

MLP Quarterly Update

11/19/2019

Price and Fundamental Performance

At the end of the third quarter, the MLP Index had a year-to-date total return of 11.6% while energy stocks were down 14.9%, oil prices were up 17.4% and the S&P was up 20.6%¹. Since the escalation of the trade war with China was announced in August, MLP stocks significantly underperformed the market but outperformed energy stocks generally. As of November 18th, the MLP Index was down 2.2% for the year, while energy stocks were down 19.0%, and oil prices were up 23.2%, and the S&P closed up 26.8%.²

MLP earnings reports for the second quarter were strong with the companies on average beating consensus estimates by 1.8% and raising their distributions by an average of 1.0%³ sequentially and 5.6% on a yearly basis. The strongest segment of the market was the transportation and storage companies, which are benefiting from strong production and export volumes, beating consensus estimates by an average of 2.2%³. The gathering and processing companies reported earnings that beat consensus estimates by an average of 1.1%.³

Outlook

We expect crude oil prices to rise during 2020 as global growth accelerates and US production growth moderates in response to pressure on producers to reduce capital expenditures. We expect to see WTI to trade in the \$55-70 range, with prices capped by steadily growing US production supported by higher global demand driven by stimulative global monetary policy and by OPEC production constraints.

The key driver of our higher price view is global monetary policy. In 2019, partly in response to Fed tightening, 10 out of 15 of the world's largest economies were tightening monetary policy, which represented over 80% of global GDP. Currently, 14 out of the 15 largest economies representing approximately 95% of global GDP, are easing monetary policy with an acceleration of activity in the last 6 months in synchrony with Fed easing. There is usually a 6 to 12-month lag in monetary policy, so global economic growth is very likely to accelerate by mid-year 2020.

Portfolio Strategies:

We continue to focus our attention on large capitalization integrated pipeline and storage companies. We believe these companies are best positioned to benefit from increasing exports of crude and natural

¹ Compiled using Bloomberg data as of 09/30/2019. "MLP", "Energy stocks", "Oil prices" refer to the Alerian MLP Infrastructure Index (AMZI), S&P Oil and Gas Exploration and Production (XOP), and the United States Oil Fund LP (USO), respectively.

² S&P refers to the S&P 500 Index (SPX).

³ Compiled with Bloomberg consensus data.

⁴ 10-year Treasury data is from U.S Department of the Treasury website.

gas liquids. We are less concentrated on gathering and processing companies with exposure to Northeast natural gas markets, which are currently suffering from weak natural gas prices.

MLP stock prices have underperformed oil prices year-to-date by 25.4% and the S&P 500 by 28.9% as of November 18, 2019.³ In addition, the group is trading at an average yield of 10.3%, growing at over 4% per year with a free cash flow yield of 12.2%, an EBITDA (cash flow) multiple of 10.8x, average dividend coverage of 1.45x, and leverage of only 4.0x EBITDA.³

The private market for midstream assets is approximately 12-15x depending on the asset type. We believe that there will be significant asset sales and acquisitions of entire companies over the next year as private equity firms and strategic acquirors take advantage of these historically low valuations of midstream assets. There have already been a significant number of M&A transactions this year, with Kinder Morgan recently announcing the sale of a liquids pipeline for 13x EBITDA and Buckeye Partners also going private at a 13x EBITDA multiple. Both Energy Transfer and MPLX have announced that they are exploring large asset sales.¹ With the 10-year treasury⁴ trading at a yield under 2% and utilities and REITs yielding 3%³, we believe that MLPs are dramatically undervalued and that the valuation gap will be closed as more asset sales and acquisitions of whole companies are announced over the next year.

For more information, visit InfraCapFunds.com.

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