BULL & BEAR BULLETIN

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Are the Transports Flashing a Warning Sign?

As this is being written on August 12, 2015, the Dow Jones Transportation Index is down more than 9% this year, a stark contrast to the 1% gain in the S&P 500 Index and the 2% decline in the Dow Jones Industrial Average. Is this a sign of upcoming economic weakness or just reflective of industry specific weakness?

Over the past eight years, the Transportation Index has been a decent barometer for the general strength of the U.S. economy, with the Index declining during the 2008 recession, preceding the need for the Federal Reserve's "Operation Twist" program in September of 2011, and declining again in the economic weakness leading up to the Fed's QE3 initiation in September of 2012 (Chart 1). The current decline leads many investors to question whether the economy is strong enough to absorb what is deemed to be a pending interest rate hike by the Federal Reserve.

The conclusion of the Federal Reserve's money printing programs and the growing anticipation of an interest rate hike over the past twelve months have contributed to a significant gain in the U.S. dollar versus other major global currencies. The strong dollar has not only affected the global commodity markets but also made U.S. exports more expensive. Until consumers accelerate their purchasing activity, the strong dollar will continue to work against U.S. exports and subsequently the transportation industry.

Another explanation for the weakness in transportation companies is the slowdown among emerging countries. Among the popular BRIC economies, Brazil is contracting by more than 1% year-over-year; Russia's economy is contracting by more than 4%; India's economy remains steady around 5% growth; and China's economy has decelerated to 7% growth, versus a 5-year average of 8%. Using the Morgan Stanley Capital International (MSCI) Emerging Markets GDP Index as an investment proxy for the strength among emerging market economies, there has been a noticeable deceleration since April that is likely weighing on the global transportation industry (Chart 2).

Combining the stronger U.S. dollar and a slower global economic growth, we are starting to see an impact on world trade volume. Global trade volume peaked at the end of 2014 and is now experiencing the most prolonged deceleration since the last recession (Chart 3). While it may be premature to forecast a global recession, the declining global trade is concerning and is definitely a headwind to the transportation industry.

At this point, it appears there are several crosscurrents affecting the Dow Jones Transportation Index. While many of these headwinds can be tied directly to economic weakness, we do not feel the transportation industry is indicative of a forthcoming recession due to the level of accommodation by central banks around the world and the lack of significant economic oversupply within the global economy. However, we do feel that consumer spending will need to accelerate to offset some of these headwinds and to prevent a softening of the U.S. economy.

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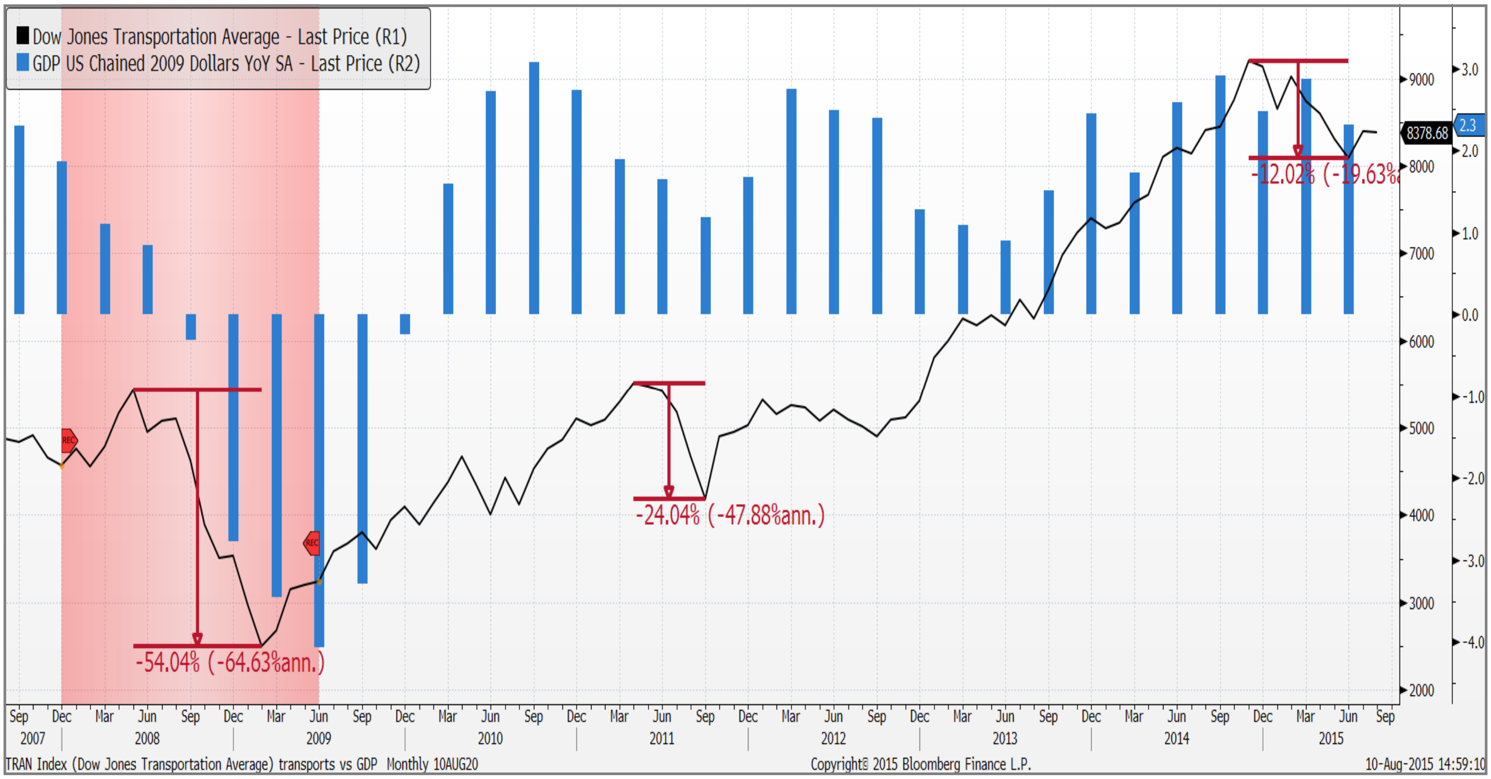

Chart 1

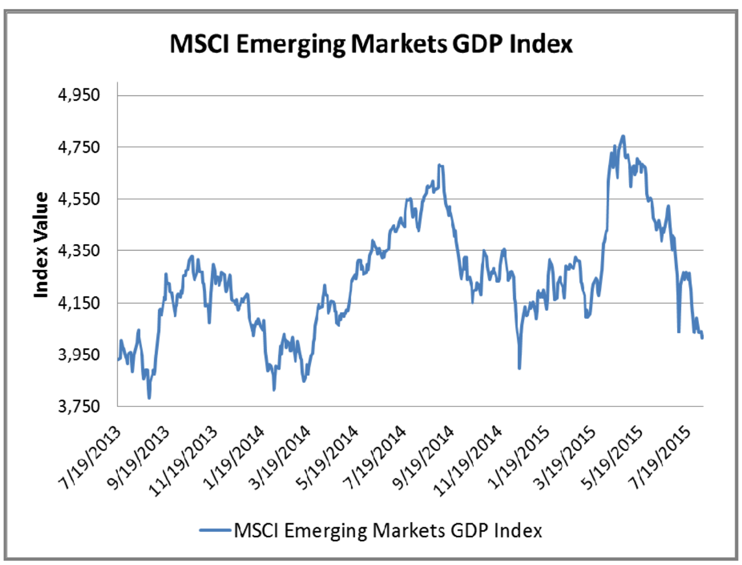

Chart 2

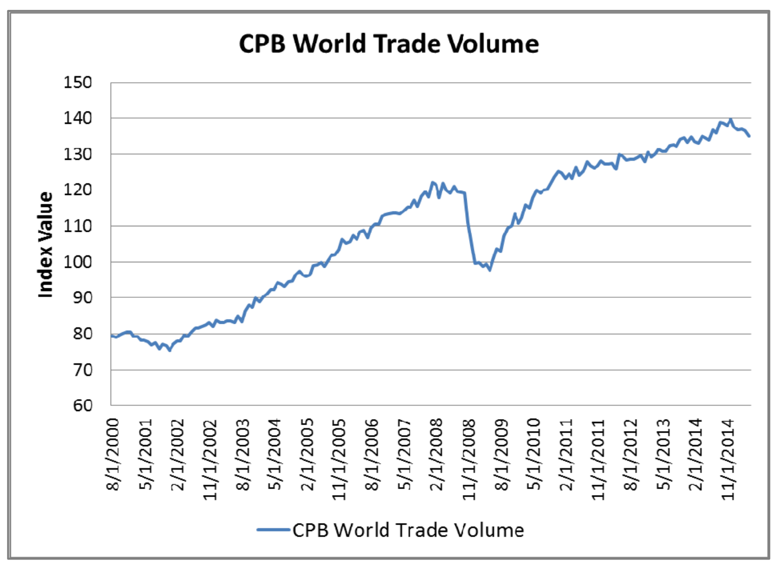

Chart 3

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