

# The Passionate Investor

## 2Q2021 Market Review and Commentary



### Market Review \*

- Equity markets generally *outperformed* fixed-income markets with the S&P 500 rising 8.55% (including dividends; +15.25% YTD) and the Barclay’s Capital U.S. Aggregate Bond index rising 1.82% (-1.60% YTD).
- Small caps *underperformed* large cap stocks (S&P 500) as the Russell 2000 small cap stock index returned +5.47% (+17.54% 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).
- International or developed, non-U.S. equity markets *underperformed* U.S. markets in both U.S. dollar (MSCI EAFE\*\*: +5.03%; +9.17% YTD) and local currency terms (+4.47%; +13.11% YTD).
- The MSCI Emerging Markets Index *underperformed* developed, non-U.S. equity markets (international) in both U.S. dollar (+4.88%; +7.58% YTD) and local currency terms (+3.42%; +8.08% YTD).
- All U.S. market sectors were *positive* during the quarter. Information technology (+13.23%; +13.76% YTD), telecommunication services (+11.16%; +19.67% YTD), and energy (+10.27%; +45.64% YTD) stocks were most distinguishable given their strength.
- High yield bonds rose 3.30% (+2.08% YTD) during the quarter. The U.S. corporate bond sector climbed 3.36% during the quarter (-1.94% YTD). 10-Year U.S. Treasury yields fell from 1.68% at the beginning of the quarter (0.87% at the beginning of the year) to 1.40% currently.
- The U.S. dollar rose versus the Japanese Yen (+0.62%; +7.50% YTD) but fell relative to the Euro (-1.12%; +3.08% YTD) and British Pound (-0.75%; -1.06% 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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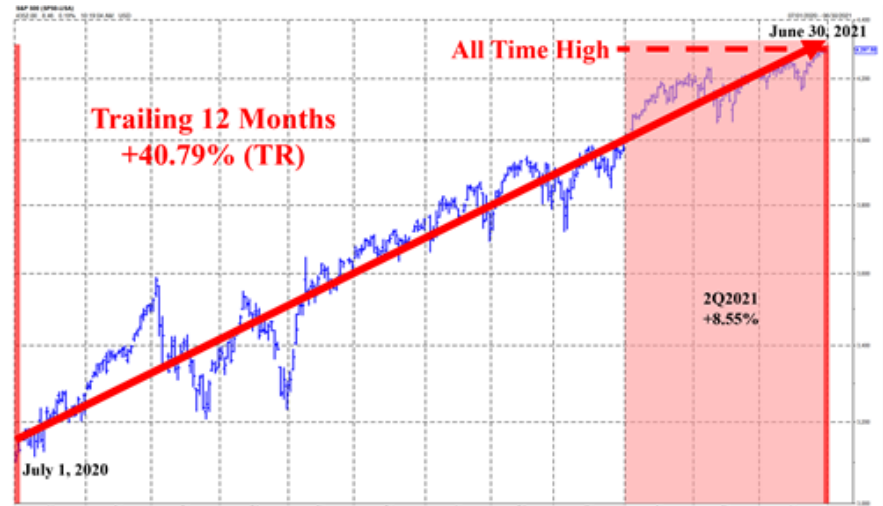
Tim Hai, CFA®, CAIA®  
CIO and Sr. Portfolio Manager

*“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

## Market Commentary

### S&P 500 - Trailing 12 Months and 2nd Quarter Performance



Source: FactSet

### 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.

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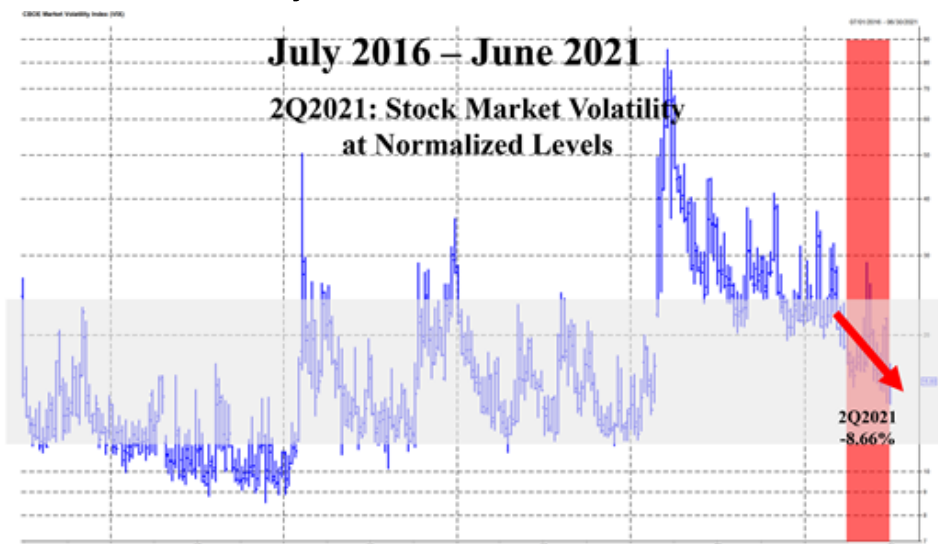
Inflationary concerns carried over into the second quarter as prices climbed along with expectations for economic growth. Rival camps argued over whether recent data pointed to inflation that is more transitory and fleeting (stemming specifically from last year’s pandemic) versus those who believe it more secular in nature and a longer-term problem for the nation. The ultimate fear from the “inflation is here to stay” camp is that the Federal Reserve will abandon or at least curtail its near-zero interest rate policy. Any change by the Fed, whether through talk or action, could upset investors and foreshadow heightened stock market volatility. Thus far, those in the opposing camp who believe that current inflation levels are transitory in nature have successfully parried the former’s thrusts. The tug-of-war can be observed through the swings in the CBOE VIX (a popular gauge of the stock market’s expected volatility; see below).

*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.*

## Market Commentary...(Cont.)

The CBOE VIX's poor quarter-end performance (down 8.66%) and, conversely, the S&P 500's march forward suggests most investors agree with the "inflation is transitory" camp. Despite the quarter's back and forth, stocks managed to finish up 8.55% (S&P 500), at all-time highs. The information technology and telecommunication services sectors led all others in a reversal from recent quarters. Small-cap stocks slowed down from their brisk first-quarter pace but still added 5.47%. International stocks from both developed and emerging markets trailed by climbing 4.47% and 3.42%, respectively. Bond markets reversed their poor first quarter as falling interest rates helped propel the Barclay's Capital U.S. Aggregate Bond index up 1.82% and high-yield bonds up 3.30%.

### CBOE VIX Trailing 5-Year Performance Volatility Back Within Normalized Levels



Source: FactSet

## Inflationary Concern?

The specter of inflation has captivated equity markets for the better part of the year and a number of clients and friends have asked us about our thoughts and approach to rising prices. Economists typically view inflation through two lenses, commonly referred to as "headline" and "core". Headline inflation is comprehensive in the prices of goods and services it measures. Notably, it includes food and energy costs which can be periodically volatile and anomalous. Core inflation looks past the anomalies in food and energy pricing and is considered by economist to be a more reliable gauge of inflation.

*"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.

## Inflationary Concern?...(Cont.)

Core (and headline) inflation measures have increased recently at a pace and level that is higher than expected. This has led some investors to believe that a change in Federal Reserve policy is at hand (i.e., higher interest rates). Economists have been particularly concerned with a low supply of labor in certain sectors of the economy that have led to increased wages. Wage inflation can be problematic because it is hard to relax and can compound existing inflationary pressure.

As alluded to in our commentary above, there are two opposing camps currently engaged together in a battle to control the inflation narrative. The first camp believes that bottlenecks in manufacturing and distribution related to last year’s pandemic have created supply/demand inequities that have driven prices up. They believe these imbalances to be short-term in nature and will self-correct in short order, as supply catches up with demand. The opposing camp believes that inflation is here and may remain a problem for years to come. They point to the labor shortages and related wage inflation we are currently experiencing and suggest that inflation is here to stay.

## The Implication Being...

Inflation erodes the purchasing power of consumers and influences their shopping behavior. Consumers who anticipate inflation will stock up on their goods now, exacerbating current inflationary pressures and worsening supply/demand imbalances. Inflation in this way is said to be a self-fulfilling prophecy. If the pessimistic crowd is correct, then Federal Reserve policy will more than likely change to reflect rising inflation. Interest rates will be lifted and other tools (i.e., asset purchases) that have helped to keep interest rates low will have to be suspended or reversed. How the Fed telegraphs its motives and intent is important. It is important to understand that well-choreographed and expected changes to policy may still impact the stock market (i.e., increased volatility). However, unexpected policy changes that surprise everyone will have even stronger implications for stocks. Poor execution by the Federal Reserve has the potential to contribute significant volatility and increase stock market inefficiency.

## A Familiar Approach

It is unclear as to how long inflationary pressures will last or how stocks will perform over that time. However, there is usually a good deal of volatility involved as information is disseminated unevenly. Volatility can also result from monetary policy failures related to strategy or implementation. Our investment strategy is agnostic as to the specific cause of volatility and view it as a symptom of market inefficiency. Thus, our long-term investment strategy reacts to volatility and not specifically to inflation. It seeks to take advantage of short-term stock market inefficiencies regardless of their root cause(s).

We do not make tactical changes to our portfolios in anticipation of changes to economic policy, inflationary pressure, or any macro-economic events. We believe this would be akin to market timing. We do not like to make binary “bets” that entail a low probability of success. Regardless of the cause, we will wait for the volatility to appear before implementing changes to our portfolio. We only make changes in our portfolios based on changes in company fundamentals and valuation and only if we believe they will meet or exceed our expectations. And although our strategy is inherently reactive in nature, we believe it better than an approach that leaves a lot left to chance.

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

— Warren Buffett

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### 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

Inflation is a normal component in an economic cycle and is not always a terrible thing as it can be indicative of a prosperous and well-functioning economy. A problem arises when inflation rises too high or too fast. It is not difficult to understand how an economy in pandemic lows can rise quickly from its trough and exhibit inflation. Fiscal policy and stimulus checks may have also compounded the matter. Market dislocations can occur as a result. However, it is also not too difficult to believe that low interest rates may have contributed to higher demand (and prices) for homes, cars, or anything you can purchase with a credit card. Time is usually helpful towards resolving supply/demand imbalances if they are only transitory in nature as some suggest. Otherwise, a more active approach will be necessary.

The Paul Volcker Federal Reserve is largely credited with winning the fight against inflation in the 1970s by raising interest rates to double-digit levels. Let us hope that today's inflation issues will not become so problematic to need such draconian measures. Measured increases to interest rates may be required but not so much that the cure kills the patient. Despite our role in the matter, we do not hope to reach a high inflation environment. Rest assured however that if events prove for the worse, we will be opportunistic and make the best out of an imperfect situation. Having a long-term investment strategy in place that can potentially help you benefit from short-term stock market inefficiencies is important. This is how we fit in and can help. Please let us know if you have any questions. We wish everyone a wonderful and temperate summer.

*“Inflation is always and everywhere a monetary phenomenon in the sense that it is and can be produced only by a more rapid increase in the quantity of money than in output.”*

*-- Milton Friedman*

## 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
- 11 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 25 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.