2 Reasons to Avoid Airlines as Economic Headwinds Build Up

Description

Air Canada (TSX:AC)(TSX:AC.B) stock was down 1.84% in morning trading on June 28. Shares have plunged 18.1% in 2018 so far after nearly doubling up in 2017. **WestJet Airlines Ltd.** (TSX:WJA) was also down 2.22% and has seen its stock drop 11.4% in 2018. WestJet rolled out its Swoop regional alternative in June, and both are faced with intensifying competition from smaller airliners in the domestic market.

Air Canada and WestJet posted record passenger traffic in 2017, coinciding with broader trends in the industry at large. However, investors may want to take profits if they have not already, as airlines could be especially vulnerable in the coming months. Volatility has returned with a vengeance to stock markets in the developed world.

Here are two reasons to remain on the sidelines when it comes to airline stocks in the second half of 2018.

The last recession was costly

The Great Recession was extremely damaging for the airline industry. Airlines lost a total of $10.4 billion in 2008 and nearly matched that number in 2009. Revenues dropped by double digits, as passenger traffic also took a nosedive. This resulted in delays of new aircraft orders and a sharp fall in the stock price of major airliners.

Air Canada managed to avert disaster in 2009, as it entered a period of crisis. Shares fell below $1, and the company fought to raise cash in a tight global credit market. Air Canada has managed to secure itself in the aftermath. Some of these measures included eliminating its $4 billion pension deficit, reaching a new CBA with its machinists and aerospace workers in 2016, and launching the low-cost alternative Rouge.

These improvements are promising, but Air Canada and the industry at large would still face major risks in the event of recession. Could global turmoil put us on such a path? Let’s take a look.

Red flags are emerging in 2018

The S&P/TSX Composite Index was down triple digits as of this writing. If this holds, it would represent the second triple-digit decline this week. Major U.S. indexes were in negative territory on the same day, as investors continue to digest the ramifications of a global trade war.

Market turmoil is not the only major concern. A report from Statistics Canada released on June 27 showed that Canadians spent less on domestic tourism for the second straight quarter. Tourism spending reached $21.8 billion in the first quarter, up 0.2% from Q4 2017. The good news is that Canadians spent more on air travel compared to the drop in activity for recreation and entertainment, vehicle fuel, and food and beverage services.

International visitors have been a huge boost. Arrival from China were up 12% in 2017 compared to the previous year. International visitors also spent 3% more on air travel than domestic consumers.

Investors should keep in mind that these trends are present in a period of relative economic strength. Canada is expected to see GDP growth drop below 2% by 2020. The blowback from ongoing trade disputes and general uncertainty could see this projection adjusted downward.

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