RAILROAD WEEK IN REVIEW

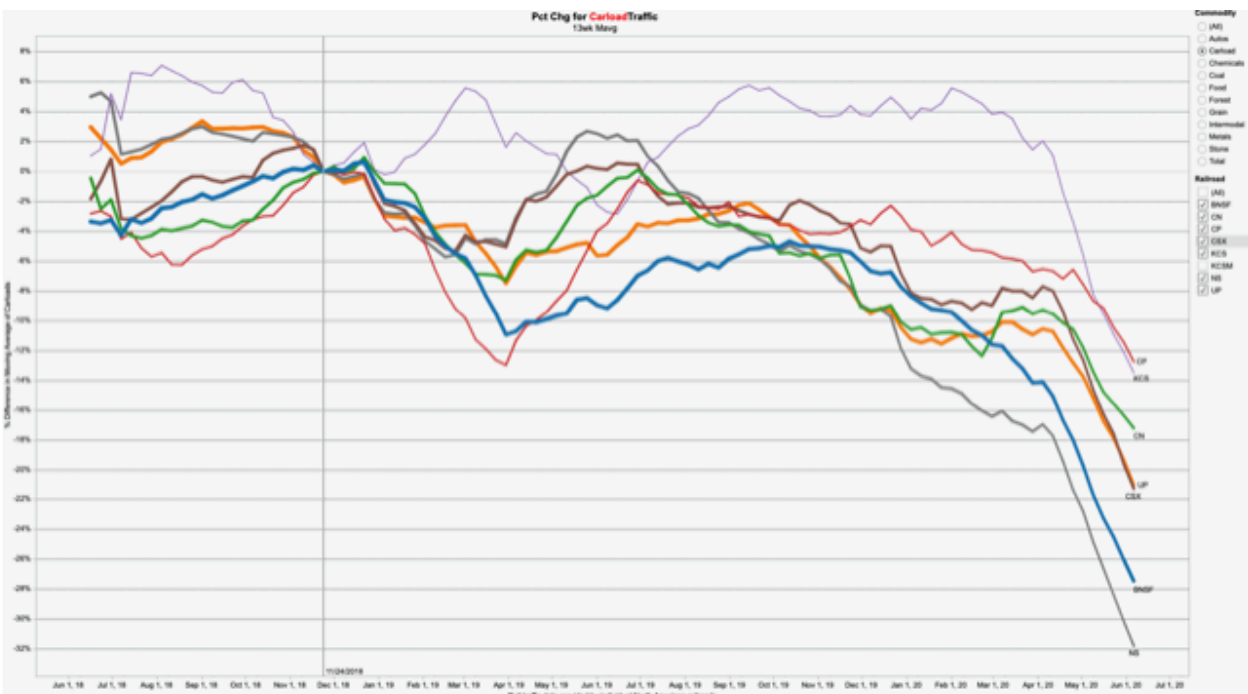
June 12, 2020

"I see in my daily reading that a report from retail and tech data firm Coresight Research found that as many as 25,000 U.S. stores will be closing permanently this year. This is a depression, not a recession, and that doesn't mean we won't see huge liquidity-induced rallies along the way. — David A. Rosenberg, Rosenberg Research, June 9, 2020

"Most major economies were teetering on the edge of a recession before the lockdowns tied to COVID-19 hit. Five of the major Group of Seven (G7) countries ended the fourth quarter of last year with negative or zero GDP growth. The economic lockdowns in response to the virus magnified these economic vulnerabilities, and led to a deep global recession." — Jeffrey Kleintop, Charles Schwab, June 8, 2020

Generally speaking, railroad revenue units seem to be improving sequentially but lagging. Week 22 sequential negative rates of change are slowing, but it's uneven, suggesting that railroads need to track inventory trends by customer. It's a given that transportation buyers seek "supply chain flexibility and operational rigor." Can the carload sector deliver?

Personally, I don't see it. Here's a chart of monthly rates of change in 13-week moving averages. This includes all carloads from auto to coal, ex-intermodal.



The vertical line is 11/24/2018 and the divisions across the bottom are successive months. Railroads from top down are CP, KCS, CN, UP, CSX, BNSF, NS. The decline began slowly last October, roughly in line with the CP peak, before COVID really hit. The sharp drop started in late March and accelerated from there as the stay-home rules kicked in.

The zero percent line is where all lines converge in this RailFax chart and go up and down in ten percent increments and weeks across. Clearly the Canadians and KCS have weathered the storm with the least volume damage. NS is dead last, down 32 percent compared to 18 percent for CSX. I think pricing plays a role. Channel checks suggest NS service is improving or at least not getting any worse. CSX service seems still to show the effects of laying off too many people and cutting resources too fast.

The Dow Theory centers around identifying the trends for the Dow Jones Transportation Average and the Dow Jones Industrial Average, and I use revenue unit volume to confirm those trends. If both Dow Jones averages are trending in the same direction, then the entire market can be said to be trending in that direction as well. A reversal in the transports presages a decline in the general market, the assumption being that reductions in the amount of stuff being moved presage an economic slowing as businesses start to detect sales slowing.

Here's the Dow Industrials as of Monday noon. The vertical line on the left is January 1; the right edge of the chart is last Monday. Note the slight increase through mid-February and the sharp sell-off starting February 18 or so. (Green is up for the day, red is down.)

Now compare the shape of this curve with the carload curve, above. The market as measured by the $DJI says a recovery is in progress. Yet a look out the window and the railroad volume chart tell me such is not the case and the market is going up largely on speculation and euphoria. It also tells me railroads are correct in continuing to retrench in train starts and in variable costs, the biggest which is labor. Read on.

Transportation buyers' views of the current environment are always useful. The internet abounds with so-called "shipper surveys," and one of the most useful comes from Jason Seidl at Cowen & Co. In his most recent missive, he writes that railroad customers continue to see lackluster demand coupled with an unpredictability of pricing and equipment availability. Some of Jason's respondents see "opportunities for modal changes." Paper is down yet chemicals, pulp and board are up appreciably.

A New York City/Long Island customer sees "catastrophic effects" on carloads. Though re-openings have continued since late May, "our expectations are for a gradual return at best." Others call the market for railroad services "really soft," citing the extended disruption in daily routines and its impact on future spending. More working from home will hurt the automotive, petroleum, housing-related, and real estate industries.

The trucker viewpoint is one of an April bottom in truck transportation demand and a gradual return to"normal," barring a spike in new Coronavirus cases. That eventuality, however, makes planning ahead difficult: "Business has changed on how it operates and how employees respond." There's a trend to paying down long-term debt, as "some over-leveraged carriers have gone under." A food hauler says rates and loads are down but they're surviving.

As for what happens next, there is optimism that business will steadily increase over the next 18 to 24 months. Still, "it's a lumpy demand curve" with grocery items and the like doing all right, while the carriers in the manufacturing space "are trying to rebound from their 30-70 percent trough." There is concern that unemployment will remain in the 12-15 precent range over the next few months and "roughly one in three Americans faces diminished purchasing power."

A sad day in Sandersville, Georgia. Ben Tarbutton, Jr., scion of the shortline community and head of the eponymous Sandersville Railroad passed away this week. He was defined by a lot of things. He was a dedicated American, knew the value of education, was filled with love of family and faith, and at the core was a solid railroader. He loved the industry because of its people, whom he felt epitomized the strong American work ethic and the ingenuity that makes this country world class. He will be missed.