Tortoise QuickTake EnergyPodcast

Tortoise

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Rob: Hello. I am Tortoise Managing Director and Portfolio Manager Rob Thummel. This week we thought we would mix it up a bit so I am joined by my fellow Managing Director and Portfolio Manager James Mick. For this podcast, James and I are going to focus on providing some interesting information on a high value topic that never gets enough attention, which is crude oil inventories.

James: Okay, thanks Rob. Before we get to main topic though, can you hit on performance and earnings as we're really in the thick of what is a protracted earnings season? And specifically, how did energy perform to start the year?

Rob: The energy sector and MLPs have remained in positive territory in 2018 despite last week's sell-off. Year-to-date, MLPs as represented by the Tortoise MLP Index® are up 3.5%, while the energy sector as represented by the S&P Energy Select Sector® Index has increased by almost 1%. Both sectors have trailed oil prices which have increased by 8% year-to-date. The other interesting thing to point out is what is happening with the 10-year Treasury rate. The Treasury rate shot up to 2.83% and has increased by almost 50 basis points since the beginning of the year. As expected, MLPs have performed well in this rising rate environment; however, REITs and Utilities have not. The REIT Dow Jones Equity REIT Index has declined by almost 6%, while the Dow Jones Utility index has fallen by 5% in 2018.

James: Rob, What do you make of last week's performance especially Friday? What happened?

Rob: Most pointed to the jobs report that created heavy selling pressure as investors became concerned about an accelerated rate hike by the Federal Reserve. But in our opinion, Friday was just a healthy pullback. Going into Friday, the S&P 500® Index and MLPs were up about 6% while the energy sector was up 5% year-to-date.

James: Okay, so we're still in the early stage of the earnings season. Any insights so far?

Rob: The strong fundamentals supporting the energy sector has carried through to earnings. So, last week, three of the largest MLPs in the Tortoise MLP Index beat the consensus of analyst expectations for fourth quarter 2017 EBITDA by an average of 3.4%. Conversely, Exxon and Chevron, the two largest stocks in the energy sector, reported lower than expected earnings per share. Exxon's earnings per share was 15% lower than consensus while Chevron's was 45% below consensus. Exxon's miss was tied to lower-than-expected upstream production volumes while Chevron's miss was associated with the negative impact of Hurricane Harvey on its downstream segment. Now one really important point highlighted by Exxon, was its plan to spend $50 billion over the next five years in the Permian Basin. Exxon plans to triple its Permian daily production to 600,000 barrels per day by 2025. This announcement from the largest energy company in the world, highlights the significant potential of the Permian Basin. We think this is a positive for the energy infrastructure stocks and oil producers that we invest in.

James: Great, so let's shift gears to the crude oil. Two big data points came out this past week that I wanted to have you hit on: (1) U.S. production of crude oil topped 10 million barrels per day in December and (2) U.S. crude oil inventories increased last week for the first time in quite a while. So, the first question: Should the market and investors be concerned about U.S. crude oil production volumes that have increased to levels that were last experienced when Richard Nixon was President?

Rob: So, we've talked in the past about how impressive the response has been from U.S. oil producers to low oil prices. The EIA data released last week just confirms this. We think investors should keep their eyes on global oil demand growth. In 2018, most forecast global oil demand growth to be around 1.5 million barrels per day. The U.S. will fill a lot of this growth worldwide, That means more exports that should benefit both U.S. producers and energy infrastructure stocks.

James: Well that sounds good for the U.S. but what do you think that other oil producers, especially OPEC oil producers, think about rising U.S. production?

Rob: Good question. I was looking at annual OPEC production data in the latest International Energy Agency report last week. Average annual OPEC production fell by approximately 450,000 barrels per day in 2017 compared to 2016. However, what was interesting was that daily OPEC revenues increased by $360 million per day. In Saudi Arabia, the largest OPEC oil producer, production fell by about 450,000 barrels per day yet daily oil revenues grew by $97 million per day. So, I think the Saudis are just fine with the less is more concept.

James: That's a good point. So let's go to the second data point from last week – U.S. crude oil inventories. Last week, U.S. crude oil inventories rose by almost 7 million barrels ending a streak of 10 consecutive weeks of inventory declines. The consensus estimate was a 3 million barrel increase in inventories. Was this a surprise to you?

Rob: No, when you look back a history for this specific week there are few notable things. First, every year for the last five years has seen oil inventories increase. The highest increase in the last five years was almost 9 million barrels while the lowest increase was almost 6 million barrels so a fairly tight range. So, the almost 7 million increase in oil inventories should not have been a complete surprise to the market. One very important point for investors to understand, is that U.S. oil inventories will increase during the first quarter of 2018. Inventories typically rise during the first quarter of every year. It is a seasonal period when refining maintenance typically occurs resulting in lower demand for crude oil. We expect this year's inventory build to be smaller relative to historical levels which should help keep oil prices stable. Global oil inventories continue to be the key data point that influences the direction of oil price. We expect global inventories to follow a similar pattern with an increase in the first quarter followed by steady declines in Q2 through Q4 of 2018.

James: Great, well thanks Rob. That sums it up for this week. Thanks for listening. We will talk to you next week.

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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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.

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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