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, welcome to this week's edition of our podcast; this is John Heitkemper, portfolio manager with Tortoise Credit Strategies. We hope you had a safe and enjoyable Memorial Day weekend with family and friends. Speaking of family, any parents out there with young kids are well aware of how setting clear expectations can often save the ordeal associated with major melt downs. Last week's two key financial market events were all about setting expectations. But before we go into more detail on those, let's first take a quick look at recent economic data releases that were important to the U.S. fixed income markets last week.

On Friday, ahead of the long weekend, the government released its second estimate of Q1 GDP growth. While this is backward-looking data, the upward revision from +0.7% quarter-over-quarter to +1.2% did paint a better picture of underlying U.S. economic growth. Importantly, the primary drivers of the improvement were consumption and business investment, suggesting that fears of recent economic softness may be overdone. Economists are currently projecting that U.S. growth will pick up to 2-3% in Q2. This range is consistent with our belief that GDP growth will come in around 2.5% for 2017.

Friday's other data release, however, was somewhat less rosy. Orders for durable goods - excluding the volatile transportation component - declined 0.4% in April, missing expectations of a 0.4% increase. Shipments also fell slightly month-over-month and missed the consensus estimate. This week, we'll get important releases on May employment and auto sales. Consensus expectations are calling for the unemployment rate to stay at 4.4% with a slight uptick in auto sales to 17 million units.

As I alluded to previously, setting expectations was a key theme in last week's two most important financial market events. First, OPEC ministers met in Vienna to discuss extending their current production targets. Various news outlets had reported ahead of the meeting that Saudi Arabia favored a 9-month extension at existing quota levels, which in the end matched the cartel's ultimate decision. One might have anticipated that this announcement would have little impact on oil, however the spot price dropped nearly 5% as there had apparently been growing expectations that OPEC would surprise with a deeper production cut. When that didn't come to fruition, the oil market staged a short temper tantrum.

The second important financial market event last week was the release of the minutes of the Federal Reserve's FOMC meeting on May 2nd and 3rd. The tone suggested that most FOMC members viewed the tepid Q1 GDP report as transitory and that another rate increase is warranted in June. When it comes to setting expectations, however, the more interesting part of the minutes dealt with how the Federal Reserve might go about shrinking its balance sheet, which currently holds around $4.5 trillion of Treasurys and mortgage-backed securities.

The minutes indicated that most FOMC members believe it's appropriate to start letting the portfolio run off later this year by not reinvesting proceeds as bonds repay. There was also wide acceptance of a staff proposal to set a dollar cap on the run off amount each quarter. By setting the cap low initially, and then pre-announcing gradual increases to the cap, the plan would attempt to avoid a so-called fire sale of the Fed's Treasury and MBS portfolio that could potentially be disruptive to fixed income markets. FOMC members also said that more details of the plan should be released soon, which the market took to mean at the June FOMC meeting, with implementation of the plan potentially starting as early as the September meeting.

Whereas the commodity markets reacted sharply to the OPEC announcement, the release of the minutes drew only a small movement in U.S. Treasury rates, possibly in part due to the FOMC's emphasis on creating a very gradual and transparent process for unwinding its balance sheet. So while it's much too early to judge the Fed's success in this endeavor, it is apparent that a key tenant of its strategy is setting clear expectations so as to avoid adverse financial market reactions. Just as it's never easy to get parent and child on the same page, it will be no small task for the Fed and financial markets to be in lockstep during the coming balance sheet run-off.

That's it for this edition of the Tortoise Credit Strategies podcast, and we hope you'll tune in again in coming weeks.

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.