WASHINGTON CROSSING ADVISORS

WWW.WASHINGTONCROSSINGADVISORS.COM

Commentary

June 8, 2011

Kevin R. Caron
Portfolio Manager
(973) 549-4051

Chad A. Morganlander
Portfolio Manager
(973) 549-4052

A Pause in Growth?

The pace of economic recovery has slowed based on our analysis of incoming data. The WCA Fundamental Conditions Index™, which evaluates changes in thirty different measures of financial and economic conditions, has slipped to a current reading near 65 from above 80 earlier this year (chart below). So long as this downward trend persists, a tactical portfolio posture with a somewhat broader diversification and closer to a neutral "risk / return" posture is appropriate. The shift was accomplished primarily through a modest increase in bond allocations beginning in May.

Since our last commentary, we have seen:

1. Automobile sales slip to an 11.8 million annualized rate of growth versus a three-month average of 12.7 million;

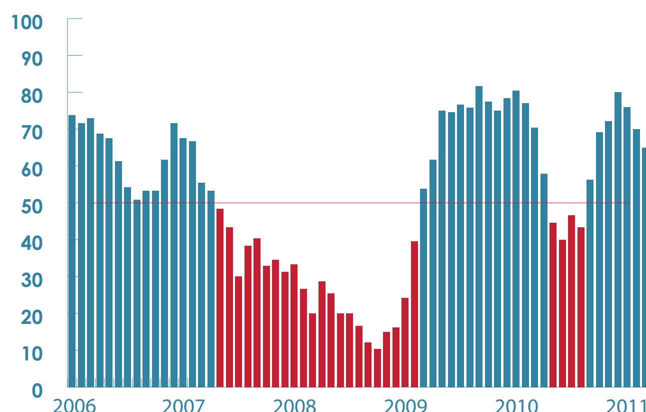
2. The rolling four-week average for initial jobless claims rise to an average of 426,000 in the latest month compared to 417,000 over the prior three months;

3. The ratio of ISM orders / inventories slip to 1.05 versus a three-month average of 1.2;

4. The Treasury yield curve flatten as the long end of the yield curve has come down;

5. The relative performance of bonds compared to stocks improve; and

6. The May unemployment rate rise to 9.1% with both total and private payrolls increasing at a much slower pace than expected.



STIFEL NICOLAUS

These recent trends do not mark an inevitable return to recession, but they are unwelcome. An economy operating with significant slack in employment, housing, and manufacturing requires a faster growth rate to draw down the pool of unemployed workers, absorb an excess supply of housing, and raise output to absorb excess capacity in the manufacturing sector. We will remain vigilant for further changes in these and other data points and make tactical changes to portfolios as necessary.

The Fed and the Dollar

The economy's slower growth gives the Fed reason to maintain its exceptionally accommodative monetary stance (short-term interest rates have been held near 0% since December 2008). By contrast, more than a dozen other countries around the world have raised interest rates this year. Those nations include China, Russia, Norway, Sweden, Poland, South Korea, Thailand, India, Indonesia, the Philippines, Malaysia, Taiwan, Chile, and Brazil. As a result, short-term U.S. Treasuries offer approximately a 1.00% lesser yield than similar debt of other nations around the world. This disparity has increased since the beginning of the year, when the differential was just 0.60%.

Combine lower Treasury yields with moderating U.S. growth compared to our trading partners, and the case for continued structural dollar weakness reemerges. The weaker dollar has contributed to a 15% year-over-year boost to U.S. exports, helped multinational earnings, prompted an upward bias to commodity prices, and boosted the U.S. inflation rate. A weak dollar also creates an incentive encouraging investors to use the dollar as a funding currency for investments in higher-yielding securities overseas.

Profitability Near Peak Levels

A bright spot amid the weaker data remains the overall level of corporate earnings as S&P 500 earnings increased 24% in the first quarter from last year. Analysts now expect S&P 500 earnings to grow 20% over the next 12-month period to $105. Assuming those earnings are delivered, and given the current S&P level of 1286, the earnings yield for the S&P 500 is over 8.2% (12.2 times earnings) on a forward-looking basis. Comparing the 8.2% forward earnings yield, a 30-year Treasury yield of 4.3% produces a historically attractive 3.9% spread to Treasury yields.

However, we believe much of the profit improvement has been driven by aggressive cost cutting and exceptionally low interest rates. These factors have helped drive corporate profits as a percent of GDP to 9.7% in the United States – near the prior peak level of 10.3% in 2006 and 45% above the 20-year average level of profitability. A "normalized" view of earnings that takes a longer view of undying earnings power net of cyclical distortions puts "normalized" earnings closer to $80. At $80, the S&P trades with a more modest earnings yield of 6.2% and a price-to-earnings ratio of just over 16 times.

Even more remarkable is that swelling profitability occurred in the face of a drive by households to pare back debt and boost savings at the expense of additional borrowing and spending. High levels of government deficits have provided some short-run macro-economic slack that has allowed for corporations and households to save and deleverage. The Federal Government deficit has increased to 9% of GDP from 2% as the result, and further increases in these deficits are likely to be constrained given increased political pressure. Pressure to curtail deficits, higher commodity prices, and already high levels of profitability may make it more difficult to sustain rapid earnings growth. Therefore, companies and sectors with greater earnings consistency may prove to be an increasingly attractive thematic for portfolios.

Japan Gears Up

Beyond earnings, another potential positive may come later this year as Japanese manufacturing picks up following that country's devastating natural disasters earlier this spring. Japanese manufacturers hope to see a meaningful pickup in output as capacity comes back online following outages. Of course, the rate of inventory growth, strength of Japanese domestic demand, and demand from around the world will play an important role in Japan's outlook.

Europe

Finally, Europe's challenge in managing fiscal imbalances continues to evolve. Recently, progress has been made toward extending additional loans to fund the Greek government to 2013, when the EU hopes to have a more comprehensive plan for meeting fiscal challenges. The current compromise involves additional loans, pledges by the Greek government to further reduce the fiscal deficit,

and promises by the Greek government to accelerate asset sales. Additionally, private investors (including Greek banks) must agree to roll over maturing Greek debt into newly issued bonds. This is far from a permanent fix but potentially gives all parties involved some "breathing room" to continue to seek a more permanent solution.

Conclusion

Additional signs of slowing growth have become apparent. Slowing growth increases the time it will take for the economy to recover and creates some uncertainty about future levels of investment in human and physical capital. Already high unemployment rates risk becoming stuck at high levels for an unacceptably long period of time. Slower growth provides the Fed with all the more reason to maintain its own promise to keep interest rates low for an "extended period of time." Corporate profitability remains high despite household's efforts to cut debts and boost savings while spending in moderation. Public sector finances remain an important "swing factor" for 2012-2013. Fiscal challenges and excess indebtedness remain a headwind from potentially more robust growth.

The recent moderation in growth is not sufficient evidence to declare a return to recession, but must be acknowledged. A broadly diversified portfolio posture with exposure across a wide variety of asset classes is consistent with our investment process and emerging trends in the data.

Tactial Asset Allocation

WASHINGTON CROSSING ADVISORS

WWW.WASHINGTONCROSSINGADVISORS.COM

Thursday, June 09, 2011

	================ CORE ==================							====== SECTOR-ENHANCED =====				
	======= TAXABLE ========				==== MUNICIPAL ====			==== TAXABLE ====			= MUNICIPAL =	
Asset Class	**Aggressive**	**Moderate Growth**	**Balanced**	**Conservative**	**Moderate Growth**	**Balanced**	**Conservative**	**Aggressive**	**Moderate Growth**	**Balanced**	**Moderate Growth**	**Balanced**
Fixed Income	**10%**	**25%**	**50%**	**65%**	**25%**	**50%**	**65%**	**10%**	**25%**	**50%**	**25%**	**50%**
CASH	10%	2%	2%	2%	2%	2%	2%	10%	2%	2%	2%	2%
DOMESTIC BONDS		23%	48%	63%	23%	48%	63%		23%	48%	23%	48%
Aggregate Bond Market												
Short-Term Treasuries				9%								
Intermediate-Term Treasuries			9%	11%						9%		
Long-Term Treasuries			9%	11%						9%		
Investment-Grade Corp Bonds		4%	10%	18%					4%	10%		
High-Yield Corporate Bonds		11%	10%	7%					11%	10%		
International Treasury Bonds		8%	10%	7%					8%	10%		
Short-Term Municipals					11%	24%	31%				11%	24%
Long-Term Municipals					12%	24%	32%				12%	24%
Equity & Other	**90%**	**75%**	**50%**	**35%**	**75%**	**50%**	**35%**	**90%**	**75%**	**50%**	**75%**	**50%**
DOMESTIC	69%	54%	32%	17%	54%	32%	17%	69%	54%	32%	54%	32%
S&P 500												
Large Cap Growth	39%	26%	12%	7%	26%	12%	7%					
Large Cap Value	14%	13%	8%	4%	13%	8%	4%					
Small Cap Growth	8%	6%	4%	2%	6%	4%	2%	8%	6%	4%	6%	4%
Small Cap Value	8%	9%	8%	4%	9%	8%	4%	8%	9%	8%	9%	8%
FOREIGN	16%	14%	8%	4%	14%	8%	4%	16%	14%	8%	14%	8%
Developed Markets												
Emerging Markets	16%	14%	8%	4%	14%	8%	4%	16%	14%	8%	14%	8%
OTHER	5%	7%	10%	14%	7%	10%	14%	5%	7%	10%	7%	10%
Gold		2%	6%	10%	2%	6%	10%		2%	6%	2%	6%
REITs	5%	5%	4%	4%	5%	4%	4%	5%	5%	4%	5%	4%
LARGE CAP U.S. SECTORS								53%	39%	20%	39%	20%
Energy								6%	4%	3%	4%	3%
Technology												
Materials								5%	4%		4%	
Industrials								6%	5%	4%	5%	4%
Consumer Discretionary								9%	7%	2%	7%	2%
Cyclical:								26%	20%	9%	20%	9%
Health Care								6%	5%	3%	5%	3%
Utilities												
Consumer Staples								6%	5%	4%	5%	4%
Telecommunications								9%	6%	4%	6%	4%
Financials								6%	3%		3%	
Non-Cyclical:								27%	19%	11%	19%	11%
TOTAL	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**

Core Equity Strategy: Invests in US Large Cap by style (Growth vs. Value)

Sector Enhanced Equity Strategy: Invests in US Large Cap by sector (ie. Technology, Utilities, etc.)

Totals may not sum to 100% due to rounding

Disclosures

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

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.

The Washington Crossing Advisors Stifel CONQUEST Portfolio requires a $50,000 minimum investment. Strategies in the Stifel Score Program are proprietary products developed by Stifel Nicolaus. More information on the Score 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 Score Program is appropriate for their needs.

STIFEL, NICOLAUS & COMPANY, INCORPORATED
HOME OFFICE: ONE FINANCIAL PLAZA | 501 NORTH BROADWAY | ST. LOUIS, MISSOURI 63102
MEMBER SIPC AND NYSE