

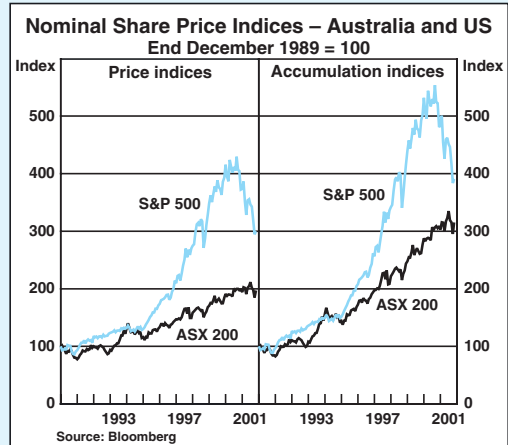
Box D: Share Market Performance and Share Buy Backs

Despite the weakness in the US share market over the past 18 months or so, US share prices have, on average, risen faster than those in Australia over the past decade (Graph D1). Since end 1989, the increase in the S&P 500 index has exceeded that in the ASX 200 by an average annual rate of 3.8 per cent. Many factors have influenced these outcomes. Amongst them are the low dividend payout ratio and the high level of share buy backs in the US.

Dividends are very much a part of the return to shareholders and should be included in any assessment of relative returns. Since end 1989, the Australian ASX 200 Accumulation Index, which takes into account dividends, has recorded an annual compound rise of 10 per cent, compared with 12 per cent for the S&P 500 accumulation index (Table D1). This margin is substantially narrower than that in the respective price indices.

The narrower margin between the US and Australian accumulation indices is due to higher dividend payments in Australia. Australia's dividend yield has averaged 4 per cent since end 1989, around double that of the US. This higher yield reflects a higher dividend payout ratio (around 80 per cent), which was encouraged by the introduction of dividend imputation in 1987.

Graph D1



The earlier downward trend in the payout ratio has been largely reversed since (Graph D2). In contrast, the US dividend payout ratio has fallen sharply since the early 1990s, to now stand at about 40 per cent.

The effects of share buy backs on returns are more difficult to assess. In theory, it can be argued that share buy backs should not affect the price of a company's shares. To buy back its own shares a company must spend funds that it would otherwise have used to generate future income. A buy back, therefore, reduces a company's market value. But the number of shares outstanding is

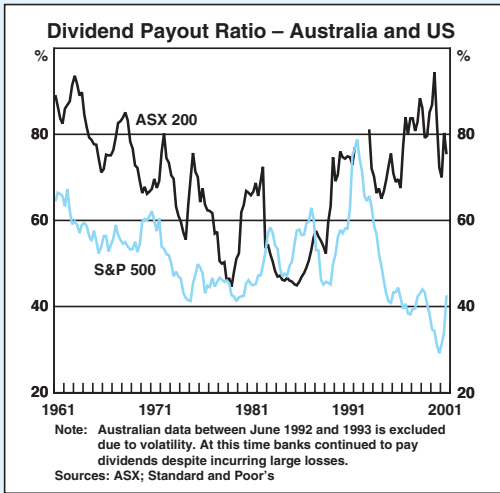
Table D1: Share Market Returns

Per cent, per annum

	Price index		Accumulation index	
	ASX 200	S&P 500	ASX 200	S&P 500
1989–2001	5.9	9.7	10.2	12.3
1989–1995	4.9	9.7	9.5	13.1
1996–2001	6.9	9.8	10.9	11.4
1998–2001	5.8	2.3	9.6	3.7

Source: Bloomberg

Graph D2



reduced by the same proportion, leaving the price per share unchanged.

On the other hand, empirical studies investigating buy backs in the US market find that buy backs lead to both a short-term price increase and longer-term market out-performance. In any event it should also be noted that, even if a buy back does not directly affect a company’s share price, the share price will nonetheless be higher than if the company had paid an equivalent amount in dividends. A payment of dividends reduces the value of the firm but does not change the number of shares outstanding.

Total buy backs for the US equity market in the five years ending December 2000 amounted to over US\$1 trillion, or 7 per cent of current domestic capitalisation. Australian share buy backs totalled A\$28 billion over the same period, or 4 per cent of market capitalisation.

As a result of the high level of buy backs, the US equity market has recorded only four significant quarters of positive net equity raisings since 1995 (Graph D3). In comparison, Australia has had only one quarter of net buy backs in that period. The high rate of buy backs in the US has meant that US net equity raisings have averaged – 0.15 per cent of total market capitalisation since 1995, compared with an equivalent figure of 0.5 per cent for Australia.

In the US, both the non-financial and financial sectors have run down their equity stock over the last five years. Net raisings by the non-financial and financial sectors amounted to US\$–761 billion and US\$–93 billion respectively. The only sector to record positive net equity issuance has been foreign corporates, which made net raisings of US\$456 billion. The use of buy backs in Australia has generally been modest, though significant use of them was made by financial institutions. ↵

Graph D3

