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 the Tortoise Credit weekly podcast. I am Jeff Brothers, Senior Portfolio Manager for Tortoise. Whatever happened to the old market adage of quiet summer trading or the summer doldrums? The bond markets have not allowed much time to relax at the beach with some summer reading this year. In today's podcast, we wanted to review the highlights from another crazy week in U.S. interest rates.

Last week the 10-year U.S. Treasury note plunged 20 basis points to a yield of 1.55% and the 30-year briefly crossed 2.0% and ended at an all-time low of 2.03%. The 10-year Treasury has now rallied 114 basis points for the year and 170 basis points from the recent high in November of last year. Recession fears, trade tensions with China, and the gravitational pull of negative interest rates globally combined to pushed yields significantly lower.

Recession fears spooked the market when the yield curve between 2-year and 10-year Treasuries went inverted on Wednesday for the first time since 2007. A yield curve inversion, when short rates move above longer term rates, has been one of the more reliable predictors of a recession. A yield curve inversion has preceded each of the past seven recessions with a lag on average of 22 months. President Trump naturally could not resist a tweet, calling Jay Powell "clueless" and blaming the Federal Reserve for the "crazy inverted yield curve." We are hesitant to endorse a view that this time might be different, but several factors might be distorting the yield curve's predictive power including the impact of negative rates globally and years of central bank quantitative easing purchases of long-term bonds.

The trade tensions with China also continue to exert downward pressure on U.S. interest rates. Last week the markets briefly sold off when the Trump Administration decided to delay raising tariffs on approximately 60% of Chinese imports until December. Trump said they "were doing this for Christmas just in case some of the tariffs would have an impact on consumers." It seems a clear admission by President Trump that the cost of the tariffs could hit consumer pocketbooks and that the trade war is weighing on economic growth and the stock market. The trade optimism and the sell off in rates was short-lived however, as China announced on Thursday plans to go ahead with "necessary countermeasures."

The downward pull on U.S. interest rates from the negative yields globally also continued last week. German 10-year rates fell 10 basis points to yield of -69 basis points and an astounding 16.4 trillion debt globally now carries a negative yield. Not surprisingly, foreign investors find U.S. rates attractive for the positive yields, but also for the safety and strong relative economic performance. With the ECB ready to cut rates again and embark on more bond purchases, the U.S. interest rate structure will continue to be distorted by negative rates abroad.

One last takeaway is that the rate decline came even though the economic data was on balance better than expected. Thankfully, consumers have not taken the summer off and retail sales for July surprised to the upside with a 0.7% increase. Both the Empire and Philadelphia Fed manufacturing indices reported better than forecast numbers and Core CPI beat estimates for the second month in a row. The Atlanta Fed's GDPNow forecast increased on the week to a very solid 2.2% estimate for the third quarter. Normally these types of strong economic readings would not be bond friendly, but the markets are gripped in the current pessimistic outlook and shrugging off the backward looking data.

To summarize our view, we believe rates have gone too far too fast, but could stay anchored in this low yield environment due to slowing global growth, muted inflation pressures, and a shift to easier global monetary policy. We also believe the U.S. economy should avoid any near term risk of a recession and would point to another old market adage – do not underestimate the U.S. consumer.

Enjoy the rest of your summer and we will talk to you again next week.

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