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Weekly Commentary

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Retail Earnings Week

Retail sales have remained strong in the U.S. despite a supposed deteriorating economic backdrop. Data from September indicated a month-over-month (MoM) increase of 0.7% which came on the heels of an upward revision of a 0.8% MoM rise in August. Despite higher interest rates and increasing credit card balances, consumer spending has remained strong. However, for October, and according to The Retail Monitor (CNBC/National Retail Association), sales excluding autos and gas fell by 0.08% while core retail sales, which also removes restaurants, fell 0.03%. The index, which is a newer tool for assessing the strength of shoppers, uses actual credit card transactions to generate data: arguably more dynamic than traditional methods that are often subject to revisions.

Commencing the week of November 13, we will get some insight into the strength of the consumer courtesy of the equities markets as several major retailers will be reporting their third-quarter results over the next few weeks. The earnings parade begins with Home Depot (HD:NYSE) on Tuesday. The country's largest home improvement retailer has exposure to the U.S. residential real estate market as homeowners, given the sharp rise in mortgage rates, are trending towards "staying put" and renovating rather than selling and moving into a new home. HD is expected to report a fourth straight quarterly decline in sales. Lowe's (LOW:NYSE) will report on November 24 and like HD, weakening retail demand could lead to reduced guidance from management and subsequent analyst downgrades. Thus far in 2023 HD shares are down 7.7% while LOW shares are down by 2.3%.

Target (TGT:NYSE) will report on Wednesday while Wal-Mart (WMT:NYSE) will follow on Thursday. The difference in stock performance could not be more different between the two. Year-to-date, TGT shares are lower by 27.3% as the retailer faces numerous challenges including poor inventory selection, a climb in organized theft, and softening sales from a weakened shopper. In fact, theft has led to several store closures. Target's revenue is expected to fall 4.7% for the quarter resulting in a second consecutive quarterly decline in same store sales. This would follow a decline of 8.5% in the prior quarter.

Wal-Mart expects sales to slow to 4%, a 50% slide from last year's results, although spending on food and personal products should remain resilient. Demand for discretionary merchandise could see a challenged shopper pulling back on purchases of non-essential discretionary merchandise. WMT shares have clearly outperformed TGT shares with a year-to-date (y-t-d) gain of 17.2% through Friday's close. Results and forward guidance will be closely followed by market watchers for any indication of where shopping habits are headed. The ever important "make-or-break" holiday shopping season begins with the U.S. Thanksgiving holiday on November 23 and the frenzy of Black Friday on November 24.

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Off-price retailers TJ Maxx (TJX:NYSE) and Ross Stores (ROSS:NYSE) will report on Wednesday and Thursday respectively. TJX and ROSS each operate a chain of physical stores that specialize in discounted brand-name apparel, home goods, personal goods and fashion accessories. Prices are generally discounted by 20% to 60% off regular prices which is attractive to value-oriented shoppers. Both companies have seen their stock performance excel thus far in 2023: TJX is higher by 14.6% y-t-d while ROSS shares are up 6.3% y-t-d. Macy's (M:NYSE), a purveyor of popular brand fashion, cosmetics, home furnishings and footwear that appeals to a more upscale shopper, also reports Thursday. Through Friday, Macy shares are down a whopping 49.9% y-t-d. The difference between the performance of "discounters" versus the "higher end" is clearly reflective of a more challenged consumer.

In Canada, Canadian Tire (CTC.A:TSX) reported third quarter results on November 9. Consolidated comparable sales fell 1.6% and was attributed to "softening consumer demand" according to CEO Greg Hicks. Mr. Hicks also stated that the company plans to "prioritize essential categories within our multi-category assortment" and will remain "focused on driving value" heading into the "important fourth quarter". For Q3, the gross margin rate was up 77 basis points driven by CTR product margin up more than 200 basis points according to CFO Gregory Craig during the earnings call. Card spending declined 2% in the quarter marking a second consecutive decline and account balances were up 4%. Headcount is targeting a 3% reduction and eliminating open vacancies will account for another 3% reduction. Shares rallied sharply following the earning release but remain "flat" for 2023 (-0.8%).

Dollarama (DOL:TSX) will report Q3 results on November 29, and this will give us a good take on the discounted retail segment in Canada. DOL shares are higher by 24.6% y-t-d as of Friday's close and the stock is trading at all-time highs. Revenue is supported by growing numbers of value-oriented shoppers as well as growth from new store expansions in Latin America. Strong brand recognition, growth in store count, increasing traffic from value-oriented shoppers, and a favorable product mix could keep margins around 30% through 2025 according to Bloomberg.

The upcoming week will be very informative as investors weigh trends in consumer spending, the current strength of the American consumer, and retail management's perspectives on forward-looking prospects for retailers in a deteriorating economy. Third quarter results, and more importantly commentary and forward-looking guidance, could serve as the proverbial "canary in the coal mine" as the prospects for a recession seem to increase weekly. We'll be paying close attention to the forthcoming headlines.

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Chart 1: Palos Domestic Funds versus Benchmarks (Total Returns) [1]	FundServ	NAVPS	YTD Returns
Palos Income Fund L.P.	PAL100	$7.78	1.44%
Palos Equity Income Fund - RRSP	PAL101	$6.46	0.41%
Palos WP Growth Fund - RRSP	PAL213	$9.21	-25.96%
Palos-Mitchell Alpha Fund [3]	PAL300	$9.84	24.94%
S&P TSX Composite (Total Return with dividends reinvested)			4.27%
S&P 500 (Total Return with dividends reinvested)			16.59%
S&P TSX Venture (Total Return with dividends reinvested)			-10.33%
Chart 2: Market Data [1]			**Value**
US Government 10-Year			4.65%
Canadian Government 10-Year			3.85%
Crude Oil Spot			US $77.17
Gold Spot			US $1,937.70
US Gov't10-Year/Moody BAA Corp. Spread			183 bps
USD/CAD Exchange Rate Spot			US $0.7246

[1] *Period ending November 10th, 2023. Data extracted from Bloomberg*

[2] *Fund is priced annually*

[3] *Fund is priced weekly on Tuesdays*

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