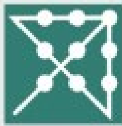
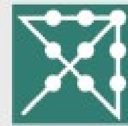
 Yardeni Research 

MORNING BRIEFING
August 30, 2023

Consumers Spending Selectively

Check out the accompanying chart collection.

Executive Summary: The rolling recession hit the retail industry during the first half of this year. Demand for many retailers' merchandise plummeted during Q2, even as consumers paid up for services like travel and dining and big-ticket items like new cars and homes. Jackie examines how the shift in consumer behavior affected the earnings of particular retailers last quarter as well as the ytd performance of particular Consumer Discretionary industries' share price indexes. … Also: US households are in good shape right now with unemployment low. But consumer debt has been on the rise, and other factors may weigh on consumer spending soon—including the resumption of student loan payments.

Consumer Discretionary I: Retailing's Rolling Recession. In recent weeks, many retailers have reported y/y declines in Q2 revenue, including Foot Locker, Home Depot, Lowe's, Macy's, Nordstrom, and Target. There were some exceptions, including Walmart and TJX; but in general, the rolling recession that we have tracked as it has rolled through various industries also has hit hard-goods retailers.

The tough retailing environment hasn't held back the S&P 500 Consumer Discretionary sector, however. It handily beat the ytd performance of the S&P 500 and eight other sectors (through Monday's close): Communication Services (40.0%), Information Technology (39.0), Consumer Discretionary (29.6), S&P 500 (15.5), Industrials (9.0), Materials (4.5), Energy (-0.2), Financials (-0.4), Real Estate (-0.9), Health Care (-1.9), Consumer Staples (-2.0), and Utilities (-10.3) (*Fig. 1*).

While consumers haven't been shopping 'til they drop lately, they have been out and about, paying up for services and big-ticket items like cars and homes. Among the Consumer Discretionary sector's top performing component industries so far this year are Hotels, Resorts & Cruise Lines (up 44.6% ytd), Casinos & Gaming (19.6%), and Restaurants (7.4%). Even more impressive, the Automobile Manufacturers industry is up 73.3% ytd thanks to shares of Tesla, which have raced ahead by 93.9% ytd. More modest ytd gains have been logged by other auto-related industries: Automotive Parts & Equipment (9.3%) and Automotive Retail (3.4%). The Homebuilding industry is another star performer in the sector, up 34.8% ytd, as the lack of home inventory has offset the impact of rising mortgage

interest rates—so far.

Meanwhile, the Consumer Discretionary sector's retail-related industries have had a miserable year, with most of them posting negative returns ytd: Housewares & Specialties (-20.3%), Apparel, Accessories & Luxury Goods (-15.8), Footwear (-14.9), Other Specialty Retail (-8.7), Computer & Electronics Retail (-7.7), Home Furnishings (-4.0), Household Appliances (-3.5), Home Improvement Retail (5.6), and Apparel Retail (10.4) (*Table 1*).

Apparel Retail, with star constituent TJX, is an exception, as US consumers love a bargain in good times and bad. Amazon's shares also have bucked the downtrend; they rose 58.5% ytd, as revenue from the company's cloud services and advertising business lines grew faster than expected last quarter. Amazon's shares are in the Broadline Retail industry, which was created earlier this year and therefore doesn't have a y/y comparison. If Amazon and Tesla stocks were eliminated from the S&P 500 Consumer Discretionary sector, the sector's ytd return would be 5.5% instead of 29.6%, Joe calculates.

But outside of a few bright spots, most retailers are struggling regardless of whether they're selling candles, high fashion, or sneakers. Growing sales is tough this year, and growing profits is even tougher. Let's take a look at what's ailing some of the retailers in the S&P 500 Consumer Discretionary sector:

(1) *Tough times in the kitchen.* Newell Rubbermaid, the sole constituent of the Housewares & Specialties industry, makes Rubbermaid kitchen products, Sharpie pens, Coleman gear, Yankee Candles, Paper Mate pens, and Elmer's glue, among other things. It posted a 13.0% y/y decline in Q2 sales to $2.2 billion and adjusted Q2 earnings per share of 24 cents compared to 56 cents in the year-ago quarter. The company has a new CEO and is in the process of restructuring by reducing its number of brands, prioritizing the top countries in which it sells, and streamlining its manufacturing and distribution processes.

Analysts are hoping that next year brings better results. They're forecasting a 1.4% increase in sales and 26.8% earnings growth in 2024, a fast improvement from the 12.2% and 45.9% declines expected this year (*Fig. 2* and *Fig. 3*). Other home-related industries with stock price indexes that have fallen ytd include Household Appliances (-3.5%) and Home Furnishings (-4.0%).

(2) *Fashion and footwear flounder.* Consumers seem to be thinking twice before splurging, whether it be on high-end duds or kicks to lounge around in. The S&P 500 Apparel, Accessories & Luxury Goods industry includes retailers Ralph Lauren (up 7.7% ytd),

Tapestry (-12.8%), and VF Corp. (-30.3%). Ralph Lauren's international exposure helped boost its overall fiscal Q1 (ended July 1) performance, as weakness in North America was offset by strength in Europe and Asia.

The shares of Tapestry, which owns Coach and Kate Spade, fell sharply earlier this month following news that it plans to buy Capri Holdings, owner of Versace, Jimmy Choo, and Michael Kors, for $8.5 billion. Mid-tier or aspirational luxury brands have had a tough time attracting squeezed consumers and an even tougher time competing against European luxury conglomerates that dominate the high end of the industry, an August 25 *WSJ* *article* reported. Meanwhile, VF Corp. has struggled as its Vans shoes have lost their cool and the company recently hired a new CEO who lacks a background in apparel and footwear retail.

The S&P 500 Footwear industry's sole member is Nike. It reported a 5% sales increase in fiscal Q4 (ended May 31) but a 28% drop in net income to $1.0 billion, citing higher operating and freight expenses, a higher tax rate, and product markdowns. Facing new competition from On, Hoka, and others, Nike—like many retailers—has needed to trim excess inventory. Nike has also been hurt by disappointing results at Footlocker, a major retailer of Nike products. Footlocker recently reported a 9.9% sales decline in its fiscal Q2 (ended July 29), and management has lowered its outlook guidance and suspended the stock's dividend.

(3) *Pressure on lotion & makeup.* The S&P 500 Other Specialty Retail industry includes Bath & Body Works (-15.0% ytd), Ulta (-12.4%), and Tractor Supply (-2.7%). Bath & Body Works expects sales to decline 1.5%-3.5% in 2023. Investors looked past Ulta's 10.1% revenue growth in the quarter ended July 29 and focused instead on the 110bps decline in gross margin to 39.3%, which was blamed on inventory shrink (goods stolen from stores) and higher supply-chain costs. The shrink problem has become a recurring theme for retailers as varied as Ulta, Macy's, and Dick's Sporting Goods.

(4) *No new computers needed.* During the Covid pandemic, consumers working from home and students learning from home scrambled to buy larger and faster computers. That surge of buying pulled forward sales and hurt the industry in the ensuing years. Yesterday, Best Buy reported big y/y declines in its fiscal Q2 (ended July) sales and earnings: Sales dropped by 7.2% to $9.6 billion and adjusted earnings per share fell 20.8% to $1.22. Best Buy shares rallied 3.9% on Tuesday nonetheless because those results beat analysts' consensus expectations and management said that demand is likely to improve in 2024.

"[W]e continue to expect that this year will be the low point in tech demand after two years

of sales declines. Next year the consumer electronics industry should see stabilization and possibly growth driven by the natural upgrade and replacement cycles and the normalization of tech innovation," said CEO Corie Barry in a company *press release*. Best Buy is the sole member of the S&P 500 Computer and Electronics Retail industry. After two years of earnings declines, analysts are hopeful the industry will post earnings growth north of 10% in 2024.

(5) *Consumers love a bargain.* The one retail-related industry that has fared well this year is the S&P 500 Apparel Retail industry; its stock price index has risen 10.4% ytd. The industry includes Ross Stores (up 3.3% ytd) and TJX (13.4%). The off-price retailers always seem to have a following, as consumers love hunting for a bargain. TJX also benefits from having the HomeGoods and HomeSense stores, which likely have gained shoppers who had frequented the now defunct Bed Bath and Beyond stores. TJX sales rose 7.7% to $12.8 billion in its fiscal Q2 (ended July 29), and its net income jumped 22.1% to $989 million.

Consumer Discretionary II: Not Shopping Doesn't Mean Not Spending. Even as interest rates have risen this year, consumers have continued to spend on travel, dining, and new homes. Most are employed, have received a raise or two in recent years, and still have low debt service costs relative to their incomes. Student loan payments are set to resume in October, and gasoline prices have been creeping up, which could crimp consumer spending. But generally speaking, consumers remain in solid shape.

Here's some of the recent data on the consumer's financial state:

(1) *Gainfully employed.* Tuesday brought news from the JOLTS report that the labor market continued to cool off modestly this summer. Job openings declined by 338,000 in July m/m to 8.8 million seasonally adjusted, and the quits rate declined to 2.3% in July from 2.4% in June. Fewer quits suggests that employees may be growing slightly more concerned about the employment picture. That said, both statistics indicate that the labor market remains strong: Job openings is far above its 2019 average of 7.2 million, and the quits rate is back down at its 2019 average (*Fig. 4*).

The next reading on the job market comes on Friday with the release of the August employment report. In July, with the unemployment rate at 3.5%, almost everyone who wanted a job had a job (*Fig. 5*). The adult unemployment rate was even lower, at 3.2%, and the rate for people with a bachelor's degree was only 2.0%. Even those with no high-school degree had an unemployment rate of only 5.2% (*Fig. 6*).

Those who have a job have also benefitted from rising wages. Average hourly earnings in private industry was $33.74 in July, up 4.4% y/y and up 10.1% over the past two years (*Fig. 7*). No doubt, some of the wage increases have been eaten away by inflation. Personal income rose 5.3% y/y in June, while real personal income rose only 2.3%. Likewise, the YRI Earned Income Proxy (aggregate weekly hours times average hourly earnings of total private industries times 52) rose 6.3% in June but only 3.3% adjusted for inflation (*Fig. 8*). (The Proxy's nominal reading fell to 5.7% y/y in July; a real rate for July is not yet available.)

(2) *Watching rising debt.* Consumers have been borrowing more freely this year. Consumer credit outstanding is at a record high of $5.0 trillion as of June (*Fig. 9*). Revolving credit card debt has jumped 11.2% y/y to $1.3 trillion as of June, and nonrevolving debt—which includes auto and student loans—has jumped 4.0% y/y to $3.7 trillion as of June.

Some solace comes from the household debt service ratio, which at 9.6 as of Q1 remains low by historical standards (*Fig. 10*). However, it should continue to climb along with interest rates, which are up sharply since Q1; the 10-year Treasury bond yield is 4.20%, up from 3.48% at the end of Q1. And while personal savings has fallen to $742 billion as of June, well below its March 2021 peak of $3.5 trillion, it remains solidly above the 12-month change in consumer credit outstanding, which is $271 billion (*Fig. 11*).

This may explain why the percentage of credit card loans that are delinquent by 90 days or more remains relatively low at 8.0% as of Q2. That's above its 2022 low of 7.6% but below the average of 9.2% from 2002 through 2008 (*Fig. 12*).

Last week, however, Macy's warned that it has seen a spike in the number of customers delinquent on their credit card payments. The company had expected delinquencies to climb after the post-Covid lull, but the "speed at which the increase occurred for us and the broader credit card industry … was faster than planned," COO Adrian Mitchell said in an earnings conference call, an August 23 CNN *article* reported. The problem "accelerated" in June and July.

(3) *Student loans & gasoline.* Retailers and investors are concerned that the resumption of student loan payments in October will prompt consumers to pull back on spending. Interest starts accruing on more than $1 trillion of student loans on Friday for the first time since it was paused beginning three years ago due to the onset of the Covid pandemic. The impact may be muted over the next 12 months when interest on student loans will accrue but loans won't be marked as delinquent or reported to credit rating agencies if payments are missed, an August 28 *WSJ* *article* reported.

The resumption of student loan payments may disproportionately affect younger consumers. Here's a breakdown of the percent of student loan holders by age group and the average amount they still owe, courtesy of Quill Intelligence data cited in an August 29 *report* from The Daily Shot: under 30 years old (23%, $23,857), 30-39 years old (32%, $42,748), 40-49 (22%, $44,864), 50-59 (15%, $44,020), 60 and older (8%, $35,897).

The weekly trip to the gas station may also begin weighing on consumers' wallets. The price of a gallon of gasoline has jumped to $3.93 as of August 28. That's up from a recent bottom of $3.20 during the final week of 2022 (*Fig. 13*).

Calendars

US: Wed: ADP Employment 195k; GDP 2.4%; PCED Headline & Core Prices 2.2%/2.4%q/q; Corporate Prices 1.3%; Pending Home Sales -0.1%; MBA Mortgage Applications; Crude Oil Inventories & Gasoline Production. **Thurs:** Headline & Core PCED 0.2%m/m/3.3%y/y & 0.2%m/m/4.2%y/y; Personal Income 0.3%; Nominal & Real Personal Consumption Expenditures 0.6%/0.0%; Initial & Continuous Jobless Claims 235k/1.709m; Chicago PMI 44.0; Natural Gas Storage; Collins. (Bloomberg estimates)

Global: Wed: Eurozone Business & Consumer Survey 93.8; Eurozone Inflation Expectations 8.6; Germany CPI 0.2%m/m/6.0%y/y; Germany Import Prices -1.4%m/m/=13.1%y/y; Spain CPI -0.3%; Italy Business & Consumer Confidence 107.7/98.0; Japan Household Confidence 36.6; China M-PMI 49.5. **Thurs:** Eurozone Headline & Core CPI -0.1%m/m/5.1%y/y & 0.3%m/m/5.3%y/y; Germany Retail Sales 0.3%m/m/-1.5%y/y; Germany Unemployment Change & Unemployment Rate 10k/5.6%; Germany Import Price Index 0.0%; France GDP 0.5%q/q/0.9%y/y; France CPI 0.7%m/m/5.2%y/y; France PPI -3.3%; Italy Unemployment Rate 7.4%; Italy CPI -0.8%m/m/5.7%y/y; UK Nationwide HPI -0.3%m/m/-3.9%y/y; Japan Housing Starts -0.8%y/y; Japan Construction Orders 2.1%y/y; China Caixin M-PMI 49.4; ECB Publishes Account of Monetary Policy Meeting; Schnabel; De Guindos; Balz; Pill. (Bloomberg estimates)

Strategy Indicators

MSCI World & Region Net Earnings Revisions (*link*): Analysts' recent earnings revisions through May suggest improving optimism about profits in the Emerging Markets and more

pessimism about Europe. The US MSCI's NERI was positive in August for a fourth straight month for the first time since June 2022, as it edged down to 2.4% from a 17-month high of 2.5% in July. That compares to a post-pandemic high of 21.1% in July 2021 and an 11-year low of -36.9% in May 2020. However, the AC World ex-US MSCI's NERI was negative for an 18th month following 17 straight positive readings, as it edged down to -2.3% from a 16-month high of -2.0% in July. NERI turned negative m/m for EAFE, Europe, and Europe ex-UK. It was positive for a fifth straight month for EM Eastern Europe and the EMU. NERI for the Emerging Markets index was negative again in August for a 22nd straight month, paced by EM Asia (22-months) and EM Latin America (7 months). Here are August's scores among the regional MSCIs: EM Eastern Europe (4.6% in August, down from 3.2% in July), the United States (2.4, 2.5), EMU (0.9, 2.4), Europe ex-UK (0.0, 3.3), EAFE (-0.8, 1.2), Europe (-0.8, 2.3), AC World (-1.0, -0.9), AC World ex-US (-2.3, -2.0), EM Latin America (-2.5, -3.5), EM Asia (-2.6, -3.7), and Emerging Markets (-2.7, -3.8).

MSCI Countries Net Earnings Revisions (*link*): NERI was positive for 17/41 MSCI countries in August, down from 18 in July. It had been positive for just 15 countries during February and March, which was the lowest count since August 2020 and down from a peak of 35/41 during May 2020, which nearly matched the record-high 36/41 from June 2004. That also compares to zero countries with positive NERI from April to June 2020. NERI improved m/m in August for 21/41 countries, up from 20 improving in July. NERI was at a 19-year high in August for the Philippines, followed by: Israel (18-year high), India (28-month high), Ireland (23-month high), Hungary (18-month high), and Japan (18-month high). Finland was at a 38-month low, followed by 37-month lows for Australia and Norway and 36-month lows for Austria and Mexico. Italy and Turkey has had positive NERI for 34 straight months, followed by Indonesia (22) and the Philippines (12). Hong Kong has the worst negative-NERI streak, at 27 months, followed by China (24), Brazil (22), and Taiwan (16). NERI flipped back into positive territory in August for the Czech Republic and India. It turned negative m/m for Austria, Germany, and Peru. The highest NERI readings in August: Egypt (20.7%), Ireland (18.1), Israel (17.1), the Czech Republic (13.7), Spain (12.0), Turkey (11.7), and the Philippines (10.2). The weakest NERIs occurred this month in Finland (-19.3), Peru (-13.2), Norway (-12.7), Canada (-10.7), Australia (-10.5), and Hong Kong (-9.0).

US Economic Indicators

Consumer Confidence (***link***): "Consumer confidence fell in August 2023, erasing back-to-back increases in June and July" notes Dana Peterson, chief economist at The Conference

Board. “August’s disappointing headline number reflected dips in both the current conditions and expectations indexes. Write-in responses showed that consumers were once again preoccupied with rising prices in general, and for groceries and gasoline in particular,” she added. The pullback in confidence was evident across all age groups, and among consumers with annual household incomes of $100,000 or more as well as less than $50,000; confidence held steady for consumer with incomes between $50,000 and $99,999. *Headline* consumer confidence slumped in August by 7.9 points, to 106.1, after jumping 11.5 points during the two months through July to a 19-month high of 114.0 (downwardly revised from 117.0). The *present situation* component fell for the third time in four months, by 8.2 points in August, though 7.0 points over the period to 144.8—with a 6.4-point gain in June offsetting some of the weakness. *Expectations* fell 7.8 points in August to 80.2, after a 16.5-point jump in July to an 18-month high of 88.0. The report notes that the expectations component was just a hair above 80.0—the level that historically signals a recession within the next year. *Current business conditions* were slightly less optimistic in August, with the percentage of consumers saying business conditions were good unchanged at 20.7% and those saying conditions were bad at 17.2%, up a percentage point from July’s 16.2%. Meanwhile, consumers’ assessment of the current labor market took a hit in August, with 40.3% of consumers saying jobs are plentiful, down from 43.7% in July, and 14.1% saying jobs are hard to get, up from July’s 11.3%. *Short-term business conditions* (six-month outlook) deteriorated again in August: The percentage expecting conditions to worsen climbed to 16.8% from 14.5% in July, while those expecting business conditions to improve fell a percentage point—to 16.2% from 17.2% in July. Consumers’ assessment of the *short-term labor market* was also less favorable, with the percentage of consumers expecting more jobs to be available six months from now little changed at 16.7%—from 16.6% in July—though 18.0% anticipated fewer jobs, up from 15.6% in July. Consumers’ *short-term financial prospects* deteriorated in August, with 16.5% expecting their incomes to improve, down from 17.8% in July; it’s steadily been declining since May’s 18.9%. Meanwhile, 12.4% expect their incomes will decrease, up from 9.9% in July.

JOLTS (***link***): There are signs in July’s JOLTS report that the job market continues to cool, with both job openings and quits falling. *Job openings* have been on a downtrend so far this year, dropping 338,000 in July and 2.4 million ytd to 8.8 million—the first level below 9.0 million since March 2021. The series peaked at a record-high 12.0 million last March. Prior to the pandemic, in early 2020, the highest level of job openings recorded was 7.6 million. Openings reached 10 million in June 2021 for the first time in the history of the series going back to 2000. There were 5.8 million people unemployed in July, so there were 1.51 available jobs for each unemployed person that month—which was the lowest since September 2021 though still a strong number. It was a recent high of 2.01 last March. By

industry, the *biggest decreases* in job openings in July occurred in professional & business services (-198,000), health care & social assistance (-130,000), other services (-64,000), wholesale trade (-32,000), manufacturing (-30,000), and construction (-23,000). The *biggest increases* occurred in information services (+101,000), transportation warehousing, and utilities (+75,000), leisure & hospitality (+62,000), and financial activities (+40,000). *Within government*, job openings in state & local government excluding education (-67,000), state & local government education (-62,000), and federal government (-27,000) all fell. Total separations fell 208,000 in July to 5.5 million. Separations include quits, which are generally voluntary separations initiated by employees—serving as a measure of workers' willingness or ability to leave jobs. Quits have declined during five of the seven months of 2023, by 253,000 in July and 542,000 ytd to 3.5 million, matching its level just before the pandemic. Quits have been in a downtrend since its peak of 4.5 million during April 2022. Hirings fell 167,000 in July to 5.8 million. It was at a recent peak of 6.8 million during February 2022.

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