

Tortoise QuickTake Podcast with James Mick

October 19, 2015

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.

Thanks for joining us today on the Tortoise Quick Take Podcast. I'm James Mick, managing director and Portfolio Manager with Tortoise Capital.

Blaise Pascal was a French mathematician from the 17th century and one of the earliest thinkers on the theory of probability. Pascal had a famous paper titled "Pascal's Wager" which viewed human's belief in God in terms of a probability issue, but took it one step further by introducing expected outcomes.

Fast forward to 1988 and a classic comedy film, *The Naked Gun*, utilized probabilities in a slightly less accurate way. One of my favorite quotes from that movie involves a conversation between Detective Frank Drebin, as played by Leslie Nielsen and Captain Ed Hocken, played by George Kennedy. When discussing the odds of their buddy Norberg surviving a recent attempt on his life, Ed tells Frank, "Doctors say that Norberg has a 50/50 chance of living, though there's only a 10 percent chance of that."

All kidding aside, probabilities provide a useful guidepost in periods of extreme volatility and uncertainty, such as the current energy market.

Before circling back to probabilities, let's review performance for the sector.

Last week:

- The broader S&P 500 Energy index was up .8%
- Exploration and production companies were down .6%
- MLPs finished down 1%
- And crude oil ended the week down about 5% to close at \$47.26

Crude oil had a volatile ride. After almost breaking \$50 last week, it fell as a result of a large inventory build. The build was not terribly surprising given the reduction in refinery operating rates as a result of planned seasonal maintenance. Demand for gasoline remained strong however, up over 3% for the 4 week average versus last year. On the flip side, with lower refinery runs and higher demand for gasoline, we saw a nice draw down of gasoline inventories. With a declining rig count, down another 10 for oil directed rigs, we expect US production will continue to decline, which should help balance the market as we move through 2016.

As we prepare for the upcoming earnings season, we will be watching for color from E&P producers on capex budgets for 2016, drilling efficiencies, number of uncompleted wells and continued cost reductions. In terms of midstream companies, we'll be evaluating commentary around capex plans, volume indications and how that ultimately translates to distribution growth. Finally, for downstream companies, we will be evaluating supply and demand commentary and outlooks for commodity prices and spreads going into the new year.

Circling back to probabilities, one of the many things we evaluate within our financial models are various paths forward for companies and commodities and the likelihood of each achieving those paths.

For example, as we look at the MLP market, the current yield on the Tortoise MLP Index is approximately 7.7%. The total return expected will be a function of the cash yield, the growth in that yield and the exit yield ascribed by the market. While the first two components are somewhat manageable to predict, the exit yield is an entirely different story. Hence, our view of utilizing various outcomes and assigning probabilities to those outcomes to determine an expected value.

As analysts, we view our role not so much as predicting the exact outcome, but rather understanding the various outcomes possible and understanding the likelihood of each occurring.

With a 7.7% yield on the Tortoise MLP Index and historical medians for the last 3, 5 and 10 year periods of 5.9%, 6.1% and 6.4%, respectively, our view is that the most likely scenario is for a tightening of the yield, adding to the total return already expected as a result of the yield and growth.

If this scenario occurs, which we feel is the most likely, it will provide patient investors an attractive return.

As with anything, probabilities are not a sure thing, but they can provide context regarding views and are extremely helpful when dealing with volatility and uncertainty.

Well, that's it for this week, thanks for your time and we look forward to speaking with you again soon.

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

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