

# The Passionate Investor

## 3Q2021 Market Review and Commentary

### Market Review \*

- Equity markets generally outperformed fixed-income markets with the S&P 500 rising 0.58% (including dividends; +15.92% YTD) and the Barclay's Capital U.S. Aggregate Bond index rising 0.05% (-1.55% YTD).
- Small caps underperformed large cap stocks (S&P 500) as the Russell 2000 small cap stock index returned -4.36% (+12.41% YTD).
- Value slightly 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 outperformed U.S. markets in U.S. dollars (MSCI EAFE\*\*:+1.41%; +14.70% YTD) but fell 0.35% in local currency terms (+8.79% YTD).
- The MSCI Emerging Markets Index underperformed developed, non-U.S. equity markets (international) in both U.S. dollar (-7.97%; -0.99% YTD) and local currency terms (-6.57%; +0.98% YTD).
- U.S. market sectors were mixed during the quarter. Financials (+2.74%; +29.14% YTD), telecommunication services (+1.60%; +21.59% YTD), and utilities stocks (+1.78%; +4.20% YTD), were most distinguishable given their strength. Industrials (-4.23%; +11.48% YTD) and materials stocks (-3.51%; +10.49% YTD) were notable given their weakness.
- High yield bonds fell 0.37% (+1.70% YTD) during the quarter. The U.S. corporate bond sector decreased 0.12% during the quarter (-2.06% YTD). 10-Year U.S. Treasury yields climbed from 1.40% at the beginning of the quarter (0.87% at the beginning of the year) to 1.46% currently.
- The U.S. dollar rose versus the Japanese Yen (+0.53%; +8.07% YTD), the Euro (+2.27%; +5.28% YTD), and British Pound (+2.40%; +1.36% 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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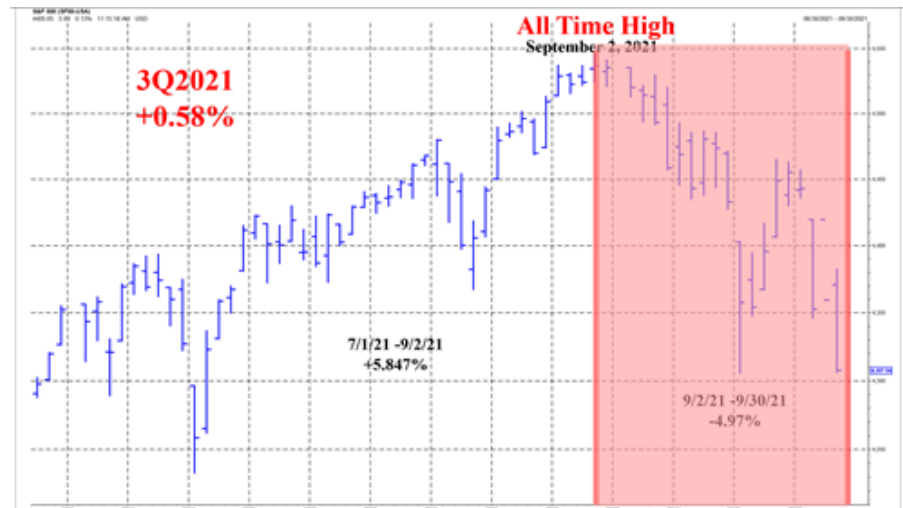


Tim Hai, CFA®, CAIA®  
CIO and Sr. Portfolio Manager

*“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 - 3rd Quarter 2021 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.

Stocks were less sanguine to end the quarter despite having lodged seemingly daily all-time highs up until early September and a marginal gain through its last week (the S&P 500 was down 4.97% from its quarterly high but up 0.58% for the quarter). For most of the quarter, increased infections and hospitalization due to the COVID-19 Delta variant had led to greater investor interest in large cap, growth-oriented stocks and technology shares in particular. However, inflationary concerns which dominated the news in the first half of the year, returned to drive headlines as the quarter came to a close; narrowing the performance gap between large and small cap stocks; and growth and value. Technology stocks also trailed in the quarter’s last week as interest rates climbed in part based on inflation expectations.

*The commentary presented herein contains the opinions of Belleros Capital Management, a DBA of Partnership Wealth Management, LLC. 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.)

### S&P 500 - Trailing 12 Month 2021 Performance



Source: FactSet

Pandemic fears helped small cap stocks fall 4.36% during the quarter. Value stocks narrowly outperformed growth stocks despite the viral trend. International stocks slightly outperformed US stocks in local currency but fell after adjusting for US dollar strength (see below). Emerging market stocks tumbled considerably on an absolute basis and relative to their developed market peers. The US bond market was flat during the quarter as 10-year government bond yields stayed essentially level (despite their climb at quarter-end). The US dollar strengthened relative to most other currencies as global investors sought higher yields from dollar denominated debt.

## A Mea Culpa?

Investors were mildly surprised in late September as the US Federal Reserve (the "Fed") signaled a sooner than expected end to the accommodative phase of its pandemic relief. The Fed indicated that asset purchases that had begun as a result of the pandemic would slowly be wound down over the course of the next year (the so called "tapering"). Moreover, it is now expected that the Fed will also begin to raise interest rates by the end of next year. The takeaway from the meeting was that committee members seemed more concerned about inflation than previously and ostensibly, admitted to having underestimated its impact and duration. The Fed however did hold fast to their belief that inflation is still transitory in nature (stemming from the pandemic) and is expected to dissipate over the next year.

*"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 Efficiency (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.

## Are Inflation Expectations Rising?

Our readers should not be surprised by a recent Federal Reserve Bank of New York survey suggesting that consumers are already feeling the pinch of inflation and that they believe prices will continue to increase (please click [HERE](#) to read this survey). We mentioned in our previous newsletter (please click [HERE](#) to read it again) the danger of inflation expectations morphing into a self-fulfilling prophecy. Consumers that expect increases in the prices of the things they buy may purchase them sooner, rather than wait for tomorrow. They may also begin to stock up on or “hoard” these goods if they believe inflation will persist. This inflationary pressure can snowball substantially if many consumers of like mind behave in a similar fashion. They can also exacerbate any supply/demand bottlenecks (i.e. inflationary pressure) that still exist due to the pandemic. Inflation expectations will then have become self-fulfilling as inflationary pressure grows uncontrollably and becomes a reality.

### Oh, By the Way...

For most of the quarter, the Delta variant of the SARS-CoV-2 virus was the narrative that drove stocks (at least) in the US. Investors worried that the new mutation would impact the economy similarly to the original variant from last year. Shares of companies dependent on a normalization or re-opening of the economy took a breather from their strong run since lows in Spring 2020. Airlines, hoteliers, cruise lines, movie operators, restaurants, energy, and retail stocks generally (companies that could be classified as being cyclical in nature, small capitalization, and/or stylistically value companies) were sold off in favor of larger companies with stronger growth profiles or those that were technology related. For these companies, resurfaced inflationary fears and stabilizing infection and hospitalization data served as a good distraction that allowed their depressed shares to recoup some of their losses.

### A Stroll Back in Time

Perhaps it would be instructive to review another period of high inflation in the US (not that we are forecasting a similar magnitude or duration of inflation today). Some of our readers may remember that the 1970s was a time of severe inflationary pressure with bouts of stagflation (periods of high inflation and unemployment) interspersed. Inflation measured 7.4% annually for the decade while the S&P 500 returned only 5.8% (annually; including dividends). The S&P 500’s “real” or inflation adjusted return was -1.4% annually. It was a terrible period for all investors but especially those who were retired or about to be so.

## A Stroll Back in Time...(Cont.)

	<b>Price Change</b>	<b>Dividend Dist. Rate</b>	<b>Total Return</b>	<b>Inflation</b>	<b>Real Price Change</b>	<b>Real Total Return</b>
1970's	1.6 %	4.3 %	5.8 %	7.4 %	-5.4 %	-1.4 %

Click [HERE](#) for the source

The good news is that stocks have performed better over a longer investment time period. We know that the S&P 500 has averaged approximately 10% annually since 1926 (geometric average; including dividends); it is roughly 7% after adjusting for inflation (Please click [HERE](#) for the source). This is certainly a much better return than an investor would have experienced in the 1970s decade alone. But there is a catch: timing is everything and the 10% market return covers the good and bad periods – including times when the market performed poorly or there were exceptionally high levels of inflation. To actually experience a 10% return, an investor would have had to have been invested for a good chunk of that period – if not all of it.

### Obligatory Plug for Our Strategy

We believe our actively managed investment strategy offers the opportunity to do better. We do not profess to know how long or severe inflation will be. However, we do know that during times of high inflationary pressures or when there are periods of high stock market uncertainty, there is usually also a period of severe or higher than normal volatility in the stock market. This is where we believe our strategy can be beneficial as it generally seeks to exploit stock market volatility and inefficiency. We do NOT make any promises, but we would hope that our performance is competitive. Understand, our intent in actively managing client portfolios is to out-perform any performance they would otherwise get from investing passively (i.e. the S&P 500). By definition, that means our goal is to add value for our clients. (Please click [HERE](#) for a full description of our investment philosophy and refer to the end of this newsletter for our investment strategy.)

*“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.

## There Is No Alternative

Some investors may be driven by inflationary fears to make “defensive” changes to their portfolios to mitigate its effect. Market timing or speculation is sometimes utilized by traders or emotional investors to help them through difficult times (Please click [HERE](#) to read our thoughts on market timing). Sometimes, other investments or asset classes offering inflation protection are utilized to mitigate the rise in prices (e.g., TIPS, derivatives/hedging strategies, public/private real estate, commodities, etc.). We would certainly caution against these measures as we view them as speculative and short-term in nature and ultimately, a form of market timing that probably deviates from their long-term investment goals. These short-term schemes are inherently expensive, oftentimes implemented too late, may lead to real and permanent losses of capital, and can produce severe opportunity costs. We believe the stock market and active investing continues to be the best option for investors.

## Closing Remarks

Market timing usually deviates from the actual market return and can lead to large-scale underperformance if not perfectly executed every step of the way. History suggests it is better, easier, and far less expensive to stay invested in and committed to a long-term investment plan. A long-term investment plan is important for those who want peace of mind and the ability to sleep at night. We will always recommend investors “stay the course” regardless of the fear “du jour.” It will help them minimize the real danger in investing: a permanent loss of capital. Combine that with an offensive strategy to actually exploit these short-term stock market opportunities and we’re that much closer to achieving our goals - together. And that is what it’s all about. Enjoy the Autumn!

*“The best defense is a good offense” -- Unknown*

## 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.