Washington Crossing Advisors

Asset Allocation Update
Fourth Quarter, 2015

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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.

125 YEARS 1890 – 2015 STIFEL

WHAT'S DRIVING GROWTH?

From 1980 to 2007, the economy grew near a robust 3-3.5% trend growth rate throughout the 27-year period. The period began with the Dow at 840 and ended 2007 with the Dow over 13,000. Recessions were of the normal variety, with business slumps followed by robust recoveries and expansions. Technology, an expanding workforce, a pervasive spirit of entrepreneurial risk-taking, freer trade, lesser regulation, and reduced tax burdens all fostered growth.

This 27-Year Period Saw

1. GDP grow to $15 trillion from $6.5 trillion,
2. Household net worth grow to $67 trillion from $10 trillion,
3. The creation of 40 million new jobs,
4. The unemployment rate fall to 4.5% from 7%, and
5. Inflation fall to 4% from 12%.

Underlying all this was solid growth in both capital and labor. Productivity also contributed to growth, as the information revolution took hold with the advent of the personal computer.

2007 and Beyond

The 2007-2009 recession was different than past recessions and marked a secular change in growth. To many Americans, the anaemic recovery of the past few years felt far different than past recoveries. It was slower and more shallow in nature. It also failed to lift all boats. Many were left behind as the economy got better but employment and wage gains were elusive for the majority of Americans.

Importantly, we see that the key drivers of economic growth weakened during and after the recession. Employment recovered very slowly, and large numbers of Americans left the workforce. Capital investment and productivity both grew more slowly than in the past. These new trends were accompanied by a reduction of private sector borrowing and an increased propensity for households to save. The government sector grew significantly through increased regulation and deficit-financed spending.

Some described the lower growth path as the "new normal" economy. To date, we have yet to see evidence that the economy has left this lower growth path. Accordingly, we continue to see the economy proceeding along a positive, but slow, growth path across our forecast horizon.

Slow Ahead

The chart below shows just how much the U.S. economy is off the 1980-2007 growth path. The real growth rate is a major driver for long-run portfolio returns.

As you can see, the growth path is sharply lower now than it had been in the past. This makes sense given the fact that all of the major drivers of economic growth are trending lower too. Table A to the right shows that labor growth is trending at 0.3% versus 1.4% in the past. Capital investment is growing at a mere 2.4% trend versus 5.6% in the past. Even productivity has slowed despite a host of technological advances in recent years.

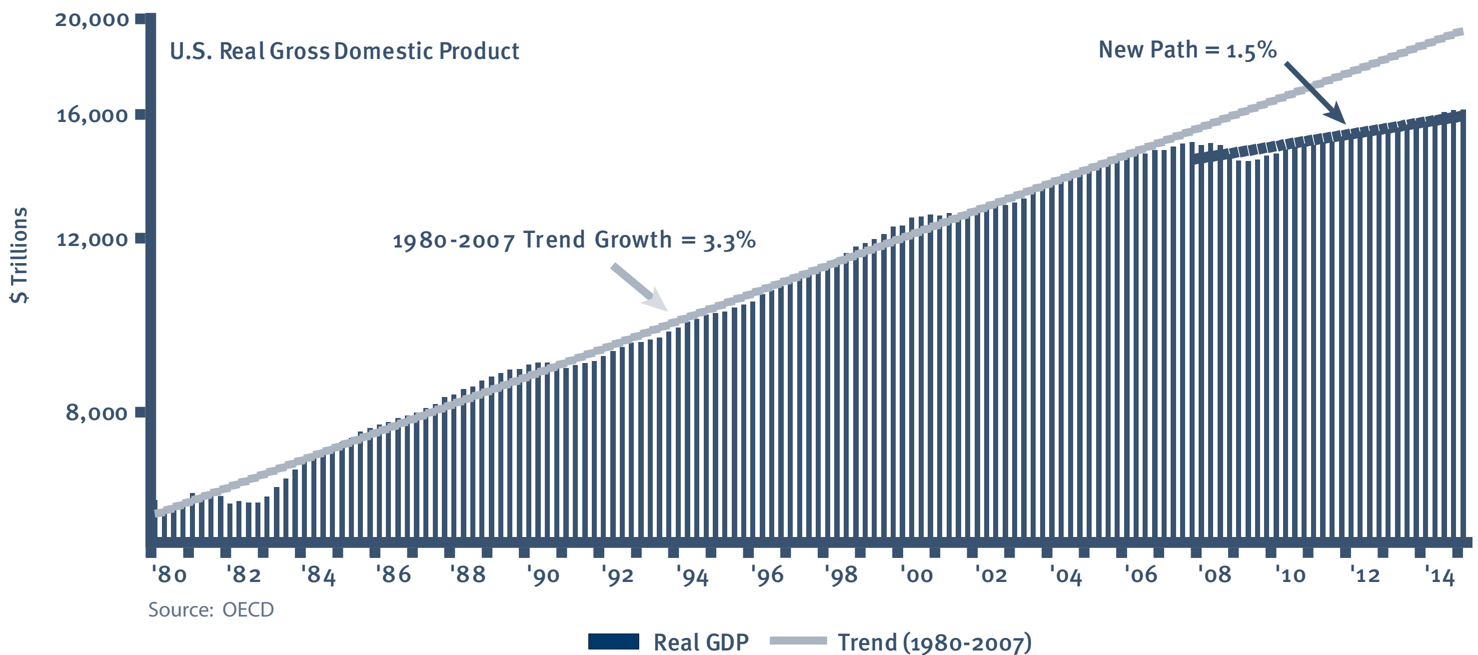
Economic theory would suggest that output growth and market returns would also be lower. Real growth is trending near 1.5%, and equity returns over the last decade are far lower than the 1980s and 1990s.

Table A

	------- TREND GROWTH -------		
FACTOR	1980-2007	2007-2014	CHANGE
	=====	=====	
Labor Hours	1.4%	0.3%	▼
Capital Investment	5.6%	2.4%	▼
Productivity	1.6%	1.1%	▼
	=====	=====	
Total Output	3.3%	1.5%	▼

Source:
Organization for Economic Cooperation and Development (OECD)

Growth Downshift
Long-Run Growth Trend
Slips Onto a New and Lower Path



Source: OECD

China

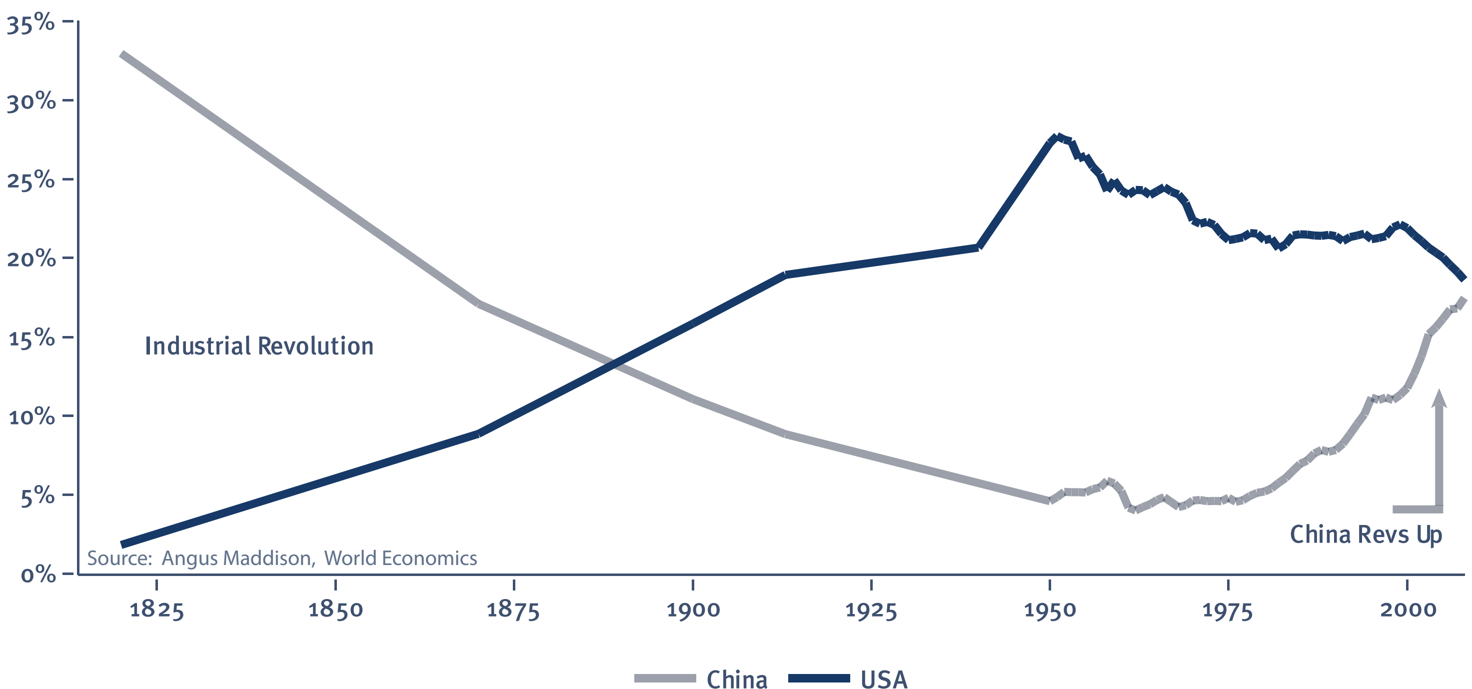
While the United States downshifted following the 2008-2009 recession, China's growth was staggering. In dollar terms, the World Bank estimates that the Chinese economy more than doubled from $5.1 trillion GDP in 2009 to $10.4 Trillion GDP by 2014. Adjusting for differences in price levels, China may well be as big as the United States in terms of output. China's growth is, however, slowing.

We are also aware that China's recent growth was augmented by a sharp rise in borrowing and credit (Table B, right). Like our mortgage boom, China grew outstanding credit by $15.7 trillion to $24.9 trillion from $9.2 trillion. It did this in just six years, according to the Bank of International Settlements. For every one dollar in output growth (GDP), three dollars of borrowing took place. This pace is unsustainable and confirms the idea that China will continue to see growth moderate from here.

Table B

CHINA CREDIT			
SECTOR	FOURTH QUARTER 2009	FIRST QUARTER 2015	CHANGE
Households	$1.2	$3.8	$2.6
Corporations	6.2	16.7	10.5
Government	1.8	4.4	2.5
	=====	=====	
Total Credit	$9.2	$24.9	$15.7
Total GDP	$5.1	$10.4	$5.3

Source: Bank of International Settlements



FUNDAMENTAL CONDITIONS UPDATE

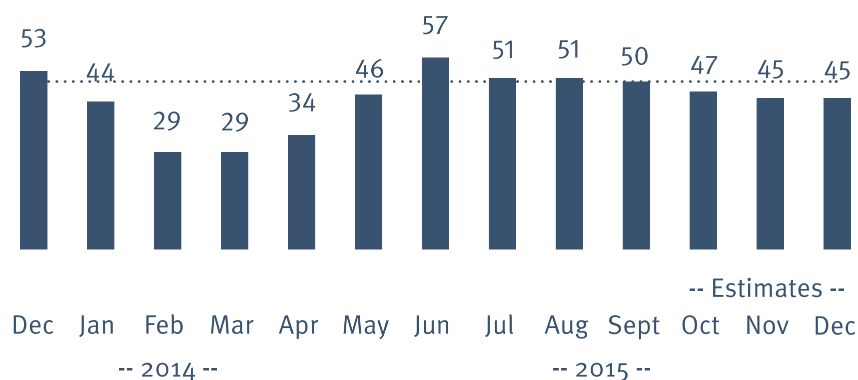
Markets reacted negatively to signs of further slowing in the global economy. China's surprise devaluation of the yuan underscored concern that global growth continues to slow. This was also evident in the foreign indicators we review within our fundamental conditions barometer. By comparison, most data from the United States appears strong by comparison to the rest of the world. Still, the current dynamics suggest a sluggish tone as we move toward year-end.

WCA Fundamental Trend Indicators

	Second Quarter Final	September Estimate	Change During Quarter
Credit and Capital Markets	57	59	Higher
U.S. Economic Conditions	55	59	Higher
Foreign Conditions	50	34	Lower
Fundamental Conditions	54	50	Lower

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.

CONQUEST ALLOCATION CHANGES (LAST QTR)

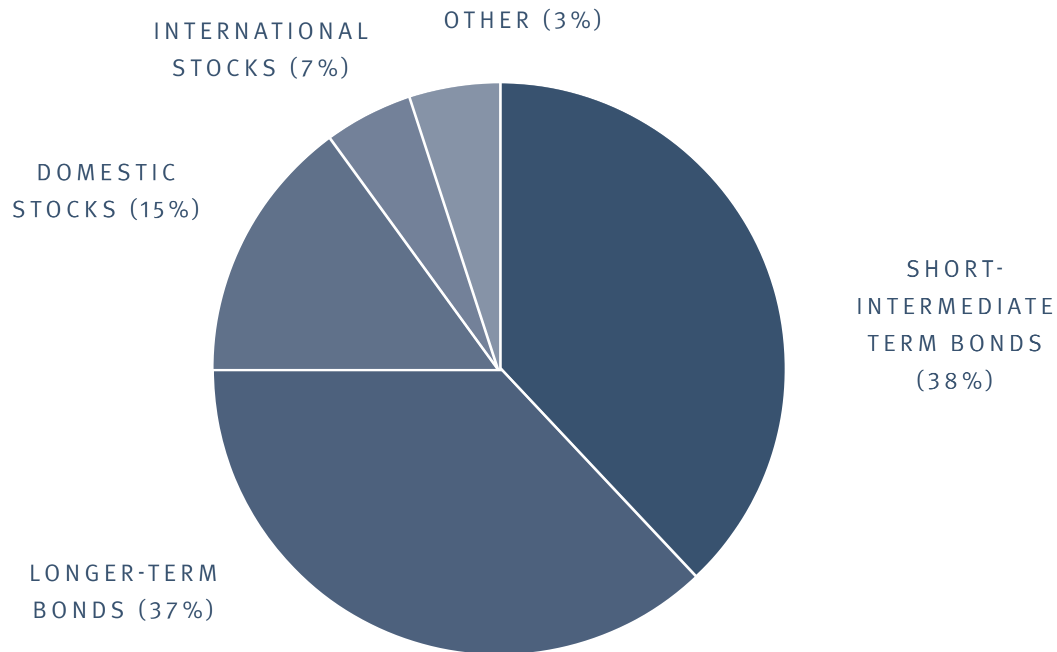
		Conservative		Balanced		Moderate Growth		Aggressive Growth	
		Current	Change	Current	Change	Current	Change	Current	Change
Bonds	Core Bonds	20%		15%		10%		0%	
	Floating Rate Securities	0%	-15%	0%	-10%	0%	-6%	0%	
	Cash & 1-3 Year Treasuries	17%		9%	-1%	1%	-3%	10%	-5%
	Mortgage-Backed Bonds	16%	+5%	10%	+4%	4%	+4%	0%	
	Intermediate Gov't/Credit	5%		7%	+2%	5%		0%	
	7-10 Year Treasuries	0%		0%		0%		0%	
	10+ Year Treasuries	0%		0%		0%		0%	
	Investment-Grade Corp Bonds	14%	+5%	7%		3%		0%	
	High-Yield Corporate Bonds	3%		2%		2%		0%	
	International Treasury Bonds	0%		0%		0%		0%	
Equities and Other	Domestic Stocks	5%	+5%	13%	+5%	22%	+5%	24%	+5%
	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	75%		50%		25%		10%	
	Subtotal Equities & Other	25%		50%		75%		90%	
	Total	100%		100%		100%		100%	

Portfolio allocations were adjusted during the quarter to reflect improvement in fundamental conditions through the first half of the year and into August. The U.S. economy picked up momentum from a 0.6% growth rate in the first quarter to a 3.9% pace in the second.

Bond allocations were also adjusted to more closely align portfolios with longer-term strategic allocations.

Conservative Portfolio

CONSERVATIVE PORTFOLIO
EQUITY POLICY RANGE: 0-50%
CURRENT EQUITY EXPOSURE: 25%

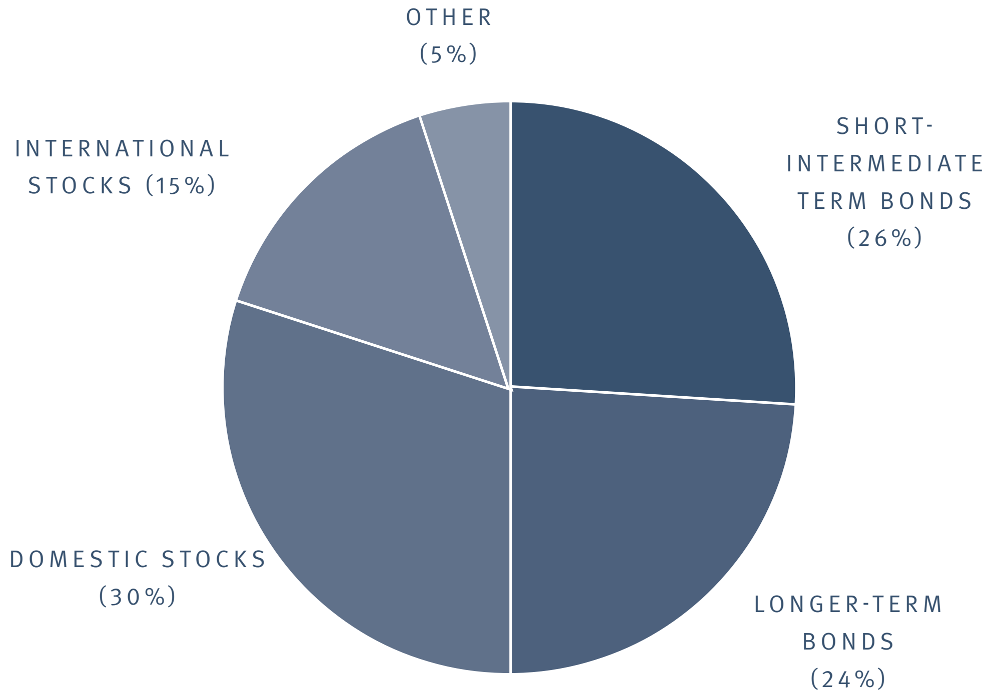


FOR A DETAILED LIST OF HOLDINGS, INCLUDING SUB-ASSET CLASSES, SEE PAGE 10

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.

BALANCED PORTFOLIO
EQUITY POLICY RANGE: 25-75%
CURRENT EQUITY EXPOSURE: 50%

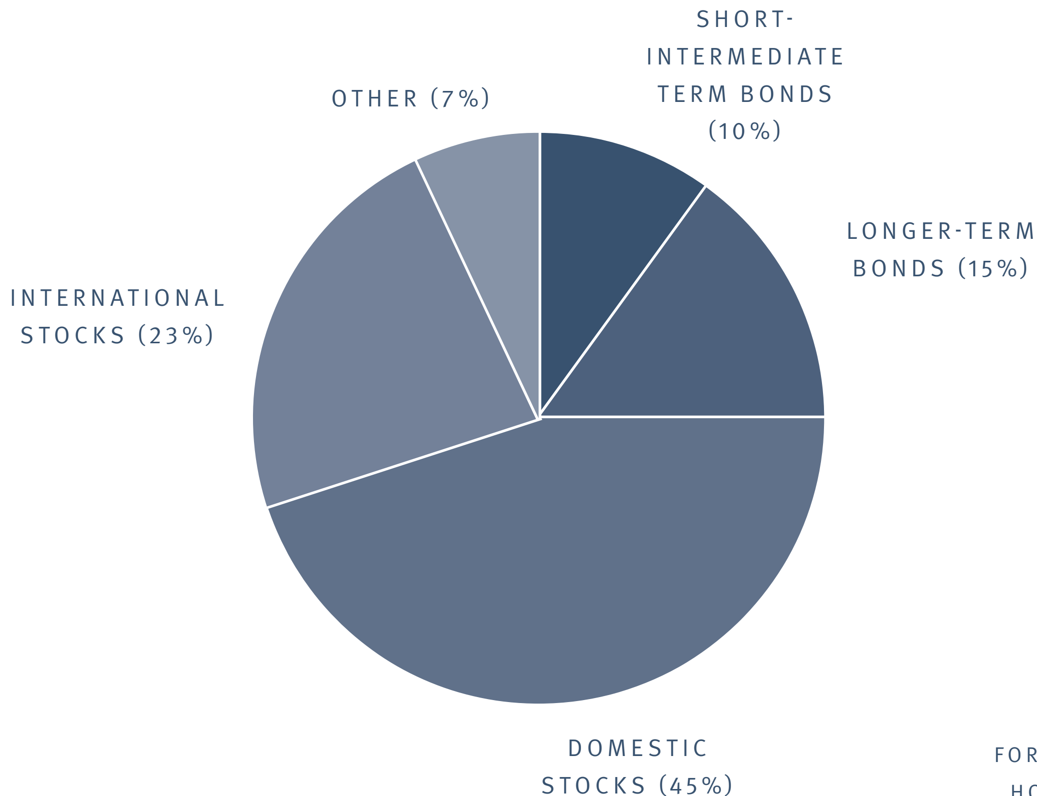


FOR A DETAILED LIST OF HOLDINGS, INCLUDING SUB-ASSET CLASSES, SEE PAGE 10

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: 75%

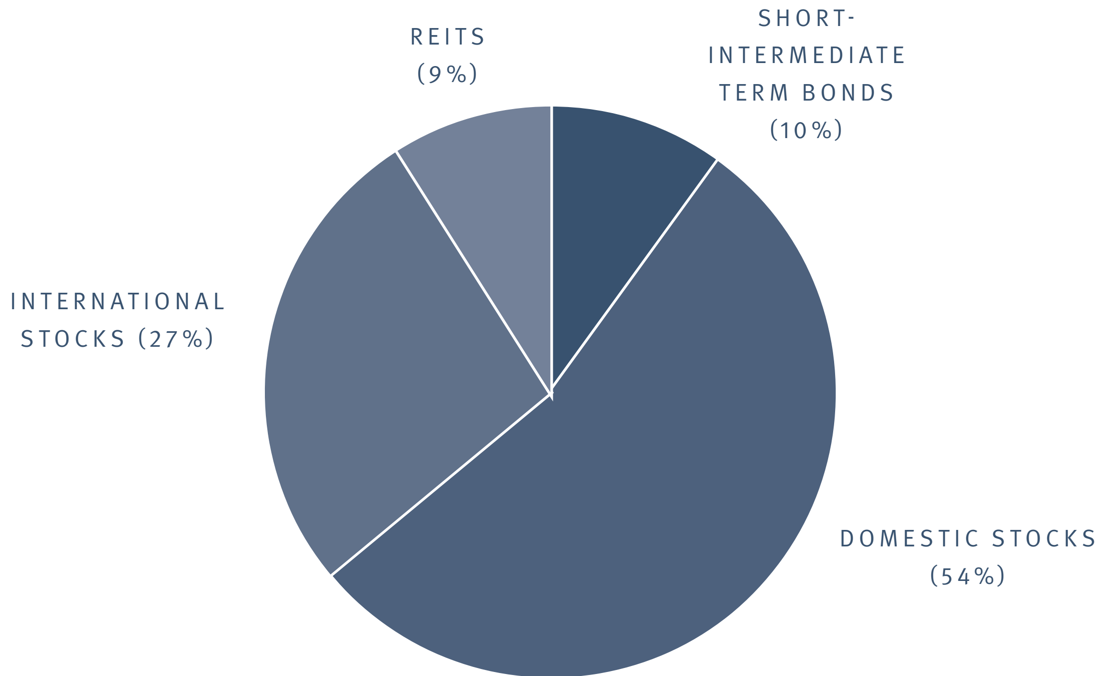


FOR A DETAILED LIST OF HOLDINGS, INCLUDING SUB-ASSET CLASSES, SEE PAGE 10

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: 90%



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.

SECTOR REVIEW

Health Care

Implementation of the numerous provisions of the Affordable Care Act (ACA) continues, and insurance pricing for 2016 is now coming out—causing some additional volatility. We continue to see uncertainties related to the ACA as a burden on the industry, although some of those uncertainties have lessened with the Supreme Court decisions and as more Americans become familiar with the law. Containing costs remains a pressing issue, and increased government involvement could mean a more challenging environment for at least some of the industry.

Technology

Balance sheets in the sector appear solid, with large cash balances and relatively low debt. In our opinion, this enables the group to pursue mergers and acquisitions that could help performance by consolidating expenses and removing competition. While we've seen an increase in business caution recently, we believe it was largely influenced by the Greek debt drama and the Chinese economic downturn. Though concerning, we believe the increased caution is temporary in nature.

Industrials

In the United States, the national Institute for Supply Management Manufacturing Index signaled expansion, although new orders came in somewhat soft in the most recent release. The European economy has improved modestly, despite the European Central Bank's accommodative monetary policy and some governments' shift away from austerity policies. China aggressively responded to slowing growth by loosening monetary policy and devaluing their currency.

Energy

The energy sector's rebound was relatively short lived. The sector is among the worst performers year-to-date, and there could be more volatility ahead. We believe the U.S. and Chinese economies will ultimately drive the direction of the energy industry. In the United States, economic growth continues, but improvements in fuel efficiency seem to be constraining demand growth. We believe other developed economies will improve—albeit slowly—in the near future.

Materials

The materials sector has taken a beating during the rout in the commodities market. There is still uncertainty surrounding global economic growth. In our view, the global economy is lukewarm at best. Also, the U.S. dollar continues to strengthen, setting the stage for restrained proftability for American companies operating outside the United States.

Financials

A still-dovish Federal Reserve provides financial services companies with low borrowing rates on money that they can then lend out at higher rates. Although the spread isn't large by historical standards, financial services companies can earn higher margins if longer-term interest rates move higher while shorter-term rates remain low. Even if longer-term rates remain relatively low, much of the financial sector would benefit from the Fed lifting rates off of the zero-bound, as cash investors would finally be able to start contributing to revenue growth.

Consumer Discretionary

There are a number of positives for the sector: the job market is still improving, consumers have reduced their debt loads, and we are finally seeing signs of wage growth. Additionally, energy costs have fallen, which increases the amount consumers have to spend—although to what extent they will choose to do so is unknown. Further support for consumers could come from the Federal Reserve, which continues to sound a dovish tone, despite the likelihood of a rate hike at some point in 2015.

Consumer Staples

With the U.S. economic outlook generally positive, the more defensive consumer staples sector seems unlikely to garner substantial sustained investor interest, unless the recent market fall gets extended more than we currently believe. Additionally, global growth concerns should begin to fade as foreign central banks aggressively attack sluggish economies. While we certainly don't think these economies are off to the races, the modest improvement could dent interest in the defensive staples group, and push investors toward sectors that are more cyclical. Investors who have gravitated toward the staples group recently may share that mindset.

Utilities

Utilities have proven resilient recently, as overall markets have been hit and the widely anticipated September Fed rate hike passed with no action taken. Investors switched between hiding out in utilities during increased market volatility and selling on the continued belief that interest rates will eventually be headed higher. Though slightly elevated, the Price/Earnings ratio has come off its highs from earlier this year, so the sector could get another look from value and income investors as the Fed delays raising interest rates.

DOMESTIC SECTOR ALLOCATION

	Weight	Notes
Consumer Discretionary	12%	We maintain our overweight allocation in this sector. This sector leads the way with regard to earnings estimates being revised higher, is currently up 4% YTD, and at 20.6 times earnings is currently undervalued.
Consumer Staples	9%	We increased our allocation from underweight to marketweight. Although earnings growth is expected to be weak (though positive) and the sector is slightly overvalued (19.2 times earnings), this sector offers better relative performance (2nd in price momentum) than its index peers.
Energy	13%	We maintain our underweight allocation in this sector. None of the metrics we monitor are heading in the right direction: valuations are stretched (15.7 times earnings), price momentum is weak (-21.3% YTD), and earnings estimate revisions show no signs of growth.
Financials	16%	We maintain our overweight allocation in this sector. At 13.6 times earnings, the sector is undervalued and sits near the top of the pack in this regard. Though currently down 7% YTD, earnings estimates continue to be revised higher.
Healthcare	13%	We reduced our exposure in the sector from overweight to marketweight. The Health Care sector has had a very good run to this point and currently trades around twenty times earnings. At this multiple, valuations appear somewhat stretched. The sector has seen a bit of a pullback recently (-2% YTD), but EPS revisions continue to climb higher.
Industrials	9%	We increased exposure to neutral from underweight. The sector has suffered a pullback in recent months (-9.8% YTD) and, at fifteen times earnings, is slightly undervalued. Earnings per share estimates have been revised higher but currently sit in the middle of the pack.
Technology	22%	We maintain a marketweight allocation in this sector. The technology sector put in a strong performance through most of 2014 but has shown signs of tiring as of late (-3% YTD). Although valuations seem fair, there has been no growth in earnings revisions.
Materials	3%	We maintain our underweight allocation in this sector. Although currently undervalued at 14.5 times earnings, expectations call for no earnings growth, and the sector is -16.5% YTD.
Utilities	3%	We recently increased our allocation in the Utilities sector to overweight. Although the sector is slightly overvalued at 15.9 times earnings, shares advanced 5.4% during the third quarter and earnings estimates continue to be revised higher.
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.