Information for professional investors

Stalling car auction sales suggest broader consumer weakness

Fixed income | November 2024

Michael Laskin
Senior Analyst, Fixed Income

- **A recent explosion in popularity of online car auctions has created a unique two-way market dataset that is liquid and representative of the whole of the US**
- **Comparing the sales of certain types of car, alongside wider income and expenditure data, shows consumer pressures rising up the wealth ladder**
- **At Columbia Threadneedle, we use interesting data sets like this to give us a more granular view of the economy and support our investment proposition**

At Columbia Threadneedle Investments we are always seeking unique data sets to help inform our investment theses. Here, for example, we use data from collector car auction results to explain confounding consumer trends over the past year and highlight a forward indicator suggesting a sharper slowdown among wealthy consumers next year.

Why does this matter? In the United States the top 20% of consumers by wealth account for 39% of total consumer spending and 47% of total income. Heretofore these consumers have been impervious to the headwinds of higher rates and have benefitted greatly from financial and real estate asset inflation. But the party may be coming to an end. If that top quintile of consumers by wealth begins to reduce their level of spend, it could have an outsize impact on consumer company earnings across the board – from staples to all sorts of discretionary items. We have already seen a preview of what this could look like, as the aspirational consumer has pulled back and severely dented demand for global luxury names, such as LVMH.

In 2023 we used historical live auction results of three different generations of BMW M3 to segment cohorts of consumers and their spending.[1] The theory is that each era of M3 represents a differently resourced car enthusiast, and that identifying pricing behaviour differences and relationships between them could help predict future consumer spending patterns. For those unfamiliar with the car, the M3 is BMW's high-performance version of its legendary 3 Series – arguably the source of the classic tagline "The Ultimate Driving Machine". It has achieved legendary status among enthusiasts. The three generations of M3 we compare are:

1) 1986-1991 BMW M3 / E30
2) 1992-1999 BMW M3 / E36
3) 2000-2006 BMW M3 / E46

There are fewer of the older models available (18,000 units of the E30 compared with 71,000 E36s and 86,000 E46s), hence they are more in demand and more expensive.

The recent explosion in popularity of online car auctions has created a unique two-way market dataset. The market is liquid, nationwide, has a significant amount of data (more than 10,000 completed auctions so far in 2024) and is updated daily. Using our proprietary scraping tool, we have captured and catalogued the BMW M3 auction results over the past five years.

Our hypothesis is that E46 buyers are the most sensitive to economic cyclicality, E30 buyers are the least sensitive, and E36 buyers fall somewhere in the middle. It makes sense that E46 buyers would show weakness first given that this lower resourced consumer was going to feel the impact of inflation first. Other consumer data supported the same conclusion: the younger and less resourced consumer cohort displayed a lot of post-Covid revenge spending, and as the economy and employment landscape normalised, so did their spending. US luxury spend peaked in mid-2022 – at the exact same time as E46 values. The younger, most aspirational cohort also spends the least in real dollar terms.

The bigger question that would be more indicative of consumer spending health was whether the most expensive car of the three we examined, the E30, would face that same pressure in subsequent months.

Sure enough, as time progressed, the pressure we saw in the E46 market migrated up the wealth ladder to collectors of the E30 and E36 M3, and in the second half of 2023 E30 M3 sales began to decline.

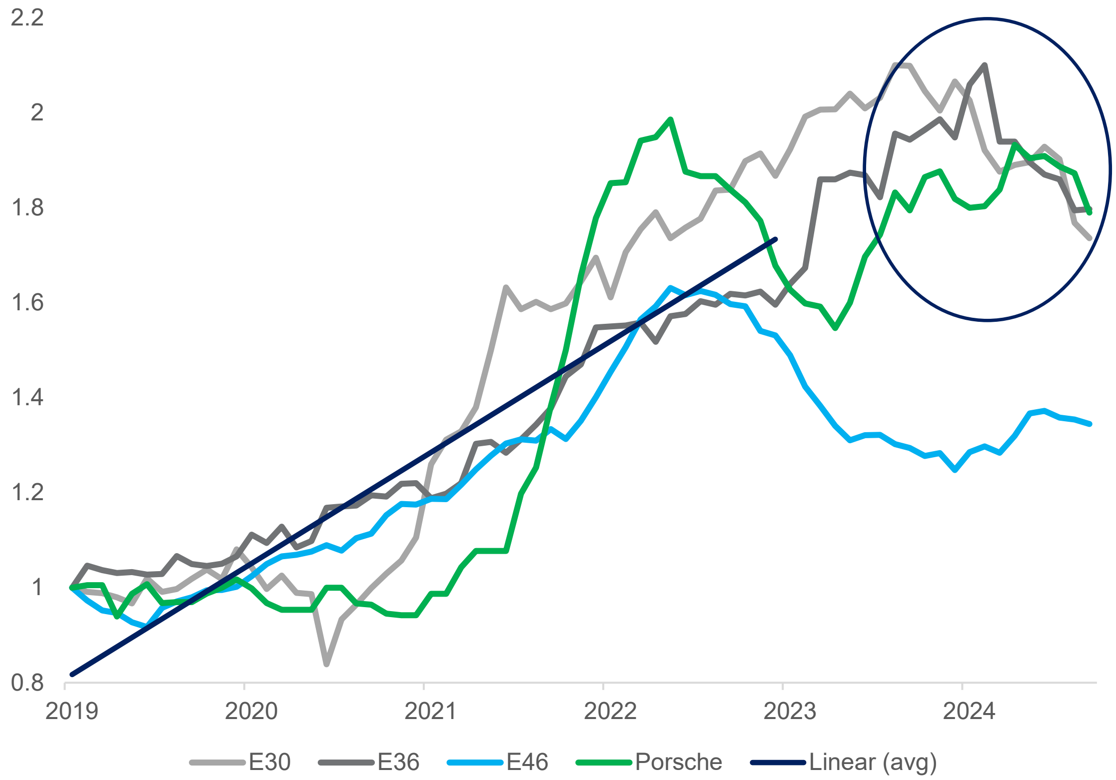
However, through 2024 we still haven't seen a steep downturn in overall consumer spending. This is because the top 20% of incomes account for around 39% of total consumer spending and 47% of total income. So, while restaurant traffic is down, it is more so at fast casual outlets or chains, not where the more wealthy cohorts eat. Branded consumer staples goods manufacturers are seeing trade decline, but that is because, like the M3 market, the incremental aspirational consumers have traded down.

[1] Columbia Threadneedle Investments, Are we on the brink of a stressed consumer? October 2023

In an attempt to quantify the upper end of that top quintile consumer, we added a fourth blue chip collector car to the analysis: the Porsche 993 Turbo. The 993 was the last air-cooled Porsche generation, and the Turbo of that era is one of the most desirable cars created by the legendary sportscar manufacturer. Examples range in price from $165,000 to upwards of $300,000.

When you apply a trend line to the E30, E36 and 993 Turbo prices you can see that they behave similarly up until the third quarter of 2023 (Figure 1).

Figure 1: BMW E30, E36, E46 and Porsche 993 Turbo auction results indexed from 2019



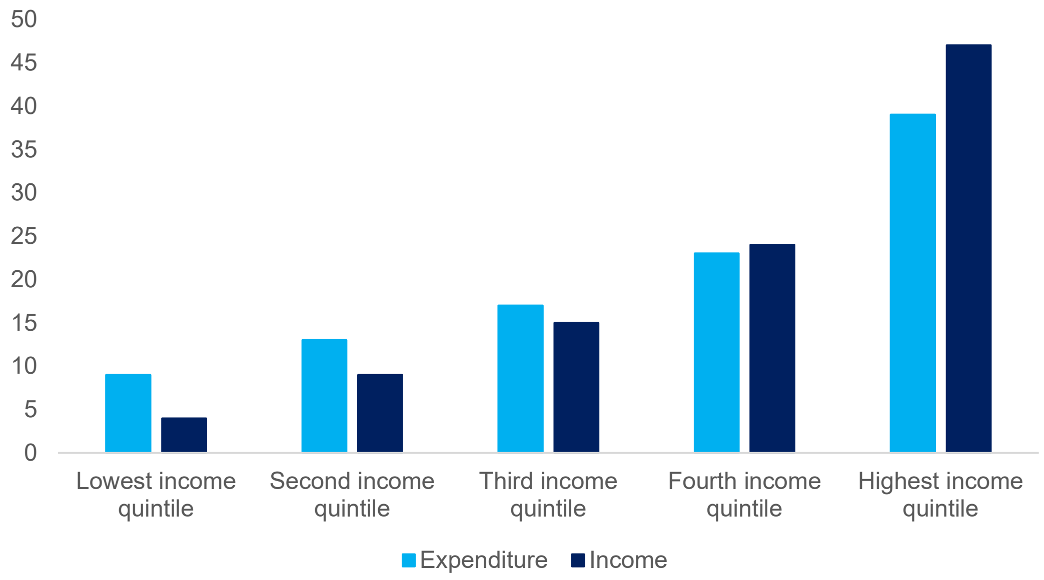
Source: www.bringatrailer.com / Columbia Threadneedle Investments analysis, October 2024

Towards the end of 2023 the values of E36 M3s began to fall quickly, and E30 M3 prices followed soon after. This price action is a result of those wealthier car owners suffering the same malaise that the E46 owners felt a year previously.

That leaves us with the Porsche, a car that represents an even wealthier consumer. In early 2024, when E30 and E36 values were declining, 993 Turbo prices flatlined and are now starting to show some softness. If the relationship between the three eras of M3 that we observed carries through to the 993 Turbo, we would expect prices to begin to show material weakness over the next several months.

In that scenario we would then expect broader consumer weakness given the cohort represented is the wealthiest and spends the most (Figure 2).

Figure 2: US income and expenditure, by quintile



Source: BLS, Haver Analytics, Apollo Chief Economist, 2022

At Columbia Threadneedle Investments we are laser focused on the spending attitudes and habits of the top quintile consumers by wealth, because up until now they seem to be unfazed by inflation. As stated, the top 20% of consumers by wealth account for 39% of total consumer spending and 47% of total income, so if this cohort reduces its spending by 10% it would result in a 4% reduction in total consumer spending!

The persistence of inflation, the correlation apparent in this data, and the downside exposure in the event of even a mild curtailment of consumer spend by the top 20% contributes to our approach to issuer selection. We seek to identify companies whose increased balance sheet leverage has driven spreads wider, but for whom the path to balance sheet repair is clear whether consumer demand remains robust or not.

When will the rubber band on fiscal policy – stretched like never before in 80 years – finally break? Led by the US, fiscal laxness argues for a higher floor for long rates in the longer dated future, ie at the end of the current Fed-inspired bond yield cycle. Will bond investors refuse to buy, or will a first mover on fiscal consolidation enjoy a market response that eventually forces others to follow?

Important Information

For use by professional clients and/or equivalent investor types in your jurisdiction (not to be used with or passed on to retail clients). For marketing purposes.

This document is intended for informational purposes only and should not be considered representative of any particular investment. This should not be considered an offer or solicitation to buy or sell any securities or other financial instruments, or to provide investment advice or services. Investing involves risk including the risk of loss of principal. Your capital is at risk. Market risk may affect a single issuer, sector of the economy, industry or the market as a whole. The value of investments is not guaranteed, and therefore an investor may not get back the amount invested. International investing involves certain risks and volatility due to potential political, economic or currency fluctuations and different financial and accounting standards. The securities included herein are for illustrative purposes only, subject to change and should not be construed as a recommendation to buy or sell. Securities discussed may or may not prove profitable. The views expressed are as of the date given, may change as market or other conditions change and may differ from views expressed by other Columbia Threadneedle Investments (Columbia Threadneedle) associates or affiliates. Actual investments or investment decisions made by Columbia Threadneedle and its affiliates, whether for its own account or on behalf of clients, may not necessarily reflect the views expressed. This information is not intended to provide investment advice and does not take into consideration individual investor circumstances. Investment decisions should always be made based on an investor's specific financial needs, objectives, goals, time horizon and risk tolerance. Asset classes described may not be suitable for all investors. Past performance does not guarantee future results, and no forecast should be considered a guarantee either. Information and opinions provided by third parties have been obtained from sources believed to be reliable, but accuracy and completeness cannot be guaranteed. This document and its contents have not been reviewed by any regulatory authority.

In Australia: Issued by Threadneedle Investments Singapore (Pte.) Limited ["TIS"], ARBN 600 027 414. TIS is exempt from the requirement to hold an Australian financial services licence under the Corporations Act 2001 (Cth) and relies on Class Order 03/1102 in respect of the financial services it provides to wholesale clients in Australia. This document should only be distributed in Australia to "wholesale clients" as defined in Section 761G of the Corporations Act. TIS is regulated in Singapore (Registration number: 201101559W) by the Monetary Authority of Singapore under the Securities and Futures Act (Chapter 289), which differ from Australian laws.
In Singapore: Issued by Threadneedle Investments Singapore (Pte.) Limited, 3 Killiney Road, #07-07, Winsland House 1, Singapore 239519, which is regulated in Singapore by the Monetary Authority of Singapore under the Securities and Futures Act (Chapter 289). Registration number: 201101559W. This advertisement has not been reviewed by the Monetary Authority of Singapore.
In Hong Kong: Issued by Threadneedle Portfolio Services Hong Kong Limited 天利投資管理香港有限公司. Unit 3004, Two Exchange Square, 8 Connaught Place, Hong Kong, which is licensed by the Securities and Futures Commission ("SFC") to conduct Type 1 regulated activities (CE:AQA779). Registered in Hong Kong under the Companies Ordinance (Chapter 622), No. 1173058.
In Japan: Issued by Columbia Threadneedle Investments Japan Co., Ltd. Financial Instruments Business Operator, The Director-General of Kanto Local Finance Bureau (FIBO) No.3281, and a member of Japan Investment Advisers Association and Type II Financial Instruments Firms Association.
In the UK: Issued by Threadneedle Asset Management Limited, No. 573204 and/or Columbia Threadneedle Management Limited, No. 517895, both registered in England and Wales and authorised and regulated in the UK by the Financial Conduct Authority.
In the EEA: Issued by Threadneedle Management Luxembourg S.A., registered with the Registre de Commerce et des Sociétés (Luxembourg), No. B 110242 and/or Columbia Threadneedle Netherlands B.V., regulated by the Dutch Authority for the Financial Markets (AFM), registered No. 08068841.
In Switzerland: Issued by Threadneedle Portfolio Services AG, Registered address: Claridenstrasse 41, 8002 Zurich, Switzerland.

columbiathreadneedle.com 11.24 | CTEA7333490.1