Federated Hermes

A four-month shopping spree

Measured from October to January, holiday retail sales impressed.

Published 02-19-2020

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BOTTOM LINE

Several major consumer bellwethers (including Apple, Walmart, Nike, Disney and Tesla) have issued cautious guidance to investors, warning in recent days that China's deadly coronavirus could have a deleterious impact on revenue and earnings goals. The good news is that this hasn't happened yet. Last Friday, the Commerce Department flashed relatively solid retail sales for January. With Christmas spending—measured from October through January in this case—now complete, 2019's 4.1% year-over-year (y/y) gain outstripped the tepid 3.3% increase of the 2018 holiday season.

Why was Christmas a 4-month retail sales holiday this year? Thanksgiving 2019 arrived later than typical (Nov. 28), resulting in six fewer shopping days until Christmas compared with 2018. That led many retailers to begin promoting Thanksgiving weekend in October, pulling sales forward at the expense of November. Moreover, Cyber Monday and Giving Tuesday fell in

December, so Thanksgiving-weekend sales were split between the two months. Finally, we include January in our analysis of Christmas sales because of post-holiday gift-card redemptions, which only count as a sale when they're redeemed, not when purchased.

And why was the data so good? In our view, the combination of a powerful wealth effect, a strong labor market, a rebound in consumer and business confidence, an elevated savings rate and lower gas prices all contributed.

But with the Wuhan coronavirus now in full bloom (more than 73,000 confirmed infections, at least 1,874 deaths and a mortality rate of 2.56%), we could very well see a negative impact on economic data and corporate earnings in February. Even in the best of times, consumers tend to hunker down during the post-Christmas frugal February to right-size their budgets. This year it's important that Passover begins on April 8 and Easter on April 12, so we'll need to patiently gauge the trajectory of the coronavirus and the impact that it may have on "Mapril" spending.

Softer-than-expected retail sales Commerce reported that nominal retail sales in January rose an in-line 0.3% month-over-month (m/m). It revised December's figures down a tick to a gain of 0.2%, November's up to 0.2% and October up to 0.3%.

But control results, which strip out food, autos, gas and building materials—and which feed directly into quarterly GDP—were disappointing. They were even in January (versus an expected gain of 0.3%), December was revised down from a 0.5% increase to 0.2%, November declined 0.2% and October was breakeven.

Weather a double-edged sword We've had a relatively warm and snow-free winter to date in the Northeast, with January the fifth-warmest month on record. That resulted in strong sales in the building materials and eating-out categories in January, rising 2.1% and 1.2% m/m, respectively. But apparel sales plunged 3.1% m/m as fewer people bought heavy winter coats and snow boots. That marked the category's largest decline since March 2009.

The consumer, in our view, remains healthy longer term due to strong underlying fundamental factors. This should help to restore consumer spending's luster once the fears surrounding the coronavirus fade and people resume a normal schedule.

Labor market still solid

- Unemployment rate (U-3), which hit a 50-year low of 3.5% in December, is now at 3.6%
- Labor force participation rate at 63.4% hit a 7-year high in January
- Wage growth, which matched a 10-year high of 3.5% on a y/y basis in August, is now at 3.1%
- Private ADP payrolls surged by 291,000 in January, a 5-year high
- Initial weekly unemployment claims, a leading economic and employment indicator, plunged by 50,000 claims over the previous two months through the week ended Feb. 1 to 203,000, just off a 50-year low of 193,000

Rebound in business and consumer confidence

- Conference Board's Consumer Confidence Index bottomed at 126.3 in September, but has bounced to 131.6 in January
- ISM Manufacturing Index hit a 10-year low at 47.2 in December, then spiked to 50.9 in January, exiting five months in contraction territory
- NFIB Small Business Optimism Index fell to a trough of 101.8 in September, but rose to 104.3 in January

- Michigan Consumer Sentiment Index bottomed at 92.0 in September, but soared to a 2-year high of 100.9 in February

25% plunge in crude oil Over the past six weeks, the price of a barrel fell from $65 to $50, due to less demand expected out of China because of the coronavirus outbreak. That's pulled lagging gas prices down 7%, from $2.60 per gallon to $2.44. The rule of thumb is that every 1 cent decline at the pumps adds $1.2 billion in consumer discretionary spending. That could translate into stronger GDP growth annually due to more robust business and consumer spending.

Powerful wealth effect Since Christmas Eve 2018's oversold trough of 2,347, the S&P 500 has surged 44% to last week's new record high of 3,385. The top socioeconomic half of America owns stocks in their retirement and college-savings plans, so that wealth effect should help to keep consumer spending humming.

Moreover, our research friends at Evercore ISI note that over the past 20 years there has been an 86% correlation between the S&P's fourth-quarter performance and holiday retail sales. So with the S&P up 8.53% in the fourth quarter (9.06% on a total-return basis), it makes perfect sense that Christmas sales rose 4.1% y/y in 2019, in line with our 4-4.5% forecast. Once we get over the figurative coronavirus hump, we expect retail sales to resume their solid upward trajectory as we believe that the health of the U.S. consumer remains strong.

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DISCLOSURES

Views are as of the date above and are subject to change based on market conditions and other factors. These views should not be construed as a recommendation for any specific security or sector.

The Conference Board's Consumer Confidence Index measures how optimistic or pessimistic consumers are about the economy.

The Institute of Supply Management (ISM) manufacturing index is a composite, forward-looking index derived from a monthly survey of U.S. businesses.

The University of Michigan Consumer Sentiment Index is a measure of consumer confidence based on a monthly telephone survey by the University of Michigan that gathers information on consumer expectations regarding the overall economy.

S&P 500 Index: An unmanaged capitalization-weighted index of 500 stocks designated to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries. Indexes are unmanaged and investments cannot be made in an index.

The National Federation of Independent Business (NFIB) conducts surveys monthly to gauge how small businesses feel about the economy, their situation and their plans.

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