

The Passionate Investor

1Q2021 Market Review and Commentary

March 2021

Market Review *

- Equity markets generally **outperformed** fixed-income markets with the S&P 500 rising 6.17% (including dividends) and the Barclay's Capital U.S. Aggregate Bond index falling 3.37%.
- Small caps **outperformed** large cap stocks (S&P 500) as the Russell 2000 small cap stock index returned +12.70%.
- Value **outperformed** Growth during the quarter (as determined by the S&P 1500 broad market index which includes large, mid, and small capitalization stocks).
- International or developed, non-U.S. equity markets **underperformed** U.S. markets in U.S. dollar (MSCI EAFE**: +3.60%) but **outperformed** in local currency terms (+7.72%).
- The MSCI Emerging Markets Index **underperformed** developed, non-U.S. equity markets (international) in both U.S. dollar (+2.34%) and local currency terms (+4.02%).
- All U.S. market sectors were **positive** during the quarter. Energy (+30.85%) and Financial (+15.99%) stocks were most distinguishable given their strength and recovery from last year's poor performance.
- High yield bonds fell 0.95% during the quarter. The U.S. corporate bond sector fell 5.01% during the quarter. 10-Year U.S. Treasury yields rose from 0.87% at the beginning of the quarter (year) to 1.70% currently.
- The U.S. dollar fell versus the British Pound (-0.93%) but climbed relative to the Euro (+3.94%) and Yen (+7.03%).

* 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 actively manages direct stock portfolios on a fully discretionary basis for institutional clients. Our primary goal is to help them outperform their benchmarks by exploiting short-term market inefficiency through a long-term investment strategy that produces investment portfolios that are differentiated in nature and is concentrated in its number of holdings. The strategy seeks to invest in the stocks of quality companies at a price that is sufficiently below our calculation of its intrinsic value. Additionally, the strategy is all capitalization in nature but tends to have a small and mid-capitalization bias that we believe is secular in nature.

Market Commentary

US stocks were again the envy of world as most indices climbed near or above their all-time highs. The quarter was notable for a few moments of increased stock market volatility and disruption – each with its own distinct cause. Shares of so called "meme" stocks like video game retailer GameStop recorded extreme spikes in share price and trading volume over a short period of time (in late January) and based on enthusiasm (not fundamental in nature) driven by social media excitement through online forums like Reddit. Interest rates in the US also increased sharply during the quarter (see below) based on rising optimism for economic growth after a year of COVID-19 related fatigue. The ensuing inflationary concerns jostled bonds and stocks alike as investors worried that the Federal Reserve would abandon its commitment to an ultra-low interest rate policy (which it refuted).

Small capitalization stocks (+12.70%) continued to outpace their large cap cousins (the S&P 500; +6.17%), while value stocks strengthened relative to growth stocks. Developed international stocks outperformed US stocks in local currency terms but trailed after adjusting for the strengthening US dollar (+7.72% and +3.60%, respectively). Emerging market stocks underperformed in both local currency and US dollar terms (+4.02% and +2.34%, respectively). Energy and Financial stocks, both among the worst performing stocks last year, outperformed during the quarter (+30.85% and +15.99%, respectively). The Barclay's Capital U.S. Aggregate Bond index fell 3.37% as bonds underperformed relative to stocks in a rising interest rate environment. Yields on 10-year U.S. Treasury bonds rose sharply from 0.87% at the beginning of the year to 1.70% currently. The U.S. dollar rose generally (particularly towards quarter-end) as investors pursued higher interest rates.

The commentary presented herein contains the opinions of Partnership Wealth Management, LLC dba Belleros Capital Management. Partnership Wealth Management, LLC is a registered investment advisor. This information should not be relied upon for tax purposes and is based upon sources believed to be reliable. No guarantee is made to the completeness or accuracy of this information. Belleros Capital Management shall not be responsible for any trading decisions, damages, or other losses resulting from, or related to, the information, data, analyses or opinions contained herein or their use, which do not constitute investment advice, are provided as of the date written, are provided solely for informational purposes, and therefore are not an offer to buy or sell a security. Investments in securities are subject to investment risk, including possible loss of principal. Prices of securities may fluctuate from time to time and may even become valueless. This information has not been tailored to suit any individual.

S&P 500 - Trailing 12 Months and 1st Quarter Performance



Source: FactSet

Investment Philosophy

What an amazing 12-months we've had. A year ago, we were in what seemed like the early-to-middle innings of a stock bear market and we did not know the market had already begun staging a rally. We believe we were successful in implementing our strategy over this period but will leave it to our clients to be the ultimate judge of that. How did we do it? Recall our investment philosophy which adheres to the belief that the stock market is inherently inefficient, especially in the short-term, and is prone to volatility in stock prices (please click [HERE](#) for a more in-depth discussion of our investment philosophy and strategy or read the adjoining blue panels in this newsletter). We also do not believe that stock market volatility is the greatest risk to investors. This dubious honor belongs to the risk of a permanent loss of capital – the actual losing of money that one experiences when an investment is sold at a price below its cost. Finally, we believe excess diversification is detrimental to investors who seek long-term value add through active portfolio management.

"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 (or Inefficiency)

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

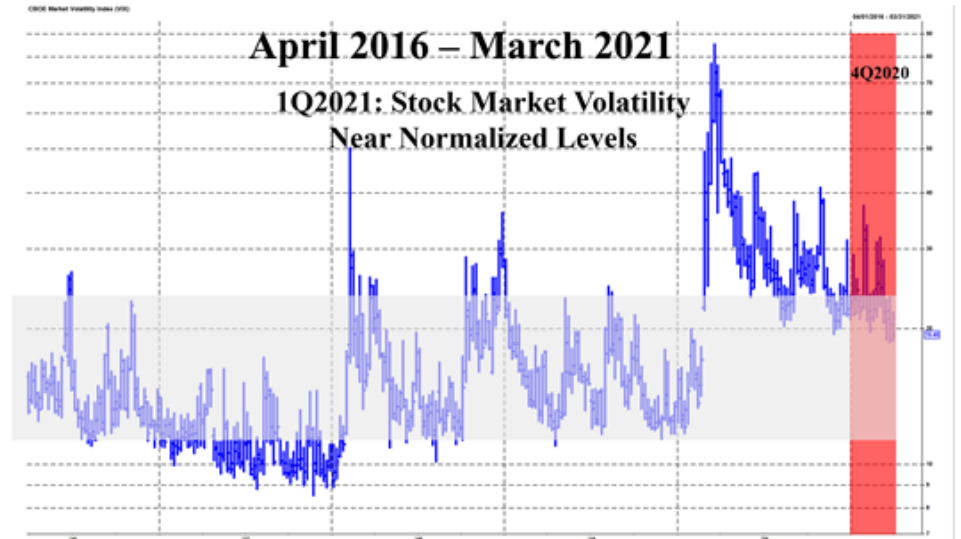
Investment Philosophy

The Main Source of Risk to Long-term Investors

Belleros Capital Management believes that the investment community’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.

CBOE VIX Trailing 5-Year Performance Volatility Near Normalized Levels



Source: FactSet

Value, Quality, and Long-Term

We were able to successfully navigate last year’s pandemic driven storm by sticking to our investment strategy. Our strategy then and now is simple: exploit short-term stock market inefficiency and volatility by investing our clients’ monies in a **concentrated portfolio of stocks** with the goal of adding value over the long-term. We afford ourselves breathing room by investing in **value** stocks that have a sufficient margin of safety or sell at a sufficient discount to intrinsic value. Further, we try to avoid or **minimize a permanent loss of capital** by investing in **quality** stocks we believe to be going concerns – stocks of companies that we believe will exist years from now because they are financially sound businesses and/or have durable competitive advantages that can protect their operations from competition. Lastly, we allow our investments sufficient time to bear fruit by adhering to a **long-term** investment time horizon.

A Unique Period in Time

The stock market and much of the events that occurred over the past year were unique in part because we (most of us) had not lived through a crisis that was existential in nature in recent memory. Many of us were swimming in uncharted waters. Comparable moments in modern history include both world wars or more obviously the Spanish influenza of 1918 – all events having occurred over 75-years ago and were not experienced by most of us. Professional and amateur investors alike were understandably confused by the ordeal as it was dynamic. Bad advice was rampant during the period as information flow was uneven and very fluid in nature. Much of it was disseminated by politicians, investment talking heads, and medical professionals – people we typically look to for answers in difficult times. And so, expectations for the future were equally problematic as no one had a clear read over what was unfolding in real time. Widespread panic ensued and irrational behavior by many stock market participants caused heightened levels of volatility.

Lesson(s) Learned

We believe emotions are one of the main scourges of investing. It may sound cheeky to suggest but we believe it is true. Emotions in many instances drive otherwise rational investors to gamble away their nest egg in a market timing scheme. Emotions and fear or greed particularly, compel investors to adjust their focus from the long-term, towards news that is more immediate and currently impacting the stock market. They allow themselves to be swayed by the chatter on television, or by the talking heads on CNBC. They become myopic and cannot see the forest for the trees. As we mentioned in our previous newsletter (click [HERE](#)), investors who attempted to time the market over the last year at best, (probably) failed to participate in much of the gains to be had over the period due to opportunity loss. At worst, they suffered a real and permanent loss of capital as they sold their holdings at lower prices as the sky seemed to be falling around them. Investors who were more disciplined, able to manage their emotions and sticking to a prescribed, long-term investment strategy, probably came out of last year in better shape.

“Wide diversification is only required when investors do not understand what they are doing.”

— Warren Buffett

Investment Philosophy

Diversification (or Not)

Belleros Capital Management believes 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 sliding 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 seeks to differentiate their investment portfolio to ward off 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](#) to learn more about our investment strategy and how we try to add value for our clients.

Closing Remarks

We believe that 2020 was a success for our clients who remained patient and continued with our long-term approach. We helped them to remain focused on our investment strategy. It helped that we kept a level head and our emotions in check. And we fulfilled our promise of being active investors, keen on adding value for our clients over the long-term. We took advantage of opportunities to defend our existing positions or to introduce new ones to our portfolios. More importantly, we were able to minimize permanent losses of capital which we believe to be the biggest danger to investors. Would we do things differently in the face of differing circumstances? We can emphatically say “No”. We understand that we have a very important job as steward of our clients’ wealth, and we understand that a long-term investment strategy (preferably ours) is the best way to help them reach their long-term investment goals. We wish everyone a prosperous and healthy spring. Please stay disciplined.

“Your success in investing will depend in part on your character and guts and in part on your ability to realize, at the height of ebullience and the depth of despair alike, that this too, shall pass.”

-- Jack Bogle

Investment Strategy

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

- Active investment management
- Long-term investing
- Seek higher quality opportunities
- Value investing
- Minimizing 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

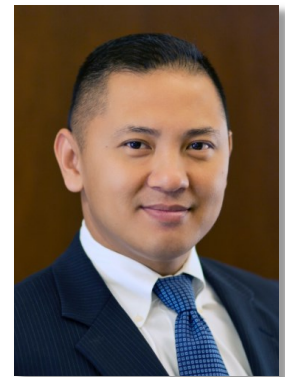
“We don’t have to be smarter than the rest. We have to be more disciplined than the rest.” — Warren Buffett

Biography

Tim Hai, CFA®, CAIA®

Chief Investment Officer and Senior Portfolio Manager

- 25 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
- 11 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.