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TRIVARIATE RESEARCH

WHERE IS THE STOCK MARKET GOING?

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WHY DO PEOPLE WANT POINT-ESTIMATES FOR THE S&P500?

One of the hardest tasks when you are a US equity strategist at a large firm is to set a price target for the S&P500. We are intimately familiar with the process. Some people use the phrase "we have seen how the sausage is made." For us it is more accurate to say that we "made the sausage." In today's research, we aim to provide investors with a window into the consensus process for S&P500 price target formation and then provide you with what we find more valuable, having escaped from that thinking, worked on the buyside, and incorporated what we find valuable for managing a US equity portfolio.

When a strategist publicly sets a price target for the S&P500, the reality is that they are ultimately going to be wedged into one of four quadrants in a 2x2 grid. They are characterized as bullish or bearish, and then eventually, they will be "right" or "wrong." It is likely that over a period of several years, a strategist will spend meaningful time in all four quadrants. If you are always bullish or bearish, some investors will likely view them as a broken record or lose respect for their ability to ingest new and changing information. Over the past few years, it seems clear that the consensus top-down views of the US equity market are frequently wrong. In 2023, equity strategists were bearish and the market ripped higher. Same in 2024. Last year many were bullish first half and bearish second half of the year. Doing the opposite of the consensus has been a more effective approach than following the consensus. Since most of the strategists at the bulge bracket firms are very smart, experienced, and have jobs that are both demanding and hard to obtain, it is interesting to ask: why are US equity strategists repeatedly and consistently bad at forecasting the level of the S&P500? We believe a large part of this stems from the challenges in establishing consistent price targets, combined with the professional motivations and incentives that influence strategists.

1) If a strategist is a contrarian bear and ultimately wrong, they can get fired, but if they are a consensus bull and wrong, they can survive. Incentive structures cause many strategists to hug consensus, move their forecasts less rapidly than data would otherwise dictate, and be trend-followers, not thought leaders. Most are narrative or story tellers, and find charts to back the narrative up, not proactive researchers who are willing to be wrong.
2) Most firms push strategists to deliver point estimates that exude confidence and have clean narratives but are destined for false precision.

HOW DOES FORMULATING AN S&P500 TARGET WORK AT A BIG FIRM?

3) Many strategists are rewarded on client votes and engagement, message consistency, internal alignment, media presence, and other intangibles, NOT on P&L and forecast accuracy. It is hard to get paid in the "real world" with your S&P500 price target without true value add, but a strategist's compensation can have a high correlation to the year-over-year Managing Director compensation pool at a large bank with a bullish consensus and ultimately wrong view of US equities. In part, that is why strategists often victory lap, even when they were actually wrong, or set "double-breaking putt" targets like "up now and down later" to eventually tell investors what part of the 2x2 grid they were in, with phrases like "we were early but right."

The reality is that many strategists are not particularly good at explaining what already happened, because they do top-down work, and therefore their narratives lag stock price by weeks or months. For instance, yesterday, we were told about the Q2 2025 labor productivity. That would be useful if our hedge fund was called "Hindsight Capital." So, what *do* strategists do? They provide a steady presence and reduce anxiety among some of their clients. There's value in some of this, but it isn't predictive.

Importantly though, some the reason they are frequently wrong is process-related and a function of the "bigness disease" plaguing many financial institutions. When we were at Morgan Stanley, the year-ahead outlook was the culmination of several hours of internal meetings with strategists and economists from the major regions in the world. The conversations would commence three weeks before the final document was due, beginning with the economics team presenting their views on interest rates and economic growth for three-to-four hours. A week later, the same group of "experts" would meet, and the relevant strategists would unveil and socialize their forecasts for policy, interest rates, and currencies. Finally, on the last multi-hour set of meetings, typically, one-to-two weeks after the initial economics view was presented, the equity strategists produce their views, with the goal of incorporating the economic, rate, and currency forecasts they were given as inputs.

HOW DOES FORMULATING AN SP500 TARGET WORK AT A BIG FIRM?

Every year we were involved in this process we had the same thoughts:

1) It is totally possible everyone here will eventually be wrong with their forecasts, but virtually impossible that the whole group can all be right.
2) Economists want more hiring, and more capital spending, and look at success differently from US stock strategists, who know higher margins drive higher multiples. Listening to a US economist to get a US equity outlook is not helpful. Equities lead the economy, so economists should listen to US equity strategists and or at least follow stock prices, not the other way around.
3) Listening to a fixed income strategist use a valuation-based argument to espouse their negative view on US equities doesn't make sense and will lose clients money.
4) For some countries in the world, you can't have an economics forecast that doesn't closely embed your view of monetary policy, interest rates, and currency. The US isn't necessarily one of them.
5) It is always hard to do independent analysis and then come back and try to rank order assets when strategists aren't grounded in the same frameworks, methodologies, or data-intensities in creating their outlooks. It is virtually impossible for different people to compare notes and consistently answer questions like: why do you like US equities over European equites this quarter?

In the end, the way it most often works in creating the ultimate forecast is that the "alpha dog" or the person who influences everyone's compensation the most, gets their view published, and others usually acquiesce. Then, the strategists who turn out to be wrong can blame someone else for this, and say it was a "house call" and not their view.

All this aside, we aren't saying that setting a point-estimate forecast for the S&P500 is easy to do – or frankly even worth doing. We are saying the way it is typically done is wrought with problems.

If one was to think about it simplistically, what is needed is an earnings view, and a price-to-forward earnings view, and multiplying the two views together delivers an S&P500 price target. We have shown before that the volatility of the multiple is higher than the volatility of the earnings, so theoretically it is easier to forecast earnings. So, let's start there.

THE CHALLENGES OF FORECASTING EARNINGS

Many years ago, a former colleague of ours spent a few months trying to build a rigorous sector-based earnings forecast model. We considered many signals, economic, consumer, industrials, currency, commodities, historical trends, and other metrics in creating this forecast. <u>It isn't hyperbole for us to say that the smartest and hardest working person we ever worked with</u> spent several months engineering and guiding a group of very talented people to build a sustainable earnings forecasting tool for the S&P500. In the end, the forecast was pretty bad. Exogenous shocks, fiscal and monetary stimulus that was previously unprecedented, new constituents, shifts in the constitution of the index, and frankly, the irrelevance of some historical data we used, all contributed to the challenge. One conclusion is that if the smartest person we know spent three months on the problem and it wasn't helpful, maybe the "easy" part of the price target, the earnings – not the multiple – really isn't that easy. If you don't believe us, go back and look at the November 2022 US equity strategy outlooks from the biggest few firms. Zero of them mentioned AI, and their earnings estimates for the out year were wildly off.

On the multiple, there definitely are some regimes where we can measure relationships between certain metrics and the changes in multiples for stocks, but they oscillate and evolve, typically because the market gets INCREASINGLY anticipatory.

With this glorious set-up, here is how we currently think about earnings, margins, and multiples and some key considerations for the US equity market.

EPS & PEF ASSUMPTIONS TO GET TO 10000 ON S&P500 BY 2030

We think there is some value in looking at longer-term data and trends. 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. Our conclusion for now is that <u>the 2026 estimates appear overly optimistic.</u>

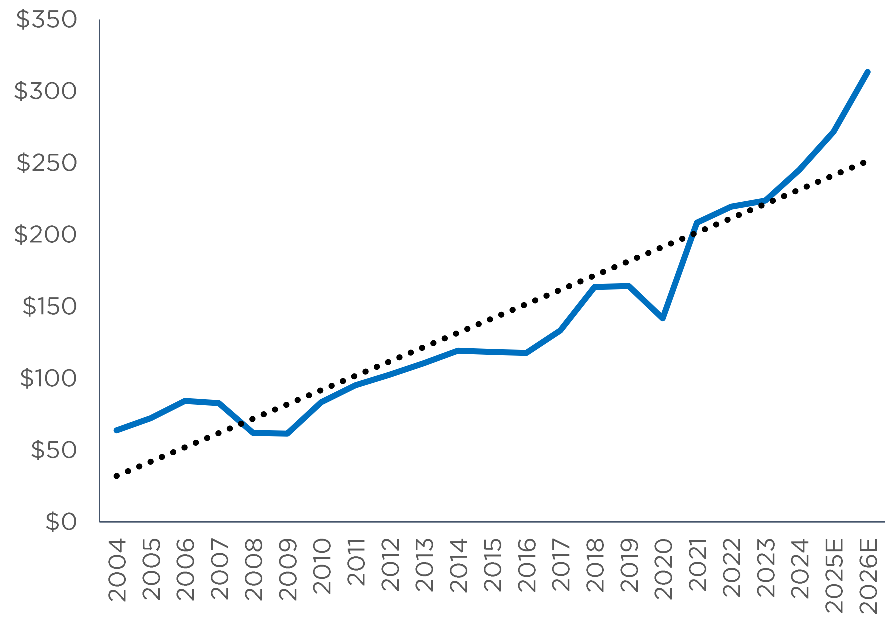
Year-End 2030 S&P500 Price Target
Applied to 2031E EPS Estimates
Under Various EPS Growth and Price-to-Forward Earnings Assumptions

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

Source: Trivariate Research

S&P500 EPS and Consensus Bottom-Up Estimates
Through End-December 2025

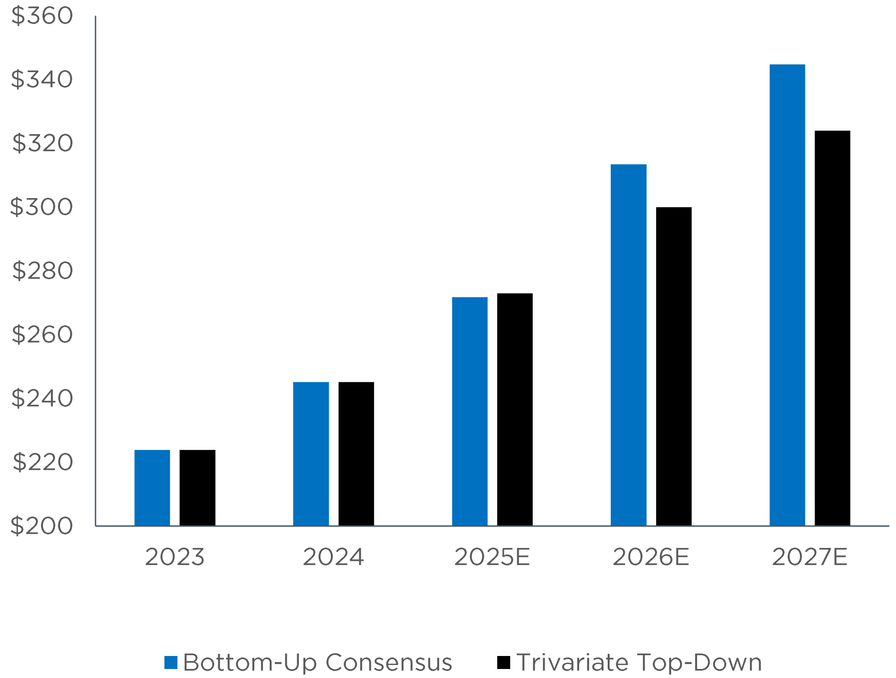


Source: Trivariate Research

THE BOTTOM-UP ANALYSTS ARE BULLISH ON EARNINGS

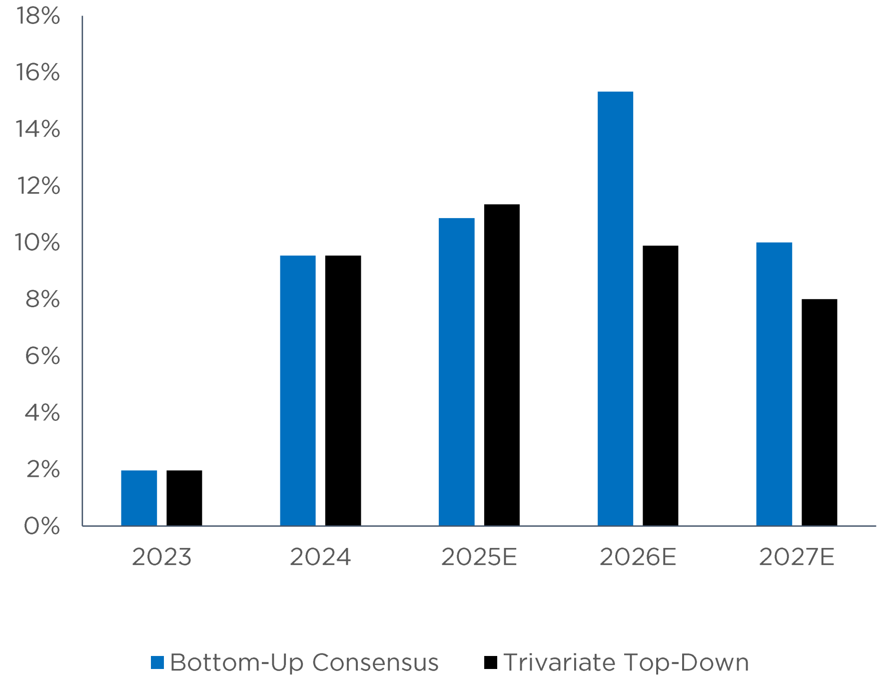
Below we show the bottom-up consensus EPS estimates and Trivariate's top-down EPS estimates for the S&P500 through 2027. We forecast $300 in 2026 EPS and $324 in 2027 EPS vs. the consensus of $313 and $345, respectively (left). The consensus outlook embeds 15.3% EPS growth for 2026 (right), followed by another year of double-digit growth in 2027. We forecast a 10% EPS growth in 2026 and 8% in 2027. Our analysis is top-down, and as we previously stated, we wouldn't put a ton of stock in our ability to accurately forecast S&P500 earnings. We moved to a much easier approach, because again, the smartest / hardest working person we know couldn't do it well given three months.

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. Both sectors' estimates appear excessively optimistic.

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 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:

The consensus top-down strategy view is uniform optimism for a fourth consecutive year of gains. 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. The Macro Consensus: "A Policy-Driven Bull Market":
    - **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 Bill Act* projected to trigger $100B+ in tax refunds in 1H 2026, front-loading consumption.

2. The Great AI Pivot: Phase 3 (Monetization):
    - **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.

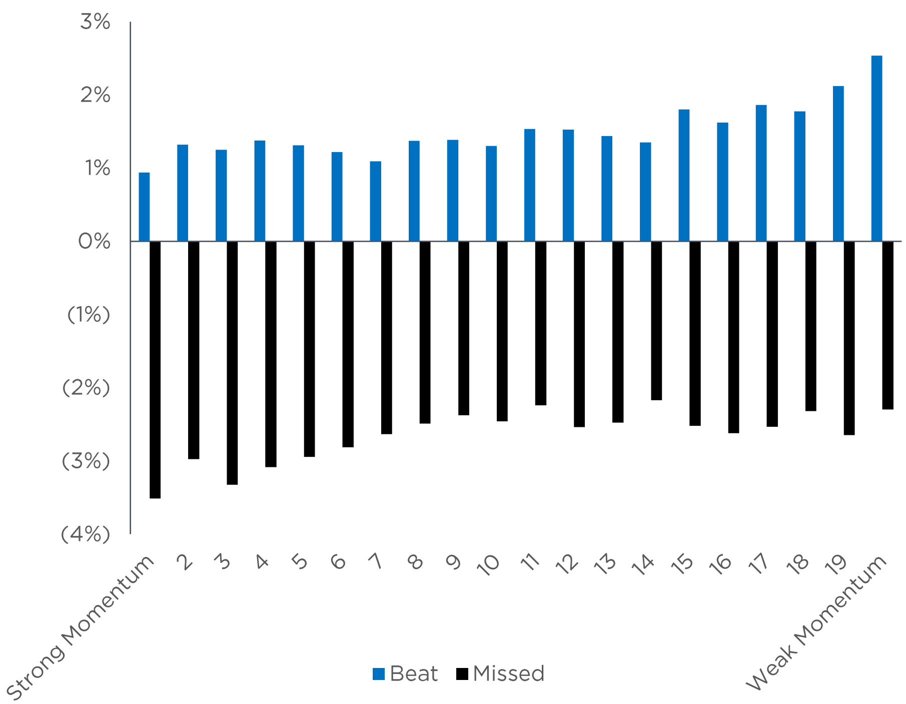
3. High-Conviction Sectors & "Best Ideas":
    - **Small Cap "Catch-Up" (#1 Consensus Trade):** Russell 2000 (IWM) expected to outperform as rates drop and domestic stimulus (OBBBA) targets local businesses.
    - **Financials:** Beneficiaries of deregulation, steepening yield curve, and a 20% surge 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. Key Risks: The "K-Shaped" Economy:
    - 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).

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. <u>In our judgment, estimates are too high and the penalty for companies missing estimates is likely to be extreme.</u>

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

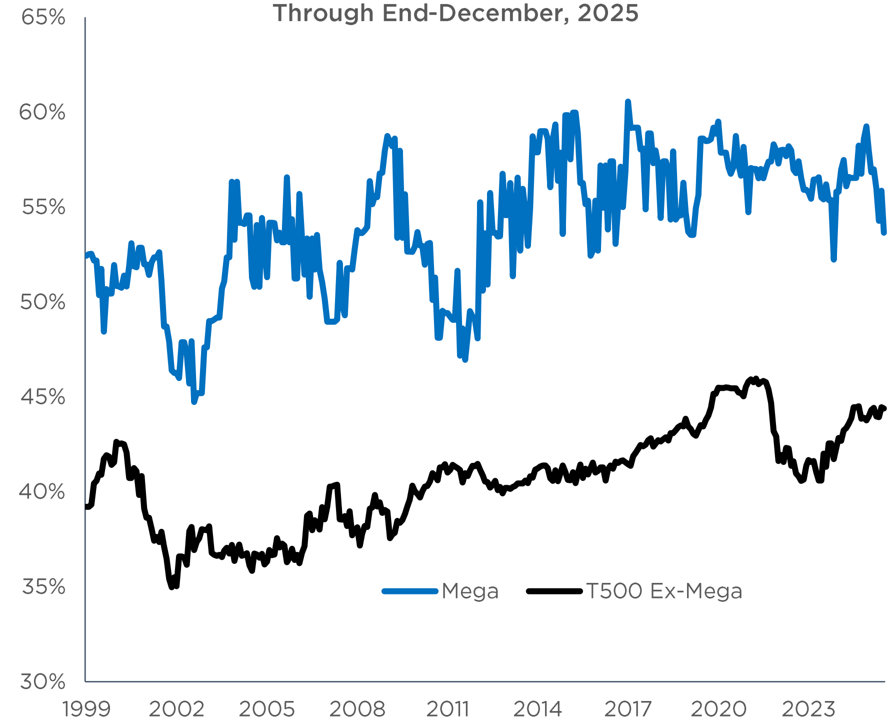
THE MEDIAN STOCK'S GROSS MARGINS HAVE BEEN FLAT FOR A YEAR

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%. <u>We think analysts should hyper-focus on both the trajectory and achievability of forecasted gross margins.</u>

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

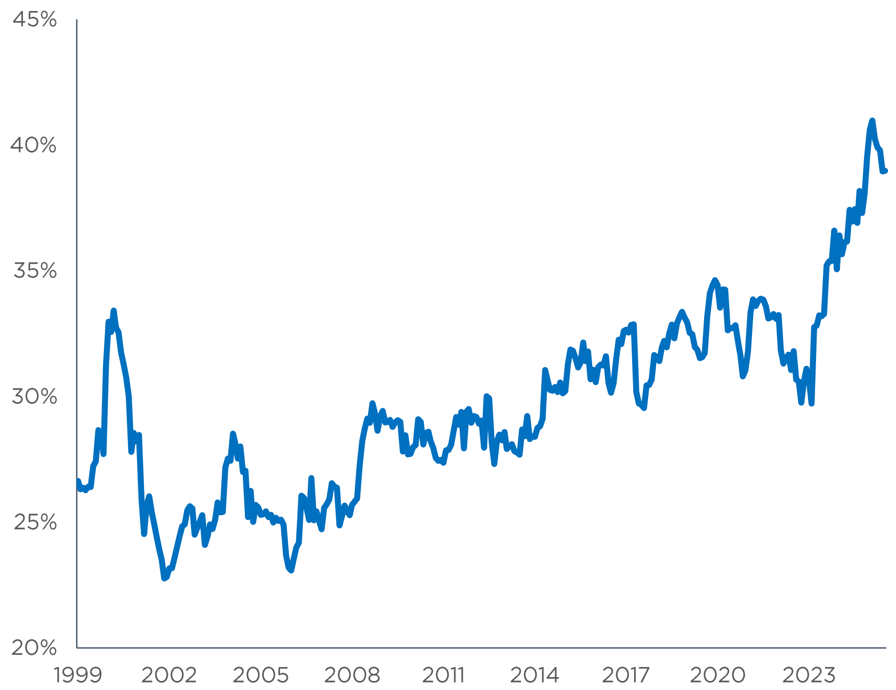


Source: Trivariate Research

VALUATION IS STRONGLY RELATED TO GROSS MARGIN LEVEL

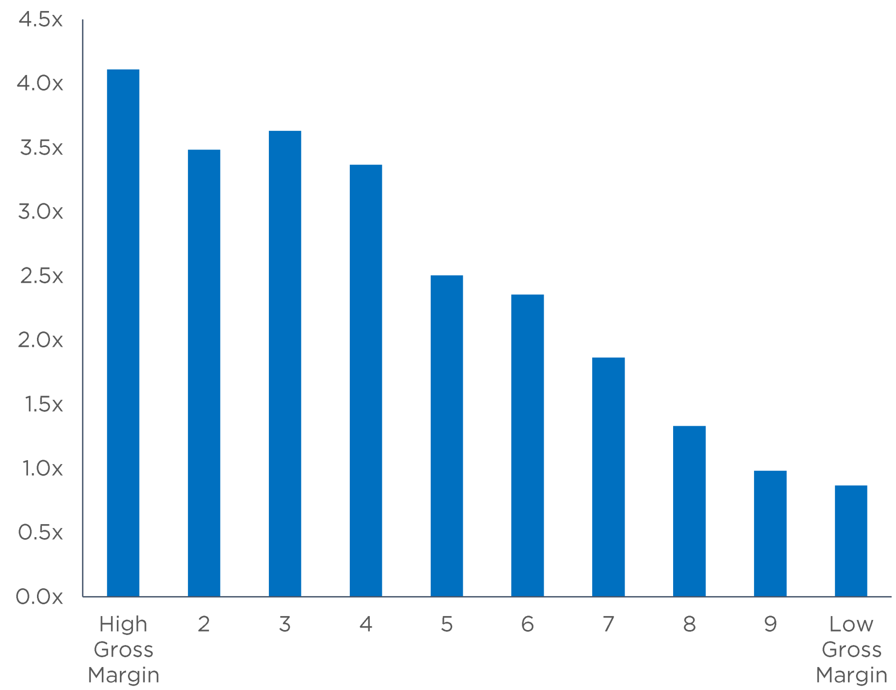
One of the reasons we expect the US equity market to trade and oscillate at higher multiples in the future than in the past is because the gross margins for the median stock are higher. Several of the largest stocks have high gross margins. We pointed out in July 2025 that 41% of all the market cap. 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



Source: Trivariate Research

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



Source: Trivariate Research

THE FED CUTTING DOESN'T CAUSE ADDITIONAL MULTIPLE EXPANSION

While forecasting the earnings is hard, forecasting the multiple is even harder. But we have some observations. 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. <u>**We think three years later the opposite logic has merit.**</u> 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

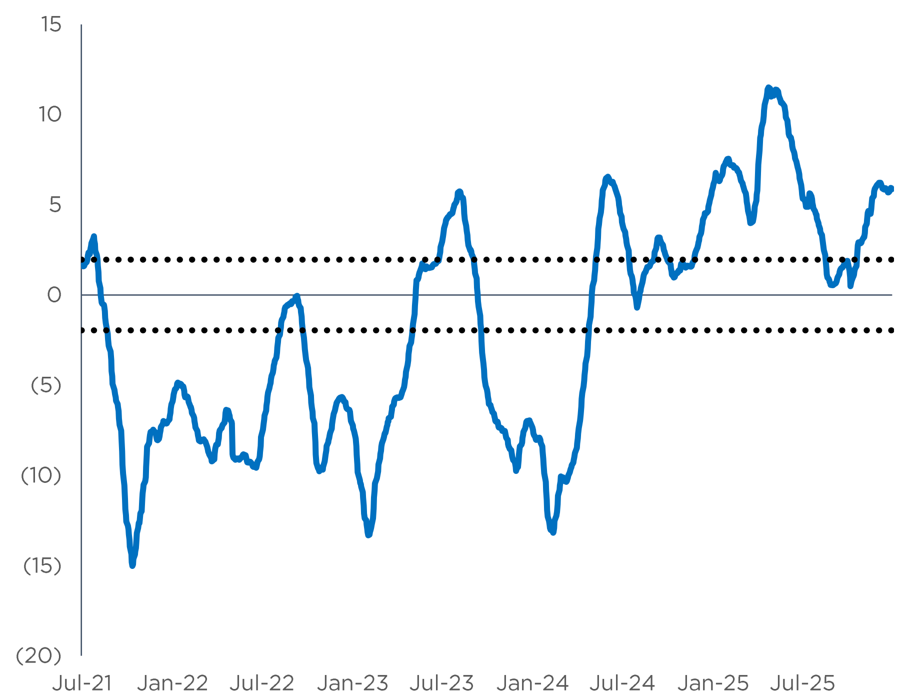
FOMC Meeting Date	50bps Cut %	25bps Cut %	No Change %	25bps Hike %	50bps Hike %
January 28	1%	11%	89%	0%	0%
March 18	2%	34%	65%	1%	0%
April 29	4%	30%	62%	2%	0%
June 17	10%	39%	48%	6%	6%

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

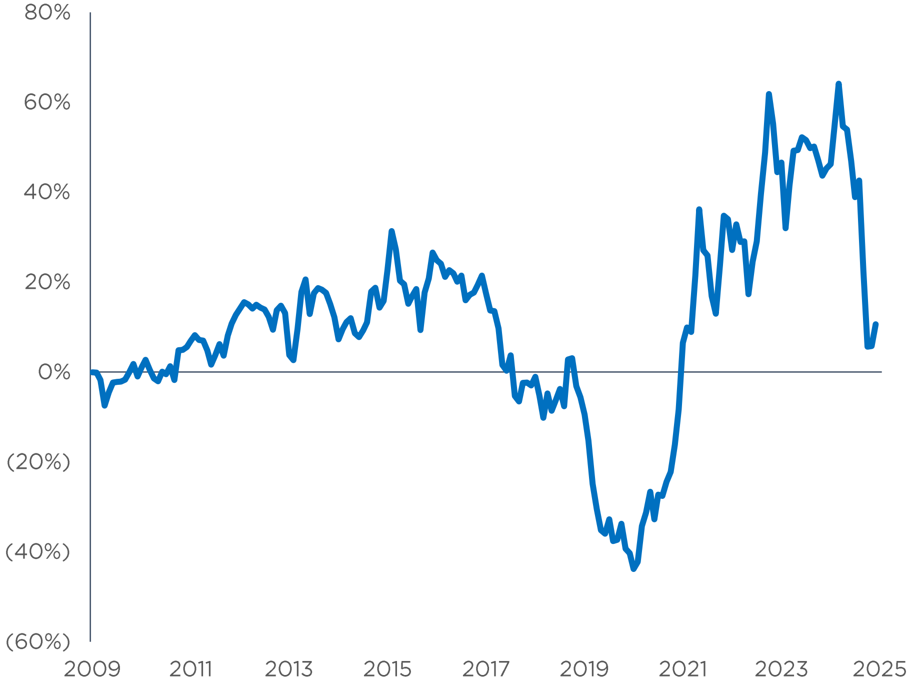


Source: Trivariate Research

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



Source: Trivariate Research

REASONS VALUATION HAS FAILED:

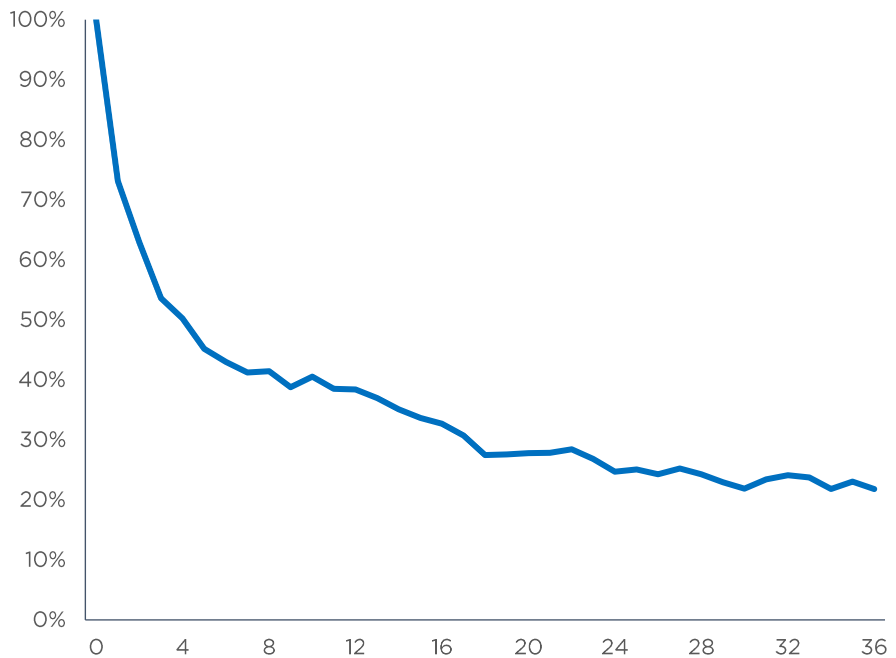
- AI Revenue Beneficiaries – Get Multiple Expansion
- AI Productivity Beneficiaries – Get Multiple Expansion
- Impregnable to AI – Get Multiple Expansion
- Potentially Disrupted by AI – See Multiple Contraction
- If you use mean-reverting valuation to pick stocks, you are selling stocks that benefit 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

Source: Trivariate Research

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

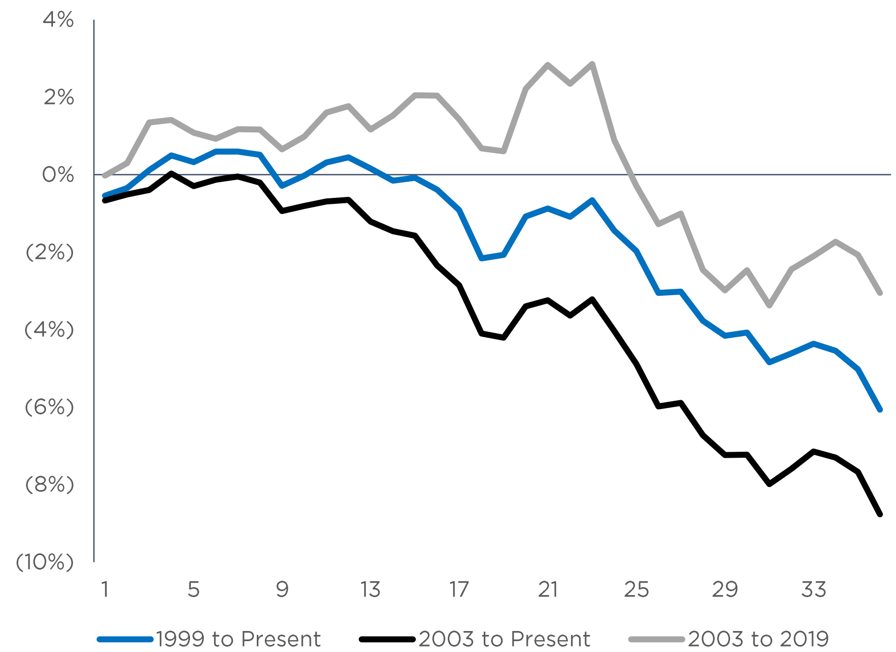
Even though valuation doesn't work in a vacuum, extreme valuation can eventually be a problem. Inspired by the multiple expansion in Walmart and Costco, we evaluated what happens to all stocks once they ascend to 40x price-to-forward earnings (PEF). It is quite consistent that once they reach 40x PEF, 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



Source: Trivariate Research

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

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.

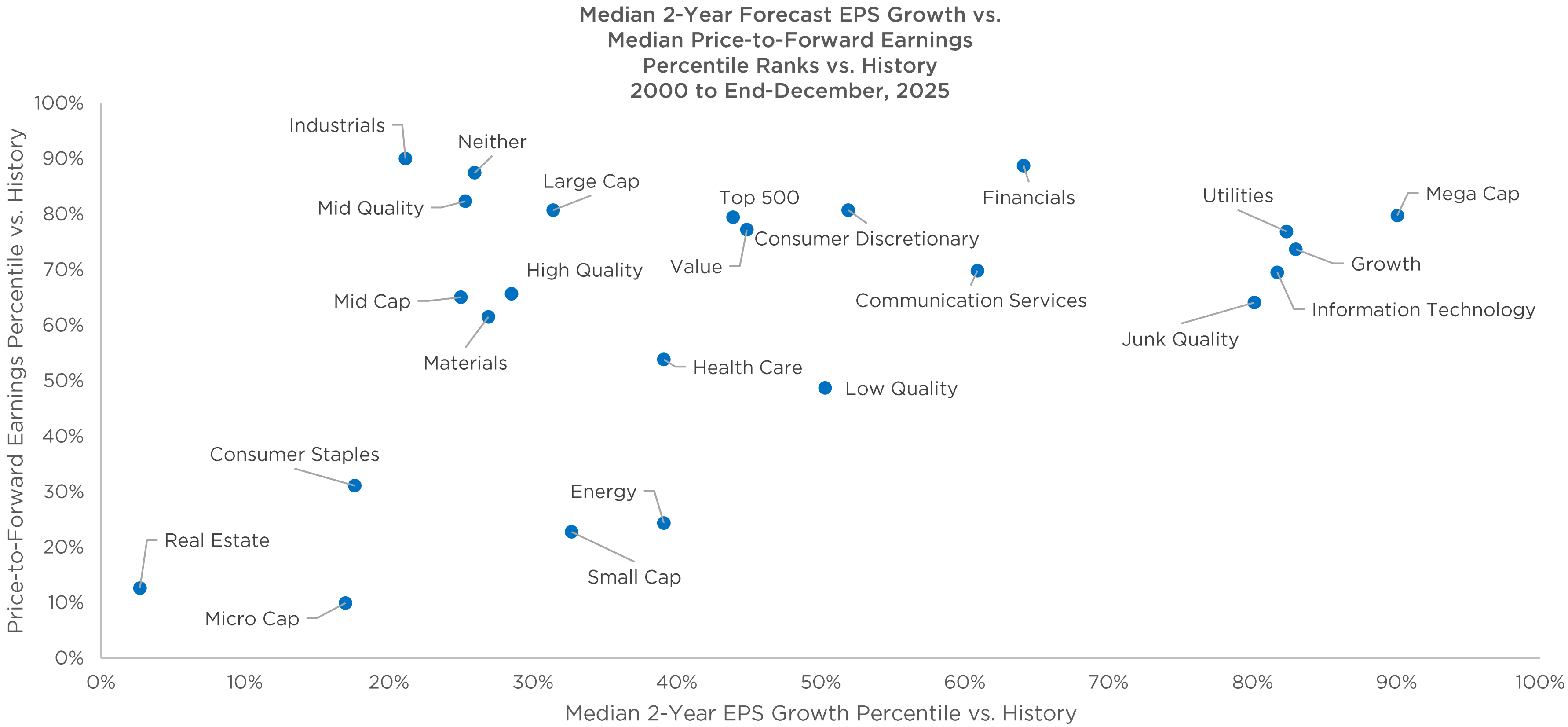
Recent Stocks First Trading >40x Forward Earnings in 3 Years
Top 900 US Equities, At Least 2 Years of Data
As of End-December, 2025

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

GROWTH EXPECTATIONS AND VALUATION ARE DISCONNECTED

One observation we have about earnings and valuation is that they are quite far from synchronized. 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. <u>Mega-caps, Junk, and Technology are expensive with high forecasted growth. Industrials are expensive with low forecasted growth.</u>



Source: Trivariate Research

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. <u>So, for 2026, if history is a guide, a below average (but perhaps still positive) return year is more probable.</u> 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. <u>These were 1942-1945, 1949-1952, and five years in a row from 1995-1999.</u>

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
	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 Years	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%
	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%
5 Years	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%
	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%
10 Years	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.

A FRAMEWORK FOR THINKING ABOUT THE S&P500 WE CAN LIVE WITH

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

1) Multiple contraction: 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) Downward revisions: Bottom-up consensus earnings expectations of 15% for 2026 are potentially overly optimistic, and stocks that have missed expectations have been harshly punished. We are using NLP to scour earnings calls for any signs of AI-related cost reductions to monitor the margin path for the top 500 US equities.

3) Bullish consensus: 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.

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 Financial Conditions to tighten.

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

LONG-TERM: Assuming 10% average per year EPS growth and 20-21x forward earnings, the S&P500 should be near 10000 by 2030, averaging 8% per year return.

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