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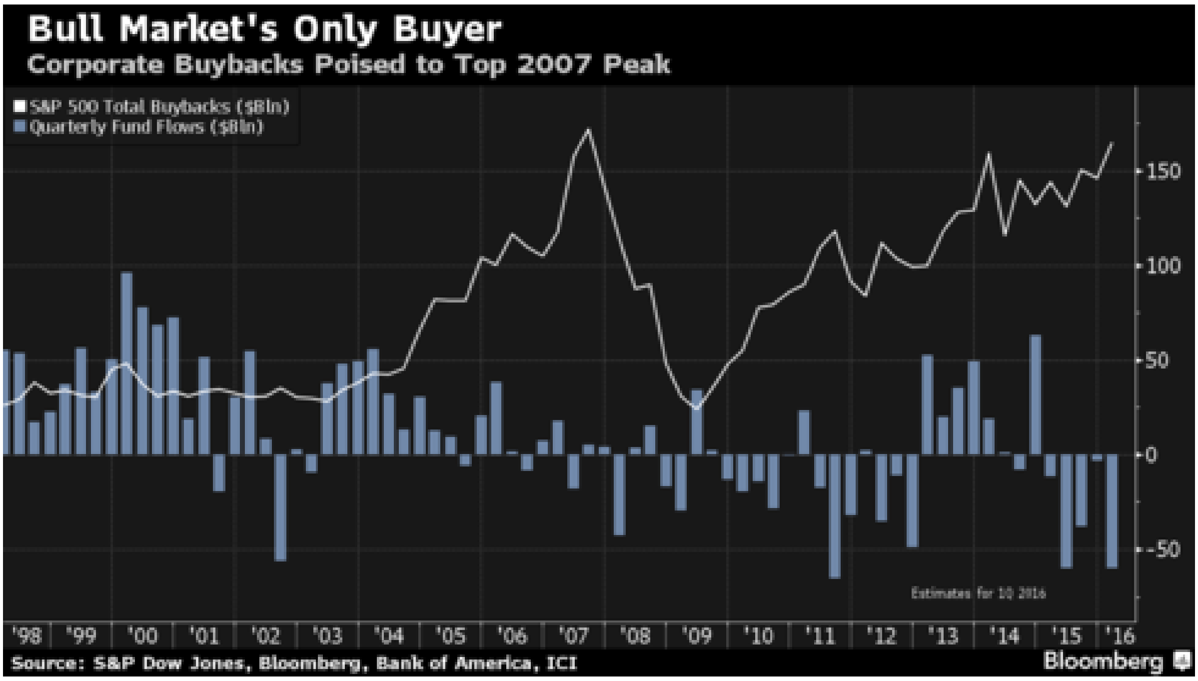
There's Only One Buyer Keeping S&P 500's Bull Market Alive

Demand for U.S. shares among companies and individuals is diverging at a rate that may be without precedent, another sign of how crucial buybacks are in propping up the bull market as it enters its eighth year.

Standard & Poor's 500 Index constituents are poised to repurchase as much as $165 billion of stock this quarter, approaching a record reached in 2007. The buying contrasts with rampant selling by clients of mutual and exchange-traded funds, who after pulling $40 billion since January are on pace for one of the biggest quarterly withdrawals ever.



While past deviations haven't spelled doom for equities, the impact has rarely been as stark as in the last two months, when American shares lurched to the worst start to a year on record as companies stepped away from the market while reporting earnings. Those results raise another question about the sustainability of repurchases, as profits declined for a third straight quarter, the longest streak in six years.

"Anytime when you're relying solely on one thing to happen to keep the market going is a dangerous situation," said Andrew Hopkins, director of equity research at

Wilmington Trust Co., which oversees about $70 billion. “Over time, you come to the realization, ‘Look, these companies can’t grow. Borrowing money to buy back stocks is going to come to an end.’”

Volatile Year

While it’s debatable whether the involvement of retail investors is necessary for stocks to advance, it can’t be disputed that markets have become more turbulent in 2016, with the Chicago Board Options Exchange Volatility Index hovering at an average level that is 32 percent higher than last year. The S&P 500 has posted daily swings of 1 percent or more in 26 of 48 trading sessions since December, a rate that if sustained would make 2016 the most volatile year since 1938.

Seven years of earnings growth has left chief executive officers flush with money to spend. Non-financial companies in the S&P 500 held more than $900 billion of cash on their balance sheets at the end of 2015, up from $870 billion a year earlier.

Companies executing repurchases through Bank of America Corp. have bought about $9 billion of shares in 2016, the second-busiest start to a year since the bull market began in 2009, the bank said in a research note last week. Other trading clients have been net sellers, with hedge funds leading the pack, dumping $3.5 billion.

Record Buybacks

Assuming Bank of America maintains a roughly 8 percent share in the total buyback pool since 2009 and the pace of transactions lasts through the end of March, corporate repurchases may reach $165 billion this quarter, data compiled by Bloomberg show. That would bring the 12-month total above $590 billion, an amount that’s higher than the record $589 billion in 2007.

“Corporate buybacks are the sole demand for corporate equities in this market,” David Kostin, the chief U.S. equity strategist at Goldman Sachs Group Inc., said in a Feb. 23 Bloomberg Television interview. “It’s been a very challenging market this year in terms of some of the macro rotations, concerns about China and oil, which have encouraged fund managers to reduce their exposure.”

Should the current pace of withdrawals from mutual funds and ETFs last through the rest of March, outflows would hit $60 billion. That implies a gap with corporate buybacks of $225 billion, the widest in data going back to 1998.

Kostin said companies tend to enact a blackout period and restrict share repurchases in the month following the end of a calendar quarter, and come back once they've reported results. In a market where everyone else is selling, the ebb and flow of corporate actions have amplified volatility. The S&P 500 slumped 11 percent in the first six weeks of the year before staging a rebound that has since trimmed the drop to about 1 percent. The benchmark gauge slipped 0.1 percent at 4 p.m. in New York.

That companies continue to boost buybacks amid turmoil is a sign of confidence and the stabilization in stocks is likely to draw investors back, according to Joseph Tanious, an investment strategist at Bessemer Trust in Los Angeles, which oversees more than $100 billion.

"I'm willing to bet that after the rally we've had in the last few weeks, fund flows will follow suit," he said. "You might see investors begin chasing that type of performance."

S&P 500 companies have churned out more than $2 trillion of repurchases since 2009, helping sustain a rally where share prices almost tripled. Bolstering the outlook for debt-financed buybacks, credit stress has eased since February, with the extra yield demanded on investment-trade bonds over Treasuries narrowing by 36 basis points.

The growth rate of buybacks is slowing as profits are poised for a fourth quarter of declines. After rising an average 37 percent in the previous five years, repurchases grew less than 4 percent in 2015. During the last two decades, there have been two times when earnings contractions lasted longer than now. Both led companies to slash buybacks, with the peak-to-trough drop reaching an average 62 percent.

While companies haven't started tightening the purse strings yet, there are signs their ability to keep the market aloft is diminishing. Since reaching an all-time high in May, the S&P 500 has lost 5.1 percent and suffered two declines exceeding 10 percent. Companies repurchasing the highest percentage of their shares have fared worse, dropping 9.1 percent.

"It's definitely not sustainable that the only buyer is companies themselves," said Vikas Gupta, Mumbai-based chief investment officer who helps oversee more than $8 billion at Arthveda Capital. "A lot of money needs to come back to the market. I'm just not sure if it's going to happen next week, next quarter or in a year. That's the part that's unclear."