HIGHTOWER

WEEKLY WISDOM

Freight Pricing and Delays Put Pressure on Businesses

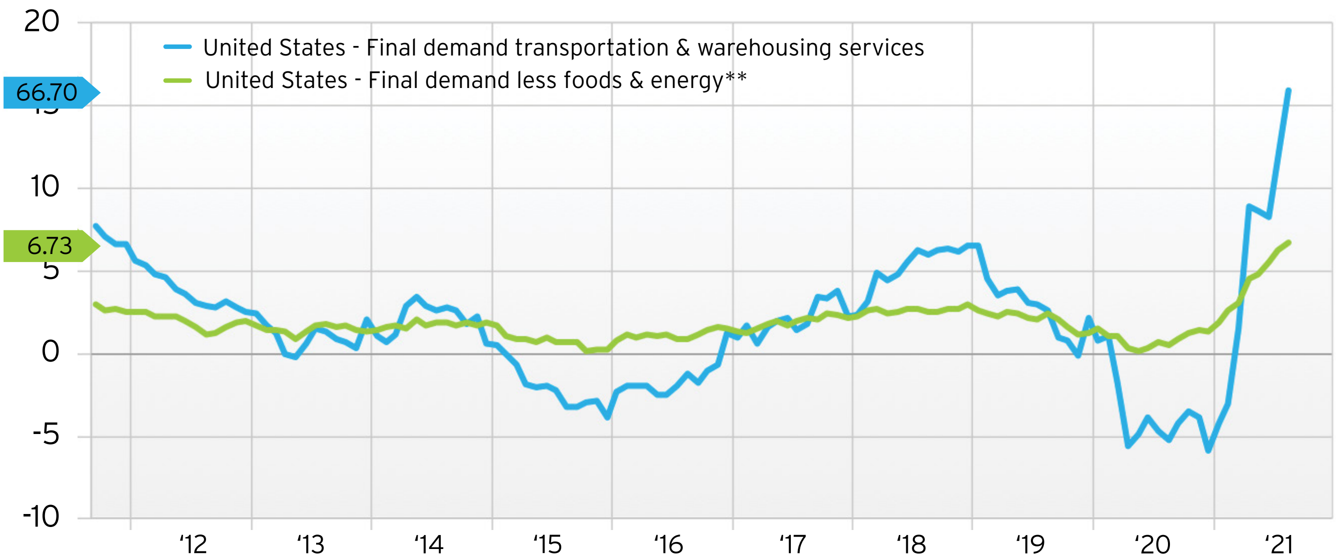
SEPTEMBER 15, 2021

Hot August PPI Numbers and Frustrated Business Sentiment

The Producer Price Index (PPI) is an inflationary indicator that captures monthly movements in selling prices from production. This is different from the Consumer Price Index (CPI), which measures pricing from the consumer's point-of-view. Often, inflated prices at the producer level are passed down to consumers so that companies can grow and maintain profits. As a result, the PPI should be viewed as a leading indicator to the CPI.

PPI recorded 8.3% annual increase and Core PPI (which excludes foods and energy) recorded 6.7% annual increase in the month of August—the ninth consecutive monthly increase. Not only are PPI levels well above pre-pandemic peak (+7.6% compared to January 2020); the one-year growth rate for Core PPI is more than double the previous peak 12-month growth of 3% recorded in December 2018 (data goes back to November 2010). One key driver of PPI comes from transportation and warehousing services, which in August was up +15% annually and +0.7% from July. [1]

Chart 1: U.S. Core PPI vs Transportation & Warehousing Services (YoY % Change)[2]



[1] Source: U.S. Bureau of Labor Statistics
[2] Source: FactSet

As freight companies expand margins by charging higher rates, customers will have to prepare themselves for higher prices, longer lead times and delays. Supplier deliveries are continuing to slow; according to ISM, no industries reported improvement in August. Challenges for customers are being experienced across road, rail and ocean freight – impacting businesses that have no alternatives as they compete for capacity to meet demand.

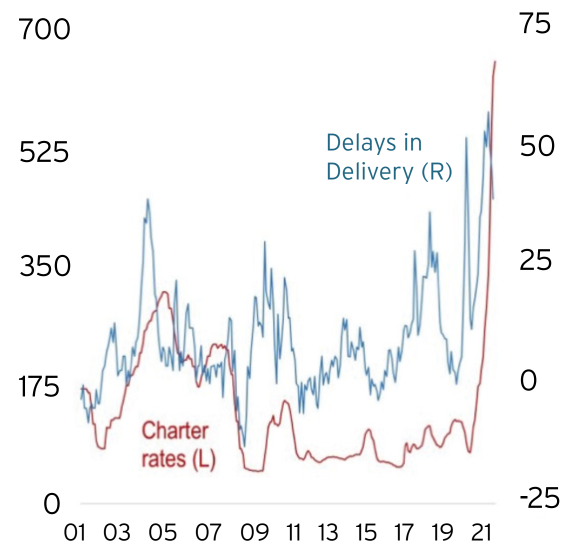
High Prices and Limited Capacity for Freight

ISM's Purchasing Manager's Index (PMI) results have been recording consistent expansion since June 2020, with peak rates of expansion recorded this past March. There are a few components within the PMI figures: manufacturing, services and the composite, which combines the two. PMIs are leading economic indicators, which is why we closely monitor each segment. Both the PMI services and the PMI manufacturing figures have been on the rise over the past year and are clearly in expansion mode – even if off their May peak levels. The figures have slowed – but again, remain in expansion territory – due to supply constraint issues, labor tightness and price increases. But importantly, growth in revenue, new orders and backlog remain strong. In other words, the PMI series as of late are impacted from supply issues more than demand.

To deal with the challenges in the supply chain and labor shortages, businesses are taking unprecedented action, looking for ways to circumvent the record rates being charged by freight providers increasing prices and restructuring actions. According to Freightos Baltic Index, spot container shipping rates from Asia to the U.S. West Coast were up 462% at the end of August, compared to the same time last year.[3] In addition to high prices, delays due to labor and capacity constraints are placing pressure on companies to receive enough inventory ahead of the holiday season to meet demand.

Several factors are contributing to the shipping delays. First, COVID outbreaks throughout the summer tightened labor and reduced efficiency at ports moving cargo inland. In addition, other factors like widespread record demand and labor tightness are contributing to congestion. Pre-pandemic, ships could enter a port, unload/reload cargo and sail off the next day; now they can spend weeks waiting off the coast. In mid-August, thirty-seven container ships were anchored off the Los Angeles ports, the highest number since February. During normal times, the number of ships waiting is between zero and one.

Chart 2: Global Container Charter/Freight Rates vs ISM Manufacturing Supplier Deliveries[4]



Rates for dry van (+13% YoY), flatbed (+19% YoY), and refrigerated (+25% YoY) trucking transportation are all up compared to this time last year. Coinciding with the increase in trucking rates, market demand for truckloads is up +38% YoY and +260% on a 2-year stacked comparison.[5] In addition; scarcity of new and used trucks, higher fuel prices, and a shortage of drivers are contributing to rising costs.

How We Got Here: Consolidation in the Shipping Industry

According to Alphaliner (a maritime data provider) the top six container operators control more than 70% of all container capacity.[6] A wave of consolidation occurred in the shipping industry over the past five years, leaving the shipping industry with fewer routes, fewer smaller ships and fewer ports available. Similarly, the railway industry experienced consolidation pre-2000, and a potential acquisition of Kansas City Southern by Canadian Pacific is currently being scrutinized because of the dominant, multi-national market share and pricing power it could provide for the combined entity.

---

[3] Source: Wall Street Journal
[4] Source: Numera Analytics, Harper Peterson, ISM
[5] Source: Wolfe Research
[6] Source: Wall Street Journal

As customers try to manage delays and high prices, they're also searching for alternative solutions to meet demand. Big box retailers are hiring their own smaller vessels to ship their goods, chartered for as much as $150,000 per day, many times more than pre-pandemic; operators wish they had more vessels to meet demand. Customers are counting on chartered vessels to deliver inventories in time for the holidays, though they can only carry a fraction of boxes the big ships haul and are not available to every business because of cost and supply.

The big shippers blame congested ports, not ship capacity, as the issue for delays. Shippers have strained relationships with customers because of their pricing tactics that have left many cargo owners without options. Companies with greater market share, which can fill more cargo boxes, are given priority over those that cannot. That said, no companies can avoid paying significant premiums to move their goods in the current environment.

Importance of Pricing Power and Market Share

As supply chain challenges are contributing to higher PPI, it's easy to understand why consumers are also having to pay a higher price for the end products. Companies with more significant pricing power can pass along at least part of these added costs to the end consumer. Companies that do not have the luxury of pricing power are more likely to see these higher freight costs eat away at their profits or force them to cut costs in other areas. That said, the high demand environment makes it extremely difficult for companies to cut costs as they look to stay competitive by investing in growing their business. This exemplifies the uneven impact that higher input costs can have on different sized companies, and the advantages of maintaining a strong balance sheet.

Meanwhile, CapEx spend is booming, as consumer spending and excess cash are spurring companies to ramp up investments. CapEx is being spent, in large part, on increasing productivity across the supply chain with technology and automation. Through Q2, U.S. business spending on equipment, structures and software has grown at an average annualized rate of 13.4%, the strongest pace since 1984.

Inflation Beyond the Supply Chain

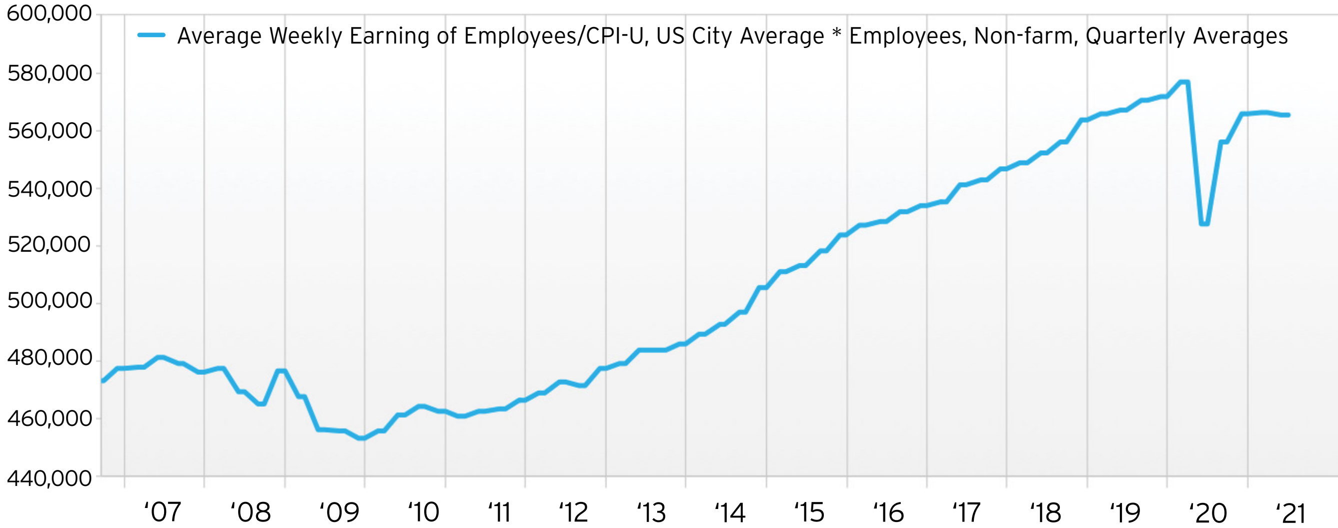
We are confident the supply chain constraints will work themselves out eventually, and that they are transitory by definition. The drawn-out recovery and high demand continue to extend these transitory inflationary pressures likely well into 2022. Low-income countries, on which the world depends for manufacturing, accounted for only 0.3% of vaccine doses administered as of August 23, increasing the possibility that COVID can further disrupt supply.[7] Semi-conductors are another component of inflation that is expected to have excess demand relative to supply for at least the next year until additional production capacity is built and COVID spread slows.

The Fed and The Taper

The emergency stimulus policy created by the Fed, which purchases $120 billion of bonds monthly, will eventually be tapered. We expect a November or December announcement of taper with the actual action some time in Q1 2022. It's important to note that taper in and of itself is not a tightening. In fact, if the Fed tapers its bond purchases by $15 billion per month, the taper will take eight months to complete, and in this same time frame, there will have been an additional $420 billion of liquidity put into the system. The point here is that taper will be slow and liquidity will remain accommodative. Rate increases are not likely until end of 2022, unless inflation continues to rise.

[7] Source: CNBC

Chart 3: Deflated Weekly Earnings for Total Non-Farm Employees[8]



Stephanie Link: CNBC TV Schedule

DATE	SHOW	TIME
Wednesday, September 15	Squawk Box	6:00 AM ET
Thursday, September 16	Closing Bell	3:00 PM ET

[8] Source: FactSet

Disclosure
Investment Solutions at Hightower Advisors is a team of investment professionals registered with Hightower Securities, LLC, member FINRA/SIPC, & Hightower Advisors, LLC a registered investment advisor with the SEC. All securities are offered through Hightower Securities, LLC and advisory services are offered through Hightower Advisors, LLC. This is not an offer to buy or sell securities. No investment process is free of risk and there is no guarantee that the investment process described herein will be profitable. Investors may lose all of their investments. Past performance is not indicative of current or future performance and is not a guarantee. In preparing these materials, we have relied upon and assumed without independent verification, the accuracy and completeness of all information available from public and internal sources; as such, neither the information nor any opinion expressed constitutes a solicitation for the purchase or sale of any security. Hightower shall not in any way be liable for claims and make no expressed or implied representations or warranties as to their accuracy or completeness or for statements or errors contained in or omissions from them. This document was created for informational purposes only; the opinions expressed are solely those of the author, and do not represent those of Hightower Advisors, LLC or any of its affiliates.

200 W Madison, 25th Floor
Chicago, IL 60606
(312) 962-3800
hightoweradvisors.com