TortoiseEcofin QuickTake Podcast

January 18, 2022

Welcome to the TortoiseEcofin QuickTake podcast. Thank you for joining us as we provide timely updates on the market.

Good to be with you today, I am Quinn Kiley, Managing Director and energy Portfolio Manager at Tortoise and I am happy to host this week's QuickTake Podcast. I hope everyone enjoyed the long weekend despite the snow and rain across much of the country. Last week started with shot to the gut as fears of a hawkish Federal Reserve caused a market sell-off Monday. Fed Chairman Powell walked back some of language in the meeting minutes and markets recovered throughout the rest of the week. The spread of the Omicron variant continues. Cases in the U.K. appear to have rolled over, following the pattern witnessed in South Africa. While not officially confirmed, a similar pattern in the U.S. and globally appears to be taking shape. Of course more tests being available means more cases reported and a lack of tests means unreported cases. Only time will tell when Omicron hits an inflection point and starts to fade, hopefully with South Africa as a guide. With that, let's look at market performance last week.

Markets were mixed:

- The Alerian MLP Index was up 3.6%, and the Index is up 10.7% year to date
- Other energy stocks, represented by the Energy Select Sector Index, were up 4.4% for the week
- In broader markets, the S&P 500 lost -0.3% and ten-year treasury yields rose slightly, finishing at 1.78%

The second trading week of 2022 was light on the news front, but earnings will kick off this Wednesday with Kinder Morgan announcing after the close. Slow as it was, there were some notable developments in the energy industry. Enterprise Products Partners announced the $3.25 billion acquisition of Navitas Midstream, a gathering & processing operator in the Permian basin. The market has suspected Enterprise would make an acquisition given its hoard of cash and de minimus share buyback plans, but the surprise was that the assets acquired were midstream rather than downstream petrochemical assets as they had hinted at previously. Regardless, on a choppy Monday, Enterprise outperformed peers and the broader market. Whether that was due to short covering or market approval is unclear but overall the transaction is likely additive to free cash flow generation in 2022, so a net positive for the company. In an expected move, Targa Resources acquired Stonepeak Partners' interest in some jointly owned midstream assets for $925 million. This completes a structural simplification effort the company had announced earlier. In other news, Exxon Mobil will acquire a 49.9% interest in Biojet AS, a Norwegian company that plans to produce biofuels from wood waste for the transportation sector. This is yet another example of how traditional energy and utility companies are leading the way towards a lower emission economy.

Given the light news week, I thought it would be helpful to give a more fulsome outlook for 2022. In our view, the set up for 2022 is very similar to what it was at the beginning of 2021. As vaccine adoption continues to spread and COVID-19 treatments are developed, the economic impact of the virus will diminish and demand for commodities will likely continue to recover to levels exceeding pre-pandemic demand. Underinvestment in energy commodity production will lead to a period of undersupply that will push prices higher. Higher prices may beget investment, and if that occurs, production will rise to meet demand in the medium term. Regulatory and political headwinds towards developing new energy infrastructure in North America means incumbent industry players are well positioned to participate in the demand recovery. Increased demand leads to increased volumes with minimal need for additional capital expenditures. The result, higher free cash flow with the ability for companies to return that cash to shareholders through increased dividends, share repurchases, and debt reduction. For the record, we support all three. We saw this dynamic begin to play out in 2021 and we think there may be a chance that it accelerates and broadens across the industry in 2022.

Essential to this scenario playing out is the presumption that the impact of COVID-19 wanes overtime. If a new variant disrupts this premise, then the outcome for investors may be more muted. At year-end 2021, inflation was near forty-year highs. The inflationary threat to the economy requires some monetary tightening by the Federal Reserve, and we fully expect to see interest rates edge higher in 2022. Given the high free cash flow yields in the energy industry, moderately higher rates should not impact investment performance. Indeed higher inflation may draw investors to the energy industry as a hedge against inflation. The impact on oil and gas producers is obvious, higher prices improve margins. The benefit of inflation to midstream companies may be less obvious. While there are some midstream assets with direct exposure to higher commodity prices, even fixed fee pipelines can benefit. Most tariff regimes and long-term contracts allow for a pass-through of inflation to the counterparty. The impact may be slightly delayed, but longer term the brunt of inflation is born by the customer not the midstream service provider. This inflation scenario does present the risk that the Fed overshoots and sends the economy into a recession. If that were to happen it would undermine the momentum from the economic recovery we are currently experiencing. One other concern is China's zero COVID policy to tamp down the spread of the virus in the run up to the Winter Olympics in Beijing. While effective in slowing the spread this winter, the policy could lead to wider infection later in the year as fewer people will have been exposed to the virus once lockdowns are lifted. If this happens, the world's largest importer of crude oil and liquefied natural gas (LNG) could see extended lockdowns and lower demand for these commodities.

There is risk to the upside as well. OPEC+ has been executing on its plan to bring 400,000 barrels per day (bpd) of capacity back to market each month. So far, the group has been unable to meet these heightened quotas and as of early January the group is at ~116% compliance; meaning there is more production capacity offline than intended. If this trend continues into the summer, lack of supply could push prices higher. Furthermore, consensus expectations are for U.S. shale production to grow between 700,000 and 1 million bpd in 2022. If capital constraints or an abundance of caution by management teams limits this growth, supply/demand imbalances could push prices higher still. On the natural gas front, LNG export capacity is tapped out, and meaningful new capacity is not expected to come on line in 2022. The Russian natural gas pipeline Nord Stream 2 could bring relief to Europe, but it is caught up in political limbo with regulatory hurdles needed to be met in Germany and negotiations between the U.S. and Russia over the latter's threatening posture towards Ukraine. If this pipe does not flow in 2022, it is likely natural gas shortages in Europe will prop up prices globally in the near term. Once again, this is a positive for incumbent LNG exporters like Cheniere, a large holding in many of our strategies.

In summary, there are many economic, political, and medical uncertainties entering 2022, similar to 2021. However, the most likely outcomes create a positive set up for energy commodity prices and high free cash flow generation from energy infrastructure companies. Broadly, we expect energy equities to outperform the broader market in 2022, as they did in 2021.

We largely expect positive earnings announcements from the energy industry in the coming weeks. We will pass along any read-throughs from Kinder's earnings in our next podcast. Thanks for joining us and we will be back next week. Please stay safe.

Thank you for joining us. And stay tuned for our next episode. Have topics you want covered or other feedback to share? Write us at info@tortoiseecofin.com.

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The **Alerian Midstream Energy Index®** is a broad-based composite of North American energy infrastructure. The capped, float-adjusted, capitalization-weighted index, whose constituents earn the majority of their cash flow from midstream activities involving energy commodities, is disseminated real-time on a price-return basis (AMNA) and on a total-return basis (AMNAX).

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