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MACRO FUNDAMENTALS
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S&P 500 & Sectors: Beware the GAAP Gap in S&P 500 Earnings

GAAP earnings remain highly overstated despite a year-over-year (YoY) rise in Core Earnings for all eleven sectors through the trailing-twelve-months (TTM) ended 1Q22, just as they did in 2021.

This report analyzes the Core Earnings[1,2], which adjust for unusual gains/losses, and GAAP earnings of the S&P 500 and its sectors (last quarter's analysis is here). You can find the same analysis on other key metrics here.

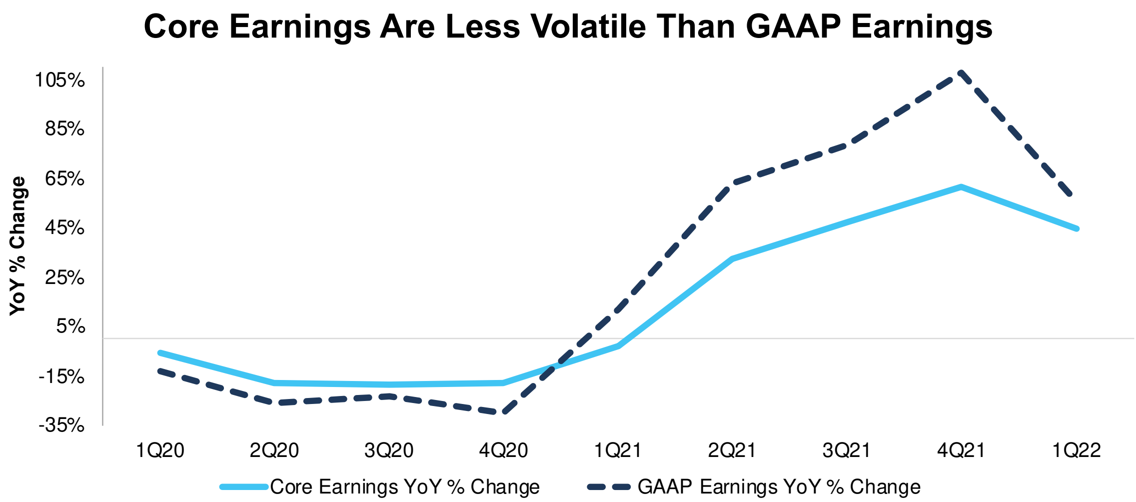
This report leverages our cutting-edge Robo-Analyst technology to deliver proven-superior[3] fundamental research and support more cost-effective fulfillment of the fiduciary duty of care.

Core Earnings Are More Reliable than GAAP Earnings

Since 2020, corporate profits did not decline or rebound as much as indicated by GAAP earnings. For instance:

- In 2021, GAAP earnings rose 107% YoY compared to a 62% rise for Core Earnings.
- In 2020, GAAP earnings fell 30% YoY compared to an 18% fall for Core Earnings.
- In the TTM ended 1Q22, GAAP earnings rose 56% YoY compared to a 45% rise for Core Earnings.

Figure 1: S&P 500 Core Earnings Vs. GAAP Earnings YoY Percent Change: 1Q20 – 1Q22



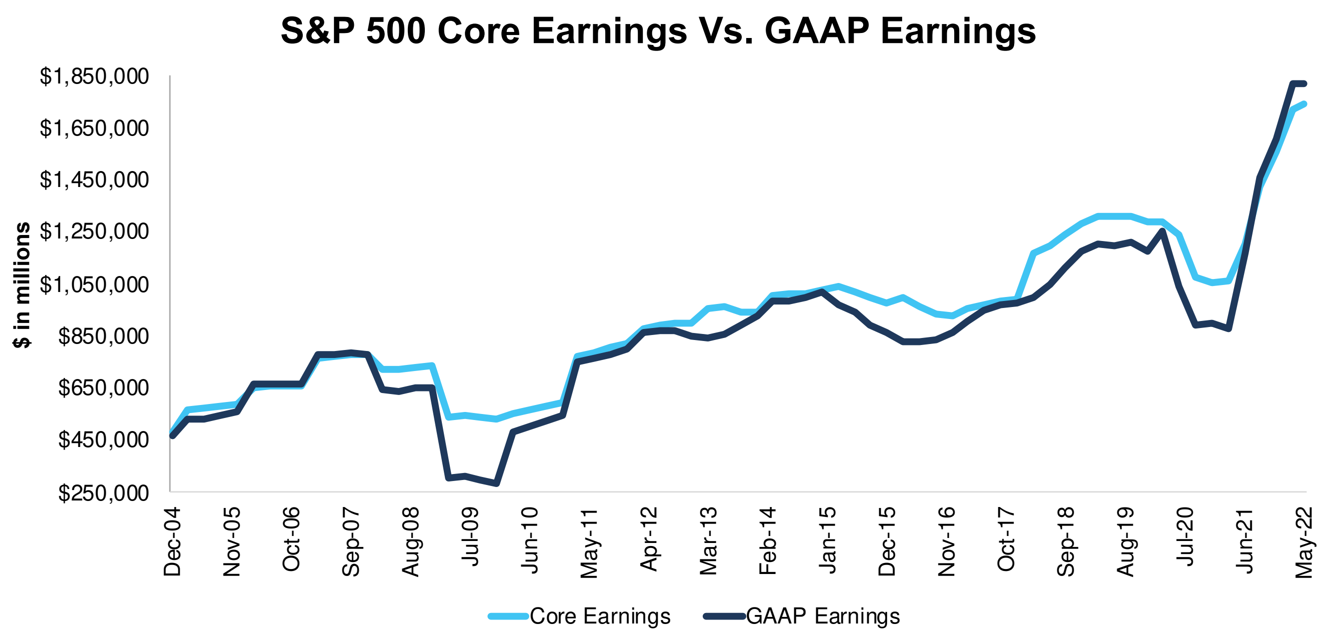
Sources: New Constructs, LLC and company filings.
Our Core Earnings analysis is based on aggregated TTM data for the sector constituents in each measurement period.
The May 16, 2022 measurement period incorporates the financial data from calendar 1Q22 10-Qs, as this is the earliest date for which all the calendar 1Q22 10-Qs for the S&P 500 constituents were available.

GAAP Earnings Overstate Core Earnings By Widest Margin in Recent History

Figure 2 shows GAAP Earnings for the S&P 500 overstate Core Earnings by a wider margin than anytime in recent history. Not surprisingly, GAAP Earnings rose much faster over the last year, 56%, while Core Earnings rose 45% over the same time.

[1] The Journal of Financial Economics features the superiority of our Core Earnings in Core Earnings: New Data & Evidence.
[2] This report is based on the latest audited financial data available, which is the 1Q22 10-Q in most cases. Price data as of 5/16/22.
[3] Our research utilizes our Core Earnings, a more reliable measure of profits, as proven in Core Earnings: New Data & Evidence, written by professors at Harvard Business School (HBS) & MIT Sloan and published in The Journal of Financial Economics.

Figure 2: S&P 500 Core Earnings Vs. GAAP: 2004 – 1Q22



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GAAP Earnings Widely Overstated at the Individual Company Level[4]

45%, or 223 of the companies in the S&P 500, report GAAP Earnings that overstate Core Earnings for the TTM ended 1Q22. When GAAP Earnings overstate Core Earnings, they do so by an average of 22%, per Figure 3. The overstatement was greater than ten percent for 20% of companies. For comparison, in the TTM ended 1Q21 and calendar 2021, the percent of companies that overstate Core Earnings was 36% and 44% respectively.

The 223 companies with overstated GAAP earnings make up 55% of the market cap of the S&P 500.

Figure 3: S&P 500 GAAP Earnings Overstated by 22% On Average

Overstated GAAP Earnings	Overstated by >10%	Average Overstatement %
223 companies	99 companies	22%

Sources: New Constructs, LLC and company filings.
We use Funds from Operations (FFO) for Real Estate companies rather than GAAP Earnings.

Ranking the Sectors by Overstated GAAP Change

Figure 4 compares the year-over-year (YoY) change in Core Earnings and GAAP Earnings from 1Q21 to 1Q22[5] for the S&P 500 and all eleven S&P 500 sectors.

[4] Overstated companies include all companies with Earnings Distortion >0.1% of GAAP earnings.
[5] May 16, 2022, is earliest date for which all the calendar 1Q22 10-Qs for the S&P 500 constituents were available.

Figure 4: 1Q22 Core Earnings & GAAP Earnings % YoY Change

Sector	GAAP Earnings % YoY Change	Core Earnings % YoY Change	Difference
Telecom Services	120%	16%	104%
Industrials	137%	97%	40%
Consumer Non-cyclicals	30%	8%	22%
Consumer Cyclicals	58%	37%	21%
Healthcare	54%	36%	18%
Technology	31%	30%	1%
Basic Materials	83%	89%	-6%
Utilities	8%	16%	-8%
Financials	18%	36%	-18%
Real Estate[6]	34%	58%	-24%
Energy	N/A*	N/A*	N/A
S&P 500	**56%**	**45%**	**11%**

Sources: New Constructs, LLC and company filings.
Our Core Earnings analysis is based on aggregated TTM data for the sector constituents.
*TTM GAAP Earnings rose from -$51.7 billion in 1Q21 to $111.7 billion in 1Q22. Core Earnings rose from -$6.5 billion in 1Q21 to $109.8 billion in 1Q22.

The Energy sector saw the largest YoY improvement, $116.3 billion, in Core Earnings, which rose from -$6.5 billion in 1Q21 to $109.8 billion in 1Q22.

The Technology sector generates the most Core Earnings of any sector and grew Core Earnings by 30% YoY in 1Q22. On the flip side, the Real Estate sector has the lowest Core Earnings, and the Consumer Non-cyclicals sector had the weakest YoY growth in 1Q22.

Details on the 11 S&P 500 Sectors

Figures 5 through 15 below compare the Core Earnings and GAAP earnings trends for every S&P 500 sector since 2004.

[6] We use Funds from Operations (FFO) for the Real Estate sector rather than GAAP Earnings.

Basic Materials

Figure 5 shows Core Earnings for the Basic Materials sector, at $60.1 billion, rose 89% YoY in 1Q22, while GAAP earnings, at $55.0 billion, rose 83% over the same time.

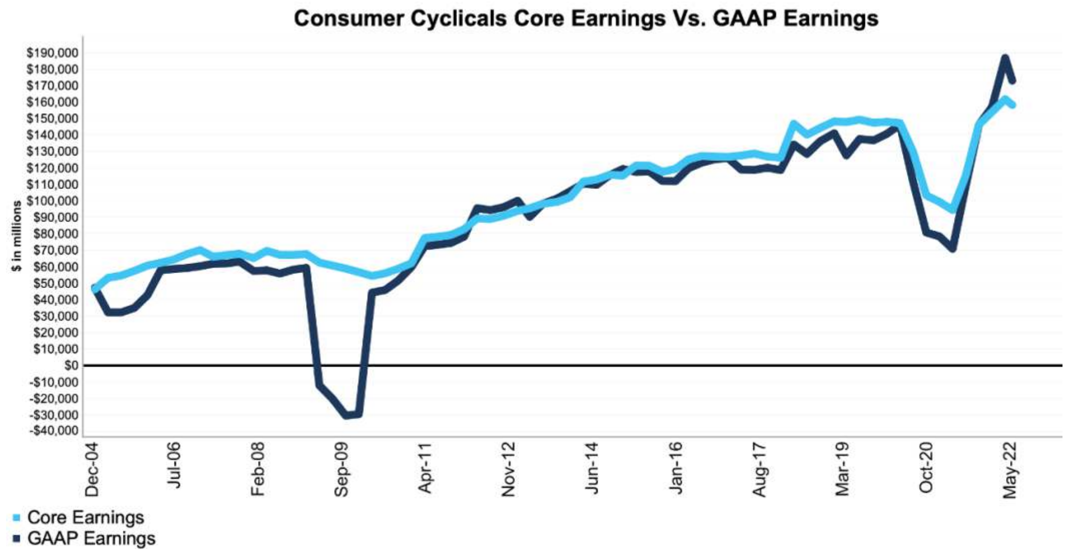
Figure 5: Basic Materials Core Earnings Vs. GAAP: 2004 – 1Q22

Sources: New Constructs, LLC and company filings.
Our Core Earnings analysis is based on aggregated TTM data for the sector constituents in each measurement period.
The May 16, 2022 measurement period incorporates the financial data from calendar 1Q22 10-Q, as this is the earliest date for which all the calendar 1Q22 10-Qs for the S&P 500 constituents were available.

Consumer Cyclicals

Figure 6 shows Core Earnings for the Consumer Cyclicals sector, at $158.2 billion, rose 37% YoY in 1Q22, while GAAP earnings, at $173.0 billion, rose 58% over the same time.

Figure 6: Consumer Cyclicals Core Earnings Vs. GAAP: 2004 – 1Q22



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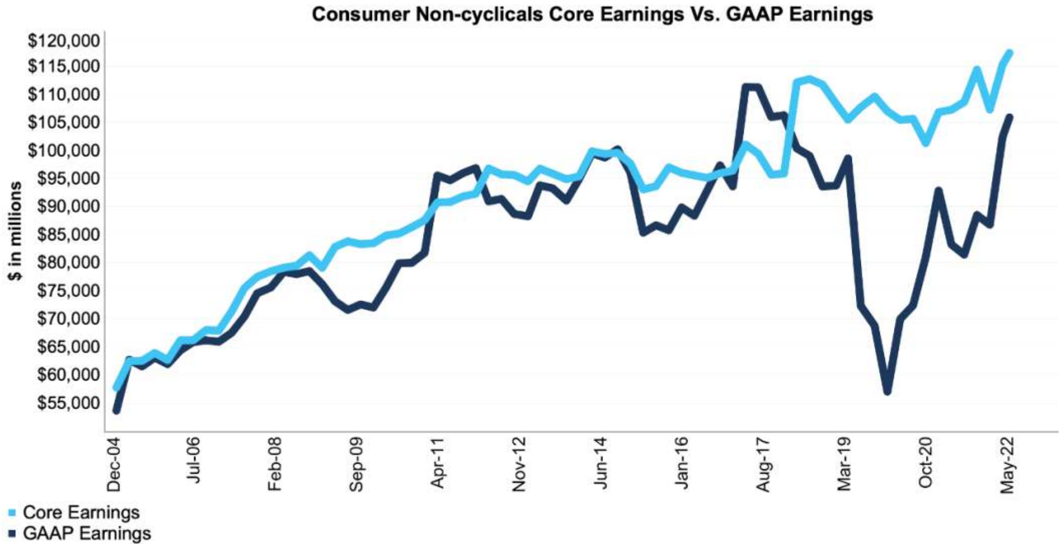
Consumer Non-Cyclicals

Figure 7 shows Core Earnings for the Consumer Non-Cyclicals sector, at $117.4 billion, rose 8% YoY in 1Q22, while GAAP earnings, at $105.9 billion, rose 30% over the same time.

Figure 7: Consumer Non-Cyclicals Core Earnings Vs. GAAP: 2004 – 1Q22



Sources: New Constructs, LLC and company filings.
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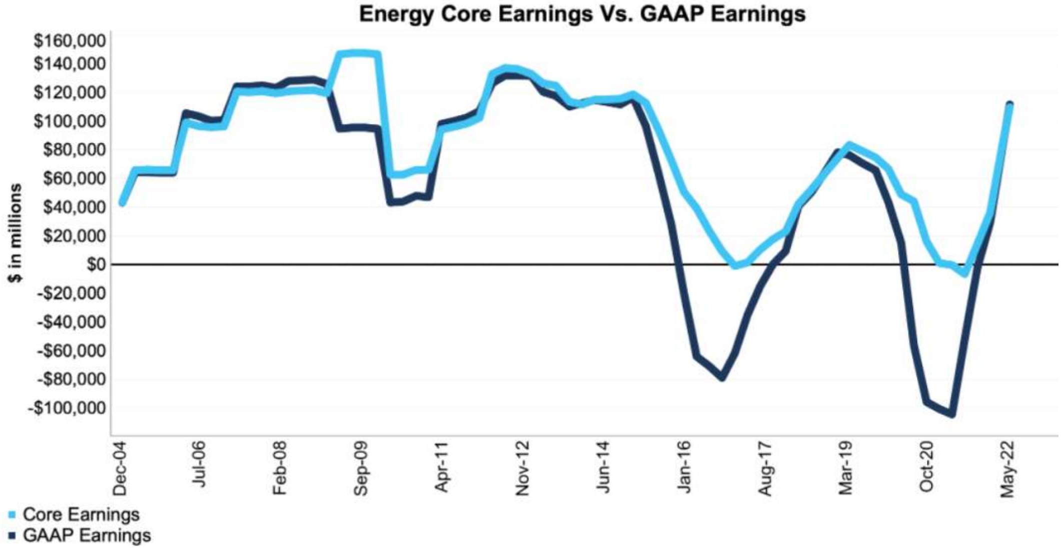
Energy

Figure 8 shows Core Earnings for the Energy sector, at $109.8 billion in 1Q22, rose from -$6.5 billion in 1Q21. GAAP earnings, at $111.7 billion, rose from -$51.7 billion in 1Q21. Large asset write-downs throughout 2020 help explain the large drop in GAAP earnings and more drastic (on a dollar basis) recovery in prior periods.

Figure 8: Energy Core Earnings Vs. GAAP: 2004 – 1Q22



Sources: New Constructs, LLC and company filings.
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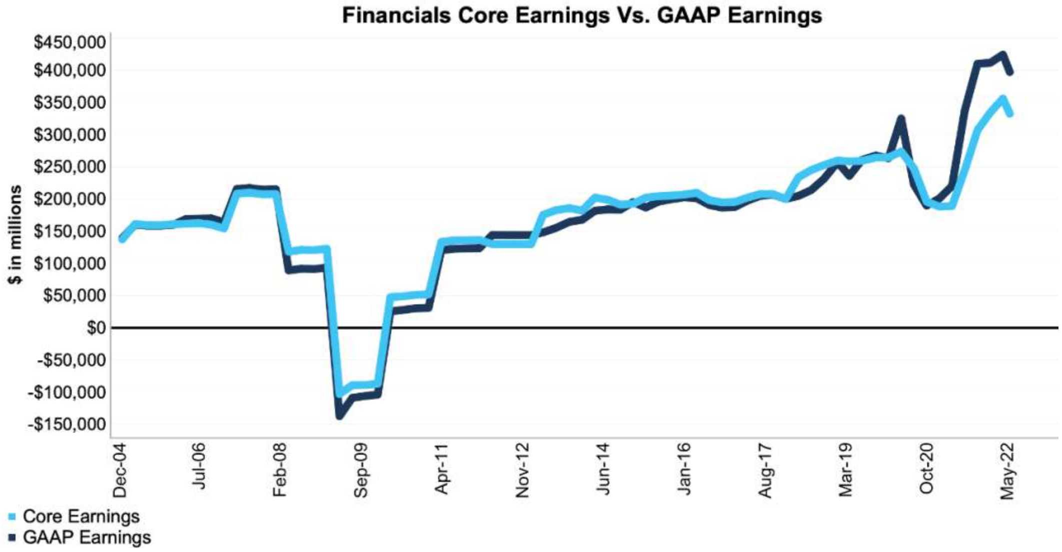
Financials

Figure 9 shows Core Earnings for the Financials sector, at $332.9 billion, rose 36% YoY in 1Q22, while GAAP earnings, at $397.5 billion, rose 18% over the same time.

Figure 9: Financials Core Earnings Vs. GAAP: 2004 – 1Q22



Sources: New Constructs, LLC and company filings.
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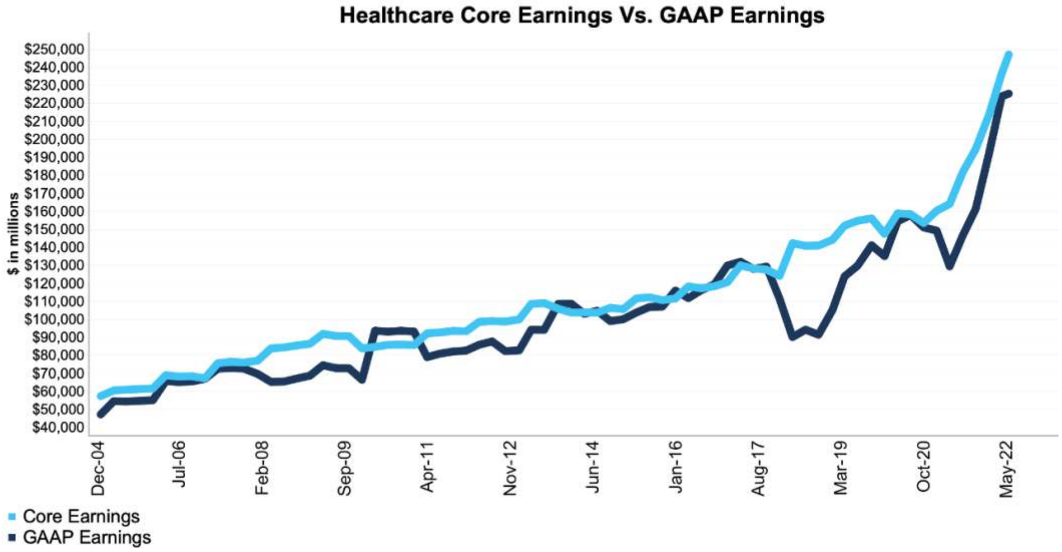
Healthcare

Figure 10 shows Core Earnings for the Healthcare sector, at $247.2 billion, rose 36% YoY in 1Q22, while GAAP earnings, at $225.4 billion, rose 54% over the same time.

Figure 10: Healthcare Core Earnings Vs. GAAP: 2004 – 1Q22



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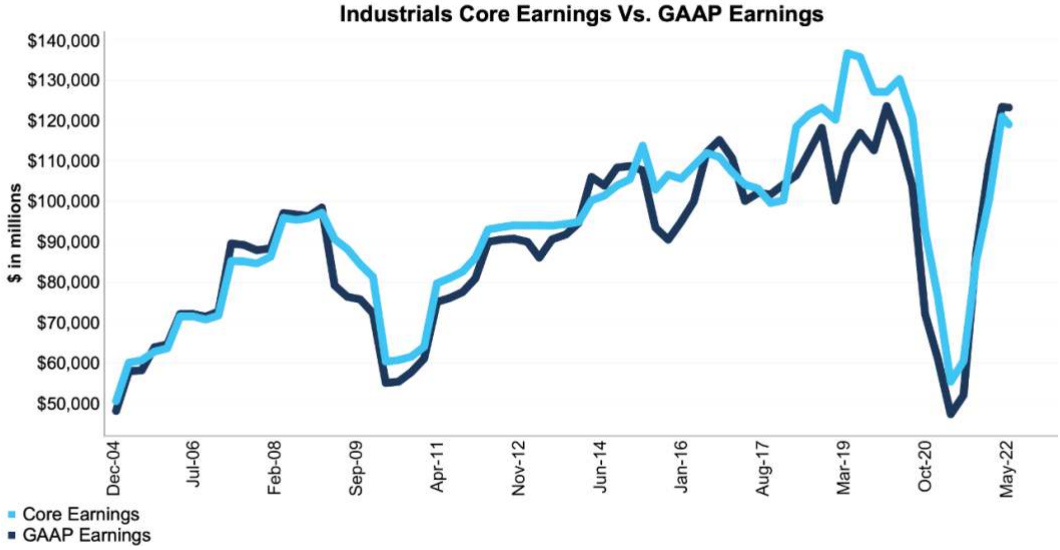
Industrials

Figure 11 shows Core Earnings for the Industrials sector, at $119.1 billion, rose 97% YoY in 1Q22, while GAAP earnings, at $123.3 billion, rose 137% over the same time.

Figure 11: Industrials Core Earnings Vs. GAAP: 2004 – 1Q22



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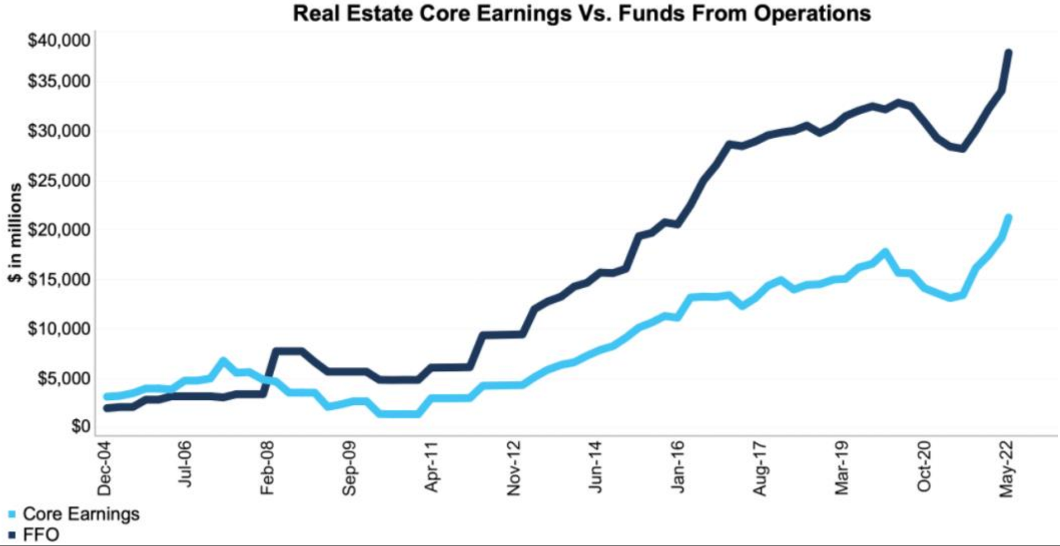
Real Estate

Figure 12 shows Core Earnings for the Real Estate sector, at $21.3 billion, rose 58% YoY in 1Q22, while funds from operations, at $37.9 billion, rose 34% over the same time. Funds from operations add back depreciation and amortization, which can materially impact reported results.

Figure 12: Real Estate Core Earnings Vs. FFO: 2004 – 1Q22



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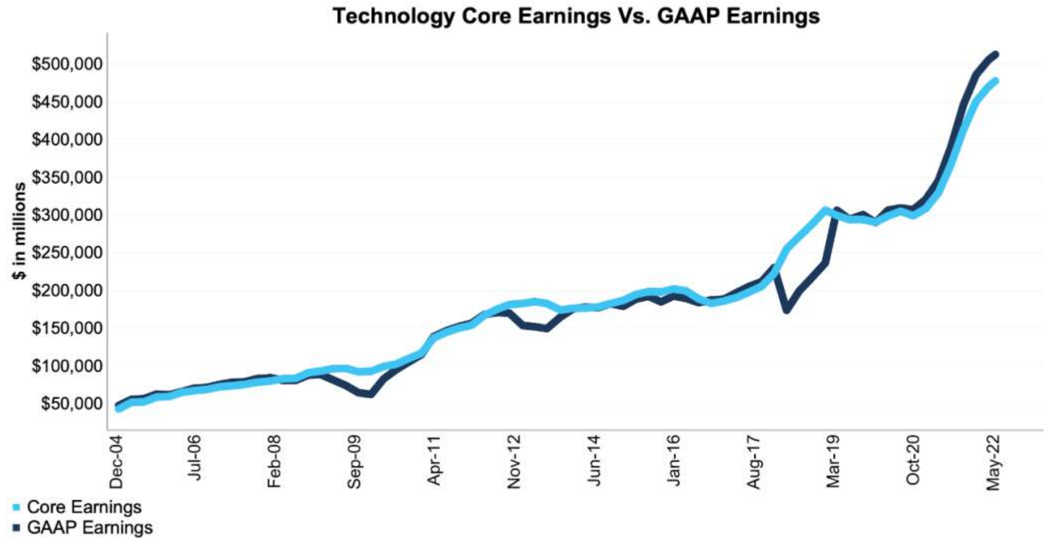
Technology

Figure 13 shows Core Earnings for the Technology sector, at $477.9 billion, rose 30% YoY in 1Q22, while GAAP earnings, at $513.0 billion, rose 31% over the same time. Earnings power within the Technology sector is unevenly distributed. In 1Q22, five, or 6%, of the seventy-nine companies in the Technology sector – Apple (AAPL), Alphabet (GOOGL), Microsoft (MSFT), Facebook (FB), and Intel Corporation (INTC) – account for 61% of the sector's total Core Earnings.

Figure 13: Technology Core Earnings Vs. GAAP: 2004 – 1Q22



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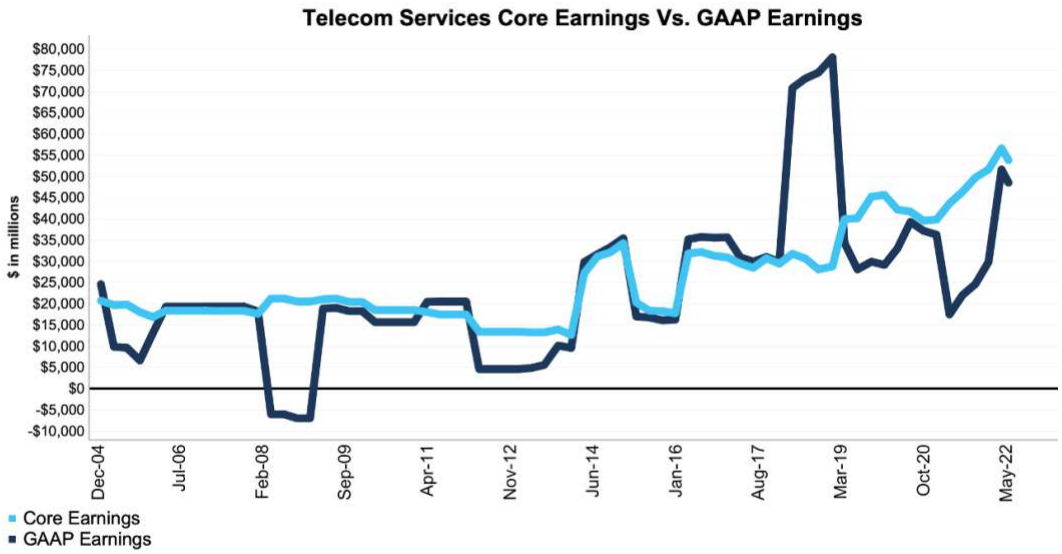
Telecom Services

Figure 14 shows Core Earnings for the Telecom Services sector, at $53.8 billion, rose 16% YoY in 1Q22, while GAAP earnings, at $48.5 billion, rose 120% over the same time.

Figure 14: Telecom Services Core Earnings Vs. GAAP: 2004 – 1Q22



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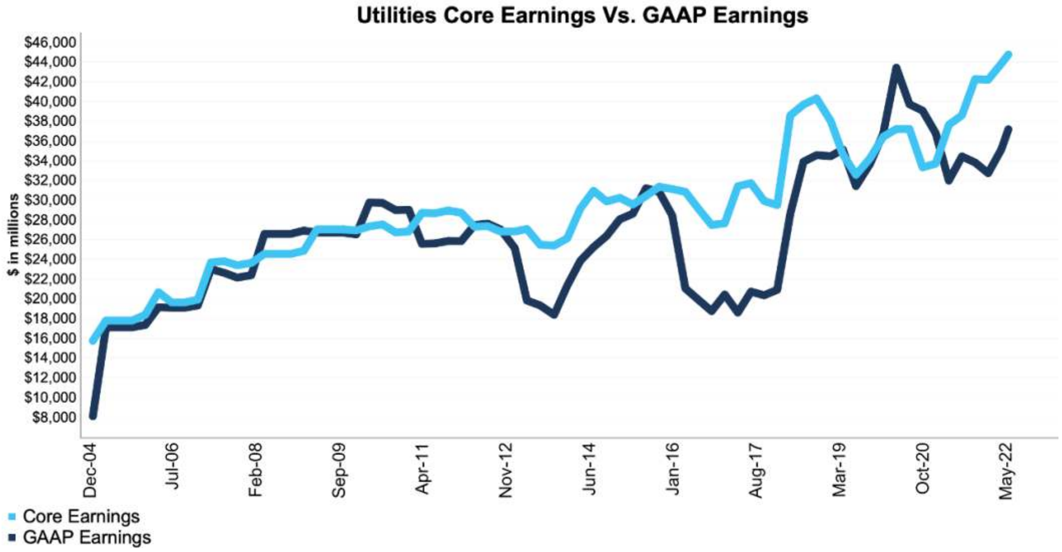
Utilities

Figure 15 shows Core Earnings for the Utilities sector, at $44.8 billion, rose 16% YoY in 1Q22, while GAAP earnings, at $37.2 billion, rose 8% over the same time.

Figure 15: Utilities Core Earnings Vs. GAAP: 2004 – 1Q22



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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: Calculation Methodology

We derive the Core Earnings and GAAP Earnings metrics above by summing the Trailing Twelve Month individual S&P 500 constituent values for Core Earnings and GAAP Earnings in each sector for each measurement period. We call this approach the "Aggregate" methodology.

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

It's Official: We Offer the Best Fundamental Data in the World

Many firms claim their research is superior, but none of them can prove it with independent studies from highly-respected institutions as we can. Three different papers from both the public and private sectors show:

1. Legacy fundamental datasets suffer from significant inaccuracies, omissions and biases.
2. Only our "novel database" enables investors to overcome these flaws and apply reliable fundamental data in their research.
3. Our proprietary measures of Core Earnings and Earnings Distortion materially improve stock picking and forecasting of profits.

Best Fundamental Data in the World

Forthcoming in The Journal of Financial Economics, a top peer-reviewed journal, Core Earnings: New Data & Evidence proves our Robo-Analyst technology overcomes material shortcomings in legacy firms' data collection processes to provide superior fundamental data, earnings models, and research. More details.

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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