TRIVARIATE RESEARCH

TIME TO BUY GROWTH

01/28/2022

ADAM S. PARKER, Ph.D., FOUNDER
adam@trivariateresearch.com
646-734-7070

COLIN COONEY, HEAD OF SALES
colin@trivariateresearch.com
617-910-7934

ALBERT MISHAAN, ANALYST
albert@trivariateresearch.com
732-710-8996

BRAD ROCHE, SR. SALES CONSULTANT
brad@trivariateresearch.com
516-434-9623

SUMMARY

Last week we wrote about one of the two most critical aspects of equity investing – the change in perception about interest rates. This week we shift to the other concept – the change in perception about growth. These two concepts are intertwined, as evidenced by the current growth scare and the recent QQQ and SPX sell-off. In part, this appears merited by a change in macro conditions. Financial conditions have materially tightened and are now the least "loose" since early in 2021. The 2022 US GDP forecast is about 25bps lower from its peak late in 2021, having slowly declined, without a single uptick. The IMF earlier in the week cited a relatively weaker US and China as rationale for tweaking lower their Global GDP forecast as well. The VIX is at 93rd percentile since 1990, highest since January 2021 and another indicator that the growth scare has been substantial.

As we discussed last week, there is a high correlation between changes in perceptions about interest rates and the stock market. Powell's message earlier in the week apparently confirmed the recent perception change. Our own judgment is that the Fed will raise less than the consensus expectations in the next two years, and that some relatively dovish sentiment may surface in 2022. While some investors are suggesting that there is a Fed "put" 5-10% lower that today's market levels, our view is that risk-reward for US equity investors is attractive today.

Unsurprisingly, US corporate earnings and the stock market tend to go up over time. Typically, what matters is positive YoY earnings growth. Earnings estimates have come down for 2022 over the last several months as rising input costs from labor, logistics, and commodities have pressured margins in industrials and other parts of the market. Despite this, earnings are still likely to grow in our view, and this fuels our growing optimism. To us, a growth scare simply means the probability that 2023 earnings are below 2022 earnings is higher than it was previously. This is more likely if the Fed hikes aggressively as the economy slows. **Whether or not this will happen is THE key investment debate.**

CONCLUSIONS – UPGRADING TECH AND DOWNGRADING CONSUMER

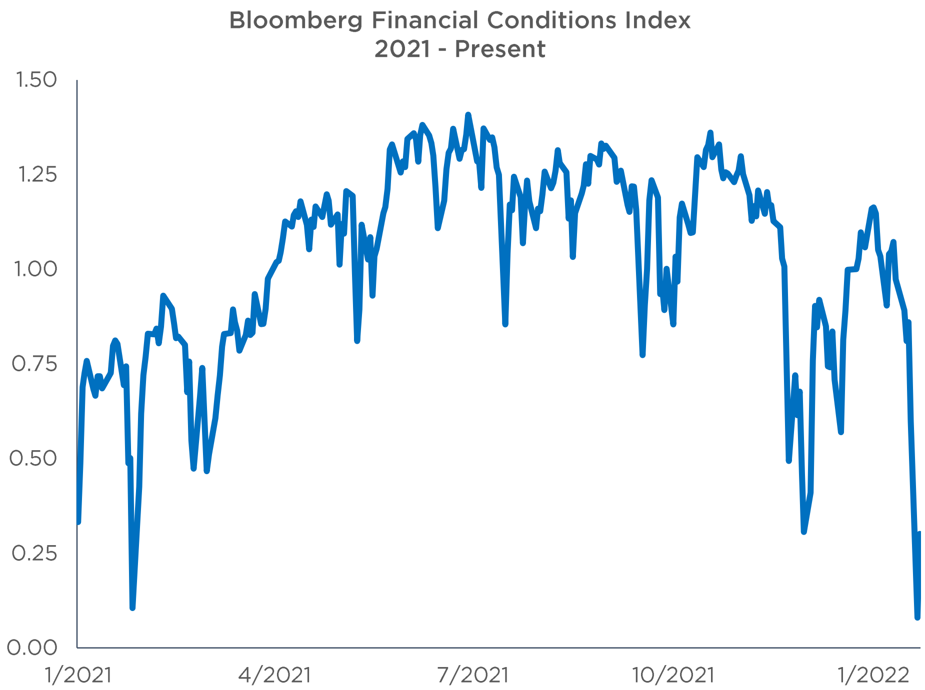
As growth scares go, this sell-off is sharper on the Nasdaq than the SP500. For the SP500, this is the 11th worst drawdown so far since 2008. The longest was 143 days, so this one is relatively short so far by "time." For the Nasdaq, this drawdown has been lengthier, and one of the worst since the Financial Crisis other than the initial COVID trade. Based on the magnitude of "typical" post-Financial Crisis corrections, we think it is reasonable to assume this drawdown is roughly 80% over. We analyzed which industries typically do best from the point where 80% of the drawdown is done through three months after the end of the drawdown. There are not a lot of signals that consistently help investors pick winners from losers at this juncture, but valuation has failed and growthier metrics like forecasted earnings acceleration and revenue growth generally sdid well. This is likely because the growth trade worked for most of the time following the Financial Crisis.

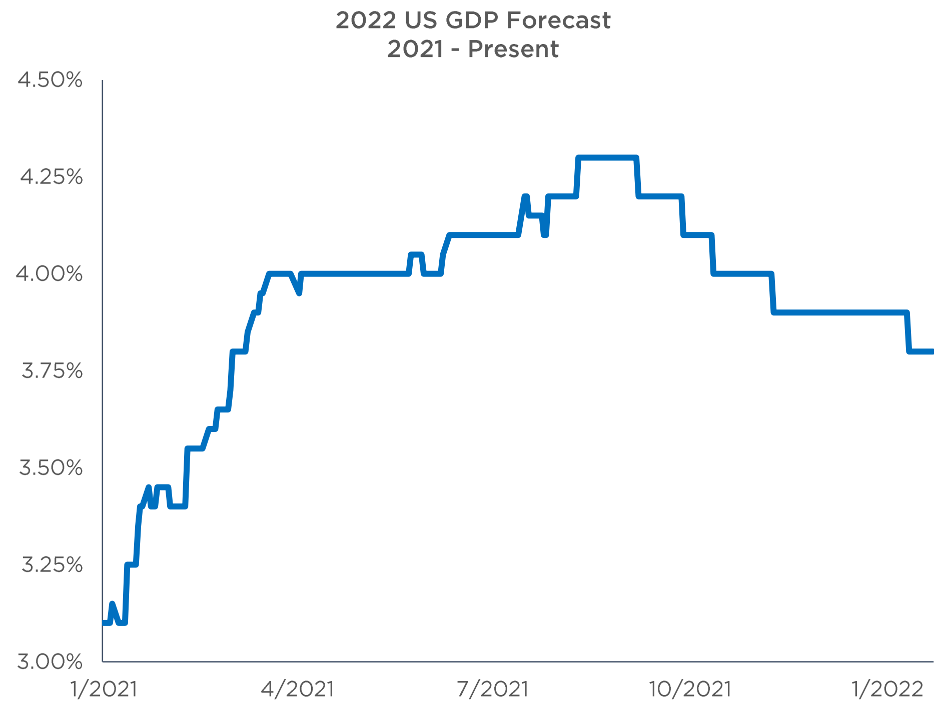
We recommend investors increase their exposure to growth stocks. **We are UPGRADING our underweight in technology to market-weight and would add to stocks with pricing power and positive free cash flow. We are DOWNGRADING consumer discretionary from overweight to market-weight, as most consumer metrics are peaking.**

Given the industry and factor performance, our judgment is to buy materials, software with profits, and healthcare services and be cautious on durables, staples, and capital goods. We like energy and materials over industrials, and healthcare over staples. Stock ideas that embody the historical signal efficacy at this point in the cycle are shown on Slide 11.

A GROWTH SCARE HAS TAKEN HOLD…

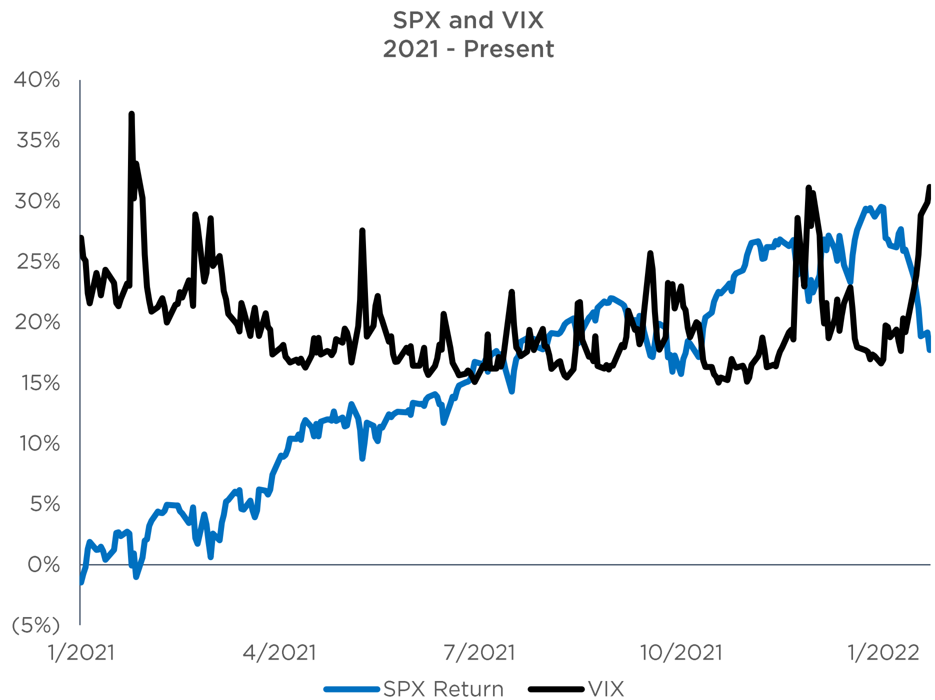
The last weeks of market activity bear many of the hallmarks of a classic growth scare, with the Nasdaq sell off the 6th worst and the SPX sell-off the 11th most pronounced since 2008. The sell-off is merited to an extent by a change in macro conditions. Financial conditions have materially tightened (left chart) and are now the least "loose" since early in 2021. The 2022 US GDP forecast (right chart) is about 25bps lower from its peak late in 2021, having slowly declined, without a single uptick. The IMF earlier in the week cited a relatively weaker US and China as rationale for tweaking lower their Global GDP forecast as well.

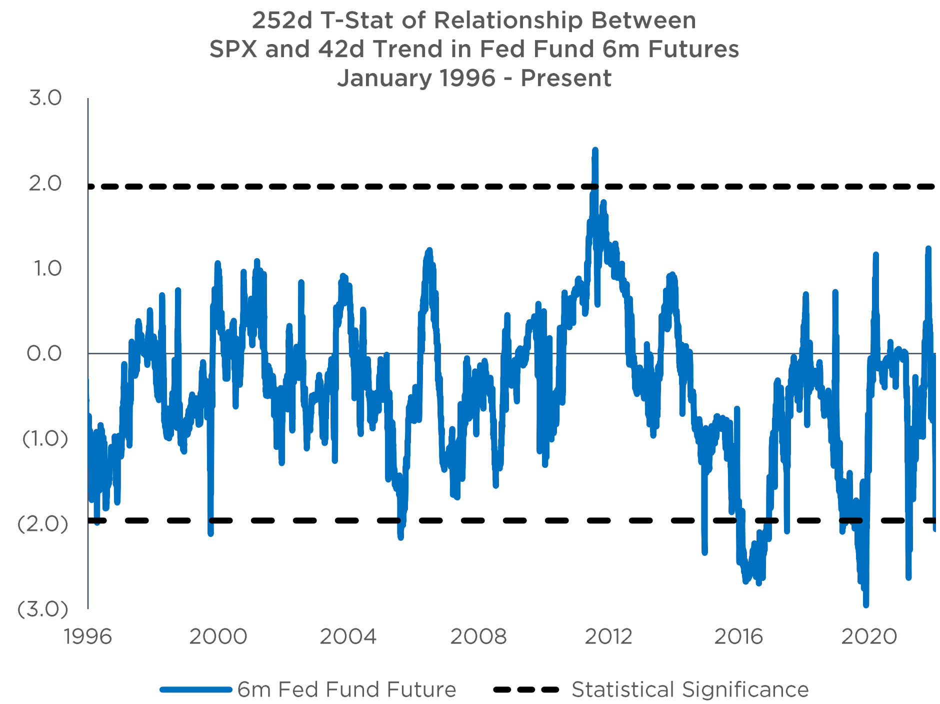




… LEADING TO A MARKET SELL-OFF AND INCREASED FEAR

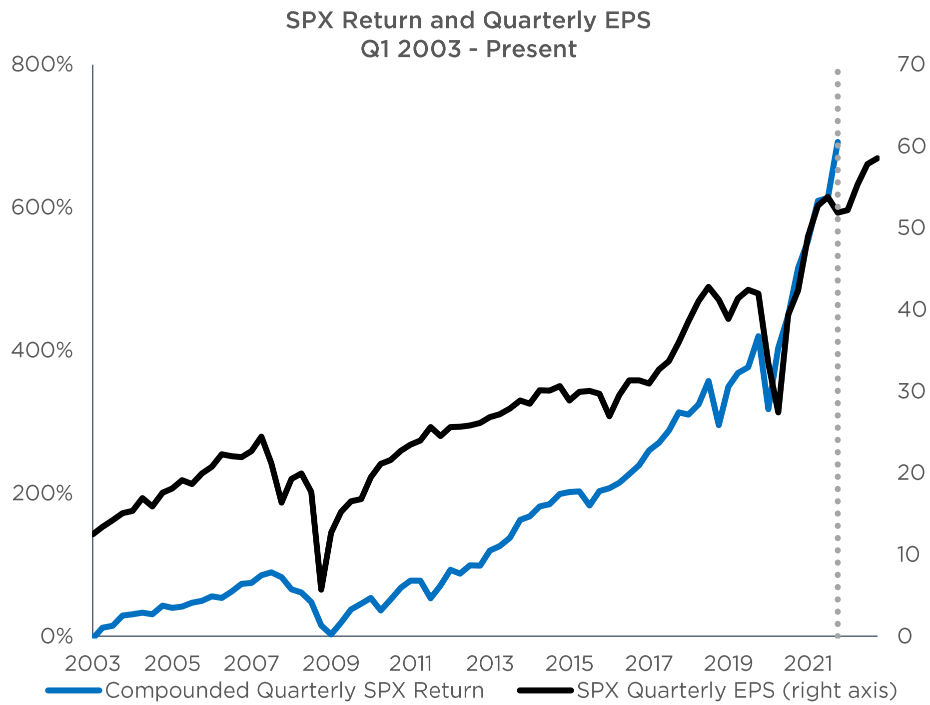
The VIX is at 93rd percentile since 1990, highest since January 2021 and another indicator that the growth scare has been substantial. As we discussed last week, there is a high correlation between changes in perceptions about interest rates and the stock market. Powell's message earlier in the week apparently confirmed the recent perception change. Our own judgment is that the Fed will raise less than the consensus expectations in the next two years, and that some relatively dovish sentiment may surface in 2022. While some investors are suggesting that there is a Fed "put" 5-10% lower that today's market levels, our view is that risk-reward for US equity investors is attractive.

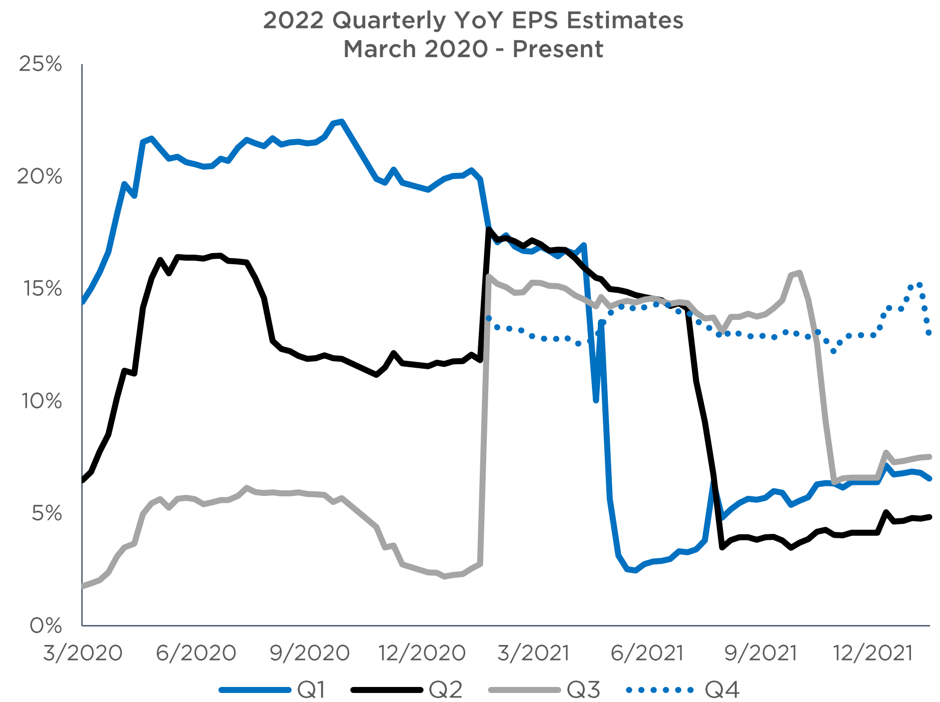




IN THE END, EARNINGS WILL MATTER

As expected, US corporate earnings and the market tend to go up over time (left chart). There is obviously more volatility in the price-to-forward earnings ratio than in earnings growth, caused by changes to perceptions about rates and growth. However, it is clearly true that the US stock market can rally while there are aggregate downward earnings revisions. Typically, what matters more is positive YoY earnings growth. Growth estimates have come down for 2022 over the last several months (right chart), as rising input costs from labor, logistics, and commodities has pressured margins in industrials and other parts of the market. Despite this, earnings are still likely to grow in our view. **The merits of this growth sell-off are about the probability that the Fed hikes aggressively as the economy slows. This increases the probability that 2023 earnings are now below 2022 earnings, even if our base case is still for 2023 earnings growth. There is more risk to that outlook than there was a few months ago.**





DIMENSIONING MARKET DRAWDOWNS SINCE THE FINANCIAL CRISIS

This growth scare has been sharper on the Nasdaq (right chart) than the SP500. For the SP500, this is the 11th worst drawdown so far since 2008. The longest was 143 days, so this sell-off is relatively short so far by "time." For the Nasdaq, this drawdown has been lengthier, and one of the worst since the Financial Crisis other than the initial COVID trade. As a starting point, we thought it was reasonable to assume that this drawdown is 80% over, meaning it would be one of the worst sell-offs (other than COVID) since the Financial Crisis. If we look at the prior drawdowns, there was typically a tangible reason for the scare- COVID in 2020, extended valuation and rising rates in 2018, European crisis in 2011 and US QE in 2012, energy scare into early 2016, etc. **What will be the phrase to describe this sell-off? Our judgment based on history and the prior explanations for the market declines is that this correction is +/- 80% over.**

SPX Drawdowns Since the Financial Crisis

Start Date	End Date	Days of Drawdown	Drawdown
10/10/2007	3/9/2009	355	(55.3%)
2/20/2020	3/23/2020	23	(33.8%)
9/21/2018	12/24/2018	65	(19.4%)
5/2/2011	10/3/2011	108	(18.6%)
4/26/2010	7/2/2010	49	(15.6%)
7/21/2015	2/11/2016	143	(13.0%)
1/29/2018	2/8/2018	9	(10.1%)
10/31/2011	11/25/2011	19	(9.6%)
4/3/2012	6/1/2012	42	(9.6%)
9/3/2020	9/23/2020	14	(9.5%)
1/4/2022	as of 1/25/2022	15	(9.1%)

QQQ Drawdowns Since the Financial Crisis

Start Date	End Date	Days of Drawdown	Drawdown
2/20/2020	3/23/2020	23	(30.1%)
8/30/2018	12/24/2018	80	(23.6%)
5/2/2011	10/3/2011	108	(18.7%)
7/21/2015	2/11/2016	143	(18.2%)
4/26/2010	7/2/2010	49	(17.3%)
11/22/2021	as of 1/25/2022	44	(15.7%)
3/27/2012	6/1/2012	47	(12.0%)
9/3/2020	9/23/2020	14	(11.8%)
9/17/2012	11/15/2012	42	(10.9%)
10/28/2011	11/25/2011	20	(10.8%)
2/16/2021	3/8/2021	15	(10.5%)

WHAT WORKED TOWARD THE END OF DRAWDOWNS AND AFTER?

Using 80% over as a governor, we looked at which industries typically do best from that point in the past – Software, healthcare services, and materials do best.

Equal-Weighted Raw Returns after 80% of drawdown is done to 3 months after end of drawdown
GICS Groups

GICS Group	6/21/2010 to 10/4/2010	9/1/2011 to 1/4/2012	11/21/2011 to 2/29/2012	5/22/2012 to 8/31/2012	12/31/2015 to 5/13/2016	2/7/2018 to 5/11/2018	12/6/2018 to 3/28/2019	3/17/2020 to 6/23/2020	9/21/2020 to 12/23/2020	Mean	Median
Software & Services	8.0%	4.3%	12.8%	5.7%	(4.6%)	14.9%	18.4%	62.7%	34.6%	17.4%	12.8%
Health Care Equipment & Services	(1.2%)	2.3%	15.7%	9.3%	(5.8%)	12.5%	0.3%	53.9%	25.3%	12.5%	9.3%
Materials	8.3%	1.2%	15.8%	8.6%	14.3%	3.5%	4.9%	44.3%	24.3%	13.9%	8.6%
Telecommunication Services	8.6%	(3.0%)	12.2%	12.9%	4.9%	5.8%	(3.7%)	34.0%	10.9%	9.2%	8.6%
Real Estate	2.5%	1.8%	14.1%	10.1%	7.6%	8.0%	7.9%	29.1%	18.3%	11.1%	8.0%
Banks	(7.1%)	8.8%	13.6%	7.9%	(3.2%)	6.5%	0.1%	16.5%	33.8%	8.5%	7.9%
Retailing	0.6%	7.4%	16.0%	8.2%	(4.7%)	2.8%	3.3%	74.2%	36.6%	16.0%	7.4%
Insurance	1.1%	8.2%	11.9%	7.0%	0.9%	4.1%	1.6%	23.3%	16.3%	8.2%	7.0%
Media	(3.9%)	4.4%	14.1%	8.9%	(0.7%)	(4.0%)	7.0%	44.6%	30.0%	11.2%	7.0%
Diversified Financials	2.4%	(0.4%)	16.5%	7.5%	(4.8%)	7.0%	3.1%	32.3%	26.5%	10.0%	7.0%
Energy	2.5%	0.2%	12.3%	5.4%	6.8%	12.4%	(2.4%)	51.6%	30.7%	13.3%	6.8%
Semiconductors & Semis Equipment	(3.3%)	(1.1%)	15.8%	2.8%	(7.1%)	6.3%	11.4%	65.3%	41.1%	14.6%	6.3%
Pharama, Biotech & Life Sciences	0.3%	(1.9%)	17.8%	11.9%	(26.4%)	6.1%	3.8%	78.2%	19.2%	12.1%	6.1%
Utilities	5.3%	5.0%	2.6%	5.3%	12.5%	8.9%	6.1%	16.7%	12.3%	8.3%	6.1%
Food, Beverage & Tobacco	0.7%	0.5%	8.7%	5.9%	5.9%	(1.2%)	2.8%	29.0%	14.1%	7.4%	5.9%
Household & Personal Products	5.8%	2.9%	10.2%	10.5%	4.7%	0.7%	2.7%	38.2%	18.1%	10.4%	5.8%
Capital Goods	0.4%	5.2%	16.0%	5.5%	5.3%	3.3%	6.2%	40.9%	29.4%	12.5%	5.5%
Consumer Durables & Apparel	1.7%	5.2%	21.2%	11.6%	(0.9%)	2.2%	5.5%	72.8%	28.2%	16.4%	5.5%
Technology Hardware & Equipment	5.1%	1.0%	12.3%	4.5%	(2.9%)	4.8%	8.1%	46.6%	32.0%	12.4%	5.1%
Commercial & Professional Services	(0.3%)	7.3%	12.1%	4.9%	2.2%	5.0%	4.4%	26.7%	17.8%	8.9%	5.0%
Food & Staples Retailing	4.6%	6.6%	7.4%	4.4%	(1.3%)	(3.8%)	(5.1%)	44.1%	15.8%	8.1%	4.6%
Consumer Services	(0.6%)	4.3%	15.5%	2.4%	(0.1%)	7.6%	2.1%	66.0%	28.8%	14.0%	4.3%
Automobiles & Components	12.2%	(1.0%)	19.2%	4.0%	(5.1%)	(6.5%)	(4.7%)	65.0%	40.3%	13.7%	4.0%
Transportation	1.2%	1.7%	15.0%	(0.6%)	(2.5%)	3.5%	(1.9%)	36.5%	19.4%	8.0%	1.7%

WHAT VARIABLES HELP YOU PICK WINNERS FROM LOSERS NOW?

From the signal perspective, there are few signals that always helped investors pick winners from losers from 80% of the way through a drawdown until three months after it ended. Expensive stocks with forecasted earnings acceleration and revenue growth did well. Likely this is because the growth trade worked for most of the time following the Financial Crisis. That means if investors are trying to think about what to buy now if we are near the bottom, history dictates buying cheap stocks probably will not work as EV-to-EBITDA and price-to-sales historically failed. Instead, growthier metrics like 3-year revenue growth, forecast EPS acceleration, and high cash relative to assets help separate winners from losers at this stage, and those are more classic growth-stock metrics.

Beta-Adjusted Spreads after 80% of Drawdown Is Complete to 3 Months After the Drawdown
Select Signals

Signal	6/21/2010 to 10/4/2010	9/1/2011 to 1/4/2012	11/21/2011 to 2/29/2012	5/22/2012 to 8/31/2012	12/31/2015 to 5/13/2016	2/7/2018 to 5/11/2018	12/6/2018 to 3/28/2019	3/17/2020 to 6/23/2020	9/21/2020 to 12/23/2020	Mean	Median
Distance to Default	5.1%	7.2%	2.2%	1.2%	3.3%	4.5%	7.5%	3.5%	(8.3%)	2.9%	3.5%
Median YoY Revenue Growth over last 3 Years	3.4%	(6.0%)	4.7%	(3.3%)	(6.5%)	1.0%	2.7%	26.2%	9.1%	3.5%	2.7%
Cash to Assets	3.5%	(2.0%)	0.9%	(0.2%)	(4.5%)	3.0%	2.3%	16.2%	10.5%	3.3%	2.3%
Dividend Coverage	3.1%	3.7%	(2.4%)	0.5%	2.3%	0.9%	(0.8%)	2.4%	2.2%	1.3%	2.2%
Forecast EPS Acceleration	0.0%	(3.6%)	3.6%	0.1%	(3.0%)	3.5%	1.8%	14.9%	6.7%	2.7%	1.8%
Stability of YoY ROE Growth	3.2%	6.2%	(0.3%)	(0.1%)	7.9%	3.3%	2.6%	(4.2%)	(1.4%)	1.9%	2.6%
Price-to-Sales	(6.6%)	2.8%	(0.5%)	1.4%	(3.7%)	(2.4%)	(5.9%)	(12.0%)	(8.0%)	(3.9%)	(3.7%)
EV-to-EBITDA	(4.3%)	5.0%	1.6%	3.9%	2.6%	(4.8%)	(8.0%)	(26.1%)	(10.9%)	(4.6%)	(4.3%)

TRIVARIATE SECTOR OVERVIEW: SUMMARY RECOMMENDATIONS

We are upgrading technology today from under-weight to market-weight. History dictates growthier metrics work from this phase forward. We are downgrading consumer discretionary from over-weight to market-weight, as most consumer metrics are peaking. We like materials / energy over industrials, healthcare over staples.

Trivariate Sector Recommendations

Sector	Total S&P 500 Market Cap. (US$ Bil.)	Current S&P 500 Weight	Trivariate-Recommended Weight		Current Trivariate-Relative Weight	Trivariate Recommendation	Comments
			Previous	Current			
Materials	976.6	2.4%	6.0%	6.0%	3.6%	Maximum Overweight	Buy the cheap stocks with upward revisions
Energy	1,324.97	3.2%	6.0%	6.0%	2.8%	Maximum Overweight	Oil is rising, and M&A is likely
Health Care	5,045.44	12.3%	15.0%	15.0%	2.7%	Overweight	Healthcare services have cheap growth, and the biotechnology sell-off appears over-done
Communication Services	4,306.28	10.5%	12.0%	12.0%	1.5%	Equal-Weight	Makes sense to keep market-weight FAANGM
Utilities	901.41	2.2%	3.0%	3.0%	0.8%	Equal-Weight	Some idiosyncratic investments are sensible
Consumer Discretionary	5,092.16	12.5%	15.0%	13.0%	0.5%	Equal-Weight	Major consumer metrics are now softening ,focus on select retailers, cautious on durables
Information Technology	11,637.27	28.5%	27.0%	29.0%	0.5%	Equal-Weight	Upgrade from underweight – focus on positive FCF, pricing power – avoid profitless software
Financials	4,701.99	11.5%	10.0%	10.0%	(1.5%)	Equal-Weight	Large cap banks better than regionals, but excess capacity and excessive optimism about rates are a problem
Real Estate	1,041.64	2.5%	1.0%	1.0%	(1.5%)	Under-Weight	Commercial real-estate is challenged
Consumer Staples	2,678.87	6.6%	2.0%	2.0%	(4.6%)	Under-Weight	Plenty of short ideas in idiosyncratic staples, and valuation of large-caps is stretched
Industrials	3,151.79	7.7%	3.0%	3.0%	(4.7%)	Maximum Underweight	Industrial activity is rolling over, but earnings expectation are very high

IDEAS USING SIGNALS / INDUSTRIES THAT WORKED IN THE PAST

Using signals that typically worked among the industries that typically outperformed (underperformed) at this point in prior sell-offs, we identify some long / short ideas below.

Buy Materials, Software with Profit, and Healthcare Services that screen well on Select Signals
Sell Consumer Staples and Capital Goods that screen poorly on Select Signals
End-January, 2022

Long

Ticker	Company Name	Industry Group	Market Cap ($ US. Bil)
ISRG	Intuitive Surgical, Inc.	Health Care Equipment & Services	94.36
APD	Air Products and Chemicals, Inc.	Materials	61.95
CRWD	CrowdStrike Holdings, Inc.	Software & Services	36.37
VEEV	Veeva Systems Inc.	Health Care Equipment & Services	34.03
PLTR	Palantir Technologies Inc.	Software & Services	26.18
VMC	Vulcan Materials Company	Materials	24.35
ABMD	Abiomed, Inc.	Health Care Equipment & Services	13.51
MASI	Masimo Corporation	Health Care Equipment & Services	11.76
TNDM	Tandem Diabetes Care, Inc.	Health Care Equipment & Services	7.44
GH	Guardant Health, Inc.	Health Care Equipment & Services	6.68
INSP	Inspire Medical Systems, Inc.	Health Care Equipment & Services	5.31

Short

Ticker	Company Name	Industry Group	Market Cap ($ US. Bil)
KHC	The Kraft Heinz Company	Food, Beverage & Tobacco	44.32
KR	The Kroger Co.	Food & Staples Retailing	33.15
CNHI	CNH Industrial N.V.	Capital Goods	20.13
TXT	Textron Inc.	Capital Goods	15.70
BG	Bunge Limited	Food, Beverage & Tobacco	13.31
TAP	Molson Coors Beverage Company	Food, Beverage & Tobacco	10.92
ACM	AECOM	Capital Goods	9.49
POST	Post Holdings, Inc.	Food, Beverage & Tobacco	6.72
MTZ	MasTec, Inc.	Capital Goods	6.53

DISCLOSURES

Disclaimer

This presentation is confidential and may not be reproduced or distributed without the express prior written permission of Trivariate Research LP and its affiliates (collectively, "**Trivariate**").

The information contained herein reflects the opinions and projections of Trivariate as the date of publication, which are subject to change without notice at any time subsequent to the date of issue. Trivariate does not represent that any opinion or projection expressed herein will be realized. All information provided is for informational and research purposes only and should not be deemed as investment advice or a recommendation to purchase or sell any specific portfolio investment, security or other asset. While the information presented herein is believed to be reliable, no representation or warranty is made concerning the accuracy of any data or other information presented. Information obtained by Trivariate from third party sources in connection with the preparation of this presentation has not been independently verified by Trivariate. Additional information regarding Trivariate is available on request.

Any projections, forecasts, targets or other estimates presented herein constitute "forward-looking statements" that can be identified by the use of forward-looking terminology such as "may," "will," "should," "could," "would," "predicts," "potential," "forecasted," "continue," "expects," "anticipates," "future," "intends," "plans," "believes," "estimates," or the negatives thereof or other variations thereon or comparable terminology. Furthermore, any projections, targets, forecasts or other estimates in this presentation are "forward-looking statements" and are based upon certain assumptions that may change. Due to various risks and uncertainties, actual events or results or the actual performance of the funds may differ materially from those reflected or contemplated in such forward-looking statements. Moreover, actual events are difficult to predict and often depend upon factors that are beyond the control of the Trivariate. Nothing herein shall under any circumstances create an implication that the information contained herein is correct as of any time after the earlier of the relevant date specified herein or the date of this presentation. In addition, unless the context otherwise requires, the words "include," "includes," "including" and other words of similar import are meant to be illustrative rather than restrictive. Forward-looking statements and discussions of the business environment included herein (e.g., With respect to financial markets, business opportunities, demand, investment pipeline and other conditions) are subject to the ongoing novel coronavirus outbreak ("**COVID**" or "**COVID-19**"). The full impact of COVID-19 is particularly uncertain and difficult to predict, therefore such forward-looking statements do not reflect its ultimate potential.

This shall not constitute an offer to sell or the solicitation of an offer to buy any interests in any fund, product or account that is or may in the future be advised or managed by, Trivariate or any of its affiliates.

All data sourced from S&P Global, Bloomberg, or our Trivariate estimates. All forward-looking-statements reflect the opinion of Trivariate.