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TRIVARIATE RESEARCH

INFLATION PLAYBOOK PART 1 OF 2 – BEST STOCK OPPORTUNITIES IN SECOND HALF OF 2021

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INFLATION: PART 1 OF 2 - INFLATION FOR 6-TO-12 MONTHS?

The primary topic of interest following our initiation is inflation. We have been asked about how inflation unfolds, and what the relative investment opportunities are between now and the end of the year. Inflation has multiple facets, and in this first of two notes analyzing inflation, we focus primarily on the relationship between equities and interest rates, both the level and slope of the curve. In our second part, we will focus on commodities and energy.

Conclusion: We think having some exposure to inflation within your equity portfolio continues to make sense. However, we are increasingly mindful this is a 6-to-12-month outlook for now, and not necessarily a longer-term view. Why?

- Primarily we are not sure what the economy looks like without massive fiscal stimulus, and the evidence for wage inflation, even though it typically lags the broader cycle still is not obvious. The employment gap today versus pre-COVID levels is nearly half in hospitality and restaurant jobs, which are lower paying. The key variable to monitor is therefore wage inflation. The FED seems to respond more to aggregate data than news from corporates.
- Wednesday's CPI print showed some headline inflation in expected areas, but more moderate inflation in key underlying areas like rent inflation. Given the FED's dual mandate of stable pricing and full-employment we see low near-term risk to a materially altered monetary policy.

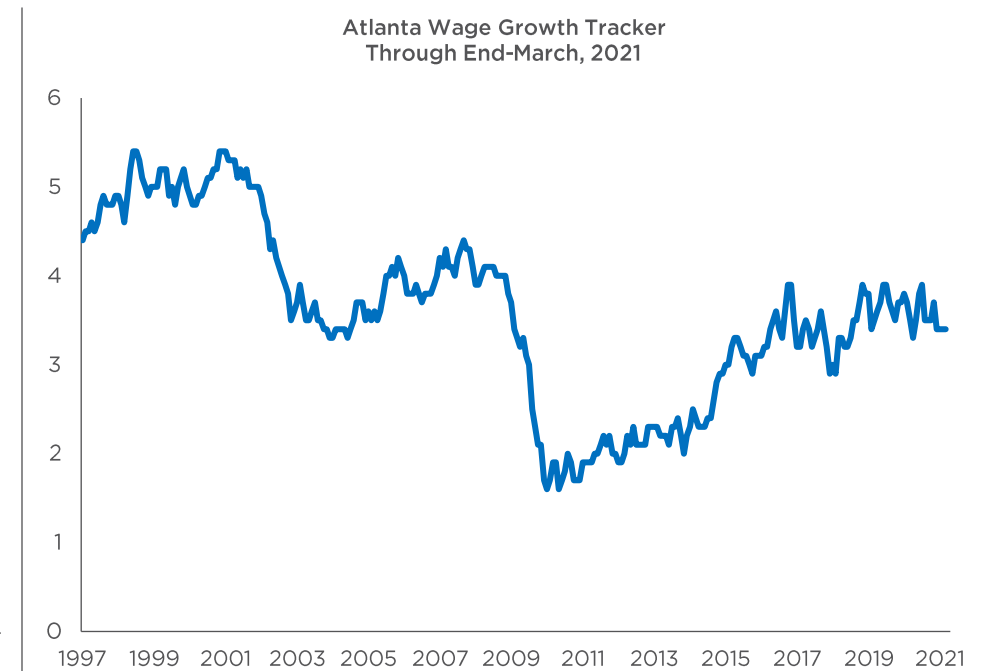
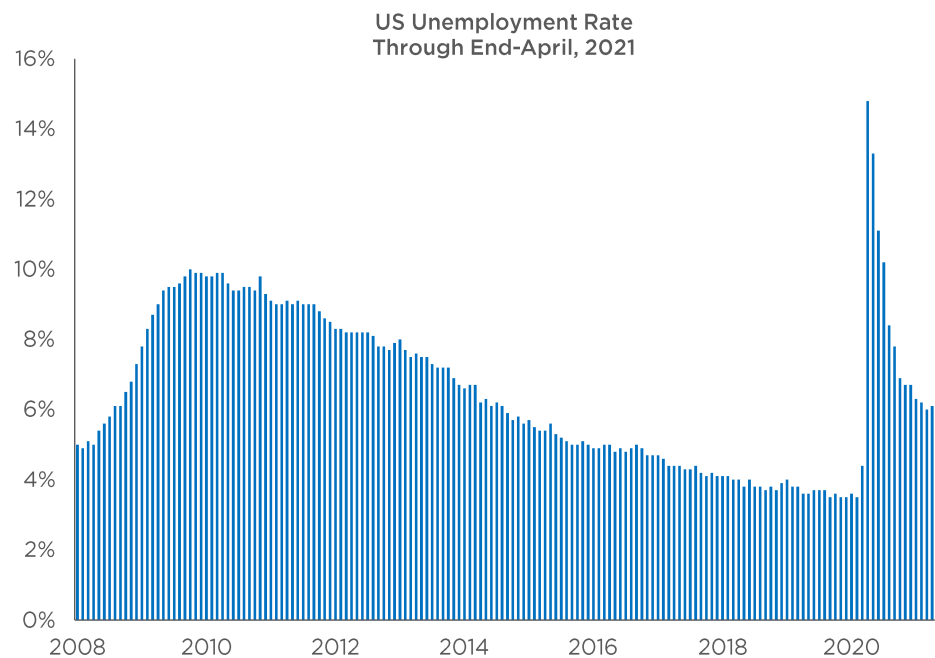
INFLATION: PART 1 OF 2 - OPPORTUNITIES RELATED TO RATES

We analyzed the market-relative returns of each of the 24 GIC industry groups for statistically significant relationships to the trend in the 10-year yield (level) and slope of the interest rate curve (2-year vs. the 10-year yield).

- More than half of the returns of each of the industry groups have never had any statistically significant relationship (above and beyond the market movement) to either slope or level
- **Buy healthcare services and technology hardware:** These groups stock returns typically have a relatively consistent and statistically significant relationship to rising rates and a steepening curve and yet have performed relatively poorly year-to-date.
- **Pair trade banks:** While the returns of banks have consistently had a strong relationship to the level of interest rates, many individual names have experienced strong price-to-tangible book multiple expansion without commensurate improvements in actual tangible book growth since the 10-year yield bottomed last August.
- **Sell utilities:** Utilities is the only industry group that has a persistent negative relationship to both the level of interest rates and the slope of the curve. Other industries like REITS and insurance had negative relationships but now do not, perhaps for fundamental reasons, as REITS now contain substantial “reopening exposure” where that fundamental promise offsets the dividend yield-interest rate relationship

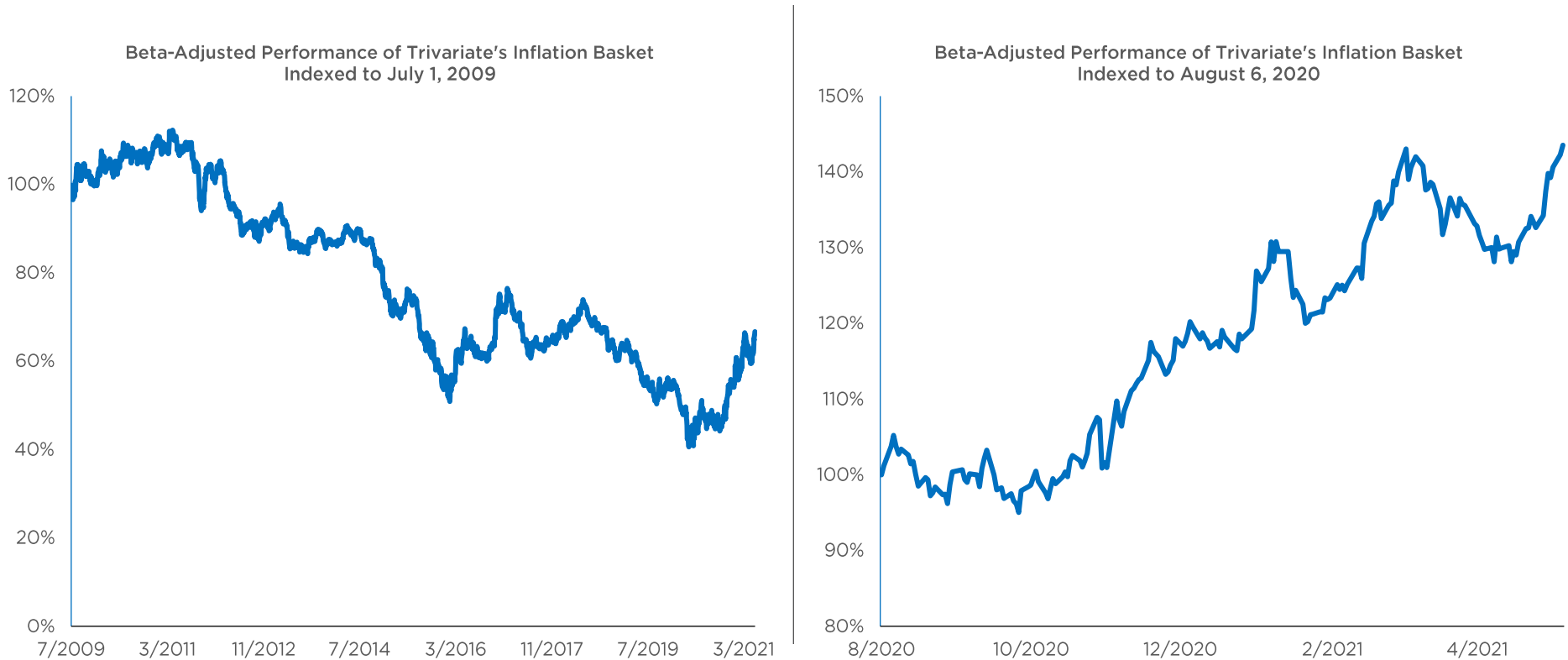
THE KEY VARIABLES TO WATCH ARE EMPLOYMENT AND WAGES

Unemployment and wage growth are the key metrics to monitor as they are most likely to cause a material change to the Fed's outlook. Several investors have implied to us that the Fed is behind the curve. A learning lesson that we have had in the past: whenever we think the experts with 30 years of experience are the dumb ones, we should "get up from the poker table." We need more evidence that the economy can still run well without a massively accommodative monetary policy, a zero percent front-end, and an enormous fiscal stimulus. Employment needs to continue to improve (left exhibit) and wage inflation must be more meaningful before we anticipate a policy shift (see right exhibit)



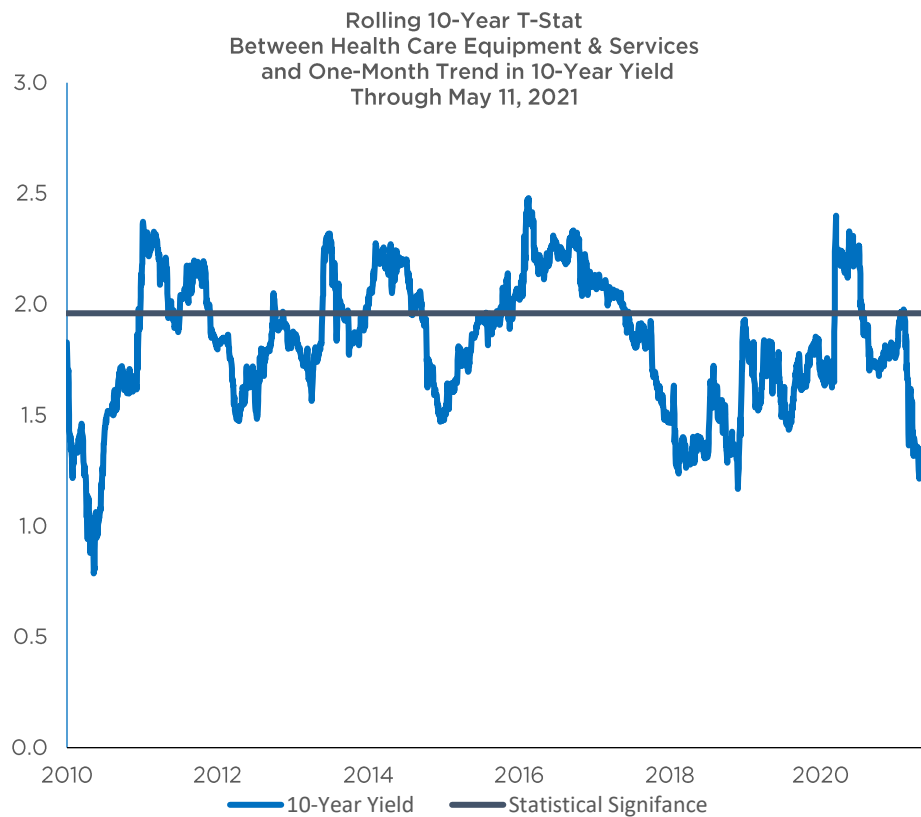
MEASURE AND MANAGE YOUR INFLATION EXPOSURE!

We created an inflation basket to aid investors in their risk management. We suggest you look at the correlation of each stock in your portfolio to our inflation basket to gauge and manage the gross and net exposure of the portfolio to changes in inflation. After years of being a one-way risk (left chart), inflation has been a substantial portfolio tailwind (right exhibit) since the 10-year yield bottomed last August. Virtually no one we talk to thinks the 10-year yield will go lower in the next six months. That is a risk!



CONCLUSION: BUY HEALTH CARE EQUIPMENT & SERVICES

Health care equipment and services is one of the few industry groups with a relatively consistent relationship to the 10-year yield over the past decade. Clearly there are fundamental issues, but the group has not outperformed the market year-to-date, despite what history dictates should have been a tailwind (see left exhibit with t-stat of 1.96 significance band). As such, we offer health care equipment and services stocks that screen well in our quantitative models as candidate long ideas (right exhibit)

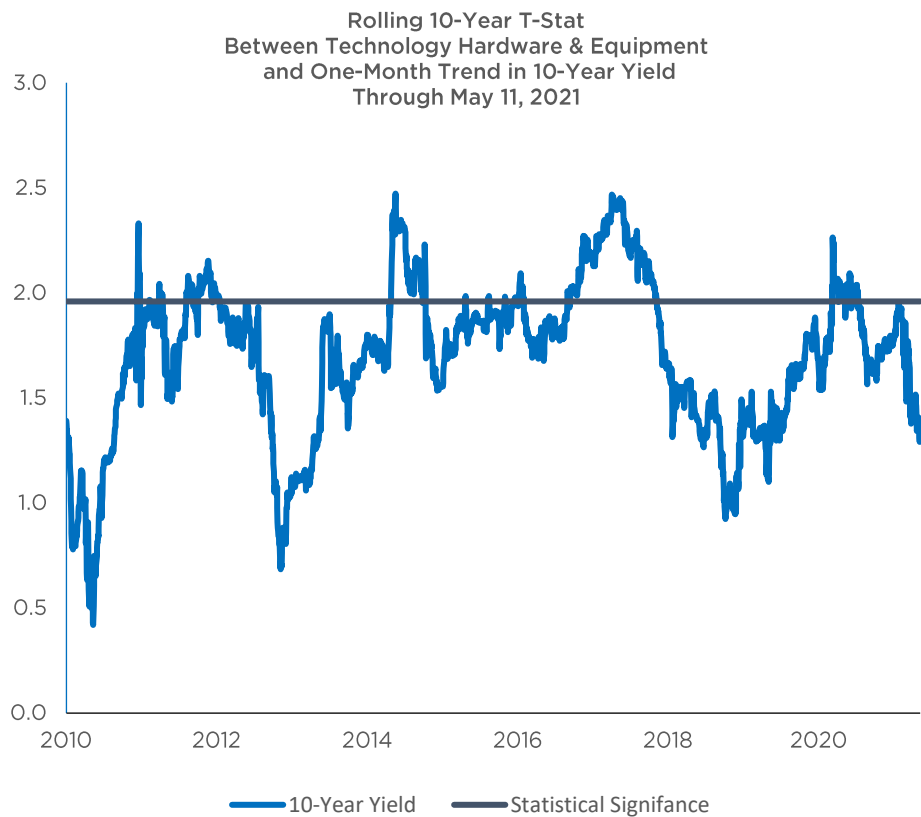


**Health Care Equipment & Services
Top Quintile Model Ranked Stocks
May 11, 2021**

Ticker	Company	Market Cap. (US\$ Bil.)
UNH	UnitedHealth Group Incorporated	388.52
ABT	Abbott Laboratories	210.36
ISRG	Intuitive Surgical, Inc.	99.08
ANTM	Anthem, Inc.	96.59
CI	Cigna Corporation	89.51
HCA	HCA Healthcare, Inc.	68.37
HUM	Humana Inc.	58.80
ALGN	Align Technology, Inc.	44.81
BAX	Baxter International Inc.	42.03
CNC	Centene Corporation	39.66
LH	Laboratory Corporation of America Holdings	29.97
CERN	Cerner Corporation	23.11
TDOC	Telemed Health, Inc.	22.53
CAH	Cardinal Health, Inc.	16.30
MOH	Molina Healthcare, Inc.	15.36
UHS	Universal Health Services, Inc.	13.24
DVA	DaVita Inc.	13.23
AMED	Amedisys, Inc.	8.47
CHE	Chemed Corporation	7.72
ACHC	Acadia Healthcare Company, Inc.	5.65
STAA	STAAR Surgical Company	5.30

CONCLUSION: BUY TECHNOLOGY HARDWARE & EQUIPMENT

In addition to health care equipment and services, technology hardware and equipment also has a relatively consistent relationship to the 10-year yield over time (see left exhibit with t-stat of 1.96 significance band). The group however has lagged this year, with the perception being that many are stay-at-home beneficiaries or are materially over-earning. Potential ideas for a catch-up trade that screen in the top quintile of our quantitative models are shown (right exhibit)

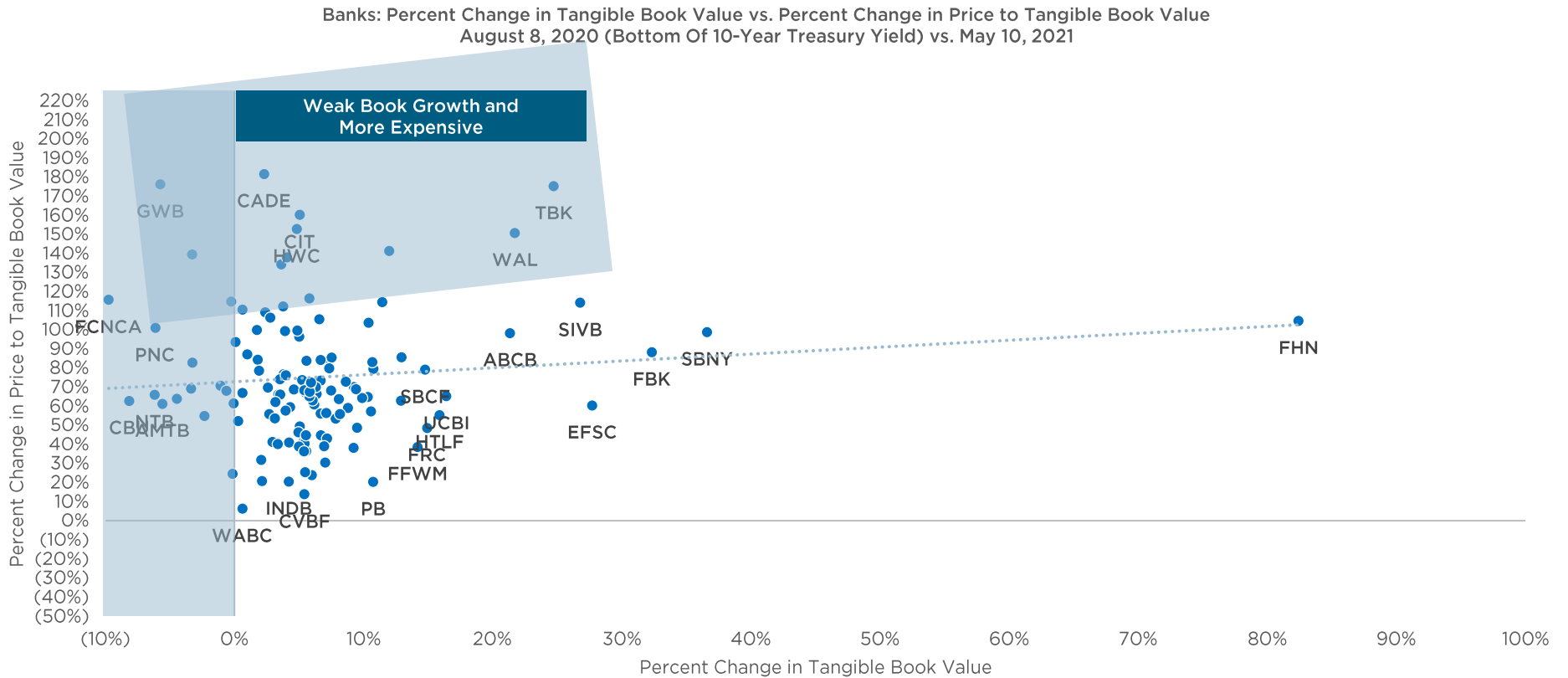


**Technology Hardware & Equipment
Top Quartile Model Ranked Stocks
May 11, 2021**

Ticker	Company	Market Cap. (US\$ Bil.)
TEL	TE Connectivity Ltd.	44.18
HPQ	HP Inc.	41.87
ANET	Arista Networks, Inc.	24.94
ARW	Arrow Electronics, Inc.	8.52
JBL	Jabil Inc.	7.97
LFUS	Littelfuse, Inc.	6.24

CONCLUSION: PAIR TRADE BANKS

Most banks have seen far more multiple expansion since interest rates bottomed last August than they have in fundamental growth in their tangible book. We think it is prudent to avoid those that have had material price-to-tangible book expansion with limited book growth (the blue shaded parts of the chart)



CONCLUSION: SELL BANKS WITH LIMITED TANGIBLE BOOK GROWTH

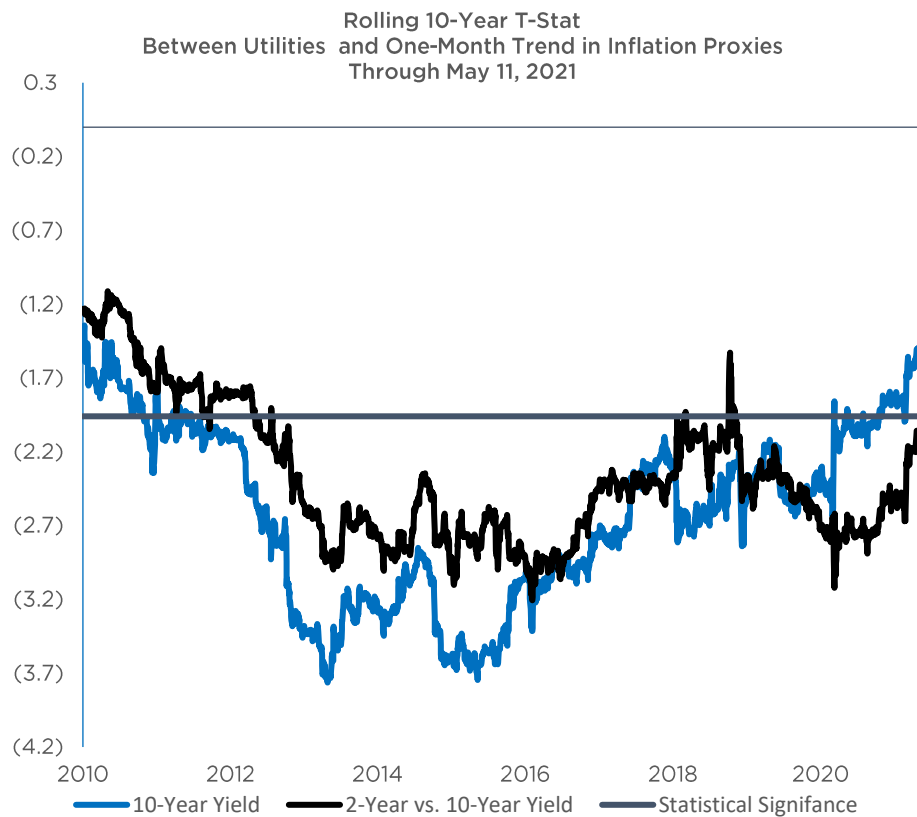
Below are banks that have seen material price-to-tangible book growth since the 10-year yield bottomed last August but have not seen appreciable tangible book expansion over that time frame. Our view is that coming on three quarters off the bottom, these stocks are up more than they should be relative to other banks, and perhaps would be a good area to search for underweight / short ideas

**Banks Stocks with Relatively Weak Tangible Book Growth
That Have Also Seen Material Price-to-Tangible Book Multiple Expansion
August 4th, 2020 Through May 10, 2021**

Ticker	Company Name	Market Cap (US\$ Bil.)	Book Value Growth	Price to Tangible Book Expansion
PNC	The PNC Financial Services Group, Inc.	84.36	(6.1%)	1.0x
TFC	Truist Financial Corporation	81.89	(3.4%)	0.7x
FITB	Fifth Third Bancorp	14.01	(0.2%)	1.1x
EWBC	East West Bancorp, Inc.	5.17	6.6%	1.1x
TCF	TCF Financial Corporation	4.74	(3.3%)	0.8x
CBU	Community Bank System, Inc.	3.46	(8.2%)	0.6x
SNV	Synovus Financial Corp.	3.34	4.1%	1.3x
PNFP	Pinnacle Financial Partners, Inc.	3.10	10.4%	1.1x
STL	Sterling Bancorp	2.49	5.8%	1.1x
PACW	PacWest Bancorp	2.47	3.6%	1.3x
FHB	First Hawaiian, Inc.	2.37	(1.1%)	0.7x
FIBK	First Interstate BancSystem, Inc.	2.25	(4.5%)	0.7x
CIT	CIT Group Inc.	2.04	7.6%	1.6x
HWC	Hancock Whitney Corporation	1.86	4.8%	1.5x
BKU	BankUnited, Inc.	1.84	11.5%	1.1x
FBP	First BanCorp.	1.34	(3.3%)	1.4x
PPBI	Pacific Premier Bancorp, Inc.	1.29	3.8%	1.1x
NTB	The Bank of N.T. Butterfield & Son Limited	1.15	(1.8%)	0.5x
GWB	Great Western Bancorp, Inc.	1.12	(7.9%)	1.8x
CADE	Cadence Bancorporation	0.90	2.3%	1.8x
FBNC	First Bancorp	0.83	0.6%	1.1x
GSBC	Great Southern Bancorp, Inc.	0.63	(2.3%)	0.5x
NCBS	Nicolet Bankshares, Inc.	0.61	(1.1%)	0.4x
LOB	Live Oak Bancshares, Inc.	0.58	7.6%	3.0x
AMTB	Amerant Bancorp Inc.	0.54	(5.8%)	0.4x
TBBK	The Bancorp, Inc.	0.43	8.0%	1.3x

CONCLUSION: SELL UTILITIES

Utilities are the only industry group of the 24 that have consistently had a negative and largely statistically significant relationship to both the slope of the curve and the level of interest rates (left exhibit). The group has lagged this year, and the stocks that screen poorly in our quantitative model are shown in the right exhibit



Utilities
Bottom Quartile Model Ranked Stocks
May 11, 2021

Ticker	Company	Market Cap. (US\$ Bil.)
NEE	NextEra Energy, Inc.	145.28
EXC	Exelon Corporation	43.43
SRE	Sempra Energy	41.94
ES	Eversource Energy	28.86
EIX	Edison International	22.25
PCG	PG&E Corporation	21.62
AES	The AES Corporation	16.88
VST	Vistra Corp.	7.87

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