TortoiseEcofin QuickTake Podcast

TortoiseEcofin

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Welcome to the TortoiseEcofin QuickTake podcast. Thank you for joining us as we provide timely updates on the market.

Thanks for joining us today on the Quick Take Podcast. I'm James Mick, Managing Director and Senior Portfolio Manager with Tortoise.

What a strange week, with extreme temperatures wreaking havoc across the country. My boys had their first actual snow day of the school year here in Kansas. Not because of the snow mind you, but because of the rolling blackouts and the lack of internet for Zoom calls. I'm pretty sure a day without a Zoom call did not upset any person under the age of 18! The weather also impacted the sports world last week, canceling several college basketball games. As we are getting close to turning the calendar on February, it's almost time for one of my favorite sporting events, March Madness. Deprived of it last year due to Covid, it's exciting to think we should, and I stress should, get to see a resumption of NCAA basketball excitement this year. Covid permitting, of course.

Moving to the financial markets, let's start things off with performance for the week that was:

- On the commodity front, crude oil was just barely negative, with spot prices falling 39 bps, while
- Natural gas was materially lower, as spot prices declined 18%, yet one month futures prices rose by 5.4%,
- Shifting to equities, the broader S&P Energy Select Sector Index® was a leader, higher by 3.5%
- Exploration and production companies, as measured by the Tortoise North American Oil & Gas Producers Index℠ also moved up, rising just over 1.7%
- Utilities, per the Dow Jones Utility Index, continued to experience weakness, down 1.1%
- And finally MLPs, as represented by the Tortoise MLP Index® lost 32 bps

The biggest news of the past week was definitely the weather. Of course we had freezing temperatures in many parts of the country, but the most attention was provided to Texas. Lots to unpack here as we will stay above the political rhetoric. It's important to start with a few facts about Texas' grid though:

- First, the Texas grid is operated by ERCOT, or the Electric Reliability Council of Texas
    - ERCOT essentially acts as a traffic cop for power in the state
- Second, Texas is essentially on an island as it relates to its grid, operating independently and therefore not able to utilize other states for imported power
- Third, Texas natural gas generation mainly operates on a just in time system, not utilizing storage as much as say the northeast
- Finally, Texas is a deregulated market, meaning supply and demand sets the price and high prices incentivize operators to run to capture those prices

So what happened?

A polar vortex encapsulated most of the Midwest, all the way down to Texas, bringing with it snow, ice and freezing cold temperatures. In many of those states, this is not uncommon, as it is February after all. However, Texas is not as equipped to deal with the extreme cold on many fronts. Lack of snow removal, salt trucks, etc, provide for a more difficult remedy than upper Midwest states.

As the cold swept through, the demand for power escalated sharply. Unfortunately, the grid could not meet the challenges. The blame did not rest on any one aspect, but pretty much all generation sources. Windmills froze up due to ice on blades, the sun wasn't shining for solar to work, natural gas at the wellhead was shut in due to freeze offs, natural gas power plants suffered from frozen components and an inability to get supply. Even a nuke plant was down. Couple all this with typical winter maintenance as the highest power loads in Texas typically occur in the heat of the summer and it was a recipe for disaster.

ERCOT instituted rolling blackouts to effectively save the grid from collapsing, according to their leadership. Prices spiked to a whopping $9,000 per megawatt hour.

Ironically, the rolling blackouts served to cause even more issues as pipeline compressor stations, which help to flow natural gas, were shut off as well, stopping the flow of gas to the power stations.

In all, it was a monumental failure. Millions without power in dangerous conditions. And it will almost assuredly lead to changes this time. Notably, Texas suffered a similar cold snap in 2011 and it was suggested, though not mandated, that groups update infrastructure to handle these types of cold weather events. After all, windmills, natural gas facilities and everything in between to generate power operates just fine in much colder jurisdictions. So we know it is clearly possible if the money is spent.

It's also likely that Texas comes under some more regulation.

My final thought on the topic, the grid needs reliability. The question is the cost benefit. We could all work at a place where our company has a backup for every position. However, that's simply not feasible from a cost perspective. As such, trade-offs have to be made. With more intermittent power sources, the dispatchable generation must be reliable and ready to go. As such, the blame here goes all around. Hopefully lessons are learned and changes are made.

In other quick hit news, here's a selection of items that caught my attention:

- In M&A news, Energy Transfer announced an acquisition of Enable Midstream, a mid-continent gathering and processing company with a nice overlapping asset footprint
    - Note, the parent companies of Enable, Centerpoint and OGE, own almost 80% of the company and have agreed to support the deal, meaning it will close
- In energy transition news, Chevron announced an expansion of its existing agreement with Brightmark to expand the joint venture to build more renewable natural gas plants at dairy farms
    - Chevron will also purchase the renewable natural gas and sell it for use in vehicles utilizing compressed natural gas
- On the macro front, economic data continues to point to a very solid GDP number for the United States
    - Additionally, cases for Covid-19 continue to trend lower
    - All this points to a continuation of the reopening trade, with value outperforming growth and cyclicals outperforming defensives in our view
- Finally, inflation expectations are moving up, with JP Morgan the latest to espouse, pointing out that central banks are willing to tolerate higher inflation in the near-term
    - Which seems like a good time to point out that many liquids pipelines have the ability to raise tariffs in accordance with a rise in inflation
        - Specifically, liquids pipelines in non-competitive markets can raise their tariffs annually to coincide with the change in the producer price index for finished goods, plus .78%
        - In the event inflation runs at say 2 to 3%, this would equate to tariff increases of approximately 2.75 to 3.75%, which drops straight to the bottom line in terms of cash flow

With that, have a great week, stay safe, and we look forward to speaking with you again soon.

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

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Utilities = Down Jones Utility Index tracks the performance of 15 prominent utility companies traded in the United States.

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Producers = Tortoise North American Oil & Gas Producers Index℠
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