SYZ WEALTH MANAGEMENT

SPOTLIGHT

November 2016

LUXURY IS NOT DEAD!

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“I think that over the next 20 years you’ll have 16 good years and maybe there will be four bad years. However I cannot tell you which these four bad years will be.”

Bernard Arnault

Chairman, CEO & Founder of LVMH

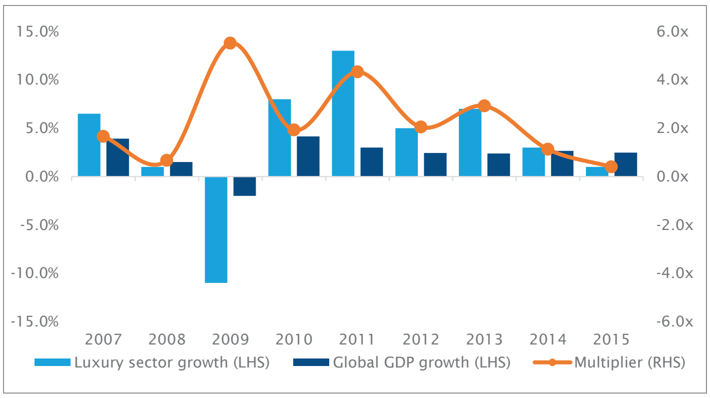
After years of strong growth, the luxury industry has entered a phase of consolidation. Luxury goods companies have to rethink their strategies as the implosion of the gift-giving bubble, the store openings euphoria and shifting consumption patterns have led to an increasingly crowded competitive landscape. Nevertheless, long-term drivers remain healthy and major luxury goods companies should benefit from the relative strength of their balance sheets.

Luxury goods companies recovered sharply from the global financial crisis as demand was fueled by the Chinese booming appetite for luxury. Within a bit more than a decade, Chinese became the largest luxury customers representing more than 30% of purchases versus c.1% in 2001. However, music stopped in 2012 with the Chinese crackdown on gift giving. This phenomenon was exacerbated by various adverse events (FX volatility, Mears in Asia and terrorist attacks in Europe) and new consumption patterns (rising demand for entry point products and increasing regional pricing arbitrages).

Almost four years after, the industry has not fully recovered yet and some specialists and market observers believe that the luxury business model is broken and that brands have lost their pricing power and competitive edge. According to Altagamma and Bain & Co., the luxury goods market should grow 2-3% per annum through 2020, below the OECD’s global GDP forecast of c.3.6%. This would be an unprecedented as the industry’s historical growth stands at an average rate of 2.5x global GDP growth (2007-15).

Are people throwing the baby out with the bath water? Probably, as suggested by Q3 results reported by LVMH, the world’s largest luxury goods conglomerate and a bellwether for the industry. LVMH delivered a solid performance in a volatile environment, beating organic growth expectation by 2%, with a significant outperformance from it’s Fashion and Leather goods division growing at 5% versus consensus expectations of +2%. Also, LVMH’s management flagged that demand from Chinese customers has increased at a double digit rate versus flat in the first half of 2016.

Could luxury good structurally underperform global GDP?



Source: IMF, Altagamma

Longer-term, luxury goods growth potential remains strong and supported by product innovation, increasing penetration of the online distribution channel and supportive demographics. According to the OECD, global middle class and middle class spending could grow at a CAGR of c.5% over 2009-2030, driven by an Asian middle class growing at a CAGR of 9%. We recently travelled to Asia (HK, Shanghai and Tokyo) and met with more than 20 industry contacts. Our key finding was that none of the companies we have met suggested that the current downturn was structural, despite the shift in Chinese consumption patterns (buying experiences versus goods). Moreover, brands and distributors flagged that the reservoir of emerging middle-class shoppers was significant and should be supportive of medium-term luxury goods demand.

Is luxury dead? Is it going to structurally underperform the global economy? Our opinion is that the industry is facing a cyclical period of consolidation that strong brands and luxury groups should be able to navigate through an adjustment of their product and distribution strategies and with the support of their balance sheets that are significantly stronger than during the global financial crisis.

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