The Vaccine rally: right and wrong?

As I write this, stocks are absolutely screaming higher on the positive Pfizer vaccine news from this morning.

Obviously, the news is great for humanity. But you know who it's even better news for? The COVID losers! Pfizer vaccine showing efficacy means that, at some point in the future, COVID can be controlled / contained and the world can get back to normal. And the COVID loser stocks are all responding to that; the S&P 500 is up ~3% today, but almost every airline, cruise company, office REIT, etc. is up 15-20% or more on the news. Pfizer's stock is up <10% on the news, so the COVID loser stocks are actually bigger beneficiaries of the vaccine than Pfizer!

It makes total sense that the COVID losers should be screaming higher on the vaccine news.... but I can't help but wonder if the market is getting too aggressive with pricing in a recovery for these stocks. Yes, eventually we'll get "back to normal", and the market is pricing that in. Heck, things might get better than normal for a while (I mentioned this in my August links, but I suspect once COVID is under control we'll see a mini-boom in vacation / cruise demand as everyone rushes to make up the trips they missed in 2020/2021). But, even with the Pfizer good news, normal is still a long way away, and until we get there these companies continue to burn money (CCL is burning $530m/month!) and their assets continue to lose value from depreciation.

If this year has proved one thing, it is that the market is a discounting mechanism. With interest rates at zero, the market is willing to project forward far, far into the future to look at a normalized environment. Over the summer, a lot of investors (including myself!) got worried looking at the market and seeing the stock price recovery for a lot of COVID exposed names (or just the market in general). Unemployment was skyrocketing, it was clear that these companies weren't going to be able to open for (at minimum) months, and until the companies could reopen fully they would burn huge sums of money. A look at the company's balance sheets made clear they'd need to raise money at some point. Combine an awful near term environment with the need to raise money, and it became really tough for a lot of investors (again, including me) to invest in these stocks. They just became too reflexive; if the market let them raise money at the right price, then the stocks were really cheap on outyear "normal" valuation. But if the markets wouldn't let them raise money, they could very easily be zeros.

Once markets stabilized from the March lows, it turns out that the market was wide open to these companies. They've been able to raise huge sums of money looking out to the normalized earnings environment a few years out, and their stocks have generally been big winners even before the COVID news.

I highlight that background just to hammer home one point: I understand the market can look through a bleak near term environment to see longer term earrings. And I get that a lot of today's move is based on the combination of a Pfizer vaccine showing a normal world is both possible and probably a little closer to the present than we thought.

Still, I can't help but wonder if the markets move today is taking a lot of these stocks too far.

Consider the cruise lines: while all of their stocks have been hit hard this year, their enterprise value hasn't moved that much (down 5-15% YTD). That doesn't seem close to right to me; these companies are burning billions of dollars and their assets are depreciating as they sit idle, they will continue to do so until the environment normalizes, and they've locked in extremely expensive and/or dilutive financing to get them to the normal times. Look at RCL: Bloomberg has their EV down only $2.5B from ~mid-February (and I suspect it understates their EV given the October stock issuance at prices significantly lower than current!). They should burn in excess of $5B this year, and I suspect they'll burn several billion dollars next year. If their EV is down less than their cash burn this year, isn't the market effectively saying that their remaining operations have increased in value? That seems crazy! Again, their assets continue to experience depreciation while they sit idle, and they've locked in a ton of extremely expensive financing. It seems obvious that the company is worth less today than it was a year ago, but the market is suggesting the opposite!

The poster child for this phenomena is probably AMC. AMC is issuing shares at an absolutely furious rate to fund their current cash burn. If you look at their 10-Q, they had ~137.3m shares out at the end of October. That compares to <110m shares at September 30 and <104m at the start of the year. All told, AMC went into this year with an EV of <$6B. They'll almost certainly burn >$1B this year, and they'll have locked in some insanely expensive financing. Despite that (and an unknown future given how much movie producers have experimented with straight to VOD), the company seems set to increase their EV this year. How is that possible?

Perhaps the market is right. Maybe all of these companies emerge into a new normal where a lot of their competition has been decimated, and they get a few years of super-normal profits (just to use an example: maybe AMC can make it to the other side, but every mom and pop theater can't, so AMC emerges into a world where there are much fewer competitive theaters). Combine that landscape with lower interest rates and maybe these businesses actually are worth more today than they were a few years ago.

It's possible.... but it feels unlikely. The market simply feels too bullish on some of these "Covid losers recovering" plays. I think there are still plenty of opportunities to buy stocks beaten down by COVID at a discount, but there are a lot fewer today than there were a week ago (which is obvious, given the massive run!) and I suspect there are a lot of overvalued COVID recovery plays.

PS= one last thing while I'm here: the flu vaccine is apparently ~50% effective. The Pfizer vaccine showed >90% efficacy. How is that possible? Small sample size? The Pfizer vaccine requires more shots / management, so it's more effective? Something else? I'm sure an answer is out there; if you know I'd be interested!