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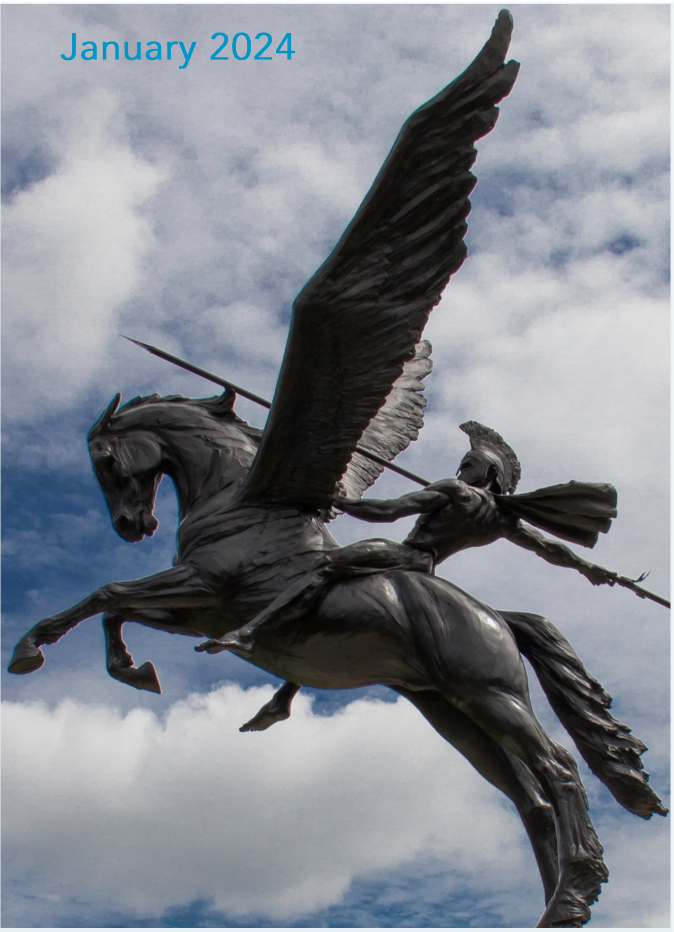

Belleros Capital Management

The Passionate Investor

4Q2023 Market Review and Commentary

Inside this issue

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*Market Review **

- *Equity markets generally **outperformed** fixed-income markets with the S&P 500 increasing 11.69% (including dividends; +26.29% YTD) and the Barclay's Capital U.S. Aggregate Bond index falling 6.82% (5.53% YTD).*
- *Small caps **outperformed** large cap stocks (S&P 500) as the Russell 2000 small cap stock index returned 14.03% (16.93% YTD).*
- *Value **outperformed** Growth during the quarter and continued to outperform over the full year (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 local currency (+5.00%; +16.77% YTD) and U.S. dollars terms (MSCI EAFE**: +10.47%; +18.85% YTD).*
- *The MSCI Emerging Markets Index **outperformed** developed, non-U.S. equity markets (international) in local currency (+5.65%; +10.29% YTD) but trailed in U.S. dollars terms (+7.93%; +10.27% YTD), during the quarter.*
- *Most U.S. market sectors were generally **positive** during the quarter. Information Technology (+17.17%; +57.84% YTD), Financials (+14.03%; +12.15% YTD), Industrials (+13.05%; +18.13% YTD), Consumer Discretionary (+12.42%; +42.41% YTD) and stocks were most distinguishable given their strength. Energy (-6.94%; -1.33% YTD) stocks were notable given their weakness.*
- *High yield bonds **rose** 8.56% during the quarter (+14.04% YTD). The U.S. corporate bond sector **climbed** 8.21% during the quarter (+7.74% YTD). 10-Year U.S. Treasury yields **climbed** from 4.57% at the beginning of the quarter (3.87% at the beginning of the year) to 3.89% currently.*
- *The U.S. dollar **fell** relative to most other major currencies during the quarter, including the Japanese Yen (-5.53%; -6.85% YTD), Euro (+4.34%; +3.50% YTD), and the British Pound (+4.44%; +5.98% 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.*

"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

The Federal Reserve's (the "Fed") hawkish bias[1] and fight against inflation negatively influenced stocks to start the fourth quarter. However, while directly lifting interest rates had been its tool of choice for much of the past several years, it has more recently resorted to rhetoric and verbal incitement when inconsistent economic data provoked occasional stock market rallies that the Fed believed worked against its stated policy. By the end of October, several economic data points emerged to suggest tempering inflation and tepid (but still strong) employment, consumer confidence, and spending. Fed Chairman Jerome Powell added fuel to the fire (later that month) by acknowledging some economic progress and policy achievements and intimated a potential change in Fed policy and implicitly lower interest rates. These events together helped spur a positive and broad rebound in stocks that would last through year-end. Perhaps finding the stock market reaction counterproductive, other members of the Fed community were quick to walk back Chair Powell's bullish comments (especially with regards to the timing of any shift in policy) with mixed results.

S&P 500 – Trailing 12-Month Performance

Source: FactSet

[1] A hawkish bias refers to Fed policy that considers inflationary concerns paramount and typically is designed to minimize its threat. Policy usually includes tools designed to increase interest rates and lower the money supply.

Market Commentary…(Cont.)

The S&P 500 capped off a strong year for stocks by adding +11.69% in its fourth quarter (including dividends; +26.29% YTD). Unlike the previous ones, this quarter's performance exhibited a broadening of participation by most of its constituents – an occurrence that is generally considered healthy and necessary for a sustainable stock market rally. This widening of participation benefited both smaller constituents in the S&P 500 as well as small capitalization and value stocks (as determined by the S&P 1500 broad market index) which largely trailed the large cap index for most of the past year. U.S. stocks, collectively, also continued to lead their international counterparts in both developed and emerging markets. Among economic sectors in the U.S., Information Technology stocks continued to lead all other market sectors, followed by strong performance in sectors including Financials, Industrials, and Consumer Discretionary. Oil prices stayed subdued despite the Israeli/Hamas and Ukraine/Russia wars. Fixed income investments generally and credit sectors (i.e. corporates and high yield) especially were strong outperformers despite a declining interest rate environment[2]. The U.S. dollar weakened against most other currencies as a result.

2023 Re-Cap

2023 was a strange year for stocks by most accounts. Although stocks had been extending their climb from October 2022 lows, the economic backdrop was subdued with the Fed still biased towards raising interest rates to defeat stubbornly high inflation. Many economists and stock market prognosticators were expecting a recession in 2023 based largely on our experience with periods of high inflation in the past. The Russia/Ukraine war was entering its second year and global supply chains were still impacted. But the stock market endured early on, forcing the Fed to jawbone stock market enthusiasm (something they would continue to do through-out the year).

[2] Bond prices and yields are inversely related, and investors typically invest in bonds as they seek general safety relative to stocks or other risk assets. This desire for safety pushes up bond prices and correspondingly lowers bond yields. Outperformance in higher risk fixed income investments like corporate and high yield bonds do not typically occur at a time when bond yields are falling (and prices are rising).

"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.

2023 Re-Cap…(Cont.)

A minor banking crisis would develop in the Spring as a handful of smaller banks mis-managed their rising interest rate strategy. The shockwave from the mini-crisis would become a drag on most stocks, but especially smaller-sized, value stocks which were already bearing the brunt of the Fed's interest rate hikes[3]. Around the same time, the potential of artificial intelligence helped propel a handful of mega-cap, technology-related stocks (click HERE to read more about these stocks) higher despite general market negativity. In the back-half of the year, several pauses in the Fed's hiking cycle, conflicting data regarding the economy, and the Israel/Hamas war led to increased stock market volatility. The Fed continued to restrain investor optimism with threats of higher rates for a potentially longer period of time.

Communication Breakdown

In early November 2023, several economic data points suggested a constructively lower inflationary environment and a moderating (but still strong) economy. Importantly, employment data also showed strong employment, leading many market participants into believing that the Fed might achieve its "soft landing" that would tame inflation without punishing the economy. Later that month, Fed Chair Jerome Powell acknowledged the increasingly favorable economic data and indicated that the Fed would not raise interest rates at that juncture. Importantly, he not only left open (if not encouraged) the prospect that the Fed may not raise interest rates further, but he also suggested the possibility that interest rates may actually be lowered several times in 2024. The stock market was broadly encouraged by the news of softening economic policy and prices were quick to rise. Perhaps sensing an unintentionally "bullish" signal by Chair Powell, several other Fed members rushed out to clarify a more modest outlook especially with regards to the timing of future interest rate reductions. The result was confusion and volatility.

[3] Rising interest rates are believed to have a greater impact on the stocks of smaller companies (relative to larger companies) because of a higher associated cost of capital and their greater dependency on debt financing.

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Communication Breakdown…(Cont.)

We have been cognizant of and vocal about Fed derived market inefficiency and stock market volatility for a while – as many of our readers will know. It is a fact of life that one will contribute to the other. Implementing economic policy, even when the policy is necessary and warranted, will create dislocations that lead to stock market volatility. The Fed has been widely viewed as being slow to recognize the generationally high levels of inflation we've experienced over the past several years and was relatedly slow to respond to it. When it did respond, some argue that its implementation of policy was heavy-handed (i.e. not gradual) and draconian in its effort to make up for lost time. Some also argue that more recent pauses and continuations (i.e. stops and starts) in rate hikes were also premature mistakes and showed indecisiveness (respectively). We understand and appreciate that managing the economy is not easy – mistakes in policy and implementation will always occur to some degree. However, the Fed has always had an uncanny ability to muck up its communication with the public and that has added unnecessary volatility to the stock market. It probably doesn't help that more than a dozen Fed officials are allowed (at any given time) to offer their personal and varying opinions to the public. Actual economic policy aside, the Fed's communication of it should always be postured neutrally to minimize dislocations and inefficiency. The Fed's performance in this regard has been quite poor.

A Breadth of Fresh Air

Fourth quarter performance in stocks was generally positive. Unlike for most of the year when only a handful of tech-related, mega-cap stalwarts accounted for much of the stock market's gains, previously unfavored market segments including mid-caps, small caps, and value stocks (generally) contributed to what many have described as an "everything" rally in stocks. A broad market rally, with extensive participation by most market segments and sectors, is seen by many investors as healthy, sustainable, and perhaps less prone to a collapse.

"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.

Multi-Period Sector Performance

	Sector	4Q2023	1-Year	Since November 2021 Highs
S&P 500	Large Cap	11.69	26.29	2.76*
Russell 2000	Small Cap	14.03	16.93	-14.31
NASDAQ	Technology	13.56	43.42	-4.87

** The S&P 500 reached a high in early January 2022*

Source: FactSet

Small Cap Revival

Small caps and value stocks in particular responded well to the economic data and news of a possible Fed "pivot" to a neutral or more accommodative monetary policy. Small cap stocks (see chart above) had been in a bear market[4] for most of 2023 and relied heavily on its fourth quarter rally to join most other stocks out of its depth (i.e. the S&P 500 and NASDAQ).

Small Cap Style Performance

	Sector	4Q2023	1-Year
S&P 600 Growth	Small Cap Growth	14.28	17.10
S&P 600 Value	Small Cap Value	15.84	14.89

Source: FactSet

Still A Long Way To Go

To be sure, despite the recent outperformance in these heretofore less favored investments, there still exists a strong gulf between the performance and valuations of large caps, technology-related stocks, and everything else. Small cap and value stocks still trail most other investments over the longer 1-year period and since highs reached by most stock market sectors and segments in November 2021 (see Multi-Period chart above and Russell 2000 chart Below). But if we are at an inflection point in economic policy and/or can manage to avoid even a moderate recession as many forecasters still believe will occur in 2024, perhaps there is room for the rally to strengthen further. Tailwinds stemming from a decline in interest rates (without a related economic collapse) and a more normalizing economic environment could help to sustain a long-term rebound in these stocks (specifically), and the broader stock market generally.

[4] When stocks collectively rise more than 20% from their most recently reached lows.

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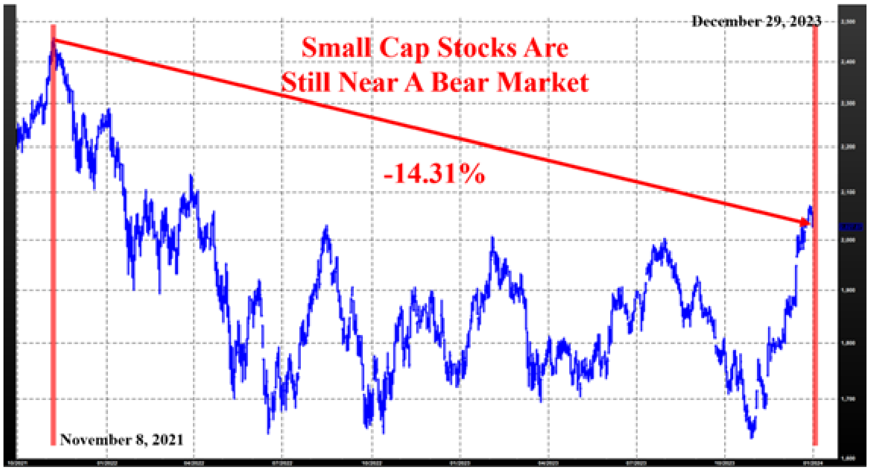
Russell 2000 Performance Since November 2021



Source: FactSet

Closing Remarks

2023 was a difficult year for active investing – especially if one was not invested in the Magnificent Seven stocks. However, the year did close out with a broad rally in stocks that included strong performances by small cap and value stocks. This is important for investors in diversified portfolios beyond the large cap stocks that populate the S&P 500 index. We are hopeful that 2024 will further this narrative as the Fed comes closer to changing economic policy to reflect lower inflation and a tempering of interest rates. Perhaps interest rates which were a significant headwind last year, can be a tail wind this year as it moderates or falls. Regardless of short-term macroeconomic events, we are confident in the long-term prospects for stocks generally and those in which we are invested specifically (our strategy). The stock market will continue to be dynamic no doubt and volatility will continue to exist. But that also means investment opportunities will be plentiful for those who are patient, disciplined, and convicted. Investing can be a tremendous opportunity for those who have the patience and temperament to wait out the volatility. And that's where we come in. We are here to not only guide the way, but to also shepherd investors from straying off the path. It requires discipline to adhere to this strategy, even when the investing landscape is bleak. We hope for brighter horizons this year. We are confident because we have history on our side. Happy New Year and best of luck to everyone.

"The investor's chief problem, and even his worst enemy, is likely to be himself." – Benjamin Graham

"Invest for the long haul. Don't get too greedy and don't get too scared."

— Shelby M.C. Davis

Please contact us to learn more about our investment strategy and how we try to add value for our clients.

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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 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

- 26 years of experience in the investment industry
- 12 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 26 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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Disclosures

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