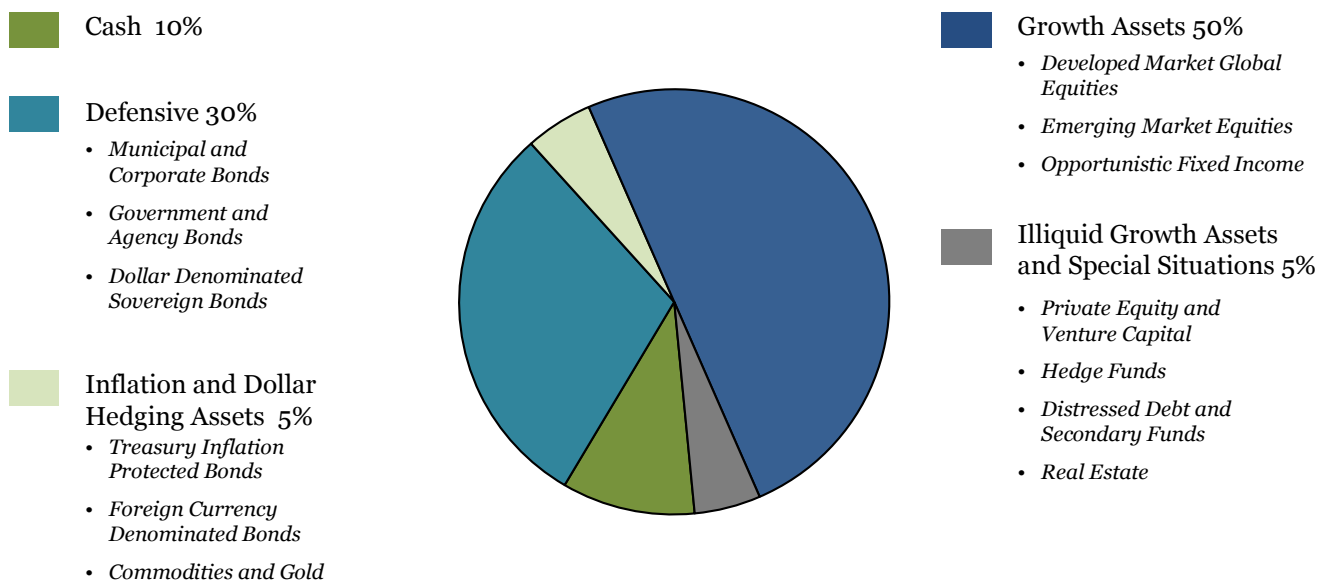
Of course, portfolio construction for any economic environment must begin with asset allocation, the purpose of which is to develop a mix of investment holdings with the appropriate risk and return characteristics for each client’s investment objectives, risk tolerance and liquidity preference. Therefore, we find it helpful to group assets by their risk/return and liquidity characteristics, rather than their security type.

We view investable assets as falling into five major categories: cash, defensive assets, inflation and dollar hedging assets, growth assets, illiquid growth assets and special situations. These categories fall along a continuum, with cash assets being the most liquid and the most likely to maintain their nominal value. At the opposite end are those investments—such as private equity and venture capital—that are expected to compensate investors for lack of liquidity.

We believe that grouping assets by risk is more helpful than grouping them by the traditional categories of stocks, bonds and cash. The latter does not account for the broad spectrum of risk within each of the asset classes.

A Balanced Portfolio

This sample asset allocation is designed to produce income with appreciation in the current economic climate.



Neutral on growth assets

Our outlook on equities is cautious over the near and medium term. We are investing in some normally defensive categories that are producing equity-like results, such as corporate bonds. For example, we recently purchased new issue debt yielding 9.25% from Rio Tinto, one of the world's leading mining and exploration companies. At the time of purchase, these bonds were yielding significantly more than the company's outstanding bonds and have performed well.

Domestic companies are more attractive than their foreign counterparts. Among U.S. stocks, we particularly like those with high yields, such as Embarq Corp. (NYSE:EQ), which is yielding 7.7%, and those issued by companies that are self-financing or have strong balance sheets, like Microsoft (Nasdaq:MSFT). We expect greater deviation among individual stocks and sectors than we have seen in the past and are actively rebalancing to take advantage of market volatility. We are also preparing to invest in distressed securities but are being patient—and keeping our powder dry—as we research opportunities for clients.

Overweight on defensive assets

In light of our concern about a protracted bottoming process in the U.S. economy, we are positioning many of our clients defensively, focusing on opportunities in the municipal and corporate bond markets.

In municipals, we see particular opportunity in the secondary market, where liquidity has been inconsistent because of the inability or unwillingness of many broker-dealers and banks to commit capital. We are focusing on independently researched AA-rated essential purpose revenue bonds, such as the Aa2/AAA New York Municipal Water Finance Authority, and dedicated tax issues, because of ongoing concerns about credit quality. For the same reason, we advocate geographic diversification for residents of even the highest tax states. Due to the steepness of the municipal yield curve and as a hedge against probable future inflation, we are taking a barbell approach by counterbalancing longer intermediate municipals with short-duration paper.

We also see opportunity in corporate bonds and taxable municipals, particularly for IRAs and clients subject to the Alternative Minimum Tax. Specifically, we like highly rated short and intermediate dated new issues from industrial corporations, such as Aa2/AAA rated Pfizer 5.35% due March 15, 2015, and from municipal issuers with excellent operating and liquidity profiles, such as the recently issued Aa1/AA+ Virginia Housing Development Authority. Uncertainty about government policy is causing us to remain particularly cautious on financial sector debt with lower claims priority in bankruptcy.

Our business

Evercore Wealth Management is growing. We now have twenty five employees. Our investments group is now managing more than \$750 million in client assets and is working with Fortigent, a Maryland-based research firm, to screen outside managers in all investment categories. Evercore Trust Company has received its license and is now serving as executor, trustee and custodian. With our team in place, and hard at work, we look forward to sharing more news with you in the coming months and to serving your wealth management needs.

May 2009

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