Mitch on the Markets

Could the "Amazon Effect" Change the Investment Landscape?

By Mitch Zacks
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You may have heard the phrase "Retail Apocalypse" recently, in reference to the wave of store closures and bankruptcies hitting the U.S. retail sector. The names on this hitlist are familiar ones: Macy's shuttering 100 stores and laying off 5,000 workers[1]; Abercrombie and Fitch shuttering 40 stores in 2017; American Apparel filing for bankruptcy and closing all 110 U.S. locations; Toys 'R Us closing all 700 U.S. stores, costing 33,000 American jobs.[2]

The list goes on and includes other major retailers like CVS and Sears Holdings. For American workers who lost jobs in these closures, and for local communities that saw malls and shopping centers turn into relics of the past, the term "Retail Apocalypse" is profoundly accurate.

Many (including President Trump) point the finger squarely at Amazon, whose pioneering of the 'e-commerce' revolution has fundamentally shifted consumers' shopping habits away from brick-and-mortar stores and onto the internet. This shift is the crux of the "Amazon Effect," which can best be described as the downstream effect that Amazon's business model is having on retailers, real estate, consumer goods manufacturers, and the everyday life of the U.S. consumer.

In my view, the brightest and most innovative business leaders – and investors alike – will see the "Amazon Effect" for *what it will create, rather than what it will destroy*. I think examining and understanding the benefits as well as the costs will inform investment strategies and create fresh opportunities for investors far into the future. Below, I take a look at the "Amazon Effect" by category, in an effort to frame the potential winners and losers.

The Amazon Effect on Retailers

The market tells a pretty eye-opening story for retailers. As I pen this article, the S&P 500 is up +74.52% over the last five years. The S&P 500 retail sector, however, as measured by XRT (exchange traded fund) is up *less than half that*, at +31.26%. But neither holds a candle to Amazon, which is up an astounding +516.03%.[3]

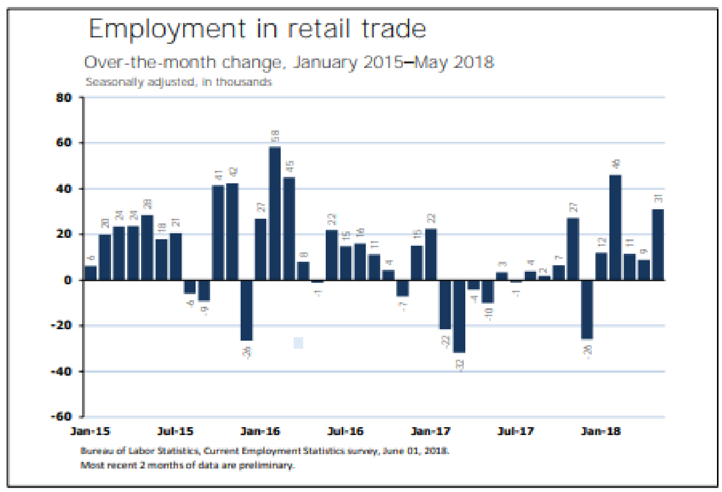
The list of bankruptcies and store closures is likely to continue for retailers who fail to adapt their business models quickly enough, which could mean shifting to an Amazon-like system of minimal inventory and much cheaper property (warehouses vs. malls). If Macy's has to pay exorbitant rent and stock for all its stores in order to sell a product that Amazon can sell with low rent and one click, there is no way for Macy's to compete long-term, in my view. I do not think this means Amazon will be the only retailer in the future – but I do think it will force rapid innovation or else bankruptcy for competitors.

The Amazon Effect on Employment

The term "Retail Apocalypse" homes-in on store closures and job losses, with readers and investors, often left with the impression that jobs are being destroyed at an alarming rate. But, the data simply does not support that sentiment. In fact, the opposite appears to be true.

That's because for all of the clerks and retail specialists in malls losing their jobs, there are new jobs for drivers, warehouse operatives, web designers, data scientists, and customer service representatives (online or call centers). The Progressive Policy Institute in Washington estimates that once warehouse workers were taken into account, there were 54,000 *more* e-commerce jobs added – than brick-and-mortar jobs lost – last year.[4]

Data from the Bureau of Labor Statistics also bears this out – in the retail trade sector, the BLS shows year-to-date employment growth that has averaged 22,000 per month. While 2017 was indeed a sluggish, 'apocalyptic' like year for retail sector employment (chart below), the trend continues to show growth in overall employment in its wake.[5]



Source: Bureau of Labor Statistics[7]

The Amazon Effect on Consumers

It's difficult to imagine any negative effects on the consumer. The Amazon Effect implies cost competition virtually across the board, with retailers being forced to do so as a method of survival. Cost cutting means not only cheaper prices for the end consumer but also more options. Wal-Mart provides a good example of this downstream effect, as they have amped up grocery sales in the wake of losing general merchandise sales to e-commerce.

As part of that effort, Wal-Mart reportedly held meetings with P&G, Unilever, Conagra, Coca-Cola and other big-name companies demanding across-the-board 15% price reductions at wholesale.[7] So, not only does Wal-Mart need to find ways to cut costs to remain competitive, they are also forcing suppliers to do the same – reducing costs across the supply chain and making prices for end consumers cheaper over time.

The Amazon Effect on Real Estate and Municipalities

Malls and strip malls were once considered prime real estate, but that has changed in the era of store closures. According to Morningstar, Sears store closings alone could cause 200 malls to close across the country. In addition to losses for property owners, there's also a potentially unwinding effect for the municipalities and communities involved: empty buildings often reduce interest in local housing, pushing down residential prices; property tax and sales tax receipts decline, putting downward pressure on municipal revenues; residents must shoulder the burden of missing tax dollars. These are all fairly negative effects.

On the flip side, however, there's also new opportunity to turn those old malls and retail outlets into spaces that serve other community purposes, like e-sports complexes where gamers gather for stadium-like competitions, or even mega-churches as the *Wall St. Journal* reported last year.[8]

Bottom Line for Investors

The "Retail Apocalypse" phrase is popular not for its accuracy across the broad economy, but rather because it invokes a feeling of doom and gloom. That's what readers and investors are often drawn to, as many people (in my view) would rather be pessimistic and correct than optimistic and wrong.

But this type of mindset when considering the "Amazon Effect" may cause investors to miss the slew of the downstream investment opportunities and business possibilities that e-commerce can bring. From new warehouse workers, to data scientists studying consumer trends, to web designers building e-commerce websites, to customer service representatives charged with enhancing the customer experience, there is a range of possibilities for how the retail sector **could actually grow substantially** – not decline – from where it is today.

Savvy investors will be along for the ride, in my view. We at Zacks Investment Management will be watching it develop closely, and I'd encourage investors to do the same.

About Mitch Zacks

Mitch is a Portfolio Manager at Zacks Investment Management. Mitch has been featured in various business media including the Chicago Tribune and CNBC. He wrote a weekly column for the Chicago Sun-Times and has published two books on quantitative investment strategies. He has a B.A. in Economics from Yale University and an M.B.A in Analytic Finance from the University of Chicago.

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[2] Fox Business, March 19, 2018, https://www.foxbusiness.com/features/retail-apocalypse-24-big-retailers-closing-stores

[3] June 13, 2018, Google Finance

[4] Financial Times, June 13, 2018, https://www.ft.com/content/cf98680c-738f-11e7-aca6-c6bd07df1a3c

[5] U.S. Bureau of Labor Statistics, June 1, 2018, https://www.bls.gov/web/empsit/ceshighlights.pdf

[6] U.S. Bureau of Labor Statistics, June 1, 2018, https://www.bls.gov/web/empsit/ceshighlights.pdf

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[8] Wall Street Journal, October 10, 2017, https://www.wsj.com/articles/for-some-struggling-malls-churches-offer-second-life-1507633201