Quarterly Commentary
2Q 2021

EGA Energy Infrastructure

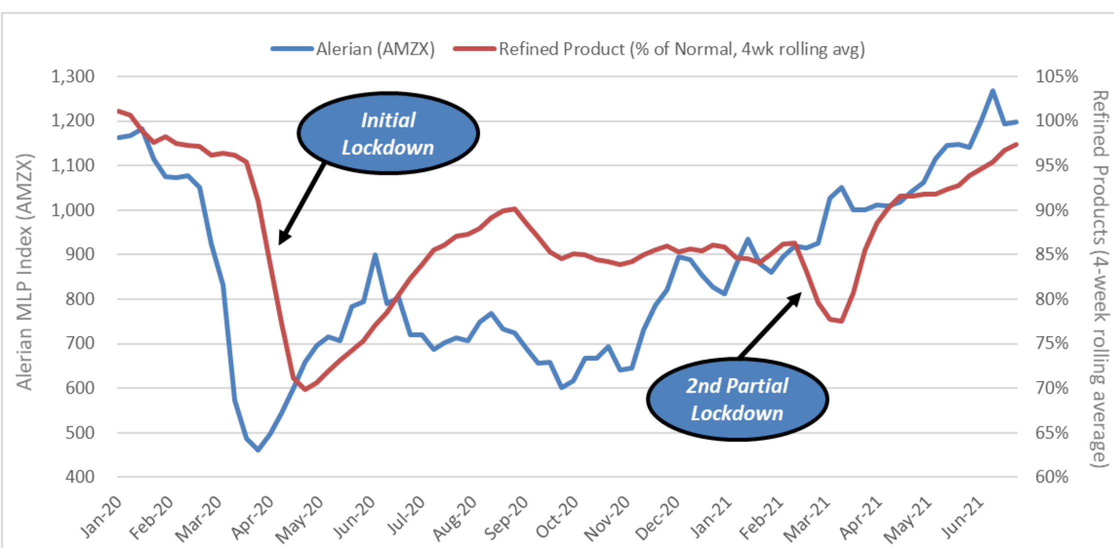
From the EGA Portfolio Management Team

Midstream Is Once Again The Market's Best Kept Secret

Something interesting is happening in 2021. Midstream is boring. It reminds us of Midstream's early years, before the shale revolution pushed the United States towards energy independence. Back then management teams had little to say, and their key priority was communicating the stability of their cash flows and dividends. Astute wealth managers would come across these quirky companies with tremendous yields and secure meetings with C-suite management that were willing and eager to talk with anybody. Today, the sector isn't so quirky, but the focus has returned sharply to fiscal discipline and cash flow stability. Midstream is once again the market's best kept secret.

The Market Re-Discovers Freedom During The "Great Re-Opening"

We're just over nine months into the "Great Re-Opening" and it seems every day an old freedom is re-discovered. On a recent road trip, we found crowded highways and resorts nearly filled to capacity. Restaurants, offices, and other commercial establishments are once again bustling. Refined product demand is >95% of normal with only a full recovery in jet fuel needed to make that final push back to 100% (see below chart).



Source: Energy Information Administration, Bloomberg

However, there is one thing that is not happening. Energy producers are not investing in new oil and natural gas production. What happens when supply doesn't meet skyrocketing demand? Prices rise. WTI Oil ended June at $73.47/barrel, a price point that historically would flood oil fields with cash to take advantage of excellent economic returns. For the most part, this isn't happening. We see two reasons for this:

(1) spare capacity exists, mostly from OPEC. However, there is only about a 6%-7% buffer (~5.5-6.0 million bpd) in spare capacity, which if demand continues to normalize should exhaust itself and potentially lead to higher prices.

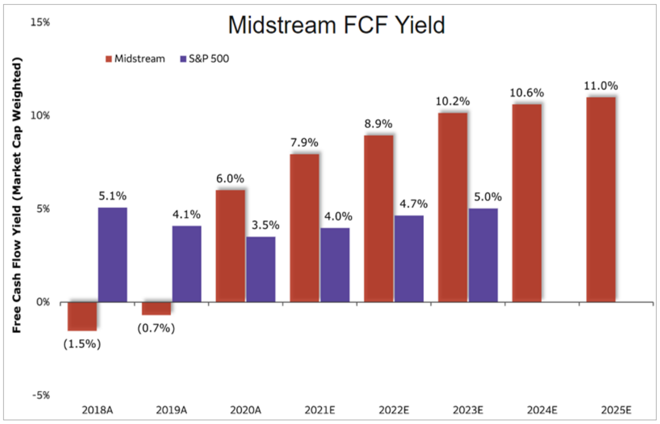
(2) financial sponsors (equity & debt markets) are hesitating to support fossil fuels due to a combination of rising pressure from political and societal forces.

Therefore, it's no surprise current conditions are supporting higher oil prices, leading many to warn that without an increase in spending oil prices will move higher, potentially much higher. Publicly traded producers are in no rush to capitalize because their investors have made it abundantly clear over the last several years they will punish producers that ramp up spending. It's therefore left to the private producers, who don't answer to public shareholders, to invest in new wells. While the private producers have increased their activity, their collective market share is meaningfully less than public producers.

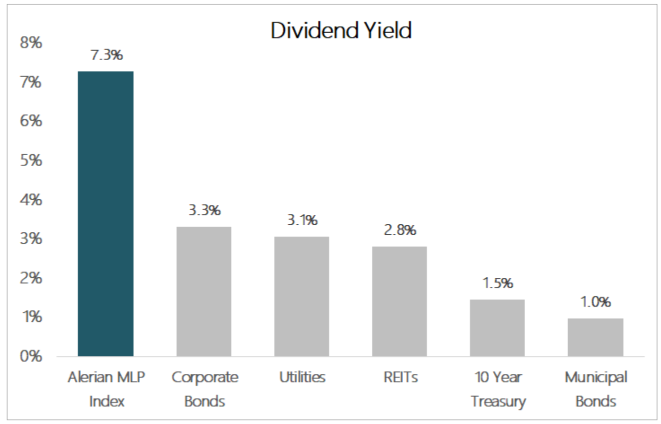
For Midstream, volumes are king. Midstream companies long ago reduced their direct exposure to energy prices so they're not benefiting as much as the producers, but the perception of stabilizing and recovering volumes is raising confidence in the economic viability of their assets. Also helping are headlines that remind the public of the importance of fossil fuels. Particularly jarring was the hacking of Colonial Pipeline. I'm not sure the public realized a single pipeline had the potential to economically paralyze such a large swathe of the United States. Add to it the winter storm blackouts in Texas and California's seemingly regular summer blackouts and the public is regaining an appreciation for the reliability of fossil fuels.

This is all happening at a time when the unexpected seems to favor Midstream. Take for example the final decision for the Dakota Access Pipeline (DAPL). In mid-2020 a judge ordered DAPL to shut down over its failure to secure an environmental impact statement (EIS) at the time of its construction. The pipeline secured a stay, which was followed by appeals, more appeals, and legal challenges. Midstream investors have been conditioned to expect the worst, and so it was with DAPL as investors for several months accepted their fate and avoided stocks tied to DAPL. Many were surprised when the same judge ruled to allow DAPL to continue operating during the EIS process. Separately, an appeals court in Minnesota rejected legal challenges to Enbridge's (ENB) Line 3 Replacement project that threatened to further delay the completion of this project.

The news cycle (a.k.a., "headline risk") appears to favor Midstream, at the same time a lack of projects and capital spending has reduced the potential for headlines in general. Few headlines and minimal controversy has transformed Midstream once again into a boring sector. It's also the reason why we believe Midstream has once again become the market's best kept secret. A quirky sector with tremendous free cash flow and dividend yields (see charts p. 3).



Source: *Wells Fargo*



Source: *Bloomberg*

Meanwhile, Midstream Makes A Case For Being Part Of The Solution

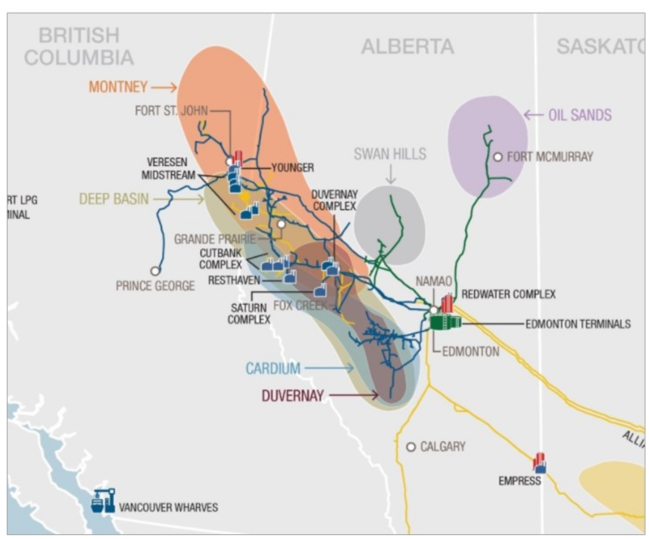
"An oil/gas analyst meets with an oil/gas management team at an oil/gas conference. What questions does the oil/ gas analyst ask? ... Anything but oil and gas!!"

The point of the above is to highlight that analysts today are pre-occupied with how Midstream companies will participate in the energy transition. These types of questions dominate earnings calls and conference meetings, which today center around hydrogen and carbon sequestration. These emerging technologies are not expected to have any material impact on cash flows for at least 5-10 years, but they may provide visibility on how Midstream companies can grow cash flows into the mid-century.

Take for example, TC Energy (TRP) and Pembina's (PBA) proposal to construct the Alberta Carbon Grid. This joint venture would utilize the two companies existing assets and newbuild infrastructure to transport carbon from Alberta's industrial and power centers to a depleted reservoir for disposal via injection. When fully constructed the open access network will be capable of sequestering 20 million tons of CO2 annually, and go a long way towards helping Canada achieve its greenhouse gas emissions (GHG) targets.

TC Energy

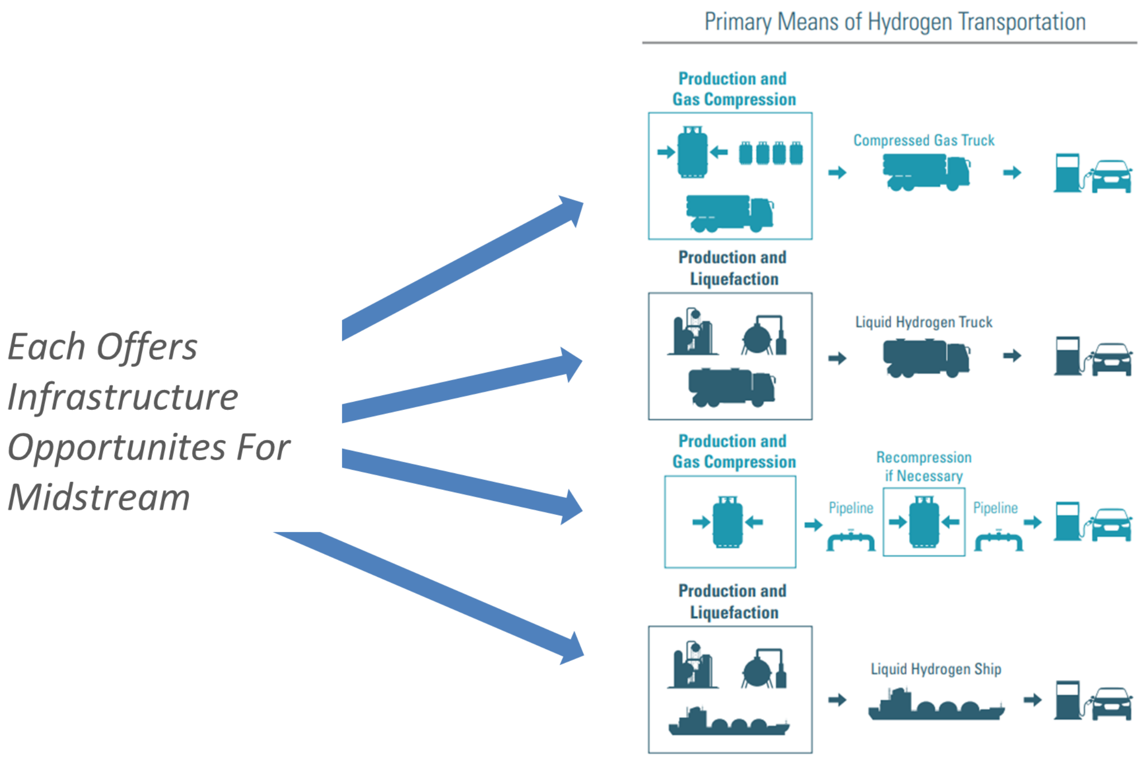
Pembina



Source: *TC Energy, Pembina Pipeline Corporation*

The Alberta Carbon Grid was just one of many initiatives announced by Midstream companies this year. Midstream companies are uniquely positioned to provide sequestration solutions, and don't need much to incentivize action in the traditional energy supply chain. Ironically, the transition to electric vehicles may further the argument for carbon sequestration. The reason is because if carbon emissions are centralized to large power plants or industrial centers, the easier it will be to capture carbon in a large enough scale to make the economics easier for sequestration.

Separately, optimism on hydrogen as a way to store energy offers a different set of opportunities for Midstream companies. Once again, if incentives are properly aligned, there is no sector better positioned to benefit from designing and building hydrogen infrastructure than Midstream.



Source: U.S. Department of Energy (US DOE)

Some consider Midstream is in the process of winding down. We reject that conclusion. There is reason to believe Midstream is in the early stages of a carbon sequestration megatrend, may participate in providing energy storage solutions via hydrogen, or perhaps contribute to another technology that aligns with their hard asset skill set. *We also stress Midstream's participation in the energy transition complements what we believe is an attractive environment for the construction of more oil and natural gas infrastructure.* There is still a surprisingly large percentage of the world that is energy insecure, and we believe the quickest, most reliable way to increase living standards globally is through fossil fuels. It is for this reason most forecasters predict oil and natural gas consumption will increase for at least the next decade.

We consider it inevitable that Main Street will catch on to the many attributes of Midstream, because usually the market's best kept secret doesn't stay that way for long.

Midstream Outperforming Where It Matters Most

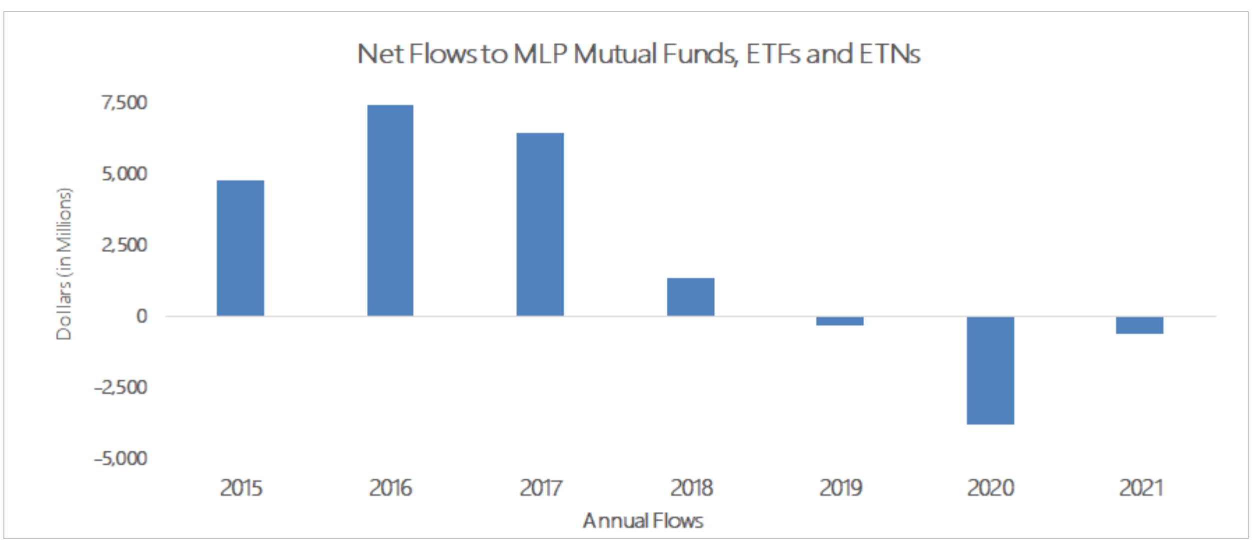
The Alerian MLP Index has quietly put together its best absolute start since the index's launch in 1996, with 1H21 total return of +48% outpacing the prior record of +33% (2009). More importantly, the Alerian outperformed the S&P 500 by +3,259 basis points in 1H21, which is the most since 2001! It's also noteworthy the Alerian has outperformed the S&P 500 every month in 2021, a streak this long hasn't been seen since 2009-10 (see below chart).

Alerian MLP Index Relative Performance to S&P 500

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Jan	(97)	277	16	1,578	642	72	708	(319)	749	289	347	541	2,368	**423**	65	(254)	745	405	(5)	(614)	300	4	462	(557)	**685**
Feb	18	(621)	(158)	(60)	1,142	(600)	271	(28)	(121)	(114)	473	271	649	**146**	9	(14)	(47)	(476)	(367)	(34)	(357)	(601)	(294)	(582)	**501**
Mar	175	(630)	(450)	(1,042)	896	351	30	442	(206)	(10)	361	(586)	(809)	(316)	(65)	(728)	163	61	(266)	154	(141)	(440)	149	(3,488)	**253**
Apr	(658)	79	370	575	313	839	(13)	(669)	497	32	183	247	144	180	35	287	(101)	353	522	1,065	(231)	771	(538)	3,680	**181**
May	(314)	108	(9)	316	67	(206)	(199)	(185)	(227)	406	(373)	(27)	372	258	(382)	(148)	(438)	104	(486)	74	(593)	264	521	419	**687**
Jun	(141)	(603)	(391)	303	78	(40)	236	33	394	(167)	252	353	(189)	1,083	276	(81)	447	385	(635)	487	(127)	(216)	(440)	(986)	**284**
Jul	25	196	587	593	657	894	18	726	146	374	204	(88)	488	53	15	369	(558)	(217)	(534)	(313)	(76)	286	(163)	(919)	
Aug	803	532	202	(317)	1,061	579	(137)	275	(149)	9	(732)	25	(685)	196	436	(65)	40	419	107	(146)	(525)	(168)	(393)	(667)	
Sep	(425)	92	(192)	1,433	513	665	266	423	44	(394)	(677)	(826)	**106**	(279)	289	(59)	(82)	(16)	(1,281)	183	(137)	(214)	(116)	(982)	
Oct	665	(445)	(812)	(336)	405	(858)	(323)	(142)	(7)	192	528	1,667	**472**	159	(66)	234	(191)	(704)	126	(263)	(647)	(116)	(838)	704	
Nov	(405)	(901)	(985)	659	(1,037)	(555)	304	109	(753)	237	6	(992)	**36**	190	(2)	(138)	(218)	(527)	(837)	(140)	(442)	(287)	(938)	1,284	
Dec	(282)	(1,044)	(888)	1,076	128	921	(2)	(100)	(202)	28	148	(476)	**467**	(495)	473	(403)	(89)	(537)	(199)	241	363	(33)	551	(133)	
First Half	(1,115)	(1,491)	(684)	1,801	**3,431**	334	1,213	(759)	1,115	447	1,384	748	2,950	1,844	(82)	(984)	824	918	(1,223)	1,087	(1,200)	(328)	(158)	(3,263)	**3,259**

Source: Bloomberg

As long-term investors, we recognize it's premature to celebrate given Midstream's struggles over the past several years. We also note that while the fundamentals of higher EBITDA, lower spending, and much higher free cash flow are compelling, it does not appear to have re-energized investors. As per U.S. Capital Advisors, Midstream has seen institutional (a.k.a., "dedicated investors") outflows of $591 million year-to-date, including surprisingly large outflows in May ($100mn) and June ($115mn).



Source: U.S. Capital Advisors

Meanwhile, analyzing its own system, Wells Fargo concluded retail ownership of Midstream continues to be uninspiring. For MLPs, retail ownership declined to 47% from 49%, a level well below its long-term average (roughly 60%). For C-Corps the data is a bit better as retail ownership increased slightly to 32% from 31%, extending what has been a modest growth trend. We cannot overstate the importance of retail to Midstream, as this investor class has historically been the backbone of the sector.

The absence of retail buying and the reality of institutional outflows leads us to believe the Alerian's outperformance is being driven by quantitative investors and generalists, a reality we do not expect will end soon as Midstream continues to screen attractive on long-term measures and certainly relative to other sectors in today's bull market. We are, therefore, cautiously optimistic that retail and institutional capital will "re-discover" Midstream in the near-term, driven by both the sector's ability to generate material free cash flow over the medium-term and what appears to be an increasingly attractive slate of long-term growth opportunities.

We'll say it one last time, usually the market's best kept secret doesn't stay that way for long.

Energy Infrastructure Team Update

There were no significant team related news items to highlight this quarter. We continue to focus on the research and portfolio execution effort and are in constant dialogue with industry experts and management teams. We continue to believe oil and natural gas will play a major and increasing role in the global economy, and owing to healthier balance sheets, higher coverage, and heightened discipline are optimistic about the long-term viability of Midstream as a sector for investors who prioritize income.

We look forward to communicating the results of your investment next quarter and thank you for your continued patronage and confidence in Eagle Global Advisors.

- The Eagle Energy Infrastructure Team