Weekly Trends

PRIVATE CLIENT SOLUTIONS

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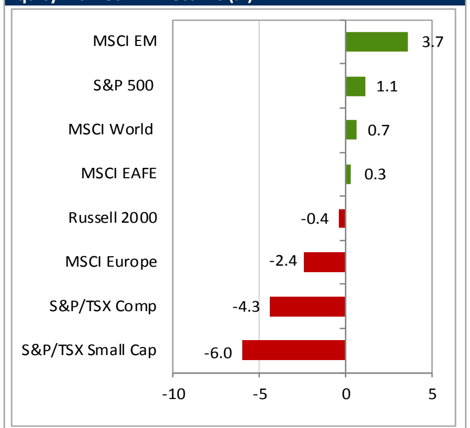
Bringing Back the Buybacks

Share buybacks and dividends are two ways corporations can reward shareholders. A number of studies have shown that companies that increase their dividends outperform companies that repurchase shares, as dividend growth signals increased confidence in the company's underlying fundamentals. Additionally, corporate managers know the negative consequences of reversing course and cutting the dividend can have on the company's share price. Share repurchases on the other hand provide greater flexibility as the buyback program can be decreased/increased with less impact on the stock's performance.

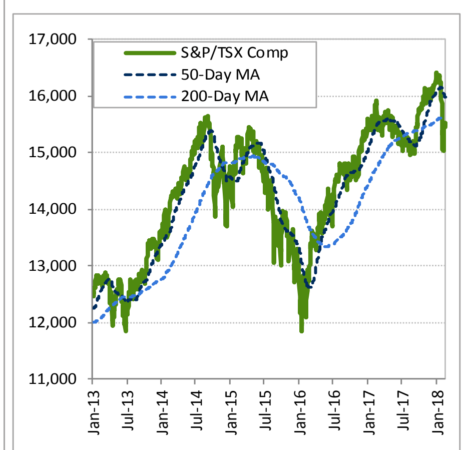
- Despite dividend versus buyback performance discrepancy, since the financial crisis S&P 500 companies have tended to favour share buybacks over dividends.
- The tax holiday introduced by the Trump administration will allow US corporations to repatriate overseas cash at a more favourable tax rate. The last time Congress allowed US corporations to bring foreign cash home was in 2004-05. According to the National Bureau of Economic Research, during the 2004-05 tax holiday $0.79 of every dollar repatriated went to share repurchases. In aggregate, buybacks rose about 70% yoy in 2005.
- With over 85% of S&P 500 companies having completed Q4/17 reporting season we are starting to see an increase in share buyback activity. In fact, according to Bloomberg, "Goldman Sachs Group's unit that executes share buybacks for clients just had its busiest week ever."
- The resumption of corporate buyback activity and the potential for additional repurchase announcements is yet another positive tailwind for the US markets.

Equity Market YTD Returns (%)



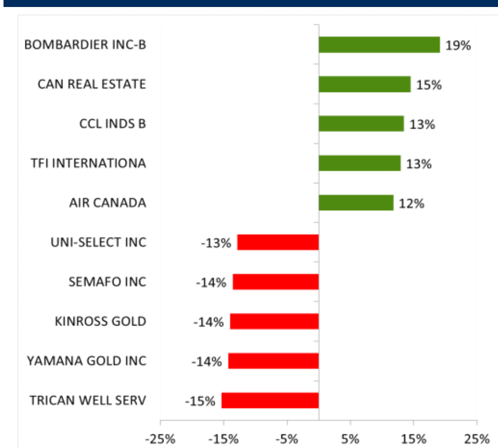
Canadian Sectors	Weight	Recommendation
Consumer Discretionary	5.5	Market weight
Consumer Staples	3.6	Underweight
Energy	18.6	Overweight
Financials	35.1	Market weight
Health Care	0.9	Market weight
Industrials	9.9	Overweight
Technology	3.7	Market weight
Materials	11.5	Overweight
Communications	4.6	Market weight
Utilities	3.6	Underweight
Real Estate	3.0	Market weight

Technical Considerations	Level	Target
S&P/TSX Composite	15,508	17,650



Source: Bloomberg, Raymond James Ltd.
Sectors are based on Bloomberg classifications

S&P/TSX Top 5 Gainers/Laggards*



S&P/TSX Market Internals

Weekly Advance	215	86%
Weekly Decline	32	13%
Advance-Decline	183	
New 52 wk high	6	2%
New 52 wk low	8	3%
No. Stocks Above 50-d	59	24%
No. Stocks Above 200-d	105	42%
Arms Weekly Index	1.12	Neutral
RSI (14-day)	42.9	Neutral
50-DMA	15,971	Downtrend
200-DMA	15,602	Downtrend

*Source: Bloomberg, Raymond James Ltd; * 5-day price return*

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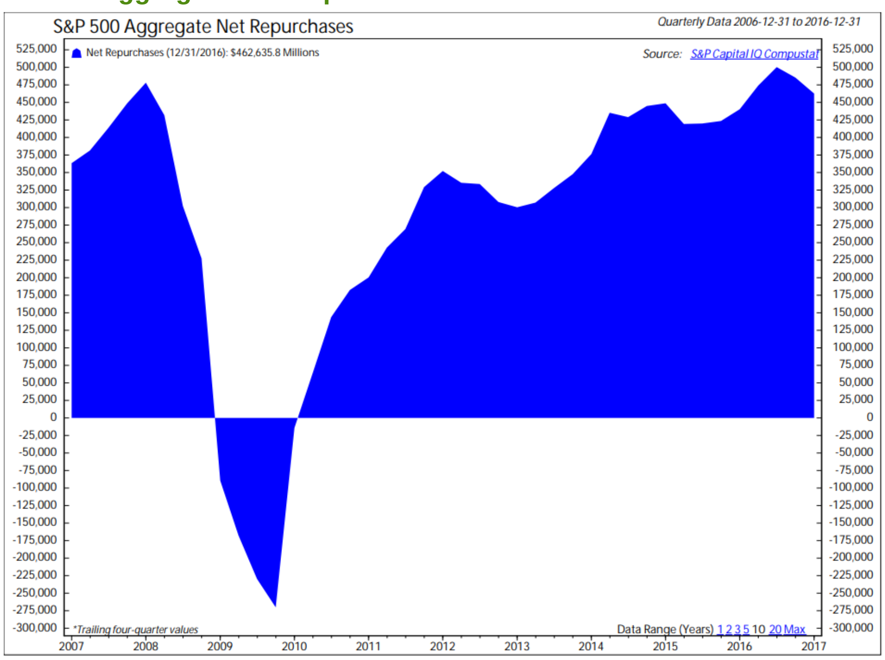
Share buybacks and dividends are two ways corporations can reward shareholders. A number of studies have shown that companies that increase their dividends outperform companies that repurchase shares, as dividend growth signals increased confidence in the company's underlying fundamentals. Additionally, corporate managers know the negative consequences of reversing course and cutting the dividend can have on the company's share price. Share repurchases on the other hand provide greater flexibility as the buyback program can be decreased/increased with less impact on the stock's performance. A bird in the hand is worth two in the bush, as they say.

Despite dividend versus buyback performance discrepancy, since the financial crisis S&P 500 companies have tended to favour share buybacks over dividends. One of the reasons for this initially was to create the illusion of earnings growth in an economic environment that was extremely challenging and offered few avenues for real earnings growth. By boosting share repurchase programs, companies spread earnings across fewer shares outstanding, thus increasing the earnings per share growth rate. As the economy strengthened, a larger portion of earnings have been generated by operating activities instead of buybacks, which is an important distinction when considering earnings quality. Another reason for favouring share repurchases is tax treatment. In theory, repurchasing shares is a more efficient way to return capital to shareholders rather than paying dividends that are taxed.

S&P 500 Aggregate Net Repurchases



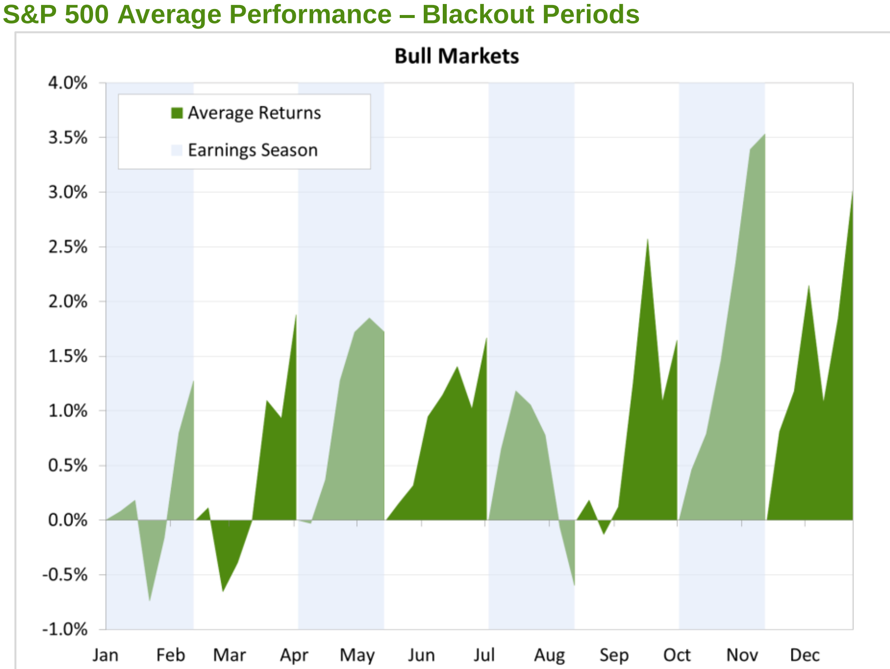
The tax holiday introduced by the Trump administration will allow US corporations to repatriate overseas cash at a more favourable tax rate. The last time Congress allowed US corporations to bring foreign cash home was in 2004-05. In 2004, the US Congress allowed US multinationals to repatriate foreign profits at a 5.25% tax rate, rather than the existing 35% corporate tax rate. According to the National Bureau of Economic Research, during the 2004-05 tax holiday $0.79 of every dollar repatriated went to share repurchases. In aggregate, buybacks rose about 70% yoy in 2005. Applying the same level of buyback activity to the trailing four-quarter buyback rate of US$515 bln, S&P 500 share repurchases may swell to almost US$900 bln in 2018. So far this year, buyback announcements have doubled compared to a year earlier indicative of future activity.

One of the nuances of share buybacks is that they can only occur outside of a corporate blackout period. Under SEC rules, companies cannot buy back any of their shares during a five-week period, which ends two days after the company's quarterly results are released. With over 85% of S&P 500 companies having completed Q4/17 reporting season we are starting to see an increase in share buyback activity. In fact, according to Bloomberg, "Goldman Sachs Group's unit that executes share buybacks for clients just had its busiest week ever." (see article here).

Corporate buyback activity can be supportive of equity prices. Considering roughly 80 quarters of data, the S&P 500 has typically shown better price returns between blackout periods when corporations were actively buying stock. On average during a bull market the S&P 500 exhibits an average return of 2.1% between blackout periods, compared to 1.5% during the blackout period.

The resumption of corporate buyback activity and the potential for additional repurchase announcements is yet another positive tailwind for the US markets. We see positive equity returns in 2018 supported by robust earnings growth (S&P 500 2018 earnings growth estimate currently is ~18%, up from ~10% at the beginning of the quarter) and supportive global economic activity.

S&P 500 Average Performance – Blackout Periods



Source: Bloomberg, Raymond James Ltd.

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