BESSEMER TRUST

Quarterly Investment Perspective

Keep On Truckin'

Rebecca Patterson, Chief Investment Officer

For many Americans, summer means hitting the road, and this year is proving no exception. The 2015 summer driving season started with a bang as Memorial Day weekend traffic reached its highest level in a decade. Gasoline prices, around the lowest level in six years, should ensure that road trips continue en masse through Labor Day in early September.

Whether heading to the mountains, a favorite town, or the seaside, summer driving also means encountering some of the 3.5 million professional truck drivers across the country. Next time you pass an 18-wheeler (and for some, fondly remember CB radios and 8-track tapes), consider this: trucking today remains one of the most illustrative sectors of the U.S. economy. Nearly every consumer good in the U.S. is put on a truck at some point.

At Bessemer Trust, we take a holistic approach to investing. We look at "top-down" macroeconomic and policy trends, but equally consider "bottom-up" micro-level issues. In this *Quarterly Investment Perspective*, we focus on the micro — specifically, what trucking can teach us about aspects of the U.S. economy, from inflation and technology to regulation and energy. Bigger picture, trucking today is signaling that the U.S. has moderate but clearly positive growth momentum. Considered alongside other indicators, that micro insight strengthens our conviction to be overweight equities in client portfolios.

Trucking 101: How Full Is Your Load?

While it might be tempting to consider all trucks as one category, there are some key distinctions within the industry. Perhaps most important, trucking is broken down into two main categories: "Less Than Truck Load" (LTL) carriers and Truck Load (TL) carriers (Exhibit 1).

Exhibit 1: Trucking 101 — LTL vs. TL

Truck Delivery	Goods Carried	Other Considerations
LTL (Less than truck load)	Mainly industrial; raw materials	Often unionized; drivers can go home at night
TL (Truck load, full load)	Mainly retail	Relatively greater driver shortage; less unionized

Source: Bessemer Trust

- **LTL drivers carry a variety of goods, but are tilted more toward industrial and manufactured products.** Drivers often go home at night, picking up and delivering loads during the day. They are often unionized and represent a smaller segment of the broader trucking market.
- **TL is more often associated with retail goods and can provide a clearer reflection of U.S. consumer trends.** TL carriers are more often what we see heading across the country, away from home for days or even weeks at a time. These drivers are more likely to fill a whole truck from a single customer and take everything from point A to point B — for instance, a truck full of hammers from a Home Depot distribution center to a store.

Beyond types of trucks, it is worth noting how incredibly fragmented this industry is. Trucking comprises "private carriers" (trucking fleets owned by a company), "for hire" carriers, and other types of carriers (the latter including owner-operators).

More than 90% of carriers operate fleets of six or fewer trucks according to the American Trucking Associations (ATA); the top 10 carriers have less than 10% of the overall market. Mom-and-pop firms (more prevalent in TL) are common in part because of low barriers to entry: to get started in trucking you effectively just need a vehicle, a licensed driver, and fuel.

Looking for a Job? Drive a Truck, Good Buddy

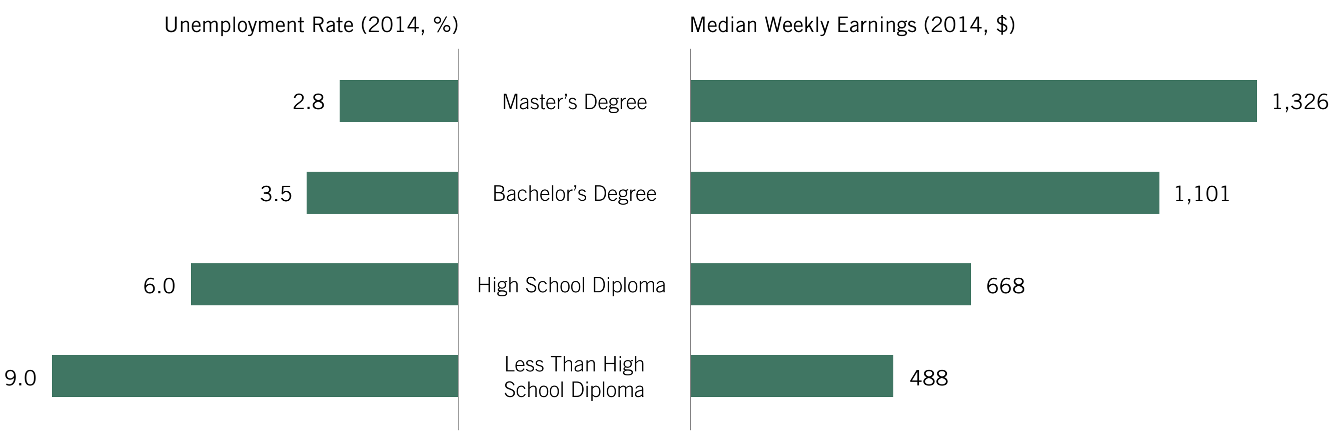
Since the 2008-2009 Great Recession, policy-makers have increased their focus on the decline of blue-collar, middle-class jobs in America and what this trend could mean for social and economic mobility, and indirectly the health of the broader economy. Technology and off-shoring have contributed to a reduction in American blue-collar jobs, which often do not require a college education. As of 2014, the unemployment rate for a high school graduate in the U.S. was 6% versus less than 3% for those with a master's degree. Those high school grads who have secured jobs have struggled on pay: the median weekly earnings for a high school graduate last year were $668 — less than half the median weekly earnings for those with a master's (Exhibit 2).

Especially given these trends, the large shortage of U.S. truck drivers is surprising. According to a May 2015 *Journal of Commerce* report, the industry is short by more than 35,000 drivers. Industry groups suggest the shortfall could increase a lot more in years to come, especially if the U.S. economy continues to recover.

Why don't more Americans want to hit the open road as a profession? Interviews with trucking companies cite increased safety regulations (including more stringent drug testing for truck drivers), an aging population reducing the pool of available driving candidates, and changing roles for men and women in households (fewer families want one spouse away for days or weeks at a time, even if technology makes staying in touch easier). Indeed, many former truckers appear to have switched over the last decade or so into construction-related jobs, which often allow them better work-life balances.

Trucking companies are looking to make driving a more attractive career option. More technology is being incorporated into trucks, and pay is rising. Heavy-truck drivers saw their overall average annual wages in 2014 rise by 2.4%, versus

Exhibit 2: Earnings and Unemployment Rates by Education



As of April 2, 2015.
Source: U.S. Bureau of Labor Statistics

1.7% for the average U.S. worker, according to the Bureau of Labor Statistics. (Other reports suggest much higher wage increases for specific trucking segments.)

While this driver shortage is interesting from a social perspective, the economics drive the issue home more forcefully. According to industry research, trucks move nearly 70% of all U.S. inland freight. Companies without sufficient drivers have to accept slower delivery times or have to pay more for faster air shipping: either option can cut into company earnings. In extreme cases when delivery chains are hurt, pain spreads beyond corporate profits to overall economic growth (recall the first quarter this year when West Coast ports were shut down, preventing the delivery of goods across the country).

Trucking and Technology: Driver-less Trucks?

If Americans don't want trucking careers, can technology provide a solution? Automated trucks are already in operation. While so far they are used in remote areas and controlled roadways (like mines in rural Australia), the future may look very different. Just this past May, Daimler AG announced that it had acquired a license by the state of Nevada to test self-driving trucks on public U.S. roads.

Driverless trucks could bring notable benefits, including greater fuel efficiency, emissions reductions, fewer driver-related accidents, and lower maintenance costs. That said, fears around what could happen to a driverless 18-wheeler are not insignificant. Politics, regulations, and psychology as much as anything are likely to mean that broad usage of fully automated trucks in the U.S. is at least a decade away. With this in mind, we expect that driver shortages will remain an unsolved challenge for some time.

That's not to say that trucking and technology will not continue to cross paths. Already for the last five years, U.S. roads have had trucks with advanced driver-assistance systems. The trucking industry is also actively exploring the potential use of "platooning," where two or more vehicles use electronic signals to maintain distances between them; they accelerate and brake simultaneously, based on the lead vehicle's actions. Platooning could improve aerodynamics and fuel efficiency, and possibly reduce accidents and maintenance costs. With at least a lead driver involved, it could see roll-out sooner.

The industry also is exploring on-demand trucks — an "Uber" of sorts for trucking, where shippers can find an available truck "just in time." LTL carriers in particular stand to benefit from on-demand trucking, as current practices suffer from inefficient load management. According to the ATA, the industry spends, on average, $16 billion per year to move empty trucks (empty return loads are called "deadheads"). The longer a truck waits to be filled, the higher the cost of maintaining it — or put another way, the longer it takes for the operator to turn a profit. Currently, brokers often serve to connect trucks with shippers, collecting a commission in the process. An Uber-like app that can directly connect shippers with trucks could reduce costs (fewer brokers needed) and potentially reduce costly "deadhead" truck time.

Trucking and Consumer Demand: "Deliver It Today, Please"

Getting around New York City, where Bessemer has its headquarters, increasingly feels like an obstacle course, as with many other places in the U.S. This is in part because of all the delivery trucks and vehicles double- and sometimes triple-parked to get goods delivered "just in time."

Certainly, online commerce is growing at a rapid clip — the U.S. Census Bureau reported e-commerce sales reaching nearly $304.9 billion in 2014, up 15.4% from the year before and versus a 3.8% year-on-year increase in overall U.S. retail sales. The National Retail Federation listed Amazon.com, Inc.

as the ninth-largest retailer in the U.S. in 2013; the e-commerce firm had no storefronts while the No. 8 retailer, Lowe's Inc., had 1,717 stores, and retailer Wal-Mart had 4,779 stores.

How does online retail and rapid delivery impact trucking? Despite what the urban obstacle courses might lead you to believe, the answer for now is "not much." Instead, online shopping has simply changed how and where trucks fit in the delivery chain.

Broadly speaking, most U.S. goods transportation is intermodal — that is, more than one mode of transportation is used to get merchandise from A to B (trucks are almost always part of the delivery chain). Looking at the U.S., rail is often used for long distances, focused relatively more on industrial goods and raw materials. Rail tends to see greater volume when energy prices are high (making trucking and air options more costly). For shorter distances and when energy prices are relatively lower, trucks are more frequently used. Air is usually focused on urgent deliveries. Taken together (plus marine transport), the Dow Jones Transportation Average is one of the oldest U.S. stock indices still in use.

In the old world with brick-and-mortar shops, trucks would be used to drive goods from distribution centers to retail outlets. Consumers would purchase goods at these outlets and take them home. Today, more trucks are driving from distribution centers to consumers' homes (or other endpoints) directly. Retail trucking volumes are well supported, but efficiencies are often hurt as trucks have more "stops." As a result, profit margins for delivery services can come under pressure. In addition, peak shopping seasons (year-end holidays) can stress truck capacity and require firms to bolster fleets to meet "surges" as more consumers expect overnight or otherwise short-term deliveries. Bottom line: Online retailing may have helped certain corners of the delivery market, but it has not benefited trucking more generally.

Lifting the Hood of the Dow Transports

The Dow Jones Transportation Average, with 20 U.S. transportation companies, including trucking, rail, air, and marine, was created in the 1880s and is still widely followed today. Investors over the years have believed that the Dow Transports would lead the broader stock market, on the assumption that more firms and people ship more goods when the economy is doing well, and vice versa. Over the years, the Dow Jones Industrial Average and the Transports index have had a strongly positive relationship. That said, we would caution against overstating the relationship, as many factors impact these individual companies and transport sub-sectors at different moments. Indeed, trucking by itself has been a much more robust, leading indicator of the U.S. economy than the Dow Transports as a group.

Trucking and the U.S. Economy: Are We "10-4"?

Trucking's golden period in the U.S. may have been the late 1970s and early 1980s: truck-focused movies like *Smokey and the Bandit* were smash hits, and songs like "Convoy" reached number one on country and pop charts. Many non-truckers saw CB radios as fashionable: "10-4" was CB slang for "everything is okay; affirmative."

Even decades later, with truckers (and trucking movies) harder to come by, the industry tells us a lot about the broader U.S. economy (Exhibit 3).

Exhibit 3: Trucking as a Macroeconomic Indicator

Truck Indicator	Economic Signal
LTL Activity	Still soft, suggesting sluggish industrial/ manufactured goods and/or raw material-related activity
TL Activity	Modestly improving in recent months, suggesting greater consumer activity
Overall Trucking Sentiment	Steady in recent weeks (in part tied to inventory overhangs) but holding well over 50, suggesting expanding trucking sentiment and, in turn, improving broad-based U.S. business sentiment

Source: Bessemer Trust

Trucking shows a gradually strengthening consumer. Consider TL versus LTL activity. As noted earlier, TL trucks tend to carry more retail goods, while LTL trucks have a broader array of merchandise, leaning more towards manufacturing and industrial goods as well as raw materials. With that in mind, it's perhaps not surprising what occurred in 2002-2008: as the U.S. economy experienced several years of above-trend growth and the consumer was strong, TL activity (i.e., retail deliveries) was more robust than LTL. Conversely, over the last five years, as U.S. energy production dramatically ramped up and the U.S. consumer was slow to recover, LTL was much more active than TL. In other words, trucking can help tell you what part of the economy is leading or lagging. Interestingly, in recent months, data have suggested that TL (retail) trucking has been improving. All else equal, this is an encouraging sign for the U.S. consumer.

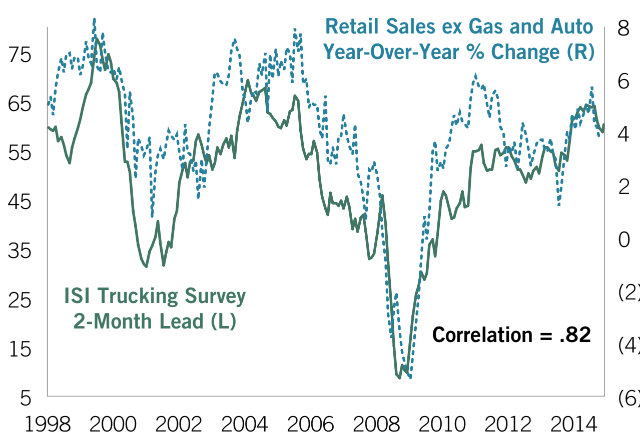
Trucking suggests some short-term inventory overhang. Another notable economic insight from trucking relates to routes. When stores see increased demand and want to stock shelves, trucking activity will often accelerate between ports and distribution centers and from distribution centers to stores. However, when inventories are already high, truck volumes will **not** increase as much between ports and distribution centers.

Inventory adjustments impact broader GDP trends. Rising inventories will add to GDP growth, while excess inventories suggest a future drag on growth. The first quarter of 2015 saw a rise in inventories. While that helped an otherwise abysmal GDP in Q1, it is less likely to continue helping in the second quarter, at least at the same pace. That means for the broader economy, other factors such as net exports or final sales will need to provide an offset to keep GDP growth moving in the right direction.

Trucking is often a leading economic indicator. Trucking can tell us where the broader U.S. economy is likely headed. It's amazing that today — even with the differences in the world from the CB-radio days of the 1970s — trucks provide one of the best micro-economic reads of the U.S. economy. We reached out to Evercore ISI, a research firm which kindly shared historical data from a bottom-up regular survey it conducts on the trucking industry. In the survey, Evercore ISI asked U.S. trucking firms to report weekly revenues excluding fuel surcharges. The trucking firms report results on a 0-100 scale, where 50 equals trend growth.

Going back to the 1990s, this trucking survey has had a strong, consistent relationship with one of the most important economic indicators for the U.S. economy — retail sales. Indeed, the trucking survey leads retail sales by two months with a .82 correlation (Exhibit 4). Retail sales is a key component of consumption which represents 69% of U.S. GDP. The historical picture suggests that, even today, trucking can provide an even more leading indicator for the U.S. Right now, these trucking data suggest a bumpy but still-improving trend for consumption (with the trucking survey indicating growth as of mid-June 2015).

Exhibit 4: ISI Trucking Survey and Retail Sales ex Gas and Auto



As of April 2015.
Source: Evercore ISI, U.S. Census Bureau

From Trucks to Portfolios

We can incorporate our trucking insights with other data points that we consider critical in order to have a more thoughtful view on the U.S. economy. Strengthening U.S. labor and housing markets, alongside rising wages, reinforce the trucking message — the U.S. is continuing to slowly recover. We see a Federal Reserve hungry to start normalizing monetary policy but comfortable moving slowly thereafter. That suggests borrowing costs for companies and households will stay low for some time.

Altogether, we remain constructive on U.S. growth and believe that while U.S. large-cap equities have lagged year-to-date versus some other peers (Europe, Japan, and China in particular), they could play "catch up" to a degree in the months ahead. We have reduced our U.S. equity exposure in recent months, but still have a modest overweight. We are currently neutral on Euro-area equities and slightly overweight Japanese stocks. We continue to express a bullish U.S. dollar view in portfolios, in part via equity hedges.

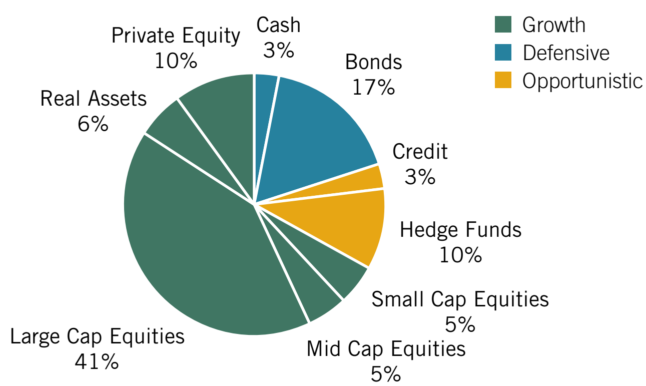
Meanwhile, given our view on the Fed, we remain significantly underweight traditional fixed income. For defensive assets and a better total return, we prefer selective credit investments, including those with floating interest rates such as non-agency mortgage-backed securities, and for appropriate clients, using low-volatility hedge funds as a complement to a small fixed-income allocation.

Overall, we remain cautious on emerging markets. Our equity mandates take a country-by-country, as well as a company-specific approach. In a period in which the Fed may finally tighten and the dollar is still rising, emerging markets will continue to face common external headwinds, making narrower selection even more critical. Our main emerging equity exposure currently is in Asia, although outside mainland China.

We are taking an equally selective approach to commodities today: potentially rising U.S. interest rates and a stronger dollar, historically, have not boded well for commodities such as gold. At the same time, though, further stimulus and stabilized growth in China, together with improving growth across some developed markets, could provide a measure of demand support for the asset class more broadly (Exhibit 5).

Exhibit 5: Bessemer's Outlook and Positioning

Asset Class	Outlook
Traditional Government Bonds	↓
Credit	↔
Commodities	↓ ↔
Developed Market Equities	↑
Emerging Market Equities and Debt	↓
U.S. Dollar	↑



Outlook as of June 30, 2015; positioning as of June 11, 2015.
This model displays Bessemer's Balanced Growth with Hedge Funds and Private Assets exposure with target portfolio allocation guidelines. Each client situation is unique and may be subject to special circumstances, including but not limited to greater or less risk tolerance, classes, and concentrations of assets not managed by Bessemer, investment limitations imposed under applicable governing documents and other limitations, that may require adjustments to the suggested allocations. Model asset allocation guidelines may be adjusted from time to time on the basis of the foregoing or other factors. Alternative investments, including Bessemer private equity, real assets, and hedge funds of funds, are not suitable for all clients and are available only to qualified investors.

A Word on Performance

As the first half of the year draws to a close, our positioning has generally benefitted Bessemer clients. Preliminary estimates indicate that our Balanced Growth Portfolio, with a roughly 70% global equity and 30% U.S. fixed income risk profile, returned 2.4% in the first six months of 2015, in-line with the index benchmark. Complete and final data as of May 31, 2015 shows this portfolio is beating its benchmark on a 1-, 3- and 10-year basis. This year, the main supports for our performance have come from both security selection, especially in large-cap equity and the Strategic Opportunities mandates, as well as from top-down, macroeconomic tilts.

We know there are always things we could do better. We were slow to add Euro-area and Japan-equity exposure this year and have been underweight mainland Chinese and Russian equities at a time when those markets have displayed exceptional (and frankly surprising) performance. Being underweight energy equities in the second quarter also hurt us versus our benchmark at the margin.

At Bessemer, our goal is to earn the best return we can without taking undue risk. That requires us always to be looking at the world and at individual securities, from as many perspectives as possible. The big picture is important, but so too is looking under the hood — including truck hoods.

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