Tortoise

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.

Hello and welcome to the Tortoise Credit Strategies weekly podcast. I'm Jeff Brothers and in today's podcast we will compare and contrast the recent trends in inflation with the more hawkish commentary coming from the Federal Reserve.

Let's start with a review of the Consumer Price Index inflation data. Last Friday, the CPI inflation report showed an as expected 0.2% monthly increase in the headline inflation number, bringing the year-over-year change to 2.2%. However, the April core inflation reading, which excludes the volatile food and energy components, showed surprising weakness, up less than expected 0.1%, after a decline in March of 0.1%. The core CPI is now running at a 1.9% annual rate and has declined four consecutive months on a year-over-year basis. This trend raises some concerns that perhaps we haven't completely left behind the deflationary pressures precipitated by the financial crisis. Digging into the details of the report, many of the components actually declined in April, including new and used vehicles, medical care, apparel prices and wireless phone services. This weakness was offset by the continued strength in shelter prices and a large increase in tobacco prices following the implementation of recent tax hikes.

Other important inflation indicators are also showing signs of rolling over. The Personal Consumption Expenditures Price Index, the Federal Reserve's preferred inflation measure, is off its recent peak of 1.8 % to 1.6% and remains below the Fed's desired 2.0% target. On the wage front, average hourly earnings, despite the improvements in the labor markets, have also fallen from a recent peak of 2.9% to now 2.5%. Lastly, the market expectations for inflation, as expressed in the breakeven inflation rate from the TIPS markets, are also showing troubling signs of weakness. After a sharp increase to a high of 2.08% in January, the TIPS breakeven rate has turned down to a 1.86% level. These recent changes could turn out to be minor blips on the path towards higher inflation, but do raise questions for the popular reflationary thesis from the beginning of the year.

Now let's turn to take a look at the more hawkish commentary from the Federal Reserve which indicates a growing confidence in achieving their dual mandate of full employment and the 2% inflation target. We received further examples of the Fed's more hawkish tone over the past week with speeches from Fed Presidents Rosengren and Dudley. In Rosengren's speech, he said he now favors three additional rate hikes this year and possibly starting to reduce the Fed's balance sheet after the next hike. He dismissed the recent economic weakness as a "temporary lull" and urged a more aggressive tightening path to avoid creating an "over-hot economy." To us, bringing the total rate hikes for 2017 to four and beginning to reduce the Fed's balance sheet earlier than expected seems a departure from the Fed's long stated "gradual approach." Also from last week, we heard from the New York Fed's Dudley who struck a more cautious tone, but did feel the economy could cope "just fine" with a gradual tightening of monetary policy. Dudley also reiterated the idea from the Fed meeting minutes that the recent economic weakness was "transitory." There's a strong case for the seasonal quirk in the GDP data. Since the financial crisis, first quarter GDP has averaged a very disappointing 1.0%. This year's 0.7% first quarter GDP was even less than that average. In the second, third and fourth quarters the economy has rebounded with an average of 2.5% GDP since the crisis. It's worth noting that the past second half rebounds in growth didn't face the potential headwinds of three or even perhaps four Fed rate hikes.

Some concluding thoughts. It will be interesting to see how the markets and Fed commentary react, if at all, to Friday's very disappointing core CPI report. The market outlook for a June rate hike, as implied in the Fed Fund Futures contract, ended the week with an almost certain 97.5% probability. Whether the first quarter's economic weakness turns out to be transitory or not, we will be watching closely to see if this signals a subtle and important shift in the Fed's policy away from following the market or in their words "data dependence" to instead a more proactive approach of leading the market or anticipating the economic data. Lastly, we aren't forecasting a near term end to the economic expansion, but we would caution that historically, recessions typically result from the Federal Reserve overstepping its bounds and tightening policy too far.

Thank you for listening to the Tortoise Credit Strategies podcast and hopefully you will join us for next week's edition.

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.

The Consumer Price Index (CPI) is a measure of the average change in prices over time of goods and services purchased by households.

The Personal Consumption Expenditure Price Index (PCEPI) is one measure of U.S. inflation, tracking the change in prices of goods and services purchased by consumers throughout the economy. Of all the measures of consumer price inflation, the PCEPI includes the broadest set of goods and services.