January 4th, 2016

Dear Turtle Creek Client,

As 2015 draws to a close, we ponder a very unusual and confounding stretch for investment markets. Whether it be due to historic swings in commodity markets, weakness in international economies, or investor behavior emphasizing momentum over long-term intrinsic value; tried and true methods of security selection did not always deliver the near-term results expected based on longer-term market history.

We remain optimistic about the longer term opportunities in securities markets. We find investment opportunities across several key themes - the Federal Reserve stepping back from its unprecedented stimulus program, the strong dollar, and commodity weakness, among others. We also find ourselves in the unusual position of taking issue with benchmark returns, a stance we normally avoid but in this particular case highlight.

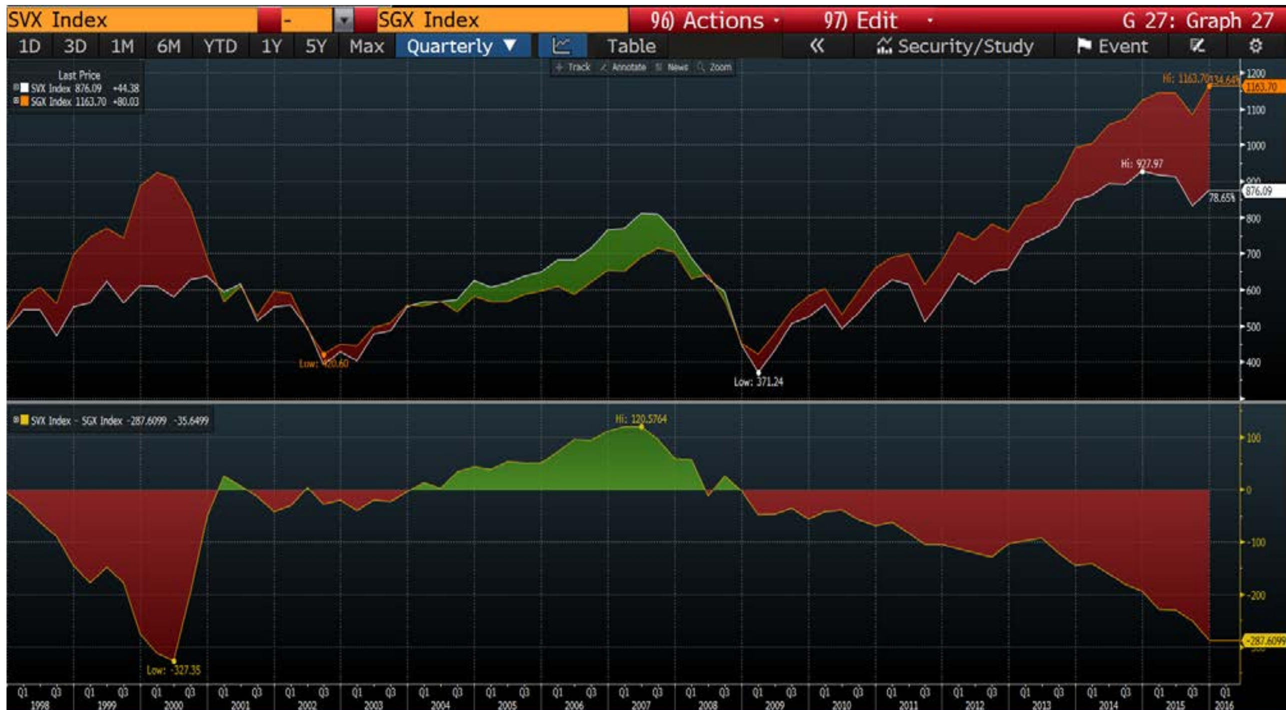
S&P 500 2015 Returns

The performance of the S&P 500 Index in 2015, approximately 1.3%, rightly drives investors to question under-performance or lost money. Even a cursory de-construction of this result shows the return to be unusual, however, and the risk-taking required to replicate the result to be questionable.

The S&P 500 is a "capitalization-weighted" index. The larger a company based on market capitalization, the larger its contribution to the overall index return. Ideally index returns will be broad-based, with companies large and small and from a variety of economic sectors advancing in harmony. But in certain cases – most notably the Nifty Fifty stocks of the 1970s and the Dot.com craze of the late 1990s - irrational investor behavior regarding very narrow portions of the market masked poor results in the broader index.

Such is the case in 2015 with the "FANG Stocks" – Facebook, Amazon.com, Netflix, and Google. The FANGS represented just 5.5% of S&P 500 at year end but more than 200% of return. Removing this handful of companies from the index turns the index return from a positive to a negative.

S&P Value and Growth Relative Performance – 1998 through 2015



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This concentration is reflected in skewed relationships which, in our experience usually end badly for those that simply follow the trend. A historic divergence between value and growth investing styles is the most notable. The S&P 500 Growth Index returned 5.6% on the year while the S&P 500 Value Index declined 3.1%. This 8.7% spread has been observed once before in recent history, the Dot.com craze of the late 1990s (see chart on page 1). The subsequent reversal dealt significant pain for to those eschewing any sort of valuation discipline.

With the exception of Google, which features remarkable competitive advantages and trades at an understandable valuation, the FANG stocks are priced for perfection. Netflix and Amazon feature marginal profitability and operate in highly competitive end markets. Turtle Creek avoids the potential for permanent impairment of your capital primarily by not over-paying for a business. We can only comprehend current market valuations of these companies by assuming extraordinary leaps of growth and profitability, speculation that seem unjustified. This is not our game, and we are happy to endure temporary underperformance versus the benchmark as a result.

The Great Commodity Bust

"What do you think about oil?" was an oft repeated question from clients this year. Legendary investor Howard Marks was recently quoted as saying "nobody knows where the price of oil is going. There's nothing intelligent to be said about the future of the price of oil." We concur. Government statisticians and major oil companies are historically wildly off the market with such predictions so we don't feign superior insight.

We do know what has happened. The bill came due in 2015 for years of excess investment in oil and gas and precious metal exploration. What once seemed like a permanent increase in commodity demand from high-growth emerging markets coupled with scientific advances and almost unprecedented cheap credit to fund capital projects drove traditional operators and new market entrants to massively inflate the supply of oil and other commodities. When this excess supply met cooling global demand, the commodity markets were not kind.

Commodity	Price 01/01/2015	Price 12/31/2015	% Change
Crude Oil (WTI Spot)	$53.27	$37.09	-30%
Natural Gas (Nymex Henry Hub Spot)	$3.56	$2.34	-34%
Copper (CME Spot)	$283	$214	-24%

The supply picture over the near term for oil continues to look grim. Embargoed nations such as Iran return to the global market. Producers clinging to life through maturing loans and expiring commodity hedges continue to pump with abandon. As recently as 2009 oil analysts pondered "Peak Oil", debating if the global economy could absorb sustained prices as high as $200 for long periods. Now the topic is "Lower for Longer", or depressed oil prices for the foreseeable future.

We are also confident that the same supply/demand dynamics under-pinning this price collapse will govern future prices. Major producers are cutting capital spending dramatically and Emerging Market and Middle East producers are spending more to produce a barrel of oil then they can recover in the market. Domestic producers will lose their credit lifelines and either be acquired or shut down. We expect supply growth at a minimum to slow. Meanwhile, demand for energy continues to increase at a steady pace, as more people drive longer distances and global economies continue to mend. We will likely look back fondly on these days of cheap oil and metals.

Another key element of avoiding permanent impairment of investment capital is to invest only in cyclical businesses that feature the financial strength to endure commodity downturns. Turtle Creek's holdings involve premier franchises sporting very strong balance sheets and the funding and cash flow to prosper for years to come.

The Strong Dollar and the Weak Global Economy

While FANG is the latest euphemism, "BRIC Economies" was its predecessor. Five years ago; Brazil, Russia, India, and China represented mighty secular investment opportunities. Each country would shrug off traditional emerging market behaviors. Their emerging middle-class spenders promised outsized growth opportunities. The U.S., limping out of the great recession, represented a very poor investment climate by comparison. Emerging markets are still emerging, however. China's growth slowed noticeably in 2015, as its technique of growth through government

funded infrastructure projects ran out of steam and its edge as an offshore manufacturing center vanished. Brazil tipped into an outright depression as sagging commodity prices and bad loans swamped its economy.

Selected Emerging Market Returns – 2014 and 2015

Index	2014 Total Return	2015 Total Return
MSCI Emerging Markets Index	-1.9%	-14.6%
Bovespa Index (Brazilian Equities)	-2.9%	-13.3%
Shanghai Index (Chinese Equities)	58.0%	11.2%
BSE Sensex (Indian Equities)	37.0%	-6.0%
MICEX Index (Russian Equities)	-2.3%	32.3%
JSE/FTSE All Share Index (South African Equities)	11.3%	5.7%
Kospi Index (Korean Equities)	-2.5%	3.1%
Mexican Bolsa Index (Mexican Equities)	1.7%	1.5%

Economists termed Federal Reserve money-printing in the wake of the U.S. financial crisis as the "Great Exhalation" of money, and much of this cash found its way offshore to BRIC Nations chasing attractive interest rates and high-growth economies. The year 2015 was the year of the "Great Inhalation", as investors quickly exited these ailing BRIC economies. Capital flows back home resulted in the U.S. Dollar appreciating dramatically compared to other global currencies. The U.S. Dollar, as measured against a basket of global currencies, is now 25% above its mid-2014 low mark.

This has resulted in a very serious headwind for corporate profits. American corporate leaders are so multi-national that 25% of all S&P 500 profits are realized in foreign currencies. This 25% of earnings is now worth 25% less due to the strong dollar trend. Add to this sagging demand in ailing international markets, and you can understand how leading American consumer and industrial companies struggled over the last twelve months.

U.S. Dollar Index Price – 2013 Through 2015

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How does this relate to your assets?

Turtle Creek's focus is to invest in superior businesses when they trade at a price significantly below our estimate of their intrinsic value, a value determined by the longer-run cash generation of a business.

The commodity and currency crises of 2015 are painful events but, as evidenced by economic history, self-correcting deviations from the longer-term growth that will be enjoyed by superior businesses. Globally diversified corporate titans ranging from IBM to Proctor & Gamble to United Technologies are trading at historically low valuation multiples. Major oil companies are currently trading at values reflecting a long-lasting impairment in commodity prices.

This is for us opportunity to acquire stakes in excellent businesses at the right price. We can't identify with precision just when supply and demand will balance or exactly when emerging markets will return to growth. All of recorded investing history says they will, however, and it will pay to grab the opportunities currently being offered to us due to short-term fears.

We appreciate your trust and confidence in Turtle Creek Management. We will continue to invest in superior businesses trading at attractive valuations while minimizing portfolio turnover and controlling risk. Frequent and in-depth client communication is a key pillar of our approach, and we hope you contact us with any questions or concerns.

Happy New Year!