The Cyclical Upswing Isn't Over Yet! Buy an Airline Today

Description

The airlines have faced a considerable amount of turbulence over the last few months thanks in part to cost pressures and fears that the next recession could be just around the corner. Higher fuel costs and expenses to improve long-term efficiencies are the main culprits for the recent stomach-churning ride, but February's nasty correction, or "market reset," has clearly exacerbated the near-term pains that the airlines have been facing.

I've urged investors to buy the dip on both **Air Canada** (TSX:AC)(TSX:AC.B) and **WestJet Airlines Ltd.** (TSX:WJA), both of which are still in the midst of a cyclical upswing. The U.S. economy is hot — so hot that it's causing investors to panic over rapidly rising inflation rates and a potentially hawkish Fed, which may hike interest rates four times in 2018. Higher wages, expenses, and fuel costs are a clear negative for the airlines, but a 15-20% pullback is way overdone since the numerous short-term issues are clouding the long-term opportunity that still exists.

Short-term pain for long-term gain

The airlines are becoming more efficient, and I believe they'll become more recession-proof in time, but to grow while putting a cap on costs, the airlines' management teams are going to need to loosen their purse strings. It's a typical case of "you've got to spend money to make money," and that has some investors hesitant. They're thinking if a recession were to happen out of the blue, the airlines would likely be on the brink as they have numerous occasions in the past.

Air Canada faces refleeting costs of ~$8 billion over the next few years. Combine that with the fact that the loyalty program insourcing efforts, and you have a firm that has very little financial wiggle room, at least in the medium term. These expenditures are not only desirable in the grander scheme of things, but they're necessary to become an investable business through economic downturns, putting a stop to the "crash landings" that airline stocks usually experience during tough economic times. When the economy is hot, airlines are among the best stocks to own, but they quickly turn to "noxious poison" as soon as the tides turn, which is why the high-risk profiles that come with airline investing are not suited for the risk averse.

In addition, ultra-low-cost carriers (ULCCs) are expected to take the air this year, and I believe it’s the beginning of an era where airlines will become more economical businesses with the ability to become very profitable through the worst of recessions. The lower cost structure will allow financially stressed Canadians to resume their travels at a ~40% cheaper rate. That means ULCCs will make up for a larger chunk of overall flights during tough economic times, and I believe the unit will provide enough relief such that government bailouts will become a thing of the past for the airlines.

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