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TRIVARIATE RESEARCH

HOW TO PUT JUNK IN YOUR TRUNK

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RESEARCH SUMMARY AND INVESTMENT CONCLUSIONS

Background: Over the past year, many investors have lamented the fall of high-quality stocks and the rise of junk stocks, making it challenging for those who don't change their investment philosophy to keep up with the market. Moreover, telling allocators you avoid high-quality stocks seems like a potentially poor marketing strategy. We have shown in our work however, that high-quality has lagged junk cumulatively over the last five years, and last week ([*Level Set – The Moving Parts*](#)), we showed that since 2019, the majority of high-quality stocks have seen multiple contraction, whereas the median junk stock has seen slight multiple expansion. Being an excellent, high-quality business, might mean you merit a higher multiple, but for the last six years, it has also meant modest multiple contraction. On the contrary, far more junk stocks have seen multiple expansion. Last week we published a note on what works within high-quality stocks ([*How To Pick High Quality Stocks Today*](#)). **Today, we thought it sensible to investigate the best way to pick junk stocks, and which to avoid.**

It's easier to pick junk stocks than high-quality stocks: Last week we utilized our 200+ variable factor library to determine what variables worked for picking stocks in the high-quality universe. We did the same for the junk universe in today's report, and our first observation is that generally, factors are FAR better for picking junk stocks than high-quality stocks. The top 10 signals have much higher Sharpe ratios for junk stocks than for high-quality stocks, **meaning investors looking to add select junk stocks to their portfolio can rely on quantitative screening MORE than for high-quality stocks.**

What works today?: We looked at our factor library to identify signals that were efficacious at predicting junk stock winners from junk stock losers since 2020. **Buying stocks with recent changes to earnings revisions, improvements in their quick ratio, and low EV-to-forecasted sales multiples was the best approach. Junk stocks with lower relative short interest also outperform.**

INVESTMENT CONCLUSIONS

Junk has performed well because revisions have improved: On a year-over-year change basis, the percentage of junk stocks beating estimates is higher than the percentage of high-quality stocks beating estimates, which is also near highs. **An important partial explanation for the reason junk stocks have performed well is the rate of change of upward earnings revisions.** From 2000 to 2019 there was not much difference in junk stock performance between stocks with high upward earnings revisions and those with average revisions. But since 2020, and particularly in the last several months, junk stocks with 1-month forward upward revisions have strongly outperformed all other junk stocks. **Buying junk stocks with strong earnings revisions trends has been key.**

Low short interest works: Over the long-term, junk stocks with low short interest (the lowest two quintiles) outperform. **Our conclusion is to buy junk stocks with low short interest, but we wouldn't necessarily short junk stocks with high short interest!**

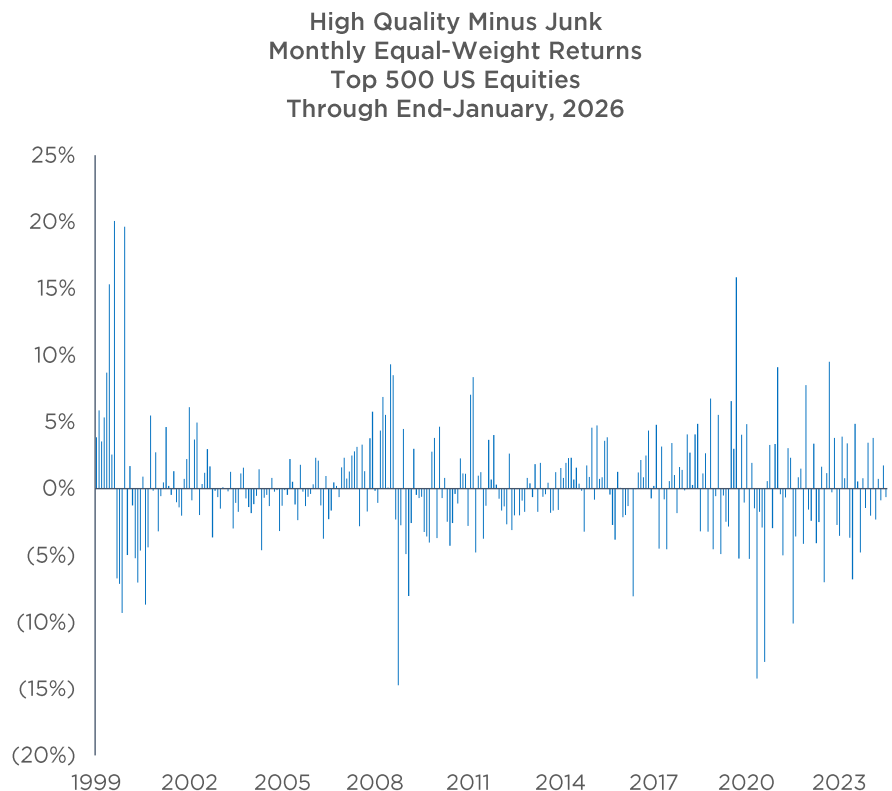
Avoid deteriorating quick ratios: Junk stocks with deteriorating quick ratios have consistently lagged other junk stocks, as any incremental balance sheet stress is clearly a negative. Recently, since 2020, junk stocks with improving quick ratios have strongly outperformed junk stocks with declining quick ratio growth, though our assessment is that it is more important to avoid junk stocks with deteriorating short-term balance sheet fundamentals.

Valuation has been ineffective: Since 2020, both free cash flow yield and price-to-forward earnings have waned in their efficacy for stock selection among junk stocks.

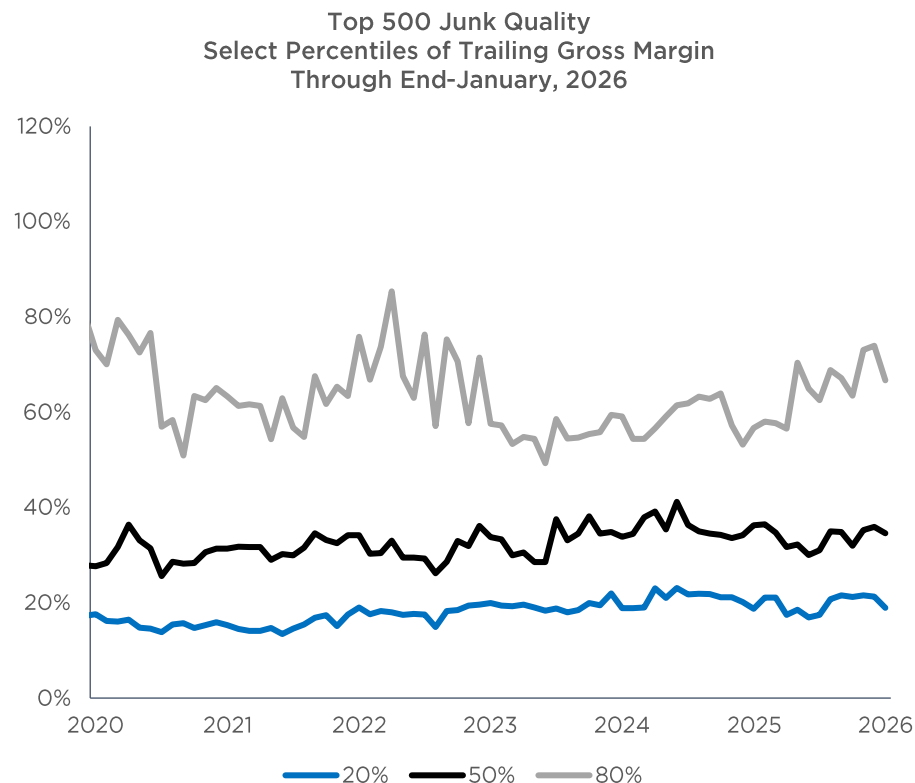
For long and short ideas, see Slide 14. Long ideas are stocks with upward earnings revisions and in the bottom-quintile of short interest and include FCX, COHR, and BE, among others. Shorts have negative earnings revisions, higher short interest, and deteriorating quick ratios, and include IP, H, RRX, and PRMB, among others.

HIGH-QUALITY HAS LAGGED JUNK FOR NEARLY FIVE YEARS

Part of the reason performance has been challenging for many portfolio managers despite the large number of stocks with dramatic moves is that high-quality stocks have lagged, and junk stocks have ripped higher. The relative weakness of high-quality stocks vs. junk stocks (left) has persisted for nearly five years. 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 (right).



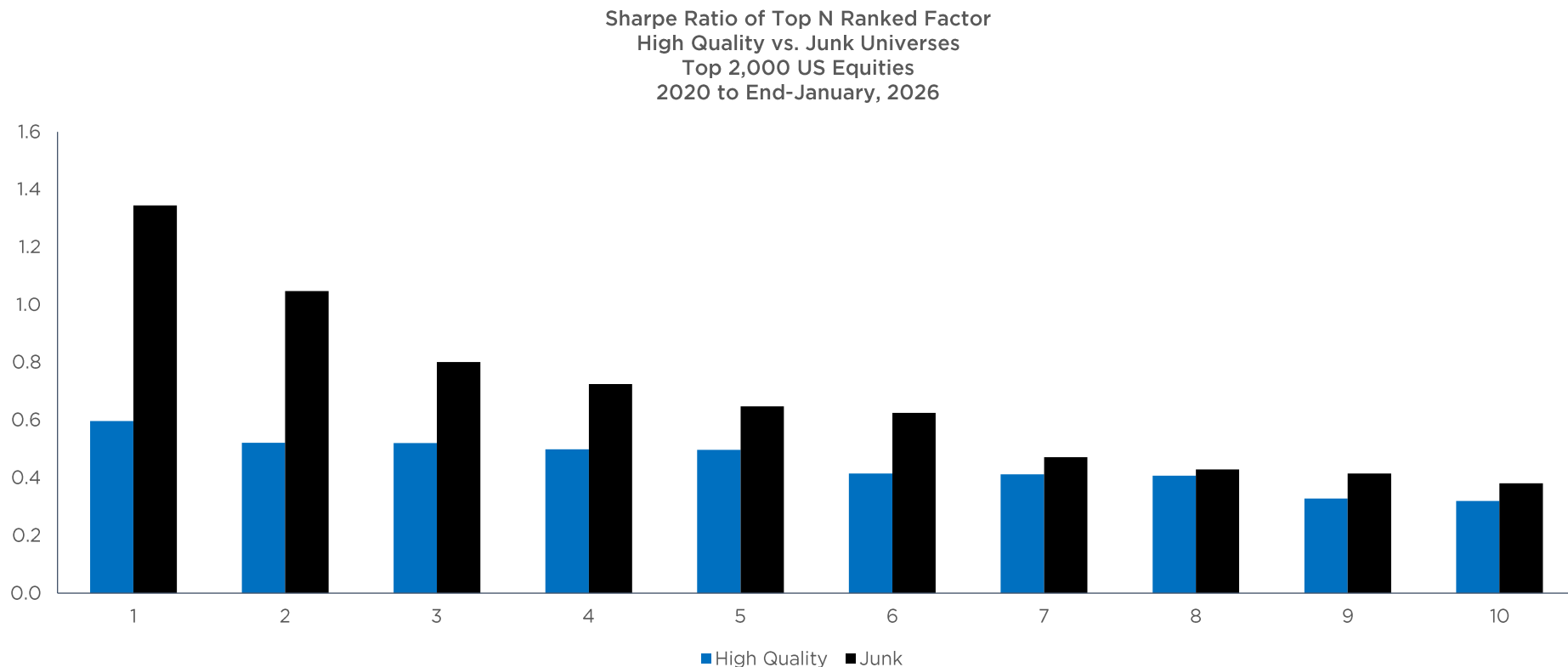
Source: Trivariate Research



Source: Trivariate Research

FACTORS WORK BETTER FOR JUNK THAN FOR HIGH-QUALITY

Last week we utilized our 200+ variable factor library to determine what variables worked for picking stocks in the high-quality universe. We did the same for the junk universe today, and our first observation is that generally factors are FAR better for picking junk stocks than high-quality stocks. The top 10 signals have much higher Sharpe ratios for junk stocks (black bars) below than for high-quality (blue bars), meaning investors looking to add select junk stocks to their portfolio can rely on quantitative screening MORE than for high-quality stocks.



Source: Trivariate Research

UPWARD EARNINGS REVISIONS AND IMPROVING QUICK RATIO WORK

We looked at our factor library to identify signals that were efficacious at predicting junk stock winners from junk stock losers since 2020. Buying stocks with recent changes to earnings revisions, improvements in their quick ratio, and low EV-to-forecasted sales multiples was the best approach. Junk stocks with low short interest also outperform.

Best and Worst Performing Signals in Junk Quality Universe Since 2020
Top 2k US Equities
As of End-January, 2026

Signal	Annualized Mean Return	Annualized Std. Dev of Returns	Sharpe Ratio	Hit Rate
1-Month % Change in Fwd EPS	17.5%	13%	1.34	67%
Quick Ratio Growth	9.6%	9%	1.05	68%
EV-to-Forecast Sales	13.3%	17%	0.80	55%
Short Interest-to-Value Traded	7.6%	11%	0.73	62%
Forecast Net Margin Expansion	7.7%	12%	0.65	59%
252-Day Momentum	15.7%	25%	0.63	67%
Accruals	6.9%	15%	0.47	53%
3-Month Momentum	8.4%	20%	0.43	60%
Indicated Dividend Coverage Ratio	4.7%	11%	0.41	60%
Beta	10.0%	26%	0.38	52%
Capital Expenditure-to-Sales	(3.1%)	16%	(0.19)	51%
Revenue Growth	(3.5%)	18%	(0.19)	45%
Net Margin	(3.3%)	17%	(0.20)	45%
Forecast Gross Margin	(3.8%)	17%	(0.22)	45%
R&D-to-Sales	(6.7%)	25%	(0.27)	42%
Net Debt-to-Market Cap.	(5.0%)	19%	(0.27)	48%
Forecast Revenue Growth	(4.2%)	15%	(0.28)	52%
Operating Margin	(5.9%)	20%	(0.30)	48%
Distance-to-Default	(7.5%)	23%	(0.33)	49%
Avg. Incremental Gross Margin (Trailing 12Q)	(4.1%)	12%	(0.35)	47%

Source: Trivariate Research

THERE'S BEEN A CHANGE IN WHAT SIGNALS TO USE FOR JUNK STOCKS

We then compared what has worked since 2020 with what had worked from 1999 to see where history has not been helpful of late. Earnings revisions, momentum, and quick ratio have worked better recently than during history. Price-to-forward earnings, capital intensity, and free cash flow yield have failed since 2020 and have been far worse than history.

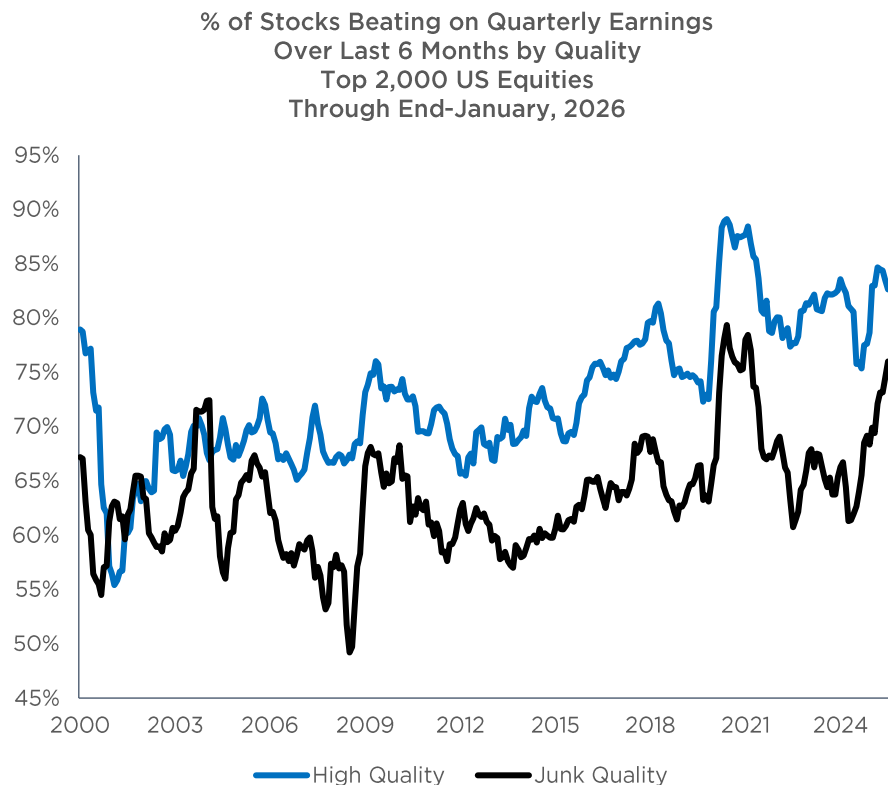
Signals with Largest Delta Between Since 2020 Mean Return and Since 1999 Mean Return
Junk Quality Universe, Top 2k US Equities
As of End-January, 2026

Signal	Since 2020 Sharpe Ratio	Since 1999 Sharpe Ratio	Difference In Sharpe Ratio	Since 2020 Annualized Mean Return	Since 1999 Annualized Mean Return	Difference In Mean Return
1-Month % Change in Fwd EPS	1.34	0.41	0.94	17.5%	4.8%	12.8%
252-Day Momentum	0.63	0.20	0.42	15.7%	5.4%	10.3%
Quick Ratio Growth	1.05	0.29	0.76	9.6%	2.3%	7.3%
Beta	0.38	0.10	0.28	10.0%	2.7%	7.3%
3-Month Momentum	0.43	0.14	0.28	8.4%	3.0%	5.4%
Forecast Gross Margin Growth	0.22	(0.07)	0.29	3.7%	(0.9%)	4.7%
Forecast Net Margin Expansion	0.65	0.28	0.37	7.7%	3.4%	4.2%
Short Interest-to-Value Traded	0.73	0.41	0.32	7.6%	4.3%	3.3%
EV-to-Forecast Sales	0.80	0.71	0.09	13.3%	10.7%	2.6%
Forecast Revenue Growth	(0.28)	(0.34)	0.06	(4.2%)	(6.1%)	1.9%
Inventory-to-Sales	(0.15)	0.05	(0.20)	(3.1%)	0.7%	(3.8%)
Price-to-Earnings	(0.17)	0.08	(0.26)	(2.9%)	1.3%	(4.2%)
Total Yield (Trailing)	0.06	0.34	(0.28)	1.2%	5.4%	(4.2%)
Indicated Total Yield	0.02	0.32	(0.29)	0.5%	5.1%	(4.6%)
Distance-to-Default	(0.33)	(0.13)	(0.20)	(7.5%)	(2.9%)	(4.7%)
R&D-to-Sales	(0.27)	(0.08)	(0.19)	(6.7%)	(1.9%)	(4.8%)
Operating Margin	(0.30)	(0.03)	(0.28)	(5.9%)	(0.5%)	(5.4%)
Free Cash Flow Yield	(0.05)	0.39	(0.44)	(0.7%)	5.2%	(5.9%)
Capital Expenditure-to-Sales	(0.19)	0.29	(0.48)	(3.1%)	4.1%	(7.2%)
Price-to-Forward Earnings	(0.05)	0.36	(0.41)	(1.2%)	6.8%	(7.9%)

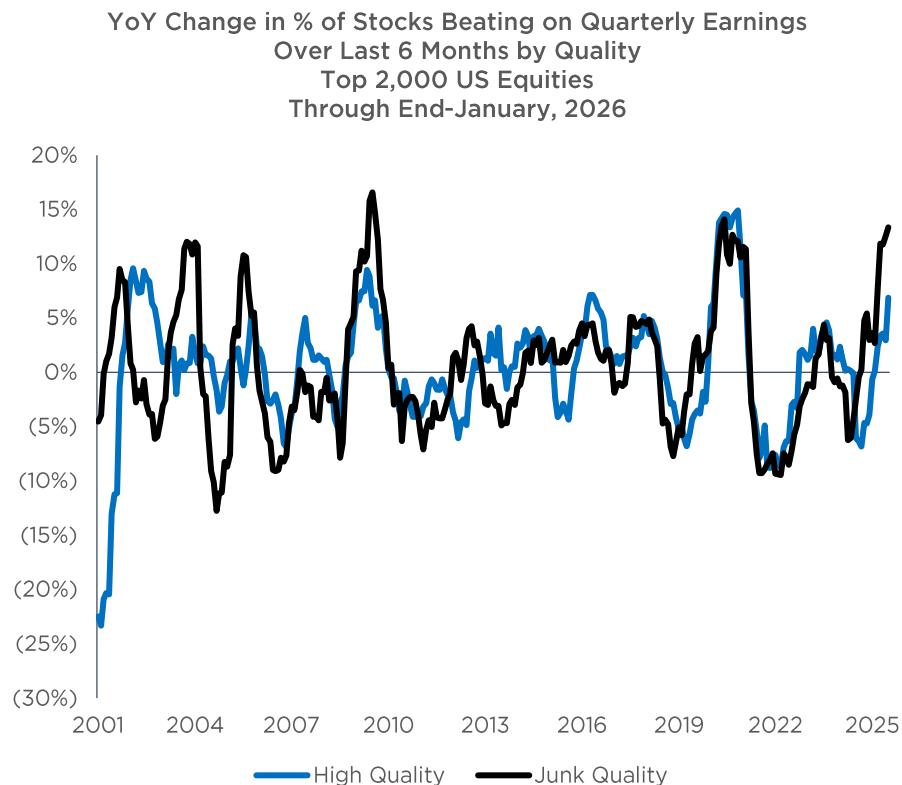
Source: Trivariate Research

EPS REVISIONS ARE A PRIMARY REASON JUNK HAS PERFORMED WELL

While it is easy to say that high-quality “should” outperform junk stocks, the facts are that the percentage of junk stocks beating on earnings is near all-time highs, having only been higher following COVID in the last 25 years (left). On a year-over-year change basis, the percentage of junk stocks beating estimates is higher than the percentage of high-quality stocks beating quarterly estimates (right), which is also near highs. An important partial explanation for the reason junk stocks have performed well is the rate of change of upward earnings revisions.



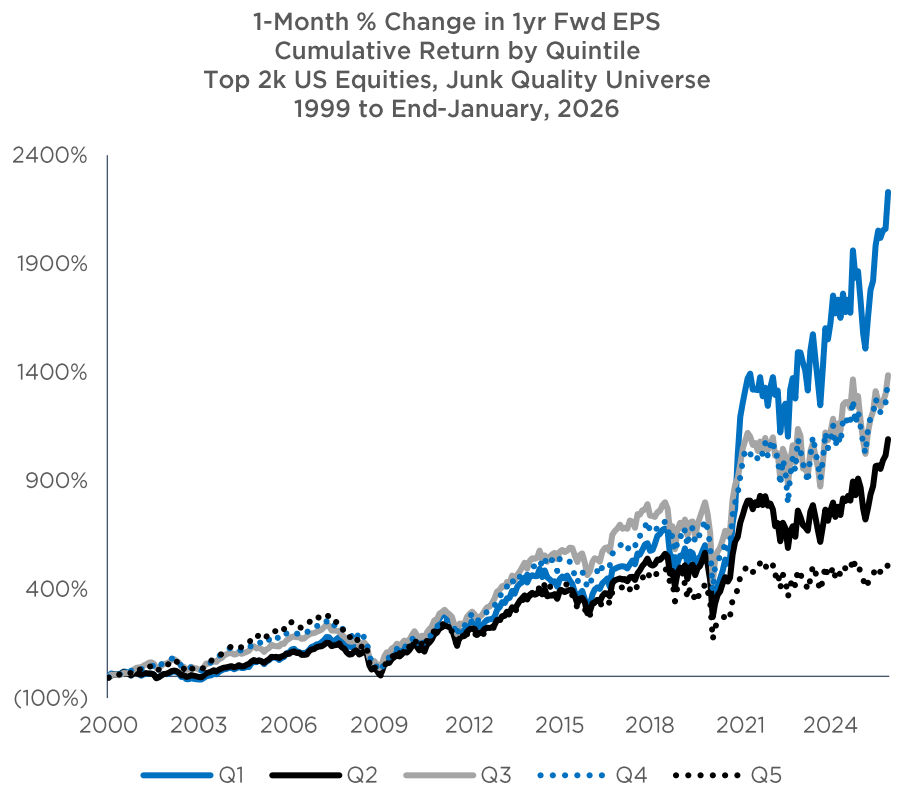
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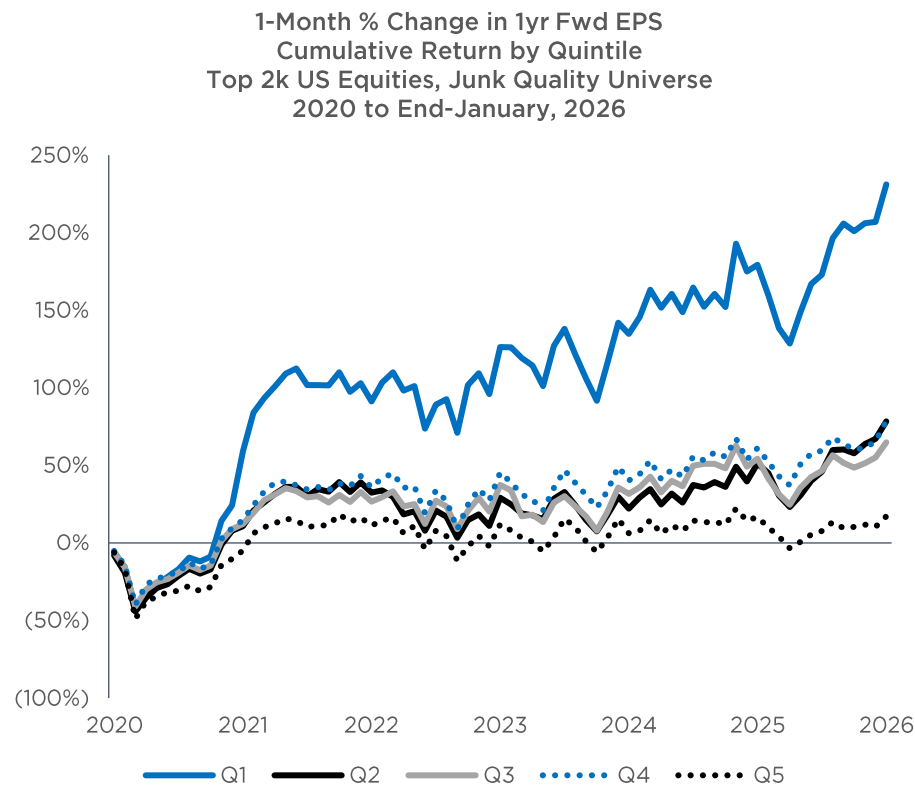
Source: Trivariate Research

IN PARTICULAR, 1-MONTH REVISIONS HAVE WORKED RECENTLY

From 2000 to 2019 there was not much difference in junk stock performance between stocks with high upward earnings revisions and those with average revisions (left). But since 2020, and particularly in the last several months, junk stocks with 1-month forward upward revisions have strongly outperformed all other junk stocks (right).



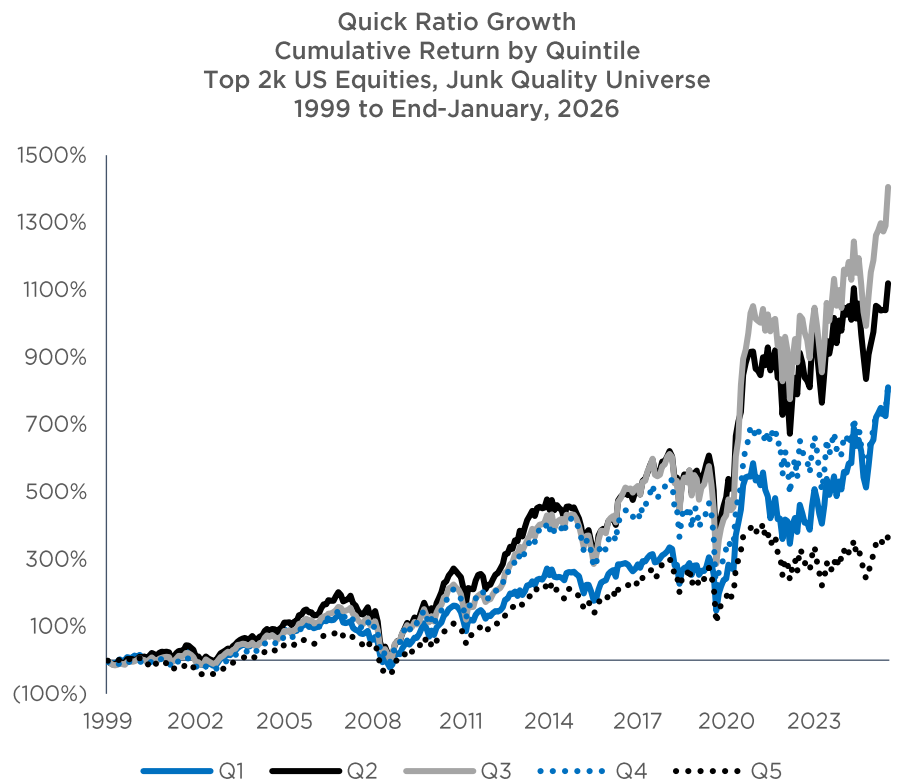
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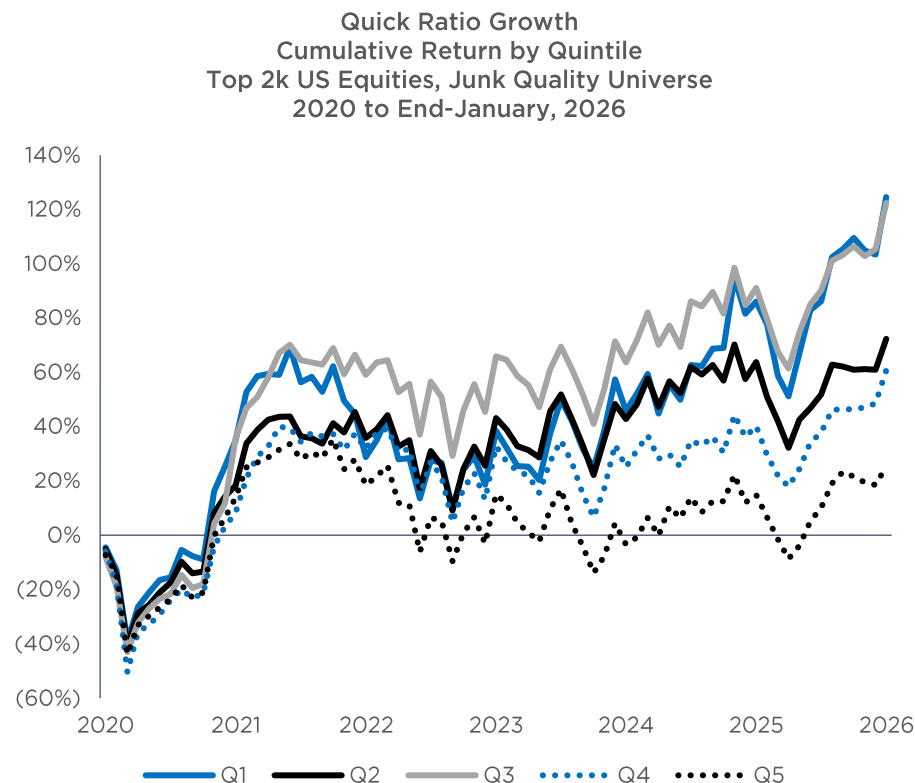
Source: Trivariate Research

AVOID JUNK STOCKS WITH DETERIORATING QUICK RATIO GROWTH

Junk stocks with deteriorating quick ratios have consistently lagged other junk stocks, as any incremental balance sheet stress is clearly a negative. Recently, since 2020, junk stocks with improving quick ratios have strongly outperformed junk stocks with declining quick ratio growth (right), though our assessment it is more important to avoid junk stocks with deteriorating short-term balance sheet fundamentals.



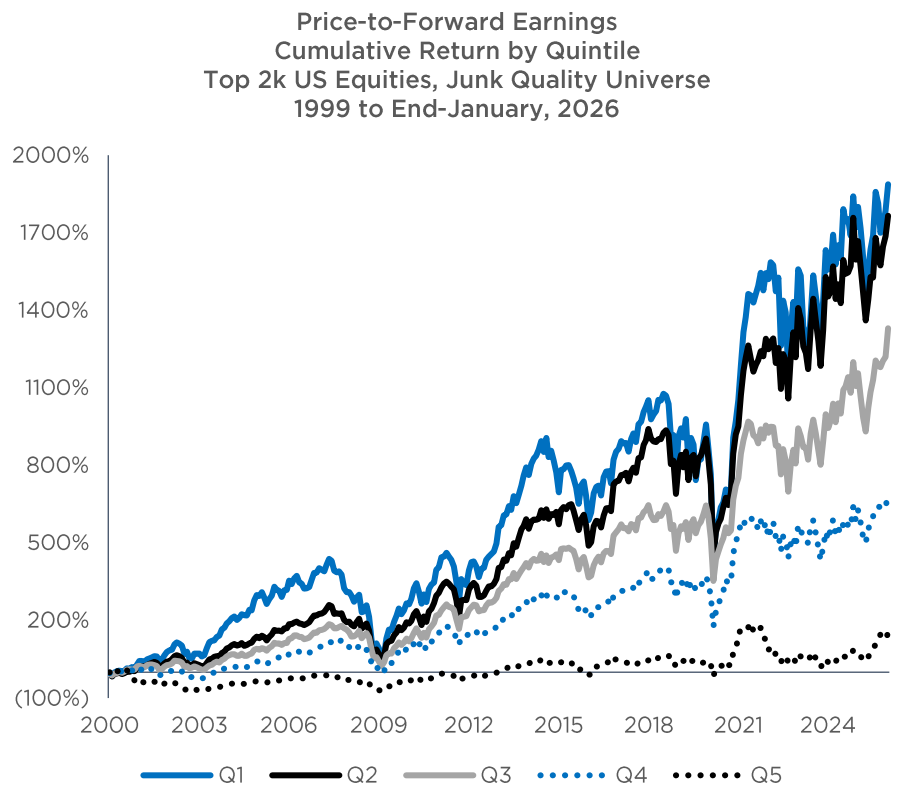
Source: Trivariate Research



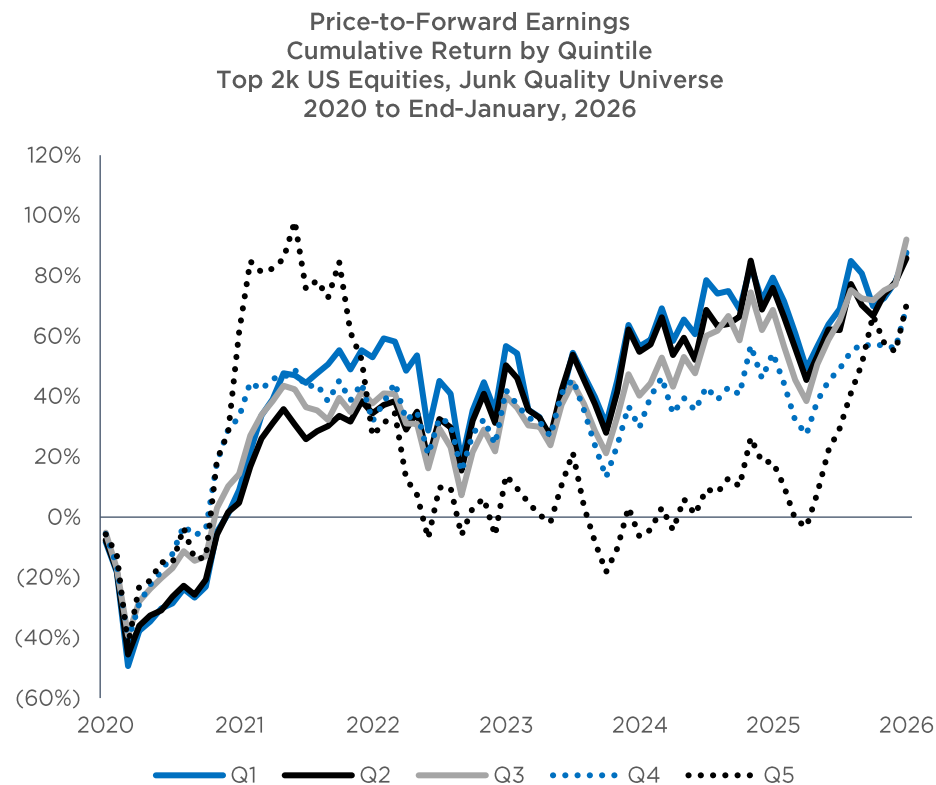
Source: Trivariate Research

PRICE-TO-FORWARD EARNINGS HASN'T WORKED SINCE COVID...

Over the long-term, from 1999-present, buying cheap junk stocks was better than buying expensive junk stocks (left). However, since 2020, expensive junk stocks have done well, particular in the last year, making the long-short spread on price-to-forward earnings as a signal for junk stock selection ineffective (right).



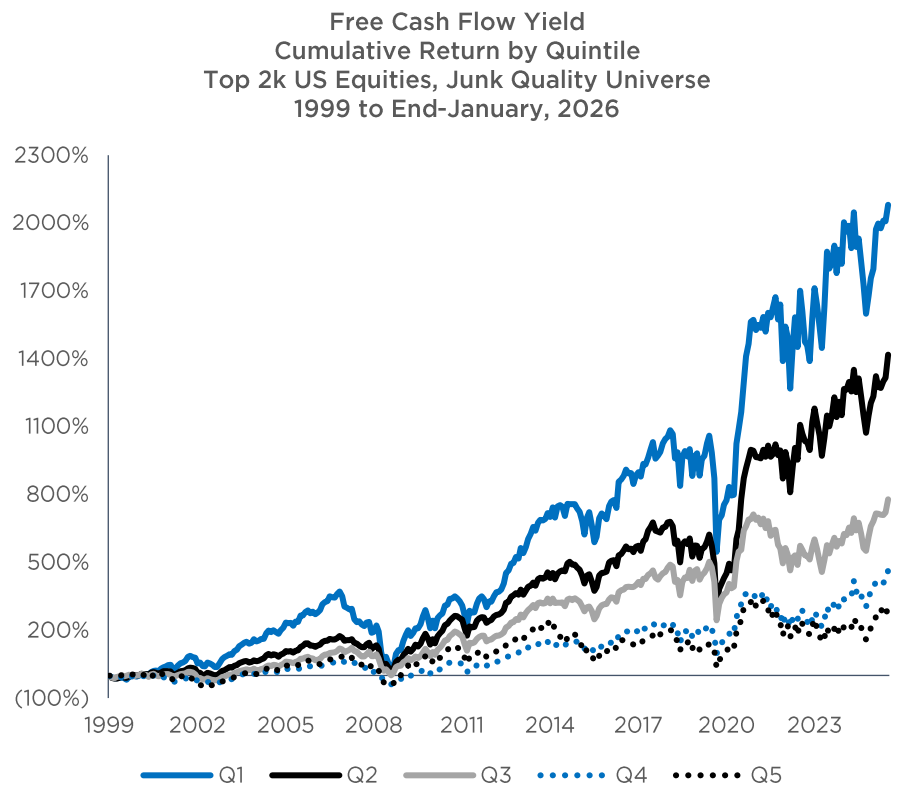
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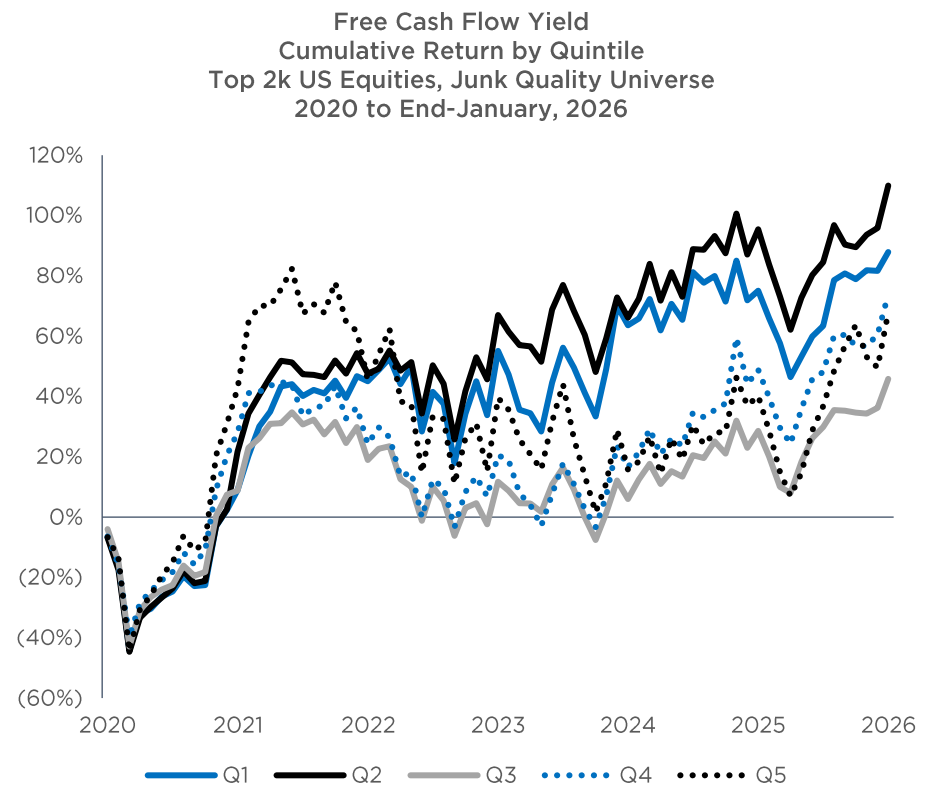
Source: Trivariate Research

...NEITHER HAS FREE CASH FLOW YIELD

As was the case for price-to-forward earnings, the long-term data (left) show that junk stocks that are cheap on free cash flow yield outperform junk stocks that are expensive. However, the spread has narrowed recently, with the second cheapest quintile performing best, and the middle quintile the worst since 2020 (right).



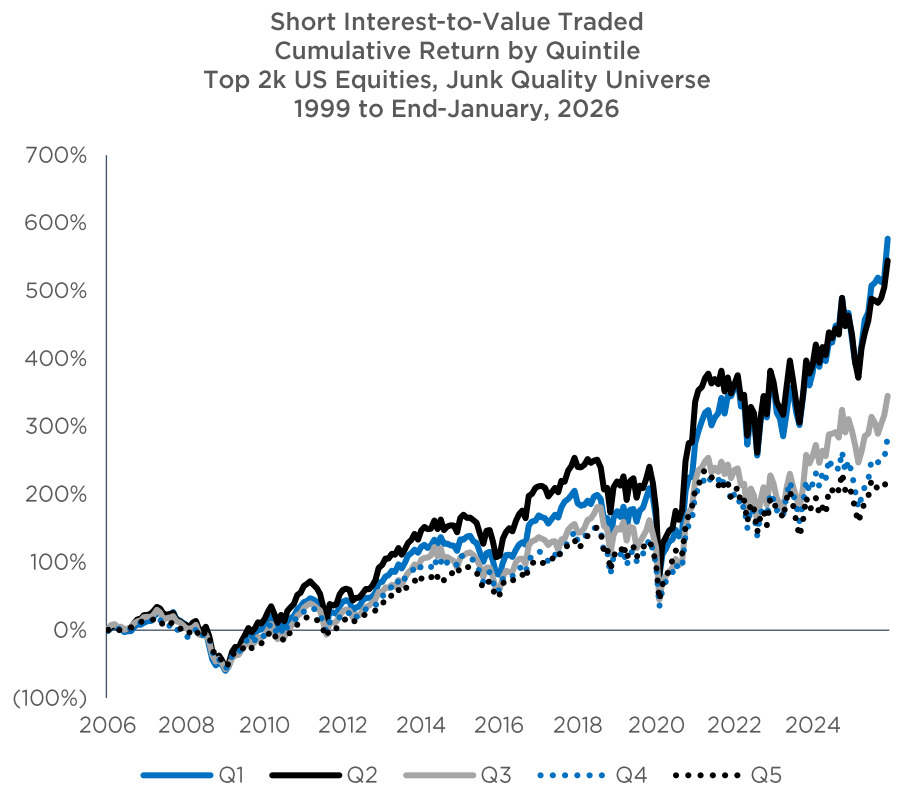
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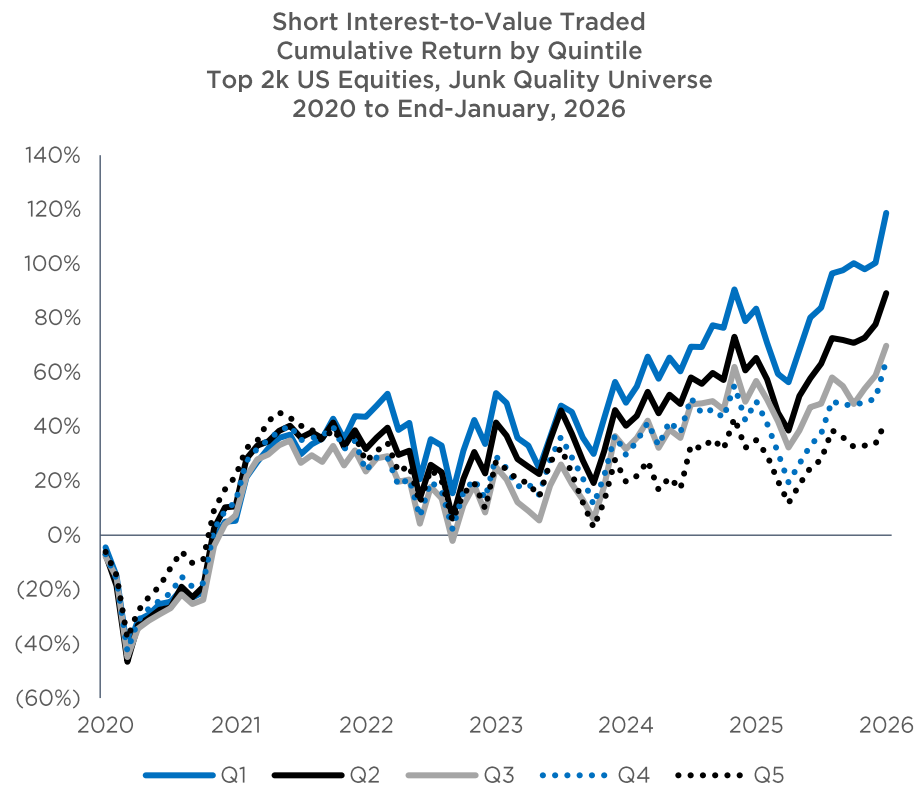
Source: Trivariate Research

BUY JUNK STOCKS WITH LOW SHORT INTEREST

Over the long-term, junk stocks with low short interest (the lowest two quintiles) outperform (left). Since COVID, junk stocks with low short interest has strongly outperformed. Our conclusion is to buy junk stocks with low short interest, but we wouldn't necessarily short junk stocks with high short interest!



Source: Trivariate Research



Source: Trivariate Research

QUANTITATIVELY DERIVED LONG / SHORT JUNK-QUALITY IDEAS

Long ideas are stocks with upward earnings revisions and in the bottom-quintile of short interest (left) and include FCX, COHR, and BE, among others. Short ideas (right) have negative earnings revisions, higher short interest, and deteriorating quick ratios, and include IP, H, RRX, and PRMB, among others.

Junk Quality Long Ideas, Top 2k US Equities
Top Quintile of 1-Month % Change in Fwd EPS
& Bottom Quintile Short Interest
As of End-January, 2026

Ticker	Company	Sector	Market Cap. (US \$Bn.)
FCX	Freeport-McMoRan	Materials	86.49
COHR	Coherent Corp.	Information Technology	36.22
BE	Bloom Energy	Industrials	35.80
AA	Alcoa Corporation	Materials	14.84
AVAV	AeroVironment, Inc.	Industrials	13.84
IVZ	Invesco Ltd.	Financials	12.12
FHN	First Horizon Corporation	Financials	11.88
LW	Lamb Weston Holdings, Inc.	Consumer Staples	6.38
AEO	American Eagle Outfitters	Consumer Discretionary	3.95
BKU	BankUnited, Inc.	Financials	3.52
DAN	Dana Incorporated	Consumer Discretionary	3.25
SBLK	Star Bulk Carriers Corp.	Industrials	2.61
NEXA	Nexa Resources S.A.	Materials	1.67
MLKN	MillerKnoll, Inc.	Industrials	1.37
THS	TreeHouse Foods, Inc.	Consumer Staples	1.24

Source: Trivariate Research

Junk Quality Short Ideas, Top 2k US Equities
Bottom Quintile of 1-Month % Change in Fwd EPS, Top 40% Short Interest,
& Bottom 40% Quick Ratio Growth
As of End-January, 2026

Ticker	Company	Sector	Market Cap. (US \$Bn.)
IP	International Paper Company	Materials	21.29
H	Hyatt Hotels Corporation	Consumer Discretionary	14.85
RRX	Regal Rexnord Corporation	Industrials	10.72
PRMB	Primo Brands Corporation	Consumer Staples	6.93
RDNT	RadNet, Inc.	Health Care	5.42
GPK	Graphic Packaging Holding Company	Materials	4.32
RHI	Robert Half Inc.	Industrials	3.46
CRGY	Crescent Energy Company	Energy	3.14
ARCB	ArcBest Corporation	Industrials	2.03
SLVM	Sylvamo Corporation	Materials	1.93
CSWC	Capital Southwest Corporation	Financials	1.35

Source: Trivariate Research

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