

Tortoise QuickTake

Credit Podcast



February 13, 2018

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.

Welcome to the Tortoise Credit weekly podcast. I'm Jeff Brothers, Senior Portfolio Manager for Tortoise. In today's podcast, we will begin with a brief review of last week's equity market sell-off and then assess the impact to the fixed income markets and any potential impact to our overall economic outlook.

The new Federal Reserve Chair, Jay Powell, was greeted on his first day on the job with a plunge of over 1,000 points in the Dow Jones Industrial Index, and the rest of his first week didn't get much better. The S&P 500® Index was down 5% for the week and is now down 8.8% from the peak on January 26th. The sell-off began with the stronger than expected increase in wages from last Friday's employment report, with average hourly earnings rising from 2.6% to 2.9%. This seemed to be the catalyst to shake up the complacent equity markets and focus attention on the potential risks of rising inflation pressures, higher interest rates, ballooning budget deficits and additional Fed rate hikes. The spike in volatility and subsequent unwinding of the popular low volatility trade also rippled through the equity markets.

Although things remain unsettled, we can offer some broad observations on the impact from the stock market correction, on the fixed income market, and to our macroeconomic outlook. First, it was very notable and unusual for interest rates to remain unchanged in the face of such a significant decline in the stock market. Normally, the U.S. Treasury market would benefit from a strong flight to quality bid, as investors seek out safety in times of uncertainty. Instead, despite some dramatic swings, interest rates finished the week unchanged with the 10-year U.S. Treasury yielding 2.85%.

A second point to make from the past week is that we have not seen a significant contagion from the equity market decline to the riskier sectors within the fixed income market. The securitized and investment grade sectors saw only modest underperformance, and the High Yield market was resilient, but did show some weakness towards the end of the week, especially in energy-related credits. There were no signs of panicked or forced selling, and if anything, it felt like investors were waiting for opportunities to purchase bonds at cheaper levels. The new issue market was also functioning as usual, with a full calendar of offerings met with solid investor demand.

Another observation from the past week is that we don't believe the recent equity correction will have any lasting or meaningful impact on our broader economic outlook. We believe the fundamentals for the domestic and global economies remain solid and expect 2018 U.S. GDP growth of around 3.0%. We will be keeping a close eye on consumer and business confidence levels for any signs of weakness, but believe the equity decline, especially given the recent strong performance, will not dent the prospects for the overall economy. We will also be watching to see whether the equity sell-off, stronger dollar and rising interest rates will tighten financial conditions enough to slow the economic recovery. We could now be entering an environment where good economic news is bad news for the stock market, as strong economic results could raise inflation and interest rate fears can put pressure on equity prices.

Another take away from the past week's market moves is that we believe volatility is here to stay. We have been concerned about the persistent low volatility environment, especially given major transitions we see unfolding in the overall economy and financial markets. The U.S. economy will be transitioning from years of easy monetary policy to tighter policy, from deflationary concerns to risks of inflation, from below-trend growth to potentially above-trend growth, and also to the emergence of fiscal policy stimulus. These types of major shifts almost never occur smoothly and should raise the level of uncertainty in financial markets. As a result, we believe these episodes of volatility will be more frequent in the years ahead.

Lastly, the past week's equity correction may serve as a reminder that the stock market can go down and perhaps highlight the benefits of the historically safer and more stable fixed income asset class.

Thank you for listening. We'll 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@tortoiseinvest.com.

The **Dow Jones Industrial Average (DJIA)** is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange (NYSE) and the NASDAQ.

The **S&P 500® Index** is a market-value weighted index of equity securities.

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