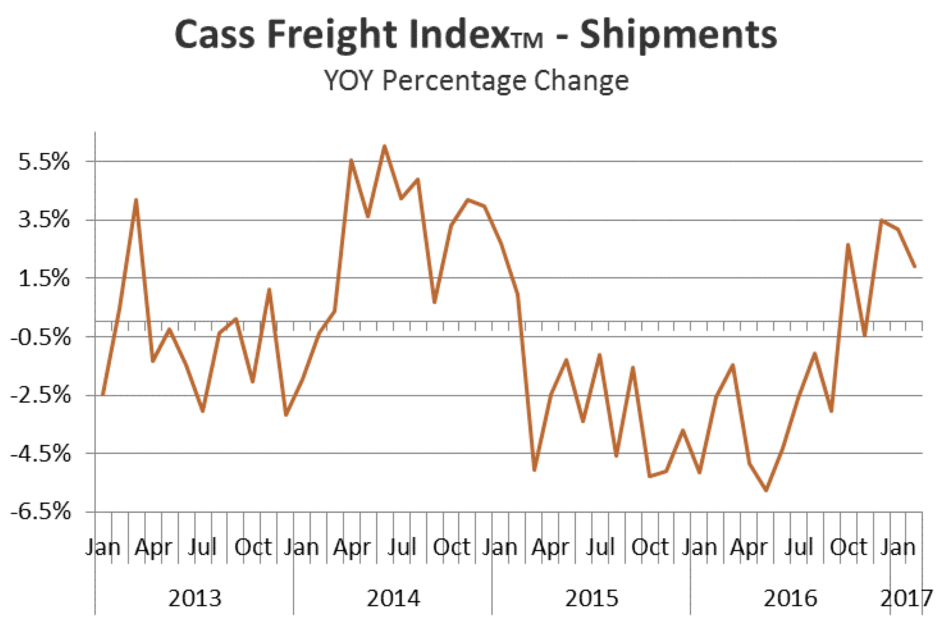
CASS FREIGHT INDEX REPORT™

February 2017

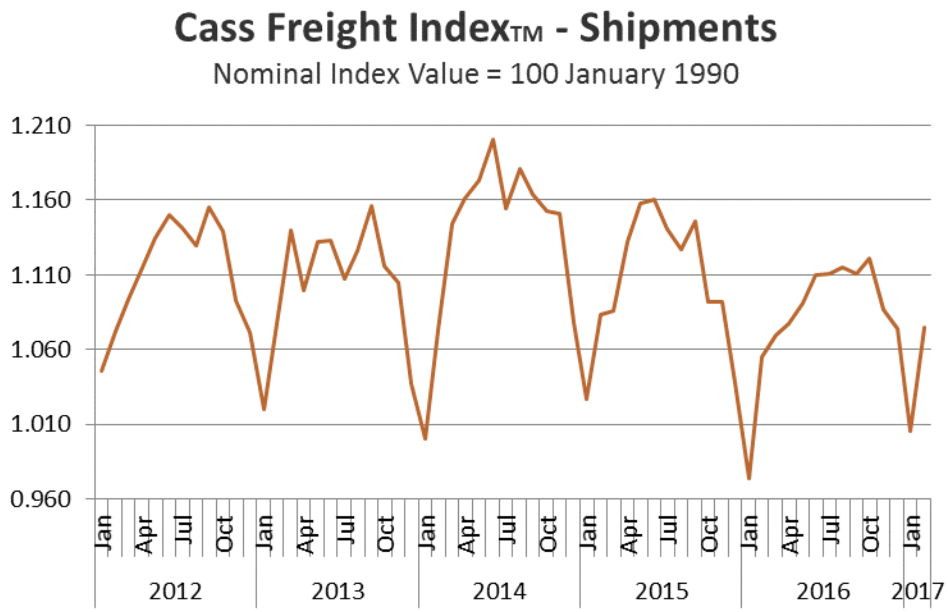
Economic Outlook from Freight's Perspective – Gentlemen, Start Your Engines!

	February 2017	Year-over-year change	Month-to-month change
Shipments	1.075	1.9%	7.0%
Expenditures	2.383	3.2%	5.1%

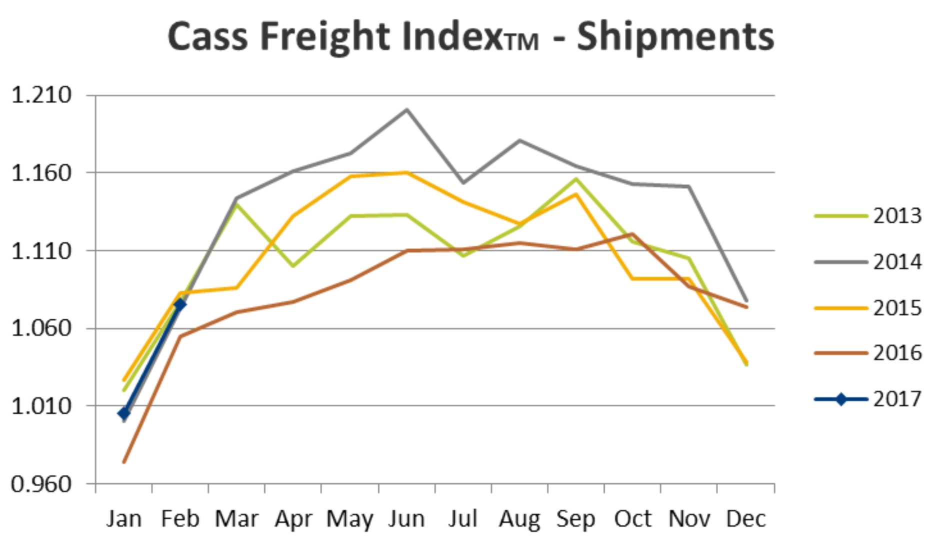
Both the Shipments and Expenditures Indexes have been positive for two months in a row. Throughout the U.S. economy, there is a growing number of data points suggesting that the economy is getting better. Some data points are simply less bad, but an increasing number of them are better, and even a few are becoming outright strong. **The 1.9% YoY increase in the February Cass Shipments Index is yet another data point which strongly suggests that the first positive indication in October may have indeed been a change in trend.** In fact, it now looks as if the October Cass Shipments Index, which broke a string of 20 months in negative territory, was one of the first indications that a recovery in freight had begun in earnest. Data is suggesting that the consumer is finally starting to spend a little. It also suggests that, with the surge in the price of crude in October of last year, 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?" However, the overall freight recession, which began in March 2015, appears to be over and, more importantly, freight seems to be gaining momentum.



Unlike in January, the February sequential pattern looked very promising (in January the YoY was up 3.2% but was down 6.4% sequentially). Since February is always one the weakest freight months for most modes of transportation (truck, rail and parcel), the sequential strength emboldens our view that the recovery is not a 'flash in the pan' but real. We also continue to receive almost-daily reports of stronger shipment volume in all modes from both hard data sources and industry anecdotes, which we will outline later in this report.

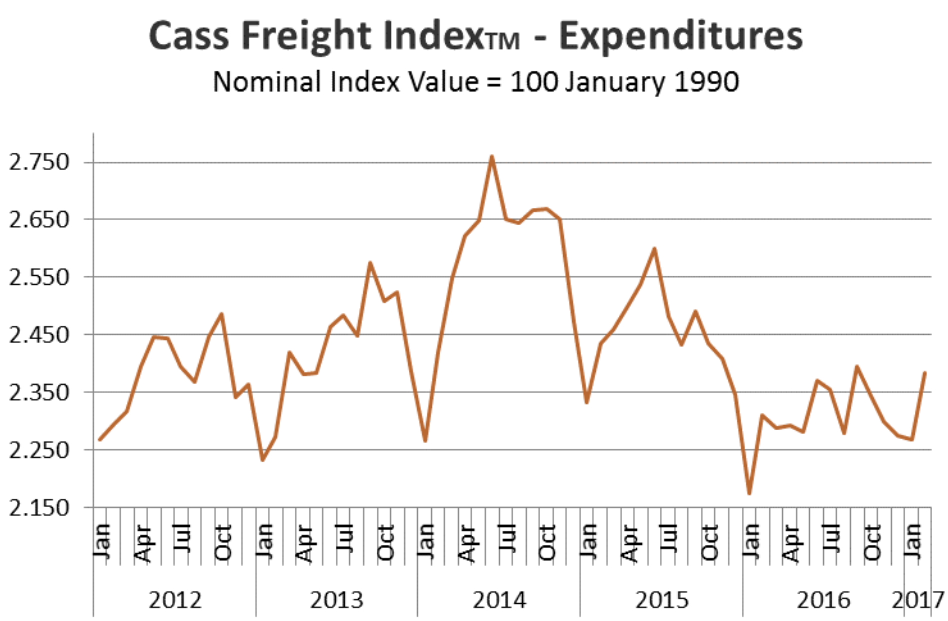


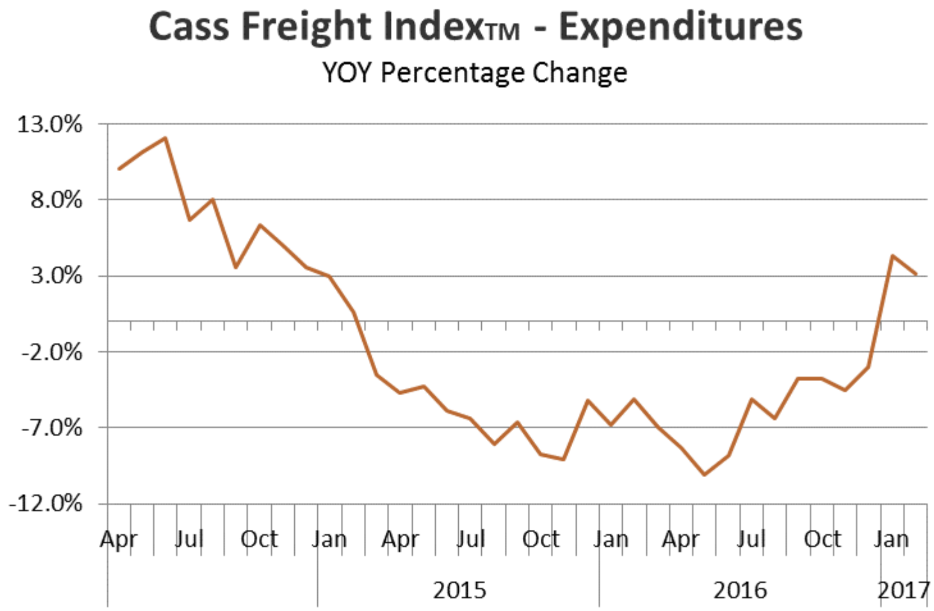
The Cass Freight Shipments Index—when viewed on a nominal YoY stacked basis—further highlights the strength of the current number. Although not quite yet back to the most recent peak reached in 2015 (1.083) and nowhere near the all-time February peak reached in 2005 (1.321), February 2017 was relatively equal to the February indices reached in 2013 and 2014 (1.077 and 1.073, respectively).



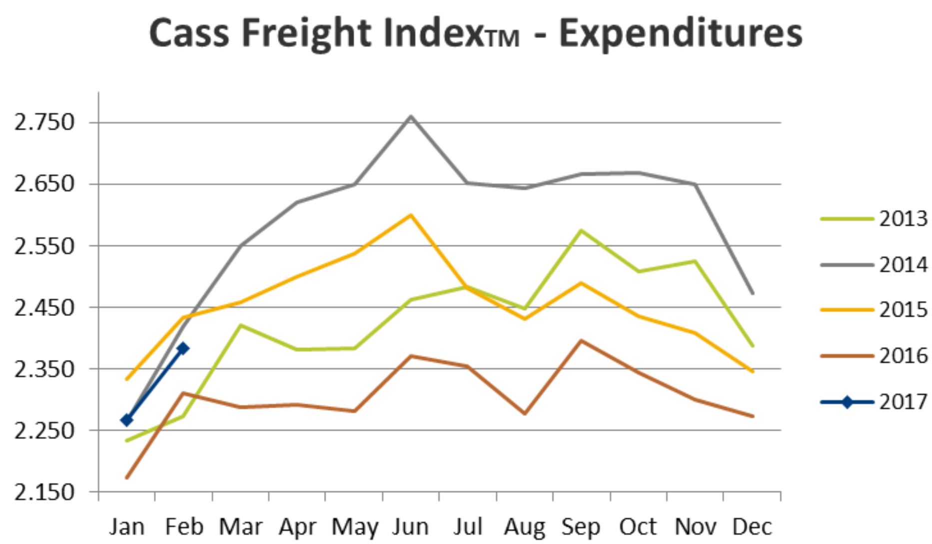
The Cass Freight Expenditures Index also continued to signal a turn in trend. Expenditures (or the total amount spent on freight) turned positive for the first time in 22 months in January, albeit against an easy comparison. Not since 2011—when the economy was still climbing out of the recession—had 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 2016 was also weak, it was 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 negative bias in the data last year. Conversely, over the last several months, we have observed that part of the increase was a result of the steady increase in the price of fuel over the last six months. But, 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) only fell 0.8% on a YoY basis in the month of February, which was less than the 1.5% and 0.9% declines posted in November and December, respectively. The proprietary Cass Intermodal Price Index (which does include fuel) faired even better, increasing 4.9% in February. This was an acceleration from the 1.5% increase it posted in December and marked the fifth consecutive YoY increase after 21 consecutive months of decline (*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 growth. 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.





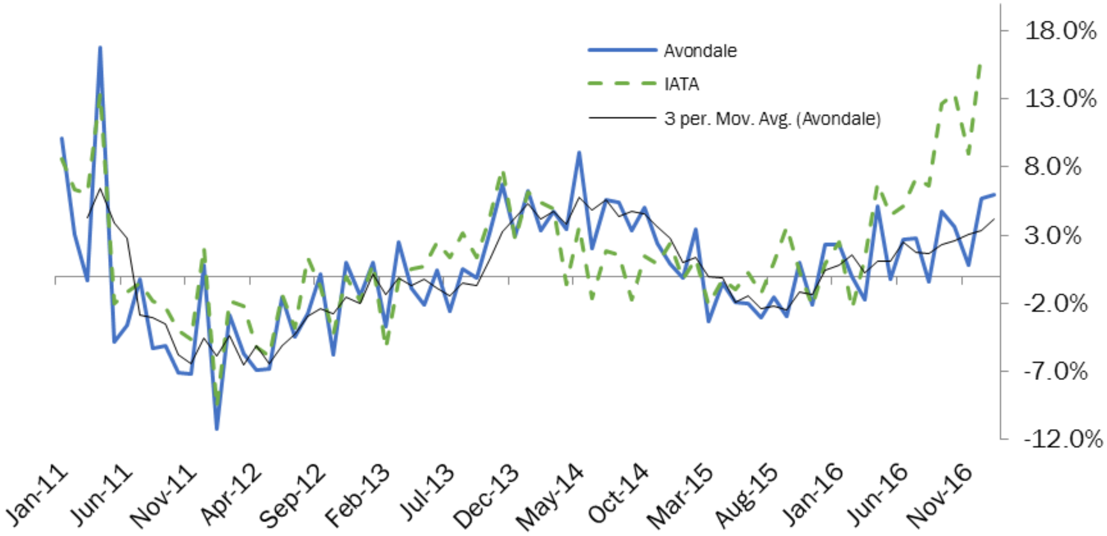
Similar to the Cass Freight Shipments Index, the Cass Freight Expenditures Index—when viewed on a nominal YoY stacked basis—highlights the strength of the current number. Although not quite yet back to the all-time peak reached in June 2015 (2.434), February 2017 was close to the February index reached in 2014 (2.419) and in excess of February 2013 (2.273).



SHIPMENT VOLUMES

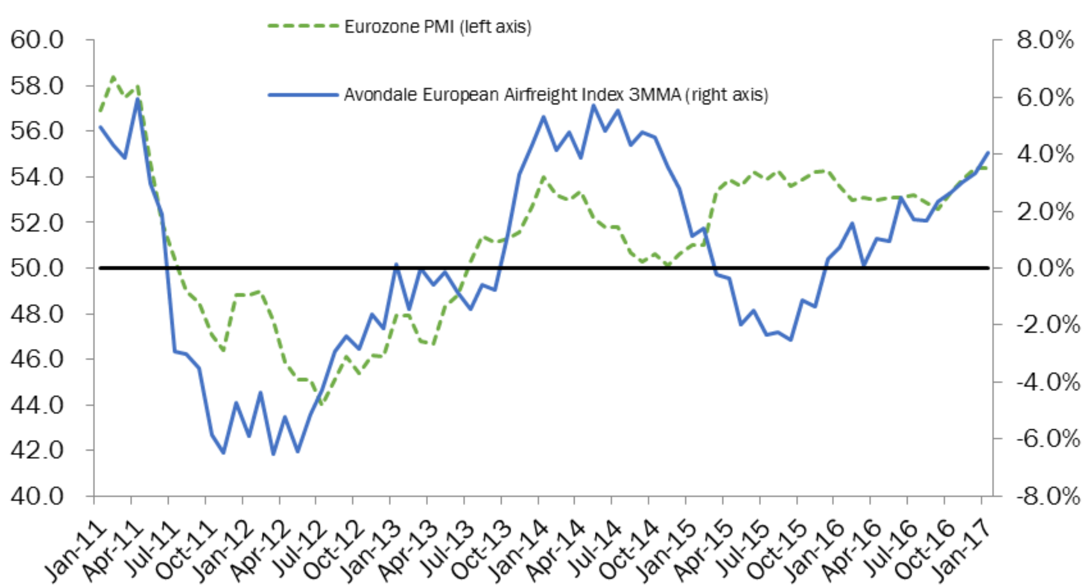
What specifically is driving recent volumes? Parcel volumes associated with e-commerce continue to show outstanding rates of growth, with both FedEx and UPS reporting strong U.S. domestic volumes. According to the proprietary Avondale Partners' index in the most recent month available (January), airfreight has also been showing strong, YoY improving strength, with the Asia Pacific lane jumping 8.0% and the Europe Atlantic lane growing 5.9%. This was a solid follow-on from December, November, October and September during which the Asia Pacific lane grew 13.2%, 7.8%, 10.5%, and 7.5% (respectively) and the Europe Atlantic lane grew 5.7%, 3.4%, 3.6%, and 4.7% (respectively). This also highlights that this resurgence began before the election.

EUROPEAN AIRFREIGHT



The strength in European airfreight gives us increasing confidence that the improving trends in the freight economy are not confined to the U.S. We should also point out that historically, strength in this index has been followed by a stronger European PMI. Simply put, it looks as if the European economy is also improving. Given the fact that in total the EU economy is the second largest in the world, we are more confident about the global economy.

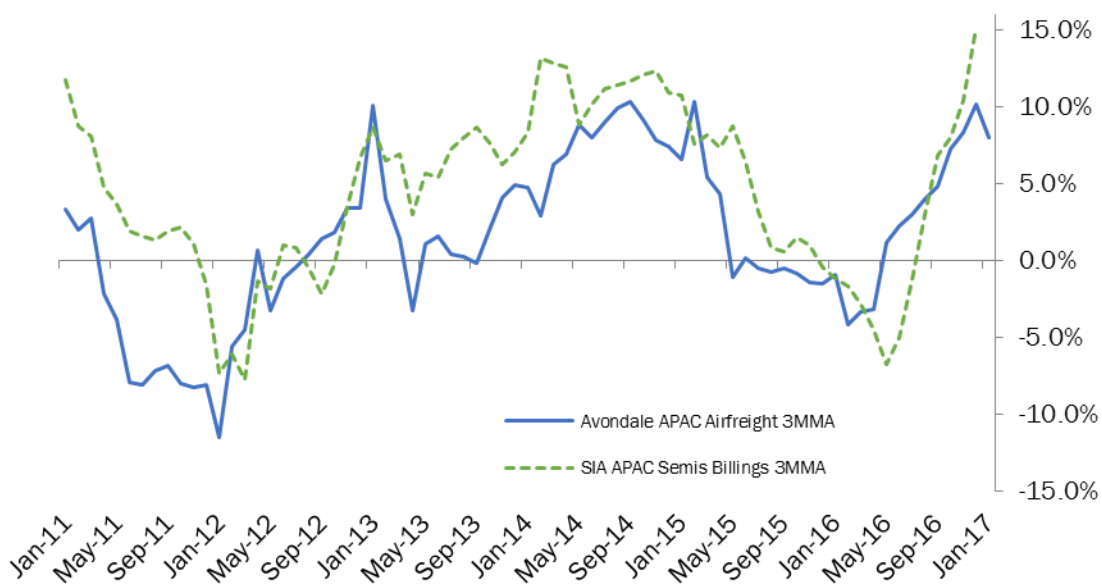
EUROPEAN AIRFREIGHT INDEX VS. EUROZONE PMI



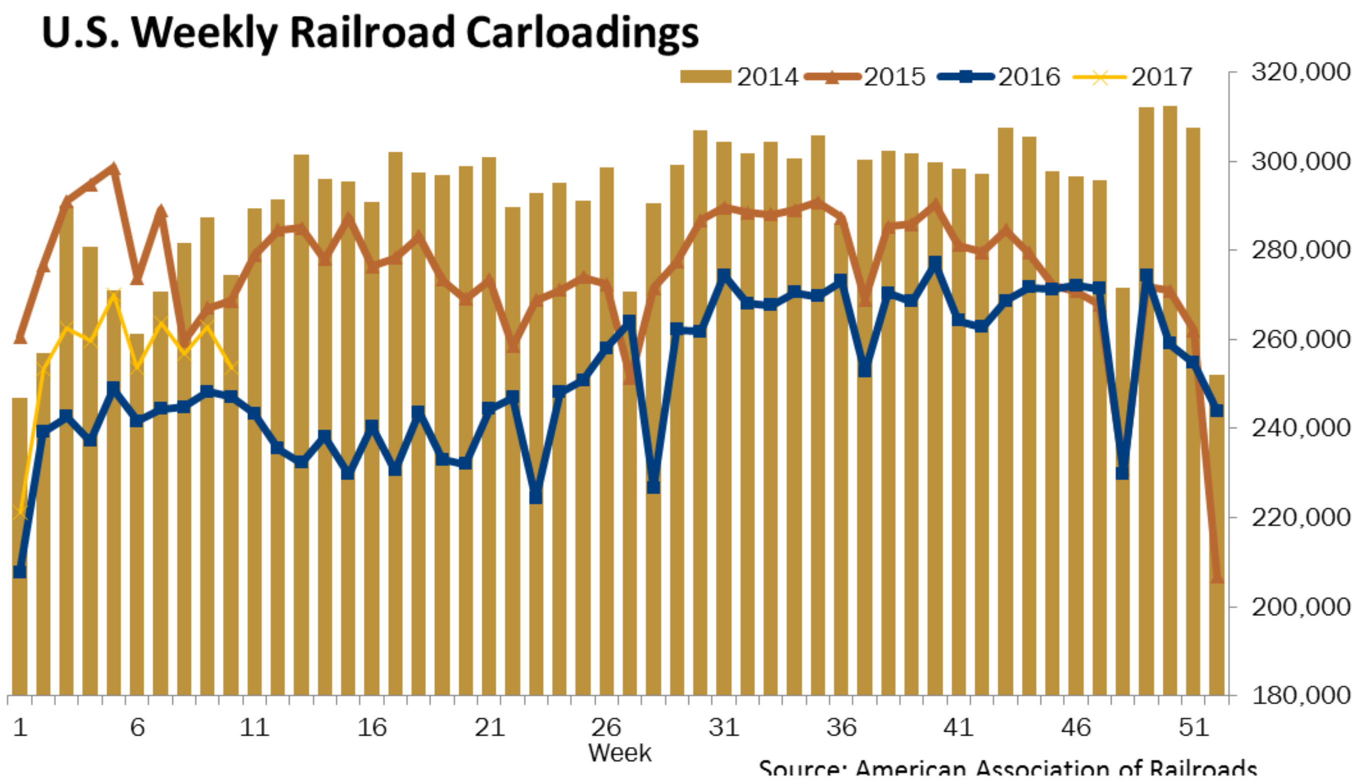
APAC AIRFREIGHT

The recent surge in Asia Pacific airfreight gives us increasing confidence in the technology segment of the global economy, not because everything that moves in this lane is a semiconductor, but because the largest overall segment/type of good that is moved via airfreight in this lane has one or more semiconductors in it. Hence, there historically has been a high level of correlation between Asia Pacific airfreight and semiconductor billings. Good news for economies in Asia, and good news for the technology segments of the U.S. economy.

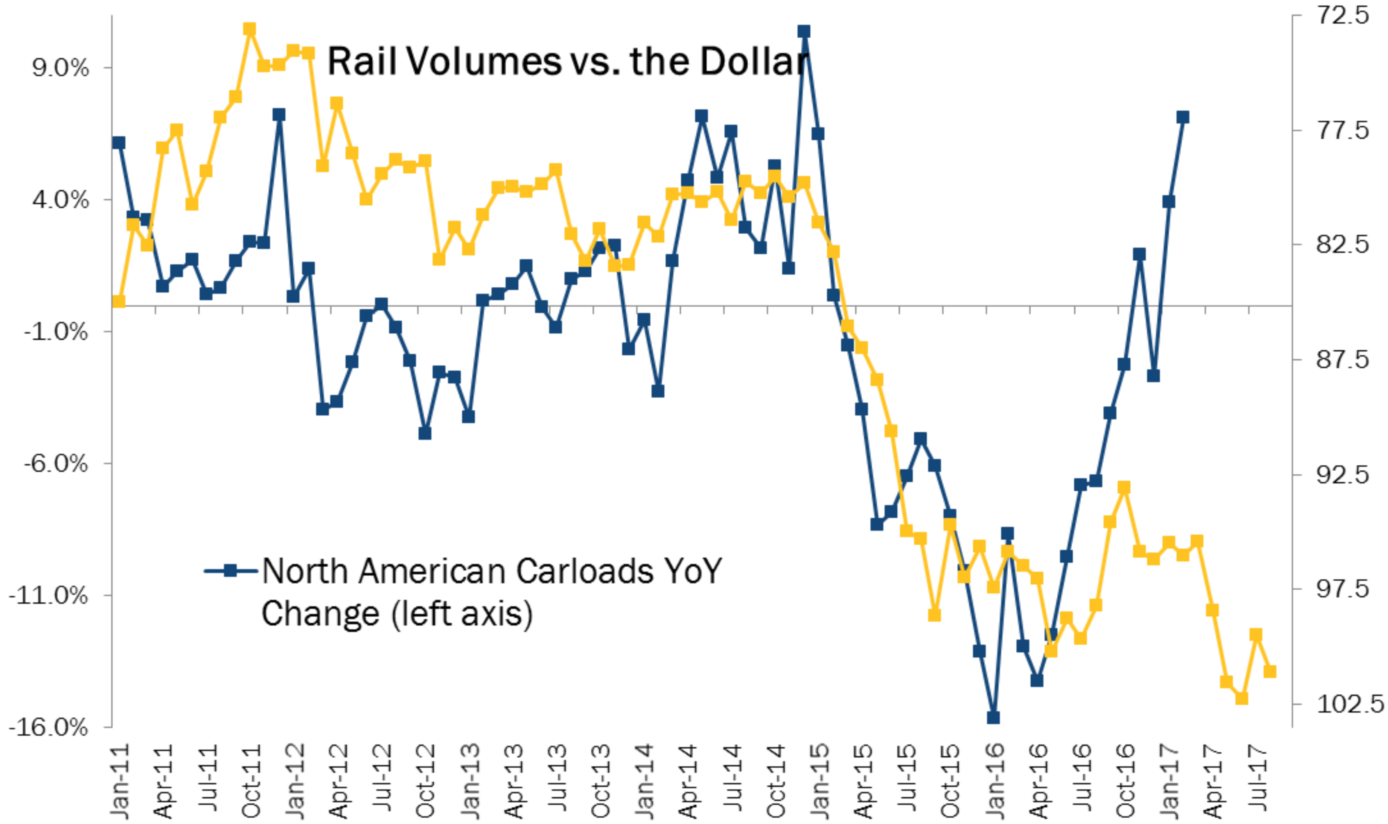
APAC AIRFREIGHT



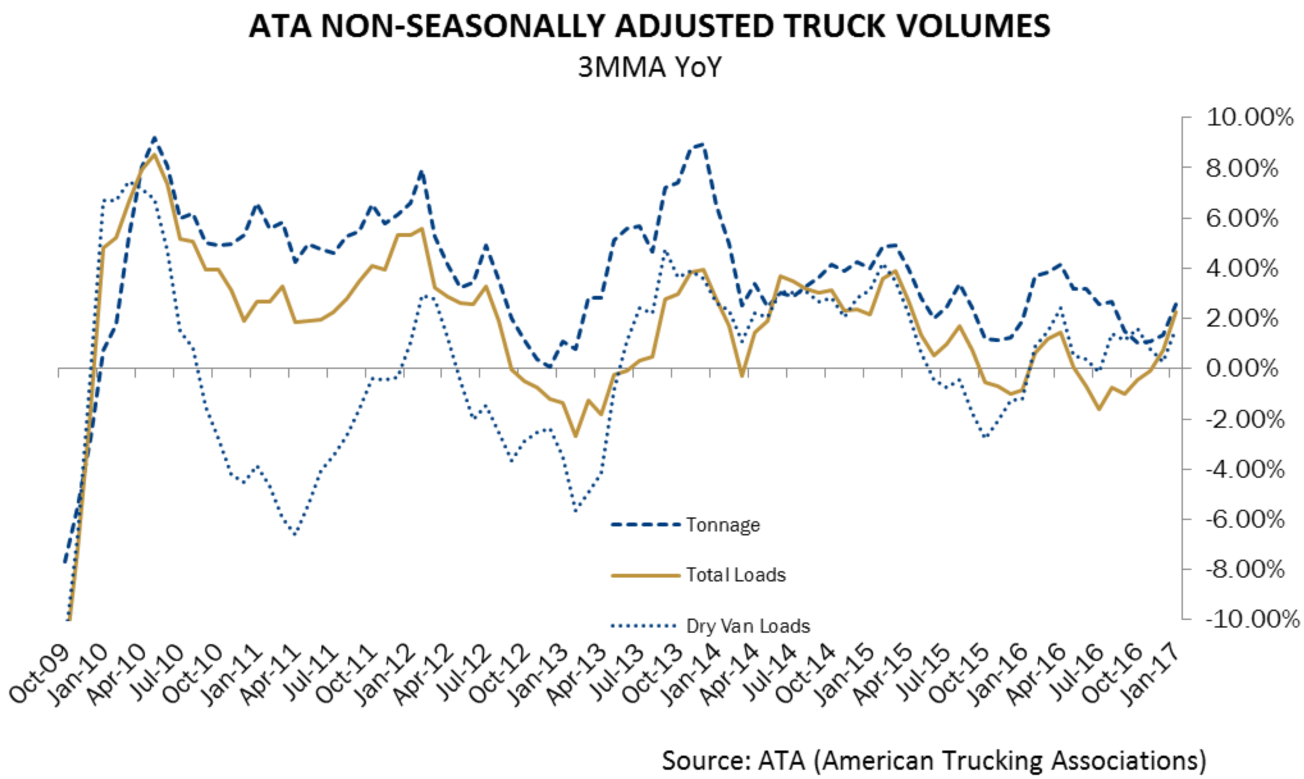
Over the last two years, rail volumes have been a significant part of the weakness in freight flows. But lately they have become increasingly less bad, and in recent weeks have turned positive. Although it was against a very easy comparison, the Association of American Railroads (AAR) reported that February YoY overall commodity carloads originated by U.S. Class 1 railroads grew by 5.3%, and even intermodal units have turned positive up 0.4%. Rails have seen persistent weakness for almost two years, with overall volumes being negative 92 out of the last 109 weeks. However, the most recent week of data suggests that the higher price of crude (WTI $49 as we write this) is driving increased activity in oil and gas exploration as companies with DUCs (drilled uncompleted wells) are choosing to proceed with fracking operations. Just as the dramatic drop in fracking led us into the industrial recession in March 2015, it now appears to be in the early stages of leading us out. Bottom line, rails may not serve as a drag to the overall Cass Shipments Freight Index in coming months, but instead are starting to be a positive.



Why have rail volumes been so weak? In addition to the reduced fracking activity, **we see the strength of the U.S. Dollar, which is driving both fewer exports and less domestic manufacturing, as the primary driver.** In the chart below, we have inverted the value of the dollar to make the inverse relationship easier to see. The current currency valuation would suggest continued weakness in rail volumes. So, which one will win out - the higher price of oil or the stronger U.S. Dollar? Longer term, who knows. In the short term, the higher price of oil is proving to be a stronger factor than the strength of the U.S. Dollar.



We continue to assert that 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 and gaining momentum (three-month moving average +2.55 not seasonally adjusted). Although truck loads have now contracted on a YoY basis four out of the last seven months, the most recent month (January) reported by the American Trucking Associations (ATA) was up 3.2% and brought the three-month moving average up to +1.6%.



The bottom line: after being a source for concern for many months, trucking industry data appears to be getting better and gaining momentum.

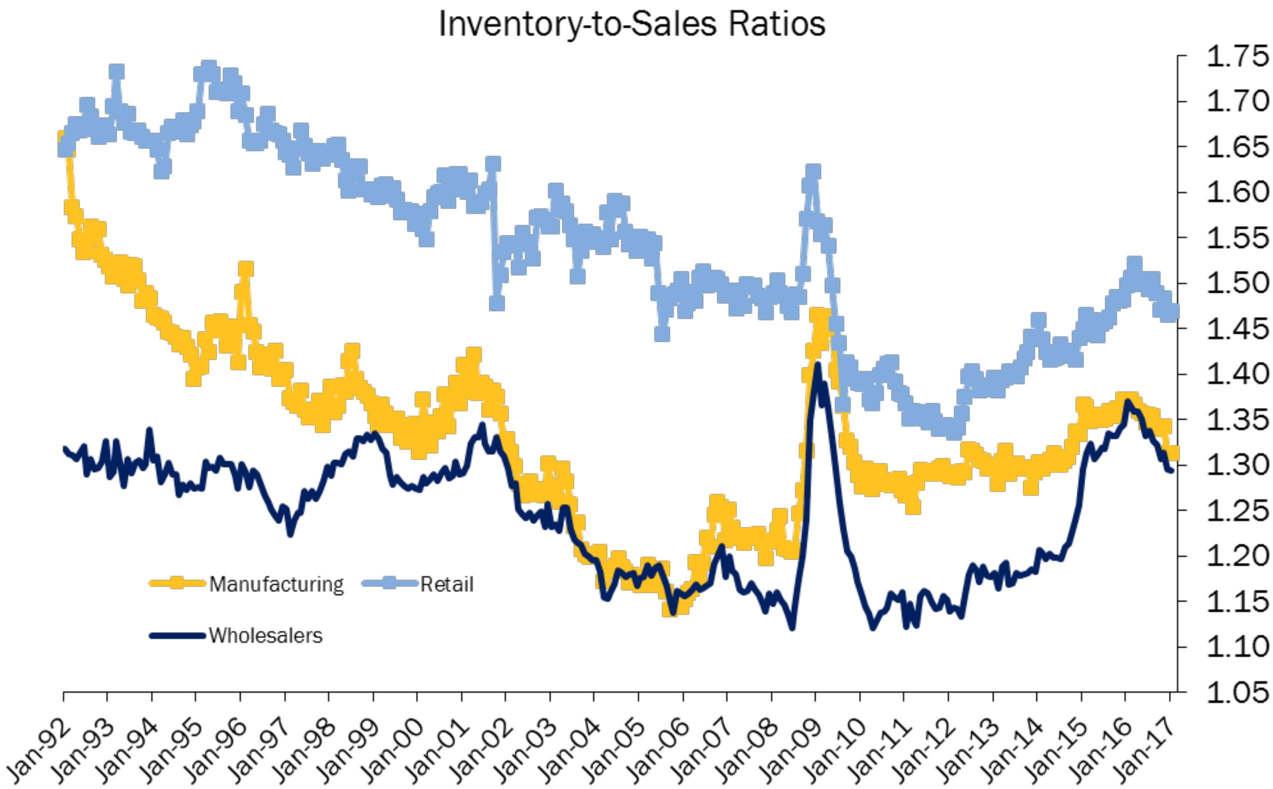
OVERALL PICTURE

Oops, They Did It Again

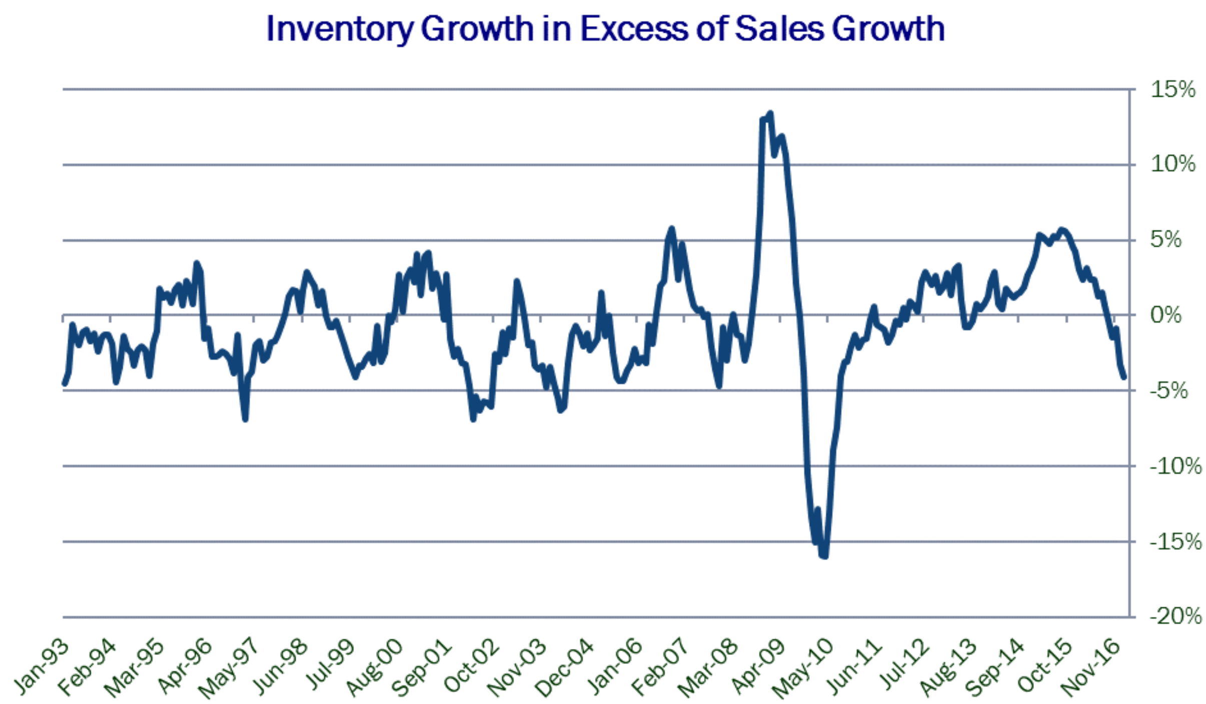
With the Federal Reserve's quarter point rate hike in December and again in March, the financial markets have begun to price in further rate hikes (probably not in June, but likely in September) and the yields for bonds have materially increased. This has only served to make the U.S. Dollar stronger. We'd remind our readers that 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. Counter to our previous outlook, we would now admit that the freight flow data is beginning to suggest that the Fed had more room than we perceived to raise rates. The acceleration in the financial markets, in addition to the reacceleration in freight flows, has put this Federal Reserve Board into a position that other central bankers are envious of: that of being able to raise rates.

First In, Last Out?

We'd be remiss if we didn't admit that part of our growing confidence that the data (both from Cass and specific industries) is showing a turn in trend and is not just a false positive, is the underlying trend in inventories at all levels of the supply chain. At the manufacturing, wholesale and retail levels, inventory to sales ratios have been consistently falling.



When this metric in the overall U.S. economy is viewed from the perspective of "How much is inventory growth exceeding sales growth?", the data shows that even as sales are accelerating, inventories are contracting. This suggests that a significant restocking throughout the economy could be coming and boosts our confidence in a continued rebound in freight flows.



Source: U.S. Department of Commerce, Bureau of Economic Statistics, and Avondale Partners

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 $20 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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