2 Reasons Now Is a Bad Time to Buy Retail Stocks

Description

Retail stocks are cyclical. We know this. And those of us who have been investing for many years now have seen this in action many times.

These days, we can safely say that we are at the end of the cycle. Rates have been very low for many years, consumer spending has been a strong driver for economic growth, and Canadians are riddled with record-high debt levels, seemingly growing tired and less willing to take on new debt.

Hence the issue I have with retail stocks.

Low rates won't spur growing debt as it has in the past. I mean, how far into debt can consumers go without pulling in the reigns? It appears this may be it. Thus slowing consumer spending growth and retail sales.

We are already seeing this take place. An overheated housing market, slow wage growth and record levels of household debt are taking their toll.

A slowing economy

In the first quarter of 2019, the Canadian economy (GDP) grew at a negligible rate of 0.1%, the same as the fourth quarter of 2018. And while consumer spending was higher in the quarter compared to a 0.2% decline in the fourth quarter, there is reason for concern.

Notwithstanding this encouraging data on consumer spending, the fact is that consumer insolvencies in Canada are on the rise. They are rising sharply, in fact, jumping 9.3% in April compared to the same month last year.

This is not a good situation.

High debt levels

The debt to income ratio (monthly debt payments divided by gross monthly income) for Canadians hit a record high of 178.5% in 2018. Simply put, Canadians are struggling to keep their heads above water.

With little room for debt levels to rise higher, the growth is consumer spending naturally has to come down.

So while some retailers continue to post strong revenue growth, like **Canada Goose Holdings Inc.** (TSX:GOOS)(NYSE:GOOS), with an outlook for 20%+ sales growth for fiscal year 2020 to 2022, these growth rates are normalizing.

In its latest quarter, Canada Goose reported strong sales that were below expectations, driving a sharp decline in Canada Goose stock price, down 20% on the day of the release. This retail stock remains vulnerable to a slowing consumer spending environment.

Aritzia Inc. (TSX:ATZ), another high growth stock, is still seeing strong revenue growth trends, but continues to be vulnerable to slowing consumer spending growth. This luxury retailer would be among the first types of retailers who we could expect consumers to scale back on in difficult times. Plus, we have the risk of changing fashion trends and different fads stealing market share away from this retailer.

So while revenue growth was strong again in the latest quarter, Aritzia stock price has not actually done anything since its IPO, I think reflecting investors' skepticism with the probability of success at this point in the cycle.

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Author
karenjennifer