TRIVARIATE RESEARCH

IS THIS 2010 AGAIN?

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THE RHYMING OF 2009 AND 2010 WHAT TO DO ABOUT IT

1) This recovery since March of 2020 has followed the path of March of 2009 in many ways
2) We evaluated some of the many ways performance and signals have rhymed for the first 300 trading days following the financial crisis and then track what investing style worked beginning in day 301 as a proxy for what is relevant for investors to do today
3) We conclude with the signals and representative stocks that are likely to work now if this pattern of recovery continues

CONCLUSION:

1. The strong run in "junk" stocks / more levered stocks will start to wane
2. Profitability and demonstrated incremental margin expansion will be rewarded
3. Valuation on average was not effective at predicting winners from losers at this same point in the recovery post the financial-crisis, though there may be pockets of intra-industry efficacy
4. We offer 4 long and 4 short ideas based on signals we think work at this point in the cycle and where we see some fundamental logic for them performing well

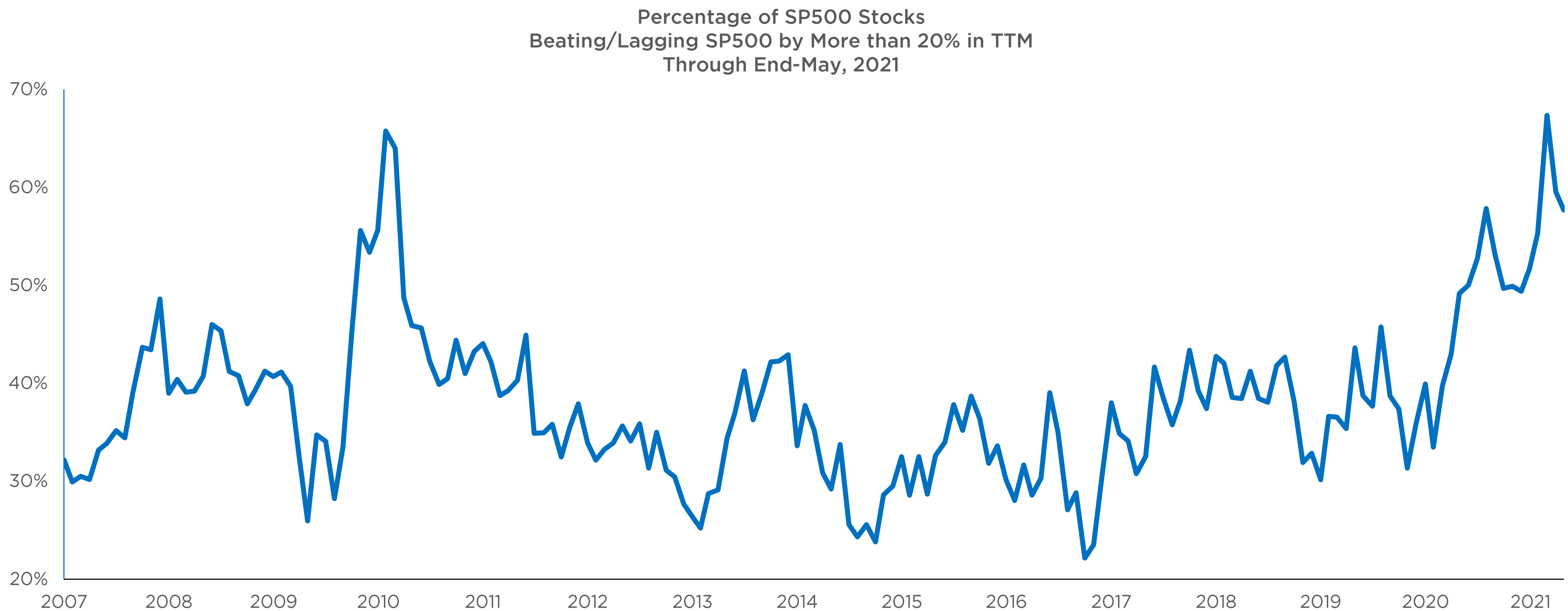
THIS CYCLE MIRRORS THE 2009 RECOVERY IN SEVERAL WAYS

The recovery we have seen since the March 2020 market lows has mirrored the 2009 recovery in many ways including:

1. **The opportunity** set – the number of stocks that beat or lagged the cycle looks identical
2. **Profitability degradation** – the stock performance of companies with both little or high margin degradation have tracked a similar path
3. **Small / micro-cap valuation and profitability** – price-to-forward earnings ratios expanded as profits contracted in 2009 and 2020 for small / micro-cap stocks the same way
4. **Junk vs. quality** – probably the way the cycles are most similar is the strong outperformance of "junk" stocks in the initial phases of the recovery
5. **Short interest failed** – heavily shorted stocks massively failed as stocks discounting some probability of bankruptcy recovered strongly following government intervention – obviously this has recently been fueled by retail armies and meme stocks, but there was also a failure of efficacy in 2009
6. **Low price** – strong outperformance of stocks that had previously underperformed and became "single digits" is another sign of similarity between the cycles

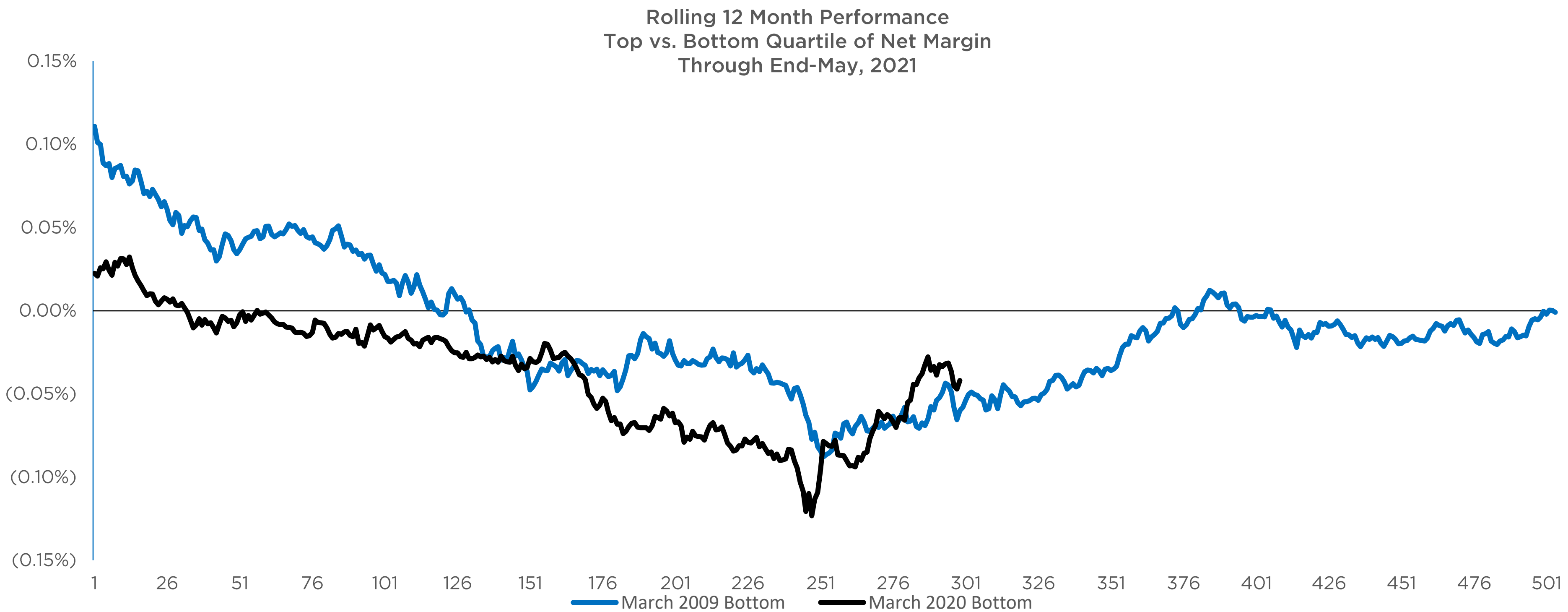
RHYME ONE: THE HUGE RECOVERY CAUSED MANY OPPORTUNITIES

The percentage of stocks lagging (beating) the SP500 was extremely high in 2020 following COVID. While this "opportunity set" is declining from its peak now, there are still plenty of stocks that have materially weaker (stronger) returns than the broader market. We expect more than half the stocks to have returns 20% lower (or higher) than the SP500's returns in the next 12 months –nearly identical to what we saw following the 2009 bottom and recovery



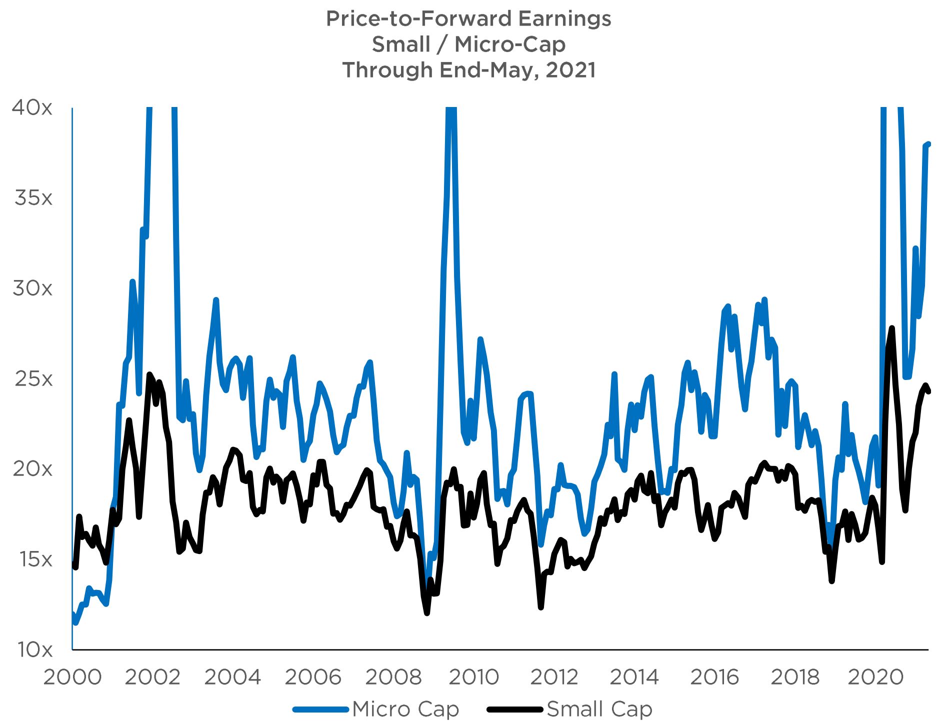
RHYME TWO: PERFORMANCE OF STOCKS RELATIVE TO PROFITS

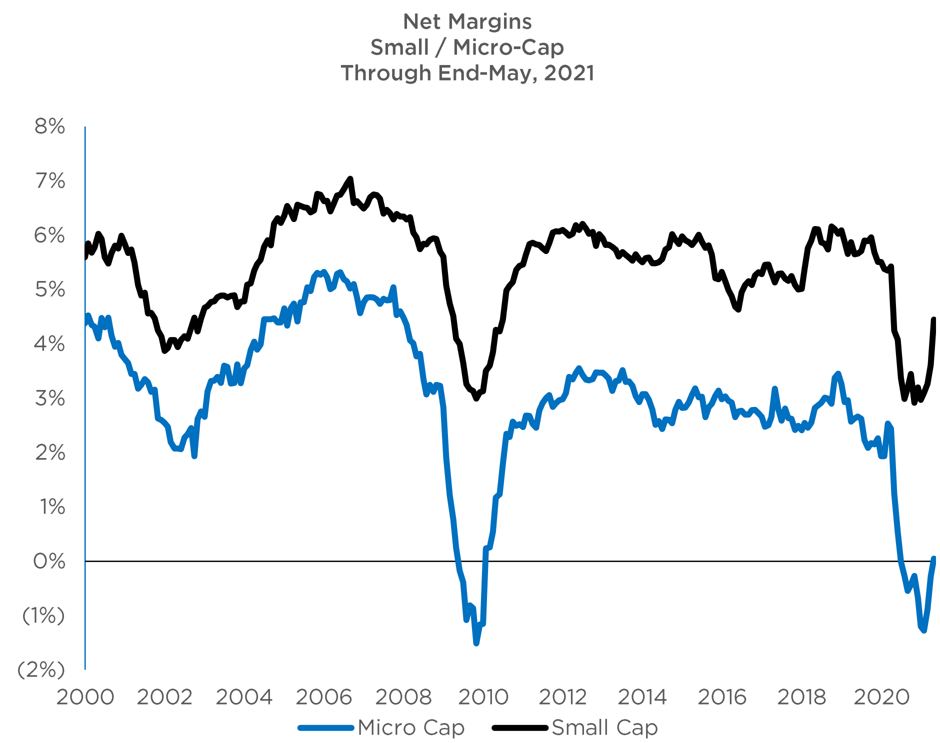
We analyzed the trailing 12-month stock performance of companies that had high vs. low profit degradation and the performance is tracking very similarly. The relative performance of the top quartile of stocks with net margins to the bottom quartile on margins shows that lower margin stocks outperformed through the first year, and then began to underperform – we expect a normalization now with higher margin companies continuing to outperform



RHYME THREE: SMALL / MICRO-CAP VALUATION AND PROFITABILITY

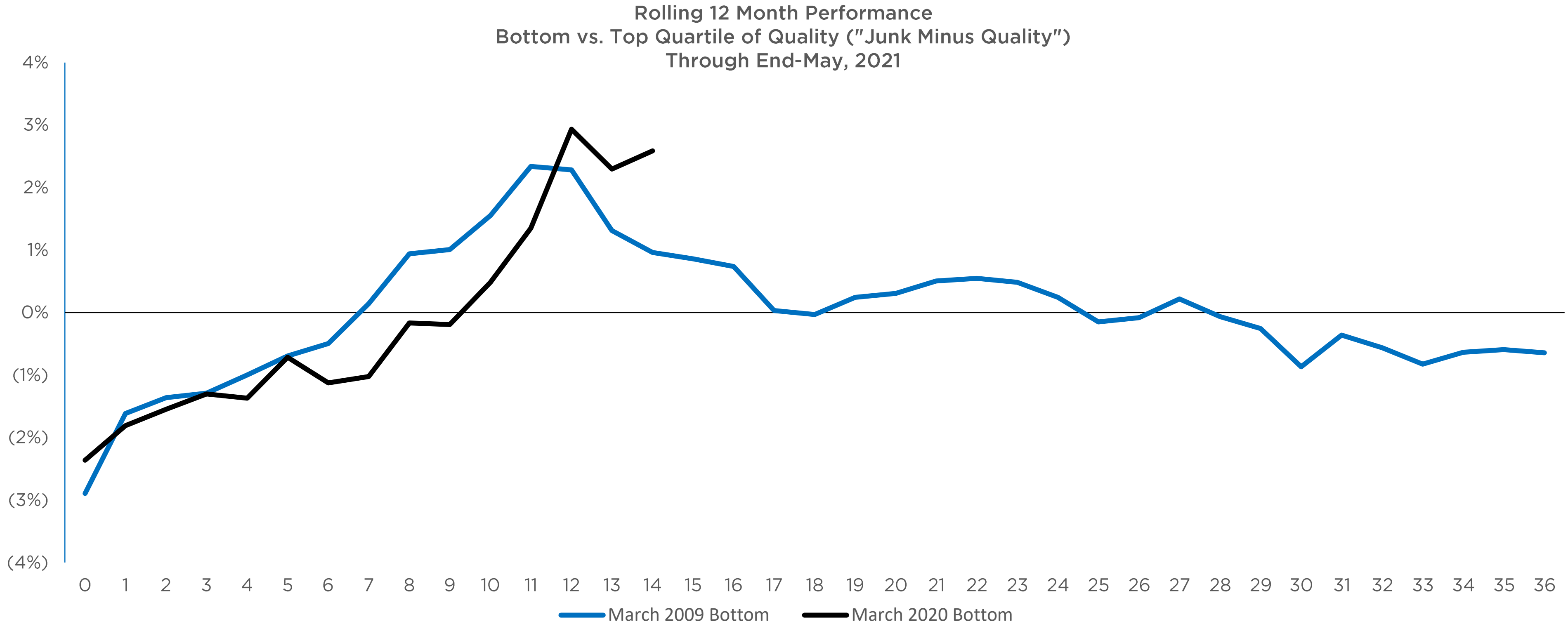
Small-and-micro-cap price-to-forward earnings have strongly expanded, but profitability has not recovered. Sure, markets are typically anticipatory, but multiples have now eclipsed prior cycle highs (left chart). Net margins for small-and-micro-caps bottomed at the same level in 2020 as they did after the financial crisis (right chart)





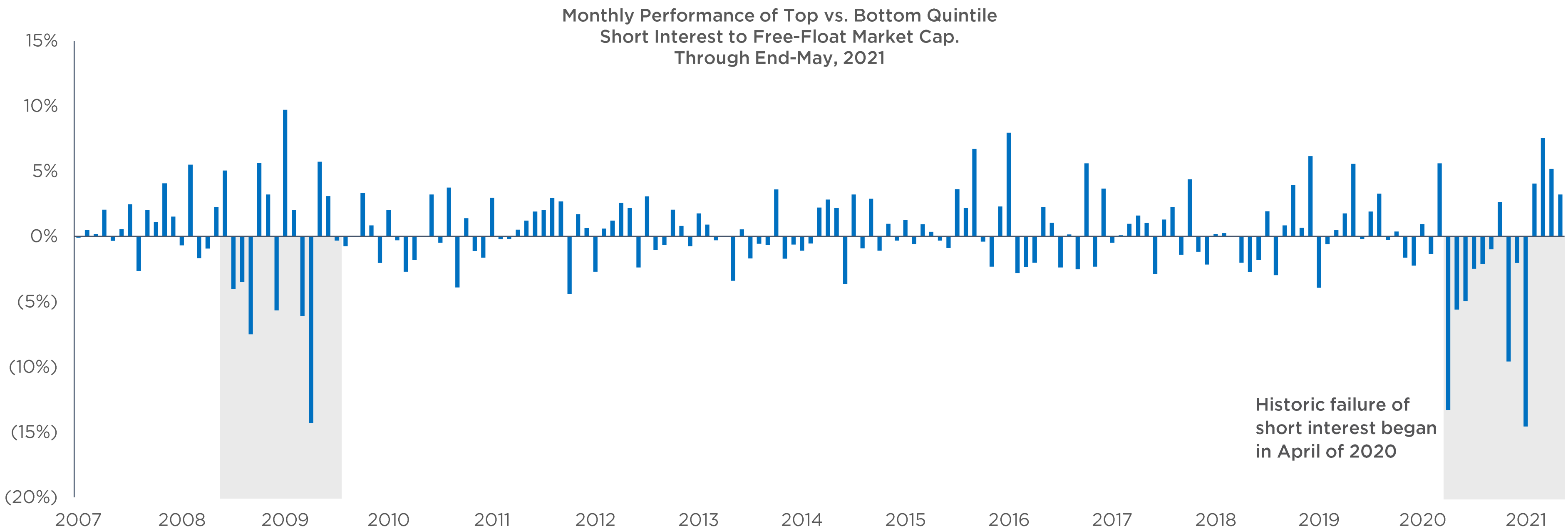
RHYME FOUR: PERFORMANCE OF JUNK VS. QUALITY STOCKS

In 2010 a portfolio manager said to me “I can’t wait until the next recession so I can just buy all the junk stocks”. That turned out to be another clear similarity we saw following both recessions. We have a model that systematically labels each stock as high, moderate, low quality or junk and we track the performance of junk relative to quality from the market bottom. Overall relative performance to date has been similar. We would be surprised to see junk continue to outperform much longer going forward, though there was some modest outperformance in May



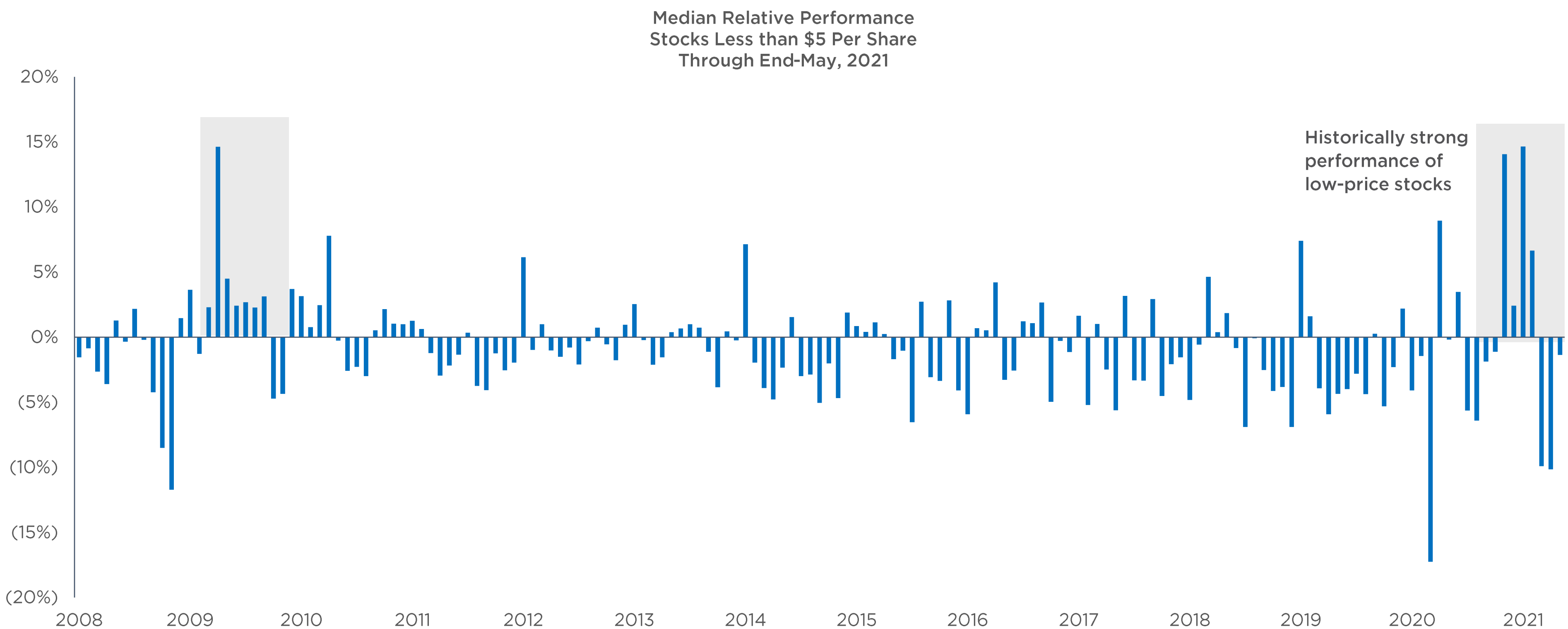
RHYME FIVE: SHORT INTEREST FAILED

Many quantitative investors use high short interest as a signal to predict subsequent stock underperformance. Many fundamental managers share their top short ideas, fueling more short interest. As such, for long periods of time, stocks with high short interest underperformed. This materially failed beginning in 2020. At our hedge fund, Trivariate Capital, we wrote in our Q2 2020 letter that we did not think it was prudent to short stocks with short interest above 15% given the failures we saw immediately following the global financial crisis. We obviously did not foresee the retail armies / meme stocks that would form several months later, but there is no doubt that monitoring short interest and avoiding stocks with above 10% short interest remains prudent risk management today



RHYME SIX: LOW PRICE

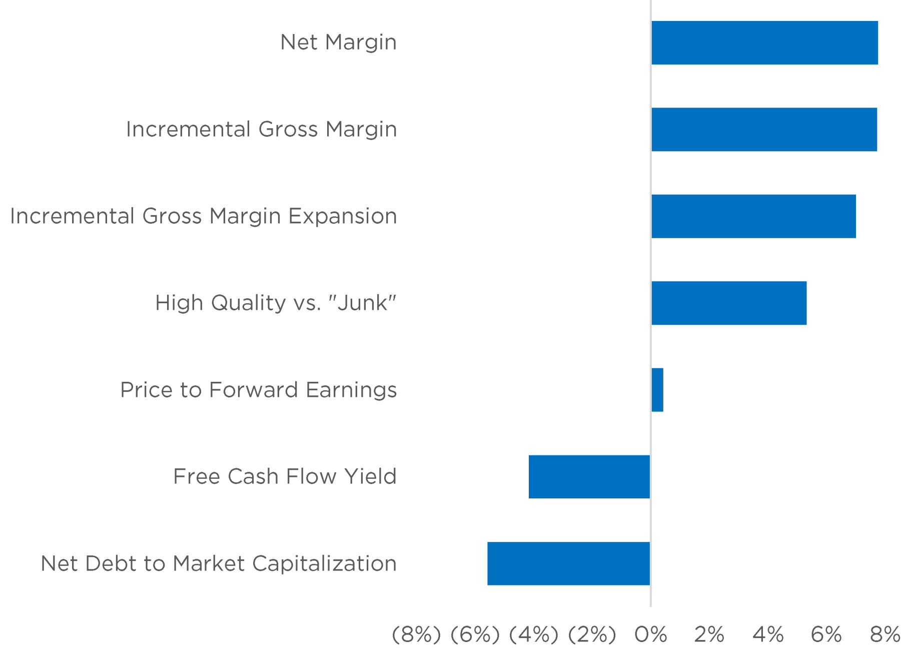
After a long period where stocks that traded at less than $5 per share underperformed, a huge recovery of "low price" stocks unfolded last year (top exhibit). When we were managing our hedge fund, we also implemented a rule not to short any stocks below $5 a share last June and changed that to $10 in the fall of 2020. A large low-quality recovery can make shorting low-price stocks very dangerous, another feature of the post-financial crisis recovery



WHAT WORKED LAST TIME AND IMPLICATIONS FOR TODAY

We are currently 300 trading days from the market bottom on March 23, 2020. In the six-month period following the 300 days after the Financial Crisis, quality beat junk, and profitability metrics such as net margin and incremental margin level and expansion were efficacious, while valuation lagged (left chart). Stocks that were cheap on price-to-forward earnings did not outperform stocks that were expensive on price-to-forward earnings. Four long and four short ideas that embody the historically efficacious metrics with fundamental logic we judge to be sound are shown on the right

Six-Month Forward Spreads
Top 500 Companies
May 17, 2010 – November 12, 2010



Rhyming Beneficiaries
June 1, 2021

Ticker	Company Name	Industry Group	Market Cap ($ US. Bil)
Long			
V	Visa, Inc.	IT Services	483.35
EW	Edwards Lifesciences Corporation	Health Care Equipment & Services	59.13
ODFL	Old Dominion Freight Line, Inc.	Road & Rail	31.06
CPRT	Copart, Inc.	Commercial Services & Supplies	29.76
Short			
Ticker	**Company Name**	**Industry Group**	**Market Cap ($ US. Bil)**
WBA	Walgreens Boots Alliance, Inc.	Food & Staples Retailing	45.67
PPL	PPL Corporation	Electrical Utilities	22.31
LUMN	Lumen Technologies, Inc.	Diversified Telecommunication Services	15.63
TAP	Molson Coors Beverage Company	Beverages	12.63

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