Tortoise QuickTake Energy Podcast

June 4, 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.

Thanks for joining us today on the Tortoise Quick Take Podcast. I'm James Mick, Managing Director and Energy Portfolio Manager with Tortoise.

Recent activity on the global scale for crude oil almost feels like an episode of the Bachelor. Will OPEC end the production cut agreement or will they continue to hold it? Meanwhile, in West Texas it's like the classic old show, Make Me Laugh. Can midstream companies get producers to laugh, i.e. commit to new pipelines for both oil and natural gas? Not to be outdone, Canada generated their own version of Superman, flying in to save the day for Kinder Morgan and oil sands producers. We'll cover all of those topics in more detail shortly.

But first, let's start with a recap of market performance:

- On the commodity front, crude oil was weak, down approximately 3.1%, while
- Natural gas finished on the positive side of the ledger, increasing 78 bps
- Shifting to equities, the broader S&P Energy Select Sector Index® moved 2.5% higher
- Exploration and production companies, as measured by the Tortoise North American Oil & Gas Producers Index℠ were also positive, up 1.6%
- And finally MLPs had a solid week, as the Tortoise MLP Index® generated a 2.7% return

Crude oil prices were all over the place this past week as news first surfaced that OPEC and Russia were considering increasing production to offset Venezuelan barrels having already left the market and Iranian barrels potentially leaving the market later in the year. After a few OPEC members came out and stated there had been no formal talks or agreements on the subject, along with a bullish inventory report in the U.S., crude rebounded. Yet it was short-lived as U.S. production continues to increase and causing concern as well as fears Russia will short-circuit the current agreement.

On this topic, a couple of things to point out:

1) The agreement has served OPEC and Russia VERY well. Crude prices have been rising substantially as a result of the inventory draws and levels are below the current 5-year average.
2) Compliance has been exceptional, mostly due to Saudi and Venezuela, one of which is of course not by choice.
3) And maybe most importantly, according to our calculations, if OPEC moves back to 100% compliance, from recent levels in the 160% range, we still see draws for 2018. In other words, we think there is plenty of room for OPEC to step in and meet some obligations, without damaging the market.

Of course, we think actual execution is a bit trickier. For instance, if you increase production, is it country level or OPEC level increases? Clearly not all these countries get along perfectly, so one could assume some hotly contested discussion on the topic.

© 2018 Tortoise

Additionally, there is a big debate about which countries actually have spare capacity. Outside of the Gulf 4 and Russia, likely not many.

Finally, many experts believe that a surge in production may result in a temporary price drop, yet as spare capacity dwindles and approaches levels deemed risky and not seen since 2007, prices will indeed go back up.

In summary, these gyrations feel overdone. Bottom line, there is room for OPEC plus Russia to bring on some capacity to compensate for Venezuela and eventually Iran if needed and not disrupt the broader global oil market.

The other major issue moving through commodity markets has been the widening spreads between Brent and WTI on the global level and the more localized spread between Midland in West Texas and WTI in Cushing, OK.

WTI moved to one of the widest discounts we have seen against Brent since 2014. Rising U.S. production, coupled with the aforementioned Venezuelan and Iranian supply issues kept Brent slightly positive on the week, compared to WTI's decline of 3%.

Midland crude oil prices relative to WTI continued to feel extreme pressure. Double digit discounts to WTI has caused concerns about Permian production growth, specifically from ConocoPhillips CEO Ryan Lance, who noted COP at least needs to look at whether it makes sense to continue increasing production at the same clip if differentials remain this wide.

Of course we believe that bodes well for the midstream entities looking to build out infrastructure from the Permian. Producers, who have been slow to commit to new pipes, particularly on the natural gas side, will have no choice but to sign up to ensure flow of supply.

Finally, in a unique event Kinder Morgan agreed in principle to sell its Trans Mountain and Trans Mountain Expansion pipeline system to the Canadian government for $4.5B Canadian dollars in our opinion. Sadly, this was a needed step. Continued regulatory issues were simply making it impossible for Kinder to proceed as the internal bickering over the pipeline continued to slow the process. Perhaps with the government now the primary owner, the project can finally get some traction and relieve another substantial bottleneck in North America's hydrocarbon value chain, as Western Canadian Select crude oil trades at a discount of more than $25 to WTI.

What to take away from all of this…in our view, and as the market is showing, continued production of crude oil, natural gas and natural gas liquids in North America, and specifically the United States, is forcing the need for new infrastructure.

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 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.

© 2018 Tortoise

The indices are the exclusive property of Tortoise Index Solutions, LLC, which has contracted with S&P Opco, LLC (a subsidiary of S&P Dow Jones Indices LLC) ("S&P Dow Jones Indices") to calculate and maintain the Tortoise MLP Index®, Tortoise North American Pipeline Index℠ and Tortoise North American Oil and Gas Producers Index℠ (each an "Index"). S&P® is a registered trademark of Standard & Poor's Financial Services LLC ("SPFS"); Dow Jones® is a registered trademark of Dow Jones Trademark Holdings LLC ("Dow Jones"); and, these trademarks have been licensed to S&P Dow Jones Indices. "Calculated by S&P Dow Jones Indices" and its related stylized mark(s) have been licensed for use by Tortoise Index Solutions, LLC and its affiliates. Neither S&P Dow Jones Indices, SPFS, Dow Jones nor any of their affiliates sponsor and promote the Index and none shall be liable for any errors or omissions in calculating the Index.

Disclaimer: *Nothing contained in this communication constitutes tax, legal, or investment advice. Investors must consult their tax advisor or legal counsel for advice and information concerning their particular situation. This podcast contains certain statements that may include "forward-looking statements." All statements, other than statements of historical fact, included herein are "forward-looking statements." Although Tortoise believes that the expectations reflected in these forward-looking statements are reasonable, they do involve assumptions, risks and uncertainties, and these expectations may prove to be incorrect. Actual events could differ materially from those anticipated in these forward-looking statements as a result of a variety of factors. You should not place undue reliance on these forward-looking statements. This podcast reflects our views and opinions as of the date herein, which are subject to change at any time based on market and other conditions. We disclaim any responsibility to update these views. These views should not be relied on as investment advice or an indication of trading intention.*

© 2018 Tortoise