All Sales Are Final

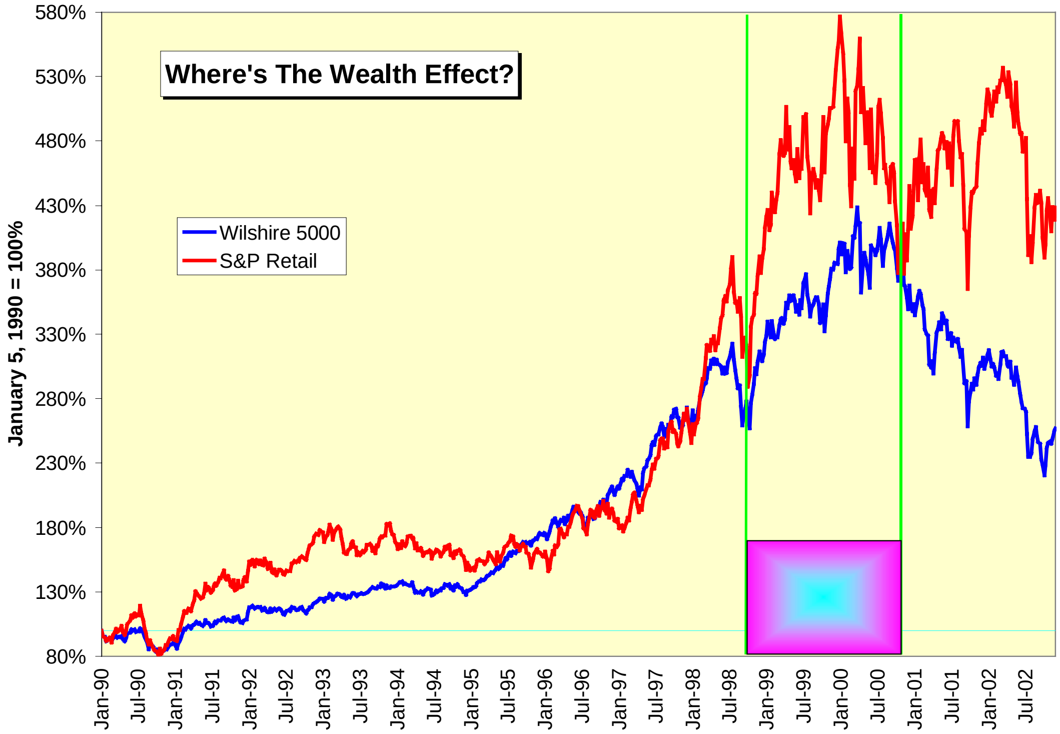
Too many years ago, I had to endure a Ralph Nader screed wherein he proclaimed, "Only two classes of people pay for everything in this country: Consumers and small taxpayers." How true, how true, but his Ralphship could have stopped at the consumer part. The cessation of consumption is synonymous with departure from this mortal coil.

OK, enough with the poetic nonsense. This is a hard-nosed financial Web site dedicated to enhancing your wherewithal for consumption, not for questioning your motives for doing so. Our topic for today is the never-ending Wall Street worry that consumers won't consume enough during the holiday season. This worry surfaces annually to supplant the complementary cause of concern, that consumers are consuming too much and will gorge themselves to death on easy credit.

Really: These narrow constraints on proper behavior are rather like the highway speed signs proclaiming a maximum speed of 55 and a minimum of 40, regardless of the fact that this narrow band is the least common speed range on any urban expressway.

The Wealth Effect

Much was made during both the bubble and its bursting of the so-called wealth effect, the alleged propensity of people to spend more when they have more money and to spend less after they get clobbered. One way of tracking this profound insight indirectly is to compare the relative performances of the S&P retail index (RELX) to the broad market as represented by the Wilshire 5000.



Much to the surprise of anyone who sees the hypercompetitive operating environment for retail, both brick-and-mortar and Web-based, the RELX outperformed the Wilshire for much of the 1990s, including the slow growth period between 1991 and 1994. This outperformance accelerated during the bubble period - does it seem possible that retail stocks did better than the overheated broad market during this period? - and then after a sharp selloff in 2000, resumed once the Fed began cutting rates in January 2001. The chart marks the boundaries between the Fall 1998 and January 2001 rate cuts, a period that included the 1999-2000 rate hikes.

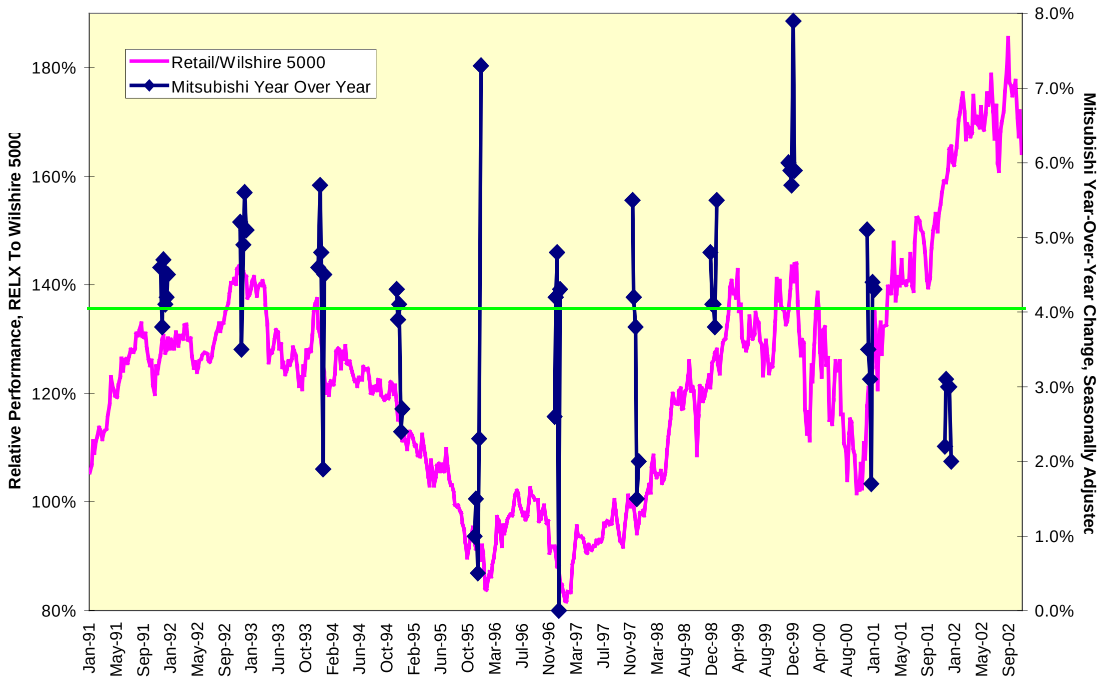
Retail stocks once again are outperforming the broad market. This is an artifact both of cheap credit and of the fact that businesses can postpone capital expenditures more easily than consumers can postpone ordinary living expenditures.

The December Effect

Is all of the fretting over holiday sales justified by its impact on the market? Let's take a look at the weekly retail sales index produced by Bank of Tokyo-Mitsubishi (and who better to divine the secrets of the American consumer's heart than a Japanese bank?) and compare it to both the broad market and the RELX. This index is seasonally adjusted to account for the obvious surge between Thanksgiving and New Year's.

The chart below strips out the non-holiday weeks from the display to present simply the seasonally adjusted year-over-year sales increases for the Thanksgiving-New Year's period. The average year-over-year weekly increase of 4.075% is superimposed.

Try To Remember The Kind Of December



As we should expect every time we delve into conventional Wall Street wisdom, no discernible causal relationship exists. The RELX outpaced the Wilshire strongly in 1997 and 1998, and again in 2001 and 2002, with very tepid increases in holiday sales. The strongest holiday sales surge occurred in 1999, and that was followed by a relative selloff in the RELX even stronger than what occurred in the Wilshire.

Lead Times And Sunk Costs

That retail sales are not a very good market indicator should be expected. Few people in our society have as difficult of a job as a buyer for a retail chain: You have to decide well in advance of a given season what the hot items will be, down to the color, and if you don't guess right, the merchandise sits in inventory. While many of the toy crazes of recent years were crude attempts at manufactured frenzy - Tickle Me Elmo, anyone? - many of the year-end shortages on the shelves are real.

If the role of the stock market is to discount earnings in advance, all of the information about what the retailers have ordered for the season should be know well in advance. In addition, the trends in price discounting and shedding of surplus inventories to resellers such as Big Lots are known by the time the shopping season starts. Unsold inventories of non-perishable goods are a sunk cost, pure and simple, and their presence on the shelves and in the warehouses, while costly, do not foretell the future behavior of the consumer with any accuracy whatsoever.

Throw Up Your Hands
So there we have it, another Wall Street worry not worthy of the wall of worry we're supposed to climb. Retail stocks riding the wealth effect on the way up and dodging the negative wealth effect on the way down. The relative performance of retailers being unaffected by holiday sales growth.

There's only one seasonal retail trend of which I am sure: In my student days, I had a job in a Washington, D.C., wine store. Eggnog was flying off the shelves (Question: I know what an egg is. What's "nog?"). When I started to restock that shelf at the end of the evening, the manager stopped me and said, "Put that stuff there, and we'll be looking at it on the Fourth of July." To amuse myself, I put one half-gallon jug on the shelf, marked it, and it stayed there until the following December.