



Here's an Air Canada (TSX:AC) Pair Trade to Act on Right Now

Description

I've said it before; I'll say it again: **Air Canada** ([TSX:AC](#)) stock on its own can be a dangerous speculation. The [COVID-19](#) pandemic has essentially made all passenger airline stocks a spec bet that's a play on the occurrence of a binary event. Airline stocks could either soar in value on the advent of a vaccine or plummet towards \$0 if this pandemic drags on longer than expected, with more government-mandated shutdowns along the way.

Air Canada remains a risky spec bet, but it can have a spot in an effectively balanced barbell portfolio

While effective containment procedures could limit the damages caused by the airlines, I'm sure you'd agree that social distancing on a narrow-bodied aircraft that recycles cabin air is pretty much impossible. Not to mention that high operating costs would make it nearly impossible for the airlines to rake in a profit, even during a partial reopening of the economy.

As long as COVID-19 is out there, the airlines are a risky bet that speculators will surely pile into with the hopes of winning the game of greater fools (the greater fool theory is real, and it has nothing to do with The Motley Fool).

Nobody knows when a vaccine will land, or how many more severe outbreaks we'll be hit with, nor does anyone know how much downside a name like Air Canada has, as it looks to do everything in its power to shore up liquidity to survive the worst typhoon it's been hit with since the 2008 Financial Crisis. As such, most investors ought to categorize airline stocks in the "no-fly" zone at this juncture.

For calculated investors who know the risk, though, Air Canada paired alongside the likes of a business that's mostly immune from COVID-19 can produce a risk/reward tradeoff that's favourable, even given the profound pandemic-related uncertainties.

Lowering the risk end of the barbell

I've described the "barbell" portfolio in prior pieces. In this piece, I'll go into a specific pair trade that leverages the strategy. I'll use Air Canada for the "risk-on" side of the barbell and a name like **KP Tissue** ([TSX:KPT](#)) for the "risk-off" side.

If a vaccine lands, you'll make a killing with Air Canada. But in the meantime, AC stock is going to continue to be ridiculously volatile and is likely to pull back to those 52-week lows on bad news that's more than likely come flowing in.

KP Tissue is a "risk-off" investment that'll be minimally impacted by COVID-19. If anything, the company will benefit, as further outbreaks trigger more panic buying of toilet paper and other tissue products that the firm manufactures.

KP isn't a buy for potential near-term sales pops in upcoming quarters, though. It's a buy for its rock-solid dividend (currently yielding 6.7%) that will be supported by operating cash flows that are resilient in the face of this pandemic. Moreover, shares of KPT are looking quite undervalued, given the stability the firm can provide in these times of off-the-charts volatility.

Shares of the toilet paper play trade at just 1.1 times book at the time of writing, and with a 0.9 five-year beta, the stock, alongside the likes of an Air Canada, can help buoy the portfolio as the tides continue to get rougher.

Foolish takeaway

Air Canada is going to be a [turbulent](#) investment that's volatile enough to make any investor sick. Air Canada held alongside KP Tissue can help absorb some of the shock as it comes and tilt the risk/reward tradeoff slightly in the investor's favour.

Once this pandemic ends, Air Canada could have lots of upside if it doesn't go bankrupt, and KPT will continue on its own muted trajectory. In a worst-case scenario, if a vaccine doesn't arrive for years, Air Canada could lead to high double-digit losses, but KPT is more likely to hold its own and probably head higher should the broader markets crumble like a paper bag.

If you seek upside but don't want to risk your shirt, consider flexing your muscles with a "barbell" pair trade with Air Canada and KP Tissue.

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