Washington Crossing Advisors

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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 23 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 wealth management 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.

ASSET ALLOCATION REVIEW

2015 is off to a slow start for investors, as stocks closed the second quarter essentially flat year-to-date and bond returns were generally negative. There are some positive takeaways from the second quarter that should not be overlooked, however.

The economy is again growing slowly (likely near 2% in the second quarter) after grinding to a halt in the first quarter. The thought of the first quarter stall leading to a recession is fading, and while our WCA Fundamental Conditions Barometer is far from strong, it has stopped slipping and has even seen a small bounce in recent weeks. The bottom line is that overall conditions seem to indicate that the economy continues to grow, a positive for equities.

The U.S. economy is producing about 2.8% more goods and services than it was a year ago, according to government data. This excludes the effects of changing prices. This pace of growth is faster than what economists estimate to be the longer-run potential growth rate for the economy based upon workforce dynamics, productivity, and other factors. Consequently, the ranks of the unemployed are diminishing, and unused and idle resources are coming back online.

We want to remain mindful of the fact that there is a direct relationship between asset returns, expected future returns, and economic activity. This is why we regularly review a broad set of indicators, which are linked to key aspects of the economy's performance. Headline-grabbing issues like Greece's recent troubles are important, but the greater importance for investors is the overall health of the economy, as this is what dictates returns over time.

We compiled a sample of key data that contribute to equity returns (below). The economy is growing slower and with less inflation than in the past, while profits and multiples are higher than normal. The dividend yield is also lower than normal, but a relatively new phenomenon of net share buybacks is adding to investors' cash return (≈2.5%). These facts lead us to our base case equity return projection of 5-6%.

MEASURE	20-YEAR AVERAGE	CURRENT
GROWTH POTENTIAL (CBO ESTIMATE)	3.2%	2.2%
CONSUMER PRICE INFLATION (HEADLINE)	3.5%	0.0%
S&P 500 P/E	17.3X	19.4X
S&P 500 DIVIDEND YIELD	3.4%	2.0%
ECONOMY WIDE PROFITS (% GDP; NIPA TABLES)	7.1%	10.7%

Source: Bloomberg as of July 10, 2015

JOBS, JOBS, JOBS

We believe we are moving through a long and shallow expansion that has been helped along by extraordinary government deficit spending and a set of ultra-accomodative monetary policies put in place by central banks around the world. It has been six years since the recession ended and more than ten years since the Fed last raised interest rates. The steady progress of the past several years has resulted in a decline in the unemployment rate to 5.3% from 10% in the autumn of 2009. The percentage of the population working, which fell from 64% in 2000 to 58% in 2010, is inching its way back up and now stands at 59%. There are even signs that wages are starting to pick up, as wages and salaries increased by 4.6% in 2014 versus a 3.3% average annual gain from 2009-2013. Employment, a coincident economic indicator, is behaving reasonably well, all things considered.

THE CONSUMER

If the job market was so good, we would expect to see booming consumption, but we are not. Automobile sales and overall consumer spending have been growing, but growth is nothing like what we saw in past cycles. Households remain cautious and are still inclined to save and pay down debts. Caution also extends to household finances, where households are holding larger cash balances, on average, than they used to. Today, the average cash balance is near 40 weeks of income in the United States compared to just 32 weeks prior to 2008. This high level of liquid cash relative to income has persisted despite an improving economy, rising stock prices, and years of near zero interest rates. Household liabilities, net of checking account balances, increased just 2% last year. In the 10 years prior, that figure grew at an annualized rate over 12%.

Along these same lines, we never experienced the surge in consumer spending that was predicted to be a result of the recent slide in oil prices. In fact, retail sales growth actually fell to 0% in the spring from 5% last summer while the oil price fell by 50%. Some rules of thumb would have had consumer spending jumping by at least 4% as a result of that slide.

INVESTMENT

Total investment spending continues to rise as a percent of GDP (near 17% currently). Capital goods orders, which are a reasonable proxy for changes in overall business spending, slipped from near $74 billion last summer to $68 billion in the first quarter. At the same time, the ratio of orders for durable goods to inventories slipped as well. Both capital goods orders and the ratio of durable goods orders to inventories seem to have stabilized during the second quarter, however.

THE FED'S NEXT MOVE

With employment, spending, and investment making steady progress, the Fed appears ready to initiate its first rate increase in over ten years. The Fed continues to hold to their "data dependent" stance, but also wants to assure markets that rate increases will proceed slowly, if at all, and only if the incoming data suggests that the economy can tolerate higher rates. We think the Fed will raise rates this fall, possibly as early as September given recent trends in employment and inflation expectations.

2015 SO FAR

The year began slower than we expected on several fronts. Economic growth has been disappointing, but recent indications suggest that the first quarter's near 0% growth rate was an isolated event. The second quarter seems to be delivering somewhat better performance, and consequently, the Fed should press forward with plans to implement a first rate increase later this fall.

We positioned portfolios more conservatively starting late last year as our barometer signalled weakness ahead. The stall in growth in the first quarter and sideways equity market performance was not accompanied by falling Treasury bond yields. In fact, those yields have been backing up over the past several months, resulting in negative returns through the first half of the year. Very recent indications suggest that growth seems to be picking up moderately as we head into the second half of the year, but more evidence is still needed before adding to equities.

SPOTLIGHT:
IS THE "RISK ON" TRADE GETTING TIRED?

While the return of a risk-taking attitude is helpful for the economy to grow, we are mindful that there is an eventual limit to the amount of risk that markets will ultimately be willing to assume. Increasing risk tolerance can be seen in the leadership of higher risk stocks since 2012 — just prior to the start of the Fed's latest round of asset purchases ("QE"). Since then, some investors have migrated toward higher risk securities in search of added return. This can, however, introduce unwanted risk into a portfolio.

We are reminded that the stock "market" is actually comprised of many different kinds of stocks. Companies with higher "torque" often tend to be associated with more variable earnings streams and higher degrees of leverage. Lower volatility companies tend to be the opposite. We believe now is an appropriate time to take a second look at lower "torque" companies with less leverage and greater consistency. Another tactic is to make sure that your portfolio allocation has not accidentally drifted too far into riskier securities as their prices have risen.

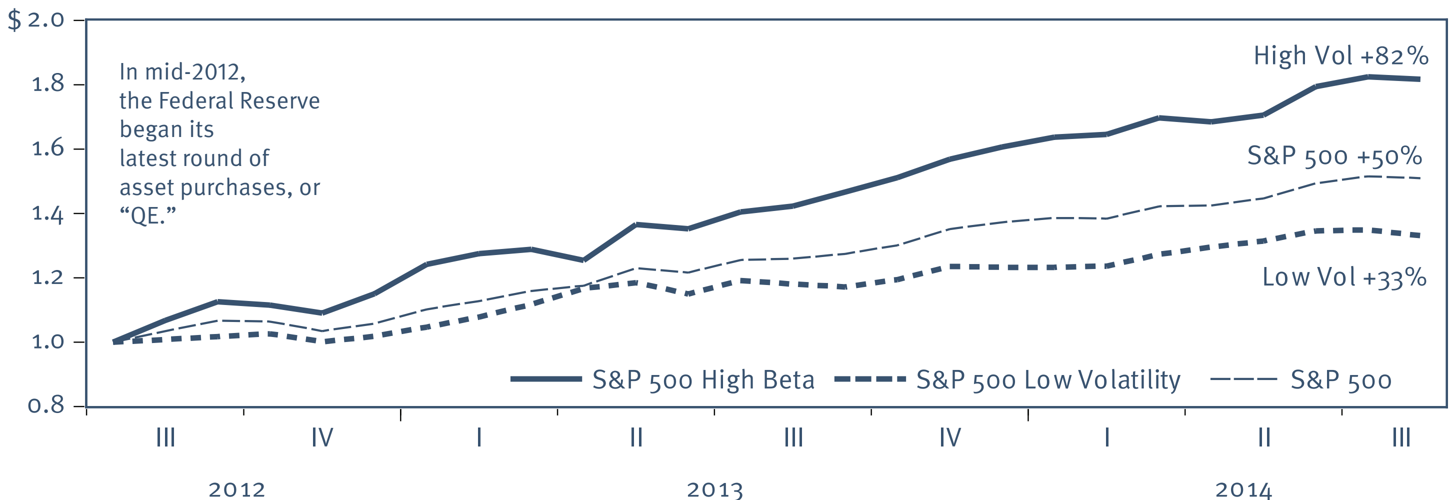
A longer perspective reveals that the tortoise actually did outrun the hare, especially after accounting for volatility (table below). In our view, the lion's share of the pickup in risk appetite is now behind us. Focus on quality and diversification should now be foremost in the minds of most investors.

Longer-Run Returns (Since 1990) By Volatility Category

	------- ANNUALIZED -------		
CATEGORY	RETURN	RISK*	RETURN /RISK
S&P High Beta Index	9.9%	23.9%	0.4
S&P Low Volatility Index	11.0%	9.4%	1.2
S&P 500 Index	7.9%	12.3%	0.6

* Annualized standard deviation

INCREASING RISK APPETITE DRIVING "HIGHER VOLATILITY" STOCKS 2012-2015 (GROWTH OF $1)



Source: Bloomberg

FUNDAMENTAL CONDITIONS UPDATE

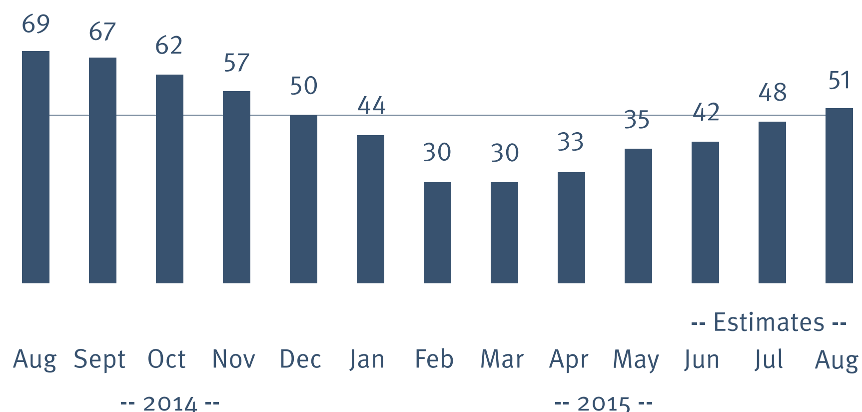
Crosscurrents between generally stronger domestic data and weakness in China, along with recurring worries over Greece, produced a grudging improvement in our WCA Fundamental Conditions Barometer through the second quarter. We expect real domestic GDP growth to accelerate from the first quarter's modest contraction, but remain below the long-term trend. Overall, the mix of data in Q2 was moderately positive.

WCA Fundamental Trend Indicators

	First Quarter Final	June Estimate	Change During Quarter
Credit and Capital Markets	25	55	Higher
U.S. Economic Conditions	35	42	Higher
Foreign Conditions	25	55	Higher
Fundamental Conditions	30	45	Higher

WCA Fundamental Conditions Barometer

Rising /Above 50 = Lower recession odds



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 and Foreign Conditions.

From each category of data, we create three 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 three underlying categories into a single summary measure. This measure can be thought of as a "barometer" for changes in fundamental conditions.

LAST QUARTER PORTFOLIO CHANGES

		Conservative		Balanced		Moderate Growth		Aggressive Growth	
		Current	Change	Current	Change	Current	Change	Current	Change
Bonds	Core Bonds	20%		15%		10%		0%	
	Floating Rate Securities	15%		10%		6%		0%	
	Cash & 1-3 Year Treasuries	17%		10%		4%		15%	
	Mortgage-Backed Bonds	11%		6%		0%		0%	
	Intermediate Gov't/Credit	5%		5%		5%		0%	
	7-10 Year Treasuries	0%		0%		0%		0%	
	10+ Year Treasuries	0%		0%		0%		0%	
	Investment-Grade Corp Bonds	9%		7%		3%		0%	
	High-Yield Corporate Bonds	3%		2%		2%		0%	
	International Treasury Bonds	0%		0%		0%		0%	
Equities and Other	Domestic Stocks	0%		8%		17%		19%	
	Large-Mid Cap Growth	3%		6%		9%		12%	
	Large-Mid Cap Value	3%		6%		9%		12%	
	Small Cap	4%		5%		5%		6%	
	Developed Foreign Markets	5%		12%		18%		22%	
	Emerging Foreign Markets	2%		3%		5%		5%	
	Gold	0%		0%		0%		0%	
	REITs	3%		5%		7%		9%	
	Subtotal Bonds & Cash	80%		55%		30%		15%	
	Subtotal Equities & Other	20%		45%		70%		85%	
	Total	100%		100%		100%		100%	

LONG-RUN STRATEGIC POSTURE:

Strategic allocations are set to reflect our long-run forecasts for key asset classes. We expect the domestic economy to grow near 2.3% over time, driven by modest growth in the labor force, positive contributions from capital investment, and increasing innovation and technology-driven productivity gains.

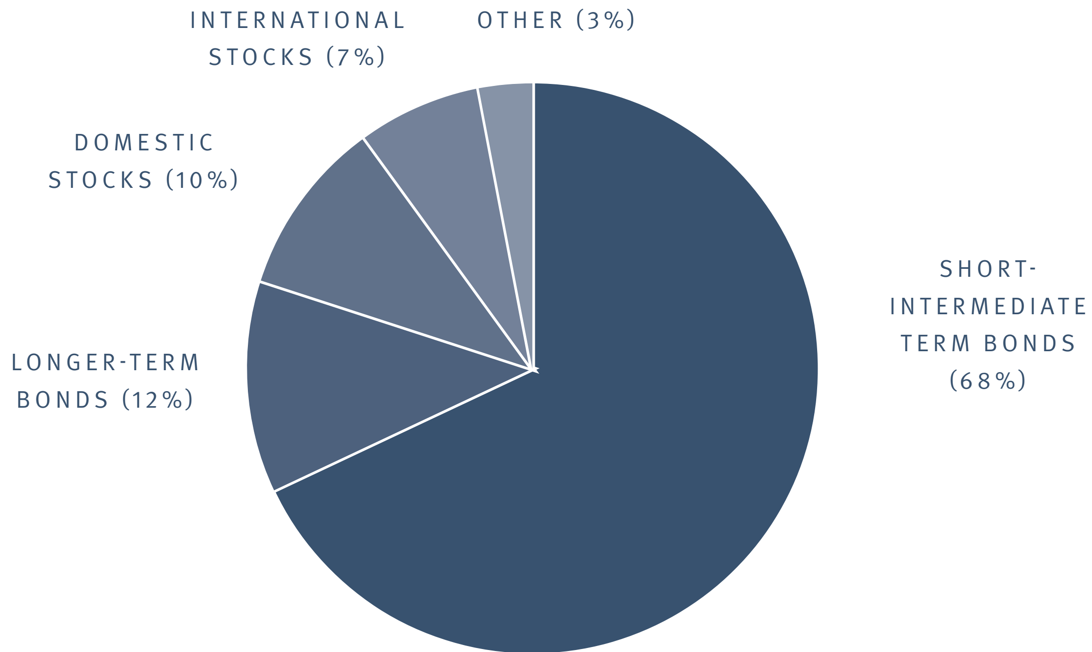
Cash returns should rise gradually toward a long-run target near 3.5-4% and should average roughly 2% over the next five years as the Fed raises rates in acknowledgement of tightening labor markets and a further closing of the economy's output gap (a measure of slack). Inflation expectations should remain anchored near 2%.

NEAR-TERM TACTICAL POSTURE:

The CONQUEST portfolios are allocated in accordance with our WCA Fundamental Conditions Index and long-run return considerations. The index slipped from September through the first quarter and appears to have stabilized in the second quarter, suggesting the U.S. economy is picking up some momentum. We remain moderately underweight equities as we move into the second half of the year.

Meanwhile, China's slipping growth rate and Greece's troubles are weighing on investor expectations. Consequently, we remain overweight domestic equities within the equity allocation. *No tactical changes were made during the second quarter.*

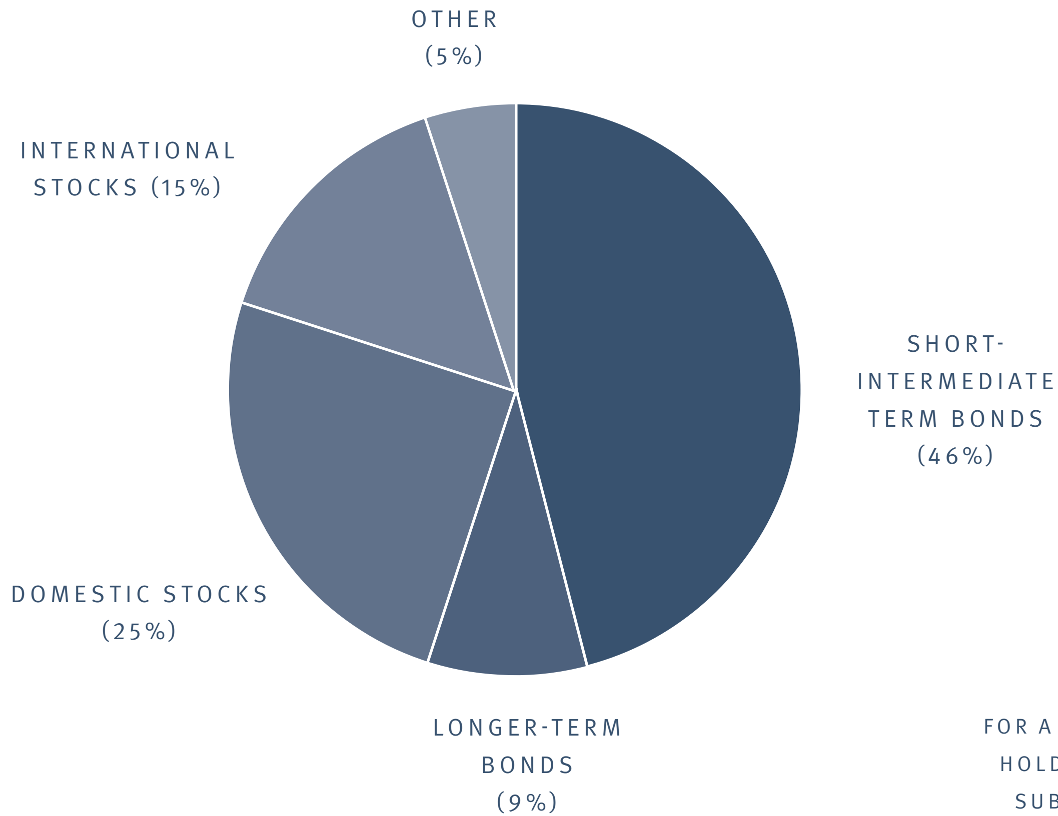
CONSERVATIVE PORTFOLIO
EQUITY POLICY RANGE: 0-50%
CURRENT EQUITY EXPOSURE: 20%



FOR A DETAILED LIST OF HOLDINGS, INCLUDING SUB-ASSET CLASSES, SEE PAGE 10

Portfolio Description

The CONSERVATIVE PORTFOLIO invests between 0-50% in equities based on fundamental market and economic conditions. The strategy seeks to provide a risk-adjusted return, over time, better than that of a fixed portfolio comprised of 25% stocks and 75% bonds. This portfolio offers the most conservative mix of stocks and bonds relative to the other portfolios mentioned herein. Investors with a short-to-medium investment horizon of at least 5 years or lower risk tolerance who desire modest growth may prefer this option over a portfolio with greater exposure to stocks.



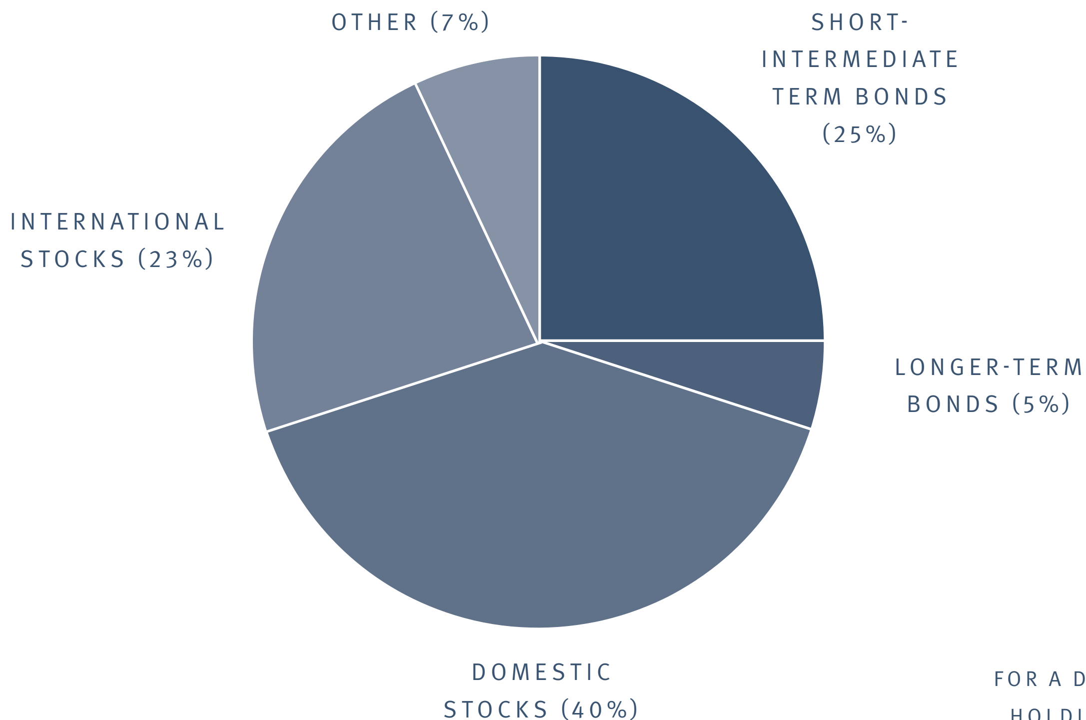
FOR A DETAILED LIST OF HOLDINGS, INCLUDING SUB-ASSET CLASSES, SEE PAGE 10

Portfolio Description

The BALANCED PORTFOLIO invests between 25-75% in equities based on fundamental market and economic conditions.

The strategy seeks to provide a risk-adjusted return, over time, better than that of a fixed portfolio comprised of 50% stocks and 50% bonds. The portfolio provides a mix of stocks and bonds without a bias toward either. It may be appropriate for investors with a time horizon of at least 10 years with a moderate risk tolerance.

MODERATE GROWTH PORTFOLIO
EQUITY POLICY RANGE: 50-100%
CURRENT EQUITY EXPOSURE: 70%



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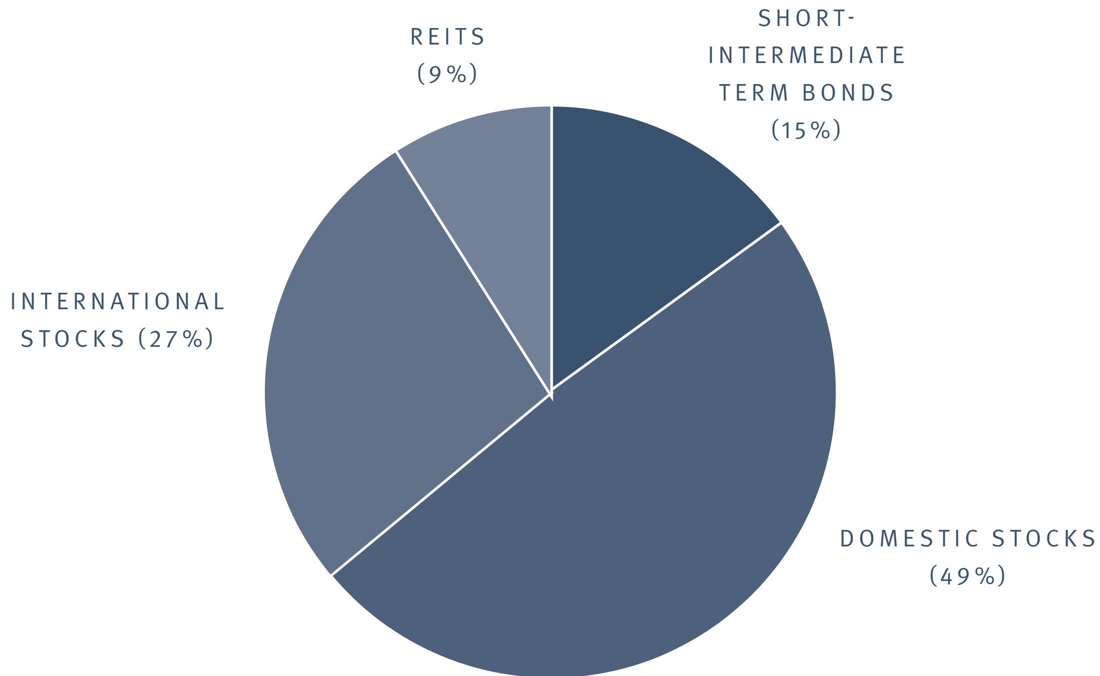
Portfolio Description

The MODERATE GROWTH portfolio invests between 50-100% in equities based on fundamental market and economic conditions. The strategy seeks to provide a risk-adjusted return, over time, better than that of a fixed portfolio comprised of 75% stocks and 25% bonds. Because the portfolio invests primarily in stocks and secondarily in bonds, the portfolio may be appropriate for investors with a time horizon of at least 15 years or those who seek principal growth with a moderate amount of income.

AGGRESSIVE GROWTH PORTFOLIO
EQUITY POLICY RANGE: 80-100%
CURRENT EQUITY EXPOSURE: 85%



FOR A DETAILED LIST OF HOLDINGS, INCLUDING SUB-ASSET CLASSES, SEE PAGE 10

Portfolio Description

The AGGRESSIVE PORTFOLIO invests between 80-100% in equities based on fundamental market and economic conditions. The strategy seeks to provide a risk-adjusted return, over time, better than that of a fixed portfolio comprised of 90% stocks and 10% bonds. Because of the high degree of exposure to stocks, investors in this portfolio should have an investing time horizon of at least 20 years or be able to accept greater variability of returns associated with stock market investing.

FORECASTS AND ASSUMPTIONS: ECONOMY

	2012 (Actual)	2013 (Actual)	2014 (Estimate)	2015 (Estimate)	2014 Growth	2015 Growth
Real Gross Domestic Product	15,369	15,710	16,060	16,422	2.2%	2.3%
Gross Domestic Product	16,163	16,768	17,700	18,400	5.6%	4.0%
Consumption	11,083	11,484	12,080	12,600	5.2%	4.3%
% GDP	69%	68.5%	68%	68%		
Investment	2,479	2,648	2,930	3,150	10.6%	7.5%
% GDP	15%	15.8%	17%	17%		
Government Spending	3,169	3,144	3,200	3,250	1.8%	1.6%
% GDP	20%	18.7%	18%	18%		
Exports	2,194	2,262	2,390	2,425	5.6%	1.5%
% GDP	14%	13.5%	14%	13%		
Imports	(2,763)	(2,770)	(2,900)	(3,025)	4.7%	4.3%
% GDP	-17%	-16.5%	-16%	-16%		
Government Deficit	1,439	1,882	2,124	2,392	12.9%	12.6%
% GDP	8.9%	11.2%	12.0%	13.0%		
Total Private Saving	3,641	3,402	3,496	3,680	2.8%	5.3%
% GDP	23%	20%	20%	20%		
Households & Institution	1,301	1,035	1,154	1,196	11.4%	3.7%
% GDP	8%	6%	6.5%	6.5%		
Business Saving / Profits	2,341	2,367	2,307	2,399	-2.5%	4.0%
% GDP	14%	14%	13%	13%		
Employment (Nonfarm Payroll)	135,064	137,395	139,868	142,300	1.8%	2.0%
Employment (Private Sector)	113,176	115,541	117,852	120,433	2.0%	2.5%
S&P 500 Operating EPS	$103.08	$108.44	$118.20	$123.00	9.0%	4.1%
Inflation Index (GDP Deflator)	105.2	106.7	108.3	110.2	1.5%	1.7%

Historic data provided by Bureau of Economic Analysis (NIPA Tables 1.1.5 / 5.1) for GDP, Bureau of Labor Statistics for employment, and Standard & Poor's for S&P 500 earnings. Forecasts and assumptions provided by Washington Crossing Advisors. Government deficit includes Federal, State, and Local.

FOUNDATIONAL ASSUMPTIONS

	2011 (Actual)	2012 (Actual)	2013 (Actual)	2014 (Estimate)	2015 (Estimate)	Long-Run Growth Forecast
Population (Millions)	311.9	313.9	316.1	318.3	320.5	0.8%
Labor Force Participation Rate	64.0%	63.6%	62.8%	63.0%	63.4%	0.0%
Gross Fixed Capital (OECD)	3.7%	5.3%	2.7%	3.9%	3.0%	2.0%
Productivity Growth	1.08%	1.09%	1.10%	1.11%	1.12	1 .0%
Forecast Inflation (Long-Term)	2.0%	2.5%	2.25%	2.0%	1.75%	1.9%

DOMESTIC SECTOR ALLOCATION

	Weight	Notes
Consumer Discretionary	12%	Benefit from improving macroeconomic indicators, strengthening consumer confidence, and low interest rates. Lower gas prices should boost overall consumer spending for some companies across certain industry groups.
Consumer Staples	9%	Foreign currency headwinds (due to a strengthening U.S. dollar) and slowing emerging market growth a potential drag. Constant currency sales trends should improve as 2015 progresses on strengthening consumer demand.
Energy	13%	Pricing still has to contend with headwinds. Volumes will help offset, since production continues to rise.
Financials	16%	Contributing factor for the sector should be the return to profitability for some of the big banks. Good results expected from asset management due to higher assets under management.
Healthcare	13%	Outperformance in managed health care attributed to gains in Medicaid and enrollment in the healthcare exchanges. The increase in insured patients and higher utilization should help other health care sub-industries.
Industrials	9%	Growth in nonresidential and commercial construction, increased transportation demand, and lower fuel costs a positive. Strengthening U.S. dollar a potential cause for concern.
Technology	22%	Strong dollar will have negative impact on financial results, given sector's exposure to foreign sales. Profits on international revenues also tend to be higher, given lower taxes abroad.
Materials	3%	Earnings likely to be hurt by falling oil prices but partly offset by lower input costs and cost reduction efforts.
Utilities	3%	Improving demand from industrial customers, and residential and commercial customer growth are all positives. Higher depreciation and interest costs exist due to high utility capital spending.
Total	100%	

DEFINITIONS AND DISCLOSURES

The Standard & Poor's 500 Index is a capitalization-weighted index that is generally considered representative of the U.S. large capitalization market. The MSCI EAFE Index (Europe, Australasia, and the Far East) is a free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the U.S. and Canada. The MSCI Emerging Markets Index is a free float-adjusted market capitalization-weighted index that is designed to measure the equity market performance of emerging markets. The Russell 1000 Index measures the performance of the 1,000 largest companies in the Russell 3000 Index, which measures the performance of the 3,000 largest U.S. companies based on total market capitalization. The average market capitalization is approximately $11 billion, and the median market capitalization is approximately $3.5 billion. The Russell 2000 Index measures the performance of the 2,000 smallest companies in the broader Russell 3000 Index. The average market capitalization is approximately $490 million, and the median market capitalization is approximately $395 million. The Russell 3000 Value Index measures the performance of those Russell 3000 Index companies with lower price-to-book ratios and lower forecasted growth values. The Russell 3000 Growth Index measures the performance of those Russell 3000 Index companies with higher price-to-book ratios and higher forecasted growth values. The S&P 500 High Beta Index measures the performance of the 100 constituents of the S&P 500 Index that are most sensitive to changes in the market. Constituents are weighted relative to their level of market sensitivity, with each stock assigned a weight proportional to its beta. The S&P 500 Low Volatility Index measures the performance of the 100 least volatile stocks in the S&P 500 Index. Constituents are weighted relative to the inverse of their corresponding volatility, with the least volatile stocks receiving the highest weights.

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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.