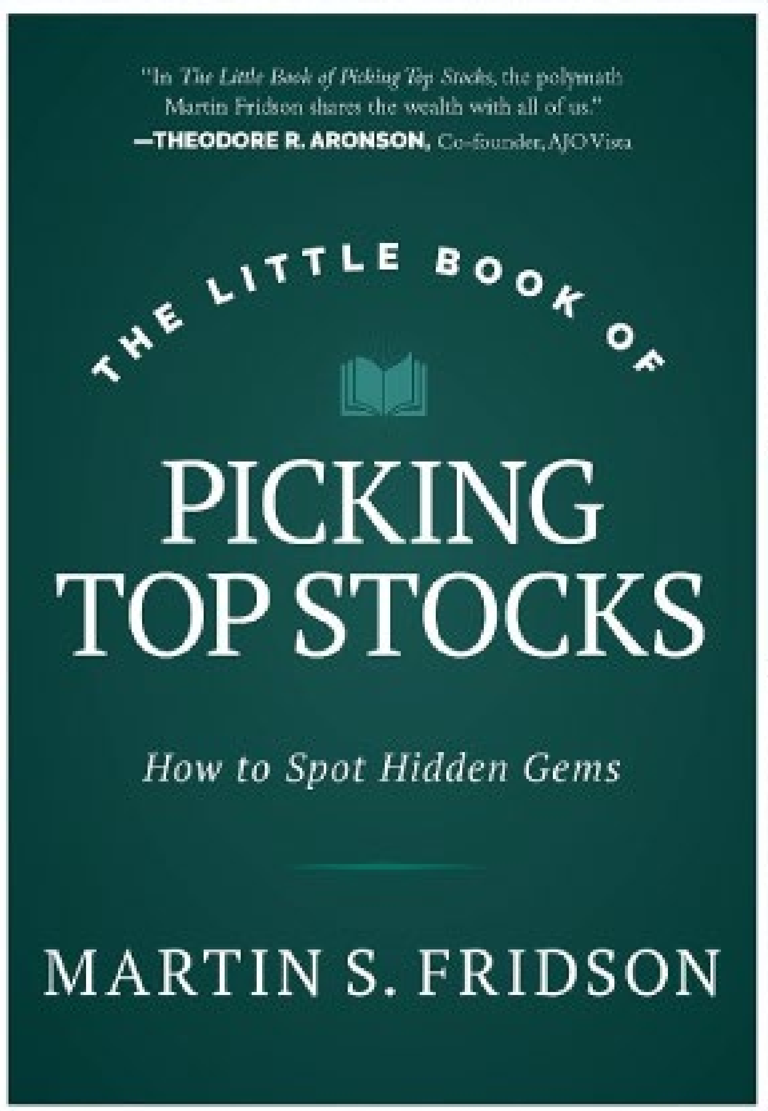
SPECIAL ISSUE

THE BIG SECRET ON WALL STREET

EXCLUSIVE ACCESS TO CHAPTER 5: BEGIN YOUR ASSAULT ON THE SUMMIT!

SPECIAL PREVIEW OF



FROM THE DESK OF PORTER STANSBERRY

Porter & Co.

The Little Book of Picking Top Stocks: Chapter Five

Marty Fridson's Formula for Stock Picking...

Plus a Look at 10 Years of Market-Beating Equities

Are you ready to satisfy that speculative urge so that it doesn't infect the primary objective of investing prudently for your children's education and your retirement?

Perhaps you like to talk about stocks with your friends and crow about the ones that worked out profitably for you. If so, you and your pals might want to create a pool on next year's #1 S&P 500 stock. Or maybe your motivation is that you just enjoy matching your wits against the market.

Whatever form your investment thrill-seeking takes, trying to pick the top performer can be a fairly harmless outlet – though it's prudent to devote only a small slice of your portfolio to speculative investments. Meanwhile, the research you devote to the quest can pay solid dividends in the form of learning about what makes stocks excel.

Gaining a fuller understanding of the market isn't the only way you can come out a winner, even if you don't succeed in picking the top stock. If your choice ends up "only" finishing in the top five, you'll probably still be a pretty happy camper. Between 2012 and 2021, the #5 stock in the S&P 500 delivered a total return in the range of 57% to 141%.

Heck, even landing in the top tenth of the index isn't too shabby. Returns on the #50 stock ranged from 20% to 71%. And that worst outcome, 20% in 2018, was a home run in the context of a -8% return on the S&P 500 as a whole.

You just have to keep in mind that the best candidates for #1 are prone to surprises. They come in two flavors. One of them is the negative kind. If you're on the receiving end of that kind of surprise, the stock you picked could wind up near the bottom of the rankings. That's why you shouldn't risk more than a small piece of your portfolio on the idea.

If you're game, here's a recap of the characteristics to look for in making your selection for next year's #1 S&P 500 stock. (See "Tipoffs to Top Stocks" for details of the calculations.)

> *Note: Using earnings per share ("EPS"), the Fridson-Lee statistic (defined in detail earlier in this book) is calculated as (Highest Analyst EPS Estimate min Lowest Analyst EPS Estimate) divided by Lowest Analyst EPS Estimate.*

Choose a stock with all of the following statistical characteristics:

- Price volatility over the previous year at least 1.5 times as great as the stock that ranked #250 by total return
- Fridson-Lee statistic (a measure of dispersion in analysts' EPS estimates) of 18% or greater
- Bond ratings of Baa3 or lower by Moody's and BBB- or lower by Standard & Poor's
- Market capitalization equivalent to 80% or less of the market capitalization of the stock that ranked #250 by total return in the previous year (some #1 stocks have been exceptions to this one)

Look for one or more of the following qualitative characteristics:

- Outside pressure for change
- Dynamic technology
- Signs of potential credit quality improvement (not including bond rating agencies' outlooks)
- Dominant competitor

You now have the blueprint for a different way of viewing stocks than you've read about anywhere else. If you're intrigued by the challenge of picking next year's best performing S&P 500 stock, these principles will focus your search on the premier candidates. Equity reports from Wall Street and independent research organizations can help you identify companies with the qualitative characteristics that strengthen the case for a stock.

Go forth with the motto, *E pluribus unum*: Out of many (500, to be precise), one. After all, why shouldn't you be among the ~~lucky~~ smart investors who own the highest-return stock in the index?

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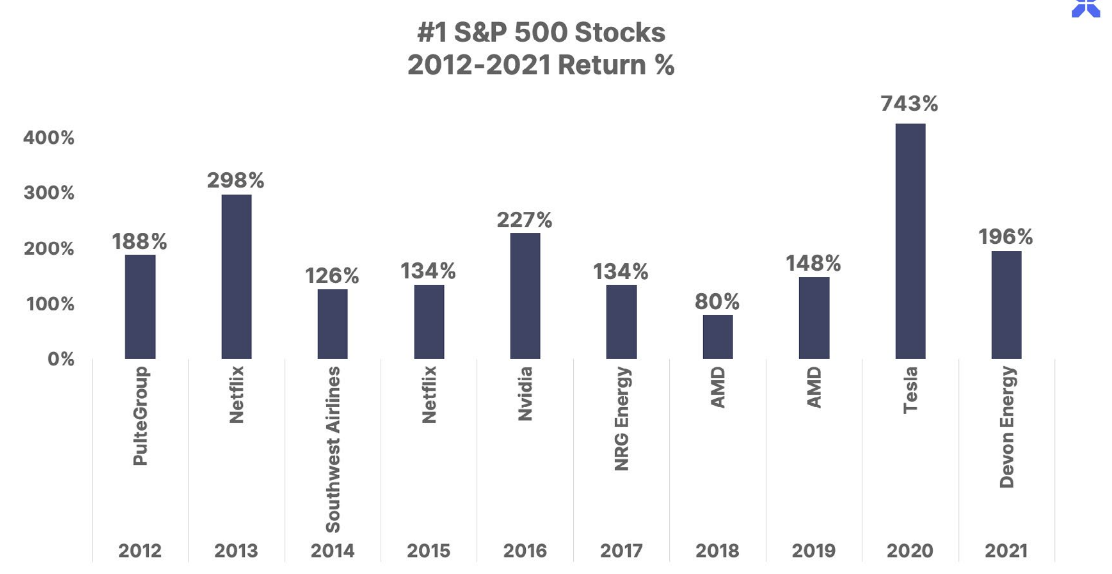
What the Top Stocks of the Past Decade Had in Common

This book takes a look at the #1 stock by total return in the S&P 500 for each year in the decade ending 2021, whose decidedly outsize returns ranged from 80% to 743% (median 168%). The chart below lays them out in a single graphic.



Source: Bloomberg | Note that Tesla returned 743% in 2020.

Most of them had four factors in common – factors from which I've derived the "Top Stocks" criteria discussed above.

1. They were not steady-as-she-goes stocks. Their price volatility was at least 1.5 times as great as that of the preceding year's #250 stock (as measured by total return).
2. Analysts' opinions varied widely. Their Fridson-Lee Statistic was 18% or higher. Definition of Fridson-Lee Statistic: (Highest EPS Estimate minus Lowest EPS Estimate) divided by Lowest EPS estimate.
3. They did not have especially strong credit ratings. Their bonds were rated Baa3 or lower by Moody's or BBB- or lower by Standard & Poor's.
4. They weren't among the largest stocks. Their market capitalization was 80% or less of the #250 stock (This last criterion has not applied in every single case.)

In addition to these measurable characteristics, most of these stocks also displayed "softer" – but still salient – qualities like activist activity, new products coming to market, and so on.

For example, prominent activist investors Elliott Investment Management and Bluescape Energy Partners helped persuade 2017 #1 NRG Energy to unlock value by cutting costs and moving toward selling the company's renewables business. The potential for 2019's top performer to take off was widely recognized by analysts before the year began. Semiconductor producer Advanced Micro Devices delivered on that promise by stealing the show at a Taipei trade show with its newest desktop and server central processing units (CPUs) and with a big design win on Google's streaming videogame service.

Now – one note of clarification. The stocks charted here beat the S&P between 2012 and 2021. Since then (and even since the publication of this book in 2023), the market climate has shifted much closer to recession territory and is now a more challenging environment for equities.

That's not to say that some – or many – of these stocks won't outperform again. In 2024, however, I see just five companies that fit all my "Top Stocks" criteria. I discuss those equities in detail in this **recent article** for *Barron's* (subscription required).

> *Note: This chapter has been slightly revised and expanded for this special issue.*