Looting Made Easy: the $2 Trillion Buyback Binge

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Corporations are taking the retirement savings of elderly public employees and using them to inflate their stock prices so wealthy CEOs and their shareholders can enrich themselves at the expense of their companies. And it's all completely legal. Under current financial regulations, corporate bosses are free to repurchase their own company's shares, push stock prices into the stratosphere, skim off a generous bonuses for themselves in the form of executive compensation, and leave their companies drowning in red ink.

Even worse, a sizable portion of the money devoted to stock buybacks is coming from "massively underfunded public pension" funds that retired workers depend on for their survival. According to Brian Reynolds, Chief Market Strategist at New Albion Partners, "Pension funds have to make 7.5%," so they are putting their money "in these levered credit funds that mimic Long-Term Capital Management in the 1990s." Those funds, in turn, "buy enormous amounts of corporate bonds from companies which put cash onto company balance sheets…and they use it to jack their stock price up, either through buybacks or mergers and acquisitions…It's just a daisy chain of financial engineering and it's probably going to intensify in coming years." ("How a Public Pension Crisis Is Driving an Epic Credit Boom", Financial Sense)

So, once again, ordinary working people are caught in the crosshairs of a corporate scam that could blow up in their faces and leave them without sufficient resources to muddle through their retirement years.

The amount money that's being funneled into buybacks is simply staggering. According to Dave Dayen at the Intercept:

> "Last year, companies spent $553 billion to repurchase outstanding shares, just short of the record $589.1 billion in 2007. Large companies like Apple, General Motors, McDonald's, Pfizer, Microsoft and more have engaged in buybacks in recent years.
>
> Returning profits to shareholders through buybacks and dividends accounted for 95 percent of all earnings in 2014. As a result, each additional dollar of corporate earnings now translates to under 10 cents of reinvestment, according to a study by J.W. Mason of the Roosevelt Institute."
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> ("SEC Admits It's Not Monitoring Stock Buybacks to Prevent Market Manipulation", Dave Dayen, Intercept)

This explains why business investment (Capex) is at record lows. It's because the bulk of earnings is being recycled into buybacks, over $2.3 trillion dollars since 2009 to be precise. And it's all connected to the Fed's zero rate policy. Zero rates have created an environment in which corporations no longer look for ways to grow their businesses, expand operations, hire more employees or improve productivity. Instead, they look for the quick fix, that is, load up on debt, buy more shares, goose the stock price, and walk away with a bundle.

It's all about incentives. The Fed has created incentives that encourage financial engineering and stock manipulation as opposed to growth and productivity. And keep in mind that repurchasing shares is a form of margin buying, the same type of margin buying that triggered Stock Market Crash of 1929.

According to Dayen: "Prior to the Reagan era, executives avoided buybacks due to fears that they would be prosecuted for market manipulation. But under SEC Rule 10b-18, adopted in 1982, companies receive a "safe harbor" from market manipulation liability on stock buybacks if they adhere to four limitations."

We won't go over the regulations now because, as you can see, they obviously don't work or these corporations wouldn't be $2 trillion in the hole. But it is interesting to note that, at one time, policymakers saw how destructive buybacks were and were prepared to prosecute offenders for manipulation. I doubt that any of our regulators today would even dream of bringing a case against these corporate behemoths, after all, they pretty much own the whole show lock, stock and barrel.

The real danger of this buyback phenom, is that the corporations have piled on so much debt that any sharp decline in the market could push one or two of these giants into default. That, in turn, could quickly take down other counterparties touching off another financial crisis. So, the question regulators should be asking themselves, is how much red ink are these corporations hiding on their balance sheets and what are the risks to the public if they're unable to repay their debts. According to Henry Blodget at *Business Insider*:

> "As corporations have borrowed more and more money, the level of corporate debt relative to the size of the economy has continued to increase. As the chart below shows, this ratio is now at its highest level ever — even higher than it was in 2007, before the last debt-fueled economic implosion. Importantly, corporate net debt — the amount of debt that corporations are carrying minus the cash they have on hand (green line below) — is also at its highest level ever as a percent of the economy."

> ("Now It's Time To Think About What Will Happen When Companies Stop Buying Back So Much Stock", Business Insider)

Let's summarize:

1. Buybacks are driving the stock market higher.

2. Corporations purchase buybacks with credit.

3. "The level of corporate debt relative to the size of the economy… is now at its highest level ever."

What can we deduce from these three observations?

First, that stock prices are a bubble and, second, that a significant stock market shakeout could leave some of the nation's biggest corporations teetering towards insolvency.

Of course, none of this is going to stop corporations from engaging in the same risky behavior. Heck, no.   In fact, CEOs are actually looking for ways to speed up the buyback process. I'm not kidding. Check clip from yesterday's *Wall Street Journal:*

> "Companies are increasingly turning to accelerated share repurchase agreements…to return cash to shareholders and secure an immediate boost to per-share profits…..But these turbo-charged stock buybacks can backfire, especially when a steep market plunge—such as the 5.3% drop in the markets over the past two trading days. That's because a steep plunge in stock prices can force the companies to potentially pay more to buy the shares through an ASR than what they would pay if they purchased the shares over time on the open market. "Things can go wrong," said Robert Leonard, head of specialty equity transactions at Citigroup Inc.…(“Accelerated Buybacks Less Favorable During Market Swoons“, Wall Street Journal)

You're darn right, they can go wrong, but who gives a rip? Not America's insatiable CEOs, that's for sure. They're just looking for faster ways to cash in, that's all that matters to them. These guys aren't even thinking about the health of their companies, let alone their customers. 'Making widgets for the masses, is for suckers', right? Corporate honchos have bigger fish to fry, like leveraging up their whole operation to its eyeballs, skimming the cream off the top, stuffing the moolah in an unmarked Caymans account, and slipping out the backdoor before the whole rickety structure comes crashing to earth. That's modern-day capitalism in a nutshell. Slash and burn, Baby, just like big boys at the Pentagon.

One last thing: Just to show the extent to which these corporate mandarins will go to enrich themselves at their company's expense, check out this blurb from this 2014 article at Bloomberg:

> "International Business Machines Corp. (IBM) is reducing stock buybacks after an $8.2 billion first-quarter splurge… IBM said last week it won't sustain its rate of share repurchases in the first quarter, when buybacks more than tripled from a year earlier to the most since 2007. The company plans to spend less than $5.8 billion total in the final nine months of this year….. IBM's sales have fallen from a year earlier for eight straight quarters…Declining sales and rising buybacks have squeezed IBM's free cash flow…The repurchases, meanwhile, have taken a toll on IBM's balance sheet. Total debt climbed to $44 billion in the first quarter, up from $33.4 billion a year ago…. During the first quarter, IBM issued $4.5 billion of new bonds, clearly used to fund buybacks, Black said…."The company tapped the bond market five different times last year, then you have a pretty sizable February issuance," Black said in the interview. "I feel like there is investor fatigue on the name." (“IBM End to Buyback Splurge Pressures CEO to Boost Revenue“, Bloomberg)

Okay, let's translate this into English: IBM spent $8.2 billion in first-quarter on stock buybacks, even though "sales have dipped "from a year earlier for eight straight quarters"; even though "declining sales and rising buybacks have squeezed IBM's free cash flow"; even though buybacks "have taken a toll on IBM's balance sheet"; and even though "Total debt climbed to $44 billion in the first quarter, up from $33.4 billion a year ago."

Unbelievable, right? And that's not even the best part. The best part is the fact that "The company tapped the bond market five different times last year." In other words, they went to the bond market with 'cup in hand' and appealed to gullible investors to lend them more money to pay their lavish executive bonuses, to shower more dough on their worthless, do-nothing shareholders, and to keep this whole ridiculous farce going on a bit longer.

Talk about balls!

Tell me this, dear reader, when can we stop referring to this activity as "buybacks" and call it by its real name; looting?

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