October 2025

Belleros Capital Management

The Passionate Investor

3Q2025 Market Review and Commentary

*Market Review **

- *Stocks Stocks outperformed fixed-income markets with the Russell 3000 climbing 8.2% (including dividends) and the Bloomberg U.S. Aggregate Bond index rising 2.0%.*
- *Small caps were stronger relative to large cap stocks as the Russell 2000 rose 12.4%, while the S&P 500 increased 8.1%.*
- *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. dollar terms (+4.8%).*
- *The MSCI Emerging Markets Index outperformed developed, non-U.S. equity markets (international) in U.S. dollar terms (+10.6%).*

** 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)	8.1%	14.8%
S&P 500 Equal Weight	4.8%	9.9%
Russell 2000 (Small Caps)	12.4%	10.4%
Russell 3000 (All Caps)	8.2%	14.4%
NASDAQ	11.4%	17.3%
Bloomberg US Aggregate Bond Index	2.0%	6.1%
MSCI EAFE (USD)	4.8%	25.7%
MSCI Emerging Markets (USD)	10.6%	27.5%

Source: FactSet

Inside this issue

Tim Hai, CFA®, CAIA®

"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 stocks of large companies domiciled in the U.S. recorded impressive gains in the 3rd quarter (8.1%). However, it was the stocks of the smallest companies that led the charge higher for stocks in general (12.4%). The rebound from the second quarter was largely driven by a resurgence in enthusiasm for artificial intelligence or "AI" related stocks, a generally positive period for corporate profits, and a 25-bps cut to interest rates by the Federal Reserve (the "Fed"). Technology and communications stocks outperformed as many companies rushed to increase exposure to AI technology. The attention given to these stocks also led to weaker consumer staple stock performance which generally suffered from a weaker operating environment.

The small cap stock outperformance is particularly noteworthy because the sector had not reported a new high since its 2022 collapse. Other stock market sectors have rebounded from their 2022 lows and continue to notch new highs on a seemingly daily basis. International stock returns were generally mixed as many developed market stocks (especially those in Europe) underperformed and the stocks of many emerging countries (e.g. China) outperformed them. The cut in interest rates also led to a weaker U.S. dollar and has helped boost bond returns across the yield curve[1].

[1] Bond are inversely correlated with interest rates and will fall in price as interest rates rise, and will rise in price as interest rates fall. The yield curve is a graphical representation of interest rates across multiple time periods.

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A New Interest Rate Cycle?

Some economists have suggested that the Fed's 25-bps cut marks the beginning of a new interest rate cycle. But perhaps not? The Fed ended 2024 by lowering interest rates on three consecutive occasions. It elected to hold off on further cuts as it determined that inflation remained sticky to begin 2025 and the new presidential administration promised potentially inflationary trade policy stemming from the use of tariffs[2]. However, what if the "new" interest rate cycle is only a continuation of the one that started in late 2024? One that shouldn't have been on pause to begin with?

What if this "wait and see" approach was incorrect? GDP fell by 0.60% in the first quarter of 2025. Inflation[3] was stubbornly close to level at 3% (its historic average; see HERE) and tariff related gains in price failed to materialize. Most importantly, an announcement that fewer jobs (over a period of a year through March 2025) were created than previously reported (see below) prompted the Fed's September's rate cut and foreshadow potentially more cuts by year end. Should last year's interest rates cuts have continued in early 2025 as the economy slowed (more than expected), inflation remained subdued, and the job market weakened?

[2] Tariffs are taxes or "duties" imposed (by the host country) to manipulate the level the imports of foreign goods and products coming into the country. Additionally, tariffs generate revenues for the host country and may be used to protect home grown or manufactured products that are deemed to be at an unfair disadvantage relative to imported goods. Tariffs are sometimes imposed in retaliation for another country's imposition of a tariff and are thought by many to be inflationary.

[3] The annual US inflation rate was 2.9% for the 12 months ending in August 2025.

"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

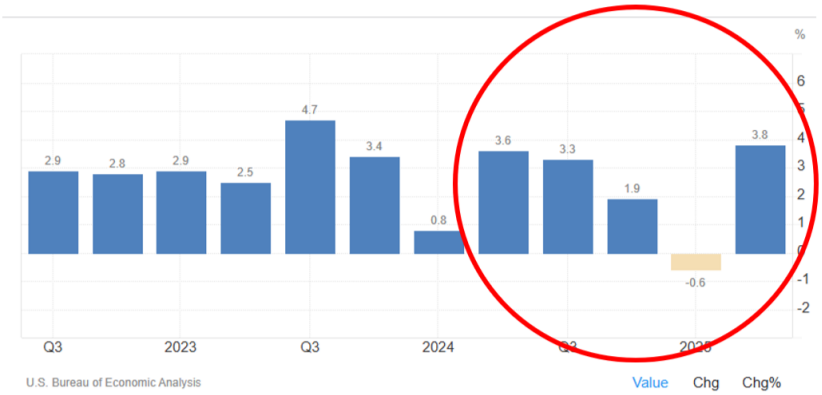
Belleros Capital Management believes that the investment community's definition of risk as volatility is inappropriate and generally does not apply to all participants. Although the effects of volatility can be particularly disastrous to investors that have near-term income or liquidity requirements, 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.

GDP and a State of Recession

Second quarter headline GDP this year was stellar, having recently been revised upwards to 3.8%. However, some economists have already begun questioning the breadth of the gains. Economist Jason Furman recently suggested that GDP has largely been driven by technology, specifically AI spending. Without the tech spending, Mr. Furman suggests a modified GDP figure to be much more subdued (see HERE). Mark Zandi, chief economist at Moody's Analytics, suggests that 22 states and the District of Columbia are officially experiencing a recession (see HERE). If Mr. Furman is correct, the chart below suggests a slowing economy (between 2Q2024 through today) that needs the help of lower interest rates.

Quarterly Gross Domestic Product



A Government Shutdown

The Federal Government is projected to shut down after the last day of September as congress is expected to fail to come to an agreement on a continuing resolution bill that would temporarily fund the government. Many talking heads on television (i.e. contributors to stock market noise) have complained about the potential damage that a shutdown would have on the Fed's ability to steer economic policy. Economists and stock market prognosticators have complained that a lack of data will potentially lead to a period of heightened volatility. We disagree. The stock market is inherently inefficient and volatile because there is too much noise and useless information. Even without a few jobs or inflation prints, there isn't a lack of news or data points to propel volatility. The market can continue to exhibit volatility regardless of a short-term pause in the availability of economic data.

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Flying Blind?

As alluded to above, a recent report by the Bureau of Labor Statistics ("BLS") suggested that the U.S. economy added 911,000 fewer jobs over a 12 month period (ending in March 2025) than initially reported (see HERE and HERE). This represents one of the largest annual revisions to the BLS jobs report on record. This also suggests that the worry of economists and market participants should not be on a lack of data, but rather about the quality and reliability of the data, and the methods used by these institutions to produce the data. Data collection has been poor and perhaps the methods of collection are outdated. This has led to poor data in the hands of the Fed and potentially bad economic policy crafted using faulty data. Economic policy is only as good as the data that it

Closing Remarks

We end this quarter's newsletter with a short conversation about market valuation. It seems like a daily event that the stock market closes at a new record high. The S&P 500 is currently valued at ~24 times expected earnings compared to its historical average of about 17 times. This is despite the stock decline (and rebound) that followed Liberation Day in early April 2025. Much of the over-valuation continues to stem from the usual suspects – mega cap stocks with exposure to AI technology. We know that stocks are highly prone to mean reversion. Undervalued stocks rise back to average valuations over time; overvalued stocks fall back down to earth. What we don't know is when the timing of these events take place.

We do not prognosticate. We also do not try to time the market. We invest with a long-term time horizon in mind. Sufficient diversification is important as we walk on the eggshells of an overbought stock market. International investors were rewarded this year for their patience and to some degree small cap investors this past quarter. But even in these markets, a valuation discount exists such that there is still a big valuation gap with mega cap technology. Investors should continue to be patient and disciplined, understanding that opportunities (corrections and bear markets), although rare, do come with greater frequency than one might think (see HERE). Investors must be vigilant and be prepared to strike when the proverbial iron is hot. We wish everyone a wonderful end to the year as we enter the last quarter. All the best.

"The stock market is a device for transferring money from the impatient to the patient" -- Warren Buffett

"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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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.