RAILROAD WEEK IN REVIEW

February 11, 2022

“The primary driver of the operating expense increase was fuel expense, up 80 percent as a result of a 74 percent increase in fuel prices. Our fuel consumption rate was flat compared to 2020 as a favorable business mix was offset by negative productivity.” — Jennifer Hamann, UP CFO, Jan 20 call

“We believe U.S. natural gas prices, which have reflected near-term premiums for winter weather and tension surrounding Ukraine, are likely to remain elevated beyond the heating season. We also see an attractive risk reward in several natural gas prone stocks.” — Stifel note, Feb 8

“Fertilizer is a global commodity and can be influenced by multiple market factors beyond the control of U.S. producers. Similar to globally traded commodities, 44 percent of all fertilizer materials are exported to a different country. This factor has an outsized impact on fertilizer prices because fertilizer production is not only influenced by what is occurring where it is produced.” — American Farm Bureau Federation

“We know that providing real-time information about customers’ freight is vital for planning their overall supply chains. At BNSF, we believe supply chain management goes beyond our network and providing our customers with door-to-door visibility of their shipments is key to mutual success for all parties involved.” — Tom Williams, group vice president of Consumer Products, BNSF

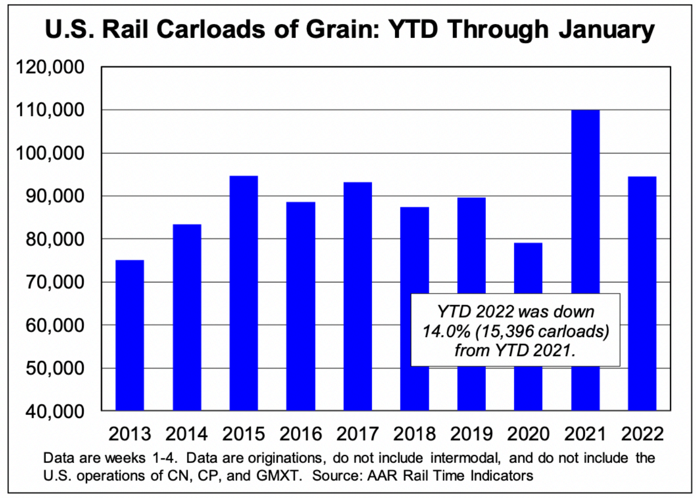
The talk of $100 oil continues. As of Monday morning Light Sweet Crude for March delivery stood at $92, up 40 percent from $67 in early December. That’s $15 per month rate of increase, and the tea leaves are suggesting that rate of increase could well be with us through May.

Putting oil prices in perspective, the Class Is in 4Q2021 saw the price paid for a gallon of fuel jump by more than 50 percent and accounted to 15-20 percent of total operating expense, up from ten percent or so a year ago.

So I’d have to say the diesel fuel price increases have been a matter of $billions to the Class Is and it looks like we’re not done yet.

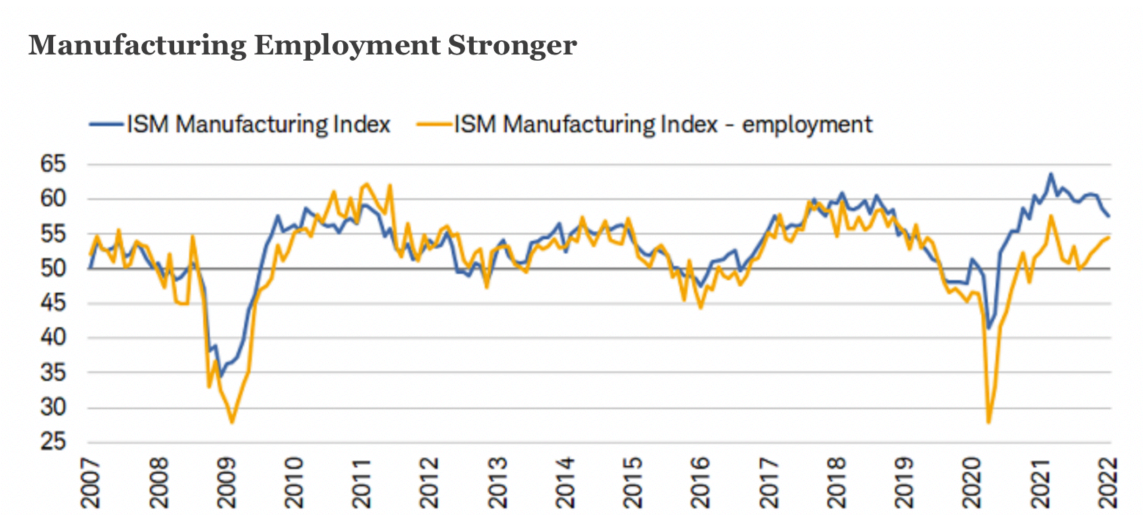
Meanwhile, March futures contracts for beans and corn rose sharply in the preceding quarter and are still ticking upward while wheat seems to be settling into a range at this point. Nat gas for March is now down to $4 per million BTU, down sharply from October’s high north of $6.

This explains partly why prices for ammonium nitrate and other nitrogen sources have been so high. Compared to Sep 2020, ammonia, MAP, and DAP prices had all doubled or worse. Moreover, delivery times became increasing erratic.



Given that fertilizer is about 15 percent of total cash costs to farmers, it's no wonder that planting rates have slowed and futures are going up. The USDA estimates 2022 U.S. wheat production will fall roughly ten percent from the 2021 number. Corn and beans will see slight increases.

The reason I think this ISM chart is important for merchandise carload trends is that more people on the shop floor indicates more stuff being made. That in turn means more inbound manufacturing materials and more outbound finished product.



Source: Charles Schwab, Bloomberg, as of 1/31/2022.

The ISM (blue) index shows a sharper uptick than the employment index partly because manufacturers are doing more with fewer people and paying the people remaining higher wages. I think the surge in metals-related carload moves last quarter and the car builders seeing increased demand for steel-carrying gons is another indicator of increased manufacturing.

One more thing: The Labor Force Participation Rate (LFPR) for prime-age (25-54 years) is now 82 percent, significantly up from the sub-80 pre-pandemic trough. Part of the reason for the renewed upward move in the LFPR is that there is presently a wide rate of industries hiring.

True, the extreme right of the chart above shows some flattening, but the economic slowdown currently underway is not about hiring trends; it's about spending trends. So, with that in mind and given the railroads' remarks on the recent earnings calls, it's most likely a pause before continuing the upward trend. Moreover, a record 50 percent of U.S. small-business owners say they raised compensation in January amid still-elevated job openings, according to the National Federation of Independent Business.

The XLB materials ETF can be a useful guide to the health of the companies providing manufacturing input stocks. The major companies in the ETF include DuPont, Nucor, Air Products, Alcoa, and International Paper. As of Wednesday morning, companies trading above their 20-day moving averages were mainly in metals — steel, aluminum, and copper to be precise. The Morningstar materials sector report says the sector outperformed the broader market in Q4.

Of particular note are companies in metals & mining, specialty chemicals, and industrial gases. As for metals, the AAR says STCC 33 "primary metals products" (castings, shapes, slabs, etc) account for about 90 percent of the total metals category; the rest is STCC 34 (fabricated metal products). In recent years, this traffic category has accounted for between 3% and 4% of total U.S. rail carloads.

So the outlook for manifest carload traffic depends very much on where you are dealing in products for further processing, and that includes everything from animal feed to scrap steel.