

Master Limited Partnerships

The master limited partnership (MLP) market, as represented by the Alerian MLP Index, had a total return in U.S. dollars of 6.6% in the third quarter, bringing the year-to-date return to 5.9%.

Investment Review

Midstream energy master limited partnerships continued to recover in the third quarter from losses suffered early in the year. Crude oil prices rose to the highest level in four years in the quarter amid strong global demand, concerns about supply declines from exporters such as Iran and Venezuela and a perceived lack of spare capacity globally. Natural gas prices increased as well, even as U.S. gas production reached record levels as domestic demand and liquefied natural gas (LNG) exports continued to ramp up. In July, the Federal Energy Regulatory Commission (FERC) provided clarity on a March ruling to potentially disallow tax benefits related to certain pipelines that suggested the impact on earnings would be less severe than originally anticipated.

With factors broadly supportive of midstream energy fundamentals, companies delivered solid operational and cash flow performance in the quarter. In addition, more companies announced plans to consolidate their organizational structures, eliminate burdensome incentive distribution rights (IDRs) and reduce leverage to more efficiently finance their future capital spending needs—moves

that were typically well received by investors.

Sector Highlights

Among diversified midstream companies (10.5% total return¹), Dominion Energy Midstream Partners rose sharply on the July revision to March's FERC ruling, and after its sponsor, Dominion Energy, offered to acquire the company. Williams Partners was acquired by The Williams Companies. Enterprise Product Partners saw strong performance amid multi-year highs in natural gas liquids (NGL) prices and strong earnings results.

In natural gas pipelines (9.7%), TC Pipelines rebounded as the FERC decision leaves the company better positioned to fund its recently reduced distribution and growth projects. Cheniere Energy Partners rallied on healthy demand for LNG and the progress it is making in developing its LNG export facilities.

In the crude/refined products sector (7.8%), Energy Transfer Partners agreed to be acquired by Energy Transfer Equity, a move that improves distribution coverage and allows the company to reduce its leverage. Andeavor Logistics rose on speculation that MPLX would acquire the company at a modest premium after the completion of the Marathon and Andeavor merger.

In the gathering and processing sector (2.5%), Enlink Midstream Partners LP jumped on merger speculation after private equity investor Global Infrastructure Partners announced a large investment in the LP and its general partner. Crestwood Equity Partners LP reported above-consensus results and announced several new projects, including the expansion of its Jackalope system joint venture in Wyoming's Powder River Basin. Noble Midstream Partners and Western Gas Equity Partners—companies with substantial assets in Colorado—declined ahead of a November ballot initiative that would severely limit new drilling activity in the state, and thus future throughput volumes.

Investment Outlook

Fundamentals for midstream energy companies appear to be steadily improving amid firm oil prices and increasing energy production volumes. The Organization of Petroleum Exporting Countries' apparent commitment to production discipline gives us more confidence around crude oil prices. The secular growth in North American energy production volumes is driving a positive shift in the fundamental cycle for midstream energy companies, translating into improving cash flows. We also find it encouraging that more companies are taking steps to strengthen their balance sheets, increase distribution coverage ratios and move towards less reliance on capital markets to fund their growth.

Index Performance (US\$)

	Alerian MLP Index
Q3 2018	6.57%
YTD	5.90%
1 Year	4.89%
3 Year	4.43%
5 Year	-2.72%
10 Year	9.18%

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

This information is not representative of any Cohen & Steers account and no such account will seek to replicate an index. You cannot invest directly in an index and index performance does not reflect the deduction of fees, expenses or taxes.

Periods greater than 12 months are annualized.

Master Limited Partnerships

North American volume growth favors gathering & processing businesses in low-cost basins. We continue to be overweight companies that have high-quality assets located in basins that we expect to benefit from accelerating production growth, which should drive cash flow growth for those companies. These include the Bakken (North Dakota) and Powder River Basin (Wyoming).

U.S. energy exports continue to accelerate. Though tariffs may slow the growth rate marginally, we believe U.S. energy policy is supportive of continued growth in energy exports. While LNG has received the most attention, demand from international markets is on the rise for U.S. energy broadly, including crude oil. In our view, companies that own assets that help facilitate energy exports will benefit from a continuation of these trends.

Continued movement away from incentive distribution rights. As more midstream energy companies transition away from the general partner/MLP structure, we expect more IDRs to be eliminated. These announcements often lead to dislocations in securities prices, which can be a potential source of alpha.

Widening differentials signal infrastructure constraints. High, stable energy prices have resulted in a resurgence of activity in North American energy production driving strong energy volumes. This has led to infrastructure constraints and a need for new pipeline development in certain regions. For example, crude oil "trapped" in West Texas is trading significantly lower than crude on the Gulf Coast, where the refineries are located, signaling a need for additional pipelines. We believe this represents an opportunity for midstream companies to take advantage of arbitrage opportunities in the short term, and build new pipelines longer term. Notably, we are seeing a resurgence of differentials for NGLs.

Private capital interest on the rise. We continue to see increased interest in publicly traded midstream energy assets from private capital. Our analysis indicates that MLPs are trading at discounts to their private-market values—a phenomenon rarely seen in this sector. We expect this discount to narrow as more private capital is deployed in the MLP space, or as midstream privatizations occur. With listed companies trading at discounts to net asset values, we believe MLPs represent one of today's most compelling total-return opportunities in an otherwise richly valued equity market.

(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 MLP Index (Total Return) is a capped, float-adjusted, capitalization-weighted index, whose constituents represent approximately 85% of total MLP float-adjusted market capitalization.

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