

Coffee, Baseball, and Investing

Are “fundamentals” back in vogue?

EXECUTIVE SUMMARY To the casual observer, it may seem that drinking coffee, watching a major league baseball game, and investing have little in common. However, by looking more closely at the behavior of U.S. coffee retailers, baseball teams, and the financial services industry over the past 20 years, it is easy to see a comparable shift in all three industries — from focusing on delivering “simple” quality products to offering consumers an expansive range of complex, often higher-priced choices. But within the past several years a backlash appears to be under way by consumers who want alternatives to expensive, intricate coffee drinks, overpriced seats and accessories at luxury baseball stadiums, and complicated investments such as derivatives or complex fixed-income securities.

In these turbulent economic times, many American consumers are speaking out against what they believe to be unwarranted higher prices. They are demanding a return to simplicity, and their voices are being heard. Starbucks®, the coffee giant that popularized the \$4 cup of coffee, faced a slowdown in 2009 after years of unprecedented growth. The retailer began testing in some markets a \$1 cup of coffee and free refills on some of its beverages in an attempt to lure consumers back. At the same time, a number of professional baseball franchises, perhaps most notably the New York Yankees®, invested huge sums of money on new lavish stadiums with more premium seating. The result: empty seats from fans unwilling to pay top dollar to be in the first two rows. Meanwhile, in the financial services industry, investment products have become so complex in the past 10 to 20 years that in some cases investors did not fully understand what they were buying. Now the industry is seeing another shift as advisors and investors are once again focusing on more basic investments as the cornerstone of a well diversified portfolio.

As these three industries try to keep up with consumers’ changing needs, attracting and retaining a loyal customer base will require refocusing on core offerings — whether that is a perfectly brewed, inexpensive cup of coffee, an entertaining, high-quality, baseball-watching experience without all the over-stimulation of many new parks, or easy-to-understand investment choices.

I. Coffee: The tremendous increase in coffee outlets, choices, and accessories

All I really want is a cup of "regular" coffee

Starbucks, which for years opened shops throughout the United States at a dizzying pace, shuttered 367 stores in 2009. Over time, the coffee chain strayed from its initial mission to provide a quality cup of coffee by expanding its lineup of drinks, selling merchandise such as CDs and T-shirts in its stores, and adding sandwiches and pastries. Certainly, there are many who favor "the Starbucks experience," spending time at one of its stores surfing the Web, reading, and drinking lattes. But there has always been a segment of the coffee-drinking population (including many Dunkin' Donuts® patrons) who simply want to order a small, medium, or large coffee, with cream and sugar or without. No fuss, no bells and whistles, and no names like a Starbucks' *Double Ristretto Venti Half-Soy Nonfat Decaf Organic Chocolate Brownie Iced Vanilla Double-Shot Gingerbread Frappuccino® with Foam*.

The retailer's store closings may be indicative of a larger cultural shift of consumers toward more basic coffee choices than what the company was serving up. However, it is impossible to look at Starbucks' growth hiccup without considering the impact of the global financial crisis of the past two years. With a large number of Americans still unemployed or in jeopardy of losing their homes, cutting back on the expensive daily cup of coffee was a no-brainer for many. Another reason for the closings could be that the company simply grew too fast, and the reduction in stores was a necessary correction, especially in light of the economic downturn.

A coffee shop on every block

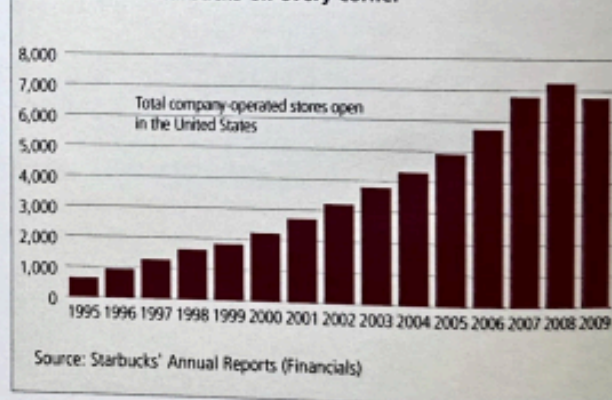
For many Americans, coffee is more than a commodity, it is a necessity. In fact, according to *Specialty Coffee Retailer*, 54% of adult Americans drank coffee on a daily basis in 2009, and 146 billion cups of coffee were consumed that same year. In addition, between 2000 and 2005 the number of coffee shops increased by 70%, reaching nearly 21,400, or roughly one coffee house for every 14,000 Americans, according to Mintel International, a Chicago-based market research firm.

Coffee was once a drink brewed mostly in the home or at the corner store, but consumer demand exploded, and soon retailers were erecting stores on every block and offering more coffee choices. More often than not, the new storefront most likely had the name Starbucks or Dunkin' Donuts. It is safe to say that both Starbucks, with 6,871 stores, and Dunkin' Donuts, with 6,566 stores, are ubiquitous in today's America. But while Starbucks was closing 367 stores in 2009, Dunkin' Donuts continued to expand, opening 171 new stores.¹ And significant market growth continued for Dunkin' Donuts, the Canton, Massachusetts-based "coffee and doughnut" company, in the first half of 2010, with 338 new store openings worldwide.²

¹ Source: www.thebigmoney.com, March 19, 2010

² Source: www.boston.com/The Boston Globe, August 26, 2010

Exhibit 1: A Starbucks on every corner



Starbucks vs. Dunkin' Donuts: A battle brewing between two java giants

The coffee industry has long considered itself recession proof, a point with which many economists agree. Still, since the start of the recession in 2007, many retailers have taken a hit, some more than others, especially higher-end, higher-priced brands such as Starbucks with more room to fall than Dunkin' Donuts or McDonald's®.

But price is just one factor in determining how coffee drinkers choose their cup o' joe. In fact in the spring of 2009, Brand Keys, a research consultancy that specializes in tracking customer loyalty and engagement, polled 26,000 consumers of 441 coffee brands in 63 categories and found that while value is the primary driver, also important is service and surroundings, quality and taste, and selection.

As Starbucks was deciding that it needed more than coffee to attract and retain consumers, Dunkin' Donuts was improving the quality of its coffee without increasing the price. "What Dunkin' Donuts seems to have figured out," writes Melanie Warner in an article published on the Web site *thebigmoney.com*, "is that there's a large segment of the population that doesn't care to figure out what a venti is. They're not ever going to order a skinny half-caf soy caramel Macchiato. Instead, they like consistent, decent-tasting, old-fashioned drip brew coffee that doesn't cost more than \$2."

Despite the sluggish economy, Dunkin' Donuts experienced strong growth across the United States as well as internationally in 2009, perhaps giving credence to the retailer's claim that it knows what coffee drinkers want. "Dunkin's deliberate targeting of the no-frills, cost-conscious coffee drinker who doesn't want to buy a CD on his way to work has been extremely effective," Warner adds.

The importance of remaining true to your brand

Starbucks, in addition to becoming oversaturated to the point of competing with itself, veered off track by moving from an up-market, exclusive brand to one that was being mass marketed and readily available on every corner. Meanwhile, Dunkin' Donuts added coffee to its "doughnut" lineup and expanded its coffee choices on a limited basis. But Dunkin' Donuts has managed to keep its price point lower than Starbucks, never faltering from its brand of coffee geared to the every woman or man.

II. Baseball: Jumbotron, luxury seats, and sushi, oh my

Has baseball watching become an exclusive pleasure of the ultra-wealthy?

The game of baseball appears to have reached new heights of extravagance and luxury with the opening of the new Yankee Stadium® and the Mets® Citi Field® in the spring of 2009 at a combined cost of \$2.3 billion. While construction costs were assumed by the two teams, the projects did receive several hundred million dollars in financial assistance in the way of public financing, tax breaks, and infrastructure improvements. The high price tag became even more controversial when it was discovered that building the new parks was given priority over funding New York schools and mass transit during a time of intensive budget tightening for the city.

In an age in which smaller, more intimate ballparks have been the norm, the new Yankee Stadium, costing \$1.5 billion, with 52,000 seats and 1,400 video monitors, is a testament to opulence. If the cost of building the elaborate park was not offensive enough to New York fans, the team's total payroll (\$201 million in 2009) and its ticket pricing structure has created even more of an uproar among some patrons. With tickets going for as much as \$2,625, many fans are being priced out of seeing games. "You have a stadium paid for by taxpayers that taxpayers can't afford to get into," says New York State Assemblyman Richard L. Brodsky.

Despite the hype surrounding the glitzy stadium, many New Yorkers seemed to need some coaxing to rationalize spending these high prices for baseball seats. Less than eight weeks before opening day 2009, the team had to run a full-page ad in *The New York Times* in a last-ditch effort to fill still-unsold premium seats.

With exorbitant ticket prices for premium seats and concession stands offering five-star restaurant menu choices (including lobster rolls, sushi, shrimp, and seat-side waitress service) becoming more commonplace around the league, one has to wonder what happened to the "take me out to the ballgame" days when a hot dog, a pretzel, and a beer were all a fan needed to enjoy an afternoon or evening at the park.

Minor league baseball games: A more affordable alternative

It seems that some Major League Baseball® fans, tired of the expense and an overall less-than-satisfying game-watching experience, are instead choosing to attend minor league games that provide the same level of high-caliber, professional baseball, are usually closer to home, and cost a fraction of their major league equivalent.

"The cost of a family of four to attend a minor league baseball game is much cheaper than any major league ballpark ticket," writes Brad Kramer on the Web site www.associatedcontent.com. "I have attended a game recently with the family and purchased tickets for a designated picnic area section of the ballpark and the tickets cost about \$10 per head. The parking was also much cheaper as I paid \$5 for up-close parking. Parking at a major league baseball game in Chicago will run at least \$20."

There are other ways to save by attending minor league games, too. "The food is also more reasonably priced when purchasing traditional ballpark items such as dogs, chips, and soda," Kramer adds. "The allure with the minor league concessions is that some night games will offer up special prices on their concessions when you purchase a ticket for a particular game. This is a great deal for big families or groups coming out to the ballpark for the evening."

It remains to be seen if Major League Baseball ticket and concession prices will ever fall from today's levels, but as more fans stay home or find more affordable alternatives, baseball owners may be forced to make tough decisions themselves to keep fans coming back and their organizations afloat.

III. Investing: Diversification and a long-term approach will never go out of style**The rise of souped-up, intricate investments**

During the 18-year bull market from 1982 to 2000 when financial markets were steadily climbing, it seemed to many throughout the financial services industry as if the sky was the limit for many investments. Did the continual rise in investment values play a role in the shortsighted decisions of anyone throughout the industry who chose to forsake the basic fundamentals — long-term investing, risk management, asset allocation, and diversification — in their quest to achieve more immediate gains?

No one can say for sure, but now that markets have cooled and volatility may be more the rule than the exception, many advisors and investors have swung to a more conservative stance, once again focusing on the basic principles of investing. In addition, the clear message from strategic branding firm Siegel+Gale's Simplicity Survey (conducted between December 29, 2008 and January 5, 2009 among 1,214 investors and U.S. homeowners) is that "people are fed up with complexity, and desperate for institutions and brands that offer simple honest communications they can understand."

Exhibit 2: Investing patterns – Primary investor focus over past 20 years

1989-1990	Diversified portfolios of stocks, bonds, domestic, international, small and large
1991-1992	Small-growth funds
1993-1994	Index funds emerged
1996-1997	Focused funds
1998-2000	Technology funds
Early 2000s	Large-cap products (growth, value, blend)
Mid 2000s	International equities and intermediate-term bonds
Late 2000s	Short- and intermediate-term fixed income

In general, as investments have become more specialized, they have tended to become more complex for investors.

Source: MFS research

A call for accountability and transparency

Siegel+Gale's Simplicity Survey indicated that nearly three-quarters of all consumers believed that complexity and confusion were major causes of the financial melt-down. Consumers also admitted to being "complacent and complicit in tolerating complexity, and in blindly trusting corporations by not reading the fine print." The good news is that there is now greater demand by investors and the industry at large for accountability and transparency. In addition, more than three-quarters of those surveyed agreed that it was the final responsibility of the consumer to make sure they understood all the risks.

Know what you are buying before you buy it

One way to address the confusion in the marketplace is for firms to encourage a return to the "fundamentals" of investing, which means different things to different investors. For some, it means focusing on reducing or eliminating debt. For stock investors, it could mean that it is a good time to refocus on why you are buying a particular stock, security, or mutual fund.

One of the first rules of investing is to know what you are buying. If you do not understand what a company does, how it makes money, and what its market is, do not buy the company's stock or bonds. Your advisor can help you find the information you need before you make a purchase. The same holds true for mutual funds, investment options for retirement products, and managed accounts. Know the objectives, risks, and charges before deciding whether the offering is right for you.

Ken Little, author of an *about.com* piece "Back to Basics for Stock Investors," perhaps best sums up the approach you and your advisor should take when he explains, "Look at the amount of debt a company is carrying and how much cash it has on hand. How well did the company do in a thriving economy and how poorly is it faring in a weak one? Forget easy money and fast deals. There are many great companies that will rebound when the economy turns around."

Fundamental investing concepts may help keep you on track

While there is no clear-cut formula for successful investing, MFS® encourages you to work with your advisor to develop a comprehensive plan for the long term. Building a portfolio with core investments as the foundation of your portfolio, with strategic allocations to satellite investment options, may be a good approach based on your financial needs, goals, and risk tolerance.

Trying to time the market successfully can be an impossible task, as many investors learned in 2009. Market rebounds often come in quick, sudden bursts, and if you are out of the market, you may miss the gains. A disciplined ADR approach (**A**llocate assets across the major asset classes, **D**iversify within each asset class, and **R**ebalance your investments periodically to keep in sync with your desired risk tolerance and allocation levels) gives you a simple way to stay focused on your long-term goals without having to engage in a guessing game over what the market will do next. Regardless of short-term market volatility, staying the course usually makes sense, and reacting to daily, weekly, or even monthly market corrections can potentially hinder your long-term financial goals.

If you are among those investors who abandoned the stock market in search of safer havens since the start of the global recession, only you can decide if and when the time will be right for you to "stick your toe back in the water." If you remain skeptical about moving your assets back into the market, your advisor can provide guidance by addressing any risk concerns, providing back-to-basics resources, and offering a broad perspective on current economic conditions, free from the sensationalism of the media. Partnering with a dependable, quality advisor and an investment manager who pursues active management and fundamental research can go a long way toward giving you the support — and courage — to reenter the market and the information to choose the right investments to help you achieve your long-term financial goals.

Conclusion

Have we come full cycle, and will the strong desire by consumers to embrace a back-to-basics approach have a lasting impact on coffee retailers, baseball owners, and the financial services industry? Only time will tell if recent changes in consumer behaviors will take hold for the long haul, but there is no denying that the current market environment is changing dramatically in all three industries. Fortunately, for those who relish the “good ole days,” it seems likely that there will always be those retailers and service providers who will continue to look for new ways to create and market high-quality products that are also affordable.

For coffee retailers, does the recent consumer backlash mean the beginning of the end for higher-priced brands as more and more coffee drinkers demand well-brewed coffees at prices more in line with today’s lighter wallets? For baseball franchises, does it mean rethinking the current interest in building luxury stadiums that are likely to go unfilled and instead coming up with innovative solutions to provide fans the opportunity to buy affordable seats and enjoy a variety of food and drinks at a range of price levels? For the financial services industry, does it mean remembering basic investing principles that encourage focusing on solid, sound, and well-researched investments that can become part of a diversified portfolio with the potential to build a sizable nest egg over the long term?

While MFS cannot offer an expert opinion on the coffee and baseball industries, we can weigh in with a reasonable amount of confidence on the financial services industry. We have been doing this since we invented the mutual fund in 1924. The biggest lesson for advisors and investors may be that it is necessary to understand investments fully and early on in the decision-making process. As investments have become more complicated, the need for the industry to step up and educate advisors and their clients has increased significantly. Still, investors should be actively involved in their own choices by treating investing like any important life purchase and asking the questions they need answered by their advisors.

It is easy to place blame on an investment industry that has grown rapidly — and often without regulation — for the confusion of individual investors who are unsure what their next move should be. But in the end, you need to be informed and avoid making rash decisions or going blindly into any investment. It is essential that you work closely with your advisor to “know what you are getting into.” Schedule regular advisor meetings to review your investments, financial goals, stage of life, and level of risk you are willing to assume — and then rebalance your portfolio as needed to align with your investing plan and desired allocations. ■

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