

## Level Set - Two Hard Incontrovertible Facts

We have been asked several times this past week about the specific indicators we are monitoring to identify the peak of the Semiconductor cycle, and in particular the Memory cycle.

For some reason we are reminded of the words from the Priest in the 1993 film Rudy, "in 35 years of religious studies I have come up with only two hard incontrovertible facts, there is a God, and I am not him." While many Technology pundits and market commentators have expressed confidence in their ability call the peak of this Semiconductor stock rally, we are not encumbered with that confidence. The smartest people in the world with very powerful computers are spending all day trying to solve this problem. If we correctly time the Semiconductor industry downgrade right, it will be luck. Sure, I was a #1 Institutional Investor ranked Semiconductor analyst. But that is ancient history, and as the old saying goes, that and \$2.90 will get you a ride downtown. (Note, yes a one-way subway ride in New York City is now \$2.90).

Lately, there have been two seeming contradictory statements that are both true. There are an incredibly large number of stocks that have doubled in the last 12 months, but not that many stocks are outperforming the market. Many SMID-cap. long-only managers have been thinking more about risk-management and universe definitions than at any other point in their careers. The number of stocks up over 100% in the last year has been previously eclipsed only by the TMT, GFC, and the COVID-19 recoveries in the last 25 years, despite the fact there was no preceding sharp market sell-off this year (see below).

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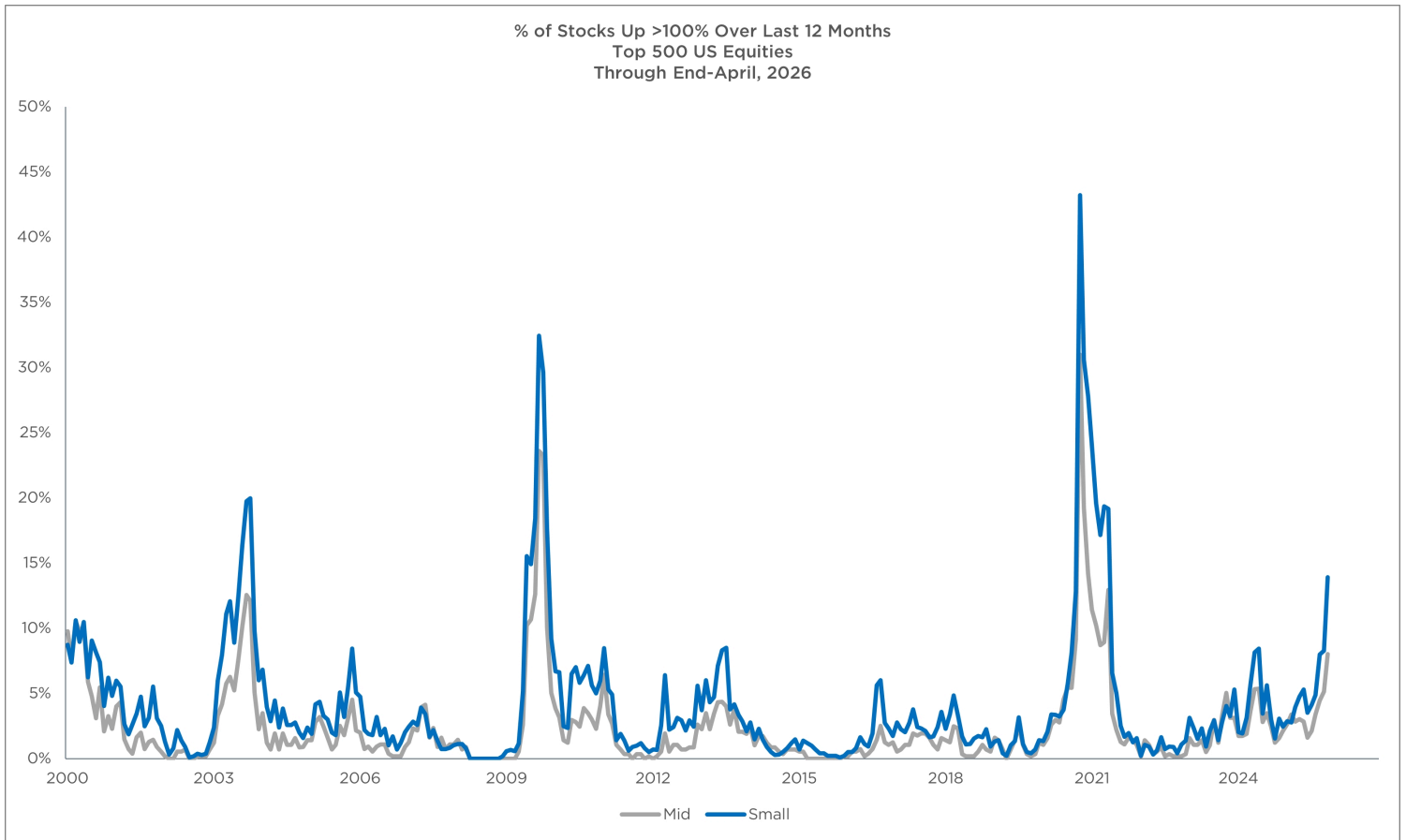
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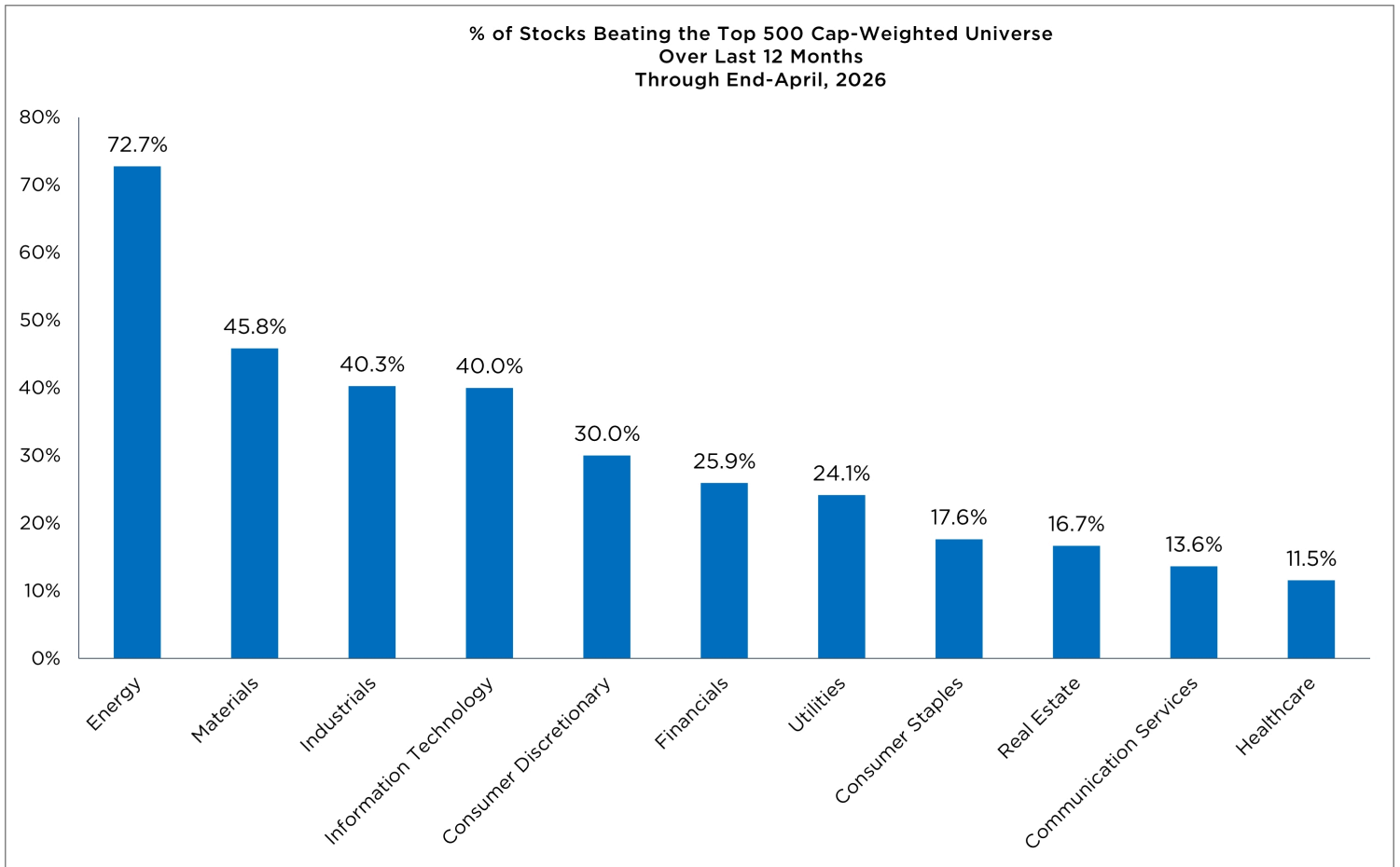
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Source: Trivariate Research, LP

At the same time, the only sector with more than 50% of its stocks beating the market is Energy - where 72.7% are outperforming the cap-weighted universe. In seven of the eleven sectors, less than 30% of stocks are outperforming (see below).



Source: Trivariate Research, LP

It seems clear there is a sustained shortage of the most crucial parts of the AI chain, including Power, Infrastructure, Memory, and Computational chips. This is assuredly part of the cause of some extreme moves, but also a lot of laggards vs. the index cap-weighted average. Most of the associated stocks from these AI sub-segments have been strong performers over the last two years. **We continue to think investors should be overweight these stocks, and our “North star” has been and remains to own Semiconductors over Software.** However, because we do not think we will be able to accurately time when these stocks materially roll-over, and because the correlation to the AI theme is so strong among many major sectors in the S&P500, it seems prudent that as these stocks appreciate, finding other investment ideas is important.

There have been a number of extreme market dynamics and challenges to outperformance because of the AI landscape, and speculation about future winners and losers. Here is our advice:

**Find stocks that have been performing well that aren’t correlated to the AI Semiconductors basket.** Ideas include WMT, LLY, XOM, JNJ, COST, CVX, KO, MRK, PM, LIN, NEE, AMGN, GILD, UNP, DE, WELL, COP, PFE, and PLD - all mega-caps (see below) !

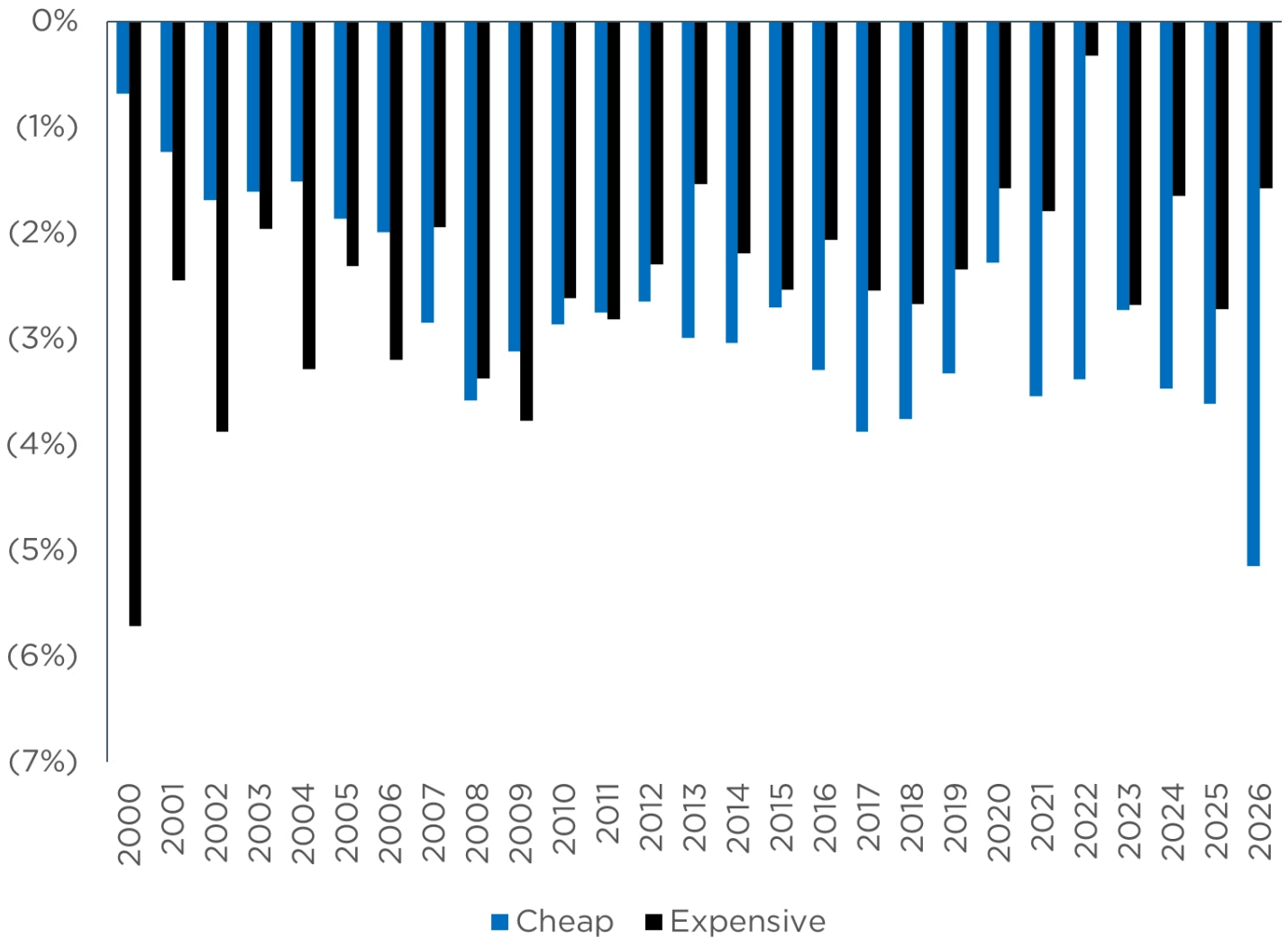
**Stocks With a 0.2 or Lower 6-Month Daily Trading Correlation to Trivariate's AI Semiconductors Basket  
And Up >10% in the Last Six Months  
As of End-April, 2026**

Ticker	Company	Market Cap. (US\$ Bil.)
WMT	Walmart Inc.	1,051.6
LLY	Eli Lilly and Company	836.3
XOM	Exxon Mobil Corporation	641.5
JNJ	Johnson & Johnson	553.3
COST	Costco Wholesale Corporation	450.1
CVX	Chevron Corporation	385.1
KO	The Coca-Cola Company	338.9
MRK	Merck & Co., Inc.	269.7
PM	Philip Morris International Inc.	257.3
LIN	Linde plc	231.7
NEE	NextEra Energy, Inc.	204.1
VZ	Verizon Communications Inc.	200.6
AMGN	Amgen Inc.	186.9
GILD	Gilead Sciences, Inc.	162.4
UNP	Union Pacific Corporation	160.0
DE	Deere & Company	159.3
WELL	Welltower Inc.	153.4
COP	ConocoPhillips	153.3
PFE	Pfizer Inc.	151.9
PLD	Prologis, Inc.	132.4

Source: Trivariate Research, LP

**Don't own stocks that miss estimates.** The penalty for missing is extremely harsh in absolute terms, and relative to the reward for beating. Stocks with bad momentum that are cheap that miss estimates are going down more than expensive stocks that miss estimates (see below). Do not look through the current environment, if it is poor, even if you believe a company's position will improve in a few quarters.

## Top 2,000 Stocks by Market Cap. Mean Industry-Relative Return for Missing EPS Over Time By Price-to-Forward Earnings Quintile Through End-April, 2026



Source: Trivariate Research, LP

**It is hard to get defensive using traditional sectors like Consumer Staples, Pharmaceuticals, and Telecom. stocks.** These sectors constitute a small part of the market (see below) and have worse relative earnings revisions. See our note ([LINK HERE](#)) from earlier this week, where we offered six ways to get defensive.

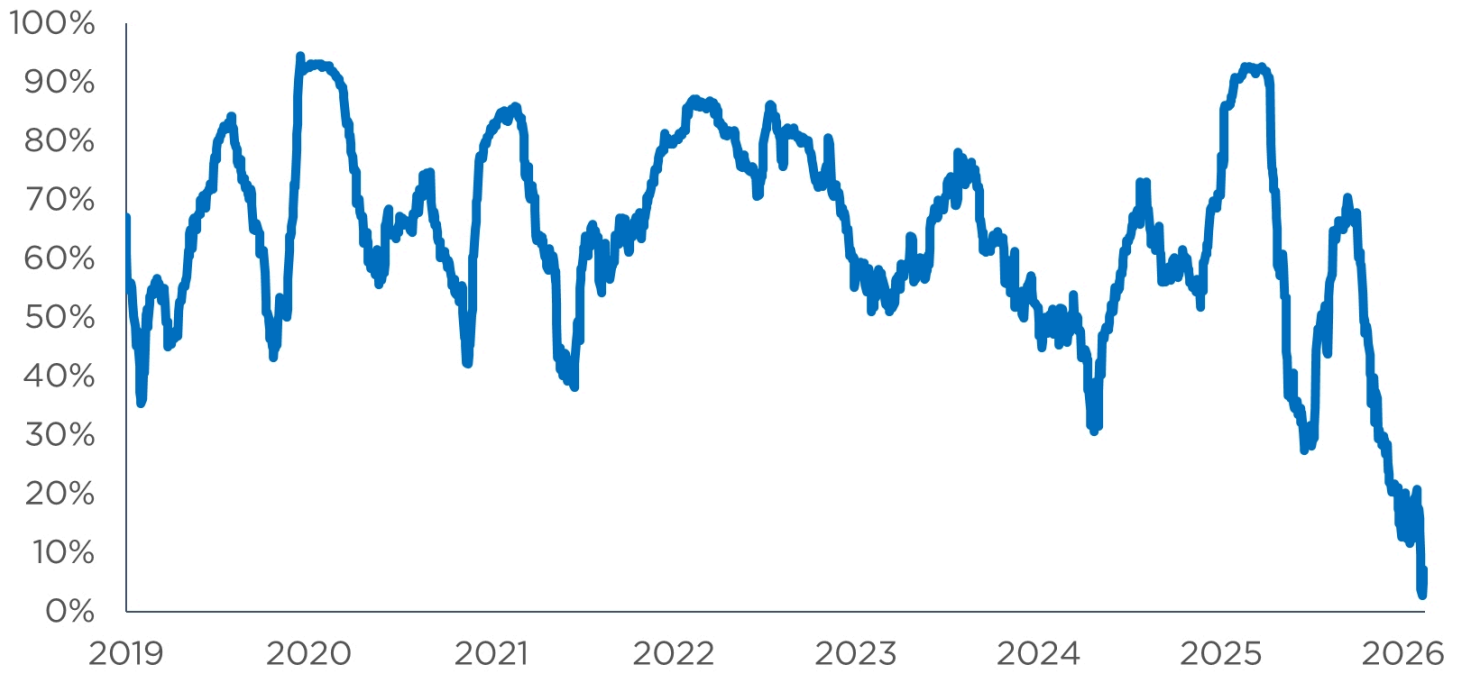
**Pharmaceuticals, Telecommunication Services,  
Consumer Staples, and Utilities  
Percentage of Top 500 Market Cap.  
Through May 8th, 2026**



Source: Trivariate Research, LP

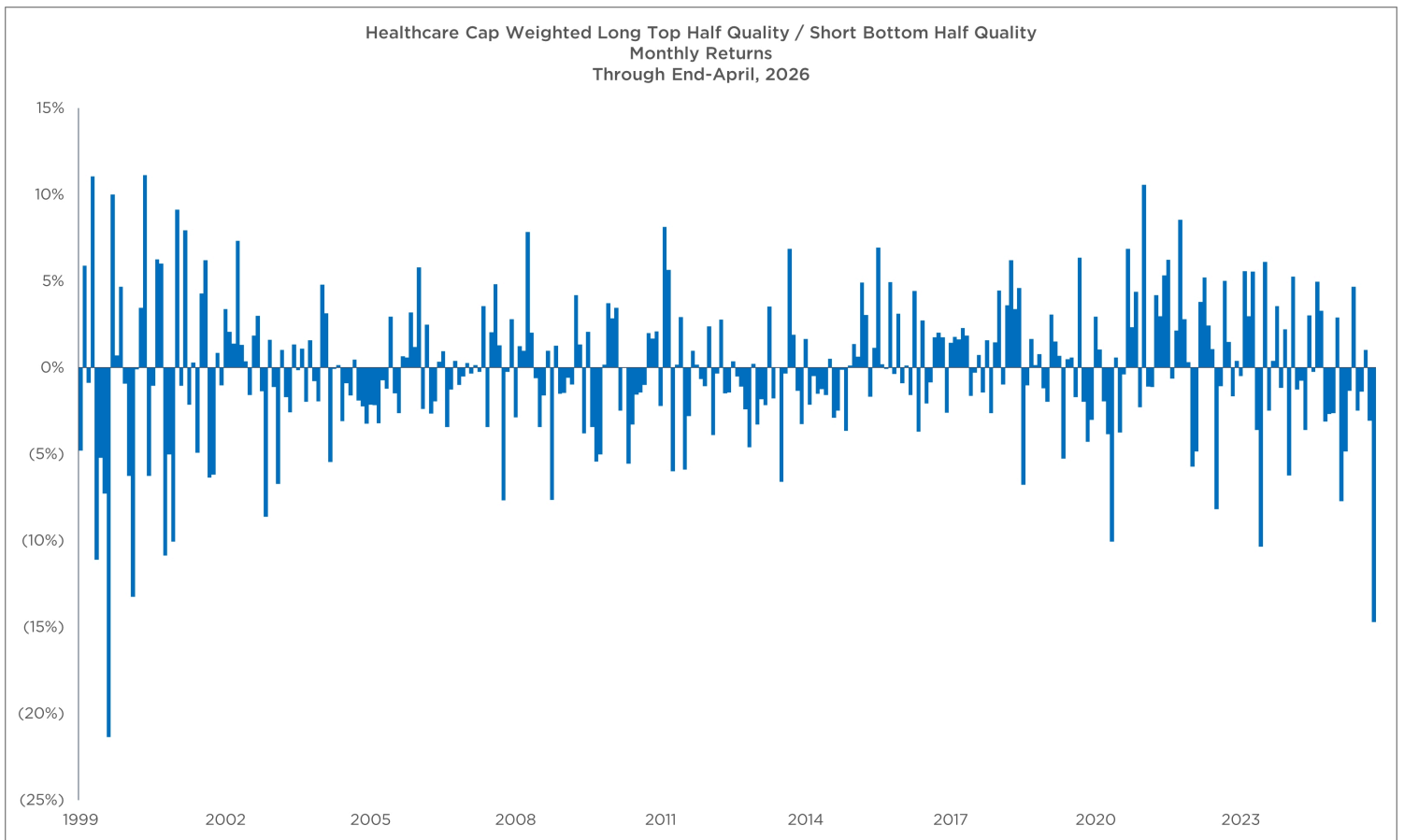
**We have been negative on the Software sector**, believing that the material amount of multiple contraction we have seen over the last year is a harbinger of earnings misses in the next year or two, and sales misses later this decade. It is interesting to note that recently (something we saw on Friday) that when Semiconductor stocks sell-off, Software now seems to perform well. **We are starting to wonder, for the first time this cycle, whether Software, even with a largely decelerating revenue outlook and earnings misses, can provide some ballast in a sustained Semiconductor sell-off.** Below we show that the 63-day rolling correlation between our AI Semiconductors and AI Software baskets are at “all-time” lows. We would only add to Sftware names that are fast-growing. **Select ideas include APP, PANW, CRWD, SNPS, and DDOG.**

### Rolling 63-Day Correlation AI Semis vs. AI Software Through May 15th, 2026



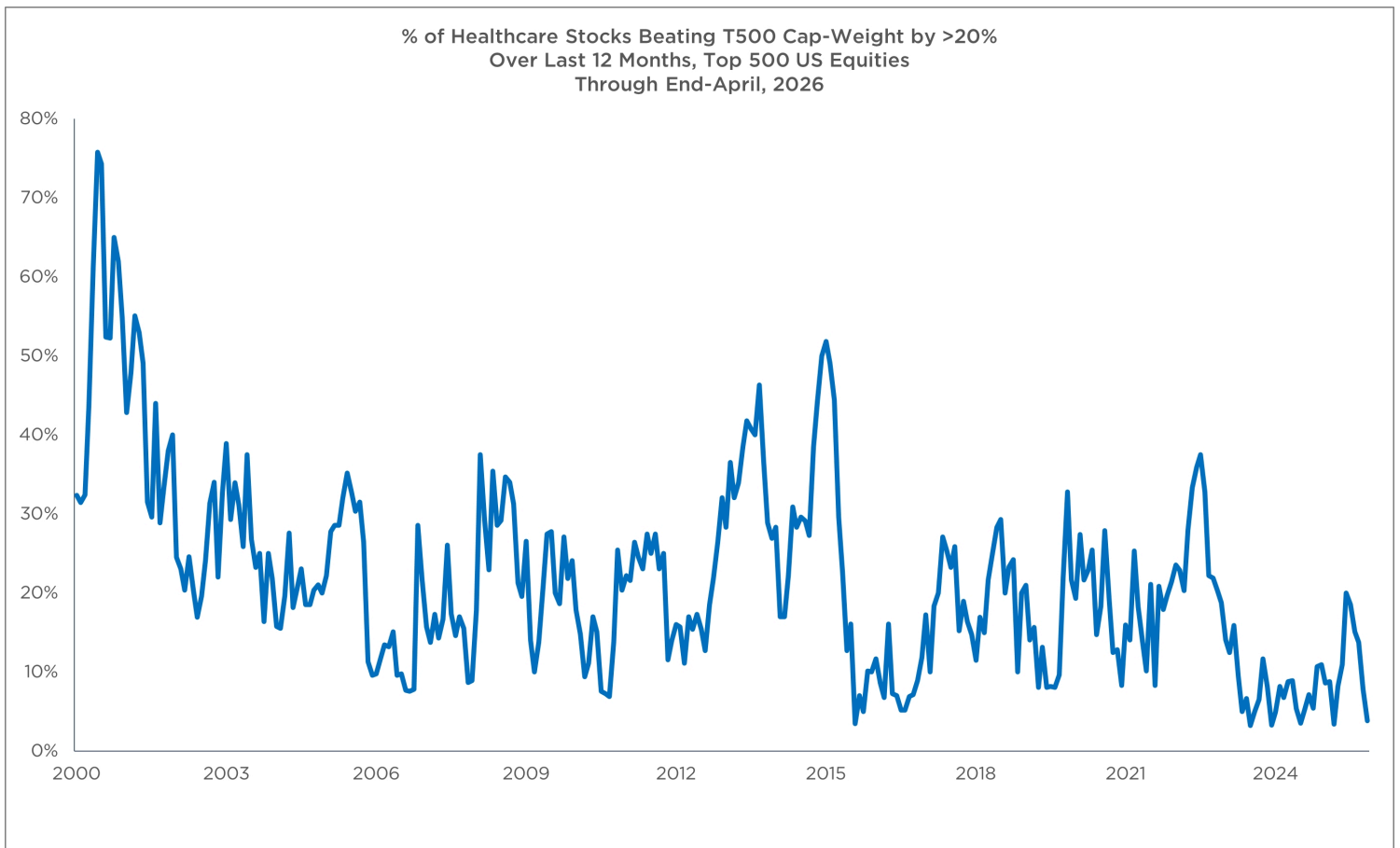
Source: Trivariate Research, LP

**Our worst call this year has been to recommend Healthcare.** Finding quality names and holding them has been virtually impossible. Recently, (see below), higher quality Healthcare stocks have lagged lower quality Healthcare stocks by the most in 25 years.



Source: Trivariate Research, LP

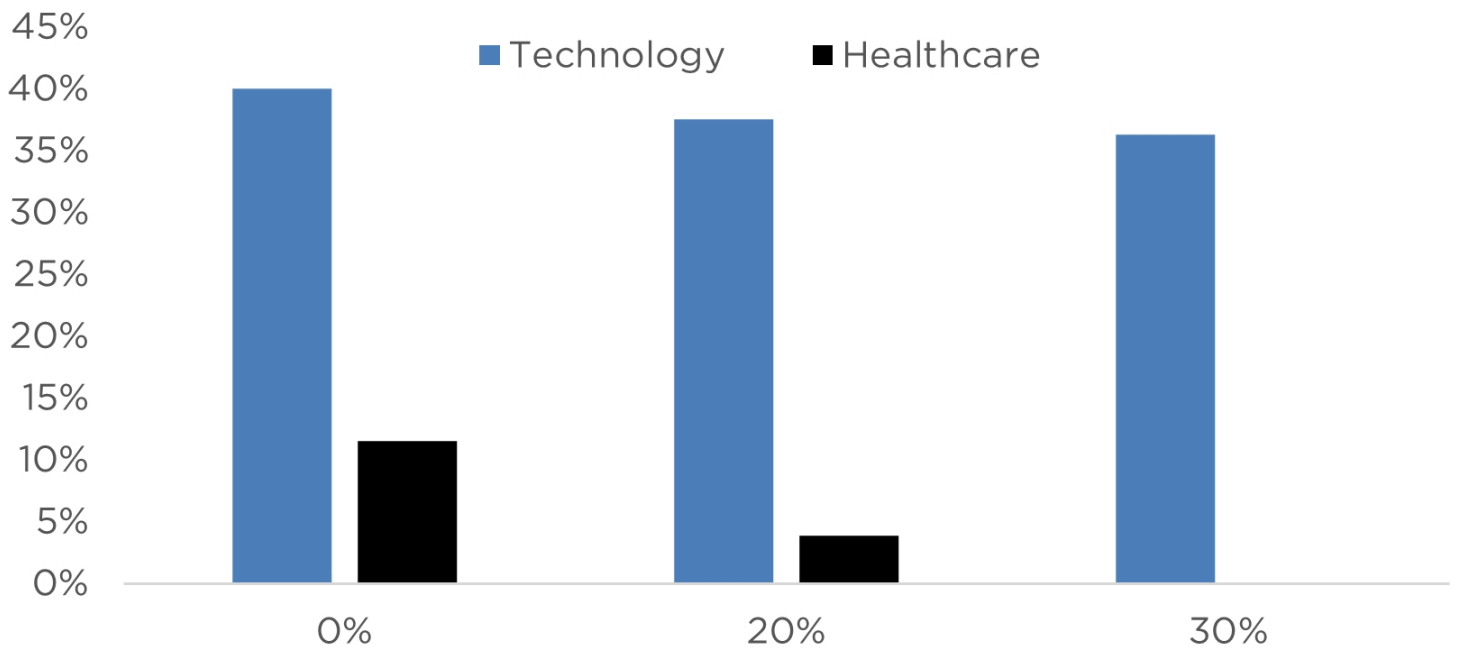
In fact, the number of Healthcare stocks that have beaten the S&P500 by more than 20% has never been lower than it has been in the last two years. If portfolio managers told their Healthcare analyst to only pitch them ideas they think can beat the S&P500 by more than 20% over the next year, the best Healthcare analysts might have said “we don’t have any, don’t waste your time.”



Source: Trivariate Research, LP

Only 11% of Healthcare stocks have outperformed the market overall, less than 4% by more than 20%, and none by more than 30% over the last year. At the same time however, 36.25% of all Technology stocks have beaten the market by more than 30%, even though only 40% of all Technology stocks have beaten the market in absolute terms. Basically, no Healthcare stocks were good, and every Technology stock that was good was incredibly good (see below). We are worried we are tethered to our thesis, but we continue to think that many Healthcare services businesses will benefit from AI productivity, and that there is limited political will from either major party to cut government spending on Healthcare by the amount that appears to be implied by stock prices. Intra-healthcare rotations have been sharp, with Drug Distributors we have been recommending, like MCK, falling nearly 25% over the last two months as Managed Care, which was previously weak, now apparently benefiting. For instance, UNH has moved from \$260 to \$394 over the last six week. We think a world exists where both can do well, and we like the fact that Healthcare and Technology have a low correlation to each other, from the portfolio construction perspective.

**% of Stocks Beating T500 Cap-Weight by >0,20,30%  
Over Last 12 Months, Top 500 US Equities  
Technology and Healthcare  
Through End-April, 2026**



Source: Trivariate Research, LP

**Our answer is to run more diversified in Healthcare.** We recently published ([LINK HERE](#)) that this regime - since 2019- is one that requires even very skilled managers to run with a more diversified portfolio than previously. Many of our clients have been highlighting the extreme challenges of Healthcare stock selection in particular.

As such, we simulated Healthcare portfolios to study the distribution of outcomes based on portfolio size and trading frequency. We chose for our analysis an investable universe that includes Healthcare stocks in the top 350 US equities (approximately equivalent to >\$30bn market capitalization today) that are also in the top half of our quality model. For each portfolio size and trading strategy we simulate 500 portfolios and show descriptive statistics of the distribution of returns for these 500 portfolios below. All of these analyses include an assumption of ZERO portfolio manager skill - and are meant to illustrate the challenges of running a concentrated low turnover top-half quality large cap. Healthcare strategy where drawdown avoidance is paramount. PM skill can definitely HELP, of course, **but it is basically impossible to avoid a large drawdown running a concentrated, low turnover, Healthcare portfolio today, a strategy many institutional investors employ.**

The initial study we did was to compare the maximum drawdown and Sharpe ratio of portfolios containing 5 to 20 stocks. For each portfolio size (columns below), we generate 500 random starting portfolios that randomly buy and sell one stock once per year. The portfolio returns series are computed cap-weighted with daily total returns. The average maximum drawdown decreases from 51.4% for the 5-stock portfolios to 45.0% for the 20-stock portfolio. On average, the marginal gain of going from a 5-stock portfolio to a 10-stock portfolio is greater than going from a 10-stock portfolio to a 20-stock portfolio. The average drawdown of a 10-stock portfolio is 3.6% better than that of a 5-stock portfolio (47.8% vs. 51.4%), but the average drawdown of a 20-stock portfolio is only 2.8% better than that of a 10-stock portfolio (45.0% vs. 47.8%). **The point is, risk can be mitigated with diversification.**

Top Half-Quality Healthcare, Large-Cap. Performance Based on 500 Simulations Varying Portfolio Sizes, Assuming No Skill and One Trade Per Year 1999-Through April, 2026								
	Number of Stocks							
Maximum Drawdown Statistic	5	7	10	12	15	17	18	20
Mean	(51.4%)	(49.0%)	(47.8%)	(46.7%)	(45.6%)	(45.5%)	(45.3%)	(45.0%)
Standard Deviation	8.2%	7.2%	6.4%	5.5%	4.5%	3.8%	3.4%	2.8%
Minimum	(75.8%)	(71.8%)	(64.7%)	(61.6%)	(61.7%)	(58.5%)	(56.2%)	(53.9%)
25th Percentile	(57.4%)	(53.9%)	(52.3%)	(50.0%)	(48.6%)	(48.1%)	(47.3%)	(46.6%)
Median	(51.2%)	(49.1%)	(47.5%)	(46.7%)	(45.4%)	(45.1%)	(45.1%)	(45.0%)
75th Percentile	(45.9%)	(43.9%)	(43.2%)	(42.9%)	(42.5%)	(42.7%)	(43.1%)	(43.3%)
Maximum	(32.1%)	(30.8%)	(32.2%)	(33.5%)	(32.9%)	(33.7%)	(36.9%)	(36.2%)

Source: Trivariate Research

**We remain negative on the Consumer Discretionary sector.** While it appears that, since the Iran War on February 27th, that Consumer Discretionary has performed reasonably well, up 4.38% vs. the S&P500 up 7.7% (4<sup>th</sup> best performing sector), this is quite misleading, and a classic aggregation error we recently highlighted that strategists make. AMZN is 36% of the market cap. of all of the Consumer Discretionary stocks in the Top 3000 US equities combined. TSLA is another 20%.

Only three of the 48 Consumer Discretionary stocks in the S&P500 have outperformed the S&P500 since February 27th - EBAY, AMZN, and SBUX, and only 10 are up in absolute terms. TSLA, the second-largest market cap. company is up 4%. At the same time, 13 of the 48 stocks are down more than 20% and 26 of the 48 stocks are down more than 10%. This, in our mind, means the “market” knows a lot of Consumer Discretionary companies are going to miss, even if the analyst estimates for the overall sector are being held firm by AMZN. **We would remain cautious on Consumer stocks.**

## Important Disclosures

### Analyst Certification

The analysts, Adam Parker, Maxwell Arnold, Colin Cooney, Chang Ge, Jesse Goodman and Ryan McGovern, responsible for the preparation of this research report certifies that: all the views expressed in this research report accurately reflect the research analyst's personal views.

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