Tortoise QuickTake Podcast

February 27, 2017

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.

Earnings season is finally winding down, and for us that means we move into conference season and traversing the United States to meet with management teams. We kick off this week with a trip to New York for a major investment bank's annual midstream conference.

This past week's earnings saw some positive organic capital projects announced on the midstream side, primarily focused in the Permian Basin and the Gulf Coast, but we also saw some equity deals continue to test the openness of the capital markets. While the bond markets remain wide open for energy, equity markets have thawed at a slower pace. Maybe this, just like the weather, is starting to change. While we thought earnings were generally positive, the market did not agree. Around Wednesday, energy sentiment turned decidedly negative and stocks faced selling pressure.

Let's recap with a quick look at market performance:

- On the commodity front, crude oil was higher by about 1%, while
- Natural gas remained incredibly volatile, down 7% for the week on warm weather throughout the U.S.
- Shifting to equities, the broader S&P Energy Select Sector Index® finished lower, down 1.3%
- Exploration and production companies, as measured by the Tortoise North American Oil & Gas Producers Index℠, were also down, falling 4%
- And finally MLPs felt the pain as well, as the Tortoise MLP Index® dropped 1.9%

About a year ago, I walked through our fundamental outlook for crude oil for 2016. Seems like a pretty good time to give you an update on what we see taking place in 2017 for the world's most talked about commodity. I'll preface this by stating this is our best estimate at this time, utilizing data from multiple reporting agencies, independent 3rd party research providers and company estimates. It reminds me of a nice quote as well that states, "Put yourself out on a limb now and then, that way you'll stand a chance of reaching the fruit." Many would call predicting commodities fruitless, nevertheless, let's give it a try. Currently, we believe the global market is approximately 200,000 barrels per day undersupplied for crude oil. Evaluating first the supply situation, we estimate that OPEC will produce an incremental 600,000 bpd in 2017 compared to last year's production of approximately 33.3 million bpd. U.S. production is expected to increase by an estimated 100,000 bpd compared to last year's average of 8.9 million. Finally, the rest of the world is expected to face declines of approximately 100,000 bpd in 2017. All told, we anticipate net supply to be up about 700,000 bpd year on year. On the demand side of the equation, we anticipate approximately 1.4 million bpd of incremental demand world-wide compared to last year. Assuming those numbers are correct and our starting point of 200,000 bpd of undersupply is accurate, the net supply increase offset by the 1.4 million barrels per day demand increase pushes the undersupply situation to roughly 900,000 bpd for 2017. That's a pretty big number, but that's what the data is telling us right now. We thought there would be draws in 2016 in the back half of the year and that's exactly what took place. Last year at this time, we predicted we would end 2016 with an undersupply situation of 100,000 bpd. Based on our numbers, we ended at roughly 200,000 bpd of undersupply. Not bad.

Yet there remain a variety of risks to the equation, so let's evaluate a few of those. First, OPEC may deviate from their stated plan. Our estimates include 100% compliance for the first six months of the year and then a return to pre-compliance levels for the back half of 2017. Feels pretty conservative, but hard to say how the cartel and its members respond. Second, is worldwide demand. We utilized an average of multiple groups to arrive at our 1.4 million barrels per day estimate, including the IEA, OPEC, EIA, independent research providers and energy companies. The range was 1.2 to 1.6 million bpd. The punchline is that our 1.4 million bpd estimate sits squarely in the range of historical demand growth for the last 2+ decades of approximately 1.0 to 1.5 million barrels per day, per year. A global recession clearly impacts this assumption, but that's not our base case.

U.S. supply is also a risk as last year we anticipated a 700,000 bpd decline and we ended up being too aggressive, as the U.S. out-produced our estimates by about 150,000 bpd. That could definitely happen again and is probably the biggest risk perceived in the market today. As the rig count ramps in the U.S. and companies announce strong growth plans, market participants are concerned U.S. shale production could derail the crude inventory rebalance.

Last year I noted how the U.S. could fill the void of shrinking world-wide production due to low prices as the short cycle nature of U.S. shale sets up well to respond to supply needs. First and foremost however, we have to see a reduction of inventories.

It's been a tense market from an inventory perspective and the builds we have seen so far this year are generally thought to be due to long sailing times from the Middle East as OPEC ramped production hard into year-end. That crude is just now hitting our shores and should finally be wrapping up as we leave February.

We certainly hope so, as the U.S. inventory number is the most watched crude oil inventory number in the world and lack of draws has been problematic for oil prices to push beyond the $55 level.

Bottom line, the crude market is healing, but it's taking longer than most would like. Specifically a stubborn U.S. inventory balance.

We'll keep you posted as the numbers roll in frequently, but we believe 2017 looks to be a solid year for crude as long as OPEC continues to comply and U.S. production doesn't ramp too quickly.

That will do it for today…have a great week 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.

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.

The 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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