

# Cumberland Advisors Market Commentary – Airlines and COVID19

Cumberland portfolios hold no airline stocks, no transportation stocks, no hotel, leisure or hospitality stocks. Sector ETFs were sold. Some of these stocks are part of the broad based ETFs which are tied to an index basket. Now let's look at airlines.



Since the advent of widespread air travel following World War II, the world has gotten much smaller. These days, it's just a hop, skip, and a jump for an American to spend a few days in Europe or for a Chinese or Japanese traveler to spend the weekend shopping on the US West Coast. Or at least that's how it was until a few weeks ago. The impact of COVID-19 on air travel has been sudden and devastating – and universal air travel has played a large role in the spread of the virus.

Writing in the *Wall Street Journal*, Prof. Niall Ferguson makes the case that “Standard epidemiological models tend to understate the threat posed by a virus such as 2019-nCoV, because they don't take account of the topology of the social networks that transmit it. Ferguson quotes Prof. László Barabási of Northeastern University:

“When it comes to the spreading of a pathogen, the epidemic parameters are of secondary importance. The most important factor is the structure of the mobility network... An influenza virus moves through a continent with the speed of a sports car or a smaller airplane.”

Ferguson notes, “This means travel restrictions tend to be imposed too late to stop the spread of a contagious virus

along the routes between the world's 3,000 busiest airports. What matters is not geographic distance but 'effective distance' in journey time."

("'Network Effects' Multiply a Viral Threat," *Wall Street Journal*, Mar. 8, 2020, <https://www.wsj.com/articles/network-effects-multiply-a-viral-threat-11583684394>)

As just one example of the potency of these network effects, we see that on Sunday, March 8, after Italian authorities put 16 million people into quarantine in Northern Italy, dozens of flights from that region were allowed to land in Britain, with no attempt made to screen the incoming passengers.

("Coronavirus farce as dozens of planes fly to UK from Italy's quarantine zones with no checks," *Telegraph*, Mar. 9, 2020, <https://www.telegraph.co.uk/news/2020/03/08/coronavirus-farce-dozens-planes-fly-uk-italys-quarantine-zones>)

Given the infectiveness of the COVID-19 virus and uncertainty about the efficacy of personal preventive measures, the last place most people want to be these days is a busy airport, much less the cabin of a cramped airliner, breathing recycled air. And so there has been a dramatic falloff in the demand for air travel, coupled with the cancellation of flights for purely epidemiological reasons.

The major carriers first canceled or reduced flights in and out of Wuhan, then China altogether; and then flights were restricted or eliminated to and from countries like South Korea, Italy, and Iran.

Here are status reports from the major US carriers, as of March 10.

#### United

Will reduce its international schedule by 20% and its domestic schedule by 10% in April. Expects reductions of at least 20% in May.

According to a recent 8-K filing with the US Securities and Exchange Commission, United will “proactively evaluate and cancel flights on a rolling 90-day basis until the Company sees signs of a recovery in demand,” and “due to the heightened uncertainty surrounding this outbreak, its duration, its impact on overall demand for air travel and the possibility the outbreak spreads to other regions, the Company is withdrawing all full year 2020 guidance issued on January 21, 2020.” (Hat tip, Peter Boockvar)

“We certainly hope that these latest measures are enough, but the dynamic nature of this outbreak requires us to be nimble and flexible moving forward,” said United Chief Executive Officer Oscar Munoz and President Scott Kirby on Wednesday, March 4.

(“Airlines Sink Most Since 2011 on Virus’s ‘Gut Punch’ to Demand,” Bloomberg, Mar. 5, 2020, <https://www.bloomberg.com/news/articles/2020-03-05/airline-warnings-show-coronavirus-s-sudden-risk-to-u-s-travel>)

### American

Plans to cut international flying during the peak summer season by 10% (including a 55% reduction in trans-Pacific capacity) and reduce domestic flying by 7.5% in April.

### Delta

Is reducing capacity on international routes by 20–25% and on domestic routes by 10–15%.

Delta CEO Ed Bastian said, “As the virus has spread, we have seen a decline in demand across all entities, and we are taking decisive action to also protect Delta’s financial position. As a result, we have made the difficult but necessary decision to immediately reduce capacity and are implementing cost reductions and cash flow initiatives across the organization.”

United, American, and Delta are all letting travelers make changes without charge to domestic or international tickets purchased before April 30.

("United, American, Delta cut more flights, some executives take pay cuts as coronavirus keeps people from flying," *Chicago Tribune*, Mar. 10, 2020, <https://www.chicagotribune.com/coronavirus/ct-coronavirus-airlines-flight-schedules-20200310-mvgrob6fzvdprhjr3qivszlzly-story.html>)

Needless to say, President Trump's March 11 announcement of a 30-day ban of incoming flights from Europe will further weaken these and other international carriers. Shares in United fell by 15 percent the day after the announcement, while American shares lost 8 percent, and Delta's plunged 14 percent.

("Airline crisis worsens over Europe travel restrictions amid coronavirus outbreak," *New York Post*, Mar. 12, 2020, <https://nypost.com/2020/03/12/airline-crisis-worsens-over-europe-travel-restrictions-amid-coronavirus-outbreak/>)

According to OAG, an aviation data provider, the ban will result in the cancellation of more than 6,700 flights, the equivalent of some two million seats, in each direction. Delta is hurt most by the ban, as the operator of 17 percent of the affected flights. United is next with 14 percent, followed by Lufthansa with 13 percent and American with 8 percent.

European officials strongly condemned Trump's decision. The sudden move caught them by surprise, and they suspected it was politically motivated. In a short statement co-signed by European Commission President Ursula von der Leyen and European Council President Charles Michel, the European Union expressed its exasperation:

"The European Union disapproves of the fact that the US decision to impose a travel ban was taken unilaterally and without consultation.... The Coronavirus is a global crisis, not

limited to any continent, and it requires cooperation rather than unilateral action.”

(“EU Condemns Trump Travel Ban From Europe as Virus Spreads,” Associated Press, Mar. 12, 2020, <https://www.usnews.com/news/business/articles/2020-03-12/eu-as-sessing-trumps-travel-ban-from-europe-as-virus-spreads>)

Sara Nelson, president of the Association of Flight Attendants, the union that represents United workers, said that the airline industry was “pretty blindsided” by Trump’s announcement. There is widespread fear about job losses among flight attendants, Nelson said. “The trajectory that this is on right now is beyond job loss, it’s about whether or not the industry can actually operate.”

Several major airlines have entered bankruptcy protection in the last two decades. Now, says Helene Becker, an airline analyst with Cowen,

“The airlines are in cash preservation mode, and we fully expect to see credit facilities extended and increased in the next week. We previously stated US airline bankruptcies were unlikely and in the near-term that still remains the case, BUT if bookings do not improve in the next three months things could deteriorate quickly.”

United borrowed \$2 billion this week. American raised \$500 million two weeks ago, and Delta borrowed \$1 billion last week.

In addition to the US travel ban, which covers the 26 European countries that make up the Schengen Area, the State Department has told Americans that they should “reconsider” all international travel, which is the most severe caution it can issue, short of “do not travel.”

(“Airline Shares Drop Sharply After Trump Imposes Travel Limits,” *New York Times*, Mar. 12, 2020, <https://www.nytimes.com/2020/03/12/business/economy/coronaviru>

[s-airlines-trump-europe.html](#))

Already in late January, the US had imposed new travel restrictions that prohibit foreigners who have been in China in the last 14 days from entering the United States.

("Airlines scramble to enforce new coronavirus travel restrictions in 'imperfect system'," CNBC, Feb. 3, 2020, <https://www.cnbc.com/2020/02/02/coronavirus-airlines-scramble-to-enforce-us-travel-restrictions.html>)

Travel to Asia has obviously been the most affected, to date. On March 10 the Global Business Travel Association reported that its member companies had canceled or suspended "all" or "most" business trips to China (95%), Hong Kong (87%), Taiwan (79%), and other Asia-Pacific countries (e.g., Japan, South Korea and Malaysia) 77%. Business travel to the Asia-Pacific region had fallen by 71% since the GBTA's last survey on Feb. 24.

("New GBTA Research Shows Coronavirus Continues to Impact the Business Travel Industry," Global Business Travel Association, Mar. 10, 2020, <https://www.gbta.org/blog/new-gbta-research-shows-coronavirus-continues-to-impact-the-business-travel-industry/>)

Korean Air warned on March 10 that COVID-19 could threaten its very survival. President Woo Kee-hong said the airline could not predict how long the crisis would last, "But if the situation continues for a longer period, we may reach the threshold where we cannot guarantee the company's survival."

("Korean Air president: Virus threatens airline's survival," *Straits Times*, Mar. 11, 2020, <https://www.straitstimes.com/business/companies-markets/korean-air-president-virus-threatens-airlines-survival>)

Cathay Pacific, Hong Kong's flagship airline, announced that capacity reductions for February and March would shrink by 40 percent instead of the 30 percent previously expected; and the airline said it was likely to extend flight reductions into

April.

("Hong Kong's flagship airline Cathay Pacific warns of significant drop in year-on-year performance in the first half of 2020 amid poor travel demand caused by coronavirus outbreak," *South China Morning Post*, Feb. 17, 2020, <https://www.scmp.com/news/hong-kong/transport/article/3051029/hong-kongs-flagship-airline-cathay-pacific-warns>)

Qantas, Australia's biggest carrier, is reducing international flights by nearly 25%. The airline has projected that COVID-19 will cost it A\$150 million (US\$100 million) through the end of June.

("Coronavirus: Asian airlines set to lose US\$27.8b as demand for flights shrivels amid outbreak," *South China Morning Post*, Feb. 21, 2020, <https://www.scmp.com/news/china/article/3051680/coronavirus-asian-airlines-set-lose-us278b-demand-flights-shrivels-amid>)

In Europe, ACI Europe, which represents European airports, said it expected passenger numbers between January and March to drop 14% – and that was before the Trump travel ban. Europe-US routes account for 20 percent to 30 percent of major European airlines' revenue and a majority of their profit.

("Airline crisis worsens over Europe travel restrictions amid coronavirus outbreak," *New York Post*, Mar. 12, 2020, <https://nypost.com/2020/03/12/airline-crisis-worsens-over-europe-travel-restrictions-amid-coronavirus-outbreak/>)

Aviation consultant John Strickland said that a number of European carriers risked collapse. "As we saw with Flybe, some airlines, particularly smaller ones, can bleed through money quite quickly. Although they've cancelled flights, they aren't making up those revenues because of falling customer demand."

("Coronavirus: Airlines cancel thousands of flights," BBC, Mar. 10, 2020, <https://www.bbc.com/news/business-51818492>)

Half (51%) of Global Business Travel Association members report canceling or suspending all or most business travel to

Europe, up from 8% ten days ago.

Flybe, Europe's biggest regional carrier, collapsed into bankruptcy after Britain rejected its request for a £100m government loan.

("Flybe collapses as coronavirus hits aviation industry," *Telegraph*, Mar. 5, 2020, <https://www.telegraph.co.uk/business/2020/03/05/flybe-collapse-s-government-pulls-100m-loan>)

Air France-KLM has warned that COVID-19 may erase €200 million (US\$216 million) from its earnings by April, but said that it was preparing for an escalation of the losses if China flights don't resume by then. The company expects to cancel 3,600 flights in March and cut capacity in its European network by 25%.

("Air France Will Cancel 3,600 Flights in March over the Coronavirus. It's Going to Get Worse for Airlines," *Barron's*, Mar. 10, 2020, <https://www.barrons.com/articles/air-france-will-cancel-3-600-flights-in-march-over-coronavirus-its-going-to-get-worse-for-airlines-51583837901>)

Lufthansa is slashing capacity by as much as 50%, has requested German government support, and has entered into talks to avoid layoffs.

("Lufthansa Seeks Government Support Amid Coronavirus Hit," *Bloomberg*, Mar. 9, 2020, <https://www.bloomberg.com/news/articles/2020-03-08/lufthansa-mulls-seeking-government-aid-amid-coronavirus-hit>)

Norwegian Air is laying off half of its employees, and its stock plunged 16 percent on March 12, the day after the US travel ban was announced.

Travel to North America has been canceled or suspended by 18% of companies – up from 2% ten days earlier, while 30% of companies have suspended or canceled travel to Latin America,

up from 3% as of ten days ago. Nearly half (47%) of companies have canceled or suspended business travel to the Middle East, compared to only 8% in the GBTA's previous poll.

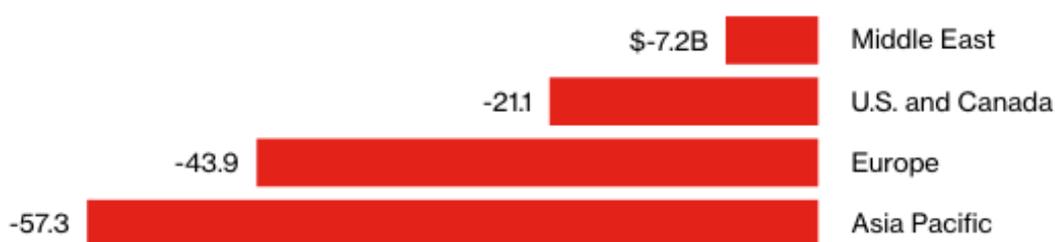
("New GBTA Research Shows Coronavirus Continues to Impact the Business Travel Industry," Global Business Travel Association, Mar. 10, 2020, <https://www.gbta.org/blog/new-gbta-research-shows-coronavirus-continues-to-impact-the-business-travel-industry/>)

Globally, projections of lost airline travel revenue this year range from \$63 billion in a "limited spread" scenario to \$113 billion if the spread of the virus is "extensive," said the International Air Transport Association (IATA) in a March 5 press release. IATA notes that losses in the latter case would be roughly equivalent to what the airline industry suffered in the global financial crisis of 2007-08.

("IATA Updates COVID-19 Financial Impacts -Relief Measures Needed-", IATA, Mar. 5, 2020, <https://www.iata.org/en/pressroom/pr/2020-03-05-01/>)

### Red Skies

Global airlines may lose \$113 billion in revenue this year due to the coronavirus



Source: International Air Transport Association

Note: Data adjusted for route overlaps. Estimates based on an "extensive spread" scenario.

These mid-March data points and projections are already extreme for an industry that has struggled, but who can say where the figures will be in another couple months, as COVID-19 continues to sweep into every corner of our nation

and our planet “with the speed of a sports car or a smaller airplane.”

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