

# Tortoise Credit QuickTake Podcast



January 17, 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'm Jeff Brothers, Senior Portfolio Manager for Tortoise. Sometimes the beginning of a New Year feels like the start of a horse race. The touts have shared their picks and pans for the various investment asset classes; the horses are carefully loaded into the starting gate; and away we go! It has been an exciting start to the race this year with stocks flying towards the first turn, commodity prices are on the pace; and the U.S. dollar is off to another sluggish start. It's a long race with plenty of twists and turns ahead, but in today's podcast we wanted to focus on U.S. interest rates which to begin the year have stumbled out of the starting gate.

To start the year, U.S. interest rates have been pushed higher by a combination of forces including better economic data, signs of inflation pressures, shifting global monetary policy and supply and demand concerns. We started the year with a 2.40% yield on the 10-year U.S. Treasury note and ended the past week at a yield of 2.54%. Rates have solidly broken out of the 2.25% to 2.40% range and have even tested 2.60% over the past week. It's too early to say we are entering a new interest rate environment, but let's review some of the drivers to the recent rate move.

First, we received additional signs that the U.S. economy has solid momentum coming into the new year. The December retail sales report and revisions to prior months showed above trend, broad-based strength in consumer spending. The labor markets remain healthy with the recent jobs report showing some softness in payrolls, but a surprising uptick in wages. Given the recent data, the Atlanta Fed GDPNow forecasts fourth quarter GDP at 3.3% which would be the third consecutive quarter of U.S. GDP greater than 3%.

Signs of inflation and rising inflation expectations have also added to the nervousness in the bond markets. Core CPI was reported a stronger than expected 0.3%, driven by owner's equivalent rents and firming new and used car prices. The December report increased the year-over-year rate of core inflation from 1.7% to 1.8%. In addition, market expectations for future inflation as represented by the breakeven inflation rate in the TIPS market have also started to climb, moving from 1.90% to 2.02% over the past month. Lastly the rise in commodity prices has also added to the inflation fears with WTI oil prices rising from approximately \$57 to \$64 over the past month.

The recent rise in interest rates has also been the result of the ongoing shift to more restrictive global monetary policy. We received further evidence of the trend last week as the European Central Bank minutes questioned the gradual path of policy tightening and the Bank of Japan elected to reduce monthly bond purchases by \$10 billion. In the U.S., market expectations for future rate hikes have also been increasing. The market now expects an 85% probability of a rate hike in March and has adjusted expectations for the full year to 2.25 hikes.

Lastly, the markets were rattled over the past week by rumors that China was considering purchasing less U.S. Treasuries. The rumor proved to be unfounded, but highlighted the risks of a disruption in demand by foreign buyers for U.S. bonds. In 2017, foreign buyers added \$160 billion in U.S. Treasuries, the most since 2012. The supply side of the equation also looks unfavorable for U.S. bonds. The supply of U.S. Treasuries is expected to increase sharply, fueled by the rising deficit and the run-off of the Federal Reserve's balance sheet. The recently passed tax bill is expected to add upwards of \$200 billion to the deficit over each of the next four years. As a result, the supply of U.S. Treasury notes and bonds is forecast to increase approximately 50% from \$400 to \$600 billion in 2018. It remains to be seen if investors will demand higher yields to absorb the additional supply.

It's still very early in the race and it's hard to believe the stock market can maintain the current pace, but for the near term we expect interest rates to continue to move modestly higher and the bond market to trail the field.

**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](mailto:info@tortoiseadvisors.com).**

**Disclaimer:** *Nothing contained in this communication constitutes tax, legal or investment advice. Investors must consult their tax adviser or legal counsel for advice and information concerning their particular situation. This podcast contains certain statements that may include “forward-looking statements.” All statements, other than statements of historical fact, included herein are “forward-looking statements.” Although Tortoise believes that the expectations reflected in these forward-looking statements are reasonable, they do involve assumptions, risks and uncertainties, and these expectations may prove to be incorrect. Actual events could differ materially from those anticipated in these forward-looking statements as a result of a variety of factors. You should not place undue reliance on these forward-looking statements. This podcast reflects our views and opinions as of the date herein, which are subject to change at any time based on market and other conditions. We disclaim any responsibility to update these views. These views should not be relied on as investment advice or an indication of trading intent.*