

Consumer Stocks Stall Amid Surprising Earnings

Better-than-expected profits and sales aren't helping consumer discretionary stocks maintain last year's big gains

By [Ben Steverman](#)

The American consumer is showing surprising signs of life lately, even if the stock market has given consumer companies little credit for improvement. The Standard & Poor's 500 Consumer Discretionary index is down 4% in 2010, just ahead of the broader S&P 500-stock index, which has declined 5.2% so far this year.

Profits and recent sales results for many consumer stocks are blowing away analyst predictions. So far 29 of 80 stocks in the S&P 500 Consumer Discretionary index have reported fourth-quarter earnings. Unlike consumer staples companies that supply customer needs, the consumer discretionary sector generally supplies customer wants. It consists of a variety of retailers, restaurants, homebuilders, automakers, media operators, and tourism companies. According to Bloomberg data, the sector is posting earnings 348% higher than a year ago and 30% above what analysts had predicted.

"It's been surprising how wide their profit margins have been," says Jeff Kleintop, chief market strategist for [LPL Financial](#). Fearing "the Great Depression," he says, retailers and other consumer-focused businesses slashed costs and inventories. In 2009 consumer stocks "got lean and mean," says Mike O'Rourke, chief market strategist at brokerage [BTIG](#). The prospect of wider profit margins helped drive a rapid advance for consumer stocks, he said.

In 2009, the S&P Consumer Discretionary index advanced 38.8%, rebounding from a 34.7% drop in 2008. This year, O'Rourke says, investors are looking not just for profit growth, but for sales expansion. In order for consumer stocks to keep rising, "the 2010 story is going to have to be a better-than-expected recovery in the economy," he says. Although the signs are very early, January data from some retailers suggest such improvement could be on the way.

upper middle class: buying again

Broadline retailers saw sales rise 2.4% in January, according to Deutsche Bank ([DB](#)), and many individual retailers did far better. Nordstrom ([JWN](#)), for example, saw same-store sales rise 14% in January, far more than the 5.4% advance Wall Street was predicting. Analysts forecast flat sales at Macy's ([M](#)), but the department store reported a 3.4% increase in same-store sales. Kohl's ([KSS](#)) saw same-store sales rise 6.5%, more than twice Wall Street's expectations.

While all consumers still feel some economic pinch, wealthy and upper-middle-class consumers are growing more confident, says Lisa Walters, principal at research and consulting firm Retail Eye Partners in New York. Lower-income consumers—many living "paycheck-to-paycheck," Walters says—continue to favor value retailers such as Wal-Mart Stores ([WMT](#)) and Target ([TGT](#)).

In the new year, more expensive retail options have been gaining ground. The discount Old Navy apparel chain, owned by Gap ([GPS](#)), boosted same-store sales 10% in January, 0.6% below analyst expectations. But the Gap's priciest chain, Banana Republic, surprised Wall Street with a 4% rise in sales, far better than the 1.2% decline analysts had predicted. "We're starting to see an opening of purse strings [that] were really closed in 2009," Walters says. Having adjusted to a lower level of spending in the past year, the consumer "feels a little less hesitant to spend when she wants to," particularly at favorite stores, Walters says.

So far in 2010, Macy's shares are down 2.5% and Gap's stock is off 5.6%. Despite its outsized January sales, Nordstrom shares have dropped 9.1%.

If investors seem less than impressed, it may be a sign of widespread skepticism that U.S. consumer spending can maintain momentum. After two years of job losses, shrinking retirement portfolios, and declining home values, consumers could take time to place trust in an economic recovery. In January, the U.S. unemployment rate fell from 10% to 9.7%, but nonfarm payrolls declined 20,000. Against this backdrop, LPL's Kleintop says he is looking for opportunities to move out of consumer stocks. "The consumer is still in a pinch," he says, with many households "mired in a tremendous amount of debt."

business spending surpasses consumers'

Ford Motor ([F](#)) saw a 5% drop in January sales, following an 18% increase in December. December's strength simply didn't continue into January, said Ken Czuby, Ford's U.S. marketing vice-president, to analysts. "That speaks to the challenging conditions we are likely to face all this year, with an economy that [seems] stuck in first gear," Czuby said. Without discounts and other incentives, "we can't seem to get the traction in the consumer's mind."

In better shape are the balance sheets of many businesses, at least those outside the financial sector. This could benefit industrial and technology stocks, Kleintop says. Their business customers "have the ability to spend where the consumer doesn't."

The strength of business spending over consumer spending was illustrated in the last quarter's report on U.S. gross domestic product. Consumption spending increased 2% while spending on equipment and software surged 13.3%.

In 2010, a true consumer recovery—and robust advances for consumer stocks—will need a strong recovery in jobs and the housing market, says Terry Morris, senior equity manager at [National Penn Investors Trust](#). "That's the fuel for consumer confidence," he says.

Consumer spending may have stabilized after a period of steep declines, and some customers are beginning to treat themselves to modest luxuries. But the consumer sector has a long way to go before it can claim to be healthy.

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