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Quarterly Update

September 30, 2009

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Past Commentaries

August 24, 2009

[Trough Earnings and the Path Forward: How Earnings Recovery Could be Different This Time](#)

June 6, 2009

[Signs of Improvement Broadening Out Portfolios & Raising Equity Exposure](#)

March 13, 2009

[A Big Hit to Wealth and What to Do Now](#)

March 5, 2009

[A Questionable Plan and a Free Market Silver Lining](#)

January 7, 2009

[Can Policymakers Create Just a Little Inflation?](#)

November 21, 2008

[Credit: Don't Want It... Can't Get It...](#)

Tactical Asset Allocation Observations Fourth Quarter 2009

- ❖ Economic improvement can be seen in credit, the U.S. economy, along with global production and trade.
 - ❖ Portfolios have been adjusted over the past two quarters to reflect this. Unlike a year ago, where we had taken risk off the table, investments in equity markets have been increased.
 - ❖ Equity focus has been broadened out from a large cap, domestic growth bias to incorporate foreign stocks, smaller capitalization stocks, and value segments of the equity market.
 - ❖ Non-equity exposure has moved away from a narrow focus on Treasury assets to include corporate bonds and government agency bonds. Gold, preferred equity, high yield corporate debt, and foreign sovereign debt have also been included, but play a smaller role.
 - ❖ Favorite equity sectors remain technology, while the most underweight sector remains energy.
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- ❖ The WCA Credit Conditions Index stands at 48.
 - ❖ The WCA U.S. Economic Conditions Index stands at 67.
 - ❖ The WCA Foreign Index stands at 58.
 - ❖ The WCA Composite Index stands at 58.

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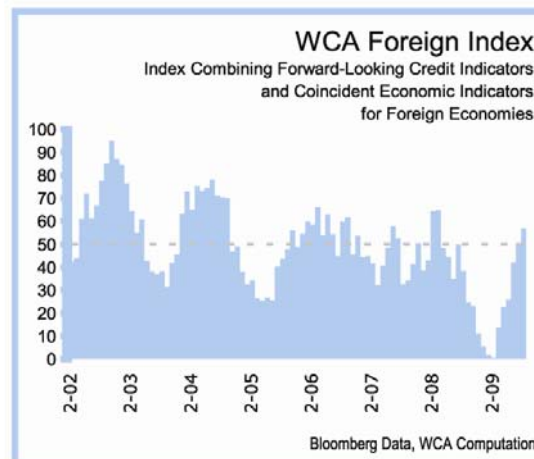
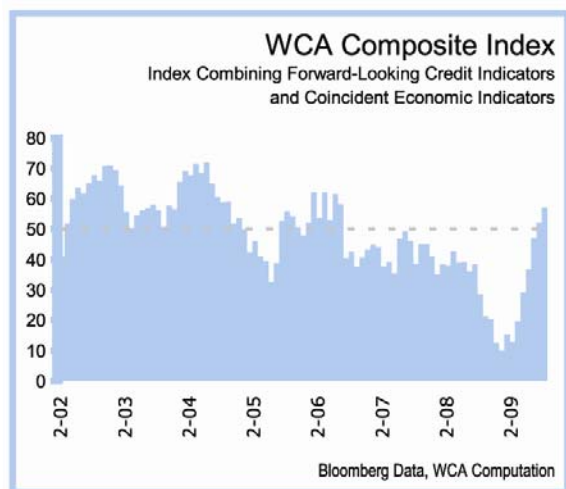
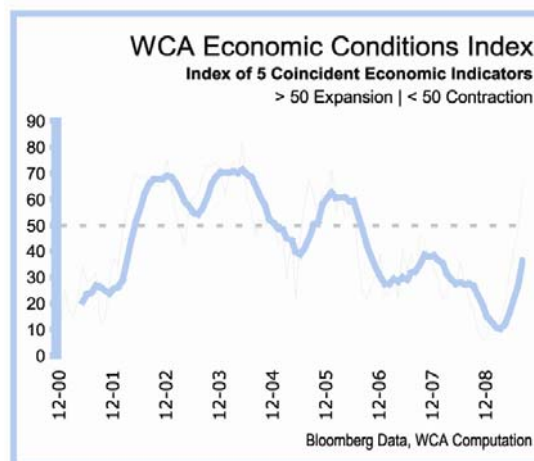
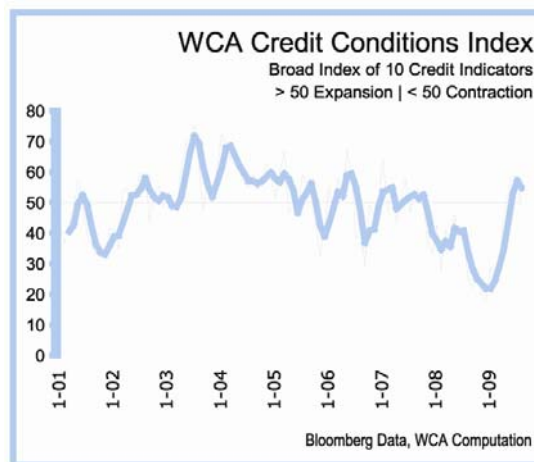


Quantitative Economic Observations

The economy improved during the second quarter. The pickup is captured in the rising WCA Composite Index seen below. The index tracks changes in over thirty timely indicators of credit-related and economic health both here and around the world. After hitting a low point last winter, the indicator has risen to just north of 50. This level is consistent with moderate economic expansion and has prompted us to raise our tactical exposure to equities.

The improvement in the data is a welcome development. Like many, however, we have lingering concerns about longer-term distortions that will almost certainly result from massive government intervention. In the months ahead, the economy will have to demonstrate that it can stand on its own as various loans, guarantees, and supports put in place during 2008 start to expire. It is unclear how the economy and financial markets will fare as these supports are withdrawn. Our best [handicapping](#) is that recovery will progress from here, but at a less robust pace than what has typically occurred following past recessions.

Consistent with the improved data, equity exposure was boosted during the quarter to a more “neutral” posture and a greater emphasis was placed on smaller-capitalization stocks.



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Economic Narrative

The stock market is up more than 50% off its bottom of last March. Underpinning the advance, of course, is the outlook for profits. The consensus opinion is for 40% growth in S&P 500 profits from today's \$54 trailing 12-month operating earnings figure to \$76 by the end of 2010¹. With the S&P trading at 1060, we can say that the U.S. equity market trades at either 20 times trailing earnings or 14 times next years' earnings, depending on how you wish to view it. Supporting stock prices from here, therefore, requires that earnings start to grow at a brisk clip and not merely come in "less bad." This will be a tall task given the ongoing contraction in credit and leverage, stubbornly high unemployment, and without additional tax or monetary policy initiatives to enhance the marginal efficiency of capital investment (as opposed to more spending plans).

As the market moves higher, a greater pressure is put on the economy to deliver results. Markets are forward-looking and anticipatory, and as such, tend to move well ahead of fundamentals. In moving ahead of fundamentals, markets also begin to shape the very fundamentals they are trying to predict. The narrowing of credit spreads in recent months, caused by investors' increased willingness to risk capital, has lowered the cost of borrowing money. In this way, market trends help shape the outcomes they are trying to predict. Hence, we are not dismissive of trends as they become evident. On the other hand, we also recognize that markets can be spectacularly wrong in assessing the future as well. A long history of bubbles, booms, and busts is testimony to this fact. This is why we combine observations of market performance with

hard data on the economy to help us in managing portfolios.

The data we look at (see page 2) has generally improved along with the out-performance of stocks (the risk asset) compared to bonds (the fear asset). The market reacted to over \$10 trillion of loans, guarantees, equity infusions, and stimulus spending that began in 2008. One way to encourage market activity is to eliminate risk, which is precisely what the loans and guarantees were all about. They effectively stopped the disorderly liquidation of debts across the global economy and, instead, preserved the status quo so that deleveraging could occur in a more orderly way. Thus far in 2009 we have seen the beginning of just such a liquidation of bad assets and debt.

With bank runs and general panic averted, the stock market has rightly priced itself higher. But at some point, things begin to look awkward. If the stock and credit markets are predicting such good things for the economy, then why are most of the government supports, guarantees, and subsidies still in place? The Federal Reserve will have to explain the uncomfortable contradiction between 0% interest rates and soaring equity valuations. Congress will have to square Depression-era like demands for deficit-financed public works projects, social programs, and endless transfer payments with emerging prosperity. Try selling auto-bailouts, cash for clunkers, mortgage forgiveness, company takeovers, and healthcare reform without the "If we don't do this, the economy will implode" rhetoric. Either it will or it won't. You can't have it both ways!

For now, forecasters see robust third quarter growth in GDP thanks to low inventories, cash for clunkers subsidies, federal government spending, and a smaller trade deficit.

¹ Bloomberg data

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Consumer spending may not even prove to be as bad as was the case in previous quarters. But our review of the most recent data shows that private sector employment is still slipping, mortgage foreclosures are still rising, credit card delinquencies have slipped again, durable goods orders are uneven at best, home prices continue in a downtrend, and confidence is still very low overall. I can hear you saying: "These are lagging indicators," to which I say, "Yes, they are." They are lagging in the sense that the honoree at a surprise party is a "lagging guest" — the honoree doesn't arrive first, but the party doesn't really get started until he or she arrives. Same can be said about things like employment and loan losses, I'm afraid.

In the meantime, we continue to follow the data with a level of healthy skepticism. For now, we see a composite picture that is better than it had been, with evidence of greater willingness by market participants to take on risk. As the government and the Fed ease away from underwriting risks and providing subsidization to private markets (because the economy is on the mend), we will observe how the markets and economy responds and will adjust portfolio positions accordingly. Specifically, for example, we are interested in following what happens to interest rates in 2010 once the Federal Reserve completes its program of purchasing mortgage-backed and Treasury securities. That will prove to be a major first test of whether markets are truly healthy enough to stand on their own.

Model Portfolio Changes

Stocks ↑ Bonds ↓

During the quarter, we increased common stock exposure to 75% from 70% in the growth model; to 50% from 45% in the balanced model; and to 25% from 20% in the

conservative model.² We also note that stocks (representing the "risk trade") have moved into a more persistent upward trend relative to Treasuries this quarter after having spent all of 2008 and the first part of 2009 in generally a bearish downtrend. We used proceeds from the shorting of our exposure to long-dated Treasuries to fund the purchase.

Small Cap ↑ Large Cap ↓

A recovery scenario typically involves rising risk-taking appetite, rising liquidity, and returning growth rates. Smaller capitalization stocks should perform better under those circumstances, and over the last few months, the Russell 2000 index of smaller capitalization companies has exhibited persistent strength compared to larger capitalization stocks. Thus, we have increased our exposure to smaller capitalization sectors in both the growth and value style categories.

Compared to the Russell 3000, our targeted portfolio exposures are close to benchmark exposure for both growth and value (after having been underweight value) and 21% overweight smaller capitalization companies. Our most overweight sector is technology (30% of U.S. sector exposure), and the most underweight sector is energy (7% of U.S. sector exposure). We currently have 40% of equity exposure outside the United States, compared to 72% of World market capitalization being non-U.S.

² Please note that individual portfolios may differ slightly from the model portfolio due to timing, distributions, and other factors.

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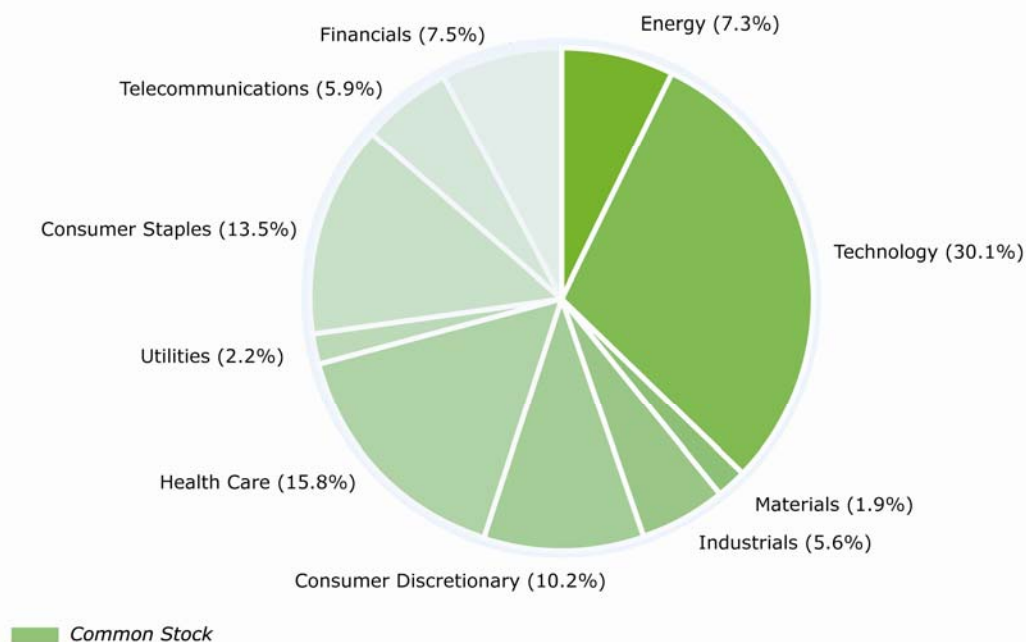
Sector Portfolio Changes

Sector	Model Weight	S&P 500 Weight	Comments
Technology	30.1%	18.5%	Technology spending is expected to increase in 2010, as companies seek to make productivity improvements to improve profitability. Expansion of wireless data services is the key driver for data processing. The sector possesses strong cash position, with modest debt and leverage.
Healthcare	15.8%	13.1%	Favorable demographic trends and expanded participation in healthcare programs and services should lead to increased volume consumption in this sector. Pricing remains an uncertainty, but we believe much of these concerns already are priced into the sector.
Staples	13.5%	11.5%	Lower commodity prices are helpful for margins. Consistent profitability makes this sector a strong defensive position with overseas growth potential longer term.
Discretionary	10.0%	9.2%	Consumer discretionary companies have performed better than the market of late, despite cutbacks in consumer spending. Retailers continue to struggle with negative year-over-year results, but some signs of stabilization can be seen in monthly retail sales trends.
Financials	7.5%	15.3%	Spread business is improved, but loan volumes remain poor. We expect more write-offs as commercial and residential real estate remain under pressure.
Energy	7.3%	11.7%	Supply continues to outpace demand for oil and natural gas producers. The sector is underperforming the market of late.
Telecom	5.9%	3.2%	Competition from alternative providers and economic conditions hurt landline companies. However, data volume remains the key driver for growth for wireless companies.
Industrials	5.6%	10.3%	Global recession has collapsed demand for industrial goods. Inventory drawdown continues as production is cut, but progress is very slow.
Utilities	2.2%	3.7%	Electricity demand remains weak due to the weaker economy; materially lower interest rates as a driver for yield-oriented electric utilities is not likely, in our view.
Materials	1.9%	3.5%	Overcapacity remains in many industries; we expect commodity prices to once again come under pressure.

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Sector Allocation Third Quarter, 2009



Investment Posture

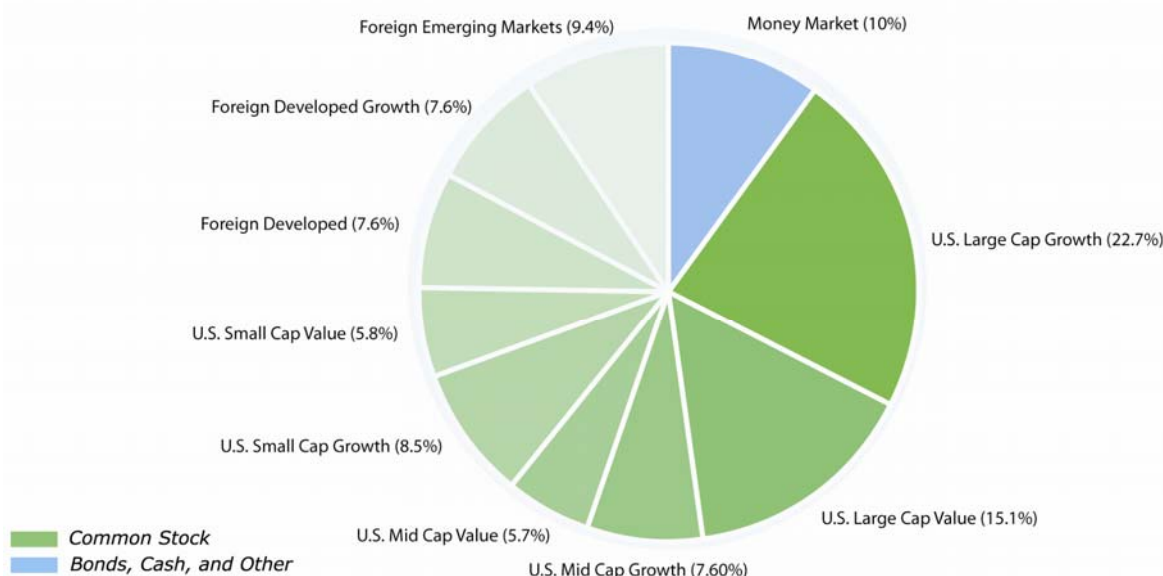
- ❖ Economically sensitive sectors (those with earnings closely tied to economic growth, such as energy, technology, materials, industrials, and consumer discretionary) have enjoyed the leadership role in the economy since March, while the more defensive sectors have tended to lag. Technology and consumer discretionary sectors have provided the most powerful leadership among the cyclical sectors.
- ❖ The more stable and consistent defensive sectors (those with earnings less closely tied to economic growth, such as healthcare, utilities, staples, telecom, and financials) have lagged.
- ❖ Our most heavily overweight sector is currently technology, and the most underweight sector is energy.

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Aggressive Portfolio Allocation

Common Stock Policy Range: 75-100%
Current Common Stock Exposure: 90%
Fourth Quarter, 2009



Investment Posture

This portfolio is intended to be a complement to a bond portfolio or as an investment for highly risk tolerant investors. The portfolio's target common stock range is 75-100% invested at all times. Currently, the portfolio is 90% invested, with the remainder held in cash or equivalents.

- ❖ During the last quarter, we increased our exposure to smaller capitalization and value equities, and increased our weighting overseas. We increased our exposure to value, bringing our style weighting essentially in line with the Russell 3000 equity index. While smaller cap and foreign exposure has been included in the portfolio this year, large cap domestic equities remain the largest segment of the portfolio.

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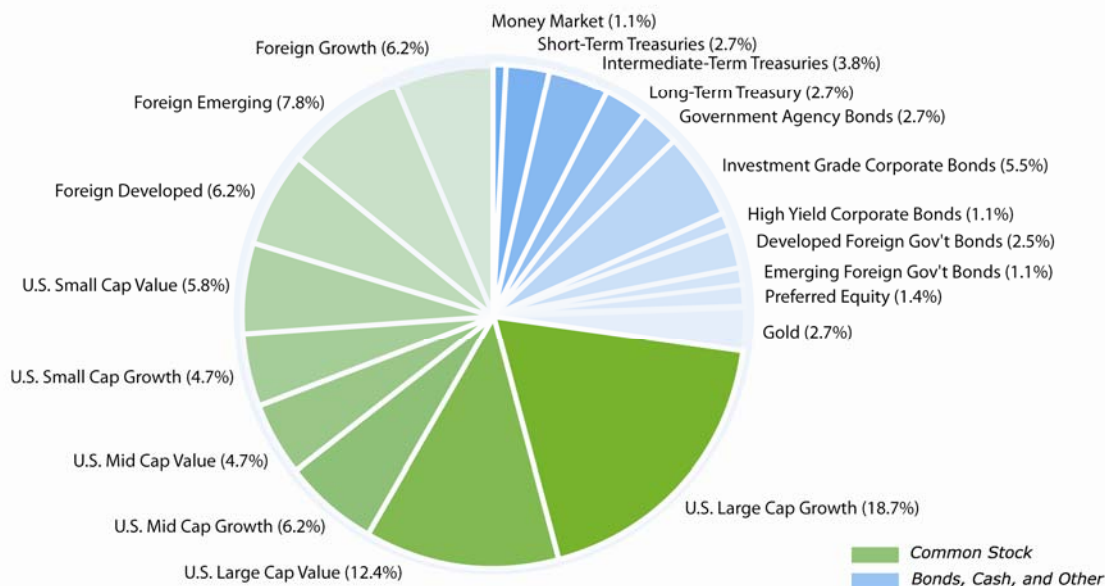


Growth Portfolio Allocation

Common Stock Policy Range: 50-100%

Current Common Stock Exposure: 73%

Fourth Quarter, 2009



Investment Posture

The growth portfolio model recommends between 50-100% of exposure to common stocks. It is most appropriate for investors with a long investment time horizon and a higher than average tolerance for risk.

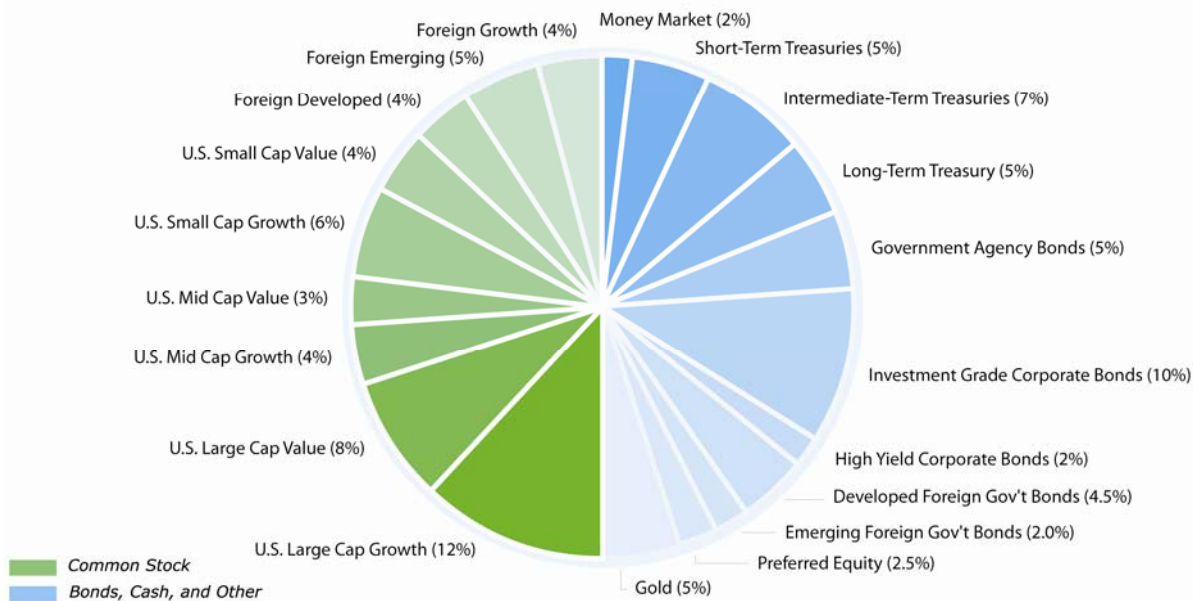
- ❖ Economic and credit trends have improved, and improvement has led us to increase our allocation to equities and corporate bonds where higher yields can be found from underweight exposure a year ago.
- ❖ The portion of the portfolio invested in common stocks has been increased, and greater exposure to overseas assets has been added. A more broadly diversified portfolio now also includes smaller-cap stocks, corporate bonds (both high grade and high yield), along with preferred stock.
- ❖ This portfolio has recently seen an increase in the percentage allocated to small and mid capitalization equities, which have demonstrated market leadership during the quarter.

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Balanced Portfolio Allocation

Common Stock Policy Range: 25-75%
Current Common Stock Exposure: 50%
Fourth Quarter, 2009



Investment Posture

The balanced portfolio invests between 25-75% in common stocks. It provides primarily a mix of equity and fixed income investments. It is most appropriate for investors with a long to medium time horizon and moderate risk tolerance.

- ❖ The balanced portfolio has a higher percentage of its assets allocated to non-common stock investments than either our growth or aggressive growth portfolios, which invest primarily in common stock. Accordingly, this portfolio has performed somewhat less this year, as bonds have taken a back seat to stocks in terms of performance.
- ❖ During the last quarter, we broadened out the portfolio to include a somewhat larger equity exposure, including increased emphasis on small and value stocks. Corporate, government agency, and foreign government bonds are the emphasis on the bond side of the portfolio currently (after having been Treasury-oriented last year). Gold remains in the portfolio as a hedge against overall financial system and geopolitical risk.

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Conservative Portfolio Allocation

Common Stock Policy Range: 0-50%
Current Common Stock Exposure: 26%
Third Quarter, 2009



Investment Posture

The conservative portfolio invests between 0-50% in common stocks. This portfolio offers a more conservative mix of equity, bond, and shorter-term Treasury instruments. Investors with a short to medium time horizon and lower risk tolerance who desire some modest growth may prefer this option.

- ❖ Economic and credit trends remain under pressure. Accordingly, the equity exposure in this portfolio has been small, and bonds have been overweighted for some time now.
- ❖ The portfolio invests across a wide variety of bond sectors and includes domestic Treasury bonds and bills, U.S. government agency debt, foreign sovereign debt, and investment grade and high yield corporate debt. Recently, this portfolio's recommended exposure to foreign assets and equities has been increased along with modest improvement in our forward-looking indicators. Overall equity exposure is near 25% of the portfolio — essentially the midpoint of our common stock policy range of 0-50% of portfolio value.

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Databank: Economy

Economic Data	3-Month	6-Month	9-Month
Source Data: Bloomberg	Average	Average	Average
Private Sector Employment (Year/Year % Change)	-5.0%	-4.8%	-4.3%
Initial Jobless Claims (Year/Year % Change)	23.6%	47.8%	58.3%
Real Personal Income (Index level; December 31, 2000 = 1)	-5.0%	-4.9%	-4.0%
Retail Sales (Year/Year % Change)	-6.4%	-8.7%	-8.8%
Consumer Expectations (Survey Index Level)	65.0	63.9	60.6
Consumer Price Index (Year/Year % Change)	-1.6%	-1.2%	-0.8%
CRB Commodity Price Index (Year/Year % Change)	-30%	-39%	-40%
Durable Goods Orders to Inventory Ratio	40%	38%	38%
Average Work Week (Hours)	39.8	39.6	39.6
Building Permits (Thousands)	572.6	540.0	542.8
Credit Data	3-Month	6-Month	9-Month
Source Data: Bloomberg	Average	Average	Average
Futures "Ted" Spread (3 Month T-Bill vs. Eurodollar)	0.19%	0.42%	0.61%
Term Spread (3 Month / 10 Year Treasury)	321 Bps	324 Bps	303 Bps
Credit Spread (Moody's Baa / 10 Year Treasury)	3.3%	4.0%	4.4%
Conforming Mortgage Spread (30 Year Mortgage / Treasury)	1.0%	0.9%	1.1%
Stocks vs. Bonds Performance (12 Month Change)	-18.4%	-29.1%	-34.7%
Credit Card Delinquencies (Percent >30 Days Past Due)	5.8%	6.0%	6.0%
Credit Card Payments (Avg. Percent of Bill Paid)	17.0%	16.6%	16.4%
Commercial Loans Held By Banks (Year/Year % Change)	-6.4%	-0.8%	2.9%
Real Estate Loans Held By Banks (Year/Year % Change)	5.7%	5.8%	5.5%
Consumer Credit Outstanding	-3.7%	-1.8%	-0.7%
Foreign Data	3-Month	6-Month	9-Month
	Average	Average	Average
German Industrial Production (Year/Year % Change)	-17.3%	-19.4%	-17.1%
German Exports (Year/Year % Change)	-20.0%	-22.2%	-19.5%
Japan Industrial Production (Year/Year % Change)	-20.4%	-26.5%	-27.6%
Japan Exports (Year/Year % Change)	-36.3%	-39.0%	-40.4%
EuroZone Industrial Production (Year/Year % Change)	-7.8%	-6.4%	-4.8%
EuroZone Exports (Year/Year % Change)	-20.6%	-23.9%	-22.3%
China Cargo Handled At Ports (Year/Year % Change)	0.5%	-1.9%	-2.8%
China Exports (Year/Year % Change)	-23.0%	-22.2%	-19.9%
Brazil Industrial Production (Year/Year % Change)	-11.1%	-11.5%	-11.7%
Brazil Exports (Year/Year % Change)	-28.8%	-22.5%	-17.7%

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Databank: Relative Market Performance

Relative Performance Index *	Latest Month	3-Month Average	6-Month Average	9-Month Average
U.S. Stocks vs. Treasury Bonds	57.8	56.8	54.0	50.1
Domestic Stocks vs. Foreign Stocks	98.9	99.1	101.0	103.6
Domestic Growth Stocks vs. Value Stocks	118.2	119.6	121.0	120.9
Domestic Small vs. Large Capitalization Stocks	101.7	100.4	99.3	98.0
Emerging vs. Developed Foreign Stocks	129.7	127.6	127.0	121.9
High Grade Corporate vs. LT Treasuries	92.2	92.8	91.2	87.8
Long-Term Treasury Bonds vs. T-Bills	111.2	109.2	108.2	109.6
High Yield vs. High Grade Corporate Bonds	86.2	84.2	82.3	78.5
Real Estate Investment Trusts vs. LT Treasuries	47.5	44.4	41.0	37.0
Inflation-Protected vs. Regular Treasury Bonds	92.6	93.1	93.1	91.0
Gold vs. Dollar	152.8	147.5	142.5	139.1
Global Statistics (\$USD)	Market Cap	% World Cap	GDP	MCap / GDP
World	43,283,830	100%	60,115,459	0.68
United States	12,812,153	30%	14,204,322	0.90
Japan	3,545,702	8%	4,909,272	0.72
China	2,719,982	6%	3,860,039	0.70
United Kingdom	2,815,375	7%	2,645,593	1.06
France	1,879,227	4%	2,853,062	0.66
Canada	1,494,561	3%	1,400,091	1.07
Germany	1,359,936	3%	3,652,824	0.37
Brazil	1,158,569	3%	1,612,539	0.72
Spain	810,444	2%	1,604,174	0.51
Italy	703,715	2%	2,293,008	0.31
Other	13,984,165	32%	21,080,535	0.66

* Relative performance indices based at 100 as of October 31, 2007

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Index Definitions

Barclays U.S. Government Inflation-Linked Bond Index measures the performance of the U.S. Treasury Inflation Protected Securities ("TIPS") market. Used as a proxy for "inflation-protected bonds."

Bloomberg/EFFAS Bond Indices U.S. Government 1-3 Year Total Return Index is a transparent benchmark for government bond markets. Indices are grouped by country and maturity sectors. Bloomberg computes daily returns and index characteristics for each sector. Used as a proxy for "short-term Treasuries."

Bloomberg/EFFAS Bond U.S. Government 10+ Year Total Return Index is a transparent benchmark for the total return of the 10+ year U.S. Government bond market. Used as a proxy for "long-term Treasuries."

FINRA-Bloomberg Active Investment Grade U.S. Corporate Bond Index and **FINRA-Bloomberg Active High Yield U.S. Corporate Bond Index** are comprised of the most frequently traded investment-grade and high yield U.S. corporate fixed coupon bonds represented by the Financial Industry Regulatory Authority (FINRA) transaction reporting facility. Used as proxy for "high yield bonds."

FTSE NAREIT Equity REIT Total Return Index is a total return performance index of all equity REITs tracked by NAREIT. Used as a proxy for REITs.

MSCI EAFE International Index 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. As of June 2007, the MSCI EAFE Index consisted of 21 developed market country indices. Used as a proxy for "developed foreign."

MSCI Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets. Used as a proxy for "emerging markets."

Russell 1000 Index is an unmanaged index that measures the performance of the 1,000 largest companies in the Russell 3000 index. The **Russell 3000 Index** measures the performance of the 3,000 largest US Companies based on total market capitalization, which represents approximately 98% of the investable U.S. equity market. Used as proxy for domestic "large cap stocks."

Russell 2000 Index is an unmanaged index that measures the performance of the 2,000 smallest companies in the broader Russell 3000 index. Used as proxy for "small cap domestic stocks."

Russell 3000 Growth Index is an unmanaged index that measures the performance of those Russell 3000 Index companies with higher price-to-book ratios and higher forecasted growth values. Used as proxy for "domestic growth stocks."

Russell 3000 Value Index is an unmanaged index that measures the performance of those Russell 3000 Index companies with lower price-to-book ratios. Used as proxy for "domestic value stocks."

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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.