Trinity Student Managed Fund
Sector Reports

Consumer Discretionary

September 2024

TRINITY SMF
STUDENT MANAGED FUND

Table of Contents

Authors

Martha McCutcheon
Sector Manager

Eoin Moore
Senior Analyst

Sector Overview

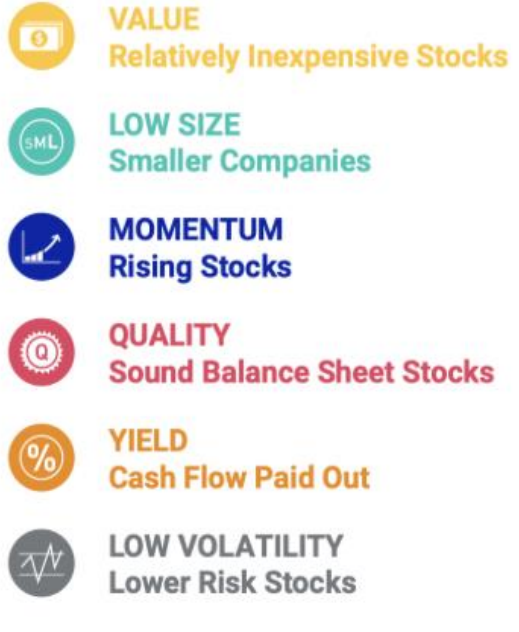
The consumer discretionary sector encompasses a vast spectrum of industries that cater to non-essential goods. Cars, household appliances, specialty items, luxury goods and leisure are considered part of the sector. The Consumer discretionary sector is particularly susceptible to changing market conditions and consumer attitude. As such it is quite a volatile sector and has historically displayed cyclical tendencies.

The consumer discretionary sector has arguably been the sector that has seen the most drastic change over the past 20 years. The emergence and continuing burgeoning nature of e-commerce has connected consumers directly with suppliers and lead to immense growth. In the 2010's the sector saw an increase in performance and rose over 340% according to the S&P.

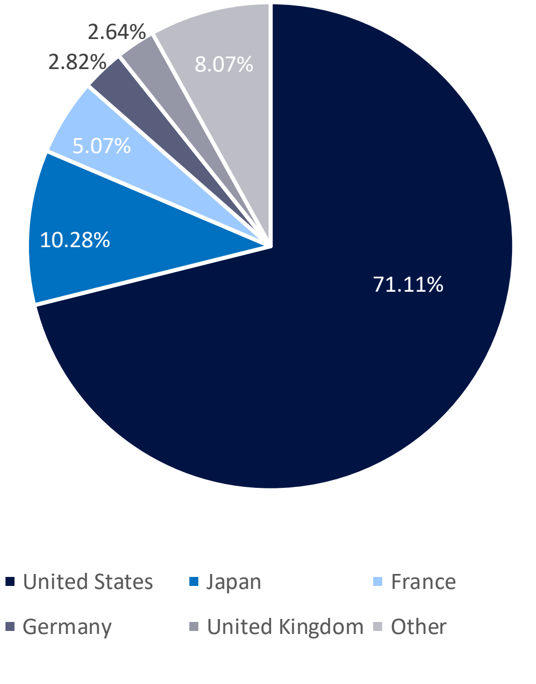
However, the growth in the sector was halted severely by the Covid 19 pandemic. Following the pandemic consumers across the world engaged in a "revenge shopping" splurge which led to exponential growth in the sector. Current market conditions however have restricted and halted this growth and the sector as a whole remains uncertain. However, declining interest rates has resulted in optimism and forecasted growth.

Some of the sectors biggest players include Amazon, Tesla, LVMH, Toyota and Home Depot.

MSCI Factors



Country Breakdown



Subsectors and Performance Indicators

Classifying companies within the broad consumer discretionary sector is complex due to the diverse segment involvement and the fact that many companies operate in more than one sector. Some prominent subsectors include:

Automobiles

Comprises a wide range of companies that are involved with the design, development and distribution of motor vehicles

Key players: Toyota, Tesla, Ferrari, Ford, Hyundai

Key PI's: Client satisfaction and Retention, ESG Targets, Conformity with Net Zero Legislation, Supply Chain Efficiency

Luxury & High-End Apparel

Creates and delivers premium clothing and accessories for high end consumers seeking exclusivity and style

Key players: LVMH, Kering, Ralph Lauren, Dior, Chanel

Key PI's: Product Quality, Exclusivity, Pricing , Consumer Sentiment, Market Share Growth, Brand Equity

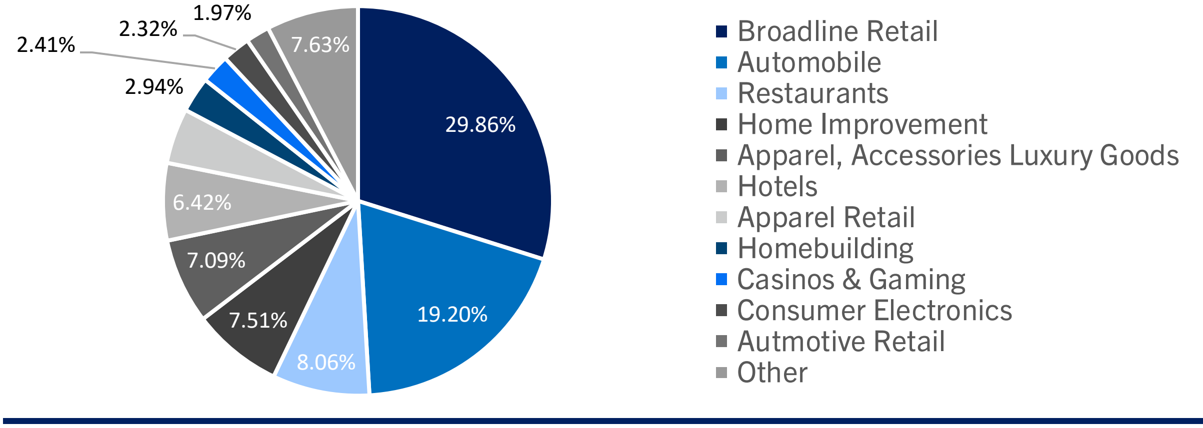
Entertainment

Encompasses companies that create and deliver content from music, film, TV and digital media

Key players: Netflix, Disney, Warner Bros, SONY

Key PI's: Subscriber growth, Content Quality, Subscription Costs, Content Available, Audience Engagement Rates

Sub-Industry Weights

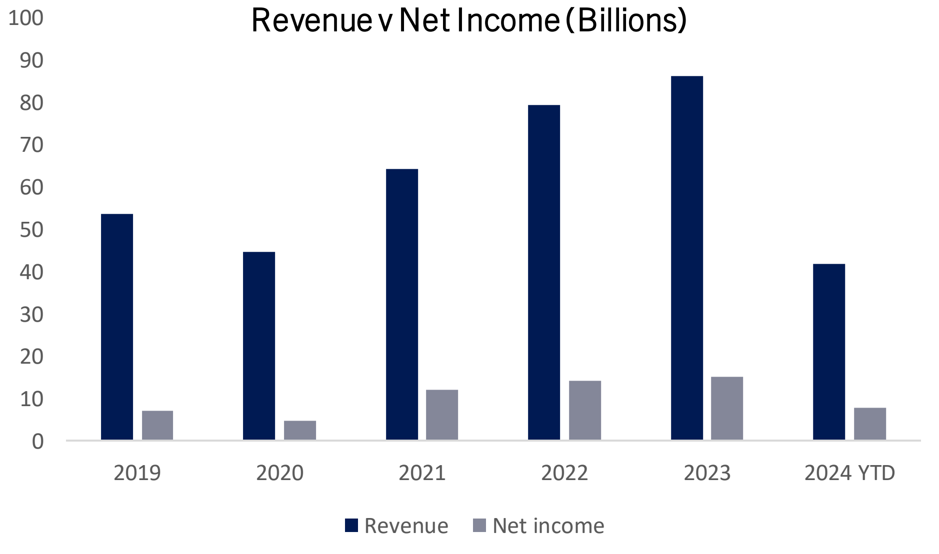


Current Holdings- LVMH (Hold)

Current Performance

LVMH has a market value of €338 billion and in H1 ‘24 reported a revenue of €41.7 billion down 1% from FY ’23. Despite this LVMH’s revenue equates an operating margin of 25.6%. LVMH has still fallen short of analyst estimates amidst a luxury slowdown. Dividends per share and earnings per share have increased 8.33% and 8.21% respectively in line with the industry average. The company’s core business groups- perfumes and cosmetics, fashion and leather goods and selective retailing saw an overall 2% increase in organic revenue from FY ‘23. This growth was seen predominantly in Q1 FY ‘24. Growth has been seen in each division with the exception of the wine and spirits and watches and jewellery divisions since the beginning of 2024. These decreases are cited to have occurred due to low demand in China and and the poor performance of Tiffany & Co following the 2021 acquisition. Fashion and leather goods as well as perfumes an cosmetics grew 1% and 4% respectively since Q4 FY’23 thanks to the successes of Dior’s Sauvage and J’adores perfumes. LVMH had a noticeable share price slump of -21% in March ‘24 and a further low in August ‘24 amidst US recession fears. However, the company’s share price has increased 6.5% since the beginning of August and is on an upwards trajectory. Year to date the LVMH share price is down 6.31%.

Share Price	P/E (LTM)	EV/EBITDA	2024 Range
€669.80	24	13.3	€631-€872



Current Holdings- LVMH (Hold)

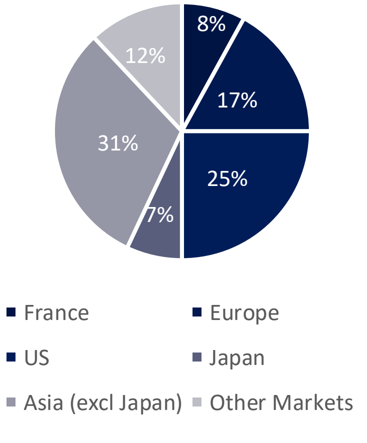
Tailwinds

1. Resilience: LVMH operates in a variety of markets across the world. LVMH's diversified portfolio of 75 companies including mass market brands like Sephora drive exceptional growth and provide stability during economic and geopolitical uncertainty.
2. Luxury Retail Customer Dynamics: Luxury retail's flexible pricing is rooted in exclusivity. This can help LVMH to offset production cost pressures. This pricing model and returning wealthy customers that are less affected by inflation ensure year on year growth.

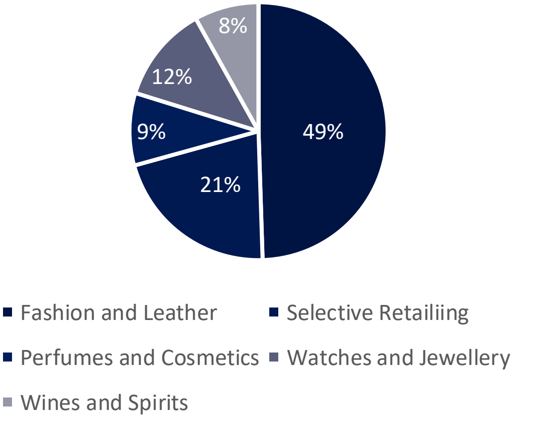
Headwinds

1. Inflation Rates: LVMH is particularly exposed to spending fluctuations. Recent increasing inflation rates have curbed the post pandemic splurge and middle-class consumer spending has declined. Increased inflation rates may result in price increases to counter higher production costs, which may lead to middle class consumers exiting the market.
2. Geopolitical tensions: LVMH's over-reliance on the US and China markets may leave them particularly exposed to fractious US-China relations. Over 50% of the company's revenue comes from both the US and China. Recent US investment curbs and potential embargos on exports following the upcoming US election may leave the company vulnerable should relations deteriorate any further.

Geographic Breakdown of Sales



Breakdown of Revenue by Division

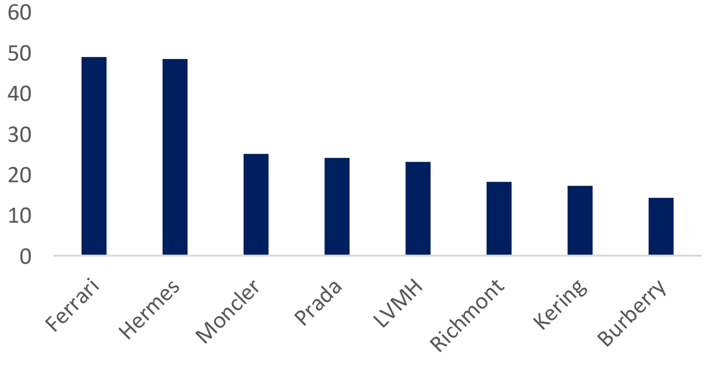


Current Holdings- Ferrari (Hold)

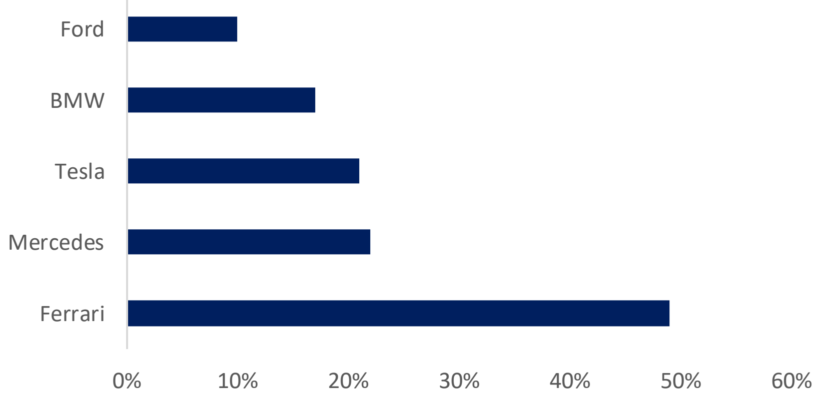
Current Performance

This year Ferrari surpassed Hermes in becoming the most valuable luxury company now valued at €68bn. Ferrari's performance in 2024 can be characterized by consistent growth. Net revenues in Q2 '24 were €1.712bn 18.9% higher than Q1 '24 net revenue figures. Revenues from cars and spare parts in H1'24 were €1.474bn up 20.2% from FY'23 figures. This was due to a richer product mix, increased personalization and higher production volumes. Ferrari also completed their multi-year share repurchase programme indicative of the company's strong growth and profits. Ferrari's EBIT margins sits at 27.4% the third highest in the industry as a whole but the highest in the automobile sector. Ferrari are expected to grow revenues by €6.52bn in 2025. Europe and the Americas remain their largest markets however, China and the APAC region are proving to be attractive investment runways.

Fwd. P/E ratio of Luxury Brands



Industry Gross Profit Margins



Current Holdings- Ferrari (Hold)

Tailwinds Headwinds

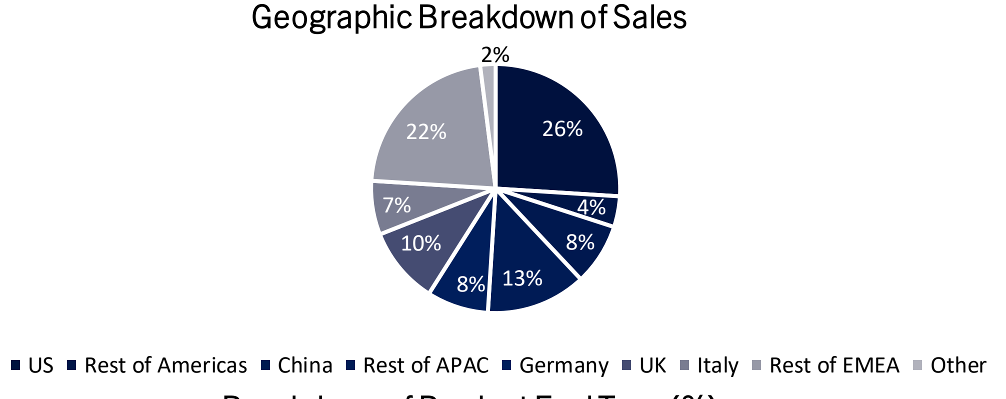
1. Exclusivity: Ferrari sells less than the market would take and prides itself on scarcity and exclusivity. As a result, it is less affected by rising inflation and interest rates due to their customer demographic. Ferrari's high end market value and "value over volume" outlook has ensured strong growth despite turbulent market conditions.

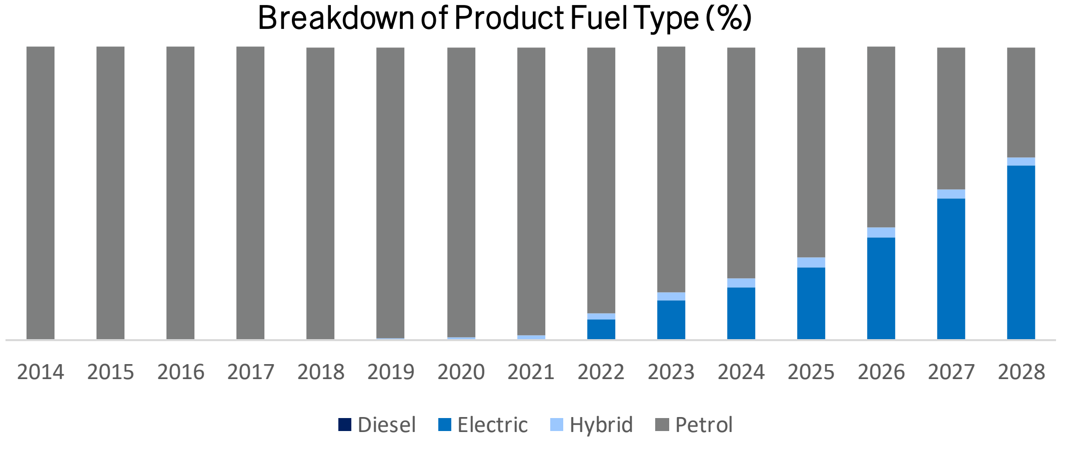
2. Personalisation: Ferrari buyers have also bought into the newly introduced personalized Ferrari look which allows buyers to modify their car for a higher price.

Headwinds

1. Supply chain risks: Ferrari has over 500 unique highly skilled suppliers resulting in potential for supply chain issues severely offsetting company products and sales.

2. Transition into the EV market: Ferrari is yet to unveil a fully electric car and is scheduled to do so in Q4 '25. This has led to declining sales in China as consumers opt for EV's instead. Other luxury car brands such as Porsche, BMW and Mercedes have already completely transitioned into a complete EV product line

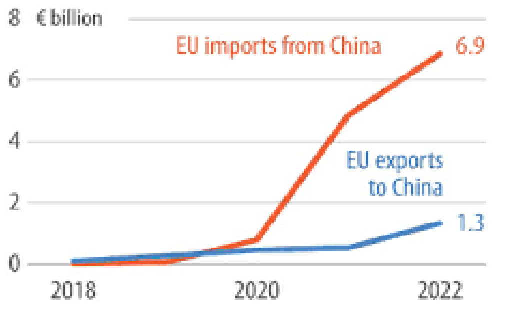




Investing Themes

BEV Growth Outside China

Over the last few years BEVs (Battery Electric Vehicles) from Chinese owned producers have taken a large market share in both the EU and the US. Car exports from China grew by 58% YOY 2022-23. These imports are currently lower in price and undercutting EU alternatives. The production of these vehicles is heavily subsidised by Beijing through ways including cheaper battery rates and tax reductions. The EU is planning on hitting these imports with additional levies and tariffs which should see a decrease in demand for Chinese BEVs and an opportunity for EU car manufacturers to reclaim and grow market share.

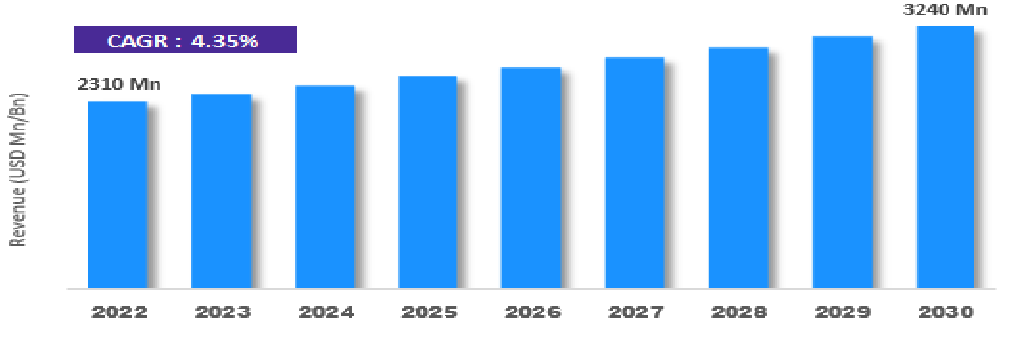


Data source: Eurostat Comext

Rise of Self-Purchasing Women in the Jewellery Market

Historically jewellery has been regarded as 'a gift for her' to mark an occasion or milestone. A growing force of self-purchasing women in senior and client facing roles has led to the transformation of jewellery into an everyday category. Van Cleef and Cartier now account for 75% of RIchemont's profits. The traditional elevated price level of jewellery in comparison to other categories has been somewhat eroded and there is now a focus among brands to provide fine jewellery adaptable for daily life and office wear with ranges easy to wear. Post-Covid 'revenge spending' saw jewellery lag leather goods however is now on track to catch up. The rise in online purchases and reliable resale platforms should further increase demand. An increase in women in the labour force and further in senior and executive roles is expected to continue into the future and this elevated status should translate into increased jewellery sales.

Global Sales of Women's Demi-Fine Jewellery 2030

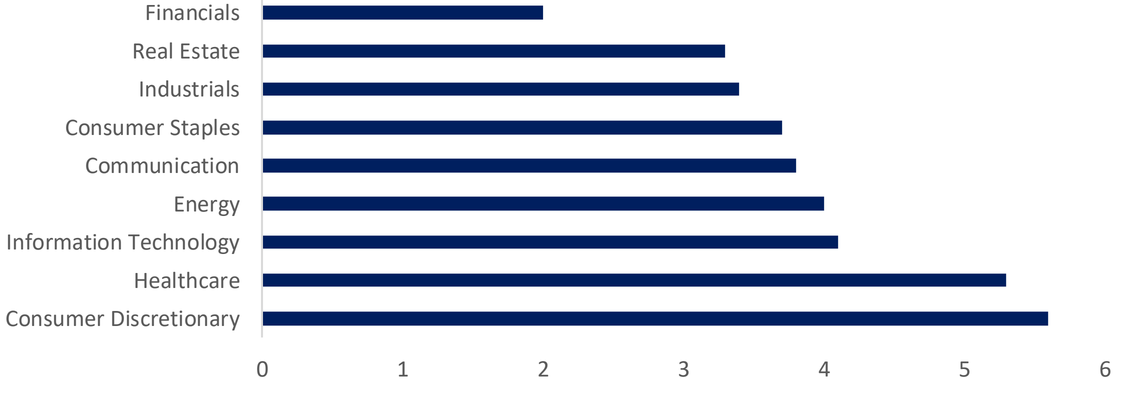


Risks

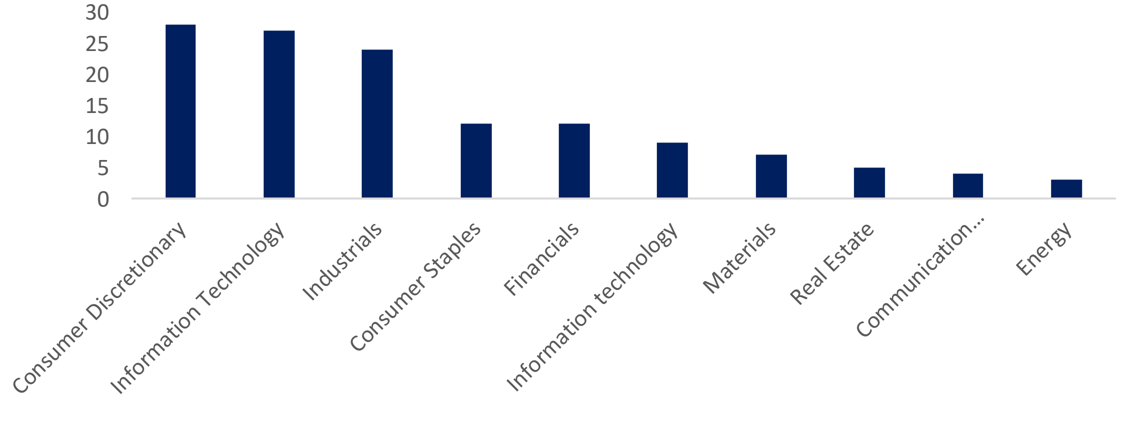
Interest Rates

Higher interest rates result in an increase in borrowing costs and dampen overall spending. However, policymakers at the Bank of England recently voted to cut rates as did other central banks in Canada, Denmark, Germany and China. J Powell Chair of the Federal Reserve noted that "the time had come for policy to adjust" and stated that the dream of a "soft landing' was "within reach" despite the post-Covid pessimism. The Fed are expected to cut rates in September and with cuts scheduled to continue over the next 12 months it appears that a period of stability is due. High interest rates were introduced by governments in order to combat inflation, however, now that inflation is calming so too are interest rates. US inflation is currently sitting at 2.89% compared to 3.18% last year which further reaffirms the point that interest rates ought to decline. Short interest in consumer discretionary stocks have plunged since the highs of September 2023 indicative of the fact that interest rates calming will increase consumer discretionary growth.

Avg. Short Interest over Shares Outstanding (end June '24)



Bankruptcy Filings by Primary Sector '24



Risks

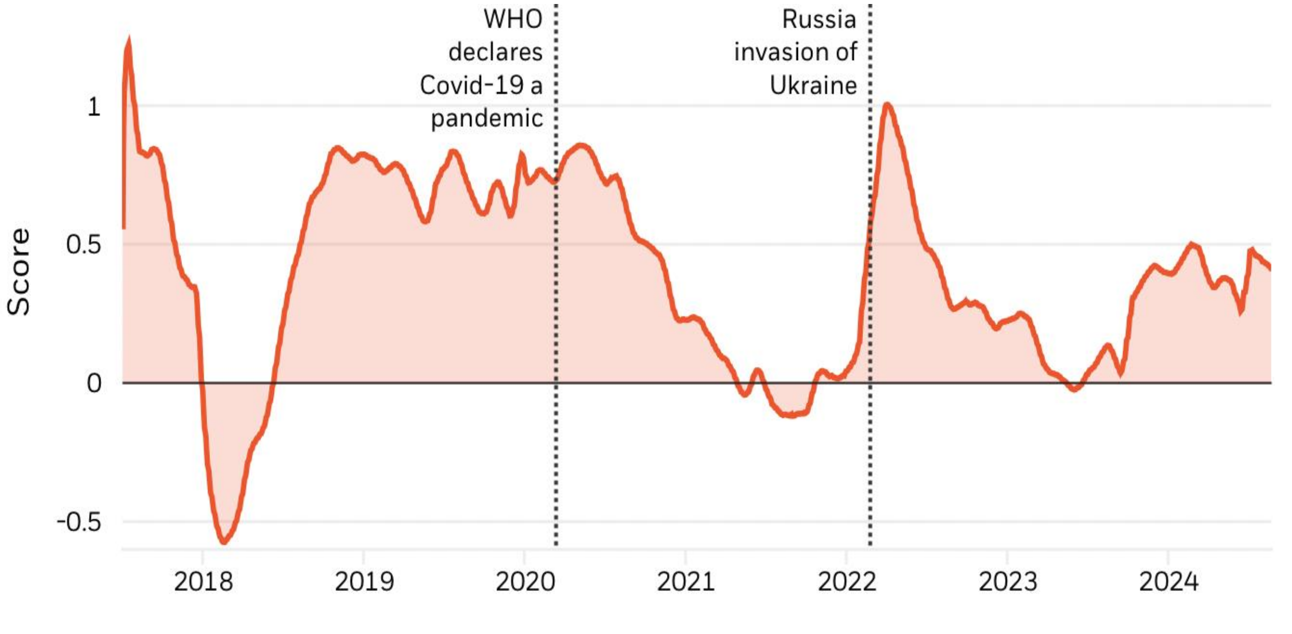
Shifts in Consumer Preferences

The consumer discretionary sector solely relates to the distribution of non-essential goods. Unlike the consumer staples sector consumers do not need consumer discretionary products to survive. As such the sector is far more volatile and susceptible to shifts in consumer preferences i.e. trends. E-commerce has empowered the consumer and consumers are now far more likely to buy from smaller businesses as opposed to market leaders. This has lead to leading companies in the sector seeing their sales fall when they fail to adapt to trends. This results in more investment into R&D and companies falling short of their sales targets.

Geopolitical Tensions

Fractious US-China relations, Beijing's listings crackdown, planned US investment curbs and US equity firms putting the brakes on China dealmaking may jeopardise a large source of revenue within the consumer discretionary sector particularly. This coupled with the incoming US presidential election and expected restrictions on Chinese trade may lead to decline in the sector. Geopolitical tensions also tend to hinder consumer confidence which may lead to customers refraining from spending. Higher interest rates result in an increase in borrowing costs and dampen overall spending.

Blackrock Geopolitical Risk Indicator: US-China



Outlook for the year

US Election

The upcoming presidential election has the potential to have a significant impact on the consumer. The looming possibility of trade wars, tax cuts, and tariffs will affect companies worldwide, especially those in the Consumer Discretionary Sector.

Trump is proposing a 10% tax on all imported goods and a 60% tax on goods imported from China (goods imported to the US from China amounted to $430 bn in 2023). In the event of a Trump sweep, companies that should outperform peers are those with a domestic-based supply chain, or those with the pricing power to either absorb or pass on this increase in cost to consumers. A republican victory also brings the possibility of a resurgence of inflation due to increased tariffs, strict immigration laws and a smaller labour market. This would put pressure on the consumer.

A split government would be a bullish outcome for companies catering to the US consumer. If the Democrats win the house, and the Republicans win the senate, the possibility of tariffs being imposed, or mass deportation are mitigated, and the Republican power in the senate will put restraint on the democratic tendency to raise taxes. A democratic presidential victory and split congress would give us certainty that there won't be a trade war.

China

Softening trends among Chinese consumers has led Asia Pacific performance to slow down. Weaker than expected economic growth in China has led to low spending confidence which has caused a recent slowdown in luxury, among other items. Some foreign companies are vacating or downsizing offices in China, and some companies are moving manufacturing elsewhere. During Covid, the lack of security of supply was realised and with weak demographics there is no longer an endless supply of cheap labour. Fast fashion companies have margins too thin to invest in technology to make up for future labour shortages. Weakening global relationships have led a trade war to be a possibility for the year ahead. This would have a negative impact on the sector, however there are no security implications for consumer goods. Some automobile companies (eg. Volkswagen) are expanding production in China to ensure supply security for their market in China. Chinese consumers may need to be selective over the coming year, but this may lead them to gravitate to top brands eg. LVMH.

Outlook for the Year

Interest Rates

The performance of the sector will continue to depend on macroeconomic considerations, notably the rates cycle. The current high interest rate environment has put pressure on consumers, making borrowing more expensive, incentivising saving and discouraging spending. The cooling of inflationary pressures has led the BoE and ECB to commence rate cuts, and consensus suggests we are likely to see 100 basis points of rate cuts by the end of the year from the Fed. As rate cuts continue through the end of 2024 and into 2025, consumers will have more room for discretionary expenditure.

Automobile companies offering vehicle financing services have generated unforeseen income from consumers paying for their cars and vans on a payback basis. The economy has somewhat adjusted to this high interest rate environment and it is unlikely that we will see rates return all the way to zero (post GFC rate). Therefore, automobile companies with financing units will continue to benefit from higher rates for the next few years.

Purchasing Tendencies

From a US perspective, expansion of the labour market (even if at a reduced rate) and continued real wage growth should help achieve a 'soft-landing' which will make consumers more likely to splash out on capital purchases (vehicles/house). Furthermore, households that have been mainly restricted over the last few years to necessary purchases can now begin to spend on luxuries.

High mortgage rates have led pending home sales in the US to the lowest level since 2001. Household durables (e.g. homebuilding), which is a discrete sector element, is always an area closely followed in times of economic uncertainty as it takes a wide range of economic factors into consideration. As we see the continuation of cooling inflation and rate cuts over the following year, pending home sales and homebuilding should too pick up.

Buy List – Renault SA (RNO)

Company Overview

Renault is a leading manufacturer of Passenger Cars & Light Commercial Vehicles under four brands: Renault, Dacia, Alpine, LADA and Mobilize. They have a geographic focus on W.EU & Emerging Markets. About 80% of their revenue comes from Europe. Renault offers financing solutions, including credit for both new and used vehicles.

Investment Thesis

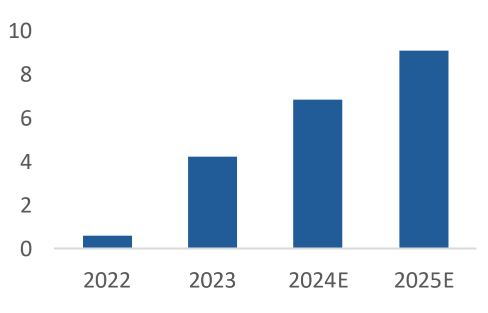
In the event of a ban or increased tariffs on Chinese BEV's (which are typically cheaper) in the EU or US, consumers will be forced to purchase from cheaper European/US based auto companies in which Renault is well placed.

Diverse product mix & pricing power with 25 new models being released between 2022 & 2025 and a long term focus on mild hybridization. The recent reduction of Renault's stake in Nissan has generated a nice cash cushion and allowed for higher dividends. Orderbook is healthy at 2.6 months.

Renault has strong cost initiatives underway, which should see EBIT and FCF remain above historical levels. Renault also has a safer and higher than sector median dividend. The current higher interest rate environment has led to increased sales financing returns.

Renault has made notable progress in AI development and is striving to become the first AI-driven automobile manufacturer, aiming to boost productivity and efficiency throughout its supply chains.

Dividend Yield



	FW P/E	P/S	EPS (1Y Growth)
RENA_FR	**3.28**	**0.19**	**19.75%**
BMWG_DE	5.48	0.31	-4.77%
MBG_DE	4.98	0.36	-4.84%

Disclaimer

The content presented in this publication is for informational purposes only and should not be considered as investment advice. The Trinity Student Managed Fund does not endorse, recommend, or provide any warranties regarding the accuracy, completeness, or reliability of the information provided herein. All opinions expressed in this publication are those of the respective authors and do not necessarily reflect the views of the Trinity Student Managed Fund.

Readers are strongly advised to conduct their own research and consult with qualified financial professionals before making any investment decisions. The Trinity Student Managed Fund disclaims any liability for any financial loss or damage arising from reliance on the information contained in this publication.

References

1. S&P 500 Consumer Discretionary Website https://www.spglobal.com/spdji/en/indices/equity/sp-500-consumer-discretionary-sector/#overview

2. MCSI Consumer Discretionary Index https://www.msci.com/documents/10199/e8096ca8-6a16-4be0-861c-971f21c2a4c6

3. Koyfin – LVMH https://app.koyfin.com/snapshot/s/eq-13qykf

4. Koyfin 8 Best Luxury Brand Stocks of 2024 https://www.koyfin.com/blog/best-luxury-stocks/

5. Financial Times – Equities – LVMH https://markets.ft.com/data/equities/tearsheet/summary?s=MC:PAR

6. LVMH – Investors https://www.lvmh.com/investors/lvmh-share

7. CNBC – LVMH Analysis https://www.lvmh.com/investors/lvmh-share

8. Yahoo Finance – Ferrari https://finance.yahoo.com/quote/RACE/

9. Ferrari – Investors https://www.ferrari.com/en-EN/corporate/investors

10. New York Times – As the EV Evolution Slows, Ferrari Enters the Race https://www.nytimes.com/2024/07/06/business/ferrari-electric-vehicles.html

11. University of Virginia – The Darden Report https://news.darden.virginia.edu/2024/08/23/what-a-fed-rate-cut-could-mean-for-your-wallet/#:~:text=This%20is%20good%20news%20for,recession%20while%20not%20reigniting%20inflation

References cont'd

12. Financial Times – Chinese offices emptier than during Covid pandemic as slowdown hits https://www.ft.com/content/2da0e160-c654-419e-9b38-734f0fe20f6d

13. Lazard – Emerging Markets https://www.lazardassetmanagement.com/research-insights/outlooks/emerging-markets

14. BlackRock – Geopolitical Risk https://www.blackrock.com/corporate/insights/blackrock-investment-institute/interactive-charts/geopolitical-risk-dashboard

15. S&P Global – US Corporate Bankruptcies https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/us-corporate-bankruptcies-in-april-reach-highest-monthly-level-in-a-year-81518100

16. MarketWatch – Short Interest https://www.marketwatch.com/tools/screener/short-interest

17. OECD – Consumer Confidence Index https://data.oecd.org/leadind/consumer-confidence-index-cci.htm

18. Financial Times – The inside story of he backchannel between the US and China https://www.ft.com/content/c62ca855-c70b-4814-aa47-96d2a0020c16

19. Financial Times - EU to hit Teslas imported https://www.ft.com/content/58ee386a-e6e0-4bc5-81fc-729d3f6b8979

20. Zion Market Research - Demi-Fine Jewellery https://www.zionmarketresearch.com/report/demi-fine-jewelry-for-women-sales-market

21. Market Screener - Renault https://www.marketscreener.com/quote/stock/RENAULT-4688/news/RENAULT-SA-JP-Morgan-remains-its-Buy-rating-47470723/

22. Renault – Group Revenue https://media.renaultgroup.com/2024-q1-group-revenue/

23. Statista – Renault https://www.statista.com/outlook/mmo/passenger-cars/renault/worldwide

24. Visable Alpha – Renault https://insights.visiblealpha.com/mex/RENA_FR/NMV/RT

25. Guru Focus – Renault https://www.gurufocus.com/stock/RNSDF/summary