

Midstream Energy & MLP

The midstream energy and master limited partnership (MLP) market, as represented by the Alerian Midstream Energy Index, had a total return in U.S. dollars of 20.88% during the first quarter of 2021.

Investment Review

Midstream energy securities and master limited partnerships (MLPs) rallied sharply in the first quarter amid an improving outlook for economic growth and rising energy prices. Positive vaccine rollout trends triggered optimism for improving global growth and greater energy demand. Concurrently, crude oil supply growth remained subdued (led by curtailed production from OPEC+), spurring a robust increase in energy commodity prices. As the midstream sector's correlation to these factors has increased in recent years, this backdrop triggered strong returns over the first quarter.

Industry consolidation is accelerating, which we expect will continue. Given expectations for slowing capital expenditures and organic growth, consolidation trends accelerated during the quarter. Roll-up transactions that were announced or completed included TransCanada's acquisition of TC PipeLines, Chevron acquiring Noble Midstream Partners, Energy Transfer's acquisition of Enable Midstream Partners, and Brookfield Asset Management's hostile takeover overture for Inter Pipeline. Given the ongoing transition away from hydrocarbons, we believe industry consolidation will be key to

retaining cash flows and completing the deleveraging process.

Companies embraced the energy transition to various degrees. Several midstream companies highlighted the flexibility of their asset base by announcing decarbonization efforts. These included hydrogen transportation agreements, carbon capture initiatives, renewable diesel plans and other renewable biofuel projects.

Fourth-quarter earnings were better than expectations, while many companies provided conservative guidance for 2021. For the most part, 2020 midstream results were better than expected, and some companies even surpassed their pre-COVID guidance. However, 2021 guidance was somewhat below expectations. That said, we believe many management teams are basing their projections on lower commodity prices and are generally attempting to manage expectations. We are optimistic about their ability to meet or exceed 2021 guidance.

The Biden administration's infrastructure proposal has indirect benefits for midstream. While there will be spirited negotiations, we believe the ultimate outcome could be stimulative for economic growth and beneficial for commodity prices. In particular, this could be supportive of oil demand and pipeline volumes. There may also be opportunities for companies to hasten the renewable transition via tax credits and deductions. We are also closely monitoring the potential for increased corporate tax rates and fewer deductions, which may favor MLPs given their non-tax status.

Index Performance (US\$)

	Linked Index ⁽¹⁾
Q1 2021	20.88%
1 Year	74.52%
3 Year	2.68%
5 Year	2.12%
10 Year	0.77%

(1) Linked Index: Prior to 04/01/19, the benchmark was the Alerian MLP Index. Thereafter, it is the Alerian Midstream Energy Index.

Data quoted represents past performance, which is no guarantee of future results.

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Periods greater than 12 months are annualized.

Investment Outlook

Commodity prices remain a key driver for midstream. We remain cautious on near-term commodity prices given uncertainties associated with the vaccine rollout, inventory levels and excess energy production capacity. However, we believe the vaccine-driven recovery will build momentum and lead to increased demand later this year. This, coupled with reduced spare capacity, should lead to strengthening energy prices. In the meantime, we feel companies will continue to do what they can to cut costs and retain cash flow. We continue to favor companies with high-quality balance sheets and substantial liquidity to meet capital expenditures, debt maturity and distribution needs through the end of 2023.

We find opportunities in a number of sectors that have positive fundamentals and catalysts. While they are more sensitive to commodity prices, we believe high-quality gathering & processing businesses should generate industry-leading free cash flow in 2021. We also have a bias toward LNG exporters who stand to benefit from the stagnation in LNG supply; this, in turn, should result in persistent high

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margins from European and Asian purchasers in the coming years.

We favor forward-thinking midstream companies that are transitioning to appropriate renewables projects. We continue to believe the renewable energy transition will be a focus, with midstream companies looking to participate. However, we emphasize the importance of not making uneconomic decisions in the process. A better alternative to acquiring non-core businesses is leveraging existing assets toward renewables business (e.g., participating in hydrogen transportation and renewable diesel opportunities). We look favorably on companies with credible expansions into energy transition projects such as these.

We are cautious on several areas that we believe face increased challenges. We avoid refined products pipelines that will increasingly face terminal value concerns as the auto industry transitions to electric vehicles. Natural gas distributors, in general, will likely face persistent regulatory pressures, particularly in more liberal coastal cities. Further, traditional refiners continue to face disruptions and a slow recovery from COVID-related demand impacts. Finally, we are wary of companies with large projects requiring permits and approvals, given the likelihood of regulatory delays/cancellations from policymakers.

(1) All sector returns in this commentary are in local currencies. Sector classification of securities in the index is determined by the investment advisor.

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The Alerian Midstream Energy Index is a broad-based composite of North American energy infrastructure companies. The capped, float-adjusted, capitalization-weighted index, whose constituents earn the majority of their cash flow from midstream activities involving energy commodities, is disseminated real-time on a price-return basis and on a total-return basis.

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