Tortoise QuickTake Energy Podcast

Tortoise

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Welcome to the Tortoise QuickTake podcast. Thank you for joining us. Today, senior members of Tortoise provide a timely update on trending topics in the market.

Hello. I am Tortoise Managing Director and Portfolio Manager Rob Thummel with this week's Tortoise QuickTake podcast.

I hope you had a great Memorial Day weekend and took a moment to honor the men and women who died while serving in the U.S. military.

Let's kick this off by talking about performance. Last week, the energy sector as represented by the S&P Energy Select Sector® Index ended a six week streak of positive weekly performance. The energy sector fell by 4.5% while MLPs as represented by the Tortoise MLP Index® declined by 1.8%. Despite the pullback, the energy sector continues to outperform the S&P 500® Index year-to-date. A decline in oil prices led the sell-off as oil prices fell by 4.7% for the week. A majority of the price decline occurred last Friday leaving investors with several questions heading into the holiday weekend. Let me address a few of these questions.

Why such a sharp sell-off in oil prices? In our opinion, comments made by the Russian and Saudi Arabian oil ministers led to the sell-off. The ministers are considering abandoning the production cut agreement for the first time in 17 months. It seems like last month Russia and Saudi representatives were discussing a long-term production cut agreement and now the talk is about ending the agreement. This on-again, off-again rhetoric is a bit Trump-esque so let's delve a little deeper into this topic.

What was the goal of the OPEC production cut agreement? With oil prices languishing in the $40s, OPEC along with Russia jointly announced a production cut agreement removing 1.8 million barrels per day of supply from the global markets.

Has OPEC achieved its goal? Yes, to a certain extent. The production cut agreement eliminated the global supply glut reducing both global and U.S. oil inventories. For example, global oil inventories declined by over 200 million barrels in the last year according to the International Energy Agency. OPEC's strong commitment to the agreement has surprised the market. For example, OPEC compliance in March and April was 165% and 172% of its original goal. This means that OPEC's production cut in April was over 2 million barrels per day that is well above the 1.2 million barrels per day required by the original production cut agreement. The impact of OPEC actions brought needed relief to OPEC through higher oil prices. As a result, OPEC is now generating higher daily oil revenue despite lower production volumes.

So, with its mission accomplished, why shouldn't OPEC and Russia abandon the production cut agreement? While global oil inventories have reached a 5-year average, the current average is inflated because of the persistent oversupply in last five years. OPEC has discussed reducing inventories to the 5-year average for the period between 2010 – 2014 when global oil inventories averaged around 2.7 billion barrels. To achieve this level, global oil inventories need to decline by an additional 100 million barrels.

So where do we go from here? First, we think Saudi and Russia must address declining oil production inside of OPEC. For example, Venezuela oil production is rapidly declining. Given the recent actions by the U.S. government, there is uncertainty about the future of Iranian oil production. Saudi Arabia and Russia are prepared to increase oil production in order to reach 100% compliance with the original production cut agreement. After that, the focus shift toward maintaining robust growth in demand. Given the strength of the global economy, oil demand growth is forecasted to be 1.6 million barrels day which is higher than 2017. Assuming that forecasted growth remains on pace, we expect OPEC to consider a gradual increase in oil production at its June 22 meeting. The timing of the increase in production would be the fourth quarter of 2018 when current supply deficit is expected to reach its peak. We do not expect OPEC and Russia to oversupply the global market.

Enough about OPEC, let's move onto the annual MLP Association Conference that occurred last week. We were there and so were many others with attendance up 3% over the previous year. The song sung by most MLP management teams was Journey's Don't Stop Believing. MLP management teams expressed optimistic outlooks emphasizing the fundamental backdrop was one of the strongest they have experienced. As proof, the growth projects keep coming. Just last week, Enterprise Products Partners announced that an oil and gas producer committed at least 205,000 barrels per day of natural gas liquids to its 550,000 barrel per day Shin Oak pipeline that is scheduled to be completed in the second quarter of 2019. In addition, SemGroup and DCP Midstream announced an open season on the White Cliffs Pipeline system and Southern Hills Pipeline that transport natural gas liquids from the DJ Basin to Mont Belvieu, Texas. Of course, the management teams also recognized challenges as well such as IDRs. However, the MLP management teams are addressing the challenges allowing investors to place a greater emphasis on the underlying fundamentals going forward.

The last but in my opinion the most important news from last week relates to comments made by U.S. Treasury Secretary Steve Mnuchin fresh off his trade talks with China. Mnuchin stated and I quote, "There's a massive opportunity for the U.S. to become a major supplier of energy to China." He went onto say referring to exports "we can easily get about $40 or $50 billion of energy". To put that in perspective, according to the U.S. Census, the U.S. exported approximately $4.8 billion of crude oil and LNG to China in 2017. So there is potential to increase U.S. oil and LNG exports to China by 10x. Of course, Mnuchin last two comments were the most significant and I quote, "If we can produce the energy and send more energy with infrastructure" highlighting the critical role that energy infrastructure plays. For many years, you have heard representatives of Tortoise advocate the potential of the US energy sector as a global energy supplier. It's becoming more apparent that others believe this as well. In our view, the opportunity is significant for the U.S. energy sector and we expect investors in the U.S. energy sector to reap benefits as this opportunity unfolds.

Those are the highlights from last 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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