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STOCK PICKS AND PANS
12/2/20

Only Three S&P 500 Sector's Core Earnings Improved in 2020

The COVID-19 pandemic, and ensuing economic damage dropped Core Earnings[1] for the S&P 500 to the lowest level since December 2017, as we highlighted in "S&P 500 Valuation Remains Over Its Skis." This report focuses on the Core Earnings of each S&P 500 sector to narrow in on where the most damage was done.

Our measure of Core Earnings leverages cutting-edge technology to provide clients with a cleaner and more comprehensive view of earnings[2]. Investors armed with our measure of Core Earnings have a differentiated and more informed view of the fundamentals of companies and sectors.

Learn more about the best fundamental research

Within the S&P 500, only the Technology, Consumer Non-cyclicals, and Healthcare sectors saw a rise in Core Earnings since the end of 2019. Given consumer habits during the pandemic, the Core Earnings improvement in these sectors may seem intuitive, as the shift to work-from-home, pantry loading, and a V-shaped recovery in healthcare spending drove growth in these sectors more than others.

Rankings the Sectors by Core Earnings Growth

Figure 1 ranks all 11 S&P 500 sectors by the change in Core Earnings from the end of 2019 through 11/17/20.

Figure 1: TTM Core Earnings Through 11/17/20 vs. Last year by S&P 500 Sector

Sector	TTM Core Earnings ($mm)	% Change in 2020
Technology	$304,028	6%
Consumer Non-cyclicals	$102,502	4%
Healthcare	$157,069	3%
Telecom Services	$38,687	-2%
Utilities	$31,697	-10%
Real Estate	$13,890	-14%
Basic Materials	$25,672	-18%
Financials	$184,975	-29%
Consumer Cyclicals	$98,194	-30%
Industrials	$72,407	-42%
Energy	$1,280	-97%

Sources: New Constructs, LLC and company filings.
Our Core Earnings analysis is based on aggregated TTM data for the sector constituents.

The Technology sector generates the most Core Earnings by far (nearly 2x the next closest sector) and grew Core Earnings by 6% thus far in 2020. On the flip side, the Energy sector has the lowest Core Earnings and the largest drop since the end of 2019. Plummeting oil prices in early March followed by the COVID-19 shutdowns across the globe hit the energy sector hardest.

Details on the S&P 500 Sectors

Figures 2-12 compare the Core Earnings and GAAP net income trends for every S&P 500 sector since 2004.

[1] Our Core Earnings are a superior measure of profits, as demonstrated in Core Earnings: New Data & Evidence a paper by professors at Harvard Business School (HBS) & MIT Sloan and the Journal of Financial Economics. The paper empirically shows that our data is superior to "Operating Income After Depreciation" and "Income Before Special Items" from Compustat, owned by S&P Global (SPGI).

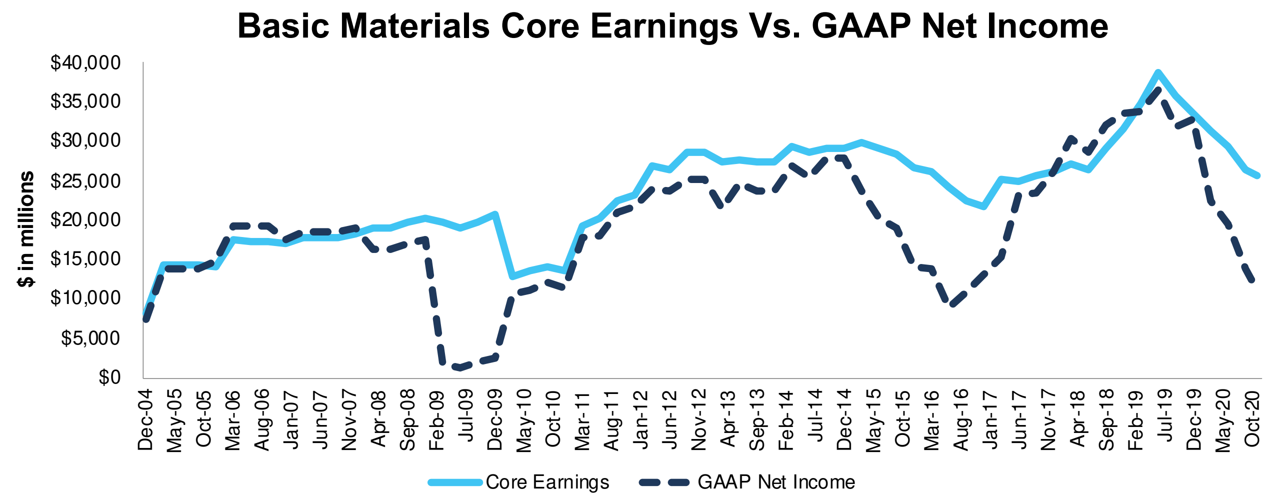
[2] For 3rd-party reviews on the benefits of adjusted Core Earnings, historically and prospectively, across all stocks, click here and here.

Basic Materials

Figure 2 shows Core Earnings for the Basic Materials sector peaked in mid 2019 and have fallen 34% since then. Asset write-downs, which occurred at record levels through the first half of 2020, help explain the large disconnect between Core Earnings and GAAP net income.

Dupont De Nemours (DD), LyondellBasell Industries (LYB), and Dow Inc. (DOW) combined for write-downs of over $4 billion TTM, which equals 16% of the Basic Materials sector's TTM Core Earnings.

Figure 2: Basic Materials Core Earnings Vs. GAAP: 2004 – 11/17/20

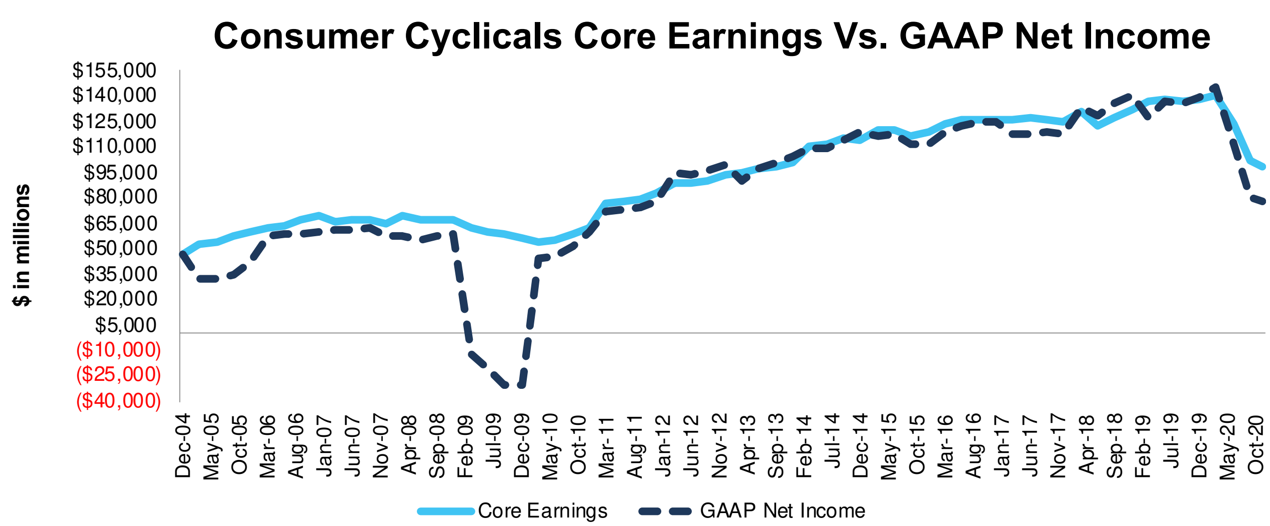


Sources: New Constructs, LLC and company filings.
Our Core Earnings analysis is based on aggregated TTM data for the sector constituents in each measurement period.

Consumer Cyclicals

Figure 3 shows that the COVID-19 pandemic impacted the Consumer Cyclicals sector differently than during the Financial Crisis, when Core Earnings were largely unchanged. Global shutdowns and depressed leisure spending caused Core Earnings to fall 30% since the end of 2019. Despite the bad look for the sector, we highlight many Consumer Cyclicals stocks that present excellent fundamental risk/reward in our "See Through the Dip" Long Ideas.

Figure 3: Consumer Cyclicals Core Earnings Vs. GAAP: 2004 – 11/17/20

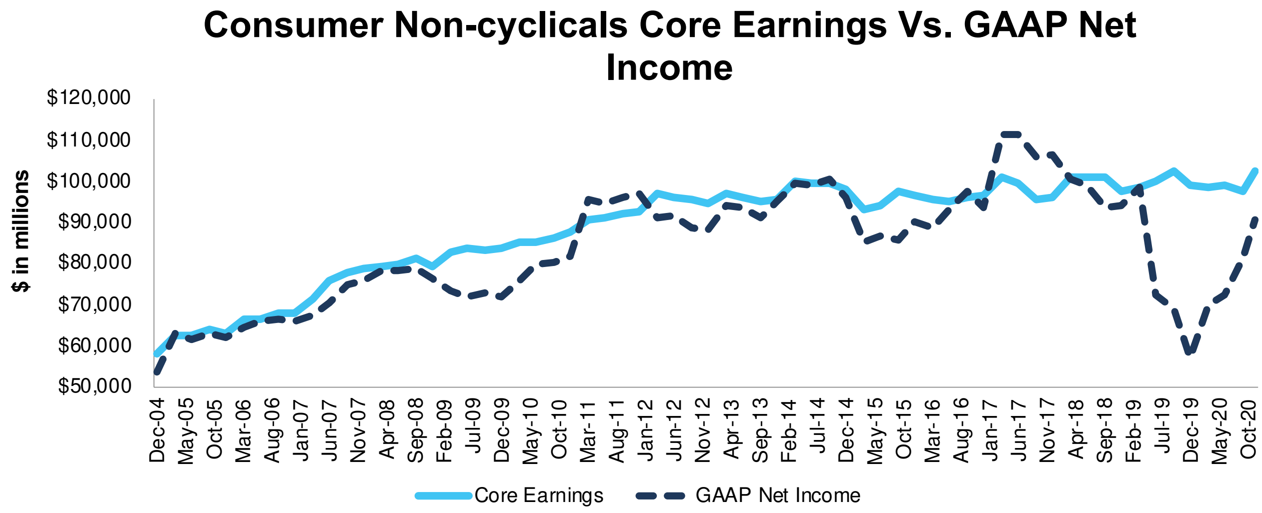


Sources: New Constructs, LLC and company filings.
Our Core Earnings analysis is based on aggregated TTM data for the sector constituents in each measurement period.

Consumer Non-Cyclicals

Figure 4 shows Core Earnings for the Consumer Non-Cyclicals sector have been relatively stable over time and rose 4% since 2019. However, investors looking at GAAP net income would see a much different picture. The drastic drop in GAAP net income is a result of Kraft Heinz's (KHC) ~$16 billion write-down in early 2019. Our Core Earnings remove such unusual charges, so investors get more accurate, and less volatile, views of profits.

Figure 4: Consumer Non-Cyclicals Core Earnings Vs. GAAP: 2004 – 11/17/20

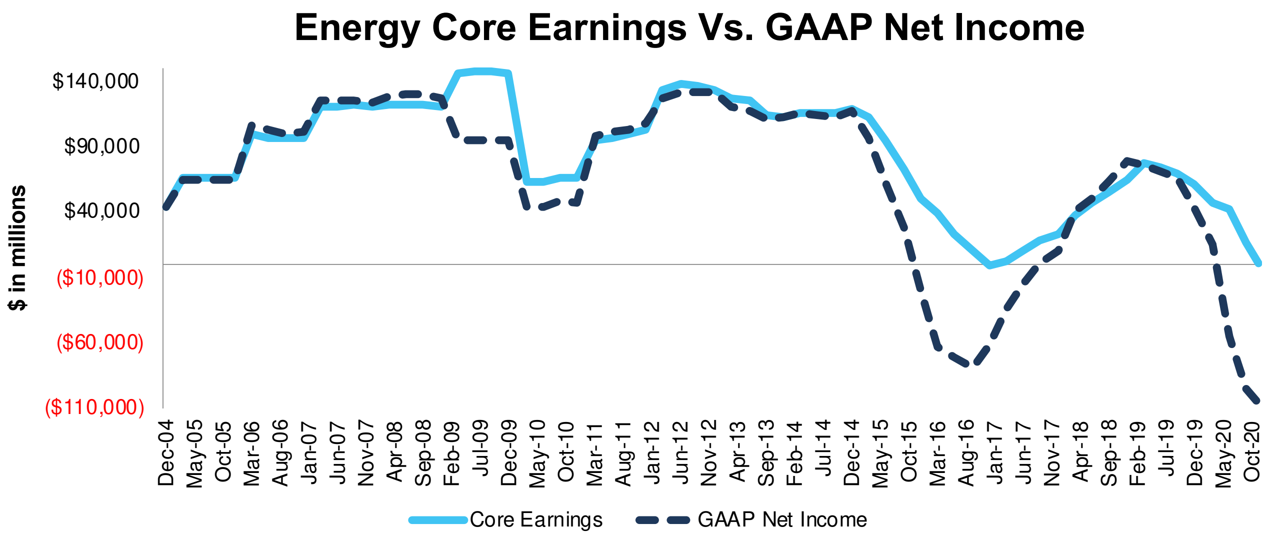


Sources: New Constructs, LLC and company filings.
Our Core Earnings analysis is based on aggregated TTM data for the sector constituents in each measurement period.

Energy

Figure 5 shows Core Earnings for the Energy sector fell 97% since the end of 2019, levels last seen at the end of 2016. Five companies, Schlumberger (SLB), Occidental Petroleum (OXY), Marathon Petroleum (MPC), Concho Resources (CXO), and Baker Hughes (BKR) have the five largest write-downs. Combined, these firms reported over $47 billion in asset write-downs over the TTM, which explains the even larger drop in GAAP net income relative to Core Earnings.

Figure 5: Energy Core Earnings Vs. GAAP: 2004 – 11/17/20

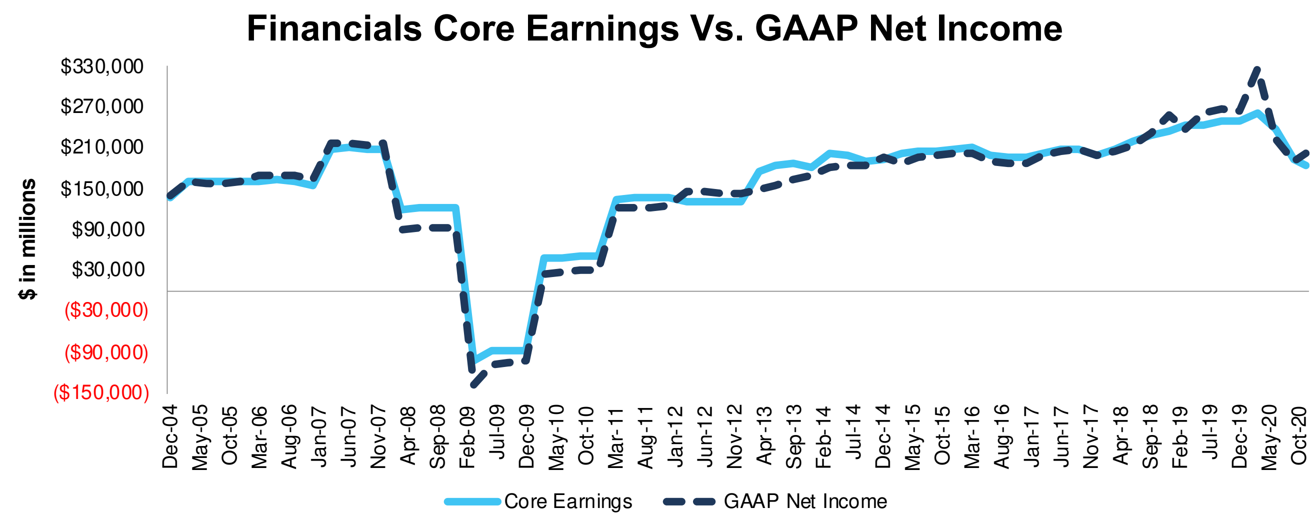


Sources: New Constructs, LLC and company filings.
Our Core Earnings analysis is based on aggregated TTM data for the sector constituents in each measurement period.

Financials

Figure 6 shows Core Earnings for the Financials sector, while down 29% since the end of 2019, have held up much better than during the Financial Crisis. The key difference between the two periods, as we pointed out in our Long Idea on [JPMorgan Chase](#) (JPM), is that many banks were the source of the problems that caused the Financial Crisis. On the other hand, today, Financial firms are playing a key role in the recovery.

Figure 6: Financials Core Earnings Vs. GAAP: 2004 – 11/17/20

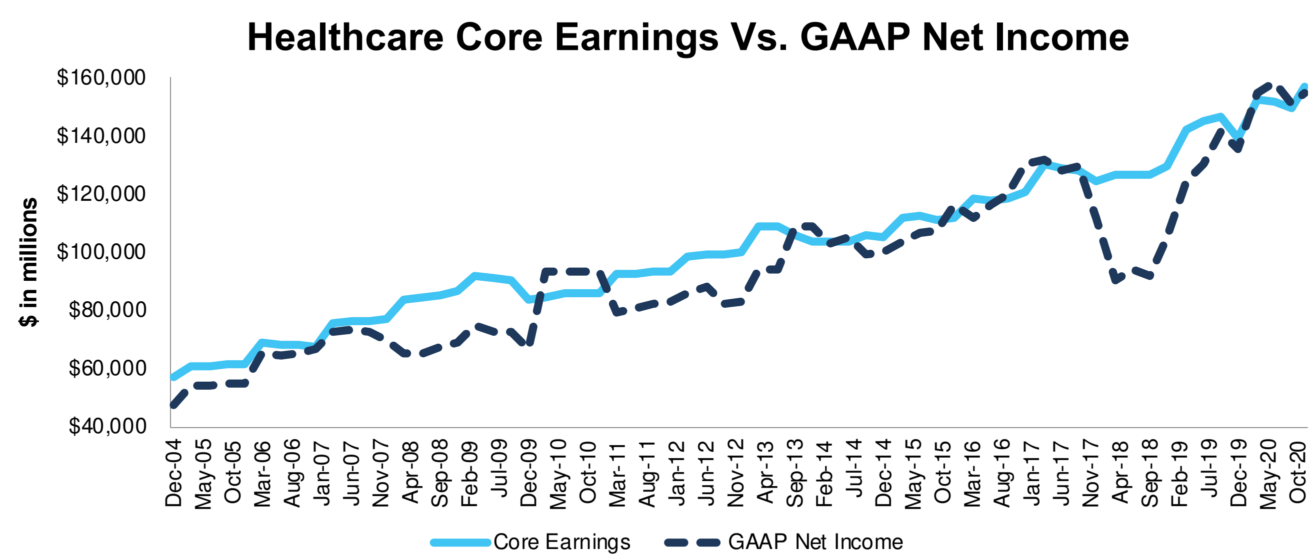


Sources: New Constructs, LLC and company filings.
Our Core Earnings analysis is based on aggregated TTM data for the sector constituents in each measurement period.

Healthcare

Figure 7 shows Core Earnings for the Healthcare sector have consistently increased since 2004 and are currently up 3% thus far in 2020. The consistent rise in demand for healthcare, after the initial drop in elective procedures during the onset of the COVID-19 pandemic, helps drive continued Core Earnings growth.

Figure 7: Healthcare Core Earnings Vs. GAAP: 2004 – 11/17/20

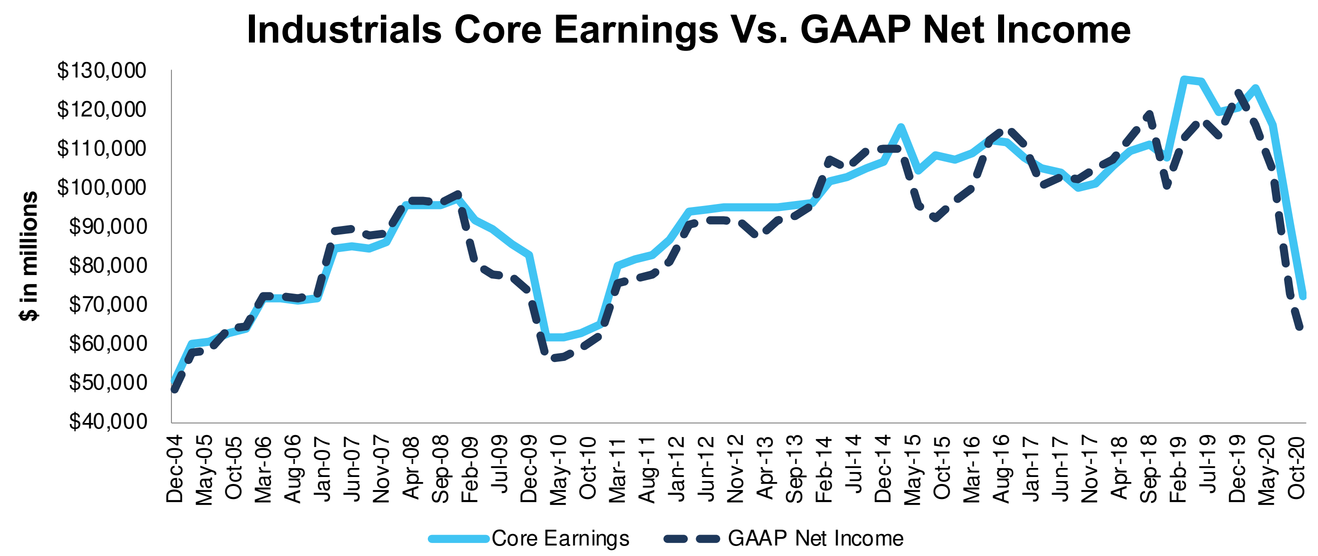


Sources: New Constructs, LLC and company filings.
Our Core Earnings analysis is based on aggregated TTM data for the sector constituents in each measurement period.

Industrials

Figure 8 shows the Industrials sector is another sector particularly impacted by COVID-19, as Core Earnings fell 42% since the end of 2019. Not surprisingly, the Industrials sector, which is most exposed to the drastic drop in airline travel and reduced capex across the globe, bore much of the brunt of the global shut downs.

Figure 8: Industrials Core Earnings Vs. GAAP: 2004 – 11/17/20

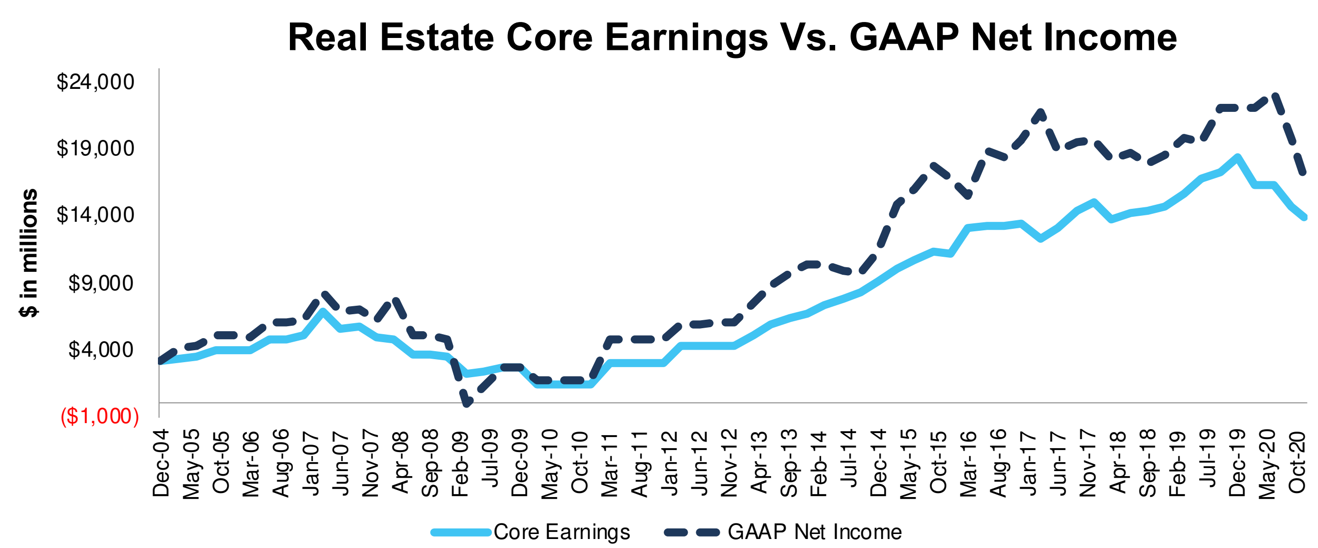


Sources: New Constructs, LLC and company filings.

Real Estate

Figure 9 shows that after many years of consistent growth, Core Earnings for the Real Estate sector have fallen 14% since the end of 2019. Doomsday expectations for many REITs left some of the best operators significantly undervalued, which led us to feature [Simon Property Group](#) (SPG) as a Long Idea in mid-April.

Figure 9: Real Estate Core Earnings Vs. GAAP: 2004 – 11/17/20

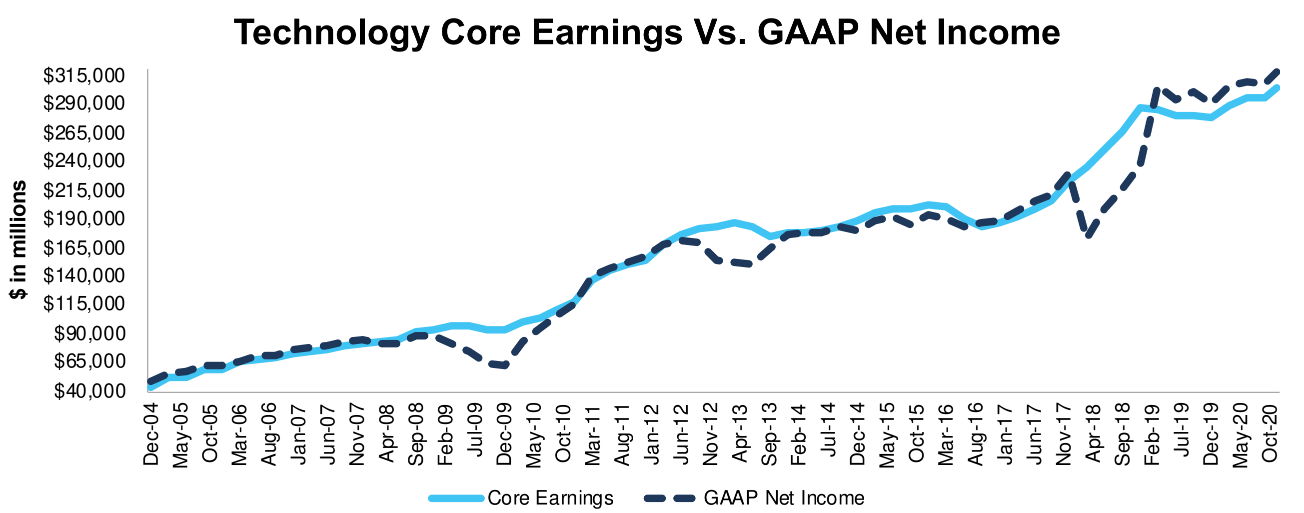


Sources: New Constructs, LLC and company filings.
Our Core Earnings analysis is based on aggregated TTM data for the sector constituents in each measurement period.

Technology

Figure 10 shows that not only did the Technology sector's Core Earnings rise 6% thus far in 2020, they have consistently risen since December 2004. However, this earnings power remains unevenly distributed. Over the TTM, five of the 74 Technology companies, Apple (AAPL), Microsoft (MSFT), Alphabet (GOOGL), Facebook (FB), and Intel Corporation (INTC) account for 58% of the sector's total Core Earnings.

Figure 10: Technology Core Earnings Vs. GAAP: 2004 – 11/17/20

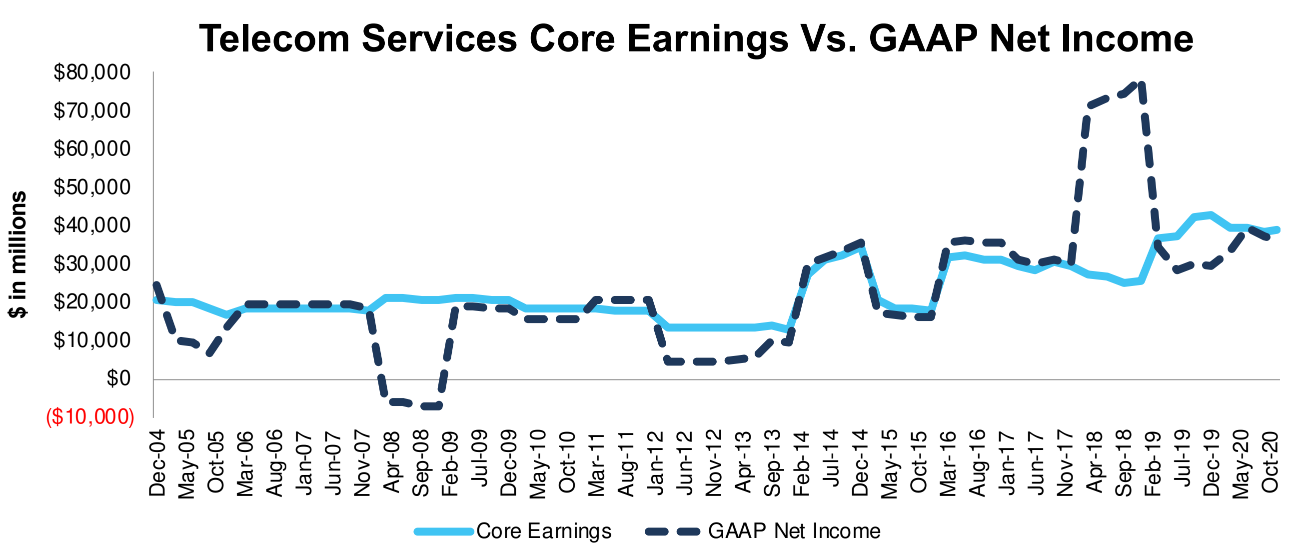


Sources: New Constructs, LLC and company filings.
Our Core Earnings analysis is based on aggregated TTM data for the sector constituents in each measurement period.

Telecom Services

Figure 11 shows Core Earnings for the Telecom Services sector, despite falling 2% since the end of 2019, are still much improved since the end of 2018. The significant jump in GAAP net income in 2018 come from the Tax Cuts and Jobs Act. At the time, we identified Verizon (VZ) and AT&T (T) as the biggest winners of tax reform, and in 2017, they recorded nearly $25 billion in combined income tax benefits. Note how our Core Earnings adjusts for the anomalous, one-time tax effects.

Figure 11: Telecom Services Core Earnings Vs. GAAP: 2004 – 11/17/20

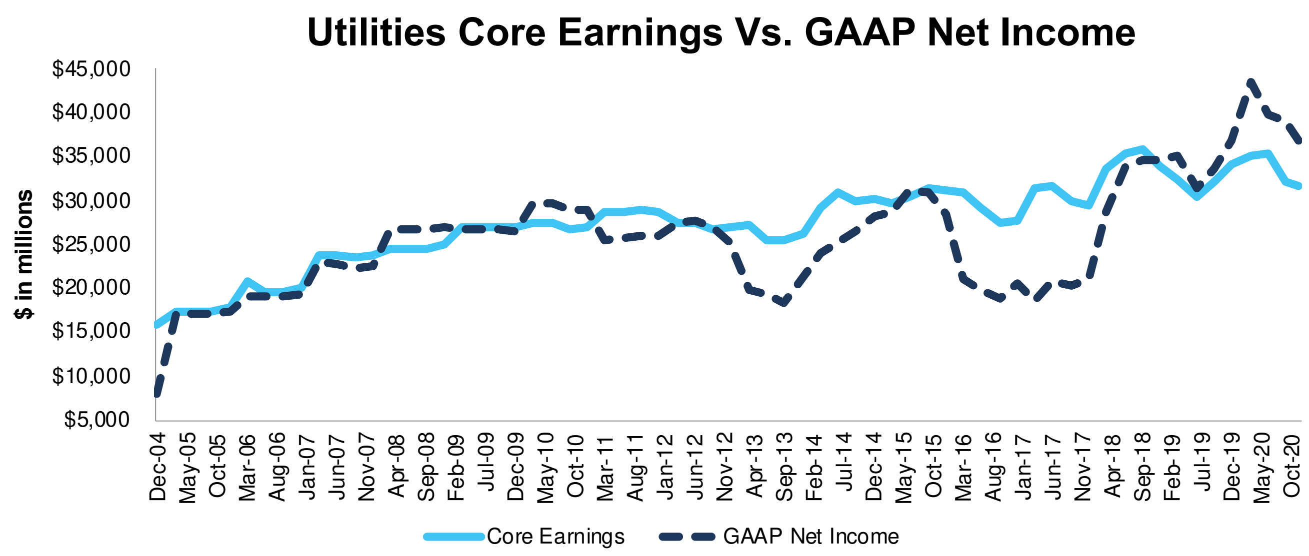


Sources: New Constructs, LLC and company filings.
Our Core Earnings analysis is based on aggregated TTM data for the sector constituents in each measurement period.

Utilities

Figure 12 shows the Utilities sector seldom sees big year-over-year changes in Core Earnings, but since the end of 2019, Core Earnings for the Utilities sector are down 10%.

Figure 12: Utilities Core Earnings Vs. GAAP: 2004 – 11/17/20



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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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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The HBS & MIT Sloan paper, Core Earnings: New Data and Evidence, shows how our superior data drives uniquely comprehensive and independent debt and equity research.

This paper compares our analytics on a mega cap company to other major providers. The Appendix details exactly how we stack up.

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Build better models:

"Core Earnings [calculated using New Constructs' novel dataset] provides predictive power for various measures of one-year-ahead performance…that is incremental to their current-period counterparts." – page 4

Exploit market inefficiencies:

"These results … suggest that the adjustments made by analysts and Compustat to better capture Core Earnings are incomplete. Moreover, the non-core items identified by NC produce a measure of Core Earnings that is incremental to alternative measures of operating performance in predicting an array of future income measures." – page 26

Fulfill fiduciary duties:

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