Level Set - Crazy Tape, Great 8, Bullish Sentiment

Index Level Returns Are Highly Misleading

The market in aggregate is off to a solid start to the year, with the S&P500 up 1.38% and the Nasdaq up 1.18%. But there headline numbers mask that massive moves of many individual stocks under the surface. On the offensive side of the ledger, there are 26 Industrial's stocks in the S&P500 that are up 10% or more this year - a sector we downgraded to Underweight to start the year because of high earnings expectations and high valuations. Huntington Ingalls (HII), Builders Firstsource (BLDR), Lockheed Martin (LMT), and Comfort Systems (FIX) are all up at least 20% so far this year in just eleven trading days. Similarly, many lower-quality Consumer Discretionary companies have ripped higher. The narrative is that President Trump wants US-consumer data to improve before the midterm election and will do his best to influence events by providing incremental monetary and fiscal stimulus. On the negative side of the ledger, only two sectors are down year-to-date. One, a consensus long, Financials, is down 78bps, fueled in part by mixed earnings from the biggest Banks this past week. The only other down sector is Technology, which is down 57bps. Within Technology, 19 companies are up more than 10% already, including many Memory-related names which remain on a tear. Sandisk (SNDK) is up 74% MORE this year, and Micron has tacked on another 27% already. But Software has remained heavily sold. In fact, 10 Software companies in the S&P500 are already down at least 10% this year, including Intuit (INTU) which is down 17.7%, ServiceNow (NOW) down 16.9%, and Salesforce (CRM) down 14.3%, among others. Below we examined the performance of bottom-half quality Consumer Discretionary stocks compared to top-half quality Software stocks and note the year-to-date comparison is quite acute. We are confident this will not be met by commensurate relative earnings revisions through earnings season.

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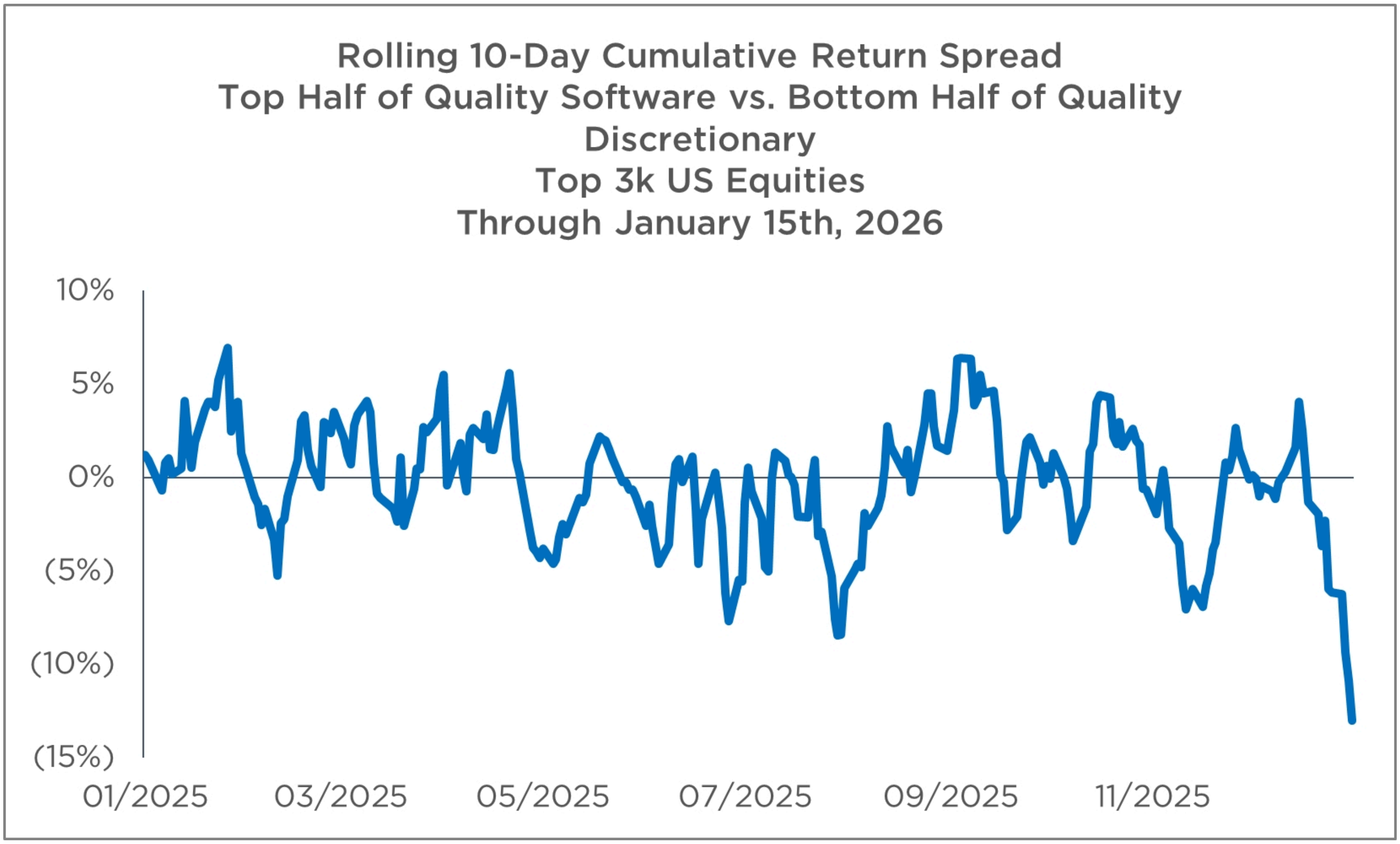


Source: Trivariate Research, LP

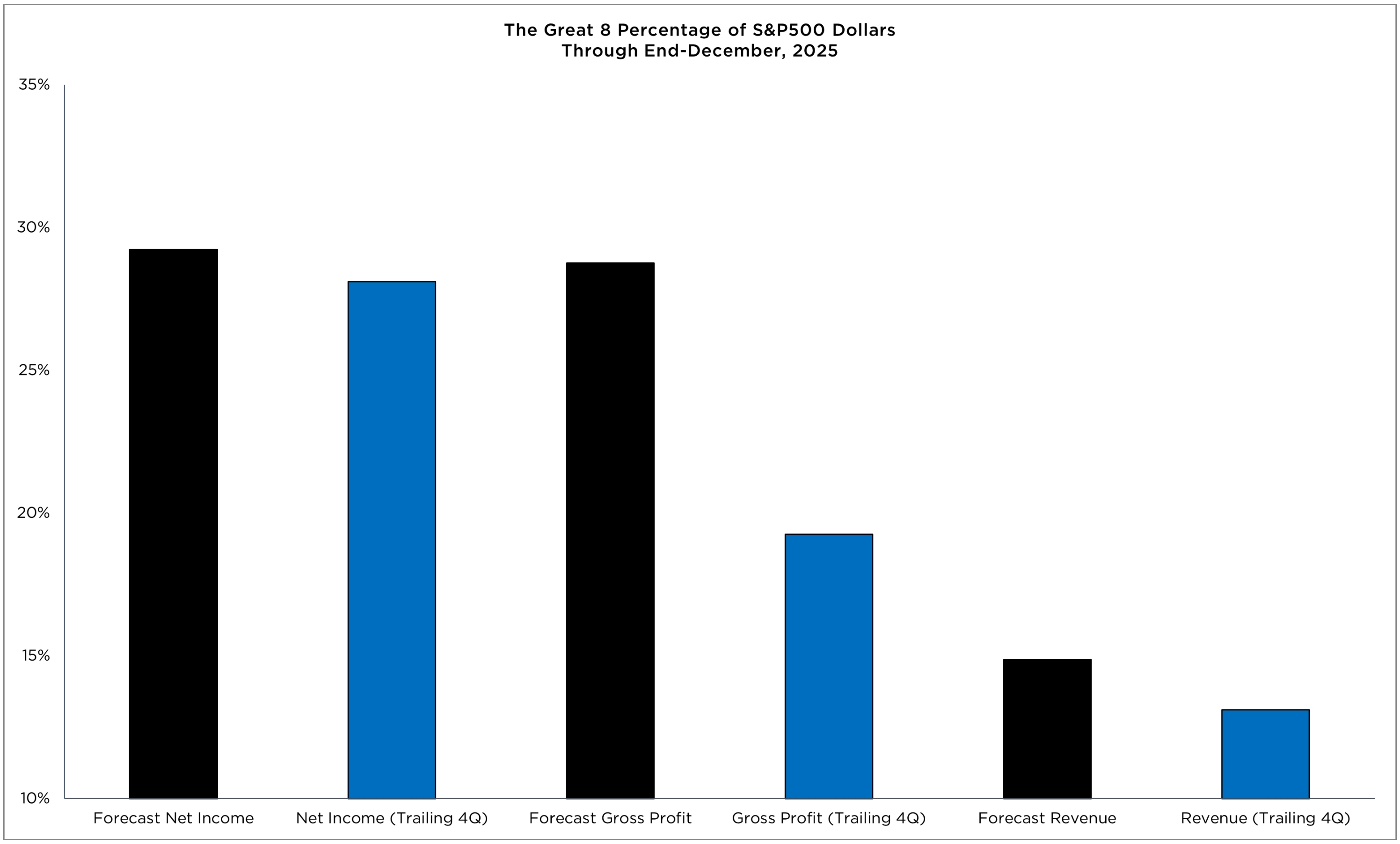
Great 8 Gross Margin Expansion Is Key

Nearly every meeting we have had this year, an investor has mentioned breadth and rotation. The Great 8 have yet to report earnings, but a strong print from Taiwan Semiconductor (TSM) this past week reinvigorated interest in the AI trade. Because these stocks are so big - as we have written over half the beta-adjusted exposure of the S&P500 is in these stocks - we suspect most investors would be hurt on a relative basis if they outperformed. So far, the Great 8 equally-weighted average has lagged the market (see below), with GOOGL and AMZN strongly outperforming META, AAPL, and MSFT. **But, the calls for sustained breadth are actually a call for the market treating income statements differently this year than it did in the past.**

Great 8 Return YTD Through January 16th, 2026		
Ticker	Company	Return
GOOGL	Alphabet, Inc.	5.43%
AMZN	Amazon.com, Inc.	3.06%
AVGO	Broadcom, Inc.	1.62%
NVDA	NVIDIA Corp.	(0.01%)
TSLA	Tesla Inc.	(2.72%)
MSFT	Microsoft Corp.	(4.91%)
AAPL	Apple Inc.	(6.01%)
META	Meta Platforms, Inc.	(6.04%)
Equal-Weight Average		(1.20%)

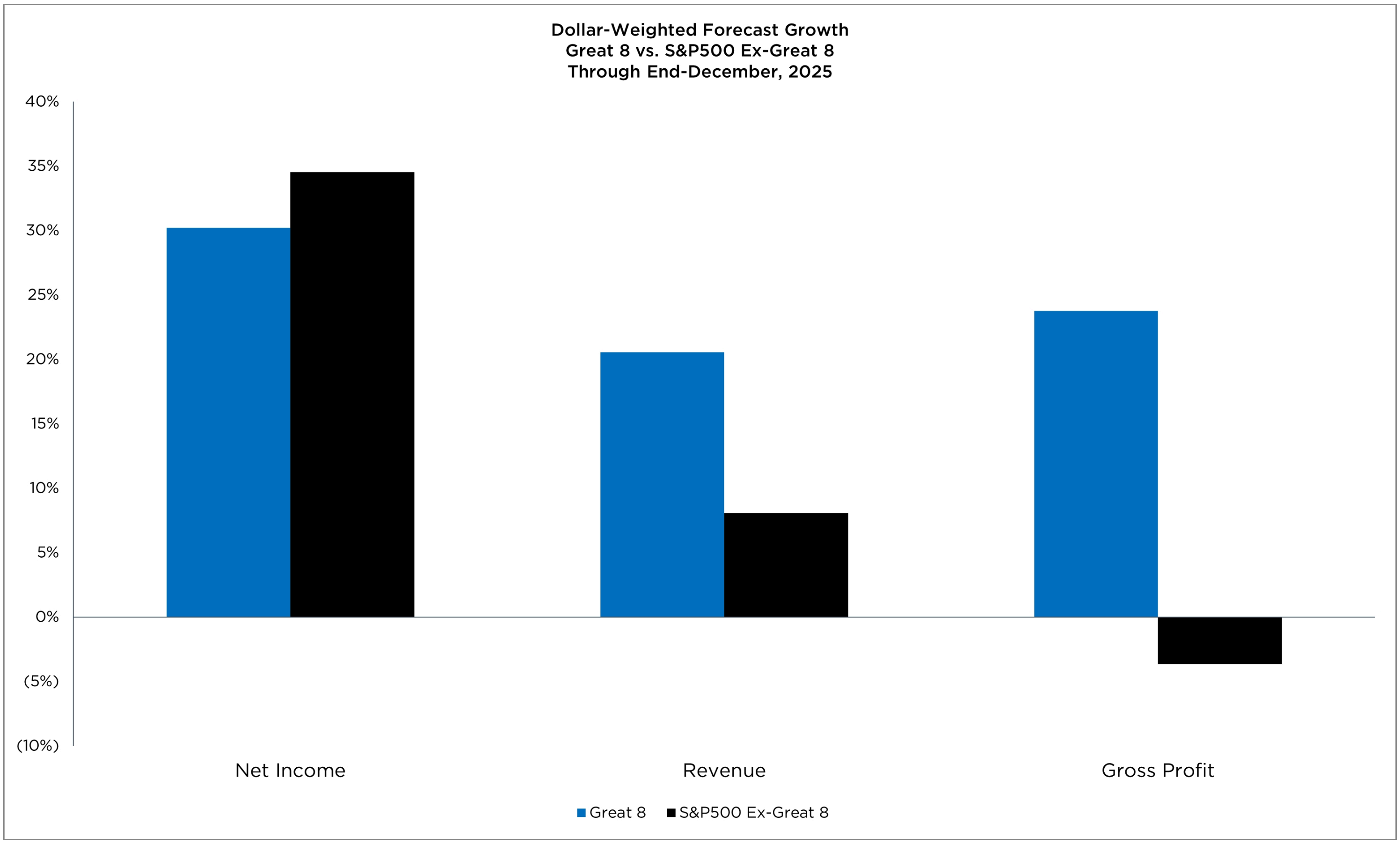
Source: Trivariate Research, LP

While the Great 8 are roughly 37% of the S&P500 by market cap., they represent on a dollar basis 13% of trailing revenue, 19% of trailing gross profit dollars, and 28.1% of trailing net income dollars in aggregate (see below blue bars). Looking at the bottom-up consensus estimates for the aggregate Great 8, they are forecasted to grow their gross profit dollars far faster than the combination of stocks 9 through 500 combined. As such, the Great 8's forecasted revenue moves to 14.9% of the total revenue of the S&P500, the gross profit dollars to 28.8%, and the net income dollars to 29.2% (black bars below).



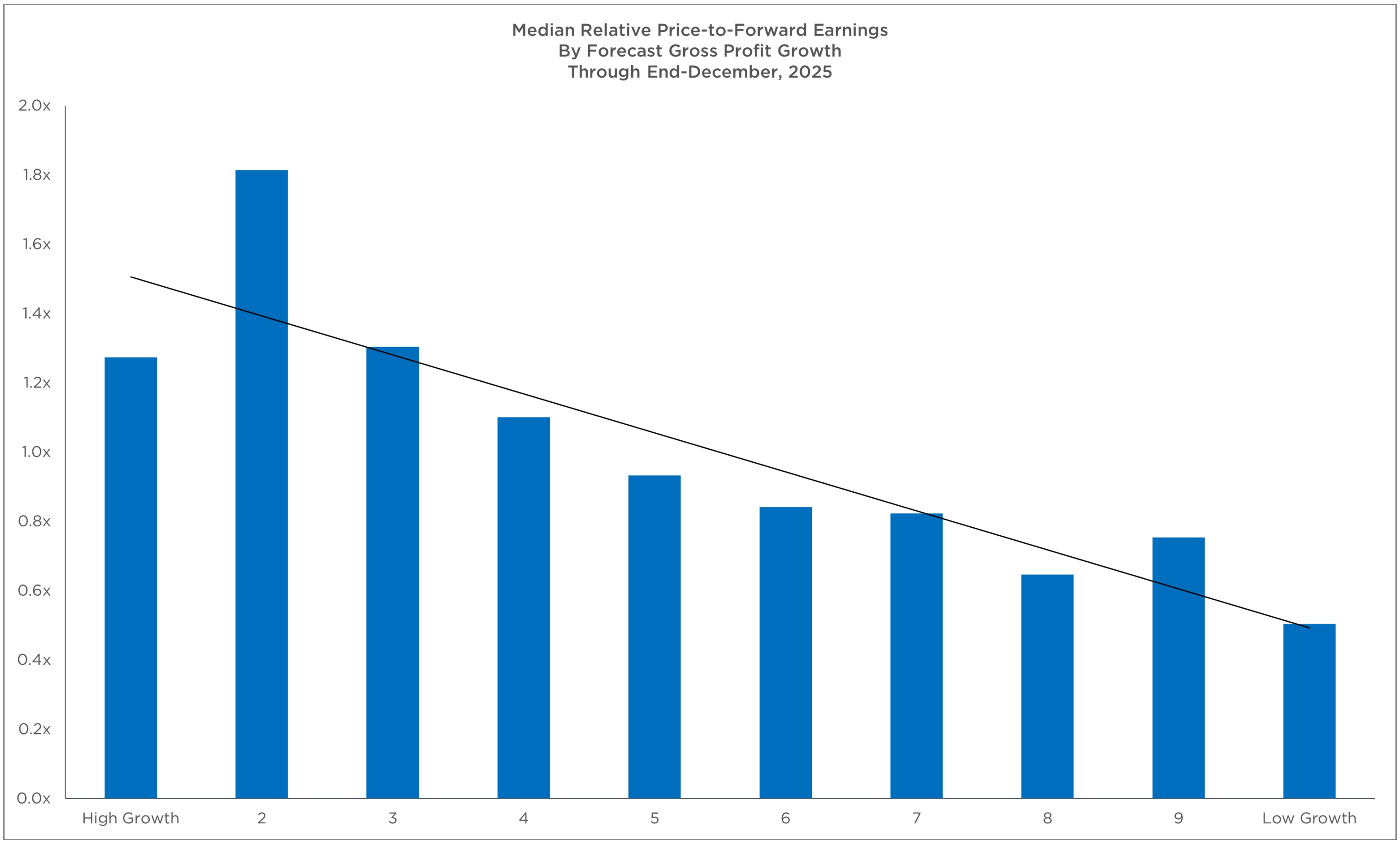
Source: Trivariate Research, LP

In terms of growth rates, the Great 8 are forecasted by the bottom-up consensus estimates to have 20.6% revenue growth, 23.8% growth profit dollar growth, and 30.2% net income dollar growth in 2026 vs. 2025. This compares to 8% revenue growth, but a decline of 3.4% in gross profit dollars, and an increase of 34.5% in net income dollars from stocks 9 through 500 combined by market cap. (see below). The bottom-up estimates embed a tremendous amount of net margin expansion - without gross margin expansion - for the "rest of market" outside of the Great 8, which likely means a lot of AI-related productivity.



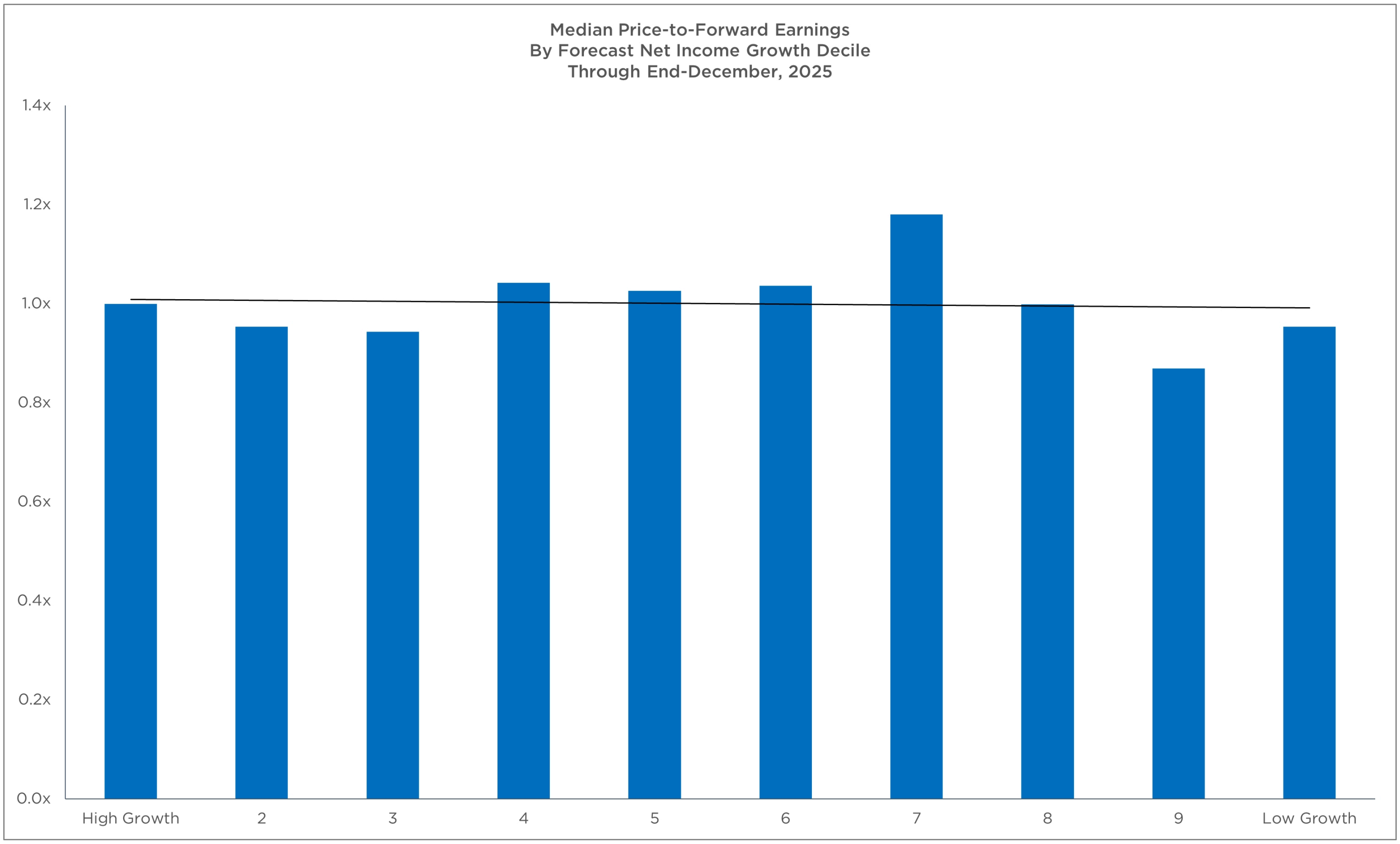
Source: Trivariate Research, LP

Historically, the market has rewarded gross profit growth. Below we show the median relative price-to-forward earnings for stocks in each gross margin growth decile. Generally, lower forecasted gross profit dollar growth companies trade at lower multiples than high gross profit dollar growth companies (see below).



Source: Trivariate Research, LP

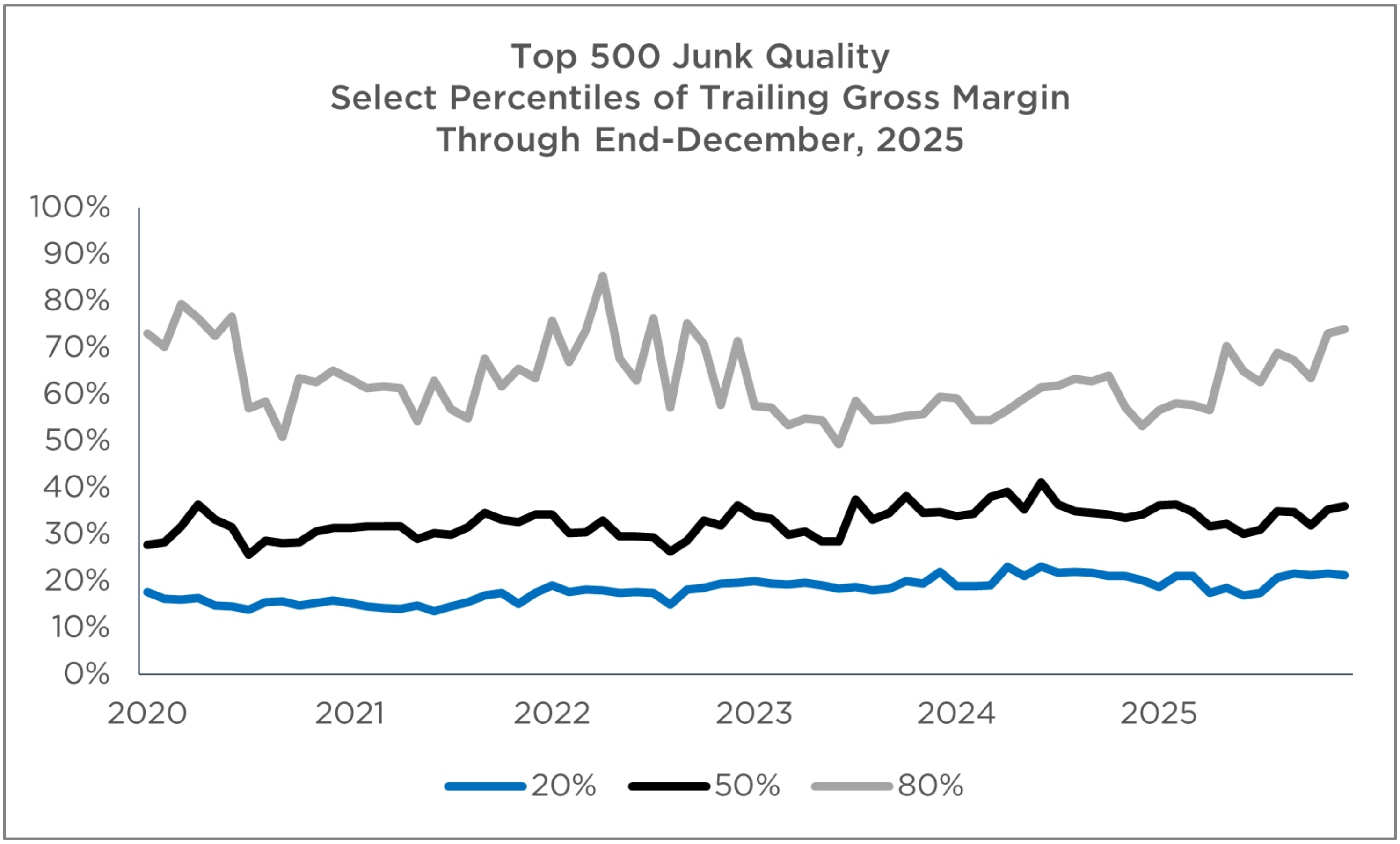
On the contrary, the price-to-forward earnings multiple does not appear to have a relationship to net income dollar growth. Below we show that stocks with low net income dollar growth trade at the same relative multiple as stocks with high net income dollar growth on average. We think this is worth highlighting, **because it implies that it is more likely that the price-to-forward earnings of the aggregate Great 8 expand than the rest of the stocks 9 through 500 by market cap., unless the estimates are way off, OR, the market changes how it rewards net margin growth relative to gross margin growth.**



Source: Trivariate Research, LP

Quality vs. Junk

Many investors have been surprised not only by the industry rotations, but by the strong move in Junk stocks to start the year. Goldman Sach's Non-Profitable Tech Index (GSXUNPTC) is up 15.7% year-to-date! Other hyper-growth junk proxies, like ARKK Innovation ETF is up 6.2% already this year. The biggest rationale we get from investors is that the skew toward Fed outcomes is more dovish, and that President Trump is going to do his best to create a helpful environment for consumers heading into the election. Perhaps part of the rally in Junk stocks can be explained by the fact that the top 20% of junk stocks are seeing some strong gross margin expansion of late.



Source: Trivariate Research, LP

Sentiment

Part of what we hope to accomplish in our weekly Level Sets is to capture sentiment. This past week we hosted a stock idea dinner, a cross-asset idea lunch, a risk-management focused dinner, and presented our year-ahead outlook with pushback, as well as dozens of client conversations. Here are our observations from the week:

1. Investors are nearly universally bullish. We literally couldn't get anyone in the risk-focused crowd to say they would position proactively for any risks. The only possible bear case we could agree would be a problem for US equites would be something that derailed the AI story, either a different and new "DeepSeek" moment, or too high or too low capital spending from the hyper-scalers in the coming quarter or two. Most investors think it is unlikely financial conditions will tighten.
2. **Non-US over US:** Many investors believe that the US underperforming last year is just the beginning of a large paradigm shift, and we heard several say they like Japan, China, and other Emerging Markets. One European CEO told us this week that if the US continues to threaten to take over Greenland, this could create a European recession, as business leaders in Europe get increasingly upset with the US policies -this is NOT in the price.
3. **Housing:** Several investors also expressed positive and negative views on Housing-related stocks over the past week - this is a battleground area for investors. Some think President Trump's desire to get the GSEs to buy mortgage-backed securities is a big stimulus, and the market has strongly rewarded most Housing-related securities year-to-date. Others think material gross margin problems will surface for the Homebuilders, as early as February. We heard a pitch to long TOLL (because their average home is $1 million) and short lower-end Homebuilders as a way to play the K-shaped Consumer through Housing-stocks, which we thought sounded reasonable. Given affordability still seems far away, our bias it to sell Housing-related stocks as they rally, not chase them.
4. **Financials:** This has been the worst performing sector year-to-date. We are recommending an Overweight in Financials, and are worried about it being a consensus long. That being said, the reason the sector is down in our view is that many of the large-cap. Banks reported Q4 earnings this week and their prints resulted in downward earnings revisions for 2026 and 2027. MS, GS and C were relatively strong, however the consensus downwardly revised their earnings outlooks for JPM, BAC, and WFC, and given their strong performance and positive sentiment, a modest sell-off isn't surprising. Some investors have asked us if rotating into the Alternative Asset Managers is a sensible way to get more "juice." Our bias is yes

at these levels, given how much KKR, BX, and APO, among others, have lagged the large cap. Banks. One investor pointed out to us last week that Bank M&A hasn't gone well for the acquirers. Our works show that acquirers generally lag, and we don't see anything disproportionately poor about Bank M&A relative to non-Bank M&A.

5. **Software is a battleground:** There appears to be some strong disagreement about the Software sector. Some think the sharp sell-off is justified, as the market is correctly identifying that major disruption is coming. Others think that businesses like NOW are quite sticky, and that the earnings season will show strong enough fundamental results to catalyze a market reversal. We actually think both could be right. We think the low expectations and low relative multiples could make for a good Software trade in the first half of this year. We are hearing that folks on the private equity side who focus on Software think this could be an ideal environment for deal-making, and perhaps that could catalyze some strong moves. However, our bias would be to sell many of these stocks if they bounced 20% or more, as concerns about many of their business models are likely not going to abate - meaning further multiple contraction is likely.
6. **NFLX saga:** We wrote when the initial NFLX deal was announced that this checked many "underperforming boxes." Growth companies doing part stock / part cash deals on average materially underperform. The stock lagged after, but last weeks all cash bid creates an improved distribution of outcomes, as all cash acquirers generally do far better than those doing stock or cash / stock combination deals.
7. **Healthcare:** The JPM Healthcare conference always generates a slew of news and updates of investor opinions on that sector. One takeaway theme that we gleaned is many of the major companies are continuing their "onshoring" theme, which is driving the strength in many Life Sciences & Tools, and Healthcare Technology companies (see TMO up 6.8% YTD, DGX up 9.2%, LH up 7.97% - all stocks we have highlighted as ones we like over the last year).

CONCLUSION

Most major companies will report earnings in the next two weeks, so we will get a tremendous amount of updated information not only on Q4, but also on how the first couple of weeks are progressing. Food inflation, hiring, consumer spend, lending, AI adoption, and many other big picture issues will continue to surface. We think the rally in lower quality Consumer and Industrial stocks will fade as fundamentals don't ultimately support the recent multiple expansion. We like Healthcare the most. Our call to like Software over Semis as a trade has been wrong - but we want to see earnings results and guidance before we throw in the towel.

Non-Technology Compounders

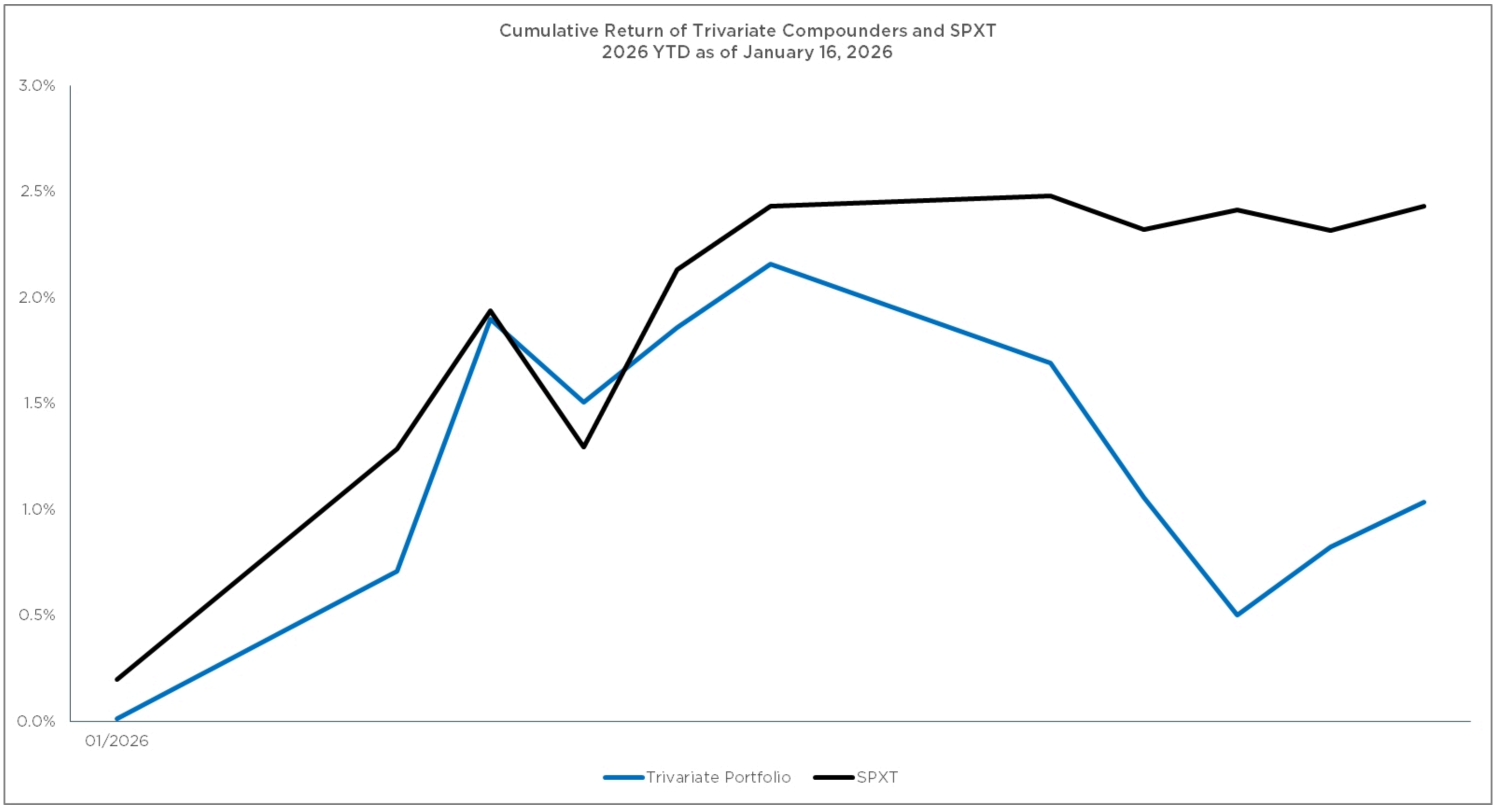
We launched a new ideas basket this year, which is 20 Non-Technology Compounders. Ideas below.

Trivector 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, LP

The portfolio is up 1.0% YTD, vs. its comparable index of 2.4%.



Source: Trivariate Research, LP

Important Disclosures

Analyst Certification

The analysts, Adam Parker, Maxwell Arnold, Colin Cooney, Chang Ge, Jesse Goodman and Ryan McGovern, responsible for the preparation of this research report certifies that: all the views expressed in this research report accurately reflect the research analyst's personal views.

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