



Don't Fret 2Q Earnings: This S&P 500 Will Continue to Rise

Most investors know that GAAP earnings are prone to [distortion](#) because they include unknown amounts of unusual gains/losses. However, most investors are not aware that legacy metrics like Street Earnings (from Refinitiv) and Operating Earnings (from S&P Global (SPGI)) still miss about \$0.45 out of every \$1.00 of unusual gains/losses ([hidden and reported](#)) – as detailed in section 5.1 of the new paper from HBS & MIT Sloan: [Core Earnings: New Data & Evidence](#). This paper also uses our new, advanced measure of [Core Earnings](#) to prove the market is inefficient at reflecting unusual gains/losses buried in footnotes.

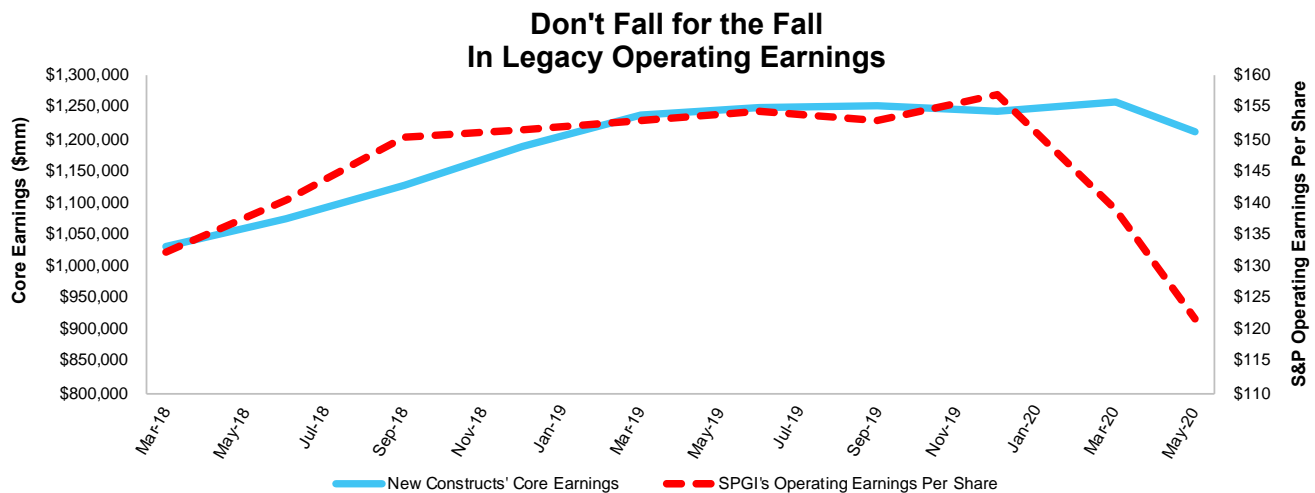
Investors armed with our measure of Core Earnings have a differentiated and more informed view of the fundamentals and, therefore, the valuation of markets and stocks.

A New View on Earnings...and Valuation

The precipitous fall expected in 2Q20 earnings significantly understates the true, core earnings of U.S. companies because these earnings metrics are not adjusted for unusual gains/losses.

Figure 1 compares the steep fall expected in consensus estimates for S&P Global's Operating Earnings¹ to our more normal [Core Earnings](#)². Specifically, the trailing-twelve-month (TTM) Core Earnings³ for the S&P 500 show a 2% fall since 2019 while consensus predicts a 22% fall. Investors would be well-served to see through the dip in SPGI's operating earnings metrics, especially when it comes to valuation, as shown in Figures 3 and 4.

Figure 1: Core Earnings vs. SPGI's Operating Earnings for the S&P 500: 2018-Present



Sources: New Constructs, LLC, company filings, and [S&P Global](#) (SPGI). Note: the most recent periods' data for SPGI's Operating Earnings is based on consensus.

Our Core Earnings analysis is based on aggregated quarterly data for the S&P 500 constituents in each measurement period.

Figure 2 further demonstrates the more normal and reliable nature of our Core Earnings compared to S&P Global's (SPGI) Operating Earnings over a longer term, including the Financial Crisis.

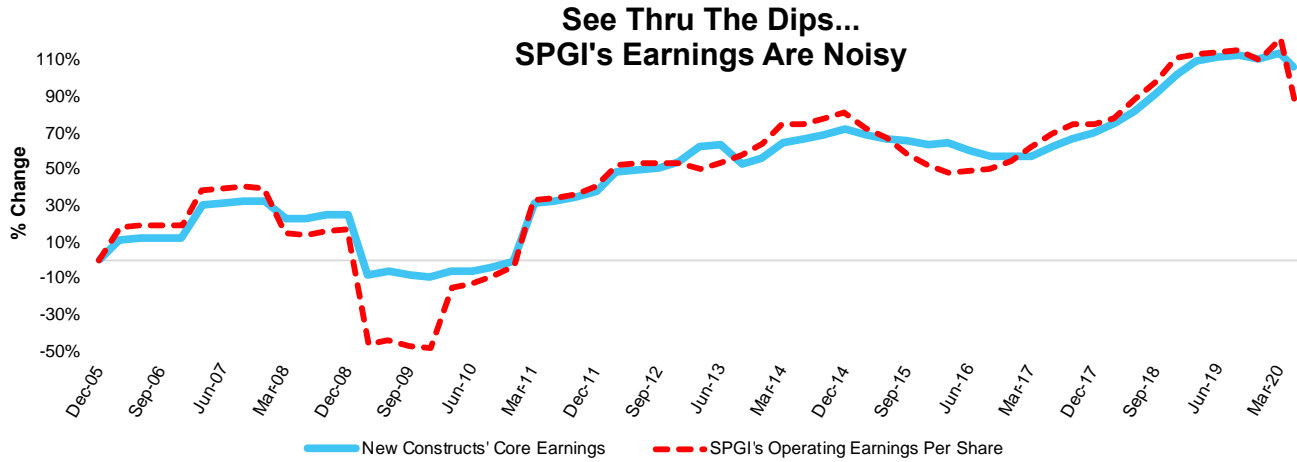
¹ We think SPGI's Operating Earnings provide the best available comparison for our Core Earnings. We can compare with any other metrics.

² For 3rd-party reviews on the benefits of adjusted Core Earnings, historically and prospectively, across all stocks, click [here](#) and [here](#).

³ Our Core Earnings data is based on all 10-Q and 10-K filings for S&P 500 constituents as of 5/26/2020. Since then, an immaterial number of companies (18) companies have filed a new 10-K or 10-Q with the SEC. Contact us at support@newconstructs.com for access to the source data behind this research.



Figure 2: Core vs. SPGI's Operating Earnings for the S&P 500 – % Change: 2005 – Present



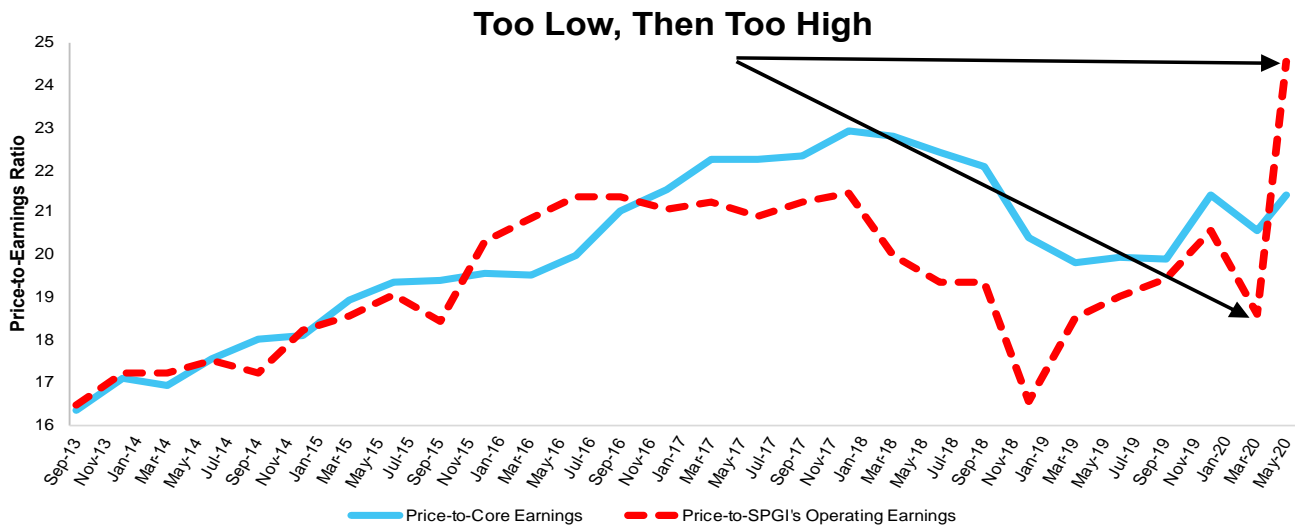
Sources: New Constructs, LLC, company filings, and S&P Global (SPGI). Note: the most recent periods' data for SPGI's Operating Earnings is based on consensus.
Our Core Earnings analysis is based on aggregated quarterly data for the S&P 500 constituents in each measurement period.

Better Earnings for Valuing the S&P 500

Not only is the market more profitable than Wall Street would have you believe, but it is also cheaper.

Per Figure 3, analyzing the price-to-earnings (P/E)⁴ of the S&P 500 based on our Core Earnings shows how much investors oversold in March and that, despite the recent rebound, the S&P 500 remains very reasonably valued compared to the past few years.

Figure 3: Price-to-Core vs. Price-to-SPGI's Operating Earnings for the S&P 500: 2013 – present



Sources: New Constructs, LLC, company filings, and S&P Global.
P/E ratios are based on four quarters of aggregated S&P 500 constituent results in each period. More details in Appendix.

In contrast, valuing the S&P based on SPGI's Operating Earnings suggests the market is more highly valued than any time since the Financial Crisis (see Figure III in the Appendix).

We believe there's upside left in this market.

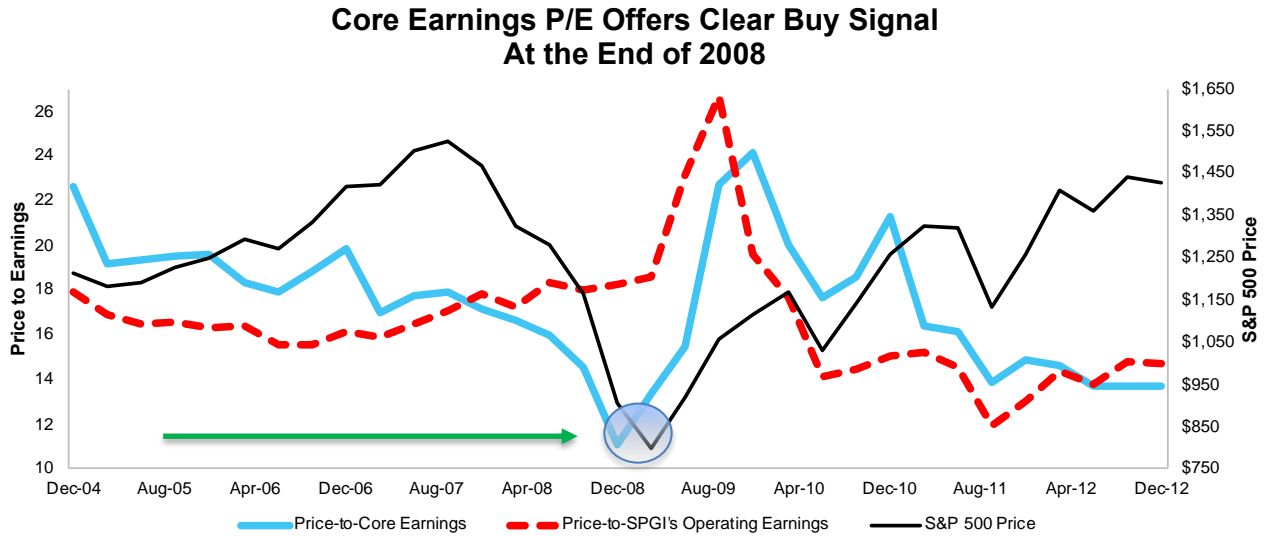
⁴ The methodology for calculating an apples-to-apples price-to-Core Earnings and price-to-SPGI's Operating Earnings is in Appendix I.



Core Earnings Proven More Reliable in the Financial Crisis

Figure 4 points out the clear buying signal provided by our Core Earnings P/E during the market crash in the Financial Crisis. Figure 3 presents a similar pattern and buying signal. Note the similarity between now and 2008 in the spiking of the P/E based on SPGI's Operating Earnings compared to the more normal Core Earnings P/E.

Figure 4: Price-to-Core vs. Price-to-S&P Operating Earnings: 2004-2012



Sources: New Constructs, LLC, company filings, and S&P Global. Note that the SPGI P/E is based on four quarters of aggregated S&P 500 results in each period. Core Earnings P/E is based on annual data.

How You Can Make Money with Our Core Earnings

Passive investing has become a [very crowded trade](#), and now is the best time in many, many years for investors to pick individual stocks, especially those armed with differentiated insight into earnings.

Table 1 lists the stocks with links to reports showing how they are among the most attractive in the market based on strong Core Earnings growth and valuations at historic discounts. Most of these picks have significantly outperformed the S&P 500 and remain undervalued.

We recommend investors consider putting money into these stocks and believe they have even more upside potential than the S&P 500 or any other index.

Table 1: Stock Picks in Today's Market

Company	Ticker	Publish Date	Performance vs S&P 500 (as of 6/23)
SYSCO Corporation	SYY	4/15/20	14%
Simon Property Group	SPG	4/20/20	19%
Darden Restaurants	DRI	4/22/20	-2%
D.R. Horton	DHI	4/27/20	25%
Southwest Airlines	LUV	5/4/20	16%
Omnicom Group	OMC	5/6/20	-10%
Hyatt Hotels	H	5/14/20	4%
Allstate Corp	ALL	5/18/20	-8%
JPMorgan Chase & Company	JPM	5/21/20	2%
Caterpillar	CAT	5/27/20	0%

Sources: New Constructs, LLC

You can find more recent reports like these in our [Long Ideas](#).



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Disclosure: David Trainer owns SYY, SPG, DHI, LUV, JPM, and H. David Trainer, Kyle Guske II, and Matt Shuler receive no compensation to write about any specific stock, style, or theme.

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Appendix I: P/E Ratio Methodology for Core & SPGI’s Operating Earnings

In the analysis above, we calculate the price-to-Core Earnings ratio as follows:

1. Calculate a trailing four quarters earnings yield for every S&P 500 constituent
2. Weight the earnings yield by each stock’s respective S&P 500 weight
3. Sum the weighted earnings yields and take the inverse (1/Earnings Yield)

This method allows us to capture the impact of changes to S&P 500 constituents on a quarterly basis. For example, a company could be a constituent in 2Q18, but not in 3Q18. This method captures the continuously changing nature of the S&P 500 constituency.

We use the earnings yield methodology because P/E ratios don’t follow a linear trend. A P/E ratio of 1 is “better” than a P/E ratio of 30, but a P/E ratio of 30 is “better” than a P/E ratio of -15. In other words, aggregating P/E ratios can result in a low multiple due the inclusion of just a few stocks with negative P/Es.

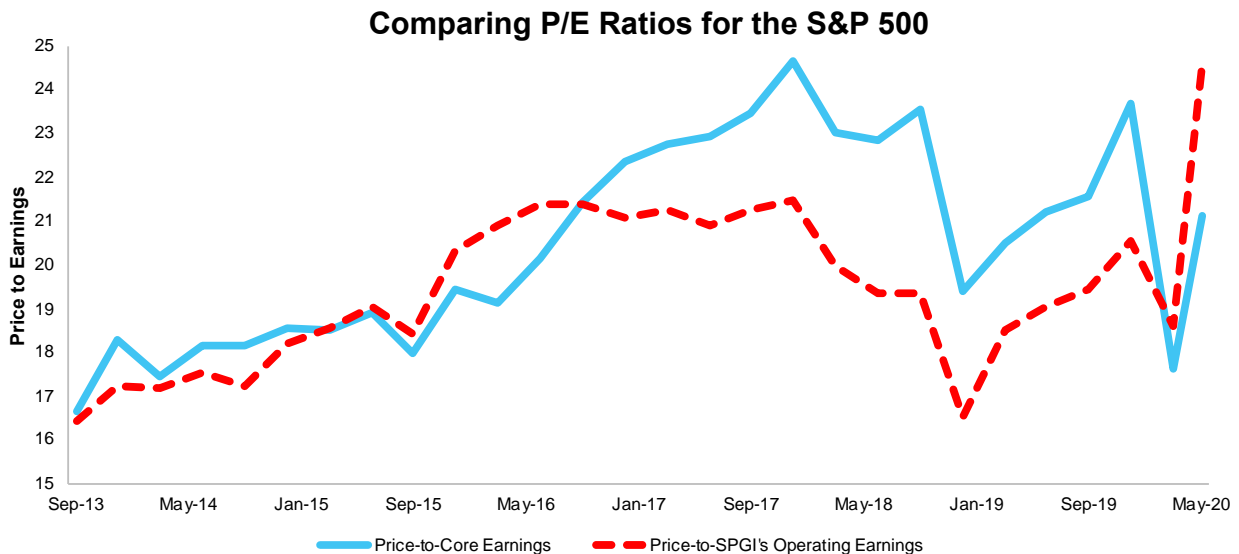
Using earnings yields solves this problem because a high earnings yield is always “better” than a low earnings yield. There is no conceptual difference when flipping from positive to negative earnings yields as there is with traditional P/E ratios.

For all periods in the above analysis, we calculate the price-to-SPGI’s Operating Earnings ratio by summing the preceding 4 quarters of Operating Earnings per share and, then, dividing by the S&P 500 price at the end of each measurement period.

Figures I and II show the price-to-Core Earnings ratio using TTM data for the companies in the S&P 500. Price-to-SPGI’s operating earnings are always calculated in the manner defined above because we do not have access to TTM Operating Earnings data for S&P 500 constituents. In these Figures, we calculate the price-to-Core Earnings ratio as follows:

1. Calculate a TTM earnings yield for every S&P 500 constituent
2. Weight the earnings yields by each stock’s respective S&P 500 weight
3. Sum the weighted earnings yields and take the inverse (1/Earnings Yield)

Figure I: Price-to-Core vs. Price-to-SPGI’s Operating Earnings: TTM 9/30/13 – present

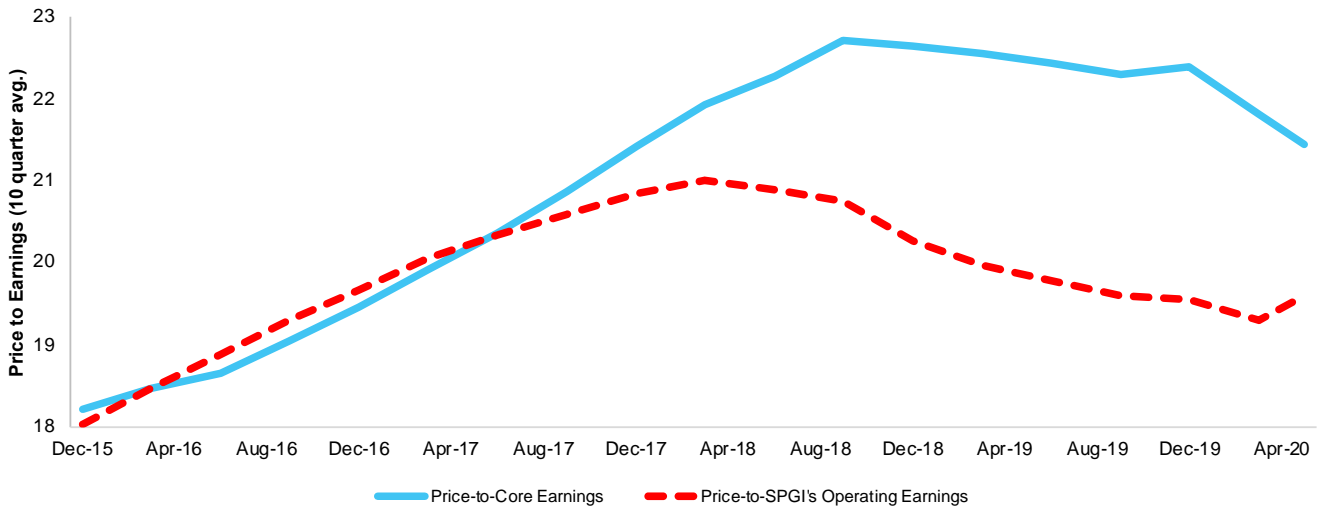


Sources: New Constructs, LLC, company filings, and S&P Global. Note that the Core Earnings P/E ratio is aggregating the TTM results for constituents in each period.



Figure II: Price-to-Core vs. Price-to-SPGI's Operating Earnings: TTM 10 Quarter Average

10-Quarter Average S&P 500 P/E Ratios Since 2016

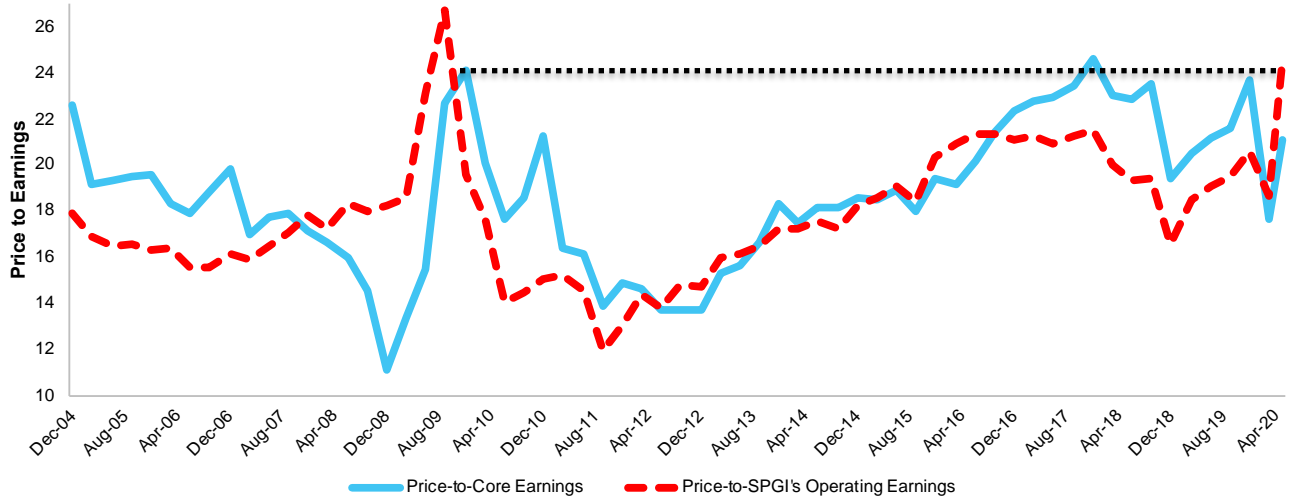


Sources: New Constructs, LLC, company filings, and S&P Global. Note that the Core Earnings P/E ratio is aggregating the TTM results for constituents in each period.

Figure III compares the price-to-Core Earnings and price-to-SPGI's Operating Earnings ratios dating back to 2004. SPGI's Operating Earnings suggest the S&P 500 is more highly valued than it has been since the Financial Crisis.

Figure III: Price-to-Core vs. Price-to-SPGI's Operating Earnings: Since 2004

Comparing S&P 500 P/E Ratios Since 2004



Sources: New Constructs, LLC, company filings, and S&P Global. Note that the SPGI P/E is based on four quarters of aggregated S&P 500 results in each period. Core Earnings P/E is based on annual data.



Footnotes adjustments matter. We are the ONLY source.

We provide ratings, models, reports & screeners on U.S. 3,000 stocks, 700 ETFs and 7,000 mutual funds.

HBS & MIT Sloan research reveals that:

- **Markets are inefficiently assessing earnings because no one reads the footnotes.**
- **Corporate managers hide gains/losses in footnotes to manage earnings.**
- **Our technology brings the material footnotes data to market for the first time ever.**

Combining human expertise with NLP/ML/AI technologies ([featured by Harvard Business School](#)), we shine a light in the dark corners (e.g. footnotes) of hundreds of thousands of financial filings to unearth critical details.

The HBS & MIT Sloan paper, [Core Earnings: New Data and Evidence](#), shows how our superior data drives uniquely comprehensive and independent debt and equity research.

This [paper](#) compares our analytics on a mega cap company to other major providers. The Appendix details exactly how we stack up.

Learn [more](#).

Quotes from HBS & MIT Sloan professors on our research:

Get better research:

“...the NC dataset provides a novel opportunity to study the properties of non-operating items disclosed in 10-Ks, and to examine the extent to which the market impounds their implications.” – page 20

Pick better stocks:

“Trading strategies that exploit cross-sectional differences in firms’ transitory earnings produce abnormal returns of 7-to-10% per year.” – Abstract

Avoid losses from using other firms’ data:

“...many of the income-statement-relevant quantitative disclosures collected by NC do not appear to be easily identifiable in Compustat...” – page 14

Build better models:

“Core Earnings [calculated using New Constructs’ novel dataset] provides predictive power for various measures of one-year-ahead performance...that is incremental to their current-period counterparts.” – page 4

Exploit market inefficiencies:

“These results ... suggest that the adjustments made by analysts and Compustat to better capture core earnings are incomplete. Moreover, the non-core items identified by NC produce a measure of core earnings that is incremental to alternative measures of operating performance in predicting an array of future income measures.” – page 26

Fulfill fiduciary duties:

“An appropriate measure of accounting performance for purposes of forecasting future performance requires detailed analysis of all quantitative performance disclosures detailed in the annual report, including those reported only in the footnotes and in the MD&A.” – page 33-34



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