S&P 500: Earnings Lower and Valuation Higher Than You Think

For nearly a year, we've red-flagged the skyrocketing use by certain companies of off-balance sheet debt to fund AI spending that they could not otherwise afford.

Hidden debt isn't just a balance sheet story, though. When there's trillions of dollars in debt hidden off balance sheet, there's also billions of expenses hidden off the income statement. We fix both.

In this report, we shine a light on this hidden expense, how it impacts earnings and the valuation, particularly the price-to-earnings (P/E) ratios, of the entire market.

$237 Billion in Hidden Costs For the S&P 500

It's no secret that debt has a cost, typically reported as interest expense on income statements. However, companies keep this interest expense off their income statement by holding trillions in obligations off-balance sheet through operating leases, residual value guarantees, and purchase commitments.

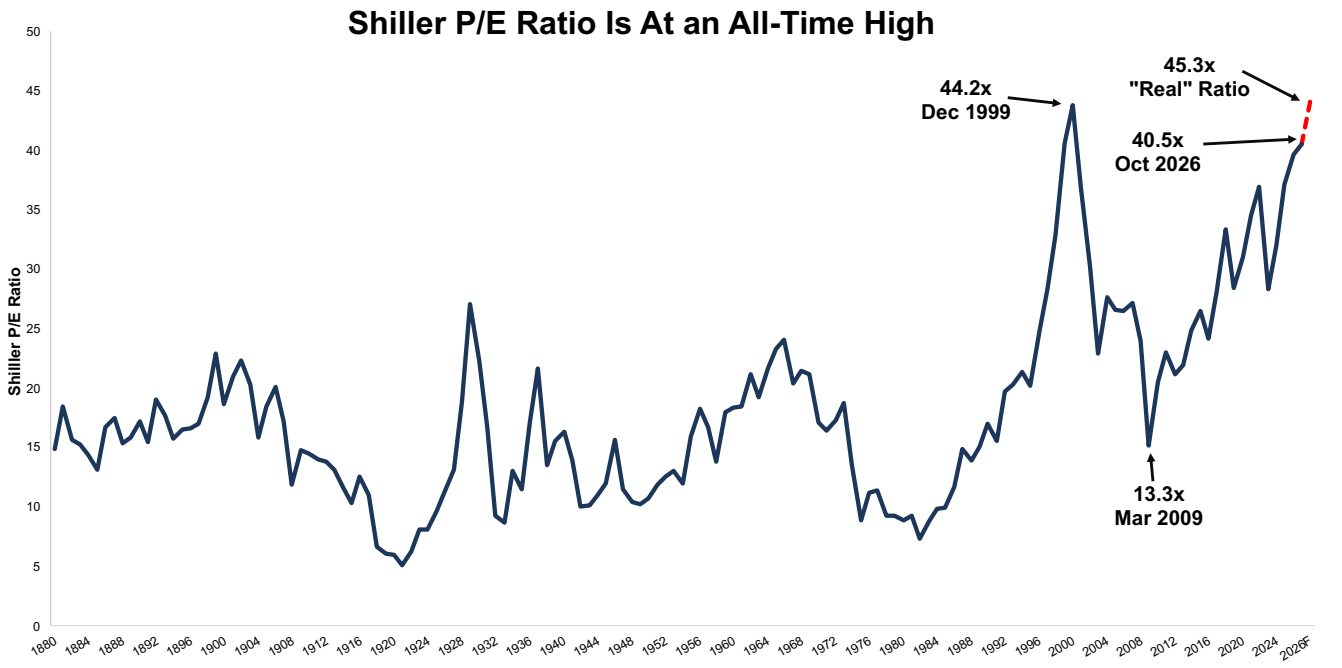
This hidden debt translates into hidden interest expenses of $237 billion in aggregate for the S&P 500. The aggregate GAAP earnings for the S&P 500 are $2.67 trillion; therefore, the aggregate adjusted S&P 500 earnings are $2.43 trillion, 9% lower.

The S&P 500 Is 9% Overvalued and Shiller P/E Is at an All-Time High

The current P/E ratio of the S&P 500 based on aggregate market cap to aggregate GAAP earnings is ~26. The adjusted P/E ratio based on aggregate market cap to adjusted earnings (net of $237 billion of hidden interest expense) is ~28.5. When we apply the current P/E ratio to the adjusted earnings, the math shows the S&P 500 should be 9% lower, or ~$7,073.

Let's extend this analysis to the Shiller P/E ratio. If we assume the Schiller P/E ratio is off by the same percent as the P/E ratio, then the adjusted Shiller P/E ratios is 45.3, higher than the 40.5 (as of 10/16/2026) on which everyone else relies. At 45.3, the Shiller PE ratio is the highest in the history of the market.

Figure 1: Shiller P/E Ratio Is 45.3 After Adjusting for Hidden Interest Expense



Sources: New Constructs, LLC and Shiller Data

Below, we'll detail the mechanics behind this hidden interest expense and how fast these risks are rising.

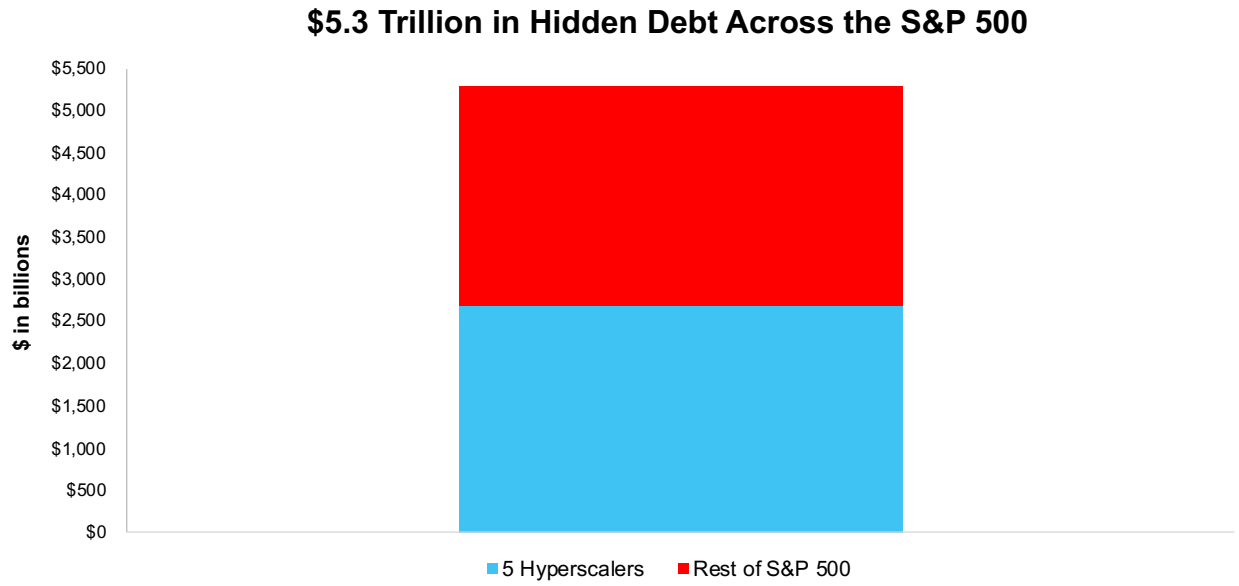
Important Disclosure Information is contained on the last page of this report.
The recipient of this report is directed to read these disclosures.

Hidden Debt Is Huge, Like $5.3 Trillion

Across the S&P 500 we've identified $5.3 trillion in hidden debt reported in footnotes. You might notice that our hidden debt number is much higher than those reported by others. The difference is that we did the diligence and checked the footnotes for all the companies. As our clients can attest, all our work is 100% auditable. Our service makes it easy to trace every single footnote adjustment back to the source.

The five largest hyperscalers, Alphabet (GOOGL), Amazon (AMZN), Oracle (ORCL), Microsoft (MSFT), and Meta (META) hold over 50% of it, or $2.7. Meanwhile, these five companies show just $580 billion of debt on their balance sheets, or just 18% of their true total debt.

Figure 2: Hidden Debt in S&P 500: Hyperscalers vs. Rest of S&P 500: TTM



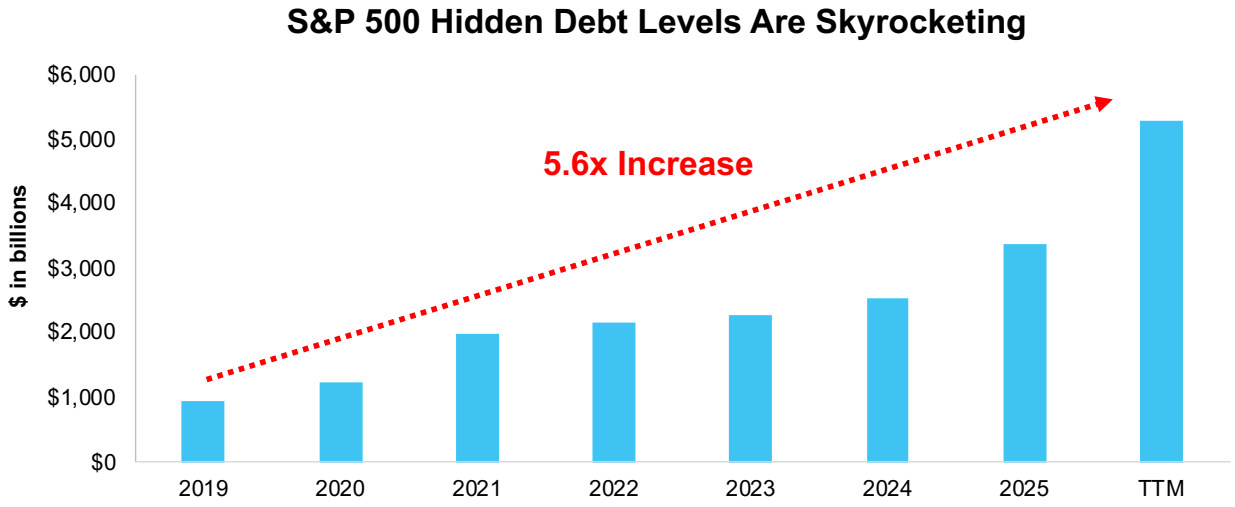
Sources: New Constructs, LLC and company filings
* Five hyperscalers in this analysis include Alphabet (GOOGL), Amazon (AMZN), Oracle (ORCL), Microsoft (MSFT), and Meta (META).

…And Growing Rapidly

Figure 3 illustrates the speed at which the S&P 500 companies are taking on hidden debt.

Across the S&P 500, hidden debt has increased from $947 billion in 2019 to $5.3 trillion over the TTM, or a 5.6x increase.

Figure 3: Hidden Debt in the S&P 500: 2019-TTM



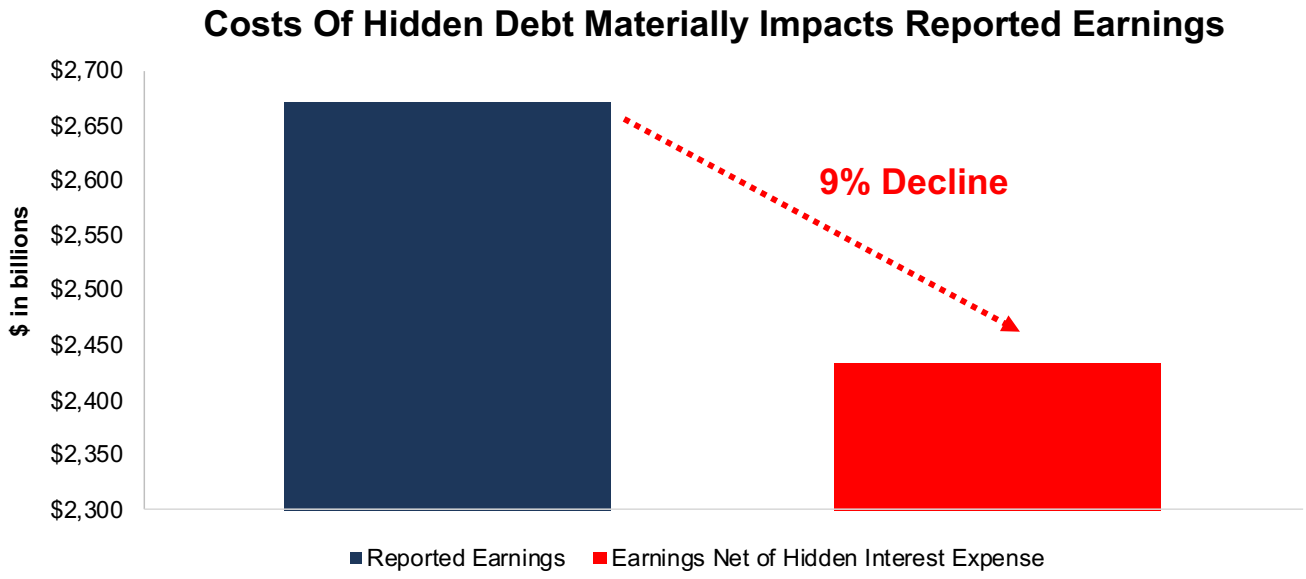
Sources: New Constructs, LLC and company filings
* S&P 500 data includes TTM data for companies in the S&P 500 at the end of each period.

Hidden Debt Creates Billions in Hidden Expenses

It's no secret that debt has a cost, or what we call hidden interest expense. Hidden interest expense equals the company's after-tax cost of debt multiplied by its hidden debt.

The average after-tax cost of debt in the S&P 500 is 4.2%. When we multiply each company's cost of debt by its hidden debt, we get aggregate hidden interest expense of $237 billion, or 9% of the total reported GAAP earnings for the S&P 500.

Figure 4: Reported Earnings vs. Earnings Net of Hidden Interest Expense: S&P 500: TTM



Sources: New Constructs, LLC and company filings

This Earnings Disconnect is Getting Worse

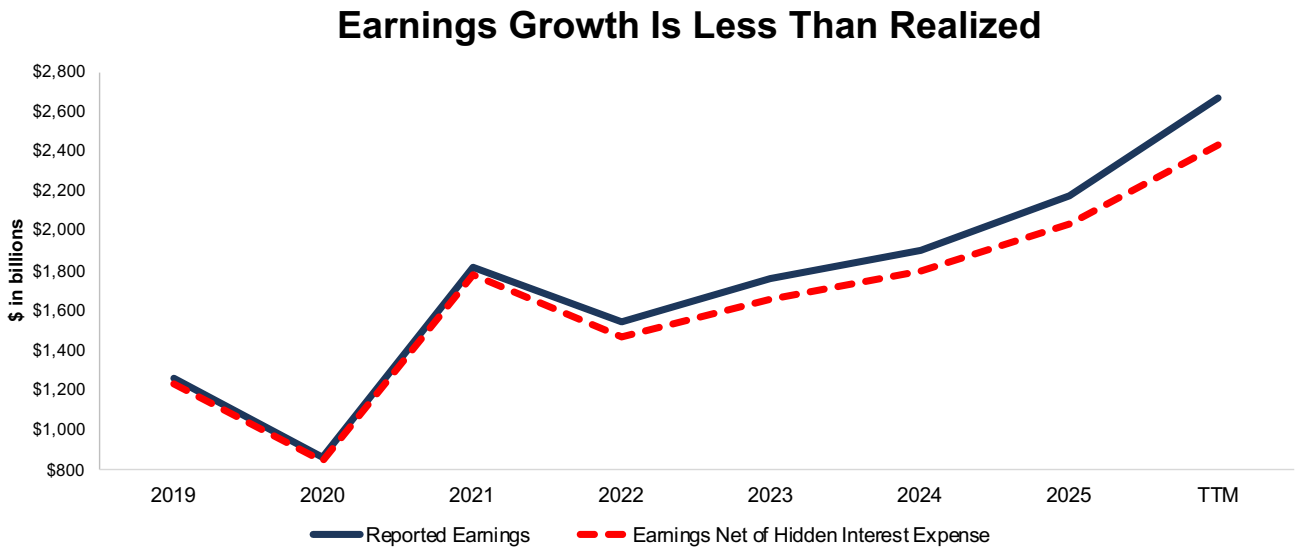
When we perform the same analysis on the S&P 500 over a longer period, we find that the hidden interest expense is getting much larger.

AI bulls have claimed strong earnings growth as the justification for the increasingly expensive valuations of many stocks and the overall S&P 500. We question that logic as, clearly, earnings growth after accounting for the very real cost of hidden debt, is meaningfully lower than the reported earnings on which everyone else replies.

Per Figure 5, reported earnings across the S&P 500 have grown 112% since 2019. However, the earnings net of hidden interest expense have grown just 98%.

In 2019, earnings net of hidden interest expense were just 2% below reported earnings. In the TTM, earnings net of hidden interest expense are 9% below reported earnings.

Figure 5: Reported Earnings vs. Earnings Net of Hidden Interest Expense: S&P 500: 2019-TTM



Sources: New Constructs, LLC and company filings
* S&P 500 data includes TTM data for companies in the S&P 500 at the end of each period.

The ultimate takeaway for investors: hidden debt creates hidden expense. When you account for these hidden expenses, the entire market is both less profitable and more expensive than traditional measures indicate.

The downside for individual stocks, including some of the largest names in the market where hidden debt is mostly concentrated, is even more serious. We'll share details on those stocks in the near future.

Lastly, we note that hidden interest expense is one of many factors that investors should consider when assessing the profitability (or lack thereof) of the S&P 500 and AI companies in particular.

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

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It's Official: We Deliver 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. The stock market is missing footnotes – and only we have that critical data.
2. Legacy fundamental datasets suffer from significant inaccuracies, omissions, and biases.
3. Our proprietary drives novel alpha. Our measures of Core Earnings and Earnings Distortion materially improve stock picking and forecasting of profits.

Best Fundamental Data in the World

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

Ernst & Young 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 Harvard Business School. 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.

Our mission is to provide the best fundamental analysis of public and private businesses in the world and make it affordable for all investors, not just Wall Street insiders.

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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