THE A.I. KEYSTONE

10 COMPANIES YOU SHOULD HAVE SOLD YESTERDAY

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She couldn't outrun the demon.

The 15-year old girl was no match for a seven-foot-tall half-goat, half-man creature wielding a whip. And the other kids around her – screaming and fleeing – were no help.

So the beating began.

This wasn't some medieval cautionary tale. It happened in 2015 at the Krampuslauf festival that is held each Christmas season in Salzburg, Austria… where, tanked up on alcohol, costumed Krampus demons go on the rampage with whips and bundles of stinging birch branches to terrorize naughty kids.

That year, the demons got a little too enthusiastic and crossed the line from PTSD-inducing terror, to all-out, bona-fide corporal punishment.

And the Austrian teenage girl – along with four other young people – ended up in the hospital with injuries ranging from welts to broken bones. "This violence had nothing to do with tradition," the girl's outraged father told reporters.

Actually, though, the violence is kind of the *point* of the tradition…

Krampus, a fearsome Alpine folklore figure who's said to be descended from a Norse god called Hel, somehow got grafted onto Christmas festivities in the seventh or eighth century. Known as the "anti-Santa Claus," he visits right before Christmas to scare naughty children into good behavior. (He's the one who traditionally provides the coal for your stocking.)

In the older legends, though, Krampus does more than just scare children. Swatting with bundled-up branches is a mild punishment. He tosses the truly incorrigible youngsters into his sack and takes them away forever. Sometimes he drowns them. Sometimes he eats them. And sometimes he carts them straight to Hell.

You don't want to be on Krampus' naughty list.

For our last regular *Big Secret* issue before Christmas, we thought it was fitting to honor Krampus with a naughty list of our own: a specially screened list of equities that are headed to financial Hell in 2024. (Our "nice list" of capital efficient stocks can be checked twice **here**.)

These miscreants are heavily-indebted, money-losing companies that are likely to suffer terribly as the **expected recession** arrives – but that will struggle no matter what next year has in store. We invite you to put on your Krampus mask and enjoy the carnage.

The peace and goodwill can come later.

It's Grinch Time

Most investors are downright jolly right now. But it's not just because of the holidays.

Rather, December 2023's Federal Reserve policy meeting ignited hopes that a long-awaited pivot from interest rate tightening to easing is finally here. The futures market is now pricing in as many as six Fed interest rate cuts in 2024… and market participants are suddenly as bullish about stocks as they've been in years.

For example, December 15 saw a massive $20.8 billion flow into the SPDR S&P 500 ETF Trust (SPY) – the largest single-day inflow in the 30-year history of the index-tracking fund.

Likewise, Bank of America's latest Global Fund Manager Survey showed investors are more optimistic about equities than at any time since the previous bull market topped in January 2022.

And new data from the Conference Board, an independent business research group, released on December 12, showed 37.4% of U.S. consumers expect stocks to rise next year – that's the highest percentage since the peak of meme-stock mania in July 2021.

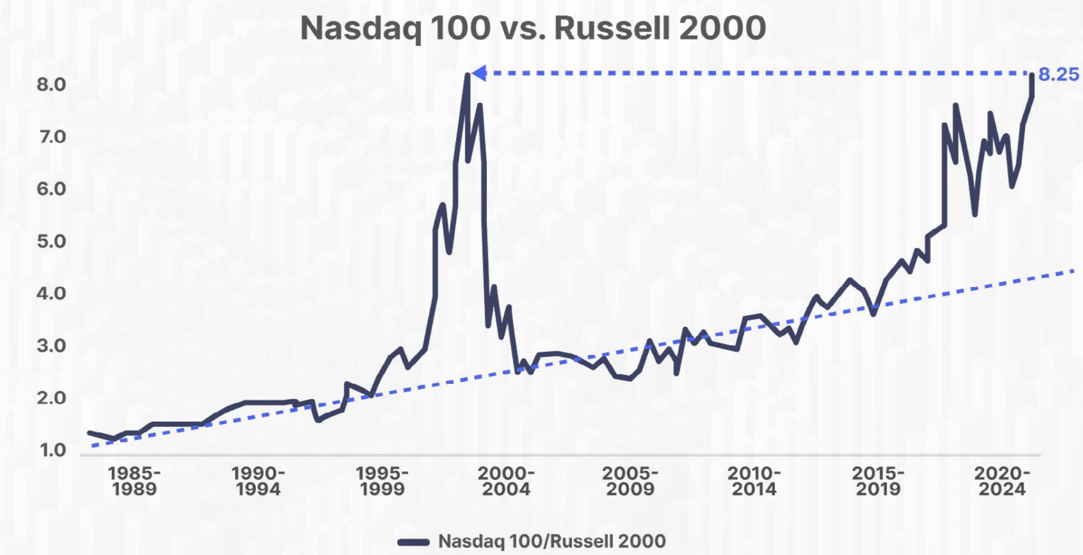
Here at Porter & Co., we're far less upbeat about what's ahead. We continue to believe a recession is likely to begin in 2024. And we've spilled plenty of ink in recent months explaining why…

For starters… **the valuation extremes in large-cap technology stocks have officially exceeded those of the dot-com bubble of 2000.**

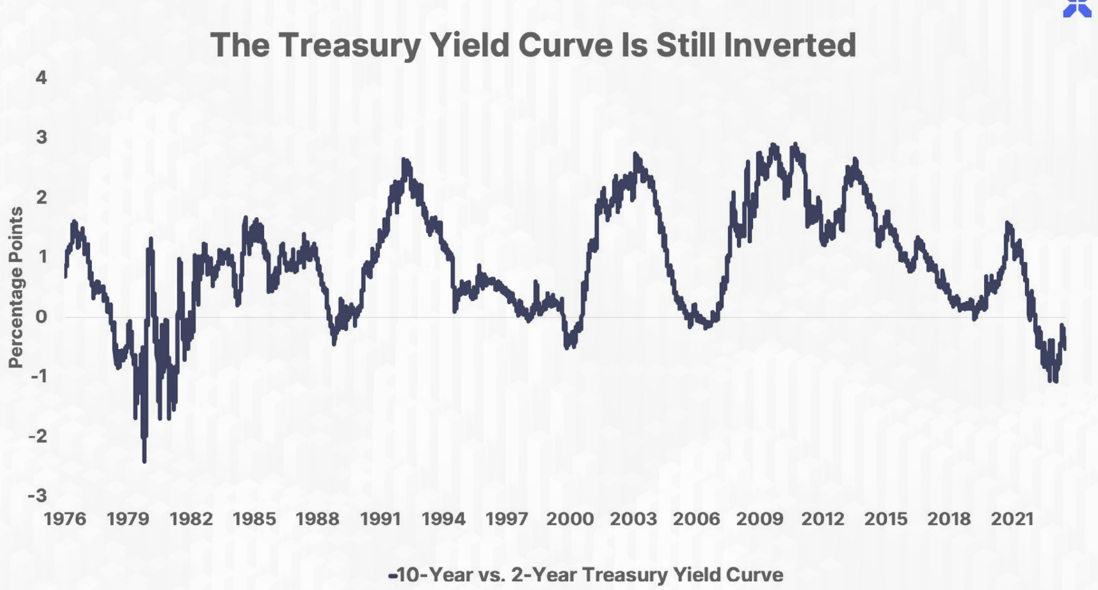
The chart below shows the relationship between the biggest tech stocks (represented by the Nasdaq 100 Index) and the smallest listed U.S. stocks (represented by the Russell 2000) over the last 25 years.

During the dot-com bubble's peak, the Nasdaq 100/Russell 2000 ratio hit 8.1 – meaning the large-cap tech index traded at 8.1 times the value of the small-cap index.

Today, tech stocks are trading at 8.2 times the value of the Russell 2000…



We've noted that **the U.S. Treasury yield curve has been deeply inverted for over a year now.** This phenomenon – which occurs when long-duration Treasury yields trade below short-duration yields – has a perfect track record at predicting recessions since at least World War II…

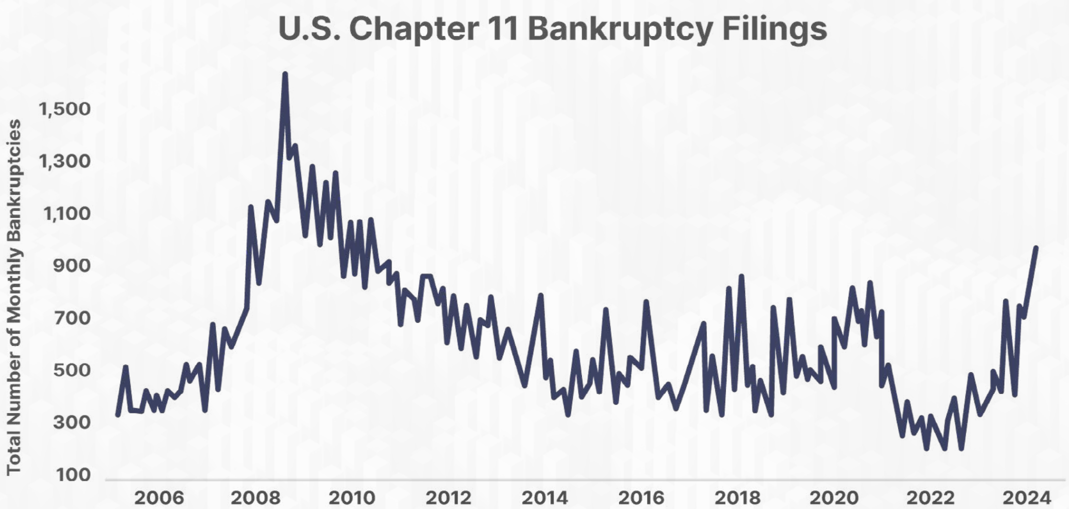


Source: St. Louis Fed

We've also pointed out that **M2 (a measure of broad money supply) has been contracting for the first time in over 70 years**. Each time this has happened – dating back to the Civil War – double-digit unemployment and a Depression have followed soon after...

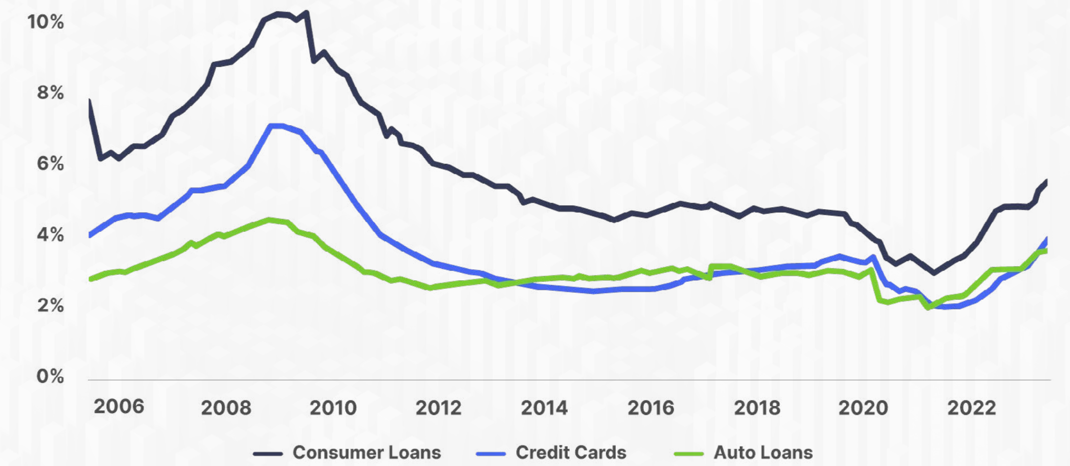
Source: Federal Reserve, Goldman Sachs Research

And we've shown that crippling levels of debt are beginning to weigh on the economy, as **corporate bankruptcies** and **consumer delinquencies** gradually tick higher...



Source: *Variant Perception*

Delinquencies by Type of Debt, 2006-2023



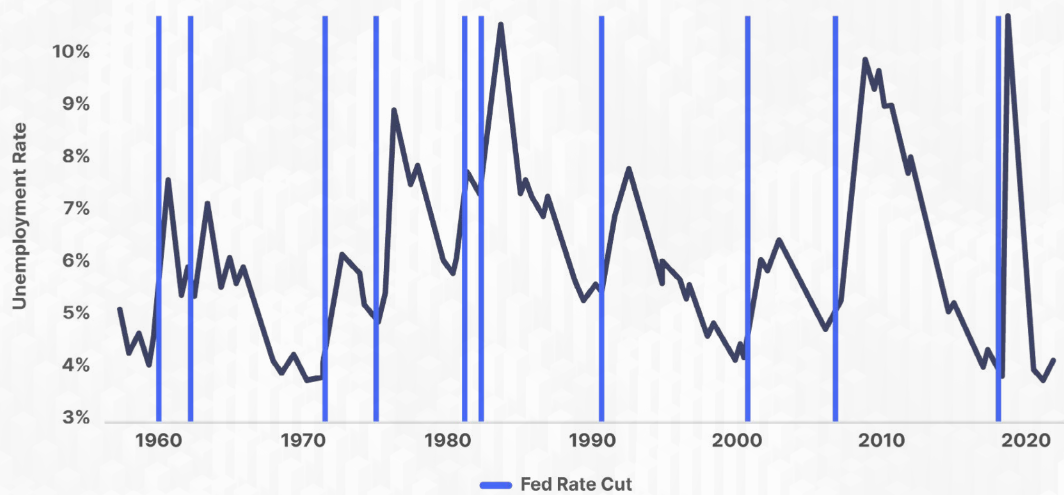
Source: Equifax/Moody's Analytics

The apparent end of the Fed's aggressive tightening cycle hasn't changed our view. In fact, it has only strengthened it.

Contrary to popular opinion, history suggests a Fed pivot – from hiking rates to cutting rates – is anything but positive for stocks or the economy.

Since 1950, the vast majority of Fed cutting cycles have preceded – within a few months on average – a dramatic rise in the unemployment rate.

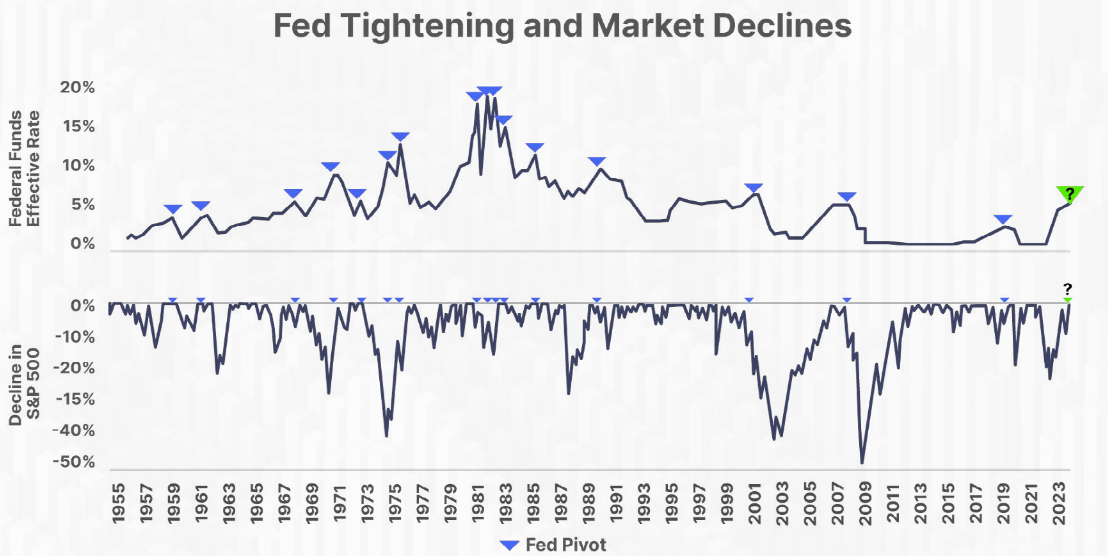
Unemployment Rate 1995-2023



Source: FRED

Similarly, Fed pivots toward easing have also historically coincided with significant stock market declines.

These declines have been particularly severe following aggressive tightening cycles when inflation has been high, stock market valuations have been extreme, and corporate and consumer debt burdens have been elevated – all of which are true today.



Source: Michael A. Gayed, CFA

These "Naughties" Are in Trouble No Matter What Happens Next

The coming recession is likely to present tough conditions for even the highest-quality companies.

This is why we've been extremely selective with new additions to the Big Secret portfolio this year... and why we have created a healthy **watchlist** of stocks to buy when prices get cheap. All along, we have urged readers to be disciplined about investing only in those stocks they can purchase at reasonable valuations.

However, in the spirit of the holiday, we've also identified a list of stocks that are likely to suffer the most in the coming downturn – what we're calling Porter & Co.'s "Naughty List."

10 Companies You Should Have Sold Yesterday

Company	Ticker	Sector	Market Cap	Total Debt	Cumulated Net Income Over Last Three Years	Cumulated FCF Over Last Three Years	Trailing 12-Month Interest Expense
Boeing	BA	Aerospace & Defense	$158,673	$52,272	-$19,756	-$4,897	$2,491
Carnival	CCL	Hotels, Restaurants & Leisure	$24,167	$32,629	-$15,620	-$13,575	$2,047
Carvana	CVNA	Specialty Retail	$10,974	$6,444	-$1,221	-$4,265	$620
Sunnova Energy International	NOVA	Independent Power and Renewables	$1,819	$7,201	-$618	-$3,623	$264
Rivian Automotive	RIVN	Automobiles	$22,751	$3,413	-$15,704	-$13,600	$180
Alnylam Pharma	ALNY	Biotechnology	$22,831	$1,309	-$2,530	-$1,389	$120
Kyndryl	KD	IT Services	$4,533	$4,178	-$4,205	-$960	$115
BioCryst Pharma	BCRX	Biotechnology	$1,180	$845	-$656	-$438	$110
BridgeBio Pharma	BBIO	Biotechnology	$6,590	$1,735	-$1,639	-$1,438	$81
Insmed	INSM	Biotechnology	$4,041	$1,197	-$1,582	-$1,269	$77

Source: Bloomberg

To identify the stocks on this list, we started with the Russell 3000 – a broad index of roughly 3,000 stocks representing 98% of the investable U.S. market by capitalization, including all large-cap, mid-cap, and small-cap U.S. stocks, along with some microcaps.

We then filtered for those that owe money to creditors (i.e., that have some amount of total debt outstanding) and that are required to make regular annual payments on that debt to avoid default.

Finally, we screened for those companies with the largest negative earnings (cumulated net income… or loss, in this case) and largest negative free cash flows (cumulated FCF) over the past three years. This is a short enough time period to be current, but long enough to ensure we don't flag healthy companies suffering a temporary hiccup.

The individual circumstances of these companies vary widely…

Some are household names – such as **aerospace and defense firm The Boeing Company (BA)**, cruise-line operator Carnival (CCL), and online automotive retailer Carvana (CVNA).

A post-Christmas update: On January 5, 2024, the plug covering an emergency door blew off during a brand-new Boeing 737 Max 9 at 16,000 feet. In the wake of the accident, the Federal Aviation Administration ("FAA") grounded over 170 of Boeing's 737 Max 9 fleet, citing loose hardware and a need for more inspections. In the meantime – just as we predicted a year ago – BA stock depressurized even faster than the jet cabin, losing about 9% between January 8 and 9, the first two trading days after the plug blew off the plane.

Most are cash-burning "growth" companies that have rarely (if ever) turned a profit.

But all the companies on this list currently have two critical problems in common...

They have significant debt burdens, and they don't earn enough cash (over and above operating costs) to cover even the interest on those debts today.

In fact, these companies don't currently "earn" anything. Each has posted significant net losses or has otherwise hemorrhaged cash over the past few years.

This combination represents a potentially existential threat in any scenario, let alone a severe economic downturn. However, it's important to note that these companies are already struggling – despite their still-historically-low financing costs – before going into a recession.

That's unlikely to change even if the economy somehow avoids a hard landing in the year ahead. And importantly, because many of these companies financed their current debt at the record-low interest rates of the past decade, these problems are likely to worsen as these debts come due at today's higher rates, even if borrowing costs move lower from where they are now.

In other words, many of these stocks could be a "zero" – meaning equity investors are likely to be wiped out through default or reorganization – regardless of what comes next.

We urge investors who own any of these "naughties" to consider selling them soon. And though we at Porter & Co. generally don't recommend shorting stocks, several of the names on this list could be strong candidates for investors looking to hedge.

Of course, recessions and major downturns in stock prices are also what every long-term investor should hope to see. These are made-to-order opportunities to buy the very best businesses at substantial discounts...