CASS FREIGHT INDEX REPORT™

May 2018

Economic Outlook from Freight's Perspective

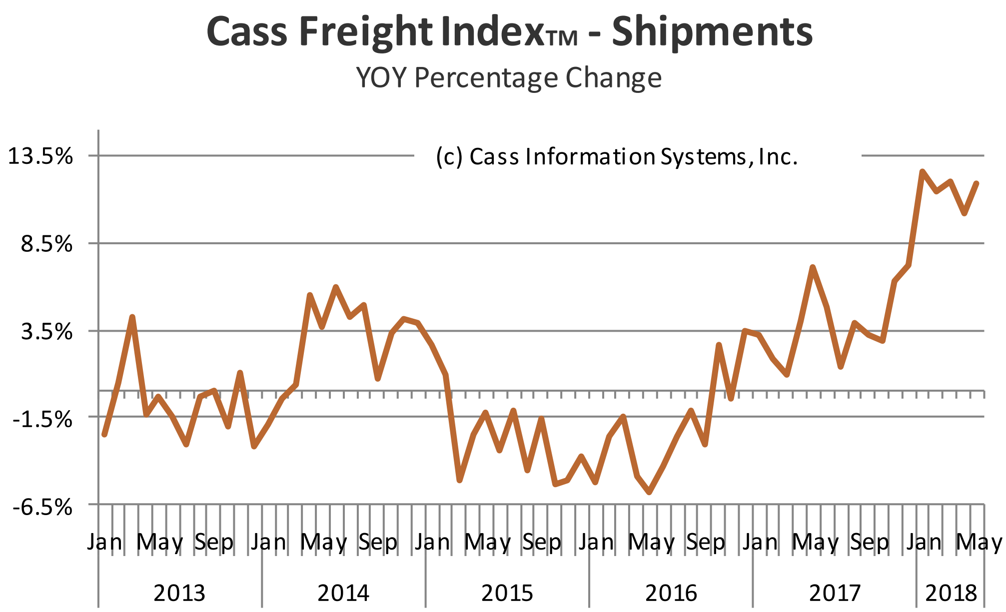
Volume Strong, Pricing Even Stronger – Can It Get Any Better?

	May 2018	Year-over-year change	Month-to-month change
Shipments	1.307	11.9%	5.9%
Expenditures	2.875	17.3%	4.9%

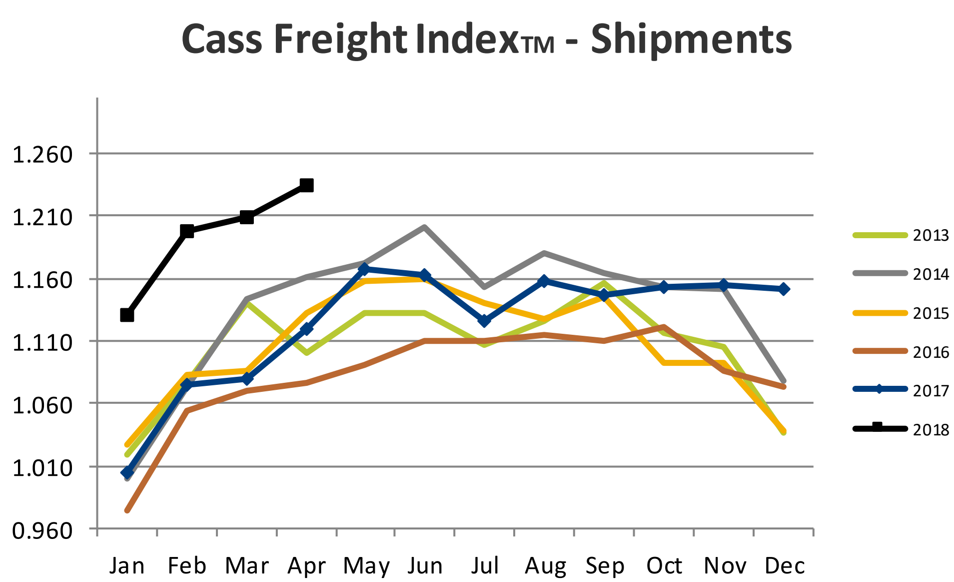
From both a volume and a pricing perspective, the U.S. freight economy is extraordinarily strong. The Cass Freight Shipments and Expenditures Indices are clearly signaling that the U.S. economy is ignoring all of the angst coming out of Washington D.C. about the potential of a trade war and all of the concerns coming out of Wall Street about the increased threat of inflation or the rise in interest rates. These indices are displaying accelerating strength on top of increasingly difficult comparisons. Demand is exceeding capacity in most modes of transportation by a significant amount. In turn, pricing power has erupted in those modes to levels that continue to spark overall inflationary concerns in the broader economy. As we explained in previous months, we do not fear long-term inflationary pressure as technology provides multiple ways to ever-increase asset utilization and price discovery in all parts of the economy, but especially in transportation. In fact, **we are seeing more signs that ELDs (Electronic Logging Devices) initially hurt the capacity/utilization of truckers, especially small truckers, but many of the truckers most adversely affected are now beginning to recover some of the loss in utilization through gains in efficiency.**

Transportation is a Leading Indicator

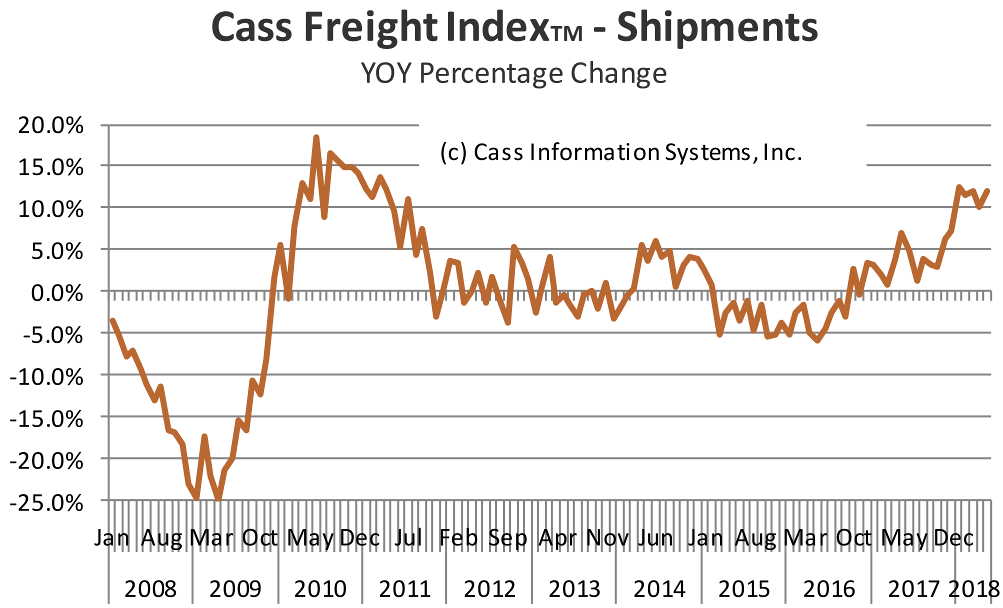
Year-over-year, shipments first turned positive twenty months ago, while expenditures turned positive seventeen months ago. The current level of volume and pricing growth is signaling that the U.S. economy is not only growing, but that the level of growth is expanding. The 11.9% YoY increase in the May Cass Shipments Index is yet another data point confirming that the strength in the U.S. economy continues to accelerate. **This level of percentage increase is usually only attained when emerging from a recession, not when comping against already strong statistics.**



The first five months of 2018 are clearly signaling that, barring a negative 'shock event', this year will be an extremely strong year for the transportation sector and the economy. May, April and March exceeded all levels attained in all months in 2014 (also a very strong year) and February was roughly equal to the peak month in 2014 (June 2014 – 1.201 vs February 2018 – 1.198) which is extraordinary. A YoY stacked chart highlights that, similar to the pattern which began in November and December 2017, the shipments index is exceeding all previous respective months.

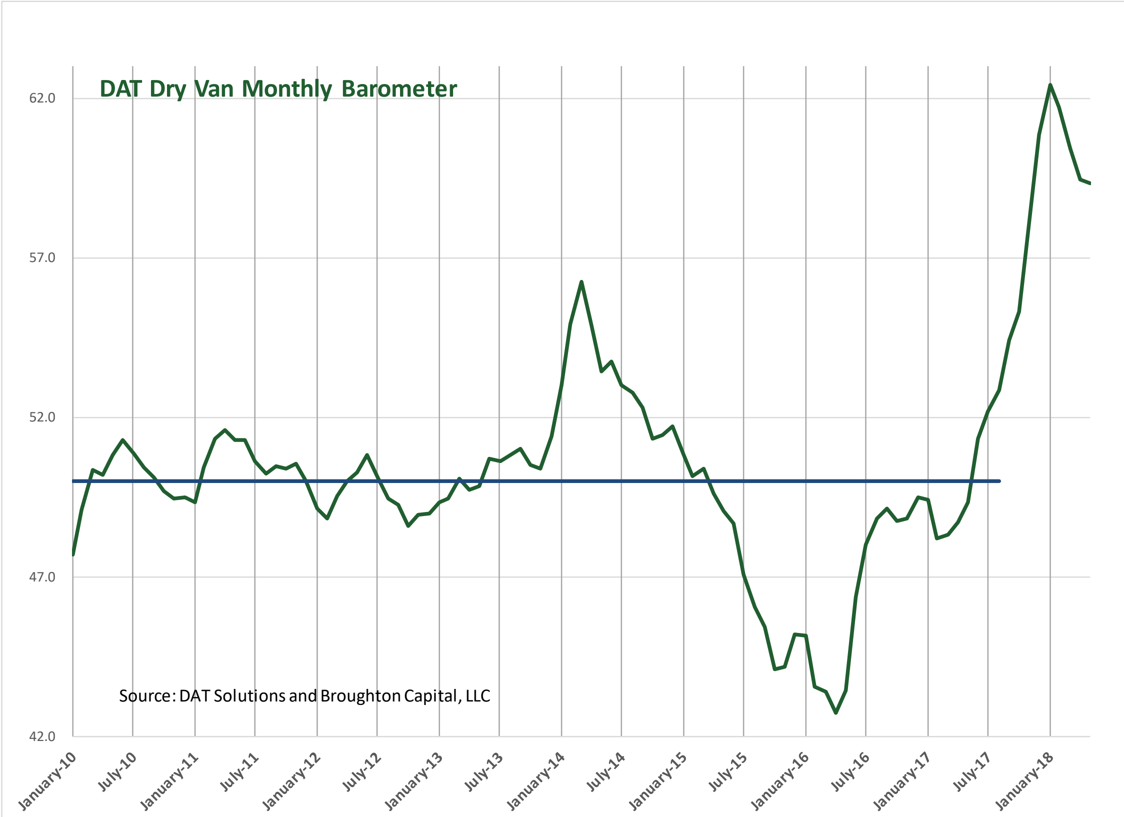


The YoY percentage change is notable because the freight recovery started in the second half of 2016 (i.e., tougher comparison) and because only when comparisons were weak (i.e., 2009-2010) were the percentage increases so high. Said another way, we normally only see such high percentage increases in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

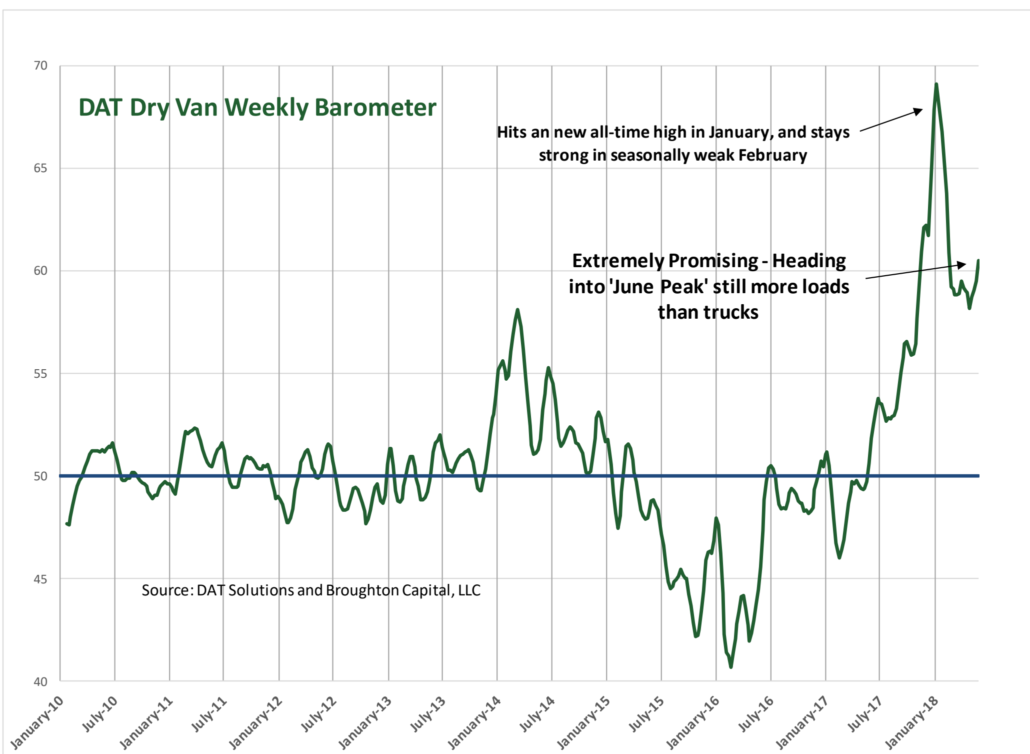


Data continues to confirm that both the consumer economy and the industrial economy in the U.S. is growing at an accelerating pace.

The Consumer Economy - The consumer is spending, albeit not as much with brick and mortar retailers. Millennials are starting to form households in earnest. Long derided by critics as "wanting to live in their parent's basement forever," we would note that instead they may have simply been doing the same as previous generations. They are marrying later than their parents, who married later than their parents, who married later than their parents. As life expectancy and the percentage of the overall population attaining higher education has increased, so has the age at which they first marry. We should also point out that household formation is an extremely strong driver of consumer spending, and that there are more millennials than baby boomers in the U.S.

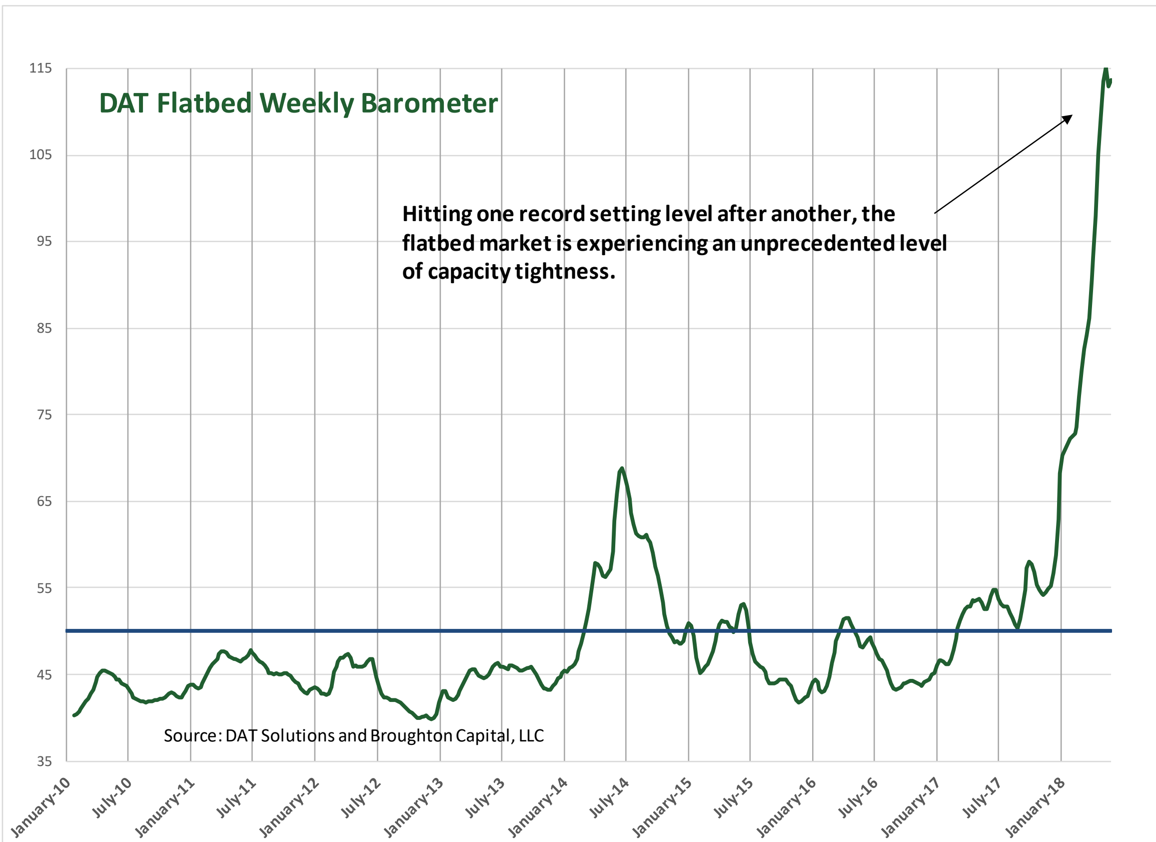


The DAT Dry Van Barometer is giving us real-time indications of stronger demand and tighter capacity in this key freight group. Indicating that the consumer economy is not only alive and well, but growing robustly.



The Industrial Economy - With the surge in the price of WTI crude back above $45 a barrel in April 2016, the industrial economy's rate of deceleration first eased and then began a steady improvement led by the fracking of DUCs (drilled uncompleted wells), first in the fields with a lower marginal production cost (i.e., Permian and Eagle Ford). Now with oil back above $60 a barrel (WTI is above $65 a barrel as we write this), the U.S. oil industry is now fracking new wells in all of the major shale fields.

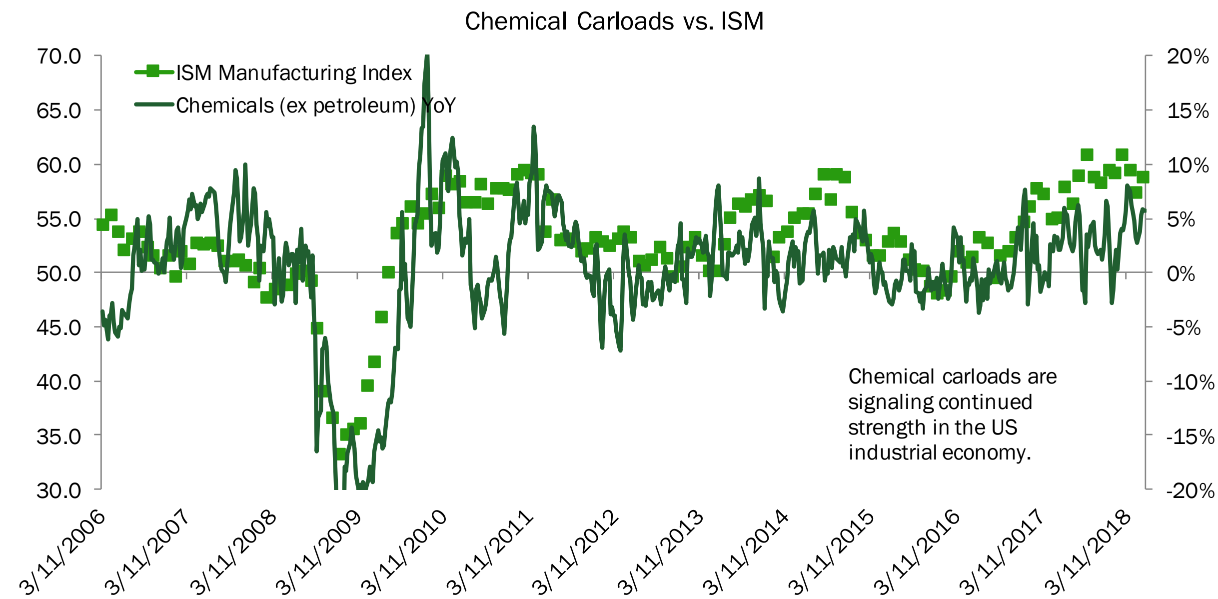
We would note that indications of accelerating strength have been coming from several modes of transportation, but none more visibly than in flatbed trucking which we view as a key heavy industrial indicator. **As long as WTI crude oil stays above the marginal cost of production (<$60 a barrel) in the major U.S. fracking fields, we expect to see continued strong industrial economic growth.**



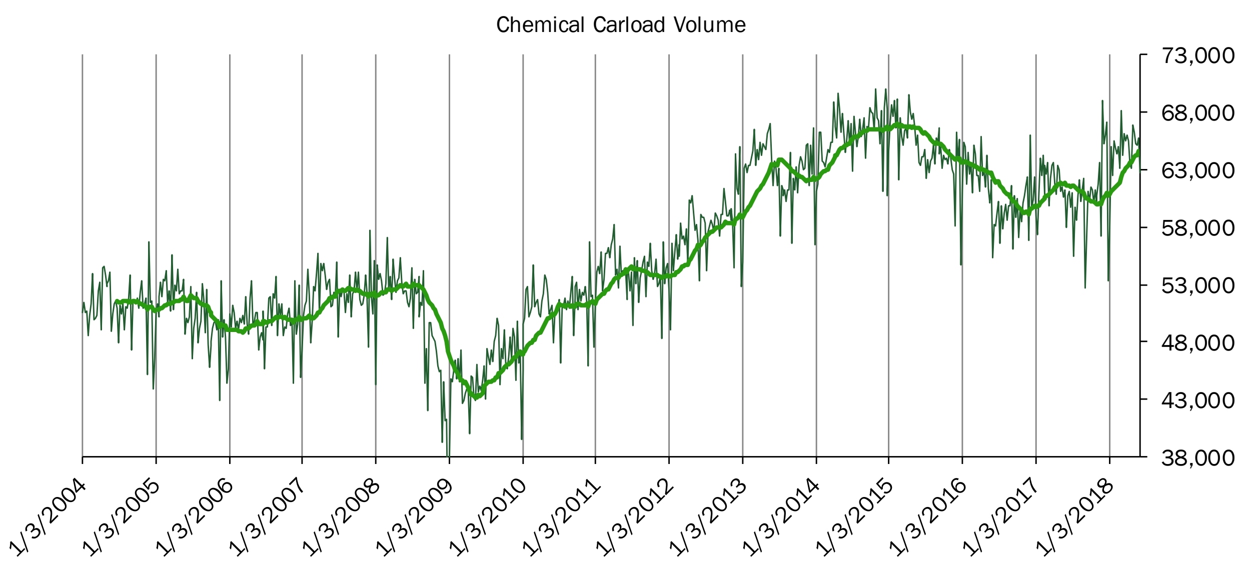
In a similar fashion to the DAT Dry-Van Barometer, the DAT Flatbed Barometer is indicating that the U.S. Industrial economy is alive and well and accelerating. It shouldn't come as a big surprise that spot rates in the flatbed segment:

- have exceeded contract rates since September 2017;
- in May YoY, were up 26.6% on a spot basis and up 10.9% on a contract basis (excluding fuel surcharge, which was up 53.8%).

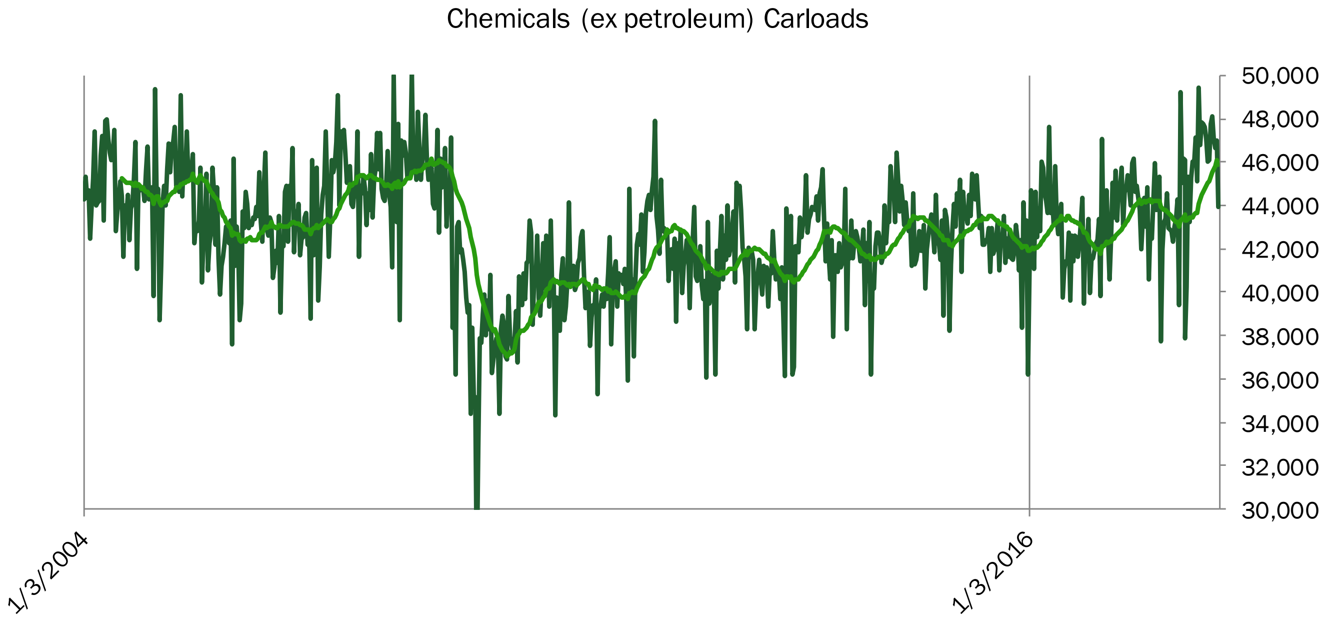
Data from the rail industry mirrors the data coming out of the flatbed segment of trucking. We have asserted for years that one of the best predictive indicators of U.S. domestic industrial activity was the chemical carload volume moving via rail. Our assertion is simple: it is almost impossible to manufacture, or even assemble, anything in mass quantity without consuming chemicals. As a result, there has historically been a very tight relationship between the railroad chemical carload volume and the ISM Manufacturing Index.



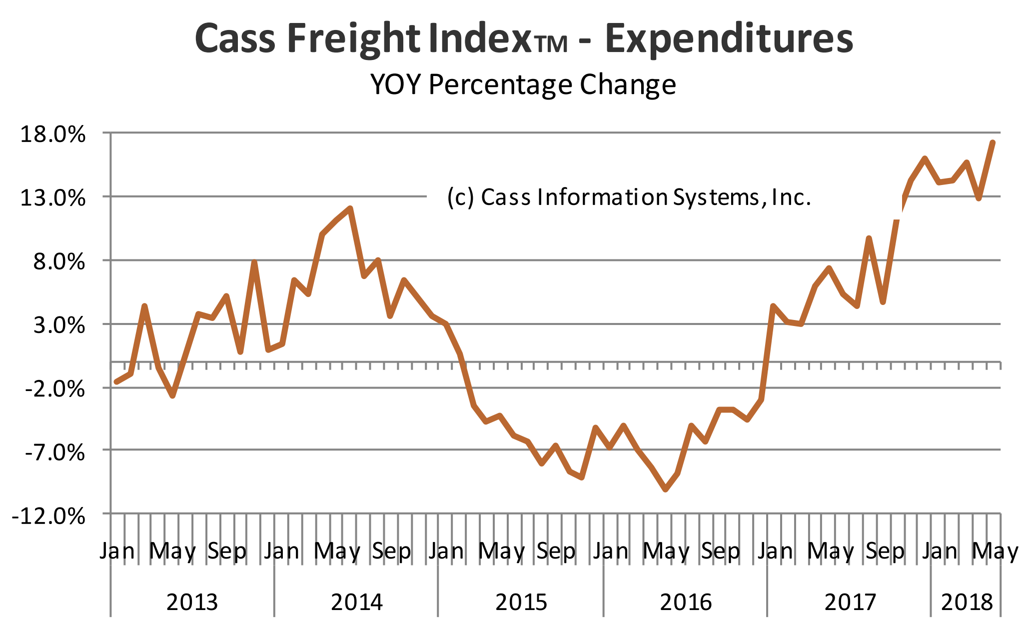
When viewed on a nominal basis the chemical carload volume looks equally bullish for U.S. Industrial Production.



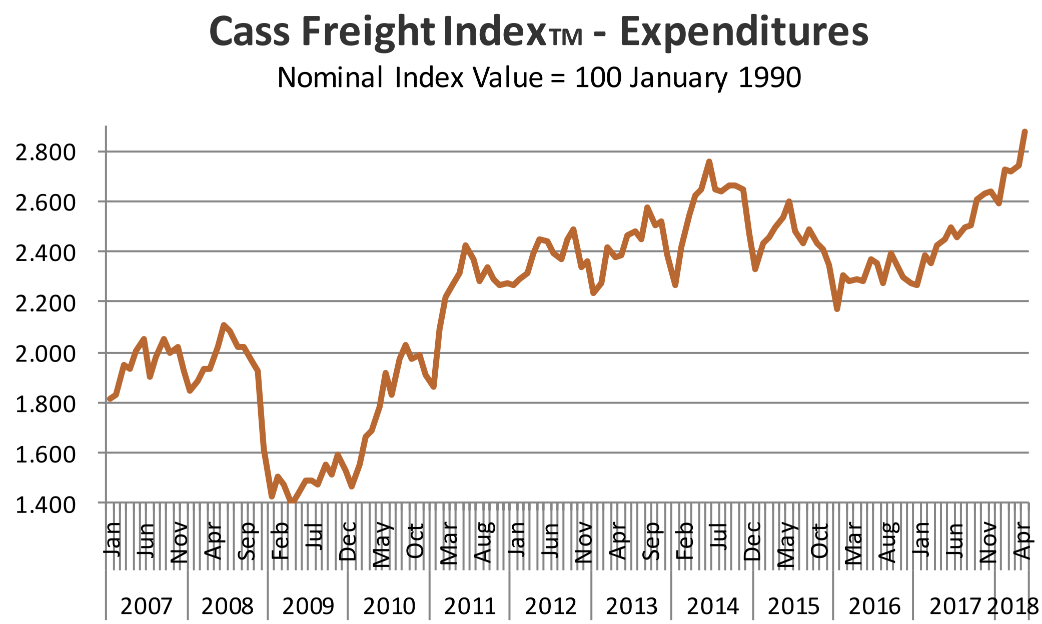
And, for those who might point to the strength provided via the growth in crude by rail, we have stripped out the petroleum carloads from the chemical carload volume. This suggests an equally bullish outlook for the U.S. Industrial Production, at least for the short to intermediate term.



Given the strength in rates being experienced in flatbed and chemical railroading, it should come as no surprise that the Cass Freight Expenditures Index is reporting such overall strength in transportation spending.



With all of the recent strength in demand, it follows that the Cass Freight Expenditures Index also posted strong percentage increases throughout 2017, and has continued into 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 and the current comparison is anything but easy. We have commented repeatedly that this was indictive of an economy that is continuing to expand. **May's 17.3% increase clearly signals that capacity is tight, demand is strong, and shippers are willing to pay up for services to get goods delivered in all major modes throughout the transportation industry**.



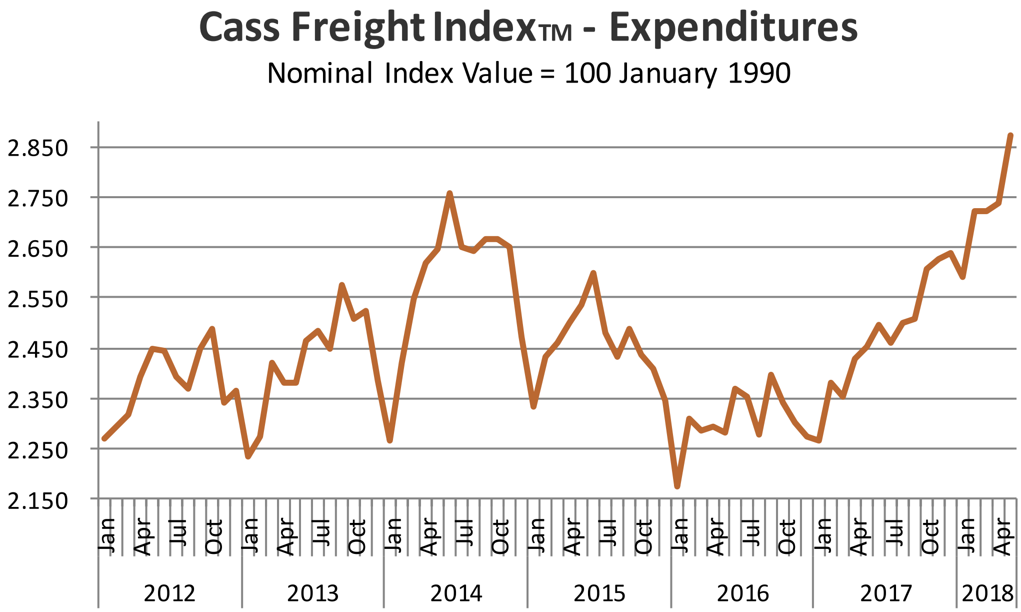
On a nominal basis, the index has exceeded the previous all-time high established back in June 2014, and the current trend appears to continue this trajectory.

Putting it all in Perspective

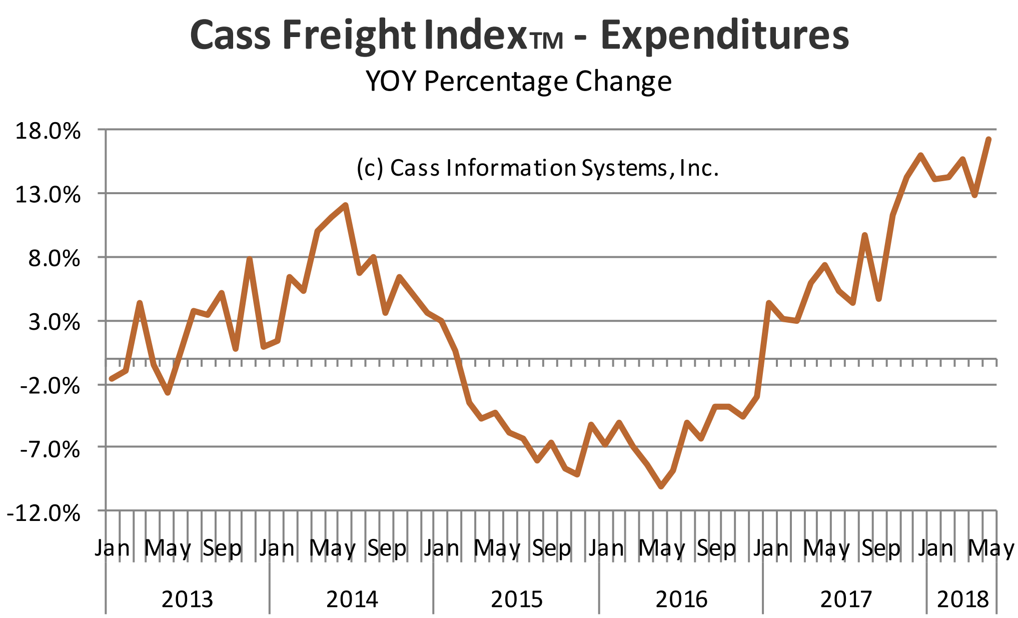
Expenditures (or the total amount spent on freight) turned positive for the first time in twenty-two months in January 2017, albeit against easy comparisons. Not since 2011—when the economy was still climbing out of the recession—had this index been so low. Our Expenditures Index in January 2016 was 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 in the current data.

Throughout much of 2017, fuel was up as much as 30% on a YoY basis (diesel is at $3.27 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. We are also seeing continued increases in the pricing power of truckers and intermodal providers. As an example, the proprietary Cass Truckload Linehaul Index (which measures linehaul rates and does not include fuel) rose 9.0% on a YoY basis in the month of May, which is the strongest percentage increase it has posted in this recovery. The proprietary Cass Intermodal Price Index (which does include fuel), increased 9.1% in May (*see those reports here for more details on the data and the underlying trends*).

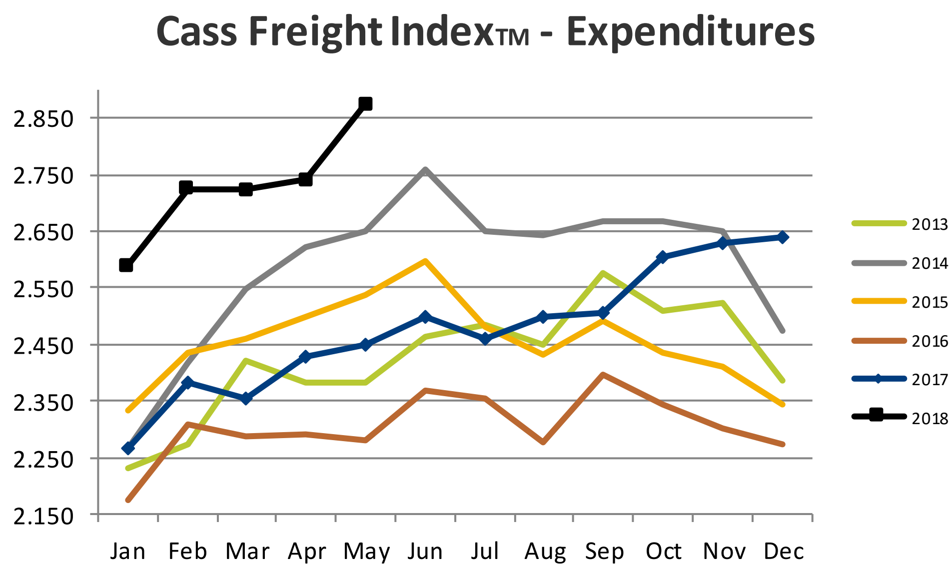
We should also remind readers of a fundamental rule of marketplaces: volume leads pricing. Repeatedly we have watched in a host of different markets that volume goes up before pricing starts to improve and volume goes down before pricing starts to weaken. Even in markets as basic as the weather, the 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 nominal basis shows how positive the trajectory has been in the last year. It has now surpassed levels achieved in 2014. 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 vs the current price of $65 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 despite oil being markedly higher in 2013 and 2014.


Cass Freight IndexTM - Expenditures
2.850
2.750
2.650
2.550
2.450
2.350
2.250
2.150
Jan
Feb
Mar
Apr
May
Jun
Jul
Aug
Sep
Oct
Nov
Dec
2013
2014
2015
2016
2017
2018

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.