Tortoise

Tortoise QuickTake Podcast

July 18, 2017

Welcome to the Tortoise QuickTake podcast. Thank you for joining us. Today, a senior member of Tortoise provides a timely update on trending topics in the market.

Hello and welcome to the Tortoise Credit Strategies weekly podcast. I'm Greg Haendel, one of the Senior Portfolio Managers on the investment team at Tortoise Credit Strategies.

In the 1992 presidential campaign for Bill Clinton, his campaign strategist James Carville coined the phrase "it's the economy, stupid." Carville's original phase was meant for the internal audience of Clinton's campaign workers as one of the three messages to focus on in the campaign. While the slogan was meant for an internal audience only, it became one of a few de facto slogans for the Clinton campaign and has since morphed and is repeated in different variations ever since. Carville's phrase is still relevant today and during the past week when we think about what drove the fixed income markets over a slow summer week; "it's the economy, stupid" and "it's the fed, stupid."

Fed Chairman Janet Yellen delivered her semiannual Humphrey-Hawkins testimony in front of Congress where she struck a modestly dovish tone, in particular as it relates to inflation or lack thereof. Yellen was upbeat on the real economy, noting continued labor market strength, growth in household spending, business fixed investment turning up and improving economic growth abroad. However, with respect to inflation, while Yellen articulated that temporary factors have contributed to the recent inflation slowdown, given the persistent shortfall from the Fed's objective they will continue to watch this closely. Further, Yellen stated that the neutral Fed Funds rate has been held down below historic levels due to factors such as weak growth abroad, dollar strength, low rates of household formation, and weak productivity growth. While some of these factors have dissipated, some remain with us thereby arguing for a lower terminal or neutral Fed Fund rate in our opinion. The market interpreted many of Yellen's comments with a modest dovish tilt while also expecting tapering of quantitative easing to begin this year as a result of the continued strength in the labor markets and desire to move toward some sort of balance sheet normalization. However, many market participants believe that increases in the Fed Funds rate, while priced into market expectations for potentially one more this year, will be more tied to the inflation portion of the Fed's mandate. Again, this distinction, if correct, would put tapering and balance sheet normalization onto more of a set path going forward while multiple increases in short term interest rates through the Fed Funds rate would be much more questionable and data dependent with the medium to longer term inflationary outlook being a primary driver. Regardless, both aspects of monetary policy, tapering and increasing short term interest rates, are contractionary policies which must be balanced carefully and typically have a lagged effect of several months before their impact can be measured in the real economy.

With regard to news on the U.S. economy, the bulk of the market-moving data came near the end of the week with a continuation of soft inflation data as well as less than stellar data on consumer spending. On the inflation front, last Friday's CPI report undershot market expectations for the fourth consecutive month. The headline CPI was reported flat for the month and on a year over year basis slipped to 1.6% from 1.9% May and below the 1.7% forecast while the core CPI (excluding the volatile food and energy components) was up a less than expected 0.1% for the month or 1.7% on a year over year basis. Digging into the details, an increase in owner's equivalent rent prices was more than offset by weakness in lodging, airfare and core goods such as new and used vehicles prices. Meanwhile June retail sales, also came in well below expectations. Total retail sales were down 0.2% in June, while sales in the control group (retail sales excluding autos, gas, and building materials) declined 0.1%. Cell phone data plans, gas station sales, department store sales, and food and beverage sales accounted for some of the notable weakness while online retailing remains strong yet has been decelerating a bit. One of the benefits of a weak CPI print is that each dollar of nominal spending translates into more real spending, and so, even with a decline in nominal sales in the retail control group, we still anticipate a modest increase in real consumer spending, thereby having little impact on real GDP for the quarter.

In summary on the economic front, we will continue to watch the trend in inflation data over the next several months to help determine how transitory the soft patch of inflation data really is and would expect any sustained continuation in below trend inflation to influence the Feds interest rate policy trajectory and not their balance sheet tapering trajectory. Further, we believe the recent softness in the retail sales data is likely short lived and on a positive note is being partially offset by some more encouraging data on industrial production recently.

As a result of the modestly dovish Humphrey-Hawkins testimony as well as the softer inflation and retail sales data, interest rates fell marginally over the week. However, as discussed in recent podcasts, we do continue to expect the longer term trend in interest rates to be higher.

Despite the week being all about the economy and the fed, earnings season started with a small handful of companies already announcing second quarter earnings. While it is too early in earnings season to determine any sort of trend and too few companies have reported, initial earnings reports from the handful of banks that have reported show encouraging signs despite the slowdown in capital markets activities. The coming weeks will be busy as earnings season gets into full swing. At Tortoise Credit Strategies, in general we expect a continuation of the positive earnings momentum we witnessed in the first quarter although we also expect credit metrics, such as leverage and interest coverage, to remain stretched consistent with what we would typically see late in the business cycle.

Thank you for listening to the Tortoise Credit Strategies podcast and hopefully you will join us for next week's edition.

Thank you for joining us. And stay tuned for our next cast. Have topics you want covered or other feedback to share? Write us at info@tortoiseinvest.com.