RAILROAD WEEK IN REVIEW

May 29, 2020

"Deere says demand trends for large farm and construction equipment are being impacted by several sources of uncertainty, including COVID-19 countermeasures, oil price shock (ethanol and lower construction equipment demand), US/China trade tensions, and other factors." — Wells Fargo analyst note, May 26

"Short lines will especially appreciate the streamlining of the RRIF application process, including the mandating of regular updates which will improve visibility, the extension of loan terms out to 50 years which will lower annual costs; and better match asset lives." — ASLRRA President Chuck Baker on legislation to improve the RRIF loan program

"While economic activity may stabilize, it may not recover at a pace sufficient to drive the economically sensitive cyclical stocks to outperform. This would be a departure from the prior market rebounds, where even though the economy didn't roar back, the recovery was seen as durable and expected to progress at a pace that supported cyclical leadership." — Jeffrey Kleintop, Charles Schwab, May 26

Norfolk Southern has realigned its merchandise commodity groupings. Through the end of 2019 commodities were grouped as Agricultural Products, Metals/Construction, Forest/Consumer, Chemicals, and Automotive. Effective 1Q2020 the groups became Agriculture/Forest/Consumer, Metals/Construction, Chemicals, and Automotive.[1]

The former "Forest & Consumer" category included beverages, canned goods, kaolin and all the STCC 24s and 26s. Under the new regime, all these have been moved to the new "Agriculture, Forest & Consumer Products" group along with the original grain, grain mill, and fertilizers in Ag Products. As a result, you can't get year-over-year comps in any of these commodities unless you go to the AAR Weekly Carload reports (which I've been doing for some time).

The 1Q2020 Ag, Food, Consumer group reported carloads as down 4.8 percent. Where was it? Well, AAR data shows all but one of the former ag products and forest/consumer commodities were down, the exception being what the AAR calls "food & kindred products" and includes "all food and feed products, except grain mill products." Lumber/plywood was off 9.6 percent, STCC 26s dropped 5.0 percent, grain fell 9.5 percent, and grain mill lost 10.4 percent year-over year.

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[1] *At the beginning of 2020, we combined the agriculture products and forest and consumer commodity groups. In addition, we also made changes in the categorization of certain other commodity groups within Merchandise. Specifically, certain commodities were shifted between agriculture, forest, and consumer products; chemicals; and metals and construction. These changes were made as a result of organizational initiatives to better align with how we manage these commodities. Prior period railway operating revenues, units, and revenue per unit have been reclassified to conform to the current presentation. — Norfolk Southern 10-Q, March 31, 2020*

This level of commodity detail is critical for short lines and anybody else settling with a “handling line” or other per-car allowance. If you’re serving a chicken feed mill, you care chiefly about grain(corn) and soy meal; if you have a lumber yard customer you care about STCC 24; if you’re in the paper business STCC 26 is your ticket. In other words, “Ag, Forest & Consumer” doesn’t do you much good. Some digging is required. (For what it’s worth, CSX runs a pretty self-explanatory commodity list in its quarterlies.)

The Kleintop quote above is fitting because it refers to the Dow Jones Transportation Index ($DJT) which in turn reflects the original Dow Theory that says the direction of transportation stocks is a leading economic indicator.

The candlestick chart is the S&P 500 Index ($SPX) and the dashed blue line is the $DJT. As you can see, the $DJT has lagged the $SPX by a wide margin until just the last few days.

Kleintop again: “Of course, the market could change its mind. A shift to cyclical leadership would be welcome news, in that it may provide support for the durability of the stock market rebound from the March 23 low. What could be the drivers that could prompt cyclical leadership to emerge?”

He suggests three things: stronger economic data, vaccine/anti-viral treatments, or simply time. He concludes,

> A rotation to cyclical leadership could bring new market leadership. The leaders and laggards of the last cycle tend to switch places, sometimes catching investors by surprise… New cycles tend to reset investor expectations for growth and because the leaders of the prior cycle tend to have the highest expectations embedded in their prices after years of outperformance. This contributes to the flip of leadership in each cycle.

The message to railroad operators is to stay very nimble, conserve resources while continuing to build customer confidence, and watch revenue ton-miles by customer because that pays the rent.

So here we are half way through the second quarter. AAR North American year-to-date revenue units declined 11.4 percent through May 23. Farm products ex-grain and food (all STCC 01 but grain and beans) was the only gainer, up less than two percent and representing some four percent of total units. For the week, grain was the winner, all of it in Canada because US grain was was actually down 2.3 percent.

Even with all this red ink, the AAR's John Gray notes that in the last week 15 of the 20 commodity groups they track had "modestly higher loadings" and intermodal units were the highest in 11 weeks. He adds, "While we can't yet say whether rail traffic and, by extension, the economy, have turned a corner, these are all encouraging signs. As areas across the country begin to reopen over the next several weeks, perhaps we can start looking for light at the end of what has become a rather long tunnel."

North American Rail Traffic
Week 21, 2020 – Ended May 23, 2020

	This Week		Year-To-Date		
	Cars	vs 2019	Cumulative	Avg/wk[1]	vs 2019
Total Carloads	**272,100**	**-26.2%**	**6,501,219**	**309,582**	**-12.6%**
Chemicals	40,616	-15.8%	933,777	44,466	-3.1%
Coal	53,135	-39.6%	1,365,386	65,018	-24.8%
Farm Products excl. Grain, and Food	24,183	-5.8%	529,141	25,197	1.8%
Forest Products	14,375	-14.7%	330,868	15,756	-7.8%
Grain	34,608	10.3%	652,051	31,050	-5.5%
Metallic Ores and Metals	32,646	-25.3%	810,696	38,605	-6.8%
Motor Vehicles and Parts	6,228	-77.4%	342,067	16,289	-38.4%
Nonmetallic Minerals	39,007	-20.4%	826,546	39,359	-10.3%
Petroleum and Petroleum Products	16,633	-33.8%	464,156	22,103	-4.2%
Other	10,669	-19.9%	246,531	11,740	-4.0%
Total Intermodal Units	**313,831**	**-10.8%**	**6,639,224**	**316,154**	**-10.1%**
Total Traffic	**585,931**	**-18.7%**	**13,140,443**	**625,735**	**-11.4%**

[1] Average per week figures may not sum to totals as a result of independent rounding.

I'm encouraged that the carload commodities that are the non-Class I railroads' bread and butter are mostly down only single digits. Moreover, the work of Susquehanna rail analyst Bascome Majors shows that Week 21 was down less than the trailing four-week average and that — to me at least — suggests improvement. But let's not break out the champagne just yet.

Kleintop and the $SPX/$DJT chart seem to say we're not out of the woods by any means. The $SPX barely held the 200-day SMA on Wednesday, and that average has acted as resistance for the last month or so. The $DJT has broken above its 20-SMA, but still has another 900 points to go to hit the 200. To paraphrase Jamie Lee Curtis in *Trading Places*, "Diesel fuel and train crews cost money, Louie." And that's why staying ahead of the curve is important.