



Timely thematic topic:

Key catalysts for energy infrastructure for 2022

As the world economy continues to reopen, we believe energy is positioned for a reflation around increased energy demand. The broader energy sector, as represented by the S&P Energy Select Sector® Index, returned 53.43% for 2021 and energy was the top performing S&P sector in 2021 by a wide margin. We believe many of the factors that drove strong performance last year have only accelerated for 2022. Specifically:

- Wall Street firms are recommending preparing portfolios for a higher inflationary environment including more energy exposure in most cases. Historically, midstream energy equities have performed well in inflationary periods.
 - We believe this isn't just a "trade" for 2022. In fact, Goldman Sachs is specifically calling for a decade-long commodity super-cycle in a recent research report.
 - Similarly, Barron's put Energy Pipelines as top income investments for 2022 in the January 3, 2022 edition.
- Fundamentally, the Omicron variant has been much less impactful than initially feared with immaterial impact on energy demand and experts calling for COVID to transition from a pandemic to endemic in 2022.
- Regarding longer-term demand, the European Union is now expected to include natural gas as a sustainable in its investment classification system known as the as the EU taxonomy pertaining to the use of electricity. This comes on the heels of South Korea recently classifying liquefied natural gas (LNG) as a sustainable investment.
- We project midstream energy to have a free cash flow yield of roughly 15% annually over the next 5 years. A FCF yield that high would create cumulative free cash flow over the next several years greater than the current market capitalization of the entire sector.

Several events in 2021 reminded investors how critical energy infrastructure is to daily life. Notable events like Winter Storm Uri in Texas, the cyber-attack of the Colonial Pipeline, Hurricane Ida in the Gulf Coast, or U.S. LNG cargoes rapidly replenishing Europe's low gas storage levels via LNG tankers all argue towards a holistic view towards energy transition.

With inflation increasing throughout the year, many investors began to recognize midstream as an asset class with inflation protection. Pipelines typically have long-term contracts with inflation protection from regulated tariff escalators. Additionally, tariffs on regulated liquid pipelines typically include an inflation escalator. This allows increases aligned with the Producer Price Index (PPI) offering some protection from inflation. Through November 2021, the Producer Price Index increased by 9.0% from the prior year which could be a material driver of cash flows in 2022.

Conclusion

The broad energy sector performance in 2021 surged in spite of investor concerns about the COVID-19 Omicron variant's impact on global energy demand. The global economic recovery is expected to continue into 2022, driving further energy demand and the need for energy infrastructure.

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