



Traditional Earnings Measures for S&P 500 Overstate True Profits

[Operating Earnings](#) calculated by [S&P Global](#) (SPGI), [Street Earnings](#)¹, and GAAP Earnings overstate the true profitability of S&P 500 companies. Entering earnings season for calendar 2Q22 our proprietary [Core Earnings](#)² measure continues to provide a more accurate measurement of profitability for the S&P 500. Using overstated earnings metrics leads investors to understate risk, a fact that has been on grotesque display in equity markets recently.

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

Learn more about the best fundamental research

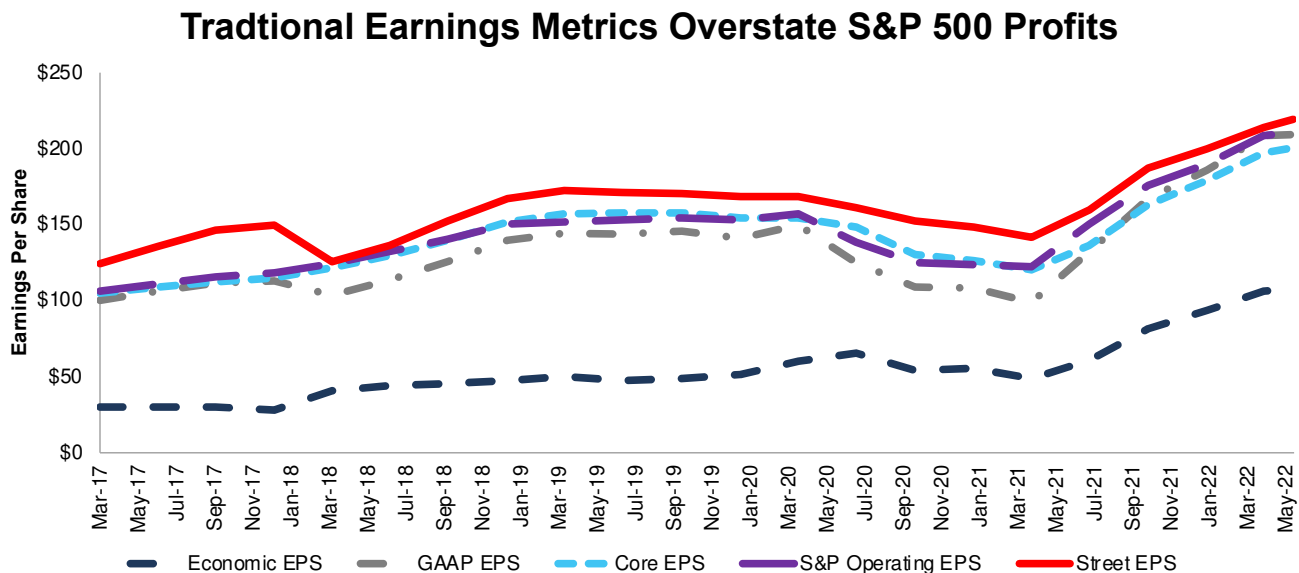
Traditional Earnings Overstate the True Profits of the Market

In the trailing-twelve-months (TTM) ended 1Q22:

- Operating Earnings are 5% higher than Core Earnings,
- Street Earnings are 10% higher than Core Earnings, and
- GAAP Earnings are 4% higher than Core Earnings.

[Economic Earnings](#), which account for the cost of capital and changes to company balance sheets, are 46% below Core Earnings. However, this gap is the smallest difference dating back to 2012.

Figure 1: Operating vs. Street vs. GAAP vs. Core vs. Economic Earnings: S&P 500 Since 2017



Sources: New Constructs, LLC, company filings, and [S&P Global](#) (SPGI). Note: the most recent period's data for SPGI's Operating Earnings is based on consensus estimates for companies with a non-standard fiscal year.

¹ Street Earnings refer to [Zacks Earnings](#), which are adjusted to remove non-recurring items using standardized sell-side assumptions.

² Our Core Earnings research is based on the latest audited financial data, which is the calendar 1Q22 10-Q in most cases.

³ 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](#).



Below we highlight the disconnect between traditional earnings measures and our Core Earnings, and specifically examine the changes in each metric over the past few years. [Flaws](#) in legacy datasets (detailed in [The Journal of Financial Economics](#)) drive the difference between the measures. Core Earnings account for unusual gains/losses buried in footnotes that legacy datasets fail to capture.

Street Earnings Overstate S&P 500 Profits

Street Earnings undersold the drop in profits in 2020 and made the rebound in profitability in 2021 look less robust than it actually was. In 2020, Street Earnings fell 16% year-over-year (YoY) while Core Earnings fell 22% YoY.

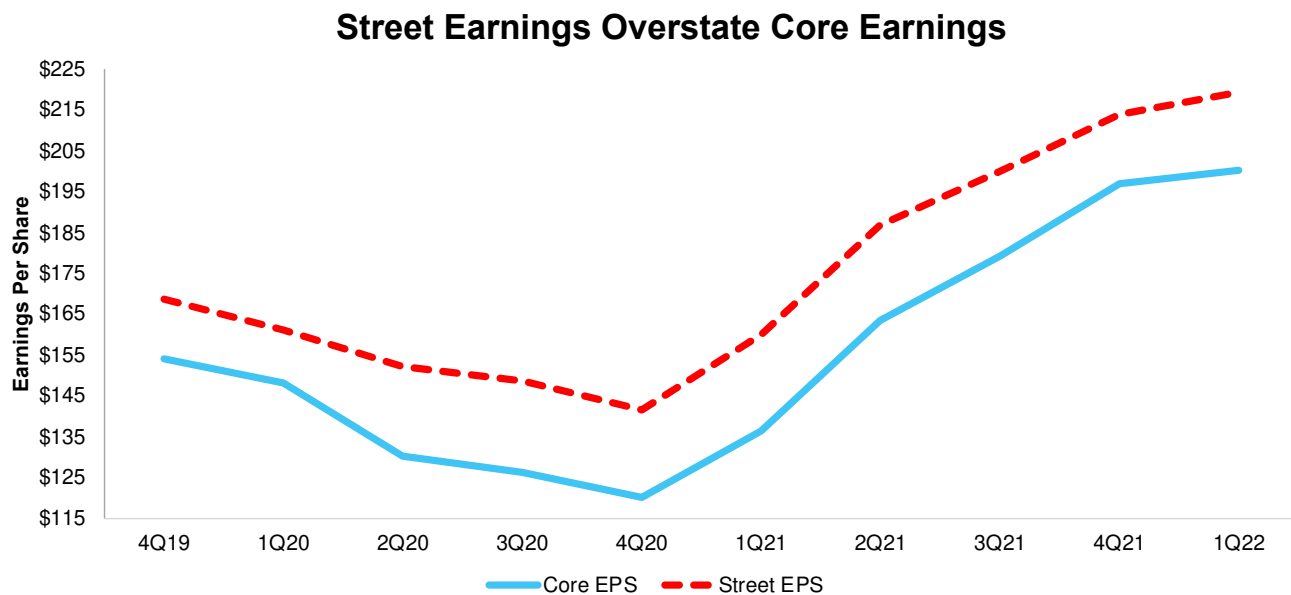
For 2021 versus 2020:

- Street Earnings improved from \$141.70/share to \$213.99/share, or 51%
- Core Earnings improved from \$120.05/share to \$197.10/share, or 64%

In the TTM ended 1Q22, Street Earnings are 10% higher than Core Earnings, though Core Earnings improved at a faster pace, rising 47% YoY, compared to Street Earnings, which rose 37% YoY.

Get more details on the S&P 500 companies with overstated Street Earnings [here](#) and understated Street Earnings [here](#).

Figure 2: Trailing Twelve Month Earnings: Core Earnings vs. Street Earnings: 4Q19 –1Q22



Sources: New Constructs, LLC, company filings, and Zacks Earnings

S&P Global's Earnings Rebound Is Overstated

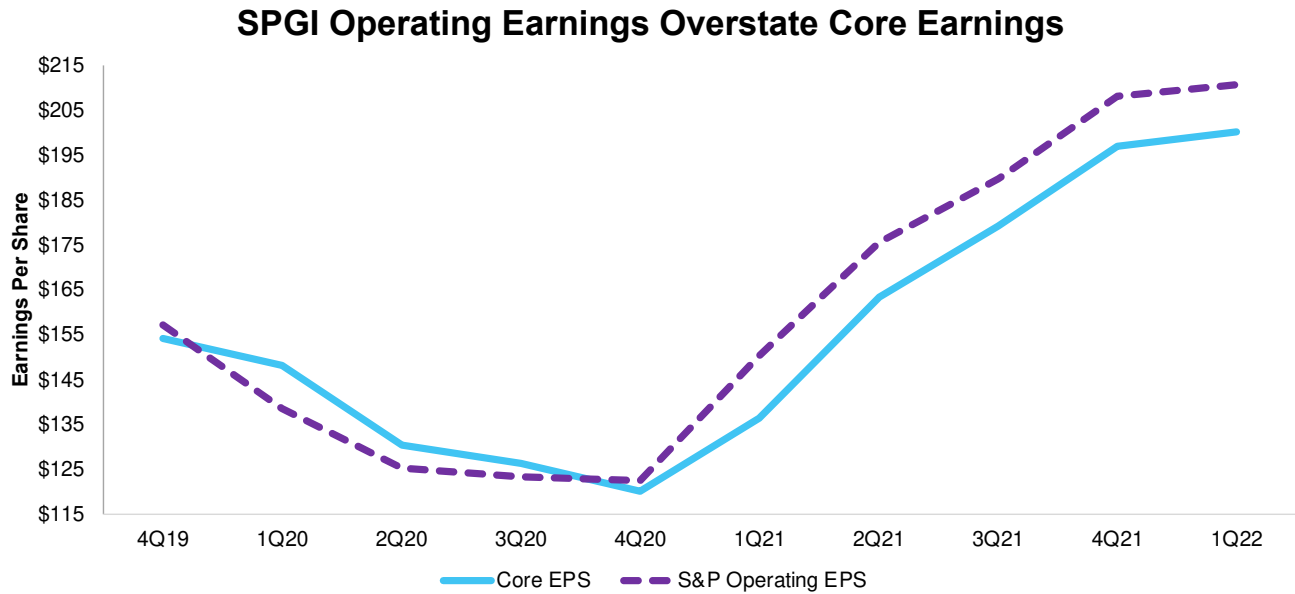
In 2021, S&P 500 company profits did not rebound as much as SPGI's Operating Earnings lead investors to believe. For 2021 versus 2020:

- SPGI's Operating Earnings improved from \$122.37/share to \$208.21/share, or 70%
- Core Earnings improved from \$120.05/share to \$197.10/share, just 64%

In the TTM ended 1Q22, Operating Earnings are 5% higher than Core Earnings, though Core Earnings improved at a faster pace, rising 47% YoY, compared to Operating Earnings, which rose 40% YoY. Get more details on our Core Earnings vs. Operating Earnings [here](#).



Figure 3: Trailing Twelve Month Earnings: Core Earnings vs. SPGI Operating Earnings: 4Q19 –1Q22



Sources: New Constructs, LLC, company filings, and [S&P Global](#) (SPGI). Note: the most recent period's data for SPGI's Operating Earnings is based on consensus estimates for companies with a non-standard fiscal year.

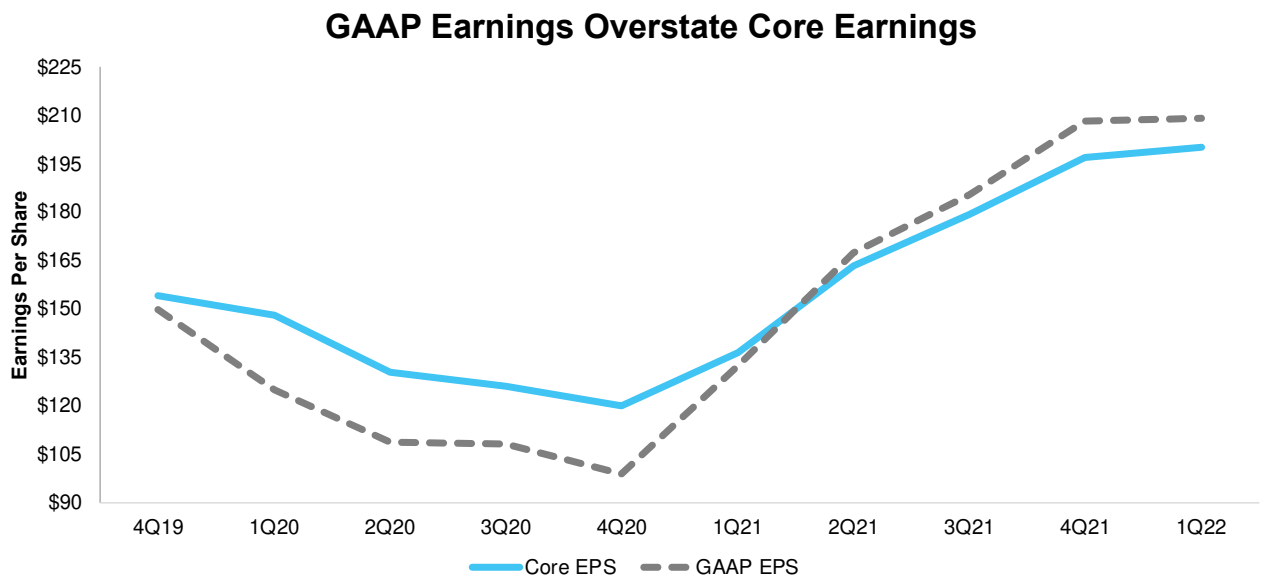
Core Earnings Are More Reliable Than GAAP Earnings

Since 2020, corporate profits did not decline or rebound as much as GAAP earnings indicate. For instance:

- In 2020, GAAP earnings fell 34% YoY compared to a 22% fall for Core Earnings.
- In 2021, GAAP earnings rose 110% YoY compared to a 64% rise for Core Earnings.
- In the TTM ended 1Q22, GAAP earnings rose 58% YoY compared to a 47% rise for Core Earnings.

Get more details on our Core Earnings vs. GAAP Earnings for the S&P 500 [here](#).

Figure 4: Trailing Twelve Month Earnings: GAAP Earnings vs. Street Earnings: 4Q19 –1Q22



Sources: New Constructs, LLC and company filings



Diligence Matters – Superior Fundamental Analysis Provides Insights

As traditional earnings measures continue to overstate the S&P 500's Core Earnings, the index requires *growing* investor optimism about future profits just to *maintain* valuations and stop price declines. Based on warnings from companies willing to face reality, and the disconnect between Core Earnings, Operating Earnings, and Street Earnings, investors can expect more companies warning about slowing earnings growth or even outright decline in coming quarters.

Our measure of Core Earnings leverages [cutting-edge technology](#) to provide clients with a [cleaner and more comprehensive](#) view of earnings. Investors armed with our measure of Core Earnings have a differentiated and more informed view of the fundamentals of companies and sectors, which allows them insights to find [high-quality](#) and [low-quality](#) stocks, [generate alpha](#), and fulfill the [fiduciary duty of care](#).

This article originally published on [July 25, 2022](#).

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

Follow us on [Twitter](#), [Facebook](#), [LinkedIn](#), and [StockTwits](#) for real-time alerts on all our research.



Appendix I: Core Earnings Methodology

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

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



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](#).



DISCLOSURES

New Constructs®, LLC (together with any subsidiaries and/or affiliates, "New Constructs") is an independent organization with no management ties to the companies it covers. None of the members of New Constructs' management team or the management team of any New Constructs' affiliate holds a seat on the Board of Directors of any of the companies New Constructs covers. New Constructs does not perform any investment or merchant banking functions and does not operate a trading desk.

New Constructs' Stock Ownership Policy prevents any of its employees or managers from engaging in Insider Trading and restricts any trading whereby an employee may exploit inside information regarding our stock research. In addition, employees and managers of the company are bound by a code of ethics that restricts them from purchasing or selling a security that they know or should have known was under consideration for inclusion in a New Constructs report nor may they purchase or sell a security for the first two days after New Constructs issues a report on that security.

DISCLAIMERS

The information and opinions presented in this report are provided to you for information purposes only and are not to be used or considered as an offer or solicitation of an offer to buy or sell securities or other financial instruments. New Constructs has not taken any steps to ensure that the securities referred to in this report are suitable for any particular investor and nothing in this report constitutes investment, legal, accounting or tax advice. This report includes general information that does not take into account your individual circumstance, financial situation or needs, nor does it represent a personal recommendation to you. The investments or services contained or referred to in this report may not be suitable for you and it is recommended that you consult an independent investment advisor if you are in doubt about any such investments or investment services.

Information and opinions presented in this report have been obtained or derived from sources believed by New Constructs to be reliable, but New Constructs makes no representation as to their accuracy, authority, usefulness, reliability, timeliness or completeness. New Constructs accepts no liability for loss arising from the use of the information presented in this report, and New Constructs makes no warranty as to results that may be obtained from the information presented in this report. Past performance should not be taken as an indication or guarantee of future performance, and no representation or warranty, express or implied, is made regarding future performance. Information and opinions contained in this report reflect a judgment at its original date of publication by New Constructs and are subject to change without notice. New Constructs may have issued, and may in the future issue, other reports that are inconsistent with, and reach different conclusions from, the information presented in this report. Those reports reflect the different assumptions, views and analytical methods of the analysts who prepared them and New Constructs is under no obligation to insure that such other reports are brought to the attention of any recipient of this report.

New Constructs' reports are intended for distribution to its professional and institutional investor customers. Recipients who are not professionals or institutional investor customers of New Constructs should seek the advice of their independent financial advisor prior to making any investment decision or for any necessary explanation of its contents.

This report is not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or jurisdiction where such distribution, publication, availability or use would be contrary to law or regulation or which would be subject New Constructs to any registration or licensing requirement within such jurisdiction.

This report may provide the addresses of websites. Except to the extent to which the report refers to New Constructs own website material, New Constructs has not reviewed the linked site and takes no responsibility for the content therein. Such address or hyperlink (including addresses or hyperlinks to New Constructs own website material) is provided solely for your convenience and the information and content of the linked site do not in any way form part of this report. Accessing such websites or following such hyperlink through this report shall be at your own risk.

All material in this report is the property of, and under copyright, of New Constructs. None of the contents, nor any copy of it, may be altered in any way, copied, or distributed or transmitted to any other party without the prior express written consent of New Constructs. All trademarks, service marks and logos used in this report are trademarks or service marks or registered trademarks or service marks of New Constructs.

Copyright New Constructs, LLC 2003 through the present date. All rights reserved.