BRIDGES | INVESTMENT MANAGEMENT

Think Forward

Market Comments
February 6, 2018

S&P 500	2,695
10 Year Treasury Yield	2.80%

For a number of months, we have been advising clients to "expect more volatility."

For most of 2017, "more volatility" was elusive: 2017 was one of the least volatile years for the stock market in history, as equity prices worked gradually higher throughout the course of the year.

But the placid environment that characterized 2017 has given way to a markedly different capital markets climate in 2018.

The stock market ripped higher to start the year, gaining 7.4% during the first 19 trading sessions (15 up days, only 4 down days), with the S&P 500 reaching an all-time high of 2,872 on January 26, one of the best starts to a new year for the stock market ever.

Interest rates also rose sharply at the start of the year, with the 10 year Treasury yield advancing from 2.40% to 2.88%. The rise in bond yields spooked equity investors, and triggered waves of intense selling on Friday and Monday, which were exacerbated by computer-driven algorithmic trading. Stocks closed down 4-5% on Monday, one of the largest single day declines in history.

From January 26 through the close on February 5 (6 trading days), the S&P 500 gave back all of its 2018 gains and then some, dropping to 2,645, a little below its 2017 year-end level of 2,674.

Futures trading overnight, and actual market trading today, saw even greater levels of stock price volatility. The Dow Jones Industrials Average opened down 550 points, promptly traded to up over 500 points, experienced wide price swings between negative and positive territory throughout the day, before rallying sharply in the last hour of trading to close up 569 points on the day. The Dow transversed more than 3,000 points of trading over the course of the day. The S&P 500 experienced similarly wide (and wild) trading swings throughout the day, and finished at 2,695, up 1.75% on the day and up 0.89% year-to-date.

While we expect elevated stock price volatility going forward, we would also expect that the extreme volatility levels experienced over the past several days to subside over time.

What comes next?

Our thoughts are summarized as follows:

1. We expect continued stock price volatility in coming weeks as investors digest and assess the tradeoff between rising interest rates (which have a tendency to reduce the valuation levels that investors will pay for stocks) and a stronger economic environment that is driving improved corporate profits. We expect an eventual resolution toward higher stock prices, but a retest of the interim lows from yesterday and today is also a material possibility.

2. We continue to believe that the S&P 500 could see as much as a 15-20% decline and a 15-20% advance from current levels (the S&P 500 closed today at 2,695, essentially unchanged from its year-end 2,674 level) over the course of 2018, as the stock market returns to more normal levels of volatility.

3. Valuations for stocks have actually improved materially over the past two weeks, as stock prices have declined about 7-8% from their January highs, while consensus earnings estimates for 2018 have risen about 7% since year-end (driven by solid fourth quarter earnings reports, and the potential for favorable effects of the corporate tax rate cut that was legislated in late December).

4. We continue to believe that fair value for the S&P 500 at year-end 2018 is approximately 3,000, versus a closing level of 2,695 today.

5. We would view sharp stock price declines from current levels as an opportunity to add equity exposure; we would view an advance significantly above 3,000 on the S&P 500 as an opportunity to reduce equity exposure, all things equal.

Ultimately, an investor's time horizon is important to understanding their capacity to withstand high levels of short term price volatility.

Most clients have effective time horizons that are measured in years, if not decades.

Consequently, while very high levels of short-term stock price volatility are not pleasant, volatility does create opportunity, and we will be especially focused on looking for places to capture incremental return that might be created by continued periods of extreme stock price volatility, within the context of longer term portfolio objectives.

If you have questions about your portfolio, or would like to discuss our outlook in more detail, we would encourage you to contact us at your convenience.

Edson L. Bridges III CFA

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 Dow Jones Industrial Average **(**DJIA**)** is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange (NYSE) and the NASDAQ.

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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