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.

Thanks for joining us today on the Tortoise QuickTake Podcast. I'm James Mick, Managing Director and Portfolio Manager with Tortoise Capital Advisors.

As I scanned the news for this past week, I struggled to come up with anything interesting to talk about. Just another quiet, boring week in the energy and stock markets. Okay, maybe not.

To quote Ron Burgundy from Anchorman, "That escalated quickly, I mean that really got out of hand fast."

All joking aside, last week was quite eventful, with Brexit taking center stage in the world and the Energy Transfer/Williams trial the centerpiece of energy markets. We'll discuss both shortly, but first let's take a look at performance:

- On the commodity front, crude oil was down marginally, at -0.7%, but did fall materially on Friday, while
- Natural gas performed well due to warmer weather, 1.5% for the week
- Shifting to equities, the broader S&P 500 Energy Select Sector® Index finished lower, at -0.6%
- Exploration and production companies, as measured by the Tortoise North American Oil & Gas Producers Index℠, also declined, returning -0.8%
- And finally, MLPs bucked the trend for the week as the Tortoise MLP Index® finished up 1.5% last week

Obviously the most newsworthy item of the week was the vote by Britain to exit the European Union on Thursday. As the results firmed, financial markets generally all took a hit. Markets hate uncertainty and this clearly introduces a whole new level of it to global markets. Broad concerns generally seem to be centered on a potential European recession from a financial perspective, but maybe more importantly on this being the tipping point for other member nations of the EU to stage their own exit, including some of the weaker peripheral countries in Southern Europe. The outcome of such moves from a geopolitical perspective create uncertainty that fuels negative sentiment in the markets. It's impossible to tell how something like this plays out, but our view is that it is likely more bark than bite on fundamentals.

Looking more specifically at potential macro impacts, we expect:

- The rising U.S. dollar will likely impact the price of oil negatively in the interim
- The negative crude oil impact will likely flow through to energy equities, MLPs included
- Crude oil spreads could widen with WTI moving back to a premium to Brent, but likely not material
- A risk of potential softening of demand in OECD Europe in relation to crude oil/refined products
- Yet, actual supply and demand in the U.S. should be mostly unaffected
- And natural gas, which is more weather dependent, should not be impacted for the most part

The financialization of crude oil, which is a fancy way of describing trades in crude based on anything but fundamentals of supply and demand, is likely to continue and the correlation with the dollar will probably result in volatility and some downside in the near-term. But at the end of the day, we feel strongly the fundamentals will matter and on that front, supply and demand should continue to move closer to balance, creating a more constructive crude oil environment.

More specific to energy and the U.S.:

- Upstream companies would likely be limited to impacts of falling crude oil prices
- Midstream companies and MLPs are North American-centric, so we would expect limited impact, save for the select few with export terminals of various products

- Downstream companies would likely be limited to exposure to exports of products as well as offset by potentially lower input costs, such as crude oil for refiners
- Exports to Europe of natural gas, natural gas liquids and diesel fuel would likely be the main link between the two continents
- We would not anticipate any big issues or risks to those exports unless as noted, OECD Europe falls into a recession
- We would note as well, natural gas in particular, and natural gas liquids to an extent, are driven more by weather and less so by the economy, further insulating those exports to Brexit impacts

In summary, we feel the impact is more macro driven and tied to crude oil prices. And while the financial trading of crude could be negatively impacted in the short-term, we remain positive on the medium to long-term crude oil outlook.

Not to be outdone on the drama scale, Energy Transfer and Williams continued their soap opera last week as well. To bring you up to speed, Energy Transfer stated on their last earnings call that the deal would not be able to close since they lacked a Section 721(a) tax opinion from law firm Latham and Watkins. Williams effectively sued over the matter and on Monday and Tuesday, a Delaware court heard the arguments from both sides. The judge was basically ruling whether or not Latham and Watkins acted in bad faith in not delivering the opinion. Late Friday the decision came from the judge, siding with ETE, which for all intents and purposes, allows them to terminate the merger agreement.

Williams plans to appeal. In addition, Williams issued a press release that if Energy Transfer did in fact terminate the merger they would take actions to enforce their rights under the merger agreement. Additional lawsuits are certainly not out of the question. The vote is scheduled for today.

So what happens now? Our best guess is that the merger does not go through. Williams and Energy Transfer move on as separate entities and go their respective ways. Williams has stated that absent the merger, WMB, the parent company and general partner to WPZ, will likely cut its dividend to shore up the balance sheets of both entities and help fund capex at WPZ. Energy Transfer has not provided guidance, but it would not be out of the question for ETE, the general partner, to cut as well in some fashion to help solidify limited partner Energy Transfer Partners.

Much as Brexit introduces uncertainty, we feel resolution of this merger could lift a black cloud that seems to hang over midstream companies, providing an uplift in sentiment.

Never boring, it stands to be an interesting next few weeks! Thanks for listening 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

The S&P Energy Select Sector® Index
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.

About Tortoise North American Oil & Gas Producers Index℠
The Tortoise North American Oil & Gas Producers Index℠ is a float-adjusted, capitalization weighted index of North American energy companies primarily engaged in the production of crude oil, condensate, natural gas or natural gas liquids (NGLs). The index includes exploration and production companies structured as corporations, limited liability companies and master limited partnerships but excludes United States royalty trusts.

About Tortoise MLP Index®
The Tortoise MLP Index® is a float-adjusted, capitalization weighted index of energy master limited partnerships (MLPs). The index is comprised of publicly traded companies organized in the form of limited partnerships or limited liability companies engaged in transportation, production, processing and/or storage of energy commodities.

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