

## >: Retail Sector Death Spiral: How to Profit

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**Editor's Note:** Our weekly telephone call to answer your questions has been posted. [Listen now](#) to hear Teeka answer more reader questions.

Last Friday's retail sales number revealed the sobering reality of the true state of the American economy. We saw purchases drop 2.8% along with consumer confidence readings that have not been seen since 1980. It was ugly all around the economy. Car sales were down 5.5%, and retail sales slid 2.2%. Even if we strip out the drop in gas prices, retail prices still dropped 1.5%, the worst in 3 years.

This is the fourth month in a row that we've seen retail sales fall. The last time that happened was in 1974. For those of you that were around back then, you know how bad the 1974 - 1975 recession was. To put it mildly, it was a horror show.

With only 35 shopping days left until December 25th, the last sector I would want to be in are retail stocks. Anecdotal data suggests that the 2008 holiday shopping season will go down as the "Christmas of socks and underwear." Sure people are very concerned about how they spend their dollars right now because of job cuts and the general poor state of the economy. But the bigger reason why this holiday shopping period looks to be a bust is the complete shut down of the consumer credit markets.

Last October (2007) we saw more than \$50 billion in consumer credit backed bonds go to market. These bonds encompass a broad swath of consumer-based finance purchases, everything from credit cards, store charge cards, auto loans and leases. This October (2008) we saw that number get crushed to a paltry \$500 million. In an economy the size of ours, \$500 million in new consumer finance purchases is peanuts. Our presidents spend more than that to get elected!

The real story for this economy and corporate earnings going forward is the availability of consumer credit. Right now we are in the midst of a retail sales death spiral. The banks won't lend, so the consumers can't buy. If the consumers can't buy, the retailers get hammered. The worse the retailers get, the worse everybody else does. Remember, two-thirds of our country's economic output is generated by consumers. So the worse the economy gets, the more jobs are lost. This only serves to reinforce the banks' view on keeping consumer credit even tighter.

The banks will not take on risk in this environment until they rebuild their capital reserves and even then it will be slow going. I blame Treasury Secretary Paulson for contributing to much of this downward spiral in the consumer finance market. By only charging 5% on the TARP money (this is the \$700 billion bail out money), the banks have little incentive to lend.

The Brits were much smarter in this regard; they forced their banks to pay them 12%. If you are a lending institution and your cost of capital is 12%, that is a huge incentive for you to put that money to work. What we have with the Paulson Plan is too much carrot and not enough stick.

What's the take away here?

It's too early to try and bottom fish the retailers. The problems they are facing will not go away overnight. No matter how much the retailers cut prices or offer generous terms, the space looks doomed. We may start seeing some of the bigger retailers begin to underwrite their own consumer finance loans and that may give a short-term boost to some players in the space. But I ask you, when you buy a retailer, do you really want to buy a consumer finance company in drag, especially in this environment?

Even the best run companies are getting killed in this economy. **Best Buy (BBY)** announced last week that this was the worst retail environment that they had ever seen. When you have the best electronics retailer in the space scared, you can bet that the weaker retailers are crying themselves to sleep every night.

We've already seen 16 major retailers go belly up in the last year, the most recent being **Circuit City (CCTYQ)**. Circuit City is using bankruptcy to void the leases on 155 retail locations that they intend to close. This move alone will save them \$40 million a year, but that \$40 million is coming straight out of the pocket of the commercial REIT operators.

Keep an eye on the commercial and office REIT guys. They are going to have to slash their dividends in an effort to stay alive through this economic crisis. One of the most spectacular flameouts in the space has been **Gramercy Capital Corp. (GKK)**. This stock was as high as \$28.50 just a year ago and is now languishing at 90 cents. The whole sector has been beat up, but never underestimate how low something can go. There may still be some excellent shorting opportunities in the sector.

Some names to look at for possible shorting candidates include **AMB Property (AMB)**, **National Retail Properties (NNN)**, **Getty Realty Corp. (GTY)**, **One Liberty Properties Inc. (OLP)**, **Agree Realty Corp. (ADC)**, **Realty Income Corp. (O)**, **Inland Real Estate Corp. (IRC)**, **Parkway Properties Inc. (P)**, **Mack-Cali Realty Corp. (CLI)** and **Liberty Property Trust (LRY)**

. Just remember that if you short any of these names that you are on the hook to make good on the dividend payment. Be sure that you don't over

size your position relative to your stop loss point and projected dividend payments.



Teeka Tiwari  
Chief Investment Officer

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