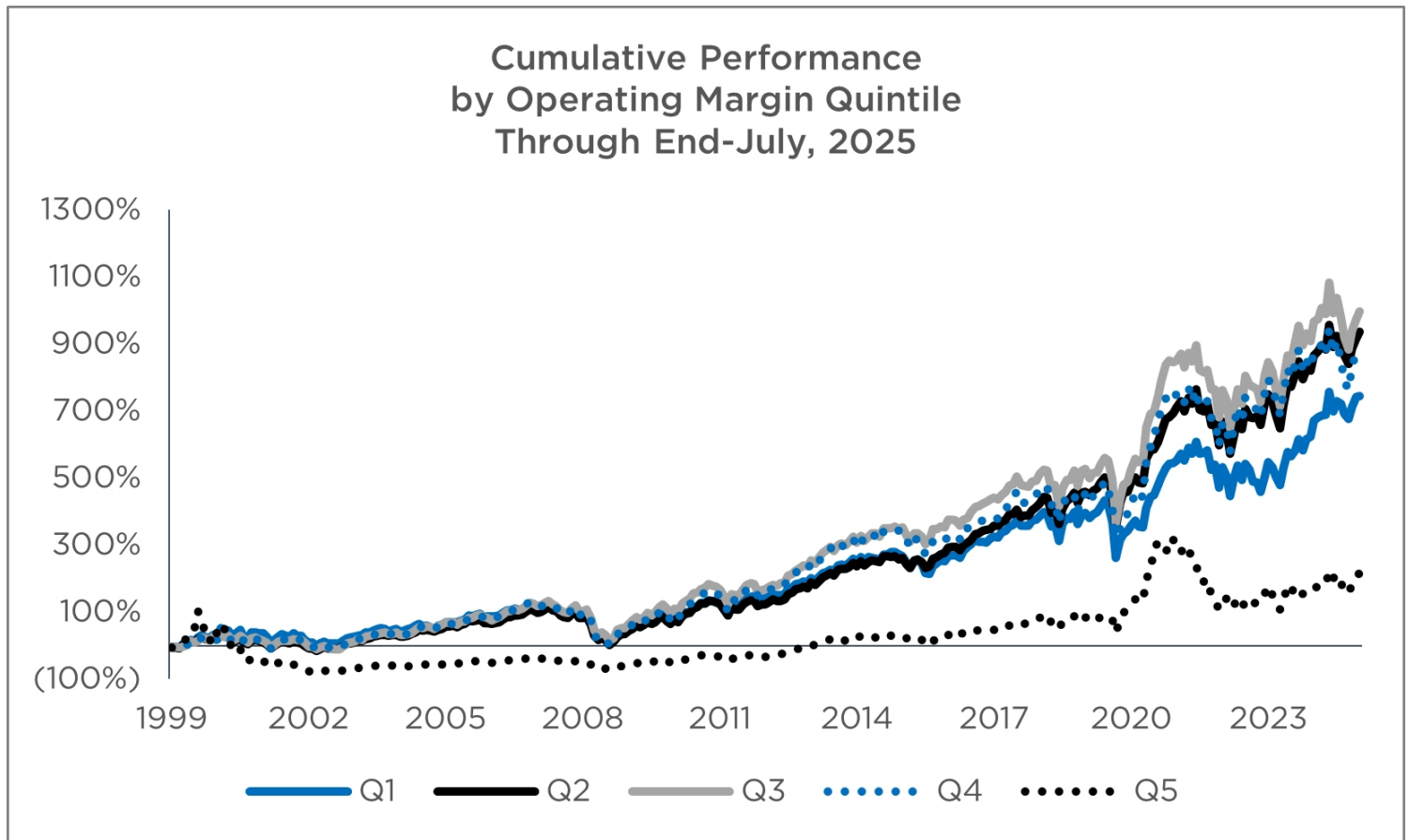


## Level Set - Can the Junk Rally Continue?

On April 9<sup>th</sup>, 2025, President Trump wrote “THIS IS A GREAT TIME TO BUY!!! DJT.” Fast-forward to today, and the S&P500 is up 30% off of the lows of early April. During this huge rally, many institutional investors have not performed particularly well on a relative basis, particularly those with relatively low portfolio turnover who skew toward buying and holding fundamentally higher-quality businesses. Let’s walk through how much the recent rally has deviated from tried and tested investment discipline. For instance, profitability *usually* matters. Over the last 25 years, the lowest operating margin businesses, Q5 in operating margin, dramatically underperformed the broader market and all businesses with higher profitability (see below).



Source: Trivariate Research, LP

But in the last year, the best performing quintile of operating margin was the lowest (Q5). Yes, the lowest operating margin businesses have strongly outperformed from the April lows.

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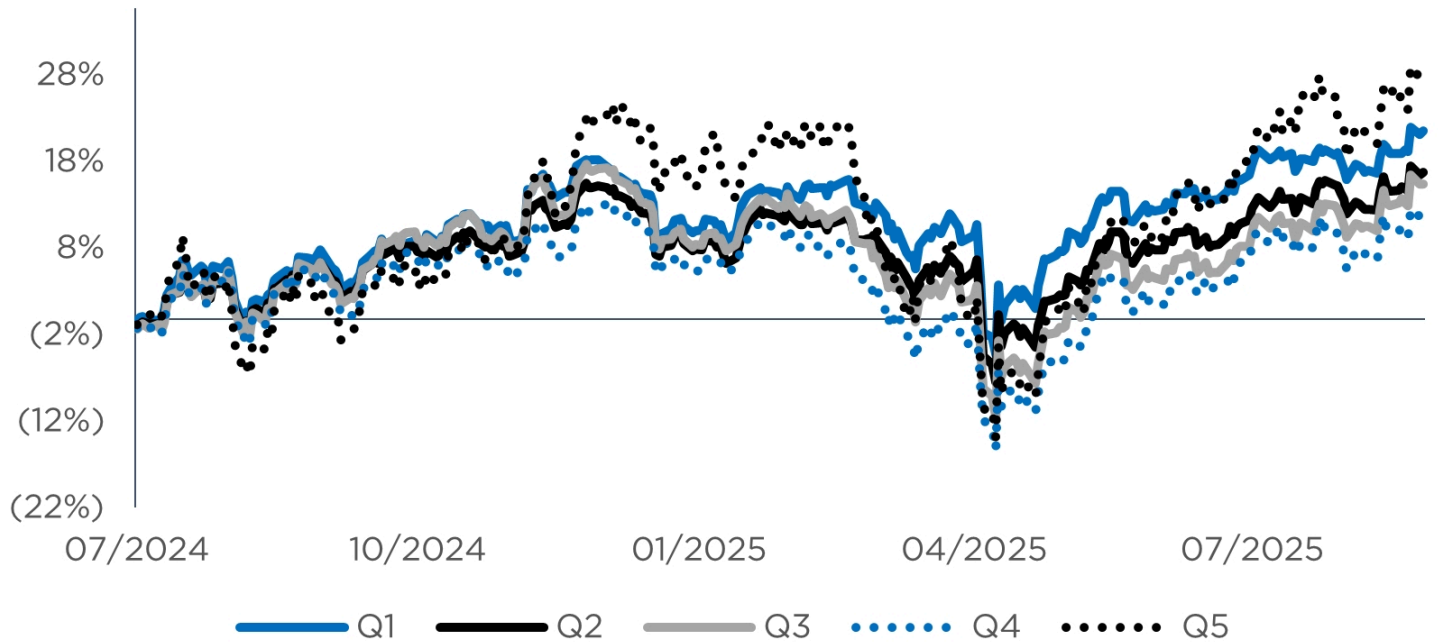
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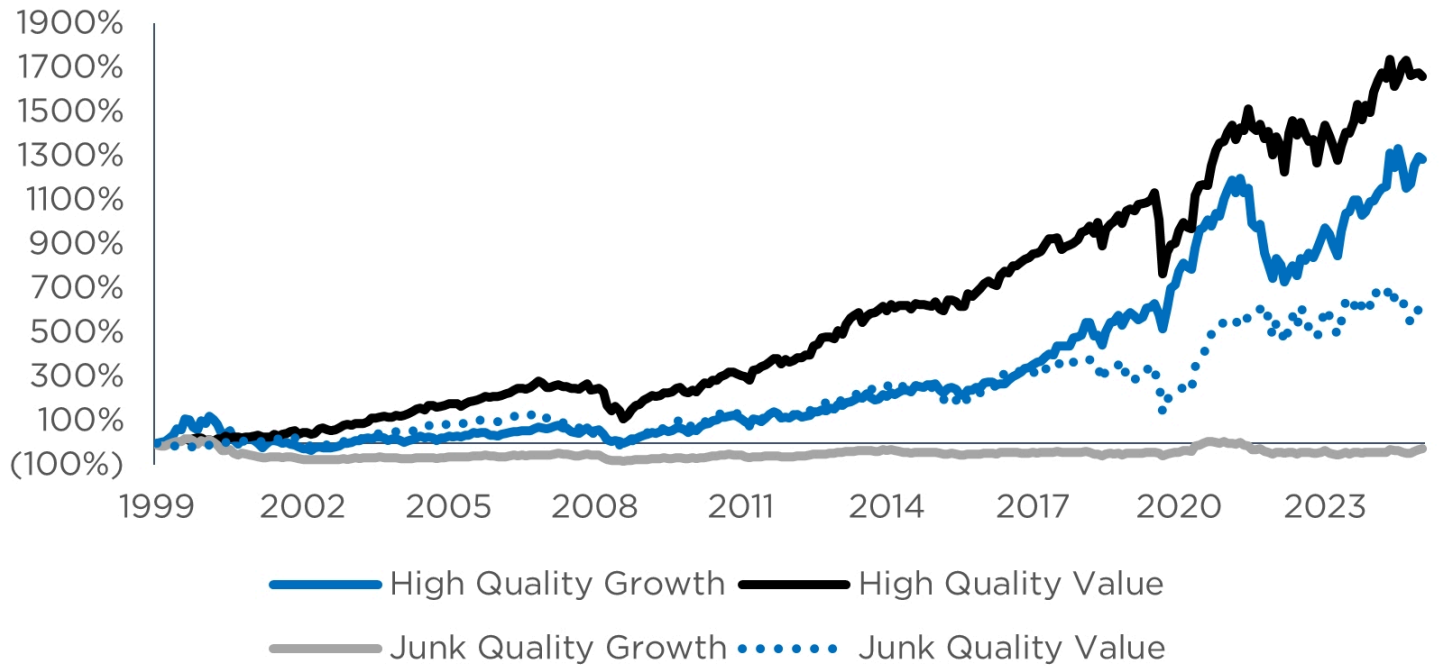
# Cumulative Performance by Operating Margin Quintile July 28, 2024 to August 26th, 2025



Source: Trivariate Research, LP

As a broader representation of this, consider our proprietary substance model. We tag stocks at the end of each month into one of four quality buckets, high-, mid-, low-quality, or junk based on several factors like level and volatility of ROE, distance to default, free cash flow generation, short interest, and turnover of the share base, among other signals. Over the long-term, high-quality companies strongly outperform (see below), both in the growth and value universes.

## Cumulative Performance by Quality and Style Cohort Through End-July, 2025



Source: Trivariate Research, LP

Over the last year however, and specifically around the Red Sweep last November and since April, junk growth stocks have strongly outperformed every other cohort. Within value, junk stocks lagged high quality through April, but junk value has made a strong comeback from April lows (see below).

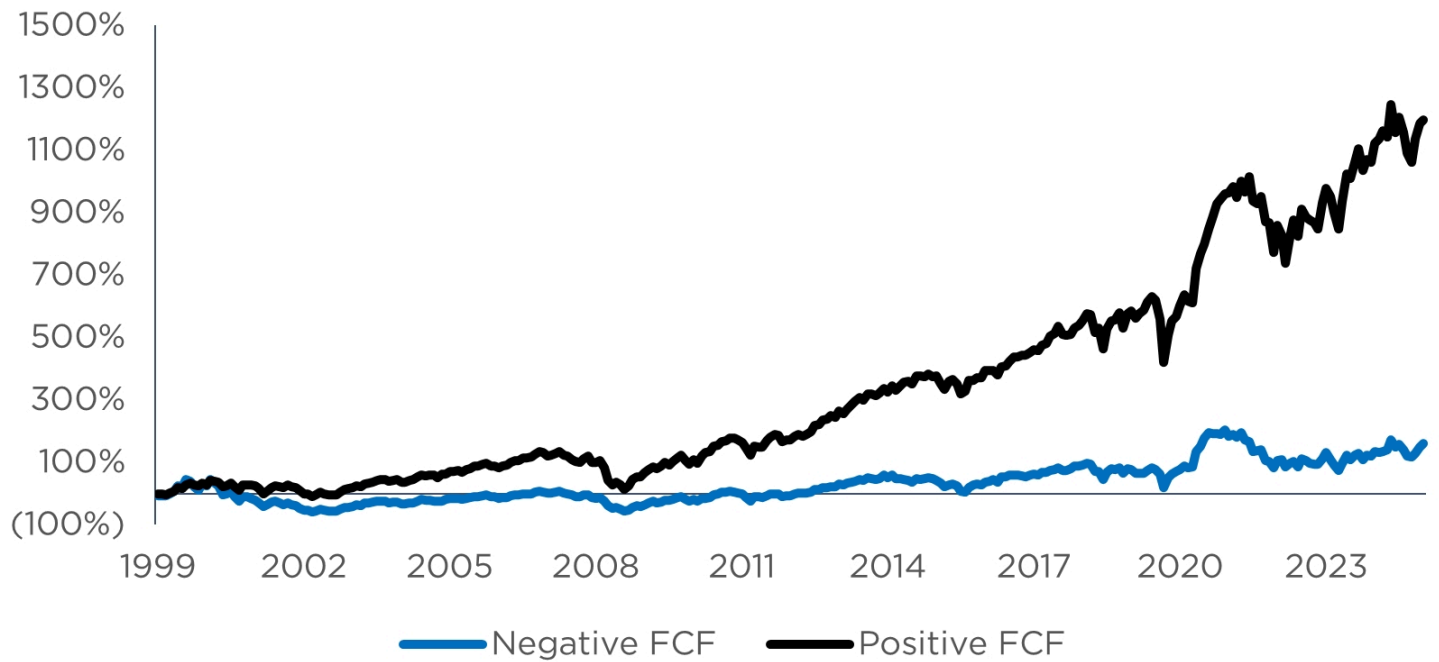
### Cumulative Performance by Quality and Style Cohort July 28, 2024 to August 26th, 2025



Source: Trivariate Research, LP

Normally, money losing companies don't make for good investments. The cumulative return of positive free cash flow companies is strong vs. those companies with negative free cash flow over the last 25 years.

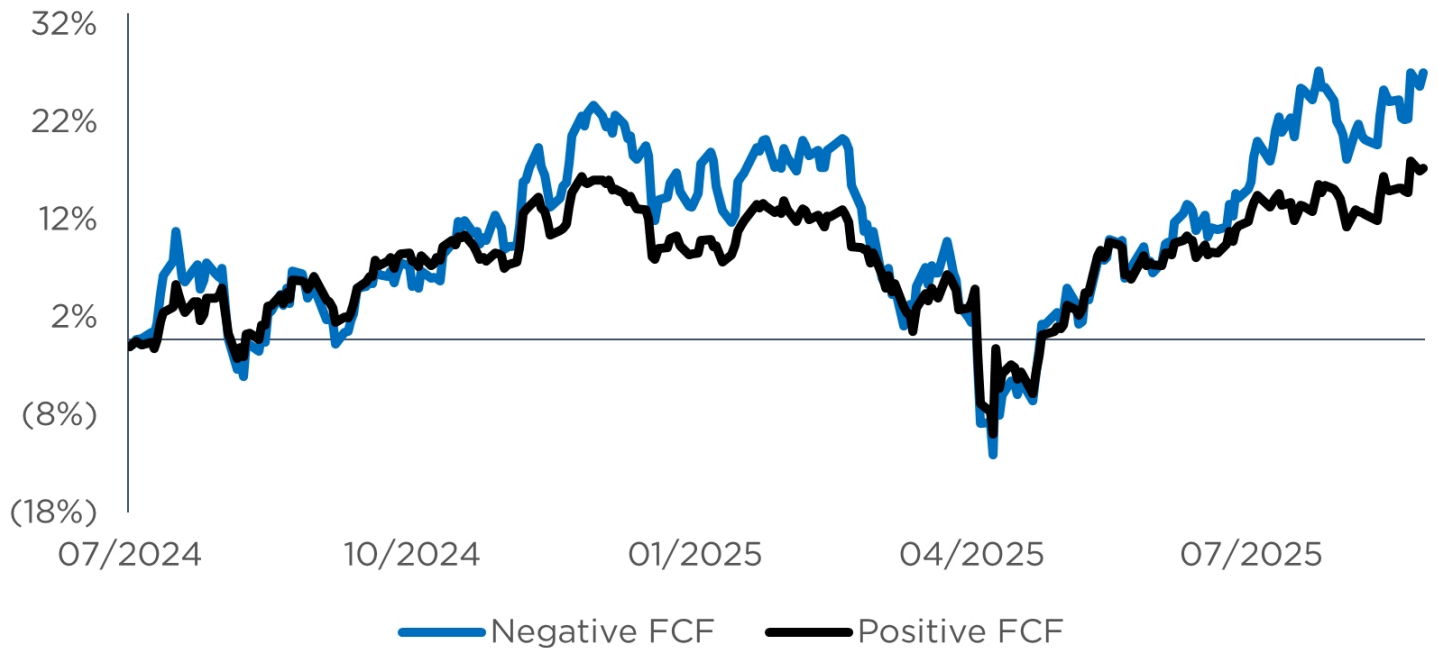
### Cumulative Performance by Positive vs. Negative Free Cash Flow (Trailing 4Q) Through End-July, 2025



Source: Trivariate Research, LP

But again, consistent with margins and quality, buying companies that burn cash has been better than buying those that generate cash off of the market lows, particularly since April of this year (see below).

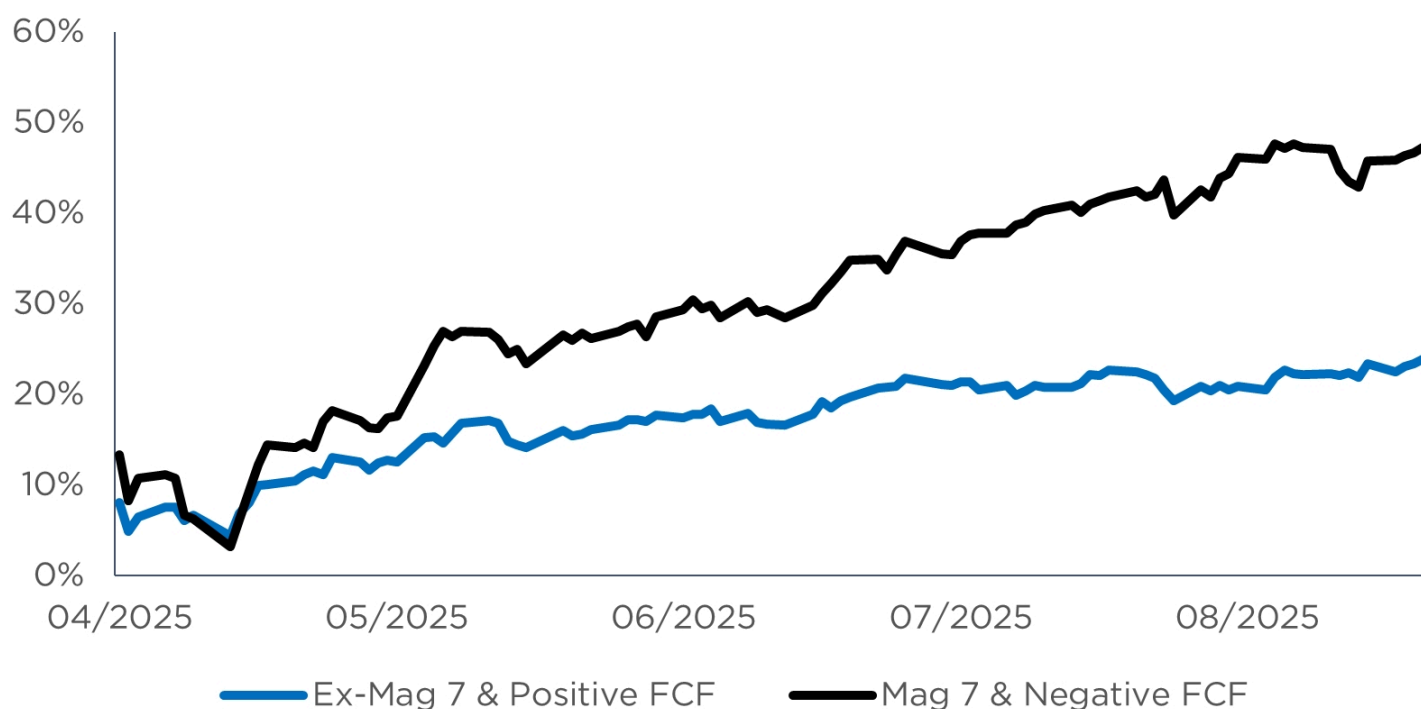
## Cumulative Performance by Positive vs. Negative Free Cash Flow (Trailing 4Q) July 28, 2024 to August 26th, 2025



Source: Trivariate Research, LP

Taking it all in, imagine you're trying to beat the S&P500, long only, and you are slightly underweight the Magnificent 7, because of either 5%-25% risk management ETF rules, internal risk management about maximum position sizes, or a belief that these are relatively low idiosyncratic risk stocks, and you'd prefer to make larger active bets elsewhere. Imagine further that you generally prefer to avoid companies that burn cash. How would that have done? Since April lows, you would be up 24% owning positive free cash flow stocks that are not in the Mag 7. **But, owning the Mag 7 and negative free cash flow stocks would have you up 47% since April lows! So, avoid the Mag 7 and avoid cash flow burners, and you are lagging by 24% since April!**

## Cumulative Cap. Weight Return of Baskets April 9th, 2025 to August 28th, 2025



We, and many institutional investors, are now asking ourselves, “what are the precedents for this, and how long can this last?” We looked at the largest junk vs. non-junk rallies in the last 25+ years. This bottom quartile of quality has outperformed by more than 15% since April, making this the 6<sup>th</sup> biggest junk rally in the last 25 years. However, the other leading junk rallies were all after “named” disasters and their recoveries, including the Financial Crisis in 2009 (2 of them), the TMT bubble (one of them) or COVID (2 of them), meaning this is the biggest “non-disaster” junk rally (see below).

Top 500 US Equities, As of August 27th, 2025  
3-Month Junk vs. Non-Junk Rallies

Beginning Date	Ending Date	Junk Outperformance	Following 3-Month Performance of Junk vs. Non-
			Junk
3/5/2009	6/4/2009	26.5%	4.5%
10/14/2020	1/14/2021	23.5%	0.9%
7/10/2009	10/8/2009	20.3%	2.0%
2/24/2000	5/24/2000	16.6%	(8.5%)
3/18/2020	6/17/2020	16.6%	0.8%
<b>4/8/2025</b>	<b>7/10/2025</b>	<b>15.1%</b>	<b>(0.9%)</b>
12/8/2000	3/13/2001	14.0%	(4.3%)
12/20/2021	3/22/2022	13.6%	(3.4%)
8/27/2019	1/25/2019	10.4%	(6.1%)
1/20/2016	4/20/2016	10.1%	1.2%
1/29/2010	4/30/2010	9.2%	(2.9%)
7/19/2021	10/15/2021	9.1%	3.8%
9/14/2016	12/13/2016	9.0%	(4.6%)
9/26/2023	12/26/2023	8.3%	(0.6%)
11/1/2010	2/1/2011	8.1%	(0.2%)
2/1/2021	5/3/2021	8.0%	(6.9%)
6/20/2001	9/25/2001	7.7%	(5.5%)
12/14/2011	3/16/2012	7.0%	(8.7%)
8/30/2000	11/29/2000	6.8%	8.1%
10/12/2017	1/12/2018	6.4%	(4.3%)

Source: Trivariate Research, LP

That is meaningful, since these prior crises were accompanied by massive fiscal and monetary stimulus. We understand that the time to buy junk stocks over quality for a 3-month trade should be near a recession trough when imminent upside to earnings and margin expansion can come from an economic recovery. We understand that stocks that are discounting a high probability of bankruptcy that then look like they will make it can be great stocks. But is that the regime we are in now? We don't think so.

## CONCLUSION

Our judgment is that the junk rally we have been in is close to ending. Either the market retreats on a tariff-induced growth scare and junk relatively lags, or the high-quality businesses catch a bid and relatively catch-up as their fundamentals remain intact. We think either way, it is hard to see a sustained continuation of the junk rally beyond something akin to a short-term rally fueled by a September interest rate cut. We would add to high-quality Financials, Healthcare, or Technology (select stock ideas below).



**Select High Quality Mega-/Large-Cap Stock Ideas**  
**Screen Well in Trivariate's Quantitative Model**  
**Technology, Healthcare, and Financial Sectors**  
**As of August 28th, 2025**

<b>Ticker</b>	<b>Company</b>	<b>Industry Group</b>	<b>Market Cap. (\$US Bil.)</b>
V	Visa Inc.	Financial Services	674.04
MA	Mastercard Incorporated	Financial Services	533.80
JNJ	Johnson & Johnson	Pharmaceuticals	422.54
CSCO	Cisco Systems, Inc.	Communications Equipment	274.94
ABT	Abbott Laboratories	Health Care Equipment & Supplies	228.64
MRK	Merck & Co., Inc.	Pharmaceuticals	207.84
NOW	ServiceNow, Inc.	Software	192.70
TMO	Thermo Fisher Scientific Inc.	Life Sciences Tools & Services	184.93
SHOP	Shopify Inc.	IT Services	183.95
SCHW	The Charles Schwab Corporation	Capital Markets	176.24
DHR	Danaher Corporation	Life Sciences Tools & Services	147.00
CRWD	CrowdStrike Holdings, Inc.	Software	110.92
ICE	Intercontinental Exchange, Inc.	Capital Markets	101.40
CDNS	Cadence Design Systems, Inc.	Software	96.54
CME	CME Group Inc.	Capital Markets	96.14
MCK	McKesson Corporation	Health Care Providers & Services	84.71
BK	The Bank of New York Mellon Corporation	Capital Markets	74.83
ADSK	Autodesk, Inc.	Software	61.72
REGN	Regeneron Pharmaceuticals, Inc.	Biotechnology	60.10
TEAM	Atlassian Corporation	Software	46.38
ZS	Zscaler, Inc.	Software	43.66
FICO	Fair Isaac Corporation	Software	36.16

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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