Tortoise QuickTake Credit Podcast

March 13, 2018

Welcome to the Tortoise QuickTake podcast. Thank you for joining us. Today, a senior member of Tortoise provides 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. Bond managers by nature worry and typically see the glass as half full. In today's podcast, we will discuss how many of the recent market worries washed away over the past week and remarkably, Goldilocks returned.

One of the bigger market concerns has been the threat of rising wages and the potential for sharply higher inflation. These dangers came to the forefront after last month's much stronger than expected increase in average hourly earnings, which climbed from 2.6% to 2.8%. Friday's employment report, however, threaded the needle perfectly between strong job gains and little signs of wage pressures. The February employment report showed a solid 313,000 job additions and an upward revision to the prior two months of 54,000. February's gains were the highest since July of 2016 and increased the three-month average to a very robust 242,000. Despite the better-than-expected payroll gains, wages actually came in less than expected with average hourly earnings increasing only 0.1%. This brought the year-over-year increase back down to 2.6% and brought a sigh of relief to the bond markets. Interestingly, the labor participation rate rose from 62.7% to 63% on the month. The increased participation rate indicates we may still not be at full employment and that slack remains in the labor markets. It might also be the cause of the subdued wage gains, as the supply of labor increased to meet the demand for jobs.

Another risk troubling the bond markets has been the pace of Federal Reserve rate hikes. The markets have adjusted expectations to meet the Fed's forecast for three rate hikes in both 2018 and 2019, but have not calibrated to a potentially faster pace. Since the strong wage and inflation reports last month and the passage of the tax cuts, there has been a steady chorus calling for four hikes this year. The Fed still speaks to a gradual pace of rate hikes, but of late, it is noticeable how both doves and hawks on the board are calling for potentially more rate increases. As an example, Fed Governor Brainard, a long time dove, last week highlighted that "former headwinds for the economy are turning into tailwinds." Friday's employment report, showing weak wage growth and some remaining labor slack, may give the Fed pause, and keep policy on a more gradual tightening path.

Also on the list of worries has been the Trump administration's steel and aluminum tariffs. In isolation, the tariffs should have minimal impact on economic growth and inflation, with benefits to domestic producers coming at the expense of consumers. The more serious consequences are the potential for the tariffs to escalate into a more damaging trade war. As the administration has softened their stance from the original announcement, the market has become more comfortable that the worst case for potential retaliatory trade wars has diminished. The original policy was to include all countries, and was then softened to exclude Canada and Mexico contingent on a NAFTA agreement, and finally excluded Canada and Mexico outright and left the door open for other exclusions. The markets also have appeared to shrug off the departure of Trump's top economic advisor Gary Cohn. The resignation of Gary Cohn, a strong voice in the administration for free trade, does raise concerns that the administration's policies could turn more protectionist.

Last, but not least, the financial markets received potentially good news last week when Kim Jong-un offered to enter into direct negotiations with President Trump. The United States has been down this path with North Korea before and it is hard to forecast the result of a face-to- face meeting between these two unpredictable leaders, but at least for now it is one more item off our list of worries.

After last week it looks like Goldilocks is back and the markets are "just right," but as bond managers we cannot help but worry about how long will it last.

Thank you for listening, 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.

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