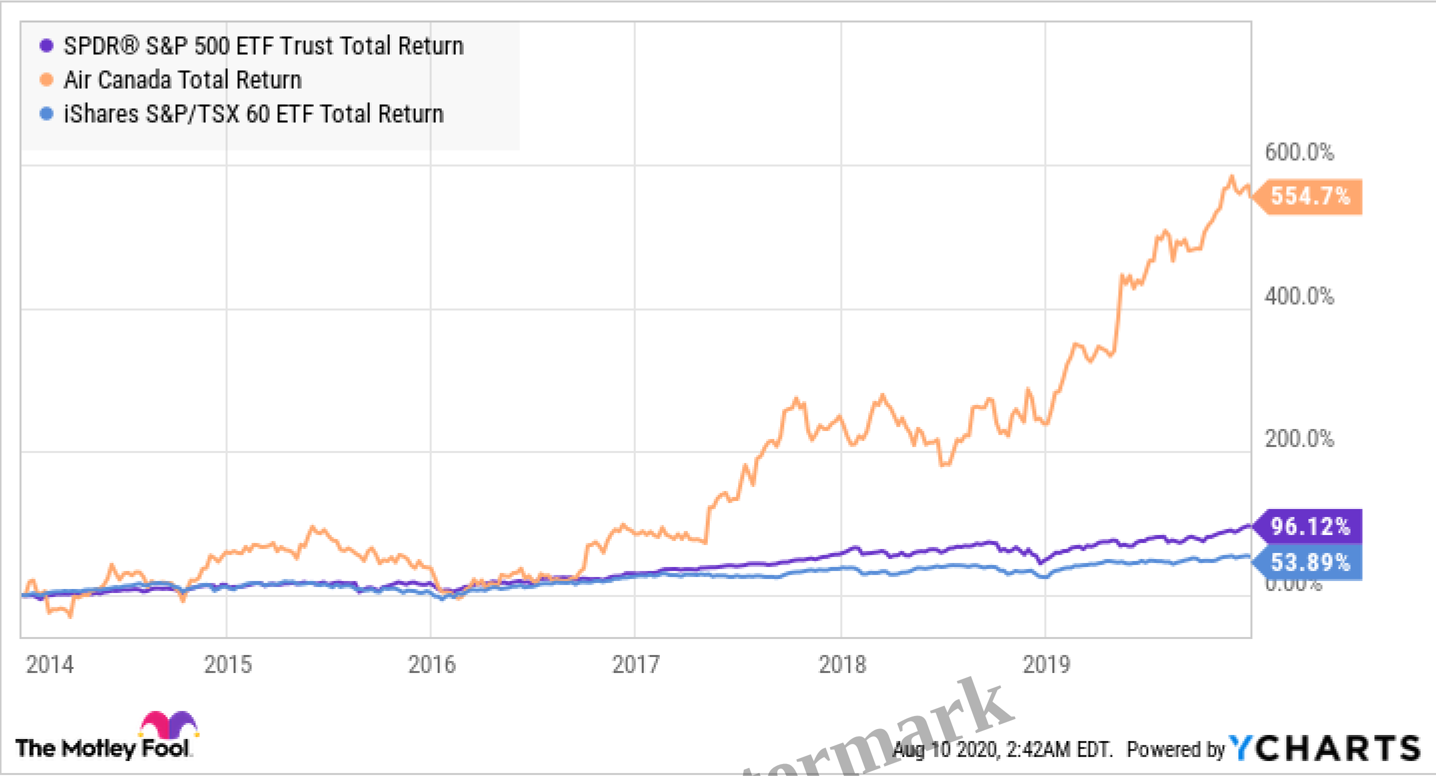
Should You Buy or Sell Air Canada (TSX:AC) Stock or Other Airline Stocks Now?

Description

If you're thinking of buying **Air Canada** (TSX:AC) stock or other airline stocks, think again. They're high-risk investments now. It doesn't mean you can't make tonnes of money from them, but real near-term risks should not be ignored.

Airline stocks outperform in a growing economy

Air Canada stock delivered returns of close to 37% per year from 2014 to 2019. That is a 6.5 bagger! During that period, the U.S. stock market generated annualized total returns of close to 11%. Needless to say, an investment in Air Canada also beat the Canadian stock market, which tends to underperform the U.S. market.



Data by YCharts. Chart comparing Air Canada stock's total returns to those of the U.S. and Canadian stock markets from 2014 to 2019.

This market-beating phenomenon exists in the airline industry as a whole. The caveat is that the economy must be growing for this to take place. A partner of Air Canada's, **Chorus Aviation** (TSX:CHR) delivered annualized total returns of about 18% from 2014 to 2019.

The difference between investments in Chorus Aviation and Air Canada stock is that much of the former's returns — about 41% — came from its dividends. At least, it used to.

The stock suspended its dividend in April, as the pandemic tsunami swept through the industry, leaving no airline unharmed. In late 2019, before the dividend cut, Chorus Aviation yielded about 6%.

High risk investing in airline stocks in the near term

Whenever dividend stocks yield 6% or higher in a normal market, investors should ask why the stocks provide an above average yield? What are the risks?

The flip side of airline stocks is that they underperform when the economy contracts. Right now, it's worse than that. Due to air travel restrictions, no thanks to COVID-19, global air travel has dropped about 50% from pre-COVID levels, according to statista.

The drop in air travel could be worse in Canada, although the article indicates numbers have since improved. However, it's too early to say air travel is on the way to a turnaround.

For one thing, no one knows how long we'll be fighting the pandemic. Experts warn that vaccines aren't a silver bullet solution, though it'd certainly help the situation. For now, we'll just have to stick with social distancing, hand washing, and mask wearing.

Airlines are simply burning cash every day. They're being as creative as they can to cut costs and become as efficient as ever. Having a good management and a solid balance sheet going into COVID-19 would help.

Unfortunately, this means it's the survival of the fittest. Many airlines will cease to exist, after the pandemic is over, at least not in the form they are now. Some have already folded.

The Foolish takeaway

Air Canada is the largest airline in Canada. Luckily, it entered 2020 with a relatively good balance sheet compared to many of its global peers. CEO and President Calin Rovinescu has also led the company since early 2009, which was a difficult recessionary period. This time looks to be an even greater challenge.

Some investors are avoiding airline stocks altogether, which could be a smart move, especially if they have a short-term investment horizon.

Buyers of Air Canada stock today should be prepared to hold for three to five years, by which time they could have more than doubled their money. In other words, if things turn out well, buyers today can make total returns of more than 20% per year over the period. Now, that'd be market outperformance!

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