



# CASS FREIGHT INDEX REPORT™

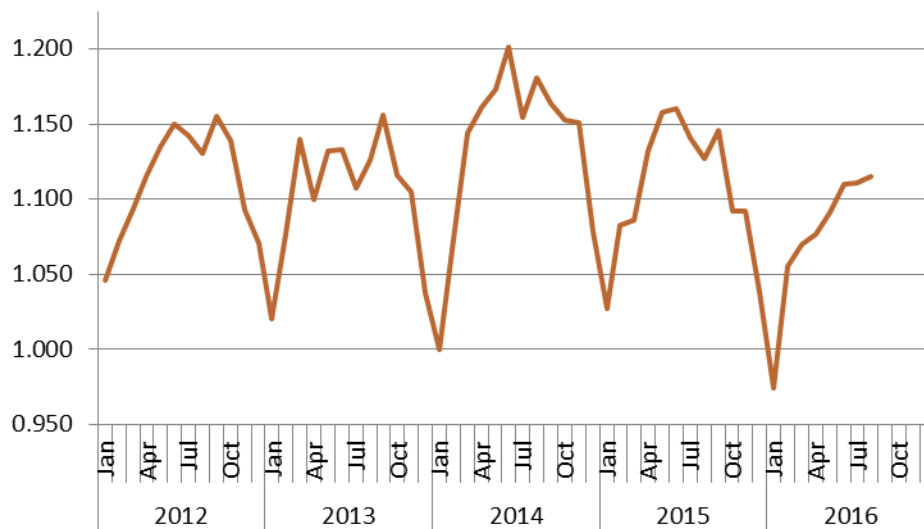
August 2016

## Economic Outlook from Freight's Perspective

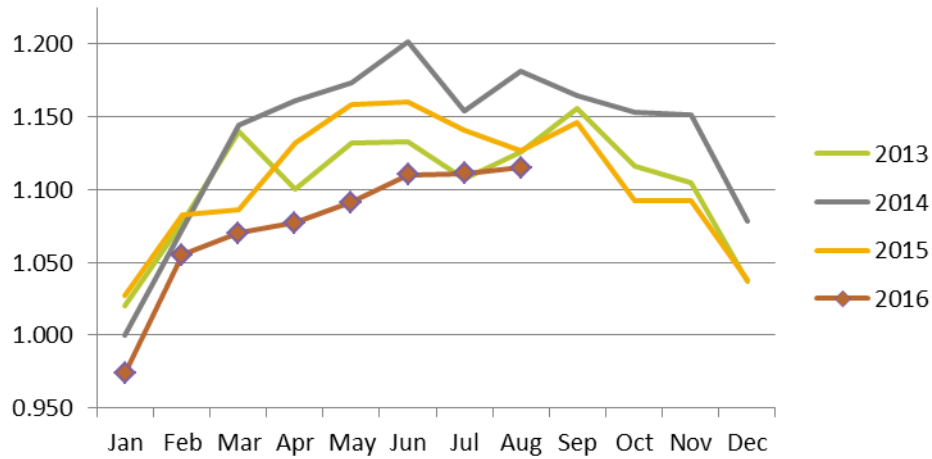
	August 2016	Year-over-year change	Month-to-month change
Shipments	1.115	-1.1%	0.4%
Expenditures	2.278	-6.3%	-3.3%

August's Cass Freight Index continued to signal that overall shipment volumes (and pricing) are persistently weak, with increased levels of volatility as all levels of the supply chain (manufacturing, wholesale, retail) continue to try and work down inventory levels. That said, there have been a few areas of growth, mostly related to e-commerce, with lower levels of expansion being experienced in transit modes serving the auto and housing/construction industries. All of this added up to slightly lower shipment volumes in August on a YoY (year-over-year) basis, marking the eighteenth straight month of year-over-year decline. That said, at least on a seasonally adjusted basis, August volume was up sequentially, offering a glimmer of hope that the contraction in volumes may be getting closer to an end.

### Cass Freight Index™ - Shipments

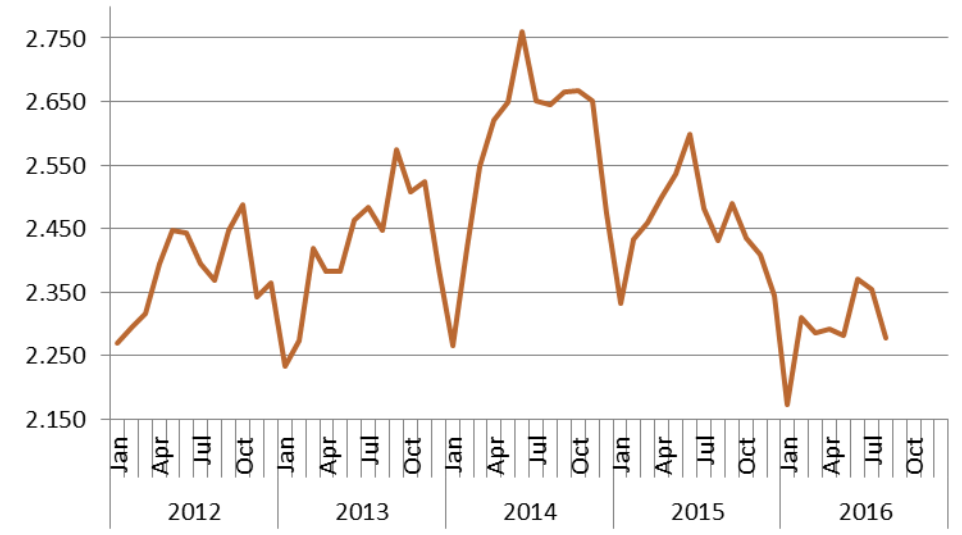


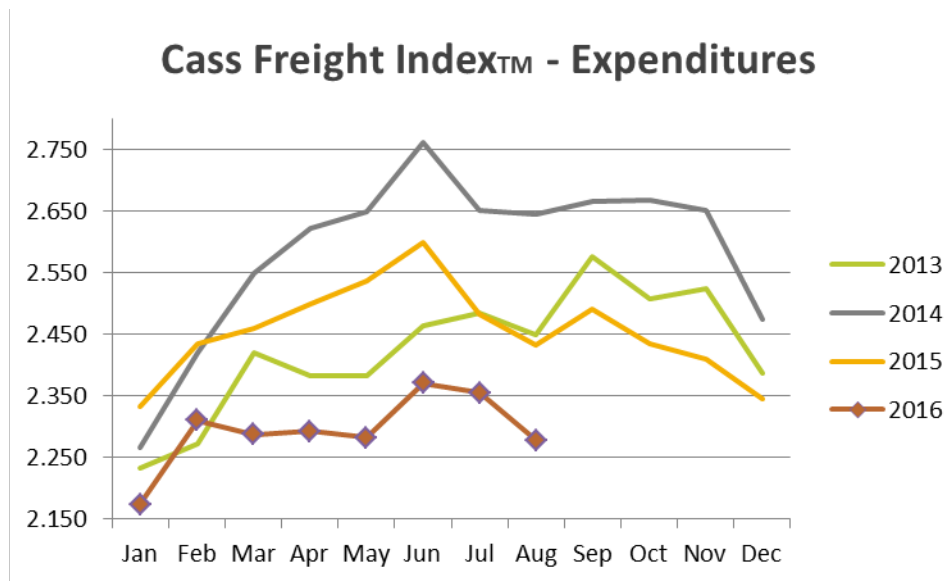
## Cass Freight Index™ - Shipments



Unfortunately, the glimmer of potential reason for hope provided by the Shipments Index was not echoed by the Expenditures Index. Total expenditures were down 3.3% sequentially, and the YoY rate of contraction reaccelerated to down 6.3% (after appearing to ease a bit in July, which was only down 5.1%).

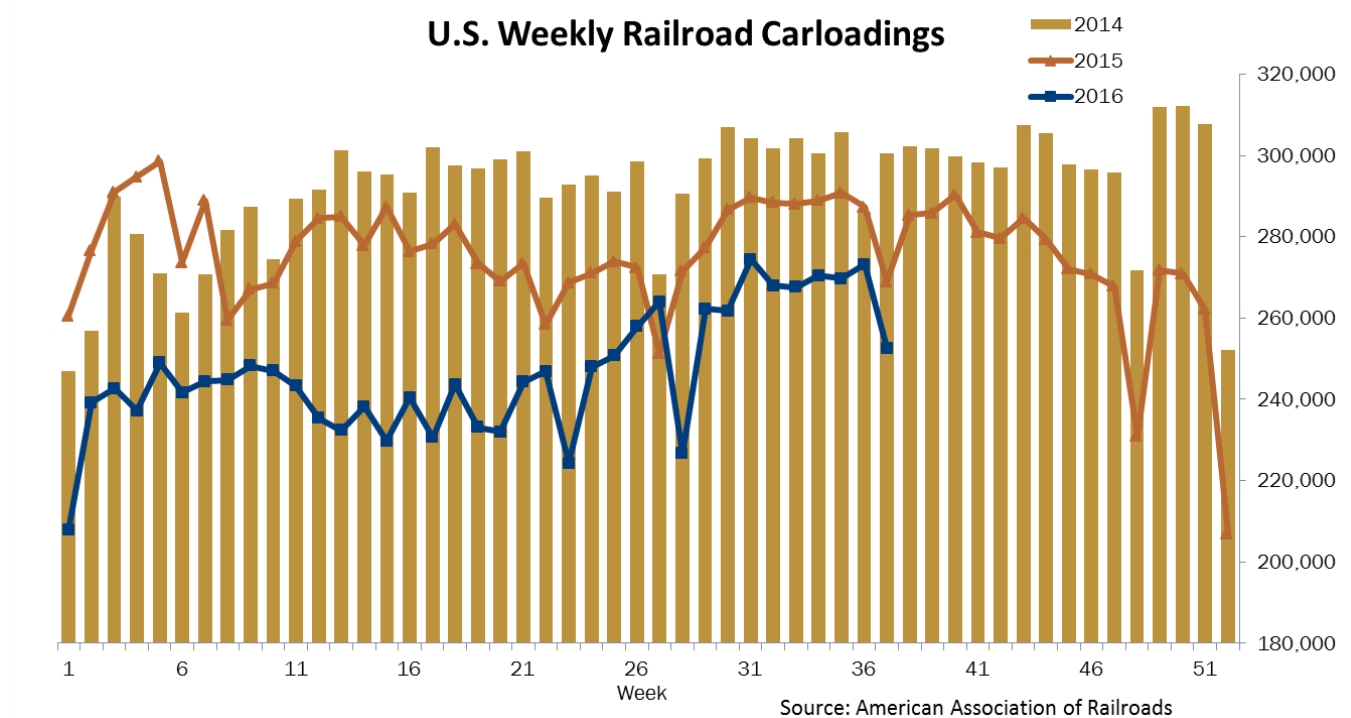
## Cass Freight Index™ - Expenditures





## SHIPMENT VOLUMES

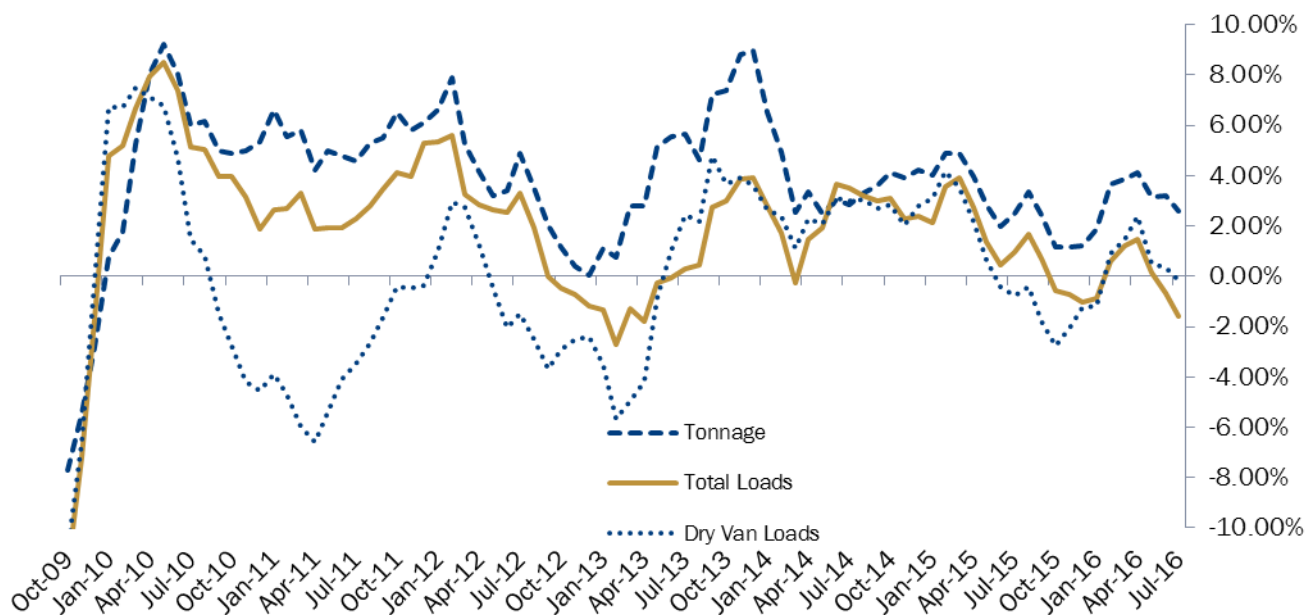
What specifically drove August volumes? It wasn't rail volume. The Association of American Railroads (AAR) reported that August YoY overall traffic for U.S. Class 1 railroads declined, as intermodal units fell 5.3% and commodity carloads originated fell 6.7%. Rails have seen persistent weakness, with overall volumes being negative 82 out of the last 83 weeks.



**We continue to assert the trucking industry provides one of the more reliable reads on the pulse of the domestic economy, as it gives us clues about the health of both the manufacturing and retail sectors. We should note that as**

the first industrial-led recovery (2009-2014) since 1961 came to an end, and the shift from 'brick and mortar' retailing to e-commerce/omni-channel continues, we are becoming more focused on the number of loads moved by truck and less focused on the number of tons moved by truck. Tonnage itself appears to be growing (three-month moving average +2.59% not seasonally adjusted, +2.74% seasonally adjusted). Counter to this, truck loads have now contracted on a YOY basis four out of the last six months, with July's -3.46% bringing the three-month moving average on total loads down to -1.59%. No matter how it is measured, the data coming out of the trucking industry has been both volatile and uninspiring.

### ATA NON-SEASONALLY ADJUSTED TRUCK VOLUMES 3MMA YoY



Source: ATA (American Trucking Associations)

The bottom line: truck volumes are mixed, as tonnage continues to be slightly positive and load volume continues to be slightly negative.

## FREIGHT EXPENDITURES

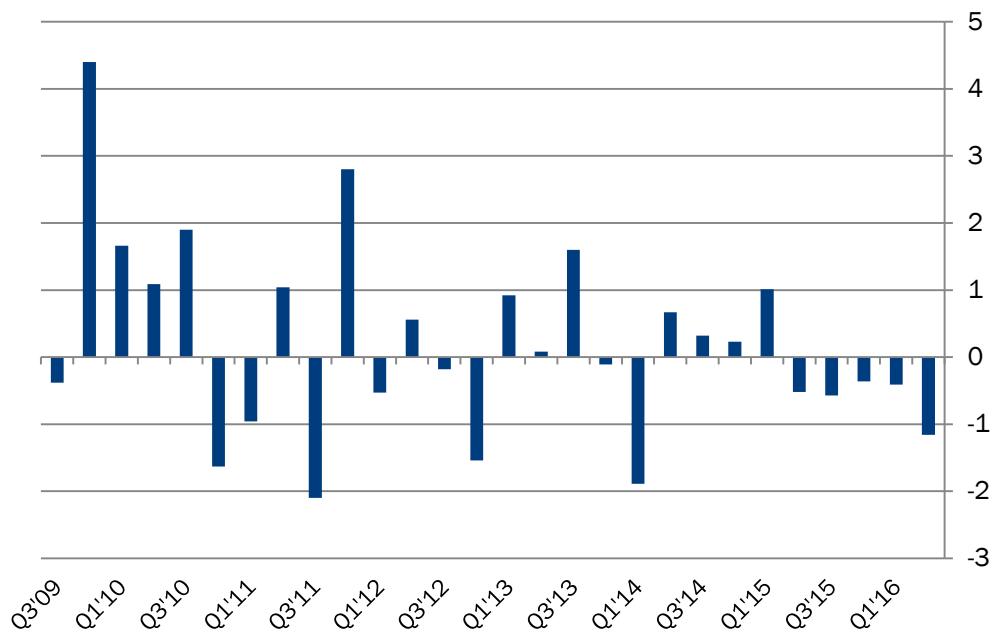
As discussed above, the 6.3% YoY decline and 3.3% sequential decline in yield overshadowed the glimmer of hope initially offered by the lessened rate of weakness in the volume index. We continue to see this weakness as driven by the excess of capacity in most modes: trucking, rail, air freight, barge, ocean container and bulk. The weakness is also driven in part by the ongoing decline in diesel and jet fuel and corresponding fuel surcharges that influence pricing realized by shippers. Although at first blush it appears that in most modes the gap between spot pricing and contract pricing appears to be closing slightly, this is more a function of slight declines in contract pricing than it is a function of improvements in spot pricing. We see little reason to predict a change in course or material strength in either the contract or spot rates for most modes. Exceptions to this do remain in the parcel marketplace and forms of expedited transit supporting e-commerce.

## OUR VIEW OF THE BACKDROP?

**The U.S. economy continues to be in a state of transition.** After the explosion in fracking activity (pun intended) drove the first industrial-led recovery (2009-2014) in the U.S. since 1961, we have been patiently waiting for the consumer to take the baton of leadership in economic growth. Fracking in the U.S. has been so successful that it drove the worldwide price of crude down and positioned the U.S. globally as the world's single largest oil producer. It also drove the North America price of natural gas to record lows not seen since the 1999 El Nino-induced levels. With the dramatic drop in crude and natural gas prices, the financial incentive to drill and frack additional wells also dropped, and the U.S. slipped into an industrial recession in March 2015. Nearly all of us practicing the dismal science of economics began predicting in the Spring of 2015 that as the price of oil and natural gas fell, the consumer would take the increase in disposable income—created by the decreases in the costs of their daily commute and heating and cooling their house—and spend it. Why? Because since the end of World War II, the greatest predictor of consumer spending, expansion or growth, was the expansion or growth of consumer disposable income. But instead of following the playbook, most U.S. consumers have been choosing to pay down debt and increase their savings rate. Simply put, the consumer has not yet picked up where the industrial economy left off.

**Inventories have now contracted from GDP for five consecutive quarters to the tune of ~3% of GDP.** This is the longest stretch outside of a recession since 1956-57 and the largest in magnitude since 1995. We expect de-stocking to continue into Q3 in retail, based on the NRF's (National Retail Federation's) Port Tracker survey. We remain concerned about elevated levels of cars on dealer lots, and we acknowledge continued efforts to streamline finished inventory in most machinery sectors. Overall inventory levels remain elevated compared to sales, but with further improvement on many ratios in '2H (which we expect), and unless demand takes another step down, we believe the persistent drag of de-stocking should progressively lessen as we enter 2017.

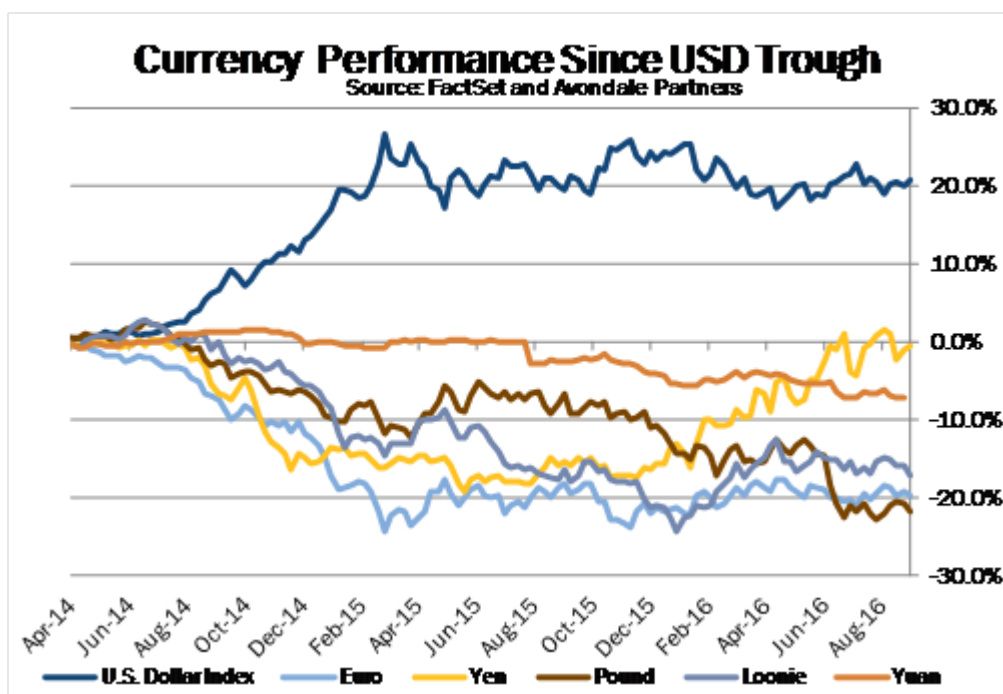
**Inventory Impact to GDP**



## OVERALL PICTURE

### Talked Themselves Into It

We believe The Federal Reserve should not raise rates again. Unfortunately, whether they do so this month (less likely), or in December (more likely), it will only serve to make the U.S. Dollar stronger. Historically, a strong Dollar has produced a serious headwind for freight volumes, first in all things exported, and then in a reduction of things manufactured or assembled domestically. Nothing in the freight flow data suggests that another rate hike is warranted, or even that the first hike in December 2015 was necessary. That said, this Federal Reserve Board of Governors seem to be very good at talking themselves into a corner from which they see no escape except to what they have been threatening to do. We understand that the unemployment rate has fallen to a point that historically has generated labor cost inflation, but we also understand that the labor participation rate has also fallen (from 66-67% throughout the 1990's to under 63% today), and together with a lack of productivity improvement, labor cost inflation isn't nearly as threatening as it has been.



### Expecting Flattish '2H

Ex auto industrial production trends did start to flatten out in Q2 (improving to up 0.2% in Q2 from down 1.2% in Q1). We see this largely as a return to more normal seasonal production patterns than anything else. Overall industrial production continues to track between 0% and +1% thanks to the lift from autos and nondurables (goods consumption picked up in Q2 as seen in the GDP data). However, we are concerned that elevated inventories on dealer lots, along with slowing sales, will lead to U.S. auto production to grow less than 1% on a YoY basis in Q3. Thus, we are now anticipating '2H manufacturing industrial production to be flat YoY, down from our prior hopes of a modest recovery into the up 1+% range.

On the consumer side of the equation, we do see some signs of hope—especially for those retailers with a strong e-tailing or omni-channel offering. With the price of oil and natural gas remaining low, we see little reason to predict a resurgence in fracking or the many types of industrial activity that fracking drives. Obviously, this would also mean that the consumer would continue to enjoy improved disposable income. As we have pointed out, the U.S. consumer has been saving and paying down debt with this disposable income for over six quarters. By this holiday season, we expect them to begin to spend at least part of their income. If not, the risk of an overall recession grows.

That said, there is a bit of irony in our prediction of possible recession. The longer the consumer saves and pays down debt, the more likely it is that the U.S. falls into a recession. But, the longer the consumer saves and pays down debt, the shorter and more mild the recession will be since there will be less excess to clean up. Stay tuned ...

## 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 \$26 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

Managing Director, Chief Market Strategist and Senior Transportation Analyst, Avondale Partners

Mr. Broughton joined Avondale Partners in January of 2008 after spending over 12 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. 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.

Currently, he is predicting that the power of the industrial recovery—led by fracking—was both under-estimated and is coming to an abrupt end. Since his downgrade of the railroad group to Market Underperform in early 2015, the stocks have fallen by over 35%. 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 Avondale:**

**Cass Truckload Linehaul Index** – measures fluctuations in U.S. truckload linehaul rates

**Cass Intermodal Price Index** – measures fluctuations in U.S. domestic intermodal costs

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