

Pipeline companies can persevere in a rising interest rate environment

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- With the rebounding U.S. economy and rates rising, investors are wondering what that could mean for their midstream energy investments and other yield-oriented securities.
- The combination of increasing vaccination coverage, the economy reopening, further fiscal stimulus, and what appears to be an accommodative Federal Reserve policy has 2021 GDP poised to increase at the highest rate in three decades. These developments reinforce a broader global reflation trade, which should benefit commodities and the broader energy sector.
- MLPs and pipelines companies outperformed bond returns in 12 of 15 periods of rising rates since 2000 by an average margin of 7.4% and 8.9%, respectively. Pipeline companies have typically fared better than bonds and other yield-oriented securities such as real estate investment trusts (REITs) and utilities during a rising interest rate environment, but it is important to remember that they are not immune.

Time periods with rising rates since 2000	10-year Treasury yield change	MLP Index returns	Pipeline company returns	Bond returns	Equity returns
Averages	0.9%	5.9%	7.3%	-1.5%	7.3%

10-year Treasury yield change source = Bloomberg. MLP returns source = Tortoise MLP Index® (as of 1/1/2000). Pipeline returns source = Tortoise North American Pipeline IndexSM (as of 1/1/2000). Bond returns source = Bloomberg Barclays U.S. Aggregate Bond Index. Equity returns source = S&P 500® Index. It is not possible to invest directly in an index. **Past performance is no guarantee of future results.**

Let's take a look at both the potential direct and indirect effects of rising rates on pipeline companies.

Direct effects

The direct relationship is fairly simple as it reflects how increasing interest expenses can affect variable or floating rate debt held by companies. The key mitigating factor is that pipeline companies have historically been very conservative in terms of their debt structure. Midstream companies, including long-haul crude oil, refined product and natural gas pipeline companies generally utilize 70 to 100% fixed-rate debt, making their cash flow growth and longer-term performance less sensitive to higher rates. In short, we believe the direct impact of rising rates on pipeline companies is minimal and in our view will not significantly hinder growth.

Indirect effects

The indirect effect of higher interest rates on midstream energy relates to their impact on total return. There are three main factors that can provide a buffer to rising rates: excess coverage can allow for slightly lower returns on invested capital; focus on internal growth versus external growth; and ability to pass through inflation in tariff rates or benefit from increased demand.

First, it's important to distinguish the catalyst for rising rates – typically either rising inflation or an improving economy. Both have potential benefits for midstream energy

- A strengthening economy benefits pipeline companies transporting energy because an increase in aggregate demand typically leads to more volumes transported.
- If inflation is the catalyst, liquids pipeline companies can receive a boost in their tariff rate by an amount based on the change in the producer price index (PPI).

We believe both a stronger economy and inflation are catalysts for rising rates in the current environment. If so, pipeline companies stand to benefit.

History as teacher

MLP and pipeline companies, like all distribution-paying entities, can experience some short-term volatility during periods of rising rates. Historically, midstream energy companies have experienced short-term volatility when interest rates increased, followed by a rebound and solid long-term performance. The following table reflects our analysis of the past 15 periods of one or more consecutive months with a 50 basis point or more increase in the 10-year Treasury since 2000. During those periods, the 10 year treasury yield change has averaged 0.9%, MLPs returned 5.9% and pipeline companies returned 7.3%, compared to -1.5% for bonds and 7.3% for U.S. equities.

Impact of rising interest rates on pipeline companies

Time period	10-year Treasury yield change	MLP returns	Pipeline company returns	Bond returns	Equity returns
3/2001 - 6/2001	0.5%	11.0%	-1.4%	1.1%	-0.9%
11/2001 - 3/2002	1.2%	0.8%	1.7%	-1.9%	8.9%
10/2002 - 11/2002	0.6%	0.2%	2.7%	-0.5%	15.2%
6/2003 - 8/2003	1.1%	7.3%	2.6%	-2.9%	5.1%
4/2004 - 5/2004	0.8%	-8.6%	-2.8%	-3.0%	-0.2%
9/2005 - 6/2006	1.1%	-0.2%	5.0%	-1.2%	5.7%
4/2008 - 5/2008	0.6%	8.3%	11.5%	-0.9%	6.2%
1/2009 - 6/2009	1.3%	32.9%	10.9%	1.9%	3.2%
12/2009	0.6%	6.9%	7.0%	-1.6%	1.9%
9/2010 - 3/2011	1.0%	24.6%	32.1%	-0.8%	27.8%
5/2013 - 8/2013	1.1%	-0.9%	-2.6%	-3.7%	3.0%
2/2015 - 6/2015	0.7%	-5.1%	-1.9%	-2.2%	4.4%
8/2016 - 1/2017	1.0%	9.4%	10.6%	-3.0%	6.0%
9/2017 - 4/2018	0.8%	-4.2%	-3.5%	-2.3%	8.4%
10/2020 - 3/2021	0.9%	61.8%	38.4%	-2.3%	15.0%
Averages	0.9%	5.9%	7.3%	-1.5%	7.3%

As of 3/08/2021 *Time periods are determined using end of month yields and returns. Periods shown are those where the 10-year Treasury yield increased by at least 50 basis points over one or more consecutive months. Returns are period-specific and are not annualized. 10-year Treasury yield change source = Bloomberg. MLP returns source = Tortoise MLP Index® (as of 1/1/2000). Pipeline returns source = Tortoise North American Pipeline IndexSM (as of 1/1/2000). Bond returns source = Bloomberg Barclays U.S. Aggregate Bond Index. Equity returns source = S&P 500® Index. It is not possible to invest directly in an index. **Past performance is no guarantee of future results.**

Looking ahead

We believe pipeline companies remain attractive long-term investments in both periods of economic growth and uncertainty. If higher interest rates are a result of accelerating economic growth and / or increased inflation, pipeline companies are well positioned to benefit through greater volumes transported and / or higher tariffs.

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The Tortoise MLP Index[®] is a float-adjusted, capitalization-weighted index of energy master limited partnerships (MLPs). The Tortoise North American Pipeline IndexSM is a float-adjusted, capitalization-weighted index of pipeline companies domiciled in the U.S. and Canada. The Bloomberg Barclays U.S. Aggregate Bond Index is a broad-based flagship benchmark that measures the investment-grade, U.S. dollar-denominated, fixed-rate taxable bond market. The index includes treasuries, government-related and corporate securities, mortgage-backed securities (agency fixed-rate and hybrid adjustable rate mortgage pass-through securities), commercial mortgage-backed securities (agency and non-agency) and asset-backed securities. The S&P 500[®] Index is an unmanaged, market-value weighted index of stocks that is widely regarded as the standard for measuring large-cap U.S. stock market performance. It is not possible to invest directly in an index.

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