RAILROAD WEEK IN REVIEW

July 17, 2020

"While sales of newly built homes were up nearly 13% in May, housing completions were down 7.3% month over month as home builders are struggling to keep up with demand for newly constructed homes; a large percentage of the sales were for homes that have not yet been built. This construction backlog should help to keep demand for lumber strong heading into the fall." — Mike Zarembski, Charles Schwab, July 13

In Week 27, the first week of the third quarter, rail volumes were -6.2% year-over-year and -3.2% sequentially, with a difficult sequential comparison because of the July 4th holiday. Metallic Ores and Minerals led the declines, with Motor Vehicles only slightly lower — a really positive sign about auto plant openings. Intermodal and Ag were positive year over year on the week." – – Jason Seidl, Cowen & Company

Lumber futures prices have made a complete recovery from their coronavirus-induced sell-off, according to Charles Schwab analyst Mike Zarembski. Prices at these levels have not been seen in the last two years. The catalysts are several. First, the COVID-19 outbreak initially caused prices per thousand board-feet (mbf) to be nearly cut nearly in half, to $260 April 2 from $463 Feb 20. Single family home construction slowed as future demand for new housing was uncertain, to say the least.

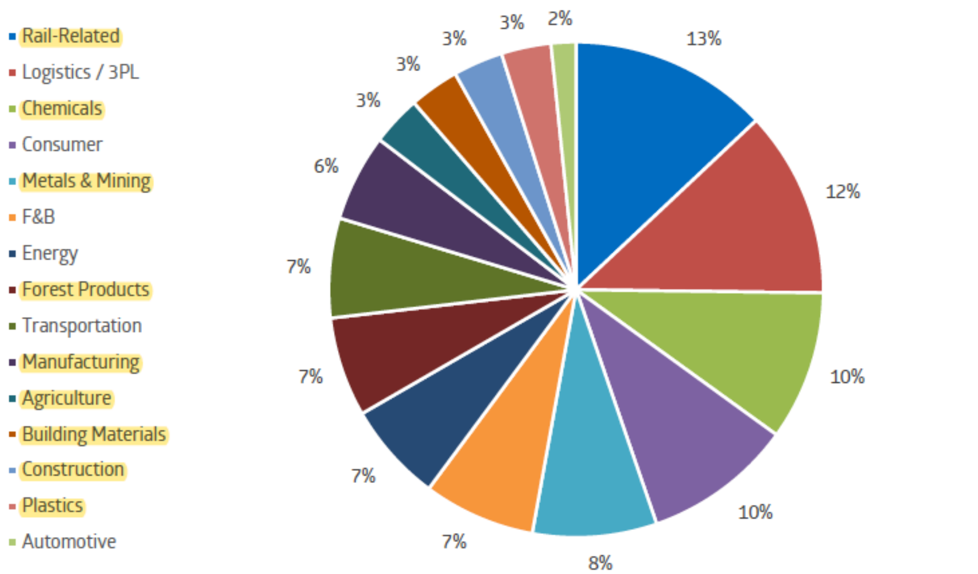
Yet HUD said three weeks ago that May building permits rose by 14.4% month-over-month in May to a seasonally adjusted annual rate of 1.2 million. New home sales jumped 13% in May, but actual housing completions were down 7.3% month. Zarembski reports that "this construction backlog should help to keep demand for lumber strong heading into the fall." He attributes the increased demand for more single-family housing to the coronavirus outbreak, especially from those residing in multi-unit dwelling in more urban areas who are now desiring more open space.

In sum, record low interest rates are also making new housing more affordable with the Freddie Mac Primary Mortgage Market Survey showing for the week ending July 9, 30-year fixed rate mortgages averaged 3.03% with average points paid at 0.8%. For comparison, 30-year fixed rate mortgages averaged 3.75% a year ago. The employment situation will have to improve as well if the shift by younger buyers to more suburban style single family homes is to be sustainable.

The latest Cowen & Co. Shipper Survey has determined that railroad customers expect price increases of 230 bips above rail cost inflation, up some 40 bips sequentially. Economic expectations are all higher sequentially; some remain below the survey's average while some are very positive indicators. Business levels over the past few months were positive for a third of the respondents. Perhaps these are answers from shippers in industries such as consumer staples or grocery whose businesses benefitted from the pandemic.

On a same customer basis, however, just two out of three answered that business levels have trended "positive" in the last three months, compared to half that last quarter. It was generally felt among respondents that the direction of the economy is improving, but the railroads may not necessarily benefit. Even though only one in five is concerned about railroad capacity, there remain relatively few signs of commodity shifts from the highway to the railroad.

There are shortages foreseen in the ready availability of box cars, tank cars, center-beams. The thought occurs that shortages in boxes and center-beams bodes well for both forest products STCCs; tank car concerns support the relative stability of the industrial chemicals trade over the past three months. These observations appear well-founded inasmuch as railroad-friendly commodities are well represented among the survey group. See highlights:



Source: Cowen 2Q20 Rail Shipper Survey, SurveyPlanet.com

Whereas customers in the Cowen Survey see car-type shortages, the AAR Cars-in-Storage data tells me these car types are available, if only customers and railroads would bring them back to active service. According to the AAR's July *Rail Time Indicators*, 26 percent of all boxcars are in storage as are 36 percent of all tank cars. Together they make up 35 percent of all cars in storage (no C-B data as such).

The AAR further notes nearly a third of the serviceable cars on North American railroads had not carried a load in the last two months. Note that the AAR calls cars "in storage" when they are in service and available for loading but there have been no loads for them. As an aside, the run rate for "cars in storage" 2016-2019 was around 300,000-400,000 units. That number spiked to more than 500,000 in the 2020 second quarter.

North American Freight Cars in Storage by Major Car Type
(as of July 1, 2020)

Car Type	Primary Commodities	Total Cars In Service	In Storage	Percent In Storage	Percent of Stored Cars
Box	Paper products, wood products, food prod.	103,017	26,858	26%	5%
Covered Hoppers	Grain, chemicals, nonmetallic minerals	572,214	170,006	30%	32%
Flats	Containers, trailers, lumber, steel, autos	75,032	24,960	33%	5%
Gondolas	Coal, nonmetallic minerals, metals, scrap	204,784	67,324	33%	13%
Hoppers	Coal, metalic ores, nonmetallic minerals	125,971	49,375	39%	9%
Intermodal	Containers, trailers	74,043	16,002	22%	3%
Refrigerator	Food products, farm products, chemicals	10,762	4,578	43%	1%
Tanks	Chemicals, petroleum, food products	437,151	156,038	36%	30%
Vehicle Flat	Autos	65,702	11,309	17%	2%
Grand Total		1,668,676	526,450	32%	100%

Source: Association of American Railroads

PFL Petroleum reports that West Texas Intermediate (WTI) closed at $40.55 last Friday as "crude has struggled to extend recent rallies as fresh outbreaks of the virus worldwide emerged." PFL is concerned that further outbreaks "will impede efforts to reopen the economy fully." Further dampening North American demand, Libya has plans to bring on 730,000 barrels a day. And Brent traded up 89 cents (+2.1%) to close at $43.24 on Friday of last week

Last week's U.S. crude inventories are up 5.6 million barrels and gasoline inventories were down by 4.8 MM/bbls as transportation demand plummeted. while distillate inventories increased by 3.14 MM/bbls. With WTI below the phycological $40 per barrel mark, nobody's in a rush to turn those machines back on and frack sand demand is now almost nil.

I'm afraid the coronavirus pandemic is going to keep transportation demand sub par for a while longer. Check this out: https://www.oliverwyman.com/our-expertise/insights/2020/apr/covid-19-pandemic-navigator.html.

> The Oliver Wyman COVID-19 Pandemic Navigator forecasts the number of new and cumulative coronavirus cases across nearly 40 countries and provides insights into how to manage after the peak. This document provides a quantitative basis on which governments, industry groups, and companies can examine the impact of COVID-19 on business, and consider how to "reopen" responsibly.