SNIPER POINT CAPITAL

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VALUE vs. QUALITY

Where Return Comes From

Mean Reversion, Future Compounding, and the Best Opportunity Set

VALUE	QUALITY	BEST OPPORTUNITY
Mean Reversion	**Future Compounding**	**Both Engines**

RESEARCH NOTE
April 4, 2026 | Strictly Confidential

Internal Investment Framework
Concept memo | Index-level overlay

Executive Summary

This note codifies the framework I use to distinguish value from quality, why the two are not opposites, and where the highest-conviction opportunities sit. I sit somewhere between Benjamin Graham and the Buffett-Munger-TCI-Valley Forge tradition: I care about price paid, but I care more about what kind of business I am buying.

The key idea is mechanical, not philosophical. Value and quality differ in *where the return comes from*. In value, fair value barely moves; the return is the price reverting to it. In quality, fair value itself compounds upward; the return is the business creating intrinsic value over time. The best opportunities sit at the intersection — a quality business priced as if it were a value stock — because both engines fire at once: mean reversion (multiple rerating) *plus* the natural compounding of the underlying earnings power.

At the index level, the same lens reframes the S&P 500 today. Headline P/E looks expensive against history, but the index has become structurally higher quality (more software, higher margins, higher ROIC, more global winner-take-most franchises). On a PEG basis — which has been by far the most predictive multi-year signal over the last decade — the index is modestly *undervalued*, with forward-return regimes consistent with that reading.

Note dated April 4, 2026. All multiples, snapshots, and forward-return regime calls reflect data through that date.

I. Value Investing — Return From Mean Reversion

The Graham heritage

Traditional value investors focus on buying businesses below intrinsic value. The central idea, formalized by Benjamin Graham in *Security Analysis* and *The Intelligent Investor*, is that return depends primarily on the price paid relative to what a business is actually worth. From the 1930s through the 1970s, Graham and early Buffett scoured for companies trading below the value of their net assets. The thesis was simple: the market would eventually recognize fair value; the company could be liquidated; or the stock would re-rate upward over time.

Markets today are dramatically more efficient. Information is widely accessible, financial reporting is heavily regulated, and screens are run by every quant desk in the world. Pure deep-value opportunities are rare. Value investing still works — buying $1 for $0.60 is always a respectable proposition — but the source of the return has narrowed.

Where the return comes from

Value names tend to share a profile: weak earnings power, deteriorating competitive advantages, limited growth, structural challenges. In these situations, the investor profits mainly from the stock re-rating toward fair value. A company trading at 5x earnings that rerates to 10x doubles — the return comes from **multiple expansion**, not from earnings growth.

But once the stock reaches fair value, future upside collapses if earnings stagnate. That is the structural ceiling on classic value: the return is front-loaded into the rerating, and the underlying business does not produce a tailwind once you arrive at fair value. Charter Communications is the archetype — rerating from 5x to 10x can deliver a great short-term outcome, but most of that return is valuation expansion, not business growth.

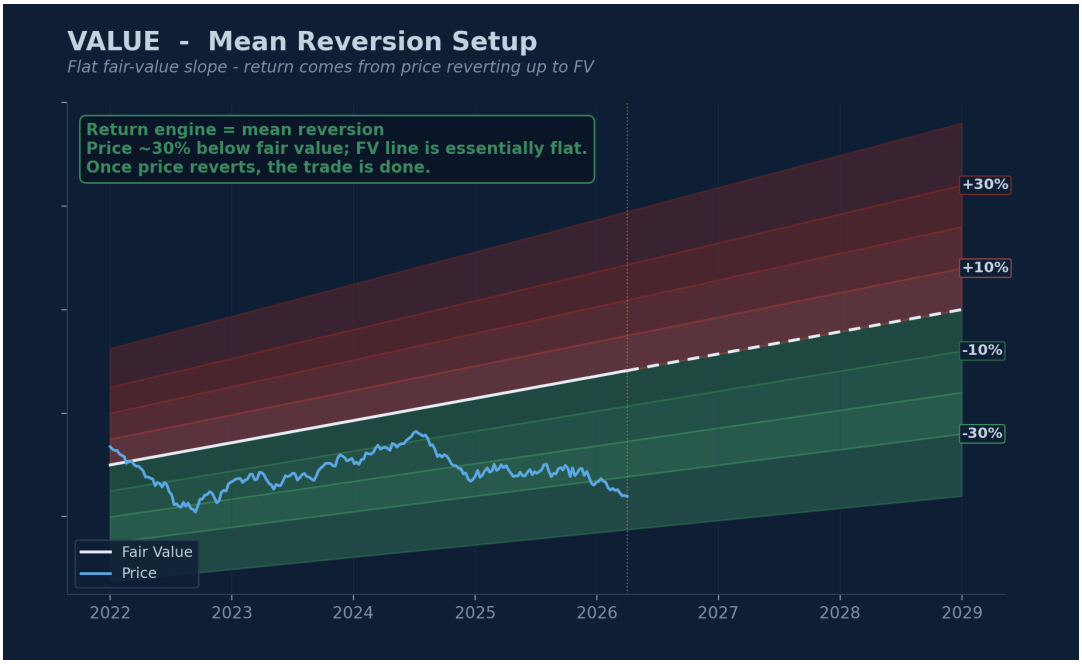

Figure 1 — Value archetype. The fair-value line (solid in history, dashed forward) has a nearly flat slope; the price has drifted lower and now sits ~30% below fair value, in the deep-green undervalued band. The forward return engine is the price reverting up to that flat fair-value line — classic mean reversion. Once price reaches fair value, the trade is done.

II. Quality Investing — Return From Future Compounding

Wonderful businesses, fair prices

Quality investing flips the emphasis. Rather than buying mediocre companies cheap, the goal is to own exceptional businesses at fair prices. Buffett framed it precisely:

> *"It is far better to buy a wonderful company at a fair price than a fair company at a wonderful price."*
> *— Warren Buffett*

Quality businesses possess: strong barriers to entry; pricing power; switching costs; durable competitive advantages; long reinvestment runways. Bought even at fair value, they continue compounding earnings for years — and intrinsic value compounds with them.

Where the return comes from

For a quality compounder, the return is **not** the stock rerating. It is the underlying business continuously increasing its intrinsic value. Fair value itself slopes upward, and the price tracks it. The math is the inverse of value: in value, price moves to a stationary fair-value line; in quality, fair value drags price upward through time. Time is the friend of the wonderful business and the enemy of the mediocre.

FICO is the canonical example. It may trade at a premium multiple, but the company has compounded earnings at extreme rates while maintaining near-monopoly positioning. The thesis is not *"buy cheap and hope the market rerates the stock."* The thesis is *"the company itself will continue creating value for decades."* That is the structural difference between quality and traditional value.

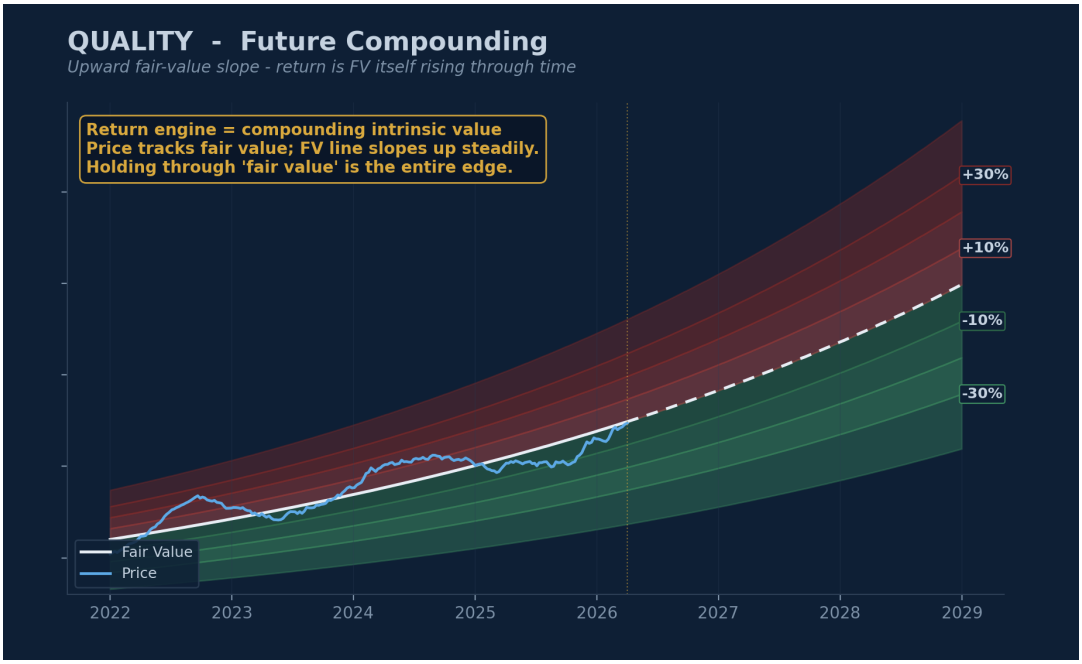

*Figure 2 — Quality archetype. The fair-value line slopes **upward** as the business compounds intrinsic value. Price oscillates around fair value — sometimes briefly above (red band), sometimes briefly below (green band), but rarely far from it. There is no big gap to close — the return is the slope of the fair-value line itself, year after year.*

III. Side-by-Side — Where the Return Comes From

The two regimes are easiest to internalize side-by-side. The dotted gold line in each panel is fair value over a fixed period of time. In the **Value** panel, fair value has a flattish slope and the price sits below it — the return engine is mean reversion. In the **Quality** panel, the price already trades near fair value but the fair-value line itself slopes upward — the return engine is the business compounding. In the **Opportunity** panel, you get both: a quality business priced like a value stock. The price has room to rerate up to fair value, *and* the fair-value line is climbing while it does.

Figure 3 — Conceptual decomposition. ***Left:*** *value — flat-slope fair value, return = price → FV.* ***Middle:*** *quality — upward-slope fair value, return = FV itself compounding.* ***Right:*** *opportunity — quality business at a value price; return = rerating plus compounding, both engines firing simultaneously.*

Two practical implications. First, once a value name reaches fair value, the trade is over — the engine cuts out. Second, in a quality compounder with an upward-sloping fair-value line, the worst thing you can do is sell at fair value, because the fair-value line keeps moving up. Holding compounders *through* fair value, not exiting at it, is the entire quality-investing edge.

IV. The Best Opportunity Set — Quality Priced Like Value

The asymmetry compounds when a high-quality business is temporarily mispriced as if it were a value stock. The market briefly assigns it the wrong fair-value line — a flat one — even though the underlying business still has the upward slope of a compounder. Two return engines are then live simultaneously:

- **Mean reversion / rerating.** The multiple normalizes back toward its appropriate level for a business of this quality.
- **Intrinsic value compounding.** Underneath that rerating, earnings continue to compound at the rate the business is structurally capable of.

Google in late 2024-early 2025 was the textbook recent example. The market temporarily priced it as a slower-growth, AI-displaced ad company even as earnings continued compounding and the core quality attributes were intact. Investors who underwrote that mispricing collected both the rerating *and* the underlying compounding as sentiment normalized.

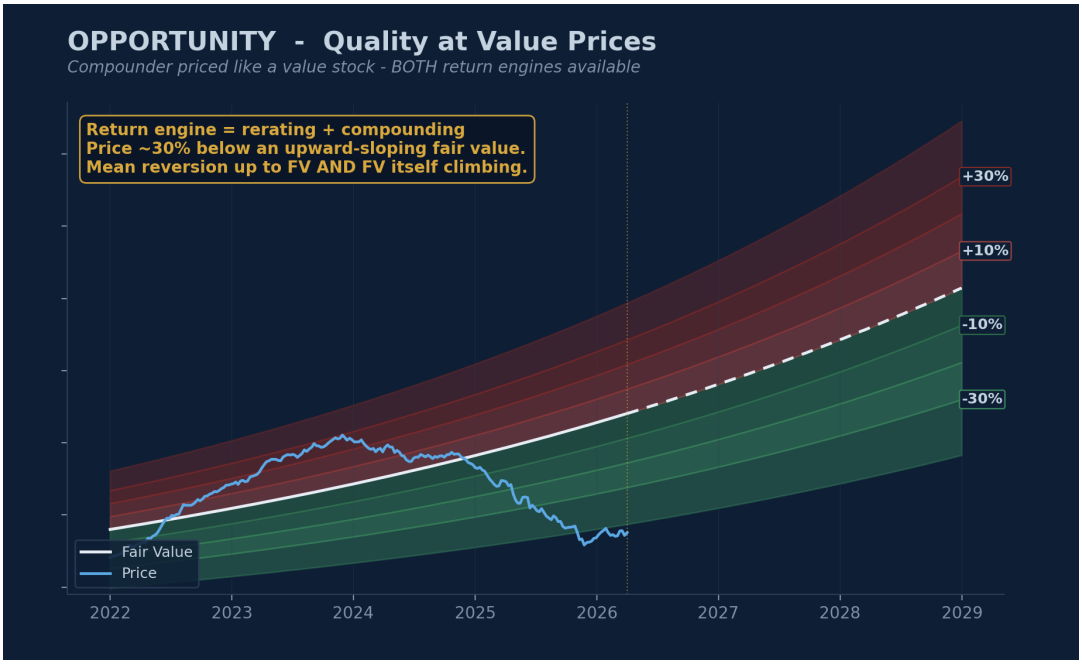

*Figure 4 — The Google-style setup. The fair-value line slopes **upward** (it is a compounder). Price rallied above fair value into the red band, then suffered a reflexive bust back down into the deep-green band — now priced like a value stock. Forward return captures both: rerating up to fair value, and fair value itself compounding while the rerating happens.*

What you need to underwrite this setup

These opportunities are rare and require deeper diligence, not less. The core questions for any candidate:

- **Is the quality real?** Competitive advantages, switching costs, pricing power, reinvestment runway, ROIC durability.
- **Why is it priced like value?** Identify the specific narrative causing the misprice (regulatory scare, growth-deceleration fear, AI displacement panic, etc.) and stress-test whether it actually impairs the long-term compounding engine.
- **What is the catalyst for the slope to be re-recognized?** Often this is simply the next two or three earnings prints — operationally validating that the compounding engine is intact.

V. The Same Lens, Applied to the S&P 500

The value-versus-quality frame is not just a single-name tool. The same logic explains why today's S&P 500 looks more expensive than it really is. The composition of the index has fundamentally changed over the last fifteen years: higher-margin businesses, more scalable software platforms, stronger returns on capital, more globally monopolistic franchises. As the **quality of the underlying constituents** has improved, the multiple the market is willing to pay has naturally risen. Comparing today's headline P/E to 2005's is comparing two different indices.

PEG has been the most predictive signal

If quality has improved, then a multiple that adjusts for growth (PEG) should out-predict raw multiples. The empirical record over the last decade confirms this directly. Across 3M, 6M, 12M, and 24M horizons, PEG has the largest absolute information coefficient of any single signal — by a wide margin.

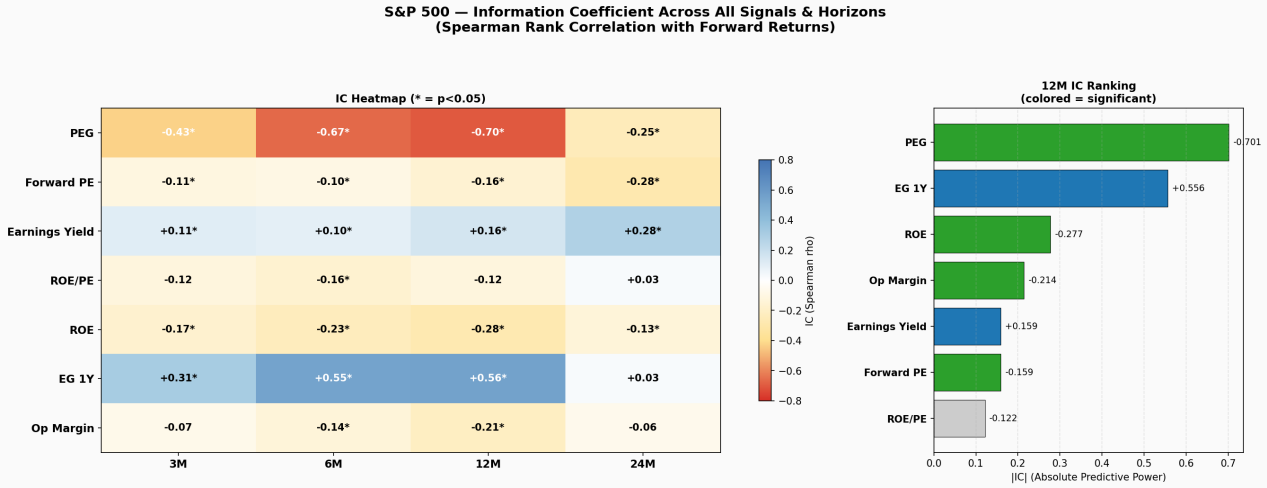

Figure 5 — S&P 500 information coefficient across signals and horizons (Spearman rank correlation with forward returns). PEG dominates across all horizons (|IC| up to 0.70 at 12M), with earnings-growth and ROE meaningfully behind. Raw forward P/E and earnings yield are roughly tied at the bottom — raw multiples have been the least predictive of forward returns.

Repricing the index in PEG terms

If you reprice the S&P 500 in PEG terms rather than P/E terms, the index does not look expensive — it looks fairly cheap. At a median PEG of ~1.85x against current earnings-growth expectations, fair value screens roughly 28% above the current S&P level. The index is sitting in the lower portion of its long-run fair-value band — what GuruFocus would label "modestly undervalued." This is not a call for a melt-up; it is a call against the narrative that the index is rich just because its P/E is north of historical averages.

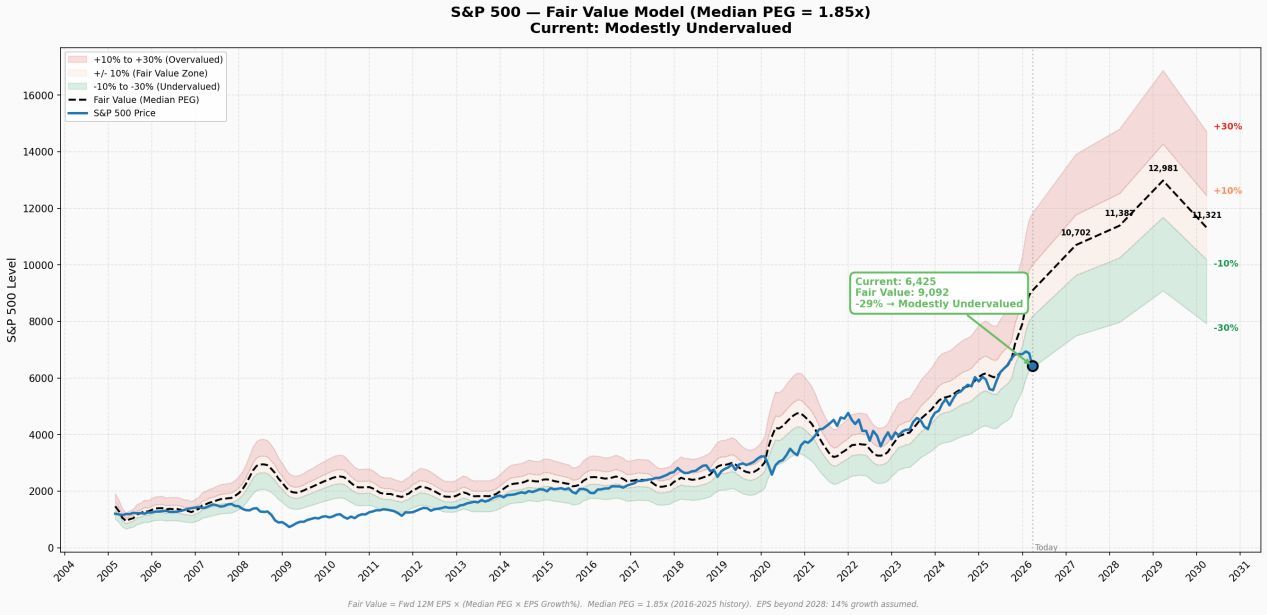

*Figure 6 — S&P 500 fair-value model using median historical PEG. Black dashed line is fair value; pink/red bands denote overvalued zones, green bands undervalued. The index closed the snapshot period inside the green band — **~28% below fair value** on this measure. Same logic as the GuruFocus single-stock charts, applied at the index level.*

Forward returns by regime

Slicing history into terciles by forward P/E and PEG produces a clean decision matrix. The current regime is **Mid PE / Cheap PEG**. Historically, this combination has delivered a median forward 12-month return of 33.9% with a 100% hit rate (n=7). The pattern across the full matrix is the central message of this section: **raw P/E tercile barely matters; PEG tercile drives almost the entire forward-return distribution.** Cheap-PEG cohorts deliver mid-20s% to mid-30s% medians with hit rates of 94-100%; Rich-PEG cohorts deliver low single digits at best and deeply negative outcomes when PE is also rich.

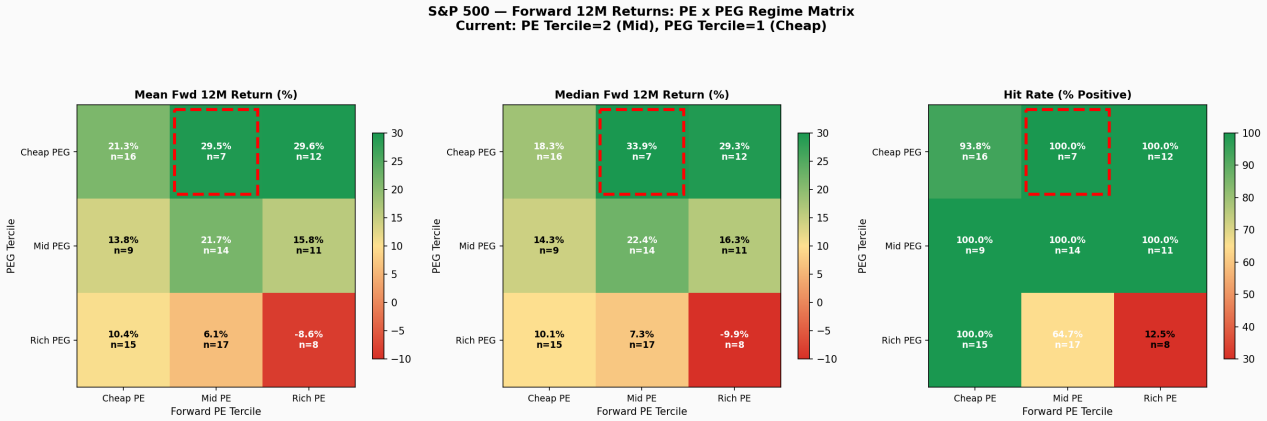

*Figure 7 — S&P 500 forward 12M returns by PE x PEG tercile. Mean, median, and hit rate. The dashed red box marks today's regime (Mid PE, Cheap PEG): historical median forward 12M return of **+33.9%** with a **100% hit rate**. The bottom row (Rich PEG) is where forward returns collapse — especially when PE is also rich (mean –8.6%, hit rate 12.5%).*

Translating the framework: **the index itself is a quality compounder currently priced more like value than its growth profile justifies.** Headline P/E says "rich." PEG says "modestly cheap." The historical evidence says PEG has been right and P/E has been noise.

VI. Synthesis

Value and quality are not opposing philosophies. They are two different answers to the same question: *where does the return come from?*

Regime	Fair-value slope	Price position	Return engine
Value	Flat / low slope	Below fair value	Mean reversion (multiple expansion)
Quality	Upward slope	Near fair value	Compounding intrinsic value
Opportunity	Upward slope	Below fair value	Rerating + compounding (both)
Expensive quality	Upward slope	Above fair value	Compounding minus multiple compression

The framework changes how I size, hold, and exit positions:

- **Concentration over diversification.** Truly exceptional businesses available at non-exceptional prices are rare. When found, they deserve real weight — not a 1% screener slot.
- **Time is the asset.** The compounding engine only matters if you hold long enough to let the fair-value line rise. Exiting at "fair value" sacrifices the upward slope.
- **Beware expensive quality.** Costco, Walmart, and Apple are outstanding businesses, but at certain prices the multiple-compression drag exceeds the compounding tailwind. The quality has to be underwritten *relative to the price being asked*.
- **At the index level, prefer PEG to P/E.** Raw multiples do not adjust for the quality and growth profile of the constituents. PEG does, and it has been the most predictive multi-year signal over the last decade.

Capitalism rewards the businesses that create the most value over time. Investing rewards owning them. The mistake is treating value and quality as competing schools; the right move is to recognize which engine you are buying and underwrite the price accordingly.

VII. Important Disclosures

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Index analysis. The S&P 500 information coefficient, fair-value-PEG, and PE x PEG regime analyses presented in Section V are based on historical data and computed by the author. Forward returns by regime are historical and may not be representative of future market behavior. Sample sizes in regime cells are small (n = 7-17 in most cells); hit-rate and median-return statistics should be interpreted accordingly. The current-regime designation reflects market data as of the date of this note.

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