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.

Hello, I'm Graham Allen, Tortoise Senior Portfolio Manager with this week's credit podcast.

It is fair to say that since the U.K. referendum of June 2016, the primary existential threat to the EU has been perceived to be Brexit Of course, as we know the whole process has degenerated into a complete dog's dinner, to use an English expression. Despite the passage of time, and the passing of the March 2019 deadline, the eventual outcome of Brexit is murkier now than at any time since the vote. We do not even know for sure which party will be in power if the UK does eventually leave the European Union. The entire process is in a state of complete flux with the eventual outcome in doubt. From a market perspective, this is the worst of all worlds.

Perhaps the only clarity we have seen in the entire Brexit process has been the success of the newly formed Brexit party in the recent European elections. The fact that the party won double the seats of the Conservative and Labour party combined, is a warning sign for both the main established UK political parties as well as the EU commission itself. To be fair, these were European elections, which historically have a lower turnout than national elections. In this case, the 37% turnout was marginally higher than the last set of European elections

The same sentiment was reflected in other European results, notably in Italy. The League Party, headed by Matteo Salvini, got the largest vote winning 28 seats representing 34% of the electorate. A strong showing that some speculate would translate into a majority if a general election were held today. Salvini is presently Deputy Prime Minister of Italy and the League Party is part of a governing coalition.

Given this, Salvini has become more strident in his opposition to the EU budgetary constraints imposed on the Italian government by the European Commission since the recent elections, most notably the Italian coalition's projected budget deficit for 2019.

Of more concern has been the suggestion that Italy could begin using a parallel currency to the Euro that could be used to pay taxes and to buy the services of state-owned companies. If implemented, this could rapidly lead to a loss of confidence in Italy's Euro denominated public debt, heretofore propped up by the European Central bank through its open market purchases. It will also call into question Italy's commitment to the Euro currency. It is the very rules of the Eurozone itself, as laid out in the original Maastrict treaty that is the cause of the present budget friction between Italy and the EU. The economic reality for any Italian leader is, "How do you persuade the electorate to absorb further cuts in spending, when the economy is effectively in recession?" This is one of the root causes of the anti-European sentiment shown in recent Italian polls. The upshot of the impasse has been the threat of an "infringement procedure' by the EU which would impose a financial penalty on Italy, which is already in a state of financial fragility.

So as an existential risk to the European structure, Italy looks increasingly like a bigger threat as it could initially target the Eurozone itself by setting up a parallel currency, and then the EU itself as it more closely aligns itself with other non-EU countries and their polices

This makes Matteo Salvini's visit to Washington this week, strengthening ties with the U.S. administration, very alarming to Brussels. He has praised the policies of the Trump administration in many areas, some of which directly oppose official EU positions, most notably on immigration. A stronger relationship with the U.S. also could lay the groundwork for an eventual trade deal with the U.S. in the event Italy does eventually leave the EU.

This is not likely anytime soon but the hardline taken by Brussels in the budget talks with Italy will only make tensions worse. It should also not be overlooked that Italy's Target 2 liabilities at the ECB have now reached €492 billion, most of which is owed to Germany. So in dealing with the EU, it does have considerable bargaining power in that it is the European Central bank's largest debtor by far.

In conclusion, although the end of Brexit is far from certain, markets have factored in a plethora of bad outcomes which will likely result in a positive reaction once resolved. The world has adjusted to the existence of the EU without the UK. This is not the case with Italy, which is, in addition to being an EU member also a member of the Eurozone. Salvini's closer ties with the Trump administration could eventually threaten Italy's

membership of the European Union itself and lead to its ultimate breakup. This has, most definitely not been factored into the markets at this point.

We hope you have enjoyed this podcast.

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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