EQUITABLE Trust

Trustees and Investment Advisors

THIS ISSUE

"In the business world, the rearview mirror is always clearer than the windshield ."

– Warren Buffet

INDIAN SUMMER OR EARLY WINTER?

The summer months were generally kind to U.S. investors despite their reputation for "always" being down. Certainly, the news regarding the economy helped. Both consumer and business confidence surveys became even more bullish. Labor force participation leveled off after years of declines as new, and presumably younger, workers are entering the work force about as fast as others are retiring.

Last December's tax cuts deserve some credit as consumers have more after-tax dollars to spend. The "repatriation" piece of tax reform, allowing U.S. companies to bring back foreign profits at low tax rates, is widely perceived to be largely contributing to share buybacks. The reality is even better in that the hundreds of billions of dollars coming in are also being used to pay down corporate debt, fund pensions more fully and increase capital spending. All of these activities are likely to create long-term positives for equities.

Of course, the tax cuts, along with increases in defense and infrastructure spending, are contributing to massive deficits, leading to a rapid increase in federal debt. As interest rates rise, the share of the budget going to service that debt could exceed the defense budget as early as next year.

September 15 marked the 10-year anniversary of the Lehman Brothers bankruptcy, still the largest in American history. The Fed commemorated the occasion by raising the funds rate another 0.25%, as widely expected. Another hike is anticipated in December. The yield-curve is still positively-sloped, and the inflation-adjusted Fed funds rate is still close to zero.

The increase in yields means holding cash and bonds is more attractive than it has been and somewhat more competitive with the expected returns for stocks. The Fed has been transparent in its current plan to raise the funds rate another four times in 2019. The futures markets are indicating that two raises are more likely. This is probably the reason the stock market is handling the Fed's pronouncements well, so far.

The equity markets in the U.S. continue to impress with S&P 500 earnings growth up 26% in the first half from the previous year. Foreign stocks have fallen further behind with recent dollar strength and trade war headlines in the news. The gap in performance should eventually close as foreign stocks are cheaper by most measures than domestic. Dollar weakness or commodity strength would also help close it.

More difficult earning comparisons and fewer share buybacks could cause earnings per share growth to slow meaningfully in 2019. However, the price earnings multiple on next year's earnings is running at about the long-term average of 16x.

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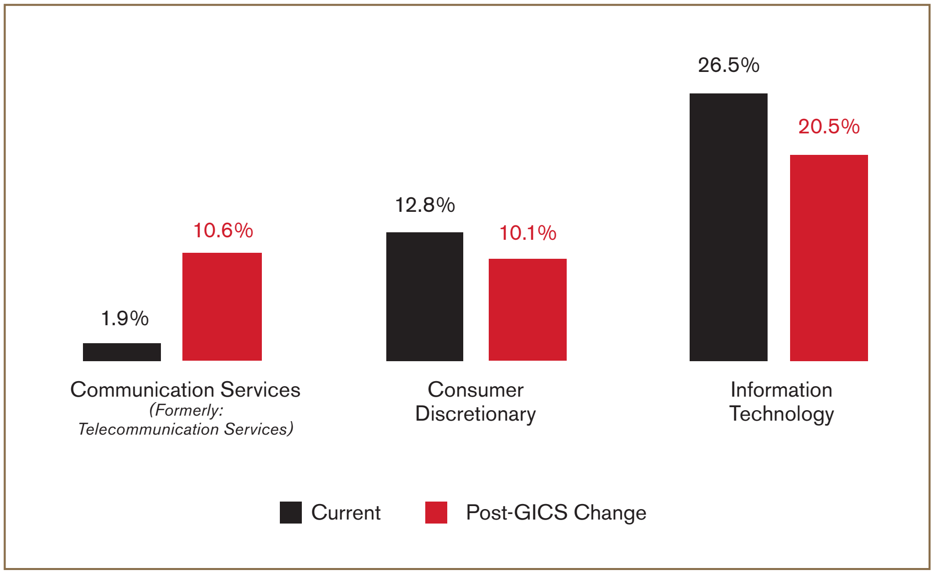
INDIAN SUMMER … *(continued)*

The Global Industry Classification Standard (GICS) is an industry taxonomy developed in 1999 by MSCI and S&P for use by the global financial community. At the end of the quarter, many widely-held common stocks were reclassified as the Telecommunications sector became much broader, now Communications Services. As a result, companies such as Alphabet, Facebook and Walt Disney joined the likes of AT&T. The changes also affected the Consumer Discretionary (e.g. Disney out and eBay in) and Information Technology (e.g. Alphabet and video games companies out) sectors whence these stocks were moved. Communications Services will have a much larger weight in the market indices than Telecommunications had, and Consumer Discretionary and Information Technology will have less. These changes were intended to make the classification system more rational in light of how companies have evolved.

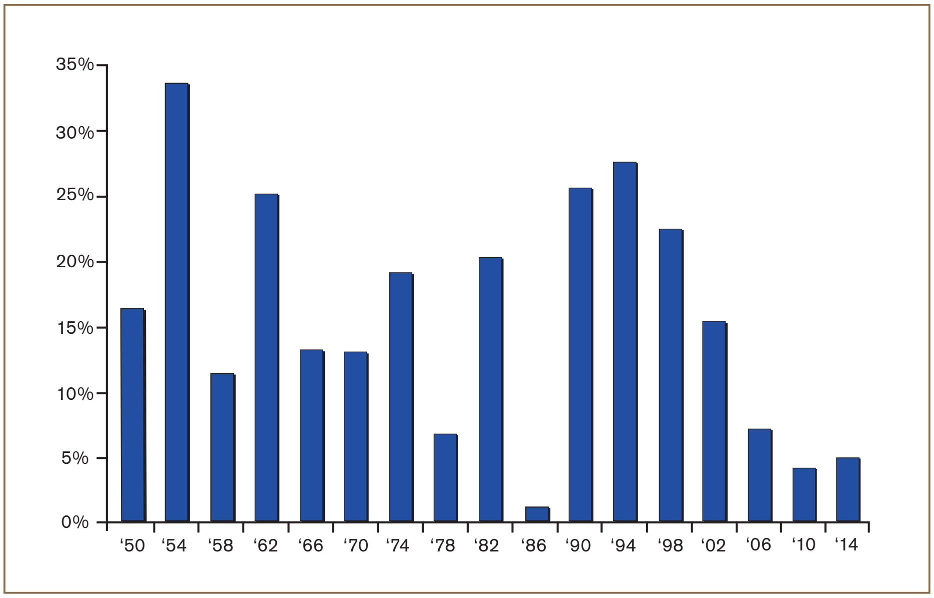
S&P 500 Sector Weights
Current vs. Post GICS Change



Source: Strategas Research Partners

Much ink has been spilled over the mid-term elections next month. As of this writing, it appears the Republicans will retain the Senate while Democrats re-take the House of Representatives. Such an outcome would probably not lead to major policy shifts. We also point out that the S&P 500 has not declined in the 12 months following a mid-term election since before 1950 (see below).

S&P 500 Price Return
12 Month Period Following Mid-Term Election – 1950 - 2014 VG = 15.3 Pct.



Source: Strategas Research Partners

As we look ahead, there is always the possibility of a stock market correction. This is especially true if the Fed takes the position that it will raise rates "until something breaks." However, in the absence of a recession, we do not foresee a bear market. As always, your Investment Officer is ready to address your questions about our views and how they apply to achieving your long-term investment goals.

Market Diary Period Ending September 30, 2018

RATES OF RETURN

FIXED INCOME	Last 3 Mo.	YTD	1 year	3 years	5 years	10 years
90 Day U.S. Treasury Bills	0.5%	1.3%	1.7%	0.9%	0.5%	0.3%
Barclays Aggregate	0.1%	-1.6%	-1.2%	1.3%	2.2%	3.7%
Barclays Municipals	0.0%	0.0%	-0.2%	1.4%	2.2%	3.4%
Barclays High Yield	2.5%	2.6%	3.1%	8.1%	5.5%	9.2%
EQUITIES	**Last 3 Mo.**	**YTD**	**1 year**	**3 years**	**5 years**	**10 years**
Global Stock Market (MSCI All Country World)	5.0%	3.8%	10.3%	13.9%	8.5%	7.6%
U.S. Stock Market (S&P 500)	7.8%	10.6%	18.4%	18.1%	13.8%	11.5%
U.S. Mid-Cap Stocks (S&P 400)	3.9%	7.5%	14.4%	16.1%	11.9%	12.1%
U.S. Small-Cap Stocks (S&P 600)	4.4%	14.5%	19.4%	19.7%	13.4%	12.5%
International Stocks (MSCI AC World ex US)	2.1%	-3.1%	2.3%	10.2%	3.9%	4.5%
ALTERNATIVES	**Last 3 Mo.**	**YTD**	**1 year**	**3 years**	**5 years**	**10 years**
Hedge Funds (Wilshire Liquid Alternatives)	1.0%	-0.6%	1.0%	1.9%	1.5%	1.5%
Commodities (Bloomberg Commodity)	-1.8%	-3.4%	0.7%	-0.8%	-7.8%	-7.0%
Gold (S&P GSCI Gold Total Return)	-4.7%	-9.4%	-7.9%	1.0%	-2.9%	3.4%

Rates of Return for periods longer than 12 months are annualized. Data is provided by Black Diamond.

BASIS LOADED: INCREASED FEDERAL ESTATE TAX EXEMPTIONS USHER IN NEW PLANNING STRATEGIES

Throughout the late 20th and early 21st centuries, estate planners and practitioners have endured a reactionary, and increasingly quixotic, task of continually revisiting strategies in order to keep up with ever-changing federal tax laws, rules and policies. In 2012 and again in 2017, planners endured months of speculation and political uncertainty, eventually being left with new paradigms to renegotiate for their clients.

To illustrate the significance of recent changes: As recently as 2008, a married couple with a net-worth of $20 million was at risk of paying as much as $8.1 million in federal estate taxes without proper estate planning. Today, in 2018, with federal estate and gift tax exemptions set at $11.18 million per individual ($22.36 million per married couple), a similarly situated couple would owe nothing.

With so few now at risk for federal transfer taxes, is estate tax planning even necessary? Are estate and gift tax planners slowly going the way of the milkman and the Blockbuster Video clerk to the occupational graveyard? This is probably not a reasonable conclusion, as the current large exemptions are set to expire on December 31, 2025. There is clearly ongoing uncertainty on the horizon.

In the meantime, as current estate and gift tax exemptions have rendered transfer taxes meaningless to a significant majority of the population, other *income* tax planning opportunities have taken a newfound importance via an unheralded provision of the tax code that has remained relatively unaffected since 1980.

Section 1014 of the Internal Revenue Code describes the rules governing the income tax basis of property acquired from a decedent's estate. Very generally, with caveats and exceptions, the cost basis of appreciated property acquired from a decedent is "stepped-up" in the hands of the person acquiring the property and becomes equal to the value of the property as of the decedent's date of death. This stepped-up basis reduces or eliminates the capital gains tax on the appreciated value of the property during the decedent's lifetime that would otherwise be realized by the new owner upon sale.

While the primary goal of estate tax planning has traditionally been to reduce the size of a client's taxable estate, strategies in recent years have attempted, somewhat counter-intuitively, to increase the size of the taxable estate (up to maximum

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exemption levels) to fully optimize this step-up in cost basis for succeeding generations.

Among the strategies being used in this new world of basis planning are:

Upstream Gifting. An individual may gift an asset to a parent (or another person with a shorter life-expectancy than the donor), with the understanding that the parent/donee will in turn leave the asset to the child/donor at death. The Internal Revenue Code requires that the donee survive the gift by at least one year after receipt of the gifted property. This is intended to prevent a step-up for deathbed gifts.

Trust General Power of Appointment Formula Clauses. With ongoing uncertainty as to the future of estate and gift tax exemption levels, many practitioners now favor a flexible general power of appointment funding formula for trusts, which has also been referred to as an "Optimal Basis Increase Trust," or OBIT. The OBIT includes a trust funding formula that allows for only so much of a deceased beneficiary's interest in the trust assets not subject to estate taxes to be includable in the decedent's taxable estate by virtue of allowing the trust beneficiary to appoint the assets to his or her estate and/or creditors. Assets in the taxable estate in excess of exemption levels are not subject to the general power and may pass outside the beneficiary's taxable estate. The assets subject to the general power would receive a "free" step-up in basis within the trust for the remainder beneficiaries.

Modification of Existing Trusts for Estate Inclusion. Existing trusts that were created and funded when estate tax exemptions were lower may no longer achieve the tax benefits originally desired, and it may be advantageous for trust assets to be includable in the trust beneficiary's estate to allow for a basis step up in appreciated property. In certain circumstances, existing irrevocable trusts may be modified under Tennessee statute to provide for the trust assets to be includable in the taxable estate of the beneficiary, at least if the increased exemption remains available at that time.

In conclusion, there remain a number of opportunities to reduce tax liability by obtaining expert estate planning advice, even for individuals and couples whose net worth does not exceed the current estate tax exemption levels. Our professionals at Equitable Trust are happy to work with you and your attorney to review current tax laws, rules and policies, and to assist in the implementation of these and other tax mitigation techniques, tailored to individual circumstances.

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