Share Repurchasing Demand Going Down?

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Pretty much every economic theory rests on the idea that prices are set by the balance between supply and demand. If there are more buyers than sellers, or more demand than supply, prices will go up because the buyers will be bidding against each other. If there are few buyers, prices will have to go down to attract more buyers back into the market.

Which raises an interesting question: who are the buyers in the stock market?

Most people don't realize that one of the most reliable bulk purchasers of equities is companies themselves. Economists at Goldman Sachs have calculated that, in dollars, there was a greater volume of corporate buying than there was demand from pensions, mutual funds or households over most of the past decade.

In virtually all cases, these companies are buying back their own stock—some $923 billion worth last year. The actually contribute more than that in terms of supply and demand, because when a company buys back its own stock with excess cash, that stock is taken off the market—reducing supply. Some analysts think that corporate buybacks was a big part of why the S&P 500 gained 15% in price since the October low.

Why would a company purchase its own shares? Precisely for the reason that was just outlined: it drives up the company stock price, which serves shareholders. But of course, that money could alternatively have been invested in creating new factories, adding new services or research and development into building a larger and more profitable company. Share buybacks are a way of tacitly admitting that you don't really know where to spend that cash on hand to benefit the company itself.

Some analysts now believe that share buybacks are going to slow down for the remainder of this year. In aggregate, companies have experienced two successive quarters of declining profits, reducing the available cash to become a major purchaser. Cash balances have fallen an estimated 13% in the last 12 months—the sharpest decline on record. And as borrowing costs (due to higher interest rates) have gone up, cash is needed to avoid incurring expensive debt.

At the same time, there are rumblings of a recession on the horizon, which, if it happens, would allow companies to buy their own shares at cheaper prices—and prop up their share prices in a market downturn.

If companies cut back on their stock purchases, it would remove one of the biggest sources of demand in the gigantic auction house that is the U.S. stock market. It's possible that bullish investors will step in to replace that demand. But most economic theory suggests that the balance between buyers and sellers, demand and supply, can be a delicate one. The good news from all this is that if prices were to fall dramatically, Corporate American might step in to shore up their respective stock prices—and buy back their own shares at a relative bargain.

Source:

https://www.advisorperspectives.com/articles/2023/05/11/corporate-americas-taste-for-buying-back-its-own-stock-is-waning

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