ADVISORY RESEARCH
INVESTMENT MANAGEMENT

MLP & Energy Infrastructure Market

Second Quarter 2019 Commentary

OVERVIEW

Master Limited Partnerships ("MLPs"), as represented by the Alerian MLP Index ("Index") returned 0.12% for the quarter and 3.09% for the one-year periods ending June 30, 2019. These returns compare to the S&P 500 returns of 4.30% and 10.42% for the quarter and year, respectively.

Year to date the Index is up 16.96% making this its best first-half performance since 2012. The return is very strong in comparison to broader energy indices and is in-line with other higher yielding assets such as REITs and utilities.

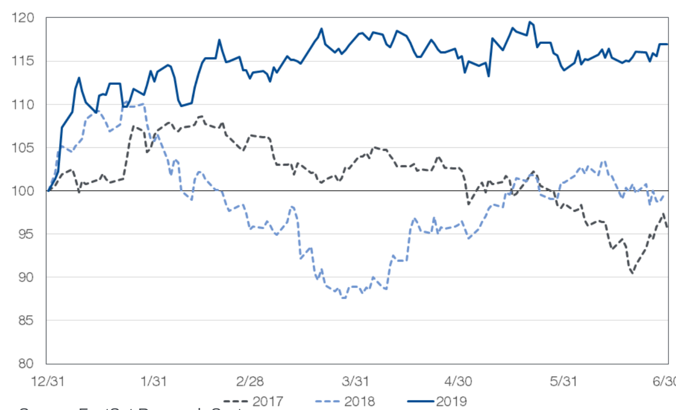
During the quarter, Piper Jaffray announced a transaction that will result in the Advisory Research MLP team joining forces with Tortoise. The transaction is expected to close in the second half of 2019. Advisory and Tortoise are two of the earliest investors in MLP & Energy Infrastructure assets and we believe the combined entity will be a leader in this category. Other than the Tortoise name, our clients should notice little change as the existing Advisory Research team will continue to manage its differentiated strategies for our clients.

OUTLOOK

We are encouraged by MLP returns through the first half of the year. As shown in the chart, strong returns early in 2017 and 2018 faded by mid-year. This year is shaping up differently as strong fundamentals combined with rising distributions are creating more investor confidence in the outlook for midstream assets.

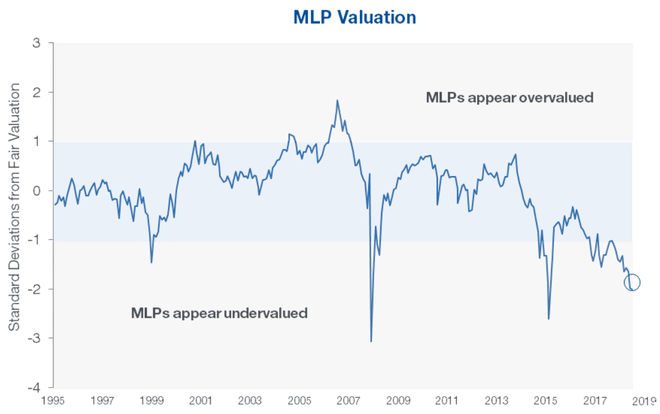
Our key issues table remains slanted to the positive. Very attractive valuation levels and the resumption of distribution growth are important positives while the challenging political and regulatory environment remains an impediment to future returns. Given the current outlook, we are confident that long-term returns should be strong compared to similar asset classes.

First Half Alerian MLP Index Performance (TR) 2017-2019



Source: FactSet Research Systems

KEY ISSUES	Positive	Neutral	Negative	Comment
VALUATIONS	☑			We believe MLPs remain undervalued on an absolute and relative basis versus comparable asset classes
POLITICAL AND REGULATORY			☑	Infrastructure regulation is increasingly local, making for a more complicated operating environment
COMMODITY PRICES		☑		Despite recent volatility, commodity prices are at the low end of our expected range
INTEREST RATES	☑			Interest rates remain low and are expected to stay around current levels
DISTRIBUTION GROWTH	☑			After 4 years of decline, distributions are inflecting and showing signs of growth
ENERGY INFRASTRUCTURE BUILD-OUT		☑		Multiple projects coming online is positive for cash flow but increased capital discipline by E&Ps may delay demand for new infrastructure for midstream companies



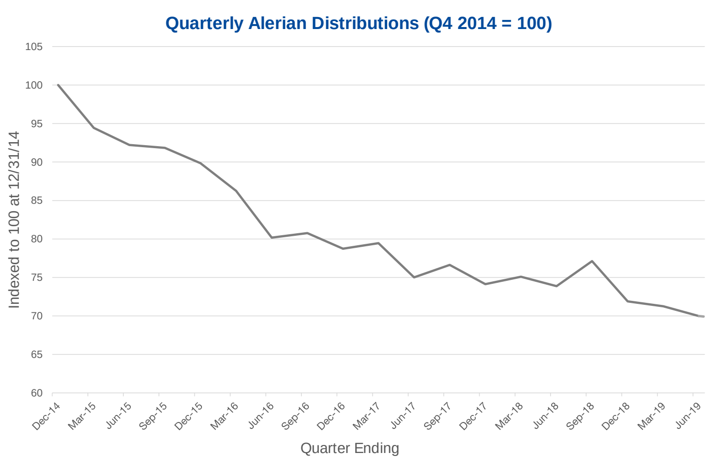
Period: 12/31/95 to 6/30/19. Source: Advisory Research, FactSet Research Systems
Composite valuation based on both relative and absolute valuation metrics.
Standard deviation is a measure of volatility, which shows how much variation exists from the average return.

Valuation is a key driver of our positive outlook. Our valuation chart shows valuation is as attractive as we have seen, outside of crisis environments. At June 30, the spread between the median MLP yield and the Bloomberg Barclays U.S. High Yield Bond Index (Ba) yield is the largest it has been over the nearly 25-year period we have tracked this metric. While Fed expectations for a rate cut have pushed corporate yields down, the Median MLP yield remains stubbornly high.

The median EV/EBITDA multiple, another key metric, was 9.6x at midyear, 2.5x below the historical average of 12.1x. It appears investors are taking note. During the quarter Buckeye Partners, an MLP with a long and successful history, was purchased for 11.6x its expected 2019 EBITDA. As we have noted in recent communications, private market valuations for energy infrastructure are higher than public market valuations. We do not believe this valuation difference is sustainable and expect public valuations to improve.

A strong fundamental outlook is also driving our positive outlook. Fundamentals for U.S. midstream infrastructure are sound and should strengthen in the latter half of 2019. Overall, we expect the supply of energy commodity volumes to be higher and demand for midstream services to remain steady. We expect this environment to be reflected by positive year-over-year EBITDA growth announcements, and thus a positive environment for total returns over the longer-term. Current valuations still reflect negative investor sentiment caused by the distribution cuts of the past four years and not our strong fundamental outlook, which presents an opportunity for investors going forward.

There are some fundamental concerns. Crude oil prices have been volatile this year. Downward pressure was caused by rising storage inventories, which we believe was due to refiners preparing for the driving season and new pipelines filling up to prepare to start delivering crude oil. Despite the negative optics of higher inventories, and associated short-term trading activity, we believe both of these observations bode well for crude oil midstream assets as we move into late 2019. Upward crude oil price activity has been the result of geopolitical events, primarily between the U.S. and Iran. The outcome of this tension is unknown, but we acknowledge this could have further impacts on crude oil pricing in the U.S. Although our portfolios and indeed the midstream asset class are oriented toward natural gas handling and transmission, we expect continued crude oil volatility to affect midstream trading for the remainder of the year. Recent weakness in prices for crude oil and natural gas liquids (NGLs), which are related, could cause weaker processing margins during the summer. Again, volumes should be higher, so any price weakness in midstream securities is transitory in our view.



Period: 12/31/14 to 6/30/1. Source: Advisory Research, Alerian
Note: SNMP cuts Q2 distribution by 70%. AMID closes before Q2 distribution paid. ANDX / MPLX closes before Q2 distribution paid. BPL closes before Q3 distribution paid.

After four-plus years of declining distributions, we expect MLPs and the broader midstream investment universe to start increasing distributions as we move through the remainder of 2019. This should serve as a catalyst to improve investor confidence and lead to higher valuations. We believe distributions are as secure as any time during the last decade. Balance sheets are healthier, distribution coverage is higher, commodity sensitivity is lower, and the asset class is less reliant on capital markets.

These changes have led to lower MLP price volatility. After two 50%+ pullbacks in the past 12 years, investors have pushed management teams to operate more conservatively. Recent performance suggests that investors are rewarding the more predictable results.

It is also noteworthy that crude oil price volatility has been increasing in recent months. Crude oil price volatility has historically been much higher than MLP price volatility. With MLPs managing their businesses in a more conservative manner, we expect that MLPs will be considerably less volatile than crude oil prices moving forward. We are seeing other signs of investor confidence returning. IPO activity has resumed and several new midstream-oriented investment products have been well received by investors.

Themes in our portfolio include a preference for midstream infrastructure that is integrated from the wellhead to the end user. These companies, which generally reside in the Diversified Infrastructure sector, benefit from touching volumes multiple times across the value chain. We are also overweight midstream entities with meaningful exposure to rising export markets. Longer-term, we continue to be overweight natural gas infrastructure compared to oil infrastructure.

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

Sincerely,

Advisory Research MLP & Energy Infrastructure Team

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