RAILROAD WEEK IN REVIEW

December 23, 2022

"Results for our key performance indicators improved this week as inventory dropped by approximately 12,000 cars since the week ending November 25th. Car Velocity, Manifest TPC, and Intermodal TPC all posted their best weekly number since we initiated our EP770 reporting. The improvement was also reflected in our EP724 trains held numbers as the number of trains held dropped below 100 per day for the first time in seven weeks." — Union Pacific Service Progress Report, December 16, 2022

"To Dow, a bull market in industrials could not occur unless the railway average rallied as well, usually first. According to this logic, if manufacturers' profits are rising, it follows that they are producing more. If they produce more, then they have to ship more goods to consumers. Hence, the two averages should be moving in the same direction. When the performance of the averages diverge, it is a warning that change is in the air." — Wikipedia

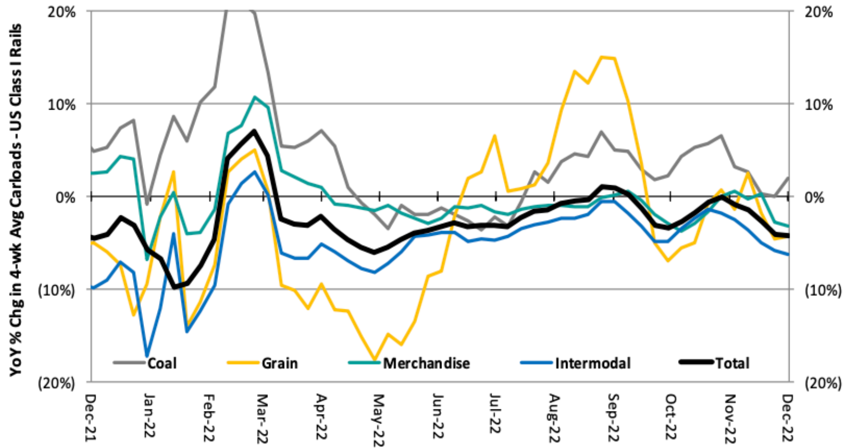
"We expect the STB will approve the CP-KCS merger in early 1Q:23, and it's possible we could get a rule-making on reciprocal switching sometime in 1H:23. We view reciprocal switching as a potential modest negative for the rails, but we don't see it as a big risk. So, big picture, we don't see anything from the STB that presents a material risk to underlying rail pricing power." — Scott Group, Wolfe Research, December 2

To my way of thinking, it is more important for railroad managers to know where trends in carload volumes are going than it is to know where they have been. I have found the so-called Dow Theory charts to be very useful and generally pretty accurate. What you see here is a chart of the Dow30 ETF, DIA, and the Dow Jones Transports ETF, IYT.

As you can see, the IYT Transportation index (orange) continues to lag the DIA, turning negative in late Nov, taking the DIA down with it a few days later. And if you did a full year chart, you'd see similar trends in Jan, Mar, and Aug.

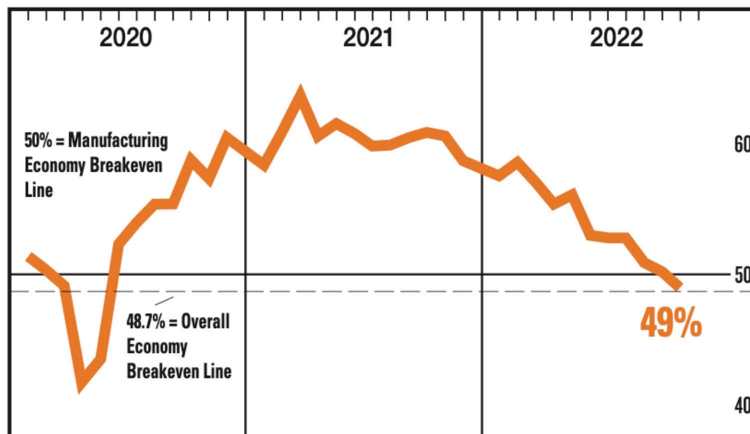
You can corroborate the chart trend with actual carloads with this chart from Susquehanna rail analyst Bascome Majors. Use the heavy black line which

represents total carloads going back a year. Note the dips in carloads in Jan, Mar, and Aug. Note too that the actual slide in loadings lagged the IYT indicators by a few days, further reinforcing the Dow Theory precept that drops in carloads flag a drop in manufacturing activity.



It works on both sides — inbound and outbound. Manufacturing requires inbound materials from plastic pellets to steel coils. You can look at the weekly commodity carload stats from both the AAR and your serving Class I to identify the trends that will most affect the resources you need today to match your traffic volumes tomorrow.

One more thing. The Institute for Supply Management holds that an index above 50 connotes industrial expansion and contraction below 50. Their latest: "In November, the Manufacturing PMI® registered 49 percent, 1.2 percentage points below the reading of 50.2 percent recorded in October.

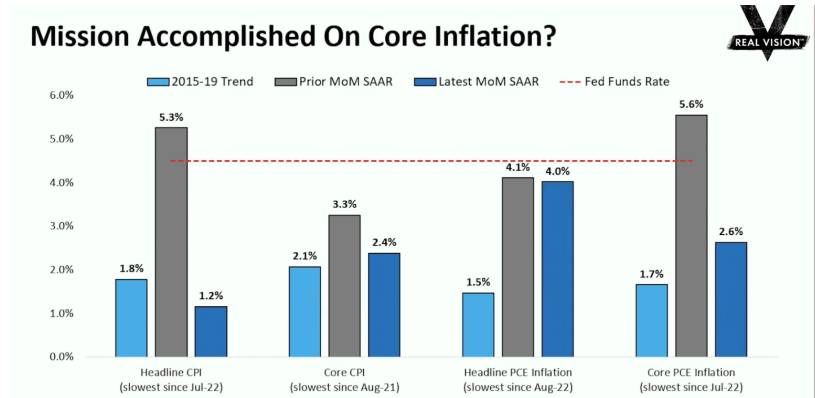


"After five months of flat or marginally positive change, the Nov decrease took the Manufacturing PMI® into contraction."

So if the ISM is pointing to contraction, AAR carloads are falling, and the Dow Theory DIA and IYT trends point to fewer revenue carloads going forward, the prudent railroad manager will want to be in position to have the right assets in place to accommodate the changes, staying well ahead of the customers' requirements.

Economist Darius Dale of 42 Macro put this chart up on *Real Vision* the other night as part of a discussion on inflation and what the Fed is doing about it. I think it is important for non-Class I railroad operators to be aware of the trends so they can anticipate how their Class I connections are likely to behave.

The four groups are Headline CPI, Core CPI, Headline PCE inflation, and Core PCE inflation. The light blue bars are the 2015-2019 trends. The grey bars are the prior month numbers. The dark blue bars are the latest month. The red dotted line is the fed funds rate.



Says Dale, "What I'm showing here in this chart, headline CPI, core CPI, headline PCE inflation and core PCE inflation on a month over month annualized rate of change basis. And as you can see, we are now tracking at annualized rates that are significantly below the Fed's target.

"It's starting to send a signal to other market participants that hey, look, the Fed, if they just kept the Fed Funds rate here, the base effects and the progress we've already made from a sequential momentum perspective are going to drag the time series down to a significantly lower level."

These charts are more about goods than services. Lower inflation means slower price hikes because demand is no longer exceeding supply, which means goods volumes are slowing and that portends lower freight volumes. Employment levels are still looking good, but that's partly because people still have jobs even though their weekly hours have been cut. And that eats into disposable income which in turn brings down discretionary spending.

You may wish to trot these ideas around to your customers for confirmation or rebuttal.

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