

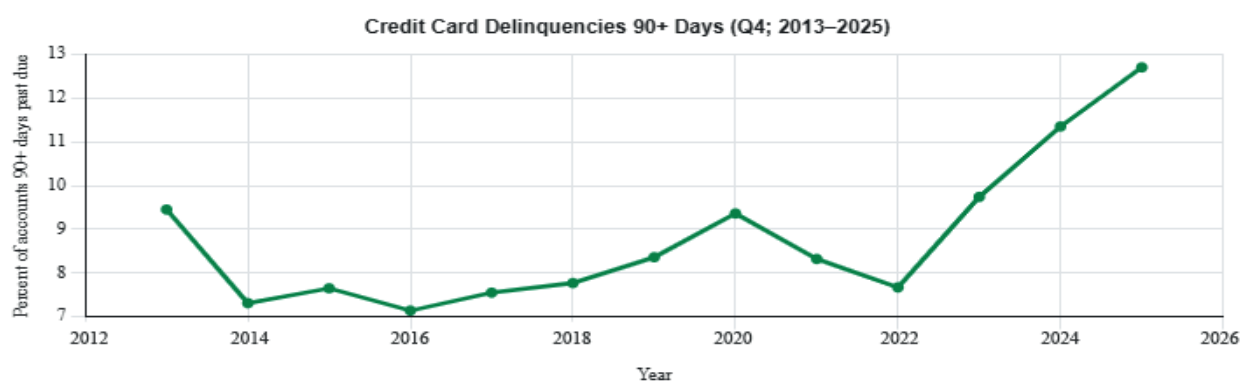
Bifurcation in Consumer Spending is Impacting the Consumer Discretionary Sector

The consumer seems to be splitting into two factions – the haves and the have nots. The higher end stocks within the Consumer Discretionary sector continue to benefit from the fact that the top 10% of consumers comprise nearly 50% of all consumer spending. The lower end consumer has seen all of their excess savings from Covid wiped out and is now seeing credit card delinquencies grow as more and more people have maxed out their credit cards and now cannot afford the payments. This is causing a major headwind to the bottom 90% of consumers. However, the consumer in the US always finds a way to continue spending until they absolutely can't anymore. We aren't convinced that the consumer is ready to shut down their discretionary spending, but it could be harder for many consumers to continue spending at the rate they have in the past.

Bifurcation in Consumer Spending

The following charts show the divergence between the top 10% of income earners and the rest of the US consumer base. In figure 1, we see the rate of credit card payments that are 90+ days delinquent. The current rate stands at 12.7%, up from below 8% in 2022. This is the second highest rate of delinquencies going back to the financial crisis when the rate hit 13.5% in 2008. This is a pretty stark indicator that the lower income consumer is not in great shape. For the last few years they have been battling inflation with credit cards, and now they are struggling to keep up with the rising credit card payments.

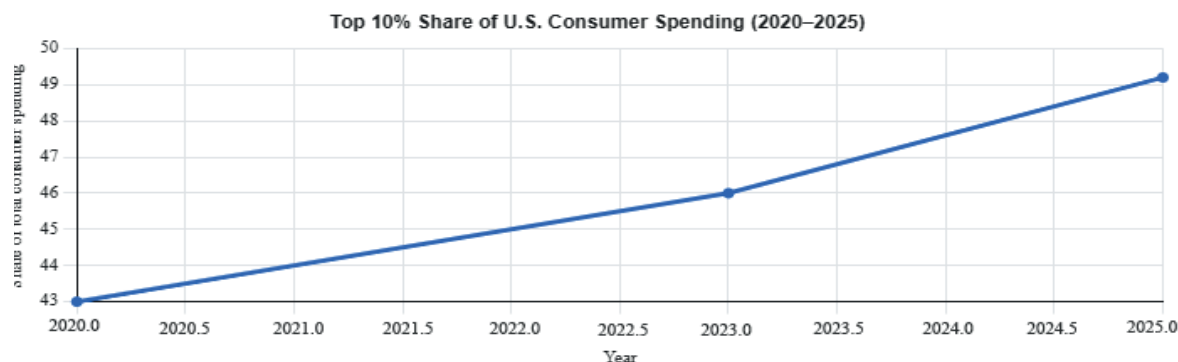
Figure 1



Source: New York Federal Reserve/Equifax

Contrast that with the data shown in figure 2 which depicts the share of US consumer spending that is generated by the top 10% of income earners. In 2020, that percentage was approximately 43%. Today, that number has risen to 49.7%. The top 10% of income earners are increasingly having to carry the load for the US economy.

Figure 2



Source: Moody's Analytics; BLS Consumer Expenditure Survey

The bifurcation in consumer spending between the haves and have nots is impacting Consumer Discretionary and Consumer Staples stocks as money is diverted into companies that cater to the two income groups. Our thesis for the last couple of years based on this divergence in spending is threefold. The first part of the thesis is that lower-end discount retailers and fast-food restaurants would benefit from lower income consumers shifting down to stretch their dollars. The other end of the spectrum is that the top 10% of income earners would continue to spend an increasing amount of money at high end retailers and restaurants. The third part of our thesis is that the middle part of each of those markets would suffer.

Figure 3



Source: Stockcharts.com

Retail Subsector Relative Performance

Figure 4 shows the retail ETF XRT as it compares to the S&P 500 over the last 2 years. XRT has underperformed by over 18%, although it was decidedly worse in November of 2025. The retail sector appears to have bottomed or at least stabilized against the S&P 500 and is trading in a range for the last 12 months. Trading in line with the S&P 500 would be a welcome change for the retail sector after showing such weakness in 2024 and early 2025.

Figure 4



Source: Stockcharts.com

Restaurant Subsector Relative Performance

Figure 5 shows the restaurant ETF EATZ as it compares to the S&P 500 over the last 2 years. EATZ has underperformed the S&P 500 by nearly 22% over the last 2 years with most of that underperformance coming in the back half of 2025. Like the retail subsector, the restaurant subsector looks to have bottomed versus the S&P 500 since November 2025 and is trying to form a trading range as it starts to trade more in line with the S&P 500.

Figure 5



Source: Stockcharts.com

High End, Middle Market and Discount Comparison

The chart shown in figure 6 is a depiction of how this thesis has played out in share price returns of the different strata of both retailers and restaurants over the last 2 years. We broke the restaurant and retail subsectors down into high, middle and discount baskets based on the consumer base they target most. Then we looked at the returns of each basket of those stocks over the last 2 years. The results played out pretty much as our thesis predicted.

While the Consumer Discretionary sector as a whole has underperformed the S&P 500, the subcomponents have fared even worse. One exception has been discount retailers, which have outperformed with a 2-year return of 44.7% versus 37.3% for the S&P 500. Dollar General has been one of the biggest beneficiaries of the shift to discount retailers. After seeing EPS contract by an average of 24%¹ per year over the last 3 years, earnings growth inflected in 2025 and has since averaged EPS growth of 20.4%¹ per quarter over the last 3 quarters and 44%¹ in 4Q25. While the stock is flat² over the last 2 years, it bottomed in January 2025 and is up 135%² since then. Walmart has also been a big beneficiary of the shift to discount retailers. The stock is up 115%² over the last two years and the company has seen EPS grow an average of 19.6%¹ over the last two years during that period.

As we suspected in our original thesis, the middle market for both the retailers and the restaurants has been the worst performing basket over the last two years. One example of a middle market restaurant stock that has been hit by this bifurcation in spending is Chipotle. After growing EPS an average of 45%¹ per year from FY20 to FY24, earnings growth has stopped dead in its tracks. It grew 2.7%¹ in FY25 and is projected to be flat in FY26. The stock price has reflected this stall in earnings growth as it has fallen 33%² in the last two years and is down 48%² from its mid-2024 peak. CAVA is another example of a middle market restaurant that has struggled in this environment. Despite growing earnings strongly from FY22 to FY24, EPS has cut in half from its high of \$1.10¹ in FY24 to \$0.54¹ in FY25. It is projected to fall again in FY26. The stock is down 55%² over that time period.

While the middle market retailers were able to generate a small positive return of 9.4%, that was mostly due to the auto parts stores being included in that basket. The middle market restaurants performed the worst out of any group with a negative 18.4% return over the last two years. Restaurants as a whole performed worse than retailers. Restaurants posted a 14.3% return while retailers posted a 23.6% return. Consumers have no choice but to buy from retailers for their everyday household items, while restaurant spending is purely discretionary.

Figure 6



Conclusion

The bifurcation in consumer spending has been the major theme driving the retail and restaurant subsectors over the last two years. We continue to see this as the major theme going forward until the data proves otherwise. Unfortunately, judging by the trends in the first two charts above, we don't see this trend slowing down anytime soon. Middle and lower end consumers have seen their purchasing power eroded by inflation over the last 5-6 years. In the first few years, they were able to sustain by increasing their use of credit card debt as a means to continue supporting their lifestyles, but increasingly this is becoming a bigger challenge as evidenced by the sharp rise in credit card delinquencies. As the middle and lower end consumers struggle to not only put food on the table, but now to pay the debts they have accumulated over the last few years, we see the share of consumer spending by the top 10% of income earners continuing to increase. These factors should continue to support our thesis of the haves versus the have nots in the Consumer sectors.

Sources:

1. FactSet
2. Stockcharts.com

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