# Washington Crossing Advisors

Portfolio Comment

www.washingtoncrossingadvisors.com April 21, 2014

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About Washington Crossing Advisors
WCA strategies are offered through the Stifel Score Program (Research-Driven Portfolios). The management team has worked together for the past 20 years as market strategists and portfolio managers.

About Stifel
Founded in 1890, Stifel is one of the leading financial services firms in the U.S., providing full-service brokerage and investment banking services. Stifel is a leading underwriter and advisor for companies and a top provider of trade execution and securities distribution with nationally recognized research and a suite of asset management strategies.

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## BOUNCING INTO APRIL

We anticipate a bounce in domestic activity through the second quarter led by an advance in business and capital spending. Retail and automobile sales figures for March were solid, indicating that final domestic demand is holding up well as we started the second quarter. Retail sales rose by 1.1% in March (the most since 2012) and automobile sales advanced to a 16.7 million unit annualized rate (one of the best months since the recovery began). Industrial production in the United States rose by a respectable 0.7% in March, and this week's durable goods report is likely to show a similarly respectable growth rate near 1.8%, according to analysts surveyed by Bloomberg. Indications of steady final demand by domestic consumers, along with improving cyclical components like production and orders, sets the stage for a bounce in activity through the second quarter.

We are not as sanguine about the prospects for Emerging Markets and China, as growth remains challenged. Chinese policymakers appear to be generally focused on restraining credit growth, and the economy is slowing in response (currently near 7% vs. double-digit a few years ago). Slower growth is spilling over to other emerging market economies, and a recently announced consumption tax in Japan is also taking a bite out of growth. Adding to pressures on emerging markets is the prospect of a stronger dollar brought about by further reductions in asset purchases by the Federal Reserve, and the prospect of eventual Fed rate hikes. The dollar has gained 8% on a trade-weighted basis since 2012, in part because of the prospects for less accommodation by the Fed as the U.S. economy strengthens. The combination of weak growth in emerging markets compared to the United States and prospects of a stronger dollar leads us to keep asset allocation portfolios tilted toward dollar assets on a tactical basis.

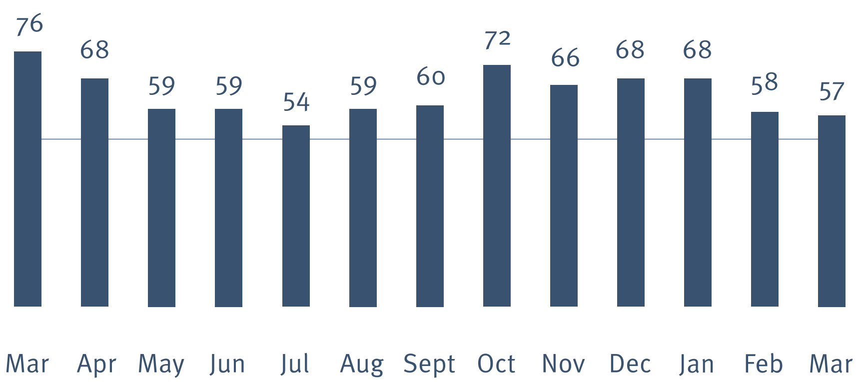
Our WCA Fundamental Conditions Barometer, which showed clear signs of decelerating through the first quarter, remains above 50, and we expect that the slippage in the index seen through the first quarter will abate, given a better tone to recent data. These indications support our case for a modest tactical equity overweight as we start the second quarter.

### Q1 Earnings Season

According to FactSet, the expected growth rate for first quarter S&P 500 earnings per share is a negative -1.3%. Earnings expectations for the quarter have been reduced from 6% anticipated growth at the start of the quarter, making it easier for companies to beat lowered expectations. Analysts continue to view the next 12 months optimistically, and the forward 12-month operating earnings estimate is $122.62. The S&P 500 trades at 15.2 times that earnings estimate, given Friday's close of 1,864. S&P 500 sales growth is expected to be 1.3% this year, while net margins are expected to rise to 10.1% (10-year average net margin is 8.4%).

## WCA Fundamental Conditions Barometer

Rising /Above 50 = Lower recession odds




WCA Fundamental Conditions Barometer Update

The WCA Fundamental Conditions Barometer (above), which measures changes in credit conditions, domestic economic activity, and foreign business conditions slipped in the first quarter, but remains at levels that suggest continued growth (levels above 50 are generally associated with better conditions). A slowdown in emerging markets, the need to reduce inventories following a buildup in the second half of 2013, and generally poor weather all contributed to the loss of momentum.

Better recent reports on jobs, domestic consumer demand, and production all suggest that the slippage in the index is set to abate.

Asset Allocation Portfolio Posture

NEAR-TERM TACTICAL POSTURE: The CONQUEST Tactical Balanced portfolio now stands at 55% equities, just slightly ahead of the 50% "neutral" allocation. From a top-down perspective, we are overweight equities, the U.S. dollar, and small caps. We are underexposed to credit (narrowed spreads), long bonds (tapering and prospects for higher rates), and emerging markets (poor relative price momentum, weakening near-term growth prospects).

LONG-RUN STRATEGIC POSTURE: Strategic allocations are set to reflect our long-run forecasts for key asset classes. We expect policy rates to remain low as central banks continue to push lower-for-longer rate strategies. Eventually, rates should rise back to more normal levels, but this is expected to happen gradually and unevenly. Fixed income returns are expected to lag current yields as rates rise. Equity returns will track moderate growth in global GDP with little to no further lift from margin expansion (margins are already elevated). Equity valuations appear reasonable and in line with historic multiples, so no additional return is being attributed to margin expansion.

A Barometer for Assessing Changing Conditions

We regularly assess changes in fundamental conditions to help guide near-term asset allocation decisions.

Analysis incorporates approximately 30 forward-looking indicators in categories ranging from Credit and Capital Markets to U.S. Economic Conditions to Foreign Conditions.

From each category of data, we create 3 diffusion-style sub-indices that measure the trends in the underlying data. Sustained improvement that is spread across a wide variety of observations will produce index readings above 50 (potentially favoring stocks); while readings below 50 would indicate potential deterioration (potentially favoring bonds).

The WCA Fundamental Conditions Index combines the 3 underlying categories into a single summary measure. This measure can be thought of as a "barometer" for changes in fundamental conditions.

## DISCLOSURES

The Standard & Poor's 500 Index is a capitalization-weighted index that is generally considered representative of the U.S. large capitalization market.

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Asset allocation and diversification do not ensure a profit and may not protect against loss. There are special considerations associated with international investing, including the risk of currency fluctuations and political and economic events. Investing in emerging markets may involve greater risk and volatility than investing in more developed countries. Due to their narrow focus, sector-based investments typically exhibit greater volatility. Small company stocks are typically more volatile and carry additional risks, since smaller companies generally are not as well established as larger companies. Property values can fall due to environmental, economic, or other reasons, and changes in interest rates can negatively impact the performance of real estate companies. When investing in bonds, it is important to note that as interest rates rise, bond prices will fall. High-yield bonds have greater credit risk than higher quality bonds. The risk of loss in trading commodities and futures can be substantial. You should therefore carefully consider whether such trading is suitable for you in light of your financial condition. The high degree of leverage that is often obtainable in commodity trading can work against you as well as for you. The use of leverage can lead to large losses as well as gains.