Level Set: Literally, Just That - Let's Level Set

Our thoughts for this year were out of consensus on January 6th, 2025 when we published our 2025 Year-Ahead Outlook we said (excerpted below):

"New policies not bullish?: We think investors have too benign an interpretation of potential new policies and their impact on US earnings….we have not seen stocks sell off on the specter of tariffs, the stronger dollar, or other potentially volatility-introducing policies articulated by the Trump team. It could be challenging for CEOs to optimize US / non-US hiring, and they may see a fall-off in demand as they attempt to raise pricing.

CONCLUSION: Given the market run, we think it is likely the market will correct in the first half of 2025. Earnings growth is plateauing. Our judgment is that the risks are skewed toward the downside for the S&P500 in the first half of the year."

Where are we now, on April 6th, 2025:

1. **Worse than we thought:** The tariff rates announced by the Trump Administration are definitely worse than we expected, though we admit we didn't think that much about the exact percentages earlier in the year. Ex-post we recall thinking 10% tariffs were possible, but reading about 30% plus tariffs from China is certainly more than we fathomed.
2. **2nd derivative is about to improve:** But now our view as of this weekend is that it is likely that the worst of the tariff news is out there, and that the second derivative of news on tariff rates may be going positive. The administration will likely want to claim some small victories, such as Vietnam asking to postpone tariffs and engage in negotiations on Friday.
3. **China matters the most:** The US GDP is more than 10x the size of both Canada and Mexico, ergo *pro rata* trade wars with those countries will clearly make them relative losers. We were seated next to the former Commerce Secretary at a dinner earlier this month when he expressed sentiment that while a sustained trade war seemed unlikely, it was his sense that President Trump had fewer people close to him that were likely to constrain some of his more fringe impulses than he had during his first term. In the end, this seems most about China, and the duration and magnitude of the trade war with that country is still uncertain. Uncertainty means lower multiples, and it means many management teams will have trouble guiding for Q2 when they report Q1 earnings in the next three weeks.
4. **A year of earnings growth lost:** It seems to us that a reasonable way to think about this so far is that one-year of S&P500 earnings growth is gone. The current bottom-up consensus EPS expectations (see below) are for $268.70 in EPS in 2025, up 9.6% from the 2024 EPS of $245. Most investors no longer believe those numbers, with $250 (1% above 2024) probably a new base case. Let's say that the 2025 EPS is $250, and then it grows 8.6% from there, in line with the long-term average. In essence, what has happened is one-year of S&P500 earnings growth has been removed by the contagion from the tariffs, and we expect the consensus 2026 EPS will be roughly in line with the actual 2027 EPS (see below).

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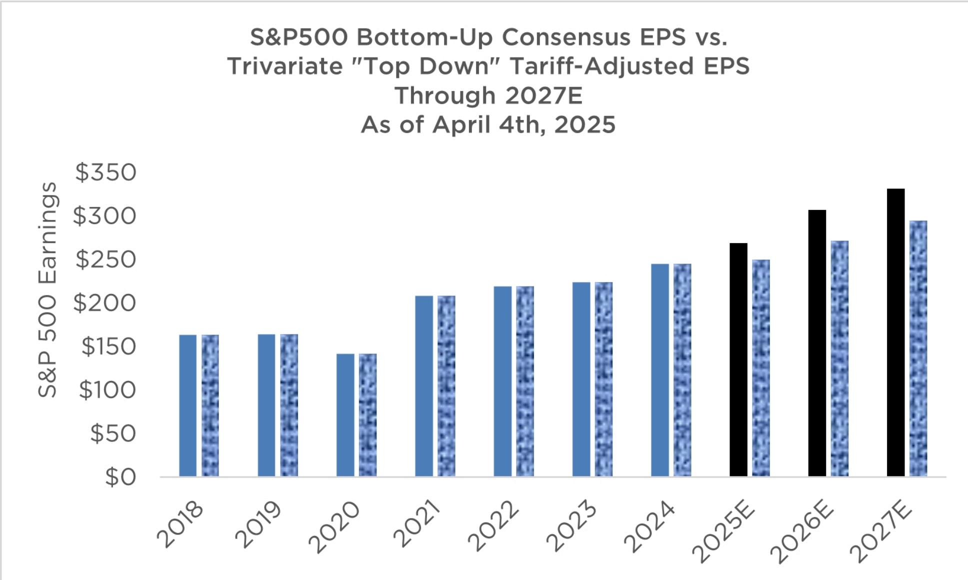
Our Assumption Is One Full Year of EPS Growth Has Been Lost

Consensus in Blue and Black, Trivariate Shaded Bars



Source: Trivariate Research, LP

Now some investors might say — couldn't earnings be down in absolute terms? It is definitely possible, but when we check the net income dollars of the top 20 names in the market, (which are currently over 25% of net income and 45% of the S&P500 market cap.) it seems unlikely to be that severe without a meaningful recession. At present, the total net income dollars of this group would have to be reduced by more than 11% for this to happen — and that doesn't account for share buybacks. Accordingly, we think flattish year-over-year 2025 vs. 2024 growth is a punitive, but plausible base case assumption.

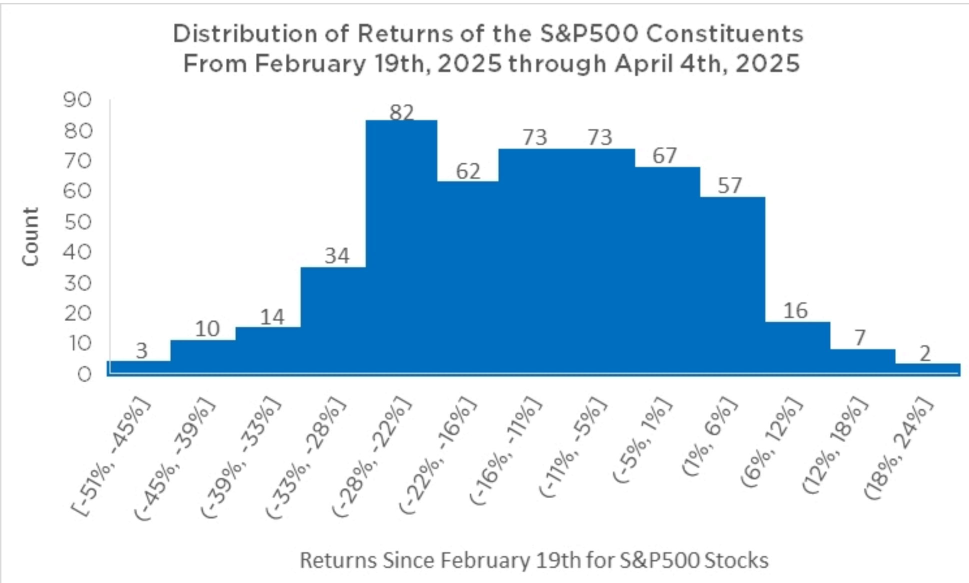
The Top 20 Companies

Consensus EPS Growth Expectations Through April 4, 2025				Net Income Dollar			
Ticker	Company	Sector	Market Cap. (US$ T.)	2024	2025E	Net Income Increase	2025 YoY EPS Growth
NVDA	NVIDIA Corporation	Information Technology	2.48	74.3	110.2	36.0	48.4%
MSFT	Microsoft Corporation	Information Technology	2.77	92.8	102.9	10.1	10.9%
GOOGL	Alphabet Inc.	Communication Services	1.85	100.1	109.8	9.6	9.6%
LLY	Eli Lilly and Company	Health Care	0.71	11.7	20.9	9.2	78.2%
AMZN	Amazon.com, Inc.	Consumer Discretionary	1.89	59.2	68.2	9.0	15.1%
AVGO	Broadcom Inc.	Information Technology	0.72	26.3	33.9	7.6	29.0%
AAPL	Apple Inc.	Information Technology	3.05	106.4	112.0	5.6	5.3%
META	Meta Platforms, Inc.	Communication Services	1.35	62.4	65.2	2.8	4.5%
NFLX	Netflix, Inc.	Communication Services	0.39	8.7	10.7	2.0	23.0%
V	Visa Inc.	Financials	0.66	20.9	22.7	1.8	8.7%
UNH	UnitedHealth Group Incorpora	Health Care	0.49	25.7	27.4	1.7	6.5%
JNJ	Johnson & Johnson	Health Care	0.39	24.2	25.5	1.3	5.3%
TSLA	Tesla, Inc.	Consumer Discretionary	0.86	8.4	9.4	1.0	11.9%
MA	Mastercard Incorporated	Financials	0.48	13.5	14.3	0.7	5.5%
COST	Costco Wholesale Corporation	Consumer Staples	0.43	7.4	8.2	0.7	9.9%
PG	The Procter & Gamble Compar	Consumer Staples	0.40	16.6	17.3	0.7	4.4%
WMT	Walmart Inc.	Consumer Staples	0.70	20.3	21.0	0.7	3.5%
BRK.B	Berkshire Hathaway Inc.	Financials	1.14	47.4	45.4	(2.0)	(4.3%)
XOM	Exxon Mobil Corporation	Energy	0.49	33.5	31.3	(2.1)	(6.3%)
JPM	JPMorgan Chase & Co.	Financials	0.64	56.9	50.7	(6.1)	(10.8%)
TOTAL			21.91	816.80	907.12	90.32	

__About a year of lost growth is currently discounted:__ If that's the case, then the current market downturn, as of Friday's close, appears to be appropriately adjusted for a year of lost earnings. Since the S&P500 peaked on February 19th, 96 of the companies are up in absolute terms, but only 12 stocks (2.4% of the universe) are up 10% or more. On the contrary, 284 of the S&P500 stocks are down more than 10%, 233 (or nearly half) the S&P500 is down more than 15%, and 171 stocks are down more than

20% since February 19th. See the distribution of returns since the market peak below. In our judgment, this is a full year of returns that have been removed from the market — about commensurate with a full year of earnings.

171 Stocks in the S&P500 Are Down More than 20% Since February 19th



Source: Trivariate Research, LP

Below we show the ten worst performing stocks in the S&P500 since February 19th, including Super Micro (Ticker: SMCI) down 50.5%, Constellation Energy (Ticker: CEG) down 46.8%, and United Airlines (Ticker: UAL) down 45.9%.

Worst Performing Stocks in the S&P500, February 19th through April 4th, 2025							
Ticker	Company	Sector	Style	Substance	Market Cap. (US $ Bil.)	Price-to-Forward Earnings	Performance Since 2/19
HPE	Hewlett Packard Enterprise Company	Information Technology	Value	Junk	17.97	7.6x	(41.0%)
NCLH	Norwegian Cruise Line Holdings Ltd.	Consumer Discretionary	Neither	Junk	7.18	7.8x	(41.9%)
VST	Vistra Corp.	Utilities	Neither	Junk	36.68	15.2x	(42.0%)
DAL	Delta Air Lines, Inc.	Industrials	Value	Junk	24.84	5.5x	(42.6%)
MCHP	Microchip Technology Incorporated	Information Technology	Neither	Junk	21.89	30.7x	(42.6%)
WDC	Western Digital Corporation	Information Technology	Value	Low Quality	11.88	6.9x	(43.5%)
EPAM	EPAM Systems, Inc.	Information Technology	Growth	High Quality	8.85	14.6x	(44.0%)
UAL	United Airlines Holdings, Inc.	Industrials	Neither	Low Quality	19.72	4.9x	(45.9%)
CEG	Constellation Energy Corporation	Utilities	Value	Junk	59.60	20.5x	(46.8%)
SMCI	Super Micro Computer, Inc.	Information Technology	Growth	Junk	19.18	9.3x	(50.5%)

Source: Trivariate Research, LP

The best performing stocks since the market high on February 19th include Dollar General (Ticker: DG), Molina Healthcare (Ticker; MOH), and American Tower (Ticker: AMT). As we are typing this, we are tempted to check if Congressperson Pelosi was long DG and short SMCI during the quarter.

Best Performing Stocks in the S&P500, February 19th through April 4th, 2025							
Ticker	Company	Sector	Style	Substance	Market Cap. (US $ Bil.)	Price-to-Forward Earnings	Performance Since 2/19
DG	Dollar General Corporation	Consumer Staples	Value	Junk	20.77	17.2x	22.5%
MOH	Molina Healthcare, Inc.	Health Care	Growth	Low Quality	19.60	14.4x	20.9%
AMT	American Tower Corporation	Real Estate	Growth	High Quality	106.67	35.9x	16.8%
AWK	American Water Works Company, Inc.	Utilities	Value	Mid Quality	29.63	26.7x	15.1%
CCI	Crown Castle Inc.	Real Estate	Value	Low Quality	46.62	175.9x	14.8%
ED	Consolidated Edison, Inc.	Utilities	Value	Mid Quality	39.80	20.0x	14.8%
MCK	McKesson Corporation	Health Care	Growth	High Quality	89.85	19.4x	13.5%
COR	Cencora, Inc.	Health Care	Growth	Mid Quality	56.11	18.7x	13.4%
NOC	Northrop Grumman Corporation	Industrials	Neither	Mid Quality	74.57	18.3x	12.5%
SJM	The J. M. Smucker Company	Consumer Staples	Value	Low Quality	12.59	11.4x	11.8%

Source: Trivariate Research, LP

Common questions: The most common questions we got last week were:

What is the administration thinking? We have no differentiated intelligence here. We did see a story going around about Secretary Bessent potentially trying to influence Trump to be more moderate intra-day on Friday, but then came the inevitable levered ETF rebalancing late in the day on Friday, causing stocks to fall through the trap door! Obviously the “Trump Put” was not at prices the consensus anticipated. Most historians do not think a sustained trade war is prudent. Many think that President Trump needs all the Republicans to get his tax bill passed, and that he likely is close to declaring some success and brokering some more moderate tariff deals or language, while declaring broad success, in the coming weeks.

The bull case? As such, there were some investors trying to time a bottom as policy shifts later this quarter to taxes, regulation, green shoots in deal-making, lower interest rates to fuel housing, lower oil prices to help the consumer offset inflation elsewhere, and success stories in terms of margin expansion and productivity from AI, and other bullish thoughts that were abundant in November and all but dead this week. The thesis is that President Trump is going to shake things up, and if something breaks, he will pivot or stop. Some investors we talked to think both Republican Congress and people of influence (i.e., wealthy contributors) might be getting annoyed. According to Bloomberg’s RICH GO feature, the**top ten richest people have lost more than one-third of a TRILLION dollars so far this year.** Many of them, from our recollection, appeared to have better seats during President Trump’s Inauguration than Second Lady Usha Vance.

Rich People Change in Net Worth YTD Through April 4th, 2025			
Name	Company	Worth in US $ Bil.	Change in Net Worth YTD
Elon Musk	Tesla	302.2	(130.3)
Jeff Bezos	Amazon	193.5	(45.2)
Mark Zuckerberg	Meta	179.2	(28.1)
Bernard Arnault	LVMH	157.7	(18.6)
Bill Gates	Microsoft	155.3	(3.4)
Warren Buffett	Berkshire	154.8	12.7
Larry Ellison	Oracle	133.8	(42.1)
Larry Page	Google	133.7	(34.6)
Steve Ballmer	Microsoft	127.0	(19.5)
Sergey Brin	Google	126.0	(32.3)
TOTAL TOP TEN		1663.2	(341.4)

Source: Bloomberg RICH GO, Trivariate Research, LP

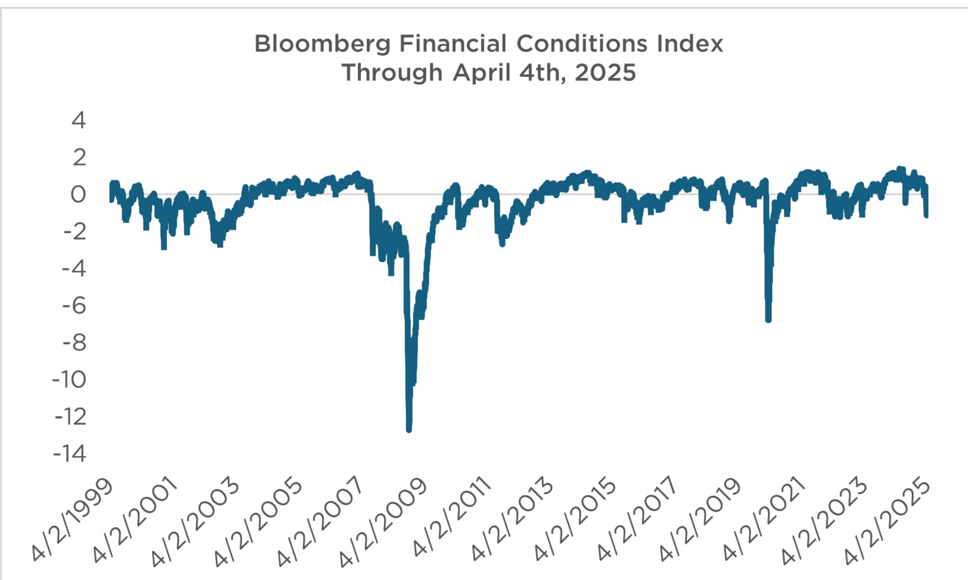
What is the Fed thinking? It is not a secret that Chair Powell and President Trump do not like each other. But we are not sure this matters. In our view, the Fed cutting the front end one or two more times doesn’t really help consumer demand or corporate capital spending plans, which are the items we need evidence of to feel comfortable that excessive damage hasn't already been done.

From Trivariate Research's 2025 Year-Ahead Outlook, January 6th, 2025:

"We learned from the last cycle that the market began discounting the next cycle once the Fed was halfway done hiking. We think that the Fed is close to halfway done cutting this cycle, and we don't think it will be incrementally positive if they keep cutting like it was earlier in the cycle. The time to start fighting the Fed is in Q1."

<u>Today:</u> We think the Fed is more than halfway done cutting, and incremental dovishness now won't be perceived as great accommodation that drives multiple expansion, but rather a sign the economy is slowing more materially than previously anticipated. That, likely, is not rewarded by the market.

What are you watching to gauge the damage and the amount of remaining downside? If we are right that the second derivative of tariff news begins to move positively, the remaining key investment controversy is how much damage has been done to the real economy and when will conditions improve. We have always liked to track 90-day credit card delinquencies to see if the consumer is really starting to get taxed. However, the data are one-month lagged and the end-February 2025 data point showed only a modest tick higher to 0.74%. We also like to focus on real-time friction gauges like the VIX and Financial Conditions. Below we show the Bloomberg Financial Conditions Index. While conditions got materially tighter late this week, they are only about 40% of the way to the COVID bottom. Our sense is that a full-on and sustained Trade War would still not be as extreme as COVID, given we were all afraid for our LIVES, not just equity returns, during the peak of that crisis. If we assume this gets "half as bad" as COVID, we are likely 2/3rds of the way there on tightening conditions. <u>**If this translated one-to-one to the equity market, admittedly a pretty loose assumption, this would imply 6-7% more downside for the market.**</u>



Source: Bloomberg BFICUS, Trivariate Research, LP

<u>**Th**e VIX</u> rocketed from $21.51 to $45.31 from Wednesday's to Friday's closes last week. This $45.31 level represents the 98.8 percentile raw value for the VIX on a daily basis in the last 35 years. On this gauge, the recent price action in the VIX is slightly more extreme than last week's movement in the Financial Conditions gauge, as the 50.9% increase of the VIX on Friday happens only about 1/10th of one-percent of the time historically.

<u>**Investment Ideas:**</u>

1. <u>**Risk-reward negative, but maybe a shade less so:**</u> We continue to think the risk-reward is skewed to the negative, as we highlighted not only in our year-ahead outlook but also in our last few weekly Level Sets. More and more strategists are lowering their price targets. They for now have an excuse as to why they were wrong, and can blame it on the "drive by shooting" of policy. The truth is conditions were slowing PRIOR to, or perhaps in anticipation of this possibility. While we LOVE the idea that we could be contrarian bulls again — that worked swimmingly in 2023 and 2024 – we just can't see

why the first part of earnings season will be anything but weak. Companies can't gauge their customers' capital spending, their end consumers' demand, or how their inventory or backlog will change in the near-term. Moreover, we have not seen any evidence recently that this is in the price, meaning stocks that miss or guide down are not outperforming. As such, we would remain cautious.

2. **Where is relative estimate achievability best now?** Healthcare, where demand is steady; Metals, where underlying prices are largely up year-to-date and the stocks have gotten shattered, and select Utilities, and Consumer Staples.
3. **Earnings Season pair-trading idea:** We like the idea of pair-trading around when companies report their Q1 earnings. For instance, companies that report and guide poorly early in the earnings season are more likely to perform poorly as the market initially gets a feel for how much Q2 numbers need to fall. Stocks in correlated businesses tend to also decline in sympathy, but typically less than the company that reported. As earnings season is two-to-three weeks old, it is increasingly hard to surprise the market with negative results, and often companies that report end-March results in early May, benefit from their "tardy" report. Our suggestion is in certain cyclical industries like Semiconductors and Machinery that investors should long companies that report later in the EPS season and short those that report earlier. How's that for a non-traditional investment idea?
4. **Consumer short ideas:** We have been correct to recommend the Consumer Discretionary sector as our biggest underweight year-to-date. The sector is down 20.69%, vs. the market down 13.73%. Our initial idea was to recommend shorting low growth retailers with impaired business models, like Target (Ticker: TGT) and Kohl's (Ticker:KSS), or heavily indebted consumer companies. There are 51 Consumer Discretionary companies down more than 30% year-to-date, and the average net debt-to-market cap of these companies is 119%, vs. 34% for the 25 Consumer Discretionary stocks that are up year-to-date. Leverage clearly mattered in phase 1 of the sell-off. As we think about stocks that could incrementally sell off going forward we are increasingly thinking it is the Consumer Discretionary stocks that trade at high multiples where growth appears to be particularly vulnerable to a correction. After all, lower multiples on lower earnings is the goal of good short ideas. In addition to the below screen, we want to be short "Travel" as we think data points could surprise to the downside. We added Booking.com (Ticker: BKNG) at 22x forward earnings, as another idea to short.

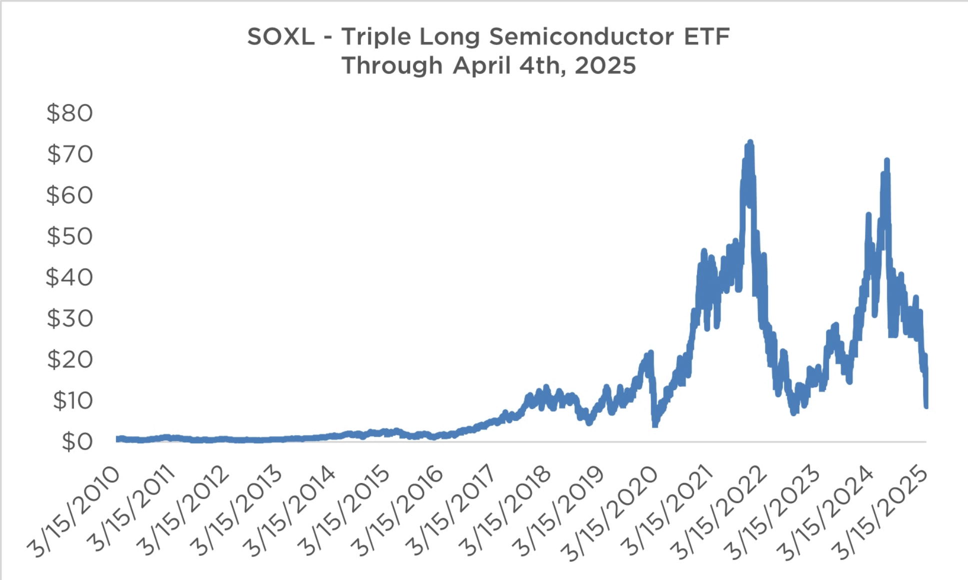
Expensive Consumer Discretionary Stocks

Consumer Discretionary Stocks that Are Expensive on Price-to-Forward Earnings
As of April 4th, 2025

Ticker	Name	Market Cap. (US$ Bil.)	Price-to-Forward Earnings	Forecasted Revenue Growth	Year-to-Date Performance
BROS	Dutch Bros Inc.	6.61	94.8x	23.5%	(1.8%)
CPNG	Coupang, Inc.	38.75	66.9x	13.6%	(8.6%)
WING	Wingstop Inc.	6.96	65.1x	17.5%	(18.1%)
DUOL	Duolingo, Inc.	14.20	53.8x	30.4%	(9.6%)
CVNA	Carvana Co.	24.37	51.4x	20.2%	(20.2%)
MMYT	MakeMyTrip Limited	10.55	46.7x	27.9%	(22.4%)
MELI	MercadoLibre, Inc.	98.63	40.6x	24.2%	8.4%
CMG	Chipotle Mexican Grill, Inc.	67.88	39.0x	11.6%	(21.5%)
H	Hyatt Hotels Corporation	11.08	36.4x	110.9%	(30.1%)

Source: Trivariate Research, LP

1. **M&A beneficiaries:- we have been wrong:** We have been totally wrong about this group. We wrote late in 2024, that these were stocks that had performed well and that would actually see a fundamental follow-through, hence meriting their big moves post-election. Our apologies. Our friends who work at major law firms doing deals are quite busy, but we now can't see how there will be a short-term recovery. Deals are being downsized (Coreweave) or delayed (Klarna). **Prospectus now, and IPO later.** Even though these stocks are trading way below the levels we previously liked them, we would cut bait, as we now no longer see April as a period of potential optimism.
2. **Semiconductors work in a recovery:** We analyzed the 3-month performance of stocks AFTER the last twenty times the market went down 10% or more. In 19 of those 20 times, Technology was up in absolute terms, and on average, Technology was the best performing sector. We are not sure when taking risk makes sense, but if it turns out to be by Q2 earnings season, our current best guess is we will get bullish on Semiconductors. We will be doing more work on the sector soon, but we will leave you with the below chart as our current rationale. The sector is cyclical. SOXL was $68 in July of 2024. It closed at $8.73 on Friday. It bottomed 50% lower in COVID from here. We aren't there yet - but it is getting close.



Source: Trivariate Research, LP

Important Disclosures

Analyst Certification

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