

## Level Set - Volatility, Bank Efficiency, Software, Semis,

### Thoughts on Volatility

There have been two different types of volatility introduced into individual equities over the last couple of months, and this came up in nearly all of our client meetings last week.

The first type is the list of companies potentially disrupted by AI.

Besides the now obvious stocks in Software sector, this list includes industries that caught some investors off-guard, including:

1. **AI Tools automating financial work flows:** LPL, RJF, SCHW, AMP, and SF.
2. **Commercial real estate services firms labor and fee compression:** CBRE, JLL, CWK
3. **AI Freight tools:** CHRW, RXO, EXPD, LSTR
4. **Insurance workflow:** WTW, AJG, MRSH, BRO, GSHD

While several of these stocks bounced higher late last week, we remain concerned that these stocks are “guilty until proven innocent”, meaning they are more likely to have multiple contraction than expansion for the foreseeable future. We think a useful exercise for investors is to imagine that they are the CEO of a company and focus on businesses that are making a high margin off of them. This likely means certain data companies, and other expensive service companies are vulnerable.

The other industries where volatility has been introduced comes more from the Trump administration. The list here includes:

1. Credit cards fee caps: AXP, COF, V, MA
2. GSEs buying MBS; FNMA, FMCC
3. Homebuilders anti-trust: LEN, PHM, TOLL, TMHC, NVR, etc.
4. Metals tariff rollbacks: CLF, NUE, STLD

Here, our sense is investors are more likely to ignore the short-term stock and industry reactions and that the subsequent price action is more case by case. For instance, we are far less compelled today than we used to be by V and MA as an investor pointed out to us last week, their case for multiple expansion and revenue acceleration is weak. However, we are more intrigued by Metals, as they are likely in a more benign demand growth vs. supply growth position for the foreseeable future, and discounting less AI growth than Semiconductor memory or Industrials like CAT.

The bottom line is this: when there is uncertainty, we should pay a lower multiple for equities than when there is certainty. We reiterate the view laid out in our 2026 year-ahead outlook that the probability of multiple contraction for the US equity market this year is greater than the probability of multiple expansion. That makes us more bearish than consensus.

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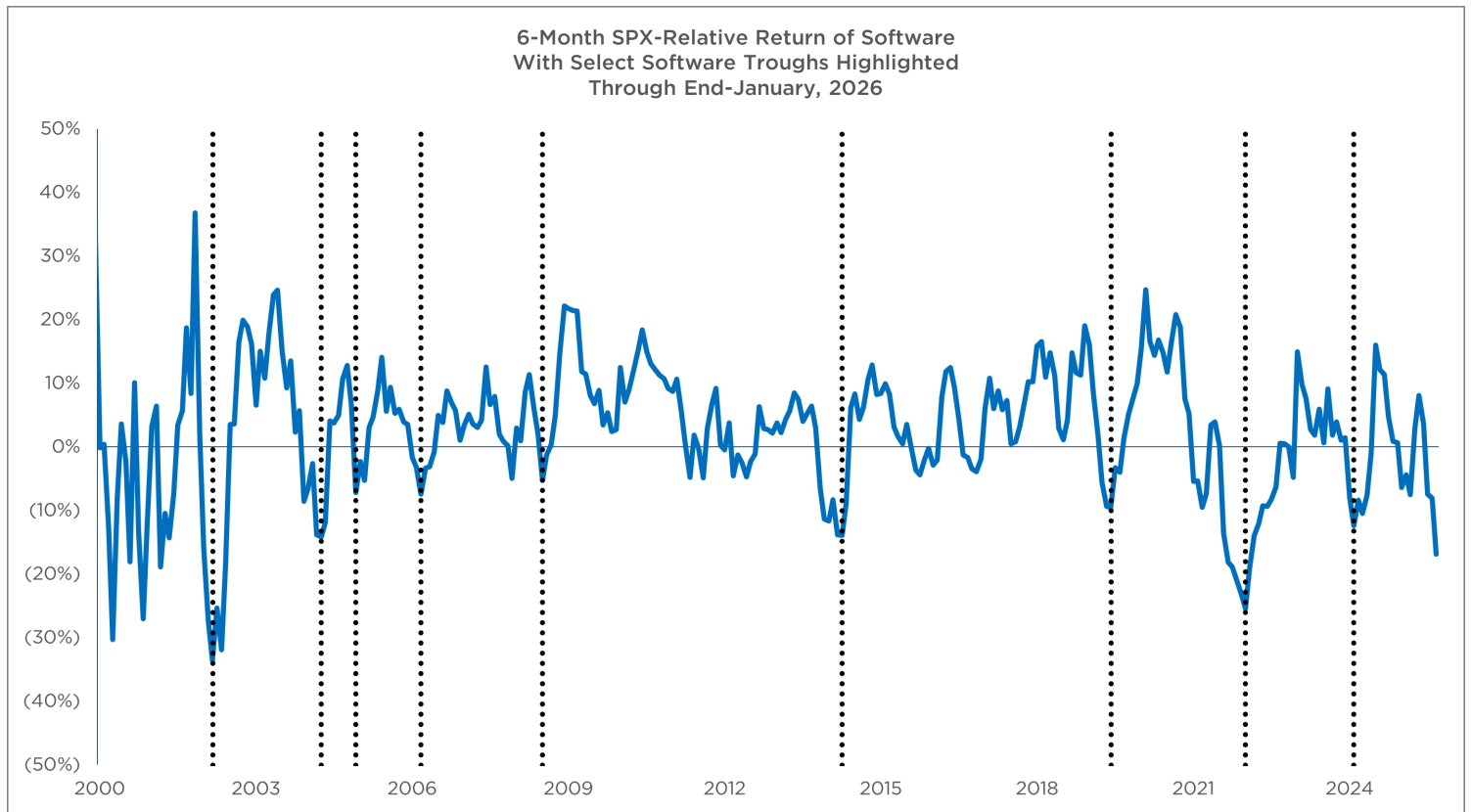
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## What to Do With Software?

In many of our meetings last week, investors asked us about the Software industry, with most believing that at least some of the major stocks are oversold. The S&P500 Software and Services index is already down over 19% this year, and most investors mentioned the compelling valuation of Salesforce (CRM) as an example of the industry being attractively valued after the huge sell-off. To be clear, we continue to think the probability that Software multiples contract is higher than the probability they expand. However, it will certainly be true that the revenue estimate achievability for some Software stocks will be better than others, and it makes sense to think about adding select Software stocks. However, our view is you should add the MORE expensive Software stocks, not the cheaper ones. The stocks that are more expensive in absolute terms, like Security (PANW, FTNT) or EDA (CDNS, SNPS) are more expensive for a reason - the market has concluded that their 5-year forward Technological obsolescence risk is lower.

**What is interesting though, is that it is not really a new thought.** We looked at the last several times Software industry EV-to-sales multiples have contracted sharply over a rolling six-month period. The nine periods we evaluated are shown below.



Source: Trivariate Research, LP

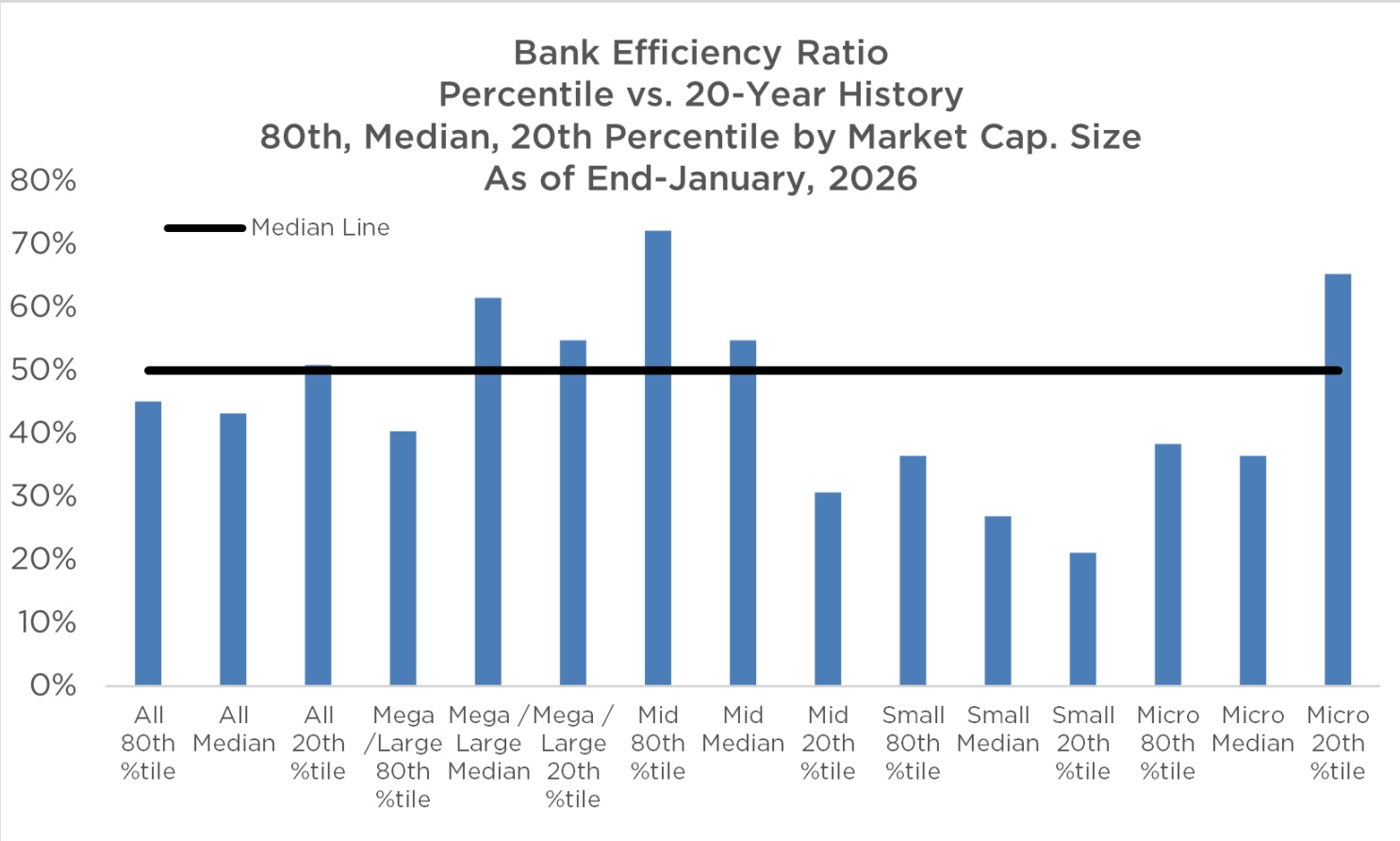
We then observed after these periods how valuation worked for picking Software stocks following these Software sell-offs. It is quite consistent since 2005 - so for the last 20 years - that buying the most expensive Software companies OUTPERFORMS buying the cheapest Software companies for the six-months following these valuation corrections. **Our judgment: if you want to add a Software name, add a fast-growing expensive one, like PANW, FTNT, SNPS, or CDNS, not CRM because it's cheap.**

Software Industry EV-to-Sales Factor Efficacy Factor Efficacy Six Months After Valuation Correction							
Date	6-Month Trailing Performance	Cheapest Quintile	Q2	Q3	Q4	Most Expensive Quintile	Q5-Q1 Spread
7/31/2002	(33.6%)	25.5%	6.0%	11.3%	19.4%	(1.6%)	(27.1%)
8/31/2004	(14.2%)	26.5%	23.6%	34.9%	24.7%	7.5%	(19.0%)
4/29/2005	(7.2%)	13.5%	21.7%	23.1%	19.2%	25.1%	11.6%
7/31/2006	(7.4%)	29.0%	25.6%	16.1%	19.2%	25.1%	(3.9%)
11/28/2008	(5.3%)	14.8%	22.8%	32.9%	15.7%	30.7%	15.9%
8/29/2014	(13.9%)	15.7%	7.4%	11.7%	23.8%	18.6%	2.8%
10/31/2019	(9.5%)	(0.5%)	(2.8%)	(3.8%)	12.6%	21.1%	21.6%
5/31/2022	(25.4%)	(8.3%)	(8.4%)	(14.2%)	0.5%	(6.0%)	2.3%
6/28/2024	(12.4%)	16.0%	11.4%	27.3%	15.3%	38.0%	22.0%

Source: Trivariate Research, LP

## Some Concerns About Financials

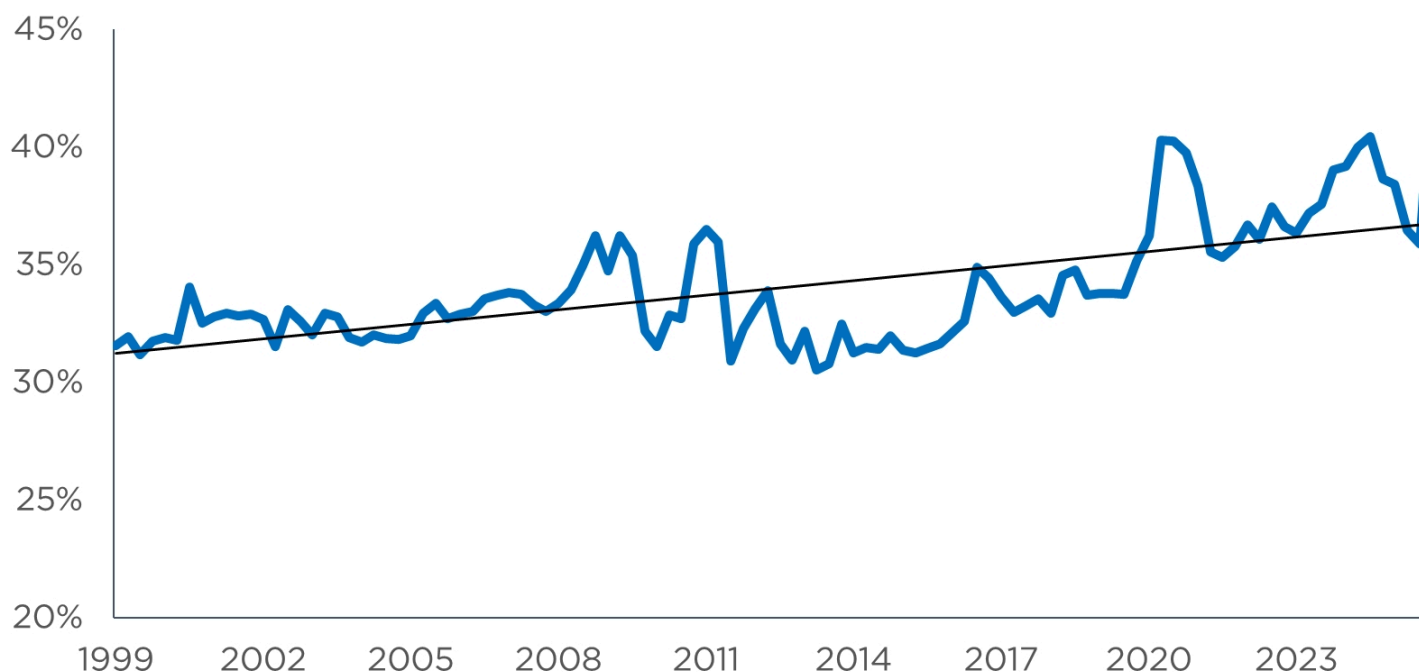
We have been recommending Financials this year, and frankly, it has not been a very good call. The S&P500 Bank index is down 3.1% year-to-date, underperforming the S&P500 which is essentially flat (down 0.1%). We should have been worried when we put the top-down strategist year-ahead outlooks into Gemini and ChatGPT two months back and saw that Overweight Financials was a consensus long idea. Doing the opposite of the strategists at the Big Banks is a good idea more than half the time. One of the reasons we stick with the call is we believe that many of the Banks are potential AI beneficiaries. Most have lots of employees, and it isn't a stretch to think that if they do a better job in predicting their employee and customer behaviors they could drive out costs and expand their margins. But the truth is, Banks are never particularly good at letting the shareholder see the ultimate benefits of the productivity investments. Most Banks have been investing for years in productivity, yet today, the Efficiency Ratio for Banks isn't particularly high vs. history, despite all this investment (see below). The median Bank currently has an efficiency ratio below its long-term median, and the mega-/large-cap banks are slightly better than their 20-year average, at the 61<sup>st</sup> percentile. Not that stellar.



Source: Trivariate Research, LP

Banks generally compete on pricing, and they pay their employees more when times are good. In fact, the median mega-/large-cap. Bank has a higher compensation ratio today than it did 25 years ago (see below).

## Mega / Large Cap. Banks Meidan Compensation Expense Ratio Since 2000 Through End-January, 2026



Source: Trivariate Research, LP

Our conclusion is that we are less excited about our Financials overweight than we were previously. The key for us will be to see increased evidence that the Banks are implementing AI productivity. We cull the earnings call transcripts of all the US equities. Among the Top 500 US equities by market cap., six Financials mentioned cost-related use cases on their recent earnings calls. That is less than we would have anticipated.

### Number of Stocks that Mentioned AI Case

#### Cost-Related AI Use Cases

As of End-January, 2026

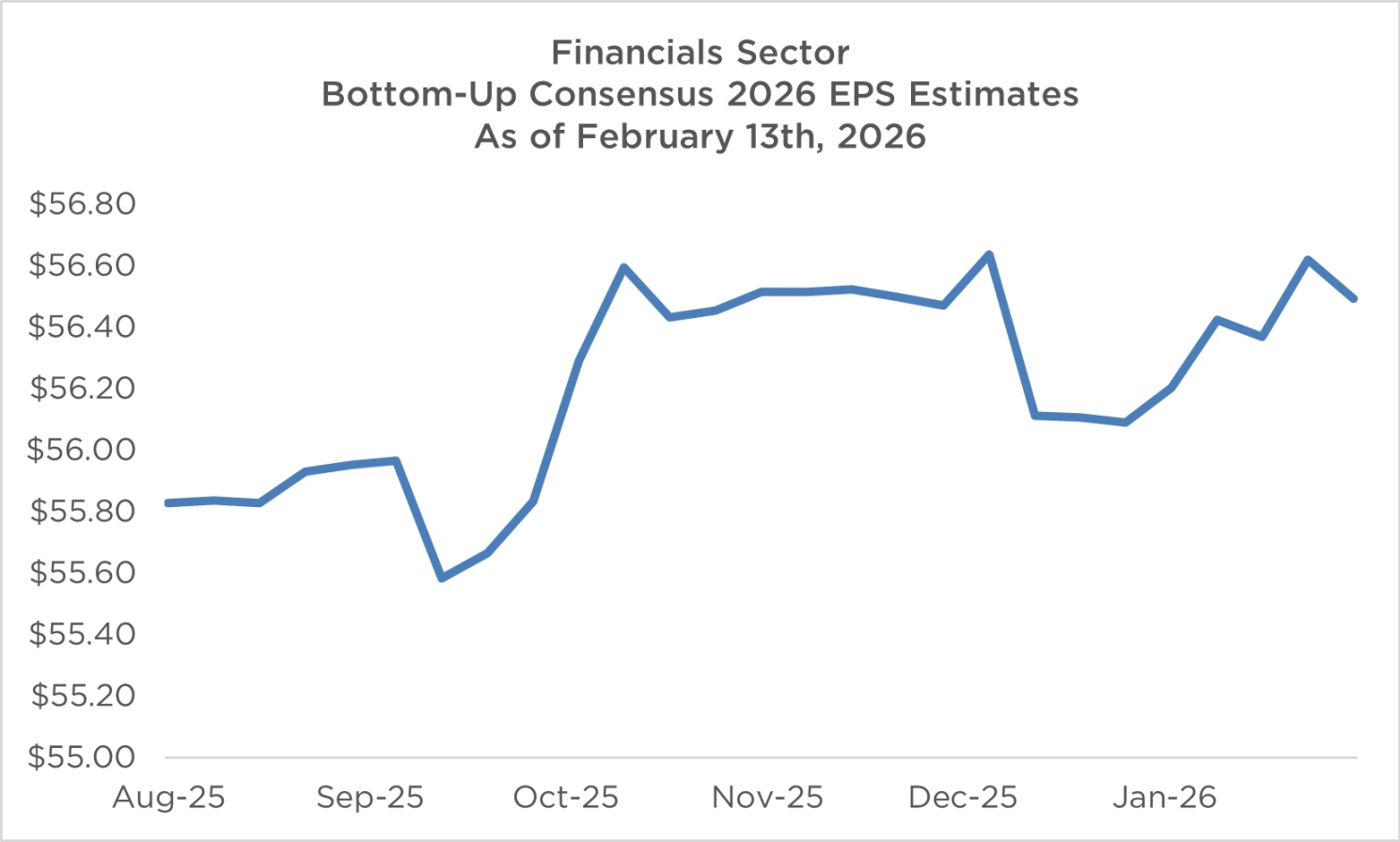
#### Sector Cost Reduction-Only

Top 500 US Equities	65
Information Technology	23
Industrials	10
Health Care	10
<b>Financials</b>	<b>6</b>
Consumer Discretionary	5
Communication Services	4
Energy	2
Real Estate	2
Consumer Staples	1
Materials	1
Utilities	1

Source: Trivariate Research, LP

We need to see many more companies driving margin expansion in the coming quarters, or we will be forced to conclude that our current stance - that Financial sector earnings estimate achievability is above average - is no longer accurate. Today,

bottom-up sell-side analyst EPS expectations for 2026 are higher than they were six months ago, though they have leveled off of late (see below).

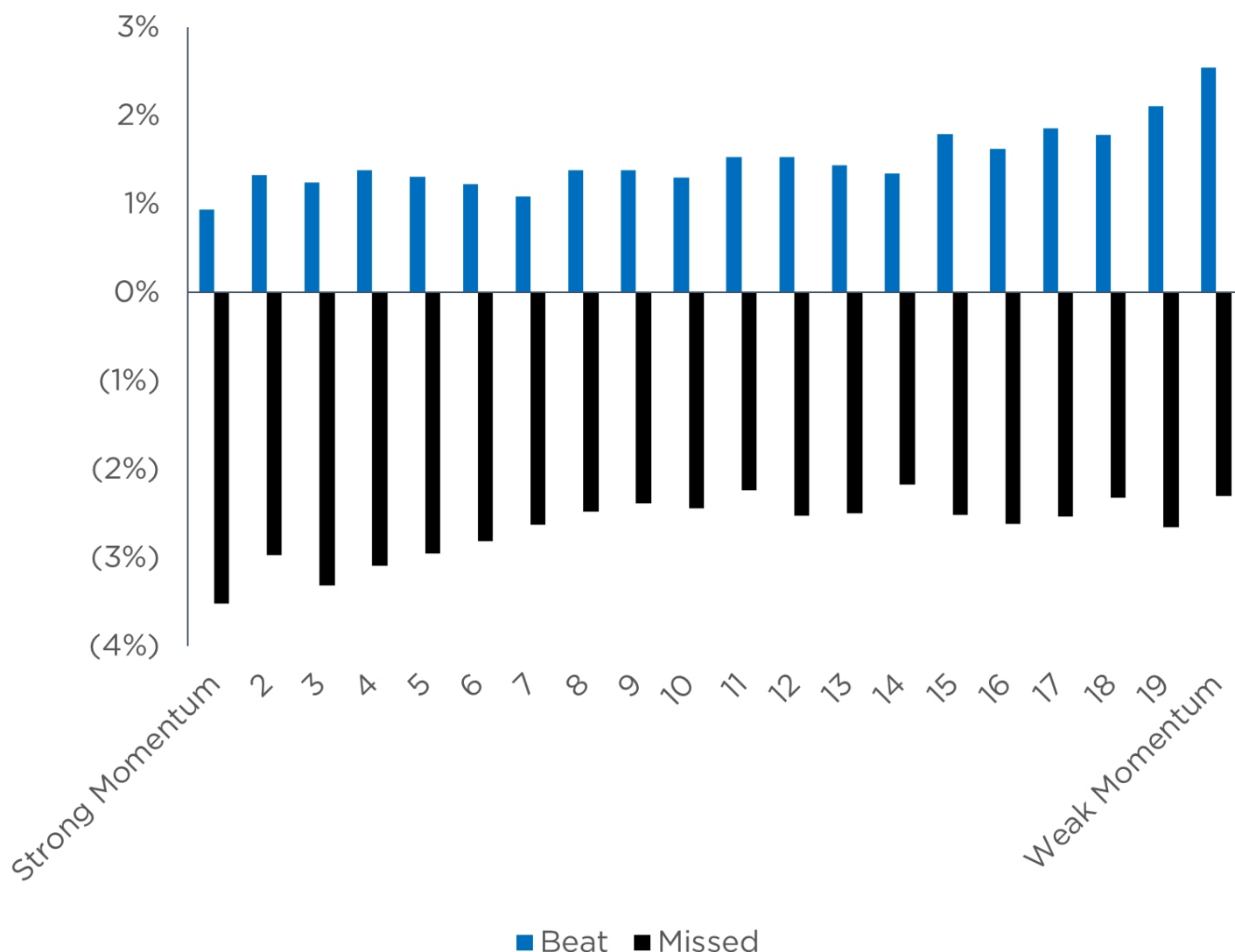


Source: Trivariate Research, LP

**CONCLUSION**

As we detailed in our 2026 year-ahead outlook, our view remains that the probability of multiple contraction for the S&P500 is greater than the probability of multiple expansion. Hence, we focus on estimate acheivability and gross margin expansion potential as our KPIs for investing. The penalty for missing estimates has been far harsher than the reward for beating estimates, for all but the worst performing 5% of stocks into their earnings prints (see below).

## Mean Industry-Relative Return On Earnings Release By Prior 2-Week Momentum Vigintile & EPS Beat vs. Miss Through End-January, 2026



Source: Trivariate Research, LP

For the first time this year since we launched the non-Technology compounders list, we are making some trades. While we don't have an exact benchmark, we are showing the comparison to the S&P non-Technology fund, which does include large positions in GOOGL and META, which we don't have in our basket.

We are selling SCHW, V, LZ, and BKNG, believing it is unlikely they see multiple expansion. We are adding MCK, DGX, WM, and KMB as potential margin expansion beneficiaries or with revenue that is impregnable to AI.

### Non-Technology Compounders

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

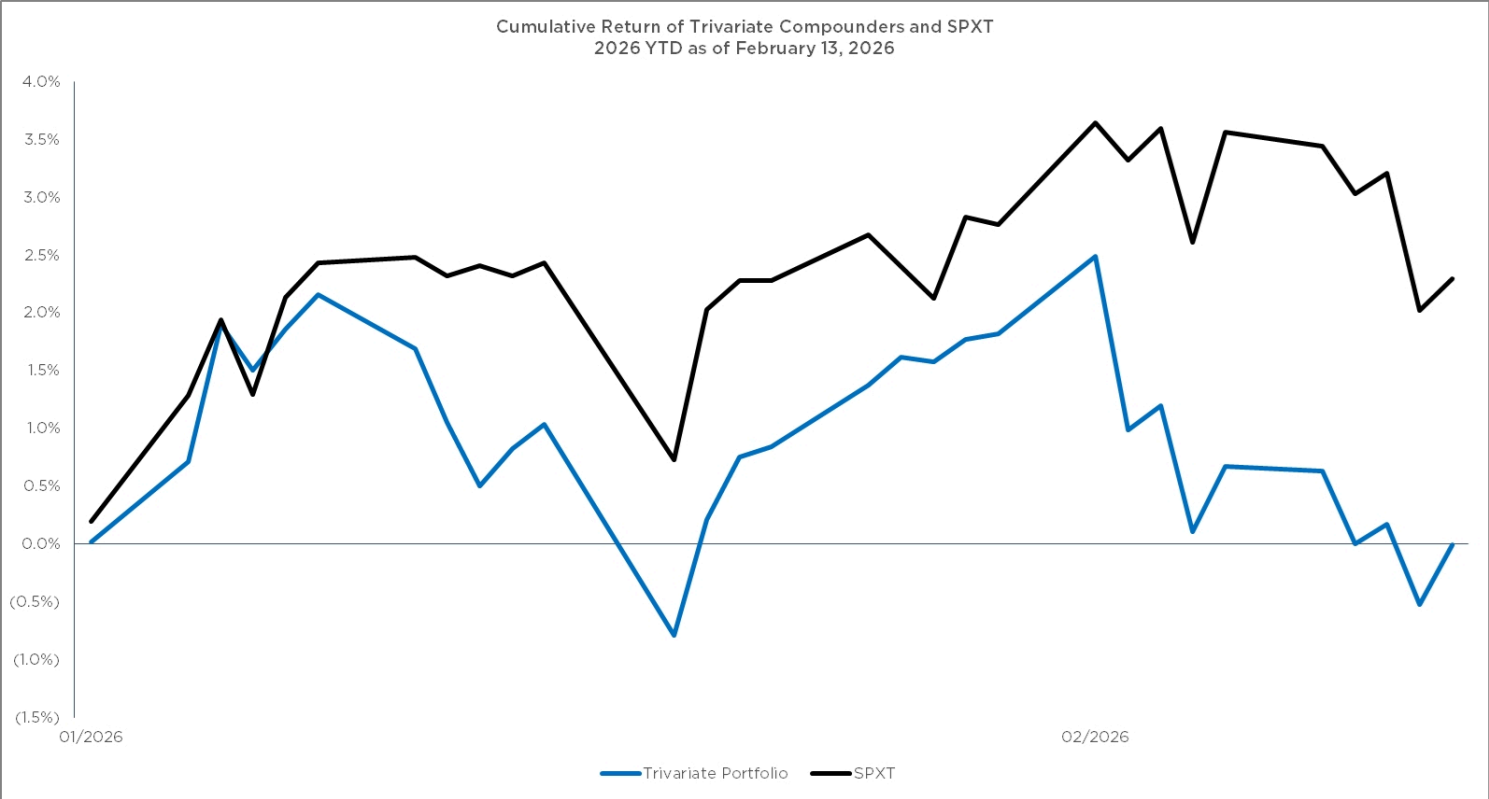
**Trivariate Compounders Portfolio**  
**As of End-January, 2026**

<b>Ticker</b>	<b>Company Name</b>	<b>Industry</b>	<b>Market Cap.</b>	<b>Beta</b>	<b>CSR</b>
AMZN	Amazon.com, Inc.	Broadline Retail	2,558.17	1.57	49%
BRK.B	Berkshire Hathaway	Financial Services	1,037.56	0.26	68%
V	Visa Inc.	Financial Services	613.41	0.65	73%
PM	Philip Morris	Tobacco	279.32	0.04	81%
TMUS	T-Mobile US, Inc.	Wireless Telecom. Serv.	220.58	0.15	84%
TMO	Thermo Fisher Sci.	Life Sciences Tools & Services	217.39	0.75	58%
LIN	Linde plc	Chemicals	213.38	0.45	67%
SCHW	Charles Schwab	Capital Markets	184.66	0.80	66%
NEE	NextEra Energy, Inc.	Electric Utilities	183.06	0.37	89%
GILD	Gilead Sciences, Inc.	Biotechnology	176.11	0.30	89%
UBER	Uber Technologies, Inc.	Ground Transportation	166.33	1.10	78%
BKNG	Booking Holdings Inc.	Hotels, Restaurants & Leisure	161.23	0.99	71%
SYK	Stryker Corporation	Health Care Equip. & Supp.	141.33	0.54	63%
WELL	Welltower Inc.	Health Care REITs	129.28	0.17	79%
WMB	The Williams Comp.	Oil, Gas & Consumable Fuels	82.14	0.51	86%
CTVA	Corteva, Inc.	Chemicals	49.19	0.63	73%
VMC	Vulcan Materials	Construction Materials	39.71	0.81	59%
CPNG	Coupang, Inc.	Broadline Retail	36.83	1.07	79%
XYL	Xylem Inc.	Machinery	33.57	0.92	52%
LZ	LegalZoom.com, Inc.	Professional Services	1.58	1.10	75%

Source: Trivariate Research, LP



The portfolio is up 0.00% YTD, vs. its comparable index of 2.30%.



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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