RECURRENT
INVESTMENT ADVISORS

Monthly Investment Commentary
February 2025

Energy Infrastructure: 10+ years ago, investors piled into midstream stocks, seeking exposure to Shale, while wanting to avoid the volatility and oil price correlation found elsewhere in energy. As oil fell in 2014-2020, midstream investors were shocked to see volatility spike and performance become closely tied to oil price. Today, many still cite this period as evidence that midstream is – and always has been - a bet on oil price. But this ignores the fact that operating cash flows were relatively stable throughout the oil price collapse. Instead, the explanatory variable is debt: a massive increase during 2014-2020 pushed equityholders to an increasingly subordinate – and leveraged – position vs. underlying cash flows. Today, as debt leverage has fallen, midstream is once again less volatile and less correlated to oil. The market has started to take note, but many investors still mistakenly put midstream in their "commodity" bucket.
Click here for our new midstream white paper, which explores midstream's excess (and growing) yield vs. fixed income

Natural Resources: Since the beginning of the Trump administration, several policies – primarily tariffs – have been enacted which have been identified as inflationary. Economists have identified the clear short-term – and potential transitory - inflationary impact from adding costs to a variety of goods. However, the lack of certainty in regulatory and cost structures have caused companies to slash CAPEX, which is likely to cause long-term inflationary pressures, as outlined in our 2022 white paper, "The Great Inflation Misdiagnosis".
Click here for our 2022 white paper, "The Great Inflation Misdiagnosis"

February 2025 Performance Summary and Market Commentaries
Please find below performance and commentary for our strategies – MLP & Infrastructure and Natural Resources. See performance tables at the bottom of the commentary. For additional information, please contact us at (832) 241-6400 or info@recurrentadvisors.com.

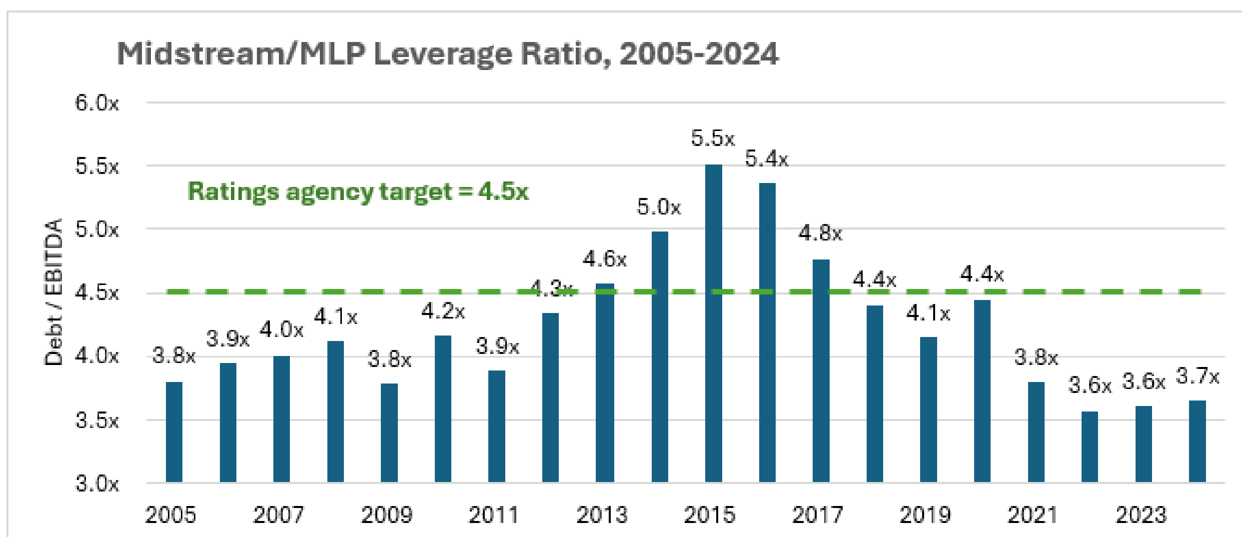
Energy Infrastructure

Performance review

During the month of February 2025, the Recurrent MLP & Infrastructure Strategy generated net returns of +0.96%, lagging the Alerian MLP Index's (AMZ) +3.43% return by -2.47%. Since the strategy's July 2017 inception, Recurrent's MLP & Infrastructure Strategy has outperformed the AMZ by +26.75% (+1.79% annualized), net of fees. On a gross basis, the Strategy has outperformed by +50.23% and +3.22% respectively. See performance section at bottom for more detail, plus performance detail on the Recurrent Energy Infrastructure Strategy, which seeks to track the MLP & Infrastructure Strategy while excluding MLPs.

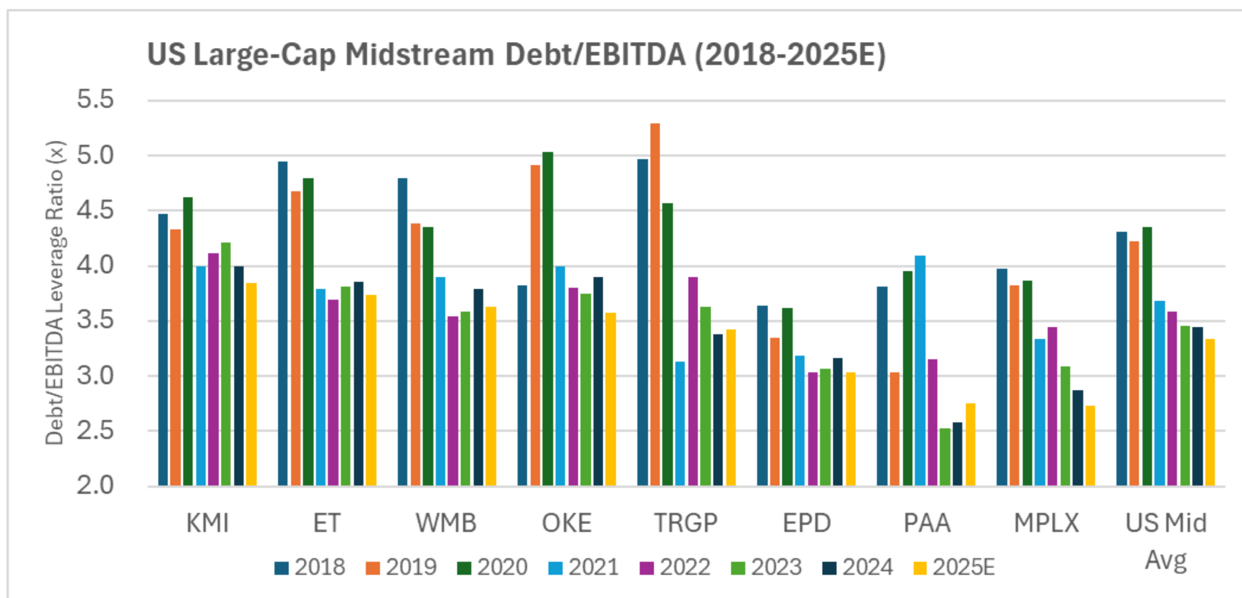
Midstream debt has fallen dramatically – and is likely to continue to fall

Perhaps no other graph has been as central to Recurrent's analysis of the midstream space as the debt/EBITDA chart shown below. It has long been our contention that debt leverage was the primary cause of the midstream sector's precipitous valuation decline, as well as the rise of unfavorable attributes like increased volatility and correlation to crude oil. As we've noted since 2017, since the increase in debt leverage caused the midstream sector's decline, the reduction in debt leverage has also necessarily been the key driver of the midstream equity recovery we've enjoyed since 2020.



Source: Recurrent research, SEC filings, Bloomberg.
Notes: Companies included in calculations include past and present members of Alerian MLP Index (AMZ). Data retrieved as of 12/31/24.

Last month, we examined how expanded 2025E capex budgets would impact midstream debt leverage ratios. We showed how 2025E capex budgets (plus dividends) will continue to be covered by midstream free cash flow (FCF). Additionally, as midstream EBITDA and cash flows grow faster than debt loads, leverage ratios are likely to fall again in 2025, based on public company-provided guidance. Notably, the only 2 large-cap midstream companies with modest increases in 2025E leverage (PAA and TRGP) have both incurred debt to refinance mezzanine financings, while PAA has also used 100% debt financing for a bolt-on acquisition. Barring those corporate actions, TRGP and PAA would have both seen 2025E leverage fall meaningfully.



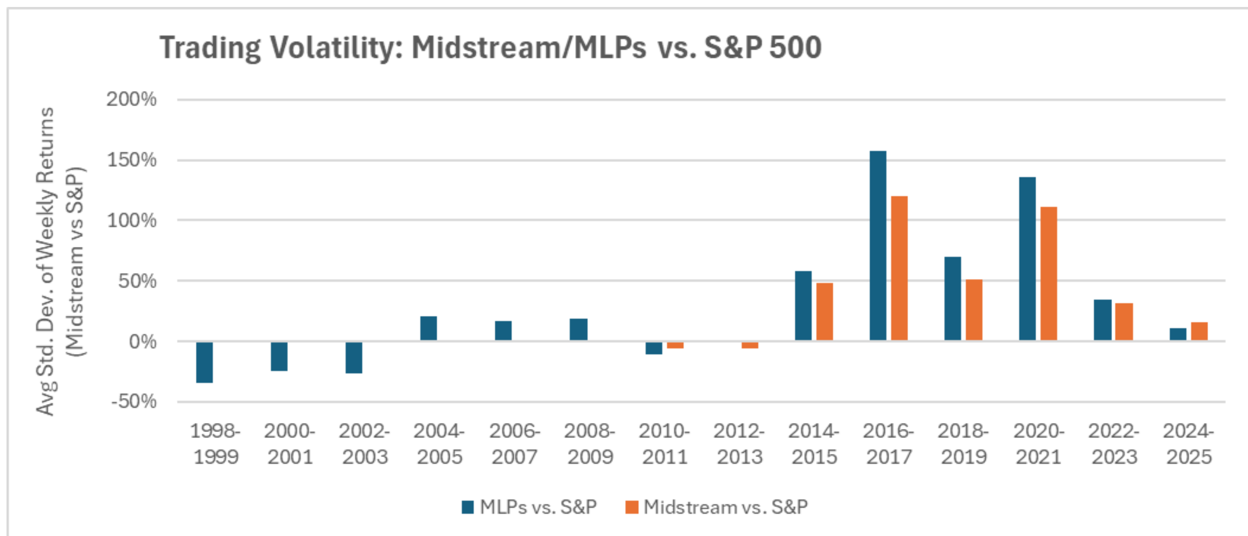
Source: Recurrent research, SEC filings, Bloomberg.
Notes: includes KMI, ET, OKE, WMB, EPD, TRGP, PAA, MPLX – large-cap US midstream companies with published 2025E guidance as of writing.

The midstream sector has been reducing debt leverage for years – has the market taken note?

Midstream companies have made incredible progress – going from one of the highest-leverage sectors in the market, to now being meaningfully less levered than other "real asset" sectors like utilities and REITs. Despite the progress made, many investors recall the original fall from grace in the 2014-2020 timeframe, and continue to view midstream as a bet on oil price, or just another energy investment, indistinguishable from Exxon or Schlumberger.

The long-term volatility trend of midstream offers insight as to why many investors remain strongly predisposed to avoid midstream, even 10 years after the original selloff. The historical volatility of midstream was lower than the much more diversified S&P 500 during the late 1990s and early 2000s. Midstream volatility reached levels comparable to the broad market until the oil downturn of 2014, when midstream volatility surged to levels over 100% higher than the S&P.

As debt reduction began in 2018-19, volatility declined, only to spike once again during the COVID selloff. Since COVID, the midstream sector has returned to a level of volatility much more comparable to the broad market (despite midstream index being much less diversified than the S&P). So while many investors remember midstream as a hopelessly volatile asset class, we see below that this reflects the realities of the high-debt 2014-2021 period, and this trading reality has changed as debt leverage has fallen.

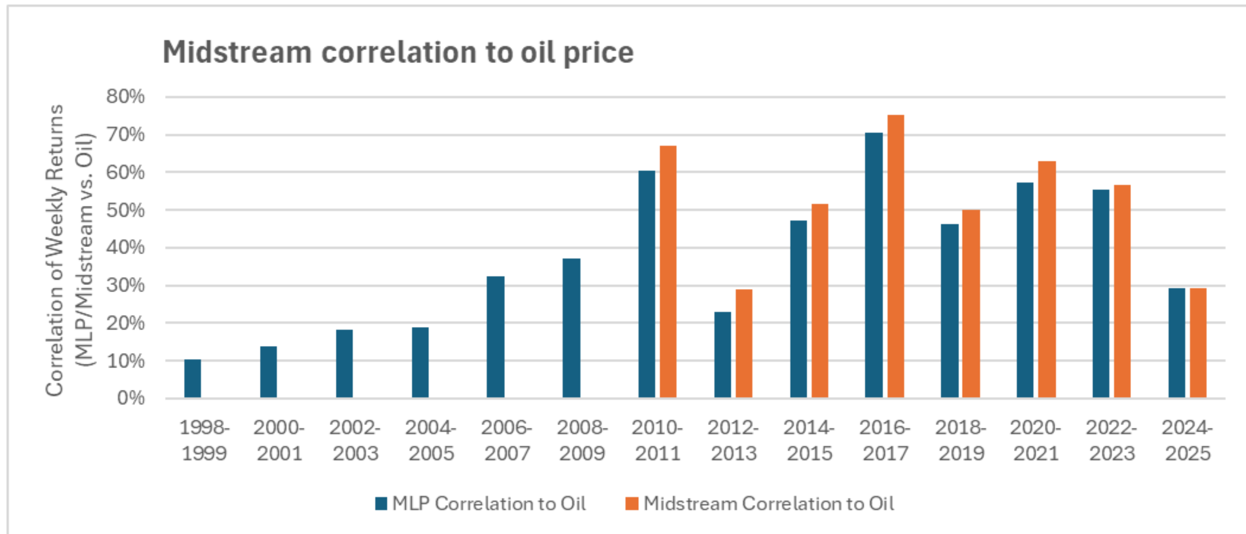


Source: Recurrent research, SEC filings, Bloomberg.
Note: "MLPs" reflect the Alerian MLP Index (AMZ), while "Midstream" reflects the Alerian Midstream Energy Select Index (AMEI).

Has debt reduction been enough to break the shackle of crude oil price correlation?

Has correlation to oil price fallen along with trading volatility? Once again, we can see how the trading behavior from the late 1990s to the mid-2000s was so attractive to generalist investors: midstream correlations to oil price were almost non-existent. MLPs had lower oil price correlation than the S&P 500 as investors discovered the sector 20+ years ago. As institutional investors discovered the space in the early 2010s, oil correlations rose – but there was little complaining as oil was rising following the Great Financial Crisis. This correlation peaked in the 2014-2021 timeframe, as correlations were consistently 50% to 75% - comparable to an index of oil producers! Worse yet, the late 2010s were a period of very high downside capture – so midstream companies exhibited higher correlation to oil when oil was falling.

This helps explain the strong memories of "midstream as an oil bet" as we write 10 years after the fact. Traumatic memories aside, we see that in the last several years trading relationship to oil price has declined fairly dramatically, from >70% correlation in 2016-17 to 50% correlations - closer to the levels of 2008-2013 – but this relationship has fallen further to ~30% in the last 15 months. This recently-observed 30% correlation is comparable to the levels of the mid-2000s – when midstream balance sheets were pristine and Shale drilling was not a meaningful business driver.



Source: Recurrent research, SEC filings, Bloomberg.
Note: Oil price reflects Brent spot price. "MLPs" reflect the Alerian MLP Index (AMZ), while "Midstream" reflects the Alerian Midstream Energy Select Index (AMEI).

Many investors remember midstream as volatile, and oil-exposed – ignoring dramatic fundamental improvements of the last 5 years

As broader market volatility has increased in recent months, many investors have found themselves looking for diversifying allocations, or sources of income that are less exposed to potential tariff risks. Many investors instinctively exclude midstream from the list of diversifying allocations, assuming that midstream would simply increase portfolio volatility or add oil correlation. As we've shown above, these assumptions are increasingly outdated. As the midstream sector's debt load has decreased, it has once again offered meaningful diversification benefits, without generating outsized volatility and diminishing portfolio risk-adjusted returns. As we move into 2025, we believe that debt reduction – the driver of lower volatility and improved total returns – will continue to support stable performance with positively-skewed performance.

Natural Resources

Performance review

During the month of February 2025, the Recurrent Global Natural Resources Strategy fell -0.16%, slightly outperforming the S&P Global Natural Resources Index's -0.21% return. During the month, the portfolio's stock selection and overweight position in the steel sector benefited performance, while stock selection in the fertilizer and agricultural chemicals sector negatively impacted performance.

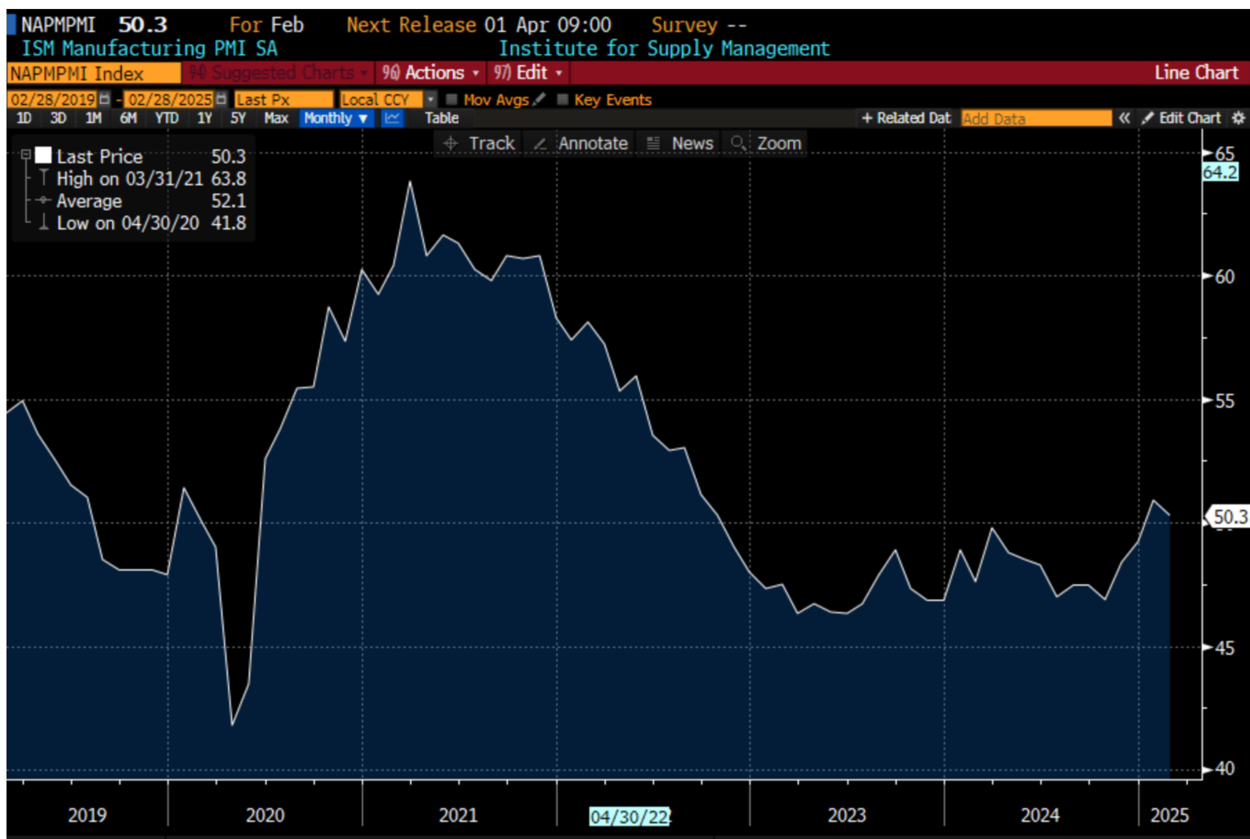
Yes, tariffs are inflationary, but not just in the short term…

One of the Trump Administration's most easily identifiable economic policies entails tariffs on

imported goods, designed to improve American industrial competitiveness while increasing government revenues. Many economists have rightfully noted that increased import tariffs will increase prices economy-wide. Additionally, retaliatory tariffs have been placed on American goods exported to many countries, accelerating inflationary pressures globally.

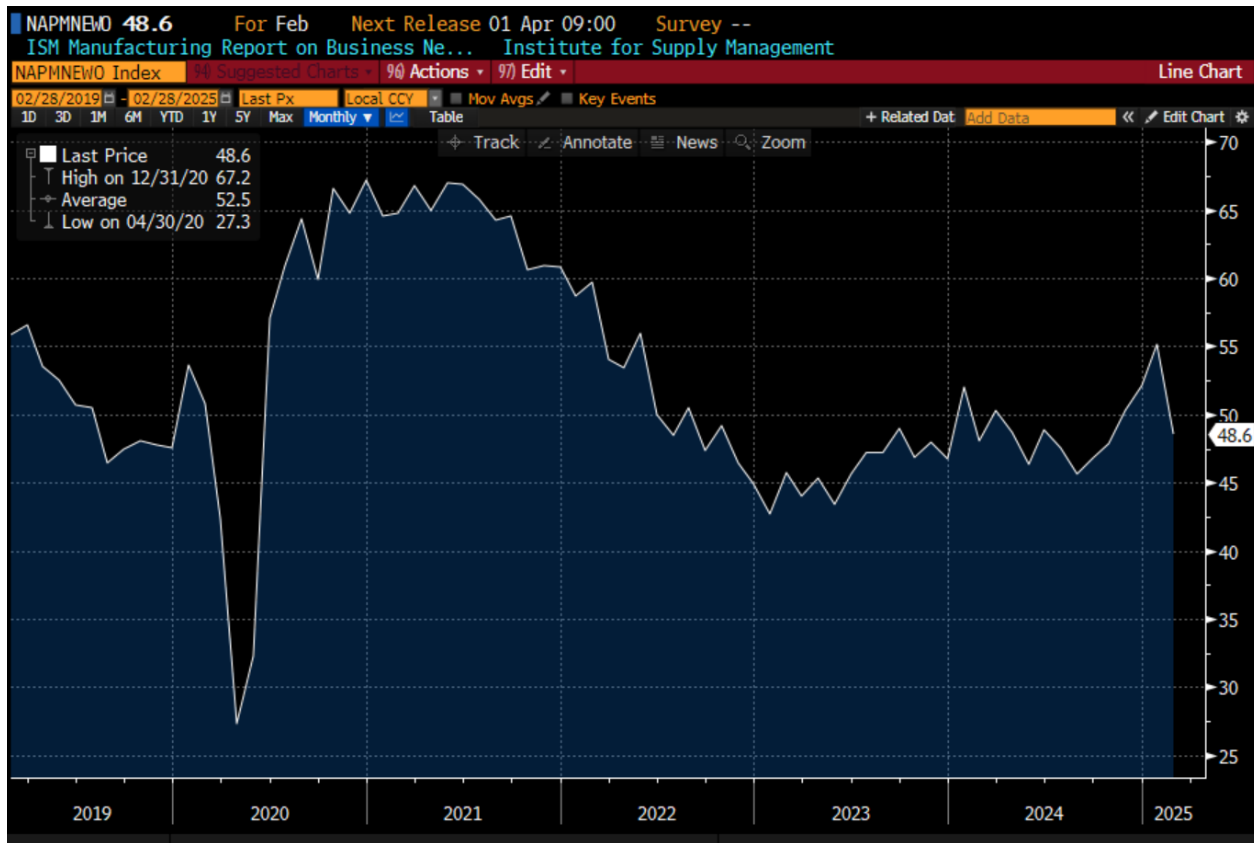
While the near to intermediate term inflationary impact of tariffs has been broadly cited by many market participants, the Administration's broader policy agenda is having an additional and longer term inflationary effect. More specifically, the change in policy and inconsistent execution have caused corporations to delay capital investment decisions.

On the surface, the post-election industrial economy appears to be relatively healthy, as evidenced by recent Purchasers Manufacturing Index (PMI) data. A reading of >50 represents an expansionary environment, as was seen with the most recent data reading 50.3, as seen in the chart below.



Source: Bloomberg, Recurrent research.

While broader manufacturing data appears to be holding strong, some leading indicators of future growth appear less rosy. As a signal of confidence in the future, new orders in the manufacturing sector improved greatly post the November election, but the data fell dramatically in February as seen in the chart below. Many economists have posited that accelerated purchases occurred in advance of tariff implementation, and more recent readings express a reaction to artificially high levels of spending.



Source: Bloomberg, Recurrent research.

Political uncertainty and its unintended consequence

Between changes in US tariff policy and responding tariffs from US trading partners, global companies are increasingly hesitant to make multi-year capital investment decisions. The specter of higher costs causing disruption along supply chains and changes in industry-wide relative cost structures causes companies to assess before making large capital commitments. Furthermore, frequent changes/alterations in policy decisions cause companies to further pause in order to both better understand the investment landscape and explore potentially favorable policy revisions.

Regardless of the reason, capital spending delays have a longer-term inflationary effect on the economy, as outlined in our white paper, "The Great Inflation Misdiagnosis". The inverse and causational relationship between commodity industry CAPEX and future inflation highlights the impact delays in CAPEX will have in causing inflationary supply shortages in the future. The dramatic and repeated changes in policy cause delays in capital decision-making processes which translate to heightened inflation, contrary to the Administration's stated goal of reducing inflation.

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