August 2014

U.S. Equipment & Software Investment Momentum Monitor

CONTACT INFORMATION:

Kelli Nienaber, Executive Director
Equipment Leasing & Finance Foundation
knienaber@elfaonline.org
www.leasefoundation.org

Adam Karson, Senior Director
Keybridge LLC
akarson@keybridgedc.com
www.keybridgedc.com
About the U.S. Equipment & Software Investment Momentum Monitor

Business leaders require actionable forward-looking intelligence to make strategic decisions. Accordingly, the Equipment Leasing & Finance Foundation commissioned Keybridge LLC to develop a series of custom leading indicators for the equipment sector. Published monthly, the “U.S. Equipment & Software Investment Momentum Monitor” consists of indices for the 12 equipment and software investment verticals listed below. These indices are designed to identify turning points in their respective investment cycles with a 3 to 6 month lead time.

The Momentum Monitor is based on Keybridge’s extensive research which shows that not all movements in economic data are reliable signals of future economic trends. Keybridge has operationalized its research by constructing indices, each comprised of between 10 to 20 high-frequency indicators. These indicators undergo rigorous testing to determine the optimal thresholds at which their short-term fluctuations are economically meaningful. In simpler terms, the Momentum Monitor sifts out the “noise” in the data and identifies the dominant trends. As a result, each Momentum Monitor index is statistically optimized to signal turning points in the investment cycle without giving false readings of shifts in momentum.

The Momentum Monitor covers 12 equipment and software verticals as defined by the U.S. Department of Commerce Bureau of Economic Analysis.

U.S. Equipment & Software Investment Momentum Monitor – 12 Verticals

1) Agriculture machinery 7) Aircraft
2) Construction machinery 8) Ships and boats
3) Materials handling equipment 9) Railroad equipment
4) All other industrial equipment 10) Trucks
5) Medical equipment 11) Computers
6) Mining & oilfield machinery 12) Software
How to Read the Monitor

Each Momentum Monitor index provides a signal of the direction and magnitude of growth in equipment investment over the next 3 to 6 months. It is important to note that index values do not correspond to particular growth rates. Instead, the Momentum Monitor indices should be interpreted within the context of prior index readings and investment growth rates. For example, there are several simple rules to follow when examining the latest index values:

1) A rising index signals that growth in investment will accelerate from the current rate;
2) A falling index signals that growth in investment will decelerate from the current rate; and
3) No change in the index signals no meaningful change from the current growth rate.

To help the reader interpret the latest Momentum Monitor signals, a summary report for each equipment vertical follows a specific outline:

1) The first sentence reports the latest growth rate for investment in a given vertical. This provides a context for interpreting the order of magnitude of growth over the next 3 to 6 months.
2) The second sentence explains the latest movement in the index, indicating whether momentum is accelerating or decelerating.
3) The report then describes the specific indicators driving the latest index value. This allows readers to understand the key drivers of the outlook.
4) Finally, the report ends with an interpretation of where investment growth is heading over the next 3 to 6 months.
The Equipment Vertical Heat Map summarizes the latest movements in each of the 12 Equipment & Software Investment Momentum Monitors. Verticals exhibiting strong recent momentum are shaded darker, while verticals exhibiting weak recent momentum are shaded lighter. The heat map provides a snapshot of the expected trends in equipment & software investment over the next 3 to 6 months. Note that trends in equipment financing activity may differ from overall investment volumes. The legend to the right provides an interpretation of the heat map color-coding.
**Agriculture Machinery:**
Investment in Agriculture Machinery increased at an annualized rate of 67.7% in Q1 2014 but is down 10.3% from one year ago. The Agriculture Momentum Index increased from 84.9 (revised) in July to 88.2 in August, its highest position in seven months. Over the past month, Cattle Exports jumped 22.8%, while Broiler Exports posted a strong gain of 11.3% as well. Additionally, Shipments of Farm Machinery rebounded and are up 5.6% year-over-year. Overall, the Index is “less negative” than recent months, but still points to weak investment on a year-over-year basis.

**Construction Machinery:**
Investment in Construction Machinery increased at a 21.7% annualized rate in Q1 2014, yet is still down 6.0% year-over-year due to a base effect from elevated levels in Q1 2013. The Construction Momentum Index decreased from 100.0 (revised) in July to 93.1 in August, an eight-month low. Housing Starts fell 9.3% and Multifamily Housing Permits dropped 13% in June, evidence of an uneven housing recovery. Overall, the Index’s recent movement suggests that growth should temporarily pick up and then moderate again over the next three to six months.

**Materials Handling Equipment:**
Investment in Materials Handling Machinery increased at a 1.8% annualized rate in Q1 2014 and is now up 6.8% year-over-year. The Materials Handling Momentum Index slipped from 96.2 (revised) in July to 95.2 in August. The Chicago Business Barometer plummeted 16%, offsetting increases in both Manufacturing Supplier Deliveries and the ZEW Economic Sentiment Survey. Additionally, Materials Handling Imports declined 2.7%. Despite the slight decline, the Index continues to signal stronger investment over the next three to six months.

**Other Industrial Equipment:**
Investment in all Other Industrial Equipment rebounded at a 20.5% annualized rate in Q1 2014 and is now up 8.6% year-over-year. The Other Industrial Equipment Momentum Index increased from 89.2 (revised) in July to 92.5 in August, a two-year high. Although the MNI-Chicago Production Index declined sharply, the ISM Manufacturing Index, Shipments, and Money Stock all increased last month. Overall, the Index’s recent movement suggests a slight pick-up in growth over the next three to six months.
Medical Equipment:
Investment in Medical Equipment increased at a 5.4% annualized rate in Q1 2014 and is now up 3.9% year-over-year. The Medical Equipment Momentum Index decreased from 95.7 (revised) in July to 92.6 in August. Federal Outlays for Medicare plummeted 60.6%, and the CPI for Physicians’ Services also dropped sharply. However, Federal Outlays for Health and Social Security Disability Benefits both increased last month. Overall, the Index suggests that growth in medical equipment investment will level off over the next three to six months.

Mining & Oilfield Machinery:
Investment in Mining & Oilfield Machinery increased at a 7.2% annualized rate in Q1 2014 and is now up 17.1% year-over-year, the fastest growth rate in ten quarters. The Mining & Oilfield Machinery Momentum Index jumped from 90.4 in July to 94.2 in August. Manufacturing Inventories continued to increase, and the ISM Manufacturing Index rose 1.8 points to 57.1. However, both Petroleum Imports and New Orders declined. Overall, the Index continues to suggest that investment will moderate over the next three to six months.

Aircraft:
Investment in Aircraft decreased at a 21.2% annualized rate in Q1 2014, yet remains up 30.2% on a year-over-year basis. The Aircraft Momentum Index increased from 101.5 (revised) in July to 106.1 in August. Positive contributions from Industrial Production, Freight Transportation, New Orders for Aircraft, and Vehicles Miles Traveled offset a negative contribution from Non-Manufacturing New Orders. Overall, the Index suggests that investment in Aircraft will remain at relatively high levels over the next 3 to 6 months.

Ships & Boats:
Investment in Ships & Boats declined at an annualized rate of 7.2% in Q1 2014. Investment is now up 1.7% from one year ago, the slowest annual growth in ten quarters. The Ships & Boats Momentum Index decreased from 95.8 in July to 88.7 in August. Ship & Boat Shipments declined 6.6%, and the Agriculture, Forestry, & Fishery Trade Balance dropped to its lowest level in nearly a year. Lastly, after increasing for three-consecutive months, New Orders decreased 49%. Overall, the Index suggests that growth in investment will remain relatively slow over the next three to six months.
Railroad Equipment:
Investment in Railroad Equipment increased at a 33.3% annualized rate in Q1 2014, yet remains down 4.2% year-over-year. The Railroad Equipment Momentum Index moderated from 117.6 (revised) in July, a nearly four-year high, to 116.2 in August. Machine Tool Orders, Coal Production, and the Change in Nonfarm Employment all pulled down the Index this month, outweighing a boost from the ISM Manufacturing Employment Index. Overall, the Index continues to signal an acceleration in railroad equipment investment over the next three to six months.

Trucks:
Investment in Trucks increased at a 10.7% annualized rate in Q1 2014 and is now up 8.1% year-over-year. The Trucks Momentum Index decreased from 98.5 (revised) in July to 93.9 in August, led by a 9.3% decline in Housing Starts and a 4.4% drop in Coal Production. However, Housing Permits hit a eight-month high, and the ISM Manufacturing Index reached its highest level in over three years. Overall, the Index’s recent movement points to slightly slower growth in truck investment over the next three to six months.

Computers:
Investment in Computers decreased at an annualized rate of 38.7% in Q1 2014 and is down 7.6% on a yearly basis, the sharpest annual rate of decline in over three years. The Computers Momentum Index increased from 80.8 (revised) in July to 83.3 in August. The Index was boosted by Appliance Retail Sales and Industrial Production of Computer and Electrical Components, while Shipments of Defense Communications Equipment declined 21%. Overall, the movement of the Index suggests that the decline in investment may bottom out over the next three to six months.

Software:
Investment in Software increased at a 3.8% annualized rate in Q2 2014 and is now up 4.0% year-over-year. The Software Momentum Index fell from 93.0 in July to 91.5 in August. A 0.5% drop in the Software Publishers PPI was a drag on the Index, and the Richmond Fed Survey on Equipment & Software Spending decreased 2 points. Exports of Travel Services and the ISM Nonmanufacturing Employment Index, however, both continued to increase. Overall, the Index points towards slowing growth over the next three to six months.