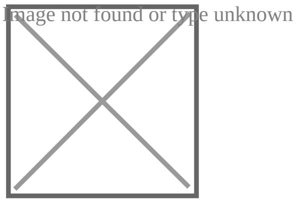
Is the Buyback Bubble Ready to Burst?



This introduction to the latest chapter of *Bubble 3.0* gives me the opportunity to highlight one of my most important and repeatedly emphasized topics: Wrong cycle investing. By that, I'm referring to the recurring tendency of most investors to buy high and sell low.

We all know we shouldn't do that, but our very nature works against wise investment decisions. As discussed in more detail in this chapter, humans have evolved to do things like move with a pack. It's great when it comes to fighting wooly mammoths but not so hot when it comes to making money in the financial markets. In fact, it's downright devastating.

A classic and recent case in point is Bitcoin. Whenever its price is rocketing, I get a flurry of emails and calls from clients about investing in it; but when it's crashing, which it frequently does, the silence is deafening. The following chart illustrates this phenomenon with far more precision. As you can see, when the leading crypto is going vertical, the same thing happens with inflows. In other words, money chases performance, as it almost always does. The more extreme and highly publicized the up-move, the greater the influx of capital. And, inevitably, the more severe the resulting losses.

Chart of Bitcoin's Price

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Most Inflows Tend to go into Bitcoin

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However, the main topic of this chapter is how corporations behave in this regard. For a sneak preview, it's exactly the same story. Companies buy their own shares hand-over-fist when they're high and rising. Then, during a crisis – like the Covid Crash of March 2020 — the repurchase activity almost vaporizes. The same scenario played out during the Global Financial Crisis (GFC). The following chart, pulled from the main body of this chapter, illustrates that reality.

Accordingly, as prices were ripping higher last year, publicly traded Corporate America was gluttonous when it came to buybacks. Here's a relevant *Wall Street Journal* headline from December:

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Back in March 2020, when their shares were being pummeled, repurchases were mostly MIA. In fact, it was actually worse than that: a long list of formerly active buyers, at much higher prices, were forced to be sellers of stock at bombed-out prices to shore up their balance sheets. Frankly, the energy sector, which I've so often endorsed, was one of the worst offenders in that regard. (Fortunately, it has learned its lesson and is rapidly paying down debt today even as it also aggressively buys back shares; however, it is doing so at still very-depressed valuations.)

With Ukraine appropriately dominating the news cycle, the topic of buyback abuses has fallen off the radar for most financial commentators. It's my conviction, though, that in the fullness of time, it will be shocking how much shareholder wealth has been squandered by senior management teams on overpriced and, often, over-leveraged repurchases.

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