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Q4 2021 ECONOMIC FORECAST

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UNCERTAINTY GIVES WAY TO SCARCITY

More than 20 months have elapsed since the coronavirus pandemic became a full-blown public health crisis. As governments took extraordinary measures to stop the spread and limit the human toll of the pandemic, an economic cost was also realized. The mitigating steps of lockdowns and social distancing unleashed a ripple effect through the economy resulting in mass unemployment in the service sectors of the U.S. economy, a decrease in manufacturing production, and an anxious wave of panic buying and online purchases from retailers. Businesses, particularly in the service sector, were shuttered in order to prevent healthcare systems from being overwhelmed. Consumption habits evolved accordingly.

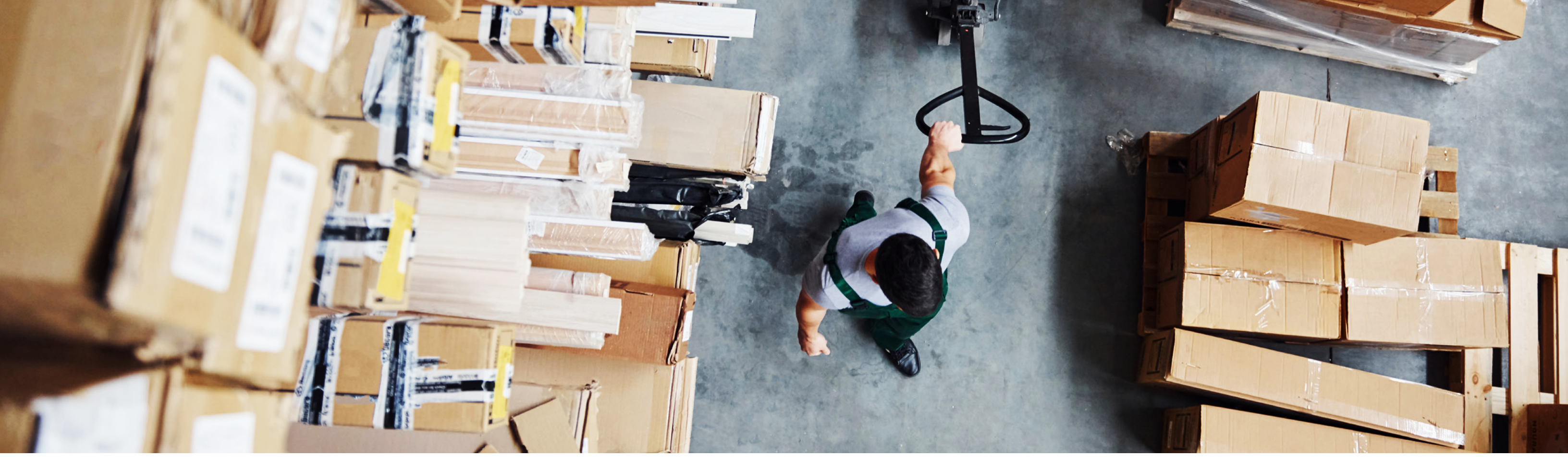
In the early days of the pandemic, our economic forecasts sought to encourage logistics and supply chain professionals who were tasked with making big decisions in the face of uncertainty. Now, after 20 grueling months of courage and poise in the face of an unprecedented public health and economic crisis, a new theme has emerged: decision-making in the face of scarcity. How will supply chain and logistics practitioners navigate high costs, sparse options, and unprecedented backlogs during the most important season of the year for consumers?

In these times, amidst such unprecedented challenges, there's little rest for the weary.

The latest numbers paint a picture of an economy that is struggling to regain muscle memory of life before lockdowns, labor shortages, and supply chain disruptions. Through the many ups and downs of a slew of public health and economic indicators – from case numbers and GDP figures to hospitalization rates and employment trends – consumer spending has by and large stood firm. The will of the American consumer was the one constant in uncertain, chaotic times. Now, those metrics are beginning to show signs of stress. Is that due to broken supply chains, creeping inflation, or waning disposable income? In a world this complex, there are no easy or immediate answers.

In August, our Q3 2021 Economic Forecast Update observed that "there are many encouraging signs and reasons for optimism, but growth can't be taken for granted. If businesses must raise wages in order to motivate people to return to work, that could very well fan the flames of long-term inflation. If inflation becomes a serious issue, the Federal Reserve may be forced to move aggressively by raising interest rates in order to tamp down economic growth." Now, three months later, many experts forecast this coming holiday shopping season to be the most expensive in several decades.

With an eye towards a discussion of what lies ahead for the remainder of 2021, let's dig into some of the recent economic data.



WHAT'S HAPPENED RECENTLY?

Throughout the coronavirus pandemic, two common themes have characterized our outlook on the freight market. The first theme is that the pandemic accelerated many of the dynamics that were already in play in the early days of 2020: carrier exits in 2019 foretold an inflationary environment in 2020. The pandemic economy intensified those underlying factors, and freight rates surged accordingly to record levels. It also defied the typical conventions around annual seasonality in freight movements. In many respects, 2020's "peak season" comprised most of Q3 and Q4. We raised the possibility that we'd see much of the same in 2021, and so far, that prediction has panned out.

The second key theme in our outlook is this: the lockdowns have motivated sweeping changes in consumer behavior that are greatly contributing to this heightened rate environment. **A broad shift towards tangible goods, in particular, via e-commerce channels has left many retailers and manufacturers scrambling to keep up**. Supply chain integrity has become every bit as pivotal as marketing to success.

With those two themes in mind, here are some numbers that have piqued our interest (as of November 2, 2021) since the release of our Q3 2021 Economic Outlook back in August.

Gross Domestic Product

- On October 28, 2021, the Bureau of Economic Analysis released its first estimate for Q3 2021 GDP. The first pass reporting indicates that economic growth slowed to a pace of 2% from a rate of 6.7% in Q2 and a 6.3% increase in Q1. Massive drops in consumer purchases of goods (-9.2%) and, specifically, durable goods (-26.2%) are alarming trends heading into the holiday shopping season.

The Bureau of Economic Analysis Economic Growth Estimates		
Q1	**Q2**	**Q3**
6.7%	6.3%	2%

- Increasing inflation concurrent with declines in personal income is the greatest antagonist to economic growth. The BEA's first estimate of Q3 economic performance reveals that inflation increased 5.4% in the third quarter while disposable personal income decreased by 0.7%. Moreover, food and gasoline prices increased at rates four to eight times greater, respectively, than overall inflation.

  Behind each statistic is a story that gets to the root of what's happening in the lives of people as their daily preferences and behaviors play out. **One possibility behind the numbers is that Americans are paying so much more for fuel, food, housing, and other essential items that they are curbing outlays on durable goods such as cars, electronics, and appliances. Another explanation is that Americans see the long turnaround times on durable goods due to supply chain disruptions and are deferring spending decisions until inventories recover. Time will tell.**

- The Institute for Supply Management's Purchasing Managers' Index reveals a slightly concerning data point. Their manufacturing survey slipped to 60.8 in October from September's reading of 61.1 (which was just shy of May 2021's all-time high reading of 61.2). The October reading, based on monthly surveys of supply chain managers across multiple industries, indicates the 17th straight month of growth for the manufacturing sector.

- While the Q3 economic numbers are certainly discouraging, there are ample reasons for optimism heading into Q4. The Atlanta branch of the Federal Reserve Bank's GDP Now Forecast expects a considerable rebound in Q4. As of November 1, 2021, this weekly forecast predicts 8.2% GDP growth in the final quarter of 2021.

+8.2% Projected 8.2% GDP growth in the final quarter of 2021.

<u>Employment</u>

- ADP's monthly payroll survey report in November revealed that payrolls in October climbed by 571,000 jobs. The services providing sector grew by 458,000, with 185,000 of those jobs within the leisure and hospitality industry. This is an encouraging trend for those who anticipate a recovery in the more experiential and services-driven areas of the economy.

↑571k Payrolls in October climbed by 571,000 jobs.

- On November 5, 2021, the Bureau of Labor Statistics reported that total nonfarm payroll employment increased by 531,000 jobs in October as the unemployment rate nudged down 0.2 percentage points to 4.6%. This report brings encouraging news after two prior months of disappointing job growth. The addition of 7,900 drivers to general trucking firms is also a promising data point.

- An October 21, 2021 report from the Department of Labor revealed that initial unemployment claims decreased to 290,000 from 296,000 the week prior – the lowest level since March 2020 at the beginning of the pandemic. Many economists expect jobless claims to return to pre-pandemic levels by the end of the year. Moreover, about 4.3 million employees quit their jobs in August, the highest exodus documented in more than a decade. It remains to be seen how many of those several million quits were from workers exiting the labor force altogether.

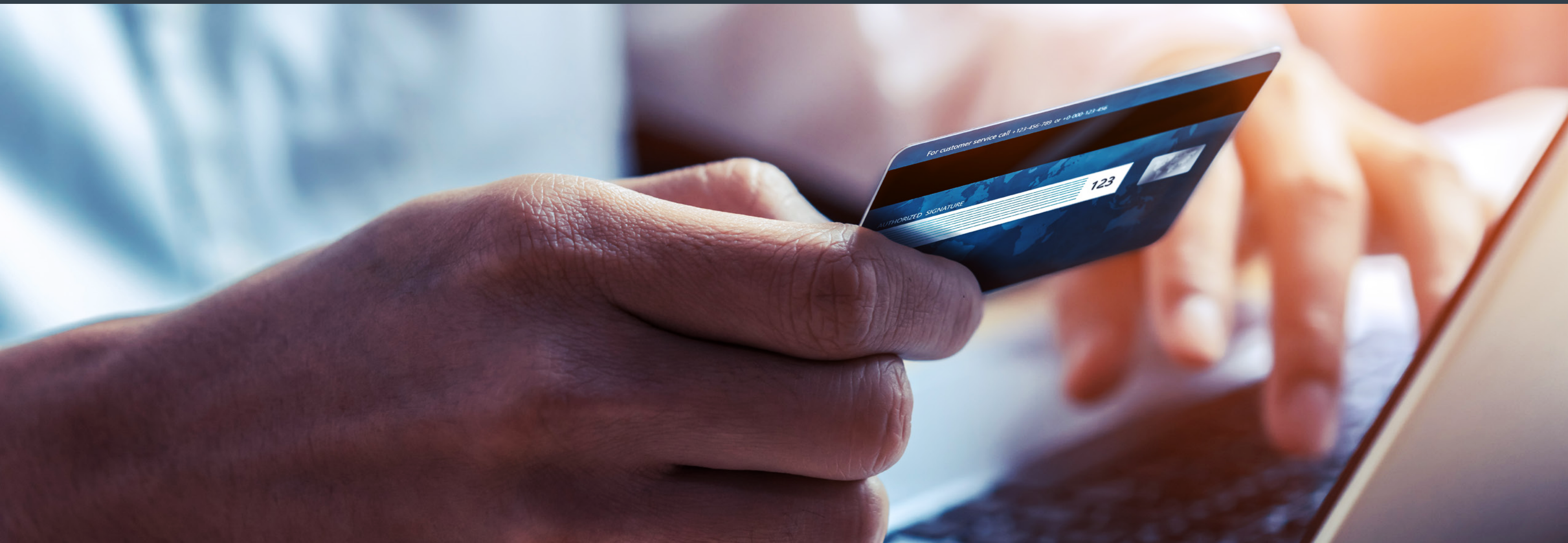
- While the United States economy is certainly in the throes of one of the tightest labor markets in recent history, a BLS weekly wage report released on October 19, 2021, indicated that full-time blue-collar real hourly earnings decreased in Q3 relative to dramatic increases in inflation. If wages fail to keep pace with price levels, the prospects of heightened economic growth for the remainder of 2021 are slim.

Consumer Sentiment

- The latest data around consumer sentiment is a bit of a mixed bag. An October 26th report by The Conference Board showed improvement in consumer confidence, while a study by the University of Michigan revealed slight declines in not only consumer confidence but current economic conditions as well. The Conference Board's consumer confidence index increased to a reading of 113.8 in October from 109.8 in September, after three straight months of decline.

- Inflation is also a likely culprit in this recent slump in consumer confidence (as well as GDP growth). A BLS report released on October 13, 2021, pointed out that the consumer price index for all items rose 5.4% in the 12 months ending in September. Without a doubt, supply chain issues are a key contributor to increasing price levels. Proctor & Gamble expects to raise prices in order to accommodate an additional $2.1 billion in input costs, $200 million of which can be attributed to freight and transportation expenditures.

+5.4% The consumer price index rose 5.4% in the 12 months ending in September.



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 readout of October's LMI revealed that transportation capacity continues to contract. Overall, the LMI is up slightly (-+0.4) in October from September's reading of 72.2. That growth, while modest, is fueled by survey responses pertaining to transportation capacity, transportation cost, and upstream inventory levels. Transportation prices are particularly pronounced – October ushered in an "astronomical rate" of 92.7 – the seventh reading above 90 in the last eight months.

- The narrative in the LMI's report attributes the 2% GDP growth in Q3 to attenuated consumer spending due to the prevalence of the Delta variant as well as supply chain issues. The publishers of the LMI see consumer demand for durable goods as something stronger than the economic numbers presently bear out. That's certainly a reason for optimism.

Freight Market Dynamics

- Class 8 truck order reporting has long served as a reliable indicator of both present realities and future trends in freight markets. After all, during inflationary freight rate environments, carriers tend to reinvest their stronger margins into new equipment with an eye towards liquidating the older equipment on the used truck market. Down the road, that glut of equipment usually leads to excess truckload capacity (relative to freight volumes), which in turn depresses rates. That's why today's Class 8 truck orders are usually a harbinger of future rate environments.

  Yet, in a world of pandemic-driven supply chain disruptions, the data isn't as reliable as it used to be. According to Don Ake, VP of Commercial Vehicles at FTR Transportation Intelligence, components shortages (superconductors, in particular) have plagued tractor manufacturers throughout 2021. "The order number is not a true indicator of 2022 truck demand. There is significant pent-up demand for trucks leftover from 2021 because OEMs were limited in their output. Add to this the robust demand expected for 2022 due to sturdy freight growth. The fleets have a tremendous need for new trucks in 2022; however, the OEMs are delaying entering orders until the supply-chain situation is clearer."

- Accordingly, a strong spring and summer of Class 8 truck orders has cooled a good bit heading into the fall. On October 6, 2021, ACT Research reported that Class 8 truck orders declined at a rate of 25.7% from August to September (and at a rate of 11.9% over the rate of truck orders in September of 2020). FTR saw similar numbers in September as well: their reporting indicates a drop of 29% from August to September and 12% year over year. Whether that's a matter of changing sentiment towards the future of freight markets or order management practices remains to be seen.

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- After a summer of marginal declines, the American Trucking Associations' truck tonnage index (which is based on contract freight) rebounded sharply by 2.4% in September to 112.9 from a reading of 110.2 in August – the largest increase of 2021 to date. ATA's chief economist also noted that the uptick in the index occurred due to improvements in productivity (e.g., each truck is hauling more) instead of an increase in truckload capacity.

- Spot rates have continued to persist at or near record highs but have recently shown some softening over the past three weeks. Late October has seen dry van rates hover in the neighborhood of $2.87/mile as flatbed rates stand pat at $3.07/mile while refrigerated units remain at $3.27/mile.

$2.87/mile

$3.07/mile

$3.27/mile

- Cowen Inc., an independent investment bank, conducts a quarterly survey of carriers in order to track quarterly trends in freight rates, driver retention, and other critical business metrics. In mid-October, they released their Q3 survey results to the public. It not only found that carriers reported a 4.9% increase in contract rates over the course of the quarter but also that carriers expect contract rates to increase another 5.1% over the next six months. Those survey results seem to jive with recent data around tender acceptance rates on contract freight, which have improved as freight rates have become more attractive; this is particularly true for loads with lengths of haul of more than 800 miles.

+4.9% Carriers reported 4.9% increase in contract rates over the course of the quarter.

+5.1% Carriers expect contract rates increase another 5.1% over the next 6 months.

- As of November 1, 2021, the U.S. Energy Information Administration reported the average retail diesel price continued to rise on a weekly basis by 1.4 cents to $3.727. A gallon of diesel fuel now costs $1.355 more than it did at this time last year.

OUR FOURTH QUARTER OUTLOOK

By and large, Q3 2021 proceeded exactly as we expected: sustained rate inflation due to the persistence of heightened freight volumes spread across a diminished driver base. Elevated freight volumes will most certainly persist for a while, and they will continue to do so in the face of sustained driver shortages.

The late summer months brought the slightest of boosts to truckload capacity. But, the spigot is still turned to only a drip, which isn't of much use when trying to fill a swimming pool. Further, inventories are still low relative to sales and will likely remain depleted through Q2 of 2022. The latest spate of economic data does suggest some softening in the economy, and thus corresponding freight volumes and rates as well. But, a "softened" Q4 in 2021 will still look exceptional compared to even the strongest freight markets of yesteryear. For the foreseeable future, freight will continue to run at a torrid pace.

How this quarter plays out will give us a sense as to whether this freight environment will persist until the summer of 2022 or through the entirety of next year.

Accordingly, we'll pay particular attention to two fundamental themes as 2021 comes to a close:

1. The Overall State of the Economy (and Consumer Demand) – Ample stimulus and unemployment benefits combined with low interest rates to preserve consumer spending throughout the coronavirus lockdowns. In a nominal sense, consumer demand has remained high relative to our supply chain's capacity to keep up, particularly in the face of productivity challenges and labor shortages. But, if inflation begins to take root and interest rates rise, without wage growth, consumer purchasing power will be diminished in real terms. So, can consumer purchasing power and sentiment remain strong over the course of another one or two quarters? Or, put another way, can it remain strong over long enough of a duration for the services sector to recover, which in turn will allow a stressed supply chain to make some welcome progress in unloading containers and replenishing inventories?

   The holiday shopping season will tell us a lot about the resilience of not only the American consumer but also the continued durability of our country's supply chains. Metrics around services consumption such as holiday travel, concert tickets, and dining out will also clarify a good bit of what the near future holds.

   Our Q3 forecast elaborated on this dynamic: "Without a doubt, a drop in the spot market is going to come. What remains to be seen is whether it'll happen in the spring or summer of 2022. Moreover, will the decline in rates come as a result of easing freight volumes or an unanticipated surge of new drivers? Or, will it be rooted in a perfect storm of both factors? Further, will a deflationary rate environment arrive in the form of a sudden, steep downhill grade or a moderate, drawn-out decline?"

It seems that if relief for inflationary rates comes relatively soon, it'll appear in the form of declining freight volumes rather than bolstered truckload capacity.

2. Truckload Capacity (Amidst Driver Scarcity) – Our prior economic forecasts have weighed the prospect of frictional changes versus structural changes in the labor market for drivers. To what extent did stimulus checks and unemployment benefits cull workers from the driver pool for good? Have lifestyle preferences changed in such a manner that drivers will only consider short-haul and local routes in favor of more home time? These mysteries aren't just confined to the driver workforce. Something major is happening in the overall labor market: 4.3 million people quit their jobs in August, with bar, restaurant, and retail staff quitting in droves in favor of prospective opportunities elsewhere.

   The American Trucking Associations maintains that we're still at a shortage of 80,000 truck drivers, a considerable increase from the pre-pandemic deficit of 60,000. The drug and alcohol clearinghouse program has sidelined 91,000 drivers from service, and that number is expected to eclipse 100,000 before the year is out. Government spending on infrastructure will definitely be a factor in driver recruitment and retention trends. However, the overall impact on the driver force remains to be seen because the legislation is stuck in an impasse on Capitol Hill.

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Surprisingly, the sunset of pandemic-related unemployment benefits hasn't prompted the recovery of truckload capacity that policymakers and industry leaders have hoped for. Moreover, aggressive increases in driver pay haven't moved the needle in an appreciable way. The earlier-discussed Cowen Inc. survey indicates that 86% of carriers expect another round of driver pay increases over the next twelve months, somewhere in the neighborhood of a 7% increase in pay per mile. Indeed, carriers across the country have tapped into every incentive imaginable to coax drivers back out on the road, to little avail.

When it comes to efforts to boost driver pay, rate per mile is only one side of the coin. The value of increased driver pay is only as impactful as a given shipper's ability to get drivers quickly loaded (or unloaded) and on their way. **One of the most challenging realities of supply chain bottlenecks and labor shortages are the elevated wait times and other inefficiencies that diminish gains that would otherwise be realized by heightened driver pay scales**.

Warehouses that are accustomed to operating with 100 people are making do with 50. Consequently, pickup and drop-off tasks that used to take less than an hour now take three to four hours (or more). In complex supply chains, those sorts of struggles are never confined to only short-staffed distribution centers and warehouses. Those inefficiencies have a cascading effect downstream for drivers and subsequent receivers and shippers alike. Loading and unloading schedules are hard enough to calibrate in normal times; the same can be said for efforts to improve driver utilization and dwell.

Whether the pay scale is $0.45 per mile or $0.75 per mile, drivers are paid only when the freight is moving. That dynamic might go a long way in explaining why pay increases haven't yielded the usual capacity gains the industry would see in normal times.

A TIME UNLIKE ANY OTHER

This is a remarkable time to work in the logistics and supply chain fields. The past several months have sparked a new level of curiosity about the complex realities driving how goods are brought to market. Our work no longer exists behind the scenes; no more is it taken for granted and written off as pure magic. Stories about container ships wedged in canals, repurposed passenger jets carrying commercial cargo, and truck drivers ferrying vaccines hither and yon have elevated supply chains from "commercial minutia" to "cultural curiosity." From our perspective, any trend that elevates truck drivers and other logistics professionals from regular folks to heroes is a trend worth embracing.

Without a doubt, this elevated interest has come about due to the sobering ramifications of supply chain disruptions on our country's standard of living. When shelves go empty in one of the wealthiest countries in the history of the world, people notice. Many of us have been long spoiled by the agility and reliability of online retailers in a digital economy; all the things we could possibly want or need are a few clicks away. For all of the convenience and value that technology has brought to our nation's economy, it can make the buying process seem inanimate. It's easy to forget about the people that ultimately make these transactions work, especially when we're making purchases from the comfort of our own homes. These recent supply chain disruptions have reminded us how even the most frictionless digital transactions still rely on physical labor. Every retail purchase relies on real people who work diligently to move goods from Point A to Point B. Regrettably, their hard work and contributions often go unacknowledged and underappreciated until things no longer work. At the end of the day, e-commerce is still driven by human efforts meeting human needs.

So many components of our supply chains, and even our national infrastructure, have lived hand-to-mouth for years. It took a global pandemic and the cascading effects of the world economy pressing "pause" to bring those realities to the fore. Many good things will come as a result of this wake-up call. But, first, our industry must navigate tight labor markets, driver shortages, bottlenecks, and other obstacles in order to keep shelves stocked and people healthy. The solutions to these challenges are within the grasp of both carriers and shippers. Indeed, technology can be utilized to help shippers and carriers not only to understand but also to take action in pursuit of the right things. Carriers will use technology to hone their operating models and better plan freight. Shippers can tap into those advancements to better schedule and load trucks. The distribution of the costs and benefits of those investments will be an afterthought, especially if it's powerful enough to make a tangible impact on the lives of drivers.

We've closed each of our prior economic forecasts by acknowledging the heroes who have kept our shelves stocked and our economy afloat in the face of adversity, and we would like to do so again here. The contributions from truck drivers, warehouse and retail workers, logistics and supply chain practitioners, and a host of other contributors have sustained our country in unprecedented times. We've also expressed how proud we are to collaborate with shippers and peers across the industry to at a time when our collective efforts have mattered the most. Our industry's work has never been more crucial – our decisions have never been more meaningful – than right now.

Thank you, again, 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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