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### *Fear Zigs, Relief Zags*

The pattern of zig zags in which Fear and Relief have taken turns as the driver of financial markets continued in the second quarter, and for most of the quarter Fear was the driver. The sharp downturn for stocks and other riskier assets during April and May was fueled by growing concerns about a European financial crisis (more on that below). However, markets reversed course in June following more aggressive policy action, and a rally in the final week trimmed the quarter's losses.

U.S. stocks finished the quarter down almost 3%, while developed market foreign stocks were off 7% and emerging-markets stocks lost 8%, despite roughly mid-single-digit gains in June for all three. On the bond side, investors' attitudes toward taking or avoiding risk were similarly evident. Investment-grade bonds and high-yield bonds both gained about 2% for the quarter, but the latter earned all of their gain in June as risk assets rallied, while the former earned all their gain in April and May.

We don't believe the sharp late-June/early-July rebound signals an "all clear." Europe's deep financial problems remain the primary force behind

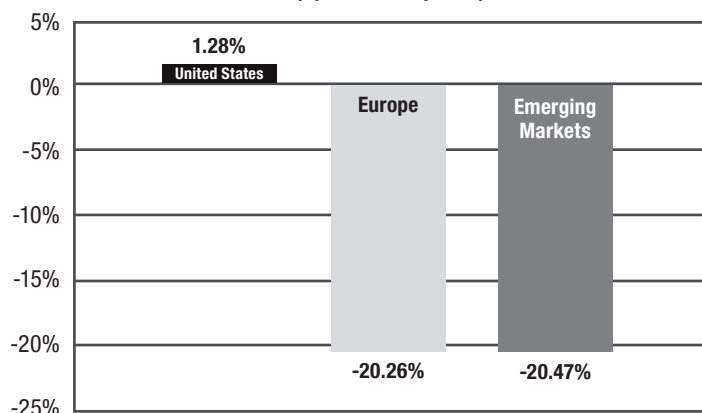
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*There is no  
such thing as  
a good tax.*

— *Sir Winston Leonard  
Spencer Churchill*

### Global Stock Market Performance

(April 2011-May 2012)



Europe and emerging-markets stock markets have hugely underperformed the U.S. stock market over the past year resulting in much improved relative value.

## Equitable Trust Quarterly Review and Outlook

### *Fear Zigs ... (continued)*

these market swings, and these problems are far from resolved. Europe has too much debt, too little growth and great difficulty in coordinating the fiscal and monetary policies across the 17-nation eurozone necessary to address the banking and financial crises that these problems can ignite.

The uncertainty about how events will play out in Europe, as well as concerns about China's slowing economy, the U.S.'s own looming fiscal problems and major unrest in the Middle East are all reasons our appetite for taking on risk is lower than normal. It is important to remember that what matters with stocks is the level of risk priced in. In other words, are stocks cheap enough to generate good returns in the years ahead even if these risks morph into serious problems?

We are not yet comfortable with a larger international weighting. However, if we see further declines in valuations, we would likely increase our weighting overseas. We make this point to remind clients that taking advantage of compelling opportunities always feels uncomfortable at the time when fear drives prices down. For us, these decisions are based on unemotional analysis of both risk and return potential and are important means by which we can add value in the years ahead in an otherwise lackluster return environment.

Our underweighted position in bonds is also important in terms of how our portfolios could perform in various market environments. In constructing portfolios that balance risk and return, the main role of stocks is to generate return, while bonds serve as a form of ballast by usually performing well in most poor environments for

stocks. We are underweight low-yielding investment grade bonds because we are confident they will generate very low returns over the next five years. Bonds are also vulnerable to rising rates. Although not a near-term concern, we consider rising interest rates increasingly probable. So, what we gain by giving up some short-term downside protection is higher current yields from high-yield bonds and dividend-paying stocks, potential capital gains from stocks and less sensitivity to damaging effects of rising rates.

In summary, there is still a range of big-picture worries that could significantly impact financial markets. The risks are major in scale and are globally intertwined. It is exceptionally difficult, given all the moving parts, to predict outcomes with confidence. Our strategy is to remain patient and highly risk-aware but be fully prepared to take advantage of any valuation-based opportunities created by fear-driven market sell-offs. Even in the slow-growth world we envision over the next several years, as developed economies continue to struggle to unwind excessive debt, we believe we can earn decent returns. But capturing these returns will require riding out difficult periods along the way, and it is always good for clients and their advisors to think honestly and in advance about whether the risks inherent in a chosen portfolio strategy are still in line with personal risk tolerance.

We are always available to talk with you about the markets and your portfolio to address any questions you may have. All of us at Equitable Trust appreciate your confidence.

**Market Diary** Period Ending June 30, 2012

	CLOSE	RATES OF RETURN				
Equities	6/30/12	Last 3 Mo.	YTD	1 year	3 years	5 years
U.S. Stock Market (S&P 500)	1362.16	-2.75	9.49	5.45	16.40	0.22
U.S. Mid-Cap Stocks (S&P 400 Mid-Cap)	941.64	-4.93	7.90	-2.33	19.36	2.55
U.S. Small-Cap Stocks (S&P 600 Small-Cap)	445.44	-3.58	7.98	1.43	19.78	1.83
International Stocks (MSCI EAFE)	1423.38	-8.37	0.77	-16.67	2.88	-8.85
Emerging Markets Stocks (MSCI Emerging Markets)	937.36	-10.00	2.29	-18.22	7.18	-2.42
Alternatives	6/30/12	Last 3 Mo.	YTD	1 year	3 years	5 years
SPDR Gold Trust (ETF)	155.19	-3.95	1.32	5.76	19.13	19.23
Crude Oil (West Texas Intermediate)	84.96	-17.53	-14.03	-10.96	6.73	3.75
Real Estate (Dow Jones REIT)	202.19	3.20	12.68	7.05	24.56	-3.63
Commodities (Dow Jones UBS Commodity)	414.18	-4.52	-2.08	-10.45	11.83	5.85
	YIELDS					
Fixed Income	6/30/12	3/31/12	12/31/11	6/30/11	6/30/09	6/30/07
U.S. Treasury Bills 91 days	0.09	0.07	0.02	0.03	0.19	4.81
2 Year U.S. Treasury	0.33	0.33	0.25	0.45	1.11	4.87
10 Year U.S. Treasury	1.67	2.23	1.89	3.18	3.53	5.03
Investment Grade Taxable Bonds (Barclay's Aggregate)	1.98	2.22	2.24	2.83	4.12	5.67
10 Year AA Municipal Bonds (Moody's)	2.39	2.75	2.53	3.12	3.69	4.14

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., Morningstar and U.S. Treasury Department.

## *New Laws, New Opportunities, New Risks to Your Net Worth and Income*

There are a number of important new issues, opportunities and risks that clients and their tax advisors should consider over the next several months. The space of these comments permits only a glimpse of these opportunities and risks.

For many Equitable Trust clients, the elimination of the Tennessee Gift Tax is a major development since our last newsletter. This change, which removed a significant impediment to Tennessee residents considering large gifts as a part of their federal

estate tax planning, was accomplished along with the phase-out of the Tennessee Inheritance Tax. In addition to outright gifts, there are a number of very effective gift strategies used for federal estate tax planning purposes in other states that have been implemented only sparingly in Tennessee because of the Tennessee Gift Tax. Among possibilities are the Qualified Personal Residence Trust or a transfer to an intentionally "defective" irrevocable Grantor Trust, and there may be other tax-saving opportunities and entirely different strategies to reconsider. Warning:

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## *New Laws, ... (continued)*

A Tennessee grantor should consider the risk of an Inheritance Tax “claw back” if the grantor makes a large gift and then fails to survive to 2015.

Another major change may call for income tax planning to manage around next year’s anticipated new 3.8% surtax on investment income (including capital gains) that is included in the healthcare overhaul upheld by the Supreme Court last month. Even prior to the surtax, many taxpayers may have been considering realizing capital gains in 2012 as a hedge against the possibility that Congress will allow the more favorable Bush tax rates from 2001 and 2003 to expire. If these rates are allowed to expire,

capital gains will be taxed at 20% in 2013 rather than at the current 15% rate, although many observers feel that this increase is unlikely for anyone with taxable income of less than \$250,000. In addition to any increase in tax liability in 2013 from expiring tax rates, the 3.8% surtax is now law, and joint filers with taxable income above \$250,000 anticipating realization of capital gains over the next few years should consider accelerating those transactions into 2012.

We will be working with clients and their tax advisors on these and other current issues as they develop, and we will be pleased to have your inquiries.

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