

### This Issue

- **Prospects for 2011;  
Moderately Bullish**  
*Edward A. Burgess, CFA  
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- **Market Diary**
- **2011 and 2012 Taxes**  
*W. Keith Keisling, JD  
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*“The hardest thing in the world to understand is the income tax.”*

— Albert Einstein

### *Moderately Bullish On Stocks for the Coming Year; Central Banks Indirectly Distort Markets*

The S&P 500 Index experienced its second consecutive double-digit positive quarterly return in the 4th quarter, up 10.8%. For the year, the stock market put in a respectable 15.1% showing, following a 26% return in 2009. Bonds experienced more muted results, with the 10-year Treasury returning -5.5% for the quarter and 8.3% for the year, including price change.

In evaluating the prospects for 2011, we discuss what has changed and what has stayed the same.

Factors continuing from 2010 into the new year:

- The Federal Reserve System and nearly all other central banks in the world are creating a great deal of money.
- Aggressive fiscal ease continues (governments at all levels and in most places are spending far more money than they are taking in).
- Stocks, the U.S. Dollar, precious metals and commodities are all still in technical uptrends.
- The stock market is still relatively expensive — 22 times 10-year average earnings vs. the long-term average of 16 times.
- Commodity inflation is rampant (see chart on next page).

What's new as 2010 concludes:

- Interest rates are rising worldwide.
- Housing prices are falling again.
- Bank failures in the U.S. are rising to their highest level in 18 years.

Unlike most pundits, we are only moderately bullish on stocks for the coming year. However, the trading levels we expect for the S&P 500 have shifted higher to a range of 1140 – 1440. That provides for about 14% of potential upside and about 10% of potential downside from current levels during the course of 2011. Most of those above-referenced pundits are extremely bearish on bonds. While we anticipate that conditions will be more difficult for investment-grade bonds this year because of rising interest rates and inflation expectations, we do not expect a major wave of municipal or corporate defaults in this country. However, there

## Equitable Trust Quarterly Review and Outlook

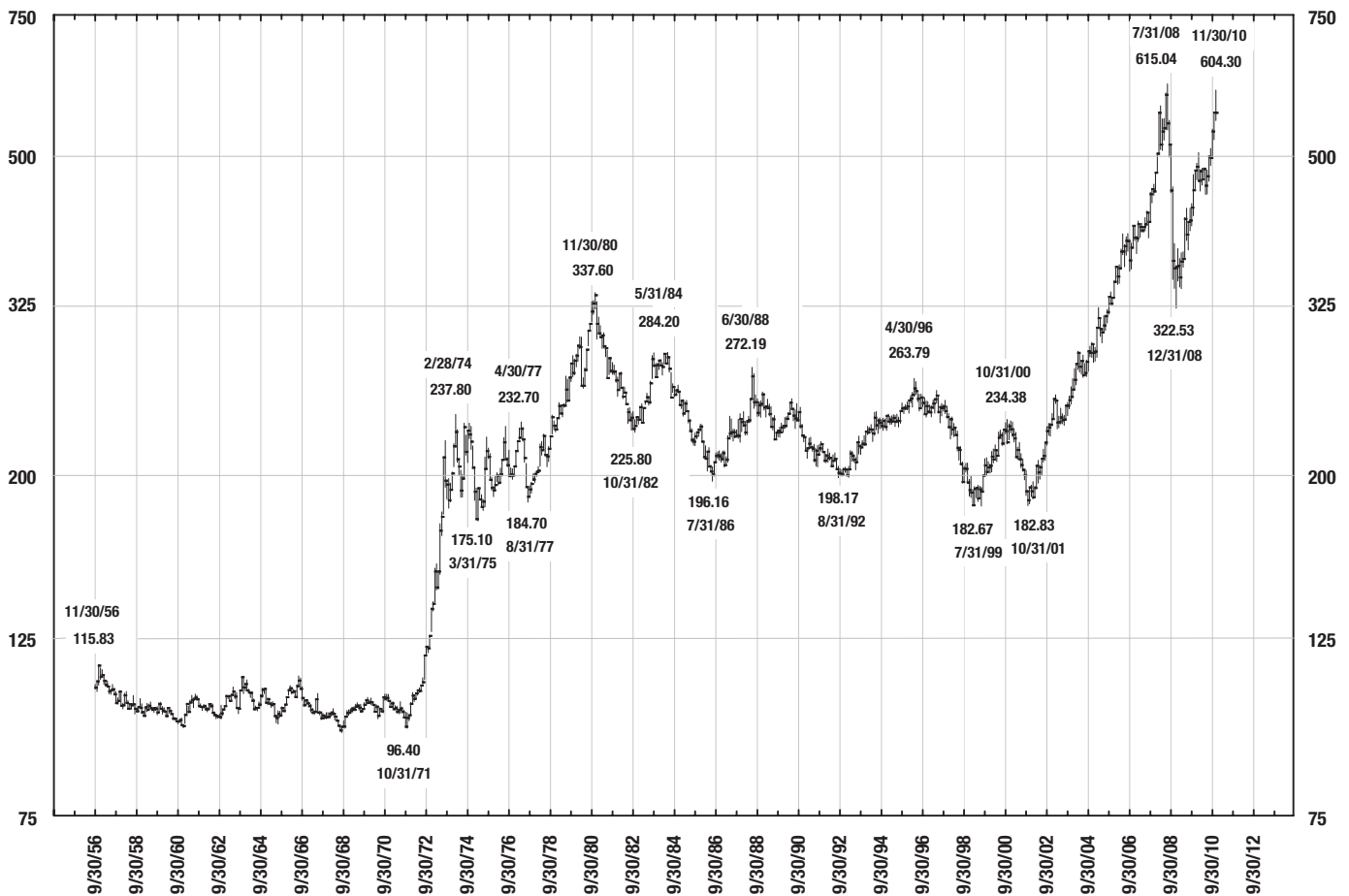
could be defaults (or close calls) in “private purpose municipal bonds” and some of Europe’s struggling economies.

The frustration for us is that we are used to watching various markets for clues about what will happen in the economy. This task presupposes that markets are free to reflect what market participants collectively think. However, as we enter the new year, we are forced to acknowledge that every market which matters is being directly manipulated or indirectly distorted by the Fed or a central bank elsewhere.

Under these circumstances, can we trust the markets to provide clues about the direction of corporate earnings and inflation?

This letter is, by its nature, our general take on the economy, markets and events and how they might affect investment portfolios. As always, your investment officer welcomes the opportunity to discuss specifically the management of your portfolio. Happy New Year!

**INFLATION**  
As measured by Reuters/CRB Continuous Futures Index – Monthly



**Market Diary** Period Ending December 31, 2010

	CLOSE	RATES OF RETURN				
Equities	12/31/10	Last 3 Mo.	YTD	1 year	3 years	5 years
U.S. Stock Market (S&P 500)	1257.64	10.76	15.06	15.06	-2.86	2.29
U.S. Mid-Cap Stocks (S&P 400 Mid-Cap)	907.25	13.50	26.64	26.64	3.52	5.73
U.S. Small-Cap Stocks (S&P 600 Small-Cap)	415.73	16.24	26.31	26.31	3.01	4.64
International Stocks (MSCI EAFE)	1658.30	6.23	4.90	4.90	-9.72	-0.26
Emerging Markets Stocks (MSCI Emerging Markets)	1151.39	7.05	16.36	16.36	-2.59	10.26
Alternatives	12/31/10	Last 3 Mo.	YTD	1 year	3 years	5 years
Gold (London Precious Metal Fix)	1405.50	7.54	29.24	29.24	19.01	22.33
Crude Oil (West Texas Intermediate)	91.38	14.27	15.15	15.15	-1.63	8.40
Real Estate (Dow Jones REIT)	176.47	6.31	21.41	21.41	-5.38	-3.18
Commodities (Dow Jones UBS Commodity)	460.36	18.94	26.40	26.40	8.25	12.79
	YIELDS					
Fixed Income	12/31/10	9/30/10	12/31/09	12/31/09	12/31/07	12/31/05
U.S. Treasury Bills 91 days	0.12	0.16	0.06	0.06	3.37	4.08
2 Year U.S. Treasury	0.61	0.42	1.14	1.14	3.05	4.41
10 Year U.S. Treasury	3.30	2.53	3.85	3.85	4.04	4.39
Investment Grade Taxable Bonds (Barclay's Aggregate)	2.97	2.56	3.68	3.68	4.90	5.08
10 Year AA Municipal Bonds (Moody's)	3.83	2.68	3.21	3.21	3.80	4.01

Rates of Return for Equities and Alternatives for periods longer than 12 months are annualized. Data provided by Bloomberg L.P., The Chart Store, Interactive Data Corp. and U.S. Treasury Department.

## *A Clearer Picture of the Tax Landscape 2011-2012. Good News for Estate Planning.*

After a year of tax uncertainty and confusion, Congress passed the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 (2010 Tax Relief Act) that not only reinstates the Bush tax cuts that were set to expire at year end but also provides additional tax incentives and favorable estate and gift tax provisions.

### Reinstated and New Tax Incentives

- Individual ordinary income tax rates remain unchanged
- As does the 15% maximum rate on long-term capital gains and qualified dividends
- Payroll tax cut (in 2011) of 2% on earned wages up to \$106,800
- Extension of Alternative Minimum Tax (AMT) benefits
- Tax-free distributions from IRAs (in 2011) of up to \$100,000 for charitable purposes if taxpayer is at least 70½
- Deduction of state and local general sales taxes

*(continued on back page)*

*Disclaimer: Any performance data quoted herein represents past performance, does not guarantee future results, nor can its accuracy be guaranteed. The commentary represents the opinions of Equitable Trust and is subject to change based on market and other conditions. These opinions are not intended to be a forecast of future events nor future results. Estate, trust and tax planning-related material is provided for discussion and information only. Competent legal and accounting advice should be acquired before adopting any of the strategies or approaches described. These materials are provided for informational purposes only.*

## *Investment Caution ... (continued)*

### Improved Provisions for Estate Planning, Including Lifetime Gifting

- \$5 million federal gift, estate and generation skipping transfer (GST) tax exemption per person (\$10 million for married couples)
- Reunification of the federal gift tax exemption with the federal estate tax exemption
- Full step-up in tax cost basis restored for assets in a decedent's estate

Now that we have a clearer picture of the tax landscape, at least for the next two years, it is important that clients review their wills and revisit estate plans to make necessary changes. We welcome the opportunity to assist you.

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