Midstream: Turbulence in the wake of Fed and OPEC meetings likely offers a buying opportunity, as inflationary pressures are likely to persist and valuations remain cheaper vs. pre-COVID levels. Despite a 9-month rally, the "catch-up trade" has hardly dented relative multiyear midstream underperformance vs. broad markets, and valuations remain cheap as the 2021 rally has been partially offset by debt reduction and free cash flow (FCF) expansion.

Natural Resources: While the emergence of electric vehicles (EVs) could impact the long-term demand for oil, EV-related demand for other commodities is rising. In 2020, EV sales reached nearly 5% of passenger vehicles globally. Since EVs require approximately 130 pounds more copper than conventional vehicles, 2020 copper demand rose by +1%, despite COVID. With average copper demand growth rates of 3%/year over the last 50 years, EV-driven growth could push copper demand structurally higher in coming years. We look to the 1963-1982 inflationary period to give a sense for what the addition of electric vehicle demand will mean for prices.

Check out Recurrent's video series, "Research in 99 Seconds," as well as our research white papers, here.

MLP & Infrastructure

Performance review

During the month of June 2021, the Recurrent MLP & Infrastructure Strategy generated net returns of +3.83%, underperforming the +5.18% return of the Alerian MLP Index (AMZ) by (1.35%). Since the strategy's July 2017 inception, Recurrent's MLP & Infrastructure Strategy has outperformed the AMZ by +3.24% (annualized, net of fees). Please see the performance section at bottom for more detail.

Mid-June Fed meeting created a "taper tantrum" for commodity assets – and a compelling entry point

The Fed's announcement that the FOMC was "talking about talking about" raising rates before YE 2023 incited a violent response from the markets, as long-dated Treasury yields dropped almost 20%, ignoring Chairman Powell's attempts to talk down any hawkishness in the weeks that followed. Commodity-related stocks similarly recoiled, with the Alerian MLP Index (AMZ) falling nearly ~10% from mid-June to early July.

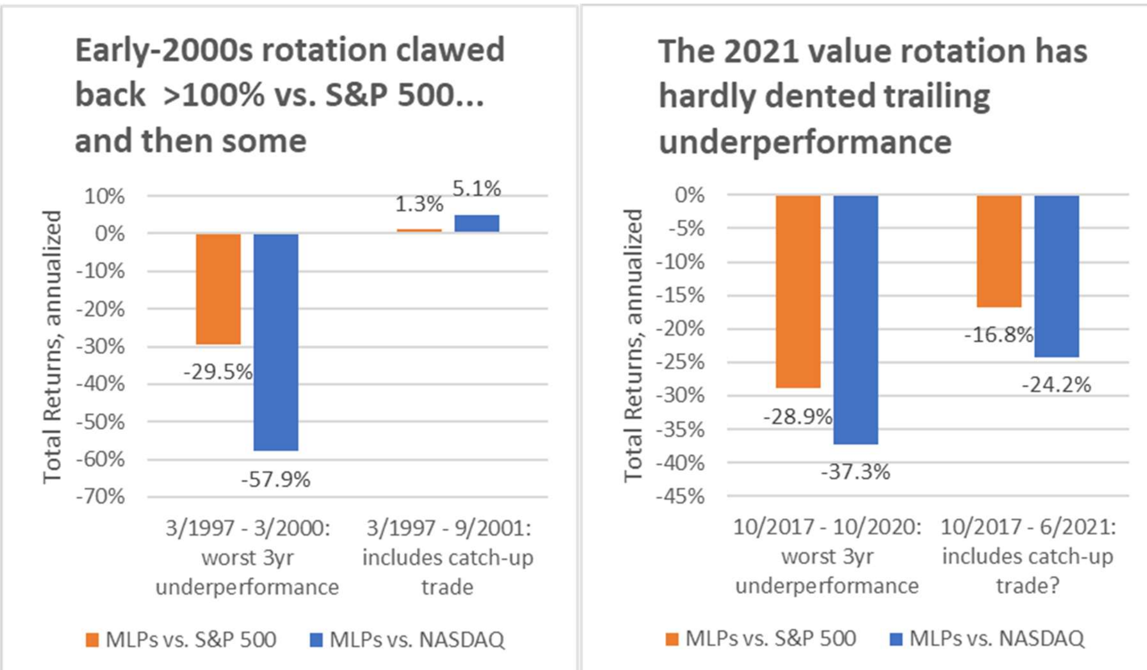
Understandably, the violent reaction prompted questions of "is the reflation rally over?" The answer, as we do our best to examine the key points, is "no", for these reasons:

1. **Relative performance** of midstream has hardly budged, even after the post-October 2020 rally (see exhibit 1 below).
2. **Inflation indicators**, including commodity prices, PPI, and wages continue to offer evidence of continuing inflationary pressure, even as economic data moves past the COVID distortions of March and April (exhibits 2+3).

3. **Valuations**, as measured by free cash flow yields, remain 25% cheaper than 2019 levels and 33% cheaper than S&P 500 multiples… midstream free cash flow yields to equity is almost 3x that of the S&P 500 (exhibit 4).

You call that a catch-up trade? A 40% YTD rally has done little to erase years of underperformance

Exhibit 1



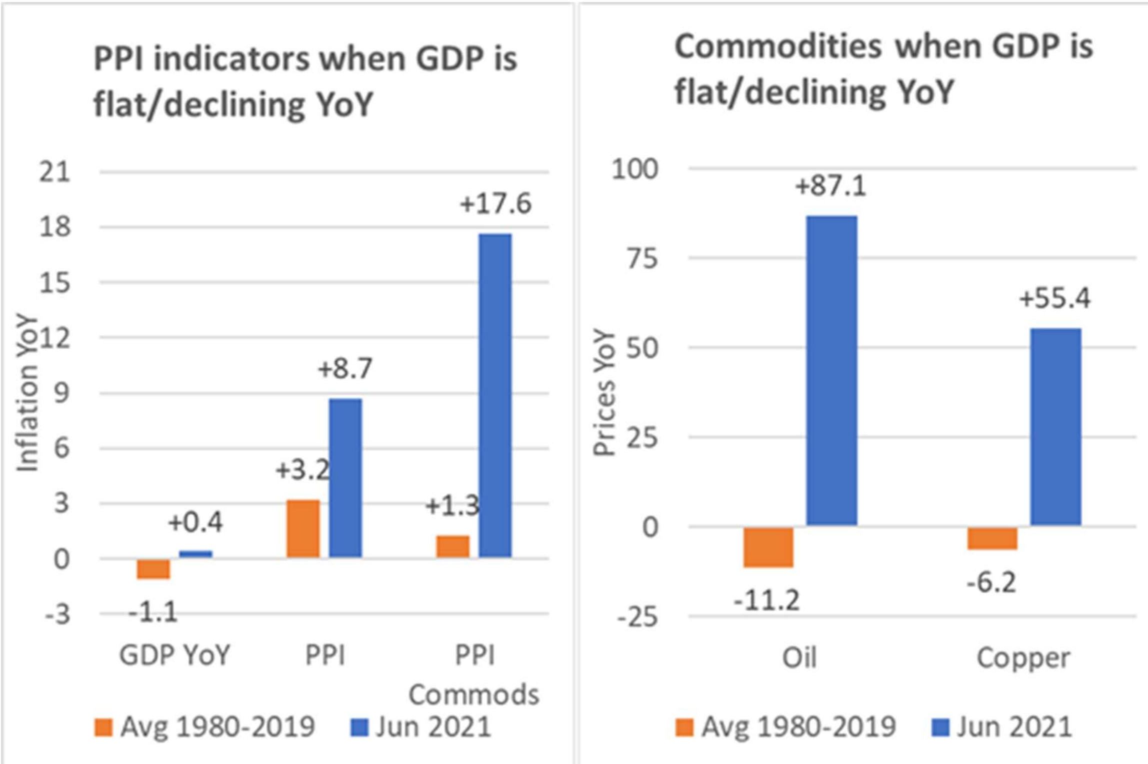
PAST PERFORMANCE DOES NOT GUARANTEE FUTURE RESULTS.

Source: Bloomberg, Recurrent research.

The data continue to support an ongoing "reflation"/"inflation" trade

It's hard to find any evidence that inflation is meaningfully subsiding in the economic data. As shown below, commodity pressures remain evident, and global economic activity is expected to accelerate in 2H 2021 as emerging market COVID impacts peaked in 1H 2021.

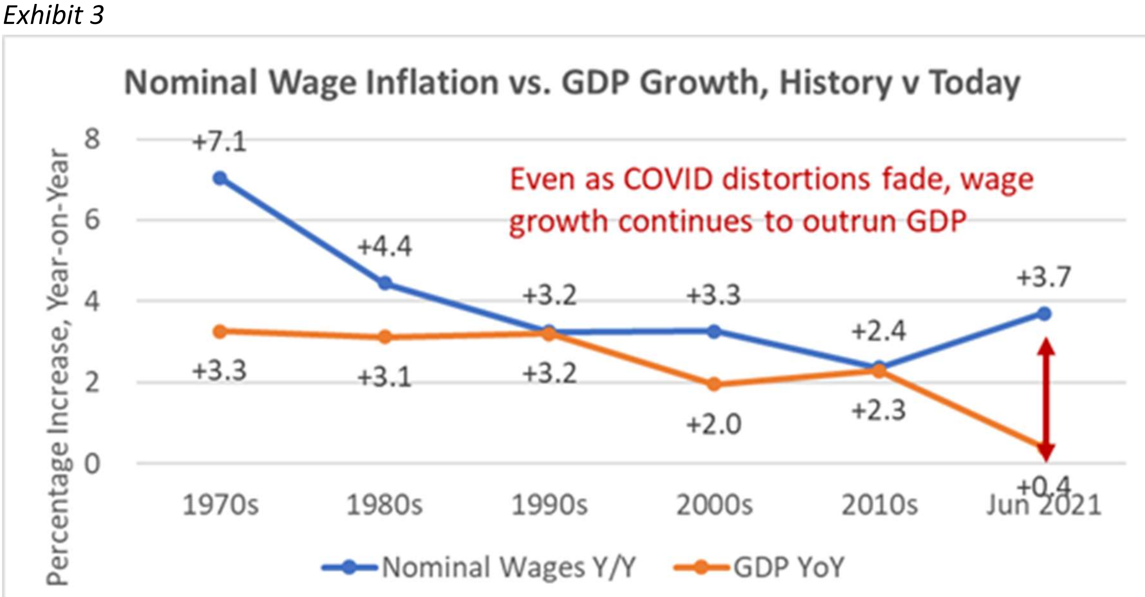
Exhibit 2



Source: Bloomberg, DOL, St. Louis FRED, Recurrent research.

As seen in the chart below, one widely-accepted sign of inflation - wage growth – continues to track above historical experience, even as the distorting "base effects" of COVID seen in March-April subside.

Exhibit 3

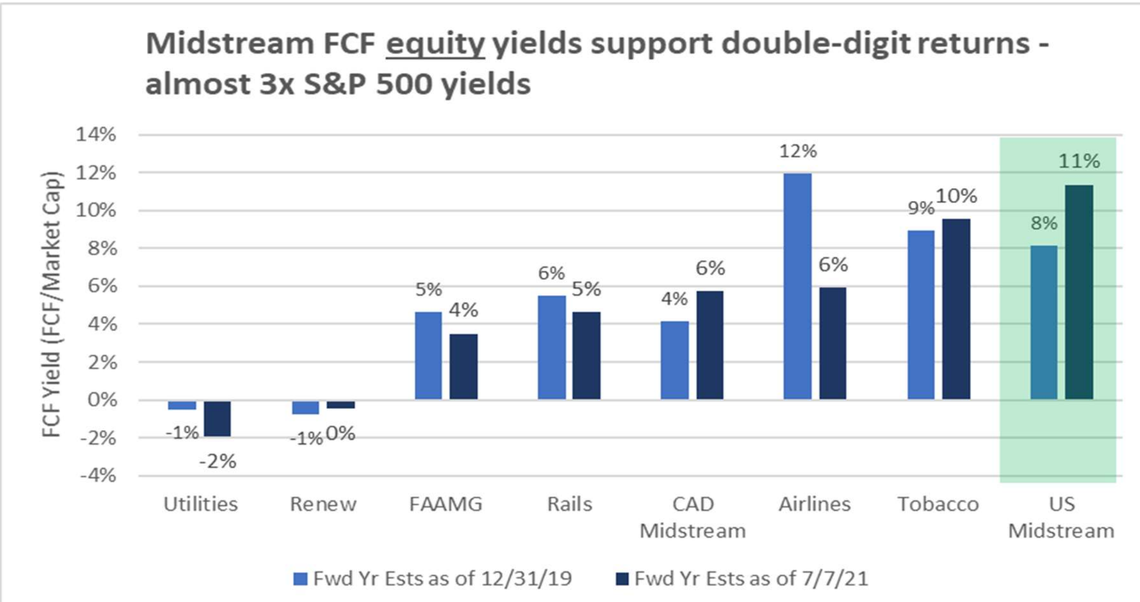


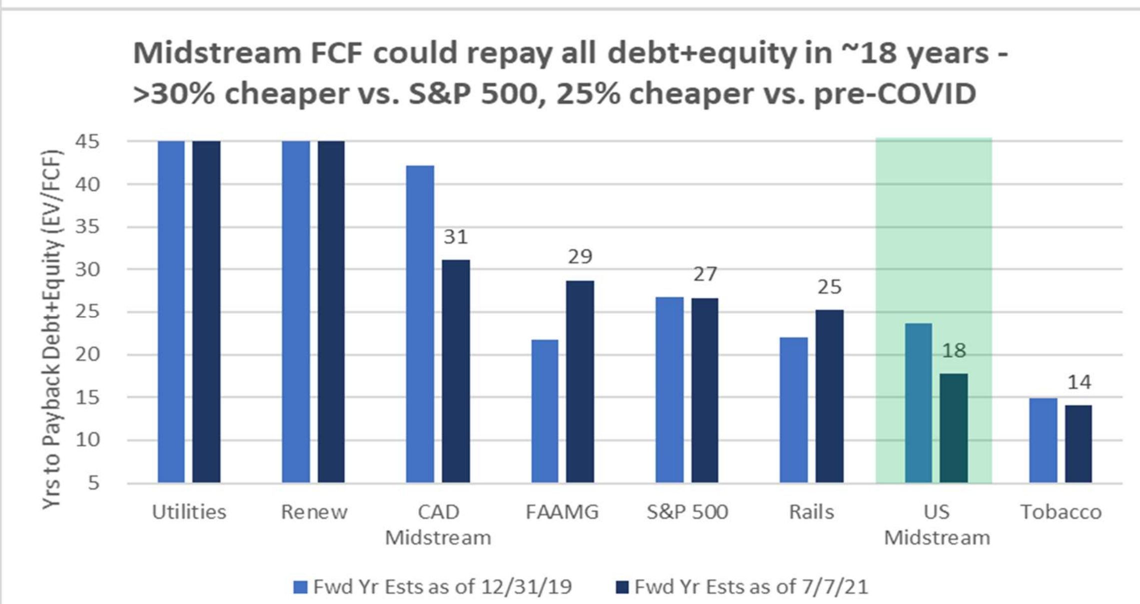
Source: Bloomberg, DOL, Recurrent research.

Valuations have risen with equity values – but valuations have also been reduced by debt reduction, FCF growth

When looking only at FCF equity yields (FCF as a % of market cap), US midstream companies are even cheaper than tobacco stocks. When looking at "payback periods," or the years required to buyout the entire debt + market cap at today's valuations (including debt and preferred stock), midstream is second only to tobacco, as measured by EV/FCF. These inexpensive valuations are consistent with a sector whose "catch-up trade" is beginning, not ending.

Exhibit 4





Source: Bloomberg, Public Filings, Recurrent research.

Natural Resources

Performance Review

In June 2021, the Recurrent North American Natural Resources strategy fell by (0.17%), underperforming the S&P North American Natural Resources Index's +0.45% increase. During the month, portfolio holdings in the copper, aluminum and steel sectors all fell more than the benchmark, after significant outperformance during 2021. Stock selection in the energy industry added to performance, as WTI oil prices ended the month above $70/barrel.

Investment Discussion – Electric vehicle demand is increasingly bullish for industrial metals – not just lithium and cobalt

In our 2017 white paper titled "From Gasoline to the Grid", we analyzed the emerging electronic vehicle (EV) market. In it, we looked at the importance of cost factors to determine increases in market share. Additionally, we looked at potential scarcity of two important components – lithium and cobalt - in electric batteries which could inhibit widespread growth.

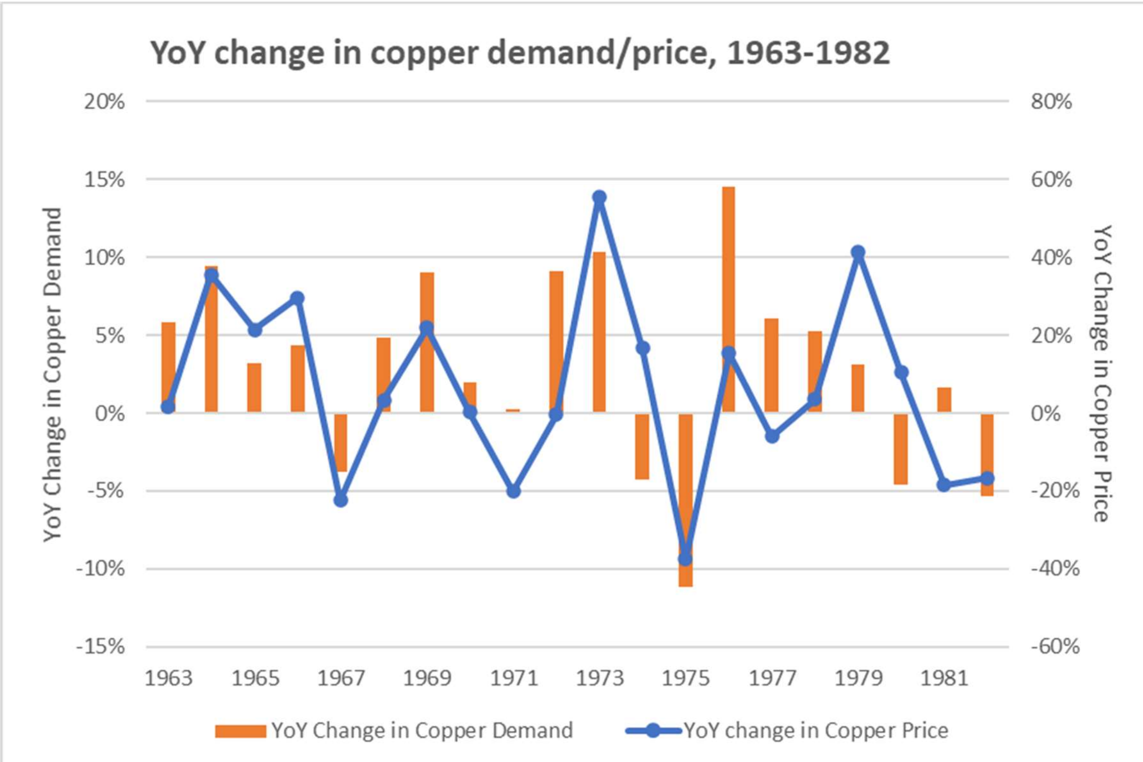
While widely used in a variety of applications, copper also plays a prominent role in the energy transition. A typical oil-powered internal combustion engine vehicle (ICE) contains approximately 50 pounds of copper. In comparison, approximately 180 pounds of copper are used in a typical electric vehicle (EV). While not necessarily a large impact on the global copper market at current market shares for EVs, it is worth considering the impact of EV market share growth on the copper market.

In 1Q 2021, research firm Canalys estimated that 3.1 million electric passenger vehicles were sold in 2020, comprising nearly 5% of global market share during a year when total auto sales fell due to COVID. This increased market share of EVs added 185,000 metric tons of global copper demand in 2020 (3.1 million cars x 130 pounds per car). This compares to annual global copper consumption of approximately 20.7 million metric tons, or +0.9% growth due to the switch to EVs alone.

According to Bloomberg analysis, despite COVID, 2020 global copper demand grew approximately +0.8%, implying that nearly all market growth was attributable to incremental demand from EVs. However, since 1961, annual copper demand has averaged roughly +3%, which is likely augmented by electric vehicles and grid electrification.

At this point, incorporating some learnings from our previously mentioned white paper helps to frame the demand outlook for copper. In 2017, we identified that EVs could account for 20-30% passenger vehicle sales before supplies of cobalt and lithium face meaningful bottlenecks. If we extend the same consideration to copper, then global copper demand would increase approximately +3.6% per year, just from EV sales (if 5% market share = 0.9% copper demand growth; then 20% = 3.6% demand growth).

While extended periods of above average demand should be generally be supportive of strong copper prices, looking back to find relationships in the historically relevant inflationary period in the 1960s-1980s can also provide insight. As seen in the chart below, during the period, changes in copper prices showed a fairly strong correlation to changes in copper demand. More specifically, in the 5 years between 1963-1982 where demand exceeded 5% YoY growth, the average increase in copper prices was 21.6%.



Sources: www.macrotrends.net, Bloomberg, Recurrent Research

Compared to long term average copper demand growth of 3%, increases in electric vehicle market share will further add to growth prospects. The likelihood of >5% YoY annual copper demand growth grows with each increase in electric vehicle market share. As such, if the inflationary 1963-1982 period is a guide, the potential grows for >15% YoY price increases.

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