TRIVARIATE RESEARCH

US Equities
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Level Set — Which Plague Is This? Our Top 5 Long and Short Ideas Now

We are less optimistic about the US equity market now compared to last week.

Our updated view is a combination of sustained tariffs of 10% on many countries for 90 days (maybe) and an escalation to a triple-digit percentage tariff war with China. We'd love to tell you we have some way to estimate the likely resulting damage to earnings and the next move coming from the White House. The truth is we have no idea. We don't understand the tariff plan or the path with China. Given that the market and uncertainty are both up, we like risk-taking less today than we did a week ago.

Our best guess so far is that a year of earnings growth has been removed, and our former 2026 earnings estimates are now our 2027 earnings expectations. But after several meetings with institutional investors in the US and Canada last week, it is apparent to us that a growing number of investors are concerned that earnings could be down in 2025 vs. 2024, **an**d that an S&P500 level of $4300-$4600 is likely the bottom. That appears to be where the consensus view is at the current moment. We think that is overly punitive based on what we know now, but in the range of outcomes.

Importantly, we don't see an eventual V-shape fundamental recovery. Our slightly more negative view comes from a growing realization that when we eventually do have an economic and fundamental recovery, it is unlikely to be "V-shaped." Investors in the last few crises, whether COVID in 2020 or the Financial Crisis in 2008, have been programmed to believe that there will be sharp recoveries following sell-offs. **This time we aren't so sure.**

Firstly, the Fed's dual mandate of full-employment and stable pricing will be challenged by the fact that both unemployment and prices for certain products will likely rise. That might make it harder for the Fed to articulate a clear data-dependent plan. We are not positive that multiples will expand if the perception about the Fed Fund Rates goes lower 2-years from now. Below, we show the price-to-forward earnings of growth stocks and the relationship with changes in the perception about interest rates. There are times when this relationship is statistically significant (perceived higher rates are bad for multiples, like in 2022, and perceived lower rates are good for multiples, like in 2023), and other times when the relationship the exact opposite (see below). Right now, the correlation is the opposite of what it was in 2022. This implies that if the perception is that the Fed Funds Rate will be lower in 24 months, the price-to-forward earnings will actually be LOWER. This makes some sense to us, as at this point an incrementally accommodative Fed probably might now be perceived as the result of a deteriorating economy that likely portends a continued decline in the trajectory of corporate earnings not just a positive for multiples. Today, these relationships between lower (higher) perceived rates and lower (higher) price-to-forward earnings for growth stocks is statistically significant (see below).

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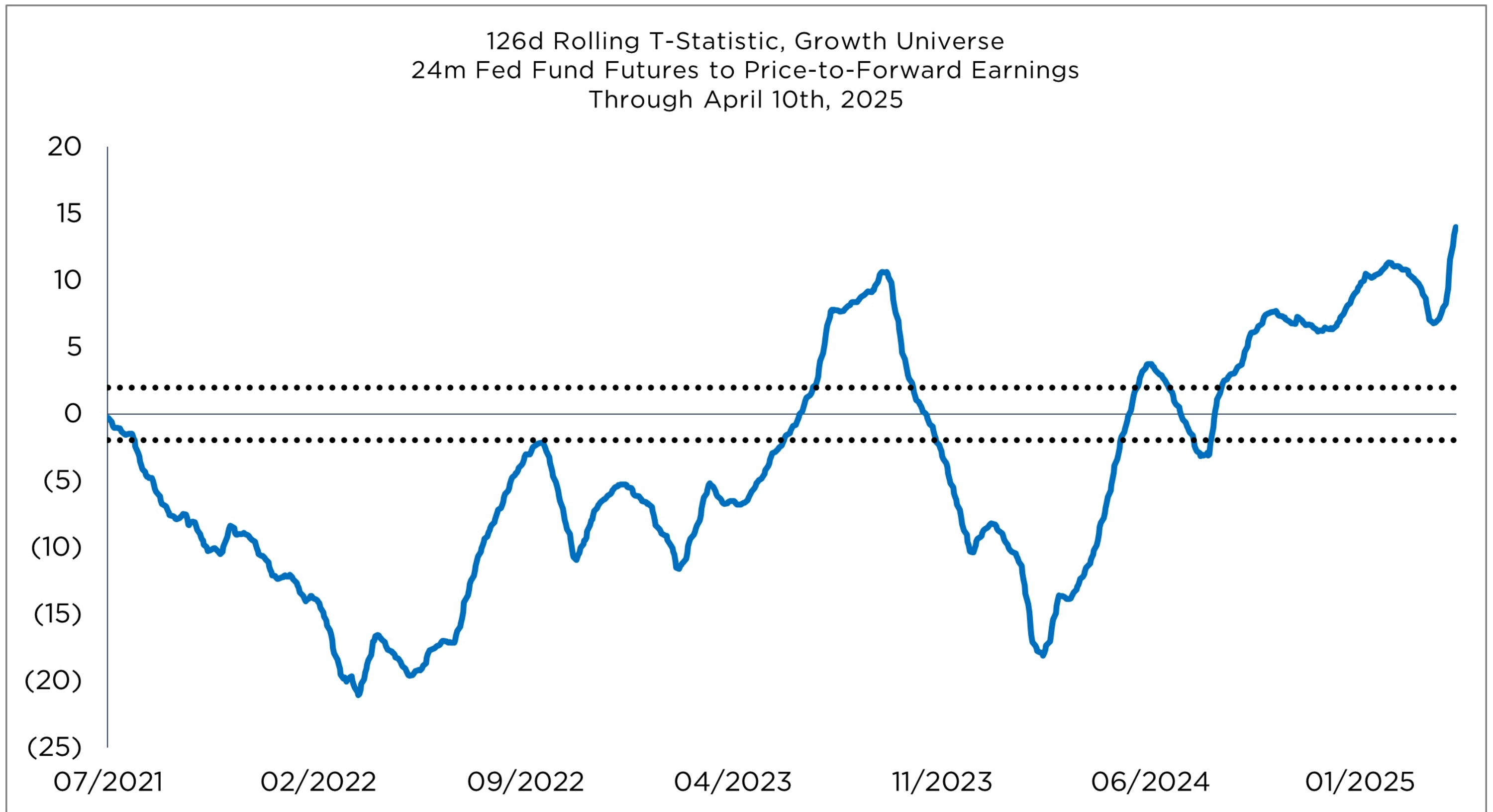
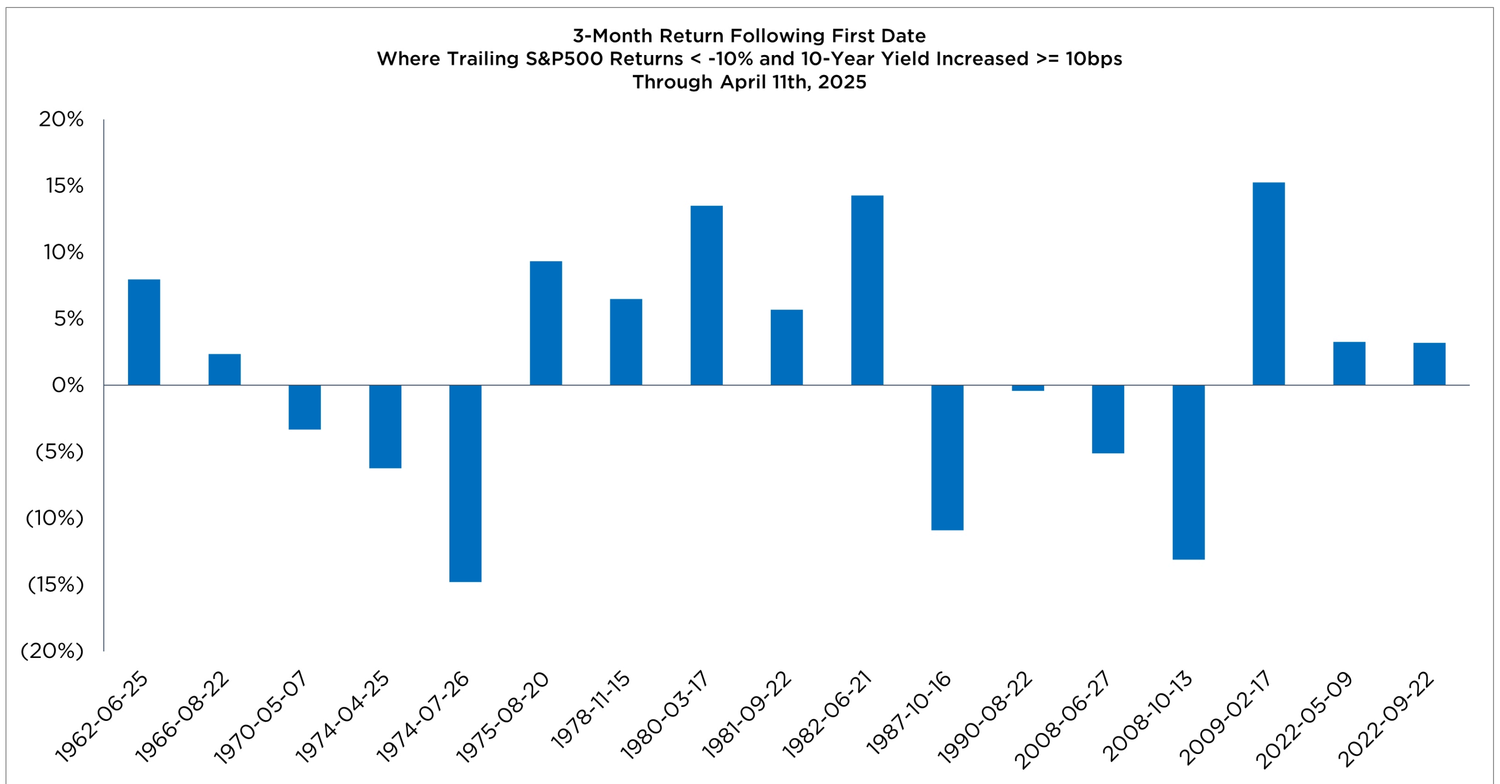
Could the Market Go Down When the Fed Cuts?



Source: Trivariate Research, LP

In addition to the potential for the front end accommodation to not cause multiple expansion, there also appears to be a lower-than-normal probability that the Fed engages in balance sheet expansion in the near future. In the past, we studied the week-over-week relationship between changes in the Fed Balance Sheet (data each Wednesday) and the week-over-week change in the S&P500, and found the relationship was strongly statistically significant. But balance sheet expansion doesn't appear imminent. It seems obvious the relationship between President Trump and Chairman Powell isn't chummy, and the Fed isn't discussing using the balance sheet in this environment. Lastly, helicopter money or other incremental fiscal stimulus doesn't seem as potentially likely today as in earlier periods, as it's antithetical to "DOGE." So, front-end monetary stimulus may not be rewarded, balance sheet expansion and fiscal stimulus are not imminent, yet all were simultaneously present during most prior recoveries. **Hence, a V-shape recovery economically without incremental monetary and fiscal stimulus feels less plausible to us now than it did in previous cycles. Our judgment is to assume any damage that has already or will result from the tariffs won't quickly work its way back into corporate earnings.**

Relationship between stocks and bonds: Several investors asked this week about the weaker US dollar and the back-up in bond yields, questioning why that was occurring coincident with the weaker US equity market. In actuality, the market closed much higher week-over-week, but nonetheless to investigate the history of this medium-term incongruity we looked at the contemporaneous 30-day return of the S&P500 and the 10-year yield. **Going back to data back to 1962,** there have been 17 distinct periods and 151 trading days out of 15,668 (or 0.96%) where the trailing 30-day return of the S&P500 was < -10% and the 10-year yield increased by at least 10 bps. **So this is rare, but certainly not unprecedented.** Is this a bull or a bear signal? With the sample size of 17, the answer is — we don't know. The average price return for the 3-month period following the first date this correlated stock-bond trend occurred is 3%, with 10 of the 17 periods up in absolute terms. To us, this is close to what quarterly returns look for periods where stocks and bonds weren't correlated in this unusual way (see below). **Our conclusion is that we can't use the last 63 years of data on stock and bond relationships to reach a strong conclusion one way or another about equity market returns based on this fact alone.**



Source: Trivariate Research, LP

Initial Financials results were not telling enough: On Friday, some major Financial companies reported earnings, headlined by JPMorgan (Ticker: JPM), Wells Fargo (Ticker: WFC), Blackrock (Ticker: BLK), Bank of New York Mellon (Ticker: BK) and Morgan Stanley (Ticker: MS). We have been arguing that as a potential buy signal we are looking for stocks to report earnings and guide Q2 numbers that result in downward revisions, and have stock prices not broadly underperform. Results of those important Financials that reported on Friday made stock performance exactly in-line with the overall Financial sector (see below), which isn't that surprising given they are combined important contributors, but also roughly in-line with the market broadly, on a large up day. That tells us that the commentary did not incrementally surprise to the downside, though there remain some doubts about how much of the commentary was backward looking and therefore still totally relevant.

Major Financials Reporting Friday April 11th Stock Performance						
			April 10, 2025		April 11, 2025	
Ticker	Company		Close		Close	% Change
MS	Morgan Stanley	$	106.58	$	108.12	1.4%
JPM	JPMorgan	$	227.11	$	236.20	4.0%
WFC	Wells Fargo	$	63.11	$	62.51	(1.0%)
BLK	Blackrock	$	858.78	$	878.78	2.3%
BK	Bank of New York Mellon	$	76.61	$	77.67	1.4%
Average						1.6%
Financial Sector						1.7%
S&P500		$	5,268.05	$	5,363.36	1.7%

Source: Trivariate Research, LP

Goldilocks guidance: While JPMorgan was able to guide, CEO Jamie Dimon thinks many companies won't be able to provide Q2 earnings guidance over the next few weeks. We mentioned this last week (maybe he read our note), and we continue to think uncertain guidance is a negative until several companies remove their guidance and don't underperform. More broadly, this is a time when investors gain or lose respect and trust for management teams. Most need guidance that is not so weak that investors really worry something idiosyncratic is wrong, but not so positive that investors suspect the management team doesn't have an understanding of the potential risks that are looming.

MEGA: While we don't know what will necessarily Make Equities Great Again in the near-term, the press and several investors have jumped on this theme that this is the end of American exceptionalism. Hence, many think US equity multiples will continue to contract with several outflows to other equity regions as part of the catalyst. We disagree. Most of the major growth themes that we believe will grow above global GDP for several years disproportionately benefit US companies. AI Semiconductors, AI Software, Life Sciences & Healthcare Services, Electrification Industrials, Power / Utilities, and Housing / Building Products are all examples of growth themes where US companies *pro rata* benefit more than other countries. Therefore, if the US equity market becomes increasingly relatively attractive, **we would BUY not SELL the US market.** The reason US stocks trade at a premium is that they have higher growth, higher margins, and more access to lower cost capital, NOT because they are "American." Multiples are highly correlated to margins, and the biggest relative bear case for US equities vs. other regions is that US margins contract more due to the current policies. That is certainly possible, but we don't think is a likely a sustained long-term case. The constitution of the US equity market is more skewed toward higher margin business models, Technology moats, lower capital intensity, higher margin Software and Services business, more Biotechnology, Banks with superior capitalization, and other directionally positive attributes. **We think the US equity market will outperform other regional equity markets on any horizon longer than one year.**

CONCLUSION: Given all this uncertainty, we wanted to leave investors with five long and short ideas meant to be considered through the lens of a 12-18 month investment horizon.

Our long ideas are ones where we think they have a combination of more achievable earnings estimates on a relative basis, a higher quality more achievable relative growth rate, and valuation that is not an impediment. Our short ideas have a combination of risk to downside in estimates and high valuation.

LONG IDEAS:

1. **McKesson (Ticker: MCK):** This is a horse we have ridden for a while, and it has strongly outperformed recently. But this company has the dream of margin expansion, and is trading at 21x forward earnings with a top-line likely double-digits per year through 2026, if not longer. MCK does $360 billion in revenue at 1.2% net margin. Better predictive analytics could drive margins to 1.5% eventually, so further multiple expansion is possible.
2. **United Therapeutics (Ticker: UTHR):** it is challenging to find any stocks with higher margins, more cash, faster top-line growth, run by a complete genius, and at a lower multiple than UTHR. The stock has fallen sharply over the last five months on fears of eventual share loss from a pending competitor product. We think these fears are overblown. This company should announce a massive Accelerated Share Repurchase (but probably won't), given they have $4.4Billion of net cash, a $12.6Billion market cap., and are generating more than $2.5Billiion in additional free cash flow in 2025 and 2026. This company is projected by the consensus to grow its revenue by 9.1% this year, at 89.1% gross margin and 43.7% net margin, yet it currently trades BELOW 10x price-to-forward earnings.
3. **Take Two Interactive (Ticker: TTWO):** What eventually is coming is the next Grand Theft Auto, and what comes with that is a step change in revenue growth and free cash flow with a historically very long tail. Even in a slowing economy, TTWO could double its revenue by the end of the decade, making the risk-reward skewed to the positive.
4. **W**aste Management (Ticker: WM): We think demand is relatively recession proof, as it was down only 1.5% in 2020! The stock trades at 30x forward earnings, but likely continues to spit-off more than $2.5Billion in free cash flow in 2025 even in a slowing and uncertain economy. With over 95% of its revenue in the US and steady demand, this stock should perform consistently even in a tariff-heavy world.
5. **Martin Marietta (Ticker: MLM):** Aggregates is a great business. During COVID revenue was flat year-over-year, but generally this business has consistent pricing and grows its top-line mid-to-high single digits every year. Business model threats like AI, or regional challenges like China are likely not relevant to the long-term growth algorithm. The stock has materially corrected since last Fall, and we think now has more attractive risk-reward than many stocks in the S&P500.

SHORT IDEAS:

1. **Chipotle Mexican Grill (Ticker: CMG):** Current bottom-up revenue expectations seem quite lofty (11.5% in 2025 and 12.3% in 2026). CMG trades at over 38x price-to-forward earnings on these potentially optimistic estimates. In an extremely competitive space, we could see a much lower multiple if growth becomes single digit in 2025.
2. **Air Canada (Ticker: ACDVF):** Surprisingly low short interest (only 4.1%) for a company where estimates are likely way too high and where no cash flow will be generated even on these optimistic estimates in the next two years. The stock is

optically cheap, so sell-side analysts love it (14 buys, 2 holds, 1 sell), and our work shows that stocks that are loved but have bad momentum are great shorts. We wanted to say American Airlines here (Ticker: AAL), as the stock is now at lows since it last went bankrupt and restructured in 2014, but our two flights on Air Canada had us sitting on seat upholstery that can't have been newer than 1994, pushing us in a Peter Lynchian-way to call out Air Canada.

3. **Intel (Ticker: INTC):** One of the greatest destroyers of shareholder value of all-time, a sustained combination of hubris and debt has resulted in the stock trading below $20 this week, the same threshold it first eclipsed in 1998. That's 27 years of no price appreciation, despite hundreds of billions of dollars spent on bad deals, capital spending, wasted R&D, ill-timed buybacks and other gross mismanagement. A poor relative product set, high China exposure, and high inventory don't make us particularly optimistic in a near-to-medium term snapback. When Semiconductors eventually work, we can name 25 would rather own than Intel. It is hard to believe Intel has only 2.8% short interest, given estimates are too high, they burn billions of dollars a year in cash, their competitive position is inferior, and they have a net debt of over $28Billion, but a new CEO likely has some wanting to give a short-term benefit of the doubt. We don't.
4. **Davita (Ticker: DVA):** For the first time in nearly 25 years there is a new product in the dialysis space from Fresenius. The product is faster and easier to use and clean. Despite this, top-line growth expectations don't really decelerate much for DVA, meaning share loss from their inferior product is not yet embedded in consensus expectations.
5. **Sprouts Farmers Market:** High growth expectations of 12.3% and 10.9% in the next two years respectively, and a hefty 33.7x price-to-forward multiple makes us cautious in a declining consumer environment. Our biggest worry about shorting it is that the sell-side is cautious and the stock has been good, but it seems very unlikely to us this company can avoid downward revisions for Q2 expectations.

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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