Porter & Co.

THE BIG SECRET ON WALL STREET

A Champion Company That Plays to Win

- Everyone Else Is Fighting for Second Best
- A "Forever Stock" Powered by Superstars

FROM THE DESK OF PORTER STANSBERRY

OCT. 27, 2023
#36

Breaking News: Porter Stansberry Returns to MarketWise as Chairman and CEO

Porter & Co. subscribers retain exclusive access to Porter's personal writing and market analysis.

As some astute subscribers noticed, after a protracted proxy fight, Porter recently regained control of MarketWise (Nasdaq: MKTW). At a board meeting last week, Porter was elected Chairman of the Board and CEO of the company, which is the publicly-traded parent of his other namesake financial research firm, Stansberry Research.

As most subscribers know, Porter retired from MarketWise in December 2020, shortly before the company's IPO. But following the sale of the company, the conditions of Porter's retirement were not honored by the company. And, worse, the company's board and management began taking actions that were detrimental to the business, to the shareholders, and to Porter personally.

As a result, beginning in January 2023, Porter began an activist investor campaign to replace the board and most of the management team.

(If you're interested in the details, you can read Porter's SEC filings from his activist campaign on **January 20**, **March 3**, **August 11**, and **August 28**.)

Everyone at Porter & Co. congratulates Porter on his big win in the boardroom. We always believed that, eventually, the shareholders would make the right decision to put Porter back in charge.

What does this mean for Porter & Co. subscribers?

Porter's plan is to merge Porter & Co. into MarketWise, where it will be an independently managed unit, like the other major MarketWise brands. **All of Porter's writing and other financial presentations will continue to be published exclusively by Porter & Co.** All Porter & Co. publications and subscription services are distinct from those of Stansberry Research. If you want to read Porter's own analysis and thoughts... you'll find them only at Porter & Co.

And, if you know Porter, you know how eager he is to return to the good life of living and writing at his farm with us, his oldest friends, and for you, his best clients.

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A Champion Company That Plays to Win

Everyone Else Is Fighting for Second Best

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The paper cutter sliced downward. A tiny scrap of cardstock fell to the floor.

That snip would cost Bill Mastro a quarter of a million dollars and land him in federal prison for nearly two years.

Crooked auctioneer Mastro, known as the "King of Memorabilia," had gotten away with a few fraudulent sales at Mastro Auctions before – including a fake lock of Elvis's hair and a Cincinnati Red Stockings baseball trophy that wasn't *really* from 1869. Now he was working on his biggest con yet.

It was 1985, and Mastro had just scored an incredible find: the world's most valuable baseball card. Via a Long Island dealer, he now had his hands on a genuine T206 Honus Wagner card – one of fewer than 60 printed in 1909, before the Hall of Fame shortstop withdrew the rights to his name and likeness. (Wagner didn't like that the cards were packaged with cigarettes.)

Mastro picked up the T206 for a steal ($25,000) because it wasn't in perfect condition. The edges were visibly crumpled. But – the shady auctioneer figured – a round or two with the paper cutter would fix that.

Snip, snip!

Now pristine – as though it had been freshly cut from a new sheet – the card easily met PSA (Professional Sports Authenticator) standards and was certified "Near Mint." Armed with the PSA stamp of approval, Mastro fobbed the card off on a private collector for $110,000.

Then he got cocky.

The Federal Bureau of Investigation – already nosing around the sports-memorabilia industry on suspicions of fraud – tapped Mastro's phone and heard him bragging about the doctored baseball card. It was downhill for Masto then: serial counts of wire and mail fraud, a $250,000 fine, and a prison sentence.

The bad publicity (and the edge trimming) didn't seem to hurt the value of the doctored T206 card, though. During the 1990s, it cycled through a series of private buyers, roughly doubling in price each time it changed hands – eventually ending up in the hands of Ken Kendrick, co-owner of the Arizona Diamondbacks professional baseball team, who paid $2.8 million for the two-by-three-inch piece of heavy paper.

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It was a testament to the magic of sports memorabilia – and the time-defying power of sports endorsements.

Although a few scattered baseball players had served as "models" in beer and tobacco advertisements in the late 1800s, Honus Wagner was the first big-name player to license his name and likeness to commercial products – starting around 1905, when he was a rising star batting .363 for the Pittsburgh Pirates.

Wagner backed out of the baseball-card deal quickly, writing that "I don't want to have my picture in any cigarettes." However, he had no problem associating his image with the "manlier" cigar, as well as with gunpowder, soft drinks, and chewing gum.

Most enduringly, in 1905, he inked a deal with Bud Hillerich, manufacturer of the Louisville Slugger baseball bat, allowing Hillerich to use the famous Honus Wagner signature as a decal on his bats. (Bud paid him $75 for the privilege, around $2,600 in 2023 dollars.)

For Bud, it was money well spent. Sales soared, putting Hillerich's small family business on the map and eventually securing the Slugger as the official bat of Major League Baseball. (Well over a century after Honus signed the bat, 14% of MLB players still wield a Louisville Slugger at the plate.)

Honus Wagner didn't hawk gum and gunpowder in vain. His enterprising attitude opened the door for a series of ever more lucrative sports-endorsement deals. As the 20th century rolled on, A-list players realized they could often make more money from signing a ball than from tossing it.

And thereby hangs a tale…

In this issue, we'll unpack one of the greatest endorsement deals of all time – and show how it transformed one company from a struggling industry laggard into one of the greatest success stories in American business.

But before we get into today's recommendation… an urgent note of caution.

Waiting for the Right Price

Financial markets have reached a critical inflection point. From 2009 to 2020, central banks flooded the world economy with a record amount of cheap money in order to maintain ultra low interest rates.

As we explained in our previous issue, by manipulating the most important factor in the economy – the price of capital – central banks have encouraged a decade of unprecedented capital misallocation. The free-money frenzy of the last decade is akin to a steady pour of dynamite filling the world's largest powder keg.

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As long as there was no spark, there was no imminent danger. When Bank of America bought hundreds of billions in long-duration Treasuries at sub-2% yields in 2020 and 2021, it seemed the ultimate "safe." After all, what's safer than government bonds?

But now, central banks have lit the match – in the form of the most aggressive rate-hiking campaign of the last 40 years. With long-term U.S. Treasury yields breaking out above 5% to new 15-year highs, a big bill is coming due for a decade of free money.

So far, the fallout has been contained to **a few regional banks**. The bull-market cheerleaders have assured the investing public that the banking crisis is "contained."

We heard the same thing in 2008. When subprime lenders and major financial institutions started going belly up, then-Fed Chair Ben Bernanke claimed the subprime crisis was "contained." Financial markets enjoyed short-lived rallies on each bailout and emergency liquidity injection. But the embers continued smoldering… until a firestorm erupted into the greatest financial crisis since the Great Depression.

Now, the stage is set for a repeat performance. Except this time, the problems run far deeper. The capital distortions are more entrenched. We can't know exactly when the mistakes made during a decade of zero percent interest rate policy (ZIRP) will reveal themselves in spectacular fashion. We only know it's a matter of when… not if.

Today, one thing is clear: the cheap-money era is over. With a high cost of capital now imposed onto the U.S. and global economies, a painful reckoning awaits.

But with every crisis comes opportunity.

As I (Porter Stansberry) have written about for the last two decades, the safest and surest path to inevitable wealth is stunningly simple. Buy the world's most dominant, capital efficient businesses and don't overpay for them.

The problem lies in that last point. Most of the time, the shares of world-leading companies trade at premium prices. But every once in a while, a financial panic – or a corporate misstep, and short-sighted investors who sell at the first sign of trouble – provides the rare opportunity to get top-shelf stocks at bargain-basement prices.

That's the opportunity we're preparing for… starting today. Our mission in the coming months is to help investors build a shopping list of the world's best businesses – companies that dominate their industries, featuring business models with high capital efficiency, that can return a growing stream of earnings to shareholders – in anticipation of their shares hitting the discount rack. We'll be creating a game plan to transform the coming crisis into a once-in-a-generation wealth-building opportunity.

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The company we're introducing today is a classic "forever stock." Over the last three decades, it's created one of the most valuable and enduring consumer brands of all time. The company has also built a world-class marketing engine that none of its competitors can come close to replicating. This enduring competitive advantage makes us confident the company will continue stoking demand for its products – and generating world-class returns, for decades to come.

The Business of Selling Aspiration

Nike (NYSE: NKE) is the world's largest athletic apparel maker.

Since its 1980 initial public offering ("IPO"), Nike shares have compounded investor capital at an incredible 17.5% per year. While many of the world's best companies have generated similar returns over one or two decades, only a rarefied few have done so for 43 years running.

A $10,000 investment made in Nike at its IPO is worth over $1 million today. That same investment in the S&P 500 is worth a comparatively paltry $95,000.

How could the often fad-driven business of making shoes and t-shirts turn into one of the world's greatest wealth-compounding machines?

Because the reality is, Nike doesn't sell apparel. Nike sells something much more enduring: aspiration. And it distributes its aspirational message through one of the most powerful marketing machines ever created. Each year, the world's most successful athletes wear Nike shoes and apparel on basketball and tennis courts, football and soccer fields, and golf courses around the world.

When a Nike endorsement partner scores the game-winning goal, or secures an Olympic gold medal, this cements an enduring association of success with the brand (the word *Nike* comes from the Greek goddess of victory).

The Nike brand name, and its iconic swoosh logo, is worth an estimated $50 billion, according to Interbrand, the world's leading brand consultancy firm. This brand value explains how it can charge hefty markups on the basic materials of fabric, nylon, and leather. And it's also how the company has consistently grown revenues, earnings, and investor capital at market-crushing rates for decades.

But with so many companies, it has gone through some significant ups and downs – and overcome enterprise-threatening challenges – to get where it is today. To understand how it all happened, let's start from the beginning.

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The Dynamic Duo Behind It All

Nike was originally formed as Blue Ribbon Sports in January 1964 by University of Oregon track coach Bill Bowerman and one of his student athletes, co-founder Phil Knight.

Bowerman was a widely respected running guru, who orchestrated winning track seasons in 23 out of his 24 years at Oregon. In 1962, Bowerman co-published the 90-page book *Jogging* that sold over a million copies – and ignited a boom that fueled record demand for running shoes over the next 15 years.

In addition to being a coach, Bowerman was something of a mad scientist, constantly tinkering with shoe designs to squeeze extra performance out of his athletes. While having breakfast with his wife one morning, inspiration struck in the form of a waffle iron.

Bowerman poured a synthetic rubber compound into the device, generating a waffle-like sole pattern. The design was an instant success. The protruding rubber waffle pattern formed a stickier grip with the track surface. Meanwhile, the synthetic compound offered a lighter-weight material than traditional shoes had at the time.

Nike created several hit models from Bowerman's breakfast-appliance design, including the 1972 Nike Waffle Racing Flat and the 1974 Waffle Trainer. These became icons of the 1970s running boom, with an enduring fan base to this day. In fact, in July 2019, an original pair of 1972 Nike Waffle Racing Flats fetched a whopping $475,500 at a Sotheby's auction.

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Winning the shoe market required more than producing the best products. Creating a strategy that would fuel the company's success for decades to come, Nike developed sophisticated marketing campaigns built around endorsement deals with the top running talent.

Nike struck its first athlete endorsement deal in 1974 with legendary distance runner Steve Prefontaine. Known as "Pre," Prefontaine trained under Bowerman at Oregon from 1969 to 1973. He was the dominant runner of his time, setting American records for every distance from 2,000 to 10,000 meters.

When Prefontaine set new running records, he often did it in the Nike Waffle Trainers. This created a powerful brand association between Nike shoes and victory on the track, unleashing a boom in demand. Nike sales grew 150-fold from $3 million in 1972 to $457 million by 1981.

Entering the 1980s, Nike had 50% market share in running shoes. It also owned 40% of the fast-growing market for basketball sneakers. But things turned south when America's running boom faded, and Nike failed to adapt to shifting consumer preferences.

The Birth of Lifestyle Fitness Brands

Through the 1970s, Nike had set the company up to capitalize on what it believed was the long-term trend in footwear: running shoes. But it turned out, the 1970s running boom – and the demand it stoked for high-performance shoes – was a cyclical fad. The real long-term trend, which continues today, is lifestyle fitness apparel.

This meant consumers wanted more fashionable footwear and clothing that could be worn outside the gym, in everyday life. Nike was caught off guard when consumer tastes shifted from pure athletic performance to more stylish shoes.

For sneakers, this meant nylon was out, and leather was in.

Initially, Knight and Bowerman refused to cater to the new taste in apparel. They swore off using leather, as it added unnecessary weight and trapped sweat inside the shoe.

This approach backfired when another new fitness craze emerged in the 1980s: aerobics – indoor group exercise classes led by a trained instructor. This new fitness regimen opened up a huge new sneaker market for the female demographic. Women buying athletic shoes in the 1980s didn't care about shaving a few seconds off their mile times. They wanted fashionable designs that matched their aerobics leggings – like the iconic, neon-colored Reebok Freestyle, an 1980s staple. Expanding from its British roots, Reebok entered the U.S market in 1980, and by 1988 it had lapped Nike in total sales.

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Meanwhile, other sports were growing in popularity, and other athletic brands were bursting onto the scene. Basketball-sneaker trends shifted toward more fashionable designs for off-the-court wear. Adidas and Converse leapt past Nike by introducing innovative new styles that consumers loved. As a sign of the times, Run-DMC – the hottest hip-hop group of the 1980s – provided the best free advertising one could ask for, featuring the German company's shoes in their hit song "My Adidas."

Meanwhile, Adidas and Converse took a page from Nike's endorsement playbook. And they were driving up the cost of hiring the stars.

Nike's landmark endorsement deal with Steve Prefontaine cost just $5,000 per year. By the mid-1980s, Converse was offering basketball superstars like Magic Johnson and Larry Bird $100,000 per year to lace up their Converse Warrior shoes on the court. Nike struggled to make competitive offers, as sales and earnings stalled.

Even when Nike made matching offers, the top NBA talent went with the competition for their more stylish shoes. Nike was increasingly viewed as "just a running-shoe company," and was losing the critical battle for mindshare in the burgeoning sneaker culture. Its once-dominant command of market share collapsed.

Nike's market share in basketball sneakers had slipped from 40% in 1980 to just 17% by 1984. This bled into waning demand for its other athletic apparel – and the company found itself with bloated inventories of warm-up gear, shorts, and t-shirts that it could only sell with margin-crushing discounts.

Under a profits squeeze, Nike shed 25% of its staff in 1984. The company's board was considering killing the entire basketball division.

But one marketing executive pushed CEO Knight and the board to do the exact opposite: spend more money on basketball. This led to an all-in bet that would become the most expensive – and most profitable – athlete endorsement deal of all time. And it cemented Nike as the world's most dominant athletic apparel company for decades to come.

An All-In Gamble on an Unproven Rookie

In 1984, few believed Michael Jordan would even survive in the NBA, let alone become the greatest basketball player of all time.

Despite Jordan's standout high school career, he was considered too small for the NBA. At the time, the league was dominated by large, physical players like Larry Bird and Magic Johnson – both taller and stronger than Jordan. The North Carolina Tar Heel entered the league as an inauspicious first-round draft pick for

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the Chicago Bulls. Jordan's own team doubted his abilities. General Manager Rod Thorn commented during the 1984 draft:

> *"We wish Jordan were seven feet, but he isn't. There just wasn't a center available. What can you do? Jordan isn't going to turn this franchise around. I wouldn't ask him to. He's a very good offensive player, but not an overpowering offensive player."*

Nike marketing executive Sonny Vaccaro, though, saw things differently. The former college basketball talent scout had viewed hours of Jordan's college-game films. His experience watching players through the years told him that Jordan was a sleeping giant. A gambler by nature, Vaccaro convinced Nike to push all of their chips onto the table and sign the untested rookie.

Nike had budgeted $250,000 for three NBA endorsement deals for the 1984 season. Vaccaro wanted to double the budget – and he wanted to spend it all on Jordan. It was an outrageous request for the cash-strapped Nike. No company had ever offered that much money for an NBA shoe deal, let alone for a relatively unknown player.

Even more unprecedented was the perpetual royalty structure. Vaccaro, working with Jordan's mom in the preliminary negotiations, proposed a 5% royalty for every Jordan-branded sneaker the company sold. In perpetuity… forever. No shoe company had ever offered a perpetual royalty on every sale, let alone a generous 5%.

Nike needed a bold offer to sign Jordan, who was a self-described Adidas fanatic. During Jordan's college days, the University of North Carolina had a sponsorship deal that required the players to wear Converse shoes during games. After the final buzzer, Jordan would immediately change out of his Converse and into Adidas.

Nike was willing to pay the 5% royalty in order to secure full buy-in from Jordan – all Nike, all the time. The deal structure aligned Jordan's incentives with those of Nike: to sell as many shoes as possible. But Jordan needed to love the shoes. So in another unprecedented move: Nike built an entire shoe line around just Jordan. They also gave him full creative control around every aspect of the shoe design and style.

Nike abandoned its no-leather rules, and gave Jordan carte blanche to design a shoe from scratch. Working with Nike's whiz designer Peter Moore, the two created the *Air Jordan 1*.

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And it was a huge success... Nike expected to sell $3 million worth of Air Jordan shoes in its first-year release in 1985. It sold $126 million. The remarkable sales performance was driven by Jordan's athletic performance on the court, as he put together one of the best NBA rookie seasons of all time.

In his first year with the Bulls, Jordan averaged an incredible 28.2 points per game, made the NBA All-Star team, and won Rookie of the Year.

It wasn't just raw stats that made Jordan a crowd favorite. It was his style. This included his famous jump shot and his poise under pressure to execute game-winning, buzzer-beating shots. Most important, it was Jordan's incredible ability to get air. His 48-inch vertical leap remains an unbroken NBA record – and it turned him into an iconic dunker who seemingly levitated through the air to the rim, earning the nickname Air Jordan.

It's hard to come up with a more powerful commercial than having the NBA's most dominant player soaring through the arena in your basketball shoes:

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By the late 1980s, Jordan was the hottest athlete in the NBA, and took Nike along for the ride. By 1989, Nike was no longer just a struggling running-shoe company. It had surpassed all of its competitors to become the world's largest seller of athletic footwear.

In the 1990s, Jordan progressed from a great player to the greatest player of all time. He led the Bulls to six national championships from 1991 to 1998. Over his full career, he set NBA records for the most points per game (30.1 points per game), league scoring titles (10), and most MVP titles (11 total including regular season and finals).

His celebrity status grew beyond the NBA: Jordan became a global phenomenon and one of the most popular celebrities in the world. And he always wore Nike, driving sales well beyond his playing days.

Nike's revenue grew from $2.2 billion in 1990 to $9.2 billion in 1997.

In 1997, cementing a legacy for the shoe franchise, Nike announced Brand Jordan – a separate Nike subsidiary dedicated entirely to the Jordan footwear line up. The division recruited rising NBA talent to endorse new evolutions of the signature Jordan models – including names like Chris Paul, Carmelo Anthony, Blake Griffin, and Jimmy Butler.

Today, the latest Air Jordan shoe release attracts crowds that stretch around the block, often for kids too young to be alive during the superstar's heyday.

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The Jordan brand remains Nike's fastest-growing business line. Last year, the segment grew 35% to generate $6.3 billion in sales, and shows no signs of slowing. Thanks to his deal with the company, Nike made Michael Jordan the highest paid athlete of all time, worth an estimated $3.3 billion.

Jordan's first contract with the NBA paid him $6.3 million over seven years. Over that same period, Jordan earned more in Nike royalties than he did playing the game. Today, he earns over $400 million in royalties each year – 4x more than he made in salary during his entire career with the NBA.

And, arguably more than anyone else, Jordan made Nike into the global behemoth it is today.

Nike and Mike: The Ultimate Power Couple

As Jordan became one of the most celebrated athletes in the world, he created a halo effect that elevated Nike's brand along with him. This boosted Nike sales across its entire product line. The company sold more tennis shoes, more t-shirts, more hats, more everything.

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This dominance provided the company with a huge war chest to extend its lead over the competition. Over the last three decades, Nike has deployed its growing profit stream into long-term deals with the best athletes in the biggest sports around the world. This includes golf legend Tiger Woods, tennis greats Serena Williams and Rafael Nadal, soccer star Cristiano Ronaldo, football celebs Aaron Rodgers and Lamar Jackson, NBA legend LeBron James, and world-renowned gymnast Simone Biles.

Nike has also formed long-term partnerships to become the official sponsor for the top sports leagues and athletic events around the world. This includes deals to supply Nike-branded apparel for Major League Baseball, the National Football League, the U.S. Olympics team, and the U.S. Open tennis tournament.

Capturing the mindshare of millions of consumers around the globe by associating the Nike logo with the leading athletes and global sporting events is one of the most valuable marketing machines of all time.

Since becoming the number-one footwear company in 1989, Nike has steadily increased its lead over the competition.

With $51 billion in global sales last year, Nike is the world's largest athletic footwear and apparel company by a wide margin. Its next closest competitor, Adidas, generates less than half of Nike's revenues with $24 billion in sales last year. We expect Nike will maintain its leading position for decades to come, for one simple reason: it can outspend its competitors to continue driving greater demand.

Nike invests $4.4 billion per year promoting its brand through athlete endorsements and sponsorship programs. Adidas spends just $2.9 billion per year promoting its brand. Not only does that mean Nike drives more sales than Adidas today, but leveraging that advantage consistently grows sales at a faster rate over time. Nike's revenue advantage – how much more it generates in sales per year – over Adidas has increased from less than $5 billion in the late 1990s to $26 billion today:

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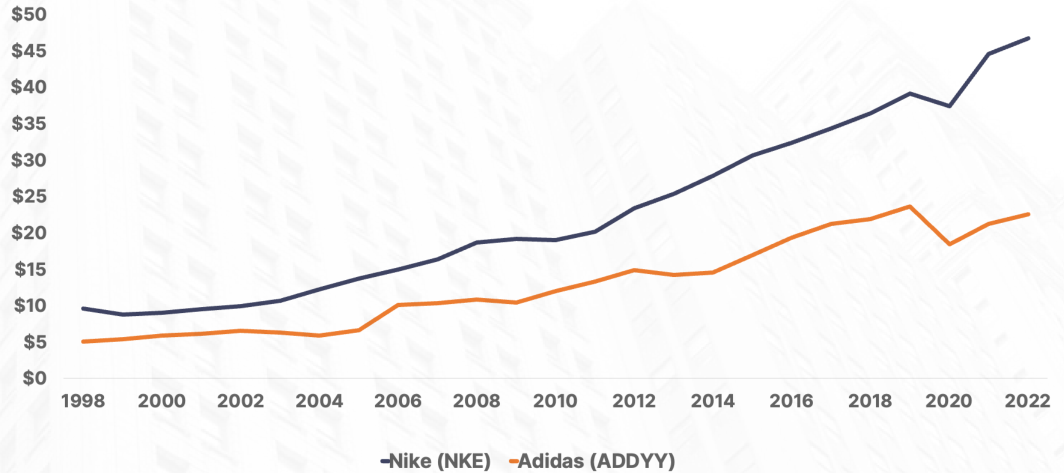
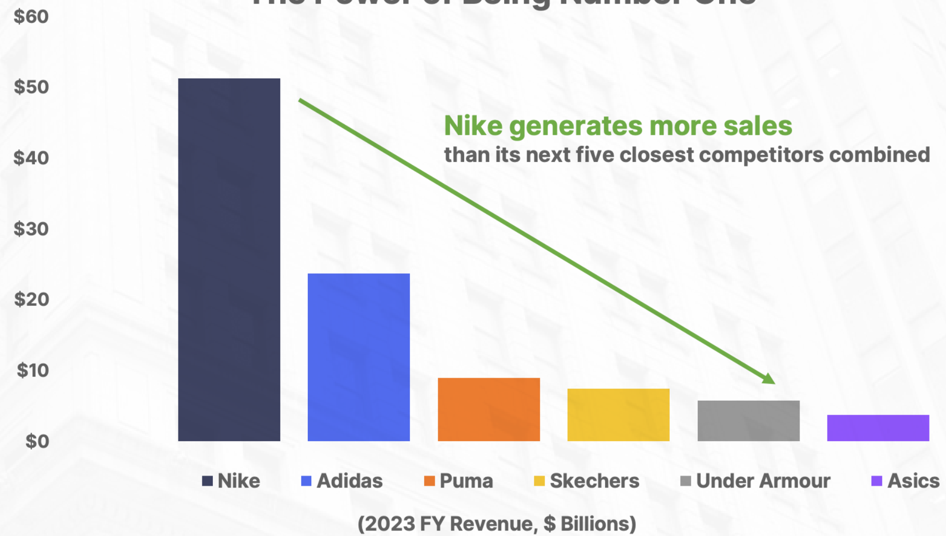


After Adidas, there's a sharp drop off to the next closest competitors... Today, Nike generates more revenue each year than all five of its closest rivals combined:



Nike has used this size advantage to cement its lead over its competitors for the last three decades. Now, everyone else is just vying for second best.

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Just Own It: A Future-Proof Forever Stock

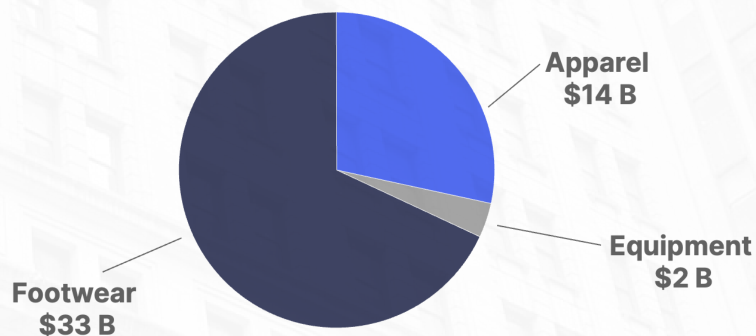
Over the last three decades, much has changed in the sports world. Viewers have switched from watching cable-connected games on the major networks and ESPN to catching events through smartphone apps and streaming services. Advertisers have shifted from a linear-TV focus to a wide array of options – cable, streaming, and social media among them. But through it all, one thing has remained the same: the best athletes in the world still wear Nike gear. And that timeless brand association still captures the mindshare of millions of sports fans around the world.

And it has paid off... The company has grown its revenues in 18 of the last 20 years, averaging annual compounded growth of 8% per year. Nike's premium brand power allows the company to sell more units and increase prices almost every year like clockwork.

Nike's greater product diversification has also created a more stable sales and earnings trajectory.

When Nike led the industry in 1989, its financials revolved around the latest Air Jordan product cycles. Today, even with the ongoing success of the Jordan brand, that once-dominant segment makes up only 15% of total sales. Nike has diversified its product mix across hundreds of other hit shoe models, plus a wide array of sports apparel and sporting equipment:

Nike Brand Revenue by Category
($ Billions, FY 2023)



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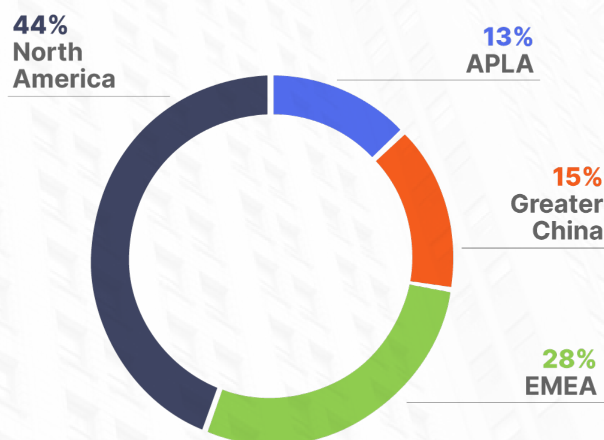
Nike has also diversified its revenue mix across the globe, with over half of its sales coming from outside of North America – into Europe, the Middle East, and Asia (EMEA); China; and Asia Pacific and Latin America (APLA):



Even more enduring from an investment standpoint is Nike's highly profitable and capital efficient business model. Since its founding, the company has never engaged in the actual production of its shoes and apparel. Instead, it outsources this more capital-intensive activity to third parties (in the same way Coca-Cola outsources the capital-intensive process of bottling its soda).

That's how Nike spends less than 2% of sales on capital expenditures and generates 10% free cash flow margins. Over the last decade, Nike has generated an average of 22% return on invested capital ("ROIC") and a 34% return on equity ("ROE").

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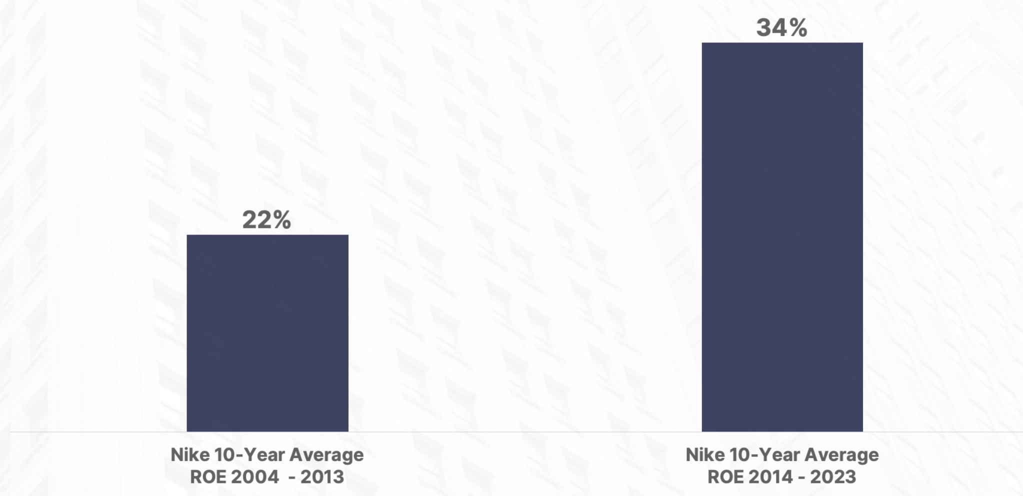
Nike's high capital efficiency means revenues grow faster than its expenses and its capital requirements over time. This leads to greater profit margins and higher returns on capital. Over the last two decades, Nike's profit margins have expanded from 8% to 10%. Meanwhile, the company's ROE has grown from 22% to 34%:



The upside for investors is that Nike can return a lot of cash to shareholders, instead of having to sink it back into the business. The company returns capital to investors through consistent share repurchases, which have reduced Nike's share count by roughly 20% over the last 20 years. It also raises its dividend annually.

On the surface, Nike's current dividend payout of $1.36 per year (or a 1.3% annual yield) might seem unimpressive. But the upside comes from Nike's fast-growing payout over time. Over the last 20 years, Nike has increased its annual dividend 16-fold, from $0.085 per share in 2004 to that $1.36 per share today.

Consider how this dividend growth adds up over time. An investor who bought $10,000 of Nike shares in 2004 only received about $85 in dividends that year. Today, that same investment is generating $1,360 in annual dividends.

Nike's aggressive dividend payout growth comes from two sources: rising earnings power and a shrinking share count to spread those earnings over. Investors who reinvest dividends into buying more Nike shares benefit from a powerful compounding effect. That is, they own an increasingly larger share of the business, both from the company repurchasing its own shares, and from reinvesting dividends into additional share purchases.

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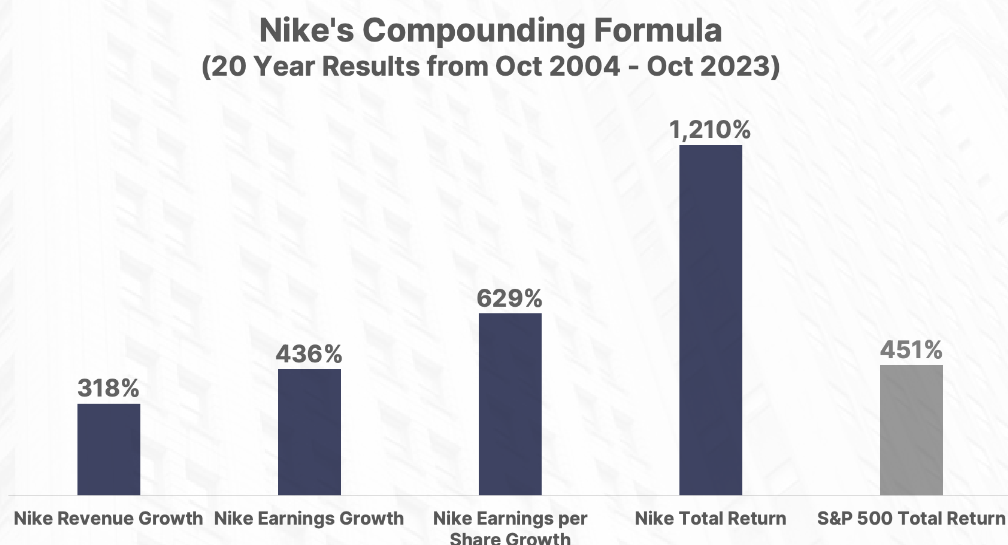
The chart below shows Nike's compounding formula over the last two decades. Since 2004, Nike's sales have grown roughly 300%. As the business has become more profitable, earnings have grown at a faster rate, of just over 400%. Meanwhile, a shrinking share count means Nike's earnings per share increase even faster, at 600%. Finally, reinvesting dividends boosts the total return to over 1,200% (or an annualized rate of 15%). For comparison, the S&P 500 has generated a total return of 451% (or an annualized rate of 9%) over the same period:



Here's the kicker. Nike has delivered nearly 3x the returns of the overall market, despite a nearly 50% decline in its share price over the last two years.

Nike shares have dropped from a peak of around $180 in late 2021 to just over $100 today. The business has experienced the same pressures facing many consumer-goods companies. That is, a mean reversion following a pandemic-driven surge in consumer spending, amplified by higher input costs that have hit margins.

As a result, Nike's earnings per share have dropped 15% from $3.79 in 2022 to $3.24 over the last 12 months. The company's falling earnings has also caused a drop in its valuation multiple.

Historically, Nike shares have traded between 20x and 30x earnings. During the COVID-19 boom in consumer spending, Nike's price-to-earnings multiple reached as high as 70x, before falling to 30x today. This 30x multiple is still too high a price, even factoring in an eventual rebound to earnings growth.

The consensus among Wall Street analysts indicates Nike's earnings will rebound to $3.74 next year, before registering new record highs of $4.37 in 2025.

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But Wall Street isn't pricing in the financial panic and sharp recession we see looming on the horizon. As we're written previously, the bill is coming due for the last 15 years of ZIRP. With interest rates above 5%, we expect the U.S. economy will buckle under today's high cost of capital.

As a result, we expect more pain for the consumer – and for Nike – in 2024.

But by 2025, as the economy recovers, we expect a rebound in nominal growth in gross domestic product ("GDP"). As a conservative estimate, we believe Nike can generate $4 per share of earnings (slightly lower than Wall Street estimates) as consumer spending recovers in 2025.

History shows that buying Nike under 20x earnings can generate world-class returns. For example, the 20-year returns investors experienced through 2023 came from a starting point of 19x earnings in Q4 2004.

We're putting Nike on the watchlist to buy when shares trade below a 19x multiple of our 2025 earnings estimate of $4 per share, or $76 per share. That's 24% below its current price of $100 per share.

Action to take: Buy Nike (NKE) below $76 per share.

New to the Porter & Co. Portfolio? Start with Our Top 3 "Best Buys" Today

Our goal at Porter & Co. is to bring you world-class investment research, focused on "inevitable" businesses that you can buy and hold forever. This is the surest and safest path to building permanent wealth.

While we don't believe in timing the market, we do keep a constant eye out for bargains. In each edition of *The Big Secret on Wall Street*, we highlight three current portfolio picks that are at an attractive buy point.

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1. **PayPal (Nasdaq: PYPL)** is one of the world's largest digital payment networks, originally founded as X.com by Elon Musk in 1998. PayPal became the largest and most trusted digital-payment option on auction site eBay and other online merchants in the late 1990s and early 2000s. PayPal was later spun out into a standalone company, and today is the most widely adopted payment option among the world's largest online merchants, with over 430 million users. The business is highly capital efficient, with 20% free cash flow margins. Misplaced fears of rising competition have caused shares to trade at their lowest valuation on record, at just 10x earnings. PayPal's unmatched payments ecosystem has created an enduring competitive advantage, allowing the company to maintain a double-digit growth rate in payment volumes and earnings per share. PayPal's high capital efficiency allows the company to return a lot of cash to shareholders, including a $5 billion buyback in 2023 – or nearly 9% of its current market capitalization.

2. **Credit Acceptance Corp (Nasdaq: CACC)** is a leading subprime auto lender, which we call the **Goldman Sachs of White Trash**. The business of making subprime loans isn't glamorous, but it's tremendously profitable and highly capital efficient. CACC has generated 68% free cash flow margins over the last three years and today trades at just 10x current year earnings. (It's at a buy point of $411 per share, or less than 18x earnings.) Shares have recently sold off on fears of a subprime auto-lending meltdown, but as we explained in a **recent portfolio** update, CACC is uniquely positioned to benefit from spiking default rates – and that's already showing up in its latest quarterly earnings report. With lending standards tightening and auto delinquencies on the rise, more consumers are entering the subprime category. This was confirmed last quarter as CACC's loan growth surged by 13%.

3. **Viper Energy Partners (Nasdaq: VNOM)** is an oil and gas royalty company – the best business in the energy sector, and the **Secret Behind T. Boone's Fortune**. Unlike oil and gas producers, VNOM never invests any capital searching for oil or drilling holes deep into the earth. It simply owns the land upon which other companies drill – and collects a percentage of the cash flow. That makes it one of most capital-efficient businesses you'll find anywhere, with 80% free cash flow margins. VNOM funnels its profits directly to shareholders, instead of back into the ground. VNOM currently trades at a 13% free cash flow yield – the best valuation since the depths of the COVID-19 pandemic. The company is returning capital to shareholders through a 5% dividend yield and a repurchase program that has reduced outstanding units by roughly 10% over the last 18 months.

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Portfolio Update

The Big Secret on Wall Street PORTFOLIO

ENERGY & COMMODITIES	Ticker	Description	Purchase Date	Cost Basis	Closing Price	Yield	Income Received	Total Return	Status	Risk Rating (1 - 5)
EQT CORPORATION	EQT	U.S. Gas-Focused E&P	06-03-2022	$47.99	$42.81	1.25%	$0.75	-9.23%	Buy Under $50	4
TELLURIAN INC.	TELL	U.S. LNG Exporter	06-17-2022	$3.53	$0.63	0.00%	$0.00	-82.15%	Buy Under $5	5
VIPER ENERGY	VNOM	Oil and Gas Royalty	09-02-2022	$30.58	$28.91	4.98%	$1.67	0.00%	Buy Under $34	3
BWX TECHNOLOGIES, INC.	BWXT	Nuclear Power Equipment	12-23-2022	$58.24	$75.68	1.22%	$0.69	31.13%	Buy Under $80	3
BLACK STONE MINERALS	BSM	Oil and Gas Royalty	02-17-2023	$15.90	$17.93	10.71%	$0.48	15.75%	Buy Under $18	2
BITCOIN	BTCUSD	Cryptocurrency	05-12-2023	$27,179.90	$34,163.90	0.00%	$0.00	25.70%	Buy Under $35,000	4
PEABODY ENERGY	BTU	Coal Mining	06-23-2023	$20.69	$23.75	1.26%	$0.00	14.79%	Buy Under $25	4
CNX RESOURCES	CNX	U.S. Gas-Focused E&P	09-29-2023	$22.82	$21.94	0.00%	$0.00	-3.86%	Buy Under $30	3
BATTLESHIP STOCKS										
CREDIT ACCEPTANCE CORP	CACC	Consumer Finance	07-29-2022	$575.91	$410.92	0.00%	$0.00	-28.65%	Buy Under $600	3
NOVO NORDISK	NVO	Pharmaceuticals	10-28-2022	$53.34	$95.20	3.71%	$2.07	82.38%	Hold	2
WINMARK CORPORATION	WINA	Specialty Apparel Stores	09-16-2022	$218.96	$404.79	0.79%	$6.00	87.61%	Hold	1
FRANCO-NEVADA CORP	FNV	Precious Metals Streamer	05-12-2023	$154.74	$133.89	1.02%	$0.68	-13.03%	Buy Under $170	2
PAYPAL	PYPL	Payment Processor	07-21-2023	$73.02	$51.75	0.00%	$0.00	-29.13%	Buy Under $90	3
FOREVER STOCKS										
ALTRIA	MO	Tobacco Maker	07-15-2022	$42.24	$39.26	9.98%	$4.74	4.17%	Buy Under $50	1
PHILIP MORRIS	PM	Tobacco Maker	07-15-2022	$90.18	$89.71	5.80%	$6.38	6.55%	Buy Under $100	1
DOMINO'S PIZZAS INC	DPZ	Restaurants	02-27-2023	$300.00	$345.94	1.27%	$2.42	16.12%	Hold	3
DEERE & COMPANY	DE	Agricultural Machinery	09-01-2023	$410.94	$369.54	1.35%	$0.00	-10.07%	Buy Under $450	3
INCOME & DISTRESSED DEBT										
MICROSTRATEGY INC	CUSIP: 594972AC5	2025 Convertible Bond	10-14-2022	$758.00	$1,279.19	0.59%	$7.50	69.75%	Hold	4
SABA CAPITAL & INCOME OPPORTUNITIES FUND	BRW	High Yield Bond Fund	03-17-2023	$8.07	$7.36	13.86%	$0.52	-2.40%	Buy Under $9	3
OAKTREE SPECIALTY LENDING CORP	OCSL	Specialty Investments	03-31-2023	$18.57	$18.90	11.64%	$1.10	7.70%	Buy Under $22	2
PROPERTY & CASUALTY INSURANCE										
W.R. BERKLEY	WRB	P&C Insurance	05-26-2023	$56.10	$67.03	0.60%	$0.61	20.57%	Buy Under $62	2
PROGRESSIVE CORPORATION	PGR	P&C Insurance	06-09-2023	$131.08	$153.86	0.26%	$0.20	17.53%	Buy Under $160	2
CHUBB LIMITED	CB	P&C Insurance	06-09-2023	$191.63	$213.09	0.19%	$1.72	12.10%	Buy Under $220	2
SKYWARD SPECIALTY	SKWD	P&C Insurance	06-17-2023	$24.66	$28.31	0.00%	$0.00	14.80%	Buy Under $35	2
BETTER THAN THE MARKET										
CAMBRIA SHAREHOLDER YIELD	SYLD	Yield Focused ETF	01-06-2023	$61.22	$58.70	2.64%	$1.17	-2.21%	Buy Under $65	2
WATCHLIST										
NVR, INC.	NVR	Homebuilder	NA	-	$5,420.25	0.00%	-		Buy Under $3,500	
FREEPORT-MCMORAN	FCX	Base Metals	NA	-	$34.10	1.76%	-		Waiting For Recession	
SOUTHERN COPPER CORP	SCCO	Base Metals	NA	-	$72.39	4.14%	-		Waiting For Recession	
SHERWIN-WILLIAMS	SHW	Specialty Chemicals	NA	-	$238.46	4.06%	-		Buy Under $150	
ULTA BEAUTY	ULTA	Specialty Retail	NA	-	$381.51	0.00%	-		Buy Under $350	
NIKE	NKE	Athletic Footwear & Apparel	NA	-	$100.01	0.00%	-		Buy Under $76	
HALL OF SHAME										
ICAHN ENTERPRISES	IEP	Specialty Investments	12-09-2022	$50.39	$20.25	39.51%	$4.00	-51.88%	Sold May 26, 2023	
ALTISOURCE ASSET MANAGEMENT	AAMC	Asset Management	07-07-2023	$58.00	$10.02	0.00%	$0.00	-82.72%	Sold August 18, 2023	

Disclaimer: this hypothetical portfolio should not be considered investment advice or a recommendation to buy/sell any financial instrument. For informational purposes only. Investors should perform their own due diligence before buying or selling any financial instrument. No express or implied guarantee of accuracy or applicability to real-world trading. Risk Ratings are based on a security's fundamentals and business model rather than its current valuation.

One Winner of the Upcoming Recession…

Winmark Corporation (Nasdaq: WINA) – the **Resale Company** – continues firing on all cylinders, with shares up more than 85% since our recommendation on September 16, 2022.

Winmark is a franchise retailer that owns popular resale stores including Play It Again Sports, Plato's Closet, and several others. Winmark collects a royalty percentage of every dollar that flows through the cash register of its franchise stores. The company's franchisor partners foot the bill for opening new locations and operating expenses, like rent and salaries. This makes Winmark's business extremely capital efficient. Over the last five years, Winmark has generated an average of 49% free cash flow margins and a 196% return on invested capital.

Since Winmark's business operates with low expenses and virtually no capital requirements, it can send a lot of profits back to shareholders.

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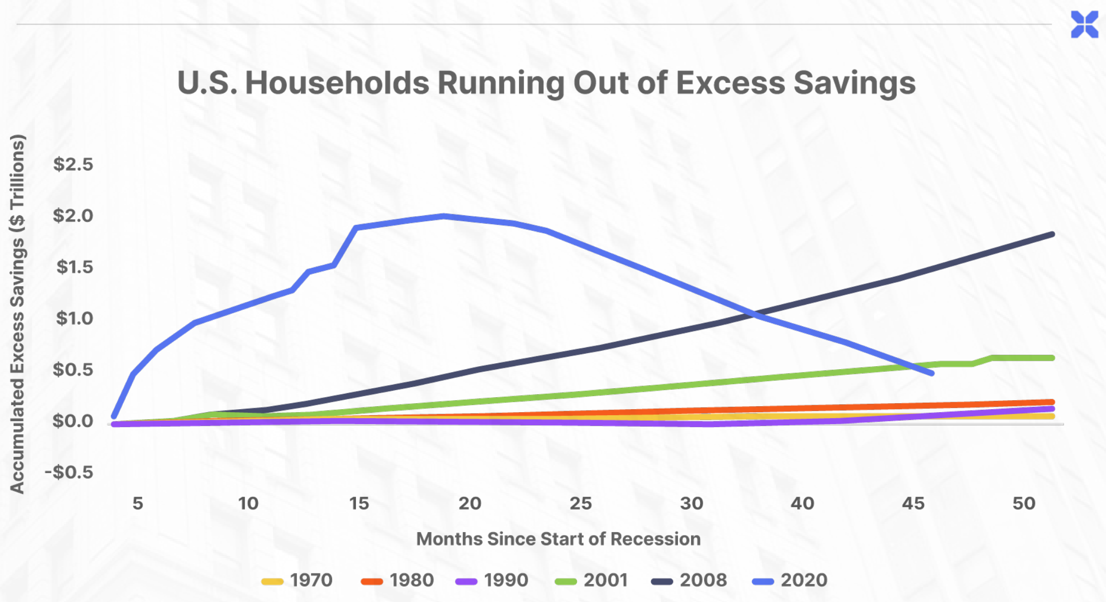
On October 18, Winmark announced a special dividend of $9.40 per share. The payment will be made on December 1 to all investors who own shares on November 15. Plus, shareholders will also receive Winmark's $0.80 regular quarterly dividend at the same time. After these payments, Winmark will have sent a total of $16.20 in dividends to shareholders since our initial recommendation on September 16, 2022. That reflects 7.4% of income generation relative to our original recommended buy price of $218.96.

Winmark's resale model is the ultimate recession-proof business. When consumer incomes drop, shoppers turn to cheaper alternatives, like Winmark's reused goods.

As stress builds in the consumer and cracks begin to show in the economy, we expect Winmark will continue thriving. Recent data points indicate this process could already be underway.

The chart below shows the excess savings consumers built up during the COVID-era stimulus bonanza are dwindling:



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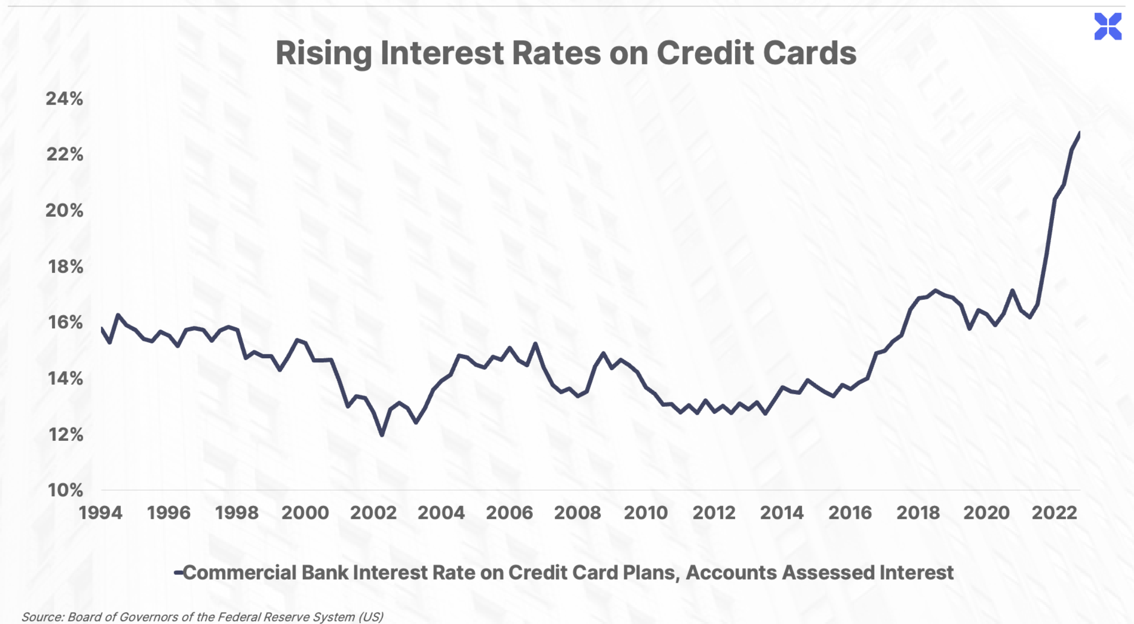
With excess savings running dry, consumers have been forced to buy on credit. U.S. consumers now carry a record $1 trillion in credit card balances, up $300 billion in just two years. Meanwhile, higher interest rates have made that debt much more expensive. The average annualized interest rate on American credit cards is a record 21%, up from 15% in late 2021:



This is on top of a record amount of auto loans, student debt, and personal loans. The toxic brew of record debt and higher interest rates is causing delinquencies to rise.

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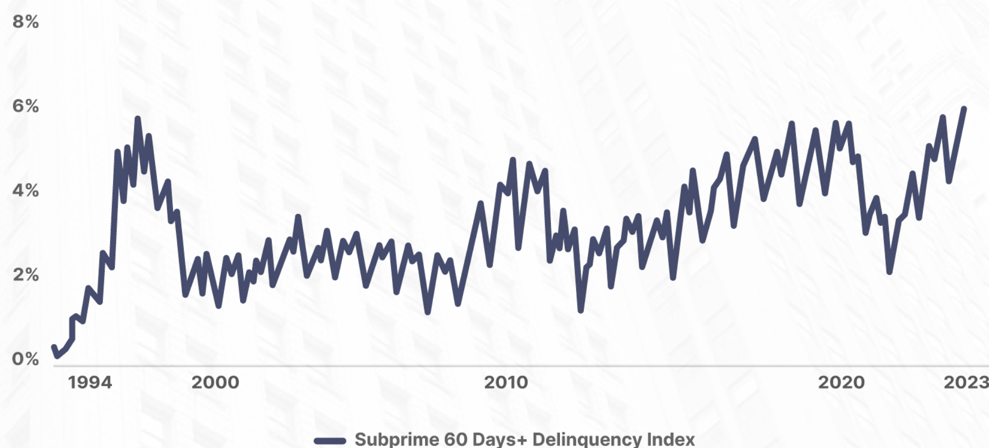
Credit card delinquencies have more than doubled since the Federal Reserve started raising rates in November 2021. Meanwhile, auto loan delinquencies have risen to 30 year highs:



Source: Fitch Ratings

Consumer distress is building, despite unemployment near all-time lows of just 3.8%. As the economy weakens further and job losses mount, we expect a tidal wave of defaults that will throw the economy into a **deep recession**.

Winmark's business is built to thrive during these kinds of environments. During the Great Financial Crisis, Winmark grew revenues 14% in 2008. We expect the company will shine once again through the upcoming crisis.

We recommend holding shares of Winmark (WINA).

The Golden Opportunity in Distressed Debt

On October 11, world-renowned distressed-debt investor Howard Marks pounded the table on the opportunities he's finding in credit markets.

In a public memo to clients of his firm Oaktree Capital Management, Marks details the "sea change" in financial markets that has dramatically shifted the risk/reward proposition in favor of debt over equities.

Specifically, he says how the prior decade of suppressed interest rates created a boon for stocks and a dearth of opportunities for debt investors. Today's "higher

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for longer" interest rate environment has flipped this prior regime on its head. Higher borrowing costs will crimp corporate cash flows, and introduce significant risks in today's richly-priced stock market. At the same time, the highest interest rates in 15 years has created a bargain hunter's paradise in the credit markets.

Marks points out that investors can now get "equity-like returns" in the debt market, while taking on less risk. These credit instruments include things like corporate bonds currently yielding over 8.5% and leveraged loans yielding 10%. Marks also notes in his memo that private loans offer "considerably higher" yields than 10%.

Portfolio holding **Oaktree Specialty Lending Corporation (Nasdaq: OCSL)**, a subsidiary of Mark's Oaktree Capital Management, is capitalizing on these higher yielding private loans.

Recall from our **original recommendation** in March 2023, OCSL makes loans to "middle-market" companies. These are private businesses with enterprise values (i.e., the sum of equity and debt) ranging between $100 million and $750 million. Because private companies aren't required to report the same level of disclosure as public companies, they are considered higher risk, and must pay higher rates to issue debt. For investment firms like OCSL, with expertise in analyzing the risks of these private companies, that creates an opportunity to generate higher yields from private market loans.

As of the end of Q2, the weighted average yield on OCSL's debt portfolio was 12.3%. That's how OCSL can afford to pay investors a juicy 11.6% dividend yield.

The best part is that these loans can come with substantially less risk compared with investing in stocks. Stockholders sit at the bottom of the "capital stack," which refers to the different layers of capital invested into a company. When a company runs into trouble, investors at the bottom of the capital stack take on losses before the next layer up becomes impaired.

This means a company can do things like suspend the stock dividend when times get tough. Bonds, on the other hand, sit above equity holders in the capital stack. They must get paid back, with interest, or else the company defaults.

And even during a default scenario, common equity holders are first in line to take losses. Bond holders sit above equity holders, and before they lose a dime, the equity must first get wiped out completely. That's why in a typical default scenario, equity holders often lose everything, whereas bondholders tend to secure at least a partial recovery of their capital.

But that doesn't make all loans less risky. The key lies in separating the quality borrowers from the hidden land mines. Oaktree's track record is second to none in this regard, thanks to Marks's conservative investment approach. We can see evidence of this in OCSL's portfolio, including the following key data points:

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- No single investment makes up more than 5% of OCSL's portfolio, insulating investors against an unexpected problem with any single company.
- 86% of OCSL's portfolio is allocated to floating rate loans. This means the yield on the majority of OCSL's assets move higher along with rising benchmark interest rates. Unlike many debt investors that have suffered losses from rising interest rates, OCSL has positioned itself to generate higher income from today's higher interest rate environment.
- 76% of the OCSL's assets are allocated to first lien secured loans. A lien is a specific claim on collateral, which secures the value of the loan in the event of default. The "first" in "first lien" means that the debt sits at the top of the capital stack, meaning it gets repaid first in bankruptcy. By allocating the majority of its capital into loans at the top of the capital stack, OCSL's portfolio comes with a healthy margin of safety against default risk.

This conservative portfolio mix, with a heavy emphasis on the most secure part of the capital structure, makes sense in today's environment. Oaktree sees the same risks that we see in today's markets. The company is well positioned with plenty of dry powder to buy assets at even more attractive prices as distress begins to mount in the economy and financial markets.

Finally, it's worth nothing that Marks typically shies away from pounding the table on big macro calls. But when he does, investors should pay attention. During the Great Financial Crisis, for example, Marks wrote the following note to clients of his firm Oaktree Capital Management:

> *"Unless the second Great Depression lies ahead, today's purchases should produce substantial returns, and in a few years we'll reminisce together about how easy it was to take advantage of the bargains of 2008-09."*
> - **October 6, 2008**

Marks' capitalized on the 2008 crisis by investing more than $6 billion between September 18, 2008, and year-end 2008. This contrarian approach has made Mark's Oaktree one of the world's largest and most successful distressed debt funds.

Today, Marks is once again drawing attention to the bargains available in the credit market. We expect Oaktree's investors, including OCSL shareholders, will prosper from partnering with one of the world's greatest debt investors in this environment. And the numbers demonstrate why.

Over the long run, the overall stock market generates a roughly 8% to 10% compounded rate of return. OCSL offers equity-like returns with its 12% yield, but with an extra margin of safety over investing in common stocks.

We're up 7.7% since first recommending OCSL in March, and our advice remains the same.

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We recommend buying shares of Oaktree Specialty Lending Corporation (OCSL) up to $22 per share.

Note to Readers

For investors interested in further distressed-debt recommendations, our Partners have full access to *Porter & Co. Distressed Investing*, a monthly advisory overseen by credit-legend Martin Fridson. If you're not a *Partner Pass* member and would like to learn more, **click here**.

Mailbag

In *The Big Secret on Wall Street* mailbag, Porter answers letters from readers. He cannot offer individual investment advice, but can respond to general questions.

Please email us at **mailbag@porterandcompanyresearch.com** to have your questions answered. We'd love to hear from you!

Today's first letter is from J.F. who writes:

> *Porter's "A Letter to My Son" is excellent and astute. I enjoyed reading it very much. Porter used the age range from 17 to 60 in the letter. Do you think you could get Porter to write a hypothetical letter to his son if he was 60 and said, "Dad, I kept your letter all these years but I did not follow your advice." Do you have any suggestions or advice at this point?*
>
> **Porter's comment: Thank you for the kind words.**
> **Many retirees find themselves in the same situation. If my son were in this position, I would start by telling him what not to do.**
>
> **When starting from behind, the common temptation is to swing for the fences in speculative trades, hoping to strike it rich and make up for lost time. But in my experience, there's no quicker path to financial ruin than trying to get rich quickly.**
>
> **The truth is, regardless of whether you're just starting a new portfolio or you're managing a multibillion-dollar one, the same timeless investment principles I've preached for decades apply the same. Buy the best businesses in the world at reasonable prices, and wait.**
>
> **It's never too late to begin accumulating shares of world-class businesses that can grow your wealth at 15% to 20% per year. The key is to just get started, and let the math of compounding start working in your favor.**
>
> **As the old proverb goes, "The best time to plant a tree was 20 years ago. The second best time is now."**

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> **If the market is overpriced and the macroeconomic risks are high, as they are today, then just waiting is the right approach. The good news today is that waiting pays. Short-term U.S. Treasuries offer yields in excess of 5% with zero risk. In the meantime, get your shopping list ready. At some point in the next 12 to 18 months, we expect a bargain hunting opportunity of a lifetime.**

Our next letter also comes from J.F., who writes:

> *Will Porter be able to provide to his Porter & Co. subscribers a video of the speech he gave at the Stansberry Research conference?*
>
> **Porter's comment: We can't share the video from Stansberry Research's Alliance Conference in Las Vegas, but it's virtually the same presentation that I gave at our Porter & Co. conference one week before.**
>
> **Our team is processing the video of the talk I gave at the Porter & Co. conference now, and we will have it ready by next week to share with The Big Secret on Wall Street subscribers, as well as our Elite and Partner Pass members.**

Porter Stansberry

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Stevenson, MD

P.S. If you'd like to learn more about the Porter & Co. team – all of whom are real humans, and many of whom have X (formerly Twitter) accounts – you can get acquainted with us **here**. You can reach me (Porter) personally via:

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