



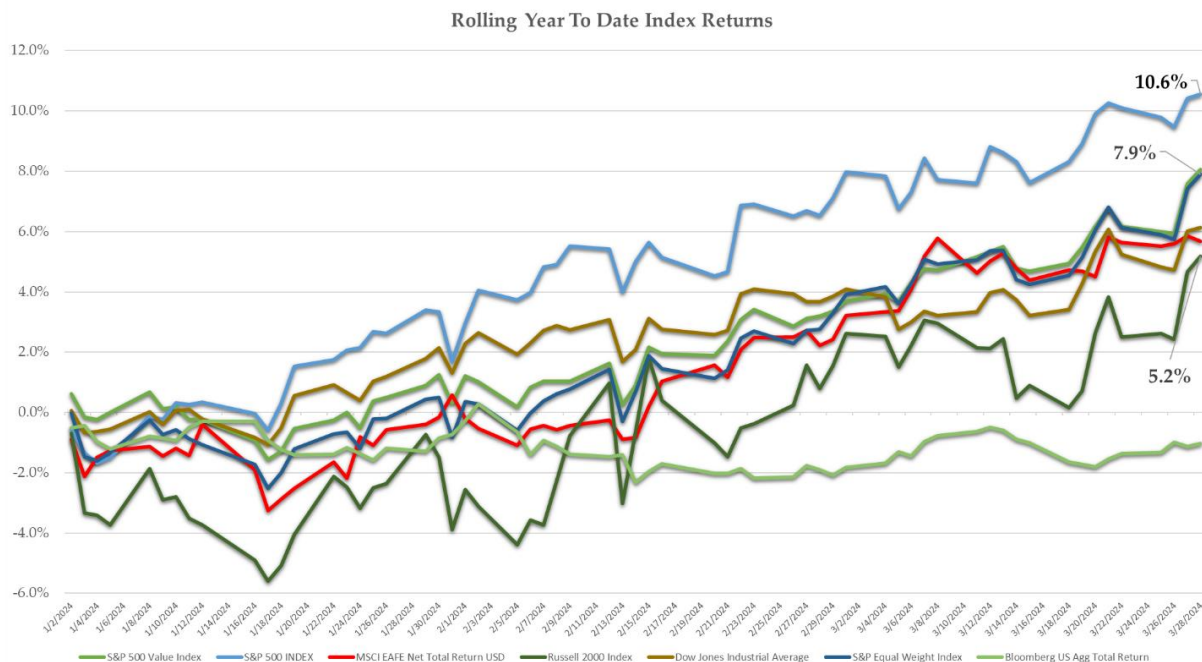
April 2024

Dear Turtle Creek Client,

Global stocks extended their winning streak through the first quarter, with both domestic and international stock markets posting gains for the period. Fixed income markets, by contrast, posted either flat returns or losses. Ongoing strength in the U.S. economy undercut what was, at the beginning of the year, a near universal prediction of Central Bank rate cuts over the next few quarters, pushing up rates across the yield curve and hurting longer dated bond indices.

Stock trading reflected a different theme to start the year. While 2023 largely reflected corporate profits defying recessionary expectations and euphoric trading in growth-oriented technology stocks, equities in the first quarter featured a more broad-based, “risk-on” tone. Investors bid up valuations across most economic sectors in anticipation of a likely soft-landing for the economy and a more accommodative rates environment.

While Turtle Creek almost always views a balanced stock market fueled by a strong economy as a good thing, we do note that the significant advances of the first quarter have pushed many stocks into fully valued territory while both recessionary and inflationary risks remain relevant. Rising valuations by nature require a subsequent fundamental follow-through, so investors should not be surprised by any market volatility that results from new data not justifying the increasingly optimistic assumptions embedded in stock prices. Over the longer-haul, we still remain optimistic about the potential return for your portfolio. We also caution that the path towards those gains could be a bumpy one.



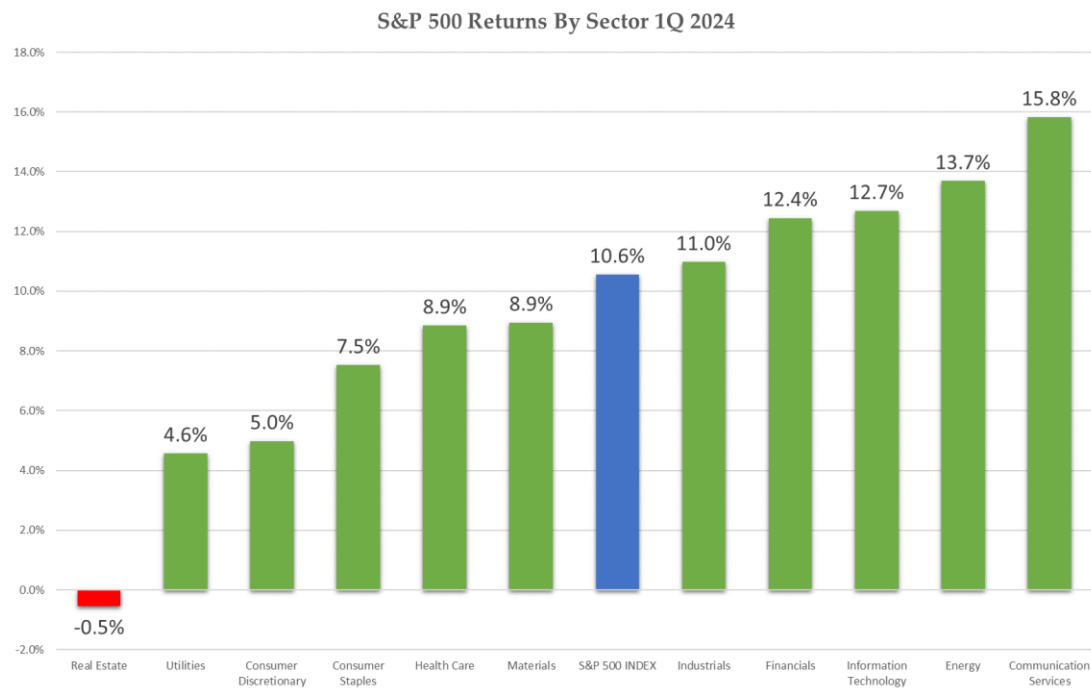
Source: Bloomberg

First Quarter Stock Market Performance

U.S. Stocks, as measured by the S&P 500 Index, gained 10.6% during the first quarter with mega-capitalization companies driving market performance. Technology and Communications companies once again posted market-beating returns, as Artificial Intelligence darling Nvidia corporation posted an 80% gain for the period and Meta Systems (formerly Facebook) advanced by 37%. Economically sensitive

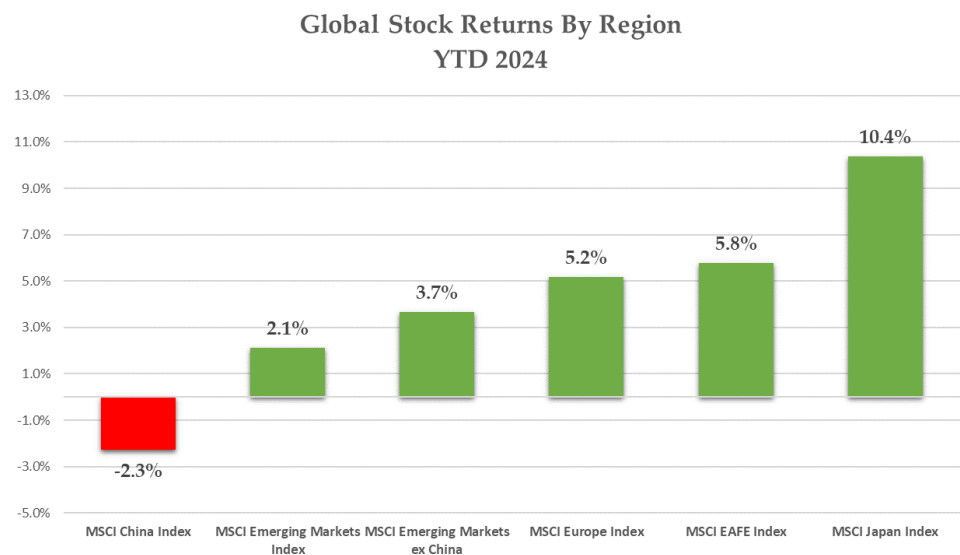
sectors such as Energy, Financials, and Industrials also lead the market. Oil prices jumped 16% during the quarter due to a mix of geopolitical tension and OPEC production cuts constraining global supply.

Defensive investments such as Utilities, Consumer Staples, and Health Care lagged overall market returns. Real Estate stocks posted a loss for the quarter, as rising interest rates and earnings headwinds pressured commercial property firms.



Source: Bloomberg

International stocks also posted positive returns. The Japanese market led international results with a 10.4% gain. Corporate governance reforms, a weakening yen, and improving profitability all drove the Nikkei Index higher during the period. European shares posted a 5% gain. Chinese shares were the only sore sport as they continued to struggle during the quarter, notching a 2.5% decline.



Source: Bloomberg

Turtle Creek often discusses the concept of permanent impairment of capital and in doing so usually references notorious periods of excess such as the Credit Bubble of 2008 or the Dot.com crash of 2000. The Japanese Asset Price Bubble of 1989 deserves even greater billing by our estimate.

The Nikkei 225 Index closed the 1989 market year at a value of 38,915 Yen, having advanced nearly 600% in a handful of years. A long period of unnecessary monetary stimulus had fueled rampant real estate and investment asset speculation. This speculative bubble finally burst in the following months, and the Nikkei would proceed to lose more than 60% of its market value over the next four years and not find a permanent floor until 2009, two decades after the peak.



Source: Bloomberg

We provide this walk down memory lane because The Nikkei closed at 39,098 on February 22nd, finally surpassing its previous historic high of almost 35 years ago. There are a multitude of investing lessons to be drawn from this painful historical episode, but the most relevant to today's market was the seeming invincibility of the Japanese Economy at that juncture. It was widely perceived as on course to surpass, potentially for good, most all other global economies and the ongoing dominance of its technology and manufacturing industries were extrapolated out for decades to justify the heady valuations embedded in Japanese stocks prior to their crash.

This is a timely lesson given the similar optimism on display in certain corners of the stock market. Just as analysts then offered nothing but unabashed optimism over the future of Japanese industry, current market pundits can provide only unwavering excitement over the sustained and exponential growth of Artificial Intelligence, as well as the long-term staying power of current industry leaders. The Japanese collapse shows that such confidence can be very misplaced, and investors should manage that risk accordingly.

Fixed Income Markets

Bond market volatility continued throughout the quarter, with the 10-Year Treasury yield reversing its recent, steep decline to climb a quarter-point during the period. Bonds entered the year amidst a backdrop of softening economic data, retreating inflation, and increasingly dovish Central Bank communications. New economic data cast doubt on this trend, however, as employment figures displayed accelerated hiring and faster-than-expected wage gains while inflation reports surprised to the upside.



Source: Bloomberg

Federal Reserve governors face a mounting quandary as they attempt to push inflation towards their two percent target without inflicting damage on the economy. The current health of the job market, ongoing economic growth, and healthy capital markets provide little theoretical justification for relaxing borrowing costs and injecting liquidity into the financial system. In cutting rates prematurely, The Fed risks over-stimulating a healthy economy and re-igniting inflation.

On the other hand, the Fed remains keenly aware of both the scale and speed of its recent monetary tightening and the long and variable lags in the eventual impact of these restrictive policies. It also notes its history of policy mistakes, failing to diagnose impending recessions and only acting when real damage is done. Some economic forecasters have emphasized more ominous recent datapoints including rising delinquencies on auto loans, mortgages, and credit cards, significant jumps in household debt balances, and declining credit availability. All of these are traditionally the first cracks in the business cycle and have historically translated to curtailed consumer spending that drags down economic growth.

In his quarter-end press conference, Fed Chair Jay Powell reiterated his commitment to an eventual relaxation in borrowing costs and expressed confidence that inflation is still trending towards targets, but hedged his intentions by noting that the timing of any rate cuts is uncertain and wholly dependent on continued progress towards the Fed's inflation goals.

Investment Strategy

With less compelling valuations on offer in risk assets and volatile trading in the bond market, we urge investors to keep an eye to the longer-term while also engaging in smart, tactical portfolio adjustments.

After a stellar 2023 and further gains to start the year, growth-oriented technology and communications investments provide a far less compelling risk/reward profile. The harvesting of some of those profits in a tax-sensitive manner makes sense at this moment. We do not offer this as blanket advice, as one the more interesting angles to first quarter stock market was the decoupling of the “Magnificent 7” mega-cap, growth stock trade. While many of those stocks continued to roar higher, traditional stalwarts such as Apple Inc. suffered losses and present emerging opportunities. Re-allocation opportunities can be seen in many laggard economic sectors including Utilities, Health Care, and Consumer Staples, all currently trading at more attractive discounts. We also continue to like the opportunity in smaller capitalization stocks given their unprecedented valuation discount.

Despite the uncertain near-term outlook for interest rates, Turtle Creek continues to see an eventual decline in both interest rates and inflation due to both the ongoing focus of Central Bankers and the longer-term structural forces that have driven rates lower for the last several decades. Because of this, we continue to urge a lengthening of bond maturities in your portfolio to take advantage of attractive yields on offer while still available.

As always, we look forward to discussing these topics or any other subject with you soon.

Sincerely,

TURTLE CREEK TRUST, LTA