Corporate Buybacks Artificially Inflated Stock Prices to Bubble Levels

By Stephen Lendman
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For many years on Wall Street, stock prices and true valuations diverged sharply — according to a Sanford Bernstein report.

When companies spend billions of dollars on earlier issued stock, their valuations are artificially inflated.

It's one of the performance metrics used to determine executive compensation comprised of salaries, bonuses and stock options, including for directors.

According to Investopedia, bonuses linked to performance encourage executives to work harder for shareholders that includes themselves.

Stock options encourage short-term performance, including by manipulating numbers to meet targets.

When CEOs ask finance executives how profits look for the current quarter, the response is likely to be how much do you want?

When stock valuations rise, executives profit greatly, giving them an incentive to elevate them artificially.

Investopedia: "Worse still, the incentive to keep the share price motoring upward so that options will stay in the money encourages executives to focus exclusively on the next quarter and ignore shareholders' longer-term interests."

"Options can even prompt top managers to manipulate the numbers to make sure the short-term targets are met."

On Monday, Bloomberg News headlined: "The No. 1 Source of Stock Demand Is a Goner, for Years to Come," saying:

According to Sanford Bernstein (SF), the biggest driver of higher stock prices for many years is now sidelined because of current economic and market conditions that negatively affect bottom line performance.

Because sales and profits are down, companies are less able to issue high-yield debt that enables them to buy back stock that inflates valuations.

SF believes buybacks could become "socially unacceptable" though it's too soon to tell.

"For at least several years, buybacks will be severely curtailed," SF predicts, adding:

Stocks will “unlikely return to their pre-crisis valuation multiples” any time soon.

For at least the past five years, buybacks added up to 1.5% to earnings-per-share growth, boosting their price that’s unrelated to true value based on performance.

Further, “(a)s governments take a larger role in economies, this could turn the tide away from shareholders-first views of economies for some time.”

“Government’s role in financial markets cannot just be packed back into the box once this is all over.”

“The absence of risk-free instruments that can deliver positive real return and at least a risk of higher inflation further bolster the case for gold.”

Buybacks were the key driver behind rising markets since the 2008-09 financial crisis.

According to S&P Dow Jones Indices, around $730 billion were spent on buybacks last year alone. In 2018, a record $806 billion was spent, fueled by the great 2017 GOP tax cut heist.

Big business got hundreds of billions of dollars in free money – used mostly for stock buybacks and generous handouts to executives.

Workers got shortchanged. Thousands got pink slips the past two years. Now it’s millions, while handouts to business is elevating the federal deficit exponentially.

The corporate bailout enacted last month is another restraint on buybacks that could be short-or-longer-term.

In return for free government money, corporate recipients are not to use it for buybacks or dividends until one year after borrowed amounts are repaid or written off, the latter option the most likely.

Whether recipients intend following this stipulation is another matter entirely. Hindsight will explain best.

Companies hurt by downturn will be forced to use government and Fed money to stave off bankruptcies and possible shutdowns in some cases.

As in 2008-09 and earlier economic crisis periods, strong companies will likely consolidate to greater size by buying weaker ones at fire sale prices.

SF said in recent days, buybacks “moved from being a purely economic question to an ethical question,” stigmatizing repurchases.

Companies not in need of government bailout help that are cash-strong will likely maintain buybacks, others in weaker condition likely to delay them for years, SF believes.

The Wall Street Journal quoted S&P Dow Jones Indices senior index analyst Howard Silverblatt, saying buybacks are “an endangered species. During bad times, you don’t do discretionary spending.”

Chief market strategist Brian Reynolds of the firm bearing his name said buybacks were the

only net source of money entering the market since the 2008-09 financial crisis.

He estimates that they added about $4 trillion in market valuation since 2009.

The Journal reported that “(i)n the decade through 2019, S&P 500 companies poured $5.29 trillion into buyback programs, according to data from S&P.”

“That was more than double the $2.59 trillion from the (prior) 10 years. Dividends saw a similar increase, nearly doubling to $3.53 trillion from $1.89 trillion.”

Other sources combined “netted out to roughly zero,” said the Journal, citing him, based on the Fed’s quarterly flow of funds reports.

“It’s going to be like riding a bucking bronco in the stock market for the next six months,” Reynolds believes.

The Journal quoted Economics Professor Emeritus William Lazonick, saying:

“Companies that retain and reinvest profits, that have an incentive to build better products, they do better.”

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