Tortoise QuickTake Credit Podcast

June 5, 2018

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.

Welcome to the Tortoise Credit weekly podcast. I am Jeff Brothers, Senior Portfolio Manager for Tortoise. I know we should not complain about the weather in Southern California, but we are heading into the infamous "June Gloom" season, when clouds and haze blanket the coast. Over the past couple of weeks, the outlook for the financial markets also turned cloudier. The laundry list of market concerns included: Italian and Spanish political chaos, the on-again trade tariffs, the North Korean summit, and emerging market risks in Turkey and Argentina. The Federal Reserve minutes also left investors in a fog as it appeared the Fed added to their inflation and employment targets a third mandate to avoid inverting the yield curve. The dark clouds have also been circling the credit markets of late as my colleagues here at Tortoise have relayed on recent podcasts. With the cloudy backdrop, volatility and illiquidity returned to the market. As an example, Italian sovereign bonds moved more than 100 basis points in a single day, an unprecedented move for a developed government bond market. Although a sideshow to the geopolitical news, the economic data over the past week was mostly positive, with Friday's employment report, in particular, stronger than expected. The net result was a wild week for U.S. interest rates, which saw 10-year U.S. Treasuries rally below 2.80% following the Italian debt concerns, but subsequently give back on a reassessment of the contagion from Italy and on stronger than expected economic news.

Turning from the gloom of the weather and recent markets, we wanted to highlight the asset-backed securities (ABS) sector as an area within the fixed income market that we believe still has clear skies. In our opinion, the ABS sector offers a compelling safe haven from the market turmoil with a combination of high quality, short maturity, strong liquidity and attractive yields. ABS is a unique fixed income asset class with the bonds secured typically by consumer-related collateral, such as auto loans, credit card receivables, or student loans. ABS is a developed market with approximately $700 billion in outstanding bonds and over $200 billion in gross annual issuance. The sector has historically provided attractive risk adjusted returns and yields range between 3.0% and 3.5% depending on the asset type, maturity and rating.

The case for ABS starts with the positive fundamentals for the sector. The collateral backing the securities continues to benefit from the overall strength of the U.S. economy and from healthy consumer finances. In particular, consumer credit trends are primarily influenced by the strength of the labor markets, which have added close to 2.4 million jobs over the past year and the unemployment rate hit a 48-year low of 3.8%. Record increases in consumer net worth from stock gains and home price appreciation also support consumer fundamentals. In addition, the recent tax cuts should provide additional disposable income to service consumer debt. Lastly, although absolute consumer debt levels have been gradually rising, measures like debt-to-income and the debt-service ratio, highlight the healthy state of consumer balance sheets. Unlike during the financial crisis, the lending excesses in today's economy appear concentrated on corporate rather than the consumer balance sheets.

Despite the positive fundamental picture, we have seen some increases in delinquencies and charge-offs across the ABS collateral types. This modest deterioration in credit trends warrants monitoring, but in general is coming off historically low levels, remains within underwriting expectations and importantly is supported by the robust structural protections with the ABS securitization.

The strength and time tested support provided by the ABS structure is a key positive factor for the sector, even in the face of some softening in the underlying credit trends. Consumer ABS structures held up extremely well through the very stressful great recession period. Even in the much maligned subprime auto sector, bonds rated AAA and AA experienced no principal losses during the crisis and investment grade bonds, according to Moody's, have a historical impairment rate of only 0.1%. The

bond structures utilize robust credit enhancement and deal triggers to protect investors against potential principal loss and redirect cash flows if credit trends deteriorate.

The outlook for the financial markets is becoming cloudier. We believe the ABS sector with its high quality, short maturities and attractive yields is a solid choice to ride out the storm.

Thank you for listening, and we will talk to you again 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@tortoiseadvisors.com.