QUARTERLY 3Q17

TACTICAL ASSET ALLOCATION

- Indicators point to growth, but we expect the pace of improvement to slow
- Low starting yields and elevated equity valuations weigh on return forecast
- Our "barometer" continues to suggest positive growth trends

We enter the second half of 2017 with data coming in well, asset prices near records, and market sentiment good. Our analysis of current fundamental conditions points to continued growth, but the "reflation" and "Trump" trades may be losing some momentum.

Portfolios are tactically tilted toward U.S. equities, with an emphasis on growth. Fixed income continues to focus on corporate bonds over Treasuries given our outlook.

Mid-Year Update

Global stock and bond markets rose throughout the first half of the year. An improving profit outlook and moderating inflation helped drive asset values to records.

According to Federal Reserve data, household net worth in the United States stands near a record $100 trillion — a three-fold increase in just twenty years (graph, bottom of next page). Higher asset values are helping to reduce leverage. The household debt service ratio, for example, now stands at record lows and the household debt-to-income ratio is down to 2002–2003 levels. The personal savings rate is back near 6% from a low of 2% in 2005. Higher asset values, years of retrenchment and rebuilding, a better economy, and higher savings rates are all helping the household sector build a stronger balance sheet.

Corporations are also faring well. Corporate profits are double the average level of the 1990's as a share of the economy, and S&P 500 profits are estimated to hit a record over the next year. Corporate net worth now stands at a record $24 trillion as the economy has grown to over $19 trillion in size. Record profits and household savings creates a large pool of investable capital for future growth.

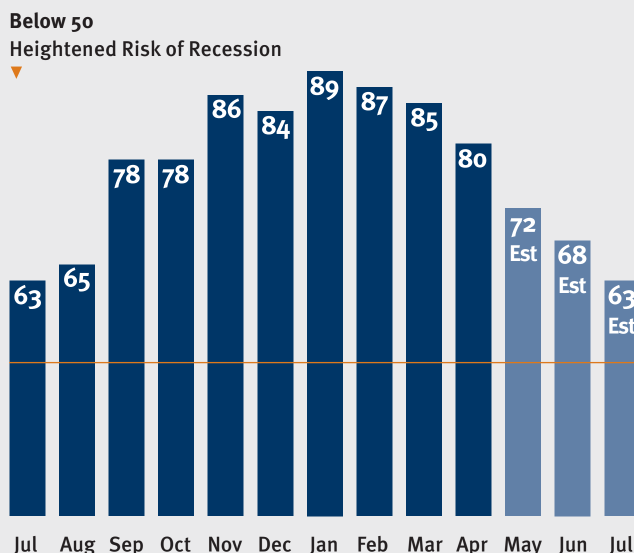
Beyond the domestic story, growth seems to be picking up outside our borders, too. We now expect Europe and Japan to grow modestly faster in 2017 than they did in 2016, for example. Surveys suggest global manufacturing continues to improve. In short, the global economy seems better positioned for balanced growth now than in recent years.

Equities Outlook

Equity markets are pressing higher, helped by improving growth and strong cash flow. Valuations, however, seem to capture much of this "good news." For example, the forward price-to-earnings ratio for the S&P 500 stands at 17.4 times analyst forecasted earnings, compared to a 10-year average of 14 times, according to FactSet Research. Earnings growth is expected to reach 5.1% this year and 11.4% next year, justifying some of the premium valuation.

Current cash returns to equity holders are also generous. The total cash yield (buybacks plus dividends) to S&P 500 shareholders is near 4.3%. On a trailing basis, total cash returns amounted to nearly 95% of overall S&P 500 operating earnings, however. We expect this ratio to decline in the future as more cash gets reinvested to fund growth and pay workers than fund buybacks.

WCA FUNDAMENTAL CONDITIONS BAROMETER



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.

Improving growth in Europe and Japan also leads us to *maintain our global tactical tilt toward developed foreign equity markets*. Continued slowing growth and a large credit overhang keep us underexposed to emerging markets (EM) for now. We continue to forecast faster domestic growth than most developed foreign economies and are *maintaining our domestic tactical tilt*.

As for sectors, we are more constructive on the risk/return outlook for healthcare versus energy. For equity income, we see a better risk versus reward trade-off in real estate (REITs) compared with utilities. These sector calls also form the basis for our tactical style shift favoring growth over value at this time.

We believe equity markets should continue to gain ground along with improving long-run fundamentals. As in the past, we believe periodic bouts of economic weakness and occasional unexpected shocks will interrupt growth from time to time. Future expectations must incorporate these risks alongside a long-run view of potential outcomes.

Fixed Income

Ample oil supply and intense retail competition is keeping a lid on consumer price inflation. Moderating inflation, in turn, explains much of the first half's Treasury bond rally, in our view. As bonds rallied and yields fell through the last quarter, the Federal Reserve raised short-term interest rates. Rising short-rates and falling long rates drove the entire yield curve to become relatively flat. The 10-year Treasury / 3-month T-Bill spread declined to about 1.15% (115 basis points) by mid-June, near a cycle low.

While flatter, the curve doesn't suggest yet a return of deflation economics or imminent recession. Instead, the decline in oil prices likely explains much of the fading consumer price inflation and the attendant drop in yields. The oil price weakness seems to be more of a supply issue unique to that commodity than a broader deflationary process, in our judgement. In short, this does not derail our longer-term view that interest rates should migrate higher from here.

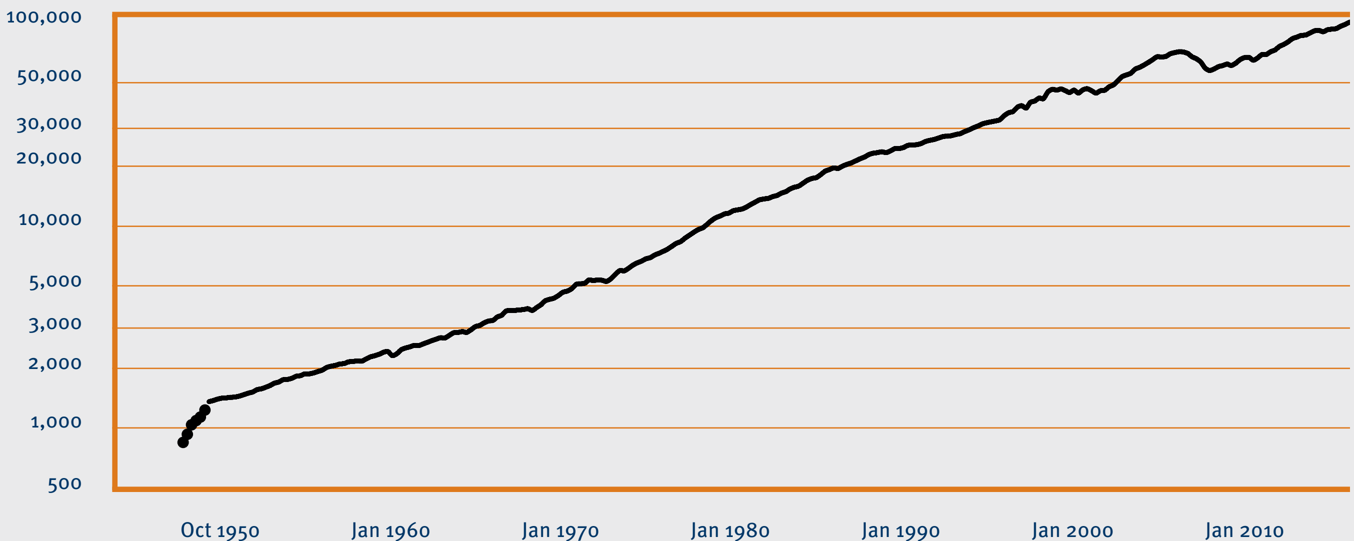
Tight labor markets and fading economic slack in the United States is likely to put upward pressure on inflation and rates. The Federal Reserve is upbeat on the economy, expects the unemployment rate to fall further, and is planning to pare its balance sheet. While there is a debate about the timing and size of tightening, the writing seems to be on the wall. These views introduce a different narrative than the "lower for longer" camp may have become accustomed to over the past decade.

Although U.S. yields are low by historic standards, foreign bonds offer nothing better (Germany's 10-year bond yields 0.47% and Japan's 10-year government bond yields 0.08%). Thus, we maintain a *tilt toward domestic corporate bonds over long-dated sovereign bonds* as we start the third quarter.

Summary

Trends in data remain positive, but the momentum that carried last year's "reflation" and "Trump" trades may be set to fade. Fading exuberance doesn't imply a recession or bear market is around the corner but may suggest a change in dynamics may lie ahead.

We remain focused on our WCA Fundamental Conditions Barometer for clues about the direction from here. We will make tactical adjustments should changing conditions warrant. Satellite portions of portfolios remain *tilted toward stocks over bonds* in light of our short-term view of fundamental data, for now.

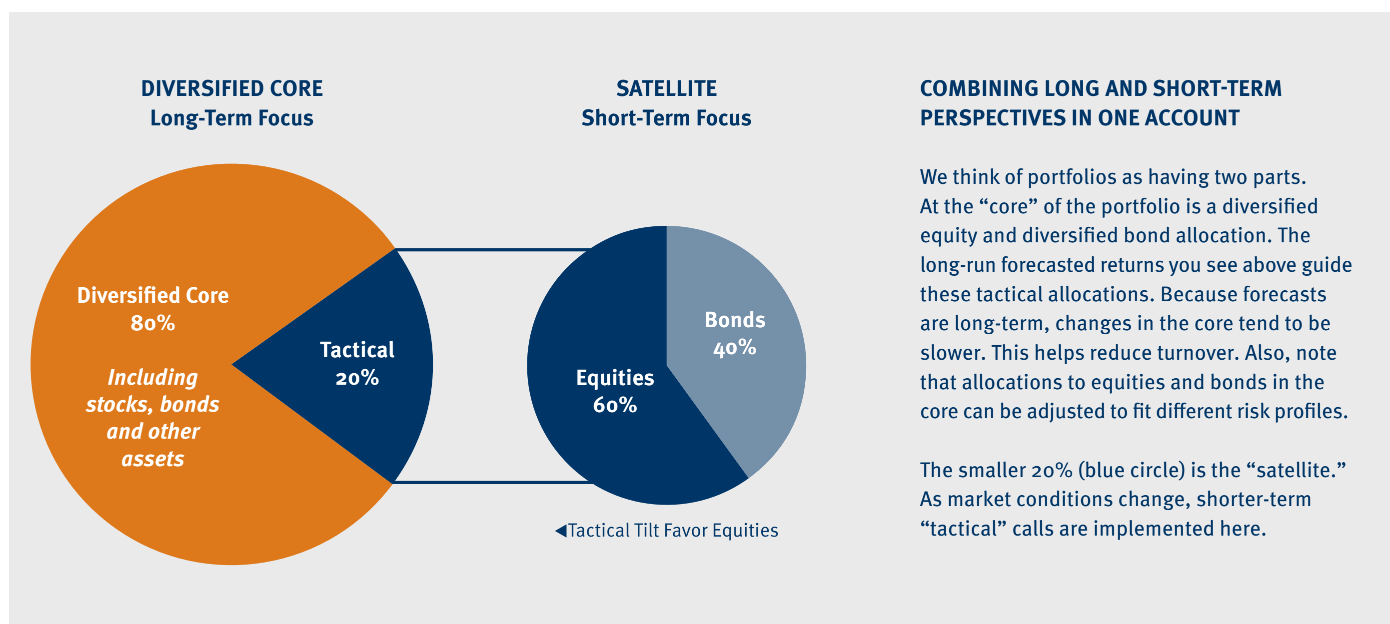


Source: Federal Reserve.

ASSET CLASS	10-15 YR VIEW RETURN	VOLATILITY	UNDERWEIGHT	NEUTRAL	OVERWEIGHT
BONDS					
Core Bonds	3.9%	2.8%	■		
1-3 Year Treasury Bond	2.3%	1.0%		■	
Mortgage-Backed Securities	2.5%	2.5%		■	
Intermediate Government/Credit	2.4%	2.4%		■	
20+ Year Treasury Bond	2.6%	11.4%	■		
Investment-Grade Corporate Bonds	2.8%	5.2%			■
High-Yield Corporate Bonds	2.9%	8.6%			■
EQUITY					
Equity	5.0%	14.5%			■
Domestic Large Cap Value	5.0%	15.7%	■		
Domestic Large Cap Growth	5.0%	14.3%			■
Foreign Developed Equity Markets	5.5%	17.4%			■
Foreign Emerging Equity Markets	5.5%	20.4%	■		
Gold	2.5%	15.7%	■		
REITs	5.4%	22.3%		■	

As of June 30, 2017. Past performance does not guarantee future results.

■ Core ■ Tactical



COMBINING LONG AND SHORT-TERM PERSPECTIVES IN ONE ACCOUNT

We think of portfolios as having two parts. At the "core" of the portfolio is a diversified equity and diversified bond allocation. The long-run forecasted returns you see above guide these tactical allocations. Because forecasts are long-term, changes in the core tend to be slower. This helps reduce turnover. Also, note that allocations to equities and bonds in the core can be adjusted to fit different risk profiles.

The smaller 20% (blue circle) is the "satellite." As market conditions change, shorter-term "tactical" calls are implemented here.

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Washington Crossing Advisors, LLC ("WCA") is an SEC registered investment advisor and wholly owned subsidiary of Stifel Financial Corp. WCA helps supervise and manage over $1 billion in assets under advisement for individuals and institutions.

The team is managed by Kevin R. Caron, CFA and Chad A. Morganlander, who were among the founding members of Washington Crossing Advisors.

Washington Crossing Advisors' views on investing and markets are regularly sought by national media outlets, including *CNBC*, *Bloomberg*, *Fox Business News*, *The Wall Street Journal*, *Forbes*, and *Reuters*.

Philosophy and Process

We believe that investments should be selected only after clear and quantified measures of value, risk, and potential reward have been made. Our investment approach combines top-down analysis of the macroeconomy with fundamentally rooted, bottom-up security analysis.

Description of Indices and Terms/ Disclosures

Description of Indices and Terms: All performance calculations of indices are calculated on a total return basis (reflecting reinvestment of dividends and other earnings). Indices are unmanaged, are not available for direct investment, and have no associated management fees.

Barclays Aggregate Bond Index: A composite of the Barclays Gov't/Corp Index, Mortgage-Backed Securities Index, and Asset-Backed Securities Index, including securities that are investment grade or better, have at least one year to maturity, and have an outstanding par value of at least $100 million.

S&P 500 Index: Capitalization-weighted composite of 500 stocks traded on the NYSE, AMEX, and NASDAQ; not the largest 500 stocks in U.S., but rather a blend of leading companies in leading industries in the U.S. economy; index comprised of 10 broad industrial sectors.

Dow Jones U.S. Select REIT: The Dow Jones U.S. Select REIT Index intends to measure the performance of publicly traded REITs and REIT-like securities. The index is a subset of the Dow Jones U.S. Select Real Estate Securities Index (RESI), which represents equity real estate investment trusts (REITs) and real estate operating companies (REOCs) traded in the U.S.

The ICE U.S. Treasury 1-3 Year Bond Index is a market value weighted index designed to measure the performance of U.S. dollar-denominated, fixed rate U.S. Treasury securities with minimum term to maturity greater than one year and less than or equal to three years.

Markit iBoxx USD Liquid High Yield Index consists of liquid USD high yield bonds, selected to provide a balanced representation of the broad USD high yield corporate bond universe.

The FTSE Developed All Cap ex U.S. Index is part of a range of indices designed to benchmark international investments. The index comprises large, mid and small cap stocks from developed markets excluding the U.S.

The FTSE Emerging Markets All Cap China A Inclusion Index is a market-capitalization weighted index representing the performance of large, mid and small cap stocks in Emerging markets. The index is comprised of approximately 3350 securities from 21 countries.

Moody's Baa Corporate Bond Index—An index comprised of industrial bonds rated Baa by Moody's with a minimum maturity of 20 years.

Consumer Price Index—A measure of the average change in prices over time for a basket of consumer goods.

Asset Allocation—Asset allocation does not ensure a profit or protect against loss.

International and Emerging Markets Investing—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.

Bonds and High Yield Bonds—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.

Commodities and Futures—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.

Real Estate—When investing in real estate companies, property values can fall due to environmental, economic, or other reasons, and changes in interest rates can negatively impact the performance.

Score Disclosure: The Washington Crossing Advisors, LLC Stifel Conquest and Dynamic Strategies Portfolios require a $25,000 and $50,000 minimum investment, respectively. Strategies in the Stifel Score Program are proprietary products developed by Stifel. More information on the Score Program is included in the Stifel Consulting Services Disclosure Brochure and Part II of the Manager's Form ADV, which may be obtained from your Financial Advisor and which further outlines the fees, services, exclusions, and disclosures associated with this program. The information contained herein is believed to be reliable and representative of the portfolios available through Stifel; however, the accuracy of this information cannot be guaranteed. Investors should consider all terms and conditions before deciding whether the Score Program is appropriate for their needs.

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