SONAR

MONTHLY MARKET UPDATE

December
2024

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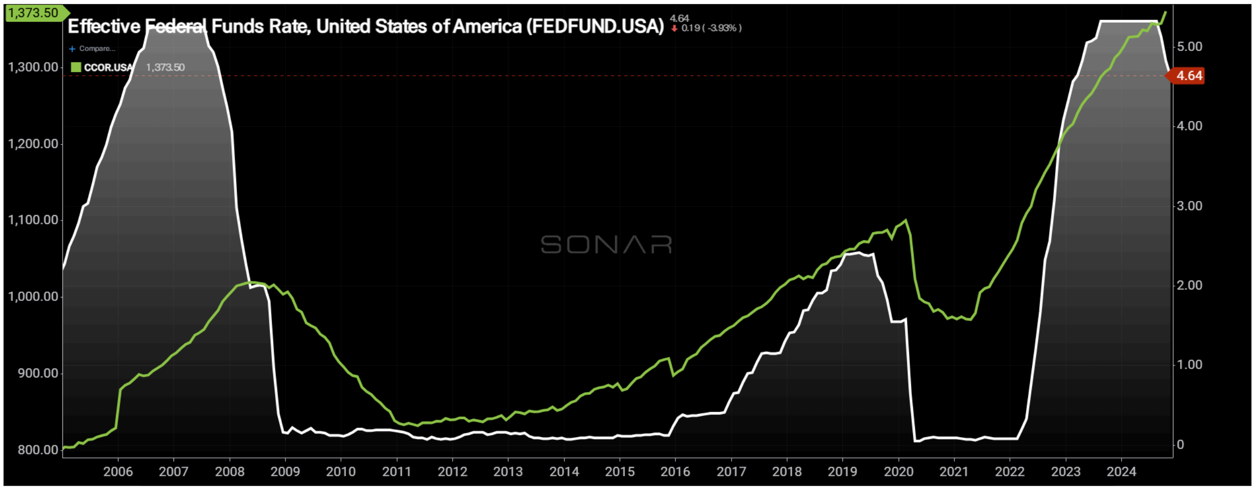
Economic Outlook

The Federal Open Market Committee has remained aggressive to close out 2024, with multiple cuts to the federal funds rate, or the overnight borrowing rate for banks. The FOMC has stated at multiple meetings that inflation has been trending in the direction that allows for the fairly aggressive easing of monetary policy. As the calendar is set to change to 2025, the challenge that the FOMC faces is whether it can continue to be aggressive in cuts to the federal funds rate or will have to temper the rate of declines.

Early expectations are for the FOMC to hold the target range for the federal funds rate unchanged at the Jan. 28-29 meeting. Two factors partially explain the reason for holding steady. First, inflation readings have been in line with expectations, outside of the Producer Price Index, which came in hotter than expected in November, but the progress to the long-term target of 2% has seemingly stalled. Additionally, the effects of interest rate movements, both hikes and cuts, are typically lagging current economic conditions. In other words, Fed officials use past months' data to determine policy decisions, and then the impacts of their decisions take time to flow into the economy. For those reasons, it makes sense for FOMC officials to pause intermittently to determine the impacts of their policy decisions.



Additionally, the uncertainty that the incoming administration brings presents challenges for the FOMC, who is supposed to be void of political influence. With potential tariffs that could be inflationary, it could derail the current direction of interest rates.

The first meeting of the year is also a prime time to pause any policy decisions as new members join the committee and various regional Federal Reserve bank governors exit. This creates a new committee voting on policy decisions, which can cause changes to policy directions.

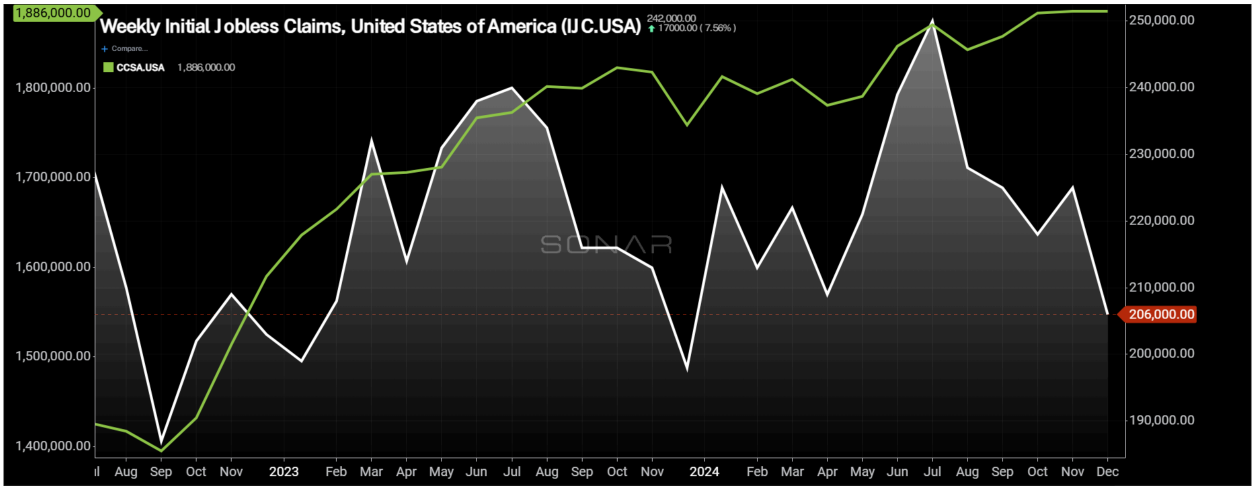
For FOMC officials, employment data is one of the indicators along with inflation data that are used to make policies. After a challenging October, the jobs report for November was better than expected. In November, after seasonal adjustments, 227,000 were added to payrolls during the month, better than the 214,000 that analysts were expecting. Even more good news on the jobs front was October's figure was revised higher to 36,000.

Even with the strong report, the unemployment rate inched higher, rising by 10 basis points to 4.2%, which matched analysts' expectations. The evidence of a more challenging labor market for individuals is the impact of the U-6 unemployment rate, which is the rate of total unemployed, plus all persons marginally attached to the labor force, plus total employed part time for economic reasons. In other words, it is a broader measure of unemployment as it measures those who are also discouraged and holding part-time jobs. The U-6 increased by 10 bps as well to 7.8% and is 80 bps higher than it was this time last year as the labor market has slowed.

The strength in hiring continued to stem from the same industries: leisure and hospitality, health care, and government.

The health care industry added 54,000 jobs during November, while there were 33,000 government jobs added. The leisure and hospitality sector added 53,000 jobs during November, with 28,900 being added by food services and drinking places, also known as bars and restaurants.

One segment that saw a fairly sizable decline was the retail sector, which on a seasonally adjusted basis lost 28,000 jobs during the month. This is a sector where seasonal adjustments have a large impact, and it was even more evident in November as the nonseasonally adjusted jobs figures showed an increase of 280,500 from the month prior.



Initial jobless claims have been inching higher in recent weeks, but the increase hasn't been a significant cause for concern, at least not yet. In the most recent week for which data is available, the week ending Dec, 7, initial jobless claims totaled 242,000, up 17,000 from the week prior and up 37,000 from the same week last year.

Continuing claims have been slowly moving up as well. Continuing claims increased by 15,000 in the week ending Nov. 30, the last week for which data is available. Over the past year, continuing claims increased by 68,000.

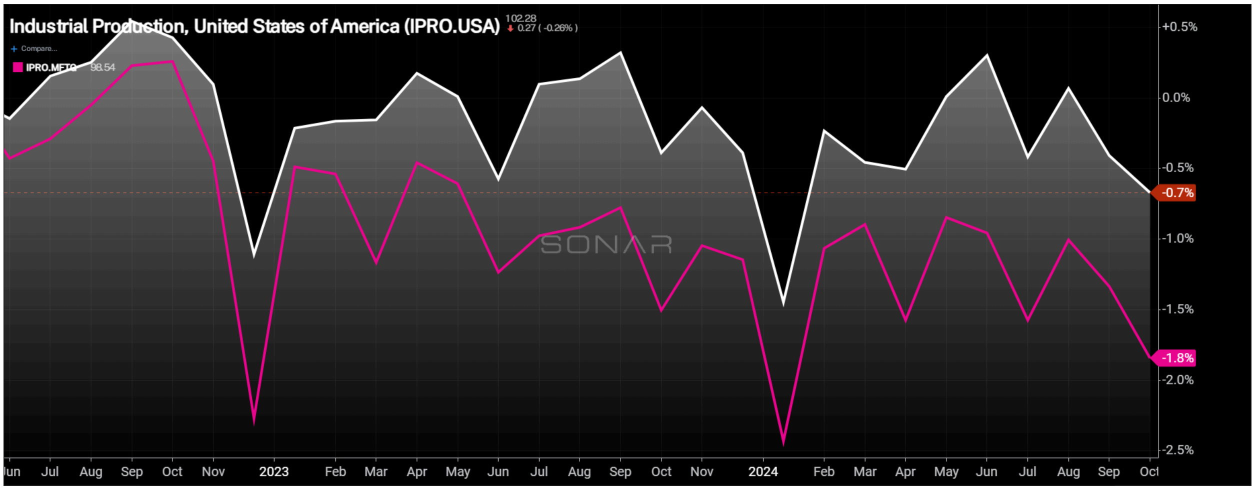
Manufacturing

The manufacturing sector of the economy remains challenged, dealing with the higher interest rate environment, which stymies demand growth as well as limits investment opportunities.

For the 24th month in the past 25, the manufacturing sector was in contraction in November, according to the Institute for Supply Management's Purchasing Managers' Index. The PMI came in at 48.4 in November, up 1.9 points month over month, showing that the rate of contraction in the manufacturing sector slowed during the month. While the PMI paints a picture of the manufacturing sector, it is important to note that any reading above 42.5 is an indication of overall economic growth.

For the first time in quite some time, the new orders component of the PMI entered expansion territory. The New Orders Index rose by 3.3 points month over month to 50.4, marking the first time new orders have expanded since March. Respondents to the survey highlighted a level of uncertainty about the future surrounding new orders heading into 2025, but a higher percentage of respondents are reporting higher levels of new orders. Twenty-one percent of respondents reported higher new order levels, up 0.6 percentage points from the month prior but 4.3 percentage points higher than it was in August.

Inventory levels remain in contraction as well, but the rate at which inventory levels are contracting has slowed. The inventory component of the PMI increased by 5.5 points m/m to 48.1, marking the third consecutive month in which inventory levels were in contraction. The majority (62.3%) of the respondents report that inventory levels are largely unchanged.



The PMI, while it is survey data, has largely reflected similar sentiment to what is being reported by the Federal Reserve in the form of the industrial production release. For the third consecutive month, industrial production was lower month over month in November. Total industrial production fell by 0.1% m/m in November and was 0.9% lower than it was this time last year.

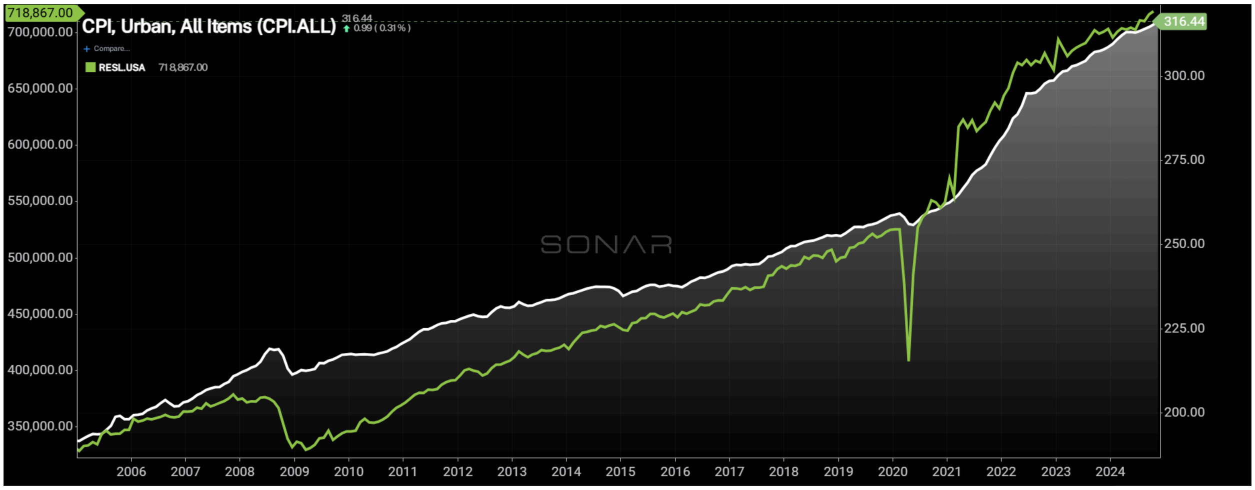
Business equipment was the primary growth engine for production during November, rising by 1.2% m/m, but that came on the heels of back-to-back months during which production fell by over 3% m/m. Even with the increase in November, production of business equipment was down 6.3% y/y during the month.

Finished consumer goods production was stable in November but remained down 0.6% y/y.

Manufacturing production increased by 0.2% m/m during November, after two consecutive monthly declines. Manufacturing is still down 1% y/y.

Consumer Conditions & Retail

Rampant inflation has become a talking point of the past as the annual rate of inflation is well down from the 9% experienced in 2022, but that doesn't mean inflation isn't still impacting the overall economy. At the same time, the consumer has been resilient and shown a willingness to spend, even in the face of inflation.



The Consumer Price Index, which is a widely used measure of inflation though it isn't the preferred inflation metric of the FOMC, continued to rise in November. The CPI increased by 0.3% m/m during November, the fastest rate of price increases since April. The 12-month running total for the CPI accelerated by 0.1 percentage points in November, rising to 2.7%. Both the monthly increase and the 12-month total matched analysts' expectations for inflation. The acceleration in the monthly figure as well as an increase in the 12-month total highlights that inflation is still prevalent, despite moving closer to the long-term target of 2%.

Core inflation, which is the CPI excluding food and energy prices due to their volatility, has flattened out over the past three months. Core inflation matched the headline CPI's increase, rising 0.3% m/m during November, the fourth consecutive month of a 0.3% increase. The 12-month running total for core CPI came in at 3.3%, the third consecutive month in which the 12-month total was 3.3%.

Food prices experienced one of the largest increases of the year, rising by 0.4% m/m in November. The increase matched September's, which was the largest since January. The 12-month running total inflation rate for food prices was 2.4%. The rise in November was almost entirely driven by food-at-home prices, which increased by 0.5% m/m. In comparison, food-away-from-home prices increased by 0.3% m/m. Even with the significant increase on food-at-home prices, they are still up just 1.6% y/y, compared to food-away-from-home prices, which are 3.6% higher.

Energy prices, which have been an area of relief for consumers in recent months, were back on the rise in November. Overall energy prices increased by 0.2% m/m in November, the first monthly increase since April. Despite the increase, energy prices are still down 3.2% y/y. Gasoline prices increased by 0.6% m/m during November but were still down 8.1% y/y.

Shelter prices continue to be the main driver of overall inflation, accounting for over one-third of the CPI. Shelter prices increased by 0.3% m/m in November, down from the 0.4% m/m increase in October. Shelter prices are still 4.7% higher than they were this time last year.

With inflation still present in consumers' everyday life, they have shown the ability to continue to spend money despite challenging conditions. Strong retail sales numbers in November highlight that fact. November's retail sales increased by 0.7% m/m, exceeding analysts' expectations of a 0.5% increase for the month. Total retail sales were up 3.8% year over year in November, even with retail holidays like Cyber Monday moving into December this year.

Motor vehicles and parts sales were a significant portion of the growth in retail sales during November, rising 2.6% m/m. Excluding autos and gasoline station sales, retail sales were up 0.2% m/m and 3.9% from where they were this time last year.

Some positives in the month are that electronics spending as well as home improvement spending were back on the rise. Electronics spending was up 0.3% m/m and is now up 1.2% y/y. Retail sales at building material, garden equipment and supplies dealers were up 0.4% m/m and up 4.1% y/y.

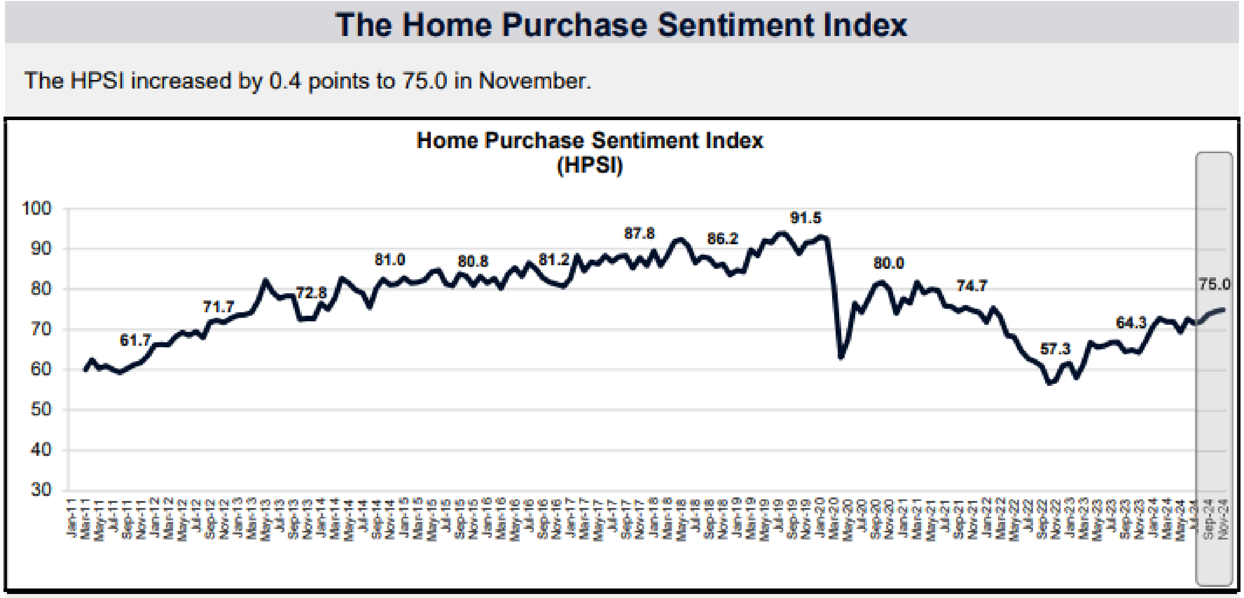
Housing & Construction

The housing market hasn't seen a significant boost despite multiple interest rate cuts, but that is because mortgage rates have actually increased rather than declined since the first interest rate cut. The reason for this is that mortgage rates are typically tied to 10-year bond yields, which have increased, a sign that those in the financial sector are having a more cautious outlook over the longer term.

According to Freddie Mac, the average 30-year fixed mortgage rate has been declining since early November but still isn't as low as rates were just ahead of the first cut by the FOMC. Over the past month, the average 30-year fixed mortgage rate declined by 18 basis points to 6.6%. Compared to this time last year, mortgage rates are down 35 bps.

If the FOMC remains aggressive, then mortgage rates will likely move lower, as the spread between which banks borrow and the rates for consumers through mortgages widens. However, if the FOMC becomes more hawkish in 2025, it threatens mortgage rates and the housing market as a whole.

Despite mortgage rates not moving significantly lower, sentiment around purchasing a home continues to improve. The Home Purchase Sentiment Index produced by Fannie Mae increased by 0.4 points m/m to 75, the highest level since February 2022. Compared to this time last year, the index is up 10.7 points, signaling that sentiment has dramatically improved.



“Over the past year, we have seen a significant improvement in general consumer sentiment toward the housing market, largely driven by increased optimism that mortgage rates will fall and improved perceptions of both homebuying and home-selling conditions,” said Mark Palim, Fannie Mae senior vice president and chief economist in the Dec. 9 release. Sentiment around buying conditions has improved at a greater rate than the overall index, though the vast majority of respondents state that it is a bad time to buy. Seventy-seven percent of respondents stated that it was a bad time to purchase a home compared to just 23% who deemed it a good time. That means the net good time to buy came in at minus 54%, (23% good time minus 77% bad time), which is actually 6 percentage points closer to 0 than it was last month and 17 points higher than this time last year.

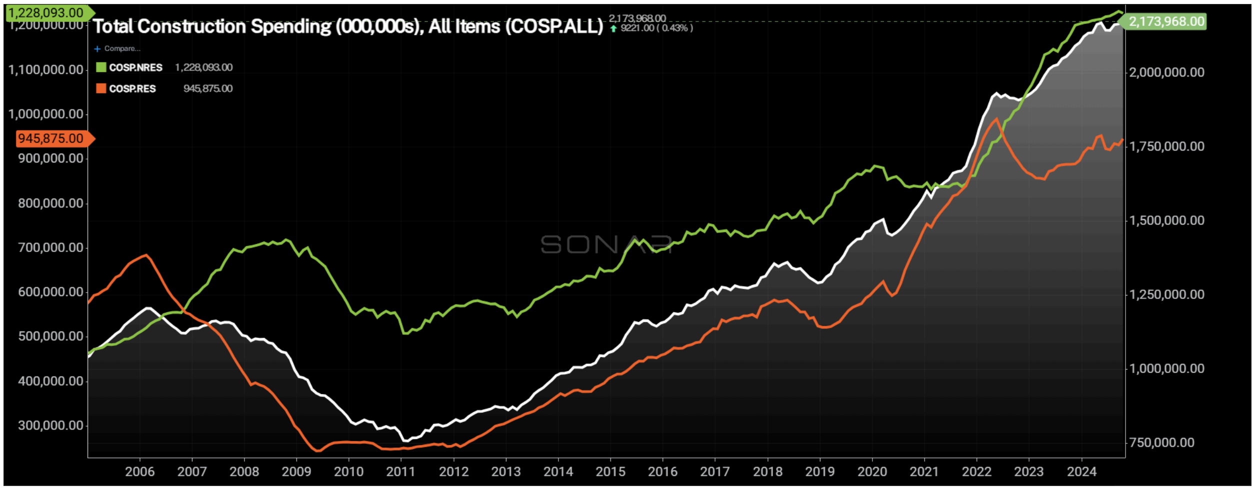
Far more respondents are expecting mortgage rates to go down in the next 12 months than have in the previous few months. Forty-five percent of respondents expect lower mortgage rates over the next 12 months compared to just 25% who expect higher mortgage rates.

The increased sentiment around buying a home is showing up in mortgage application numbers. The weekly mortgage application survey conducted by the Mortgage Bankers Association showed that mortgage applications increased by 5.4% week over week for the week ending Dec. 6, the most recent week for which data is available.

Additionally, existing home sales, which make up the vast majority of home sales, were on the rise in recent months. According to the National Association of Realtors, existing home sales increased by 3.4% m/m in October and were 2.9% higher y/y. It marked the first y/y increase in existing home sales in multiple years.

The increased demand levels, coupled with supply side challenges, have caused the sale price for homes to continue inching higher. The average existing home sale price increased to $407,200 in October, up 4% y/y.

Construction spending continues to accelerate, though the recent months have been more challenging than earlier in the year. Total construction spending grew by 0.4% m/m in October to a seasonally adjusted annual rate (SAAR) of $2.173 trillion. Total construction spending was 5% higher than it was in October 2023.



October’s increase in construction spending was driven by the residential side of the sector. Residential construction spending increased by 1.5% m/m in October to a seasonally adjusted annual rate of $945.9 billion. Residential construction spending was 6.4% higher than it was during October 2023.

Nonresidential construction spending took a breather in October, declining by 0.4% m/m to a seasonally adjusted annual rate of $1.228 trillion. Even with the monthly decline, nonresidential construction spending was 3.9% higher y/y. The manufacturing subsegment of nonresidential construction spending fell by 0.1% m/m to a SAAR of $236.1 billion but was up 16.6% y/y. This is a positive sign overall for the U.S. manufacturing sector that there has been significant growth over the course of the past year.

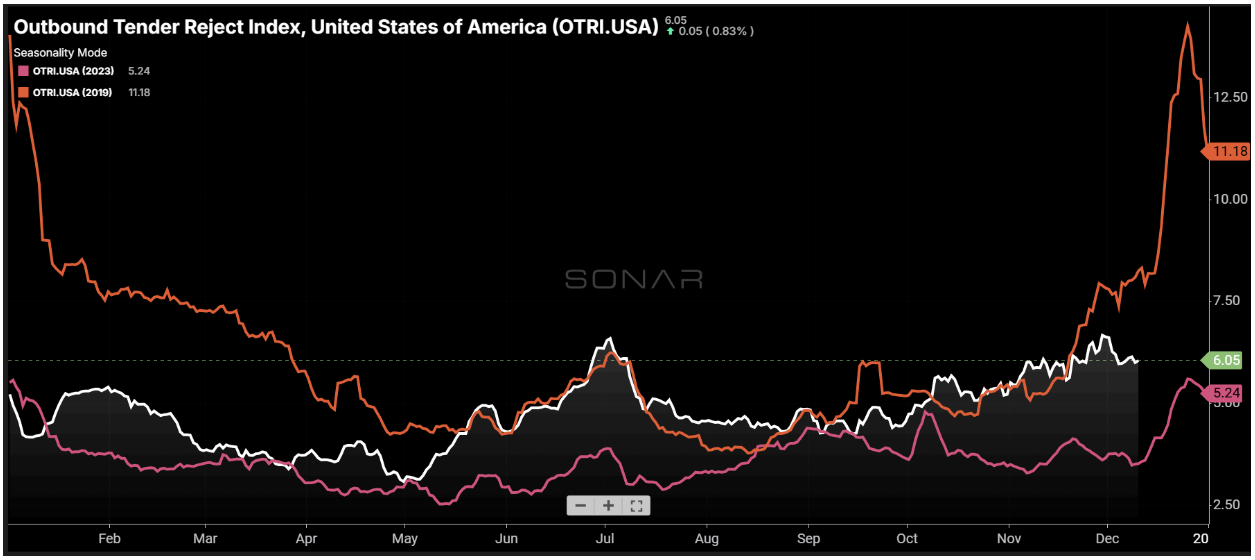
Freight Market Overview

National Summary

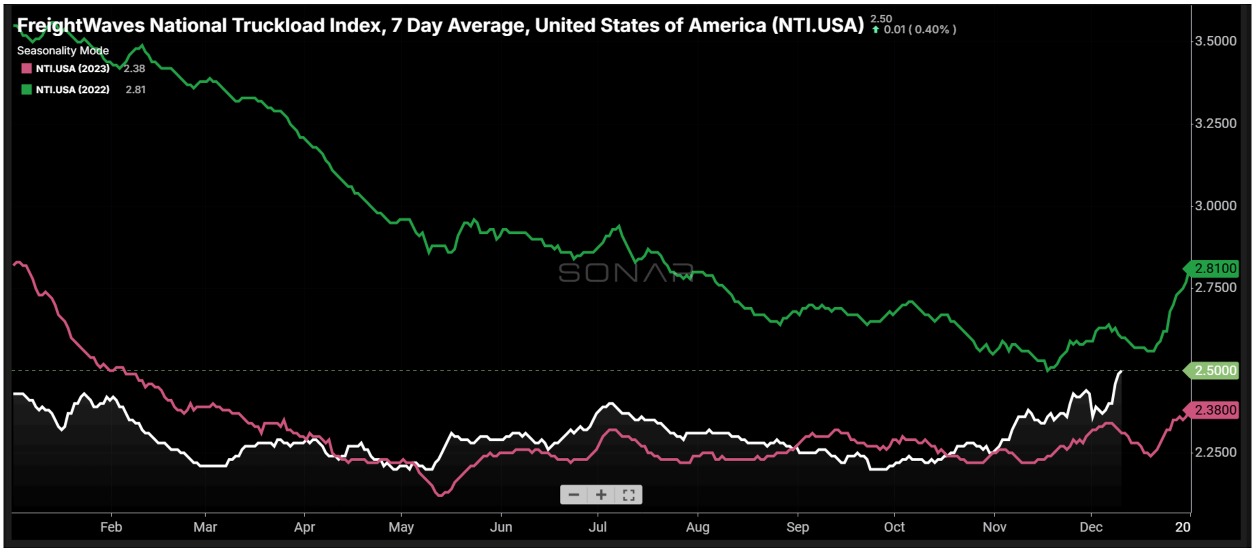
The domestic freight market continued its slow trend of tightening throughout the Thanksgiving holiday. Spot and rejection rates increased and sustained at relatively higher levels from mid-November into the middle of December. Intermodal demand continued to be a relief valve for long-haul truckload, potentially acting as “moving storage” for companies importing goods with longer lead times to expected fulfillment. Concerns around tariffs and relatively low prices from China are helping fuel this trend. At a bare minimum, the truckload market is measurably tighter than it was at this point last year and continues to see capacity bleed off. Contract rates are coming in higher than the previous year, illustrating that the sentiment has certainly changed in terms of expectations over the next 12 months. January and February are not known as volatile periods exclusive of weather, but the market appears to be priming for a pretty strong transition in 2025.

Trucking

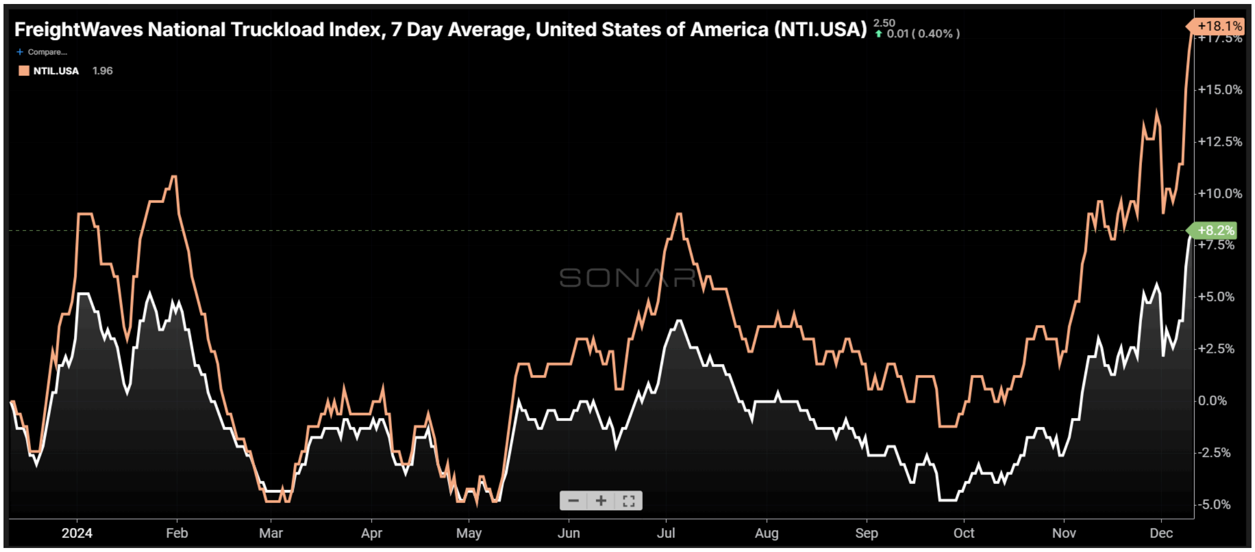
National tender rejection rates (OTRI) hit their highest point of the year (YTD) on Nov. 29, with a value of 6.67%. This topped the previous high for 2024 of 6.59% that was hit on July 2.



The OTRI slipped back a bit but remained relatively high compared to the previous two years. Rejection rates fell below the 2019 values, which exceeded 7.5% through most of the holiday season that year. The 2019 market has been a relatively effective blueprint since about mid-May for how to view the current environment. The break with trend during Thanksgiving has been the strongest since the two annual figures started their strong alignment.



Dry van spot rates (NTI) strengthened their growth in November and became increasingly volatile. A compressed shipping season between Thanksgiving and Christmas potentially helped create an additional sense of urgency, compared to the previous two years. Mixing of shorter-haul freight was also inflationary to the average-rate-per-mile calculation, though the market was definitively more active than in 2023.



Removing the total estimated cost of fuel from the spot rate (NTIL) shows that fuel has been a deflationary influence on rates over the past year, masking some of the inflationary market pressures that have been growing. The NTIL was up 18% in mid December versus the same point in 2023. THe NTI, which includes fuel costs, was only up 8% by comparison.

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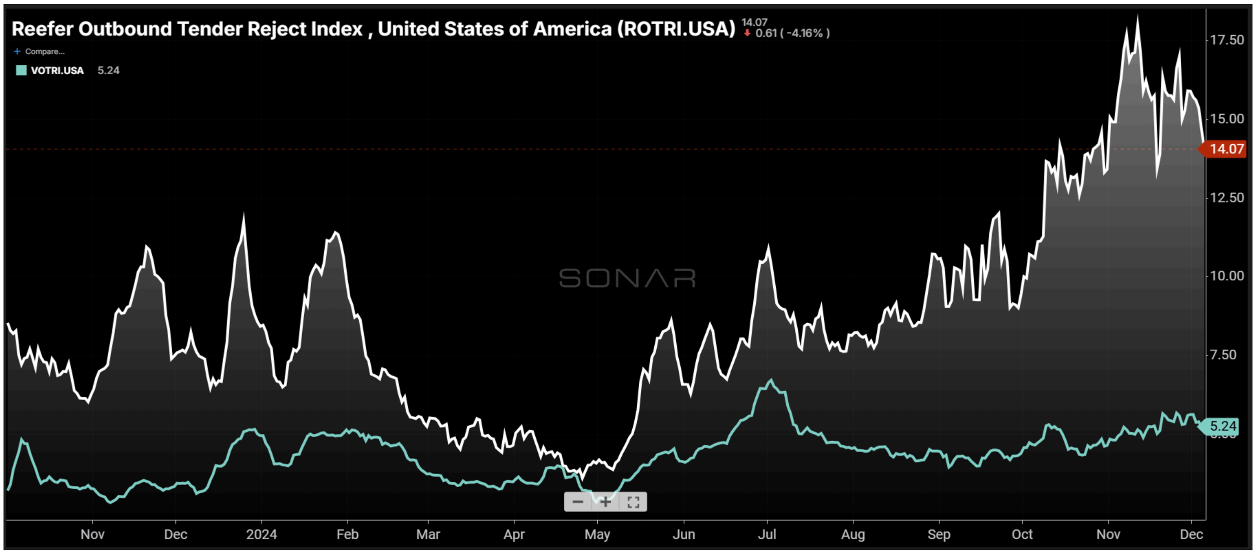
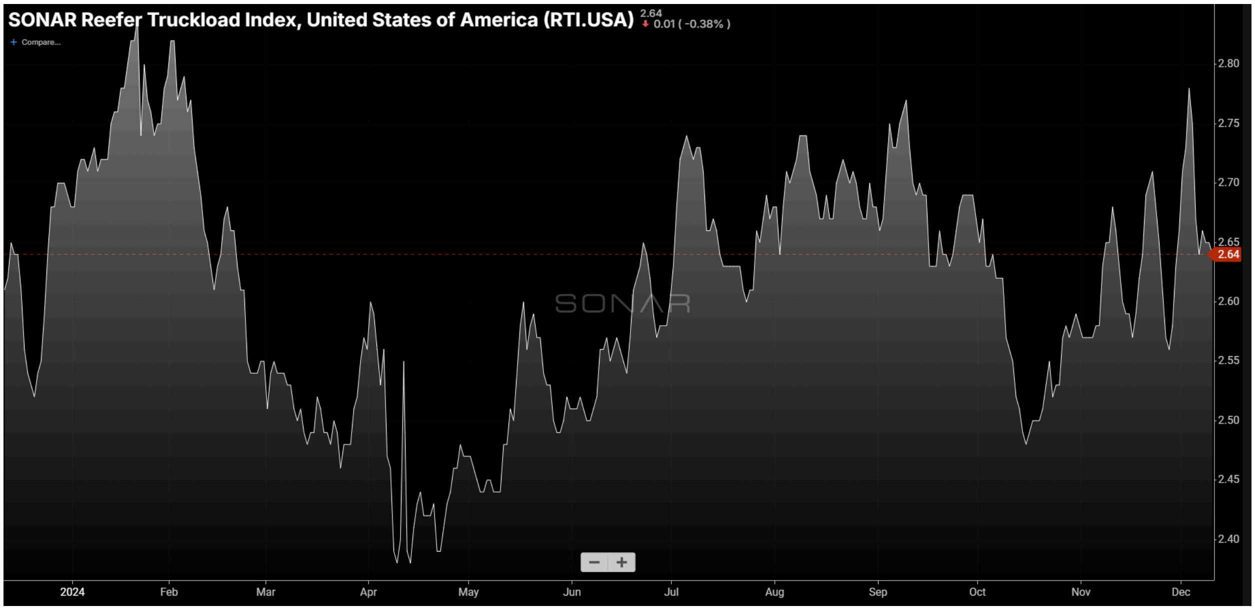


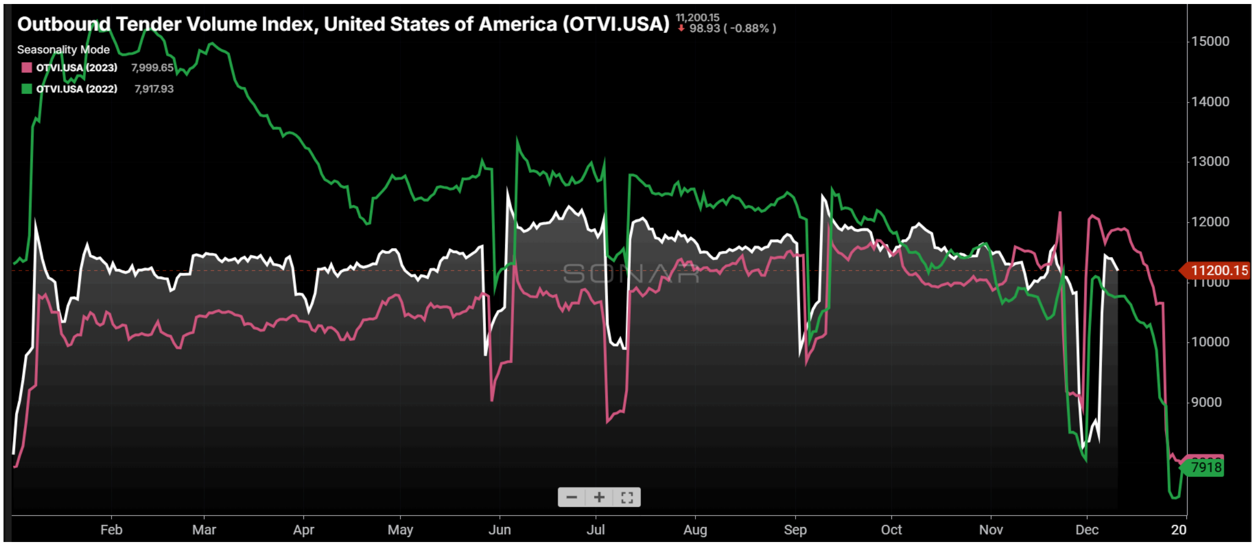
Breaking the rejection rates down into the reefer (ROTRI) and van (VOTRI) trailer types shows that the temperature-controlled contract environment was much more responsive to disruption than the more populous van segment. The ROTRI was significantly higher than the previous year in November, topping 18% for the first time since April 2022.

Van rejection rates failed to eclipse Fourth of July's peak values during Thanksgiving, remaining below 6%, but were significantly higher than they were last year, when they were at 3.19%.

It should be noted that reefer load tenders only represent 10%-15% of the total tender dataset, whereas dry van tenders represent roughly 65%-70% of the total volume. The lower volume means the ROTRI will be more volatile in general, but this level of divergence from van is unusual even allowing for the fact that it is more responsive by nature.



Reefer spot rates (RTI) have not increased to the same scale as their van counterparts into December. It appears that contract rate compliance has deteriorated but not injected significant energy into the spot market. Many lanes show spot rates already exceeding contract rates or being relatively close. Carriers may simply be choosing to cover the more lucrative spot loads at this point without a significant influx of new volume.



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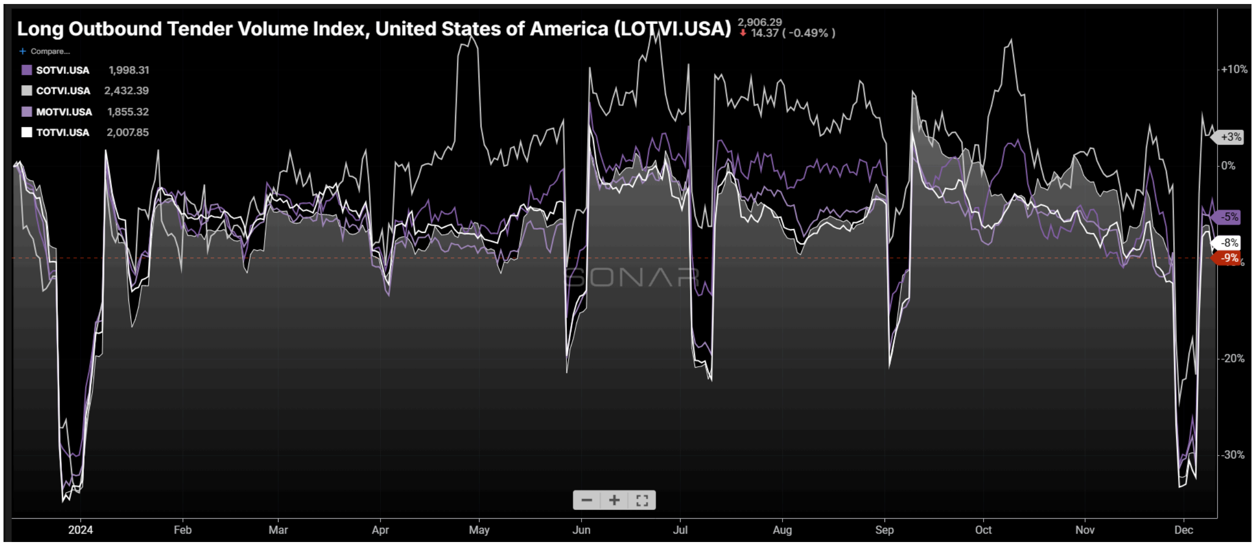
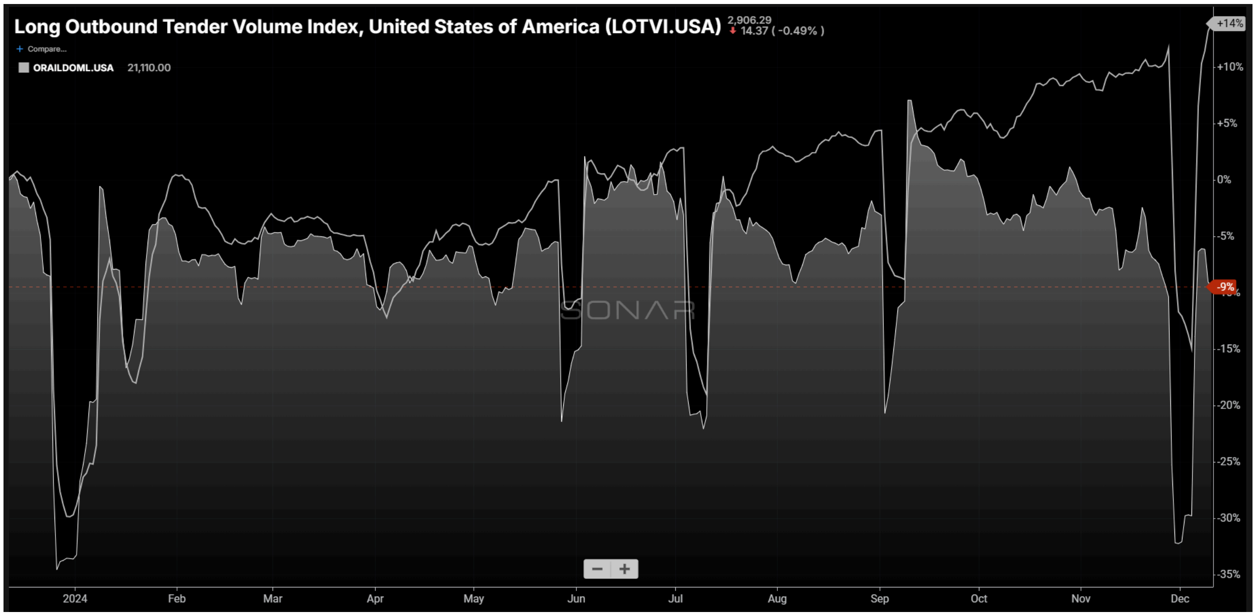
The National Outbound Tender Volume Index (OTVI) has been trending lower since September and was fairly erratic in late November and early December, removing the holiday week. Year over year, total truckload demand was down about 4%-6% during this period.



Demand for loads moving more than a day away from the origin drove most of this decline. Local haul (fewer than 100 miles) tenders were up about 3% in the weeks following Thanksgiving, a segment that is not as fungible with the rails.



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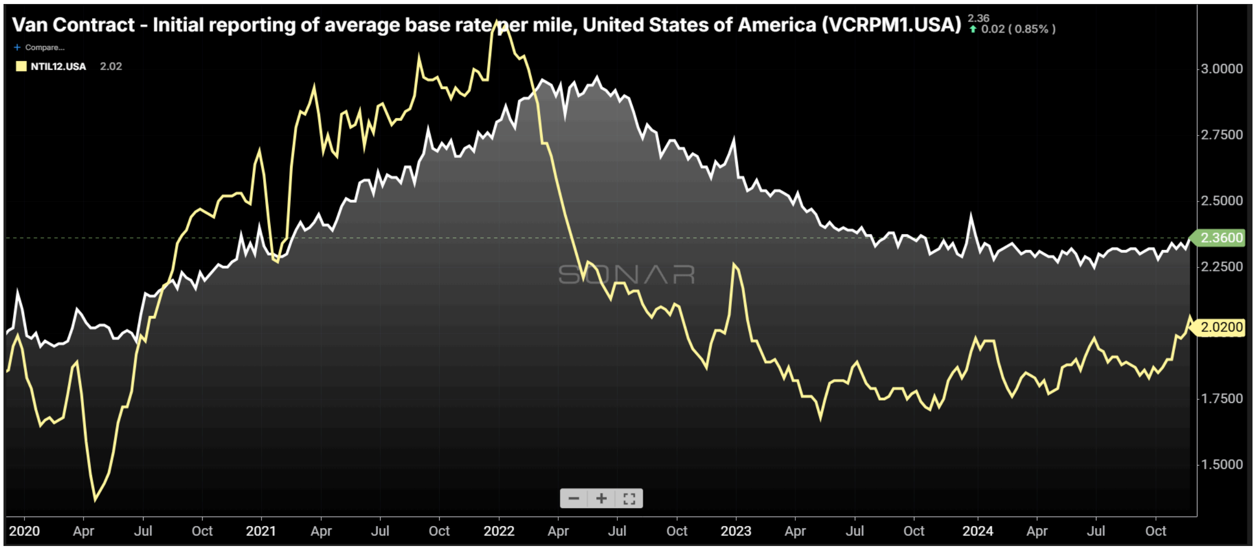
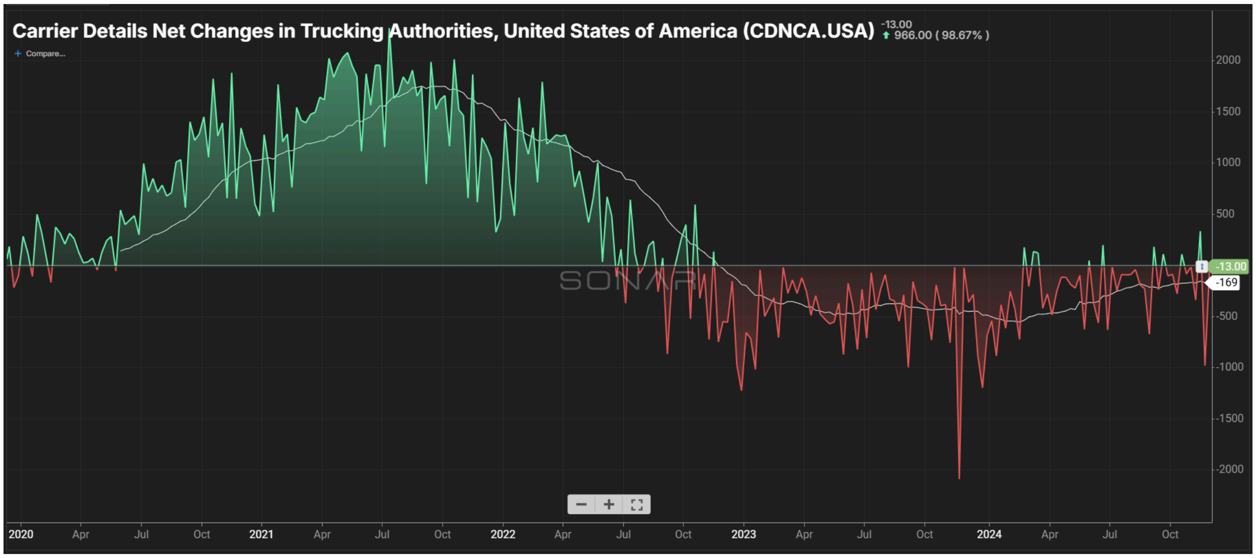
Looking at a chart of long-haul tender volumes (LOTVI) versus loaded domestic intermodal containers moving on the rail (ORAILDOML), it is fairly clear that shippers are choosing intermodal over truckload shipping. It is unusual to see intermodal demand growing at this time of year. It is further evidence that shippers are ordering goods in front of potential tariffs with less sense of urgency around getting them to their final destination.

The growing use of intermodal is keeping a cap on a potential breakout moment in the truckload sector as it replaces the need for long-haul capacity coming from the West Coast. A single domestic container moving from Los Angeles to Chicago replaces eight days of truck capacity for a solo driver going out and back. Los Angeles is one of the most challenging markets for national carriers to keep covered as it is essentially a freight island with little inbound demand relative to outbound.



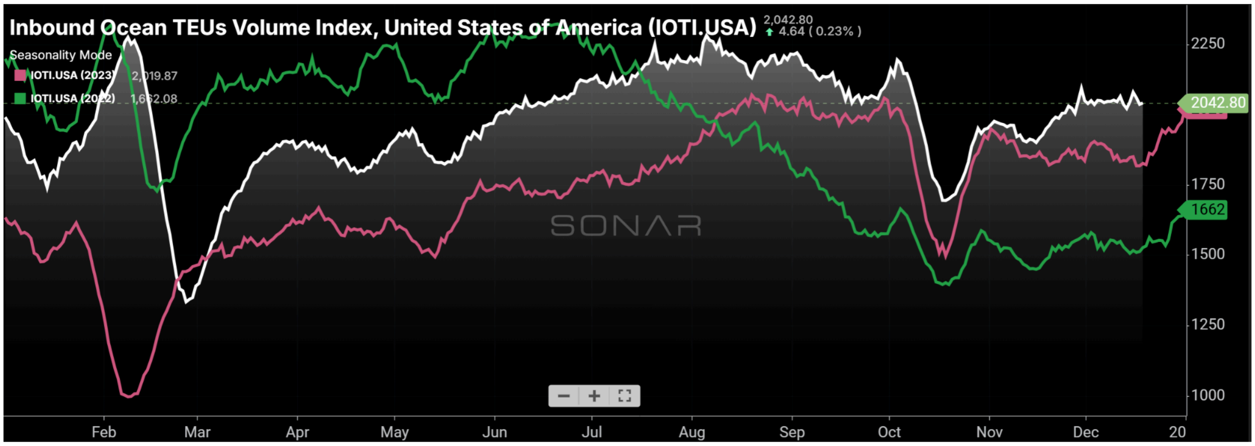
As mentioned above, contract rates (VCRPM1) are starting to show signs of upward pressure, something the spot market (NTIL) has had since May 2023. The spot market is still offering a strong discount in general, but that is shrinking. Shipper sentiment appears to be driving rate increases on some level as many expect the excess capacity to continue to bleed off in the coming months, leaving many exposed to service deterioration. Being on the bottom of the market in terms of rate would mean heavy exposure to service failures and an increasingly volatile spot market.



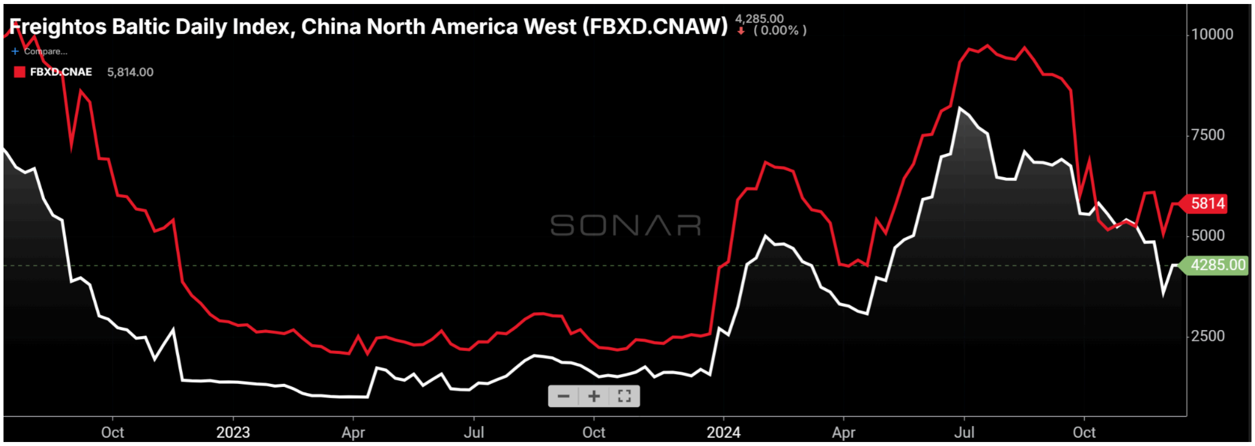
Carrier Details analysis of FMCSA carrier authority data still suggests a strong exodus is about to occur in the coming months as it typically does around the holidays. Capacity should continue to exit into the spring months, putting the market in a much more responsive state.

Maritime

U.S. import volume remained at a very strong level through the first half of December, amid a pull-forward to avoid tariffs, with particular volume strength for the U.S. West Coast ports. The Port of Los Angeles reported a record November, which was about 15% higher than 2023 volume and similarly ahead of the November average of the past five years. That port expects another record in December, citing a 13% increase in the volume of empty international containers leaving the port on vessels. Typically, an increase in empty international containers heading back to Asia means that ocean carriers want those containers back quickly in order to fill them with more merchandise that is produced in Asia for U.S. consumption. The West Coast ports' share of imports remained elevated as shippers are still wary of the potential for another strike by the International Longshoremen's Association, which could take place on Jan. 16.



Looking ahead to next year, there is uncertainty in the ocean sector for a few reasons. The current pull-forward of U.S. imports to avoid tariffs may lead to a subsequent decline at some point. In addition, ocean carriers continue to add capacity. That could pressure rates, which remain at historically high levels (see chart below). Ocean industry observers expect the industry to add about 8% to capacity in 2025 and an additional 6% in 2026. Even if that increase in capacity were partially offset by retirements of old vessels, it seems unlikely that global trade will keep up at the same pace, particularly if a trade war makes supply chains less global in nature. For now, the Red Sea attacks have continued and there is little reason to expect them to cease, but if the Red Sea were to fully open, that would further pressure on ocean rates since the extra time associated with routings around the Cape of Good Hope has been estimated as reducing effective capacity by 8%-10%.



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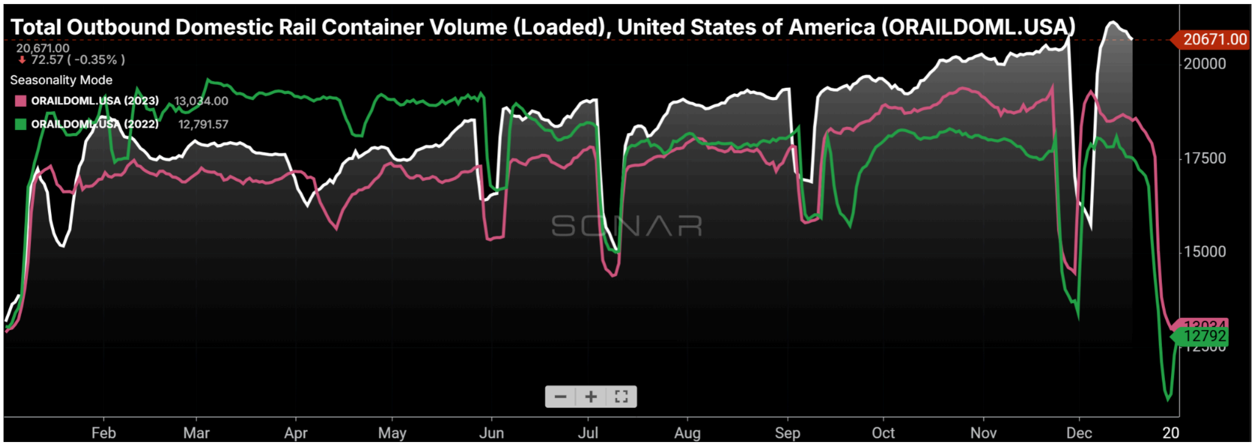
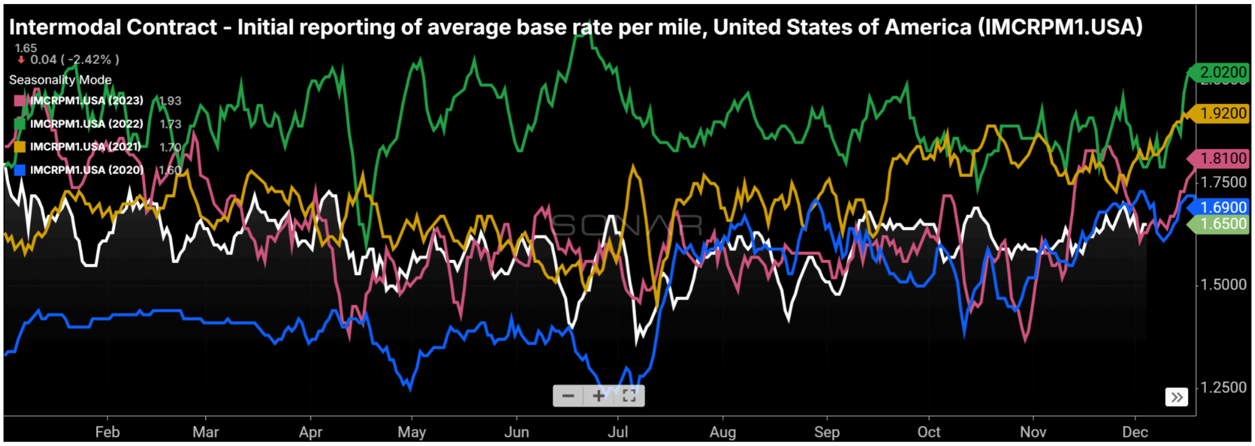
Intermodal/Rail

In the first half of this year, the import volume strength highlighted above primarily translated into international intermodal volume with relatively little impact on domestic intermodal volume. That started changing late in the second quarter in response to shortages of oceangoing containers amid delays at certain ports around the world, such as the Port of Singapore. In recent months, domestic intermodal has outpaced international intermodal volume growth amid an increase in transloading of imports from international containers into domestic containers. The concentration of imports at the U.S. West Coast ports also supported intermodal volume growth since those routings are much more compatible with the rail intermodal network, as compared to routings that originate at the East Coast ports. In addition, much of the import-related long-haul volume freight movement this year was less time-sensitive given that it represented a pull-forward (ahead of the ILA strike deadline or tariffs, etc.), which made intermodal a viable option for more shippers.



In addition, both service and rates have been supportive of the domestic intermodal growth shown in the above chart. Rail service has been solid by and large, and the domestic intermodal companies have been able to deploy a large portion of the containers they recently have taken delivery of.



Next year, domestic intermodal contract rates look set to rise, directionally consistent with an expected increase in truckload contract rates. On its most recent earnings call, domestic intermodal carrier Hub Group told analysts it expects intermodal contract rates to increase, but the magnitude of that increase remains uncertain.

Air Cargo

Data showing demand momentum for air cargo continued in November, but some industry stakeholders are cautioning that the 2025 growth rate in air cargo volumes could be cut by half, or more, from this year's elevated levels.

Logistics giant DSV said it expects air cargo volumes to be flat in 2025 compared to this year as businesses fully adapt to ocean supply chain disruptions that have pushed more freight to air and cross-border e-commerce tapers off due to consumer behavior and regulatory scrutiny of an import loophole favored by Chinese sellers. If the prediction pans out, it would mark a significant change from the 11% year-over-year air traffic growth so far in 2024. It would also follow the 15-to-20-month cycle that is normal for the air cargo sector.

Volatile geopolitical factors and widespread tariffs threatened by President-elect Donald Trump could create headwinds for air cargo in 2025.

A tight capacity situation for main-deck freighters could get worse with the impending retirement of older aircraft due to age restrictions, manufacturing struggles that are slowing freighter deliveries and regulatory delays in approval for Boeing 777-300 passenger-to-freighter conversion programs.

Freight analytics firm Xeneta is forecasting air cargo demand will grow 4% to 6% next year, depending on the trade lane, while capacity increases in the 4% to 5% range.

Airfreight consulting firm Rotate expects demand growth below 4.4% next year, in large measure due to capacity constraints.

We are still seeing strong demand growth, but the peak season is less noticeable because year-over-year demand has been about 12% all year with no seasonal dips. Volumes increased 10% in November, although there has been a small decrease in tonnage the past two weeks. Global combination rates (spot and contract) are up about 6 points month over month and 11% from a year ago. Spot rates are stronger at 21% higher than in early December 2023.

Outlook

Christmas is sure to come for the freight market this year, at least to a stronger extent than it did in the previous two for many service providers. Spot and rejection rates are hitting their highest values since the end of the pandemic era in 2022. It may not be the extreme environments we have seen in 2017 or 2020-21, but it is more than we have seen in what has been the longest market downturn in modern history. Demand concerns still exist in the coming year, but the market is experiencing a strong supply side correction that will carry that momentum deep into 2025. A mild peak season with rejection rates around 9%-10% may be the best thing for the truckload market in the long run as it will tamp down any knee-jerk responses from carriers that are on the fence about deciding to leave or stay. January and February should be seasonally weaker than November and December, pending weather outbreaks. We are looking at March as a potential wild card month for increased market activity as spring shipping returns.