First Quarter 2024 Market Commentary

Joseph Bonacci, CFA, Portfolio Manager

And the turtles, of course…all the turtles are free
***As turtles and, maybe, all creatures should be.* - Theodor Seuss Geisel (Dr. Suess), "Yertle the Turtle"**

Suess tells the story of Yertle, tyrant of a pond named Sala-ma-sond. Yertle believes he rules everything he can see and orders the other turtles to stack themselves underneath him to expand his kingdom by increasing his ability to see territory further from the pond. Despite the cries of pain from a turtle named Mack, Yertle orders an increasing number of his subjects to join the column as his ambitions grow. Mack eventually becomes angered by the treatment he and the other turtles are forced to endure and decides to burp which causes the stack to crumble, sending Yertle hurtling back into the mud and ending his reign of terror.

**"I'm Yertle the Turtle! Oh, marvelous me!
For I am the ruler of all that I see!"**

Although a metaphor for Adolph Hitler, Yertle is a symbol of any self-serving autocratic ruler or government, while Mack represents the citizens who wish to live in a society governed by democracy. We believe the existence of the inequalities described in the story explain much of the persistent underperformance of emerging markets equities compared to domestic stocks. Many emerging market nations are ruled either by an authoritarian government or are only nominally democratic. This stifles innovation, weakens corporate governance, and causes capital flight.

When Emerging Markets Forget to Emerge: The Cost of Corruption

Emerging markets equities' absolute and relative performance has been abysmal, which has rendered the asset class uninvestable. For the decade ending March 2024, the MSCI Emerging Markets Index returned 2.95 percent annualized compared to 12.96 percent for the S&P 500 Index. So called BRIC investing, purchasing the shares of companies domiciled in Brazil, Russia, India, and China, was once perceived as a sure thing, especially during the period from 2003-2007 when emerging markets roared. This era seems like a distant memory for most investors. In fact, Morningstar recently announced the retirement of the BRICs category from its mutual fund universe. This long stretch of underperformance has led to a handful of the largest American tech giants outgrowing the entire asset class. According to Morningstar, "the combined market value of Apple, Microsoft, Amazon.com, Nvidia, and Alphabet exceeds that of the entire Morningstar Emerging Markets Index."

China and Russia have been case studies of how political turmoil negatively affects investor confidence, corporate governance, and capital flows. Since 2020, the Chinese government has sought to mitigate the influence of large companies like Alibaba through regulatory action, while Russia's war in Ukraine has cut off foreign capital. Meanwhile, scandals like Operation Car Wash in Brazil are a reminder that many democracies remain fragile and susceptible to rampant corruption. Brazilian judicial officials estimate the massive fraud fleeced $2.1 billion from the country's largest company, Petrobras. Most of the money funded the campaigns of corrupt politicians and lavish lifestyles of the scheme's perpetrators while many ordinary Brazilians were mired in abject poverty. Until emerging market nations enact meaningful democratic reforms that bolster shareholders' rights investors are wise to search elsewhere for investment opportunities. It's difficult for an entrepreneur to focus their talents on building a business when their government struggles to meet the basic needs of its people. Investors should not be forced to deal with a Yertle, active management is all about allocating capital to where it's most appreciated.

A Case Study in Successful Governance: Japan

Corporate governance reform in Japan demonstrates what meaningful and enduring public policy change looks like. The Tokyo Stock Exchange recently instituted enhanced disclosure rules for listed companies. An excerpt from a January 2023 presentation issued by the exchange states, "Quite a few foreign investors cite a complete lack of information as a reason for their reluctance to invest in Japan." In response, the exchange now compels listed companies to "comply or explain" if they are trading below a price-to-book (P/B) ratio of one, which can be a symptom of inefficient capital allocation decisions. Companies also are strongly encouraged to publish regulatory documents in English given the global nature of investing. We believe changes like these will strengthen shareholders' due diligence process and result in higher valuations of Japanese shares. In fact, Warren Buffett has endorsed Japanese equities as the regulatory changes take effect, and the Nikkei 225 currently trades around 40,000—a level not seen since 1989.

Although none of our strategies have ever held a dedicated emerging markets equities position, we recently altered our manager roster to reduce our exposure to a negligible amount. Our foreign developed markets managers also have shifted to an overweight position in Japanese shares which we believe will continue to add value for the foreseeable future. Please visit us at SierraRidgeWealth.com and follow us on LinkedIn (@SierraRidgeWealth) to learn more about how our unique approach to investing is helping investors make better decisions.

Total Return As of 03/31/2024 (%)	1 Year	3 Year	5 Year	10 Year	Since Inception
MSCI EM NR	8.15	-5.05	2.22	2.95	7.58
S&P 500 TR	29.88	11.49	15.05	12.96	10.44
MSCI EAFE NR	15.32	4.78	7.33	4.80	8.47