Tortoise

Tortoise QuickTake Podcast

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Welcome to the Tortoise QuickTake podcast. Thank you for joining us. Today, a senior member of Tortoise provides a timely update on trending topics in the market.

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Last week, energy overlooked an outstanding inventory report and gave back some of the pre-holiday rally.

Crude and E&Ps lost 4% pulling down the S&P Energy Select Sector® Index 1% while MLPs staged a late Friday rally to eke out a 20 basis point gain.

We believe the driver for weaker returns in spite of positive fundamental data were announcements from Volvo and France of plans to shift towards greater use of electric vehicles and an updated Bloomberg New Energy Finance report which ramped up their forecast for the adoption of electric vehicles. We certainly agree that electric vehicles and clean energy sources in general will play a big part of global energy consumption going forward. As a reminder, we stated on our last quarterly call that we were actively evaluating renewable projects for portfolios where we view it suitable. That said, I think there is a bit of confusion from the three announcements I mentioned from last week and the impact of this trend in general on global oil demand.

Let's start from the top down and hit the Bloomberg New Energy Finance report from last Thursday, forecasting electric vehicles will account for over 1/2 of all new light-duty vehicle sales globally by 2040, up significantly from their 2016 forecast. They believe this would displace about 8 million bpd of transport fuels by 2040 which is a big number, but should be put in context. Global oil demand is currently 95 million bpd and forecast to grow to 110 million bpd by various independent agencies which also forecast the impact of electric vehicle adoption into the fleet. In other words, even with this more aggressive 8 million bpd forecast from BNEF, demand for oil is still expected to grow. On a related note, new EVs will require more electric generation supporting a very strong demand growth forecast for natural gas.

Regarding the anecdotal but related announcements which further support the shift to more electric vehicles, in the case of Volvo, clarification is needed. They don't plan to stop selling internal combustion engines in 2019…they plan to stop developing new models which only have combustion engines. In other words, all new models will have some element of engine electrification which includes hybrids and what are called "light hybrids". These cars still rely on a traditional engine for primary power but get some assistance powering the motor from a battery, more in the case of hybrids, less in the case of light hybrids. Finally, France announced a pledge to phase out all gasoline and diesel engines by 2040. To put that in perspective, the country's transportation fuel consumption currently makes up less than 1% of global oil demand so while the news has gotten a lot of attention it's not a game changer in the EV story in our view.

In summary, there is clearly a movement towards more electric vehicles on the road, but we think it's helpful to put it into perspective as it relates to total demand and the need for energy infrastructure. We expect continued modest growth for oil, net of current transportation trends, based on population and economic growth and the development of emerging economies. As for as natural gas, we expect enormous growth partially driven by the EV trend we just covered. More EVs require more electric generation from a grid that is already phasing out coal and replacing with natural gas and renewables.

Shifting to news...partially offsetting the supportive inventory data was a Reuters report that OPEC exports grew 450 mbpd in June. Related, the Russian oil minister said Wednesday they did not see the need for deeper OPEC led production cuts as the market is rebalancing. This is modestly offset by further production cuts announced by Canadian oil sands producer, Syncrude, who is still struggling to ramp production following a fire at their upgrader in March. In news for our portfolio companies, activist investor Jana Partners disclosed a 5.8% stake in EQT seeking a split up of the E&P and midstream business which the company has been evaluating. And In the Permian, Enterprise announced additional contracts for its new crude pipeline which is now 83% committed.

Changing gears, as I mentioned at the start, the DOE reported bullish inventory numbers last week with a 6.3 million barrel draw and reductions in every region. Along with a crude draw, gasoline and distillate dropped a combined 5.5 million barrels. A rebound in production following Tropical Storm Cindy was more than offset by increased refinery runs, lower imports and higher exports leading to the large inventory pull. Typically we would have expected this to drive a bounce in oil prices and it did…for a few hours. In this market nothing seems to be enough to get prices to rebound.

In times like this it's helpful to keep the big picture in mind. Energy infrastructure is an essential part of our economy and cash flows have been steadily growing during the downturn in oil prices on the back of fee-based revenue and volume growth. I'll leave it at that for this week…thanks for listening.

Thank you for joining us. And stay tuned for our next cast. Have topics you want covered or other feedback to share? Write us at info@tortoiseinvest.com.

The **S&P Energy Select Sector Index** is a capitalization-weighted index of S&P 500® Index companies in the energy sector involved in the development or production of energy products.