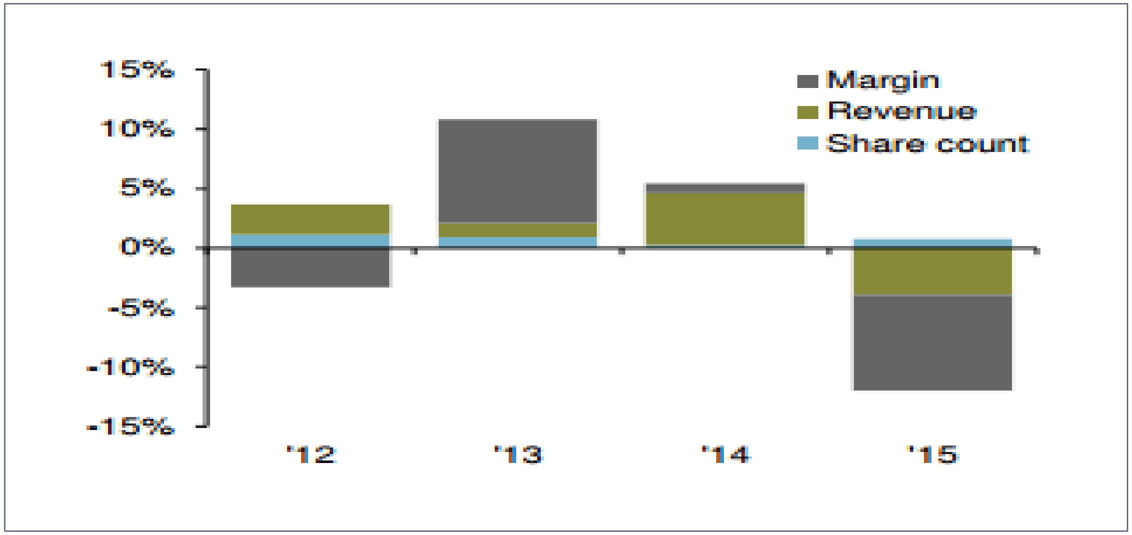
Market Recap

The True Impact of Share Buybacks



Source: JP Morgan

The Dollar's Effect on Corporate Sales and Earnings

Source: Morgan Stanley

Earnings season officially gets under way this week with banks leading the way. With estimates pointing toward sharply lower earnings for Q1 2016, investors are understandably nervous about the prospective impact to EPS (influenced by revenue, margins, and share count) and, therefore, to the market's performance overall. Concerns are further elevated because stock buybacks are projected to slow. Since the financial crisis, analysts have suggested that share buybacks have played a large role in buoying stock prices (fewer shares, alongside flat net income, yields higher EPS). In hindsight, however, it appears that buybacks have not had as big of an impact as suggested; since 2012, share count reductions have only boosted EPS by about 0.8% per year. For the remainder of '16, slowing share repurchases will take a back seat to the factors impacting revenues and margins, such as rising wages and the strength of the U.S. dollar.

Broad market P/E values are now slightly above historical averages following a recovery from the selloff earlier in the year. This places the focus squarely back on earnings with respect to investment performance. Simply put, we should not be looking to multiple expansion to drive stock market gains – the boost will have to come from growth in global profits. Global profits (measured in U.S. Dollars) have been negative since August 2014, with domestic U.S. profits slowing since 3Q 2015. The relationship between the strength of the dollar and those profits is clear – as the dollar rises, profits decrease (with changes in the dollar leading the sales response by 9 months). Accordingly, during the first quarter 2016 earnings season, the market may witness a number of upside surprises as multinational companies benefit from the dollar's decline since late last year.

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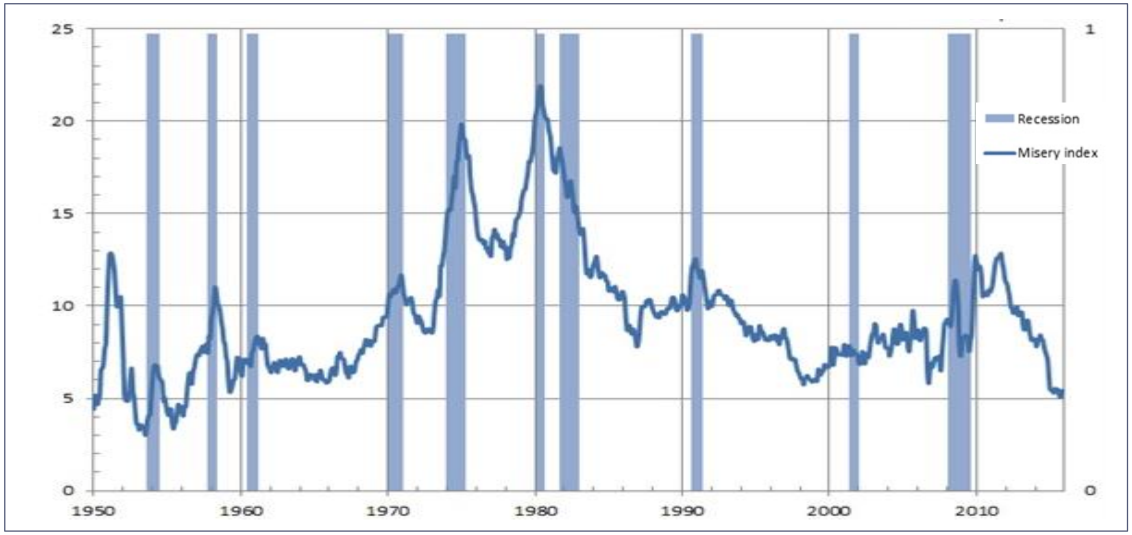
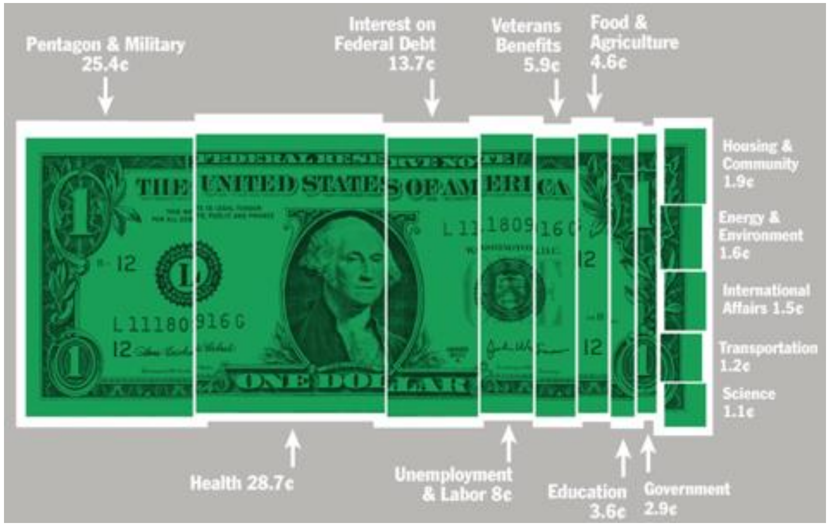
The Misery Index: Sum of Unemployment and Inflation



Source: Brookings Institution

The misery index is an economic measure invented by former Brookings economist Arthur Okun in the 1970's. The index, which combines unemployment and inflation, has been at its lowest levels since the 1950's over the past year, at an average of 5.37. The index peaked at 21.98 in 1980, the final year of the Jimmy Carter presidency. Not only is the indicator intended to jointly summarize the dual hardships of unemployment and inflation, but it also sheds light on the relationship between these two figures. For example, unusually low unemployment may signal an overheated economy and lead, in turn, to higher (or accelerating) inflation. Today, the index may be somewhat overstated by failing to fully capture lagging labor force participation and the contribution of lower oil costs toward keeping a lid on inflation. Nonetheless, today's read looks very positive. The economy and jobs market are improving, with job gains continuing and real wages beginning to increase.

Where Your 2015 Federal Income Tax Dollar Went



Source: National Priorities Project

As Monday's tax deadline looms, you may be wondering how your 2015 federal income tax dollars were allocated. According to the federal-budget research organization, National Priorities Project, out of every federal income tax dollar collected, 28.7 cents went toward health-care programs and 25.4 cents was spent on defense. Interest on the federal debt accounted for the third-largest outlay, at 13.7 cents per dollar, followed by unemployment and labor at 8 cents. The budget allotted 5.9 cents for veterans' benefits, 4.6 cents for food and agriculture, 3.6 cents for education, and 2.9 cents for government. The smallest line items were housing and community (1.9 cents), energy and environment (1.6 cents), international affairs (1.5 cents), transportation (1.2 cents), and science (1.1 cents).

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