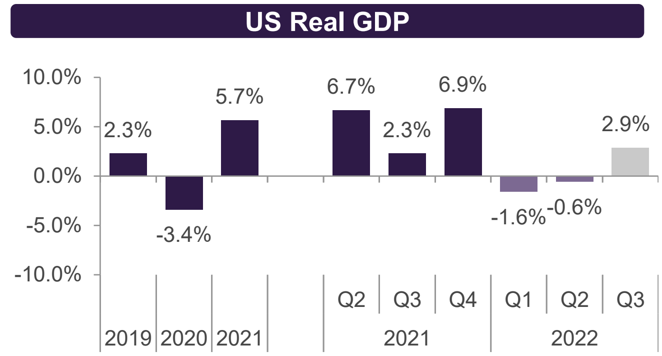
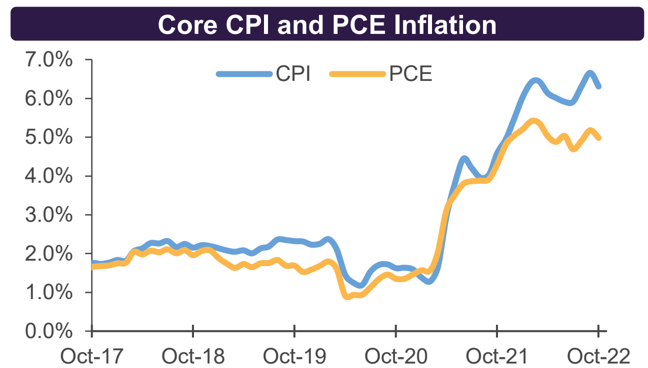
Logistics & Supply Chain Update

Industry Consulting Team | Q4 2022

U.S. Economy Remains Resilient

- **U.S. Q3 GDP was revised higher to 2.9% from 2.6% previously, reflecting a more resilient economy than many had been estimating.** Headwinds from inflation and rising interest rates have yet to curtail consumers from spending while wages accelerate and $1.5T in post pandemic savings cushion consumer balance sheets. Additionally, a narrowing of the trade deficit was a significant contributor to the expansion. The U.S. is exporting more goods to Europe, while imports from Asia are decreasing. The War in Ukraine puts the U.S. in a position to continue to supply Europe with increased energy, industrial and ag products.
- Manufacturing activity in the U.S. slowed in November as **the ISM Manufacturing PMI reflected a contraction for the first time in 2 ½ years**. However, in a sign inflation is cooling in some spots, prices paid for inputs declined for the 2nd straight month in the report. **Conversely, the ISM Services Index showed a significant expansion, at 56.5** up from 54.4 in October as more consumers engage in travel, restaurants, and experiences. Longer term, we still see underlying strength in industrial and infrastructure sectors as investment from Federal stimulus bills makes it way through the economy, and supply chain managers continue to bring production back to North America.





Freight Demand Reflects Mixed Signals

- **ATA truck tonnage was up 3.9% in October y/y yet was down 2.3% sequentially vs September.** Truck tonnage stayed in expansion territory for much of 2022 coinciding with elevated freight demand. Inversely, a contracting housing market, combined with anemic durable goods spending, and more services demand, may lead to more variability in freight indicators.
- **The Cass Freight Shipments Index declined 1.4% from September to October but was 2.9% above October of last year**. Freight volumes are likely to be more modest in the coming months against tougher y/y comparisons and slower goods spending.
- **The Cass Freight Expenditures component, which represents total spending across freight modes, slowed to an 11% y/y** increase in October compared to a 21% y/y gain in September. While still high, we're likely to see the prices component decrease as lower spot freight pricing feeds through to contract pricing – which makes up a significant portion of the Index. Contract freight has held up quite well against falling spot rates across most modes but will likely normalize as bids come up for renewal.
- The costs to ship goods, an early warning sign two years ago of rising inflation, may now be a harbinger of falling prices. In both Fed and IMF research, higher transportation inputs were shown to be a significant contributor to higher inflation since the pandemic began, perhaps as much as 150 basis points according to the IMF study.
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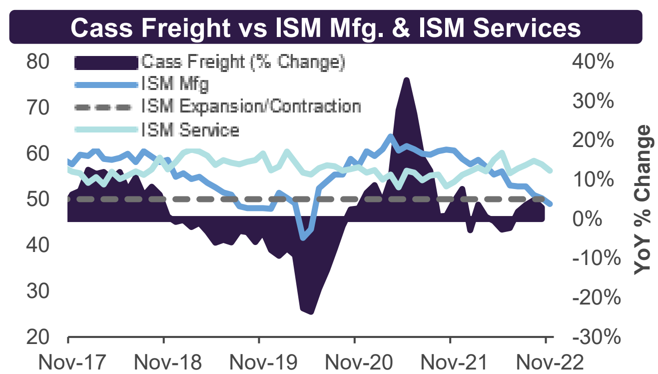

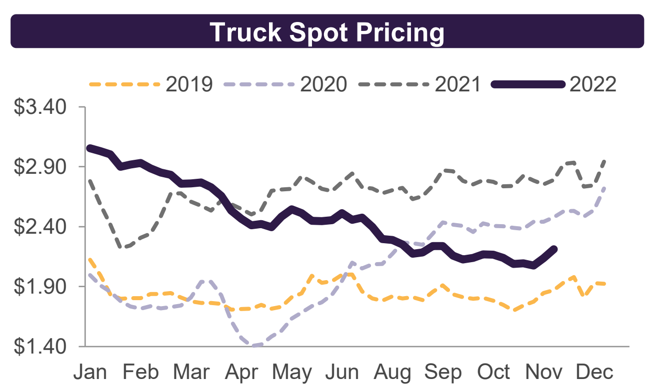

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With freight rates across most modes now back to pre-pandemic levels, it could bode well in helping the Fed to slow the pace of rate increases going forward.

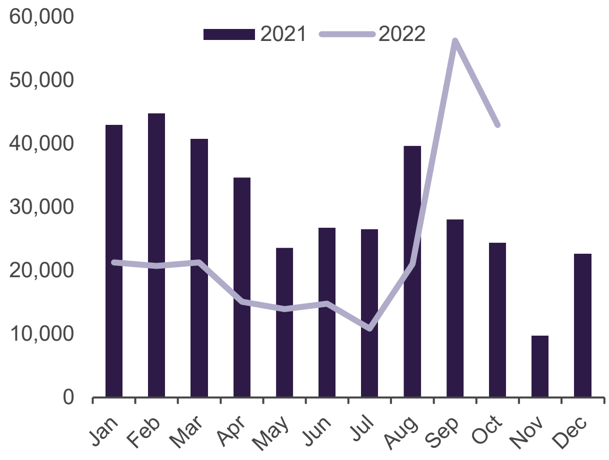
Equipment Availability Improves

- A lack of available equipment including new Class 8 vehicles has been a signature of the pandemic's impact on supply constraints for trucking and logistics firms. The issues around supply scarcity originated when a shortage of semiconductors spread to other vehicle parts as labor became a key limiter across global production facilities. The capacity crunch led to firms extending the average age of fleets - leading to higher operating costs. The upside, we did not see an excessive capacity expansion as in prior demand surges. With freight conditions normalizing, the lack of excess capacity may keep a higher floor on transport pricing compared to other similar contractions.
- As labor and supply chain constraints ease, OEM orderbooks are starting to open up. ACT Research has shown Class 8 orders improving on a y/y basis the last few months. After posting a record level in September of 53,271 trucks, Class 8 orders in October were 42,500 compared to 23,391 a year earlier. While November only posted 34,400 units, this was 254% above last November. Our view is the surge is likely related to delayed maintenance capex, not necessarily net new capacity, as companies look to replace aging fleets. ACT, forecasts U.S. retail sales for class 8 vehicles to be 258,600 for the current year but sees a decline of 11% for 2023, or a total of 233,000 vehicles for the year.

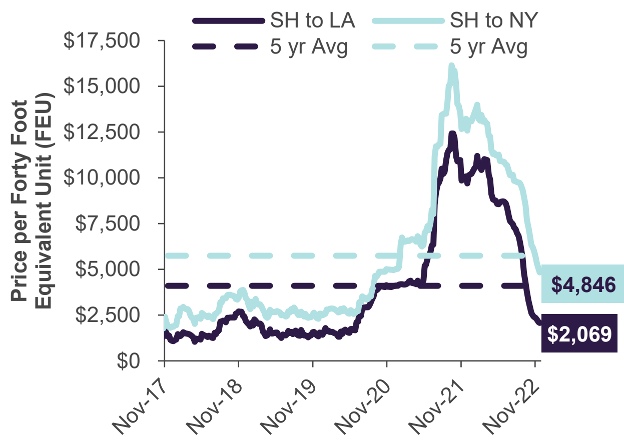
Ocean Freight Rates Return to Pre-pandemic Levels

- Ocean spot container rates from Asia to the U.S. continued to fall from record levels and are now back to pre-pandemic rates. Asia to the U.S. West Coast container rate benchmarks fell 90% to below $2,000 per 40-foot container (FEU) in November from a peak of near 12,000 last year. As Asian imports to the West Coast (WC) collapse and shippers seek alternative gateways during an ongoing labor dispute between WC ports and ILA dock workers. Notably, over the last 3 months the Port of LA lost 25% of its cargo volume compared to the prior period.
- Some of the diversion in cargo away from WC ports is likely to stick as shippers seek better efficiency and lower total landed costs in their supply chains. East (EC) and Gulf Coast (GC) ports have improved terminals, deeper channels and expanded rail and road networks. In fact, EC and GC ports have outspent WC ports 11:1 over the last decade improving their infrastructure. Further, market share shifts from West to East will likely continue as global supply chains reorient to the new realities of demographics and geo-politics. Manufactures are shifting as much production as possible out of China to Southeast Asia making the Suez Canal a more viable alterative, which directly benefits EC ports. As more near-shoring moves to Mexico, GC ports will see increasing cargo flows.

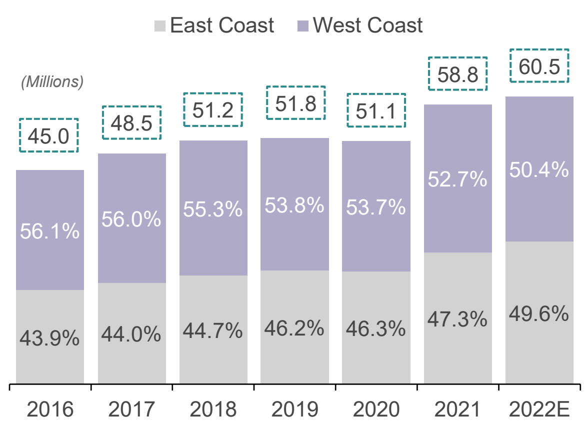
Class 8 Orders



Ocean Freight Rate Index



U.S. Port Container Volumes



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Sources: Bloomberg, Wall Street Journal, Capital IQ, Company Reports, Federal Reserve Economic Data, Port Websites, Bureau of Economic Analysis, Institute for Supply Management, Cass Information Systems, American Trucking Associations, FTR Transportation, ACT Research, International Monetary Fund