Buybacks are Buoying the Bull

By Charles Biderman *Thu, Mar 28, 2013*

Something other than fundamental value is driving the stock market, warns the chairman of TrimTabs Investment Research and portfolio manager of the TrimTabs Float Shrink ETF.

The stock market surge seems to have stalled a bit lately. There's Cyprus, a slowing global economy and nervousness by portfolio managers as the quarter comes to a close. But for as long as the Fed keeps creating billions of fake money daily and companies keep shrinking the number of shares outstanding, there is little doubt that more money chasing fewer shares has to inflate stock prices to new nominal highs, at least for the near term.

Why do I speak of nominal highs? The fact is that if we adjust stock prices for the asset-inflation bubble created by the Fed, stocks are not at real highs. Even Fed Chairman Bernanke admitted that at his most recent press conference. And there's every indication that the Fed will keep inflating this asset-price bubble.

For example, the Fed will keep creating $4 billion in fake money daily to buy back its previously created fake money. And as the new fake money enters the system, there is more money available to buy the same number of assets. That is a classic definition of inflation. So everything else being equal the Fed's fake money creation results in inflated stock and bond prices.

But there is more bullish stuff happening on top of that, also as a result of the Fed's zero interest rate policy. Over the past seven weeks, since the start of February, companies have been reducing the total number of shares outstanding by $120 billion.

There are two ways the number of shares shrink: buybacks and cash takeovers. No surprise, then there has been a record number of buybacks announced since the start of February. There has also been a bumper crop of new cash takeovers.

The number of shares grows when companies and or insiders sell new shares. Bottom line, since the start of February the trading float of shares has shrunk by $120 billion. That translates into an annual rate of over $900 billion and that would compare with $248 billion in total float shrink for all of 2012.

Here's why this is such a big deal. In essence, over the last seven weeks companies have given shareholders $120 billion in cash in exchange for shares. Compare that $120 billion with just $50 billion of new money going into all equity mutual and exchange traded funds so far for all of 2013.

Remember, 80% of US stocks are held by institutions. Institutions typically have a constant rate of cash holdings, whether 1% or 5%. When the number of shares held by institutions shrinks by $100 billion, or around 80% of $120 billion, that means those institutions have more money with which to buy the fewer shares available in the equity markets. Therefore, the price of the remaining shares should go up.

Yes, some self-styled market gurus poo poo buybacks and even claim they are a contrary indicator. That might be so if you only look at buybacks. However add in float shrink and the track record is much better.

Looking back, I started tracking supply and demand of stock and money in 1995. Since then, the market has gone up 11 of the 13 years that the trading float has shrunk. Moreover, the stock market has gone down three of the five years the trading float has grown. In other words, float shrink by itself has correctly predicted market direction in 14 of the last 18 years. In the other four years, demand for shares overwhelmed the impact of float change.

Bottom line, all there is in the stock market are shares of stock and the money available for investment.

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