July 2026

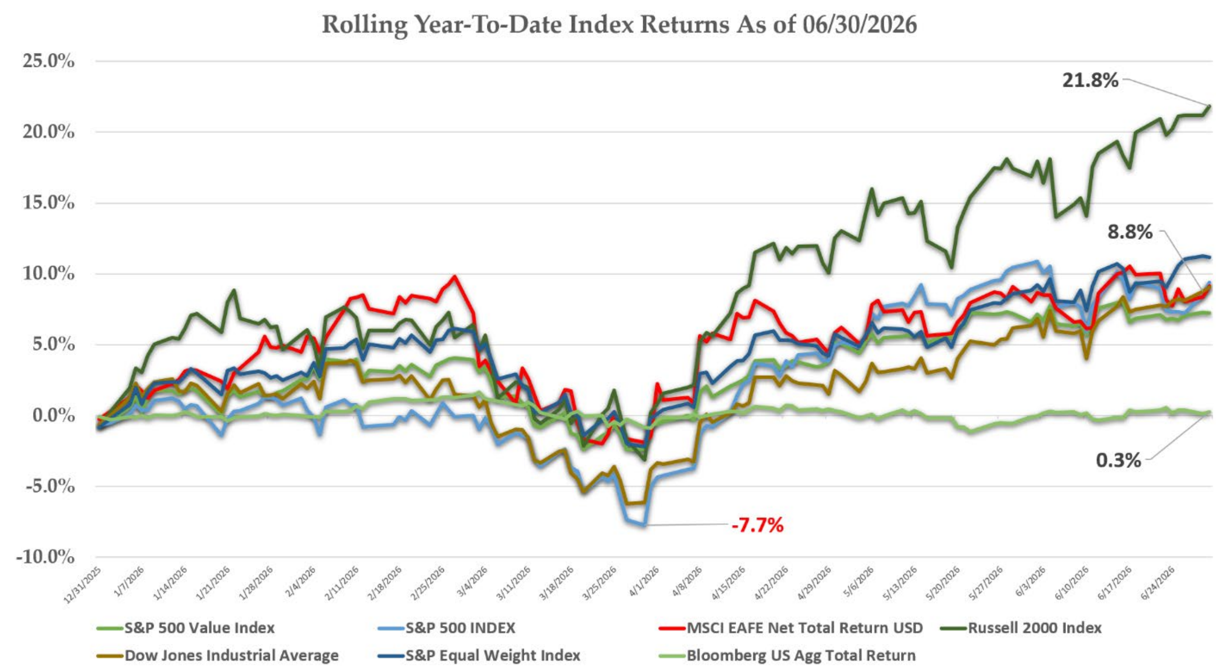
Dear Turtle Creek Client,

U.S. Stocks surged through the second quarter, driven by a resurgence in the artificial intelligence trade and a rapid retreat from geopolitical risks that drove stocks to losses during the first quarter. The U.S.-Iran conflict came to a swift truce, reopening global oil markets and quickly lowering commodity prices. New Federal Reserve Chair Kevin Warsh calmed jittery bond markets through his public support for Fed independence and hawkish public comments on recent inflationary trends.

The quarter marked a retreat from the "debasement trade", or investors crowding into perceived safe havens such as gold, cryptocurrencies, and real estate due to fiscal irresponsibility in Washington and potential economic headwinds from the Trump administration's trade policies.

It also marked an evolution of the AI trade, with many semiconductor manufacturers and technology hardware firms taking over stock market leadership while prior AI trade beneficiaries such as Nvidia. Microsoft and Amazon posted results that largely tracked the broader stock market. Memory and PC chip stocks in particular posted outsized results, with firms such as Micron, SanDisk, Intel, and AMD more than doubling due to surging demand from data centers.

Turtle Creek Trust has signaled caution over the last several quarters, noting historically rich market valuations, the potentially unsustainable pace of Artificial Intelligence spending, and signs of rekindling inflation that could pressure fixed income returns. Even with this quarter's strong results, we view these risks as ongoing and will remain on a defensive footing, booking profits where possible in a tax-sensitive manner and keeping portfolios in line with their strategic assets allocation.



Source: Bloomberg, Turtle Creek Research

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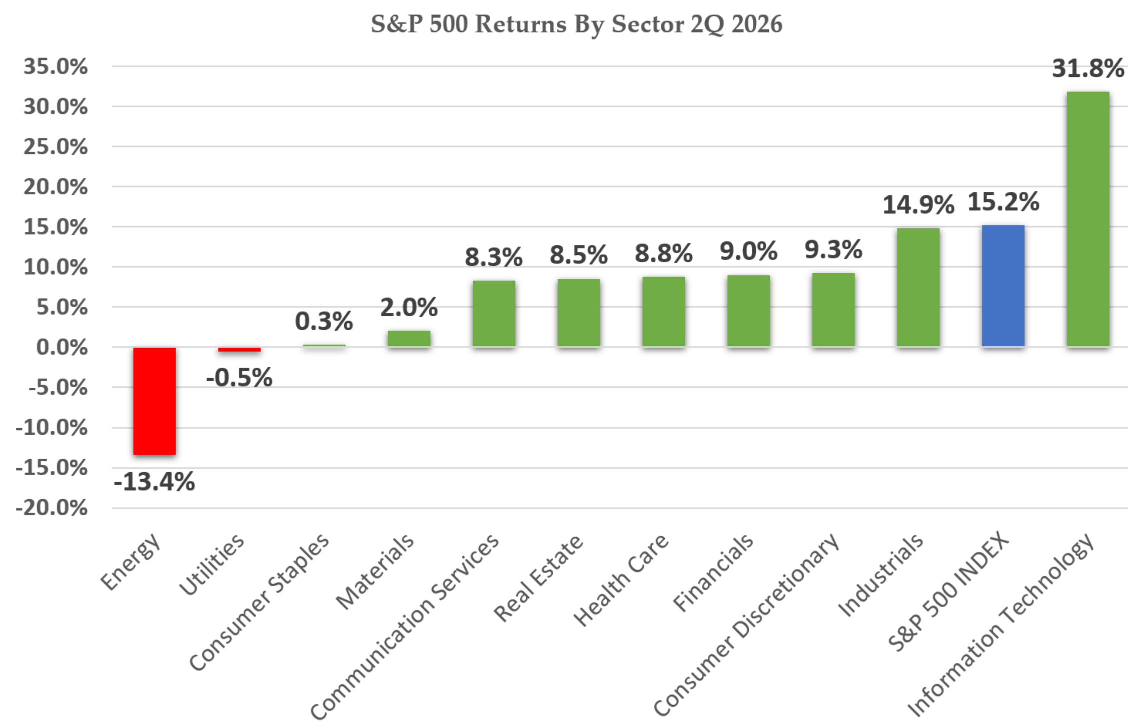
<u>**Second Quarter Stock Performance**</u>

U.S. Stocks, as measured by the S&P 500 Index, advanced 15.2% during the second quarter, the 10th best quarterly performance for the index in the last 50 years. While most economic sectors posted gains during the period, outsized performance from the Information Technology sector was the primary driver of index returns. The Tech sector surged nearly 32% during the quarter and was the only economic sector to lead overall market returns. Industrial stocks also kept pace with the market due to strong performance from manufacturers and airlines recovering from first quarter volatility. Defensive sectors such as Health Care and Consumer Staples that were bid up during the Iran invasion posted flat returns. Energy stocks posted a 13.4% loss due to declining oil prices. Smaller capitalization stocks also posted double digit gains for the period.



Source: Bloomberg, Turtle Creek Research

International stocks also posted outsized returns, with both Emerging and Developed Market indexes posting double-digit gains for the period. Factors driving international market returns were similar to those aiding U.S. stocks. Most international markets suffered steeper losses compared to U.S. stocks during the outbreak of the Iran conflict due to their greater dependence on Middle Eastern oil exports. As the Iran conflict transitioned to a truce and the International Brent Crude Oil price collapsed, these markets enjoyed a broad-based relief rally. Financial Services, Industrial, and Real Estate firms all rebounded sharply during the quarter.

But the AI trade was an even bigger swing factor, especially for Emerging Markets stocks, as international semiconductor firms represent larger percentages of their respective indices. Dutch semiconductor manufacturing firm ASML Holdings, the largest EAFE index constituent, more than doubled the period and accounted for more than 10% of the MSCI EAFE index return for the quarter. Just four semiconductor companies – SK Hynix, Samsung, Taiwan Semiconductor, and MediaTek – accounted for 80% of all Emerging Market returns in the period.

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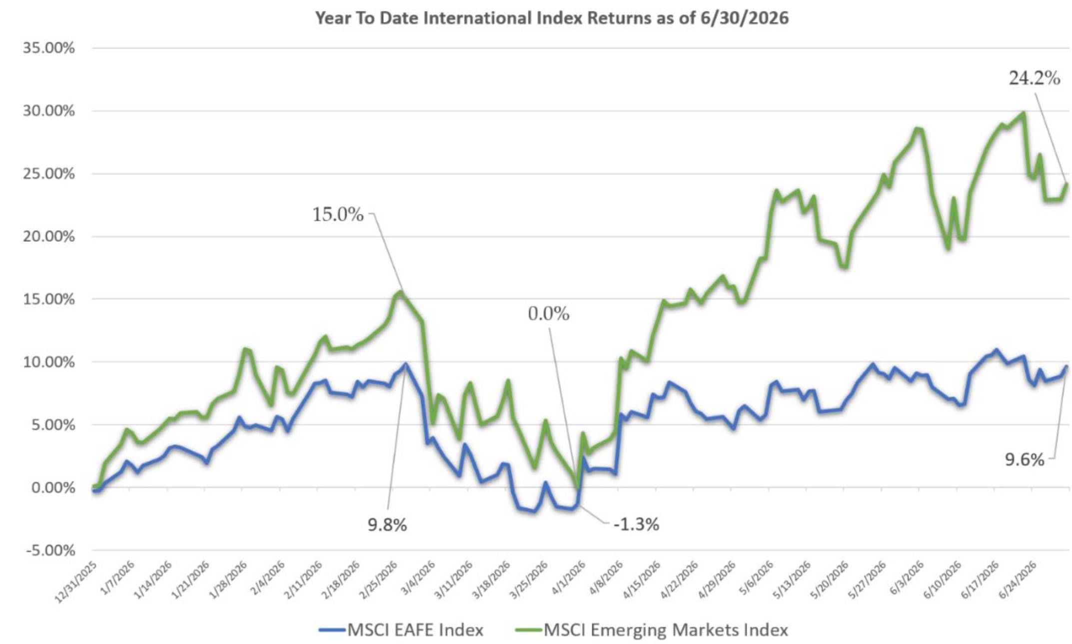
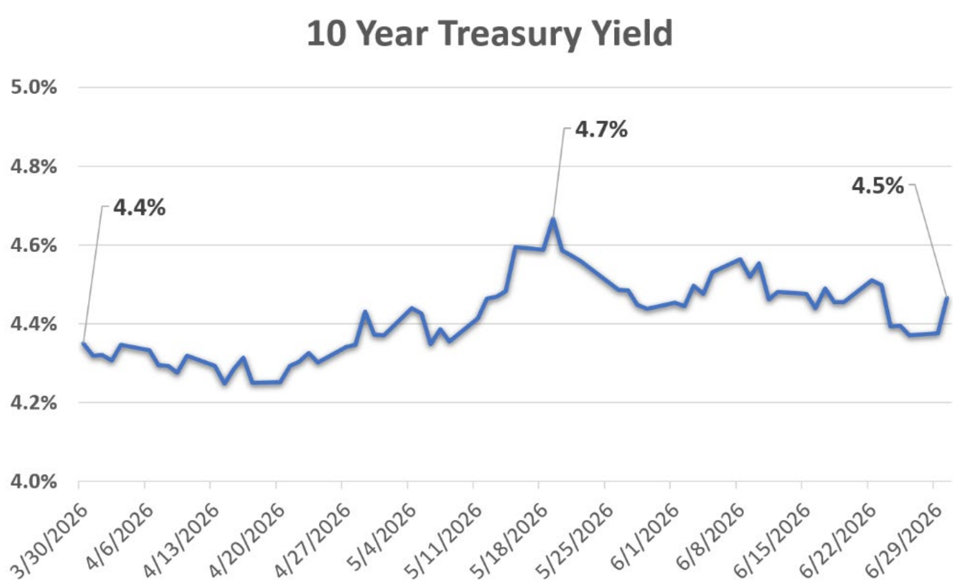


Source: Bloomberg, Turtle Creek Research

<u>**Fixed Income Markets**</u>

Bond yields traded in sympathy with stocks, posting volatile swings but ending up nearly flat for the quarter. The benchmark 10 Year Treasury yield jumped 30 basis points through May as global oil prices climbed and a series of inflation reports exceeded forecasts. Rates reversed in late May, however, with the confirmation of New Fed Chair Kevin Warsh and a decline in commodity prices. Political wrangling over the Fed had unsettled bond investors throughout the year, and Warsh's confirmation provided needed clarity to the the rate setting committee that was in transition due to the expiring term of long-serving Fed Chief Jerome Powell. Warsh and other Fed governors used public remarks to vigorously defend Fed independence and signal a hawkish stance towards recent inflation reports. Rates declined in response.



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The “debasement trade” is the recent trend of investors dumping U.S. sovereign assets such as U.S. Dollars and Government Bonds out of fear that sustained inflation would erode their value. Investors became spooked by mounting challenges to the U.S.’s reputation for inflationary discipline. The reintroduction of tariffs, the deficit enhancing 2025 Congressional budget, and the White House’s more aggressive stance towards Fed Independence all tested investor’s belief in the full faith and credit of the United States government. Gold, Silver, Real Estate, and Cryptocurrencies were the most favored alternatives. The price of Gold and Silver saw five-fold jumps in their dollar denominated prices starting with the initial outbreak of post-COVID inflation in 2019 to today.

Technically stretched and overbought, these commodities all peaked between late 2025 and January 2026. All saw major repricing that continued throughout this latest quarter. Bitcoin finished the quarter at $60,214, more than 50% below its October 2025 peak value. Silver also saw a 50% decline from its January 2026 peak, while gold lost 25% of its value. The confirmation of Kevin Warsh and the subsequent tilt towards a hawkish stance by the Fed in May further extended their undwinding, helping push down long bond yields in the process. The 30 Year Treasury yield had increased nearly a full percentage point since 2025, but peaked in May and declined steadily through June.

A Potential Bubble in Expected Corporate Profits

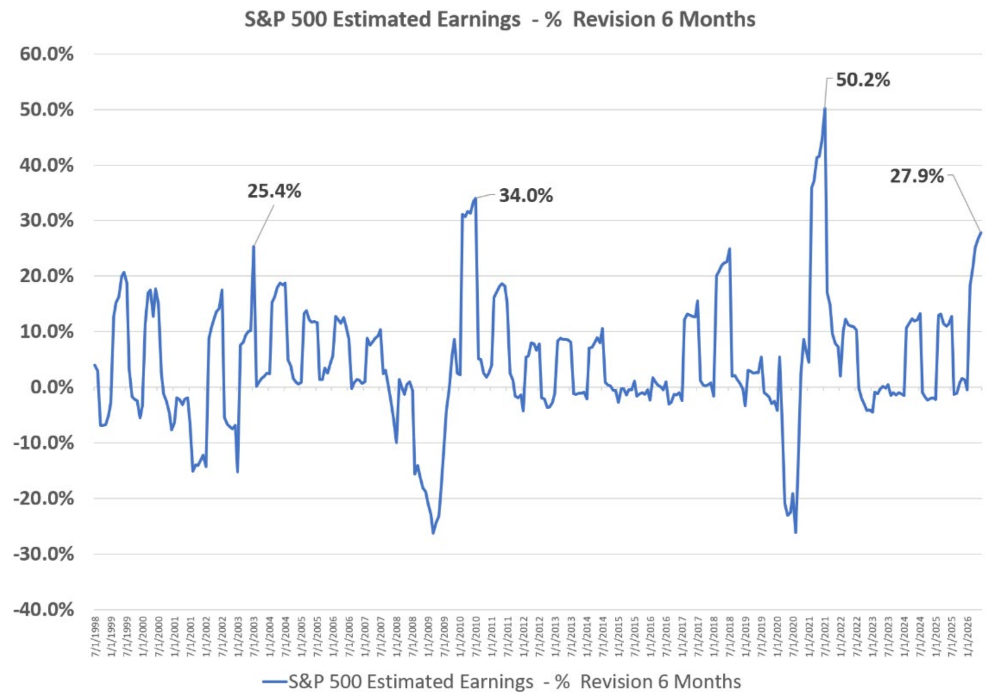
With the AI trade resurgent, the debate over its durability also intensified during the quarter.

AI proponents argue that, unlike the Dot-com era when useless businesses were awarded fanciful valuations, this time is actually different. Market advances today are fully justified by the extraordinary profits generated by AI-related businesses. Furthermore, these profits should be durable, making stocks reasonably priced by current measures. Formerly cyclical semiconductor firms have entered into a new era of sustained demand for their products and extended mismatches between supply and demand should help them maintain current profit margins that are well in excess of any historical comparison.

AI skeptics note with concern current market leadership by the most cyclical of companies. Memory chip maker Micron Technology now sports a trillion-market capitalization, but as recently as 2023 was reeling from 50% decline in sales while producing large operating losses. They also point out the long history of market speculation that proves how investors over-extrapolate the potential financial reward of new technologies. They view today’s AI speculation as no different than similar historical episodes of irrational exuberance ranging from tulip bulbs to railroads to internet stocks to the recent housing bubble.

What is clear is that market analysts have sided with AI proponents and forecast a significant acceleration in S&P 500 earnings per share over the next several years. The consensus for S&P 500 operating earnings per share has been hiked by almost 28% in the last six months, the fourth steepest revision to S&P earnings in the last 30 years. Previous revisions of this magnitude – 2003, 2010, 2021 - all took place in the wake of recessions and reflected temporarily depressed corporate profits healing as the business cycle switched to expansion.

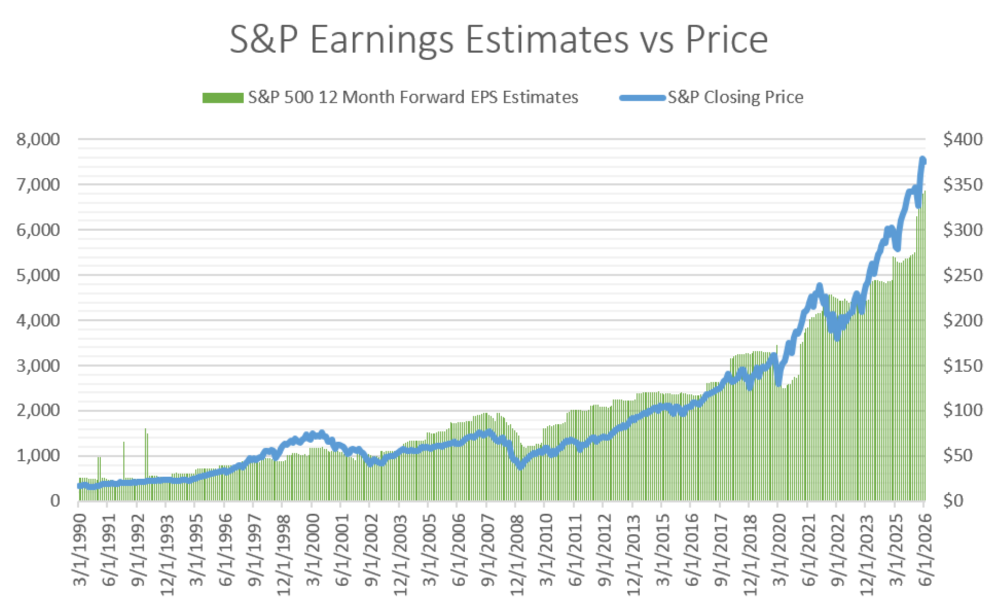
Today’s revisions, by contrast, are taking place years into an economic expansion with corporate profit margins already near all-time highs. They are supported by a narrow group of companies including energy firms benefiting from recently elevated commodity prices and technology hardware firms profiting from AI-related capital expenditures that are now larger than the most significant capital booms in market history. In short, for the next few years Wall Street forecasters agree that this time is different. The eventual reversion to the means that has plagued previous instances of excess investment will be avoided due to special nature of today’s technology expansion.



Source: Bloomberg, Turtle Creek Trust Research

Investment Strategy

We have noted in previous letters that market forecasters are, based on historical data, ultimately trend chasers that almost always fail to spot critical inflection points and who only cut their forecasts after the markets have sold off in advance. The Dot-com crash., the Credit Crisis of 2008, and the inflation shock of 2022 all saw analysts hike earnings estimates aggressively into market peaks only to quickly reduce them months after markets had already sensed shifting economic winds. We view current Wall Street optimism as a risk factor, setting a historically high bar for corporate profits over the next several years.



Source: Bloomberg, Turtle Creek Trust Research

Turtle Creek Trust has always considered sustained or permanent impairment of your investment capital as the primary measure of investment risk, and we do view many of the factors driving current market returns as echoing historical episodes where unfounded optimism resulted in long lasting or even permanent drawdowns in sections of the stock market. Should this time not be different, and the competitive forces that have historically caused great booms and busts in the companies leading today's markets still hold, prudent portfolio management steers us to trim back winners now and reallocate to other sections of the stock market that provide better risk adjusted potential returns.

The permanent decline in the debasement trade is a less certain affair, as the factors that caused it in the first place are still very relevant, even with stable Central Bank leadership. Over the near-term, bubbling inflation and a hawkish Fed imply short rates that will either stay flat or increase due to a Fed rate hike. Over the longer-term, accelerating U.S. budget deficits and the country's growing debt burden remain critical issues, so lasting relief for the longer end of the yield curve is uncertain. Given this setup, taking duration risk seems unwise.

From a macro perspective, the economy remains in good health. Despite recent softness in hiring, the labor market has remained resilient and household balance sheets reflect large amounts of liquid reserves. While we have expressed concern over potentially unrealizable market expectations for certain industries, we do see longer-term opportunities for your portfolio in many sections of global markets.

We look forward to discussing these topics, and other questions or concerns with you soon.

Sincerely,

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