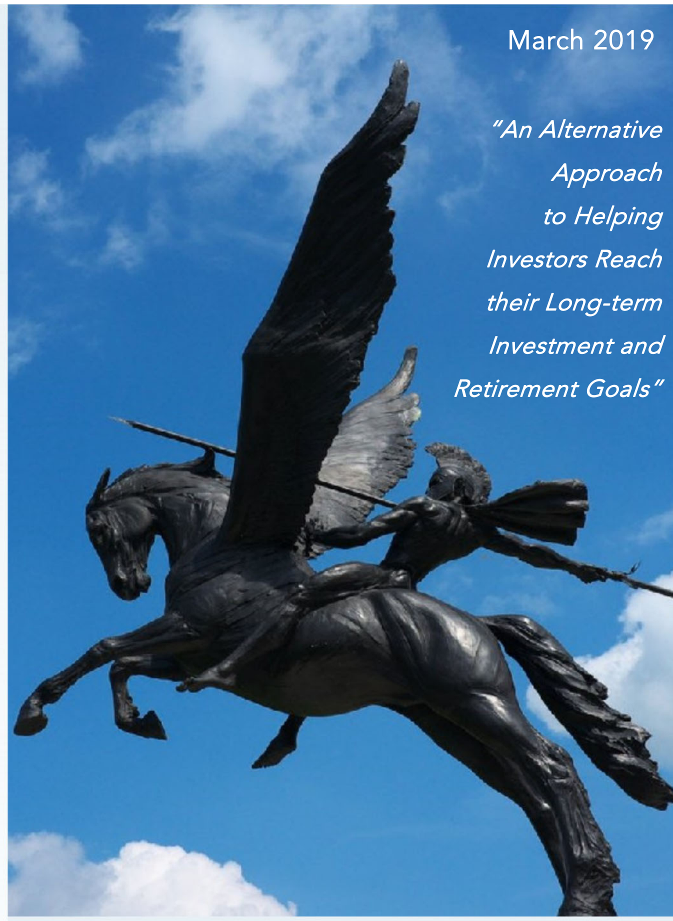
Belleros
Capital Management

The Passionate Investor

1Q2019 Market Review and Commentary



*Market Review **

- Equity markets generally ***outperformed*** fixed-income markets with the S&P 500 rising +13.65% (including dividends) and the Barclays Capital U.S. Aggregate Bond index increasing +2.94%.
- Small caps ***outperformed*** large cap stocks (S&P 500) as the Russell 2000 small cap stock index returned +14.58%.
- Growth ***underperformed*** value during the quarter (as determined by the S&P 1500 broad market index which includes large, mid, and small capitalization stocks).
- Non-U.S. equity markets generally ***underperformed*** U.S. markets in both US dollar and local currency terms (MSCI EAFE**: +10.13% in USD; +10.73% in local currency).
- Emerging markets ***underperformed*** both U.S. and non-U.S. developed markets (MSCI EAFE**) in both USD and local currency as the MSCI Emerging Markets Index rose 9.95% in USD and in +9.86% in local currency.
- The quarter was notable based on strong performance in most international markets. China (+17.69%), Canada (+15.60%), Russia (+12.24%), Australia (+11.43%), and France (+11.91%), were particularly notable based on their strength during the quarter (all quoted in USD).
- All U.S. market sectors were positive during the quarter. Information Technology (+19.86%), Industrial (+17.20%), Energy (+16.43%), and Consumer Discretionary (+15.73%) stocks were most distinguishable given their strength. Healthcare stocks were notable in that they lodged the worst performance during the quarter (+6.59%).
- High yield bonds rose 6.33% during the quarter. The U.S. corporate bond sector climbed 4.70% during the quarter). 10-Year U.S. Treasury yields fell from 2.69% at the beginning of the quarter to 2.41% currently.
- The U.S. dollar rose versus the Euro (+1.78%) and Yen (+0.88%) during the quarter. The U.S. dollar fell versus the British Pound during the quarter (-2.31%).

** Unless otherwise noted, performances stated above reflect data provided by Standard and Poor's, Russell Investments, MSCI, and Barclay's Capital.*
*** The MSCI EAFE Index is a large capitalization, developed market benchmark that tracks non-U.S. or foreign equity markets.*

Inside this issue

Market Review……………………………...1
Market Commentary……..……………..….2
The Fed's Contribution………………...…2
Making Volatility Work for You..……….....3
Our Favorite Scapegoat..………………....4
Closing Remarks………………………......4
Investment Strategy……………………….5
Biography………………………………….6
Code of Ethics and Privacy Policy……....7

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"cynical market observers might say the Fed has been a key contributor to market inefficiency over the past decade, if not since the 1977 inception of their dual mandate to promote price stability and low unemployment..."

Market Commentary

Investment markets globally experienced a strong snap-back rally in the first quarter of 2019. Market breadth, a term used to describe the scope of stock market gains was wide. In the U.S., the S&P 500, which was very close to succumbing to bear market status just before the Christmas break, rallied smartly to finish the quarter up 13.65% (to levels just shy of all-time highs as we write this newsletter; see chart below). The stocks of smaller companies, as represented by the Russell 2000 small cap stock index increased 14.58%. All economic sectors of the U.S. economy (as defined by the Global Industry Classification Standard) delivered positive returns. International markets (developed and emerging) also staged comebacks as both MSCI EAFE and MSCI Emerging Markets indices returned +10.13% and +9.95%, respectively (in U.S. dollar terms). Bond markets posted strong absolute performance (for bonds) as the Barclays Capital U.S. Aggregate Bond index increased 2.94%. High yield bonds which typically exhibit equity-like volatility increased 6.33%.

S&P 500 Trailing 1-Year Performance (through April 17, 2019)

Source: FactSet

The Fed's Contribution

We believe the Federal Reserve (the "Fed") contributed significantly to stock market volatility over the past six months. Indeed, cynical market observers might say the Fed has been a key contributor to stock market volatility over the past decade, if not since the 1977 inception of their dual mandate to promote price stability and low unemployment. Interest rates were raised four times last year under new Fed Chair Jerome Powell. The last two increases (September and December) came during a period of increasingly ambiguous economic data in the U.S., amidst several potentially contagious global disruptions (Brexit, China/U.S. tariff negotiations, slowing economic growth globally, etc.), and under the auspice of several more interest rate increases to come (many market observers had been expecting at least two more increases in 2019). Shortly into the New Year, the central bank reversed itself, this time, clearly telegraphing its intention to hold off on future interest rate increases (none are now expected in 2019).

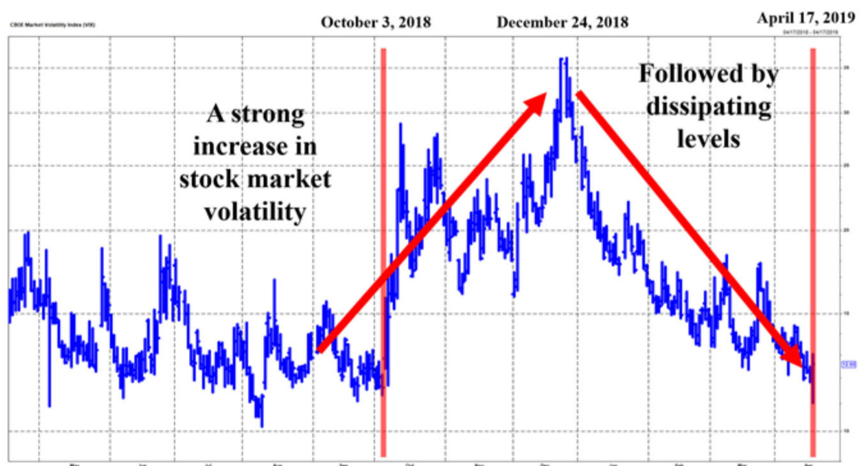
Company Description

Belleros Capital Management is an independently owned investment management and advisory firm serving investors who have a desire to embark on an investment strategy that will help them reach their long-term investment and retirement goals. The firm actively manages investment accounts on a fully discretionary basis for our clients. Our primary purpose is to help investors reach their financial goals through a plan to minimize the "all-in" investment-related fees they pay, increase the value-add they receive from their investments, and by working with them to develop a strong level of investment discipline that will help them maximize their wealth generation potential.

The Fed's Contribution (Cont.)

We consider this quick policy reversal the Fed's version of a mea culpa (admission of guilt). The Fed's last two interest rate increases and their abrupt about face in the first quarter coincide well with the recent spike in stock market volatility (as shown in the chart below; the Chicago Board Options Exchange's Volatility Index is a widely publicized index of stock market risk/ volatility).

CBOE VIX Trailing 1-Year Performance (through April 17, 2019)



Source: FactSet

Making Volatility Work for You

There are no promises or guarantees in stock market investing. But perhaps we can revise the notion to include one exception: ***stocks are inherently volatile***. This is why they offer better returns relative to cash and bonds. This concept is known in investment circles as an equity risk premium; the extra return investors demand to compensate them for the extra risk (relative to bonds) they are accepting by investing in stocks. Volatility is also a symptom of the market's inherent short-term inefficiency. And though volatility is always omnipresent in the stock market, it is not constant. As we've seen over the past six months, volatility can at times overwhelm. But this is okay, and volatility need not strike fear in the hearts of investors. Indeed, equity investors ***should*** expect volatility from stocks and by virtue of their investment, understand that they have implicitly accepted the risks. However, investors can better position themselves to deal with volatility by utilizing an investment management strategy that seeks to capitalize on the stock market's inefficiency and inherent volatility. Patient and disciplined investors with generally long-term time horizons can treat volatility as an opportunity to exploit stock market inefficiency. Imagine that: the same volatility that Wall Street has trained investors to fear can be a source of opportunity.

"In the short run, the market is a voting machine but in the long run, it is a weighing machine."
— Ben Graham

Investment Philosophy

Market Efficiency (or Inefficiency)

Equity or "stocks" are inherently volatile assets due to the sheer number of participants involved, the diversity of their motives, and the wide range of emotions they employ. Stocks are frequently prone to excessive volatility when emotions particularly run hot. We believe this excessive volatility is a sign of short-term stock market inefficiency. However, we believe the stock market is more efficient over the long-term as rational investment behavior reasserts itself. Similarly, excessive volatility causes the market prices of stocks to deviate from their intrinsic values. As time progresses, the market prices of stocks generally return to their intrinsic values. We believe that stock market inefficiency as represented by excess volatility is exploitable and represents an opportunity for profit. In our experience, excessive volatility can and does extend to all manner of companies and stocks. Even the best companies and their stock can be affected by stock market inefficiencies and come to exhibit excess volatility, creating exploitable investment opportunity for the astute investor.

"We steer clear of the foolhardy academic definition of risk and volatility, recognizing, instead, that volatility is a welcome creator of opportunity"
— Seth Klarman

Investment Philosophy

The Main Source of Risk to Long-term Investors

We believe that the investment industry's definition of risk as volatility is inappropriate and generally does not apply to all participants. Although the effects of volatility can be particularly disastrous to investors that have near-term income or liquidity requirements, long-term investors can and should be less constrained by it. As opposed to gambling or speculation, we believe that investing is by definition a long-term strategy. We believe that stock market volatility is a source of investment opportunity for long-term investors, especially when it is excessive. Investors with a strategy to benefit and exploit stock market inefficiencies and excessive volatility should therefore concern themselves with (and try to avoid) greater risks such as a permanent loss of capital, the risk of outliving one's wealth, or the failure to meet their long-term investment and retirement goals.

Our favorite Scapegoat

We make no secret of the fact that the Fed is one of our favorite punching bags. We genuinely believe that the Fed (and central banks generally) have been reliable sources of stock market volatility. But perhaps we should be more grateful to the Fed for the work that they do. It is after all, an enormous task to steer a $20 trillion economy. There is a lot of room for error. Mistakes will be made. And these mistakes can be amplified by another source of stock market inefficiency and volatility: market participants themselves who can overreact to Fed policy or even misinterpret their actions. We view volatility and short-term market inefficiency as a source of great opportunity. Having a steady supply of this precious commodity affords us the opportunity to add value on a continual basis. We should all be thankful to the Fed for that.

Closing Remarks

We'd like to thank everyone for their continued support. We know fear is a natural instinct for investors as they see stock prices collapse around them. However, this phenomenon is a normal part of the stock market cycle. We should be thankful for the opportunity presented when they do occur. That is because they don't occur too often and when they do, they don't last too long. We should also be thankful for the more typical, upward trajectory of the stock market and its longer-term efficiency (also a normal part of the stock market cycle). The best investors learn how to suppress their fears and invest wisely without emotions. This requires a lot of discipline. **Belleros Capital Management** can help in this regard. This is what we do on a daily basis. Please contact us with any questions you may have regarding this newsletter, our firm, or how we may be able to help you. We wish everyone a warm and wonderful Spring - especially after such a cold and volatile winter. Cheers!

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Investment Strategy

We seek to exploit stock market volatility in the short-term through a **long-term**, active investment management strategy that seeks to purchase higher **quality** stocks with sustainable competitive advantages and economic moats, and at prices below our calculation of intrinsic value (otherwise known as "**value** investing"). These characteristics help us defend against what we believe is the biggest risk in investing: a permanent loss of capital. In addition, we intend to show our discipline and conviction in our investments by employing a concentrated portfolio mandate that is differentiated and allows us to focus on only the best investment candidates available. Further, we seek to show our conviction through our portfolio weighting scheme which skews exposure to the best investment candidate.

- Active investment management
- Long-term investing
- Seek higher quality opportunities
- Value investing
- Avoid permanent losses of capital
- High conviction
- Invest with confidence
- Disciplined approach
- Volatility is an opportunity
- Concentrated stock portfolio
- Differentiated from the index

"Risk is not inherent in an investment; it is always relative to the price paid. Uncertainty is not the same as risk. Indeed, when great uncertainty – such as in the fall of 2008 – drives securities prices to especially low levels, they often become less risky investments." — Seth Klarman

"We don't have to be smarter than the rest. We have to be more disciplined than the rest." — Warren Buffett

"Wide diversification is only required when investors do not understand what they are doing."
— Warren Buffett

Investment Philosophy

Diversification (or Not)

We believe the idea of portfolio diversification is counter-intuitive and works against our active management goals. The idea of diversification is meant to limit the impact of stock market volatility. We believe stock market volatility represents an investment opportunity that is exploitable. Therefore, limiting the opportunities we seek to exploit would seem rather perverse. Diversification is a scale. Too little and you risk putting all your eggs in too few baskets; too much and your portfolio and expected return mimics the broader stock market (index). We believe excessive diversification (in addition to high investment-related fees) is a main contributor to poor active management performance relative to passive/index investing. We believe investors who seek excess returns above and beyond what one could expect to receive from the broader stock market should choose an investment manager that minimizes fees and concentrates their investment portfolio to ward off the indexing-like characteristic of diversification.

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Biography

Tim Hai, CFA®, CAIA®

Chief Investment Officer and Senior Portfolio Manager

- 22 years of experience in the investment industry
- 8 years of equity portfolio management experience
- 8 years exp. manager research and due diligence
- 6 years experience overseeing public equity and fixed-income assets for a $10 billion multi-employer pension plan
- 6 years experience overseeing a $1.2 billion program of investment managers utilizing a concentrated stock mandate
- Completed coursework in international investing and currency management with the Oxford International Investment Programme at the University of Oxford, United Kingdom, 2010
- M.B.A. - Loyola College of Maryland, 2000
- B.S. Finance – University of Maryland, College Park, 1996
- Achieved Chartered Financial Analyst designation in 2003
- Achieved Chartered Alternative Investment Analyst designation in 2011

Tim has 22 years of diversified investment experience that includes the research and direct investment management of stocks and bonds for high net worth and small business clients. Additionally, Tim has experience in manager research and due diligence, having helped oversee and manage a $10 billion institutional pension fund. Tim had direct oversight of the pension fund's equity and fixed-income investment portfolios that were managed by outside investment managers. Tim had specific oversight over the pension fund's $1.2 billion concentrated managers program that sought to extract value add from some of the country's best investment managers through a mandate that required high conviction and a limited number of stock positions.

Tim received his B.S. in Finance from the University of Maryland, College Park and his MBA from Loyola College of Maryland. More recently, he also completed coursework in international investing and currency management with the Oxford International Investment Programme at the Said Business School at the University of Oxford, United Kingdom. Tim holds the Chartered Financial Analyst ("CFA") and Chartered Alternative Investment Analyst ("CAIA") designations. He is a member of the CFA Institute and the CFA Society Washington, DC. He is also a member of the Washington, DC Chapter of the CAIA Association.

Code of Ethics and Privacy Policy

Belleros Capital Management is a fiduciary; we will act in the utmost good faith, performing in a manner believed to be in the best interest of our clients. We believe that our business methodologies, ethics rules, and adopted policies are designed to eliminate or at least minimize material conflicts of interest, and to appropriately manage any material conflicts of interest that may remain. It is important to point out that no set of rules can anticipate or relieve all material conflicts of interest. Our firm will disclose to its advisory clients any material conflict of interest relating to the firm, its representatives, or any of its employees which could reasonably be expected to impair the rendering of unbiased and objective advice.

Code of Ethics

We have adopted a Code of Ethics that establishes policies for ethical conduct for our personnel. Our firm accepts the obligation not only to comply with all applicable laws and regulations but also to act in an ethical and professionally responsible manner in all professional services and activities. Firm policies include prohibitions against insider trading, circulation of industry rumors, and certain political contributions, among others. We periodically review and amend our Code of Ethics to ensure that they remain current, and we require firm personnel to annually attest to their understanding of and adherence to the firm's Code of Ethics. A copy of the firm's Code of Ethics is made available to any client or prospective client upon request.

Privacy Policy Statement

We respect the privacy of all clients and prospective clients (collectively termed "customers" per federal guidelines), both past and present. It is recognized that clients have entrusted our firm with non-public personal information and it is important that both access persons and customers are aware of firm policy concerning what may be done with that information.

The firm collects personal information about customers from the following sources:

- Information provided to us to complete their plan or investment recommendation;
- Information provided via engagement agreements and other documents completed in connection with
- the opening and maintenance of an account;
- Information customers provide verbally; and
- Information received from service providers, such as custodians, about client transactions.

The firm does not disclose non-public personal information about our customers to anyone, except in the following circumstances:

- When required to provide services our customers have requested;
- When our customers have specifically authorized us to do so;
- When required during the course of a firm assessment (i.e., independent audit); or
- When permitted or required by law (i.e., periodic regulatory examination).

To ensure security and confidentiality, the firm maintains physical, electronic, and procedural safeguards to protect the privacy of customer information. Within the firm, access to customer information is restricted to personnel that need to know that information. All access persons and service providers understand that everything handled in firm offices is confidential and they are instructed not to discuss customer information with someone else that may request information about an account unless they are specifically authorized in writing by the customer to do so. This includes providing information about a family member's account.

The firm will provide customers with its privacy policy on an annual basis and at any time, in advance, if firm privacy policies are expected to change.