



## All Cap Index & Sectors: Economic Earnings Continue to Fall in 1Q23 (Free, Abridged)

Trailing-twelve-months (TTM) [Economic Earnings](#) for the NC 2000<sup>1</sup>, our All Cap Index, have been falling quarter-over-quarter (QoQ) since 1Q22. 1Q23 was no different. TTM Economic Earnings in 1Q23 were lower than 4Q22 TTM levels for all but one sector: Financials. Eventually, a higher WACC will likely result in weaker returns on invested capital ([ROIC](#)) (see our report on the ROIC trends for the NC 2000 [here](#)) as the Fed's tightening has the intended effect on the economy.

This report is an abridged and free version of [All Cap Index & Sectors: Economic Earnings Continue to Fall in 1Q23](#), one of our quarterly reports on [fundamental market and sector trends](#). The full reports are available to our [Professional](#) and [Institutional](#) members or can be purchased below.

The full version of this report analyzes the economic earnings<sup>2</sup> (which adjust for [unusual items](#) on both the income statement and balance sheet) and GAAP earnings for the NC 2000 and its sectors (last quarter's analysis is [here](#)).

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Economic earnings provide a more accurate measure of the true underlying cash flows of businesses than GAAP earnings. Reports on the drivers of economic earnings are [here](#).

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

### Economic Earnings Fall Further in 1Q23

TTM Economic Earnings for the NC 2000 fell from \$564.3 billion in 4Q22 to \$453.5 billion in 1Q23, while TTM GAAP Earnings rose from \$1.76 trillion to \$1.81 trillion over the same time. TTM Economic Earnings have fallen QoQ in the last five quarters and are nearing levels last seen in 4Q20.

The NC 2000's falling Economic Earnings are the continuation of a trend we foresaw in our 1Q22 report [All Cap Index & Sectors: 1Q22's Soaring Economic Earnings Aren't Sustainable](#). Indeed, a major headwind facing Economic Earnings is a rising weighted average cost of capital ([WACC](#)). WACC for the NC 2000 sits at 7.3% in 1Q23, which is up from 7.0% in 4Q22 and 4.8% in 1Q21. Investors can protect themselves by paying closer attention to Economic Earnings, which accounts for the effects of high inflation on a firm's WACC.

See Figure 1 in the [full version](#) of our report for the chart of Economic Earnings vs. GAAP earnings for the NC 2000 from December 1998 through the TTM ended 1Q23.

### Key Details on Select NC 2000 Sectors

The Consumer Non-cyclicals sector's decline in GAAP earnings understates the decline in the sector's Economic Earnings the least. On the flip side, the Financials sector's increase in GAAP earnings overstates the decline in Economic Earnings the most.

The Energy sector saw the largest QoQ improvement in TTM Economic Earnings, which rose from \$136.6 billion in 4Q22 to 146.6 billion in 1Q23.

The Technology sector's TTM Economic Earnings fell by 11% QoQ in 1Q23, though it generates the highest TTM Economic Earnings of any sector. On the flip side, the Utilities sector has the lowest TTM Economic Earnings and was one of ten sectors that destroyed shareholder value in 1Q23.

<sup>1</sup> 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.

<sup>2</sup> This report is based on the latest audited financial data available, which is the 1Q23 10-Q in most cases. Price data as of 5/15/23.

<sup>3</sup> Our research utilizes our more of reliable fundamental data, 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](#).

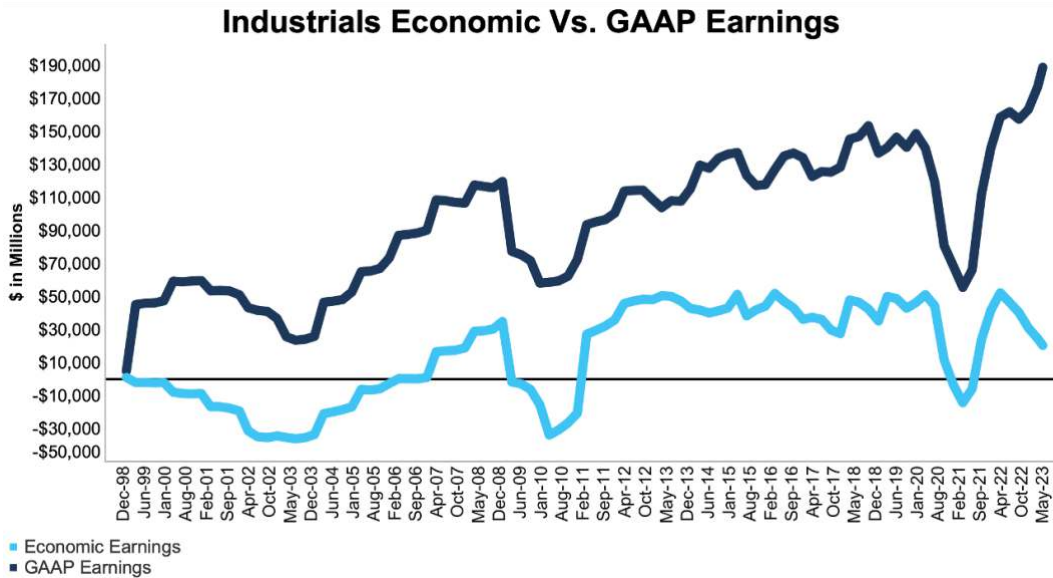


Below, we highlight the Industrials sector which saw economic earnings decline 17% QoQ in 1Q23.

**Sample Sector Analysis<sup>4</sup>: Industrials**

Figure 1 shows Economic Earnings for the Industrials sector, at \$20.5 billion, fell 17% QoQ in 1Q23, while GAAP earnings, at \$189.1 billion, rose 7% over the same time.

**Figure 1: Industrials Economic Earnings Vs. GAAP: 4Q98 – 1Q23**



Sources: New Constructs, LLC and company filings.

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

The May 15, 2023 period incorporates the financial data from calendar 1Q23 10-Qs, as this is the earliest date for which all of the calendar 1Q23 10-Qs for the NC 2000 constituents were available.

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*Disclosure: David Trainer, Kyle Guske II, and Italo Mendonça receive no compensation to write about any specific stock, style, or theme.*

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<sup>4</sup> The full version of this report provides analysis for all eleven sectors.



## ***Appendix: Calculation Methodology***

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We derive the economic earnings and GAAP earnings metrics above by summing the Trailing Twelve-Month individual NC 2000 constituent values for economic 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***

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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.

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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, 1<sup>st</sup> 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, 2<sup>nd</sup> 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, 5<sup>th</sup> 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, 2<sup>nd</sup> 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, 3<sup>rd</sup> para.
- “Our results ultimately suggest that Robo-Analysts are a valuable, alternative information intermediary to traditional sell-side analysts.” – pp. 20, 3<sup>rd</sup> para.

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We believe every investor deserves to know the whole truth about the profitability and valuation of any company they consider for investment. More details on our cutting-edge technology and how we use it are [here](#).



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