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As consumer spending cools, some consumer stocks sizzle

Determining bright spots amid gloom challenges money managers

By **Jeff Benjamin**
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How recession-strapped consumers will spend their limited dollars is a question that is perplexing the financial markets and the pricing of consumer-related stocks.

“Most of the stocks that have done best so far this year look lousy on a [price-to-earnings-ratio] basis,” said John Buckingham, chief investment officer at AI Frank Asset Management Inc. in Laguna Beach, Calif. “Right now, it's all about expectations and how the market is viewing the outlook, because the earnings reports have not justified this stock market rally.”

Consider J.C. Penney Co. Inc. (JCP), which last month announced that its second-quarter per-share loss will be between 15 and 25 cents. Although the loss is about half an original estimate, the Plano, Texas-based retailer's stock has gained more than 53% since the start of the year.

Meanwhile, Wal-Mart Stores Inc. (WMT), the world's largest retailer and a company that many analysts say is perfectly suited for the economic environment, has lagged the market and missed the rally.

Shares of the Bentonville, Ark.-based company have fallen more than 11% this year, while the Standard & Poor's 500 stock index has gained almost 6%.

“Since the March 9 market low, Wal-Mart has gone nowhere, but I'd be buying a company like this today because it hasn't appreciated in this rally,” said Mr. Buckingham, whose firm manages \$400 million in assets.

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John Buckingham: *Earnings do not justify the stock market rally.*

One logical strategy in an environment where reduced consumer spending is expected to trim more than \$700 billion from the \$14 trillion U.S. economy is to avoid those areas associated with discretionary consumer spending.

“The idea right now would be to invest in consumer staples instead of consumer cyclicals because there will still be demand for staples re-gardless of the economy,” said John Lynch, chief market analyst with Boston-based Evergreen Investment Management Co. LLC, which has \$162 billion under management.

The caveat, he added, is that the stock market doesn't appear overly concerned at the moment with the threat of reduced consumer spending.

“It has been an atypical recession, and it will be an atypical recovery,” said Mr. Lynch, citing the recent strong performance of materials and technology sector stocks, which typically lead in the later stages of a recovery, not the early stages.

Some market watchers are describing the unusual rebound not as a recovery at all but a bear market rally that is riding on little more than corporate cost slashing, including lots of job cuts.

“Investors have to be very wary of companies that could run out of cost cutting, especially if consumer spending ends up being significantly lower than it has been,” said Donald Schreiber, founder and chief executive of Wealth Builders Inc., a Little Silver, N.J.-based firm with \$325 million under management.

“Right now, it looks and feels like things are getting better, but earnings have been disastrous,” he added. “Things will look real rosy for a while, but you need increasing revenue and increasing profits, and that has to come not just from cost cutting.” Mr. Schreiber cited Dearborn, Mich.-based Ford Motor Co. (F) as an example of a company that could do well as the economy recovers.

“Ford has mostly weathered the financial storm, but it still needs to increase sales,” he said. “Consumers will buy American cars again, and they might have a preference for Ford because it wasn't bailed out by the government.”

Ford shares are up almost 180% so far this year.

Travel and leisure are often among the first areas to suffer in an economic downturn, but the current environment has played out well for online travel service provider Priceline.com Inc. (PCLN). The Norwalk, Conn.-based company's stock has gained more than 64% this year.

“The mentality of the consumer is changing to more of a bargain-hunting attitude,” said Jay Wong, head of equities at Payden & Rygel, a Los Angeles-based asset management firm with \$2 billion under management. “We've tried to focus on names that we think will do well in a slowdown.”

Part of that focus involves a consideration of the changing shopper demographics at deep-discount retailers such as Dollar Tree Inc. (DLTR).

“Everything in the store is a buck,” Mr. Wong said. “You buy something, and if it doesn't work, you're out a buck.”

Shares of Chesapeake, Va.-based Dollar Tree are up almost 9% so far this year.

One approach in analyzing the affects of a more cost-conscious U.S. consumer is not to dwell too heavily on the fact that consumer spending typically accounts for nearly three-quarters of the U.S. economy.

“Companies don't have to re-place all the spending by U.S. consumers; they just to have replace the incremental spending that has been reduced,” said Robert Levitt, president of Levitt Capital Management LLC, a Boca Raton, Fla.-based firm with \$450 million under management.

His strategy is to look abroad to places such as China, where he anticipates that “the primary automobile battleground will be taking place for the next 50 years.”

This could bode well for a company such as General Motors Co., the post-bankruptcy successor to General Motors Corp., one of the leading sellers of cars in China.

“The depressing scenario in the U.S. is not shared around the world,” Mr. Levitt said. “China appears to be the first country to emerge from the global recession, and we're starting to see the world shift from a focus on trying to sell goods to the U.S. consumer to selling to all consumers around the world.”

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