RAILROAD WEEK IN REVIEW

November 5, 2021

"Our supply chain problem isn't a 'bottleneck' at the ports. It's the systemic collapse of an over-levered, financialized transport industry. Ports, warehouses, containers, trucking, rails … it's all connected and it's all fucked up." — A Twenty Year Truck Driver, retweeted by Ben Hunt, epsilontheory.com

"FRA expects NS to evaluate its conductor training program, in line with our letter of Sept. 9, 2021, which identified significant deficiencies in NS' May 22, 2018, conductor certification program, to ensure that it is sufficient to prepare and protect individuals in performing duties as a certified conductor." FRA Deputy Administrator Amit Bose, Oct. 28 letter to NS CEO James Squires

"A theme of my recent reports and videos has been the shift from an age of abundance to an age of scarcity. Shortages of myriad varieties, including labor and semiconductors, are likely to be persistent and carry well into next year, suggesting a significant rebound in the big GDP driver of consumption is not in the cards." — Liz Ann Sonders, Charles Schwab Chief Investment Strategist, November 1

"A growing consensus that the oft-predicted transitory burst of inflation is proving to be not so temporary after all, as the decades-long shift to margin-maximizing initiatives like just-in-time inventory management strategies and low-cost overseas manufacturing leave supply chains brittle and vulnerable to disruption." — Almost Daily Grant's, November 2

Norfolk Southern is in the FRA crosshairs over safety, of all things. Time was when NS consistently won the Harriman Safety Award every year. Yet now we have FRA Deputy Administrator Amit Bose writing to NS CEO Jim Squires, "NS has had five conductors/brakemen suffer amputations and crushing injuries in the past seven months."

Bose adds , "Particularly, NS should consider any potential relationship between recent changes to the duration of its conductor training, and the frequency and severity of conductor incidents and injuries. NS' revised conductor certification program is due Nov. 12, 2021." Specifically mentioned are incidents on Oct. 20 and 26 in which "your employees, who were certified conductors with less than a year of service," were injured by moving equipment.

The speed with which NS has reduced headcount in the name of PSR, and the subsequent push to hire more T&E personnel (WIR Oct 29) may a root cause. FRA again: "Particularly, NS should consider any potential relationship between recent changes to the duration of its conductor training, and the frequency and severity of conductor incidents and injuries. NS' revised conductor certification program is due Nov. 12, 2021."

The unions are on this big time. *Railway Age* Editor Bill Vantuono writes, “The Brotherhood of Locomotive Engineers and Trainmen (BLET) and the SMART Transportation Division (SMART–TD) have each filed Motions for Preliminary Injunctions against Norfolk Southern in the United States District Court for the Northern District of Ohio, Eastern Division, ‘to stop the railroad from forcing locomotive engineers to work as conductors, and for disciplining those who don’t.’”

Railway Age Capitol Hill Contributing Editor Frank Wilner, who has close ties with these organizations, properly notes you can’t just take any engineer and put him on the ground. “Highly skilled locomotive engineers are not concomitantly highly skilled yard conductors. Many locomotive engineers had minimal ground service training before being promoted, and for many there has been a lengthy period since they worked a ground service job, with few having familiarity with the yards to which they are being, or will be, assigned.”

Having worked both as an engineer and conductor, I agree fully with what Wilner writes. It takes time to learn the yard work of any yard, and clear communication between engineer and conductor is critical. The engineer has to know where his ground crew is at all times, and the ground crew members need to make sure the engineer knows where they are before he touches the controls. A sorry state of affairs and I would have thought NS leadership would know better.

Knowing where the economy is likely headed is crucial in planning resource allocation for the upcoming quarters. As you can see, the S&P had a blowout 2Q2021 with significant gains in all sectors, particularly Industrials and Materials, both significant carloads commodity groups.

S&P 500 y/y earnings by sector

Sector	1Q21	2Q21	3Q21	4Q21	1Q22	2Q22	3Q22	4Q22	FY21	FY22
Consumer Discretionary	226.1%	380.5%	12.8%	11.5%	2.5%	23.8%	41.9%	46.5%	81.9%	27.5%
Consumer Staples	11.1%	20.4%	6.0%	2.1%	5.0%	4.7%	7.5%	9.9%	9.3%	7.1%
Energy	28.0%	243.3%	1713.1%	8332.7%	150.4%	49.8%	1.5%	-6.2%	1332.6%	30.1%
Financials	138.0%	158.2%	35.3%	3.3%	-18.4%	-16.4%	-4.8%	5.5%	64.0%	-9.4%
Health Care	26.7%	27.2%	23.6%	22.5%	6.6%	3.3%	4.1%	5.8%	26.9%	3.4%
Industrials	3.0%	698.4%	85.2%	53.1%	55.8%	32.1%	32.1%	36.0%	87.7%	37.3%
Materials	62.4%	139.5%	91.9%	64.7%	31.6%	1.7%	-7.1%	-12.3%	88.7%	0.6%
Real Estate	5.8%	38.7%	21.7%	14.0%	8.5%	-2.3%	7.0%	11.0%	18.8%	6.7%
Technology	44.9%	49.6%	35.7%	14.7%	5.2%	3.1%	6.8%	13.6%	34.0%	7.4%
Communication Services	53.1%	72.8%	35.4%	11.6%	0.8%	1.5%	7.1%	16.2%	38.9%	7.8%
Utilities	-0.9%	12.6%	0.8%	0.1%	6.2%	-7.9%	3.7%	16.7%	2.0%	6.9%
S&P 500	**52.8%**	**96.3%**	**39.2%**	**22.2%**	**6.3%**	**4.1%**	**7.8%**	**12.8%**	**48.4%**	**7.7%**

Source: Charles Schwab, I/B/E/S data from Refinitiv, as of 10/29/2021.

The chart above suggests we’re entering a much less aggressive period — possibly through the end of 2022. Look at Industrials and Materials again: Industrials eking out a 1/3 gain Q/Q starting in Q2 and beyond; Materials flat or down beyond March.

Yes, energy was at the other end of the scale: the spike in oil and nat gas prices, the resurgence of coal in generating electricity, and the inability of renewables keep the lights on and heat up. But I think supply and demand will come more into balance as 2022 progresses. Says Sonders, "Energy is clearly the top earnings driver—driven by the 'base effects' relative to last year's pandemic/lockdown era when oil prices briefly fell into negative territory."

Canadian Pacific filed its 4,342 page STB application for control of the KCS on October 29, paying a fee of $1,930,000 in the process. Three days later on November 2 the STB issued its Proposed Procedural Schedule and Request for Comments. In the latter, the Board proposes a 245-day schedule starting October 29, 2021, to go through the process, with final decision to be announced at a later, unstated, date.

The filing says right up front — addressing the Board's environmental concerns — "the transaction will shift more than 60,000 trucks off the Continent's highways annually and onto new, more efficient and environmentally friendly CPKC intermodal services." Moreover,

> No lines will be abandoned and no facilities will be rationalized, as the goal of the Transaction is to support growth in traffic across the entire CP/KCS network. Likewise, competition will be enhanced and nowhere diminished, as CP and KCS connect at only a single point and operate no parallel lines. And routing options will be expanded and not reduced, as CPKC will keep all existing gateways open on commercially reasonable terms and create no new bottlenecks.

The new railroad will offer "more efficient single-line service," with through intermodal and carload service between Canada and the upper midwest and the US southeast and Mexico with no KC interchange. Blocking will benefit. "CPKC will build efficient, longer distance blocks that bypass Kansas City, connecting KCS's Shreveport yard and CP's yards in St. Paul and Chicago." And I'm sure it won't stop there.

The combined CP and KCS will operate as a single system improving asset utilization and turn-times without increasing loco or car fleet sizes. The carload product is enhanced "by replacing interchanges with a single continuous network, eliminating unpredictable delays associated with interchange, creating opportunities for longer distance blocking, longer trains, and fewer stops."

Perhaps CP's Keith Creel sums up the transaction best in his Verified Statement: "CP's proposed acquisition of KCS is a perfect fit with CP's strategic goal of pursuing growth opportunities on behalf of our shippers." Say Amen to that.

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