THE WALL STREET JOURNAL.

Why the IPO Market Can't Be Judged by Its Size

Relatively few companies have gone public this year, but that often coincides with strong stock performance for those firms that take the plunge

Food distributor US Foods Holding Corp. launched an initial public offering last month. It was one of only 31 IPOs so far this year. Photo: Richard B. Levine/Zuma Press

By Spencer Jakab
June 19, 2016 12:23 p.m. ET

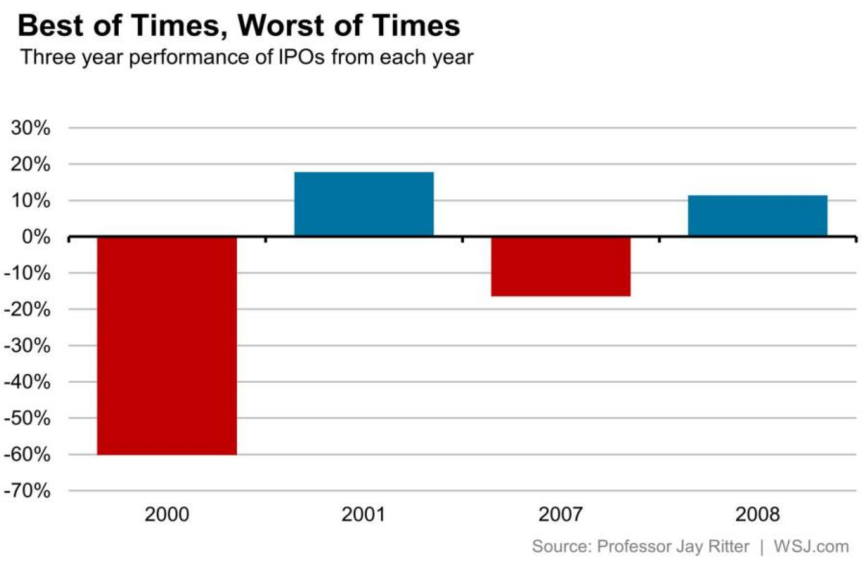
For investors, 2016 is turning out to be a banner year for IPOs. For bankers, not so much.

Market turbulence has made it hard for companies to go public, with just 31 IPOs so far this year. That makes 2016 the quietest year for new stock offerings since also turbulent year of 2009. The pipeline for the rest of the year looks pretty thin as well.

But where the IPO market is weak on numbers, it has been strong on performance. Tracking firm IPOScoop says the total return of IPOs this year is more than 24%, with 22 winners and only eight decliners. One was unchanged.

This fits with history. In years when there are lots of IPOs, the bankers feast on fees but investors end up nursing losses. An environment of easy money and exuberance that creates the most fertile ground for these companies to be offered to the public is often a prelude to stormy financial seas. The flip side is that the returns in times when IPOs are fewer are generally better, perhaps also because more solid companies make the cut.

For example, red-hot 2000 saw 381 new U.S. issues according to Jay Ritter , a finance professor at the University of Florida and a leading expert on IPOs. But the average three-year return of IPOs that year was an absolutely awful negative-60%. The next year investors grew far more selective and there were just a fifth as many issues. It turned out to be a boon to their performance as they rose by nearly 18% on average over three years.



The same pattern was seen more recently. In 2007, the tail end of an easy-money fueled bull market, there were 159 deals with an average three-year negative-16.5% performance. The following tumultuous year saw just 21 deals but they rose by 11.4%.

Bankers listing shares also get less greedy. A hallmark of a hot market is selling stock above the underwriters' price range but, according to Dealogic, none have done so this year.

This year's drought may be a good thing, then. When it comes to IPOs, less is more.