FREIGHTWAVES SONAR

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SONAR highlight reel: Shippers feel chills as October approaches

SEPTEMBER 2021

WHITE PAPER

SONAR highlight reel: Shippers feel chills as October approaches

This "SONAR highlight reel," which we publish every other week, is intended to concisely hit data highlights and trends in truckload, intermodal and maritime.

Spot rates have rebounded in the majority of the country after a post-Labor Day hiccup, according to Truckstop.com. Freight demand is unwavering on the back of a strong consumer, which sets up a stronger than normal peak season. Capacity constraints remain in place with no signs of easing in Q4. The backdrop for a stronger rate environment during the final quarter is as strong as it has ever been.

In the rail industry, we believe that mounting pressure from an activist investor may mark a dramatic shift in focus at Canadian National Railway from an approach that balances volume, pricing and margins to an approach that is overly focused on cutting costs and capital expenditures at the expense of service levels. Elsewhere in the rail industry, there remains plenty of demand for intermodal, but capacity is unable to keep up due to numerous capacity constraints (chassis, containers, drayage, terminal congestion, port congestion).

Maritime capacity is being tied up along both coasts as backlogs at the ports continue to grow. Upward pressure on spot rates has started to dissipate, thanks to the ocean carriers announcing caps on their rates. Capacity is being re-routed to the trans-Pacific, which is fueling congestion while demand hasn't wavered. Import volume levels continue to outperform year-ago levels.

Dry van spot all-in rates per mile[1] (w/w chg.)

LAX-DAL	$3.55 (+$0.21)
CHI-ATL	$3.61 (+$0.65)
PHL-CHI	$2.32 (+$0.22)
ATL-PHL	$2.95 (-$0.57)
DAL-ATL	$2.49 (+$0.08)
DAL-LAX	$1.37 (-$0.24)
National	**$3.49 (+$0.28)**

Freight volume index (weekly change)

Ontario, CA	698.94 (+2.3%)
Atlanta	602.51 (-6.1%)
Dallas	509.04 (+0.5%)
Harrisburg, PA	506.13 (-2.7%)
Allentown, PA	450.32 (+3.2%)
Los Angeles	435.1 (+2.1%)
National	**15,985.32 (+0.7%)**

Tender rejection rates (weekly change)

Ontario	18.05% (+158 bps)
Atlanta	19.63% (+35 bps)
Dallas	20.64% (-66 bps)
Harrisburg	25.02% (-27 bps)
Allentown	24.7% (+141 bps)
Los Angeles	18.04% (+158 bps)
National	**22.19% (+72 bps)**

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[1] Truckstop.com all-in per-mile rate

Relative capacity tightens ahead of the close of Q3; rates rebound

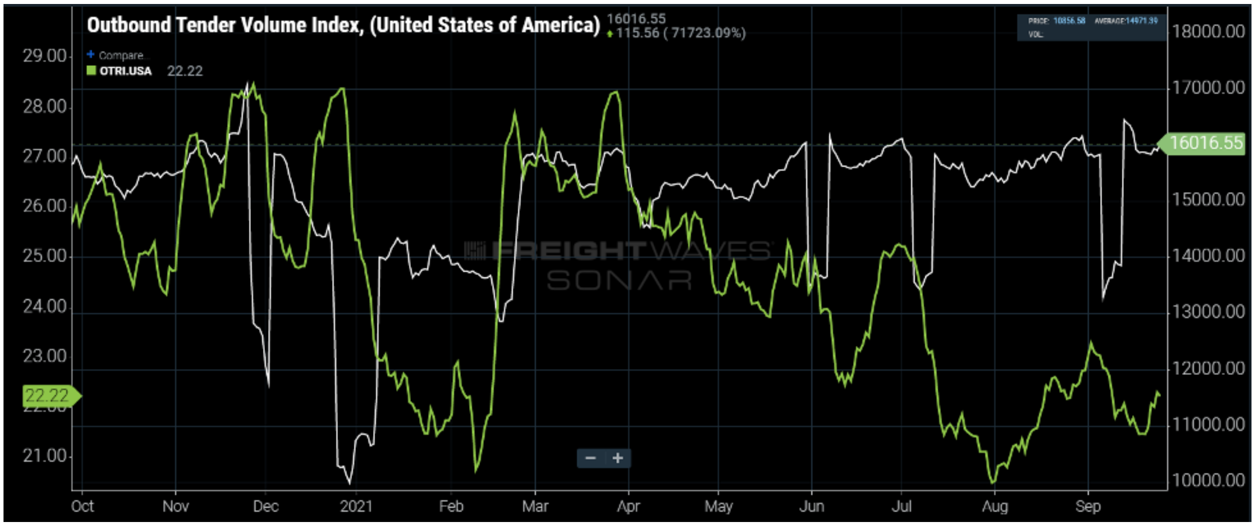


Chart: FreightWaves SONAR. Outbound Tender Volume Index {white, right axis} and Outbound Tender Reject Index {green, left axis}

The Outbound Tender Volume Index (OTVI) has started to increase to kick-off the final week of the quarter. Over the past week, OTVI has increased 0.7%, eclipsing the 16,000 mark once again. The increase sets up the final week of Q3 to be quite strong. Additionally, the increase comes just two weeks after setting a new non-holiday season-related high, which is likely to be challenged during the fourth quarter.

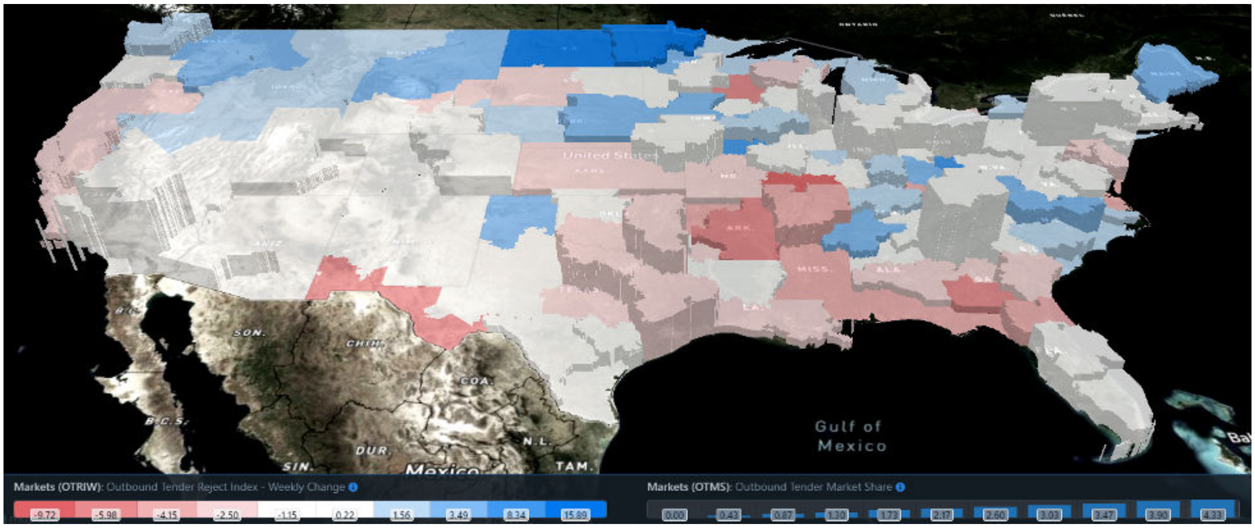
The back half of September is traditionally a stronger period for freight. Volume levels hold strong as shippers have greater need to move freight before the third quarter comes to a close. This year is no different; volume levels on average were above August levels for much of the month, with the exception of the pullback due to Labor Day. Pulling out the holiday-affected week, freight volumes have been over 1% higher on average than August levels, with no sign of slowing down.

Absolute tender volumes are still running up by nearly 2% year-over-year (y/y) which is remarkable considering that comps have become increasingly difficult during September. As stimulus measures expire, freight demand still seems to be on solid footing thanks to the strength of the consumer. That is going to be beneficial for freight volumes as we enter the traditional peak season, which is forecast to be one of the strongest in recent memory.

OTVI, which includes both accepted and rejected tenders, hasn't wavered and with rejection rates pulling back during September, accepted freight volumes continue to outperform. Accepted tender volumes, which account for the rejection rate, are up 8.5% y/y. Over the past week, accepted tender levels have been flat as rejection rates have started to increase into the final week of the quarter.

The increase in contract rates over the past year has helped drive better carrier compliance. However, carriers are still maintaining pricing power in the market thanks to the unwavering demand. Rejection rates have been moving downward on a year-over-year basis since the beginning of August, though the gap has recently widened to the widest point of the year, down nearly 400 basis points (bps) y/y.

Traditionally, the last week of a quarter leads to a period of tightening as volumes ramp up. Over the past week, rejection rates have increased by 72 bps, ahead of the final week of the quarter. Shippers have to be able to secure capacity to move inventory to necessary locations.



Relative capacity loosening across a majority of the country. SONAR: OTRIW {color} and OTMS {height}

Relative capacity across the country was pretty balanced over the past week in terms of the number of markets that tightened and those that loosened. Seventy-four of the 135 markets in SONAR experienced tightening of relative capacity – led by the two tiny North Dakota markets, Bismarck and Fargo – as rejection rates increased by 1,671 bps and 1,589 bps w/w, respectively.

Relative capacity in Dallas loosened more than the other large freight markets over the past week. Rejection rates in Dallas fell by 66 bps w/w to 20.64%. The pullback in rejection rates over the past week has turned the rates negative compared to the past year, sitting just 71 bps below year-ago levels.

In other large freight markets, like Ontario, the capacity situation was relatively unchanged over the past week. The rejection rate in the Southern California market has been sub-20% since early July, which is around the same time rejection rates turned negative on a yearly basis. As it stands right now, rejection rates are over 1,000 bps lower than a year ago, but expect some tightening during the last quarter of the year as carriers make final pushes out of the Los Angeles/Ontario area.

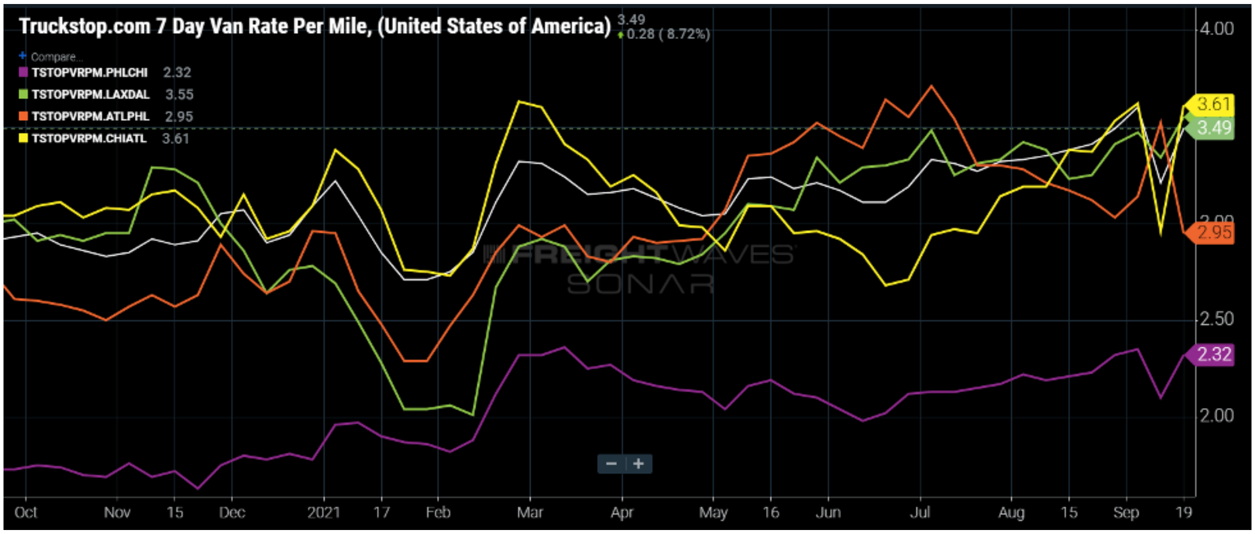


Chart: FreightWaves SONAR. Truckstop.com's dry van spot rates: National {white}, Los Angeles to Dallas {green}, Atlanta to Philadelphia {orange}, Philadelphia to Chicago {purple} and Chicago to Atlanta {yellow})

Truckstop.com's national spot rate, which includes fuel surcharge and other accessorials, climbed by 28 cents per mile to $3.49. The increase erased nearly all of the hiccup in last week's data when rates fell by 39 cents per mile. The snapback in rates wasn't a surprise given that the daily volume and rejection rates hadn't made any significant moves to the downside.

Given the tightness in the market and the strength in freight demand, rates will likely go higher in the coming months. Right now, the Truckstop.com national spot rate is just 11 cents off the all-time high and will likely challenge that level in the coming weeks as carriers become more selective about accepting freight.

The bounce-back in spot rates has brought rates back to 18% above year-ago levels, comps with which have been getting increasingly difficult during the back half of 2021. The increase in spot rates this week is thanks to the vast majority of the 102 lanes within SONAR – 87 to be exact – moving higher w/w.

Contract rates have continued to climb higher due to the upward trend in spot rates, but also because of the tightness in the market as well as the freight demand. Contract rates have increased by nearly 25% over the past year and are currently sitting at the highest level in the dataset, which dates back to January 2017.

The rise in contract rates is likely going to weigh on shippers for some time. Those seeking rate relief in 2022 will probably be in for a rough time. In the previous upcycle in 2017-2018, contract rates increased by nearly 20% before plateauing when the market turned during the last couple of months in 2018. In 2019, contract rates were relatively stable even when rejection rates fell to historically low levels. Ultimately, time will tell what happens to contracted rates when market conditions aren't as fragile, though that is likely not to occur for the time being. Freight demand is as strong as it has been and congestion across other modes of transport is putting increased pressure on the truckload market.

Activist situation at Canadian National could shift railway's focus

Much of the newsflow in the rail industry since the publication of the last SONAR Highlight Reel has been on the topic of the activist investor situation at CN. While it remains unclear what will ultimately happen, it appears that Canadian National is redirecting its focus to margins and cost cutting. As a result, shippers that utilize CN could see a degradation in service levels in the coming months as the railway rolls out its plan to get to a 57% operating ratio next year, mostly as a result of reducing employee headcount. The changes at CN could indicate an end to the railway taking a customer-focused approach of "growing with customers" (which started under former CEO Claude Mongeau and continued under current CEO J.J. Ruest) in a manner that is "GDP-plus." In addition to reducing expenses and capital expenditures, it appears that CN will be taking a more aggressive approach to pricing. The seemingly slight change in CN's wording to investors from pricing "ahead of rail inflation" to "well ahead of rail inflation" might not seem so minor to shippers.

The Canadian railroads' volume (blue line) outperformed the U.S. railroads' volume (orange line) in recent years. Intensifying pressure on CN from an activist investor could cause the railway to prioritize operating ratio improvement over volume growth and service levels.

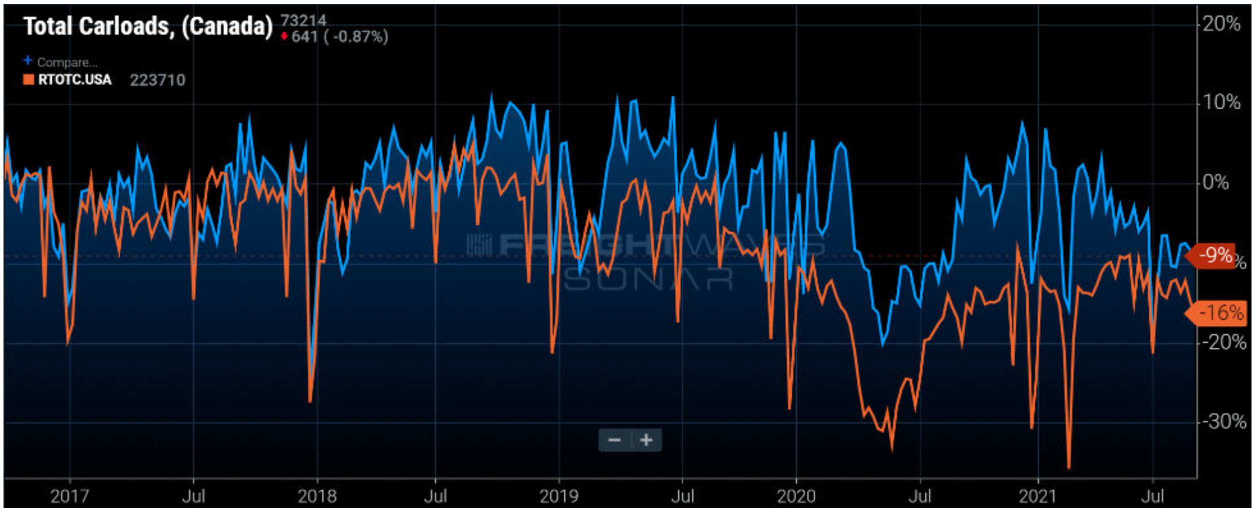


Chart: FreightWaves, SONAR. Five-year chart comparing rail carloads originated by the Canadian railroads {Blue} to rail carloads originated by the U.S. railroads {Orange}

Activist investor situation aside, total industry-wide intermodal volume continues to be constrained by a multitude of factors, including chassis and container availability, drayage capacity, intermodal terminal congestion and congestion at/near the ports. At the FreightWaves Intermodal Summit, Union Pacific described the chassis shortage as being the ultimate capacity constraint of 2021. Also at the Intermodal Summit, Norfolk Southern described intermodal terminal throughput as being a major issue that is constraining capacity. This is largely the result of a lack of drayage capacity to move intermodal containers out of terminals and alleviate congestion.

Due to network congestion, and despite plenty of demand, both international intermodal volume (below left) and domestic intermodal volume (below right) are below 2020 levels.

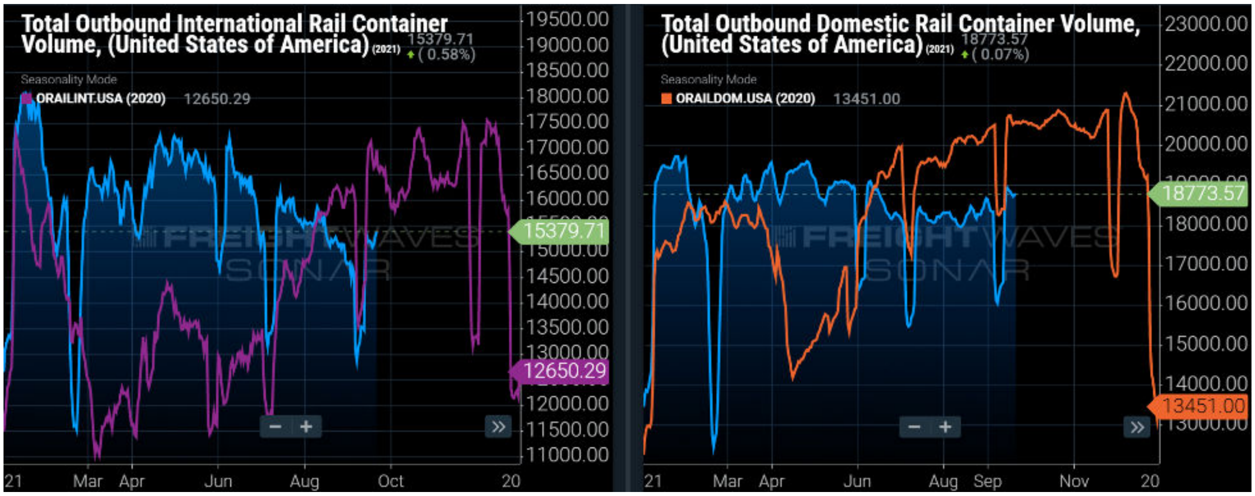


Chart: FreightWaves, SONAR. Left chart above compares 2021 and 2020 international intermodal volume; right chart above compares 2021 and 2020 domestic intermodal volume

The railroads have responded to this congestion by reopening intermodal terminals. That includes Norfolk Southern reopening an intermodal facility in Greencastle, Pennsylvania, starting on September 10. In addition, BNSF is reopening an intermodal facility in Arkansas that is located 27 miles from Memphis, Tennessee. BNSF will use the Memphis terminal for international intermodal containers coming from Los Angeles, which should be a less congested alternative to moving containers to Chicago. Some of the railroads have also responded by leasing additional warehouse space near their intermodal terminals in order to alleviate congestion at the terminals.

With BNSF's reopening of its Memphis-area intermodal facility, international intermodal volume is roughly flat in the LA-to-Memphis lane, while it is down significantly y/y for each of the other dense international intermodal lanes.

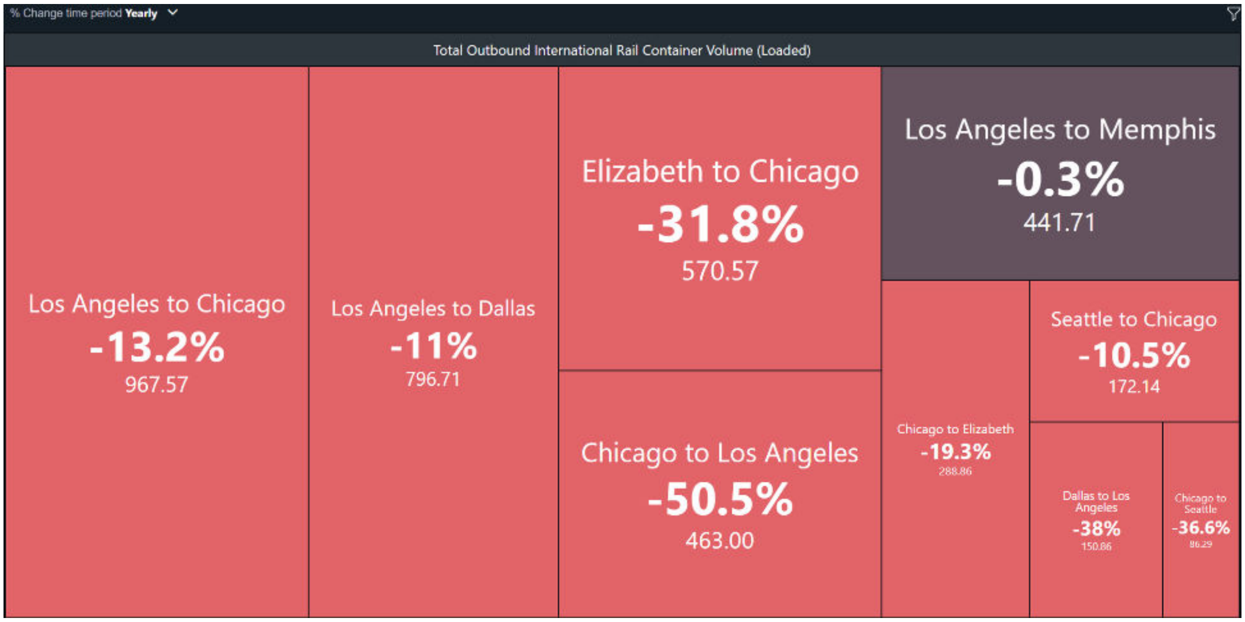


Chart: FreightWaves, SONAR. Tree map showing the average daily international intermodal volume in each of the above lanes during the past week and their respective year-over-year changes.

The Class I railroads have also responded by increasing intermodal spot rates to move 53-foot containers. The chart below shows that intermodal spot rates to move 53-foot containers door-to-- door are higher year-over-year in 10 of the 11 densest domestic intermodal lanes. In many of those lanes, intermodal spot rates are at levels where the Class I railroads are essentially pricing themselves out of the market for spot loads in order to protect capacity for customers moving intermodal loads under contracts. The Class I railroads increased rates sharply in early August in several of those lanes, particularly in lanes outbound from Los Angeles.

Intermodal spot rates are higher y/y in nearly all of the domestic intermodal lanes.

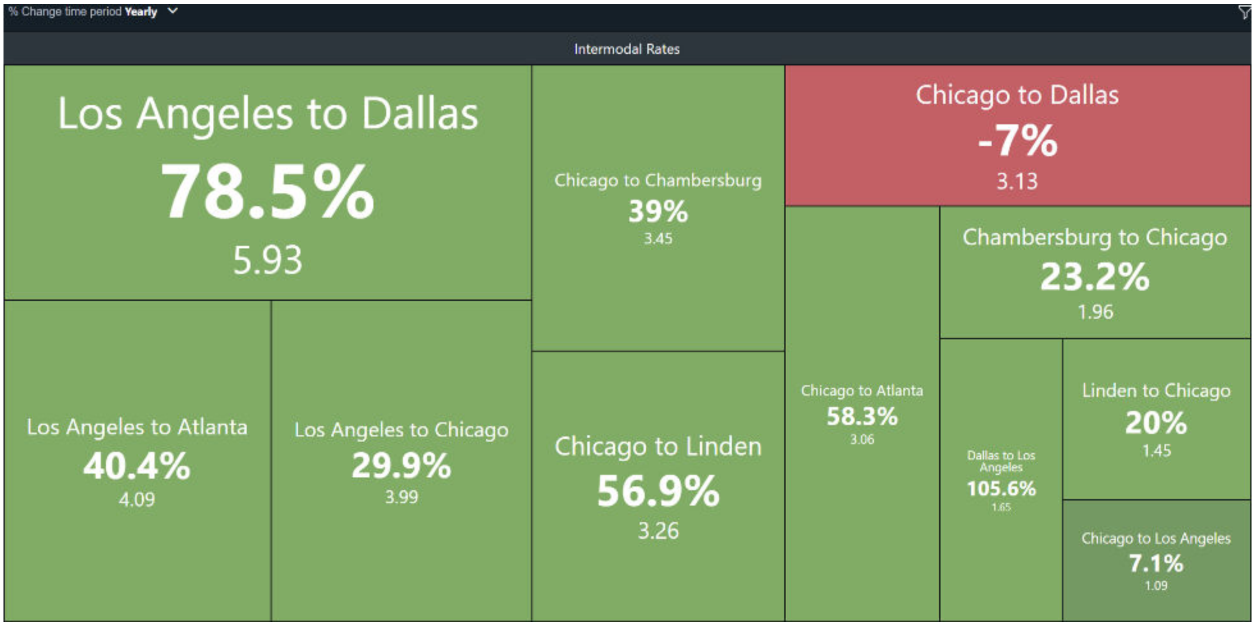


Chart: FreightWaves, SONAR. Tree map showing intermodal spot rates to move 53' containers door-to-door, including fuel surcharges.

Due to congestion, delays and equipment shortages, domestic intermodal volume (blue) and international intermodal volume (green) have underperformed both long-haul truckload volume (orange) and maritime import shipments (purple).

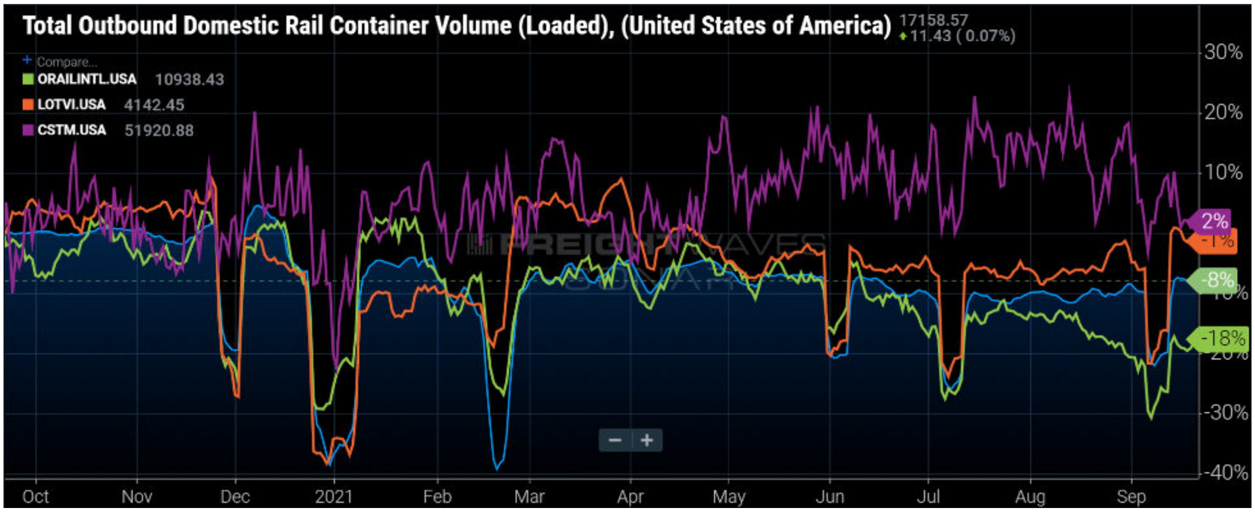
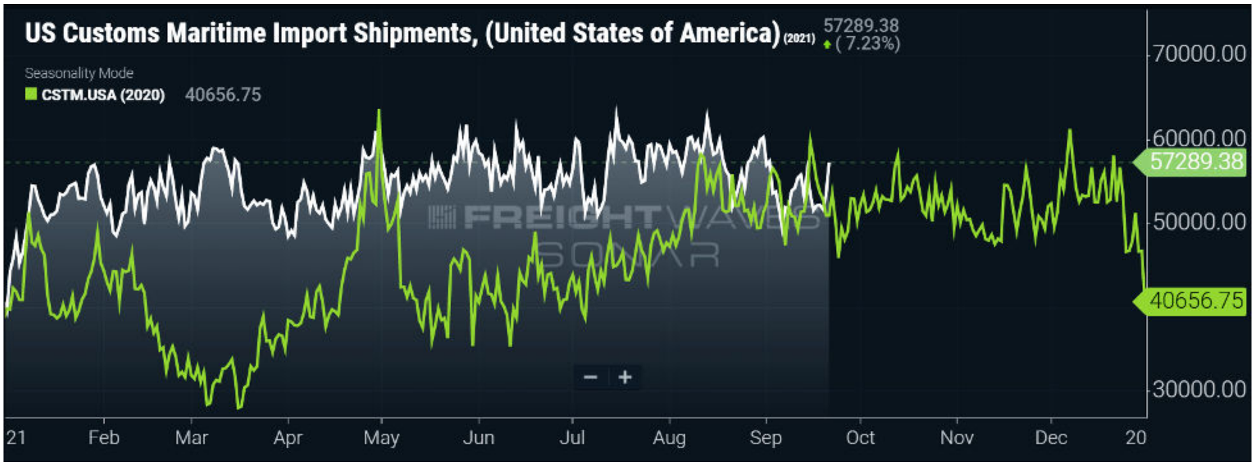


Chart: FreightWaves, SONAR. One-year relative chart comparing loaded domestic intermodal volume, loaded international intermodal volume, long-haul truckload tenders and maritime import shipment volume.

Spot rate growth dissipates, as expanding trans-Pacific vessel fleet fuels congestion

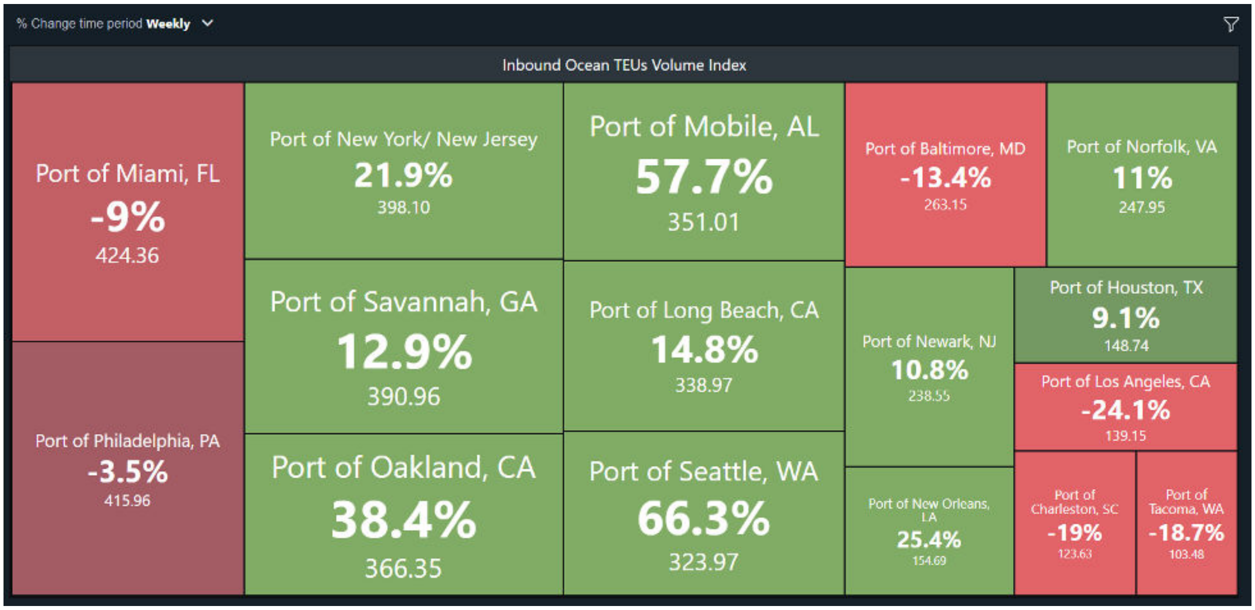
In the most recent week, containerized and non-containerized import volumes passing through U.S. Customs and Border Patrol began surfacing from their recent dive. That is an indication that late August's booking surge is beginning to trickle its way into surface-side transportation modes. With the recent increase, aggregate U.S. import volumes are now up 7% y/y, and 24% when compared to pre-pandemic 2019. The unabating peak season level of import shipments has fueled worsening congestion along both coastlines, keeping vessels tied up for weeks at a time.



(Chart: FreightWaves SONAR, Containerized and non-containerized maritime import shipments clearing U.S. Customs and Border Patrol YTD {White} compared to full year 2020 {Green})

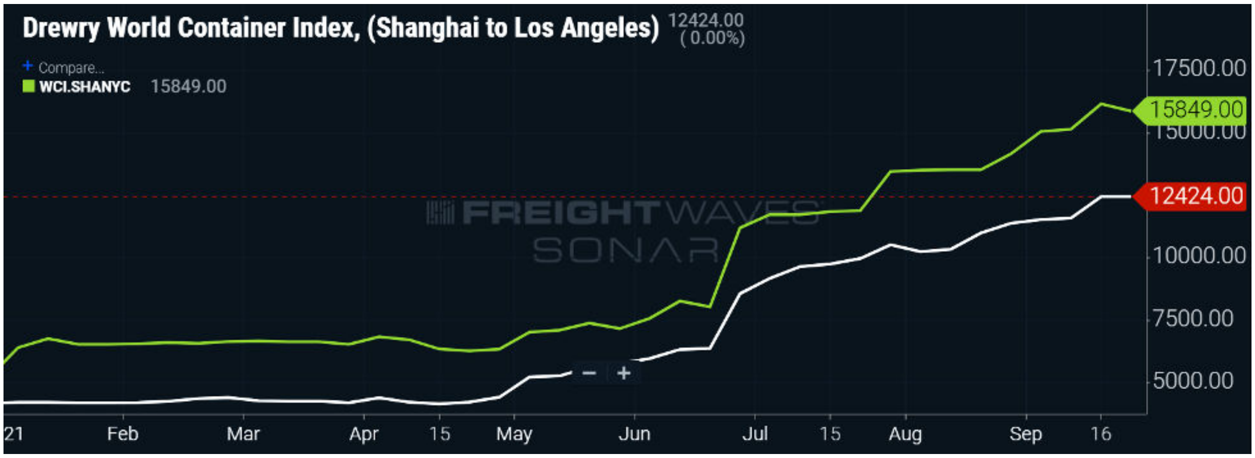
The current queue of container vessels in San Pedro Bay reached 74 on Friday, more than doubling the available number of berths at the ports of LA and Long Beach combined. The 74 ships that are awaiting a berth carry around 440,000 TEU on their decks; the port of LA imported 485,672 loaded TEU in the whole month of August. In an effort to alleviate some of the congestion in San Pedro Bay, the ports of LA and Long Beach will begin moving to round-the-clock operations. It is also expanding gate hours and calling upon marine terminal operators to incentivize the use of those additional gate times. The pilot program will be tested for a fixed operating period; it is hoped that gate availability meets cargo demand, maximizing the port's container throughput.

Auxiliary U.S. ports of entry, which have much more limited capacity than that of LA and Long Beach, have begun to see increased levels of congestion. The port of Savannah currently maintains a vessel queue of nearly 25, while 5 to 10 ships remain anchored outside of Seattle, Houston and New York/New Jersey.



(Chart: FreightWaves SONAR, Inbound Ocean TEU volume index for 16 major U.S. port complexes. Percent changes are calculated from the most recent week's readings.)

There seems to be no relief on the horizon, as new bookings data continues to remain relatively strong. In the last week, 10 of the 16 major U.S. ports posted an increase in TEU volumes with confirmed bookings. The largest increases came by way of popular auxiliary ports of entry, as more shippers sought to navigate around the congested regions. Despite the congestion in San Pedro Bay, the port of Long Beach posted new bookings growth of nearly 15%, while the port of LA posted a 24% decline.



(Chart:FreightWaves SONAR, Drewry World Container Index Shanghai to New York assessment{Green} compared to the Shanghai to Los Angeles assessment{White})

Eastbound rates along the trans-Pacific took a slight breather in the most recent week, according to the Drewry World Container Index. The Shanghai to New York assessment declined by 1.8% to $15,849/FEU, while the Shanghai to Los Angeles assessment remained flat at $12,424/FEU. Despite growth cooling with the onset of fall, spot rates are still up 225% y/y from Shanghai to New York, and 204% y/y from Shanghai to LA.

While a number of carriers have capped spot rates, congestion on both North American and Chinese shorelines will continue to ramp up as we move through peak season. Since January, rerouted extra-loading vessels have added around 40% to the available services on the trans-Pacific routes. While the number of vessels has increased, they are often much smaller vessels (1,000 to 4,000 TEU), meaning many more are required to move the same amount of container capacity. This added vessel requirement will only add to congestion and strip more available capacity, likely prolonging or worsening the current excessive spot rate environment.

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