After three years of vigorous growth buyback are going sideways

There are a lot of silly theories about what moves the stock market. One thinks of "psychologically important levels"; of "money on the sidelines"; of the venerable Fed Model. Among the dreck, though, there are a few that make good sense. Here's one: in the short term, buybacks support stocks. Last year, for example, companies in the S&P 500 bought back nearly 3 per cent of the index's equity (netting out the companies' equity issuance). That is a lot of incremental demand and, indeed, corporations have been one of the few consistent net buyers of US equities in recent years.

The possibility that this source of (short-term) support might dissolve is alarming. In the second quarter, S&P companies bought back a net $104bn in shares, 7 per cent more than in last years' second quarter, on S&P Capital IQ data. No need to panic.

Zoom out a little, however, and complacency fades. First off, one-quarter aside, the trend is heading in the wrong direction: over two years, buybacks are going sideways, after three years of vigorous growth. Further, the buying is concentrated. Four companies — Apple, Oracle, Qualcomm, and AbbVie — contributed more than a fifth of the total buying last quarter. Other former buyback stalwarts — GE, Goldman Sachs, Chevron, Walmart, and Coca-Cola — are backing off.

Looking at buybacks by sector raises another worry. The energy sector was buying more than $10bn a quarter a year ago; less than $2bn now. Materials has seen a similar collapse. Media's buying is off by a third. These sectors have performed poorly this year. One wonders if, in a buyback driven market, operational weakness starts stocks falling.

This makes boards shy of buybacks, taking a buyer out of the market and depressing prices. And fewer buybacks mean lower earnings per share growth — a third hit to the shares. A buyback driven market may, in other words, be a very volatile one. So don't panic; but some worry is in order.