Midstream: As midstream continues to rally, we are seeing the thesis of our 2020 white paper begin to play out. In the depths of COVID, Wall Street slashed midstream revenue estimates, and assumed inflexible capex. Our white paper argued that slower growth should offer much more room to cut spending. Today, midstream's free cash flow outlook has improved more than any other sector since 2019, as capex cuts more than offset revenue declines. With valuations still near multi-year lows, FCF yields remain unreasonably high, even after the rally.

Natural Resources: In November, dual catalysts of the election and positive vaccine results benefited natural resources, energy in particular. Despite the rally, many subsectors remain inexpensive vs. mid-cycle levels, and continue to provide an attractive risk-reward. Going forward, potential economic normalization and further stimulus/inflationary pressures would be supportive for natural resources sectors.

OPEC: From an energy perspective, we are encouraged by OPEC's December decision to incrementally re-introduce latent oil supplies back into the global market. While many view the OPEC action as a claim of market share, we view the decision as the appropriate economic action which is supportive to the long-term health of the oil market, as we discuss below.

Download new 2020 white paper here: Recurrent's 2020 Midstream/MLP White Paper.
Download our white paper on the "dispatch curve" that governs the oil market here.

Other white papers are available at www.recurrentadvisors.com.

November 2020 Performance Summary and Market Commentaries

Please find below performance and market commentary for our two 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

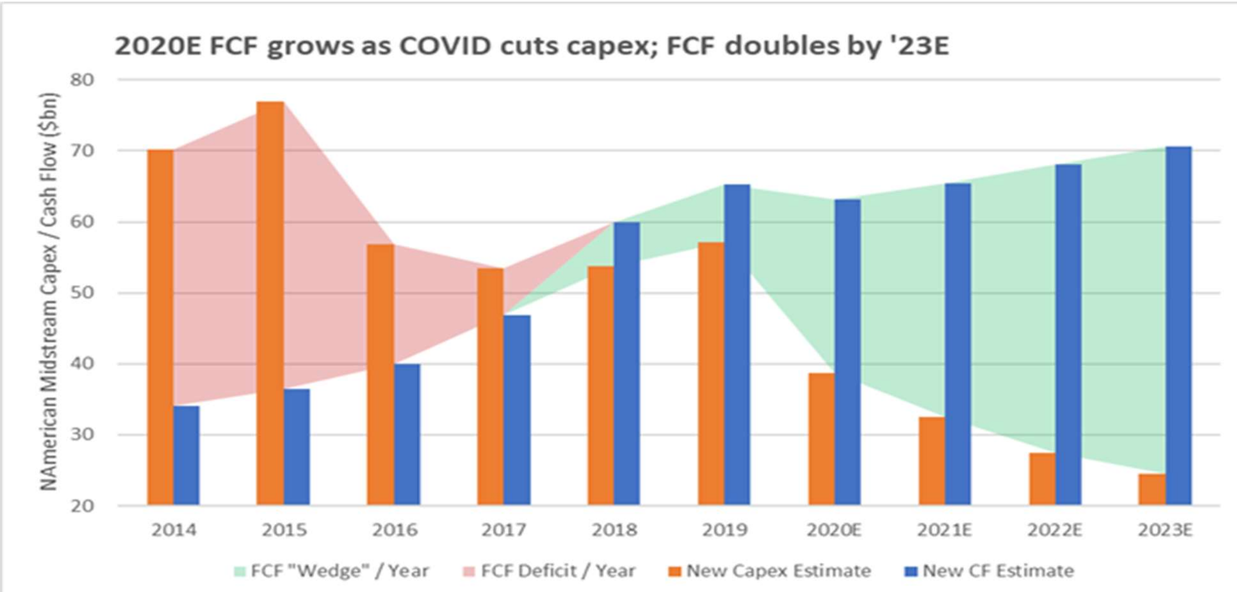
During the month of November 2020, the MLP & Infrastructure Strategy generated net returns of +24.99%, exceeding the +23.78% return of the Alerian MLP Index (AMZ) by +1.21%. Since the strategy's July 2017 inception, Recurrent's MLP & Infrastructure Strategy has outperformed the AMZ by +4.36% (annualized, net of fees). Please see the performance section below for more detail.

As laid out in our white paper, "The Virtues of Slower Growth" – midstream is generating more cash flow with less revenue

Our June 2020 white paper drew a broad parallel between the midstream industry in 2020 and the tobacco industry in 1999 – both deeply out of favor with investors, with structurally lower growth expectations, but with plenty of cost cutting opportunities and room for organizational right-sizing.

Tobacco adopted a strategy of lower growth, cash returns to shareholders, and spent the 15 years from 2000-2015 outperforming the broad S&P 500 by over 10% annually. We have suggested in the past that a similar path is emerging for midstream, as growth investments wane and cash flows remain relatively intact, despite lower commodity prices.

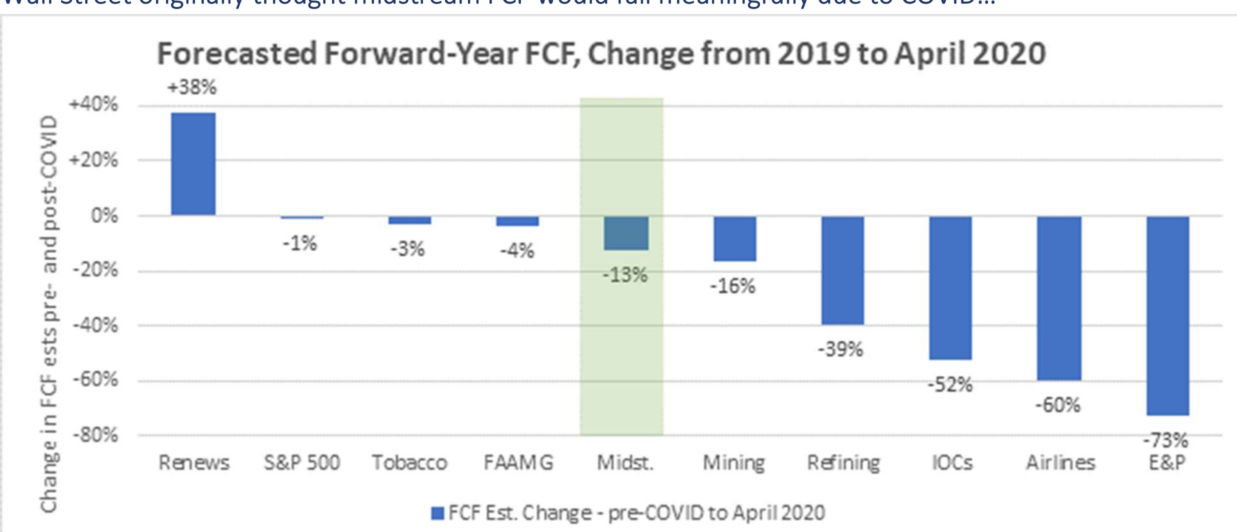
This graph from our June 2020 white paper reflected our view that COVID would NOT reduce midstream FCF



Source: Bloomberg estimates, Recurrent research, public filings; Notes: Includes companies in Alerian Midstream Energy, Alerian MLP Index.

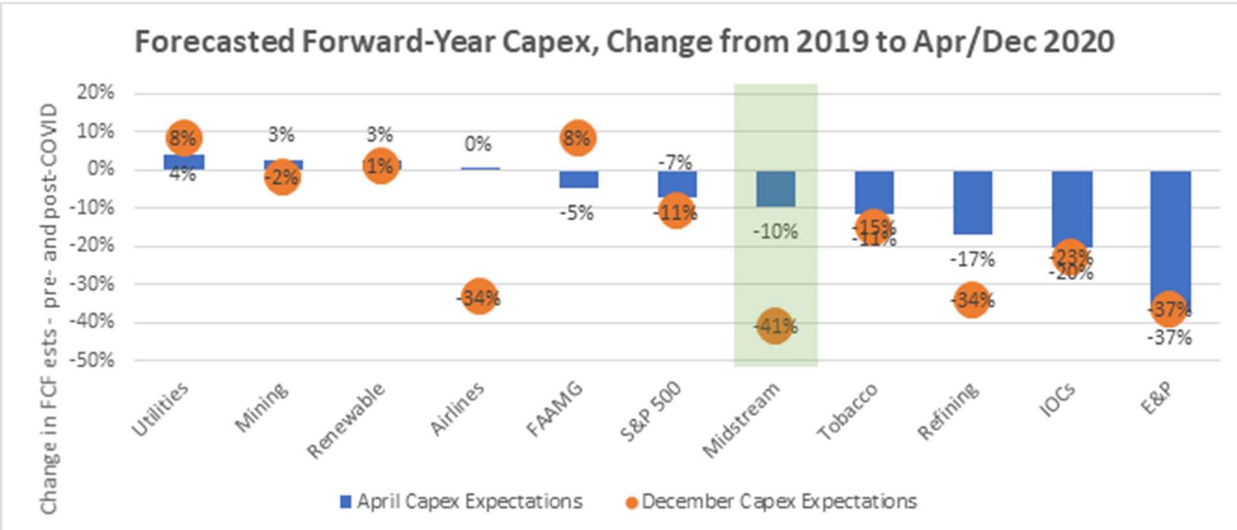
Key to the midstream industry's future FCF generation is the migration from a "growth" mindset to a "cash flow harvesting" mindset. While cash flows from operations do not change dramatically, reduced capex has a much larger effect on FCF, as we show below.

Wall Street originally thought midstream FCF would fall meaningfully due to COVID…



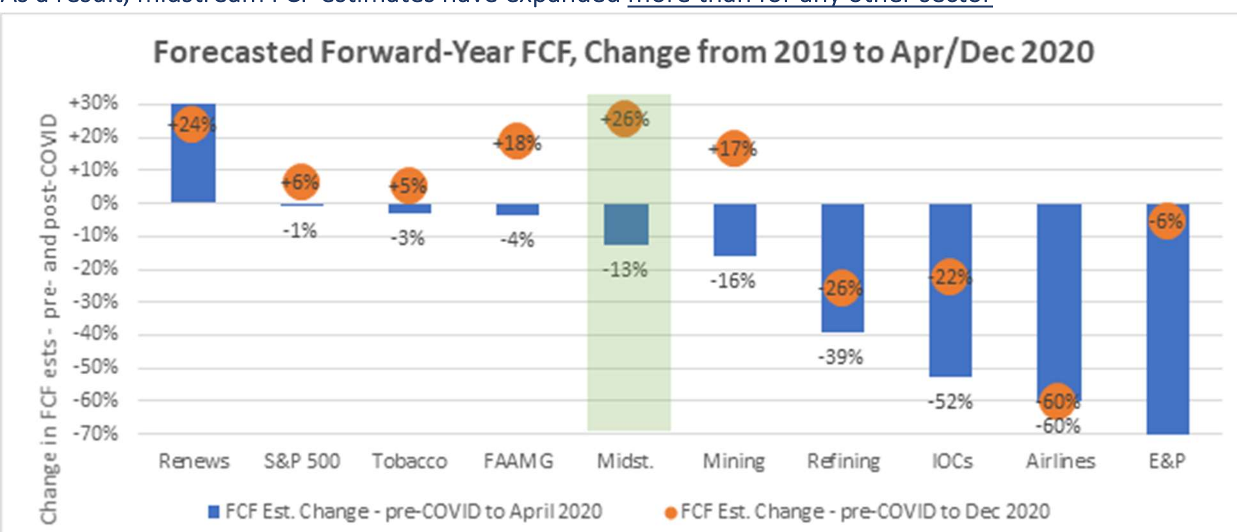
Source: S&P Indices, Bloomberg estimates, Recurrent research
Note: Utilities excluded as FCF is significantly negative in all periods.

Analysts focused on potential revenue declines, but it was capex cuts where midstream stood out
Despite a much more stable business model, midstream capex cuts have been comparable to airlines, or E&Ps



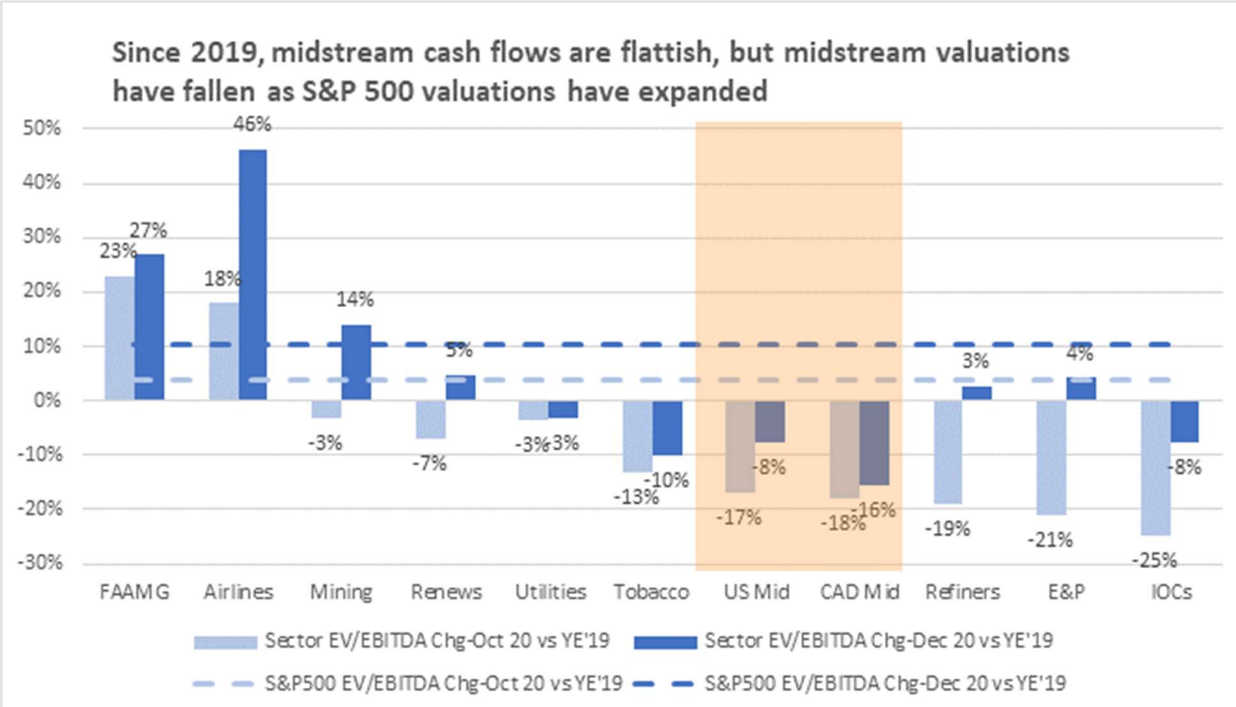
Source: S&P Indices, Alerian Indices, Bloomberg estimates, Recurrent research

As a result, midstream FCF estimates have expanded more than for any other sector



Source: S&P Indices, Alerian Indices, Bloomberg estimates, Recurrent research
Note: Utilities excluded as FCF is significantly negative in all periods.

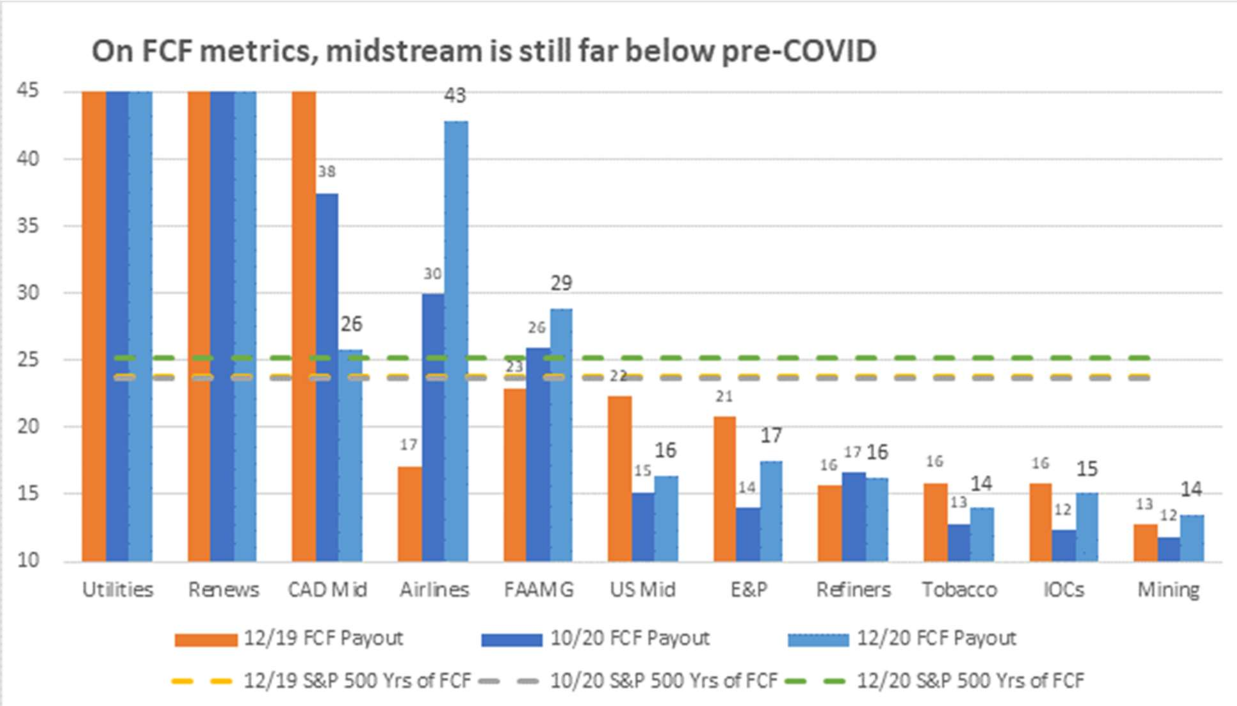
Despite cash flow outperformance, midstream EV/EBITDA valuations remain well below 2019's levels



Source: Recurrent research, Bloomberg data

In the midst of a powerful rally that has lifted the midstream group +24% in November alone (continuing into early December), some have wondered "can this midstream rally last?" While disappointing performance in recent years have understandably scarred many investors, the fundamentals remain encouraging: midstream EV/EBITDA multiples remain below 2019 levels, and midstream's 9.0x EV/EBITDA multiple sits nearly 30% below the S&P 500. As we show below, when comparing total enterprise value vs. FCF, midstream remains among the cheapest sectors. With many investors now meaningfully underweight energy and commodity-oriented sectors, and with FCF yields remaining well above other sectors, there is certainly room for positive performance to continue in 2021.

When comparing FCF to total debt + equity valuations, midstream has hardly moved off the October bottom



Source: S&P Indices, Alerian Indices, Bloomberg estimates, Recurrent research
Note: CAD Midstream excludes TRP KXL capex beyond 2021.

Natural Resources

Performance Review

Due to the improved global economic prospects resulting from Pfizer and Moderna's positive vaccine announcements, the Recurrent Natural Resources Strategy rose by 24.11%, outpacing the S&P North American Natural Resources' 16.96% return in November 2020. During the month, portfolio holdings Viper Energy Partners, Plug Power and Alcoa rose by 61.5%, 88.5% and 54.0% respectively, and the portfolio underweight in the gold sector further added value.

Investment Discussion – how OPEC's plan to accelerate the return of curtailed barrels is *positive* for the oil market

Given the expanding "second wave" of COVID infections, with global oil demand 8-9% below normalized levels, some believed that OPEC's recently-announced plans to begin a phased reversal of COVID-era cuts as soon as January 2021 was perhaps premature or bearish for a still-fragile oil market. Due to the economic attributes of OPEC oil production, we believe OPEC's decision to pre-emptively introduce barrels – increasing production by 500,000 barrels per day/per month in Q1 2021 – actually marks a profound and enlightened change in strategy. As the lowest-cost incremental production growth in the global market, it is economically appropriate that OPEC's curtailed production should be among the very first barrels to return to market as the market normalizes. In fact, an orderly return to "full production" is a necessary precondition, in our view, for a sustainable oil price, and a further delay in reversing production cuts would risk overheating the market as vaccines take effect in 1H 2021.

As oil markets normalize, low-cost "baseload" barrels should return first

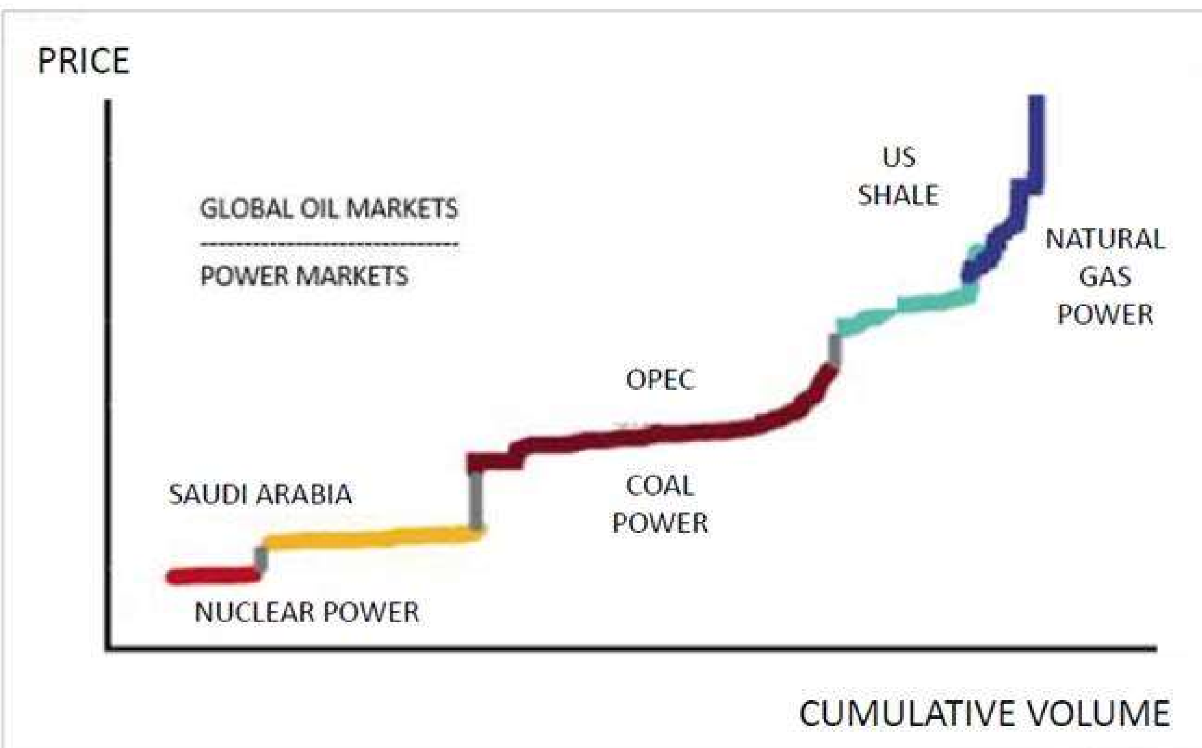
In H2 2020, the global oil market has exhibited clear signs of returning to health. The oil market is currently undersupplied due to reduced production from OPEC and the US, and after a period of historic increases, global oil and refined product inventories have broadly returned to their 5-year ranges. According to press reports from the December 3rd OPEC meeting, two questions were broadly debated:

1. "Should increased oil supply be imminently introduced into the market?", and if so,
2. "Which entity should supply the additional barrels?"

While many people viewed OPEC's decision to gradually increase production as a reclamation of market share, instead the decision reflected a pure economic framework, as outlined in our white paper titled "The Impact of Shale on Energy Cycles," written 5 years ago. Similar to a "dispatch curve" concept in US unregulated electricity markets, low-cost producers such as nuclear plants consistently run at maximum capacity and are "price takers." High-cost natural gas power plants, which can quickly turn on and turn off to meet daily and hourly changes in demand, run variably and their cost of operation effectively serves as "price makers."

A "dispatch curve" framework entails that high-cost shale barrels re-enter the market later

In the case of oil markets, OPEC's production profile – low-cost and slower to turn on/turn off – compares most closely to nuclear power plants. On the other hand, the role of US shale oil production aligns most closely to the high-cost, rapid response profile of natural gas power plants. The relationship is shown in the chart below.



This OPEC meeting was particularly important, because the plan devised in Q2 2020 was to reintroduce 2 million barrels of daily production back into the global market in January 2021. Global oil demand, while improved, has not returned as quickly as expected. As a result, the market is currently undersupplied by less than 1 million barrels/day, a positive development but not strong enough to maintain the original plan. Early reports suggested that the 2 million barrels/day reintroduction would occur, but 3 months later than originally expected.

OPEC's flexible, monthly decision framework reduces the risk of oil markets overheating

That plan, while generally constructive for the oil market, had one major shortcoming, unique in the US shale era. With an already undersupplied market and demand likely to rise in the coming months, oil prices rose by $10/barrel since the positive vaccine announcements. With increasing prices, US shale is increasingly incentivized to grow oil production, facilitated by its quick turn-on capability. OPEC, if it waited 3 months to increase production, would risk production increases from high-cost US shale, precluding the economically appropriate introduction of OPEC barrels.

It is for this reason – ensuring that low-cost barrels return to market first – that OPEC's earlier-than-expected but phased strategy is enlightened. By introducing barrels before they are "necessary", OPEC is acting quickly to ensure that the oil market recovery is built upon a baseload of low-cost barrels, with higher-cost, rapid-response barrels acting as a stabilizing mechanism over time. The global oil market will remain slightly undersupplied for now, further reducing inventories, and with these "appropriate" barrels returning first, severe supply/demand dislocations are less likely. US shale will see price signals which mute the return of shale oil supply, and the market will act in a more orderly fashion, supporting the longer-term health of the global oil market. We remain encouraged by the demand recovery post-COVID, and are similarly encouraged by OPEC's sensible decision to change course and gradually return barrels to the market.