MARKET COMMENT: JULY 2022

Betting against the crowd:

Why now could be the right time to invest in retail.

These are challenging times for investors. Supply chains are in turmoil, disrupting global equity markets. Interest rates are rising and will continue to do so – but inflation is rising much faster. The threat of recession looms, and service-dominated economies like the UK's look especially vulnerable.

In such a volatile environment, where should private wealth put its capital to work? Commercial property remains an attractive option… but only for investors who are ahead of the changing dynamics.

One of the most significant changes is the behaviour of the big institutions. As they hunt for solid (if not necessarily spectacular) returns, their property investment strategies are increasingly focused on lower-priced assets. Many are eyeing the same prizes, driving up acquisition costs in sectors like logistics and industrial.

It's hard for private wealth to compete with institutional demand. In general, our advice is not to try. Better, we say, we seek out unloved sectors. Wherever there's market uncertainty, there's the opportunity to find real bargains. Select retail is very much a case in point.

Why the conventional wisdom on retail is wrong

It's inarguable that COVID accelerated the uptake of ecommerce… but not to the extent widely assumed.

Most investors continue to swallow the story that things have jumped forward by 5 years. The reality is more like 18 months. As a percentage of the UK's total retail sales, ecommerce has fallen back sharply from its January 2021 peak of 37.8% and now stands at around 26%.[1]

It's also the case that the nature of ecommerce is changing. As retailers struggle with 'profitless prosperity', there's much greater emphasis on cross-channel solutions like click & collect and in-store returns. Zara, for instance, now charges £1.95 for returns – but waives the fee if customers hand-deliver items to a store. Many other companies will follow suit.

[1] Internet sales as a percentage of total retail sales (ratio) (%) - Office for National Statistics (ons.gov.uk)

Whilst some estates remain over-sized, retailers of all stripes know that physical stores are fundamental to their future. They bring the brand proposition to life in ways that are impossible to achieve online. Major retailers in the USA opened more stores than they closed last year[2] whilst direct-to-consumer brands continue to invest heavily in real estate[3]. Amazon has just opened its 19th Fresh grocery store – and its first outside London – in Sevenoaks.

The fact is most people still love shopping in the 'real' world. According to Google, 61% of us prefer to shop with retailers that have physical locations[4]. We're inherently social animals and enjoy the buzz, the face-to-face interaction and the opportunities for discovery that stores provide; which is precisely why retail brands are now so concentrated on delivering uncommon experiences that increase a visit's value and excitement.

Put all the above together and the bottom-line is clear: reports of the death of physical retail have been greatly exaggerated.

To find diamonds, you need to look in the right places

Of course, it's not all good news. Many high streets have been decimated and their decline seems irreversible.

But take a walk around Chiswick, Marylebone or the Cadogan Estate's development in Pavilion Road, Chelsea and you'll see that others are thriving. Similar success stories can be found as far afield as Rye in Kent, Beaconsfield in Buckinghamshire, Sherborne in Dorset or Ilkley in Yorkshire.

More than ever before, investors need to be highly selective. We recommend a simple, five-point checklist to our clients:

1. Rather than city centres, look at market towns with good access to major conurbations. COVID shifted the emphasis back to 'shopping local', and it is these towns that are best placed to capitalise.
2. Prioritise towns that have a distinctive personality, feel curated to location and have a high level of embedded demand. In particular, search out towns where the shift to hybrid working will act in retail's favour.
3. Examine the retail mix closely. Winning high streets offer an attractive balance of chains and independents across retail, hospitality and leisure.
4. Consider properties leased by independents as well as those occupied by national retailers. The latter may feel more fire-proof but are often weighed down by multiple locations and high overheads. Many independents are performing extremely well, especially when trading out of strategically advantageous sites.
5. Look in your own backyard first. Investing close to home doesn't just increase comfort levels. There are genuine business advantages to be had from understanding what makes the local community tick.

Following this checklist can pay rich dividends.

We worked recently with a client in the South-West who was keen to diversify beyond agriculture. Applying our golden criteria, we identified the right location in the right town: a property already leased to a well-known retailer with an offering perfectly tuned to the local demographic.

The outcome? Ownership of an asset yielding 6.5% on a minimum six-year term, and one with above-average potential to appreciate in capital value.

We would never advise betting against the crowd just for the sake of it. The trick is spotting when market noise is drowning out the signals that really matter; and that is what's happening currently with retail. For private investors who know where to look, the sector has high potential.

[2] 2021 was a turning point for retailers, with store openings outpacing store closures (nbcnews.com)
[3] 11 DTC Brands Opening Physical Retail Stores in 2021 | Shopify
[4] How shoppers use mobile for in-store shopping - Think with Google