BRIDGES | INVESTMENT MANAGEMENT

Think Forward

Market Comments
April 5, 2016

S&P 500	2045
10 year Treasury	1.72%

Executive Summary:

1. Stocks posted marginal gains in the first quarter; the S&P 500 had a total return of 1.34%. Trading during the quarter was extremely volatile. The S&P 500 declined 10% from the start of the year through February 11, and then rallied 13% through the end of the quarter to finish marginally positive. Generally, stocks that were the worst performers in 2015 were among the better performers in the quarter, and vice versa. The S&P Midcap and S&P Small Cap indexes returned 3.78% and 2.65%, respectively. International stocks declined marginally during the quarter; the MSCI World Index returned -0.26%. Bonds returned 3.03% as interest rates declined during the quarter; the 10-year Treasury yield fell from 2.27% to 1.77%.

2. Corporate earnings are the most important variable affecting equities in 2016. The trajectory of corporate earnings flattened out during 2015, as profits were impacted by 1) sluggish global economic conditions, 2) a persistently strong dollar, and 3) materially lower oil prices. Concerns surrounding weakening economic conditions and sharply lower energy prices drove stock prices down during the first half of the first quarter of 2016; but investor concerns moderated as oil prices stabilized. For the time being, U.S. equity prices and oil prices are likely to be strongly correlated.

3. We estimate fair value for the S&P 500 at year-end 2016 to approximate 2200, and ~2350 for year-end 2017, which implies total returns from current levels (the S&P 500 ended the first quarter of 2016 at 2060) of ~8% through year-end 2016, and ~15% through year-end 2017.

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

5. We expect that the capital markets will continue to experience elevated levels of volatility in 2016, and we believe that the S&P 500 could trade in a range of 1700-2400 during the year. Our approach will continue to be opportunistic -- using periodic stock price declines to add capital to great companies at attractive valuations as opportunities to do so arise.

6. We continue to look for opportunities to invest in great companies that afford us the ability to earn good long-term returns in two ways: 1) through ongoing increases in company business value driven by strong corporate financial performance, and 2) through increases in the valuation of our companies from “undervalued” to “fairly valued” over time. These opportunities are difficult to find at current equity market levels (which are generally close to our estimate of “fair value”), but will be more prevalent during material equity market declines.

Ted Bridges, CFA
President