Be Wary of Retail Stocks as the Consumer Is Losing its Lustre

Description

The retail industry is a famously (or infamously) cyclical one — a fact that we may have forgotten as a result of the seemingly never-ending ride that the good news out of the consumer-led economic rally has brought us.

Well, times are changing, and we may be remembering this fact now.

This consumer-led economic boost was brought to us courtesy of record low interest rates.

And while interest rates are still low relative to history, the most recent 25-basis-point increase in the Bank of Canada's benchmark rate brought it to 1.75% — a whopping 125-basis-point increase from 2017 levels.

It's a big move that will invariably put the consumer at risk, especially considering their record-high household debt levels, as debt becomes more expensive, eating away at disposable income — and eating away at consumer spending and retail sales.

Let's take a look at some of the retail stocks that are increasingly coming under pressure.

Roots (TSX:ROOT)

Roots stock is trading below its IPO price once again, almost 70% lower to be more precise, as the stock continues its volatile ride. The whole way down, I have been saying that I still did not view valuation as attractive, even though it's been quite low at less than 10 times earnings.

The challenges remain, and with second-quarter results that have come in below expectations, as same-store sales increased a very modest 1.1%, the future is unclear.

And with slowing consumer spending, the company will have added difficulties with its expansion to the U.S., which has proven to be a very risky move, even in the best of times.

At this point, I can say that valuation on Roots stock is looking more attractive, and I will watch it more closely.

Aritzia (TSX:ATZ)

Aritzia stock is 12.5% higher than its 2016 IPO price of $16, and 55% higher than a year ago, as the stock continues its volatile ride.

The company achieved same-store sales growth of 10.9% in the latest quarter, the first quarter of fiscal 2019, with a 22.2% increase in net income, as the retailer opened two new stores and expanded two existing stores.

Results continue to look good, but the macro environment makes me leery of premium, luxury retailers.

Canada Goose Holdings (TSX:GOOS)(NYSE:GOOS)

Bucking the trend, Canada Goose stock is trading 149% higher compared to a year ago, as the company has defied the odds and continues to post solid results.

The stock is trading at sky-high valuations that are not sustainable in my view, especially considering an increasingly nervous investor, a weakening consumer spending environment, and the company's increased investments in China.

Canada Goose has been very successful in establishing its premium outerwear brand, with consumers paying upward of $800 for their Canada Goose jackets, but going forward, key risks remain.

The company has been expanding globally, but 39% of its revenue still comes from Canada, and as such, it is still vulnerable to a weakening in Canadians' purchasing power.

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