Tortoise QuickTake Credit Podcast

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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.

John Heitkemper: Thanks for joining this week's Tortoise QuickTake credit podcast. I'm John Heitkemper, portfolio manager for High Yield bonds and leveraged loans at Tortoise. Welcome to February, the month where we can forget about those New Year's resolutions and get back to our old habits. Here at Tortoise, though, we're trying to hold firm to our 2018 goals, one of which is to mix up these podcasts a bit. This week, we'll be joined by senior credit analyst Andrew Kim, who will chat about a few of the industries that he covers. Welcome Andrew!

Andrew Kim: Thanks John; good to be here.

John Heitkemper: Andrew, one of the sectors in which we've been overweight in credit is building materials. Can you tell us about recent industry trends and what we might expect if an infrastructure bill were to get passed?

Andrew Kim: Sure. Thanks John. The building materials sector is benefitting from increased private and public construction activity driven by population growth and improving economic conditions.

New home demand continues to be strong as consumer confidence is high due to a low unemployment rate and increased household wealth as a result of appreciating home and stock prices. New homes supply is also well balanced, as the current level of new home starts of 1.3 million annualized rate is still below the historical average of 1.5 million.

Public construction activity is also experiencing several tailwinds, including population growth, increased state funding levels and the $305 billion *Fixing America's Surface Transportation Act*, which was signed into law in December 2015. While public construction activity remains firm, increased infrastructure expenditure is in dire need as the result of decades of underinvestment.

This leads us to the proposed $1.5 trillion infrastructure bill, which is targeted to address this critical need for increased investment in infrastructure. If the bill were to get passed, the building materials sector would benefit significantly from increased levels of construction activity. While on the surface the proposed bill appears to address the underinvestment problem, it lacks certain details so we are monitoring its progress and what it might mean to the building materials sector.

John Heitkemper: Thanks for that overview. So with a solid economic backdrop, we like the building materials sector. Despite positive economic momentum, one industry that actually feels like it is peaking, or may even be past its peak, is autos. Can you talk about where you think we are in the auto cycle and what that might mean for the credits that you cover?

Andrew Kim: Sure. The auto sector has experienced a seven year turbo-charged expansion since 2009. The U.S. auto market peaked in 2016, with U.S. light vehicle sales of 17.5 million vehicles. U.S. light vehicle sales decreased slightly to 17.2 million in 2017 and 17.1 million annualized rate in January 2018.

While the U.S. auto market has peaked, U.S. light vehicle sales are expected to remain healthy relative to historic levels, with estimates for 2018 sales in the high 16 million to low 17 million vehicle sales range. Outside of the U.S., global light vehicle sales are expected to increase in the low single digit growth rate in 2018.

Despite our outlook for low-to-moderate growth for the global auto industry, we maintain a cautious view on the auto sector due to potential negative implications from recent NAFTA renegotiation discussions, increasing raw materials costs and structural shifts within the industry related to electrification, mobility and autonomous vehicles.

John Heitkemper: Thanks Andrew. I wanted to touch on a more topical industry. This is switching gears a bit, but you also cover pharmaceuticals. It's a sector that's seen a tremendous amount of consolidation in recent years, and there's been a lot of political pressure on the industry to clamp down on drug price increases. Can you just spend a few minutes talking about how some of these big trends influence our investment process as it relates to this industry?

Andrew Kim: Sure. The pharmaceuticals industry has gained a lot of media and political attention in the last couple of years as a result of exorbitant price increases of certain life saving drugs.

For example, Mylan Pharmaceuticals agreed to a $465 million settlement, resolving claims that it overcharged the government for its EpiPen, which is used as an emergency allergy treatment. Mylan had increased the price of EpiPen by 600% to $600 from $100.

Actions taken by Mylan and other pharmaceutical companies have fueled public outrage, and certain political leaders have publicly voiced their concerns regarding this matter. Recently, in his State of the Union speech, President Trump stated that one of his greatest priorities was to reduce the price of prescription drugs.

In addition to the public scrutiny and political pressure to reduce drug prices, the pharmaceutical industry is currently experiencing other headwinds as well. Faster approval times for new drug applications at the FDA has intensified the competitive landscape, as new competing drugs quickly enter the market. There has also been consolidation among buyers for drugs, which has increased their bargaining power, and pharmaceutical balance sheets are stretched from past acquisitions.

As a result of these industry headwinds, we are taking an overall cautious view on the pharmaceuticals sector. However, while there are no immediate cures for the current ailments of the industry, not all companies are alike and we believe there could be opportunities to invest in certain well-managed companies within the sector.

John Heitkemper: Thanks Andrew. We really appreciate you coming on the podcast this week. Thanks for listening and please tune in for future Tortoise credit podcasts.

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.