RECURRENT
INVESTMENT ADVISORS

Energy Infrastructure: should midstream investors be preparing for another COVID-style shock? On the supply side, tariffs are driving supply-side **capex** cuts across the economy, much as COVID did 5 years ago. On the demand side, COVID (briefly) brought transportation to a screeching halt in 2020, but tariffs' impact on energy is unclear, as slowing trade may be offset by energy needed to rebuild supply chains and ship around tariff barriers. For midstream investors, the difference between 2025 and 2020 is even more stark: midstream's financial condition is radically improved, with lower debt loads and soaring free cash flow (FCF). For sectors pricing in big growth, tariffs could be painful; for midstream, FCF may actually increase while investors wait for tariff clouds to part.

Natural Resources: since the most recent investment commentary, foundational elements of the global economy have changed. As outlined the last month's investment commentary, uncertainty breeds investment delays, as was the case in the early/mid 1970s. In just the last few days, initial signs of both short term inflation and decreasing CAPEX have emerged, increasing the likelihood of longer and stronger inflationary pressures.

Click here for our 2022 white paper, "The Great Inflation Misdiagnosis"

March 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.

MLP & Infrastructure

Performance review

During the month of March 2025, the Recurrent MLP & Infrastructure Strategy generated net returns of 0.72%, outperforming the Alerian MLP Index's (AMZ) 0.05% return by 0.67%. Since the strategy's July 2017 inception, Recurrent's MLP & Infrastructure Strategy has outperformed the AMZ by 28.30% (1.86% annualized), net of fees. On a gross basis, the Strategy has outperformed its benchmark by 52.19% and 3.29% 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.

Does the tariff shock pose a comparable risk to COVID in early 2020?

It is frequently observed that investors "fight the last war" whenever an economic shock arrives on the market's doorstep. When thinking about potential risks from a trade war, many midstream investors look to the most recent steep selloffs from 2020 and 2015 as reference points.

One clear parallel to 2020, and even to 2015, is found in broad economic business surveys, which indicate that businesses are reducing capital investments (CAPEX) and expansion plans in the face of an uncertain environment. However, there is a key difference: in 2020, businesses were cutting back in the face of collapsing demand as economic conditions worsened due to the pandemic. In 2015, economic surveys showed slowing activity, but not the same magnitude as 2020. Today, businesses are reacting to collapsing supply as industrial chains are severed and key inputs become scarce, even as consumers remain ready to spend.

From an energy perspective, the first phase of COVID saw rapid demand declines lead to longer-lasting supply disruptions over the subsequent months. As energy demand recovered, significantly reduced supply resulted in higher prices across the economy. The similarity between the COVID era and today's tariffs is clearest in this regard: the impact of tariffs is likely to reduce supply more than slow demand. The result will likely be longer-lasting inflation. We have outlined this both in last month's and this month's investment commentary, since it is such an important and hotly-debated topic.

Midstream market reactions in previous bouts of economic uncertainty

While the oil price collapse in 2015, COVID in 2020, and tariffs in 2025 today all led to broad "risk off" market moves, the differences between periods are noteworthy and instructive.

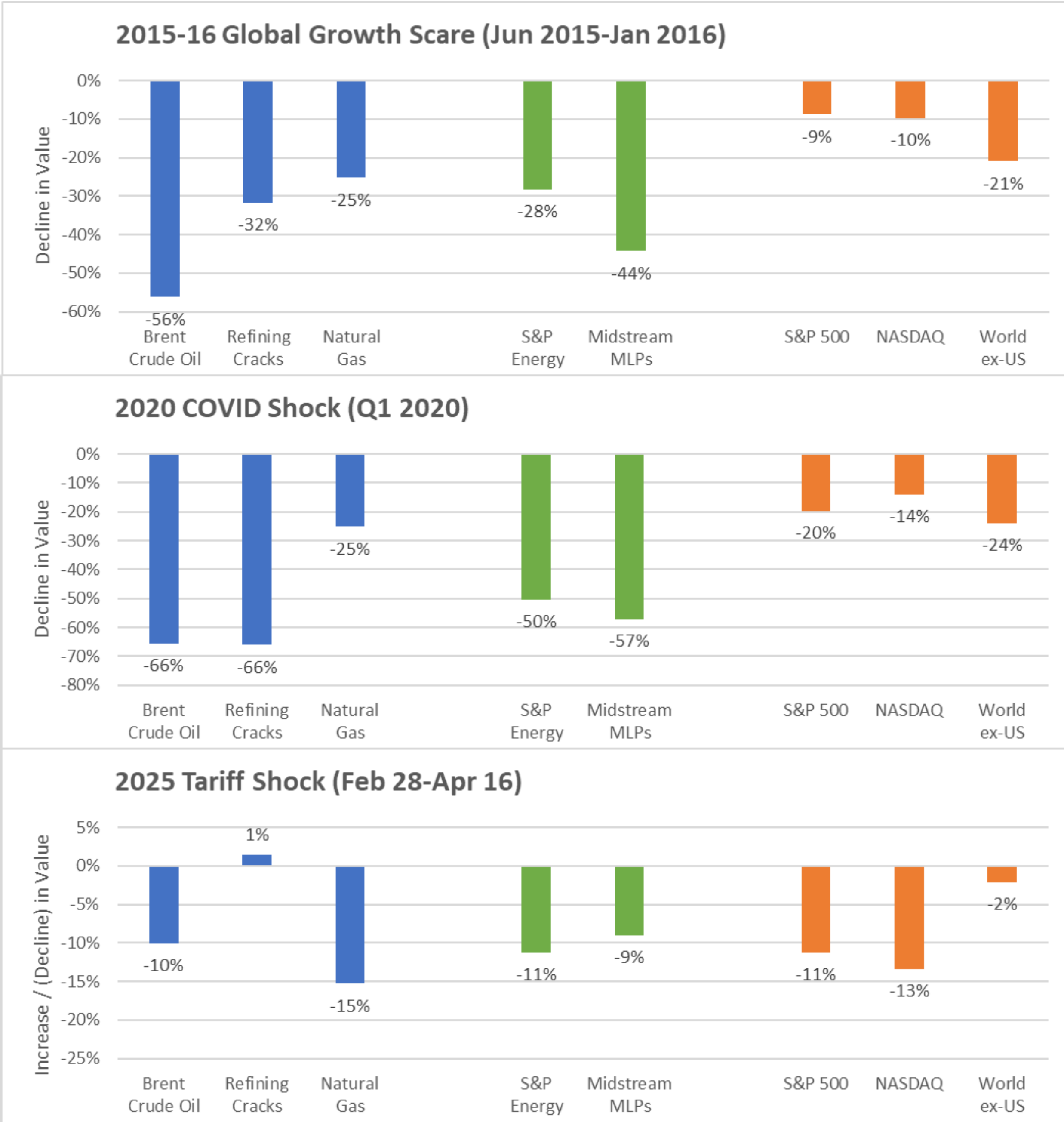
In 2015, midstream fell idiosyncratically more than energy equities and much more than the broad market due to midstream's uniquely high debt leverage, large capex budgets and excessive dividend payout policies left the sector financially vulnerable.

In 2020, COVID's immediate impact was felt in transportation sectors, leading to a >20% drop in demand for transportation fuel. With supply unable to react as quickly as demand fell, oil prices and refining margins fell by 66% in a month. Broad based energy equities were cut in half in Q1 2020, reflecting leverage to lower commodity prices. Midstream equities fell even more in just one month, with the performance downturn greatly exacerbated by the debt leverage closed-end investment funds bore leading into the downturn.

So while midstream business operations in 2015 and 2020 were relatively insulated from commodity price risks and operating volatility, midstream stocks were singled out for excessive debt, high capex and a corresponding lack of free cash flow, which all worked to offset midstream's lack of direct commodity risk.

Examining midstream equities' reaction to tariffs

While energy and midstream markets in 2025 have also exhibited volatility, the dynamics have been notably different vs. 5 and 10 years ago. Midstream stocks are now outperforming US equities and other energy subsectors since tariff news hit. Investors are pondering the possibility that a supply-side shock – leading to inventory stockpiling and re-onshoring of cross-border value chains – could actually stimulate demand for raw materials and energy products. Midstream companies are spending a relatively small amount on new capex and are less exposed to rising raw material costs than ever before. Ironically, midstream's large free cash flow is biased <u>higher</u> in an inflationary environment.



Source: Recurrent research, Bloomberg.
Note: Refining Cracks = NYMEX 321 12mo strip; Midstream MLPs = Alerian MLP Index; World ex-US is MSCI AW ex-US Index.

Is it unreasonable to think midstream could extend YTD outperformance into the rest of 2025?

So far in 2025, midstream has held up relatively well – slightly ahead of broad energy and broad equity markets, and lagging international equities. Compared to midstream's asymmetric downside in 2015-16 and 2020, long-suffering midstream investors should be happy, right?

We would argue that midstream investors should be able to hope for something more. After all, the 2015- and 2020-era balance sheet and free cash flow risks are long gone. The commodity price risks that have recently pushed energy stocks (-11%) down with oil price (-10%) are dramatically reduced or even non-existent in midstream – but midstream has still captured most of energy's downside (-9%). Finally, the ~30% foreign earnings generated by the S&P 500 look less exciting today, compared to midstream's largely North American (and almost entirely tariff-exempt) assets.

Midstream financial situation heading into...

	2014-16 Oil Crash	2020 COVID Crash	2025 Tariff Crash(?)
Free Cash Flow (CFFO-Capex)	-$20 bn/Yr	Roughly Zero	+$40 bn/yr
Total Capex ($billion)	$50 bn	$55bn	sub-$40 bn
Leverage (Debt/EBITDA)	5.5x	4.6x	3.8x
Dividends (% of CFFO)	~80%	~60%	<%50
Global Energy Demand Growth	+1%/yr	-20%/yr	+1%/yr

Could tariffs impact midstream growth in 2025 and beyond?

Several months ago, we wrote about how midstream capex forecasts had increased throughout 2024, as midstream companies pursued LNG- and AI-related growth opportunities. While these projects are additive to medium- and long-term EBITDA growth, they also marginally reduce near-term FCF for midstream companies. On the supply side, tariffs are poised to increase the cost of steel and various types of mechanical equipment going forward. On the demand side, international buyers of US LNG have to consider the implications of a Russian ceasefire, a global economic slowdown, while Chinese buyers grapple with punitive US import tariffs. Meanwhile, AI leaders such as Microsoft are indicating that the pace of construction for AI hyperscalers may moderate going forward.

For midstream companies, this development may moderate longer-term midstream growth prospects, but given midstream's robust FCF profile, it augments near-term cash flow yields. Many other sectors – like utilities – would remain FCF negative even with a slowdown in the AI buildout. With midstream's defensive financial posture, and valuations that have lagged behind growth in midstream profitability, we would argue that midstream is well-positioned for a variety of tariff outcomes.

Natural Resources

Performance Review

During the month of March 2025, the Recurrent Global Natural Resources Strategy declined -1.20% net of fees, underperforming the S&P Global Natural Resources Index's 1.49% increase. During the month, the portfolio's stock selection in refining and paper companies negatively impacted performance, as did the weightings in specialty and commodity chemicals. Additionally, the portfolio's underweight in gold mining negatively impacted performance, as it was the strongest performing sector during the month.

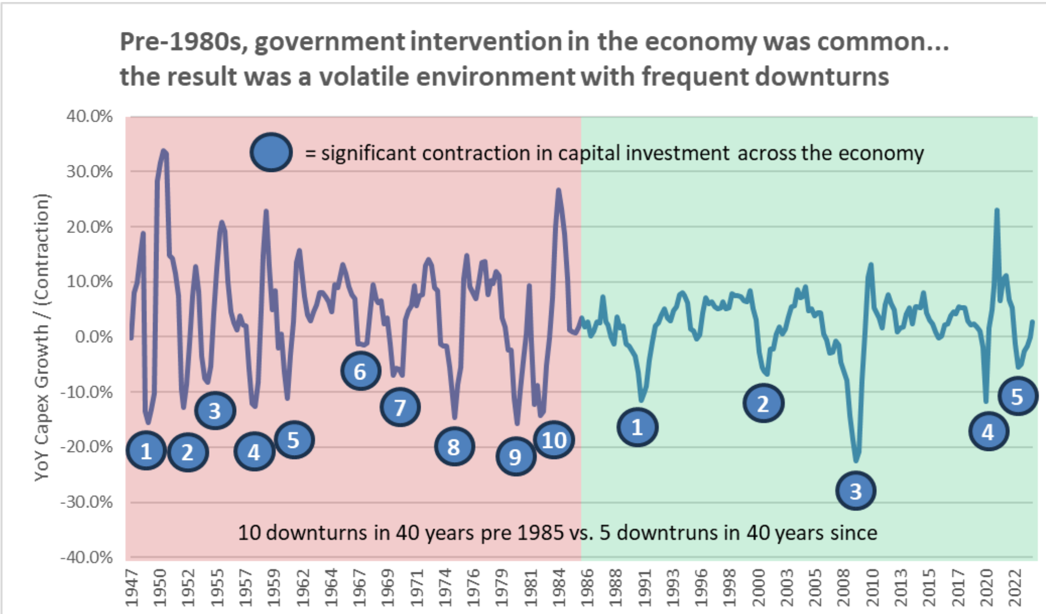
Investment Discussion: historical perspective on the interplay between capital investment and government intervention in the economy

In last month's monthly investment discussion, we noted that the rapidly changing regulatory environment would have a negative impact on CAPEX. Uncertainty about the future causes intermediate and long term investment decisions to be paused – whether in terms of capital spending or hiring decisions – which ultimately result in inflationary pressures.

Since the last monthly investment letter, the global economic landscape has changed dramatically, with new tariffs enacted by the United States. Soon thereafter, many tariffs were revised – either up or down – as determined by country or industry, or both. For some period of time, the "rules" have been in flux. As we outlined in last month's investment letter, until the rules are clearly defined, capital investment will pause.

As we try to identify historical precedents to learn from, the early 1970s experience has many similarities. Starting in the early 1970s, President Nixon announced a number of economy-altering policies, including price/wage caps and de-linking gold from the US dollar. These measures were designed to limit inflation in advance of the 1972 Presidential election. Despite the profound changes to the basic economic structure, inherent cost-certainty inspired more companies to invest in their businesses. On an inflation adjusted basis, CAPEX economy wide grew from 1970 to 1973.

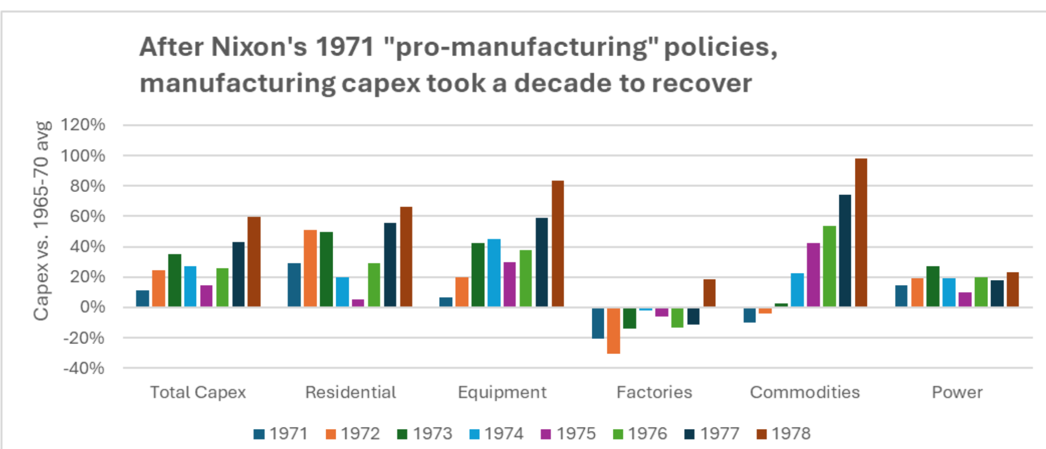
After the price caps were removed after the 1972 election, inflation accelerated until President Nixon once again instituted the price caps in June 1973. This time, the economic uncertainty of instituting, rescinding and reinstituting price caps caused capital investment to slow economy wide, especially when measured on an inflation adjusted basis, as seen in the chart below. Importantly, the volatility of policy was reflected in CAPEX volatility, with eight periods of negative CAPEX growth the 33 year period from 1952-1985. This contributed to the inflationary period which defined the 1970s.



Source: Recurrent research, US Bureau of Economic Analysis (BEA), Bloomberg.

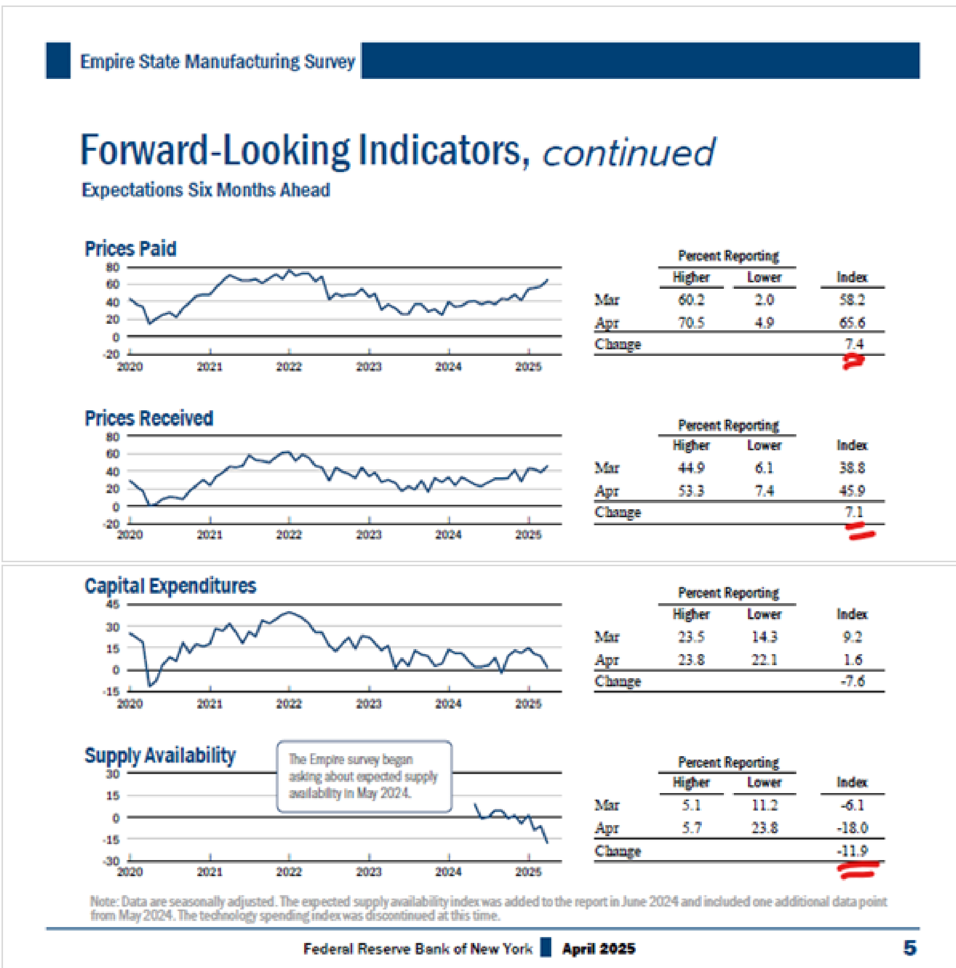
As the regulatory regime stabilized, so did CAPEX planning and execution. In the period from 1985 to 2024, there were only 4 period of negative inflation adjusted CAPEX – from 1990-1992, the post 2000 tech bubble, the Great Financial Crisis, and COVID. Regime stability helped long term CAPEX planning, reducing inflationary pressures over time.

The impact on manufacturing CAPEX was even more profound. In the early 1970s as the original inflation and subsequent wage/price caps were instituted, manufacturing CAPEX fell well below the average levels experienced between 1966-1970, only briefly recovering in 1975, to fall again until the second inflationary period of the late 1970s. Given the general size and duration of manufacturing investments relative to other parts of the economy, uncertainty about market structures and pricing causes CAPEX delays.



Source: Recurrent research, US Bureau of Economic Analysis (BEA), Bloomberg.

With the two charts in mind, we think back to our 2022 white paper which highlighted the causal relationship between CAPEX and future inflation. Since the beginning of the year, dynamically changing economic policies have slowed CAPEX plans, recently evidenced by the Empire Manufacturing Survey of April 15th. While a survey and not actual data, CAPEX expectations fell significantly compared to the March survey, and expectations for "supply availability" weakened dramatically. All the while, prices paid and received rose notably. Again, this is a survey and not yet actualized data. However, the expectation that both CAPEX and supply would fall means that the economy's supply/demand balance would tighten over both the near and long term, accelerating inflation as demand recovers. In the 1970s, a similar confluence of conditions caused a second stagflationary climate in the late 1970s, in which energy and natural resources sectors outperformed broader markets.



Source: NY Fed Empire Manufacturing Survey