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HONEY, I SHRUNK THE STOCK MARKET

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Honey, I Shrunk the Stock Market

Fellow Investor,

As part of our continuing commitment to better serve investors, we've formed a Private Client Group here at Navellier & Associates whose sole goal is to offer high-net-worth investors customized investment solutions.

We're excited about this service, as it will allow us to work directly with you to create an asset allocation strategy mix designed to fit your specific investment goals.

To introduce you to this service, along with our proprietary approaches to balanced portfolio management, we're offering you, as a qualified investor, a personal review of your current holdings.

That way you'll get our personal take on your current assets and allocations along with our best ideas for this current economic environment.

There's no cost for the portfolio review or obligation whatsoever to invest with us.

It's simply our way of introducing you to our Private Client Group and our customized solutions so that you can get the benefit of our 31 years of investment experience and get our take on your current holdings and how we might work together in the future.

With market uncertainty high, our personal portfolio review can bring you customized solutions appropriate to your net worth, investment objectives, level of risk, and growth and income goals.

Accordingly, your free review will include not only an evaluation of your current portfolio, but also our ideas on how we might help your portfolio in this current economic environment and continue to help you meet your growth and income goals.

To schedule your free appointment, just email info@navellier.com or call 800-887-8671 and we'll get you started.

My office will call you within the next 48 hours to schedule your review and assessment. Again, it's yours **free**, from Navellier's Private Client Group, with no obligation to invest with us.

Sincerely,

Louis Navellier, Chief Investment Officer, Navellier & Associates, Inc.

To schedule your free review email info@navellier.com or call 800-887-8671.

PUT YOUR HOUSE IN ORDER

I'm afraid it's time to say your goodbyes to the stock market.

It's my unfortunate duty to inform you that it's dying. I'm sorry but there is nothing more we can do. There's not much time, so you should make your final preparations.

The very stock market we love and that has captivated attention and sparked curiosity for what seems like as long as anyone can remember is coming to its end.

Source: Seeking Alpha

It's vanishing before our very eyes. Stocks are disappearing at an alarming rate. At the current rate of stock vaporization, the average large capitalization growth stock will disappear in approximately 17 years. If that sounds crazy, check this: The entire S&P 500 will disappear in 27+ years!

So pay attention to those great stocks now because they'll be gone within a generation.

Why are stocks disappearing when the economy seems so healthy? The economic data is solid and strong but not too strong. The amount of disposable income and discretionary spending cash in the pockets of American consumers is rising.

Then there's the latest tax reform package, enacted in late 2017 and taking effect in 2018. Corporate taxes in the U.S. were slashed from 35% (or 39%, when surcharges were included) to 21%.

With this lovely backdrop for the stock market, why am I saying it's shrinking into oblivion?

My initial thinking, like many, was that the corporate tax cut is a great thing. I admit I was a bit naive.

You see, if this record amount of cash was being deployed back into capital investment for growth or bolstering employment, the growth of corporate earnings would be the logical justification. More money in corporate pockets means more money to invest to grow business and strengthen the economy. More hiring eventually means higher wages. Higher wages mean more disposable income for the American consumer fueling the economy even further in a “virtuous circle” of wealth creation.

So once the record eye-popping tax cut happened, that should have been the gunshot signal for “off to the races.” It was indeed, but not exactly in the way the White House sold it. There are clear beneficiaries of the pro-business policy shift, but it doesn’t really resemble the original pitch.

So, what gives? Who really benefits from this new windfall of corporate cash?

The good news is that shareholders benefit. The bad news is that you may not be benefiting in the traditional way, the way you would ideally want it to be.

As we are about to examine in this white paper, the tax plan has triggered an avalanche of corporate cash repatriation. The record influx of capital back into America was originally billed to bolster labor, technology, and capital investment for businesses. Instead it has resulted in a “kid-in-the-candy-store” binge-buying of one thing:

Share buy-backs.

This is why the stock market is disappearing in front of your very eyes. At the current share buy-back pace, which has been kicked into overdrive in 2018, the average Navellier large-capitalization growth stock will disappear in 17 years while the S&P 500 will disappear in 27+ years.

How does this help you? And how might it hurt you?

How will we choose to spend our waning hours with our beloved stocks?

Let’s find out...

The short version of what is happening:

- Tax rates decrease
- Overseas money comes home
- Companies buy more of their own stock
- Shares outstanding decrease, prices increase
- While rates remain low, forecasted p/e multiples remain low
- Companies continue to buy back shares....repeat cycle

The Longer version:

Countless stories begin and end with money. This one is no different.

**"MONEY, IT'S A GAS, I'M ALLRIGHT JACK,
KEEP YOUR HANDS OFF OF MY STACK." – PINK FLOYD**

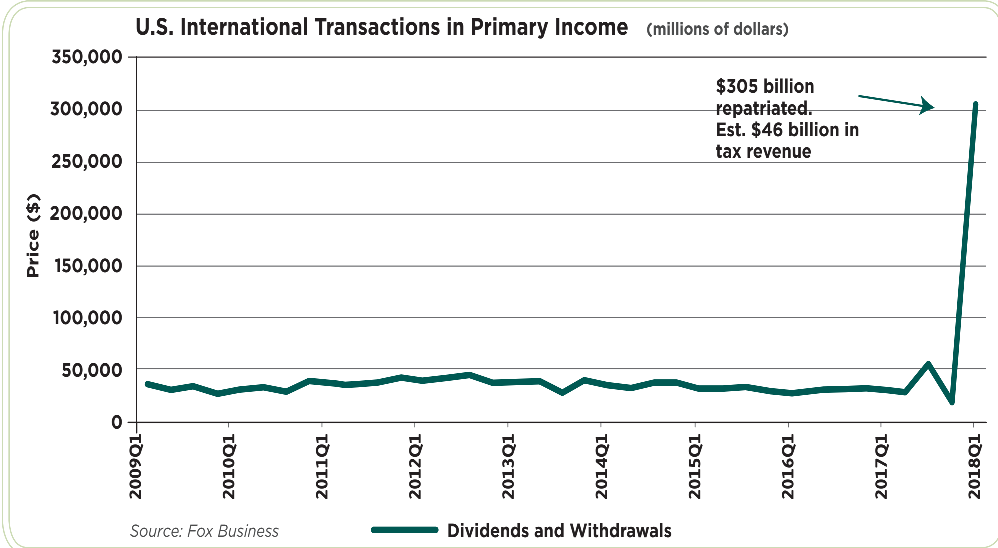
Source: Wikipedia

The great shrinkage of the stock market begins with an avalanche of money. This is counterintuitive, but as we will see, as money floods into the country, it acts like fuel for the black hole swallowing up stocks.

Prior to December of 2017, there was an astonishing amount of money sitting overseas. The United States Public Interest Research Group estimated that there was about $2.6 trillion of U.S. corporate cash hanging out overseas. Almost 10% of that was Apple's alone, at $252 billion!

The Trump administration essentially removed the roadblock of bringing this cash back into the U.S. Tax reform slashed the tax rate on foreign earnings when bringing funds back into the U.S. The new Republican tax law now allows U.S. companies to bring cash back home at a reduced rate. It sounds like a TV ad: "Act now for this limited time offer!" The new tax reform means companies could repatriate earnings overseas for as little as 8%. This is a far cry from the 35% tax assessed prior to the change in the law.

The effects were felt immediately. The Bureau of Economic Analysis reported that more than $300 billion was brought back into the United States in the first quarter of 2018. This was a record breaker. Compare that to the same period in 2017, when only $38 billion came back to the U.S.



Companies that built factories overseas often did so to avoid taxes. They earned revenue in those countries and sat on the cash, not wanting to pay tax in two jurisdictions.

Some companies have released what their tax bill will be, related to bringing their cash back home. Others have yet to do so. **Microsoft** (MSFT) hasn't said yet what the impact will be, but the last quarterly report says that MSFT has $132 billion sitting overseas.

For an idea of just how much money is at stake look at this incomplete list of companies and their tax bills:

- **Apple** (AAPL) had $252 billion overseas. Apple reported they would pay $38 billion in taxes in one shot to bring their cash home.
- **Citigroup** (C) paid $22 billion in repatriation taxes.
- **Goldman Sachs** (GS) announced their first loss for a quarter in six years because they paid $4.4 billion in taxes for their overseas cash. This resulted in a $1.93 billion quarterly loss.
- **Bank of America** (BAC) said they will pay $2.9 billion, which halved the company's quarterly profit.
- **American Express** (AXP) Reported a quarterly loss for the first time in more than 20 years, Amex is paying $2.6 billion to bring their cash home. This caused a $1.2 billion loss.
- **JP Morgan Chase** (JPM) will pay $2.4 billion for its overseas cash.

(Please note: Louis Navellier does currently hold a position in MSFT but does not own AAPL, C, GS, BAC, AXP, or JPM. Navellier & Associates does currently own a position in MSFT for client portfolios but does not actively buy AAPL, C, GS, BAC, AXP, or JPM for client portfolios).

Just those companies alone account for nearly $75 billion in taxes related to cash repatriation.

Meanwhile, U.S. small and mid-sized public companies are positioned to profit from the corporate tax cuts more than the large corporations represented in the S&P 500.

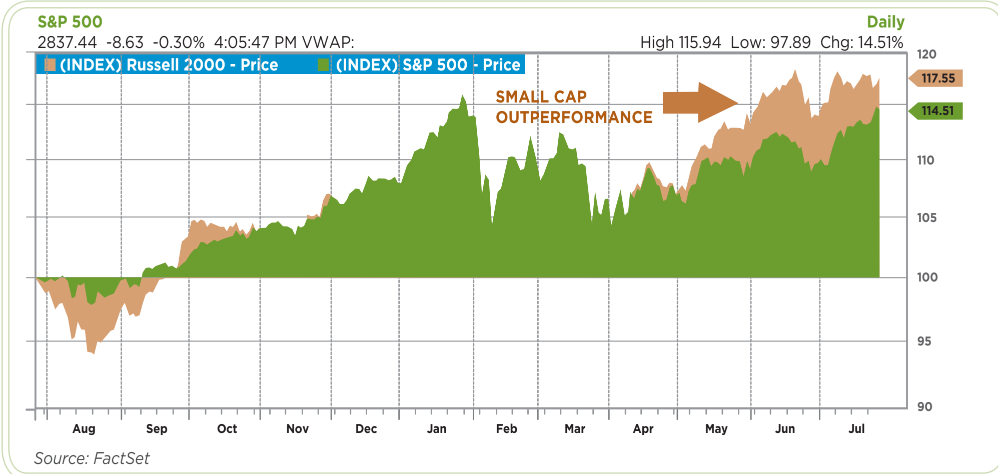
So who benefits from all this cash coming home, aside from Uncle Sam?

Obviously, the infusion of cash will support growth of business and fuel our domestic economy. Naturally this boost of cash should help spark growth and jobs. Well, that's what should happen in theory anyhow.

Another outcome of repatriated cash is a strong U.S. dollar. This naturally puts pressure on commodity prices as they are priced in dollars. But it also has an interesting effect on small-cap domestic stocks. Small-cap stocks outperform when the dollar rises. They are a bit immune to the effect of dollar strength as they derive most of their sales domestically. Big companies with significant multinational operations feel the effect of a strong dollar on their bottom line. This effect is not nearly as big for small-cap stocks.

For instance, the S&P SmallCap 600 has 78.8% of its revenues derived from the U.S., while the S&P MidCap 400 has 73.3% and the S&P 500 has the lowest percentage at 70.9%*. Smaller caps stand to gain from tax cuts but they stand to lose from rising rates. They generally have to borrow more and have more sensitivity to credit costs. For now, with the outperformance in small cap stocks seen in indexes like the Russell 2000, the market is still expecting rates to remain low for a while.

* https://money.usnews.com/investing/investing-101/articles/2018-06-25/small-and-mid-cap-stocks-benefit-from-tax-cut



Naturally the cash has to end up somewhere. Some companies are paying a special dividend. Some are paying their employees special bonuses. Some are increasing wages. And some are doing buy-backs.

It's time to go into the details of the what, why, who, where, and how of corporate stock buy-backs.

WHAT IS A BUY-BACK?

A share buy-back is when a company buys its own shares. It's also known as a share repurchase. The company goes out and buys its own stock on the open market and reduces the number of shares available.

Companies might do this for several reasons. Naturally, there's the obvious effect of increasing the value of the shares remaining – those that were not repurchased. This is done by reducing the supply of available shares. Companies might also want to prevent someone else taking a controlling stake in the company.

A company might also buy back its stock to deliver equity-tied compensation. If employee or management compensation is tied to the price of shares, like stock bonuses or options, the company can buy shares and give those shares to employees. This doesn't dilute the existing shareholders.

A buy-back is really a company investing in itself, so if a company feels that its shares are undervalued, they can buy some back, which boosts the value of the stock to remaining shareholders. This has the added effect of boosting earnings per share, so if the P/E ratio is maintained, the stock price goes up.

Companies can buy back their stock either by a tender offer or in the open market. The tender offer is when the company gives the option to shareholders to sell (or tender) their shares at a premium to the current market in a window of time. The company can also just go into the open market and buy back their shares as mentioned above. According to Wikipedia, more than 95% of worldwide buy-backs happen in the open market.

In order to buy stock, the company needs cash. A company can issue debt to raise cash to buy back shares or use cash on hand. With the recent tax reform, corporations are seizing the opportunity to repatriate cash sitting offshore at a reduced tax rate. All of a sudden, a lot of companies have a lot of cash.

Let's look at an example of a buy-back:

Imagine two companies, Company A and Company B.

Company A had a great year of reported financials, but the stock of company A is trading at a discount relative to company B. To reward shareholders, company A might announce a share buy-back. Let's say they buy back 5% of the outstanding shares.

Company A had $10,000,000 in earnings and had 10 million shares outstanding. For this example, the company had earnings of exactly $1 per share. The shares currently trade at $10 per share. This means the Price to Earnings ratio is 10.

Shares Outstanding = 10,000,000

Earnings of $10,000,000

EPS = $1.00

Share price = $10.00

P/E Ratio = 10

Share Buy-back = 5% (500,000 shares)

Company A now buys 500,000 shares in the open market. Earnings per share (EPS) is still $10 million but for 9.5 million shares outstanding. EPS just jumped up to a little over $1.05 per share.

$10,000,000/950,000 = $1.0526 EPS

Now either the P/E must fall, or the share price must rise. To maintain the same P/E ratio of 10, the shares need to rise to $10.53 or +5.3%.

Now that the company bought their own stock in the open market, they can also juice up their growth rates. Reducing shares outstanding means earnings per share (EPS), revenue, and cash flow grow faster. Also, as the shares available go down, the cash available to pay dividends remains the same. Now each shareholder gets a bigger dividend.

Now if Company A grows its earnings and dividends, dividend growth rates start rising.

This acts almost like a functional "special dividend." Imagine a company wants to retain their dividend payout ratio but suddenly has loads of cash to distribute to shareholders. Well they can buy back their stock, reduce shares outstanding, and boost dividends to shareholders without changing the payout ratio.

Each share remaining after a buy-back is now worth a larger percentage of ownership in the corporation. And here, now that EPS goes up, the P/E ratio either goes down or the stock price goes up.

The downside to share buy-backs is that investors now perceive the company has nothing better to do with its cash. Many growth companies typically are less likely to pay a dividend because they prefer to plow money back into growth. If a company suddenly has loads of cash and is paying a dividend already, investors may scratch their heads and ask, "They can't find something to invest in other than themselves?"

WHERE IS ALL THE MONEY GOING?

So, with all this cash coming home, and more cash on the balance sheets of small-cap companies, it should signal a positive impact on the economy, right?

Well the answer might not be so simple. As Mark Zandi, chief economist at Moody's Analytics, said: "The repatriated cash will go to more stock repurchases, dividend increases, and paying for mergers and acquisitions. All of this has no significant impact on the economy."*

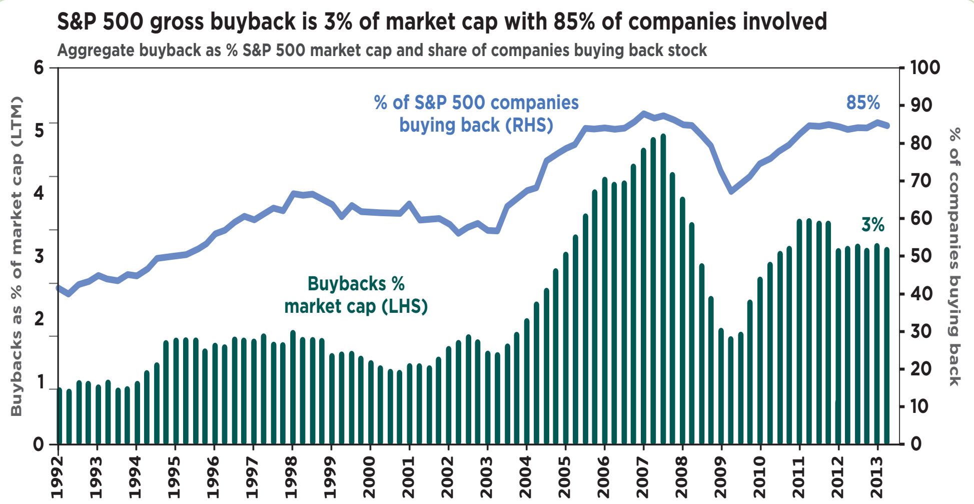
It's clear that most of this money is going directly to buy-backs.

Now that we know how much money is coming home and what a share buy-back is and how it works, let's discuss what's been going on with the ***Incredible Shrinking Stock Market.***

Share buy-backs have been on the rise for a while now. In 1980 there were only about $5 billion in buy-backs. By 2005, that figure swelled nearly 70-fold to $349 billion. Now jump to the present, and in just Q1 2018, companies have completed $178 billion of buy-backs. This is up more than 42% from Q1 2017, according to S&P. It blew away the previous quarterly record from the third quarter of 2007.

* American money flowing back into America By Suzanne O'Halloran, Published June 26, 2018Business LeadersFOXBusiness https://www.foxbusiness.com/markets/american-money-is-flowing-back-into-america

Not only is the nominal value of buy-backs increasing, so is the number of companies doing it. Look at the following chart of the percent of S&P 500 companies buying back their stock.



Source: Compustat and Goldman Sachs Global Investment Research.

NOTE: At times, this chart is a bit misleading. In 2013, for instance, the S&P 500 rose 30%! Because the graph shows share volumes as a percent of market cap, it doesn't truly reflect the fact that corporations increased their share buy-back spending monstrously in that year (i.e. 3% above 30% = +33%).

Apple had completed $200 billion in share buy-backs since 2012. Apple's cash hoard is so monstrous that six out of the 10 biggest share buy-backs in U.S. history were done by Apple. The $200 billion they've bought since 2012 is enough cash to buy all of **Verizon**, **Coca-Cola,** or **Boeing**. Chew on that for a minute.

Now, contemplate this: U.S. companies announced $201.3 billion in stock buy-backs and cash takeovers in May 2018 alone. That's a record monthly amount. Apple represents nearly half of that! Apple recently said it would buy back $100 billion more of its own stock. They didn't specify when or how long that would take, but that's about 10% of the market cap, currently at $1 trillion, the first trillion-dollar stock.

The buy-back announcements keep coming:

- **Broadcom** (AVGO) pledged a $12 billion buy-back.
- **Micron** (MU) pledged a $10 billion buy-back.
- **Facebook** (FB) pledged a $9 billion buy-back.
- **T-Mobile** (TMUS) pledged a $7.5 billion buy-back.
- **Qualcomm** (QCOM) just upped the ante on their previous announcement to buy back $8.8 billion. On July 25th, 2018 QCOM said they would buy back $30 billion, more than 30% of the float!

(Please note: Louis Navellier does not currently hold a position in VZ, KO, QCOM, TMUS, FB, and AVGO, but does own MU and BA. Navellier & Associates does not currently own a position in QCOM, TMUS, FB, VZ, KO, and AVGO for client portfolios. However, Navellier & Associates does current own MU and BA for client portfolios).

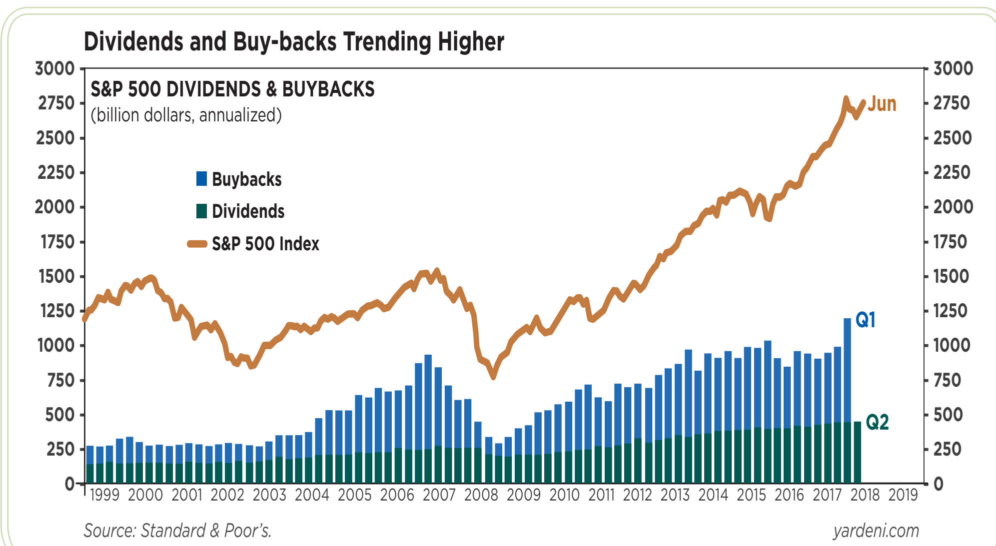
Companies buying back their stock clearly boosts prices. They reduce the number of outstanding shares, which naturally increases demand for the remaining shares and inflates the earnings per share.*

So, when the White house claimed that the bulk of the tax cut would go to American workers, their hope and political promise was dead wrong. White House Press Secretary Sarah Huckabee Sanders made the following comment at a press conference in January right after the bill came into effect. She said:

"More than 70% of this [tax cut] will be returned to workers."

It just didn't happen. The money went to shareholders and to corporate executives with compensation tied to shares and share prices.

Over the past year, S&P 500 companies have given their shareholders a record $1 trillion in the form of buy-backs and dividends, led by Apple, Cisco Systems, and other technology giants.*



Wages are not growing nearly as fast as share prices benefitting from buy-backs propping up their values. The hourly wage on average has risen 2.7% from a year ago (as of May 2018). The S&P 500 rose nearly 11% in that same time period, after peaking at +20%, in comparison.

* https://money.cnn.com/2018/06/05/investing/stock-buybacks/index.html

* https://www.wsj.com/articles/stock-buybacks-are-booming-but-share-prices-arent-budging-1531054801

Some companies, of course, actually chose to reward their workers with a one-time bonus. Unfortunately, bonus income is taxed at a higher rate, so the money not used to reward shareholders and instead used to reward workers ends up partially back in the pockets of the IRS.

Companies bought back record amounts of their stock in Q1, $178 billion of shares. This was up more than 42 percent from Q1 2017. It was the largest amount ever repurchased, topping the previous record from the third quarter of 2007.* But companies also invested in real estate, equipment, and factories. Investments in these area surged +21 percent vs. Q1 last year. Dividends also grew nearly 10%. There was a total of $109.2 billion in dividends issued in Q1 compared to $100.9 billion in the same quarter in 2017.*

The conclusion is obvious: Tax reform repatriates money, but most of this money is going directly into the stock market and raising share prices. Now, the question becomes: How long can this go on?

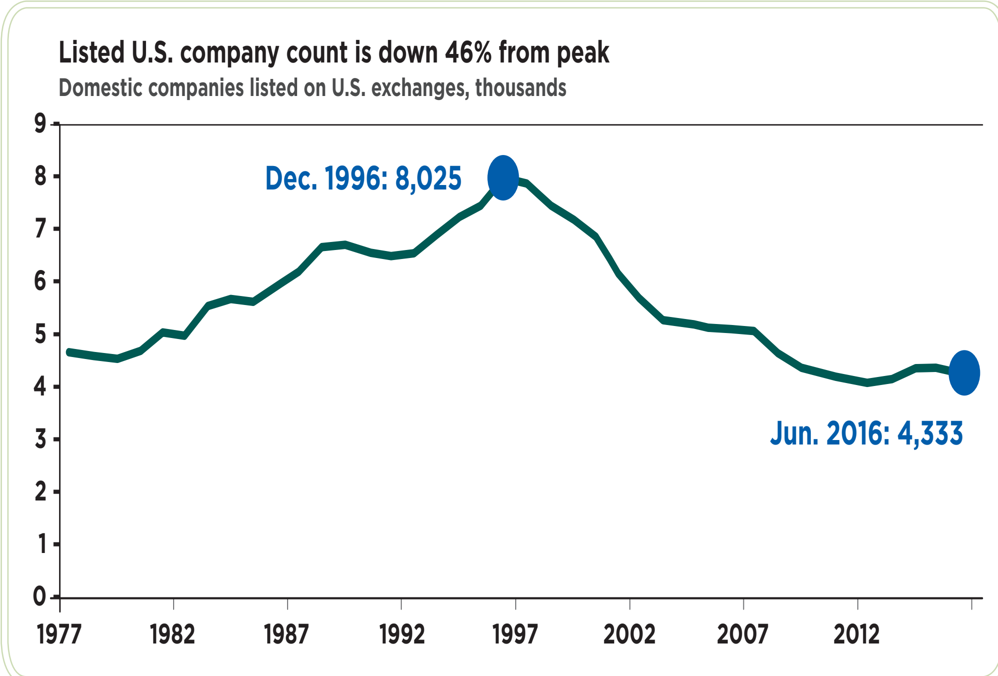
MEANWHILE, THOUSANDS OF COMPANIES ARE "GOING DARK" (Going Private)

In addition to buying back shares, many companies are going "all the way" into oblivion by buying up all of their shares over time, going private. Many executives become tired of the quarterly "rat race" of reporting numbers which may "beat" or "miss" the expected earnings target by a penny or two and so the stock gets hammered. They don't want to manage toward quarterly expectations, which they consider to be an unhealthy short-term focus for a company's long-term health, so they take the company private.

Other companies disappear through mergers and acquisitions. Taking the two together, plus a few bankruptcies along the way, the number of publicly traded companies on the major U.S. stock exchanges has been cut nearly in half between the end of 1996 and 2016:

* https://seekingalpha.com/news/3368526-buybacks-set-record-share-gains-match

* https://www.nbcnews.com/business/economy/what-did-corporate-america-do-tax-break-buy-record-amounts-n886621



Obviously, if another 4,000 company names disappear in the next 16 to 17 years, the stock market will evaporate by means of "going private," or by mergers and acquisitions into a few giant corporations.

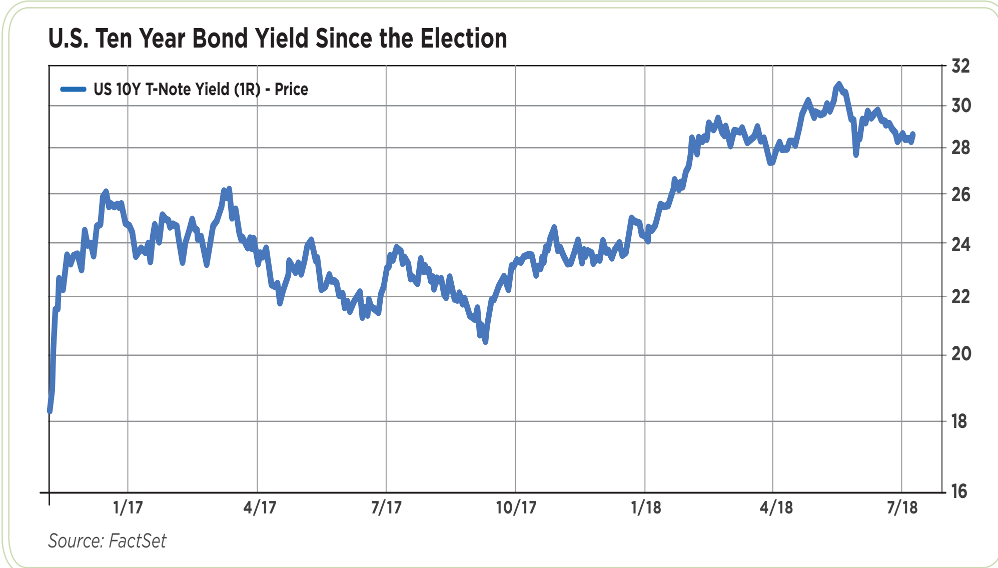
IS THE STOCK MARKET REALLY GOING TO DISAPPEAR?

Now that we can see that tax reform has unleashed a tsunami of share buy-backs, we need to ask: Is this a one-time event? Or will buy-backs continue indefinitely? To answer that question, we need to take a look at the current environment related to interest rates, debt issuance, and P/E ratios.

Rates

There has been a lot of talk about **interest rates** and the Federal Reserve's intentions for raising them. When are they going up? How fast will they go up? Will rate rises quash global growth?

The reality is rates have been relatively stable, especially when we look at the U.S. 10-Year Bond Yield.

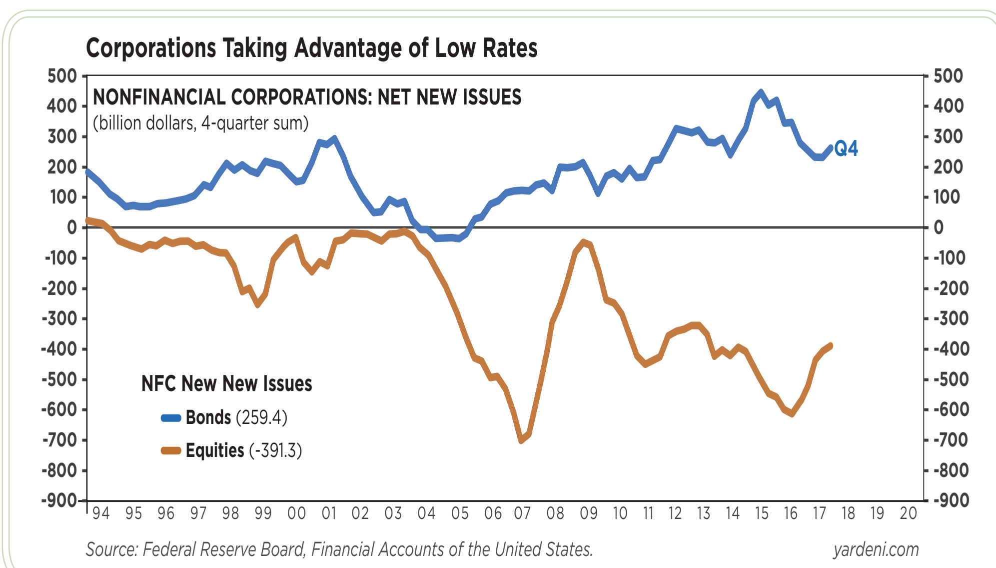


As we can see, rates have been relatively stable and calm since the start of 2017. In reality, this tells us that further Fed rate hikes will slow down. This will also make it easier for more corporate debt issuance.

It's not going to last forever, though. Rates will eventually increase and hamper borrowing. At that time, P/Es will rise and buy-backs will subside. For now, though, it's party time.

Debt

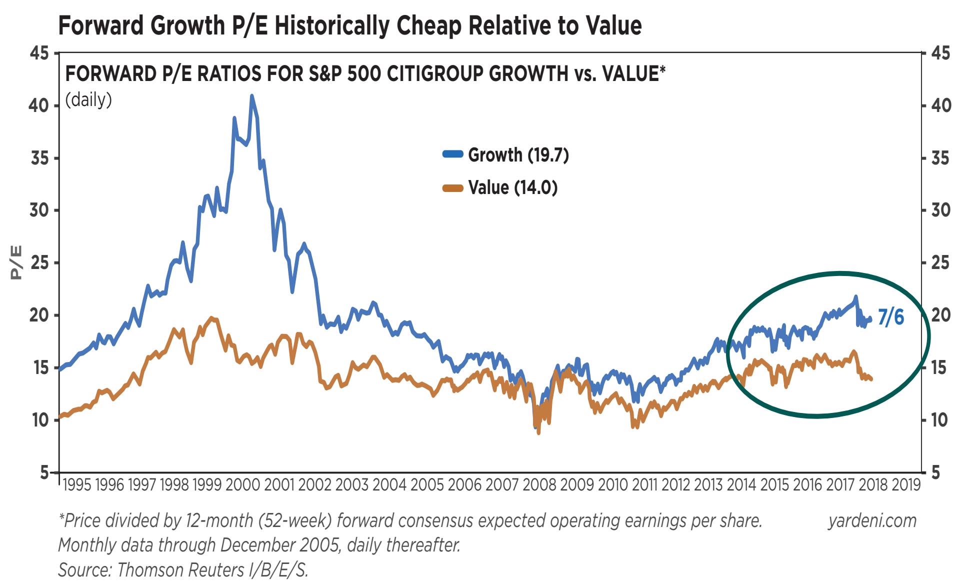
Debt issuance has actually been growing. Companies are issuing debt to help facilitate buying back more stock. This would mean outstanding stock is shrinking. That's precisely what this chart shows:



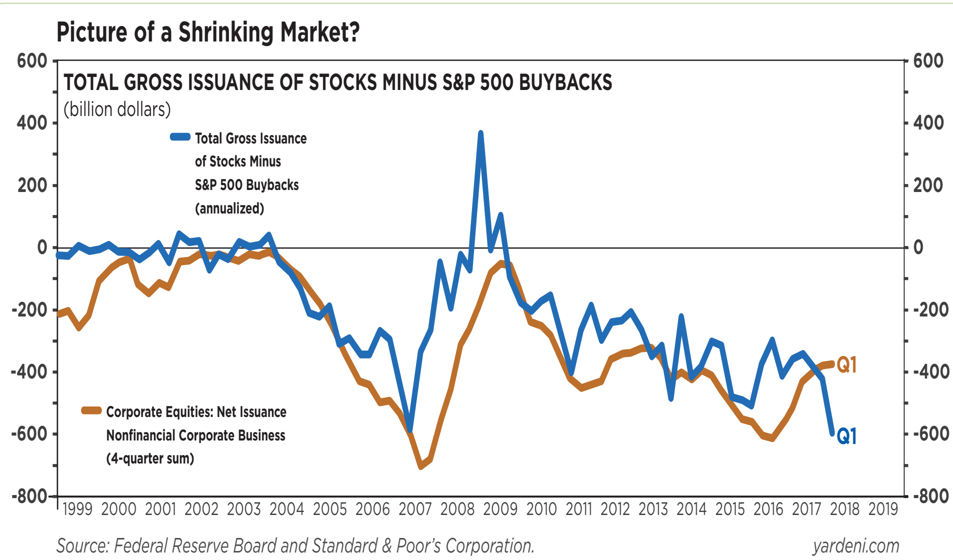
As this chart shows, net new stock issues in non-financial corporations is -$391.3 billion at last count.

P/E Ratios

Next, let's talk about P/E Ratios for a moment. As we will see in the following chart, they are historically low. Not only are they low, but they continue to fall. Couple this fact with historically low interest rates, and you have an environment which essentially inspires even more stock buy-backs.



The following chart shows the incredible shrinking stock market best of all. We can see that the gross issuance of new stock is rapidly decreasing. The number of outstanding shares is dwindling. The stock market is slowly vanishing. It's dying. In front of our very eyes.



HOW IT ALL ENDS

The phenomenon we are witnessing now is fascinating. Low interest rates spur corporate borrowing through debt issuance. They take the money and buy-back shares. Tax reform is allowing a massive repatriation of foreign money to come back home. Corporations are taking the money and buying back shares. As the outstanding float goes down, share prices go up.

A particular winner in this is growth. Growth-heavy companies that earn most of their revenue in the U.S. stand to benefit the most from what's happening. Naturally this is bullish for the market, and buy-backs are great for shareholders. As Louis Navellier has summed up the process:

"The bottom line is as long as bond yields and forecasted P/E ratios remain low, stock buy-backs will persist, especially while ROE remains high and cash flow remains strong. The average large capitalization growth I recommend will disappear in approximately 17 years at the current stock buy-back pace, while the S&P 500 will disappear in 27+ years. Naturally, as stock prices resume rising, it will raise forecasted P/E ratios and potentially postpone stock buy-back activity. However, right now Corporate America is buying back its outstanding stock at the fastest pace ever recorded, so the stock market's eventual demise may be fast approaching!"

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