Transports' Fuel On The Bill

"If capitalists had been present at Kitty Hawk when the Wright brothers' plane first took off, they should have shot it down." – Warren Buffett

Get into your time machine and head back to those halcyon days of the Pleistocene to explain to our cave-dwelling ancestors how things have gone down since they departed to the Big Mammoth Hunt in the Sky. You might have a hard time explaining a few of our modern industries, but you would have no problem explaining the businesses of transportation companies: You pick something up at Cave A and take it to Cave B. All FedEx and UPS have done is add barcodes and RFID tags.

As movement takes energy and as the prices for all petroleum-based fuels have been hitting records on a daily basis with no end in sight, you might think there is a simple corollary to this simple business: If fuel costs you more, your operating margin and hence your stock price should be reduced. And given the confluence of horrific air travel and airlines dropping like flies with those rising fuel prices, the mental association between those rising fuel prices and death to transports is complete.

Too bad the data do not support this simplistic conclusion. Fuel prices are but one component of the business, and these prices can be and often are passed successfully downstream to customers.

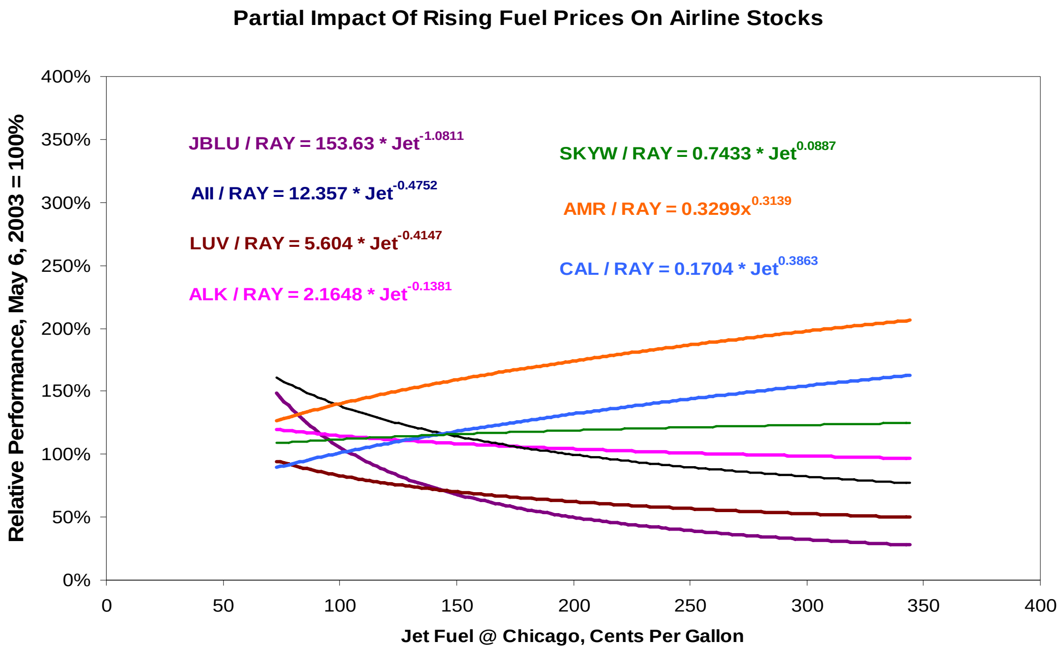
The Tests

Let's take a broad universe of transportation companies and divide them up into the categories of airlines, ocean shippers, railroad, service and logistics firms, delivery firms and truckers and compare their performance relative to the broad Russell 3000 index (RAY, the *Bloomberg* mnemonic, in the charts below) from the Federal Reserve's so-far successful war on deflation commencing May 6, 2003 to the present against various fuel prices.

If the relative performance of the transport stocks is affected negatively by rising fuel prices, we should see a series of downtrends in the scatter charts below. Only the trendlines and the associated equations are displayed below for visual clarity. We must note something about the trends constructed: While we should adhere to the principle of parsimony in data analysis; that is, the simplest model is the best, many of these trends are cubic. The relative performance of the stocks in question is not a linear function or even a geometric function; it is a function of fuel prices taken to the third power. The data have spoken, and it is incumbent upon us to listen.

Airlines

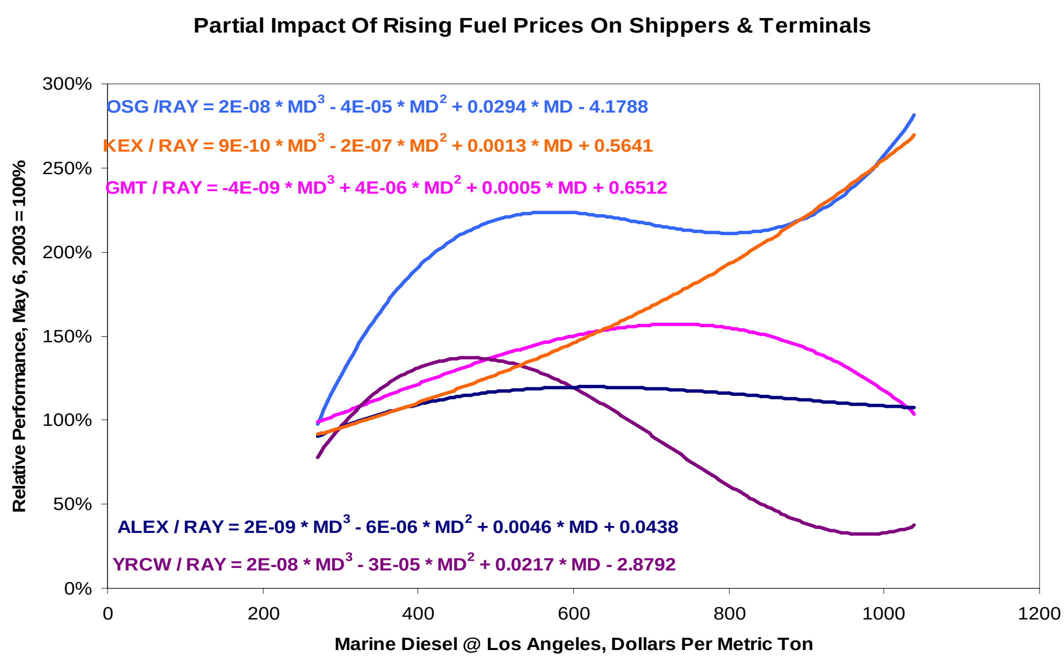
Seven airlines are included, which admittedly biases the sample somewhat as those firms no longer listed or operating under bankruptcy protection are included. Four of the airlines, Jet Blue, AirTran, Southwest and Alaska Air, have negative geometric trends toward fuel prices as measured by jet fuel prices at Chicago O'Hare airport. The inclusion of Southwest, a poster child for successful hedging of jet fuel, is somewhat surprising. Three of the airlines, Skywest, American and Continental, have positive trends.



Ocean Shipping

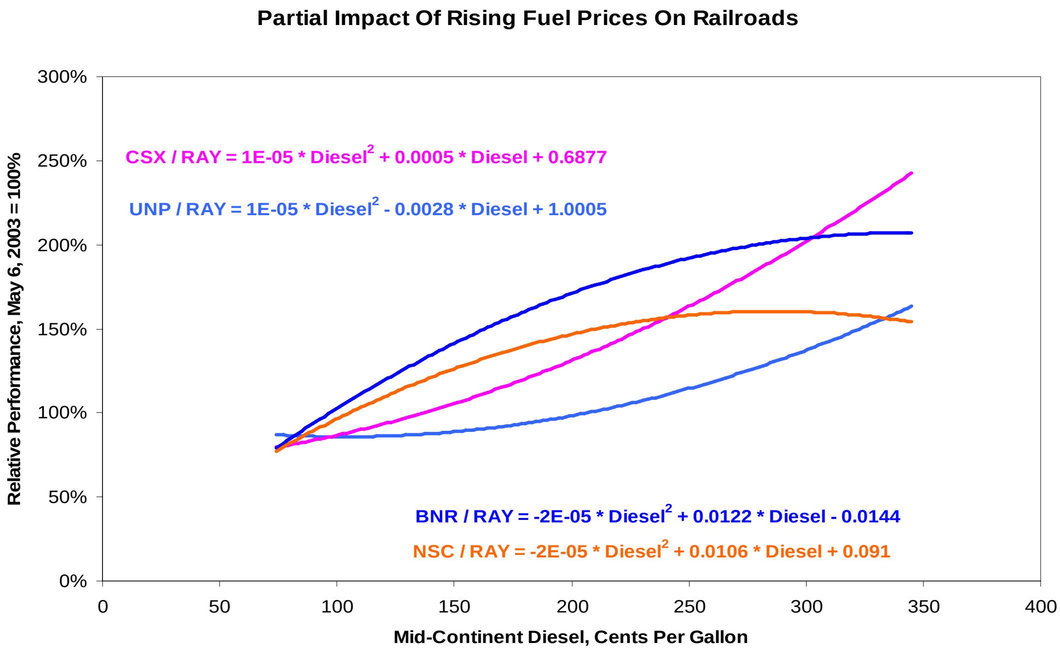
This is a difficult group to assess; much of the world's ocean shipping either is domiciled outside of the U.S. or is held privately. Moreover, many ocean shipping vessels use a heavy residue called Bunker C that tracks crude oil price trends closely for fuel; here we will use marine diesel at Los Angeles instead.

Overseas Shipping and Kirby have been able to shrug off rising fuel prices. Terminal operator GATX' relative stock performance has been flat as a function of rising fuel prices. Only Alexander & Baldwin and YRC Worldwide have seen their relative stock prices sink as a function of rising fuel prices.



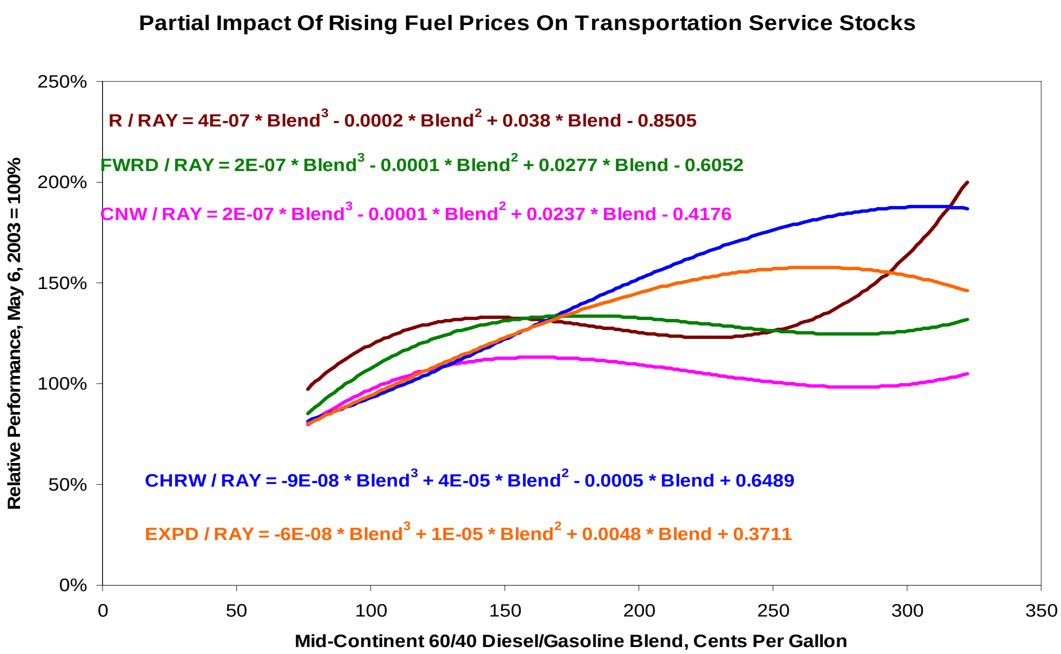
Railroads

We mentioned this group last week in association with coal. Two of the stocks, Union Pacific and CSX, have seen their relative stock performances rise along with mid-continent diesel fuel prices, while both Burlington Northern and Norfolk Southern have seen the opposite.



Service & Logistics

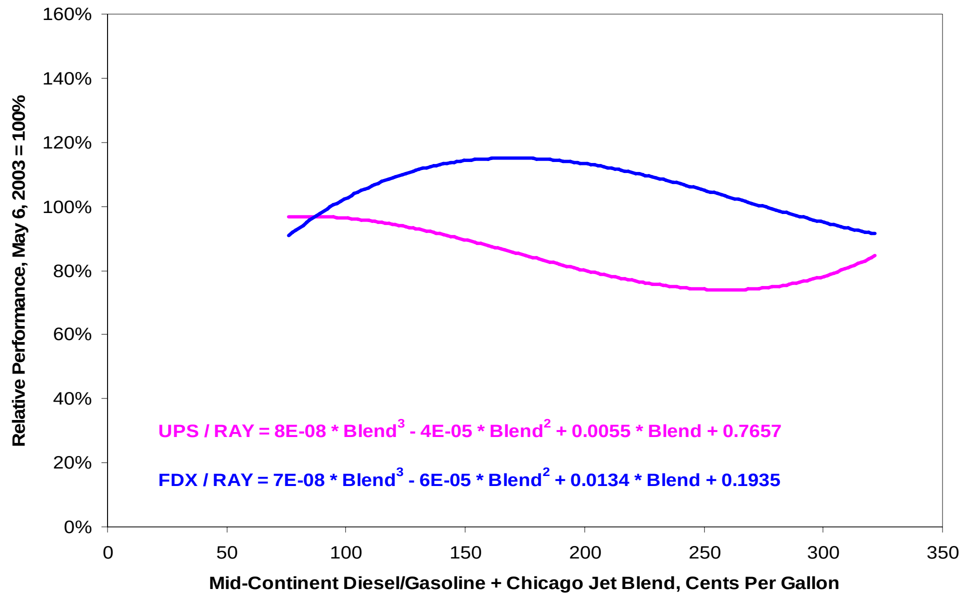
These firms for the most part are a derivative function of fuel demand; they depend on the health of the economy and of fuel-consuming shippers. If we map their relative performance against a 60/40 blend of mid-continent diesel fuel and gasoline, we get one very strong positive correlation, Ryder Systems, and two weaker positive correlations, for Con-Way and Forward Air. C.H. Robinson and Expeditors International have negative correlations.



Delivery

Even though FedEx and UPS often are treated as a pair, their relative performance against a 40/40/20 blend of mid-continent diesel and gasoline and Chicago jet fuel are different. UPS' relative performance has been able to rise along with fuel prices, while FDX' relative performance has declined. As UPS is one of the more economically sensitive firms, and as they were mentioned only two weeks ago as evidence of a U.S. economic slowdown, we should take their ability to pass on higher fuel costs as a positive.

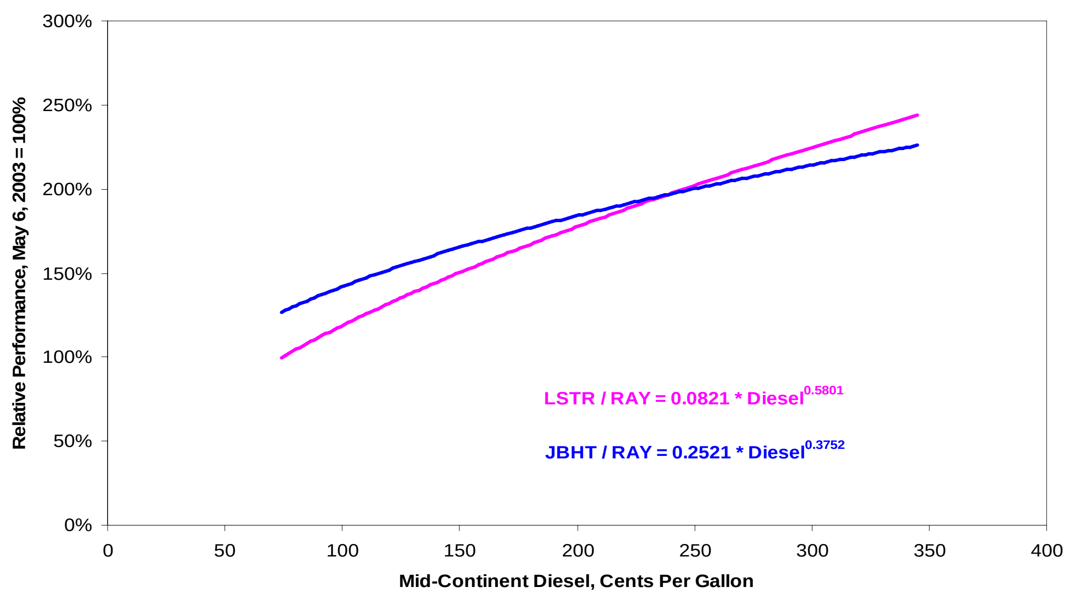
Partial Impact Of Fuel Prices On Delivery Stocks



Trucking

Finally, let's take a look at two trucking firms, J.B. Hunt and Landstar System, as a function of mid-continent diesel fuel prices. This is an eye-opener: Both firms' relative performance has increased as a geometric function of fuel prices. As in the case of UPS, we can use their ability to pass on rising fuel costs as prima facie evidence of economic strength.

Partial Impact Of Fuel Prices On Trucking Stocks



What is striking about the above analysis is what we did not see, and this is a series of negative trends in relative performance as a function of rising fuel prices. U.S. transportation firms – and yes, I am aware of the survivor bias in this statement – have been able to pass their costs along to their customers in an economy that has weakened but has not collapsed.

This may not always be the case; if global fuel demands continue to rise, we very well may see the combination of a weak U.S. economy with rising fuel prices in the future, and transportation stocks no doubt would collapse in such a scenario. But ours is not to speculate on the future, merely to point out that once again a connection so simple a caveman could understand it is wrong.