CASS FREIGHT INDEX REPORT™

February 2018

Economic Outlook from Freight's Perspective

Volume Continues to be Strong, Pricing Even Stronger
– Unnecessarily Raises Broader Inflation Concerns

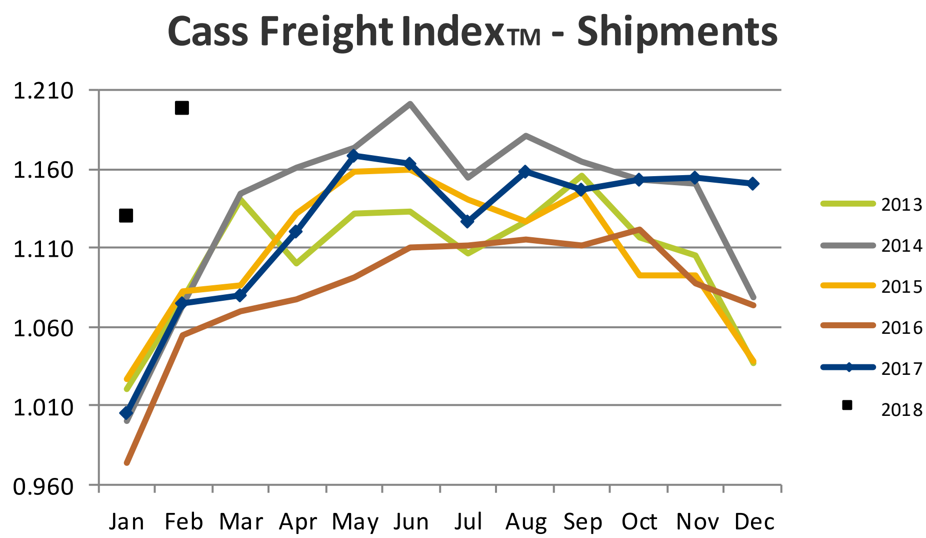
	February 2018	Year-over-year change	Month-to-month change
Shipments	1.198	11.4%	5.9%
Expenditures	2.724	14.3%	5.2%

Volume has continued to grow at such a pace that capacity in most modes has become extraordinarily tight. Pricing power has erupted in those modes to levels that spark overall inflationary concerns in the broader economy. Not only did the Shipments and Expenditures Indexes extend their run of positive YoY comparisons, but those comparisons have become increasingly positive, leading many to cite transportation costs as one of the many sources of potential inflation.

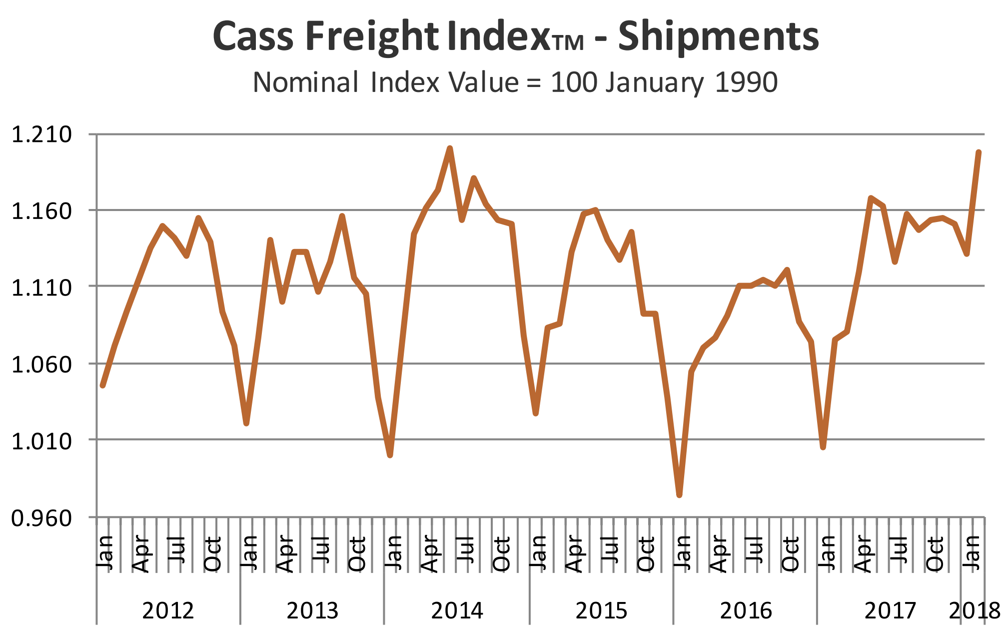
Although we expect outsized pricing power for service providers in the short to intermediate term, we are less concerned about long-term inflationary pressure. At the risk of pointing out the obvious, pricing in transportation is cyclical, for two basic reasons. One, the industry is asset intensive and beholden to the level of economic demand for its services (i.e., transportation companies are at the mercy of the economic cycle), as is true for many cyclical industries, especially in an era in which technology provides for both improved price discovery and enhanced asset utilization/asset visibility. The second reason is that times of improved pricing often spur decisions to create capacity – either through adding assets or using technology to improve asset utilization. We observe, then, the industry's ability to use increased profitability to fund enough capacity to kill outsized pricing gains in the long term.

A Leading Indicator?

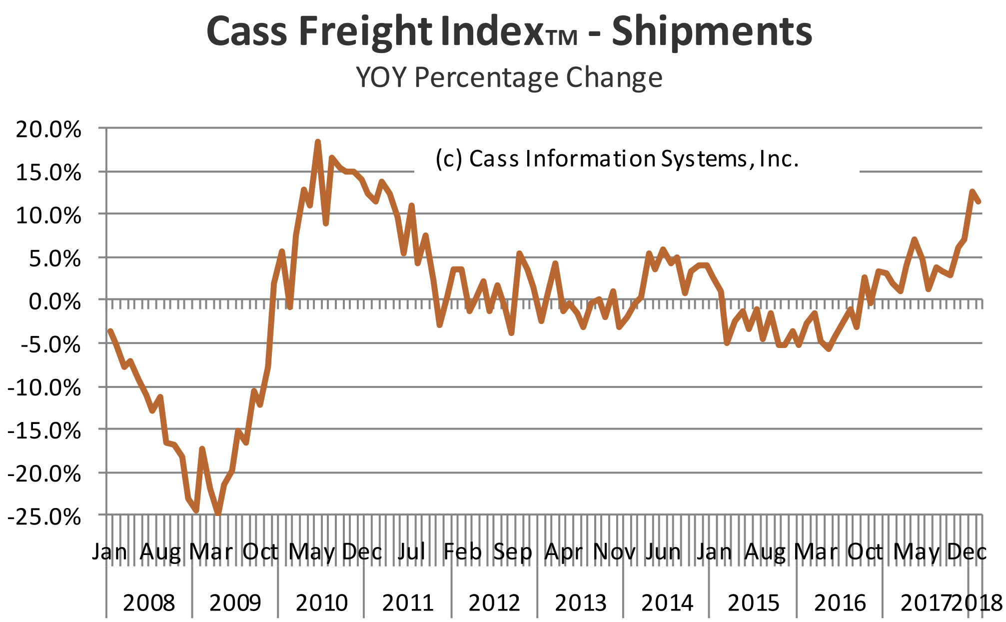
Shipments first turned positive seventeen months ago, while expenditures turned positive fourteen months ago. Throughout the U.S. economy, we are continuing to see a growing number of data points suggesting that the economy continues to get increasingly better. The 11.4% YoY increase in the February Cass Shipments Index is yet another data point confirming that the strength in the U.S. economy continues to accelerate.



Although a seasonally weak part of the year, February was roughly equal to the peak month in 2014 (June 2014 at 1.201 vs. February 2018 at 1.198), which is extraordinary. January and February are clearly signaling that 2018 is off to a strong start, with volume well above other recent years. A YoY stacked chart highlights that, similar to November, the December 2017 shipments index exceeded the previous four Decembers. We should point out that 2014 was during a very strong freight market overall and was before the industrial recession (which started in December of 2014) had begun.



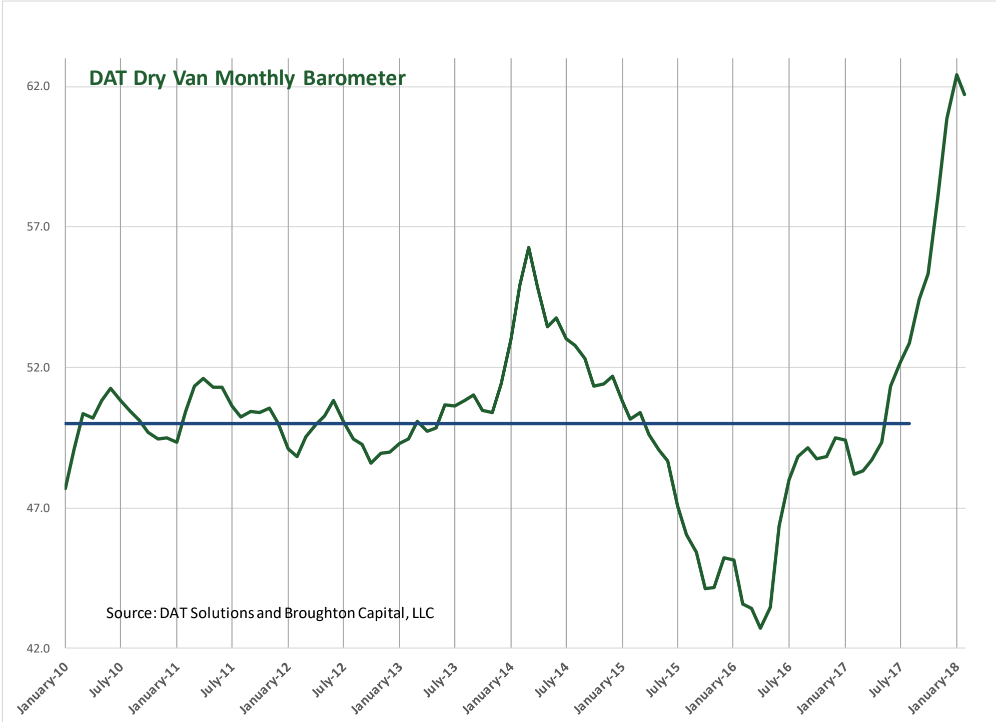
When viewed on an unstacked basis, it becomes readily apparent that the nominal value for February was higher than all the monthly values posted in 2015, 2016 and 2017. With February normally being one of the more seasonally weak months of the year, we find this data point extremely bullish. With both January and February 2018 well above January and February in the record freight year of 2014, we find it easy to predict that 2018 is poised attain new record highs.



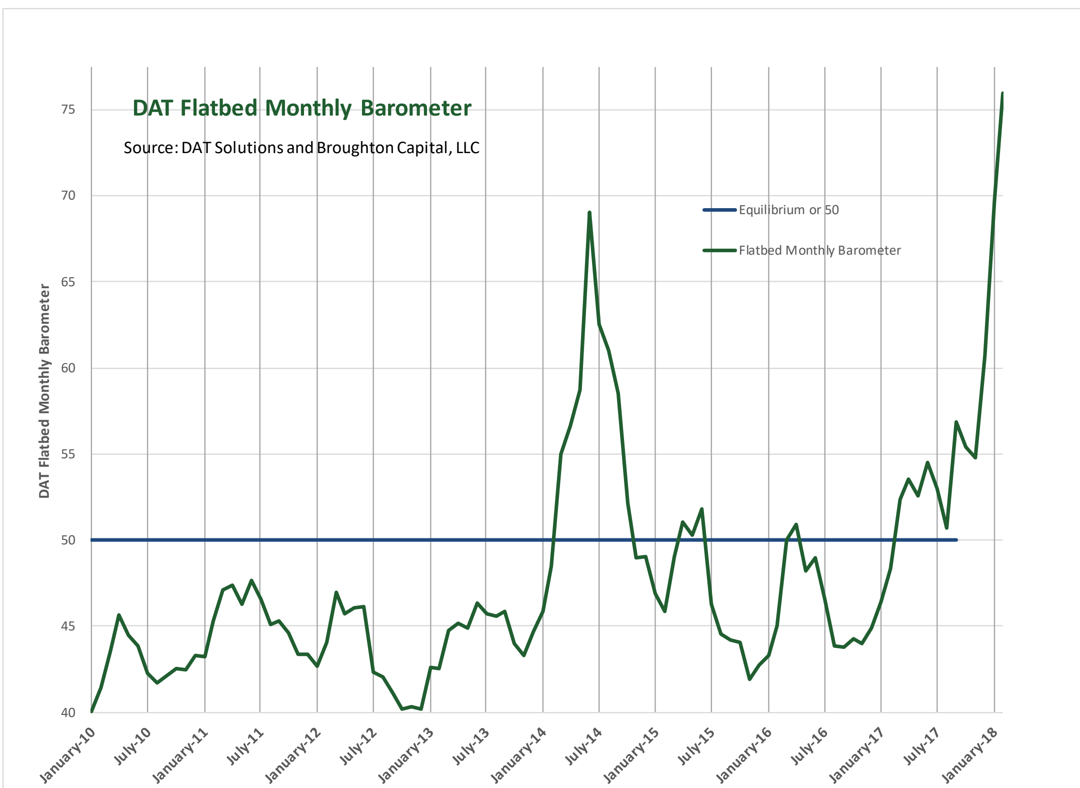
The YoY percentage change is notable because the freight recovery started in the second half of 2016 (i.e., tougher comparison) and because only when comparisons were weak (i.e., 2009-2010) were the percentage increases so high. Said another way, we normally only see such high percentage increases in volume when related to easy comparisons. **That these percentage increases are so strong – and strong against tough comparisons – explains why our outlook is so bullish, why capacity is so constrained, and why realized pricing is so strong.**

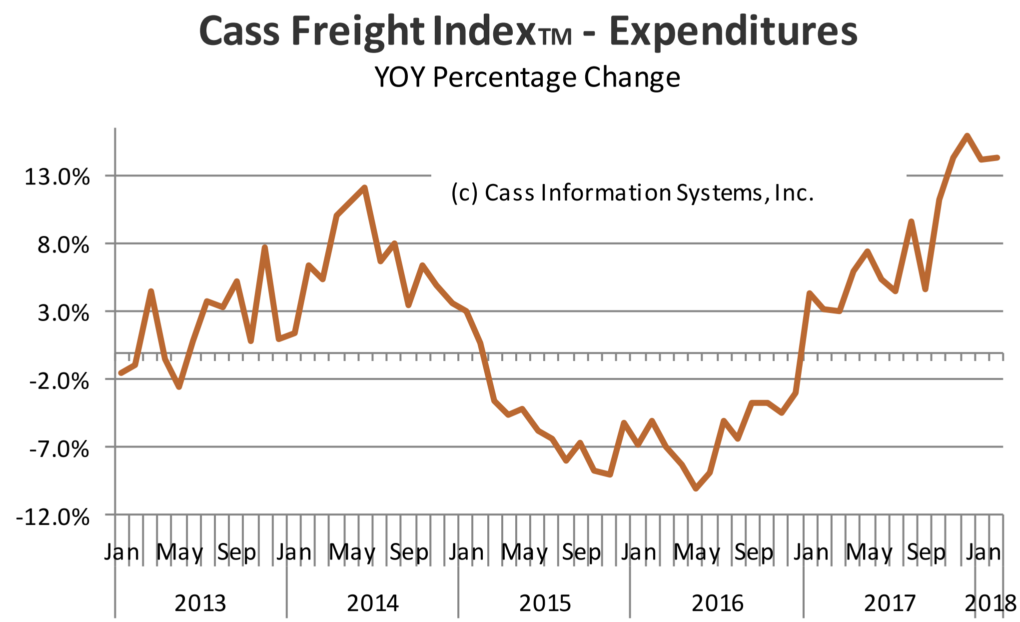
Data continues to suggest that the consumer is starting to spend, albeit not with brick and mortar retailers. It also suggests that, with the surge in the price of crude in October of 2016, the industrial economy's rate of deceleration first eased and then began a modest improvement led by the fracking of DUCs (drilled uncompleted wells), especially in the fields with a lower marginal production cost (i.e., Permian and Eagle Ford). We have been questioning, "How fast will the recovery from here be?" We would note that indications of accelerating strength have been coming from several modes of transportation.

The DAT Dry Van Barometer is giving us real-time indications of stronger demand and tighter capacity in this key freight group, indicating that the consumer economy is not only alive and well, but growing robustly.

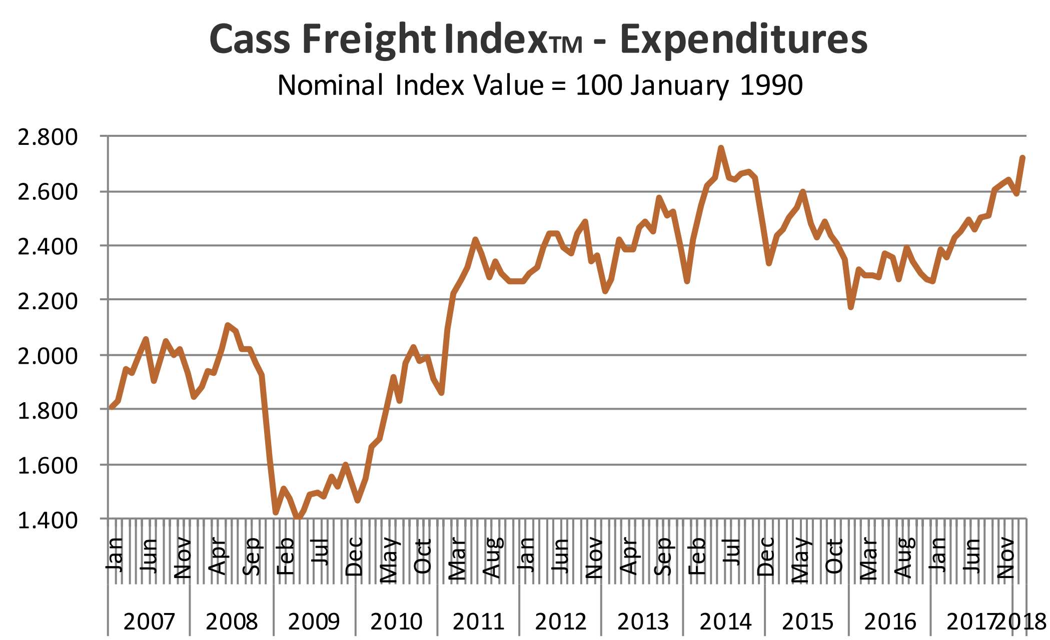


In a similar fashion, the DAT Flatbed Barometer is indicating that the U.S. industrial economy is also alive and well and accelerating. There was first a pickup in activity in rebuilding from last summer's hurricanes, but that strength has continued as the price of WTI crude has stayed above $55 a barrel and the U.S. oil industry has begun fracking new wells in all the major shale fields (Permian, Eagle Ford, Barnett, Bakken, etc.).





With all of the recent strength in demand, it should come as no surprise that the Cass Freight Expenditures Index posted strong percentage increases throughout 2017, and this has continued in early 2018. As we commented on the Shipments Index, we have to go back to the easy comparisons of 2009-2010 to find such large percentage increases. The current comparison is anything but easy. We have commented repeatedly that this is indicative of an economy that is continuing to expand. **February's 14.3% increase clearly signals that capacity is tight, demand is strong, and shippers are willing to pay up for services to get goods picked up and delivered in modes throughout the transportation industry**.



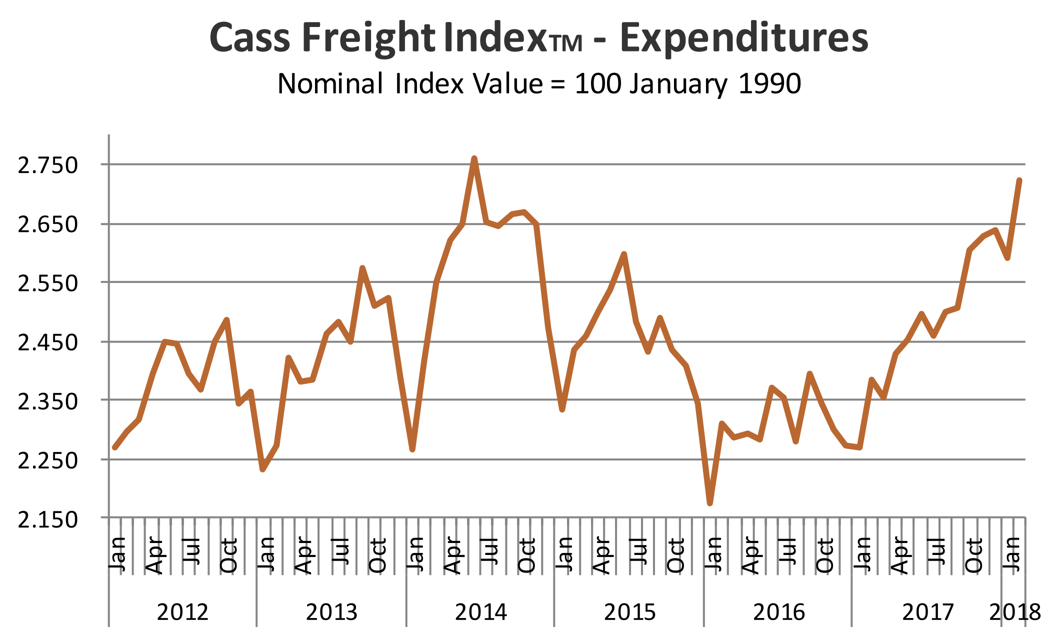
On a nominal basis, the index is just below the all-time high established back in June 2014 and appears that it will blow through that record with ease in coming months. Stay tuned …

Putting it all in Perspective

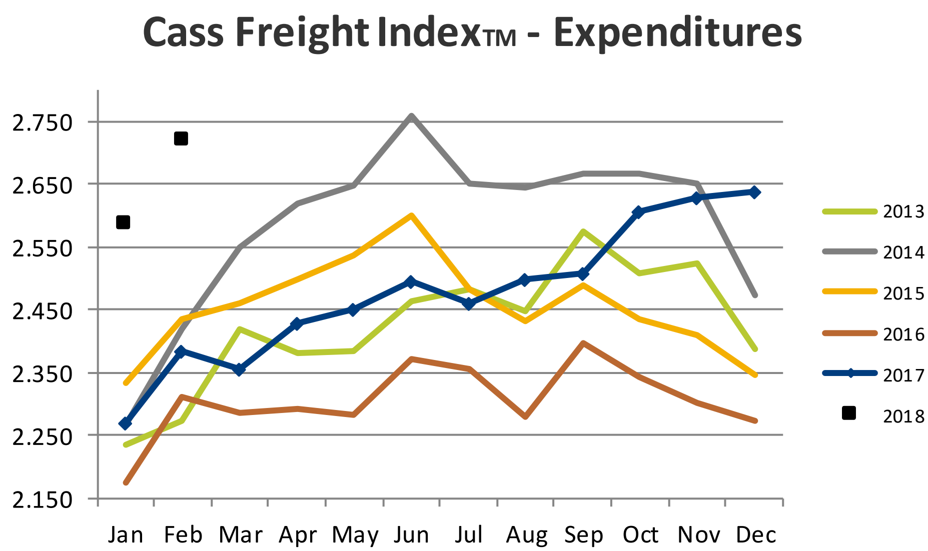
Expenditures (or the total amount spent on freight) turned positive for the first time in 22 months in January 2017, albeit against an easy comparison. Not since 2011 – when the economy was still climbing out of the recession – had this index been so low. Our Expenditures Index in January 2016 was the worst in five years, as demand had weakened and crude oil had fallen below $30 a barrel. Although February and March of 2016 were also weak, they were not nearly as weak as January 2016 and hence a slightly tougher comp. Since fuel surcharges are included in the Expenditures Index, fuel was a positive bias in 2017 and continues to be so in the current data.

Throughout much of 2017, fuel was up as much as 75% on a YoY basis (diesel is at $3.00 a gallon on a national average basis as we write this), and we have pointed out that part of the expenditures increase was a result of the relatively steady increase in the price of fuel and the related fuel surcharges. That said, the YoY increase attributable to fuel is now diminishing (up an average of 18.6% on a YoY basis in February), and we are also seeing some improvements in pricing power of truckers and intermodal shippers. As an example, the proprietary Cass Truckload Linehaul Index (which measures linehaul rates and does not include fuel) rose a healthy 6.5% on a YoY basis in the month of February. The proprietary Cass Intermodal Price Index (which does include fuel) increased 5.4% in February. But as we've pointed out, fuel is a now a diminishing factor on a YoY basis. (*See those reports here for more details on the data and the underlying trends*).

We should also remind readers of a fundamental rule of marketplaces: volume leads pricing. Repeatedly, we have watched in a host of different markets, that volume goes up before pricing starts to improve and volume goes down before pricing starts to weaken. Even in markets as basic as the weather, the number of hours of sunshine (sunrise to sunset) starts to decline long before the temperature starts to fall.



Viewing the Cass Freight Expenditures Index on a nominal basis shows how positive the trajectory has been in the last year. It is now at the levels achieved in the 2014 period, which is ahead of our "by the second quarter of 2018" prediction. To put how strong the underlying pricing is in perspective, we should remind readers that the price of oil was at or above $100 a barrel throughout most of 2014, versus the current price of ~$60 a barrel.



Similar to the Cass Freight Shipments Index, the Cass Freight Expenditures Index, when viewed on a nominal YoY stacked basis, highlights that the February Expenditures Index has exceeded all previous levels for January since the recovery from the 2008-2009 recession. **As we've noted, since oil was markedly higher in 2013 and 2014, we see this data point as very encouraging**.

OTHER ISSUES

Is Inflation Returning?

Current financial news headlines are full of stories about inflation and the resurgence of inflation in the U.S. economy. At the macro level, signs that there has been a rebirth of some inflation are present. The yield on the 10-year U.S. Treasury has climbed from an ultra-low 2.1% to 2.9% in the last six months (a 38% increase in yield). The value of the U.S. Dollar, as measured in terms of the world's other major currencies, has gone down by 15% in the last year, and 7% in the last three months alone. Given the number of smart people investing in these markets (and the amount of money they are investing), it is risky to ignore what the 'wisdom of crowds' is trying to tell us. As we have discussed in previous articles, we continue to assert that the more people investing, and the larger amounts being invested, the more predictive a market becomes (i.e., wisdom of crowds).

We will return in coming months to our more standard format of reviewing each mode and what is happening in each mode. We believe it continues to make sense to take a slightly different approach for now. What specifically is driving the recent strong surge in volumes and pricing? Yes, parcel volumes associated with e-commerce continue to show outstanding rates of growth, with both FedEx and UPS reporting strong U.S. domestic volumes, but the current strength is more than just the ongoing growth of e-commerce.

On the capacity side, we should point out that most modes of transportation under-invested in infrastructure and capacity over the last two to three years, with the notable exceptions being FedEx, UPS and XPO Logistics. Hence, capacity in general hasn't expanded. The Electronic Logging Devices (ELDs) rule recently imposed on the trucking industry may not constrain capacity as much as is widely feared, but it certainly won't expand capacity. Capacity concerns aside, we believe this is much more of a demand story and we see two basic factors at work on the demand side:

Industrial economy – we should first remind our readers that in the U.S., the 2009–2014 period was the first industrial-led recovery since 1961. The advent of fracking and the substantial supplies of natural gas and crude oil that have been developed in the U.S. have lowered the global price of oil and made the U.S. the world's largest producer of crude oil. Fracking and all of the industrial activity that it spawned were a powerful economic boom to our country. As the price of oil fell from over $100 a barrel in 2014 to under $40 a barrel in early 2016, the same force that led the economic expansion died. In turn, as oil climbed back above $50 a barrel in the fall of 2016, industrial activity stopped contracting. In more recent months, as oil climbed above $55 and then above $60, industrial activity has returned to boom levels. Simply put, industrial activity is alive and well, and accelerating strongly. The recent changes to the tax law and the ability to accelerate depreciation should only serve to further strengthen the capital-intensive industrial economy.

Consumer economy – to be fair and accurate, there really hasn't been a consumer recovery since 2009. Consumer income and consumer spending growth have been anemic. Then the stock market began to rally in the fall of 2016 and has continued to do so. This has increased confidence throughout the baby boomer demographic as they have watched the value of their 401(k)s and other investments grow. Data suggests that they began to spend some of that increased wealth this holiday shopping season. Also at work is the millennial generation. After being long derided as "never going to start household formation," they have begun to prove the critics wrong. Just as has been true for almost 100 years, each generation has waited a little longer to get married and buy that first house. The millennials are no exception. That said, there are more millennials than boomers. Millennials have started to form households, and have started the goods accumulation phase of their lives that accompanies it. Consumer spending is poised to be strong for the foreseeable future, and the recent appearance of some wage inflation only emboldens our view on this.

Bottom line, both the industrial and consumer economies are shifting into high gear.

About The Cass Freight Index

The Cass Freight Index represents monthly levels of shipment activity, in terms of volume of shipments and expenditures for freight shipments. Cass Information Systems processes more than $25 billion in annual freight payables on behalf of its clients. The Cass Freight Index is based upon the domestic freight shipments of hundreds of Cass clients representing a broad spectrum of industries. The index uses January 1990 as its base month. Visit http://www.cassinfo.com/frtindex.html or call 314-506-5500 to get detailed information about the Cass Freight Index, including historical data.

About the Author: Donald Broughton

Founder and Managing Partner of Broughton Capital, a deep data driven quantimental economic and equity research firm.

Prior to starting Broughton Capital, Mr. Broughton spent nine years as the Chief Market Strategist and Senior Transportation Analyst for Avondale Partners. Before that, Mr. Broughton spent over twelve years at A.G. Edwards. At A.G. Edwards, in addition to being the Senior Transportation Analyst, he was the Group Leader of the Industrial Analysts and served on the firm's Investment Strategy Committee. Prior to going to Wall Street, Mr. Broughton spent eight years in various distribution and operations management roles in the beverage industry, including serving as the Corporate Manager of Distribution for Dr. Pepper/Seven-Up companies and Chief Operating Officer for Bevmark Concepts.

Many in the transportation industry know him for his quarterly tracking of trucking bankruptcies. He is also known for his development of a 'Value to Density Spectrum' study of the tangible goods flow and its economic ramifications.

Broughton's equity research has earned acclaim and is regularly quoted by The Wall Street Journal, Bloomberg, Fortune, Forbes, and numerous other national media outlets. He is a frequent guest on CNBC, Nightly Business Report, CNN, Fox, NPR and other broadcast media.

His stock-picking performance has been repeatedly recognized by The Wall Street Journal, which has ranked him in its "Best on the Street" survey for his picks in both the cargo and railroad industry groups. Forbes has highlighted his performance in its "When Picky Analysts Pick" series. He has been ranked by Zacks Investment Research and Starmine as a 5-Star Analyst (their highest ranking) based on the historical performance of his recommendations.

Beginning in mid-2006, Broughton published reports warning of an impending economic slowdown and by early 2007 published reports explaining why a recession was coming. In early 2009, as the world became convinced that the 'sky was falling' he upgraded large cap industrials and names such as FedEx and Union Pacific. More recently, in July of 2010 and again in September 2011 his "Blue Car Report" explained why fears of a double dip were severely overblown and outlined why the market would have significant rallies by the end of those years. He believes that the current market is struggling to digest the end of the industrial-led recovery and the beginning of the consumer-led recovery in this cycle. But fear not, the consumer both in the U.S. and globally is about to be better than expected.

Other indexes published by Cass and Donald Broughton:

Cass Truckload Linehaul Index – measures fluctuations in U.S. truckload linehaul rates
Cass Intermodal Price Index – measures fluctuations in U.S. domestic intermodal costs
Visit http://bit.ly/s9iniq to view or subscribe.