Tortoise QuickTake Podcast

March 27, 2017

Welcome to the Tortoise QuickTake podcast. Thank you for joining us. Today, a senior member of Tortoise provides 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 Portfolio Manager with Tortoise Capital Advisors.

The end of March brings a variety of emotions for sports fans. There is the madness and the sadness of the NCAA basketball tournament, while hope springs eternal for baseball fans. One of soccer's premier tournaments, the Champions League hits the final stretches and of course the Masters kicks off the first major in golf. It's a great time to be a sports fan!

March hasn't been so great for energy stocks. Negative sentiment has mainly been driven by crude oil. We have discussed in great detail on previous podcasts, but inventory builds in the US, as a result of heavy imports, is weighing on investors' minds and causing angst. Additionally, the "will they or won't they" around an extension of OPEC's output agreement for another six months is dominating headlines.

Let's start with a recap of market performance:

- On the commodity front, crude oil was lower by 1.7%, while
- Natural gas turned in a positive week, plus 4% on colder weather throughout the U.S.
- Shifting to equities, the broader S&P Energy Select Sector Index® finished lower, down 1.7%
- Exploration and production companies, as measured by the Tortoise North American Oil & Gas Producers Index℠, were also down, falling 2.5%
- And finally MLPs were marginally lower, as the Tortoise MLP Index® fell 32 bps

Some interesting tidbits related to crude oil for the week:

- The oil rig count was up 21 for the week, bringing the total rigs operating to 652. That's a 280 rig gain year over year and a level we haven't seen since September of 2015.
- A notable news agency reported that Saudi exports to the U.S. were set to decline by 300,000 bpd in March, which would be a nice trend to see. Note however, given the lag in shipping times, we won't see that impact for probably six weeks, but still a positive none-the-less.
- OPEC compliance was the main topic as the monitoring committee established by OPEC and non-OPEC participating countries met in Kuwait City on Sunday. Per the committee, compliance was at 94% for February, plus 8% compared to January. It also noted that the end of refinery maintenance season, a noticeable slowdown in US inventory stock builds and a reduction in floating storage should support positive efforts to achieve market stability. Importantly, the committee also noted that it would evaluate whether or not the agreement should be extended during their April meeting, at which point they would make a recommendation to the participating countries.

This sounds very constructive, but one of the biggest concerns is that data may simply not be available yet to really determine the extent of the cuts on world inventory levels given the significant lag in timing of said data. We'll be watching this closely as we move forward

We seemingly spend a great deal of time discussing crude oil on our podcasts and rightfully so, as it is a key macro driver for energy. But I thought we would discuss some supply and demand fundamentals for that other commodity, natural gas, just to mix things up.

Similar to crude oil, we do a walk forward of supply and demand for natural gas to determine how inventory levels will change. Unlike crude oil, the demand side of the equation is much more dependent on weather and therefore can move around quite a bit.

Here's a quick breakdown:

In 2016, the U.S. produced about 72.2 billion cubic feet, or bcf, per day of natural gas. Additionally, we imported another 5.8 bcf per day, primarily from Canada, which brings total supply to approximately 78 bcf per day. On the demand side, we averaged just a shade over 79 bcf per day, resulting in slight inventory draws over the course of the year. In fact, 2016 saw draws for the full year of just about 332 bcf, or almost 1 bcf per day.

For 2017, here is what we are projecting. We anticipate total supply to be down just slightly at 77.9 bcf per day, or essentially flat. Overall demand is also projected to be down just slightly to 78.9 bcf per day. Yet for demand, it's important to break out the components as they can vary greatly based on weather.

To put that into context, let's evaluate the components of demand. Industrial demand is projected to be flat and is not highly weather dependent. Residential/commercial demand is projected to increase by about .4 bcf per day, but is highly dependent on weather as that is the key driver. Power burn is expected to fall by 3.8 bcf per day as that is related to warm summer weather. The hotter the summer, the higher the power burn demand, but it is also a function of price, as low natural gas prices relative to coal incent switching by utilities to burn natural gas instead of coal.

The EIA expects this to decline in 2017. Offsetting the decline in power burn are two components that are growing in importance, exports to Mexico of natural gas and exports of LNG. We anticipate exports to Mexico to grow by 1.1 bcf per day, on a base of only 3.7 bcf per day, so very strong growth. Similarly, we expect LNG exports to increase by 2.2 bcf per day, off an even smaller base of .6 bcf per day. As we have been stating for some time, exports continue to be a key cog in the U.S. supply demand picture in terms of balancing inventory levels of energy commodities.

A couple of key tidbits regarding natural gas. Exports will be key to helping keep the market balanced. Weather always plays a big role and will be important again as it drives a substantial amount of demand. Relative prices of coal and natural gas will also impact inventory levels in the summer. Production will be back-half weighted as new pipes in the Marcellus come online. The gas rig count sits at 155, which is up from a low of 81 in August of last year, but not that dramatically different than the 162 at year end 2015. In other words, we've have been producing a lot of gas from very few rigs for some time and expect that to continue.

In summary, we expect a balanced natural gas market and a slight draw on average for 2017. Not much different than we have seen recently and not much different than 2016. We have plenty of natural gas in the U.S. and as demand increases, supply can be bumped to meet that demand.

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.

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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.

Tortoise North American Oil & Gas Producers Index℠
The Tortoise North American Oil & Gas Producers Index℠ is a float-adjusted, capitalization weighted index of North American energy companies primarily engaged in the production of crude oil, condensate, natural gas or natural gas liquids (NGLs). The index includes exploration and production companies structured as corporations, limited liability companies and master limited partnerships but excludes United States royalty trusts.

The Tortoise MLP Index®
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.

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