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 the Tortoise Credit weekly podcast. I am Jeff Brothers, Senior Portfolio Manager for Tortoise. I was really looking forward to today's podcast. I had a week packed with interesting and potential market moving information to draw from. Unfortunately, the Federal Reserve meeting, the employment report, the Treasury refunding announcement and U.S.-China tariff negotiations all failed to move the needle on U.S. interest rates. The 10-year U.S. Treasury finished the week unchanged at 2.95% and despite all the news, traded in an eight basis point range. Instead of recapping the data, I will address the market's fixation with nice round numbers. Do you remember the fuss around Dow 20,000? Today the markets are focused on the magical 3.0% level on 10-year Treasury yields. After a sharp rise, over the past six months, the 10-year Treasury yield hit the wall at 3%. In today's podcast, we will discuss why Treasury yields have held at 3.0% and our outlook for a potential break of this important line in the sand.

One reason that yields stopped short of the 3% level was that first quarter economic growth did not live up to expectations. The U.S. economy got off to another slow start to begin the year, with first quarter GDP of 2.3%, compared to 3.2% and 2.9% in the third and fourth quarters of last year. The biggest drag on output was the sharp deceleration in consumer spending, as shoppers kept their wallets closed, despite the benefits of tax cuts.Personal consumption increased only 1.1%, the lowest level since 2013. The weakness, however, was not just confined to the U.S., as both Europe and Asia experienced a similar falloff in economic activity. To break through the 3.0% yield barrier we will need to see a return of the synchronized global growth story.

An adjustment in inflation expectations also fueled the move higher in interest rates. The stronger than expected inflation and wage reports in January raised fears that price pressures were beginning to emerge. The line in the sand at 3.0% held, however, as subsequent readings have shown a moderation in both price and wage pressures. The markets have adjusted to an outlook for 2.0% inflation, but to push 10-year rates through 3.0% we will need to see a reacceleration in price pressures.

As growth and inflation expectations were adjusting, so too was the view on Federal Reserve policy. Similar to how the markets believed inflation was a relic of the 1970s, many market participants were skeptical of the Fed's rate hike forecasts. Last year the markets were expecting only one rate hike in 2018 and none in 2019 compared to the Fed's view of three hikes in each year. With the improved economic growth, rise in inflation and tax cuts, the debate has now shifted to whether the Fed will raise three or four times this year. This shift in market sentiment has put pressure on interest rates, especially on short maturity Treasuries. With the market and the Fed views more closely aligned, it will take something new on the growth, inflation, or supply and demand front to breach the 3.0% rate level.

Lastly, we wanted to comment on 3.0% 10-year yields from a market technical perspective. The run up to 3.0% coincided with a record accumulation of short positons in the market. Now with everyone on the same side of the boat, it has become difficult to find new sellers to push rates up the next leg. With the selling pressure exhausted, it will take time and consolidation around current yield levels to relieve the bearish market positioning.

We do not believe there is any particular magic in the 3.0% 10-year yield level. The pause in rates at 3.0% was a result of disappointing first quarter results and market expectations for growth and inflation getting head of themselves. The very crowded technical short position also slowed the momentum for rising rates. We remain positive on economic growth and expect a rebound from the seasonally weak first quarter. We also expect a gradual rise in inflation pressures that could push core CPI up to 2.5% by year-end. Increased supply from the growing budget deficit should also put upward pressure on rates. It may be a hard fought battle, but we believe we will eventually cross the line in the sand. Ultimately 3.0% is just another number.

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.

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