Tortoise QuickTake Energy Podcast

July 16, 2018

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.

Last week, the incredible rescue of Thailand's Wild Boar soccer team, the World Cup semi-finals, Wimbledon and President Trump's trip to Europe overshadowed activity in the energy sector.

Looking at performance across the energy sector. Both MLPs as represented by the Tortoise MLP Index® and the energy sector as represented by the S&P 500 Energy Select Sector® Index rose by almost 1% last week. Investors welcomed positive returns during a period when oil prices declined by almost 4%.

Oil prices were a bit of an enigma. Last Wednesday, the EIA announced the largest weekly decline in U.S. oil inventories in two years. A decline of this size usually results in oil prices moving higher. However, oil prices surprised many experiencing the worst daily performance since February 2016 falling by 5% on Wednesday. The oddity that occurred in the oil markets last week probably shouldn't have been a complete surprise. Who would have ever thought that a Macy's Day-sized balloon of a U.S. president in a diaper would be paraded through the streets of London either.

The IEA, OPEC, and EIA released their monthly reports on the state of the energy markets last week. Here are a few highlights from each report.

The EIA forecasts U.S. oil production to average nearly 12 million barrels per day in 2019. This is significant because according to that figure, the U.S. would become the world's leading producer of crude. The EIA also reduced its gasoline demand forecast for the first time since 2012 citing higher gasoline prices as the reason the adjustment.

Listen closely to this next point as it is the most important point in this podcast in my opinion. The IEA expressed its concern over global oil supply disruption describing the current situation being stretched to the limit. The concern relates to a reduction in OPEC's spare capacity to increase the global oil supply. A majority of OPEC's spare capacity resides with Saudi Arabia. Some have questioned the Saudi's ability to produce beyond 11 million barrels per day. The report highlights two potential sources of new Saudi supply. First, the Neutral Zone shared with Kuwait could potentially produce up to 500,000 barrels per day. Second, additional offshore and onshore Saudi oil fields are being prepared to pump an additional 350,000 barrels per day by 2019. Ok, you can stop listening now. I'm just kidding.

The last relevant report came from OPEC. The OPEC Monthly Oil Market Report featured its oil market outlook for 2019. OPEC's report forecasts world oil demand to grow by 1.5 million barrels per day in 2019 requiring OPEC oil production of 32.2 million barrels per day to keep the market balance. This is roughly in-line with current OPEC production levels. Therefore, the report concludes that OPEC will have sufficient supply to support oil market stability.

In an interesting development reported by Platts last week, the committee overseeing the OPEC/non-OPEC supply agreement stated that they will no longer track individual country compliance quotas as the deal has now shifted to a collective production ceiling. Current production cuts remain 700,000 barrels per day above the targets so returning to 100% compliance is important to balance the global oil market.

In other news, the second quarter earnings season kicks off this week. We believe this should be a really good earnings season for many energy companies as oil prices are 8% higher in the second quarter of 2018 compared to the first quarter of 2018. In addition, oil prices are 41% higher in the second quarter of 2018 relative to the second quarter of 2017. I expect the second quarter earnings season to be captivating. In our opinion, four questions will set the course for the energy sector in the second half of 2018. From a macro perspective, will the U.S. and China tariff war escalate impacting U.S. exports of oil and natural gas? U.S. oil and gas producers will continue to produce low cost commodities that compete in the global market. Energy infrastructure companies will address the impact of steel tariffs on future projects although we do not expect tariffs to slow the expansion of the U.S. energy infrastructure network. A second question is what will be the outcome of the high stakes global oil market poker game being played by the U.S. and Saudi Arabia? Saudi Arabia is already taking steps to increase oil production to bring the global oil markets back into balance. A third question will the rising Permian Basin oil price discount or basis differential impact U.S. oil production? We think so as the discount has increased from 37 cents in the first quarter to 8 dollars in the second quarter. Relief is in sight in late 2019 when new pipelines become operational. But in the meantime, certain Permian Basin producers will potentially announce lower capex and lower production starting this quarter. We believe that Permian producers will likely reduction production by 300,000 – 400,000 barrels per day in 2019. Lastly, will natural gas prices ever recover? A scorching start to summer after a prolonged winter has natural gas inventories 19% below historical levels; however, prices are not budging. U.S. remains in an enviable position as a low cost supplier of natural gas to the world. In our opinion, this position gets stronger should prices remain low.

In company specific news last week, TransMontainge Partners, a refined products storage MLP, received a buyout offer from ArcLight at a price of $38 per common unit. Supported by this offer to go private, TransMontainge units were up 6.5% last week.

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 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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