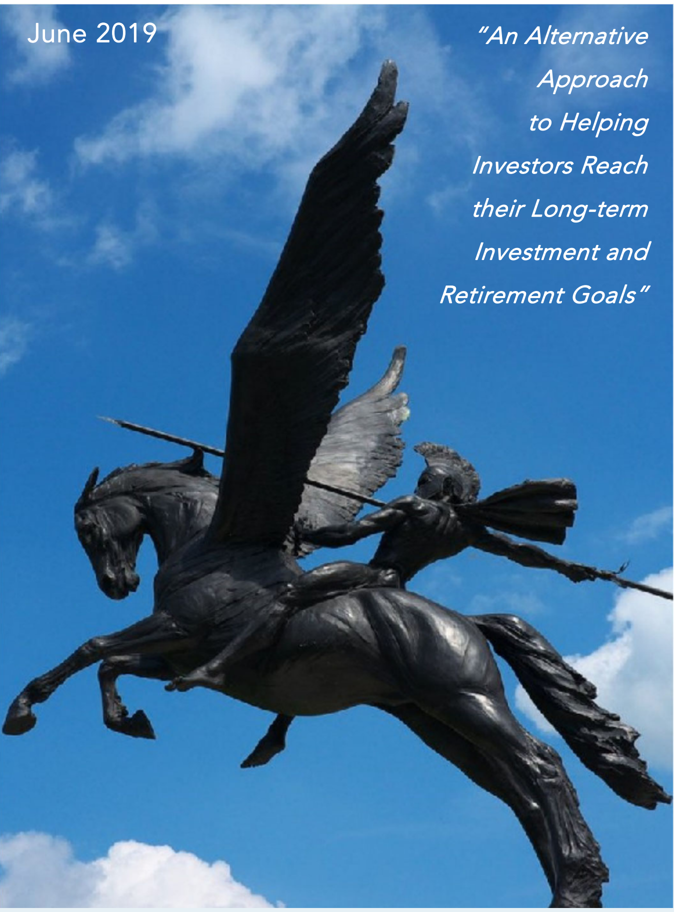

Belleros Capital Management

The Passionate Investor

2Q2019 Market Review and Commentary

Market Commentary

U.S. stocks ended the second quarter in explosive fashion, with the S&P 500 climbing 7.05% in the month June alone. However, the full quarter's more benign (+4.30%) performance masks the pronounced volatility experienced and poor performance in May (-6.35%). The volatility was caused in part by heightened risks for an all-out economic trade war between the United States and China (and to a lesser degree Mexico). Investors were cheered by early June when the Federal Reserve (the "Fed") acknowledged that it would intervene if necessary, to stabilize the U.S. economy. International stocks in developed market countries reacted similarly, climbing +3.97% in U.S. dollars. The stocks of smaller companies in the U.S., which are typically less affected by global trade, offered poorer (though still good) returns at +2.10%. Emerging market stocks (+0.74% in USD) experienced poor performance due in large part to continued weakness in China (-3.92% in USD). Bond markets as represented by the Barclays Capital U.S. Aggregate Bond Index (+3.08%) offered good safety to investors fearful of a global economic slowdown. The future health of the U.S. economy became more questionable as the U.S Treasury bond yield curve inverted for bonds with maturities between three months and ten years.[1]

Inside this issue

Tim Hai, CFA®, CAIA®
CIO and Sr. Portfolio Manager

[1] The yield curve is a graphical representation of maturities and interest rates offered on bond or fixed-income contracts. A normal yield curve is upward sloping with longer-term bonds offering higher yields. An "inverted" yield curve is downward sloping with short-term bonds offering higher yields. An "inverted" yield curve is believed by many capital market participants to be a sign of a looming recession. Please click HERE to read a previously issued article on yield curves.

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Market Review *

- Equity markets generally ***outperformed*** fixed-income markets with the S&P 500 rising 4.30% (including dividends; +18.54% YTD) and the Barclay's Capital U.S. Aggregate Bond index increasing +3.08% (+6.11% YTD).
- Small caps ***underperformed*** large cap stocks (S&P 500) as the Russell 2000 small cap stock index returned +2.10% (+16.98% YTD).
- Growth ***outperformed*** value during the quarter and YTD (as determined by the S&P 500).
- Non-U.S. equity markets generally ***underperformed*** U.S. markets in both US dollar and local currency terms (MSCI EAFE**: +3.97% in USD; +3.08% in local currency; +14.49% and +14.15% YTD, respectively).
- 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 0.74% in USD and +0.33% in local currency (+10.76% and +10.23% YTD, respectively).
- Russia (+17.28%; +31.63% YTD), Australia (+7.36%; +19.64% YTD), England (+7.31%; +18.89% YTD), Brazil (+7.21%; +16.02% YTD), and Canada (+5.11%; +21.50% YTD) were notable based on their strong performance during the quarter (all quoted in USD). China (-3.92%; +13.08% YTD) was notable based on its weakness during the quarter.
- Most U.S. market sectors were ***positive*** during the quarter. Financials (+8.00%; +17.24% YTD), Materials (+6.31%; +17.26% YTD), Information Technology (+6.06%; +27.13% YTD), and Consumer Discretionary (+5.28%; +21.84% YTD) stocks were most distinguishable given their strength. The Energy sector was notable given its weakness (-2.83%; +13.13% YTD).
- High yield bonds climbed 2.97% during the quarter (+9.49% YTD). The U.S. corporate bond sector rose 4.18% during the quarter (+9.08% YTD). 10-Year U.S. Treasury yields fell from 2.41% at the beginning of the quarter to 2.00% currently (2.69% at the beginning of the year).
- The U.S. dollar rose versus the British Pound during the quarter and full year period (+2.33%; +0.07% YTD). The Yen climbed versus the U.S. dollar during the quarter and year (+2.66%; +1.80% YTD). The Euro rose versus the U.S. dollar during the quarter but fell relative to the U.S. dollar year-to-date (+1.42%; -0.38% YTD)

* *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.*

"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

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.

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

Investment Philosophy

Market 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.

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A Microcosm of the Prior Year

Recall the year leading up to last quarter when U.S. stocks (see chart below) climbed strongly towards what was hoped to have been its tenth straight year of gains. The ascent would eventually fall short of that mark, interrupted by a near bear-market collapse at year-end.[2] Then, stocks were once again lifted by encouraging news that the Fed would holdoff from future interest hikes; offering stocks respite and lifting them towards a strong rebound in the first quarter of this year.

S&P 500 April 2018 Through March 2019 Performance

Source: FactSet

2Q2019 (see chart below) offered a very similar yet truncated feel relative to the twelve months preceding March 31, 2019. A strong April followed a strong first quarter. Similarly, mid-quarter panic sent many investors rushing for the exits. The stock market would eventually turn positive once again following words of assurance by the Fed late in the quarter. The rebound would leave most major stock market indices in the U.S. back near all-time highs by quarter end.

[2] *While the S&P 500 came close to falling into bear market status, it **did not** actually cross the -20% level that many investors define as a "bear market"; broader market indices such as the Wilshire 5000 actually **did** cross over that line.*

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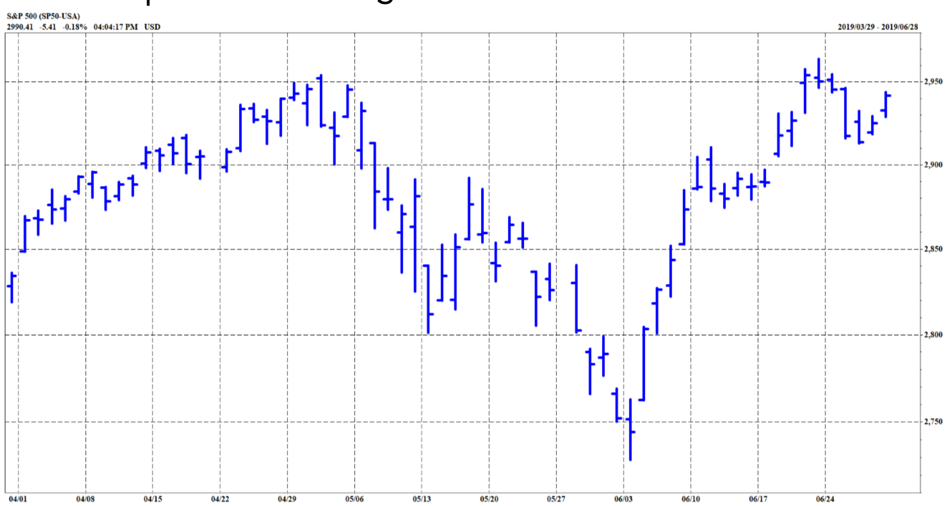
Investing involves risk including the potential loss of principle. No investment strategy can guarantee a profit or protection against loss in periods of declining value. Past performance does not guarantee future results. Opinions expressed are subject to change without notice and are not intended as investment advice or to predict future performance.

A Microcosm of the Prior Year (Cont.)

S&P 500 April 2019 Through June 2019 Performance



Source: FactSet

Redefining Investment Risk

Belleros Capital Management exploits short-term stock market inefficiency by first redefining investment ***risk***. Unlike many of our peers, we eschew the idea that volatility is risk or the main risk we (as long-term investors) should concern ourselves with. We believe that volatility (especially when in an excessive state) is a symptom of the market inefficiency that we are looking to exploit. As such, volatility should be thought of as opportunity. We believe risk is better defined as a ***permanent loss of capital***, or the chance that investors ***actually*** lose money. For us, ***investing*** is not gambling or a get rich quick scheme. We believe that the stock market is inefficient in the short-term, but more efficient over the long-term. Thus, we attempt to exploit ***short-term stock market inefficiency*** with the understanding that stocks will normalize (i.e. become more efficient) over the long-term.

"Owners of stocks, however, too often let the capricious and often irrational behavior of their fellow owners cause them to behave irrationally as well. Because there is so much chatter about markets, the economy, interest rates, price behavior of stocks, etc., some investors believe it is important to listen to pundits – and, worse yet, important to consider acting upon their comments." – Warren Buffett

"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

Belleros Capital Management believes 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.

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

Investment Philosophy

<u>Diversification</u>

Belleros Capital Management believes that 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 of the indexing-like characteristic of diversification.

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Volatility and the Human Factor

While volatility is inherent to stock market investing, even periods of excess volatility (like the kind we experienced last quarter and over the past year) occur with greater frequency than most people realize. Beyond supply and demand factors, we believe the human factor is a big reason for this. Stock market participants are a diverse lot and they do not necessarily play by the same set of rules. They each have their own goals and agenda and can even interpret the same piece of news quite differently. Most importantly, as humans, we are all prone to emotions. Emotions factor into many of the decisions we make. This is not necessarily a good or bad thing. But emotions can also lead to irrational and impulsive behavior. Even worse, allowing investment decisions to be influenced by emotions can be disastrous and may lead to a ***permanent loss of capital***. We do not allow emotions to influence our investment-related decisions.

Avoiding a Permanent Loss of Capital

To further avoid a permanent loss of capital, we limit our investment universe to the stocks of companies that we consider to be good or great; we do not buy junk. These quality investments are defined by fiscal conservatism (i.e. good balance sheets) and/or strong competitive advantages that allow them to be "going concerns" (i.e. likely to remain in business for the foreseeable future). In our experience, even the stocks of some of the best companies are susceptible to market inefficiency in the short-term. We buy these stocks when their prices fall below our estimation of their worth. And we try to give ourselves ample room for error (i.e. a margin of safety) just in case the stock becomes more inefficiently priced than expected. We invest for the long-term as the normalization process may take several years. We believe this strategy is the best path forward for most investors seeking to ***maximize their wealth generation potential*** over the long-term.

Closing Remarks

We'd like to thank everyone for their support over the past year. It's hard for us to believe that a year has passed since we first committed ourselves to ***Belleros Capital Management***. We'd also like to thank all of our friends and family who have helped along the way. We have a special thank you for our clients who have entrusted us to help them with their future. We understand this awesome responsibility and will always strive to work in your best interests. We hope everyone has a great remainder to their Summer. Stay cool.

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Capital Management

Investment Strategy

We seek to exploit stock market volatility in the short-term through a **long-term**, active investment management strategy that purchases 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

Biography

Tim Hai, CFA®, CAIA®

Chief Investment Officer and Senior Portfolio Manager

- 22 years of experience in the investment industry
- 6 years experience overseeing public equity and fixed-income assets for a $10 billion multi-employer pension plan
- 8 years of equity portfolio management experience
- 8 years exp. manager research and due diligence
- M.B.A. - Loyola College of Maryland, 2000
- B.S. Finance – University of Maryland, College Park, 1996

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.

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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.