Quarterly Review and Outlook

April 2012

EQUITABLE Trust

Trustees and Investment Advisors

This Issue

To Everything There Is a Season

The New Year began with a bang as the S&P 500 Index soared nearly 12%. The bond market however was more fickle, generating a loss of 1.6% as measured by the 10-Year Treasury market. Both outcomes reflect some optimism about a recovery for the economy and much respect for the impact of loose monetary policy from the world's central banks.

We continue to have concerns about long-term economic problems such as sluggish employment growth and government budget imbalances. However, the fact that the market is making new highs so far this year suggests the probability of a recession in the near-term is low.

As for the stock markets, when one analyzes the seasonal patterns which occur nearly every year with the patterns which occur only in presidential election years, we should expect some market weakness beginning in the second quarter of this year. While stock market volatility is low and bond and money markets orderly, we can foresee a pullback in stocks that might present an intermediate-term buying opportunity. "Sell in May and go away" is a time-worn saying in the investment business. As with many such propositions, there is an element of truth (see the chart below).

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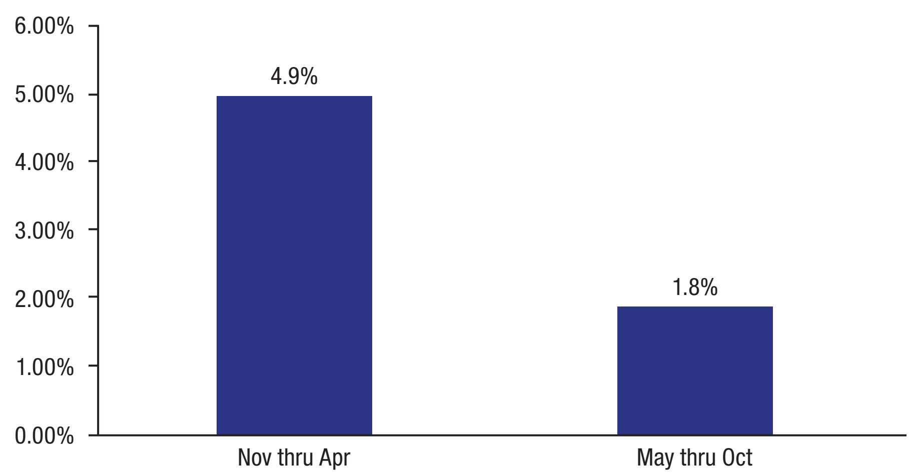
S&P 500 Average Performance: November-April vs. May-October



* Based on data back to 1928

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"The health of the people is really the foundation upon which all their happiness and all their powers as a State depend."

— Benjamin Disraeli, 1877

To Everything ... *(continued)*

There are several good reasons for this calendar rule to be true again in 2012:

- Current investor sentiment is very bullish, a contrary indicator
- Earnings growth is likely to slow. Per share earnings are up 102.8% since the March 2009 low while per share revenues are up only 5.2%. Sustainably high profit margins seem inconsistent with subpar real growth in the U.S., European recession and a slowdown in China
- 2012 Presidential politics is unlikely to make investment risk-taking attractive
- Economic growth is likely to struggle as recent reports indicate personal consumption spending has grown faster than personal income.

The U.S. stock market is unlikely to suffer a true bear market until either the Federal Reserve tightens or the political outlook shifts adversely. Federal spending is currently flat. Income tax receipts are growing and the federal deficit should begin to shrink in the near-term. Tax policy and major regulations are highly unlikely to change before the election.

But for every silver lining, there is a cloud. If the economy does well this year, President Obama is likely to win reelection, which would set the stage for political gridlock next year. Gridlock is often positive because it forces the government to leave the economy alone. Next year, gridlock could have the opposite effect, since major changes are already predestined under current laws.

In January 2013, the Bush tax cuts are set to expire, Obamacare's costs begin to hit, the payroll tax cut expires and automatic federal spending cuts must be implemented with 50% of those targeted at defense spending. Owners of Subchapter S corporations, which typically provide the most net job creation, will be hardest hit by the tax increases. If the next Congress and the President do not pass revised legislation, these tax increases will automatically be implemented. The President's 2013 budget projects Washington will extract 17.6% more in revenue next year while federal spending will rise only 0.2%.

Other years where real federal receipt growth was in double digits but real spending growth was in low single digits or negative include 1920, 1935, 1937, 1938, 1956, 1960, 1969 and 1977. With the exception of 1935, these years were all associated with bear markets. The Crash Year of 1987 also featured a large gap between receipt growth (+7.4%) and spending growth (-2.3%).

We will stick to our current path of buying fixed income and equity investments on pullbacks while looking for potential sources of risk that can be pruned from portfolios when the markets are extended.

Market Diary Period Ending March 31, 2012

	CLOSE	RATES OF RETURN				
Equities	**3/31/12**	**Last 3 Mo.**	**YTD**	**1 year**	**3 years**	**5 years**
U.S. Stock Market (S&P 500)	1408.47	12.59	12.59	8.54	23.42	2.01
U.S. Mid-Cap Stocks (S&P 400 Mid-Cap)	994.30	13.50	13.50	1.98	28.55	4.78
U.S. Small-Cap Stocks (S&P 600 Small-Cap)	463.45	11.99	11.99	5.03	29.22	3.62
International Stocks (MSCI EAFE)	1553.46	9.97	9.97	-8.76	13.72	-6.27
Emerging Markets Stocks (MSCI Emerging Markets)	1041.45	13.65	13.65	-11.05	22.25	2.31
Alternatives	**3/31/12**	**Last 3 Mo.**	**YTD**	**1 year**	**3 years**	**5 years**
SPDR Gold Trust (ETF)	162.14	6.68	6.68	15.96	21.55	19.75
Crude Oil (West Texas Intermediate)	103.02	4.24	4.24	10.90	27.54	9.35
Real Estate (Dow Jones REIT)	195.93	9.19	9.19	5.48	32.86	-6.15
Commodities (Dow Jones UBS Commodity)	433.77	2.55	2.55	-11.89	19.44	7.35
	YIELDS					
Fixed Income	**3/31/12**	**12/31/11**	**12/31/11**	**3/31/11**	**3/31/09**	**3/31/07**
U.S. Treasury Bills 91 days	0.07	0.02	0.02	0.09	0.21	5.04
2 Year U.S. Treasury	0.33	0.25	0.25	0.80	0.81	4.58
10 Year U.S. Treasury	2.23	1.89	1.89	3.47	2.71	4.65
Investment Grade Taxable Bonds (Barclay's Aggregate)	2.22	2.24	2.24	3.08	4.06	5.28
10 Year AA Municipal Bonds (Moody's)	3.57	2.53	2.53	3.42	3.70	3.90

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.

Is this the end of the low tax era?

With the 2011 expiration of the alternative minimum tax patch, the expiration of the Bush tax cuts along with the dozens of other provisions set to expire this year, the tax landscape is undergoing tremendous change. Is this the end of the low tax era? With so many variables still undetermined, it is impossible to predict. But, rates are likely to increase. Below is a summary of the important changes scheduled over the next two years.

In the absence of intervening legislation, almost 30% of taxpayers (most significantly taxpayers with incomes of $200,000-$500,000) will find themselves owing additional alternative minimum tax (AMT) in 2012. AMT is imposed on an adjusted amount of taxable income above certain thresholds. The thresholds at which AMT begins are not automatically adjusted for inflation. Each year in the recent past, Congress has made adjustments known as The Patch, to offset the failure of the tax law to adjust for inflation. Unfortunately, the last inflationary adjustment expired in 2011. If Congress does not enact another patch, the exemption amount will drop back to 2000 levels, reducing the AMT exemption on your 2012 return by approximately 40%.

While it seems logical that Congress would enact a patch, given their past history of doing so, Congress

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Is This the End ... *(continued)*

would need to reach an agreement on how to fund lost revenues which are estimated to be between $85-$100 billion. Not likely, given their small appetite for compromise in a polarized election year. If a patch is ultimately enacted, it will most likely occur after the November elections. In the meantime, taxpayers must decide whether to pay additional estimates to cover a tax liability they may or may not owe or risk the penalty for underestimating.

Beyond 2012, there is more uncertainty and potentially more and higher taxes. This year marks the expiration of the Bush-era tax cuts. Absent further extension of these cuts or a compromise on tax reform, taxpayers in the highest bracket will see an increase in the tax rate on ordinary income from 35% to 39.6%, an increase in the tax rate on long-term capital gains from 15% to 20% and an increase in the tax rate on qualified dividend income from 15% to 39.6%.

We will also see a return of the "stealth tax" which reduced the amount of allowable itemized deductions based on a taxpayer's income. This tax was phased out as part of the Bush-era tax cuts and its return potentially disallows up to 80% of current itemized deductions, with no carry over. For taxpayers in the top 39.6% tax bracket, this effectively adds another 1.2% to their marginal tax rate, resulting in a combined marginal rate of 40.8%.

In 2013, we are also introduced to the Medicare tax. Key to funding President Obama's healthcare reform, the tax applies a rate of 3.8% on the investment income of higher-income taxpayers (modified gross income of $250,000/married filing joint). The imposition of the Medicare tax results in the increased combined tax rate on interest and dividends of 44.6% and long-term gains at a rate of 25% for taxpayers in the highest bracket.

Optimism is difficult given the Congressional debate over how to balance the budget. Even if a major tax agreement cannot be reached before the election, we can remain hopeful for a lame-duck compromise or another extension early in 2013. We will be watching closely and communicating additional information as it becomes available.

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