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.

Welcome to the Tortoise Credit Strategies' weekly podcast. I'm Jeff Brothers, Senior Portfolio Manager for Tortoise Credit. With the World Series in full swing and hopes for a Dodgers victory parade outside our offices here in Los Angeles, today's podcast will stick to the baseball theme and try to answer the question "who's on first" to be named the next Federal Reserve Chair. The appointment could be one of the Trump administration's most critical decisions especially given the transition within interest rate policy, the Fed's balance sheet and government regulation. The U.S. economy is on firm footing with back-to-back quarters of 3% GDP, continued strength in the labor markets and improving corporate profits. Inflation measures, however, remain stubbornly low and well below the Fed's stated target of 2%. And lastly, the administration remains dedicated to reducing the regulatory burden, but the Fed is tasked to maintaining the safety and soundness of the financial system. Will Trump favor continuity or take the opportunity to revamp the institution?

So who's on first? Janet Yellen's term ends in February and President Trump is expected to announce his selection later this week. The process began with five potential candidates: Gary Cohn, Kevin Warsh, Jerome Powell, John Taylor and Janet Yellen.

Recent indications are that Gary Cohn, the current Director of the National Economic Council, has fallen out of the running. His criticism of the violence in the Charlottesville protests may have sealed his fate, but he is also considered too crucial in his current role as the driving force in the administration's tax reform efforts. Kevin Warsh, a Fed Governor from 2006 to 2011, was an early favorite but has also faded from the picture. Warsh is considered the most hawkish of the choices and since leaving the board has been very critical of Fed policy, especially the use of the balance sheet. Warsh went so far as to call the Fed's policies reverse Robin Hood with the rich getting richer. His stance on reducing bank regulation appeals to the administration, but his lack of continuity with current monetary policy could potentially rattle the markets and push interest rates higher. Cohn and Warsh can't be completely ruled out, but both were omitted as choices in Trump's informal straw poll on Fed Chair preferences with Senate Republicans last week.

So what can we expect from the remaining three candidates with regards to monetary policy, regulation, and the markets?

Yellen is perceived as the most dovish choice and interest rates have generally moved lower when the probability of her renomination has increased. In her favor, Yellen would bring continuity and certainty to the markets as she would be expected to continue the current policies of gradual rate hikes and normalization of the balance sheet. Reportedly, she was very impressive in her interview with President Trump, who after bashing her on the campaign trail now says he "likes her a lot." In her interview she highlighted that the economy was doing well and the Fed policies supported growth. Trump often claims as an accomplishment the strong labor markets and record equity prices and may be hesitant to upset the apple cart. Many Republicans, however, distrust the extraordinary measures the Fed utilized during the crisis and would like a return to more traditional policies. Yellen is also the candidate least likely to favor relaxed regulation and financial supervision.

John Taylor is an academic economist from Stanford University and is best known for the monetary policy rule named after him – the Taylor rule. Unlike Yellen's Fed, Taylor would be expected to utilize a rules-based rather than discretionary policy to guide the Fed. Taylor is considered more hawkish, especially since the Taylor rule suggests a 3.75% Fed funds rate compared to the current 1.25% rate today. In a recent speech, Taylor said he supported Trump's core principles and favored tax breaks and a roll back in regulation. Even if Taylor shows some flexibility on his rules-based approach, the initial reaction to his nomination would likely be a rise in interest rates and a flattening of the yield curve.

Lastly, Jerome Powell is a lawyer by training and has been on the Fed board since 2012. Recent reports have Powell back as a front runner. There were even rumors last week that perhaps Trump would go for a double play to use our baseball analogy and nominate Powell for the Chair and Taylor for the Vice-Chair. The Vice-Chair position is currently open since Stanley Fischer resigned in September. Excluding Yellen, Powell would provide the most continuity with current policies and in fact he hasn't cast a dissenting vote during his tenure at the Fed. His pragmatic, consensus-building approach may also favor him with those that criticize the Fed for being too academic. Even though the Fed is an independent body, it doesn't' hurt that Powell is a Republican. As opposed to Yellen, he seems open to reduced bank regulation which also aligns him with the administration. The bond market would probably have a minimal reaction to a Powell nomination as he would likely continue the current policies.

President Trump is known for surprises, but we think Powell checks off most of the boxes and will be the final choice for the next Chair of the Federal Reserve.

Thank you for listening, go Dodgers and 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.