# TRIVARIATE RESEARCH

# THE 2026 US EQUITY MARKET OUTLOOK

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# OUTLINE

**Part 1:** The Short- and Long-Term Outlook

**Part 2:** Risk Management

**Part 3:** Artificial Intelligence and Technology Trends

**Part 4:** The US Consumer

**Part 5:** Great 8, Cohort, and Sector Ideas

**Part 6:** Available Alpha

**Part 7:** Management Decision-Making

**Part 8:** The Compounders: **Trivariate's Compounding Stock Ideas**

**Part 9:** SUMMARY CONCLUSIONS (Pages 81-83)

# EXECUTIVE SUMMARY OF MARKET OUTLOOK

BASE CASE:

1) <u>Multiple contraction:</u> We think the probability the price-to-forward earnings for the S&P500 contracts is HIGHER than the probability the multiple expands in 2026.

2) <u>Downward revisions:</u> Bottom-up consensus earnings expectations of 15% for 2026 are overly optimistic, and stocks that have missed expectations have been harshly punished.

3) <u>Bullish consensus:</u> Consensus is generally bullish, and doing the opposite of consensus has been fruitful the last three years.  Only 3x in the last 100 years has the market rallied double-digits for four or more years, so history dictates less appreciation is likely.

We forecast 10% EPS growth in 2026, but multiple contraction, meaning modest appreciation for the S&P500 for 2026 is our base case.

BULL CASE:

More companies than consensus expects show significant progress on AI adoption and there is *incremental* monetary and fiscal stimulus.

BEAR CASE:

1) Private credit hiccups or Fed action cause <u>Financial Conditions to tighten</u>.

2) <u>AI disappoints</u>, either because capital spending is too high, or margin savings is competed away on pricing, driving downward earnings revisions.

<u>LONG-TERM:</u>  Assuming 10% average per year EPS growth and 21x forward earnings, the S&P500 should be near 10000 by 2030, averaging 8% per year return.

# CAN THE S&P500 GET TO 10000 BY 2030?

On the left side below, we show a range of price-to-forward earnings multiples (from 17x to 25x) on the y-axis and a range of per year earnings growth assumptions (from 6% to 14%) from now through 2031 on the x-axis. The cells that populate the table are the year-end 2030 S&P500 price, depending on the earnings growth and valuation assumptions. The goal is to identify assumptions for the S&P500 that result in a 10,000 level by 2030. For instance, paying 21x a market that grows 10% per year, or 19x a market that grows 12% per year would both yield an S&P500 above 10,000 by the end of the decade. This does not seem unreasonable (as we first published over two years ago), and from today's levels this represents 45% appreciation over five years, or roughly the long-term average returns. But nearer-term, bottom-up consensus estimates are forecasted to be well above trend for the next year (right), owing to optimism about AI-productivity and implementation. <u>The 2026 estimates appear overly optimistic.</u>

### Year-End 2030 S&P500 Price Target
### Applied to 2031E EPS Estimates
### Under Various EPS Growth and Price-to-Forward Earnings Assumptions

| Price-to-Forward Earnings | 6% EPS Growth | 8% EPS Growth | 10% EPS Growth | 12% EPS Growth | 14% EPS Growth |
|---|---|---|---|---|---|
| 17x | 6,559 | 7,338 | 8,192 | 9,127 | 10,150 |
| 19x | 7,331 | 8,201 | 9,155 | 10,201 | 11,344 |
| 21x | 8,103 | 9,064 | 10,119 | 11,274 | 12,538 |
| 23x | 8,874 | 9,927 | 11,083 | 12,348 | 13,732 |
| 25x | 9,646 | 10,791 | 12,047 | 13,422 | 14,926 |

Note: Assumes 2025 EPS of $272

### S&P500 EPS and Consensus Bottom-Up Estimates Through End-December 2025
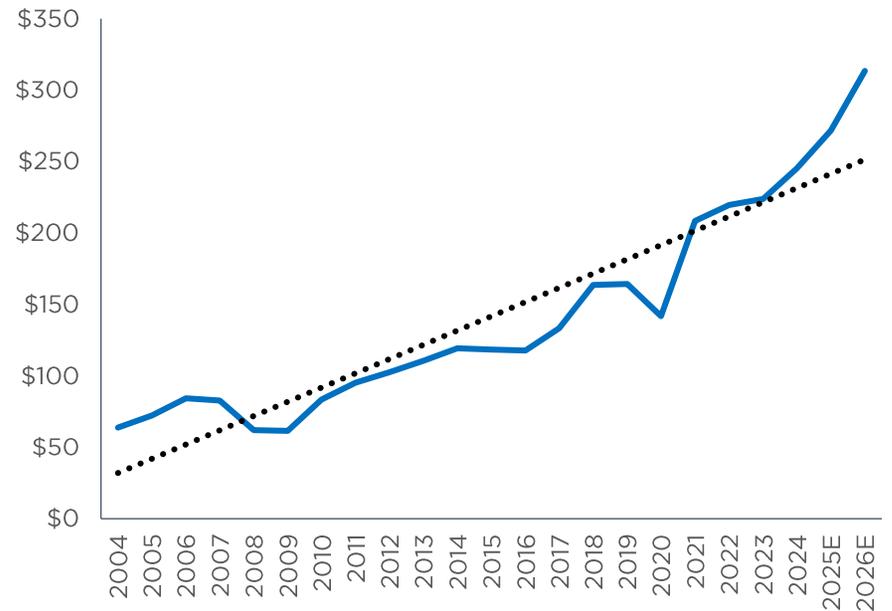
# THE BOTTOM-UP ANALYSTS ARE BULLISH ON EARNINGS

Below we show the bottom-up consensus EPS estimates and Trivariate's top-down EPS estimates for the S&P500 through 2027. We forecast $300 in 2026 EPS and $324 in 2027 EPS vs. the consensus of $313 and $345, respectively (left). The consensus outlook embeds 15.3% EPS growth for 2026 (right), followed by another year of double-digit growth in 2027. We forecast a 10% EPS growth in 2026 and 8% in 2027.



**S&P500 EPS Estimates**
**Bottom-Up Consensus vs. Trivariate Top-Down**
**Through End-December, 2025**

Source: Trivariate Research



**S&P500 EPS Growth Estimates**
**Bottom-Up Consensus vs. Trivariate Top-Down**
**Through End-December, 2025**
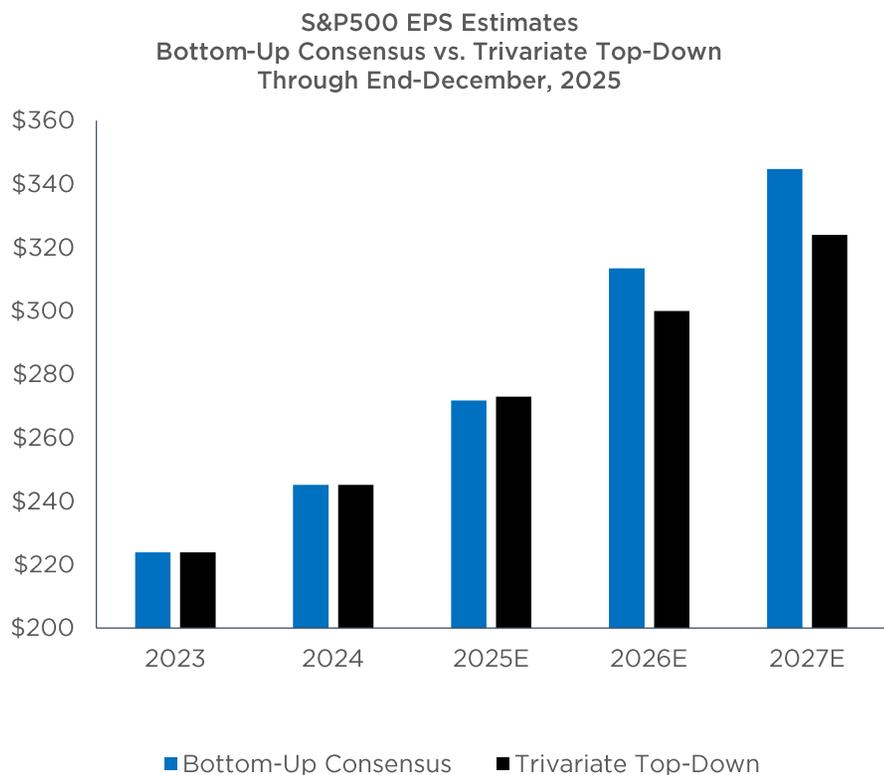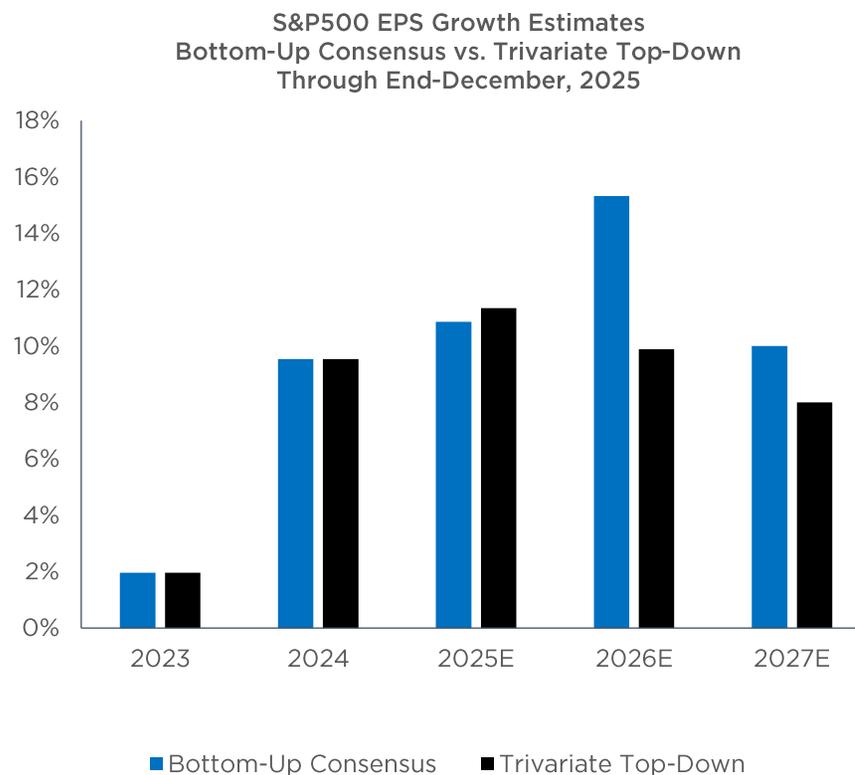
Source: Trivariate Research

# TECHNOLOGY AND INDUSTRIAL EPS EXPECTATIONS ARE VERY HIGH

At the sector level, only Consumer Staples and Energy are forecasted to have declining year-over-year earnings in 2025.  The highest 2025 bottom-up earnings expectations are in Technology, Communication Services, and Financials. For Q4, five of the 11 sectors are forecasted to have a year-over-year earnings decline.  The Technology EPS estimates embed an acceleration to 30.7% EPS growth in 2026 vs. 24% in 2025.  Industrials expectations embed a recovery not yet in evidence, with 14.8% EPS growth expectations for 2026 vs. just 6% in 2025.  <u>Both sectors' estimates appear excessively optimistic.</u>

**Bottom-Up Analyst Earnings Growth Expectations**
**January 2nd, 2025**

| Sector | 2024 | 1Q25 | 2Q25 | 3Q25E | 4Q25E | 2025E | 2026E |
|---|---|---|---|---|---|---|---|
| S&P 500 | 9.5% | 12.6% | 11.1% | 12.5% | 7.6% | 10.9% | 15.3% |
| S&P ex-Financials | 8.3% | 14.4% | 10.8% | 10.3% | 7.9% | 10.7% | 16.8% |
| Consumer Discretionary | 14.9% | 7.4% | 4.4% | 7.3% | (4.4%) | 3.5% | 10.1% |
| Consumer Staples | 3.0% | (6.3%) | (1.5%) | (1.4%) | (2.1%) | (2.8%) | 6.1% |
| Energy | (23.8%) | (18.9%) | (20.9%) | (2.9%) | (0.2%) | (11.6%) | 7.4% |
| Financials | 15.0% | 5.0% | 12.2% | 22.9% | 6.3% | 11.5% | 9.1% |
| Health Care | 1.9% | 41.8% | 6.0% | 2.7% | (0.9%) | 10.6% | 9.1% |
| Industrials | (0.5%) | 8.9% | 1.0% | 20.2% | (3.4%) | 6.0% | 14.8% |
| Info Tech | 23.0% | 18.8% | 22.9% | 28.7% | 24.9% | 24.0% | 30.7% |
| Materials | (11.8%) | (3.5%) | (2.6%) | 25.2% | 12.0% | 7.1% | 20.2% |
| Communication Services | 21.5% | 27.6% | 45.2% | (8.5%) | 5.7% | 15.2% | 11.2% |
| Utilities | 20.3% | 6.6% | (1.3%) | 3.3% | 3.8% | 3.2% | 11.0% |
| Real Estate | 3.1% | 5.1% | 3.6% | 5.7% | 3.7% | 4.5% | 6.8% |

Source: Trivariate Research

# THE TOP-DOWN STRATEGISTS ARE ALSO BULLISH

We arrived at what the 2026 top-down consensus macro view was by putting the various sell-side outlooks into ChatGPT and Gemini and asking for summary bullets.  Below is what surfaced:

<u>The consensus top-down strategy view is uniform optimism for a fourth consecutive year of gains.</u>  Consensus S&P 500 is 7,555, representing 10% returns from today's levels with a range of 7,100 (Bank of America - Bearish on AI ROI) to 8,000 (Deutsche Bank - Bullish on Productivity).

1. <u>The Macro Consensus: "A Policy-Driven Bull Market":</u>
    - **The "Policy Put":** Markets supported by the Fed (managing growth, not inflation) and the White House.
    - **Monetary Stimulus:** "Shallow" cutting cycle (2–3 cuts) targeting a terminal rate of 3.00%–3.25%.
    - **Fiscal (OBBBA) Stimulus**: *One Big Beautiful Act* projected to trigger $100B+ in tax refunds in 1H 2026, front-loading consumption.

2. <u>The Great AI Pivot: Phase 3 (Monetization):</u>
    - **The Shift:** Rotation from "Builders" (Chips/Hardware) to "Adopters" (Software/Industrials) that use AI to defend margins.
    - **The Capex Floor:** Hyperscalers (MSFT, AMZN, GOOG) projected to spend $440B+ in 2026 capex - a Goldilocks spending scenario is required to create continued excitement.

3. <u>High-Conviction Sectors & "Best Ideas":</u>
    - <u>**Small Cap "Catch-Up" (#1 Consensus Trade):**</u> Russell 2000 (IWM) expected to outperform as rates drop and domestic stimulus (OBBBA) targets local businesses.
    - **Financials:** Beneficiaries of deregulation, steepening yield curve, and a 20% surge in M&A volume (GS, JPM, C, MS).
    - **The Energy Buildout:** Utilities and Nuclear as "back-door" AI plays required to power data centers.

4. <u>Key Risks: The "K-Shaped" Economy:</u>
    - Labor Market Polarization: J.P. Morgan and others warn of a "K-shaped" economy where high-end consumers thrive on asset gains while the lower-income labor market cools, potentially leading to a 35% recession risk.
    - The "AI Air Pocket": If the $500B+ in AI spend fails to generate accretive revenue by mid-2026, Technology multiples face a sharp reset (BofA Bear Case: 5,500).

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# PENALTY FOR MISSING IS WORSE THAN THE REWARD FOR BEATING

Despite the strong market performance, the reward for beating earnings estimates has been smaller than the penalty for missing earnings (left), an increasing concern for the overall market in our view given how high earnings expectations are for 2026 and the strong stock market performance.  Only two of the last ten mega-/large-cap. companies with earnings misses have managed to subsequently outperform their industry average (right), CEG and WBD (deal), with several materially lagging, including AZO, HD, XYZ, DASH, LYV, AXON, and CMG, among others.



T-Statistic of Industry-Relative Return On Earnings Release
By Prior 2-Week Momentum Vigintile & EPS Beat vs. Miss
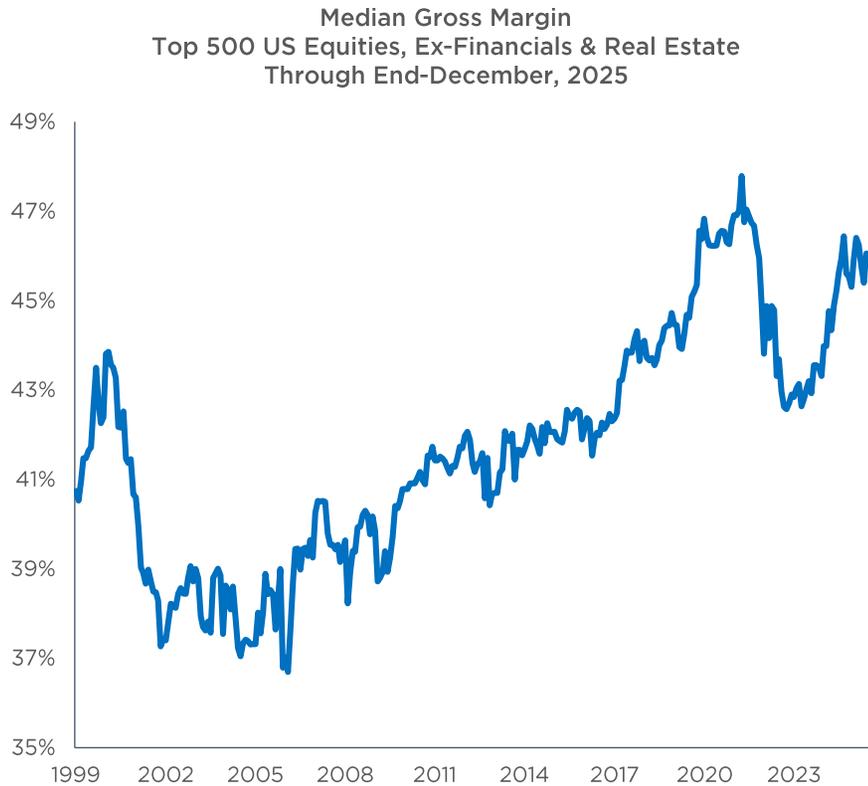Through End-December, 2025
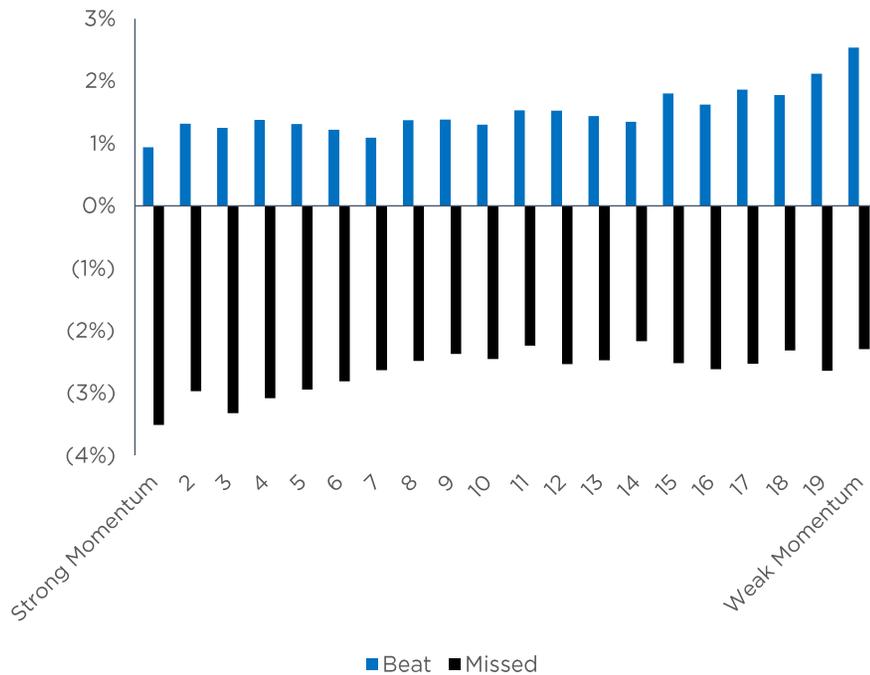
Source: Trivariate Research

Recent Mega / Large Cap Earnings Misses
As of End-December, 2025

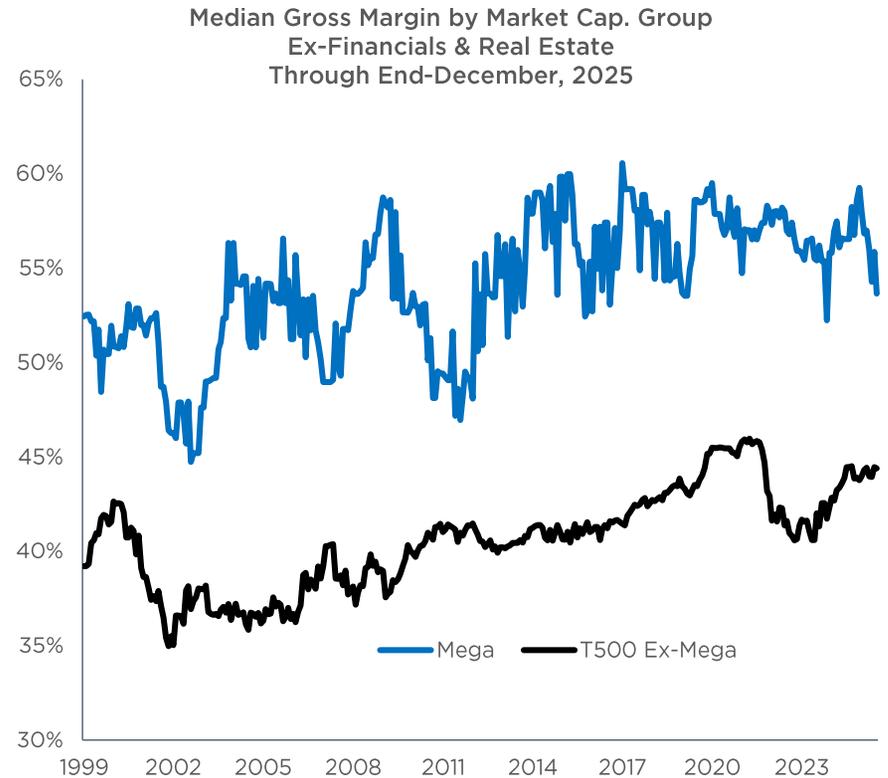| Date | Ticker | Company | Industry-Relative Earnings Reaction |
|---|---|---|---|
| 12/9/2025 | AZO | AutoZone, Inc. | (11.4%) |
| 11/18/2025 | HD | The Home Depot, Inc. | (6.2%) |
| 11/7/2025 | CEG | Constellation Energy Corporation | 1.7% |
| 11/6/2025 | XYZ | Block, Inc. | (10.6%) |
| 11/6/2025 | WBD | Warner Bros. Discovery, Inc. | 0.2% |
| 11/5/2025 | DASH | DoorDash, Inc. | (15.9%) |
| 11/4/2025 | LYV | Live Nation Entertainment, Inc. | (9.5%) |
| 11/4/2025 | AXON | Axon Enterprise, Inc. | (11.1%) |
| 11/4/2025 | SHOP | Shopify Inc. | (3.4%) |
| 11/4/2025 | MPC | Marathon Petroleum Corporation | (2.6%) |
| 11/3/2025 | WMB | The Williams Companies, Inc. | (0.8%) |
| 10/30/2025 | AJG | Arthur J. Gallagher & Co. | (5.8%) |
| 10/30/2025 | XEL | Xcel Energy Inc. | 2.6% |
| 10/30/2025 | LNG | Cheniere Energy, Inc. | 0.4% |
| 10/29/2025 | CMG | Chipotle Mexican Grill, Inc. | (15.4%) |
| 10/29/2025 | BA | The Boeing Company | (9.6%) |
| 10/29/2025 | FI | Fiserv, Inc. | (45.2%) |
| 10/29/2025 | AEP | American Electric Power Company | 7.2% |
| 10/29/2025 | MELI | MercadoLibre, Inc. | 7.2% |
| 10/28/2025 | EA | Electronic Arts Inc. | 1.8% |

Source: Trivariate Research

# THE MEDIAN STOCK'S GROSS MARGINS HAVE BEEN FLAT FOR A YEAR

Gross margins for the median company in the Top 500 by market cap. are slightly lower today than in February of 2025, when they last peaked at 46.4% (left). The median stock had a gross margin of 45.9% at the end of December, just a touch down from 46.0% at the end of November. For mega-caps (the top 50 stocks by market cap.) the median stock's gross margins fell to 53.7% at the end of December from 55.9% at the end of November, the lowest level since April of 2024 (right). While the smaller companies (stocks 51 through 500 by market cap.) have lower median margins, they have been more stable over the last three months and were level in December vs. November at 44.4%.

**Median Gross Margin**
**Top 500 US Equities, Ex-Financials & Real Estate**
**Through End-December, 2025**



Source: Trivariate Research

**Median Gross Margin by Market Cap. Group**
**Ex-Financials & Real Estate**
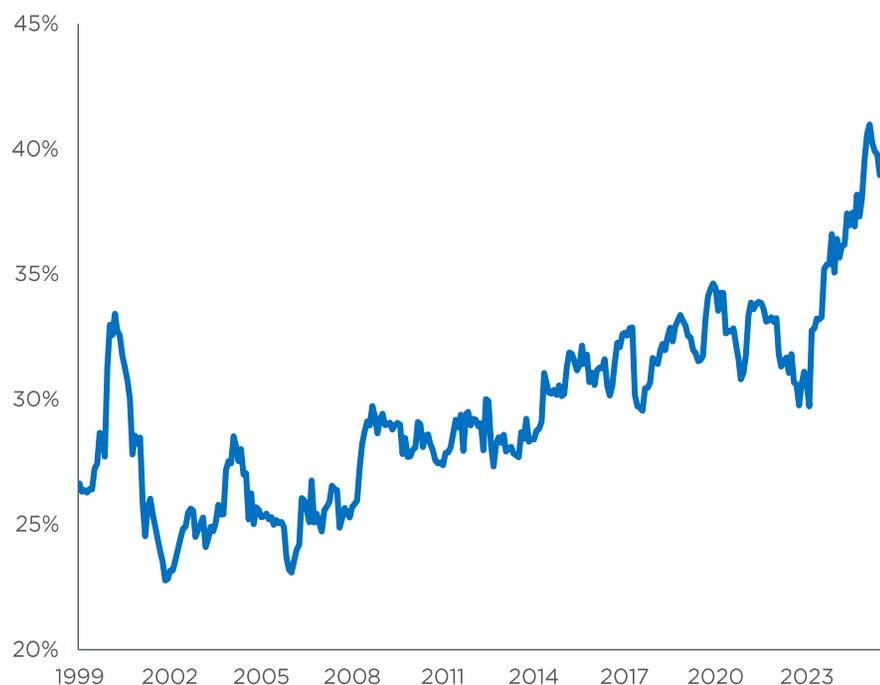**Through End-December, 2025**



Source: Trivariate Research

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# VALUATION IS STRONGLY RELATED TO GROSS MARGIN LEVEL

One of the reasons we expect the US equity market to trade and oscillate at higher multiples in the future than in the past is because the gross margins for the median stock are higher.  Several of the largest stocks have high gross margins.  We pointed out in July 2025 that 41% of all the market cap. in the US equity market had gross margins above 60% (left), though that number has subsequently dipped to 39% with some of the mega cap. margin degradation we just highlighted.  We think the bull case for individual stocks, and for the overall market is gross margin expansion, because we have found that there is a strong relationship between gross margins and EV-to-forecasted sales (right). Market-wide valuation will only go lower if margins for many stocks go lower.

**Percent of Market Cap. With >60% Gross Margins**
**Top 3000 US Equities, Ex-Financials & Real Estate**
**Through End-December, 2025**

**Median EV-to-Forecast Sales by Gross Margin Decile**
**Top 3000 US Equities with Revenue >$100m**
**Through End-December, 2025**

Source: Trivariate Research
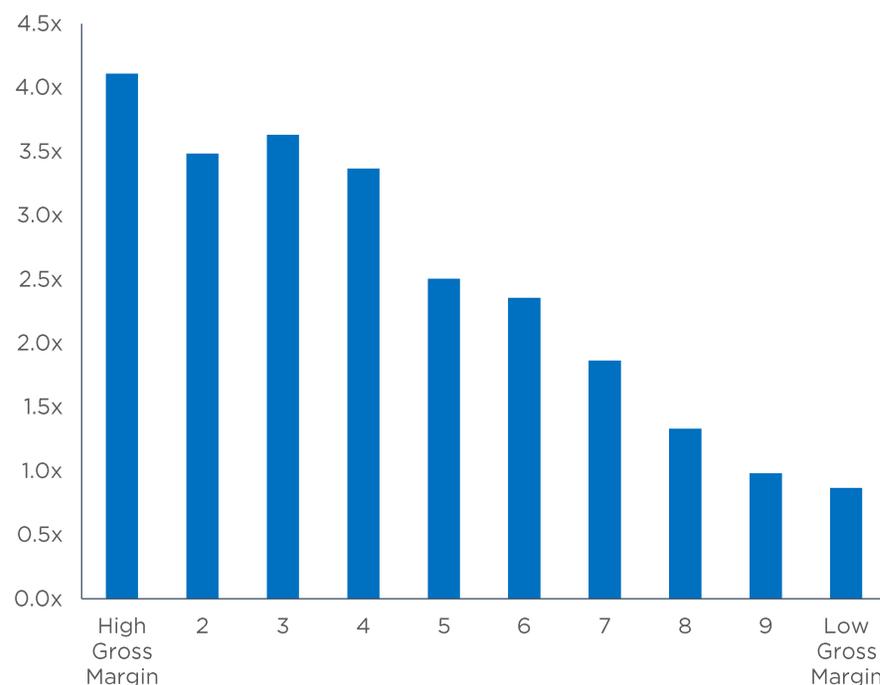
Source: Trivariate Research

# THE FED CUTTING DOESN'T CAUSE ADDITIONAL MULTIPLE EXPANSION

Late in 2022, large Technology stocks that had massively underperformed bottomed, and in 2023 those stocks started strongly outperforming.  Part of the reason was that at that time the Fed appeared to be closer to the end than the beginning of its hiking cycle, and the market warmed to the idea that eventual accommodation was coming.  We think three years later the opposite logic has merit.  It seems like the consensus view based on Polymarket odds is that there will be one or two more cuts (left), meaning this Fed is likely close to the end of the accommodation cycle.  The relationship between the 24-month forward Fed Fund Futures and the price-to-forward earnings for the market has now reversed (right), meaning cutting might mean multiple contraction from here, as incrementally it means macro news is deteriorating.  The bull case might be that the Fed pauses because the data are reasonably strong.

### Fed Funds 2026 Rate Decisions
### Polymarket Predictions

| FOMC Meeting Date | 50bps Cut % | 25bps Cut % | No Change % | 25bps Hike % | 50bps Hike % |
|---|---|---|---|---|---|
| January 28 | 1% | 11% | 89% | 0% | 0% |
| March 18 | 2% | 34% | 65% | 1% | 0% |
| April 29 | 4% | 30% | 62% | 2% | 0% |
| June 17 | 10% | 39% | 48% | 6% | 6% |

### Total Number of Fed Rate Cuts in 2026
### Polymarket Predictions

| 0 (0 bps) | 1 (25 bps) | 2 (50 bps) | 3 (75 bps) | 4 (100 bps) | 5 (125 bps) | 6 (150 bps) |
|---|---|---|---|---|---|---|
| 4% | 9% | 23% | 18% | 17% | 11% | 8% |

Source: Trivariate Research

### 126d Rolling T-Statistic, Top 500 US Equities
### 24m Fed Fund Futures to Price-to-Forward Earnings
### Through End-December, 2025
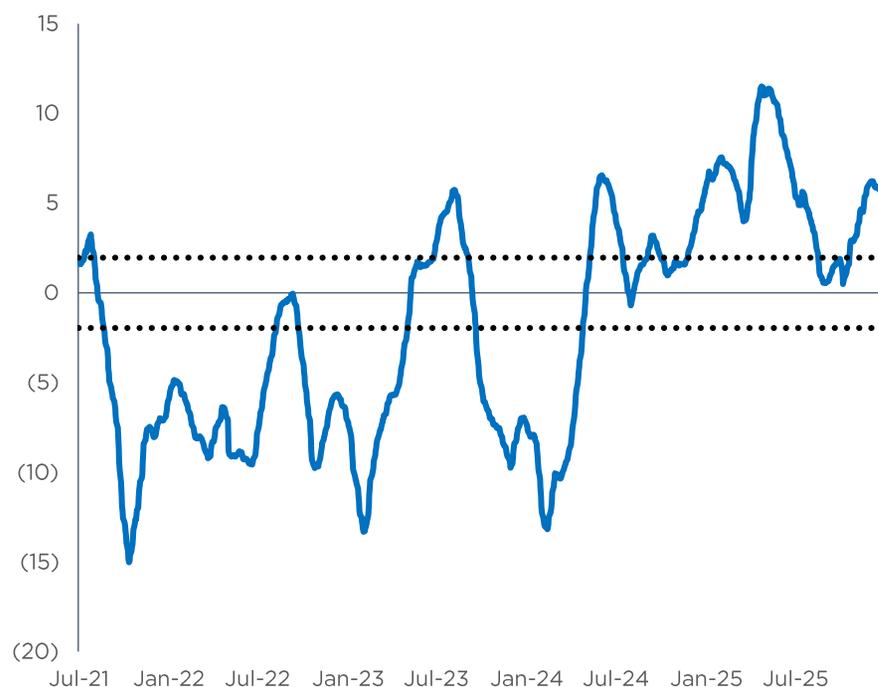


Source: Trivariate Research

# VALUATION LEVEL ISN'T HELPFUL FOR STOCK SELECTION

In the summer of 2025, we wrote about how valuation was not particularly effective for picking stocks. Over the last fifteen years, the cumulative return of buying stocks in the cheapest quintile on price-to-forward earnings and shorting those in the most expensive quintile has generated almost no total return, firm evidence that valuation in a vacuum has no efficacy (left). Why is this (right)? Today perhaps it is because AI revenue or productivity beneficiaries are getting more expensive, as are those stocks with business models deemed to be impregnable to AI. On the contrary, stocks that are getting cheaper have a higher-than-average probability of being disrupted by AI. Structural issues like retail and quant money could mean this lasts.

### Cumulative Return of Price-to-Forward Earnings Quintile Spread (Least Expensive - Most Expensive) Through End-December, 2025
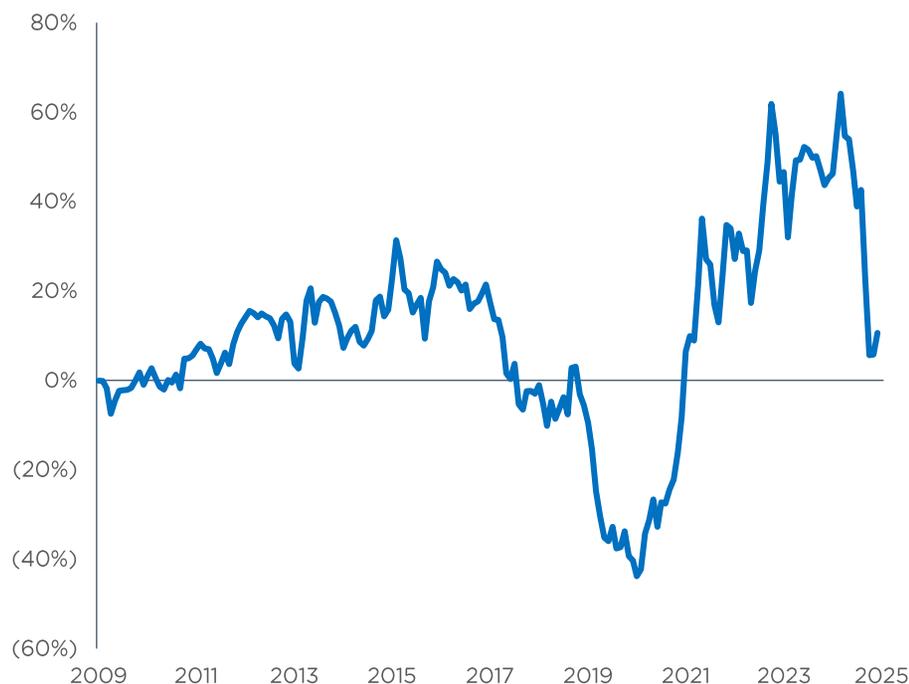


REASONS VALUATION HAS FAILED:

- AI Revenue Beneficiaries – Get Multiple Expansion

- AI Productivity Beneficiaries – Get Multiple Expansion

- Impregnable to AI – Get Multiple Expansion

- Potentially Disrupted by AI – See Multiple Contraction

- If you use mean-reverting valuation to pick stocks, you are selling stocks that benefit or are impregnable to AI and buying stocks that are potentially disrupted. Valuation might not work now because:

- Quant Money Is Run Valuation Neutral

- Retail Investors' Insensitivity and Stock Splits Indicate Low Price "Works"

- Valuation Has not Worked for Sustained Periods for the Past 15 Years

# THE AVG STOCK AT 40X LAGS BY 9% OVER THE NEXT THREE YEARS

Inspired by the multiple expansion in Walmart and Costco, we evaluated what happens to all stocks once they ascend to 40x price-to-forward earnings (PEF). It is quite consistent that once they reach 40x PEF, their multiples begin to contract. In fact, only 38% of the companies that achieved this lofty valuation trade at 40x PEF or higher a year after this first occurred (left), and only 25% maintain this valuation two-years later. The median performance of those stocks eclipsing 40x is roughly in-line with the market for the first ten months and then begins to lag.  Since 2003 (so eliminating the Technology Bubble unwind) the median stock lags the market on a beta-adjusted basis by 870 basis points over the subsequent three years (right).

### % Trade >40x Price-to-Forward Earnings by Months After First Trading >40x Forward Earnings Top 900 US Equities, First in 3yrs Through End-December, 2025

### Compounded Mean Beta-Adjusted Returns by Months After First Trading >40x Forward Earnings Top 900 US Equities, First in 3yrs Through End-December, 2025



Source: Trivariate Research
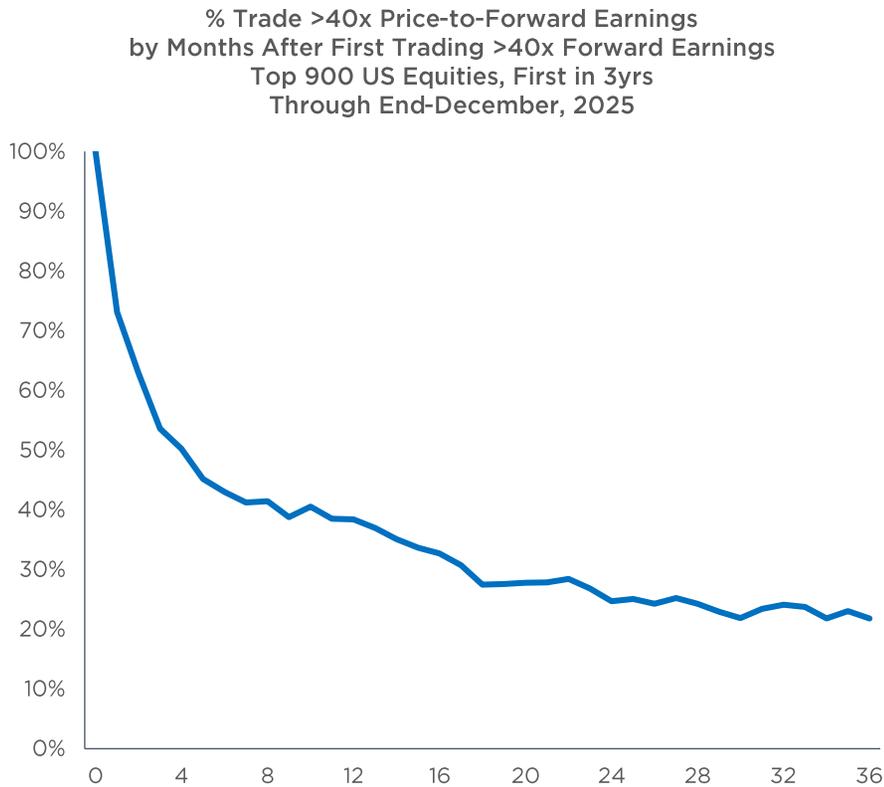
Source: Trivariate Research
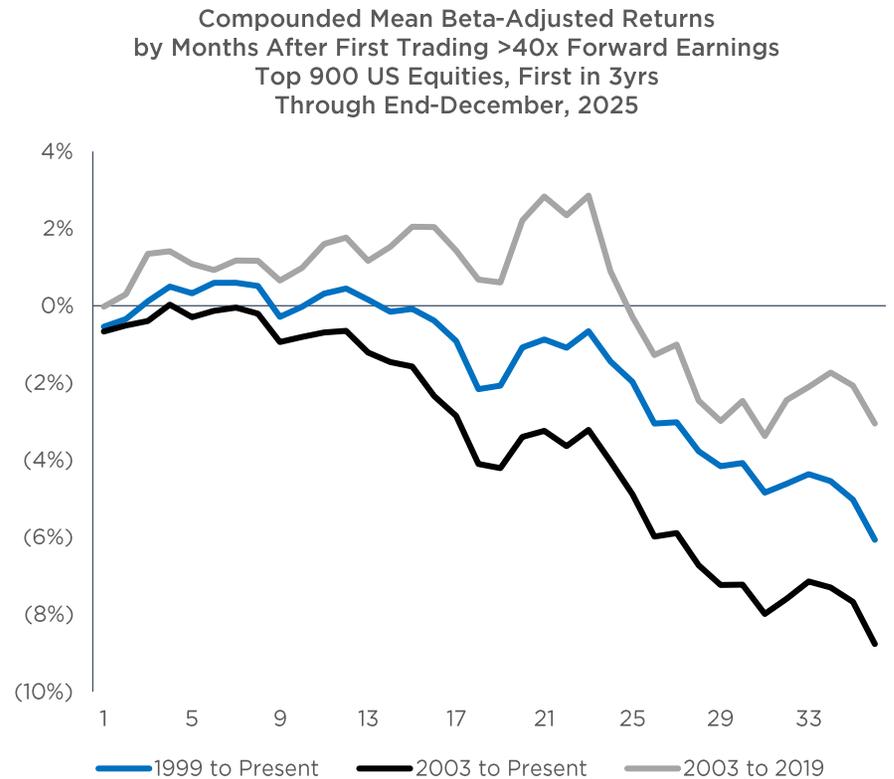
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# ONLY 4 OF THE LAST 19 COMPANIES TO GET TO 40X HAVE DONE WELL

Below are the most recent examples of companies that hit 40x forward earnings for at least the first time in three years.  If history proves correct, selling these names six to nine months after the initial date of surpassing 40x earnings would seem prudent.  More recently, only four of the last 19 names to first eclipse 40x have generated positive subsequent beta-adjusted returns.  CRCL and TSEM just reached this threshold.

**Recent Stocks First Trading >40x Forward Earnings in 3 Years**
**Top 900 US Equities, At Least 2 Years of Data**
**As of End-December, 2025**

| Month Stock First Got to 40x | Ticker | Company | Sector | Market Cap. (US Bil.) At Time When First >40x Forward Earnings | Price-to-Forward Earnings | Beta-Adjusted Return Since Date |
|---|---|---|---|---|---|---|
| 12/31/2025 | CRCL | Circle Internet Group, Inc. | Information Technology | 18.67 | 67x | N/A |
| 12/31/2025 | TSEM | Tower Semiconductor Ltd. | Information Technology | 13.18 | 40x | N/A |
| 11/28/2025 | MTSI | MACOM Technology Solutions | Information Technology | 13.11 | 42x | (2%) |
| 11/28/2025 | AVGO | Broadcom Inc. | Information Technology | 1902.92 | 43x | (14%) |
| 10/31/2025 | CIEN | Ciena Corporation | Information Technology | 26.79 | 43x | 23% |
| 10/31/2025 | SAIL | SailPoint, Inc. | Information Technology | 12.07 | 78x | (7%) |
| 10/31/2025 | PSTG | Pure Storage, Inc. | Information Technology | 32.44 | 43x | (33%) |
| 10/31/2025 | CW | Curtiss-Wright Corporation | Industrials | 22.45 | 42x | (8%) |
| 9/30/2025 | ORCL | Oracle Corporation | Information Technology | 801.76 | 41x | (33%) |
| 9/30/2025 | KRMN | Karman Holdings Inc. | Industrials | 9.55 | 144x | (2%) |
| 8/29/2025 | ROKU | Roku, Inc. | Communication Services | 14.23 | 194x | (1%) |
| 7/31/2025 | TTAN | ServiceTitan, Inc. | Information Technology | 10.58 | 200x | (15%) |
| 7/31/2025 | FAST | Fastenal Company | Industrials | 52.94 | 41x | (18%) |
| 6/30/2025 | NKE | NIKE, Inc. | Consumer Discretionary | 104.85 | 42x | (19%) |
| 6/30/2025 | BWXT | BWX Technologies, Inc. | Industrials | 13.16 | 41x | 8% |
| 6/30/2025 | QXO | QXO, Inc. | Industrials | 14.44 | 53x | (20%) |
| 6/30/2025 | WLK | Westlake Corporation | Materials | 9.74 | 78x | (12%) |
| 6/30/2025 | TLN | Talen Energy Corporation | Utilities | 13.23 | 52x | 10% |
| 6/30/2025 | DRS | Leonardo DRS, Inc. | Industrials | 12.37 | 43x | (33%) |
| 5/30/2025 | ULS | UL Solutions Inc. | Industrials | 14.34 | 40x | 1% |
| 4/30/2025 | NFLX | Netflix, Inc. | Communication Services | 481.63 | 44x | (33%) |

Source: Trivariate Research

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# GROWTH EXPECTATIONS AND VALUATION ARE DISCONNECTED

The chart below illustrates each cohort and sector's percentile ranking relative to its own historical data for price-to-forward earnings (y-axis) and projected 2-year median earnings per share growth (x-axis). Few areas are cheap vs. history (micro-caps, Real Estate, small caps, Energy, and Consumer Staples), but all are forecasted to have below median 2-year EPS growth.  Industrials look expensive and have low forecasted growth.  Mega-caps, Junk, and Technology are expensive with high forecasted growth.

**Median 2-Year Forecast EPS Growth vs.
Median Price-to-Forward Earnings
Percentile Ranks vs. History
2000 to End-December, 2025**

Source: Trivariate Research
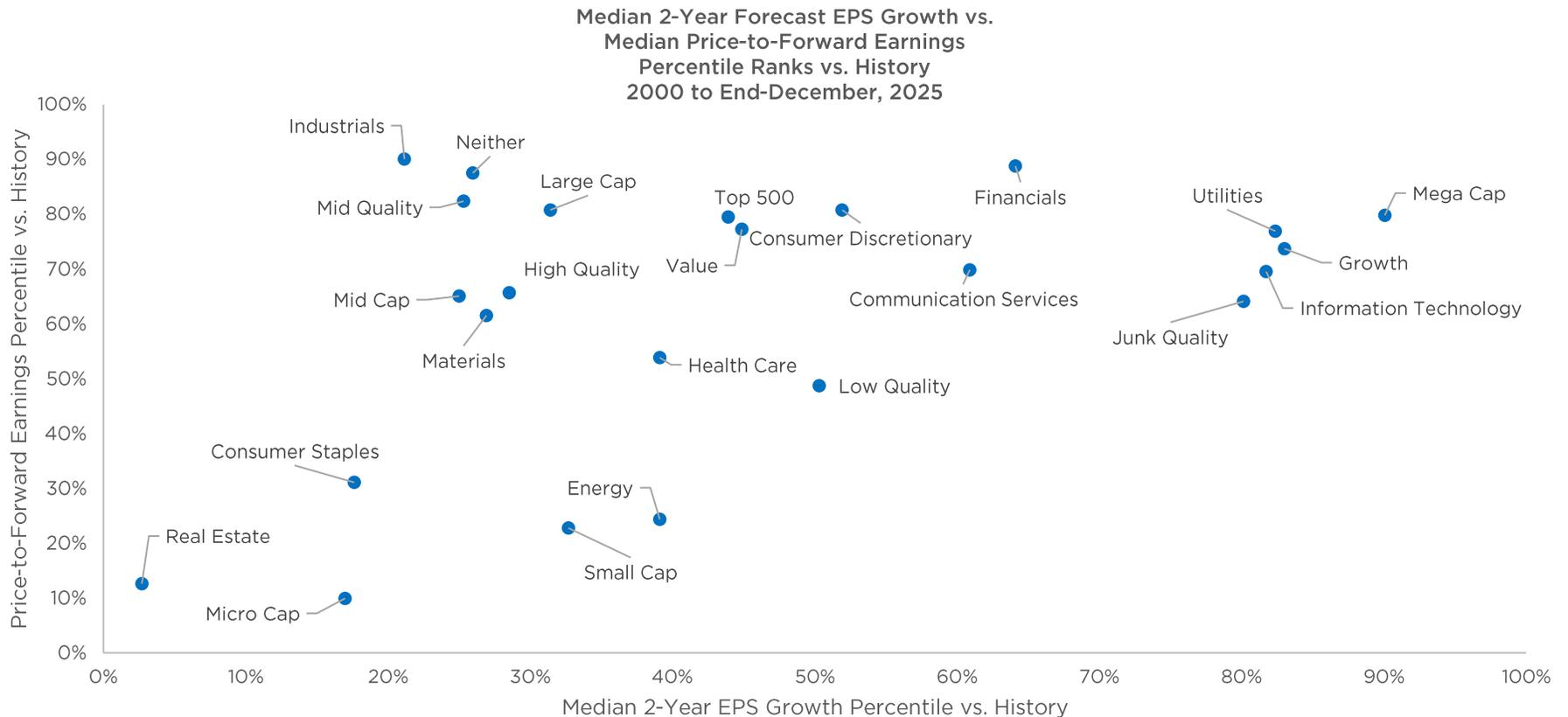
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# THERE IS LITTLE PRIOR EVIDENCE OF 4 STRAIGHT DOUBLE-DIGIT YRS.

Longer-term, strong S&P500 returns in 3-, 5-, and 10-year increments often portend lower subsequent annual returns. We looked at 3-,5-, and 10-year periods of time, by quintile of performance, and then observed the distribution of outcomes over the next 12 months for each quintile of the previous period's returns. The worst performing group - for each longer-term period - was the best performing quintile previously. The best performing was closer to the median performance over the previous period in most cases. Today, the S&P500 is in its top quintile vs. its 98-year history on 3-, 5-, and 10-year returns. So, for 2026, if history is a guide, a below average (but perhaps still positive) return year is more probable. Given the strong returns (24%, 23%, 16% the last three years), we investigated the long-term precedent for four double digit years in a row. There have been three instances since 1928, where the S&P 500 has returned double digits for 4 or more calendar years in a row. These were 1942-1945, 1949-1952, and five years in a row from 1995-1999.

**One-Year Subsequent S&P500 Returns**
**Periods Following 3-, 5-, and 10-Year Returns by Performance Quintile**
**1928 to 2025**

| Trailing Period | Period Returns by Quintile | Quintile Minimum | Quintile Maximum | # of Days | Mean | Standard Deviation | Minimum | 25th Percentile | Median | 75th Percentile | Maximum |
|---|---|---|---|---|---|---|---|---|---|---|---|
| 3 Years | Best | 49.29% | 169.80% | 4632 | 5.02% | 18.79% | (52.00%) | (8.03%) | 4.10% | 19.93% | 50.44% |
| | 2 | 32.08% | 49.29% | 4712 | 9.86% | 15.36% | (44.71%) | 0.11% | 11.45% | 20.28% | 54.94% |
| | 3 | 19.37% | 32.08% | 4729 | 10.88% | 14.56% | (46.89%) | 3.10% | 12.32% | 19.18% | 66.37% |
| | 4 | (1.41%) | 19.37% | 4765 | 7.91% | 18.89% | (55.47%) | (2.34%) | 8.28% | 18.96% | 82.56% |
| | Worst | (84.28%) | (1.41%) | 4773 | 9.34% | 25.98% | (71.07%) | (5.05%) | 10.12% | 22.03% | 171.11% |
| 5 Years | Best | 83.16% | 287.07% | 4452 | 4.48% | 17.87% | (52.00%) | (7.84%) | 5.27% | 17.07% | 50.02% |
| | 2 | 57.09% | 83.16% | 4640 | 9.35% | 16.04% | (48.82%) | (0.21%) | 9.04% | 19.58% | 50.44% |
| | 3 | 31.66% | 57.09% | 4672 | 8.06% | 16.56% | (47.69%) | (3.23%) | 10.27% | 19.79% | 54.06% |
| | 4 | 0.46% | 31.65% | 4671 | 8.33% | 16.59% | (43.25%) | (2.36%) | 9.64% | 19.80% | 74.78% |
| | Worst | (72.82%) | 0.45% | 4672 | 13.83% | 18.87% | (33.03%) | 3.42% | 12.14% | 23.75% | 98.19% |
| 10 Years | Best | 191.73% | 387.51% | 4267 | 4.63% | 14.40% | (34.32%) | (6.98%) | 6.96% | 14.67% | 40.32% |
| | 2 | 139.99% | 191.72% | 4321 | 14.40% | 14.48% | (31.46%) | 4.54% | 15.01% | 25.77% | 50.44% |
| | 3 | 72.21% | 139.98% | 4420 | 11.19% | 14.74% | (33.60%) | 1.66% | 10.55% | 20.98% | 74.78% |
| | 4 | 22.41% | 72.19% | 4419 | 5.68% | 18.29% | (48.82%) | (7.87%) | 10.37% | 18.75% | 50.82% |
| | Worst | (64.35%) | 22.40% | 4420 | 7.99% | 16.25% | (47.69%) | (1.71%) | 7.68% | 17.34% | 68.57% |

Source: Trivariate Research

# SUMMARY: 5 REASONS THE US EQUITY MARKET MIGHT TAKE A PAUSE

We are more neutral than bullish on US equities for the following five reasons:

1.  The earnings expectations appear too high, particularly in Technology and Industrials, and the penalty for missing estimates has been harsh.

2.  Margin expansion has become increasingly challenging for the median stock, and multiple expansion is correlated to margin expansion.

3.  We don't think that if the Fed cuts interest rates it will drive the price-to-forward earnings expansion as has been the case for the last three years.

4.  The historical precedent for continued double-digit returns is low, though there has been three prior examples in the past 100 years.

5.  The bottom-up and top-down consensus are bullish, so investors can't romanticize they are contrarian bulls.  The top-down consensus has been consistently wrong over the past few years.

Source: Trivariate Research

- We have spent meaningful time over the last two years analyzing portfolio construction and studying the optimal way to build an equity portfolio.

  - <u>Beta:</u> Portfolio beta is particularly crucial in years when the S&P 500 rises by less than 8%, as high-beta stocks can cause significant alpha erosion.

  - <u>Less than 1:</u> Over time, the optimal portfolio beta, whether under max-Sharpe ratio or minimum volatility is less than 1.

  - <u>Growth:</u> For **growth** portfolio managers, owning stocks with extreme betas (top and bottom deciles) results in better performance than owning stocks with average beta, even though the overall portfolio beta should be less than 1. This is not the case for value or small cap portfolios.

- We created nearly 25 custom baskets of stocks that provide exposure to disparate growth areas.  AI Semiconductors and Electrification Industrials are two such baskets and right now they have the highest correlation (0.75) of all of our baskets, meaning stocks like ETN and NVDA are not diversifying.  <u>We would highly recommend portfolio and risk managers monitor the rolling correlation of returns between these growth-themed baskets to avoid "Texas hedges" in their portfolio.  Two thematic ideas:</u>

- <u>1) Potential Long ideas: Stocks with a low correlation to AI Semis that are still up more than 10% in the last 6 months.</u>

- <u>2) Potential risk management problems: Stocks with high correlation to our AI Semis basket that are not Technology.</u>

# BETA DOESN'T MATTER WHEN THE STOCK MARKET IS UP A LOT

The long-term betas for the mid-point of each decile (meaning the 5th, 15th, 25th percentiles and so on) are shown on the left. Five percent of stocks have a beta less than 0.21, and the median stock in the lowest beta decile has 10.4% of annualized alpha. On the contrary, only 5% of stocks have a beta higher than 2.52 historically, and the highest beta decile realizes an annual NEGATIVE alpha of 580bps per year over the last 25 years (left). Assuming these historical betas by decile hold constant, we simulated the expected return (market assumption*beta + alpha) for various S&P500 return scenarios (right). Once the market's returns are below 8%, the higher beta is no longer enough to offset the typical alpha destruction that comes from these stocks.

## Performance Statistics of Beta Deciles
### 1999 Through End-December, 2025

| Beta Decile | Annualized Alpha | Hit Rate | Median Beta |
|---|---|---|---|
| 1 | 10.4% | 66.2% | 0.21 |
| 2 | 6.1% | 61.2% | 0.51 |
| 3 | 4.4% | 58.7% | 0.69 |
| 4 | 3.4% | 55.2% | 0.83 |
| 5 | 3.1% | 55.2% | 0.95 |
| 6 | 3.5% | 54.1% | 1.09 |
| 7 | 1.4% | 49.5% | 1.25 |
| 8 | (0.5%) | 44.8% | 1.47 |
| 9 | (2.3%) | 42.7% | 1.76 |
| 10 | (5.8%) | 43.4% | 2.52 |

Source: Trivariate Research

## Implied Annual Return Under Different Assumptions
### As of End-December, 2025

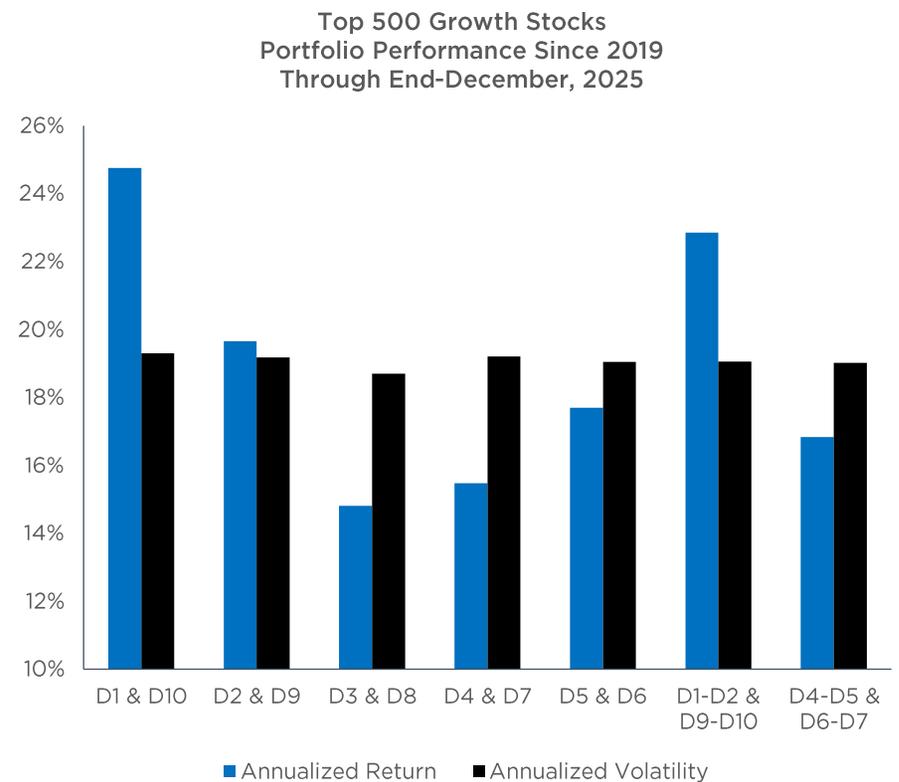| Move | D1 | D2 | D3 | D4 | D5 | D6 | D7 | D8 | D9 | D10 |
|---|---|---|---|---|---|---|---|---|---|---|
| (30%) | 4.2% | (9.1%) | (16.2%) | (21.6%) | (25.3%) | (29.2%) | (36.1%) | (44.5%) | (55.1%) | (81.3%) |
| (25%) | 5.2% | (6.5%) | (12.8%) | (17.4%) | (20.6%) | (23.8%) | (29.8%) | (37.2%) | (46.3%) | (68.7%) |
| (20%) | 6.3% | (4.0%) | (9.3%) | (13.2%) | (15.8%) | (18.3%) | (23.6%) | (29.8%) | (37.5%) | (56.1%) |
| (15%) | 7.3% | (1.5%) | (5.9%) | (9.1%) | (11.1%) | (12.9%) | (17.3%) | (22.5%) | (28.7%) | (43.5%) |
| (10%) | 8.4% | 1.1% | (2.5%) | (4.9%) | (6.4%) | (7.4%) | (11.1%) | (15.2%) | (19.9%) | (30.9%) |
| (5%) | 9.4% | 3.6% | 1.0% | (0.7%) | (1.6%) | (2.0%) | (4.8%) | (7.8%) | (11.1%) | (18.3%) |
| 0% | 10.4% | 6.1% | 4.4% | 3.4% | 3.1% | 3.5% | 1.4% | (0.5%) | (2.3%) | (5.8%) |
| 5% | 11.5% | 8.7% | 7.8% | 7.6% | 7.8% | 8.9% | 7.7% | 6.8% | 6.5% | 6.8% |
| 6% | 11.7% | 9.2% | 8.5% | 8.4% | 8.8% | 10.0% | 9.0% | 8.3% | 8.3% | 9.3% |
| 8% | 12.1% | 10.2% | 9.9% | 10.1% | 10.7% | 12.2% | 11.5% | 11.2% | 11.8% | 14.4% |
| 10% | 12.5% | 11.2% | 11.3% | 11.7% | 12.6% | 14.3% | 14.0% | 14.1% | 15.3% | 19.4% |
| 12% | 12.9% | 12.2% | 12.7% | 13.4% | 14.5% | 16.5% | 16.5% | 17.1% | 18.8% | 24.4% |
| 14% | 13.4% | 13.2% | 14.0% | 15.1% | 16.4% | 18.7% | 19.0% | 20.0% | 22.4% | 29.5% |
| 15% | 13.6% | 13.7% | 14.7% | 15.9% | 17.3% | 19.8% | 20.2% | 21.5% | 24.1% | 32.0% |
| 20% | 14.6% | 16.3% | 18.2% | 20.1% | 22.0% | 25.2% | 26.5% | 28.8% | 32.9% | 44.6% |
| 25% | 15.6% | 18.8% | 21.6% | 24.2% | 26.8% | 30.7% | 32.7% | 36.1% | 41.7% | 57.2% |
| 30% | 16.7% | 21.3% | 25.0% | 28.4% | 31.5% | 36.1% | 39.0% | 43.4% | 50.5% | 69.8% |

Source: Trivariate Research

# BUT OVER TIME RUNNING A FUND WITH LESS THAN 1 BETA IS PRUDENT

We analyzed three different portfolios to show a range of outcomes for portfolio performance based on beta at the portfolio level.  Firstly, the lowest volatility portfolio (or Min Volatility) in blue on the left, secondly the maximum Sharpe ratio portfolio in black, and lastly the maximum return portfolio in gray.  The optimal portfolio betas over the last 20 years have oscillated between 0.65 and 1.25, with lower volatility for the Min Vol. and Max Sharpe portfolios than the Max Return approach, where the current optimal beta is high vs. history.  In most cases, a portfolio beta less than 1 is optimal. **On the right, we show the distribution of the betas for a growth portfolio, randomly sampling from each beta decile.  Performance where stocks are only selected from the top and bottom deciles of beta is superior to sampling from the middle, even when forcing the overall portfolio beta to be slightly less than 1.**

### Optimal Portfolio Beta
### 2005 Through End-December, 2024



Min Volatility   Max Sharpe   Max Return

### Top 500 Growth Stocks
### Portfolio Performance Since 2019
### Through End-December, 2025



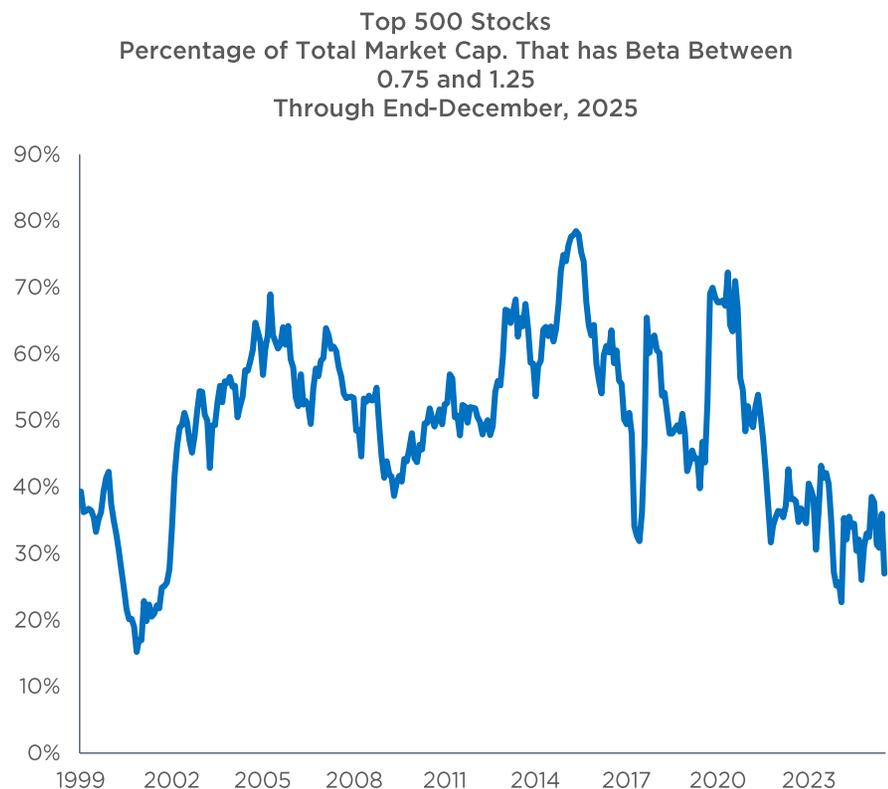Annualized Return   Annualized Volatility
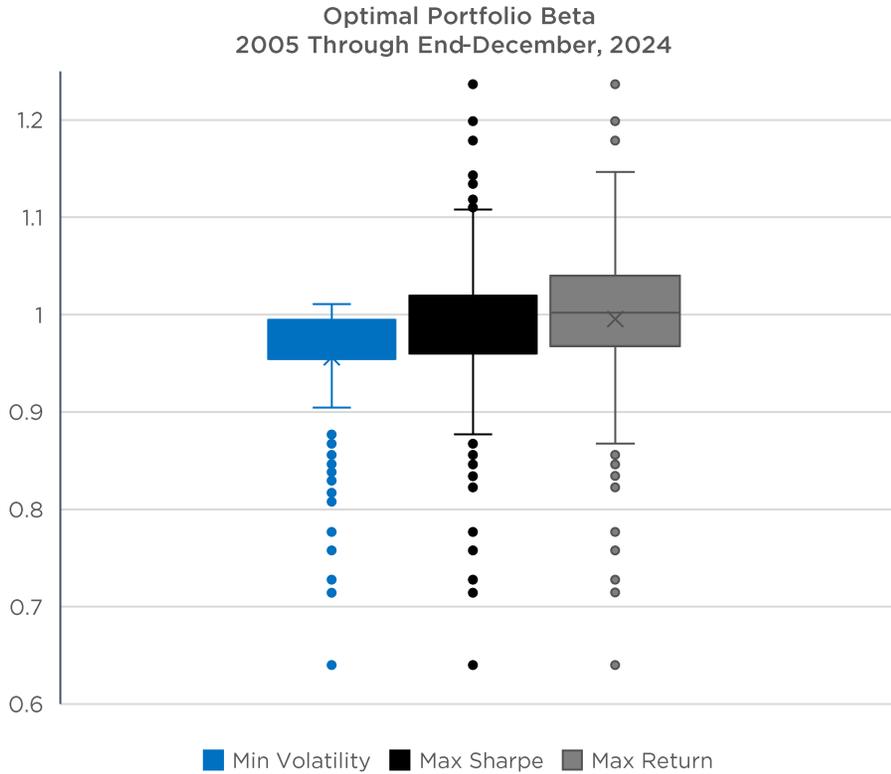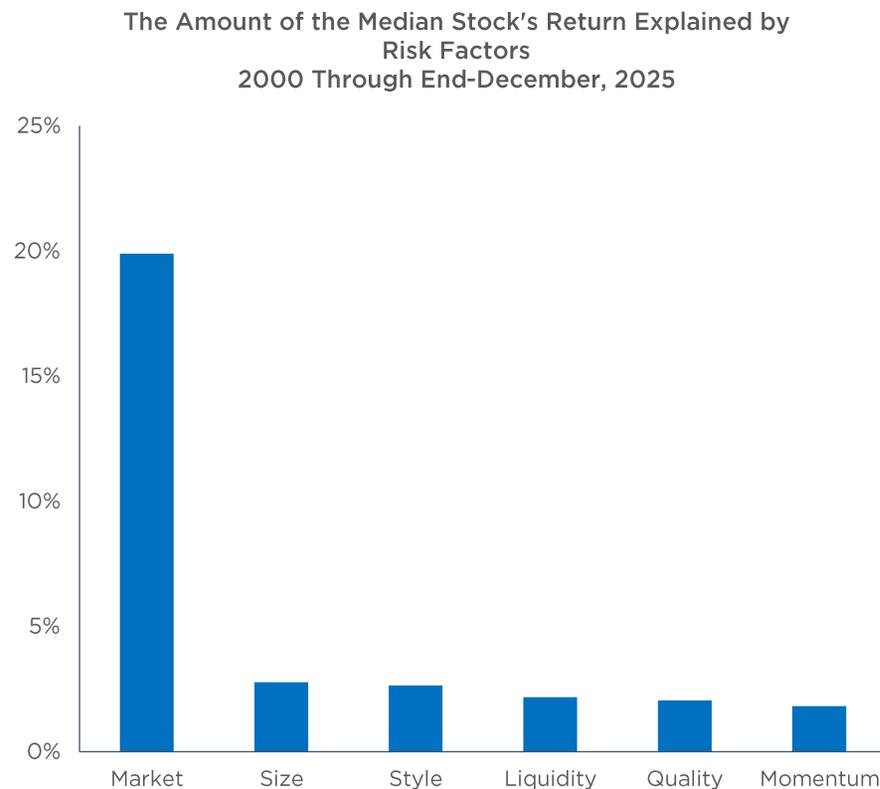
Source: Trivariate Research

Source: Trivariate Research

# TODAY'S MARKET HAS SOME LARGE HIGH BETA STOCKS

Because so many stocks have extreme betas, the amount of the investable universe with near average beta is incredibly low vs. history (left). The result is naturally that market movement explains a significant portion of the total returns of each stock today, and then for the rest of the universe size (mega-/large- vs. mid-cap.) and style (growth vs. value) explain most of the rest of performance. Once adjusting for the impact of the market, size, and style (which obviously includes the Great 8 stocks), there isn't that much left over for quality, despite the fact most investors focus on this attribute (right).

**Top 500 Stocks**
**Percentage of Total Market Cap. That has Beta Between**
**0.75 and 1.25**
**Through End-December, 2025**

**The Amount of the Median Stock's Return Explained by**
**Risk Factors**
**2000 Through End-December, 2025**

Source: Trivariate Research

Source: Trivariate Research

TRIVARIATE RESEARCH

# AI SEMIS / ELECTRIFICATION INDUSTRIALS ARE VERY CORRELATED

We created nearly 25 custom baskets of stocks that provide exposure to disparate growth areas.  AI Semiconductors and Electrification Industrials are two such baskets.  Importantly though, some of the growth themes today are not particularly diversifying (left).  For instance, a stock like NVDA (in AI Semis basket) might trade very similarly to ETN (in the Electrification basket). The 126-day correlation of returns between six major growth baskets is shown on the right.  Right now, AI Semiconductors and Electrification Industrials have the highest correlation (0.75), and AI Software and Utilities / Power have the lowest.  <u>We would highly recommend portfolio and risk managers monitor the rolling correlation of returns between these growth-themed baskets to avoid "Texas hedges" in their portfolio.</u>

### AI Semi vs. Electrification Industrials
### 21-Day Rolling Correlation of Returns
### Through End-December, 2025
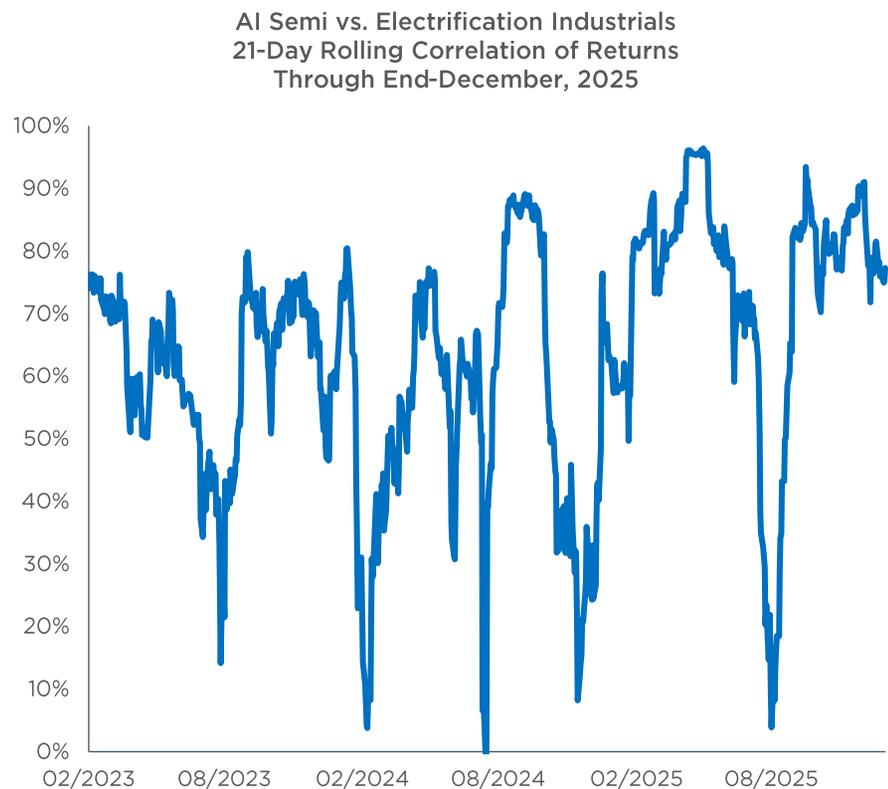


Source: Trivariate Research

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

|  | AI Semi | AI Software | Utilities / Power | Healthcare Services | Housing | Electrification Industrials |
|---|---|---|---|---|---|---|
| AI Semi | 100.0% | 50.4% | 46.6% | 35.2% | 37.9% | 75.5% |
| AI Software | 50.4% | 100.0% | 16.8% | 42.6% | 47.8% | 57.2% |
| Utilities / Power | 46.6% | 16.8% | 100.0% | 28.0% | 38.6% | 55.3% |
| Healthcare Services | 35.2% | 42.6% | 28.0% | 100.0% | 44.6% | 40.6% |
| Housing | 37.9% | 47.8% | 38.6% | 44.6% | 100.0% | 49.2% |
| Electrification Industrials | 75.5% | 57.2% | 55.3% | 40.6% | 49.2% | 100.0% |

Source: Trivariate Research

# MANAGE YOUR CORRELATED / ANTI-CORRELATED IDEAS TO AI

A growing risk is that everything in the market is correlated to the AI trade. In fact, for much of 2025 we observed that the S&P500 traded as if it was 50% an AI Semiconductors basket. As such, we are constantly searching for diversifying ideas. We show non-Technology stocks with a high correlation to our AI Semiconductors basket (left) that may not be diversifying, and stocks up 10% or more in the last six months that have a low correlation to our AI Semiconductors basket (right) as ideas for managing risk (left) and searching for uncorrelated alpha (right).

**Stocks With a 0.5 or Higher 6-Month Daily Trading Correlation to Trivariate's AI Semiconductors Basket, Non-Tech. Stocks As of End-December, 2025**

| Ticker | Company | Market Cap. (US$ Bil.) |
|---|---|---|
| MS | Morgan Stanley | 282.2 |
| CAT | Caterpillar Inc. | 268.1 |
| ETN | Eaton Corporation plc | 123.7 |
| CEG | Constellation Energy Corporation | 110.3 |
| HOOD | Robinhood Markets, Inc. | 101.7 |
| PWR | Quanta Services, Inc. | 62.9 |
| VRT | Vertiv Holdings Co | 61.9 |
| COIN | Coinbase Global, Inc. | 61.0 |
| VST | Vistra Corp. | 54.7 |
| ROK | Rockwell Automation, Inc. | 43.7 |
| NRG | NRG Energy, Inc. | 30.5 |
| HUBB | Hubbell Incorporated | 23.6 |
| CW | Curtiss-Wright Corporation | 20.3 |
| MTZ | MasTec, Inc. | 16.9 |
| NVT | nVent Electric plc | 16.5 |
| WCC | WESCO International, Inc. | 11.9 |
| AYI | Acuity Inc. | 10.9 |
| STRL | Sterling Infrastructure, Inc. | 9.4 |
| IESC | IES Holdings, Inc. | 7.7 |
| PRIM | Primoris Services Corporation | 6.7 |

Source: Trivariate Research

**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 End-December, 2025**

| Ticker | Company | Market Cap. (US$ Bil.) |
|---|---|---|
| LLY | Eli Lilly and Company | 962.2 |
| WMT | Walmart Inc. | 888.0 |
| XOM | Exxon Mobil Corporation | 507.5 |
| JNJ | Johnson & Johnson | 498.6 |
| ABBV | AbbVie Inc. | 403.8 |
| MRK | Merck & Co., Inc. | 261.3 |
| RTX | RTX Corporation | 245.9 |
| TMO | Thermo Fisher Scientific Inc. | 217.7 |
| AMGN | Amgen Inc. | 176.3 |
| TJX | The TJX Companies, Inc. | 170.6 |
| NEE | NextEra Energy, Inc. | 167.2 |
| DHR | Danaher Corporation | 161.7 |
| GILD | Gilead Sciences, Inc. | 152.3 |
| WELL | Welltower Inc. | 127.4 |
| MDT | Medtronic plc | 123.2 |
| CB | Chubb Limited | 122.8 |
| PLD | Prologis, Inc. | 118.6 |
| BMY | Bristol-Myers Squibb Company | 109.8 |
| HCA | HCA Healthcare, Inc. | 106.5 |
| MCK | McKesson Corporation | 101.2 |

Source: Trivariate Research

Given how important Technology stocks are to the US market, and the huge impact AI has on investing, we created a focused section in our 2026 outlook, broken into two parts.

- AI Beneficiaries:
  - <u>Cost:</u> 15% of companies mentioned AI-related cost reductions over the last quarter. Process and back-office automation and Software and IT productivity were the most frequent areas of focus to-date.
  - <u>Revenue:</u> 18% of companies mentioned AI-related revenue growth, though we think this is "squishier" as it contains phrases like "product experience and retention." 29 companies (5.8%) in the S&P500 mentioned AI enabling revenue monetization optimization, an important focal point, during Q4
- **10 Technology Trends for 2026 and Beyond:** Late in 2025, research firm Gartner, Inc. came out with a report highlighting the ten Technology trends to watch for 2026. We searched the earnings call transcripts, filings, company websites, press releases and news of **385 public US Technology companies**, then identified those that have exposure (supplier/adopter) to these trends and created baskets of stocks that are **suppliers** in these key areas. Over 40% of all Software companies are focused on at least one of these ten trends. The AI Supercomputing basket has the highest forecasted revenue growth and the second highest median forecasted gross margin expansion of the ten baskets.
- MSFT, NVDA, IBM, ORCL, ACN, HPE, and NET **are the only companies with exposure to at least 5 of the 10 new trends.**

# SOME AI PHRASES ARE BEING USED LESS FREQUENTLY AT COMPANIES

We used natural language processing (NLP) to search earnings call transcripts for AI-related keywords (something we first started and began publishing in April of 2023). Total AI mentions reached near peak levels at the end of December (left), now at 1038 companies over the last three months. However, some important words, like "Generative" are being used far less frequently over the last three months than in 2024 (right).

Rolling 3-Month Total Number of Companies With More than One Mention in Earnings Call by AI-related Keyword Category
As of End-December, 2025

| Month | AI | Autonomous | Compute | Generative | Machine Learning | Language Model |
|---|---|---|---|---|---|---|
| 2024-04 | 675 | 98 | 68 | 212 | 172 | 134 |
| 2024-05 | 740 | 116 | 70 | 227 | 171 | 140 |
| 2024-06 | 729 | 111 | 67 | 221 | 168 | 133 |
| 2024-07 | 728 | 97 | 61 | 217 | 154 | 128 |
| 2024-08 | 723 | 91 | 63 | 204 | 133 | 111 |
| 2024-09 | 709 | 91 | 62 | 199 | 125 | 106 |
| 2024-10 | 704 | 104 | 61 | 196 | 131 | 110 |
| 2024-11 | 692 | 107 | 70 | 179 | 144 | 105 |
| 2024-12 | 680 | 105 | 69 | 168 | 137 | 106 |
| 2025-01 | 692 | 104 | 71 | 171 | 137 | 106 |
| 2025-02 | 756 | 100 | 63 | 184 | 127 | 136 |
| 2025-03 | 773 | 100 | 63 | 183 | 124 | 133 |
| 2025-04 | 758 | 128 | 62 | 171 | 117 | 128 |
| 2025-05 | 746 | 136 | 50 | 135 | 106 | 122 |
| 2025-06 | 738 | 132 | 52 | 130 | 101 | 120 |
| 2025-07 | 840 | 138 | 52 | 142 | 109 | 134 |
| 2025-08 | 931 | 159 | 65 | 161 | 122 | 159 |
| 2025-09 | 914 | 162 | 66 | 163 | 121 | 160 |
| 2025-10 | 977 | 163 | 80 | 151 | 127 | 180 |
| 2025-11 | 1040 | 159 | 80 | 151 | 119 | 179 |
| 2025-12 | 1038 | 155 | 80 | 139 | 116 | 175 |

Source: Trivariate Research

Number of Mentions of AI vs. Generative-related Keywords During Earnings Calls
Through End-December, 2025
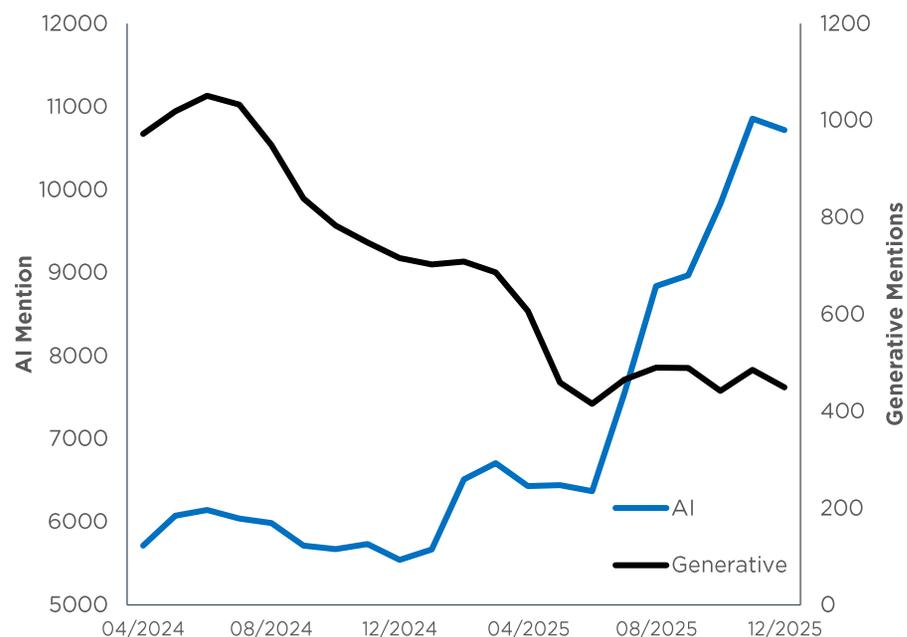


Source: Trivariate Research

We then identified stocks that cited AI use cases during 2025 earnings calls and classified those use cases into two primary categories—revenue growth and cost reduction—then further tagged each into the following sub-categories:

Revenue Growth Categories

1. **AI Offerings & Infrastructure Monetization:** The company sells AI—models, platforms, data products, AI-enabled services, chips/servers/networking—where AI is the revenue product.

2. **Sales & Marketing Effectiveness:** AI that improves sales or marketing performance: better targeting, conversion, win rates, or upsell—so the company generates more revenue per lead/customer.

3. **Monetization Optimization:** AI that directly improves pricing, yield, revenue management, ad monetization, or decisioning that lifts revenue per customer/transaction.

4. **Product Experience & Retention:** AI embedded in the company's product/service that improves user experience and drives higher conversion, retention, engagement, ARPU, or attach rates.

5. **Innovation & R&D Acceleration:** AI that speeds up or improves R&D, design, experimentation, and pipeline creation, enabling faster time-to-market or higher hit-rate of new products.

# …AND AI-RELATED COST-REDUCTION CATEGORIES

## Cost-Reduction Categories

1. **Process & Back-office Automation:** AI that reduces labor/time/cost in repeatable workflows and back-office operations.

2. **Software & IT Productivity:** AI that reduces cost/time in software development, engineering and IT operations.

3. **Customer Service Automation:** AI that lowers cost to serve via contact center / support automation.

4. **Supply Chain, Logistics & Distribution Efficiency:** AI that lowers cost through planning, inventory, routing, fulfillment, and distribution operations.

5. **Manufacturing, Field Ops, Robotics & Maintenance:** AI that lowers cost through production/field operations, quality, uptime, and automation.

6. **Risk, Fraud, Compliance, Trust & Security:** AI that reduces losses and operating cost from fraud, risk, compliance burden, security incidents, and trust/safety enforcement.

7. **Analytics, Forecasting & Decisioning:** AI that reduces cost by improving planning, forecasting, and decision quality, lowering waste and rework.

8. **Energy/Resource Efficiency & Sustainability:** AI that reduces cost via energy, fuel, water, materials, or emissions-related operational efficiency.

# 15% OF S&P500 COMPANIES MENTIONED AI-RELATED COST-REDUCTION

During 2025, companies in the Technology and Financials sectors were most likely to cite both revenue growth and cost-reduction use cases from AI (left). 18% of S&P500 companies mentioned AI-related revenue growth opportunities and 15% mentioned AI-related cost-reduction use cases on their earnings calls in Q4 of 2025 (right).

### Number of Stocks that Mentioned AI Use Cases in 2025 Earnings Calls As of End-December, 2025

| Sector | Cost Reduction-Only | Revenue Growth-Only | Both | Total |
|---|---|---|---|---|
| Communication Services | 21 | 8 | 19 | 48 |
| Consumer Discretionary | 4 | 13 | 20 | 37 |
| Consumer Staples | 8 | 7 | 11 | 26 |
| Energy | 5 | 6 | 14 | 25 |
| Financials | 9 | 7 | 4 | 20 |
| Health Care | 4 | 4 | 6 | 14 |
| Industrials | 2 | 6 | 0 | 8 |
| Information Technology | 1 | 1 | 4 | 6 |
| Materials | 2 | 3 | 0 | 5 |
| Real Estate | 1 | 2 | 1 | 4 |
| Utilities | 1 | 3 | 0 | 4 |
| T500 | 58 | 60 | 79 | 197 |

Source: Trivariate Research

### Rolling 3m Percentage of S&P 500 Companies Mentioning AI Use Cases in Earnings Calls Through End-December, 2025



Cost Reduction — Revenue Growth

Source: Trivariate Research

# PRODUCT EXPERIENCE, AUTOMATION, AND PRODUCTIVITY ARE KEYS

The most common AI phrase related to revenue growth was "Product Experience & Retention" mentioned by 106 companies on conference calls in 2025. Back-office automation (73 companies), Software & IT Productivity (53) and Customer Service Automation (47) were the most frequent cost-reduction opportunities fueled by AI that surfaced on earnings calls. Sample tickers for each category are shown below.

**Number of Stocks that Mentioned AI Use Cases in 2025 Earnings Calls**
**As of End-December, 2025**

| Category 1 | Category 2 | Company Count | Sample Tickers |
|---|---|---|---|
| Revenue Growth | Product Experience & Retention | 106 | IBKR, VZ, SYK, DHR, MSFT |
| | AI Offerings & Infrastructure Monetization | 57 | VZ, IBM, MSFT, NOW, TSLA |
| | Sales & Marketing Effectiveness | 40 | ADP, NOW, GEN, PFE, YUM |
| | Monetization Optimization | 29 | META, GOOGL, PINS, TPR, APP |
| | Innovation & R&D Acceleration | 13 | SYK, DHR, V, PFE, AVGO |
| | Others | 6 | BKNG, NDAQ, CPNG, LDOS, PINS |
| Cost-Reduction | Process & Back-office Automation | 73 | NTRS, ADP, CHRW, NOW, AMP |
| | Software & IT Productivity | 53 | T, MSCI, MSFT, NDAQ, NOW |
| | Customer Service Automation | 47 | VZ, T, ADP, NOW, CHTR |
| | Manufacturing, Field Ops, Robotics & Maintenance | 30 | T, CVX, JCI, AMZN, PSA |
| | Supply Chain, Logistics & Distribution Efficiency | 25 | MSCI, GWW, RL, DELL, MSFT |
| | Analytics, Forecasting & Decisioning | 24 | CVX, AMZN, YUMC, CCI, PAYX |
| | Risk, Fraud, Compliance, Trust & Security | 16 | PYPL, AFRM, RBLX, APP, CAH |
| | Energy/Resource Efficiency & Sustainability | 5 | META, GOOGL, LIN, AEM, NOW |

Source: Trivariate Research

# TEN TECHNOLOGY TRENDS FOR 2026 AND BEYOND

Late in 2025, research firm Gartner, Inc. published a report highlighting the ten Technology trends to watch for 2026.  We searched the earnings call transcripts, filings, company websites, press releases and news of **385 public US Technology companies**, then identified those that have exposure (supplier/adopter) to these trends and created baskets of stocks that are **supplier** in these key areas. The trends we analyzed are:

1.  **AI Super Computing Platform:** Platforms integrating CPUs / GPUs /AI ASICs etc., to orchestrate data-intensive machine learning / simulation/ analytics workloads.

2. **Multiagent Systems:** Collections of AI agents that interact to achieve complex goals.

3. **DSLMs:** Domain-specific language models trained / fine-tuned for an industry / function.

4. **AI Security Platforms:** Unified security for AI apps; guardrails vs prompt injection / data leakage / rogue agents.

5. **AI-Native Development Platforms:** GenAI-enabled platforms that accelerate software creation, enable smaller teams.

6. **Confidential Computing:** Trusted Execution Environments (TEEs) / in-use protection even from infrastructure owners.

7. **Physical AI:** Robots / drones / smart equipment that sense / decide / act in the real world.

8. **Preemptive Cybersecurity:** Proactive defense using AI Security Operations (SecOps), denial / deception, etc.

9. **Digital Provenance:** Ability to verify origin/integrity; Software Bill of Materials (SBOM), attestation, watermarking.

10. **Geopatriation:** Moving workloads out of global public clouds into sovereign / regional / on-prem due to geopolitical risk.

**Multiagent Systems:** 120 companies, led by Software (80) and IT Services (27). This basket has been the laggard on returns (-4.8%), with mid-range valuation (4.1x EV/Sales and multiple contraction of half a turn in 2025), and forecasted revenue growth of 11.7% and gross margin expansion of +2.2%, near average for these ten baskets. The biggest three stocks are NVDA, MSFT, ORCL.

**AI Super Computing Platform:** 115 companies, led by Other Tech (40) and Semiconductors (36). This basket has been the best performing (+40.9%) with the fastest forecasted revenue growth (17.8%) and above-average gross margin expansion (+3.5%). The biggest three stocks are NVDA, AVGO, ORCL.

**AI-Native Development Platforms:** 64 companies, concentrated in Software (35) and IT Services (16). Performance of 3.2% has been "mid", and valuation is on the cheaper side at 3.8x EV-to-forecasted sales despite forecasted revenue growth of an above average 13.2%. The biggest three stocks are AAPL, MSFT, AVGO.

**Physical AI:** 63 companies, skewed toward Other Tech (30) and Semiconductors (22). Returns are among the leaders (+27.8%) because of the Semiconductor exposure, but the average stock's valuation is on the cheaper side (3.7x). The reason is because this group has the slowest forecasted revenue growth (10.5%) among these Technology baskets. The biggest three stocks are NVDA, LRCX, ACN.

**Domain-Specific Language Models:** 55 companies, dominated by Software (40). Because of this, returns are near the bottom (-1.7%) and valuation is mid-range (3.9x) but with the largest multiple drawdown (-0.96x) in 2025. The biggest three stocks are NVDA, MSFT, APP.

# CYBERSECURITY / CONFIDENTIAL COMPUTING ARE ALLURING

**AI Security Platforms:** We found 51 companies, led by Software (29) and Other Tech (11). Returns are near the bottom (-0.1%); valuation sits in the upper half but not the richest (5.1x; -0.36x in 2025), with below-average forecasted revenue growth (11.2%) but above-average forecasted gross margin expansion (+3.1%). The biggest three stocks are NVDA, MSFT, CSCO.

**Digital Provenance:** We found 27 companies, led by Software (14) and Semiconductors (6). Returns are mid-pack (+15.7%); valuation is on the expensive side (5.4x; -0.10x in 2025), with mid-pack forecasted revenue growth (11.8%) and gross margin expansion (+2.3%). The biggest three stocks are AMD, ADBE, PANW.

**Preemptive Cybersecurity:** We found 26 companies, led by Software (11) and Other Tech (8). Returns are among the leaders (+20.3%) and it's the cheapest basket (3.5x; -0.25x in 2025) but forecasted revenue growth is 11.1% and forecasted gross margin expansion is the weakest of the baskets (+1.1%). The biggest three stocks are MSFT, TWLO, HPQ.

**Geopatriation:** We found 24 companies, concentrated in Software (15) and IT Services (7). Returns have been muted (+4.9%), perhaps because this is the most expensive basket (6.5x; -0.15x in 2025) with above-average forecasted revenue growth (16%) and near-average forecasted gross margin expansion (+2.7%). The biggest three stocks are MSFT, ORCL, PLTR.

**Confidential Computing:** We found 17 companies, led by Semiconductors (9). Returns are among the leaders (+20.9%); valuation is on the expensive side (5.9x; -0.15x in 2025), with higher-than-average forecasted revenue growth (13.0%) and the strongest gross margin expansion (+4.0%). The biggest three stocks are NVDA, MSFT, ORCL.

# OVER 40% OF SOFTWARE STOCKS ARE FOCUSED ON THESE 10 TRENDS

Of the 385 US public Technology companies we evaluated, Multiagent Systems (120 companies) and AI Super Computing Platforms (115) are the most common. Only 17 companies are doing Confidential Computing (left). Among just supplier exposure, Software companies dominate the mix (right), with 163 of the 385 (42%) companies involved in at least one of these ten new Technology trends.

**Number of Stocks with Exposure to Each of the Ten Tech Trends**
**As of End-December, 2025**

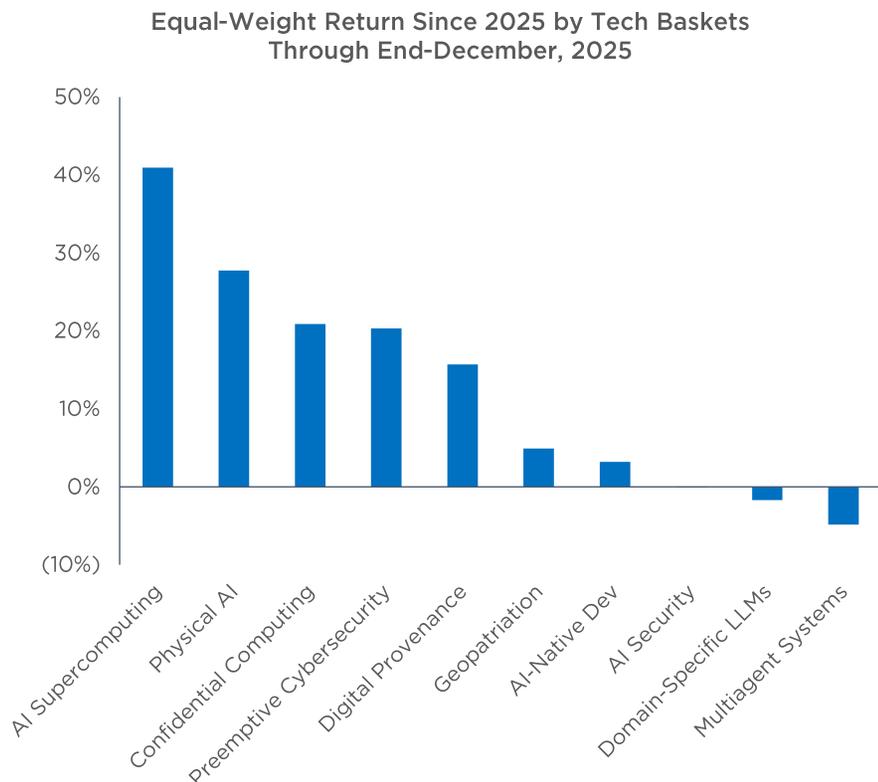| 2026 Technology Trend | Adopter | Supplier | Adopter % of T3000 Tech | Supplier % of T3000 Tech |
|---|---|---|---|---|
| Multiagent Systems | 5 | 120 | 1.3% | 31.2% |
| AI Super Computing Platform | 4 | 115 | 1.0% | 29.9% |
| AI-Native Development Platforms | 10 | 64 | 2.6% | 16.6% |
| Physical AI | 7 | 63 | 1.8% | 16.4% |
| Domain-Specific Language Models | 3 | 55 | 0.8% | 14.3% |
| AI Security Platforms | 2 | 51 | 0.5% | 13.2% |
| Digital Provenance | 4 | 27 | 1.0% | 7.0% |
| Preemptive Cybersecurity | 5 | 26 | 1.3% | 6.8% |
| Geopatriation | 0 | 24 | 0.0% | 6.2% |
| Confidential Computing | 1 | 17 | 0.3% | 4.4% |

Source: Trivariate Research

**Number of Stocks with Supplier Exposure to 10 Tech Trend**
**As of End-December, 2025**

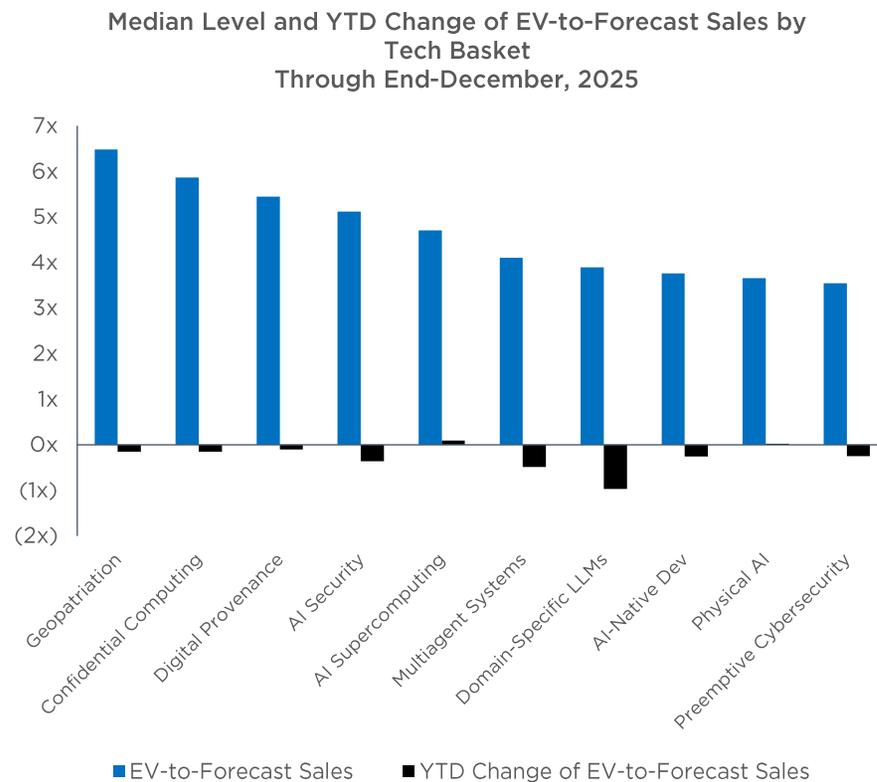| 2026 Technology Trend | Semi. & Semi. Equip | Software | IT Service | Other Tech | Total |
|---|---|---|---|---|---|
| Multiagent Systems | 2 | 80 | 27 | 11 | 120 |
| AI Super Computing Platform | 37 | 28 | 10 | 40 | 115 |
| AI-Native Development Platforms | 5 | 36 | 16 | 7 | 64 |
| Physical AI | 22 | 5 | 5 | 31 | 63 |
| Domain-Specific Language Models | 4 | 40 | 6 | 5 | 55 |
| AI Security Platforms | 1 | 29 | 10 | 11 | 51 |
| Digital Provenance | 7 | 14 | 1 | 5 | 27 |
| Preemptive Cybersecurity | 3 | 11 | 4 | 8 | 26 |
| Geopatriation | 1 | 15 | 7 | 1 | 24 |
| Confidential Computing | 9 | 4 | 1 | 3 | 17 |
| Total T3000 Stocks | 76 | 163 | 37 | 109 | 385 |

Source: Trivariate Research

# 8 OF THE 10 BASKETS SAW MULTIPLE CONTRACTION IN THE LAST YR

Performance has been best for the AI Supercomputing basket, because it is populated with many Semiconductor companies (left). Multiagent systems and domain-specific LLMs are down in absolute terms. Interestingly, none of these baskets has seen big moves in their valuation in the last year, with eight out of ten posting modest multiple contraction on EV-to-forecasted sales (right).

### Equal-Weight Return Since 2025 by Tech Baskets Through End-December, 2025



Source: Trivariate Research

### Median Level and YTD Change of EV-to-Forecast Sales by Tech Basket Through End-December, 2025



■ EV-to-Forecast Sales   ■ YTD Change of EV-to-Forecast Sales
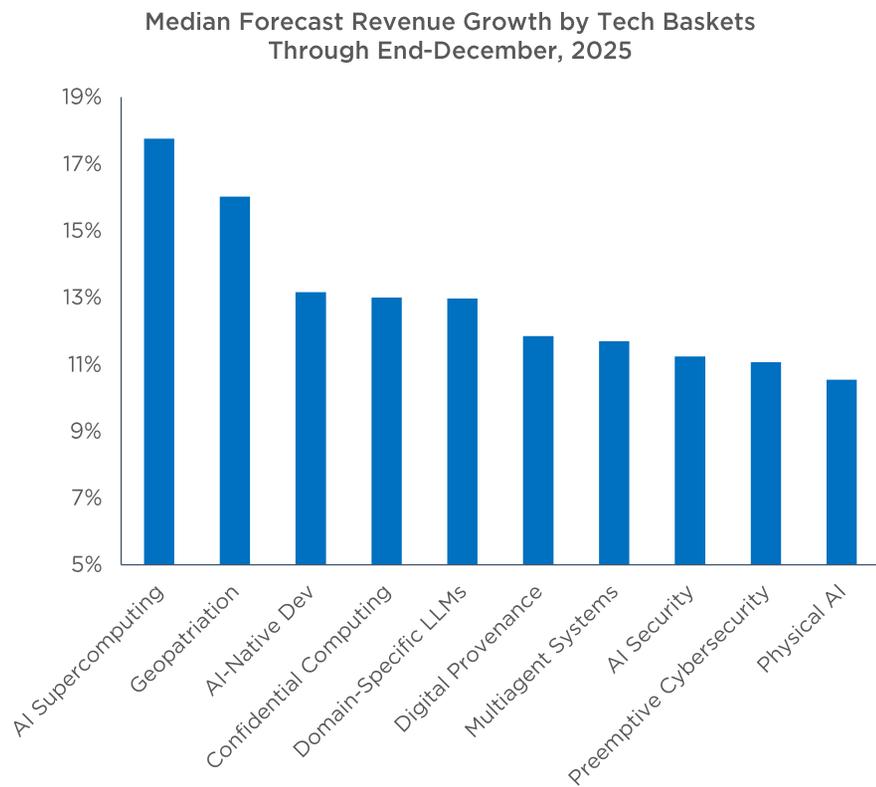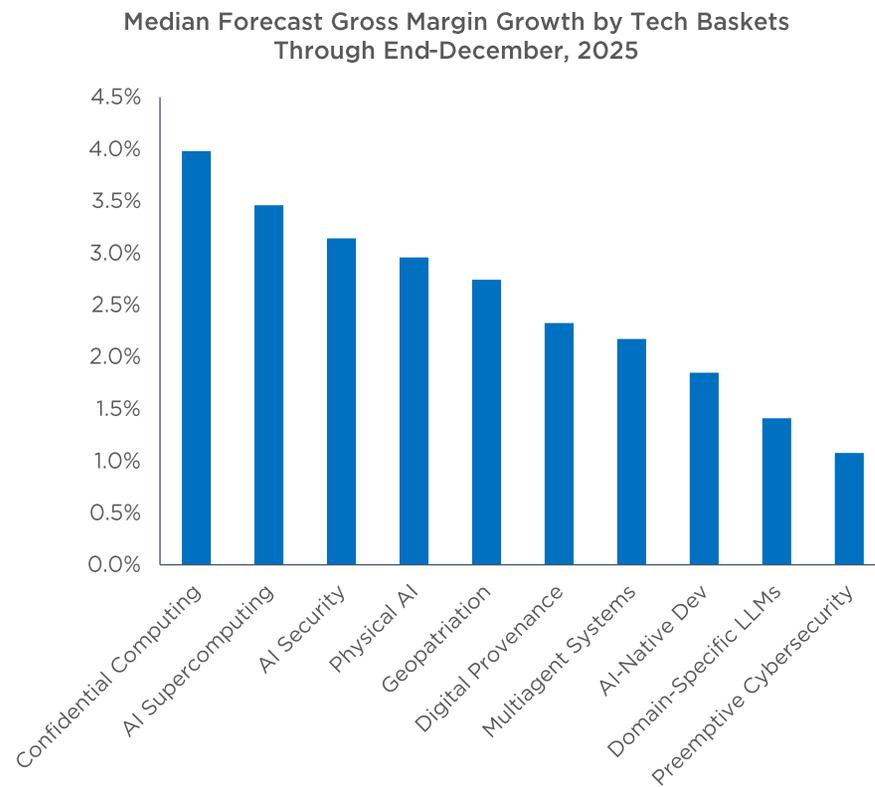
Source: Trivariate Research

# AI SUPERCOMPUTING HAS HIGH REVENUE AND MARGIN FORECASTS

The likely reason that the AI Supercomputing basket has performed best is that its forecasted revenue growth is the highest (left) and its forecasted gross margin expansion is the 2nd highest (right) among the ten baskets.

**Median Forecast Revenue Growth by Tech Baskets Through End-December, 2025**



**Median Forecast Gross Margin Growth by Tech Baskets Through End-December, 2025**



Source: Trivariate Research

Source: Trivariate Research

# THE STOCKS WITH THE MOST EXPOSURE TO THE TEN NEW THEMES

Below we show that MSFT is exposed to 9 of the 10 themes, and NVDA 8. IBM, ORCL, ACN, HPE, and NET are playing in five of the ten.

**T2000 Tech Stocks with Exposure to Four or More Tech Trends**

| Ticker | Company | Industry | Market Cap. ($Bn) | Trend Count | Trends |
|---|---|---|---|---|---|
| MSFT | Microsoft Corporation | Software | 3594.45 | 9 | AI Security, AI Supercomputing, AI-Native Dev, Confidential Computing, Digital Provenance, Domain-Specific LLMs, Geopatriation, Multiagent Systems, Preemptive Cybersecurity |
| NVDA | NVIDIA Corporation | Semiconductors & Semi. Equipment | 4531.76 | 8 | AI Security, AI Supercomputing, AI-Native Dev, Confidential Computing, Domain-Specific LLMs, Multiagent Systems, Physical AI, Preemptive Cybersecurity |
| IBM | International Business Machines | IT Services | 276.88 | 5 | AI Security, AI Supercomputing, AI-Native Dev, Confidential Computing, Multiagent Systems |
| ORCL | Oracle Corporation | Software | 560.00 | 5 | AI Security, AI Supercomputing, Confidential Computing, Geopatriation, Multiagent Systems |
| ACN | Accenture plc | IT Services | 165.09 | 5 | AI Supercomputing, Domain-Specific LLMs, Geopatriation, Multiagent Systems, Physical AI |
| HPE | Hewlett Packard Enterprise | Technology Hardware, Storage & Peripherals | 32.06 | 5 | AI Supercomputing, Confidential Computing, Domain-Specific LLMs, Geopatriation, Multiagent Systems |
| NET | Cloudflare, Inc. | IT Services | 69.06 | 5 | AI Security, AI Supercomputing, Geopatriation, Multiagent Systems, Preemptive Cybersecurity |
| CRWV | CoreWeave, Inc. | IT Services | 35.68 | 4 | AI Security, AI Supercomputing, AI-Native Dev, Multiagent Systems |
| PANW | Palo Alto Networks, Inc. | Software | 128.39 | 4 | AI Security, Digital Provenance, Multiagent Systems, Preemptive Cybersecurity |
| AKAM | Akamai Technologies, Inc. | IT Services | 12.55 | 4 | AI Security, AI Supercomputing, Geopatriation, Multiagent Systems |
| CTSH | Cognizant Technology Solutions Corporation | IT Services | 40.06 | 4 | AI Security, AI-Native Dev, Domain-Specific LLMs, Multiagent Systems |
| OTEX | Open Text Corporation | Software | 8.07 | 4 | AI Security, AI Supercomputing, Domain-Specific LLMs, Multiagent Systems |
| DDOG | Datadog, Inc. | Software | 47.69 | 4 | AI Security, AI-Native Dev, Domain-Specific LLMs, Multiagent Systems |
| S | SentinelOne, Inc. | Software | 5.10 | 4 | AI Security, AI-Native Dev, Domain-Specific LLMs, Multiagent Systems |
| CRWD | CrowdStrike Holdings, Inc. | Software | 118.17 | 4 | AI Security, AI Supercomputing, AI-Native Dev, Multiagent Systems |
| SNPS | Synopsys, Inc. | Software | 89.87 | 4 | AI Supercomputing, AI-Native Dev, Digital Provenance, Multiagent Systems |
| ZBRA | Zebra Technologies Corporation | Electronic Equipment, Instr. & Components | 12.30 | 4 | AI-Native Dev, Digital Provenance, Domain-Specific LLMs, Multiagent Systems |
| CSCO | Cisco Systems, Inc. | Communications Equipment | 304.35 | 4 | AI Security, AI Supercomputing, Confidential Computing, Multiagent Systems |
| BOX | Box, Inc. | Software | 4.28 | 4 | AI Security, AI-Native Dev, Geopatriation, Multiagent Systems |
| SNOW | Snowflake Inc. | IT Services | 75.06 | 4 | AI Security, Domain-Specific LLMs, Geopatriation, Multiagent Systems |

Source: Trivariate Research
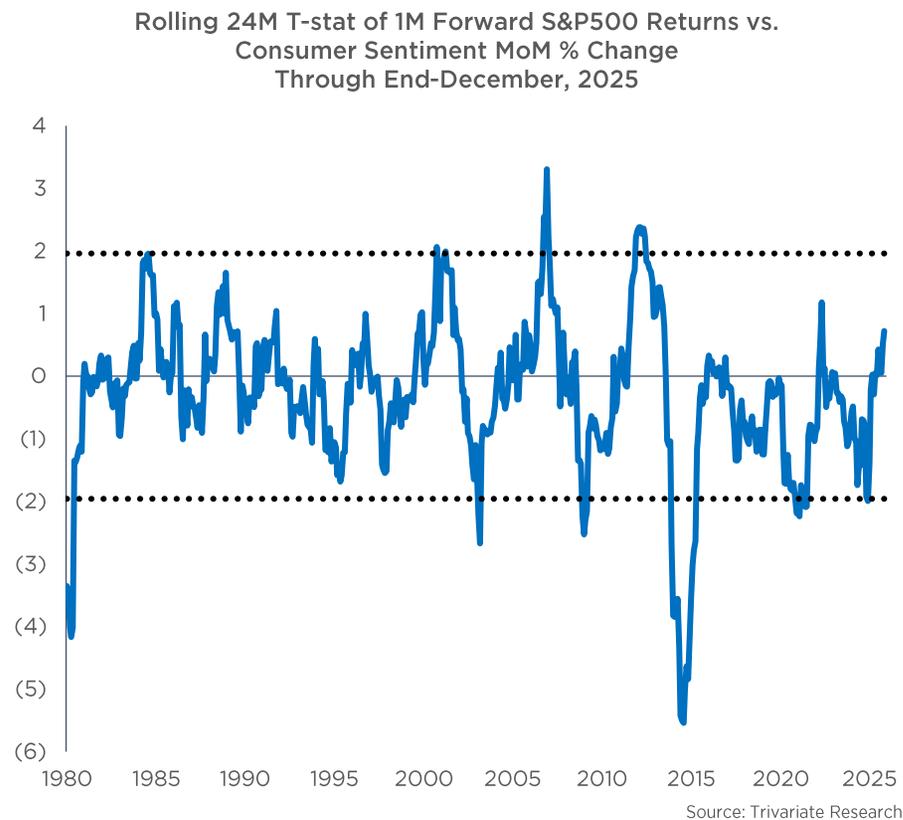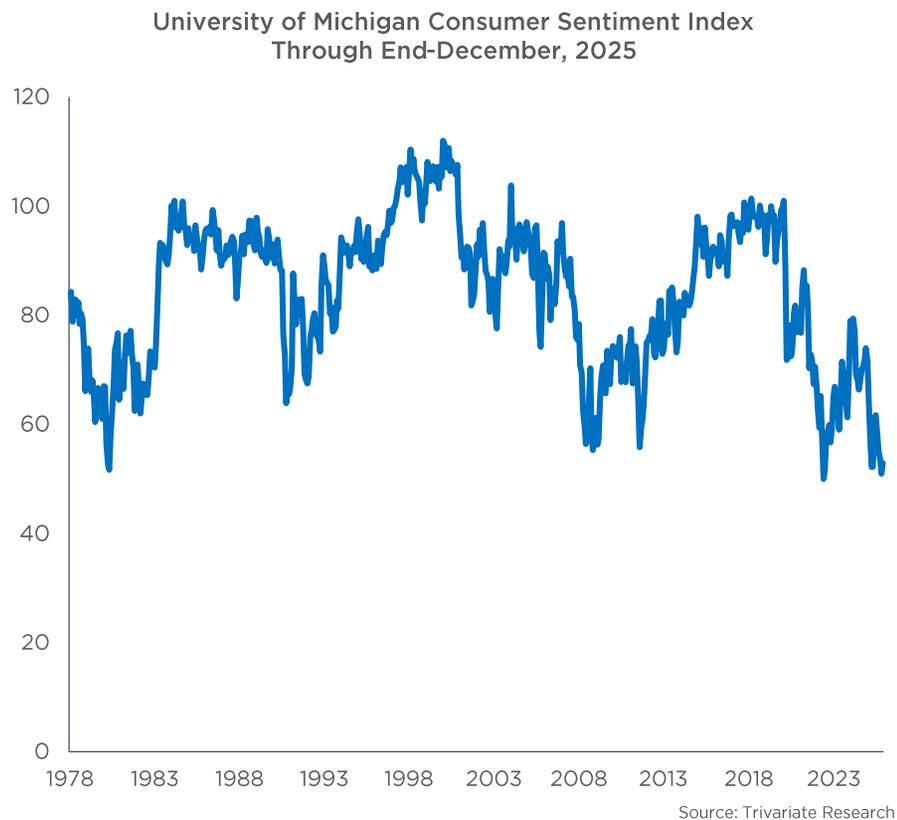
The health of the US Consumer remains a major investment controversy. The consensus view is that there is labor market polarization, where high-end consumers thrive on asset gains while the lower-income labor market continues to cool. Spending of the US consumer is certainly key to avoid a recession. Moreover, AI spending is partially justified by effectively targeting US consumers to spend their discretionary dollars, a pool that could be impaired.

- <u>We don't think historically low Consumer Confidence matters for stocks.</u>

- Usually, Discretionary beats Staples at this point in the interest rate cycle. As part of our 2026 outlook, <u>we are downgrading Consumer Staples from Equal-Weight to Underweight and upgrading Consumer Discretionary from Underweight to Equal-Weight</u>.

- <u>Consumer Staples have performed poorly for a reason</u> – consistent downward earnings revisions. We think many of the issues causing serial disappointment are structural, not cyclical.

- <u>Estimates are overly optimistic:</u> Many Consumer industries are forecasted to have accelerating revenue growth despite weak recent performance. We are wary.

- <u>Be cautious of heavily shorted Consumer Discretionary stocks</u>. Those with positive price momentum and high short interest massively underperform if they miss earnings but can outperform strongly if they beat – so risk management around the position sizes of these stocks is crucial.
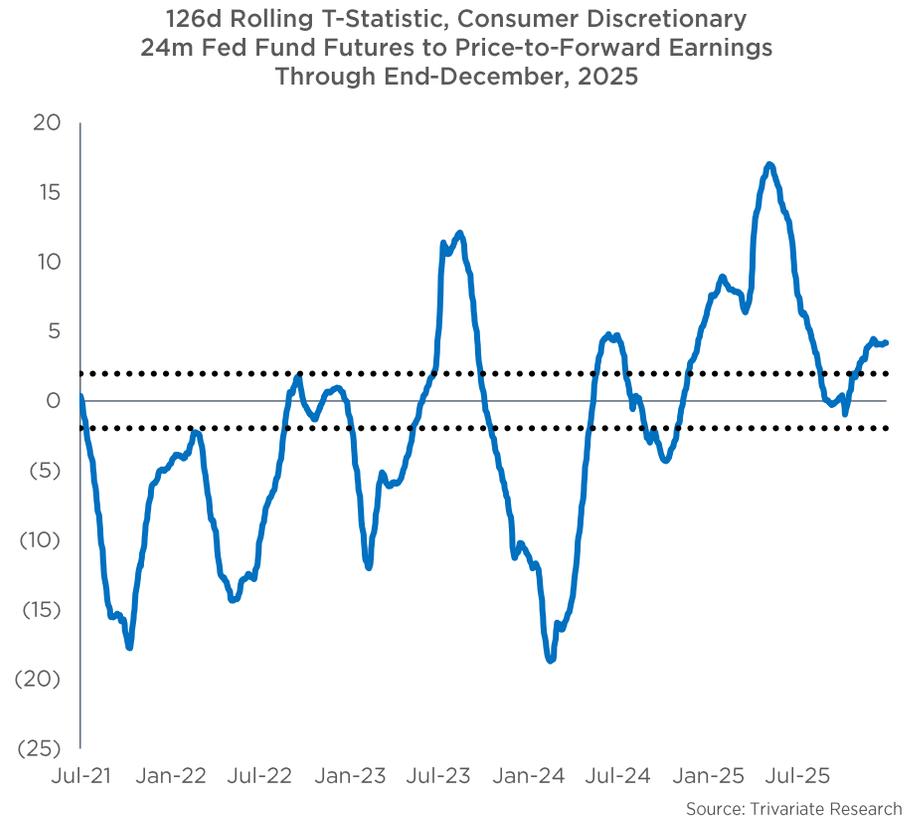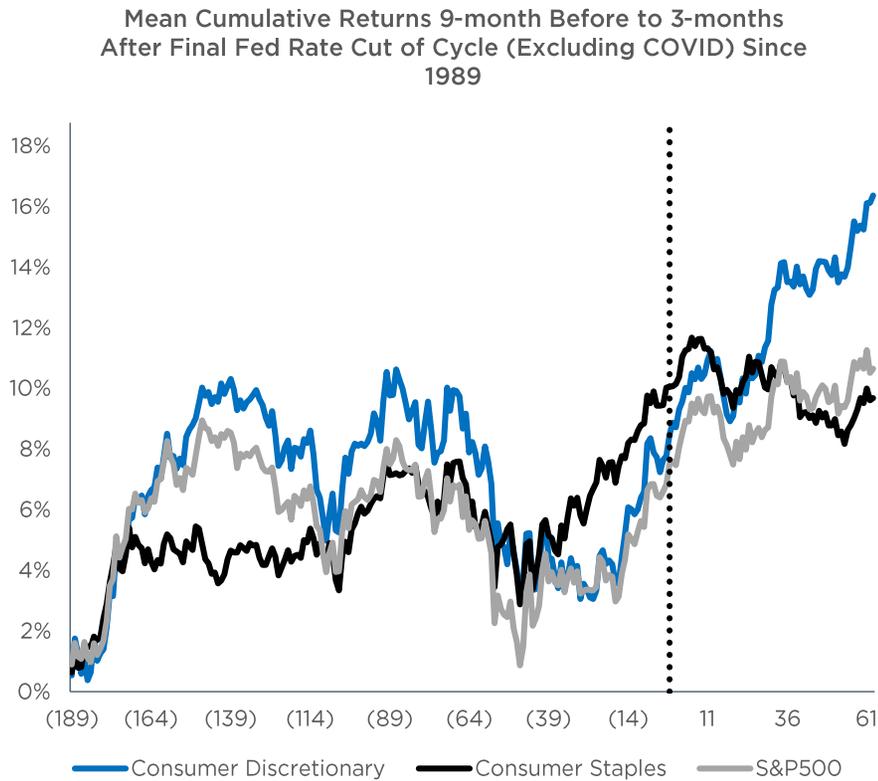
# CONSUMER CONF. IS LOW, BUT ITS UNCORRELATED TO S&P RETURNS

Many investors and the media have been citing the fact that the US Consumer Confidence is near 50-year lows (left), though the end-December data point did modestly tick-up from the end-November point. This would appear to be a troubling omen, but we analyzed the relationship between the S&P500 returns and the change in the University of Michigan (the leaders and the best) Consumer Sentiment index and found the relationship to be near zero today (right) and almost never statistically significant in the last 45 years.

### University of Michigan Consumer Sentiment Index
### Through End-December, 2025



Source: Trivariate Research

### Rolling 24M T-stat of 1M Forward S&P500 Returns vs.
### Consumer Sentiment MoM % Change
### Through End-December, 2025
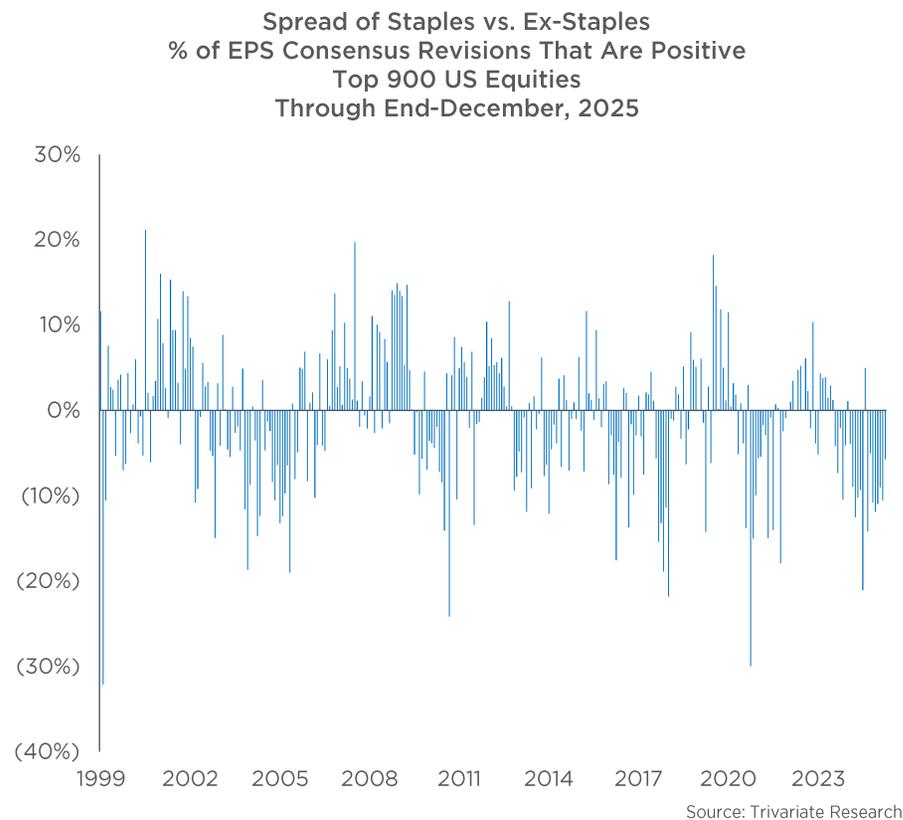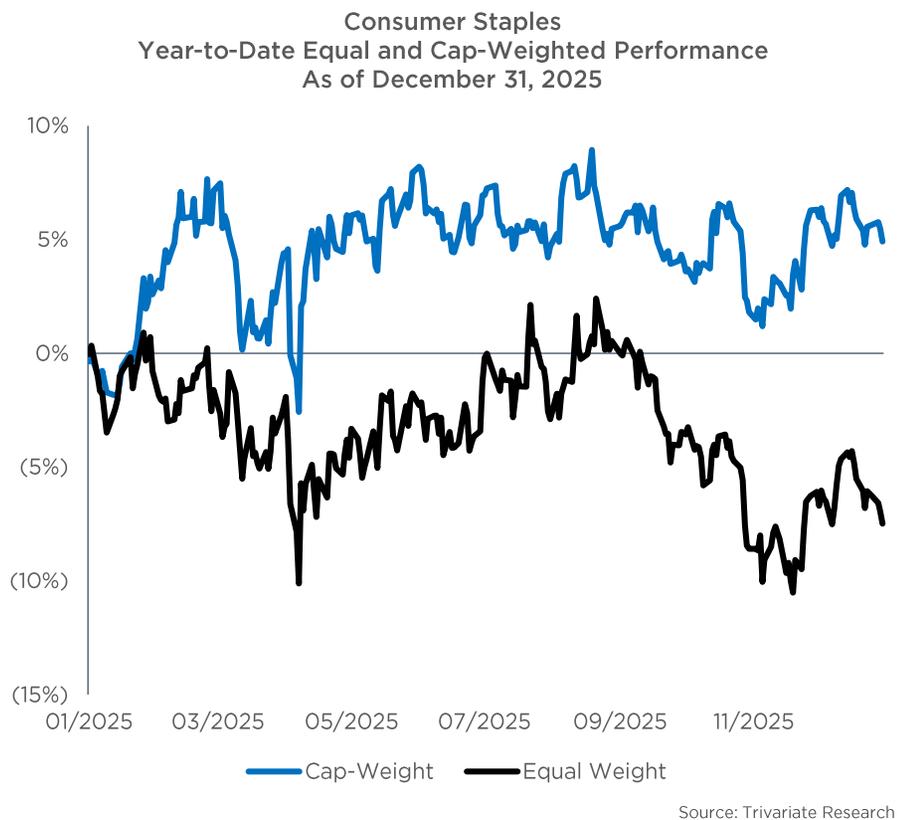


Source: Trivariate Research

# DISCRETIONARY BEATS STAPLES AT THIS POINT IN THE RATE CYCLE

We analyzed how the Consumer Discretionary and Consumer Staples sectors perform vs. the S&P500 during the nine-months before the last interest rate cut of a cycle and the three months after, assuming today's time frame is relevant. Consumer Discretionary stocks typically perform well the last three months of this period (left), beating both the overall market and Staples.  The relationship between the Fed Fund Futures two years forward and the price-to-forward earnings of the Consumer Discretionary sector has changed recently (right), with lower rates maybe now meaning no positive relationship to multiples.

**Mean Cumulative Returns 9-month Before to 3-months After Final Fed Rate Cut of Cycle (Excluding COVID) Since 1989**

Consumer Discretionary
Consumer Staples
S&P500

Source: Trivariate Research

**126d Rolling T-Statistic, Consumer Discretionary 24m Fed Fund Futures to Price-to-Forward Earnings Through End-December, 2025**

Source: Trivariate Research

The equally-weighted Consumer Staples sector was down in absolute terms last year (left).  But, when we analyzed the bottom-up consensus earnings revisions for Consumer Staples compared to the overall market excluding Consumer Staples, we have seen the worst stretch of relative estimate achievability in over twenty years (right). Staples have had worse earnings revisions than the overall market in 19 of the last 21 months.  In our judgment, many of the issues impacting the sector are structural.

**Consumer Staples**
**Year-to-Date Equal and Cap-Weighted Performance**
**As of December 31, 2025**



Cap-Weight    Equal Weight

Source: Trivariate Research

**Spread of Staples vs. Ex-Staples**
**% of EPS Consensus Revisions That Are Positive**
**Top 900 US Equities**
**Through End-December, 2025**



Source: Trivariate Research

One of the challenges for US consumer stocks is that the growth rate for the overall group seems likely to slow. Many investors are banking on a first half of the year recovery from the One Big Beautiful Bill Act to drive positive Consumer spending. Hotels, Restaurants, & Leisure stocks are forecasted by the bottom-up consensus to grow total spend over 16% in 2026, much higher than the long-term median growth of 3%. Homebuilders and other Household Durables are forecasted to have the lowest revenue growth vs. their business model average.
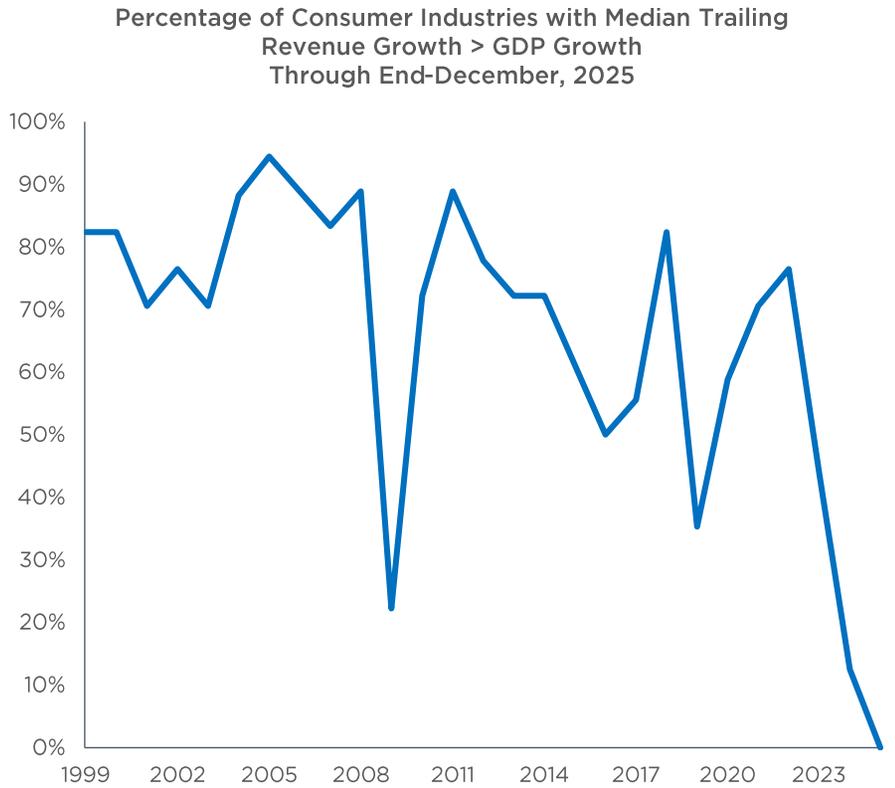
**GICS Consumer Industries, Total $ Forecast Revenue Growth vs. History**
**As of End-2025**

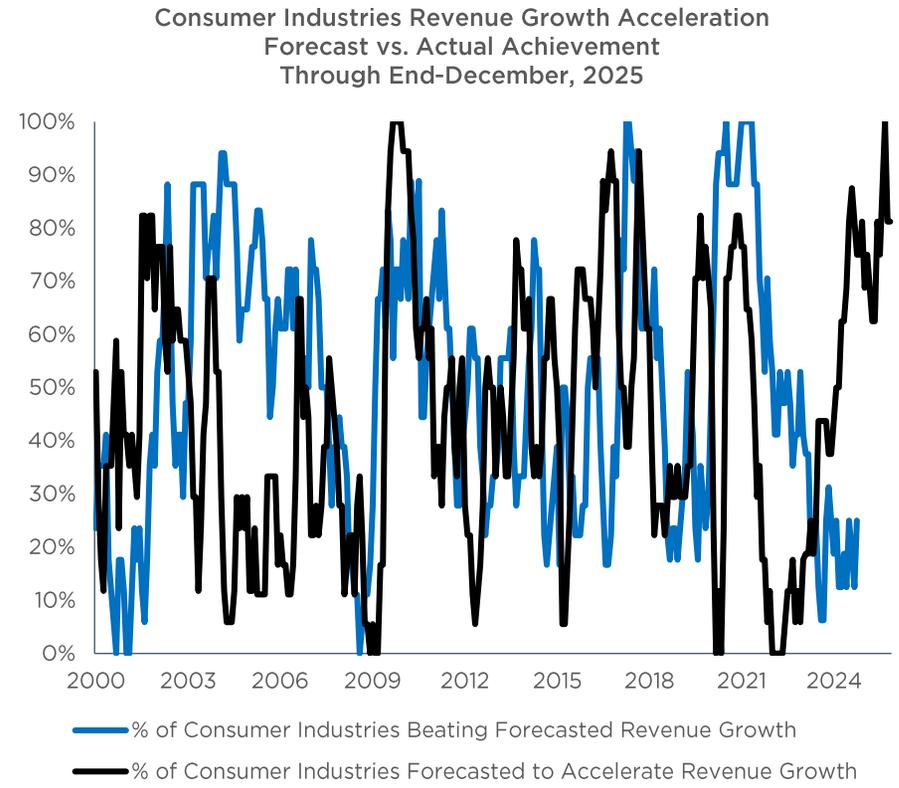| Industry | Total $ Forecast Revenue Growth | Median Total $ Revenue Growth since 1999 | Forecast Growth Minus Historical Median | Top 1000 Tickers with Best/Worst Forecast Revenue Growth |
|---|---|---|---|---|
| Hotels, Restaurants & Leisure | 16.28% | 3.07% | 13.21% | MAR (301.24%), HLT (163.07%), H (121.70%) |
| Broadline Retail | 14.76% | 1.94% | 12.83% | MELI (40.67%), GLBE (32.76%), CPNG (19.32%) |
| Distributors | 7.18% | 3.89% | 3.29% | LKQ (34.65%), GPC (4.82%), POOL (3.50%) |
| Food Products | 4.42% | 1.14% | 3.28% | BG (52.50%), DAR (6.03%), MDLZ (5.94%) |
| Automobile Components | 1.70% | 0.45% | 1.25% | ALV (5.32%), APTV (4.46%), MBLY (4.13%) |
| Tobacco | 1.56% | 0.40% | 1.16% | |
| Specialty Retail | 4.48% | 3.66% | 0.82% | DKS (47.94%), CVNA (38.36%), MUSA (19.27%) |
| Personal Care Products | (1.84%) | (1.73%) | (0.12%) | |
| Consumer Staples Distribution & Retail | 3.42% | 4.34% | (0.91%) | TGT (1.48%), KR (2.65%), SYY (3.09%) |
| Beverages | 1.02% | 2.10% | (1.09%) | STZ (-5.60%), BF.B (-0.31%), TAP (-0.29%) |
| Household Products | 1.11% | 3.02% | (1.91%) | CLX (-4.04%), KMB (-2.27%), PG (2.48%) |
| Automobiles | (0.55%) | 1.87% | (2.42%) | F (-7.87%), GM (-0.40%), TSLA (12.31%) |
| Textiles, Apparel & Luxury Goods | 1.48% | 4.93% | (3.46%) | VFC (-0.15%), NKE (1.44%), TPR (2.23%) |
| Leisure Products | (3.49%) | 1.71% | (5.21%) | |
| Diversified Consumer Services | (10.47%) | (4.14%) | (6.32%) | |
| Household Durables | (7.67%) | 5.75% | (13.42%) | TMHC (-16.84%), NVR (-13.54%), TOL (-4.85%) |

Source: Trivariate Research

<u>None of the 16 industries in the Consumer Discretionary and Staples sectors grew faster than GDP last year (left).  That hasn't happened in over 25 years.</u>  What is worrisome however is that the median stock in most of the Consumer industries missed revenue expectations, and yet, over 80% of the Consumer industries are forecasted to have accelerating revenue growth in 2026 (right).  If the broader consumer is slowly eroding, accelerating revenue expectations in a large group of Consumer-focused stocks is likely a recipe for disappointment.

**Percentage of Consumer Industries with Median Trailing Revenue Growth > GDP Growth Through End-December, 2025**



Source: Trivariate Research

**Consumer Industries Revenue Growth Acceleration Forecast vs. Actual Achievement Through End-December, 2025**



— % of Consumer Industries Beating Forecasted Revenue Growth
— % of Consumer Industries Forecasted to Accelerate Revenue Growth

Source: Trivariate Research

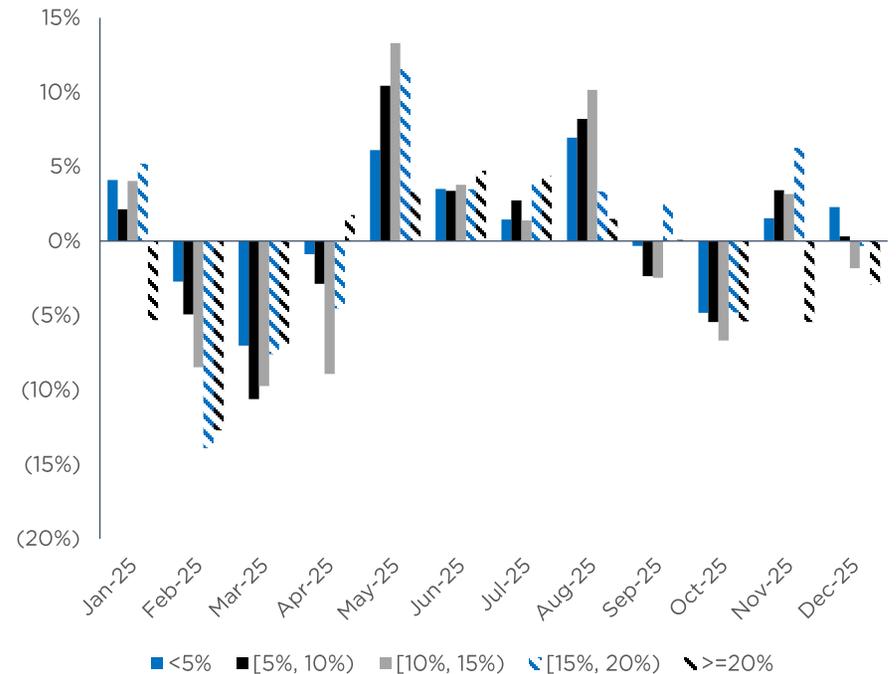# HEAVILY SHORTED CONSUMER STOCKS HAVE EXTREME VOLATILITY

One phenomena that keeps episodically resurfacing, often in the Consumer Discretionary sector, is the performance of heavily shorted stocks. We broke the Consumer Discretionary sector into five buckets based on the amount of short interest for each stock. Historically, stocks with the lowest short interest (between 0% and 5%) performed best. Stocks with 15-20% short interest performed the worst, lagging those with 20-100% short interest (left). However, over the last year we have seen powerful short squeezes, or huge moves on earnings in Consumer stocks that had high short interest (for instance KSS) or inconsistent and volatile market reactions. In November, stocks with 20%-100% short interest materially lagged, but those with 15%-20% short interest performed best. We think it is dangerous to have large short positions in Consumer Discretionary stocks with more than 15% short interest.

**Equal-Weight Cumulative Monthly Returns by Short Interest Bucket**
**Consumer Discretionary Stocks ex. micro-caps**
**Through End-December, 2025**



Legend: <5%, >=20%, [10%, 15%), [15%, 20%), [5%, 10%)
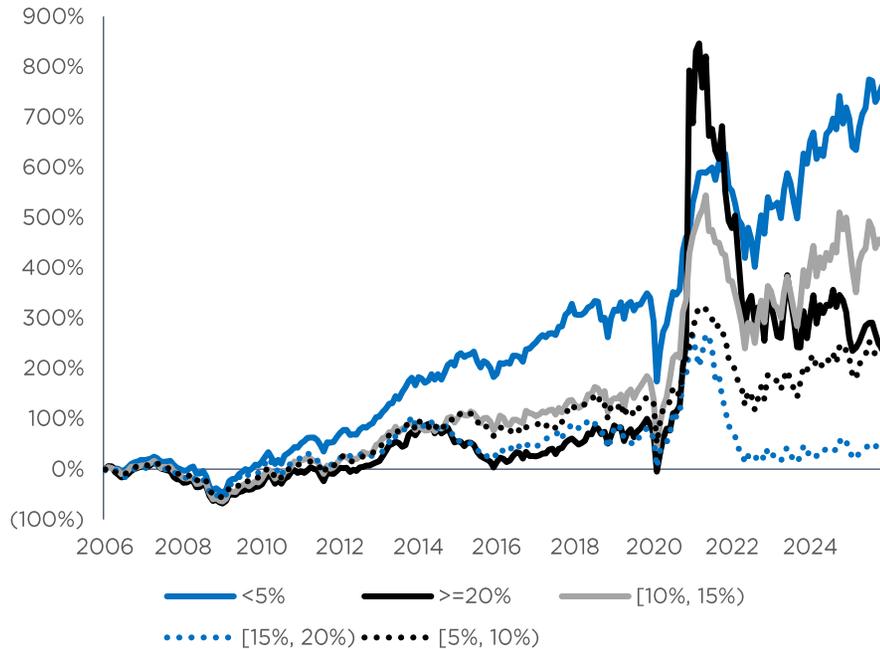
**Equal-Weight Monthly Returns by Short Interest Bucket**
**Consumer Discretionary Stocks ex. micro-caps**
**Through End-December, 2025**



Legend: <5%, [5%, 10%), [10%, 15%), [15%, 20%), >=20%

Source: Trivariate Research

Source: Trivariate Research

# HEAVILY SHORTED CONSUMER STOCKS GO UP A LOT IF THEY BEAT

Overwhelmingly, it appears that shorting Consumer Discretionary stocks that beat earnings is the biggest source of negative short alpha. Shorting stocks that are heavily shorted and have performed well that miss earnings gets rewarded. But if they have performed poorly and beat, the stocks can meaningfully appreciate.



**Median 1M Forward Industry Relative Return After Earnings Results for Consumer Discretionary Stocks ex. micro-caps by Short Interest Bucket and 1M Momentum Quantile Through End-December, 2025**

Legend: ■ Miss  ■ Beat

Short Interest Buckets: <5%, [5%, 10%), [10%, 15%), [15%, 20%), >=20%

TRIVARIATE RESEARCH
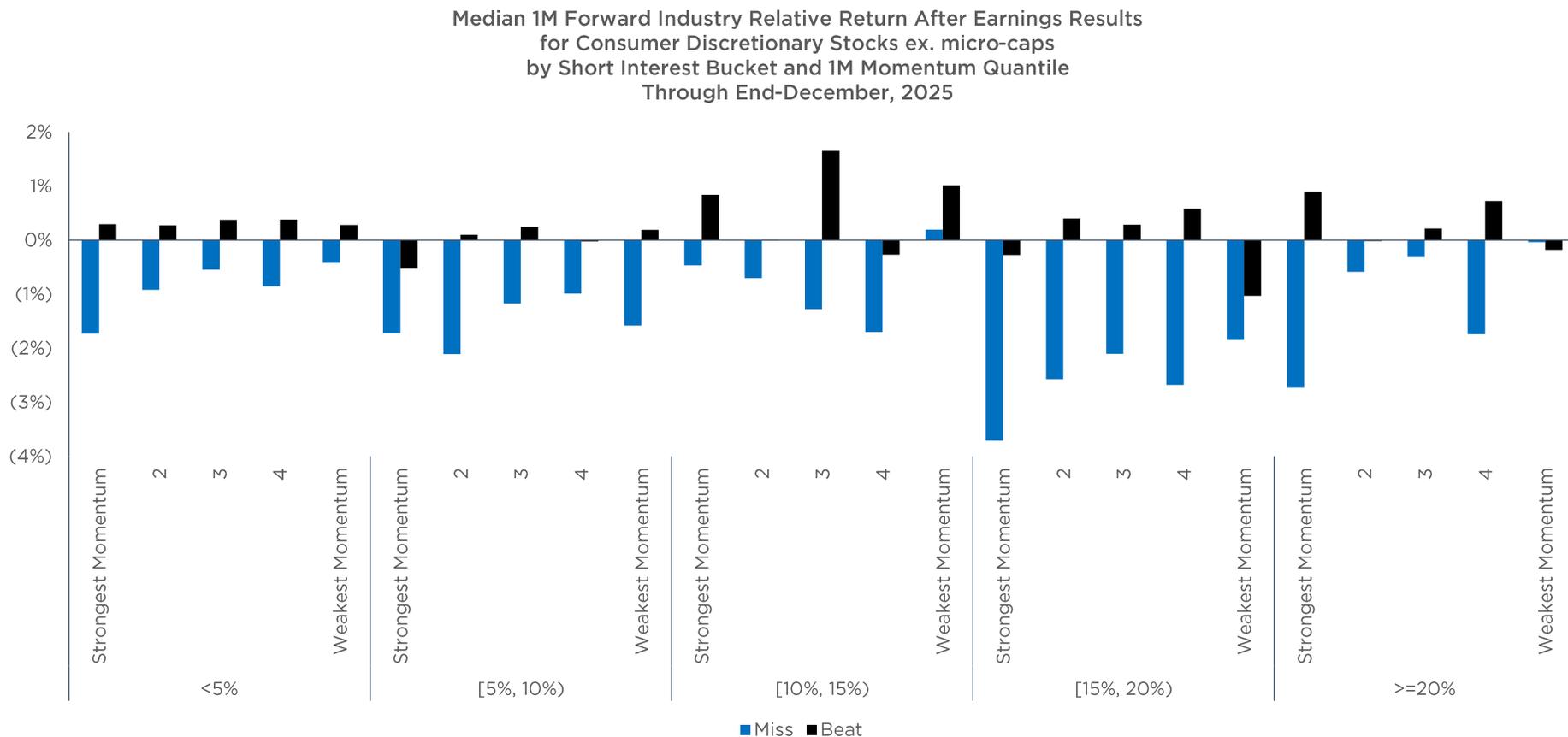
# POTENTIAL CONSUMER SHORT IDEAS

Below is a list of Consumer stocks that are likely to significantly underperform if they miss expectations, due to their high short interest, strong recent momentum, and elevated revenue growth forecasts.

**Consumer Discretionary Stocks in Top 2000 by Market Cap., >15% Short Interest, Top 2 Quintiles of 21-Day Price Momentum, and Forecasted Accelerating Revenue Growth in 2026**
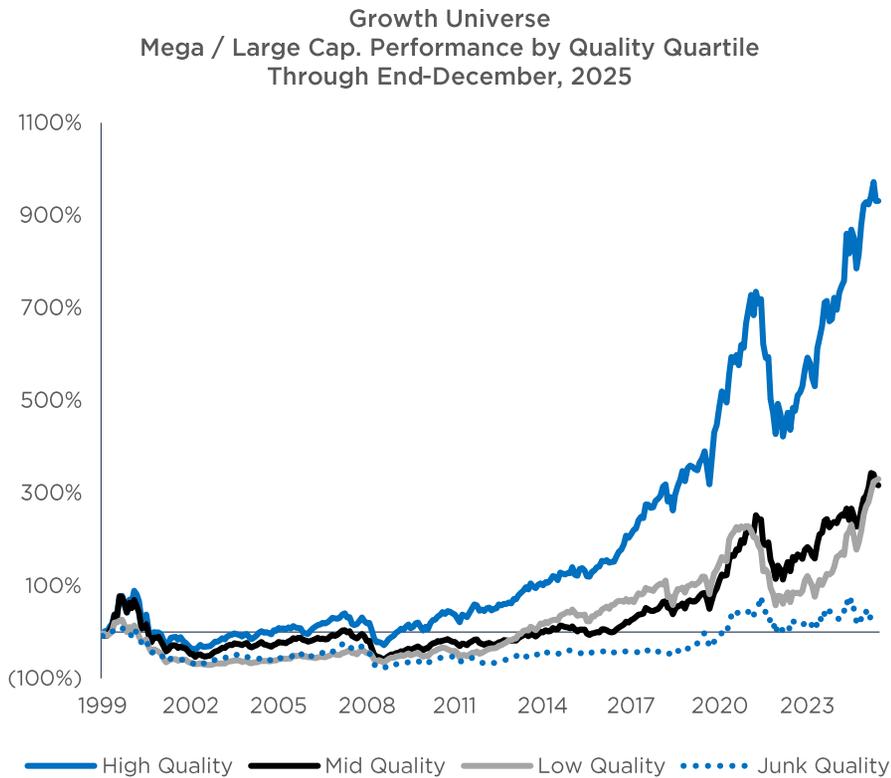**As of End-December, 2025**

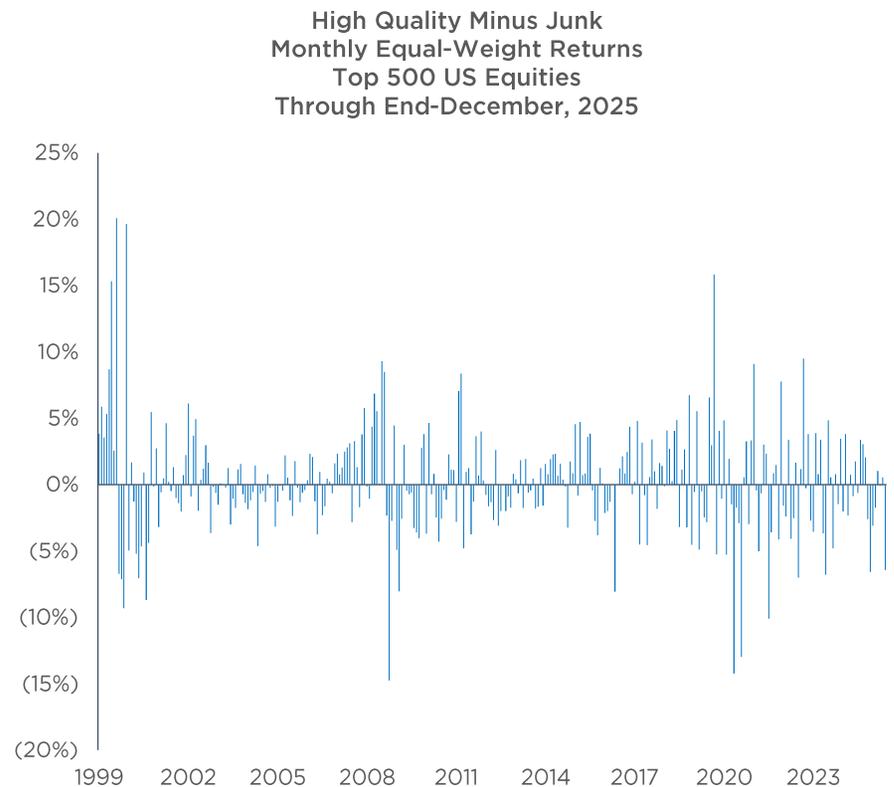| Ticker | Company Name | Industry | Market Cap ($Bn.) | Short Interest | 21D Momentum | Revenue Growth TTM | Forecast Revenue Growth NTM |
|--------|--------------|----------|-------------------|----------------|--------------|--------------------|-----------------------------|
| MMYT | MakeMyTrip Limited | Hotels, Restaurants & Leisure | 7.81 | 17.29% | 13.25% | 14.55% | 30.17% |
| CAVA | CAVA Group, Inc. | Hotels, Restaurants & Leisure | 6.81 | 15.69% | 15.06% | 23.93% | 25.09% |
| CHH | Choice Hotels International, Inc. | Hotels, Restaurants & Leisure | 4.38 | 16.95% | 6.66% | 4.54% | 71.90% |
| RH | RH | Specialty Retail | 3.36 | 24.57% | 11.49% | 9.74% | 10.50% |
| CAKE | The Cheesecake Factory Incorporated | Hotels, Restaurants & Leisure | 2.52 | 18.45% | 6.54% | 4.90% | 5.45% |
| DRVN | Driven Brands Holdings Inc. | Diversified Consumer Services | 2.44 | 18.56% | 4.88% | 5.36% | 5.71% |
| UAA | Under Armour, Inc. | Textiles, Apparel & Luxury Goods | 2.07 | 19.24% | 8.52% | -6.51% | -0.95% |
| PRKS | United Parks & Resorts Inc. | Hotels, Restaurants & Leisure | 1.98 | 22.88% | 2.72% | -3.27% | 1.93% |
| REAL | The RealReal, Inc. | Specialty Retail | 1.84 | 24.83% | 11.68% | 14.30% | 15.42% |
| MCW | Mister Car Wash, Inc. | Diversified Consumer Services | 1.82 | 15.32% | 4.71% | 6.98% | 8.31% |
| SVV | Savers Value Village, Inc. | Broadline Retail | 1.46 | 23.91% | 2.75% | 6.45% | 9.88% |
| LUCK | Lucky Strike Entertainment Corporation | Hotels, Restaurants & Leisure | 1.18 | 16.70% | 4.05% | 3.88% | 4.48% |

Trivariate RESEARCH

- **Quality:** We like high-quality, like seemingly every other investor, <u>but it hasn't worked vs. junk for five years.</u>  The catalyst for it to work in a flat to up tape is beating expectations. <u>Quality doesn't work in isolation.</u>

- <u>Small caps:</u> We disagree with the consensus view on small caps.  They are cheap for a reason – they are increasingly lower quality.  Small caps historically outperformed close to a recession bottom because of better growth in the recovery.  But that is not where we are in the cycle now.  We continue to recommend an underweight.

- <u>Great 8:</u> <u>We recommend a market-weight for the group – for risk-management purposes.</u> At 55% of the S&P500 on a beta-adjusted basis, with EPS narratives that switch quarterly, changing correlations, low-to-average company-specific risk, and a very loved and well covered group of stocks, it is hard to differentiate.  A risk to many is they outperform.

- <u>Sectors: We are downgrading Consumer Staples and Industrials from Equal-Weight to Underweight and upgrading Consumer Discretionary from Underweight to Equal-Weight as part of our 2026 outlook.</u>  For Industrials, high earnings expectations, expensive valuation, and weak macro trends are our rationale.  For Staples, weak fundamentals that are structural not cyclical underpin our negativity.

- <u>We recommend an overweight positioning in Healthcare and Financials, and an Underweight in Consumer Staples, Comm. Services, and Industrials.</u>

- <u>Within Technology, we are reversing our call, and now like Software over Semis.</u>

# QUALITY HASN'T BEEN A HELPFUL FACTOR FOR FIVE YEARS

We have a proprietary model that tags stocks as high-, mid-, low-quality, or junk each month. Among growth stocks, the highest quality quintile has massively outperformed over time, and junk has meaningfully lagged (left). The 25-year average shows high-quality beats junk by 21bps per month, or nearly 2.5% per year. **However, since the beginning of 2020, junk has beaten high-quality by an average of 17bps per month and a median of 27bps per month (right).** Initially this was due to the huge risk-on trade in the post-COVID recovery. But recently, it has been fueled more by speculation and optimism about AI implementation. <u>We like high-quality over junk, but it can't be in isolation, it has to be in the context of achievable estimates.</u>



Growth Universe
Mega / Large Cap. Performance by Quality Quartile
Through End-December, 2025

— High Quality  — Mid Quality  — Low Quality  ····· Junk Quality

Source: Trivariate Research



High Quality Minus Junk
Monthly Equal-Weight Returns
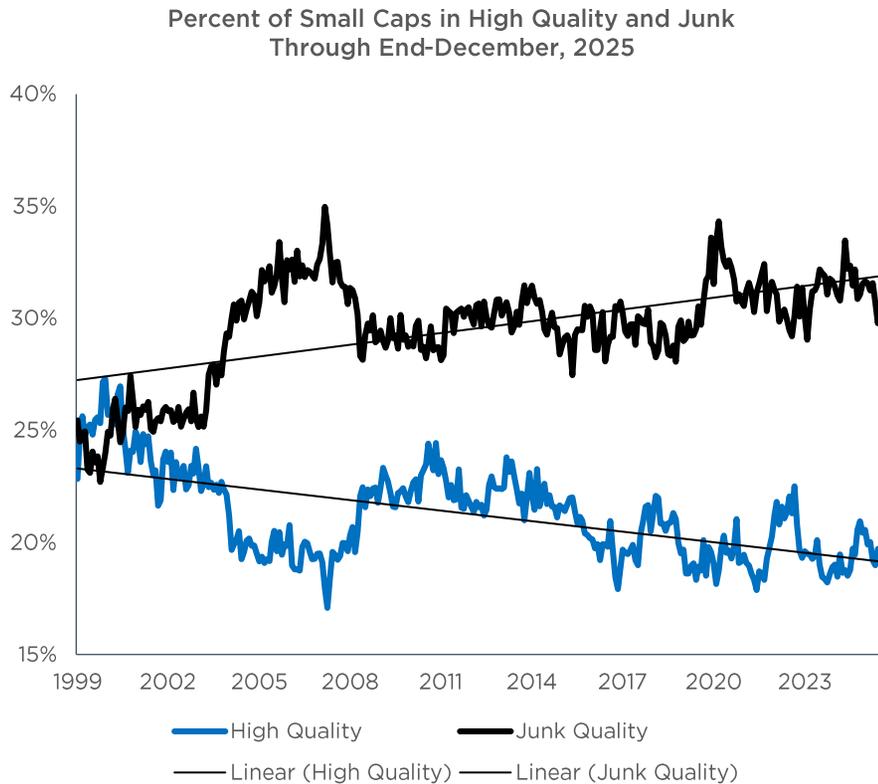Top 500 US Equities
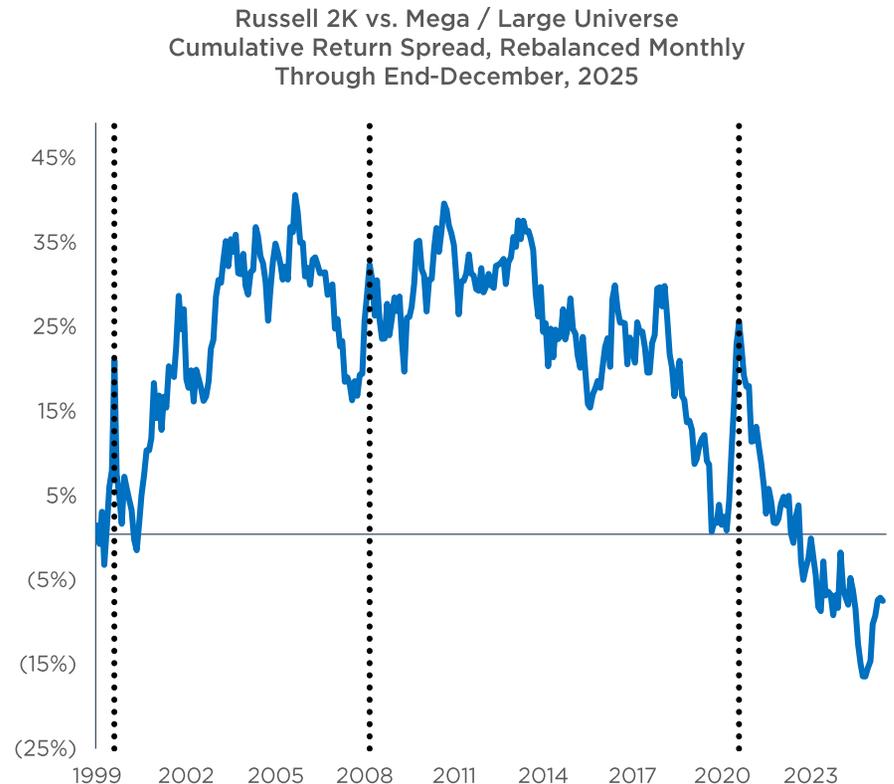Through End-December, 2025

Source: Trivariate Research

TRIVARIATE RESEARCH

# WE DISAGREE WITH THE CONSENSUS – WE DON'T LIKE SMALL CAPS

The consensus view from top-down sell side strategists is a preference for small caps.  We know why – they are cheaper vs. their own history than the large caps.  But that is partly true for a reason – which is that small caps have become increasingly more junk and increasingly less high-quality (left).  Small caps. typically outperform on a relative basis right before a recession bottoms (right).  To argue that this point in the cycle, is an argument for an accelerating economy and incrementally higher earnings revisions for small caps., something we think is very unlikely.

### Percent of Small Caps in High Quality and Junk Through End-December, 2025



High Quality ——— Junk Quality
——— Linear (High Quality) ——— Linear (Junk Quality)

Source: Trivariate Research

### Russell 2K vs. Mega / Large Universe Cumulative Return Spread, Rebalanced Monthly Through End-December, 2025



Source: Trivariate Research

# WE THINK MARKET-WEIGHT THE GREAT 8 IS PRUDENT

On the left, we show the performance of the great 8 stocks (NVDA, AAPL, AMZN, AVGO, GOOGL, META, MSFT, and TSLA) around EPS reports the last two years. We show in green, stocks that were up more than 5% on the first day of trading after their earnings release, and in red those down more than 5%. In Q3, Amazon (AMZN) performed the best and META the worst.  For Q2, META was the best, and AMZN the second worst. Microsoft (MSFT) was 2nd best in Q1 2025, but the worst in both Q3 and Q4 2024. We highly doubt that fundamental analysts can call the quarters of these companies consistently well and then position capital to generate positive P&L impact with this much quarter-to-quarter performance deviation. The correlation of returns of these stocks appears to be cyclical, but hard to time (right).   NVDA had zero correlation to AAPL three months ago but near 80% off the market lows last April.

## Magnificent 7 Earnings Results, One Day Post-Results Performance
### As of End-December, 2025

| Quarter | AMZN | MSFT | AAPL | GOOGL | NVDA | META | TSLA | AVGO |
|---------|------|------|------|-------|------|------|------|------|
| Q3 2025 | 9.6% | (3.0%) | 0.2% | 5.2% | (0.4%) | (11.3%) | 1.4% | (12.8%) |
| Q2 2025 | (6.7%) | 4.1% | (3.2%) | 0.4% | (0.9%) | 10.5% | (8.1%) | 10.7% |
| Q1 2025 | 3.0% | 8.0% | (3.4%) | 4.3% | 2.7% | 3.2% | 10.2% | (5.4%) |
| Q4 2024 | (3.0%) | (7.2%) | (1.4%) | (4.9%) | (5.1%) | 1.9% | 0.6% | 1.8% |
| Q3 2024 | 2.7% | (5.9%) | (3.1%) | 4.6% | (0.2%) | (4.3%) | 19.5% | 22.7% |
| Q2 2024 | (10.2%) | (2.0%) | (1.0%) | (5.0%) | (8.3%) | 7.5% | (10.6%) | (11.1%) |
| Q1 2024 | (1.1%) | (0.7%) | 8.3% | 8.1% | 8.8% | (11.0%) | 14.1% | 14.9% |
| Q4 2023 | 10.7% | (3.0%) | 0.8% | (8.7%) | 13.1% | 21.7% | (12.7%) | (3.1%) |

Source: Trivariate Research

## 63-Day Rolling Correlation of NVDA to Rest of Great 8
### 2023 Through End-December, 2025



Legend: AAPL, AMZN, AVGO, GOOGL, META, MSFT, TSLA
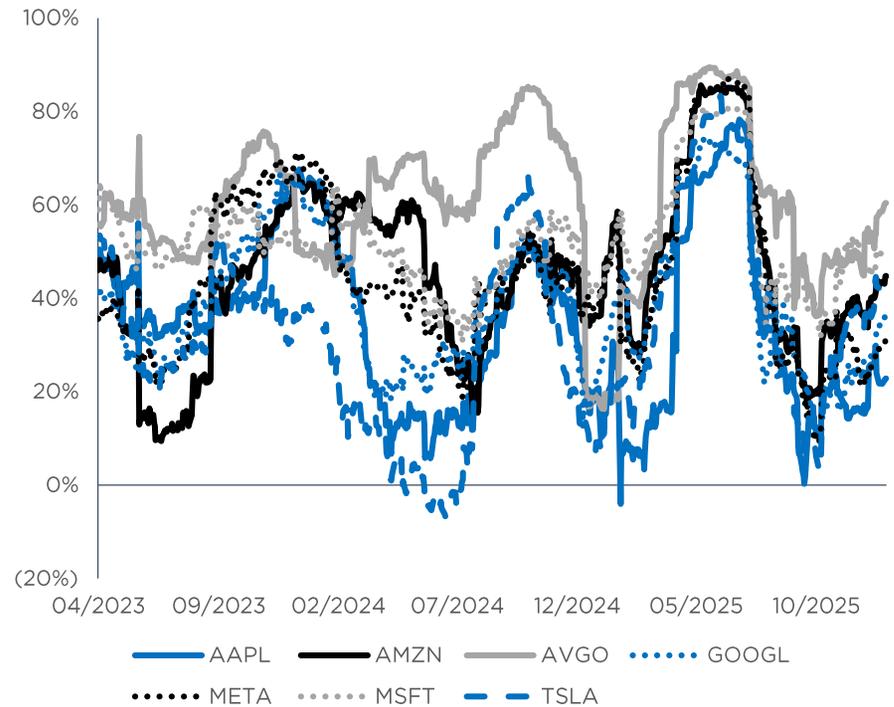
Source: Trivariate Research

# THE GREAT 8 ARE 55.7% OF THE S&P500 ON A BETA-ADJUSTED BASIS

The largest 8 names are now 38.0% of the S&P500 market cap., but 55.7% on a beta-adjusted basis (left). We use the median of four horizons to compute the beta, and of course we aren't saying this a perfect metric, but there is no doubt that the "impact" on performance of these stocks is even greater than their raw sizes.  Moreover, these are very loved stocks (only 3.2% Sell ratings across 462 ratings on these eight stocks), so it is very difficult for an investor to romanticize that they are a contrarian bull.  Moreover, the volatility of the stocks is explained more by macro factors than the average stock, with NVDA the most "macro" of the Great 8 today, with a company-specific risk (CSR) of only 40% (right).   <u>We think market-weight this group for those benchmarked against the S&P500 is prudent and that a real risk for many investors is that the Great 8 gets bigger before it gets smaller.</u>

### Attributes of the Largest 8 Stocks, Market Cap. and Beta
### As of End-December, 2025

| Ticker | Market Cap. (US $Bn.) | Percent of S&P500 Market Cap. | Beta | Beta-Adjusted Size |
|---|---|---|---|---|
| NVDA | 4,532 | 7.0% | 1.91 | 13.4% |
| AAPL | 4,017 | 6.7% | 1.10 | 7.4% |
| MSFT | 3,594 | 5.8% | 0.86 | 5.0% |
| GOOGL | 3,781 | 6.5% | 1.25 | 8.1% |
| AMZN | 2,468 | 4.0% | 1.53 | 6.2% |
| AVGO | 1,641 | 3.0% | 2.18 | 6.5% |
| META | 1,664 | 2.6% | 1.38 | 3.6% |
| TSLA | 1,496 | 2.3% | 2.39 | 5.5% |
| Great 8 Total | 23,193 | 38.0% | 12.59 | 55.7% |
| S&P500 | 61,704 | 100% | 1.00 | 100% |

Source: Trivariate Research

### Attributes of the Largest 8 Stocks, Sell-Side Analyst Ratings
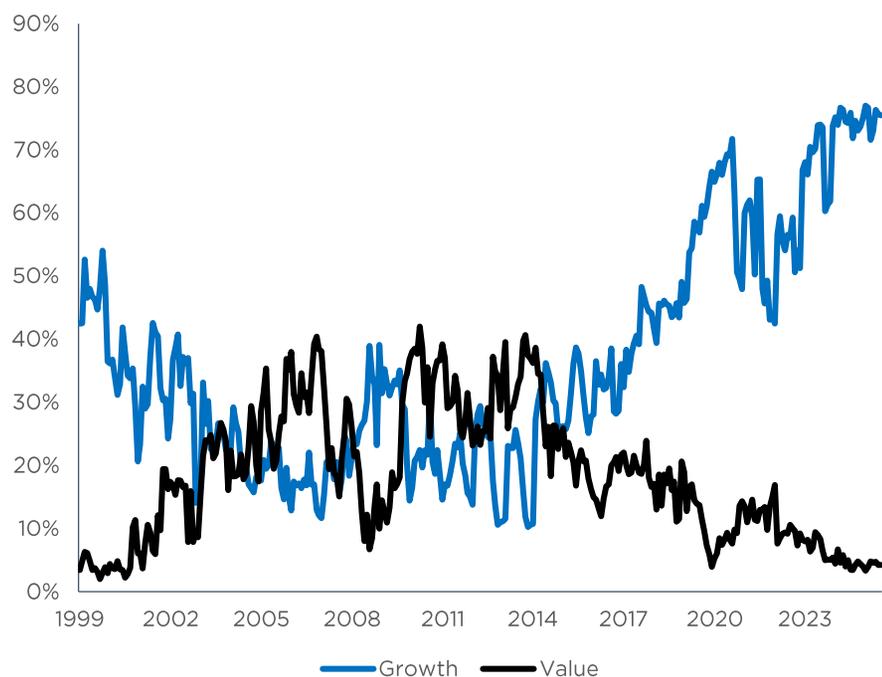### As of End-December, 2025

| Ticker | Market Cap. (US $Bn.) | Buy | Hold | Sell | Buy / Total | Sell / Total | CSR |
|---|---|---|---|---|---|---|---|
| NVDA | 4,532 | 60 | 3 | 1 | 93.8% | 1.6% | 40% |
| AAPL | 4,017 | 29 | 15 | 4 | 60.4% | 8.3% | 65% |
| MSFT | 3,594 | 55 | 2 | 0 | 96.5% | 0.0% | 55% |
| GOOGL | 3,781 | 58 | 9 | 0 | 86.6% | 0.0% | 63% |
| AMZN | 2,468 | 64 | 3 | 0 | 95.5% | 0.0% | 53% |
| AVGO | 1,641 | 46 | 2 | 0 | 95.8% | 0.0% | 52% |
| META | 1,664 | 60 | 7 | 0 | 89.6% | 0.0% | 65% |
| TSLA | 1,496 | 19 | 17 | 10 | 41.3% | 21.7% | 62% |
| Great 8 | 23,193 | 391 | 58 | 15 | 84.3% | 3.2% | 59% |

Source: Trivariate Research

# ONLY 4.2% OF THE MEGA CAP UNIVERSE IS VALUE

We define the mega-cap universe as the top 50 stocks by market capitalization. We have a proprietary style model that labels stocks as growth, value, or a middle ground we call "neither" based on several factors at the end of each month. Below, we show the percentage of mega-cap market cap. that falls into the growth or value categories. From 2003 to around 2014 the percentage of market cap. among the top 50 stocks was roughly equally split between growth, value and "neither." <u>Today, 75.5% of the mega-cap. universe is growth, and 4.2% is value (left)</u>. In practice, this means it's nearly impossible to be a mega-cap. value investor. Among mega-/large-cap. growth stocks, Technology is 51.6% of the mega-/large-cap. growth universe (right), whereas Consumer Staples, Materials, Utilities, and Real Estate are 1% COMBINED!

**Percentage of Mega-Cap Universe Total Market Cap. That is Growth or Value Through End-December, 2025**



Source: Trivariate Research

**Percentage of Mega-/Large-Cap Growth Universe Total Market Cap. By Sector End-December, 2025**

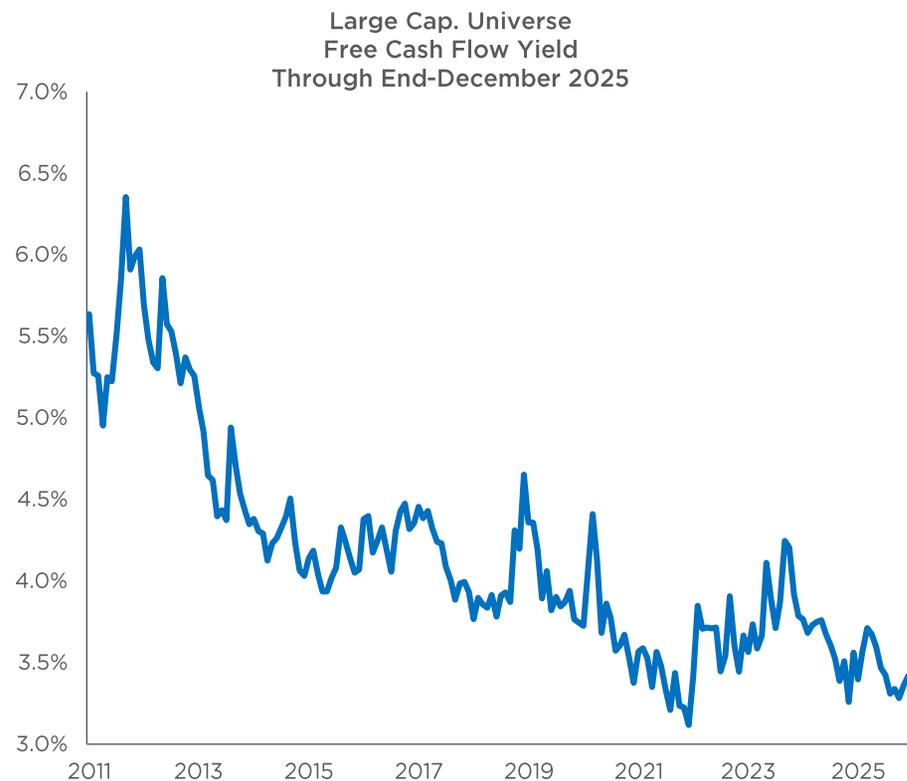| Sector | % of Market Cap. |
|---|---|
| Information Technology | 51.6% |
| Communication Services | 16.7% |
| Consumer Discretionary | 12.9% |
| Financials | 9.9% |
| Health Care | 5.2% |
| Industrials | 2.8% |
| Materials | 0.5% |
| Consumer Staples | 0.2% |
| Utilities | 0.2% |
| Real Estate | 0.1% |

Source: Trivariate Research

# VALUE STOCKS AREN'T THAT CHEAP, AND FCF YIELD IS LOW

The median value company now trades at 15.4x earnings (left) and is not cheap vs. its own history (the 77th percentile relative to the last quarter of a century.  The large cap. universe has a 3.4% free cash flow yield, a level that has generally declined for 15 years (right).  <u>Using valuation as an argument for recommending value stocks has no merit.  Using valuation to pick value stocks, also is not effective for security selection.</u>

**Top 500
Median Value Company
Price-to-Forward Earnings
As of End-December 2025**

**Large Cap. Universe
Free Cash Flow Yield
Through End-December 2025**
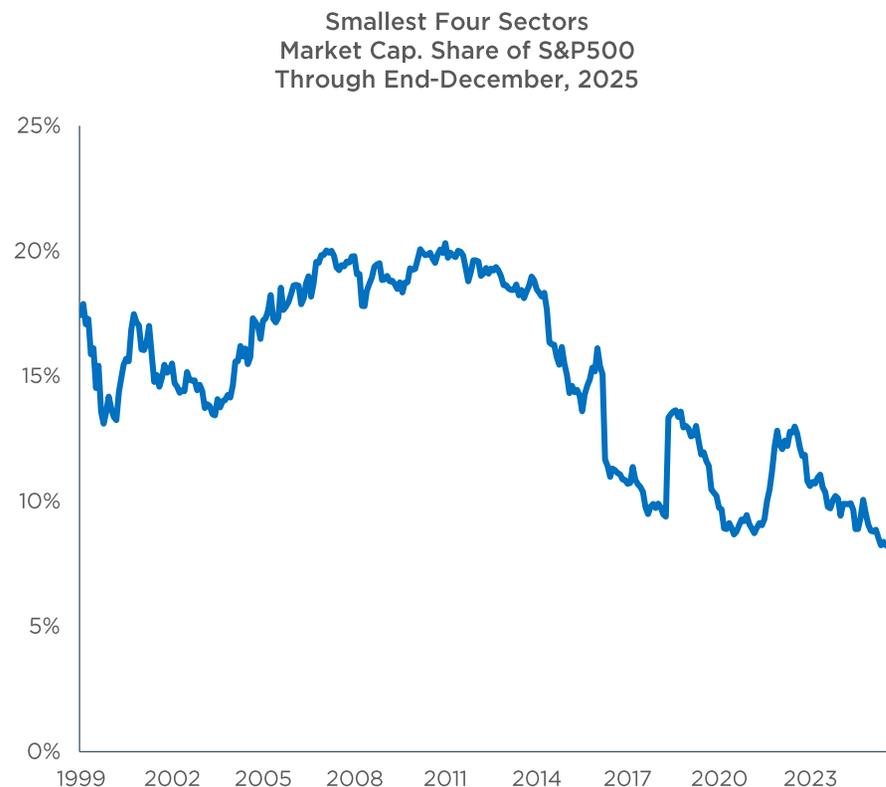
Source: Trivariate Research
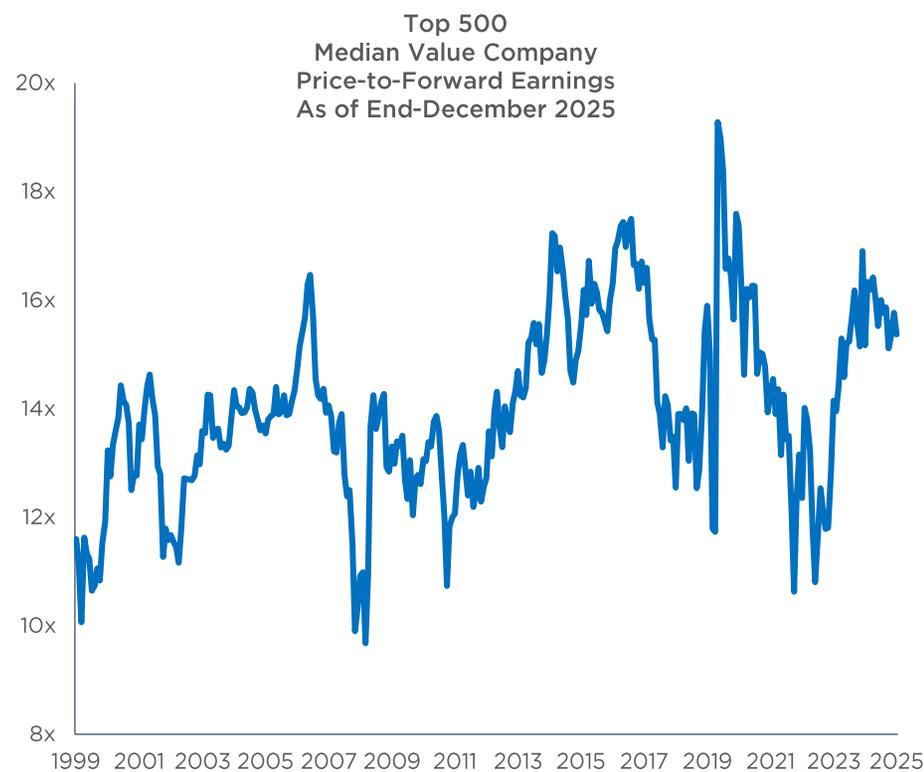
Source: Trivariate Research

TRI**V**ARIATE RESEARCH

# THE CONCENTRATION OF SECTOR EXPOSURE IS VERY HIGH

We looked at the percentage of S&P500 returns that comes from the largest three sectors over time.  Today, the <u>top three account for 58.6% of the market cap., near the highest levels since 2001</u>.  These are Technology, Financials, and Communication Services (left).  At the same time, the smallest four sectors – REITs, Utilities, Materials, and Energy – are at just 8.2% of the S&P 500, the lowest level in 25 years (right).  What does that mean?  <u>The performance of the market is more about Technology and Financials and Comm. Services than other sectors. The headline level of the market might not move as much as some of the swings in the underlying sectors.</u>

**Largest Three Sectors**
**Market Cap. Share of S&P500**
**Through End-December, 2025**



Source: Trivariate Research

**Smallest Four Sectors**
**Market Cap. Share of S&P500**
**Through End-December, 2025**



Source: Trivariate Research
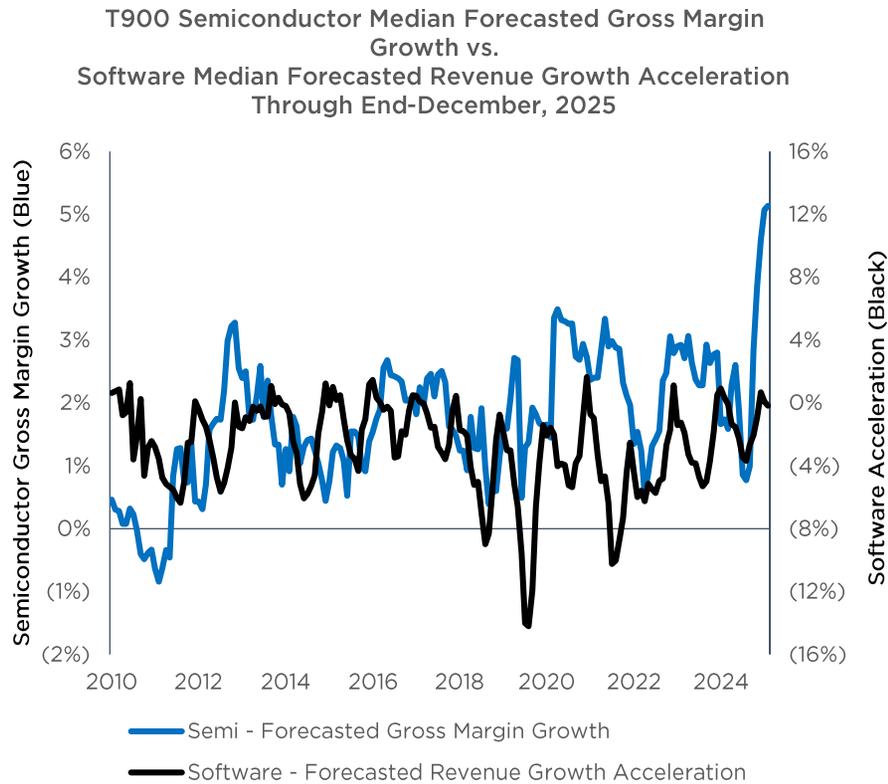
# TRIVARIATE SECTOR RECOMMENDATIONS

We are downgrading Consumer Staples and Industrials from Equal-Weight to Underweight and upgrading Consumer Discretionary from Underweight to Equal-Weight as part of our 2026 outlook. We recommend an overweight positioning in Healthcare and Financials, and an Underweight in Consumer Staples, Comm. Services, and Industrials.

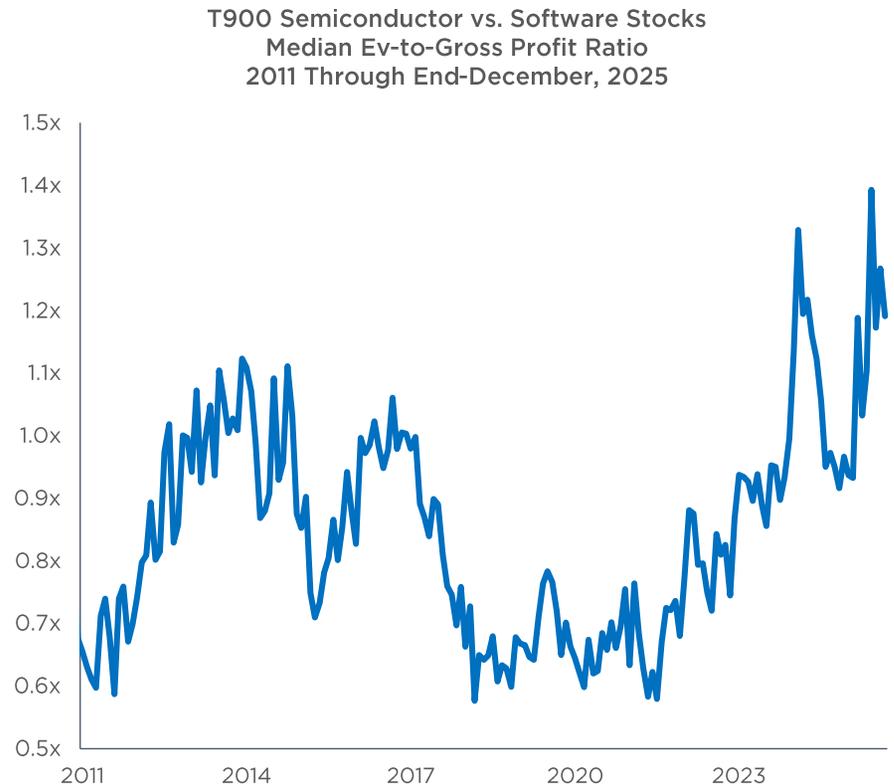## Trivariate Sector Recommendations as of January 2nd, 2026

| Sector | Total S&P 500 Market Cap. (US$ Trillion.) | Current S&P 500 Weight | Trivariate Old Recommended Weight | Trivariate Changes for Jan 2026 | Trivariate New Recommended Weight | Trivariate-Relative Weight | Trivariate Recommendation | Comments |
|---|---|---|---|---|---|---|---|---|
| Health Care | 5.84 | 8.8% | 13% | 0% | 13% | 4.2% | Overweight | Best performing sector in Q4, benefits from M&A, many AI productivity beneficiaries, low correlation to Semis |
| Financials | 8.62 | 13.0% | 18% | (1%) | 17% | 4.0% | Overweight | Estimate achievability likely also above average, though we are worried about this being a consensus long |
| Materials | 1.09 | 1.7% | 2% | 1% | 3% | 1.3% | Equal-Weight | We remain bullish on supply-demand dynamics of copper and aluminum, as we first began calling out in 2024 |
| Energy | 1.71 | 2.6% | 2% | 1% | 3% | 0.4% | Equal-Weight | Energy remains out of favor, but supply-demand dynamics may improve |
| Utilities | 1.33 | 2.0% | 2% | 0% | 2% | (0.0%) | Equal-Weight | Estimate achievability is above-average |
| Information Technology | 20.67 | 31.2% | 34% | (3%) | 31% | (0.2%) | Equal-Weight | A balance of select AI exposure and mega-cap tech exposure, with caution on euphoric valuations and eroding fundamentals for some businesses |
| Real Estate | 1.08 | 1.6% | 0% | 1% | 1% | (0.6%) | Equal-Weight | Metrics for stock selection are becoming more effective, commercial remains challenged. |
| Consumer Discretionary | 6.64 | 10.0% | 5% | 4% | 9% | (1.0%) | Equal-Weight | Some fiscal benefits are coming, and the sector typically works at this point in the interest rate cycle |
| Industrials | 4.93 | 7.5% | 8% | (3%) | 5% | (2.5%) | Underweight | Industrial activity is still weak, Valuations are now stretched and estimate achievability now looks below average |
| Communication Services | 10.98 | 16.6% | 12% | 2% | 14% | (2.6%) | Underweight | We think older Comm. Services is over valued relative to growth prospects |
| Consumer Staples | 3.26 | 4.9% | 4% | (2%) | 2% | (2.9%) | Underweight | Staples keep missing, due to less pricing power, and other structural trends |

**Trivariate RESEARCH**

# EXPECTATIONS ARE HIGH FOR SEMIS AND LOW FOR SOFTWARE

After preferring Semiconductors to Software last year, we are tactically reversing that call for 2026.  Semiconductors have very high gross margin expectations (left), whereas relatively few Software companies are forecasted to have revenue acceleration.  The huge move in Semiconductors last year, and the general weakness in Software has made for relative valuation to be near 15-year highs for median Semiconductor stock relative to the median Software stock on Enterprise Value-to-Gross Profit (right), meaning Semiconductors that miss could be subject for a harsh correction, and the bar is relatively low for many Software companies to potentially beat. It seems prudent to prefer lower expectations than the highest expectations in 15 years.

**T900 Semiconductor Median Forecasted Gross Margin Growth vs.**
**Software Median Forecasted Revenue Growth Acceleration**
**Through End-December, 2025**



Semi - Forecasted Gross Margin Growth
Software - Forecasted Revenue Growth Acceleration

Source: Trivariate Research

**T900 Semiconductor vs. Software Stocks**
**Median Ev-to-Gross Profit Ratio**
**2011 Through End-December, 2025**
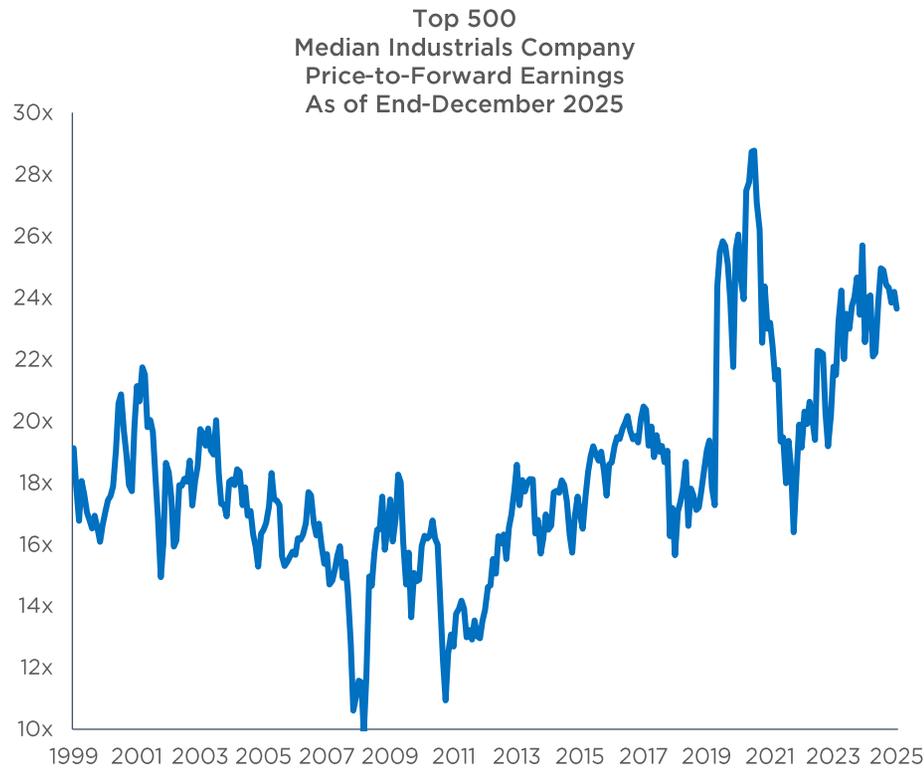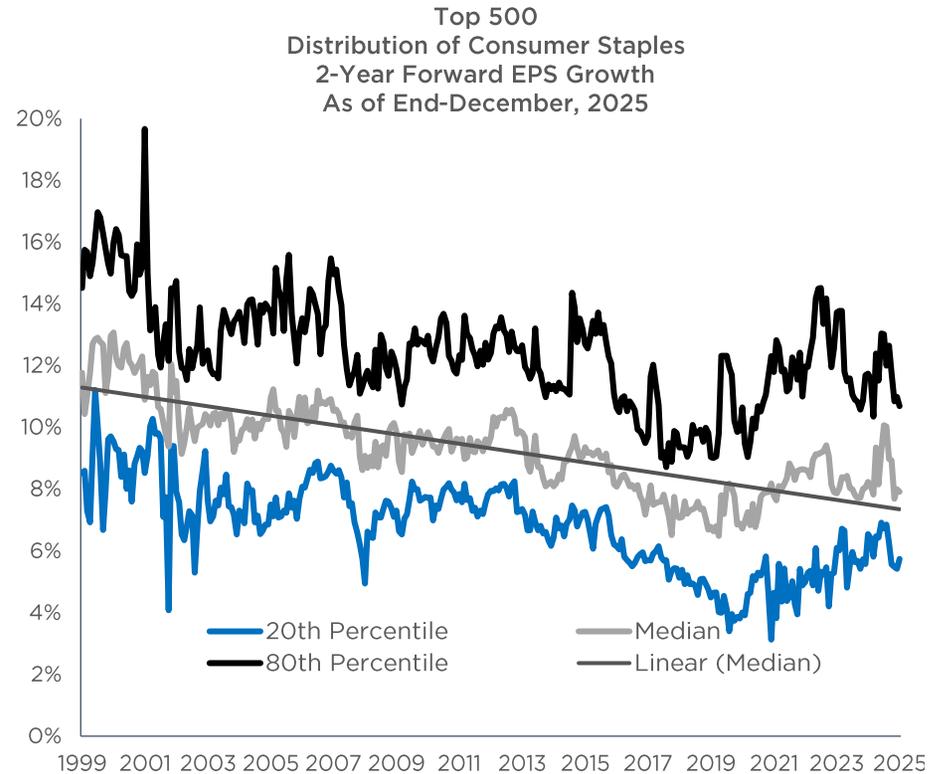


Source: Trivariate Research

# INDUSTRIALS ARE EXPENSIVE, STAPLES HAVE WEAK TRENDS

In addition to the high EPS expectations we highlighted earlier, Industrials are expensive (left), with the median stock trading in the 90th percentile vs. its own history at 23.6x earnings.  With the penalty for missing being harsh and big picture Industrial activity muted, we think an underweight is prudent.   For Consumer Staples, the consensus view of 2-year forward earnings continues to decline (right), with growth now forecasted to be lower than 4% per year for the next two years.  That is only the 17th percentile vs. history for the median Consumer Staples' stock, and we think many of the headwinds are structural – lack of incremental pricing power, GLPs, margin pressure from concentrated Retailers, a slowing Consumer, etc.

**Top 500
Median Industrials Company
Price-to-Forward Earnings
As of End-December 2025**



**Top 500
Distribution of Consumer Staples
2-Year Forward EPS Growth
As of End-December, 2025**



Legend: 20th Percentile, 80th Percentile, Median, Linear (Median)

Source: Trivariate Research

Source: Trivariate Research

- **Where should a CIO allocate resources for alpha opportunity?** Q4 2025 saw a BIG increase on two of the important metrics we track for alpha availability.  **We think 2026 will be a great year for alpha generation** – the question will be – will the huge moves be on metrics that make sense to fundamental analysts – or be more like 2025 where many of the outsized moves came in junk / profitless stocks.

- Median pairwise correlations fell: During Q4, pairwise correlations (PWC) fell in all 25 Industry Groups.  PWC fell the most in Semiconductors, Technology Hardware & Equip., and Energy.

- Company-specific risk (CSR) increased: Company-specific risk (CSR) rose in all 25 industry groups. CSR rose the most in Utilities, Transportation, REITs, and Energy.

- Valuation dispersion fell: We analyzed the dispersion of price-to-forward earnings (cross-sectional standard deviation) for each industry. Valuation dispersion fell in 17 of the 25 Industry Groups.  REITs and Pharmaceuticals, Biotech., & Life Sciences saw the biggest increases in valuation dispersion.

- The areas of focus have moved around meaningfully this year. Pharma/ Biotech, Media & Entertainment, and Telcomm. Services are worth incremental analyst focus by bottom-up stock pickers.  Chief Risk Officers and Portfolio Managers should spend time on Banks, Consumer Durables, and Insurance, as they are the most "macro."

- See Slides 67 and 68 for stocks where differentiated views can really aid relative-to-index performance.

# CORRELATIONS WERE LOWER IN EVERY INDUSTRY GROUP IN Q4

During Q4, pairwise correlations (PWC) fell in all 25 Industry Groups (left).  PWC fell the most in Semiconductors, Technology Hardware & Equip., and Energy. We analyzed the dispersion of price-to-forward earnings (cross-sectional standard deviation) for each industry (right). Valuation dispersion fell in 17 of the 25 Industry Groups.  REITs and Pharmaceuticals, Biotech., & Life Sciences saw modest increases in valuation dispersion.

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

| Industry Group | Change in Median Pairwise Correlation | Level of Median Pairwise Correlation | PWC % Rank vs. History |
|---|---|---|---|
| Consumer Staples Distribution & Retail | (2.4) | 21.6 | 38.1 |
| Banks | (4.6) | 69.1 | 90.3 |
| Health Care Equipment & Services | (5.8) | 18.5 | 45.1 |
| Food, Beverage & Tobacco | (5.9) | 21.7 | 51.9 |
| Real Estate Management & Dev. | (6.6) | 32.6 | 15.9 |
| Utilities | (9.3) | 33.2 | 16.9 |
| Telecommunication Services | (9.6) | 12.1 | 1.9 |
| Household & Personal Products | (9.7) | 22.5 | 63.6 |
| Commercial & Professional Services | (10.6) | 22.1 | 31.9 |
| Consumer Durables & Apparel | (11.7) | 40.0 | 83.3 |
| Insurance | (11.8) | 32.7 | 45.0 |
| Equity Real Estate Investment Trusts | (12.1) | 41.8 | 36.9 |
| Materials | (12.3) | 24.9 | 19.3 |
| Consumer Discretionary Dist. & Retail | (12.4) | 26.7 | 53.1 |
| Media & Entertainment | (12.6) | 18.7 | 19.9 |
| Pharma, Biotech & Life Sciences | (12.7) | 17.8 | 25.4 |
| Automobiles & Components | (14.2) | 29.6 | 35.6 |
| Consumer Services | (15.4) | 21.0 | 26.6 |
| Capital Goods | (16.0) | 26.8 | 26.0 |
| Software & Services | (16.4) | 24.7 | 46.6 |
| Financial Services | (17.4) | 26.9 | 25.7 |
| Transportation | (18.4) | 27.1 | 30.4 |
| Energy | (18.8) | 28.8 | 12.4 |
| Technology Hardware & Equipment | (20.6) | 28.6 | 46.2 |
| Semis & Semi. Equipment | (24.5) | 34.7 | 30.1 |

**Cross-Sectional Dispersion in Price-to-Forward Earnings**
**Level and 3m Change in 3-Month Average**
**As of End-December, 2025**

| Industry Group | Change of PEF Dispersion | Level of PEF Dispersion |
|---|---|---|
| Equity Real Estate Investment Trusts (REITs) | 3.5x | 18.4x |
| Pharmaceuticals, Biotechnology & Life Sciences | 2.1x | 18.1x |
| Materials | 1.1x | 14.7x |
| Telecommunication Services | 1.0x | 14.9x |
| Technology Hardware & Equipment | 0.7x | 15.4x |
| Health Care Equipment & Services | 0.5x | 19.3x |
| Consumer Staples Distribution & Retail | 0.1x | 9.9x |
| Energy | 0.1x | 14.2x |
| Real Estate Management & Development | (0.1x) | 20.7x |
| Semiconductors & Semiconductor Equipment | (0.2x) | 18.9x |
| Commercial & Professional Services | (0.3x) | 11.7x |
| Capital Goods | (0.3x) | 14.9x |
| Household & Personal Products | (0.4x) | 9.3x |
| Media & Entertainment | (0.6x) | 18.2x |
| Utilities | (0.6x) | 7.5x |
| Automobiles & Components | (0.7x) | 12.0x |
| Transportation | (0.8x) | 14.2x |
| Insurance | (0.9x) | 7.7x |
| Software & Services | (1.4x) | 18.9x |
| Food, Beverage & Tobacco | (1.5x) | 8.8x |
| Consumer Services | (1.5x) | 14.1x |
| Consumer Durables & Apparel | (1.8x) | 11.3x |
| Consumer Discretionary Distribution & Retail | (1.8x) | 12.9x |
| Financial Services | (1.9x) | 9.4x |
| Banks | (2.0x) | 2.9x |

# COMPANY-SPECIFIC RISK ROSE IN ALL 25 INDUSTRY GROUPS IN Q4

Where should a CIO allocate resources for alpha opportunity? We have our own 7-factor model for company-specific risk (CSR). The median stock's CSR is above long-term averages (left), at 64.3% for the top 3000 US equities. CSR rose in all 25 industry groups in Q4 (right). CSR rose the most in Utilities, Transportation, REITs, and Energy.



**Top 3000 US Equities**
**Median Company-Specific Risk**
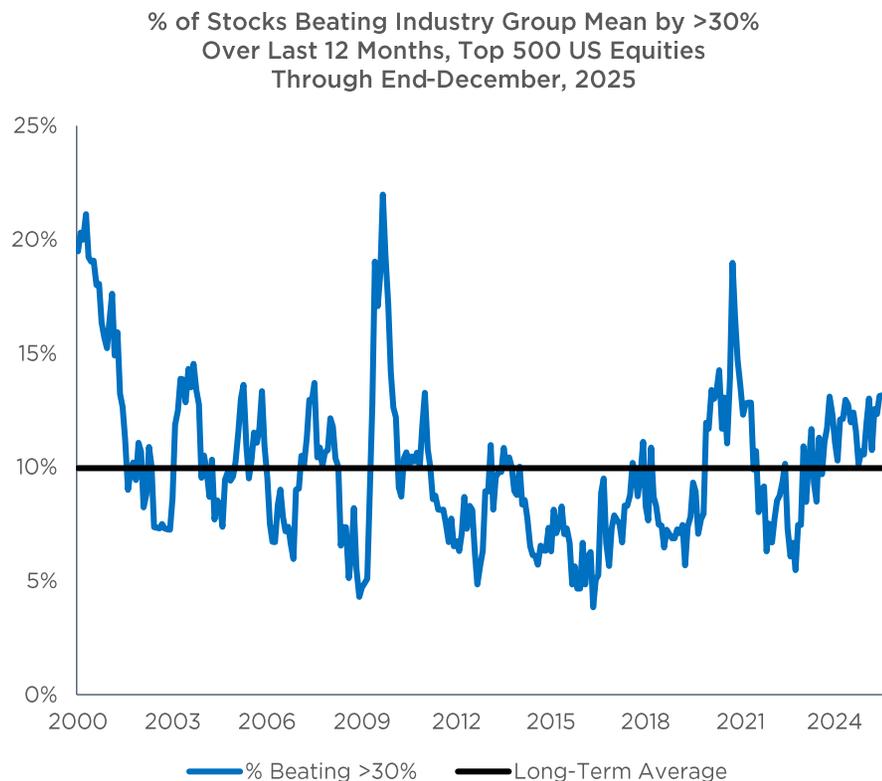**Through End-December, 2025**
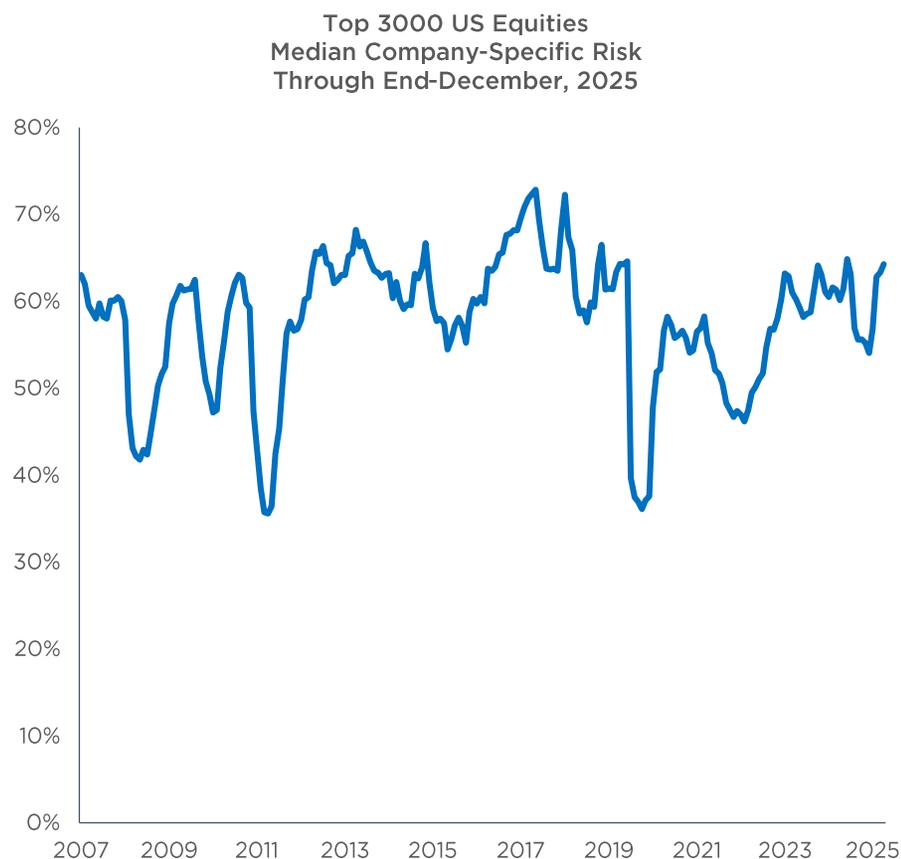
Source: Trivariate Research

**Company-Specific Risk**
**3-Month Change and Level by Industry Group**
**As of End-December, 2025**

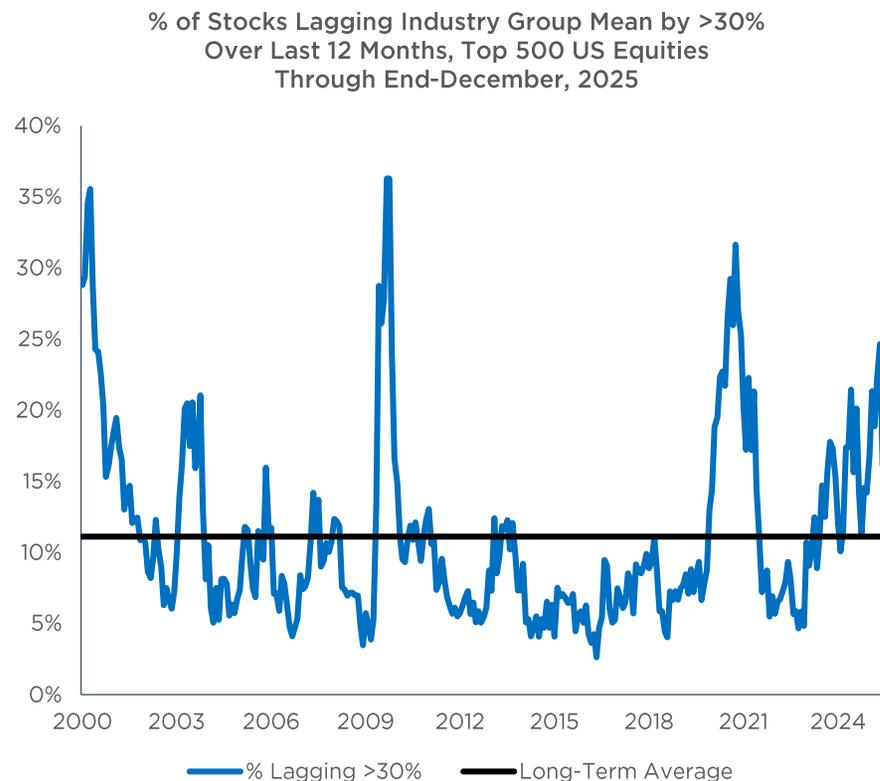| Industry Group | Change in CSR | Level of CSR | CSR % Rank vs. History |
|---|---|---|---|
| Utilities | 13.5 | 70.1 | 95.4 |
| Transportation | 11.5 | 63.2 | 73.1 |
| Equity Real Estate Investment Trusts (REITs) | 11.1 | 58.7 | 71.2 |
| Energy | 10.8 | 64.2 | 91.3 |
| Financial Services | 9.1 | 59.4 | 74.4 |
| Consumer Discretionary Distribution & Retail | 8.8 | 68.7 | 78.5 |
| Media & Entertainment | 8.6 | 72.2 | 96.5 |
| Telecommunication Services | 8.5 | 78.8 | 95.9 |
| Consumer Services | 8.1 | 70.7 | 83.1 |
| Pharmaceuticals, Biotechnology & Life Sciences | 8.1 | 77.9 | 88.1 |
| Insurance | 7.8 | 67.2 | 91.8 |
| Household & Personal Products | 7.6 | 69.6 | 59.8 |
| Materials | 7.6 | 60.9 | 86.3 |
| Food, Beverage & Tobacco | 7.2 | 76.4 | 85.8 |
| Semiconductors & Semiconductor Equipment | 7.1 | 57.6 | 61.2 |
| Consumer Staples Distribution & Retail | 6.9 | 78.5 | 94.1 |
| Automobiles & Components | 6.6 | 60.6 | 80.8 |
| Technology Hardware & Equipment | 6.6 | 59.3 | 56.6 |
| Consumer Durables & Apparel | 6.5 | 54.4 | 34.7 |
| Capital Goods | 5.9 | 56.6 | 82.2 |
| Software & Services | 5.9 | 63.4 | 72.1 |
| Health Care Equipment & Services | 5.8 | 72.1 | 82.6 |
| Commercial & Professional Services | 5.8 | 66.0 | 92.7 |
| Banks | 5.5 | 36.8 | 22.4 |
| Real Estate Management & Development | 2.6 | 59.2 | 93.9 |

Source: Trivariate Research

# IN SOME WAYS, THIS HAS BEEN A GOOD YEAR FOR FINDING IDEAS

The percentage of stocks beating their industry average (left) is well above average, and it is rarely better than the last 12 months for finding relative-to-industry short ideas (right).  13% of all stocks in the Top 500 by market cap. beat their industry group average by more than 30% in the last 12 months, and 18% lagged by more than that.  <u>The challenge for investors was that the attributes of the winners and losers was atypical (i.e., profitless companies, high beta, and junk outperforming) NOT that there weren't ex-post opportunities.</u>

**% of Stocks Beating Industry Group Mean by >30%**
**Over Last 12 Months, Top 500 US Equities**
**Through End-December, 2025**



% Beating >30%        Long-Term Average

Source: Trivariate Research

**% of Stocks Lagging Industry Group Mean by >30%**
**Over Last 12 Months, Top 500 US Equities**
**Through End-December, 2025**



% Lagging >30%        Long-Term Average

Source: Trivariate Research

# IN WHICH INDUSTRIES SHOULD CIOS DEPLOY RESOURCES?

The areas of focus shifted meaningfully this year. <u>Pharma/ Biotech, Media & Entertainment, and Telcomm. Services</u> are worth incremental focus by bottom-up stock pickers.  Chief Risk Officers and Portfolio Managers should spend time on <u>**Banks, Consumer Durables, and Insurance**</u>, as they are the most "macro."

### Industry Group Ranking of Available Alpha Metrics as of End-December, 2025

| Industry Group | CSR Level | CSR 3m Change | PWC Level | PWC 3m Change | Valuation Dispersion Level | Valuation Dispersion 3m Change | % Beating or Lagging >=20% | Mean Rank | The Largest 3 Companies |
|---|---|---|---|---|---|---|---|---|---|
| Pharmaceuticals, Biotech & Life Sciences | 3 | 10 | 2 | 10 | 7 | 2 | 4 | 5.4 | LLY, JNJ, ABBV |
| Media & Entertainment | 5 | 7 | 4 | 11 | 6 | 14 | 6 | 7.6 | GOOGL, META, NFLX |
| Telecommunication Services | 1 | 8 | 1 | 19 | 9 | 4 | 17 | 8.4 | TMUS, T, VZ |
| Health Care Equipment & Services | 6 | 22 | 3 | 23 | 2 | 6 | 8 | 10.0 | UNH, ABT, ISRG |
| Technology Hardware & Equipment | 19 | 18 | 16 | 2 | 8 | 5 | 2 | 10.0 | AAPL, CSCO, APH |
| Energy | 13 | 4 | 17 | 3 | 12 | 8 | 16 | 10.4 | XOM, CVX, COP |
| Software & Services | 14 | 21 | 10 | 6 | 4 | 19 | 3 | 11.0 | MSFT, ORCL, PLTR |
| Semiconductors & Semiconductor Equipment | 22 | 15 | 22 | 1 | 3 | 10 | 5 | 11.1 | NVDA, AVGO, AMD |
| Materials | 16 | 13 | 11 | 13 | 11 | 3 | 12 | 11.2 | LIN, SCCO, NEM |
| Transportation | 15 | 2 | 15 | 4 | 13 | 17 | 14 | 11.4 | UBER, UNP, UPS |
| Consumer Services | 7 | 9 | 5 | 8 | 14 | 21 | 18 | 11.7 | MCD, BKNG, DASH |
| Household & Personal Products | 9 | 12 | 9 | 18 | 21 | 13 | 1 | 11.9 | PG, CL, EL |
| Equity Real Estate Investment Trusts (REITs) | 21 | 3 | 24 | 14 | 5 | 1 | 21 | 12.7 | WELL, PLD, AMT |
| Consumer Discretionary Distribution & Retail | 10 | 6 | 12 | 12 | 15 | 23 | 13 | 13.0 | AMZN, HD, TJX |
| Commercial & Professional Services | 12 | 23 | 8 | 17 | 17 | 11 | 7 | 13.6 | ADP, WM, CTAS |
| Food, Beverage & Tobacco | 4 | 14 | 7 | 22 | 22 | 20 | 9 | 14.0 | KO, PM, PEP |
| Consumer Staples Distribution & Retail | 2 | 16 | 6 | 25 | 19 | 7 | 24 | 14.1 | WMT, COST, TGT |
| Capital Goods | 23 | 20 | 13 | 7 | 10 | 12 | 19 | 14.9 | GE, CAT, RTX |
| Financial Services | 18 | 5 | 14 | 5 | 20 | 24 | 20 | 15.1 | BRK.B, V, MA |
| Real Estate Management & Development | 20 | 25 | 19 | 21 | 1 | 9 | 12 | 15.2 | CBRE, CSGP, Z |
| Automobiles & Components | 17 | 17 | 18 | 9 | 16 | 16 | 15 | 15.4 | TSLA, GM, F |
| Utilities | 8 | 1 | 21 | 20 | 24 | 15 | 23 | 16.0 | NEE, CEG, SO |
| Insurance | 11 | 11 | 20 | 15 | 23 | 18 | 22 | 17.1 | PGR, CB, MMC |
| Consumer Durables & Apparel | 24 | 19 | 23 | 16 | 18 | 22 | 10 | 18.9 | NKE, DHI, GRMN |
| Banks | 25 | 24 | 25 | 24 | 25 | 25 | 25 | 24.7 | JPM, BAC, WFC |

Source: Trivariate Research

# WHERE FUNDAMENTAL ANALYSTS SHOULD SPEND TIME

1. **People**: When There Is a New CEO Or CFO It Is Challenging To Link Prior Experience At Public Companies Of the New C-suite Executives To a Stock.

2. **M&A:** Deals That Are More Than 20% Of Market Cap.

3. **Litigation:** Where Legal Outcomes Have a Big Impact On Valuation

4. **High Idiosyncratic Risk:** Small Cap. Biotech, Or Other Hard-to-predict Outcomes

5. **Unique Businesses:** In Multiple Industries, Require Sum-of-the-parts Valuation

6. **Complex Capital Structure:** Tracking Stocks, Imminent Secondaries, Complicated Ownership

7. **New Entities:** IPOs, Spin-offs, Remain-cos

# STOCKS WHERE FUNDAMENTAL EXPERTS SHOULD FOCUS

Below we show mega / large cap. (left) and small / mid cap. (right) stocks outside of Healthcare that are hard to replicate with a 30-stock basket and have high company-specific risk.  <u>This means that if you are a good stock picker, have done fundamental work, and have a differentiated view on one of these stocks, and you are ultimately right, you will separate your performance from the index MORE if you have large over / underweight positions on these names relative to their index weights. WMT, NFLX, COST, IBM, and PM are the largest market cap. examples.</u>

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

| Ticker | Company | Market Cap. (US$ Bil.) |
|---|---|---|
| WMT | Walmart Inc. | 887.96 |
| NFLX | Netflix, Inc. | 428.44 |
| COST | Costco Wholesale Corporation | 382.77 |
| IBM | International Business Machines | 276.88 |
| PM | Philip Morris International Inc. | 249.68 |
| TMUS | T-Mobile US, Inc. | 227.10 |
| LMT | Lockheed Martin Corporation | 111.92 |
| MELI | MercadoLibre, Inc. | 102.12 |
| CME | CME Group Inc. | 98.47 |
| SBUX | Starbucks Corporation | 95.76 |
| NU | Nu Holdings Ltd. | 81.11 |
| MNST | Monster Beverage Corporation | 74.91 |
| RBLX | Roblox Corporation | 56.88 |
| EA | Electronic Arts Inc. | 50.96 |
| CMG | Chipotle Mexican Grill, Inc. | 48.92 |
| TTWO | Take-Two Interactive Software, Inc. | 47.31 |
| AXON | Axon Enterprise, Inc. | 45.11 |
| CPNG | Coupang, Inc. | 43.09 |
| KR | The Kroger Co. | 39.54 |
| EBAY | eBay Inc. | 39.37 |

Source: Trivariate Research

**Least Replicable Mid / Small Cap. Stocks with High CSR, Ex-Healthcare End-December, 2025**

| Ticker | Company | Market Cap. (US$ Bil.) |
|---|---|---|
| SATS | EchoStar Corporation | 31.29 |
| FWON.K | Formula One Group | 24.38 |
| WMG | Warner Music Group Corp. | 16.02 |
| CHWY | Chewy, Inc. | 13.72 |
| CART | Maplebear Inc. | 11.81 |
| NYT | The New York Times Company | 11.27 |
| ACI | Albertsons Companies, Inc. | 9.43 |
| TIGO | Millicom International Cellular S.A. | 9.26 |
| PPC | Pilgrim's Pride Corporation | 9.26 |
| GME | GameStop Corp. | 8.99 |
| MKTX | MarketAxess Holdings Inc. | 6.74 |
| HRB | H&R Block, Inc. | 5.51 |
| TDS | Telephone and Data Systems, Inc. | 4.74 |
| CALM | Cal-Maine Foods, Inc. | 3.86 |
| OSCR | Oscar Health, Inc. | 3.80 |
| BRBR | BellRing Brands, Inc. | 3.17 |
| LRN | Stride, Inc. | 2.81 |
| CHEF | The Chefs' Warehouse, Inc. | 2.54 |
| IRDM | Iridium Communications Inc. | 1.82 |
| HLIT | Harmonic Inc. | 1.11 |

Source: Trivariate Research

# HEALTHCARE NAMES WHERE FUNDAMENTAL EXPERTS SHOULD FOCUS

Below we show mega / large cap. (left) and small / mid cap. (right) Healthcare stocks that are hard to replicate with a 30-stock basket and have high company-specific risk.  <u>LLY, ABBV, GILD, HCA, and MCK are the largest five stocks.</u>

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

| Ticker | Company | Market Cap. (US$ Bil.) |
|---|---|---|
| LLY | Eli Lilly and Company | 962.25 |
| ABBV | AbbVie Inc. | 403.83 |
| GILD | Gilead Sciences, Inc. | 152.28 |
| HCA | HCA Healthcare, Inc. | 106.53 |
| MCK | McKesson Corporation | 101.25 |
| CVS | CVS Health Corporation | 100.74 |
| REGN | Regeneron Pharmaceuticals, Inc. | 79.19 |
| COR | Cencora, Inc. | 65.52 |
| ALNY | Alnylam Pharmaceuticals, Inc. | 52.54 |
| INSM | Insmed Incorporated | 37.12 |

**Mid / Small Cap. Healthcare**
**Least Replicable Stocks with High CSR**
**End-December, 2025**

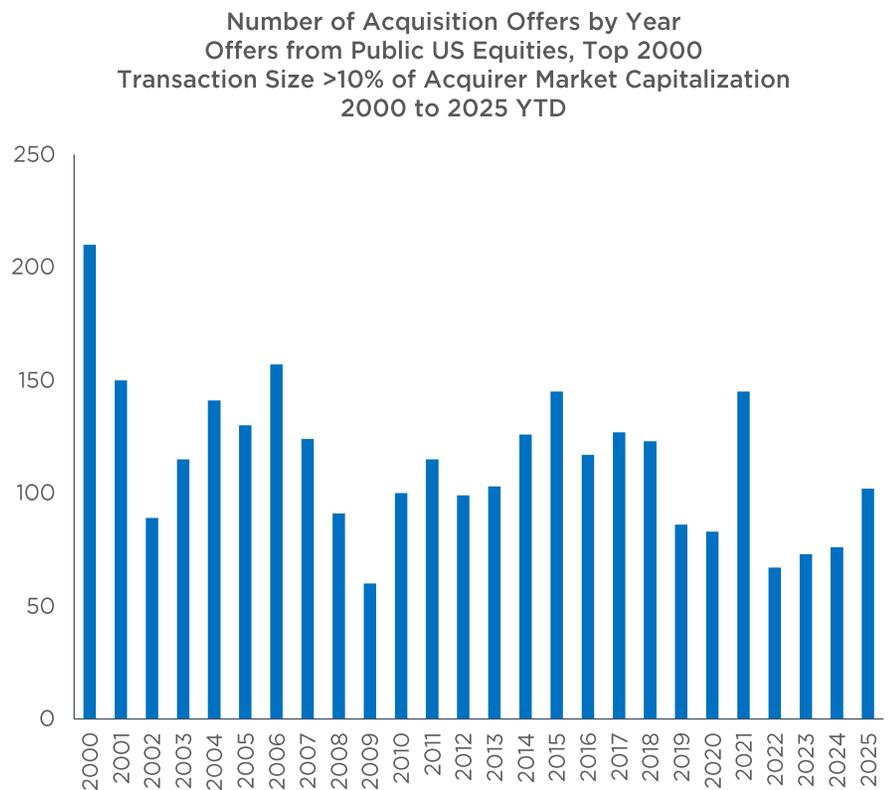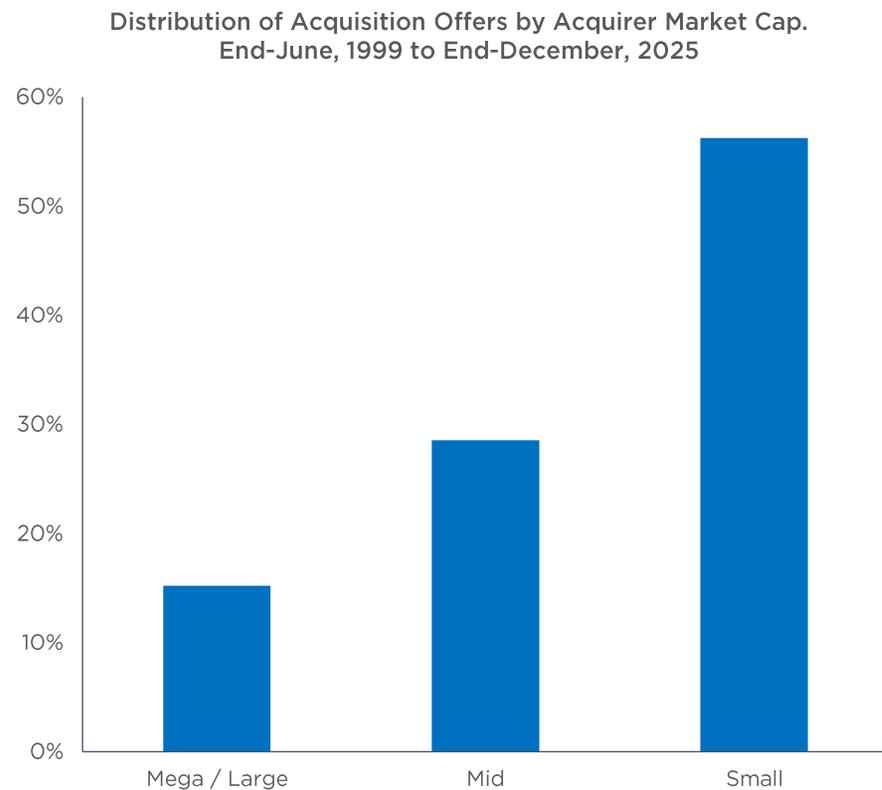| Ticker | Company | Market Cap. (US$ Bil.) |
|---|---|---|
| NTRA | Natera, Inc. | 31.69 |
| HUM | Humana Inc. | 30.81 |
| DXCM | DexCom, Inc. | 25.89 |
| UTHR | United Therapeutics Corporation | 20.98 |
| PODD | Insulet Corporation | 20.00 |
| WST | West Pharmaceutical Services, Inc. | 19.79 |
| INCY | Incyte Corporation | 19.39 |
| EXAS | Exact Sciences Corporation | 19.27 |
| RPRX | Royalty Pharma plc | 16.51 |
| NBIX | Neurocrine Biosciences, Inc. | 14.14 |
| GH | Guardant Health, Inc. | 13.16 |
| JAZZ | Jazz Pharmaceuticals plc | 10.33 |
| HALO | Halozyme Therapeutics, Inc. | 7.91 |
| PTCT | PTC Therapeutics, Inc. | 6.10 |
| IRTC | iRhythm Technologies, Inc. | 5.72 |
| PTGX | Protagonist Therapeutics, Inc. | 5.46 |
| LNTH | Lantheus Holdings, Inc. | 4.41 |
| BHC | Bausch Health Companies Inc. | 2.58 |
| ARDX | Ardelyx, Inc. | 1.42 |
| STAA | STAAR Surgical Company | 1.15 |

# PART 7: MANAGEMENT DECISION-MAKING

- On average, M&A fails for the acquirer, <u>particularly for growth stocks.  Deals done with all stock or of foreign public companies are typically inferior.</u>

- Accelerated share repurchases (ASRs) generally work well, and <u>the average company doing an ASR since COVID has beaten the S&P500 by 1100bps over the subsequent three years.</u>  We think more companies should do ASRs immediately.

- <u>Buybacks now work:</u> Over the past five years, open market repurchases, and accelerated share repurchases have proven to be an effective strategy, performing far better than in previous market regimes.

- <u>Companies that announce a stock repurchase plan and do not pay a dividend go on to outperform their industry group by an average of 8.4% over the next 3 years, compared to 1.8% for those that pay a dividend.</u>

- <u>IPOs:  History says to avoid companies that lose money at the time of IPO.  This should be of interest for OpenAI and SpaceX and other high-profile offerings in the future.</u>

- <u>The biggest 10 US equities are nearly 34% of all capital spending dollars – this will be a HUGE market issue in the next two years.</u>

- The average company issuing a convertible bond goes down 15% in absolute terms a year before the issuance, but performance stabilizes relative to the company's industry average afterwards.

# WE ANALYZED OVER 3000 DEALS, 56% WERE SMALL CAPS

We looked at all M&A for the last 25 years for US companies, small-cap or larger, that did a deal of at least 10% of their market capitalization, where they acquired more than 50% of the target. <u>Our study comprises 3,008 announced deals.</u> Among the acquirers we analyzed, 56% were small-caps, 29% mid-caps, and 15% mega-/large-caps (right).
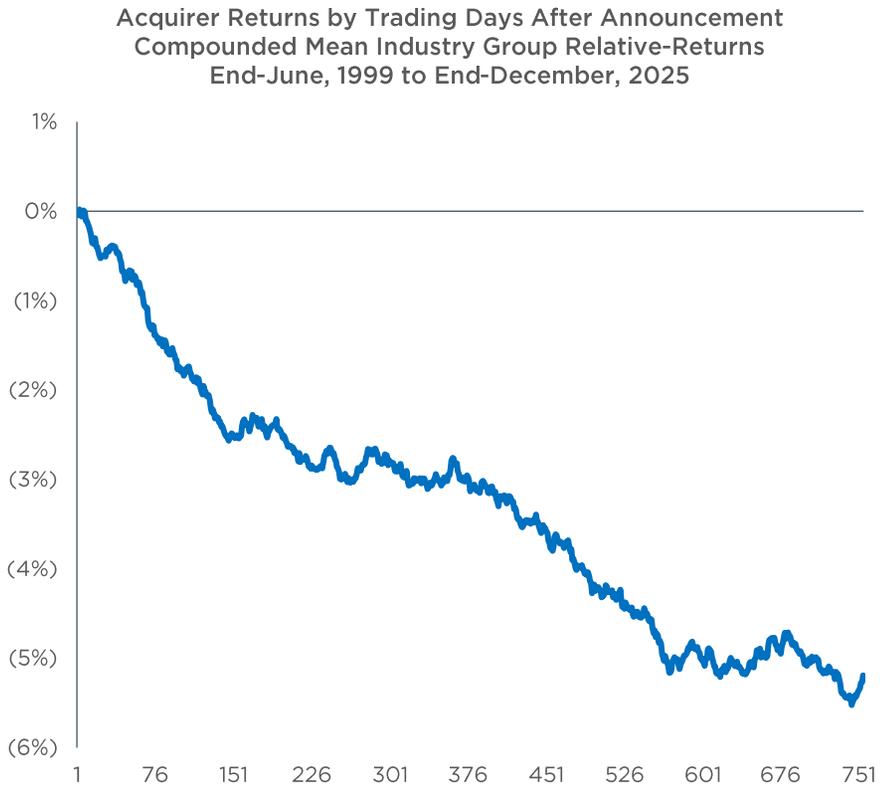
**Number of Acquisition Offers by Year**
**Offers from Public US Equities, Top 2000**
**Transaction Size >10% of Acquirer Market Capitalization**
**2000 to 2025 YTD**

**Distribution of Acquisition Offers by Acquirer Market Cap.**
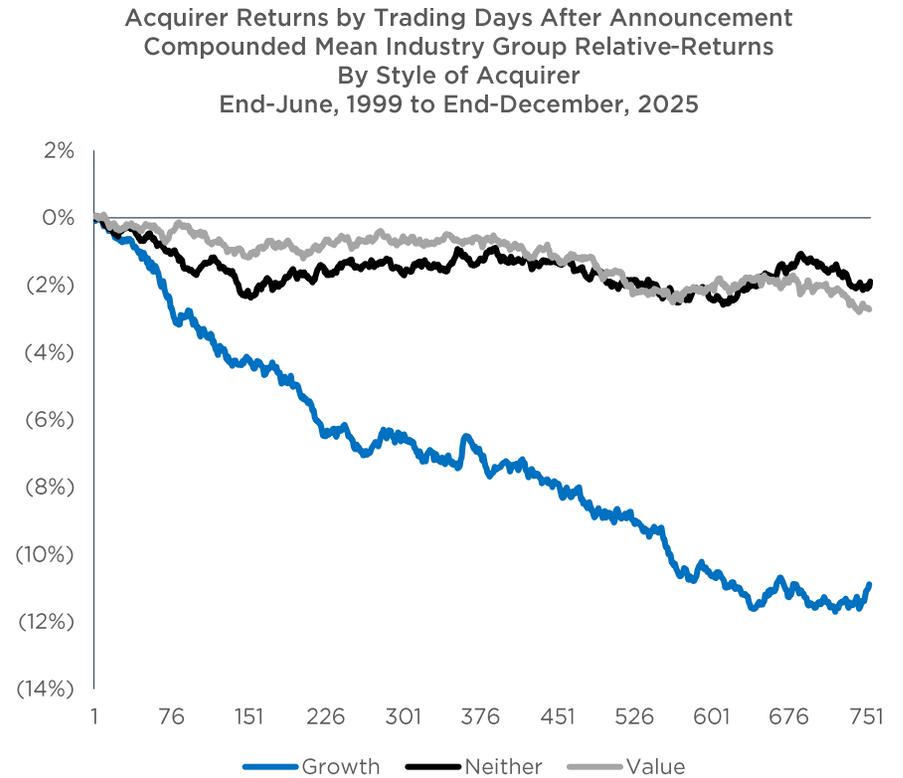**End-June, 1999 to End-December, 2025**

Source: Trivariate Research

Source: Trivariate Research

# GROWTH COMPANIES SHOULD THINK HARD ABOUT DOING M&A

In aggregate, doing a deal isn't a good idea.  The average acquirer lags its industry group by nearly 6% over the subsequent three years following a deal (left).  Clearly, the performance of growth companies doing deals is much worse than value, or the middle ground, "neither" (right).  In fact, the average growth company that does an acquisition lags its industry-group's performance by 11% over the next three years.
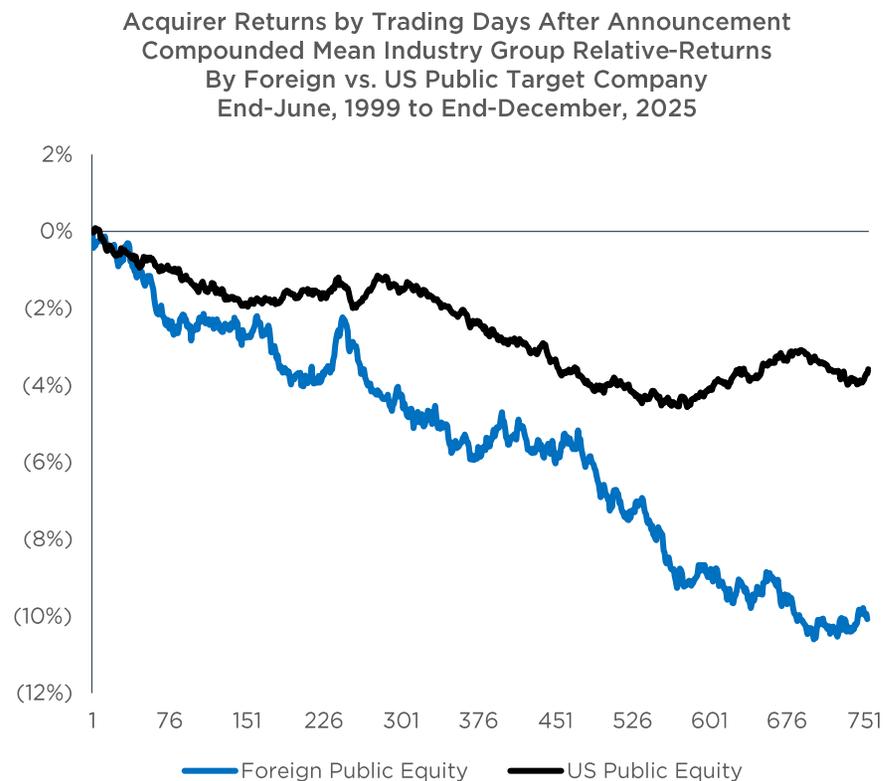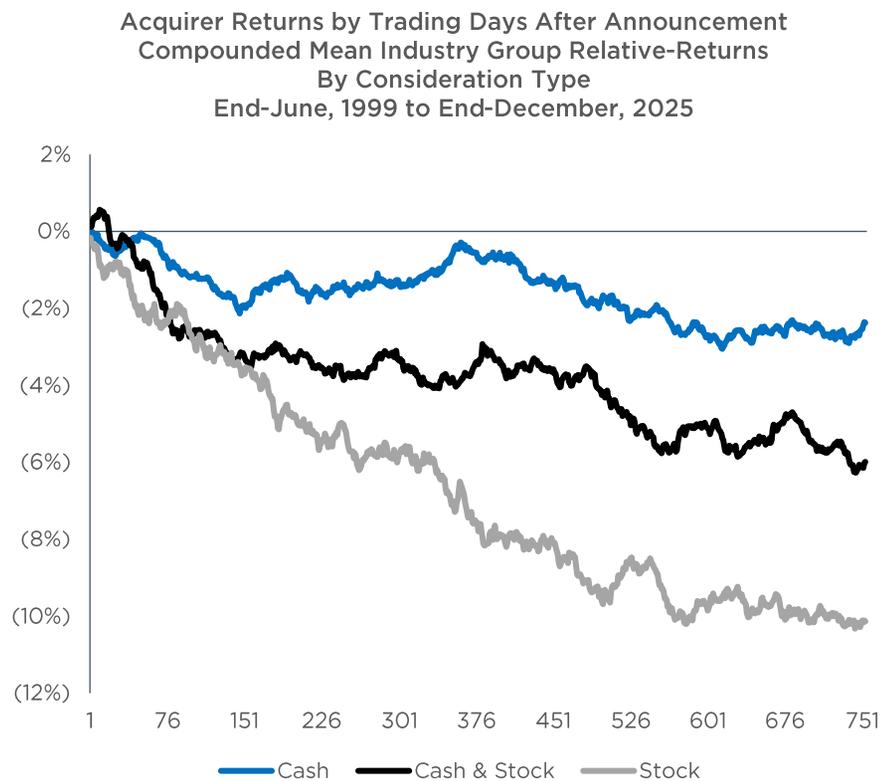
**Acquirer Returns by Trading Days After Announcement
Compounded Mean Industry Group Relative-Returns
End-June, 1999 to End-December, 2025**

**Acquirer Returns by Trading Days After Announcement
Compounded Mean Industry Group Relative-Returns
By Style of Acquirer
End-June, 1999 to End-December, 2025**



Source: Trivariate Research

Source: Trivariate Research

# AN ALL-STOCK DEAL OF A FOREIGN PUBLIC COMPANY? NO THANKS

There is no question that the performance of companies doing all-cash deals is way better than those doing all-stock deals (left). The average acquirer doing an all-stock deal lags its industry group average by 10% over the next three years.  Buying a foreign public company on average results in inferior performance versus buying a US company (right), likely due to a realization of less cost and revenue synergies.

Acquirer Returns by Trading Days After Announcement
Compounded Mean Industry Group Relative-Returns
By Consideration Type
End-June, 1999 to End-December, 2025

Acquirer Returns by Trading Days After Announcement
Compounded Mean Industry Group Relative-Returns
By Foreign vs. US Public Target Company
End-June, 1999 to End-December, 2025



Source: Trivariate Research

Source: Trivariate Research

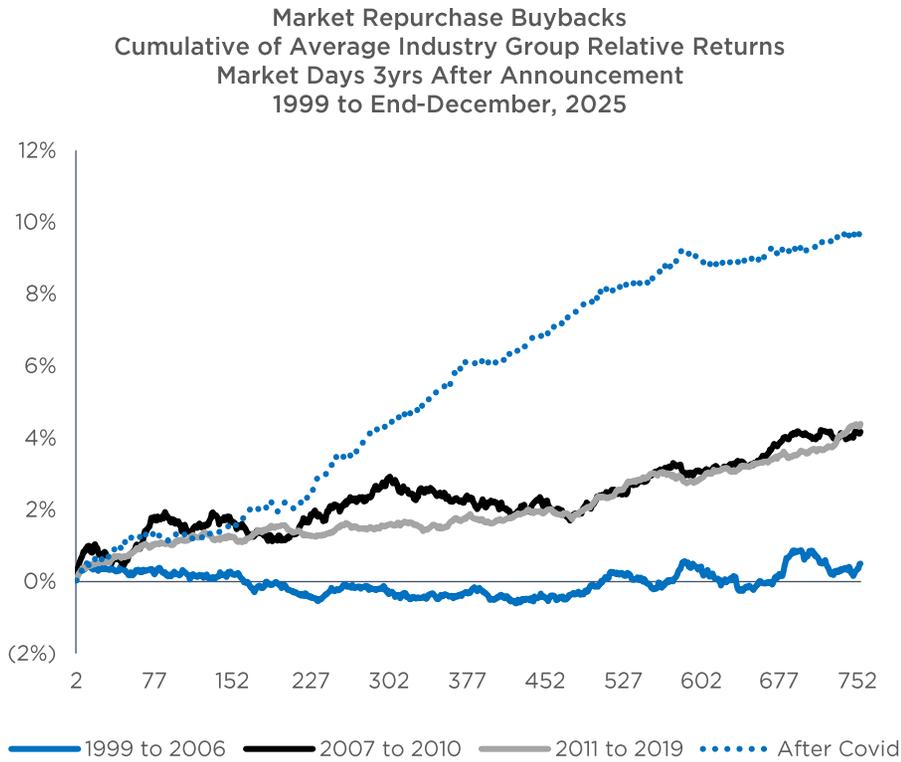# THE MOST RECENT M&A PERFORMANCE HAS GENERALLY BEEN WEAK

Below is a screen of the most recent M&A announcements.  Performance for acquirers has been poor over the last month, other than BMRN.

**Recently Announced M&A Transaction Offerings of Public US Equities**
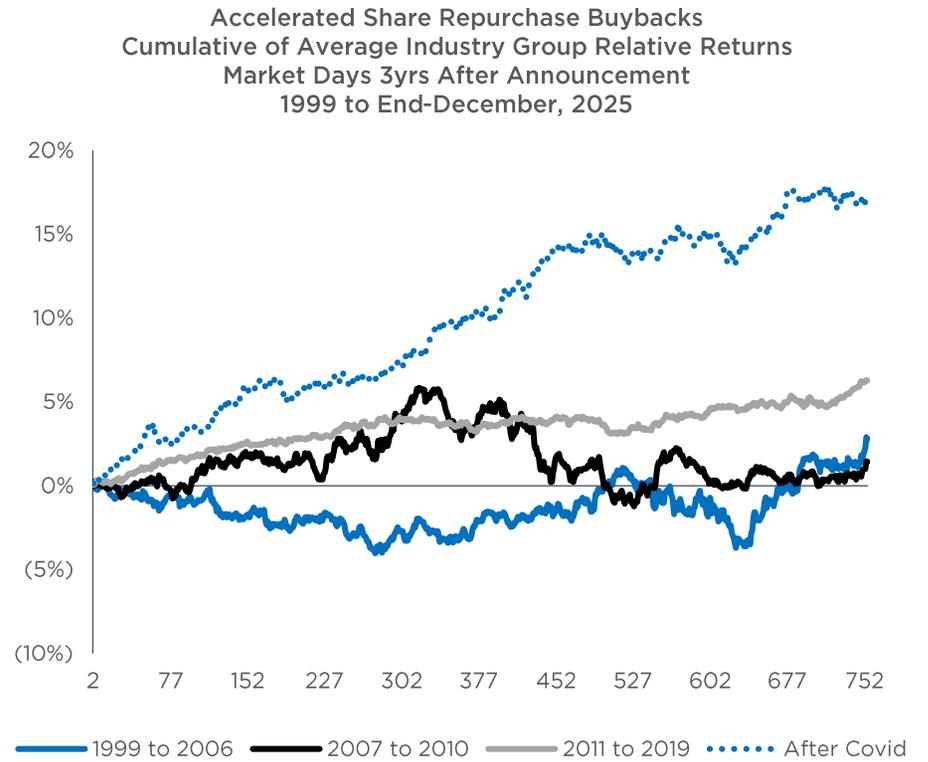**As of End-December, 2025**

| Announcement Date | Acquirer Ticker | Acquirer Company | Target Company | Transaction Size | Acquirer Style | Consideration Type | Net Margin Quintile | Return Since Announced |
|---|---|---|---|---|---|---|---|---|
| 12/29/2025 | OCFC | OceanFirst Financial Corp. | Flushing Financial Corporation | 0.57 | Value | Stock | Q4 | (5.5%) |
| 12/19/2025 | BMRN | BioMarin Pharmaceutical Inc. | Amicus Therapeutics | 5.23 | Growth | Cash | Q1 | 7.6% |
| 12/17/2025 | COUR | Coursera, Inc. | Udemy, Inc. | 1.06 | Growth | Stock | Q5 | (8.4%) |
| 12/17/2025 | UWMC | UWM Holdings Corporation | Two Harbors Investment Corp. | 1.30 | Neither | Stock | Q5 | (11.1%) |
| 12/17/2025 | CVBF | CVB Financial Corp. | Heritage Commerce Corp | 0.81 | Value | Stock | Q1 | (5.2%) |
| 12/11/2025 | ENVA | Enova International, Inc. | Grasshopper Bancorp, Inc. | 0.39 | Neither |  | Q3 | 3.7% |
| 12/08/2025 | AR | Antero Resources | HG Energy II Production Holdings | 2.80 | Neither | Cash | Q2 | (7.0%) |
| 12/08/2025 | MIRM | Mirum Pharmaceuticals, Inc. | Bluejay Therapeutics, Inc. | 0.81 | Growth | Cash & Stock | Q3 | 18.0% |
| 12/05/2025 | NFLX | Netflix, Inc. | Warner Bros. Discovery, Inc. | 87.03 | Growth | Cash & Stock | Q1 | (6.2%) |
| 12/02/2025 | BWIN | The Baldwin Insurance Group | Cobbs Allen Capital Holdings, LLC | 1.41 | Neither | Cash & Stock | Q5 | (10.8%) |
| 12/01/2025 | PRG | PROG Holdings, Inc. | Purchasing Power, LLC | 0.42 | Value | Cash | Q4 | 0.7% |
| 12/01/2025 | SGI | Somnigroup International Inc. | Legget & Platt | 3.29 | Growth | Stock | Q3 | (3.0%) |
| 11/24/2025 | ATMU | Atmus Filtration Technologies | Koch Filter Corporation | 0.45 | Growth | Cash | Q2 | 8.4% |
| 11/20/2025 | ABT | Abbott Laboratories | Exact Sciences Corporation | 23.54 | Neither | Cash | Q1 | (1.4%) |
| 11/17/2025 | ITRI | Itron, Inc. | LocusView Solutions, Inc. | 0.53 | Neither | Cash | Q1 | (4.6%) |
| 11/17/2025 | ROCK | Gibraltar Industries, Inc. | OmniMax International, Inc. | 1.34 | Growth | Cash | Q4 | (5.9%) |

# THE STORY IS CHANGING- BUYBACKS ARE BETTER THAN EVER

Over the past five years, open market repurchases, and accelerated share repurchases have proven to be an effective strategy, performing far better than in previous market regimes of the last 25 years.  We have written many times for years that buybacks over the long-term weren't an effective strategy for capital deployment, as from 1999-2019 the total cumulative excess return relative to industry average was barely positive (left).  But since COVID, the strategy has improved. ASRs have also been a far better strategy since COVID (right).

**Market Repurchase Buybacks**
**Cumulative of Average Industry Group Relative Returns**
**Market Days 3yrs After Announcement**
**1999 to End-December, 2025**

**Accelerated Share Repurchase Buybacks**
**Cumulative of Average Industry Group Relative Returns**
**Market Days 3yrs After Announcement**
**1999 to End-December, 2025**



Legend: 1999 to 2006 — 2007 to 2010 — 2011 to 2019 ••••• After Covid

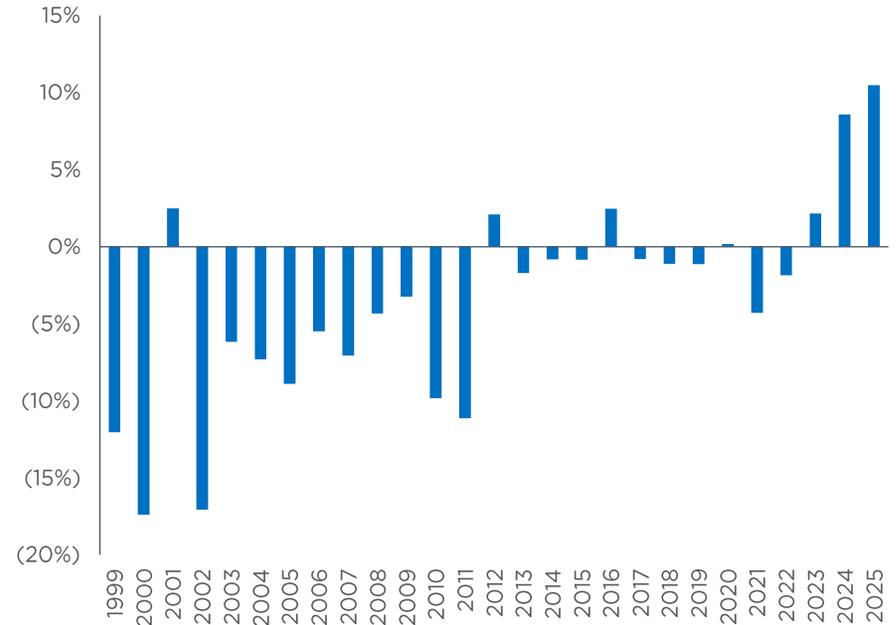Source: Trivariate Research

Source: Trivariate Research

We dimensioned the average 1-year industry group relative return following buyback announcements by prior 1-year momentum and percentage of shares to be repurchased. Companies in the bottom quintile of momentum (underperforming their industry group by at least 38.7%) that announced a buyback < 2% of the shares outstanding performed best (left). This cohort likely reflects companies that are buying back stock opportunistically. As the percentage that they buy back increases, the trailing momentum matters less. The composition of companies that announce buybacks has dramatically shifted in the last three years, with the average company that announces a buyback in 2025 having outperformed their industry group by 10.5% over the last year (right). Prior to this change, companies announced share repurchase plans after underperformance.

**Mean 1-Year Industry Group-Relative Return**
**By Trailing 1-Year Momentum Quintile**
**And Percentage of Market Cap. Company Plans to Purchase**
**1999 to End-December, 2025**

| 1yr Momentum Quintile | < 2% | >2% & <5% | >5% & <10% | >10% |
|---|---|---|---|---|
| Q1 | 3.1% | 3.5% | 4.1% | 9.3% |
| Q2 | (3.0%) | 3.5% | 2.8% | 5.9% |
| Q3 | 1.8% | 1.6% | 2.8% | 5.2% |
| Q4 | (2.9%) | (1.1%) | 4.6% | 4.0% |
| Q5 | 9.1% | 1.8% | 2.9% | 8.5% |

**Mean Industry Group-Relative Return**
**1-Year Before Buyback Announcement**
**By Year of Announcement**
**Through End-December, 2025**

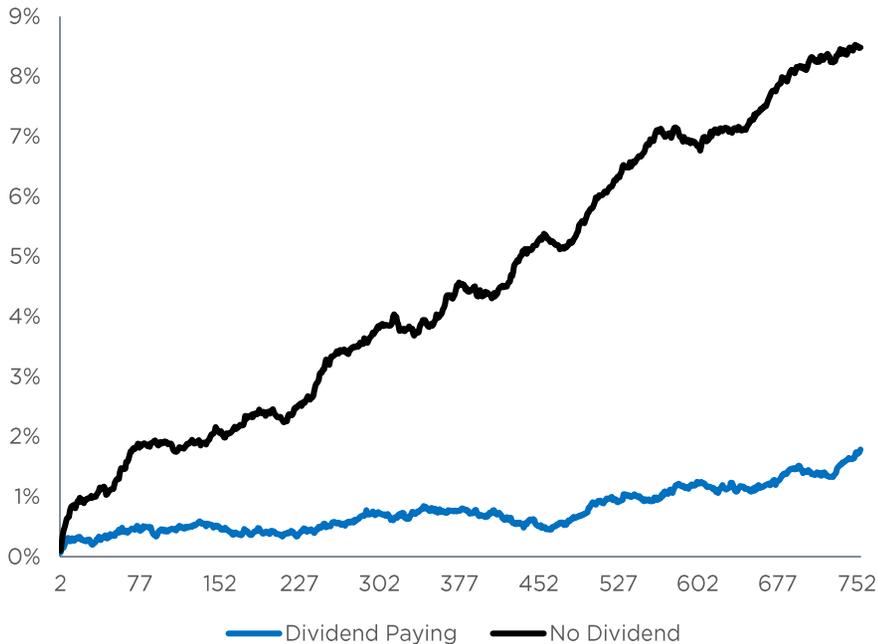

Source: Trivariate Research

Source: Trivariate Research

# COMPANIES WITHOUT A DIVIDEND FAR OUTPERFORM

<u>Companies that announce a stock repurchase plan and do not pay a dividend go on to outperform their industry group by an average of 8.4% over the next three years, compared to 1.8% for those that pay a dividend</u> (left). We believe that dividend-paying companies perceiving their stock as undervalued should pursue an Accelerated Share Repurchase or declare a significantly larger authorization for ongoing buybacks to boost performance. This difference in returns cannot be explained by growth vs. value, as value stocks that announce a buyback only slightly underperform growth stocks (right).

Market Repurchase Buybacks by Dividend Paying
Cumulative of Average Industry Group Relative Returns
Market Days 3yrs After Announcement
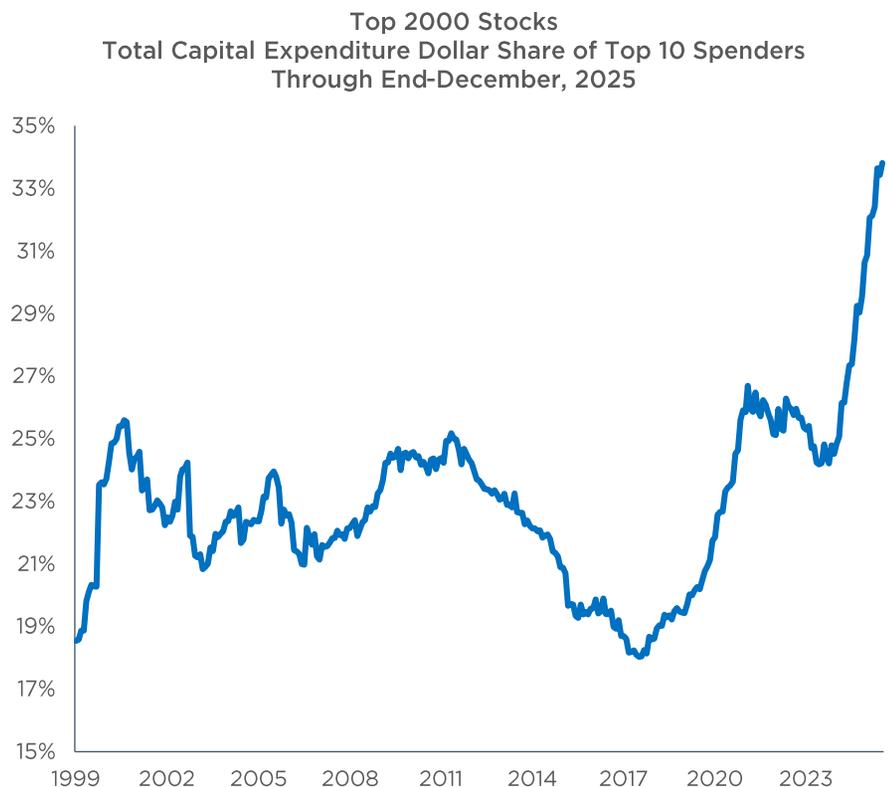1999 to End-December, 2025

Market Repurchase Buybacks by Style
Cumulative of Average Industry Group Relative Returns
Market Days 3yrs After Announcement
1999 to End-December, 2025



Source: Trivariate Research

Source: Trivariate Research
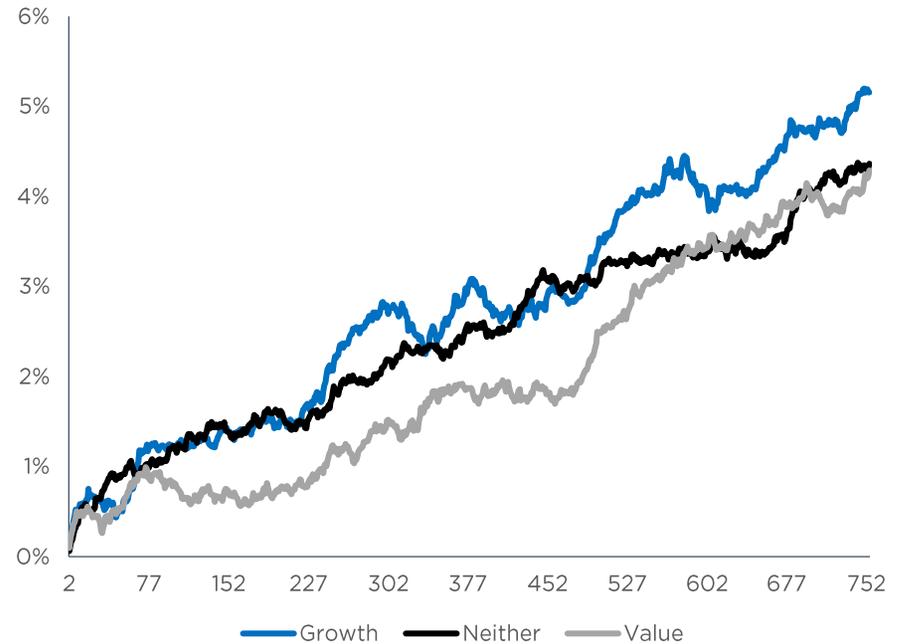
TRIVARIATE RESEARCH

# THE BIGGEST TEN CO'S ARE 33.8% OF ALL CAPEX!

There's currently a concentration of capital spending we have only seen once in at least 25 years, <u>with the biggest ten spenders now at 33.8% of the total capital spending dollars of the top 2000 public US companies</u> (left).  The top ten biggest spenders over the last year in dollars (right) include AMZN, GOOGL, MSFT, and META.  These capital intensity figures are for the last four quarters and are poised to go materially higher for several of the biggest companies, a couple of which guided to 11-figure annual capital spending budgets for 2026.  <u>A key debate is whether there is a return on this investment –we think the answer is yes, and soon, but that these levels of capital intensity are not sustainable indefinitely without material valuation re-rating.</u>

**Top 2000 Stocks**
**Total Capital Expenditure Dollar Share of Top 10 Spenders**
**Through End-December, 2025**



Source: Trivariate Research

**Top 10 Stocks By Annual Capital Expenditure Dollars**
**As of End-December, 2025**

| Ticker | Industry Group | Market Cap. ($Bn) | Trailing CapEx ($Bn) | CapEx-to-Sales | % vs. History | 2025 CapEx-to-Sales | 2025 % vs. History |
|--------|----------------|-------------------|----------------------|----------------|---------------|---------------------|--------------------|
| AMZN | Consumer Disc. Distr. & Retail | 2,467.52 | 120.13 | 17.4% | 99.2% | 17.5% | 99.5% |
| GOOGL | Media & Entertainment | 3,781.30 | 77.87 | 20.2% | 100.0% | 23.0% | 100.0% |
| MSFT | Software & Services | 3,594.45 | 69.02 | 23.5% | 100.0% | 26.7% | 100.0% |
| META | Media & Entertainment | 1,663.78 | 62.73 | 33.1% | 100.0% | 35.6% | 100.0% |
| ORCL | Software & Services | 560.00 | 35.48 | 58.1% | 100.0% | 36.0% | 97.8% |
| XOM | Energy | 507.49 | 27.75 | 8.5% | 80.6% | 8.5% | 80.8% |
| WMT | Con. Staples Dist. & Retail | 887.96 | 25.71 | 3.7% | 72.3% | 3.5% | 68.8% |
| NEE | Utilities | 167.19 | 23.95 | 91.1% | 85.8% | 85.1% | 79.5% |
| T | Telecom. Services | 176.10 | 20.90 | 16.8% | 79.1% | 16.9% | 79.5% |
| MU | Semis & Semi. Equipment | 321.23 | 18.04 | 42.6% | 85.0% | 36.4% | 71.0% |

Source: Trivariate Research

# IPOS WERE GOOD IN 2016-2019, GENERALLY BAD SINCE

Performance of IPOs has been mixed over the long-term, and relatively poor since 2020.  Below we show the cumulative performance of IPOs following the first day of performance over different time frames.  Performance was weak post-Financial Crisis, roughly in-line with industry-average performance from 2009-2015 and did well from 2016-2019.  Since 2020, however, the average IPO has lagged its industry average by 3.5% over the subsequent three years following its first closing price.
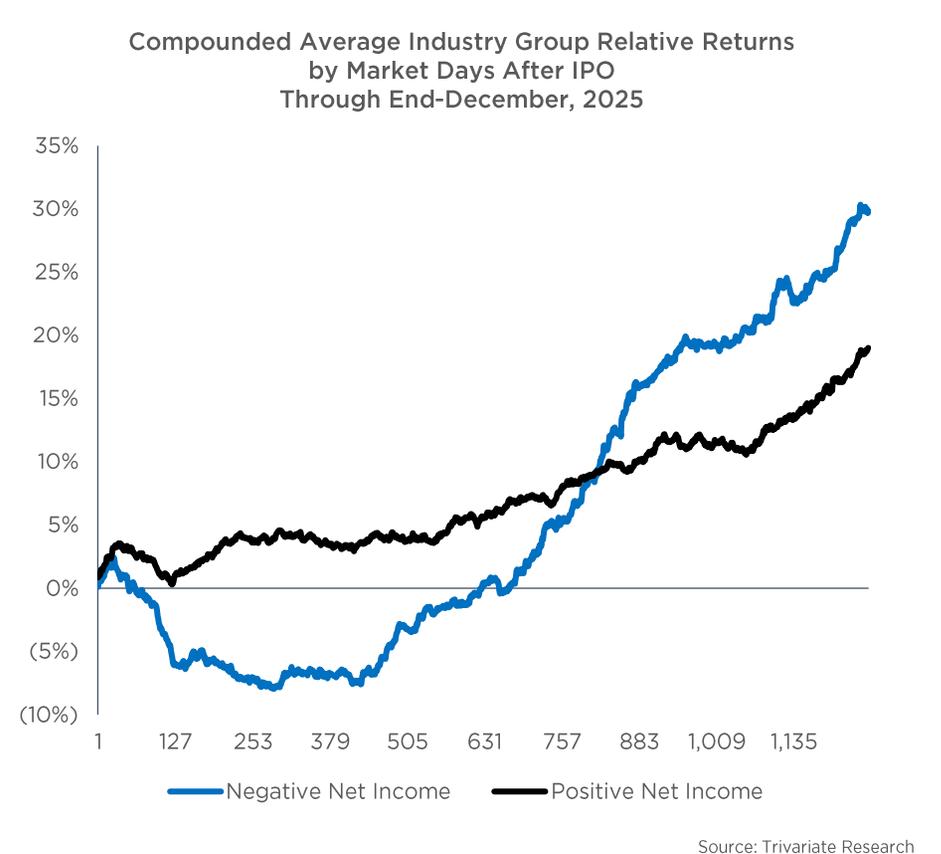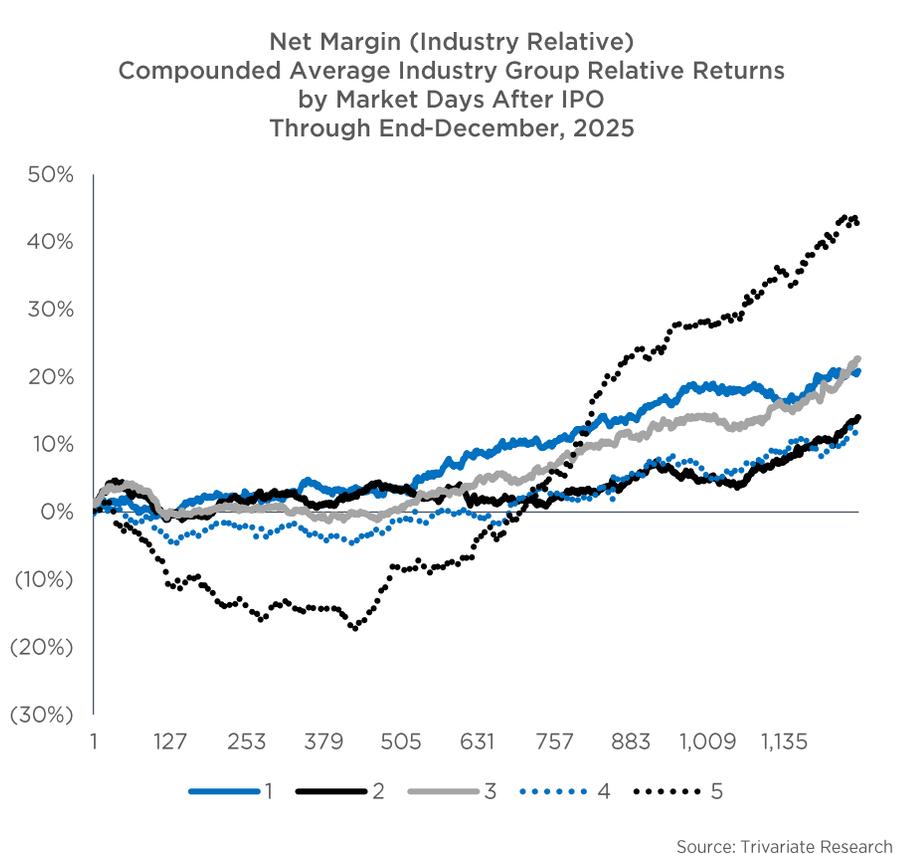
Compounded Mean Industry Group-Relative Return by Time Period of IPO Date
Market Days After First Closing Price, First 3 Years
Through End-December, 2025



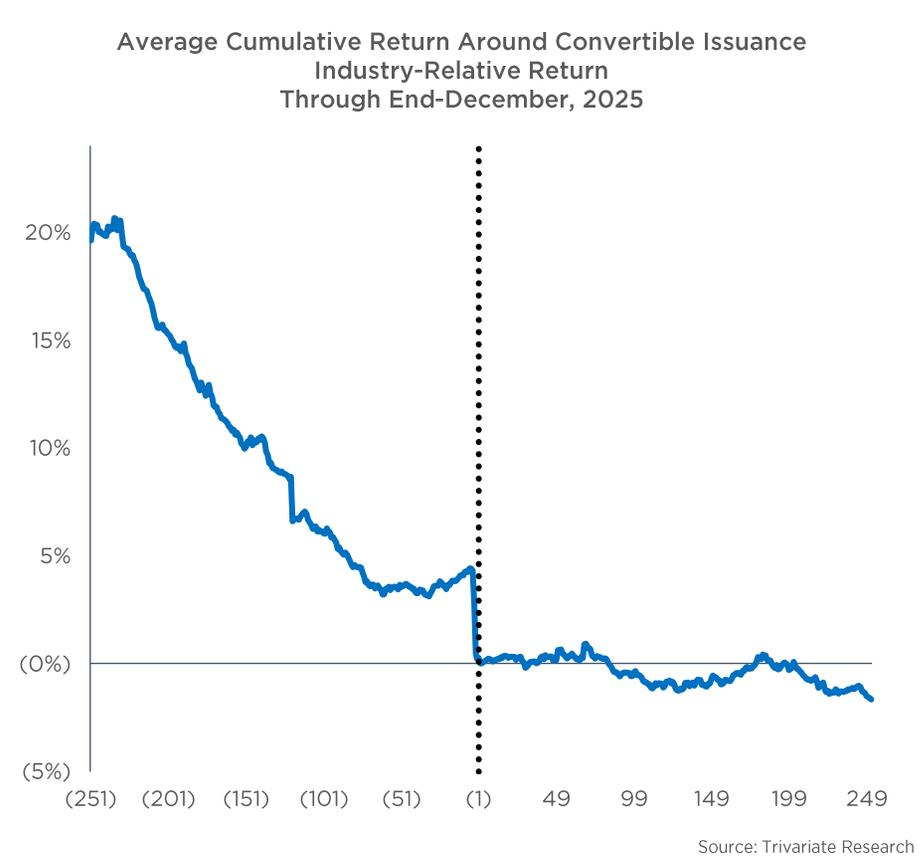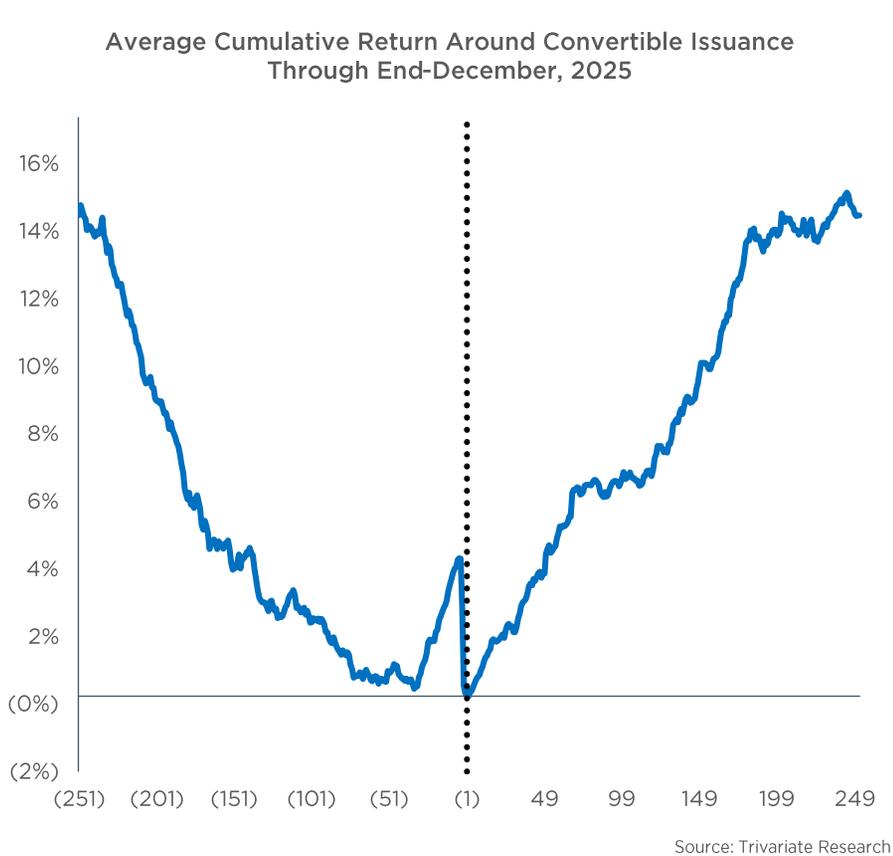Legend: 2000 to 2008 — 2009 to 2015 — 2016 to 2019 — 2020 to Present
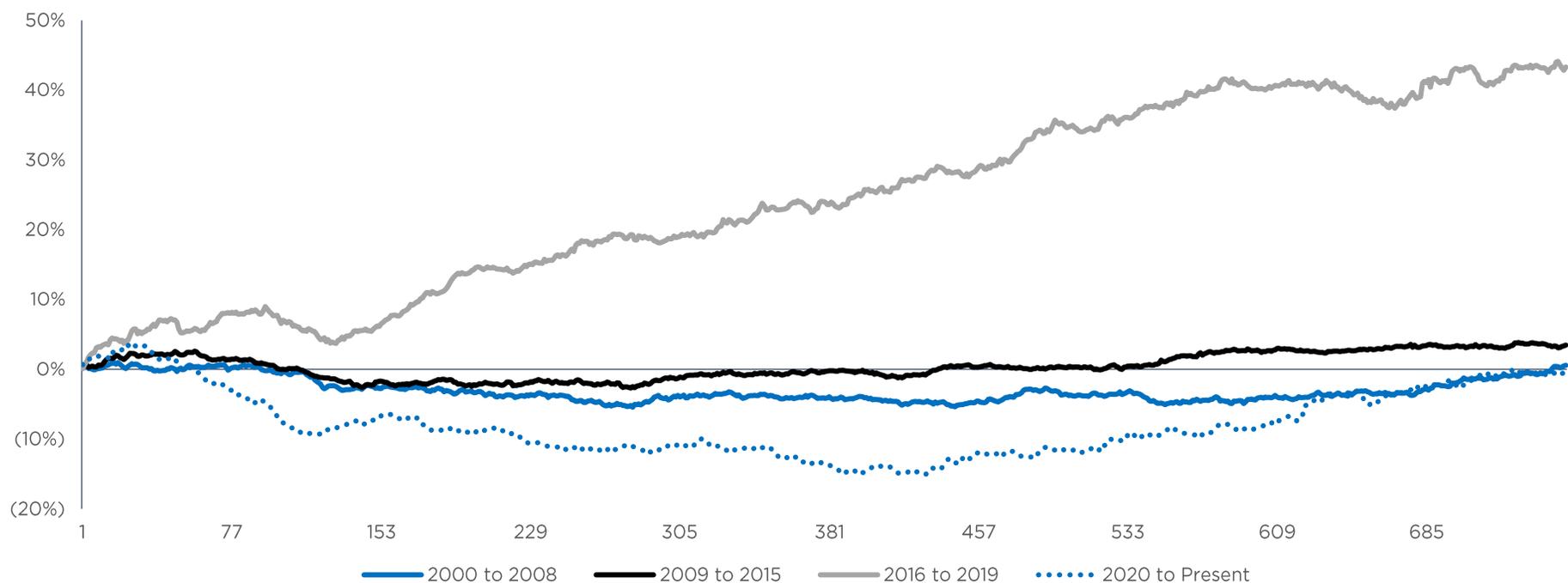
# AVOID IPOS THAT LOSE MONEY IN THE FIRST YEAR

Investors asked if net profitability matters for IPO success. With SpaceX and OpenAI on the horizon, these questions are likely to surface in 2026. We broke the net margin of IPOs into quintiles and found the lowest quintile of net margins on average sharply underperformed during the first year, but then eventually did best after three years (left). The results show that negative net income companies strongly underperform (by more than 10% on average) over the first 18 months (400 days) of trading, those with positive net income (right). For companies nearing profitability, waiting to go public until generating positive net income may be prudent. Circle (Ticker: CRCL) is losing money in 2025 but expected to make profits next year, as a recent example.



Net Margin (Industry Relative)
Compounded Average Industry Group Relative Returns
by Market Days After IPO
Through End-December, 2025

Legend: 1, 2, 3, 4, 5

Source: Trivariate Research



Compounded Average Industry Group Relative Returns
by Market Days After IPO
Through End-December, 2025

Legend: Negative Net Income, Positive Net Income

Source: Trivariate Research

# ISSUING A CONVERTIBLE BOND CAN STOP THE BLEEDING

The average company issuing a convertible bond goes down 15% in absolute terms a year before the issuance (left), but performance stabilizes relative to the company's industry average afterwards.



Average Cumulative Return Around Convertible Issuance
Through End-December, 2025

Average Cumulative Return Around Convertible Issuance
Industry-Relative Return
Through End-December, 2025

Source: Trivariate Research

Source: Trivariate Research

**Trivariate's New Non-Technology Compounders:** We are launching a new basket of 20 non-Technology stocks that we think will be "Compounders" for the foreseeable future.  We anticipate this basket will have relatively low turnover.  Generally, these companies have reasonable growth expectations, and many are low beta and have above average company-specific risk.  Most have forecasted gross margin expansion, and positive and growing free cash flow.  None are in the most expensive decile of the market on enterprise value-to-free cash flow.

We will track the performance of this basket and will only make "trades" Friday after the close, to avoid any perceptions of impropriety. The position sizes will be equal, and the initial notional assets under management will be $1 billion, for the purposes of keeping track of performance. We are starting with 20 positions of a notional $50,000,000 each and will track the performance with these positions starting on January 1st, 2026.

<u>See the next slide for our current positions.</u>

# TRIVARIATE'S 20 NON-TECH. SECTOR "COMPOUNDERS"

The constituents of the current basket are shown on the left. The highest beta stocks are AMZN, UBER, CPNG, and LZ. The highest CSR stocks are LZ, NEE, CPNG, WMB, GILD, and TMUS, among others. This list has outperformed the S&P500 excluding Technology over the last year (right), preserving capital better during the market correction in Q1 of 2025.

## Trivariate Compounders Portfolio
### As of End-December, 2025

| Ticker | Company Name | Industry | Market Cap. | Beta | CSR |
|---|---|---|---|---|---|
| AMZN | Amazon.com, Inc. | Broadline Retail | 2,467.52 | 1.53 | 53% |
| BRK.B | Berkshire Hathaway | Financial Services | 1,084.82 | 0.28 | 65% |
| V | Visa Inc. | Financial Services | 670.64 | 0.68 | 66% |
| PM | Philip Morris | Tobacco | 249.68 | (0.17) | 73% |
| TMUS | T-Mobile US, Inc. | Wireless Telecom. Serv. | 227.10 | 0.02 | 84% |
| TMO | Thermo Fisher Sci. | Life Sciences Tools & Serv. | 217.70 | 0.79 | 54% |
| LIN | Linde plc | Chemicals | 199.10 | 0.42 | 63% |
| SCHW | Charles Schwab | Capital Markets | 177.53 | 0.77 | 65% |
| BKNG | Booking Holdings | Hotels, Rest. & Leisure | 172.62 | 0.92 | 74% |
| UBER | Uber Technologies | Ground Transportation | 169.78 | 1.15 | 75% |
| NEE | NextEra Energy | Electric Utilities | 167.19 | 0.34 | 90% |
| GILD | Gilead Sciences | Biotechnology | 152.28 | 0.33 | 82% |
| SYK | Stryker Corporation | Health Care Equip. & Supp. | 134.41 | 0.57 | 61% |
| WELL | Welltower Inc. | Health Care REITs | 127.39 | 0.25 | 75% |
| WMB | The Williams Comp. | Oil, Gas & Consumable Fuels | 73.41 | 0.50 | 81% |
| CTVA | Corteva, Inc. | Chemicals | 45.29 | 0.52 | 76% |
| CPNG | Coupang, Inc. | Broadline Retail | 43.09 | 1.03 | 78% |
| VMC | Vulcan Materials | Construction Materials | 37.69 | 0.70 | 59% |
| XYL | Xylem Inc. | Machinery | 33.16 | 0.80 | 55% |
| LZ | LegalZoom.com, Inc. | Professional Services | 1.76 | 1.09 | 77% |

Source: Trivariate Research

## 2025 Cumulative Equally-Weighted Performance
### Trivariate Compounders vs. Top 500 Ex-Technology



— Trivariate Compounders   — Top 500 US Equities Ex-Tech.

Source: Trivariate Research
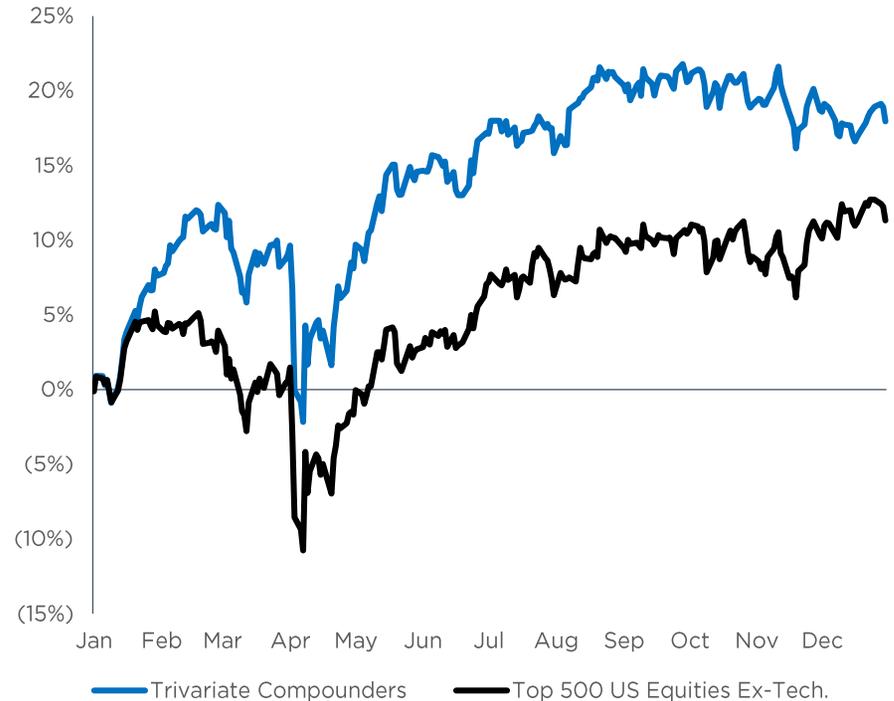
TRIVARIATE RESEARCH

# THE BASKET IS VERY HIGH QUALITY, AND HAS NO VALUE STOCKS

The basket of non-Technology Compounders has 18 high-quality stocks, and no junk (left).  It is comprised of nine growth stocks, zero value stocks, and 11 in the middle ground we call "neither" (right).

**Trivariate Compounders Portfolio**
**Quality Attributes**
**As of End-December, 2025**

| Quality Exposure | Weight | Beta | Count | Average Beta-Adjusted Weight |
|---|---|---|---|---|
| High | 90% | 52.54% | 18 | 2.92% |
| Mid | 5% | 2.49% | 1 | 2.49% |
| Low | 5% | 7.63% | 1 | 7.63% |
| Junk | --- | --- | --- | --- |
| Total | 100% | 62.66% | 20 | 3.13% |

**Trivariate Compounders Portfolio**
**Style Attributes**
**As of End-December, 2025**

| Quality Exposure | Weight | Beta | Count | Average Beta-Adjusted Weight |
|---|---|---|---|---|
| Growth | 45% | 40.10% | 9 | 4.46% |
| Neither | 55% | 22.57% | 11 | 2.05% |
| Value | --- | --- | --- | --- |
| Total | 100% | 62.66% | 20 | 3.13% |

# THE BASKET HAS SOME NON-TECH SECTOR DIVERSIFICATION

The basket has 6 mega-caps (out of the 50), 12 large caps, and one mid- and small-cap each (left). There are three stocks in five different sectors (right), including Materials, Energy, Consumer Discretionary, Healthcare, and Financials. There are no stocks in the Technology sector, though positions like AMZN and UBER clearly have a Technology bent.

### Trivariate Compounders Portfolio
### Size Attributes
### As of End-December, 2025

| Quality Exposure | Weight | Beta | Count | Average Beta-Adjusted Weight |
|---|---|---|---|---|
| Mega | 30% | 15.67% | 6 | 2.61% |
| Large | 60% | 37.56% | 12 | 3.13% |
| Mid | 5% | 3.99% | 1 | 3.99% |
| Small | 5% | 5.44% | 1 | 5.44% |
| Micro | --- | --- | --- | --- |
| Total | 100% | 62.66% | 20 | 3.13% |

### Trivariate Compounders Portfolio
### Sector Attributes
### As of End-December, 2025

| Quality Exposure | Weight | Beta | Count | Average Beta-Adjusted Weight |
|---|---|---|---|---|
| Energy | 5% | 2.49% | 1 | 2.49% |
| Materials | 15% | 8.21% | 3 | 2.74% |
| Industrials | 15% | 15.20% | 3 | 5.07% |
| Consumer Discretionary | 15% | 17.39% | 3 | 5.80% |
| Consumer Staples | 5% | (0.85%) | 1 | (0.85%) |
| Health Care | 15% | 8.49% | 3 | 2.83% |
| Financials | 15% | 8.64% | 3 | 2.88% |
| Communication Services | 5% | 0.12% | 1 | 0.12% |
| Utilities | 5% | 1.71% | 1 | 1.71% |
| Real Estate | 5% | 1.26% | 1 | 1.26% |
| Total | 100% | 62.66% | 20 | 3.13% |

BASE CASE:

1) <u>Multiple contraction:</u> We think the probability the price-to-forward earnings for the S&P500 contracts is HIGHER than the probability the multiple expands in 2026.

2) <u>Downward revisions:</u> Bottom-up consensus earnings expectations of 15% for 2026 are overly optimistic, and stocks that have missed expectations have been harshly punished.

3) <u>Bullish consensus:</u> Consensus is generally bullish, and doing the opposite of consensus has been fruitful the last three years.  Only 3x in the last 100 years has the market rallied double-digits for four or more years, so history dictates less appreciation is likely.

We forecast 10% EPS growth in 2026, but multiple contraction, meaning modest appreciation for the S&P500 for 2026 is our base case.

BULL CASE:

More companies than consensus expects show significant progress on AI adoption and there is *incremental* monetary and fiscal stimulus.

BEAR CASE:

1) Private credit hiccups or Fed action cause <u>Financial Conditions to tighten</u>.

2) <u>AI disappoints</u>, either because capital spending is too high, or margin savings is competed away on pricing, driving downward earnings revisions.

<u>LONG-TERM:</u>  Assuming 10% average per year EPS growth and 21x forward earnings, the S&P500 should be near 10000 by 2030, averaging 8% per year return.

# SUMMARY CONCLUSIONS

- **Quality:** We like high-quality, like everyone else, <u>but it hasn't worked vs. junk for five years.</u> The catalyst for it to work in a flat to up tape is upward earnings revisions. <u>Quality doesn't work in isolation.</u>

- **Small caps:** We disagree with the consensus view on small caps. They are cheap for a reason – they are increasingly lower quality. Small caps historically outperformed close to a recession bottom because of better growth in the recovery. That is not where we are in the cycle now.

- **Great 8:** <u>We recommend a market-weight the group – for risk-management purposes.</u> At 55.7% of the S&P500 on a beta-adjusted basis, but with EPS narratives that switch quarterly, changing correlations, low-to-average company-specific risk, and a very loved and well covered group of stocks, it is hard to differentiate.

- <u>**Sectors:** We are downgrading Consumer Staples and Industrials from Equal-Weight to Underweight and upgrading Consumer Discretionary from Underweight to Equal-Weight as part of our 2026 outlook.</u> For Industrials, high earnings expectations, expensive valuation, and weak macro trends are our rationale. For Staples, weak fundamentals that are structural not cyclical underpin our negativity.

- <u>We recommend an overweight positioning in Healthcare and Financials, and an Underweight in Consumer Staples, Comm. Services, and Industrials.</u>

- <u>Within Technology, we are reversing our call, and now like Software over Semis.</u>

# SUMMARY CONCLUSIONS

The health of the US Consumer remains a major investment controversy.  The consensus view is that there is labor market polarization, where high-end consumers thrive on asset gains while the lower-income labor market continues to cool.  Spending of the US consumer is certainly key to avoid a recession.   Moreover, AI spending is partially justified by effectively targeting US consumers to spend their discretionary dollars, a pool that could be impaired.

- We don't think historically low Consumer Confidence matters for stocks.

- Usually, Discretionary beats Staples at this point in the interest rate cycle.  As part of our 2026 outlook, we are downgrading Consumer Staples from Equal-Weight to Underweight and upgrading Consumer Discretionary from Underweight to Equal-Weight.

- Consumer Staples have performed poorly for a reason – historically bad downward earnings revisions.  We think many of the issues are structural, not cyclical.

- Estimates are overly optimistic: Many Consumer industries are forecasted to have accelerating revenue growth despite weak recent performance.  We are wary.

- Be cautious of heavily shorted Consumer Discretionary stocks.  Those with positive price momentum and high short interest massively underperform if they miss earnings but can outperform strongly if they beat – so risk manage the position sizes accordingly.

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