Level Set: 7 Issues You Should Be Thinking About

Issue 1: The penalty for missing: IBM's negative preannouncement last week was met with a dramatic market reaction. The penalty for missing estimates remains very harsh, and cheap stocks that miss have never gone down more.

In fact, year-to-date in 2026, low-valuation stocks that have missed EPS estimates have faced the most severe market penalties on record (see below).

Adam Parker
Founder
646-734-7070
adam@trivariateresearch.com

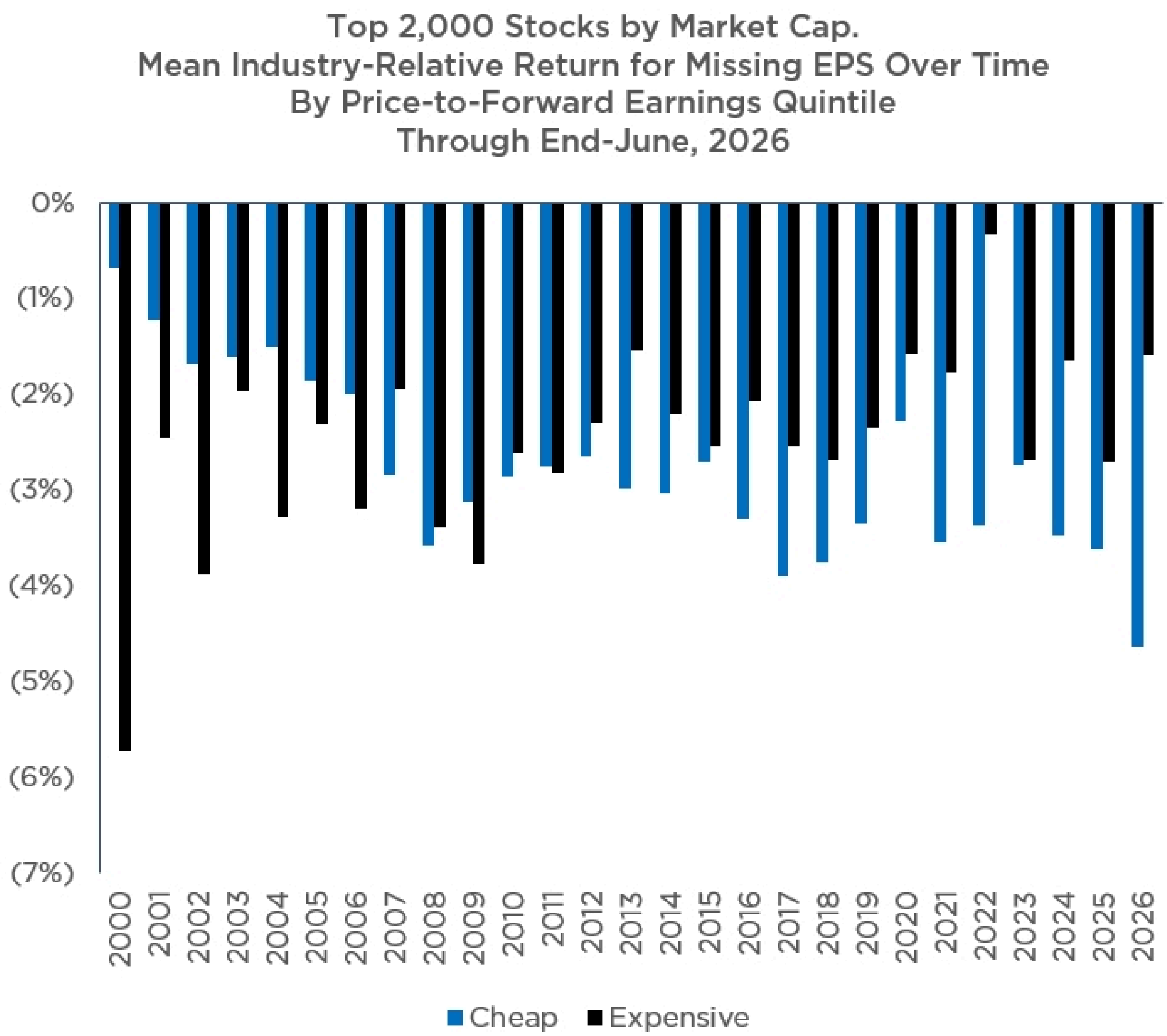
Chang Ge
Analyst
614-397-0038
chang@trivariateresearch.com

Maxwell Arnold
Analyst
347-514-1234
maxwell@trivariateresearch.com

Jesse Goodman
Analyst
917-741-5744
jesse@trivariateresearch.com

Colin Cooney
Head of Sales
617-910-7934
colin@trivariateresearch.com

Ryan McGovern
Director of Research Sales
973-271-8017
ryan@trivariateresearch.com



Source: Trivariate Research, LP

Issue 2: The Great 8 Underweight: There is no doubt that many long only investors indexed to the S&P500 who are underweight the Great 8 have performed well this year. Investors calling for "breadth" are getting it, as the best performing of the Great 8 year-to-date is Apple, the 134th best performing stock in the S&P500 (see below). In fact, all the Great 8 except AAPL and GOOGL have fared worse than median. You could have picked 133 stocks and outperformed any of these names - that's the breadth everyone's been dying for! The question is - why doesn't this dynamic feel better? We suspect there are some investors that thought they would be outperforming by more than they are with their underweight in the Great 8, and, we worry that a big risk for some long-only investors is they are positioned for the group to continue to lag.

Rank of YTD Performance of Great 8 Stocks Through July 15th, 2026				
Ticker	**Company**	**Market Cap. (US $Tn.)**	**YTD Return**	**YTD Return Rank**
AAPL	Apple Inc.	4.90	23.0%	134
GOOGL	Alphabet Inc.	4.23	10.9%	234
NVDA	NVIDIA Corporation	4.91	8.9%	257
AVGO	Broadcom Inc.	1.76	7.5%	272
AMZN	Amazon.com, Inc.	2.66	7.1%	277
META	Meta Platforms, Inc.	1.64	(2.0%)	346
TSLA	Tesla, Inc.	1.43	(15.3%)	427
MSFT	Microsoft Corporation	2.93	(18.2%)	443

Source: Trivariate Research, L.P.

To dimension the impact on portfolios, imagine a scenario where a portfolio manager was underweight the Great 8 at the beginning of this year, and maintained the underweight until today. Given the S&P500 excluding the Great 8 outperformed the Great 8 by 6.6%, for each 1% that an investor was underweight the Great 8, their portfolio would be 6.6bps higher. Hence, investors who went very underweight the Great 8 have helped their portfolio meaningfully this year (see below).

YTD Return of the Great 8 and S&P500 Ex-Great 8 As of July 16th, 2026		
Cohort	**YTD Return**	**Initial Weight**
Great 8	6.4%	37.4%
S&P500 Ex-Great 8	13.1%	62.6%
Difference	6.6%	

Source: Trivariate Research, L.P.

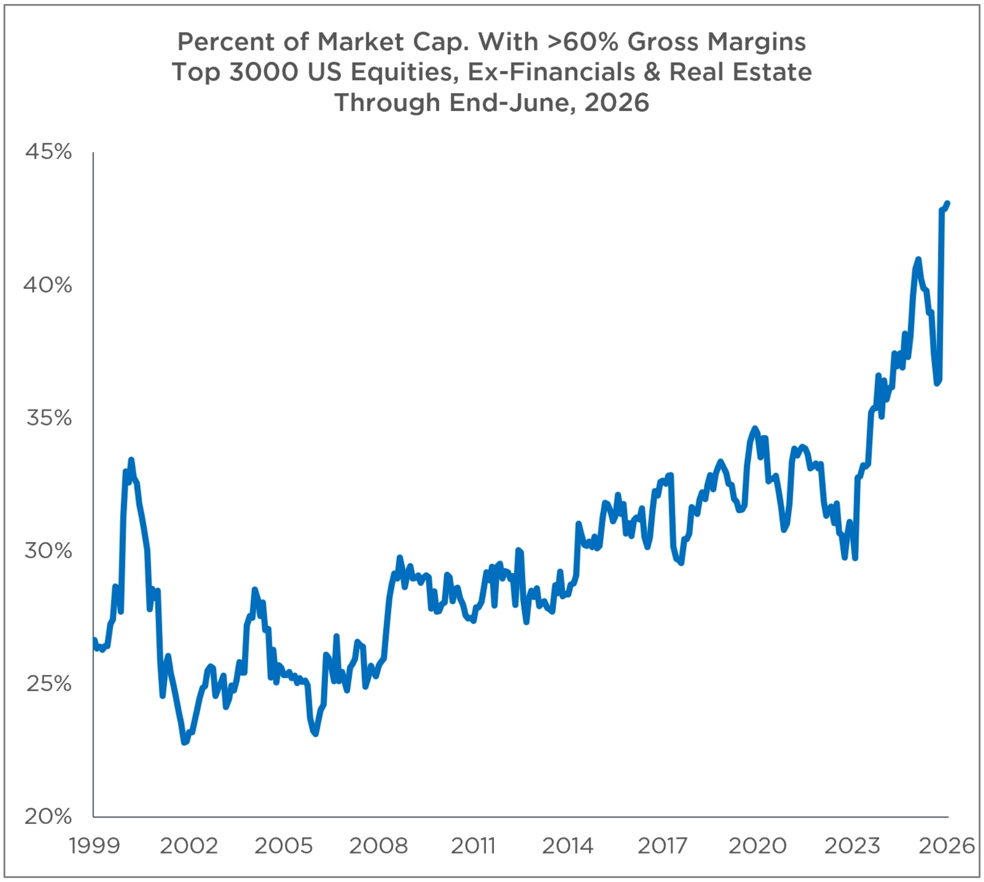
While we haven't heard the word "bubble" as much in the past two weeks, likely due in no small part to the recent AI Semiconductor rollover, we certainly get that investors are concerned about the US equity market valuation and how to envision material upside. Trivariate's top-down forecast for 2027 S&P500 EPS is $386, and the consensus bottom-up estimates are $401. A range of 19x to 22x price-to-forward earnings, in blue below, shows the S&P500 trading between $7334 and $8822 at year-end, representing 3% downside to 17% upside. Typically, the market moves more dramatically than assumptions like these, but it is quite challenging to forecast future price-to-forward earnings ratios.

S&P500 Price Target Based on EPS and Multiple Assumptions

Price-to-Forward Earnings	2027 Expected Earnings					
	$340	$355	$370	$386	$401	$410
17x	5,780	6,035	6,290	6,562	6,817	6,970
18x	6,120	6,390	6,660	6,948	7,218	7,380
19x	6,460	6,745	7,030	7,334	7,619	7,790
20x	6,800	7,100	7,400	7,720	8,020	8,200
21x	7,140	7,455	7,770	8,106	8,421	8,610
22x	7,480	7,810	8,140	8,492	8,822	9,020
23x	7,820	8,165	8,510	8,878	9,223	9,430
24x	8,160	8,520	8,880	9,264	9,624	9,840

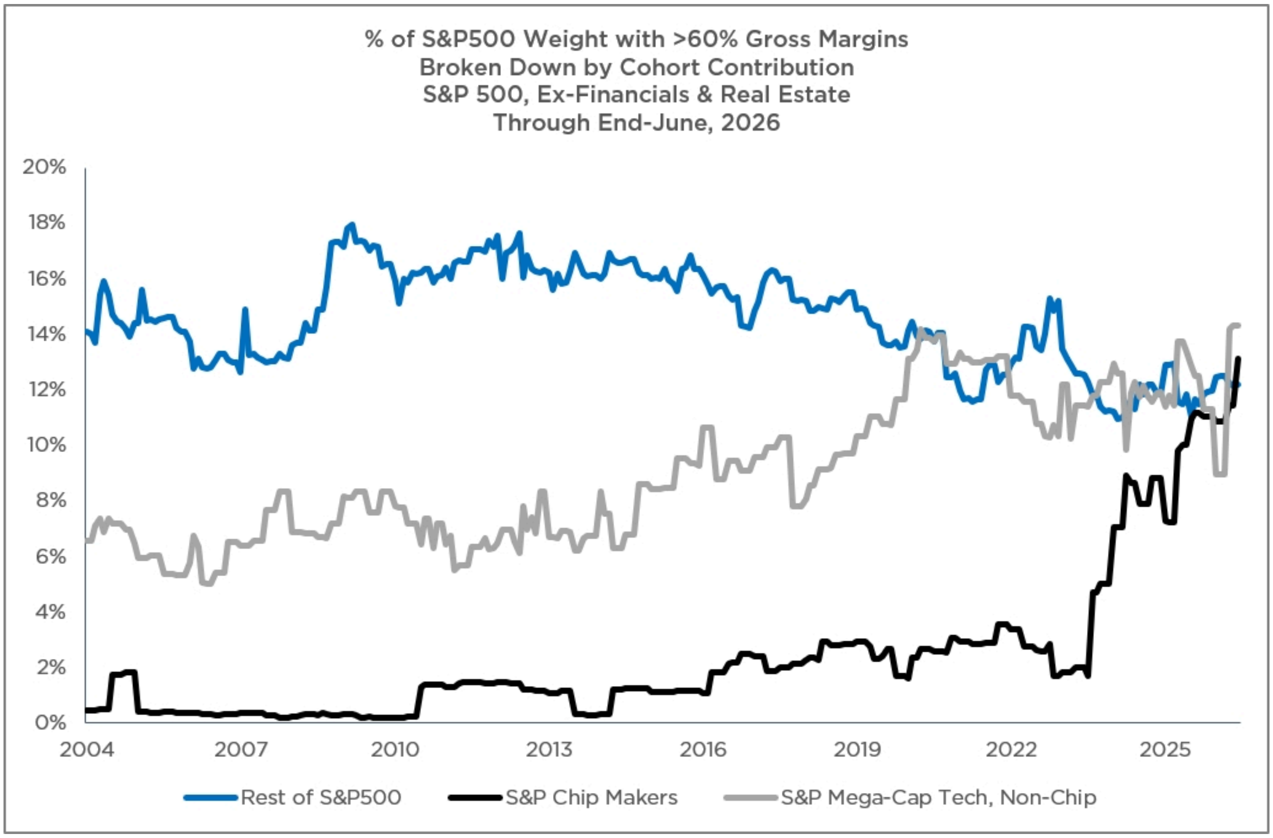
Source: Trivariate Research, LP

Issue 3: The Gross Margin Impact from Semiconductors: We do know that at some level, valuation and gross margins are inextricably linked. As such, we have argued for years that the market will oscillate at higher levels in the future than in the past, because so much of the market's gross margins are structurally higher than they used to be. Today, 43.1% of the market cap. of the Top 3000 stocks have gross margins greater than 60% - the highest ever (see below). So, for investors making the case that the market multiple is going to decline, they are essentially saying that profit margins are about to materially roll over for many of these more profitable businesses.



Source: Trivariate Research, LP

When you break down the key driver of the higher gross margin cohort, it is driven by a large rise in the percentage of Semiconductor market cap. that has above 60% gross margins (NVDA, AVGO, and MU, to name three off the top of our heads), and also by a slow and steady grinding higher of non-Semiconductor Mega-Caps. The rest of the market has **NOT** seen an increase in the percentage of market cap. with above 60% gross margins, and has less today than 20 years ago (see below).



Source: Trivariate Research, L.P.

Issue 4: Financials Earnings: We saw a slew of Financials earnings this past week, and our summary is:

Solid earnings: 2Q26 Financials earnings are broadly ahead of expectations, with capital markets the standout driver: GS delivered a blowout, while BAC showed strong equities revenue and operating leverage; JPM, C, and WFC were solid but closer to the bar.

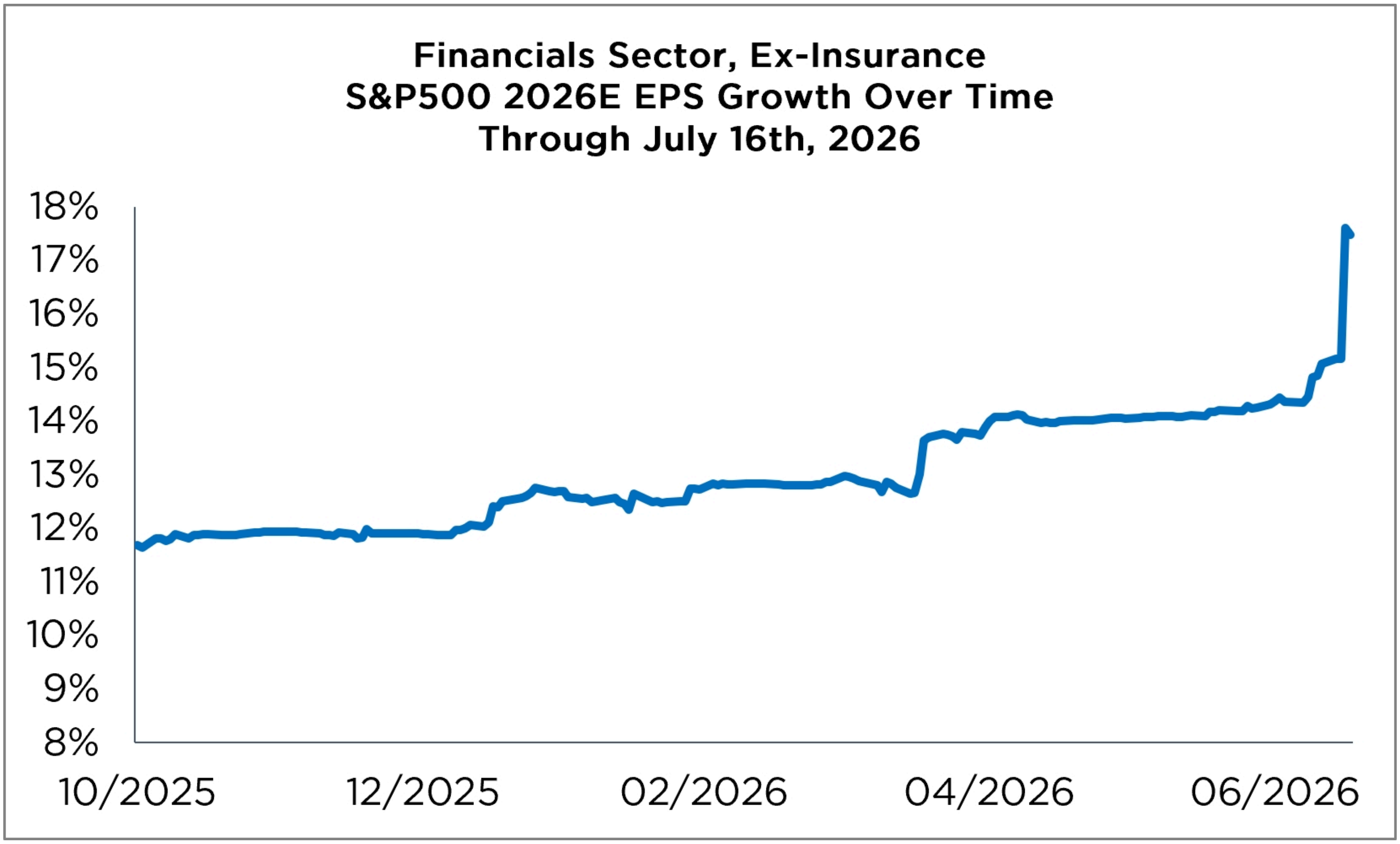
Bank fundamentals remain constructive: Loan growth is accelerating, deposits are generally improving and credit remains stable. CFG, USB, PNC, MTB and RF reported positively; TFC's weaker net interest income outlook and FITB's expense-driven guidance were the notable disappointments.

Fee-sensitive businesses are outperforming: BLK posted strong flows and organic base-fee growth, BNY delivered record sales and raised guidance, and STT beat on fees, NII and deposits. M&A pipelines remain healthy, with activity potentially on track for a record year.

In insurance, TRV's result was stronger than expected across premiums, underwriting and reserve development, reinforcing the favorable P&C backdrop. The watch item is accelerating commercial pricing deceleration.

Our take from talking to investors about Financials: Expectations and positioning are now elevated: Diversified Banks are crowded longs, while P&C and Capital Markets names have the strongest recent flows. Key risks are margin pressure, rising expenses, slower Insurance pricing and any failure of expected second-half growth to materialize.

We have been cautious overall on Financials, concerned about a more Hawkish-than-consensus Fed - which did get some support from commentary this week. Within Financials, we continue to prefer JPM, GS, and MS to Alternative Asset Managers, where we still see downside risk to marks, and Regional Banks, where reports have been slightly softer, such as with RF, FITB, and TFC. Overall EPS is rising however (see below), and so far this year that has been correlated to returns. We were worried at the beginning of the year that the universal consensus was to be bullish Financials, and that fueled our downgrade soon after. Financials in aggregate have been the 3rd worst performing sector year-to-date, but have performed better over the last month. If estimates prove to be more achievable than average in the second half of the year, we are inclined to get more optimistic.



Source: Trivariate Research, LP

Issue 5: K-Shaped Is More Balance Sheet than Income Statement:

For several years, a consistent narrative has held that the US consumer is in a K-shaped environment.

The idea is that some consumers continue to get wealthier, while a significantly larger percentage of the US population is getting poorer. We certainly want to avoid the politics and policy element, and we admit we focus primarily on corporate results, but we are wondering if perhaps that narrative is more about the lower third not participating in balance sheet improvement than the income statement. Why do we say this? The narrative often jumps from the lower-income consumers are frustrated and trading down to the lower-income consumers are financially deteriorating and about to stop spending - and that can make investors too bearish on select US Consumer stocks.

The first statement is well-supported. The second is not—at least not broadly.

What is the evidence that the lower-end consumer is doing better than perceived?

1. Lower-income wage growth has recently re-accelerated: Bank of America's deposit-account data showed after-tax wage growth for lower-income households accelerating from **2.9% in May 2026 to 4.1% in June**. PNC also reported that the spending-growth gap between lower- and higher-income customers was the smallest in three years. That is inconsistent with a lower-income cohort falling rapidly behind.

2. Credit performance at major Banks remains healthy: JPMorgan, Bank of America and Wells Fargo recently reported stable or declining card delinquencies and charge-offs, while card spending and loan balances continued to grow. The banks still describe lower-income customers as pressured, but not as broadly defaulting or retrenching. **90-day credit card delinquencies are the lowest they have been since September 2023!**

3. <u>**More card accounts are being paid in full:**</u> Philadelphia Fed data reportedly showed a record **36.9% of credit-card accounts paid in full during the first quarter of 2026**, while the percentage making only minimum payments declined to approximately **10.2%**. That is not what one would expect from broad-based consumer balance-sheet deterioration.

4. <u>**Most households still describe their finances as acceptable:**</u> In the Federal Reserve's household survey, **73% of adults said they were doing okay or living comfortably**, up slightly from the previous year. In addition, **63% could cover a $400 emergency expense with cash or its equivalent**, unchanged for three years. Those figures are below the stimulus-supported 2021 peak, but they do not indicate a collapsing household sector.

5. <u>**Lower-income consumers are adapting rather than disappearing:**</u> Bank of America data show lower-income households increasing spending at discount apparel stores far faster than affluent households. Consumers are trading down to value grocers, private labels and discount general merchandise—but spending is continuing. This is better characterized as **substitution and price sensitivity**, not demand destruction.

6. <u>**Aggregate consumption remains positive:**</u> June 2026 core retail sales rose **0.5%**, following an upwardly revised **0.8% increase in May**. Higher-income consumers still contribute disproportionately, but the overall data do not show the bottom half falling out of the economy.

We are not saying things are perfect. Large banks also have increasingly prime customer bases, so their strong performance may somewhat overstate the health of genuinely low-income borrowers.

What part of the K-shape economy is real?

The strongest K-shaped evidence is in **wealth**, not necessarily current income or spending. To us, that is more balance sheet than income statement, and for a chunk of US equities, the income statement matters more.

Higher-income households own most equities and disproportionately own appreciating real estate. They have benefited from:

- Rising stock prices
- Locked-in low mortgage rates
- Home-equity appreciation
- Higher interest income on savings
- Greater ability to absorb inflation

Lower-income households have fewer financial assets, rent more frequently and devote more of their income to food, shelter, transportation and utilities. Consequently, they can feel worse—even while remaining employed, receiving wage increases and continuing to spend.

Our conclusion, is that the US Consumer has a K-shaped balance sheet, but not necessarily a K-shaped income statement. Affluent households are indisputably winning more from asset inflation. But the claim that the typical middle- or lower-income household is already in severe financial decline looks too bearish.

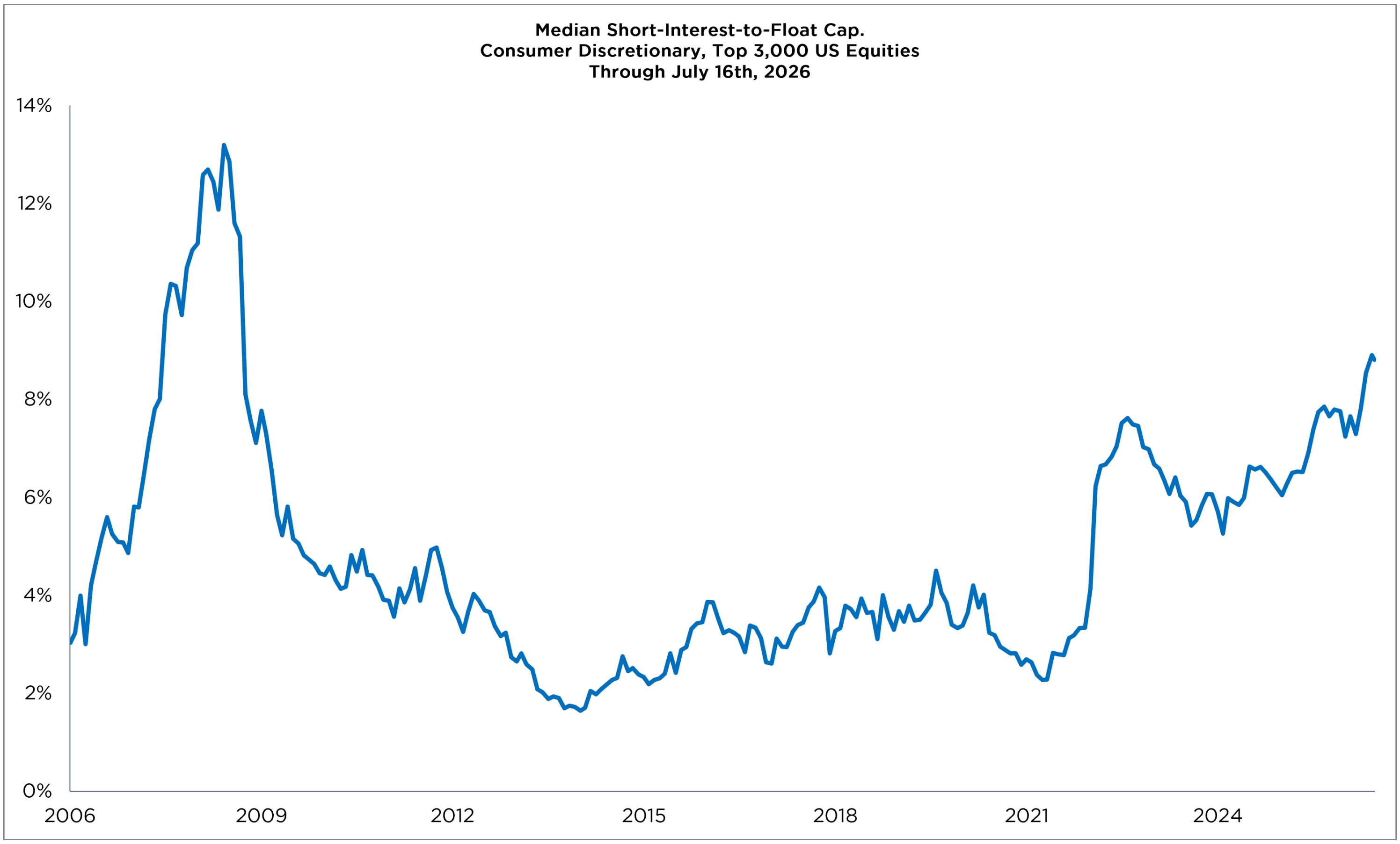
The lower-end consumer is:

- employed,
- generally current on most obligations,
- receiving improving wage growth,
- continuing to spend,
- but becoming much more price-sensitive.

From our perspective, that is **consumer adaptation**, not consumer capitulation.

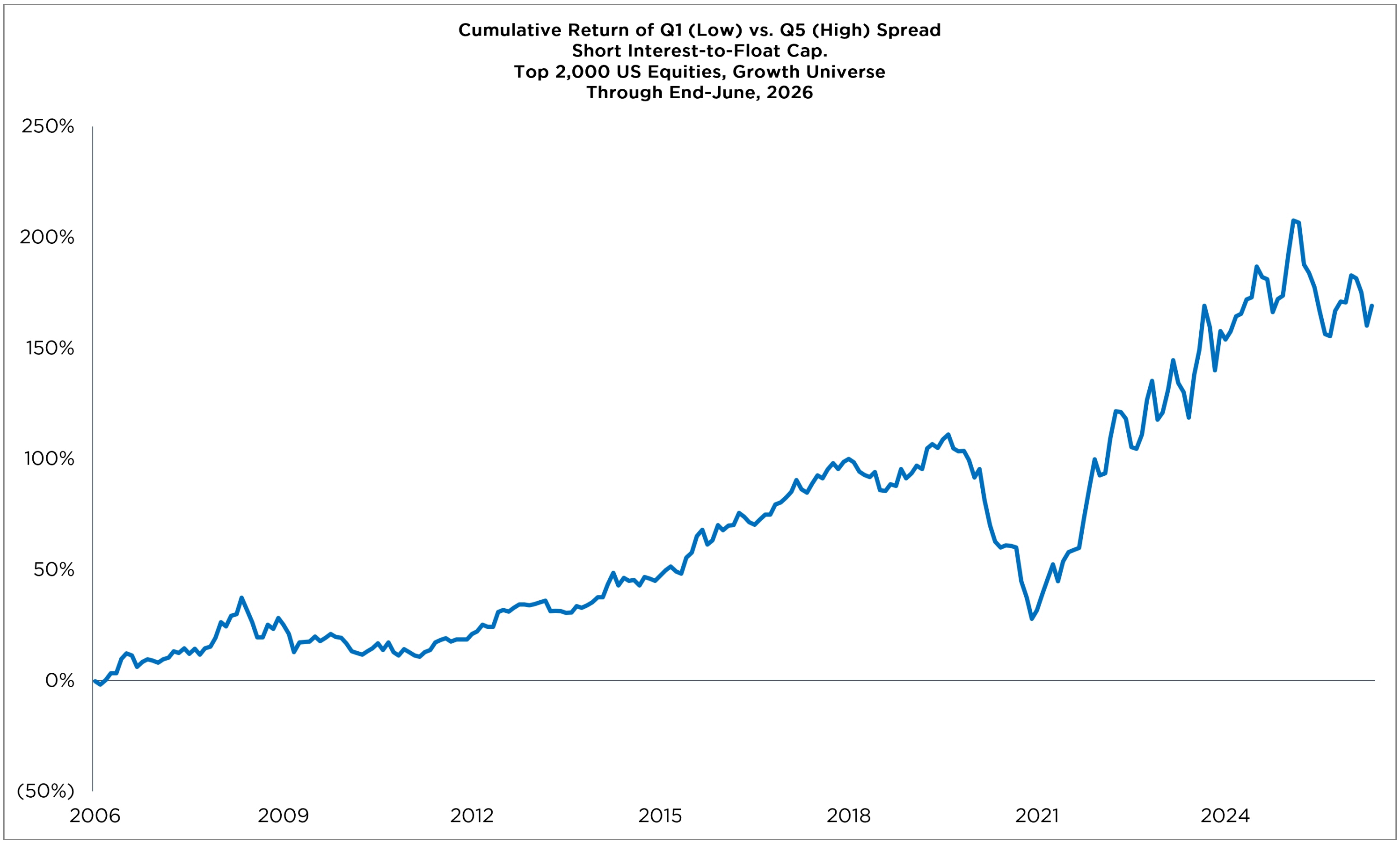
The conventional K-shaped narrative is probably **roughly half reality and half overstatement**. It accurately captures wealth inequality and affordability frustrations, but frequently exaggerates the degree of deterioration in current cash flow, creditworthiness and consumption. The better description may be a **"compressed consumer" economy**: lower-income households are pressured and trading down, but they have not broadly broken.

This observation about the US Consumer leads us to comment on the topic of short-selling. We had been recommending an underweight on Consumer Discretionary for the first several months of the year, moving to Market-Weight six weeks ago as we saw stocks react positively to the initial Hormuz-related resolution commentary. Many low-end, low-quality Consumer Discretionary stocks have high short-interest. In fact, today, we count 255 companies in the Consumer Discretionary sector among the top 3000 US public equities, and 108 of them have more than 10% short interest! Today, we have the highest percentage of heavily shorted Consumer Discretionary stocks since the Great Financial Crisis (see below).



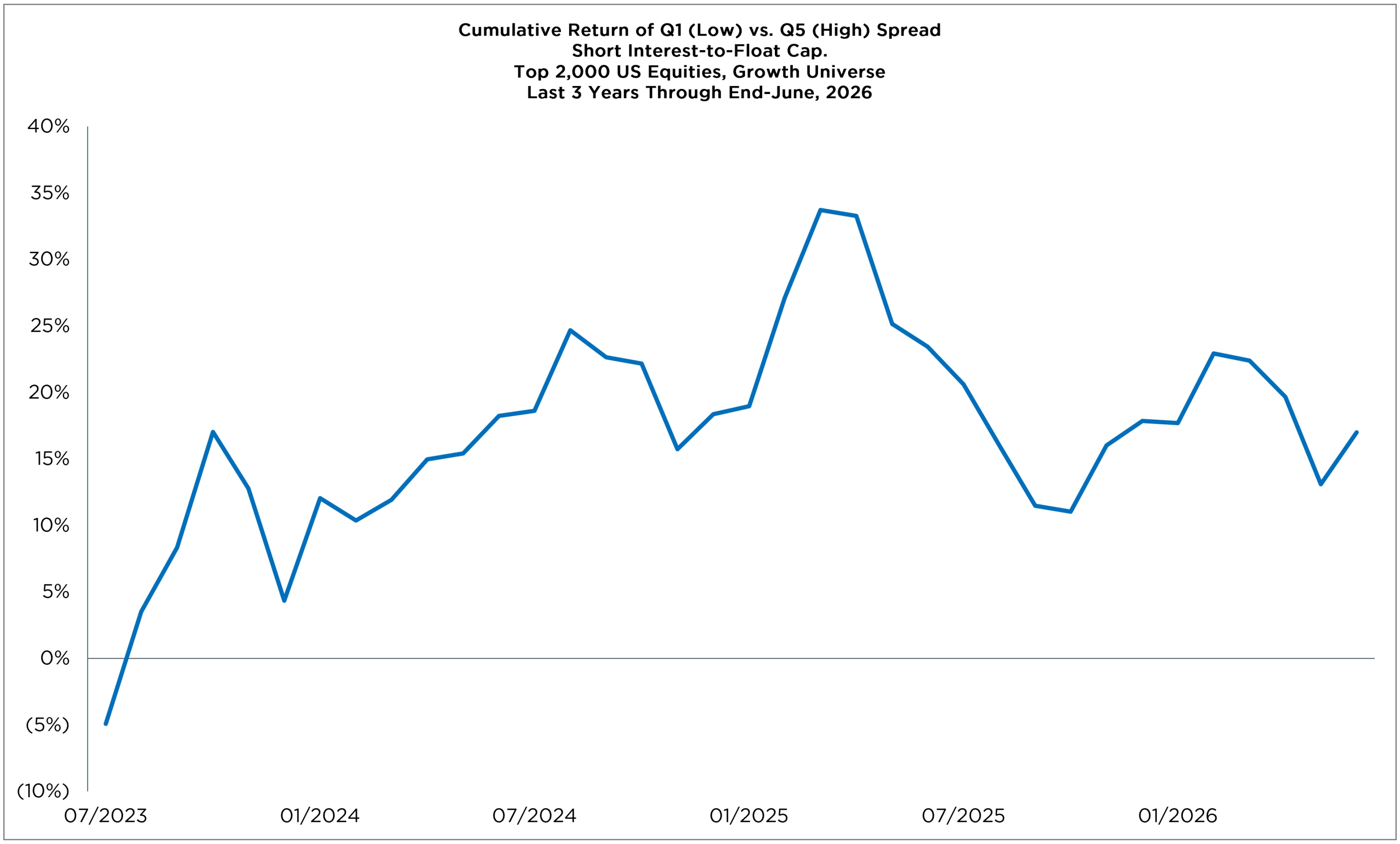
Source: Trivariate Research, LP

Issue 6: Shorting the wrong stuff: We realized this past week that buying stocks with high short interest is not as negative of a quantitative signal as it was last time we studied this in detail. We have been telling clients to be wary of buying too many stocks with above 10% short interest. The chart below shows the cumulative return an investor would derive by longing stocks with low short interest and shorting stocks with high short interest. When we last focused on this topic a few quarters ago, it seemed clear that investors could generate excess returns by avoiding high short interest stocks, as many had lagged since the post-MEME blow-up phase of 2021 (see below).



Source: Trivariate Research, LP

But when you zoom in on efficacy over the last 2.5 years, the case for long low short interest and shorting high short interest doesn't look very compelling. We told an investor last week that they should reduce the number of long ideas that have short interest above 10% in their portfolio. Recently, that doesn't seem to have much quantitative merit.



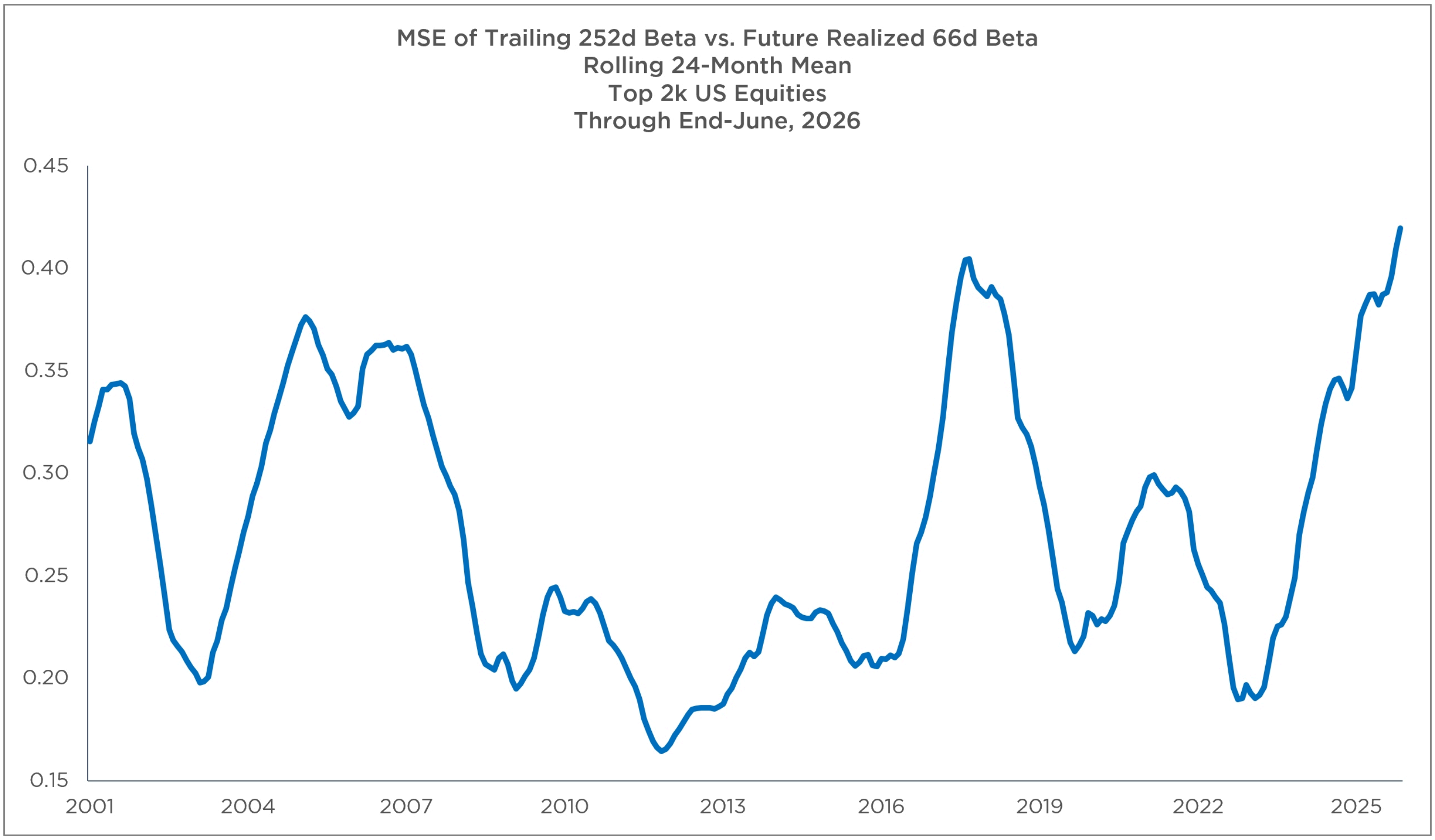
Source: Trivariate Research, LP

Investors find it to be understandably frustrating when the stocks they are short go UP on big down days. We looked at the last 76 trading days when the market was down 75bps or more, and screened for stocks on average were up in absolute terms on those days by more than 20bps. So these are SHORTS you lose money on during those big down days, or if you are long only, defensive stocks that protect capital on big down days. JNJ, KO, VZ, T, LMT, MO, SO, DUK, MCK, and CME are the largest cap. (see below).

Stocks That Average Being up >20bps on Days the Market Is Down 75bps or More Last 76 Such Down Days Through Mid-July, 2026			
Ticker	Company	Industry	Market Cap. (US $Bn.)
JNJ	Johnson & Johnson	Pharmaceuticals	620.51
KO	The Coca-Cola Company	Beverages	362.48
VZ	Verizon Communications Inc.	Diversified Telecommunication Services	178.21
T	AT&T Inc.	Diversified Telecommunication Services	149.74
LMT	Lockheed Martin Corporation	Aerospace & Defense	120.05
MO	Altria Group, Inc.	Tobacco	120.02
SO	The Southern Company	Electric Utilities	108.75
DUK	Duke Energy Corporation	Electric Utilities	98.90
MCK	McKesson Corporation	Health Care Providers & Services	95.10
CME	CME Group Inc.	Capital Markets	88.81
NOC	Northrop Grumman Corporation	Aerospace & Defense	76.96
CL	Colgate-Palmolive Company	Household Products	74.59
AEP	American Electric Power Company, Inc.	Electric Utilities	73.80
D	Dominion Energy, Inc.	Multi-Utilities	62.27
COR	Cencora, Inc.	Health Care Providers & Services	59.56
CAH	Cardinal Health, Inc.	Health Care Providers & Services	54.72
EXC	Exelon Corporation	Electric Utilities	48.18
ED	Consolidated Edison, Inc.	Multi-Utilities	41.21
WEC	WEC Energy Group, Inc.	Multi-Utilities	37.74
KMB	Kimberly-Clark Corporation	Household Products	36.57
KR	The Kroger Co.	Consumer Staples Distribution & Retail	36.34
CBOE	Cboe Global Markets, Inc.	Capital Markets	29.00
WRB	W. R. Berkley Corporation	Insurance	28.77
AWK	American Water Works Company, Inc.	Water Utilities	25.69
WTRG	Essential Utilities, Inc.	Water Utilities	10.95
ADC	Agree Realty Corporation	Retail REITs	9.43
PPC	Pilgrim's Pride Corporation	Food Products	6.78
NJR	New Jersey Resources Corporation	Gas Utilities	5.98
SBRA	Sabra Health Care REIT, Inc.	Health Care REITs	4.98
AWR	American States Water Company	Water Utilities	3.33
CWT	California Water Service Group	Water Utilities	2.99
HTO	H2O America	Water Utilities	2.61
DMC	Del Monte Corporation	Food Products	1.34
MSEX	Middlesex Water Company	Water Utilities	1.03

Source: Trivariate Research, L.P.

Issue 7: Trailing beta has never been a worse predictor of future beta: We have studied and built beta forecasting models for years, and we have found the exercise to be a challenging endeavor. However, the mean square error of trailing 252d vs. realized beta over the following 66d (for top 2,000 US Equities) has NEVER been a worse predictor (see below). Realized betas have been WAY higher. This makes it VERY challenging for a portfolio manager to run a below 1.0 beta book in reality, something we empirically showed was prudent in our work last year. That is why we continue to recommend that portfolio managers should own Semiconductors, but also to diversify into other sectors. **Today for instance, we are recommending Healthcare (the best performing sector over the last month) and Energy (the second best performing sector over the past month) - and they have served as diversification tools versus our Technology overweight.**



Source: Trivariate Research, LP

Important Disclosures

Analyst Certification

The analysts, Adam Parker, Maxwell Arnold, Chang Ge, Colin Cooney, Ryan McGovern and Jesse Goodman, 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.

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.