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## Business Day

PERSONAL BUSINESS

WEALTH MATTERS

### Telling the Truth on Fees, Warts and All



CHESTER HIGGINS Jr./THE NEW YORK TIMES

John Apruzzese, chief investment officer, left, and Jeff Maurer, chief executive, of Evercore Wealth Management.

By PAUL SULLIVAN

Here's a sales pitch you don't often hear: Let us invest your money. You can count on a return of 3 percent, though there is a chance it will be less. But we can guarantee this return for 10 years.

Sure, the 12 percent returns of Bernard L. Madoff proved ephemeral and the financial crisis lowered investors' expectations. But 3 percent? Maybe less? That certainly seems to be a meager return,

particularly given the stock market's fast start this year.

Yet this was the pitch I heard when I met Jeff Maurer, chief executive of Evercore Wealth Management, and John Apruzzese, Evercore's chief investment officer. They formed the firm four years ago with several former executives from U.S. Trust. I joked with them that offering such measly returns did not seem to be a good way to win new business.

"We don't win every client we pitch," Mr. Apruzzese said.

It turns out, though, that these low returns do not come from poorly performing investments. The firm is simply being honest. That 3 percent return includes projections on performance of many types of investments but also assumptions on tax rates, inflation and fees — both theirs and those of the outside managers they use.

"One of our key principles was transparency on fees, which has hurt us," Mr. Maurer said. "Another was how we talked about what could happen in a downturn, which has also hurt us."

Mr. Maurer said his firm preferred to say that there was a chance your portfolio could go down 25 percent, instead of trying to attach a probability to its happening. Saying there was a 1 percent chance, he said, was misleading because the chance of a market collapse like the one in 2008 was small. But it happened nonetheless.

Fees, of course, are a constant source of friction in investing. If you are the type of person who believes it is impossible to get better than the market rate of return, then you probably believe that the lowest-fee index fund or exchange-traded fund is the way to go. On the other hand, if you are the type of person who believes that managers can get returns higher than the market average, you may be willing to pay higher fees, calculating that the net return will be better or at least the swings in the investments' value will be less volatile.

What piqued my interest was that Mr. Maurer and Mr. Apruzzese made a point of disclosing all the charges, even the ones investors would not see. With that knowledge, investors could understand what those fees were doing to their portfolios' returns.

So I asked to come back and play a prospective client to see how they revealed the fees. For the record, I was not assessing the quality of their advice or their offerings but how they presented likely returns, warts and all.

Evercore manages \$4.7 billion and has an average account size of \$10 million, so the firm serves a rarefied niche. Most of its clients also have the bulk of their wealth in taxable accounts and not in tax-deferred retirement accounts, where the money is taxed only when it is taken out.

But regardless of their wealth, all investors would benefit from asking their advisers to subtract not just their management fees, as most already do, but the fees in the investments themselves. Investors would also benefit if their advisers factored in inflation and any probable taxes. At the very least, this would give a sense of the real return and help investors be more realistic.

For the purpose of the meeting, Mr. Maurer and Mr. Apruzzese created a fictional me who resembled a typical 40-year-old client of theirs. The fictional me began his career at a top-tier consulting firm and is now an executive at a financial firm. He earns \$500,000 a year with a \$500,000 bonus. He has company stock worth \$1.5 million with a lot of embedded capital gains and he inherited \$4 million in 2010. He has a \$500,000 mort-

gage on a \$2 million house. His goal is to retire at age 60.

Mr. Maurer said this typical client would probably arrive with over half of his \$10 million portfolio in cash and municipal bonds and another 20 percent in retirement accounts. Only about 10 percent would be invested in equities other than the company stock.

Mr. Apruzzese walked me through the six baskets the firm uses for thinking about how money is invested: cash, defensive assets (municipal and taxable bonds), credit strategies (high-yield bonds, mortgage-backed securities), diversified market strategies (commodities, foreign bonds, liquid alternative investments), growth assets (stocks) and illiquid alternatives (private equity, venture capital).

This was a fairly standard approach. Advisers generally aim to divide up a portfolio in ways that investors can understand, regardless of their level of financial sophistication. Another popular way is to put money into fictional buckets for specific needs, like current expenses or charity.

For me, the firm presented three investment options — capital preservation, balanced and capital appreciation, which could be translated as conservative, moderate and aggressive portfolios. Mixing the six baskets together for each objective generated pretax, after-fee returns of 6.1 percent, 7 percent and 8.2 percent a year, with maximum losses of 15 percent, 25 percent and 35 percent, respectively. The projections were for the next decade.

I selected the balanced portfolio, and Mr. Apruzzese showed me how taxes reduced the solid 7 percent return to 5 percent, by factoring in long- and short-term capital gains at the highest federal rates. Inflation of 2 percent knocked it down to 3 percent. (The capital preservation portfolio fell to 2.3 percent, while the capital appreciation portfolio ended up at 3.9 percent.)

"When some people see that 3 percent return, we never hear from them again," Mr. Maurer said. "We have clients come in and say I was at X competitor and they said there were no fees. I say, 'O.K., but they're selling you all their own products and the fees are embedded in them.'"

But what about Evercore's fees? That came later, though Mr. Maurer said most clients did not focus on them the way I did. "It's about explaining what the fees are," he said. "We don't get a placement fee or any revenue sharing. We try to get

the lowest fees possible for that investment solution."

Like most wealth management firms, Evercore has a sliding fee scale for its advice — the more money you have, the lower the fee. On \$10 million, the management fee was 0.88 percent, though no fee was charged on the \$1.5 million in company stock. The firm manages municipal bonds and core equity portfolios itself but does not charge a fee on top of the management fee. This equated to \$76,250 a year to them.

On the \$4.5 million of the portfolio invested with outside managers, the fees were 1.03 percent or \$46,480. Many of those fees, though, would normally be deducted from the returns of the funds in a way that most investors would not notice. Mr. Apruzzese said calling attention to those fees was important.

In total, the fictional me paid 1.23 percent of the portfolio, or \$122,730, in annual fees.

"By expressing it in dollars, that makes a real impact on clients," Mr. Apruzzese said. "Most advisers talk in percentages or, worse, basis points, and no one knows what a basis point is."

Still, what I would have liked to see was a pre-fee return along with the returns before taxes and inflation. I asked why it was not presented this way. Mr. Apruzzese said it was because the firm showed clients returns that it expected would be lower than the actual returns. Those higher gains would then cover the fees. But he added that most clients — the kind of people who actually have the \$10 million I was pretending to have — preferred to talk about what they could do with their money and not be bogged down in the minutiae.

As a real-life example, he said that the \$800 million that the firm manages as a balanced portfolio had returned an average of 10.75 percent annually from February 2009 to March 2013. With several caveats for taxes, Mr. Apruzzese said that became 9.89 percent after fees, 8.21 percent after taxes and 5.85 percent when the Consumer Price Index over that time was factored in.

Even though it was not my money, I felt disappointed. A solid double-digit return was whittled down to a decent single-digit one before my eyes. But with nearly half the gain consumed by fees, taxes and inflation, it was a reminder that all investors should be focused on the real return and forget about that dazzling headline number.