Retail outlook: Who will be in the driver's seat this holiday season?

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The holidays are just around the corner. Here are our expectations for shoppers and investors this year.

The mismatch between supply and demand within the retail space has reversed in advance of this year's holiday shopping season. This could have different implications for shoppers and investors.

Retail outlook for shoppers

Last year's shopping season was dominated by concerns about supply chain delays and low inventory at retailers, which drove many consumers to forgo the hunt for savings in favor of getting shopping done early.

That dynamic is unlikely to repeat this year. Supply chain issues have improved and many retailers, scarred by the challenges of restocking last year, have bulked up on inventory ahead of the holiday season. With elevated retail inventories, and increasing consumer caution, it seems unlikely shoppers will need to buy early.

Retailers will be monitoring sales closely to calibrate when/whether to entice shoppers with promotional sales. If they get this wrong, it could mean that shoppers will find a lot more merchandise at off-price retailers (e.g., Nordstrom Rack or TJ Maxx) at the end of the year and the beginning of 2023.

That said, the higher prices that retailers have successfully implemented since the pandemic are not going to reverse entirely. Items may not be materially more expensive than last year, but relative to, say 2019, consumers should expect to be paying more (and in some cases, a lot more).

Mari Shor, CFA
Senior Equity Analyst

COLUMBIA THREADNEEDLE INVESTMENTS

Retail outlook for investors

Higher inventory levels pose a risk to pricing power — the ability of retailers to pass through inflation costs to consumers. Given that pricing power has been a key driver of retailer earnings over the past two years, this change is significant.

And even though the prospects for a recession continue to rise, a contracting economy in 2023 is still **not** the base case scenario for many companies. This creates risk in the sector. While retailers have expressed confidence that they will be able to manage inventory without hyperactive cost cutting, there is still a risk for earnings.

Higher end retailers, which have been stellar performers in the sector, are expected to maintain an advantage over lower end sellers because their customers may be more economically secure, and because they are likely to retain their ability to sustain their pricing power. At the same time though, losses in the stock market and housing market could begin to dampen demand here as well.

One of the most surprising developments of the post-pandemic world has been the resilience of consumer spending on goods versus services. Spending on goods is expected to grow by an annual compounded rate of 10% (7% excluding Amazon) between 2019 and 2024, while spending on services is expected to grow by 5% during the same period.[1]

Outlook for 2023

Volatility and uncertainty will continue to define the retail space through the holiday season and beyond. Shoppers may have the upper hand — with high levels of inventory and limited pricing power among sellers, promotions are more likely.

But investors should remain cautious. Many companies have not factored a recession into their guidance, so there's a downside risk to estimates and stock prices in the near term. The backdrop is uncertain, with the possibility of sharp swings in consumer behavior that are difficult to predict. Macroeconomics headwinds are dominating the narrative, but the direction is unclear.

Keeping an eye on trends relating to inventory and inflation will help investors understand how the retail story will unfold.

To find out more, call 800.426.3750
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[1] Source: Columbia Threadneedle Investments, as of September 30, 2022.

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