Tortoise Energy Podcast

July 20, 2020

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

Good to be with you today, I am Quinn Kiley, Managing Director and energy Portfolio Manager at Tortoise and I am happy to be with you for this week's Energy Podcast. As we enter the summer doldrums the news has been fast and furious in the midstream world. As my colleague Jim Cunnane covered last week, there was quite a bit of legal news surrounding midstream development, especially concerning the Dakota Access Pipeline. The news that a U.S. district court ordered an expanded environmental impact statement from the Army Corps of Engineers and for the pipeline to shut down until it was completed, truly shook up the market. That the pipelines owner, Energy Transfer, would challenge the ruling was never in doubt, but the potential outcome created uncertainty, which we all know the markets do not appreciate. On Tuesday of last week, a panel from the same D.C. district court that ruled against Energy Transfer issued a stay order on that ruling. Effectively alleviating the need to shut down the pipeline as the case is further reviewed. While this court action does not remove the uncertainty of the outcome from this case, it does remove the immediate need for the pipeline to shut down. Markets swiftly traded higher on the news. With that review, let's look at market performance for the week.

Markets were mixed:

- The Alerian MLP Index finished up 2.6%, and remains down over -38% year-to-date
- Other energy stocks, represented by the Energy Select Sector SPDR (XLE), was up 3.2% for the week
- In broader markets, the S&P 500 gained 1% for the week and the ten-year treasury was flat

Midstream markets reversed a negative trend that has seen us drop 25% off of June highs. Continued concerns about the economic impact of the pandemic, especially as it relates to crude oil and natural gas demand globally, has taken a little froth out of the market rebound we experienced from the March lows. To be fair, the current state of the global energy market is tenuous. Price pressures have forced U.S. producer to reduce production, OPEC+ has agreed to voluntarily reduce production as well, but demand remains lower on reduced travel and economic activity. All of these variables can swing and impact global markets, but today we see some positive signs. OPEC+ remains on track to balance markets, compliance appears strong but the plan to increase production in August creates some market angst. Lower prices overall did force U.S. producer to shut in production, but a relatively quick snap back has allowed some of those volumes to come back on-line. Given the reporting nature of the fragmented U.S. market, we won't have a true sense of the improved volumetric production until we hear from companies on their second quarter earnings. Speaking of earnings, midstream announcements will kick off this week with Kinder Morgan. Starting with a large diversified name, there may be read throughs across the energy value chain, so we look forward to hearing from them and expect midstream trading this week to reflect Kinder's second quarter outcome and more importantly their second half outlook.

Speaking of upcoming catalysts, July is typically a significant month for midstream as we hear not only second quarter earnings, but also second quarter distribution and dividend announcements. Early in the year, the significant down draft in equity prices and economic activity gave companies a free pass to reduce payouts and conserve cash. Today, with the economic rebound, albeit modest, the expectation from the markets is less clear. We think there is still some remaining risk of distribution reductions. Energy Transfer, ONEOK, and Phillips 66 Partners are controversial names as their outcomes will be influenced by the court proceedings around the Dakota Access Pipeline and its impact on the Bakken basin. There has also been some positive market reaction to companies sustaining their quarterly payouts. The market cheered flat distribution announcements from Crestwood Equity Partners and Western Midstream Partners last week. As of Friday, there had been ten distribution announcements so far, all flat with the previous quarter. Relatively high yield has always been an attractive attribute for midstream investments. We think there is clearly a portion of the market that is yield seeking, but there is the economic reality that times are uncertain. In uncertain times, strong balances sheets are very important to investment returns. As result, there is a group of investors that will favor any corporate action to improve liquidity and balance sheets. These dueling factions make management decisions and subsequent market reaction uncertain. What is not uncertain is the essential nature of energy infrastructure to our economy and indeed our daily way of life.

Speaking of infrastructure, the Biden campaign announced their proposal last week for a $2 trillion green infrastructure plan. The plan would spend the money over four years on transportation infrastructure and sets a goal of carbon-free power generation in the U.S. by 2035. The plan addresses many areas of the economy, but as it relates to energy the main thrust is to use the procurement power of the federal government to accelerate adoption of cleaner technologies like renewables and electric vehicles by having the government directly purchase these technologies for its own use. The plan, as announced, does not directly speak to banning the practice of hydraulic fracturing, commonly referred to as “fracking”, to produce oil and gas. Generally, the announcement is in line with Tortoise’s Teal Energy Deal, announced last year, that envisions the world moving to a more electrified future with natural gas becoming a greater part of energy consumption as coal and other dirtier sources are retired as the world reduced CO_2 emissions.

Finally, there was recent merger and acquisition activity worth noting this morning. Chevron announced an agreement to acquire Noble Energy for a firm value of $13 billion including debt. The deal was all stock for a slight premium of 12% over the 10 day volume weighted average price. Noble brings high-quality U.S. and international off-shore assets to Chevron at what looks like an attractive price. Noble is the parent company of Noble Midstream Partners, a gathering and processing MLP. The market has initially viewed the transaction as positive for the MLP and we will watch developments with interest as the deal progresses.

Thanks for joining us and we will be back next week. Please stay safe.

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@tortoiseadvisors.com.

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).

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.

S&P 500® Index is an unmanaged, market-value weighted index of stocks that is widely regarded as the standard for measuring large-cap U.S. stock market performance.

It is not possible to invest in an Index.