

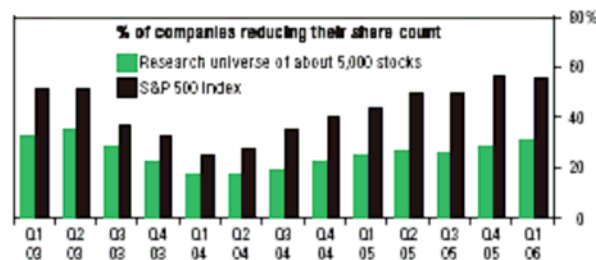
Invest in companies that invest in themselves

S&P 500 Index companies spent a record \$349 billion on buybacks in 2005, up from \$197 billion in 2004 and \$131 billion in 2003. The 2005 buybacks represented about 3.1% of the index's market capitalization, the highest percentage in at least 15 years. Spending on buybacks rose sharply in each of the last three years, after two years of declines. Despite the 77% increase in spending on buybacks in 2005, the average number of shares for S&P 500 companies rose 1.8%. Why the increase?

Because over time, companies tend to issue more stock than they buy back. While corporate cash balances remain at historically high levels, many companies continue to issue stock to fund acquisitions or cover expenses, especially those related to expansion. Companies also issue shares for stock-based compensation plans.

In each of the 11 years from 1994 through 2004, non-financial U.S. companies issued more stock than they repurchased, with the dollar value of buybacks lagging the dollar value of share issuance by an average of 38%. While complete data for 2005 is not yet available, the record amount of buybacks suggests U.S. companies repurchased more than they issued for the year. More than half of S&P 500 Index components saw their share counts decline last year.

BIG COMPANIES LEAD BUYBACK CHARGE

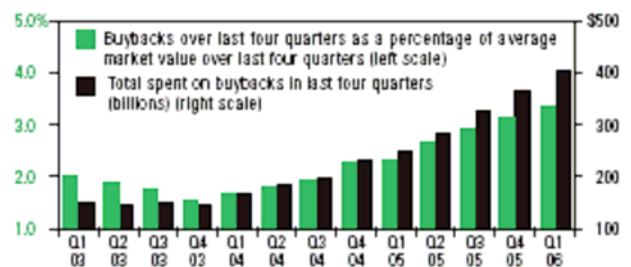


In the March quarter, more than 55% of companies in the S&P 500 Index reduced their share count relative to year-earlier levels, up from 25% two years earlier. A similar trend holds marketwide, though small and medium-size companies are less likely than large companies to repurchase shares.

Small and medium-size companies are less likely to repurchase shares than large companies, as illustrated by the above chart. But in recent quarters, even smaller companies have gotten in on the action. About 30% of the roughly 5,000 stocks in the Quadrix® research universe reduced their share count in the 12 months ended March, up from about 17% in the same period two years earlier.

The amount of money U.S. companies spent on stock buybacks has risen steadily over the last nine quarters, as shown in the chart at right. In general, investors like buybacks. They sometimes signal that management believes the stock is undervalued and

BUYBACKS ON THE RISE



Spending on stock buybacks has more than doubled over the last two years. For the 2,684 U.S.-traded companies for which data is available, buybacks have increased on an absolute basis and have also risen as a percentage of market capitalization. Those companies spent more than \$300 billion on stock buybacks over the last 12 months.

expects higher earnings going forward. Studies show that stocks announcing buybacks tend to outperform the market in the short run. But not every company that buys back shares represents an attractive investment, particularly for investors looking ahead a year or more. Here are two potential trouble spots with buyback stocks:

Growth concerns: Some companies repurchase stock to divert attention away from slowing profit growth. Buybacks reduce the number of shares with a claim on each dollar of net income, potentially causing per-share earnings to rise at a faster rate than operating profits. To avoid such traps, consider a company's growth rate for total sales and profits, not just per share results.

All talk, no action: Not all companies that announce buybacks actually repurchase the stock. Other companies make tiny purchases that have little practical effect. Investors should not take companies at their word. Instead, consider whether the company has a history of buybacks, and whether it generates enough cash to keep repurchasing stock.