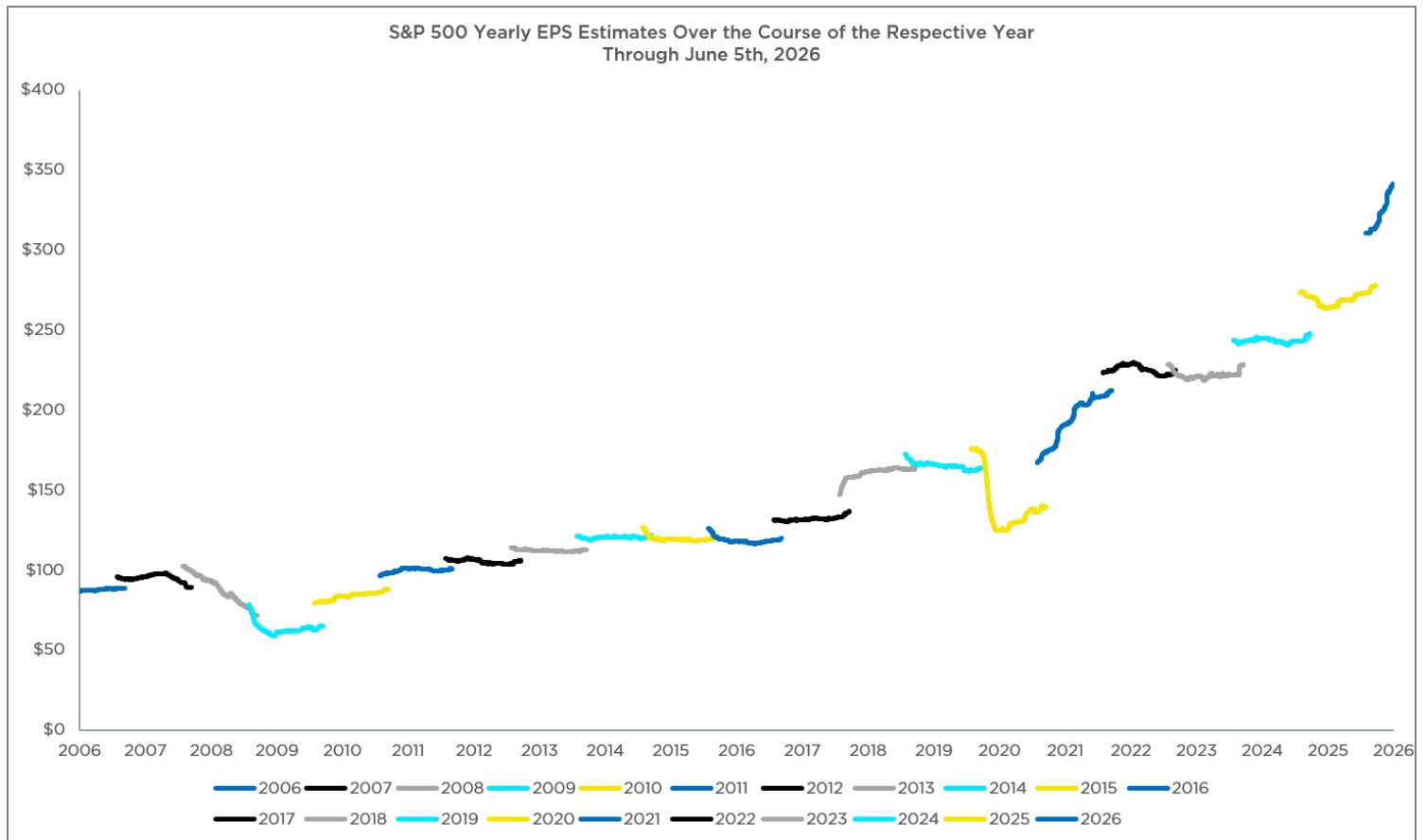


## Level Set - Earnings Upside and the Challenges of Value Investing

For many years, it was considered common knowledge that sell-side analysts, in aggregate, were too optimistic about their earnings forecasts. Often they started a new year with a view that the year’s earnings would grow 13-15%, and the actual earnings growth was closer to 7-8%. The market, many times, appreciated during those regimes nonetheless, particularly if there was a general sense that earnings would continue to grow the following year in absolute terms. There were far fewer, but still some years historically, where analyst estimates were collectively too negative - typically prior to recession recoveries where analysts systematically under-estimated the power of leverage in a recovery. For example in 2010, post the Financial Crisis, estimates went from \$79.08 to \$87.91, an 11.17% upside surprise from when estimates were initially posted.



Source: Trivariate Research, LP

Over the last 20 years, initial estimates called for 9% growth, and actual EPS growth was 6%. The years with the biggest upside surprises were 2021, coming out of the COVID-19 recovery, and 2010, accelerating out of the Financial Crisis - both of which

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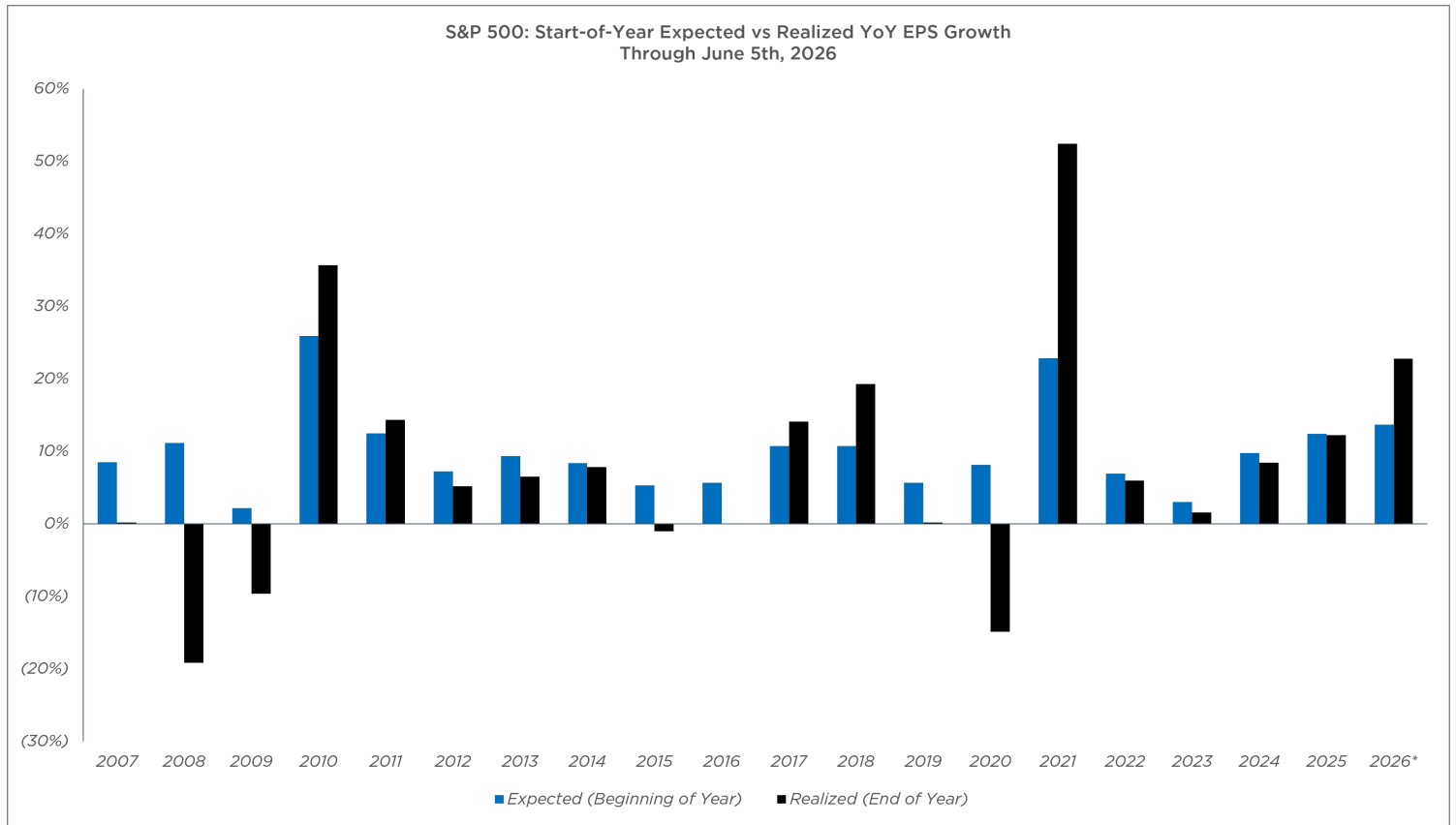
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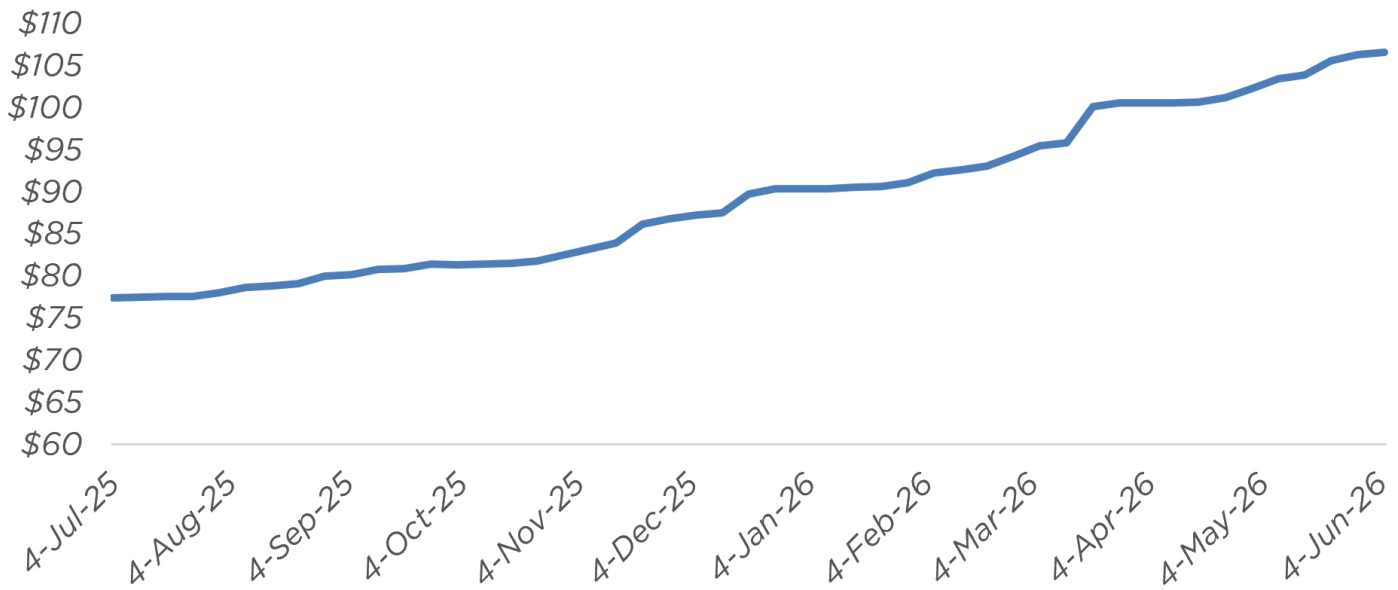
were accompanied by massive incremental fiscal and monetary stimulus - and this year so far. In 2026 however, the upside and initially conservative estimates being increased is more from a step change in technological productivity than incremental government intervention, which was the case the only two previous times with this much upside.



Source: Trivariate Research, LP

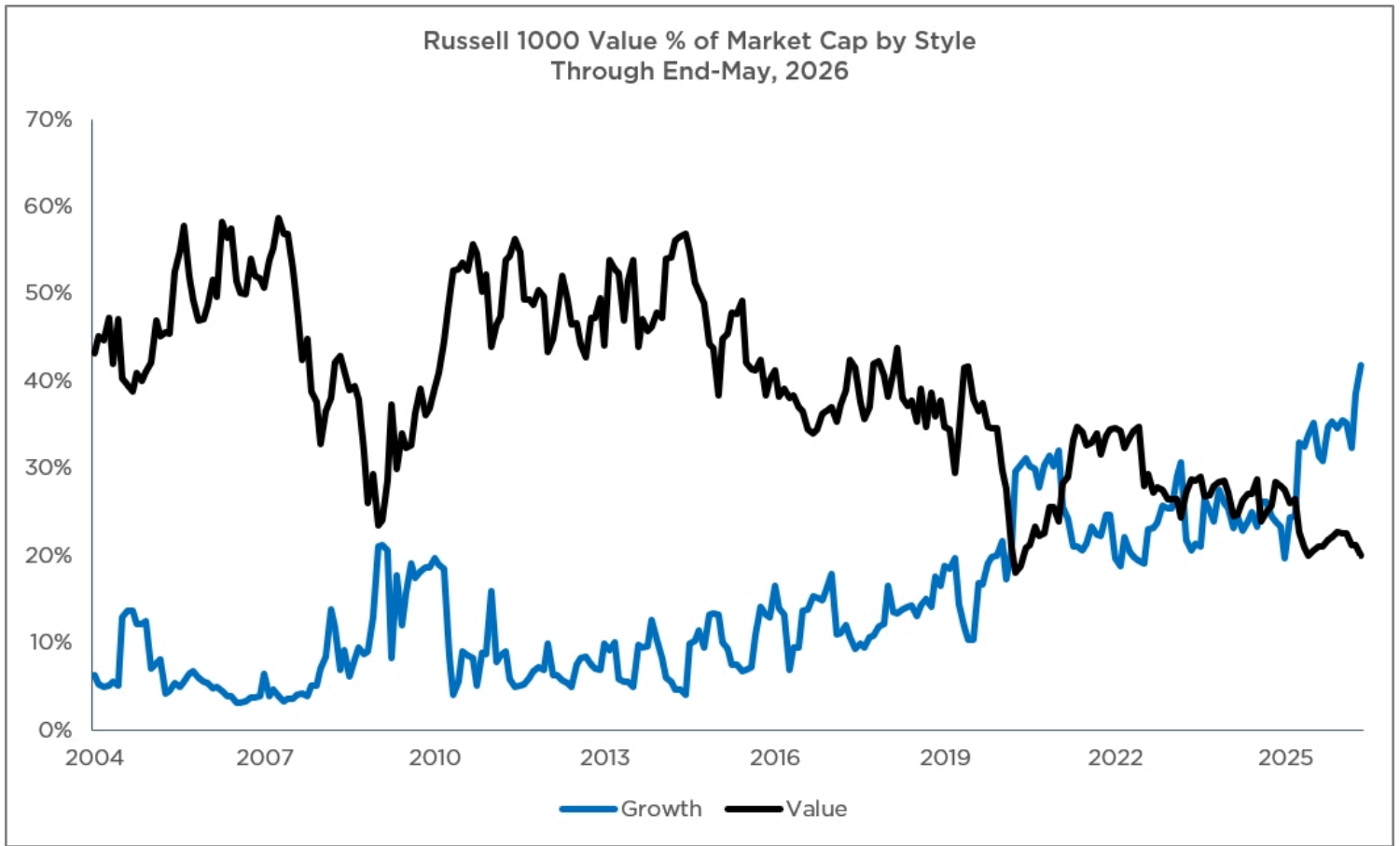
What makes this year stand out is not just that estimates have trended higher, it is the **MAGNITUDE** of the upward revisions. The S&P500 Technology sector EPS for 2026, from the bottom-up consensus estimates, has moved from \$77.44 to \$106.02 from mid-July 2025 until this past week. That is a 37.7% increase!

### Technology Sector Consensus Bottom-Up EPS Estimates Mid-2025 through June 5th, 2026



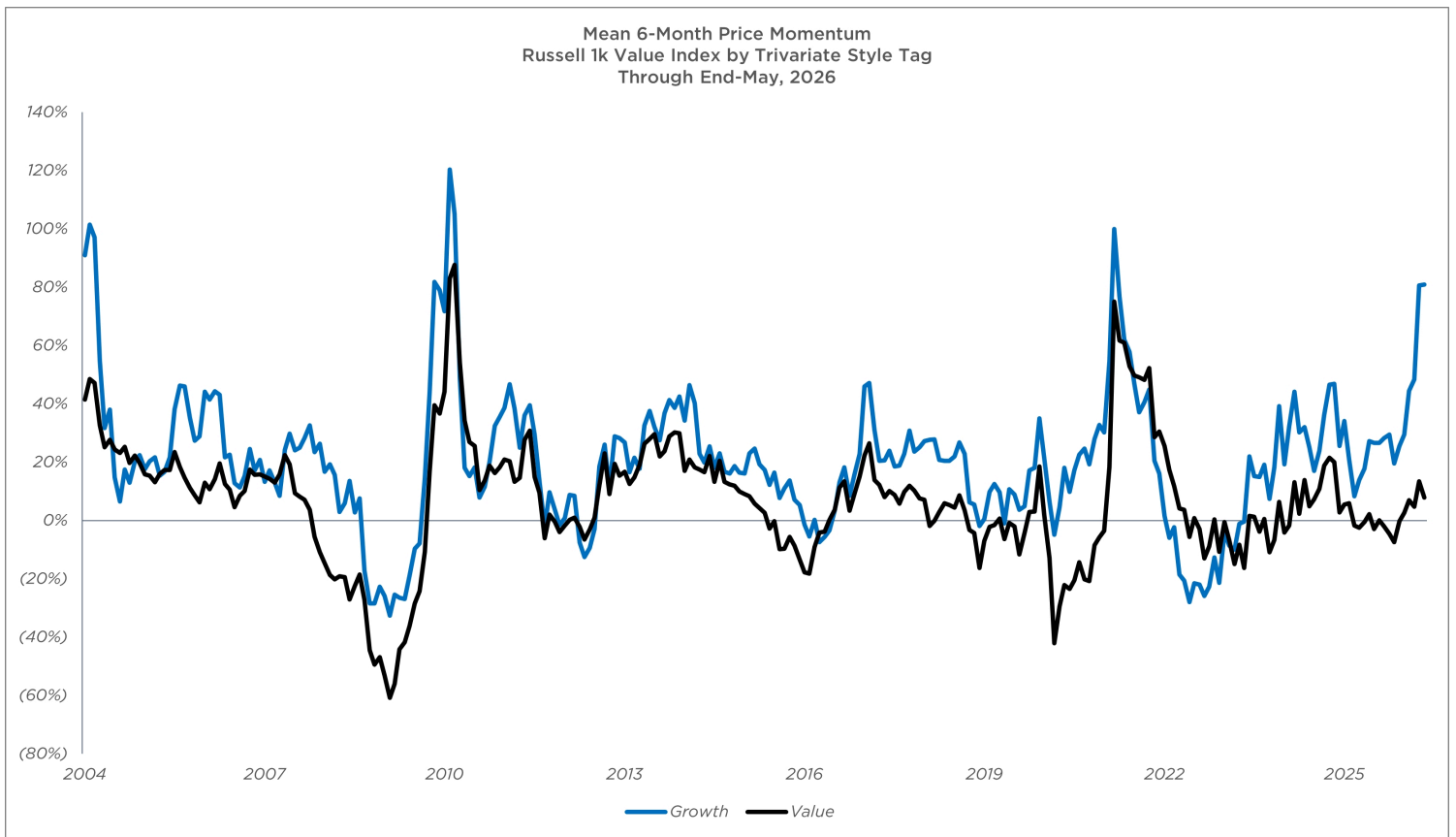
Source: Trivariate Research, LP

The result of this massive move in earnings and stock prices is some challenges for index-based investors. We did a few meetings and analyses for Value portfolio managers this past week, and took a look at the Russell 1000 Value Index in more detail. For those not familiar, we tag the Top 3000 stocks by market cap. each month as growth, value, or a middle ground we call “neither” based on a model that ranks stocks on several metrics including indicated dividend yield, price-to-book, net debt-to-market capitalization, 2-year forecast EPS growth, 2-year forecast revenue growth, and price-to-forward earnings. Stocks that are cheap, have debt, have a high dividend yield, and are forecasted to have slower growth are generally value. **Today, the Russell 1000 Value universe has substantially more of its market cap. (i.e., index weight) in the GROWTH universe than in VALUE (see below).**



Source: Trivariate Research, LP

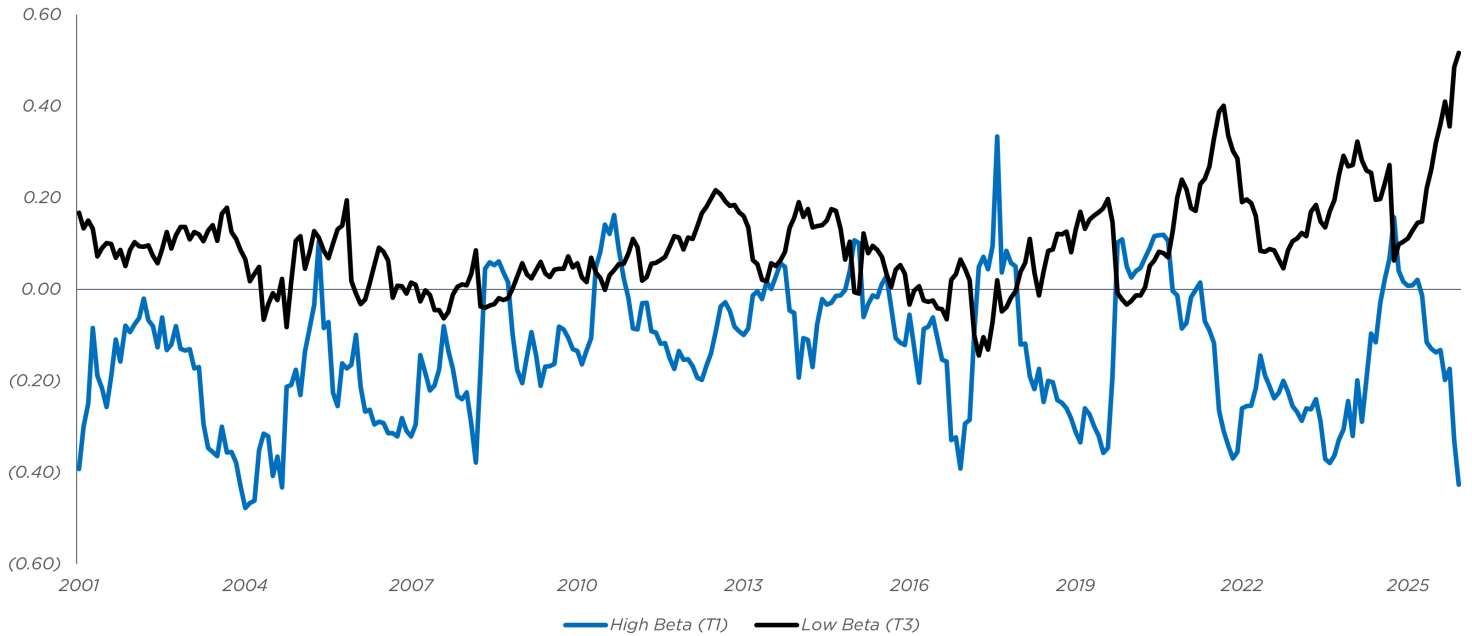
Unsurprisingly, the 6-month price momentum of the growth stocks in the value index is far better than the value stocks in the value index, causing most value portfolio managers to completely rethink and adapt. Using historical investment heuristics to get paid in the value universe has been demonstrably ineffective.



Source: Trivariate Research, LP

One particular concern we have is that many portfolio managers are potentially poorly positioned for downside capture using lower beta names than they may expect. Our fear that they may not protect as much capital in a sharp market sell-off as optical betas otherwise indicate is born out by what we measure as asymmetric beta. We compared every stocks' beta to its beta on days the market was down 75bps or more in rolling 2-year periods. Interestingly, low beta stocks had MUCH higher beta on days the market was down 75bps or more than it did generally. This means an investor buying a .4 beta stock, expecting, with no alpha, a stock to be down 4% when the market is down 10%, might be surprised to have it down 9%. Interestingly, high beta stocks simultaneously seem to have lower betas on the big market down days than they do in steady state. **This is another way of saying high beta stocks have been good stocks, and low beta stocks have been bad.**

Median Downside Beta  
 (Beta on Days Market Is Down 75bps or More Minus Overall Beta)  
 By High and Low Beta-Tertile  
 Through End-May, 2026

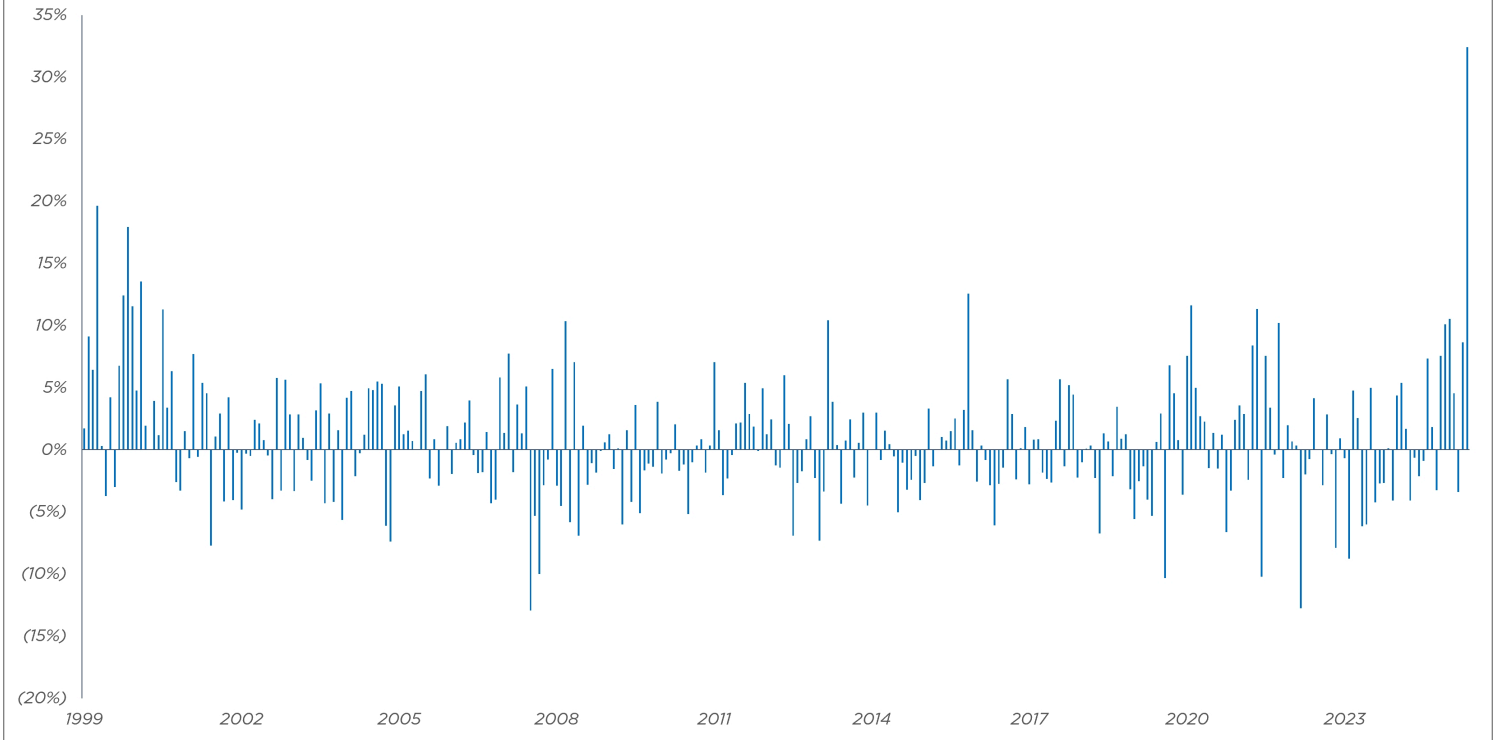


Source: Trivariate Research, LP

During Friday's sharp sell-off, 77% of the S&P500 beat the index - the complete opposite of the concentration on the upside we have seen so acutely in April and May. The worst 25 performing stocks, other than LULU which guided down, were all obvious AI revenue plays. We have freely admitted that timing these sharp rotations is challenging, and that is why we recently wrote about running more diversified, playing for defense, and thinking through the non-obvious AI revenue beneficiaries ([How Should You Think About AI Revenue Exposure?](#)). Mid-week, we wrote about finding non-AI cyclicals ([Which Non-AI Cyclicals Should You Own?](#)).

While we have been publishing for more than a year, with some caveats, that valuation in isolation is not effective for predicting subsequent stock returns, and we have been identifying that cheap stocks that are missing estimates are going down more than expensive stocks that are missing estimates, we wanted to take a look at stocks with positive momentum that are cheap. Well, that just worked the best it ever has (see below), because it includes MU and SNDK!

Monthly Total Return of Cheapest Quintile on Price-to-Forward Earnings - Other 4 Quintiles  
Among Stocks in Top Quintile of 6-Month Momentum  
Top 900 US Equities, Cap-Weighted  
Through End-May, 2026



Source: Trivariate Research, LP

## CONCLUSION

We think we need a combination of fundamentals, like expanding gross margins, positive momentum, and a low correlation to AI Semiconductors, combined with compelling valuation. Below we show stocks that have forecasted gross margin expansion but ostensibly are under-earning, as their current gross margins are below their own long-term median, have positive 6-month price momentum, and, are cheap vs. their own histories and in absolute terms (below 17x price-to-forward earnings). This list should provide some protection against any short-term AI rotation. **The largest names by market cap. include VZ, PFE, CVS, SYY, BIIB, and DG, among others.**

**Top 900 Universe****Positive 6-Month Price Momentum, Less than 17x Price-to-Forward Earnings****Cheaper than Long-Term Median, Gross Margins Below Long-Term Median and Forecasted to Improve Through End-May, 2026**

<b>Ticker</b>	<b>Company</b>	<b>Sector</b>	<b>Market Cap. (US \$ Bil.)</b>	<b>Price-to- Forward Earnings</b>	<b>6-Month Performance</b>
VZ	Verizon Communications Inc.	Communication Services	199.63	9.6x	22%
PFE	Pfizer Inc.	Health Care	149.21	8.8x	5%
CVS	CVS Health Corporation	Health Care	116.08	12.3x	18%
SYY	Sysco Corporation	Consumer Staples	36.25	15.4x	1%
BIIB	Biogen Inc.	Health Care	28.94	13.6x	8%
DG	Dollar General Corporation	Consumer Staples	24.36	15.3x	7%
DOW	Dow Inc.	Materials	24.33	11.5x	51%
LYB	LyondellBasell Industries N.V.	Materials	21.51	6.7x	48%
AA	Alcoa Corporation	Materials	20.49	11.1x	99%
WMG	Warner Music Group Corp.	Communication Services	16.45	16.8x	13%
BBY	Best Buy Co., Inc.	Consumer Discretionary	16.42	12.0x	1%
HRL	Hormel Foods Corporation	Consumer Staples	12.78	15.5x	4%
ALGN	Align Technology, Inc.	Health Care	12.53	15.4x	19%
SJM	The J. M. Smucker Company	Consumer Staples	11.01	10.4x	5%
SIRI	Sirius XM Holdings Inc.	Communication Services	9.94	9.5x	44%
BAX	Baxter International Inc.	Health Care	9.70	9.7x	1%
OSK	Oshkosh Corporation	Industrials	8.11	11.7x	3%
MIDD	The Middleby Corporation	Industrials	7.01	16.1x	32%

Source: Trivariate Research, LP

## 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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