Air Canada (TSX:AC) Stock: Double or Nothing

Description

It seems like the laws of investing don't work on **Air Canada** (TSX:AC). The first rule of investing is to buy the dip and sell the rally. But despite countless warnings, investors are buying the rally in the hope of recovery. The second rule of investing is to buy a stock of a company that has future earnings potential. But all I see for Air Canada are losses, debt, and more losses. Defying these rules, this stock is running rogue, hovering in the $25-$30 range.

Air Canada stock doubles

You can see the rogue nature of AC stock in its last 12-month rally. The stock lost 75% of its value last March (from $51 to $12.4) when Canada announced a nationwide lockdown. That stock movement was justifiable. But nothing changed for AC after that as the Canadian government never lifted the international travel restrictions. There was some domestic air travel, but nothing could reduce the cash burn. The longer the travel restrictions stay, the harder it is for the airline to stay put.

But the AC stock more than doubled from its March low to $27.5 on vaccine news. The vaccine news revived investors' hope that AC will fly again and quickly recoup its losses. More than 100% rally of a stock that is drowning in debt and losses seem unreasonable. It is like you are betting on a losing game.

Even if I take the most optimistic scenario where the government lifts travel restrictions in the second half, and there is pent-up demand, AC will still make losses. It makes no logical sense to chase the stock's rally as you are doing nothing but funding its losses.

Make double or nothing with Air Canada stock

Here I will reiterate that buy the dip and sell the rally is the universal rule that works if you are long on the stock. There are many other complex derivatives like short selling that run by different rules. But here, I will only talk about the simple way of stock investing.

Those who bought AC stock near its low of $12-$15 doubled their money in a year, provided they took over the greed and sold the stock when it crossed the $26 mark. But those who defied the investing rule and hoped on to the rally at $25-$26 got nothing. In fact, they lost money. Now they are holding on to the stock with hopes that it will recover.

AC is not a stock worth holding for the long term. It is like a tossed coin in which you get heads where your money will double if you invested in the dip, or get tails where you will get nothing if you invested in the rally.

Why is Air Canada stock soaring despite losses?

When AC stock is fluctuating at such high levels, with a beta value of 2.55, why are investors still buying the stock? The traders are using the stock's high trading volume and volatility to their advantage. They are buying the dip intending to make a short-term profit and squaring their position with a put option to reduce risk. In the put option, you benefit when the stock price falls.

Then there are bullish investors, who are inspired by AC's 1,700% rally between August 2013 and January 2020. They believe that AC will bounce back to the pre-pandemic level in three to five years and give another 1,000% rally. Hence, they jumped on to buy the stock on any bit of positive news hoping that this is the bounce-back point.

A 1,000% rally (where $1,000 can become $10,000) is quite a strong motivation to buy AC stock at $25 and above. But what these investors have not discounted is the risk of bankruptcy. Before starting its 1,700% rally in 2013, AC went through bankruptcy and seven years of losses. So when you look at the rally, it happened in 14 years (23% average annual growth rate) and not seven years.

Final thoughts

The bears are fearful of bankruptcy and are therefore exiting their position in AC when the stock rallies. Instead of being a ping pong ball between the bulls and the bears, buy a stock, which has strong earnings potential, at a dip.

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