New Constructs®
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FUNDAMENTAL MARKET ANALYSIS 4/13/21

S&P 500 Priced for Significant Earnings Rebound

In our [3Q20 analysis](#) of the S&P 500's true [Core Earnings](#)[1], we noted the rapid decline in profitability had not deterred the index's valuation from racing to all-time highs. That trend remains unchanged. The S&P 500 clearly expects record economic growth to translate into record earnings growth.

In this report, our Core Earnings research is based on the latest audited financial data, which is the 2020 10-K for most companies. Operating Earnings from S&P Global is based on the same time frame.

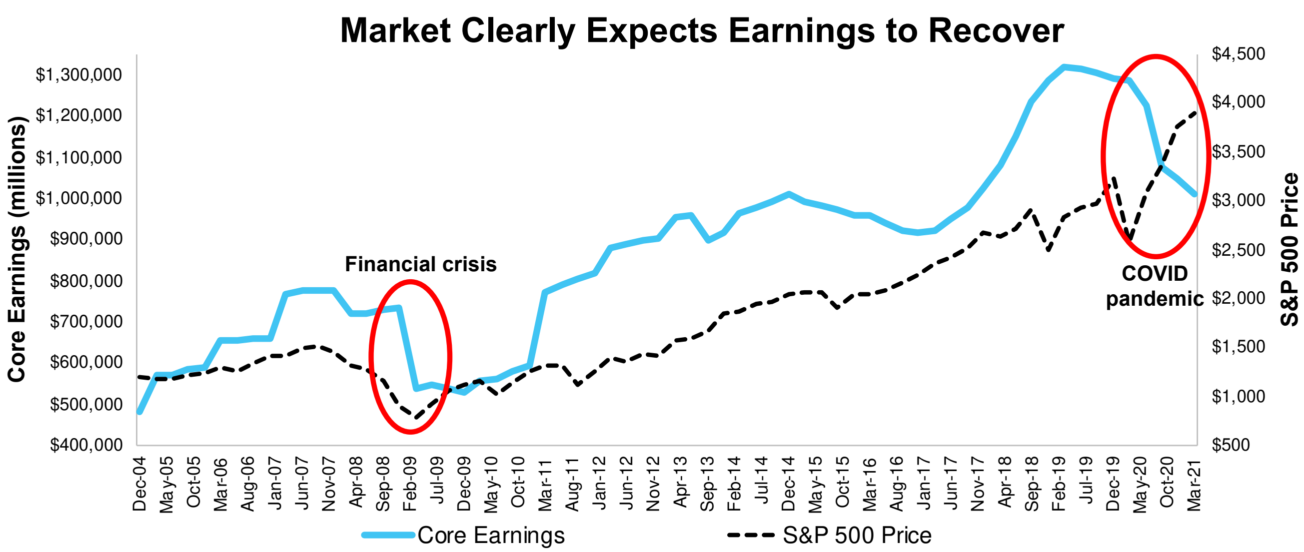
S&P 500 Pricing In Major Earnings Recovery

Figure 1 shows how the S&P 500 price continues to rise in the face of a stark decline in Core Earnings.

Figure 1 also illustrates how different the market's response to the COVID-19 pandemic has been compared to the Financial Crisis in 2008/2009. During that crisis, the S&P 500's price fell with Core Earnings and didn't rebound until 2Q09, around the time Core Earnings bottomed. Today, the market has already soared to all-time highs while Core Earnings remain depressed.

We continue to see positive news regarding the vaccine rollout and the "reopening" of economies around the world. The good news and expectations for earnings growth appear priced in to most stocks, and we think investors with fiduciary duties should consider taking some gains and reallocating to more undervalued and safer stocks.

Figure 1: Core Earnings vs. S&P 500 Price: 2004 to Present (through 3/23/21[2])



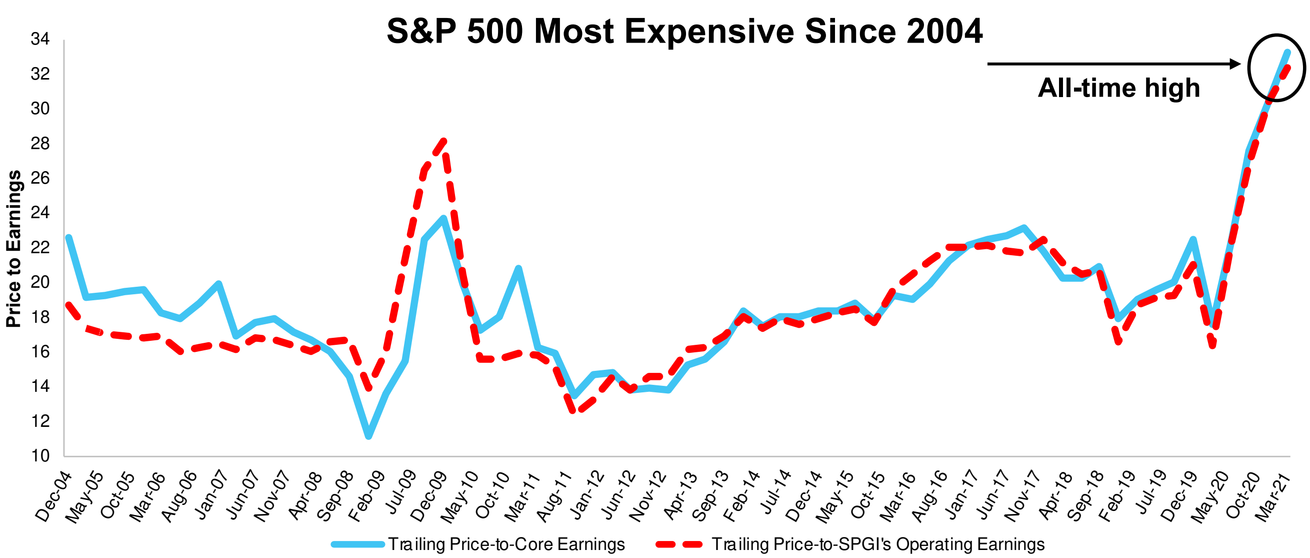
Sources: New Constructs, LLC, company filings, and [S&P Global](#) (SPGI).
Our Core Earnings analysis is based on aggregated TTM data through 6/30/13, and aggregated quarterly data thereafter for the S&P 500 constituents in each measurement period. More details in Appendix I.

[1] Only Core Earnings enable investors to overcome the inaccuracies, omissions and biases in legacy fundamental data and research, as proven in [Core Earnings: New Data & Evidence](#), a forthcoming paper in [The Journal of Financial Economics](#).
[2] The earliest date 2020 10-Ks for the S&P 500 constituents were available.

S&P 500 Hasn't Been This Expensive Since 2004

Figure 2 shows how the trailing price-to-earnings (P/E) ratios based on our Core Earnings and S&P Global's (SPGI) operating earnings are currently at all-time highs (data goes back to 2004), breaking records previously set in 3Q20. Both ratios clearly indicate that the market is fully valuing a significant recovery in earnings.

Figure 2: Price-to-Core vs. Price-to-SPGI's Operating Earnings: TTM 12/31/04 – Present (through 3/23/21)



Sources: New Constructs, LLC, company filings, and S&P Global.
Our Core Earnings P/E ratio is aggregating the TTM results for constituents through 6/30/13 and aggregating four quarters of results for the S&P 500 constituents in each measurement period thereafter. SPGI's P/E is based on four quarters of aggregated S&P 500 results in each period. More details in Appendix II.

The Earnings Rebound Has Not Arrived

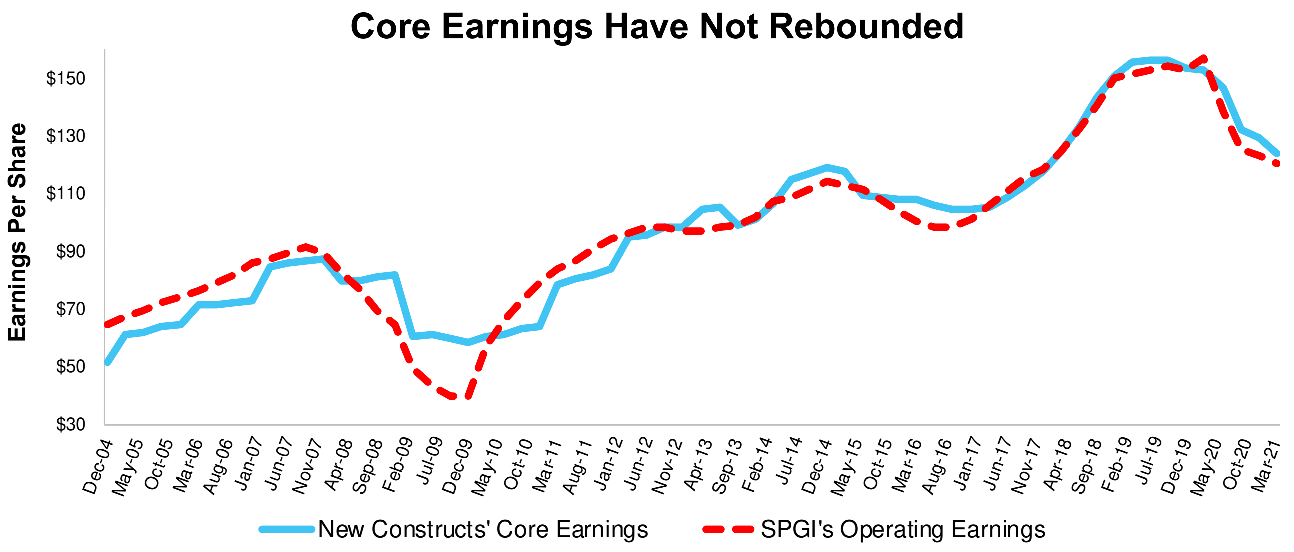
2020 Core Earnings per share for the S&P 500 fell 4% quarter-over-quarter while 2020 S&P Global's Operating Earnings per share[3] for the S&P 500 fell 2%. Despite the strong price performance of the S&P 500 in 2020, the subsequent earnings recovery had not yet materialized by the end of 2020.

Figure 3 highlights how different our measure of Core Earnings has been from SPGI's Operating Earnings in prior periods. The differences are due to errors, omissions, and biases in legacy fundamental datasets (detailed in a paper forthcoming in The Journal of Financial Economics) that fail to capture the full impact of unusual gains/losses buried in footnotes. Missing these unusual gains/losses causes earnings measures to be unreliable and subject to management manipulation.

Relying on legacy providers' data can put investors at risk of not understanding the true trajectory of earnings at a company level and across the entire market.

[3] We think SPGI's Operating Earnings provide the best comparison to how we calculate Core Earnings.

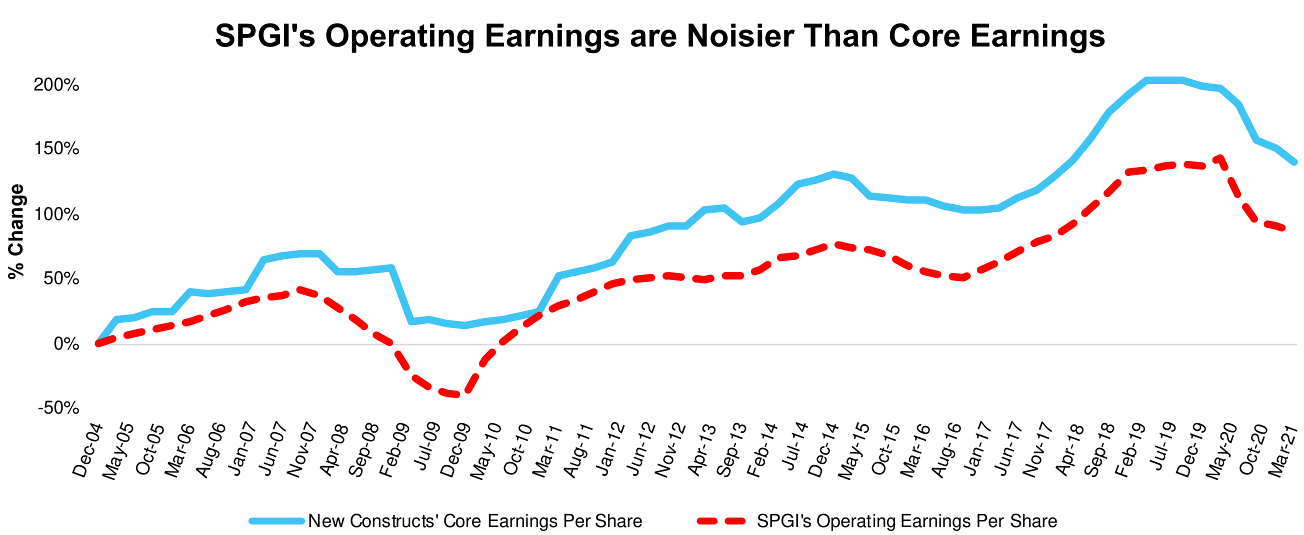
Figure 3: Core Earnings vs. SPGI's Operating Earnings Per Share: 2004 – Present (through 3/23/21)



Sources: New Constructs, LLC, company filings, and S&P Global. Note: the most recent periods' data for SPGI's Operating Earnings is based on consensus.
Our Core Earnings analysis is based on aggregated TTM data through 6/30/13, and aggregated quarterly data thereafter for the S&P 500 constituents in each measurement period.

Figure 4 charts the percentage change in our Core Earnings and SPGI's operating earnings and clearly illustrates that SPGI's operating earnings took a more pronounced decline during the financial crisis and have yet to align with Core Earnings.

Figure 4: Core vs. SPGI's Operating Earnings Per Share for the S&P 500 – % Change: 2004 – 3/23/21



Sources: New Constructs, LLC, company filings, and S&P Global (SPGI). Note: the most recent periods' data for SPGI's Operating Earnings is based on consensus.
Our Core Earnings analysis is based on aggregated TTM data through 6/30/13, and aggregated quarterly data thereafter for the S&P 500 constituents in each measurement period.

Where & Where Not to Put Your Money

We've recently identified numerous "Micro-Bubbles" or groups of stocks with extraordinary levels of risk compared to peer firm's stocks. Micro-Bubble winners are undervalued stocks of companies positioned to excel during and after the stocks in Micro-Bubbles burst, and investors can find quality risk/reward in these names. On the flip side investors should avoid Micro-Bubble losers, which are stocks of companies that are priced for unrealistic growth in profitability and market share despite weak fundamentals and often a lack of competitive advantage.

Figure 5 shows all of our micro-bubble winners and losers.

Figure 5: Micro-Bubble Winners & Micro-Bubble Stocks

Micro-Bubble Winners	Micro-Bubble Losers	Report Date
The Walt Disney Company (DIS)	Netflix (NFLX)	3/24/21
JPMorgan Chase (JPM)	No one specific loser	3/10/21
No one specific winner	Spotify Technology (SPOT)	3/1/21
General Motors Co (GM)	Tesla Inc (TSLA)	2/18/21
Kellogg Company (K)	Beyond Meat Inc. (BYND)	2/16/21
Hyatt Hotels Corp (H)	Airbnb, Inc. (ABNB)	2/10/21
Williams-Sonoma Inc. (WSM)	Wayfair, Inc. (W)	2/3/21
Sysco Corporation (SYY)	DoorDash, Inc. (DASH)	1/27/21
Alphabet, Inc. (GOOGL)	GoDaddy Inc (GDDY)	9/26/18
Microsoft Corporation (MSFT)	Dropbox Inc. (DBX)	9/26/18
Oracle Corporation (ORCL)	Salesforce.com Inc. (CRM)	8/16/18
Walmart, Inc. (WMT)	Amazon.com Inc. (AMZN)	8/16/18

Sources: New Constructs, LLC and company filings.

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Disclosure: David Trainer owns SYY, H, and JPM. David Trainer, Kyle Guske II, Matt Shuler, Alex Sword, and Devyn DeLange receive no compensation to write about any specific stock, style, or theme.

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Appendix I: Core Earnings Methodology

In the Figures above, we use the following to calculate Core Earnings:

- aggregated annual data for constituents in the S&P 500 for each measurement period through 6/30/13
- aggregated quarterly data for constituents in the S&P 500 for each measurement period post 6/30/13 to present

While we prefer aggregated quarterly numbers, we have examined the potential impacts of the two methodologies and have found no material differences.

Appendix II: P/E Ratio Methodology for Core & SPGI's Operating Earnings

In Figure 2 above, we calculate the price-to-Core Earnings ratio through 6/30/13 as follows:

1. Calculate a TTM earnings yield for every S&P 500 constituent
2. Weight the earnings yields by each stock's respective S&P 500 weight
3. Sum the weighted earnings yields and take the inverse (1/Earnings Yield)

We calculate the price-to-Core Earnings ratio for periods post 6/30/13 as follows:

1. Calculate a trailing four quarters earnings yield for every S&P 500 constituent
2. Weight the earnings yield by each stock's respective S&P 500 weight
3. Sum the weighted earnings yields and take the inverse (1/Earnings Yield)

We use the earnings yield methodology because P/E ratios don't follow a linear trend. A P/E ratio of 1 is "better" than a P/E ratio of 30, but a P/E ratio of 30 is "better" than a P/E ratio of -15. In other words, aggregating P/E ratios can result in a low multiple due the inclusion of just a few stocks with negative P/Es.

Using earnings yields solves this problem because a high earnings yield is always "better" than a low earnings yield. There is no conceptual difference when flipping from positive to negative earnings yields as there is with traditional P/E ratios.

By using quarterly data as soon as its available, we better capture the impact of changes to S&P 500 constituents on a quarterly basis. For example, a company could be a constituent in 2Q18, but not in 3Q18. This method captures the continuously changing nature of the S&P 500 constituency.

For all periods in Figure 2, we calculate the price-to-SPGI's Operating Earnings ratio by summing the preceding 4 quarters of Operating Earnings per share and, then, dividing by the S&P 500 price at the end of each measurement period.

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.

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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