Quarterly Review and Outlook

July 2013

EQUITABLE Trust

Trustees and Investment Advisors

This Issue

"For every complex problem there is an answer that is clear, simple and wrong."

— H. L. Mencken

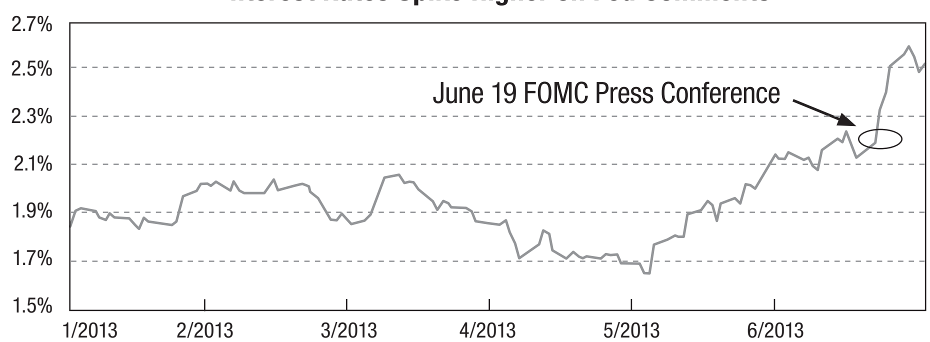
A Difficult Path to Normal

The non-U.S. stock markets of the world were solidly thrashed late in the second quarter, but three significant indicators rose: The S&P 500 Index, longer-term interest rates and the U.S. dollar. Below, we will show why we believe these moves are interrelated.

For the three months ended in June, the S&P 500 Index returned 2.9% while the MSCI All Country World Index was flat. Developed markets outside the U.S. lost nearly 1% and emerging markets shed more than 8%. No refuge was found in the bond market as the Barclays Aggregate Index lost 2.3%. Gold lost 25% during the quarter.

The slide wasn't caused by economic reports, which were largely positive. House prices continued to rebound. Household assets and net worth reached record highs. Even the Federal fiscal deficit declined more than expected. Improved financial performances from municipalities and U.S. corporations have enhanced the creditworthiness of municipal and corporate bonds. Instead, we believe that Ben Bernanke, Chairman of the Federal Reserve, should take some credit for introducing the word "taper" in his testimony before Congress (see chart below).

Interest Rates Spike Higher on Fed Comments



Data as of 6/30/13. Source: Board of Governors of the Federal Reserve System.

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A Difficult Path ... *(continued)*

Tapering, which he described as taking one's foot off the gas rather than hitting the brakes, was clearly (but perhaps, incorrectly) interpreted by the markets as putting an end to the policies which had led to such strong market performances over the last four years.

Interest rates shot up on Treasuries and on mortgages. Higher rates in the U.S. markets caused global fixed income investors to pile on, driving the U.S. dollar sharply higher. Also noteworthy, the Bank of Japan said it would not expand its quantitative easing program. These developments triggered a general unwinding of the "carry trade," in which investors (mostly short-term traders and hedge funds) borrow the currencies of countries with low-yielding debt and/or depreciating currencies and invest in higher yielding/appreciating currency investments, such as emerging-markets local-currency bonds. As the carry trade unwinds, prices on emerging-markets bonds and stocks drop, yields rise and emerging-market currencies depreciate against the dollar. Thus, emerging-markets local-currency bonds and stocks are being hit with the double whammy of falling security prices and falling currencies. These trends have also pressured commodity prices.

Investors are also fretting about the pace of growth in China. There is concern that the People's Bank of China might be too successful in reining in excess credit growth there.

We believe the markets have overreacted to all of these developments, and we have not materially changed our longer-term asset class views or risk assessments. For the most part, we were ready for the second quarter. We have much lower exposure to bonds than normal, and what fixed income exposure we have is focused on shorter duration, high yield and absolute return-oriented bond investments. Our current equity allocation favors the U.S. over foreign markets.

After all, we are not surprised that with economic growth, monetary policy eventually needs to return to normal. That means interest rates should move higher over time. Normalcy means that valuations should also move eventually toward their long-term averages. Developed and emerging-markets stocks were already priced well below their normal levels before the second quarter. These valuations are now even more interesting. We expect the market turbulence to continue this summer as investors adjust to new perceptions and if normal seasonal patterns prevail. With evidence of stabilizing currencies, interest rates and commodity prices, we would entertain opportunities to build on positions in developed and emerging-market stocks and bonds.

With the modest recovery in the U.S. and recent poor performance of nearly every investment other than U.S. equities, it's natural to question the benefits of diversification beyond just the U.S. market. We observe that poorly diversified portfolios or asset allocations that are structured to perform well in only one scenario have often led to increased volatility and risk of loss. We diversify into bonds, alternative strategies, developed and emerging-market stocks as well as U.S. equities. Uncertainties in global fiscal and monetary policy lead us to construct diversified portfolios to meet our clients' goals over the long term without being overly dependent on any single, unpredictable outcome.

Market Diary Period Ending June 30, 2013

	CLOSE	RATES OF RETURN				
Equities	**6/30/13**	**Last 3 Mo.**	**YTD**	**1 year**	**3 years**	**5 years**
Global Stock Market (MSCI All Country World)	631.84	-0.23	6.38	17.21	12.96	2.86
U.S. Stock Market (S&P 500)	1606.28	2.91	13.82	20.60	18.45	7.01
U.S. Mid-Cap Stocks (Russell Mid-Cap)	7844.64	2.21	15.45	25.41	19.53	8.28
U.S. Small-Cap Stocks (Russell 2000)	4521.24	3.08	15.86	24.21	18.67	8.77
International Stocks (MSCI EAFE)	5681.14	-0.73	4.47	19.14	10.55	-0.16
Emerging-Markets Stocks (MSCI Emerging Markets)	1813.50	-7.95	-9.40	3.23	3.72	-0.11
Alternatives	**6/30/13**	**Last 3 Mo.**	**YTD**	**1 year**	**3 years**	**5 years**
Hedge Funds (HFRI Equity Hedge Total)	16271.35	0.70	6.50	12.80	7.90	5.10
SPDR Gold Trust (ETF)	119.11	-25.50	-28.52	-25.73	-1.81	4.67
Crude Oil (West Texas Intermediate)	96.95	-0.30	5.58	14.01	8.65	-7.08
Real Estate (Dow Jones REIT)	6662.65	-1.29	5.65	7.69	18.08	6.97
Commodities (Dow Jones UBS Commodity)	250.54	-9.45	-10.47	-8.01	-0.26	-11.61
Fixed Income		**Last 3 Mo.**	**YTD**	**1 year**	**3 years**	**5 years**
Barclays 1-10 Year Muni Blend Bond Index		-1.83	-1.34	0.34	3.36	4.60
Lipper High Yield Bond Index		-1.30	1.70	9.80	10.20	8.50
Barclays Aggregate Bond Index		-2.32	-2.44	-0.69	3.51	5.19
Barclays Global Aggregate ex US Bond Index		-3.08	-6.48	-3.40	3.57	2.65

Rates of Return for periods longer than 12 months are annualized. Data provided by The Chart Store, Morningstar and Investment Scorecard.

Terminology of Trusts

You may be familiar with the general benefits of trust ownership and management of family assets; however the terms used by planners to refer to particular types of trusts can be confusing. With that thought in mind, we have described some trust names that you may have encountered. Some of these trusts may precisely address your family circumstances.

Living (Revocable) Trust – A personal trust that you establish for yourself during your lifetime to provide continuity of asset management and support in the event of your disability as well as more privacy in the settlement of your estate.

Marital Trust – A marital trust may take one of many different forms, but generally these trusts are designed to take advantage of the deduction against estate tax that is available for transfers between spouses. The spouse is the only beneficiary of a marital trust for his or her lifetime. However, a marital trust can be structured so that upon the death of the beneficiary spouse, the grantor spouse directs the remaining balance of the assets to whomever he or she names in the document.

Credit (Bypass) Trust – These terms refer to a trust created upon the death of one spouse to be funded

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Terminology ... *(continued)*

with the maximum amount available as an exemption against estate taxes. The trust may benefit the surviving spouse (and the entire family) during the surviving spouse's lifetime, but upon the surviving spouse's death, the assets in this trust "bypass" inclusion in the surviving spouse's taxable estate.

Asset Protection Trust – This is a relatively new type of trust in the U.S. but is not available in every state. It is available in Tennessee, but the rules must be carefully followed. The intent of this trust is to protect assets from future creditors of the Grantor.

Community Property Trust – This is another new trust now available in Tennessee. It is designed to provide income and the advantages of estate tax characteristics of community property ownership to the Grantor of the trust.

Generation Skipping Trust – Some transfers to younger generations may incur a separate type of tax appropriately called "generation skipping tax" (GST). Thoughtful planning may enable you to pass considerable assets through several generations without incurring GST.

Charitable Trust – These trusts, frequently identified by the acronyms CRAT, CRUT, CLAT or CLUT are typically designed to benefit a charity and the grantor's family, and in doing so reap certain tax benefits.

Special Needs Trust – This trust provides additional support to a disabled individual and coordinates with (rather than replaces) other benefits to which a disabled individual might otherwise be entitled to receive.

Of course, this only barely scratches the surface of trust structures and requires much more legal review by your estate planning attorney prior to implementation, but if any of the descriptions make you more curious, contact any of us at Equitable Trust.

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