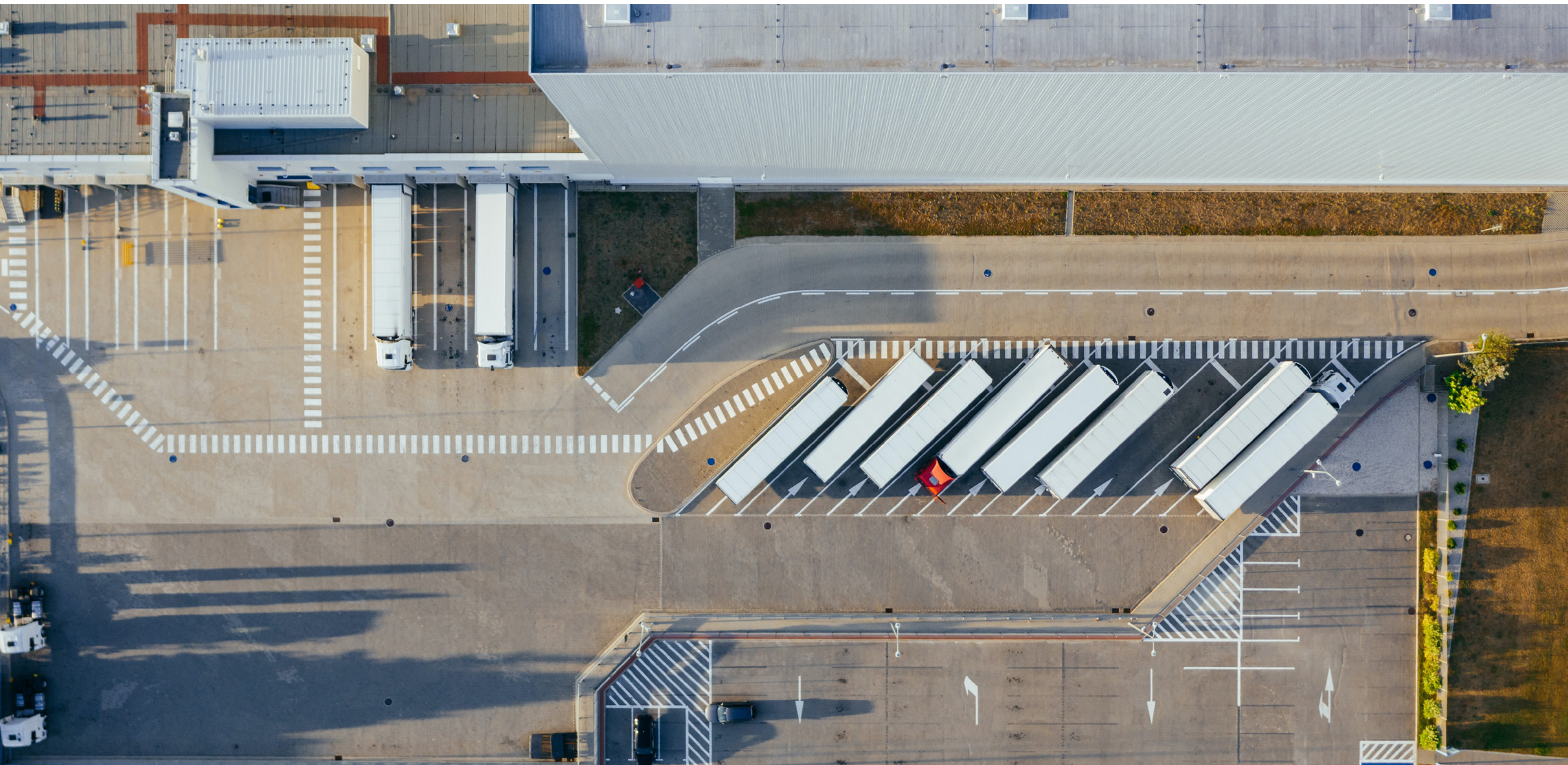
U.S. XPRESS

2021 ECONOMIC OUTLOOK

Forecast

01/20/21



A NEW YEAR BRINGS NEW POSSIBILITIES (AND UNCERTAINTIES)

Well before 2020 drew to a close, many accepted the tough reality that the year to follow will be accompanied by as many questions as answers for a pandemic-weary nation. What does the future hold, particularly as coronavirus vaccines are distributed amidst a rise in cases (and a new President is inaugurated)? How soon will our nation recover from the public health and economic damage? And, when the day comes that COVID fully subsides, what will life look like in a post-pandemic world?

Hope for the future comes from not just the two vaccines currently in circulation but from a slew of encouraging economic indicators as well. Here's one data point that gives us a dash of optimism: the Transportation Security Administration screened 1.28 million passengers at airports on Sunday, December 27, 2020 – the highest number of passengers since mid-March. While that figure is roughly 50% of that day's passenger traffic in 2019, it does give us a glimpse into the better days that are ahead.

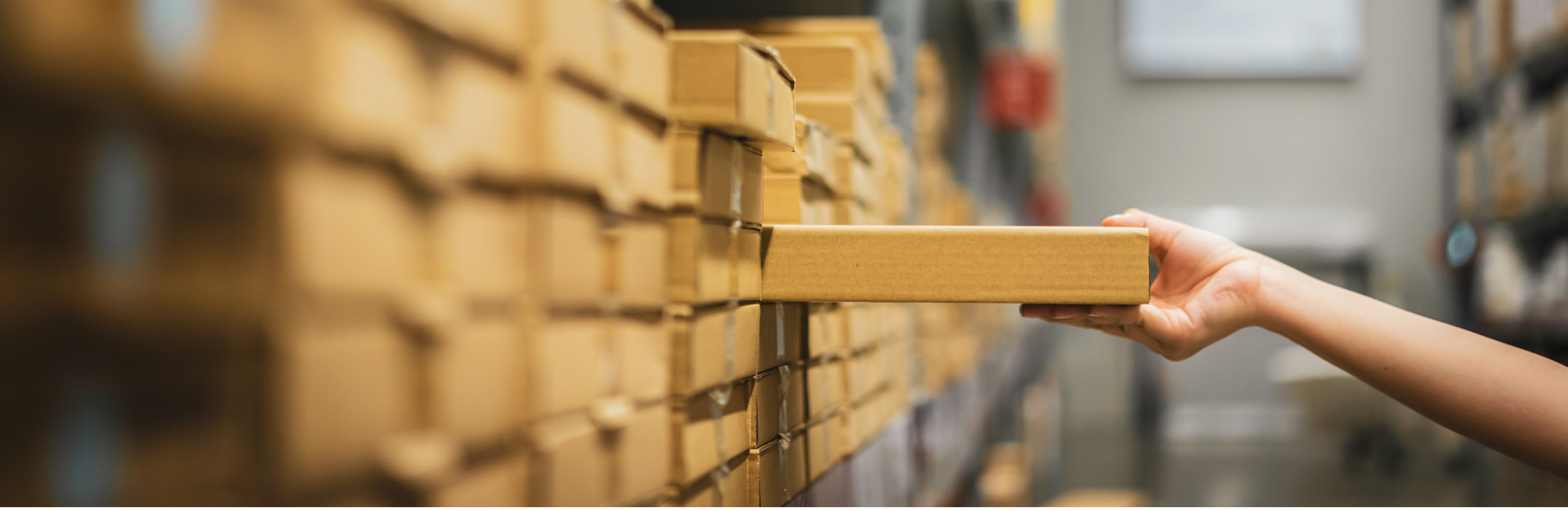
Looking out one year over the horizon is a difficult task, particularly amidst a global pandemic. However, it's abundantly clear that 2021 will be a story of contending tailwinds and headwinds. Our economy has stubbornly persevered in the face of a once-in-a-century public health crisis (and attendant swings in gross domestic productivity). Shippers and carriers of freight have made tough decisions amidst the fog of a pandemic, without the benefit of the usual clarity we've all taken for granted.

As we've said many times before in our quarterly economic forecasts, heroes have emerged; particularly in trucking. We've heard so many stories that demonstrate the resilience and determination of carriers and shippers of freight. We've never been prouder of our industry than we are today.

In our September 2020 quarterly forecast, we observed that "expectations are everything: even amidst times of great uncertainty. Few shippers and carriers expect freight to follow the usual rules for the foreseeable future. However, it's becoming increasingly clear that high tide conditions will persist for a long while. Shippers and carriers will have to plan (and act) accordingly."

Freight markets (and the overall economy) have moved in a manner consistent with our expectations. Driver shortages, capacity crunches, and ample freight (driven by evolutions in buying habits) were the common themes of 2020. By and large, 2021 looks to offer more of the same. The chief determinant, of course, is the trajectory of the pandemic.

With an eye towards a discussion of what lies ahead in 2021, let's dig into some of the economic data that's been reported since December 2020. Our hope for the New Year is a country that's on the mend – physically, financially and psychologically.



WHAT'S HAPPENED RECENTLY?

Over the course of the COVID-19 pandemic, a common theme throughout our analyses and forecasts of economic data has been the exacerbation of dynamics that were already in play. Carrier exits in 2019 foreshadowed an inflationary rate environment in 2020. But, the pandemic economy intensified those underlying factors. Consequently, freight rates surged to record levels in the fall. In many respects, 2020's "peak season" comprised most of Q3 and Q4.

Consumer behavior in response to lockdowns was another trigger for a heightened rate environment in 2020. Woody Allen once said, "80% of success in life is just showing up." In retail, 100% of a sale hinges on merely having the product on the shelf, whether in a store or a warehouse. Supply chain integrity became every bit as pivotal as marketing to success.

Many of the metrics we've identified below point to a continuation of those aforementioned freight market trends. However, a few of the below data points prompt the sneaking suspicion that consumers are waiting for the other shoe to drop (i.e. personal consumption).

Here are some numbers that have piqued our interest (as of January 8, 2021) since the release of our prior forecast update in September 2020:

Gross Domestic Product

- On December 22, 2020, the Bureau of Economic Analysis reported that Q3 2020 GDP increased 33.4% (annualized) by $1.65 trillion to a level of $21.17 trillion. This remarkable rebound occurred on the heels of a 31.4% decline in GDP during the prior quarter.

+33.4% **Q3 2020 GDP increase by $1.65 trillion to a level of $21.17 trillion.**

- As of January 8, 2021, the Atlanta Branch of the Federal Reserve Bank's "GDP Now" tracker estimates 8.7% GDP growth occurred during Q4.

+8.7% Estimated GDP growth during Q4.

- With an eye towards the first quarter of 2021, Goldman Sachs currently predicts 5% growth (an increase from an earlier forecast of 3%). Moreover, Goldman is bullish on 2021 – they expect meaningful growth in all four quarters at a clip of 5.8% (versus a previous prediction of 5.3%).

- By contrast, J.P. Morgan forecasts a double dip recession coming in the form of a 1% contraction of GDP in Q1 of 2021.

Employment

- On January 8, 2021, the Bureau of Labor Statistics reported that total nonfarm payroll employment declined by 140,000 jobs in December 2020 as the unemployment rate remained unchanged at 6.7%. December's employment figures were preceded by a November of modest improvement (nonfarm payroll employment rose by 245,000 jobs). However, this decline in jobs could mark a turning point where the economy cools off as the country continues to navigate the reopening process.

-140K Total nonfarm payroll employment decline in December 2020.

Personal Consumption

- A December 23, 2020 report by the Bureau of Economic Analysis revealed that personal income decreased by $221.8 billion, a 1.1% decline, in November. Moreover, personal consumption expenditures decreased $63.3 billion (0.4%).

-$221.8 Billion personal income decrease in November.

-$63.3 Billion personal consumption expenditures decrease.

- MasterCard SpendingPulse analyzed sales activity in the Mastercard payments network in addition to survey-based data for other payment forms (e.g. cash and check) during the 2020 holiday shopping season (from October 11 to December 24). MasterCard's analysis found that not only did U.S. retail sales (excluding automotive and gasoline) jump 3%, but online sales grew 49% compared to 2019.

+3% U.S retail sales increase (excluding automotive and gasoline) compared to 2019.

+49% Online sales increase compared to 2019.

- On December 22, 2020 the Conference Board released their monthly Consumer Confidence survey results. Consumer confidence declined in December (for the second month in a row) to 88.6 from 92.9 in November. Concomitantly, the Present Situation Index, a measure of consumers' certainty around current business and labor market conditions, declined considerably from 105.9 to 90.3. This trend suggests a degree of trepidation about the future in consumers.

Class 8 Truck Orders

- According to a study by ACT Research, preliminary Class 8 truck orders posted their third-highest number in history in November: 51,900 units. November 2020 orders increased 33% from October and are 197% higher than order volumes reported in November 2019.

+33%
FROM OCTOBER TO NOVEMBER

Class 8 truck orders posted their third-highest number in history in November: 51,900 units.

- ACT's analysis jives with FTR Transportation Intelligence's data tracking November orders at 52,600.

- This dramatic increase in Class 8 orders follows a three-year low for orders in September (and a bleak summer for truck manufacturers altogether).

- ACT has a rule of thumb regarding upticks in Class 8 truck orders: when carriers make money, they invest in new equipment. Yet FTR sees this recent surge in orders waning over the next couple of months (due to the seasonal nature of those new purchases by large carriers).

Logistics Managers' Index

The Logistic Managers' Index (LMI) is a survey of leading logistics executives that calculates a score based on an array of industry components ranging from warehousing capacity, utilization and prices to transportation capacity, utilization and prices as well. Any reading above 50 indicates expansion while readings below 50 indicate contraction.

- The December 2020 index (released January 5, 2021) suggests that the logistics industry is still expanding, albeit at a slower pace. While the most recent LMI reading of 66.7 is down from November's read out of 70.8, it's still well above the all-time low of 51.3 recorded in April, 2020.

66.7 **Most recent LMI reading which is down from November's read out of 70.8**

- For the fifth month in a row, the transportation capacity index was below 40%. December's reading of 39% was 3.9 percentage points higher than November, but it's still a powerful demonstration of the truckload capacity constraints facing shippers.

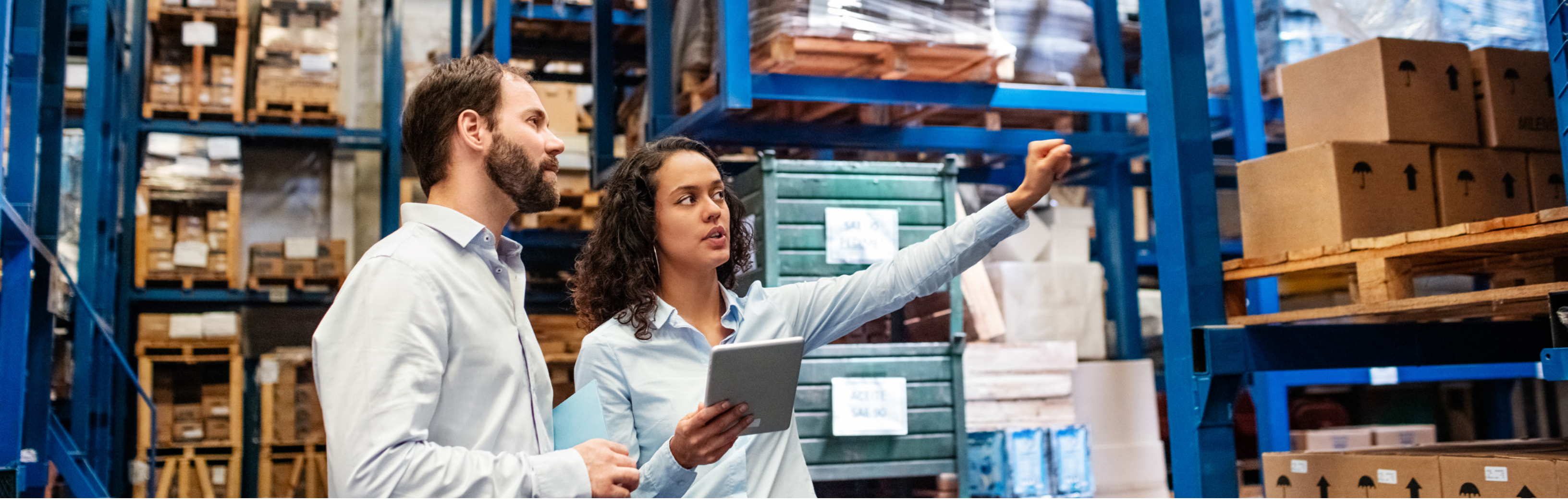
- Here's one revealing excerpt from the report: "Warehousing and transportation capacity could not have continued contracting at the rates we saw earlier in Q4 without every warehouse and truck disappearing entirely. Interestingly, prices are the most resilient metric we're tracking in December, as they continue their rapid climbs."

Freight Market Dynamics

- A recent study by FTR Research projects tractor utilization to hover between 96 and 98% for the duration of 2021. As a reference point, FTR measures utilization at just shy of 100% during the inflationary rate period persisting through most of 2017 and early 2018.

- Average spot market rates for all load types (van, refrigerated and flatbed) tracked by FTR Research hovered between $2.18 and $2.20 for the final 19 weeks of 2020 – well in excess of peak season trends in 2018 and 2019.

- **The December LMI data reported an elevated transportation price rating of 85.1%. Furthermore, the five months spanning from August to December of 2020 have yielded the highest transportation price index levels in two years.**



OUR OUTLOOK INTO 2021

As we said earlier, 2021 will be a story of contending tailwinds and headwinds. An array of economic factors – from new housing starts to industrial output, inventory stocking and consumer demand – will determine how freight markets behave amidst the ongoing pandemic. The key question in most observers' minds will be: "How long will the current freight peak linger?"

Our review of proprietary shipper survey data indicates an all-time low in inventory levels (in the 15-year history of the survey). Moreover, earnings reports from retailers have shown sales tracking ahead of inventories at twice the rate in the latter half of 2020. The National Retail Federation recently adjusted its container imports forecast upward. As such, we believe that it will take five to six months for shippers to replenish their inventories (absent any further coronavirus lockdowns).

While the recent uptick in Class 8 orders suggests that additional truckload capacity will be realized soon, driver shortages will persist for the foreseeable future. The sheer number of drivers in the industry will determine whether those new tractor orders will serve as asset "replacement" or "growth." The structural barriers to driver employment will likely keep capacity in check for the time being.

So, the question remains, "How long will the current freight peak linger?" If we were to fast-forward to one year from today and give you the full story with the benefit of hindsight, we believe the conversation would center around four motifs:

1. **Flagging Truckload Capacity Prompting Another Round of Driver Pay Increases** – While a recent change to the CDL instruction and testing process will hasten the turnaround time for new driver licensing, that likely won't move the truckload capacity needle in an environment of stifled driving school enrollment and higher insurance costs. Roughly 100,000 fewer CDLs were issued in the first half of 2020 as compared to the same timeframe in 2019. This trend didn't slow down in the back half of 2020, so subsequent analyses will likely show a shortfall of roughly 200,000 CDLs for the year. To put that figure in perspective, that shortage is the equivalent of more than ten fleets at the largest carrier in the United States.

Moreover, as of December 1, 2020, approximately 50,000 drivers have been flagged by the Drug & Alchohol Clearinghouse system. In that time frame, only 12% of those drivers have been cleared to return to duty.

If high tide freight volumes persist for another six months, another round of driver pay increases is not out of the realm of possibility. Moreover, Congress has signaled additional stimulus checks will be sent out to supplement the $600 already disbursed at the end of 2020 (to the tune of $2,000). That extra aid will be welcome news for the many workers who have struggled to make ends meet. However, one potential consequence is that further stimulus could dissuade new drivers from entering the labor market (while also keeping many current drivers at home).

There's a distinct possibility that a tough driver market could become even tougher over the course of Q1 2021. **The shippers that thrive in this environment will be those who have access to carriers with superior operating models – those that can attract and retain good drivers.** The same can be said for shippers who are able to work with the brokerage operations that can aggregate capacity to fill the gaps in coverage. Extraordinary demands will be met by exceptional approaches.

2. **Heightened Inventory Replenishment Concurrent with Attenuated Economic Growth** – Several Wall Street analysts are bullish about the economic prospects for 2021. We earlier shared that Goldman Sachs is currently projecting GDP growth just shy of 6% in 2021. The head of transportation and shipping research at Deutsche Bank expects a remarkable 2021 for both the industrial and consumer components of the U.S. economy.

   Our view of the economy is slightly more tempered in light of presently escalating coronavirus cases and attendant lockdown measures in several regions of the country. However, we do expect robust economic growth once the pandemic has subsided; that's more a matter of "when" than "if."

   Either way, inventory replenishment will determine much of the direction of the freight market in 2021, particularly if further lockdowns are warranted. According to Hackett Associates, the retail inventory-to-sales ratio plummeted more than 25% from 1.68 in April to 1.22 in June. By and large, retailers had to rely on imports to maintain inventories heading into the holidays. The data suggests that trend will persist in 2021.

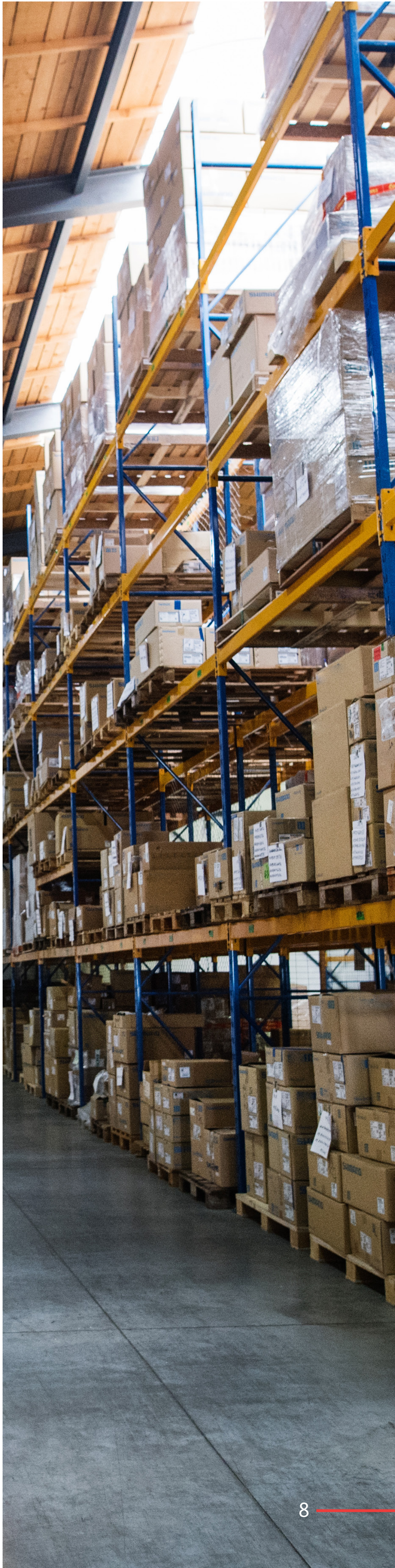
   Moreover, a record-breaking volume of holiday shopping season returns and the distribution of coronavirus vaccines will further exacerbate capacity constraints during January and February.

3. **Ramped-Up Government Spending** – Now that the Democrats control the Presidency and both chambers of Congress, 2021 will usher in an entirely new slate of policy prescriptions that could have wide repercussions for the trucking industry. We discussed earlier the prospective impact of additional stimulus checks on the labor market for drivers. Beyond that, many political observers expect unemployment benefits to be increased to levels consistent with what was provided once the lockdowns were initiated last spring. **The resultant cash infusion into the economy will present somewhat of a double-edged sword for carriers – it'll stimulate consumption (and thus bolster freight volumes) while sidelining drivers who would have otherwise entered the labor market.**

   An increased mandatory insurance minimum is another potential dimension in a sustained truckload capacity crunch. The prospect of $2 million in minimum insurance coverage would drive many small carriers out of business while applying considerable upward pressure on rates for those that remain. While we haven't yet encountered a thorough econometric analysis of the impact of this policy on truckload capacity or rates, the ripple effects could be even stronger than those of the Drug & Alcohol Clearinghouse and perhaps even the ELD mandate.

   Further, the new administration plans to present a bold infrastructure program as part of its stimulus plan. Much like enhanced unemployment benefits and $2,000 checks, this reinvestment in highways, bridges and other transportation assets could also introduce some advantages and disadvantages. A slew of construction projects across the country could induce drivers to leave the labor market for jobs closer to home. However, we don't believe an infrastructure program would have a material effect until Q4 2021 at the earliest or Q1 2022 at the latest.

   Amidst these unprecedented interactions between elevated freight volumes and constricted truckload capacity, an emerging trend we see developing over the next couple of years is technology-driven consolidation in the trucking industry. Digital freight brokers and even a few ELD providers are showing the freight industry how to tap into artificial intelligence and machine learning to aggregate capacity and optimize freight. **In a post-COVID environment, big ambitions around technology and scale may finally be realized.**



4. **Current Freight Peak Extends into a "Freight Plateau" Over the Duration of 2021** – The aforementioned numbers around inventory restocking and economic growth strike us as significant enough to sustain heightened truckload demand through at least the first four to six months of the year. That dynamic, in concert with ongoing truckload capacity issues, should prolong bolstered spot rates for the foreseeable future.

   Accordingly, **we expect average contract rates to increase between 8% to 15% over the course of next year**. However, we do anticipate spot rates to ease in the fall months of 2020 before one more bout of heightened freight activity during the holiday peak season. Research from the transportation finance team at a national bank also jives with our thinking: they predict spot rates favoring carriers through mid-2021.

   Freight demand will likely taper as early as Q3 of 2021 (or as late as Q1 of 2022) as consumers pivot back towards experience goods such as travel, restaurants, concerts and the like.

A YEAR THAT WILL MATTER IMMENSELY

In sum, we believe the trajectory of the 2021 freight market will ultimately hinge on inventory restocking, the available supply of drivers and the overall health of the country's economy (and its people, as well). We expect the inflationary rate environment to persist for most of 2021 before a slight easing in freight volumes late 3rd quarter. The key caveat in all of this, of course, is the spread of COVID-19 and the attendant public health measures taken to mitigate the toll of the virus.

We've closed our three prior economic forecasts by acknowledging the heroes who have kept our shelves stocked and our economy afloat in the face of adversity. Their contributions have literally saved lives. We've also expressed how proud we are to collaborate with shippers and peers across the industry to sustain our nation's supply chain amidst struggles and uncertainties unlike any ever seen.

Each New Year is an opportunity to take stock of the past year while looking forward in anticipation to the future. However, that's particularly true of 2021 – this will be a year that matters immensely. Every decision you make, big or small, will have repercussions.

While it's hard to say when this pandemic will pass, one thing is for certain: we'll all share a collective sigh of relief and celebrate together once the victory over coronavirus is won. Don't lose sight of the fact that there will be a day when social distancing is a distant memory and faces look familiar again.

As always, thank you for your diligence and strength in rising to the occasion. It's been a privilege to be on this journey with each and every one of you.

Best wishes for a prosperous and, above all, healthy 2021.

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