Quarterly Review and Outlook

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EQUITABLE Trust

Trustees and Investment Advisors

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"This time,
like all times,
is a very good one,
if we but know
what to do with it."

— Ralph Waldo Emerson (1803-1882)

Stocks: The Cheapest House on an Expensive Street

While the last three months witnessed the usual ups and downs in the economy and the markets, the quarter will be remembered most for what happened at its end – Brexit, the British voters' decision to leave the European Union.

Markets around the world corrected sharply at the news, as the "remain" side had been widely expected to prevail. The negative initial reaction resulted from concerns that the vote cast doubt on the stability of the European Union and could lead to a contagious slowing of global economic growth. However, the U.K. represents just 4% of global GDP, and the ultimate outcome of the vote remains to be seen. It will take at least two years for Britain to negotiate a separation from the EU, but all parties obviously have a strong interest in coming to a reasonable agreement. As market participants digested this news over the ensuing week, the global stock market had recovered to near pre-vote levels, and the S&P 500 Index had approached all-time highs. (See the charts below and on next page.)

The Bank of England proactively cut interest rates, leading other countries to follow suit. Increased demand for relatively higher-yielding U.S. fixed income securities caused domestic bond prices to rise and yields to fall, even without Fed action. The futures markets in the U.S. indicate that the Fed Funds rate is now much less likely to be raised in 2016 and even opens the possibility of a cut. Thus, the theme of lower rates for longer continues.

MSCI ACWI Index

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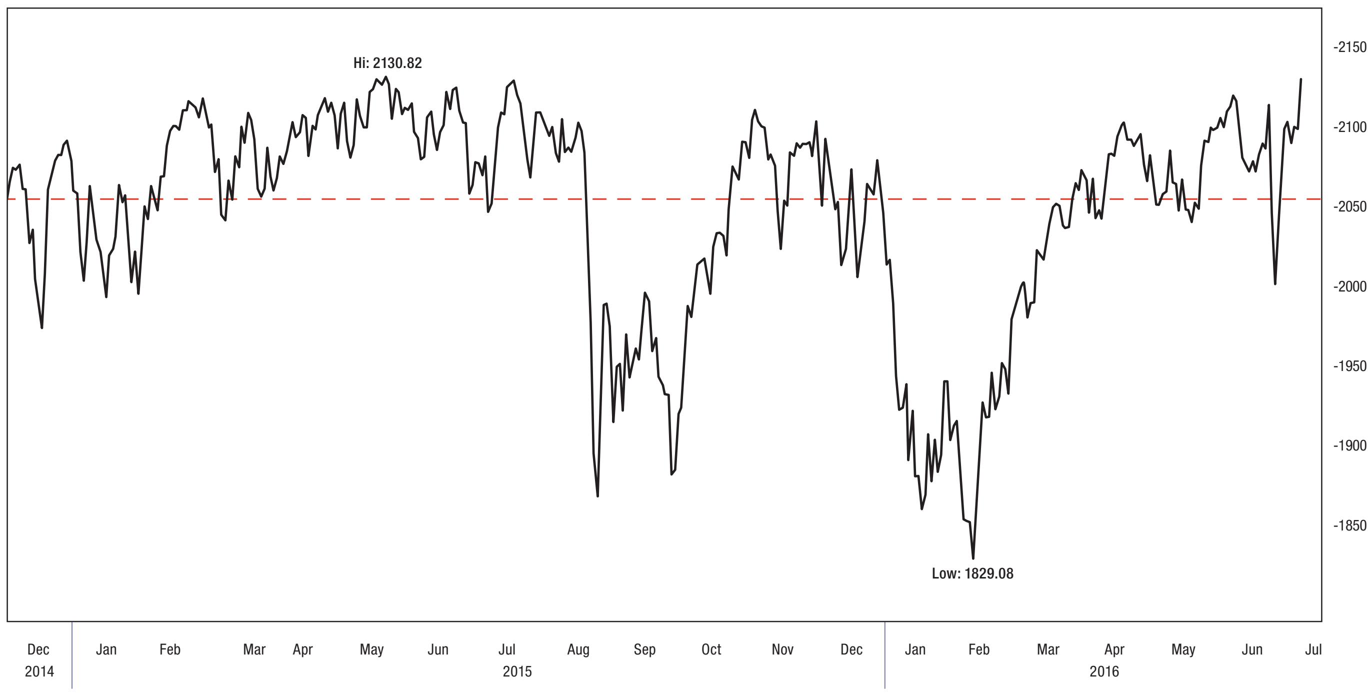
S&P Index



Source: © 2016 Bloomberg Finance L.P.

Equity analysts everywhere are adjusting the earnings models for the stocks they follow. For the most part, these adjustments are relatively minor except with companies focused on the U.K. home market. These revaluations are likely to lead to more volatility over the next few weeks, which can in turn create favorable investment opportunities.

Meanwhile in the U.S., Hillary Clinton and Donald Trump locked up the nominations of their respective parties earlier in the quarter. Even here uncertainty remains as both candidates sport remarkably high "unfavorable" poll ratings with voters, increasing the likelihood of reduced voter turnout on Election Day or increased interest in third-party candidates. Political uncertainties usually abound in the third quarter of any presidential election year and cause consternation in the markets. This year will almost certainly not be an exception.

Economic data in the U.S. continue to show a very slow but steady expansion. Unemployment remains low as the labor participation rate has remained under pressure, and overall demand for labor is muted. As a result, wages are fairly stagnant. Consumer spending appears to be leveling off, and sales growth for most publicly-traded companies is harder to come by.

Earnings growth in the main stock indices has been hard to achieve, since earnings from the Energy sector are expected to be spectacularly negative until next year. Profit margins in most sectors are already high by historical standards. These facts have contributed to the flat returns in the U.S. equity markets over the past 18 months.

With very low yields on both cash and bonds, our return expectations for them are very modest for the remainder of the year. We are overweight equities despite our longer-term concerns about the consumer, sales growth and profit margins. With continued economic growth, a friendly Fed, shares breaking out to new highs in the U.S. after the Brexit overreaction and the lack of viable alternatives offered by cash or bonds, the weight of the evidence remains bullish for stocks.

We continue to position portfolios so that they will be resilient across a variety of scenarios, including periods of increased volatility. While uncertainty and sharp reversals are inevitable and unpleasant aspects of investing, we emphasize that the discipline to weather storms and to stay focused on the long-term drivers of investment performance is especially important at times like these.

Market Diary Period Ending June 30, 2016

	RATES OF RETURN					
Equities	**Last 3 Mo.**	**YTD**	**1 year**	**3 years**	**5 years**	**10 years**
Global Stock Market (MSCI All Country World)	1.17	1.57	-3.14	6.64	5.98	4.86
U.S. Stock Market (S&P 500)	2.46	3.84	3.98	11.64	12.08	7.42
U.S. Small-Cap Stocks (Russell 2000)	3.79	2.21	-6.74	7.08	8.35	6.18
International Stocks (MSCI EAFE)	-1.23	-4.04	-9.64	2.66	2.25	2.15
Emerging Markets Stocks (MSCI Emerging Markets)	0.78	6.52	-11.75	-1.24	-3.46	3.87
Alternatives	**Last 3 Mo.**	**YTD**	**1 year**	**3 years**	**5 years**	**10 years**
Hedge Funds (HFRX Global Hedge Fund)	1.10	-0.80	-5.60	-0.60	-0.50	-0.30
Global Real Estate (FTSE/EPRA NAREIT)	3.57	8.83	10.49	7.87	7.70	4.72
Commodities (Bloomberg Commodity)	12.78	13.25	-13.32	-10.55	-10.82	-5.59
Energy (Bloomberg Commodity - Energy)	20.35	9.14	-34.48	-24.25	-19.87	-19.02
Gold (Gold Spot)	7.00	24.56	12.70	2.57	-2.55	7.92
Fixed Income	**Last 3 Mo.**	**YTD**	**1 year**	**3 years**	**5 years**	**10 years**
Barclays Aggregate	2.21	5.31	6.00	4.06	3.76	5.13
Barclays Municipals	2.61	4.33	7.65	5.58	5.33	5.13
Barclays High Yield	5.52	9.06	1.65	4.20	5.84	7.61

Rates of Return for periods longer than 12 months are annualized. Data is provided by Northern Trust and Hedge Fund Research.

Trusts And Divorce

The subject of divorce is never comfortable or pleasant. However, like many of the issues of prudent planning (including our own mortality), consideration of the uncomfortable is part of the planner's responsibility. Trusts can play an important role toward solving some of the problems that arise during the process of addressing the unfortunate event of divorce proceedings.

As we have mentioned several times in past articles, Tennessee is a particularly flexible planning jurisdiction. Most, but not all, states are either a community property state or an equitable distribution state for determining property rights between divorcing spouses. With respect to marital rights, a Tennessee resident may create a trust subject to the traditional common law of the state known as "equitable distribution" or we may intentionally create a community property trust with our spouse. Not all of the important differences may be addressed in a single article, but it is important to know that this option exists. The community property trust option may provide significant income tax and other advantages, but this option also carries ownership differences that should be carefully considered. These differences are also significant in the context of a divorce. Depending upon the circumstances, the assets of a trust that is not a community property trust might be separate property or marital property. On the other hand, both spouses always have rights to assets in a community property trust. Essentially, upon death, the surviving spouse and the deceased spouse's estate each own one-half of the assets in the community property trust.

Most trusts that are created by senior family members to benefit succeeding generations provide for the members of the family tree. They certainly may, but often are not intended to, benefit the spouse — especially the divorced

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spouse — of a child or grandchild. The issue in Tennessee for such a trust is whether the assets of the trust represent marital or separate property. Usually, the assets of an irrevocable or testamentary trust for descendants are separate property – at least initially. However, a court may determine that the assets are marital property, and thus subject to division in a divorce, based on a number of factors. These include the terms of the trust, the power(s) of the spouse to demand assets from the trust, or, if one divorcing spouse is the trustee, the abuse of the discretion of the trustee. For example, in one equitable distribution case a court decided that because a spouse had used the assets in the trust to purchase vacation homes for himself, the trust was not insulated from the claims of his spouse. It is likely that independent administration by a professional fiduciary would have made a significant difference in that case.

Finally, a less common relationship between divorce and trusts may exist in the use of trusts to implement a program of asset division and structured payments following the divorce. Proper use of trusts in the divorce settlement context may provide many advantages that are otherwise difficult to obtain. A trust structure may be used to allocate value and still protect ownership in a closely held family business. A trust may be used to protect against loss of resources due to the death of a spouse, especially when life insurance is not an acceptable option for some reason. A trust may provide protection from subsequent financial insolvency or bankruptcy. Of course, trusts in this context can also provide the usual benefits of trusts such as gift and generation-skipping tax savings, as well as professional asset management.

Even though divorce is not a driving force in most planning situations, it is an unfortunate and often very costly reality in today's world that may be ignored only at one's peril. Of course, the most dire consequences of divorce are not financial at all, but if the financial issues can be addressed in a structured and less emotional environment, they will, at least, not contribute to other difficult issues.

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