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Please contact us if you'd like more information about how Bridges Investment Management, Inc. can help you meet your long-term financial objectives.

THINK FORWARD

BRIDGES INVESTMENT MANAGEMENT | QUARTERLY NEWSLETTER JANUARY 2017

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Welcome to the Bridges Investment Management Quarterly Newsletter – Think Forward. Our goal is that this newsletter will be a useful tool to keep in touch with you.

If you would like to receive this newsletter by email, please send us a message at **contact@bridgesinv.com** or sign up on our website.

Thanks and happy reading!

CAPITAL MARKETS: RECAP OF 2016 AND OUTLOOK FOR 2017-2018

BY TED BRIDGES

2016 was marked by significant stock market volatility within the context of rising stock prices during most of the year. The S&P 500 declined 12% during the first six weeks of the year, bottoming at 1829. From there, the index rallied to 2238, a gain of 22% from the bottom, and 10% on the year. The three most important factors impacting stocks during the year were: 1) reasonably good aggregate corporate profit growth (6% year-over-year ex-energy for the 12 months ending September 30),
2) Trump's surprise presidential win and 3) a sharp rise in interest rates since early July (the 10-year Treasury yield rose from 1.36% on July 8 to 2.54% on December 23). Small cap (+25%) and midcap (+20%) stocks outperformed large cap stocks as investors embraced riskier equities during the second half of 2016. Many companies that struggled in 2015 performed much better in 2016; examples included Berkshire Hathaway (-12% in 2015, +25% in 2016) and Union Pacific (-33% in 2015, +38% in 2016).

Post-election, sectors of the market perceived to be beneficiaries of Trump's articulated policy goals of reduced federal government regulation, meaningful tax code reform and infrastructure spending rallied sharply. Stocks ended 2016 close to our year-end 2015 estimate of year-end 2016 fair value of 2250-2300.

We believe that 2017 will resemble 2016: on balance a positive year for stocks, stocks likely to outperform bonds and plenty of capital markets volatility during the year. U.S. stock valuations ended 2016 at levels that are close to our estimate of "fair value" (at about 18 times 2016 earnings), which would suggest that stock returns in 2017 should approximate the level of year-over-year corporate profit growth, without much change in valuation levels. Our year-end 2017 fair value estimate for the S&P 500 is 2350-2425, or roughly 18 times estimated 2017 earnings per share of $130-135 (versus 2016 earnings per share for the S&P 500 of about $120). Profit improvement in

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2017 could result from higher year-over-year oil prices, higher interest rates (which would benefit bank profits), improved overall economic growth (especially if Trump has early success on some of his economic policy initiatives) and a moderation in the strength of the U.S. dollar (which would help profits of U.S. companies that derive significant sales outside the U.S.).

If Trump has early success on his policy objectives of reducing the burden of federal regulation and tax code reform (including a reduction in corporate income tax rates), corporate profits would likely be higher than currently reflected in consensus expectations, giving upside to stock prices. A key risk to stocks in 2017 is the degree to which and speed with which Trump is able to make material progress toward his stated policy objectives. The 5% rise in the S&P 500 since the election indicates that investors are anticipating meaningful federal regulation and tax code reform. If Trump struggles on some or all of those fronts, stocks could give back some of their post-election gains.

We expect stock price volatility to remain elevated in 2017 and would not be surprised to see the S&P 500 trade both 20% lower and 20% higher during 2017 from its year-end 2016 level of 2238. Periodic short-term downside stock price volatility does create opportunities for long-term investors to buy great companies at attractive valuations. We continue to expect that stocks will outperform bonds (they did by a wide margin in 2016: S&P 500 total return was 11.9% versus 2.7% for the Barclays U.S. Aggregate Bond Index) as we believe interest rates are likely to rise on balance in 2017, which will make generating positive returns from bonds difficult.

Longer term, we believe that current valuations for U.S. stocks imply annual total returns of 6-9% on average over the next five to ten years, well above the returns implied at present by interest rates.

THE FIRST 100 DAYS

BY DOUG PLAHN

U.S. citizens experienced arguably one of the most contentious Presidential elections in recent history during 2016, resulting in the election of Donald J. Trump to become the 45th President of the United States. President-elect Trump appeared to connect with voters on his America First economic plan and message on bringing change to Washington. President-elect Trump will have a Republican majority in both chambers of Congress as we enter 2017. The new Administration will work with the 115th Congress and U.S. Senate to prioritize a legislative agenda for the first 100 days with the goal of fostering better economic growth in this country.

The legislative priorities that have been outlined by President-elect Trump which would have the most economic impact over the long-term are as follows:

I. Individual and Corporate Tax Reform
Focus on simplifying and reducing taxes for both individuals and businesses in order to stimulate GDP growth toward the 3-4% level. The Trump plan could also include a 10% tax rate for the repatriation of trillions of American corporate dollars currently held overseas. The primary goals are to provide more capital for investment activity in the United States and to create a significant amount of new jobs.

II. Deregulation
The economic growth engine of this country continues to be small business formation. A rollback of the elevated regulatory environment could be beneficial from both an access to capital and global competition perspective.

III. Energy and Infrastructure
The removal of some of the restrictions placed on the energy industry could provide more opportunities for increased investment in this country, furthering the new Administration's goal of energy independence for the United States. Infrastructure needs could be addressed by leveraging public-private partnerships and utilizing tax incentives to spur private investment.

The U.S. stock market advanced 5% from the day of the election to the end of the year, with some sectors (e.g. financials, energy and industrials) of the market up much more based on the perception they could be prime beneficiaries of Trump's policy agenda. As markets are forward looking, we believe that post-election stock prices in general have begun to reflect investors' perception of better future earnings. Hence, capital markets volatility during 2017 may be influenced by the success or failure of the new Administration to work with Congress to bring forth the policy initiatives accordingly. Despite the short-term volatility that may persist during 2017, we remain positively biased toward equities over the long-term and would view a sharp decline in equity prices as an opportunity to invest in outstanding companies at attractive valuations.

BRIDGES INVESTMENT MANAGEMENT SUPPORTS THE BOYS & GIRLS CLUBS OF THE MIDLANDS

On Wednesday, November 16, 2016, members of the Bridges team participated in the Boys & Girls Clubs of the Midlands 9th Annual Stock Market Challenge. The event featured a real-life stock market simulation to help teach kids about the importance of financial literacy. The Firm is proud to support the Boys & Girls Club of the Midlands with its vision of transforming our community by providing youth with impactful, fun and educational opportunities in a safe environment.

2016 CLIENT APPRECIATION EVENT

Thank you to all of our valued clients and friends who joined us on October 13th at Anderson O'Brien Fine Art Gallery for an evening of art, food and fun. We couldn't do the work that we do if it wasn't for the relationships that we have with each of you. For that, we thank you. For those who couldn't make it, we certainly hope to see you next year!