WASHINGTON CROSSING ADVISORS

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S&P 500 Index: 1,458
10 yr Treasury: 4.75%

Joseph V. Battipaglia
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The Case for Growth

In our *2007 Outlook* we noted that the current seven-year cycle favoring value stocks over growth stocks has been unusually long and generated significant excess returns. We now believe that the intensifying downturn in housing, spreading credit risk, sharply falling rates of household borrowing, and the potential for peak commodity prices may mark a "tipping point" for style investing. Given the lagging performance by growth in recent years and ongoing fundamental improvements in earnings, we view the growth segments of the U.S. equity market as more appealing at this time with less risk than the value segments of the markets.

Therefore, we are changing our recommended tactical asset allocation mix to **65% growth stocks** (from 55% previously) and **35% value (**from 45% previously) for the U.S. equity portion of portfolios.

Sectors Driving Growth

We see the leading growth sectors, such as technology, telecommunication, media, consumer services and health care to be well positioned for an improvement in relative performance. Core inflation measures appear to be improving, which supports the value placed upon future earnings streams. Balance sheets are generally strong for growth companies with relatively little leverage and earnings growth rates that are modest but rising. Unlike volatile energy and commodity sectors, most growth sectors are far from cyclical peak levels. Lastly, we see the valuations for major growth indices like the S&P / Citigroup Growth Index, for example, to be more attractive than similar value indices (see *Outlook 2007* for more on valuation).

By sector, we note that growth is heavily influenced by technology (23%), health care (16%) and consumer services (13%). Collectively, we believe the growth sectors are well positioned to benefit from the long-run secular tends of investment in new productivity-enhancing technologies and the replacement of and aging technology base, increased demand for health-related and consumer services targeted to a demographically changing U.S. population.

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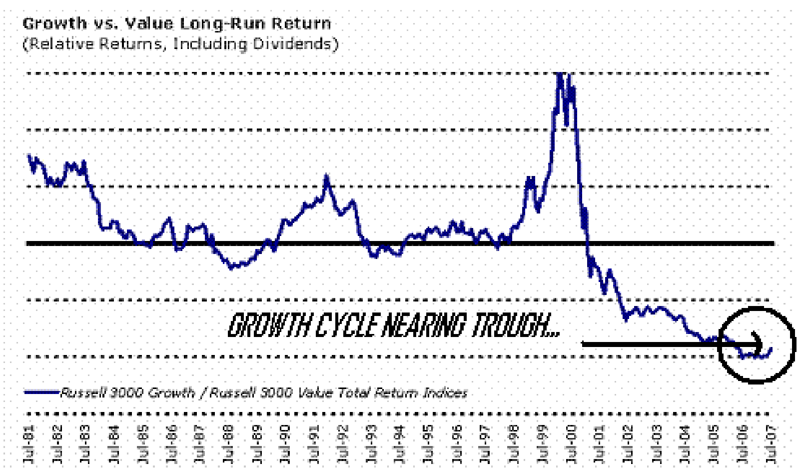
Cycles and Style

We believe that market trends run in cycles. To this end, we have prepared the chart below to depict the growth / value cycle. The chart shows the relative performance of the Russell 3000 Growth Index compared to the Russell 3000 Value index. The indices include both price appreciation *and* dividends. Two things are striking about this index. First, it appears that value investing *has* outperformed growth investing over the past couple of decades. It is also apparent that, in the intermediate term, valuations tend to go to extremes before reverting to a more balanced level. Just as growth went to an extreme in 1999, the value indices are at a similar extreme today. Since growth has now hit an extreme low point relative to value, we think that markets will likely begin to look at growth in a new light. While it is difficult to predict precise tops and bottoms, we believe that now is a good time to re-allocate some funds into growth at the expense of value.



25 Years of Style Cycles
Russell 3000 Value vs Growth Total Return Indices

Cycle Start	Cycle End	Length (Years)	Outperformance Total	Outperformance Annualized
Value Cycles				
Mar-00	Jul-07	7.2	167.0%	14.6%
Mar-96	Dec-97	1.8	4.4%	2.5%
Jun-91	Sep-93	2.3	18.1%	7.7%
Sep-86	Aug-88	1.9	7.1%	3.6%
Nov-82	Nov-84	2.0	24.8%	11.7%
Growth Cycles				
Dec-97	Feb-00	2.2	67.5%	26.9%
Sep-93	Mar-96	2.5	7.7%	3.0%
Aug-88	Jun-91	2.8	23.4%	7.7%
Nov-84	Sep-86	1.8	-4.1%	-2.3%

At **7.2 years**, the current cycle represents the longest cycle on record. While the growth-led bull market of the 1990's was fast, the current cycle has been long. Cumulatively, **value stocks have outperformed value by 167%** from the top of the last growth cycle that ended in March, 2000. The table below illustrates the duration and magnitude of past cycles.

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Changing Recommended Tactical Portfolio Allocations

The following table has been updated to reflect our recommended tactical asset allocation changes to growth and value within the U.S. equity portion of portfolios.

Asset Class	Aggressive Growth	Growth	Balanced	Con-servative
INCOME & DEFENSIVE				
Cash & Short-term Treasuries	2%	9%	25%	44%
Int-term Treasuries		5%	5%	5%
Long-term Treasuries		10%	10%	10%
TIPS		3%	5%	5%
Invest Grade Corporate Bonds		7%	16%	23%
High yield Corporate Bonds				
REITS				
Gold				
EQUITIES				
Large Cap Growth	42%	27%	16%	5%
Large Cap Value	21%	13%	8%	3%
Mid Cap Growth	16%	10%	8%	2%
Mid Cap Value	11%	7%	4%	1%
Small Cap Growth				
Small Cap Value				
Micro Capitalization				
Foreign Emerging Markets				
Foreign Developed Markets	8%	5%	3%	2%
TOTAL:	100%	100%	100%	100%

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