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 weekly Tortoise credit podcast. I'm Greg Haendel, senior portfolio manager at Tortoise. College basketball enthusiasts often look forward to the month of March as the NCAA Division 1 basketball tournament begins. This year the tournament starts on March 17th and as is always the case it will offer several unpredicted surprises as well as disappoints thereby rightfully earning the name "March Madness." Similarly, the financial markets have already begun their version of March Madness, with a few notable events or surprises this past week and several high profile events in the coming weeks. In today's podcast we will briefly discuss some of the March Madness market moving events this past week followed by some discussion surrounding market catalysts or additional events expected for the remainder of the month.

Beginning with March Madness month to date, several events or notable pieces of data caused sentiment to turn modestly negative, equity markets to decline, credit spreads to widen, and interest rates to fall. On Thursday, the ECB held their regularly scheduled policy meeting and surprised markets by drastically cutting their growth forecast from 1.7% to 1.1%; more than the market had expected. Further, the ECB changed their forward guidance on rates to now keep their short term policy rate on hold at least through the end of 2019 while also announcing several policy actions including a new series of quarterly TLTRO's (targeted long-term refinancing operations) starting in September 2019. Unfortunately the worsening growth outlook and less generous TLTRO program than the market had expected weighed on sentiment. Friday morning economic data out of both the U.S. and China also weighed on sentiment. Specifically, China announced much weaker than expected exports for the month of February, down approximately 20% year over year while the February U.S. employment report, specifically non-farm payrolls was also weaker than expected. Given the stronger household survey employment report and modestly higher than expected average hourly earnings, some are discounting the weak non-farm payroll report as noise from weather-related distortions.

Other notable events this past week include some increased friction surrounding the U.S./China trade talks. The big holdups in the U.S. China trade talks appear to be the mechanism and monitoring of enforcement, the ramifications for noncompliance, and a hesitation by China to send President Xi to a Trump-Xi summit in Florida unless the agreement is complete in order to prevent humiliation should President Trump have a change of heart. On a technical supply/demand front, equities were weighed down recently by substantial new supply from IPOs and add-on issuance while new issue supply in investment grade corporate credit exceeded expectations at approximately $40 billion for the week, which weighed on credit spreads. On the earnings front, Q4 earnings announcements are coming to an end with general high level takeaways being revenue growth and EBITDA growth remain good yet have modestly decelerated while investment grade credit leverage continued to trend higher and has reached a post financial crisis peak; driven primarily by M&A. Lastly, on a company specific basis, the CEO of General Electric, Larry Culp, gave candid yet bearish free cash flow guidance this past week at a JP Morgan conference, thereby reversing a bullish stock and bond rally for the company that began early this year due to positive corporate turnaround momentum. As a result, GE equity declined and credit spreads widened as investors recalibrated the timing and extent of the turnaround in the business.

There remain several notable March Madness events in the weeks to come that have both positive and negative longer term implications for the markets. First and foremost, the markets and investors are expecting some sort of U.S./China trade deal with speculation around a March 27th signing ceremony. However, due to some of the holdups previously mentioned, some market pundits don't believe the event will occur until April. Further, markets are already largely assuming and pricing in a decent outcome which implies some downside risk should a deal be worse than expected or pushed off beyond April. On

March 20th, the FOMC is expected to leave interest rates on hold yet more importantly they are also expected to provide more detail surrounding the targeted size of their balance sheet as well as the target for excess reserves. At its peak, the Fed's balance sheet was roughly $4.5 trillion and has since shrunk to approximately $4 trillion as a result of quantitative tightening (QT). The market had assumed QT would end in mid-2020 with a balance sheet around $3 trillion. Recent Fed communications have suggested balance sheet normalization could conclude by the end of 2019, leaving the size of the balance sheet north of $3.5 trillion. As such, a formal plan with specific balance sheet guidance with QT ending in 2019 and the balance sheet remaining larger than $3.5 trillion would likely be seen as a market positive. This would mean an earlier than expected end to this portion of restrictive monetary policy and essentially an end to the crowding out behavior we've mentioned in previous podcasts. Further on the central bank policy front, the Bank of Japan is expected to meet on March 15th, although few expect any market moving changes to their policy or outlook.

As we march toward the end of March, surprises could unfold as it relates to Brexit, the U.K. separation from the EU which is due to take effect on March 29th. As it currently stands, as of the time of this podcast, no deal has been reached and approved between the U.K. and EU and no deadline extension has been extended. In turn, this lays the foundation for a hard Brexit which essentially reverts U.K. trade with the EU and several other countries to WTO trade rules. Most believe this would have a negative impact on both the U.K. and EU economies, at least short term. On March 12th, the U.K. parliament is set to vote on Theresa May's revised Brexit plan which, absent parliamentary approval, could force a U.K. leadership change and leave the U.K. without a Brexit deal as well as no March 29th deadline extension for the time being. The biggest wildcard in March Madness could be the release of the long awaited Mueller probe and associated report to Congress which is expected to occur any day or week. Significant uncertainty still exists regarding when this will be released, how much the public will have access to, and whether the content could cause any significant ramifications to high ranking political officials.

The month of March tends to be an exciting and uncertain one for both NCAA basketball fans as well as financial market participants. While the NCAA tournament hasn't yet begun as of the date of this podcast, March Madness within the financial markets is already in full swing. The remainder of March could offer some unforeseen twists and turns, both positive and negative, for the financial markets as well as NCAA basket fans.

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@tortoiseadvisors.com.