Level Set - The Best Way to Deviate

Last Thursday, it seemed obvious to us that the consensus view was that the S&P500 would rally through Q4, sell-off or have a big rotation in Q1, and then rally again. We have been writing about this "triple-breaking-putt" view for a couple of months now. However, Friday's sharp sell-off in response to President Trump's China re-escalation has many investors prognosticating that we could be entering a new regime. We disagree. We don't know if the President's comments were pre-meeting posturing, but his previous tariff-related rhetoric would indicate that he is not looking for a sustained tariff war with China but seeks a more balanced trade deal between the countries. When the China-volatility settles, we expect to be back focusing on imminent earnings season starting with the Financials and evaluating whether the slowdown in the US consumer is taking a more negative trajectory.

Either way, it seems to us that the key to beating the S&P500 is timing when to diversify beyond AI-related securities. Most stocks that were not high-beta and not correlated to the AI Semiconductors trade hurt portfolio performance over the last few months. From our meetings on the road last week it seems apparent to us that the gap between AI believers and AI non-believers among institutional investors is widening, with some convinced that return on hyper-scaler productivity is "obviously bad," and others convinced that the return is so high that there is a real risk that the hyper-scalers like Microsoft (MSFT) will spend all of their current cash flow from operations, taking free cash flow to zero, because they are that confident the return will be so good. That's a divergent set of investor views!

We think this all comes down to risk management, and just like we saw on Friday, and on the "Deep Seek" day in January, correlations between the growth themes are high. We have been writing since December of last year about the correlation of returns between the major growth themes, such as AI Semiconductors, Electrification Industrials, and Power / Infrastructure. We saw on Friday how poorly Semiconductors companies acted, with the triple-levered Semiconductors ETF, SOXL, down 19.1% in one day. Below we show the 6-month daily return correlation between some of Trivariate's custom thematic baskets, and how there is little portfolio diversification between Semiconductors, and Electrification Industrials or Software.

Six Growth Theme Baskets: 126-Day Correlation of Returns As of End-October, 2025

Trivariate Custom Basket	Correlation to AI Semiconductors Basket
Electrification Industrials	81.9%
AI Software	75.9%
Housing	65.3%
Utilities / Power	53.9%
Healthcare Services	45.1%

Source: Trivariate Research, LP

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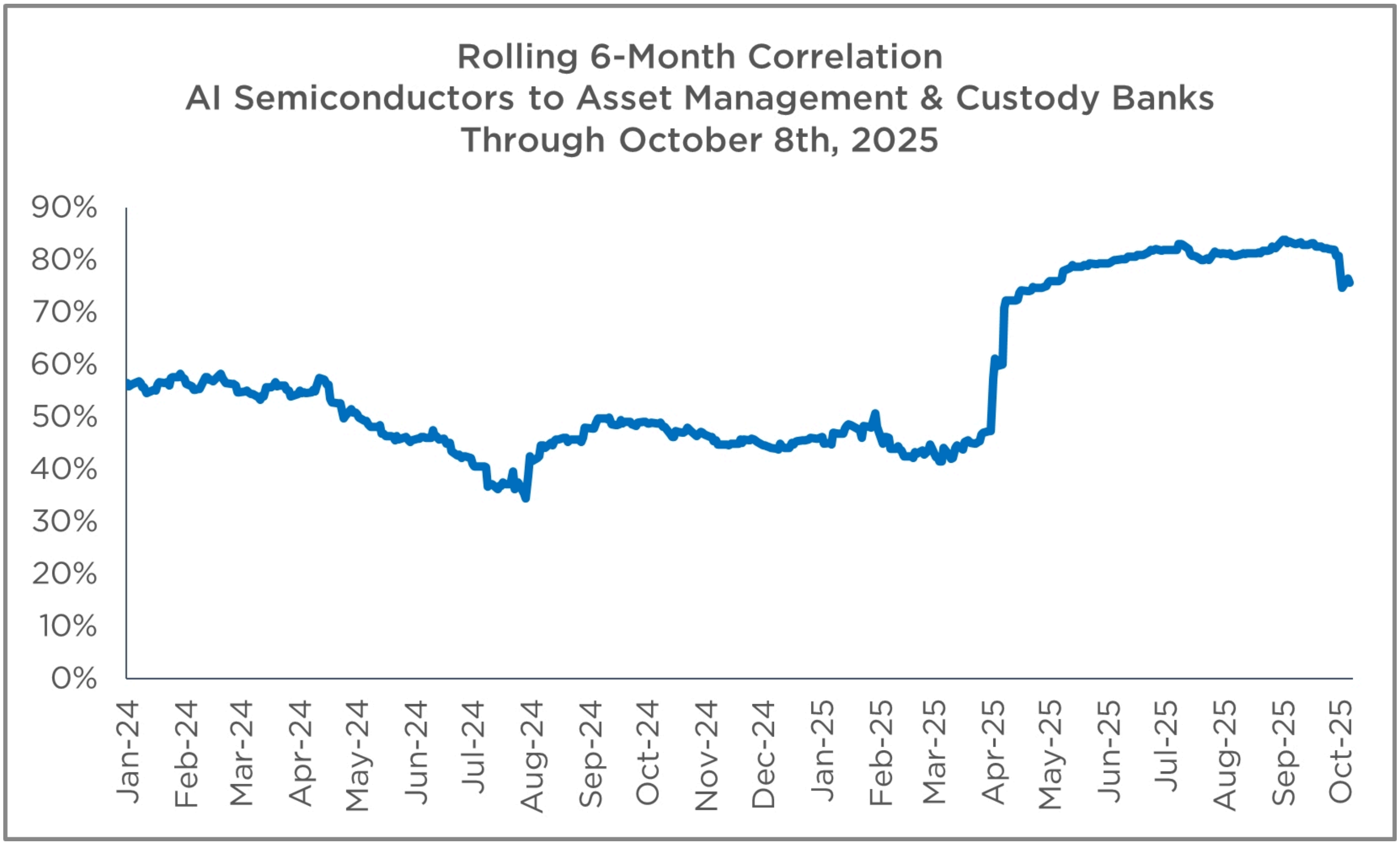
If you suspect that there are some hard-to-see correlations in your portfolio, below we show the correlation between non-Technology stocks and the AI Semiconductors basket, featuring stocks with a 0.8 or higher return correlation in the last six months. The major Financials, most of which report this coming week, have been extremely correlated to AI Semiconductors over the last six months, including the Big Three, JPMorgan (JPM), Goldman Sachs (GS), and Morgan Stanley (MS), but also including Blackstone (BX), KKR (KKR) and Apollo Global (APO).

Stocks With a 0.8 or Higher 6-Month Daily Trading Correlation to Trivariate's AI Semiconductors Basket, Non-Tech. Stocks As of September 25th, 2025

Ticker	Company	Market Cap. (US$ Bil.)
JPM	JPMorgan Chase & Co.	861.9
MS	Morgan Stanley	253.7
GS	The Goldman Sachs Group, Inc.	251.6
AXP	American Express Company	236.7
CAT	Caterpillar Inc.	217.2
C	Citigroup Inc.	188.0
COF	Capital One Financial Corporation	142.3
ETN	Eaton Corporation plc	142.0
BX	Blackstone Inc.	137.4
KKR	KKR & Co. Inc.	120.9
PH	Parker-Hannifin Corporation	94.3
PNC	The PNC Financial Services Group, Inc.	79.8
APO	Apollo Global Management, Inc.	77.9
EMR	Emerson Electric Co.	73.2
MAR	Marriott International, Inc.	70.8
JCI	Johnson Controls International plc	69.2
CMI	Cummins Inc.	57.0
AMP	Ameriprise Financial, Inc.	46.4
CCL	Carnival Corporation & plc	39.6
ARES	Ares Management Corporation	35.8

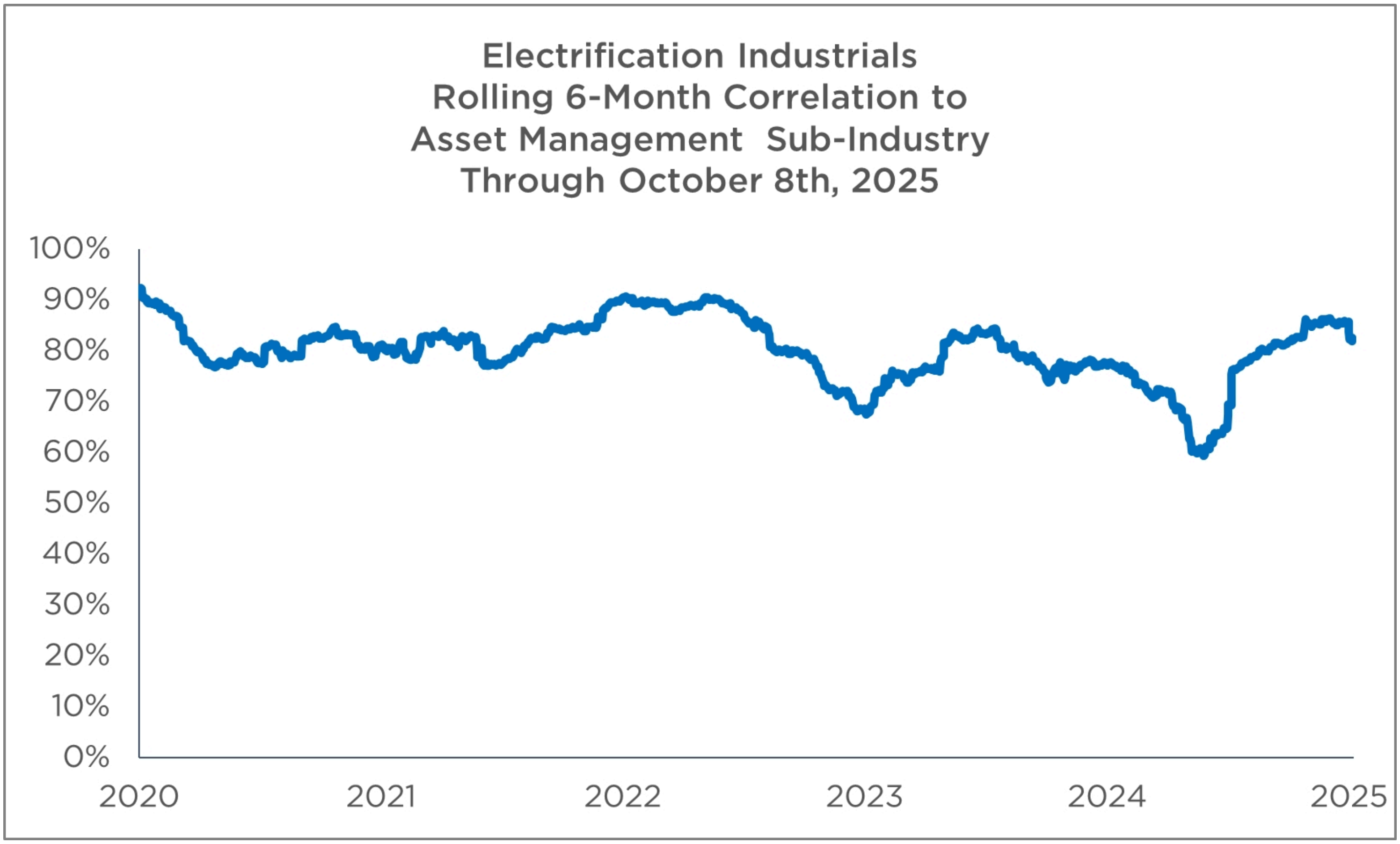
Source: Trivariate Research, LP

In fact, it is clear that sector-based risk management is no risk management at all. Below we show the rolling 6-month return correlation between AI Semiconductors and the Asset Management Sub-Industry. Apollo (APO), Blackstone (BX), and KKR were all down more than 4% on Friday, as there appears to have been a step-change in the return correlation beginning six months ago.



Source: Trivariate Research, LP

Electrification Industrials, another major long-term growth theme that has attracted portfolio managers over the last few years with stocks like Eaton (ETN), Parker-Hannifan (PH), and Emerson (EMR) has consistently been correlated to the Alternative Asset Manager space (see below).



Source: Trivariate Research, LP

Our belief is investors need to search for stocks ideas that have decent fundamentals that are NOT correlated to the AI complex. Below we list stocks that have a 0.2 or lower correlation to our AI Semiconductors basket and are up at least 10% in the last six months, likely meaning they have some reasonable fundamental prospects. The screen includes Healthcare, Utilities, Defense, Tobacco, Automotive Supply Retailers, and Housing-Related securities, among others. We think this is a good place to look for stocks.

Stocks With a 0.2 or Lower 6-Month Daily Trading Correlation to Trivariate's AI Semiconductors Basket & Up >10% In Last 6m
As of September 25th, 2025

Ticker	Company	Market Cap. (US$ Bil.)
JNJ	Johnson & Johnson	428.0
WELL	Welltower Inc.	114.8
LMT	Lockheed Martin Corporation	113.1
MO	Altria Group, Inc.	109.5
CVS	CVS Health Corporation	94.6
MCK	McKesson Corporation	91.6
NEM	Newmont Corporation	91.6
ORLY	O'Reilly Automotive, Inc.	88.7
NOC	Northrop Grumman Corporation	83.9
AEM	Agnico Eagle Mines Limited	80.3
AZO	AutoZone, Inc.	68.9
COR	Cencora, Inc.	57.9
DHI	D.R. Horton, Inc.	49.2
XEL	Xcel Energy Inc.	45.7
EBAY	eBay Inc.	42.6
RKT	Rocket Companies, Inc.	40.1
HSY	The Hershey Company	37.6
AU	AngloGold Ashanti plc	33.2
WRB	W. R. Berkley Corporation	28.3
ATO	Atmos Energy Corporation	26.7

Source: Trivariate Research, LP

Moreover, those who follow our work know that we spend some time on "available alpha," i.e., stocks that have high company-specific risk (CSR) from our proprietary seven-factor model and low replicability, meaning it is hard to create hedge baskets for them. Our thesis is that good stock pickers should have big positions in these hard to replicate names (either over or under-weight) because if they are right, they will separate from the index more than more macro stocks that are easy to replicate. Below we show non-Healthcare mega-/large-cap. stocks that have high CSR and are hard to replicate. These include Walmart (WMT), Netflix (NFLX), and T-Mobile (TMUS), among others. **If an investor is a good stock picker and has an over- or under-weight position in one of these names, we would suggest making these positions relatively larger vs. the index.**

Least Replicable Mega / Large Cap. Stocks with High CSR, Ex-Healthcare End-September, 2025

Ticker	Company	Market Cap. (US$ Bil.)
WMT	Walmart Inc.	821.68
NFLX	Netflix, Inc.	509.45
TMUS	T-Mobile US, Inc.	269.40
IBM	International Business Machines Corp.	262.84
RTX	RTX Corporation	223.98
MELI	MercadoLibre, Inc.	118.48
LMT	Lockheed Martin Corporation	116.55
CME	CME Group Inc.	97.37
SBUX	Starbucks Corporation	96.16
RBLX	Roblox Corporation	96.03
MSTR	Strategy Inc	92.42
NU	Nu Holdings Ltd.	77.37
MNST	Monster Beverage Corporation	65.72
CPNG	Coupang, Inc.	58.70
AXON	Axon Enterprise, Inc.	56.34
CMG	Chipotle Mexican Grill, Inc.	52.55
EA	Electronic Arts Inc.	50.29
TTWO	Take-Two Interactive Software, Inc.	47.66
KR	The Kroger Co.	44.67
EBAY	eBay Inc.	41.56

Source: Trivariate Research, LP

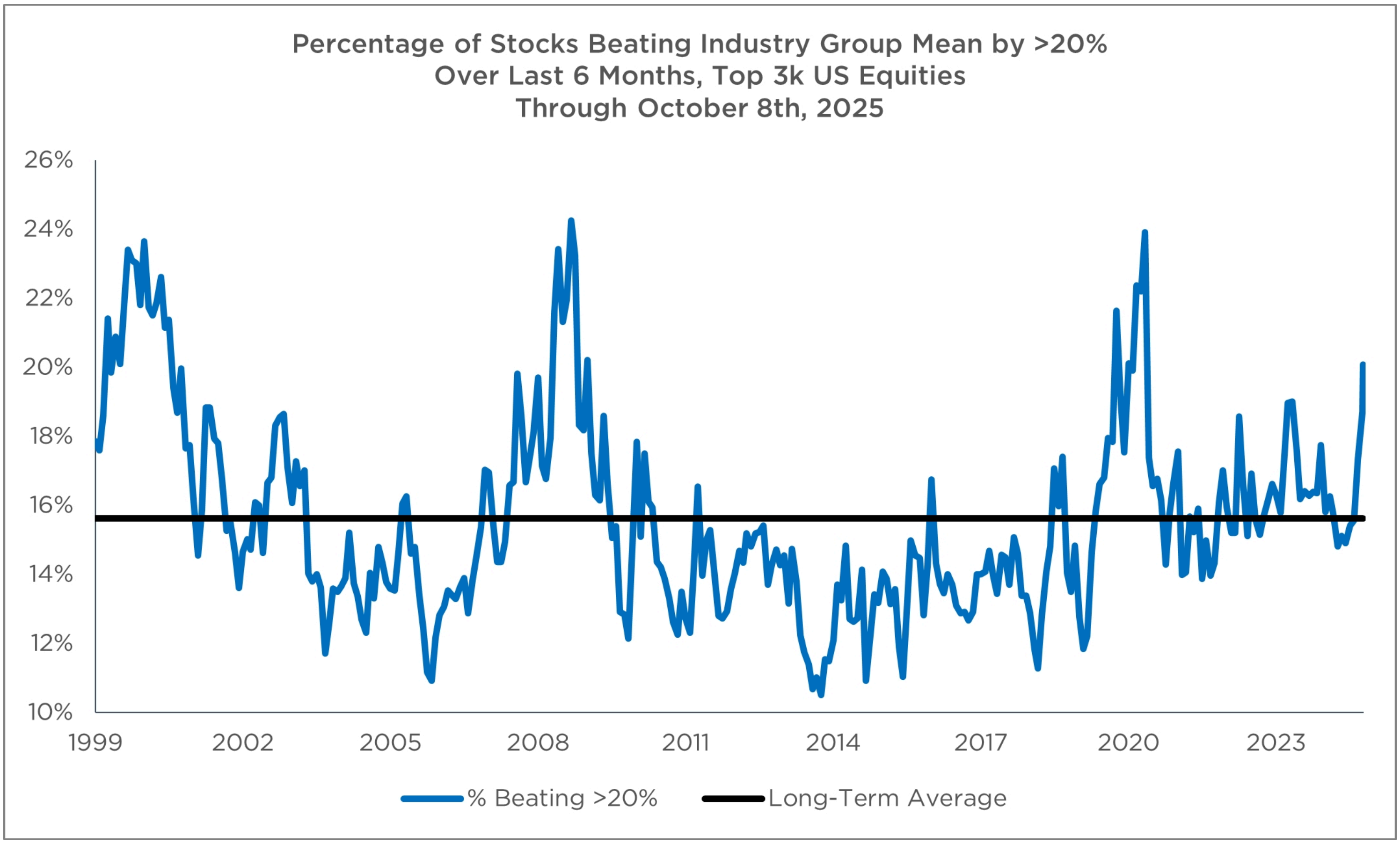
Healthcare ideas that have high CSR and are hard to replicate include Eli Lilly (LLY), UnitedHealth Group (UNH), and Gilead (GILD) among others.

Mega / Large Cap. Healthcare
Least Replicable Stocks with High CSR
End-August, 2025

Ticker	Company	Market Cap. (US$ Bil.)
LLY	Eli Lilly and Company	684.97
UNH	UnitedHealth Group Incorporated	312.73
GILD	Gilead Sciences, Inc.	137.73
HCA	HCA Healthcare, Inc.	99.73
CVS	CVS Health Corporation	95.62
CI	The Cigna Group	76.94
COR	Cencora, Inc.	60.59
ALNY	Alnylam Pharmaceuticals, Inc.	59.77
EW	Edwards Lifesciences Corporation	45.66

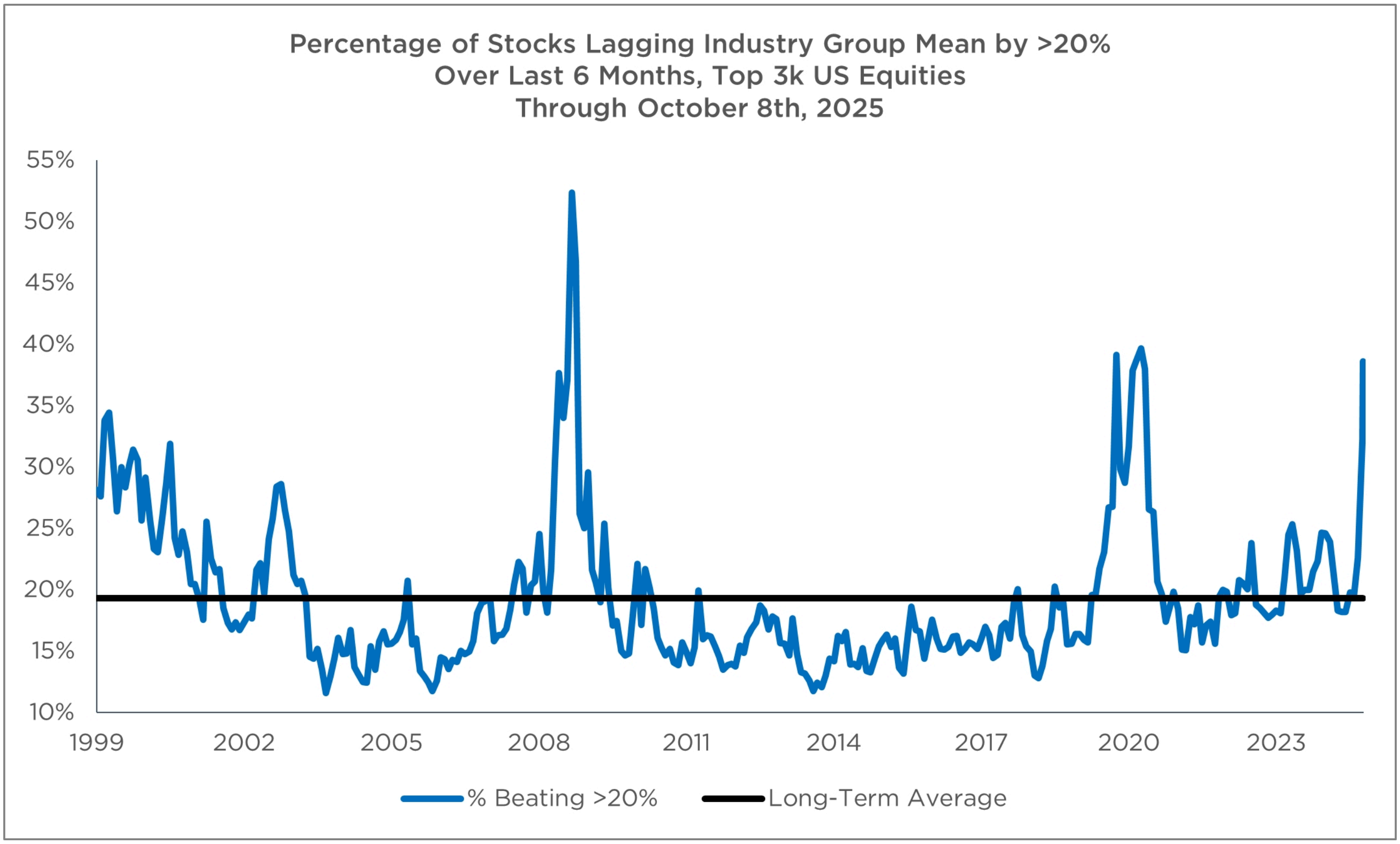
Source: Trivariate Research, LP

Several investors from our recent travels have mentioned the challenges of generating performance in the recent environment. We took a look at "capturable" alpha and find it to be BETTER - not worse - than normal on some common metrics. We looked at the percentage of stocks beating or lagging their industry group equal-weight averages by more than 20% on a rolling six-months basis. This year has seen the fourth-highest number of great relative buy ideas in 25 years, with only the TMT bubble, the pre Financial Crisis bubble, and the pre-COVID bubble higher. To us this chart looks like a late cycle indicator, but one that isn't at peak yet!



Source: Trivariate Research, LP

Even better than finding buy ideas, the recent regime has been great for finding relative to industry short ideas, or underweights. 38.7% of all stocks have lagged their industry group average by more than 20% in the last six months, the third-highest level in over a quarter of a century.



Source: Trivariate Research, LP

It looks like it is “easy” to find stocks that are beating or lagging the market, but in reality it is challenging because of the correlation of stocks. The median pairwise correlation of stocks in each industry group is HIGHER in 24 of the 25 Industry Group GICS in the last quarter. That means MORE stocks are trading alike (see below). Moreover, many of the industry groups have current correlations that are well above the long-term averages, with only the Utilities, of the 25 groups, having current pairwise correlations below long-term averages. This makes sense given the bifurcation of business models in the group - some now data center focused - and some still traditional rate-based businesses.

Pairwise Correlation
3-Month Change and Level by Industry Group
As of End-September, 2025

Industry Group	Change in Median Pairwise Correlation	Level of Median Pairwise Correlation	PWC % Rank vs. History
Transportation	12.5	45.8	91.4
Consumer Durables & Apparel	12.2	51.9	91.8
Household & Personal Products	7.9	32.2	86.9
Semis & Semi. Equipment	7.2	59.7	90.7
Automobiles & Components	6.4	44.1	84.6
Technology Hardware & Equipment	6.2	49.7	94.2
Media & Entertainment	5.6	31.6	72.7
Consumer Services	5.1	36.7	84.8
Real Estate Management & Dev.	4.9	39.2	63.6
Consumer Discretionary Dist. & Retail	4.5	39.4	85.0
Pharma, Biotech & Life Sciences	4.4	30.7	83.1
Commercial & Professional Services	4.3	33.0	72.0
Software & Services	4.2	41.5	88.5
Capital Goods	3.9	43.2	84.0
Food, Beverage & Tobacco	3.8	27.7	82.1
Financial Services	3.7	44.6	83.6
Health Care Equipment & Services	3.4	24.4	68.1
Materials	3.3	37.5	70.1
Insurance	2.8	44.7	87.6
Banks	2.7	73.8	97.0
Equity Real Estate Investment Trusts	2.3	54.1	73.4
Consumer Staples Distribution & Retail	2.1	24.1	55.7
Energy	1.8	48.1	76.8
Utilities	1.7	42.6	36.3
Telecommunication Services	(0.1)	21.8	58.3

Source: Trivariate Research, LP

CONCLUSION

Our view is investors need to own more names and take bigger positions that have high CSR and are hard to replicate. They should focus on ideas not significantly correlated to the AI Semiconductors complex, given how pervasive that theme is in so many different industries in the market.

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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