Belleros
Capital Management

The Passionate Investor

4Q2019 Market Review and Commentary

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

Inside this issue

Market Review……...……………………1
Market Commentary……...…………..….2
Time in the Market……………….………3
A Victim of Their Own……..…………4-5
A Quick Response……………………..5-6
Closing Remarks…………………………6
Investment Strategy and Biography……7
Code of Ethics and Privacy Policy………8

December 2019

"An Alternative Approach to Helping Investors Reach their Long-term Investment and Retirement Goals"

Market Review *

- Equity markets generally ***outperformed*** fixed-income markets with the S&P 500 rising 9.07% (including dividends; +31.49% YTD) against the Barclay's Capital U.S. Aggregate Bond index's 0.18% (+8.72% YTD) gain.
- Small caps ***outperformed*** large cap stocks (the S&P 500) as the Russell 2000 small cap stock index returned +9.94% (+25.52% YTD).
- Growth ***outperformed*** value during the quarter but ***underperformed*** over the YTD period (as determined by the S&P 1500 broad market index which includes large, mid, and small capitalization stocks).
- Non-U.S. equity markets (MSCI EAFE**) generally ***underperformed*** U.S. markets in both US dollar (+8.21%; +22.66% YTD) and in local currency terms (+5.23%; +22.31% YTD).
- Emerging markets ***outperformed*** both U.S. and non-U.S. developed markets (MSCI EAFE**) in USD. The MSCI Emerging Markets Index rose 11.93% during the quarter (+18.88% YTD).
- Russia (+17.09%; +52.72% YTD), China (+14.72%; +23.66% YTD), and Brazil (+14.36%; +26.66% YTD) were notable based on their strong performance during the quarter (all quoted in USD). Australia (+4.36%; +23.15% YTD), Canada (+5.08%; +28.50% YTD), and India (+5.32%; +7.58% YTD) were notable based on their relative weakness during the quarter.
- All U.S. economic sectors were ***positive*** during the quarter. Information Technology (+14.40%; +50.29% YTD), Health Care (+14.37%; +20.82% YTD), and Financials (+10.47%; +32.13% YTD) stocks were most distinguishable given their strength. The Utilities sector was notable for its weakness during the quarter (+0.75%; +26.35% YTD).
- High yield bonds rose 3.50% during the quarter (+12.56% YTD). The U.S. corporate bond sector climbed 0.81% during the quarter (+13.18% YTD). 10-Year U.S. Treasury yields rose from 1.68% at the beginning of the quarter to 1.91% currently (+2.69% at the beginning of the year).
- The U.S. dollar fell versus the British Pound (-7.50%; -4.02% YTD) during the quarter and full year period but had more mixed results versus the Euro (-2.96%; +1.81% YTD) and the Yen (+0.56%; -0.95% YTD), over the same timeframe.

** 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 international equity markets.*

Belleros
Capital Management

"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.

Market Commentary

U.S. stock markets ended the year in high fashion as domestic economic conditions showed signs of thawing. Additionally, several macro-economic factors that were only recently problems, turned positive: interest rate policy in the U.S. has loosened; public support in the United Kingdom (the "U.K.") for Brexit has been reaffirmed, and relations have warmed in a multi-year trade dispute between the U.S. and China. Together, these events helped to produce a risk-on environment that lured many sidelined investors out of cash and bonds (+0.18%; +8.72% YTD).

Most U.S. stock market proxies shrugged off the volatility experienced through the first three quarters of the year; closing at or near all-time highs. The S&P 500 had substantial gains during the quarter (+9.07%) and year (+31.49%). Small cap stocks also rebounded from their lows to end the year in strong fashion (+9.94; +25.52% YTD). International stocks (in USD) from both developed (+8.21%; 22.66% YTD) and emerging markets (+11.93%; 18.88% YTD) largely rode the coattails of positive events in the U.S. and U.K.

S&P 500 2019 Performance

Source: FactSet

Investment advisory services are offered through Dover Road, LLC; a Maryland registered investment advisor doing business as Belleros Capital Management. This document is not to be directly or indirectly interpreted as a solicitation of investment advisory services to residents of another jurisdiction unless the firm and the provider of this document is registered and/or licensed in that jurisdiction, or as otherwise permitted by statute.

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.

Belleros
Capital Management

Time in the Market (Not Market Timing)

Many bearish investors remain unconvinced by the stock market's recent bout of enthusiasm, despite the positive changes in outlook on several fronts (see above). Indeed, they have moved on from using those factors as their "cause célèbre", and now just fret about market valuations being too high or cling to their continued belief in a looming recession (despite little evidence for one). Many of these prognosticators have lost considerably if they avoided market exposure this year (at least in terms of opportunity cost).

We at Belleros Capital Management ("BCM") are sympathetic to these observers because to some degree, we share or at least understand their concerns. We would however approach things quite differently. If you have been reading our blog or newsletters over the past year (can you believe it's been this long?), you will know that we sternly argue against market-timing. We believe the odds of a successful market timing scheme are quite low and that the potential losses, real or otherwise, are too high (please click here to read our full argument against market timing). We believe a better strategy involves "time in the market" or maintaining market exposure on a consistent basis regardless of the volatility. We then let our investment philosophy and strategy guide the way (highlighted in the adjoining blue panels and on page seven of this report). We are confident in our long-term investment approach that seeks out the stocks of good or high-quality companies that sell at attractive prices below our calculation of their intrinsic value.

Importantly, we always maintain our market exposure. There may be occasions where cash levels in our portfolios are elevated because of our sell discipline and valuation guidelines, but this is transitory in nature and not tactical (or speculative). We do not make buy or sell decisions in anticipation of what we believe might or might not happen (in the market). The expected return for stocks ***is*** superior relative to most other investments ***over the long-term***. But only if you are invested and stay so consistently for the duration of your investment time horizon. The market generally does not reward investors to sit in cash and/or bonds.

"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.

Belleros
Capital Management

A Victim of Their Own Success

Much has been made recently of Berkshire Hathaway's (Class A shares) failure to outperform the S&P 500 over the past decade. In fact, the insurance company that has become a proxy of famed investor Warren Buffett's investment prowess, has failed to outperform the S&P 500 benchmark over the trailing 1-, 3-, 5-, and 7-year periods as well (see below). Mr. Buffett's defenders suggest that the stock market's strength over the past decade have stretched valuations, making it nearly impossible for the famed investor to put his cash hoard to work ($120 billion and counting). Further, they argue that a source of the Oracle's greatness rests in his discipline and patience; he allows the stock market to come to him. But this perhaps is only part of the reason for the stock's poor relative performance (in our humble opinion). The stock market has been on a decade long tear and valuations do seem stretched generally. But there are and have been pockets of value in stocks for those who are interested and ***can*** invest in them.

Comparative Performance Between BRK.A and the S&P 500

	Period				
	1-Year	3-Year	5-Year	7-Year	10-Year
S&P 500 *	31.49%	53.17%	73.86%	161.68%	256.66%
Berkshire Hathaway Cl. A	10.98%	39.11%	50.26%	153.31%	242.33%

* Including dividends

Source: FactSet

We do not doubt Mr. Buffett's genius or the durability of his investment philosophy. But, Perhaps the ***bigger*** problem (pun intended) is not that all stocks are too expensive, but rather Berkshire Hathaway has become too big to take advantage of undervalued opportunities in small caps or otherwise. At a $550 billion market cap, Berkshire Hathaway has become one of the largest companies in the world. A company this big must make big-sized investments consistently to be able to sustain its growth and historic level of performance. The stock market's most recent

"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.

Belleros
Capital Management

A Victim of Their Own Success (Cont.)

"correction" (defined as a price decline of at least 10% from peak to trough) in late 2018 illustrates this. The S&P 500 corrected -19.4% while most other broad market indices (the S&P 500 index only includes the largest capitalization companies) that include smaller companies did in fact fall into bear market territory (defined as a price decline of at least 20% from peak to trough). Smaller-capitalization and likewise foreign stocks were big losers during this period and would have been opportunities to other, more nimble investors. Some fans suggest that all Mr. Buffett needs is a 40% or 50% stock market calamity for him to take advantage of (me and everyone else as well). But if you know your market history, these melt downs don't come around too often; it could be a *long* wait.

We do not fault Mr. Buffett for becoming a victim of his own success. But this does suggest that market beating performance is becoming harder to come by for the world's most famous investor (Mr. Buffett, to his credit, admits as much and has often recommended other investors utilize a passive S&P 500 vehicle). Obviously, we don't believe Mr. Buffett's problem is necessarily our own. ***The moral of the story*** is that investors should not always assume that the investment manager with the most assets under management is the best for them. Also, past is not necessarily prologue in investing and investors should not weigh too heavily an investment manager's past investment success. Most mutual fund companies come to mind on both counts.

A Quick Response

CNBC News anchor Becky Quick recently revealed that her investment portfolio is invested almost entirely in stocks (Click HERE for the link). She was quoted as saying "You're never going to make enough money if you have 40% of your money in bonds". We don't typically watch CNBC or listen to promoters of such market noise. We would in this case agree with her point that the typical investors' portfolio should feature stocks. However, our reason is less tactical but more pragmatic. The basis for her decision relates to the current level of interest rates which are historically low. Bond prices are inversely correlated to interest rates and the current low level of interest rates suggest they may experience a period of prolonged underperformance (relative to stocks) if interest rates should normalize upwards.

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

Investment Philosophy

Diversification

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.

"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

Please contact us for a complimentary review of your investment advisory fees, your current investment portfolio, and to discover how we can help you maximize your wealth generation potential.

A Quick Response (Cont.)

BCM believes that most investors are under-allocated towards growth assets and stocks in particular. This is because most investors underestimate their life expectancy and financial needs in retirement. Consider that the average life expectancy of an American citizen is 78 (this figure has only recently tapered off due to rising suicide levels and the opioid crises). By definition, half of us will live longer than that. And, although we are living longer, we won't necessarily remain in the best of health. Chances are very high that many of us will experience greater costs for healthcare or will require extended care or assisted living at some point in our life (or will have a family member that requires it).

We suspect a good many of American households, including those who count themselves among the affluent and high net worth crowd will be at risk of outliving their wealth. For this reason, we ***generally*** believe that most investors should invest the majority (if not all) of their investment portfolio in stocks (there are other factors and considerations, but we believe most people fall into this category). We believe the risk of outliving one's wealth to be the greatest financial risk faced by most Americans. Maximizing one's wealth generation potential by properly aligning your investment portfolio's growth with your long-term time horizon is incredibly important.

Closing Remarks

Although the past year's stock market experience has been anything but smooth, it has been rewarding; especially after such a hard end to 2018 (the same can be said of the past decade). BCM ends the year and decade with its first full calendar year in existence. And what a strong first year it has been, having grown from virtually zero assets under management to roughly $20 million. We'd like to thank everyone who has helped out along the way. We hope to return the favor. Best wishes to everyone in this new year and new decade. Cheers!

Belleros
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.

Belleros
Capital Management

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.