Quarterly Review and Outlook

January 2013

EQUITABLE Trust

Trustees and Investment Advisors

This Issue

"Plus ça change, plus c'est la même chose "

"The more it changes, the more it's the same thing."

— Jean-Baptiste Alphonse Karr January 1849.

Risk-Taking Rewarded; Now a Tilt Toward Conserving Capital

Looking Back on an Eventful Year

If we had to summarize the year in one short sentence: Risk-taking was rewarded handsomely. Broad measures of the U.S. stock market were up 16% or more while investment-grade bonds, as measured by the Vanguard Total Bond Market Index, returned 4.1% from interest and price appreciation while cash investments yielded slightly more than nothing. Further, high yield and emerging market debt outperformed investment-grade bonds while developed and emerging market stocks outpaced their domestic counterparts. It is not exactly what we expected. But, the facts speak for themselves.

The economy's recovery progressed at a snail's pace (we were right on that point). There is still enough economic "slack" that the economy can grow even further before requiring the mass hiring of workers. Employment growth, while improving, is still at the slowest pace for a recovery in more than 60 years. The private sector is delevering in a meaningful way, preparing both household and business balance sheets for better times ahead.

Growing fiscal prudence, alas, has not applied to the federal government, which is continuing to run a deficit of more than $1 trillion. The "Fiscal Cliff" arrived and our leaders came up with a deal that raises taxes on nearly everyone who works (not just the "rich") and raised spending.

Looking Ahead to 2013

We'll have new "cliffs" to ponder in short order. The federal debt limit will be hit around the end of February and spending will have to be addressed by the end of March, or the "sequestration" of discretionary spending will no longer be deferred. These struggles could reward stock market "bears" with the rare opportunity to be right.

The rest of the developed world also faces debt-related challenges. Our friends at Litman Gregory Analytics put it this way: "The solutions are

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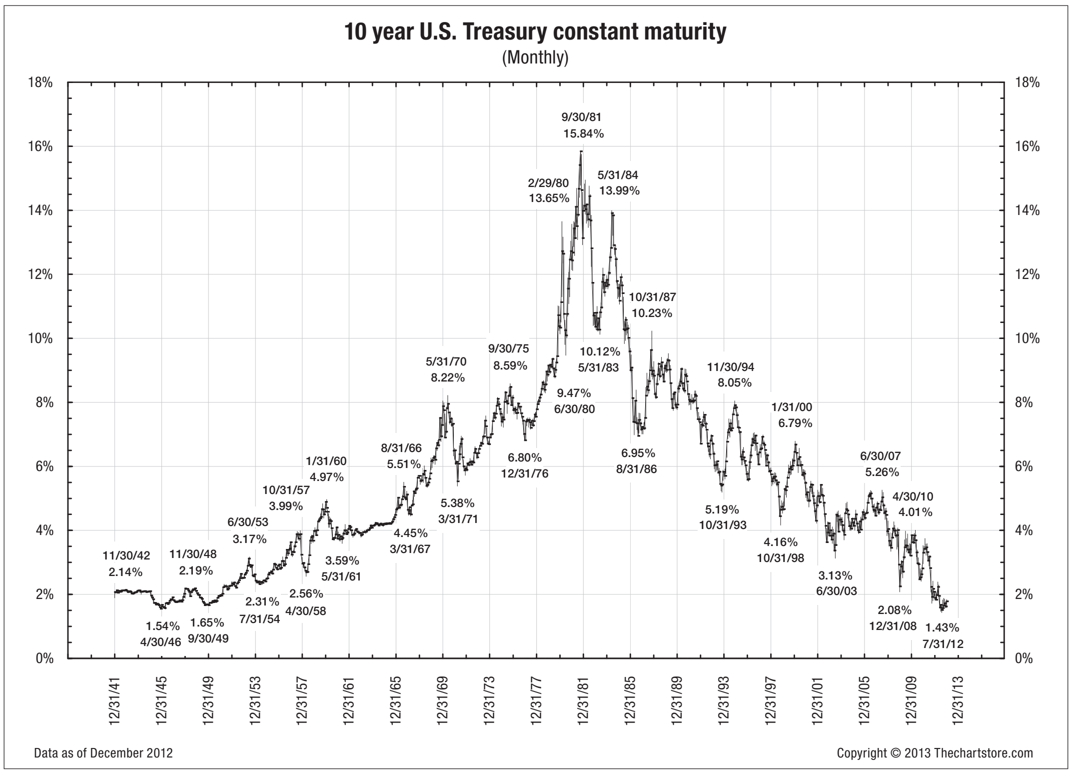
Risk-Taking Rewarded ... *(continued)*

not easy and there are no quick fixes. Failures could play out in various ways, from another financial crisis to sharply higher inflation several years down the road. A brighter spot is that developing countries are generally less indebted and growing faster. However, growth has slowed there as well, partly due to the impact of reduced demand from the heavily indebted developed countries."

We still expect a "near zero" environment for cash investments as central banks everywhere print money competitively. Readers of this newsletter will recall that we have been less-than-bullish on investment-grade bonds for some time as they have appreciated to record levels. We now believe that the 30-year long bull market in high quality bonds is at or near its end.



This statement implies not only lower expected returns for bonds but also higher risks for fixed income investors. We are particularly paying attention to holdings in investment-grade bond funds where we are preparing to shorten maturities by reducing holdings in intermediate-term funds and adding to short-duration funds in order to protect capital.

While not raging bulls on the stock market, we continue to think equities are "the best house in a bad neighborhood." We will continue to buy stocks of high quality companies. As market conditions permit, we see opportunities to make additional investments in emerging market stocks. We will select investments keeping three themes in mind:

- Credit is now more available to the private sector
- On the margin, spending is shifting away from consumer goods and services and toward capital spending by businesses
- Commodity resources will be subject to greater demand from emerging market countries

We look forward to 2013 and to all its possibilities. Happy New Year!

Market Diary Period Ending December 31, 2012

	CLOSE	RATES OF RETURN				
Equities	**12/31/12**	**Last 3 Mo.**	**YTD**	**1 year**	**3 years**	**5 years**
U.S. Stock Market (S&P 500)	1426.19	-0.38	16.00	16.00	10.87	1.66
U.S. Mid-Cap Stocks (S&P 400 Mid-Cap)	1020.43	3.61	17.88	17.88	13.62	5.15
U.S. Small-Cap Stocks (S&P 600 Small-Cap)	476.57	2.22	16.33	16.33	14.07	5.14
International Stocks (MSCI EAFE)	5438.30	6.60	17.90	17.90	4.04	-3.21
Emerging Markets Stocks (MSCI Emerging Markets)	2001.60	5.61	18.63	18.63	4.98	-0.61
Alternatives	**12/31/12**	**Last 3 Mo.**	**YTD**	**1 year**	**3 years**	**5 years**
SPDR Gold Trust (ETF)	162.02	-6.40	5.26	5.26	14.21	14.29
Crude Oil (West Texas Intermediate)	91.83	-0.38	-7.08	-7.08	4.97	-0.87
Real Estate (Dow Jones REIT)	6306.05	2.31	17.12	17.12	17.94	5.08
Commodities (Dow Jones UBS Commodity)	438.75	-6.33	-1.06	-1.06	0.07	-5.17
Fixed Income		**Last 3 Mo.**	**YTD**	**1 year**	**3 years**	**5 years**
Barclays 1-10 year Muni Blend		0.30	3.56	3.56	4.75	5.13
Lipper High Yield Bond Index		3.20	15.40	15.40	10.90	7.70
Barclays Intermediate Govt/Credit		0.35	3.89	3.89	5.19	5.18
Barclays Global Aggregate ex US		-1.04	4.09	4.09	4.47	5.06

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

Your Taxes Are Going Up, Likely More Than You Might Expect

In the waning hours of 2012 and into the New Year, Congress and the President agreed on changes to the Internal Revenue Code. The legislation, known as the American Taxpayer Relief Act of 2012, became effective January 1, 2013.

Here are the highlights:

Income Taxes

- Expiration of the 2% cut for the employee portion of Social Security tax.
- Increase in highest tax rate from 35% to 39.6% for those individuals with at least $400,000 of taxable income and couples with at least $450,000 of taxable income.
- "Back-door" tax increases for individuals with at least $250,000 of taxable income and couples with at least $300,000 of taxable income: (1) Phase out of personal exemption, and (2) Limitation on itemized deductions.
- Dividends and long-term capital gains both taxed at 20% if the taxpayer is in the 39.6% bracket; otherwise, taxed at 15% except for taxpayers in lowest two brackets.
- Affordable Care Act's tax of 3.8% on net investment income above threshold of $200,000 for individuals and $250,000 for couples.
- "Fix" of Alternative Minimum Tax ("AMT").

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Your Taxes ... *(continued)*

- IRA charitable donation (up to $100,000 for taxpayers age 70½ and older) made applicable to both 2012 and 2013. 2012 IRA donations can be made through January 31.
- Deduction for state sales tax made applicable to both 2012 and 2013.

At the bottom of the range of taxpayers, everyone who receives a paycheck will be subject to the two percentage point increase in the payroll tax. At the other end of the spectrum, according to a tax partner at Ernst & Young, "A person making $500,000 a year will pay $9,124, or 7%, more in taxes in 2013. A couple earning $1 million a year in wages and business and investment income will pay $53,350 extra, or 20% more in taxes." (*New York Times 1/12/13*)

Gift and Estate Taxes

- Retention of $5 million individual exemption for gift and estate taxes, indexed for inflation. ($5.12 million in 2012; IRS hasn't yet announced 2013's adjustment amount but it is expected to be $5.25 million.)
- Increase in gift and estate top tax rate from 35% to 40%.
- Annual exclusion amount (for gifts) increased to $14,000.
- Federal gift and estate tax remains unified.
- Portability of a spouse's estate tax exemption was made permanent. This allows a deceased spouse's estate to transfer any unused portion of the $5 million exemption (as adjusted for inflation) to a surviving spouse.

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