

Belleros Capital Management

The Passionate Investor

3Q2026 Market Review and Commentary

*Market Review **

- *Stocks **outperformed** fixed-income markets with the Russell 3000 **rising** 1.4% during the quarter (including dividends) and the S&P U.S. Aggregate Bond index **falling** 3.1% during the quarter.*
- *The Russell 2000 index (-7.2%) of small cap stocks **underperformed** the S&P 500 index (+2.0%) of large cap stocks.*
- *International or developed, non-U.S. equity markets (as determined by the MSCI EAFE**) **underperformed** U.S. markets in both U.S. dollar (+0.3%) and local currency (+0.6%) terms.*
- *The MSCI Emerging Markets index **underperformed** developed market stocks in both U.S. dollar (-0.4%) and local currency (-2.9%) terms and during the quarter.*

Month and Quarter-to-Date Performance

Index	QTR	YTD
S&P 500 (Large Caps)	2.0%	11.8%
S&P 500 Equal Weight	-2.3%	8.6%
S&P 1500 Growth	2.5%	15.3%
S&P 1500 Value	-0.1%	7.5%
Russell 2000 (Small Caps)	-7.2%	13.7%
Russell 3000 (All Caps)	1.4%	12.4%
NASDAQ	2.5%	15.6%
S&P US Aggregate Bond Index	-3.1%	-2.3%
MSCI EAFE (USD)	0.3%	10.8%
MSCI EAFE (Local)	0.6%	12.4%
MSCI Emerging Markets (USD)	-0.4%	23.4%
MSCI Emerging Markets (Local)	-2.9%	23.1%

** 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.*

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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

Stock market breadth was quite narrow in the 3rd quarter as the few winners seemed to include only large stocks that had anything to do with "AI" or artificial intelligence. Investors may recall that this general trend has been in place since the post-COVID period began. The S&P 500 index of market cap-weighted large caps stocks once again ***outperformed*** most other indices. However, an imbalance was apparent even among these stocks as the S&P 500 index of equal weighted stocks fell 2.3%. As the name implies, every company in the equally weighted index is given the exact same weight - approximately 0.2% - regardless of its size or market cap. The quarter's negative return suggests that a majority of stocks in either index had negative performance in the third quarter despite the strength in a handful of the top stocks.

The broader weakness in stocks was corroborated by most other market sectors and regions from U.S. small caps to emerging market (the Russell 2000 index fell 7.2% while the MSCI Emerging Markets index fell 2.9% during the quarter in local currency). The reason for the diverging performance is complex. AI has been a tailwind for the larger cap technology stocks and their fundamental (earnings-based) strength has lifted them up. However, despite their own improving fundamentals, a cloud or headwind driven by inflation, tariffs, and geopolitical tensions (i.e. the U.S./Iran war) pushed hard against most of these laggards. Rising interest rates (in particular) negatively impacted returns on bonds[1], small caps, and emerging market stocks.

[1] *Bond prices are inversely related to bond yields.*

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A Strong Outlier

Energy stocks surged 16.5% as crude oil prices and supply was severely impacted by the U.S./Iran war (see HERE). However, what was painful for consumers (especially at the pump) proved beneficial to shareholders. Investors with only a nominal exposure to the energy sector benefited from its natural hedge against rising energy and oil prices. Investors with a more than casual exposure to energy investments may have experienced significant support in their investment portfolio. Investors would have welcomed this diversification during the third quarter given dismal bond returns.

Fundamental Underweight

The S&P 500 has a de minimis exposure to the energy sector (3.4%; see HERE). By comparison, the technology sector weight (including technology-related stocks) in the S&P 500 is over 40% (see HERE). This relative (and absolute) underweight to energy stock exposure is probably experienced by most investors who are passively invested. Given the energy sector's importance to the U.S. and world economies (generally), perhaps an argument can and should be made for a larger exposure here. Investors may find that a 3% to 15% target to energy stock exposure may be warranted and beneficial.

Rising Interest Rates

The Fed raised interest rates by 25 basis points or 0.25% in the 3rd quarter with many market participants expecting several more increases over the next year. Regardless of the reason for higher rates, they represent a large hurdle for borrowers or home buyers (and consumers generally). This growing impediment can lead to lower economic growth over time. Investors with pre-existing exposure to bonds prior to the recent uptick in yields have been seriously impacted by falling prices. This is especially true for active bond investors who've recently purchased bonds at higher prices. Rising interest rates increase the likelihood of a permanent loss of capital or sharply lower bond returns. Unlike in most years, 2026 is shaping up to be an uncharacteristically poor year for bond investors and not a safe harbor for them.

"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.

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Glass Half-Full[2]

There exists a strong silver lining (or opportunity) for bond investors who have experienced ***unrealized*** losses. Recall that bonds are characterized by their coupon, term to maturity, and price features. In particular, ***most*** bonds are issued at par and mature at par if they are "held to maturity". This means that (generally) although bond prices may fluctuate in price between their issue and maturity dates, (assuming no default risk) bond prices will always revert back to par value when they mature. This is guaranteed. Bond investors who purchased their securities at par value need only hold onto their investments to maturity to re-coup losses. Price losses on bonds (that do not have a call feature) are said to be "unrealized" or temporary in nature, and, if held to maturity, will see their prices reverse course and rise back to "par" value.

An even bigger opportunity (perhaps) exists for investors who do not already have an exposure to bonds. Bond yields, particularly those with longer maturities and are issued domestically, are currently offering very attractive coupons or yields relative to the past few ***decades***. Yields are also attractive in low-default government-issued bonds. Also, although market timing is not (never) advised, bond yields may become even more attractive over the ensuing year as many investors expect interest rates to rise further (although this is not guaranteed). Patient investors may be able to benefit from this opportunity. Buying multiple tranches or issues (over time) and utilizing a buy and hold (till maturity) strategy will allow patient investors to capitalize on this opportunity.

[2] The discussion above involves plain vanilla bond that are the most basic and standard type of debt security, featuring a fixed coupon rate, regular interest payments, a set face value (par value), and a defined maturity date with no complex features. In our example, we ignore securities with credit or default risks and limit the discussion to plain vanilla bonds that are bought and held to maturity. This discussion is neither a recommendation to buy these investments nor a promise or guarantee of performance.

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Reality Check

After several years of AI domination and outperformance, investors may be overconfident in their investment skills and ability to outperform the stock market. Indeed, they may believe they can plant a stick in the ground and expect it to grow into a strong and tall oak tree. However, we would caution against this irrational exuberance. While AI stocks have risen in recent year based in part on strong enthusiasm and solid fundamentals, the outperformance is not as healthy as one might think. The lack of market breadth, despite some broadening of gains over the past year is still a concern and warrants caution.

Leadership among the top stocks may change numerous times over the next several years and today's winners may not be tomorrow's winners. One needs only to review the dot.com era of stocks and compare the similarities with then-stock market leader Cisco Systems to today's Nvidia. Cisco was the market darling back then and it was expected to continue its unprecedented growth rate until it didn't. It's also important to understand that Cisco didn't collapse as a leading technology company. It just couldn't beat the theory of mean reversion (see HERE). It was priced to perfection and its stock price baked in unrealistic expectations. Even fast growing companies tend to slow down to a terminal or constant growth rate over time and that's just what Cisco stock did. Cisco's stock followed a fast descent into obscurity as it took several decades to recoup its dot.com era price highs (see HERE).

Prospective Thinking

We encourage investors to think more prospectively and not retrospectively. They should be happy with their investment performance since the COVID days. But they should not lull themselves into thinking it can last forever. Investors should review their financial plan to see where they are in relation to their goals. They should dot their proverbial I's and T's. They should review their asset allocation and determine if they still align with their long-term retirement and investment goals. Most investment professionals agree that asset allocation is a big determinant of portfolio returns. They should review their investment portfolios to determine if they still match their risk/reward profile. Finally, they should rebalance and diversify their investment portfolios as necessary.

"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.

Mixed Signals

The economy and investment marketplace is becoming increasingly harder to make sense of (as if that were ever easily done). Geopolitical tensions, tariffs, inflation, and interest rates muddy the water. Questionable fiscal and monetary policy and actions make navigating capital markets even more difficult. The different signals they flash don't foster confidence. Consider the differing signals currently on display in stocks, bonds, and the economy overall. Many stocks are at all-time highs and because of investor optimism based in part on strengthening corporate fundamentals. The economy shows moderate inflationary signs beyond short-term supply-side constraints (despite the Fed's actions) and a resilient labor market. However, the bond market flashes strong warning signs daily with bond yields and interest rates climbing fast.

Closing Remarks

All of these different signals make an economist or stock market prognosticator's job of forecasting the future impossible. Not that we've ever believed them capable of doing so with precision or accuracy. We do not prognosticate or tell fortunes. In times like this, we would lean into the basics. Review your financial plan, asset allocation, and investment portfolio. We are here to help if you need - this is what we do. Most importantly, diversify your investment portfolio, realize some of your investment gains, and rotate them into stocks that may benefit in the future (hint: this is also not an easy task and we typically start with undervalued assets). Although we've seen numerous skeletons and jack-o-lanterns since August, our favorite time of year only began a few weeks back. Since we've already seen a few Christmas displays, let us hope that Fall doesn't drive by so fast. All the best.

"Only when the tide goes out do you discover who's been swimming naked."
-- Warren Buffett

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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.