Level Set - Three Out of Consensus Views

We love it when we have a meeting, and a client says "Tell me three things that you are currently thinking that is not what everyone else is saying." At the beginning of the year we put all the widely available year-ahead sell-side and buy-side 2026 year-ahead outlooks into ChatGPT and Gemini and discovered the consensus views were: bullish on US equities, bullish on small caps, the Fed will be accommodative, and there will be increasing breadth for US stocks. Our experience from the regular investor meetings we do is that consensus, at least in rhetoric, is most often a reflection of two-week price momentum. But, when you write your views down, often the macro consensus turns out to be wrong, or at least unfold much differently.

For years, we have observed that what most commonly unfolds in the equity market is the opposite of the top-down strategy consensus, and at the portfolio level, what is bad for active managers often materializes. **With that backdrop, here are three views we have been espousing in our recent meetings that we don't think are particularly consensus.**

1. We don't think quality works to pick stocks.
2. We don't think valuation works to pick stocks.
3. We think the Great 8 can outperform the US equity market in 2026.

Out of Consensus View #1: We don't think quality works to pick stocks.

One of the reasons performance has been challenging this year 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 has persisted for nearly five years (see below).

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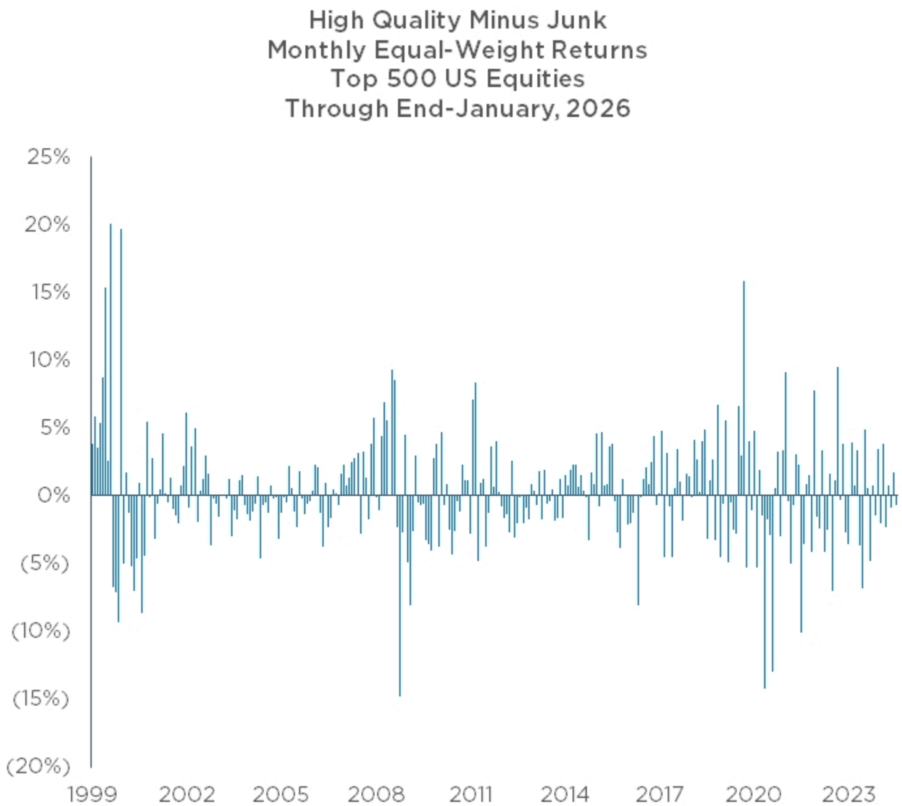
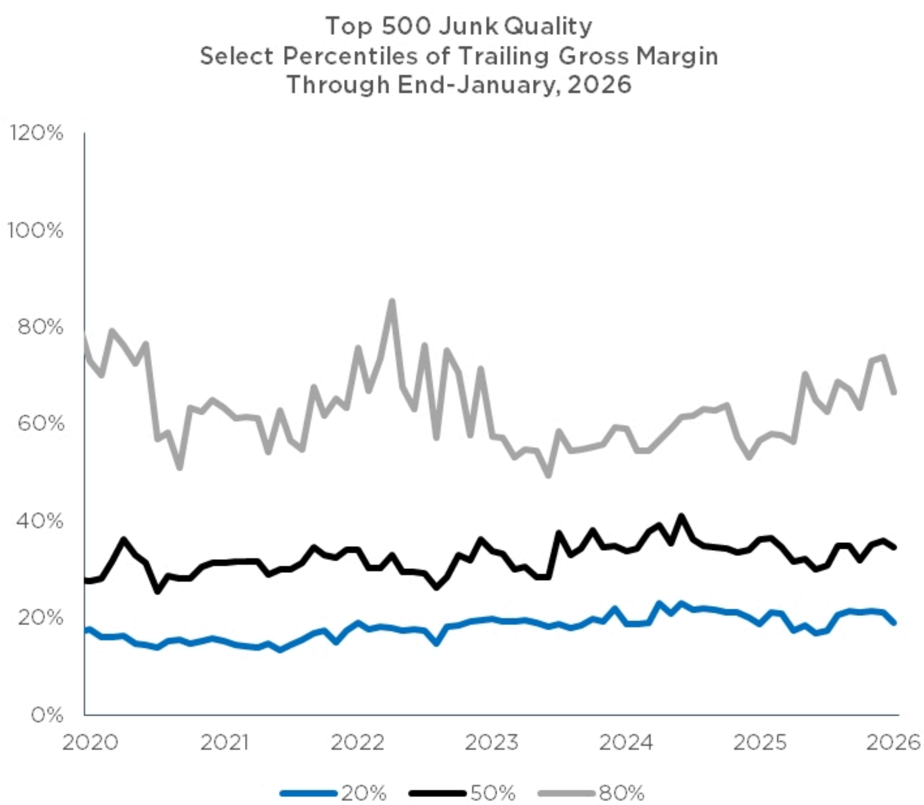


Source: Trivariate Research, LP

Why has junk worked? Well, perhaps one explanation is that the top 20% of junk stocks are posting gross margin expansion (see below) and as our work has shown, gross margin expanders are frequently multiple expanders.



Source: Trivariate Research, LP

In fact, the multiples of high-quality stocks have generally contracted over the past few years, as the maintenance of high-quality carries no multiple expansion on average. Improvement in quality however, can. Below we show the 25th, median, and 75th percentile stock in each of our quality buckets (high, mid, low, junk) and the change in the price-to-forward earnings multiple from the end of 2019 through the end of 2025. On average, the higher the quality, the more the multiple compression.

Change in Price-to-Forward Earnings Multiple
By Quality Cohort Over Six Year Period
End-2019 vs. End-2025

Substance	N	25th Percentile	Median	75th Percentile
High	331	(10.2x)	(4.0x)	0.4x
Mid	334	(6.4x)	(2.5x)	2.1x
Low	341	(4.8x)	(1.3x)	2.4x
Junk	319	(3.9x)	0.0x	4.0x

Source: Trivariate Research, LP

Another factor that is important to note is that for long-only, S&P500 benchmarked investors, the constitution of the market is skewed toward quality. This dynamic makes it very difficult to construct a portfolio that is higher quality than the index. In fact, 83.7% of the S&P500 is in the top half of quality, and 59.2% is in the highest quality quartile. The story is the same on a beta-adjusted basis. How can the S&P500 beta be greater than 1? Our definition is the median of four horizons for each stock. We compute a daily beta for 63 days, 126 days, 252 days, and 378 days (so 3, 6, 12, and 18 months) and then take the median. 57.2% of the 105.4% is high-quality, and only 4.5% of the 105.4% is junk. **However you compute it, the S&P500 is very high quality, so being MORE high quality than the S&P500 is very challenging and not necessarily a positive.**

S&P500 Substance Exposure
As of February 13th, 2026

Substance Category	S&P500 Weight	Bench Beta-Adjusted Weight
High	59.2%	57.2%
Mid	24.5%	29.2%
Low	12.4%	14.4%
Junk	3.9%	4.5%
Total	99.9%	105.4%

Source: Trivariate Research, LP

While we aren't recommending an all-in strategy of buying low quality companies, we do think investors should focus on companies that are growing fast enough within high quality to offset multiple contraction. **If investors hold market-weight high-quality, they already hold 60% of their portfolio in the highest quality quantile. So do they need to be MUCH MORE HIGH QUALITY than that? Maybe not.** We looked at our factor library to identify signals that were efficacious at predicting high-quality stock winners from high-quality stock losers since 2020. Buying stocks with high R&D-to-sales, high revenue growth, and low debt was the best approach. Avoiding relatively higher short interest also worked. Profitability level and valuation did not matter for stock selection.

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

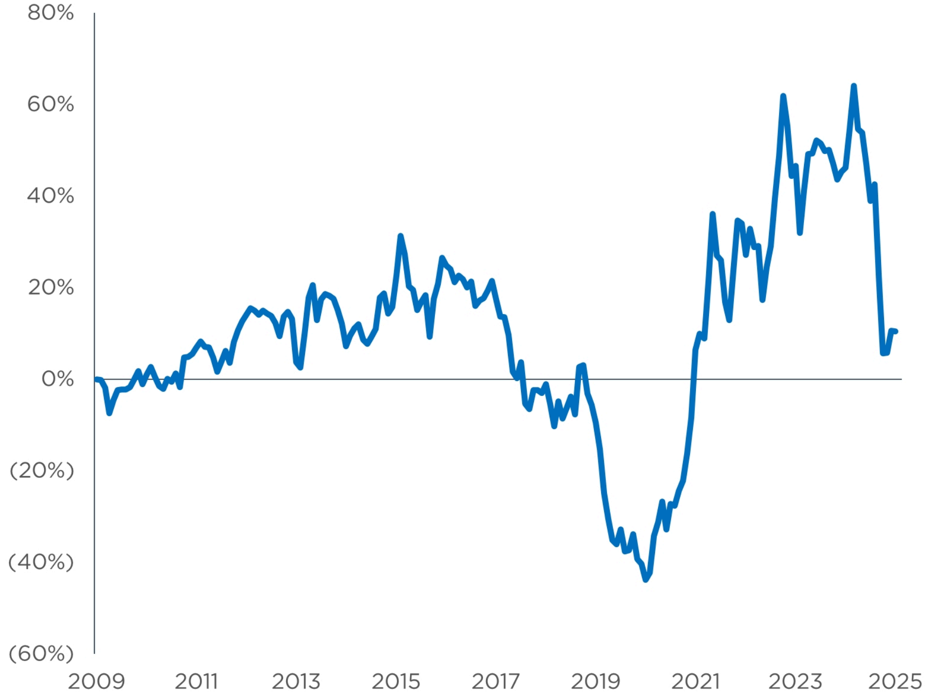
Signal	Annualized Mean Return	Annualized Std. Dev of Returns	Sharpe Ratio	Hit Rate
R&D-to-Sales	9.7%	20%	0.49	58%
Revenue Growth	8.9%	14%	0.64	58%
Net Debt to Market Cap	6.8%	12%	0.57	52%
Beta	5.9%	21%	0.28	52%
Buyback Yield	5.5%	12%	0.48	52%
EV-to-Forecast Sales	4.4%	15%	0.29	55%
Short Interest-to-Value Traded	4.3%	8%	0.52	60%
EPS Growth (Trailing 12Q)	4.2%	7%	0.57	60%
Forecast Gross Margin	3.9%	17%	0.23	55%
Dividend Coverage Ratio	3.4%	9%	0.37	55%
Gross Margin	(0.5%)	10%	(0.05)	50%
Dividend Growth (Trailing)	(1.3%)	6%	(0.21)	47%
Accruals	(1.8%)	9%	(0.20)	45%
Price-to-Earnings	(2.3%)	20%	(0.12)	40%
Price-to-Forward Earnings	(3.3%)	21%	(0.15)	47%
Inventory-to-Sales	(3.4%)	9%	(0.36)	47%
Quick Ratio Growth	(3.8%)	7%	(0.58)	40%
Net Margin	(3.9%)	15%	(0.26)	45%
Operating Margin	(5.1%)	16%	(0.32)	45%
Indicated Annual Dividend Yield	(7.1%)	15%	(0.49)	45%

Source: Trivariate Research, LP

Out of Consensus View #2: We don't think valuation works to pick stocks.

In the summer of 2025, we wrote about valuation and concluded it is 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.

Cumulative Return of Price-to-Forward Earnings Quintile Spread (Least Expensive - Most Expensive) Through End-January, 2026



Source: Trivariate Research, LP

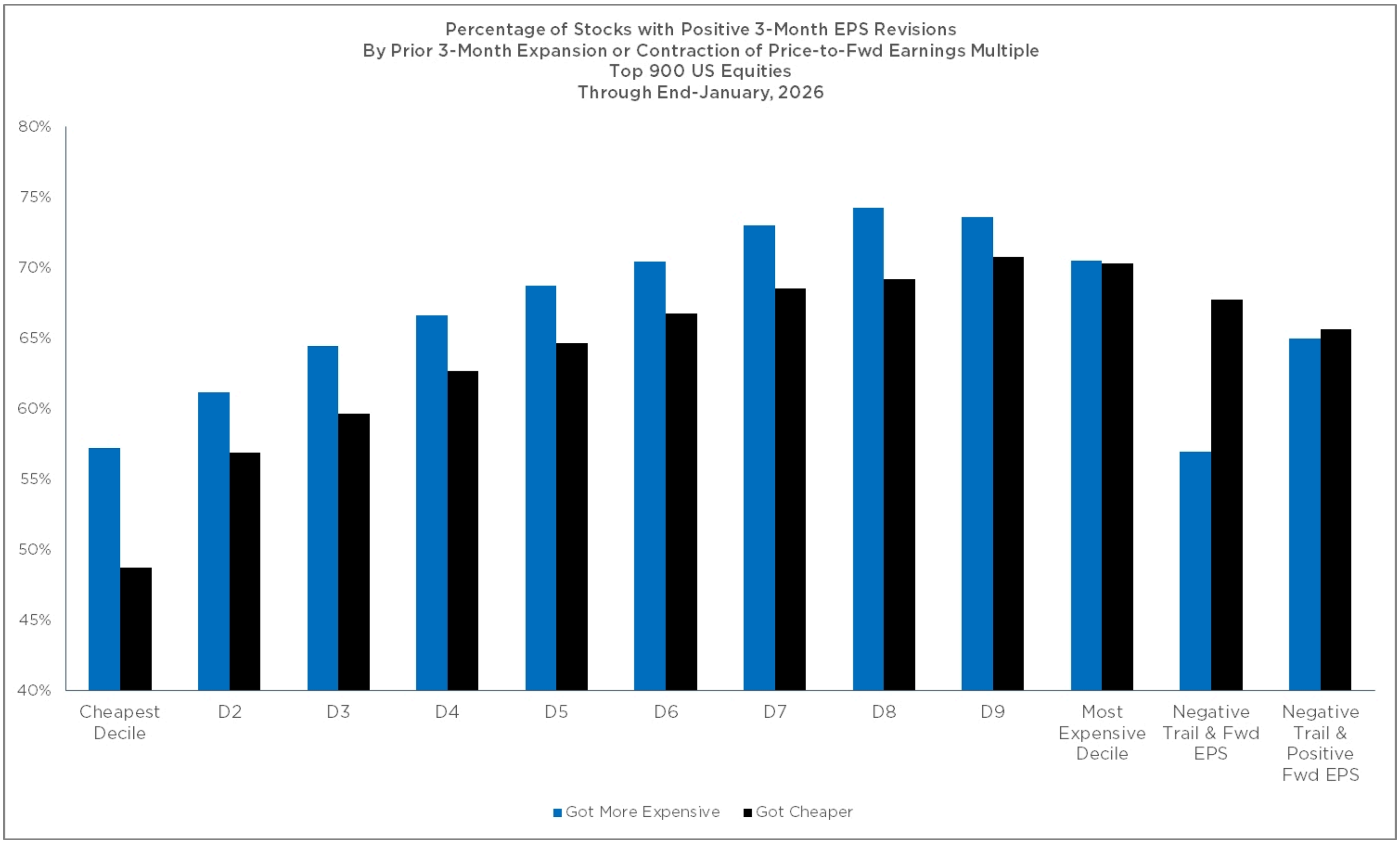
Why is this? Today perhaps it is because AI revenue or productivity beneficiaries are getting more expensive, as are those stocks with business models deemed to be impregnable to AI. On the contrary, stocks that are getting cheaper have a higher-than-average probability of being disrupted by AI. Structural issues like increasing retail investor participation and quant-driven strategies means this trend could last. In the end though, it has become clear that stocks that get more expensive have a higher probability of beating their next quarter's estimates. Below we show the percentage of stocks that have positive 3-month forward earnings revisions by how much their price-to-forward earnings changes over the three months PRIOR to their earnings reports.

There are two important observations:

1) Companies that are cheap are MUCH less likely to subsequently beat consensus EPS estimates than companies that are expensive.

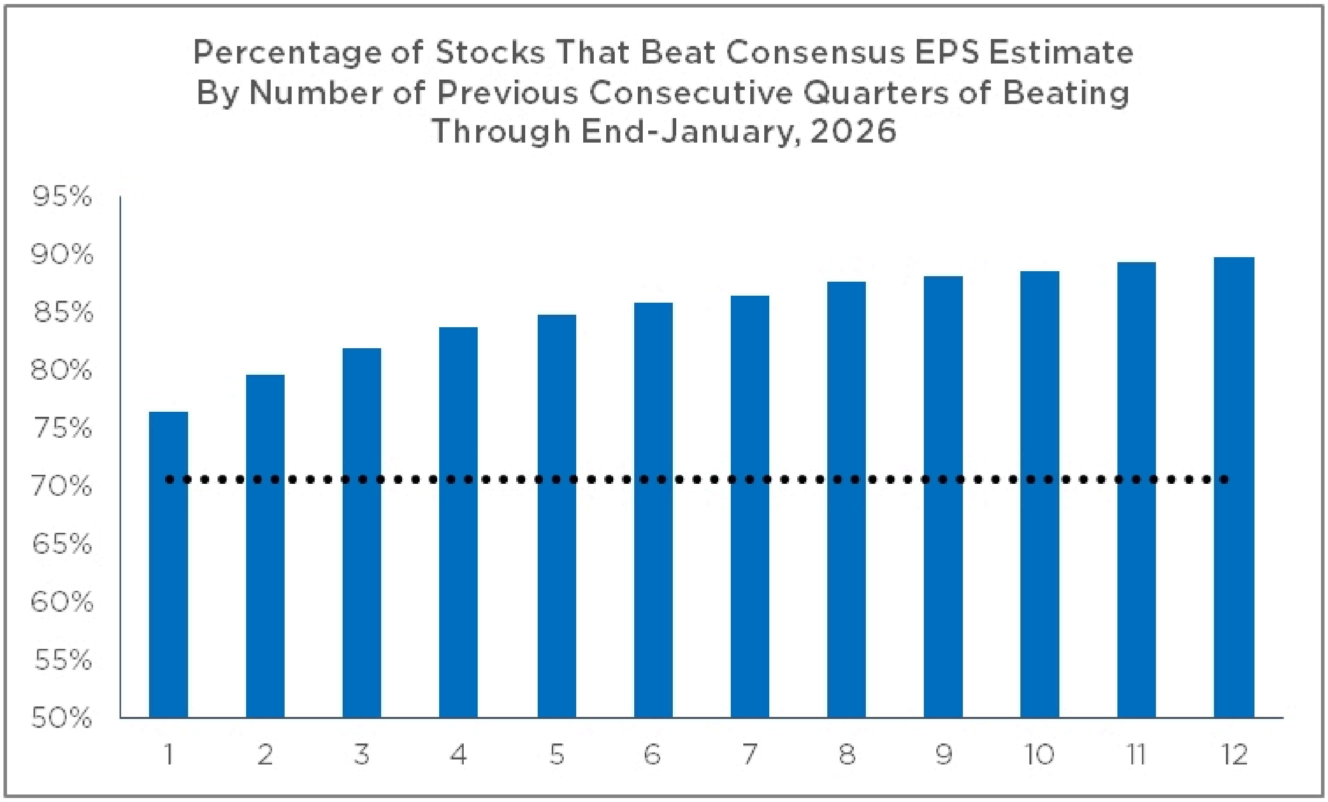
2) Companies that get more expensive – regardless of their starting valuation level – are far more likely to have subsequent upward revisions.

For example, 74% of stocks in the 2nd most expensive decile on price-to-forward earnings (9th cheapest) with price-to-forward earnings multiple expansion over the previous quarter have upward earnings revisions. 57.2% of stocks that are in the cheapest decile of price-to-forward earnings and have gotten more expensive subsequently have upward revisions. Only 49% of stocks in the cheapest decile that got cheaper the previous quarter end up with upward revisions. Buying cheap stocks that got cheaper is a way to decrease your chance of buying a stock with upward revisions. For companies that lose money, the signal is less reliable (see below).



Source: Trivariate Research, LP

Moreover, and importantly, there is a serial correlation to stocks that just beat estimates. The percentage of stocks that beat estimates if they beat last quarter is 76%, but the percentage that beat estimates if they have beaten six quarters in a row is 86%. So, the *conditional* probability a company beats a second time given they just beat is HIGHER than the unconditional probability. Some companies either fundamentally create upside or have enough flexibility to continuously surprise analysts to the upside (see below), or analysts systematically underestimate the power of their leverage, or position.



Source: Trivariate Research, LP

While there is some evidence to avoid extremely cheap and extremely expensive stocks, we maintain valuation isn't effective for security selection in the middle 80% of the distribution. To us, buy low sell high means buying companies with LOW estimates, and selling those with HIGH estimates, which is why we spend so much time on gross margin forecasts and estimate achievability. **Expensive stocks that miss earnings expectations are going down after their earnings reports the same amount as cheap stocks that are missing estimates. Hence, it is the missing that matters, not the valuation.**

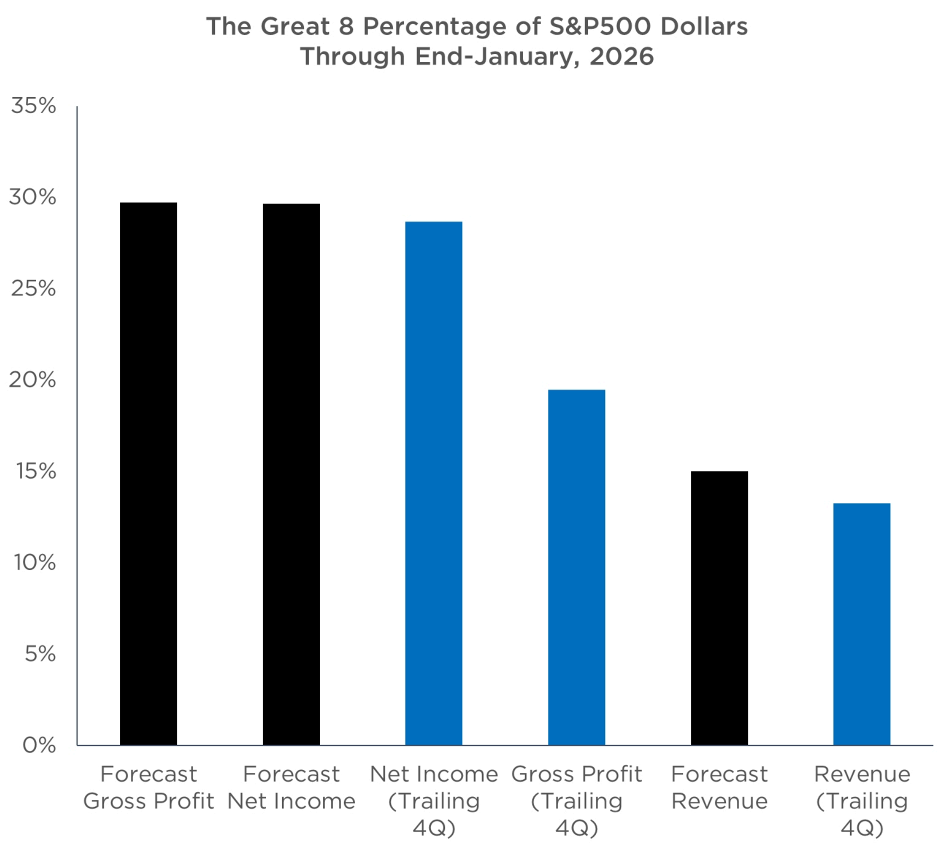
Out of Consensus View #3: We Think the Great 8 Can Outperform the US Equity Market in 2026

So far in 2026, all but META have underperformed the S&P500, with MSFT and AMZN underperforming the most (see below). Nearly every day it seems, there is an article in the financial press about the high percentage of active managers beating the index. But, not one of the stories mentions that this is because of mandated or structural underweight to the Great 8 in many cases.

Great 8 Year-to-Date Performance Through February 20th, 2026		
Company	Ticker	YTD Performance
Amazon.com	AMZN	(7.24%)
Alphabet Inc.	GOOGL	(0.05%)
Meta Platforms	META	0.81%
Microsoft Inc.	MSFT	(16.01%)
Apple Inc.	AAPL	(2.37%)
Broadcom Inc.	AVGO	(4.31%)
Nvidia	NVDA	0.51%
Tesla	TSLA	(5.99%)
Equally-Weighted Avg		(4.33%)
S&P500		0.74%

Source: Trivariate Research, LP

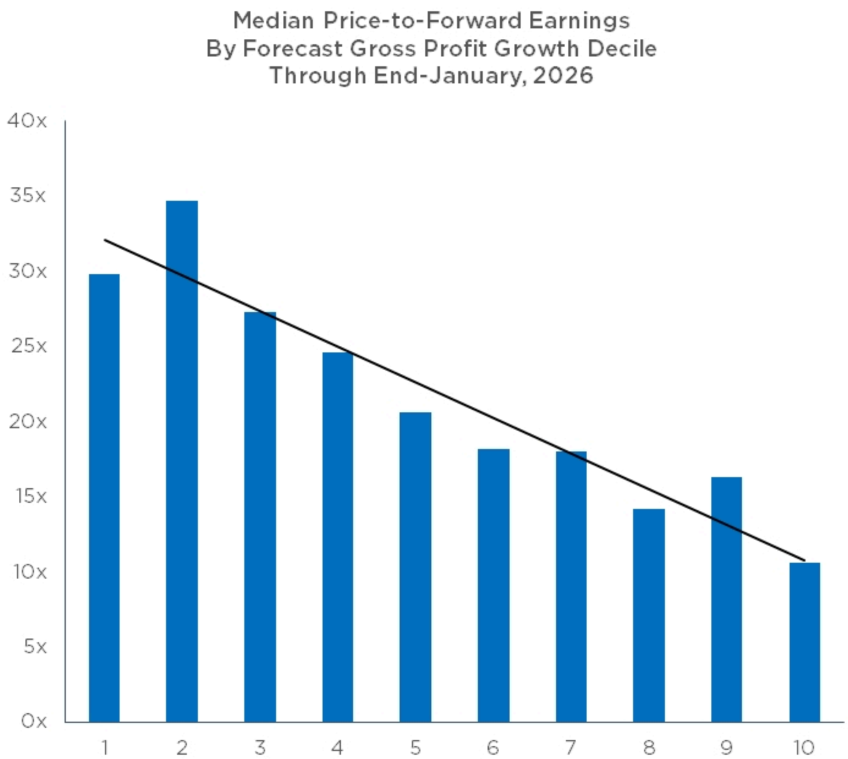
While the Great 8 account for roughly 37% of the S&P500 by market cap., they represent on a dollar basis 13% of trailing revenue, 19% of trailing gross profit dollars, and 28.7% of trailing net income dollars in aggregate (see below blue bars).



Source: Trivariate Research, LP

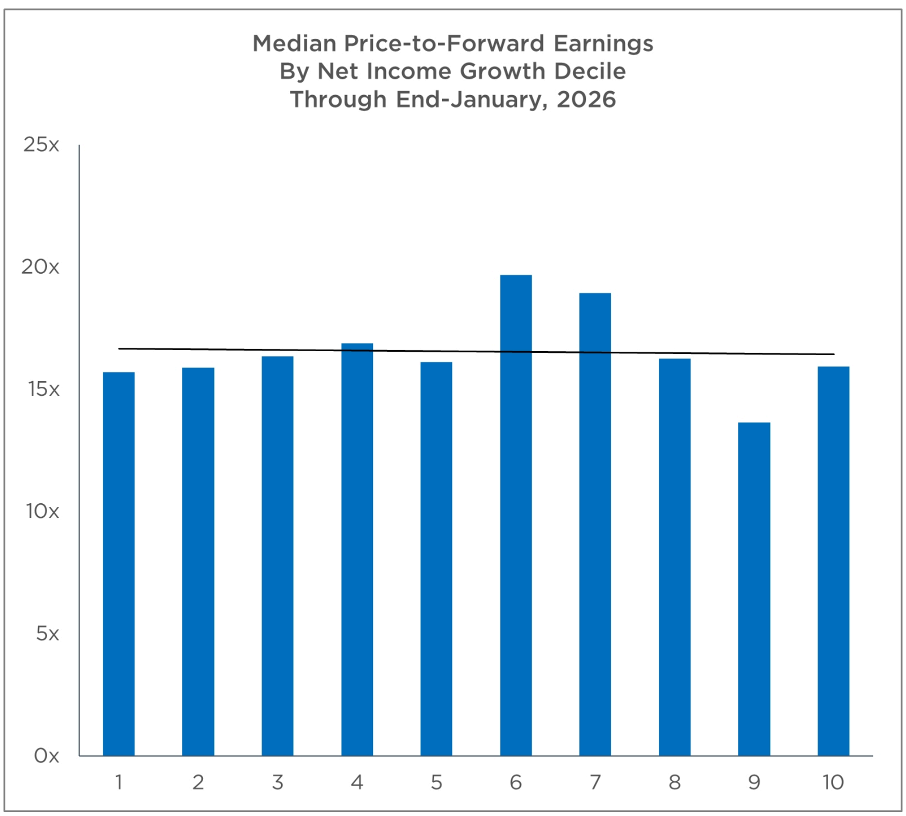
So why do we think that Great 8 can outperform?

1. The gross profit dollars are forecasted to grow faster for the Great 8.
2. Higher forecasted net income dollar growth with declining gross profit dollar growth for the other 492 likely means a good deal of AI productivity is embedded in the other 492 companys' numbers, making estimate achievability potentially more difficult. We know the penalty for missing EPS estimates has been harsher than the reward for beating estimates.
3. The market historically has rewarded gross margin growth (which the Great 8 is forecasted to have in aggregate), not net margin growth. Below we show the relationship between gross profit growth decile and price-to-forward earnings.



Source: Trivariate Research, LP

On the contrary, there does not appear to be a strong relationship between net income growth and price-to-forward earnings, with the fastest and slowest growth deciles trading at similar multiples, and the 6th and 7th fastest growing the most expensive.



Source: Trivariate Research, LP

CONCLUSION

We think the narrative of saying you buy high-quality stocks at attractive valuations, and that there will be breadth in the market - all SOUNDS good - but we aren't sure any of it will unfold that way.

Non-Technology Compounders

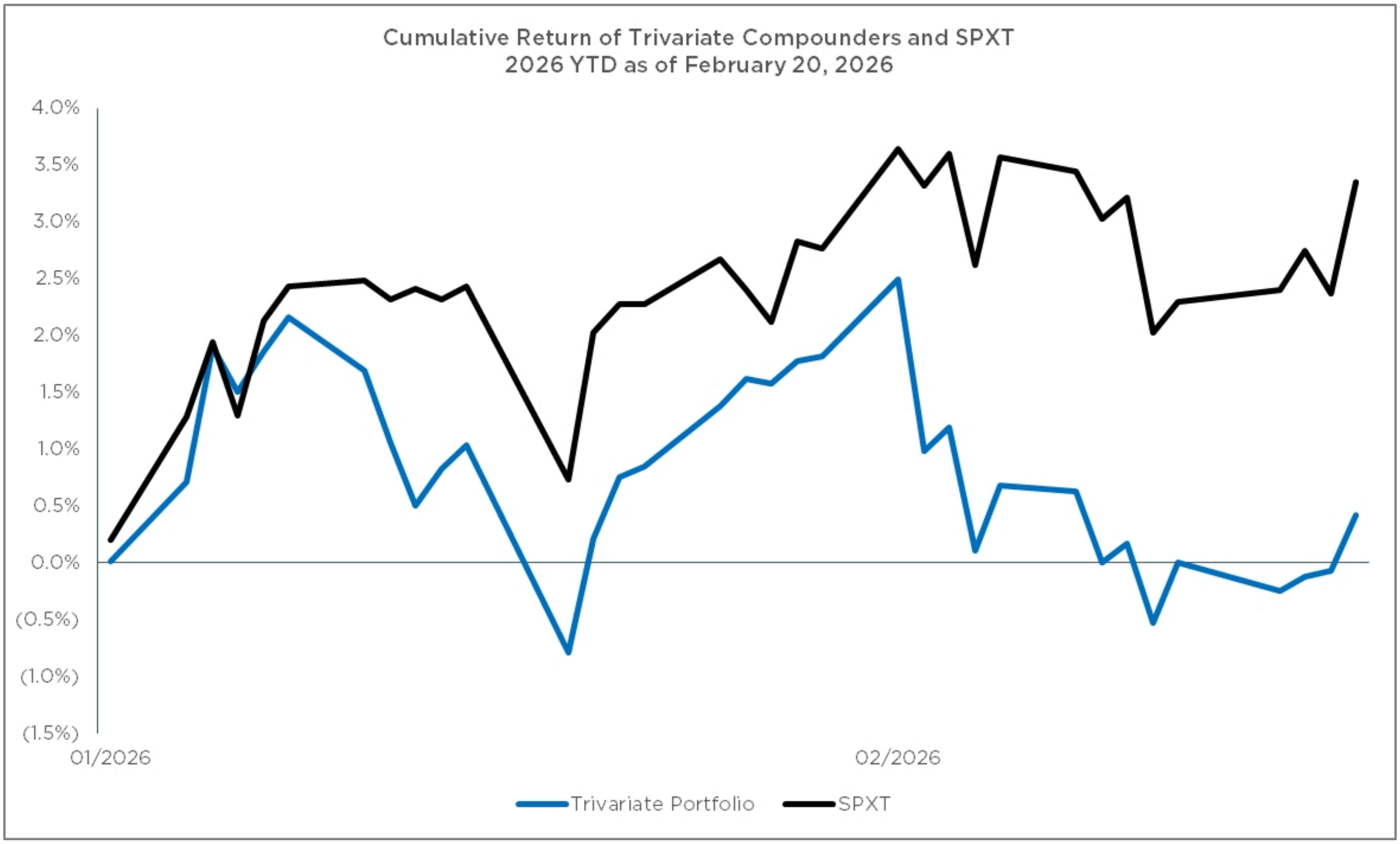
We launched a new ideas basket this year, which is 20 Non-Technology Compounders. Ideas below.

Trivariate Compounders Portfolio
As of February 20th, 2026

Ticker	Company Name	Industry	Market Cap.	Beta	CSR
AMZN	Amazon.com, Inc.	Broadline Retail	2,255.51	1.40	49%
BRK.B	Berkshire Hathaway	Financial Services	1,074.37	0.29	68%
PM	Philip Morris	Tobacco	285.50	0.07	81%
TMUS	T-Mobile US, Inc.	Wireless Telecom. Serv.	237.41	(0.10)	84%
LIN	Linde plc	Chemicals	231.84	0.39	67%
NEE	NextEra Energy, Inc.	Electric Utilities	192.06	0.33	89%
TMO	Thermo Fisher Sci.	Life Sciences Tools & Services	191.96	0.91	58%
GILD	Gilead Sciences, Inc.	Biotechnology	187.84	0.38	89%
UBER	Uber Technologies, Inc.	Ground Transportation	152.01	1.12	78%
SYK	Stryker Corporation	Health Care Equip. & Supp.	145.51	0.52	63%
WELL	Welltower Inc.	Health Care REITs	145.27	0.18	79%
MCK	McKesson Corporation	Health Care Providers & Serv.	116.05	0.07	86%
WM	Waste Management	Commercial Services & Supp.	92.89	0.15	79%
WMB	Williams Companies	Oil, Gas & Consumable Fuels	89.12	0.35	86%
CTVA	Corteva, Inc.	Chemicals	51.32	0.61	73%
VMC	Vulcan Materials	Construction Materials	39.86	0.79	59%
KMB	Kimberly-Clark	Household Products	36.19	(0.11)	65%
CPNG	Coupang, Inc.	Broadline Retail	34.25	1.34	79%
XYL	Xylem Inc.	Machinery	31.36	0.94	52%
DGX	Quest Diagnostics	Health Care Providers & Serv.	22.27	0.04	77%

Source: Trivariate Research, LP

The portfolio is up 0.42% YTD, vs. its comparable index of 3.35%.



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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