VIEWPOINT2024

PORTFOLIO ASSUMPTIONS

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 $8 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*.

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 risk and are constructed with a forward-looking view of financial markets.

For quarterly reports that highlight key macroeconomic insights and market observations, please visit: www.washingtoncrossingadvisors.com.

** As of December 31, 2023. Total assets include assets under management and assets under advisement.*

Executive Summary

Over the past year, the economy and financial markets have surpassed most forecasters' expectations. The U.S. economy grew at an annualized rate of 5% in the third quarter of 2023, with falling inflation, stable employment, and a rise in the S&P 500 stock index.

The majority of data we review improved early in 2023. However, the rate of improvement then stalled, making the year ahead more challenging as higher interest rates impact the economy. Additionally, the equity markets' narrow leadership and high valuations could make further gains more difficult. Nonetheless, fixed-income investors will find starting yields more appealing today than in previous years.

It is satisfying to see the economy defy the widespread negativity that gripped the markets a year ago. As we step into 2024, we position asset allocation portfolios tactically with a slight tilt toward stocks due to recent data trends.

Where's the Recession?

Get ready for a surprise: our economy is growing at 5% a year, and the S&P 500 index is up 19% through November. A year ago, most professional forecasters were crowing about a coming recession in 2023. But the "Recession of 2023" wasn't to be. The experts were wrong. Neither the continuing Russo-Ukrainian war nor the outbreak of the Israel-Hamas war was enough to dampen investors' mood or derail growth.

And guess what? All the hand-wringing over China's troubles failed to take us into recession and did not stop the S&P 500's advance. What's more, do you remember the three big bank failures last spring? Well, investors shrugged off that shock quicker than you can say "market exuberance." In 2023, risk-takers regained the mantle of "cool kids on the block," buoyed by the magic of new AI technologies and a dream that inflation would disappear, opening the door to a new round of rate cuts.

But, dear reader, don't let the S&P 500's victory lap lull you into a false sense of security. After all, 80% of the stock markets's gains were concentrated in just a dozen companies. The average stock return was far less than the market average. Also, higher interest rates are starting to crimp spending. Sales of homes and automobiles are extremely lackluster.

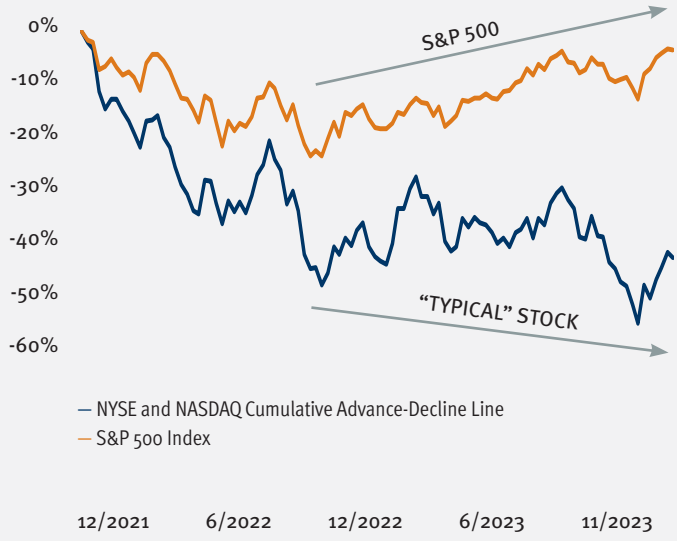
So, while it makes sense to recognize improvement in some of the data, it is not the time to play fast and loose with risk. Our guidance? Keep a balanced and diverse strategy because defense is essential in riskier markets. Even though the S&P 500 and the U.S. economy gained ground in 2023, we should raise an eyebrow because interest rates are changing behavior in ways that will penalize growth and because some markets seem to be ignoring this risk altogether.

Credit . . . Check!

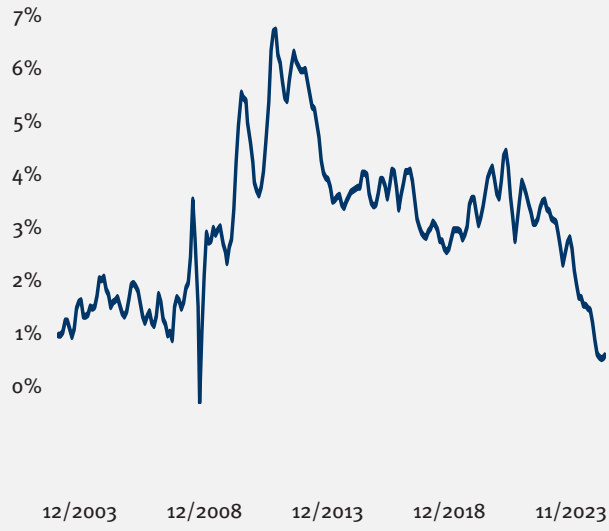
Not only is the stock market and economy performing better, but other markets are following suit. Take corporate credit, for example. The Moody's Baa corporate bond index yield is 5.5%, which is about 1.6% higher than the 3.9% yield available on a U.S. Treasury bond. Credit markets are signaling full speed ahead.

Yet, such a slight difference in yield, or "spread," is unusual. In the past 20 years, investors were only willing to accept such small compensation for credit risk less than

MARKET "BREADTH" DIVERGES
MORE STOCKS DECLINING THAN ADVANCING
Source: WCA



EQUITY RISK PREMIUM—Difference Between S&P 500 Forward Earnings Yield & Yield on 10yr U.S. Treasury (3mo. Moving Average)
Source: WCA



1% of the time. If there is to be a recession, spreads would be much wider, more like 3-4% above Treasury yields. If you're searching for signs of a recession, today's small corporate bond spreads won't show it.

Neither will you find many signs of stress by looking at the job market. The December 2023 unemployment rate of 3.7% is nearly the lowest in 50 years. And, even after accounting for inflation, wages and salaries are up 2.4% from a year ago. On average, job changers are earning 8% more, according to Automatic Data Processing.

Record Wealth

Risk tolerance plays a major role in boosting investment, asset values, and wealth. Over the years, the value of assets owned by U.S. households has gone up, as per Federal Reserve (Fed) data. In the fifteen quarters since 2019, the total value of U.S. household assets rose a record $35 trillion (+30%) and now totals $170 trillion. If we remove $20 trillion in liabilities (home mortgages, credit card balances, and other loans), net worth is a record $150 trillion. These values are underpinned by confidence in the economy, stability of the underlying rule of law and institutions, and faith in the continued availability of capital.

It is clear that changes in wealth, plus a $1.7 trillion increase in income, have shaped much of the economy's direction in recent years. Despite the risk posed by higher interest rates, market participants looked the other way in 2023, focusing instead on signs of an improving outlook.

Higher Rates Start to Bite

Despite the success of 2023, *we should be skeptical about what we are seeing because high interest rates are starting to bite*. It is well understood that high rates hurt households and corporations' liquidity. Consider a first-time homebuyer, for example.

Today, mortgage rates are over 7%, and the average home price has doubled from a decade ago, making it extremely difficult for many young families to grab the first rung of the economic ladder. We also know that businesses are squeezed by higher rates.

This is especially true for smaller, heavily indebted companies in cyclical industries. When sales drop and interest costs rise, the viability of investments in such business is questioned. And often, lenders, including banks, are put at risk, which can lead to less lending, slower growth, and layoffs. These changes often take 12 to 18 months to fully materialize after a Fed rate hiking cycle is complete.

These are just a few examples of how higher interest costs might crimp the economy's growth. It is a possibility we must consider, especially as some corners of financial markets embrace risk.

Equity Risk "Premium"

As with tight spreads in the corporate bond market, there are signs that risk may not be well compensated for in equity markets, either. This is evident in the "equity risk premium" for the S&P 500. With U.S. Treasury rates in the 4-5% range, we estimate the so-called S&P 500 "equity risk premium" is being squeezed (chart, bottom right).

If we want to know how investors feel about risk, it helps to have a point of reference. For that reference point, we will turn to the U.S. Treasury bond, where an investor can reasonably expect to earn a 4.1% return for the next 10 years. With this number in hand, we can compare that return with an "earnings yield" for the S&P 500.

As of this writing, analysts expect $240 in earnings in the year ahead, and with the S&P 500 trading near 4,770, the earnings yield is about 5% ($240/4,770 = 5%). The difference between the S&P 500's earnings yield and the 10-year U.S. Treasury yield is near 1%.

This unusually low number raises questions about the attractiveness of stocks relative to bonds. Conversely, bond investments are relatively more attractive, given today's prices and yields. This leads us to conclude that now might be a good time to consider a balanced strategy over an all-stock one.

Conclusion

It is clear that although the S&P 500 and the U.S. economy gained ground in 2023, we should raise an eyebrow here for two main reasons. First, interest rates are changing behavior in ways that will clearly penalize growth. And, more importantly, because some markets appear to be ignoring this reality altogether.

Obviously, a big part of our outlook rests with interest rates. It could prove possible that inflation fades away and rate cuts follow. This could alleviate some risk, and our skepticism here could prove unwarranted. But maybe not. Rest assured that the year ahead will bring more unexpected changes and, of course, a presidential election.

For now, our "barometer" of financial conditions shows sideways movement (see page 6). Thus, we start 2024 with a slight tilt toward stocks, but risk exposures remain close to benchmarks.

Portfolio Strategy

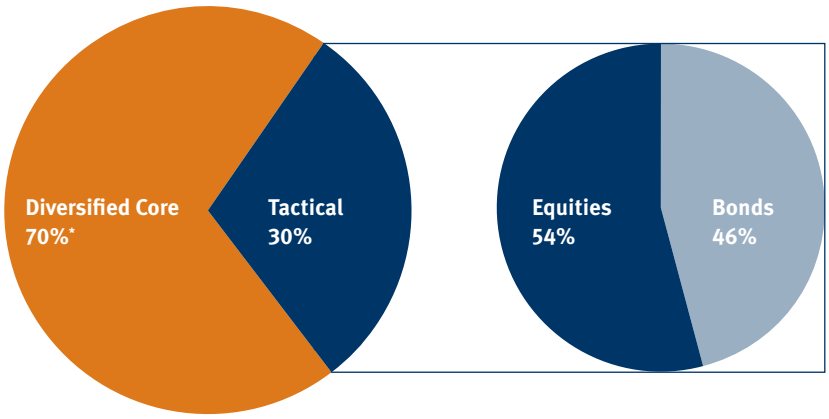
We enter 2024 with a slight overweight to stocks over bonds as improving data trends led to greater tactical equity exposure. As the year progressed, growth picked up, and both the economy and S&P 500 posted respectable gains. Yet, the pace of improvement stalled, and for most of the past year, we have maintained a risk exposure close to benchmarks. From a longer-term basis, we are pleased to see bonds offering higher yields. Those yields now exceed the inflation rate, providing bond investors with a positive expected real return.

PORTFOLIO STRATEGY

PORTFOLIO STRUCTURE

DIVERSIFIED CORE
Longer-Term Focus

SATELLITE
Shorter-Term Focus



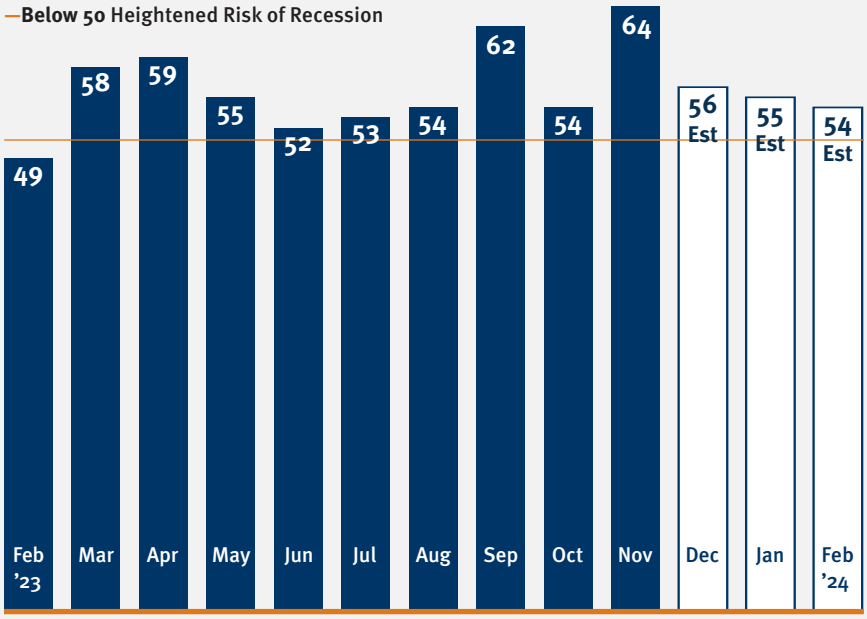
COMBINING LONGER- AND SHORTER-TERM PERSPECTIVES IN ONE ACCOUNT

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 7 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

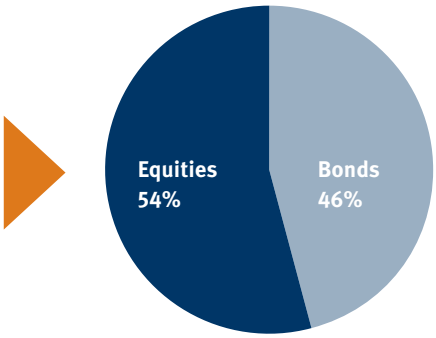
WCA FUNDAMENTAL CONDITIONS BAROMETER



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 Focus

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



As of December 31, 2023.
* Including stocks, bonds, and other assets.

ASSET CLASS	10-YEAR VIEW RETURN	RISK	RETURN/RISK	TACTICAL POSITION
BOND ASSUMPTIONS				
Core Bonds	3.5%	4.0%	0.9	UNDERWEIGHT
1-3 Year Treasury Bond	3.4%	1.5%	2.3	NEUTRAL
Mortgage-Backed Securities	3.4%	3.5%	1.0	OVERWEIGHT
Intermediate Government/Credit	3.5%	3.2%	1.1	UNDERWEIGHT
20+ Year Treasury Bond	4.0%	12.9%	0.3	UNDERWEIGHT
Investment-Grade Corporate Bonds	3.5%	7.2%	0.5	OVERWEIGHT
High-Yield Corporate Bonds	3.6%	9.3%	0.4	NEUTRAL
EQUITY ASSUMPTIONS				
Core Equity	4.2%	15.8%	0.3	OVERWEIGHT
Domestic Large Cap Value	4.1%	15.5%	0.3	UNDERWEIGHT
Domestic Large Cap Growth	4.2%	17.6%	0.2	OVERWEIGHT
Foreign Developed Equity Markets	3.9%	16.8%	0.2	UNDERWEIGHT
Foreign Emerging Equity Markets	4.0%	21.1%	0.2	UNDERWEIGHT
Gold	3.5%	16.3%	0.2	NEUTRAL
REITs	3.8%	20.2%	0.2	NEUTRAL

As of December 31, 2023. Past performance does not guarantee future results.

Core Satellite

CORE POSITIONING: DECISION TREE	
EQUITY vs. FIXED	Data trends support slight tilt to equity
FOREIGN vs. DOMESTIC	Increasing tilt to U.S. over foreign
EMERGING vs. DEVELOPED	Favor developed over emerging
GROWTH vs. VALUE	Keep tilt to growth over value
CREDIT vs. SOVEREIGN	Focus on higher quality credit
SHORT vs. LONG DURATION	Underweight duration
NON-CORRELATED ASSETS	Neutral

These views are provided by Washington Crossing Advisors, LLC. (WCA) 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. Risk 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, WCA 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.

Equity Market Outlook

Global stocks rose last year, as did the S&P 500. The market value of global stocks now stands near $106 trillion, and the market value of United States companies is roughly $48 trillion.

While both global and domestic stock indices advanced last year, it is important to remember the advances come on the back of approximately 20% declines in 2022. Accordingly, as of the time of this writing in early December 2023, equity markets are still below levels achieved in 2021.


346.17
215.43
▲+0.23%
▲+0.09%

Narrow Leadership

The S&P 500 measures the performance of the largest domestic companies in the United States. Increasingly, that performance is dominated by a handful of global technology giants. From January through November of 2023, for example, the top dozen stocks by size in the S&P 500 contributed over 16% of the S&P 500's 20% return. By contrast, the average performance among the 1,000 largest U.S. stocks was about 4%. So, while we were pleased to see some positive results from the stock market in 2023, we see that a narrow set of companies drove the advance.

Before we make too much of the success of these dozen companies, we must also tell you that the same companies registered declines of anywhere from 40-65% the prior year. These are huge year-to-year swings for companies that increasingly dominate the success or failure of the leading benchmark for U.S. stocks. These dozen companies are collectively valued at over $15 trillion, with some individual market capitalizations reaching over $3 trillion. Moreover, the returns of the stocks are highly correlated with one another, and they are just about all technology companies.

Such a heavy concentration in so few companies means that the level of diversification in a single equity index is less from what it used to be.

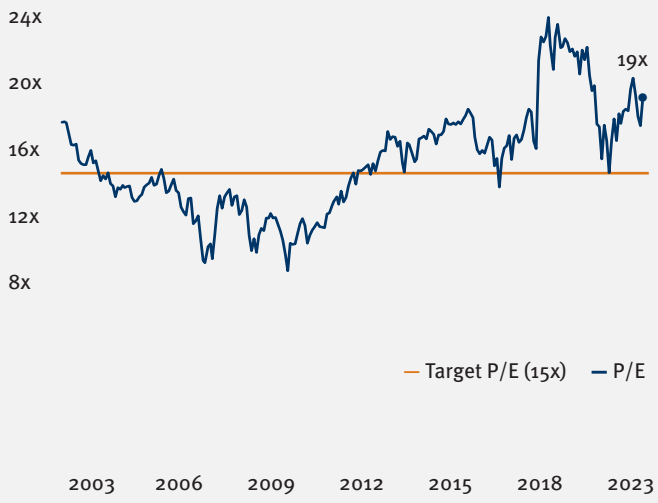
Big Profits

An analysis of the composition of one of the world's most iconic equity indices would be incomplete if we ignore fundamentals. Supporting the $40 trillion index are some very profitable businesses. We estimate that the 500 companies' revenue of over $15 trillion accounts for more than half of the annual output of the entire U.S. economy (currently $27 trillion). The sales of the dozen largest companies in the S&P 500 by market capitalization are about $2 trillion. The size of the largest companies not only holds sway over the performance of the S&P 500 but also accounts for a substantial portion of the total output of the entire economy.

A pickup in profits helped lift the market last year from January through November, just before the writing of this report. Through November, the S&P 500 returned about 21%. Roughly 6% of the return is directly attributable to an increase

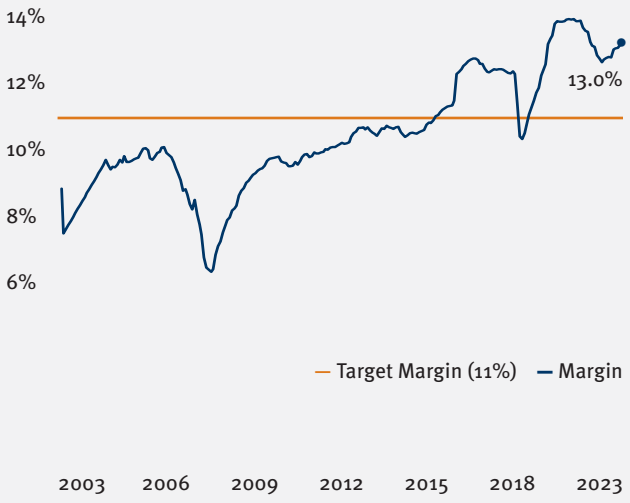
S&P 500 FORWARD 12-MONTH P/E RATIO

Source: Bloomberg



S&P 500 FORWARD 12-MONTH PROFIT MARGIN

Source: Bloomberg



in forecast S&P 500 per share profits by analysts during the year. Another 2% can be attributed to dividends paid. The remaining 13% resulted from a rise in the price-earnings multiple paid.

But why did the multiple rise, you ask? For most of the year, interest rates rose, so rising multiples are not easily traced to falling interest rates. Instead, as we pointed out in our macro economy overview, investors' appetite for risk increased. As a result, the premium charged for taking on risk, especially in large mega-cap companies, fell during the year. In essence, the market concluded that large-cap domestic stocks were attractive because starting valuations seemed reasonable and because hope emerged that an economic "soft landing" could be achieved.

Positioning

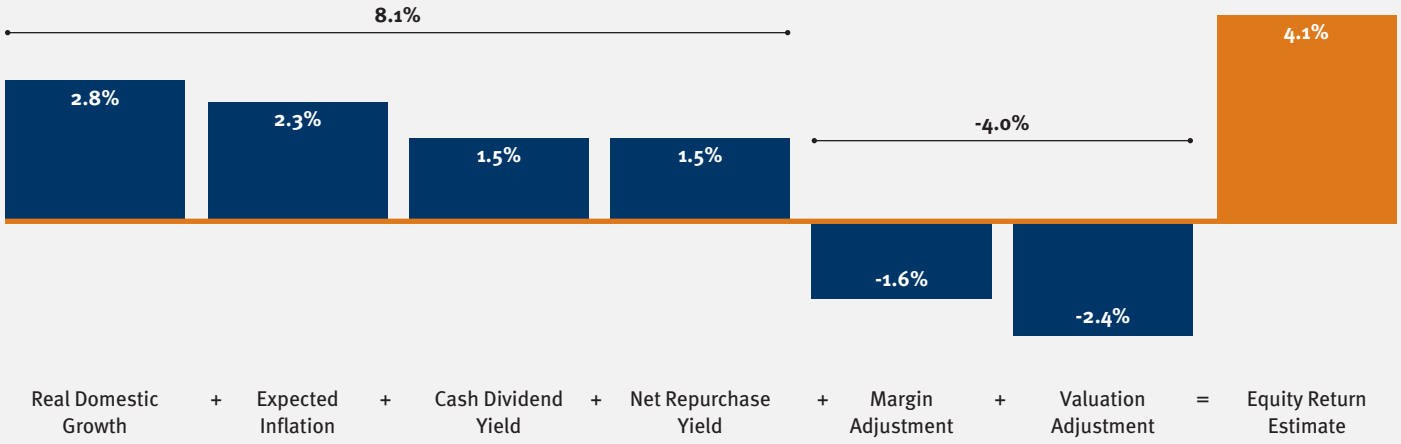
As we start 2024, our read of incoming data is primarily positive. The economy is expanding, although higher interest rates are beginning to pressure some parts of the economy. In the months ahead, we will be watching what happens to areas such as housing and manufacturing, each struggling with a shortage and an excess of inventory, respectively. Another area of interest is capital investment, which is a good indicator of business trends and the profit outlook. Here, we see positive signs.

In the year ahead, challenges for the equity market could emerge from several places. As interest costs, labor, and other inputs rise, profit margins will likely come under pressure. The current margin of 13% is likely to come down to 11% as this process unfolds (right chart, page 10). Also, we are starting the year with the S&P 500 trading at over 19x forward earnings. This multiple is about 20% higher than our long-run expectation of 15x (left chart, page 10). Consequently, we see profit margins and multiples as exerting a headwind for stocks.

On the other hand, some growth in the economy, a modest rate of inflation, ongoing share repurchases, and dividend payments should be enough to offset headwinds over time.

The chart below shows how we envision the various long-run drivers of equity market return contributing to our long-run equity market return expectation (see "Long Run Capital Market Assumption and Tactical Positioning" table, page 7).

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



Source: Washington Crossing Advisors, LLC. Assumptions are estimates based on historic performance of the above factors looking back the previous 15 years 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. Margin and valuation adjustments assume normalization measured as annualized log return differentials over our forecast horizon.

Fixed Income Outlook

We see the existing yields across the curve as a welcome development for investors. As inflation rates come down, starting yields on quality fixed income investments improve in real terms. Although some have begun to expect rate cuts in the offing, we are not yet convinced.

Time to Cut?

Recent indications by the Federal Reserve open the door to possible rate cuts. The case for such cuts is best made by observing improvements in the inflation rate. Consumer prices in the United States are up 3.2% year-over-year through October. While above the central bank's 2% target rate, the pace of increase is far slower than in mid-2022 when consumer prices were rising near 9%.

On the other hand, there are signs that the job market is still running hot, something the Fed sees as threatening price stability. The U.S. labor market improved in November with higher employment and wages, reducing the chance of an early Fed rate cut. The November jobs report showed that the unemployment rate fell to a low 3.7%, workforce participation increased, and wage growth rose more than anticipated. These trends argue against an early exit to restrictive monetary policy.

Left Guessing

Markets may speculate that a rate cut could come as soon as the spring, but we still need to be convinced. The Fed will only backtrack on its promise to hold the line on inflation if there is a clear threat to growth, financial markets become roiled, or policymakers become convinced that their 2% inflation target has been sustainably achieved. At the long end of the Treasury yield curve, we are also unconvinced that rates will continue to descend. A year ago, the 10-year U.S. Treasury bond offered investors a yield of 3.9%. Those yields rose throughout the year on signs of strength in the economy, leading to a near 5% yield by the end of October.

With our "barometer" (see page 6) stuck in neutral, we see the long end of the yield curve staying in the range of 3.75-4.75% in the months ahead (chart below, right).

Credit

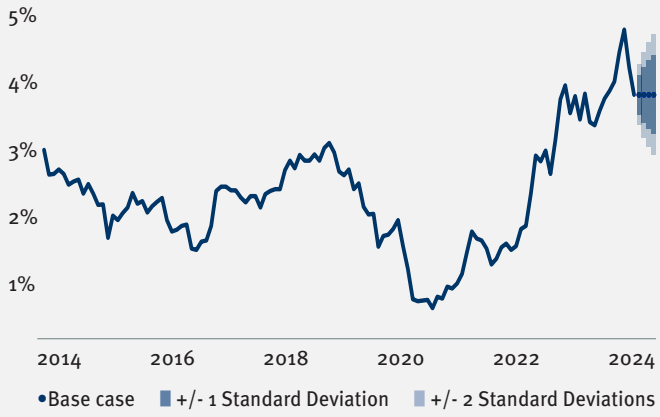
There is reason to expect higher interest rates to impose costs on borrowers. Should financial conditions tighten, those costs could rise significantly. But there are only a few global defaults happening today. Moody's Investor Service, for example, estimates that the global speculative-grade default rate is near 4.5%. This default activity level is close to the historical average and does not indicate a high stress level. Whatever weakness may be present in the global economy, it has not risen to a level that sends shivers down the spines of credit markets. Moreover, few signs of worry are seen in the spread between the yield on high-yield bonds and Treasuries (chart below, left). This situation is likely to change in the months ahead, even under the assumption of moderate economic growth. This is because debts incurred during the prior period of easy credit come due and must be rolled over at a higher cost. Risks that previously profitable investments turn bad under new and higher-cost financing terms are skewed to the upside. Accordingly, we see a rise in credit spreads in the year ahead.

Good News

The excellent news for fixed-income investors is that markets are finally offering rates of return above the inflation rate. With inflation falling toward low-single-digit numbers, short-term Treasury rates near 5.5% and longer-term Treasury rates near 4.5% produce attractive returns after inflation. Such a positive starting point for yield should help future fixed-income returns, all else being equal. This setup is a welcome development for investors who have endured ultra-low rates for most of the past decade.

CREDIT SPREAD (U.S. CORPORATE HIGH YIELD)
Source: Bloomberg; WCA

10YR U.S. TREASURY BOND YIELD
Source: Bloomberg; WCA



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.

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.

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.

Diversification—Diversification does not ensure a profit or protect against loss.

Dividends—Changes in market conditions or a company's financial condition may impact a company's ability to continue to pay dividends, and companies may also choose to discontinue dividend payments.

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 Dynamic Strategies Portfolios require a $25,000 and $50,000 minimum investment, respectively. Strategies in the Stifel Opportunity Program are proprietary products developed by Stifel. More information on the 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 is appropriate for their needs. Indices are unmanaged, do not reflect fees and expenses, and are not available for direct investment. Past performance does not guarantee future results. 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.

Assets Under Management represents the aggregate fair value of all discretionary and non-discretionary assets, including fee paying and non-fee paying portfolios. Assets Under Advisement represent advisory-only assets where the firm provides a model portfolio and does not have trading authority over the assets.

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