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Multi-decade highs in GDP and PMI are a boon for freight markets

April 23, 2021 | 9:10 AM ET

Overview

Freight flows continue to be robust across nearly all modes as the consumer goods spending boom brought on by COVID-19 and stimulus meets an industrial recovery. This is being fed by unstoppable import demand and playing catch-up on low inventory levels. If a shipper wishes to book a ship, a truck or an intermodal container, expect rejections, delays and massive increases in price.

The backdrop for truckload is near ideal as GDP growth in 2021 will be the fastest in three decades. The consumer is on fire. Consumer balance sheet strength, further stimulus and the improving unemployment picture continue to support the consumer's ~50% contribution to truckload volumes. As far as the remaining half of volumes, the industrial economy is starting to materially accelerate given we just saw a 37-year high in the ISM PMI in March.

Due to easy comparisons from April 2020 when the U.S. economy fell off a cliff, current tender rejection adjusted volumes are running up 35.8 y/y. Spot rates nationally inclusive of fuel remain above \$3 per mile and are up 88% y/y. Knight-Swift called for 15% contract rate inflation on its earnings call.

New Class 8 truck orders continue to set records and will negatively impact rates at some point, but that point is looking more like 2022.

Macro indicators (y/y changes)

Industrial prod m/m change	+1.4% (+1.0%)
Total retail sales m/m change	+9.8% (+27.7%)
March U.S. Class 8 orders	40,000 (+422%)
March U.S. trailer orders	27,400 (+75.5%)

Truckload indicators (y/y change)

Tender rejection rate	25.74% (+2,261 bps)
Average dry van spot rate	\$3.08/mi (+68.3%)
LAX to DAL spot rate	\$2.79/mi (+130.6%)
CHI to ATL spot rate	\$2.99/mi (+83.4%)

Tender volumes (y/y change)

Atlanta	631.42 (+61.75%)
Dallas	447.54 (+76.55%)
Los Angeles	388.99 (+94.05%)
Chicago	263.15 (+76.6%)

Tender rejections (y/y change)

Atlanta	27.58% (+2,410 bps)
Dallas	23.43% (+2,118 bps)
Los Angeles	25.51% (+2,328 bps)
Chicago	24.24% (+2,169 bps)

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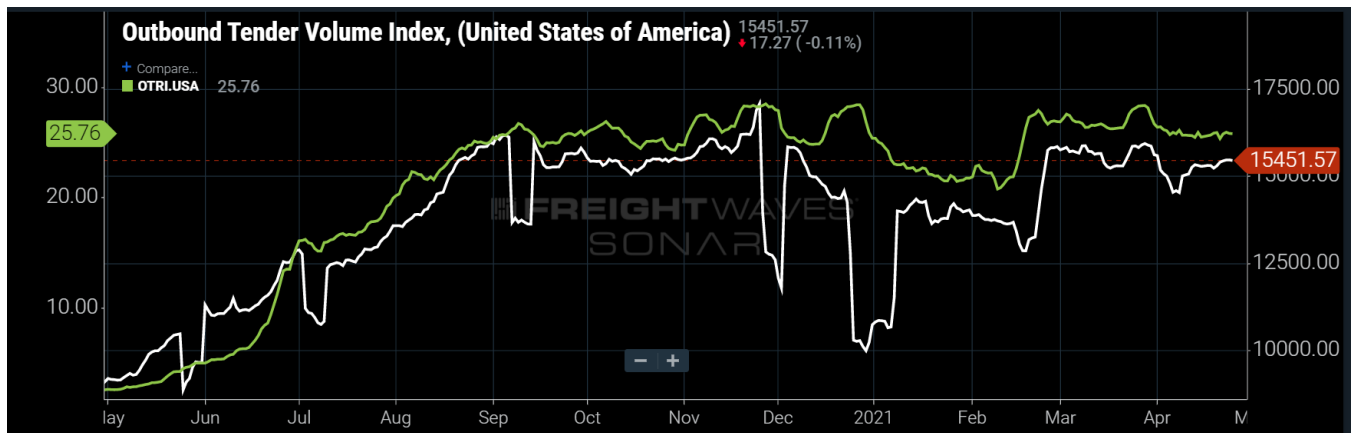
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Truckload markets

Truckload continued the momentum from March through April as volumes remain near all-time highs, tender rejection rates are stable at extremely high levels and trucking rates are above \$3/mi for the second consecutive month.



(Chart: FreightWaves SONAR. National Outbound Tender Volume Index [white] and National Outbound Tender Reject Index [green])

The beginning of April can best be described as sluggish, especially when compared to the end of February and throughout March. Truckload volumes, as measured by the Outbound Tender Volume Index (OTVI), fell by 8.8% between March 28 and April 8. Tender volumes briefly fell below 15,000, which was the lowest level since the winter storm in mid-February that served as another catalyst for tightening capacity and elevated tender volumes. Since April 8, truckload tenders have rebounded more than half of the fall around the Easter holiday, climbing back 4.8% to 15,232.71.

There has been minimal relief to the capacity side of the equation to offset the surge in freight demand that started with the winter storm. The Outbound Tender Rejection Index (OTRI), a measure of relative capacity in the market, has stabilized right at 25%, ranging between 25% and 26% for much of April. Rejection rates over the past month have fallen less than 100 basis points, a minuscule fall during a typically softer period for freight ahead of the summer season.

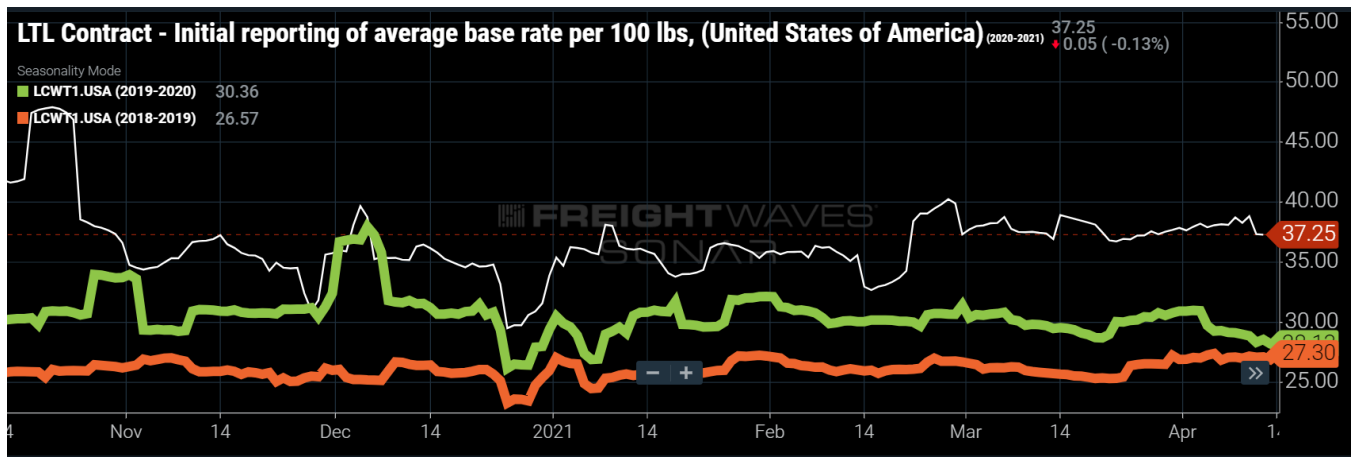
A combination of impacts have yet to occur, which will keep truckload capacity tight for the foreseeable future. The surge in new Class 8 truck orders, more than the annual replacement in just the past six months, is being significantly impacted by the semiconductor shortage as delivery of new trucks is now likely being pushed into the final month of 2021 and even into early 2022.

Further impacts from a proposed infrastructure bill will bring about increased blue collar positions that will keep pressure on driver recruitment and retention, thus making securing truckload capacity more difficult.

In a recent shipper survey conducted by FreightWaves, 73% of respondents believe that truckload capacity will not loosen in 2021. We believe that, while incremental capacity is being added to the market in the form of owner-operators and large fleets adding trucks, the overall strains on capacity

will continue throughout the rest of the first half of the year, with capacity unlikely to loosen until the back half of the year at the earliest and likely not occurring until 2022. Of the shippers that believe that capacity will loosen capacity in 2021, the reopening of the services sector, lower consumer goods demand and a slowdown in the industrial recovery will serve as catalysts as opposed to a bunch of new drivers entering the market.

The difficulty securing truckload capacity that has plagued the market is keeping upward pressure on trucking rates. The national Truckstop.com's market rate, which includes fuel surcharge and other accessorials, continues to hang above \$3/mi, an increase of over 87% y/y as the U.S. economy shut down amid the beginning of the COVID-19 pandemic. Looking at the two-year comparison, current market rates are nearly 50% higher. Contract rates within FreightWaves SONAR, which represent more than \$2 billion in transportation spend annually, are now at the highest level of all time. Since the beginning of February, contract rates have climbed 6% and are expected to continue to climb higher given a rapid correction in capacity is unlikely and freight volumes are healthy through the summer.



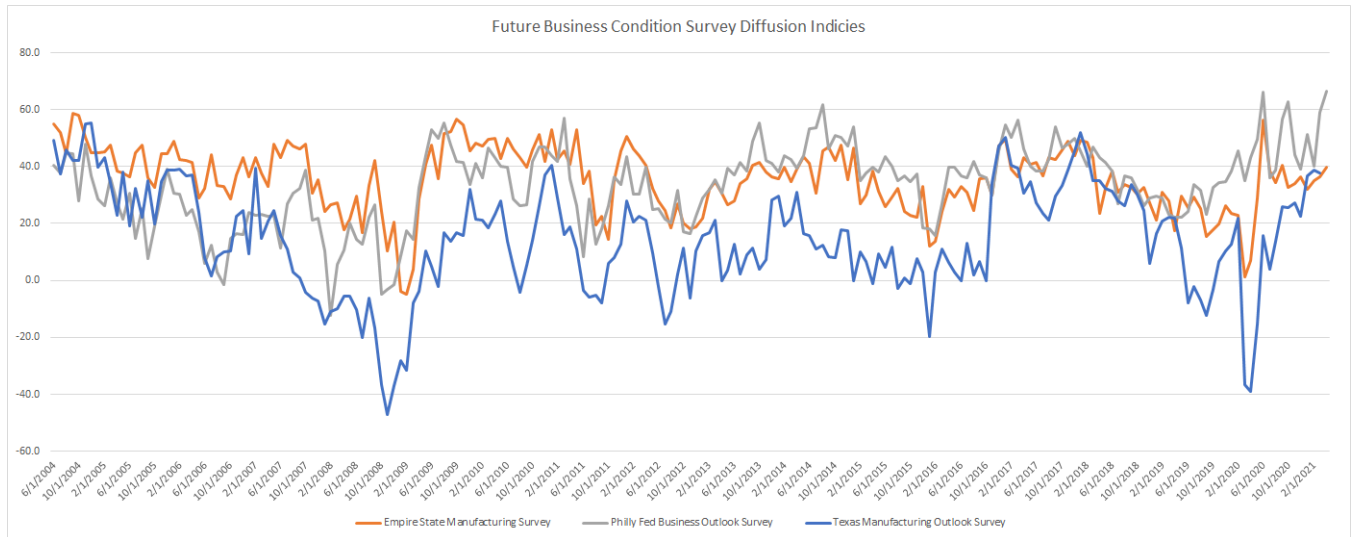
(Chart: FreightWaves SONAR: LTL Contract Price per hundredweight over the past three years: 2021 [white], 2020 [orange] and 2019 [green])

Over the past month, the average LTL contract price per hundredweight has increased by just under 2%, reaching \$38.69, still well below the spikes in LTL contract rates experienced in late September and throughout October. The overall tightness in both the truckload and LTL markets is putting upward pressure on contract pricing.

Consumer spending, following the third round of direct payments in the latest COVID-19 relief bill, is still running extremely high, 14% above 2019 levels, with certain sectors like apparel running ~30% higher than 2019 levels, according to Bank of America credit card spending. The faster slowdown in spending following stimulus checks suggests that individuals could be saving money for travel and leisure activities that pose a risk to overall freight demand.

Macroeconomic conditions

The business sentiment outlook over the next six months is improving across the country as state economies begin to lift COVID-19 restrictions.



(Chart: Regional Federal Reserve manufacturing surveys, Freightwaves analysis; Future Business Activity Diffusion Indices; Dallas Fed [blue], New York Fed [orange] and Philadelphia Fed [gray])

Business leaders in the New York area expect business conditions to improve over the next six months, according to the Empire State Manufacturing survey. The diffusion index, the difference in the percentage of firms reporting expected improvements and those that expect conditions to worsen, jumped 3.4 points in April, reaching the highest level since September. Of survey respondents, 56.2% believe that business conditions over the next six months will improve, compared to the 16.4% that believe conditions are set to worsen.

A vast majority of the respondents expected that the number of new orders will increase over the next six months as the index jumped 3.2 points, as 57.8% of firms believe higher order levels are coming down the pipeline. Conversely, firms are less optimistic about the number of shipments in the upcoming months as the index fell by 3 points, as the percentage of firms that expect lower shipment levels reached 14.9%, an increase of 6.6 percentage points m/m. Firms are less optimistic about increasing inventory levels, as the percentage of firms that expected higher inventory levels fell by 6.1 percentage points to 29.5%.

Manufacturing businesses south of the New York metro area are even more optimistic about business conditions over the next six months, according to the Manufacturing Business Outlook Survey conducted by the Federal Reserve Bank of Philadelphia. In April, the six-month forward-looking general business activity diffusion index increased by 7.5 points as 71% of respondents expect that business conditions will improve compared to just 4.4% that believe that conditions will worsen. The current diffusion index level of 66.6 is the highest level since pre-2004, even surpassing the June 2020 level of 66.3.

While firms are expecting business activity to improve, they also expect that delivery times will lengthen, though the spread between the percentage of firms that expect delivery times to lengthen and those that expect delivery times to fall narrowed significantly in April. The overall delivery time diffusion index fell by 12.9 points to just 3.5, as 17.6% of all respondents expect longer delivery times. A vast majority of respondents believe that the number of shipments will increase over the next six months as the diffusion index jumped to 63, an increase of 9.6 points; 68.1% of all respondents are expecting the number of shipments to increase compared to just 5.1% that expect the number of shipments to decrease.

The outlook in Texas was a little muted compared to the other two regional Federal Reserve banks. The overall outlook for the next six months took a step back in March, responses collected during the last week of the month compared to the first week in the month, as the general business activity diffusion index fell 0.2 points. The overall index still sits well above the historical average and March marked the tenth consecutive month with a positive overall reading — 41.3% of respondents expect that business conditions will improve over the next six months, a 4.6 percentage point decrease from the previous month.

Though there has been a slowdown in the overall index, optimism for the number of shipments and new orders over the next months continues to grow. The diffusion index for new orders increased by 12.3 points, the most of any index reported by the survey; 53.2% of all respondents expect that the number of new orders will increase over the next six months compared to just 8.6% that believe that new orders will slide. The diffusion index for shipments also increased by 5.9 points to 41.9, well above the historical average; 54.3% of firms believe that the number of shipments will increase over the next six months.

The firms that offered comments on the survey all highlighted that the freeze in February continued to impact production and supply chains in March.

March was a strong month on the employment front, adding 916,000 to nonfarm payrolls, according to the Bureau of Labor Statistics, the fastest growth since August 2020, easily beating the Dow Jones estimate of 675,000. Transportation had one of the stronger months, adding 47,500 jobs on a seasonally adjusted basis, an increase of 0.8% month-over-month. The majority of the transportation jobs in March stemmed from couriers, messengers and transit and ground passenger transportation segments, adding 16,700 and 12,800 jobs, respectively. Truck transportation added 3,300 jobs during the month, down 2.2% y/y. While adding jobs across the transportation sector is a positive, both warehousing and storage along with rail transportation continue to trim jobs, falling for the third consecutive month.

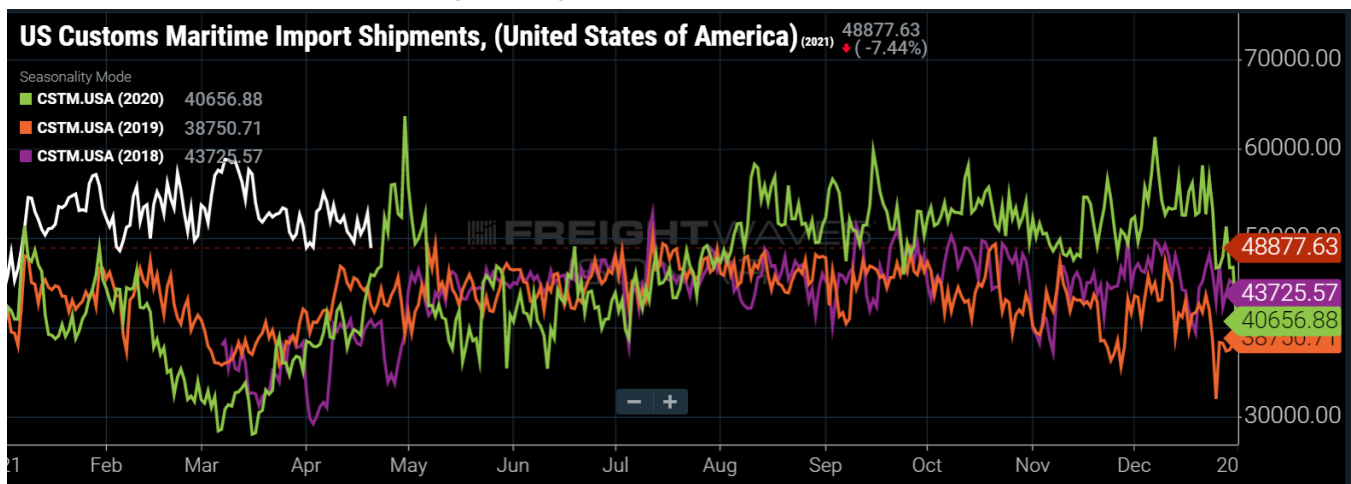
Imports and exports — elevated import volumes, container shortages and lane imbalances persist

U.S. Customs import shipments continue to shine, though comps become increasingly difficult during the beginning of May. During 2020, as China reopened and the U.S. inventories were deeply depressed, total bills of lading surged to begin May before falling off during the summer months. For much of the past month, import shipments have been running up in excess of 10% over 2020 levels and nearly 20% above 2019 levels.

The congestion at the ports still presents many challenges to North American supply chains. The spillover effect from the ports of Los Angeles and Long Beach is not only affecting other West Coast ports, like the Port of Oakland in California, but also East Coast ports, like the ports of Savannah, Georgia; Norfolk, Virginia; and New York/New Jersey. The backlog of ships in San Pedro Bay, awaiting berthing at either the port of LA or Long Beach, has started to work itself out. The number of ships awaiting berth sits at ~20 vessels, well below the more than 40 container ships that were anchored at one point, but still poses quite the challenge for port operations.

While the Southern California ports are playing catch-up, the congestion at the Port of Oakland has worsened. The number of ships anchored awaiting arrival doubled to begin April, sitting at 24 ships in San Francisco Bay as of April 9. While the increased congestion is largely due to the rerouting of ships from Southern California, one of the cranes at the port remains out of commission and will likely remain that way until the end of May.

Import shipment volume passing through customs remains well above seasonal levels.

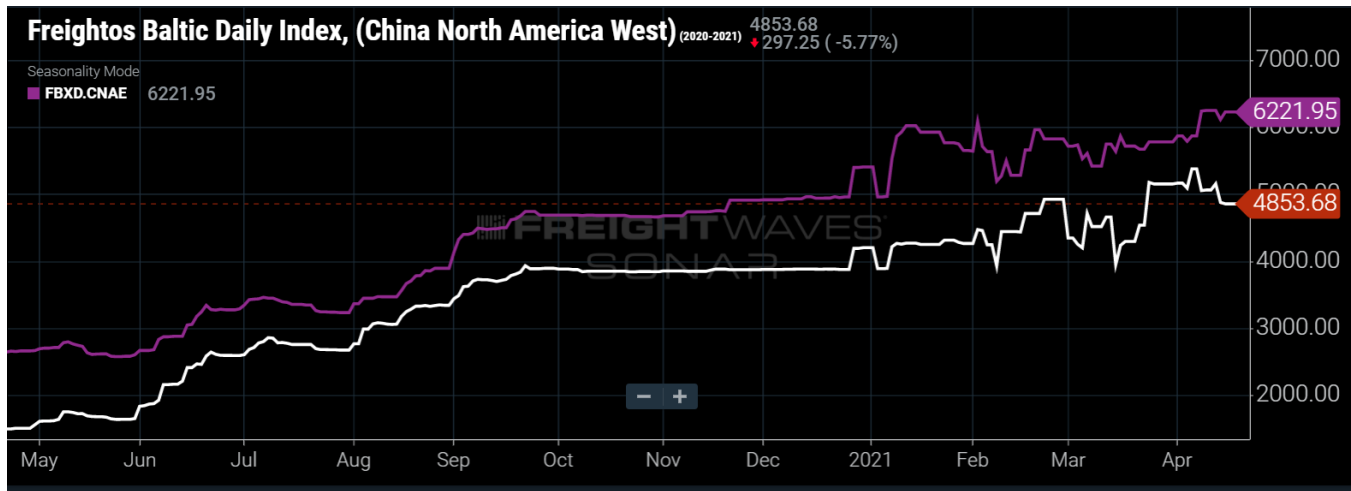


The Inbound Ocean TEU Index, based on bookings data from the point of origin destined for U.S. ports, continues to set new all-time highs. The number of TEUs that have been booked since the beginning of April has risen by over 20% and is expected to continue rising into May. The current level is 8% higher than the previous peak in mid-September ahead of the holiday season. The TEUs that are being booked now are between 15 and 30 days from hitting the ports in normal conditions, but under the current conditions that is even longer.

Additionally, the Suez Canal blockage by Evergreen's Ever Given is adding to the global container shortage given the large delays. While the Suez Canal services a majority of the East Asian to Europe trade, impacts are going to be felt in the U.S., especially those headed to the East Coast, as shippers will struggle to secure container capacity.

Those impacts are showing up in the daily container spot rates that are pictured below as China to the North American rates (white) continue to set new highs. The ocean spread, the difference in the daily container spot rate from China to the East Coast and the spot rate from China to the West Coast, is currently \$1368.27/container, ~20% off the previous high. The China to West Coast spot rate (purple) has been cut by roughly \$500 since early April.

Daily ocean spot rate spread widens as shipping to the North American East Coast becomes increasingly expensive.

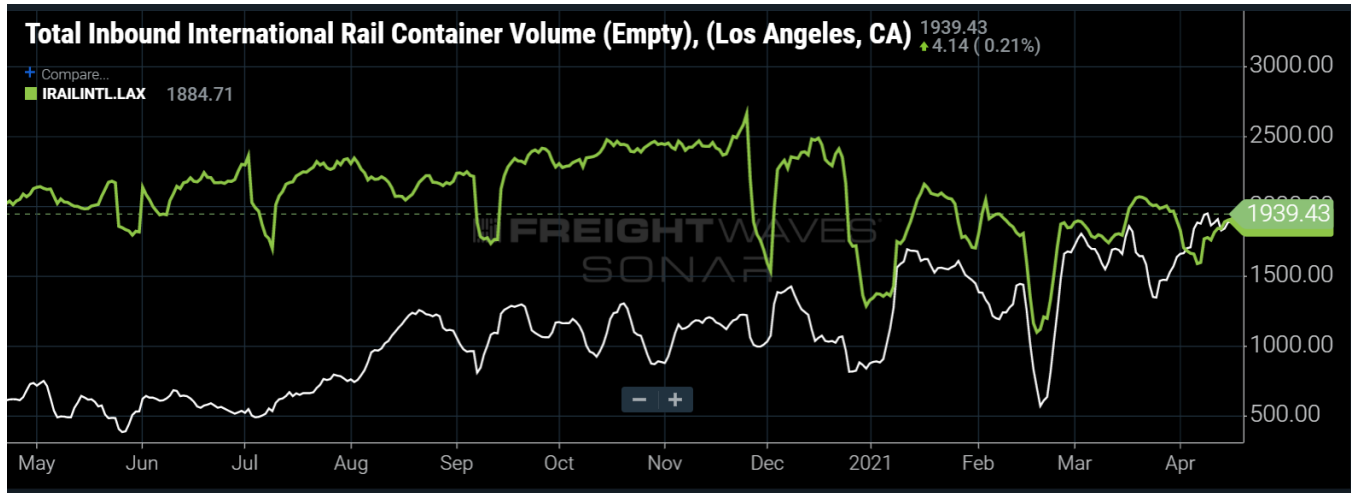


We expect that import levels will remain strong throughout the summer, especially given that ocean bookings seem to be accelerating as we head into a traditionally strong period. As shippers still fight to replenish inventories, depleted by the increased consumer spending, we expect for the overall freight demand to be strong. As the peak retail season seemingly starts earlier and earlier every year and with the current elevated import levels, delays at ports and difficulty securing containers, it is likely that shippers will be pulling peak retail season freight through earlier, likely coming in over the next few months.

While imports remain white hot, the export market is in a bit of a conundrum as the Biden administration tries to undo actions of the previous administration and China attempts to replenish the country's hog population. That sets up U.S. exports, which are primarily in agriculture and grain products, to have a strong year. The Outbound Ocean Shipments Index, a measure of shipments leaving the U.S., has increased by ~60% since the beginning of the year, suggesting that exports are showing strength in the current environment.

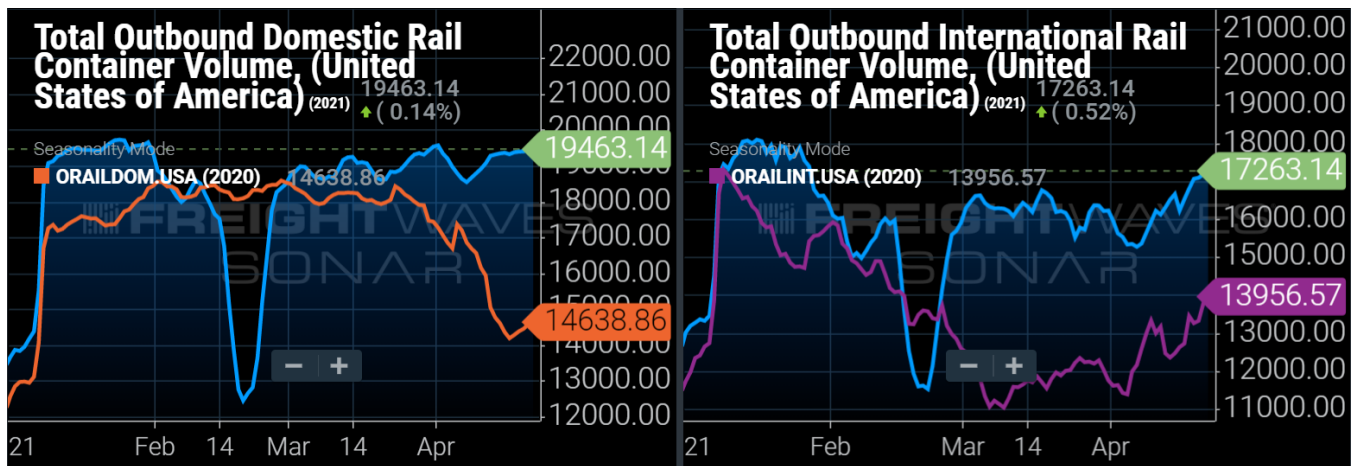
However, the global container shortage is severely impacting exporters as shippers need the containers overseas as soon as possible, meaning a majority of containers are returning to the container ships empty. This is showing up in international intermodal container volumes heading into Los Angeles, pictured below. The number of loaded international intermodal containers has fallen by nearly 500 containers per day since November, while empty container volumes have increased by nearly 1,000 containers per day. In a normal environment, the number of loaded international intermodal containers vastly exceeds the number of empty containers. However, since the beginning of April, the number of empty international intermodal containers into Los Angeles has outperformed the number of loaded containers, spelling trouble for exporters.

More international intermodal containers are heading back to Los Angeles empty (white) than loaded (green) to avoid potential loading delays.



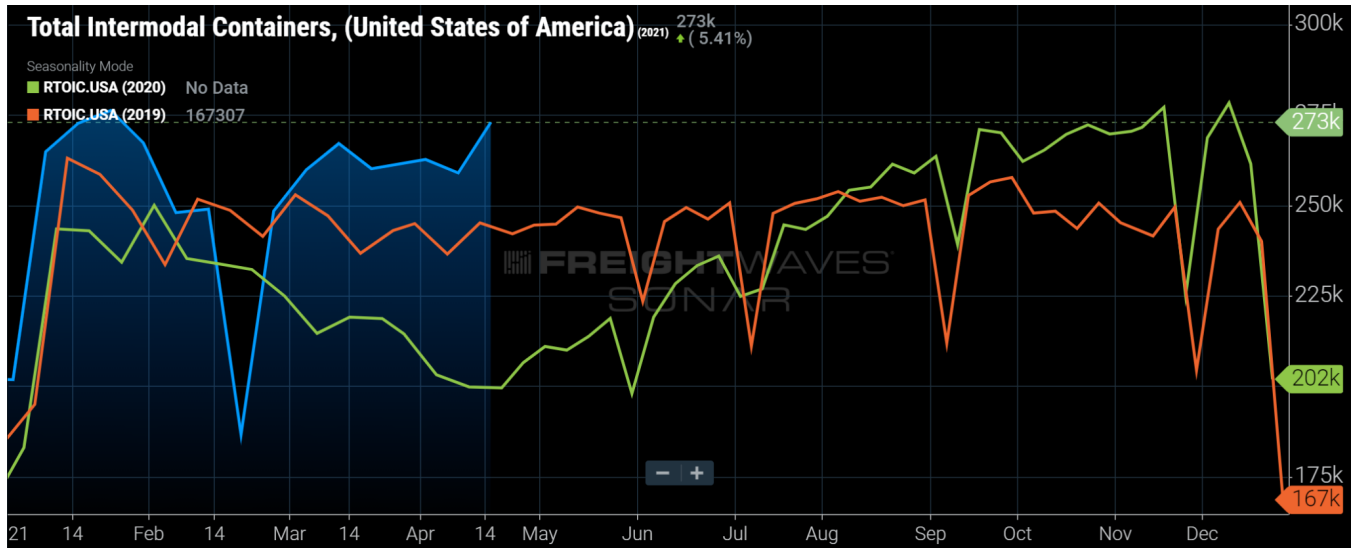
Rail intermodal — volume and rates reflect elevated import volume and tight truckload markets

Intermodal volume started the year off strong as last fall's peak intermodal season was elongated and persisted through the end of January. Intermodal volume fell off sharply in February amid winter storms but came roaring back at the beginning of March and that strength has persisted through late April.



As shown in the chart above, intermodal patterns have differed in April between the distinct domestic and international intermodal segments. Already at a high level, domestic intermodal volume (above left) has flattened out on a sequential basis after recovering from the February winter storm. The likely constraint in domestic rail intermodal volume is the availability of domestic containers in addition to imbalances in the freight network that are more severe than they typically are.

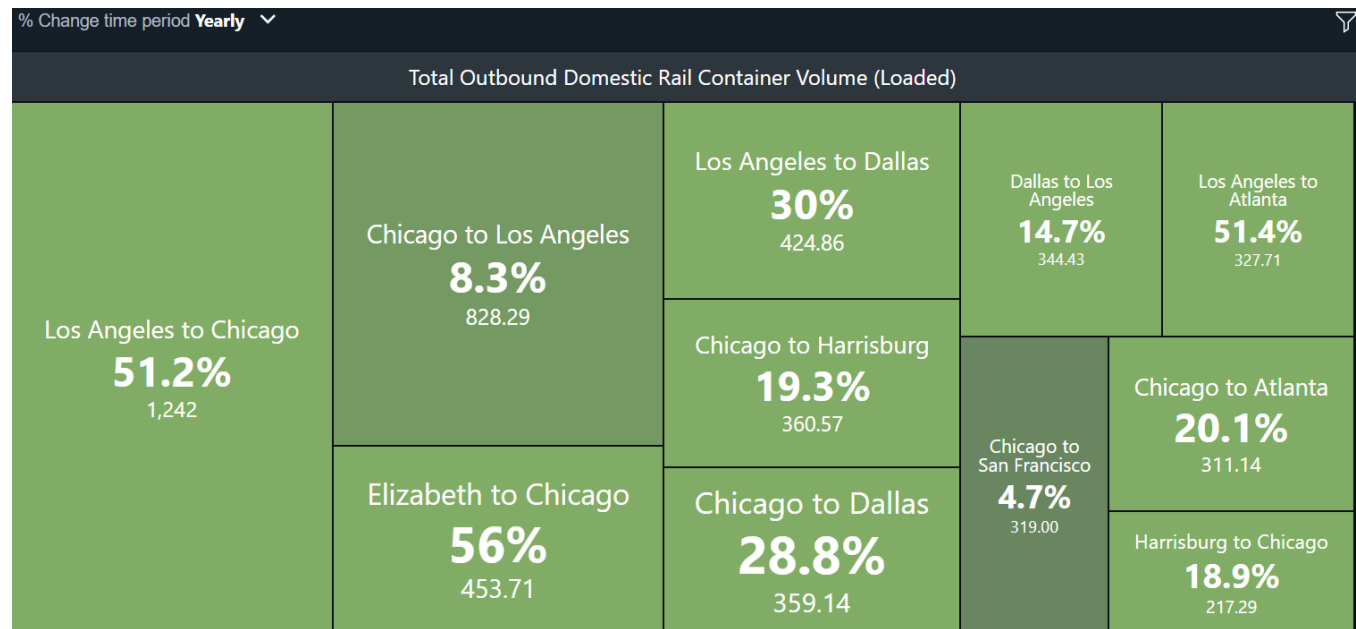
Defying typical seasonality, intermodal volume picked up to peak season levels in mid-April.



SONAR intermodal volume data shows that international intermodal is outperforming domestic intermodal on a sequential basis in recent weeks. On a year-over-year basis, domestic intermodal is outperforming international intermodal, which we attribute to lapping a freight market that was depressed at this time last year; international intermodal volume is higher by 23% y/y during the past week, while domestic intermodal volume is higher by 33% y/y. The sequential increases in international intermodal volume in April can be attributed to the continued elevated import volume and also the increase in empty container volume. The container ship lines that own or lease international containers are requesting that those containers are returned to the West Coast ports quickly, which is increasing the velocity of container movements. We are seeing that in the overall international intermodal volumes that include “revenue empties.”

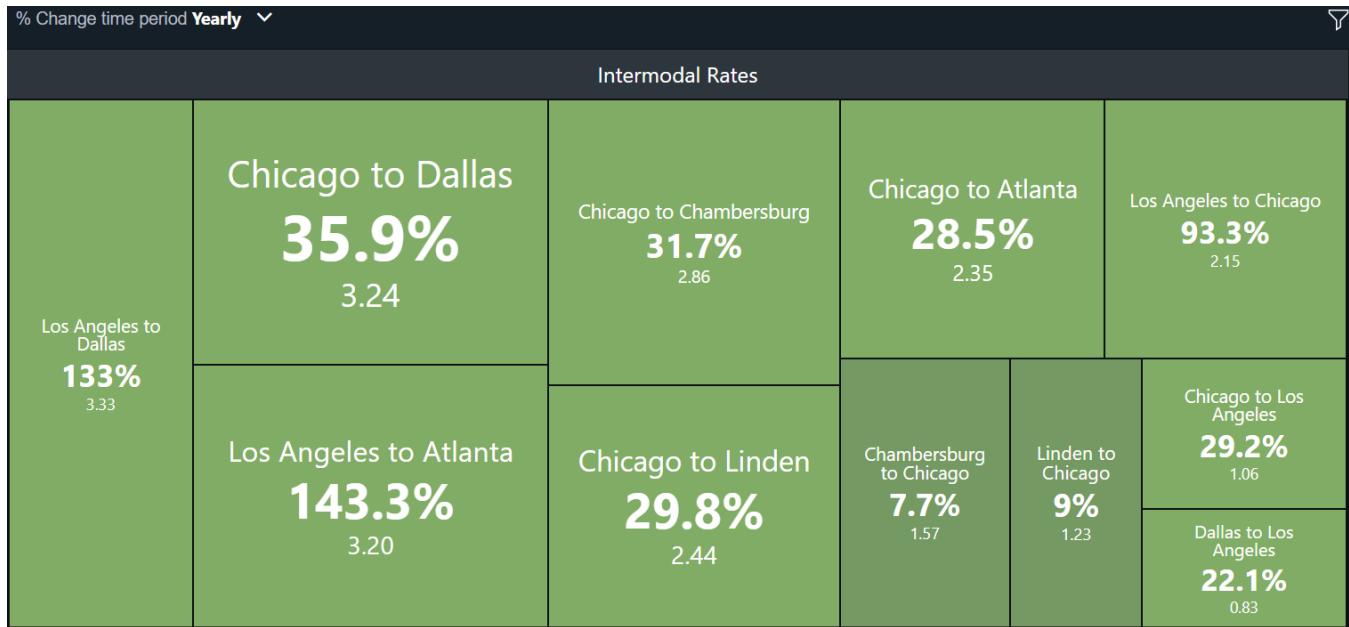
For added detail on the domestic intermodal volume increase during the past week, we show the year-over-year change in loaded domestic intermodal container volume (i.e., excluding any intermodal movements in ISO containers) for the 11 densest domestic intermodal lanes that originate and terminate in the U.S. As shown below, while volume is higher y/y on each of the 11 densest lanes, that magnitude of the increase by lane is mixed with the clear pattern that eastbound lanes that originate at West Coast ports are up stronger. That can be attributed to greater market share at the West Coast ports and the global container shortage that encourages transloading from 40-foot international containers into 53-foot domestic containers.

Loaded domestic intermodal volume is up y/y in each of the densest domestic intermodal lanes.



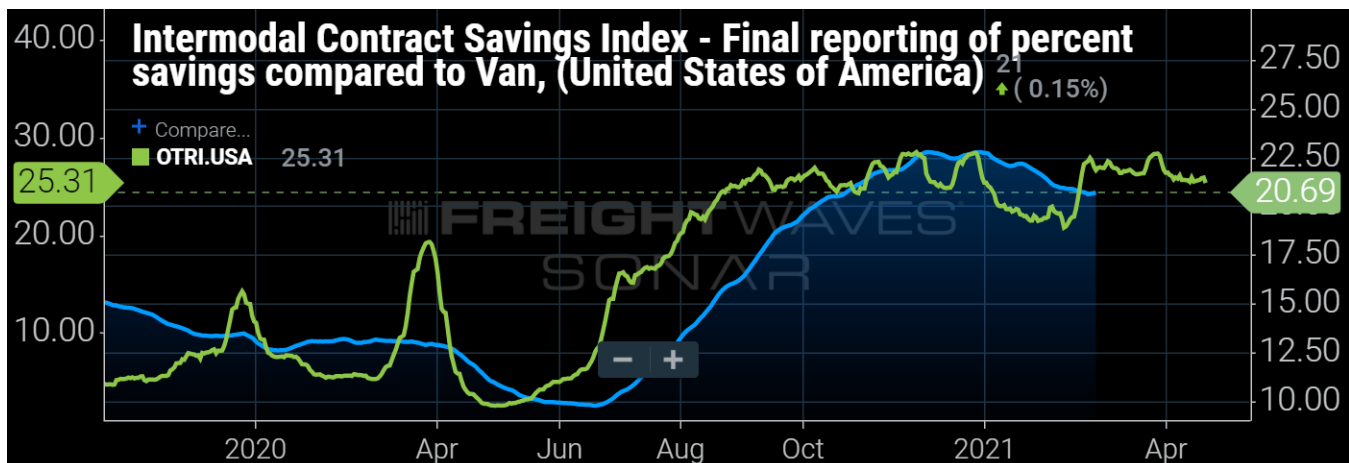
Domestic intermodal spot rates (which are door-to-door rates to move 53-foot domestic containers and include fuel and all congestion-related surcharges) shown below are higher than at this time last year in each of the 20 densest domestic intermodal lanes. But the degree of the change in spot rates versus the year-ago period is widely mixed by lane. Consistent with changes in volume, the eastbound lanes from the West Coast have some of the largest y/y changes, such as LA to Chicago and LA to Dallas, which are up 93% y/y and 133% y/y, respectively. In those key eastbound lanes, the Class I railroads appear to be protecting capacity for contractual shippers. While a small minority of intermodal volume moves on the spot market, we believe that spot rates are an important indicator of the direction of contract rates, which we expect to increase significantly as they renew (some contracts renewed in 4Q20 or 1Q21 while some have not yet renewed). Along similar lines, the public domestic truckload-based intermodal providers are guiding analysts to expect intermodal contract rate increases in the high-single to low-double-digit range. J.B. Hunt has taken a particularly aggressive stance on analyst calls, indicating that it would raise intermodal rates significantly in an effort to improve intermodal margins closer to historical levels.

Higher domestic intermodal spot rates in each of the densest lanes portend intermodal contract rate increases.



The chart below shows the intermodal savings rate, graphed against U.S. tender rejections. The intermodal savings rate is the difference between truckload contract rates and intermodal contract rates on freight movements that have the same three-digit origin and destination and that were moved on the same day. The data compares rates in purely domestic lanes with both truckload and intermodal rates including fuel surcharges. The data shows that the savings that shippers can realize by utilizing rail intermodal increased during the past year as the domestic truckload market tightened. We attribute that to truckload contracts being more volatile than intermodal contracts and, perhaps, shippers became less willing to utilize intermodal as service became questionable.

As the truckload market tightened last year, the intermodal savings percentage (truckload contract rate less intermodal contract rate on same lanes) increased.



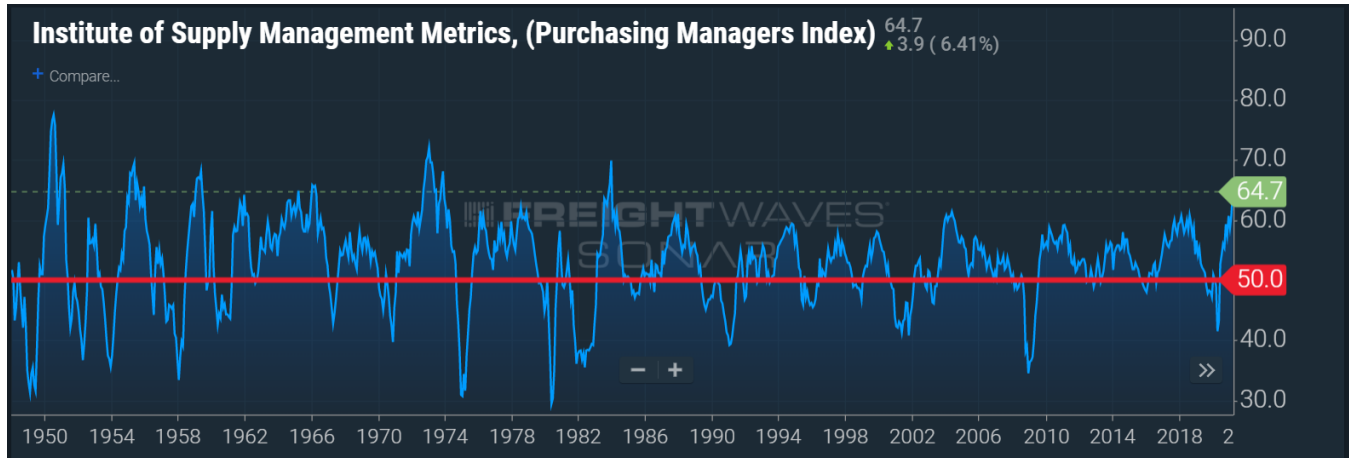
What else we're watching

This week, Knight-Swift called for 15% contract rate inflation on its earnings call. In most respects for carriers, if true for the broader industry (as we believe it mostly is), it is hard to imagine a more ideal backdrop for asset-based carriers. But the reality is more gray and nuanced. For example, it has perhaps never been more difficult to seat trucks. This means driver wage inflation eats up some of the incremental margin from rate increases and limits miles driven potential for carriers. A carrier's revenue is a function of average utilization (miles driven per truck), number of trucks and average rate per mile. The latter is indubitably a major positive, but revenue is being capped for all but the smallest of carriers by an inability to grow their fleets (either through backlogs for new trucks and/or the inability to seat them). Fleet counts for many public carriers is actually flat to negative on a y/y basis right now despite a raging bull market. Paradoxically, the inability to seat trucks is also the catalyst for an extension of this bull market into 2022.

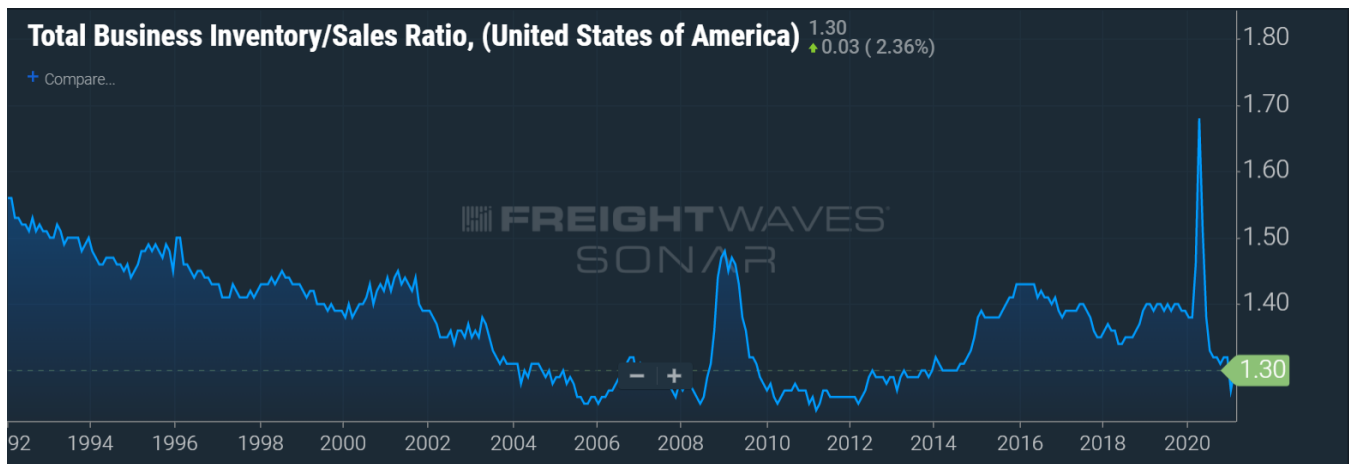
With large carriers unable to grow their fleets and driver counts, this brings us to our first significant caveat for what could bring an end to this bull market. In recent weeks, the FreightWaves Passport Research team has written extensively about the significant growth we've seen in capacity on the smaller fleets and owner-operator side of supply. As a result, any faltering in demand could come back to bite us in late 2021 or early 2022 because smaller carriers are equivalent to retail traders in the stock market. They tend to be rational at an individual level (i.e., "I want to earn more profits for myself now"), but at the group level, their herdish and late-cycle behavior often causes a self-fulfilling end to the cycle. This behavior also exposes the extremely limited barriers to entry present in the market.

Furthermore, we are starting to see significant green shoots on ultra-COVID-sensitive and exposed services spending categories such as airlines and entertainment, which could be a canary in the coal mine as a signal that goods spending may be peaking. We have yet to see a material weakening in goods-related spending.

In terms of the 50% of nonconsumer-driven trucking volumes, the ISM PMI just hit a 37-year high in March, reaching 64.7 (note that 50 is the dividing line between expansion and contraction). One would have to go back to 1983 to match that feat. This means the U.S. economy, particularly through the remaining stimulus disbursement period and if an infrastructure stimulus bill develops, is likely to run red hot. In fact, on that measure, many investment banks have increased their projections for real GDP in 2021 to 7%+. Considering trend-level growth for the past decade, plus has been more like 2%, this is an enormous event, even considering easy comparisons in the April and May 2020 time frame.



With that kind of growth and stimulus adding fuel to the fire, inflation still presents a material risk to the economy and transportation markets. This is because there is growing potential for a shorter than normal and more robust economic cycle than is typical, which could cause the Federal Reserve to have to prematurely hike interest rates and slow the economy to tame inflation. It is important to remember that elevated and record transportation rates are inflation for the rest of the economy, even though they represent revenues for our industry. And on that front, countless publicly traded companies are calling out transportation tightness and inflation as a major issue and challenge for their business at the moment that is causing margin pressure.



(Chart: FreightWaves SONAR, inventory-to-sales ratio; TBIS.USA)

Retailers remain focused on growing inventory. The current inventory-to-sales ratio sits at 1.3 times, substantially below pre-pandemic levels. Pre-pandemic levels averaged closer to 1.5 times. For context, the last time the inventory-to-sales ratio contracted this severely was more than 10 years ago during the credit crisis and it took nearly five years for the inventory-to-sales ratio to get back to 1.5 times, so quick-mean reversion is no guarantee. The current blistering pace of retail sales growth means there will be no quick fix to this situation and playing catch-up is likely to be the theme for the medium term.

Finally, we thought it interesting to end on what nearly 50 surveyed shippers told us would be the most likely catalyst to loosen trucking capacity in 2021. The most common response — about 75% of respondents said that there was no catalyst and that they didn't foresee capacity loosening in 2021.

