October 2024

Belleros Capital Management

The Passionate Investor

3Q2024 Market Review and Commentary

*Market Review **

- *Equity markets **outperformed** fixed-income markets with the Russell 3000 increasing 5.88% (+19.40% YTD); including dividends) and the Barclay's Capital U.S. Aggregate Bond index rising 4.33% (+2.04% YTD).*
- *Small caps **outperformed** large cap stocks as the Russell 2000 rose 8.90% (+10.01% YTD) and the S&P 500 rose 5.53% (+20.81%).*
- *Value **outperformed** Growth during the quarter (as determined by the Russell 3000 market index which includes large, mid, and small capitalization stocks).*
- *International or developed, non-U.S. equity markets (as determined by the MSCI EAFE**) **outperformed** U.S. markets in U.S. dollars terms (+6.77%; +10.99% YTD).*
- *The MSCI Emerging Markets Index **outperformed** developed, non-U.S. equity markets (international) in local currency (+7.68%; +14.05% YTD) terms.*

** 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.*

Quarterly and Year-To-Date Performance

Index	QTD	YTD
S&P 500	5.53%	20.81%
S&P 500 Equal Weight	9.06%	13.54%
Russell 2000	8.90%	10.01%
Russell 3000	5.88%	19.40%
NASDAQ	2.57%	21.17%
Barclay's Capital U.S. Aggregate Bond index	4.33%	2.04%
MSCI EAFE	6.77%	10.99%
MSCI Emerging Markets	7.68%	14.05%

Source: FactSet

Inside this issue

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.

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Market Commentary

The S&P 500 rose 5.53% during the quarter as investors generally cheered on the first interest rate cut since COVID (early 2020). However, the S&P 500's gain masks the weakness in stocks (mega-cap and technology) that have outperformed since the spring of 2023 (see chart below). The NASDAQ composite, which is heavily skewed towards the stocks in the technology sector, gained a more pedestrian +2.57% over the same period. That the index failed to surpass the Barclay's Capital U.S. Aggregate Bond index (+4.33%) during the quarter further highlights its relative weakness.
Developed markets internationally returned +6.77% during the quarter, while emerging market climbed 7.68% (both in U.S. dollar terms).

The Federal Reserve's (the "Fed") decision to cut interest rates by 50-basis point marks the official end to the Fed's interest rate hiking campaign that saw short-term rates increase 11-times from near zero to over 5.25% over the span of 18-months. September's rate decision helped small cap stocks surge +8.90% during the quarter, improving the performance gap between it (though not eliminating it) and large caps stocks. The September hike also improved the fortunes of stocks that do not feature prominently in the market cap weighted S&P 500 (the "standard" index). The closely related S&P 500 Equal Weight index addresses the bias in the standard index's exposure towards its largest and best performing stocks (+9.06%).

Performance Since 3/31/2023

Index	Since 3/31/2023
S&P 500	48.82%
S&P 500 Equal Weight	23.88%
Russell 2000	23.72%
NASDAQ	40.23%
Barclay's Capital U.S. Aggregate Bond index	1.33%

Source: FactSet

A New Day

It's a special day for us. We're happy to announce that Belleros Capital Management is once again an independent firm. It's been six years since our firm's original launch, and we're keen on gaining back our independence. What does that mean for you and the newsletter? Hopefully, nothing. I will continue to be passionate about the things I write about. Clients will continue to receive quality investment advisory services focused on growth and capital appreciation. Readers of the newsletter may notice a broader list of topics that we may opine on from time to time. Above all, expect to continue receiving our own opinionated content that is not afraid to ruffle feathers or explain things as we see them. We hope that our readers continue to enjoy our unique take on the news and events that shape the investment landscape.

Split Personality

While many stock market participants ***improperly*** consider the standard index a stock market proxy, the past 18-months would suggest that it is not. Stock market performance since spring 2023 has been varied and narrow as the chart above shows. There has been a stark performance difference between the standard index (especially the Magnificent Seven[1] stocks) and everything else. Consider that the standard index has historically performed in-line with its close sibling the S&P 500 equal weight index. They share the same holdings, but their exposure or weighting schemes are different. Until recent quarters, the indices shared similar historical performance profiles and were highly correlated to each other (see below).

Uncoupled Performance

Index	QTD	YTD	Since 3/31/2023	Past 20 Years	Long-Term Correlation
S&P 500	5.53%	20.81%	48.82%	405.53%	97.00%
S&P 500 Equal Weight	9.06%	13.54%	23.88%	399.19%	97.00%

Source: FactSet

[1] The Magnificent Seven references a group of seven high-performing and influential stocks in the technology sector. This group included the stocks of Alphabet (GOOGL; GOOG), Amazon (AMZN), Apple (AAPL), Meta Platforms (META), Microsoft (MSFT), NVIDIA (NVDA), and Tesla (TSLA).

"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.

A New Direction

The Fed fulfilled its promise from earlier this year to lower interest rates. Although many prognosticators had teed up a September cut that wouldn't occur too close to a Federal election, the Fed did surprise (some) as to the size of the cut. Hopefully, the 50-basis point (0.50%; "bps") decrease was more of a "catch-up" nod to other central banks that had already begun their own easing cycles and not one done to appease markets that seemed ahead of the official announcement. An ideal central bank should not be taking its cues from short-term investors and speculators. Most importantly, we hope that the Fed's cut didn't reflect an approaching economic storm that the stock market doesn't currently foresee.

Happy Birthday Mr. President

President Jimmy Carter will have become our first "centenarian" or 100-year-old president (retired) by the time this newsletter is available. His age is a reminder of our potential longevity as medical technology and quality of life improves. The average life expectancy in the US today is 78 (years of age) with women averaging slightly higher, and men slightly lower. A normal distribution suggests just as many of us will live longer than the average as those who will live below that average. We have always believed that most investors are underprepared for retirement in part because they underestimate their life expectancy, overestimate their health, and therefore underestimate the expenses they may incur during retirement (See below).

President Carter is an extreme case for sure, having a history of medical issues including brain and liver cancers. He has been living in hospice care for almost two years and he's probably benefited from home health care for many years before that. Unlike most other Americans, he has the means and support to live comfortably (as possible). Many of us will require and need such services (at a similar level of care) but may not be able to afford it. Those of us that have time to plan for this would be wise to prepare for the worst and hope for the best, rather than vice versa. (See below)

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Happy 59 ½ Birthday Generation X

The oldest members of Generation X turned 59 ½ this past summer. A 59 ½ age is significant because it is the age at which prospective retirees are allowed to make taxable distributions or withdrawals from their 401(k) or IRA without incurring a 10% tax penalty. However, just because you can doesn't necessarily mean you should. While investors who are retiring early or are experiencing financial hardship may be excused for tapping into their nest egg early, those who plan on retiring at the "full" retirement age of 67 and just want extra spending cash now, should be cautioned as they are withdrawing funds that could otherwise grow and compound for a significant number of years more. They would be taking from their future and limiting their nest egg's growth.

Investors who wish to transfer their 401(k) to an IRA should also be forewarned. 401(k) programs are notorious for either not having enough investment options available, or in some cases having too many. Many accuse their employers or 401(k) administrators of not providing adequate investment advice. Not having an ideal set of investment options and the lack of advice are often cited as reasons for 401(k) transfers. However, a primary benefit of the 401(k) structure is that they do typically offer enough investment options to achieve broad diversification. Asset allocations can be developed for participants of any given risk/return profile for a relatively low price. Investors who just want diversification at a low cost will find it difficult to replicate in a typical investment advisory relationship.

Speaking of Gen Xers

Generation X is often called the sandwich or forgotten generation because they follow the baby boom generation and precede the millennial generation, both of which are larger cohorts and typically get more media exposure. This hits close to home for us at Belleros Capital Management as we too are members of the cohort. Perhaps this generation is worthy of greater attention if only because of its proximity to retirement. But there is also cause for concern. As we mentioned above, we believe most investors are behind on saving for the long-term investment and retirement goals. Several studies, data points, and our personal experiences lead us to believe a vast majority of us are unprepared financially for retirement (80% to 90%).

"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.

Speaking of Gen Xers…(Cont.)

Below are some data points for the Gen-X group that point to this glaring problem:

In recent polls of Gen X:

- The average investor polled says they’ll require $1.5 million (see HERE or HERE) in retirement to live comfortably.
- Many advisors recommend prospective retirees to have saved 10x their final year’s salary (see HERE).
- However, the median investor polled had only $150k saved or worse (see HERE or HERE).

We’ve seen similar data (recently and over the years; some covering only Gen X, some more inclusive) slightly above and slightly below this, but they all suggest the same thing: most investors (including Gen-X) are well behind on their personal retirement goals. Combining the above data to our previously held (discussed above) belief (that most investors underestimate their life expectancy, overestimate their health, and underestimate their financial needs in retirement) points to a more severe problem.

Closing Remarks

Wow! Sorry to paint such a bleak picture. We don’t typically write with such pessimism. However, this is an issue that we believe is very important and only just simmering as many of us reach retirement age. But there is a silver lining. Many of us have time left to improve our situation. It all starts by placing yourself in a position to succeed – we can help you with this. To start, develop a plan. Determine where you are financially and where you would like to be in retirement. There are plenty of informational websites (see HERE) and financial templates available for free on the internet (see HERE). Take credible steps that can help get you there – utilize the levers available to you to bridge the gap between now and retirement. Many are obvious (save early, save more, spend less, etc.) and some not so (max out your employer’s 401(k) match, make catch-up contributions to your retirement accounts when they become available to you, etc.). Some investors have already pulled these levers. Some have not. Some of us will feel comfortable doing this alone. Others will not. Please get help if you need it. Just do it.

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Closing Remarks...(Cont.)

But there are other levers to pull. And this is where we can help place you in the best position to succeed.

- The same studies above suggest Gen-X investors are under-invested and have an unusually high amount of cash in their investment accounts. This is market timing based on fear or speculation. Market timing can lead to real and permanent losses of capital and potentially larger opportunity costs.

- Many investors' investment accounts are sub-optimally invested and not positioned for the growth they'll need to bridge the gap to get to their retirement goals.

- Many investors are paying too much in investment-related fees because they are paying multiple parties on the same assets. ***Investors will hard pressed to reach their goals with a burden that averages 1.50% to 1.75%*** (See HERE). Especially those who are working from behind.

- Finally, we are a growth and capital appreciation focused investment advisor. Unlike most of our peers, we actively manage a ***proprietary*** investment management strategy designed to add value for clients (but not guarantee) over the long-term. ***There isn't an intermediary***. (Please read HERE or in the blue adjoining columns for our investment philosophy and strategy)

A lot of our fellow Gen X members are not where they need to be in preparation for retirement. But many of us do have the most important ingredient required to help them get back on track: ***time***. But the window is closing faster than we think. Some of us can do it without help. Many of us cannot. We can help in this regard. What's most important is that you do start planning your retirement – with or without help. Whatever you do, just get off the sideline. Your future prosperity depends on it. Please take it seriously.

Please contact us to discuss in greater detail how we can help you address the above topics. Until then, please enjoy the changing season and all the good things autumn brings (beautifully colored foliage, Thanksgiving, Halloween, school :), etc.). All the best.

"Expect the best. Prepare for the worst."
-- Zig Ziglar

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

— Shelby M.C. Davis

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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

- 28 years of experience in the investment industry
- 16 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 28 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.

"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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