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5 Stocks That Lost a Bundle on Buybacks

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Stock buybacks aren't the equal of dividends, I've learned over the past year.

Companies that generate spare cash are meant to return a portion to stockholders. Managers can do that in two ways. They can distribute a small payment for each share owned (a dividend) or use the money to buy and retire stock.

Theoretically, investors should slightly prefer buybacks. They make shares scarcer and thus more valuable by, all things equal, the same amount dividends would add to wallets. Investors are taxed on dividends but not buybacks, tilting the benefit.

Companies grew plenty fond of buybacks in recent years. In the early 1980s, 90 cents of each dollar returned to shareholders was delivered through dividends, and the rest through buybacks. Two years ago buybacks topped dividends for the first time.

That seemed to change things for stock pickers. High dividend yields have long been a powerful predictor of plump stock returns, perhaps because high yields are one result of low share prices. One strategy, popularized by Michael O'Higgins in his 1991 book "Beating the Dow," called for investors to simply buy at the start of each year the 10 highest yielders of the 30 stalwarts in the Dow Jones Industrial Average. This Dogs of the Dow approach beat the market by three percentage points a year over a half century ended 1995, but results fizzled over the next 10 years.

In a book I wrote two years ago on stock-screening strategies, I reported on an updated dogs approach that redefined yield to include dividend and buyback spending, instead of dividends alone. A company with a stock market value of $100 million that spends $3 million on dividends has a dividend yield of 3%, but if it spends another $4 million on buybacks, it has a net payout yield of 7%. Four prominent finance professors published a study of the predictive power of this new measure. Over 22 years ended 2005, the original dogs, based on dividend yields, beat the Dow by three percentage points a year. The new dogs, based on dividends and buybacks, beat it by twice as much.

I wonder now if that finding will hold once fresh research becomes available. Part of the appeal of dividends is that investors can reinvest payments in good years and bad, thereby purchasing more shares when prices are low. The past six months have shown how much easier it is for companies to scrap their repurchase plans in a downturn than to forsake their dividends.

A few high-profile companies have cut their dividend payments of late, but for each S&P 500 company that cut payments last year, six increased them. Even in the dismal fourth quarter, payments for the S&P 500 shrank just 6.1%. That figure would surely be lower, but for the high weighting the index has long assigned to now-troubled banks. (True to form, dividend payers did better than nonpayers for the year, losing 39% versus 45.4%.)

Buybacks, on the other hand, imploded. Companies reduced payments at a faster rate than their stock priced dropped -- by 57%, Bloomberg reports. Company managers, it seems, are prone to that most common of investor mistakes: buying high, and then clutching cash when prices fall. Dividends impose discipline. Buybacks don't.

Consider the capital lost by the companies below, which spent giant sums on shares just before prices plunged. They've now drastically slowed their buying.

Buybacks Gone Bad

Company	Ticker	Industry	Stock Market Value ($mil.)	Buyback Spree	A Year Later...	Even Though the Stock Price Fell...
Abercrombie & Fitch	ANF	Clothing Stores	1,650	$288 million over 39 weeks ended Nov. 3, 2007	spent 83% less	64%
Best Buy	BBY	Electronics Stores	11,684	$3.5 billion over nine months ended Dec. 1, 2007	spent nothing	59%
CBS	CBS	Diversified Media	4,166	$3.4 billion over nine months ended Sep. 30, 2007	spent 99% less	54%
Motorola	MOT	Communications Equipment	10,674	$2.5 billion over nine months ended Sep. 29, 2007	spent 94% less	72%
The Home Depot	HD	Home Improvement Stores	37,504	spent $10.8 billion over nine months ended Nov. 2, 2008	spent 99% less	25%