Midstream: in our recent white paper and monthly letters, we've detailed how midstream valuations remain deeply discounted despite stronger earnings growth and better debt metrics. The discount is supposedly due to terminal value risks associated with the Energy Transition, despite evidence that the Transition is slower and less straightforward than was widely believed. Recent midstream earnings reports confirm a trend that we've observed for several years – not only has midstream growth been persistent and above Wall Street expectations, but growth is occurring even as capex reinvestment rates remain near-maintenance levels.
Click here for our new midstream white paper, which explores midstream's near-record excess earnings yields vs. fixed income.

Natural Resources: In recent weeks, natural resources investors have focused significant attention on weak Chinese economic data, which has highlighted continuing post-COVID growth challenges. While current economic data signifies weakness, a study of the last decade shows that in months with initial <50 Chinese PMI readings, global natural resources investors have consistently been rewarded over 24-month time horizons.
Click here for our 2022 white paper on Shale's increased strategic importance in a time of ESG

*October 2023 Performance Summary and Market Commentaries*
Please find below performance and commentary for our strategies – MLP & Infrastructure and Natural Resources. Performance follows at the bottom of the commentary. For additional information, please contact us at (832) 241-6400 or info@recurrentadvisors.com.

# MLP & Infrastructure

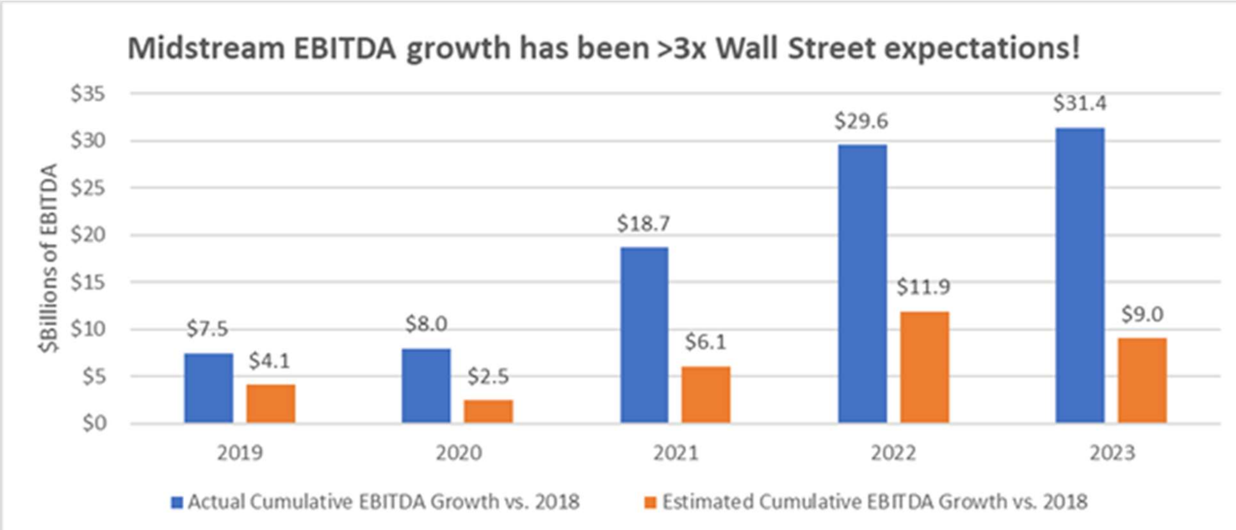
## Performance review

During the month of October 2023, the Recurrent MLP & Infrastructure Strategy generated net returns of -2.35%, lagging the Alerian MLP Index's (AMZ) +0.42% return by 2.77%. Since the strategy's July 2017 inception, Recurrent's MLP & Infrastructure Strategy has outperformed the AMZ by +21.84% (+2.47% annualized), net of fees. Please see the performance section at bottom for more detail.

## Since 2018, Wall Street has modeled Midstream as a low-growth/no-growth industry – but growth has persisted

As Midstream experienced a painful multi-year downturn from 2014 through 2020, many analysts' cash flow growth forecasts began to reflect the painful downturn in stock prices. During and even after COVID, Wall Street forecasts for Midstream EBITDA growth have been anemic – reflecting concerns about lower Shale productivity and the impact of the Energy Transition on oil and gas demand. This "lack of growth" has been reflected in valuation multiples which remain well below pre-COVID levels. Interestingly, actual financial results have dramatically exceeded expectations in the past 5 years, reflecting an industry that has achieved meaningful operating leverage and margin expansion from assets which only became recently operational.

Below, we see that on a cumulative basis, Midstream industry EBITDA has expanded by $31bn, or nearly 50% - approximating $100bn on an annual basis today. If we were to look at the cumulative expectations for year-over-year EBITDA growth published by Wall Street analysts over that time, we would see $9bn of cumulative EBITDA growth. In other words, actual cumulative EBITDA growth has more than tripled analyst expectations over the past 5 years.

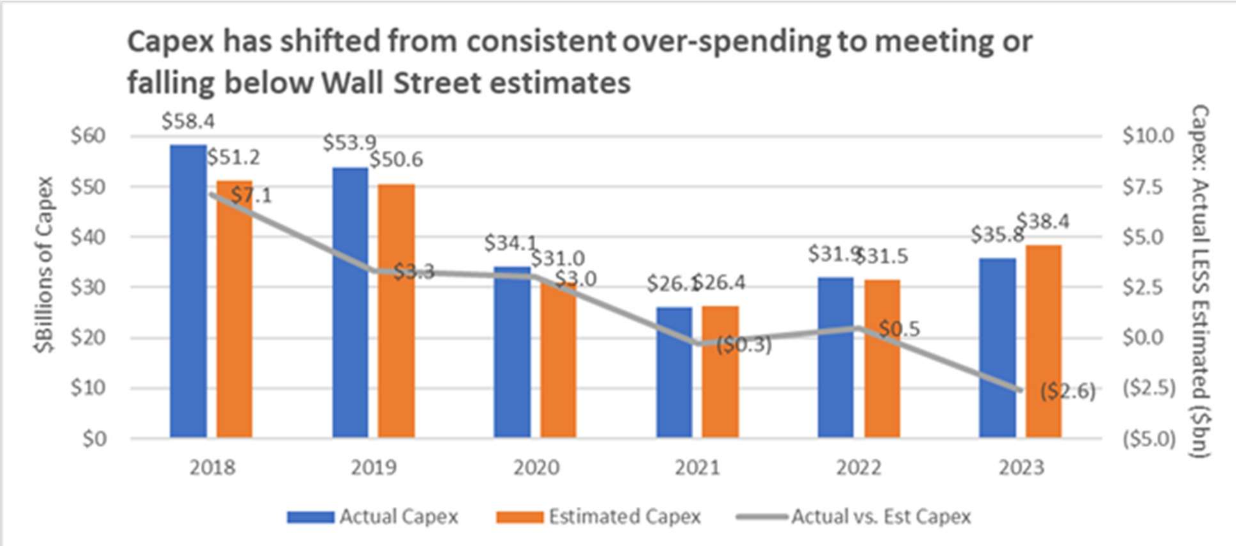



*Source: Recurrent Advisors' research, Bloomberg, public filings.*
*Note: "Estimated cumulative EBITDA growth" was calculated by comparing actual quarterly EBITDA delivery vs. then-current Wall Street analyst estimates, and comparing actual EBITDA delivery with the EBITDA level that would've met analysts' quarterly forecasts.*

## A skeptical reader might ask, "Aren't Wall Street estimates made to be beaten?" – but there's more to the story

We appreciate the skepticism that comes with midstream and energy investing, especially as the sector remains largely out of favor among investors. A possible reply might be, "They beat analyst estimates - so what?" And that question is fair in anticipating the fact that growth isn't noteworthy simply because it exceeded Wall Street's forecast – it's only noteworthy if the growth is generated in a capital-efficient way. And here again, we see that Midstream is outperforming expectations – while EBITDA is sometimes subject to "sandbagging," management teams generally do not sandbag capital expenditures. And we see again that Midstream is beating Wall Street capex estimates even while growing cash flow.

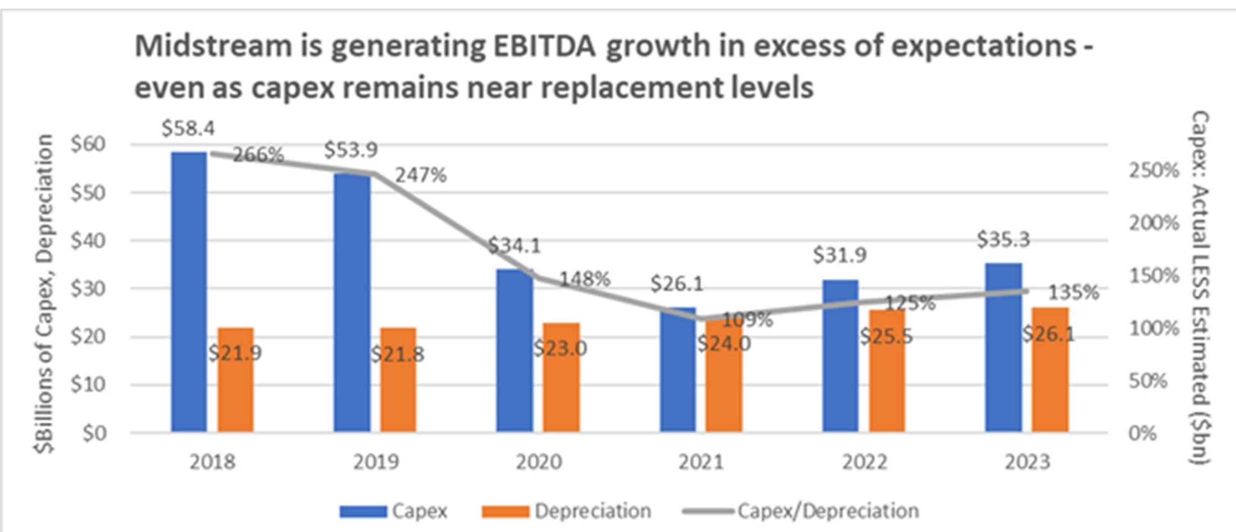
Below, we can see that Midstream was exceeding capex forecasts – effectively running over budget on growth projects – by billions of dollars annually during 2018-2020. The result was a free cash flow outlook that consistently disappointed. Since 2021, Midstream industry capex has met or fallen below forecasts, with over $2bn in excess free cash flow coming from YTD 2023 capital discipline alone.




*Source: Recurrent Advisors' research, Bloomberg, public filings.*

## Even with large-cap Canadian midstream names outspending, most growth is being supported by near-maintenance capex

We noted two months ago that Canadian large cap midstream companies had maintained high capex business models, and their stock performance has suffered considerably as a result. But even with significant Canadian capex burdens, the Midstream sector broadly remains highly disciplined. Below, we take Wall Street forecasts out of the equation and compare the companies to themselves. As recently as 2018, Midstream capex was 2.7x greater than book depreciation. As spending has dropped by >$20bn in the last 5 years, capex today approximates 125-135% of book depreciation, despite meaningful economy-wide cost inflation in the last 3 years.




*Source: Recurrent Advisors' research, Bloomberg, public filings.*

In our recent white paper, we noted that midstream earnings yields were double-digit, and meaningfully above REIT or utility earnings yields. Importantly, with midstream capex approximating book depreciation levels, this means that Midstream free cash flow yields are also likely to be double-digit – compared to a sector-wide dividend payout that remains approximately 6% to 7% today. With double-digit free cash yields and persistent EBITDA growth (even in a lower capex environment), Midstream continues to defy forecasts of obsolescence and decline even despite valuations that reflect a thus-far illusory terminal value risk.

## Natural Resources

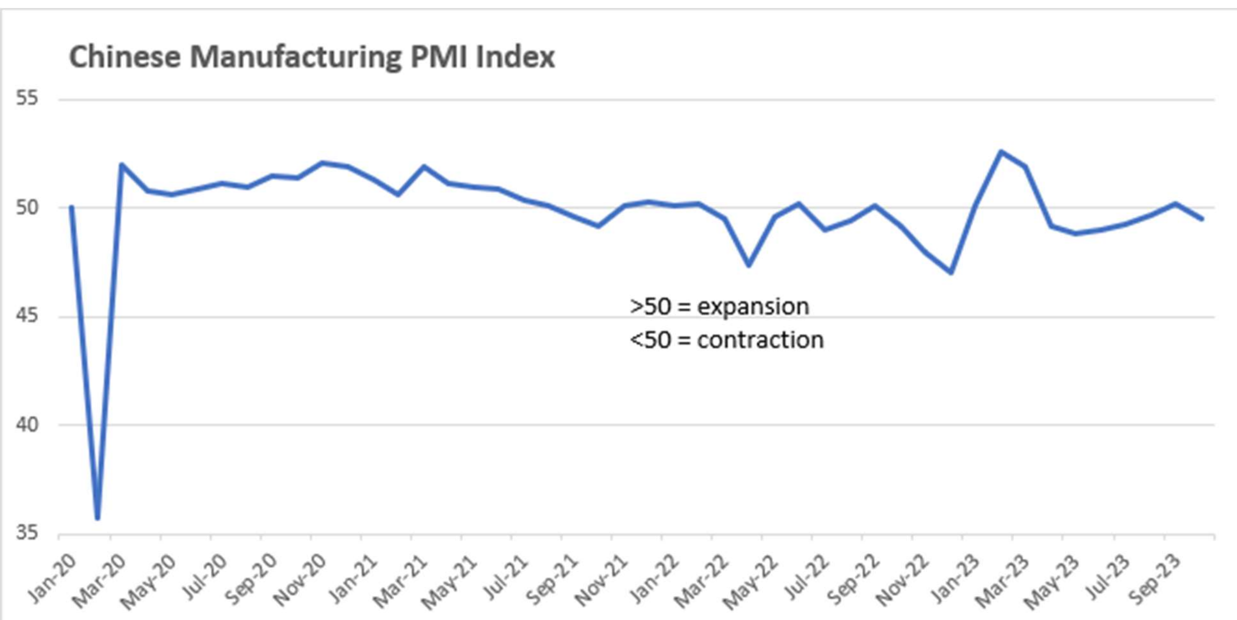
### Performance Review

During the month of October, the Recurrent Global Natural Resources Fund fell by -6.63% net of fees, underperforming the S&P Global Natural Resources Index's -5.02% return. During the month, overweight positions in economically sensitive sectors such as diversified metals, steel, and aluminum underperformed the broader index. In contrast, energy stocks performed better on a relative basis. Since inception, the Recurrent Global Natural Resources Strategy has outperformed the S&P Global Natural Resources Index by 17.50%, net of fees (2.56% annualized).

### Investment Discussion

With global economies suffering from tepid growth and rising inflation, economic concerns loom large in investors' minds. In industries reliant on economic growth, the concerns are only further heightened. More specifically, natural resources investors look to Chinese economic data to offer insights into the health of the world's largest consumer of natural resources.

In November, the Chinese Manufacturing Purchasing Managers Index (PMI) showed the Chinese economy contracted for the 6th month in the last 7. More than other global economies, China has struggled to return to pre-COVID growth levels. The PMI index has showed signs of contraction in more than 1/3 of the months since COVID, as seen in the chart below.




*Source: Bloomberg, Recurrent research*

In the face of weak economic growth, particularly in 2023, global natural resources equities have underperformed broader markets. In US Dollar terms, the Global Natural Resources Index has fallen -5.08%, while the MSCI World Index is up 10.68%, more than a 15% differential.

As a broader question, with economic indicators weaker and in the wake of natural resources underperformance, the question is when to increase weightings to natural resources. Surprisingly, our review of Chinese PMI and global natural resources performance since 01/01/2012 shows that there have been 7 instances where Chinese PMI made an initial fall below 50. From the first month of a <50 reading on the Chinese PMI, the average 12-month performance for global natural resources is +6.5%. Furthermore, 24-month performance is 26.6%, as shown in the table below.

| Time of 1st <50 reading | Performance after 12 months | 24 months |
|---|---|---|
| 8/31/2012 | -1.70% | 13.63% |
| 1/31/2015 | -27.34% | 7.90% |
| 8/31/2015 | 8.90% | 30.10% |
| 7/31/2016 | 16.80% | 37.20% |
| 12/31/2018 | 16.45% | 16.39% |
| 2/29/2020 | 32.40% | 63.20% |
| 9/30/2021 | 0.35% | 17.82% |
| **Average** | **6.55%** | **26.61%** |

In the face of weak Chinese economic data, immediate investor sentiment may be bearish. However, for those investors with a longer-term investment horizon, this analysis of natural resources industry performance demonstrates the difference between economics and investments. Importantly, in every 24 month period after an initial < 50 PMI statistic, the total return is positive, offering confidence to invest for the long term when short term economic data is weak..

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