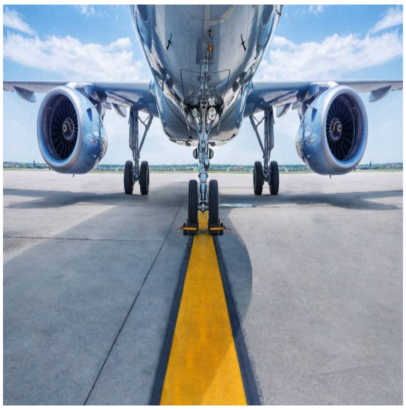

$1,000 Invested in Air Canada (TSX:AC) a Year Back Is Worth This Much Today

Description

This exact day last year, the pandemic pushed **Air Canada** (TSX:AC) stock three years back to 2017. This is because the pandemic wiped three years of profits with just a snap. Who would have thought the stock of a drowning business, on which every analyst had a Sell rating, would double your money? You don't believe me? The numbers say it all.

$1,000 in Air Canada stock is worth…

On March 18, 2020, AC stock closed at $12.9, and today, it is trading at $28.57. This gap in the stock price represents a 120% upside. In short, it means $1,000 invested in AC a year back is worth $2,215 today. Don't rush to buy the stock just by seeing these numbers. This is a common mistake retail investors make and land up losing money.

Don't get lured by past numbers. The stock price is influenced by the company's future growth potential and not by its past performance.

But you can argue that AC's future growth potential didn't look quite optimistic for the entire 2020. Still, the stock surged 120%. At present, there is COVID-19 vaccine and AC has reduced costs, raised liquidity, opened a dedicated cargo airline, and is close to a bailout. Aren't these the signs of recovery? They are, but investors have already priced in these factors.

Air Canada's future growth potential

As for Air Canada's future growth potential, you will see revenue growth but no profits or positive cash flows. It has a variable expense of fuel, which accounts for 20% of its revenue. In the best-case scenario, AC gets permission to fly and sees pent-up demand for air travel. But this doesn't mean it can fill its planes with passengers. It will have to follow social-distancing norms.

Last year in July, when domestic travel resumed, AC benefitted from lower oil prices. But now, oil prices have recovered significantly and will likely return to the pre-pandemic level by the time the government lifts air travel restrictions. This will increase AC's operating expense.

The airline has committed to reducing its carbon emissions, and one of its strategies is to use fuel-efficient planes. It will use Airbus A220 and Boeing 737 MAX narrow-body fleets that consume 20% less fuel. Such efforts are keeping investors hopeful and preventing the stock from falling below $20.

What should you do?

However, I won't buy AC stock at the $28 price point. Remember, the 120% rally in the last 12 months is a result of the catapult effect. Warren Buffett says, "Bad news is an investor's best friend." Buying at a dip is more fruitful than grabbing on to the rally because the recovery rally is faster than a stock's normal growth.

If you want to take advantage of AC's recovery rally, buy the stock when it falls below $24 and not when it is trading close to its post-pandemic high. AC is not an undervalued stock. But it has high trading volume, and that is driving its stock price. If you buy AC stock around the $24 price point, you will get meaningful returns when the stock touches or crosses the $30 price.

Last year, a $30 price was the most bullish analyst estimate and marked the start of recovery. Today, the stock is close to reaching this price point with hopes of a bailout. But the stock could fall to $24 if the bailout terms are not favourable or if there are more travel restrictions.

This year, a $33 price is the most bullish analyst estimate for AC and marks the hopes of ease in travel restrictions by September. This looks likely at present, but it might get delayed if the pandemic worsens.

Final thoughts

Don't invest a significant portion of your portfolio in AC. Invest around 5% or less of your portfolio amount in AC, depending on your risk appetite. From your $6,000 contribution in the Tax-Free Savings Account, invest $300 in AC and the remaining in high-quality growth and dividend stocks like **Enbridge** . The latter can mitigate some loss from AC with its more than 7% dividend yield.

As for the growth, the $300 could become $660 if AC repeats or exceeds its last year's performance. Rather than tying your hopes with a single stock and a single trade, always have a Plan B. Plan B (Enbridge in this case) will protect you if Plan A doesn't materialize.

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