



# THE EARNINGS ILLUSION

NAVIGATING MULTIPLE  
COMPRESSION SCENARIOS

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APRIL 2026 RESEARCH INSIGHTS



“The stock market is a device for transferring money from the impatient to the patient.”, Warren Buffett. In a compression cycle, this truth cuts deepest.

Imagine reading a company’s quarterly earnings release. Revenue is up 22%. Profit margins expanded. Earnings per share just hit a record high; the fourth consecutive quarter of double-digit growth. You’d expect the stock to be soaring. Instead, you open your brokerage account and find the share price down 18% from where it was a year ago. Your investment, despite being backed by a genuinely great business, is deeply underwater.

This is not a hypothetical. It is one of the most common, and most devastating, experiences in investing. The culprit is a force called multiple compression: the market’s decision to pay fewer dollars per dollar of earnings, regardless of how rapidly those earnings are growing. It is the single biggest reason why investors who correctly identify great businesses still lose money in the short and medium term. And right now, in the current market environment, it is the dominant variable separating winners from losers across almost every asset class we cover.

### **Our Market Stance**

We are operating in a market that has split into two distinct worlds. In the first world, earnings growth is real, accelerating, and durable, but share prices are lagging or declining because investors are paying lower multiples on those earnings than they did 18 months ago. In the second world, prices are holding up or rising, but mostly because sentiment remains elevated and the underlying earnings story hasn’t yet been stress-tested by rates, cycle turns, or structural change.

Our position as investors is clear: we want to be buyers in the first world and cautious spectators in the second. We are specifically hunting for high-quality, high-growth businesses, those capable of sustainably delivering 18% or more in earnings growth, whose valuations have been dragged down not by any failure in the business, but purely by the mathematics of a compression cycle. When we find them, we step in. Why? because when compression eventually reverses, and it always does for companies with genuine earnings power, the investor who bought at the trough benefits from a dual tailwind: earnings growth compounding from below, and multiples expanding from above.

The sections that follow walk through the mechanics of multiple compression, examine live case studies from market examples and the broader market, expose the value trap dangers that lurk beneath seemingly cheap valuations, and present our investment playbook for capitalizing on the disconnect between price and intrinsic value, as seen in our Global Equity Special Fund (USD), Mutli-Asset Strategy Special Fund (USD), Global Shariah Equity Special Fund(USD), Africa Equity Special Fund (ZAR) funds.

## 2.1 A Simple Analogy - Restaurant Delicacies Limited

Let us take a hypothetical example of a restaurant, Restaurant Delicacies Ltd. It earns KES 5 million in annual profits and as an investor, you agree to pay KES 50 million for it. You have effectively paid a 10x multiple of the restaurant's earnings. Now, assume that in the next year, the restaurant's profit grows to KES 6 million, a 20% improvement. But, when you try to sell the business, prospective investors are only willing to pay a multiple of 7x on earnings due to factors such as increased competition. As a result, you sell the business for KES 42 Million (7x \* KES 6,000,000). Despite an increase in the restaurant's profits, you lost KES 8 million on the investment, which is a -16% return on investment. The business got better though your investment got worse. This is what multiple compression is.

The price you pay as an investor is a function of two components: the earnings themselves and what the market is willing to pay per unit of earnings. Multiple compression affects the second component, where the market reprices/readjusts the same stream of profits at a lower valuation.

## 2.2 The Math (Technical)

Every equity valuation can be decomposed into two components:

$$\text{Share Price} = \text{Earnings Per Share} * \text{P/E (Price-to-Earnings) Multiple}$$

$$P = \text{EPS} * (\text{P/E})$$

This means that returns for equity investments are the product of earnings growth and multiple change.

### An Example

Assume our hypothetical company above, Restaurant Delicacies Ltd. is a listed entity, trading at KES 100 per share, with an EPS (Earnings per Share: How much profit is attributable to one share holder) of KES 5.00, implying a P/E multiple of 20x. Over the following year, EPS grew by 25% to KES 6.25. If the P/E multiple was unchanged, the expected share price would be KES 125 (KES 6.25 \* 20x), which will be a 25% gain on the share price. But, what happens if the market compresses (assumes that the company may not perform well afterwards) the multiple from 20x to 15x?

Metric	Year 0	Year 1
EPS	KES 5.00	KES 6.25 (+25%)
P/E Multiple	20.0x	15.0x (-25%)
Share Price	KES 100.00	KES 93.75
Investor Return	—	-6.3%

Figure 1: Even 25% EPS growth fails to protect shareholders when the P/E multiple contracts by five turns. Source: Arvocat Research

In as much as the earnings were positive, the use of a lower multiple resulted in a lower share price, below the investor's buying price.

## 2.3 Multiple Compression vs. Margin Compression

Margin compression and multiple compression are related but separate forces, and confusing them leads to analytical errors.

	Margin Compression	Multiple Compression
<b>What Shrinks?</b>	Profit margins (operating, net)	The valuation multiple (P/E, EV/EBITDA)
<b>Root Cause</b>	Rising costs, pricing pressure, input inflation, competitive intensity	Rising interest rates, growth deceleration, sentiment shift, sector rotation
<b>Where It Lives</b>	The income statement (revenue to earnings)	The market's perception of those earnings
<b>Who Controls It?</b>	Management (partially)	The market (entirely)
<b>Example</b>	Gross margin falls from 65% to 55% due to input cost inflation	P/E falls from 30x to 18x despite stable margins

Figure 2: The critical distinction between margin and multiple compression. Source: Arvocat Research

The most dangerous scenario for an equity investor is when both forces operate simultaneously: margins compressing (reducing the E in P/E) while the multiple itself is also falling (reducing the P/E ratio applied to those lower earnings). This double compression creates the gut-wrenching drawdowns that destroy portfolios. Conversely, the strongest scenario is when margins expand while the multiple re-rates higher, which is the mirror image that produces explosive returns.

Multiple compression is not random. It is driven by identifiable, recurring catalysts. Mastering these patterns allows investors to anticipate compression before it arrives, rather than merely diagnosing it after the fact. There are four primary catalysts, each with distinct mechanics and implications.

- Interest Rates
- Growth Deceleration
- Peak Cycle Earnings
- Sentiment and Sector Rotation

### 3.1 Interest Rates

Interest rates are the single most powerful force acting on equity multiples across the entire market. The present value of a future cash flow stream is inversely related to the discount rate applied to it, as seen in the formula below:

$$[PV = CF_1 / (1+r) + CF_2 / (1+r)^2 + CF_3 / (1+r)^3 + \dots] \text{ Where } r = \text{Risk-Free Rate} + \text{Equity Risk Premium}$$

When the risk-free rate rises (driven by central bank policy, inflation expectations, or fiscal dynamics), the discount rate  $r$  increases mechanically. This mathematically lowers the present value of all future cash flows, and therefore compresses the fair value multiple the market is willing to assign. The effect is especially severe for long-duration assets such as companies whose value is derived primarily from earnings far into the future, such as high-growth technology and biotech names. These sectors are typically susceptible to multiple compression.

For example, if our restaurant is expected to grow their free cash flows at 25% annually for ten years then at 3% into perpetuity, a 2% (200bps) increase in the discount rate (from 8% to 10%) can reduce the intrinsic value by 25-35% without any change to the company’s operational outlook.

This was experienced back in 2022-2023, where the Federal Reserve raised the fed fund rate by over 500bps. Growth stocks whose valuations are values on terminal-year cashflows experienced devastating multiple compression despite any fundamental deterioration in their businesses.

For example, between March 2022 and July 2023, the Federal Reserve raised the Fed Funds Rate by over 500bps (from almost 0% to 5%). Microsoft’s share price fell by 31% from its Nov 2021 peak of \$336 to a low of \$222 in late 2022, despite earnings remaining resilient. Quarterly earnings never dipped below \$2.20 throughout the entire hiking cycle. The chart below illustrates how growth stocks, whose valuations lean heavily on terminal-year cash flows discounted at higher rates, can experience devastating multiple compression without any fundamental business deterioration. The P/E in this instance contracted from 35x to 25x.

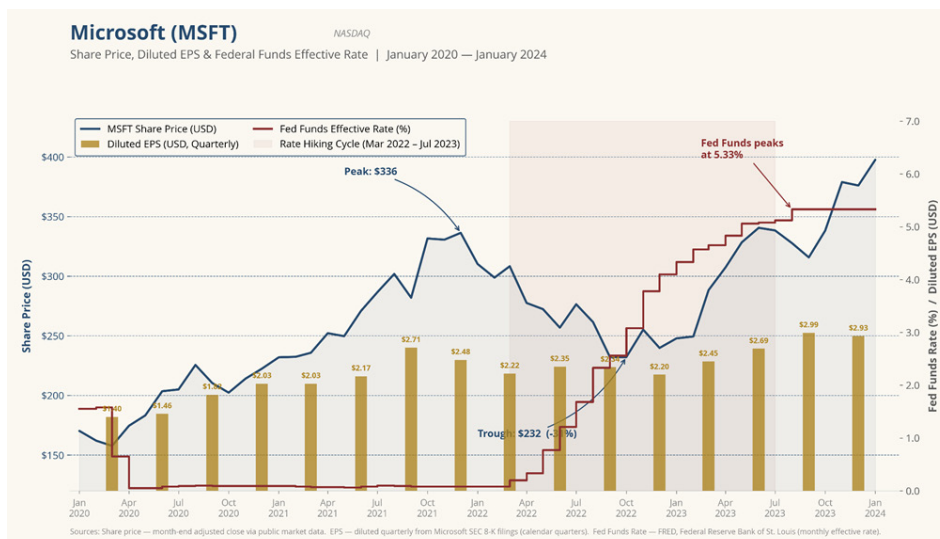


Figure 3: Microsoft’s share price, diluted EPS and Fed Funds Rate behaviour over a quantitative tightening period. Source: Arvocap Research

### 3.2 Growth Deceleration

This catalyst is structural and company-specific. Markets assign premium multiples to companies growing at extraordinary rates precisely because that growth is rare and valuable. But as companies scale, maintaining 40–50% revenue growth becomes mathematically and operationally impossible. A \$500 million revenue company adding \$250 million in new revenue is achievable. A \$50 billion company adding \$25 billion is a different proposition entirely.

As growth inevitably decelerates from, say, 50% to 20% to 15%, the market reprices the stock to reflect its new growth trajectory. The company has matured, not failed. However, the multiple assigned to a 15% grower is structurally lower than the multiple assigned to a 50% grower, all else equal.

Growth Phase	Revenue Growth	Typical P/E Range	Multiple Trend
Hyper-Growth	>40%	50–100x+	Expanding / Peak
Rapid Growth	20–40%	25–50x	Stabilising
Steady Growth	10–20%	15–25x	Compressing
Mature	<10%	10–18x	Floor / Trough

Figure 4: Stylised relationship between growth phase and equilibrium multiple range.  
Source: Arvocap Research

The critical insight is that a company's stock can decline even as its earnings grow, simply because the rate of growth is decelerating. The transition from hyper-growth to steady growth is where the most violent multiple compression typically happens.

For example, Salesforce in the 2010s was a hyper-growth machine, growing revenues by 30-35% annually, with the market prioritizing market share over profitability and assigning the stock a premium multiple of 10-12x EV/Sales. In 2015, adding \$1.2 billion in new revenue represented 31% growth, but in 2024, on a \$35 billion base, the same \$1.5 billion represented less than 5%, indicating a maturing business. As growth decelerated to the 10-15% range between 2022-2025, its multiple was compressed down to single digit multiples, prompting the company to pivot from top line growth to free cashflow growth. This provided better incentives for investors, who eventually valued the company from its ability to grow free cash flows and maintain operating margins above 20%.

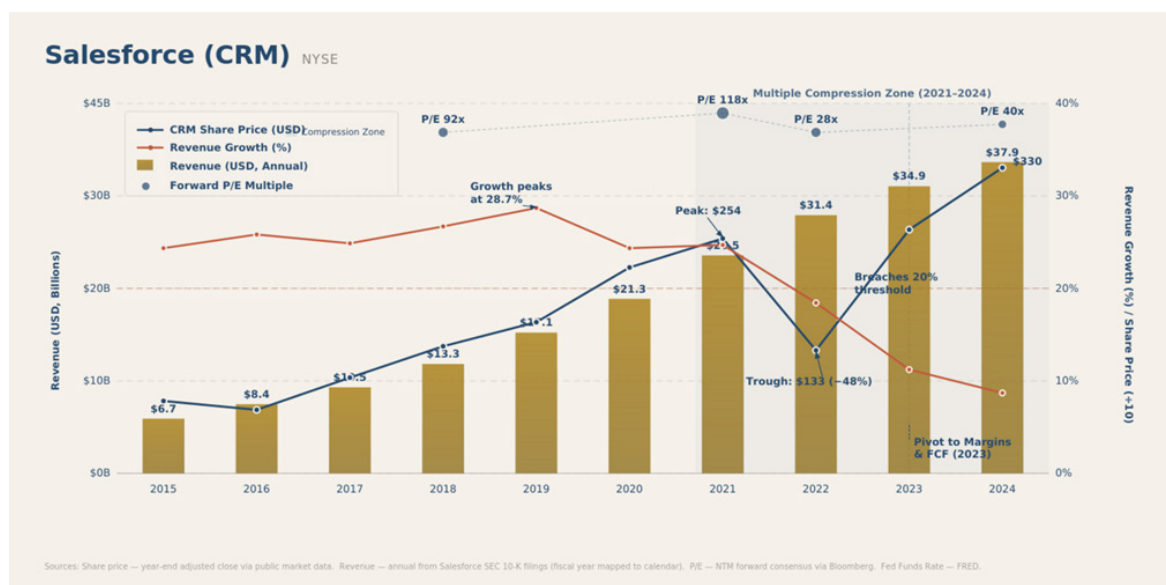


Figure 5: Stylised relationship between growth phase and equilibrium multiple range.  
Source: Arvocap Research

### 3.3 Peak Cycle Earnings

Cyclical businesses present a particular challenge because their earnings are inherently mean-reverting. When oil trades at \$120 per barrel, energy producers report record earnings. But the market, correctly, anticipates that oil will not stay at \$120 forever.

The result is a counterintuitive pattern: cyclical stocks often appear cheapest at the peak of the cycle (lowest P/E) and most expensive at the trough (highest P/E). This is not a market malfunction; it is rational forward pricing. When current earnings are at cyclical highs, the market assigns a low multiple because it expects those earnings to decline. When current earnings are depressed, the market assigns a high multiple because it expects recovery. In summary,

Low P/E at Peak = Market expects earnings to fall  
High P/E at Trough = Market expects earnings to recover

### 3.4 Sentiment and Sector Rotation

The fourth catalyst is psychological. Market sentiment oscillates between euphoria and anxiety in broadly predictable patterns, and these shifts drive multiple expansion and compression independent of fundamental changes.

During euphoria phases, investors extrapolate recent success indefinitely, assign premium multiples, dismiss risks, and crowd into momentum. Growth sectors, thematic trades, and story stocks command enormous valuations, as seen in 2024/25. During anxiety phases, the mirror image prevails: investors extrapolate recent pain, assign trough multiples, obsess over risks, and flee to perceived safety.

Sector rotation is the mechanism through which sentiment shifts manifest in portfolios. As capital rotates from growth to value, or from cyclicals to defensives, the sectors losing capital experience multiple compression while the recipients experience expansion. This rotation can be violent and indiscriminate, creating opportunities for analysts disciplined enough to distinguish temporary sentiment-driven repricing from permanent fundamental deterioration.

Phase	Investor Behaviour	Multiple Effect
Euphoria	Aggressive buying, risk-on positioning, growth at any price, leverage	Multiples expand to unsustainable levels; premiums widen
Anxiety	Defensive rotation, risk-off, flight to quality, liquidity hoarding	Multiples compress across growth sectors; discounts widen
Capitulation	Forced selling, margin calls, redemptions, indiscriminate liquidation	Multiples overshoot to the downside; baby thrown out with bathwater
Recovery	Selective re-entry, quality first, then breadth follows	Multiples begin normalising; strongest names re-rate first

Figure 6: The sentiment cycle and its mechanical effect on equity multiples. Source: Arvocat Research

### 4.1 When It Hurts: The Definitive case of Multiple Compression

Microsoft in 2022 is the cleanest illustration of what multiple compression looks like in practice, and why it is so disorienting for investors who focus primarily on business fundamentals. Microsoft entered the year as one of the most respected franchises in global equity markets. Azure, its cloud computing platform, was growing at over 40% per annum. Office 365 renewals were accelerating as hybrid work entrenched itself permanently into corporate life. LinkedIn was generating record advertising revenue. By virtually every operational measure, Microsoft's management was executing flawlessly.

And yet shareholders lost money. The mechanism was not operational failure, it was multiple compression, the mechanical repricing of what investors are willing to pay per dollar of earnings when the risk-free rate of money rises sharply. Microsoft is a classic long-duration equity: the bulk of its intrinsic value resides not in this year's earnings, but in the enormous stream of future cash flows that Azure's growth trajectory promises over the next decade and beyond. When the Fed, pressured in part by the Ukraine-driven energy shock running through global inflation, raised rates aggressively, those distant cash flows were discounted at a higher rate, and the present value of the entire enterprise contracted.

The table below captures the arithmetic with precision:

Metric	Jan 2022 (Pre-War)	Jan 2023 (Post-War)	Change
EPS	\$10.29	\$11.43	+11.1%
P/E Multiple	36x	23x	-36.1%
Stock Price	\$338.00	\$263.00	-22.2%
Shareholder Return	—	—	-22.2%

Figure 7: Microsoft Corporation — January 2022 vs. January 2023. Sources: Microsoft Corp. earnings releases, Bloomberg consensus estimates

Read that table carefully. Microsoft grew its earnings per share by 11.1% over the period, exceptional performance by any measure, delivered against a backdrop of war in Europe, an energy crisis, and the fastest rate-hiking cycle in four decades. Management executed flawlessly. Revenue grew. Margins held. The Azure growth engine continued to compound. And yet the shareholder who bought in January 2022 lost 22.2% of their capital by January 2023. The 11.1% earnings growth did not merely fail to produce a positive return; it failed to prevent a significant loss.

The explanation is contained in a single row of the table: the P/E multiple contracted from 36x to 23x, a compression of 36%. That multiple compression completely overwhelmed the positive earnings growth. It did not matter that Microsoft deserved a premium multiple on the strength of its franchise. In a world where a risk-free government bond suddenly yielded 4–5%, investors had no rational basis to pay 36x for even the highest-quality growth equity. The denominator of the valuation equation changed, and the stock price followed mechanically.

### 4.2 When It's Justified: Cyclical Peak Compression, Brokerages & Energy (2022 - 2024)

Cyclical sectors such as commodities, energy, financials, and shipping frequently produce extraordinary, yet temporary, earnings at the peak of their economic cycles. While investors are often tempted to extrapolate these peak earnings using standard P/E multiples, the broader market rarely takes the bait. Applying a "normal" multiple to peak-cycle earnings is a classic value trap. When the market compresses a multiple, it is actively pricing in the entire cycle, not just the current anomalous year.

## Case Studies in Cyclical Pricing

**South African Financials (2021–2023):** Post-pandemic trading surges and ballooning net interest margins drove earnings growth of 30–40%. Yet, P/E multiples steadily compressed from highs of 18–20x down to 12–14x. The market correctly anticipated that rates would eventually stabilize and volumes would normalize, anchoring valuations to long-term structural earnings rather than the temporary peak. Ultimately, paying 18x for peak earnings often means you are effectively paying 30x for mid-cycle reality.

**The Energy Sector:** When Brent crude hits \$90–\$100 per barrel, energy stocks often trade at an unambiguously “cheap” 8–10x earnings. However, the market knows commodities are highly volatile and mean-reverting. Today’s \$8 EPS can easily become tomorrow’s \$3 EPS. The low multiple isn’t a discount; it’s a necessary, rational buffer against inevitable cyclical downturns.

When a cyclical company’s P/E looks surprisingly cheap relative to its elevated earnings, it is rarely an unpriced opportunity. Instead, it is the market’s explicit warning that the earnings themselves are an anomaly.

The critical question for investors is never “Is the P/E low?” but rather, “Where are we in the earnings cycle?”

### 4.3 When It Creates a SpringBoard: The Resilient Compounders

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This archetype forms the absolute bedrock of our investment philosophy. A Resilient Compounder is a business possessing genuinely durable, high-quality earnings growth that suffers severe multiple compression due to macro-environmental fears or broader market sentiment—factors entirely divorced from its actual business fundamentals.

The strategic objective is to identify and acquire these exceptional assets at their valuation trough. Doing so positions a portfolio to capture the “dual engine” return:

Engine 1: Earnings Compounding. The business continues its relentless, fundamental growth from below.

Engine 2: Multiple Expansion. The market inevitably corrects its sentiment, rerating the valuation multiple upward.

By marrying durable fundamentals with artificially depressed multiples, this archetype offers the most powerful setup for long-term wealth creation.

## 5.1 Apple (AAPL) - The Ultimate Compounder that the Market Keeps Mispricing

Apple is, in many respects, the most instructive case study in the modern history of multiple compression and expansion, precisely because it has been through this cycle multiple times, and each time, the market's pessimism has proved misplaced.

At the start of 2022, Apple's P/E ratio stood at approximately 32x. The company was compounding revenues at mid-to-high single digits and EPS at roughly 10–15% annually through a combination of operating leverage and an enormously powerful share buyback programme. The balance sheet held over USD 200 billion in gross cash and was generating north of USD 90 billion in free cash flow annually. By any fundamental measure, Apple was, and remains, one of the most exceptional businesses ever created.

And yet, as the Fed began raising rates and growth stocks broadly de-rated, Apple's multiple was dragged down alongside the rest of the technology sector. By September 2022, the P/E had contracted to approximately 22x, a compression of nearly 32% in the valuation multiple alone. The stock declined roughly 27% from its January 2022 highs to the October 2022 trough, even as earnings continued to grow. In the fiscal year ending September 2022, Apple's EPS was USD 6.15, up from USD 5.61 in 2021, representing approximately 10% growth. The market didn't care. The multiple compression overwhelmed the earnings growth completely.

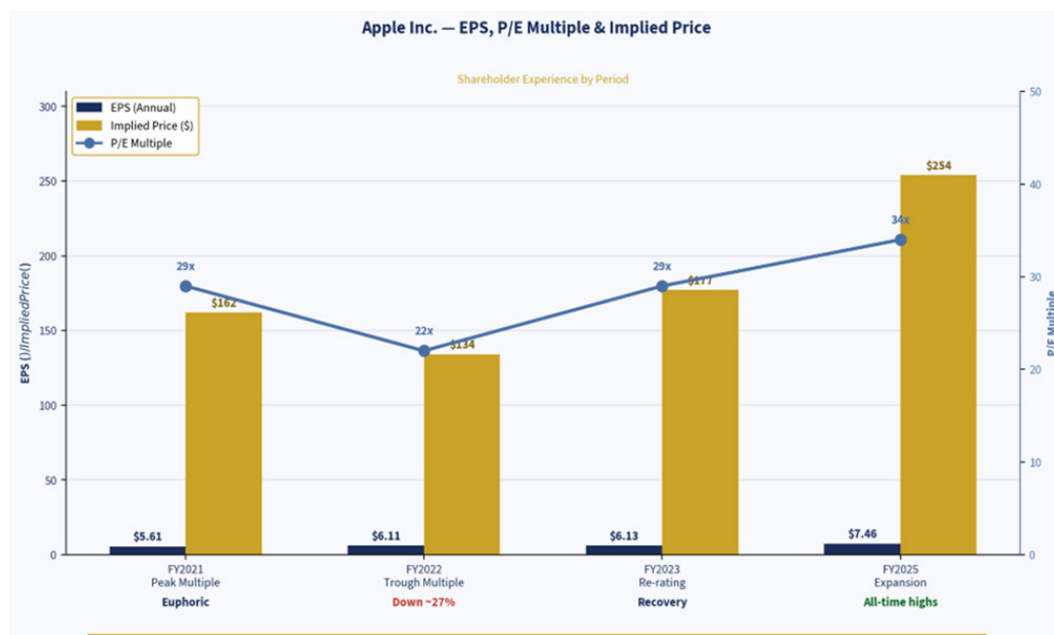


Figure 8: Apple Inc. Multiple Compression Illustration. Source: Arvocat Research

Apple's trajectory from late 2022 through early 2024 perfectly illustrates this "springboard" effect. During the 2022 macro-driven selloff, Apple's multiple compressed to roughly 22x earnings. Yet, the underlying business had not changed; the market's willingness to pay simply contracted. Investors who looked past the sentiment and bought the fundamental thesis secured an exceptional asset characterized by: Deep Moats: An installed base of over 1.2 billion active devices creating enormous switching costs, High-Quality Revenue: Recurring Services revenues boasting 30%+ gross margins and Relentless Capital Return: Buybacks shrinking the share count by 3–4% annually.

By 2024, the macro environment stabilized, AI optimism reignited the ecosystem narrative, and the P/E multiple rapidly re-expanded to approximately 35x as underlying earnings grew. The result? The stock roughly doubled. These returns looked magical, but they were entirely mathematical, which is the predictable outcome of buying a high-quality compounder at a temporarily depressed multiple. That gap between intrinsic business value and a fearful market price is where alpha is born.

## 5.2 Amazon (AMZN) - The MArgin Expansion Machine That Rose From Negative Earnings

Amazon teaches this complementary lesson: what happens when a market-dominant franchise stumbles operationally, the market writes it off, and then management executes a disciplined turnaround that the consensus didn't believe was possible. Amazon's 2022–2025 arc is the most complete demonstration of the full multiple compression-to-expansion cycle in recent large-cap history.

### Margin Compression (2021 - 2022)

At its pandemic peak in 2021, Amazon traded at roughly \$185 per share with a 57x P/E, priced as a secular compounder. By 2022, the narrative shattered due to a confluence of operational and external shocks:

- **Overcapacity:** Massive pandemic-era over-investment in fulfillment centers left the company with bloated headcount and excess capacity as physical retail normalized.
- **Earnings Destruction:** A \$12.7 billion pre-tax write-down on Rivian Automotive flowed directly to the bottom line.
- **Financial Collapse:** Operating income fell by more than half, free cash flow swung to a negative \$19.8 billion, and the company posted a net loss of \$0.27 per share.

The market responded with a brutal 54% drawdown, sending the stock to \$85 by January 2023. Investors priced in margin compression, earnings destruction, and a sentiment shift that viewed Amazon as a bloated empire rather than a nimble innovator.

The bearish consensus critically underestimated two factors: the inherent operational leverage in Amazon's model and management's willingness to execute aggressive restructuring. Under CEO Andy Jassy, Amazon cut 27,000 jobs, rationalized its regional logistics networks, and imposed strict capital discipline.

Crucially, its highest-quality segments, i.e. AWS and the near-100% incremental margin advertising business continued to scale. The financial reversal was violent:

Operating Income: Surged from \$12.2 billion in 2022 to nearly \$80 billion by 2025.

Free Cash Flow: Rebounded from a \$19.8 billion deficit to a \$32.2 billion surplus in just twelve months.



Figure 9: Amazon's earnings swung from a USD 0.27 loss to USD 7.29 in EPS over three years, while the P/E ratio compressed from recovery highs to approximately 28x. Source: Arvocap Research

A true value trap such as a legacy brick-and-mortar retailer losing market share suffers from permanent competitive impairment. Amazon's distress was purely operational. Investors who focused on the underlying unit economics of AWS, the structural margin growth of the advertising business, and management's historically proven ability to harvest long-term investments possessed the fundamental conviction required to buy when the market panicked.

### 6.1 The Value Trap - When Low P/E is a Warning, Not a Discount

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A forward P/E of 8x, for example, should trigger skepticism, not excitement. Your first question as an investor must be: "Why is the market pricing this so low?" While P/E is often backward-looking or short-term, the market is a forward-discounting machine. It prices the entire future stream of earnings, adjusted for risk and survival. An 8x multiple is rarely a gift; it is usually a verdict. It signals the market's belief that current earnings are unsustainable, the business model is deteriorating, or the balance sheet is compromised.

In the early 2000s, Kodak appeared "inexpensive" by every traditional metric. It possessed a dominant brand and healthy surface earnings. Value investors saw an opportunity; the market saw a "melting ice cube."

By protecting its \$15 billion-per-year film business and suppressing the digital technology it had actually invented, Kodak ignored a structural evaporation of its industry. The stock, which once looked like a bargain at \$20, hit zero by 2012.

A low P/E in a structurally declining industry is a warning sign. In a value trap, the low multiple doesn't represent a discount; it represents a terminal diagnosis.

### 6.2 The Holding Period Effect - Time Heals, But Only for the Right Companies

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Multiple compression is far more dangerous to the investor with a 1-to-3-year time horizon than to the investor with a 10-year horizon.

This "healing" power of time only exists for businesses with durable earnings.

**The Compounder:** Time erodes the relevance of the entry multiple. As long as the "E" in the P/E ratio keeps rising, the eventual return remains positive.

**The Value Trap:** Time is an enemy. When the underlying earnings collapse, there is no "Engine 1" to offset the multiple contraction. You aren't waiting for a recovery; you are witnessing a permanent impairment of capital.

Patience is a superpower, but only when applied to the right asset. The investor who sits through three years of compression in a Resilient Compounder is usually rewarded with a strong recovery. The investor who shows the same patience with a Value Trap is simply documenting their own decline toward zero. Therefore, business quality must always be diagnosed before valuation. If the earnings power isn't structurally sound, a low multiple is a trapdoor, not a floor.

### 6.3 The "Adjusted" Earnings Trap

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Beyond the structural decline of a business, there is a technical danger that turns a supposed bargain into a trap: the explosion of non-GAAP or "adjusted" earnings. In modern reporting, companies increasingly bypass legally audited GAAP figures to present a customized version of "profitability." By excluding significant expenses, they create an illusion of health that can lead investors to apply a "cheap" multiple to a fundamentally inflated number.

#### Common Exclusions That Distort Value

- **Stock-Based Compensation (SBC):** Often dismissed as a "non-cash" charge, SBC is a real economic cost. It dilutes shareholders and transfers value from owners to employees. If a tech firm reports \$3.50 in adjusted EPS but only \$1.80 in GAAP EPS, any P/E ratio applied to the higher number is fundamentally misleading.
- **Recurring "One-Time" Charges:** Many companies take "restructuring charges" annually. If an expense recurs every year, it is not an anomaly; it is a standard cost of doing business.
- **Amortization of Intangibles:** While excluded from adjusted figures, this represents the ongoing cost of assets purchased during acquisitions. Ignoring it ignores the capital required to stay competitive.

The practical danger for multiple compression analysis is immense. A stock may appear to trade at a "compressed" 12x adjusted earnings, creating the appearance of a value opportunity. In reality, that same stock might be trading at 24x non-adjusted earnings, a valuation that is not compressed at all.

## 7.1 Capitalizing on the Disconnect

When buying a great business after its multiple has compressed, this sets the stage for the ultimate dual-engine return: steady earnings growth compounded by future “Multiple Expansion.” This allows you to capture two independent return engines simultaneously.

Engine 1: Earnings Growth (the company delivers)

Engine 2: Multiple Expansion (the market re-rates)

Let us model a concrete scenario. You identify a high-quality compounder whose P/E has been compressed from its historical average of 28x to 18x due to a broad market risk-off event. The company continues to grow EPS at 20% per annum. You project that over 3 years, the multiple will partially re-rate to 24x (still below its historical peak).

Metric	Entry	Year 1	Year 2	Year 3
EPS	KES 5.00	KES 6.00	KES 7.20	KES 8.64
P/E Multiple	18.0x	20.0x	22.0x	24.0x
Share Price	KES 90.00	KES 120.00	KES 158.40	KES 207.36
Cumulative Return	—	+33.3%	+76.0%	+130.4%

Figure 10: Cumulative return example over a 3 year period. Source: Arvocat Research

In this model, the investor earns a 130% cumulative return over three years, representing a 32% annualised return. Of this return, approximately 0.73% came from earnings growth (EPS from KES 5.00 to KES 8.64) and approximately 0.57% came from multiple expansion (18x to 24x). Neither engine alone would have produced this result; it is the combination that generates outsized performance.

This is the asymmetry we seek: a business so fundamentally strong that earnings growth is highly probable, purchased at a valuation so depressed that multiple normalisation is also highly probable. When you combine two strategies that both have a high chance of winning and move in the same direction, your potential gains grow much faster than your risks.

## 7.2 Portfolio Positioning

Our funds' positioning framework converts multiple compression events into portfolio alpha through a four-stage process. It begins with universe construction, screening for “resilient compounders”. These are companies with double-digit earnings growth potential, recurring revenue, pricing power, high returns on capital, and strong free cash flow. Qualified names are then placed on an active watchlist with pre-defined entry triggers, monitored against their own historical valuation ranges, sector peers, and the broad market, with alerts set when multiples approach the lower quartile or fall more than two standard deviations below their three-year average.

When a macro or sentiment-driven compression event pushes a watchlist name into our target zone, we deploy capital with conviction, but only after verifying that the compression is external to the company's fundamentals, not driven by deteriorating earnings, competitive positioning, or management guidance. Post-entry, we manage positions with patience: sizing to withstand further drawdown by scaling in from half to full position, setting stop-losses tied to thesis invalidation rather than price alone, and projecting a 2–4 year holding period. We exit when the multiple has re-expanded to its historical average and the earnings growth trajectory begins to decelerate, or when our total return target is achieved..

## 8.1 Investing for Intrinsic Value

Let us end where we began: with the paradox of progress. A company that relentlessly grows earnings, expands margins, and reinvests capital at high rates of return will, with arithmetic certainty, make its shareholders wealthy over the long run.

Compounding is the “irresistible force” of finance. Sustained over a decade, it overwhelms almost any starting valuation, any multiple compression cycle, and any transient rotation of market fashion.

In the current environment, we are seeing this philosophy put to the test. The market is currently navigating a dual-climatology of fear:

**AI Sentiment Volatility:** The shift from “AI euphoria” to “AI fatigue” has triggered broad multiple compression across the technology stack.

**Geopolitical Instability:** Conflict in the Middle East has spiked risk premiums, causing a flight from “risk assets” regardless of their underlying health.

For our funds, such as the Global Equity Special Fund (USD), Mutli-Asset Strategy Special Fund (USD), Global Shariah Equity Special Fund(USD), Africa Equity Special Fund (ZAR), these are opportunities to absorb quality, not reasons to retreat.

When a business model remains intact, growing, and mission-critical, yet its multiple is being crushed by macro-induced tremors, we are presented with a “springboard” setup. We are identifying elite businesses whose valuations have been impaired by headlines, not by their competitive moats.

### The Great Wealth Transfer

The investor who “rents” popularity (buying a stock because of the ongoing narrative and not the fundamentals) is perpetually one step behind. By buying into multiple expansions (paying 35x for what was 20x) and fleeing during compression (accepting 18x for what they paid 35x), they participate in the classic transfer described by Warren Buffett: wealth moving from the impatient to the patient.

Multiple compression is not the enemy of the disciplined investor; it is the most reliable ally. It is the mechanism that creates the entry points necessary for outsized alpha. The market’s occasional loss of nerve, occasionally driven by interest rates, sector rotation, or geopolitical anxiety, is what allows us to buy great businesses at fair prices.

### The Strategic Mandate

The best investment returns are born from the courage to hold through the “compression trough” while the “E” in the P/E ratio continues its quiet, relentless climb.

Our mandate is simple: distinguish the Resilient Compounder from the Value Trap, ignore the macro noise, and let the mathematics of compounding do the heavy lifting.

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