

Level Set: Our Top Ideas Right Now

Following a busy week of meetings in New York and Boston, we thought it would make sense to share a list of our top investment ideas in this week's Level Set.

- **We think the S&P500 will get to 7000 before the end of 2026.** The main driver of this thesis is that we think earnings can grow 10% in 2026, fueled by the median company having gross margin expansion, strong results from Financials, and multiple proof cases across many sectors of AI productivity.
- **We like large caps. over small caps.** Small caps are an inferior asset class, and the idea that they are cheap vs. large caps as a reason to bet on mean-reversion does not appeal to us. Small-caps typically work when we are close to a recession bottom and fiscal and monetary policy will be incrementally beneficial. We don't think a couple of further Fed cuts will be enough to create a sustained small cap. rally. Large caps are more likely to be AI revenue beneficiaries, AI productivity beneficiaries, or have business models that are impregnable to AI. Small caps are more likely to be disrupted by AI and have their business models leapfrogged by those investing heavily in AI. Furthermore, in an era of increasing cost pressures from tariffs, large caps have a higher probability of maintaining pricing power or having the ability to pressure their suppliers to limit the impacts of tariffs than their small cap competitors. Bottom-line: We prefer large caps. to small caps.
- **Pain trade is lower not higher.** We heard a couple of times last week how the pain trade is higher. That is only the case for the group of investors who are long-short and have more than a low net exposure. On the contrary, for most quantitative hedge funds and long only money managers, the pain trade is LOWER, not higher. Obviously, we would rather have 200bps of alpha drag in a market up 10%, than 500bps of positive alpha in a tape down 10%. That's more assets at the end of the period than the beginning of the period - and therefore less painful. It is possible that if a fund's performance has been sustainably weak, any further alpha drag causes redemptions, so it is theoretically possible for an up tape to be a net negative for a money management firm, but in aggregate we don't think too many hedge fund owners who run net long prefer a down tape. **But, why do people say this?** We think it is because we have had a sustained low quality or "junk" rally, and most bottom-up stock pickers long high-quality companies and short / underweight "junk" ones - so the recent rally has caused many to underperform. Below we show that most of the prior periods where "junk" beat "non-junk" were following the TMT bubble, the Financial Crisis, or COVID, though there were few other periods as long as what we have seen this year, including in 2003/2004, and 2016.

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

Top 500 US Equities, As of End-July 2025

Junk vs. Non-Junk Rallies

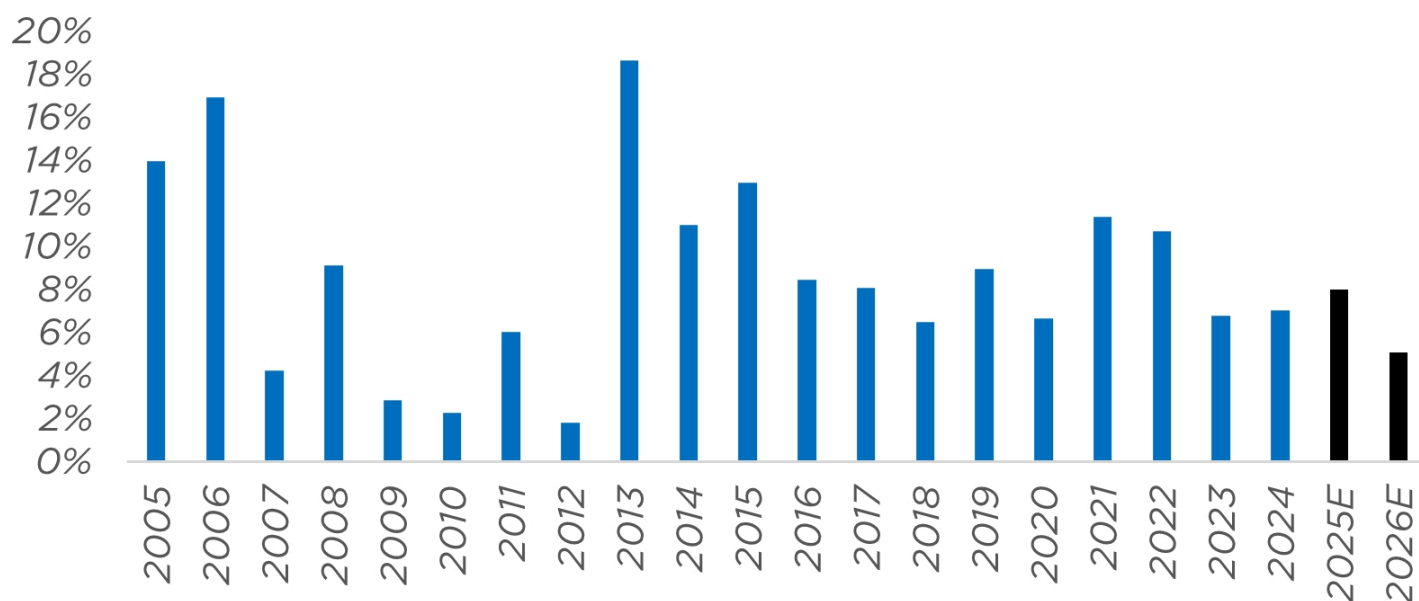
Number of Consecutive Months of Junk Equal-Weight Outperformance

Beginning Date	Ending Date	Consecutive Months	Junk Outperformance
8/31/2000	3/30/2001	7	19.2%
10/30/2009	4/30/2010	6	11.5%
9/30/2020	2/26/2021	5	31.4%
6/30/2016	11/30/2016	5	12.3%
10/29/2010	3/31/2011	5	9.4%
4/30/2004	9/30/2004	5	4.5%
8/30/2019	12/31/2019	4	9.2%
6/29/2012	10/31/2012	4	4.1%
12/31/2001	4/30/2002	4	3.0%
2/29/2000	5/31/2000	3	18.5%
2/27/2009	5/29/2009	3	17.3%
6/30/2009	9/30/2009	3	15.4%
4/30/2025	7/31/2025	3	9.5%
1/29/2016	4/29/2016	3	6.6%
7/30/2021	10/29/2021	3	5.4%
6/29/2001	9/28/2001	3	4.6%
11/28/2003	2/27/2004	3	4.2%
4/29/2005	7/29/2005	3	4.0%
2/28/2013	5/31/2013	3	3.3%
5/30/2003	8/29/2003	3	2.6%

Source: Trivariate Research, LP

- **We think the junk rally will end soon.** Given most junk rallies are fueled by incremental fiscal and monetary policy, and dreams of explosive upside in earnings growth from a recession recovery, this junk rally is somehow different. Profitless companies and hyper-growth junk have worked as Retail investors have been aggressively buying high-momentum securities. Mean-reversion can work, but it might take much longer than it did in the past for valuation-focused investors. That's why we wrote two weeks ago that other than at the extremes, **we don't think investors should use valuation to pick stocks.**
- **We recommend an Overweight Financials:** This seems like our most consensus sector call when we are discussing it with institutional investors - so we worry about it from that standpoint. But, this past earnings season was very fundamentally strong - less provisioning than expected for consumer losses, multiple ways to win, and stocks with strong momentum that are not directly tied to the AI trade. That is all positive. We have been highlighting for nearly a year now that for the first time in over 20 years we think investors can beat the S&P500 just by owning a diversified basket of Financials. We like Capital One (Ticker: COF) on the Discover (DFS) deal for all the synergies and shareholder returns. We like Morgan Stanley (MS), Goldman Sachs (GS), and JPMorgan (JPM) for their diversity of income streams including private wealth. Bank of America's CEO (BAC) made universally positive comments across multiple business units in an interview last week. While some investors are concerned about the Insurance pricing cycle, Progressive (PGR) and AJGallagher (AJG), among others, look relatively attractive.
- **We recommend an Overweight in Healthcare:** This has been a bad call by us over the last year. But, we are sticking to our guns. Healthcare revenue per share has grown every year, for more than 25 years in a row (see below). This means an aging population consistently demands more Services, Tools, Diagnostics, Drugs, Managed Care, and Hospitals, among other Healthcare-related needs.

S&P500 Healthcare Bottom-Up Consensus Revenue Growth Per Share Through 2026E As of August 1st, 2025



Source: Trivariate Research, LP

There are certainly concerns about government spending cutting into the Healthcare revenue, and the persistent lack of efficacy of Drug Development, but our view is that a reason to like Healthcare stocks today is it is that many will benefit greatly from AI deployment. So many Healthcare companies are grossly inefficient, and can benefit from predicting their employee and customer behavior better, and reducing costs. We have been recommending McKesson (MCK), Cardinal (CAH), and Cencora (COR), but also like Quest Diagnostics (DGX) and many of the other product companies in the Healthcare sector. A few investors asked us this week for other potential AI productivity beneficiaries - we think a starting point is to look for companies that have a high number of total employees and relatively low margins, under the thesis that some employee leverage or productivity is possible. Potential ideas are shown below.

Select Potential Productivity Beneficiaries - Low Margins and High Number of Employees As of End-July, 2025

Ticker	Company Name	Sector	Market Cap. (\$Bil.)
BRK.B	Berkshire Hathaway Inc.	Financials	1,024.54
BA	The Boeing Company	Industrials	167.75
NKE	NIKE, Inc.	Consumer Discretionary	110.31
LMT	Lockheed Martin Corporation	Industrials	98.28
DELL	Dell Technologies Inc.	Information Technology	89.75
CVS	CVS Health Corporation	Health Care	78.76
UPS	United Parcel Service, Inc.	Industrials	72.96
ELV	Elevance Health, Inc.	Health Care	63.74
GM	General Motors Company	Consumer Discretionary	50.78
KR	The Kroger Co.	Consumer Staples	46.35
F	Ford Motor Company	Consumer Discretionary	44.06
SYN	Sysco Corporation	Consumer Staples	38.01

Source: Trivariate Research, LP

- **Technology:** We recommend S&P500 benchmark investors own about 1/3rd of their portfolio in Technology. **We like both Semiconductors and Software**, and don't necessarily feel a need to pair-trade the group, though we hear from investors often about owning one industry over another. We think Software will require more stock selection, and Semiconductors is more of a risk management / allocation call, given how low the company-specific risk is of most Semiconductors, and how correlated their returns are. Among Software, we like both **Disinformation Security**, like Palo Alto (PANW), CrowdStrike (CRWD), Fortinet (FTNT), Checkpoint (CHKP), and Okta (OKTA) among others, to capitalize on what we see as above average estimate achievability. The Cyberark (CYBR) proposed deal from PANW came up in several meetings last week as a bullish sign for what Security Software assets are worth. We also like Semiconductors, but have some short-term concerns about tariffs, given ASML's (ASML) comments on their earnings call three weeks ago - which we did not conclude were only company-specific. With Nvidia's (NVDA) earnings on August 27th the biggest fundamental data point left this month, and one that is highly unlikely to disappoint, we don't see a huge reason to sell strongly performing Semiconductor positions today. We are most negative on IT Services, given the value-add / pricing of many of these businesses may continue to come into question.
- **We Recommend an Underweight in Consumer Discretionary:** We have been negative on this sector for more than 2 years - initially highlighting the shrink problems at Target (TGT), the business model at Kohls (KSS), and the challenges facing Dollar Stores and Restaurants. Recently, as investors suspected the Federal Reserve might cut interests rates again, we have seen a rotation into select Consumer stocks - as an example, we were asked about Home Builders twice in meetings last week. We get the logic for owning Consumer stocks for a short, trading-oriented rotation in anticipation of a Fed cut. But, the truth is, the Consumer is slowing, but still in reasonably strong shape. The Consumer stocks - are in large part - outside of select winners like Costco (COST), Walmart (WMT), and Amazon (AMZN) not particularly well suited to handle tariffs without some margin erosion. We just think many companies here are poorly positioned to maintain both topline growth and margins. We would sell any short-term rate-induced Consumer Discretionary rallies at this point in the cycle.
- **Three questions came up in nearly every meeting last week:**
 1. How should we think about the hyper-scaler capital spending and when / how can we evaluate the return on this capital spending?
 2. How will the huge government deficit - 7% of GDP annually - ultimately wind down to lower levels, and what impact will that have on the stock market?
 3. How should we think about the impact tariffs will have on the market and earnings?

For someone who is bullish on US equities, and thinks the distribution of outcomes are skewed to the positive, these are the three "bear case" questions that are toughest for us to reconcile. Of course, you always sound dumber when you are bullish - but here are our current answers:

1. We think this isn't an "if" but a "when" it is a problem. Today, the spending seems to be rewarded the same way capital spending was rewarded for Cable, Telecommunications, and Media companies during the run-up to the TMT bubble. It varies somewhat by company, but the Mag 7 companies roughly had 7%-9% capital spending-to-sales from 2017-2023, and capital-spending-to-sales now appears to be closer to 15%. With the capital spending likely only on assets that have a 3-to-4 year useful life, depreciation will be a higher burden on cost of goods sold, gross margins will go lower, and the enterprise value-to-forecasted sales will decline. This feels inevitable, unless the return remains high enough and the dream of AI proof cases are alluring enough that the capital spending will be rewarded for 4-8 more quarters. That's frankly our current view. It is also possible that this level of spending is "one-time" in nature, and begins to trickle down in a year or two back towards 10% capital spending-to-sales. That seems less likely to us in the near-to-medium term, though we can't completely rule it out.
2. We don't know and haven't found it useful to give investment advice on how much US equities to own, or frankly even how to position a US equity portfolio for changes to the deficit. There is no question that if the US begins to move toward austerity, it will not benefit many large public companies, unless their AI productivity is very strong. Healthcare and Defense are the most common areas investors think will be impacted, but we've seen more political intervention of late - the President propping up the Semiconductor Industry last week, but than also criticizing Intel's (INTC) CEO.
3. As we wrote in our Level Set last week, we are a little nervous that there is maximum complacency about tariffs right now - and that is the time we might actually see some more impact on the economy and companies. We don't expect to hear much in August, but there are a slew of investor conferences in September, including in Technology, Healthcare, and Industrials. It is possible we will get some updates that there was a pull forward in demand, or some ripple from tariffs that

is hitting companies that investors are now largely convinced won't matter.

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.