globalmatters Weekly

momentum global investment management

> "China's high savings rate could support a swift recovery in luxury spending if consumer confidence rebounds."

Delicate China

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The Chinese consumer, once a major driving force behind global luxury sales, is currently showing signs of weakness. This slowdown is influencing the broader economic landscape and the decline in consumer spending is having a huge impact on the luxury sector, leaving notable brands like Burberry and Kering (parent company of brands like Gucci, Balenciaga and YSL) particularly vulnerable.

The luxury market has long depended on Chinese consumers, whose appetite for high-end goods has fuelled significant growth. However, recent data indicates a cooling in this market. The economic slowdown in China, coupled with a decline in consumer confidence, has resulted in decreased demand for luxury products where brands such as Burberry and Kering have reported a significant slump in sales.

[1]Burberry, for instance, reported a 21% drop in quarterly sales in China, and the brand has now suspended its dividend and replaced its CEO, highlighting the severe impact of reduced Chinese spending. Its shares fell 16% on the day of the trading update and are now trading at levels not seen since 2010. Similarly, [2]Swiss watchmaker Swatch Group reported a substantial drop in sales in the first half of 2024, attributing the decline to weaker demand in China and forecasting a challenging market environment for the rest of the year. [3]Kering also saw its shares drop by 16% in July after reporting a decline of 12% in sales over Q2 2024, reflecting further concerns about sluggish Chinese consumer spending.

Several factors contribute to the current economic challenges in China. The country's GDP growth rate of 4.7% in the second quarter of the year fell short of expectations, despite government efforts to stimulate the economy. Falling property prices have also led to Chinese shoppers tightening their belts. This shift is particularly concerning for the luxury market, which relies heavily on middle-class spending. High youth unemployment further exacerbates the situation, leading to hesitation among consumers to invest in luxury goods amidst economic uncertainty.

Despite the current challenges, the long-term growth potential for the luxury market in China remains promising. The Chinese government continues to emphasise economic growth, setting a target of 5% for this year, which if met could help revive consumer spending. Official data from the People’s Bank of China shows that household deposits reached a record of 146 trillion yuan as at the end of June, with Chinese households adding 9.3 trillion yuan to their savings in the first half of the year alone. However, this increase in savings is not yet translating into spending, dragging second-quarter growth down to 4.7%, below expectations of 5.1%. With sluggish retail sales increasing by just 2% in June, its slowest pace since December 2021.

Adding to the pressure, a weak yen has made luxury goods in Japan more attractive, driving wealthy Chinese consumers to shop abroad instead of at home.[4]LVMH for instance reported a 57% surge in sales in Japan over Q2 2024 (+44% over H1 2024), where many Chinese nationals are taking advantage of the favourable exchange rate. Similarly, Kering has seen sluggish demand in China but reported an increase in Japanese sales for the second quarter. Despite these shifts, China's high savings rate could support a swift recovery in luxury spending if consumer confidence rebounds.

Given the current weakness in Chinese consumer spending, this period could present a compelling opportunity to build or increase exposure to the luxury sector. Luxury markets are inherently cyclical and while we might not have reached the bottom yet, current conditions offer long-term investors a chance to build positions in strong brands at more attractive valuations.

The Chinese market remains a crucial area for luxury brands despite current economic challenges. Whilst the ongoing economic slowdown has clearly impacted consumer spending, brands that can successfully navigate this period by maintaining consumer engagement and adapting their strategies to align with current conditions will be well-positioned to benefit from a recovery. At Momentum, we have recently introduced Burberry to the portfolios within our direct UK equity exposure. We continue to see the company as having a valuable brand with a solid luxury core offering and assuming Burberry’s brand equity remains intact, we believe the shares offer significant value. With much of the negativity already priced in, any upside in Chinese consumer spending could provide a substantial tailwind to the sector.

Sources: [1]First Quarter Trading Update [2] Half-Year Report 2024 - Swatch Group [3] First-half 2024 results | Kering [4] 2024-first-half-results-lvmh, slide 24 of Presentation.

Market Review - week ending 9 August 2024

- Global equities were flat
- Japan saw its worst currency move since 1959 as the Yen/USD carry unwind caused a global rout
- Brent crude rose 3.7% to $79.66 a barrel
- Gold fell 0.5% to $2431.32 per ounce

US

- US equities were flat
- Volatility spiked in a 24-hour shock with the VIX index rising from 20 to 65
- Goldman Sachs economists raised their odds for a US recession in the next year to 25% from 15% after the weak jobs report, but this week's employment data reassured the market with a 233k rise (vs 241k expected)
- JP Morgan now sees a 35% chance the US will tip into recession by year-end, up from 25%. It also expects a 30% chance of the Fed and its peers keeping rates "high-for-long," compared with a 50-50 assessment as recently as two months ago
- Donald Trump said presidents should have some say over interest rates and monetary policy, which would buck the Fed's tradition of political independence. He also proposed three September debates with Kamala Harris — on Fox, NBC and ABC.

UK

- UK equities rose 0.2%
- PM Sir Keir Starmer called for an emergency COBRA security meeting in a bid to quell anti-immigrant protests across the UK, adding that those responsible will be punished for what he described as "far-right thuggery"
- UK July PMI (Purchasing Managers' Index) for Composite was 52.8 (vs 52.7 expected), Services 52.5 (vs 52.4)
- UK Halifax House price index year on year for July was +2.3% (previously +1.9)

Europe

- European equities fell 3.9%
- German CPI (Consumer Price Index) month-on-month was in line with expectations at 0.3%
- Retail sales volumes in the eurozone unexpectedly declined 0.3% sequentially in June after increasing 0.1% in May. This weakness reflected a drop in the sales of food, drinks, and tobacco

Rest of the World/Asia

- Global emerging market equities rose 0.3%
- Japanese equities fell 2.1%, partially recovering after falling 12% on Monday, the most significant fall since 1959 and the worst Yen/USD move ever as investors unwound carry trades. On Thursday, JPMorgan thought 75% of the carry trade had been unwound
- The Bank of Japan said they "won't be able to hike again this year, may conduct another hike by March"
- Chinese equities rose 1.7%, July CPI Month-on-month was 0.5% (vs 0.3% expected), but factory-gate prices fell 0.8%, extending a deflationary run that began in late 2022

Market Performance - week ending 9 August 2024

		Cumulative returns			
Asset Class / Region	**Currency**	**Week ending 9 August**	**Month to date**	**YTD 2024**	**12 months**
Developed Markets Equities					
United States	USD	0.0%	-3.2%	12.7%	20.9%
United Kingdom	GBP	0.2%	-2.0%	8.4%	12.6%
Continental Europe	EUR	0.5%	-3.5%	5.5%	10.6%
Japan	JPY	-2.1%	-11.1%	6.2%	11.3%
Asia Pacific (ex Japan)	USD	-0.1%	-2.2%	6.3%	8.7%
Australia	AUD	-2.1%	-3.9%	4.4%	10.2%
Global	USD	0.0%	-3.4%	9.8%	17.6%
Emerging Markets Equities					
Emerging Europe	USD	-3.9%	-6.3%	8.3%	14.4%
Emerging Asia	USD	0.1%	-2.0%	8.5%	9.5%
Emerging Latin America	USD	6.1%	2.6%	-12.6%	-2.3%
BRICs	USD	0.9%	-0.9%	6.3%	4.7%
China	USD	1.7%	-0.5%	2.8%	-8.8%
MENA countries	USD	-2.4%	-2.9%	-2.8%	-0.3%
South Africa	USD	0.0%	-3.4%	6.3%	12.2%
India	USD	-1.5%	-2.6%	12.1%	23.9%
Global emerging markets	USD	0.3%	-1.9%	5.8%	8.2%
Bonds					
US Treasuries	USD	-0.9%	0.9%	2.3%	5.3%
US Treasuries (inflation protected)	USD	-0.5%	0.1%	2.6%	4.9%
US Corporate (investment grade)	USD	-0.8%	0.4%	2.9%	8.3%
US High Yield	USD	0.3%	-0.1%	4.6%	11.2%
UK Gilts	GBP	-0.6%	0.5%	-0.4%	6.9%
UK Corporate (investment grade)	GBP	-0.7%	0.0%	1.9%	10.7%
Euro Government Bonds	EUR	-0.1%	0.4%	0.7%	5.4%
Euro Corporate (investment grade)	EUR	-0.3%	0.1%	2.4%	7.2%
Euro High Yield	EUR	0.1%	-0.1%	4.3%	10.8%
Global Government Bonds	USD	-0.1%	1.5%	0.1%	3.7%
Global Bonds	USD	-0.4%	1.1%	0.9%	5.2%
Global Convertible Bonds	USD	0.1%	-1.0%	-0.3%	3.0%
Emerging Market Bonds	USD	0.0%	0.6%	3.9%	9.9%

		Cumulative returns			
Asset Class / Region	**Currency**	**Week ending 9 August**	**Month to date**	**YTD 2024**	**12 months**
Property					
US Property Securities	USD	0.7%	1.6%	7.0%	13.8%
Australian Property Securities	AUD	-1.9%	-3.2%	11.8%	23.2%
Asia Property Securities	USD	2.2%	-0.6%	-6.9%	-4.9%
Global Property Securities	USD	0.6%	0.5%	4.0%	11.8%
Currencies					
Euro	USD	0.1%	1.0%	-1.3%	-0.5%
UK Pound Sterling	USD	-0.2%	-0.6%	0.0%	0.3%
Japanese Yen	USD	0.2%	2.7%	-3.9%	-2.0%
Australian Dollar	USD	0.9%	0.7%	-3.8%	0.7%
South African Rand	USD	-0.3%	-0.7%	-0.3%	3.7%
Swiss Franc	USD	-0.5%	1.8%	-2.9%	1.4%
Chinese Yuan	USD	0.1%	0.7%	-0.9%	0.6%
Commodities & Alternatives					
Commodities	USD	1.7%	-0.8%	2.3%	-2.9%
Agricultural Commodities	USD	-0.1%	-0.4%	-3.0%	-5.4%
Oil	USD	3.7%	-1.3%	3.4%	-9.0%
Gold	USD	-0.5%	0.2%	17.9%	26.9%

Source: Bloomberg Finance L.P. Past performance is not indicative of future returns.

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