Quarterly Review and Outlook

October 2012

EQUITABLE Trust

Trustees and Investment Advisors

This Issue

Just How Good is the Good News?

The third quarter was a risk-on period with markets reacting positively as several central banks moved to stimulate their economies. U.S. large-cap stocks were up 6% while investment-grade bonds gained 1.5%. From the stock market low on June 1, large-cap stocks were up 10.7% versus 1.6% for core bonds. European stocks rose dramatically on the heels of major policy action from the European Central Bank and were up nearly 9% for the quarter and 17% from the June low. Emerging-markets stocks gained 6.5% in the third quarter and also posted double-digit gains from the June low.

It is tough to summarize the global investment environment and our portfolio positioning in just a handful of paragraphs, but one noteworthy theme that helps tie things together emerges from looking at, and reconciling, the differences between what shorter-term market behavior seems to be telling us versus what our broader, longer-term analysis tells us. The strong stock market in recent months seems to suggest that things are pretty good, while our analysis warns us that serious risks and challenges remain.

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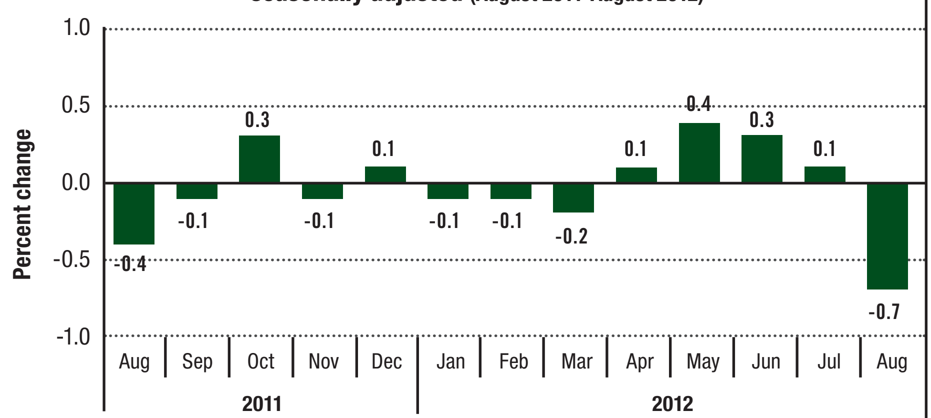
Over-the-month change in real average hourly earnings for all employees, seasonally adjusted (August 2011-August 2012)



Source: U.S. Bureau of Labor Statistics

> *"In the long-run every Government is the exact symbol of its People, with their wisdom and unwisdom ... "*
>
> *— Thomas B. Macaulay (1800 – 1859)*

Just How Good ... *(continued)*

Short-term positives for the market (along with a few negatives):

- The European Central bank has stepped in and said that it will do "whatever it takes to preserve the Euro" through an open-ended commitment to buy the bonds of distressed eurozone governments who request financial assistance and agree to certain domestic conditions. This action brought down borrowing costs in Spain and Italy where there was particular concern of default. However, since the end of the quarter, Spain's sovereign debt has been downgraded to BBB- by Standard & Poor's.
- The Fed made a similarly open-ended commitment to buy government-backed mortgage bonds, better known as QE3. It also pushed out its promise to keep interest rates near zero until at least 2015. This action forces investors to accept higher risk in hope of receiving returns in excess of the inflation rate. This action has led investors to buy riskier bonds, stocks and hard assets. When the buying pressure is sufficient, markets generally rise. The Fed hopes that investors, feeling richer, will then make purchases which will foster actual economic growth. It is not clear that this plan is working.
- The U.S. unemployment rate has improved slightly. Over the quarter, the official unemployment rate dropped to 7.8% from 8.3%. Some of the drop can be explained by a reduction in the labor participation rate. Since the broader U-6 unemployment rate is largely unchanged over the quarter, it seems likely that the reported improvement is derived largely from growth in part time work. Also, we have read third-party analyses which conclude that the good news is contradicted by the payroll tax withholding numbers (which have not risen) and higher rates of government (public sector) hiring. Further, August brought a significant drop in real average hourly earnings on a seasonally adjusted basis (see graph).

The really big issues remain:

- The European Central Bank's actions, at best, buy time for the eurozone's constituent nations to get their fiscal houses in order. However, with much of Europe already in recession, it will be difficult for the national governments to raise taxes and/or cut expenses without hampering their respective constituent economies.
- Likewise, the Fed buys time for the President and Congress to put our federal government on a more sustainable path. Without the Fed's buying almost all of the new debt being issued to fund the deficit, interest rates would be soaring, making the deficits even worse, with higher rates hindering the struggling economy as well.

Our longer-term outlook for various asset classes hasn't changed much since we last wrote:

- We still expect cash to yield little or nothing for as far as the eye can see.
- Much of our bond exposure is now in high-yield bonds and unconstrained or absolute-return-oriented fixed-income funds. Looking out over our five-year tactical investment time horizon, we believe these non-core-bond funds

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Market Diary Period Ending June 30, 2012

	CLOSE	RATES OF RETURN				
Equities	**9/30/12**	**Last 3 Mo.**	**YTD**	**1 year**	**3 years**	**5 years**
U.S. Stock Market (S&P 500)	1440.67	6.35	16.44	30.20	13.20	1.05
U.S. Mid-Cap Stocks (S&P 400 Mid-Cap)	989.02	5.44	13.77	28.54	14.33	3.83
U.S. Small-Cap Stocks (S&P 600 Small-Cap)	468.00	5.40	13.80	33.35	15.14	3.29
International Stocks (MSCI EAFE)	1510.76	6.98	10.59	14.33	2.59	-4.77
Emerging Markets Stocks (MSCI Emerging Markets)	1002.66	7.89	12.33	17.33	5.96	-0.98
Alternatives	**9/30/12**	**Last 3 Mo.**	**YTD**	**1 year**	**3 years**	**5 years**
SPDR Gold Trust (ETF)	171.89	11.00	12.46	9.20	20.80	18.57
Crude Oil (West Texas Intermediate)	92.19	8.51	-6.72	16.40	9.30	2.45
Real Estate (Dow Jones REIT)	203.47	-0.38	14.47	32.06	20.52	1.60
Commodities (Dow Jones UBS Commodity)	458.27	10.64	8.35	11.04	12.84	6.35
Fixed Income		**Last 3 Mo.**	**YTD**	**1 year**	**3 years**	**5 years**
Barclays 1-10 year Muni Blend		1.41	3.25	5.14	4.62	5.44
Lipper High Yield Bond Index		4.50	11.80	18.30	11.80	6.80
Barclays Intermediate Govt/Credit		1.40	3.53	4.40	5.18	5.71
Barclays Global Aggregate ex US		4.37	5.18	4.80	4.28	5.98

Rates of Return for periods longer than 12 months are annualized. Data provided by The Chart Store, Interactive Data Corp., Morningstar and Scorecard.

Real Estate Management

Real estate can be an important component of one's assets, providing diversification to an investment portfolio that otherwise might consist of only stocks, bonds and mutual funds. At the same time, real estate can present unique challenges to the owner and certainly to family members who later inherit the property and who may lack the original owner's knowledge and sophistication.

As a fiduciary, Equitable Trust Company assists clients with the management of commercial, industrial, farm, and residential properties.

Our professional staff analyzes the nature of the title to the property, environmental exposure, insurance coverages, existing leases and the potential for income and appreciation. In making lease, purchase, sale, and other important decisions, we solicit and consider the informed knowledge of beneficiaries and other related parties.

All real estate is managed from our Nashville office, and we have extensive knowledge of local real estate agents, appraisers, contractors and other real estate professionals who play an integral part in maximizing the client's return on investment.

Please call on us if we can be of assistance.

Just How Good ... *(continued)*

have the potential to generate significantly better returns than core bonds, driven in part by their ability to manage interest-rate risk without being tied to a benchmark, and in part by the managers' ability to add value from opportunistic investments across sectors as well as from individual security selection. For example, PIMCO Unconstrained has exposure across a diverse range of sectors in which the firm is finding attractive credits, including investment-grade bonds of U.S. banks, non-agency mortgage-backed securities, and local-currency emerging-market bonds.

- Equities offer a lower-than-average expected return but still seem to have far more potential than cash or bonds.
- Real assets, e.g. gold, commodities and real estate, are volatile but offer some upside in the event that massive central bank money printing continues.

We appreciate your continued confidence. If you have questions about the markets or how your portfolio is positioned, please don't hesitate to contact us.

EQUITABLE Trust

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