PGIM India Mutual Fund

INVESTMENT PERSPECTIVES | JENNISON ASSOCIATES

GLOBAL CONSUMERS IN THE NEXT ECONOMY

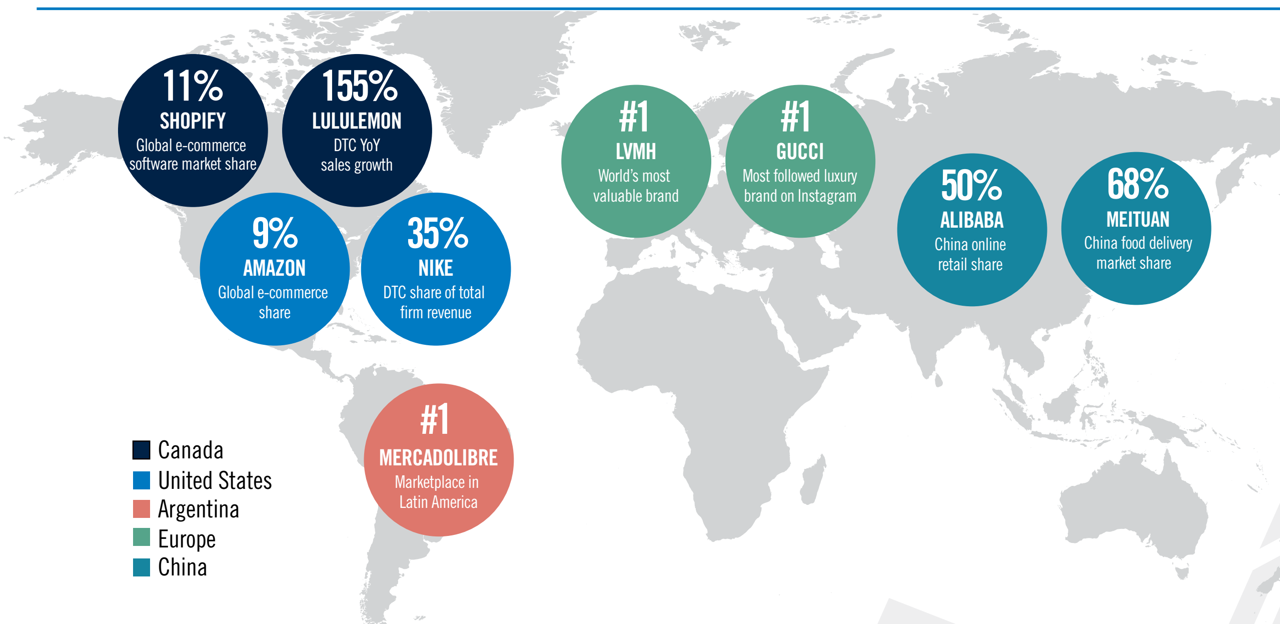
THE RETAIL TRANSFORMATION: A WORLD TOUR

Three shifts impacting investors as retail adapts to a younger, richer, tech-savvy global consumer

E-commerce has been displacing brick-and-mortar stores for years, but the trend accelerated dramatically in 2020 as lockdowns and shuttered retail locations forced consumers to the internet in droves. In the U.S. alone, e-commerce gained 5% penetration in a few short months, a milestone that previously took 6 years, from 2014-2019, to reach.[1] With demand pulled forward by approximately 2 years, e-commerce penetration is expected to reach 25% by the end of the year.[2] This reality spells disaster for traditional retailers that don't fully embrace new technologies. While an online presence is now a prerequisite for survival, a website alone isn't enough for success in today's increasingly digital and interconnected world.

Not all retailers are equipped to serve customers who have become accustomed to instant gratification, seamless transaction options, and choices of products and delivery methods tailored to individual preferences. Historically, it has taken significant investment in infrastructure and logistics to support this type of business model. A case study is Amazon, which started as an online bookstore in 1994 and slowly built itself up to be the U.S. e-commerce juggernaut that other retailers fear. Much of Amazon's success can be traced to two powerful forces—the coming of age of digital-native millennials and the failure of other retailers to as effectively scale their businesses to meet the demands of this critical demographic. Today's retail leaders marry strong digital ecosystems with stellar customer experiences and convenience, which has been a source of resilience amid the pandemic as well as an avenue for durable growth for years to come.

RETAIL LEADERS AROUND THE WORLD



Source: Statista. Data as of December 2019 for Nike and Alibaba, as of April 2020 for Shopify and Meituan. All other data as of September 2020.

PGIM INVESTMENTS

THREE TRANSFORMATIVE SHIFTS IMPACTING RETAIL INVESTORS

1 Millennial Makeup and Mindset

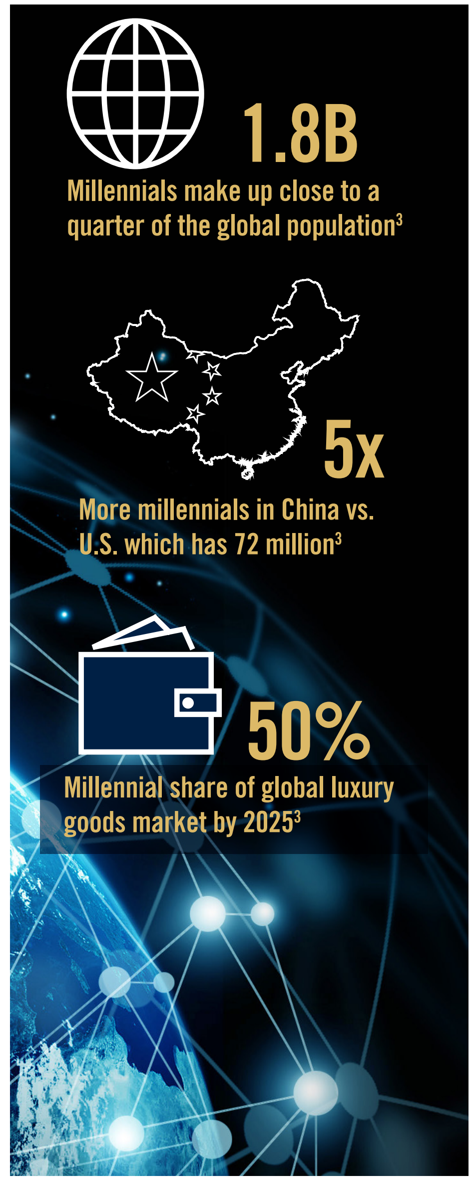
According to Head of Global Equity at Jennison Associates, Mark Baribeau, CFA, *"The most significant consumer group in the world is the millennials… this digital native generation is coming of age in an era marked by revolutionary technologies, globalization, and economic disruption. They will be the driving force behind the rapidly changing retail landscape."*

Half of the planet is now considered middle class or above, and by 2030 the middle-class population in the Asia-Pacific region alone is expected to reach 3.5 billion. Born from 1981 to 1996, 1.8 billion millennials make up the largest adult cohort in the world, accounting for close to a quarter of the global population and 35% of its workforce. While there are 72 million millennials in the U.S., China is home more than 5 times that number.

Tech-savvy millennials do their research online, want high-quality merchandise, are price-sensitive and comparison shop, care about sustainability, and turn to social media for help with purchase decisions. They seek both luxury and value brands and also want convenience. This information-inundated group poses a distinct challenge to retailers aiming to differentiate themselves and stand out.

Notably, millennials accounted for 32% of the global luxury goods market in 2018 and are projected to represent 50% of that market by 2025.[3] Tomorrow's winning brands will focus on first reaching consumers online—likely through social media—and then using physical storefronts to provide memorable experiences and exclusive products to enhance brand engagement. Luxury brands like LVMH and Kering's Gucci are prime examples. LVMH, the world's most valuable brand, has large-scale advantages, a robust digital platform, and strong distribution control, which collectively help generate consistent and meaningful cash flows. Gucci is the most followed luxury brand on Instagram, the leading social media platform for luxury goods globally.

With the pandemic halting tourism this year (a key source for luxury sales), the luxury market has been challenged, but remains underpinned by robust structural growth. Digital and local strategies for strong luxury brands have worked particularly well this year, especially in major markets like China. In China, consumers splurged in online "revenge spending" and formed massive lines at physical stores when they eventually reopened, demonstrating resilience of the sector. In fact, the global luxury market has been a long-time pillar for growth for investors, outpacing both broader global and U.S. equity markets, often recovering faster from setbacks. If this dynamic holds up, European luxury could be one of 2021's sleeping giants.



LUXURY OUTPACED BROADER EQUITIES OVER PAST 15 YEARS

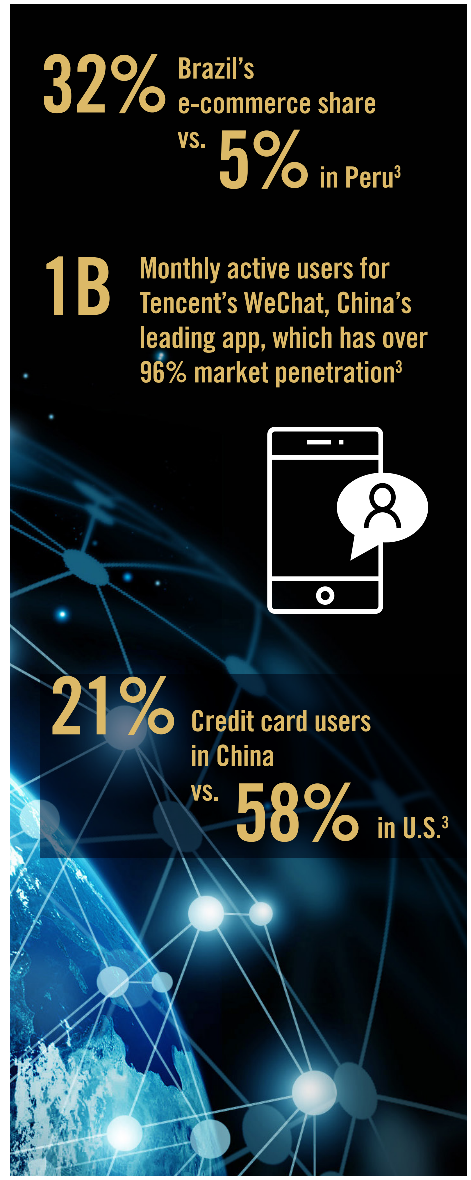
Source: Morningstar Direct. Annualized Returns from 6/30/05-11/4/20.

2 Tailored Localized Connectivity

Amazon established a winning formula in turning inventories quickly and charging lower prices through a vertically integrated, direct-to-consumer ecosystem. Its flexible, robust logistics network has driven its dominance in U.S. markets. However, replicating this model in certain global regions has proven difficult, with local firms retaining market control through extensive delivery networks and a deep understanding of local shoppers. Amazon has found it extremely difficult to gain traction in regions such as Latin America and China, although it continues to study consumer habits and preferences there. It faces stiff competition from Mercadolibre in Latin America and Alibaba in China, both strong brands with dominating market shares. These regions are both critical for e-commerce growth given their burgeoning middle classes.

Meituan is another company that not only understands the millennial market and its lifestyle, but also addresses their needs in a one-stop super app. The app integrates Amazon-like services, deals akin to Groupon, reviews made popular by Yelp, food delivery services like UberEats, and serves up tailored suggestions based on consumer preferences and notifications-based geolocation. Meituan efficiently connects consumers and merchants with a comprehensive support system that includes marketing, on-demand delivery infrastructure, and cloud-based payment systems—providing a strongly connected platform that has been in high demand in the COVID era.

Emerging Markets (EM) Portfolio Manager Albert Kwok, CFA, of Jennison Associates notes that *“the pandemic has caused EM consumers to change their behaviors quite rapidly, especially in regards to grocery delivery, e-commerce, cloud computing, online video, online education, and gaming. There has been increasing internet adoption by lower tier city populations and even older demographics, who had been slower to alter their behaviors to embrace the digital transformation. We also expect to see more resources allocated to the healthcare industry, which could make digital health and telemedicine more mainstream. Many of these changes will be structural, not temporary.”*

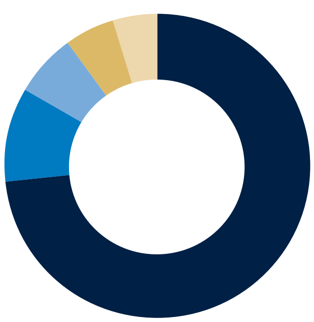


3 Integrated Direct-to-Consumer Models

While getting "Amazoned" is a serious threat for businesses and industries as Amazon's footprint continues to expand, companies like Shopify, a cost-effective e-commerce enablement service, helps small businesses around the world compete globally through digital means. The service facilitates website creation and connectivity to vendors and platforms—such as for digital payment and logistics—that create a more integrated customer experience. While Shopify boasts a 47% 5-year compound annual growth rate, the company's revenues grew 96% year-over-year in 3Q 2020 alone, as many businesses quickly set up online operations to not only survive, but thrive.[4]

Vertically integrated omni-channel brands with control over their distribution are well positioned for retail success, as they offer customers the best of both online and offline worlds. Direct-to-consumer (DTC) models not only cut out middlemen, but provide brands with pricing control and critical information. This intelligence allows them to build demand-driven supply chains and better meet evolving consumer needs. Responsiveness to customers, in turn, boosts sales and profits for both the brands and investors. Nike and Lululemon are examples of companies in the rapidly growing athleisure market whose DTC sales have grown dramatically. Nike saw a fivefold increase in its DTC sales over the last decade which now comprise 35% of its total revenue, while Lululemon's DTC net sales grew 155% year-over-year in its fiscal 2Q 2020, representing 61% of its total revenue (versus 25% in 2Q 2019).[3,4]

GLOBAL RETAIL REVENUES BY CHANNEL



- 73% Traditional in-store transactions
- 10% E-commerce with delivery from warehouse
- 6% Ship from store
- 6% BOPIS (buy online pickup in store)
- 5% Local develiery from store or other methods

Source: Statista as of January 2020.

The aftershocks of COVID-19's disruption to the retail industry will be felt for months, if not years. However, e-commerce is a bright spot within retail, offering both strong short-term gains and compelling long-term growth opportunity in a post-COVID world—that is, for retailers that can reinvent themselves for the modern consumer. Investors that identify and tap into emerging trends early may be better able to ride the waves of the retail tsunami that is underway in the NEXT—or new exceptional technologies—economy.

[1] U.S. Census Bureau
[2] Morgan Stanley
[3] Statista
[4] Company website

S&P 500 Index is a market capitalization-weighted index of 500 U.S. stocks, providing a broad indicator of price movement. **S&P Global Luxury Index** measures the performance of 80 companies engaged in the production, distribution, or provision of luxury goods and services. **MSCI All Country World Index (ACWI)** is a market capitalization-weighted index designed to provide a broad measure of equity-market performance throughout the world. Indices are unmanaged and an investment cannot be made directly in an index.

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