Cetera® Investment Management LLC

The Travel Recovery

It's Been a Long, Strange Trip

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Peak August heat is setting in and the weather isn't the only thing that is a scorcher right now. **The travel economy is red hot.** Tourism was in a drought during the first few years of the pandemic, but things are heating back up as more people warm up to traveling again. The travel and leisure sector is an important part of the service economy. It's also sensitive to the economic cycle and can provide a pulse on the health of consumers in real time. Despite several headwinds the last few years, the travel economy stayed in the fast lane on the road to recovery. In this commentary we will take a journey through the travel economy and look for clues about what's next to come. Buckle up and join us for a ride.

You have likely heard forecasts about a recession on the horizon. While it is quite possible, there are reasons to believe we may not have one in the near-term. And if we do, it may be mild. One of those reasons is in "plane sight."

The travel and leisure industry is booming.

On the Road Again

Paving the Way. The U.S. National Highway System has roughly 160,000 miles of highways. Overall, the United States has an estimated 4 million miles of roads. The economic impact of the expansive American road network is difficult to measure, but it paved the way for coast-to-coast economic expansion.

The Main Street of America. No highway in America is more iconic than Route 66. The 2,400-mile route from Chicago to Los Angeles opened in 1926 and spans a diverse landscape through eight states. It was never the longest or most traveled route in the U.S. but is easily the most famous. Route 66 is the perfect drive if you're interested in traveling to another era.

Sightseeing. In addition to Route 66, other popular road trips in the U.S. include the Pacific Coast Highway from California to Washington, the Road to Hana in Maui, the Blue Ridge Parkway in the Smoky Mountains, and the Overseas Highway through the Florida Keys.

All Roads Lead to Rome. The Roman empire had a vast network of roads covering about 250,000 miles (including 50,000 paved miles) throughout Europe, Northern Africa, and the Middle East. Roman roads were used for trade and transportation, but the primary purpose was for military use. Sections of original roads and bridges remain to this day and some of the network is used for modern highways.

Traveling at Different Speeds

This economic expansion has been anything but normal. Different parts of the economy have cycled through this expansion at vastly different speeds. The travel and leisure sectors took a back seat in the initial stage of the expansion when the goods economy was in the driver's seat, largely because of the environment we were in. Early in the pandemic the goods sector experienced tailwinds resulting from stimulus checks and Covid-19 restrictions. There was a bounty of discretionary savings and limited options to spend within the service sector at the time. In the first year of the pandemic, spending surged in categories such as bikes, boats, and recreational equipment.

Overall, consumer goods spending jumped 23% by March 2021 when compared to pre-pandemic levels. Since then, consumer goods spending has leveled off when adjusted for inflation, while service spending growth has been on an upward trajectory. As travel restrictions lessened and consumers felt more comfortable going out for dinner and taking a vacation, the travel and leisure expansion took off. Consumers are the driving force of the economy, accounting for roughly two-thirds of GDP growth. Spending on services was about 69% of consumer spending before the pandemic. While that figure dropped in the initial stages of the pandemic when goods spending took off, services spending recovery has driven service consumption to 67% of total spending as of May.

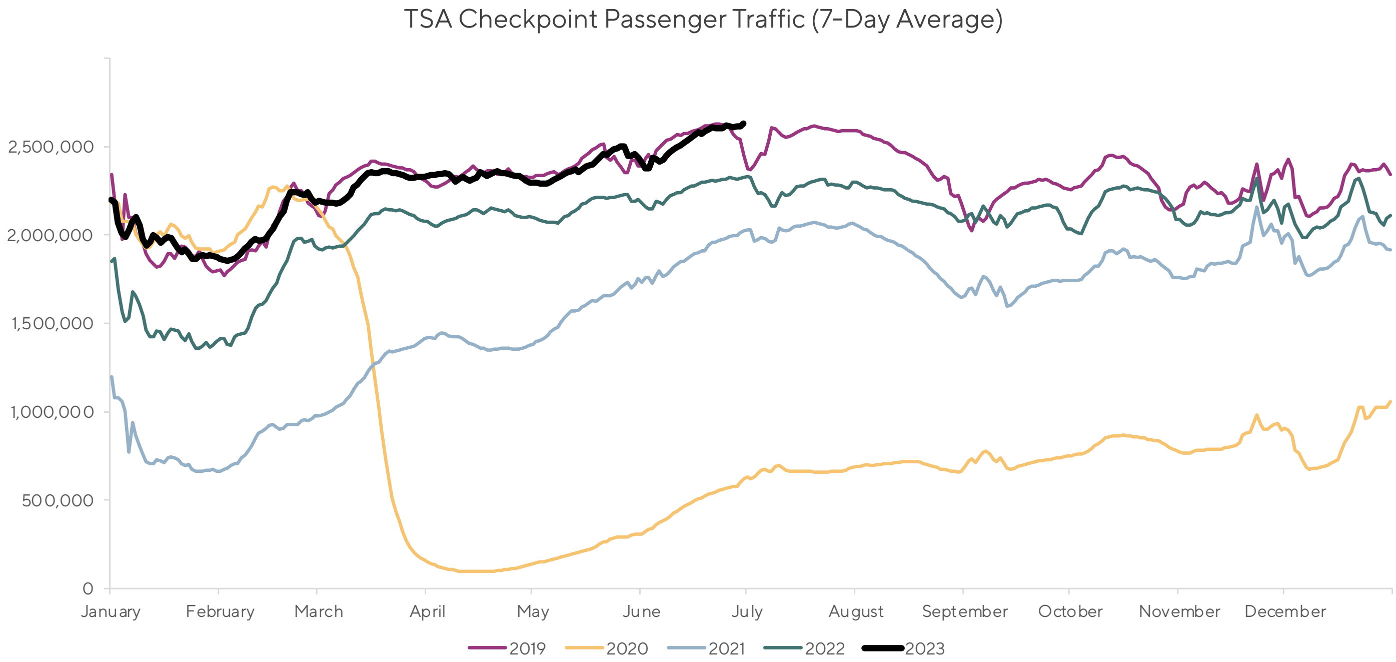
Consumption patterns are normalizing but the pandemic, and a unique economic recovery, created several strong headwinds including high inflation, global supply chain issues, and product shortages. Though consumers are dealing with higher borrowing costs as the U.S. Federal Reserve is on an aggressive path of interest hikes to slow inflation, that impact hasn't been felt in the travel sector. It's still recovering in the fast lane.

Cleared for Takeoff

Domestic air travel is back. Last year airlines struggled to keep up with rising demand, dealing with staffing issues and getting their fleets fully in service, which led to many notable delays. Based on TSA air passenger throughput figures, air travel in 2022 was about 90% of 2019 levels. That was a big improvement from 2021 when air passenger throughput was 68% of pre-pandemic figures. Pent-up demand for travel remains, and an average of 2.27 million passengers have flown per day in 2023 through June 30, slightly ahead of 2019 levels through the mid-point of the year.

Notably, more people flew domestically on June 30 (the Friday ahead of July 4) than any day in history, according to TSA. The previous record was the Sunday after Thanksgiving in 2019. If you've been to an airport this year, you know that long lines and packed flights are the norm. Busy airports can be stressful, but it's a good sign for the economy. Lingering inconveniences aside, it's hard to appreciate where we are today without seeing the recovery in air travel over the last three years, as shown in **Figure 1**.

Figure 1: Air Travel Recovery



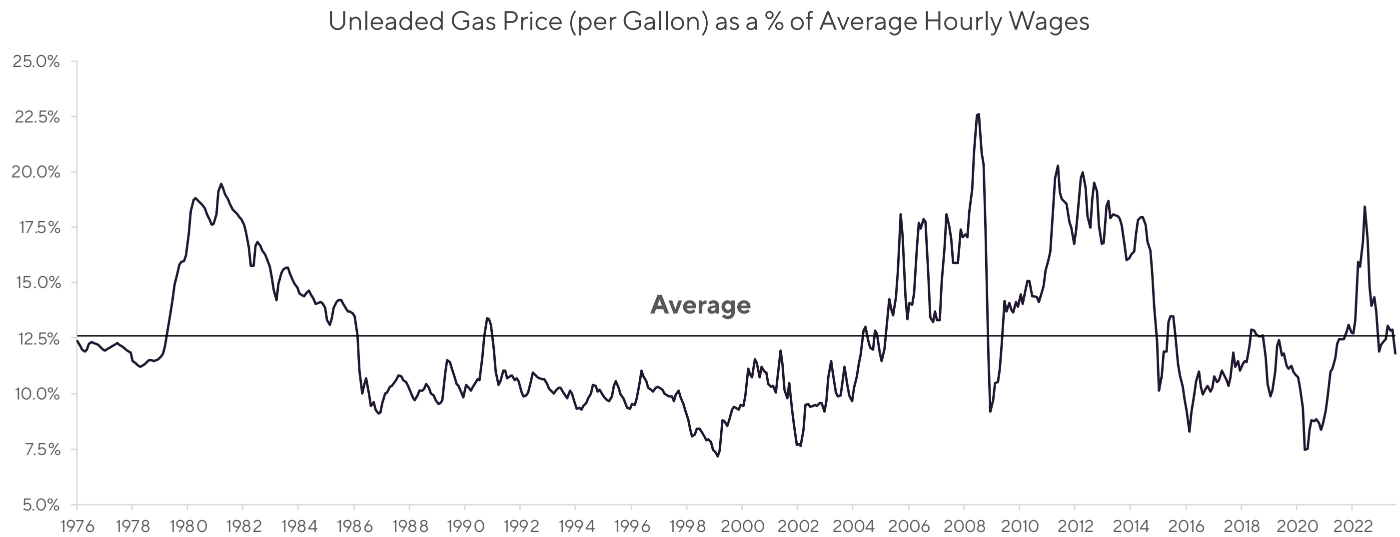
Source: Cetera Investment Management, Transportation Security Administration (TSA). Data as of 6/30/2023.

International air travel, on the other hand, still hasn't fully recovered, though air traffic is flying higher this year compared to the last few years. Through the first six months of 2019, there were an average of 3.15 million monthly non-resident arrivals into the U.S. In 2023, the monthly average through June is 2.27 million, or 28% below 2019 levels. There is still room for growth to get back to pre-pandemic levels. Compared to 2022 figures, international arrivals are up 42% this year, but they are up a whopping 368% compared to the first six months of 2021. Air travel has grown by leaps and bounds since planes were grounded in March 2020. Though we went through a lot of turbulence, clear skies have emerged, and the airline recovery continues to climb.

Roadtrip Anyone?

The most popular way to travel in the U.S. is by car. The 4th of July weekend alone saw an estimated 50 million Americans hit the road to travel more than 50 miles to their destination.[1] Road trips aren't as expensive at the gas pump as they were last summer. Retail gas prices peaked at a national average of $5.01/gallon in June 2022, but as of July, the national average is 32% lower at $3.40/gallon. It's still above the average of around $3 a gallon in July 2021, but easing prices have made it easier on the pocketbook to fill up the tank when compared to last summer. If you adjust fuel prices relative to the average hourly wage, gas prices are slightly below the historical average of 12.6% dating back to 1976 **(Figure 2)**. This figure doesn't factor in fuel mileage, which has improved over time.

Figure 2: Gas Prices Relative to the Average Hourly Wage Wages



Source: Cetera Investment Management, FactSet, Federal Reserve Bank of St. Louis, U.S. Bureau of Labor Statistics, U.S. Department of Energy. Unleaded Gas Price is the national average ($/gallon) of unleaded regular gas. The average hourly wage is represented by the average hourly earnings of production and nonsupervisory employees. Data as of 7/7/2023.

Vehicle miles traveled is still recovering. It's around 3% lower than the pre-pandemic level because of dynamics around working from home, resulting in fewer commutes to the office. However, the number of people taking a road trip around holidays is still speeding up.

Sail Away

Not everyone is a land lover, and many prefer to vacation on the open waters. According to the Cruise Lines International Association, the number of cruise ship passengers is forecasted to exceed 2019 figures this year.[2] They project 31.5 million passengers in 2023. The swift recovery of the cruise ship industry is truly amazing considering it was impacted by the pandemic more than any other sector. The industry was shut down in the U.S. for 15 months and many travelers were hesitant to return to cruise ships when restrictions were lifted because of health concerns. Thanks to a resurgence of demand, the cruise ship industry is no longer sailing through choppy waters. According to AAA, the most popular destinations for Americans are Alaska, Hawaii, Mexico, and international ports in the Caribbean and the Mediterranean.[3] If you decide to book a late summer or early fall cruise, don't forget to bring motion sickness pills and plenty of sunscreen. For a natural alternative, you might want to try ginger. Thank us later.

Help Wanted

Employment in the leisure and hospitality sector was decimated at the onset of the pandemic. Total employment in this sector fell by 8.2 million in only two months, dropping to the lowest level since 1988. With such a big hole to dig out of, the labor recovery for leisure and hospitality jobs wasn't as swift as the overall labor market, and total employment in this sector still hasn't reached pre-pandemic levels. As demand for dining out and travel increased and the shortfall in service workers persisted, wage growth for leisure and hospitality jobs rose fast in attempt to draw more workers back.

In 2021, for example, wages in the leisure and hospitality sector surged 14%, well ahead of wages for the total private sector labor force (+5%). Higher wages were successful in bringing more individuals back into the sector. Leisure and hospitality employment increased by a combined 3.5 million in 2021 and 2022, or 29.3% of total employment growth over this period. It's an impressive figure considering leisure and hospitality is only 10.6% of the total labor force. A supply and demand mismatch remains, but it is narrowing, and job openings are easing in this category. The bulk of the recovery for leisure and hospitality employment is behind us. More subdued job growth is expected moving forward.

Are We There Yet?

The only thing that will slow the travel sector down at this point is a recession. Consumers have whittled away at excess pandemic savings, but there is still an estimated $500 billion left according to the Federal Reserve Bank of San Francisco.[4] Moreover, consumer debt obligations remain manageable. Approximately 9.6% of total U.S. net of tax income is used for paying down debt. The average since 1980 is 11.2% and the peak was 13.2% in the fourth quarter of 2007 right before the great financial crisis. Meanwhile, consumer balance sheets are also in good health. In earnings calls, airline executives have noted how much pent-up demand remains for travel and how bookings for summer travel were earlier than normal. Inflation hit most areas of the economy, and the tourism industry is no different, yet inflation couldn't squash the travel bug. Job losses did, however. For now, the labor market is still growing well ahead of pre-pandemic figures. Through June, the labor market is growing by an average of 278,000 jobs a month this year. The average in the final two calendar years (2018-19) prior to the pandemic was 177,000 jobs per month.

Fortunes can turn quickly if a recession takes hold, which is a legitimate risk in the next 12 months. The future of this economic expansion will depend on whether it can withstand the weight of elevated interest rates for an extended period. So far, parts of the economy have bent, but the broader economy hasn't broken. The fate of international tourism is in the hands of the global economy. The travel recovery is running strong, and China reopening will likely result in an uptick in tourists visiting our shores. Until time travel arrives, we won't know for certain where this recovery is headed next. The good news is that tourism industry remains strong as we head into the final months of 2023. Optimism is present in the stock market, too. Both the S&P 500 airline index and the S&P 500 hotels, resorts, and cruise lines sub-index are outpacing the S&P 500 by a sizable margin this year.

You Have Arrived at Your Destination

The tourism industry is feeling (almost) normal for the first time in years. It's been a long, strange trip and there is certain to be more adventure around the corner. As we make our way back home, it's a good reminder to always look ahead. Summer isn't over—There are more opportunities to explore before cooler weather sets in. Travel is great, but don't take an extended vacation away from your finances.

Moreover, financial planning is a great way to have a smart approach to saving for travel. The long-term benefits of investing have the potential to boost your travel budget. Your Cetera Financial professional is here to guide you through your financial journey. And who knows, they might have some valuable travel advice as well.

Bon voyage!

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[1] https://newsroom.aaa.com/2023/06/record-breaking-travel-volumes-expected-july-4th-weekend/

[2] https://time.com/6263225/cruise-covid-19-protocols/

[3] https://newsroom.aaa.com/2023/01/cruise-lines-gearing-up-for-strong-year/

[4] https://www.frbsf.org/economic-research/publications/economic-letter/2023/may/rise-and-fall-of-pandemic-excess-savings/

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A diversified portfolio does not assure a profit or protect against loss in a declining market

Glossary

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The S&P 500® Airlines comprises those companies included in the S&P 500 that are classified as members of the airlines sector.

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