

## Important Topic: Stock Buybacks Revisited

In 2015 Apple's revenues were \$233 billion. In 2019 Apple's revenues are close to \$260 billion, a total increase of only 11% over four years, or roughly 2.5% annualized growth. During the same period Apple's earnings have gone from \$9.22 to \$11.90 per share an almost 30% increase, nearly 3x the revenue growth rate. During this time the stock price has nearly doubled. How?

## Welcome to the benefits of stock buy backs.

As Apple buys back its shares there are fewer outstanding shares with which to share the earnings. In theory, if one buys back half of one's shares then the earnings per share doubles without any increase in sales. Today there are many companies buying back stock to show investors strong bottom line earnings growth despite rather mediocre top line results.

But this is not a trick or an accounting sleight of hand. The companies in question either have the cash on hand (Apple certainly does from past earnings that were not distributed to shareholders) or are able to borrow funds (at near historically low rates) and have the ability to carry the debt. These funds belong to the shareholders but instead of paying out a dividend, the funds are used to buy and cancel shares thereby driving the value of each remaining share higher. The resulting capital gain is taxed at a lower rate than dividends and everyone wins.

The only red flag being waved is where a company incurs debt it cannot carry. Trying to keep up with the share price increases, weaker companies are borrowing more money than they may be able to carry. This requires analysis on a case by case basis.

Also note that while share buybacks are positive, it does not override fundamental concerns about a company. Both Cisco and The Gap have been buying back shares but have not seen their price increase. In each of these cases investors have sufficient concerns about the future of the company. A reduction in the number of shares outstanding does not remove or offset these concerns.

## Market Update – January 2020

January was another month of mixed results. While the Canadian and US markets posted positive results the European, Emerging Markets and Global Small cap markets fell. The bond market was strong helping provide overall positive results.

Within each market we continue to see volatility. One day the Dow Industrial Average Index drops 500 points and the next it recovers all that it lost.

This has played on many people's nerves and emotions but if you have been reading these monthly reports it should come as no surprise. This is normal. After the market fell the 500 points in one day I received a couple of calls from clients wondering if the dip was an opportunity to buy while others called and asked if the dip was the beginning of a market correction and whether they should sell.



My recommendations came as no surprise. A 500 point fall is only 2% and we expect such events to occur every other month. On its own it means little.

If one has additional funds to invest I would recommend investing the money on a predetermined schedule so that the emotions of the day do not override a thoughtful and prudent investment plan. If one wishes to buy only on a dip then the predetermined schedule can state exactly that. Set a certain percentage of the funds to be invested by a set trigger, be that a fall of 2%, 5% or more. Then do not modify the plan.

If one is looking to avoid a market fall, don't try. An endless number of studies have shown the damage done through such attempts. There is no pattern, no indicator, no guru who can signal a time to sell before the market falls. One may sell, only to watch the market continue to rise for several years. Further the reasons one sold can change suddenly. For example, earning growth can suddenly justify what one thought was an expensive market. Government actions, like cutting interest rates, can also suddenly drive the market higher.

The best results come from continuously investing in quality, competitive companies with solid and growing profits that are trading at inexpensive prices. One would think that this would be impossible to find with so many investors looking for just that. In truth it is very difficult but not at all impossible. Excellent companies are overlooked or fall out of favour and the patient investor can find ample opportunities.

Looking forward, we believe the economy is stable, earnings are ok, political uncertainty and volatility remain high (as always), inflation remains benign and interest rates remain low. As a result, we remain neutral in the short term, but positive in the medium and long term. We continue to hold our positions and invest cautiously.

For the Month, the bond market was down 2.6%, the Canadian market was up 2.3%, the US market was up 2.0% (in US\$), International markets were down -2.9%, the Emerging markets were down 4.3%, the Real Estate market was up 0.7% and the preferred market was up 0.1%. (Reuters 1/31/20)

Have a great month and let us know if there is anything we can do for you,

Meir

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