EQUITABLE Trust

Trustees and Investment Advisors

THIS ISSUE

"You make most of your money in a bear market, you just don't know it at the time."

– Shelby Cullom Davis
1909-1994

THE BEAR IS BACK

A decade of consecutive positive annual returns for the S&P 500 ended in 2018. The index recorded its first annual loss (4.4%) since 2008, its worst quarterly performance (-13.5%) in seven years and its worst December since 1931. The benchmark declined approximately 20% from its September peak, meeting the standard industry definition of a bear market.

Foreign equity markets suffered even more than domestic ones in 2018. China's economy and market struggled with prospects for slower growth and the ongoing trade dispute with the United States. Emerging markets, whose fortunes are closely linked to China's, struggled as well. U.S.-based investors in international stocks also faced the headwind of a strong U.S. dollar for much of the year.

While the mid-term election and trade war rhetoric probably contributed, more fundamental factors also played significant roles in this bear market. Corporate earnings have become a concern. While most companies easily surpassed analyst expectations for the quarter, many bellwether companies "guided" expectations lower for this year. Multiple economic indicators including manufacturing surveys and the November jobs report missed consensus estimates. Adding to the distress, the Federal Reserve overlooked the stock market's gyrations and proceeded to increase the overnight borrowing rate for banks by 0.25% for the fourth time in 2018.

By quarter-end, the market seemed to regain its footing as the U.S. and China announced a "truce" in the trade war. Economic data were a little brighter, and expectations for the Fed to aggressively raise rates in 2019 faded.

This confluence of recent events and longer-term expectations led portions of the U.S. Treasury yield curve to "invert," a condition in which short-term yields are higher than long-term. Market bears cite the fact that every post-war recession was preceded by such an inverted yield curve. We would like to point out that this curve has also inverted at times without a recession following.

We expect volatility to continue in 2019. The length and depth of this bear market will be correlated to the economy. If there is no recession in 2019 (our base case), then the market should settle down and begin a new bull market in a matter of months. If a recession comes this year, the bear will no doubt be longer and deeper. In any case, bear markets do not last forever and historically have been good times for investors with long-term time horizons to buy equities.

There are bright spots, too. Cash yields now exceed expected inflation for the first time since the financial crisis of 2008. In the most recent *Institutional Investor* survey, bears outnumber bulls (a contrarian indicator) for the first time since 2016. There is growing consensus that the Fed will be much less aggressive in raising interest rates in 2019. The real rate (inflation-adjusted) on Fed Funds is just barely 0%. All recessions going back to 1970 were preceded by a real Fed Funds rate of 4% or higher (see chart on top of next page).

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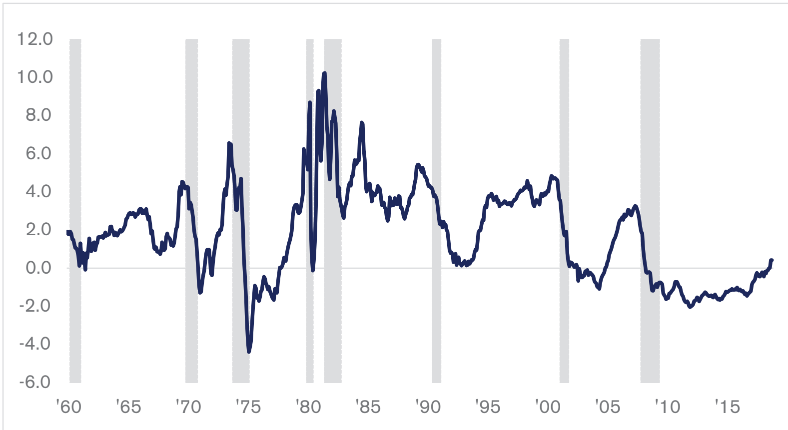
THE BEAR ... *(continued)*

U.S. Real Fed Funds Rate
(Effective Fed Funds Rate Less Core PCE Y/Y)

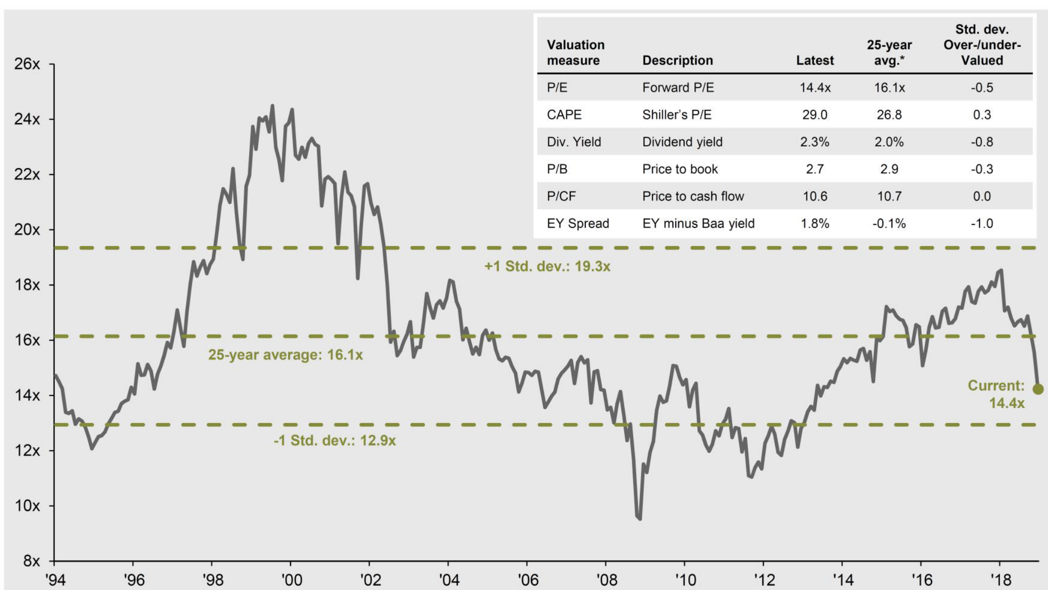


Real Fed Funds Rate At The Start of Recession	
Apr-60	1.91
Dec-69	4.22
Nov-73	5.18
Jan-80	5.58
Jul-81	10.25
Jul-90	4.08
Mar-01	3.54
Dec-07	1.91

Source: Strategas Research Partners

Furthermore, this correction has brought stocks back to a much more reasonable valuation which provides a greater margin of safety and more potential upside for new purchases than was the case for much of 2018 (see chart below).

S&P 500 Index: Forward P/E Ratio



Valuation measure	Description	Latest	25-year avg.*	Std. dev. Over-/under-Valued
P/E	Forward P/E	14.4x	16.1x	-0.5
CAPE	Shiller's P/E	29.0	26.8	0.3
Div. Yield	Dividend yield	2.3%	2.0%	-0.8
P/B	Price to book	2.7	2.9	-0.3
P/CF	Price to cash flow	10.6	10.7	0.0
EY Spread	EY minus Baa yield	1.8%	-0.1%	-1.0

Source: J.P. Morgan

The news for the U.S. consumer continues to improve; wages are rising as unemployment remains at record lows. One more boost from the 2018 tax cut will occur as taxpayers receive their tax refunds in the first and second quarters of 2019. Meanwhile, retail prices for gasoline are falling, leaving more room for discretionary consumer spending.

Volatile markets can be unnerving and stressful. We work tirelessly to understand the risks facing both the markets and the economy, and we are committed to helping you effectively navigate this challenging investment environment. It's critical to stay invested, remain patient and stay focused on long-term investment goals.

Thank you for your ongoing confidence and trust. Please do not hesitate to contact us with any questions, comments or to schedule a portfolio review.

Market Diary Period Ending December 31, 2018

RATES OF RETURN

FIXED INCOME	Last 3 Mo.	YTD	1 year	3 years	5 years	10 years
90 Day U.S. Treasury Bills	0.57	1.93	1.93	1.06	0.65	0.39
Barclays Aggregate	1.64	0.01	0.01	2.06	2.52	3.48
Barclays Municipals	1.61	1.64	1.64	1.67	2.42	3.30
Barclays High Yield	-4.53	-2.08	-2.08	7.25	3.84	11.14
EQUITIES	**Last 3 Mo.**	**YTD**	**1 year**	**3 years**	**5 years**	**10 years**
Global Stock Market (MSCI All Country World)	-12.75	-9.42	-9.42	6.62	4.27	9.47
U.S. Stock Market (S&P 500)	-13.52	-4.38	-4.38	9.28	8.51	13.14
U.S. Mid-Cap Stocks (S&P 400)	-17.28	-11.08	-11.08	7.68	6.04	13.70
U.S. Small-Cap Stocks (S&P 600)	-20.10	-8.48	-8.48	9.49	6.35	13.62
International Stocks (MSCI AC World ex US)	-11.46	-14.20	-14.20	4.49	0.68	6.58
ALTERNATIVES	**Last 3 Mo.**	**YTD**	**1 year**	**3 years**	**5 years**	**10 years**
Hedge Funds (Wilshire Liquid Alternatives)	-3.72	-4.26	-4.26	1.00	0.18	2.28
Commodities (Bloomberg Commodity)	-9.96	-12.99	-12.99	-0.79	-9.43	-4.16
Gold (S&P GSCI Gold Total Return)	7.24	-2.81	-2.81	5.72	0.68	3.50

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

GIFTING: NO GOOD DEED GOES UNPUNISHED

While you are still basking in the joy of holiday giving and right before you start collecting tax information for your CPA, it is a good time to revisit your 2018 gifting.

Lifetime gifting is a highly effective strategy to reduce the size of your estate. It not only shifts the value of gifted assets out of your estate, it can also shift future appreciation of those assets out of your estate. In addition, there are the mutual and nontangible benefits of providing immediate use and enjoyment of the gifted assets.

While there are two levels of exemption from gift tax – the annual gift tax exclusion ($15,000 per beneficiary in 2018 and 2019) and the lifetime estate tax exemption ($11.18 million in 2018 and $11.4 million in 2019) – most clients prefer to use only their annual gift tax exclusion because it has no tax filing requirement. The premise behind the annual gift tax exclusion is to shelter gifts commonly made on birthdays, holidays, anniversaries and other special occasions. Conceptually, the annual exclusion gift exclusion is rather straightforward: anyone can gift to anyone – annual gifts of up to $15,000 a year without having to file a gift tax return or pay gift taxes. Such annual gifts are also not counted against their estate tax exemption when a person dies and leaves assets to their heirs. But if you find that you made gifts to any single beneficiary in excess of the annual gift tax exclusion amount in any one year, a gift tax return must be filed for the amount gifted in excess of the annual gift tax exclusion. Those excess gifts may not require the payment of a gift tax; they may simply be applied against your estate tax exemption and documented with a gift tax return. It is important to note that married couples can give up to twice the annual gift tax exclusion amount to the same beneficiary without having to file a gift tax return as long as the gifts are made from their individual accounts. Otherwise, if spouses wish to split a joint gift, they must file a gift tax return to "split" the total gift between them.

With an annual gift tax exclusion as high as $15,000, most people don't give a second thought about the necessity of a gift tax return. But maybe they should. The Internal

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Revenue Service (IRS) says, "[*A gift is*] *any transfer to an individual, either directly or indirectly, where full compensation (measured in money or money's worth) is not received in return.*" So in addition to cash, securities and partnership interests, a gift can be the cost of covering the living expenses of an individual for whom you do not have a legal support obligation, adding someone's name to a title of an asset (i.e., automobile or real estate deed), lending with no interest, forgiving a note or paying off a note on behalf of someone, covering the cost of a family vacation or making the vacation home available free of rent, charging below-market rent, making a contribution to a 529 plan, covering the cost of college books, room and board (even if paid directly to the university), the check with the birthday card and among other things, the cost of their Christmas present. There are many other transactions that may be considered gifts; the key is determining if an item of value was transferred without adequate and full consideration.

As to every rule, there are exceptions. The following gifts can be made in any amount without affecting your annual gift tax exclusion:

- Gifts to U.S. spouses are generally unlimited.
- Gifts to charity.
- Gifts made for qualified educational expenses.
  - Payments must be **made directly to the educational institution,** and the payment must be made for **tuition** only.
- Gifts made for qualified medical expenses.
  - Payments must be **made directly to the medical provider**.

If annual gifting has been recommended as part of your estate planning, don't put it off. The annual gift tax exclusion is a use-it-or-lose-it proposition. Just make sure that you maintain accurate records, understand valuations, comply with the IRS rules and understand the broader definition of a gift. Otherwise your good intentions could leave you filing an unexpected gift tax return in April.

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