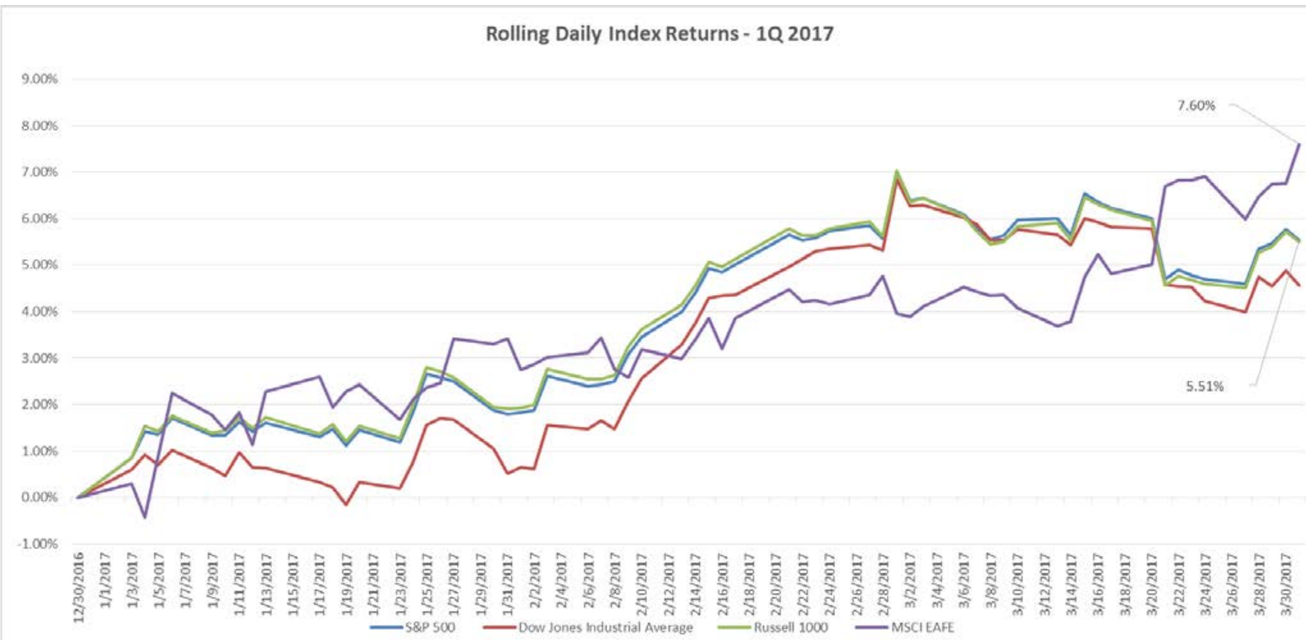
TURTLE CREEK

April 18th, 2017

Dear Turtle Creek Client,

Onward and upward was the theme for the first quarter of 2017. The factors that drove strong market performance in 2016 - an acceleration in global economic growth and the prospect of more favorable regulatory and tax policies - persisted through the first months of the New Year. These trends were reflected in continued strength in U.S. equities, a robust recovery in international stock markets, and interest rates sustaining gains realized in the prior year.



Elements of First Quarter Domestic Stock Market Performance

While market sentiment market did not change in our view, investors rewarded different firms and industries during the quarter. The 2016 market year featured sharp recoveries in energy and commodity markets, a resurgence in industrial demand, and significant improvement in banking and financial services companies. The first quarter of 2017 has so far featured strong gains in technology and consumer product shares.

We have explored in detail both investor angst and the potential opportunity in pharmaceutical and biotechnology stocks in our previous letter. These shares also rallied significantly as the prospect of government regulatory intervention became less likely, driving the overall health care sector to a strong performance. Shares in energy and telecommunications companies, meanwhile, retreated from their strong gains of 2016 and represented the worst performing groups during the quarter.

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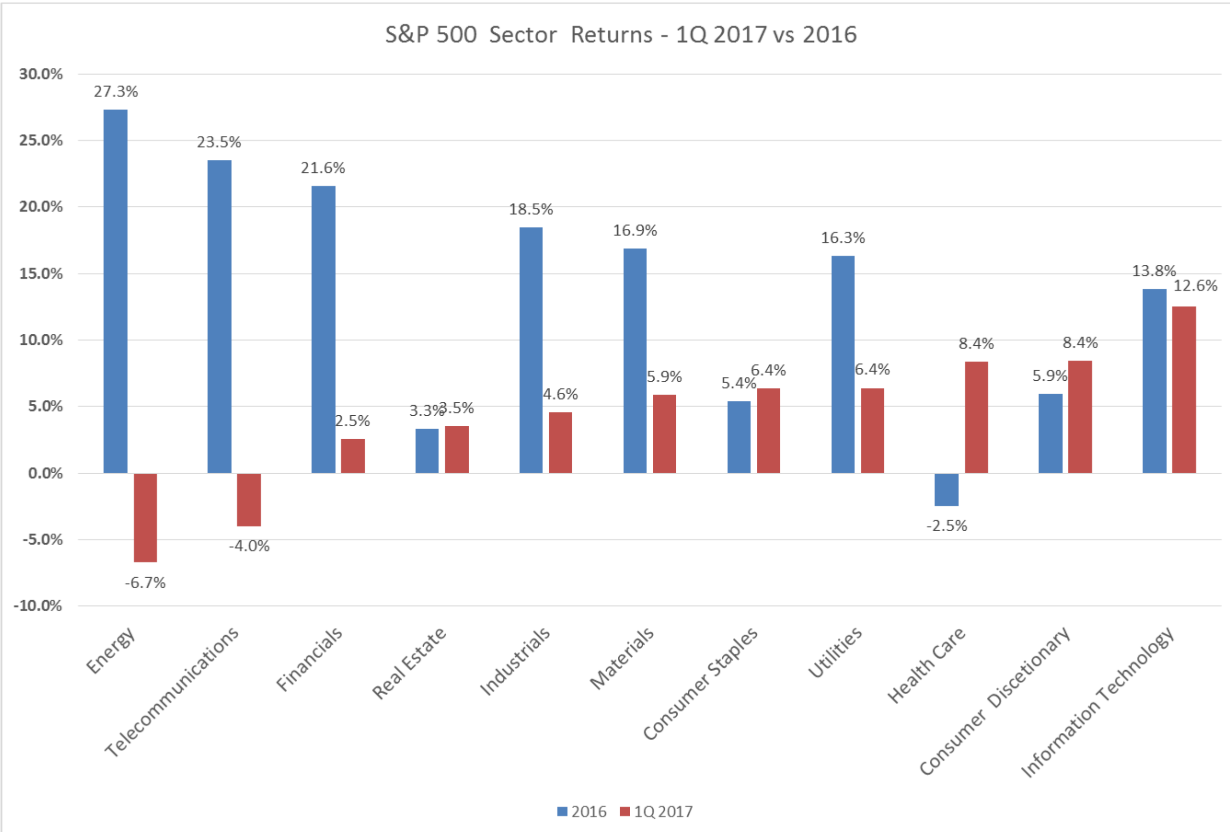


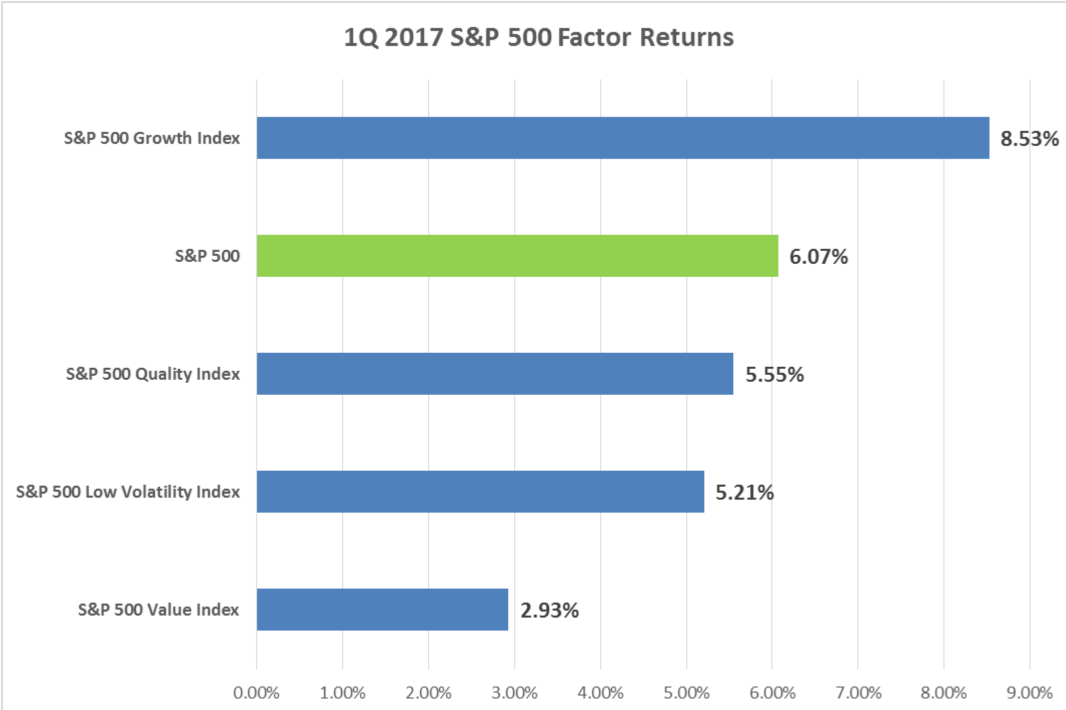
The Underlying Nature of Stock Market Returns

One of the great developments of 20th Century financial theory was the academic determination to understand the true variables underlying stock market returns. In a financial services industry known to harness astrology or psychology to define the future, the development of reliable data on investment markets and the application of statistical methods to sort this data represented a true positive step forward in our collective understanding of portfolio outcomes.

Key to this study was the decision to sort investments into different shapes and sizes, known as "Factors". Recent Nobel Laureate Eugene Fama and his partner Kenneth French were seminal contributors recognizing that stocks with lower valuation multiples ("Value Stocks") and smaller companies ("Small-Capitalization Companies") did better than their peers without adding additional risk. Since then, multiple researchers have analyzed the "Quality Factor", noting that firms with stable and above average profit margins consistently outperform the market. The "Low Volatility Factor" is another recently accepted variable, noting that firms with less stock market gyrations do better than their more volatile peers over time. The ever popular strategy of buying high multiple "Growth companies" grades out quite poorly in this exercise, delivering lower returns and much greater volatility.

While Turtle Creek Management applies appropriate skepticism to purely academic approaches to investing, we do view these conclusions as a logical and overdue validation for the classic portfolio management strategy of investing in superior businesses (Quality and Low Volatility) and only doing so at an attractive price (Value).

We also like that these factors provide a tool to peer into stock market returns and see what has worked and what has not. By these measures, first-quarter stock market returns were rather unattractive. The types of stocks that represent safer, smarter bets over a long-term investment cycle under-performed while high multiple growth stocks primarily in the technology sector carried the overall market.

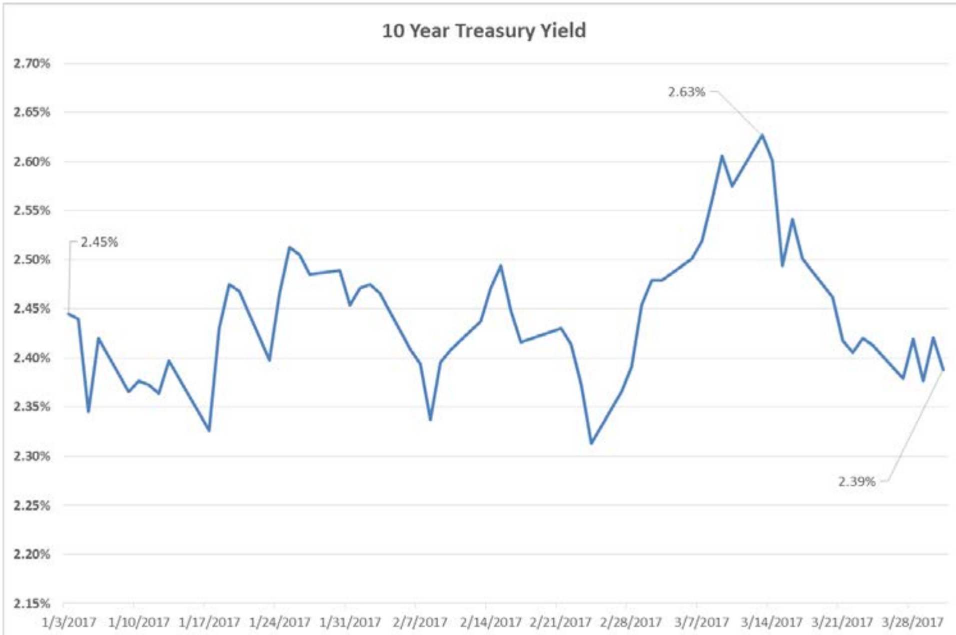


Our parents have likely at some point posed to us the question, "If all your friends jumped off a cliff, would you do the same?" This stark question is asked to highlight the need for independent judgment when the larger crowd is making sub-optimal choices. "Process vs. Outcome" is the more sophisticated business term applied to capture the same concept. Process-oriented investors do the right thing no matter the near-term outcome because of their certainty that such decision-making delivers superior long-term results. Outcome-oriented investors, by contrast, simply desire near-term results no matter the tactics. And just as fad-diets usually fail to deliver a healthier lifestyle, the pursuit of high-multiple growth stocks may feel good for a short period but historically fails to deliver great longer-term results.

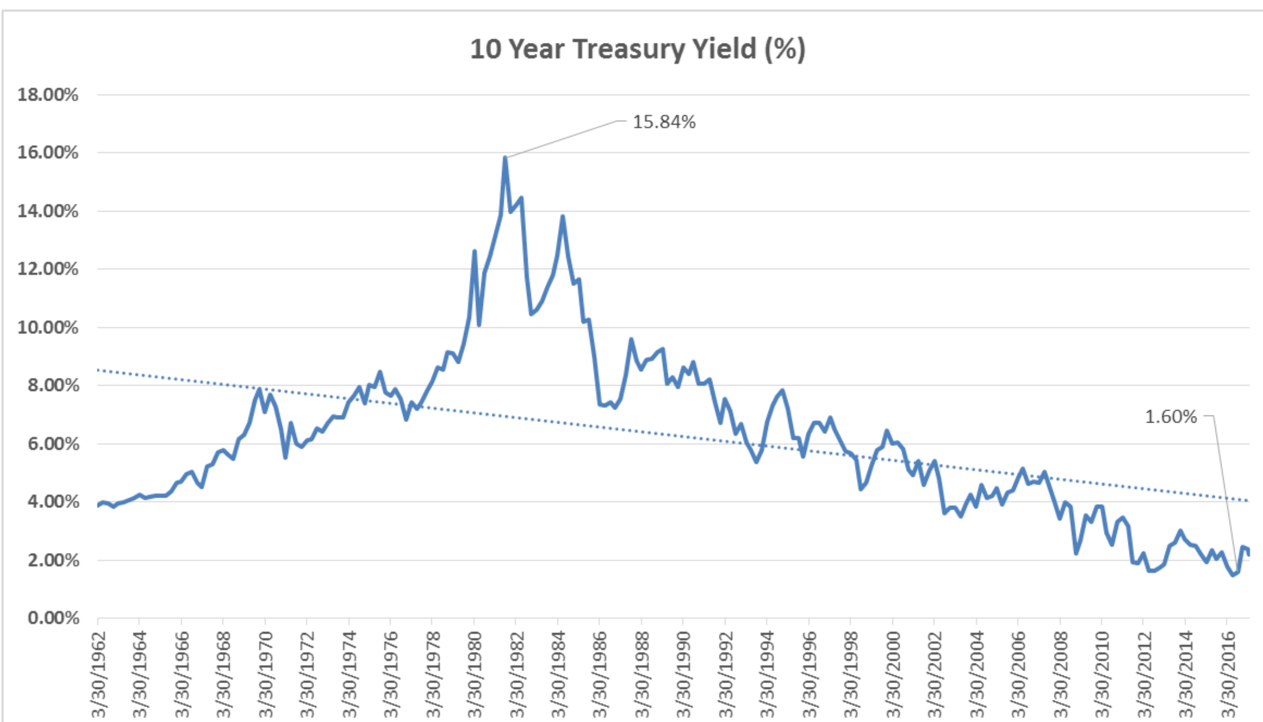
If an investor's goal is to realize superior returns without taking excess risk over the longer investment timeline, the wisest process did not deliver a market-beating outcome in the first quarter.

Fixed Income

Compared to the stock market's unshaken optimism, fixed income markets wrestled with larger dilemmas during the quarter. The 10-year Treasury yield initially sustained its advances from the prior year, climbing to a three-year high of 2.63%, only to abruptly reverse course in the last few weeks of the quarter.



To understand this back and forth, it is helpful to review who controls interest rates and how they think. At the core of the bond market sits the Federal Reserve, a government body enacted to ensure stable prices for American citizens (controlled inflation) and maximum employment (Low Unemployment Rate). To achieve these goals it is allowed to shape and influence borrowing conditions. Just below the Fed sits the world of bond-traders, who attempt to divine Fed thinking and in doing so push bond prices and yields up or down based on the latest economic data-points and their personal hunches regarding the direction of the economy. To say the Fed has been busy the last ten years would be an understatement. Current interest rate levels are without historical precedent. Looking back over 55 years of Treasury bond history helps frame the remarkably low current levels for government bonds.



Federal Reserve decision makers are primarily academics by trade and use models and data-points to gauge the appropriate interest rate for the market on the margin. Up until a few years ago, there was little debate regarding the wisdom of the Fed's tactics given the economic wreckage of the 2008 Credit Crisis. But the Federal Reserve's key indicators are currently saying its ultra-low rate policy is no longer justified. The national unemployment currently sits at a respectable 4.7% and economic growth has recovered. The Fed now worries over the risks of inflation and communicates frankly its plan to increase rates over the next several years back to historical norms. Despite this backdrop, several economic data-points during the quarter gave bond traders pause and their subsequent trading drove bond yields down.

We view the weekly gamesmanship on display in the bond market as besides-the-point. Given the larger backdrop of Federal Reserve rate hike plans and an overall US Economy that empirically cannot explain or justify current bond yields, the ongoing upward "normalization" towards bond rates in line with longer-term averages seems the surest future outcome.

How This Relates To Your Assets

In previous quarterly letters we communicated that even with the significant stock market advances of the last few years, your specific investments holdings appeared at worst fairly valued and we were able to source an adequate number of attractive investment opportunities for new portfolios.

Sourcing such new investments is admittedly becoming harder as market averages continue to grow. Additionally, certain portfolio holdings are now trading at valuations that could be hard to justify over the longer-term. In such an environment you should expect some intelligent harvesting of your winning positions, executed with our usual sensitivity to tax obligations. For newer portfolios and idle cash, greater patience will be required as we wait for the right opportunities.

In terms of your fixed-income holdings, we have not changed our view that we are in the early stages of a multi-year normalization towards higher rates and therefore your bond investments will remain short-duration and high credit quality.

Please call or write should you want to discuss these topics or any other topic. As always, we greatly appreciate the trust and confidence you have placed in our firm.

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