Artisan Partners Global Equity Team

The Alluring Resilience of Luxury Goods

Resilient Growth

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Pricing power—which companies have it, and which don't—has been a popular topic since inflation came back to roil markets. Charles Henri-Hamker, portfolio manager on the Artisan Partners Global Equity Team, has an idea of where to find it.

When Charles joined Mark Yockey and the Artisan Partners Global Equity Team in 2000, the dot-com bubble had just burst, and the team was interested in expanding its sustainable growth footprint by researching consumer products companies. With a background in finance and economics from The European Business School, Charles, a native of France, had been analyzing consumer goods companies since the early 1990s. His experience working for JPMorgan in Paris and London provided him a solid foundation for his consumer goods coverage at Artisan Partners, coverage he maintains today. Charles found that unlike many of the unprofitable Internet companies at the time, many of these companies had strong margins and cash flows, expanding geographies and product lines, and management teams with strong track records of compounding growth over long periods of time. In addition, he observed that the earnings and valuations of many of them were being driven by "premiumization," a trend in which consumers increasingly trade up for higher quality and price. This led him to luxury goods, a segment he still covers today.

Last year, most of the companies in the luxury goods segment, roughly defined as those with brands that serve as symbols of wealth and status, experienced rising prices on higher volumes. Even with soaring inflation and higher interest rates, owners of prestigious labels such as Louis Vuitton, Chanel, Tiffany, Cartier and Hermès continued to grow sales volumes despite significant price increases across the segment. What is fueling this growth?

Demographics as a Key Driver

Over the past decade, luxury spending in China has generated unprecedented growth in the industry, as wealth continues to increase among members of its population. From 2020 through 2022, however, China's zero-COVID policy dampened sales. Nevertheless, strong growth in the US and surprisingly resilient demand in Europe has kept the market for luxury growing.

Looking past geography, demand for luxury goods across Europe, the United States, China and other emerging markets has been driven by new generations of consumers with high disposable incomes and a quest for status, driven in part by social media. Millennials (those currently 27 to 42 years old) and Gen Z consumers (those 12 to 26 years old) are adopting luxury at a faster pace than previous generations. Generation Alpha, the cohort succeeding Gen Z, is the newest opportunity for increased growth. Spending by Gen Z and Gen Alpha, the two youngest generations, is predicted to grow three times faster than for other generations until about 2030, by which time Gen Alpha, currently comprising close to 2 billion people, will likely account for up a third of the luxury market. Heavily influenced by platforms like Instagram and TikTok, Gen Alpha is expected

Portfolio Managers (L-R):

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42 Years Investment Experience

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33 Years Investment Experience

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19 Years Investment Experience

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Associate Portfolio Manager
22 Years Investment Experience

to overtake other generations in number and will represent the largest generation in our history. Their buying behaviors will undoubtedly shape consumer trends well into the future.

> "That's the beauty of luxury goods industry. They really are very good at shaping and driving consumers' aspirations. From a very young age, there's this quest for the status and luxury symbols."
>
> —Charles Henri-Hamker

Charles carefully studies these demographics in support of his team's eponymous investment theme. He analyzes structural changes in populations to gain insights on consumer spending that may lead to investment opportunities. He finds that demographics influence practically everything: economic growth rates as well as buying behavior and consumer trends in every income cohort. With his soft, melodic French accent, he sums up the benefits of having an in-depth understanding of these trends, explaining, "The demographics are basically influencing everything…the growth rate of the economy, the productivity, the living standard, the selling rates. So it hits every single sector we're investing in."

Other findings that Charles believes to be significant involve how spending patterns evolve in relation to externalities. For example, China's one-child policy, initiated in 1979, has created what Charles refers to as a "golden child phenomena," where a generation of children without siblings grew up with their family's full attention. As adults, this generation of Chinese can often rely on the wealth and savings of six people—both parents and two sets of grandparents—to cover their living expenses, leaving them with high disposable incomes. Their accumulated savings are often spent on experiences, such as travel, and luxury goods, purchased for their own enjoyment and as a sign of their special status and wealth within China's society. In fact, across emerging markets in general, and within Asia in particular, luxury spending has increased as shoppers graduate from premium products to luxury brands. This shift in spending has created opportunities for luxury companies to expand to new geographies like never before.

> "Luxury brands serve as a way for people to signal their socioeconomic status. It is a way to show others that one can afford the best."

However, the importance of demographics as an investment theme is perhaps most evident when one follows the thread from changes in populations to changes in demand to changes in stock valuations. This is something that Charles and the investment team tracks meticulously. He notes that for the last 22 years, the luxury segment has seen five pullbacks in stock prices, often caused by macro events, and each time they have grown shorter in duration. He determines that growing global secular demand, driven by demographics, is responsible for these successively quick snapbacks.

Luxury Companies in the Artisan Non-U.S. Growth and Global Equity Portfolios

In general, the investment team appreciates the long-term prospects of luxury stocks given the promising demographics and growth profiles of their target market. One portfolio holding that Charles has known for over 25 years and has high conviction in is LVMH, or Louis Vuitton Moët Hennessy, the world leader in luxury goods. LVMH is best known for luxury leather bags, luggage, haute-couture labels like Celine and Dior, as well as several premium drink brands. The company's founder, Bernard Arnault, notably one of the wealthiest people in the world, has grown the company to be the largest luxury purveyor in the world. A strong management team, dynamic innovation, a diversified portfolio and high-quality products have enabled LVMH to outperform most of its competitors and gain market share. The Vuitton and Dior brands represent a little more than 50% of the company's profits. About a third of its business is in spirits, champagne and cognac, which include brands like Moët & Chandon, Dom Perignon, and Hennessy. Sephora, a global retailer of personal care and beauty brands, also accounts for a considerable portion of the company's profits.

Similarly, Richemont, a Switzerland-based luxury firm, has been a significant holding for the team. It provides exposure to hard luxury, which encompasses watches, jewelry and other longer-lasting and "timeless" products as opposed to soft goods, such as clothing and leather goods. Known for its prestigious maisons that represent high-end brands, almost 60% of Richemont's profits come from Cartier and Van Cleef & Arpels, iconic jewelry brands in this segment. The company also owns stylish high-end brands such as Baume & Mercier, Dunhill, Montblanc and Piaget.

In another product category, premium liquor, Charles chronicles the history of winemaking that goes back to neolithic times, beginning surprisingly in China. It is in this context that he discusses portfolio holding Wuliangye Yibin, a fast-growing Chinese state-owned baijiu maker with roots dating back to the Ming Dynasty. Baijiu is a prestigious clear liquor made from various grains. It has a strong cultural heritage and is normally consumed on special occasions, akin to champagne in the West. He believes the stock has several catalysts for growth and has a very durable earnings outlook.

Finally, Charles covers Pernod Ricard, another luxury spirits holding that benefits from the aforementioned premiumization trend and has delivered widening margins and durable growth this year, even in the midst of inflation. The Paris-based company owns celebrated brands such as Absolut Vodka, Chivas Regal, Glenlivet Scotch Whisky and Jameson Irish Whiskey, among many others. These products have similar gross margins and pricing power and benefit from aspirational demand as do many other luxury brands.

"Luxury goods are personal indulgences, they are the opposite of necessities"

Alluring Growth

The Artisan Partners Global Equity Team is attracted to the luxury segment for its high gross margins, significant cash flow, strong pricing power, high barriers to entry and a resilient global customer base supported by secular growth trends that can be measured and forecasted via changing demographics. While consumers on both sides of the Atlantic are proving to be surprisingly resilient themselves, Charles expects the reopening of China will accelerate growth in luxury spending even higher in 2023 and 2024. And while these stocks are by no means recession-proof, they do provide what the team sees as alluring growth characteristics and attractive valuations for investors trying to navigate the current market environment. Luxury, it seems, is not just for those wanting to spend their wealth, but it can serve those interested in building it as well.

Read more about the Artisan Partners Global Equity Team and its passion for helping clients achieve their goals by researching and investing in resilient growth opportunities across the globe.

For more information: Visit www.artisanpartners.com

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