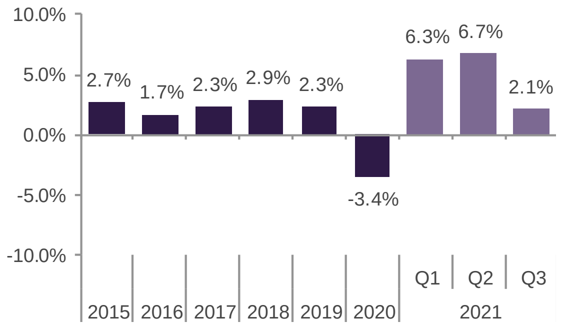
Logistics & Supply Chain market update

Industry Consulting Team | Q4 2021

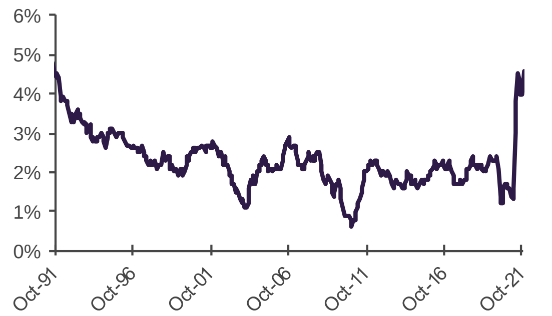
Economic Backdrop Remains Strong

- **The second reading of U.S. Real GDP grew at just 2.1% in Q3**, illustrating many of the issues affecting the economy over the past quarter. Adjusted for inflation, however, **Nominal Q3 GDP was up 7.8%,** highlighting the impact to *real* growth from inflation. The strong underlying conditions reflect a resilient consumer that has faced headwinds from COVID variants, inflation and a supply chain crisis, yet continued unabated on a goods spending binge. To underscore the point, **September Retail Sales increased 13.9% from the previous year while October was up 16.3% YoY**. Fueled by over $2 trillion in excess consumer savings and a tight jobs market, retail sales growth is likely to continue well into 2022, but could shift from pandemic driven goods spending to more services.
- **Consumer Prices increased 6.2% YoY** (a 31-year high) accelerated by supply constraints and record demand. Some elements of inflation are certainly transitory as seen by the increase in used car prices. The semiconductor shortage has driven new car inventories on dealer lots down from an average of 3.5 million units to 1.2 million, while **pushing up used car prices 37%** in October – a big driver of headline inflation that will abate as chip production increases. Home prices and rents are also leading to higher headline prices given an estimated shortfall of 4 million single family homes relative to rising household formation, and the lingering impacts from the Great Recession that curtailed housing supply over the last decade.
- **Inventory-to-sales ratios are near record lows** as sales remain high and supply chain constraints are limiting producers ability to restock. Low inventory levels support estimates that the current economic and freight boom will be elongated as inventories will take longer to rebuild in the face of supply constraints, and a shift to more resilient (just-in-case) supply chains that require higher inventory levels going forward.

U.S. Real GDP



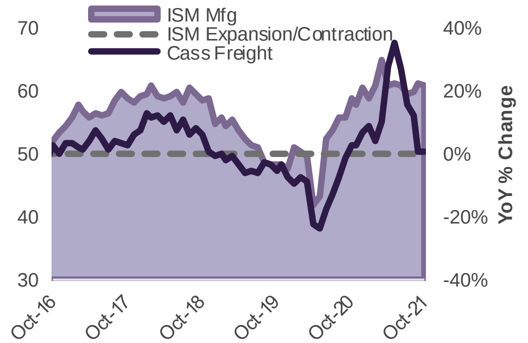
CPI (ex. Food & Energy)



Freight Volumes Hit by Bottlenecks but Poised to Rebound

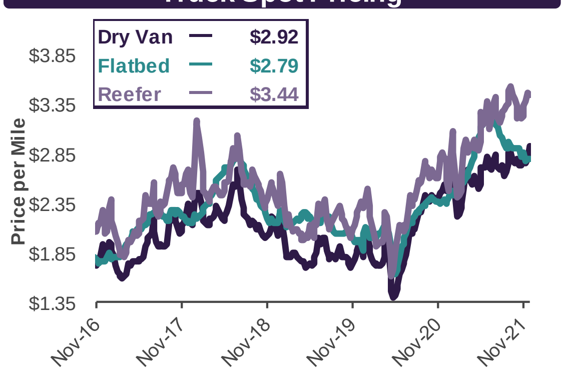
- Freight volumes stalled across most modes in the quarter, as goods were mostly stuck at sea or in ports. Ships and ports have become virtual warehouses as current labor, infrastructure and equipment constraints negated the ability to move cargo off vessels and docks. The lack of turnover in chassis, containers, and other transportation equipment are a signature of the supply chain crisis as equipment is often dislocated from the end users that need it most; keeping logistics networks locked up. As a result, **Cass Freight Shipments in September and October increased 0.6% and 0.8% respectively from the previous year** despite strong underlying economic conditions.
- Industrial activity remains relatively strong as **ISM Manufacturing increased throughout Q3 to 61.1** (above 50 is expansion) bolstered by order backlogs and low inventories. Still, bottlenecks and price uncertainty threaten manufacturing output in the short-term as orders get delayed or canceled. Over the medium to long term industrial activity will get a significant boost from the recently past infrastructure bill and a gradual easing in supply constraints.

Cass Shipments vs. ISM Mfg Index



Capacity Constraints Lift Profits for Carriers

Truck Spot Pricing



- The pandemic has taken a secular driver shortage and made it worse. Early retirements, new federal safety standards, and a strong jobs market have all contributed to a depleted driver base. Trucking companies are getting creative with recruiting, and wages continue to move higher, with some companies offering sighing bonuses in excess of $20,000 - mostly leading drivers to the highest bidder without necessarily increasing the net pool of drivers. This dynamic should support strong freight rates going forward as capacity remains tight and shippers are more enlightened to the current reality - focusing more on need than price.
- Increased freight demand and rising wages have kept spot rates elevated near record levels. With another record earnings season, **public truckload carriers saw a 65% growth in earnings**. The demand for used-equipment boosted carriers operating margins as large gains on equipment sales were recorded during the quarter.
- **ATA Tonnage recorded the largest sequential gain in September of 2.4%** as trucks hauled a more balanced freight profile, given increasing share of industrial goods. Increased demand for freight and elevated rates are expected to continue the earnings upside into 2022.

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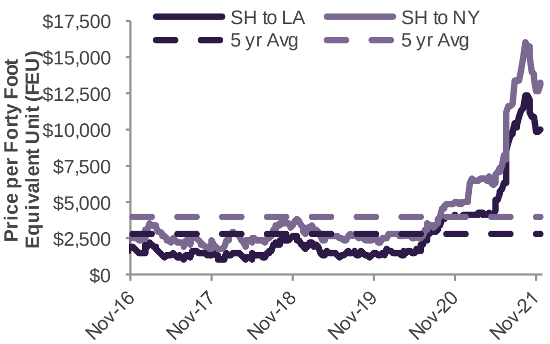
Ocean Freight: Pricing Starts to Ease

Benchmark Ocean Freight Rates



- Since the pandemic began, ocean freight pricing has been rising to unprecedented levels. At it's peak, the cost to ship a container from Shanghai to Los Angeles **hit over $12,000 while lanes to the East Coast exceeded $16,000 - 300% higher than 5-year averages**. Starting in mid-September, rates began to fall gradually, now down 20% from their all-time-highs. The decrease matches recent trends in freight volumes over the last 2 months, but is mainly attributed to the recent vessel queues at North America ports and canceled sailings.
- The 3 largest U.S. ports (Los Angeles, Long Beach, and New York/New Jersey) account for 50% of all U.S. imports. On the West Coast, there have been a record number of vessels queued at sea that are unable to unload due to completely full docks. The result has caused **dwell times for containers on dock to increase from 4-5 days to as much as 12 days.** Shippers are reacting by sending more cargo to alternative gateways, mostly on the East and Gulf coast. Labor disputes on the West Coast could also divert more cargo as the ILWU negotiates a new 6 year agreement with West Coast port operators.

Creative (Desperate) Measures to Circumvent Supply Chain Crisis

- **Chartering Ships:** Port congestion in LA/LB and other busy ports have led large "big-box" retailers to charter their own ships to address record high freight costs and delays that have more than doubled the price and time to get goods to market. However, in many cases these smaller (unscheduled) vessels are not able to get ahead of the long queues in harbor as larger steamship lines have reservations with ports in advance with their regular weekly service strings. Although these shippers had good intentions, many of these newly charted vessels are actually adding to port congestion. The Port of LA estimated recently that of the 70+ ships at anchor, roughly half were from unscheduled chartered ships from "big-box" retailers.
- **Air over Ocean:** Although a costlier option, many retailers have opted to sidestep ocean transportation altogether and utilize air freight to ensure their products get to market. Peloton reportedly spent $100 million in air and ocean freight deliveries while Amazon expanded its fleet of planes with the purchase of 11 Boeing 767 airliners all to transfer cargo. The diversion to air freight solutions has been a boon for plane makers and airlines alike as air freight costs to Hong Kong and Europe increased by almost 90% from the previous year as of October.

Port Infrastructure Changes on the Horizon

- The current supply chain crisis has spotlighted the acute need of investment at key U.S. logistics hubs. East & Gulf Coast ports have been improving their harbors and terminals over the last decade to accommodate an expanded Panama Canal and larger vessels. Current projects underway to further improve container operations will make East & Gulf coast ports even more competitive:
- **Georgia Port Authority:**, expanding on-dock rail, adding 1.6 million TEUs of new capacity, and deepening harbor to 47' (54' at high tide) by 2022
- **South Carolina Ports:** phase 1 of new terminal added 700,000 TEUs of new capacity. Deepening harbor to 52' - expected completion in 2022
- **Port of Virginia:** improving rail and terminal capacity. Deepening channel to 55'
- **Houston Port Authority**: expanding terminal capacity and improving harbor to accommodate larger ships
- **North Carolina Ports**: expanded cold storage capacity, improved rail connectivity and proposed deepening harbor to 47'
- **JaxPort:** undergoing terminal upgrades to improve container throughput by 1.5 times current capacity
- **Port of Tampa:** improving berths and yards to receive more vessels and accommodate 60% more containers
- **Port of Baltimore**: began rail improvements to allow for double stack intermodal train units

Select North America Port Volumes

	2019		2020		2021		
	Total TEUs (000s)	YoY %Δ	Total TEUs (000s)	YoY %Δ	YoY %Δ	Total TEUs (000s)	YoY %Δ
West Coast Ports:						September	
Los Angeles	9,338	(1.3%)	9,213	(1.3%)	26.5%	904	2.3%
Long Beach	7,632	(5.7%)	8,113	6.3%	24.3%	748	(5.9%)
Vancouver	3,397	0.0%	3,468	2.1%	15.6%	312	3.0%
Seattle / Tacoma	3,775	(0.6%)	3,320	(12.0%)	15.9%	331	7.1%
Oakland	2,500	(1.8%)	2,461	(1.6%)	4.2%	183	(19.0%)
Prince Rupert	1,211	16.9%	1,141	(5.7%)	(4.6%)	85	(23.0%)
Total West Coast	**27,853**	**(1.7%)**	**27,718**	**(0.5%)**	19.8%	**2,562**	**(2.4%)**
East & Gulf Coast Ports:						September	
New York / New Jersey	7,471	4.1%	7,586	1.5%	23.7%	724	0.5%
Savannah	4,599	5.7%	4,682	1.8%	25.5%	472	14.5%
Virginia	2,938	2.9%	2,814	(4.2%)	29.5%	306	19.4%
Houston	2,987	10.6%	2,989	0.1%	15.8%	282	10.7%
Charleston	2,436	5.2%	2,310	(5.2%)	20.4%	205	5.1%
Jacksonville[1]	1,338	5.3%	1,295	(3.2%)	11.9%	107	(9.5%)
Other*	3,252	(19.6%)	5,205	60.0%	N/A	N/A	N/A
Total East & Gulf Coast*	**22,804**	**6.4%**	**22,610**	**17.5%**	20.7%	**2,097**	**3.2%**

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Port Information is as of September 30, 2021
Benchmark Ocean Freight Rates are as of November 25, 2021
Other Ports include Ports of: Everglades, Jacksonville, New Orleans, Mobile, Tampa Bay, Miami, North Carolina, Baltimore & Philadelphia

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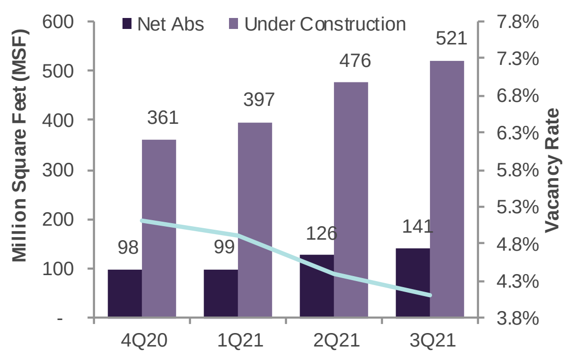
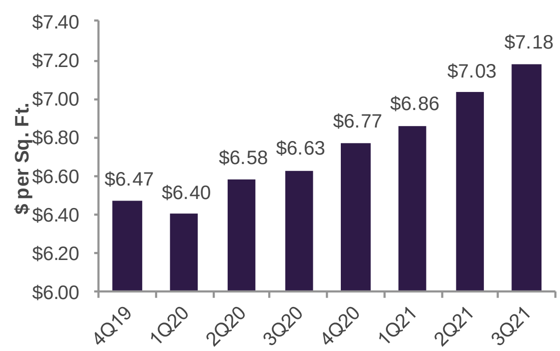
Limited Industrial Warehouse Capacity

- Supply chain issues and the consumer spending binge from the pandemic have caused increased demand for warehouse capacity, specifically near U.S. ports. In the 3rd quarter, **141 million square feet (MSF) went under contract (absorbed) – the most space ever to be absorbed in single quarter and 98% above YTD 2020 absorptions.**
- Supply for warehouse/distribution space has concurrently been trending down since its records in 2019 and 2020. **YTD 2021 supply totaled 247 MSF** which was nearly a 5% drop from the previous year's total. As demand outpaced supply during Q3, **vacancies saw another quarter of downward trends with a record 4.1% vacancy rate.** Vacancies in markets around America's largest ports such as Southern California, Savannah, Hampton Roads, and Central New Jersey reached below 2% (effectively fully-occupied). Pipelines for new construction across the country exceeded 500 MSF as the need for more warehouse space grows
- With limited availability in the market, asking rents for industrial space have **increased from $6.63 per square foot (PSF) in Q3 2020 to $7.18 PSF in Q3 2021 (8.3% increase)**
- As e-commerce activity continues and supply-chain bottlenecks stabilize, there will be increased opportunity for third-party logistics and last-mile providers. It is estimated that for every $1 billion increase of e-commerce spend, 1.25 million square feet of new warehouse space is needed. What's more, with elevated transportation prices, there will a greater need to position goods as close to the end-consumer to keep deliveries timely and cost efficient.

Industrial Warehouse Capacity

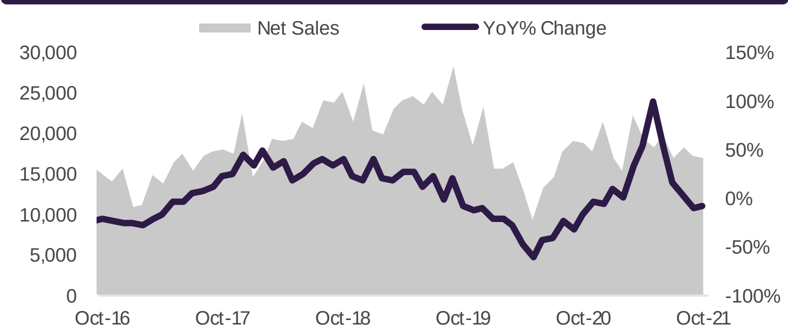


Industrial Asking Rents

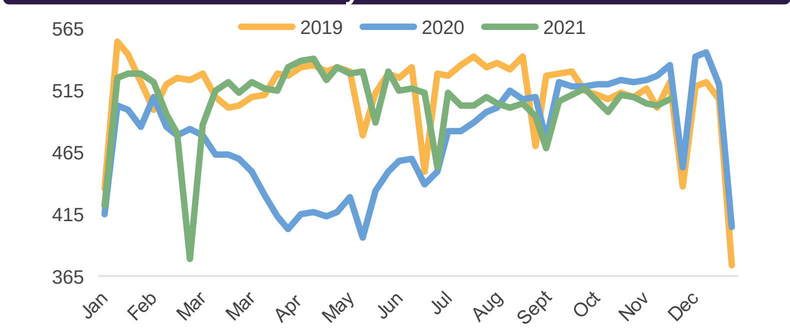


Key Freight Market Indicators

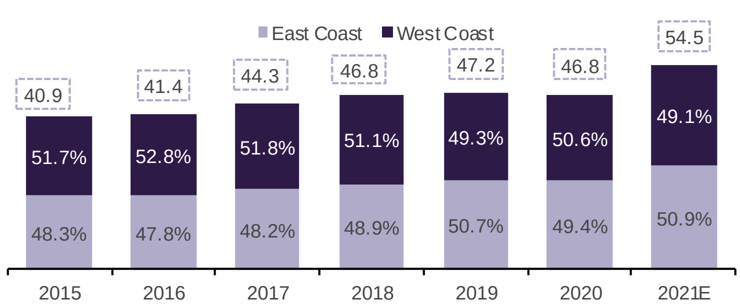
Class 8 Net Sales



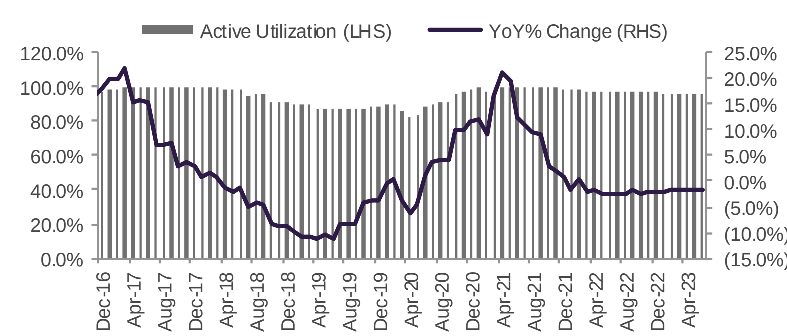
Weekly Rail Carloads



East vs. West Coast Port Volumes



Active Truck Utilization



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Sources: Bloomberg, Wall Street Journal, American Trucking Associations, Institute for Supply Management, Cass Information Systems, AAR's Rail Time Indicators, IATA, US Census Bureau, Bureau of Economic Analysis, Bureau of Labor Statistics, Federal Reserve Economic Data, FreightWaves, Colliers, CBRE, Cushman & Wakefield, Company Earnings Reports, US Port Websites