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COMMERCE

How big of an effect will the market shake-up have on luxury?

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Affluent millennials

By FORREST CARDAMENIS

It is too soon to know if the recent drops in the stock market will be of serious consequence to the luxury market, but an overdue correction to the U.S. market will likely see affluent consumers proceed with caution.

At the moment, the market is still volatile and it is difficult to discern how much the drop in the U.S. market is caused by fears and how much by underlying economic issues. Nevertheless, if stocks continue to fall, it will certainly have an effect on luxury spending in the United States, just as it has in Russia, China, Brazil and elsewhere.

“Part of it is real,” said Milton Pedraza, CEO of Luxury Institute, New York. “There’s no question that China has some bubbles to deal with, real estate and stock market, that are being popped right now.

"China is declining, there are other parts of the world like Russia and Brazil and the Middle East that are suffering because commodities like oil aren’t going to give those countries the revenue they would’ve had," he said. "But on the other hand there’s a big overreaction, and that’s going to cause some people to say ‘Alright, let me get back in the

market because things are cheap.'"

Money never sleeps

Although there are already indications that the recent drops are affecting the U.S. market, particularly high-end cars and jewelry as opposed to apparel, there is also evidence of over-reaction. Although July saw consumer confidence drop from 99.8 to 90.9, the largest drop since August 2011 and far worse than expected, the latest numbers over-performed the expectation of 93.4 by 8.1 points.

Breguet China

As per Business Insider, the surge can be attributed to perceived improvements in the job market and favorable projections for business conditions in the short-term future. Additionally, there has been speculation that the Federal Reserve will not hike U.S. rates in the near future, although such reports have recently come into question.

However, if stocks continue to decline, it will likely cause consumer confidence to take a hit.

"What you see in the August numbers is a reflection of what's going on in an improving U.S. economy," Mr. Pedraza said. "Will we see a potential dip in September because people do get scared when the stock market dips? Probably.

Affluent consumers

"If [the stock market] continues to get worse, there is no question it will affect luxury spending," he said. "There is no question that China's luxury spending and Russian luxury spending and Brazilian luxury spending over the last year has been down. The growth rates have been down or outright declined vs. the previous year.

"One thing to keep in mind is that one of the most highly correlated factors in luxury spending, historically, and that drives the cyclicality of luxury, is the value of the stock market. Whether the stock market is going up and down, it very often determines the psychology of wealthy people, who obviously own the stocks, and their spending. Luxury has always been cyclical. Let's see if it continues to be volatile, or if the damage becomes more widespread."

Although consumer confidence may initially suggest a hopeful outlook, it is important to remember that the consumer confidence index, recorded by The Conference Board, is not necessarily geared toward upper-classes. More importantly, the cut-off date for August numbers was Aug. 13, meaning that the damage done to the stock market in the past week will not show up until September numbers are released.

The outlook does not look good.

"Our last index found affluent consumer confidence down and today it is only a few points above its historic low from Q4 2008," said Pam Danziger, president of Unity Marketing, Stephens, PA. "We continue to see a very cautious point of view from the affluent consumer segment."

Louis Vuitton, China

Unity Marketing keys its consumer confidence index to households in at least the 20th percentile of income, whereas The Conference Board's numbers are adjusted for the U.S. average consumer. Affluent households are more likely to have money invested in stocks, so a drop in the stock market will hit their bank accounts harder than it will the average consumer.

On the other hand, luxury spenders are more informed and aware of the economic state than average consumers, meaning that decreased confidence does not necessarily mean there will be a huge dip in spending.

"The recent stock market fluctuations should come as no surprise to most affluent investors, so I don't think it will necessarily change their spending habits too much, since currently their spending is depressed anyway," Ms. Danziger said.

The U.S. stock market, and by extension, the luxury market, may be partially at the mercy of the Chinese markets.

According to Bloomberg, China's intervention in equity markets and ability to rebound has had and will continue to have a major impact on global markets. China's inability to recover may lead stockholders to continue to sell, while a recovery could signal a strong global market and encourage buying.

"We are seeing an inability from China's side to really control what's going on," said Philip Guarino, director of China Luxury Advisors, Paris. "There's a transition happening that China is trying to push through, a move away from an investment-based to a consumer-based economy. All of this turmoil is happening because of the trials and

tribulations associated with that.

"I think what will happen is the world is going to have to digest that China has slowed down and that they can't expect these rosy numbers that they had for years and years. It's not going to continue to grow at that pace," he said. "On the China side, it could be really really bumpy because they are trying to transition the economy from investment-based to consumer-based and it still hasn't happened, and they're trying to maintain the same level of demand in the process."

As Mr. Guarino wrote for China Luxury Advisors, the devaluation of the renminbi was actually quite small. The devaluation was a response to projected slowness in growth and has also spurred dips in markets globally.

"It's a signal as opposed to actual reality," Mr. Guarino said.

Big trouble in little China

The drop in the U.S. stock market is intrinsically tied to the markets and economies of other countries, troubles in which have already hit some luxury brands.

Two weeks ago, Luxury Daily reported that China's devaluation of its renminbi is intended to boost the country's slouching trade, but the impact of the altered exchange rate will likely extend to the luxury industry.

Following the announcement of the steepest decline in the yuan in the past decade, hard luxury goods companies and automakers such as BMW, Swatch Group and LVMH saw their shares take some of the hardest hits, declining as much as 5 percent. With the luxury industry looking to China for sales growth, the now more expensive merchandise may be cause for an altered outlook in the market (see story).

China's ability to recover will also have a major impact on luxury markets abroad. Luxury brands stand to benefit enormously from affluent Chinese tourists if they effectively position themselves, according to a study by Hurun Report published in June.

Chinese travelers go to the U.S. to visit friends and family, to Japan for shopping and culinary experiences, France for shopping and business and Australia for leisure. Since the imperative of personal relationships guarantees the U.S. abundant tourists, brands in key cities must improve the experiences they provide (see story).

If the recent drops in the U.S. market can be seen as a correction for overly generous growth rates in the recent past, it seems intuitive that people will return to buying when it becomes apparent that growth is slowing, not halting or reversing.

"There will be volatility in the U.S. market because it's overdue. It's a correction of sorts," China Luxury Advisor's Mr. Guarino said. "In terms of China, I've heard conflicting stories, one from luxury CEOs themselves who've all said there's been a slow down in consumption in China. Others who've said consumer competence is still fairly high."

Taken altogether, the only picture being painted is that it is too soon to tell. Recent devaluation in the market and slowed growth is real, but the medium- and long-term

impact on the stock market and affluent consumers worldwide is harder to forecast.

The outlook should remain at least partially optimistic.

"There's no question that If we survived the 2008 debacle we're certainly going to survive this one," Luxury Institute's Mr. Pedraza said.

Final Take

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