



FISHER INVESTMENTS™ on
**CONSUMER
DISCRETIONARY**



- An in-depth look at the global Consumer Discretionary universe, including automobiles, consumer durables and services, retailing, and media
- Tips and tools for security analysis and portfolio management
- A useful guide for investing in any market condition

Foreword by *New York Times* bestselling author Ken Fisher



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Fisher Investments Press brings the research, analysis, and market intelligence of Fisher Investments' research team, headed by CEO and *New York Times* best-selling author Ken Fisher, to all investors. The Press covers a range of investing and market-related topics for a wide audience—from novices to enthusiasts to professionals.

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Fisher Investments on Consumer Discretionary

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with
Erik Renaud and
Andrew Teufel



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Foreword

You're holding the seventh in a series of investing guides from Fisher Investments Press—the first ever imprint from a money manager—produced in partnership with John Wiley & Sons. These guides are your introduction to a usable, top-down strategy for analyzing standard investing sectors (Energy, Materials, Consumer Staples, Health Care, Industrials, etc.) as well as other investing regions and categories. They are meant to stand alone—each an in-depth introduction to a category sparking your interest. Or, read together, they are a do-it-yourself training regimen for the full breadth of capital markets analysis.

This guide is on Consumer Discretionary—currently about 9 percent of total world stocks (as measured by the MSCI All Country Index). Discretionary may bring to mind luxury goods, cars, restaurants, and fancy vacations. And it's that, but the sector is far more diverse. It's also clothing and the firms making and distributing textiles. It's auto parts, but also power tools, building materials, and even some heavy manufacturing.

The major defining characteristic is these are goods and services you typically want. Contrast that with Consumer Staples firms, which make the things you need—though it's not always and everywhere like that, and the book shows you how to know. Overall, consumer spending is much more stable than most think, but Discretionary spending will be more volatile than Staples spending. Hence, Consumer Discretionary tends to be more economically sensitive, while Consumer Staples is seen as more defensive.

But it's never as easy as just timing economic cycles—though that itself isn't easy. First, the sector is too broad,

and some areas are more economically sensitive than others. To invest successfully here, you must know what distinct drivers impact each of Discretionary sector's diverse industries and sub-industries—the book shows you. And you must remember that stocks look forward, not back, so it's perfectly normal for Discretionary stocks to start zooming when the world looks bleak and you can't imagine why folks would spend on cruises, cars, and jewelry.

And it's wrong to think Consumer Discretionary is inherently riskier just because it's overall more economically sensitive than Consumer Staples or any other sector. Or that Discretionary should get better or worse returns. Given enough time, finance theory says all equity categories should net similar returns when properly accounted for—though traveling drastically different paths over the short to intermediate-term. Ultimately, given enough time, newly created supply or the destruction of existing supply (which is simply little more than investment bankers creating paper or destroying paper) tends to equalize categories. In the nearer term, demand tends to drive stock prices, but longer term (what may seem for most like an eternity but really isn't) supply swamps demand for that category. That's why a good portfolio is broadly diversified and why this book (and the entire series) can help you learn to be a better investor.

What the book won't give you is hot stock tips for 2010, 2011, 2018, or 2035. Such a thing doesn't exist—someone telling you otherwise is selling you something that's probably bad for you. Rather, this book provides a workable, repeatable framework for increasing the likelihood of finding profitable opportunities in the Consumer Discretionary sector. And the good news is the investing methodology presented here works for all investing sectors and the broader market. This methodology should serve you not

only this year or next, but the whole of your investing career. So good luck and enjoy the journey.

Ken Fisher

CEO of Fisher Investments

Forbes Portfolio Strategy columnist

Author of the *New York Times* Best Sellers

The Ten Roads to Riches and

The Only Three Questions That Count

Preface

The *Fisher Investments On* series is designed to provide individual investors, students, and aspiring investment professionals the tools necessary to understand and analyze investment opportunities, primarily for investing in global stocks.

Within the framework of a “top-down” investment method (more on that in Chapter 7), each guide is an easily accessible primer to economic sectors, regions, or other components of the global stock market. While this guide is specifically on Consumer Discretionary, the basic investment methodology is applicable for analyzing any global sector, regardless of the current macroeconomic environment.

Why a top-down method? Vast evidence shows high-level, or “macro,” investment decisions are ultimately more important portfolio performance drivers than individual stocks. In other words, before picking stocks, investors can benefit greatly by first deciding if stocks are the best investment relative to other assets (like bonds or cash), and then choosing categories of stocks most likely to perform best on a forward-looking basis.

For example, a Technology sector stock picker in 1998 and 1999 probably saw his picks soar as investors cheered the so-called “New Economy.” However, from 2000 to 2002, he probably lost his shirt. Was he just smarter in 1998 and 1999? Did his analysis turn bad somehow? Unlikely. What mattered most was stocks in general, and especially US Technology stocks, did great in the late 1990s and poorly entering the new century. In other words, a top-down

perspective on the broader economy was key to navigating markets—stock picking just wasn't as important.

Fisher Investments on Consumer Discretionary can help guide you in making top-down investment decisions specifically for the Consumer Discretionary sector. It shows how to determine better times to invest in Consumer Discretionary, what Consumer Discretionary industries and sub-industries are likelier to do best, and how individual stocks can benefit in various environments. The global Consumer Discretionary sector is complex, covering many sub-industries and countries with unique characteristics. Using our framework, you can be better equipped to identify their differences, spot opportunities, and avoid major pitfalls.

This book takes a global approach to Consumer Discretionary investing. Most US investors typically invest the majority of their assets in domestic securities; they forget America is less than half of the world stock market by weight—over 50 percent of investment opportunities are outside our borders. However, because the US is the world's biggest consumer market and is home to the largest share of Consumer Discretionary stocks in the world, this guide may feel more US-centric than the others in the *Fisher Investments On* series. Still, Consumer Discretionary companies may have global operations, and consumer markets outside the US are growing rapidly. Given the vast market landscape and diverse geographic operations, it's vital to have a global perspective when investing in the Consumer Discretionary sector.

USING YOUR CONSUMER DISCRETIONARY GUIDE

This guide is designed in three parts. Part I, "Getting Started in Consumer Discretionary," discusses vital sector basics

and Consumer Discretionary sector high-level drivers. Here we'll discuss macro drivers—consumer spending, income, and employment—and explain how to capitalize on a wide array of macro conditions and industry-specific features to help you form an opinion on each of the industries within the sector. We'll also discuss additional drivers affecting the sector that ultimately drive Consumer Discretionary stock prices.

Part I also includes a discussion on the history of the modern Consumer Discretionary sector. Topics discussed include early trade relations in the colonies and how the industrial revolution contributed to a dramatic increase in discretionary income, in turn creating the Consumer Discretionary industries we're familiar with today.

Part II, "Next Steps: Consumer Discretionary Details," walks through the next step of sector analysis. We'll take you through the global Consumer Discretionary sector investment universe and its diverse components. The Consumer Discretionary sector is fairly diverse, which makes a thorough analysis challenging but also increases your chances of finding successful investment opportunities and profitable segments of the market.

There are currently 12 industries within the Consumer Discretionary sector. We will take you through the major components of the sector in detail, including a description of their business and industry, an introduction to how they operate, and what drives profitability—to give you the tools to determine which industry will most likely outperform or underperform looking forward. Part II concludes with a discussion about the tremendous opportunity credit represents in Emerging Markets against the backdrop of Brazil's successful financial liberalization.

Part III, "Thinking Like a Portfolio Manager," delves into a top-down investment methodology and individual security

analysis. You'll learn to ask important questions like: What are the most important elements to consider when analyzing retail or automotive firms? What are the greatest risks and red flags? This book gives you a five-step process to help differentiate firms so you can identify ones with a greater probability of outperforming. We'll also discuss a few investment strategies to help determine when and how to overweight specific industries within the sector.

Note: We've specifically kept the strategies presented here high level so you can return to the book for guidance no matter the market conditions. But we also can't possibly address every market scenario and how markets may change over time. Many additional considerations should also be taken into account when crafting a portfolio strategy, including your own investing goals, your time horizon, and other factors unique to you. Therefore, you shouldn't rely solely on the strategies and pointers addressed here—they won't always apply. Rather, this book is intended to provide general guidance and help you begin thinking critically not only about the Consumer Discretionary sector, but about investing in general.

Further, *Fisher Investments on Consumer Discretionary* won't give you a "silver bullet" for picking the right Consumer Discretionary stocks. The fact is the "right" Consumer Discretionary stocks will be different in different times and situations. Instead, this guide provides a framework for understanding the sector and its industries so that you can be dynamic and find information the market hasn't yet priced in. There won't be any stock recommendations, target prices, or even a suggestion whether now is a good time to be invested in the Consumer Discretionary sector. The goal is to provide you with tools to make these decisions for yourself, now and in the future. Ultimately, our aim is to give you the framework for repeated, successful investing. Enjoy.

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I

**GETTING STARTED IN CONSUMER
DISCRETIONARY**

1

CONSUMER DISCRETIONARY BASICS

Whether you're a blue-blooded socialite or a blue-collared mechanic, the Consumer Discretionary sector plays a material role in your everyday life. How? Consumer Discretionary may conjure images of high-end jewelry, luxury cruises, mega-big-ticket electronic goodies, and other high-priced glamour items—and those items do fall within the sector, but it is much broader than that. For example, just the process of buying and enjoying this book likely involved a number of goods and services from Consumer Discretionary firms.

Odds are, you purchased this book from a bookstore (a Specialty Retail firm). Perhaps you drove your car (produced by the Automobile industry) to that bookstore and stopped for a coffee (Hotels, Restaurants, & Leisure firm) on the way to or from. Maybe you're reading this from the comfort of a recliner or on the screen of a new handheld device (both built by a Household Durables firm). The book itself was published by John Wiley & Sons (a Media firm). These are just a few industries included in the Consumer Discretionary sector.

Although these categories represent the sector from a high level, it is important to reiterate this segment's breadth. Auto manufacturers, homebuilders, sports equipment manufacturers, hotel developers and operators, advertising agencies, newspaper publishers, cruise lines, car dealerships, retail websites, department stores, and beauty

salons are all examples of Consumer Discretionary firms. In other words, it's more diverse than you might think.

This chapter introduces you to the Consumer Discretionary sector and its five industry groups. You should finish the chapter with a high-level understanding of the sector, how to identify its components, and what exactly makes a firm Consumer Discretionary.

CONSUMER DISCRETIONARY 101

Globally, the Consumer Discretionary sector makes up about 8.8 percent of world stocks—just a bit smaller than the Staples sector (see [Table 1.1](#)). This amount isn't static. All sectors change in relative size as they come in and out of favor and the stocks get bid up or down.

It's not a massive sector, but the variety of firms included is immense. One might ask, "What do newspapers and cruise lines have in common? Why are they in the same sector?" Or perhaps, "What about cigarettes or beer? Those are discretionary goods, right?" Or even, "What's the difference between Consumer Staples and Consumer Discretionary?" To answer these questions, let's begin with some definitions.

[Table 1.1](#) MSCI ACWI Sector Weights

Source: Thomson Reuters, as of 6/30/2009.

Sector	Weight (%)
Financials	20.2
Energy	12.0

Information Technology	11.8
Industrials	9.9
Consumer Staples	9.8
Health Care	9.7
Consumer Discretionary	8.8
Materials	7.6
Telecommunication Services	5.3
Utilities	4.9

Elastic versus Inelastic

Frequently in this book, we'll refer to a product being *elastic* or *inelastic*, or that demand is *elastic* or *inelastic*. So what does that mean? It means a lot like it sounds. Elastic demand stretches and snaps back, whereas inelastic demand stays constant. This is the core of the difference between Discretionary and Staples firms. When times are flush, the economy is growing, incomes are rising, and people are more likely to buy bigger ticket items, take pricier vacations, eat out at restaurants, etc. That benefits Consumer Discretionary firms' bottom lines and usually translates into rising stock prices too. But when the economy slows or goes into recession, demand for those things snaps back, usually hurting Discretionary firms' earnings and stock prices.

On the flip side, demand for Consumer Staples goods is usually inelastic. Whether times are good or bad, people still need to brush their teeth and buy basic foodstuffs. If the economy is raging, people don't buy *more* toothpaste. And if the economy falls, they typically also don't spend less (or at least, not much less) on these items. Demand is stable—*inelastic*. Sectors that are more inelastic are sometimes also called *defensive* because they usually perform better on a relative basis during bear markets or when the broad market is overall sluggish.

Misleading Names

The first word, “Consumer,” is simple—if you have ever purchased something, you are a consumer. (Note this definition does not typically include purchases made by businesses.) Put another way, if a good is made for “final” use by someone, it's a consumer good. Goods made for businesses are often called “capital” or “enterprise” goods because they're used in the process of creating something else.

The second piece, “Discretionary,” if taken as the dictionary definition, refers to something done based on one's prerogative (i.e., needs versus wants). Basic food, shelter, and clothing are most frequently associated with necessities, while most everything else can be classified as a want, or discretionary. Using this definition, restaurants (food), homebuilders (shelter), and apparel manufacturers (clothing) might seem better categorized as Staples, as these are all necessities, not discretionary items. Similarly,

cigarettes and alcohol *would* be considered Discretionary, since they are clearly not necessities.

Except, seemingly illogically (at least at first) restaurants, homebuilders, and apparel manufacturers are included in the Consumer Discretionary sector, while tobacco and spirits producers are Staples (see *Fisher Investments on Consumer Staples* for more information). So, to understand how to identify a Consumer Discretionary firm, it's better to define the group using common characteristics. Typically, firms in the Consumer Discretionary sector are:

- Economically sensitive
- Highly correlated to broad stock market performance
- Sensitive to consumer sentiment

Correlations and R-Squared

Few of us voluntarily hearken back to Statistics 101, but this book relies heavily on the use of correlations and correlation coefficients (R-Squared) to gauge the strength of certain relationships. We'll skip the heavy math and keep it simple with some qualitative explanations of what these measures describe. A correlation tracks directional relationships between two or more variables and falls between 1.0 and -1.0. A correlation very close to 1.0 means two things are strongly *positively* correlated—they move in the same direction at the same time and in about the same amount. A correlation close to -1.0 means two things are strongly *negatively* correlated—one's up when the other's down. A correlation close to 0 means there's no relation—their movements are entirely independent and there's no clear pattern.