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“Consensus is what many people say in chorus but do not believe as individuals.”

— Abba Eban

Remaining Cautious as the Economy Heals

As the third quarter of 2013 came to a close, the Fed surprised nearly everyone by deciding not to taper its purchase of Treasuries and mortgage securities while Congress and the President surprised nearly no one by failing to avoid a partial federal government shutdown. Financial assets were buffeted at various times during the quarter but “stuck the landing,” with both stocks and bonds showing positive returns at quarter-end.

Despite the headlines from Washington, the U.S. economy continued to heal in the third quarter. House prices continued to recover, rising 21% since the end of 2011 based on the S&P Case-Shiller 20-City Home Index. According to some estimates, homeowners have recovered 50% of the equity they lost in the downturn. Household assets and net worth achieved another all-time high, the Purchasing Managers Index is gaining momentum, and equity markets continued to reward investors.

In fact, many economists consider the stock market itself a reliable leading economic indicator. Its rise seems to be predicting continued economic growth. Further, economically sensitive sectors of the market (Consumer Discretionary, Industrials and Financials) are outperforming defensive ones (Consumer Staples, Utilities and Telecoms). That said, the math behind the market’s valuation indicates this year’s performance (so far) will be difficult to replicate in 2014. Also, some sectors are indicating economic stress with the normally economically-sensitive Energy, Materials and Information Technology sectors underperforming the market and one defensive sector (Health Care) outperforming. (See Chart on next page.)

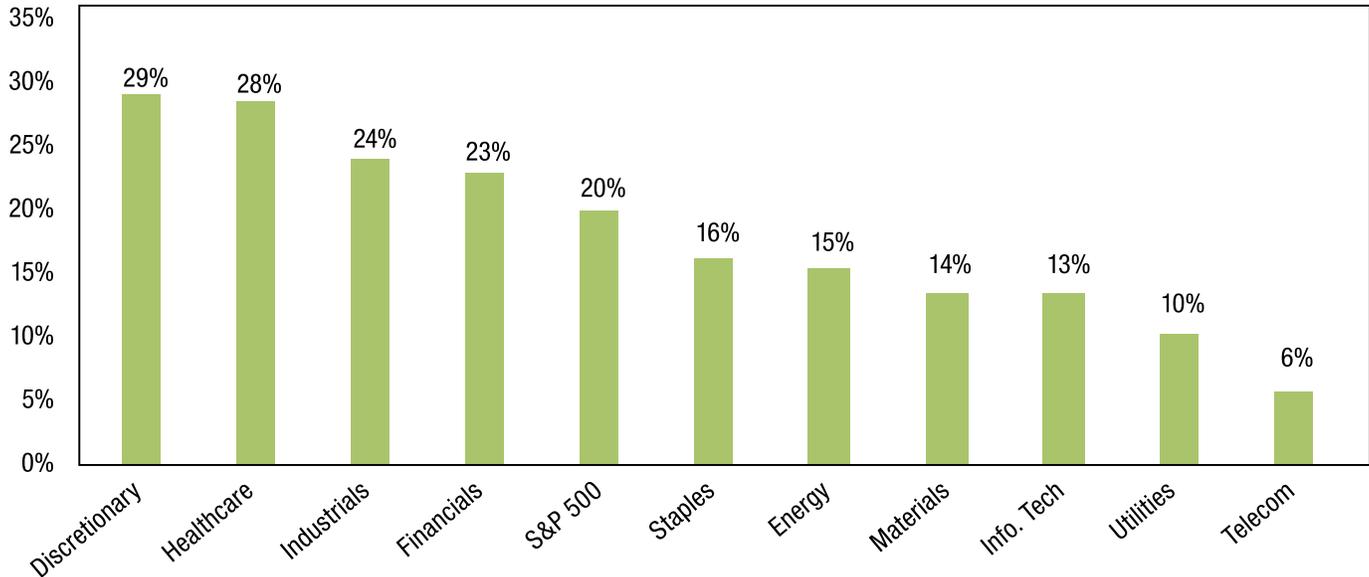
The consensus earnings estimate for 2013 S&P 500 earnings is probably too optimistic at \$110/share. To get a double-digit price return one year from now, earnings will have to rise to \$121 or the price multiple will

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Equitable Trust Quarterly Review and Outlook

Remaining Cautious ... (continued)

Year-to-Date Performance of S&P 500 By Sector



Source: Bloomberg, LP

have to expand. With revenue growth stagnant in many industries and profit margins already at historic highs, a 10% earnings gain seems unlikely. Price multiples could expand from current levels, but it is uncertain what the catalyst would be. If the Fed finally starts to “taper” in the first quarter of 2014, as implied by the futures markets, interest rates should rise. Multiple expansion would then be unlikely.

Meanwhile, fixed income continues to be a difficult place to make money. High-yield securities offer some protection against the threat of gradually rising interest rates. Otherwise, we are keeping maturities shorter than usual, as we expect rates to gradually rise over time. Shorter maturities provide more price protection than long-dated bonds and provide more opportunity to reinvest at higher rates in the future.

Our portfolio positioning hasn't changed much since last quarter. We are still maintaining fewer bonds and fixed income funds than normal. While stocks still offer below-average expected returns, we think they will perform better than other asset classes. We would treat any sizeable correction in the equity markets as a buying opportunity. For all but the most aggressive portfolios, we maintain exposure to alternative investments as hedges.

Market Diary Period Ending September 30, 2013

	CLOSE	RATES OF RETURN				
Equities	9/30/13	Last 3 Mo.	YTD	1 year	3 years	5 years
Global Stock Market (MSCI All Country World)	682.53	8.02	14.92	18.37	10.81	8.30
U.S. Stock Market (S&P 500)	1681.55	5.25	19.79	19.34	16.27	10.02
U.S. Mid-Cap Stocks (Russell Mid-Cap)	8448.33	7.70	24.34	27.91	17.53	12.97
U.S. Small-Cap Stocks (Russell 2000)	4982.85	10.21	27.69	30.06	18.29	11.15
International Stocks (MSCI EAFE)	6340.63	11.61	16.59	24.29	8.97	6.85
Emerging-Markets Stocks (MSCI Emerging Markets)	1920.46	5.90	-4.05	1.33	0.00	7.56
Alternatives	9/30/13	Last 3 Mo.	YTD	1 year	3 years	5 years
Hedge Funds (HFRX Global Hedge Fund)	1197.61	1.10	4.29	5.13	0.52	0.40
Gold (SPDR Gold Trust ETF)	128.18	11.17	-20.53	-25.62	0.09	8.01
Crude Oil (West Texas Intermediate)	102.36	6.23	11.47	11.04	8.58	0.33
Real Estate (Dow Jones REIT)	6453.01	-3.15	2.33	4.70	12.09	5.30
Commodities (Dow Jones UBS Commodity)	255.88	2.13	-8.56	-14.35	-3.16	-5.29
Fixed Income		Last 3 Mo.	YTD	1 year	3 years	5 years
Barclays 1-10 Year Muni Blend Bond Index		0.72	-0.63	-0.34	2.79	4.75
Lipper High Yield Bond Index		2.30	4.10	7.40	8.60	11.00
Barclays Aggregate Bond Index		0.57	-1.89	-1.68	2.86	5.41
Barclays Global Aggregate ex US Bond Index		4.38	-2.38	-3.39	1.52	4.80

Rates of Return for periods longer than 12 months are annualized. Data provided by The Chart Store, Hedge Fund Research, Informais, and Morningstar.

New Health Care Surtax Adds Value to an Effective Charitable Giving Technique

The current government shutdown has focused widespread attention on all aspects of the **Affordable Care Act**. One provision that draws a lot of attention is the new 3.8 percent surtax on most types of investment income (i.e. capital gains, dividends and rental income) for high-income households. A “high-income household” is defined in terms of modified adjusted gross income (MAGI); for most taxpayers, the amount on your income tax return after most deductions. Households filing joint returns with MAGI above \$250,000 are “high income households” for purposes of this statute.

Almost any form of well-planned charitable giving carries the benefit of both income and estate tax savings. However, the new 3.8% surtax on investment income will come as a surprise to many taxpayers and will create a new focus on techniques that can reduce income in excess of the MAGI threshold amount.

There are several forms of Charitable Trusts which, for taxpayers in just the right circumstances, can be the perfect tool to obtain a significant current charitable deduction. However, with respect to the new surtax, the technique can have the practical effect

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New Health Care ... (continued)

of leveling income over a longer period of time. This “leveling” effect might enable a taxpayer to maintain MAGI below the threshold amount and thereby avoid the investment income surtax altogether.

Two primary types of Charitable Trusts are Charitable Remainder Trusts (CRTs) and Charitable Lead Trusts (CLTs). Both can provide significant tax benefits, but the focus here is on the CRT because of its “leveling” effect on a donor’s taxable income. A donor contributes assets to a CRT and the trust provides a current return to the donor or other named beneficiary. Then, at the end of the term of the trust, whatever is left is paid to the charities

designated in the trust document. In the present low interest rate environment, the remainder interest of a newly created CRT would be expected to be higher, thus providing a greater tax benefit.

There are many factors and options one should be aware of and consider in the funding of a CRT. Investments with the potential for inordinate isolated income distributions or large gains realized in low basis investments might be used in funding and thus achieve a leveling effect on MAGI over the term of the trust. If MAGI can be managed to a point below the surtax threshold amount, then the ordinary benefits of a CRT are magnified.

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