The energy sector enjoyed a strong year with investors demonstrating their enthusiasm about the domestic energy renewal underway in North America. We expect this trend will continue well into the future due to the abundant domestic supply and robust production of North American crude oil and natural gas. This growing production continues to create opportunity across the value chain, beginning with upstream production companies, but also driving a critical need for midstream pipeline and related infrastructure to move newly discovered oil and gas from gathering areas to downstream end users. Here is our 2014 summary outlook for each sector of the energy value chain.

Upstream: resources in motion

According to the U.S. Energy Information Administration (EIA), energy production from countries that are not members of the Organization of the Petroleum Exporting Countries (OPEC) are expected to grow by a record high of almost 2 million barrels per day (bbl/d) in 2014, with the U.S. and Canada together on track to produce nearly 70 percent of such growth. The EIA projects annual average domestic crude oil production will approach 8.5 million bbl/d in 2014 and 9.3 million bbl/d in 2015. The 2015 forecast, if realized, would mark the highest annual average production in 43 years. This tremendous production growth has resulted in declining foreign petroleum imports, which peaked at more than 60 percent of U.S. demand in 2005 but represented an average of just 33 percent in 2013. The EIA also projects net imports to continue to decline in 2014 and reach 24 percent of consumption in 2015, which would be the lowest level in more than three decades. At Tortoise, we expect the greatest North American oil production out of the Permian, Bakken and Eagle Ford basins. Total production from these basins is forecasted to grow at an average annual rate of approximately 8.5 percent for the next five years,¹ as expected output per well is increasing while drilling times and costs have declined.

On the natural gas side, 2013 production levels were in line with 2012 levels, enabling the U.S. to meet its natural gas needs independent of foreign imports. We expect that North American gas production will remain relatively stable in 2014, but anticipate that the Marcellus and Utica shales will continue to gain market share as low natural gas prices have stalled drilling in some other parts of the country. The Marcellus is now producing almost 15 percent of U.S. natural gas supply, an amount that is expected to grow to 18 percent in 2014.¹ Over the long term, we expect this robust production to drive an increased use of natural gas from a myriad of sources, such as power generation and manufacturing. And, as global demand for gas increases, it’s anticipated that foreign demand for liquefied natural gas (LNG) trade will also expand due to its relatively low domestic cost.
Historically known as the exploration and production (E&P) sector, the production side has gained significance in recent years. In our view, it will continue to dominate in 2014. However, this production growth will require close scrutiny as growth, operating efficiency and price realization can vary significantly by basin. Oil and gas producers also should continue to benefit from improvements in technology. One example is pad drilling, which involves drilling multiple wells from one site. It has improved efficiencies and reduced the number of drilling rigs needed to drill an equivalent number of wells without reducing the volume of oil and gas coming out of each well. We believe technology advances will continue to drive production growth for upstream companies. We expect and welcome more standardization of best practices related to the safety of drilling practices and look forward to the Environmental Protection Agency’s report on the potential impact of hydraulic fracturing on drinking water resources, which is due for release in draft format soon.

Midstream: continued positive momentum
We expect to see upside potential for midstream companies in 2014, with the key driver being the continued infrastructure build-out to support the production growth from various plays across the country. Specifically, petroleum pipelines should remain steady in the months ahead, supported by growing production, and we currently anticipate a tariff escalator of 3.9 percent in July (percent change in the producer price index plus 2.65 percent). Refined products pipelines are expected to be relatively stable with the potential for a marginal uptick in volumes as an improving economy, employment picture and expanding exports help offset efficiency gains. Although we expect a lower short-term growth outlook and continue to monitor re-contracting rates, we expect natural gas pipeline companies should benefit from the build-out in the Marcellus and longer-term by expanding demand potential, driven by power generation and LNG exports. On the gathering and processing side, we think companies will benefit from near-term infrastructure build-out supporting liquids-rich production, though we expect ethane prices will remain under pressure.

Through 2016, we project more than $100 billion in MLP, pipeline and related organic growth projects. Those currently underway include new crude oil pipelines, rail and storage terminals, along with natural gas and natural gas liquids infrastructure. The project backlog for crude oil / liquids pipelines continues to build, and refined products exports should provide tailwinds in both volumes and new infrastructure needs. Capital markets have been providing the necessary support, and we expect that will continue to be the case. Similar to 2013, we also expect to see some energy companies restructuring to unlock value. We believe these assets, which are absolutely critical to our energy needs, are attractive to investors in periods of economic growth and uncertainty.
From a macroeconomic perspective, we anticipate GDP growth to be in the 2-3 percent range in 2014. An improving economy is a positive for most energy companies, as it should translate into more end-user demand, generating more volumes of oil and gas shipped through pipelines. Specifically as they relate to MLP and pipeline companies, we believe that rising interest rates would provide short-term headwinds, but distribution growth ultimately should allow the companies to generate positive returns.

Downstream: solid fundamentals
Our outlook for the downstream remains solid. We believe cleaner generation and electric transmission are the focus of growth efforts, and a constructive regulatory relationship will provide a path to modest earnings growth. We continue to monitor allowed return on equity to ensure companies are earning a reasonable return.

North America’s abundant natural gas production has resulted in stable and globally competitive prices for natural gas and associated gas liquids. We think global demand for U.S. LNG will expand due to its low domestic cost compared to other places in the world. That should increase U.S. exports over time.

Other areas within the downstream sector that we anticipate will continue to benefit from lower costs associated with robust oil and natural gas production are refineries, storage terminals and facilities and the distribution networks that transport upstream energy products to end consumers. Additional beneficiaries include manufacturing and petrochemical companies that use NGLs and crude oil byproducts to create a wide range of consumer and industrial products.

Conclusion
We believe that now is a great time to invest in North American energy. Production is growing at a steady clip, generating the need for additional infrastructure. New projects in turn are driving growing cash flows and attractive return potential. The tremendous volumes of North American oil and natural gas have not only made the U.S. a global leader in energy production, they are favorably impacting our economy, consumers and our national security, with implications worldwide in our ability to compete.

The tremendous volumes of North American oil and natural gas have made the U.S. a global leader in energy production. They also are favorably impacting our economy, consumers and our national security, with implications worldwide in our ability to compete. They also are creating opportunity across the entire energy value chain, from producers in the oil patch to key transporters of the newfound abundant oil and natural gas to end users in the downstream sector. At Tortoise, we think the future of North American energy is bright.

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Contact us
As always, we look forward to hearing from you. For additional information, please call 866-362-9331 or visit www.tortoiseadvisors.com.

About Tortoise Capital Advisors
Tortoise Capital Advisors, L.L.C. is an investment manager specializing in listed energy investments. Tortoise has the longest tenure of managing registered MLP funds and pioneered the first listed MLP fund in 2004. As of Dec. 31, 2013, Tortoise had approximately $14.2 billion of assets under management in NYSE-listed closed-end investment companies, open-end funds and other accounts. www.tortoiseadvisors.com

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