



## December 2024: Featured Stock from our Most Dangerous Stocks Model Portfolio

With market melting down, now is time for real due diligence on stocks. Tough times get us just as excited as good times because we are prepared.

In our recent training, [The AI-Powered Edge: Your 2025 Investment Playbook](#), we showed how our superior fundamental research gives investors an edge (you cannot get anywhere else) in any market.

Picking winners is only half the battle. Just blow up in your portfolio could wipe all your juicy 2024 gains. You do not have to take that risk. Let us prove it to you with a free stock pick.

Avoiding the big losers is exactly what our Most Dangerous Stocks Model Portfolio aims to help investors do. By understanding the true profits of a business, coupled with rigorous analysis of a stock's valuation, this Model Portfolio identifies companies that are vastly overvalued and hold large downside risk. The results speak for themselves: the Most Dangerous Stocks Model Portfolio outperformed shorting the S&P 500 and Russell 2000 (combined) by 16% year-to-date through 3Q24.

Today, we're giving you a free stock pick. We are sharing this month's featured stock for our Most Dangerous Stocks Model Portfolio.

This feature provides a concise summary of how we pick stocks for this Model Portfolio. It is not a full Danger Zone report, but it gives you insight into the rigor of our research and approach to picking stocks. Whether you're a subscriber or not, we think it is important that you're able to see our research on stocks on a regular basis. We're proud to share our work.

We update this Model Portfolio monthly. December's [Most Attractive](#) and [Most Dangerous](#) stocks Model Portfolios were updated and published for clients on December 4, 2024.

### Free Featured Stock: Xylem Inc. (XYL)

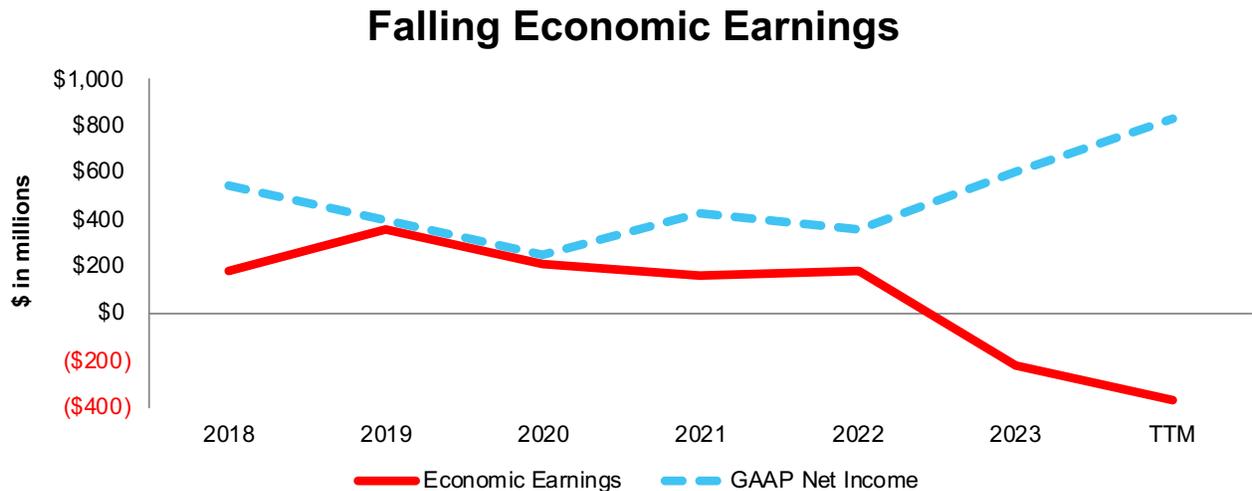
Xylem Inc. (XYL: \$121/share) is the featured stock from December's Most Dangerous Stocks Model Portfolio.

Xylem's net operating profit after tax ([NOPAT](#)) margin fell from 12% in 2018 to 10% in the TTM while the company's [invested capital turns](#) fell from 0.8 to 0.6 over the same time. Falling NOPAT margins and invested capital turns drive Xylem's return on invested capital ([ROIC](#)) from 10% in 2018 to 6% in the TTM.

Xylem's [economic earnings](#), the true cash flows of the business, which take into account changes to the balance sheet, fell from \$179 million in 2018 to -\$370 million in the TTM. Meanwhile, the company's GAAP net income rose from \$549 million to \$830 million over the same time. Whenever GAAP earnings rise while economic earnings decline, investors should beware.



**Figure 1: Xylem’ Economic vs GAAP Earnings Since 2018**



Sources: New Constructs, LLC and company filings

**XYL Provides Poor Risk/Reward**

Despite its poor and declining fundamentals, Xylem’s stock is priced for significant profit growth, and we believe the stock is overvalued.

To justify its current price of \$121/share, Xylem must improve its NOPAT margin to 15% (equal to best-ever NOPAT margin) and grow revenue by 13% (compared to 8% over the last decade) compounded annually through 2033. In this [scenario](#), Xylem grows NOPAT 18% compounded annually to \$2.8 billion in 2033. We think these expectations are overly optimistic, especially considering the company’s NOPAT has grown just 6% compounded annually over the last five years.

Even if Xylem improves its NOPAT margin to 12% (above five-year average NOPAT margin of 11%) and grows revenue 10% compounded annually through 2033, the stock would be worth no more than [\\$81/share today](#) – a 33% downside to the current stock price.

Each of these scenarios also assumes Xylem can grow revenue, NOPAT, and FCF without increasing working capital or fixed assets. This assumption is unlikely but allows us to create best case scenarios that demonstrate the high expectations embedded in the current valuation.

**Critical Details Found in Financial Filings by Our [Robo-Analyst Technology](#)**

Below are specifics on the adjustments we made based on Robo-Analyst findings in Xylem’s 10-Qs and 10-Ks:

**Income Statement:** we made over \$430 million in adjustments, with a net effect of removing over \$130 million in [non-operating expenses](#). Professional members can see all adjustments made to Xylem’s income statement on the GAAP Reconciliation tab on the Ratings page on our website.

**Balance Sheet:** we made over \$6.3 billion in adjustments to calculate invested capital with a net decrease of over \$4.0 billion. One of the most notable adjustments was for [deferred tax assets](#). Professional members can see all adjustments made to Xylem’s balance sheet on the GAAP Reconciliation tab on the Ratings page on our website.

**Valuation:** we made around \$3.8 billion in adjustments to shareholder value with a net decrease of over \$2.6 billion. The most notable adjustment to shareholder value was for [total debt](#). Professional members can see all adjustments to Xylem’s valuation on the GAAP Reconciliation tab on the Ratings page on our website.

*This article was originally published on [December 19, 2024](#).*

*Disclosure: David Trainer, Kyle Guske II, and Hakan Salt receive no compensation to write about any specific stock, style, or theme.*

*Questions on this report or others? Join our [online community](#) and connect with us directly.*



## *It's Official: We Deliver 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. The stock market is missing footnotes – and only we have that critical data.
2. Legacy fundamental datasets suffer from significant inaccuracies, omissions, and biases.
3. Our proprietary drives novel alpha. Our measures of [Core Earnings](#) and [Earnings Distortion](#) materially improve stock picking and forecasting of profits.

### **Best Fundamental Data in the World**

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, 1<sup>st</sup> 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, 2<sup>nd</sup> para.

### **Superior Models**

Ernst & Young 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, 5<sup>th</sup> 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, 2<sup>nd</sup> para.

### **Superior Stock Ratings**

Robo-Analysts’ stock ratings outperform those from human analysts as shown in this [paper](#) from Harvard Business School. 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, 3<sup>rd</sup> para.
- “Our results ultimately suggest that Robo-Analysts are a valuable, alternative information intermediary to traditional sell-side analysts.” – pp. 20, 3<sup>rd</sup> 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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