



How Our Core Earnings Provide a More Informed View of the Market – Behind the Markets

CEO David Trainer recently joined Jeremy Schwartz, EVP and Global Head of Research at WisdomTree, on the [Behind the Markets](#) podcast on July 10, 2020.

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Topics covered included:

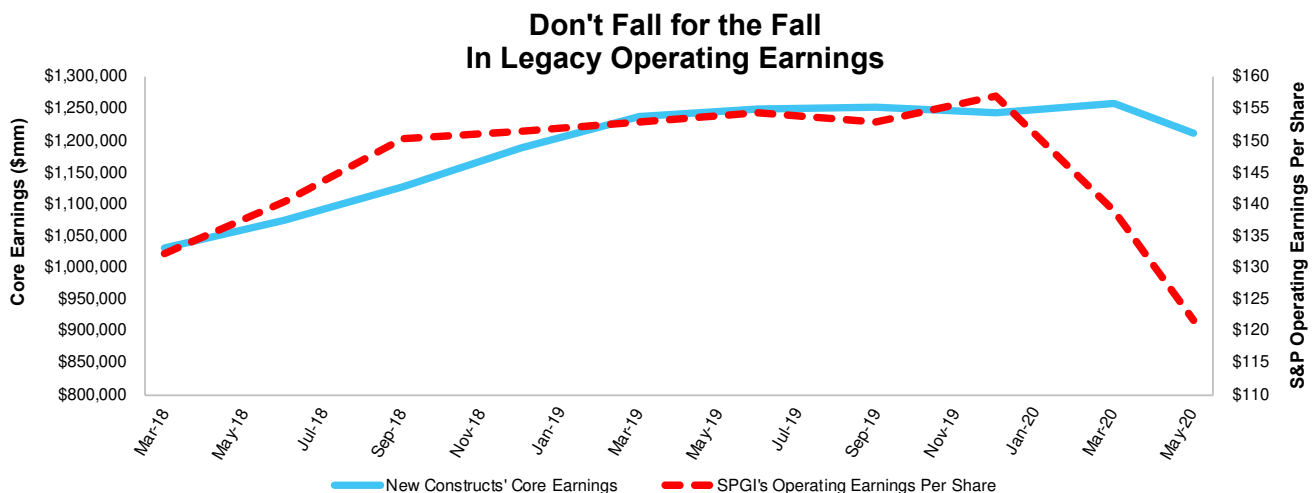
1. Why the expected fall in 2Q20 earnings understates the true, [core earnings](#) of U.S. companies
2. The market is cheaper than [Wall Street would have you believe](#)
3. The level of [earnings distortion](#) in earnings reports

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 [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.

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.

The 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.

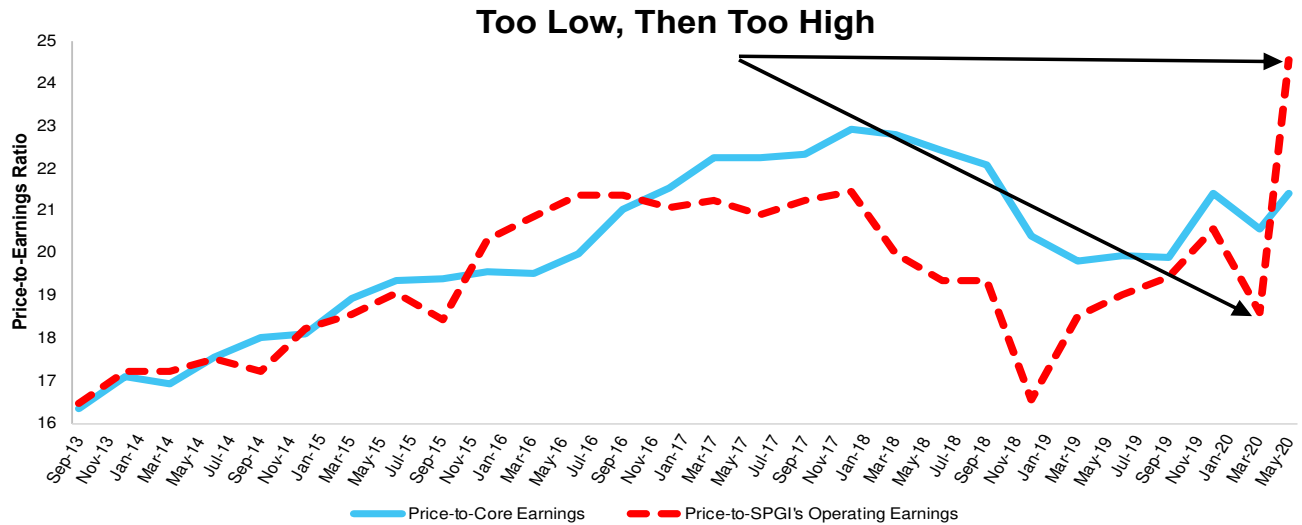
¹ We think SPGI's Operating Earnings provide the best available comparison to our calculation of Core Earnings. We can compare with any other metrics.

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

³ The Core Earnings data in this analysis 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.

Per Figure 2, 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 2: 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.

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.

[Our recent report](#) shows how investors armed with a cleaner measure of Core Earnings have a differentiated and more informed view of fundamentals and, therefore, the valuation of markets and stocks.

This article originally published on [July 14, 2020](#).

Disclosure: David Trainer, Kyle Guske II, and Matt Shuler receive no compensation to write about any specific stock, sector, style, or theme.

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



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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