MLP and Energy Infrastructure Market

Second Quarter 2020 Commentary

OVERVIEW

Master Limited Partnerships (MLPs), as represented by the Alerian MLP Index ("Index") returned 50.18% for the quarter and -41.43% for the one-year period ending June 30, 2020. In comparison, the S&P 500® Index returned 20.54% and 7.51 for the quarter and one-year, respectively. Coming off the worst quarter in history for the midstream energy and MLP market, Q2 exhibited strong performance as the market rebounded off its extreme lows in March.

OUTLOOK

The second quarter felt like one of the longest quarters in history, yet the S&P 500 delivered one of its best quarterly performances of all-time. The energy sector represented by the S&P 500 Energy Select Sector Total Return Index outperformed the S&P 500 in the second quarter rising by 32.14%. Energy infrastructure as represented by the Alerian MLP Index outperformed the energy sector rising by 50.18%. Investors continually ask us what the most compelling attribute of the midstream sector is currently. Right now, the answer has to be the current income or yield offered by the midstream sector. The current yield of the Alerian MLP Index is approximately 12%. The dividend yield of the S&P 500 is 2%, so clearly the energy infrastructure sectors offer investors a great opportunity to capture current income in a period when Treasury yields are low and yields are expected to remain low at historically low levels in the future.

Although MLPs and midstream securities performed well in the second quarter and appear significantly undervalued, they remain significantly down for the year-to-date and 1-year periods. Investor sentiment is poor as investors have faced distribution cuts across MLPs, midstream securities, and investment products tied to them. Investment products with leverage including closed end funds, reduced leverage significantly in the first quarter of the year and increased it by a much lessor amount in the second quarter. This negatively impacted performance and likely led to further investor concern. Investor sentiment is also being impacted by the regulatory environment, discussed below, and the potential impact of the upcoming U.S. elections.

As we enter the third quarter, we are heading into what is traditionally the hottest time of the year. For much of the country, July is likely to live up to the billing. Meteorologists are projecting that excessive heat will persist over the short term for most of us. While this may be a challenge for outdoor activities it does increase energy usage, as consumers fire up their air conditioning. NOAA (National Oceanic and Atmospheric Administration) has also issued a watch for a La Niña this year, which portends an active Atlantic hurricane season. Of course, an active hurricane season could temporarily disrupt Gulf Coast production and possible some midstream assets.

For midstream investors, the hot weather would normally provide a good backdrop for positive returns. But as we enter the third quarter, regulatory issues are drawing everyone's attention. An early ruling by the U.S. District Court for the District of Columbia ordered the Dakota Access Pipeline (DAPL) to shut down by August 5. Although the

1,000+ mile, 30-inch diameter DAPL pipeline has been operating for 3 years the court ruled that the original Corps of Engineers permit should not have been granted due to an inadequate environmental impact review. The big stories here are first that this appears to be an unprecedented judicial order to shut down a normally operating pipeline and second that this pipeline is a major player in the takeaway capacity in the Bakken.

This impacts MLPs and midstream companies, Energy Transfer and Phillips 66 Partners, which are major owners of the pipeline and holdings in the Fiduciary/Claymore Energy Infrastructure Fund and would be directly damaged by the potential shutdown. The EBITDA impact of a shutdown could be low-to-mid single digits for Energy Transfer and potentially higher for Phillips. The market impact was significant as investors immediately priced in meaningful odds that a shutdown will occur. ONEOK, a midstream corporation, was also impacted over expectations that a significant amount of North Dakota based oil production might be shut in due the lack of cost-efficient takeaway capacity. DAPL is the largest pipeline in the Bakken and a shutdown would force volumes to other pipelines with capacity or to more expensive rail options. Either way producer takeaway will be more expensive and shut ins would be likely.

There was also good regulatory news as we entered the third quarter. The Supreme Court on July 6th agreed to reinstate streamlined permitting for pipelines across the country, except for Keystone XL. The justices partially granted the Trump administration's request to freeze a lower court's order that barred the use of a fast-track water permitting program for pipelines while an appeal process plays out in the Ninth Circuit. But the court, however, declined to revive the key permit for the embattled Keystone XL project. For MLPs and midstream companies this ruling is an important risk reducer for new projects with clear exception of TC Pipelines, who faces additional delays with Keystone. A winner is the Mountain Valley Pipeline, EQM Midstream's 300+ mile natural gas pipeline which is nearing completion after a series of delays.

These recent events served as an additional reminder that large, new build midstream growth projects are becoming increasingly more expensive and time consuming to complete. Of course, the flip side to the difficulty completing and operating these new projects is that existing infrastructure becomes more valuable. There is a silver lining here.

Despite the challenges with growth projects, MLPs and midstream companies continue to operate effectively in a challenging environment. Distribution announcements are a key indicator of continued management confidence in their businesses and many large, diversified MLPs maintained their distributions in the second quarter. In early July, the announcements started for the third quarter. Enterprise Products and Plains All American were two early notables and both were in-line with expectations.

The macro factors that impacted the energy sector in the first half of 2020 such as declining global energy demand and global oil oversupply are expected to turnaround in the second half of 2020. So, what do we believe will be the key drivers for the second half of 2020 in the energy sector? First, global energy demand gradually returns as economies revive. Second, global oil markets shift from being oversupplied to being undersupplied and that results in global oil inventories approaching normal levels. Third, U.S. energy companies stay disciplined, cut capital expenditures, and return capital to shareholders. The companies that are poised to lead the energy sector positioning themselves to deliver free cash flow that will be returned to investors in the form of dividends and stock buybacks over the next decade.

Thank you for your continued trust and support. As always, we welcome any questions you may have.

Sincerely,

The Tortoise St. Louis investment team

As of 6.30.2020, the Fiduciary/Claymore Energy Infrastructure Fund's portfolio contains has the following allocations for the companies referenced in this commentary: Energy Transfer LP, 7.6%; Phillips 66 Partners LP 5.9%; Enterprise Products Partners, LP 8.3%; Plains All American Pipelines, LP 8.2%; EQM Midstream, 0%; and ONEOK, 0%.