2018 HOLIDAY SHOPPING SEASON OUTLOOK

The most important time of the year for brick and mortar and online retailers is approaching quickly: the holiday shopping season. When it comes to retail sales, the state of the consumer is key. Unemployment, wages, inflation, consumer sentiment and specific macro-economic risks are all ingredients that influence consumer spending during the holiday shopping season. Let's take a closer look at these data points to understand what the holiday shopping season of 2018 could shape up to be.

UNEMPLOYMENT, WAGES & INFLATION

A low unemployment rate means there is a larger gross potential audience of wage-earning consumers to purchase goods. The U.S. Labor Department's most recent Monthly Employment report released early October showed that unemployment fell to near a 49-year low of just 3.7%. When considering unemployment, it's crucial to consider the direction of wages at the same time. Rising wages, especially those that are not outpaced by inflation, can create tailwinds for consumer spending. According to the same U.S. Labor Department report, wages in the form of average hourly earnings grew in September by 0.3%, which equals a 2.8% growth rate in wages year over year. In comparison to inflation, which is estimated to be at 2.7%, wage growth is keeping pace with inflation. These three data points - unemployment, wages and inflation - all seem to point to a consumer that is likely to be in a position to spend more, not less, this holiday season.

CONSUMER CONFIDENCE & SENTIMENT

While economic statistics are one way to assess the consumer, another way is to gauge the attitude of the consumer through measures of consumer confidence & sentiment. Research shows that emotions like fear and greed heavily influence buying and selling decisions. Let's examine two of the most followed measures of consumer attitudes: The Consumer Confidence Survey and the University of Michigan's Survey of Consumers.

The Consumer Confidence Survey® reflects prevailing business conditions and developments for the months ahead. This monthly report details consumer attitudes and buying intentions, with data available by age, income, and region. The September 2018 reading of this survey showed consumer confidence at an 18-year high according to the official news release. "Consumers' assessment of current conditions remains extremely favorable, bolstered by a strong economy and robust job growth," said the Director of Economic Indicators at The Conference Board, which is the publisher of the Consumer Conference Index.

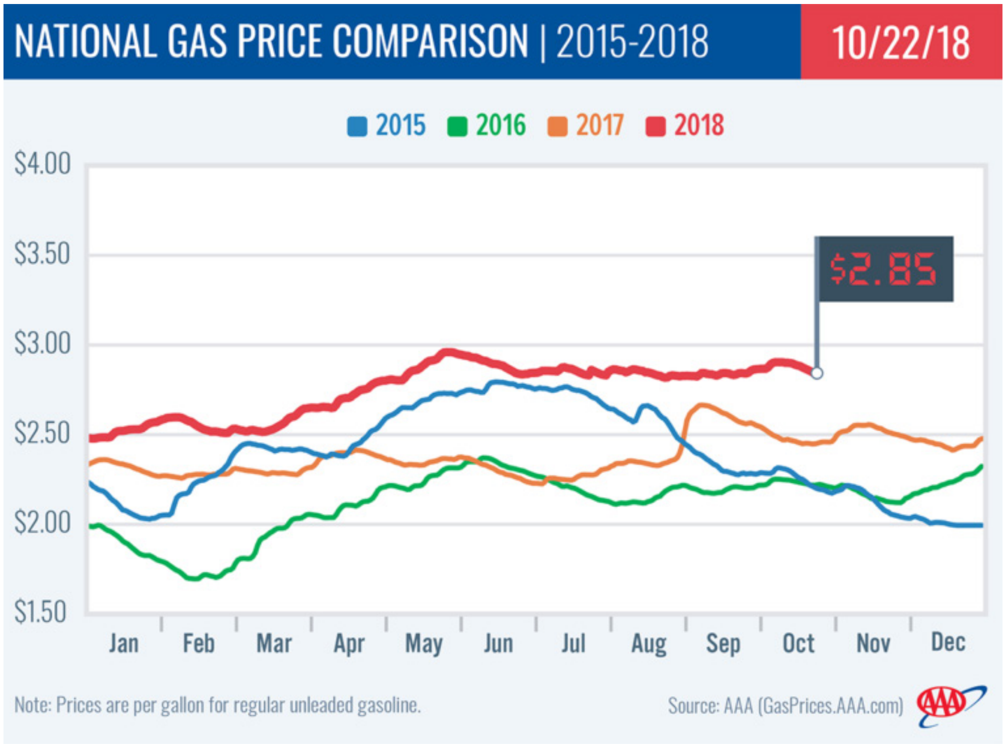
The University of Michigan's Survey of Consumers is a monthly survey of U.S. consumer confidence levels conducted by the University of Michigan. It is based on telephone surveys that gather information on consumer expectations regarding the overall economy. The results form the Michigan Consumer Sentiment Index. According to the University's official survey comments, "consumer sentiment remained at very favorable levels in September, with the Index topping 100.0 for only the third time since January 2004. Most of the September gain was among households with incomes in the bottom third, whose index value of 96.3 was the highest since November 2000. In contrast, the Sentiment Index among households with incomes in the top third lost a total of 8.1% during the past seven months since reaching its cyclical peak of 111.9 in February 2018. This divergence across income subgroups has been observed in past economic cycles and indicates that the expansion has now benefitted nearly all population subgroups. All households held very optimistic expectations for improved personal finances in the year ahead, the most favorable financial prospects since 2004."

Clearly both surveys show a healthy consumer outlook, which should be bullish for 2018 holiday retail sales.

MACRO ECONOMIC RISKS

Stepping back from economic statistics and consumer outlook, there are certainly other factors that will likely influence consumer spending. We believe two that are important to consider given their potential consumer impact are gasoline prices and tariffs.

In a nation with significant automobile usage, higher gasoline prices mean less money to spend on other goods. According to AAA, fall season gas prices in the U.S. have not been this high since 2014. According to AAA, "Crude oil accounts for half of the retail pump price and crude is selling at some of the highest price points in four years. That means fall and year-end prices are going to be unseasonably expensive." Crude oil prices are being driven higher by geopolitical tensions with Iran and Venezuela, along with stronger demand for oil due a healthier global economy. A gas price shock is a consumer spending risk to consider going into year end, especially for low wage earners as gasoline purchases account for a larger percentage of spending.



The Trump administration has made foreign trade - and more specifically tariffs on trade - one of the most watched issues of 2018. Whether it be renegotiating the NAFTA agreement with Mexico and Canada or the ongoing negotiation on trade with China, clearly the issue of tariffs is front and center. In fact, The University of Michigan's Survey of Consumers highlighted trade as the only negative concern by consumers in their latest results. According to the official survey commentary, "The single issue that was cited as having a potential negative impact on the economy was tariffs. Concerns about the negative impact of tariffs were cited by nearly one-third of all consumers in September." We believe extensive tariffs on Chinese and U.S. goods would likely create a slowdown in consumer spending due to higher costs and perhaps less availability of the affected goods. This is clearly a risk to consumer spending, but one that is more likely to occur in 2019 since most retailers already have secured 2018 goods in anticipation of the holiday season. Still, this issue appears to be a concern on a significant amount of consumers' minds.

RECORD BREAKING HOLIDAY SHOPPING IN 2018?

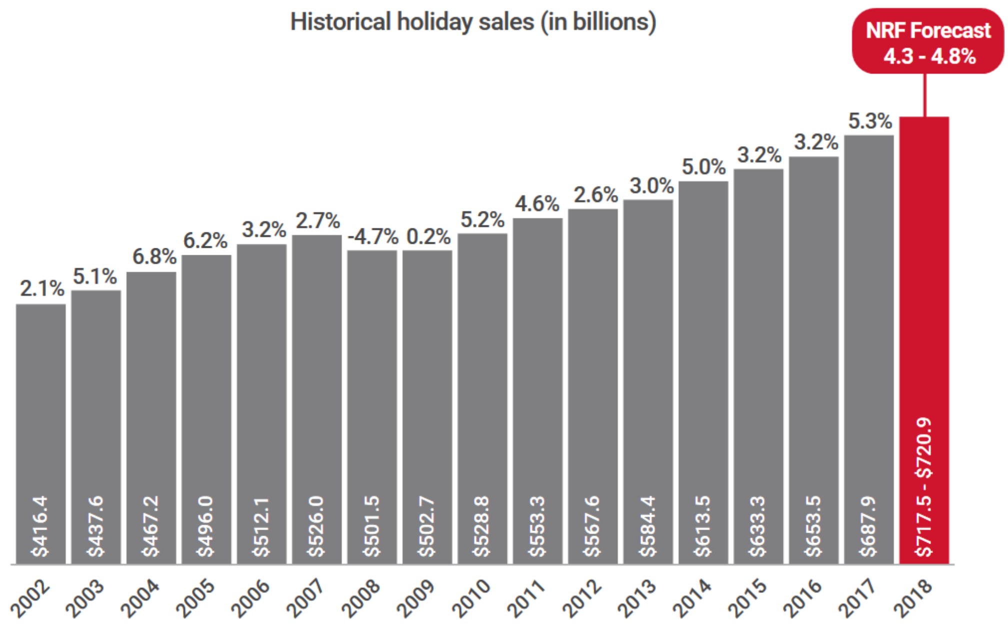
Economic data combined with consumer surveys appear to point to a robust 2018 holiday shopping season, but could it be a record breaker?

According to the National Retail Federation (NRF) 2018 holiday retail sales are expected to hit a new all-time high, eclipsing 2017's record by an estimated 4.3 - 4.8%. According to the NRF, "Last year's strong results were thanks to growing wages, stronger employment and higher confidence, complemented by anticipation of tax cuts that led consumers to spend more than expected," NRF Chief Economist Jack Kleinhenz said. "With this year's forecast, we continue to see strong momentum from consumers as they do the heavy lifting in supporting our economy. The combination of increased job creation, improved wages, tamed inflation and an increase in net worth all provide the capacity and the confidence to spend."

Here's a NRF graph showing 2018's forecast relative to previous year's results.

HISTORICAL HOLIDAY SALES AND 2018 FORECAST

Holiday sales for 2018 are expected to increase by 4.3-4.8% over 2017.



Source. U.S. Census. Reflects May 25, 2018 Census revisions for 2013-2017.
NRF holiday spending is defined as the months of November and December. NRF forecast excludes automobiles, gasoline and food services.

In our view, the 2018 holiday shopping season should benefit both brick-and-mortar and online retail stocks. Investors may want to review their current portfolio allocations to this market segment which appears to be setting up for strong underlying business results.

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