TRIVARIATE RESEARCH

TRIVARIATE'S SECOND HALF OUTLOOK

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INVESTMENT CONCLUSIONS

1. **The 2H of the year should be a good market for alpha generation**
2. **Everything does make sense, at least year to date** – the market is up 15% YTD and analysts have taken up their earnings expectations for 2021 by 14% since December 31st of 2020. Incremental gross margin expectations appear more achievable in materials and retailers than in capital goods and semiconductors
3. **On inflation, we see disinflationary forces eventually surfacing again**, and are not surprised to see bear flattening. **If we see steepening again, owning healthcare services** might be an under-the-radar screen way to gain exposure. We would be **neutral on banks heading into earnings**, as many have seen strong multiple expansion without commensurate growth in their tangible book. **We remain VERY bullish on energy and materials**, as they have the "triple crown" of positive earnings revisions, positive momentum, and cheap valuation vs. history
4. **This cycle is rhyming the 2009-2010 recovery in many ways**, and the conclusion is clear - **buy stocks with high and expanding profitability, do not use price-to-forward earnings** to separate winners from losers in the next six months. When we analyzed what to do after growth-stock sell-offs, the answer was the same – positive free cash flow and margin expansion work best for picking winners
5. **We prefer large cap over small, but would be balance on growth vs. value**, with some margin-expanding growth and energy / materials in value
6. Stock ideas from our research that embody our work are shown on slide 50

FOUR REASONS THIS A GOOD ALPHA GENERATING MARKET

1. **Company-specific risk** rose sharply then leveled for the broader market. It has become depressed in banks, with over 70% of that sector's returns explained by our 7-factor model. Semiconductors are one of the few industries that have become even more macro of late
2. **Valuation dispersion** is very high across the broader market, particularly in retailers and staples
3. There is a **large opportunity set** and potential shorts are abundant
4. **Pairwise correlation** is low and falling in most areas, including in retailers, but has risen to near 20-year highs in banks. During the last 6 months, the average pairwise correlation of a bank stock was near 0.7

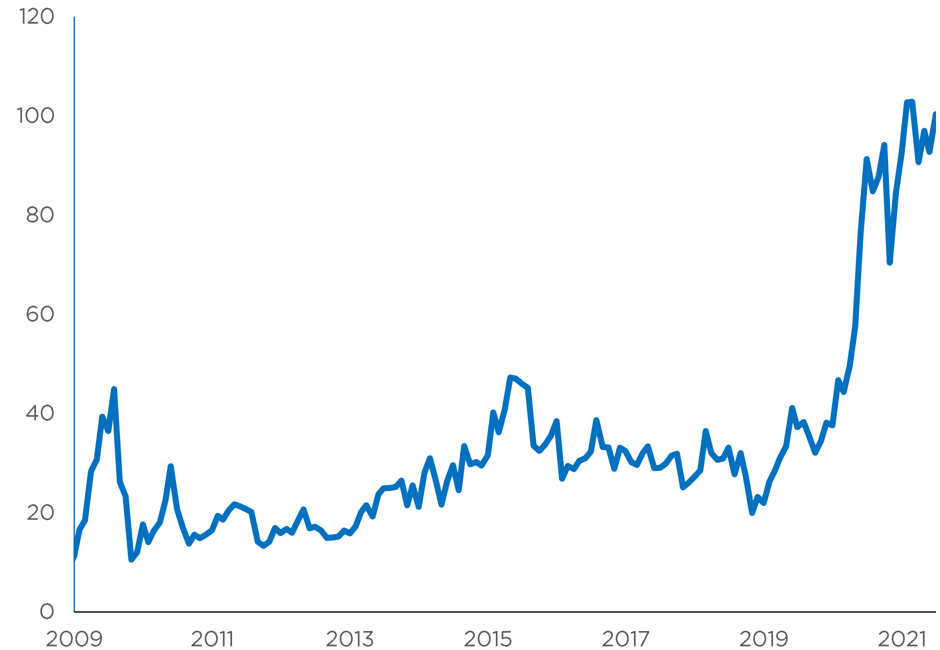
Putting it all together, we think the second half of this year likely will see above average alpha generation as the combination of company-specific risk, pairwise correlation, valuation dispersion and the "opportunity set" look above average

COMPANY-SPECIFIC RISK AND VALUATION DISPERSION HAVE RISEN

Since the market bottomed in March 2020, company-specific rose sharply and has now leveled off (left chart). Below we show how much of the median's stock return can be explained by our proprietary seven factor model – equity market beta, two size factors (mega/large vs mid and mid vs. small/micro), style (growth vs. value), substance (quality vs. junk), liquidity, and momentum. At the peak of the COVID market hysteria, nearly 70% of the average stocks' return could be explained by these macro signals. Today, it is less than 50%. Generally, fundamental stock pickers generate more alpha when company-specifics are increasingly mattering more. Dispersion of price-to-forward-earnings has also widened to a decade-high point (right chart), which is not necessarily bullish overall but does bode well for fundamental stock picking as mis-pricings are more common when dispersion is wide and widening

Company-Specific Risk
Median Stock in SP500
Through End-June, 2021

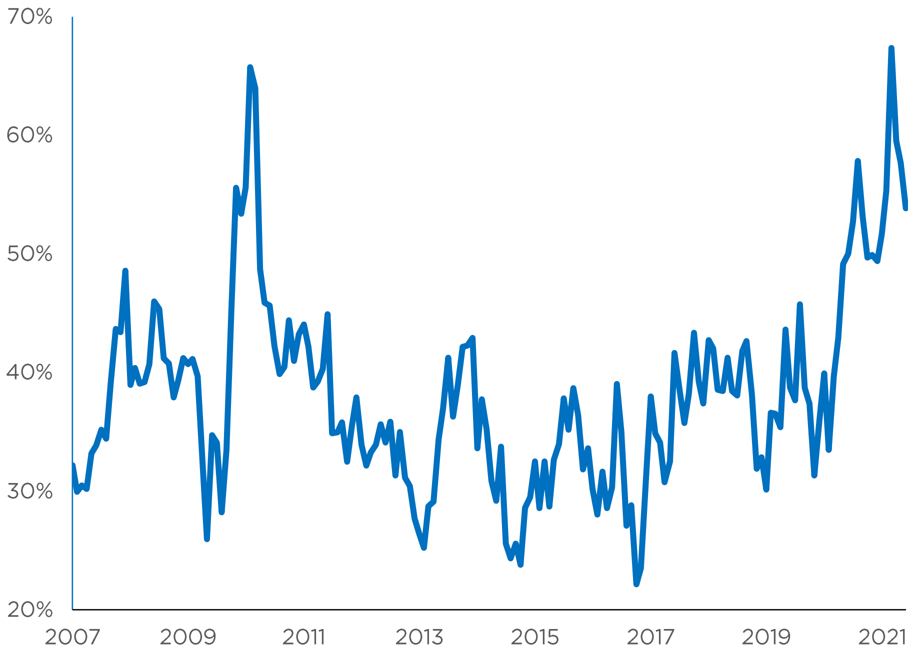
Dispersion of Price-to-Forward Earnings
SP500 Stocks
Through End-June, 2021



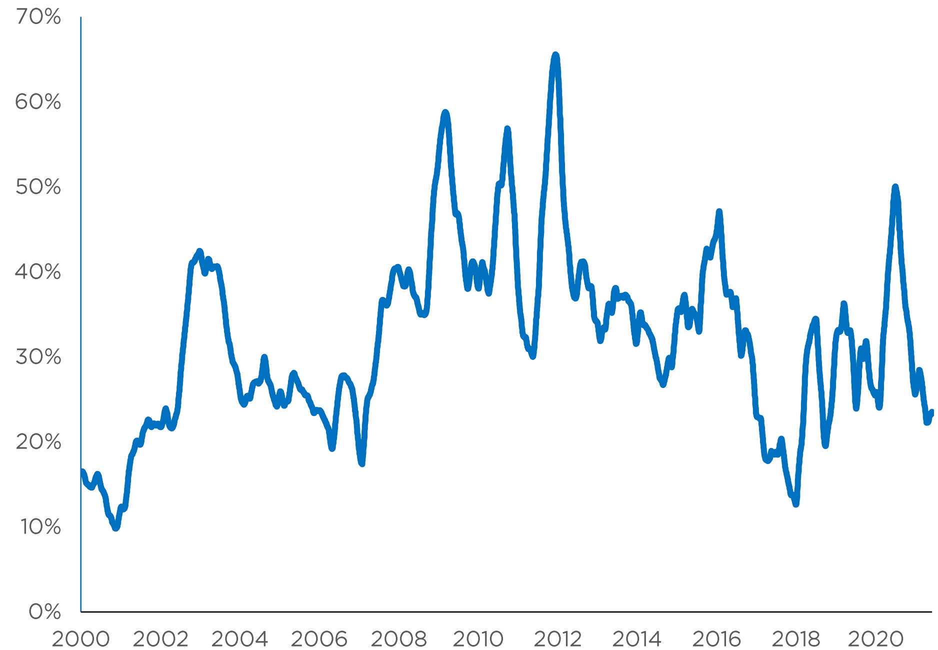
THERE IS AMPLE OPPORTUNITY AND CORRELATIONS ARE DOWN

The percentage of stocks lagging (beating) the SP500 was extremely high in 2020 following COVID (left chart). While this "opportunity set" is declining from its peak now, there are still plenty of stocks that have materially stronger (weaker) returns than the broader market. We expect more than half the stocks to have returns 20% higher (or lower) than the SP500s returns in the next 12 months, which we define as the "opportunity set". The median pairwise-correlation of returns of each of the SP500 stocks has declined sharply since the peak of the COVID crisis in March of 2020 (right chart). At 0.24 for the most recent period, correlations are now below the 20-year average and meaningfully below post financial-crisis averages

Percentage of SP500 Stocks
Beating/Lagging SP500 by More than 20% in TTM
Through End-June, 2021

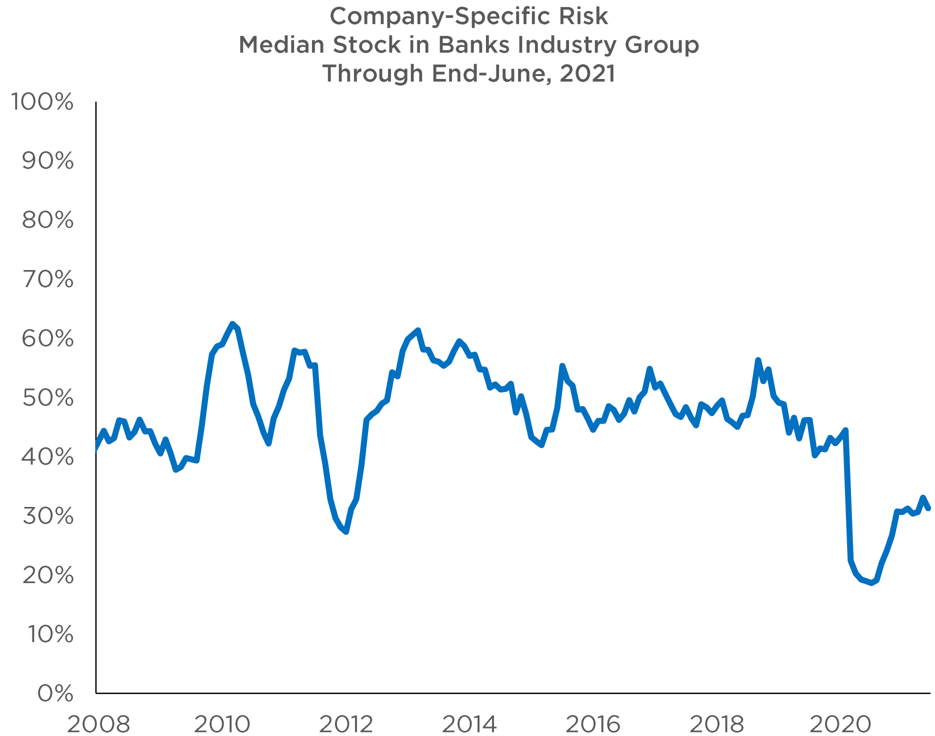


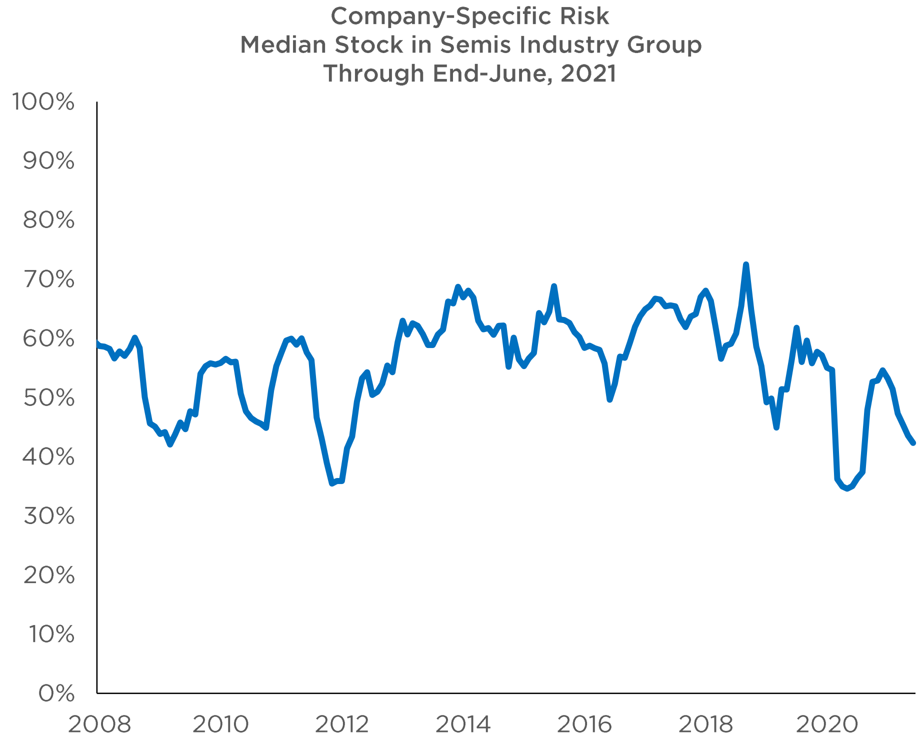
Median Pairwise SP500 Stock Correlation
Rolling 126d Average
Through End-June, 2021



BANKS ARE A MACRO CALL, AND SEMIS ARE INCREASINGLY SO

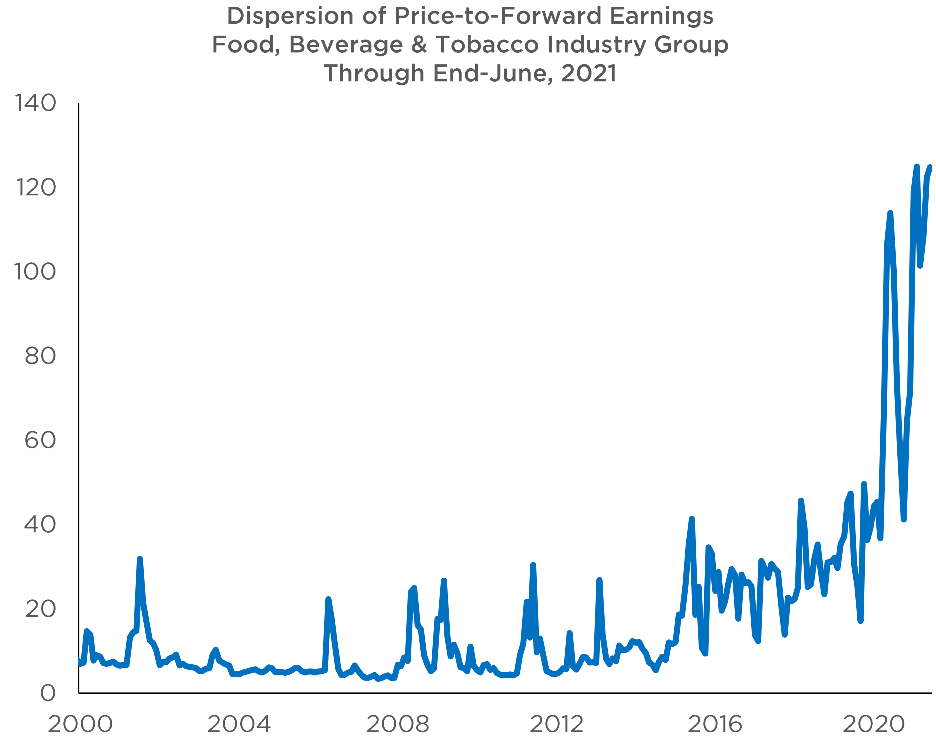
We looked at the returns of the banks (left chart) and semiconductors (right chart) returns to see what was explained by our 7-factor company-specific risk model. The returns of the banking industry are about 70% explained by macro factors Semiconductors are one of the few industries that have become less company-specific this year





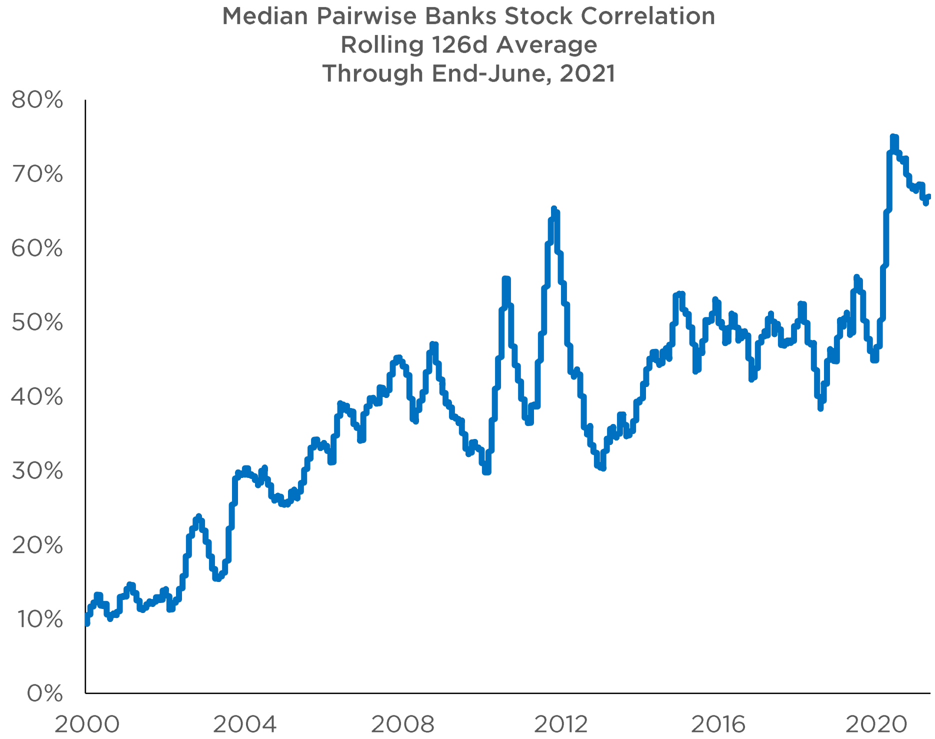
RETAILERS AND STAPLES HAVE WIDE VALUATION DISPERSION

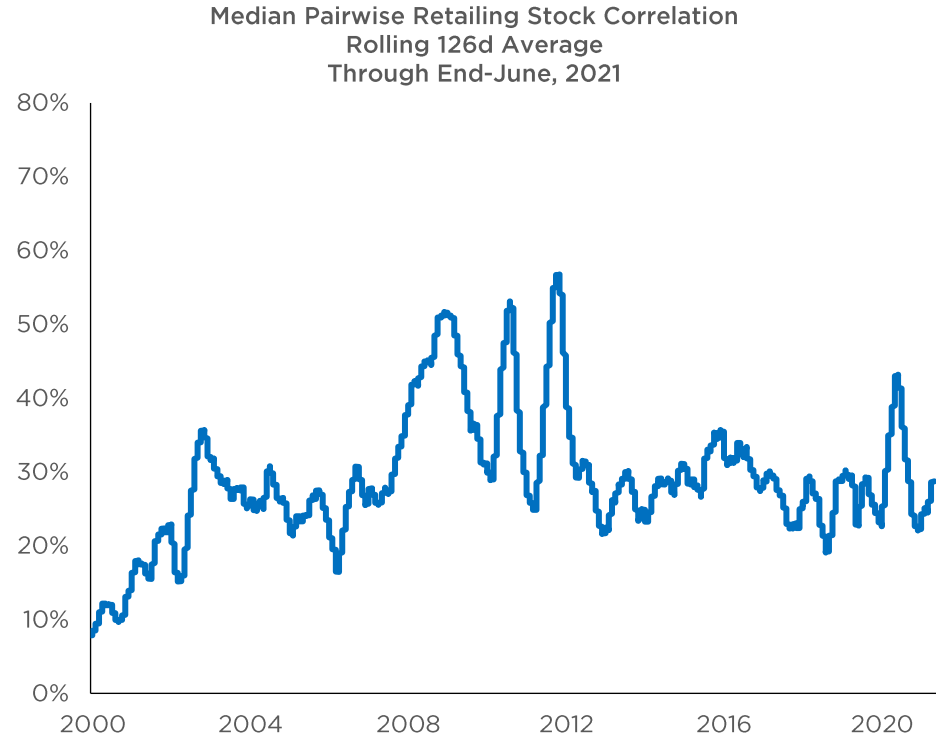
Driving the market wider dispersion are several sectors, with retailing (left chart) and food, beverage, & tobacco (right chart) particularly standing out. We analyzed the industry level profit margins and don't see any materially fundamental cause, meaning there will likely be good stock-picking opportunities in these industries with valuation levels so historically dislocated



BANK STOCK CORRELATIONS NEAR 20-YEAR HIGH, RETAIL LOW

While pairwise correlations for the broader market are low, that is not the case for every industry, with banks (left chart) being the most notable standout. The average 126-day pairwise correlation for a bank is nearly 0.70, which is just off of 20-year high levels. Retail stock correlations on average are only 0.30 (right chart) – a logical reason why investors ubiquitously view banks as a more macro call (growth, rates, etc.) and retailing a more idiosyncratic call (trends, inventory, etc.)



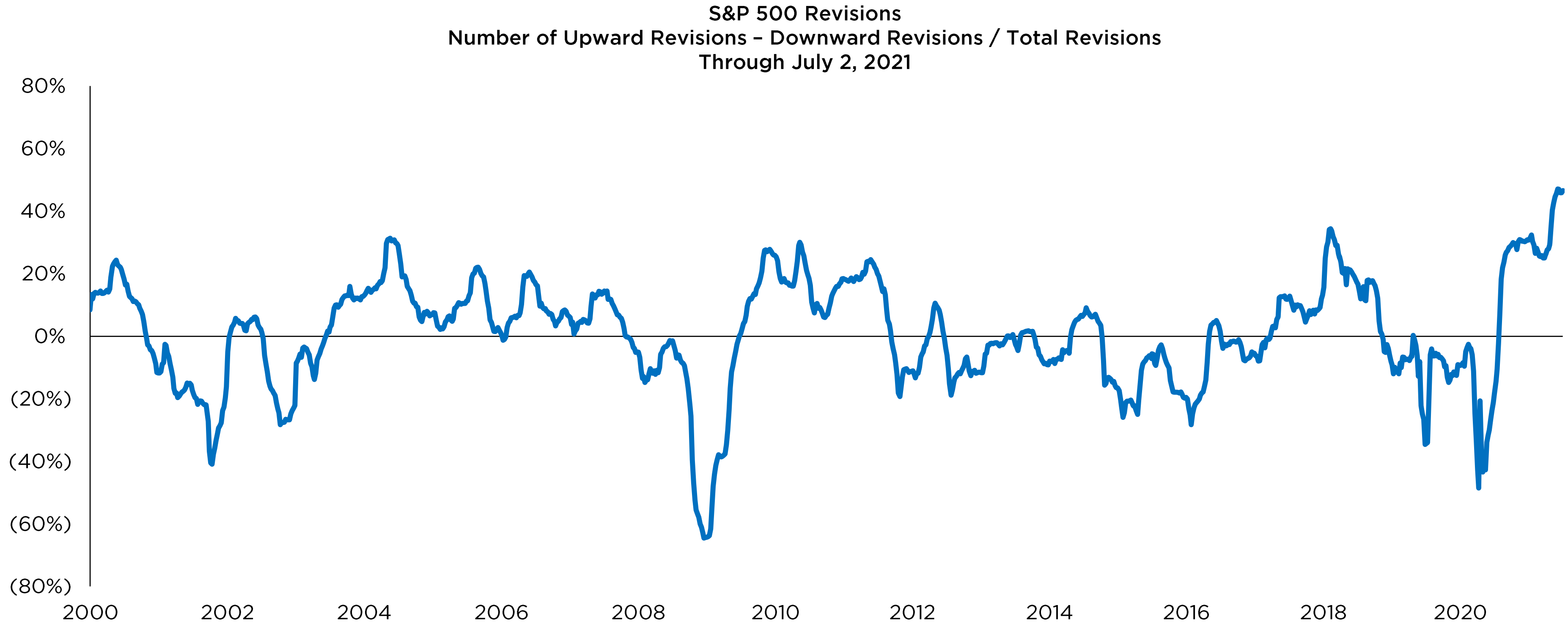


DOES EVERYTHING ACTUALLY MAKE SENSE?

1. **Earnings revisions have sharply risen during the first half of the year**. The SP500 is up 15% YTD, and the bottom-up analyst earnings estimates for calendar year 2021 are now 14% higher than they were on December 31st of 2020. Maybe everything does make sense, at least year to date!
2. Retailers, capital goods, banks, and energy have all seen near record high number of upward revisions (relative to total analyst estimates this year). Our suspicion is that energy and retail estimates are relatively more achievable than banks and capital goods in 2H of 2021
3. Utilities have seen more downward revisions than upward revisions YTD. If we were at a long-only firm, we would be adding to our utilities exposure into July earnings. Expectations are low and the bull-flattening is usually associated with better performance if sustained
4. Incremental gross margin expectations are crucial to gauge at this point in the cycle. Materials and retailers on average appear to have lower expectations and potentially above average estimate achievability. Capital goods and semiconductors have analyst estimates that embed incremental margin expansion above the business model averages in many cases, potentially a harbinger for below average estimate achievability

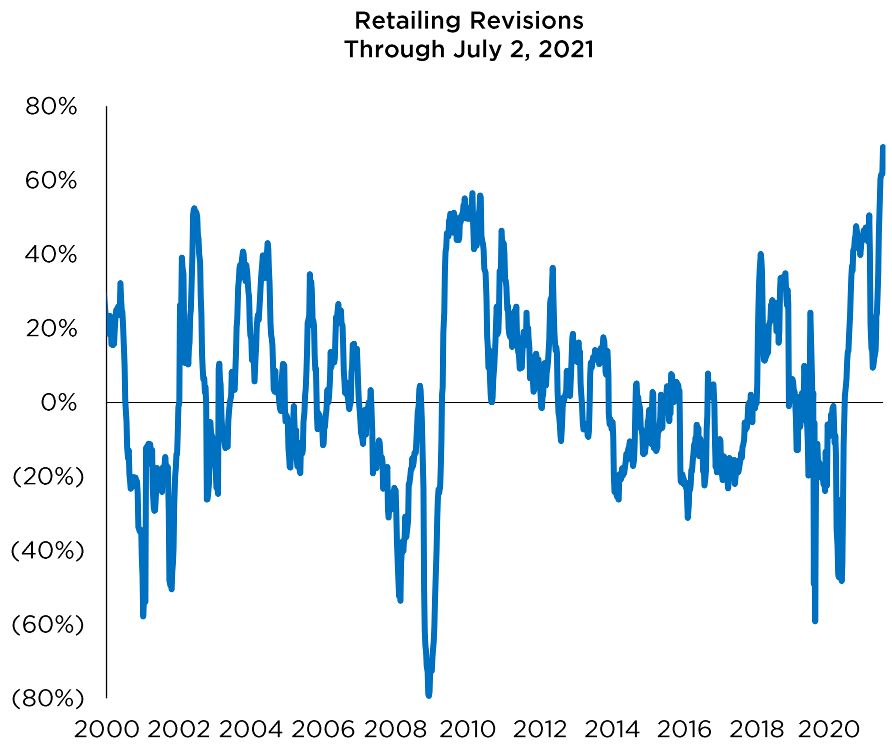
MORE ANALYSTS HAVE RAISED NUMBERS THAN ANYTIME IN 20 YEARS

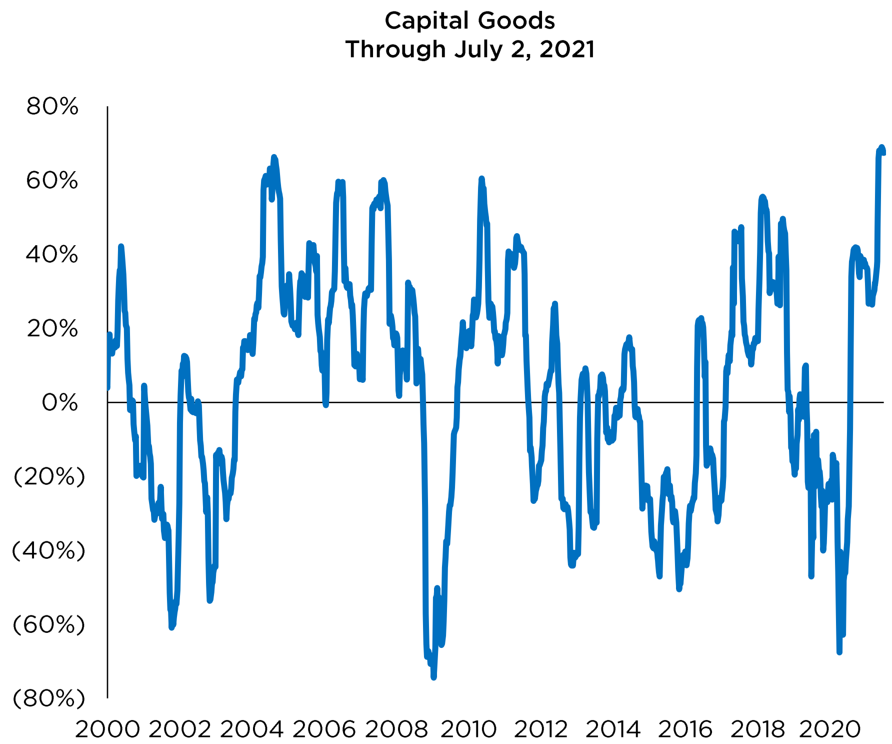
We show the number of upward revisions less the number of downward revisions divided by the total number of analysts here as a proxy for how many analysts have been raising or lowering numbers. For the SP500, we have just seen the highest percentage of analysts raise their earnings numbers than any week in the last 20 years! For context, earnings expectations for the SP500 were 167.9 on December 31st, 2020 and are 191.98 now, meaning estimate are 14.1% higher today for 2021 earnings than they were at the beginning of the calendar year



RETAILERS AND CAPITAL GOODS HAVE SEEN 20-YEAR HIGH REVISIONS

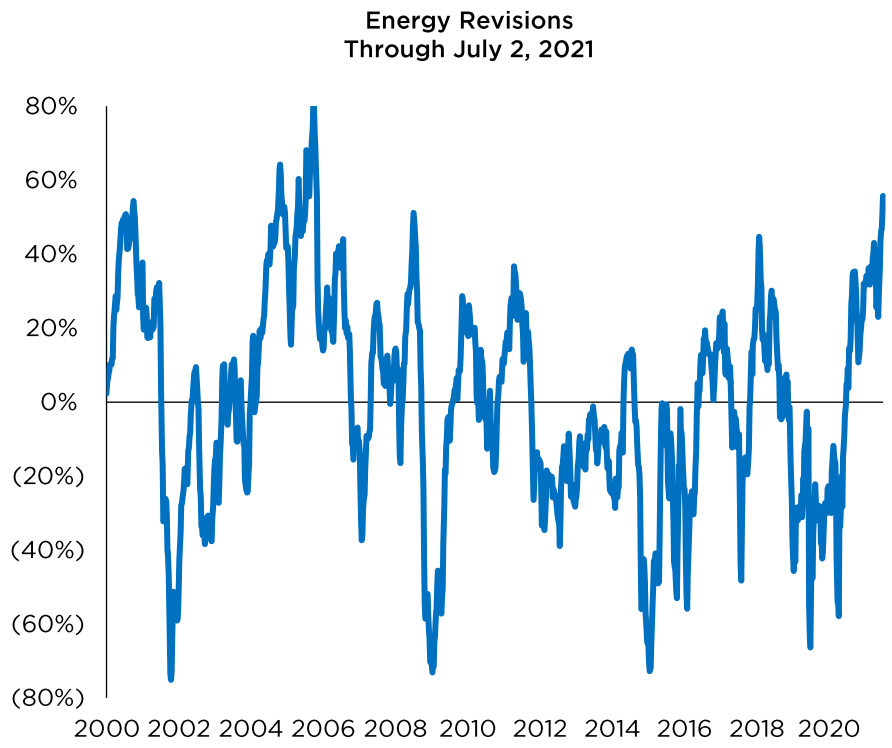
Economically sensitive businesses like retail (left), where the consumer has been handed money and has a high saving rate have seen a record high number of upward revisions this year. Capital goods, coming off a year of massive downward revisions last year, has not also seen near-cycle high upward revisions (right chart)

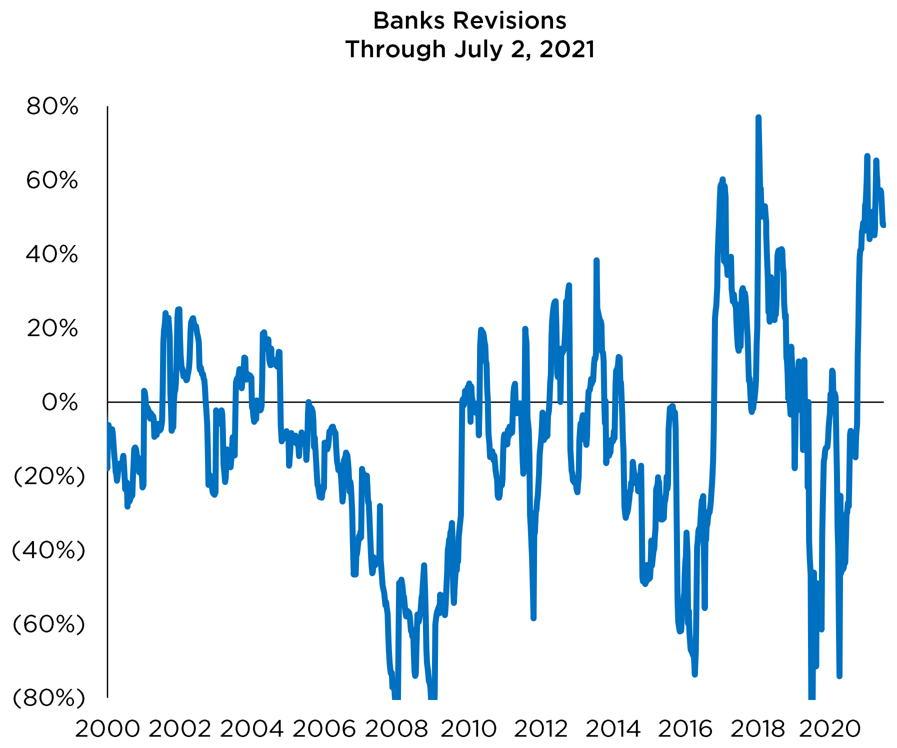




ENERGY ESTIMATES COULD RISE BUT MAYBE BANKS ARE TOO HIGH?

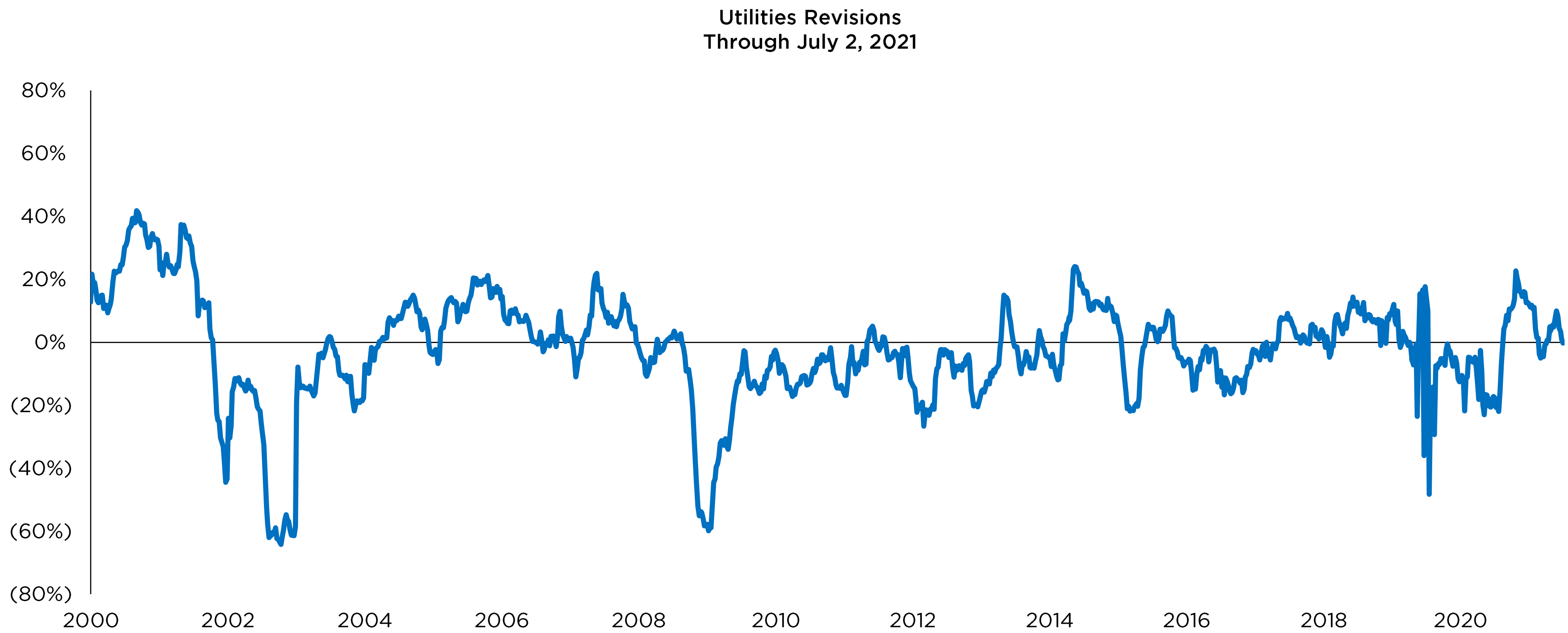
Energy estimates have come up as well, though we think there is likely further upside given how much oil has risen in the recent week (left chart). Bank estimates have also seen some substantial upgrades (right chart) but we think estimate achievability is at best average for banks, with net interest margins likely not expanding as much during the quarter as management team's thought when they guided in April





UTILITIES ESTIMATES HAVE BEEN CUT AS THE MARKET'S HAVE RISEN

The utilities sector is one of the few with more downward than upward revisions YTD. Given these stocks usually perform well during bull-flattening due to the relative attractiveness of their dividend yields vs. the risk-free rate, we could see tactically buying these stocks into earnings



EARNINGS EXPECTATIONS PEAK IN Q2 AND DECELERATE UNTIL Q1

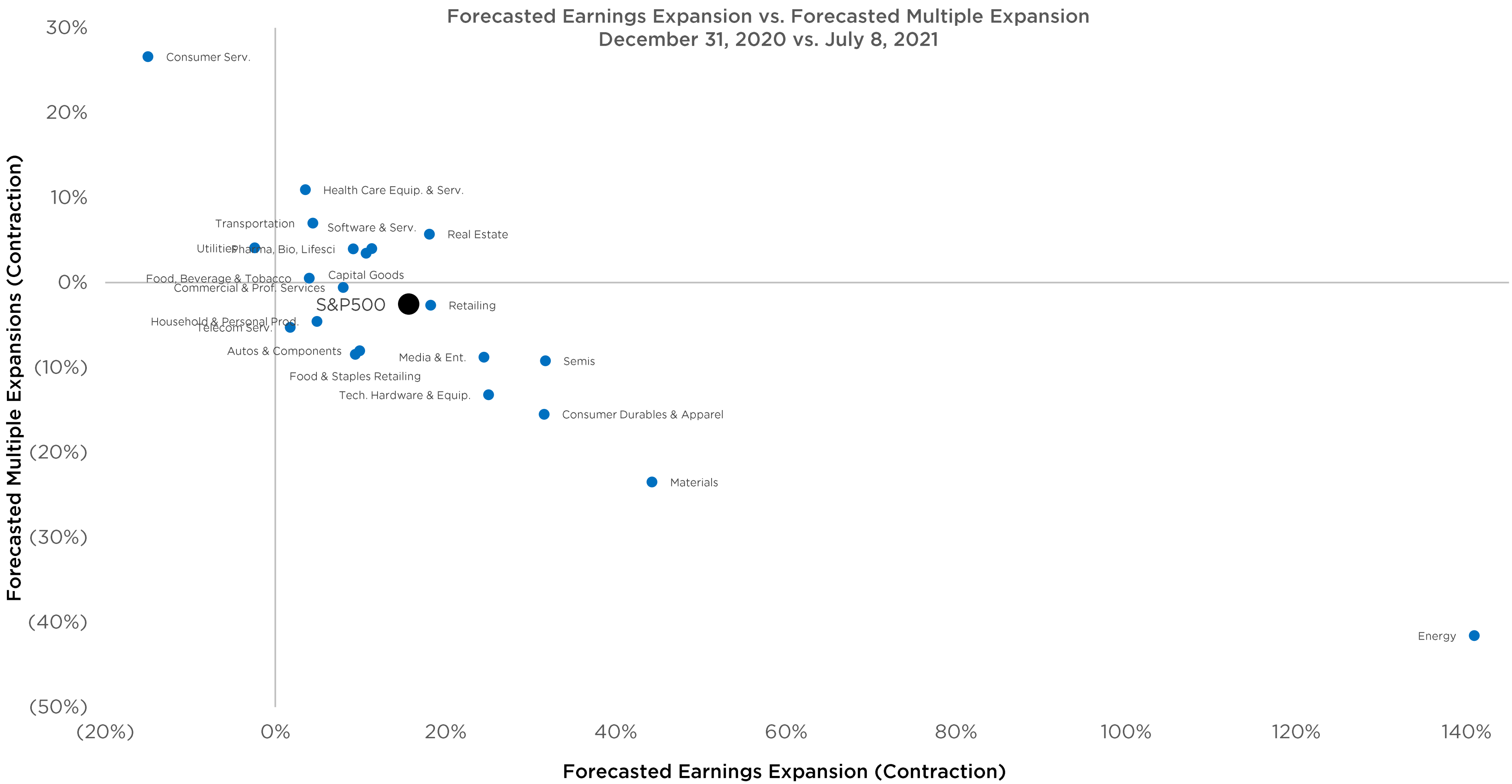
The bottom-up analyst earnings growth expectations are for 65% YoY earnings growth this quarter, in part a function of the trough last year. Earnings will decelerate but remain in the high teens through Q4, trough in Q1 2022, and the accelerate again from there. The energy sector lost money in 2020, so the rebound off the trough is to be expected. Industrials companies have very high YoY earnings growth expectations every quarter through 2022, which may be a risk as input costs rise

Bottom-Up Analyst Earnings Growth Expectations
July 5th, 2021

Sector	1Q21E	2Q21E	3Q21E	4Q21E	1Q22E	2Q22E	3Q22E	4Q22E
S&P 500	46.7%	64.9%	21.4%	17.9%	3.3%	14.4%	14.4%	14.0%
S&P ex-Financials	33.2%	52.1%	23.6%	23.2%	9.9%	16.6%	15.3%	14.4%
Consumer Discretionary	224.2%	185.5%	5.8%	21.4%	14.6%	52.2%	41.0%	27.9%
Consumer Staples	8.3%	6.8%	1.5%	4.2%	5.4%	8.9%	8.6%	9.1%
Energy	16.0%	N/A	N/A	N/A	79.7%	31.2%	11.6%	5.6%
Financials	130.9%	170.2%	11.0%	(3.8%)	(20.5%)	3.8%	9.6%	11.6%
Health Care	21.7%	10.6%	7.5%	10.3%	(0.6%)	6.1%	8.5%	8.3%
Industrials	(4.6%)	318.6%	73.3%	134.0%	61.7%	47.0%	29.8%	21.1%
Info Tech	37.7%	27.6%	19.7%	11.5%	4.2%	12.2%	14.9%	15.1%
Materials	53.7%	111.2%	67.9%	35.1%	16.0%	(5.2%)	(7.2%)	(2.2%)
Communication Services	49.7%	35.8%	15.2%	6.6%	(0.2%)	12.5%	16.7%	20.9%
Utilities	(1.0%)	(1.9%)	1.8%	6.6%	8.5%	7.0%	4.1%	6.8%
REITS	3.4%	17.3%	13.1%	10.4%	1.3%	1.9%	5.5%	7.6%

EARNINGS EXPANSION AND MULTIPLE CONTRACTION ARE COMMON

Very few industries have seen both increased earnings expectations and higher price-to-forward earnings multiples this year. On a 12-month forward basis, we have seen modest multiple contraction YTD overall, and massive multiple contraction in energy and materials where the market thinks earnings strength is not sustainable



PARTICULARLY YTD FOR CYCLICALS

Many energy and materials companies have seen massive YTD changes to their earnings outlook accompanied by strong multiple contraction. AA has had 81% YTD multiple contraction because the earnings outlook has been revised so positively

Stocks in Top 5% of Forecasted Earnings Expansion and Top 5% of Forecasted Multiple Contraction
Grater than $5 Bn. Market Capitalization
December 31, 2020 vs. July 8, 2021

Ticker	Company Name	Industry Group	Market Cap (US$ Bil.)	Forecasted EPS Expansion	Forecasted Multiple Contraction
XOM	Exxon Mobil Corporation	Energy	254.61	143%	(40%)
CVX	Chevron Corporation	Energy	197.82	102%	(41%)
MRNA	Moderna, Inc.	Pharmaceuticals, Biotechnology & Life Sciences	93.47	216%	(52%)
MU	Micron Technology, Inc.	Semiconductors & Semiconductor Equipment	86.81	204%	(67%)
EOG	EOG Resources, Inc.	Energy	46.62	179%	(42%)
DOW	Dow Inc.	Materials	45.87	144%	(55%)
SYY	Sysco Corporation	Food & Staples Retailing	38.01	82%	(46%)
DFS	Discover Financial Services	Diversified Financials	34.79	90%	(34%)
LYB	LyondellBasell Industries N.V.	Materials	33.1	99%	(46%)
NUE	Nucor Corporation	Materials	28.04	422%	(67%)
WY	Weyerhaeuser Company	Real Estate	26.25	214%	(67%)
CNHI	CNH Industrial N.V.	Capital Goods	21.09	76%	(32%)
WDC	Western Digital Corporation	Technology Hardware & Equipment	20.78	206%	(60%)
DRI	Darden Restaurants, Inc.	Consumer Services	18.83	83%	(34%)
XPO	XPO Logistics, Inc.	Transportation	15.69	71%	(33%)
STLD	Steel Dynamics, Inc.	Materials	12.66	351%	(60%)
SC	Santander Consumer USA Holdings Inc.	Diversified Financials	12.39	186%	(36%)
MOS	The Mosaic Company	Materials	11.68	131%	(45%)
WLK	Westlake Chemical Corporation	Materials	11.07	221%	(67%)
DAR	Darling Ingredients Inc.	Food, Beverage & Tobacco	10.8	75%	(34%)
CF	CF Industries Holdings, Inc.	Materials	10.65	162%	(50%)
RS	Reliance Steel & Aluminum Co.	Materials	9.45	96%	(37%)
OLN	Olin Corporation	Materials	6.86	1035%	(84%)
MAT	Mattel, Inc.	Consumer Durables & Apparel	6.85	75%	(35%)
AA	Alcoa Corporation	Materials	6.6	535%	(81%)
LPX	Louisiana-Pacific Corporation	Materials	5.93	279%	(53%)

THERE ARE SOME NAMES THAT HAVE HAD MULTIPLE CONTRACTION

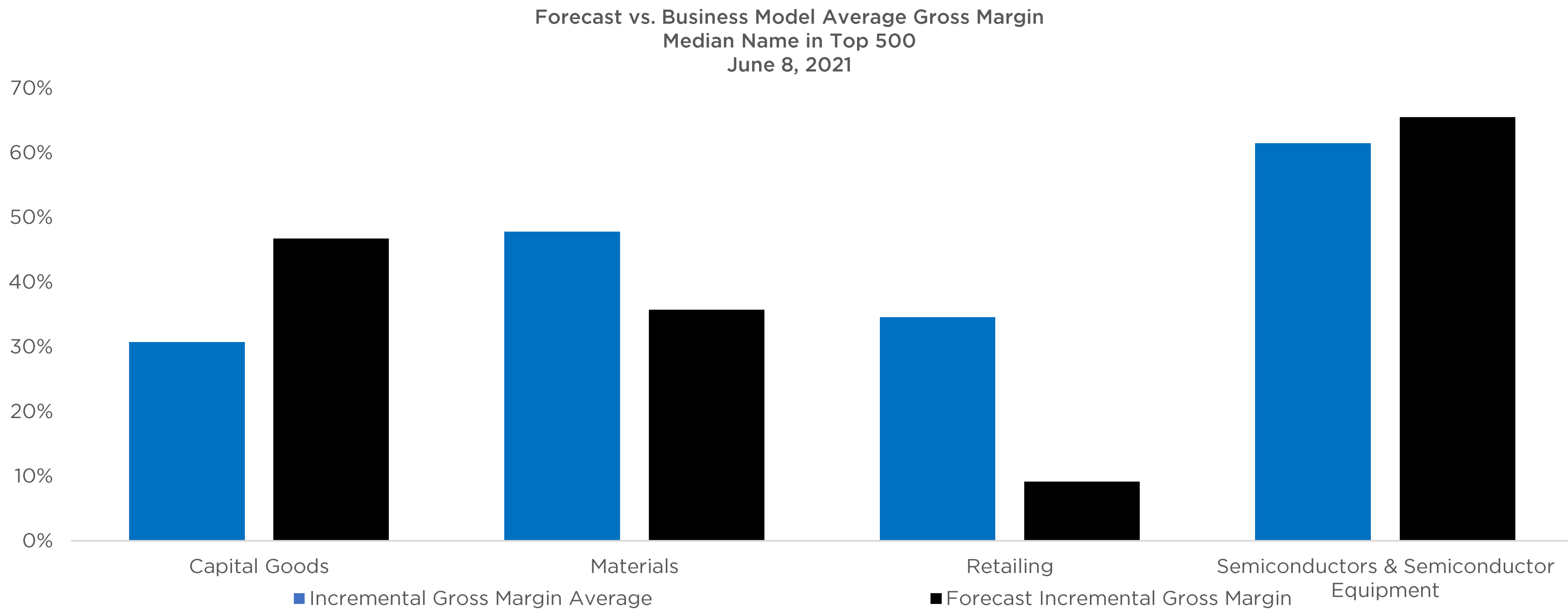
Some stocks have had material downward revisions to their earnings outlook but had materially price-to-forward earnings expansion as these downward revisions were unfolding, likely the result of increased optimism about their longer-term outlook

Stocks in Bottom 5% of Forecasted Earnings Expansion and Top 5% of Forecasted Multiple Contraction
Names larger than $5 Bn. Market Capitalization
December 31, 2020 vs. July 8, 2021

Ticker	Company Name	Industry Group	Market Cap (US$ Bil.)	Forecasted EPS Contraction	Forecasted Multiple Expansion
TMUS	T-Mobile US, Inc.	Telecommunication Services	183.11	(36%)	67%
GE	General Electric Company	Capital Goods	112.98	(27%)	65%
BKNG	Booking Holdings Inc.	Consumer Services	88.84	(34%)	51%
BIIB	Biogen Inc.	Pharmaceuticals, Biotechnology & Life Sciences	55.56	(27%)	106%
LVS	Las Vegas Sands Corp.	Consumer Services	38.39	(81%)	641%
PSX	Phillips 66	Energy	35.38	(21%)	47%
EQR	Equity Residential	Real Estate	30.06	(32%)	98%
PPL	PPL Corporation	Utilities	21.67	(45%)	83%
HZNP	Horizon Therapeutics Public Limited Company	Pharmaceuticals, Biotechnology & Life Sciences	20.86	(16%)	50%
BMRN	BioMarin Pharmaceutical Inc.	Pharmaceuticals, Biotechnology & Life Sciences	15.16	(31%)	37%
AFG	American Financial Group, Inc.	Insurance	10.21	(16%)	63%
NBIX	Neurocrine Biosciences, Inc.	Pharmaceuticals, Biotechnology & Life Sciences	9.36	(28%)	50%
ADT	ADT Inc.	Commercial & Professional Services	8.59	(30%)	88%
RGA	Reinsurance Group of America, Incorporated	Insurance	7.39	(35%)	42%
PRGO	Perrigo Company plc	Pharmaceuticals, Biotechnology & Life Sciences	6.23	(40%)	71%
PLNT	Planet Fitness, Inc.	Consumer Services	6.03	(36%)	43%
ELY	Callaway Golf Company	Consumer Durables & Apparel	5.98	(87%)	734%
JWN	Nordstrom, Inc.	Retailing	5.36	(22%)	37%
TRIP	TripAdvisor, Inc.	Media & Entertainment	5.2	(88%)	835%
QDEL	Quidel Corporation	Health Care Equipment & Services	5.16	(73%)	143%

INCREMENTAL GROSS MARGIN EXPECTATIONS VS. HISTORY

We think it is extremely important for investors to assess the incremental margins of the stocks in which they are investing. We know incremental margin expansion is a key signal at this point in the cycle. Analysts should have some knowledge about the fixed and variable costs of a business, and whether the incremental margin expectations embedded in the consensus outlook are achievable. We measure the median stocks expectations for the next year vs. the incremental margins the company has on average achieved previously, as a proxy for estimate achievability. Capital goods and semiconductors are expecting more incremental margin expansion than "normal", retails and materials less expansion than they have achieved on average



ONGOING INFLATION FOR 6-TO-12 MONTHS?

The primary topic of interest from investors over the last two months has been inflation. We have been asked about how inflation unfolds, and what the relative investment opportunities are between now and the end of the year.

Conclusion: We think having some exposure to inflation within your equity portfolio continues to makes 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, because we are not sure what the economy looks like without massive fiscal stimulus. We were bullish following the FED's June meeting – as they acknowledged inflation, but are waiting for more evidence as to its sustainability, which we believe is optimistic for equities
- While there are many who think that inflation is more than transitory, we remain unconvinced that this lasts beyond 12 more months because of deglobalization, demographic change, and the outlook for sustained fiscal stimulus (among other rationale)
- We would not be surprised to see the 10-year yield trend lower, despite the strong economy. That statement is based only on the fact that every single equity person with which we have discussed this thinks yields will trend higher, and the last time everyone thought that, in 2013, it took 2-3 more years for the Fed to act. As a former colleague says – when it comes to the 10-year yield, "Nobody knows nothing"…

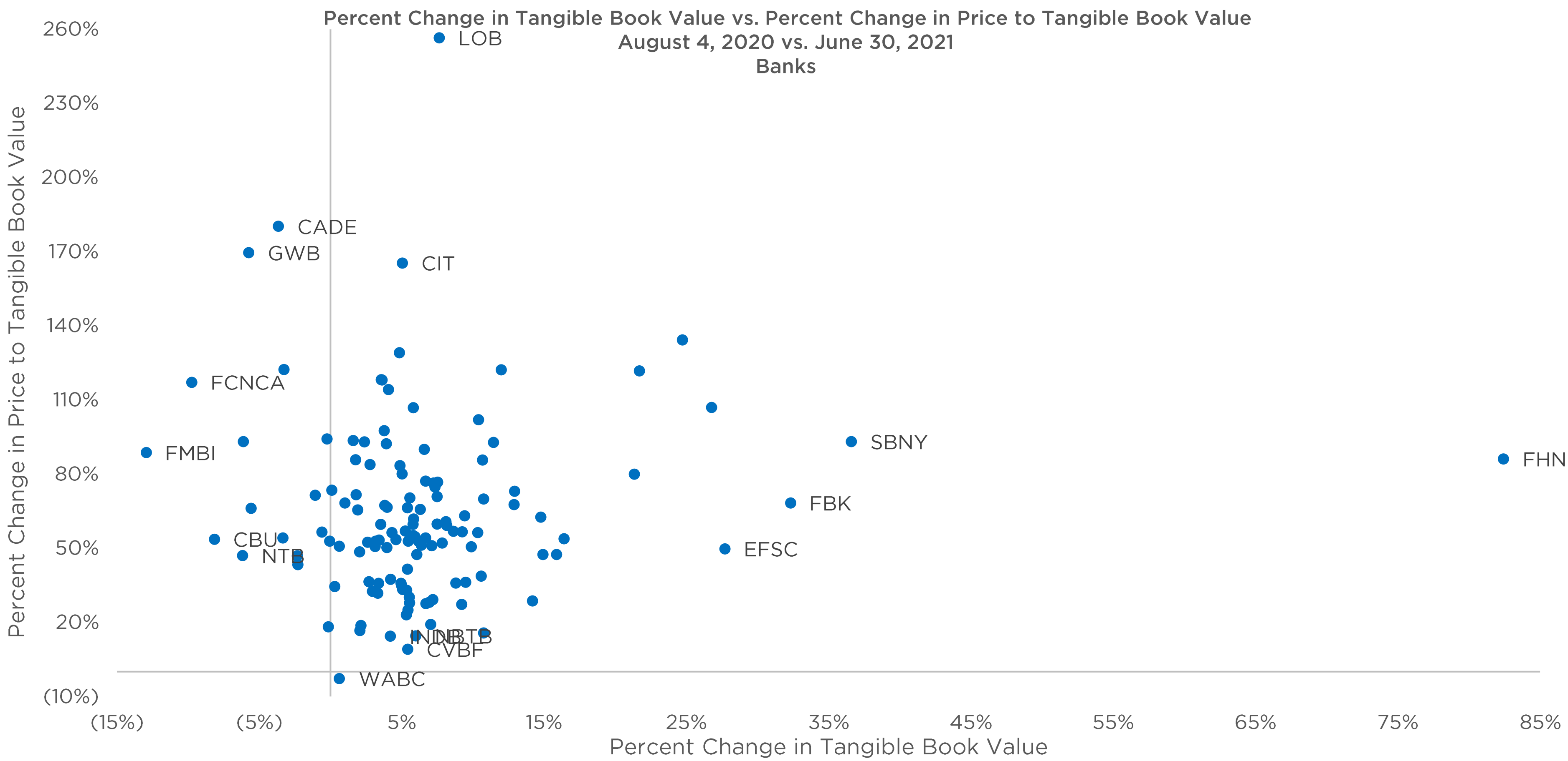
EQUITY INVESTMENT CONCLUSIONS RELATED TO RATES

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). Here is our advice if you think the 10-year yield starts rising again later this year:

- **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 in August of 2020
- **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
- **Focus your investments**: 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

CONCLUSION: PAIR TRADE BANKS INTO JULY EARNINGS

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 given NIMs likely did not expand much during Q2 with the 10-year yield drifting lower since most banks guided for Q2 earnings



BANKS STOCKS WITH LIMITED TANGIBLE BOOK GROWTH SO FAR

Below are banks that have seen material price-to-tangible book growth since the 10-year yield bottomed last August, 2020 but have not seen appreciable tangible book expansion over that time frame. Our view is that these stocks are up more than they should be relative to other banks, and perhaps would be a good area to search for under-weight / short ideas, particularly given banks guided in April with a view that yields would back up, not trend lower

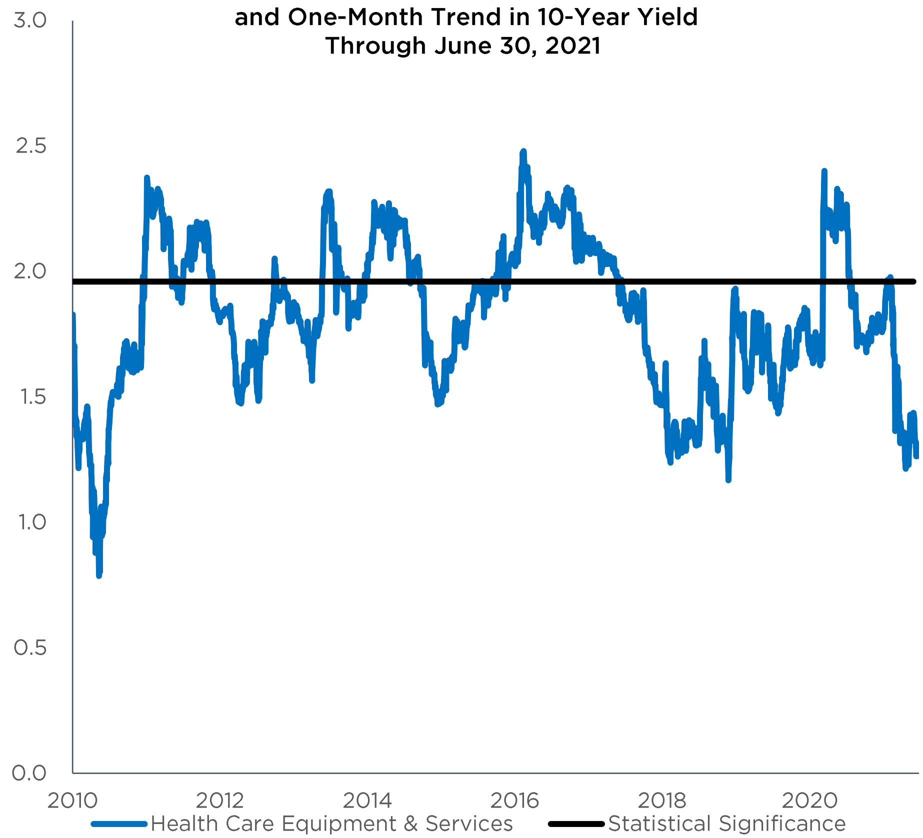
Banks Stocks with Relatively Weak Tangible Book Growth
That Have Also Seen Material Price-to-Tangible Book Multiple Expansion
August 4th, 2020 Through June 30, 2021

Ticker	Company Name	Market Cap (US$ Bil.)	Book Value Growth	Price to Tangible Book Growth
PNC	The PNC Financial Services Group, Inc.	81.05	-6.1%	93.2%
TFC	Truist Financial Corporation	74.64	-3.4%	54.1%
SIVB	SVB Financial Group	30.78	26.8%	107.0%
FITB	Fifth Third Bancorp	26.89	-0.2%	94.2%
HBAN	Huntington Bancshares Incorporated	21.08	3.6%	118.2%
WAL	Western Alliance Bancorporation	9.52	21.7%	121.7%
FCNCA	First Citizens BancShares, Inc.	8.09	-9.7%	117.1%
PNFP	Pinnacle Financial Partners, Inc.	6.68	10.4%	101.9%
SNV	Synovus Financial Corp.	6.52	4.1%	114.2%
BPOP	Popular, Inc.	6.05	2.4%	93.0%
CIT	CIT Group Inc.	5.11	5.1%	165.4%
WBS	Webster Financial Corporation	4.82	3.9%	92.2%
PACW	PacWest Bancorp	4.81	3.6%	118.1%
STL	Sterling Bancorp	4.77	5.8%	106.8%
CBU	Community Bank System, Inc.	4.08	-8.2%	53.6%
PPBI	Pacific Premier Bancorp, Inc.	4.00	3.8%	97.6%
BKU	BankUnited, Inc.	3.98	11.5%	92.8%
HWC	Hancock Whitney Corporation	3.86	4.8%	129.1%
FHB	First Hawaiian, Inc.	3.69	-1.1%	71.5%
CADE	Cadence Bancorporation	2.60	-3.7%	180.2%
FIBK	First Interstate BancSystem, Inc.	2.60	-2.3%	43.4%
FBP	First BanCorp.	2.55	-3.3%	122.2%
LOB	Live Oak Bancshares, Inc.	2.54	7.6%	256.5%
FMBI	First Midwest Bancorp, Inc.	2.27	-12.9%	88.7%
TBK	Triumph Bancorp, Inc.	1.83	24.7%	134.3%
GWB	Great Western Bancorp, Inc.	1.81	-5.7%	169.5%

CONCLUSION: BUY HEALTH CARE EQUIPMENT & SERVICES

If we get a rise in the 10-year yield again, 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)

Rolling 10-Year T-Stat Between Health Care Equipment & Services and One-Month Trend in 10-Year Yield Through June 30, 2021



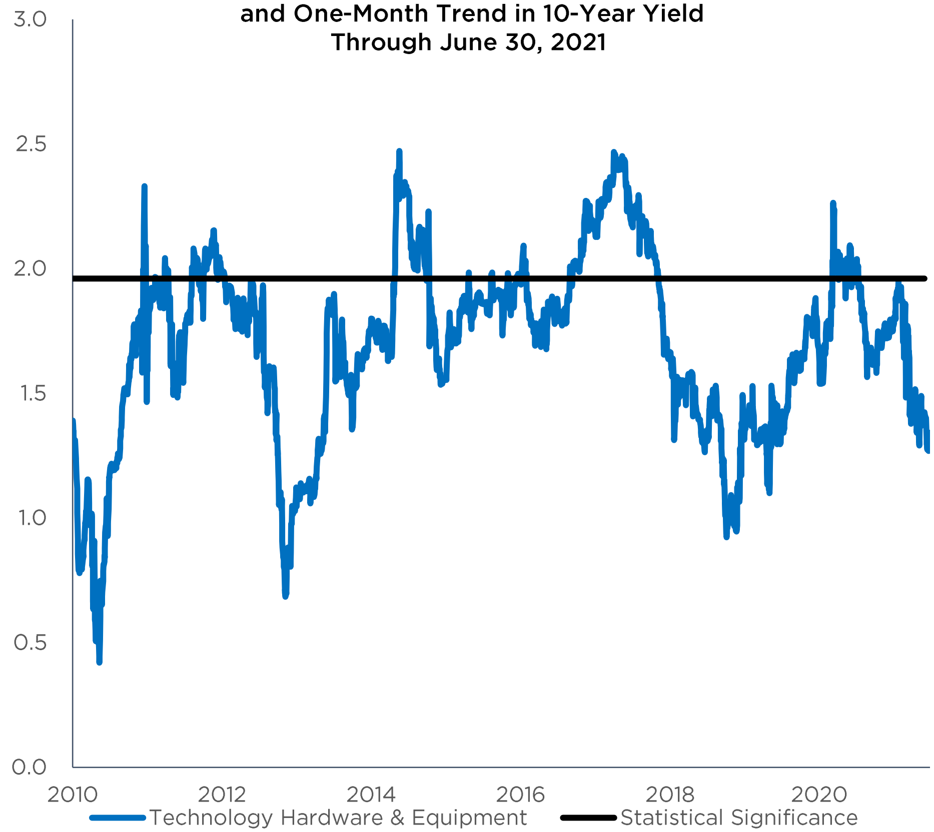
Health Care Equipment & Services Top Quintile Model Ranked Stocks June 30, 2021

Ticker	Company	Market Cap. (US$ Bil.)
UNH	UnitedHealth Group Incorporated	377.90
ABT	Abbott Laboratories	205.99
MDT	Medtronic plc	166.82
ISRG	Intuitive Surgical, Inc.	108.90
ANTM	Anthem, Inc.	93.48
CI	Cigna Corporation	81.35
HCA	HCA Healthcare, Inc.	68.36
EW	Edwards Lifesciences Corporation	64.38
HUM	Humana Inc.	57.12
IDXX	IDEXX Laboratories, Inc.	53.86
ALGN	Align Technology, Inc.	48.35
VEEV	Veeva Systems Inc.	47.55
BAX	Baxter International Inc.	40.48
LH	Laboratory Corporation of America Holdings	26.93
TDOC	Teladoc Health, Inc.	25.70
ABC	AmerisourceBergen Corporation	23.75
CERN	Cerner Corporation	23.55
CAH	Cardinal Health, Inc.	16.56
MOH	Molina Healthcare, Inc.	14.78
DVA	DaVita Inc.	12.79

CONCLUSION: BUY TECHNOLOGY HARDWARE & EQUIPMENT

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) if yields back-up again

Rolling 10-Year T-Stat
Between Technology Hardware & Equipment
and One-Month Trend in 10-Year Yield
Through June 30, 2021



Technology Hardware & Equipment
Top Quartile Model Ranked Stocks
June 30, 2021

Ticker	Company	Market Cap. (US$ Bil.)
TEL	TE Connectivity Ltd.	44.68
HPQ	HP Inc.	36.27
ANET	Arista Networks, Inc.	27.65
CGNX	Cognex Corporation	14.84
FFIV	F5 Networks, Inc.	11.13
FLEX	Flex Ltd.	8.74
ARW	Arrow Electronics, Inc.	8.40
LFUS	Littelfuse, Inc.	6.26

CONCLUSION: SELL UTILITIES IF THERE IS INFLATION

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 sector has been the worst performing year-to-date, and the stocks that screen poorly in our quantitative model are shown in the right exhibit. Tactically it might make sense to get more optimistic into earnings given the bull flattening and the underperformance, but if you think inflation fears resurface in the 10-year yield again, being cautious on utilities will be prudent

Rolling 10-Year T-Stat
Between Utilities and One-Month Trend in Inflation Proxies
Through June 30, 2021

Utilities
Bottom Quartile Model Ranked Stocks
June 30, 2021

Ticker	Company	Market Cap. (US$ Bil.)
NEE	NextEra Energy, Inc.	143.73
SRE	Sempra Energy	40.11
EIX	Edison International	21.94
PCG	PG&E Corporation	20.19
AGR	Avangrind, Inc.	19.91
VST	Vistra Corp.	8.394

CAN YOU STILL OWN ENERGY & MATERIALS? YES YOU CAN!

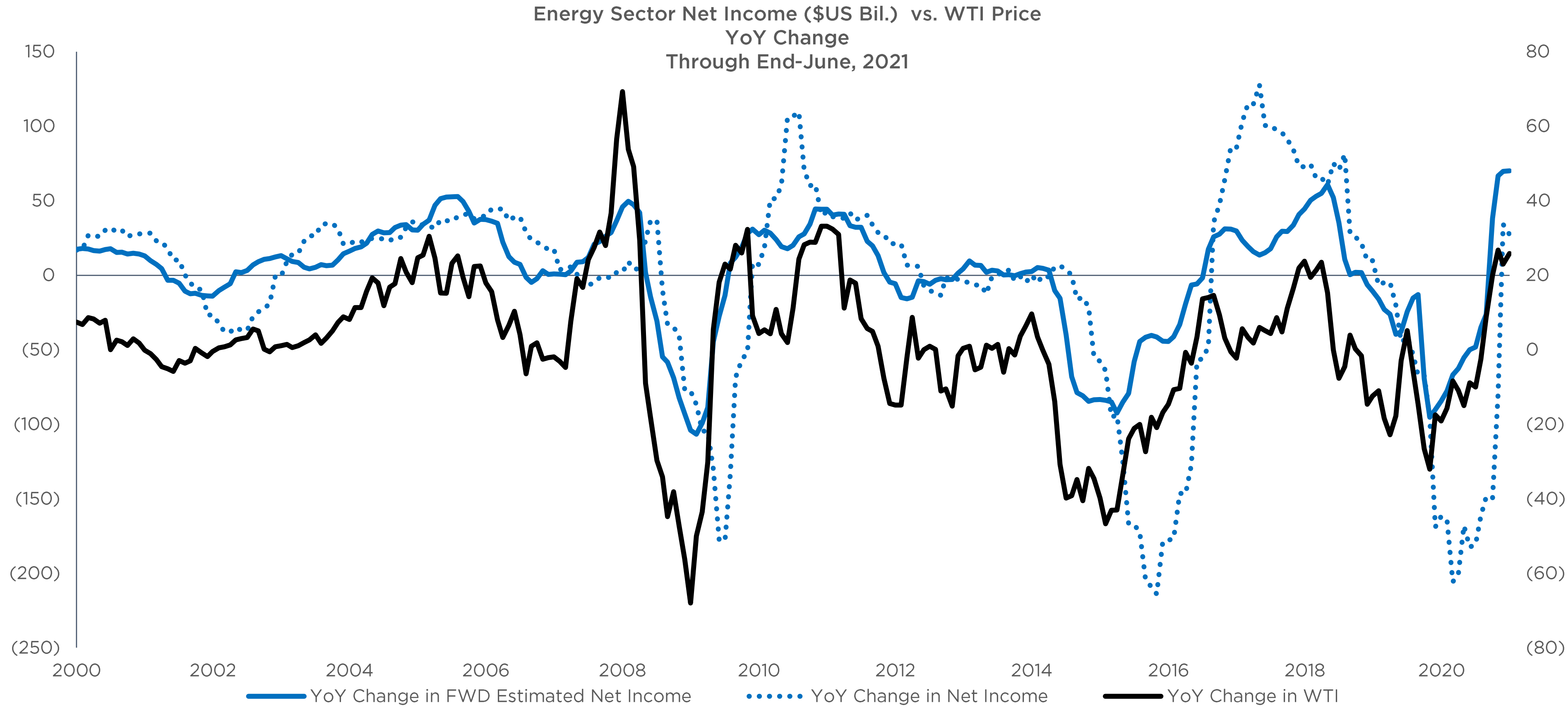
Oil prices rose another 10% in June, and **our judgment is that you should still own energy and materials**

For energy, rising oil means higher earnings revisions and higher net income. Earnings revisions are highly effective at picking winners from losers within the cohort for the 6-months following periods when oil is rising, meaning energy stocks beating estimates will likely perform strongly. Additionally, despite the strong rally, the sector is quite cheap versus history on price-to-book, which was the most efficacious valuation metric for picking energy stocks historically. In the last decade it is VERY rare for a sector to have positive revisions, positive momentum, and cheap valuation versus history. Despite what seems obvious to be sustained demand growth exceeding supply growth for the sustainable future, there is a lot of negative sentiment, and firms have dropped coverage or don't have analysts. **We remain VERY bullish on energy!**

For materials, the huge year-over-year move in commodities nearly guarantees that the sector is poised to see record profitability next year, **yet valuation is at 18-year lows vs. the market excluding materials**. Revisions and valuation also work here so we offer long ideas in energy and materials, and we recommend investors own this group as the underlying commodities likely still rise in the coming year

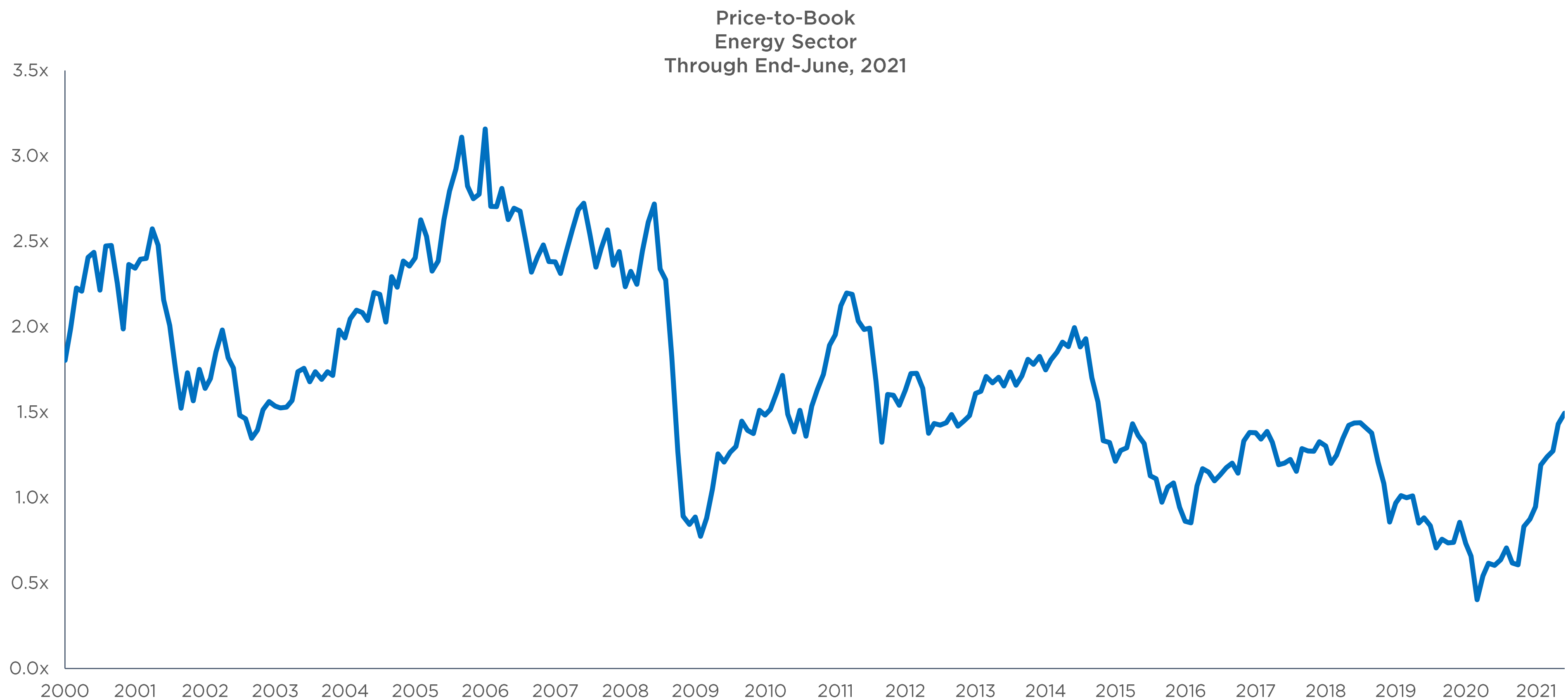
THERE IS A LAG BETWEEN OIL PRICES, ESTIMATES, AND REPORTS

For energy, oil prices are a leading indicator for net income of the energy sector. The black line below shows the change in WTI , which is typically a 3-to-6-month leading indicator for the dashed blue line, which is reported net income. The analysts typically wait until after oil lags (solid blue line), but right before the companies report earnings, so their forecasts are not particularly anticipatory



DESPITE THE RALLY, ENERGY IS STILL CHEAP VS. ITS OWN HISTORY

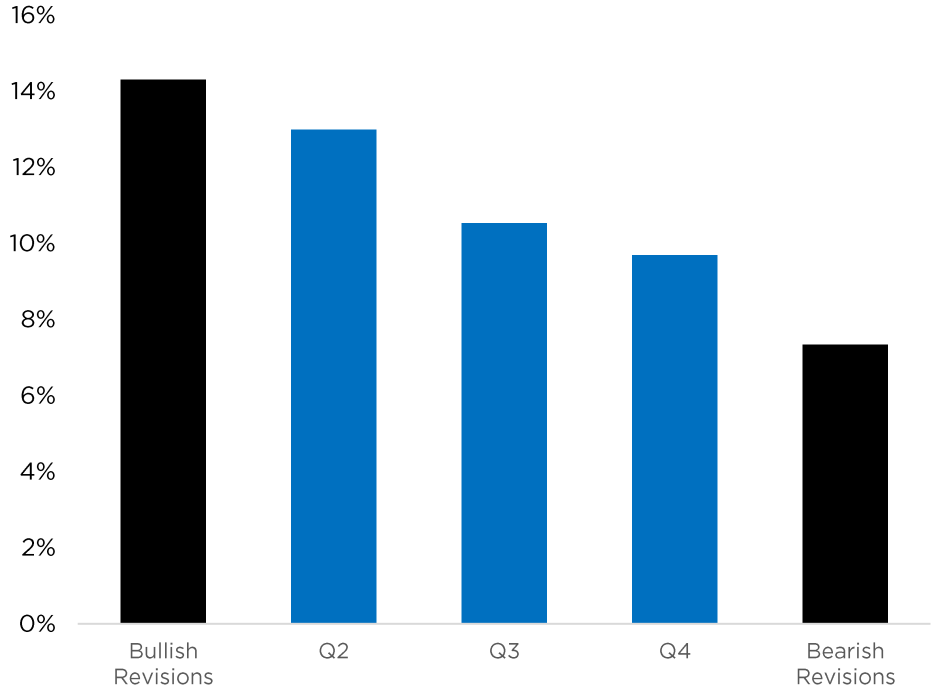
Despite the strong rally in the last six months, the valuation of the group is still quite attractive versus history, only slightly above the bear-levels of the 2016 energy crisis



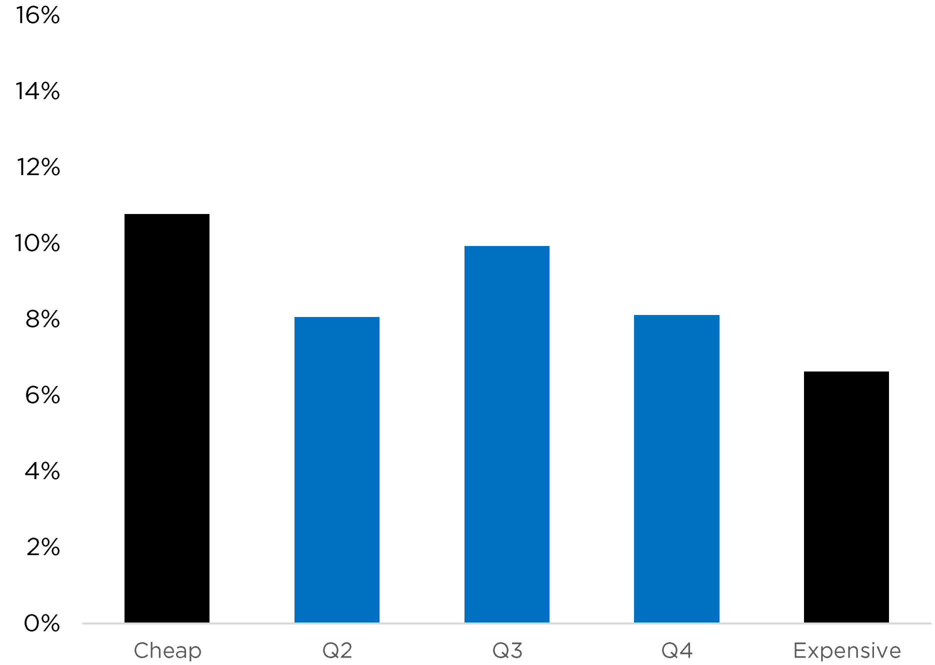
USE ENERGY EARNINGS REVISIONS & VALUATION WHEN OIL IS RISING

We analyzed whether earnings revisions were efficacious at predicting subsequent energy sector returns when oil is rising. Given that stocks prices are typically anticipatory, we have received several questions about how much more energy stocks could rally. During a rising oil regime, analyst earnings revisions have historically been highly effective at picking winners from losers, with the top quintile on revisions beating the bottom quintile by approximately 7% during the average subsequent 6-month period. While for the broader market we do not necessarily anticipate valuation metrics to work particularly well, valuation has also worked, with the cheapest quintile on price-to-book outperforms the most expensive quintile by approximately 5%

Energy Sector: Earnings Revisions Efficacy
When Oil is Trending Upward over the Previous 6 Months
Through End-June, 2021

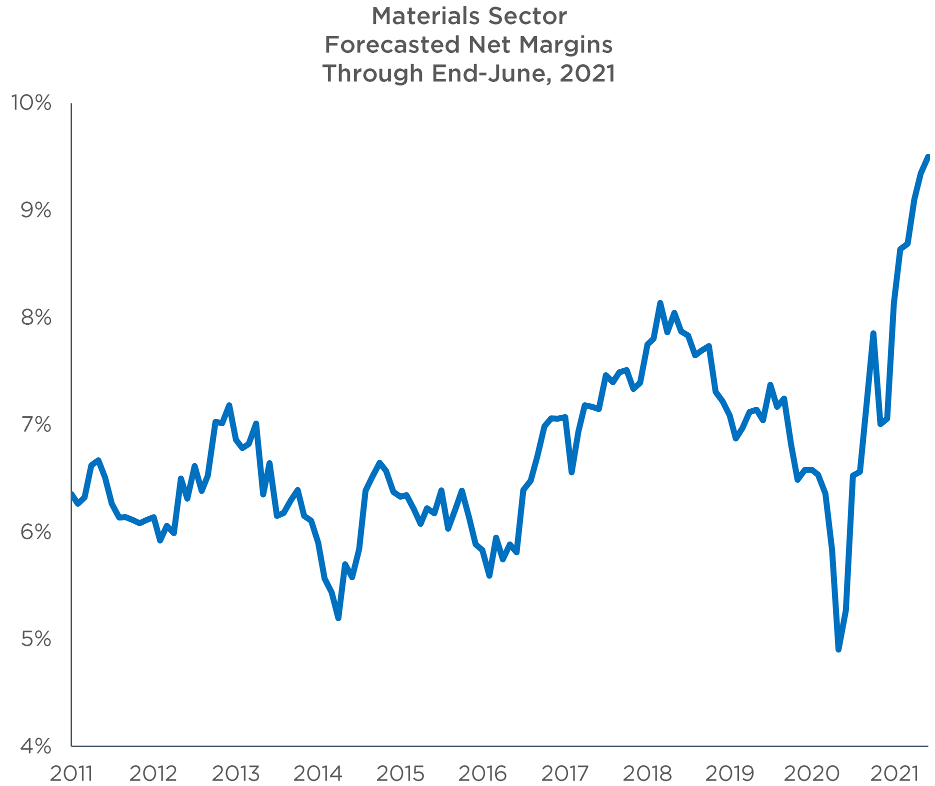


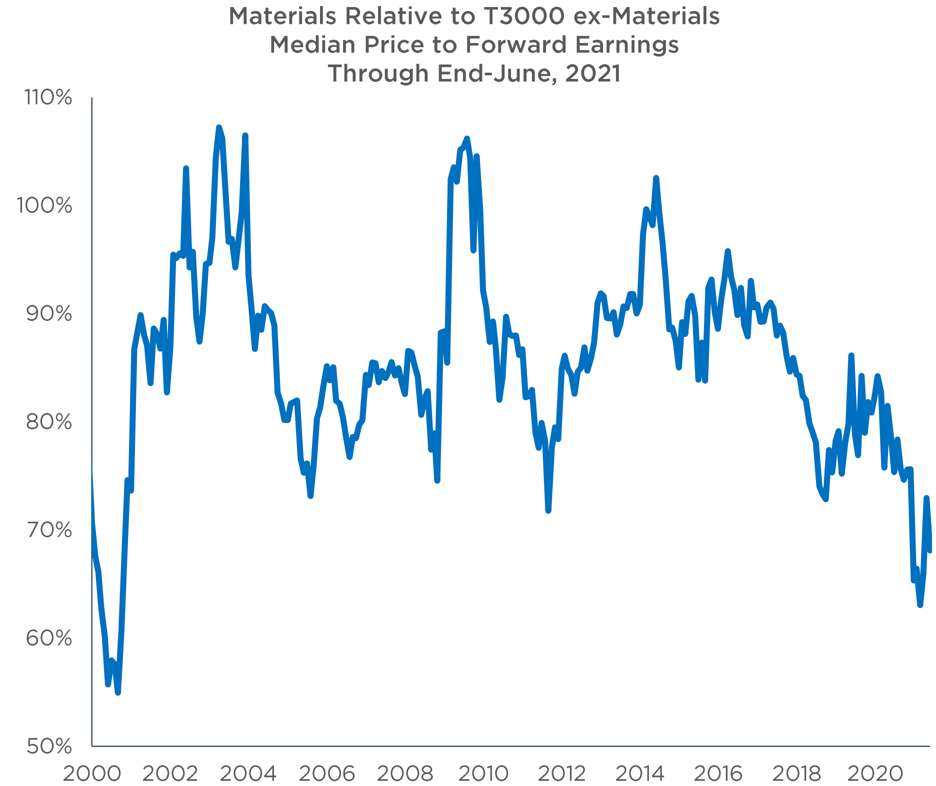
Energy Sector: Price-to-Book Efficacy
When Oil is Trending Upward over the Previous 6 Months
Through End-June, 2021



THE MARKET IS SKEPTICAL OF RECORD MATERIALS PROFIT ESTIMATES

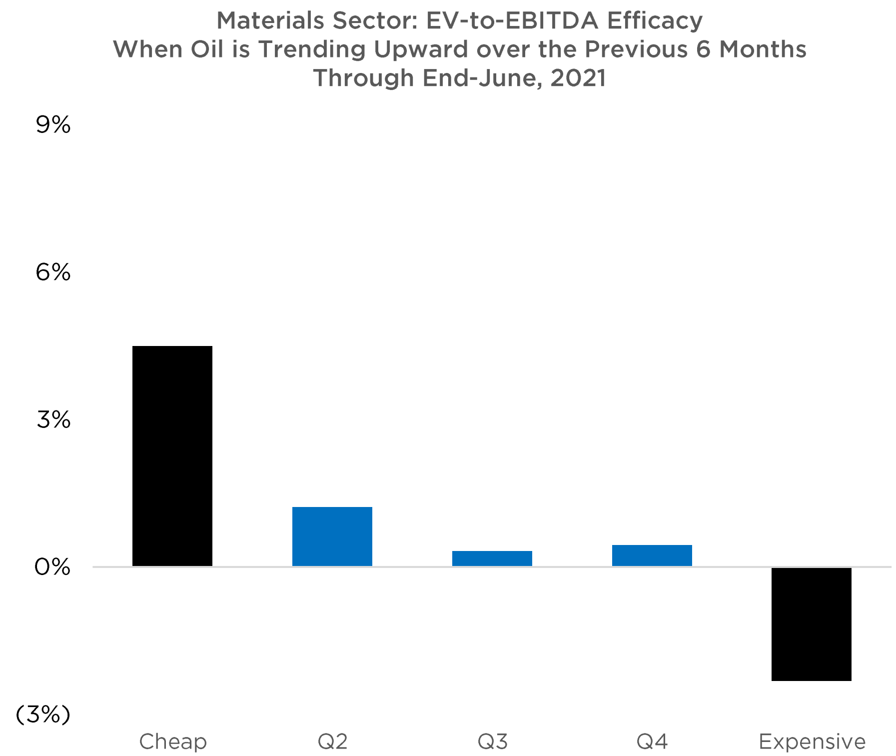
The consensus expectations are that net margins for the materials sector will achieve record highs, yet the valuation on a relative to the market basis has recovered to levels near 18-year lows. Our belief is that many of the companies can structurally improve cycle to cycle with the anticipated profit expansion, helping future investments and balance sheet repair. We like the risk-reward of a sector with high but likely achievable near-term estimates and attractive relative valuation





EARNINGS REVISIONS & VALUATION WORK FOR MATERIALS

As was the case in energy, materials stocks with upward analyst earnings revisions and cheaper valuation outperform those with less upward or downward revisions as oil and commodity prices rise. The top vs. bottom quintile spreads on earnings revisions average 6% on average over the subsequent six months following rising revisions, and the cheapest quintile on EV-to-EBITDA outperforms the most expensive by 7% on average



ENERGY / MATERIALS THAT ARE CHEAP WITH POSITIVE REVISIONS

Tying it all together, we are bullish on energy and materials given the combination of estimate achievability and valuation. The below screen shows stocks that are in the energy and materials sector and are in the top 25% of both valuation and earnings revisions today

Energy and Materials Sector
Top Quartile in Estimate Revisions and Valuation
June 30, 2021

Ticker	Company	Industry Group	Market Cap. (US$ Bil.)
STLD	Steel Dynamics, Inc.	Metals & Mining	12.59
MOS	The Mosaic Company	Chemicals	12.12
MRO	Marathon Oil Corporation	Oil, Gas & Consumable Fuels	10.73
AA	Alcoa Corporation	Metals & Mining	6.88
LPX	Louisiana-Pacific Corporation	Paper & Forest Products	6.16
AR	Antero Resources Corporation	Oil, Gas & Consumable Fuels	4.71
MUR	Murphy Oil Corporation	Oil, Gas & Consumable Fuels	3.59
UFS	Domtar Corporation	Paper & Forest Products	2.77
TSE	Trinseo S.A.	Chemicals	2.32
CDEV	Centennial Resource Development, Inc.	Oil, Gas & Consumable Fuels	1.89
NEXA	Nexa Resources S.A.	Metals & Mining	1,16

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:

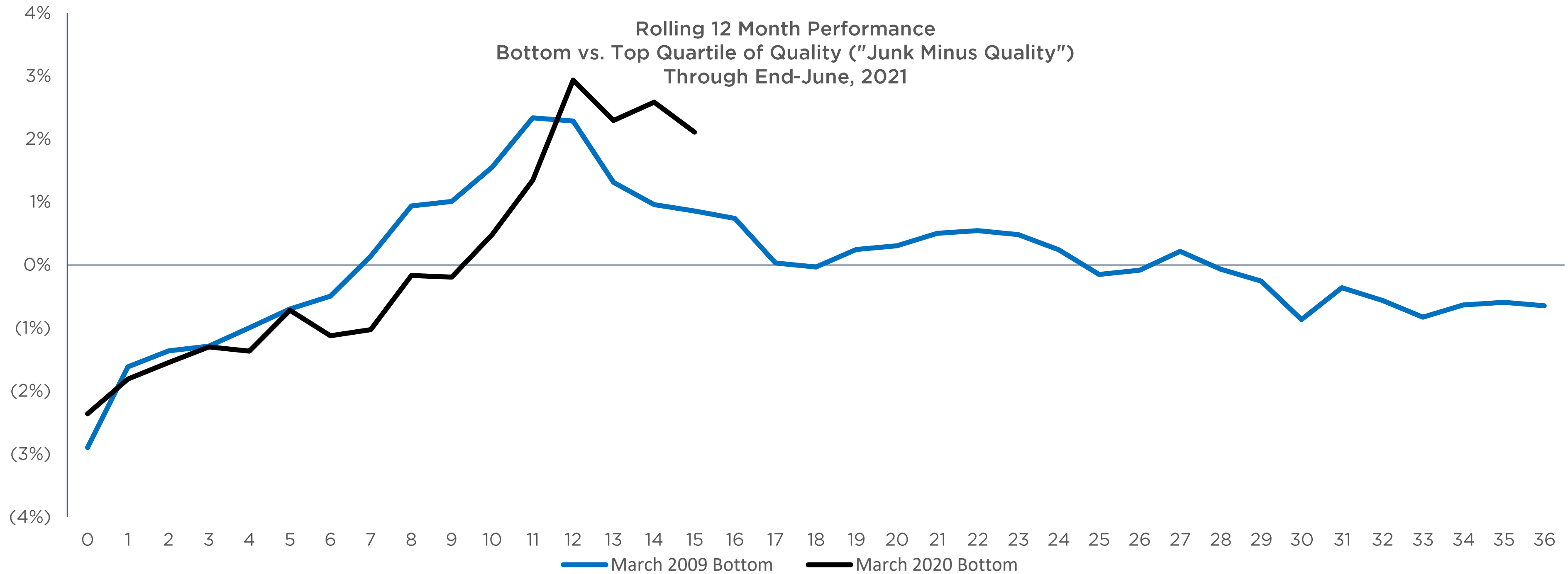
1. **Junk vs. quality** – probably the way the cycles are most similar is the strong outperformance of “junk” stocks in the initial phases of the recovery
2. **Profitability degradation** – the stock performance of companies with both little or high margin degradation have tracked a similar path

As was the case last cycle, we have started to see these change in recent weeks. The important point is to assess what worked last time in terms of stock selection. The answer is clear- own stocks that have expanding and achievable gross margin expectations. Price-to-earnings valuation is not likely to be broadly effective at picking winners from losers over the next six months.

We also analyzed what signals are efficacious following previous growth stock sell-offs. The answer was similar – positive free cash flow and margin expansion work, negative free cash flow and margin contraction fail

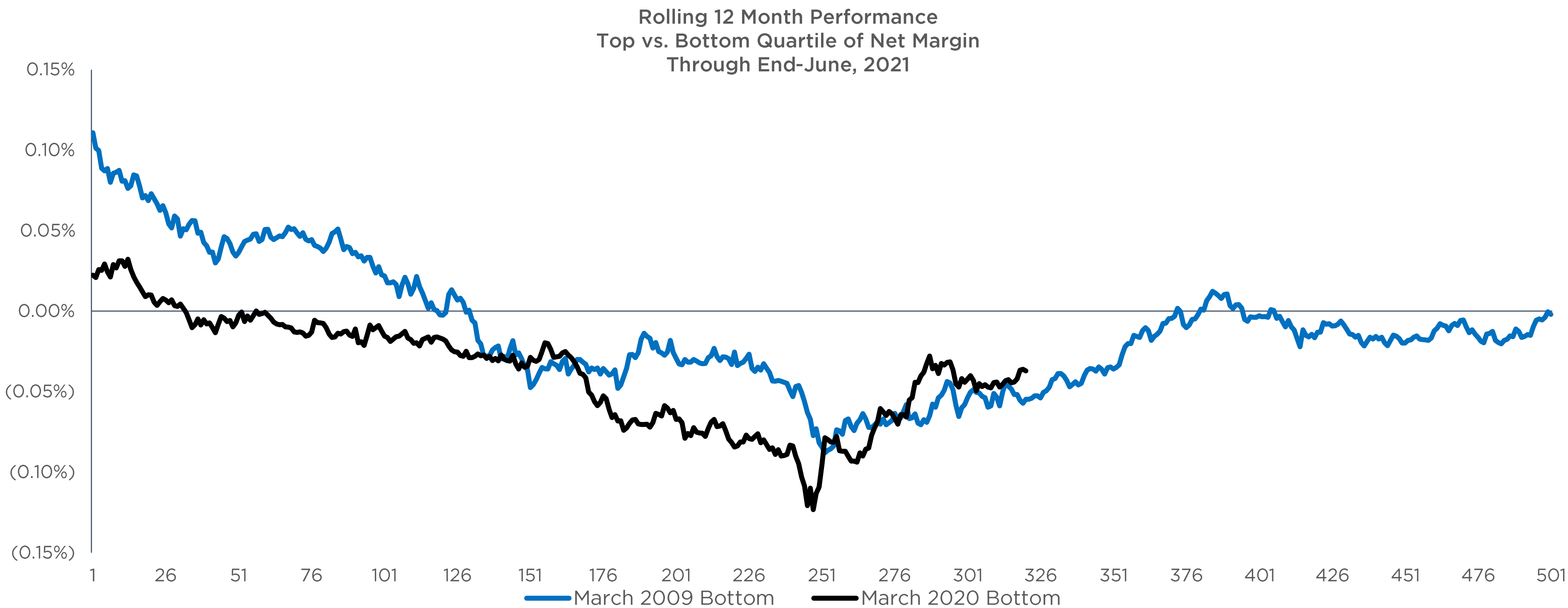
TODAY'S REGIME RHYMES THE AFTERMATH OF THE FINANCIAL CRISIS

In many ways the recovery after the COVID-19 crisis mirrored what we saw following the financial crisis. Both crises were followed by enormous government intervention, both with monetary and fiscal policy, and this is in part why we see parallels between now and the period from mid 2009 through 2011. One clear similarity is the rally we saw in junk stocks 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. We have also observed a strong commonality in factor efficacy between the COVID recovery and the financial crisis recovery, likely owing to the massive government stimuli applied in both regimes



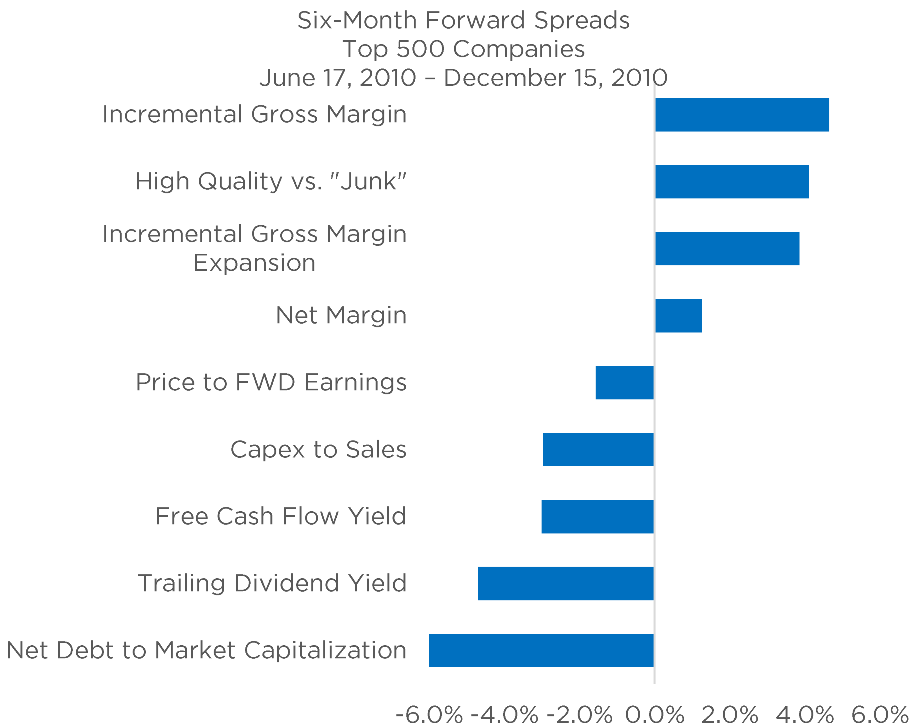
PERFORMANCE OF STOCKS RELATIVE TO PROFITS

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



WHAT WORKED LAST TIME AND IMPLICATIONS FOR TODAY

We are currently 328 trading days from the market bottom on March 23, 2020. In the six-month period following the 328 days after the Financial Crisis, quality beat junk, and profitability metrics such as 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



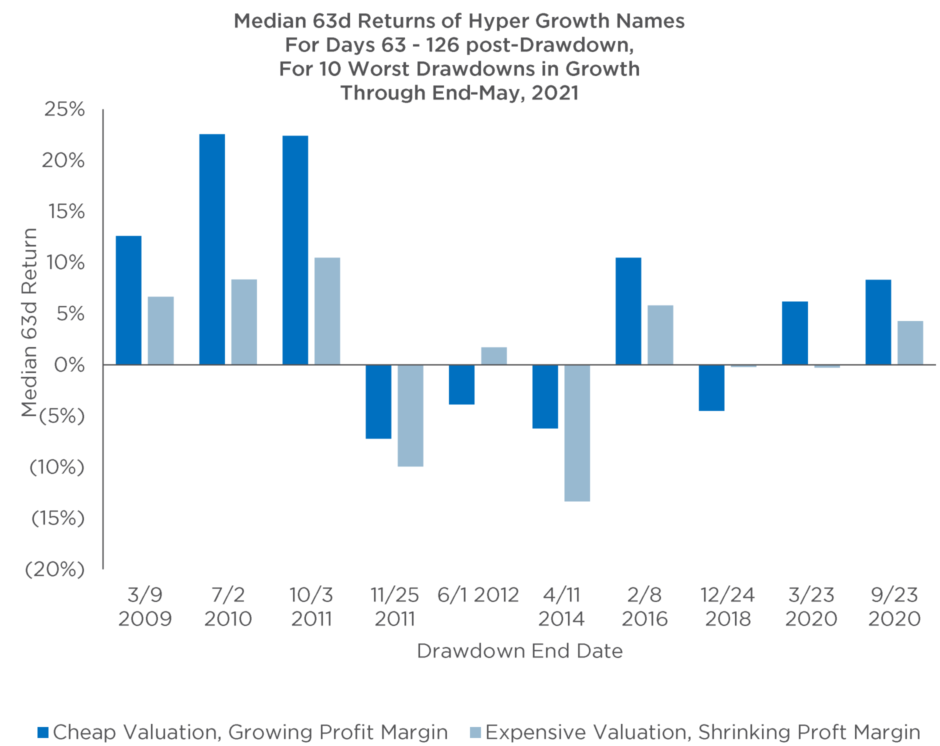
Rhyming Beneficiaries
June 30, 2021

Ticker	Company Name	Industry Group	Market Cap ($ US. Bil)
Long			
ODFL	Old Dominion Freight Line, Inc.	Road & Rail	29.43
TTWO	Take-Two Interactive Software, Inc.	Entertainment	19.41
TYL	Tyler Technologies, Inc.	Software	18.43
LITE	Lumentum Holdings, Inc.	Communications Equipment	6.23
Short			
WBA	Walgreens Boots Alliance, Inc.	Food & Staples Retailing	45.48
KR	The Kroger Co.	Food & Staples Retailing	28.66
NRG	NRG Energy, Inc.	Electric Utilities	9.87
VST	Vistra Corp.	Independent Power & Renewable Energy Electricity Producers	8.94
CONE	CyrusOne Inc.	REITs	8.76
HBI	Hanesbrands Inc.	Textiles, Apparel & Luxury Goods	6.52

AFTER THE GROWTH SELL OFF USE MARGINS AND POSITIVE FCF

We looked at the largest growth-universe drawdowns in absolute terms, and relative to the SP500 since the financial crisis. The sharp growth stock sell-off starting in mid-February may be over, but clearly is still the source of apprehension, particularly given the starting valuation levels prior to the sell-off were the most extreme sine the financial crisis. On an absolute basis it was only the 11th worst drawdown, **but relative to the SP500 the drawdown lasted until May 13th this was the WORST index-relative growth-stock drawdown since the financial crisis**

Date		Days of Drawdown	Drawdown		Prior 12-Month Momentum	Relative to SP500 Price -to-Sales
Starting	Ending		Absolute	Relative		
2/20/2020	3/23/2020	23	(30.4%)	(33.8%)	(8.1%)	2.6x
10/14/2008	3/9/2009	100	(30.2%)	(31.7%)	(30.2%)	1.1x
10/2/2018	12/24/2018	58	(24.2%)	(19.2%)	(0.5%)	2.3x
7/25/2011	10/3/2011	50	(21.4%)	(17.9%)	2.5%	1.4x
7/21/2015	2/8/2016	140	(17.9%)	(11.9%)	(2.7%)	1.9x
4/26/2010	7/2/2010	49	(17.3%)	(15.6%)	20.7%	1.5x
4/4/2012	6/1/2012	41	(12.4%)	(9.2%)	(3.8%)	1.4x
9/3/2020	9/23/2020	14	(11.5%)	(9.5%)	39.1%	2.8x
3/6/2014	4/11/2014	27	(11.0%)	(2.9%)	21.7%	1.8x
11/9/2011	11/25/2011	12	(10.6%)	(9.1%)	(5.2%)	1.3x
2/16/2021	3/8/2021	15	(10.4%)	(2.8%)	35.5%	3.3x



TRIVARIATE RESEARCH

HOW DO YOU PAIR-TRADE GROWTH STOCKS?

We found that three-to-six months following large growth-stock sell-offs, margin expansion and free cash flow were efficacious signals to predict subsequent stock returns. We offer favored and disfavored ideas on this theme

Hyper Growth Stock Screen, Long Cheap and Growing Profitability, Short Expensive and Shrinking Profitability
End-June, 2021

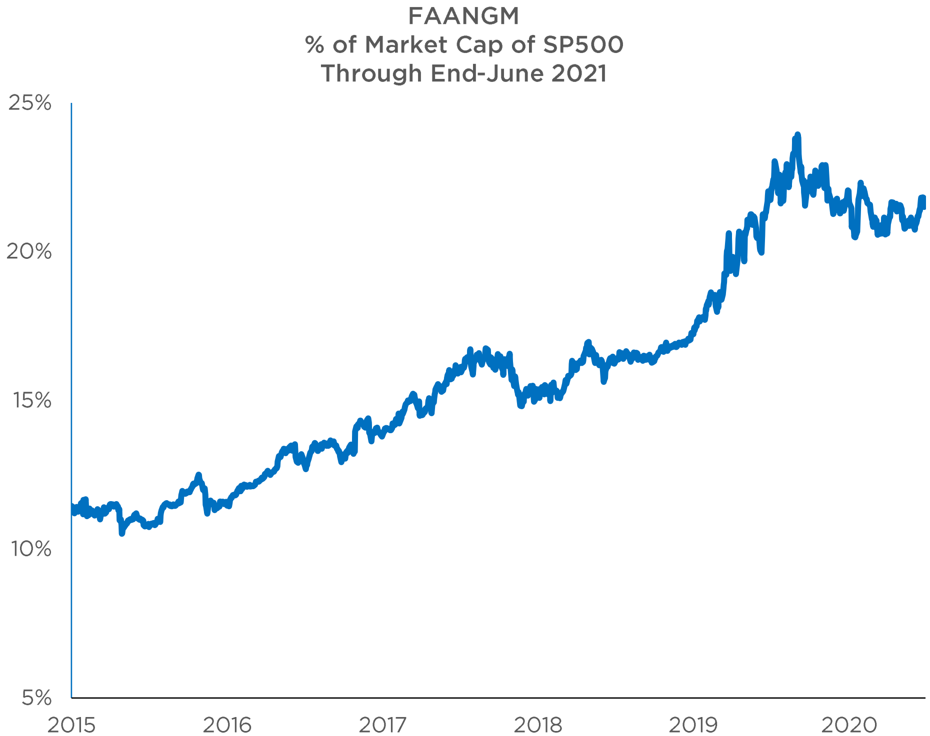
Long				Short			
Ticker	Company Name	Industry Group	Market Cap ($ US. Bil)	Ticker	Company Name	Industry Group	Market Cap ($ US. Bil)
PYPL	PayPal Holdings, Inc.	IT Services	342.41	DIS	The Walt Disney Company	Entertainment	319.36
AMD	Advanced Micro Devices, Inc.	Semiconductors & Semiconductor Equipment	114.13	SQ	Square, Inc.	IT Services	111.02
NOW	ServiceNow, Inc.	Software	108.51	TWTR	Twitter, Inc.	Interactive Media & Services	54.78
ALGN	Align Technology, Inc.	Health Care Equipment & Supplies	48.35	LUV	Southwest Airlines Co.	Airlines	31.40
VEEV	Veeva Systems Inc.	Health Care Technology	47.55	PAYC	Paycom Software, Inc.	Software	21.01
LULU	Lululemon Athletica Inc.	Textiles, Apparel & Luxury Goods	47.50	SEDG	SolarEdge Technologies, Inc.	Semiconductors & Semiconductor Equipment	14.36
GNRC	Generac Holdings Inc.	Electrical Equipment	26.14	SAM	The Boston Beer Company, Inc.	Beverages	12.43
TYL	Tyler Technologies, Inc.	Software	18.43	TREX	Trex Company, Inc.	Building Products	11.79
DT	Dynatrace, Inc.	Software	16.57	PEN	Penumbra, Inc.	Health Care Equipment & Supplies	10.00
FIVE	Five Below, Inc.	Specialty Retail	10.82	GLOB	Globant S.A.	IT Services	9.07
PCRX	Pacira BioSciences, Inc.	Pharmaceuticals	2.67	SHAK	Shake Shack Inc.	Hotels, Restaurants & Leisure	4.19
MODV	ModivCare Inc.	Health Care Providers & Services	2.38	RIOT	Riot Blockchain, Inc.	Software	3.61
UCTT	Ultra Clean Holdings, Inc.	Semiconductors & Semiconductor Equipment	2.21	GRWG	GrowGeneration Corp.	Specialty Retail	2.83

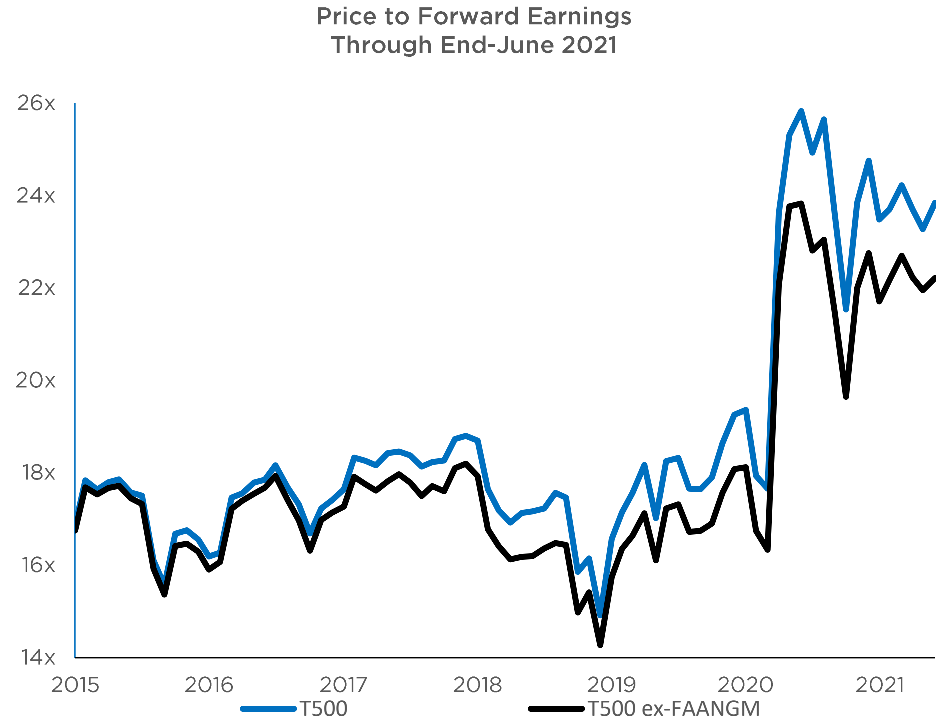
WE ARE OPTIMISTIC ABOUT US EQUITIES

- **Our conclusion: We are bullish on US equities for 2021.** When investors look back several years from now what will they observe? As strong economy with strong profit growth, accommodative monetary policy and massive fiscal stimulus
- **Does it matter that the market is expensive?** While there is no question that the US stock market is expensive on forward earnings vs. its own history, we do not think history is a relevant determinative of subsequent return. FAANGM and a longer-growth runway for software and biotechnology partially justify the higher multiples. We generally do not see signs of management hubris, with capital spending unlikely to impede margin progress and inventory levels for a decreasingly relevant set of companies relatively tame. **Hence optimism about the sustainability of earnings growth and the maintenance of these higher multiples is likely. The biggest risks are wage and raw input costs pressures rising enough to offset revenue growth, which is why incremental margin assessment is key**
- **We prefer large-over-small cap stocks today:** Mega / large caps showed far less downside during COVID relative to previous downturns. For small / micro caps, margins plummeted the same way they did during the financials crisis, but multiples have been potentially excessively anticipatory of a margin recovery
- **IN SUMMARY: We have a strong economy, solid earnings growth, limited impediments to margin expansion, massive fiscal stimulus and an accommodative monetary policy. We are optimistic about US equities because we do not see major impediments to margin expansion in the coming quarters. The biggest risk in our mind is input costs rising faster than revenue for select companies**

CHANGING MARKET CONSTITUTION – FAANGM

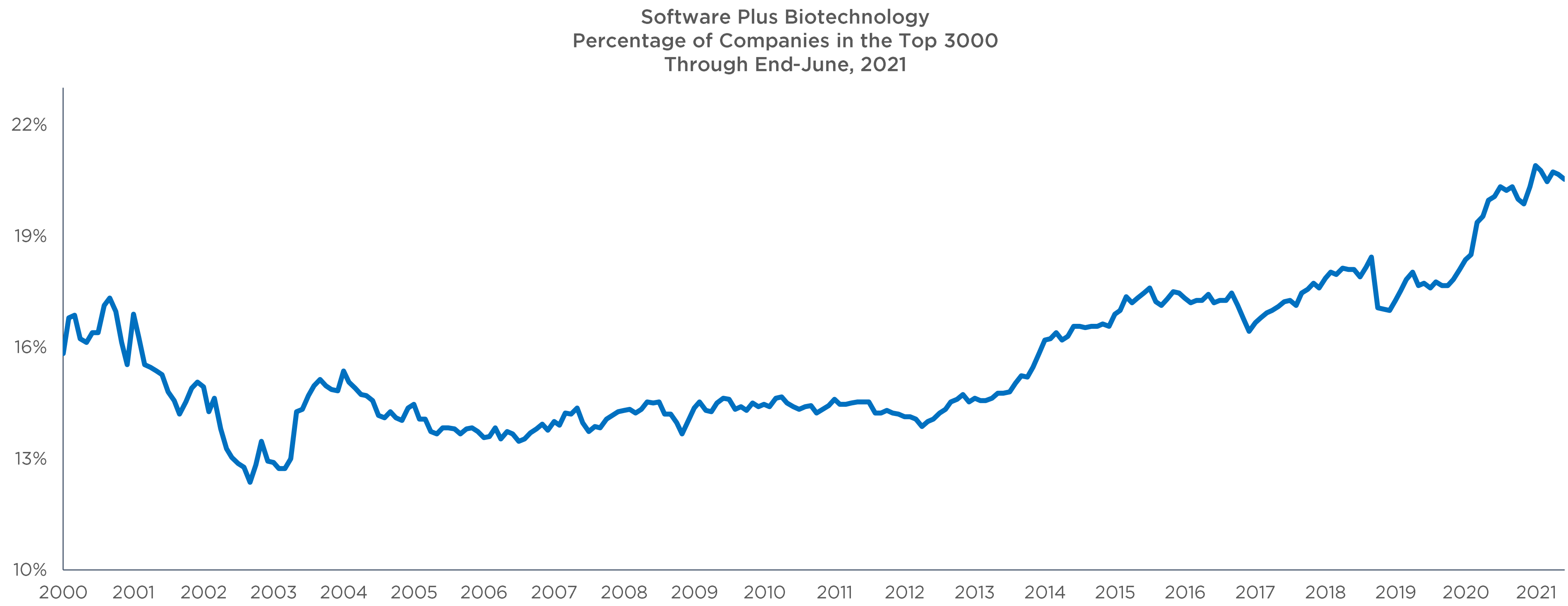
When we think about comparing today's market to previous cycles, and what might justify in part the higher multiple today, the constitution of the market is one key factor. FAANGM is now 22% of the S&P500 market capitalization (left chart) and that alone has added more than 2 turns to the market multiple over the last couple of years (right chart)





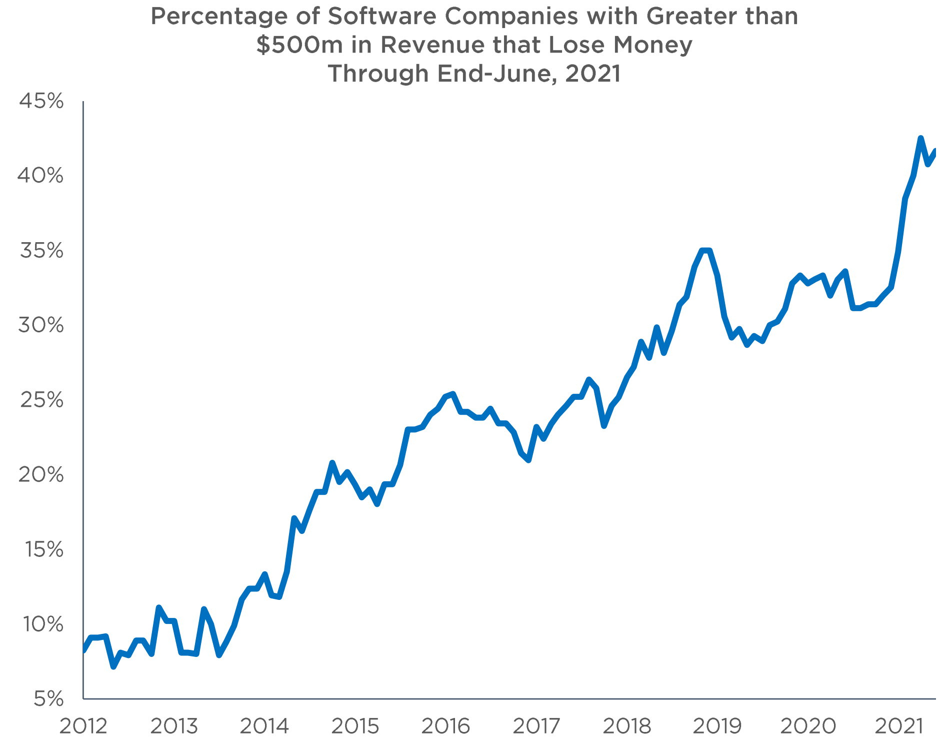
SOFTWARE & BIOTECH ARE A LARGER SLICE OF THE PIE

Twenty percent, or 600 of the biggest 3000 public US equities are currently in the Software & Services or Pharmaceuticals, Biotechnology, and Life Sciences industries. That is nearly twice the number we had 20 years ago! Investors are buying long-dated potential growth, not current profitability



CURRENT PROFITS CLEARLY DO NOT MATTER AS MUCH

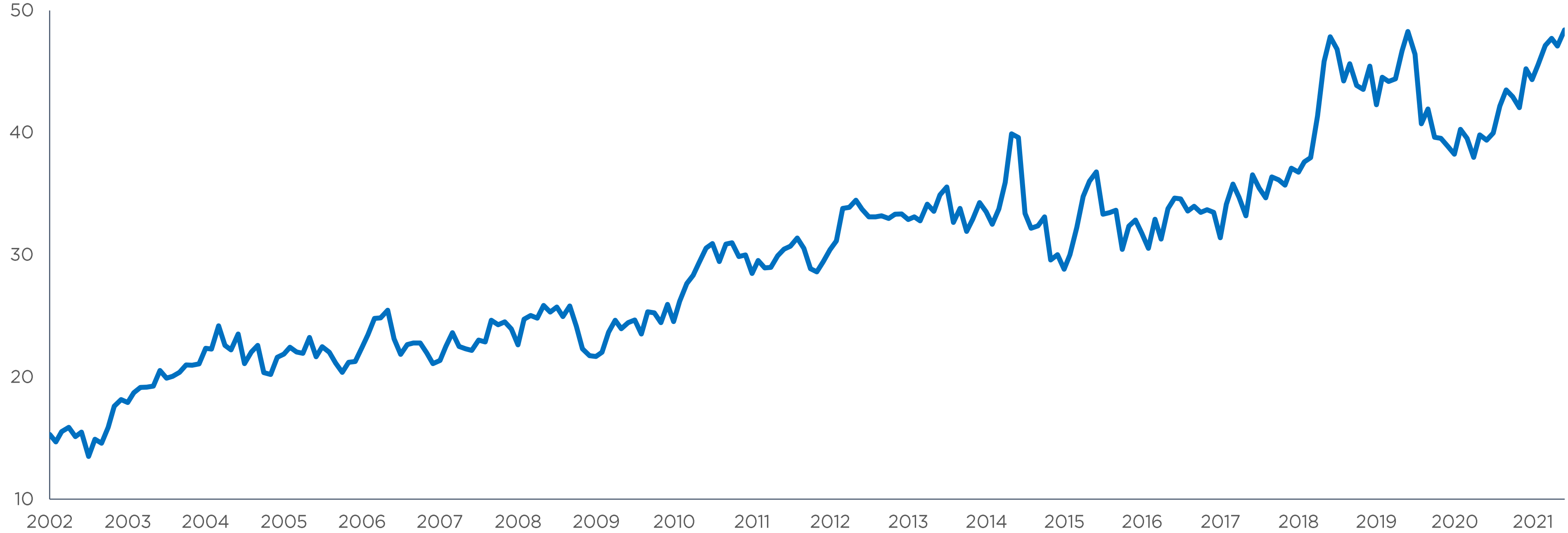
Investors in hyper growth stocks do not seem to care that much about current profitability, because nearly 15% of the largest 3000 companies by market capitalization have lost money on an annual basis every quarter for the past two years (left chart). In industries like software, over 40% of the companies that have more than $500 million in annual trailing revenue still lose money (right chart). Investors clearly are not concerned focused on current profitability



GROWTH STATUS LASTS LONGER

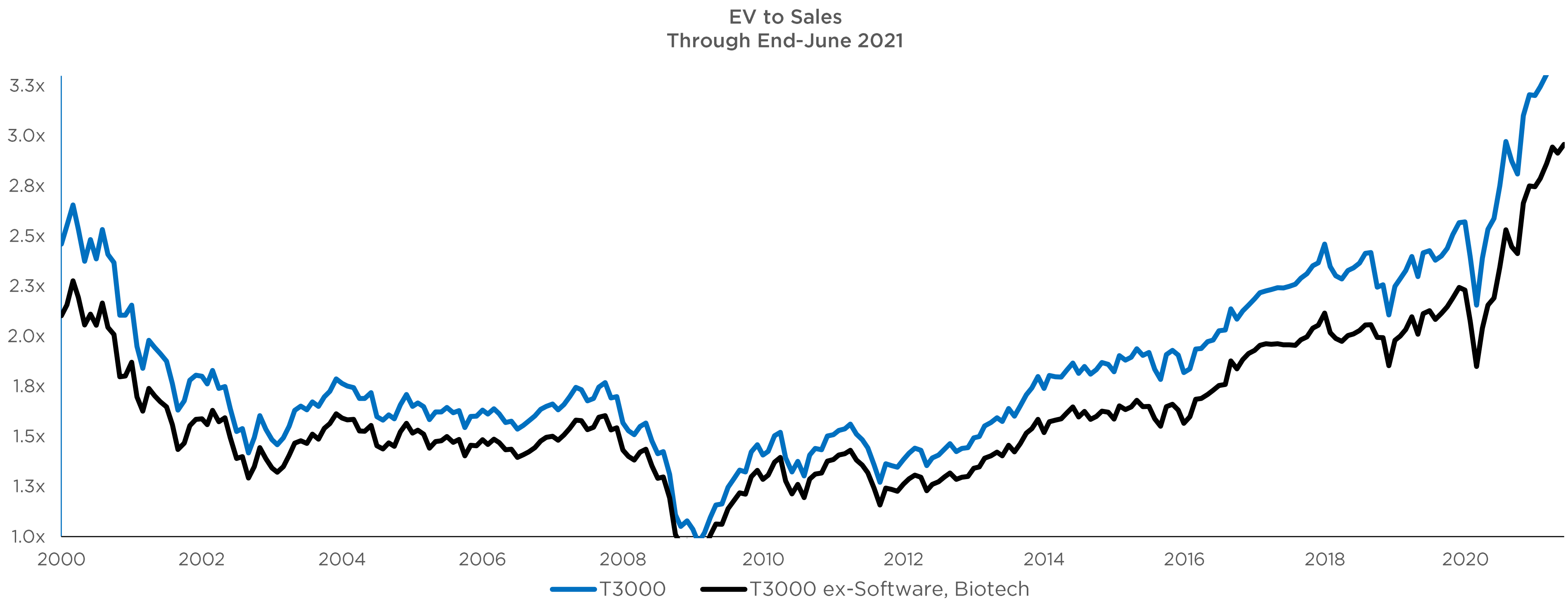
We think that the elevated market valuation is in part sensible because these faster-growing businesses are maintaining their growth status for the longest amount of time ever. The average number of consecutive months a growth stock in the SP500 has been able to grow is now at a record level of 48 months straight, up from just under two years in 2007. If a company's growth can be consistently maintained for a longer period, paying a higher premium in advance has merit

Average Number of Consecutive Months
An SP500 Growth Stock Has Been in Growth Universe
Through End-June, 2021



THESE COMPANIES DRIVE UP THE MARKET-WIDE VALUATION

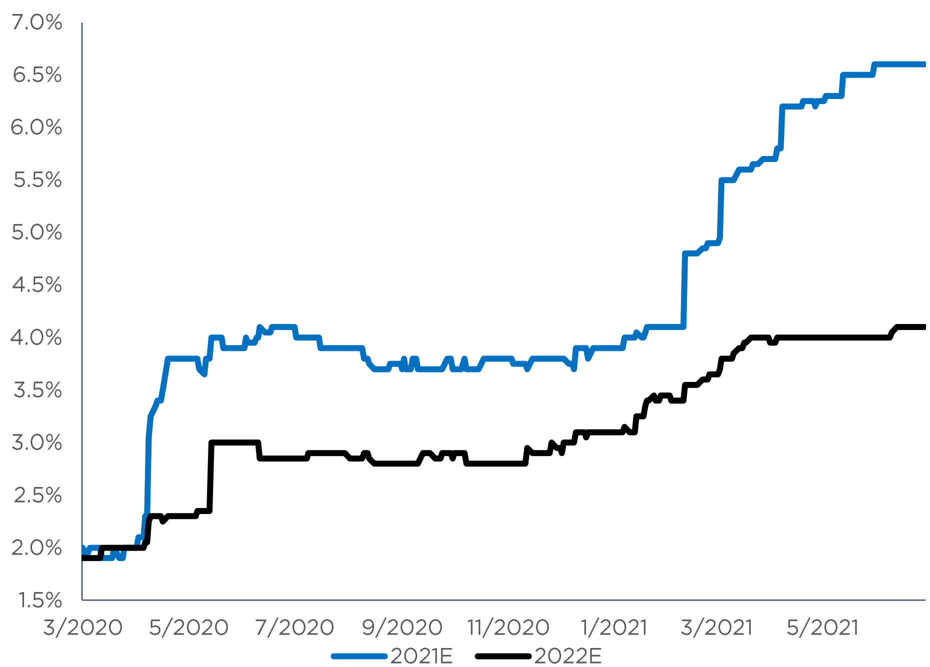
The market valuation has been increasingly influenced by this growth phenomena, which is largely fueled by software and biotechnology



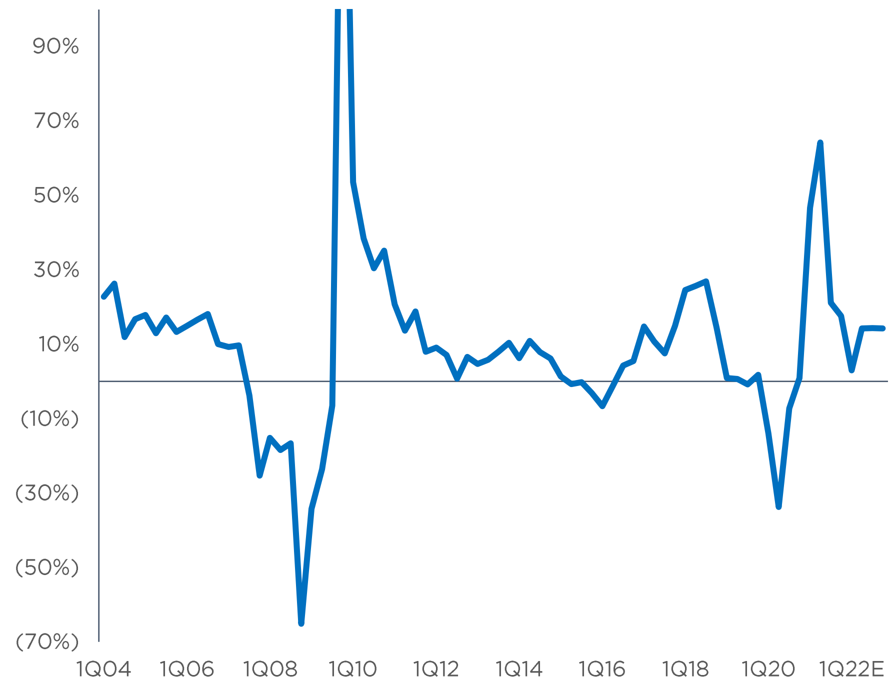
ECONOMIC STRENGTH AND EARNINGS GROWTH LIKELY CONTINUE

The forecasted 2021 and 2022 US economic outlook has continued to improve throughout the year (left chart). The consensus sell-side estimates are for strongly accelerating earnings growth through Q2 next year, due to easy comps (right chart). While earnings will decelerate beginning in Q3, double digit year-over-year growth is forecast through 2022. Our experience is that it does not really matter if estimates are achievable in the out year – what matters more is that investors **believe** earnings will continue to grow. With massive monetary and fiscal stimuli persisting through the year, getting overly bearish on the earnings outlook does not appear prudent, especially if GDP expectations continue to be optimistic

US QoQ GDP Forecasts 2021 and 2022 Through End-June, 2021

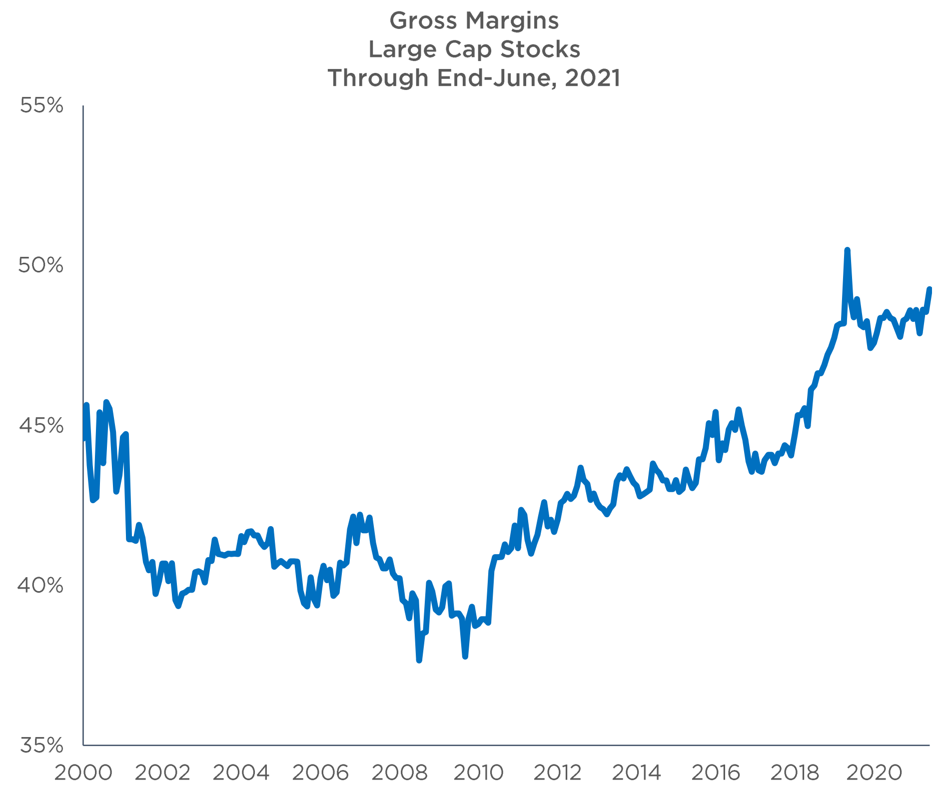


SP500 Year-over-Year Earnings Growth Through 2022E As of End-June, 2021



LARGE CAPS MAINTAINED HIGHER PROFITABILITY THIS CYCLE

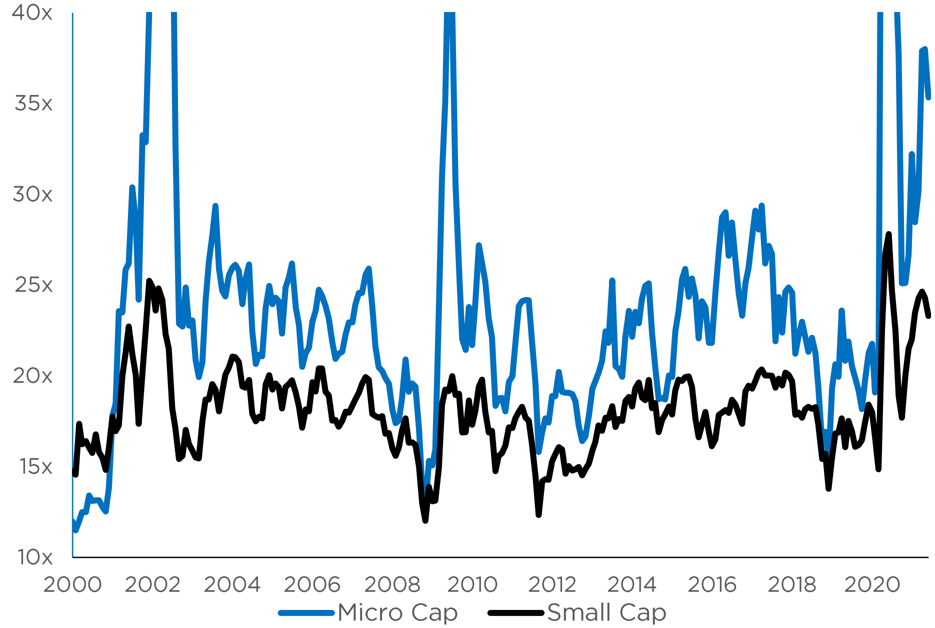
There is no question that in absolute terms, the price-to-forward earnings of the market has expanded this cycle. At 25x forward consensus expectations, multiples have not been sustainably higher since the TMT bubble unwind. But this valuation is supported in part by expanding and stable profitability for large cap stocks. These names have stabilized at materially higher levels than during previous recessions and had limited pullback during the worst part of the COVID pandemic. We do not think profit mean reversion (and therefore multiple mean reversion) is likely in the near-to-medium term



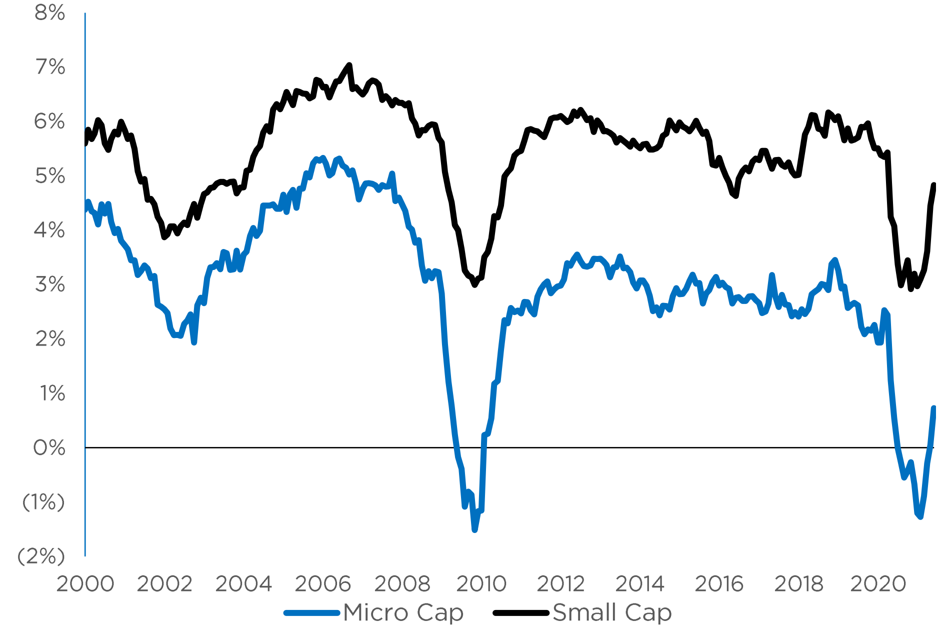
SMALL CAPS: EXPENSIVE AND EXCESSIVE MARGIN EXPECTATIONS?

Small-and-micro-cap price-to-forward earnings are now near cycle-highs, but profitability has not recovered. Sure, markets are typically lead, but multiples have now eclipsed prior cycle highs in an extremely anticipatory fashion. Based on valuation and profitability, we prefer mega / large to small / micro-cap at this point in the cycle. The risk-reward just seems better for large than small caps right now. Further, a weakening dollar, the potential for rising taxes, and higher input costs all typically hurt smaller business proportionately more than larger ones in the US

Price-to-Forward Earnings
Small / Micro Cap
Through End-June, 2021

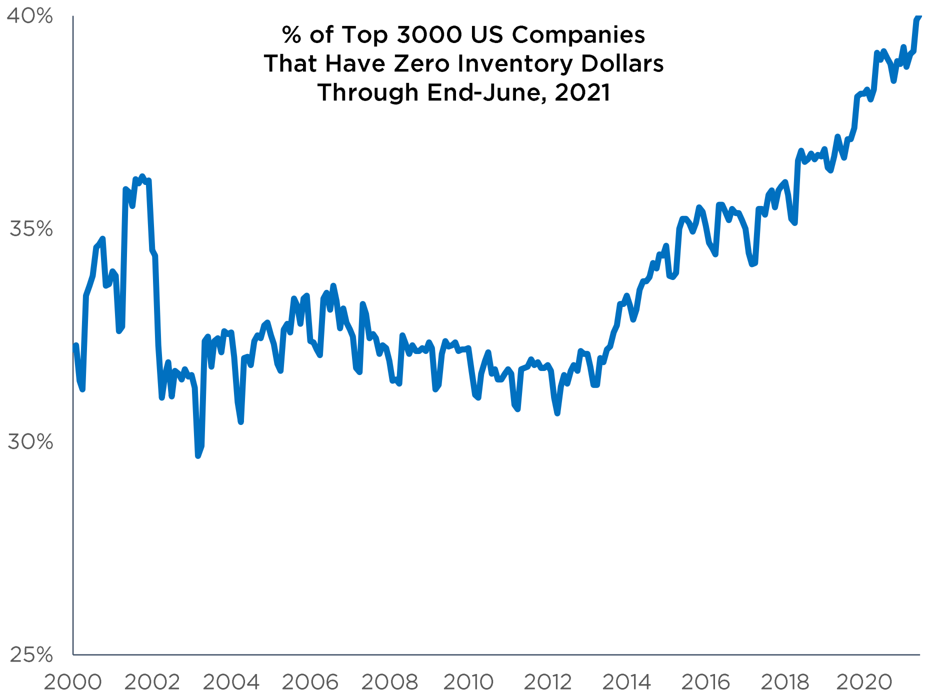


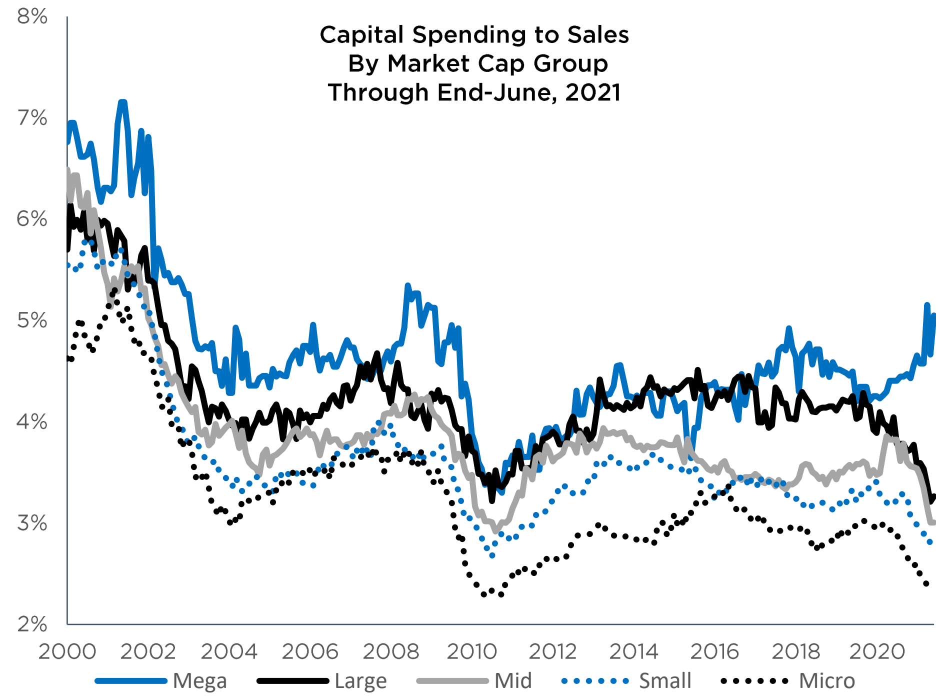
Net Margins
Small / Micro Cap
Through End-June, 2021



FEW MARGIN IMPEDIMENTS LOOM

Overall inventory is less of a risk than it was in the past, because now approximately 40% of the top 3000 US equities do not even have inventory as part of their business model. That is roughly 300 more stocks than 20 years ago. Moreover, we are more likely to hear about shortages (AAPL's earnings) than excesses in many area of manufacturing today. Therefore, an inventory burn off or backlog cancellation seems highly unlikely to impede margin expectations for the coming couple of quarters. Excessive capital spending optimism can also be bad. However, we generally have not seen any increases in capital intensity (right chart), so there is limited fear of having to throttle back manufacturing. In the end, management hubris that caused cycle tops previously seems less likely when inventory and capital spending are under control





STOCK IDEAS

We picked some ideas to focus on that embody our research. These are stocks that either screen well, or risky in our various frameworks presented within – so quant plus judgment. We did not do deep fundamental research on these names

Stock Ideas for 2H 2021
July 6, 2021

Long

Ticker	Company Name	Industry Group	Market Cap ($ US. Bil)
AMZN	Amazon.com, Inc.	Retailing	1853.76
MU	Micron Technology, Inc.	Semiconductors & Semiconductor Equipment	91.28
CERN	Cerner Corporation	Health Care Equipment & Services	23.97
TYL	Tyler Technologies, Inc.	Software	19.21
STLD	Steel Dynamics, Inc.	Materials	12.30
FIVE	Five Below, Inc.	Retailing	10.92
MRO	Marathon Oil Corporation	Energy	10.41
BE	Bloom Energy Corporation	Capital Goods	4.48

Short

Ticker	Company Name	Industry Group	Market Cap ($ US. Bil)
NVDA	NVIDIA Corporation	Semiconductors & Semiconductor Equipment	515.81
PNC	The PNC Financial Services Group, Inc.	Banks	79.86
TWLO	Twilio Inc.	Software & Services	67.54
WBA	Walgreens Boots Alliance, Inc.	Food & Staples Retailing	41.26
KR	The Kroger Co.	Food & Staples Retailing	27.98

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