April 6, 2020

Welcome to the Tortoise podcast. Thank you for joining us. Today, Tortoise provides a timely update on trending topics in the market.

Hello I am Matt Sallee, Energy Portfolio Manager at Tortoise. You'll have to excuse my scratchy voice today, don't worry I feel fine but I've been on non-stop conference calls and yelling at my kids a ton.

That said, I have the dubious honor this week of covering the hot mess that was Q12020. That reminds me of a funny meme I saw a few days ago that said "2020, pull over, I want the heck out". Just FYI that is the PG version.

So how about first quarter performance? If you're listening to this podcast or have access to a TV, computer, radio, or any other communication device you probably know that it was a bloodbath. The S&P dropped 20%, the 10 year approached 50 base points, this VIX touched over 80, and oil dropped under $20 and the list goes on. To top it all off, the AMZ index closed the quarter at 91. To put this in perspective, that is over 40% lower than the 152 low point the index hit in November 2008. I mean jeez, pipelines are going to see volumes decline, but in our estimation these companies are going to be fine. In most cases for investment grade interstate pipelines we think the distribution payments won't be reduced. Now it's important to distinguish between those companies, especially those that are more natural gas and demand pull driven vs supply push and particular gathering and processing companies. For gathering I'm hard pressed to think of a company who won't cut their distribution if they haven't already.

So what gives me so much confidence in the interstate pipeline companies? In a word, homework. We do our homework and stress test the heck out of our portfolio to test for commodity prices, crude oil production declines, refined product demand shock and lack of access to capital markets among a host of other company specific factors. We are testing 25% cuts in refined product demand, a 30%-40% decline in U.S. crude output, $20 crude, even $10 crude…and we assume the crude oil production drops will never come back. Here is the punchline with 25% near term refined product decline and permanent $30 crude leading to a cumulative 30% production decline we think the vast majority of our portfolio companies not only have sufficient liquidity, can maintain investment grade ratings but can even sustain distributions. This is a far different outcome than what we believe is priced in the market today. For more details regarding our stress test and what we think the market is pricing in stay tuned for an upcoming special podcast where Brian Kessens will cover this topic in detail.

Speaking of our outlook. There has been a lot of debate about how low oil prices will go and speculation it will hit zero or even go negative. It's really hard to say on the NYMEX paper market but in the physical spot market I will tell you that it is already really close. Mid-last week prices in West Texas were around $10 and in North Dakota and Canada we got down to $3 and $4 per barrel, respectively. This is due to the vast oversupply in the market with refinery runs down from the freefall in product demand. This is already leading to the logistics system clogging up and we estimate storage theoretically will approach full in the U.S. in the next 30-60 days at the current pace. To avoid this we expect to see several hundred thousand bbls per day of conventional low output, high cost wells shut in permanently along with curtailments across the rest of the U.S. as netbacks turn negative. While this is painful in the short term, as the economy get backs to normal at some point in the future (hopefully) the E&P industry will be healthier as weaker competitors shut in, merge or otherwise go away leading to reserves being held in the hands of better capitalized, stronger and more disciplined operators.

Which brings me to my next point. The President tweeted last Thursday that he's hopeful OPEC and Russia will agree to cut at least 10 mbpd of supply. We got a bit of confirmation Friday with the announcement of a virtual OPEC meeting to discuss steps to stabilize the market….I wonder if they will use Zoom? This could take the form of Saudi cutting from the current stated 12 mbpd to 9 mbpd, other gulf countries cutting and additional 1 mbpd, Russia cutting 1 mbpd along with a handful of other countries chipping in. While it seems far-fetched I think it's possible because they don't really have a choice. I say this because companies in Canada, Russia, Brazil and likely the U.S. are already curtailing production due to the netbacks I mentioned earlier and possibly soon from physical constraints. So why not announce production cuts in an attempt to stabilize the market, it can't hurt. I don't think it changes the bottom line since we will likely still be oversupplied until the world gets back to some form of normal, even with huge production cuts, high cost production will be wiped out which is healthy.

So while acknowledging the challenging volume outlook ahead we believe some upcoming developments might give the space a boost. Most simplistically assuming we are right about distribution sustainability for Investment Grade pipeline group (which is between 90-100% of our midstream equity portfolios) then simply announcing a flat dividend is likely to be bullish because virtually every name is pricing a cut. Case in point, my favorite midstream company, Energy Transfer, announced a flat dividend on March 31st and subsequently outperformed the AMZ by 20% over the next 3 trading days. Full disclosure here, Enterprise also declared a flat dividend on March 18 and is up 17% but that's less than 30% return for the AMZ since then but a heck of a lot better than the 3% for the S&P500. I've been nothing but wrong about midstream performance for some time now but maybe now the bar is low enough that I'll finally be right. You better stay tuned to find out….

And with that, I'm Matt Sallee, stay safe, San Diego.

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.

The S&P 500® Index is a market-value weighted index of equity securities.

The **PCE inflation rate** is the Personal Consumption Expenditures Price Index. It measures price changes for household goods and services. Increases in the PCEPI warn of inflation while decreases indicate deflation.

Broad Energy = The S&P Energy Select Sector® Index is a capitalization-weighted index of S&P 500® Index companies in the energy sector involved in the development or production of energy products.

Producers = Tortoise North American Oil & Gas Producers Index℠
The Tortoise North American Oil & Gas Producers Index℠ is a float-adjusted, capitalization weighted index of North American energy companies primarily engaged in the production of crude oil, condensate, natural gas or natural gas liquids (NGLs). The index includes exploration and production companies structured as corporations, limited liability companies and master limited partnerships but excludes United States royalty trusts.

MLPs = The Tortoise MLP Index® is a float-adjusted, capitalization weighted index of energy master limited partnerships (MLPs). The index is comprised of publicly traded companies organized in the form of limited partnerships or limited liability companies engaged in transportation, production, processing and/or storage of energy commodities.