July 12, 2022 | 4:30 PM ET

2022 spot vs. contract survey

Overview

The 2022 version of the Spot vs. Contract survey is the sequel to the original 2019 edition.

The 2019 edition of the survey responded to freight market participants claiming that larger carriers with little exposure to the trucking spot market had little to be worried about with the collapse in spot rates that began in the second half of 2018. Mainstream thinking contended that contract rates were impervious to volatile swings in the spot market.

Why the contract market in trucking would differ from the spot market in any other commoditized market was a mystery to the research team at FreightWaves. Long-term contracts in the lumber or oil markets are always based on the present spot price along with expectations over the course of the contract period. Contract prices in any industry are not picked out of the clean air. Any forecast of future rates are anchored in the present before assumptions about the future are calculated.

Indeed, most other markets are based on binding contracts between buyers and sellers. When the ink is dry on the signatures, there is little to no legal recourse for terminating the contract. This makes forecasting future pricing all the more detailed. Trucking differs greatly as most contracts are nothing more than mere "paper rates" that are not legally binding and represent not much more than a handshake. This is not to say that contracts are not taken seriously. All parties to the contract (shippers, carriers, brokers, etc.) realize that underperformance can and will end both the contract and any future business relationships with their customers and/or vendors.

The need for the survey was as apparent then as it is now. The spot market's collapse has restarted the conversation and, as our survey will show, it is only a matter of time before shippers begin to take the necessary actions to begin clawing back the contract increases awarded just a few months ago.

Table of contents:

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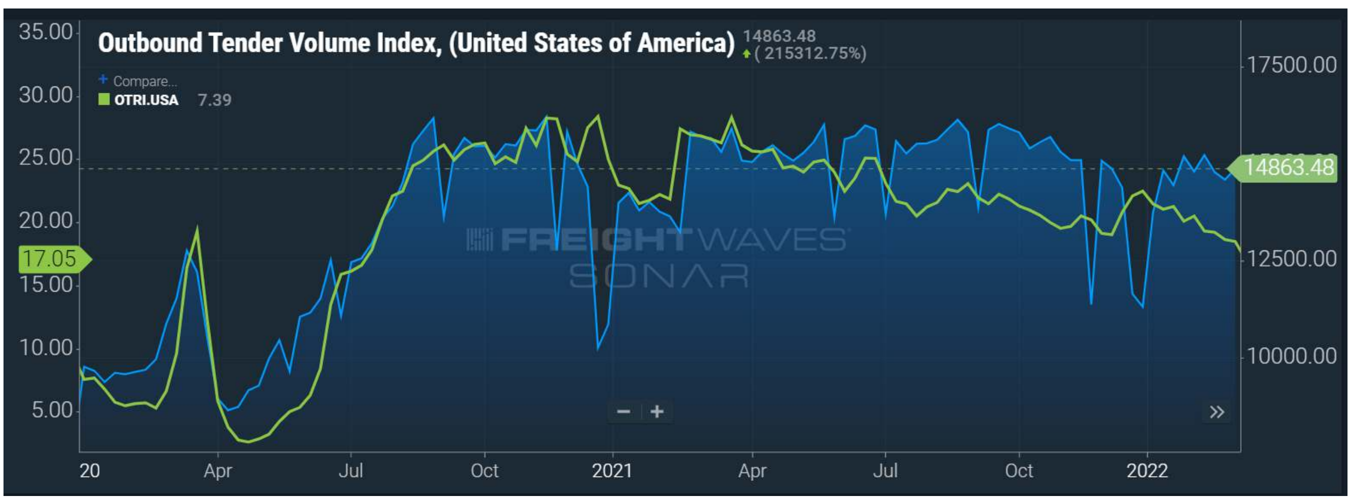
Key highlights

- According to a survey of 1,364 shippers, brokers and carriers, the spot market is increasingly becoming an attractive alternative to the contract space.
- Brokers and carriers slightly underestimate shippers' willingness to move their loads to the spot market.
- A majority from all three parties, however, agree spot rates only need to be 11% to 20% under contract rates before shippers start to shift their habits.
- When it comes to seeking discounts in the spot market, shippers are more cautious about long-term pricing trends than some brokers and carriers assume. Nearly one-fourth of shippers say contract rates need to outpace spot rates for three to four months, whereas only one-fifth of brokers and carriers believe that waiting period is necessary.
- Nevertheless, almost one-half of shippers, brokers and carriers agree that one to three months is an acceptable time frame before pulling the trigger.
- Brokers and carriers also underestimate shippers' willingness to move their freight into the spot market. Once their preferred conditions are met, over 10% say they would shift focus to the spot market with more than 50% of their loads.
- Looking at future trends, shippers are more eager to renegotiate for lower linehaul rates than many brokers and carriers expect.
- Following turbulence over the past two years, shippers are in broad agreement that capacity has become easier to secure in the first two quarters of 2022.
- On the other hand, brokers and carriers are neutral about seeing FTL load volumes decline over that same period.
- Neither shippers nor brokers and carriers, however, expect load volumes to increase greatly in the back half of 2022.
- As for expectations about future spot rate trends, shippers believe more strongly than brokers and carriers that rates still have some room to fall.
- Given that all three parties expect a continued rise in diesel prices, there are still sources of upward pressure on future rates.
- One strong point for optimism is that none of the three camps expect layoffs for the remainder of the year, though brokers and carriers are a bit less optimistic than shippers.
- Even still, all three groups expect inflationary pressures either to remain or increase further in the second half of 2022.

Spot market collapse in trucking

After a record year of freight demand in 2021, carriers playing in the spot market benefited from a blank check when naming rates. The federal stimulus enabled consumers to pay off a mountain of credit card debt and, with cash to spare and little else to do, they turned to online shopping and ramped up spending on durable goods (e.g., furniture and home appliances). Since durable goods tend to be bulkier than other retail products, warehouses — especially those near busy import markets like Los Angeles — quickly ran out of floor space. It became urgent for freight to flow closer to its final destination.

Meanwhile, capacity was quite limited. Many carriers had exited the industry during the most recent downturn in 2019, while others left during the tumultuous period at the start of the pandemic in 2020. Of those remaining, many had not yet migrated to the markets where demand was highest, like Los Angeles. In short, there was a great mismatch between supply and demand that allowed carriers (and brokers) to reap record profits from increasingly desperate shippers.

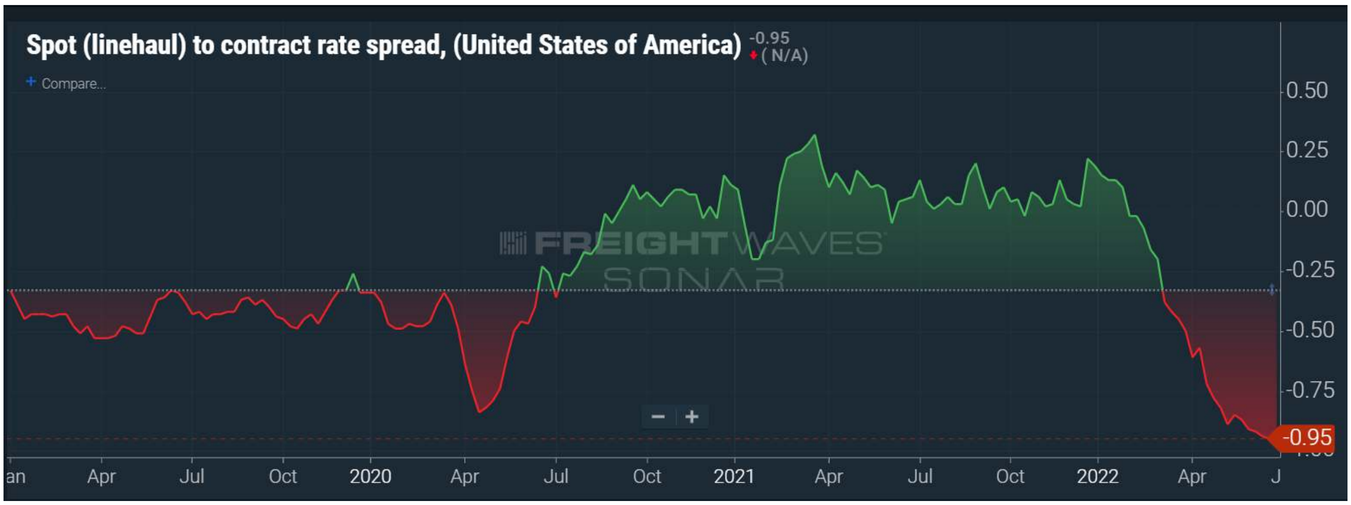


SONAR: OTVI.USA (blue; right axis) and OTRI.USA (green; left axis). Volatility for volumes and rejections throughout the pandemic. At the height of the boom for consumer goods, rejection rates hit almost 30%.

In this period of elevated demand, a lot of freight moved from the contract market to the spot market. Shippers generally prefer to move their freight under contractual agreements with carriers. Contracts allow a set-it-and-forget-it approach to lanes with consistent volume, freeing up manpower on the shipper side of operations and making it easier to balance the books. Rates on these contracted lanes are typically adjusted on an annual basis when requests for quotation (or proposal) are issued.

Although freight contracts offer convenience and predictability, they lack adaptability within a volatile market. Unlike most contractual agreements, carriers are not obligated to accept the loads offered under contract. Contract rates are thus also known as “paper rates” because they are nonbinding.

When these contracted loads are rejected by carriers, they fall to the spot market. Since lanes are priced daily or even hourly, the spot market is more sensitive to volatility and imbalances between supply and demand. When freight demand outstrips capacity, as it did in 2021, carriers can charge a premium on spot rates. It is not unheard of for a carrier to reject a contracted load and then, once it has fallen to the spot market, offer to haul that same load for a much higher rate.



SONAR: RATES.USA. Baseline view of the spread between dry van contract and spot rates. As of July 2022, the spread is wider than April 2020 during the economic lockdowns.

Shippers in such unfavorable conditions are largely left with one of two options. The first is to dedicate time and attention to navigating the spot market, although deals are rare when capacity is limited. The second is to offer higher contract rates in the hopes of retaining capacity and dealing with fewer tender rejections. Shortening a contract's bid cycle to a quarterly or monthly basis allows rates to be more current and competitive with a red-hot spot market.

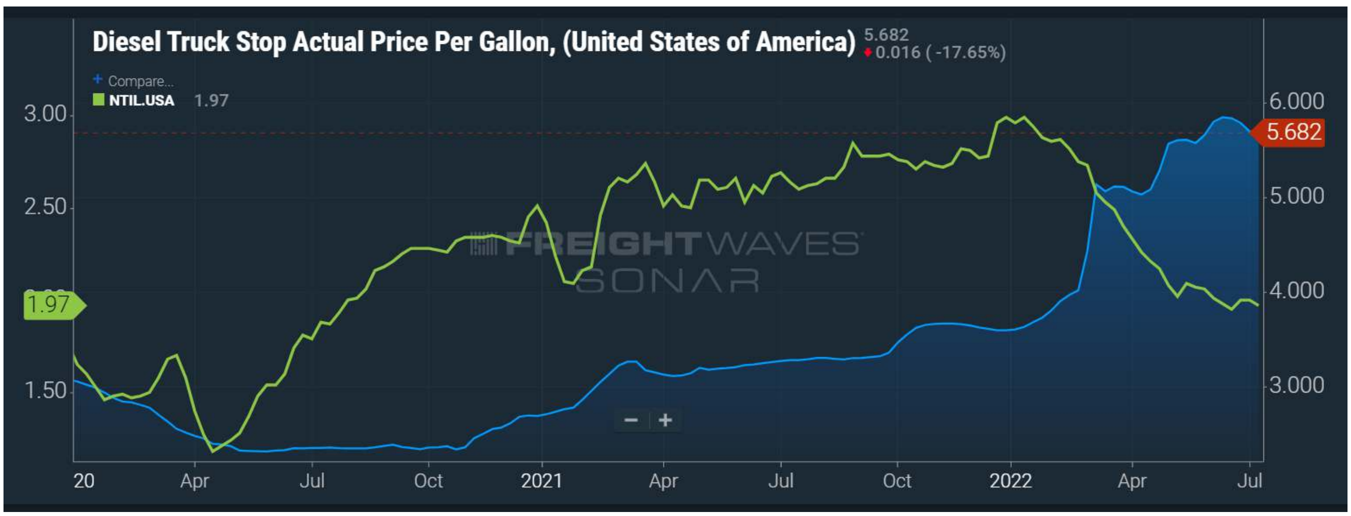
After a year of dealing with supply chain headaches, shippers broadly elected to raise their contract rates. Consequently, contract rates began to rise in the fall of 2021 and really took off at the beginning of 2022. At the start of March, when spot rates began to experience a slower rate of growth, contract rates had risen more than 23% on a yearly basis.

Even without any external influences from the economy at large, these rising contract rates would have effected lower tender rejections. Lower tender rejections would have meant fewer loads falling to the spot market, which in turn would have caused spot rates to cool.

Unfortunately for carriers, a perfect storm was also gathering. Prior to the pandemic, consumer demand was heavily in favor of services, which are not significant drivers of freight. When stay-at-home measures were put in place to restrict the spread of COVID-19, however, these services — restaurants, movie theaters and airline travel, for example —

became extremely inaccessible if they did not shut down altogether. Lockdown measures have since been lifted or scaled back across the country, allowing consumers to resume spending on services.

Inflationary pressures were mounting, leading to decreased discretionary spending across the board. To compound matters, retailers also were facing overstocked inventories at a time when consumer demand was slowing. After almost two years of retail spending, consumers have effectively purchased whatever they wanted by now. With a sufficient amount of personal goods, consumers are now turning to travel and dining — luxuries not widely indulged upon since the pandemic's beginning.



SONAR: DTS.USA (blue; right axis) vs. NTIL.USA (green; left axis). 2022 has seen a steep decline in dry van spot rates, even as diesel prices have surged.

Globally, a surge of the Omicron variant in China led to extended lockdowns for its manufacturing hubs of Shenzhen and Shanghai, weakening U.S. import volume. In February, Russia began its large-scale invasion of the Ukraine. The accompanying sanctions from Western nations all but removed the second-largest exporter of oil from the global market, sending the prices of oil and its derivatives (such as gasoline and diesel fuel) skyrocketing.

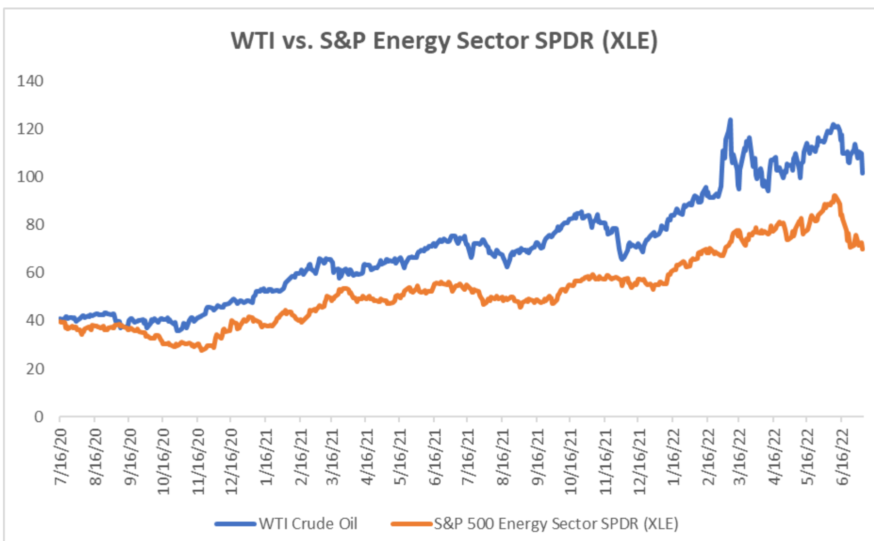
In light of these factors and others, freight demand plummeted in March and April. Predictably, with fewer opportunities in the market, spot rates followed suit. Carrier compliance along contracted lanes improved rapidly. Declining tender rejections further restricted the amount of freight that fell to the spot market, which in turn weakened spot rates further. At the time of writing, spot rates continue to be in a protracted decline, though their floor has yet to be seen.

Shippers are finding themselves with the pricing power that until recently belonged to carriers. In their next bid cycle, shippers will likely push for lower contract rates. But shippers also have the freedom to take advantage of discounted rates from carriers in the spot market — just as carriers once sought higher spot rates from shippers.

Spot rates determine valuations, not contract rates

Spot markets have been the route for many commodities to be traded on exchanges across the country. Arguably, the most well-known commodity traded based on a spot market is oil. The West Texas Intermediate (WTI) crude oil price is one of the benchmarks for the oil market, especially in the U.S., while Brent Crude also serves as a benchmark on many international exchanges.

These spot markets are the basis for how many companies within the industries are traded on the various stock exchanges around the world. The stock price for Hess Corporation, an exploration and production company exposed to the oil market, follows movements in the WTI spot price. Numerous other exploration and production companies follow similar trends.



Source: Barchart historical prices

The spot market is an integral part of the transportation industry, even for those that consistently express they have "little to no exposure" to the spot market. Over the past two years, all of the major publicly traded trucking companies — and transportation companies for that matter — have mentioned their contract side of the business, but it represented between 80% and 90% of revenue.

That indicates even the largest carriers in the country have some level of exposure to the spot market, whether it is 5%, 10% or upward of 20%. This exposure is partially why transportation companies trade on spot market prices, in addition to the fact that spot rates lead contract rates.

Trucking stocks trade on spot rates

The spot market is an integral part of the transportation industry, even for those that consistently express that they have "little to no exposure" to the spot market. Over the past two years, all of the major publicly traded trucking companies — and transportation companies for that matter — have mentioned their contract side of the business, but it represented between 80% and 90% of revenue.

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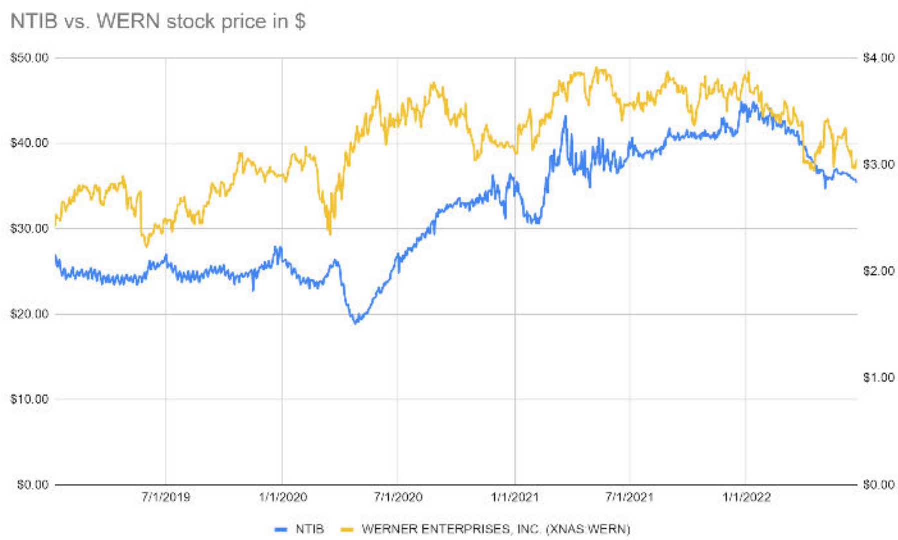
Knight-Swift stock price tracks closely with FreightWaves National Truckload Index

Source: FreightWaves SONAR, company earnings, Knight-Swift stock price (red, left axis) and the National Truckload Index - Business Day (blue, right axis)

Knight-Swift (NYSE: KNX), the largest publicly-traded trucking company, reported the contract side of the business represented 85% of revenue in the truckload segment in the first quarter of 2022. As spot rates started to decline throughout the first quarter, KNX stock price reacted negatively as well despite the company generating the vast majority of the revenue from contract freight movements.

Despite trading within a range, Werner Enterprises moves with the spot market



Source: FreightWaves SONAR, company earnings, Werner Enterprise stock price (yellow, left axis) and the National Truckload Index - Business Day (blue, right axis)

Werner Enterprises, one of the larger truckload companies in the world, generates nearly 90% of the company's revenue from contracted rates. When the spot market started to experience spot rates decline in the beginning of 2022, Werner's stock price followed suit as did investors' appetite for domestic transportation spot rates.

Despite being exposed to the intermodal market, J.B. Hunt's stock price tracks

Source: FreightWaves SONAR, company earnings, J.B. Hunt stock price (red, left axis) and the National Truckload Index - Business Day (blue, right axis)

One of the more interesting companies whose stock price tracks spot rates is J.B. Hunt, the largest domestic intermodal company in the country. While the company generates 46% of its revenue from intermodal, three of the four other segments of the company are based on truckload: Dedicated Contract Services (DCS), Integrated Capacity Solutions (ICS) and Truckload (JBT).

Though 46% of the company's revenue comes from the intermodal segment, 60% of its operating income is generated from this segment.

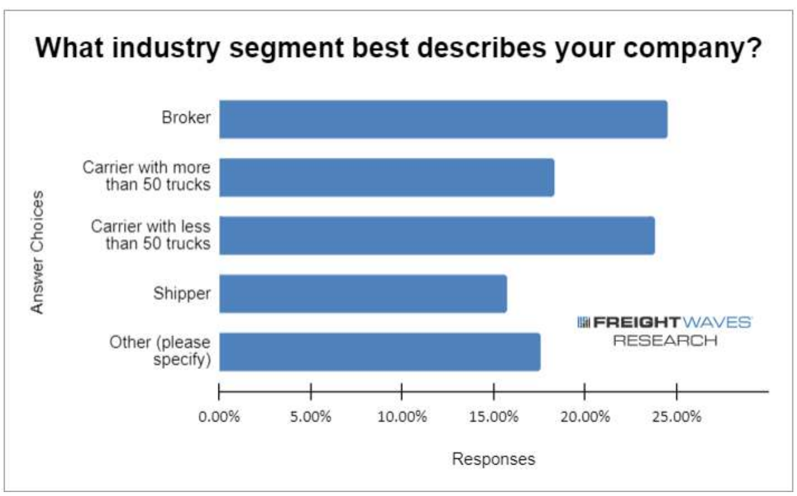
So despite being heavily exposed to a different market than the truckload market, the transportation sector as a whole is traded based on the spot market, regardless of the fundamentals.

Ultimately, investors and analysts are constantly looking for insights into what is happening in the truckload market, and the spot market provides an opportunity to see how the freight market is reacting.

2022 spot vs. contract survey

In all, we received 1,364 responses to the survey. A majority of those respondents (42.16%) self-reported as carriers. For clarity purposes in the analysis, we lumped carriers in with brokers and excluded anyone as "Other."

In the following sections, you will find comparisons between the responses from shippers (n = 141 completed surveys) and those from brokers and carriers (n = 503 completed surveys).



Source: FreightWaves' 2022 spot vs. contract rates survey

Results vary only marginally between shippers and brokers/carriers. Still, the latter would do well to realize their shipper customers are willing to move loads to the spot market slightly earlier than believed. Shippers came in with a weighted average of 2.35, meaning 11% to 20% is the likeliest rate range for this event to occur. Brokers and carriers were remarkably close to that mark, with a weighted average of 2.41. That skew toward the high side, while small, suggests some in this group could be in for a surprise if shippers start shifting loads earlier than expected.

Shippers: How far must spot rates fall below contract rates before you start moving some of your loads to the spot market?

Brokers/Carriers: How far must spot rates fall below contract rates before your shipper customers start moving some of their loads to the spot market?

	1 to 10%	11 to 20%	21 to 30%	31 to 40%	41 to 50%	More than 50%
Shippers	21.28%	43.97%	23.40%	4.96%	2.13%	4.26%
Brokers/Carriers	18.29%	44.93%	24.25%	5.96%	2.98%	3.58%

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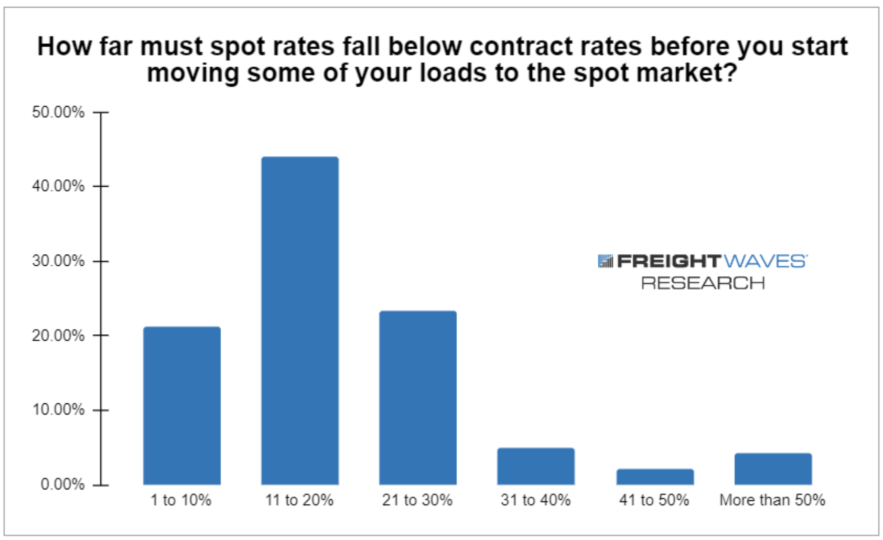
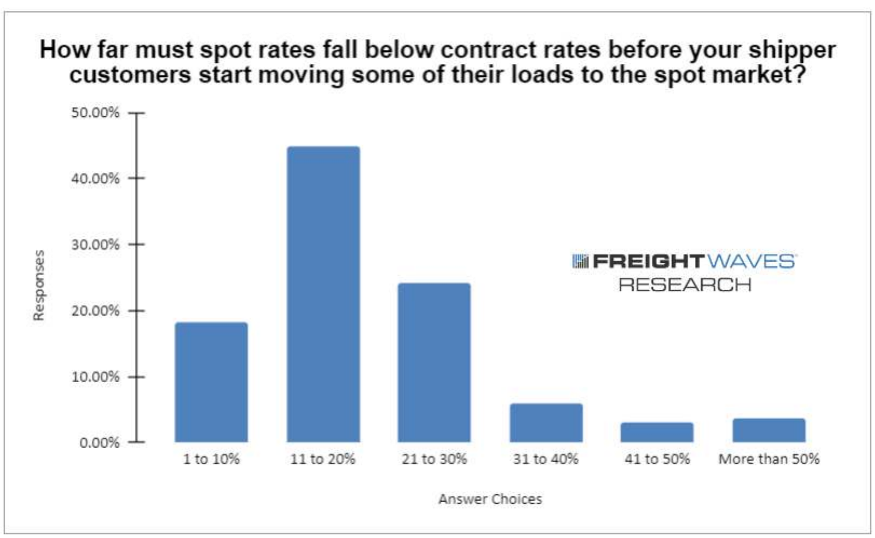
Source: FreightWaves' 2022 spot vs. contract rates survey





Source: FreightWaves' 2022 spot vs. contract rates survey

Question results are shown above. Both groups scored weighted averages that fell in the one-to-three-months range. But brokers/carriers scored 2.30 while shippers scored 2.26, suggesting they think shippers will wait longer to move loads than they actually will.

Shippers: How long do spot market rates need to stay at the level you selected, before you would move some of your loads into the spot market or negotiate with your contracted transportation providers?

Brokers/Carriers: How long do spot market rates need to stay at the level you selected, before you see your shipper customers move some of their loads into the spot market or negotiate with your contracted rates?

	Less than a month	One to three months	Three to four months	Five to six months	More than six months
Shippers	19.15%	48.23%	24.11%	4.26%	4.26%
Brokers/Carriers	20.28%	47.12%	20.48%	6.16%	5.96%

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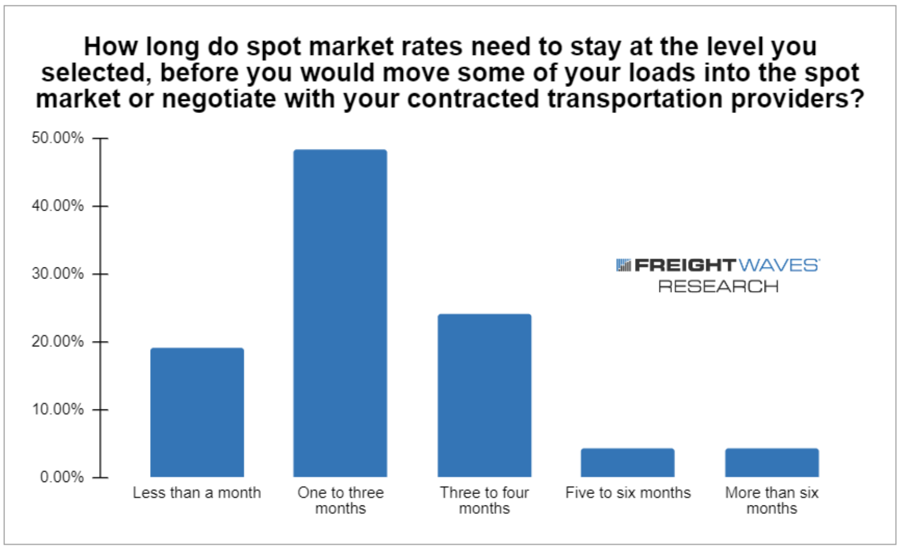
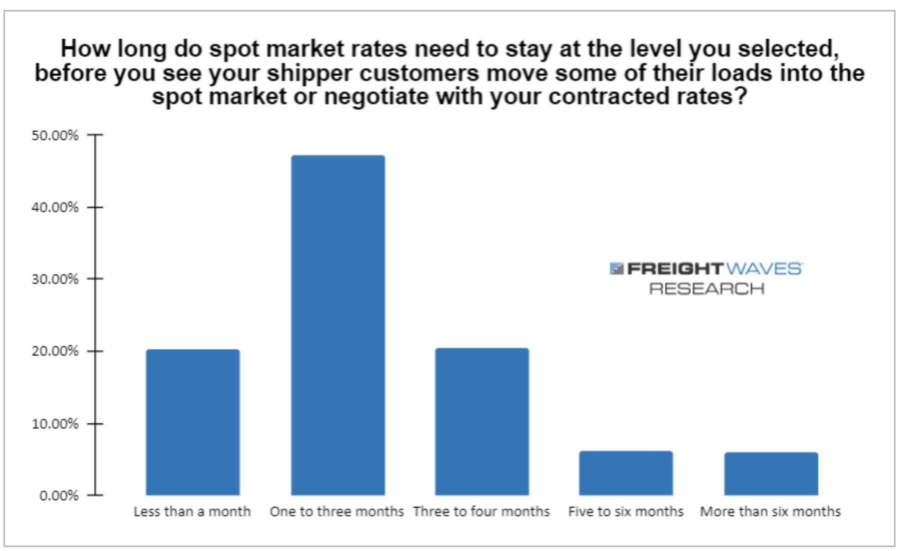
Source: FreightWaves' 2022 spot vs. contract rates survey





Source: FreightWaves' 2022 Spot vs. Contract rates survey

The trend continues. The weighted average for shippers (2.72) surpassed that for brokers/carriers (2.55). This means both reported a normal percentage of loads moved between 11% to 30%. But shippers are more likely to be on the higher end of that range than brokers and carriers.

Shippers: What is a normal percentage of loads you would move away from contract when spot market rates meet your criteria above?

Brokers/Carriers: What is a normal percentage of loads your shipper customers move away from contract when spot market rates meet your criteria above?

	1 to 10%	11 to 20%	21 to 30%	31 to 40%	41 to 50%	More than 50%
Shippers	25.53%	28.37%	21.28%	9.22%	4.96%	10.64%
Brokers/Carriers	28.03%	30.42%	20.87%	6.76%	6.96%	6.96%

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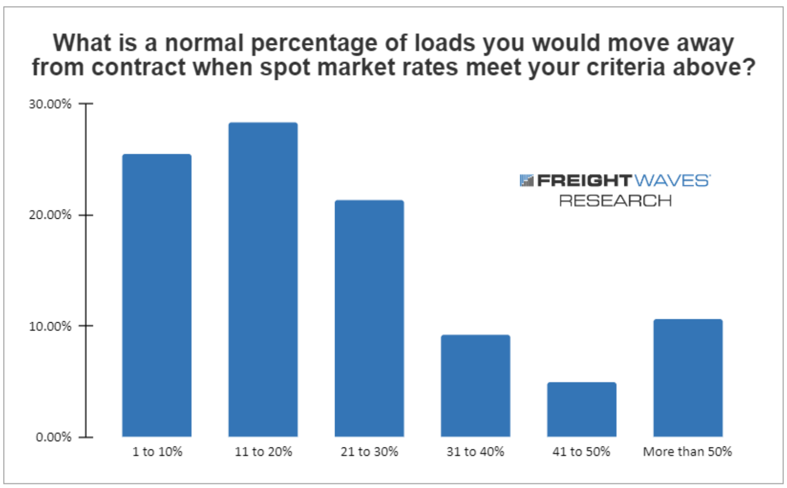
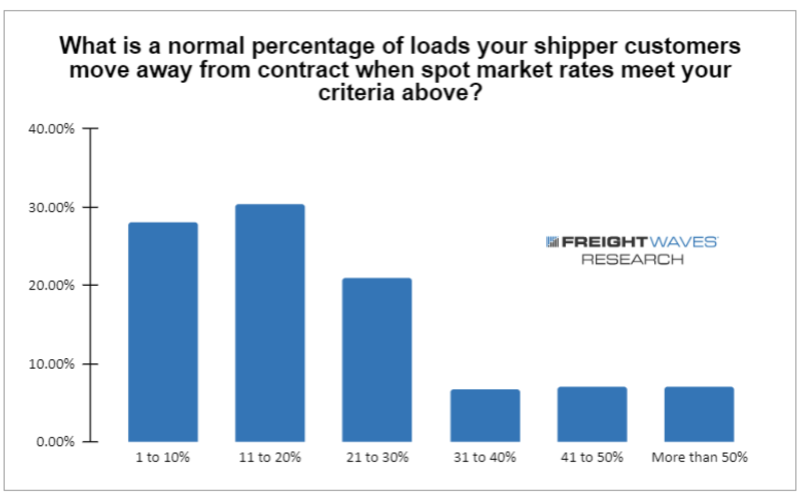
Source: FreightWaves' 2022 spot vs. contract rates survey





Source: FreightWaves' 2022 spot vs. contract rates survey

With this series of questions, we sought to gauge agreement with a variety of trends. Any weighted average above 3 indicates overall agreement; any average below 3 indicates disagreement. The further a score is from 3, the stronger the sentiment.

- Shippers scored 3.93 when presented with a statement about plans to negotiate lower linehaul rates with full truckload providers. That most closely aligns with moderate agreement. Brokers and carriers, however, came in at 3.44. That shows they agreed with the statement on the whole but not as much as shippers.
- Shippers moderately agree (3.95) that full truckload shipment capacity will become easier to secure in the first half of 2022. Brokers and carriers were closer to neutral (3.3) regarding whether they were seeing full truckload load volumes decline.
- Both shippers and brokers/carriers are feeling neutral about the prospect of load volumes increasing in the second half of 2022 when compared to the first half.
- Both shippers and brokers/carriers believe full truckload spot rates might have more room to drop before reaching a floor. Each slightly disagreed over whether they had already found a bottom (2.62 for shippers, 2.93 for brokers/carriers).
- They're also in agreement that diesel won't be coming down in cost at any time in the near future. Both groups moderately agree that the remainder of 2022 will see diesel stay either at the same level or move higher.
- Likewise, it seems neither side thinks product orders will see an increase in the latter half of 2022. Shippers scored neutral agreement (3.16) that they had plans to increase product orders. Brokers/carriers were actually in the slight disagreement camp (2.87) that shipper customers would increase product orders.
- Both moderately agreed that they do not anticipate any layoffs at their company in the second half of 2022.
- They also moderately agree that inflation will remain at its current level or even increase through the second half of the year.

Please rate how much you agree with the following statements on a scale of one to five. (With 5 meaning strongly agree.)

	Shippers	Brokers/Carriers
Shippers: "We have or plan on negotiating lower line-haul rates for a portion of our lanes with our full truckload transportation providers." Brokers/Carriers: "We anticipate our shipper customers negotiating lower line-haul rates for a portion of their lanes with us."	3.93	3.44
Shippers: "We're seeing full truckload shipments capacity become easier to secure in the first half of 2022." Brokers/Carriers: "We're seeing full truckload load volumes decline in the first half of 2022."	3.95	3.3
Shippers: "We expect our load volumes to increase in the second half of 2022 as compared to the first half of the year." Brokers/Carriers: "We're expecting load volumes to increase in the second half of 2022 compared to the first half of this year."	3.28	3.04
"We expect full truckload spot rates have reached a floor and will climb higher in the second half of 2022."	2.62	2.93
"Diesel will stay at the current level or move higher for the remainder of 2022."	3.75	3.88
Shippers: "We plan on increasing our product orders in the second half of 2022." Brokers/Carriers: "We anticipate our shipper customers will increase their product orders in the second half of 2022."	3.16	2.87
"I do not anticipate any lay-offs in our company in the second half of 2022."	3.91	3.74
"We expect inflation to remain at its current level or increase in the second half of 2022."	3.73	3.8

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Source: FreightWaves' 2022 spot vs. contract rates survey

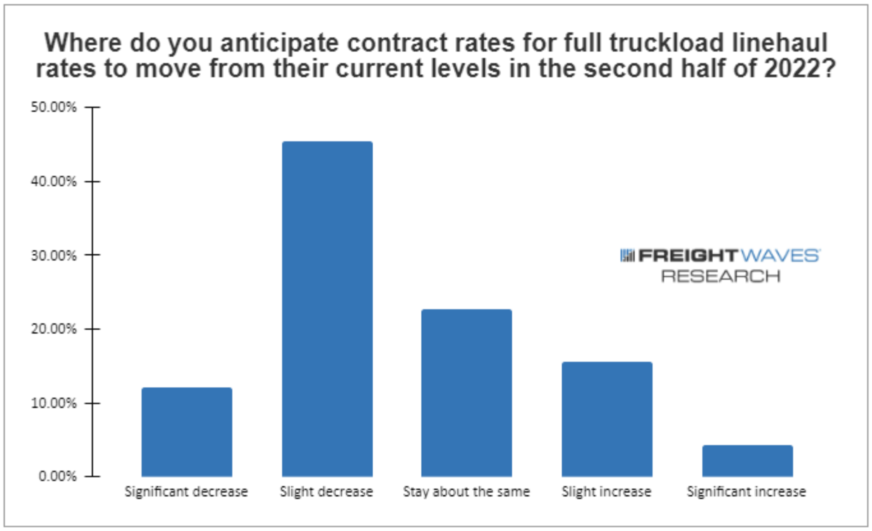
Shippers scored a 2.55 weighted average here, and brokers/carriers scored 2.64, meaning both expect a slight decrease in contract rates for full truckload linehaul rates. Despite those results, about 20% of respondents in each camp expect some kind of increase, even if it's small.

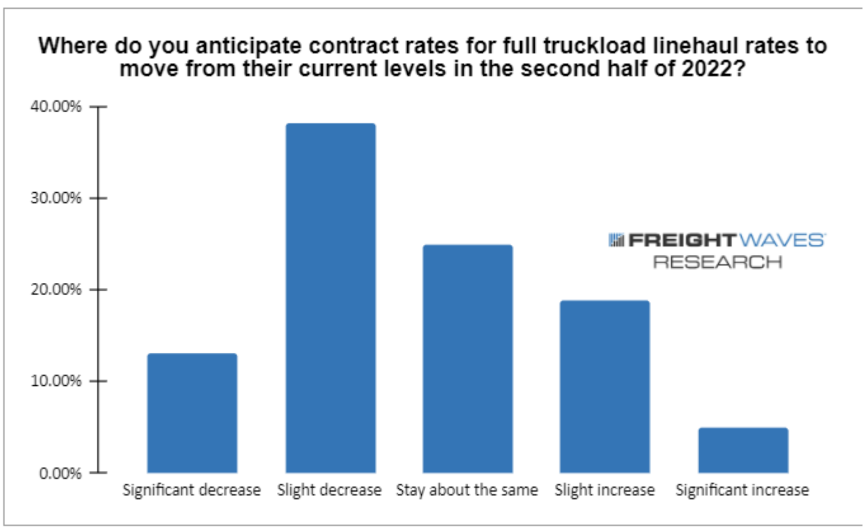
Where do you anticipate contract rates for full truckload linehaul rates to move from their current levels in the second half of 2022?

	Significant decrease	Slight decrease	Stay about the same	Slight increase	Significant increase
Shippers	12.06%	45.39%	22.70%	15.60%	4.26%
Brokers/Carriers	13.12%	38.17%	24.85%	18.89%	4.97%

FREIGHTWAVES RESEARCH

Source: FreightWaves' 2022 spot vs. contract rates survey





Source: FreightWaves' 2022 spot vs. contract rates survey

If these survey results are any indication, the second half of 2022 will see a lot of lane movement/renegotiating. Shippers and brokers/carriers both expect a median of 40% of lanes moving to the spot market or requiring renegotiating. That's a sizable chunk.

Shippers: What percentage of your lanes do you anticipate moving to the spot market or re-negotiate with your transportation providers in the second half of 2022?

Brokers/Carriers: What percentage of your lanes do you anticipate having to re-negotiate with your shipper customers in the second half of 2022?

	Mean	Median	Mode	Range
Shippers	47.12%	40%	20%	0-100%
Brokers & Carriers	43.05%	40%	50%	0-100%

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Source: FreightWaves' 2022 spot vs. contract rates survey

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