Featured Stocks in July's Most Attractive/Most Dangerous Model Portfolios

June Performance Recap

Our Most Attractive Stocks (-14.2%) underperformed the S&P 500 (-8.3%) from June 2, 2022 through July 5, 2022 by 5.9%. The best performing large cap stock gained 1% and the best performing small cap stock was up 8%. Overall, 12 out of the 40 Most Attractive stocks outperformed the S&P 500.

Our Most Dangerous Stocks (-9.5%) outperformed the S&P 500 (-8.3%) as a short portfolio from June 2, 2022 through July 5, 2022 by 1.2%. The best performing large cap short stock fell by 22%, and the best performing small cap short stock fell by 25%. Overall, 22 out of the 37 Most Dangerous stocks outperformed the S&P 500 as shorts.

The Most Attractive/Most Dangerous Model Portfolios underperformed as an equal-weighted long/short portfolio by 4.7%.

This report leverages our cutting-edge Robo-Analyst technology to deliver proven-superior[1] fundamental research and support more cost-effective fulfillment of the fiduciary duty of care.

Eleven new stocks made our Most Attractive list this month, and five new stocks also fell onto the Most Dangerous list. July's Most Attractive and Most Dangerous stocks were made available to members on July 7, 2022.

Our Most Attractive stocks all have high and rising return on invested capital (ROIC) and low price to economic book value ratio. Most Dangerous stocks have misleading earnings and long growth appreciation periods implied by their market valuations.

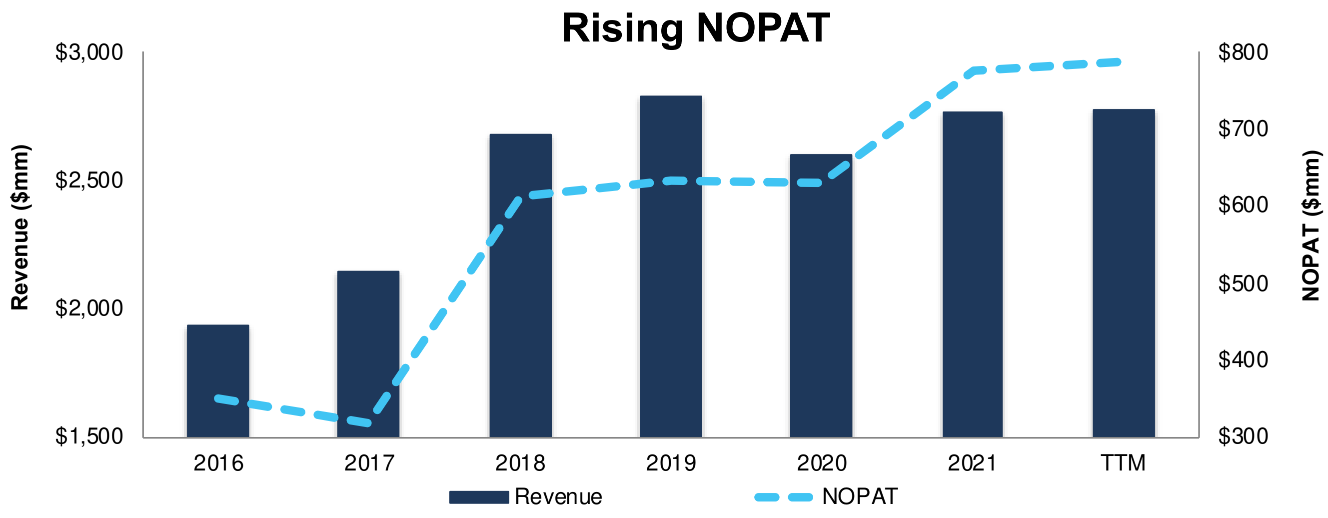
Most Attractive Stocks Feature for July: Popular Inc. (BPOP: $76/share)

Popular Inc. (BPOP) is the featured stock from July's Most Attractive Stocks Model Portfolio.

Popular has grown revenue by 7% compounded annually and net operating profit after-tax (NOPAT) by 17% compounded annually over the past five years. Popular's NOPAT margin has increased from 18% in 2016 to 28% TTM, while invested capital turns rose from 0.3 to 0.4 over the same time. Rising NOPAT margins and invested capital turns drove the company's return on invested capital (ROIC) from 5% in 2016 to 11% TTM.

[1] 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.

Figure 1: Revenue & NOPAT Since 2016



Sources: New Constructs, LLC and company filings

Popular Is Undervalued

At its current price of $76/share, BPOP has a price-to-economic book value (PEBV) ratio of 0.6. This ratio means the market expects Popular's NOPAT to permanently decline by 40%. This expectation seems overly pessimistic for a company that grew NOPAT by 17% compounded annually over the past five years and 14% compounded annually over the past ten years.

Even if Popular's NOPAT margin falls to 23% (equal to five-year average, compared to 28% TTM) and the company's NOPAT declines by <1% compounded annually for the next decade, the stock is worth $109/share today – a 58% upside. See the math behind this reverse DCF scenario. Should Popular grow profits more in line with historical levels, the stock has even more upside.

Critical Details Found in Financial Filings by Our Robo-Analyst Technology

Below are specifics on the adjustments we made based on Robo-Analyst findings in Popular's 10-Qs and 10-K:

Income Statement: we made $357 million in adjustments, with a net effect of removing $159 million in non-operating income (6% of revenue). Clients can see all adjustments made to Popular's income statement on the GAAP Reconciliation tab on the Ratings page on our website.

Balance Sheet: we made $2.5 billion in adjustments to calculate invested capital with a net increase of $714 million. One of the most notable adjustments was $695 million related to total reserves. This adjustment represented 11% of reported net assets. Clients can see all adjustments made to Popular's balance sheet on the GAAP Reconciliation tab on the Ratings page on our website.

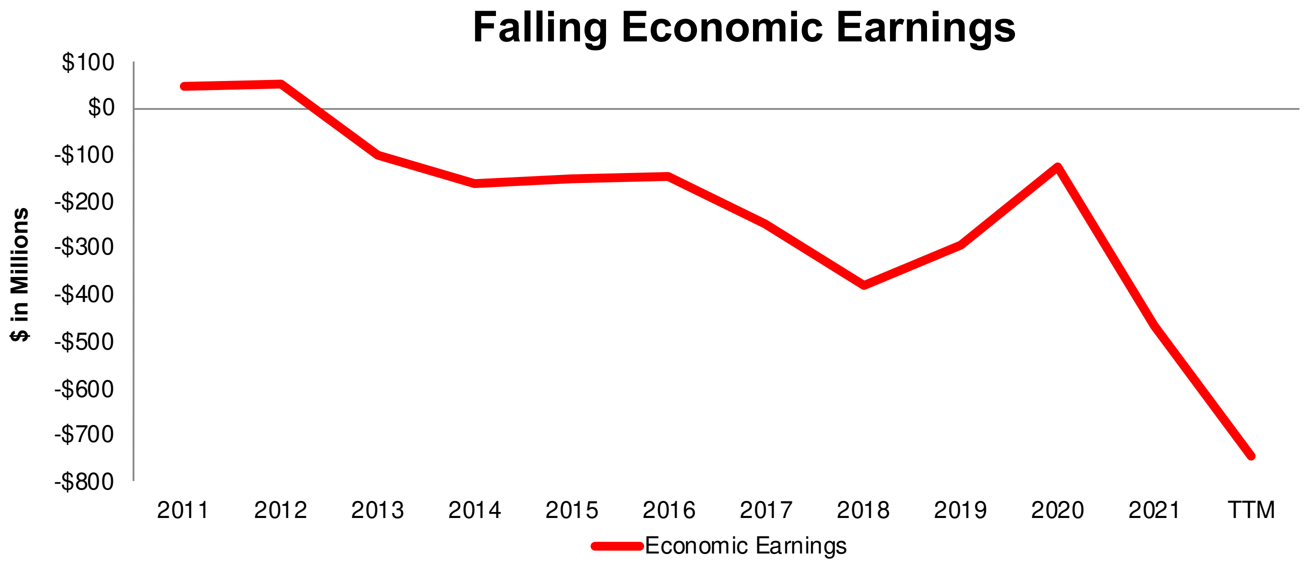
Valuation: we made $347 million of adjustments, all of which decreased shareholder value. One of the most notable adjustments to shareholder value was $151 million in underfunded pensions. This adjustment represents 3% of Popular's market cap. Clients can see all adjustments to Popular's valuation on the GAAP Reconciliation tab on the Ratings page on our website.

Most Dangerous Stocks Feature: Realty Income Corp (O: $69/share)

Realty Income Corp (O) is the featured stock from July's Most Dangerous Stocks Model Portfolio.

Realty Income's economic earnings, the true cash flows of the business, have fallen from $47 million in 2011 to negative $743 million over the TTM. The company's NOPAT margin has fallen from 63% to 35%, while invested capital turns fell from 0.11 to 0.08 over the same time. Falling NOPAT margins and invested capital turns drove Realty Income's ROIC from 7% in 2011 to 3% TTM.

Figure 2: Economic Earnings Since 2011



Sources: New Constructs, LLC and company filings

Realty Income Provides Poor Risk/Reward

Despite its poor fundamentals, Realty Income's stock is priced for significant profit growth, and we believe the stock is overvalued.

To justify its current price of $69/share, Realty Income must improve its NOPAT margin to 49% (three-year, pre-pandemic average from 2016 - 2019, compared to 36% TTM) and grow revenue by 14% compounded annually for the next decade. See the math behind this reverse DCF scenario. In this scenario, Realty Income grows NOPAT by 17% compounded annually over the next ten years. Given that Realty Income's NOPAT grew by just 8% compounded annually since 2016, we think these expectations look overly optimistic.

Even if Realty Income can achieve a NOPAT margin of 49% and grow revenue by 10% compounded annually for the next decade, the stock is worth just $39/share today – a 43% downside to the current stock price. See the math behind this reverse DCF scenario. Should Realty Income's revenue grow at a slower rate or NOPAT margins remain below pre-pandemic levels, the stock has even more downside.

Each of these scenarios also assumes Realty Income can grow revenue, NOPAT, and FCF without increasing working capital or fixed assets. This assumption is unlikely but allows us to create truly best-case scenarios that demonstrate how high expectations embedded in the current valuation are.

Critical Details Found in Financial Filings by Our Robo-Analyst Technology

Below are specifics on the adjustments we made based on Robo-Analyst findings in Realty Income's 10-Qs and 10-K:

Income Statement: we made $547 million in adjustments, with a net effect of removing $415 million in non-operating expense (20% of revenue). Clients can see all adjustments made to Realty Income's income statement on the GAAP Reconciliation tab on the Ratings page on our website.

Balance Sheet: we made $13.6 billion in adjustments to calculate invested capital with a net decrease of $3.2 billion. One of the most notable adjustments was $3.2 billion in midyear acquisitions. This adjustment represented 8% of reported net assets. Clients can see all adjustments made to Realty Income's balance sheet on the GAAP Reconciliation tab on the Ratings page on our website.

Valuation: we made $17.6 billion in adjustments, with a net decrease to shareholder value of $17.4 billion. Apart from total debt, the most notable adjustment to shareholder value was $103 million in excess cash. This adjustment represents <1% of Realty Income's market cap. Clients can see all adjustments to Realty Income's valuation on the GAAP Reconciliation tab on the Ratings page on our website.

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

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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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