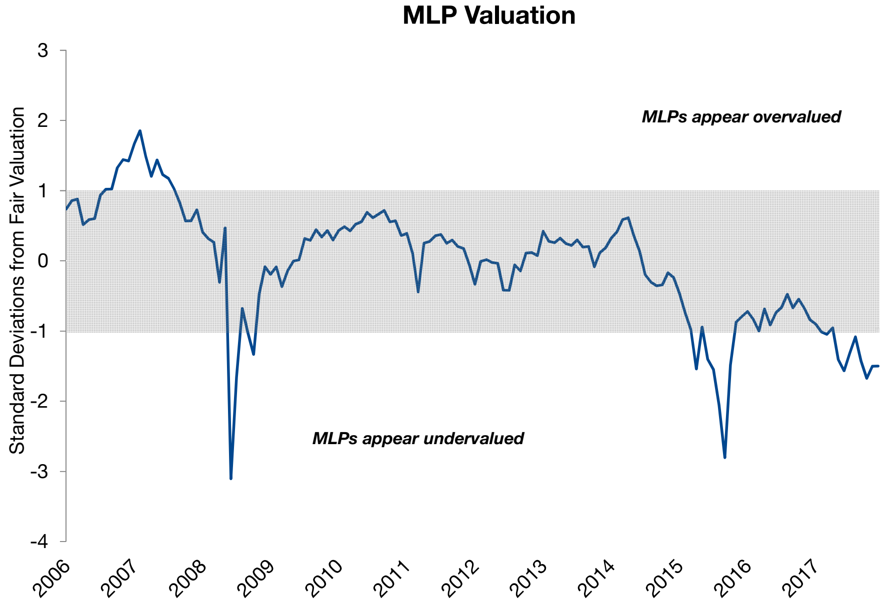
MLP Market Update

May 2018

COMMENTARY

Master Limited Partnerships ("MLPs"), as represented by the Alerian MLP Index ("Index"), gained 5.1% during the month of May. Year to date, the Index is now in positive territory, up 0.9%. If the second quarter ended on May 31, performance for the quarter to date would rank 11th all-time for the Index. Fundamentals have been improving steadily since February 2016. Recent price rebounds since the weakness attributed to the Federal Energy Regulatory Committee (FERC) policy shift may represent a catch up for MLPs relative to the strong industry environment for energy, in general. Despite recent performance, MLPs remain undervalued due in large part to the uncertainties we discuss below.



Period: 12/31/1995 – 05/31/2018
Source: FactSet Research Systems
Composite valuation based on both relative and absolute valuation metrics. Past performance is no guarantee of future results
Valuations and long-term return expectations do not represent or predict the performance of any particular investment.

OUTLOOK

2018 has been an eventful year for MLPs and energy infrastructure companies. The inflection point may well have been the FERC's policy statement that pipelines it regulates that are owned by MLPs will not be allowed to recover tax allowances through their tariffs going forward. Although not all midstream assets are impacted, and very few companies are acutely harmed, the surprise announcement triggered a series of events that may have long-term implications for investors in listed energy infrastructure. We will discuss the immediate implications, as well as some potential outcomes, and how investors might want to think differently about their investments in the future.

The FERC policy decision caused the entire MLP group to sell off the last two weeks of March. In April, the market realized that the impact was minimal for most energy infrastructure companies, and most names in the group rallied back. Several MLPs, Enbridge Energy Partners (EEP/EEQ), Spectra Energy Partners (SEP), Williams Partners (WPZ), Dominion Partners (DM), TC PipeLines (TCP), and Boardwalk Pipeline Partners (BWP), eventually acknowledged that the FERC policy shift would have material negative impacts on their cash flows. Whether the companies initially claimed harm (EEP) or not (TCP), they have all reacted to the policy change in one way or another. EEP/EEQ, SEP, and WPZ have all announced that their parent companies will buy in the underlying MLPs, simplifying their structure by leaving a single corporate midstream entity as the surviving entity. TCP, who had previously claimed no harm, slashed its distribution by 35% and announced that TCP was no longer a viable funding entity, leading many market participants to assume that TCP's parent company, TransCanada Corporation will try to buy-in the MLP at its current discounted price. BWP has been a wounded MLP for years after slashing its distribution by 81% in 2014. BWP announced that the FERC decision may force them to convert to a corporation, and their partnership agreement allows the MLP to be bought in by its parent company, Loews Corporation, in such a circumstance. Finally, DM has filed a complaint with the FERC, making a legal argument that the FERC abdicated its regulatory role to the courts and the policy-making process is invalid as a result. More to come on that front, but the fate of DM as an independent MLP is uncertain for now. The end result of these announcements and potential acquisitions for current target unitholders are a near-term tax realization and lower cash payments going forward should the investor retain the parents' shares.

These simplification announcements were initially welcomed by the market, although longer term the performance benefit has been more muted. The initial positive reaction is notable, as these transactions were proposed at little to no premium to the targets' previous closing prices. The reasons are two-fold: 1) bringing the MLPs under the corporate parent likely solves the FERC issue, and thus restores visibility to the underlying pipeline cash flows, and 2) the market has a perception that a simpler story without incentive distribution rights or apparent conflicts of interest makes for a more valuable traded entity. The first reason is unique to a few negatively impacted MLPs; the second may be applicable to other MLPs with public midstream parents, whether in corporate form or a publicly traded partnership (MLP). Accordingly, other simplification transactions have been announced and more may be coming down the pike. The table below shows those transactions already announced and those we believe are likely within the next two years.

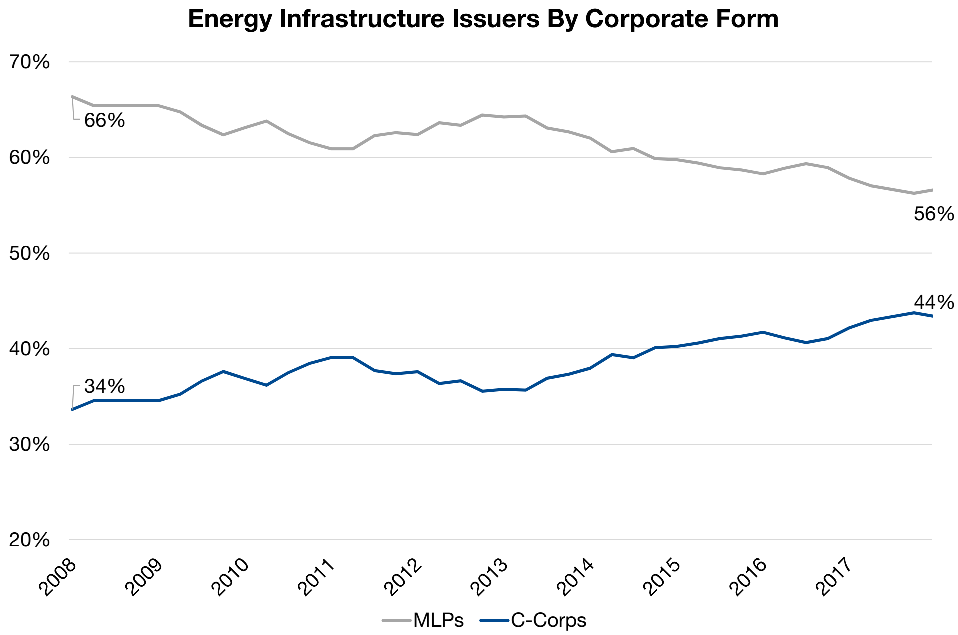
Announced Simplification Transactions

Acquirer		Target		Impacted By FERC
Name	**Ticker**	**Name**	**Ticker**	
Alliance Resource Partners, L.P.	ARLP	Alliance Holdings GP, L.P.	AHGP	No
Cheniere Energy, Inc.	LNG	Cheniere Energy Partners LP Holdings, LLC	CQH	No
Enbridge Inc.	ENB	Enbridge Energy Partners, L.P. Class A	EEP	Yes
Enbridge Inc.	ENB	Enbridge Energy Management, L.L.C.	EEQ	Yes
Enbridge Inc.	ENB	Spectra Energy Partners, LP	SEP	Yes
EQT Midstream Partners LP	EQM	Rice Midstream Partners LP	RMP	No
NuStar Energy L.P.	NS	NuStar GP Holdings, LLC	NSH	No
Tallgrass Energy GP LP Class A	TEGP	Tallgrass Energy Partners LP	TEP	No
Williams Companies, Inc.	WMB	Williams Partners, L.P.	WPZ	Yes
American Midstream Partners, LP	AMID	Southcross Energy Partners, L.P.	SXE	No

Expected Simplification Transactions

Acquirer		Target		Impacted By FERC
Name	**Ticker**	**Name**	**Ticker**	
Antero Midstream GP LP	AMGP	Antero Midstream Partners LP	AM	No
Energy Transfer Equity, L.P.	ETE	Energy Transfer Partners LP	ETP	No
EnLink Midstream LLC	ENLC	EnLink Midstream Partners, L.P.	ENLK	No
Loews Corporation	L	Boardwalk Pipeline Partners, LP	BWP	Yes
Cheniere Energy, Inc.	LNG	Cheniere Energy Partners, L.P.	CQP	No
MPLX LP	MPLX	Andeavor Logistics LP	ANDX	No
TransCanada Corporation	TRP	TC PipeLines, LP	TCP	Yes
Western Gas Equity Partners LP	WGP	Western Gas Partners, LP	WES	No

Should these transactions occur, one outcome is an altering of the available investment choices in the midstream energy sector. Long ago, before the Financial Crisis, the only way to invest in listed midstream was through MLPs. Since the Financial Crisis, the midstream sector has evolved, with more and more opportunities to invest through a choice of corporations or MLPs. This evolution was a key driver of why we launched our open-end funds as Regulated Investment Companies (RIC) that invest in both MLPs and energy infrastructure corporations.



Period: 6/30/08 to 5/31/18. Source: Advisory Research, Inc.
Note: Contains all issuers which are a part of the MLP and Energy Infrastructure universe.

The increasing number of corporate midstream investment options was originally prompted by energy conglomerates breaking up and resulting in an entity that was primarily owning and operating energy infrastructure assets. More recently, the number of MLPs has decreased through transactions like those described above where the corporate general partner (GP) buys in the underlying MLP. If we narrow our investment universe down to pure play midstream entities, pro forma for the transactions listed above, there will be 41 midstream MLPs and 12 corporations. Both groups offer attractive cash payouts to investors and an expectation that those payouts will grow in the future. The corporations tend to be larger and more liquid and pay slightly lower yields but with slightly higher dividend/distribution growth. For midstream investors, both MLPs and corporations offer attractive characteristics and whether to choose either or both is dependent on the specifics of the investor.

Midstream Characteristics	Number	Market Cap ($Bn.)	3 Month Average Daily Volume ($mm)	Current Yield (%)	2018 (Run Rate) Distribution Growth (%)	2018 (Run Rate) EBITDA Growth (%)	Last 12 Month Debt/EBITDA
Midstream MLPs	41	2.7	9.4	7.7	6.0	10.7	4.3x
Midstream C-Corps	12	7.6	53.9	5.1	7.4	6.8	4.4x

Data as of May 31, 2018.
2018 distribution growth & EBITDA growth are consensus median estimates from the FactSet Research Systems estimates database.
The characteristics are the median value for the universe they are a part of (Midstream MLPs vs C-Corps).
Source: Advisory Research, Inc., FactSet Research Systems

Investors seeking exposure to these must-run midstream assets must now evaluate both MLPs and midstream corporations. Indeed, since the most recent trend began with the collapse of the various Kinder Morgan entities in 2014, we have been discussing this changing environment with our clients. Although MLPs remain more tax efficient vehicles, where appropriate, we have owned both MLPs and corporations and are likely to do so in the future. Our separately managed accounts and open-end mutual funds are well positioned for these dynamics, but other MLP investment products may not be. Specifically, we expect to see some MLP-dedicated (C-Corp) funds, who pay taxes at the fund level, add more midstream corporations to their portfolios and in some cases the fund may convert to a RIC to eliminate the tax inefficiency of holding corporates in those funds.

Another knock-on effect of these simplification transactions is the impact to the common benchmarks for the midstream sector. The indices with the most passive dollars tied to them are the Alerian MLP Infrastructure Index (AMZI) and the Alerian MLP Index (AMZ). If we look at the deals announced so far, they will result in removing approximately 15.3% and 12.4% from the AMZI and AMZ, respectively. Those numbers grow to 39.9% and 35%, if one includes the deals that are likely to be announced in the future. In our view, it is likely that Alerian once again changes the rules of these indices to accommodate the changing midstream investment landscape. If not, investors may seek to change to a benchmark that includes corporations. We assume Alerian will, in fact, change its index rules to protect the $15 billion dollars of assets in affiliated products upon which its business model relies. Potential changes may include making listed general partners structured as MLPs eligible for index inclusion, as they once were. Some market participants expected Alerian to include midstream corporations in the indices as part of last year's index reconfiguration, and that may happen this time around. Whether changes are made or not, we expect to see some funds in investment products that are not configured appropriately for today's midstream environment to rotate into those products that are.

MLP governance continues to be a hot topic among investors. Meaningful governance differences exist between MLPs and corporations in important areas such as the management's fiduciary standard, board independence, and shareholder votes. MLP partnership agreements provide guidance to the management but in many cases general partners have significant discretion in their decision-making. We have seen many examples of strong MLP governance over the past 25 years. Unfortunately, the recent exercise of that discretion by many management teams and sponsors has eroded the faith of investors, first by cutting distributions and later by buying in their MLP, often creating a taxable event for the investor and frequently offering a small or non-existent premium. Many investors feel that the current MLP structure is unfriendly to the LP unitholder. We will be working with other MLP investors to strengthen MLP governance, seeking more independent Boards and stronger LP voting rights.

A related topic is incentive distribution rights (IDRs), which have been a part of the MLP structure since the late 1980's. When they were introduced, they were viewed as an incentive for the GP to grow the distribution to the benefit of both the LP and the GP. Typically, the management team's units were subordinated to the LP units and the IDRs were viewed as the management's upside for success. Over the years, the subordination terms weakened, which limited management teams' risk if their growth plans did not work out. Management teams were more incented to take on risk and to grow rapidly to realize the potential value of the IDRs. The side effects were more distribution cuts for the failed growers and a very high cash cost of capital for those who successfully executed on growth. Unwinding IDRs is a challenge as there is a conflict of interest between the GP and the LP. This unwinding process has resulted in some good and bad examples of governance. Going forward we believe IDRs will have some place in the MLP structure, but they need to be capped at reasonable levels and have stronger LP protections when they are unwound.

Despite a very noisy year for energy infrastructure, we believe the table may be set for a strong 2018 as we look forward. Valuations remain attractive, fundamentals are sound, and although disruptive, the trend in simplifications removes uncertainty from tens of billions of dollars of market capitalization for the group.

ATTRIBUTION

The broad based MLP rally continued in May following improved returns in April. Boosted by a strong earnings season, nearly all MLPs in the Index participated in the rally, except those entities perceived to be negatively affected by the recent FERC decision. Those 6 names (SEP, EEP, TCP, DM, WPZ, and BWP) returned on average -8.3% during the month. Natural gas related sectors traded well as gathering and processing and midstream natural gas sectors were two of the top performing sectors. One clear trend that emerged were names with the highest expected distribution growth performing better than names with lower distribution growth.