

The State of Freight: Outlook for 2016



A Presentation To CITT Canada Logistics Conference

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Outline

- ☐ Global Snapshot
- ☐ US Consumer Alive and Well
- ☐ Canadian Economy In A Tug Of War
- ☐ Key Takeaways For Freight Markets: Rail, TL And LTL
- ☐ A Word On Fuel
- ☐ Railcar And Trailer Demand
- ☐ Bottom Line: Freight Markets Mixed, But Still Signs of Life

Slower For Longer: Global GDP Idles, But US Revving Its Engine

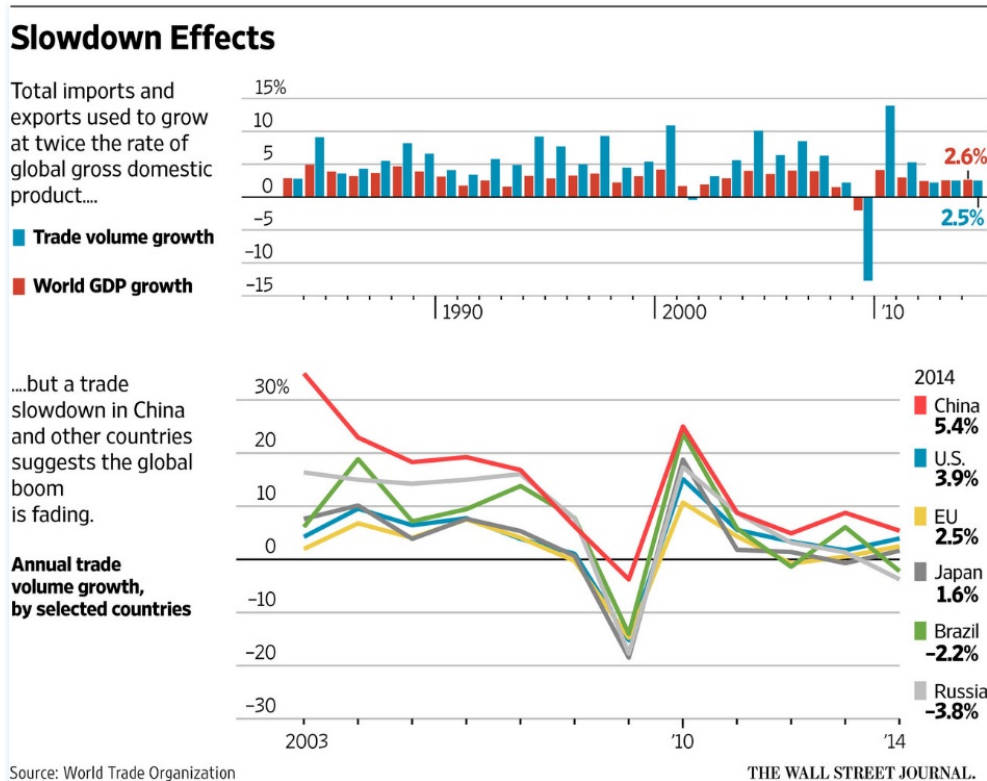
	<u>Real GDP (annual percentage change)</u>			
	2000-13	2014	2015f	2016f
World	3.9%	3.3%	3.0%	3.4%
Canada	2.2%	2.4%	1.0%	1.7%
US	1.8%	2.4%	2.5%	2.8%
UK	1.8%	3.0%	2.6%	2.3%
Euro zone	1.2%	0.9%	1.4%	1.6%
China	9.9%	7.3%	6.8%	6.4%
India	7.0%	7.1%	7.3%	7.6%
Japan	0.9%	-0.1%	0.9%	1.2%
Brazil	3.5%	0.1%	0.9%	1.2%

Source: BNS

- ❑ China continues to decelerate - impacting global growth and trade, especially commodities ...
- ❑ ... offset to China could be the *relatively* strong US economy (lower unemployment, improved consumer confidence, greater household formation and spending, etc.)

- ❑ Many countries witnessing modest growth, including Canada, aided by proximity to the US growth engine, a weak Canadian dollar, low interest rates and low energy costs.
- ❑ Bottom line: While global output growth has moderated, the US has been a relative area of strength, which should buffer Canada to a degree (largest trading partner).
- ❑ In 2016, global growth should pick up once again to 3.4-3.5%.

Slower For Longer: Global Trade Remains Weak

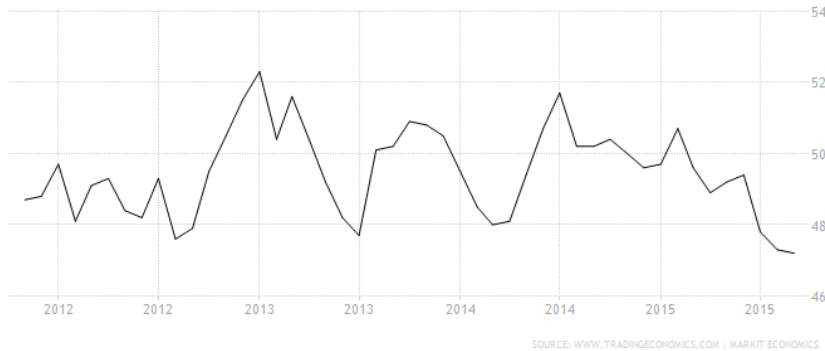


Source: WTO

- ❑ World trade growing below the moderate pace of economic growth, vs. 2000-2007 when trade was greater than GDP growth.
- ❑ Industrial activity remains weak, with new orders for capital goods generally soft.
- ❑ Sluggish growth in emerging economies, including China, a key factor in weak trade numbers, especially the basic commodities.

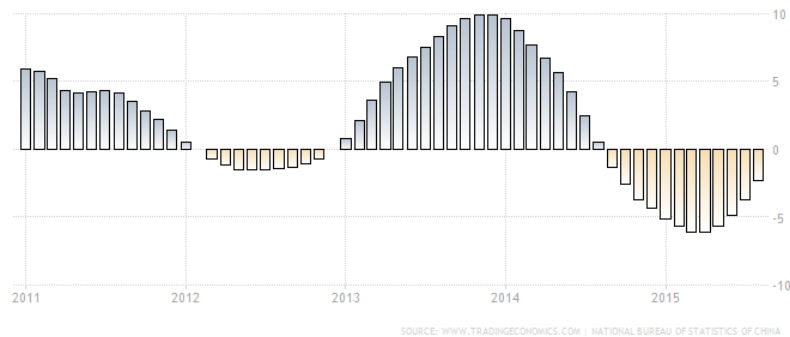
Slowdown in China: Continues To Stall Out

CHINA CAIXIN MANUFACTURING PMI



- ❑ Business indicators point towards weaker growth in China
- ❑ Chinese real estate and equity values have been under pressure.

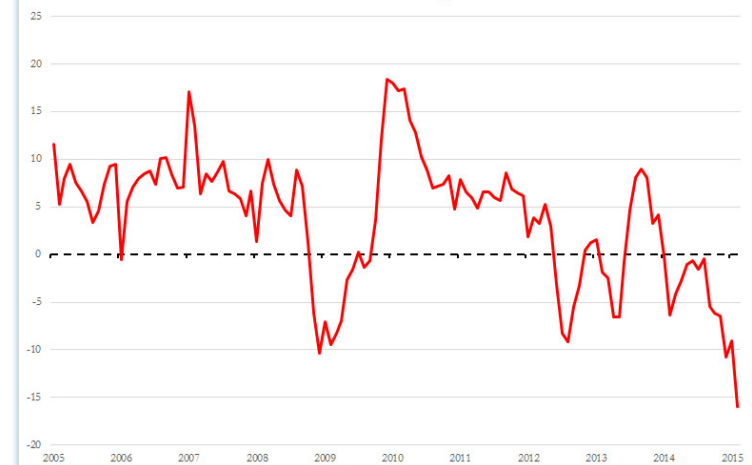
CHINA NEWLY BUILT HOUSE PRICES YOY CHANGE



Source: Tradingeconomics.com, RBC

- ❑ Chinese manufacturing is stagnating.

China Rail Freight Y/Y%

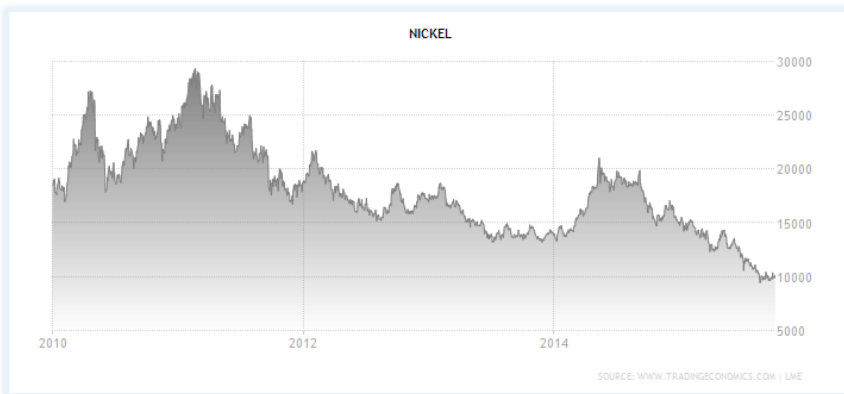
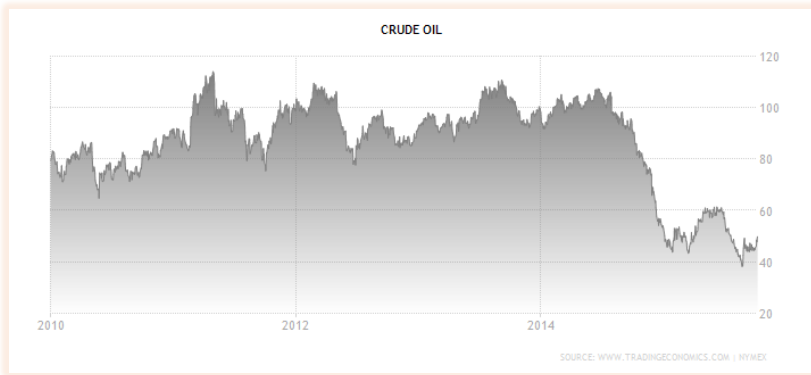


- ❑ Bottom line: Global growth has lost steam, dragged down by the weakness in China. China introducing various easing initiatives to spur growth.
- ❑ Becoming a consumer-driven economy vs. being focussed on infrastructure build.

Lower For Longer: Slowdown in China Impacting Commodities

- Commodity prices have plummeted. Commodity producing nations face downside risks, e.g. Canada vs. US.

- Low energy prices ultimately a net positive for the US economy and central Canada, but the improvement tends to lag by a few quarters. Negative for western Canada.



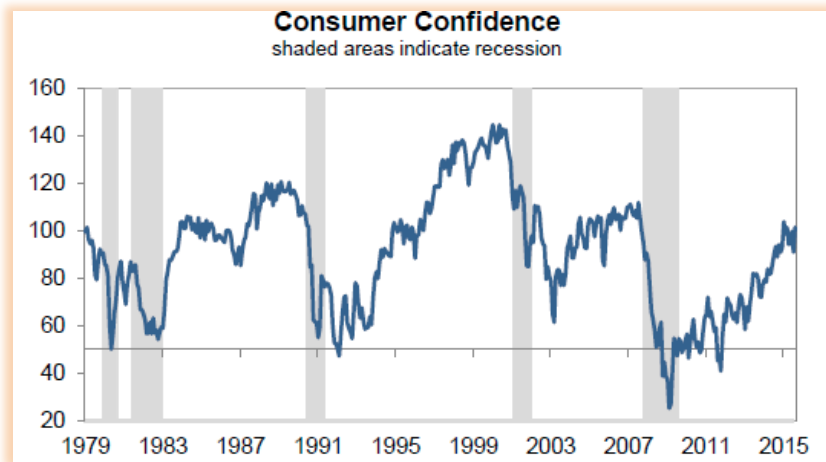
Source: Tradingeconomics.com

US Consumer Alive And Well

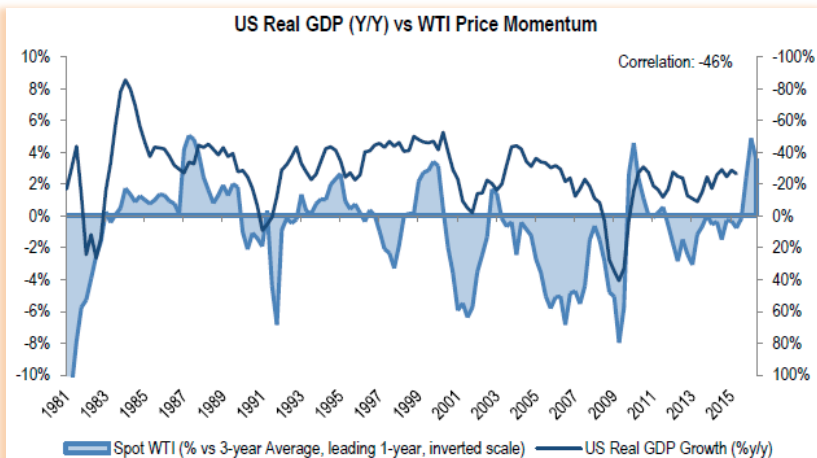
- ❑ The US could post stronger output growth, driven by greater employment, strengthening income trends, improving consumer confidence, household formation and expenditures, lower costs (e.g. energy) and lower household debt. No signs of recession.



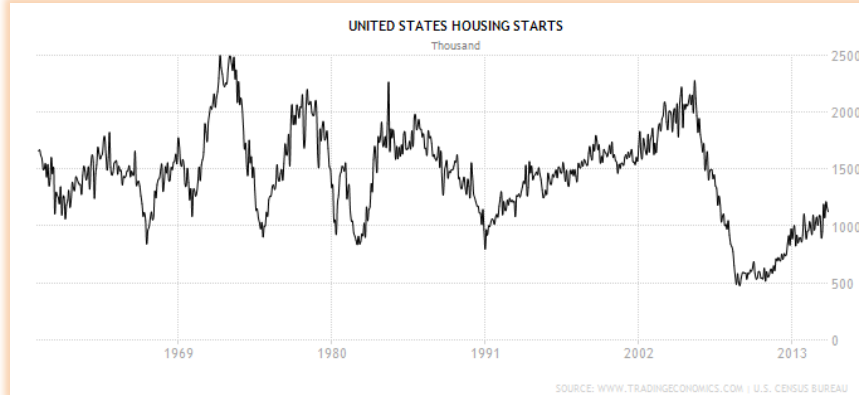
- ❑ Canada's employment picture has also improved.



- ❑ Consumer confidence still fairly strong. Low energy prices are a net positive for the US economy and consumption.

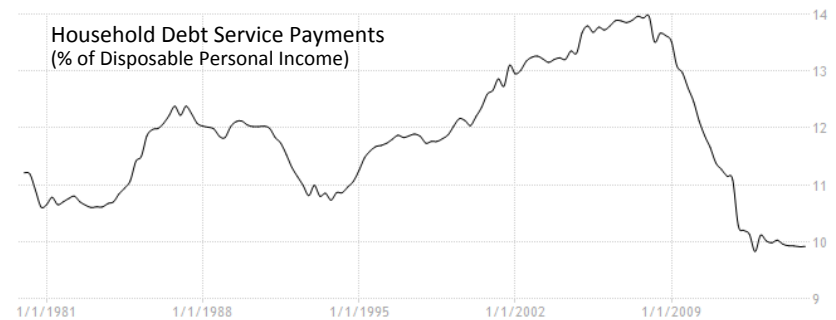


US Household Formation Gathers Steam

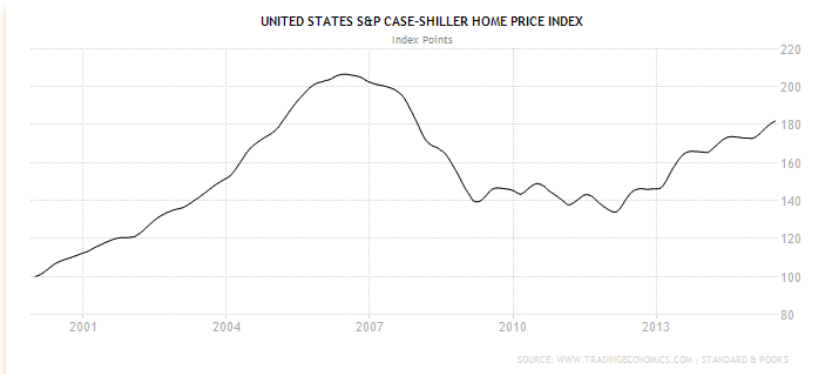


- ❑ Labor force growth drives housing starts. Housing starts are running around 1.2 million homes (seasonally adjusted annual rate).
- ❑ Should lead to other major purchases, e.g. cars, appliances, etc.

- ❑ Household debt remains near record lows. Consumers have significantly deleveraged, which points toward stronger retail sales, aided by low interest rates and energy prices.

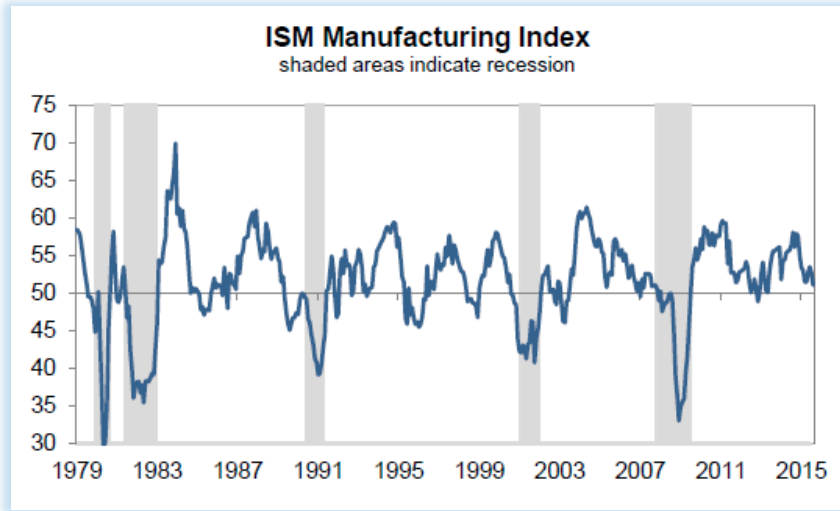


- ❑ House prices continue to rise.



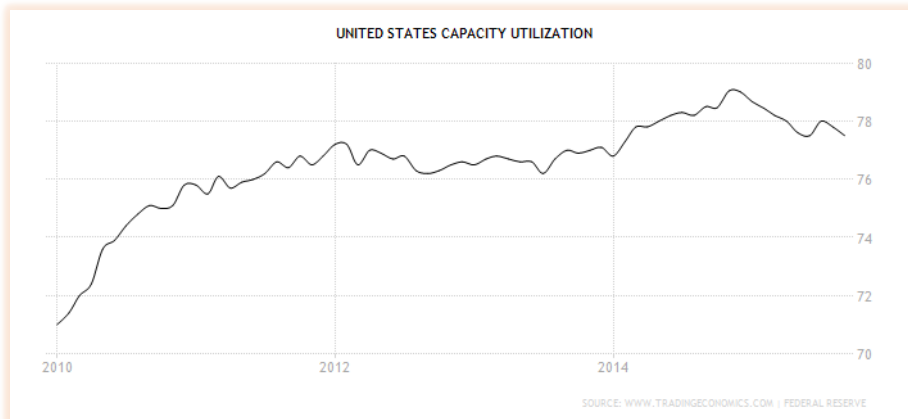
Source: Tradingeconomics.com

US Industrial Complex Tepid, Despite Consumer Strength



Source: BMO Capital Markets, Haver, NBER, ISM

❑ Capacity utilization beginning to roll over.

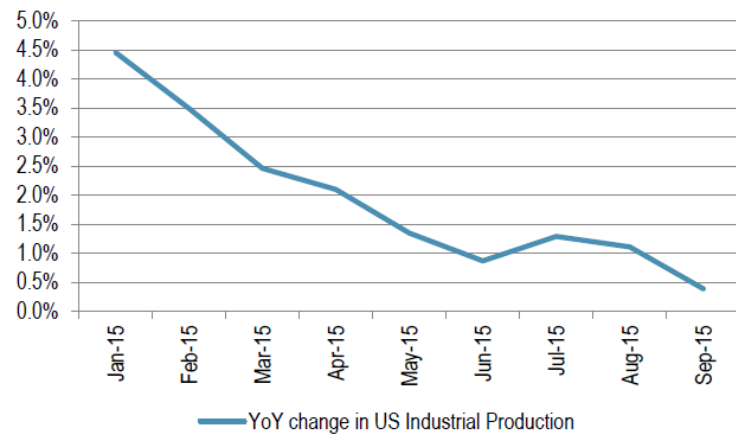


Source: Tradingeconomics.com

- ❑ Slumping demand in many export markets, a strong US dollar, reduced capital spending, and weakness in the energy markets are weighing on the manufacturing sector.
- ❑ While the ISM Manufacturing Index is still above the neutral 50.0 threshold, the September reading was one of the lowest recorded over the past two years.
- ❑ Output and new business volumes continue to expand at slower rates than those seen earlier in 2015.

Correlation Between Industrial Production And Truck Tonnage

Growth in Industrial Production has been moderating

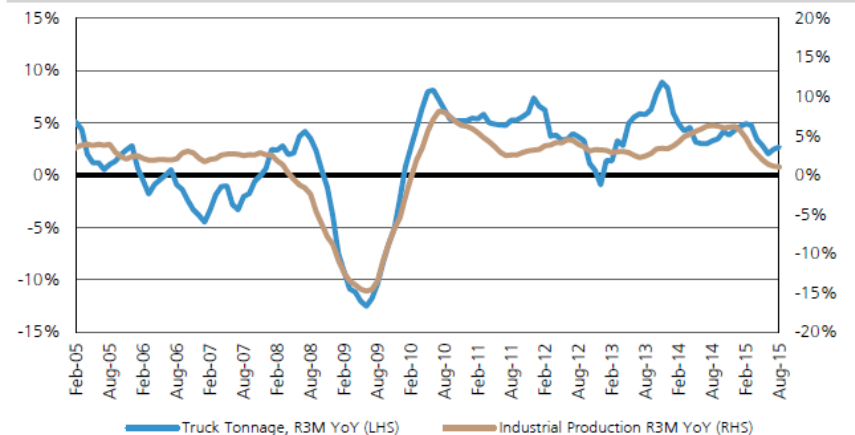


Source: UBS, Federal Reserve

- Bottom line: The industrial recession is being caused by the decline in the energy and commodity sectors, a strengthening US dollar and economic deceleration in China. Consumer are holding it all together in the US.

- Industrial production is a key indicator for truck tonnage and the overall health of the trucking industry (about 80% correlation).

Y/Y changes in truck tonnage are highly correlated with changes in Industrial Production



Source: UBS, Federal Reserve, ATA

Canada in A Tug Of War: US Consumer Should Trump China

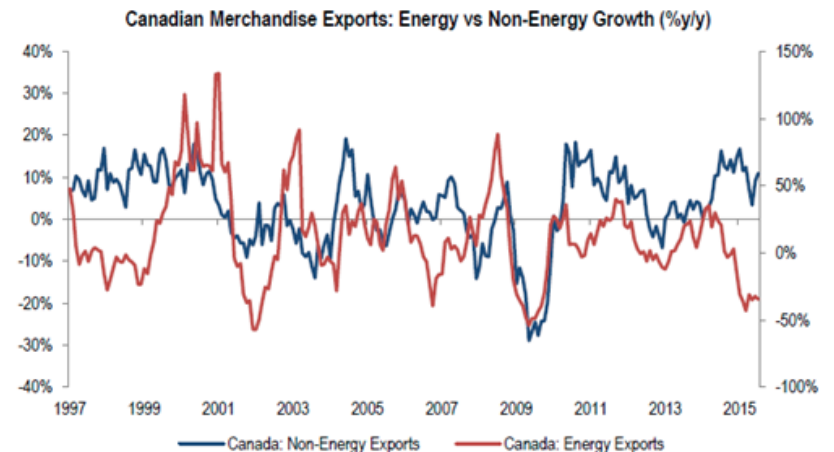
Canada's Top Trading Partners - 2014

United States	71.3%
European Union	8.5%
China	5.3%
Mexico	2.3%
United Kingdom	2.3%
Japan	1.9%
Germany	1.6%
South Korea	0.9%
Hong Kong	0.8%
Italy	0.8%
Netherlands	0.8%
Other	3.4%

Source: Statistics Canada

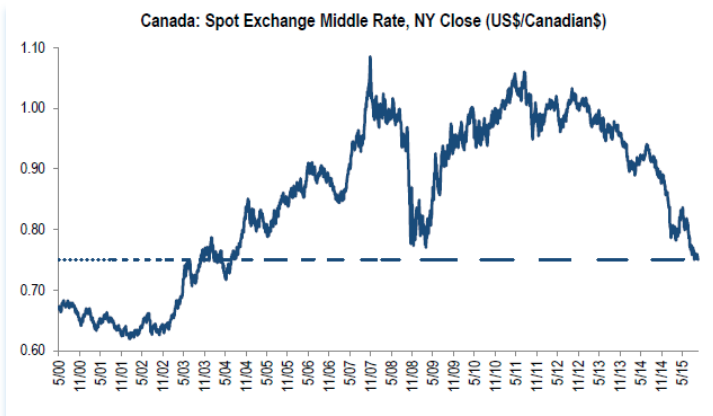
- ❑ The US buffers Canada from some of the global weakness and should trump the China effect.

- ❑ Canada trades with the world, but its main trading partner is the US, accounting for over two thirds of trade.
- ❑ The US has decoupled from the malaise of the rest of the world.
- ❑ Canada in a *tug of war* between the weak commodity export markets and increasing trade with the US.



Source: BMO Capital Markets, Haver, NBER, Statistics Canada

Weak Canadian Dollar Spurs Exports

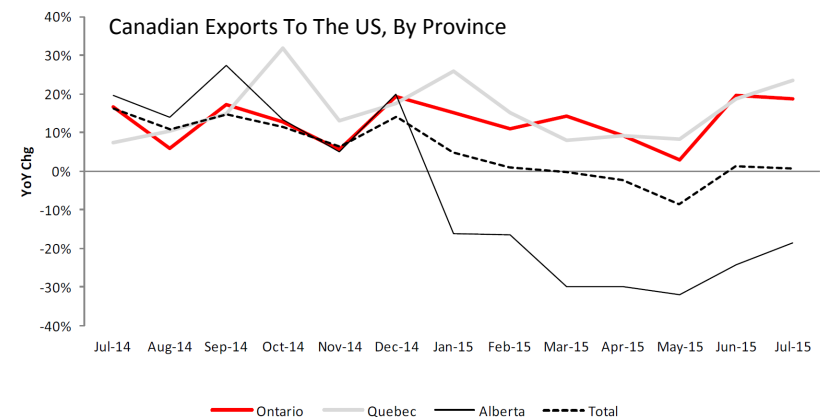


Source: BMO Capital Markets, Haver, NBER, WSJ

- ❑ The Canadian dollar hit its lowest level since 2004.
- ❑ US-centric growth is the key to restoring Canada's non-commodity related export growth, reducing its reliance on emerging markets, especially China.
- ❑ A weaker Canadian versus US dollar should support trade.
- ❑ Non-energy exports are growing – perhaps a manufacturing renaissance.



Source: Tradingeconomics.com

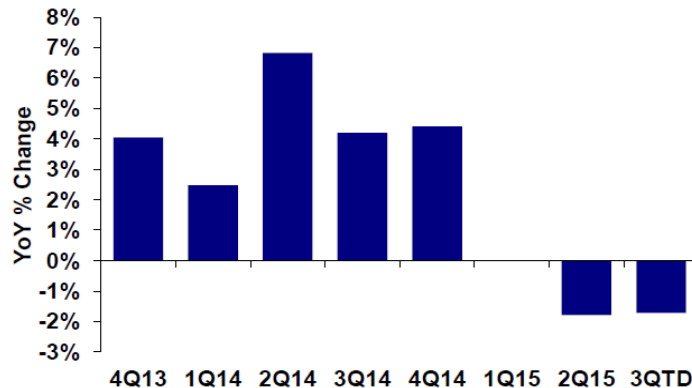


Note: Latest data shown is for July (our last update was for June)

Source: Industry Canada, Macquarie Research, October 2015

Key Takeaways For Freight Markets: Railroads Power Through Soft Patch

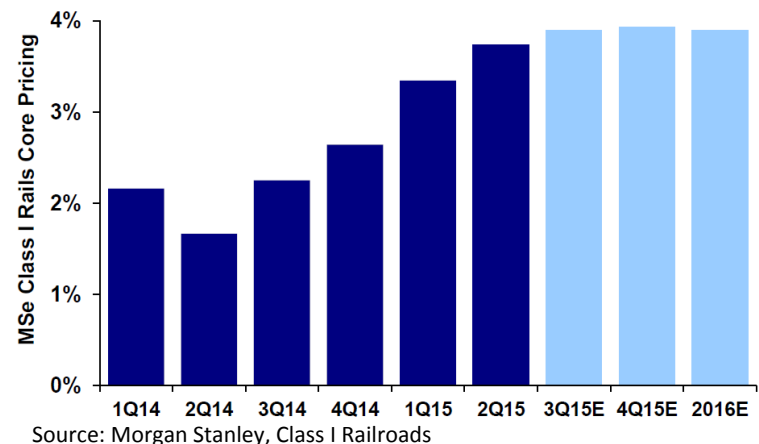
Class I Total Traffic YoY % Change



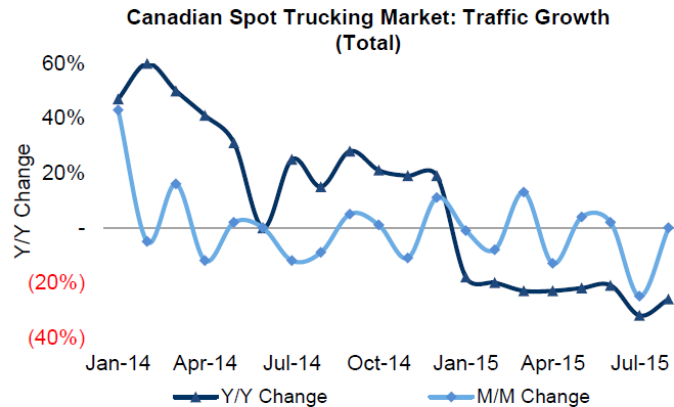
- ❑ Rail traffic trends remain lacklustre. All Class I railroads are witnessing modest declines in traffic (coal, energy, and some industrial markets).
- ❑ The improving job market, low fuel prices, and a strong US dollar should support increased consumer spend, aiding the international intermodal market.

- ❑ Pricing remains positive and resilient. Slack volumes call into question sustainability of pricing story.
- ❑ Rail service levels have improved to earn stronger pricing power.
- ❑ Railroads aligning resources with volumes (e.g. furloughing employees, storing locomotives, etc.).
- ❑ Benefitting from decline in on-highway diesel (fuel surcharge revenue billed on a two-month lag).

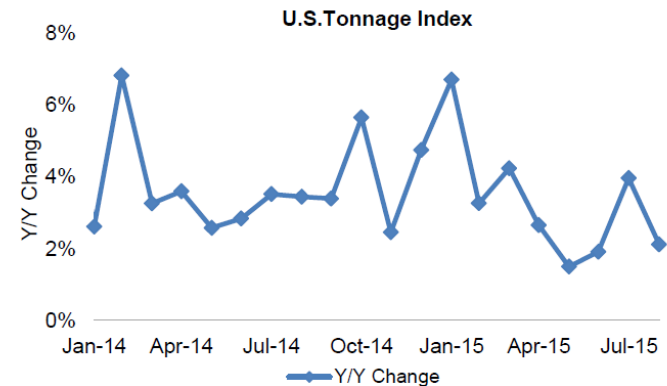
MSe Class I Rails Core Pricing



Key Takeaways For Freight Markets: Truckload Putting On The Brakes



Source: Transcore LinkLogistics, American Trucking Association, RBC Capital Markets



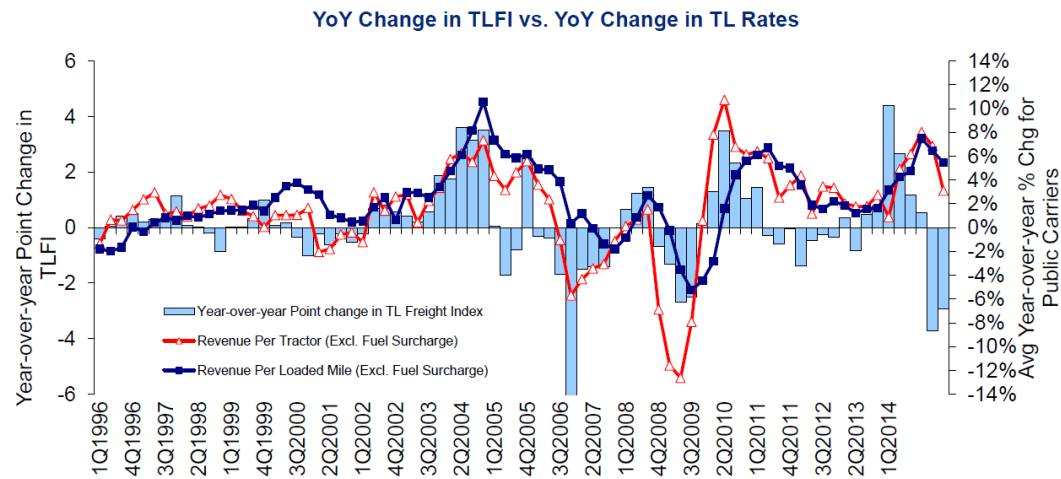
- ❑ TL demand growth is not encouraging, but supply has started to adjust. Specialty TL has been weaker than TL. Peak season was weaker than expected.
- ❑ While the truck market has been more balanced in 2015, a wave of regulatory measures could weigh on trucking capacity and put upward pressure on utilization in time.

Cass Freight Index™



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Key Takeaways For Freight Markets: Mixed Truckload Rates

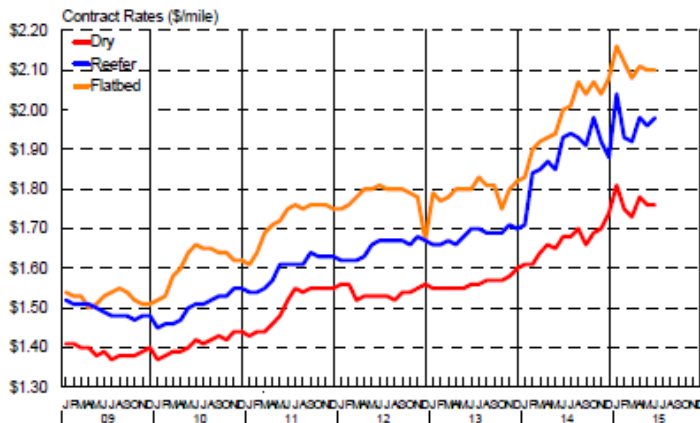


Source: Morgan Stanley

- ❑ Soft spot market pricing could undermine TL pricing momentum - carry through to contract rates in time. Carriers are adjusting supply.
- ❑ Lower fuel surcharge collection could impact top line to a degree.
- ❑ Lower fuel costs/surcharges making TL more competitive versus intermodal.

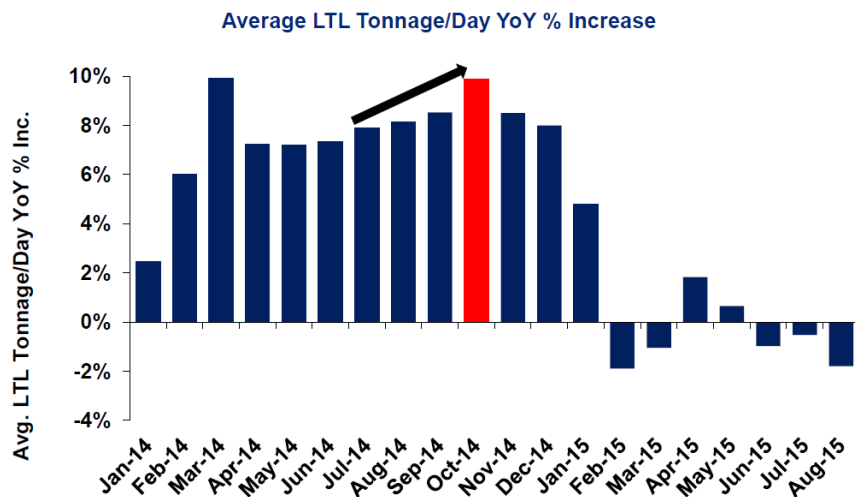
DAT Trendlines: Contract Rates

January '09 - June '15



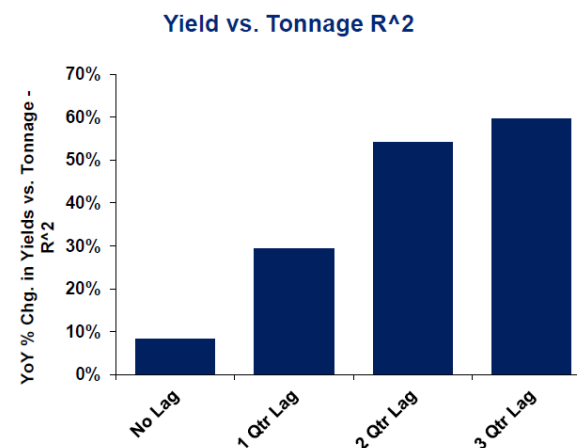
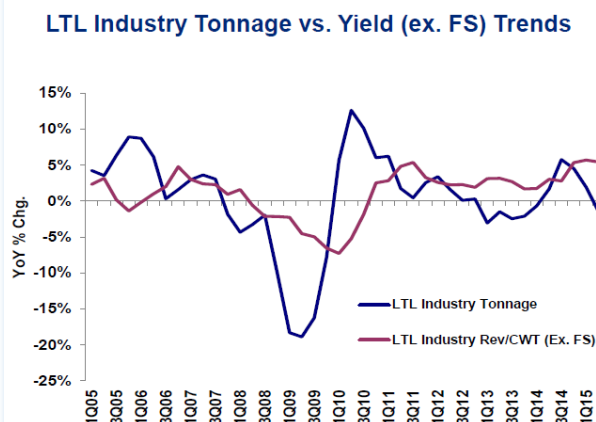
- ❑ Shippers still remain concerned about the medium to long term availability of capacity, which could lead to higher rates.
- ❑ Longer term, increasing regulations and potentially a modest pick up in traffic, likely consumer-driven, could tighten the truck market, with higher rates serving to offset inflationary pressures, e.g. wage inflation.

Key Takeaways For Freight Markets: LTL Faces Continued Headwinds



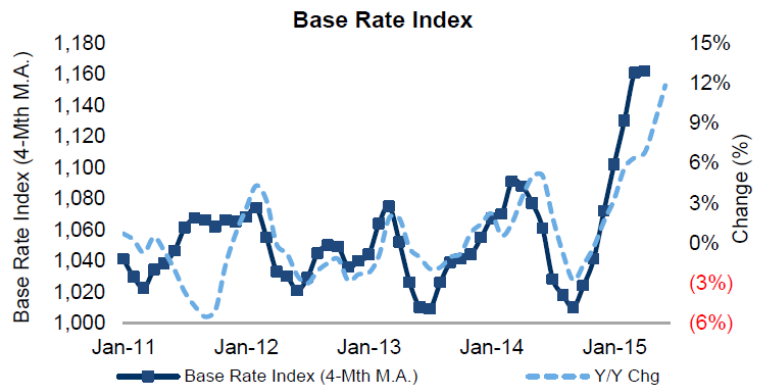
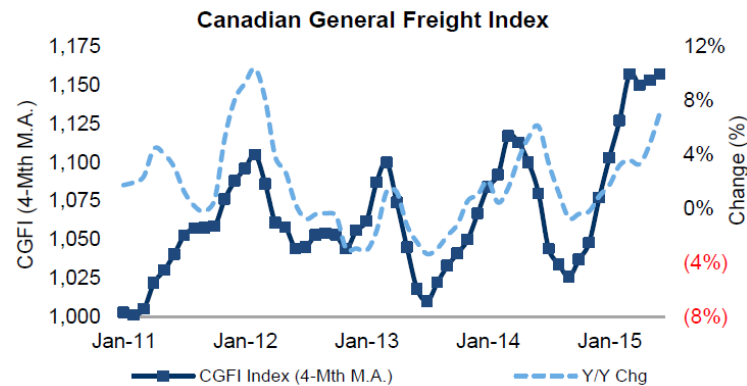
- Have witnessed soft LTL tonnage trends throughout much of 2015, with October expected to be a tough comparable.
- LTL has faced difficult pricing comparisons, compounded by lower fuel surcharge collection, similar to TL.

- LTL industry pricing has a strong correlation with tonnage growth, with a two to three quarter lag. We expect pricing will continue to soften.



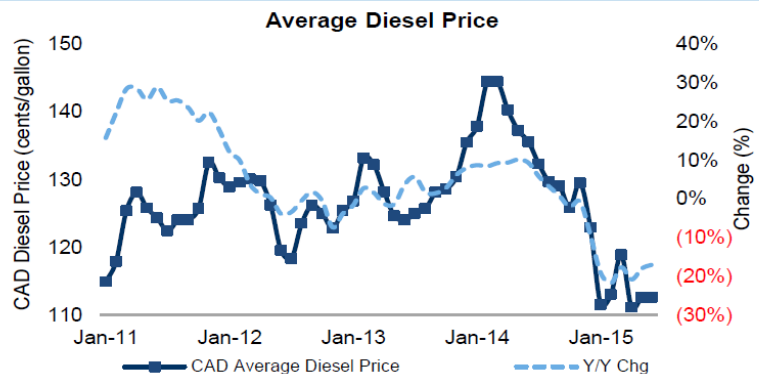
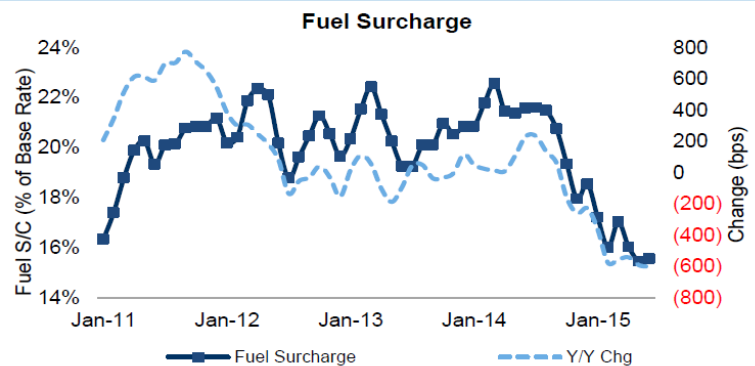
Source: Morgan Stanley

Canadian Rates And A Word On Fuel



Source: Nulogx

- ❑ According to Nulogx, rates have begun to roll over to a degree, but are hanging onto previous gains. Rates are being driven by cross-border strength. TL rates have fared relatively better than LTL rates, which have weakened.
- ❑ Fuel surcharges have rolled over, in line with diesel prices.

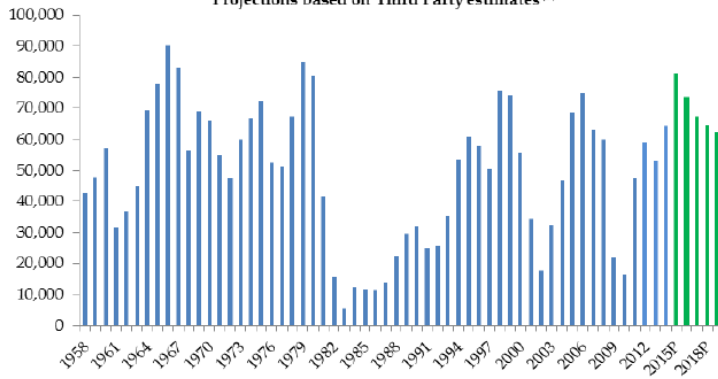


Source: Nulogx

Railcar Deliveries Rolling Over

Railcar Deliveries (1958 - 2019P)

Projections based on Third Party estimates⁽³⁾



- ❑ Manufacturers should see revenues increase for the next 1.0-1.5 years as they work through a record backlog of orders related to crude transportation.
- ❑ Regulations requiring safer tank cars require a significant retrofit of the fleet. The replacements are likely reflected in the backlog; new orders on the wane with the fall in crude oil prices.

Center Flow® Covered Hopper Cars



Pressureaide® PD Cars



Thru-Sill Covered Hopper Cars



Tank Cars



Coal Cars



Mill Gondola Cars



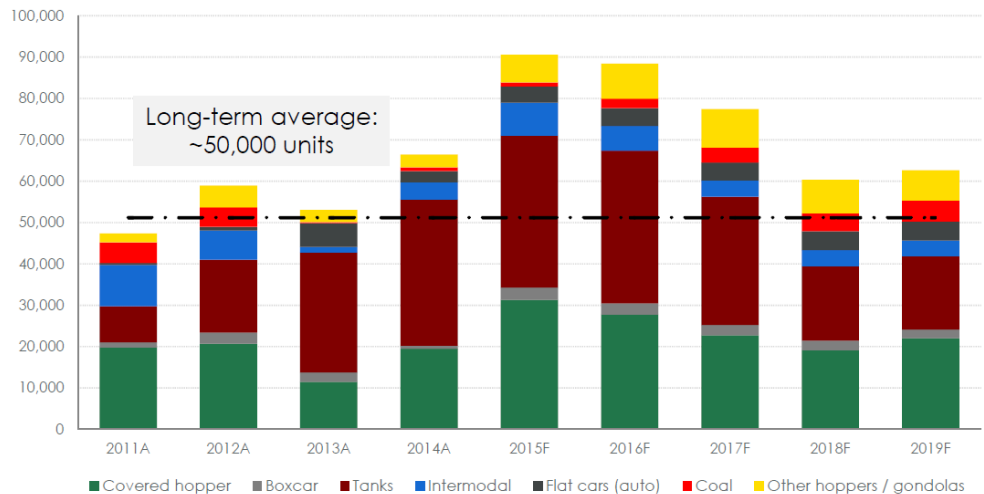
Intermodal Well Cars



Center Beam Cars



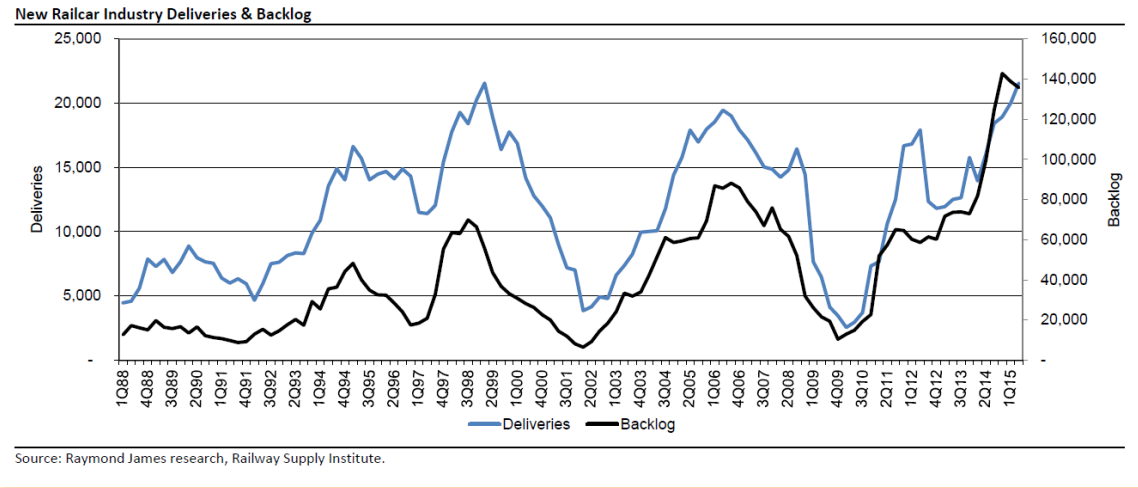
Different car types have different cycles



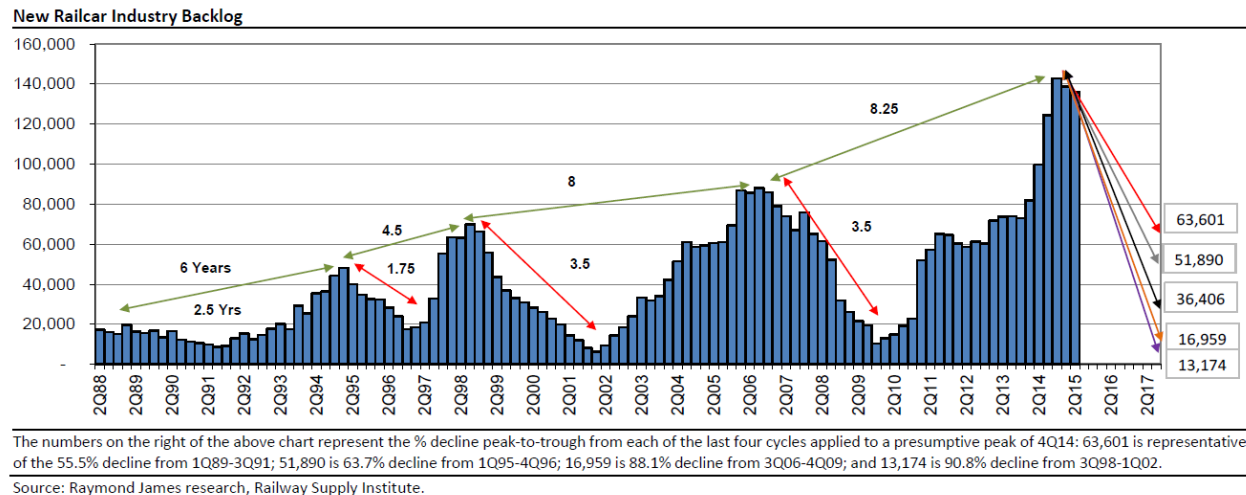
Source: FTR Associates – Rail Equipment Outlook (March 2015)

... Pace Of Railcar Manufacturing Decline Could Quicken

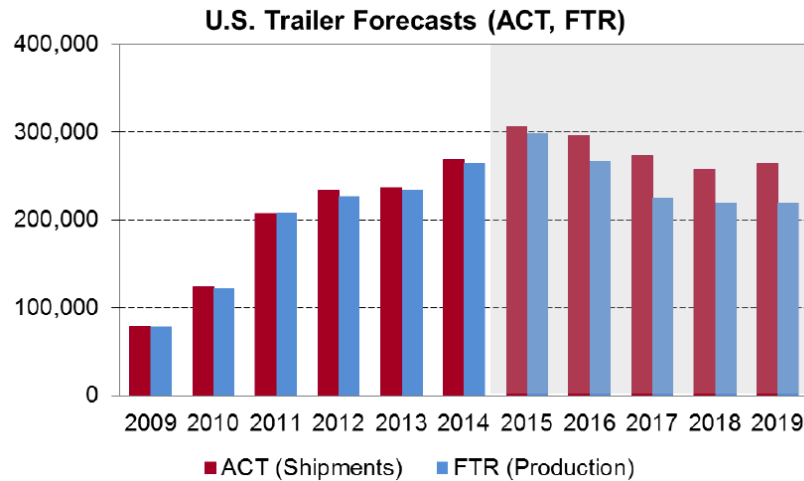
- Since 1988, the trough in deliveries has tended to lag the trough in the backlog by one to two quarters.



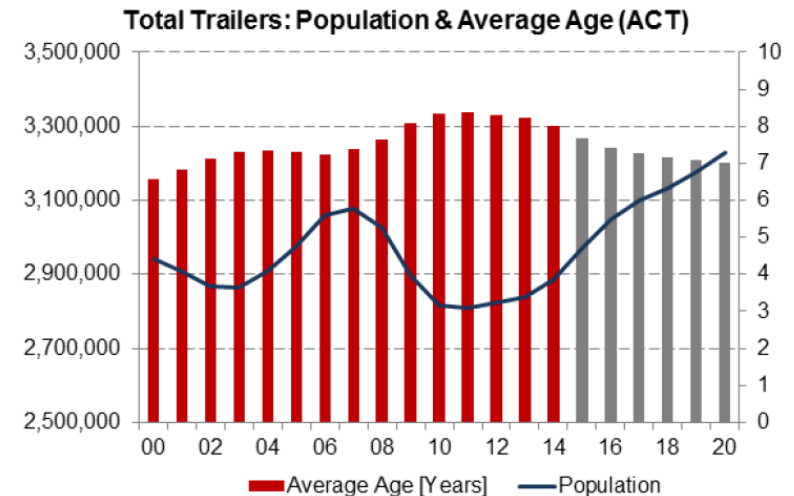
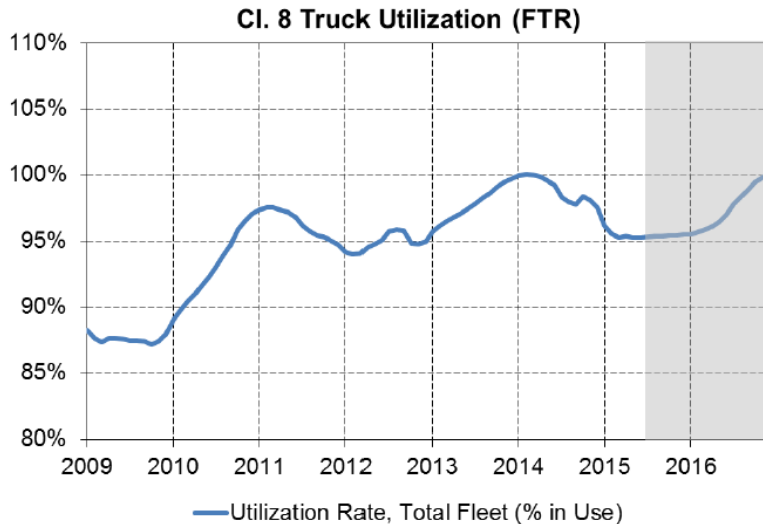
- Certain aspects of this cycle may support a higher trough/elongated cycle, e.g. non-crude by rail demand, like chemical end-user demand, auto racks, boxcars and covered hoppers.



Trailer Demand Relatively Strong And Resilient



- ☐ Trailer demand remains above replacement levels.
- ☐ The average age of equipment remains near its record high, implying continued demand for new trailers, aided by low cost financing.
- ☐ Three or more years of significant underbuy during the period of 2008-2010.
- ☐ Trailer population expected to return to 2007 levels around mid-2017.



Source: ACT Research

Bottom Line

- ❑ Global output growth has moderated, with the US a relative area of strength, which should buffer Canada to a degree given it is the country's largest trading partner.
- ❑ Global trade has slackened given China's shift towards becoming a consumer-driven economy and much less desire for commodities (less infrastructure build). The US revival and a weak Canadian dollar may offset weakness in the commodity markets.
- ❑ The US could post even stronger output growth, driven by greater employment, strengthening income trends, improving consumer confidence, household formation and expenditures, lower costs (e.g. energy) and lower household debt. No signs of recession.
- ❑ The industrial sector has been weakened by a decline in the energy and commodity markets, the strengthening US dollar and the ongoing economic deceleration in China. The consumer is holding it all together in the US.
- ❑ The US buffers Canada from some of the global weakness and should trump the China effect. The weak Canadian dollar is leading to increased non-energy exports and cross-border traffic, and a hoped-for manufacturing renaissance.
- ❑ Freight traffic has been relatively tepid, with the railroads holding the line on pricing, with improved service and right-sizing of capacity.
- ❑ Truckload has fared relatively better than LTL, although the peak season was softer than expected. While TL somewhat balanced, with recent weakness, LTL has been soft for most of 2015. Yields appear to be hanging in, despite soft volume metrics.
- ❑ Demand for railcars and trailers appears to be rolling over.
- ❑ Bottom line: The US remains the key catalyst to growth in the absence of weak global demand and trade.



The Murray Wealth Group (MWG) is a private client wealth management firm offering discretionary investment management services to individuals and families. MWG is a long-only, growth-oriented equity manager offering five strategies, including four equity and one fixed income strategy, which are constructed to deliver strong absolute returns.

Our flagship strategy is the MWG Global Growth Equity Fund, which focuses primarily on large cap equities with a developed markets footprint. The majority of the stocks in this portfolio are best-in-class global companies. We also offer the following strategies: US Growth Equity, Canadian Growth Equity, Dividend Growth and Fixed Income. Our solutions are available to investors on either a segregated basis or through investment in units of the respective pooled funds (US Growth Equity not available on a pooled basis at this time).

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