

Market Comments
October 5, 2017

S&P 500 2,519
10 Year Yield 2.33%

Total returns for various stock and bond indexes for the third quarter, the first nine months of 2017, and the last twelve months are summarized in the following table:

<u>Index</u>	<u>Third Quarter</u>	<u>YTD</u>	<u>Last 12 Months</u>
S&P 500 Index	4.48	14.24	18.60
S&P MidCap Index	3.22	9.40	17.51
S&P Small Cap Index	5.96	8.90	20.95
MSCI World Index - ex U.S.	6.25	21.60	20.20
Barclays U.S. Aggregate Bond Index	0.85	3.14	0.07

Stocks posted very solid gains in the third quarter, continuing the rally that has been in place since the mid-February 2016 stock market lows. From February 15, 2016, through September 30, 2017, the S&P 500 has a total return of 40%.

International stocks were the best performers in the third quarter (+6.25%); in the U.S., small stocks (+5.96%), large stocks (+4.48%) and midcap stocks (+3.22%) all posted positive total returns. Over the trailing twelve months, small cap stocks had the best total return (20.95%); while both international and domestic equities also enjoyed strong returns. The past year has been very strong for equity investors.

Corporate earnings growth remains the primary driver of the positive stock price performance to date in 2017, as earnings results have generally beaten consensus expectations on both the top line (revenues) and the bottom line (net income). We believe that the level and trajectory of corporate earnings remains the single most important factor affecting stock returns for the remainder of 2017 and into 2018.

Trading volatility remains muted relative to historic levels. The stock market rally over the past six quarters has been characterized by below normal volatility and strong persistence of stock prices, even in the face of negative headlines and an inability of the Trump Administration to make meaningful progress against its key agenda items of tax, health care, and regulatory reform. We expect that stock price volatility will eventually revert to more normal levels, but it is impossible to identify what the catalyst to a choppy market environment will be.

U.S. stocks remain close to our estimate of "fair value," and we believe equities are currently priced to provide mid-to-high single-digit returns from current levels over the next several years, albeit with continued elevated levels of volatility. Our fair value estimate for year-end 2018 for the S&P 500 is 2700, which would imply total returns of 7-10% over the next five quarters.

A meaningful stock market correction (a decline of 10% or more) is probably overdue, but the combination of solid corporate earnings growth and very low interest rates has supported the equity market's continued advance over the past six quarters.

It is important to consider the recent stock market advance within a longer term context: the S&P 500 has returned 349% since its March 2009 low, a compound annual rate of return of 19.15%. Over the past ten years (which coincides with the October 2007 stock market high), the S&P 500 has returned 103%, or 7.32% annually.

In our opinion, equity returns are ultimately, and over the long run, a function of four primary drivers: 1) the level of corporate earnings, 2) the estimated growth of corporate earnings, 3) the level of interest rates, and 4) the valuation multiple that investors are willing to accord companies based on the first three variables.

Looking forward: 1) the level of corporate profitability is at all-time highs, and company profit margins are also high relative to history; 2) earnings growth has shown improvement in recent quarters, and might be expected to range in the mid-single-digits over the next several years; 3) interest rates are near historic lows (lower interest rates support higher valuations, because the value of a future dollar of earnings is higher when the interest rate used to discount that dollar of earnings is low); and 4) current valuation metrics are near the high end of "average" or the low end of "high".

The combination of these variables suggest that stocks could continue to work higher if earnings performance remains solid, but current valuations allow little room for earnings disappointments or significantly higher interest rates.

It would not surprise us to see stocks 15-20% lower, 15-20% higher, or both, over the next 12-18 months. A material stock price decline from current levels would improve implied long-term returns for equities and create a more attractive entry point for cash than exists at present; we would be inclined to reduce commitments to stocks (based on stretch valuations) in the event of a 15-20% increase in stock prices in the short-term with no change in underlying fundamentals.

Interest rates were essentially unchanged during the third quarter, as the yield on the 10-year Treasury ended the quarter at 2.33%. Bond returns, as measured by the Barclays U.S. Aggregate Bond Index, materially lagged equity returns for the quarter, the year-to-date and the trailing twelve month intervals.

Bonds remain unattractive in our view because 1) interest rates remain very low, and 2) we believe the probabilities favor an eventual return to somewhat higher interest rates over the next several years. We expect yields on the 10-year Treasury will eventually return to a range of 2.5-3.5%. We will become more constructive on bonds once yield levels increase to the point where they exceed long-term inflation expectations by 1% or more.

Adroit asset allocation remains critical, given 1) almost zero returns for cash, 2) unattractive implied returns for fixed income given very low interest rates, and 3) equity valuations are not cheap and stock prices have advanced to all-time high levels over the past eight years with few meaningful corrections along the way. In the current capital markets environment, valuation discipline, rigorous process, and an understanding of both historical valuation and volatility norms and a range of reasonable future outcomes is essential to navigating through the current challenging environment for investors.

While we are encouraged by the positive returns for stocks to date in 2017, it has been an exceptionally difficult environment to commit cash, because the persistent rise in stock prices over the course of the year has afforded few, if any, attractive entry points along the way. We will continue to exercise discipline and vigilance as we invest cash for new clients, while maintaining a strong focus on both market and company-specific valuation levels. We remain constructive on the long-term outlook for stocks, but we are mindful of the risks inherent in a capital markets environment that has experienced a very long, virtually uninterrupted stretch of price appreciation.

Ted Bridges, CFA
President

The Fund's investment objectives, risks, charges, and expenses must be considered carefully before investing. The statutory and summary prospectus contains this and other important information about the investment company; any may be obtained by calling 1.866.934.4700 or by visiting www.bridgesfund.com. Read it carefully before investing.

Mutual fund investing involves risk. Principal loss is possible. Small and medium capitalization companies tend to have limited liquidity and greater price volatility than large-capitalization companies. Investments in debt securities typically decrease in value when interest rates rise. This risk is usually greater for longer-term debt securities. The Fund invests in foreign securities which involve political, economic and currency risks, greater volatility and differences in accounting methods. Investing in value stocks presents the risk that value stocks may fall out of favor with investors and underperform other asset types during given periods. Equities, bonds, and other asset classes have different risk profiles, which should be considered when investing. All investments contain risk and may lose value.

Earnings growth is not a measure of the Fund's future performance.

The S&P 500 Index is a broad based unmanaged index of 500 stocks, which is widely recognized as representative of the equity market in general.

The S&P MidCap 400 Index, more commonly known as the S&P 400, is a stock market index from S&P Dow Jones Indices. The index serves as a barometer for the U.S. mid-cap equities sector and is the most widely followed mid-cap Index in existence.

The S&P 600 SmallCap Index measures the small cap segment of the U.S. equity market.

The MSCI World Index – ex U.S. is a stock market index of 1,643 'world' stocks. It is maintained by MSCI Inc., formerly Morgan Stanley Capital International, and is used as a common benchmark for 'world' or 'global' stock funds. The index includes a collection of stocks of all the developed markets in the world, as defined by MSCI.

The Barclays U.S. Aggregate Bond Index is a broad based index maintained by Barclays Capital, and is often used to represent investment grade bonds being traded in the United States.

Fair value is a rational and unbiased estimate of the potential market price of a good, service, or asset.

It is not possible to invest in an index.

Past performance does not guarantee future results.

Opinions expressed herein are those of Ted Bridges and are subject to change. They are not guarantees and should not be considered investment advice.

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