

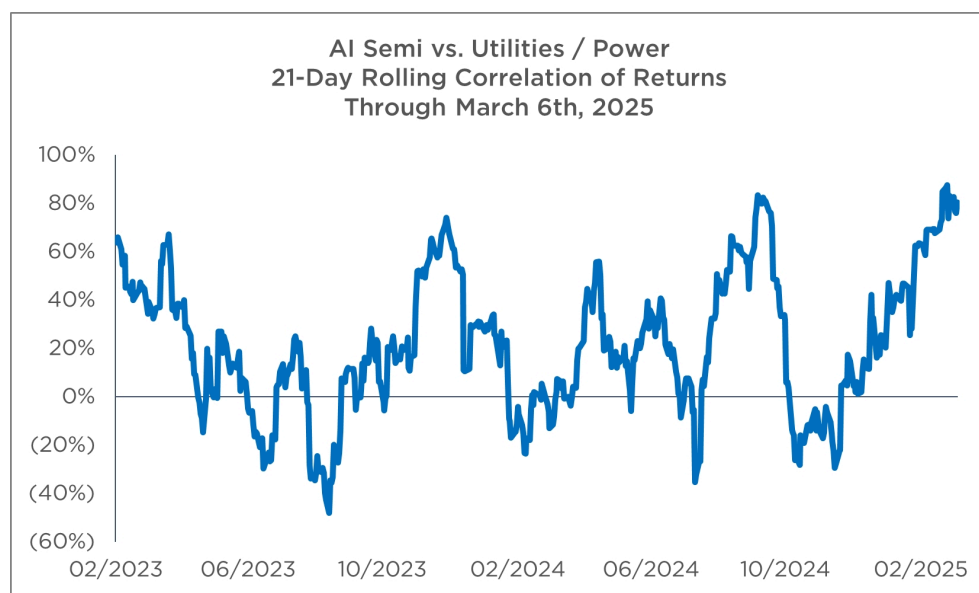
Level Set: What Should You Do If the Growth Themes Are Correlated?

Since 2023 we have identified and written about major growth themes that are poised to continue to grow above GDP for the next several years. These include widely known categories of stocks like AI Semiconductors, AI Software, Power / Utilities, and Electrification Industrials. Most portfolio managers have some or substantial exposure to these themes, as positive changes to the perception about future revenue growth are always attractive to professional stock pickers.

So far this year however, we have written several times about how the growth themes appear to be increasingly correlated, particularly on down days.

We track the rolling correlations of our custom thematic stock baskets, and found recent correlations between several of the stocks in these different thematic baskets to be at highs. Below, we show that our AI Semiconductors and Utilities / Power basket has a 21-day rolling correlation of 0.76, meaning you are not going to have much diversification from stocks that power Data Centers vs. owning the Semiconductor designers / manufacturers themselves.

Semis and Utilities are Very Correlated



Source: Trivariate Research, LP

In addition, the AI Software and Utilities / Power baskets are highly correlated. After briefly being negatively correlated in both July and October of 2024 the baskets have been highly correlated since early February (see below).

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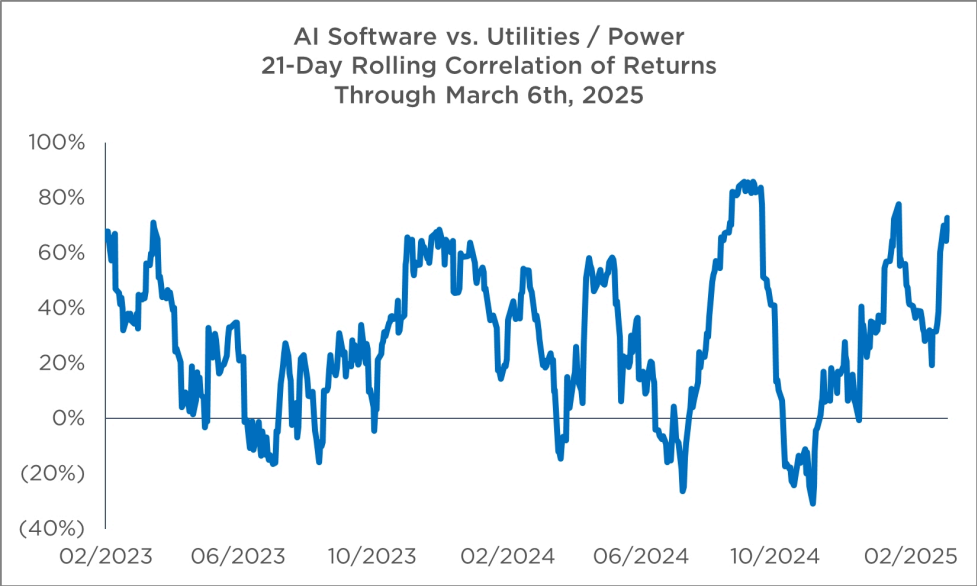
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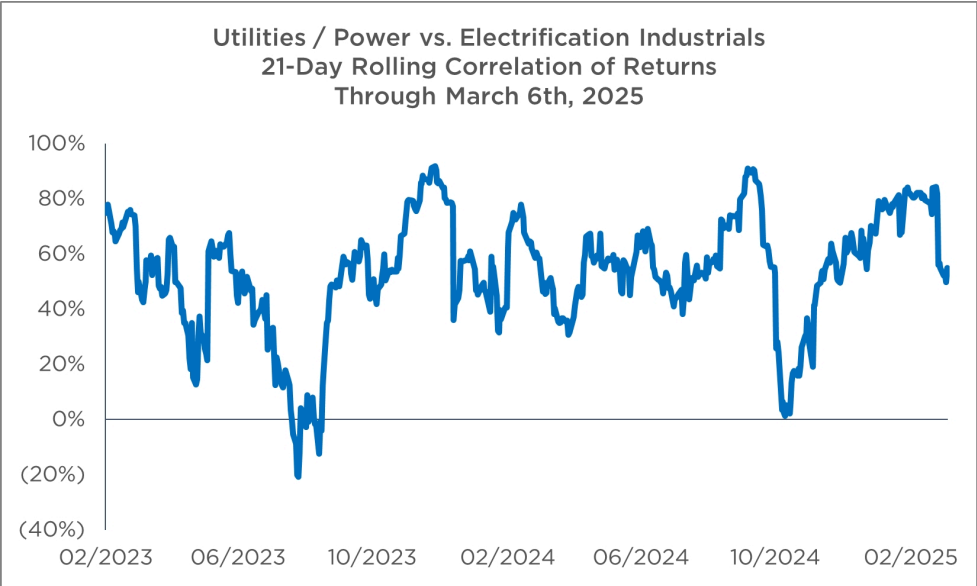
So Are AI Software and Utes



Source: Trivariate Research, LP

The Electrification Industrials and Utilities / Power baskets had a 0.84 correlation toward the end of February, though that has moderated some the last ten trading days.

Electrification Industrials Are Not Particularly Diversifying



Source: Trivariate Research, LP

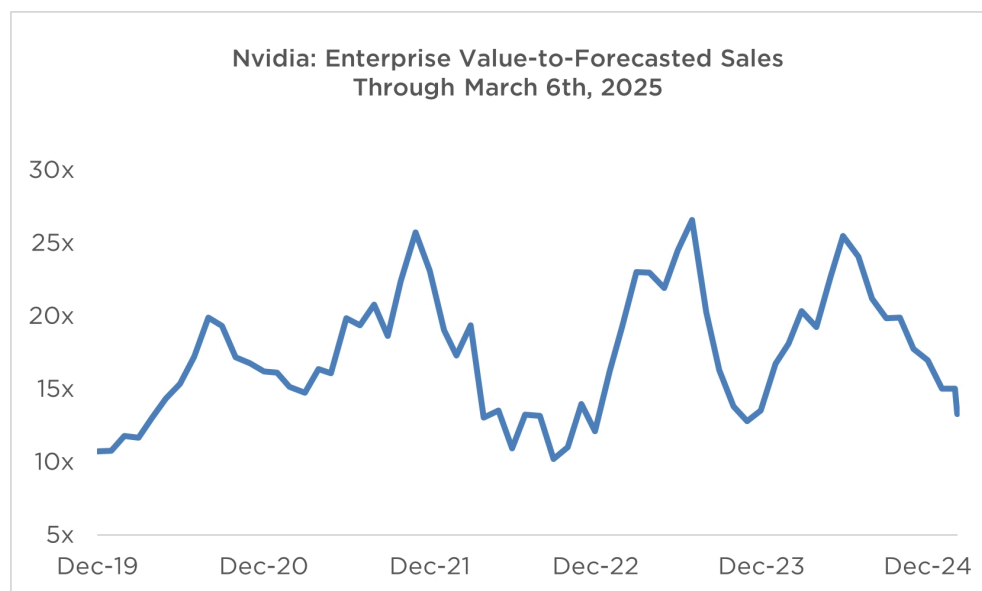
We spoke with many investors this week about their favorite stock ideas, and often, when someone pitched a stock like Eaton (Ticker: ETN) or Schneider in France, or Vistra (Ticker: VST), someone in the room would say, “Well why not just own Nvidia (Ticker: NVDA?)” This logic resonates with us that we should be comparing attributes differently when the baskets are this correlated.

If the stocks exposed to the major growth themes are going to be highly correlated, then selecting the best companies across all the correlated themes seems sensible. With that in mind, we took the basket constituents of AI Semiconductors, AI Software, Power / Utilities, and Electrification Industrials, and identified the stocks in each basket with attributes most associated with subsequent success.

CONCLUSION: We believe investors must increasingly consider risk management when it comes to stocks with exposure to the important growth themes. Given how correlated these groups of stocks are to each other today, investing in stocks with the best attributes in each theme makes more sense than just overweighting the best company in any one theme. We recommend investors size accordingly across all the themes using the lists of our favorite stocks in each basket as discussed above while keeping in mind that some of these stocks are highly correlated to each other.

AI Semiconductors: In our AI Semiconductor basket, the stocks with forecasted gross margin expansion, forecasted revenue growth above 10%, and free cash flow yield above 2% are **Broadcom (Ticker: AVGO), which put up a good quarter this past week, Teradyne (Ticker: TER), and KLA Corporation (Ticker: KLAC)**. These are our preferred AI Semiconductor names today. NVDA will likely not have gross margin expansion the next couple of quarters, so it doesn't make this quantitatively-derived list, but the stock now is getting sufficiently cheap that many investors have been asking about it. Many Technology investors attended Morgan Stanley's Technology Conference last week in San Francisco and one of the main themes that came out of the week was that capital spending plans were not at risk. AVGO's quarter last week was strong. NVDA is high beta, and that is one of the reasons we grew cautious on the Mag 7 a month ago. But, the stock is down almost 25% from earlier this year and is trading at relatively low multiples vs. its own history on price-to-forward earnings (now 24x) and on enterprise value-to-forecasted sales (below). At the same time, the sales outlook for calendar year 2025 now looks more achievable than investors feared a few weeks ago.

NVDA's Valuation Has Gotten More Compelling Even as Sales Seem More Certain



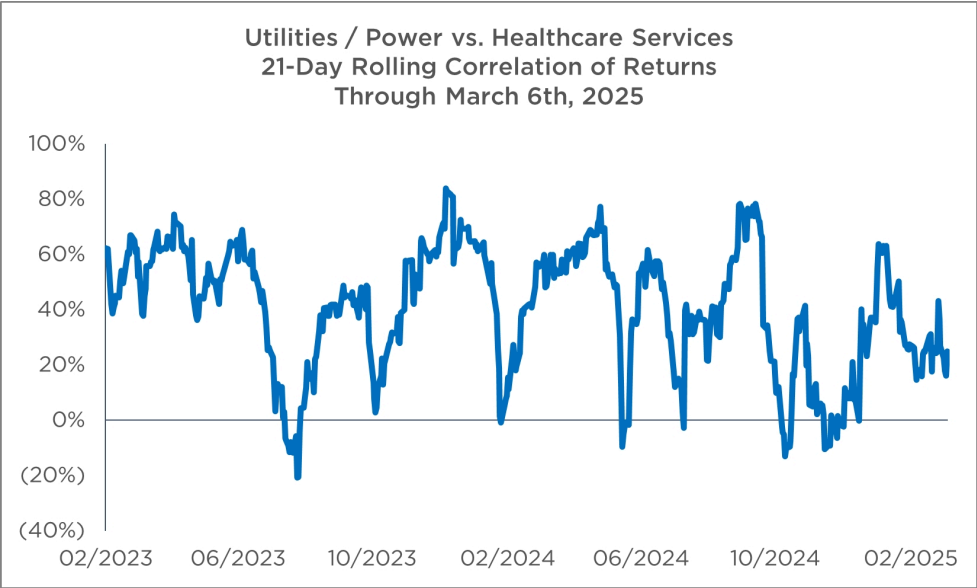
Source: Trivariate Research, LP

AI Software: In our AI Software basket, we want to avoid companies with forecasted growth that is too high. Stocks with forecasted revenue growth between 10% and 20%, with free cash flow yield above 2%, that have an enterprise value-to-forecasted sales below 10x include Microsoft (**Ticker: MSFT**), Oracle (**Ticker: ORCL**), Intuit (**Ticker: INTU**), and Elastic N.V. (**Ticker: ESTC**).

Power / Utilities: Stocks with forecasted growth above 10% and forecasted positive free cash flow yield include **VST, Quanta Services (Ticker: PWR), WEC Energy Group (Ticker: WEC), NRG Energy (Ticker: NRG), and National Fuel Gas (Ticker: NFG)**.

Electrification Industrials: Stocks with forecasted revenue growth above 5%, free cash flow yield above 3%, and forecasted gross margin expansion include ETN, nVent Electric (Ticker: NVT), Generac (Ticker: GNRC), Federal Signal Corp. (Ticker: FSS) and Bluebird Corp. (Ticker: BLBD).

For investors that want growth exposure that has a lower correlation to the above themes, both our Housing / Building Products and Healthcare Services baskets might make sense. For example, the rolling correlation between the Utilities / Power basket and our Healthcare Services basket is below 0.2 today (see below). For stocks in these baskets or others, please reach out.



Source: Trivariate Research, LP

Important Disclosures

Analyst Certification

The analysts, Adam Parker, Maxwell Arnold, Colin Cooney, Chang Ge 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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