Quarterly Review and Outlook

October 2015

EQUITABLE Trust

Trustees and Investment Advisors

> *"Loyalty to country ALWAYS. Loyalty to government, when it deserves it."*
>
> *— Mark Twain*

What Goes Up, Can Come Down

The third quarter brought the first 10% correction to the U.S. stock market in nearly four years, something which normally occurs about once each year. The move coincided with the Greek bailout referendum, major market gyrations in China, a large drop in the price of oil and the Fed's reluctance to normalize interest rates.

The S&P 500 Index has seen 10% or larger corrections 52 times since the end of World War II. Such pullbacks are not unusual, and investors can expect to experience these drops repeatedly over their lifetimes. Knowledge of market history and cycles is useful for putting the present moment into context and thinking through potential scenarios, risks and investment opportunities.

Some 10% corrections become 20% bear markets; however, most don't. How do we cope with the uncertainty about current experience? If the U.S. and the rest of the globe avoid recession, chances are good that this correction will be limited. The global economy is seeing modest growth. Central banks' monetary policies are accommodative. Low-energy prices are helping consumer spending and are boosting most businesses' profits. In short, a global recession is not our base case.

These facts lead us to believe that the market's retreat is only a correction. Consequently, we are using this setback as an opportunity to put cash to work and to upgrade portfolios, by which we mean to sell legacy positions at smaller gains than we would have just a few months ago and reinvest the proceeds in equities with better long-term potential.

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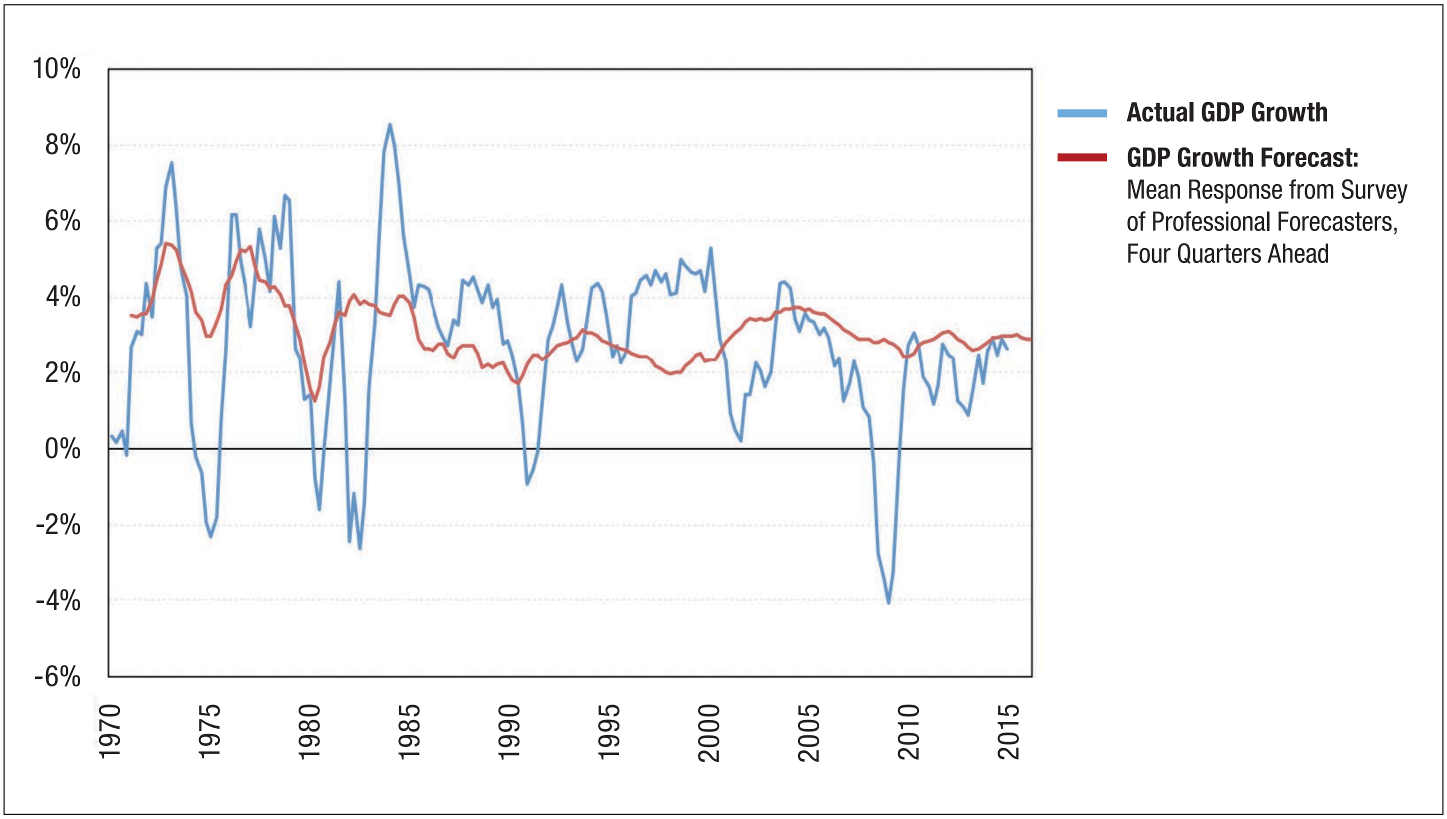
What Goes Up ... *(continued)*

One risk to this approach is that a recession could begin unexpectedly. Economists are not very good at predicting them. (See chart below).

Professional Forecasters are Notoriously Bad at Predicting Recessions



Source: © 2015 Lipman Gregory. U.S. Bureau of Economic Analysis/Federal Reserve Bank of Philadelphia. Data as of 8/14/2015.

Other risks include a loss of confidence in the Federal Reserve's zero interest rate policy and flare-ups of tensions in Afghanistan, Iraq and Syria or with Russia or China. We constantly monitor these risks along with energy markets and economic data to confirm or adjust our outlook.

The significant changes in the markets in the third quarter haven't caused us to change our investment allocation targets. We still think cash should be put to work productively. Bonds are still projected to offer lower-than-average returns as interest rates will rise eventually. Equities and other risk assets have been marked down so that they are better values with less downside than they had previously and more upside, hence, more attractive for long-term investment.

The world is an uncertain place. The role of financial markets is to reflect new developments — both positive and negative — in security prices as quickly as possible. Investors who accept dramatic price fluctuations as a characteristic of liquid markets may have the distinct advantage over those who are easily frightened or confused by day-to-day events and are more likely to achieve long-run investing success.

Market Diary Period Ending September 30, 2015

	RATES OF RETURN					
Equities	**Last 3 Mo.**	**YTD**	**1 year**	**3 years**	**5 years**	**10 years**
Global Stock Market (MSCI All Country World)	-8.32	-5.60	-4.51	9.28	8.99	5.44
U.S. Stock Market (S&P 500)	-6.44	-5.29	-0.62	12.39	13.32	6.80
U.S. Small-Cap Stocks (Russell 2000)	-11.92	-7.73	1.25	11.03	11.74	6.53
International Stocks (MSCI EAFE)	-10.16	-4.83	-8.11	6.29	4.64	3.67
Emerging Markets Stocks (MSCI Emerging Markets)	-17.79	-15.27	-19.00	-4.96	-3.25	4.59
Alternatives	**Last 3 Mo.**	**YTD**	**1 year**	**3 years**	**5 years**	**10 years**
Hedge Funds (HFRX Global Hedge Fund)	-4.30	-3.00	-4.70	1.20	0.00	0.20
Global Real Estate (FTSE/EPRA NAREIT)	-3.18	-5.03	1.66	5.80	7.00	5.15
Commodities (Bloomberg Commodity)	-14.47	-15.80	-25.99	-16.02	-8.88	-5.67
Energy (Bloomberg Commodity - Energy)	-22.34	-20.92	-49.84	-21.81	-16.03	-20.59
Gold (Gold Spot)	-4.80	-5.79	-7.85	-14.26	-3.13	9.05
Fixed Income	**Last 3 Mo.**	**YTD**	**1 year**	**3 years**	**5 years**	**10 years**
Barclays Aggregate	1.23	1.13	2.94	1.71	3.10	4.64
Barclays Municipals	1.65	1.77	3.16	2.88	4.14	4.64
Barclays High Yield	-4.83	-2.43	-3.40	3.52	6.14	7.26

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

Trust Me, Baby

The first time I recall learning about an Incentive Trust was in November, 1999 in a Wall Street Journal article entitled *Trust Me, Baby: Heirs Meet "Incentive" Arrangements*. The article included interviews with affluent parents and advisors to affluent families about how trusts could be established to protect wealth, avoid abuses of inheritance, promote success within a family and reinforce a family's values. Well, exactly half of those trust objectives were familiar to me. At the time, the most creative of trusts provided for distributions based upon a beneficiary's health, maintenance, education and accustomed standard of living or dissolution at a certain age. Using a trust to promote success within a family and to reinforce a family's values was a new and exciting concept. The article impressed upon me the broad opportunity for a trust document to include terms intended to promote any number of objectives and values or discourage certain behaviors by using distributions of the trust as an incentive.

Typical incentive trusts encourage a beneficiary to pursue education, promote a healthy lifestyle, pursue business opportunities or develop a lifestyle of "giving back." A benefactor can tie the transfer of wealth to descendants' acceptance of the benefactor's core values, reward achievement, mentor after death by passing along important life lessons or cater to the needs or propensities of a single beneficiary. The options are endless if you can verbalize a goal, a trust can be structured to promote that goal.

Below are examples of the more typical incentive trust language:

Upon attainment of a bachelor's degree in a subject which the trustee, in the trustee's discretion, deems reasonably likely to prepare the beneficiary for financial self-sufficiency, the trustee will write a check for the equivalent amount of the four-year tuition plus 20%

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bonus for above average-performance. Individuals who place a high value on education may consider payouts for the completion of advanced degrees.

Upon presentment of a W-2, 1099 or other similar documentation, the trustee can match the amount of income reported up to $50,000. The trust can include provisions that reward beneficiaries for maintaining gainful employment, entering a profession or for assuming important responsibilities in a family business. Billionaire Warren Buffett was famously quoted in Fortune magazine as saying that "the perfect amount to leave to [one's] children is "enough money so that they would feel they could do anything, but not so much that they could do nothing." But, keep in mind that requiring gainful employment could punish stay-at-home parents who are living responsibly and raising their children.

If the trustee believes that any beneficiary may have substance abuse problems, we request that the trustee limit distributions to those deemed necessary for basic living requirements, and to the extent practical, make payments directly to providers rather than making distributions to the beneficiary. The trust can promote a healthy lifestyle by restricting distributions if the beneficiary indulges in destructive behavior. The trust can cover the cost of rehabilitation and restrict distributions if a beneficiary does not complete a rehabilitation program. The trust can also require random testing.

The trustee may match a beneficiary's donations to public charities and community involvement.

As you see, trust documents can be written in such ways to cover issues beyond the basic needs of life and incorporate provisions to promote family values. Trust documents can also be drafted to address any number of specific concerns. I once read of a client whose child was killed in a car crash driving at excessive speed. Based upon the accident and his concern for the safety of his remaining children, the client included a term in his trust to pay each child $10,000 anually if the child did not incur a driving violation.

An incentive trust is a way to pass on more than money; you can pass on the ideals that are most important to you. The options are endless. Trust me, baby.

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