



Operating Earnings Fall in 2Q22, Now Understate Core Earnings

2Q22 [Operating Earnings](#) calculated by [S&P Global](#) (SPGI) for the S&P 500 dropped from record highs in 1Q22 and are now lower than [Core Earnings](#)¹ for the first time since 3Q20. We saw a similar trend in GAAP Earnings in 2Q22, as detailed [here](#).

Stocks remain more expensive than they appear based on SPGI's Operating Earnings, but the valuation disconnect is diminishing. Despite falling ~13% in 2022, the S&P 500's current valuation requires more earnings growth than analysts expect, even after Operating Earnings fell in 2Q22. Last quarter's analysis of Core vs. Operating Earnings for the S&P 500 is [here](#).

This report leverages our cutting-edge [Robo-Analyst technology](#) to deliver [proven-superior](#)² fundamental research and support more cost-effective fulfillment of the [fiduciary duty of care](#).

Learn more about the best fundamental research

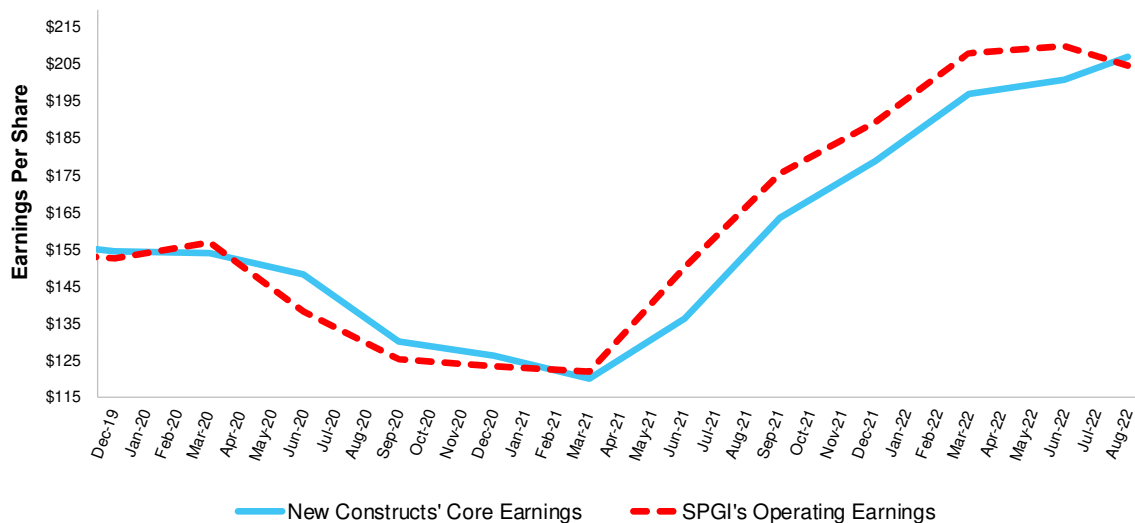
Operating Earnings Rebound Comes to End in 2Q22

Figure 1 shows Operating Earnings for the S&P 500 understated Core Earnings for the first time since 3Q20.

In 2Q22, Operating Earnings are 1% lower than Core Earnings. Looking at an annual basis, we find that 2Q22 Core Earnings improved at a faster pace, rising 27% year-over-year (YoY), compared to Operating Earnings, which rose 17% YoY.

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

SPGI Operating Earnings Fall Below Core Earnings



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. More details on the Core Earnings calculation are available in Appendix I.

SPGI's Operating Earnings do not exclude the unusual expenses that exaggerated the rebound in 2021 and make profits look worse in 2Q22 than they are.

¹ Our Core Earnings research is based on the latest audited financial data, which is the calendar 2Q22 10-Q in most cases. Price data as of 8/12/22. Operating Earnings from S&P Global is based on the same time frame.

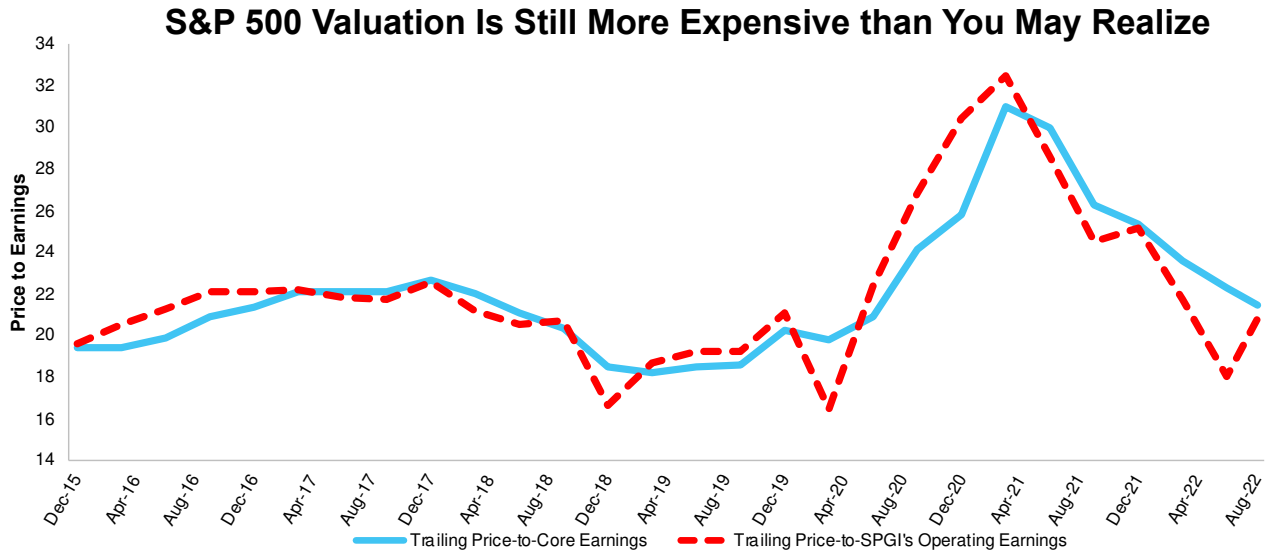
² Our research utilizes our [Core Earnings](#), a more reliable measure of profits, as proven in [Core Earnings: New Data & Evidence](#), written by professors at Harvard Business School (HBS) & MIT Sloan and published in [The Journal of Financial Economics](#).



S&P 500 Is Still More Expensive than Operating Earnings Imply

At the end of 2Q22, Core Earnings for the S&P 500 reached new highs, surpassing previous records set in each of the past four TTM periods ended [1Q22](#), [2Q21](#), [3Q21](#), and [2Q21](#). The drop in Operating Earnings, along with the rebound in the S&P 500 price in 2Q22, has closed the gap between the S&P 500's valuation measured by price-to-Operating Earnings and price-to-Core Earnings. However, by both measures, the market remains above historical levels. Without a significant improvement in Operating Earnings, which seems unlikely given current macro environment, the S&P could have a long way to fall before it trades in-line with historical levels.

Figure 2: Price-to-Core vs. Price-to-SPGI's Operating Earnings: TTM as of 12/31/15 – 8/12/22



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

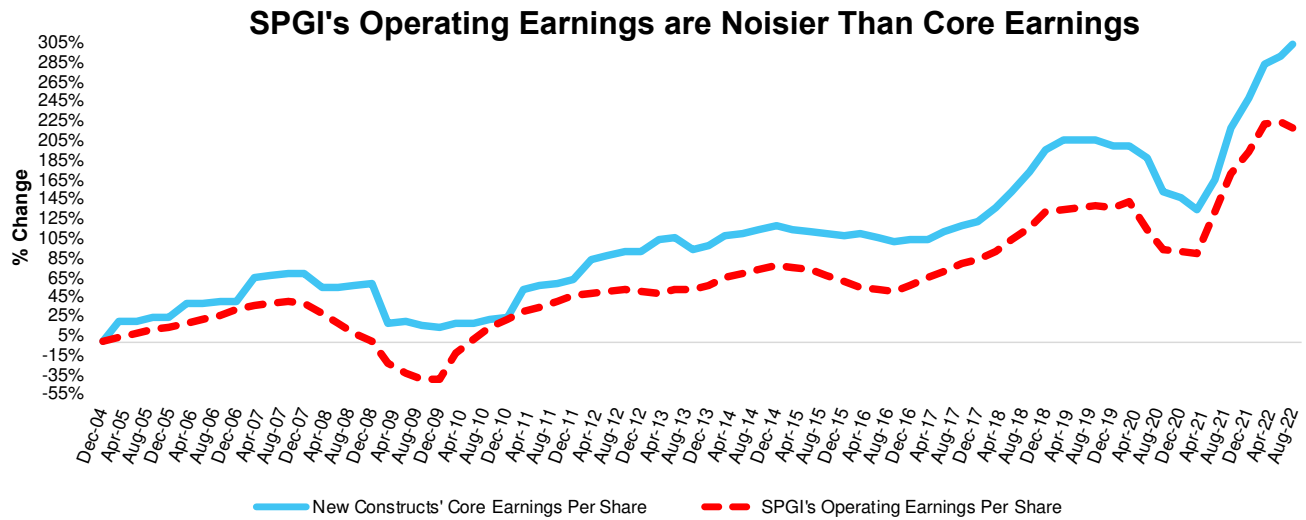
Figure 2 shows the S&P 500 trailing P/E ratios based on Core Earnings and SPGI's Operating Earnings have fallen significantly from their peaks in March 2021, but P/E based on Operating Earnings significantly rose quarter-over-quarter (QoQ) through August 12, 2022. Prices have come down relative to earnings since valuations peaked in 2021, but the P/E ratio based on Operating Earnings (20.9) remains below the P/E using Core Earnings (21.5).

Core Earnings are Less Volatile and More Reliable

Figure 3 highlights the percentage changes in Core Earnings and SPGI's Operating Earnings from 2004 to present (through 8/12/22). [Flaws](#) in legacy datasets that lead to a failure to capture unusual gains/losses buried in footnotes (detailed in [The Journal of Financial Economics](#)) drive the difference between the two measures of earnings.



Figure 3: Core vs. SPGI's Operating Earnings per Share for the S&P 500 – % Change: 2004 – 8/12/22



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

This article originally published on [August 29, 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 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 the 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](#).



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.