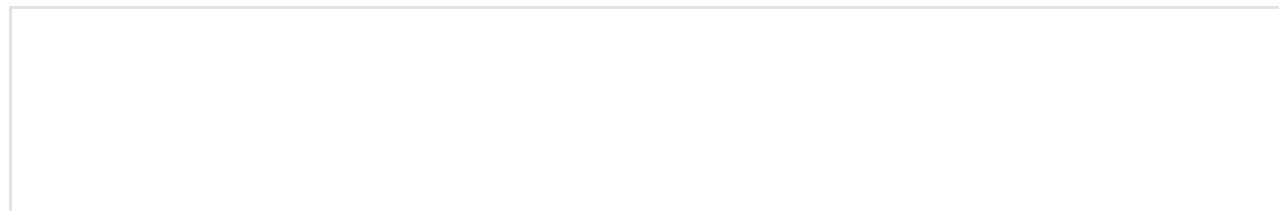


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ELECTRONIC INVESTOR

Where to Find the Web's Forensic Accountants

Two Websites, one of which also runs an ETF, are designed to highlight companies' hidden accounting strengths and weaknesses.

By **MIKE HOGAN**

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Every corporate Website, quarterly financial report, and earnings call is packed with numbers and ratios, industry terms of art, acronyms—even, it sometimes seems, the CEO's hat size. Unfortunately, the many marginal pieces of data frequently obscure the gem or two of truly valuable information. Often, the people whose job it is to track the company—insiders, institutional investors, and Wall Street analysts—are the first to divine the real drivers of corporate growth. Two outfits, however, claim they are about to bring this knowledge to small investors.

The first is New Constructs (newconstructs.com), a new Website founded by David Trainer, an investment strategist who's on the investors technical advisory committee of accounting watchdog FASB. The site provides an all-around long/short investing/trading advisory service, whose recommendations are based on forensic accounting of the 3,000 U.S.-listed companies it covers. Its analysts dig through reams of mostly mind-numbing SEC filings and comb the Internet, seeking telling details sometimes hiding in plain sight.

"All too often, we find significant data hidden in the footnotes that reveal the risks companies are trying to hide," says Trainer, who has been providing the same services to institutions for years.

Retail investors can subscribe to New Constructs' coverage of stocks or 400 exchange-traded funds, or 7,000 mutual funds for \$50 a month per service by clicking on the a la carte tab on the Website. Most popular are the Most Attractive and Most Dangerous lists, which contain at least 20 fresh long and short stock recommendations, plus detailed investing theses for them.

THE HAYSTACK OF SEC FILINGS and accrual-based earnings reports do more to obscure financial prospects than to reveal them, Trainer insists. "Accounting data must be translated into economic earnings to understand the profitability and valuation relevant to equity investors," he says. "Respected investors like Ben Graham have repeatedly emphasized that accounting results should not be used to value stocks."

New Constructs converts the data into measures of true cash-flow potential. For example, Chinese media company SINA (ticker: SINA) made the most-dangerous list in October 2013 after Trainer discovered one-time, nonoperating items glossing over the impact of operating expenses that had been growing four times faster than revenue for two years.

By Trainer's calculations, SINA's reported \$32 million in 2012 profits papered over an \$18 million net-operating loss after taxes, or Nopat, his preferred measure of real value growth. After more analysis, he shorted SINA at about \$86 a share. It has since fallen to around \$61.

Trainer recommended buying AutoZone (AZO) in February, after finding what he considered understated growth projections in its SEC filings. While AutoZone has traded at about \$536 recently, Trainer's discounted-cash-flow analysis suggests a per-share value around \$850 if after-tax profit climbs only 6% a year going forward. If Nopat continues to grow at its 11% average annual rate since 1998, Trainer maintains that the value of a share will be \$1,000 by February 2015.

THE SECOND TRACKER OF financials for the little guys is the Forensic Accounting ETF (FLAG), which offers investors an opportunity to make multiple long bets in one trade. It's one of a growing number of not-quite-active ETFs whose investing strategy is captured by an index—in this case, the Del Vecchio Earnings Quality Index.

Index creator John Del Vecchio is a long-time forensic accountant and heads Index Deletion Strategies, a specialized research firm focused on financial-statement analysis. He's also the author of a book, *What's Behind the Numbers?* Forensic Accounting buys shares of S&P 500 companies with high-quality earnings, while avoiding those with aggressive revenue-recognition practices.

Reflecting its newness, Forensic Accounting has just \$9 million in assets. Its Website is flagetf.com.

Both the New Constructs and Forensic Accounting sites let retail investors take advantage of very specialized skills without doing the heavy lifting.

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