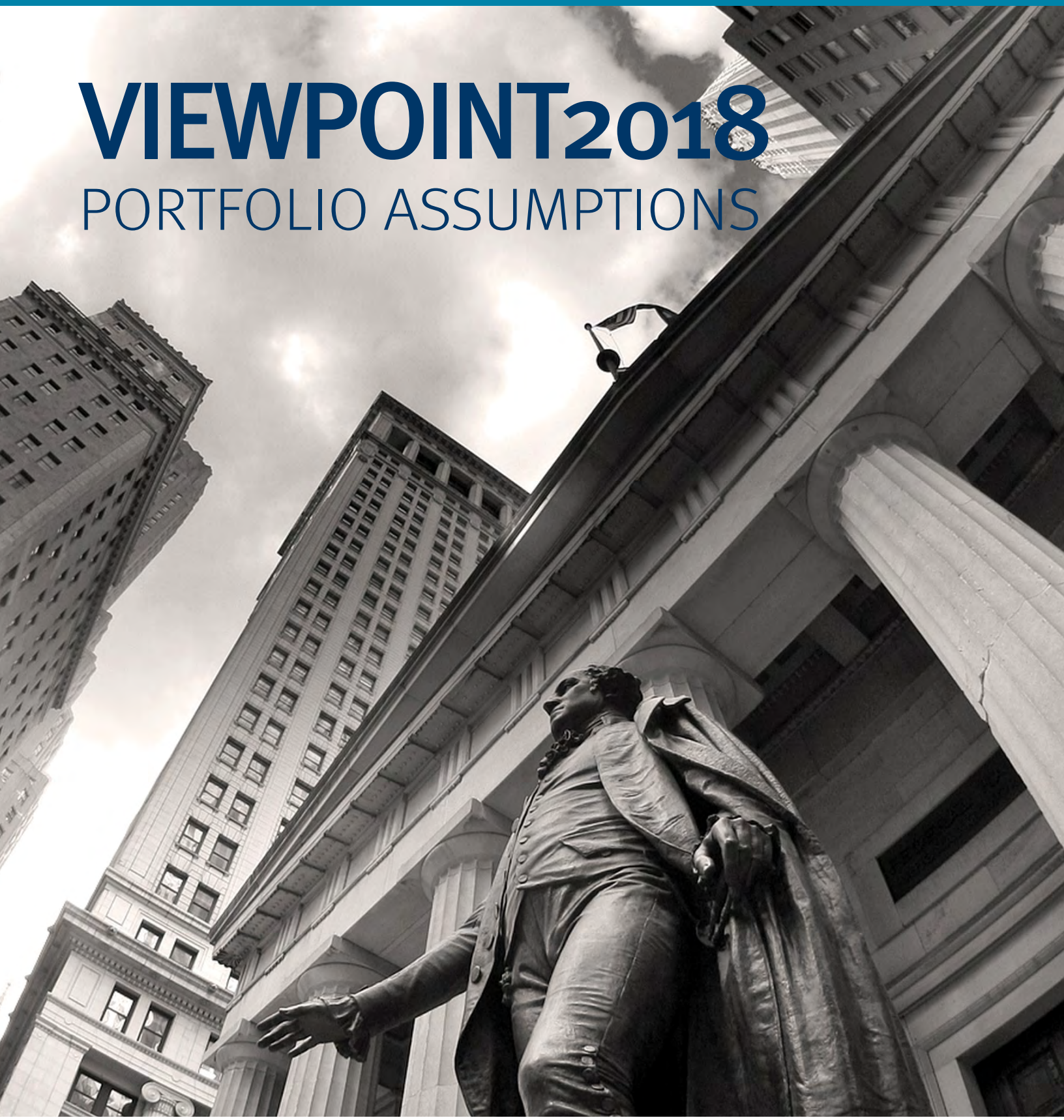
WASHINGTON CROSSING ADVISORS

VIEWPOINT2018

PORTFOLIO ASSUMPTIONS



WASHINGTON CROSSING ADVISORS

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 first 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 macro economy with fundamentally rooted, bottom-up security analysis.

Asset Allocation Strategies

Conquest Portfolios

Asset allocation portfolios seek to balance risk and reward by apportioning portfolio assets according to the investor's goals, risk tolerance, and investment horizon. Portfolios seek strong returns relative to underlying inflation and are constructed with a forward-looking view of financial markets.

Dynamic Strategy Portfolios

Portfolios include stocks, bonds, and alternative investments and are managed relative to our 3-5 year outlook for asset class performance. The portfolios are offered as passive portfolios (greater tax efficiency) or active portfolios (greater flexibility).

Strategies only available through Stifel, Nicolaus & Company, Incorporated. Visit www.washingtoncrossingadvisors.com for quarterly reports that highlight key macro economic insights and market observations.

Executive Summary

Our 2018 Viewpoint begins on an optimistic note. Growth continues to pick up by most accounts, businesses are again investing, and asset values are near records. Confidence necessary for risk taking is apparent, and inflation remains at bay. On the other hand, we are now confronted with higher valuations in many asset classes, which we feel should eventually weigh on long-run returns.

This annual Viewpoint, along with quarterly updates, provides an organized way of looking at the economy, financial markets, and your portfolio.

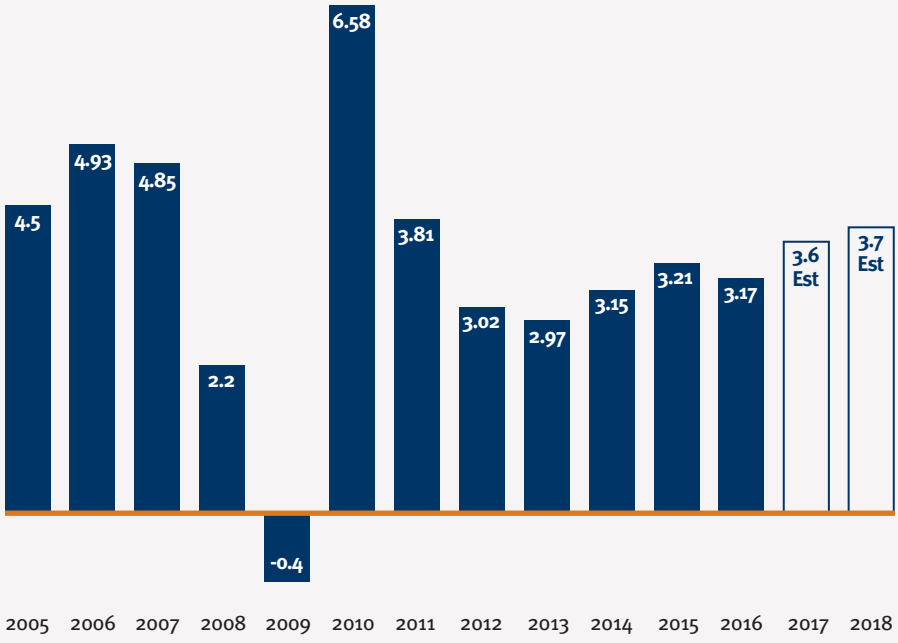
2017 was a turnaround year for the global economy as growth accelerated from a slowdown in 2016 (chart below). Growth surprised to the upside across most major economies, and inflation was nowhere to be seen. Financial conditions were exceptionally supportive and, in turn, helped promote a rebound in global capital investment, profits, and asset values. The long-running expansion and bull market show little sign of slowing down as we go to print with this 2018 Viewpoint.

If this scenario is starting to sound familiar, it should. During the 1990s, a similar virtuous cycle fed economic momentum. The 1990s boom brought a surge in technology-related capital investment, rising optimism, and lofty expectations, which led to an ebullient stock market. An increasingly wealthy investor class felt more secure and spent and saved accordingly. Growth continued unabated for a surprisingly long time.

This positive feedback loop eventually broke down once overly-optimistic growth assumptions became fully priced into markets and tightening economic conditions cast doubt on overly aggressive assumptions. Just as then, potential threats to today's positive environment also exist. Unsettled global politics, a surge in interest rates or commodity prices, uncertainty surrounding China's credit-driven growth model, or potential for policy error could all unnerve markets at some point. As of this writing, however, investors are squarely focused on improving growth; markets are behaving well, and the music continues to play.

WORLD ECONOMIC GROWTH (ANNUAL PERCENT CHANGE)

Source: International Monetary Fund



Consumer

According to a survey by the University of Michigan, consumer sentiment is approaching levels last seen during the late 1990s. The number of jobs in the United States increased by 1.4% through the third quarter, and hourly wages were up by 2.7% from the year prior. At the same time, household net worth in the United States is nearing $100 trillion for the first time in history. The combination of employment opportunity, rising income, and significant wealth gains undergirds a healthy consumption outlook as we start 2018.

Business

Rebounding global activity and profits enlivened business spending in 2017. After a mixed year in 2016 brought declining profits, order rates, and investment, 2017 saw positive trends. Economy-wide corporate income grew by 7.3% through the third quarter in 2017 versus no growth in 2016. Core capital goods orders, a good proxy for business investment, swung from a -5.5% yearly contraction in the second quarter of 2016 to +7.2% growth through the third quarter of 2017. This turnaround indicates improving business optimism, low cost of capital, and prospects for lower taxes.

Government

The tax package that is currently winding through the Congress is likely to alter the trajectory of deficits and debt in the United States. We see government's fiscal stance as becoming more expansionary in 2018-2019, but the exact details of the proposed packages remain unclear at the time of this writing. We currently expect tax reform to

proceed, potentially boosting investment and adding to potential long-run growth. Last year, we raised our growth projection by 0.25% to 2.75% from 2.50% to account for a modest acceleration of capital investment under the plan, but we are making no further changes to our growth expectation at this point.

Monetary Policy

The Federal Reserve raised interest rates in 2017, resulting in less accommodative monetary policy. Perhaps because policy rates have already been increased to align more closely with inflation, the market seems unconcerned about further rapid rate increases from here. The Federal Reserve, acknowledging persistent low inflation, reduced their long-run forecast for policy rates by 0.25% to 2.75% in 2017. The recent nomination of Jerome Powell to replace Janet Yellen as Federal Reserve Chair appears well-received by markets. A non-academic, Mr. Powell is seen as a moderate who is likely to deviate little from the path of gradual rate increases and balance sheet reductions. He is also seen as a proponent of re-examining Obama era financial regulations.

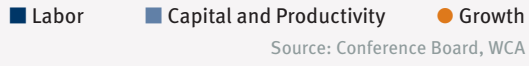
Short-Term Outlook

Given our read of recent incoming data, we expect continued growth into the new year. Therefore, we start the year with a 3% 2018 domestic growth forecast as our base case. Supportive financial conditions, continued job gains, and rising capital investment are keys to achieving this growth rate. Prospects for tax reform further encourage growth, offsetting some tightening of monetary policy. For the longer term, we expect growth to moderate, based on limits to sustainable increases in labor, capital, and productivity.

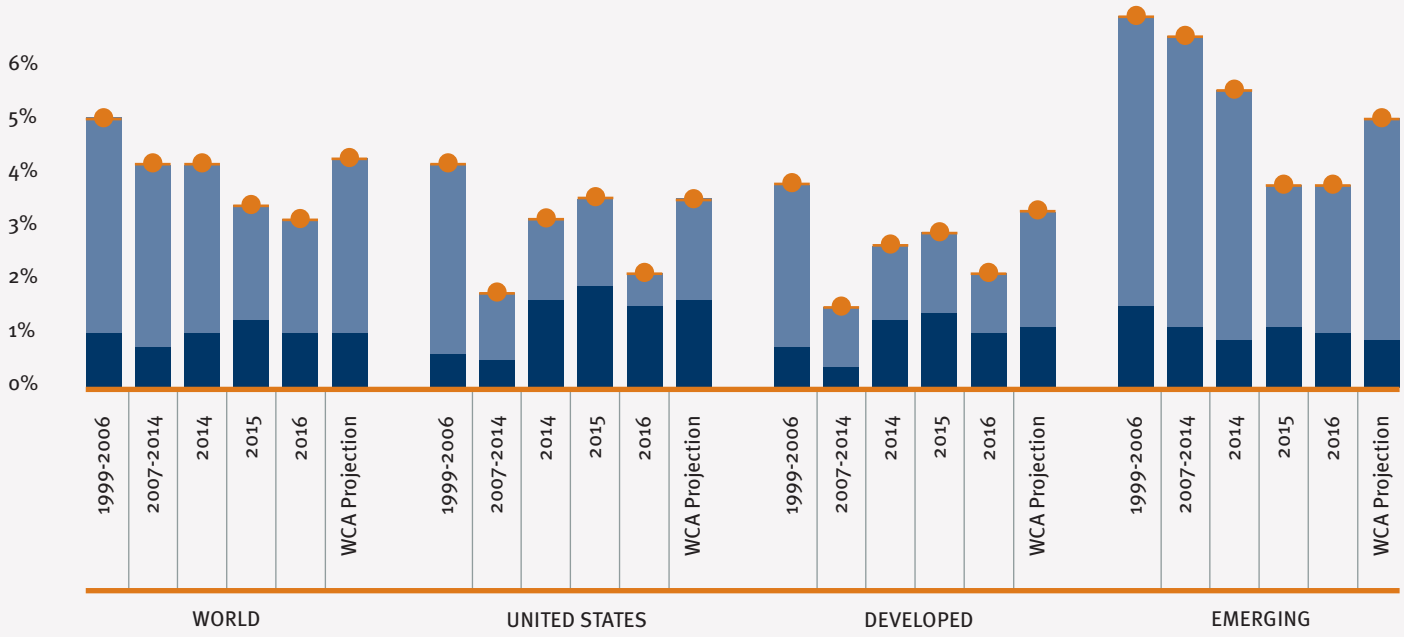
Long-Term Outlook

Our long-run growth projections call for 2.7% growth in the United States, 2.6% in developed economies, 4.0% in emerging economies, and 3.4% global growth (chart below). We expect new technologies to enhance worker skills and productivity and rising real wages to lift labor force participation. We also foresee a gradual increase in global investment, following years of slow growth and deleveraging, especially among developed economies.

CONTRIBUTIONS TO LONG-RUN GROWTH



Source: Conference Board, WCA



Portfolio Strategy

The better performing global economy lifted prices of most risk assets in 2017. Continued signs of growth augur well for the near-term outlook for stocks and the economy, but high starting valuations signal lower long-run returns. Moreover, most market measures of risk are lower than normal, which helps to drive momentum favoring risk assets, but also stores potential for future risk. We begin 2018 with a tilt toward equities given positive trends in incoming data.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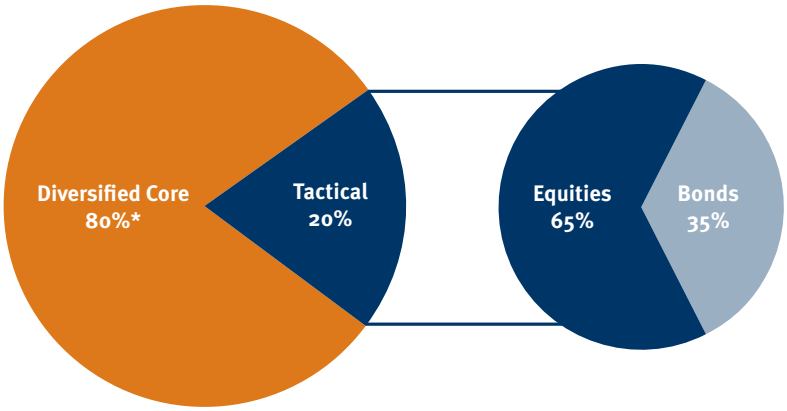
PORTFOLIO STRATEGY

PORTFOLIO STRUCTURE



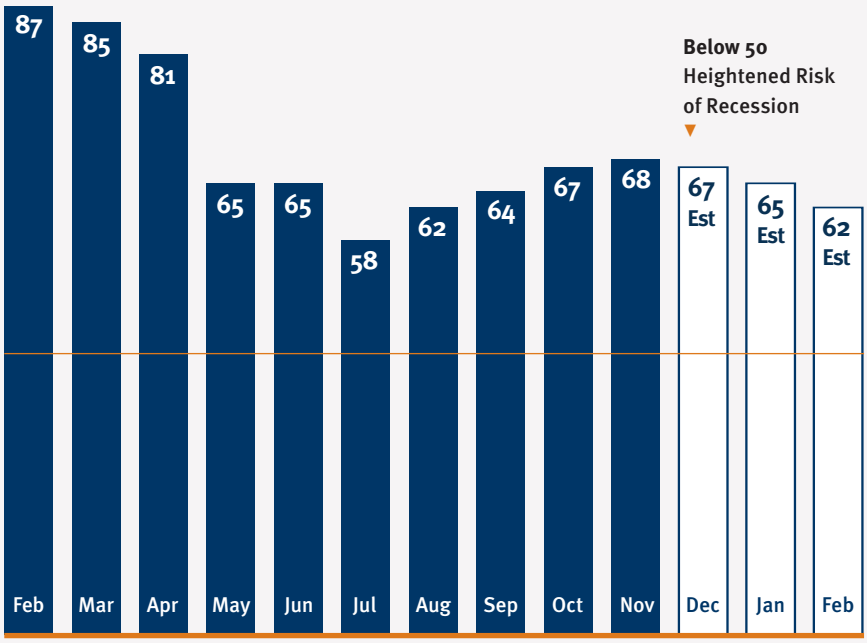
COMBINING LONG- AND SHORT-TERM PERSPECTIVES IN ONE ACCOUNT

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 on page 7 guide these tactical allocations. Because forecasts are long term, changes in the core tend to be slower. This helps reduce turnover. Also, 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.

SATELLITE POSITIONING: SHORT-TERM FOCUS

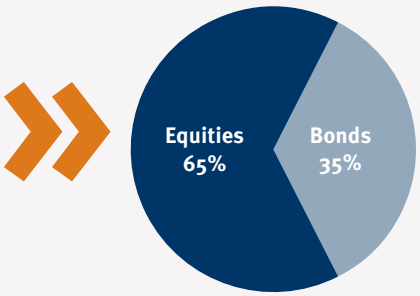
WCA FUNDAMENTAL CONDITIONS BAROMETER



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.

SATELLITE
Short-Term Focus

Asset allocation is tactically overweight equities versus bonds at the start of 2018. This view is supported by the WCA Fundamental Conditions Barometer, which remains above 50 (see chart left).



Given continued signs of fundamental improvement and growth, therefore, the shorter-term tactical portion of portfolios is 15% overweight stocks and 15% underweight bonds.

ASSET CLASS	10-15 YR VIEW RETURN	10-15 YR VIEW VOLATILITY	UNDERWEIGHT	NEUTRAL	OVERWEIGHT
BONDS					
Core Bonds	2.2%	2.9%			
1-3 Year Treasury Bond	2.0%	1.1%			
Mortgage-Backed Securities	2.0%	2.3%			
Intermediate Government/Credit	2.1%	2.4%			
20+ Year Treasury Bond	2.1%	11.9%			
Investment-Grade Corporate Bonds	2.6%	6.0%			
High-Yield Corporate Bonds	3.9%	10.3%			
EQUITY					
Equity	5.2%	14.0%			
Domestic Large Cap Value	5.3%	14.5%			
Domestic Large Cap Growth	5.0%	13.6%			
Foreign Developed Equity Markets	5.4%	16.3%			
Foreign Emerging Equity Markets	5.7%	20.2%			
Gold	1.7%	14.0%			
REITs	6.0%	20.9%			

As of December 31, 2017. Past performance does not guarantee future results.

■ Core ■ Tactical

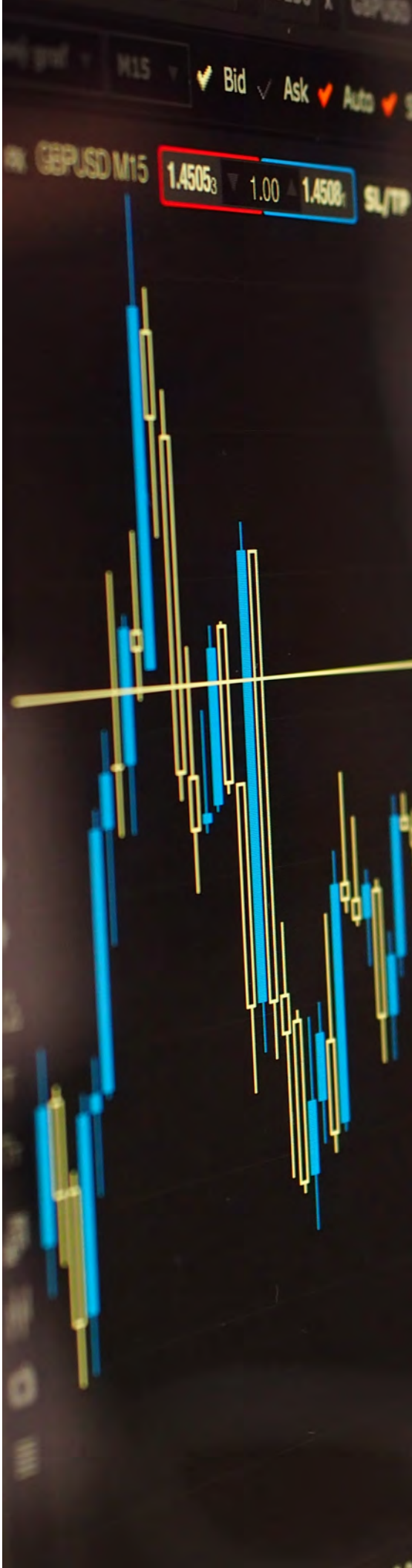
CORE POSITIONING: LONG-TERM FOCUS

DEVELOPED VS. EMERGING	› **Equities are allocated with a tilt toward developed over emerging markets.** Improving growth in the United States and Europe, higher expected volatility in emerging markets, and a neutral view on the dollar lead us to a tactical overweight for developed versus emerging markets.
GROWTH VS. VALUE	› **Domestic style exposure now is neutral between growth and value.** Outsized gains in technology shares reduces the relative attractiveness of growth over value. Returning style bias to neutral versus benchmarks.
DURATION AND CREDIT QUALITY	› **Portfolio duration and credit exposure is currently neutral versus target exposure across most categories of fixed income.** We remain modestly overweight high-yield corporate bonds, however, given still favorable macroeconomic conditions and prospects for corporate tax reform.

These views are provided by Washington Crossing Advisors, LLC. Assumptions are estimates based on historic performance and an evaluation of the current market environment. These are estimates only and not intended to represent future performance. References to future expected returns and performance do not constitute a promise of performance for any asset class or investment strategy. Volatility refers to an expected standard deviation of returns, a measure of uncertainty around our estimate. The forecasts contained herein are for illustrative purposes only and not to be relied on as advice or interpreted as a recommendation to engage in the purchase or sale of any security or financial product. These forecasts are based upon subjective estimates and assumptions about circumstances and events that may not have taken place and may never do so. In addition, Washington Crossing used historic index returns in evaluating past return relationships. This information was gathered from third-party sources we deem reliable, but no independent verification has been undertaken. Actual returns could be higher or lower than shown herein. Opinion subject to change without notice.
* Including stocks, bonds, and other assets.

Equity Market Outlook

A return of noninflationary growth is just what the doctor ordered last year, and without pushback from global central banks, most markets are performing well. Rising confidence in the global expansion, and a continued lack of attractive government bond yields, is leading to gains across global stock markets. Here we look at how global equity and bond markets have fared, and where we see opportunities and risks going forward.



A steady drumbeat of improving growth drove world stock markets to records in 2017. At nearly $80 trillion, the value of public companies around the world now exceeds the level of global output measured in dollars ($65 billion as of 2016, according to the World Bank). Improving growth lifted stock values, and investors became more accepting of risk. Just about every class of risk assets experienced falling volatility as investors grew increasingly complacent and the economic backdrop brightened.

Emerging Economies

Outside the United States, China remains a significant source of potential growth and risk. For years, China aggressively pursued a state-directed, heavily subsidized, investment-driven growth model at the expense of consumers and households. This growth model is now showing signs of distress. In 2007, China's former Premier Wen Jiabao, warned that China's economy was becoming "unstable, unbalanced, uncoordinated, and unsustainable." Since then, risks have likely grown instead of becoming more stable as debt grew in relation to the economy's size. China's credit-to-GDP ratio rose from 120% in 2007 to 220% today, for example. Continued buildup of leverage likely increases financial fragility in China while decreasing the country's efficiency in allocating capital. Sooner or later, suddenly or gradually, unsustainable credit expansion will come to an end and hidden risks will be exposed.

Recent attempts by Beijing to rein in credit has the potential to sour financial conditions in China and impose a penalty on growth. While China should eventually evolve toward a more stable consumer-centric economy, the road from today's model to a "rebalanced" model is unlikely to be smooth. China will struggle to reach its stated goal of doubling its GDP from 2010 levels by 2020 while "rebalancing" toward consumption without also undergoing rapid and far-reaching political changes. Given these challenges, we remain cautious regarding the near-term outlook for China and emerging markets. For now, we favor tilting exposure toward more developed regions of the globe.

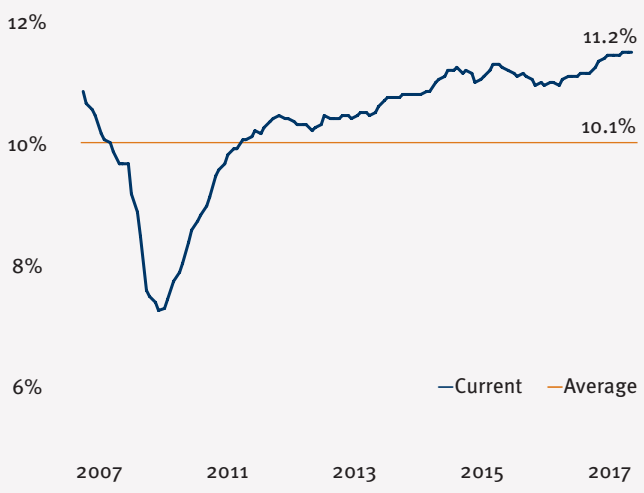
Developed Economies

Advanced economies are seeing a stronger rebound coming from the euro area, Japan, and Canada, according to recent forecasts of the International Monetary Fund. Stronger consumption, investment, and trade are all helping to create demand. Developed markets such as the United States and Europe are seeing a combined unemployment rate near 5.4%, close to the lowest levels of the past 40 years.

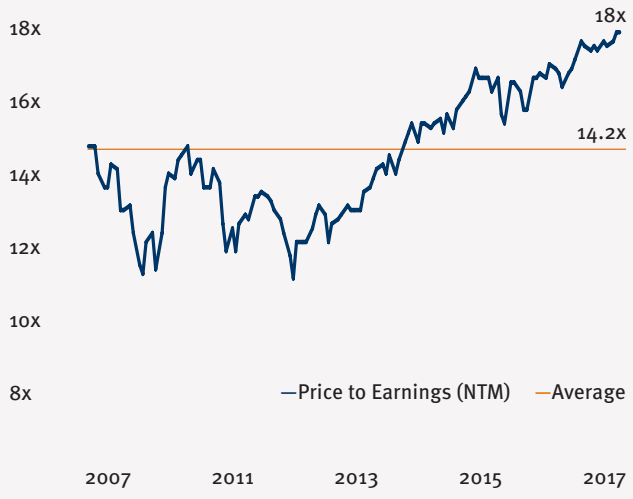
Supportive financial conditions continue as we head to print late in 2017, and earnings forecasts seem to highlight a positive

S&P 500 FORWARD 12-MONTH MARGIN

Source for S&P 500 Charts: FactSet



S&P 500 FORWARD 12-MONTH P/E RATIO



outlook for developed market equities as we head into 2018.

In the United States, the technology sector saw outsized gains relative to the overall market for most of last year. By contrast, value-oriented sectors like financials and energy lagged behind. In our view, the relative attractiveness of growth is less appealing versus value than it was a year ago. Consequently, we are lowering growth's weighting to neutral, and are raising value's weight to neutral, versus our benchmark. We begin 2018 with a neutral tactical bias between growth and value.

Given positive trends, we see higher expected returns for 2018 in equities relative to bonds and cash. However, our return expectations are lower this year than last because of the sharp move up in equity markets in 2017. A reduced expected dividend yield, above-average profit margins, and higher starting valuations (chart) lower our long-run return expectation for stocks. Last year's price moves led us to reduce our long-run equity return assumption to 5.1% from 6.0% a year ago (chart below).

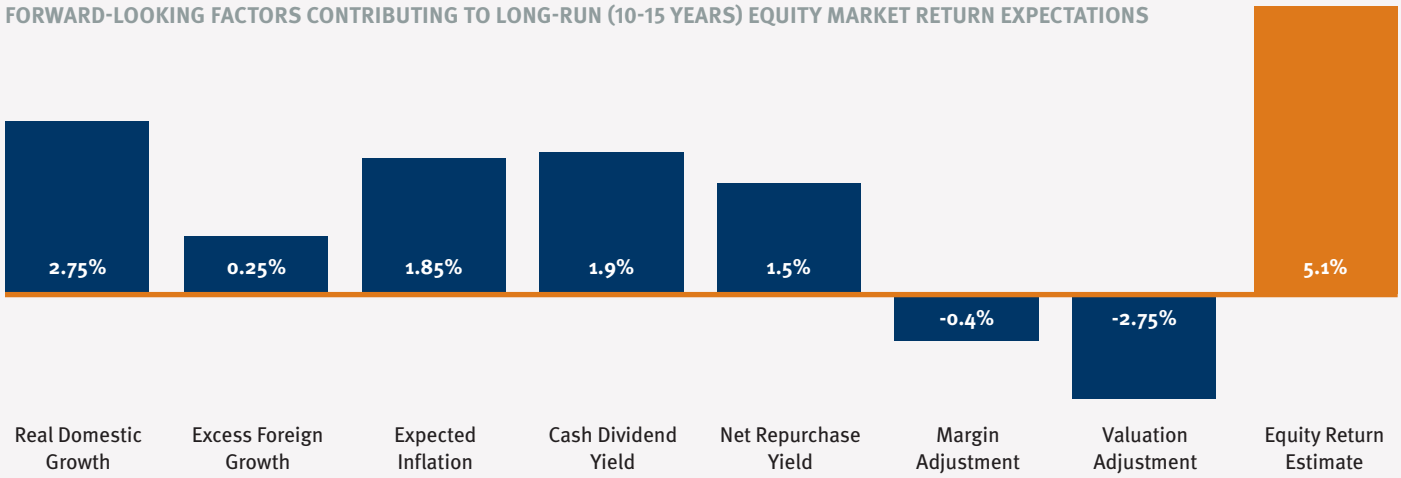
Risks

Although we have to look hard to find signs of weakness in the incoming data, we recognize that risks could resurface in 2018. In no particular order, we see five potential hazards to our outlook. First, we note that inflation trends remain very low. Persistent disinflation could weaken the central bank's ability to lower interest rates in a downturn to restore full employment. Second, a sudden tightening of financial conditions in China could spill over into the global economy, creating acute burdens for some financially immature emerging economies. Third, a faster-than-expected normalization of monetary policies, including an unforeseen rise in long-term interest rates, could expand risk premia, tighten financial conditions, and injure growth. Fourth, various protectionist political movements could spread, jeopardizing trade. Of course, other unforeseen factors could also arise relating to geopolitics, natural disasters, or causes.

Conclusion

Accelerating global growth, without inflation, enlivened profit expectations, encouraged risk-taking, and drove global equity markets to records again in 2017. We are emboldened by trends in the data that support the bull case for equities as we close out 2017. Still, we are mindful that valuations are already full, and risks still exist. While we remain tactically overweight stocks, we project lower returns from here and have begun to tilt away from areas that may be overestimating growth and underpricing risk.

FORWARD-LOOKING FACTORS CONTRIBUTING TO LONG-RUN (10-15 YEARS) EQUITY MARKET RETURN EXPECTATIONS



Source: These views are provided by Washington Crossing Advisors, LLC. Assumptions are estimates based on historic performance and an evaluation of the current market environment. These are estimates only and not intended to represent future performance. References to future expected returns and performance do not constitute a promise of performance for any asset class or investment strategy. The forecasts contained herein are for illustrative purposes only and not to be relied on as advice or interpreted as a recommendation to engage in the purchase or sale of any security or financial product.

Fixed Income Outlook

The Federal Reserve continues to raise short-term interest rates slowly as inflation remains below target. We believe bond investors should continue to see low yields as rate normalization is tempered by a low global yield and low inflation environment. Tight spreads and low starting yields reduce our return expectations for now.

Cash and Equivalents

The Federal Reserve continues to lift short-term interest rates, albeit very slowly. Since the Federal Reserve first raised rates in 2015, progress toward tightening has been plodding. The chart below compares the current rate cycle versus the '94-96 cycle and the '04-06 cycle. As you can see, a pattern of slower and shallower increases seems to emerge, and based on current market expectations, the present period appears to be continuing this trend.

A long-running disinflationary trend approaching deflation at times removes some of the urgency for rate increases. Even today, inflation remains well below the Fed's 2% long-run target despite years of stimulus. Because monetary policy works with lags and because the economy is at full employment, some at the Federal Reserve worry that not raising rates fast enough could lead to inflation or other adverse outcomes. Therefore, the Fed seems intent on continuing with slow rate increases despite inflation remaining below 2%. Markets appear to be pricing in a more leisurely pace of increases than the Federal Reserve now forecasts.

Government Bonds

The advantage to holding long-term U.S. Treasury bonds relative to short-term bonds fell again in 2017. The difference between two- and ten-year U.S. Treasury bond yields fell to 0.65% in November, the lowest level since 2007. A lack of attractive government bond yields overseas may be contributing to the flatter Treasury yield curve, in our view.

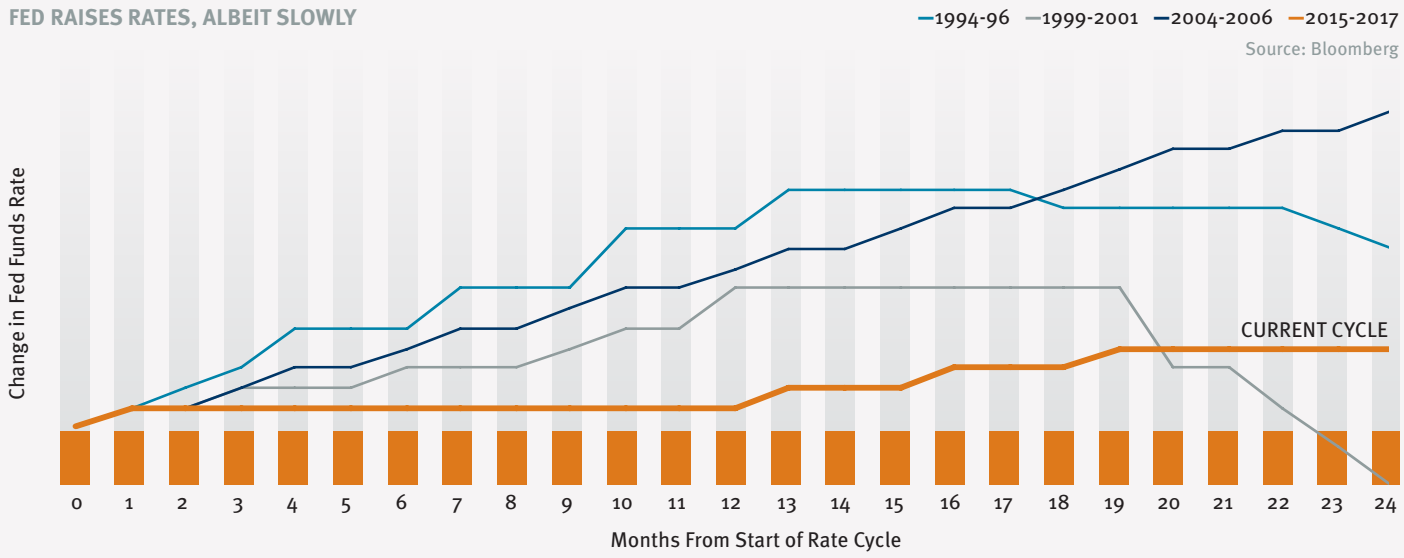
Consider the fact that at 2.8%, the U.S. thirty-year Treasury offers a yield alternative to global investors that many other nations cannot. Thirty-year sovereign yields from the United Kingdom, Japan, and Germany stand at 1.8%, 0.8%, and 1.2%, respectively, for example. Even after adjusting for inflation, U.S. Treasury yields are 1-2% higher than these other economies. With few better choices, many global investors should continue to find value holding U.S. bonds despite prospects for higher deficits as a result of expected tax legislation. We expect global demand for yield to delay the process of interest rate normalization for a while longer.

Corporate Bonds

Corporate bond yields fell in 2017, and the spread between corporate and Treasury debt narrowed further. Recently, the difference between the yield on Moody's Baa corporate bond index and a ten-year U.S. Treasury fell to below 2% for the first time since 2007. The narrowed spread reflects a more optimistic profit outlook and the potential for the repatriation of foreign cash held overseas under proposed tax legislation.

So long as the economy continues to move in the right direction, we would expect corporate spreads to remain relatively tight, but low starting yields should limit future returns.

FED RAISES RATES, ALBEIT SLOWLY



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.

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Indices are unmanaged, do not reflect fees and expenses, and are not available for direct investment.

Past performance does not guarantee future results.

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Any projections, targets, or estimates in this report are forward looking statements and are based on WCA's research, analysis, and assumptions made by the Adviser. Due to rapidly changing market conditions and the complexity of investment decisions, supplemental information and other sources may be required to make informed investment decisions based on your individual investment objectives and suitability specifications. All expressions of opinions are subject to change without notice. Clients should seek financial advice regarding the appropriateness of investing in any security or investment strategy discussed in this commentary.

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