BRIDGES TRUST

Market Commentary & Outlook

April 2018

S&P 500 2,641
10 Year Treasury 2.76%

The following table summarizes total returns for key indexes for the first quarter of 2018, the past twelve months, and since year-end 2008, which marked the approximate bottom of the 2008-2009 financial crisis:

Index	First Quarter	Trailing 12-Mo	Cumulative Since 2008	Annualized Since 2008
S&P 500	(0.76%)	13.98%	255.77%	14.71%
S&P 400 Midcap Index	(0.77%)	10.96%	301.64%	16.23%
S&P 600 Small Cap Index	0.55%	12.59%	292.33%	15.93%
MSCI World Index Ex U.S.	(1.25%)	16.87%	128.05%	9.32%
Barclays U.S. Aggregate Bond Index	(1.46%)	1.20%	38.68%	3.60%

The first quarter of 2018 was marked by significantly higher levels of stock and bond price volatility.

The S&P 500 rallied +8% during the first four weeks of the year, reaching an all-time high of 2,875 on January 26. Stocks then declined -12% in the next eight trading days and spent the rest of the quarter trading in very wide intra-day and intra-week swings, ultimately ending the first quarter down slightly from year-end 2017 levels.

During March the U.S. equity market passed the ninth anniversary of the current bull market, which began on March 9, 2009. The S&P 500 had declined -55% from October 2007 through March 9, 2009; from there, the S&P 500's total return was +372% or +19% compounded annually, through March 31, 2018. Peak-to-peak (October 2007 through March 31, 2018), the S&P 500 returned +112% or +7.43% annually. More recently, the S&P 500 is up +42% from the mid-February 2016 lows, and +23% since the November 8, 2016 election.

Interest rates rose during the first quarter, resulting in negative returns for bonds. The yield on the 10-year Treasury rose from 2.41% to 2.74%. We expect interest rates will work higher over the rest of 2018, making the environment difficult for bond investors.

In our view, the strong move in U.S. equities has taken stocks from extremely undervalued in early 2009, to somewhat undervalued at the lows of February 2016, and now close to our estimate of fair market value. From current valuation levels, our expectation would be that stock prices should more or less track the rate of earnings, cash flow, and dividend growth going forward.

International stocks have significantly lagged U.S. stocks since the 2009 market lows, but they have outperformed U.S. stocks over the past twelve months. We expect to continue to increase our exposure to international equities (especially emerging market equities) over the course of 2018, as valuations for international stocks are somewhat cheaper than U.S. equities.

We remain underweighted and defensively positioned in fixed income, as interest rates 1) remain near historic lows, 2) have begun to move higher (and appear likely to continue to do so going forward), and 3) bond valuations seem unattractive both in absolute terms and relative to other asset classes. We would anticipate using higher interest rates to opportunistically increase allocations to bonds and lengthen bond portfolio maturities when implied bond returns become more favorable.

Going forward, the most important factor affecting stocks remains the level and trajectory of corporate earnings. U.S. corporate earnings have shown solid improvement over the past eight quarters, and we expect that trend to continue as 1) the global economy has synchronized, driving solid earnings growth both in the U.S. and abroad, and 2) corporate tax cuts enacted at the end of 2017 begin to benefit the bottom line for U.S. companies.

The cut in the corporate income tax rate has positively impacted the outlook for corporate earnings in 2018. The consensus estimate for S&P 500 earnings per share in 2018 has increased from $145 per share at year-end to $158 per share at the end of the first quarter. Our year-end 2018 fair value estimate for the S&P 500 is 3,000 ($158 per share earnings times a year-end trailing P/E of 19x, and/or $175 estimated per share earnings for 2019 times a forward P/E of 17x). Our 2018 year-end fair value estimate for the S&P 500 implies roughly 10% returns for the rest of the year.

We expect capital market volatility to remain high during the remainder of 2018, as investors weigh the impact of continued earnings growth (positive) and higher interest rates (negative) and the risk of trade tariffs (negative). We would not be surprised if the S&P 500 traded as low as 2,200 or as high as 3,200 this year (the index closed the first quarter at 2,641). Price volatility is not bad per se: stock price volatility provides opportunities to position capital at favorable valuation levels.

We expect the remainder of 2018 to be challenging, but we will continue to focus on identifying and owning high quality companies, an approach which should serve us well if/when stock prices correct. We will look for opportunities to add to portfolio holdings at attractive valuation levels during periods of material stock market weakness.