January 2025

The Passionate Investor

4Q2024 Market Review and Commentary

*Market Review **

- *Equity markets outperformed fixed-income markets with the Russell 3000 increasing 2.6% (23.8% YTD); including dividends) and the S&P U.S. Aggregate Bond index falling 2.6% (1.8% YTD).*
- *Small caps underperformed large cap stocks as the Russell 2000 rose 0.3% (+11.5% YTD) and the S&P 500 rose 2.4% (+25.0% YTD).*
- *Growth outperformed Value 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**) underperformed U.S. markets in U.S. dollars terms (-8.1%; +3.8% YTD).*
- *The MSCI Emerging Markets Index outperformed developed, non-U.S. equity markets (international) in local currency (-8.0%; 7.5% YTD) terms.*

** Unless otherwise noted, performances stated above reflect data provided by Standard and Poor's, Russell Investments, NASDAQ, 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 (Large Caps)	2.4%	25.0%
S&P 500 Equal Weight	-1.9%	13.0%
Russell 2000 (Small Caps)	0.3%	11.5%
Russell 3000 (All Caps)	2.6%	23.8%
NASDAQ	6.2%	28.6%
S&P U.S. Aggregate Bond index	-2.6%	1.8%
MSCI EAFE	-8.1%	3.8%
MSCI Emerging Markets	-8.0%	7.5%

Source: FactSet

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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

Most stocks (as demonstrated by the S&P 500 Equal Weight index (the "EW" index; up 13.0%) enjoyed a good 2024 where economic data proved largely good and respectable. Inflation, though still outside of the Federal Reserve's (the "Fed") stated comfort zone, continued to trend lower from its 2022 peak. Unemployment levels remained low and economic growth comfortably outside of recessionary levels. The Fed helped most stocks by lowering interest rates a cumulative 1.0% or 100 bps (basis points) and stocks bounced after a convincing win in the year's Presidential election. This "American exceptionalism" amid considerable geopolitical risk abroad contributed to a strong U.S. dollar which has tempered foreign stocks returns and the repatriated earnings of U.S.-based global corporations. Bonds also benefited from the Fed's rate cuts (+1.8% YTD), but struggled as inflationary concerns rose late in the fourth quarter (-2.6%).

Importantly, artificial intelligence ("AI") and any connection to the technology helped determined winners and losers. The standard S&P 500 index (the "standard" index; +25.0% YTD) which is weighted by market cap (i.e. size) and shares all the same stock constituents as the EW index, illustrates the influence and skew of the largest and best performing stocks over the past several years. These AI driven Magnificent 7[1] stocks collectively climbed 67.0% on average in 2024. But perhaps the best demonstration of the Midas touch of AI is once sleepy Vistra Corp, a previously unknown and uninteresting Utilities stock. Vistra ended 2024 as the best performing stock in the S&P 500, even outpacing Nvidia (second place) as the pacesetter for the year (+258% versus +171%, respectively) as investors surmised the heightened need for power generation in an AI world and the benefits that might be afforded to a company like Vistra.

[1] The Magnificent 7 is a whimsical name given to seven stocks that have been rewarded by the stock market as potential monetary beneficiaries of AI technology. The group includes Alphabet (GOOGL; GOOG), Amazon (AMZN), Apple (AAPL), Meta Platforms (META), Microsoft (MSFT), NVIDIA (NVDA), and Tesla (TSLA).

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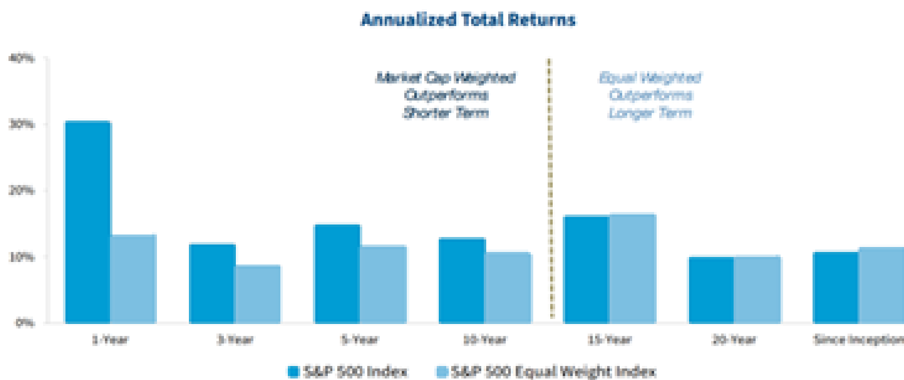
A Common Theme

AI has been a common theme, and a large determinant of winners and losers among stocks over the past several years. Exposure to the technology has meant strong returns for the standard index since early 2023. The NASDAQ (+28.6% YTD) has outperformed the standard index in part because it has greater exposure to the Magnificent 7. The EW index has a smaller exposure to the Magnificent 7 and has trailed accordingly. Small caps, value, and foreign stocks have especially trailed (mostly) because of a lack of exposure to the technology and the Magnificent 7. This has led to a pronounced valuation disparity between these investments which can mostly be attributed to the AI haves and have nots. The first chart below shows that valuations for small caps, value, and foreign stocks have fallen materially and are near internet/dot-com bubble period levels.

The second chart shows that although short-term performance has skewed materially in favor of the (market cap weighted) standard index, long-term performance still tilts in favor of the EW index.



"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.

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Mean Reversion

Mean reversion is a statistical theory that says asset prices fluctuate around a long-term average. When prices deviate materially away from the average (i.e. mean) in one direction, the theory suggests that a "reversion to the mean" will occur where prices move back in the opposite direction. This implies an overcorrection as prices return to their long-term average. Many investors believe that the valuation disparities discussed above will eventually disappear as asset prices "normalize" back towards their long-term averages.

The theory is widely accepted by professional investors and is the basis for the famous phrase "buy low and sell high". It is also utilized in our investment strategy which can be read HERE and in the investment strategy section of this newsletter. The main shortcoming of the theory is that the timing of mean reversion isn't exactly spelled out. Specifically, prices can remain far away from their long-term average for quite some time. Although there are no guarantees, the theory suggests patient investors will eventually be rewarded for their conviction.

Happy Anniversary Cisco!

This March marks the 25th anniversary of Cisco Systems reaching its peak dot-com price. The company rose to fame during the telecom/dot-com bubble as a provider of networking equipment that is a critical part of the internet's infrastructure backbone. We won't debate the Magnificent 7/Cisco comparisons here. However, we will remind our readers that history is littered with former stock stalwarts (General Electric, AIG, etc.) and Cisco serves as a fair reminder that it's incredibly difficult to maintain a leadership position in perpetuity – especially in the technology space.

The company's story is a cautionary tale. Although Cisco survives and may rightfully be considered a blue-chip stock today, it did resemble a modern-day Icarus who flew too high to the sun and fell from staggering highs. Cisco's stock didn't crash to the ground like Icarus, and its stock collapse wasn't a result of business failure. Rather, the stock market and its participants collectively and without much warning, came to the realization that stock's price was well ahead of its fundamentals (i.e the stock was very overpriced).

"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.

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Happy Anniversary Cisco!...(Cont.)

When the dot-com bubble burst, the company's lofty valuations left it vulnerable to a significant fall in its stock price. Many speculators who didn't heed the "buy low and sell high" maxim lost a lot of money if they recently bought the stock at high prices (and subsequently sold it at lower prices) or suffered opportunity costs as they missed out on an opportune time to sell shares that had appreciated in price. Investors who were more patient still waited a long time to recoup the high ground as it took Cisco stock over 20 years to reclaim its dot-com highs. We would caution investors in a similar position today to be mindful of concentration risk.

Talking 'Bout My Generation

The oldest members of Generation X ("Gen-X") are turning 60 in 2025. Sixty is significant because a six-handle makes it clear that retirement is within arm's reach. If retirement wasn't already on the minds of members of Gen-X, it should be now. We've been alerting our readers (read HERE) to the retirement threat many of us face. We say threat because many of us who grew up in the 1980's are behind on saving for our long-term investment and retirement goals. A comfortable retirement future is in jeopardy and many of us risk outliving our wealth.

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"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.

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"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

Closing Remarks

Fortunately, most of us Gen-Xers are not retiring today. Most of us have some time left before that day arrives. Even then, many of us will have a lengthy retirement period to improve our situation. This has good and bad implications depending on how prepared you are. For those who are prepared, longevity means more time spent enjoying ourselves. For most others, it could mean less time to enjoy yourself and more time to worry about outliving your wealth.

We encourage Gen-X and everyone outside this artificial threshold who are similarly situated to start planning as soon as possible for your future. Some of us have already started and are ahead of the rest of us. Others may need help and encouragement. The beginning of 2025 seems like a great time to start thinking seriously about your retirement future. More importantly, it's a great time to start doing something about it.

Last but not least, our thoughts and prayers go out to the Carter family and country. No matter your politics, he was our president. It was just last quarter that we congratulated him on his 100th birthday (please read it HERE) and discussed longevity risk and the potential for us to live longer than we expect, though not necessarily with the vigor of our youth. He lived a better life than most and I am almost certain that he passed in the company of good friends and family. Rest in peace.

We'd like to wish everyone a very happy and prosperous 2025. If you have any questions or comments about investing or the stock market (e.g. reversion to the mean), or about financial planning and your retirement future, please contact us. We'd be glad to hear from you. Happy New Years and all the best.

"Reversion to the mean is the iron rule of the financial markets."
— John C. Bogle

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

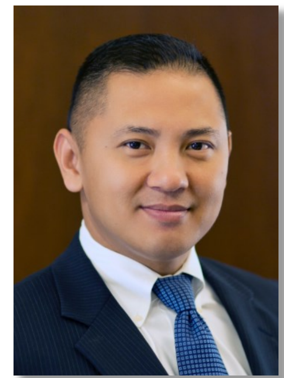
*We seek to exploit stock market volatility in the short-term through a **long-term**, active investment management strategy that seeks to purchase higher **quality** stocks with sustainable competitive advantages and economic moats, and at prices below our calculation of intrinsic value (otherwise known 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

- 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.