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COMMENTARY

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Service Industry Eagerly Awaits Summer Vacations

- The travel industry is expected to grow revenues as travel picks up.
- Headwinds, such as inflation, will take a bite out of bottom lines though.
- Overall, trend to services over goods should continue.

The pandemic began in the U.S. in early 2020 and triggered a first-time ever services-led recession. Fearful of the pandemic, Americans hunkered down in their homes and generally avoided travel. Instead, they spent significantly on goods such as televisions, refrigerators, and exercise bikes. With hopeful signs that the pandemic is reaching endemic status, Americans have packed their suitcases, dusted off their swimming trunks (or bought new ones that fit better), and purchased suntan lotion in anticipation of summer travel. Almost universally, travel is expected to surge, and this is reflected in travel-related businesses. With the jump in demand, airlines, hotels, car rental companies, and dining establishments will likely see a surge in their top line growth, however, higher input costs may pressure profit margins' bottom lines if they cannot pass these costs onto consumers.

The travel-related industries are following suit. They are tuning up their planes, fluffing the pillows in their hotel rooms, and washing their rental car fleets in anticipation. This summer will likely prove to be one of the strongest in terms of travel that we have seen in such a long time. With over 66% of Americans fully vaccinated, they are feeling confident. Many have already purchased much of the consumer goods they desire, and their spending habits have now shifted from "Zooming" in their home offices to zooming across the globe. Let's take a deeper dive into what's expected in these travel industries.

Airlines will be huge beneficiaries this summer and they are already seeing benefits. Travelers are indeed flying more, as evidenced by TSA checkpoint travel data. The number of travelers is well off 2020 lows and some days are even exceeding 2020 levels now. April's CPI report showed that airline fares surged 18.6% month-over-month and 33.3% year-over-year on this demand and higher fuel costs. Although higher fuel costs are also impacting profit margins, the jump in fares, record levels of bookings, a pick-up in business travel, and CEO optimism from the major carriers suggests that airlines should be in a great spot this summer.

Travelers need to stay somewhere, so the hotel industry should also be a beneficiary. Not only is leisure travel picking up quickly, but demand from business travelers continues to get stronger. Based on data from STR, though still below comparable pre-pandemic levels, occupancy rates are rising fast. This has and will allow hotels to raise prices quickly and they are doing so as average daily room rates and revenue per available room are 10.5% and 4.1% higher than pre-Covid 2019 levels, respectively. The April CPI report also verified this new pricing power of hotels. There, we continue to see a year-over-year surge in "Lodging Away from Home." This surge in revenues should benefit the hotel industry if these trends remain in place.

To get summer travelers from the airports to their hotels, car rental agencies will also see a surge in demand. Though revenues will likely pick up, they may be limited due to supply availability. When people stopped traveling and renting cars during the pandemic, rental agencies sold off their excess fleets. Unfortunately, as business and demand have picked up, the supply chain constraints of new cars have impacted their ability to find and purchase inventories. Rental car companies used to pick up excess inventory from auto manufacturers. However, the well-documented supply chain issues have impacted the ability of car companies to manufacture cars. The good news is that recent data suggests supply chains are improving and car manufacturers are getting the assembly lines moving again. However, this will take some time to help the rental car fleets and profit margins could be impacted.

One last area we should not forget is food. After all, throughout their summer vacations, travelers need to eat. Restaurants will likely be another beneficiary; however, staff shortages and rising food prices will likely impact profit margins. Furthermore, older Americans are still a bit hesitant to eat out given lingering COVID concerns. With the uncertainty around surging food prices and poor service levels, expect a choppier profit trajectory for restaurants.

While we painted an optimistic and enthusiastic picture for the summer travel season, there are significant overhangs. High inflation will likely crimp consumer spending, especially for lower income households. Though the labor picture remains strong, the Fed's attempt to rein inflation in via reduced monetary stimulus will likely impact the economy throughout. Higher borrowing costs, for example, may limit the amount of excess discretionary spending consumers have for vacations. Furthermore, uncertainty around Fed policy will likely weigh on the stock market, leading to significant market volatility for some time. Because a significant amount of consumer wealth is in equity markets, this uncertainty could also weigh on summer spending. Consumer spending continues to hold up well, but there are some signs that spending growth is slowing from elevated levels.

So, while the optimistic picture for the travel industry is not all clear skies and smooth roads, it still should shape up to be a good year for the industry. Overall, we expect the trend from consumer spending on goods to services to continue. It is an important reminder that industries that have led us out of the recession and done well recently may not the be the future growth leaders. Investors must continue to look to the future for opportunities rather than chase past winners.

This report is created by Cetera Investment Management LLC. For more insights and information from the team, follow @CeteraIM on Twitter.

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