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FINANCIAL SERVICES

How will stock market volatility affect luxury consumption?

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The most affluent may be insulated from stock market dips. Image credit: Bally

By SARAH JONES

Global stock markets have been taking a tumble, as volatile trading threatens to eat away at the net worth and investment assets of affluent individuals.

Marking a change of pace from what had been a relatively calm ascent, both the Dow Jones Industrial Average and the S&P 500 saw their steepest declines in years on Feb. 5. The market remains turbulent, potentially altering luxury consumers' confidence and spending plans.

"Market gyrations with this much of acute volatility can undermine confidence and create emotional uncertainty regardless of the reality of what is actually in their accounts," said David Friedman, New York-based founder of several ventures in the wealth intelligence space including Wealth-X, WealthQuotient, Premex.io and ProspectGraph.

"But, this impact is greater the lower you go on the scale of the UHNW market," he said. "The larger family offices with assets of greater than $500M are migrating mostly towards direct investments and cash with little deployed in the equity markets.

"This investment paradigm is insulating them from the typical equity market volatility and steep gyrations. A majority of the UHNW market has wealth between $30-50M and it is that segment that continues to have large equity portfolios and therefore will bare the brunt of the emotional pressure of their wealth rising and falling with such large dips."

Ups and downs

After reaching record highs earlier this year, the Dow Jones Industrial Average plunged 1,175 points on Feb. 5, marking the greatest point decline in its history. The S&P 500 similarly fell from its record high on Jan. 26.

This triggered a sell-off as consumer confidence in the stock market slid and investors looked to rid themselves of assets quickly.

Beyond the U.S., international trade felt reverberations of the falls, as indexes in Asia and Europe also saw sell-offs. Britain's FTSE 100 fell 255 points before seeing a partial rebound.

There is no immediate development tied to the losses in the markets, but some attribute the widespread sales to consumer concerns about expected rising interest rates.

But some have pointed to this decline as a form of correction for markets that had risen too fast too quickly. While typically the Dow only rises about 8 percent a year, its January trading was up about 26 percent year-over-year.

Affluent consumers may lose some confidence in light of the turbulent stock market. Image credit: Michael Kors

"The macro environment is positive," said Marie Driscoll, principal of Driscoll Advisors, New York. "In fact Friday's good jobs report sparked this sell-off as does the potential of interest rate increases through 2018.

"Our economy is just starting to accelerate from a 2 percent to 2.5 percent GDP growth rate to 3 percent to 3.5 percent rate. Interest rates will rise," she said. "There are many under-employed people that aren't factored into the 4.1 percent unemployment rate.

"I don't think an economic crash is on the horizon and in the absence of alternative undervalued investments, I don't think the stock market will crash either."

For ultra-affluent entrepreneurs at the helm of public companies, these shifts are having an impact on their net worth as their companies' stocks ride a trading roller coaster. Warren Buffett, for instance, lost $5 billion in one day on Monday as Berkshire Hathaway shares fell 6 percent.

"Investors should have a long-term time horizon and near term price volatility should not factor into their liquidity needs," Ms. Driscoll said. "The market's volatility is a re-pricing of risk and potential alternative credit based investments.

"The S&P 500 increased 22 percent in 2017 and 10 percent in 2016. The market doesn't only go up," she said. "In January 2018 the S&P 500 rose 5.6 percent, this recent sell-off doesn't reflect a weak macro economic outlook or reduced corporate profits. This is all rational commentary.

"Investors are also emotional. They have benefited from the wealth effect of the last 25 months. This is a normal part of investing, albeit the heightened volatility on the downside evokes some fear. If you don't have near-term liquidity needs sit tight. Some of the luster of the wealth effect will wear thin, though."

The most affluent are apt to be insulated from stock market movements. Image courtesy of Neiman Marcus

According to a Spectrem study of affluent investors with between $100,000 and $25 million in net worths, 68 percent of their assets are tied to investments. Of this 68 percent, close to 60 percent is invested in equities.

Economist Edward Wolff's research also found that the Americans whose household incomes place them in the top 10 percent own 84 percent of stocks.

Even though affluent investors may lose money as they sell stock at discounts or see the value of their investments retract, typically those with the most assets are the most insulated from economic turbulence. The most wealthy have net worths that typically prevent them from giving up their luxury lifestyle even in the face of shrinking portfolios.

However, consumers who are mass affluent may alter their spending plans if their investments take too much of a hit. These consumers who might only upgrade to luxury on occasion may be more apt to do without if their financial situation changes.

"The wealth effect is real, feeling wealthy based on the value of your investment portfolio, real estate, art work, etc., has an impact on spending and splurging," Ms. Driscoll said. "If the market stabiles over the next few weeks or months this correction isn't likely to have an impact on spending.

"Should the dip continue, big purchases are more likely to be postponed or passed over, while small luxuries continue to be in demand," she said. "Vacations, planned frequently long in advance and for the whole family, aren't cancelled."

Given a more sustained drop, brand outreach to affluents will also need to be more strategic.

"Hopefully luxury brands have capitalized on the record making equity performances of the last year since the ultra affluent both had money to spend and felt wealthy," Mr. Friedman said.

"If the recent volatility is really a signal for a broader retreat in equity markets, they will need to pivot towards understanding their clients better to engage them in more bespoke ways," he said. "Just broadcasting their brand narratives and 'hoping' they will continue to grow will prove to be challenging."

Taking stock

Since the 2008-2009 global financial crisis, the stock market had been on a steady incline, which in turn had given wealthy consumers the confidence to increase their spending.

As wealth continues to grow, luxury brands are beginning to learn that one of the best ways to engage with confident luxury consumers is through individualized, bespoke experiences. But the impressive performance of the United States stock market is only partly the cause of the booming luxury industry (see story).

During times of stock market volatility, sometimes affluent consumers turn to alternative investments.

In 2015, foreign consumers were expected to pour money into Western real estate, then considered a more stable investment than stocks as Chinese and U.S. indexes see-sawed (see story).

"For those on the high end including demi-billionaires ($500M) to billionaires, being insulated through their direct investment portfolios, may be keen to actually leverage their dry powder to be opportunistic in such markets and acquire assets and luxury items at a discount since they possess the leverage in such environments," Mr. Friedman said. "For the broader UHNW market, their emotional reaction to the equity market gyrations will drive a pull back from luxury purchases revolving around assets, but investments around luxury experiences could be more buoyant."