

## Level Set: Are 2 Pillars Getting A Little Wobbly?

The S&P500 is up 37% since April lows, eclipsing 6900 on Thursday's close before declining 1% on Friday. **The two primary pillars of the bull case have been a dovish Fed and growth in AI.** While episodic fears have emerged about both, nothing has cracked the bull narrative yet. However, this week we got some data on both of these key elements of the bull case, **and our judgment is that this incremental information was slightly negative.** Why?

**On the Fed,** We are slightly more negative simply because we have to be closer to the end of the Fed cutting cycle than the beginning. Going back to 2022, the S&P500, Nasdaq, and many high-profile stocks performed poorly because of a hawkish Fed and rising rates. The correct call was to be massively short long-dated assets for that entire year, and then toward the end of 2022 - around three years ago today - the best move was to cover your shorts and go long the losers from that year, which included Meta (META), Nvidia (NVDA), and Tesla (TSLA) among others. Why? Because the Fed was almost done hiking rates, and eventually accommodation was coming. Our view is that we are at the polar opposite part of the cycle today. The Fed has cut the front end 175bps since September 2024. Experts now expect that the Fed may cut only one more time, in June 2026, and after that probabilities and outlooks appear to fluctuate around that level. Below we show that only during the June 2026 Fed meeting do more than 50% of respondents believe that the Fed will cut interest rates 25bps. The government shutdown certainly isn't providing clarity on the full employment part of the Fed's mandate, but nonetheless, there does not appear to be sufficient conviction among respondents that several more interest rate cuts are coming. In fact, more than 50% of experts today think the Fed will hike in 2027. Hence, the bull case pillar of Fed accommodation has to be closer to the end than the beginning, and this past week's action supports that.

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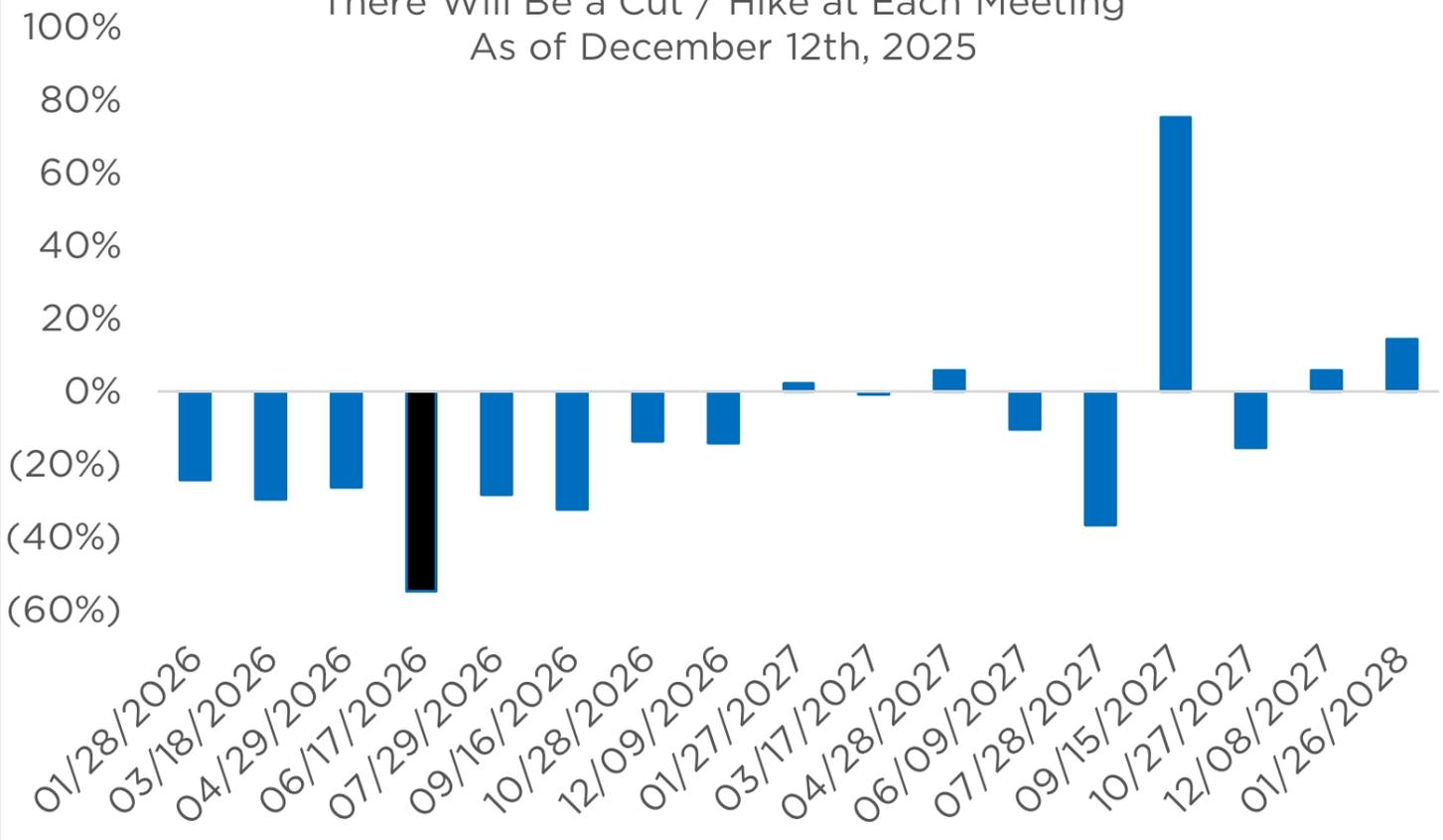
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World Interest Rate Probabilities  
 Percentage of Respondents Thinking  
 There Will Be a Cut / Hike at Each Meeting  
 As of December 12th, 2025

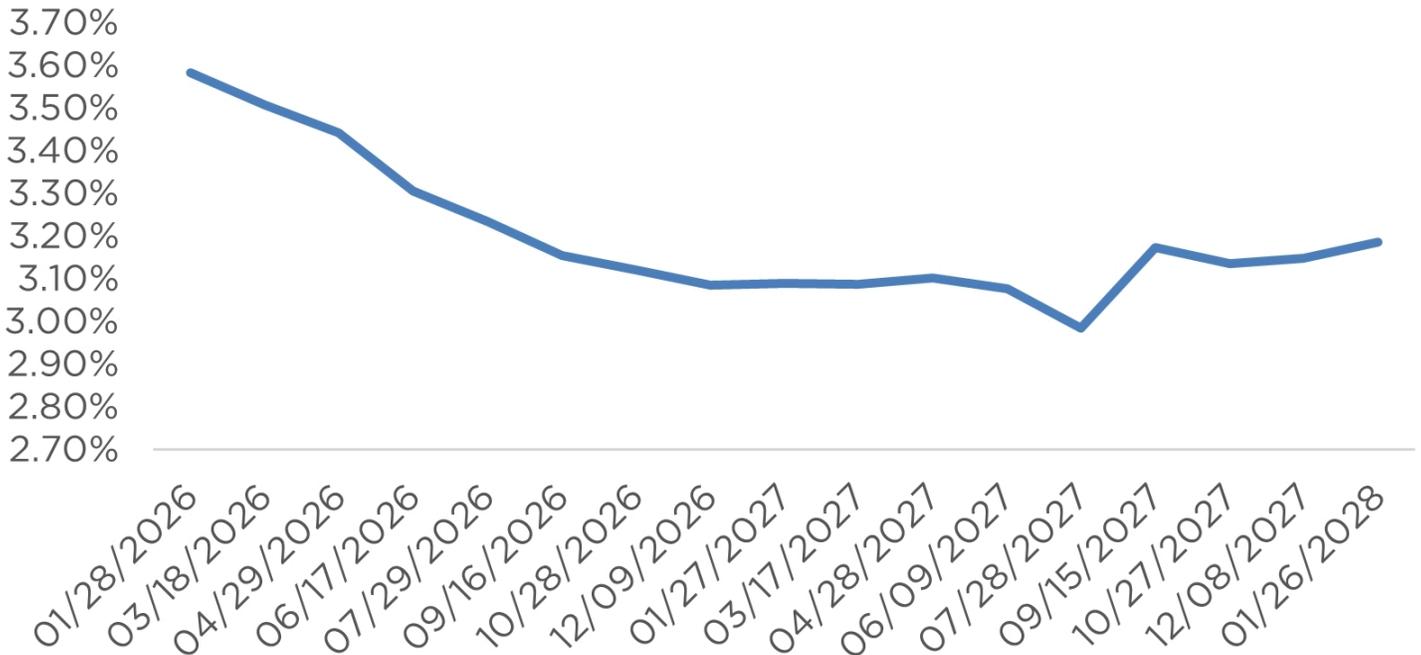


Source: Trivariate Research, LP, Bloomberg LP WIRP Function

Less than -50% means more than half the respondents think there will be a cut

The Polymarket, which has been more accurate than polls in recent memory, largely supports this one more cut notion. Today, Polymarket expects no change at the January Fed Funds meeting, with a 78 cents bet garnering a \$1 payout if there is no change in the Fed Funds rate at the January meeting, 61 cents for no change (and 36 cents for a 25bps cut) at the March meeting, and 62 cents for no change (and 32 cents for a 25bps cut) at the April meeting. **The result appears to be that the current “consensus” view of the Fed Funds rate is lower and then flattish, with the available information, and that likely means less upside to stock multiples in 2026 than we have seen in the previous three years.**

## World Interest Rate Probabilities for US Implied Fed Funds Rate As of December 12th, 2025

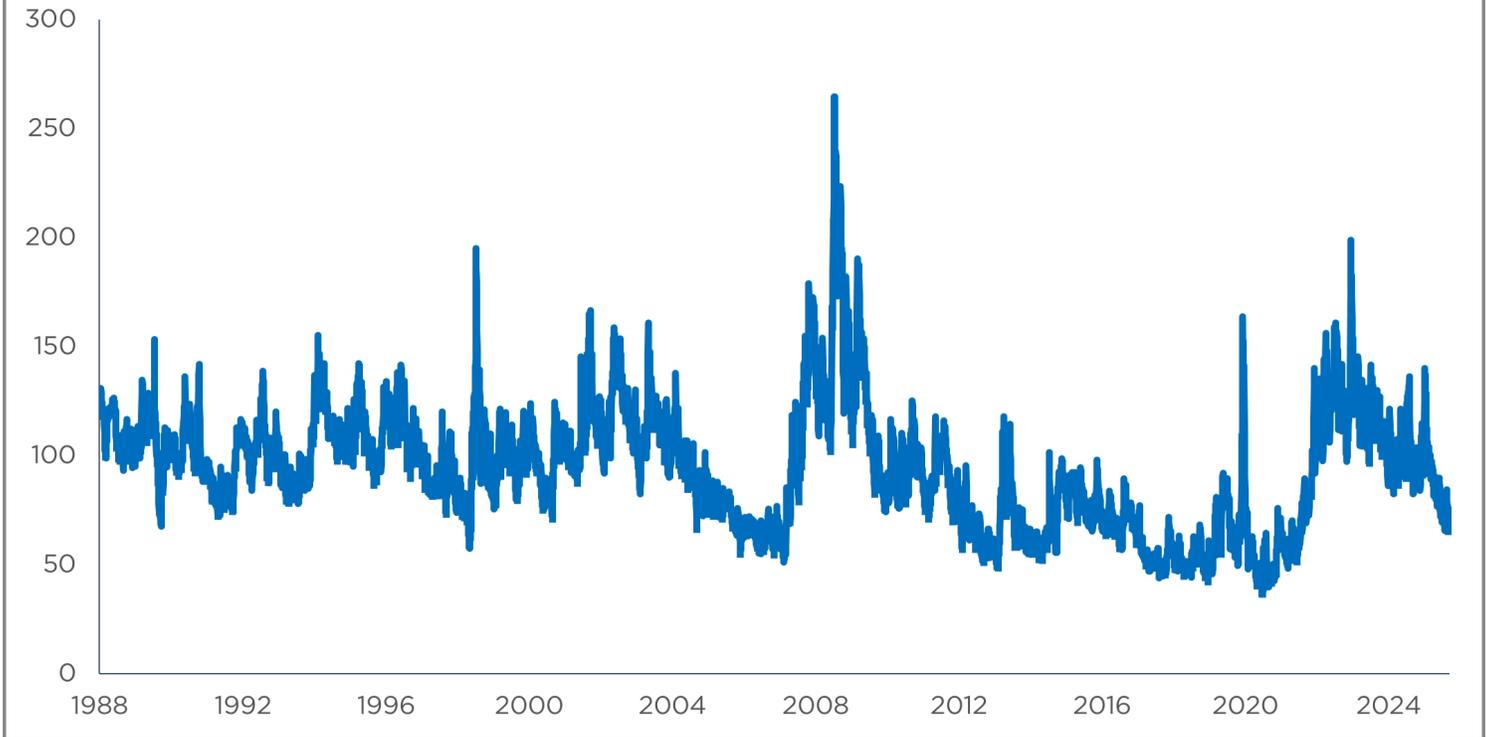


Source: Trivariate Research, LP, Bloomberg LP WIRP Function

A caveat to our view that stock price multiples are less likely to expand based on Fed action today than a year ago is that this assumes no material change to the **Fed Balance Sheet**. Years ago we studied the week-over-week change in the Fed's balance sheet and compared it to the week-over-week change in the S&P500, and the relationship was strongly statistically significant. President Trump has mentioned there will be a new Fed Chair early in 2026. The Polymarket currently says there is an 82% chance (buy yes 89 cents, buy no 25 cents) this announcement will happen by the end of January, 95% by the end of March. Polymarket has Kevin Hassett at 54%, down recently, and Kevin Warsh at 37%, a more recent share gainer. If investors (and we) start believing the Fed will expand their balance sheet, that would change our view that the Fed-related pillar of the bull case is starting to wobble a bit.

So far, the bond market has remained extremely steady, implying there will not be material changes to the supply demand balance of longer-dated Treasuries. We took a look at the MOVE Index, which is a measure of bond market volatility that tracks a basket of options on interest rate swaps. The index tracks implied yield volatility of a weighted basket of at-the-money one-month options on the 2-year, 5-year, 10-year, and 30-year interest rate swaps. Current price is benign, and quite far from indicating fear (see below), with a meaningful decline even in the last two weeks. Financial conditions, as measured by the Bloomberg Financial Conditions Index, have also eased in the last couple of weeks. The VIX has fully retreated back below \$16 from its mid-November spasm. So, while we are slightly more worried about the potential for the Fed to drive higher multiples for equities, we are not worried about bond market volatility creating fear in the near-term.

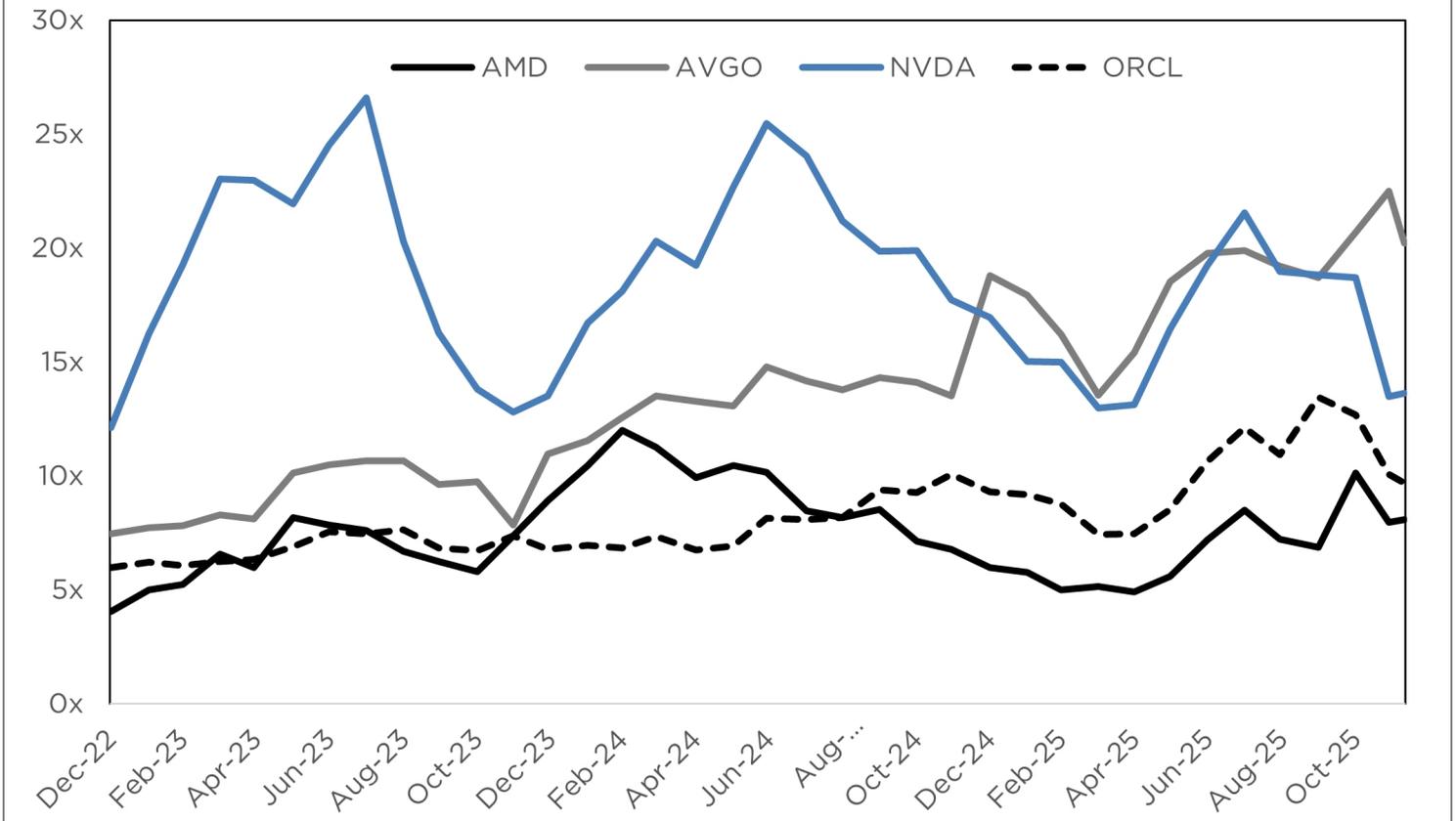
Bloomberg MOVE Index  
Through December 12th, 2025



Source: Trivariate Research, LP

**The other pillar of the bull case is AI.** In the last ten days a couple of big “AI” stocks reported earnings, Oracle (ORCL) and Broadcom (AVGO), and they showed solid metrics in absolute terms on reported revenue and earnings, but also saw material multiple contraction. While we recently wrote that the market is not discriminating between AI-related stocks when it comes to free cash flow yield ([see our recent note here](#)), **it does appear that some of the initial primary revenue beneficiaries have seen multiple contraction on enterprise value-to-forecasted sales. NVDA, ORCL, AVGO, and AMD all have seen what appear to have been peak multiples, with particularly sharp declines in these initially strong AI stocks.**

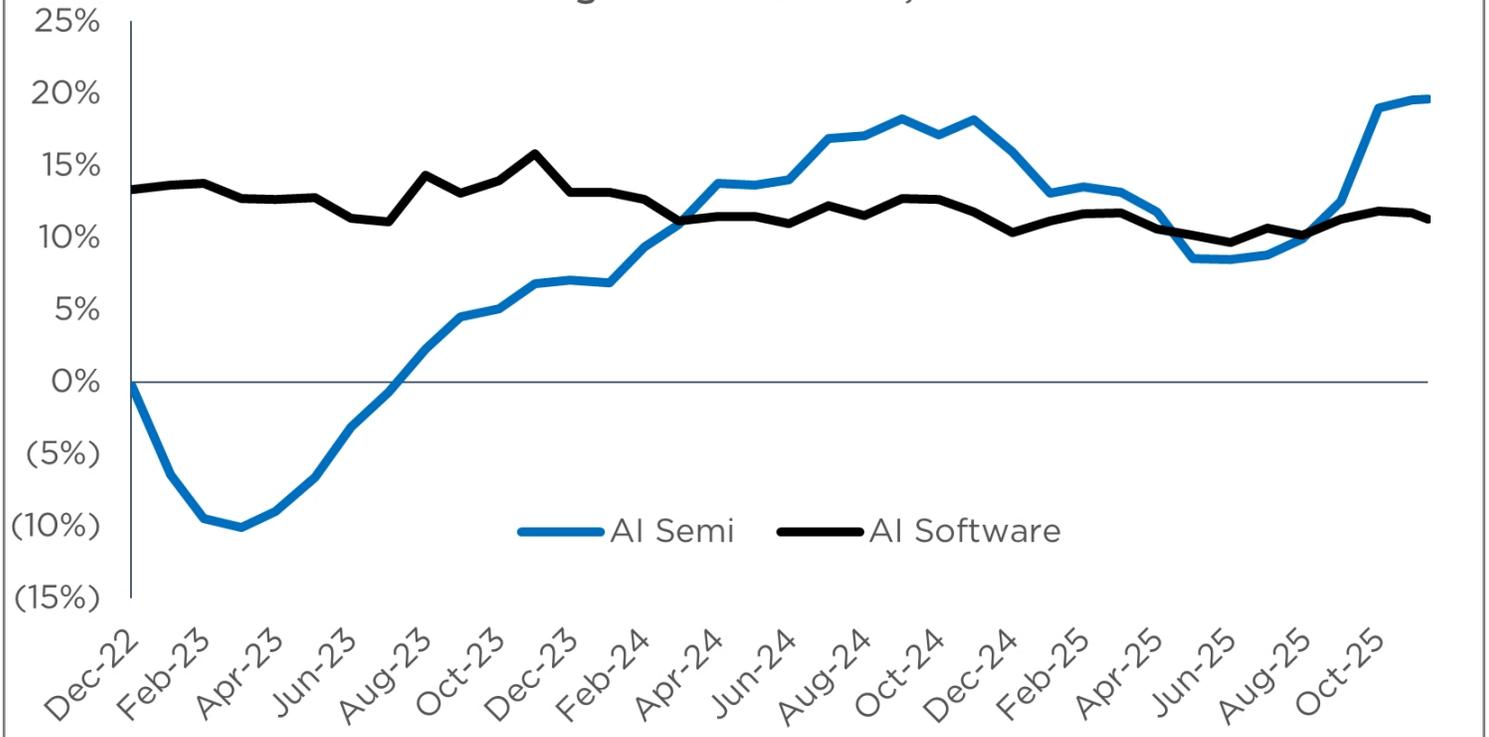
### EV-to-Forecasted Sales of Major AI Stocks Through December 11th, 2026



Source: Trivariate Research, LP

This is happening despite the fact **that we are not** seeing meaningful deceleration in forecasted revenue growth (below) for AI related stocks, leading us to believe multiples have peaked because of concerns about either the Fed as we mentioned above, or the sustainability of gross margins. Software growth has remained relatively constant, and the median AI Semiconductor stock saw cyclically high revenue the past quarter (see below).

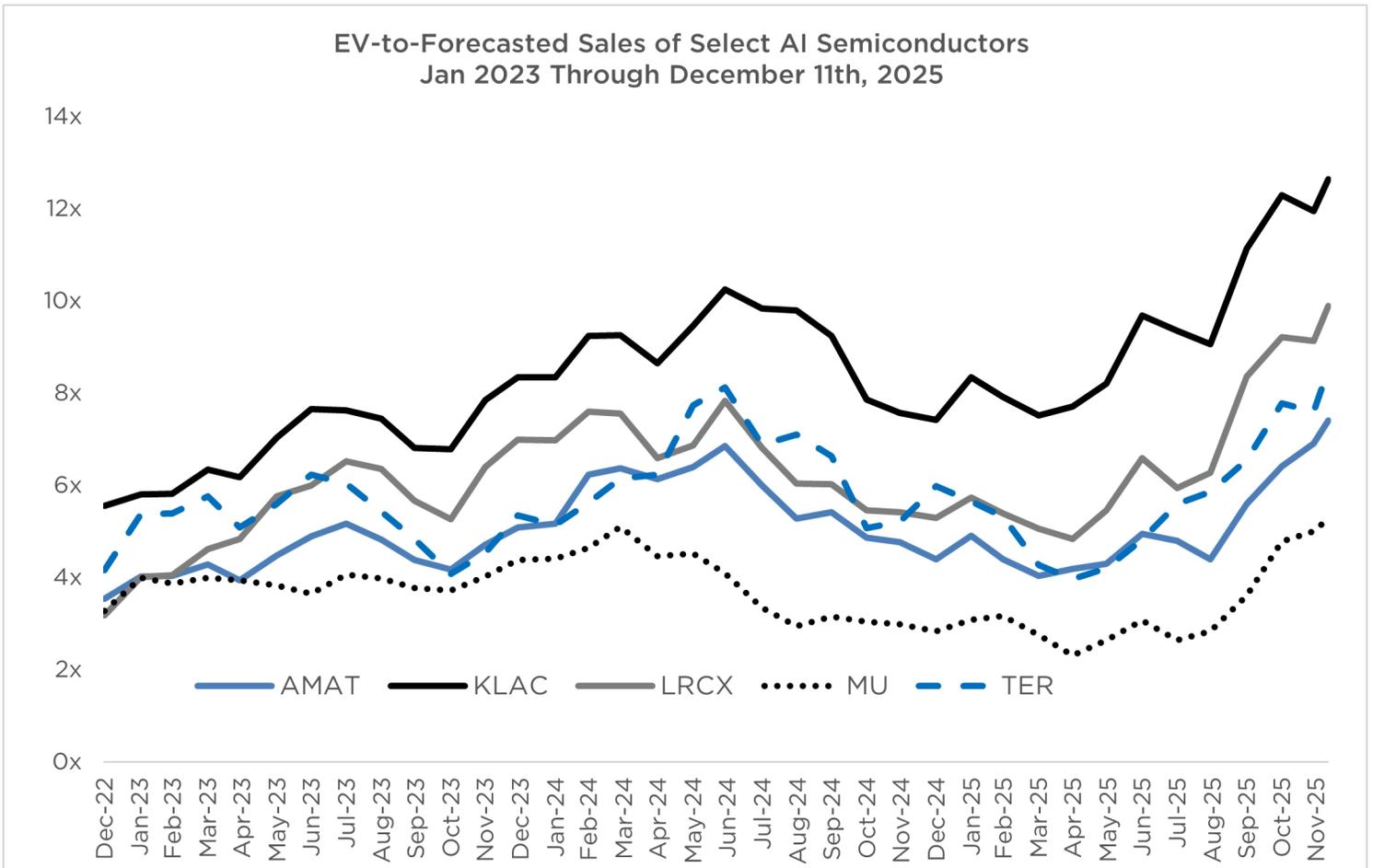
## Median Forecast Revenue Growth Stock Basket Through December 11th, 2025



Source: Trivariate Research, LP

There are, however, pockets of the AI trade where multiples have continued to expand, particularly in Semiconductor Capital Equipment and Memory. Applied Materials (AMAT), KLA (KLAC), Lam Research (LRCX), and Teradyne (TER) are among the stocks with multiples at cycle highs. Micron, where 2027 revenue estimates have gone from \$50 Billion to \$70 Billion in the last few months is also now at peak multiples vs. its own history (see below). **Our judgment is that these stocks are near peak valuations as well now, and that ultimately, for the AI Semiconductor stocks to continue to outperform, it will come more from fundamental strength than multiple expansion, consistent with our view of the broader market.**

EV-to-Forecasted Sales of Select AI Semiconductors  
Jan 2023 Through December 11th, 2025



**Below the surface in the AI trade is a hyper focus among investors on the data center space.** Fermi (FRMI) has gone from \$30 to \$10 in the last two months, and was down over 30% on Friday because an agreement with its first tenant at a Texas data center was terminated. My favorite quote from reading research summaries was a sell-side analyst who says he “sees this as a short-term negative” as the stock was trading 45% down on the day at that point. *You think?* Investors are focused on data center capital spending guidance, believing it is poised to double through 2027 even if an overbuild by the end of the decade is a near certainty.

## CONCLUSION

The market has rallied because of a dovish Fed and AI strength. The impact the dovish Fed has on the market appears to be waning, and the impact the AI trade has on the multiples of some revenue beneficiaries may have peaked. This makes our 2H call to be bullish US equities a little less exciting, at least temporarily. Hubris and debt ultimately cause the top of every cycle, and we are not there yet in our view. But we are only a few more NFLX deals and Bob Iger and Sam Altman CNBC interviews away from ratcheting up our concerns that arrogance is growing too far too fast. We promise 45-50 Level Sets per year - and think this is our last one for 2025. Please join us for our Year-Ahead outlook on January 5<sup>th</sup> at 11am ET. **The registration link is above.**

## Important Disclosures

### Analyst Certification

The analysts, Adam Parker, Maxwell Arnold, Colin Cooney, Chang Ge 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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