Belleros Capital Management

The Passionate Investor

3Q2020 Market Review and Commentary

October 2020

"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 8.93% (including dividends; -5.57% YTD) and the Barclay's Capital U.S. Aggregate Bond index increasing 0.62% (+6.79% YTD).
- Small caps underperformed large cap stocks (S&P 500) as the Russell 2000 small cap stock index returned +4.93% (-8.69% YTD).
- Value outperformed growth 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 underperformed U.S. markets in both U.S. dollar (MSCI EAFE**: +4.88% and -6.73% YTD) and local currency terms (+1.30% and -9.08% YTD, respectively).
- The MSCI Emerging Markets Index outperformed non-U.S. developed (international) markets. The index slightly underperformed U.S. stocks in local currency (8.79% and 2.93% YTD) but outperformed in USD (9.70% and -0.91% YTD).
- Most U.S. market sectors were positive. Consumer Discretionary (+15.06%; +23.38% YTD), Materials (+13.31%; +5.47% YTD), Industrial (+12.48%; -3.99% YTD), and Information Technology (+11.95%; +28.69% YTD) stocks were most distinguishable given their strength. The Energy sector was notable given its weakness (-19.72%; -48.09% YTD).
- High yield bonds climbed 4.28% (-0.58% YTD). The U.S. corporate bond sector rose 1.13% (+7.67% YTD). 10-Year U.S. Treasury yields experienced
- a slight increase from 0.65% at the beginning of the quarter to 0.66% currently (2.69% at the beginning of the year).
- The U.S. dollar fell versus the British Pound (-4.63%; +2.41% YTD), the Euro (-4.41%; -4.47% YTD), and Yen (-2.18%; -2.89% 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 international equity markets.*

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

"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.

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Market Commentary

U.S. stocks rose 8.93% (the S&P 500), ending the quarter at essentially its pre-coronavirus level and with potentially its fastest recovery ever (+5.57% YTD). Indeed, that marker was breached earlier in September (see chart below) and the index remains within shouting distance of the all-time high. Still, the quarter was characterized by excessive volatility as investors contended with a second wave of COVID-19 cases, conflicting and moderating U.S. economic data, a lack of consensus as to a vaccine arrival date, failure by Congress to secure a second round of economic stimulus, and general uncertainty regarding the U.S. Presidential election in November. The U.S. Federal Reserve continued to be accommodative, even signaling that the current low interest rate regime may remain in place through 2024. Benchmark 10-Year U.S. Treasury bond yields remained flat and near their lowest level ever. Home prices, demand for homes generally, and mortgage refinancing activity have soared even as savers and fixed-income investors have struggled to earn good yields on everything from savings accounts to long-term bonds.

Small cap and international (non-U.S. developed market) stocks came off their lofty second quarter performance trajectory, climbing a more subdued 4.93% and 4.88% (in USD; respectively). Emerging market stocks kept pace with U.S. large caps, rising 8.79% in local currency and 9.70% in U.S. dollar terms. The U.S. Consumer Discretionary sector continued its strong ascent from the first quarter with a sector-leading +15.06% second quarter climb. The Energy sector was also quick to give up on its second quarter gains, falling 19.72% as global demand for energy fell due to viral concerns and ensuing slower economic activity. Bonds offered a mixed bag as the Barclay's Capital U.S. Aggregate Bond index increased 0.62% and credit sensitive sectors like high yield bonds climbed 4.28%. The U.S. dollar fell relative to most other currencies.

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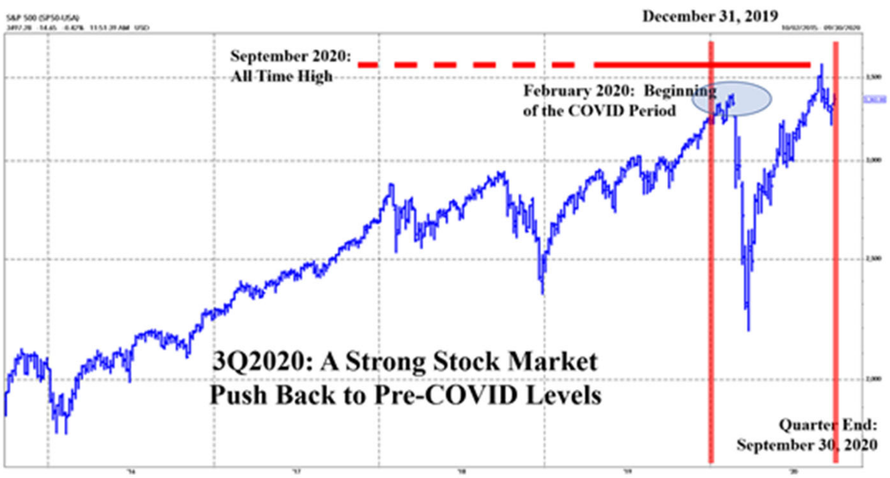
S&P 500 Trailing 5-Year Performance



Source: FactSet

Excessive Volatility in Our Future?

There has been a lot of chatter recently suggesting the potential for an excessively volatile stock market over the next several months. Many market pundits and prognosticators believe current market levels which are near all-time-highs, represent unwarranted optimism for an economy that is still struggling with the coronavirus pandemic. They believe that the current stock market level is unhinged from the reality of underlying corporate and economic fundamentals, possibly subjecting stocks to a near-term future of excessive volatility and poor returns. Chief among the supposed threats to the stock market include continued poor economic data as corporations and individuals struggle regardless of a Stimulus 2.0; that cold weather will lead to yet another spike in COVID-19 (and ensuing economic disruptions) cases especially as a vaccine fails to reach the market in a timely manner; or that the presidential race will be to too close to call on election day or may even be contested, leading to weeks or months of confusion and political turmoil.

"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.

"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.

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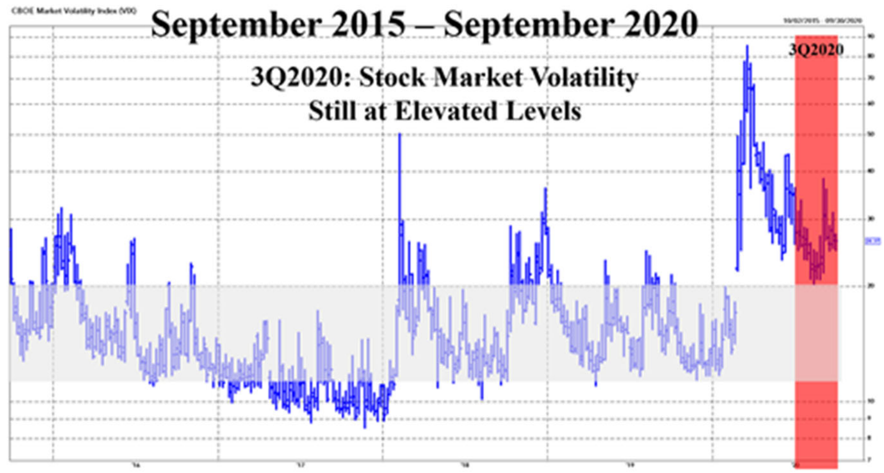
CBOE VIX Trailing 5-Year Performance



Source: FactSet

What Do We Think?

We've no doubt that stock markets generally appear to be long-in-the tooth. We believed this before the coronavirus impact, and we certainly believe it now as most stock market indices flirt with record highs. But we do not make macro bets or utilize stock market ("index") mutual funds or exchange-traded funds ("ETFs"). We prefer the precision of owning individual stocks where we have a greater deal of confidence in our ability to determine valuations, more easily distinguish between fundamental and non-fundamental threats to the stocks we follow, and can cherry pick the quality of the companies we invest in. We also believe that the stock market has been and continues to be excessively volatile (albeit at lower levels experienced in the spring; please refer back to the CBOE-VIX chart above) despite its strong third quarter performance. Lastly, valuation concerns for the stock market generally have less meaning for our clients' individual and customized stock portfolios that are generally undervalued on both relative and absolute terms (although we acknowledge that volatility is sometimes contagious and can spread to all corners of the market).

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How Do We Prepare for it?

The quick answer is that we don't. We do not "prepare" our clients for such events because we believe the act of preparing for such an event involves speculation. As our readers know, we do not speculate or try to time the market as we view these schemes as short-term in nature (as opposed to our long-term investment strategy) and inherently have a low probability of adding value. Importantly, we do not keep our heads in the sand and ignore the macro events that affect stocks generally. We are not ignorant of such noise. Rather, we try to be cognizant of how the noise affects the investments we own or would like to own. We calmly and continually keep an eye on the broader markets and monitor how our portfolios and the universe of stocks we follow are affected. To the extent that the investment we care about are affected in a non-fundamental way (and do not represent a permanent impairment to our investment thesis for them), we will seek to capitalize on this short-term investment opportunity and invest for the long-term. So, our typical game plan is to wait for the event to unfold. We then wait for the market to over-react as it oftentimes does. This is what we refer to as short-term market inefficiency. We will exploit this inefficiency when the opportunity presents itself and hope to receive value add over the long-term.

Changes at Belleros Capital Management

We (yours truly) will be joining and working under the umbrella of Partnership Wealth Management ("PWM"; please click HERE to find out more about them) effective immediately (October 1, 2020). PWM is a registered investment advisory firm based in Baltimore, Maryland. The company offers a more comprehensive set of services for clients including but not limited to financial planning, estate planning, retirement planning, and investment management services. I will be partnering with a team of advisors with a combined 30 years of experience and a dedicated CERTIFIED FINANCIAL PLANNER™ professional on staff. We can help meet the needs of more people by offering a larger variety of services, while still providing customized stock portfolios and our unique investment approach. We will continue to be dedicated towards helping investors and our clients reach 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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"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.

Changes at Belleros Capital...(Cont.)

Importantly, I will perform in the same capacity (as stock analyst and portfolio manager) at PWM as with Belleros Capital Management. Belleros Capital Management will formally begin to operate as a fully owned subsidiary of PWM on January 1, 2021. This newsletter will be distributed in the future by PWM.

Closing Remarks

I chose a career in investments over 25 years ago in part because of the dynamic nature of the stock market and excitement it offered. Change is the only constant and every day offers new challenges. After all these years, it never fails to disappoint (regardless of whether we view the change as particularly good or bad). As with every newsletter or market commentary I write, there never seems to be shortage of new topics or events. This quarter's commentary is no different, especially with changes here at Belleros Capital Management. I am excited for the change and the opportunity to work with the incredible team at Partnership Wealth Management. Please let us know if you ever need help or if you have any questions. Best wishes to everyone this upcoming holiday season. We could all use some good cheer and tidings after such a long year.

"Change is the law of life. And those who look only to the past or present are certain to miss the future."

-- John F. Kennedy

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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

- 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.