



# COVID-19 IMPACT

Forecast Update

09/22/20



# RESURGENCE HAS ARRIVED

On April 21st, the leadership team at U.S. Xpress released a forecast exploring the potential impact of COVID-19 on freight markets, truckload capacity, and the overall economy. The first section of that forecast was subtitled: “Optimism is Allowed.” As several states and municipalities wrestle with the contending forces of managing the spread and economic recovery, we still see plenty of things to be hopeful about.

As the public health and economic repercussions unfolded, we maintained our belief that the pandemic has the potential to cull truckload capacity unlike any event in recent memory. As a refresher, here’s an excerpt from that initial forecast:

“Just as we expect the industry to experience unprecedented weak demand in the second quarter, we believe that will give way to a sharp increase in demand on a level we’ve never before seen. Even more impactful will be the fact that we will see this heightened demand concurrent with supply levels decimated in the wake of a rough second quarter. By that time, fleet counts will have retracted across the board. Bankruptcies could remove more capacity in a single quarter or two than any previous cycle we have ever experienced, including the ‘Great Recession’ of 2008.”

We then reinforced that view in a June, 2020 forecast update. Here’s the near-term future we envisaged: “When [the country enters] a full recovery, spot rates will run to historical highs; but the bigger story will be the amount of freight that will have to be deprioritized and sit on docks because there isn’t enough capacity to handle all of the demand.”

By and large, freight markets and the economy at large have moved in a manner consistent with our expectations. Directionally speaking, things have unfolded as we suspected they would. Consequently, **we’ve had an ongoing series of dialogues with shippers and key partners in order to address challenges arising from widespread truckload capacity shortages. The entire trucking industry is scrambling to rise to the occasion.**

Roughly two and half months have passed since we shared that June update to our April forecast. In the items below, we’ve tabulated some of the data that’s been reported within the past couple of weeks. As before, our hope is that the worst is behind us: not only with respect to the public health repercussions of the virus but in terms of the deterioration of our economy, as well.



## WHAT'S HAPPENED RECENTLY

The past several weeks have yielded many data points that reinforce our earlier viewpoint with regards to the impact of COVID-19 on the freight market as well as the economy in the broad. It's worth reiterating that, in trying to understand the impact of COVID-19 on the freight industry, U.S. Xpress is staying mindful of the tradeoffs between fast data, which tends to be noisy, and slow data, which tends to be slightly more longitudinal in nature and thus somewhat more reliable.

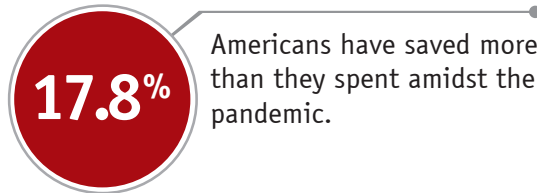
With that caveat in mind, here are some numbers that have gotten our attention (as of September 18, 2020) since the release of our prior forecast update in June:

- Gross Domestic Product: As many expected, 2nd quarter GDP took a tumble: a 34.2% decrease (annualized) corresponded to a \$2.15 trillion reduction in value. This plummet came on the heels of a 3.4% drop (\$186.3 billion) in the 1st quarter of 2020. However, 3rd quarter will usher in a tremendous rebound as the country steadily reopens. Presently, the Atlanta Federal Reserve Bank's "GDP Now" tracker estimates 32% growth in 3Q GDP.

**34.2%** 2nd quarter GDP decrease (annualized). → **\$2.15** Trillion reduction in value.

- Jobless Claims: One of the starkest economic indicators arising from the lockdowns is the sheer number of jobless claims. Millions upon millions of Americans have filed for unemployment benefits. However, the labor market is showing a heartbeat. The number of Americans filing for unemployment benefits, during the week ending August 22nd, fell below 1 million (880,000) for the first time in a long while. More recently, the week ending September 12th yielded 860,000 additional claims, a decrease of 33,000 from the week before. The Department of Labor also tracks the "continuing claims" of those collecting unemployment compensation for at least two consecutive weeks: that figure has declined to 12.63 million from a peak of 24.9 million in early May. The pandemic has certainly taken its toll, but progress is being made towards recovery.
- Employment: On September 4th, the Bureau of Labor Statistics released its monthly non-farm payroll survey data. The report indicated unemployment in August dropped 1.8 percentage points to 8.4%. Total non-farm payrolls increased by 1.4 million in August while the number of unemployed persons fell by 2.8 million to 13.6 million. Altogether, there are 7.8 million more unemployed Americans than there were in February before the shutdowns.

- **Personal Consumption:** On August 28th, the Bureau of Economic Analysis released their monthly reporting regarding personal income and consumption. Personal consumption increased by 1.9% in July over the previous month, a slower rate of growth compared to the preceding months of rapid growth as various regions reopened their economies. Moreover, a 17.8% personal savings rate means that Americans have saved more than they spent amidst the pandemic. That bodes well for future consumption down the road.



Americans have saved more than they spent amidst the pandemic.

- **Manufacturing Activity:** The Institute for Supply Management released their monthly Purchasing Manager's Index (PMI) on September 1st. This key measure of national factory activity increased for the fourth month in a row to 56.0 (from 54.2 in July). A PMI reading above 50 points indicates a manufacturing sector in expansion, which is good for several facets of the economy. The PMI index is at its highest level since November, 2018.

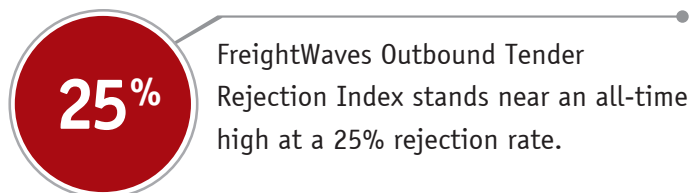
#### Purchasing Manager's Index (PMI) (July-September)



- **Class 8 Truck Orders:** Class 8 truck orders were in their doldrums in April, 2020 (3,678) – this indicator displayed a 71% drop year-over-year in orders. However, in subsequent months, truck orders are on a healthier trajectory at rates of 13,932 in June (40% growth year-over-year) and 18,488 in July (140% growth year-over-year). Yet Class 8 retail sales are tracking approximately 45% lower year-over-year.
- **Logistics Managers Index (LMI):** The LMI is a survey of leading logistics executives that calculates a score based on an array of industry components ranging from warehousing capacity/utilization/prices to transportation capacity/utilization/prices. The August, 2020 index (released September 1st) stands at 66.0. This reading is not only the highest index rating since November, 2018 but also reveals remarkable improvement from an all-time low in April, 2020 at 51.3%. As with the PMI, an LMI reading above 50% indicates expansion, while a reading below 50% indicates contraction.

The continued growth in LMI is motivated mostly by the transportation side of the equation.

**Transportation capacity has tightened at the second fastest rate of contraction observed in the four-year history of the LMI.** That rapid decline in capacity has driven transportation prices up to a rating of 83.8 from an all-time low of 37.7 in April, 2020. These dynamics have not only driven considerable spot rate inflation, but tender rejections as well. As of September 2nd, the FreightWaves Outbound Tender Rejection Index stands near an all-time high at a 25% rejection rate.



Indeed, this freight environment may last for a while. The overall LMI is expected to increase to 69.1 over the next 12 months.

- **Spot Market Dynamics:** A transportation research firm's "Truck Freight Recovery Index" hit a new peak in mid-August at 165 after bottoming out at 28.9 in April, 2020. Spot freight volumes are a critical driver of this rating.

## OUR OUTLOOK

One consistent theme across our forecasts is our agreement with the industry analysts who predicted, even before the onset of the pandemic, an inflationary spot market entering 2020 due to a slump in truckload capacity resulting from carrier exits. As we observed in our initial forecast, the COVID-19 economy will most likely exacerbate those anticipated carrier bankruptcies. We noted in our June update that Q3 of 2020 would usher in a sense of relief and resolve as the country focuses on recovery – confident that the worst very well may have passed. By and large, this prediction seems to be on track.

However, **a reopening economy with bolstered industrial and consumer activity means an ever-growing volume of freight that must be moved. Even the steadiest of recoveries will have dramatic ripple effects for shippers and carriers alike.** Here's one point of demonstration: a recent analysis from FreightWaves revealed that contract load volumes averaged 6.8% higher year over year during the Q2 2020. Moreover, their "Outbound Tender Volume Index" is 30% higher than 2018 levels, which was a banner year for freight. The carriers that can maintain fleet counts will be the chief beneficiaries in this environment.

**+6.8%** Contract load volumes averaged 6.8% higher year over year during the Q2 2020.

**+30%** Outbound Tender Volume Index is 30% higher than 2018 levels.

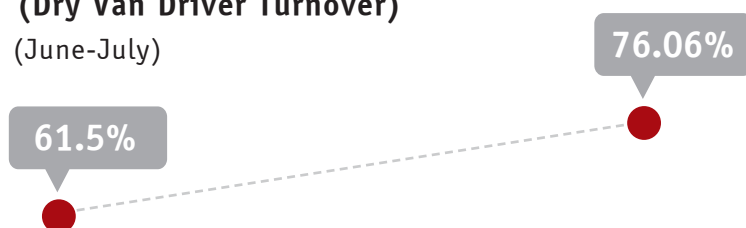


With the aforementioned factors in mind, we believe three themes will drive freight markets over the remainder of 2020 (and perhaps for the duration of 2021 as well):

1. Rising Driver Turnover – When freight volumes erupt, drivers are a precious commodity. That’s particularly true as the U.S. economy recovers amidst the pandemic. Many of you are no doubt familiar with the challenges carriers have encountered in keeping drivers on the road. The Truckload Carriers Association recently reported that dry van driver turnover increased from 61.5% in June, 2020 to 76.06% in July – the largest single month jump since January, 2019. Driver turnover dropped to 55.8% in April once the full effects of the economic shutdowns were realized. The earlier cited BLS unemployment report indicated that employment levels for trucking are 5.8% under February’s levels.

#### **The Truckload Carriers Association (Dry Van Driver Turnover)**

(June-July)



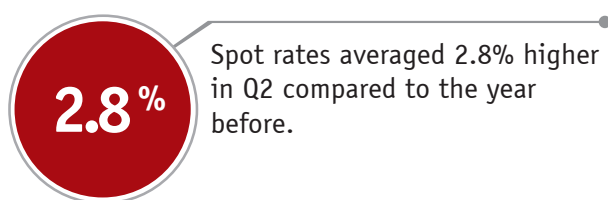
Much of this trend is motivated by economic conditions; for example, construction jobs (due to robust housing starts) are dissuading several drivers from returning to the road. Moreover, the effects of reduced enrollment in CDL schools from earlier this year are still lingering. The recently inaugurated Drug and Alcohol Clearinghouse will also prompt drivers to exit the industry, as well.

In taking these items into consideration, **we believe that the driver supply will face considerable headwinds for the foreseeable future. Unlike what was observed during a couple of quarters in 2018, 2020 is on pace to see an exit of approximately 200,000 drivers due to the Drug and Alcohol Clearinghouse and declines in CDL issuances. We suspect that this circumstance will result in a driver wage increase this year – potentially as high as 15%.**

2. Diminishing Truckload Capacity – Carrier bankruptcies nearly quadrupled in 2019 over 2018. Also, rising insurance premiums will further hobble smaller carriers. Concurrently, new truck orders were on a 20-month downtrend from November, 2018 to May, 2020. Yet, the 16,000 new truck orders placed in June, 2020 are 30% below most analysts’ calculated replacement demand level of 23,000 trucks. A rapid acceleration in Class 8 orders must occur in order to keep pace with current freight volumes.
3. Overwhelming Load Volumes – The aforementioned FreightWaves analysis revealed that contract volumes ran at a 6.8% clip higher in Q2 compared to the prior year. Two months into Q3, freight has continued to flow at unprecedented levels. For example, tender volumes were 18% higher on August 31, 2020 than on the same day in 2019.

Furthermore, there are no clear indications that freight volumes will settle down anytime soon. Think of the absence of seasonality – how the market skipped over the usual summer lull that gives way to rejuvenated activity in the fall and holiday seasons. **It seems as if the usual laws of physics that govern the freight market have been suspended for now. Accordingly, several industry analysts expect these elevated freight volumes to persist through 2021.**

Of course, each of these three themes will greatly influence trucking rates over the next four to six quarters. In the months since spot rates plunged in April (after the frantic days of panic-buying in March), spot rates averaged 2.8% higher in Q2 compared to the year before. If heavy freight volumes remain over the coming months and quarters, spot rates will likely surpass the heights seen in 2018 (absent considerable gains in truckload capacity). Industry research has revealed that shippers expect carriers to revisit contract rates after three consecutive months of heightened spot market activity.



In short: 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.**

## OUR INDUSTRY HAS PERSEVERED. BE PROUD.

Without a doubt, 2020 will be remembered as one of the most trying times in modern history. The pandemic has taken a considerable toll on the health and economic wellbeing of so many of our neighbors and friends. However, as we expressed before, we've never been prouder of the courage and resiliency on display in the trucking industry. Once this pandemic has finally run its course, we'll have truckers to thank for keeping our shelves stocked and our economy afloat. Their contributions have literally saved lives. They've been truly relentless.

It goes without saying, but we're in awe of the diligence and strength on display in our shippers and peers alike. You've sustained our nation's supply chains amidst forces and uncertainties never before seen. You've tirelessly navigated one challenge after another on a daily basis.

**"Our industry's work has never been more crucial – our decisions have never been more meaningful – than right now."**

Thank you for rising to the occasion. It's been a privilege to be on this journey with each and every one of you.



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