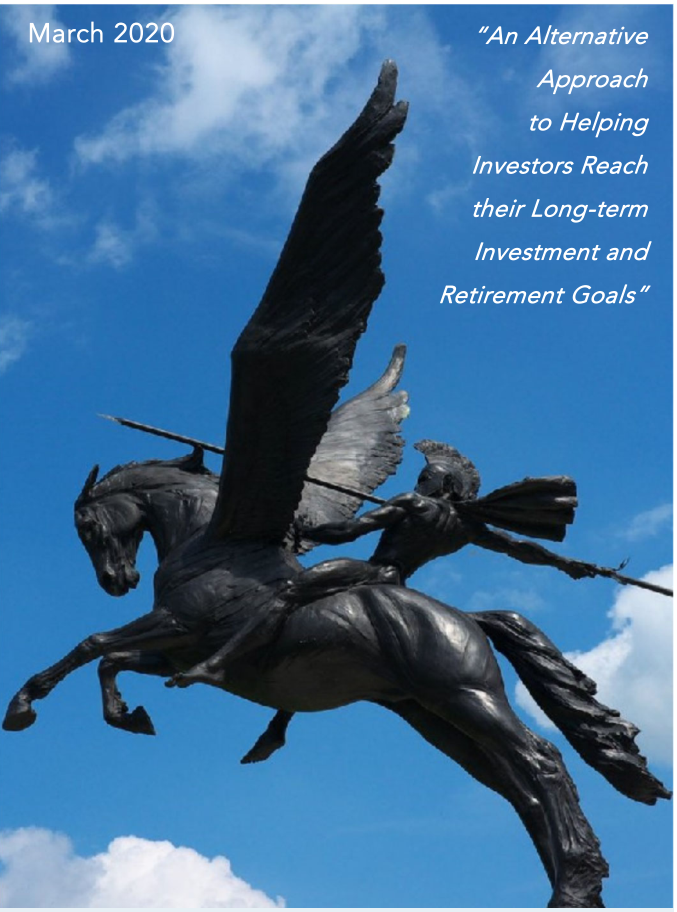

March 2020

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

Belleros Capital Management

# The Passionate Investor

## 1Q2020 Market Review and Commentary

### *A Moment of Reflection*

Before we delve into this quarter's newsletter, we'd like to send prayers and best wishes to everyone trying to survive the coronavirus. We know that many of us are pre-occupied by much more important things as we get better ourselves, care for a sick relative or friend, or grieve for a loved one who's passed on. This is and has been a very difficult period to live through despite our varying degrees of impact. Many of us are acutely feeling the economic fallout from the virus if we have been laid-off or furloughed from work. Those of us in the small business community have been severely impacted and are trying to salvage our lives and dreams. Still, even more of us are affected by social distancing measures that may have us working from home whilst also taking care of our young ones who are home from school.

Unfortunately, at this time, we cannot offer much more than our words of hope. We hope that this period of human tragedy will pass and that we will come out stronger and more united as a community. Despite the lack of clarity towards the future, we are still optimistic that the impact is generally small and short-lived. We don't mean to minimize the severity of the virus' level of impact on society already and we certainly understand that for too many of us the ultimate price has been huge and has already been paid. Nothing we say can change that. But we are hopeful that the time is near when we can close the book on this dark chapter – at least with regards to the human impact (the economic impact may be with us a good deal longer). Our thoughts and prayers are with you all.

Inside this issue




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

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# Market Review *

- Equity markets generally underperformed fixed-income markets with the S&P 500 falling 19.72% (including dividends) against the Barclay's Capital U.S. Aggregate Bond index's 3.15% gain.
- Small caps underperformed large cap stocks (the S&P 500) as the Russell 2000 small cap stock index declined 30.61% (price returns hereafter).
- Growth outperformed 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 (MSCI EAFE**) generally under-performed U.S. markets in both US dollar (-22.72%) and in local currency terms (-20.43%).
- Emerging markets underperformed both U.S. and non-U.S. developed markets (MSCI EAFE**) in USD. The MSCI Emerging Markets Index declined 23.57% during the quarter.
- Most international markets were negative during the quarter. China (-10.22%), and Japan (-16.63%) were notable based on their better relative performance during the quarter (all quoted in USD). Brazil (-50.20%), Russia (-36.34%), and Australia (-33.23%) were notable based on their relative weakness during the quarter.
- All U.S. economic sectors were negative during the quarter. Information Technology (-11.93%), Health Care (-12.67%), and Consumer Staples (-12.74%) stocks were most distinguishable given their relative strength. The Energy sector was notable for its weakness during the quarter (-50.45%).
- Both high yield and U.S. corporate bonds fell during the quarter (-15.02% and -0.67%, respectively). 10-Year U.S. Treasury yields fell from 1.91% at the beginning of the quarter/year to 0.70% currently.
- The U.S. dollar strengthened relative to the British Pound (+6.40%) and the Euro (+2.25%) during the quarter; it weakened relative to the Japanese Yen (-0.66%) over the same period.

* *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.



## Market Commentary

The first quarter of the year provided stark contrast to last year's fourth quarter. The coronavirus and COVID-19 disease caused by it, spread fear and panic in people and stock market alike. Stocks sold off globally as investors projected their worst fears in terms of human impact and recessionary potential. Recall that only several months ago (it understandably seems like a distant memory at this point), U.S. stock markets were celebrating all-time highs based on the widespread belief that several macro-economic factors that had dominated the news cycle last year (better economic data and a stabilized interest rate policy in the U.S.; a resolution to the Brexit question in the United Kingdom; and warming relations between the U.S. and China after years of trade dispute), had finally found desirable conclusions. The global pandemic has had a sobering effect on investor optimism - the level of which has not been felt since the Great Recession of 2008/2009 (a recurring theme below).

The S&P 500 fell 19.72% and the MSCI EAFE trailed with a 20.43% loss in local currency. The S&P 500 achieved bear market status during the quarter, falling nearly 35% (intraday) at its trough (the MSCI EAFE has been in a bear market since 2018). Of particular note, the S&P 500 ended its longest bull market of all-time (an eleven-year wonder that began in early 2009). Investors rushed into safe haven assets such as bonds (the Barclay's Capital U.S. Aggregate Bond index climbed 3.15%) and cash. High yield bonds, which are very stock-like in terms of their risk/reward profile, fell 15.02%. Even municipal bonds were stressed (-0.63%) as investors sold off typically safe paper in search of liquidity or based on the economic outlook or credit capacity of the issuer. Most other investment assets fared worse as they succumbed to a heightened level of volatility. Small cap stocks fell 30.61% to their lowest levels in four years. Small cap value stocks, which have historically out-performed most other asset classes and sectors (as measured by the Russell 2000 Value index) fell a humbling 35.66%. Emerging market stocks by comparison fell a more encouraging 23.57% (in USD). Energy stocks were down significantly (-50.45%) based on the fear of a pandemic-driven economic slowdown globally and exacerbated by a Saudi Arabian/Russian oil-price tussle.

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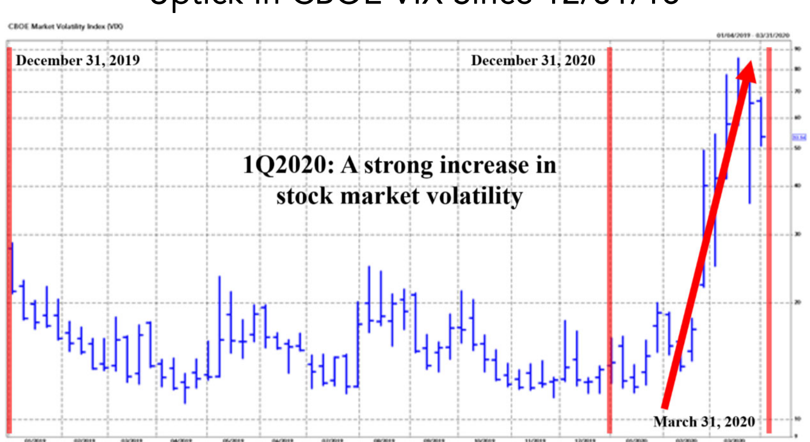
S&P 500 Performance Since 12/31/18


*Source: FactSet*

## Increased Volatility by Any Measure

To say that the quarter experienced an uptick in volatility is an understatement. In recent years, the Chicago Board Options Exchange's Volatility Index (the "VIX") has been used to gauge stock market volatility. Below is a chart showing the VIX's performance through the past five quarters (since January 2019). It is followed by a longer-term chart that shows VIX performance since the Great Recession in 2008/2009. Both charts show a sharp increase in stock market volatility but the second, longer-dated chart puts the recent bout of volatility into perspective: it shows that stock market volatility has increased to Great Recession levels.

Uptick In CBOE VIX Since 12/31/18




*Source: FactSet*

*"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

**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.

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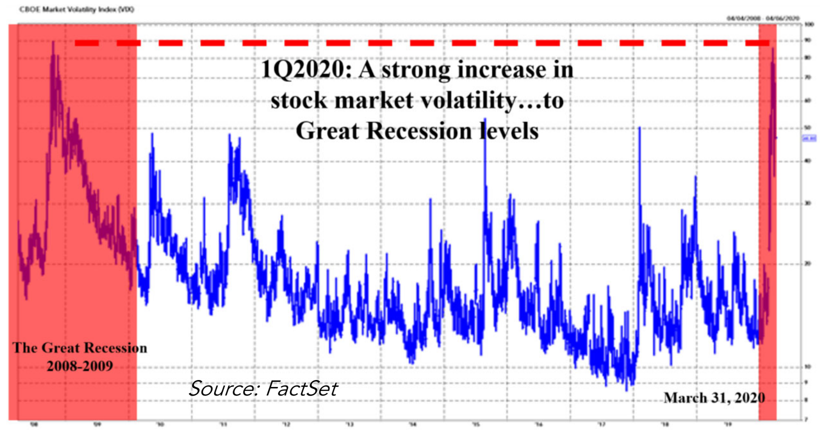
### The CBOE VIX Reaches Great Recession Levels




## Increased Volatility by Any Measure (Cont.)

Investors that lived through the Great Recession probably don't need the chart above to remind them of 2008/2009. Below is a chart we created detailing the number of days (annually) since 2008 that the S&P 500 changed at least 3% in either direction (during a single trading session). For example, in 2008 (during the Great Recession), the S&P 500 recorded 45 days of +/- 3% gains or losses (or more); most of which were clustered during the final months of the year. In 2009, the S&P 500 recorded 23 days with at least a 3% change – all of which occurred in the first half of the year when the stock market hit its trough. The decade since 2008/2009 has been relatively quiet with a few moments of heightened volatility scattered here and there. There were zero days of +/- 3% gains or losses (or more) between 2012 through 2014. In fact, there were only 12 such days between 2012 and 2019. 2020 has thus far seen a large uptick in volatility not seen since the Great Recession. The first quarter of this year has already seen 20 days of S&P 500 gains or losses of at least 3%; mostly over the last five-weeks of the quarter. Importantly, we must remind ourselves that the year has not ended and there are still three more quarters to go.

**Days with +/-3% Gains or Losses on the S&P 500**

| Year | # | Notes: |
|---|---|---|
| 2008 | 45 | The Great Recession |
| 2009 | 23 | Recovery from the Great Recession |
| 2010 | 10 | Flash crash and first Greek bailout |
| 2011 | 13 | More Greek turmoil |
| 2012 | 0 | |
| 2013 | 0 | |
| 2014 | 0 | |
| 2015 | 4 | China slowdown worries; anticipating changes in Fed interest rate policy |
| 2016 | 1 | Brexit vote |
| 2017 | 0 | |
| 2018 | 4 | Fed mea culpa |
| 2019 | 3 | Fed mea culpa |
| 2020* | 20 | Coronavirus |

* Through 1Q2020 *Source: Yahoo Finance*

## How We Approach the Heightened Level of Volatility

Our readers should by now understand that Belleros Capital Management does not believe in market timing. The market timing concept relies on speculation in an attempt to avoid losses when the stock market falls and participate in gains when a rebound occurs. We do not believe market timing is successful over the long-term because of the guess work and real costs and risks involved (please click HERE for a longer discussion on this topic). We are also not content to ride out periods of excess volatility like passive or buy/hold investors. We believe the stock market is inherently volatile, allowing investors the potential to earn better returns than investments in bonds or cash equivalents. However, stocks are especially inefficient in the short-term and are prone to periods of excessive volatility that force stock prices to severely deviate from their intrinsic values. Conversely, we believe the stock market is more efficient over the long-term. As it normalizes, stocks prices will generally approach their intrinsic values much like a bond reaches par value at maturity. We believe periods of excessive volatility like the one we've recently experienced, is evidence of short-term stock market inefficiency. This inefficiency represents an investment opportunity to those who would accept it.

## No Magic Bullet

Our strategy is no secret and we do not guarantee success in either avoiding a bear market crash or outperforming in a rebound (please read the adjoining columns in this newsletter or click HERE to better understand our strategy). It is not a get rich quick scheme but instead aims to add incremental value over a long period of time. Our response to the current stock market challenge is but a small portion of the value we believe we can add over that timeframe. We do this by remaining calm while the stock market seemingly implodes around us. Investment decisions we make are made without emotion and fear. We do not employ market timing schemes to avoid a sell-off for the reasons mentioned above. We understand that attractive stock market or equity returns only accrue to investors who stay invested in the market through both the good times and the bad. We do however attempt to minimize permanent losses of capital and make investment decisions we believe will help our portfolios climb back from the depths more quickly. That is, we distinguish

*"Periods of excessive volatility like the one we've recently experienced, is evidence of short-term stock market inefficiency. This inefficiency represents an investment opportunity to those who would accept it."*

*"Our strategy is no secret and we do not guarantee success in either avoiding a bear market crash or outperforming in a rebound...It is not a get rich quick scheme but instead aims to add incremental value over a long period of time."*

*"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](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.*

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## No Magic Bullet (Cont.)

between unrealized gains and losses (which are only recorded on paper) and realized ones that may lead to a permanent loss of capital if a sell trade has been executed below its cost basis. Thus, we attempt to avoid or minimize permanent losses of capital that can really damage your long-term investment goals. Again, no promises are made. However, we are confident in our long-term investment strategy and stay true to it. We believe that if we follow and execute on our strategy, we can get back to pre-crises levels sooner, and potentially outperform over the longer-term as our stocks get back to their intrinsic values.

## Closing Remarks

This has been a very difficult period for investor and citizen alike. But there are reasons to be hopeful in both human and economic terms. Even now, there are signs that we are nearing the peak of the coronavirus' human impact. Several developed countries have also reported improving health data and some have hinted towards a re-opening of their economies. And, there is always hope that the warming weather and approach of spring will suppress the spread of the contagion. We should also be optimistic regarding a potential vaccine. But it is better to hope for the best, and plan for the worst. We must remain vigilant. We must continue to take at least the simplest precautions to protect ourselves and our loved ones. Now is not the time to be foolish or cavalier. This should be balanced with sensible measures to avoid economic collapse – if prudent. That is the tightrope we are currently walking along. It's okay to be concerned but do not panic. And never, under any circumstances make decisions, investment or otherwise, under the influence of emotions. We are confident that we will make it through and be stronger and better people for it. We wish everyone the best during this strange time. Take care and be safe.

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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 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

- 24 years of experience in the investment industry
- 10 years of equity portfolio management experience
- 6 years experience overseeing public equity and fixed-income assets for a $10 billion multi-employer pension plan
- 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 24 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.