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# TRIVARIATE RESEARCH

## GROSS MARGINS ARE ROLLING OVER, BUT NET MARGIN EXPECTATIONS REMAIN HIGH

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# RESEARCH SUMMARY AND INVESTMENT CONCLUSIONS

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**Background:** We have focused on the topic of gross margins for many years. We met with an investor recently who told us that analyzing margins was “their thing and that they have been focused on it since 2023.” I was forced to – as the kids say – “flex.” We launched coverage of US large cap. Semiconductors on October 1<sup>st</sup>, 2002, with a title “Share Gainers and Margin Expanders are Multiple Expanders.” (Mic. Drop). The point is that we have long focused on the drivers of gross margin expansion, with a strong belief that companies that consistently expand gross margins or beat the consensus expectations for gross margins subsequently outperform. This year however, the “Other 492,” as they are known, are forecasted to have a gross profit dollar decline in 2026 but also forecasted to have a collective net profit dollar growth that is quite strong. So, how can that be? Likely because analysts are beginning to embed AI productivity in their forecasted estimates for many companies. With that in mind, in today’s note we take a detailed look at gross and net margins, and analysts forecasts for both, to assess investment opportunities in the US equity market.

**Current gross margin trends are turning negative:** Gross margins for the median company in the Top 500 by market cap. are slightly lower today than in February 2025, when they last peaked at 46.4%. **The median stock had a gross margin of 45.9% at the end of December, just a touch a touch lower than 46.0% at the end of November, but that fell sharply to 44.9% by the end of January.** Generally, lower forecasted gross profit dollar growth companies trade at lower multiples than high gross profit dollar growth companies. On the contrary, the price-to-forward earnings multiple does not appear to have a relationship to net income dollar growth. 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 dynamic is worth highlighting, because market-wide multiple expansion this year will only happen if the gross margins expand, or if the market starts to change in the way it rewards net income growth!**

**But net margin expectations remain high:** While gross margins have rolled over, the distribution of net margins, including 20<sup>th</sup> percentile, median, and 80<sup>th</sup> percentile are forecasted to be at new highs from the bottom-up analyst forecasts. The median mega-/large-cap. company is expected to have 18.3% net margins in the next 12 months, hovering near the all-time high of 18.6% from November of 2025. **That potentially contradicts the reality of the reported gross margins.**

**Highlights from our sector work are shown on the next slide.**

## INVESTMENT CONCLUSIONS

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**Consumer Discretionary:** It appears the bottom 20% of Discretionary stocks have poor margin trends and serially disappoint expectations. We would look for short ideas among low margin Consumer Discretionary stocks, particularly for those that lose money today but are forecasted to turn a profit in 2026.

**Consumer Staples:** We are recommending an underweight in Consumer Staples, and analyzing the profit margins makes us feel better about the call. Gross margins have not expanded for 25 years. Net margins estimates for the median stock are consistently above what ultimately gets achieved AND have been trending lower since 2017.

**Technology:** Interestingly, Technology forecasted and trailing gross margins are generally quite close to each other across the distribution, and trended higher from the TMT crisis 25 years ago until recently. **It appears that across the distribution, gross margins peaked last October for the Technology sector.** Net margin expectations are typically well above what is ultimately achieved in the Technology sector and are particularly high today vs. history for the bottom 20% of stocks, a potential problem for performance in our judgment.

**Healthcare:** Healthcare gross margins have slowly trended higher for the median stock, even if expectations consistently prove to be too high. Net margins have picked up sharply for the median and top 20% of stocks. We dug into why the gross margins are low but net margins are high for the median Healthcare stock vs. history, and part of it is that Pharmaceuticals percentage of total Healthcare mega-/large-cap. Market cap. has been trending lower for years.

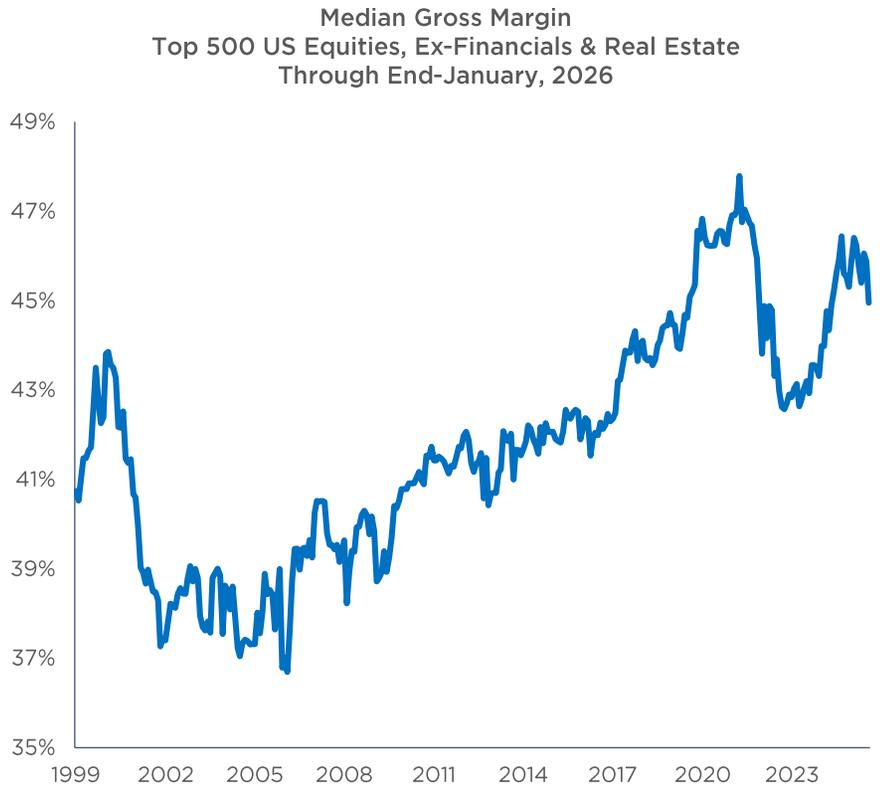
**Industrials:** Interestingly, for the 80<sup>th</sup> percentile, net margin forecasts are barely above trailing margins, implying either low expectations, or that margins are “tapped out” for this most profitable group.

**Multiple expansion implies upward revisions:** In the end, revisions for stocks have driven performance, and stocks where the multiple expands over the previous quarter have a higher probability of subsequently beating estimates than the stocks where the multiple contracts.

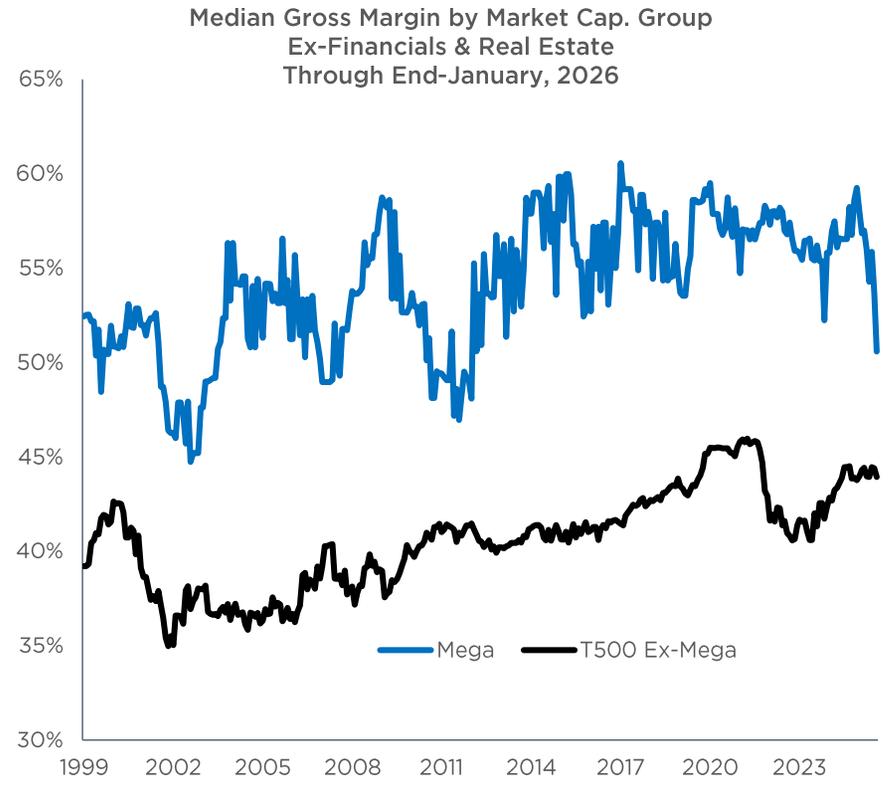
**Quantitatively-derived long / short ideas:** On slide 15, we show long ideas that have had recent multiple expansion, and are forecasted to have margin expansion, but not more net margin than gross margin expansion. This should help with estimate achievability. **Long ideas include MRK, TMUS, MCD, NEE, and UBER, among others.** The short ideas have seen recent multiple contraction, have forecasted gross margin contraction but net margin expansion, reducing estimate achievability. **Ideas include APH, CRM, ANET, and LVS, among others.**

# THE MEDIAN STOCK'S GROSS MARGINS ARE FALLING

Gross margins for the median company in the Top 500 by market cap. are slightly lower today than in February 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 lower than 46.0% at the end of November, but that fell sharply to 44.9% by the end of January. For mega-caps (the top 50 stocks by market cap.) the median stock's gross margins fell to 50.5% at the end of January from 55.9% at the end of November, the lowest level in over ten years (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, though still dipping from 44.4% at the end of December to 43.9% at the end of January.



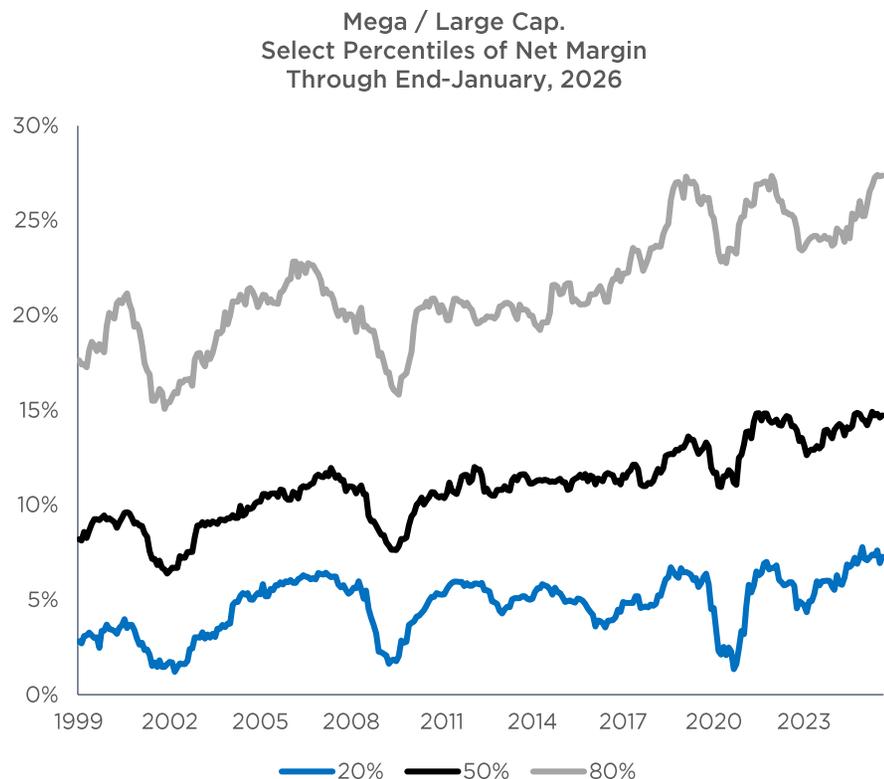
Source: Trivariate Research



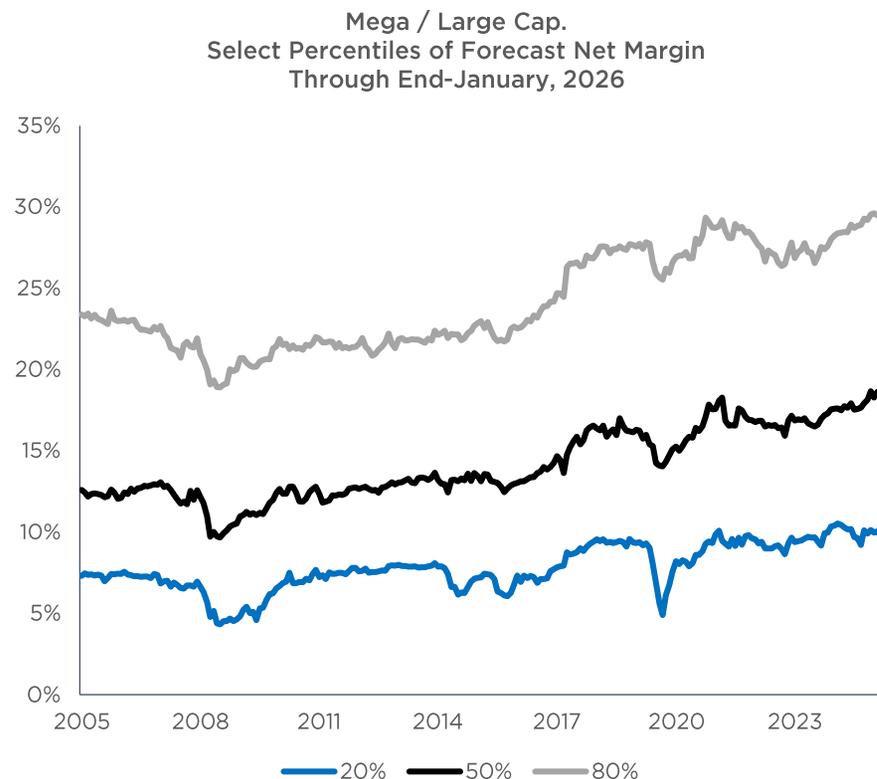
Source: Trivariate Research

# THE MEDIAN LARGE-CAP IS FORECASTED TO HAVE 18.3% NET MARGINS

While gross margins have rolled over, the distribution of net margins, including 20<sup>th</sup> percentile, median, and 80<sup>th</sup> percentile are all at all-time highs (left), and are forecasted to be at new highs from the bottom-up analyst forecasts (right). In fact, the median mega-/large-cap. company is expected to have 18.3% net margins in the next 12 months, hovering near the all-time high of 18.6% from November of 2025.



Source: Trivariate Research

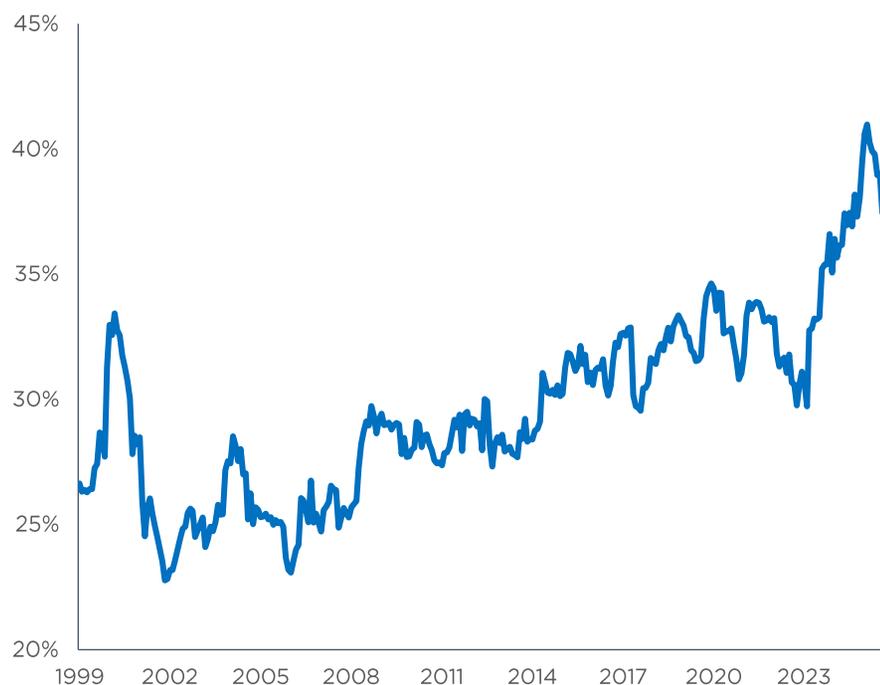


Source: Trivariate Research

# VALUATION IS STRONGLY RELATED TO GROSS MARGIN LEVEL

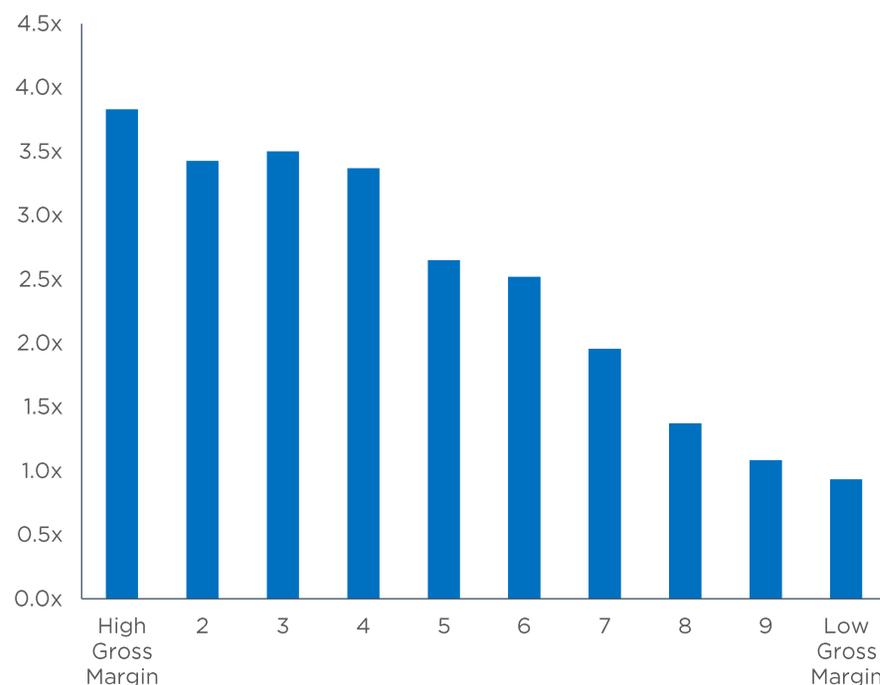
Several of the largest stocks have high gross margins. We pointed out in July 2025 that 41% of all the market cap. in the US equity market had gross margins above 60% (left), though that number has subsequently dipped to 37.4% with some of the mega cap. margin degradation we just highlighted. We think 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. But today, gross margins are softening while net margins are expected to expand. How will the market treat that?

Percent of Market Cap. With >60% Gross Margins  
Top 3000 US Equities, Ex-Financials & Real Estate  
Through End-January, 2026



Source: Trivariate Research

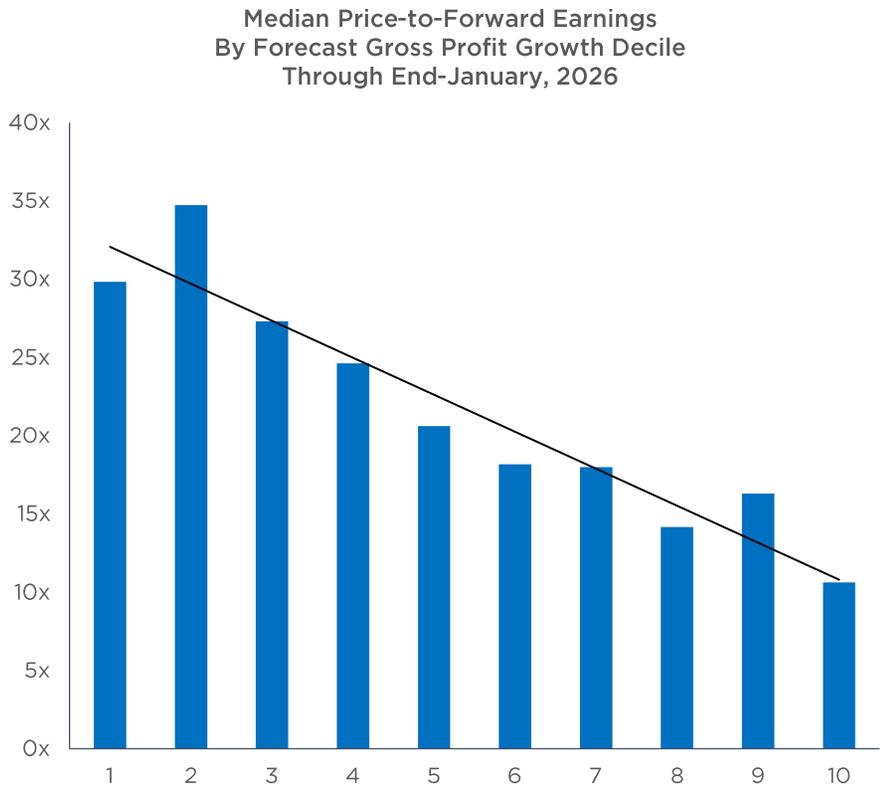
Median EV-to-Forecast Sales by Gross Margin Decile  
Top 3000 US Equities with Revenue >\$100m  
Through End-January, 2026



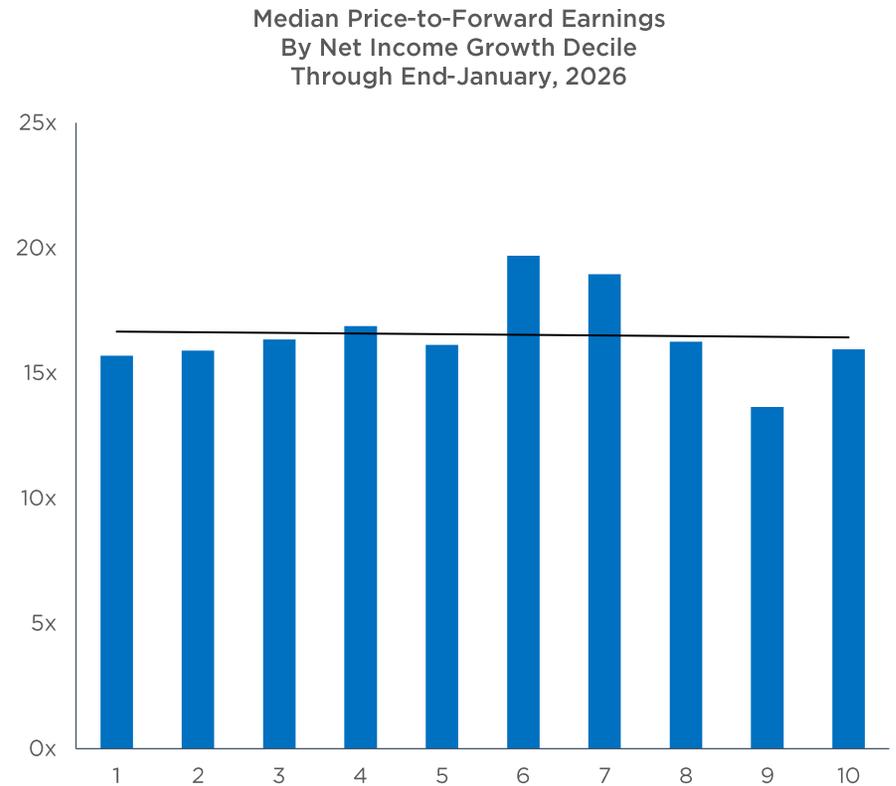
Source: Trivariate Research

# THE MARKET HISTORICALLY REWARDED GROSS NOT NET PROFITS

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 (left). On the contrary, the price-to-forward earnings multiple does not appear to have a relationship to net income dollar growth. On the right, 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 market-wide multiple expansion this year will only happen if the gross margins expand, or if the market starts to change in the way it rewards net income growth!



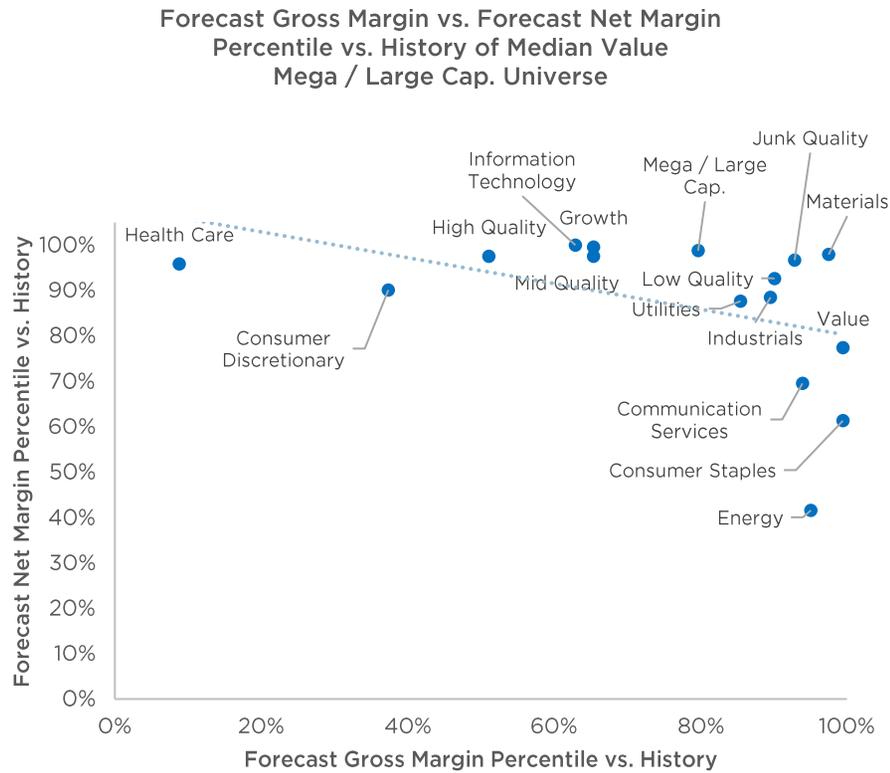
Source: Trivariate Research



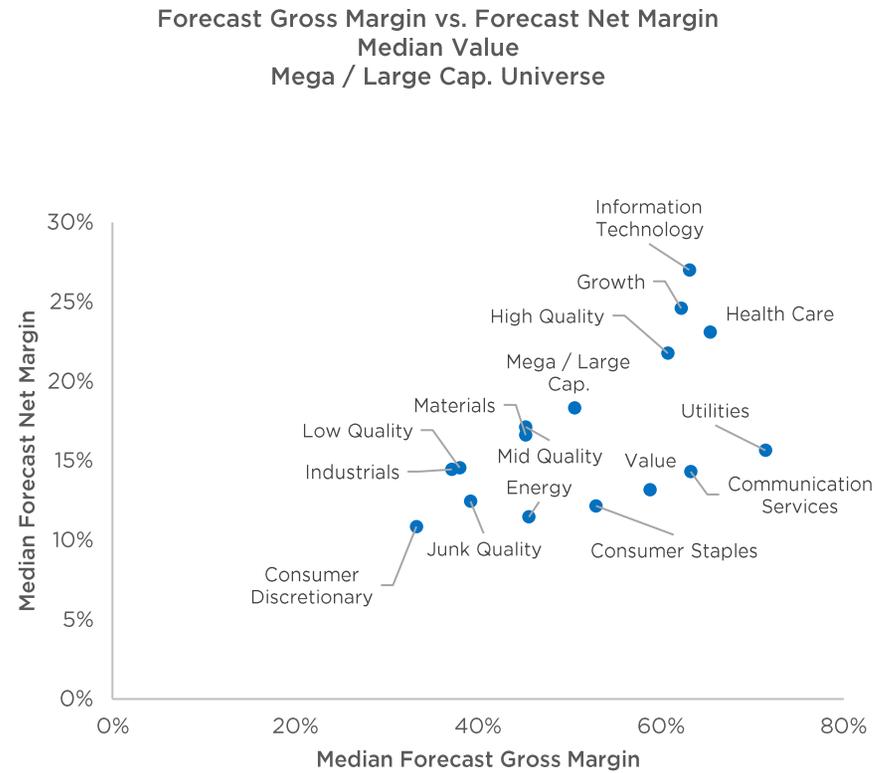
Source: Trivariate Research

# LARGE CAPS. ARE FORECASTED TO HAVE NEAR-RECORD MARGINS

Most sectors and cohorts in the US equity market are forecasted to have very high gross margins and net margins vs. their own history. Materials, and Low Quality and Junk stocks all sit near the top right corner (left chart) indicating close to all-time vs. their own history profitability. Healthcare gross margins are low, but net margins are high due to a sector mix-shift. Overall, there is a strong relationship between gross and net margin forecasts (right), with Technology profitability slated to lead the pack. Consumer Discretionary net and gross margins are forecasted to be the lowest of any sector.



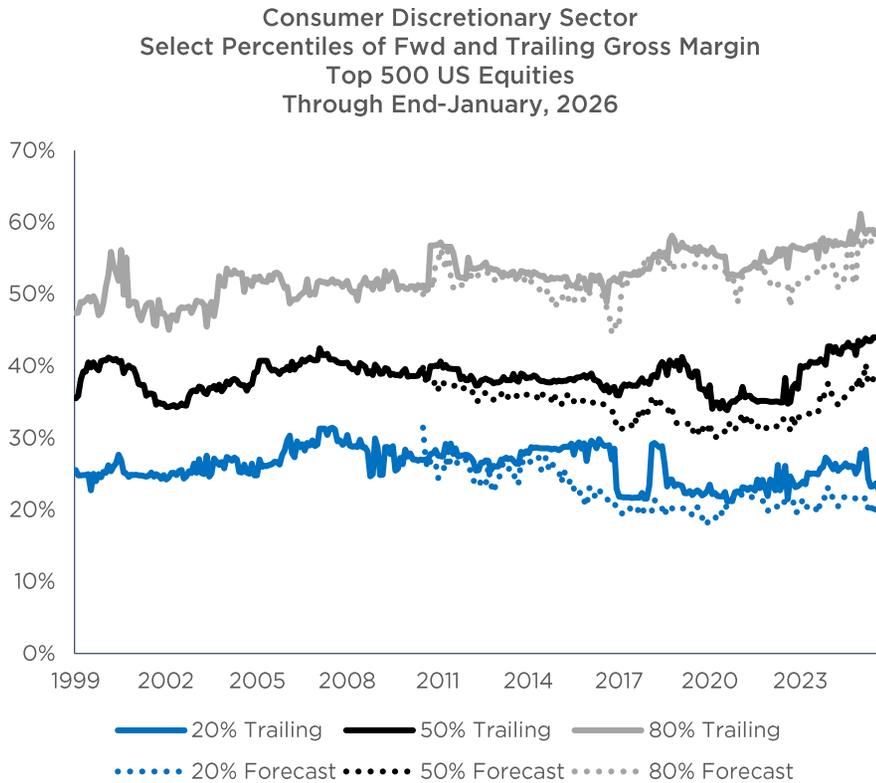
Source: Trivariate Research



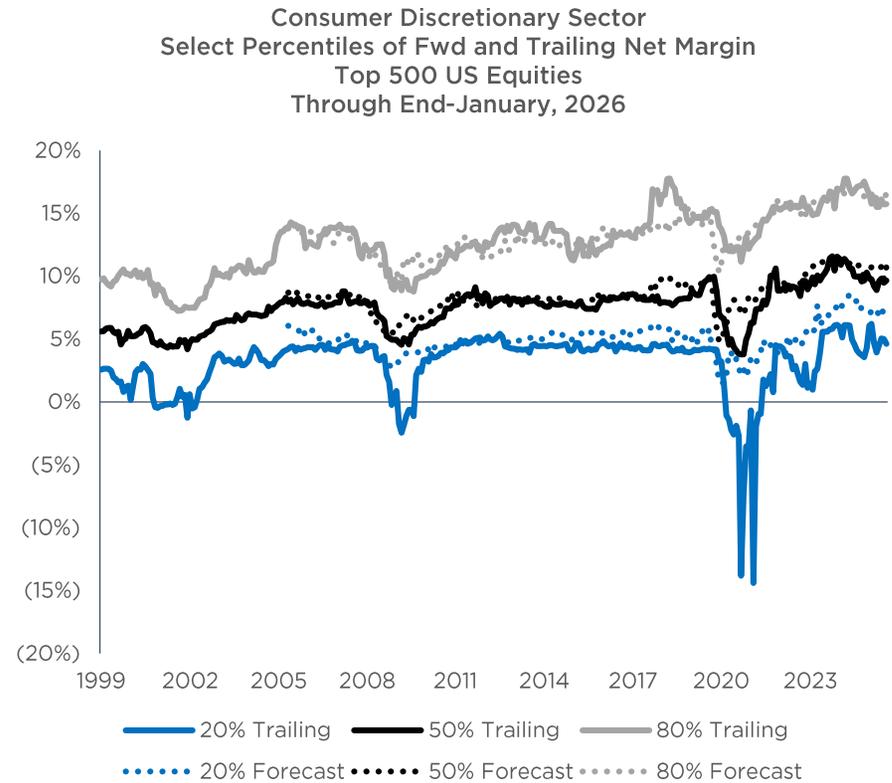
Source: Trivariate Research

# THE BOTTOM 20% OF DISCRETIONARY STOCKS HAVE POOR TRENDS

We dug into the Consumer Discretionary margin expectations given the sector has the lowest absolute margin expectations of any sector. We show the gross margin forecasts (left) for the 20th percentile, median, and 80th percentile stocks are generally and consistently BELOW what the trailing gross margins are, a phenomena we do not see in other sectors. However, the median and 80th percentile stocks have shown steady gross margin expansion. For net margins (right), the expectations are near the trailing profitability, except for the bottom 20% where expectations are consistently higher than what is achieved. It appears the bottom 20% of Discretionary stocks have poor margin trends and serially disappoint expectations.



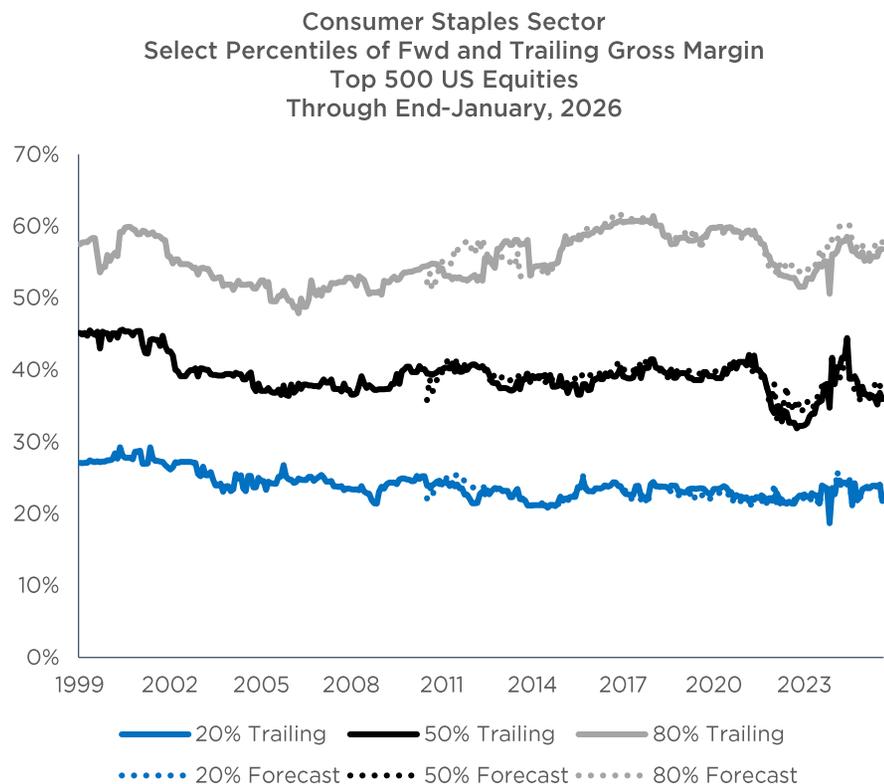
Source: Trivariate Research



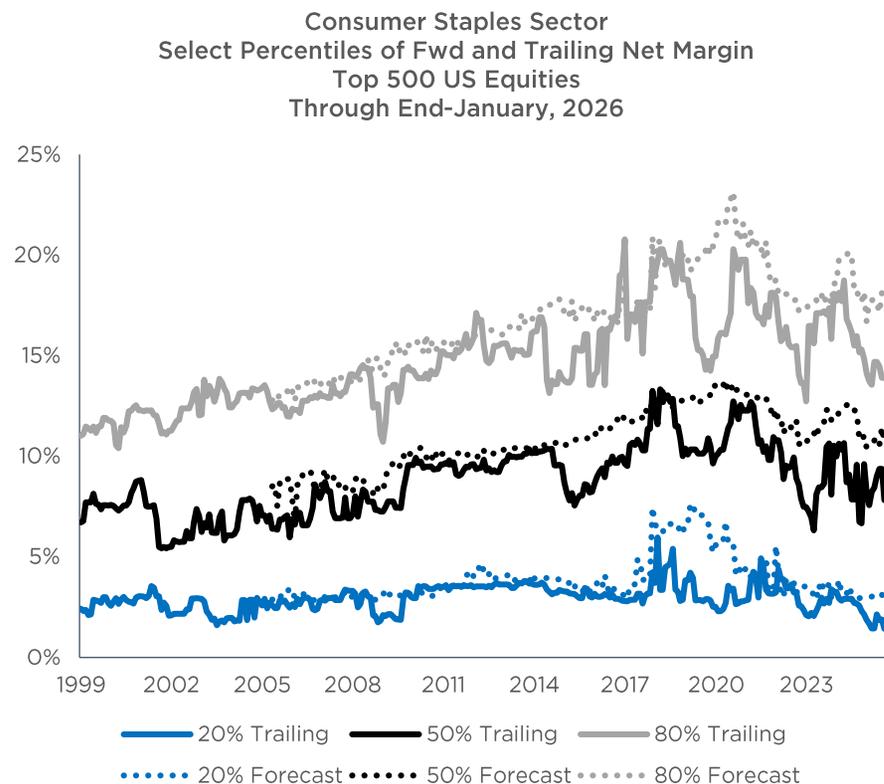
Source: Trivariate Research

# STAPLES MARGINS HAVE NOT IMPROVED IN MORE THAN 10 YEARS

Gross margin expectations (left) generally are in-line with trailing results, across the distribution, for Consumer Staples, but have not expanded for 25 years. Net margin estimates (right) for the median stock are consistently above what ultimately gets achieved, AND net margins have been trending lower across the distribution since 2017.



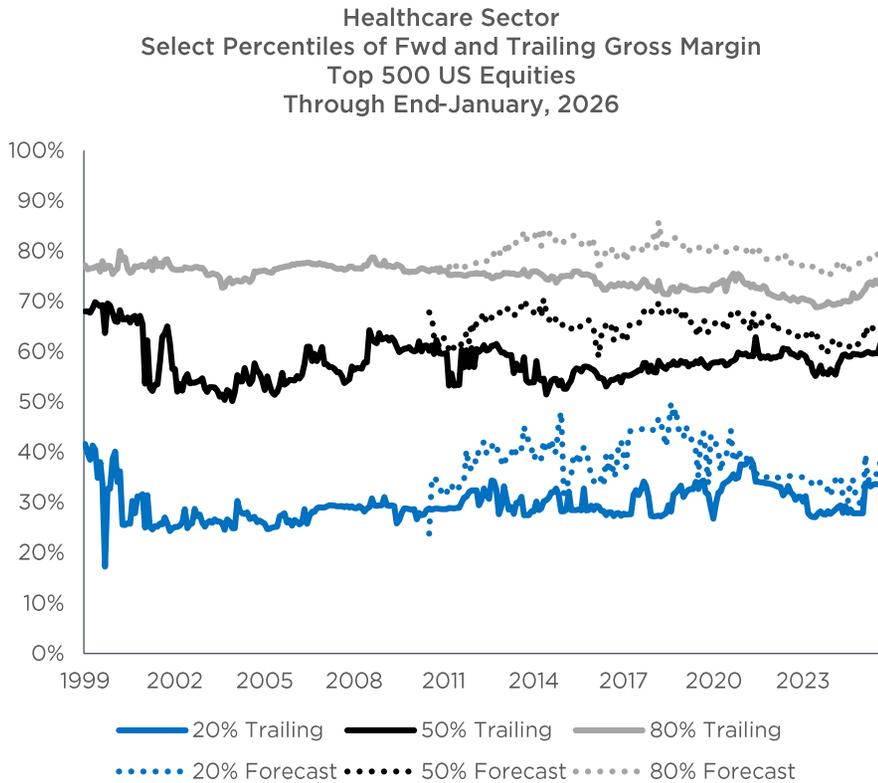
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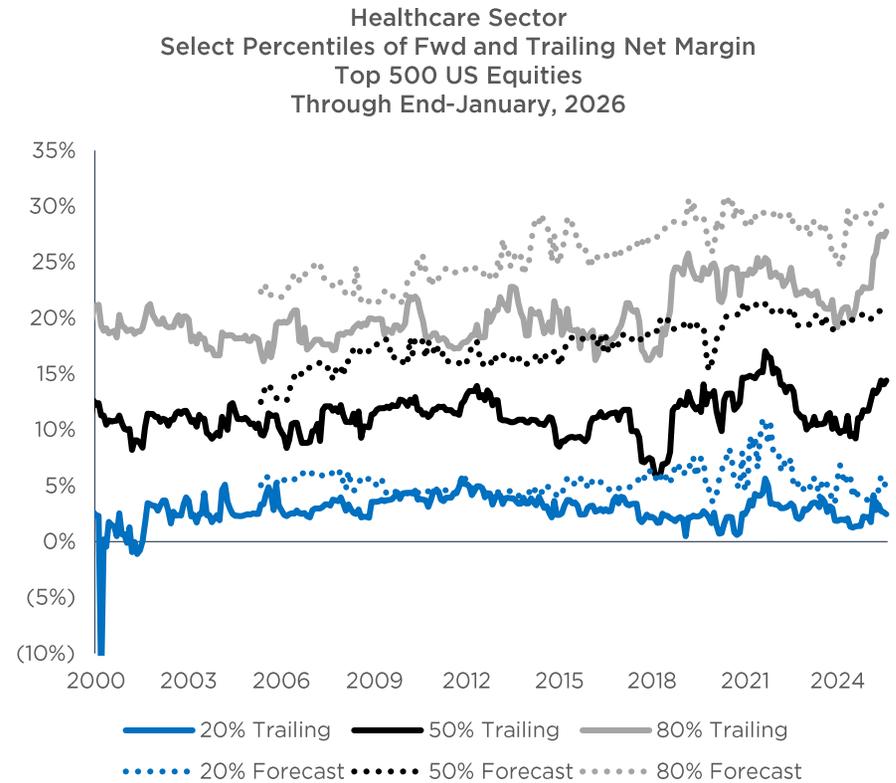
Source: Trivariate Research

# HEALTHCARE NET MARGINS HAVE BEEN IMPROVING OF LATE

Healthcare gross margins have slowly trended higher for the median stock (left), even if expectations consistently prove to be too high. Recently (right), net margins have picked up sharply for the median and top 20% of stocks. We dug into why the gross margins are low but net margins are high for the median Healthcare stock vs. history, and part of it is that Pharmaceuticals percentage of total Healthcare mega-/large-cap. Market cap. has been trending lower for years.



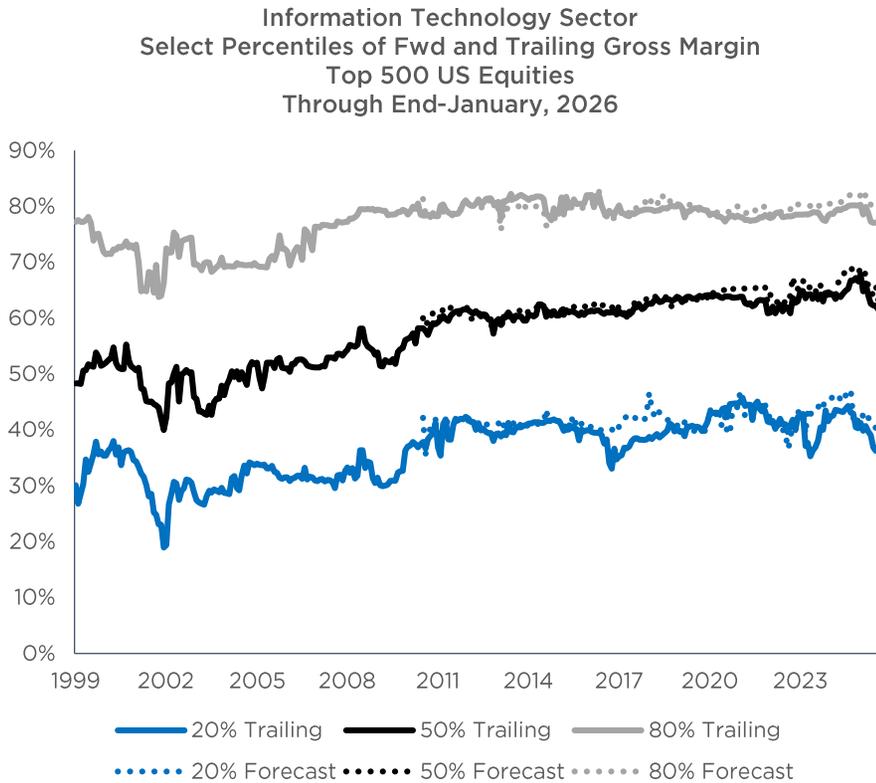
Source: Trivariate Research



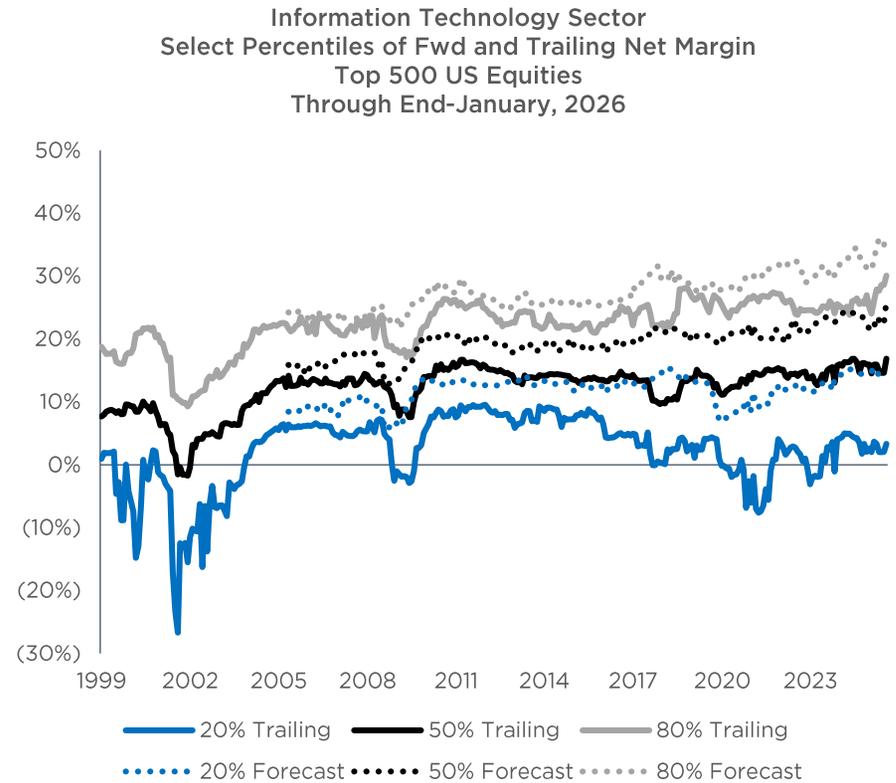
Source: Trivariate Research

# LEAST PROFITABLE TECH. STOCKS HAVE HIGH MARGIN FORECASTS

Interestingly, Technology forecasted and trailing gross margins are generally quite close to each other across the distribution, and trended higher from the TMT crisis 25 years ago until recently. It appears that across the distribution gross margins peaked last October for the Technology sector. Despite that, net margins have trended higher for the median and 80<sup>th</sup> percentile stock. Interestingly, net margin expectations are typically well above what is actually achieved in the Technology sector and are particularly high vs. history for the bottom 20% of stocks, a potential problem for performance in our judgment.



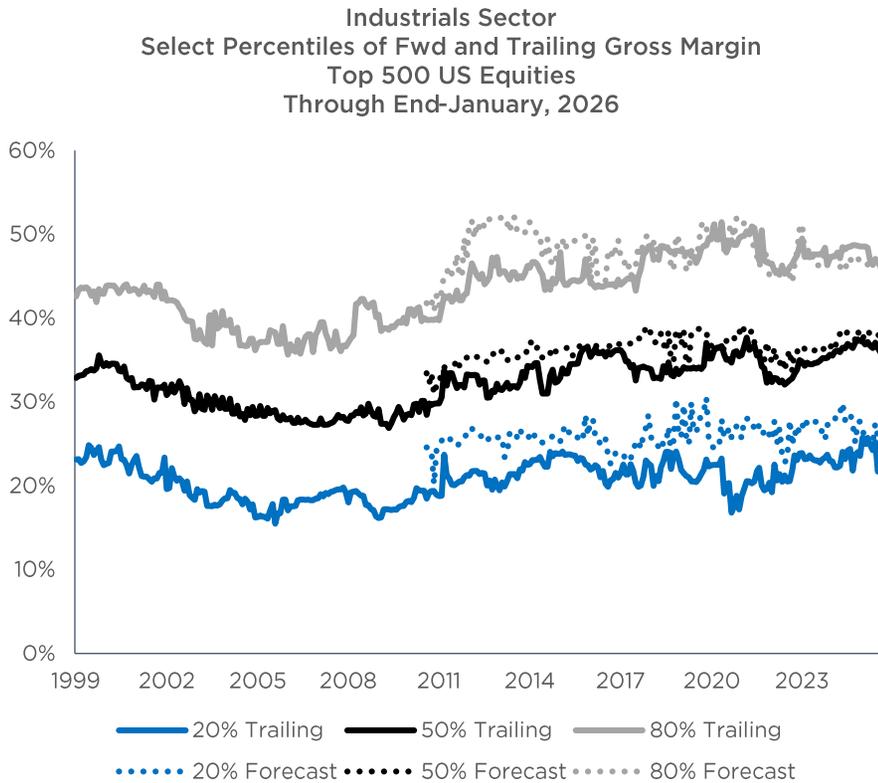
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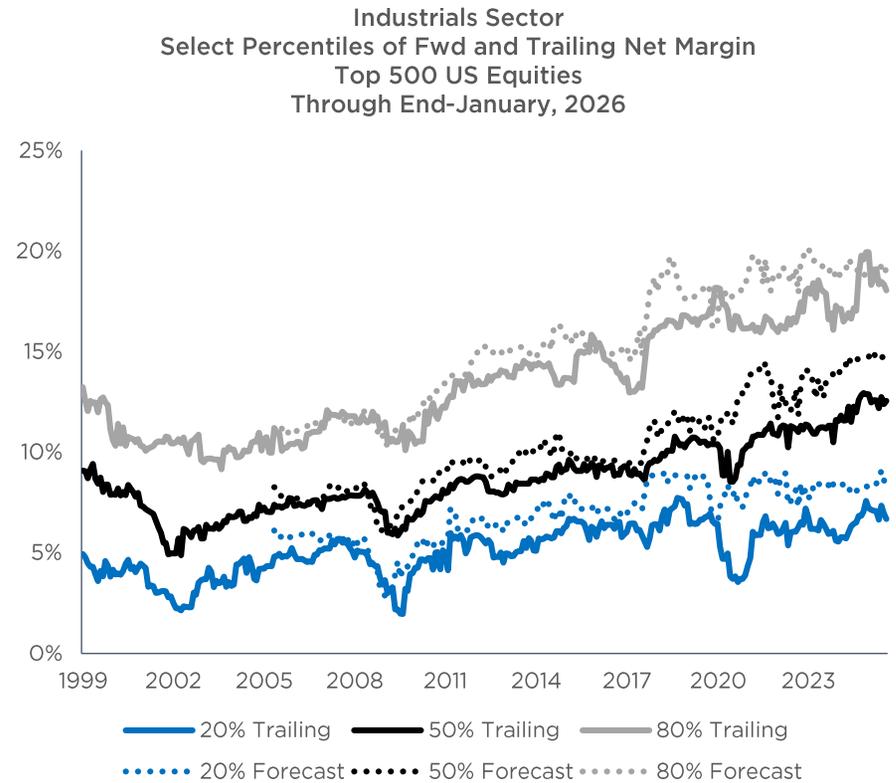
Source: Trivariate Research

# INDUSTRIALS NET MARGINS HAVE STEADILY EXPANDED

Gross margins have not improved for the top and bottom quintiles, but have for the median Industrial over the last three years (left). Expectations for the 80<sup>th</sup> percentile Industrial on gross margins have not been above trailing levels for a few years. Across the distribution, public Industrials companies have steadily expanded net margins (right), even if expectations for the median stock are particularly high vs. history today. Interestingly, for the 80<sup>th</sup> percentile, net margin forecasts are barely above trailing margins, implying either low expectations, or that margins are “tapped out” for this most profitable group.



Source: Trivariate Research

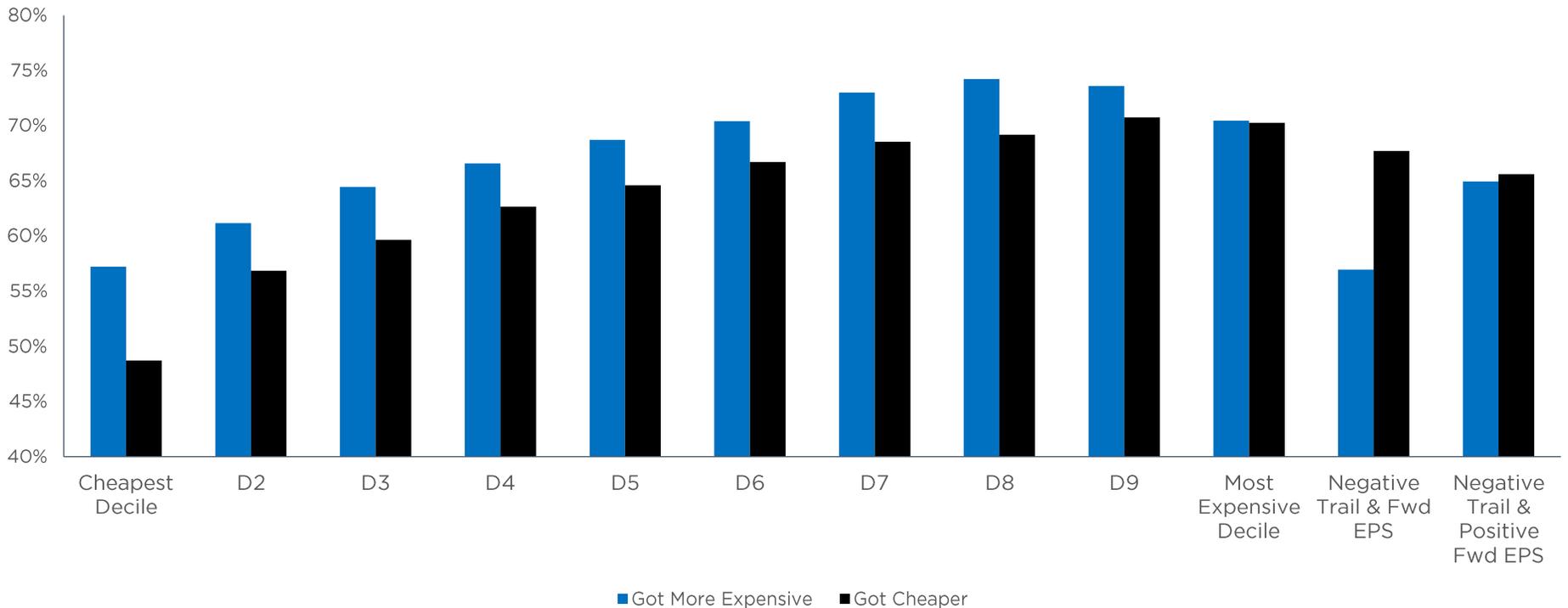


Source: Trivariate Research

# MULTIPLE EXPANSION OFTEN PREDICTS UPWARD EPS REVISIONS

In the end, revisions for stocks have driven performance, and stocks where the multiple expands over the previous quarter have a higher probability of subsequently beating estimates than the stocks where the multiple contracts.

Percentage of Stocks with Positive 3-Month EPS Revisions  
By Prior 3-Month Expansion or Contraction of Price-to-Fwd Earnings Multiple  
Top 900 US Equities  
Through End-January, 2026



Source: Trivariate Research

## QUANTITATIVELY-DERIVED STOCK IDEAS

The long ideas (left) have had recent multiple expansion, and are forecasted to have margin expansion, but not more net margin than gross margin expansion. This should help with estimate achievability. Long ideas include MRK, TMUS, MCD, NEE, and UBER, among others. The short ideas (right) have seen recent multiple contraction, have forecasted gross margin contraction but net margin expansion, reducing estimate achievability. Ideas include APH, CRM, ANET, and LVS, among others.

**Long Ideas, Top 900 US Equities**  
**Price-to-Fwd Earnings Expansion, Fwd GM are Up,**  
**& Fwd Net Margins are Up Less Than Fwd Gross Margins**  
**As of February 20<sup>th</sup>, 2026**

| Ticker | Company                     | Sector                 | Market Cap.<br>(US \$Bn.) |
|--------|-----------------------------|------------------------|---------------------------|
| MRK    | Merck & Co., Inc.           | Health Care            | 303.45                    |
| TMUS   | T-Mobile US, Inc.           | Communication Services | 237.41                    |
| MCD    | McDonald's Corporation      | Consumer Discretionary | 234.46                    |
| NEE    | NextEra Energy, Inc.        | Utilities              | 192.06                    |
| UBER   | Uber Technologies, Inc.     | Industrials            | 152.01                    |
| COP    | ConocoPhillips              | Energy                 | 135.11                    |
| GLW    | Corning Incorporated        | Information Technology | 119.69                    |
| WM     | Waste Management, Inc.      | Industrials            | 92.89                     |
| ITW    | Illinois Tool Works Inc.    | Industrials            | 85.01                     |
| CRH    | CRH plc                     | Materials              | 82.89                     |
| CL     | Colgate-Palmolive           | Consumer Staples       | 76.65                     |
| COR    | Cencora, Inc.               | Health Care            | 70.24                     |
| PCAR   | PACCAR Inc                  | Industrials            | 67.56                     |
| LHX    | L3Harris Technologies, Inc. | Industrials            | 66.52                     |
| AME    | AMETEK, Inc.                | Industrials            | 53.47                     |
| GWV    | W.W. Grainger, Inc.         | Industrials            | 53.39                     |
| BDX    | Becton, Dickinson and       | Health Care            | 52.79                     |
| CTVA   | Corteva, Inc.               | Materials              | 51.32                     |
| FERG   | Ferguson Enterprises Inc.   | Industrials            | 49.86                     |
| WAB    | Westinghouse Air Brake      | Industrials            | 45.15                     |

Source: Trivariate Research

**Short Ideas, Top 900 US Equities**  
**Price-to-Fwd Earnings Contraction, Fwd GM are Down,**  
**& Fwd Net Margins are Up**  
**As of February 20<sup>th</sup>, 2026**

| Ticker | Company                   | Sector                 | Market Cap.<br>(US \$Bn.) |
|--------|---------------------------|------------------------|---------------------------|
| APH    | Amphenol Corporation      | Information Technology | 185.66                    |
| CRM    | Salesforce, Inc.          | Information Technology | 173.49                    |
| ANET   | Arista Networks, Inc.     | Information Technology | 166.86                    |
| LVS    | Las Vegas Sands Corp.     | Consumer Discretionary | 38.98                     |
| XYL    | Xylem Inc.                | Industrials            | 31.36                     |
| VLTO   | Veralto Corporation       | Industrials            | 23.11                     |
| CRDO   | Credo Technology Group    | Information Technology | 22.41                     |
| LULU   | lululemon athletica       | Consumer Discretionary | 21.97                     |
| FLUT   | Flutter Entertainment     | Consumer Discretionary | 21.21                     |
| JHX    | James Hardie Industries   | Materials              | 20.31                     |
| SMCI   | Super Micro Computer      | Information Technology | 19.42                     |
| BWXT   | BWX Technologies, Inc.    | Industrials            | 18.87                     |
| GRAB   | Grab Holdings Limited     | Industrials            | 17.96                     |
| SSNC   | SS&C Technologies         | Industrials            | 17.42                     |
| KTOS   | Kratos Defense & Security | Industrials            | 16.37                     |
| HUBS   | HubSpot, Inc.             | Information Technology | 12.31                     |
| RMBS   | Rambus Inc.               | Information Technology | 11.06                     |
| W      | Wayfair Inc.              | Consumer Discretionary | 10.65                     |
| DT     | Dynatrace, Inc.           | Information Technology | 10.56                     |
| BAH    | Booz Allen Hamilton       | Industrials            | 9.31                      |

Source: Trivariate Research

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