Quarterly Review and Outlook

October 2016

EQUITABLE Trust

Trustees and Investment Advisors

This Issue

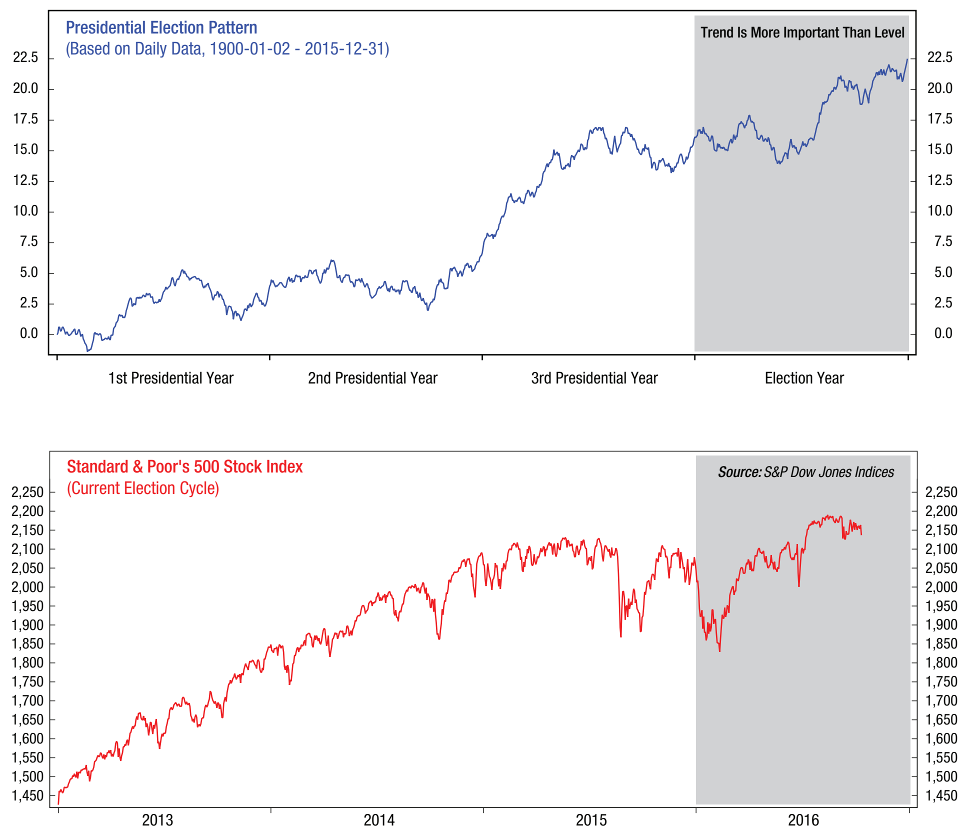
"The four most dangerous words in investing are: "This time it's different."

— Sir John Templeton (1912 – 2008)

The Bear is Still Hibernating

We are just about finished with the seasonally weakest time of year — especially presidential election years. The third quarter offered a 3.9% return in the S&P 500 Index and a tepid response in the bond market. However, if the fourth quarter follows typical patterns, the stock market should be fairly strong going into year-end.

Dow Industrials Four-Year Presidential Cycle vs S&P 500 Index Current Election Cycle



This leads long-term investors to a bigger question: Is there evidence that this long bull market is coming to an end? After all, this bull has been with us a very long time and represents a sizeable move from the 2009 lows.

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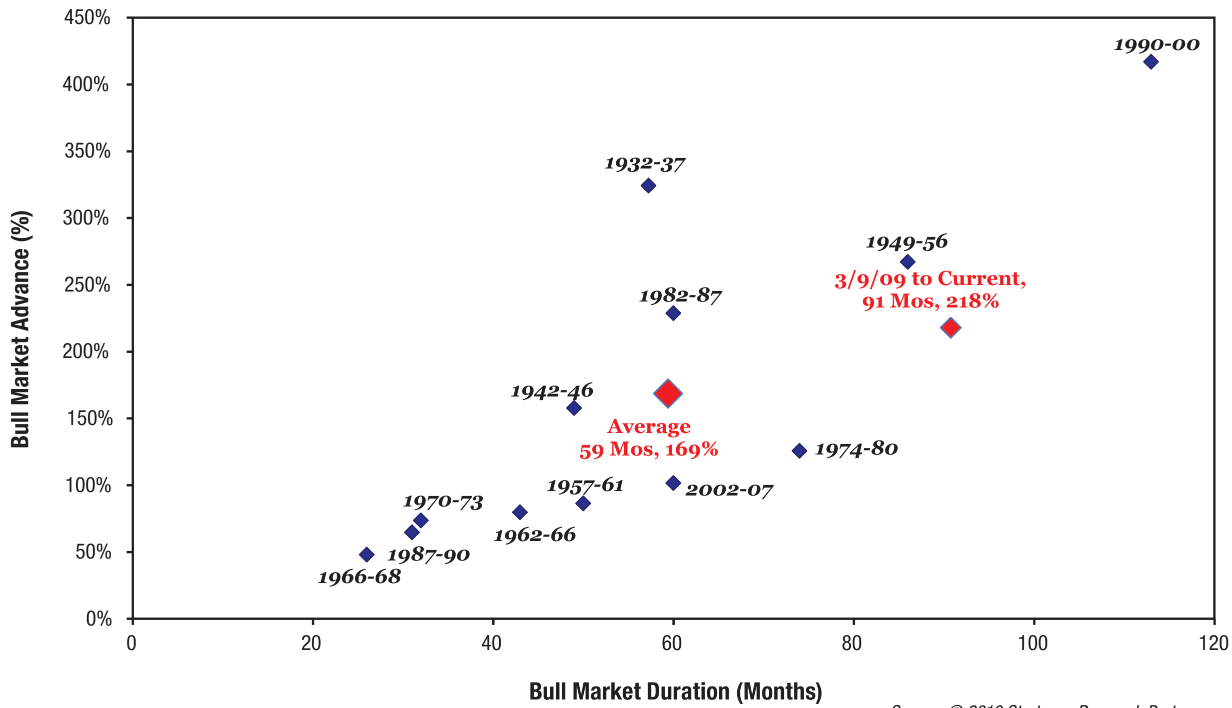
The Bear ... (continued)



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The 2000 and 2007 market tops shared nine common features. We list them below along with our comments about how each applies to the markets now:

1. Blow-off top – There are no signs of panic buying or speculative excess in the public equity markets.
2. Heavy inflows of cash into equity funds – Individual investors are not participating. In fact, more money is still flowing into bond funds.
3. Large pick-up in mergers and acquisitions – Deal value and volume are well below 2015 levels and previous tops.
4. Initial Public Offerings – Deals and deal volume are off almost 50% this year and well below previous peaks.
5. Rising real interest rates – With nominal interest rates steady and inflation expectations rising, "real" interest rates are actually falling.
6. Weakening earnings estimates – This is the one negative element in place in 2016.
7. Fewer stocks making new highs – This market's breadth is far healthier today that it has been over the last two years.
8. Shift to defensive leadership – Since the February 2016 low, cyclical stocks have outperformed.
9. Widening credit spreads – There has been a pick-up in corporate defaults but credit spreads are behaving.

In short, only one of nine common features of major market tops is in place. Accordingly, we answer our own question with a "not yet."

We must always acknowledge that other concerns can affect market behavior in the short run. Global security issues involving regional conflicts and terrorism can sway markets. Health concerns like Zika, Ebola and SARS can disrupt trading, too. Around the world, the political order is being shaken by rising populist and isolationist sentiments. The presidential election campaign demonstrates the U.S. is not immune to this ebb and flow. And, we know investors can be diverted from a sound investment plan by fear and greed. However, when we calmly assess the facts, we believe this is a good time to be invested in equity markets.

Market Diary Period Ending September 30, 2016

	RATES OF RETURN					
Equities	**Last 3 Mo.**	**YTD**	**1 year**	**3 years**	**5 years**	**10 years**
Global Stock Market (MSCI All Country World)	5.43	7.08	12.62	5.77	11.26	4.94
U.S. Stock Market (S&P 500)	3.85	7.84	15.42	11.14	16.35	7.23
U.S. Small-Cap Stocks (Russell 2000)	9.05	11.45	15.46	6.70	15.81	7.05
International Stocks (MSCI EAFE)	6.50	2.20	7.10	1.04	7.97	2.39
Emerging Markets Stocks (MSCI Emerging Markets)	9.16	16.29	17.20	-0.23	3.38	4.28
Alternatives	**Last 3 Mo.**	**YTD**	**1 year**	**3 years**	**5 years**	**10 years**
Hedge Funds (HFRX Global Hedge Fund)	2.20	1.30	0.70	-0.20	1.30	-0.20
Global Real Estate (FTSE/EPRA NAREIT)	2.01	11.02	16.43	7.85	12.43	3.91
Commodities (Bloomberg Commodity)	-3.86	8.87	-2.58	-12.34	-9.37	-5.33
Energy (Bloomberg Commodity - Energy)	-3.66	5.15	-18.72	-25.87	-17.59	-17.20
Gold (Gold Spot)	-0.55	23.87	17.73	-0.33	-4.12	8.17
Fixed Income	**Last 3 Mo.**	**YTD**	**1 year**	**3 years**	**5 years**	**10 years**
Barclays Aggregate	0.46	5.80	5.19	4.03	3.08	4.79
Barclays Municipals	-0.30	4.01	5.58	5.54	4.48	4.75
Barclays High Yield	5.55	15.11	12.74	5.30	8.34	7.80

Rates of Return for periods longer than 12 months are annualized. Data is provided by Northern Trust and Hedge Fund Research.

IRS Takes Aim at Valuation Discounts

Many families and individuals, under the watchful eye and guidance of their legal and tax advisors, have successfully reduced estate and gift taxes utilizing discounted values for assets of all types whenever these assets are given away during life or bequeathed at death. Most valuation methodologies account for factors that reduce the value of assets, including various transfer restrictions and prohibitions, high voting thresholds, liquidity obstacles and minority interests. The existence of these factors and similar limitations result in the securities having discounted values for tax purposes.

Applying these factors, or discounting the value of assets for transfer tax purposes, allows the transferor to give away a larger percentage of the asset or to die with an estate that has a lower value for estate tax calculations.

Two of the more common discounts result from lack of marketability and lack of control. As the names imply, ownership interests that have restrictions on the ability to sell them to outsiders (including terms such as price and governance rights) impair marketability. In addition, blocks of shares that represent less than 50% of the voting rights for a company are worth much less than if the number of shares constituted control of the governance and management of the company. These discounts, when used properly, easily achieve reductions in value of 35% or more and have routinely withstood IRS scrutiny upon audit or legal challenge in court.

The IRS is particularly concerned with restrictions that are self-imposed by individuals or families that control corporations, partnerships and other entities for the sole purpose of reducing taxes rather than

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factors which exist for valid business purposes. To combat or eliminate a number of these discounts, the IRS recently published proposed regulations that, among other important changes, would disregard a host of restrictions that would otherwise apply to reduce the value of certain assets for tax purposes. As an example, the proposed regulations would require taxpayers to disregard, in determining values for estate and gift tax purposes, any or all of the restrictions that adversely impact (i) an owner's ability to demand that the company redeem the stock, i.e. buy it from an owner desiring to sell; (ii) the amount of consideration to be received by the owner upon the redemption of the shares; (iii) how soon any redemption payment can be made to the selling owner; or (iv) the selling owner's right to receive cash instead of non-cash assets that are paid in kind and in lieu of cash.

Most experts weighing in thus far have reached two conclusions. First, the proposed regulations, if adopted in their current form, will immediately be challenged in court. It is very likely that many of the litigated fact patterns will enable taxpayers to prevail based on long-standing uniform valuation principles and constitutional limits on the IRS's scope of authority to create and enforce the proposed regulations. Second, while these experts believe some or many of the proposed regulations will not withstand judicial scrutiny, they nonetheless are urging clients to actively discuss any plans to utilize discounts with their advisors and act before December 31, 2016.

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