TRIVARIATE RESEARCH

US Equities
May 18, 2025

Level Set: Great Call, Mr. President and New Thoughts on a Barbell

It turns out the best market call this year was President Trump's proclamation on April 8th to "Go out and buy stocks now." We have been analyzing and creating quantitative signals for the better part of two decades, and forgive us, we never studied the "buy stocks because the President says so" factor. **Our bad. The market was up all five days this week, and 16 of the last 19 days.**

We are surprised by the magnitude and speed of the market rally since April lows. As we have written several times, we are NOT surprised that Technology has performed well in the recovery, as in 19 of the last 20 quarters that followed S&P500 sell-offs of 10% or more, Technology was up in absolute terms, performing the best on average of any sector.

We appreciate that there can be meaningful disconnects between price action and fundamentals. However, we are starting to think the upside-downside ratio for the S&P500 is not particularly attractive.

Firstly, the 2H 2025 earnings estimates generally appear too high. The 20-year median Q3 year-over-year earnings growth is 4.7%. The growth in 2024 was 7.2% (higher than the long-term average) and yet estimates for 2025Q3 call for 7%. This is an above normal expectation for growth, against a more challenging than average comparison, six months lagged from the first major tariff implementation in nearly a century. Does this holistically make sense? We don't think so. At the sector level, the highest absolute year-over-year growth assumptions in Q3 are in Industrials up 19.1%, vs. a long-term Q3 median of 5.4%. While that may seem preposterously high, it is important to observe it is against an easy "compare" of a decline of 9.5% in Q3 of 2024. Energy and Materials also declined a year ago. **Hence, the sector with the highest Q3 expectations vs. typical seasonal growth is Technology, with 15.3% EPS expectations vs. 21.1% a year ago, and a long-term average of 6.0%. The forecasted growth in Consumer Discretionary in Q3 is expected to be 10.1% less than the growth seen in Q3 2024,perhaps a primary reason the sector has been the worst-performing sector year-to-date.**

Long-Term Average Quarterly Growth vs. 2025 Bottom-Up Estimates

Quarter	S&P500	Consumer Discretionary	Consumer Staples	Energy	Financials	Health Care	Industrials	Info Tech	Materials	Communication Services	Utilities	Real Estate
Average Q3	4.8%	8.4%	4.0%	(7.8%)	5.1%	5.1%	5.4%	6.0%	2.4%	14.1%	4.9%	17.1%
2024Q3 Growth	7.2%	6.8%	2.7%	(29.3%)	6.0%	12.4%	(9.5%)	21.1%	(10.7%)	22.1%	18.3%	2.8%
2025Q3E	7.0%	(1.7%)	1.8%	(10.5%)	7.5%	7.6%	19.1%	15.3%	13.8%	1.7%	(0.8%)	3.4%
Difference	2.3%	(10.1%)	(2.1%)	(2.7%)	2.4%	2.5%	13.7%	9.3%	11.4%	(12.4%)	(5.7%)	(13.7%)
Average Q4	6.1%	12.3%	4.7%	(12.9%)	10.3%	6.7%	10.0%	9.8%	0.7%	13.6%	5.1%	16.3%
2025Q4E	6.2%	(2.9%)	5.2%	(3.0%)	3.2%	9.8%	1.1%	13.6%	14.9%	4.1%	8.3%	3.3%
Difference	0.1%	12.3%	4.7%	(12.9%)	10.3%	6.7%	10.0%	9.8%	0.7%	13.6%	5.1%	16.3%

Source: Trivariate Research, LP

On an annual basis, the bottom-up consensus earnings estimates embed 7.7% year-over-year growth for 2025 and 13.6% growth for 2026. We think a better assumption is that the total earnings in 2027 will be closer to the current expectations for 2026 — if not lower. Now, just because estimates are too high, does not mean the market has to go lower. There is ample history

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

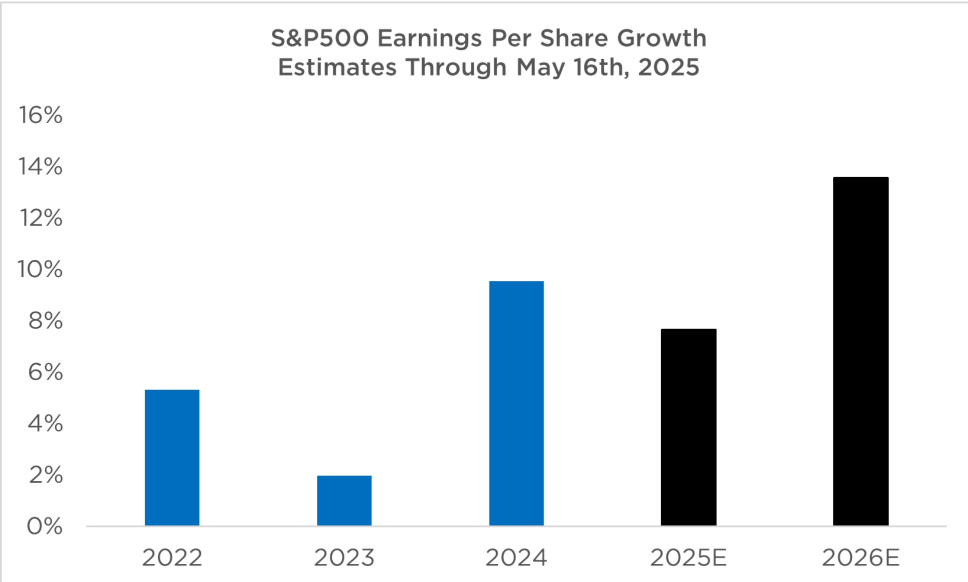
Maxwell Arnold
Analyst
347-514-1234
maxwell@trivariateresearch.com

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

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

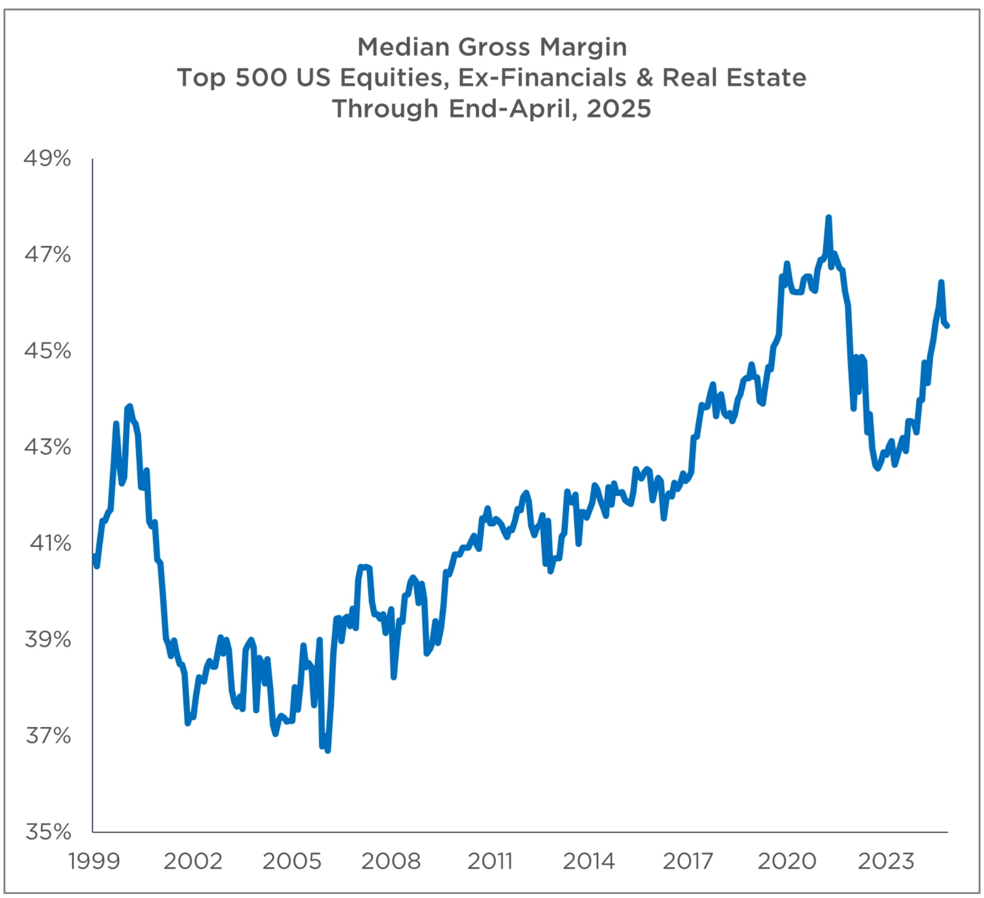
Ryan McGovern
Director of Research Sales
973-271-8017
ryan@trivariateresearch.com

of downward revisions being accompanied by rising markets, particularly if there is optimism about higher earnings or more certainty in the following year.



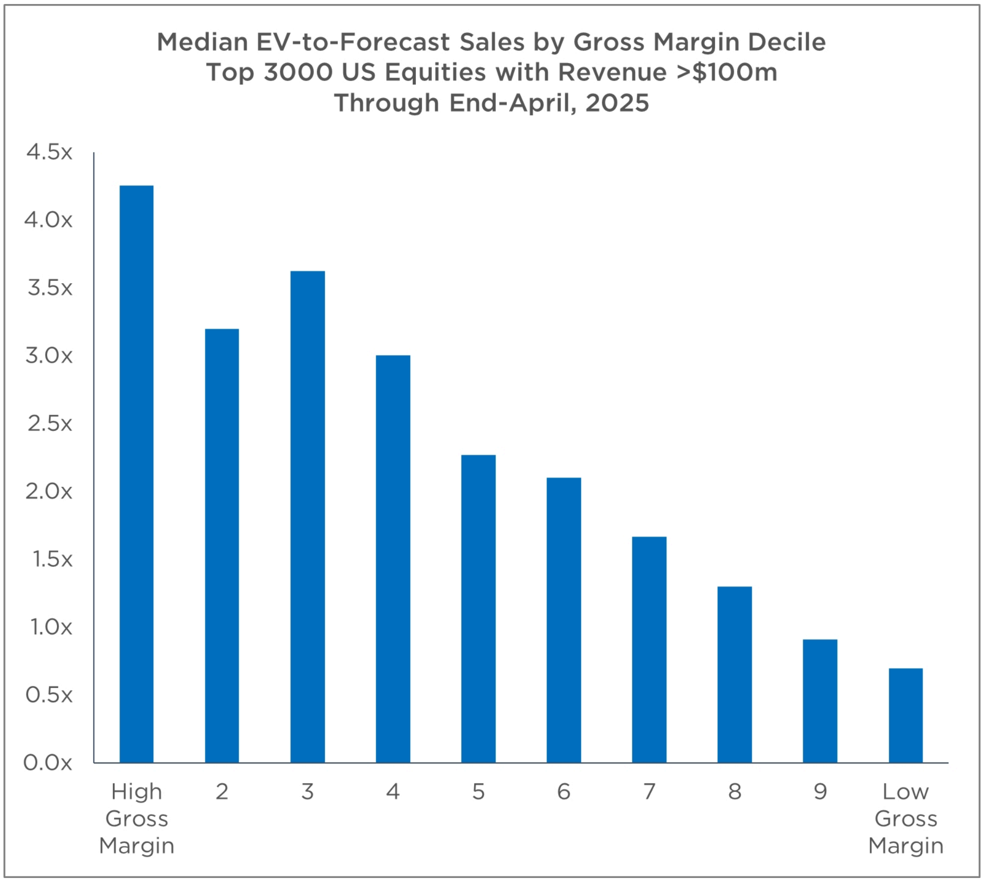
Source: Trivariate Research, LP

We expect many companies to disappoint in the second half of this year, and see the risk-reward as skewed to the negative for risk-taking today. **The median stock saw some gross margin contraction in April, despite the strong market rally. The median company's gross margins fell to 45.5% in April, down nearly 100bps from the two months earlier (see below)**. Given tariffs may cause some companies to be challenged in passing along pricing without a commensurate loss in unit demand, and / or they might see rising input costs in certain areas, we think there is risk to lower margins for more than half the S&P500 in the coming quarter.



Source: Trivariate Research, LP

In our judgment, margin expansion will matter for multiple expansion this year. There has consistently been a relationship between gross margin level and valuation. Below we show the relationship between stocks in each decile of gross margins and the average stocks' enterprise value-to-forecasted sales.



Source: Trivariate Research, LP

CONCLUSION: Given the huge market rally and this backdrop of uncertainty, what can we do to outperform? Many investors are trying to use an investment barbell as part of their strategy, owning some defensive stocks in case we have a correction, but are too afraid not to own some offense in case of a continued rally.

In light of the large market movements, we are making some changes to our sector recommendations today.

1. **We are downgrading Industrials from Overweight to Equal-Weight,** reducing our recommended exposure from 12% to 9%, vs. the S&P500 bench weight of 8.2%. **Industrials have been the best-performing sector year-to-date,** up 8.92% vs. the S&P500 up 1.3%. We upgraded the sector as part of our year-ahead outlook because we thought the Industrial sector recession last year would lead to easy comparisons in the second half of this year. However, with high inventory that is likely rising in the current environment, and an uncertain spending environment for some Industrials customers, we no longer think the risk-reward is quite as attractive.
2. **We are upgrading Financials from Equal-Weight to Overweight.** We added 1% to Financials, a sector that has also beaten the market this year, up 6.6%, but the rally has largely been fueled by Insurance (up 8.7%). We like several names in this group for "offense" if the risk-on trade continues, including the **Alternative Asset Managers. KKR, (Ticker: KKR), Blackstone (Ticker: BX), and Apollo (Ticker: APO)** are all down more than 10% year-to-date and will likely continue to rally off their recent lows.
3. We are tweaking our weights in 3 other sectors, adding 2% to Materials, now at 4% vs. the bench weight of 1.8%, 1% to Technology, now at 29% vs. bench weight at 29.4%, and lowering our massive Healthcare Overweight from 15% to 14%, vs. the bench weight of 9%.

In absolute terms, our biggest positions are Technology (29%), Financials (17%), and Healthcare (15%). See our recommendations below.

Overweight Healthcare and Financials, Underweight Consumer Discretionary and Comm. Services

Trivariate Sector Recommendations as of May 18th, 2025

Sector	Total S&P 500 Market Cap. (US$ Trillion.)	Current S&P 500 Weight	Trivariate Old Recommended Weight	Trivariate Changes for May 18, 2025	Trivariate New Recommended Weight	Trivariate-Relative Weight	Trivariate Recommendation	Comments
Healthcare	**5.02**	**9.0%**	15%	**(1%)**	14%	5.0%	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
Financials	**7.88**	**14.2%**	16%	**1%**	17%	2.8%	Overweight	Think the alternative asset managers and money center banks can be good offense
Materials	**0.99**	**1.8%**	2%	**2%**	4%	2.2%	Equal-Weight	If the economy improves, some Metals & Mining have material upside
Industrials	**4.55**	**8.2%**	12%	**(3%)**	9%	0.8%	Equal-Weight	Sector has been the best performing YTD, and we now think tariffs could hurt the earnings margins for some business
Utilities	**1.26**	**2.3%**	3%	**None**	3%	0.7%	Equal-Weight	Some idiosyncratic investments are sensible, and the power euphoria has regained steam
Energy	**1.63**	**2.9%**	3%	**None**	3%	0.1%	Equal-Weight	Oil is tough to forecast, and its hard to see a sustained period of multiple expansion
Consumer Staples	**3.40**	**6.1%**	6%	**None**	6%	(0.1%)	Equal-Weight	There is substantial bifurcation of fortunes here, and pricing power is starting to be a challenge
Information Technology	**16.35**	**29.4%**	28%	**1%**	29%	(0.4%)	Equal-Weight	Keeping market-weight the group, Semis have rallied too much in our view
Real Estate	**1.12**	**2.0%**	1%	**None**	1%	(1.0%)	Equal-Weight	Pockets of success, but likely a very low recovery to CRE
Communication Services	**7.52**	**13.5%**	9%	**None**	9%	(4.5%)	Underweight	Cautious on businesses that are heavily indebted and need ARPU growth
Consumer Discretionary	**5.93**	**10.7%**	5%	**None**	5%	(5.7%)	Underweight	The consumer appears to be slowing, and many face structural challenges

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.

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.