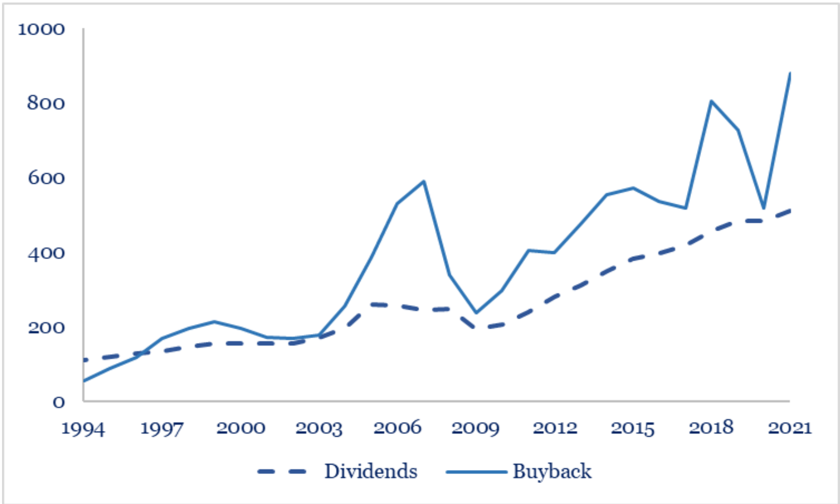
# Have Buybacks Peaked?

Share buybacks were virtually non-existent in the US equity markets prior to 1982, when there were regulations aimed at limiting the potential for share price manipulation. In 1982, the US Securities and Exchange Commission adopted Rule 10b-18, which established a safe harbor for companies wishing to distribute cash to investors via share buybacks. Consequently, share buybacks became popular and since 1997, the amount of share buybacks has surpassed dividends as the primary means of cash repayment to shareholders (Exhibit 1).

**Exhibit 1. Share Buybacks vs. Dividends in the US ($ billions)**




Source: S&P Dow Jones Indices

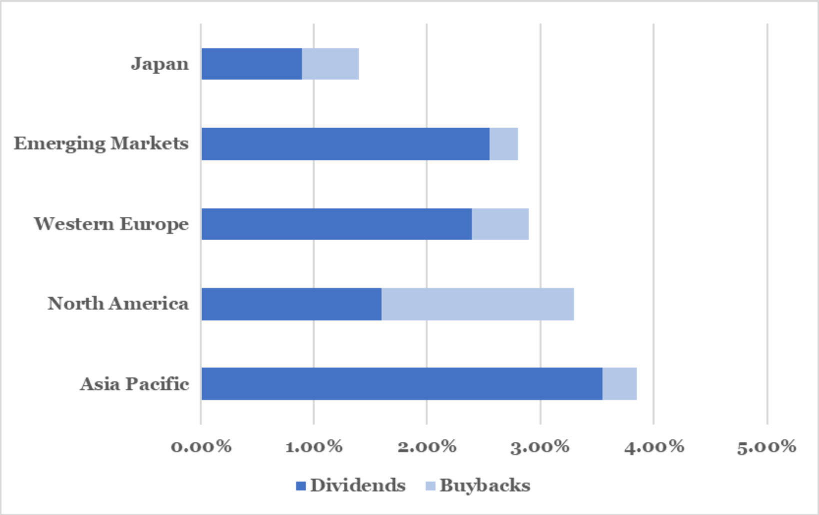
There are several reasons why companies prefer buybacks to dividends. First, buybacks reduce the number of shares outstanding thus giving a boost to earnings per share. Furthermore, unlike dividend payments, companies have more flexibility to change their buyback policies as they are not considered mandatory. Furthermore, the differing tax rate on capital gains versus that on dividends favors repurchases.

Although buybacks have trended higher over the last few decades, they have tended to follow economic cycles with an increase in activities during a boom when the market is up and there is an abundance of cash flows. This is because the decision to buy back shares is a strategic capital allocation decision taken in the context of the operating costs, capital expenditure and tax obligations of a company. During a downturn when cash flows are tight, capital expenditure and dividends become higher priorities over buybacks. This is captured in Exhibit 1 by the fall in buybacks in 2009 during the Great Financial Crisis and again in 2020 when the pandemic triggered a global recession.

## Prevalence of Buybacks in Global Equity Markets

While share buybacks are dominant in the United States, they are not as popular in other parts of the world. In a study conducted by MSCI, they found that share buybacks were much more prevalent in North America, and particularly in the US relative to other global equity markets. Their findings are presented in Exhibit 2. The total payout over a 15-year period ending in July 2017 relative to total assets at the end of 2016 was the highest in the Asia Pacific region. However, dividends made up most of the payment to shareholders outside the US while share buybacks were more common in the US.

**Exhibit 2. Share Buybacks vs. Dividends in Global Equity Markets**




Source: MSCI

In a separate report, S&P Dow Jones Indices found that the proportion of dividend paying companies in the US decreased from 78% in 1980 to 43% in 2018 while those buying back shares increased to 53%. Meanwhile, in developed Europe and Asia Pacific, although the percentage of firms buying back shares increased during this time, they were lower at 26% and 28.5%, respectively in 2018.

The upward trend in share buybacks has continued in the US reaching a new high in the fourth quarter of 2021. US companies bought back $270.1bn worth of shares, up 15.1% from the previous quarter, according to S&P Dow Jones Indices.  Total buybacks reached $881.7bn in 2021, rising 69.6% from 2020 and up 9.3% from the prior annual record set in 2018.  Companies continued their record-breaking buybacks in the fourth quarter of 2021 ahead of any expected policy changes in 2022. The record buybacks in 2021 led to one out of seven companies in the S&P500 increasing their earnings-per-share by at least 4% due to lower share count.

## Recent Slowdown in Buybacks

Are share buybacks likely to continue at the same pace in 2022? We think it is unlikely. Higher inflation resulting from the supply and demand imbalances during the pandemic has led the Federal Reserve to raise the federal funds target rate for the first time in more than 3 years. A Bloomberg survey of 48 economists taken in mid-April shows that the Fed funds rate is expected to rise to 2.5% by year-end, including 50bps rate hikes in May and June. As rates move higher, companies will face a higher interest burden deterring debt issuance and causing greater focus on strengthening of balance sheets. Hence, companies will be more hesitant to take on debt to repurchase shares.

Jill Carey Hall, an equity and quantitative strategist at Bank of America Securities observed in a recent report that the dollar amount of buyback announcements as a percentage of market capitalization in the first quarter of 2022, was 50% below the pre-Covid average in the US. Her analysis is based the real time read from corporate client buyback activity, which has tended to be directionally correlated with the buyback trend. Hence, they are expecting a negligible impact to S&P500 earnings per share from net buybacks, which could present an additional headwind for US equities in 2022.