

January 2024



# The Passionate Investor

## 1Q2024 Market Review and Commentary

### Market Review \*

- Equity markets **outperformed** fixed-income markets with the S&P 500 increasing 10.56% (including dividends) and the Barclay's Capital U.S. Aggregate Bond index falling 0.78%.
- Small caps **underperformed** large cap stocks (S&P 500) as the Russell 2000 small cap stock index gained 5.18%.
- Growth **outperformed** Value 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 (as determined by the MSCI EAFE\*\*) **underperformed** U.S. markets in local currency (+9.98%) and U.S. dollars terms (+5.81%).
- The MSCI Emerging Markets Index **underperformed** developed, non-U.S. equity markets (international) in both local currency (+4.28%) and U.S. dollars terms (+2.16%).
- All U.S. market sectors were **positive** during the quarter. **Telecommunications Services** (15.82%), **Energy** (+13.69%), and **Information Technology** (+12.69%) stocks were most distinguishable given their strength. **Utilities** (+4.57%) and **Consumer Discretionary** (+4.98%) stocks were notable given their relative weakness.
- High yield bonds **increased** 2.13% during the quarter. The U.S. corporate bond sector **fell** 0.55% during the quarter. 10-Year U.S. Treasury yields rose from 3.89% at the beginning of the quarter to 4.21% currently.
- The U.S. dollar **rose** relative to most other major currencies during the quarter, including the Japanese Yen (+7.35%), Euro (+2.23%), and the British Pound (+0.91%).

\* 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

Stocks ended the quarter in good fashion as Federal Reserve (the "Fed") Chair Jerome Powell told investors that the Fed, without a commitment to timing and despite some signs that inflation is still a concern, expects to lower interest rates later on this year. Larger stocks and most of the same technology-related stalwarts of the past year continued to lift most stock market benchmarks as investors sought safety in size. The idea of artificial intelligence and its future contributions to society continued to support tech shares. Information technology and telecommunication services outperformed most other economic sectors as a result. The energy sector was also strong as oil supplies weakened and the Israeli/Hamas war continued to impact sentiment. Utilities stocks trailed other economic sectors as rising interest rates made dividend-paying stocks less attractive. Smaller stocks gained as well but continued to trail their larger stock peers as investors were perversely discouraged by stronger than expected economic activity. International stocks from both developed and emerging markets rose during the first quarter but trailed stock returns in the U.S. in both local currency and U.S. dollar terms. Interest rates climbed as the Fed held off from lowering interest rates as they continued to monitor the inflation landscape<sup>1</sup>. Bonds were generally weak as a result and the U.S. dollar strengthened relative to most other currencies.

## Is the Threat of Recession Over?

First of all, as always, we do not prognosticate the economy or stock market. But there are clearly mixed signals from the Fed. They've suggested that they expect to lower interest rates by year end. They would not do that if they didn't believe an economic slowdown was some measure of a risk. But they clearly recognize inflation data that is still hotter than they want or expect. They've acknowledged that (See [HERE](#)) but still suggest it only "bumps" on the road and that they are still open to lower interest rates. This is the kind of uncertainty that creates stock market volatility. That interest rate cuts are still on the table implies that recession risks still exist albeit at low probability.

<sup>1</sup> Bond prices and yields are inversely related. If bond prices are expected to rise as interest rates fall, any risk to that thesis will negatively impact bond prices.

## Didn't We Already Experience One?

We should distinguish between what is a technical recession versus what is a recession as determined by a committee of economists at the National Bureau of Economic Research ("NBER"). A technical recession is defined as an economy that has suffered two consecutive quarters of negative growth. Below is a mosaic of clues that suggest that there was an actual recession in 2022:

- The U.S. experienced a technical recession in the Fall of 2022 (See [HERE](#)).
- The rate of inflation as measured by the Consumer Price Index, peaked at a similar time at 9.1% in June 2022 (its largest year-over-year increase since 1981; See [HERE](#)) and fell to 3% by June 2023 (See [HERE](#)). Disinflation, the term used to describe a falling rate of inflation (as opposed to negative inflation or deflation), is typically accompanied by a recession (See [HERE](#)).
- The Fed began increasing interest rates (considerably; by 5.25%) in March 2022 and did not stop until July 2023. Periods of rising interest rates (especially when they occur over such a short period of time) often lead to periods of recession.
- The S&P 500 experienced an earnings recession between late 2022 through June 2023. An earnings recession occurs when the index experiences two consecutive quarters of negative earnings in aggregate.
- Most major stock market indices (see below) declined to bear market territory between late 2021 and late 2022 (using weekly data)<sup>2</sup>. Bear markets are often accompanied by economic recessions.

### Indices in Bear Market Territory in 2022

Index	Return	Period
<b>S&amp;P 500</b>	-22.45%	1/7/22 to 10/14/22
<b>S&amp;P 500 Equal Weight</b>	-20.21%	1/7/22 to 9/30/22
<b>Dow Jones Industrial Average</b>	-20.75%	1/7/22 to 9/30/22
<b>NASDAQ</b>	-32.93%	11/26/21 to 10/14/22
<b>Russell 2000</b>	-30.15%	11/12/21 to 9/30/22

Source: FactSet

*"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.

<sup>2</sup> A bear market occurs when the index in question falls by 20% from its previous high.

*"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

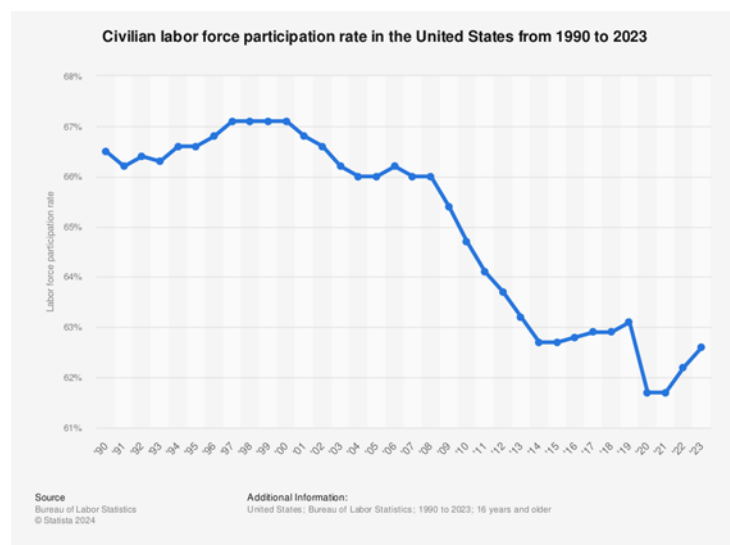
### The Main Source of Risk to Long-term Investors

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.

## Didn't We Already Experience One?...(Cont.)

The NBER has not declared an official recession since 2020's COVID induced slump. Much of its consternation boils down to labor market discrepancies that refute the recessionary evidence listed above. The NBER defines a recession as "a significant decline in economic activity that is spread across the economy and that lasts more than a few months." (See [HERE](#)) Numerous data points are considered in declaring a recession, but a fair amount of the refuting data is based on measures of employment and the unemployment rate. A fair amount of decision making is also subjective based on the human component. Measures of employment for a similar period to the data used above suggest strength. However, the labor force participation rate measures the economy's active workforce and shows people (ages 16 years and older) that are currently employed or are looking for employment. The measurement shows an acute drop in workforce (albeit after a long period of decline) participation leading up to the COVID era and a slow rebound since then. Does the employment data used by the Fed mask underlying weakness as shown by the labor force participation rate? Could COVID related deaths and COVID induced retirement, perhaps, artificially decreased the unemployment rate as measured by economists and increased hiring data as the economy backfilled vacant jobs left open by early retirees?





## Didn't We Already Experience One?... (Cont.)

A bifurcated economy between higher income and lower income households also contributes to the idea that a recession occurred in 2022. Many Americans exited the COVID environment flush with cash from quarantine savings and government stimulus. Americans that were better off saved their government checks while those (the majority we presume) with less wealth spent theirs on necessities. Inflation ensued and supply chain snarls did not help as prices for items like food (at home) and gasoline prices rose at 40 year highs (See [HERE](#)). By the end of 2022, the bulk of savings and government stimulus was spent by most recipients, contributing to economic weakness. Today, the rate of inflation has fallen but cumulative inflation is still significantly higher than it was several years ago and wages have failed to keep up (See [HERE](#)). Could the spending prowess of the few with the wealth to spend have masked a broader weakness in the economy as experienced by the many?

Finally, could the slowdown that was experienced by many in 2022 be that same shallow recession that many prognosticators were/ have been calling for? Could any weakness in the economy today just be lingering weakness from a technical recession experienced a few years ago. Perhaps. Although the threat of a recession as determined by the NBER may be low, for many, a technical recession arrived a few years ago and continues to affect them. This may explain why so many voters have expressed their pessimism with regards to the economy and their own personal finances (See [HERE](#)). The NBER has not declared a recession since the COVID period. However, we would not be surprised if the recession board at some point announces an official recession during that time period well after the fact. For many people, it's perhaps just semantics as they are continuing to feel a recession-like hit to their finances. This large group could benefit from an interest rate cut now and doesn't need some board of experts to tell them what they already know.

## Flawed Benchmarks

We've written previously about the deficiencies of everyone's favorite stock market proxy (i.e. the S&P 500). In short, the S&P 500 is presented as a broad market benchmark that almost all investors use to compare their own portfolios against (right or wrong). However, *this benchmark is not broad*, as:

*"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.

## Flawed Benchmarks...(Cont.)

- a) it only represents large cap stocks, and
- b) it is not really diversified by market sector (over 40% of its exposure is in technology-related stocks; See [HERE](#)).

In addition, the index is market cap weighted in favor of its largest (technology-related) constituents.

The Russell 2000 index of small cap stocks is also market cap weighted in favor of its largest constituents. Two stocks, according to the Wall Street Journal (See [HERE](#)), Super Micro Computer (a server manufacturer that has benefited from the artificial intelligence fervor) and MicroStrategy (a software company that has invested heavily in actual cryptocurrencies), returned 255% and 170%, respectively, during the quarter. By comparison, Nvidia, the hottest stock of its Magnificent Seven brethren returned "only" 87% over the same period. These same two stocks are also the largest stocks in the index with a combined market cap of \$88 billion (\$60 billion and \$28 billion, respectively), which compares with the median market cap of Russell 2000 stocks of \$900 million. The stocks make up 2% and 1% of the index, respectively. Together, these two stocks contributed roughly 1/3rd of the index's 5.2% return for the quarter.

## Our Raison D'être

A [recent news article](#) reminds us of our main objective: helping investors reach their long-term financial goals and helping them avoid outliving their wealth. We do this by helping investors maximize their wealth generation potential. The article suggests that despite a good (last) year for stock investors, they are still far from their retirement savings goals. The most important revelation is that:

It would take \$1.46 million to retire comfortably, according to a recent survey of 4,588 adults...That is up from \$1.27 million a year ago. And over \$1 million more than the average<sup>3</sup> survey participant's nest egg.

<sup>3</sup> The "mean" in mathematic or statistical context refers to the average of two or more numbers.

## Our Raison D'être...(Cont.)

The average participant's nest egg figure falls in line with the general assumptions that we've assumed over the years. Our yard stick is based on several outside studies suggesting that roughly 5% to 10% of investors have accumulated over \$1 million in savings (retirement or otherwise); another 5%-10% of investors have accumulated between \$500k to \$1 million. However, the vast majority of households (80% to 90%) have accumulated less than \$500 million and are far behind the \$1.46 million suggested in the article. A more troubling [article](#) suggests the median<sup>4</sup> level of savings for those between the retirement ages of 65-74 years is \$200k versus the mean or average savings of \$609k (suggesting a large skew in the data set towards wealthier households).

But what if your goal should be to prepare for a worst-case scenario where you may require even more accumulated wealth to live comfortably with assistance? The article goes on to suggest that:

The actual size of the nest egg you need depends on factors including your income, marital status, expected longevity, where you plan to live in retirement, and whether you want to leave money to heirs...

We would add health as a factor to the list above. We believe most people underestimate their longevity and are overconfident in their ability to be healthy in retirement and therefore they underestimate their expenses and the level of savings and investments they will need. Americans currently have a life expectancy of 78 and this should only rise despite the pandemic setback. The U.S. Department of Health and Human services suggests "approximately 70% of people over 65 will require some degree of long-term care services during their lifetime" (as quoted in this article). A similar report (quoted in the same article) by the "AARP suggests that the lifetime probability of becoming disabled...or of being cognitively impaired, is 68% for people aged 65 and older". Another report similarly suggests "an average healthy 65-year old couple has a 75% chance that one partner will require significant long-term care in later life and a one-in-four-chance that both will need such care".

<sup>4</sup> The "median" refers to the middle point in a data set of numbers. It may be more useful than a mean or average calculation when extreme data points exist in a data set that artificially inflate or depress results (i.e. defined as skewness).

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

*— Shelby M.C. Davis*

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Please [contact us](#) to learn more about our investment strategy and how we try to add value for our clients.

*"The best way to measure your investing success is not by whether you're beating the market but by whether you've put in place a financial plan and a behavioral discipline that are likely to get you where you want to go."*

— Benjamin Graham

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## Costs for Assisted Living

Recent data (See [HERE](#)) suggests that the median assisted living costs per month in the U.S. is over \$5,500 or more than \$66k annually. Costs vary depending on the state (location) where people intend to live and for the level of care they will need. Studies also show that staying at home and paying for in-home care is even more expensive. Given the exorbitant costs involved, the level of attained savings/investments achieved by most people, and the high probability that one will require some level of assisted care in retirement, it doesn't require a lot of math knowledge to understand that most people have not saved enough and that what they have saved could get wiped out rather quickly in a worst-case scenario. Assuming or preparing for the worst-case scenario can considerably increase the amount of savings you will need and suggests investors get more aggressive in building their wealth.

## Expect the Best but Plan for the Worst

Investors have a daunting task ahead of them in preparing for retirement and beyond. But our point is not to discourage or frighten them needlessly. But we do think investors should have a less cavalier attitude about retirement and perhaps be a little more aggressive in building and maintaining their wealth. In addition to the obvious (saving more, saving early, spending less, investing, etc.), investors must pull all levers available to them. They must consider the potential that they may live longer, with deteriorating health, and rising associated costs. They must understand the obvious that life continues beyond their retirement date and that they cannot afford to ease up on meeting or beating their savings and investment goals. They must always be vigilant. Better to err on the side of having saved too much than too little.



## Optimize Your Investment Strategy

One obvious area where investors can help themselves more over the long-term is in their investment portfolio. Investing is a long-term endeavor and should not be treated as a gamble. Investors should focus on their long-term well being and not on the constant noise in the here and now. They should not be afraid to pay for help in planning or investing if value is conveyed (monetary or otherwise). For many people, most of the levers mentioned above (saving more, spending less, etc.) are already employed and they are limited in how else they can help themselves. Active investing is another lever that long-term investors can use to increase their wealth. They should consider some exposure to active investing (if they haven't already) and the potential (and not promise or guarantee) for extra returns that exist beyond passive investing. There are risks and costs associated with this. However, given the current position of most households and investors in preparing for retirement, investors may find it less a luxury and more of a necessity if one wishes to truly maximize their wealth generation potential.

## Expectations Are Important

Active investing does take *discipline* and *patience* as any investment manager will go through periods of underperformance or relatively poor performance. Investors may find that many active managers' performance will not track the "market" (i.e. tracking error), especially over the short-term when deviations will exist that may be stark in contrast to market returns. This difference in behavior stems from the variations in the underlying portfolio and exposures (i.e. differentiation). But this is what an active investor should want as this will be the source of potential value add. Similar price behavior (to an index) from an active manager may suggest closet indexing and negative value add after fees are considered. It is impossible for active managers to outperform year-in and year-out and investors should not expect this. The idea is to have an investment manager that strings along several periods of outperformance with a few poor ones sprinkled in-between. ***There will be periods of underperformance or relatively poor performance*** (the repetition here is intentional). The idea is that over time, there are more good years than bad ones and outperformance is achieved over the long-term.

Please [contact us](#) to learn more about our investment strategy and how we try to add value for our clients.

## Closing Remarks

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Investors and households have a tall task ahead of them in preparation for retirement. Many are not as prepared as they should be, and many have limited ability to change this. We believe investors must save as if they will live longer than expected and assume higher expenses as they may need some level of assistance in their daily lives. Investors should not be discouraged by this but use it as a reminder to stay vigilant. In short, they should assume the best but prepare for the worst. They should be prepared to pull all levers available to them to fortify their future. The list includes saving more (and early), investing, and spending less. Perhaps the list should also include living healthily to improve your quality of life in retirement and thereby lower your healthcare costs and the probability that you may need some form of assistance in your daily life. And there is always being lucky enough.

But there is also hope. Investors should also be prepared to make investment decisions today that may be helpful or rewarding in the future – even if that means taking a little more risk than has usually been recommended. Active investing can be a vehicle that investors use to benefit themselves and help them maximize their wealth generation potential. Active investing does have added risks and costs, but we believe they are manageable. Thankfully, the stock market is always generous with inefficiencies and long-term investment opportunities. There are opportunities that exist such as those created by the dueling threats of recession and inflation. Investors are uncertain about which force is stronger and that has supplied the stock market with ample amounts of volatility. The catch is that active investing may be central to adding value from these opportunities. Given the help they need in reaching their retirement goals, investors may find that they critically need the potential that active investing conveys despite added risks and costs.

Spring has returned and we love the idea of getting back outside, mowing the lawn, using our fire pit, and starting our garden. However you like to enjoy yourself, we wish you the best as the weather clears and our useable space multiplies. All the best.

***“Expect the best. Prepare for the worst.”***

***-- Zig Ziglar***

## 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*

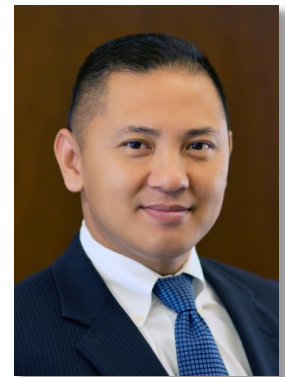
*“We don’t have to be smarter than the rest. We have to be more disciplined than the rest.” — Warren Buffett*

## 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.

## Disclosures

*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.*

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