BRIDGES
INVESTMENT MANAGEMENT, INC.

Market Comments

April 2, 2012

S&P 500	1408
10 Year Treasury	2.21%

Stocks enjoyed a very strong first quarter – the best first quarter for U.S. equities since the first quarter of 1998. The S&P 500 had a total return of 12.58% in the quarter, while the NASDAQ Composite, driven by strength in technology companies, rose 18.97%. The S&P Midcap Index advanced 13.49% and the S&P Small Cap Index rose 11.99%, and the EAFE Index returned 10.86%.

Stock price returns were driven by a combination of: 1) continued solid corporate earnings growth; 2) a sense that European monetary authorities were addressing the financial morass; and 3) continued commentary from the Federal Reserve that suggests the Fed will remain accommodative as long as economic conditions are soft.

Despite the price strength of the first quarter, U.S. equities remain reasonably valued, if not somewhat undervalued. We continue to believe that fair value for the S&P 500 is between 1500-1550, or 14-15x estimated 2012 earnings of about $105 per share. This would imply additional 8-10% upside for stocks in 2012 from current levels. We are using a fair value target of 1600-1650 for the S&P 500 for 2013 (14-15x estimated 2013 earnings per share of $112-115).

We are less sanguine about bonds. The yield on the 10-year Treasury rose from 1.81% at year-end to 2.21% during the first quarter, which put pressure on bond returns. The Barclays U.S. Aggregate Bond Index had a total return of 0.30% in the quarter.

The problem bonds face is that valuations remain high (interest rates are low). If interest rates have bottomed, the negative price momentum in bonds as rates continue to work higher could chase capital out of fixed income as investors may no longer view bonds as "safe." It would not surprise us if the yield on the 10-year Treasury reached 3% during the second half of 2012.

The 25% rally in stocks over the past two quarters has done much to change the longer term return experience of bond and stock investors. Since 1999, bonds have significantly outperformed equities, with annualized returns of 6.36% versus 1.51% for stocks. Over the past five years, the return experience is similar: bonds have annualized returns of 6.07% versus 1.25% for stocks.

However, more recently, stocks have gained the upper hand. Since the bear market low on March 9, 2009, stocks have returned 121.97% (29.77% annualized) versus 23.55% for bonds (7.15% annualized). Returns for the two asset classes are roughly equal over the past twelve months, and since the recent market low of October 3, 2011, stocks are up 30% versus 1% for bonds.

We believe that stock returns will be better than bond returns on balance over the next several years, because equity valuations are moderate, while bond valuations remain elevated.

The most important factor for the remainder of 2012 is corporate earnings. Year-over-year comparisons will become more difficult as 2012 unfolds, and higher equity prices remove

some margin of error for earnings disappointments. We believe corporate earnings growth will be satisfactory, but the recent advance in stocks will be unsustainable in the short run if earnings disappoint investors over the next several quarters.

We expect an increase in capital markets volatility over the next several quarters, in part due to the strong run in equities over the past six months, and in part due to the risks investors face, including recessionary conditions in Europe and the uncertainty surrounding the U.S. elections in November. While we remain constructive on the outlook for equities for the remainder of 2012, we believe the market environment will remain challenging.

Our focus remains on identifying and owning companies with strong business franchises that should be able to grow their earnings in a continued soft economic environment. Despite the strong move in stock prices over the past two quarters, our companies remain attractively valued relative to our assessment of their ability to grow business value over the next several years.