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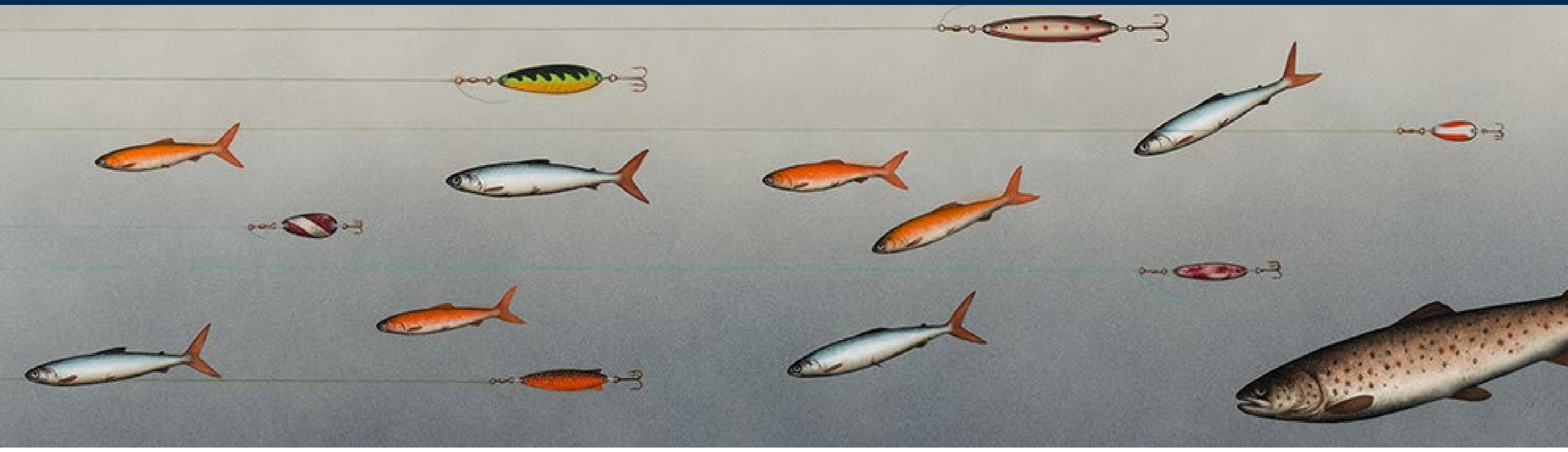

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"IT'S THE CONSUMER, STUPID"

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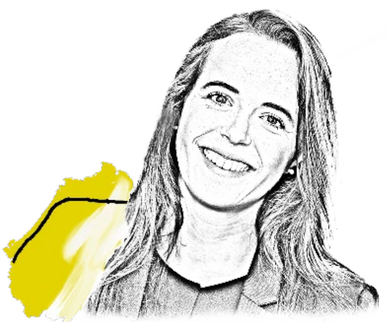
Is the mighty US consumer finally feeling the pinch? Amidst signs of a slowdown in spending, investment manager Ashley-Jane Kyle takes a look at how some consumer-facing companies are faring.



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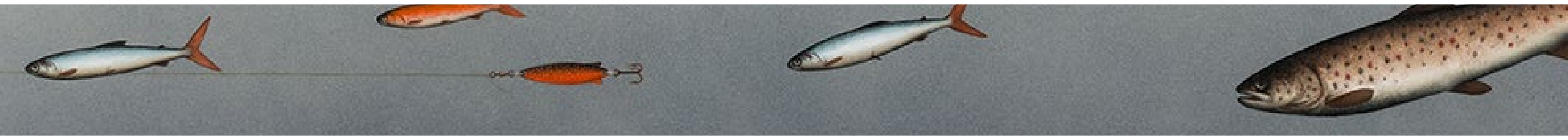


Few quotes are more enshrined in American electoral folklore than James Carville's "it's the economy, stupid." A strategist on Bill Clinton's 1992 presidential campaign, Carville was exhorting his fellow Democrats to focus relentlessly on the recession that had started on the watch of sitting Republican president George H.W. Bush. His counsel paid off. Clinton won comfortably.

Carville knew that voters' perception of the economy was more often than not the issue on which presidential elections turned. Three decades later, not much has changed – November's vote is in large part shaping up to be a referendum on the current administration's economic stewardship.

But rather than GDP or other broad indicators of economic vigour, the question of economic competence this time around is being scrutinised through the lens of the consumer. Whether its Kamala Harris' vow to tackle "price gouging" or Donald Trump's pledge to end America's inflation "nightmare", both candidates have put the issue at the centre of their pitch to voters. Whilst their proposed solutions might differ, they share a belief that these are tough times for the US consumer.

THE VIEW FROM THE GROUND

So, how does the reality on the ground compare to the political rhetoric? Recent news flow has offered conflicting signals. A spate of cautious announcements from some of the totemic names of Main Street America was quickly followed by good numbers from sector bellwether Walmart and a solid retail sales report. Having become a little frayed, investor nerves were duly calmed.

"There is enough evidence to suggest people are becoming more discriminating in how they part with their dollars"

Despite this welcome data, however, questions around the health of the American consumer haven't gone away. Certainly, there is enough evidence to suggest people are becoming more discriminating in how they part with their dollars. After a sustained period of elevated interest rates and inflation that's hardly surprising. What's less clear is the extent to which this is happening and whether it heralds a more fundamental deterioration in demand.

WHAT ARE WE HEARING?

Over recent weeks and months, we've listened to a range of views from management teams. Some have been notably more cautious than others. On balance though, we've been reassured by what we've heard. Some, such as TJX Companies and Costco, have seen few signs of consumer fatigue to date. Others are experiencing a degree of slowing. In several cases, however, we think this represents a cooling of post-pandemic growth rates that were likely unsustainable over the long term.

O'Reilly Automotive is a case in point. One of the largest specialty retailers of car parts and equipment in the US, O'Reilly sells to both DIY customers and professional installers. When we spoke with the business in June, management struck a cautious note on consumer activity, highlighting the hit to lower-income customers from inflation (a common refrain in company discussions of late). This was reflected in weaker-than-expected second-quarter results and reduced full-year guidance.

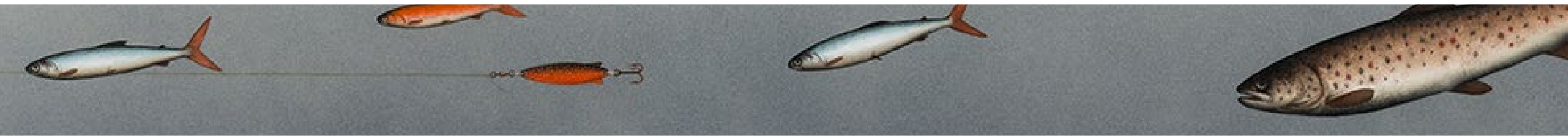
"The long-term narrative for O'Reilly remains robust"

Longer-term, however, this is a story of sales returning to normal after four years of above-trend growth. During Covid-19, O'Reilly leveraged its impressive distribution network and inventory management expertise to take business from less sophisticated operators and significantly increase its market share. Profitability was also boosted by an ability to pass on high levels of cost inflation to customers. As these tailwinds have eased, so too naturally has growth. But the long-term narrative for O'Reilly remains robust and rooted in hard-to-replicate competitive advantages.

The same near-term 'normalisation' story is also playing out at Booking Holdings. The online travel agent's most recent second-quarter results were impressive, but it was a more circumspect outlook for the third quarter that caught the eye of investors. Management attributed much of this to a shorter booking window (the time gap between booking and trip) and lower flight prices, whilst noting tentative signs that the US consumer was moving down the quality spectrum in areas like accommodation.

Although the market reacted badly to this guidance, it's worth remembering that Booking was a major beneficiary of 'revenge travel' – the vacationing boom that followed the easing of pandemic restrictions. Even in 2022, when some regions still had travel bans, the company was posting record revenues, comfortably surpassing pre-pandemic levels. Some of the steam might now be coming out of that surge, but this is still a company guiding for 7% year-on-year revenue growth in 2024.

Similarly, sales growth at LVMH is moderating after a very strong run in recent years. In part, this is due to a more cautious "aspirational" customer in the US – defined by McKinsey as people who buy at least one luxury item every year and spend between $3,000 and $10,000 on fashion annually. Not the richest 1% then, but the next 10%. Management attributes this to the impact of inflation and sees demand recovering only gradually.



> *"Sales growth at LVMH is moderating after a very strong run in recent years"*

In truth, interest rates and inflation were always going to bite into sales of luxury goods at some stage. Likewise, the depletion of household savings built up during the pandemic. According to estimates by the San Francisco Federal Reserve, the total of US savings has gone from a high of $2.1 trillion in August 2021 to -$72 million in March of this year. Those stimulus cheques couldn't last forever!

But the luxury companies feeling the pinch most severely are those further down the exclusivity spectrum, those with far less cachet than the roster of prestigious *maisons* under the LVMH umbrella. When the 10% are confident enough to resume luxury spending, Louis Vuitton, Dior, Bulgari, Berluti etc should be amongst their go-to labels.

FOCUSED ON THE LONG TERM

Consumer health has been a regular feature of our research discussions in recent months and, whilst optimistic on a long-term view, we don't rule out a further moderation in spending in the near term. Should this happen, it's important for investors to remain vigilant for any suggestion that belt-tightening is having a material impact on a company's fundamentals. Those best placed to weather such periods are likely to share some common characteristics:

- Strong brands
- Leading positions in their respective niches
- Genuinely differentiated products and services

Whilst short-term headwinds and cycles are inevitable, these attributes should bolster their ability to navigate any challenging periods and deliver over the long term.

On that final point, we'll give the last word to Booking Holdings CEO Glenn Fogel, whose remarks on a recent call resonated with our own long-held belief in looking through the noise and staying focused on the long term - *"There's gonna be volatility, there's gonna be variations…macro events that happen that can influence a quarter or a week or a day. But in the long run, we just continue to build what we've been trying to build for a long time, which is a better service."*

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