Tortoise QuickTake Credit Podcast

Tortoise

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

Welcome to the Tortoise Credit weekly podcast, I am Jeff Brothers, senior portfolio manager for Tortoise. In this week's podcast, we will attempt to read the tea leaves of the dramatically divergent signals coming from the bond and stock markets. The bond market is sending strong signals of a potential recession, while the stock market remains untroubled and is continuing to power ahead.

Let us start with the view coming from the interest rate markets. Last week the bond market sent out a strong warning that the long U.S. economic expansion might be reaching a conclusion. The most important signal came when the 10-year U.S. Treasury yield fell below the 3-month yield for the first time since 2007. A yield curve inversion, when short-term rates move above long-term rates, has been one of the most reliable indicators of a future recession and from a San Francisco Federal Reserve study, the 3-month to 10-year yield spread is the best summary measure for a yield curve inversion. A yield curve inversion has accurately forecast the last seven recessions. The lag time from inversion to recession is quite variable, but on average occurs in 27 months. Some market participants claim that this time is different and perhaps unique technical factors might be reducing the yield curve's predictive powers. Years of quantitative easing by the Federal Reserve, which focused on purchasing longer maturity Treasuries, reduced the available supply and pushed down long rates. The Fed's recent decision to end the balance sheet run-off earlier than expected reinforced the supply and demand imbalance.

Aside from the yield curve inversion, there were other ominous signals from the bond market including the decline in 10-year Treasury rates to below 2.40%, the move to negative yields in Germany, and the shift in market expectations towards a cut in rates by the Federal Reserve in 2019. The pessimistic view from the bond market may hinge on the belief that despite their recent dovish reversal, the Fed went too far in raising rates, especially given the weaker growth in China and Europe, and now lacks sufficient ammunition to battle the next slowdown.

The stock market and riskier sectors in the bond market, however, seem to be telling a different narrative. Stocks, high yield bonds, and investment grade credit all shrugged off the bond market worries and produced strong performance to end the quarter. The stock market finished the quarter up 13.1%, the best quarter since 2009. High yield and investment grade credit bonds also rebounded with returns of 7.3% and 3.3% respectively. All three of these economically sensitive sectors recovered most, if not all of the losses from the disastrous fourth quarter. The glass half-full view is a Goldilocks scenario with the Federal Reserve remaining on hold, continued low inflation, and slowing but still solid U.S. economic growth. The strong start to the year highlights that riskier markets, in retrospect, probably overreacted to recession fears in the fourth quarter and perhaps the bond market is doing so again.

What is our read of the tea leaves at Tortoise Credit? We respect the bond market warnings, especially concerning the yield curve inversion. The yield curve inversion is a cause for caution, but we would want to see a deeper and more persistent curve inversion before concluding the economy was heading to a recession. We are still positive on the U.S. economy in 2019 and see a return to trend growth of around 2%. With the strength of the labor markets, continued solid consumer spending, and the Fed on hold, we believe the U.S. economy should avoid a recession in the near-term. Although we are bond market people here at Tortoise Credit, for now, at least, we side with the more optimistic story the stock market is telling.

Thank you for listening, we will talk to you again 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@tortoiseadvisors.com.

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