



Market dynamics and consumer impact: Identifying opportunities

The consumer sector landscape is continually evolving, driven by changes in consumer behaviour and economic conditions. Investment Analyst Emma Henderson explores how companies are navigating these challenges and provides insights into the outlook for Chinese consumers in light of recent stimulus efforts in China. Emma also explains how Magellan gains exposure to the Chinese consumer through multinational companies and examines how these companies are performing in the current tough consumer environment.

How has the consumer landscape evolved since July this year?

In Western markets, consumer trends from July remain broadly consistent. While there has been some slowdown in the U.S. consumer, strong employment continues to support a relatively healthy level of consumer spending. Lower-income consumers continue to feel pressure from inflation, affecting their spending on essentials and impacting sectors like dollar stores and fast food. Middle to higher-income consumers are healthier but cautious due to rising living costs and uncertainties. Brands excelling in this environment offer strong product innovation or good value for money. Travel and experiences are outperforming goods, and the convenience economy, including expedited shipping and food delivery, remains strong despite some discretionary spending pullbacks.

We often focus on Western markets, but with recent news of Chinese government stimulus, does this make the Chinese market more appealing to you and the team, given Magellan's cautious stance over the years?

Recent news about Chinese government policies has been a key driver of share price movements for certain consumer sectors, such as luxury and beauty brands. Ahead of this recent news, our caution about the Chinese economy and consumer health had been growing due to continuing falls in property prices, low business confidence, rising unemployment, and low consumer confidence. Early third-quarter earnings reports have confirmed a consumer deterioration.

The recent government stimulus news is seen as positive but is expected to mainly reduce further downside risk rather than drive an immediate acceleration in consumption activity. We expect the size of the stimulus to likely be modest and not focused on direct consumer support, unlike Western fiscal stimulus measures. Other measures to support local government finances and the property market should indirectly benefit consumers and may drive a more gradual improvement in confidence and spending.

We don't hold any domestic Chinese stocks in our portfolio, but we do have exposure to the Chinese economy through some multinationals. How are these companies faring during this time?


We don't hold domestic Chinese companies due to concerns about regulatory changes and corporate governance. Instead, we've selectively maintained exposure to the Chinese consumer through small holdings in multinationals like LVMH and L'Oreal, which are high-quality businesses in the luxury and beauty sectors. These companies have not been immune to the broader consumer slowdown, and have posted negative growth in their China businesses in recent results, however have outperformed many peers, reflecting their strong brands, customer loyalty, and disciplined growth strategies. Companies that chased growth indiscriminately are now suffering more from the slowdown.

We've also had some exposure to the Chinese consumer through restaurant companies. Can you provide insight on this?

Yum! Brands, which includes KFC and Pizza Hut, provides some additional exposure to the Chinese consumer market. Within a pressured China restaurants sector, Yum! Brands has shown greater earnings resilience as a result of its franchised model, which is more defensive during disruptions. This model allows Yum! Brands to earn royalty fees without facing margin pressure from promotions or negative sales trends. Additionally, the strong financial and operational position of Yum! Brands' strategic partner in China, Yum! China, has enabled continued store expansion and quick adaptation to consumer needs, helping KFC and Pizza Hut brands gain traffic share even in a challenging environment.

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