Tortoise QuickTake Podcast

July 11, 2017

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.

Welcome to the Tortoise Credit Strategies weekly podcast. I'm Jeff Brothers, Senior Portfolio Manager for Tortoise Credit. In today's podcast we will review the important events from the past week and provide a brief update on the bond markets.

The big news over the past week was the much anticipated jobs report on Friday, which again showed solid job additions, low unemployment rate and still very muted wage pressures. Non-farm payrolls increased a much better than expected 222,000 and the prior two months were revised higher by 47,000. This pushed the 3-month average in payrolls gains to a very solid 194,000. The job growth was broad-based with strong additions to healthcare, leisure and hospitality, and financial jobs. The unemployment rate surprisingly ticked up to 4.4% as labor market participation increased on the month. Despite the strong job growth, wage pressures remain absent, as average hourly earnings again disappointed with a less than expected increase of 0.2%. Average hourly earnings are now running at a very modest 2.5% annualized pace. The jobs report left unresolved the conundrum facing the bond markets and the Federal Reserve over the lack of wage pressures in the face of strong jobs growth in the U.S. economy. We expect this report will do little to divert the Federal Reserve from its slow and steady path towards tightening monetary policy. Similar to the payroll report, the ISM manufacturing and non-manufacturing surveys beat consensus estimates with both indices increasing and the manufacturing survey climbing to the highest level since August of 2014. The gains in the surveys were broad based and indicate optimism for both current and future activity in the economy. Although we will have to wait to see how the economic data unfolds, the payroll and ISM reports are encouraging signs that the U.S. economy may be rebounding from the very weak start to the year.

The other highlight from last week was the minutes from the Federal Reserve's June meeting. The notes were a mixed bag and provided little new information about the Fed's next move. The commentary indicates that the Fed remains divided over the timing of the balance sheet reduction with some members wanting to start in a couple of months, while others favored waiting until later in the year. We would also highlight the continued stark contrast between the Fed's expectations for the future pace of rate hikes and the market's outlook. The Fed's dot plot shows a median expectation from the Fed for one hike this year and three more in 2018 and 2019. The market expectations, from the implied rate in the Fed Fund Futures contract, forecasts only two hikes in total through 2019. This disconnect between the market and Fed view could be due to the Fed's belief that current weakness in economic growth and inflation is "transitory" while the market seems to have a more skeptical outlook.

In a holiday shortened week, the most notable highlight in the bond market was the continued sell-off in interest rates, which began two weeks ago with Mario Draghi's upbeat assessment of the European economy and the potential reduction in the ECB's quantitative easing policy. His comments set in motion a "taper tantrum" reminiscent to the Fed's warning of a potential reduction in asset purchases in the middle of 2013. For the week, the 10-year U.S. Treasury yield increased 8 basis points to yield 2.39% and has now climbed 25 basis points from recent low on June 26th. The treasury yield curve was also under pressure and steepened on the week, with the difference between 2-year and 10-year treasury yields rising from 92 to 98 basis points. The Draghi comments also provided a catalyst for a shift in the bond market technicals. From a technical perspective, the bond markets were vulnerable to a correction with sentiment and market speculation overwhelmingly bullish and expecting new interest rate lows. Bullish speculation positions for the long U.S. Treasury futures contract prior to the ECB news were at the highest level since 2008. Similarly, from a fundamental basis, the bond markets could be at an important turning point. In our opinion, it appears the economic pessimism following the dismal start to the year is now well factored into current bond yields. As an example, the Citigroup Economic Surprise Index, which compares consensus forecasts to actual results, looks to have reached a bottom after the steep decline in the first half of 2017.

In conclusion, we believe the fundamentals for the U.S. economy, global monetary policy and the technicals for the bond market have all reached an important inflection point and we would view the recent move in interest rates as the beginning of a trend towards higher rates in the future.

Thanks for listening, we'll talk to you next week.

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.

Citigroup Economic Surprise Index

The Citigroup Economic Surprise Indices are objective and quantitative measures of economic news. They are defined as weighted historical standard deviations of data surprises (actual releases vs Bloomberg survey median). A positive reading of the Economic Surprise Index suggests that economic releases have on balance [been] beating consensus. The indices are calculated daily in a rolling three-month window. The weights of economic indicators are derived from relative high-frequency spot FX impacts of 1 standard deviation data surprises. The indices also employ a time decay function to replicate the limited memory of markets.