



All Cap Index & Sectors: Earnings Distortions Flash Warning Signs for Equity Investors

GAAP earnings remain overstated despite a year-over-year (YoY) rise in [Core Earnings](#) for all eleven sectors of the NC 2000¹ through the trailing-twelve-months (TTM), ended 1Q22, just as they did in [2021](#).

This report analyzes the Core Earnings^{2,3} and GAAP earnings of the NC 2000, our All Cap Index, and its sectors (last quarter's analysis is [here](#)). You can find the same analysis on other key metrics [here](#).

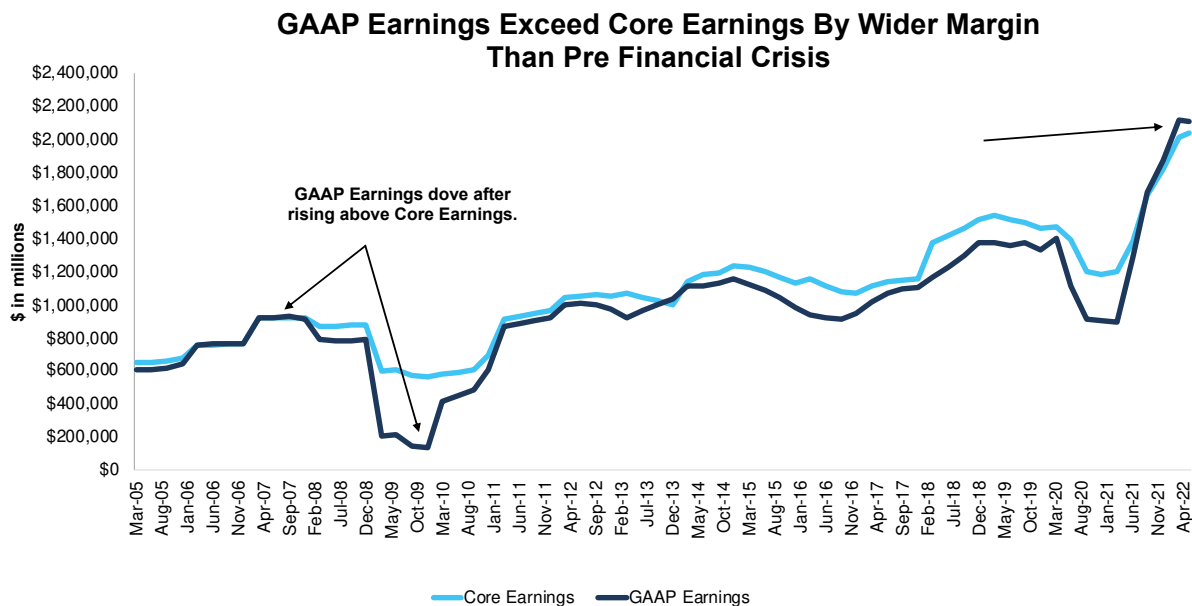
This report leverages our cutting-edge [Robo-Analyst technology](#) to deliver [proven-superior](#)⁴ fundamental research and support more cost-effective fulfillment of the [fiduciary duty of care](#).

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GAAP Earnings Exceed Core Earnings By Wider Margin Than Before the Financial Crisis

Figure 1 shows GAAP Earnings for the NC 2000 overstate Core Earnings by far more than before the Financial Crisis. The last time GAAP Earnings exceeded Core Earnings was in the TTM ended June 2007. Not long after, GAAP earnings took a dive. Fast forward to the present, and we see GAAP Earnings spiking up past Core Earnings even more than in 2007. This crossover could presage a steep decline in GAAP Earnings in the near future. Using superior fundamental data protects us from falling for misleading trends in unscrubbed data.

Figure 1: NC 2000 Core Earnings Vs. GAAP: 2005 – 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 NC 2000 constituents were available.

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 [The Journal of Financial Economics](#) features the superiority of our Core Earnings in [Core Earnings: New Data & Evidence](#).

³ 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.

⁴ 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](#).

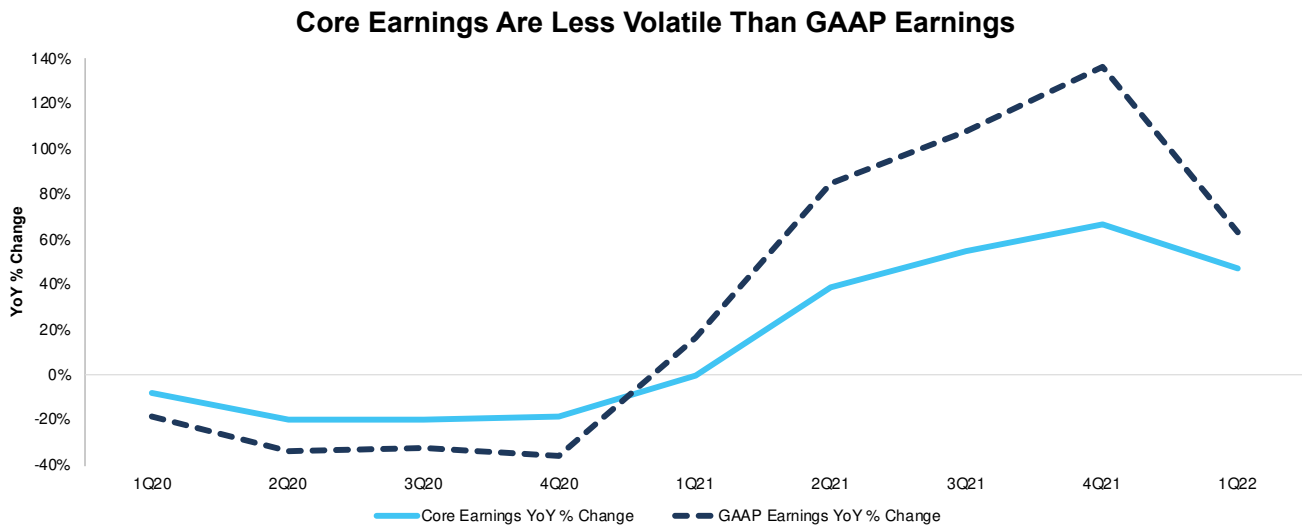


Core Earnings Are More Reliable than GAAP Earnings

GAAP Earnings rose much faster over the last year, at 63%, compared to 47% for Core Earnings. Since 2020, corporate profits have been much less volatile than indicated by GAAP earnings. For instance:

- In 2020, GAAP earnings fell 36% YoY compared to an 18% fall for Core Earnings.
- In 2021, GAAP earnings rose 136% YoY compared to a 67% rise for Core Earnings.
- In the TTM ended 1Q22, GAAP earnings rose 63% YoY compared to a 47% rise for Core Earnings.

Figure 2: NC 2000 Core Earnings Vs. GAAP Earnings YoY Percent Change: 1Q20 – 1Q22



Sources: New Constructs, LLC and company filings.
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GAAP Earnings Widely Overstated at the Individual Company Level⁵

42%, or 830 of the companies in the NC 2000, 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 38%, per Figure 3. The overstatement was greater than ten percent for 20% of companies. For comparison, in the TTM ended 2021 the percent of companies that overstate Core Earnings was 40%.

The 830 companies with overstated GAAP earnings make up 52% of the market cap of the NC 2000.

Figure 3: NC 2000 GAAP Earnings Overstated by 38% On Average

Overstated GAAP Earnings	Overstated by >10%	Average Overstatement %
830 companies	397 companies	38%

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 Change

Figure 4 compares the year-over-year (YoY) change in Core Earnings and GAAP earnings from 1Q21 to 1Q22⁶ for the NC 2000 and all eleven NC 2000 sectors.

⁵ Overstated companies include all companies with Earnings Distortion >0.1% of GAAP earnings.

⁶ May 16, 2022 is earliest date for which all the 1Q22 10-Qs for the NC 2000 constituents were available.

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

Sector	GAAP Earnings % YoY Change	Core Earnings % YoY Change	Difference
Telecom Services	119%	16%	104%
Industrials	141%	88%	53%
Consumer Cyclical	96%	49%	47%
Consumer Non-cyclicals	33%	9%	24%
Healthcare	53%	38%	15%
Basic Materials	126%	113%	13%
Real Estate ⁷	31%	22%	9%
Utilities	23%	19%	4%
Technology	32%	30%	2%
Financials	17%	32%	-15%
Energy	N/A*	N/A*	N/A*
NC 2000	63%	47%	16%

Sources: New Constructs, LLC and company filings.

Our Core Earnings analysis is based on aggregated TTM data for the sector constituents.

*GAAP Earnings rose from -\$69.2 billion in 1Q21 to \$123.4 billion in 1Q22 and Core Earnings rose from -\$3.4 billion in 1Q21 to \$135.8 billion in 1Q22.

The Energy sector saw the largest YoY improvement, \$139.2 billion in Core Earnings, which rose from -\$3.4 billion in 1Q21 to \$135.8 billion in 1Q22.

The Technology sector generates the most Core Earnings, at \$486.9 billion, and grew Core Earnings by 30% YoY in 1Q22. On the flip side, the Real Estate sector has the lowest Core Earnings at \$36.3 billion, and the Consumer Non-cyclicals sector, at just 9%, had the weakest YoY growth in 1Q22.

Details on the 11 NC 2000 Sectors

Figures 5 through 15 compare the trends in Core Earnings and GAAP earnings for every NC 2000 sector since 1998.

⁷ 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 \$99.1 billion, rose 113% YoY in 1Q22, while GAAP earnings, at \$92.5 billion, rose 126% over the same time.

Figure 5: Basic Materials Core Earnings Vs. GAAP: 1998 – 1Q22



Sources: New Constructs, LLC and company filings.

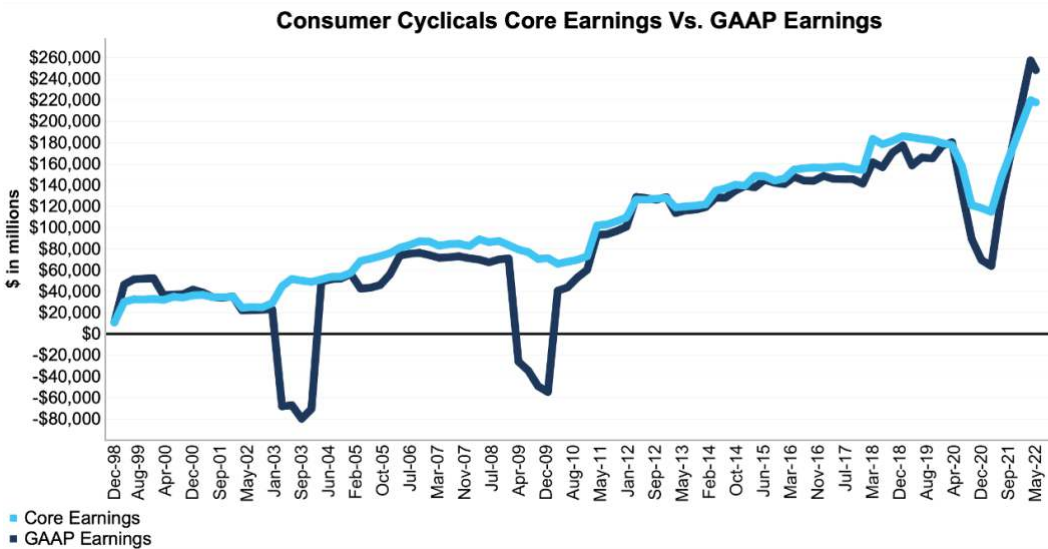
Our Core Earnings analysis is based on aggregated TTM data for the sector constituents in each measurement period.

The May 16, 2022 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 NC 2000 constituents were available.

Consumer Cyclicals

Figure 6 shows Core Earnings for the Consumer Cyclicals sector, at \$217.9 billion, rose 49% YoY in 1Q22, while GAAP earnings, at \$248.3 billion, rose 96% over the same time.

Figure 6: Consumer Cyclicals Core Earnings Vs. GAAP: 1998 – 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.

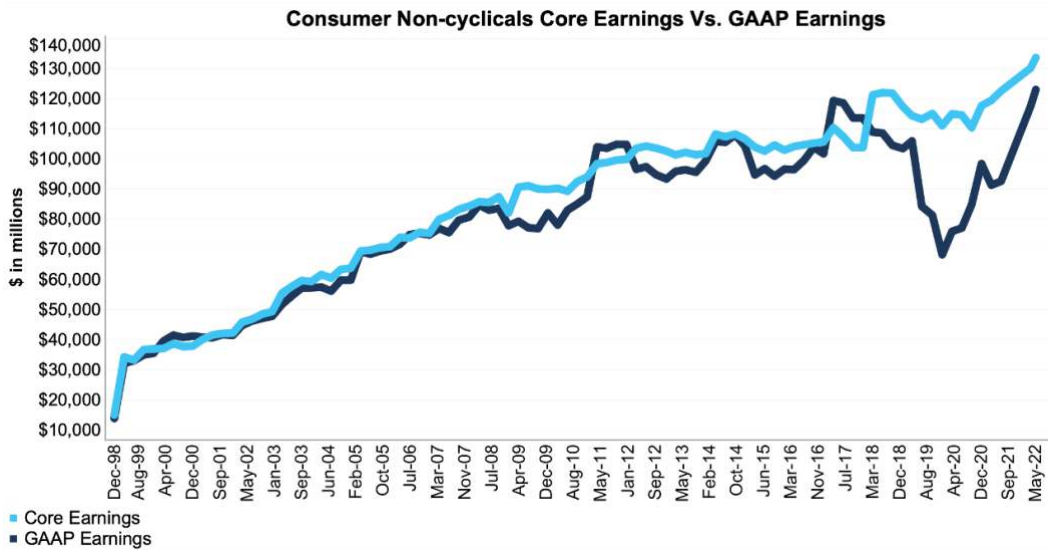
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Consumer Non-Cyclicals

Figure 7 shows Core Earnings for the Consumer Non-cyclicals sector, at \$133.7 billion, rose 9% YoY in 1Q22, while GAAP earnings, at \$123.0 billion rose 33% over the same time.

Figure 7: Consumer Non-Cyclicals Core Earnings Vs. GAAP: 1998 – 1Q22



Sources: New Constructs, LLC and company filings.

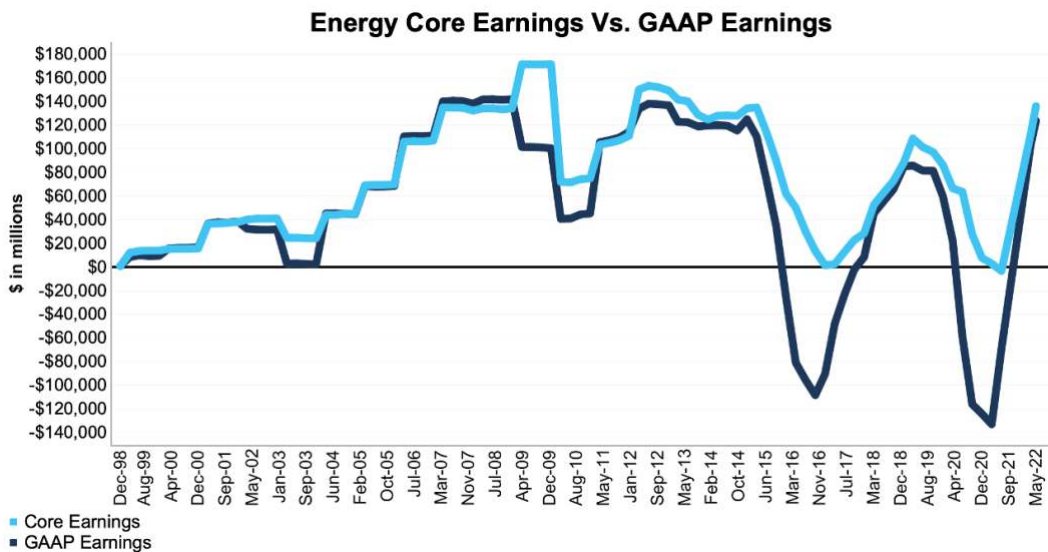
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Energy

Figure 8 shows Core Earnings for the Energy sector, at \$135.8 billion in 1Q22, rose from -\$3.4 billion in 1Q21, while GAAP earnings improved from -\$69.2 billion in 1Q21 to \$123.4 billion in 1Q22.

Figure 8: Energy Core Earnings Vs. GAAP: 1998 – 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.

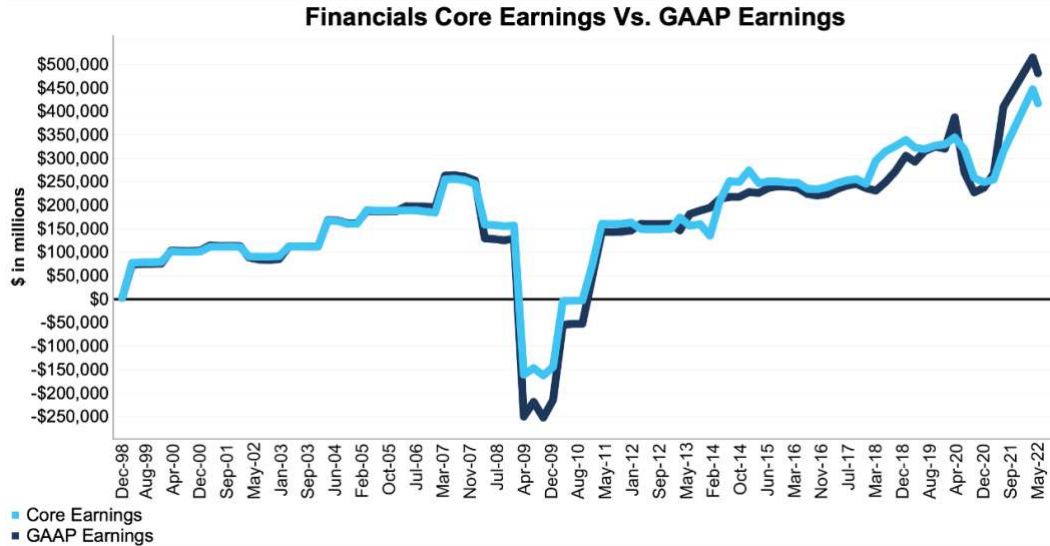
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Financials

Figure 9 shows Core Earnings for the Financials sector, at \$417.3 billion, rose 32% YoY in 1Q22, while GAAP earnings, at \$481.4 billion, rose 17% over the same time.

Figure 9: Financials Core Earnings Vs. GAAP: 1998 – 1Q22

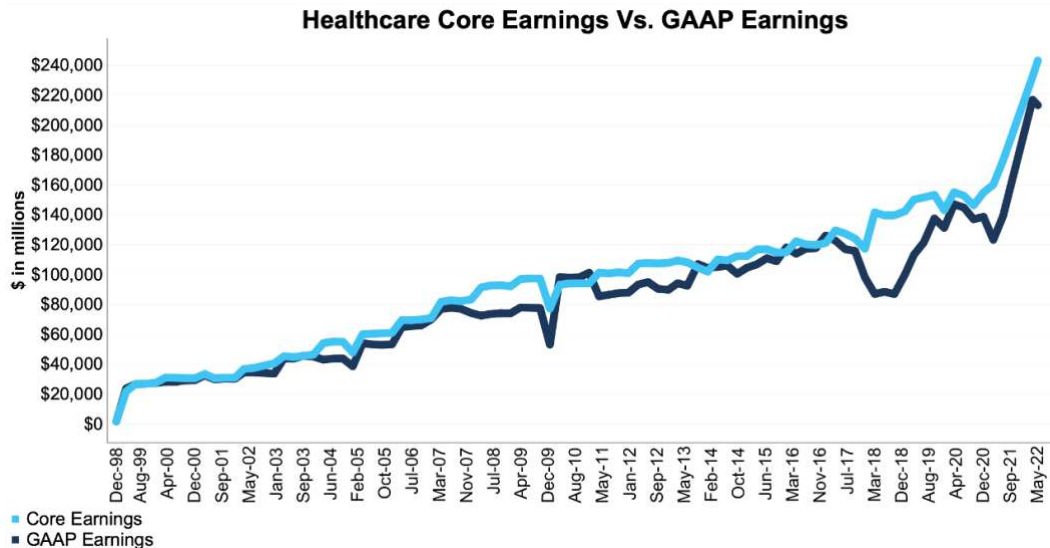


Sources: New Constructs, LLC and company filings.
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Healthcare

Figure 10 shows Core Earnings for the Healthcare sector, at \$243.2 billion, rose 38% YoY in 1Q22, while GAAP earnings, at \$213.3 billion, rose 53% over the same time.

Figure 10: Healthcare Core Earnings Vs. GAAP: 1998 – 1Q22



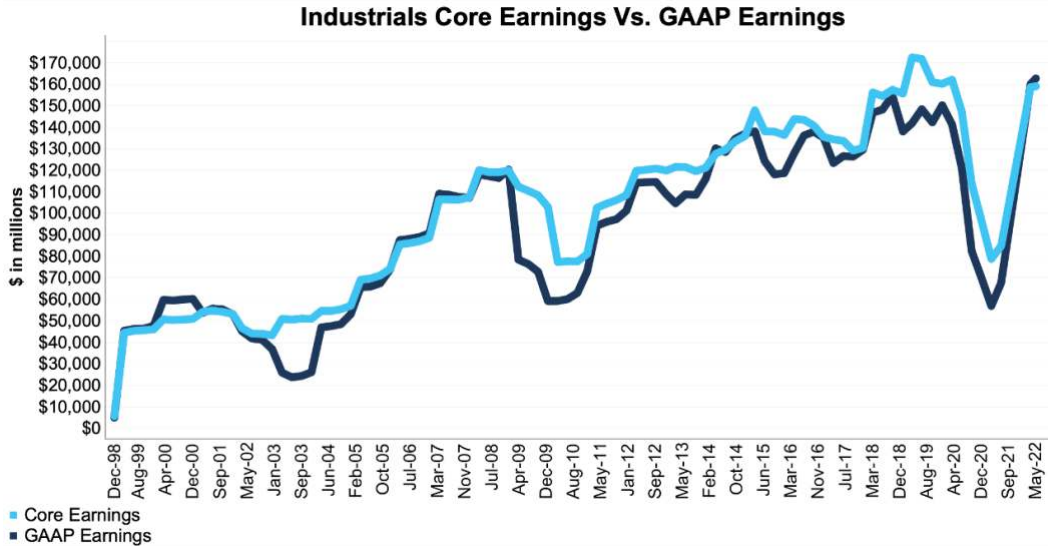
Sources: New Constructs, LLC and company filings.
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Industrials

Figure 11 shows Core Earnings for the Industrials sector, at \$159.1 billion, rose 88% YoY in 1Q22, while GAAP earnings, at \$162.8 billion, rose 141% over the same time.

Figure 11: Industrials Core Earnings Vs. GAAP: 1998 – 1Q22

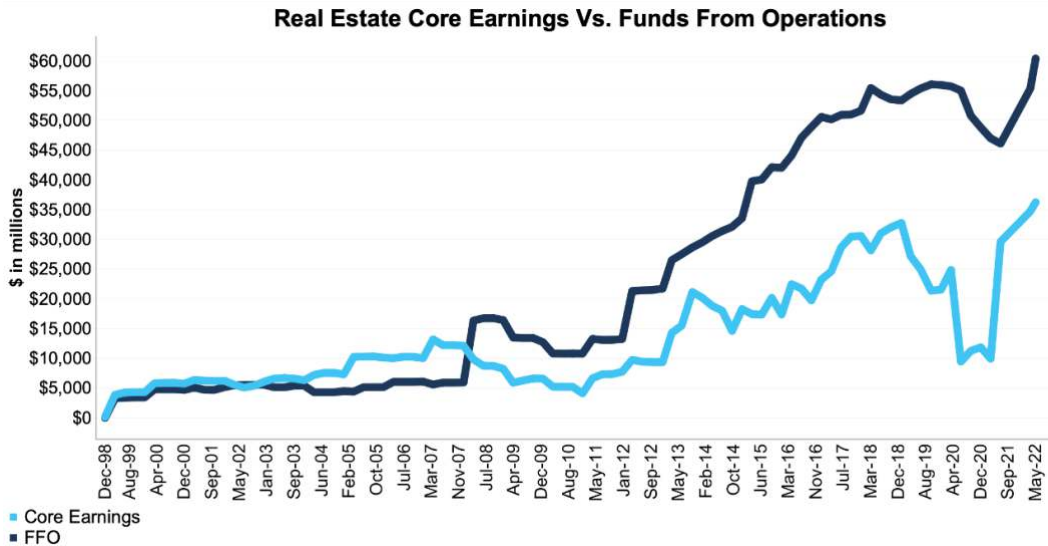


Sources: New Constructs, LLC and company filings. Our Core Earnings analysis is based on aggregated TTM data for the sector constituents in each measurement period. The May 16, 2022 period incorporates the financial data from calendar 1Q22 10-Q, as this is the earliest date for which all the calendar 1Q22 10-Qs for the NC 2000 constituents were available.

Real Estate

Figure 12 shows Core Earnings for the Real Estate sector, at \$36.3 billion, rose 22% YoY in 1Q22, while funds from operations (FFO), at \$60.4 billion, rose 31% over the same time.

Figure 12: Real Estate Core Earnings Vs. FFO: 1998 – 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 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 NC 2000 constituents were available.

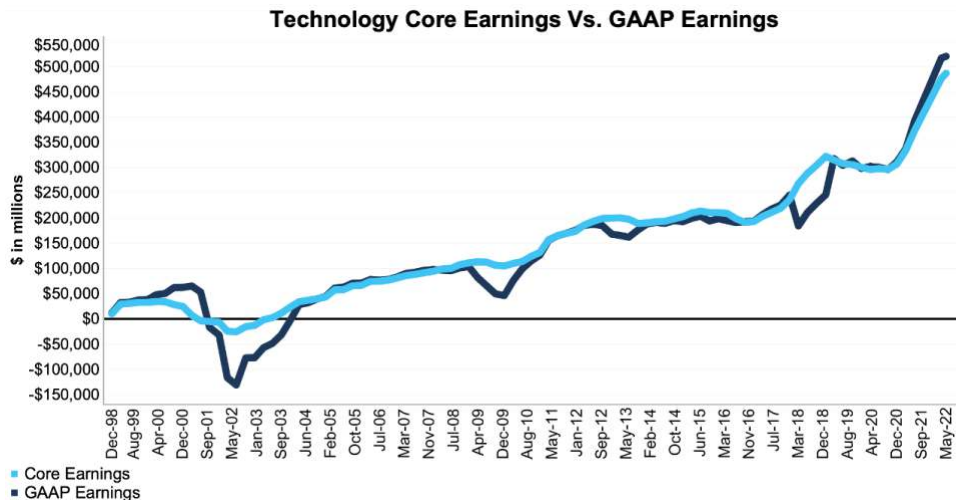


Technology

Figure 13 shows Core Earnings for the Technology sector, at \$486.9 billion, rose 30% YoY in 1Q22, while GAAP earnings, at \$520.5 billion, rose 32% over the same time as well. Our analysis of the NC 2000 and [S&P 500 Technology sector](#) illustrates disparity in profitability between the largest and smallest Technology companies.

For example, in 1Q22, five, or 2%, of the 321 companies in the Technology sector – Apple (AAPL), Alphabet (GOOGL), Microsoft (MSFT), Facebook (FB), and Intel Corporation (INTC) – account for 60% of the sector’s total Core Earnings.

Figure 13: Technology Core Earnings Vs. GAAP: 1998 – 1Q22

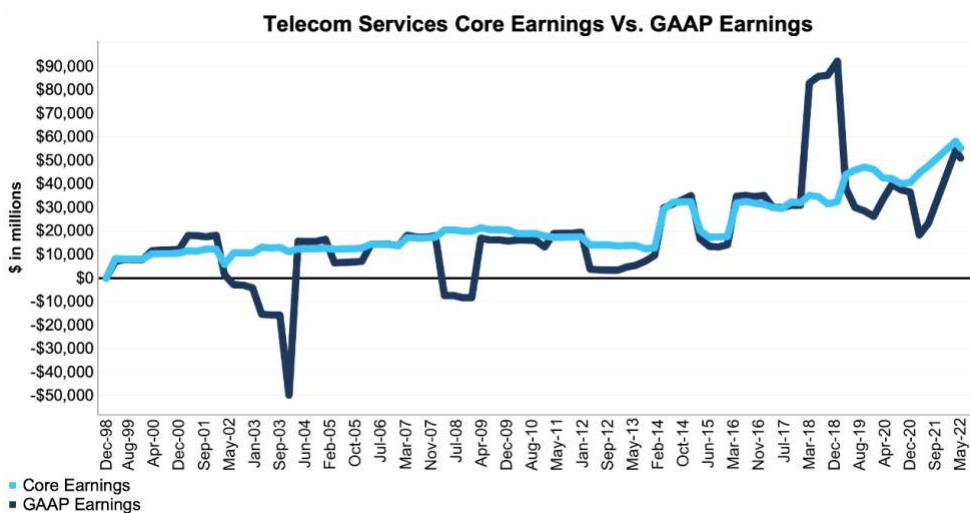


Sources: New Constructs, LLC and company filings. Our Core Earnings analysis is based on aggregated TTM data for the sector constituents in each measurement period. The May 16, 2022 period incorporates the financial data from calendar 1Q22 10-Q, as this is the earliest date for which all the calendar 1Q22 10-Qs for the NC 2000 constituents were available.

Telecom Services

Figure 14 shows Core Earnings for the Telecom Services sector, at \$55.2 billion rose 16% YoY in 1Q22, while GAAP earnings, at \$51.0 billion rose 119% over the same time.

Figure 14: Telecom Services Core Earnings Vs. GAAP: 1998 – 1Q22



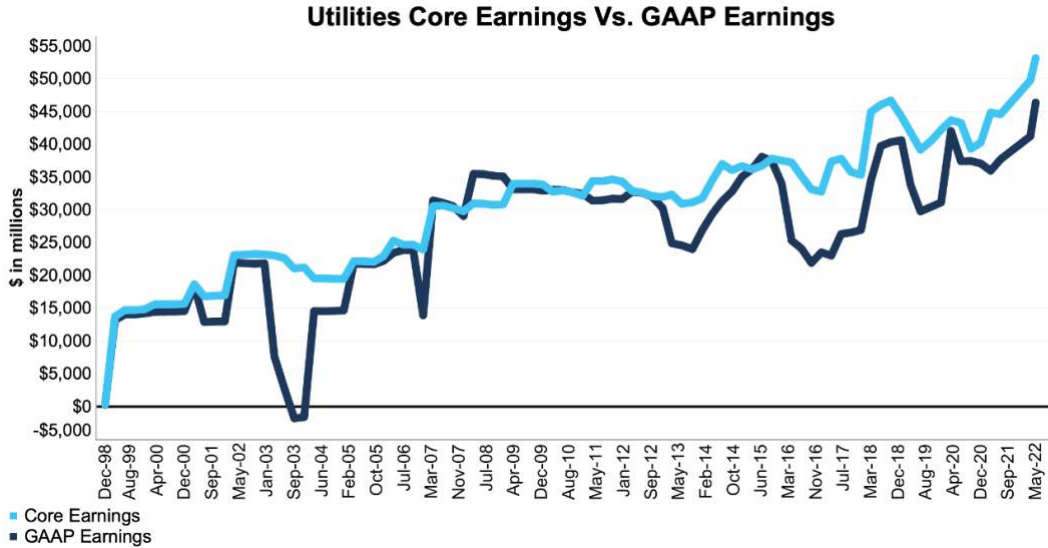
Sources: New Constructs, LLC and company filings. Our Core Earnings analysis is based on aggregated TTM data for the sector constituents in each measurement period. The May 16, 2022 period incorporates the financial data from calendar 1Q22 10-Q, as this is the earliest date for which all the calendar 1Q22 10-Qs for the NC 2000 constituents were available.



Utilities

Figure 15 shows Core Earnings for the Utilities sector, at \$53.2 billion, rose 19% YoY in 1Q22, while GAAP earnings, at \$46.4 billion, rose 23% over the same time.

Figure 15: Utilities Core Earnings Vs. GAAP: 1998 – 1Q22



Sources: New Constructs, LLC and company filings.
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Appendix: Calculation Methodology

We derive the Core Earnings and GAAP Earnings metrics above by summing the Trailing Twelve-Month individual NC 2000 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.



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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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