Market Update – The Rearview & the Road Ahead

Demand Levels & Outlook

Overview of Tariff Impacts on Downstream Industries

Recent developments in U.S. trade policy, particularly the introduction of tariffs on steel and aluminum, have significant implications for freight demand across various industries. By analyzing the 2017 input-output accounts, we can assess the industries most exposed to cost increases due to these tariffs.

Inflationary Pressures from Tariffs

The economic dynamics of tariffs indicate a direct inflationary impact on manufacturers and, consequently, on the freight sector.

- **Aluminum:** The U.S. imports ~47% of its aluminum, mostly from Canada. Tariffs will increase costs, prompting both importers and domestic producers to raise prices.
- **Steel:** Only ~13% of U.S. steel is imported, yet past behavior (e.g., 2018 tariffs) suggests that domestic mills will follow suit by raising prices.

Implications for Freight Demand

As tariffs increase costs for key industries, freight demand could face mixed effects. Higher costs for manufacturers could slow production, reducing freight volume in affected sectors. Companies seeking lower-cost alternatives may increase imports of finished goods, leading to shifts in freight demand toward intermodal and port-related transportation. The need for raw materials could rise domestically, leading to increased demand for bulk trucking and rail transport.

Behavioral Economics & Price Pass-Through

Firms affected by tariffs are likely to pass costs onto consumers. Research from behavioral economics supports this expectation:

- When external cost shocks occur, businesses justify price increases to maintain reference profit margins.
- Historical data from the 2018-2019 tariff period shows nearly full cost pass-through to consumers.
- The washing machine tariff case demonstrated that firms not only raised prices on tariffed items but also on related non-tariffed products (e.g., dryers), exacerbating inflation.

Some argue a stronger U.S. dollar will offset tariff impacts. However, this only holds when transactions are made in a foreign currency, which is not the case for many raw material imports.

Energy Infrastructure Investment & Freight Opportunities

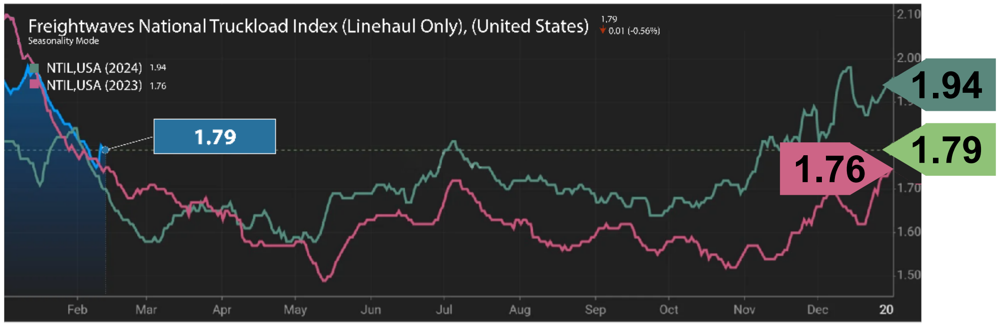
The demand for freight related to energy infrastructure is rising. Data from the Bureau of Economic Analysis on inflation-adjusted private fixed investment in electric power generation structures highlights this trend:

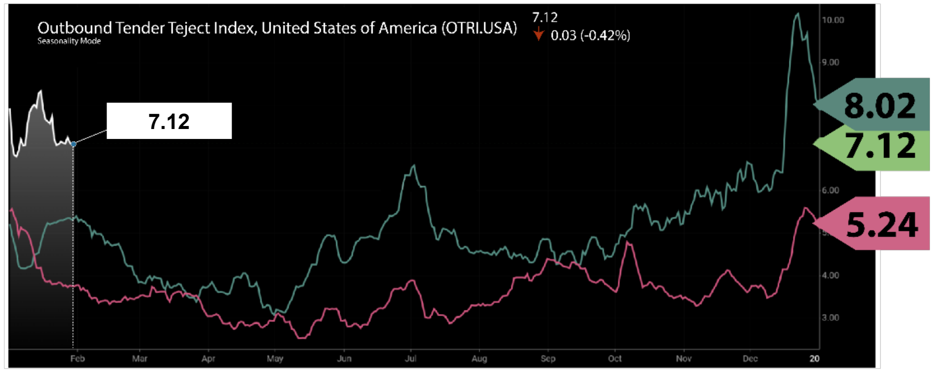
Renewable Energy Investment

- Investment in wind, solar, dry-waste, and geothermal power has doubled since 2019 and quadrupled since 2013.
- Growth began in 2019-2020, suggesting the transition between presidential administrations was not the sole driver.

Traditional Energy Investment

- Investment in coal, natural gas, and other non-renewable power sources has declined 10% from 2019 levels.
- The 2015-2016 surge in investment was driven by increased natural gas plant construction due to fracking.





Source: FreightWaves

Supply, Capacity & Carrier Operating Costs

Reefer Market: Seasonal Tightening in Florida

Plant City Rolls Out the Red Carpet

The Florida Strawberry Festival (February 27 - March 9) marks a crucial period when reefer capacity begins to tighten, with Florida shipping approximately 5,000 refrigerated truckloads of strawberries over eight weeks. This translates to 650 loads per week, signaling the beginning of broader produce season disruptions that last through May.

Load-to-Truck Ratio & Spot Rates

- Reefer load post volumes are up 6% year-over-year, despite a 12% decline the previous week.
- The reefer LTR currently stands at 8.13, reinforcing market tightness.
- The national reefer spot rate has declined by $0.05/mile in the past week, settling at $1.94/mile. This figure is $0.02/mile lower than last year but still $0.08/mile higher than the long-term Week 7 average ($1.87/mile, excluding pandemic disruptions).

Cross-Border Freight: Laredo Sees Capacity Constraints

Rejection Rates & Trade Uncertainty

Laredo, Texas, the largest U.S.-Mexico freight crossing, has seen rejection rates climb to their highest levels since the pandemic era. The Outbound Tender Reject Index rose from a 3.8% average (October–mid-December) to over 6% in late December and remains elevated.

This increase suggests that market tightening is influenced by more than demand, which has been running 10% higher year-over-year. One potential factor is trade uncertainty, as fluctuating U.S. tariff policies on Mexico drive shippers to accelerate cross-border shipments before potential cost increases.

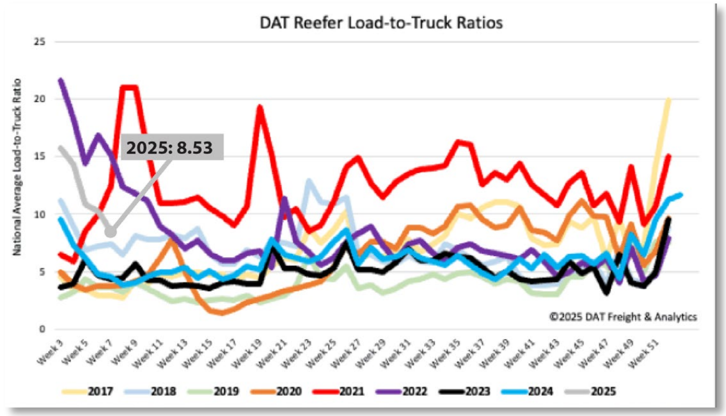
Dry Van Market: Mexicali's Manufacturing Influence

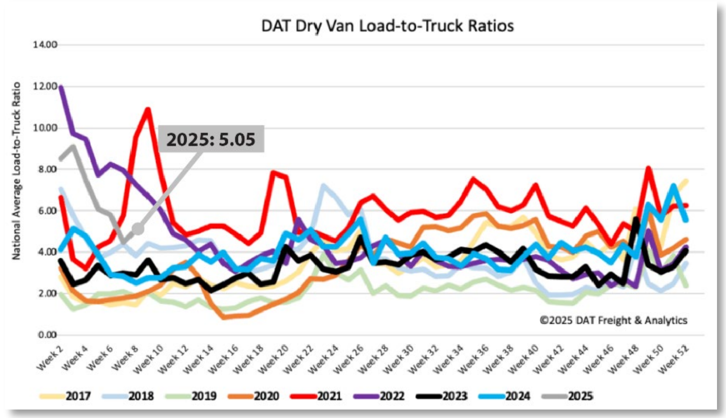
Mexicali's Expanding Role

Mexicali, a major manufacturing hub in Baja California, continues to influence dry van freight flows into the U.S. through California and Arizona. With a growing presence in aerospace, medical devices, and electronics, Mexicali has strengthened its position in cross-border logistics.

Load-to-Truck Ratio & Spot Rates

- Load Post Volumes: Dry van load post volumes are up 11% year-over-year, following a 4% weekly gain.
- Load-to-Truck Ratio (LTR): The dry van LTR is currently 5.05, reflecting moderate capacity constraints.
- Spot Rates: The national 7-day rolling average spot rate decreased by $0.03/mile last week, settling at $1.66/mile. Despite a 5% weekly decline in volumes, dry van rates remain $0.02/mile higher than last year.
- Top 50 Lanes: On DAT's top 50 lanes by volume, the average rate stands at $1.94/mile, still $0.28/mile higher than the national rolling average





Source: DAT

Contract & Spot Market Rate Trends

The Closing Gap: Spot vs. Contract Rates

The gap between dry van truckload contract and spot rates (excluding estimated fuel costs) has narrowed steadily over the past 2.5 years. This trend is driven by gradual capacity reduction and slow yet consistent demand growth, reshaping freight dynamics despite going largely unnoticed by market participants.

Capacity Correction: A Prolonged Reset

The truckload capacity correction has been more prolonged than in past cycles. Following the spring 2022 market collapse, demand for transportation services fell nearly 20% (Feb–May 2022), while spot rates dropped 17%. Excluding fuel cost fluctuations, linehaul rates plunged ~30%, exacerbated by fuel price spikes after Russia's invasion of Ukraine.

Market Rate Evolution

Spot rates typically lead contract rates. When demand exceeds supply, spot rates spike first, followed by contract rate increases in subsequent months as shippers renegotiate. In early 2023, the narrowing of the spot-contract spread was driven by contract rates declining faster than spot rates, rather than spot rates lagging. By May 2023, spot rates appeared to bottom out and began a slow recovery, helping stabilize the freight recession. However, at that point, spot rates remained ~30% lower than contract rates—a significantly wider gap than the 10%-15% difference in 2019, another recessionary period..

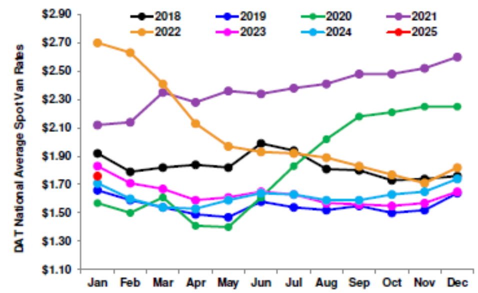
Contract Rates Begin to Rebound

Most contract rate declines happened in 2023, continuing into late 2024 before rebounding slightly. Leading into peak season (Nov–Dec 2024), the spot-contract spread hovered at 16%, compared to 10%-15% in 2019. A key shift in market expectation may be influencing pricing decisions, as stakeholders anticipate tightening capacity.

Market Volatility Looms

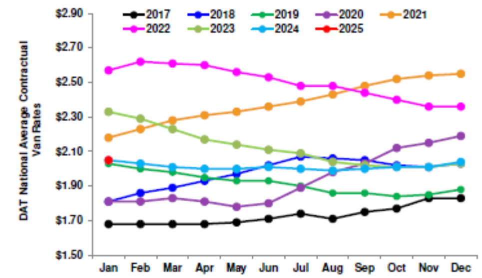
A linear regression model suggests the spot-contract spread won't fully close until August 2026, though carrier leverage could accelerate rate corrections. Carrier exits continue to outpace new entrants, with recent seasonal surges highlighting ongoing supply instability. While some carriers hint at recovery, most remain cautious as rebalancing continues.

Exhibit27: National Average Spot Van Rates ex. Fuel Surcharge



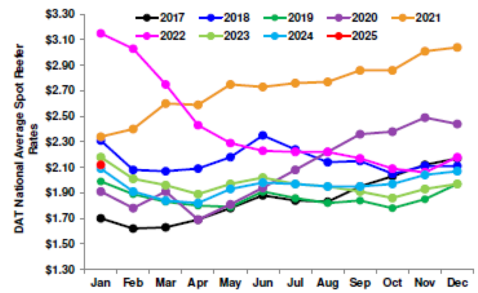
Source: Morgan Stanley Research, DAT Solutions (www.dat.com/resources/trendlines); Note: DAT sources from over $24 B in transactions and 65k lanes.

Exhibit28: National Average Contract Van Rates ex. Fuel Surcharge



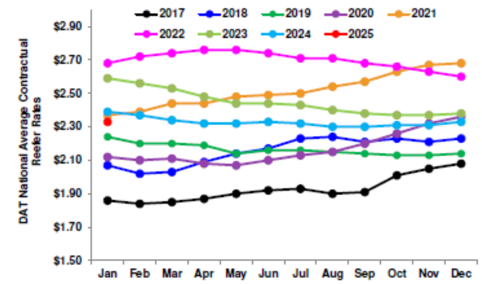
Source: DAT Solutions, Morgan Stanley Research

Exhibit29: National Average Spot Reefer Rates ex. Fuel Surcharge



Source: DAT Solutions, Morgan Stanley Research

Exhibit30: National Average Contract Reefer Rates ex. Fuel Surcharge



Source: DAT Solutions, Morgan Stanley Research

Exhibit31: National Average Spot Flatbed Rates ex. Fuel Surcharge

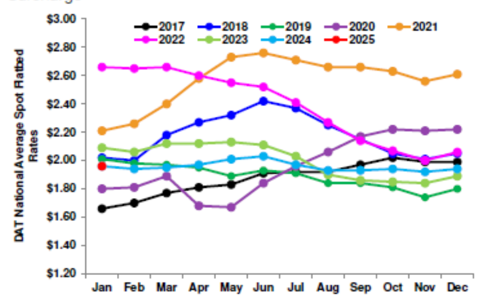
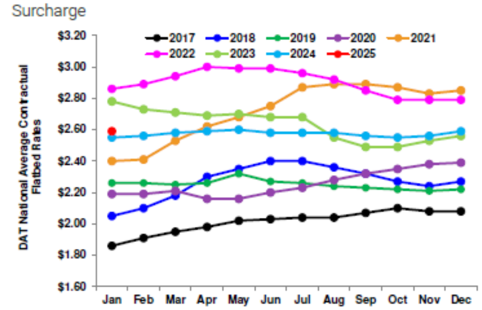


Exhibit32: National Average Contract Flatbed Rates ex. Fuel Surcharge



Source: Morgan Stanley

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