Washington Crossing Advisors

Portfolio Comment

WWW.WASHINGTONCROSSINGADVISORS.COM

May 20, 2014

Kevin R. Caron
Portfolio Manager
(973) 549-4051
kevin.caron@stifel.com

Chad A. Morganlander
Portfolio Manager
(973) 549-4052
chad.morganlander@stifel.com

Matthew J. Battipaglia
Analyst
(973) 549-4047
matthew.battipaglia@stifel.com

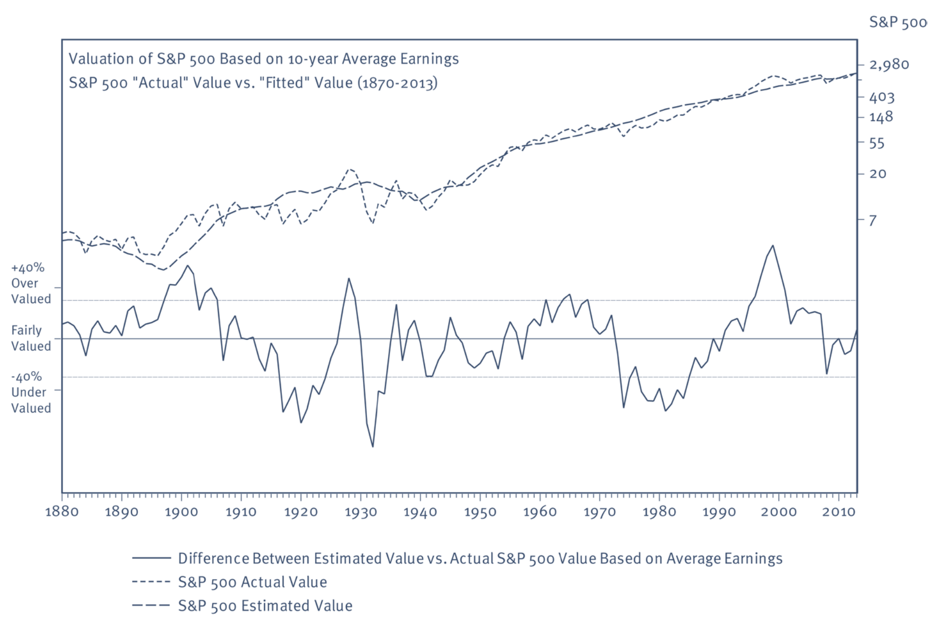
LOOKING FOR LIFT

Our barometer for measuring changes in fundamental conditions is hovering just north of 50. This means that slightly more than half of the trends we monitor regarding risk appetite and economic growth are still positive (although the percentage of positive signals has declined from near 80% at the start of the year). Recent incoming economic data are also generally supportive of continued growth.

Liquidity is abundant. Deals like the proposed AT&T Direct TV merger are becoming more common, and M&A activity is robust. Generally speaking, private equity is flush with cash and multiples paid are generous. Spreads between corporate debt and Treasury debt are narrower than average. Liquidity premiums priced into smaller companies are lower than average. Investors appear to be willing to accept risk and are providing liquidity, making prospective investment opportunities more attractive to users of capital. Capital spending is expected to pick up as a result. *Barron's* reports this week, for example, that companies may be opting for more capital spending over stock repurchases and estimates that capital spending may rise to 7% growth this year versus 2% last year — a potentially bullish factor for future growth.

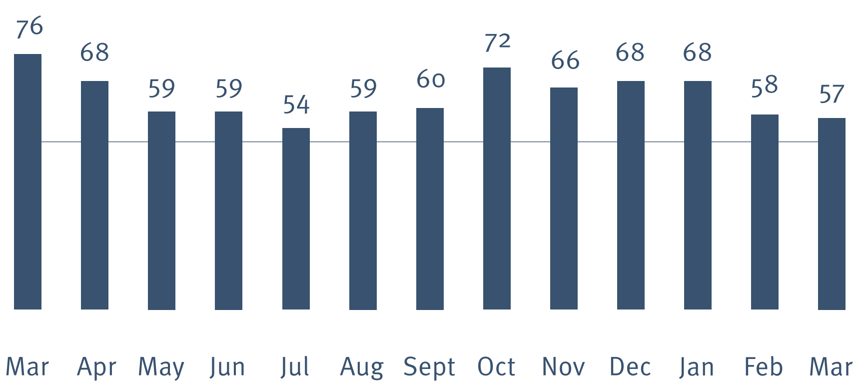
Our basic view on stocks remains that growth drives returns over time, and valuations matter more at extremes. Today, we see the equity market slightly ahead of fair value given the underlying level of earnings, but the basic relationships between prices and underlying earnings power are nowhere near the extremes seen in past cycles. The chart below takes a long view and relates the level of the S&P 500 to an average of 10-year earnings. From over 100 years of data, we create a hypothesized value of the S&P based only on average earnings and compare that to the actual value. The historical perspective suggests that the S&P 500 is currently trading reasonably close to where it should be given underlying earnings power.

S&P 500 Within Fair Value Range



WCA Fundamental Conditions Barometer

Rising /Above 50 = Lower recession odds



Asset Allocation Portfolio Posture

NEAR-TERM TACTICAL POSTURE: 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.

The information contained herein has been prepared from sources believed to be reliable but is not guaranteed by us and is not a complete summary or statement of all available data, nor is it considered an offer to buy or sell any securities referred to herein. Opinions expressed are subject to change without notice and do not take into account the particular investment objectives, financial situation, or needs of individual investors. There is no guarantee that the figures or opinions forecasted in this report will be realized or achieved. Employees of Stifel, Nicolaus & Company, Incorporated or its affiliates may, at times, release written or oral commentary, technical analysis, or trading strategies that differ from the opinions expressed within. Past performance is no guarantee of future results. Indices are unmanaged, and you cannot invest directly in an index.

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.