QUARTERLY 3Q22

TACTICAL ASSET ALLOCATION

- Recession Signals Mount
- Inflation and Rates Weigh on Confidence
- Profit Outlook Holds Up (For Now)
- Better Valuations a Plus for Long-View
- Maintain Caution Near-Term

As we write this, more and more observers are calling for a recession in the United States. Is this a far-fetched or exaggerated claim? Probably not. After all, the textbook definition of a recession is two quarters of back-to-back contraction. For the first quarter, the U.S. economy shrunk by 1.6%, according to the Bureau of Economic Analysis. And in early July, the Federal Reserve Bank of Atlanta estimated the second quarter could shrink by as much as 2%. Unless the situation changes soon, it is entirely plausible that we are already in a “technical” recession.

Caution, For Now

Whether the economy is in a recession technically or not, the deterioration in the outlook is not lost on markets. The stock markets, vexed by surging inflation (chart, above right) and interest rates, has fallen roughly 15% in the past year. However, there has been little deterioration in the profit outlook for stocks (at least not yet). The combination of falling stock prices and rising profits means higher, not lower, long-run returns. But before celebrating this fact, we must navigate what's happening here and now. So, even though valuations are better now than a year ago, we maintain a cautious tactical posture as interest rates rise and key fundamental indicators misbehave.

Valuations Better

It seems odd that the gloom of a market decline, as we are now experiencing, has a bright side, but this is just how markets work. By our math, one of the biggest challenges to investors a year ago was high asset values. Those valuations implied expectations for growth and risk that, in hindsight, may have been overly optimistic. A wave of cash from the government and trendy, pandemic-themed investments stretched the bounds of reason and rational expectations.

Those valuations created the pre-conditions for this year's correction. The S&P 500 index of large-capitalization domestic stocks declined to around 3,700 from 4,300 in the past year, a 13% decline. But analysts have yet to turn sour on those same companies' earnings prospects in the coming year. Earnings forecasts are actually up about 20% in the past year. The combination of rising earnings and falling stock values means better valuations. The price-earnings multiple for the index is now about 16x versus 22x a year ago — 30% lower. All else being equal, this better valuation helps boost longer-term expected returns.

Ahead of Ourselves

Lest we get ahead of ourselves, we must now take stock of what is happening with inflation and interest rates. Markets were shocked into attention in the spring as inflation (chart, above right) surged to 8%. While forwards markets seemed to doubt the Federal Reserve's (Fed's) intentions about raising rates early in the year, this is no longer the case. Today, these markets are "ahead" of the Fed and are pricing in even more hikes than the Fed's official projections. The combination of higher inflation and interest rates is weighing on confidence. On top of the Ukraine-Russia war, consumers are experiencing much higher prices and many shortages. All this frustrates and complicates simple planning for households and businesses, contributing to a feeling of malaise not felt in decades. Consider that consumer sentiment just hit a record low last month (chart, middle right).

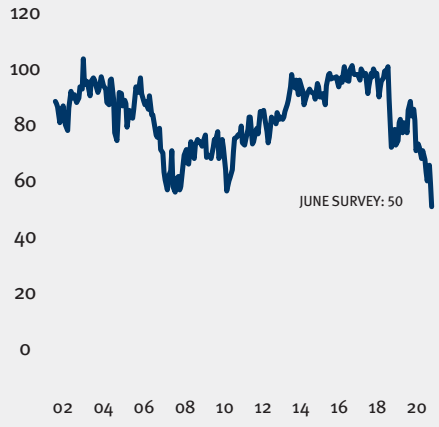
More Evidence

Recently, manufacturing data turned down (chart, bottom right), consumer spending became fragile, and corporate bond spreads widened (indicating worry over corporate health). These facts, combined with other observations, are causing our own WCA Fundamental Conditions Barometer (next page, bottom) to trend lower. The takeaway is that we should not fight the evidence of this slowdown, especially as the Fed pulls in the monetary reins.

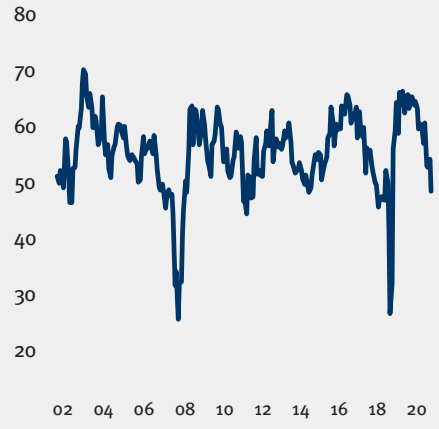
The good feelings of a year ago, cultivated through government checks, an ultra-accommodative Fed, and post-vaccination "reopenings," have all but evaporated. As more data confirms that growth is in question, a risk case is that business investment, hiring, and profit forecasts follow suit. For this reason, where appropriate, we suggest positioning portfolios with a tilt toward bonds and away from stocks on a near-term, tactical basis.

INFLATION: U.S. CONSUMER PRICES (Yr/Yr Change)
Source: Bureau of Labor Statistics

U.S. CONSUMER SENTIMENT (University of Michigan)
Source: University of Michigan



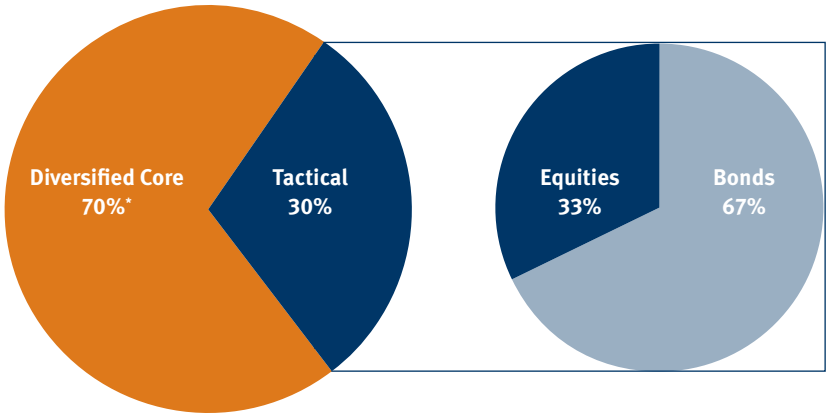
NEW ORDERS FOR MANUFACTURED PRODUCTS
Source: Institute for Supply Management



PORTFOLIO STRUCTURE

DIVERSIFIED CORE
Longer-Term Focus

SATELLITE
Shorter-Term Focus



COMBINING LONGER- AND SHORTER-TERM PERSPECTIVES IN ONE ACCOUNT

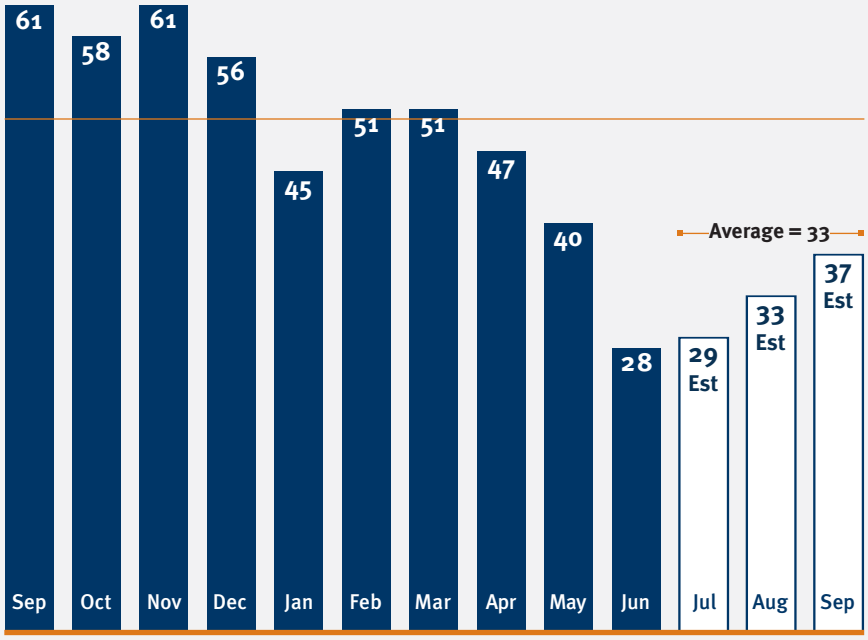
We think of portfolios as having two parts. At the "core" of the portfolio is a diversified equity and diversified bond allocation. The forecasts, valuations, and trends on page 4 guide these allocations. Because these factors are longer term, changes in the core tend to be slower than the satellite, reducing turnover.

The smaller 30% (blue circle) is the "satellite." As fundamental conditions change, shorter term "tactical" tilts between stocks and bonds are implemented here.

SATELLITE POSITIONING: SHORTER-TERM FOCUS

WCA FUNDAMENTAL CONDITIONS BAROMETER

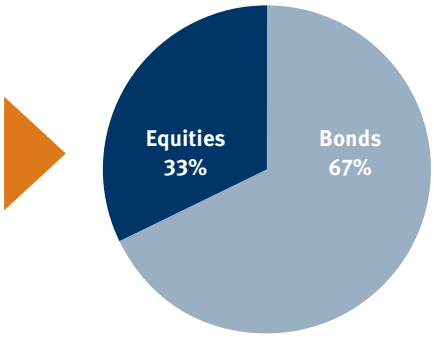
—Below 50 = Heightened Risk of Recession



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
Shorter-Term Tactical

The equity allocation is tactically adjusted to align with the forecast barometer (see chart left).



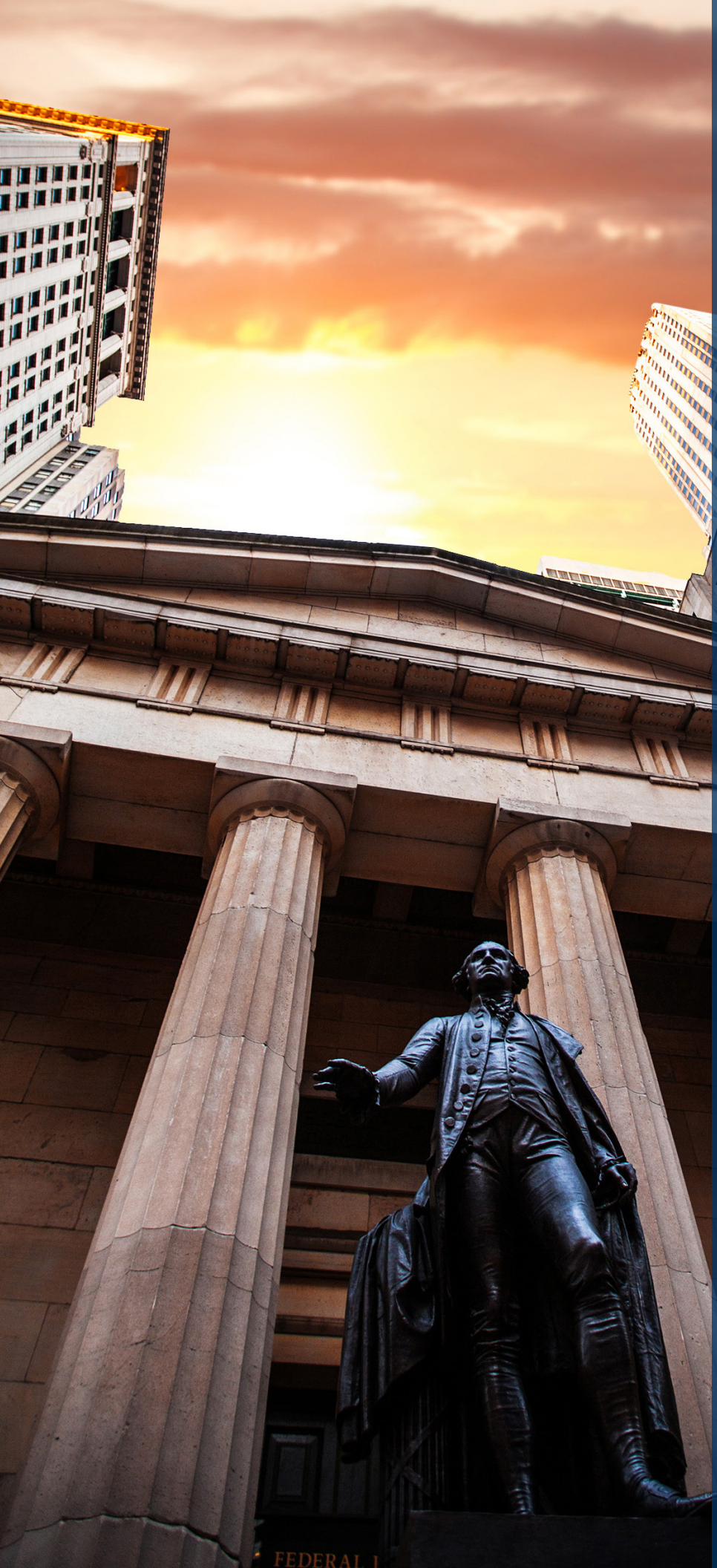
As of June 30, 2022.
* Including stocks, bonds, and other assets.

ASSET CLASS	10-YEAR VIEW RETURN	Y/Y CHANGE	RISK	RETURN/RISK	3-6 MONTH VIEW WEIGHT vs. BENCHMARK
BOND ASSUMPTIONS					
Core Bonds	3.2%	1.2%	3.5%	0.9	OVERWEIGHT
1-3 Year Treasury Bond	3.0%	1.0%	1.0%	3.0	OVERWEIGHT
Mortgage-Backed Securities	3.6%	1.2%	2.6%	1.4	NEUTRAL
Intermediate Government/Credit	3.2%	1.1%	2.5%	1.3	UNDERWEIGHT
20+ Year Treasury Bond	3.2%	2.0%	11.8%	0.3	NEUTRAL
Investment-Grade Corporate Bonds	4.6%	2.3%	6.5%	0.7	OVERWEIGHT
High-Yield Corporate Bonds	7.0%	2.5%	6.8%	1.0	UNDERWEIGHT
EQUITY ASSUMPTIONS					
Equity	8.3%	4.4%	14.1%	0.6	UNDERWEIGHT
Domestic Large Cap Value	9.2%	3.8%	14.1%	0.7	OVERWEIGHT
Domestic Large Cap Growth	7.3%	4.6%	15.1%	0.5	UNDERWEIGHT
Foreign Developed Equity Markets	11.9%	6.3%	14.0%	0.9	NEUTRAL
Foreign Emerging Equity Markets	13.1%	6.7%	15.6%	0.8	NEUTRAL
Gold	2.2%	-0.1%	14.6%	0.2	OVERWEIGHT
REITs	8.7%	2.9%	15.3%	0.6	NEUTRAL

As of June 30, 2022. Past performance does not guarantee future results.

Core Satellite

CORE POSITIONING: DECISION TREE	
EQUITY vs. FIXED	Overweight bonds vs. stocks on weakening data
FOREIGN vs. DOMESTIC	Neutral allocation as dollar strength expected to fade
EMERGING vs. DEVELOPED	Overweight emerging over developed
GROWTH vs. VALUE	Maintaining tilt toward value over growth
CREDIT vs. SOVEREIGN	Lean toward higher quality credit vs. high yield
SHORT vs. LONG DURATION	Duration moves closer to neutral from underweight
NON-CORRELATED ASSETS	Maintain gold tilt versus high yield corporates and REITs



About Washington Crossing Advisors

Washington Crossing Advisors, LLC ("WCA") is an SEC registered investment adviser and wholly owned subsidiary of Stifel Financial Corp. WCA helps supervise and manage over $7 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 macro economy with fundamentally rooted, bottom-up security analysis.

** Assets under advisement as of June 30, 2022.*

Description of Indices and Terms 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.

Bloomberg Barclays Aggregate Bond Index: A composite of the Bloomberg 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.

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.

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.

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.

Opportunity Disclosure: The Washington Crossing Advisors, LLC Stifel Conquest and Conquest Alternatives Portfolios require a $25,000 minimum investment. More information on the Stifel Opportunity 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 Opportunity Program and these strategies are appropriate for their needs.

The S&P CoreLogic Case-Shiller 20-City Composite Home Price NSA Index is a value-weighted average that seeks to measure the value of residential real estate in 20 major U.S. metropolitan areas. The index is a composite of single-family home price indices for the nine U.S. Census divisions.

This commentary often expresses opinions about the direction of market, investment sector, and other trends. The opinions should not be considered predictions of future results. The information contained in this report is based on sources believed to be reliable, but is not guaranteed and not necessarily complete.

All investments involve risk, including loss of principal, and there is no guarantee that investment objectives will be met. It is important to review your investment objectives, risk tolerance, and liquidity needs before choosing an investment style or manager. Equity investments are subject generally to market, market sector, market liquidity, issuer, and investment style risks, among other factors to varying degrees. Fixed Income investments are subject to market, market liquidity, issuer, investment style, interest rate, credit quality, and call risks, among other factors to varying degrees.

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. Registration with the SEC does not imply a certain level of skill or training.

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