CERTAIN SECTORS HAVE A HIGHER SENSITIVITY TO EUROPE'S RECOVERY

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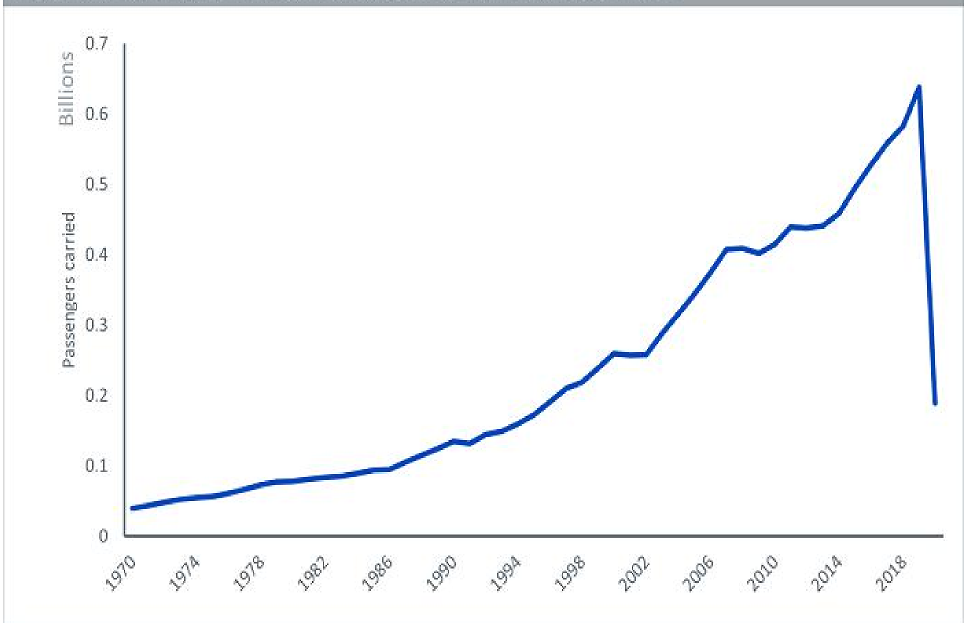
In the market crash of March 2020, European stock indices lost about seven years of gains[1]. European airlines, however, lost 25 years of gains in passenger numbers.

The notion that airlines experienced meaningful turbulence during the pandemic would hardly surprise anyone. The extent of the damage done, however, might be a detail many aren't aware of. For tactical investors, this presents a potential opportunity.

So let us start with Europe's travel and leisure sector. The sector contains three main types of businesses. First, airlines. While all sectors classified as 'consumer discretionary' were impacted by the jolt to spending patterns during the pandemic, things were meaningfully worse for airlines. There were outright bans on travel. Air transport passengers carried in the Euro area fell by 70% in 2020 (see figure 01 below).

Figure 01: Euro Area air transport passengers carried fell sharply in 2020



Source: Bloomberg, data as of 21 February 2022.

Hotels, resorts, and restaurants are the second type of businesses in the sector. Fewer people flying naturally meant fewer people staying in hotels. This may have been somewhat offset by people going on more domestic holidays but that only partially cushioned the blow. Hotel occupancy rates for Europe fell from over 70% in 2019 to under

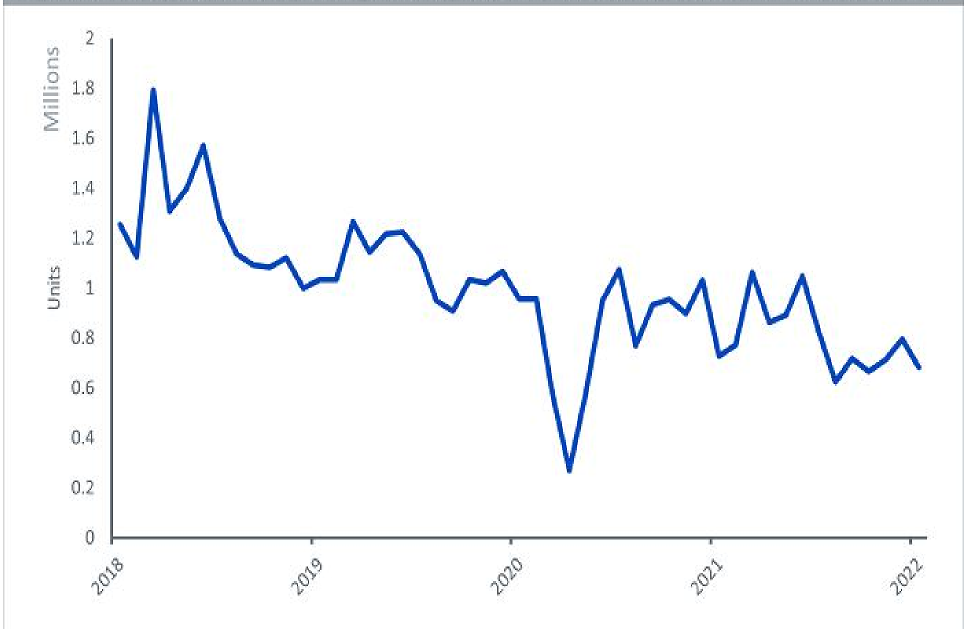
30% in the first half of 2020[2].

The only real cushion was offered by the third type of businesses in the travel & leisure sector – online gaming and betting companies. Well, there more people at home with more time at their disposal, and fewer options for entertainment. But then again, this subsector is relatively small compared to the other two.
Overall, therefore, travel & leisure's trajectory versus with the broader market can be described by the following: 1. A larger initial drawdown, 2. Slower and incomplete recovery, and 3. Higher volatility.

But now that things are beginning to improve, the sector may benefit from what economists refer to as 'pent-up demand'. Everyone else simply refers to the phenomenon as 'people going on more holidays and business trips'.

Let's move on and discuss another sector in which the brakes were slammed – automobiles. Buying a new car, in most cases, is discretionary spending. And when the world was engulfed in economic uncertainty during the pandemic's first wave, this discretionary spending was immediately slashed. New car registrations collapsed (see figure 02 below).

Figure 02: Europe's monthly passenger car registrations have yet to recover from the 2020 shock



Source: Bloomberg, data as of 21 February 2022.

But the sector's afflictions weren't over when people started browsing cars again (yes ordering cars online became a thing in the pandemic). Unfortunately, when demand returned, supply had taken a more lasting hit. Automobile manufacturers found themselves short of semiconductor chips. Consumers have had to wait months for deliveries. Things didn't improve in 2021, but there is hope in 2022. According to Gartner, the global chip industry committed to spending $146bn in 2021, up by around one third from 2020[3]. Although only one-sixth of this will go towards legacy chips, such as those used in cars, the additional investment will still help ease the supply situation this year.

Now, an astute observer may also ask how Europe's automobile sector might be affected by the rapidly accelerating switch towards electric vehicles. The answer is that all automobile manufacturers are going electric. Ferrari and Maserati enthusiasts might need to get used to an artificial revving noise. Parts manufacturers will just adapt. But given how quickly manufacturers have embraced impending bans on internal combustion engine vehicles, and responded with a proliferation of electric vehicles, it appears the sector will not only endure the transition but thrive as a result.

So, two sectors crashed particularly hard in the last two years – travel & leisure, and automobiles & parts. If 2022 is the year when the pandemic becomes endemic, i.e., restrictions come to an end and 'normalcy' resumes, people are likely to spend more on being out and about – in cars, planes, restaurants, cruise ships, and hotels.

Tactical investors are unlikely to let these changing dynamics go unnoticed.

Sources

[1] Based on the performance of the Euro Stoxx 60 Index.

[2] Source: Fitch Ratings

[3] https://www.motortrend.com/news/automotive-car-industry-semiconductor-chip-shortage-reasons-solution

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