FFTW Weekly Commentary
FOR PROFESSIONAL INVESTORS

Oh SNAP, US retail sales were what?

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Key takeaways

- December US retail sales came in softer than expected.
- The secular headwinds of declining brick-and-mortar (mall) traffic at the expense of e-commerce continued.
- The Food and Nutrition Service (FNS) announced SNAP benefits could be used for online food shopping in select markets.

Full commentary

There's a saying on Wall St, "*As January goes, so goes the year*". But what does that even mean? I don't think anyone knows what it means but it is provocative. It's not even a particularly enlightening statement because you only have to think back to this time last year. Globally risk assets were under pressure from a number of catalysts and in fact the S&P500, considered the global risk barometer, ended the month of January down 5%. Many had thought 2016 was setting up to be a dire year for the US consumer and asset class returns. But January did not foretell the coming year's performance as the S&P finished 2016 up nearly 12% and the US consumer remained resilient. Perhaps we should update this tagline with something more specific that better represents an accurate statement - *"As goes the health of the consumer, so goes retail sales"*.

The last few months of 2016 consumer confidence surged and all signs were pointing towards a bumper holiday sales season for retailers. Over the last few months and quarters we've seen the consumer retail sector come under pressure with a series of negative data points and fourth quarter updates from retailers (i.e. Macy's, Kohl's, Limited Brands, Sears, Neiman Marcus). So suffice to say the US retail sector needed a robust consumer to spend in December. Unfortunately last week when the December US retail sales were released they came in softer than expected. On a positive note, US retail sales were up 0.6% month-over-month led by gains in autos and gasoline. However the closely watched, Control Group (retail sales less food, auto dealers, building materials, gas stations) [see chart one] was up a paltry 0.2% month-over-month or 3.3% year-over-year. Spending at restaurants (an indicator of discretionary spending) fell by 0.8% month-over-month after a 1.2% rise in November.

So while the reported numbers were at best mixed and at worst disappointing, one underlying story continued on course. The secular headwinds of declining brick-and-mortar (mall) traffic at the expense of e-commerce. Chart two shows the persistent trend for consumers to shop on their couch rather than brave Mother Nature and venture out to the store. Sears announced earlier this month it was closing 150 stores in an attempt to right size its business model. But for every casualty there is a success story and it is one most everyone has heard of, Amazon.com. For years Amazon has been carefully sculpting itself into the go-to place for couch surfing and impulse buying of nearly every product imaginable. And as Amazon gained market share it caught the eye of the US bellwether brick-and-mortar, Wal-Mart.

Wal-Mart spent years attempting to build its own online presence with limited success relative to the Amazon model. So in 2016 Wal-Mart entered two noticeable transactions to address where it sees the market heading. In June it sold its Chinese e-commerce business to JD.com, in exchange for a 5% stake in the company. Then in August it acquired Jet.com, the fast growing US online retailer. And, just last week, Wal-Mart acquired online footwear retailer ShoeBuy.com to further strengthen its online offerings.

So as Wal-Mart pivots its business model to facilitate more online transactions, Amazon looks to increase its market share in an area which until recently had been dominated by companies like Wal-Mart. In 2014 the US Farm Bill mandated a feasibility test be conducted on the implications of allowing online retail food stores to accept SNAP benefits (formerly referred to as food stamps). Earlier this month the Food and Nutrition Service (FNS) announced a select group of online retailers would participate in this study. This group was comprised of established brick-and-mortar grocery stores and Amazon. Interestingly Wal-Mart was not one of the eligible participants.

Last year the US Department of Agriculture funded $74 billion in SNAP benefits. A study released last week announced the number one item in the shopping carts of SNAP beneficiaries was soft drinks at roughly 9.3% (~$6.9 billion). Non SNAP eligible households spent on average 7.1% on the carbonated beverages. It's important to note that this is only a feasible test and any advance conclusions should be tempered. But the potential benefit for SNAP beneficiaries, particularly those in food deserts is a clear positive. And for Amazon, which last reported annual revenue of roughly $128 billion, it marks a clear opportunity to continue expanding its online distribution.

This week's market developments

Monday, January 9
- Germany Industrial Production growth increased to 0.4% m.o.m. (s.a.) for November

Tuesday, January 10
- France Industrial Production growth increased to 2.2% m.o.m. (s.a.) for November

Wednesday, January 11
- UK Industrial Production growth increased to 2.1% m.o.m. (s.a.) for November
- UK Manufacturing Production growth increased to 1.3% m.o.m. (s.a.) for November

Thursday, January 12
- Eurozone Industrial Production growth increased to 1.5% m.o.m. (s.a.) for November

Friday, January 13
- US PPI Final Demand growth remained at 0.3% m.o.m. (s.a.) for December
- US Retail Sales Advance growth decreased to 0.6% m.o.m. (s.a.) for December
- US University of Michigan Sentiment Index (prelim estimate) decreased to 98.1 for January

Source: Bloomberg, as of end January 13, 2017

Charts of the Week

Chart 1: Retail Sales YoY % Less (Food, Auto Dealers, Building Materials, Gas Stations)

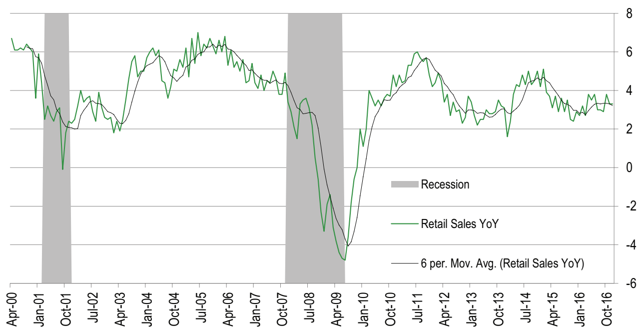
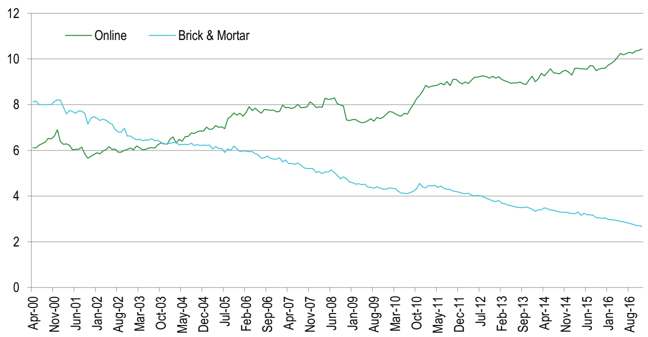


Chart 2: Category Percentage of Retail Sales"Clicks Over Bricks"



Sources: Bloomberg

Next week's market developments

Monday, January 16

- Japan Machine Tool Orders growth is expected to increase to 4.4% y.o.y. (s.a.) for December

Tuesday, January 17

- UK CPI growth is expected to increase to 0.3% m.o.m. (s.a.) for December
- UK PPI Output growth is expected to increase to 0.4% m.o.m. for December
- US Empire Manufacturing is expected to decrease to 8.5 for January

Wednesday, January 18

- Eurozone CPI growth is expected to increase to 0.5% m.o.m. (s.a.) for December
- US CPI growth is expected to increase to 0.3% m.o.m. (s.a.) for December
- US Industrial Production growth is expected to increase to 0.6% m.o.m. (s.a.) for December

Thursday, January 19

- US Housing Starts are expected to increase to 1,187,000 for December

Friday, January 20

- UK Retail Sales ex Auto/Fuel is expected to decrease to -0.4% m.o.m. (s.a.) for December

Source: Bloomberg, as of end January 17, 2017

Central Bank Watch

	Last move	Date of move	Current policy rate	Implied 3-Month Rate on December 2016 Interest Rate Futures Contract	Next meeting
Fed	+25 basis points	December 14, 2016	0.50% - 0.75%	0.68%	February 1, 2017
ECB	-5 basis points	March 10, 2016	0.00 %	-0.18%	January 19, 2017
BoJ	-20 basis points	February 16, 2016	-0.10 % - 0.00%	0.06%	January 31, 2017
BoE	-25 basis points	August 4, 2016	0.25%	0.37%	February 2, 2017

Source: Bloomberg

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