ALPINEMACRO
A Unique Mind On The Markets

EQUITY STRATEGY

February 26, 2025

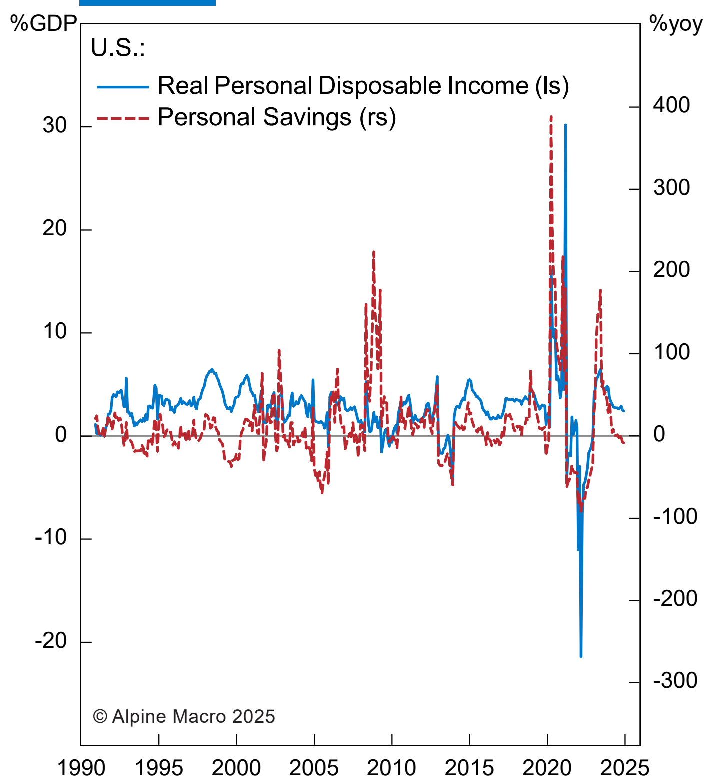
Here's The Deal In Retail

Retailers resemble a value segment without a high-conviction catalyst to stimulate growth or with much value to unlock. It's an early cyclical sector that can't hit the 'reset button' as macro concerns mount with a downshift in retail sales raising eyebrows alongside cost pressures and cracks in consumer confidence.

Most retail industries are staring down anemic growth this year with whisper hopes for an inflection higher later in 2025 but that won't be enough to move the needle just yet for investors.

The playbook for retail — across Specialty, Textiles, and Apparel — is to avoid mass market brands reliant upon promotional activity (price takers) and lean into larger retailers with distribution scale (price setters). The opportunity to hunt value is likely a 2H 2025 story.

Chart 1 **Lower Firepower For Retail Demand**

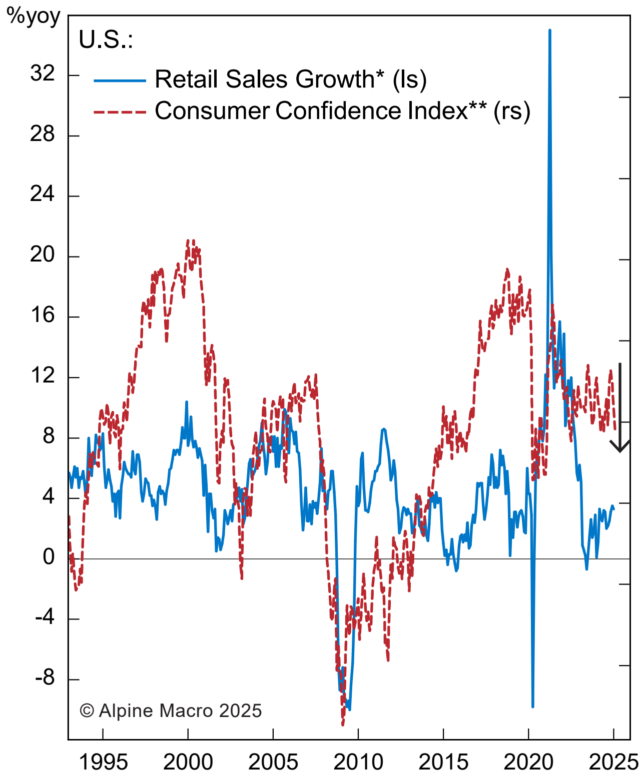


Macro Headwinds

"It's Brutal Out There" – Olivia Rodrigo

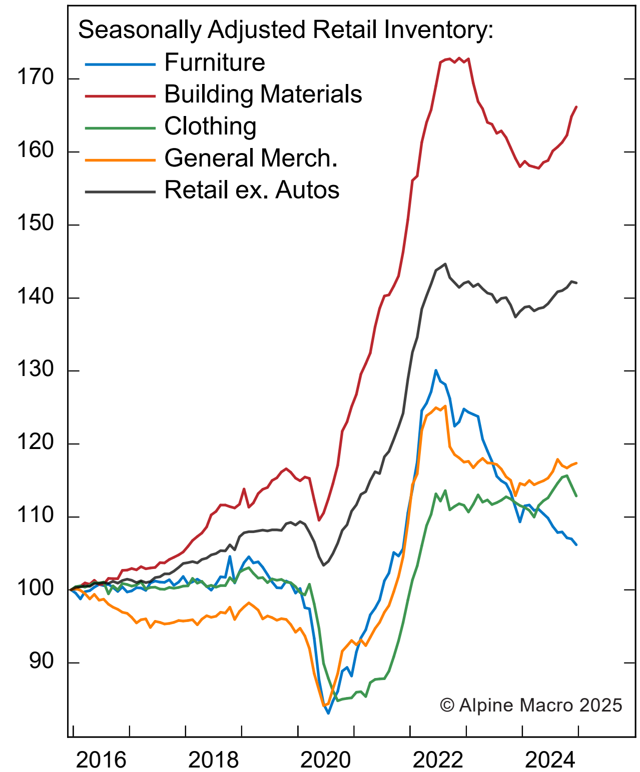
The Playbook		
Upside	**Downside**	**Game Plan**
- Producer Prices, Johnson Red Book stabilizing - Momentum in niche luxury and "athleisure" - Turnaround narrative at leading apparel retailer	- Consumer Confidence, disposable income, retail prices declining - Inventory overhang stifles refreshment cycle - Uninspiring valuation - Tariffs, currency	- Underweight Retail overall, avoid mass market brands - Prefer larger retail "boxes" with scale - Prefer Home Improvement to Apparel - Retail recovery gains focus in 2H25

Chart 2 Dip In Confidence Is A Drag On Retail



*Excluding Autos & Food
**Source: Conference Board

Chart 3 Excess Goods Inventory Remains



Note: All series' are rebased to Dec 2015=100

Retail goods are the poster category for post-pandemic recalibration following supply shocks and fiscal largesse.

The group now struggles through headwinds which impede top-line growth and profitability, the most notable of which include: **(1)** weaker demand, and **(2)** a loss of pricing power to absorb higher costs.

(1) Weaker Demand

Retail demand is heavily influenced by the health and wealth of consumers along with the inventory cycle, each of which faced substantial whipsaws following the pandemic.

Stimulus is in the rear-view and consumers have burned through excess savings leaving disposable personal income the primary source to fund retail purchases, but that runway is narrowing. As we show in **Chart 1**, real disposable income growth fell to 2.4% in December from an average level over 4% since 2023. Meanwhile, personal savings is negative.

Consumer demand will not crater but sentiment has recently flipped from encouraging to concerning. Retail sales, which are a proxy for related equity revenues, have a tight relationship with consumer confidence which has collapsed following the post-U.S. election surge. Any letup in the labor market would intensify the risk of consumer slowdown (**Chart 2**).

Chart 4 Goods Deflation Compressing Sales

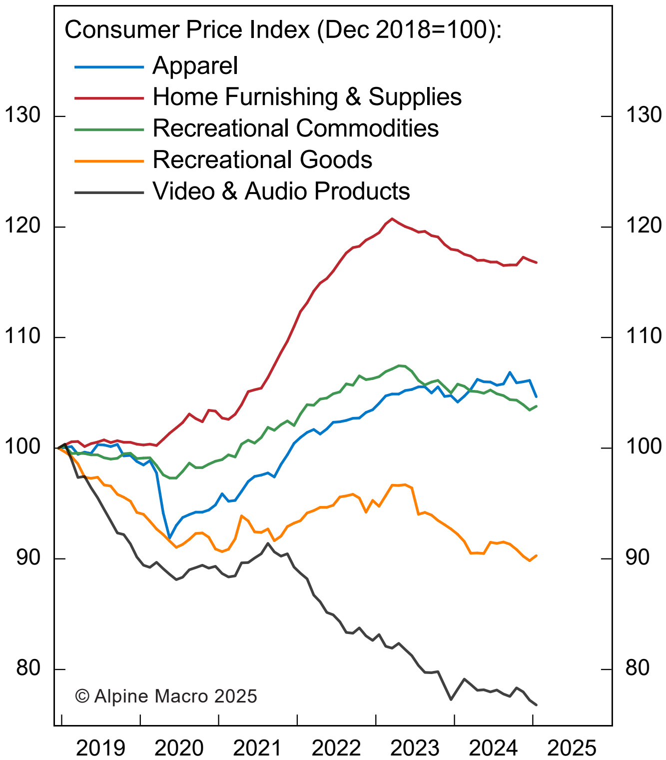
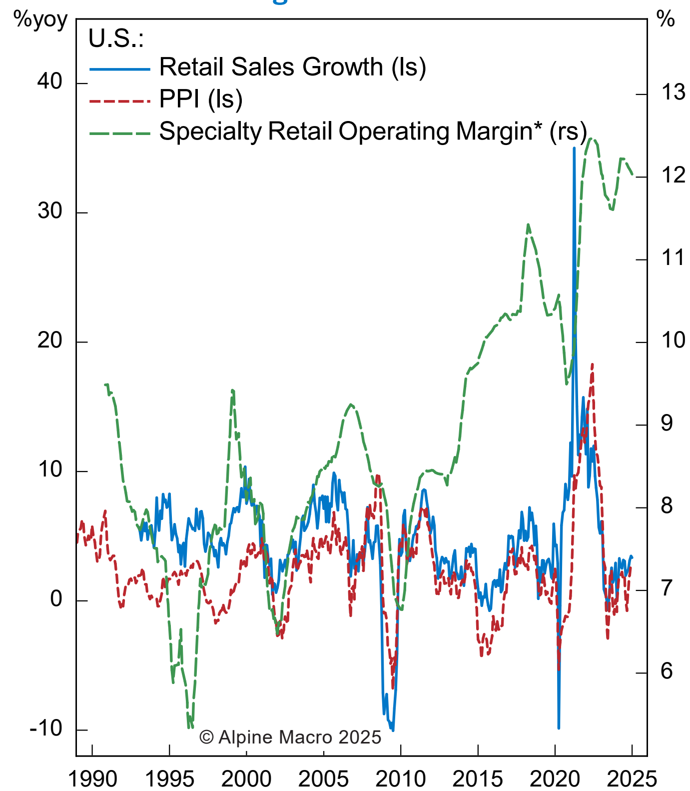


Chart 5 Next Move For PPI Impacts Sales & Margins



*Source: Bloomberg Finance L.P.

Compounding the demand issue is an inventory overstock in many categories, which delays product refreshment or innovation. Core retail inventories are ~31% higher than pre-pandemic levels on a nominal basis and 8% higher in real terms. The biggest overhang is in building materials, but clothing and general merchandise also have inventory to burn off (Chart 3).

(2) Inability To Pass Off Costs

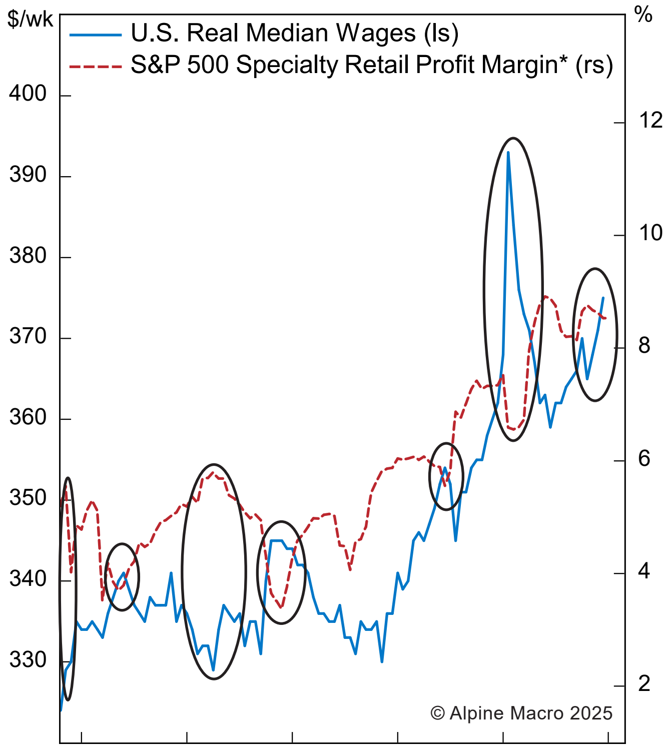
Consumers are in a state of price revolt following inflationary surges and are exhibiting cost sensitivity in goods, even across upper income cohorts.

Retail goods categories are bearing the brunt and exhibit deflationary tendencies, which is a welcomed sign for the broader economy but a headwind for corporate profitability. As shown in Chart 4, Apparel, Recreational Goods, Home Furnishings, and V&A Products have experienced negative pricing since 2023.

At the producer level, prices often lead retail sales and margins, and here the outlook is slightly more stable with finished goods bumping higher in recent months (Chart 5).

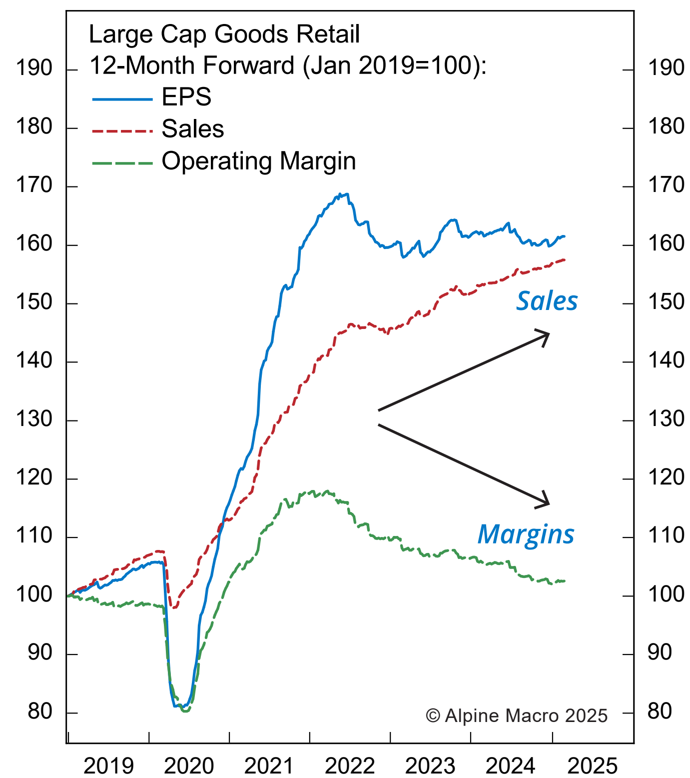
This is still not enough, however, to offset the jump in real weekly wages which are siphoning off profits in these labor-intensive industries. Chart 6 illustrates how wages choke off margins. Finally, currency translation already weighs on profitability (~100-150bps) with tariffs a looming risk.

Chart 6 Wage Spikes Push Down Margins



*Source: Bloomberg Finance L.P.

Chart 7 Discounts Save Sales, Sacrifice Profitability



Note: All series' represent a cap-weighted basket comprised of 34 large cap companies across Distributors, Specialty Retail, and Textiles & Apparel; source: Bloomberg Finance L.P.

Below, we detail what is working and what is not working on a micro level to blunt macro headwinds.

Micro Failure: Destructive Discounting

The biggest issue plaguing many brands is discounting, or offering products at "off price" levels, to jumpstart sales and cull inventory. The problem with discounting is that its less profitable and creates a precedent that's difficult to reverse. In industry parlance this contributes to a negative "push" product dynamic and shifts the "earnings algorithm" away from value and towards cheap volume.

Chart 7 shows the effects of discounting with sales moving higher at the expense of margins, leaving earnings flat.

Some of the promotional activity has coincided with marketplace strategies that have proven ineffective at best. Nike (**NKE**), for example, shifted emphasis away from wholesale partners (ex. Foot Locker) in favor of their digital sales channel. The expectation was that this would stimulate new demand while increasing profitability by cutting out middlemen. Instead, this cannibalized total product demand and ~ 50% of Nike Digital is now discounted, crushing profitability.

Micro Success: Higher Value Branding

It's not all broken, with direct-to-consumer thriving in luxury and "athleisure" categories where the products align to lifestyle and attract higher value and less price-sensitive customers (Chart 8).

Lululemon (**LULU**) and Ralph Lauren (**RL**) have enjoyed major success on this front but even higher-end brands within larger portfolios are succeeding where others aren't, such as The North Face within VF Corporation (**VFC**) where lower promotional costs helped boost margins by 150bps last quarter.

At Ralph Lauren, management went all-in on marketing to reposition its value perception following major COVID declines. The company reduced their discount rate by 500bps, slashed partnerships with lower-tier department stores, and eliminated limits on ad-spend with a focus on return-on-investment.

Expect Nike to borrow the playbook as new CEO Elliott Hill signals his intent to lead with "brand momentum through sport" and innovation but it will come at significant cost with turnaround uncertainty. We remain skeptical.

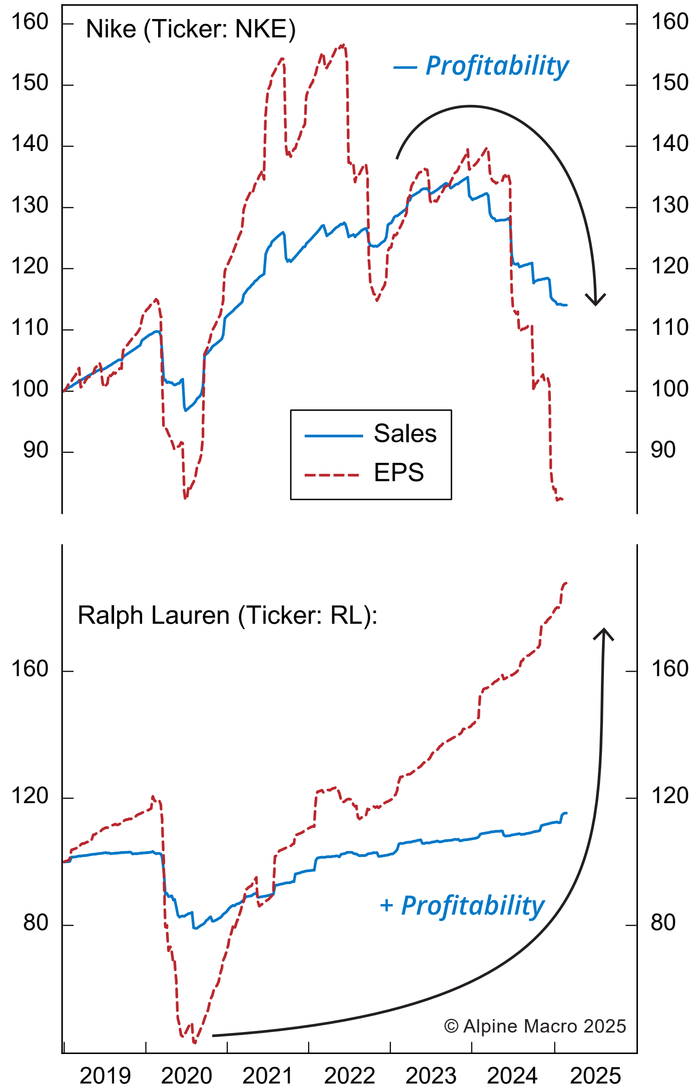
The bottom line is that: A) the backdrop for goods is promotional outside of leading-edge brands, and B) consumers demand choice. This provides an opportunity for bigger "box" retailers with scale.

The Benefits Of The Bigger Box

Consumers prefer one-stop shops in many categories making scale and optionality often more important than brand. In sporting goods, for example, 80% of shoppers desire a multi-branded experience which benefits larger box stores.

This puts larger retailers in the catbird seat as gate-keepers, giving them negotiation power over brands that need visibility within their marketplace.

Chart 8 Working (RL) vs Broken (NKE)



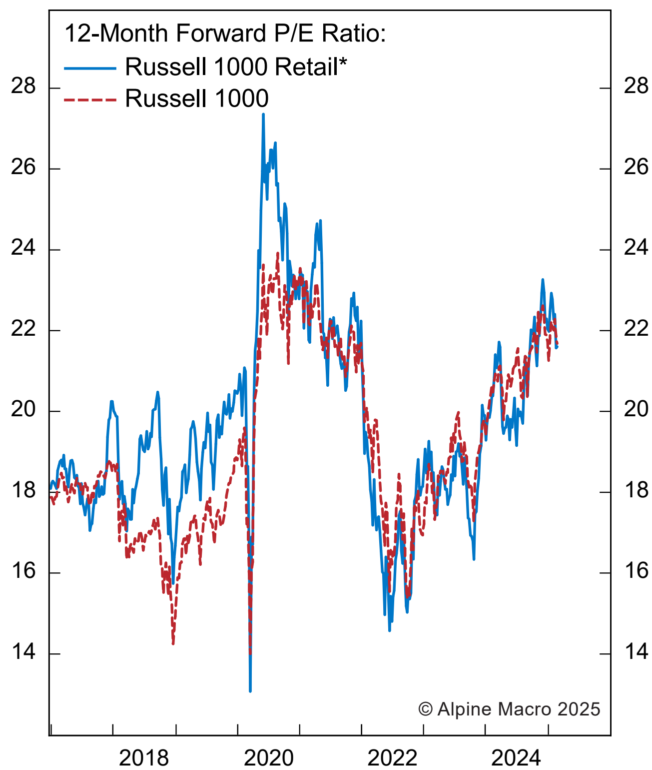
Note: All series' are rebased to 2019 Q1=100;
Source: Bloomberg Finance L.P.

The "Walmart-ization" of retail upends traditional dynamics and creates advantages for emerging brands and large retailers, often at the expense of tired incumbents, around four elements of consideration:

1) Pricing

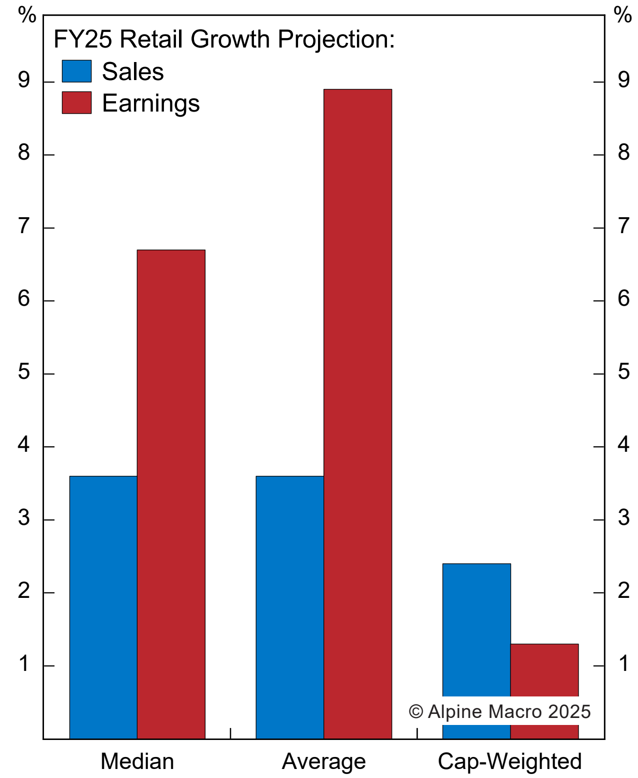
Larger retail distributors exert leverage on brand partners to push pricing in exchange for shelf space.

Chart 9 Retail Is Not A Bargain To Market



*Cap-weighted basket comprised of 34 large cap companies across Distributors, Specialty Retail, and Textiles & Apparel;
Source: Bloomberg Finance L.P.

Chart 10 Retail Expectations Underwhelming



Note: Includes 17 companies within Specialty Retail, Distributors, Textiles, Apparel & Luxury Goods industries;
Source: Bloomberg Finance L.P.

This often results in a cramdown of average unit retail price in exchange for driving comp through volume.

2) Promote

Brands increasingly pay or partner with larger retailers for advertising, which will likely accelerate as they look to move past inventory drawdowns and highlight refreshed product cycles. Retail media networks for companies such as Target (**TGT**) and Walmart (**WMT**) are growing at +20% annually.

3) Product Innovation

Larger retailers and wholesalers are encouraging brands to innovate or supply premium products and will often assist in their development. This is especially important for emerging brands where established retailers take more of an investor-incubator approach.

4) Private Label

Private label now represents about of 21% of retail spending. The upside for retailers is that these vertical brands carry higher margins with lower promotion risk and add pressure to legacy, low-value brands.

Ultimately, what matters for investors is that the power dynamics within Retail are shifting and bigger can mean better in many cases.

Value Play, But Limited Value Or Growth

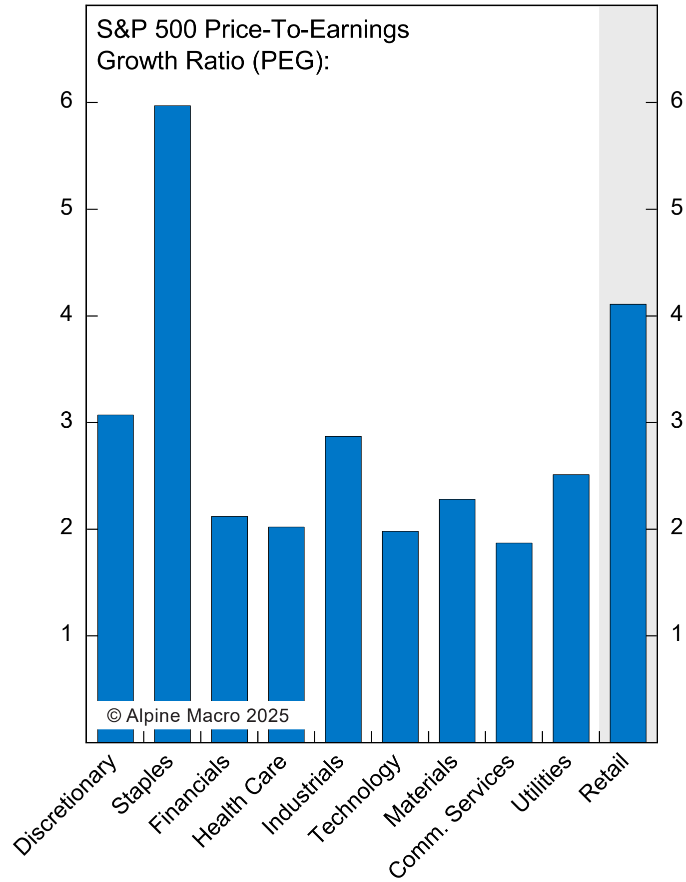
For all of Retail's struggles the group is not cheap, trading at parity with the broader large cap market and the 77th percentile on a historical basis (**Chart 9**). The top is particularly heavy with forward earnings multiples for the five largest companies averaging 26x, indicating little room for mean-reverting upside.

Complicating matters is the uninspiring growth outlook for most retailers which limits upside. Sales and earnings for a basket of large cap retailers are expected to grow by just 2% and 1% this year, respectively. This growth outlook trails nearly all non-commodity equity segments (**Chart 10**).

As an early cyclical sector, an upturn in macro drivers such as manufacturing would be welcomed but the excesses built during the pandemic that have yet to be resolved indicate that further bloodletting likely remains.

The lack of growth makes the group even less attractive from a value standpoint as retailers are

Chart 11 Little Bang For Retail Buck $



Note: All series are Cap-weighted

Box 1 Tool Time: Fix Is Coming For Home Improvement

Home Improvement stocks have suffered as growth for Lowe's (**LOW**) and Home Depot (**HD**) has declined for the past seven quarters. The group struggles under higher rates and inflation with policy adding additional risk, pushing out the timeline for turnaround.

There are green shoots for upside: 1) expectations are washed out, 2) valuation is reasonable, and 3) certain category drivers are stabilizing such as the NAHB Remodeling Index and existing home sales.

With flattish revenues expected for FY25E the hurdle rate is low and any thaw in housing or big-ticket purchases would be a boost. Lower rates are a clear catalyst. Alternatively, immigration policy is a threat as undocumented immigrants are estimated to comprise nearly 30% of the construction market.

Investors should note the faster growth in the professional contractor market relative to do-it-yourself (DIY). Approximately ~50% of Home Depot's revenues come from their PRO segment, and ~25% for Lowe's.

more expensive on a growth-adjusted basis than any S&P 500 sector outside of Consumer Staples (**Chart 11**).

Conclusion

The bottom line is that retailers offer an unappealing mix of slow growth without much value, and no immediate catalysts to jump start a cyclical reset. The best-case scenario will be for struggling leaders in the category to lay the groundwork for turnaround and show incremental improvement.

At a minimum, retailers will likely need two quarters to reduce inventory and refresh their product cycle before investors can look towards growth.

In the meantime, we would avoid most categories of retail and branding with a preference for larger box distributors with scale. Within the group, we note an opportunity within Home Improvement (**Box 1**) which should benefit from lower rates and a stabilization of certain category drivers.

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Investment Recommendations				
Strategic Recommendations (6 - 12 months)				
Recommendations	Open Date	Performance		Active Return
		Vehicle	S&P 500	
Long S&P Industrials	5/29/2024	11.27%	13.35%	-2.08%
Long S&P Utilities	6/12/2024	13.95%	10.12%	3.83%
Long S&P 600	6/24/2024	6.36%	9.59%	-3.23%
Short S&P Materials	7/24/2024	-3.37%	9.25%	12.62%
Long Regional Banks (KRX)	8/21/2024	9.64%	6.22%	3.42%
Long U.S. Home Construction ETF: ITB	01/15/2025	-6.50%	0.34%	-6.84%

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