MAJOR TOPIC: Rolling Along

BULLET POINTS: (1) Truck tonnage index barreling along to new highs. (2) Pedal to the metal in December. (3) Truck and train data support Double Recovery scenario. (4) Intermodal container loadings also at new record high. (5) More brand new autos riding the rails. (6) Third shifts. (7) SMidCap forward earnings at record high, while LargeCap stalls at previous high. (8) Why are margins under more pressure at large than small companies? (9) The decoupling question. (10) Still overweighting Air Freight & Logistics and Railroads.

BLOG (link): Today’s post focuses on trucks and trains.

CALENDAR: Tuesday--NFIB, Retail Sales (0.7), Business Inventories & Sales, Plosser. Wednesday--NAHB (26), Production (0.7), TICs, Empire, FOMC Minutes, Fisher. Thursday--PPI (0.4/0.2), Starts (675k), Philly, Claims (365k). Friday--CPI (0.3/0.1), Leading Indicators (0.5). (Bloomberg consensus estimates.)

I) US ECONOMY: Keep on trucking! This seems to be our economy’s new motto. The American Truck Association (ATA) Tonnage Index sank to a cyclical low of 100.2 during April 2009. That was the weakest since January 2002. It has been recovering since then and rose to 116.6 during November of last year, which matched the previous cyclical high during 2008. The truckers must have put the pedal to the metal during December because the ATA index soared 6.8% to a record high of 124.4 (see blog). This is yet another indicator suggesting that the recovery is over and that the economy is expanding into record territory.

What is unique about the current expansion is that some of the most cyclical sectors that always participated and contributed to previous economic recoveries have lagged behind this time and are still well below their previous peaks. So they still have plenty of room to recover and to contribute to the overall economy’s expansion. This why I see a “Double Recovery” scenario ahead for the US economy. That would be the exact opposite of the dreaded “Double Dip” scenario that has been in fashion for the past couple of years. Let’s have a closer look at the truck tonnage data and see if they are confirmed by railcar loadings, which is another very useful transportation indicator:

(1) Truck Tonnage. For all of 2011, truck tonnage rose 5.9% over the previous year--the largest annual increase since 1998. Tonnage for the last month of the year was 10.5% higher than December 2010, the largest year-over-year gain since July 1998. ATA notes that trucking serves as a good barometer of the US economy, representing 67.2% of tonnage carried by all modes of domestic freight transportation, including manufactured and retail goods.
Total Railcar Loadings. Debbie and I monitor the weekly data on railcar loadings by smoothing out the data using 26-week moving averages. On this basis, total loadings have stalled around the recent cyclical high in recent weeks. They are 19% above the 2009 low, but still 10% below the 2006 record high. Car loads, which carry bulk commodities, remain on a gradual uptrend. Intermodal loadings, which include containers and trailers, are also on an uptrend, which has stalled recently. (See our new weekly publication, US Railcar Loadings.)

Railcar Loadings by Product. Since early 2009, there have been V-shaped rebounds in car loadings of chemicals & petroleum products and metals & related products. Still depressed are coal, nonmetallic minerals, pulp & paper products, and waste & scrap material. Lumber & wood products remain depressed, but have been gradually trending higher since early 2010. Most encouraging, and consistent with the Double Recovery scenario, is that motor vehicle loadings rose to a new cyclical high in early February. They are highly correlated with auto production (blog).

Intermodal. The ATA truck tonnage index is most highly correlated with intermodal railcar loadings, especially intermodal containers (blog). The difference between total intermodal loadings and intermodal containers is the relatively small loadings of intermodal trailers, which remain near the recent recession lows. The loadings of intermodal containers rose in January to a record high, confirming the strength in truck tonnage during December.

Anecdotal evidence is mounting that the increase in truck and train traffic reflects more activity at our nation’s factories, particularly the auto assembly plants. The 2/9 issue of Businessweek included an article titled, “Third Shifts Return to the U.S. Auto Industry.” It notes: “For the first time since the car industry’s collapse in 2009, many plants are running 24 hours a day. At the nadir, some plants ran only one eight-hour shift. U.S. auto plants this year may operate at about 81 percent capacity after falling as low as 49 percent in 2009, according to estimates from researcher IHS Automotive.”

* S&P 500 Transportation, Railcar Loadings & Truck Tonnage (link): What’s the latest on US train and truck traffic? Truck tonnage was up big at the end of 2011, while railcar loadings remained stalled around their cyclical high in the early weeks of 2012. Railcar loadings are recovering from their recent dip, and were little changed near their cyclical high again during the week of February 4. The y/y growth rate has slowed considerably since the fall of 2010, though is turning higher again. Truck tonnage increased for the fourth straight month in December (jumping 6.8% during the month), with the y/y rate accelerating 10.5%, the highest since 1998. ATA’s Chief Economist notes, “While I’m not surprised that tonnage increased in December, I am surprised at the magnitude of the gain. Not only did truck tonnage increase due to solid manufacturing output in December, but also from some likely inventory restocking.”

II) STRATEGY: During economic expansions, corporate profits tend to rise. Profitable companies tend to hire. Small companies tend to hire more than large companies. Ergo, employment is most likely to expand fastest when there are lots of small profitable companies. When companies expand their payrolls, profit margins tend to get squeezed. However, that squeeze can be offset by rising revenues as overall employment growth boosts sales.
Over the past 12 months through January, the ADP survey shows that large, medium, and small companies increased their payrolls by 98,000, 828,000, and 979,000. What is puzzling me is why profit margins seem to be getting squeezed more for LargeCaps than for SMidCaps. Joe and I have observed that despite an improving outlook for the S&P 500's 2012 and 2013 revenues, the recent downturn in consensus earnings expectations for both years implies that profit margins are under pressure. How does that make any sense if large companies aren’t the ones doing the hiring?

S&P 500 forward earnings have flattened out over the past year. Meanwhile, the forward earnings of the S&P 600 SmallCaps rose to a record high during the week of February 3. The forward earnings of the S&P 400 MidCaps is down only slightly from its record high in mid-January. Business must be very good for small and medium-sized companies in America if they can crank out record profits while expanding their payrolls.

We are still left with the puzzle of what exactly is squeezing margins at large companies given their slow pace of hiring. Is it possible that margins are more cyclical for large than for small companies? Joe and I are working on solving this puzzle. Stay tuned.

* S&P 500/400/600 Forward Earnings & Valuation (link): How goes the US earnings recovery? It has slowed considerably since August from the fast pace that began in May 2009, and forward earnings was mostly lower for the three S&P market cap indexes last week. Valuations, however, remained near their best levels in seven months for all three indexes last week. Forward earnings rose for LargeCap last week, but remains 0.7% below its record high in August. MidCap and SmallCap are 0.9% and 0.1% below their record highs (hit in mid-January and two weeks ago, respectively). The Q4-2011 blended estimate/actual rose for the LargeCap and SmallCap indexes last week--but the usual bounce from positive surprises has been considerably smaller than in recent quarters for all three indexes. The current blended Q4 y/y earnings growth rates are 8.6% for LargeCap, 9.2% for MidCap, and 12.1% for SmallCap--the slowest growth for each since Q4-2009. On the heels of the relatively anemic earnings surprises so far in Q4, analysts lowered nearly all of their 2012 quarterly estimates for all three indexes last week. Analysts still expect double-digit growth for all of the quarters in 2012 for MidCap and SmallCap, but their expectations for LargeCap are down to a single-digit pace for Q1-Q3. Although analysts tempered their expectations again last week, investors left valuations mostly steady at seven-month highs: LargeCap’s P/E was unchanged at 12.5, MidCap’s remained stable at 14.8, but SmallCap’s edged down to 15.5 from 15.9.

III) GLOBAL ECONOMY: The decoupling question is back. The last time it was asked was in the summer of 2008. Back then, the US economy was falling into a mild recession and the worry was that it would drag the global economy into a recession as well. The hope was that emerging economies might decouple from the US and continue to grow. What actually happened is that the financial meltdown in the US during the fall of 2008 quickly morphed into a global credit crunch. As a result, the volume of world trade plunged 18% from the end of the summer through January 2009.

Yet, it started to recover by mid-2009. To an important extent, that rebound was led by emerging economies, in general, and by China, in particular. Today, the weakest link in the global economy is Europe. Since the end of last year, economists around the world, including the ones at the IMF, have been lowering their global GDP forecasts for this
year mostly because of the widespread view that Europe is falling into a recession that could depress growth elsewhere. The IMF forecasts a 0.5% contraction for the euro zone in 2012.

That view is starting to change a bit as better-than-expected growth in the US suggests that our economy might decouple from Europe’s this year. A more radical notion is that strength in the US might actually provide a lift to Europe--the idea being that the US is more important to Europe than Europe is to the US. The weak link in this argument is that Europe is very important to most emerging economies. If they weaken along with Europe, the US might not be able to decouple from that sort of widespread global weakness. Here are a few updates on the global economy:

(1) This morning we learn that industrial production in the euro zone fell 1.1% in December. German output plunged 2.7%. On the other hand, German economic expectations improved far more than predicted in February based on the widely watched ZEW index, which rose for the third consecutive month after declining for nine straight months. The economic expectations index rose to 5.4 points in February, the first positive reading since May 2011, from January's unrevised -21.6.

(2) China's Premier Wen Jiabao said Tuesday his country is ready to increase its participation in efforts to resolve Europe's debt crisis, after holding talks with EU leaders in Beijing. Wen did not elaborate on how China would participate, but earlier this month he said Beijing was considering offering help through the IMF or bail-out funds.

(3) Central banks continue to pump liquidity into the global economy. The Bank of Japan unexpectedly added 10 trillion yen ($128 billion) to an asset-purchase program and set an inflation target of 1% “for the time being.” The CPI inflation rate was -0.2% y/y during December. The Bank of England announced that it will continue to implement its program of quantitative easing, and increased it by 50 billion pounds to 325 billion pounds.

* World Trade (link): Has the global trade boom been losing steam? Some, but not too much. The volume of world trade increased 1.0% in November after falling 1.1% in each of the prior two months (which followed a two-month gain of 2.7%). It’s just south of its record high in August, and in the middle of its recent flat trend. The value of world trade ticked up 0.1% in November after a 1.9% loss and a 2.3% gain the previous two months. It’s also just south of its record high, near the bottom of its narrow flat trend. The value of trade is up 72.4% since bottoming in February 2009. G7 exports increased 48.0% over same period, while export growth in the rest of the world was up 87.3%. Recent data show that both are stalled at recent highs. Emerging nations’ exports, as a share of total exports, surpassed G7 economies’ in July 1996. Since then, their share has expanded from 50.1% to 66.9%, while the G7’s share has declined from 49.9% to 33.1%. Industrial commodity prices are down sharply from cyclical highs, but have been rising again recently, a favorable sign for global trade.

* G7 Exports (link): More upside for G7 exports? Yes, for the US and Canada, though there is likely more downside for the remaining economies. G7 exports fell for the third straight month, down 0.2% in November and 3.1% over the three-month span. Still, they are only 4.6% below their pre-recession July 2008 record high. By country, exports were mixed during the latest month. (All country data is through December, except for Italy’s.)
Here’s a snapshot: (1) In Europe, German exports fell for the third time in four months, sinking 7.1% in December and 11.8% since August. French exports tumbled 5.6% in December, more than reversing gains the prior two months (which followed an 8.6% drop). They’re down 11.3% from August’s cyclical high. Italian exports climbed 1.0% in November after sliding a total of 5.3% the previous two months. UK exports remain in volatile flat trend around cycle high, though are down 2.9% the past two months. (2) Japanese exports have declined the past three months, by a total of 7.4%. (3) In North America, US exports increased 0.8% in December (after a two-month decline), and are back within 1.5% of September’s record high. (4) Canadian exports broke out of their recent flat trend, jumping 4.7% in December (after a 2.9% gain in November) to a new cyclical high.

* Emerging Economies Exports (link): Are exports still making new highs in Emerging Markets? Not across the board--now, it’s a mixed bag among the countries we track. China is at a new record high, while Mexico is back at its record high and the Ukraine has climbed to a new cyclical high. Malaysia, Singapore, South Korea, Taiwan, Chile, Colombia, and Russia all are stalled around their highs. Exports in India, Thailand, Brazil, and Poland have made big moves down in recent months, though the first two are turning up. Exports in the remaining countries we track have turned down, while Venezuelan exports continue to fluctuate in a very volatile flat trend at recent lows.

* US Trade (link): What’s the latest news on the US trade front? Trade was still only a slight negative to Q4 real GDP (with initial estimates showing a -0.11pps contribution), despite another widening in December’s deficit. The real goods trade gap widened for the second straight month to $47.7bn after a big narrowing from August to October (from $46.0bn to $43.9bn). For Q4, the deficit averaged $46.2bn, slightly wider than Q3’s $45.7 billion (in line with what BEA assumed in the first release of Q4 GDP). Real merchandise exports and imports both increased 1.4% during the month, climbing for the third time in four months, with the former up 2.3% over the time period and the latter 2.8%. The nominal US goods deficit widened for the second straight month (to $63.5bn) after narrowing from $65.7bn in June to $57.1bn in October. Excluding oil, the deficit widened for the third straight month (to $36.5bn); that followed a steady narrowing from $36.2bn to $31.4bn the prior three months. On a 3-month basis, nominal merchandise exports slipped 1.3% (saar) in the three months ending December (the first decline since August), slowing from 11.8% in the comparable October period. Imports rose 2.3% (saar) over the three-month period, improving from a 2.8% decline in October (which was the first negative reading since mid-2009). Nonpetroleum imports rose 1.8% over the period through December, slowing from 18.1% during Q1.

* US Exports to New vs. Old World Exports (link): Are US companies finding more customers for their exports in Emerging Markets--i.e., the “New World”? Currently, they’re keeping the ones they’ve got. Since the start of 2000, EMs’ share of US exports has increased from 30.5% to 41.0% in December 2011 (flattening out in recent months). These exports are up 50.4% from their 2009 low, based on 12-month sums, and 84.9% based on actual monthly data. US exports to all regions except the “Old World” economies of Japan and Europe were little changed at 73.3% of total exports, up from a recent low of 69.6% at the start of 2009.

IV) FOCUS ON S&P 500 TRANSPORTATION (link): The stock price index for the overweight-rated S&P 500 Transportation Composite is up 4.4% ytd--after a barely perceptible decline of 0.3% in 2011. Its recent gains put the index just 4.5% below its record high in July. Forward earnings hit a record high in January as analysts raised the
consensus earnings forecasts for 2012 and 2013. The forward P/E of 14.0 is up from a three-year low of 12.0 in September, but this industry’s 14% premium remains close to September’s three-year low of 13%. NERI jumped back into positive territory in January for the first time in five months--rising to 10.8% from a three-year low of -20.4% in October. NERI has been in positive territory for 24 of the past 28 months, and should remain strong amid diminishing worries about slower economic growth in 2012.

* **Air Freight & Logistics** *(link)*: The stock price index for overweight-rated Air Freight & Logistics is up 5.6% ytd--making a round trip after having fallen by the very same 5.6% in 2011. Despite its recent comeback, however, the index remains 11.2% below the record high in May 2006. Forward earnings rose 1.0% m/m in January to a record high. Analysts expect annual earnings growth of 13% in 2012 and 13% in 2013, just two-thirds of the 21% growth reported in 2011. The P/E ratio was up to 15.5 in early February from a 32-month low of 13.5 in September, but the industry’s premium to the market of 26% continues to move downward and is near a three-year low. NERI was negative in January for a sixth straight month following two years of positive readings through August, but improved to -3.2% from -18.0% in December. We expect NERI will turn positive again relatively soon.

* **Railroads** *(link)*: The stock price index for overweight-rated Railroads industry is up 3.4% ytd after rising 10.5% in 2011. It now stands just 4.3% below its record high in July. Forward earnings rose 2.0% m/m in January to a record high as analysts increased their annual earnings forecasts for 2012. Analysts expect earnings growth of 16% in 2012 and 14% in 2013, down by a third from the 25% reported in 2011. The P/E ratio of 12.8 is up from the 30-month low of 10.6 in September, and Railroads’ premium to the market of 4% is up from a 2% discount in September. NERI staged a remarkable improvement in January--surging to a 12-month high of 27.8% from 0.4% in December--and is now up from a 21-month low of -12.5% in November. NERI has been positive in 21 of the past 23 months--the best among the Transport industries.

V) LINKS: Questions, comments, problems: requests@yardeni.com or call 480-664-1333.

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