Tortoise

Tortoise QuickTake Podcast

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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 Jeff Brothers, senior portfolio manager for Tortoise Credit. In today's podcast we will review the important events in the bond market of the past week and then turn to a brief update on the health of the U.S. consumer.

Although there was little economic news to move the markets over the past week, there were plenty of fireworks on the political front. On Thursday we heard the much anticipated testimony from former FBI director James Comey, which created some bold headlines, but didn't differ too much from previously reported details. What's certain is the dark cloud over the administration won't be going away any time soon which could have consequences for Trump's pro-growth fiscal agenda. The other shocker came from the surprise results in the U.K. snap election where Teresa May's hopes for solidifying her position heading into Brexit backfired as the Conservative party lost their majority in Parliament. Like the Comey testimony, May's failed gamble created more political uncertainty and potential financial consequences especially as the U.K. enters the crucial Brexit negotiations. Interestingly, the U.S. bond markets, which typically react sharply to uncertainty, had a muted reaction to both political events. This could be the result of the Comey testimony not revealing anything more damaging or perhaps the bond markets are waiting for more insight from this week's important Fed meeting. U.S. interest rates sold off for the week with the 10-year U.S. Treasury rising 4 basis points to end the week at 2.20%. The stock market ploughed ahead despite the uncertainty and riskier assets in the bond market performed well, supported by strong investor demand for higher yielding securities.

Now let's turn to a brief update on the health of the U.S. consumer. The recent release from the NY Fed showed that consumer debt levels have now surpassed the peak levels from 2008 and raised concerns of another unsustainable debt bubble. The debt debate takes on increased significance given the surprising and dramatic pull back in consumer spending in the first quarter when personal consumption came in at only 0.6%, the weakest level since 2009, which some have blamed on an overleveraged consumer.

First, let's take a look at the data from the NY Fed report on household debt. The report revealed that aggregate household debt increased in the first quarter to $12.73 trillion finally exceeding the peak from 2008. This was the eleventh consecutive quarterly increase in household debt and follows the long period of deleveraging brought on by the financial crisis. Interestingly, mortgage debt, the biggest portion of household debt, and credit card debt still remain below the peak from nine years ago. The biggest increases in debt levels have come from student loans and auto loans which also happen to be areas sighted in the report as having the most stress from delinquencies.

Before jumping to the conclusion of impending doom for the economy it is important to consider the debt in context. For example, the household debt relative to disposable income has fallen dramatically since the crisis and is at its lowest point since 2003. Similarly, the ability to repay the debt, using the ratio of household debt service payments divided by disposable income, remains steady and at record lows. Lastly, rather than looking at the total debt in isolation, comparing the liabilities to the assets of consumers also paints a more encouraging picture. While debt has been increasing, so too has the consumer net worth which is at a record high of $94.8 trillion, driven by house price and stock market gains.

There are a couple of important caveats to consider when looking at the aggregate debt data. First, income and net worth gains have not accrued equally across households and while debt levels seem manageable, some subsets of borrowers such as recent graduates with student loans may be experiencing a greater debt burden. And lastly, debt service levels are very low, but have benefited from low interest rates, which could be less manageable if interest rates were to rise.

To summarize we consider the U.S. consumer to be in good health even for the later stages of the credit cycle. We don't share the media doomsday viewpoint on debt levels, which tends to look at the debt in isolation rather than in context to income, debt service, or net worth. And lastly, we believe this positive outlook for consumer finances should support the U.S. economy with improved consumer spending following the weak first quarter.

Thank you for listening, we'll talk to you next week.

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.