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MACRO FUNDAMENTALS

3/24/23

Street Earnings Overstated for 74% of S&P 500 in 4Q22

Street Earnings, as reflected in Zacks Earnings, are marketed as being adjusted to remove non-recurring items. Our Core Earnings[1] show Street Earnings fail to account for a material amount of unusual items, which distorts investors' view of profitability across the S&P 500. This report shows:

- the prevalence and magnitude of overstated Street Earnings in the S&P 500
- why Street Earnings (and GAAP earnings) are flawed and not adjusted as promised
- five S&P 500 companies with overstated Street Earnings and a Very Unattractive Stock Rating

Over 180 S&P 500 Companies Overstate EPS by More than 10%

For 339 companies in the S&P 500, or 68%, Street Earnings are higher than Core Earnings[2] for the trailing-twelve-months (TTM) ended 4Q22. In the TTM ended 3Q22, 339 companies also overstated their earnings.

When Street Earnings are higher than Core Earnings, they are overstated by an average of 19%, per Figure 1. For over a third of the S&P 500 (186 companies), Street Earnings are overstated by more than 10% vs. Core Earnings.

Figure 1: Street Earnings Overstated by 19% on Average in TTM Through 4Q22

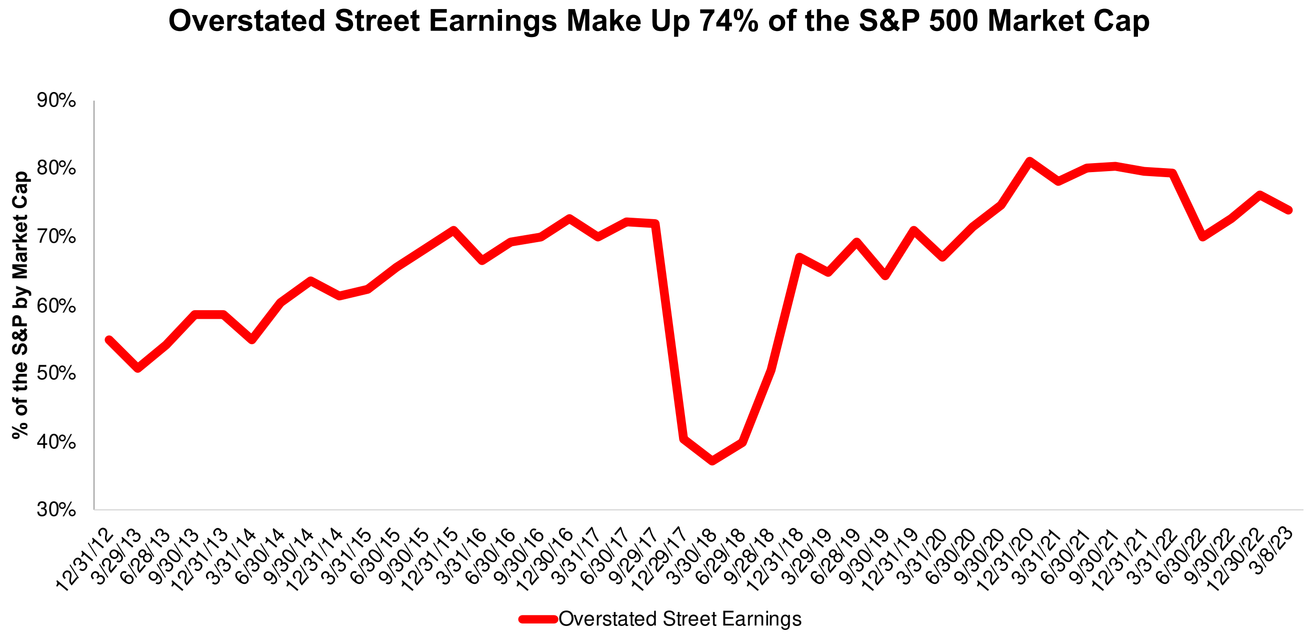
Overstated Street Earnings	Overstated by >10%	Average Overstated %[3]
339 companies	186 companies	19%

Sources: New Constructs, LLC and company filings.

The 339 companies with overstated Street Earnings make up 74% of the market cap of the S&P 500 as of 3/8/23, which is down from 76% in 3Q22, measured with TTM data in each quarter.

[1] The Journal of Financial Economics features the superiority of our Core Earnings in Core Earnings: New Data & Evidence.
[2] Our Core Earnings research is based on the latest audited financial data, which is the calendar 2022 10-K in most cases. Price data as of 3/8/23.
[3] Average overstated % is calculated as Street Distortion, which is the difference between Street Earnings and Core Earnings.

Figure 2: Overstated Street Earnings as % of Market Cap: 2012 through 3/8/23



Sources: New Constructs, LLC and company filings.

The Five Worst Offenders in the S&P 500

Figure 3 shows five S&P 500 stocks with a Very Unattractive Stock Rating and the most overstated Street Earnings (Street Distortion as a % of Street Earnings per share) over the TTM through 4Q22. "Street Distortion" equals the difference between Core Earnings per share and Street Earnings per share. Investors using Street Earnings miss the true profitability, or lack thereof, of these businesses.

Figure 3: S&P 500 Companies with Most Overstated Street Earnings: 2022

Ticker	Name	Street EPS	Core EPS	Overstated %*	Stock Rating
MGM	MGM Resorts International	($0.66)	($1.43)	116%	Very Unattractive
CPT	Camden Property Trust	$5.99	$1.31	78%	Very Unattractive
CARR	Carrier Global Corp	$2.33	$0.57	76%	Very Unattractive
PEG	Public Service Enterprise Group	$3.47	$1.42	59%	Very Unattractive
AVB	AvalonBay Communities	$8.11	$3.92	52%	Very Unattractive

Sources: New Constructs, LLC and company filings.
*Measured as Street Distortion as a percent of Street EPS.

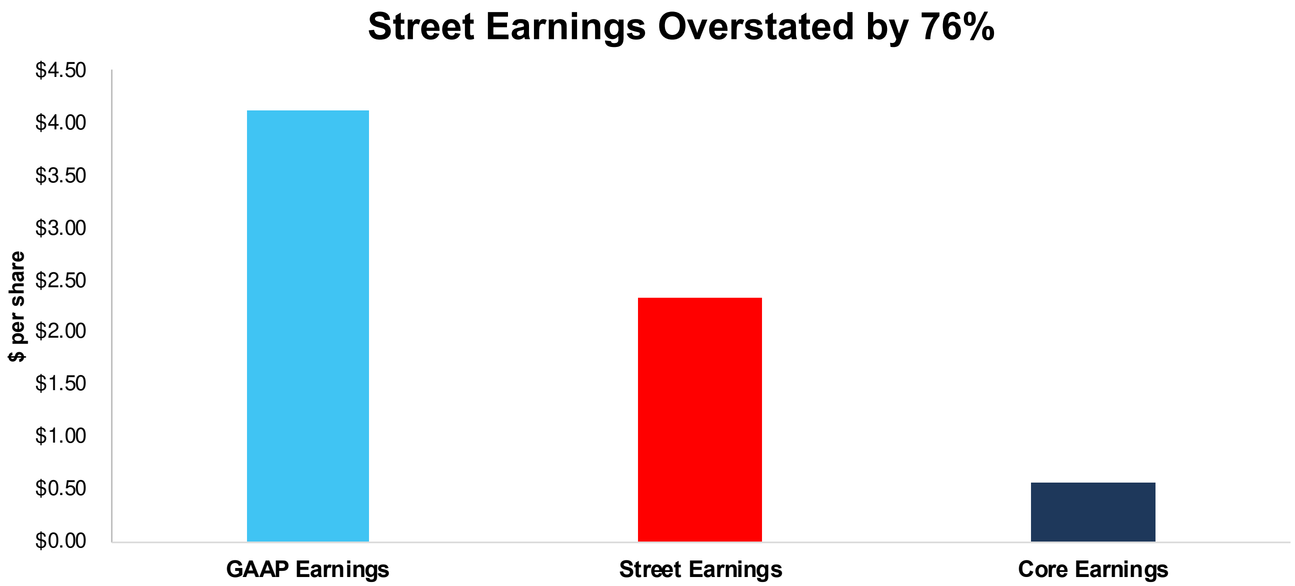
In the section below, we detail the hidden and reported unusual items that distort GAAP Earnings for Carrier Global Corp (CARR). All of these unusual items are removed from Core Earnings.

Carrier Global's 2022 Street Earnings Overstated by $1.76/share

The difference between, or Street Distortion in, Carrier Global's Street Earnings ($2.33/share) and Core Earnings ($0.57/share) is $1.76/share, or 76% percent of Street Earnings.

Carrier's GAAP Earnings Distortion is even higher at $3.54/share, which indicates that Street Earnings are correctly identifying some non-operating and unusual items. However, given the disconnect between Street and Core Earnings, it's clear that Street Earnings still miss material adjustments.

Figure 4: Comparing Carrier Global's GAAP, Street, and Core Earnings: 2022



Sources: New Constructs, LLC and company filings.

Below, we detail the differences between Core Earnings and GAAP Earnings so readers can audit our research. We would be happy to reconcile our Core Earnings with Street Earnings but cannot because we do not have the details on how analysts calculate Street Earnings.

Carrier Global's Earnings Distortion Score is Strong Miss and its Stock Rating is Very Unattractive. Carrier Global receives a Very Unattractive rating largely due to its low return on invested capital (ROIC) of 4% and the expensive valuation of its stock. Despite trading at $45/share CARR has an economic book value (EBV), or no-growth value, of -$16/share. Low ROIC and an expensive valuation land Carrier Global in our Most Dangerous Stocks Model Portfolio in March as well.

Figure 5 details the differences between Carrier Global's Core Earnings and GAAP Earnings.

Figure 5: Carrier's GAAP Earnings to Core Earnings Reconciliation: 2022

	2022 ($ per share)
GAAP Net Income	$4.10
– Hidden Unusual Gains, Net	$2.04
– Reported Unusual Gains Pre-Tax, Net	$2.13
– Tax Distortion	($0.64)
= Core Earnings	**$0.57**

Sources: New Constructs, LLC and company filings.

More details:

Total Earnings Distortion of $3.54/share, which equals $3.0 billion, is comprised of the following:

Hidden Unusual Gains, Net = $2.04/per share, which equals $1.8 billion and is comprised of:

- $1.8 billion gain on sale of investments
- $2 million in amortization of prior service cost
- -$9 million in restructuring costs bundled in cost of sales
- -$22 million in restructuring costs bundled in selling, general, and administrative
- -$29 million in acquisition-related costs

Reported Unusual Gains Pre-Tax, Net = $2.13/per share, which equals $1.8 billion and is comprised of:

- $1.8 billion in other income
- -$4 million in non-service pension expense

Tax Distortion = -$0.64/per share, which equals -$547.8 million

This article was originally published on March 24, 2023.

Disclosure: David Trainer, Kyle Guske II, and Italo Mendonça 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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