MLP and Energy Infrastructure Market

Third Quarter 2019 Commentary

OVERVIEW

Master Limited Partnerships (MLPs), as represented by the Alerian MLP Index returned -5.02% for the quarter and -8.13% for the one-year period ending September 30, 2019. In comparison, the S&P 500® Index returned 1.70% and 4.25% for the quarter and one-year, respectively. Year to date, MLPs returned a strong 11.08% in comparison to broader energy indices but underperformed other higher-yielding assets such as REITs and utilities which each returned more than 20% for the same time period.

The Advisory Research MLP team officially joined forces with the Tortoise team in a transaction that closed during the third quarter. This brings together two highly experienced and tenured midstream energy pioneers with strong track records and complementary investment philosophies anchored in fundamental research. We believe the combined entity can be best-in-class. Other than the Tortoise name, our clients should notice little change as the St. Louis investment team will continue to manage differentiated strategies for our clients.

OUTLOOK

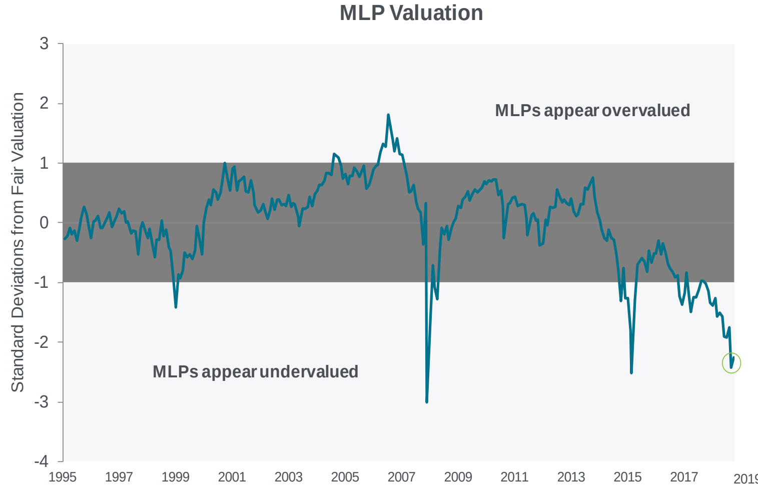
Energy equities had weak performance during the third quarter, amidst broader weakness in crude oil and natural gas prices. Fears of a global economic slowdown have dampened expectations for global oil demand. This concern appears to be widely held enough that the Iranian attack on Saudi Arabia's crude oil infrastructure barely elicited a crude oil price response.

This example of the relationship between geopolitical risk and crude oil prices was not enough to buck the downward trend in crude oil prices. West Texas Intermediate crude oil prices remain almost 30% below last year's highs. We believe this is a key factor affecting investor sentiment towards energy equities and the reason why prices have only marginally improved despite reduced risk in the energy industry through stronger balance sheets and lower capital spending plans. Our long-term outlook is bullish as we believe the industry is much healthier than investor sentiment indicates. Valuations are attractive and energy securities should benefit if value investing begins to outperform.

KEY ISSUES	Positive	Neutral	Negative	Comment
VALUATIONS	☑			We believe midstream remains 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 potential signs of growth
ENERGY INFRASTRUCTURE BUILD-OUT		☑		We believe the multiple projects coming online is positive for cash flow but increased capital discipline by exploration & production companies (E&Ps) may delay demand for new infrastructure for midstream companies

Our Key Issues table above remains weighted to the positive. Very attractive valuation levels and the resumption of distribution growth are important catalysts while the challenging political and regulatory environment remains an impediment to future returns. Given the current outlook, we are confident that long-term returns will be strong. During the weak third quarter, midstream equities meaningfully outperformed other sub-sectors of the energy industry.

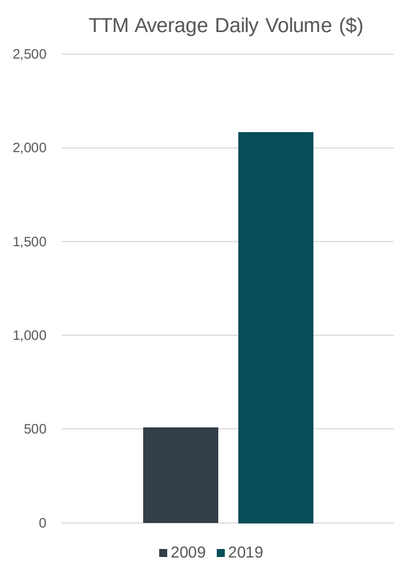
Valuation is the most prominent driver of our positive outlook for long-term returns. Our valuation chart, to the right, shows that valuation is the most attractive it has been since crude oil bottomed in early 2016. At September 30, the spread between the median MLP yield and the Bloomberg Barclays U.S. High Yield Bond Index yield is the largest it has been over the nearly 25-year period we have tracked this metric. While market expectations for a rate cut by the Federal Reserve have pushed bond yields down, the median MLP yield remains stubbornly high.

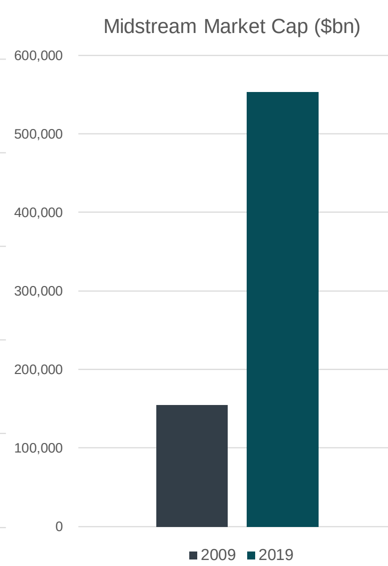


Period: 12/31/95 to 9/30/19. Source: Tortoise, FactSet Research Systems
Composite valuation based on both relative and absolute valuation metrics.
Standard deviation is a measure of volatility, which shows how much variation exists from the average return.

The median TTM EV/EBITDA multiple, another key metric, was 9.6x at quarter end, which indicates that MLPs were trading at a discount to where they traded when oil bottomed in 2016. To put this in perspective, these public valuations are well below where private equity has recently transacted midstream assets, which was around 12.0x. In addition, bonds for the majority of midstream companies are trading at or above par value, another indication that the sector continues to be undervalued. While sentiment is negatively impacting public equity valuations, the same cannot be said about similar, or in some cases identical, assets trading in other markets. We expect the current market environment to lead management teams of public midstream companies to sell non-core assets and/or buy back their own equity.

We acknowledge that recent rhetoric around the MLP structure and the need for simplification amongst the group has not been helpful for performance. Overall, regardless of corporate structure, the midstream sector has been on a long march towards higher capitalization and improved liquidity, as displayed in the charts to the right. Total market capitalization for midstream has grown 13.6% annually over the past ten years. This growth story has been largely overlooked in recent years as energy price declines have been at the forefront of news headlines. Today, we believe this presents an interesting entry point for investors into the midstream sector. Because of its relative outperformance to other subsectors within the energy sector, we think the midstream sector will be the preferred energy investment category.





Tortoise St. Louis investment universe, Fact Set Research Systems

One key component of the midstream business is natural gas liquids (NGLs). U.S. supply is abundant and requires continued investment in infrastructure to continue exporting NGLs to the rest of the world. Given a lack of capacity in this area, NGL prices currently reflect an oversupply situation. As capacity is added, we expect facilities to fill up quickly as this low-cost supply can be exported to the global market.

In the near term, it is likely that low prices will negatively impact earnings of E&Ps. In contrast, midstream companies have less direct commodity price exposure, given the fee-based nature of their contracts, and should perform better than E&Ps. However, negative sentiment towards energy may cap midstream returns in the near term. Over the medium and longer term, we expect crude oil, natural gas, and NGL production to be higher, which bodes well for midstream earnings.

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. These integrated midstream companies do not have meaningful customer concentration. This should allay investor concerns about smaller E&P bankruptcies. We are also overweight midstream entities with meaningful exposure to rising export markets. Longer term, we continue to be overweight in natural gas infrastructure compared to oil infrastructure. Natural gas is cheap, abundant and markedly cleaner than oil or coal when used as a fuel for electric generation. As the country and the world move towards greater electrification of the economy, we believe natural gas will be the largest source of energy to fuel this growth.

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

Sincerely,

The Tortoise St. Louis investment team

Note: This commentary contains forward-looking statements about various economic trends and strategies. You are cautioned that such forward-looking statements are subject to significant business, economic and competitive uncertainties and actual results could be materially different. There are no guarantees associated with any forecast; the opinions stated here are subject to change at any time and are the opinion of Advisory Research, Inc. The data is obtained from sources we deem reliable; it is not guaranteed as to its accuracy. Past performance does not guarantee future results. Valuations and long-term return expectations do not represent or predict the performance of any particular investment. Investing in Master Limited Partnerships may require tax filings in multiple jurisdictions. This report is for informational purposes only and is not an offer to sell or a solicitation of an offer to buy any securities. The Alerian MLP Index is the leading gauge of energy infrastructure Master Limited Partnerships (MLPs). 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 (AMZ) and on a total-return basis (AMZX). The Alerian MLP Equal Weight Index is the equal-weighted version of the widely used Alerian MLP Index (AMZ). The index, which includes the same companies as the float-adjusted, capitalization-weighted AMZ but allocates the same weight to each constituent at each rebalancing, is disseminated real-time on a price-return basis (AMZE) and on a total-return basis (AMZEX). It is not possible to invest directly in an index.