Tortoise QuickTake Credit Podcast

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

Welcome to this week's Tortoise credit podcast. I'm John Heitkemper, portfolio manager for high yield bonds and leveraged loans at Tortoise.

It was pure coincidence that I happened to be driving past the ports of Long Beach and Los Angeles last week, just a couple days after President Trump threatened by tweet that the U.S. would increase tariffs from 10% to 25% on $200 billion of Chinese goods beginning on May 10th, thereby raising the stakes in last week's trade negotiations between the two countries. I'll admit, the 5-year-old boy in me is always mesmerized by those ports, as giant cranes unload hundreds of containers from massive, sea-going ships. The containers are then loaded onto rail or truck for their ultimate end market, the U.S. consumer, but not before they clog up the L.A. freeways in front of me, as I'm trying to make my way home. But I digress.

As you'd expect, the President's surprise announcement caught financial markets off guard, putting an end to a rally that saw April finish with the S&P 500 at all-time highs and credit spreads – both High Yield and Investment Grade – near year-to-date tights. As trade negotiations – and media banter – unfolded during the week, it became clear to markets that a deal is not getting done in the near-term, leaving equities down over 2%, the VIX at its highest point in four months and credit wider, about 25 basis points in High Yield and 5 basis points in IG. Overall, last week's reaction didn't signal all-out doom, as the prevailing logic is that there's still a deal to be had between the U.S. and China. That was last week, however, and after China responded early Monday with its own tariff increase, U.S. equities moved sharply lower again.

This burst of volatility doesn't come at a great time for credit markets. The technicals have proven extremely positive in both High Yield and IG for most of 2019, underpinning their 8.8% and 5.4% respective year-to-date gains through the end of April (per Barclays indices). Investors flocked to U.S. credit after the Q4 2018 sell-off only to see new supply underwhelm demand. U.S. High Yield funds have seen inflows of $15 billion year-to-date, whereas new issue volumes are down 10% compared to the same period last year.

However, the strong technical backdrop for credit is reversing course in May. With Q1 earnings season largely behind us, companies are free to tap the credit markets again, and May is typically one of the busiest times of the year for new issues in both the High Yield and Investment Grade markets. In the IG universe, new supply already exceeds $50 billion in May, as both Bristol-Meyers and IBM tapped the market for massive deals – nearly $40 billion between them – to fund acquisitions. The story was similar in High Yield last week, as 15 deals for $12 billion priced, the largest weekly total since March 2017.

We are only half way through May, and there's likely more supply to come, assuming markets are stable enough to absorb the paper. In IG, May supply estimates are in the $130-150 billion range, while the High Yield forward calendar stands at nearly $29 billion. Surely some of these deals will sit on the shelves if volatility remain elevated, but Wall Street syndication desks don't like to sit locked and loaded indefinitely. These new deals are likely to come – maybe all at once – as soon as the waters appear calm.

This is all to say that U.S. credit spreads could see more pressure over the short-term as new supply clears the market. The Bloomberg Barclays U.S. High Yield index ended last week at a spread of 382 basis points, closer to the tight end of the year-to-date range of 346 to 537. The story is similar in IG, and over the next several weeks, there appears to be more room for spreads to leak wider, although we're not suggesting a retest of the recent wides seen at the start of the year. After all, fundamentals still appear supportive - Q1 earnings are coming in ahead of expectations – and this trade hiccup could be resolved just as quickly as it started. In fact, the higher 25% tariff rate will not even impact goods that are already on a ship and en route to the U.S. Theoretically, that gives negotiators a couple of weeks to hammer out a deal, or at least make enough progress for Trump to retract his tweet. But that has me wondering, how long does it take for one of those ships to cross the ocean to L.A.? For some reason, I bet it's faster than it will take me to get out from behind all those trucks on the 110 freeway.

Thanks for listening, and please tune in for future Tortoise credit podcasts.

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

The **Bloomberg Barclays US Corporate High Yield Bond Index** measures the USD-denominated, high yield, fixed-rate corporate bond market. Bonds from issuers with an emerging markets country of risk, based on Barclays EM country definition, are excluded.

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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