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.

Welcome to this week's Tortoise credit podcast. I'm John Heitkemper, portfolio manager for high yield bonds and leveraged loans at Tortoise.

Well, it was supposed to be a week of high level meetings and topical panels among the world's business and political elites in the snow-covered Swiss Alps. Instead, this year's World Economic Forum in Davos was highlighted by an outright schoolyard snowball fight over the U.S. dollar. Lobbing projectiles from behind one icy berm was U.S. Treasury Secretary Steve Mnuchin, who on Wednesday argued that a weak dollar is good for America's trade prospects, leading some to conclude that talking down the currency might be a weapon in potential trade wars stoked by the Trump Administration.

Lest anyone forget who really speaks for the Administration, however, President Trump himself caused everyone to look up from their fondue when he contradicted his Treasury Chief by claiming that he is, in fact, in favor of a strong dollar. Then European Central Bank President Mario Draghi jumped on the admonition bandwagon, suggesting that Mnuchin had broken G-20 agreements against pushing for competitive devaluations.

Trump's return fire did not sway currency traders, however, and the dollar ended the week lower, bringing the year-to-date decline on the Bloomberg Dollar Index to 3.5%. Since the beginning of 2017, the Dollar Index is down about 12.5%.

Of course, one significant corollary to a weaker U.S. dollar is the recent strength in commodities. Oil, as measured by WTI, has rallied nearly 10% this year and gained nearly 50% from its 2017 low. Copper and gold have also posted impressive 21% and 9% advances since mid-year 2017. In addition to the weaker dollar, this commodity run is underpinned by synchronized global growth, better-than-expected economic results in China, and hopes for a U.S. infrastructure spending bill.

With underlying commodity prices firming by the day, the fundamental backdrop for high yield commodity industries appears favorable and improving. Led by a rally in the energy and metals & mining sectors, the U.S. high yield market is off to a quick start in 2018, up +1.1% per JP Morgan U.S. High Yield Index. This trend is a continuation of a theme that was in place for much of the second half of 2017, when oil and other commodity prices started climbing. Since June 30, 2017, the energy and metals & mining industries have been two of the three top-performing high yield sectors, posting gains of 9.3% and 6.5%, respectively, versus +3.9% for the overall index. After experiencing an extensive default cycle in the 2015-2016 period, when cumulative defaults in energy and metals & mining were 18.4% and 24.7%, respectively, the key question for investors is whether the recent run is the beginning of a new cyclical rally or just a temporary reach for yield.

To the extent current conditions hold, high yield commodity credits should demonstrate continued fundamental improvement. In the metals & mining sector, there are a number of benchmark credits that could receive upgrades that would return them to investment grade. In energy, high yield management teams largely remain focused on spending within cash flow and continued deleveraging. Rising commodity prices and the risk-on financial markets have also opened a window for commodity credits to issue new debt to push out near-term maturities. While the energy sector still offers more yield than the high yield index, as this spread collapses, look for investors to think hard about their commodity exposure. It's one thing to get extra yield by going into commodities, but it may be harder to stomach if that pick-up evaporates, even if the currently favorable backdrop appears to have legs. After all, no one wants to get blindsided by an incoming snowball.

Thanks for listening and please tune in for future Tortoise credit podcasts.

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