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# TRIVARIATE RESEARCH

## THREADING THE NEEDLE

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## RESEARCH SUMMARY AND CONCLUSIONS

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A key investment debate today is whether the Fed can “thread the needle” and raise rates without causing a recession. Clearly, the perception of rate changes morphed into a growth scare. Given that the US consumer is so pivotal to the recession debate, we analyzed key metrics that make up our proprietary consumer gauge and looked at margins and multiples for various consumer stock cohorts to find dislocations and opportunities.

- **Current consumer metrics are strong:** Jobs and wages remain strong, and as such, confidence and retail sales have commensurately remained robust. YoY personal income declined, but 90-day credit card delinquencies remain at all-time lows. In aggregate, our proprietary Consumer Activity Gauge is positive and increasing. A roll-over would most likely require a material change to the employment picture.
- **High gross exposure to discretionary:** Our quantitative model works particularly well at picking winners from losers in the consumer discretionary sector, particularly when our overall gauge is positive and increasing. In nearly  $\frac{3}{4}$  of the months historically the top quintile of our model beat the bottom quintile when activity was this strong.
- **Earning expectations high and recent results mixed:** For both discretionary and staples, expectations rise in the 2H of 2022, though the discretionary sector is expected to have a year-over-year decline in earnings this quarter before the recovery. Results for consumer companies reporting in the last two weeks have been mixed, with more upside surprise than downside overall. However, the performance into the print was crucial, as many companies modestly missing had such bad stock performance prior to the report that they bounced under the pretense that things could have been worse.

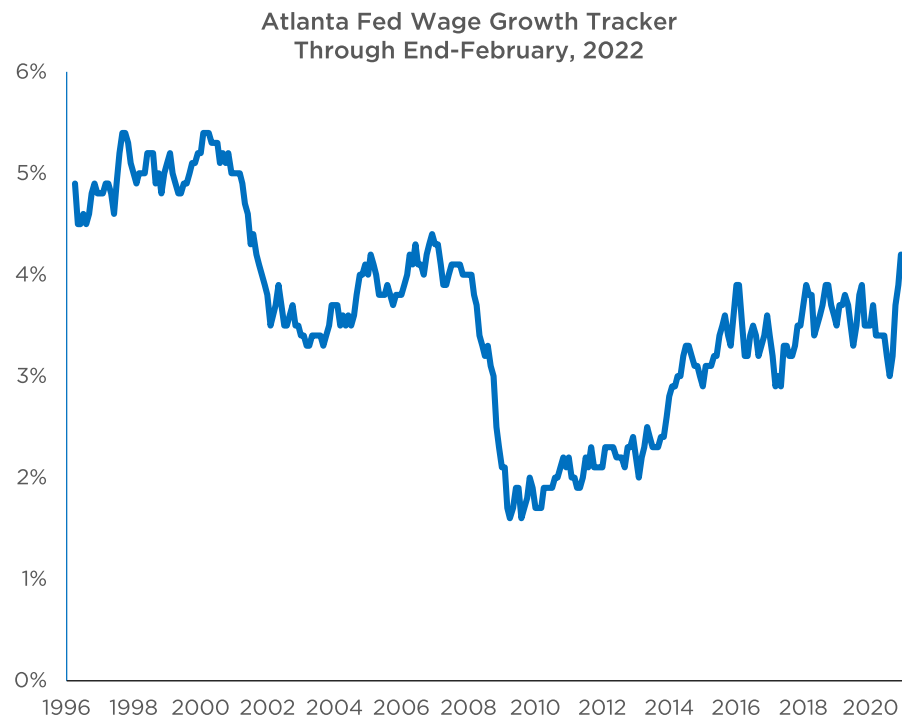
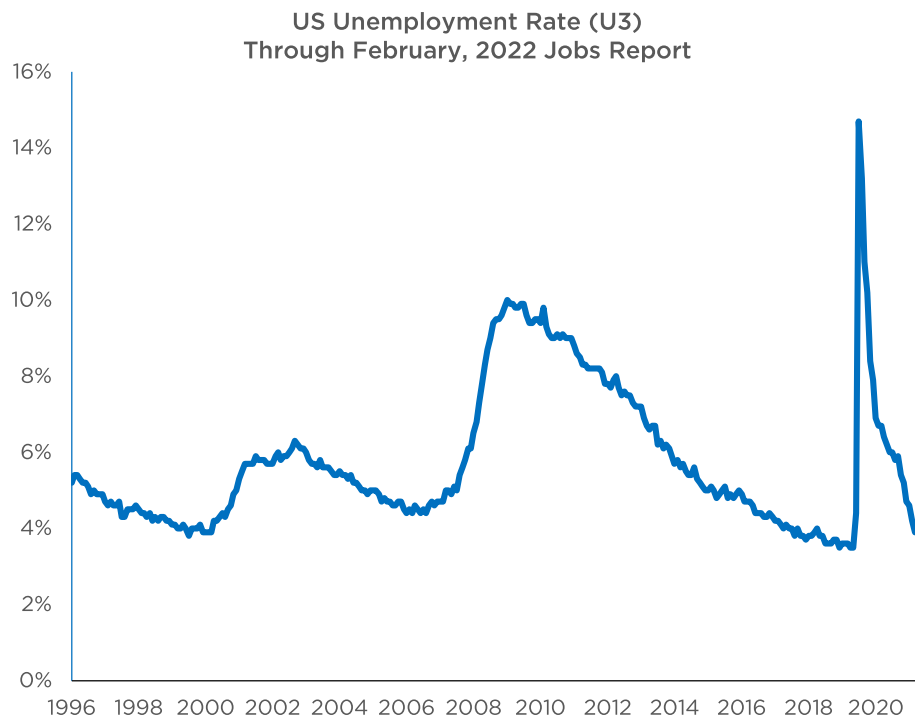
## RESEARCH SUMMARY AND CONCLUSIONS

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- **Last hiking cycle:** We analyzed the consumer sub-industries returns following the last initial rate hike in December of 2015. Household and personal products and food, beverages and tobacco performed well, whereas autos and retailers were weak. Interestingly, that is the identical industry performance scorecard to what typically works when our consumer activity gauge is strong. So, what's in the price now?
- **Consumer discretionary:** Growth stocks look expensive, as there are more profitless discretionary stocks now than anytime in the last 20 years. Value stocks are trading near all-time lows on price-to-forward earnings. Junk stocks have seen some margin recovery but valuation multiples remain low, signaling relative opportunity in our judgment.
- **Consumer staples:** Growth stocks remain incredibly expensive, and value stocks are average vs. history on price-to-forward earnings. The profitability gap has widened between high quality and junk, but the multiples have not – indicating junk stocks could be good candidate for relative multiple contraction. Small / micro caps look particularly expensive relative to mega / large given current margin levels.
- **Consumer long ideas on page 16:** Longs include junk and value discretionary that are cheap on price-to-forward earnings and are forecasted to have margin expansion and revenue growth. Value staples with above 3% forecasted revenue growth are also attractive.
- **Consumer short ideas on page 17:** Expensive junk staples with low forecasted growth, expensive growth staples where multiple have not been reset, and growth discretionary where forecasted sales is less than 10 YoY.

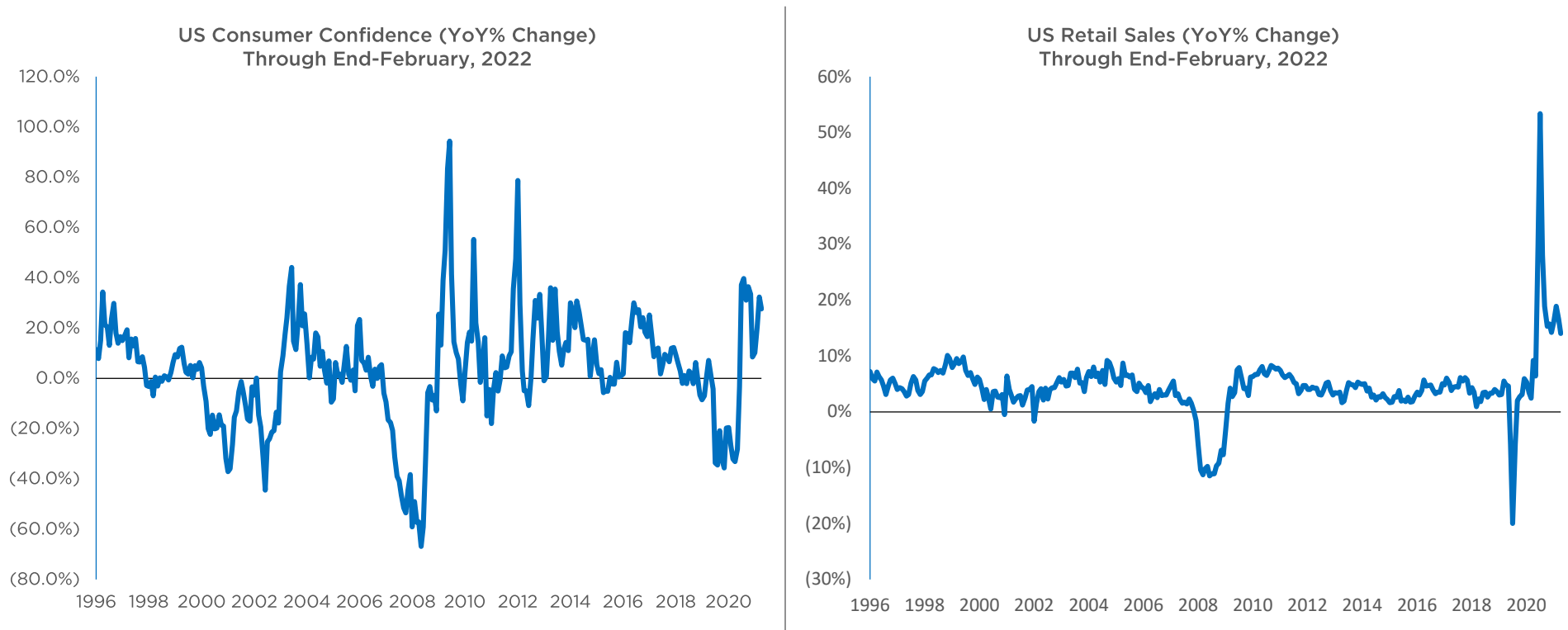
## THE US JOBS AND WAGES ENVIRONMENT IS VERY STRONG

Nearly every corporate has discussed the fact that the US hiring environment remains challenged. The unemployment rate (left) is nearing all-time lows. While labor participation still is not strong, the lack of ability of corporates to find motivated staff likely means upward wage pressure will persist. One measure of that is the Atlanta Fed Wage Growth Tracker (right) which has shown a sharp up-tick in wages over the last 12 months.



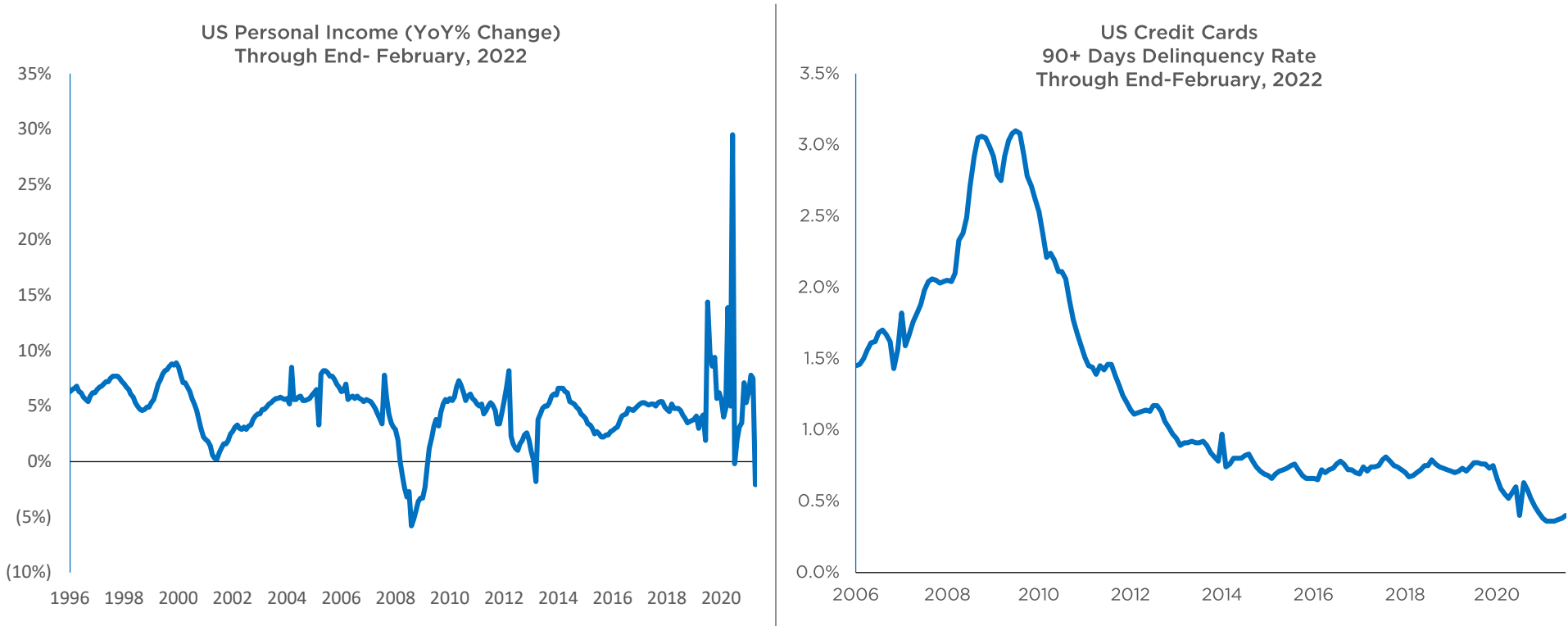
# CONSUMER CONFIDENCE AND RETAIL SALES REMAIN ROBUST

Despite the strong employment backdrop, there is a lot of debate about how robust consumer behavior will be in a period following massive fiscal stimulus and with rising oil and food prices. So far, US consumer confidence has remained robust (left chart). Retail sales have also remained strong (right chart), despite rising prices, a sign the US consumer has remained engaged.



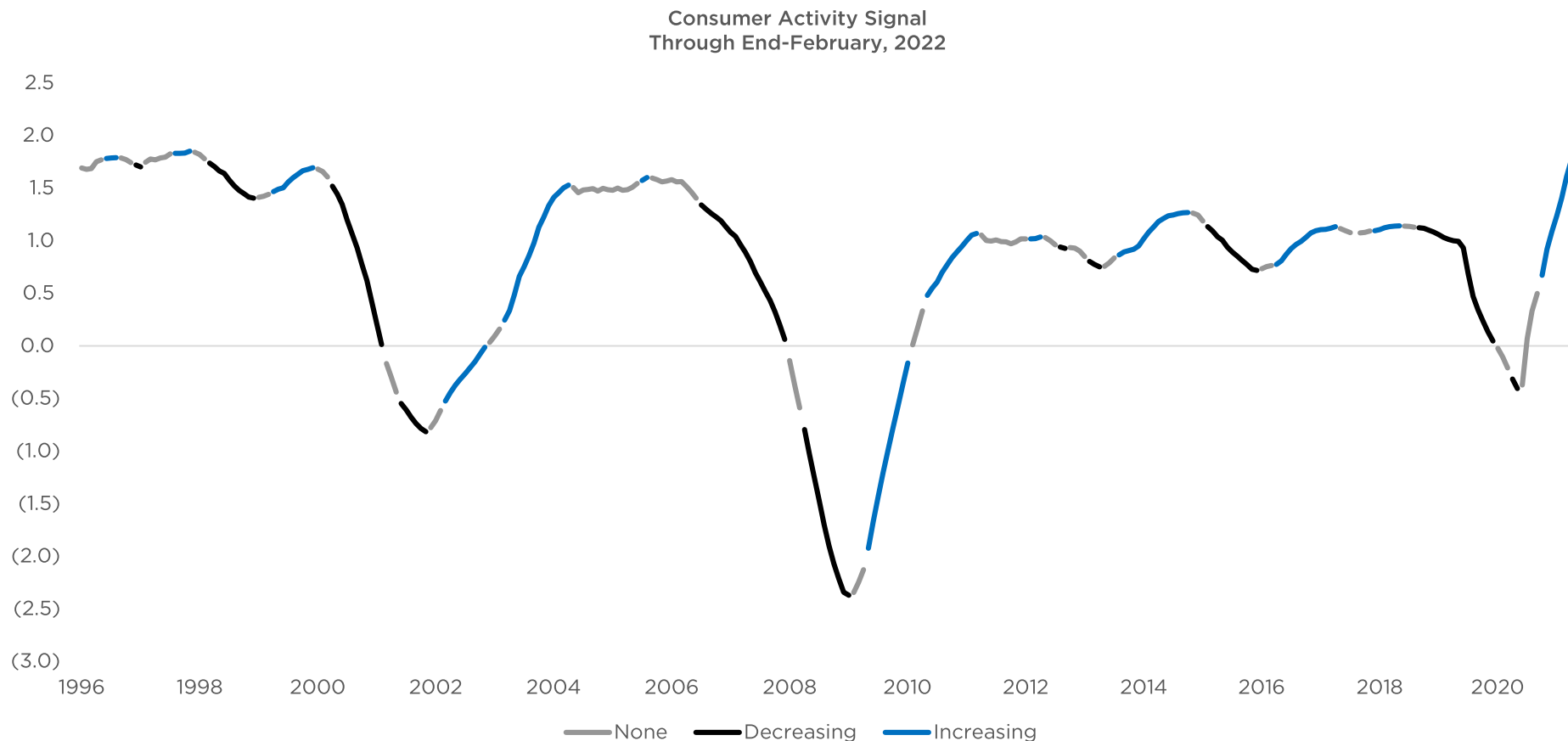
# INCOME HAS DIPPED BUT CREDIT CARD PAYMENTS REMAIN STRONG

A year after a huge increase in personal income, current conditions have dipped to negative (left chart), and that in part has sparked some concern about whether the US consumer is strong enough to withstand higher oil and food prices. We have not seen any pressure though on credit card payments (right) as minimum payments that are 90+ days delinquent are at all time lows and showed no ripple higher with forced lockdowns and government stimulus like we say during and following the Financial Crisis.



## THE KEY APPEARS TO BE THAT OVERALL ACTIVITY REMAINS STRONG

We combined the labor, spending, expenses, and other consumer macro variables into our proprietary US consumer gauge. Below shows the consumer activity as quite robust now, with the key debate being whether it is near peaking. Our gauge would require materially softer labor and wage trends and weaker retail sales for this to be likely, and most corporates are facing the opposite challenge - labor shortages in the US. Analysts should focus on companies with a higher percentage of ex-US wages, as they are likely better positioned to handle this aspect of expenses. Overall, we think an increasing consumer activity gauge is likely for the next several months at a minimum.



## STRONG ACTIVITY MEANS GOOD ALPHA POTENTIAL

Importantly, our ability to pick winners from losers in the consumer space is strong when activity is increasing, implying investors should run with larger-than-normal gross exposures in the consumer space today. For instance, the top quintile of our model beats the bottom quintile in 72.7% of the months over the 15 years when consumer activity is positive and increasing, vs. 58.9% of the time when it is not. In aggregate, our quantitative framework is particularly effective for picking winners from losers within the consumer discretionary sector, with top vs. bottom quintile spreads over 14% on average.

Performance of Consumer Discretionary Model  
When Consumer Activity Is Positive and Increasing  
Through End-February, 2022

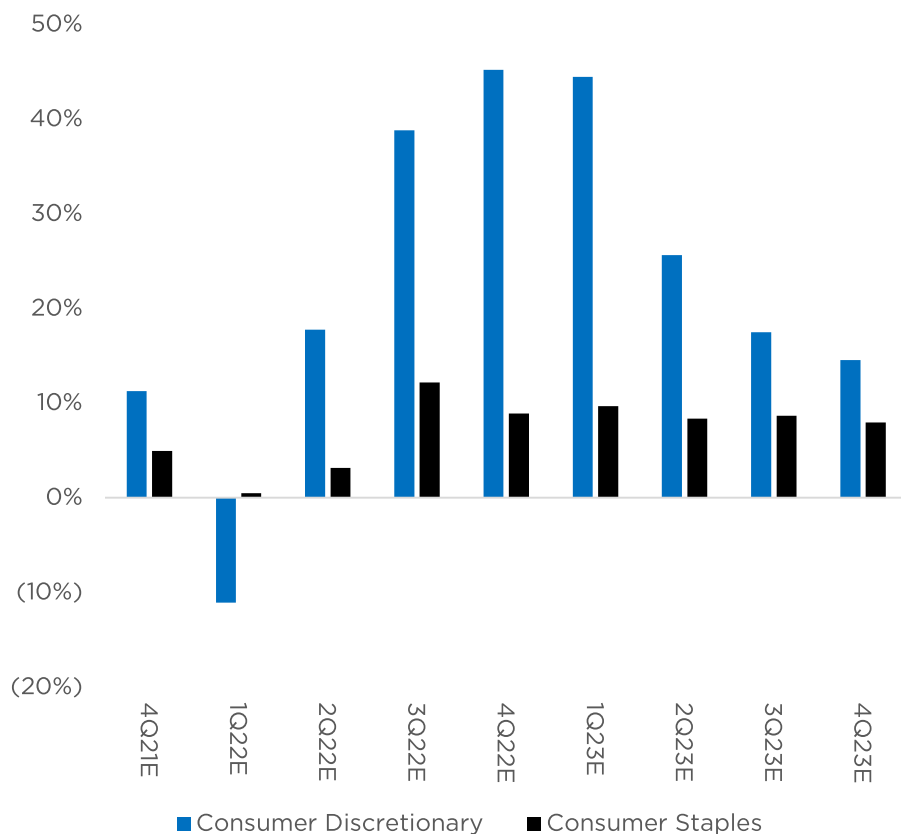
Stat	Consumer Activity Positive and Increasing	Consumer Activity Not Positive and Increasing	Difference
Hit Rate	72.7%	58.9%	13.8%
Weighted IR	1.21	0.80	0.41
Weighted Mean	11.4%	9.7%	1.7%
Weighted Median	14.8%	14.0%	0.8%



## HIGH 2H EXPECTATIONS AND MIXED RECENT RESULTS

The median analyst estimate is for negative earnings for the consumer discretionary sector (left chart) in Q1, followed by a strong hockey stick in expectations in the second half of the year. Staples expectations also accelerate in the 2H and are predictably steady through 2023. We think there are likely risks to both sectors in the 2H. Recent results (right) show more upside than downside surprise, but prior momentum was key to the T+3 market reaction.

Analyst 12-Month Forward Earnings Growth Estimates  
Consumer Discretionary and Consumer Staples Sectors  
As of Mid-March, 2022



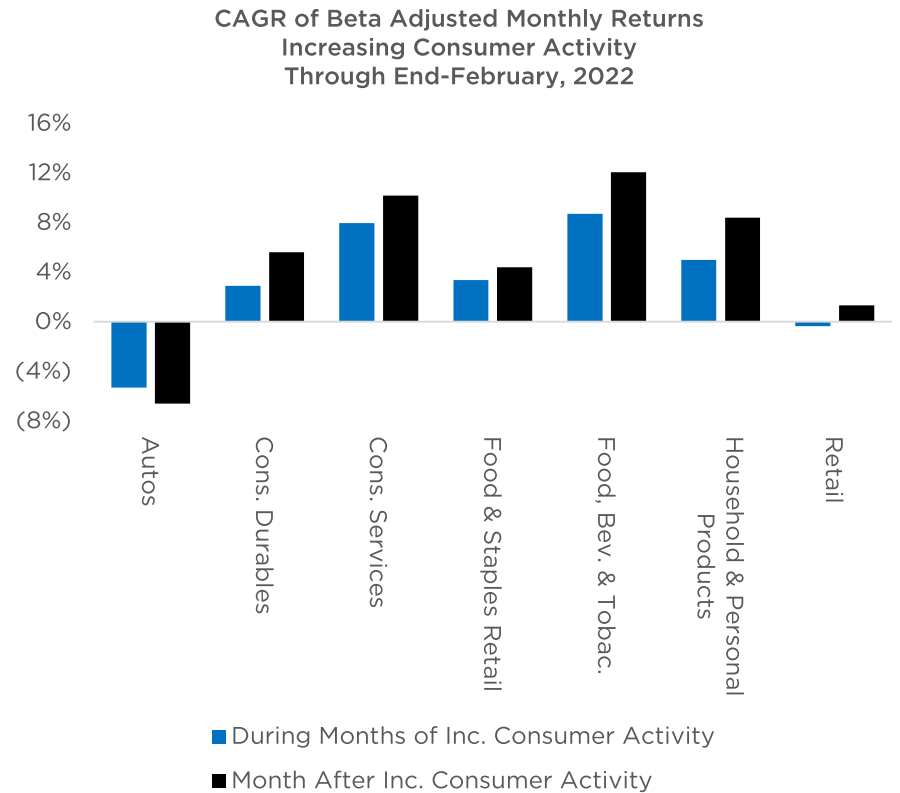
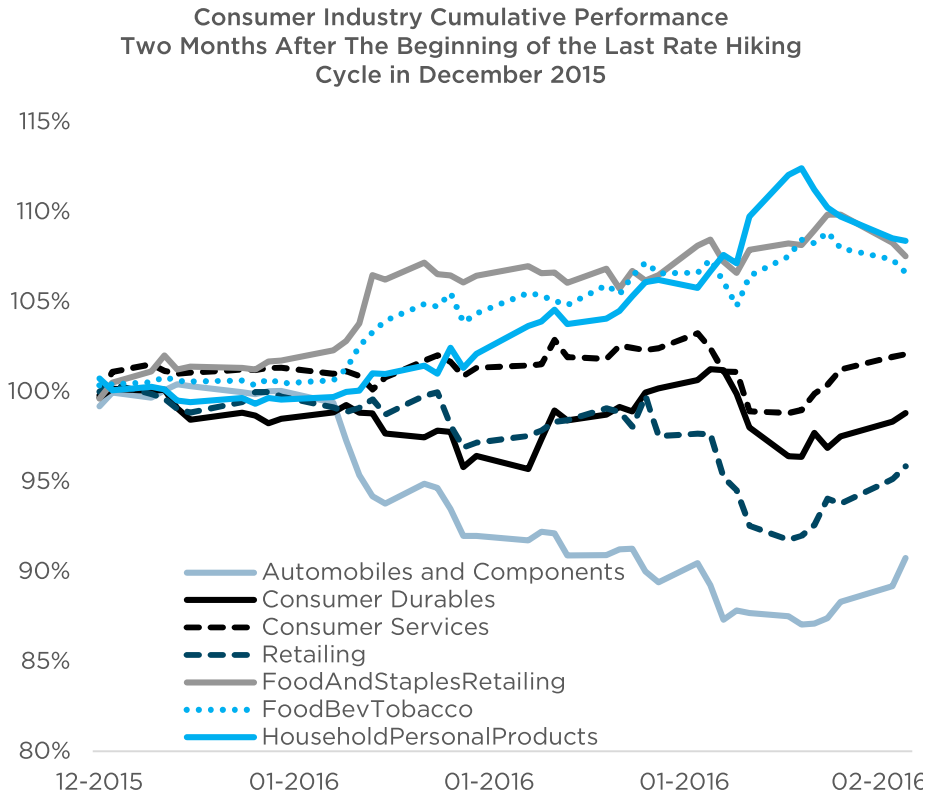
Recent Consumer Earnings Reports and Reaction

Ticker	Company Name	US \$ Bil	Report	EPS Est.	EPS Actual	Surprise	T+3 Perf.
DRI	Darden Restaurants Inc.	16.58	24-Mar	\$ 2.08	\$ 1.93	(7.2%)	(0.9%)
MCW	Mister Car Wash	4.76	24-Mar	\$ 0.07	\$ 0.11	62.6%	0.6%
COOK	Traeger Inc.	0.85	23-Mar	\$ (0.26)	\$ (0.29)	(10.1%)	(18.1%)
GIS	General Mills	40.58	23-Mar	\$ 0.79	\$ 1.08	37.4%	8.0%
DG	Dollar General	50.69	17-Mar	\$ 2.57	\$ 2.57	0.0%	1.9%
DBI	Designer Brands, Inc.	1.00	17-Mar	\$ 0.16	\$ 0.15	(6.3%)	6.7%
SIG	Signet Jewelers	3.87	17-Mar	\$ 5.01	\$ 5.01	0.0%	5.6%
WRBY	Warby Parker, Inc.	3.86	17-Mar	\$ (0.09)	\$ (0.41)	(555.6%)	10.1%
WSM	Williams-Sonoma	10.48	16-Mar	\$ 4.82	\$ 5.42	12.4%	4.1%
ARCO	Arcos Dorados Holdings	1.73	16-Mar	\$ 0.16	\$ 0.22	37.5%	4.7%
LE	Lands' End	0.58	16-Mar	\$ 0.31	\$ 0.21	(32.3%)	4.2%
MCG	Membership Collective	1.58	16-Mar	\$ (0.16)	\$ (0.21)	(31.3%)	(3.3%)
SCVL	Shoe Carnival	0.87	16-Mar	\$ 0.44	\$ 0.72	63.6%	6.1%
BRLT	Brilliant Earth Group	0.96	16-Mar	\$ 0.05	\$ 0.11	120.0%	26.2%
GES	Guess?, Inc	1.32	16-Mar	\$ 1.15	\$ 1.14	(0.9%)	12.4%
DOLE	Dole*	1.25	15-Mar	\$ 0.10	\$ 0.14	40.0%	7.3%
BKE	Buckle, Inc.	1.77	11-Mar	\$ 1.39	\$ 1.69	21.6%	4.7%
ULTA	Ulta Beauty, Inc.	20.67	10-Mar	\$ 4.58	\$ 5.41	18.1%	(4.3%)

Note: \* Mrs. Parker finds Titos, Club Soda and Pineapple juice to be delicious

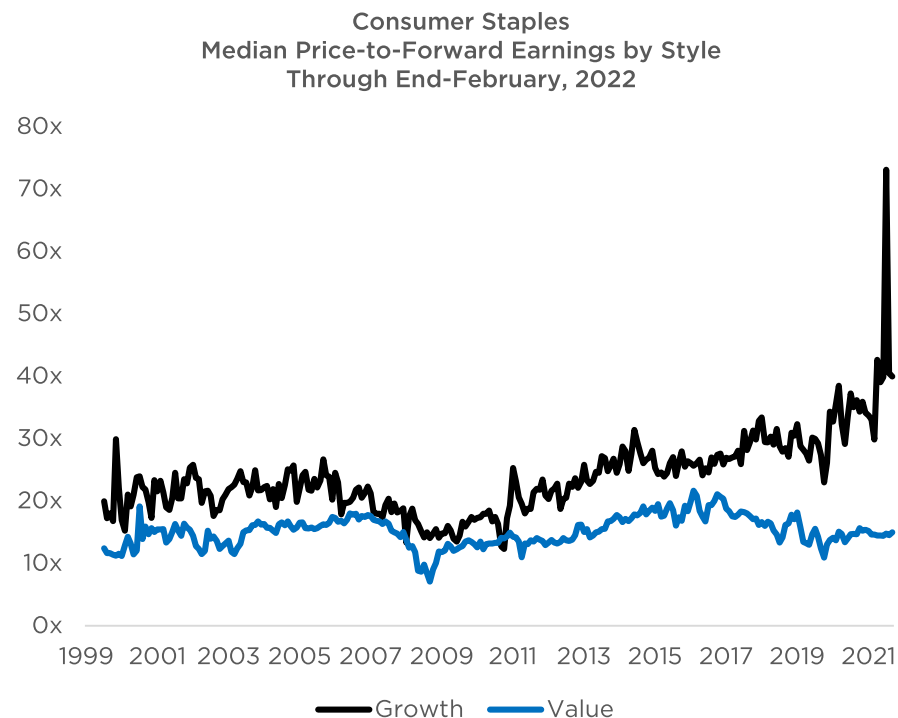
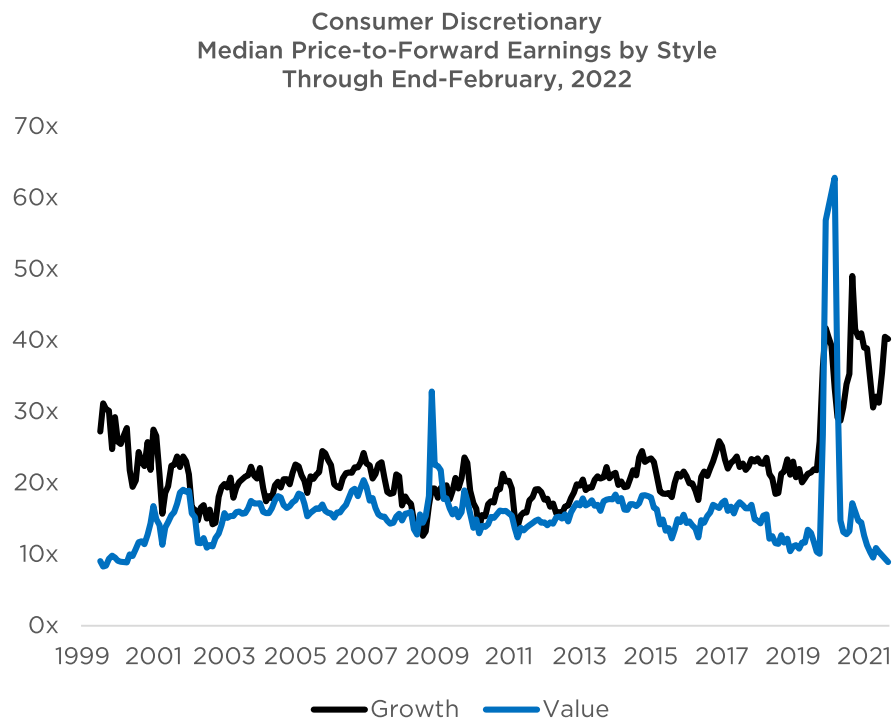
# PRIOR CYCLES AND STRONG ACTIVITY YIELD THE SAME PLAYBOOK

The recent hiking cycle changes the perception of about all stocks. We looked at the consumer sub-industries cumulative two-month returns following the December 2015 cycle and found autos and retailers lagged, while staples outperformed (left chart). That is a very similar playbook to what works when our consumer activity gauge is strong (right chart) with autos and retail lagging, and staples and services typically performing well. A debate therefore is whether this is all in the price in terms of margin recovery and valuation or whether more is to come.



## CONSUMER GROWTH STOCKS STILL EXPENSIVE

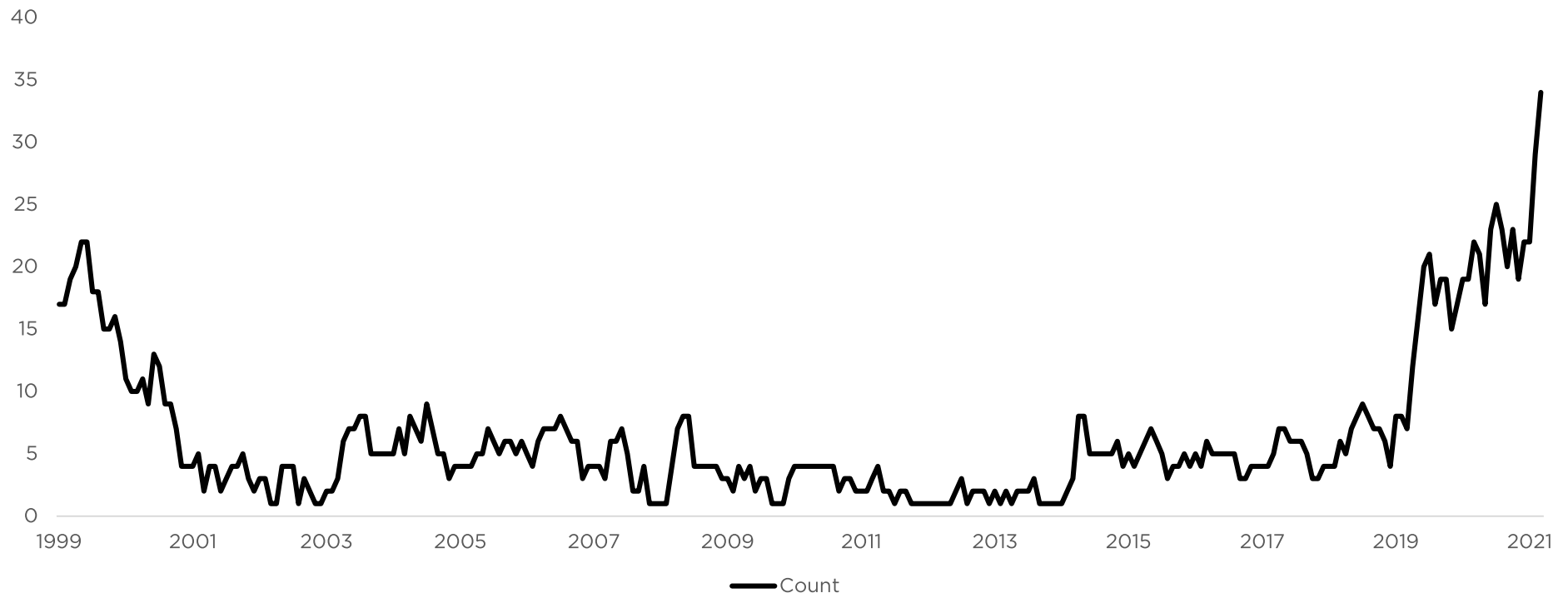
We broke down the consumer discretionary and staples sectors to see margin potential or valuation has been discounted differently than in the past. For discretionary (left) value stocks trade at historically low multiples, and the recent growth stock correction has not caused discretionary growth stocks to see multiples anywhere near historically average levels. For staples (right), price-to-forward earnings levels appear average, but like growth multiple remain quite high.



# THERE ARE MORE PROFITLESS DISCRETIONARY STOCKS THAN EVER

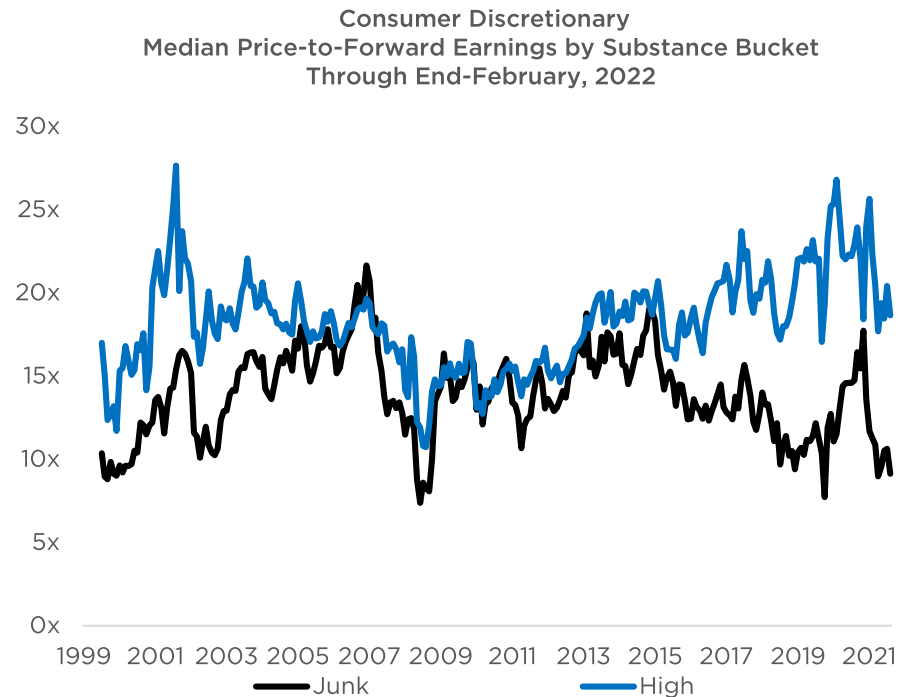
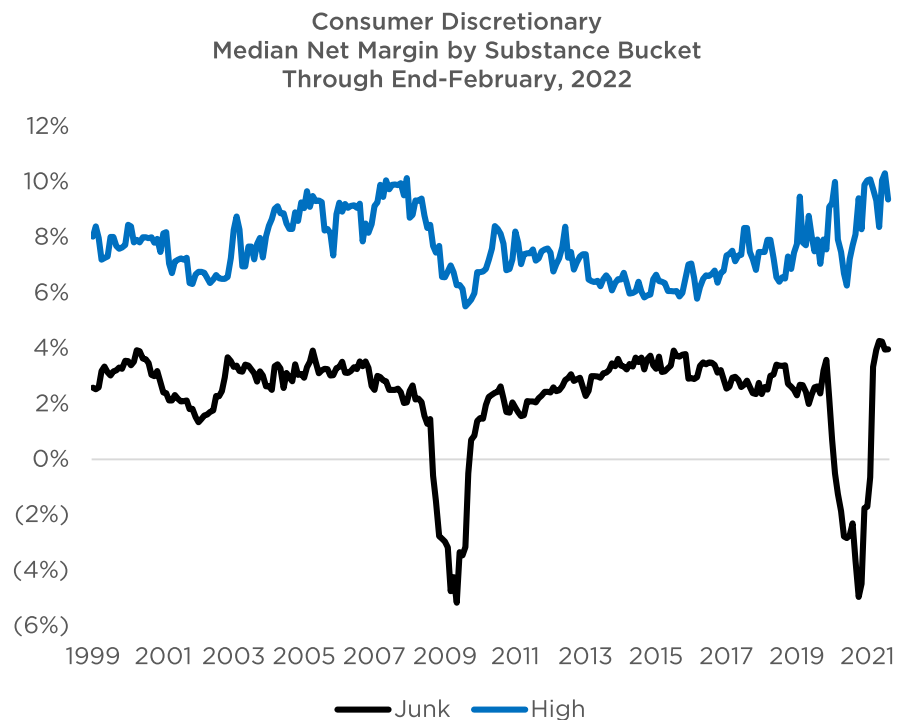
A potential partial explanation for the persistently elevated consumer discretionary multiples is the fact that there are more profitless stocks than ever.

Number of Growth Consumer Discretionary Stocks With Negative Earnings, Top 3000 Marketcap Through End-February, 2022



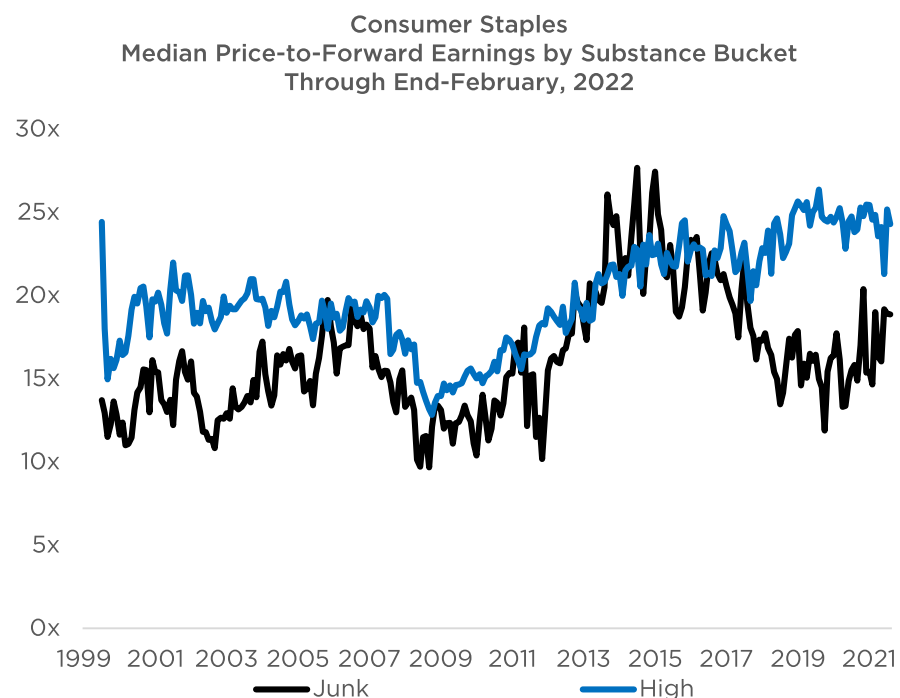
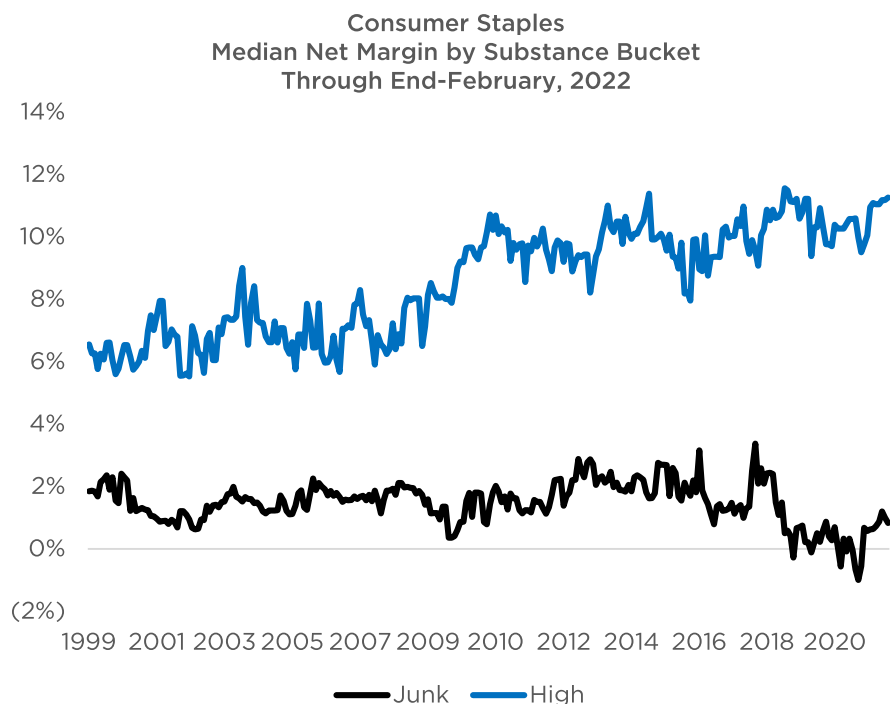
## JUNK MARGINS HAVE RECOVERED BUT MULTIPLES HAVE NOT

We also analyzed margins and valuation by quality buckets. The lowest quality quartile, “junk” has seen margins fully recover, and the highest quality margins are strong (left). Price-to-forward earnings multiples are oscillating around five-year averages for the highest quality quartile but are relatively low for the junk consumer discretionary stocks (right). This signals there is potential for junk multiples to expand.



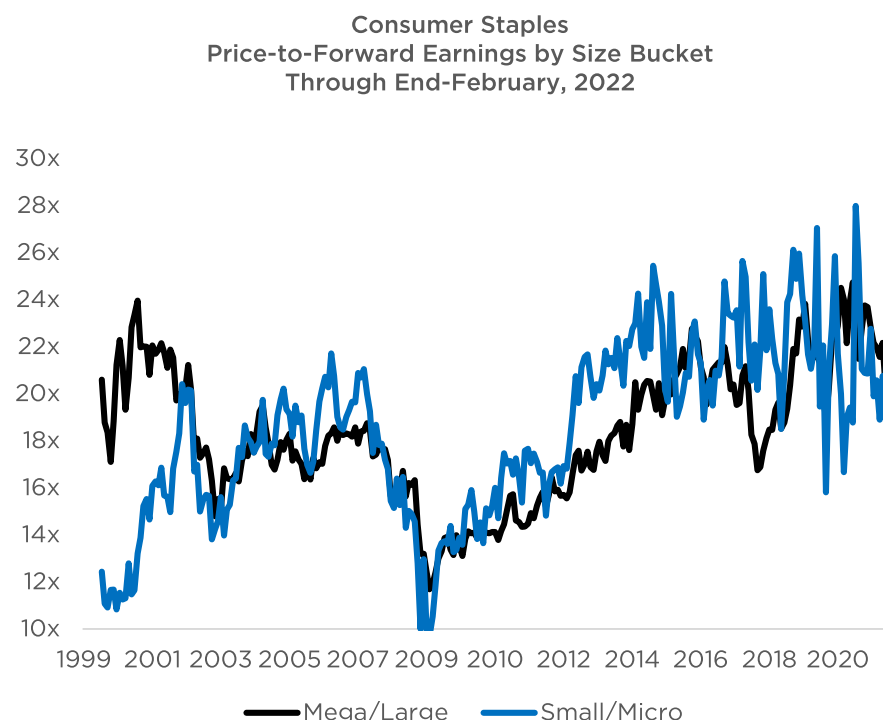
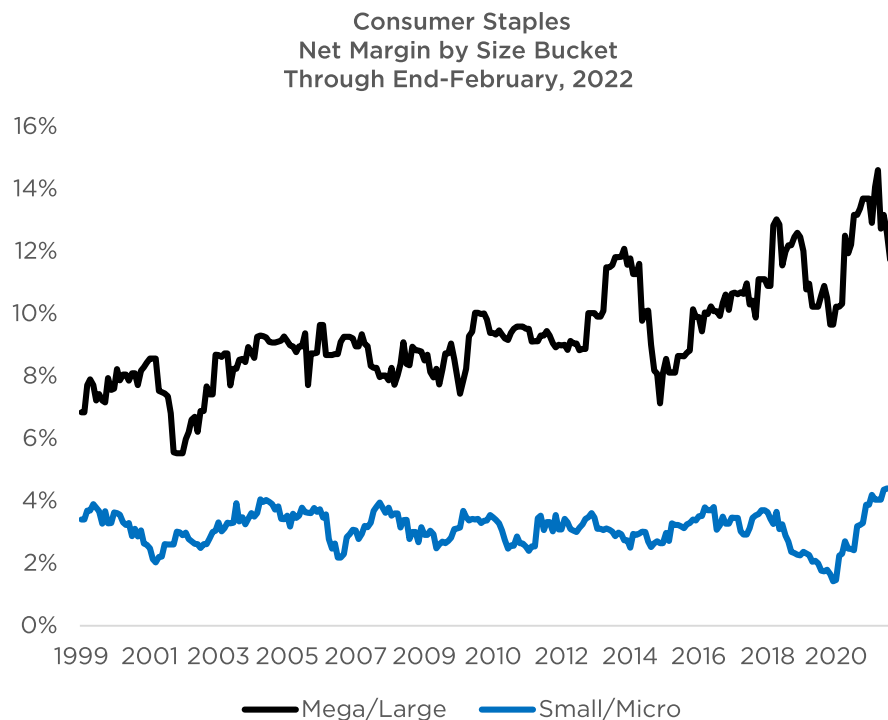
# JUNK STAPLES STOCKS BARELY MAKE MONEY

The median “junk” consumer staples stock barely makes money (left), where as the quality staples have consistently expanded net margins over the last two decades. Despite this profitability gap, the specter of higher growth kept price-to-forward earnings levels close through history. It seems to us consumer staples junk stocks need to grow fast and expand margins to merit the narrow valuation disconnect to the highest quality bucket (right).



## SMALL CAP STAPLES SEEM EXPENSIVE GIVEN CURRENT PROFITABILITY

Like the highest quality bucket, the profitability for the mega / large staples has also expanded over time (left). The profitability gap is substantial relative to the small / micro universe, though that group has seen steady expansion since COVID lows. Despite this, the price-to-forward earnings (right) for small /micro cap. staples is higher today than for the mega / large cap staples. We think this is overly generous, short of a fundamental story driving material revenue growth and margin expansion for a small / micro cap. staple.



# LONG IDEAS IN THE CONSUMER SPACE

## Select Quantitatively Derived Consumer Longs

Ticker	Company Name	Sector	Industry Group	Market Cap (\$ US. Bil)	Comment
PM	Philip Morris International Inc.	Consumer Staples	Food, Bev. & Tobacco	145.14	Value with above 3% rev. growth + margin expansion
MDLZ	Mondelez International, Inc.	Consumer Staples	Food, Bev. & Tobacco	85.48	Value with above 3% rev. growth + margin expansion
TJX	The TJX Companies, Inc.	Consumer Discretionary	Retailing	72.92	Junk with margin expansion and revenue growth
GM	General Motors Company	Consumer Discretionary	Autos & Components	64.75	Junk with margin expansion and revenue growth
HRL	Hormel Foods Corporation	Consumer Staples	Food, Bev. & Tobacco	27.10	Value with above 3% rev. growth + margin expansion
MGM	MGM Resorts International	Consumer Discretionary	Consumer Services	18.43	Junk with margin expansion and revenue growth
DRI	Darden Restaurants, Inc.	Consumer Discretionary	Consumer Services	16.86	Junk with margin expansion and revenue growth
KMX	CarMax, Inc.	Consumer Discretionary	Retailing	16.66	Junk with margin expansion and revenue growth
BG	Bunge Limited	Consumer Staples	Food, Bev. & Tobacco	15.75	Value with above 3% rev. growth + margin expansion
CAG	Conagra Brands, Inc.	Consumer Staples	Food, Bev. & Tobacco	15.50	Value with above 3% rev. growth + margin expansion
HAS	Hasbro, Inc.	Consumer Discretionary	Cons. Durables & Apparel	12.39	Junk with margin expansion and revenue growth
TAP	Molson Coors Bev. Company	Consumer Staples	Food, Bev. & Tobacco	11.49	Value with above 3% rev. growth + margin expansion
ARMK	Aramark	Consumer Discretionary	Consumer Services	9.41	Junk with margin expansion and revenue growth
INGR	Ingredion Incorporated	Consumer Staples	Food, Bev. & Tobacco	5.70	Value with above 3% rev. growth + margin expansion
TNL	Travel + Leisure Co.	Consumer Discretionary	Consumer Services	5.00	Cheap Value with forecasted revenue growth
GT	The Goodyear Tire & Rubber Co.	Consumer Discretionary	Autos & Components	4.00	Cheap Value with forecasted revenue growth
SPB	Spectrum Brands Holdings, Inc.	Consumer Staples	Household & Personal	3.73	Value with above 3% rev. growth + margin expansion
LCII	LCI Industries	Consumer Discretionary	Autos & Components	3.11	Cheap Value with forecasted revenue growth
AEO	American Eagle Outfitters, Inc.	Consumer Discretionary	Retailing	3.10	Cheap Value with forecasted revenue growth
EPC	Edgewell Personal Care Co.	Consumer Staples	Household & Personal	2.00	Value with above 3% rev. growth + margin expansion



# SHORT IDEAS IN THE CONSUMER SPACE

## Select Quantitatively Derived Consumer Shorts

Ticker	Company Name	Sector	Industry Group	Market Cap (\$ US. Bil)	Comment
ULTA	Ulta Beauty, Inc.	Consumer Discretionary	Retailing	20.35	Growth more than 20x PEF + grows rev. less than 10%
CLX	The Clorox Company	Consumer Staples	Household & Personal	16.75	Expensive Junk with Low Revenue Growth
W	Wayfair Inc.	Consumer Discretionary	Retailing	13.41	Growth more than 20x PEF + grows rev. less than 10%
BURL	Burlington Stores, Inc.	Consumer Discretionary	Retailing	12.64	Growth more than 20x PEF + grows rev. less than 10%
GME	GameStop Corp.	Consumer Discretionary	Retailing	9.38	Growth more than 20x PEF + grows rev. less than 10%
CHDN	Churchill Downs Incorporated	Consumer Discretionary	Consumer Services	8.66	Growth more than 20x PEF + grows rev. less than 10%
CHGG	Chegg, Inc.	Consumer Discretionary	Consumer Services	4.63	Growth more than 20x PEF + grows rev. less than 10%
SMPL	The Simply Good Foods Co.	Consumer Staples	Food, Bev. & Tobacco	3.73	Expensive growth
SSTK	Shutterstock, Inc.	Consumer Discretionary	Retailing	3.49	Growth more than 20x PEF + grows rev. less than 10%
SKIN	The Beauty Health Company	Consumer Staples	Household & Personal	2.82	Expensive growth
CRCT	Cricut, Inc.	Consumer Discretionary	Cons. Durables & Apparel	2.71	Growth more than 20x PEF + grows rev. less than 10%
HMHC	Houghton Mifflin Harcourt Co.	Consumer Discretionary	Consumer Services	2.67	Growth more than 20x PEF + grows rev. less than 10%
OSTK	Overstock.com, Inc.	Consumer Discretionary	Retailing	2.18	Growth more than 20x PEF + grows rev. less than 10%
MED	Medifast, Inc.	Consumer Staples	Household & Personal	2.09	Expensive growth
BGS	B&G Foods, Inc.	Consumer Staples	Food, Bev. & Tobacco	1.86	Expensive Junk with Low Revenue Growth
ELF	e.l.f. Beauty, Inc.	Consumer Staples	Household & Personal	1.35	Expensive growth
SPTN	SpartanNash Company	Consumer Staples	Food & Staples Retailing	1.24	Expensive Junk with Low Revenue Growth
SFIX	Stitch Fix, Inc.	Consumer Discretionary	Retailing	1.22	Growth more than 20x PEF + grows rev. less than 10%
LOCL	Local Bounti Corporation	Consumer Staples	Food, Bev. & Tobacco	0.57	Expensive growth
VITL	Vital Farms, Inc.	Consumer Staples	Food, Bev. & Tobacco	0.55	Expensive growth
RAD	Rite Aid Corporation	Consumer Staples	Food & Staples Retailing	0.53	Expensive Junk with Low Revenue Growth

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