Three All Cap Index Sectors Trade Below Economic Book Value Post 3Q21 Earnings

This report is an abridged and free version of All Cap Index & Sectors: Price to Economic Book Value Through 3Q21, one of our quarterly series on fundamental market and sector trends.

Key Points:

- The trailing PEBV ratio for the NC 2000[1], our All Cap Index, fell from 1.7 in 3Q20 to 1.5 in 3Q21, implying constituent profits will increase 50% from 3Q21 levels in the long run.
- Investors are most pessimistic about the Telecom Service sector's outlook where stocks are priced for a decline in profits of 50% from 3Q21 over the long run.
- The full version of this report analyzes[2,3] market cap, economic book value, and the trailing price-to-economic book value (PEBV) ratio for the NC 2000 and each of its sectors (last quarter's analysis is here). These reports are available to clients with a Pro or higher membership or can be purchased here.

These reports leverage more reliable fundamental data[4] that overcomes flaws with legacy fundamental datasets to provide a more informed view of the fundamentals of companies and a new source of alpha.

NC 2000 Trailing PEBV Ratio Fell in 3Q21

The trailing PEBV ratio for the NC 2000 fell from 1.7 in 3Q20 to 1.5 in 3Q21. This trailing PEBV ratio compares the NC 2000's expected future profits (embedded in its equity valuation) to TTM profits in 3Q21. At 1.5, the NC 2000's valuation implies the profits of the NC 2000 stocks will increase 50% from 3Q21 levels.

See Figure 1 in the full version of our report for the chart of PEBV Ratio for the NC 2000 from December 1998 through 3Q21.

Key Details on Select NC 2000 Sectors

Among NC 2000 sectors, Telecom Services, Consumer Non-cyclicals, and Financials, trade below their economic book value and Basic Materials trades at its economic book value. The Telecom Services sector has the lowest trailing PEBV ratio among the eleven All Cap Index sectors based on prices as of 11/16/21 and financial data from 3Q21 10-Qs.

A trailing PEBV ratio of 0.5 means investors expect the Telecom Service sector's profits as of 3Q21 to decline by 50%. On the flip side, investors expect the Real Estate sector (trailing PEBV ratio of 3.4) to improve profits more than any other All Cap Index sector.

Below, we highlight the Healthcare sector.

Sample Sector Analysis[5]: Healthcare: Trailing PEBV Ratio = 1.2

Figure 1 shows the trailing PEBV ratio for the Healthcare sector fell from 1.5 in 3Q20 to 1.2 in 3Q21. The Healthcare sector market cap rose from $5.1 trillion in 3Q20 to $6.0 trillion in 3Q21, while its economic book value rose from $3.4 trillion in 3Q20 to $5.0 trillion in 3Q21.

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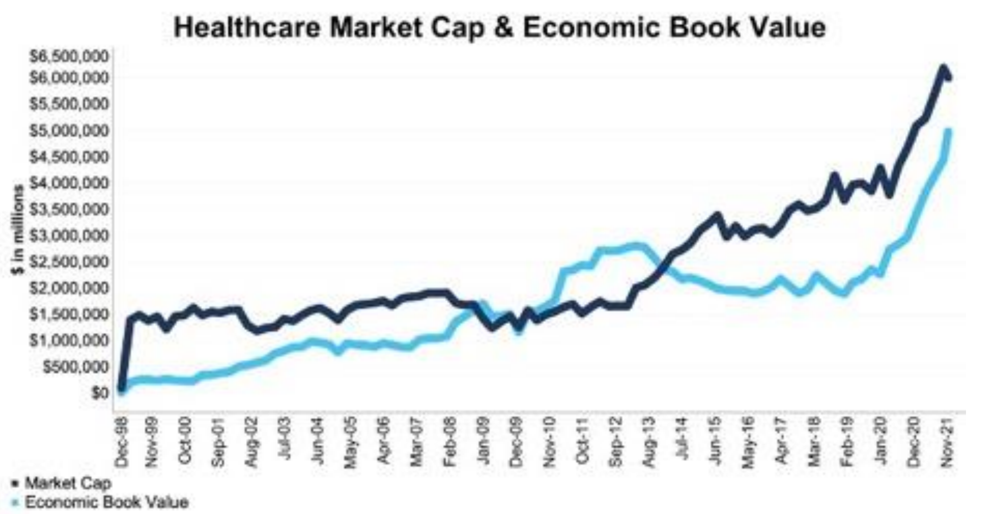
[1] The NC 2000 consists of the largest 2000 U.S. companies by market cap in our coverage. Constituents are updated on a quarterly basis (March 31, June 30, September 30, and December 31). We exclude companies that report under IFRS and non-U.S. ADR companies.
[2] We calculate these metrics based on S&P Global's (SPGI) methodology, which sums the individual NC 2000 constituent values for market cap and economic book value before using them to calculate the metrics. We call this the "Aggregate" methodology.
[3] Our research is based on the latest audited financial data, which is the 3Q21 10-Q in most cases. Price data is as of 11/16/21.
[4] Three independent studies prove the superiority of our data, models, and ratings. Learn more here.
[5] The full version of this report provides analysis for every sector like what we show for this sector.

Figure 1: Healthcare Trailing PEBV Ratio: December 1998 – 11/16/21

Sources: New Constructs, LLC and company filings.
The November 16, 2021 measurement period uses price data as of that date and incorporates the financial data from 3Q21 10-Qs, as this is the earliest date for which all the 3Q21 10-Qs for the NC 2000 constituents were available.

Figure 2 compares the market cap and economic book value trends for the Healthcare sector since 1998. We sum the individual NC 2000/sector constituent values for market cap and economic book value. We call this approach the "Aggregate" methodology, and it matches S&P Global's (SPGI) methodology for these calculations.

Figure 2: Healthcare Market Cap & Economic Book Value: December 1998 – 11/16/21



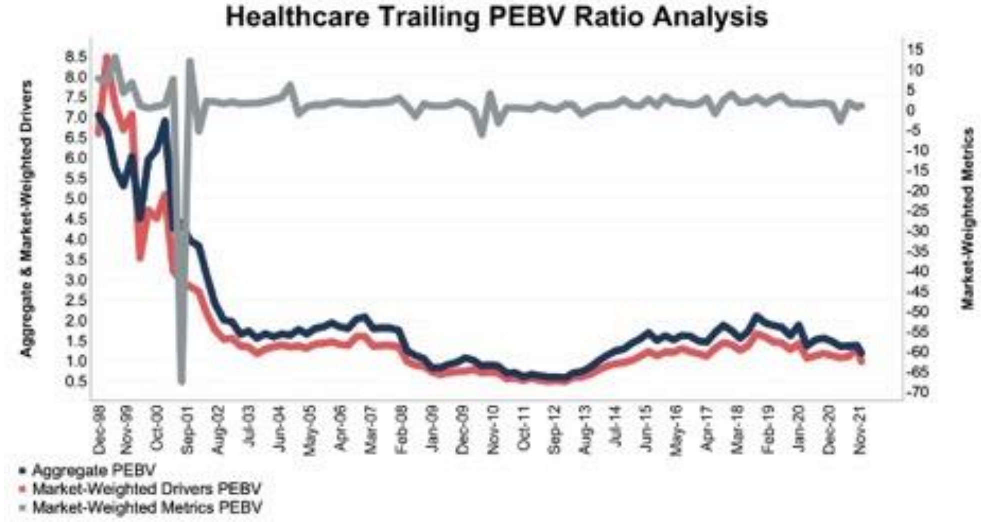
Sources: New Constructs, LLC and company filings.
The November 16, 2021 measurement period uses price data as of that date and incorporates the financial data from 3Q21 10-Qs, as this is the earliest date for which all the 3Q21 10-Qs for the NC 2000 constituents were available.

The Aggregate methodology provides a straightforward look at the entire NC 2000/sector, regardless of firm size or index weighting, and matches how S&P Global (SPGI) calculates metrics for the S&P 500.

For additional perspective, we compare the Aggregate method for trailing PEBV ratio with two other market-weighted methodologies. These market-weighted methodologies add more value for ratios that do not include market values, e.g. ROIC and its drivers, but we include them here, nonetheless, for comparison. Each method has its pros and cons, which are detailed in the Appendix.

Figure 3 compares these three methods for calculating the Healthcare sector's trailing PEBV ratios.

Figure 3: Healthcare Trailing PEBV Ratio Methodologies Compared: December 1998 – 11/16/21



Sources: New Constructs, LLC and company filings.
The November 16, 2021 measurement period uses price data as of that date and incorporates the financial data from 3Q21 10-Qs, as this is the earliest date for which all the 3Q21 10-Qs for the NC 2000 constituents were available.

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Disclosure: 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: Analyzing Trailing PEBV Ratio with Different Weighting Methodologies

We derive the metrics above by summing the individual NC 2000/sector constituent values for market cap and economic book value to calculate trailing PEBV ratio. We call this approach the "Aggregate" methodology.

The Aggregate methodology provides a straightforward look at the entire NC 2000/sector, regardless of firm size or index weighting, and matches how S&P Global (SPGI) calculates metrics for the S&P 500.

For additional perspective, we compare the Aggregate method for trailing PEBV ratio with two other market-weighted methodologies. These market-weighted methodologies add more value for ratios that do not include market values, e.g. ROIC and its drivers, but we include them here, nonetheless, for comparison:

1. **Market-weighted metrics** – calculated by market-cap-weighting the trailing PEBV ratio for the individual companies relative to their sector or the overall NC 2000 in each period. Details:
    a. Company weight equals the company's market cap divided by the market cap of the NC 2000 or its sector
    b. We multiply each company's trailing PEBV ratio by its weight
    c. NC 2000/Sector trailing PEBV ratio equals the sum of the weighted trailing PEBV ratios for all the companies in the NC 2000/sector
2. **Market-weighted drivers** – calculated by market-cap-weighting the market cap and economic book value for the individual companies in each sector in each period. Details:
    a. Company weight equals the company's market cap divided by the market cap of the NC 2000 or its sector
    b. We multiply each company's market cap and economic book value by its weight
    c. We sum the weighted market cap and weighted economic book value for each company in the NC 2000/each sector to determine the NC 2000 or sector's weighted market cap and weighted economic book value
    d. NC 2000/Sector trailing PEBV ratio equals weighted NC 2000/sector market cap divided by weighted NC 2000/sector economic book value

Each methodology has its pros and cons, as outlined below:

Aggregate method

Pros:

- A straightforward look at the entire NC 2000/sector, regardless of company size or weighting.
- Matches how S&P Global calculates metrics for the S&P 500.

Cons:

- Vulnerable to impact of companies entering/exiting the group of companies, which could unduly affect aggregate values. Also susceptible to outliers in any one period.

Market-weighted metrics method

Pros:

- Accounts for a firm's market cap relative to the NC 2000/sector and weights its metrics accordingly.

Cons:

- Vulnerable to outlier results from a single company disproportionately impacting the overall trailing PEBV ratio.

Market-weighted drivers method

Pros:

- Accounts for a firm's market cap relative to the NC 2000/sector and weights its size and economic book value accordingly.
- Mitigates the disproportionate impact of outlier results from one company on the overall results.

Cons:

- More susceptible to large swings in market cap or economic book value (which can be impacted by changes in WACC) period over period, particularly from firms with a large weighting in the NC 2000/Sector.

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Best Fundamental Data in the World

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Key quotes from the paper:

- "[New Constructs'] *Total Adjustments* differs significantly from the items identified and excluded from Compustat's adjusted earnings measures. For example… 50% to 70% of the variation in *Total Adjustments* is not explained by *S&P Global's (SPGI) Adjustments* individually." – pp. 14, 1st para.
- "A final source of differences [between New Constructs' and S&P Global's data] is due to data collection oversights…we identified cases where Compustat did not collect information relating to firms' income that is useful in assessing core earnings." – pp. 16, 2nd para.

Superior Models

A top accounting firm features the superiority of our ROIC, NOPAT and Invested Capital research to Capital IQ & Bloomberg's in Getting ROIC Right. See the Appendix for direct comparison details.

Key quotes from the paper:

- "…an accurate calculation of ROIC requires more diligence than often occurs in some of the common, off-the-shelf ROIC calculations. Only by scouring the footnotes and the MD&A [as New Constructs does] can investors get an accurate calculation of ROIC." – pp. 8, 5th para.
- "The majority of the difference…comes from New Constructs' machine learning approach, which leverages technology to calculate ROIC by applying accounting adjustments that may be buried deeply in the footnotes across thousands of companies." – pp. 4, 2nd para.

Superior Stock Ratings

Robo-Analysts' stock ratings outperform those from human analysts as shown in this paper from Indiana's Kelley School of Business. Bloomberg features the paper here.

Key quotes from the paper:

- "the portfolios formed following the buy recommendations of Robo-Analysts earn abnormal returns that are statistically and economically significant." – pp. 6, 3rd para.
- "Our results ultimately suggest that Robo-Analysts are a valuable, alternative information intermediary to traditional sell-side analysts." – pp. 20, 3rd para.

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