MARKET MINUTE

WITH McGAREL

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The equity market capitalization of the S&P 500 Index is $44 trillion dollars as of 5/31/24. The forecasted earnings of the index for 2024 is expected to surpass $2.0 trillion dollars. That would be the best ever earnings for the index. It would also be the 4th year in a row where earnings have been significantly higher than the $1.3 trillion earned in 2019, which at the time was the highest ever.

In summary, the earnings produced by the largest American companies are on an unprecedented tear. The dividend payout ratio of the S&P 500 Index is approximately 30% of earnings. Based on $2.0 trillion of anticipated earnings, that leaves a lot of "extra" earnings (~ $1.4 trillion) to reinvest in the business or to reward shareholders.

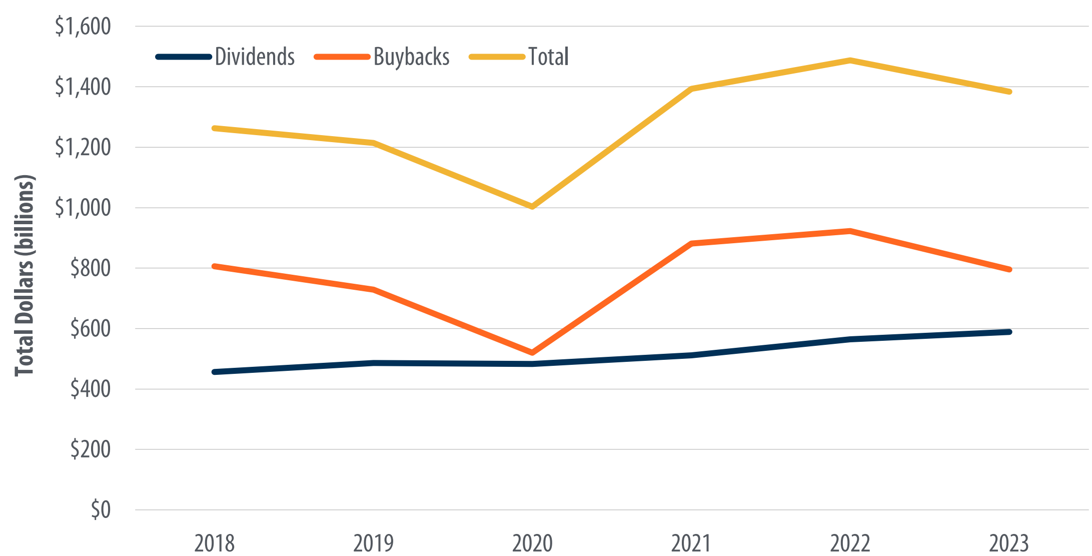
Many companies are using that extra cash flow to reward shareholders through common share buybacks. Over the last 5 years, S&P 500 Index companies have spent significantly more on buybacks than dividends (see chart below). The effect on earnings per share (EPS) can be dramatic when the share count decreases. For example, over the last 5 fiscal years, Apple has reduced its share count by over 18%, from 19.0 billion shares outstanding to 15.6 billion. As a result, Apple's EPS has risen 105% despite net income increasing just 63%.

In the past, many companies announced buybacks but didn't follow through with the share repurchases as they are typically not binding. A downturn in the economy or deteriorating business performance are often cited as reasons to suspend or delay buybacks. Other companies buy back stock to offset the impact of dilution due to stock issued to executives and employees as compensation which often results in little to no net reduction in shares outstanding. In these cases, the benefits to shareholders are modest, if at all, as only a net reduction in share count boosts earning per share, all else equal.

It is a different story today. Common shares are being repurchased and the share counts are shrinking materially. For example, the 25 companies in the S&P 500 Index with the largest dollar amount of buybacks in 2023 reduced their share count by an average 8.8% over the previous 3 fiscal years. This boosts EPS growth above the absolute growth rate in earnings as the denominator of the calculation is shares outstanding (net income divided by average common shares outstanding). It also results in current shareholders owning a higher percentage of the company and its future profits without having to purchase more shares. It is more tax efficient for shareholders than cash dividends as well.

We've written in the past about the Federal Reserve's (Fed) desire to slow economic growth to rein in inflation and its likely negative impact on earnings growth. If companies continue to buy back shares as they have in the recent past it will provide a boost to what could otherwise be a mediocre growth environment for corporate earnings. This EPS growth boost may provide support for stocks even in the slower growth environment the Fed is trying to engineer.

S&P 500 Index Components of Shareholder Yield



Source: SPGlobal.com

Past performance is no guarantee of future results.

The **S&P 500 Index** is an index of 500 companies used to measure large-cap U.S. stock market performance.

Indices are unmanaged and investors cannot invest directly in an index. An index does not charge management fees or brokerage expenses, and no such fees or expenses were deducted from the performance shown.

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