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TRIVARIATE RESEARCH

EARNINGS AND THE PENALTY FOR MISSING

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RESEARCH SUMMARY AND INVESTMENT CONCLUSIONS

Cutting our top-down EPS estimates: As a result of the tariffs, we pushed our 2026 estimates to 2027, arguing that one-year of EPS growth for the S&P500 has been damaged from the recent policies. On January 1st, we forecasted $261 in 2025 earnings and $271 in 2026 earnings based on our top-down assessment. We now forecast $247 in 2025, $257 in 2026, and $271 in 2027 earnings, representing 1% growth this year, 4% in 2026, and 5.3% in 2027. The consensus expectations are $267 for 2025, which still represents 9% growth vs. 2024, followed by $305.5 or 14.3% growth for 2026. If we assume 10% bottom-up consensus for 2027, that yields $336 off today's numbers, a level we think embeds a massive acceleration that is implausible. <u>We expect more than-normal-downward EPS revisions this year.</u>

By sector and overall, vs. history: We computed the year-over-year quarterly median EPS growth by sector and for the overall market and compared this "average" to the consensus bottom-up estimates embedded in the quarterly estimates for each quarter in 2025. <u>Communication Services and Technology are forecasted to have above average growth for Q2.</u> Energy estimates embed a 2H rebound vs. a year ago. <u>The S&P500 overall is expected to grow EPS 10.7% in Q3, which is 3.6% above the long-term 3rd quarter average of 7.1%.</u>

Market reaction by style, and size: We looked at the EPS and revenue revisions by style (growth, value, and a middle tertile we call "neither") and analyzed the one-day beta-adjusted market reaction to positive vs. negative revisions. <u>The market reaction to growth stocks is on average about twice as dramatic as the T+1 reaction for neither and value stocks on both earnings and revenue revisions.</u> We analyzed the performance of companies by market cap with positive and negative earnings revisions both related to earnings results and not related to earnings results. The smaller the stock, the more revisions matter for subsequent one-day performance following an earnings result. Positive revisions matter more than negative revisions for small and micro caps both for earnings- and non-earnings-related earnings revisions than for stocks that are mid-cap or larger.

INVESTMENT CONCLUSIONS

Interestingly, high-quality misses are hurt the most: High-quality stocks have more volatility on earnings-related revisions than lower quality stocks, with upward revisions rewarded the most and downward revisions penalized the most relative to other quality buckets. Junk stocks are more affected by non-earnings-related downward revisions. In aggregate the price movements on earnings-related revisions are far greater than those on non-earnings-related revisions.

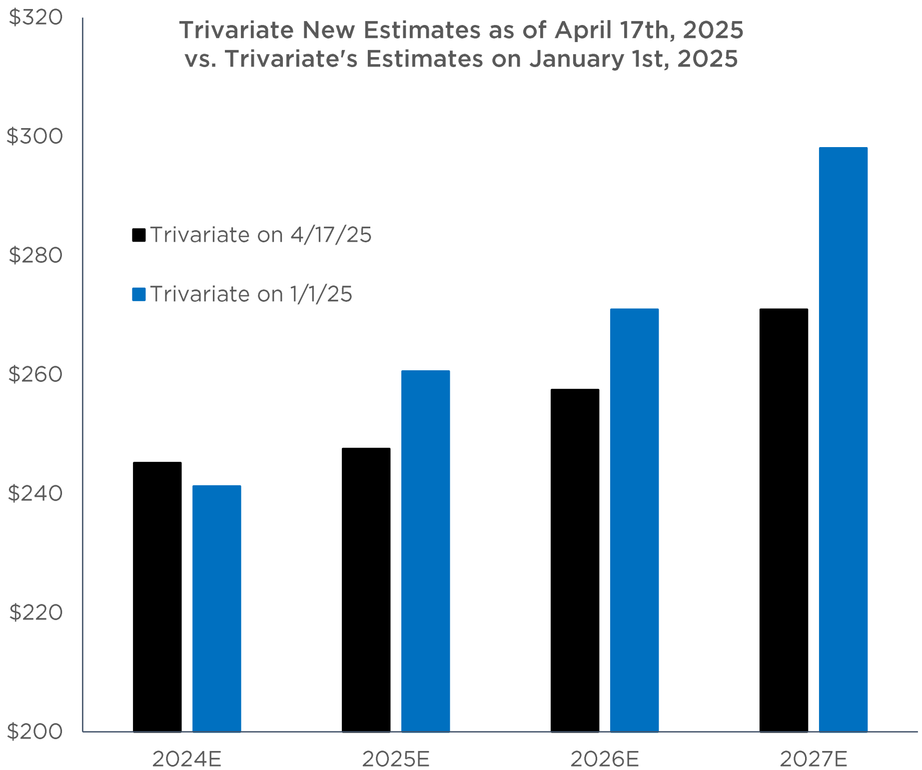
Sector level: There's a positive skew for revisions for 10 of the 11 sectors during earnings season, but a negative skew in 5 of the 11 when the revisions are not earnings-related. We assessed the market reward-for-beating relative to the penalty-for-missing by sector for both earnings-related and non-earnings-related earnings revisions. Energy, Technology, and Healthcare have the most positive asymmetric skew during earnings-related EPS revisions. Materials is the only sector with a negative skew, both during and around earnings results. The magnitude of the skew is the same for Industrials whether the revisions are earnings-season-related or not.

Penalties becoming harsher: We tracked the market penalty for negative EPS revisions over time, and the recent penalty for revisions of greater than 5% has been harsh, with the average penalty the last two months in the 4^{th} percentile relative to the last 25 years. <u>This means only 1 in 25 months are downward revisions punished as much as they have been over the recent period.</u> We have not seen companies reporting earnings that result in downward earnings revisions perform well yet this cycle. Meanwhile, positive revisions have performed in-line with the market recently, something we think will change dramatically, as we suspect companies that can produce results that drive upward earnings revisions would be a refreshing positive that is rewarded in today's environment.

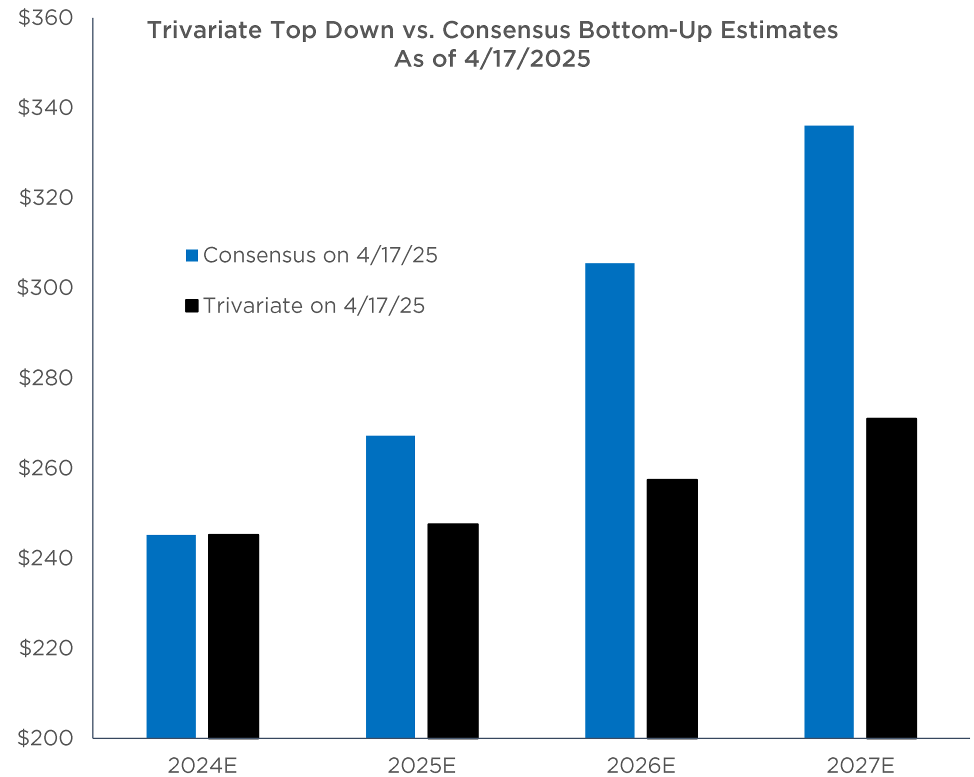
CONCLUSION: We think the consensus numbers need to be materially lowered, and the penalty for downward revisions has been harsh. This combination keeps us cautious with so many companies about to report earnings in the next two weeks.

WE ARE REDUCING OUR ALREADY BELOW CONSENSUS EPS ESTIMATES

As a result of the tariffs, we pushed our 2026 estimates to 2027 (left), arguing that one-year of EPS growth for the S&P500 has been damaged. On January 1st, we forecast $261 in 2025 earnings and $271 in 2026 earnings based on our top-down assessment. We now forecast $247 in 2025, $257 in 2026, and $271 in 2027 earnings, representing 1% growth this year, 4% in 2026, and 5.3% in 2027. The consensus expectations are $267 for 2025, which still represents 9% growth vs. 2024, followed by $305.5 or 14.3% growth for 2026. If we assume 10% growth for the bottom-up consensus for 2027, that yields $336 off of today's numbers, a level we think embeds a massive acceleration that is implausible.



Source: Trivariate Research

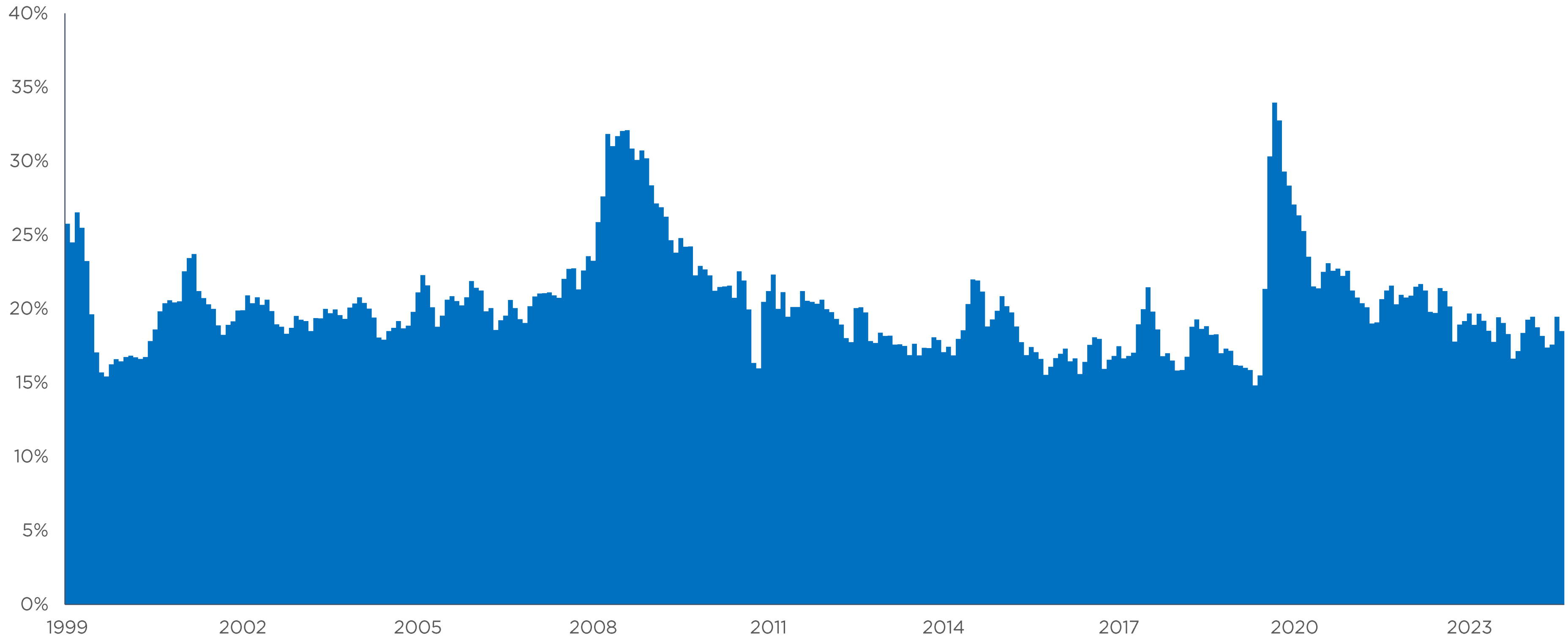


Source: Trivariate Research

WE HAVE NOT SEEN ANY NOTICEABLE INCREASE IN EPS REVISIONS

Every person we talk to knows the bottom-up EPS estimates embedded in the consensus outlook are too high. It does seem to us somewhat unusual that the sell-side has not proactively cut estimates more than the long-term average heading into Q1 earnings season. Below we show the percentage of analyst earnings revisions to EPS that are more than 2% over rolling 3-month windows, and so far, this year, there has not been an above average trend to meaningful revisions. Given the noticeable economic slowdown, it seems obvious estimates will need to be meaningfully downwardly revised.

Percent of Revisions to EPS Consensus Mean That Are >2%
3-Month Rolling Average
Through April 15th, 2025



Source: Trivariate Research

IT'S HARD TO SEE HOW Q3 CONSENSUS NUMBERS ARE ACHIEVABLE

We computed the year-over-year quarterly median EPS growth by sector and for the overall market and compared this "average" to the consensus bottom-up estimates embedded in the quarterly estimates for each quarter in 2025. Our prior expectation was that most sectors should have BELOW long-term average expectations for earnings in Q2 and the second half of 2025. Looking at the Q2 2025 forecasts, only Communication Services and Technology are forecasted to have above average growth. Energy estimates embed a 2H rebound vs. a year ago. The S&P500 overall is expected to grow EPS 10.7% in Q3, which is 3.6% above the long-term 3rd quarter average of 7.1%.

Quarterly Bottom-Up Consensus YoY EPS Expectations for 2025 and 2004 to 2024 Median
As of April 11th, 2025

Sector	1Q25E	2Q25E	3Q25E	4Q25E	Q1 Median	Q2 Median	Q3 Median	Q4 Median	Q1E vs. Long-Term Median	Q2E vs. Long-Term Median	Q3E vs. Long-Term Median	Q4E vs. Long-Term Median
Technology	17.1%	18.1%	17.6%	16.2%	13.9%	11.7%	7.3%	12.4%	3.2%	6.4%	10.3%	3.8%
Healthcare	*8.8%	8.7%	11.9%	16.7%	8.8%	10.1%	9.6%	9.2%	0.1%	(1.4%)	2.3%	7.4%
Utilities	7.9%	3.6%	(2.0%)	8.8%	7.4%	7.7%	8.0%	5.3%	0.5%	(4.0%)	(9.9%)	3.5%
S&P 500	6.4%	8.3%	10.7%	10.2%	8.0%	10.3%	7.1%	9.7%	(1.5%)	(2.0%)	3.6%	0.5%
Communication Services	3.5%	29.4%	3.8%	6.6%	12.0%	13.8%	14.2%	13.1%	(8.5%)	15.6%	(10.4%)	(6.5%)
Real Estate	2.0%	2.1%	4.2%	4.2%	14.3%	12.7%	14.8%	9.2%	(12.3%)	(10.6%)	(10.6%)	(5.1%)
Industrials	2.0%	4.2%	23.8%	5.3%	8.4%	8.7%	11.1%	10.7%	(6.4%)	(4.5%)	12.7%	(5.4%)
Consumer Discretionary	0.3%	0.3%	5.2%	4.7%	9.5%	10.9%	9.0%	11.5%	(9.2%)	(10.6%)	(3.8%)	(6.8%)
Financials	0.0%	3.8%	9.7%	4.6%	7.8%	6.8%	6.2%	9.7%	(7.8%)	(3.0%)	3.5%	(5.2%)
Consumer Staples	(8.1%)	0.9%	2.9%	6.0%	3.6%	3.3%	3.7%	5.2%	(11.7%)	(2.4%)	(0.8%)	0.9%
Materials	(11.9%)	2.4%	19.2%	19.9%	12.3%	5.0%	7.1%	12.3%	(24.2%)	(2.6%)	12.1%	7.6%
Energy	(18.3%)	(11.3%)	7.3%	16.3%	5.4%	4.9%	2.0%	(5.6%)	(23.7%)	(16.2%)	5.3%	21.8%

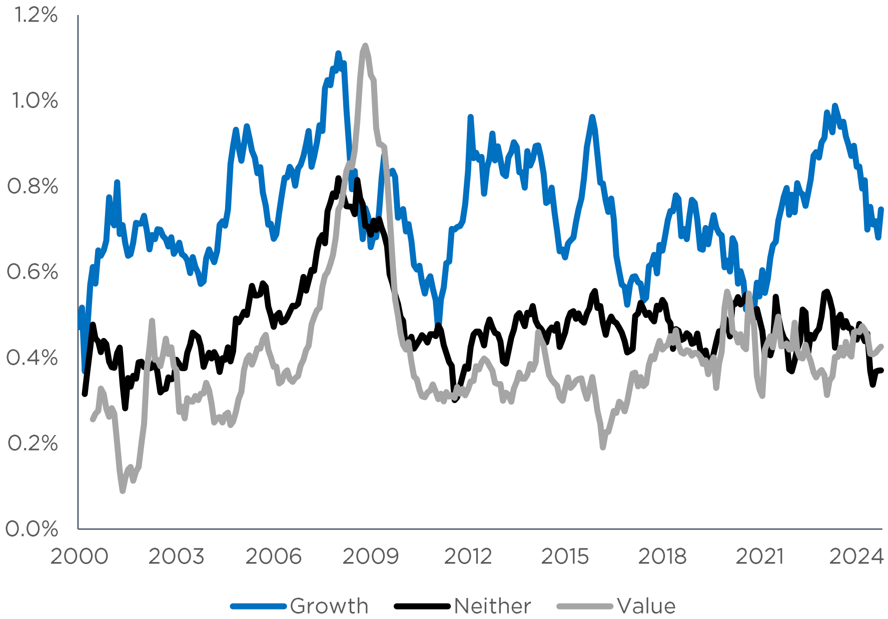
*Note: Q1 2024 Healthcare EPS is adjusted upwards to remove effect of $12.1 billion acquisition of Karuna by BMY

Source: Trivariate Research

REVISIONS MATTER MORE FOR GROWTH THAN VALUE STOCKS

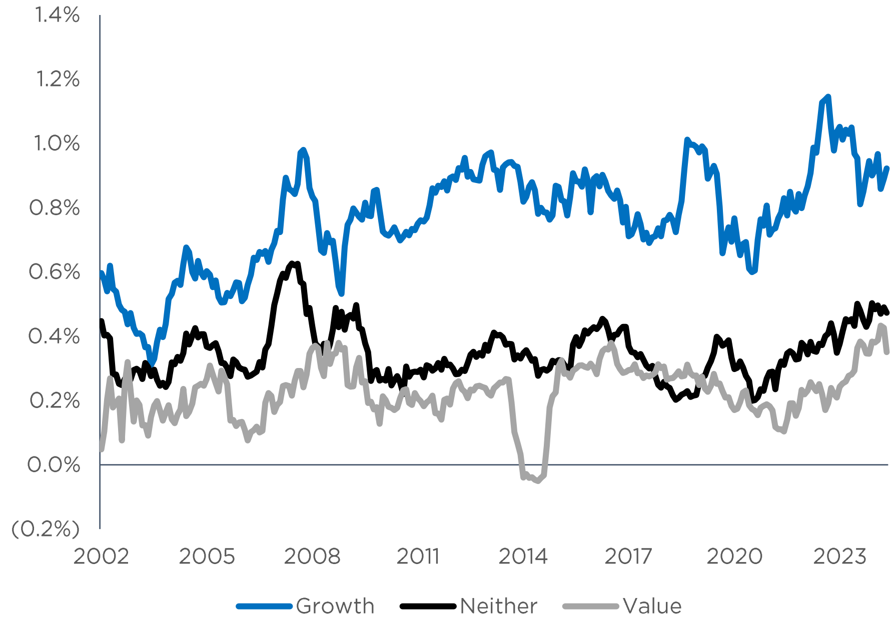
We looked at the EPS (left) and revenue (right) revisions by style (growth, value, and a middle tertile we call "neither") and analyzed the one-day beta-adjusted market reaction to positive vs. negative revisions. <u>The market reaction to growth stocks is on average about twice as dramatic as the T+1 reaction for neither and value stocks on both earnings and revenue revisions.</u>

EPS Normalized Consensus Mean by Style
Mean 1-Day Beta-Adjusted Market Reaction to Revision
Spread of Positive vs. Negative Revisions
12m Rolling Average
Through End-March, 2025



Source: Trivariate Research

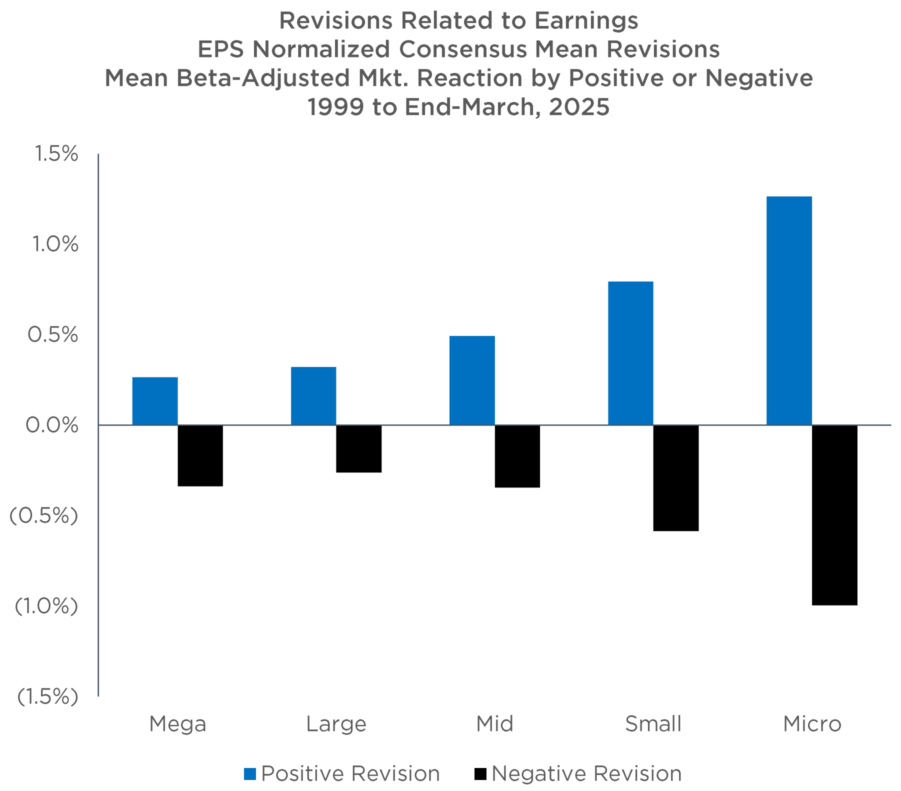
Revenue Consensus Mean by Style
Mean 1-Day Beta-Adjusted Market Reaction to Revision
Spread of Positive vs. Negative Revisions
12m Rolling Average
Through End-March, 2025



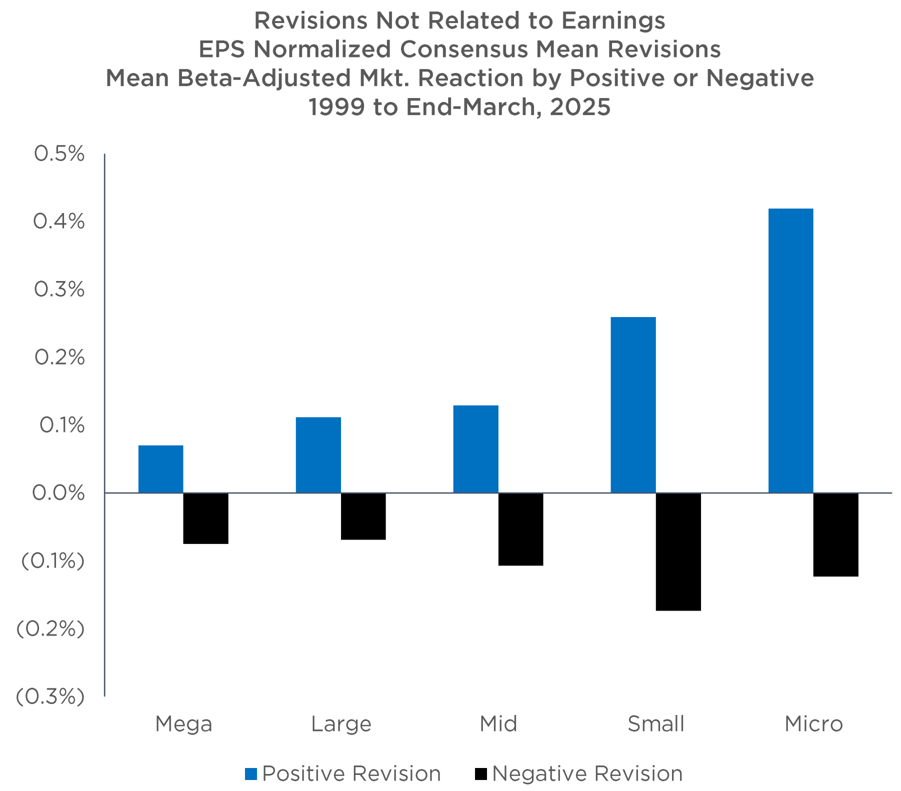
Source: Trivariate Research

WHEN IT COMES TO REVISIONS, SIZE MATTERS

We analyzed the performance of companies with positive and negative earnings revisions related to earnings results (left) and not related to earnings results (right) by market cap. size. Unsurprisingly, the smaller the stock, the more revisions matter for subsequent one-day performance following an earnings result. Positive revisions matter more than negative revisions for small and micro caps both for earnings and non-earnings-related earnings revisions than for stocks that are mid-cap or larger.



Source: Trivariate Research

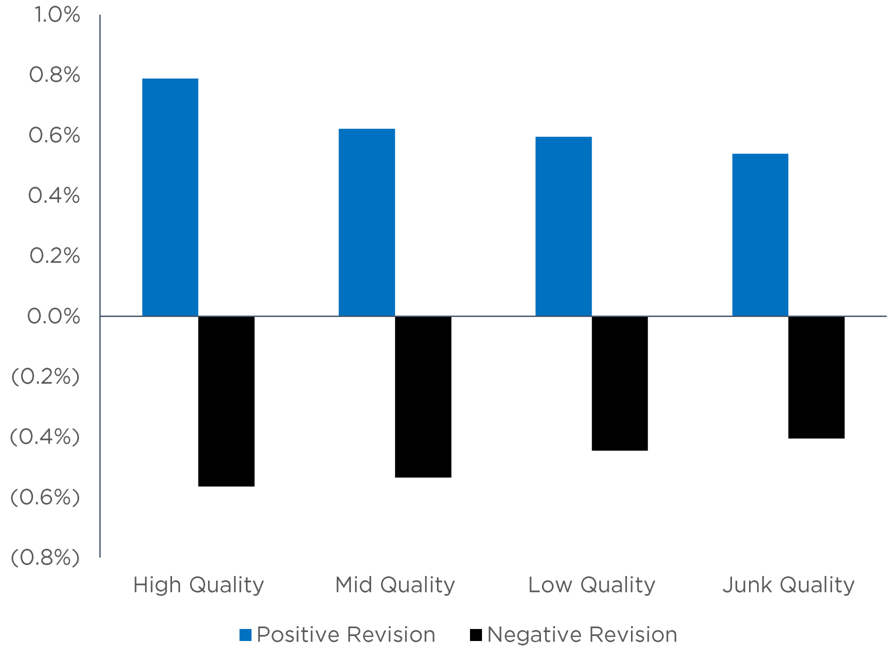


Source: Trivariate Research

HIGH-QUALITY STOCKS REACT THE MOST TO EPS-RELATED REVISIONS

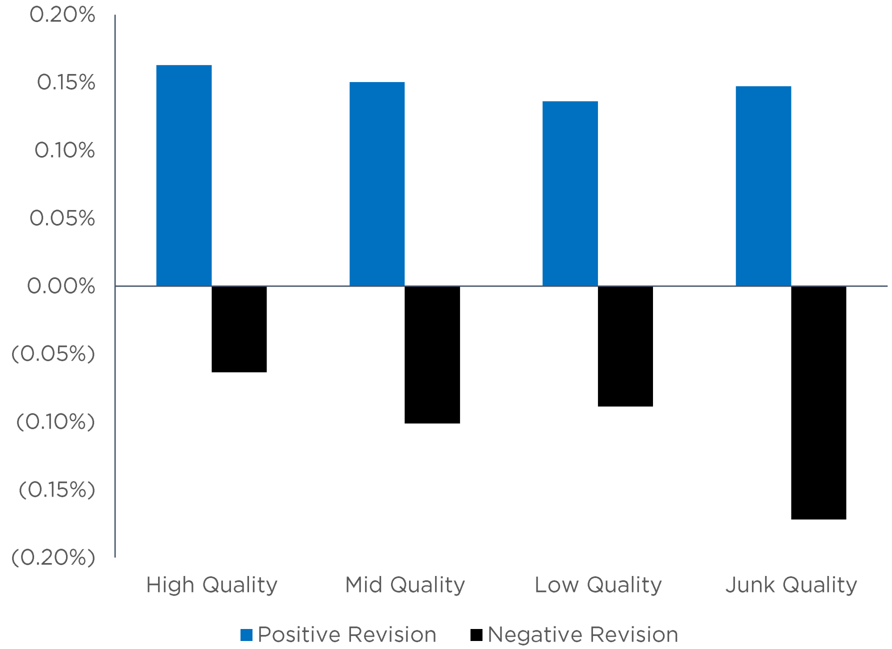
High-quality stocks have more volatility on earnings-related revisions than lower quality stocks, with upward revisions rewarded the most and downward revisions penalized the most relative to other quality buckets (left). Junk stocks are more affected by non-earnings-related downward revisions (right). In aggregate the price movements on earnings-related revisions are far greater than those on non-earnings-related revisions.

Revisions Related to Earnings
Net Income Consensus Mean Revisions
Mean Beta-Adjusted Mkt. Reaction by Positive or Negative
1999 to End-March, 2025



Source: Trivariate Research

Revisions Not Related to Earnings
Net Income Consensus Mean Revisions
Mean Beta-Adjusted Mkt. Reaction by Positive or Negative
1999 to End-March, 2025

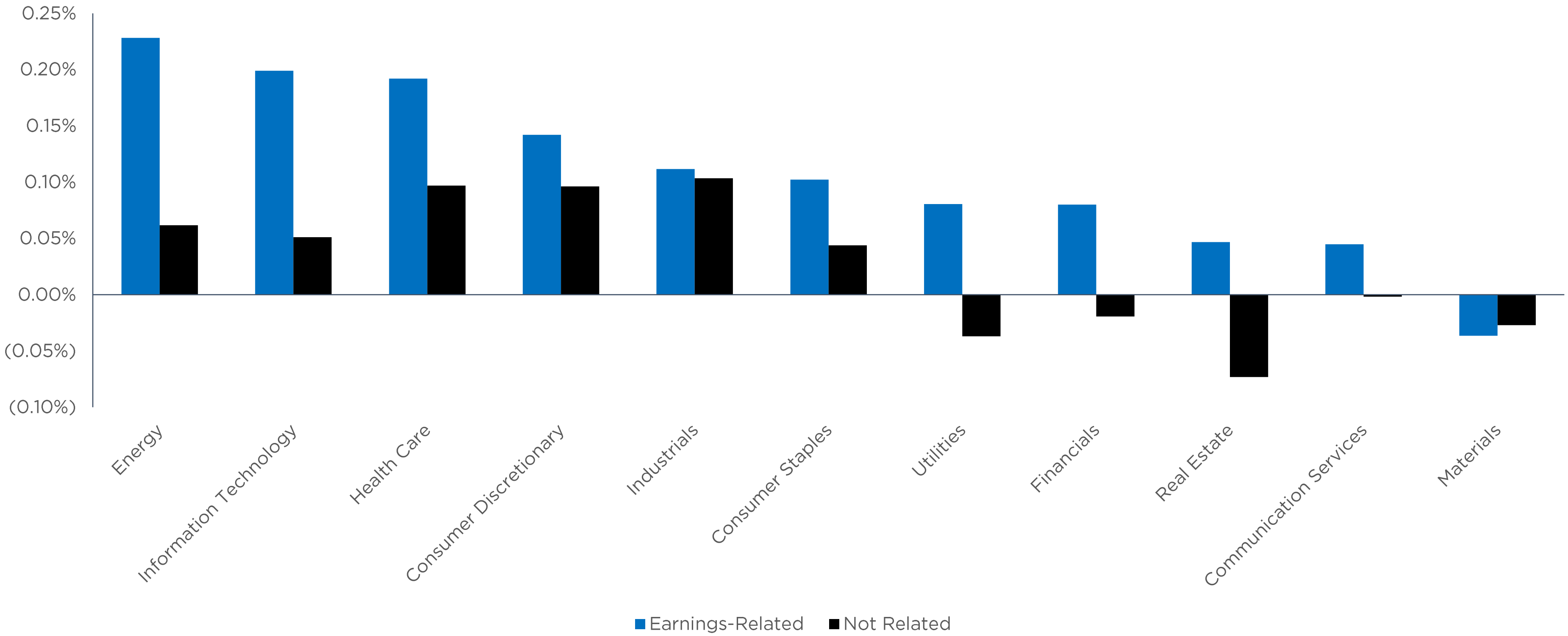


Source: Trivariate Research

THERE'S A POSITIVE SKEW TO EPS REVISIONS DURING EPS SEASON

There's a positive skew for revisions for 10 of the 11 sectors during earnings season, but a negative skew in 5 of the 11 when the revisions are not earnings-related. We assessed the market reward-for-beating relative to the penalty-for-missing by sector for both earnings-related and non-earnings-related earnings revisions. Energy, Technology, and Healthcare have the most positive asymmetric skew during earnings related EPS revisions. Materials is the only sector with a negative skew, both during and around earnings results. The magnitude of the skew is the same for Industrials whether the revisions are earnings-season related.

Asymmetry of Sector-Adjusted Mkt. Reaction to Positive vs. Negative EPS Consensus Mean Revisions
Ex-Pharma, Biotech, & Life Sciences
1999 to End-March, 2025

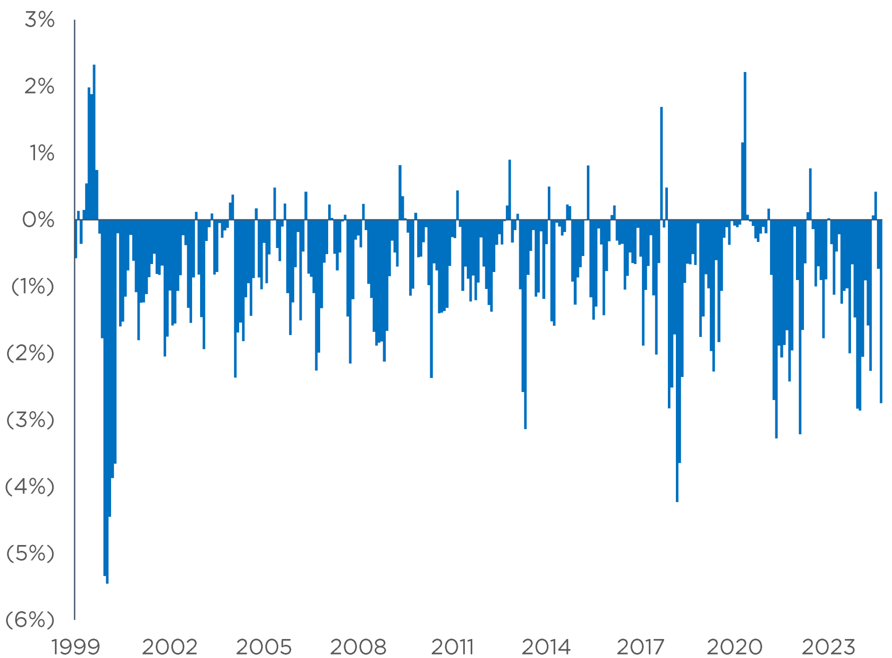


Source: Trivariate Research

ONLY 4% OF THE TIME ARE NEGATIVE REVISIONS PUNISHED THIS MUCH

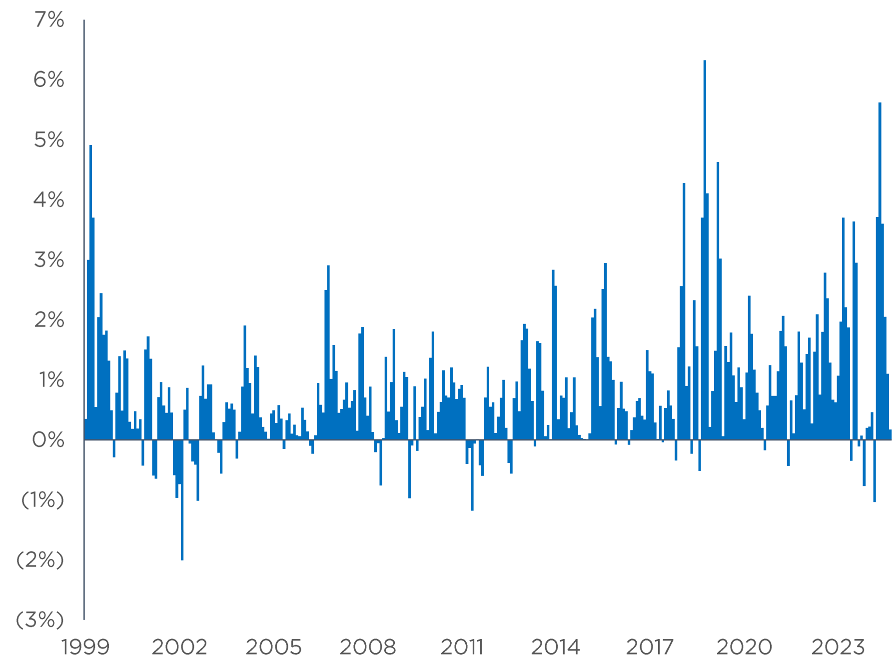
We tracked the market penalty for negative EPS revisions over time, and the recent penalty for revisions of greater than 5% has been harsh, with the average penalty the last two months in the 4th percentile relative to the last 25 years (left). <u>This means only 1 in 25 months are downward revisions punished as much as they have been over the recent period.</u> We have not seen companies reporting earnings that result in downward earnings revisions perform well yet this cycle. At the same time, positive revisions have performed in-line with the market recently (right), something we think will change dramatically, as we suspect companies that can produce results that drive upward earnings revisions would be a refreshing positive that is rewarded in today's macro landscape.

Mean Beta-Adjusted Mkt. Reaction for Daily Negative Revisions of >5% to Consensus Mean EPS Over Year
Average of the Daily Performance over the Last 2 Months Through April 15th, 2025



Source: Trivariate Research

Mean Beta-Adjusted Mkt. Reaction for Daily Positive Revisions of >5% to Consensus Mean EPS Over Year
Average of the Daily Performance over the Last 2 Months Through April 15th, 2025



Source: Trivariate Research

TRIVARIATE SECTOR RECOMMENDATIONS

We are recommending Healthcare and Industrials. We are cautious on Communication Services and Consumer Discretionary.

Trivariate Sector Recommendations as of April 16th, 2025

Sector	Total S&P 500 Market Cap. (US$ Trillion.)	Current S&P 500 Weight	Trivariate Recommended Weight	Trivariate-Relative Weight	Trivariate Recommendation	Comments
Health Care	**5.14**	**10.4%**	15%	4.6%	Overweight	We think Healthcare has above average estimate achievability, many companies that could benefit from AI-fueled productivity, and likely participates if M&A picks up
Industrials	**3.96**	**8.0%**	12%	4.0%	Overweight	Industrial activity has been weak, and comps are easy in 2H 2025 – tariff war is now a problem however
Financials	**7.14**	**14.4%**	16%	1.6%	Equal-Weight	Earnings growth should be above average, and shareholder return is strong.
Information Technology	**13.53**	**27.4%**	28%	0.6%	Equal-Weight	We recommended reducing exposure to Mag 7 in early February – we think it is close to the time to buy Semiconductors
Utilities	**1.19**	**2.4%**	3%	0.6%	Equal-Weight	Some idiosyncratic investments are sensible, and the power euphoria has been reset by huge sell-offs in certain stocks, risk-reward now seems better
Materials	**0.92**	**1.9%**	2%	0.1%	Equal-Weight	Tariffs could hurt some stocks and help others
Energy	**1.53**	**3.1%**	3%	(0.1%)	Equal-Weight	Hard to understand how multiples materially expand, but if we are not headed to a recession oil prices likely rise
Consumer Staples	**3.30**	**6.7%**	6%	(0.7%)	Equal-Weight	Low correlation to other offensive areas but valuations becoming less compelling
Real Estate	**1.06**	**2.1%**	1%	(1.1%)	Equal-Weight	Pockets of success, but likely a very low recovery to CRE
Communication Services	**6.72**	**13.6%**	9%	(4.6%)	Underweight	Cautious on businesses that are heavily indebted and need ARPU growth
Consumer Discretionary	**4.97**	**10.0%**	5%	(5.0%)	Underweight	The consumer is slowing, first phase of underperformance is indebted companies, second is expensive ones with high expectations

Source: Trivariate Research

DISCLOSURES

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