TRIVARIATE RESEARCH

WHERE WE ARE AND WHAT WE SHOULD DO
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HOW DO WE ASSESS WHERE ARE WE ARE TODAY?

- We created twelve proprietary indices using over 100 variables that systematically process "macro" data. The macro data have various frequencies, ranging from daily through monthly and are downloaded from Bloomberg, except for corporate profitability and company-specific risk data, which we compute.   We smooth and transform the data to create twelve indices or gauges of where we are in the investing world today.   Our proprietary gauges include:

1. Economic activity
2. Consumer activity
3. Corporate profitability
4. Financial conditions
5. Currency
6. The slope and level of the US Treasury yield curve
7. Industrial activity
8. China activity
9. European activity
10. Oil
11. Commodities
12. Company-specific risk

AND WHERE ARE WE? THINGS ARE GENERALLY VERY GOOD

Many of our signals have multiple inputs (right side of below chart) and are designed to capture larger and longer-term trends, not shorter-term / smaller counter-trend movements. When we look at our 12 gauges (listed alphabetically below) we can see economic activity, industrial activity, oil, commodities, Europe, and China are all generally increasing / improving.   The 3-month curve is bull flattening while the 12-month one is bear steepening. Financial conditions are loosening.   While consumer activity has improved for sometimes, the metrics are mixed enough on a YoY basis that we still haven't officially included things are improving

Current Regime for Each Macro Signal

Macro Signal	Current Regime	Examples of Components
China	Increasing	Fiscal Expenditures, New Auto Registrations, Electricity Consumption, Exports, Consumer Confidence, Financial Conditions, Residential Property Sales, 10-Year Yield
Commodities	Increasing	Aluminum, Corn, Cotton, Copper, Lumber, Natural Gas, Soybeans, Sugar, Silver
Consumer Activity	Increasing	Credit Card Delinquency, Retail Sales, Consumer Confidence, Wage Growth, Unemployment
Corporate Profitability	Increasing	Operating Margin, 1-Year FWD Earnings Expectations, 2-Year FWD Earnings Expectations
Company-Specific Risk	Increasing (More Idiosyncratic, Less Macro)	The amount unexplained by our 7-factor model
Currency	Dollar Weakening	AUD, CAD, CHF, DXY, EUR, GBP, INR, JPY, SEK
Economic Activity	Increasing	CEO Confidence, Inflation, Philly Fed Business Outlook, Small Business Optimism, Leading Indicators
Europe	Increasing	Financial Conditions, 5y5y Forward Break-evens, Unemployment, Consumer Confidence, CDS Spreads
Financial Conditions	Loosening	Credit Spreads, US Treasury Implied Volatility, 30-Year Fixed Mortgage Rates
Industrial Activity	Increasing	Dry Van Rate per Mile, Baker Hughes Total Rig Count, AAR N. America Total Carloads, US Capacity Utilization, Private Non-Residential Construction, US C&I Loans
Oil	Increasing	WTI, Brent
Yield Curve 63d	Bull Flattening	US 2-Year Yield, US 10-Year Yield
Yield Curve 126d	Bear Steepening	US 2-Year Yield, US 10-Year Yield
Yield Curve 252d	Bear Steepening	US 2-Year Yield, US 10-Year Yield

WHAT SHOULD WE DO ABOUT IT?

1. We recommend that investors **gross up their TMT exposure**. Our work shows that our multi-factor quantitative alpha model in TMT performs materially better at picking winners from losers when economic activity is positive and increasing than when it is not

2. We recommend that investors **gross down their durables exposure**. We struggle to separate winners from losers in durables like homebuilders when economic activity is positive and increasing

3. We recommend that investors **gross up their consumer discretionary exposure**.   Our discretionary model also performs better when our consumer activity gauge is positive and increasing

4. Other recommendations include: **gross down exposure to staples and real estate**, and **gross up exposure to banks, healthcare, and high yielding "junk" stocks**

Stocks that screen well (poorly) in areas we highlight are being grossed up today include:

**Select TMT long ideas include**: GOOGL, CDNS, Z, TTWO, IAC

Select TMT short ideas include: SPLK, FLT, SSNC, FIVN, FWONK

Select Discretionary long ideas include: HD, TSCO, ULTA, RH, AAP

Select Discretionary short ideas include: BKNG, MTN, STMP, SFIX, URBN

ECONOMIC ACTIVITY IS POSITIVE AND INCREASING

We show the economic activity gauge we created below. We evaluate where we are in the economic activity cycle by looking at variables like CEO Confidence, Philly Fed Business Outlook, Small Business Optimism, US Economic Surprise, US LEI, US 5y5y Forward Breakeven, etc. We obviously have a positive and increasing economic activity today. However, using our system we couldn't positively corroborate this until May 2021, especially after experiencing a "false start" in February 2021. Based on the underlying data, it seems likely that our economic activity signal will continue to be positive and increasing for the next few months, at a minimum

Economic Activity Signal
Through End-June, 2021
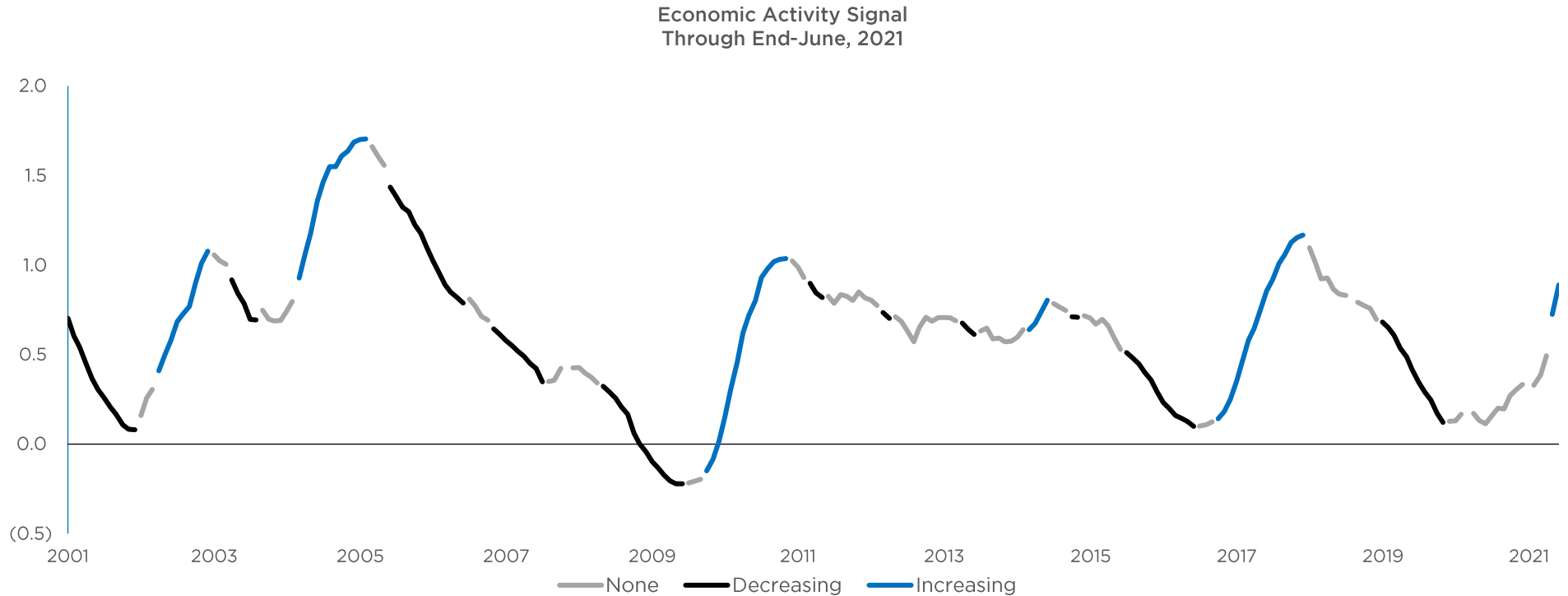
CONSUMER ACTIVITY IS LIKELY TO CONTINUE IMPROVING

Our consumer activity gauge consists of retail sales, wage growth, personal income growth, credit card delinquencies, payrolls, unemployment, and consumer confidence. While there might be what seems like obvious consumer strength, there are some conflicting signals we monitor on a YoY basis. Credit card delinquencies are at a 20-year low, perhaps the most telling sign of consumer positioning. YoY payrolls and retail sales have also spiked, remaining at elevated levels (due to base effects). Additionally, unemployment continues to come down.   However, wage growth, personal income, and hourly earnings growth, have rolled over recently – in part because of base effects due to government intervention in 2020. We expect our consumer activity gauge to keep positive and improving, with payrolls, hourly earnings growth, and retail sales, the most positive contributors

Consumer Activity Signal
Through End-June, 2021
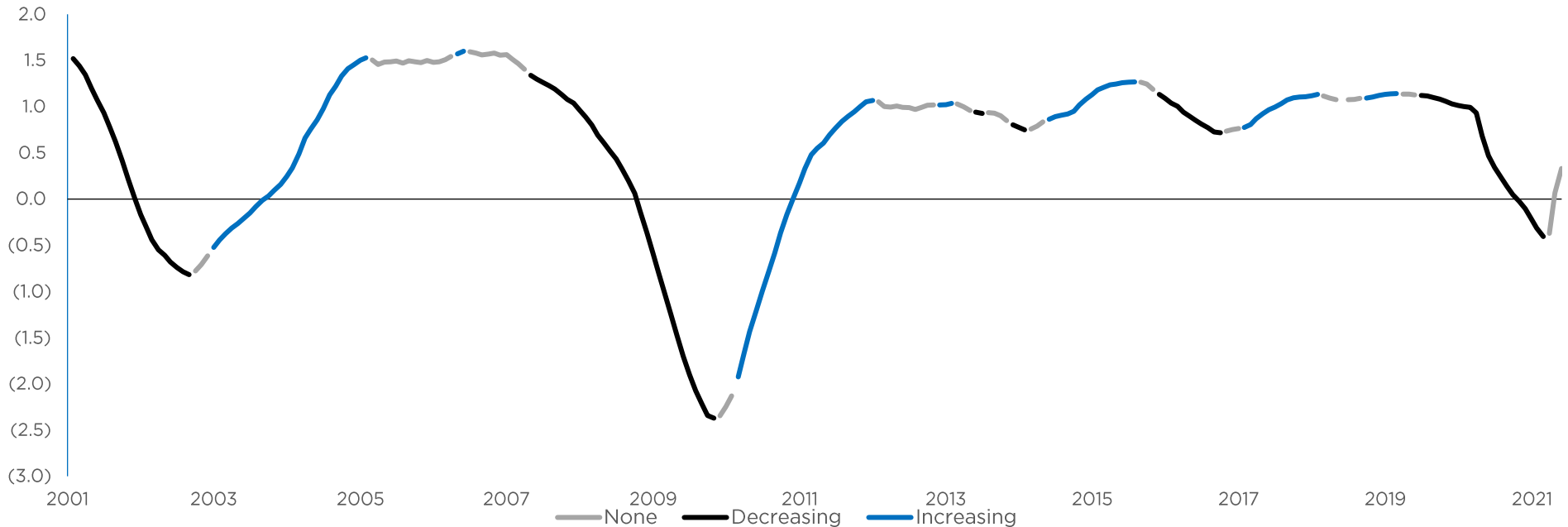
CORPORATE PROFITABILITY HAS RECOVERED STRONGLY

Our corporate profitability gauge includes a combination of trailing operating margins, forecasted net margins, and the forward 2-year earnings growth expectations. The trend has been strongly positive over the past several months

Corporate Profitability Signal
Through End-June, 2021
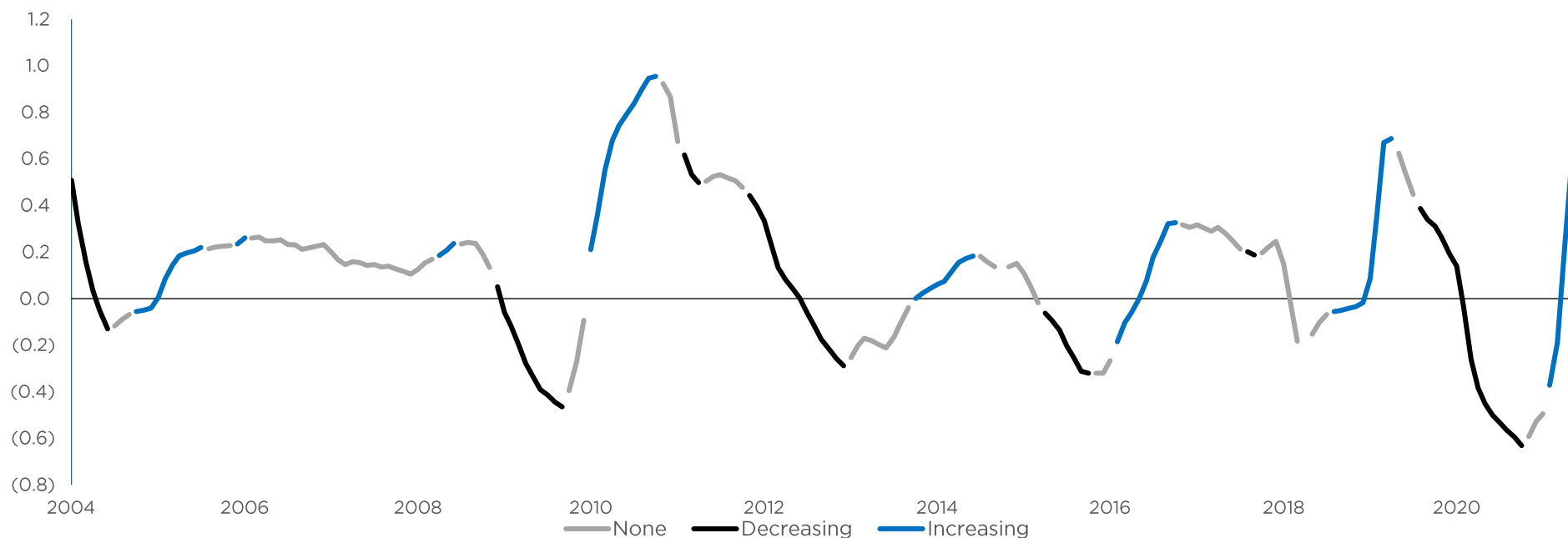
BUT IS PEAKING IN Q2, THEN BOTTOMING IN Q1 2022

The year over year growth in corporate profitability will peak in Q2 of 2021, dip, then bottom in Q1 of 2022 and accelerate from there. The SP500 earnings growth for Q2 2021 is forecasted to 46.8%, the peak quarter. This bottoms at 3.4% in Q1 and then accelerates to mid-teens growth for the remainder of 2022

SP500 Earnings Estimates and Earnings Growth Expectations
July 16, 2021

Sectors	SP Earnings Estimates										Year-over-Year Earnings Growth				
	Q1 2021	Q2 2021	Q3 2021	Q4 2021	2021	Q1 2022	Q2 2022	Q3 2022	Q4 2022	2022	Q1	Q2	Q3	Q4	Year
Consumer Discretionary	3.81	3.36	3.71	3.88	14.77	4.35	5.03	5.22	4.98	19.59	14.1%	49.7%	41.0%	28.2%	32.7%
Consumer Staples	2.83	2.83	3.11	3.02	11.79	2.99	3.07	3.40	3.30	12.75	5.4%	8.4%	9.1%	9.4%	8.1%
Energy	1.08	1.59	2.02	1.97	6.67	1.98	2.15	2.25	2.05	8.43	83.0%	35.4%	11.2%	3.7%	26.5%
Financials	10.64	9.35	7.92	8.15	36.05	8.46	8.32	8.52	8.97	34.26	(20.5%)	(11.0%)	7.5%	10.1%	(5.0%)
Health Care	8.33	7.86	7.87	7.74	31.80	8.29	8.37	8.60	8.38	33.63	(0.5%)	6.5%	9.3%	8.3%	5.8%
Industrials	2.44	3.21	3.74	3.98	13.36	3.95	4.59	4.76	4.78	18.08	61.8%	43.2%	27.3%	20.3%	35.4%
Info Tech	10.53	9.76	10.27	12.25	42.81	10.96	10.94	11.78	14.11	47.80	4.1%	12.1%	14.8%	15.2%	11.7%
Materials	1.32	1.82	1.72	1.56	6.41	1.54	1.70	1.56	1.49	6.30	17.2%	(6.3%)	(9.1%)	(4.1%)	(1.7%)
Communication Services	5.46	4.62	4.72	5.37	20.17	5.46	5.20	5.52	6.51	22.68	0.0%	12.5%	17.1%	21.2%	12.5%
Utilities	1.38	1.18	1.75	1.07	5.38	1.49	1.26	1.82	1.14	5.71	7.9%	6.7%	4.1%	6.4%	6.1%
REITS	1.16	1.18	1.16	1.18	4.68	1.18	1.21	1.24	1.28	4.90	2.1%	2.3%	6.3%	8.0%	4.7%
S&P 500	48.98	46.76	47.98	50.16	193.88	50.65	51.85	54.66	56.98	214.14	3.4%	10.9%	13.9%	13.6%	10.5%

GROSS UP TMT EXPOSURE AND IDEAS

Our model performance is way better in TMT when the economy is improving (left chart). Our Q1-Q5 spread is 17.6% when economic activity is increasing, vs. 7.8% when it is not. Select long / short ideas from our quantitative model are show on the right chart. GOOGL, CDNS, Z, TTWO, and IAC screen well, SPLK, FLT, SSNC, FIVN, and FWONK are among those that screen poorly today

TMT Model Performance Through End-June, 2021

Stat (Beta-Adjusted)	Economic Activity Increasing	Economic Activity Not Increasing	Difference
Weighted Mean	17.6%	7.8%	9.8%
Weighted Median	17.9%	6.1%	11.5%
Weighted Information Ratio	1.84	0.84	1.00
Hit Rate	67.7%	58.0%	9.7%
Weighted Asymmetry	1.31x	N/A	N/A
Cartesian Product	55.4%	N/A	N/A

Prospective TMT Model Longs and Shorts July 19, 2021

Long

Ticker	Company Name	Industry Group	Market Cap ($ US. Bil)
GOOGL	Alphabet Inc.	Interactive Media & Services	1700.01
CDNS	Cadence Design Systems, Inc.	Software	38.32
Z	Zillow Group, Inc.	Interactive Media & Services	26.05
TTWO	Take-Two Interactive Software, Inc.	Entertainment	18.53
IAC	IAC/InterActiveCorp	Interactive Media & Services	11.88

Short

Ticker	Company Name	Industry Group	Market Cap ($ US. Bil)
SPLK	Splunk Inc.	Software	21.97
FLT	FLEETCOR Technologies, Inc.	IT Services	20.47
SSNC	SS&C Technologies Holdings, Inc.	Software	18.36
FIVN	Five9, Inc.	Software	12.73
FWONK	Formula One Group	Entertainment	10.58

THE IMPROVING CONSUMER EQUATES TO GROSSING DISCRETIONARY

Our discretionary model performs substantially better when our consumer activity gauge is positive and increasing (left chart). The top vs. bottom quintile spread averages 20.1% vs. a 9.4% spread when the consumer activity gauge is not increasing. Select long / short ideas are shown in the right chart

Discretionary Model Performance Through End-June, 2021

Stat (Beta-Adjusted)	Consumer Activity is Increasing	Consumer Activity Is Not Increasing	Difference
Weighted Mean	20.1%	9.4%	10.7%
Weighted Median	21.8%	13.3%	8.5%
Weighted Information Ratio	1.93	0.80	1.13
Hit Rate	77.1%	56.9%	20.2%
Weighted Asymmetry	1.18x	N/A	N/A
Cartesian Product	59.0%	N/A	N/A

Prospective Discretionary Model Longs and Shorts July 19, 2021

Long

Ticker	Company Name	Industry Group	Market Cap ($ US. Bil)
HD	The Home Depot, Inc.	Specialty Retail	339.04
TSCO	Tractor Supply Company	Specialty Retail	20.85
ULTA	Ulta Beauty, Inc.	Specialty Retail	17.72
RH	RH	Specialty Retail	13.71
AAP	Advanced Auto Parts, Inc.	Specialty Retail	13.35

Short

Ticker	Company Name	Industry Group	Market Cap ($ US. Bil)
BKNG	Booking Holdings Inc.	Hotels, Restaurants, & Leisure	84.88
MTN	Vail Resort, Inc.	Hotels, Restaurants, & Leisure	12.18
STMP	Stamps.com Inc.	Internet & Direct Marketing Retail	5.92
SFIX	Stich Fix, Inc.	Internet & Direct Marketing Retail	5.87
URBN	Urban Outfitters, Inc.	Specialty Retail	3.50

OTHER GROSS RECOMMENDATIONS

Our durables model performance poorly when corporate profitability is increasing, fueling our judgment that picking winners from losers is challenging in areas like home builders, air conditioning, and select apparel today. The top quintile of our durables model UNDERPERFORMS the bottom quintile by 1.6% on average when corporate profitability is increasing but outperforms the bottom quintile by 9.6% when it is not increasing (left chart). We show the additional gross exposure recommendations activated by our 12 proprietary gauges, including grossing up banks, healthcare, and high yielding junk, grossing down REITS and staples (right chart)

Durables Model Performance Through End-June, 2021					Other Current Gross Exposure Recommendations		
Stat (Beta-Adjusted)	Corporate Profitability Increasing	Corporate Profitability Not Increasing	Difference		Model	Grossing Action	Justification
Weighted Mean	(1.6%)	9.6%	(11.2%)		Banks	UP	Financial Conditions are loosening
Weighted Median	(2.6%)	11.2%	(13.8%)		Healthcare	UP	European financial conditions/general economic activity is increasing
Weighted Information Ratio	(0.17)	0.80	(0.97)		High Yielding Junk	UP	Economic Activity and Commodities are increasing, Consumer Activity will soon be as well
Hit Rate	42.9%	64.8%	(22.0%)		REITs	DOWN	Yield Curve over past 126d is in bear steepening
Weighted Asymmetry	0.94x	N/A	N/A		Staples	DOWN	Increasing Corporate Profitability and Yield Curve over past 126d is in bear steepening
Cartesian Product	37.4%	N/A	N/A				

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