BRIDGES | INVESTMENT MANAGEMENT

*Think Forward*

# Market Comments
## April 14, 2015

| | |
|---|---|
| S&P 500 | 2095 |
| 10 year Treasury | 1.94% |

Executive Summary:

1. The first quarter of 2015 was positive for both stocks and bonds. International stocks and mid-cap U.S. equities were up 5%; the S&P 500 was up 1%. Bonds returned 1.6% as interest rates moved lower on balance during the quarter.

2. Corporate earnings are the most important variable for equities in 2015. Earnings may be negatively impacted by 1) sluggish global economic conditions, 2) a persistently strong dollar, and 3) materially lower oil prices, but overall, we expect that corporate earnings will trend higher over the course of 2015.

3. Valuations for U.S. equities appear to be at the high end of "fair value" at around 16-17x estimated 2015 earnings. We do not expect a significant uptick in equity valuations in 2015 unless 1) corporate earnings accelerate or 2) interest rates remain at extremely low levels, and large amounts of capital flow from the bond market to the stock market.

4. We estimate fair value for the S&P 500 to be around 2250-2300 for 2015, and around 2400 for 2016, which implies total returns of ~8% for stocks from current levels through year-end 2015, and ~15% through year-end 2016.

5. Bond valuations appear to be very high and implied returns for bonds over the next several years are low; we remain underweighted to target fixed income allocations in portfolios, and we are likely to remain so until such time as interest rates increase to levels that create more attractive implied intermediate returns for bonds.

6. We expect that capital markets volatility will continue to increase during 2015, making for a challenging environment for investors. Volatility is not bad per se, and in fact it can allow more opportunities to invest capital at more attractive valuations than exist at present. We would not be surprised to see a 10-20% correction at some point during 2015, but we believe such a decline would create a good opportunity to deploy cash at attractive valuation levels.

7. We continue to look for equity opportunities that afford us the opportunity to win two ways: 1) through ongoing increases in business value driven by strong corporate financial performance, and 2) through increases in valuations from "undervalued" to "fairly valued" over time. These opportunities are hard to find at current equity market levels, but should be more prevalent in the event of a material equity market correction.

8. We favor companies that can generate significant levels of free cash flow, and which have a track record of allocating free cash flow in ways that increase shareholder value, through capital spending, research and new product development, accretive acquisitions, share repurchases, and/or dividend increases.

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