LPL RESEARCH

PRIVATE CLIENT THOUGHT LEADERSHIP

November 2015

DISRUPTIVE INSIGHTS

DOES BLACK FRIDAY STILL MATTER?

"SALES FOR THE HOLIDAY SEASON OVERALL HAVE ACTUALLY INCREASED OVER THE YEARS, DESPITE THE DROP IN BLACK FRIDAY SALES."

LOWER BLACK FRIDAY SALES ESTIMATES

The day after Thanksgiving, also known as Black Friday, seems to receive more media hype each year, as it is the unofficial kick off of the holiday season. Markets also pay attention, as Black Friday has historically been an early indicator of consumer demand during the important holiday shopping season. But Black Friday sales estimates have fallen for the past two years, leading to the question, is the weekend after Thanksgiving as impactful as it was in the past? And, should investors be worried?

THE EVOLVING CONSUMER

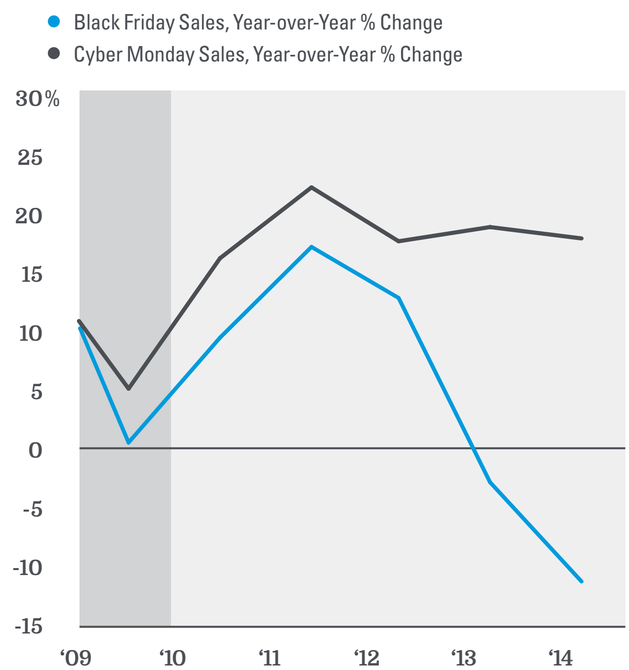
The Black Friday weekend has been a draw for consumers since the 1950s, but media coverage has picked up steam in recent years, with people braving cold weather, long lines, and short tempers to find the best deals. Contrary to popular headlines discussing the frenzied madness, sales estimates for the Black Friday weekend have actually decreased over the past couple of years. Does this mean that Black Friday shopping is becoming less relevant for consumers?

One driver of lower Black Friday sales relative to history is the wider usage of internet retailers. Online sales have increased over the past decade, so much so that they earned their own discount day—Cyber Monday. This term was originally coined in 2005 when everyone returned to work the Monday after Thanksgiving. Corporate networks used to have much higher speeds than the typical home, and employees still in the Black Friday mindset would go into work and do their holiday shopping online. With broadband internet access widely available now, online sales are no longer dependent on Cyber Monday, though the propensity for online retailers to offer special deals on the day means it continues to be relevant.

Online retail has seen stronger growth than traditional retailers in recent years [Figure 1], which is no surprise given that online is starting from a smaller base. Traditional brick and mortar retailers have also turned to the internet and account for at least part of the pickup in online sales. Traditional retailers are working hard to compete in the online world, often leveraging their large distribution and physical store networks by allowing free delivery to a customer's local store.

While Cyber Monday sales have seen strong growth over the past few years, the gains haven't been enough to offset an overall decline in the four-day weekend (Black Friday through Cyber Monday) [Figure 2]. The recent trend of stores opening on Thanksgiving, as well as additional discounting closer to Christmas (Super Saturday, the Saturday before Christmas, is one such example), indicates customers may be spreading out purchases throughout the holiday season and diminishing the importance of the four-day shopping period. Sales for the holiday season overall have actually increased over the years, despite the drop in Black Friday sales.

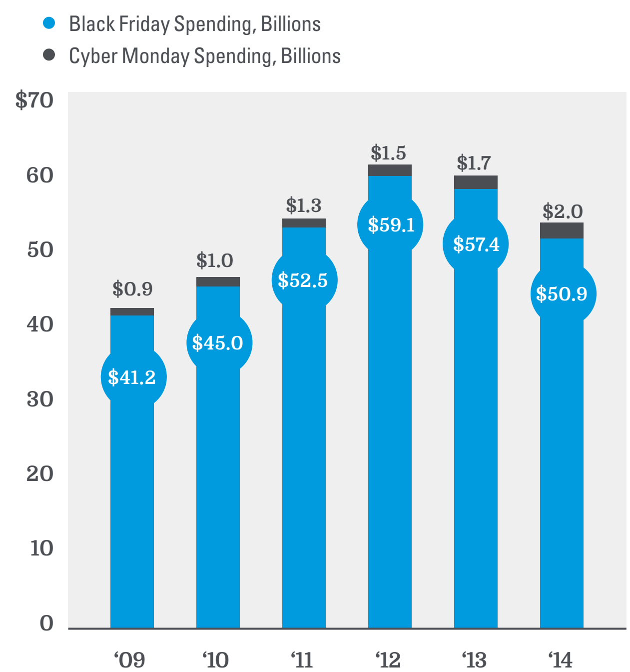
1 CYBER MONDAY SALES ARE GROWING FASTER THAN BLACK FRIDAY SALES



Source: LPL Research, National Retail Federation, comScore 10/29/15

Shaded area indicates a recession.

2 CYBER MONDAY HAS SEEN GAINS, BUT NOT ENOUGH TO OFFSET BLACK FRIDAY'S DECLINES



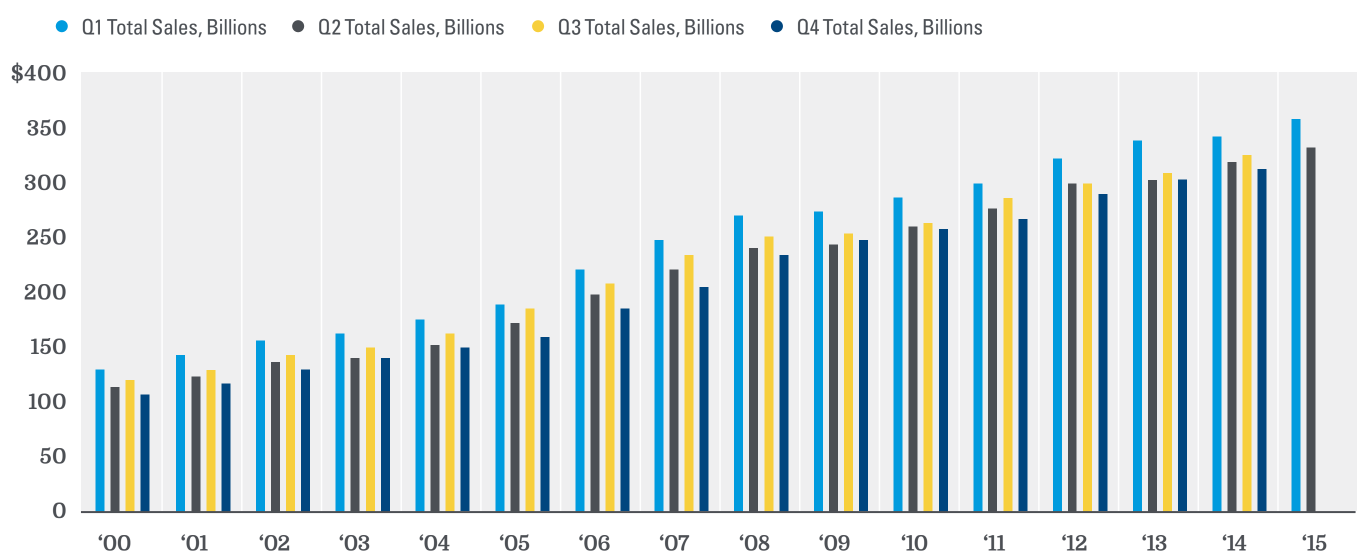
Source: LPL Research, National Retail Federation, comScore 10/29/15

DISCOUNTS LEAD TO PROFITS FOR RETAILERS

Black Friday clearly matters to retailers, as it is among the busiest shopping days of the year. Every year, companies from department stores to electronics retailers—and even home improvement warehouses—advertise heavily discounted items to draw shoppers in. Over time, these tactics have been successful and led to increased sales during the holiday season. Figure 3 shows total quarterly sales for the top 15 retailers in the S&P Retail Select Industry Index over the past 15 years. Due to the importance of the holiday shopping season, many retailers operate on a fiscal year that ends in January, meaning that the first quarter (Q1) is the quarter that includes holiday shopping figures.

Increased sales are great, but what really matters to retailers and their shareholders is profits. The heavy advertising of discounts would lead one to believe that Black Friday sales are less profitable; however, gross profit margins for retailers are actually highest during

3 HOLIDAY SEASON SALES HAVE BEEN INCREASING OVER THE PAST 15 YEARS

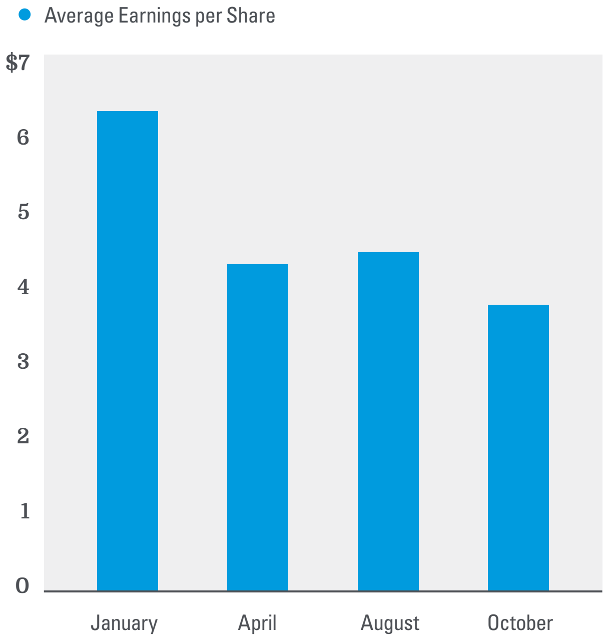


Source: LPL Research, FactSet, Standard & Poors 10/29/15

This chart represents the 15 largest retailers in the S&P Retail Select Industry Index through Q2 2015.

GROSS PROFIT MARGINS FOR RETAILERS ARE ACTUALLY HIGHEST DURING THE HOLIDAY SEASON.

4 **AVERAGE EARNINGS PER SHARE FOR RETAILERS ARE HIGHEST DURING THE HOLIDAY SHOPPING SEASON**



Source: LPL Research, FactSet, Standard & Poors 10/29/15

This chart represents the 15 largest retailers in the S&P Retail Select Industry Index through December 2014.

the holiday season. And, as Figure 4 shows, the holiday season (the January quarter) is also the most profitable quarter for retailers on an earnings per share (EPS) basis.

There are a few reasons for what seems like a contradiction between big discounts and profits. First, retailers often negotiate pricing for Black Friday deals with their suppliers, meaning supplier profit margins absorb some of the impact of lower prices. Additionally, retailers frequently offer discounted prices on big ticket items, such as electronics, to entice customers to visit the store and buy higher margin products. Discounts have reportedly been heavier in recent years, as stores compete to bring in customers, and this is keeping margins lower than they were in the mid-2000s, though margins did recover somewhat during the 2014 season. Given high sales and solid overall margins, retailers are likely to continue offering Black Friday and Cyber Monday deals for the foreseeable future.

HOLIDAY SHOPPING & STOCK MARKET RETURNS

Several firms, including the National Retail Federation (NRF), ShopperTrak, comScore, and IBM, provide sales and retail traffic estimates for both Black Friday and Cyber Monday, and investors watch these estimates closely to get an early read on the mood of consumers and determine if retailers will see expanded profits. But do these estimates on their own offer an opportunity for excess returns?

Figure 5 shows the relationship (correlation) between movements in Black Friday sales estimates and first quarter sales, as well as fourth quarter and first quarter moves in retailer stocks, as measured by the S&P Retail Select Industry Index. A correlation of 0 means there is no relationship between the two values; a correlation of 1 indicates a strong relationship, where a 1% gain in one number would translate to a 1% gain in the other. A correlation of -1 would indicate that a 1% gain in the first number would translate to a 1% loss in the other.

5 **CORRELATIONS BETWEEN BLACK FRIDAY AND CYBER MONDAY ESTIMATES AND RETAIL INDEX PERFORMANCE**

Correlation Since 2008 Between	Q1 Reported Sales	Q4 Retail Index Performance	Q1 Retail Index Performance
Black Friday	83.5%	-44.1%	54.2%
Cyber Monday	95.9%	13.2%	-29.9%

Source: LPL Research, FactSet, Standard and Poor's, National Retail Federation, comScore 10/29/15

The correlation between estimates of Black Friday and Cyber Monday sales and actual sales for the 15 largest retailers in the S&P Retail Select Industry Index are actually high, indicating that the sales estimates are generally in-line with reality. However, there is little, if any, relationship between Black Friday/Cyber Monday sales estimates (or actual reported sales results) and the performance of the S&P Retail Select Industry Index in the fourth quarter (or the S&P 500 as a whole) since 2008. First quarter results see a somewhat improved relationship for Black Friday sales estimates, but Cyber Monday estimates are less correlated. So overall, while Black Friday and Cyber Monday are good predictors of total holiday sales, neither does a good job of explaining subsequent stock market returns.

Why wouldn't widely followed metrics like Black Friday and Cyber Monday sales be good indicators of future market moves? Market participants are always looking for an informational edge, and while early sales results are important, over time, market participants have focused on their own forecasts. Forecasts can be projected by aggregating individual company estimates or by looking at broader economic data. The "official" estimates can still move markets if they are out of line with these market-derived forecasts, but are just one factor investors use for investment decision making regarding retailers.

Over the past five years, these market-derived forecasts have caused the S&P Retail Select Industry Index to see its strongest average performance during the fourth quarter; and the first quarter, when the strongest sales are likely to be reported, has come in at a close second [Figure 6]. Given that markets are forward looking, market participants bid up the index during the fourth quarter in anticipation of higher first quarter profits, and then if earnings beat expectations additional gains may be made in the first quarter.

One thing to note is that this relationship works in both directions. Seasonal strength in the retail index over the past few years has been driven by increasing sales, but it is possible that if holiday expectations are weak, fourth quarter performance could be hurt. And weak actual profits in the first quarter could cause a similar downturn in performance. Ultimately, shorter-term market performance will be driven by the relationship between expected profits and actual profits.

6 THE S&P RETAIL SELECT INDEX HAS SHOWN SEASONALITY OVER THE PAST FIVE YEARS

Time Frame	Average Return
Q1	7.7%
Q2	0.0%
Q3	3.2%
Q4	9.9%

Source: LPL Research, FactSet, Standard and Poor's 10/29/15

The performance data presented represents past performance and is no guarantee of future results. All indexes are unmanaged and cannot be invested into directly. Unmanaged index returns do not reflect fees, expenses, or sales charges. Index performance is not indicative of the performance of any investment.

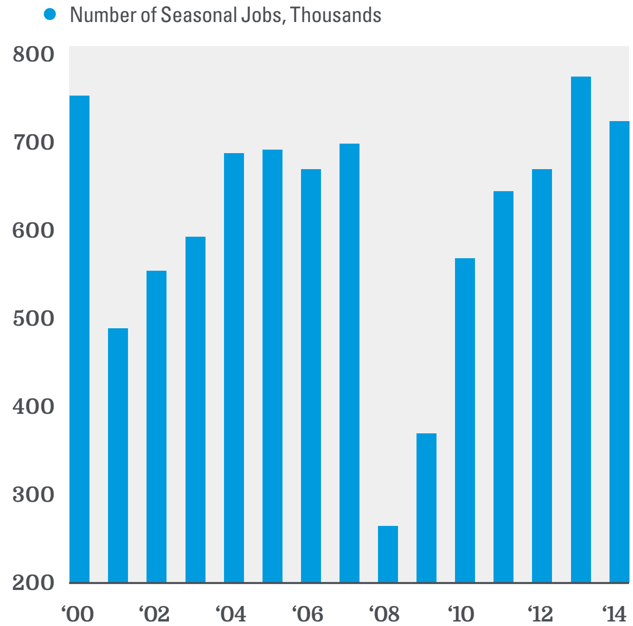
WHILE BLACK FRIDAY AND CYBER MONDAY ARE GOOD PREDICTORS OF TOTAL HOLIDAY SALES, NEITHER DOES A GOOD JOB OF EXPLAINING SUBSEQUENT STOCK MARKET RETURNS.

HOLIDAY SHOPPING AS AN ECONOMIC INDICATOR

Holiday spending in 2014 topped $600 billion according to the National Retail Federation, which equates to approximately 3.5% of total gross domestic product (GDP) for the year. Though the numbers don't flow through to GDP directly, holiday sales figures have had an approximately 92% correlation with fourth quarter GDP growth over the past 10 years, which makes sense given that consumer spending makes up roughly 70% of the U.S. economy's output.

However, spending is not the only way the holiday season affects the economy. Knock-on effects, such as additional employment, can have an impact as well. Holiday hiring has been significant in recent years [Figure 7], with the NRF estimating that companies will add between 700,000 and 750,000 seasonal employees for 2015, not including additional indirectly related jobs such as manufacturing and transportation.

7 SEASONAL JOBS CAN ALSO HAVE AN IMPACT ON U.S. ECONOMY



Source: LPL Research, National Retail Federation, Bureau of Labor Statistics 10/29/15

CONCLUSION

As online retailers attempt to gain ground from their traditional brick and mortar counterparts, and traditional retailers continue to figure out how to make their online and physical store divisions work together more seamlessly, Cyber Monday will likely continue to see bigger percentage sales gains than Black Friday in the future.

More importantly though, the increased level of competition in the retail arena also means that retailers are likely to continue extending discounts throughout the holiday season, meaning the combined Black Friday/ Cyber Monday season is likely to continue to decline in importance over time. Regardless of the waning significance of this specific weekend, the overall holiday shopping season will no doubt remain an important source of deals for consumers, profits for retailers, and returns for investors.

IMPORTANT DISCLOSURES

The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual. To determine which investment(s) may be appropriate for you, consult your financial advisor prior to investing. All performance reference is historical and is no guarantee of future results. All indexes are unmanaged and cannot be invested into directly.

There is no assurance that the techniques and strategies discussed are suitable for all investors or will yield positive outcomes. The purchase of certain securities may be required to affect some of the strategies. Investing in stock includes numerous specific risks including: the fluctuation of dividend, loss of principal and potential illiquidity of the investment in a falling market.

Because of its narrow focus, specialty sector investing, such as healthcare, financials, or energy, will be subject to greater volatility than investing more broadly across many sectors and companies.

INDEX DESCRIPTIONS

The S&P 500 Index is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

The S&P Retail Select Industry Index is made up of companies in the S&P Total Market Index that fall under the GICS retail sub-industry. The S&P Total Market Index tracks all US stocks listed on the NYSE, AMEX, NASDAQ National Market, and NASDAQ Small Cap exchanges.

DEFINITIONS

Earnings per share (EPS) is the portion of a company's profit allocated to each outstanding share of common stock. EPS serves as an indicator of a company's profitability. Earnings per share is generally considered to be the single most important variable in determining a share's price. It is also a major component used to calculate the price-to-earnings valuation ratio.

RES 5292 1115 | Tracking #1-439381 (Exp. 11/16)