Election 2020: A high likelihood of divided US government and an effective vaccine provide a constructive backdrop for "real asset" valuations. A Republican Senate and Democratic President are likely to deliver the largest stimulus in US history, but with meaningfully reduced "green" spending in order to secure bipartisan approval. We believe new energy regulations are unlikely near-term as America struggles with post-COVID unemployment. Meanwhile, widespread vaccine distribution is likely in early 2021, boosting expectations of a return to "normal." All of these variables point to generally higher inflation and higher energy demand over the next 12+ months – in short, we see fiscal stimulus and vaccine as clearly inflationary and supportive of "real asset" valuations.

Midstream: sentiment is exceedingly negative, despite improving fundamentals. "Calling a bottom" is a thankless exercise, but with valuations at ~50% discounts vs. S&P 500, free cash flow yields comparable to tobacco and mining, a lot can go right in the next several years. That is not a typo - "a lot can go right". Catalysts have been in short supply YTD as COVID-driven selling has not been met by new buyers. However, recent management commentaries point to a potential catalyst: amidst a pandemic, midstream companies are pointing to unprecedented buybacks in 2021, with potential to more than offset investor outflows in the year ahead.

Natural Resources: Historically, in traditional "value" sectors, the combination of inexpensive valuations and operational momentum provides favorable conditions for strong stock performance. With weak relative performance leading into COVID due to global trade disruption, natural resources sectors are inexpensively valued, and stand to benefit from a return to "normal."

Download new 2020 white paper here: Recurrent's 2020 Midstream/MLP White Paper.
Other white papers are available at www.recurrentadvisors.com.

October 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 October 2020, the MLP & Infrastructure Strategy generated net returns of -1.99%, lagging the 4.38% return of the Alerian MLP Index (AMZ) by -6.37%. Since the strategy's July 2017 inception, Recurrent's MLP & Infrastructure Strategy has outperformed the AMZ by +3.92% (annualized, net of fees). Please see the performance section below for more detail.

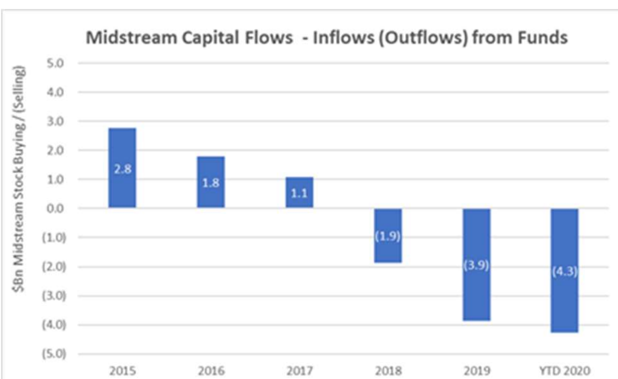
We would note that the Recurrent midstream portfolio has been (and remains) positioned for a post-COVID recovery in mobility, with significantly less exposure to drilling and wellhead volumes (Gathering & Processing, G&P) and more exposure to motor fuel demand (businesses such as fuel distribution, fuel transportation and refining) vs. the Alerian MLP Index. During October, fears of a "second wave" of COVID infections caused negative performance in mobility-oriented stocks. In the likely event of vaccines or improved widespread treatment for COVID, we expect to have significant leverage to this recovery compared to the benchmark and peers.

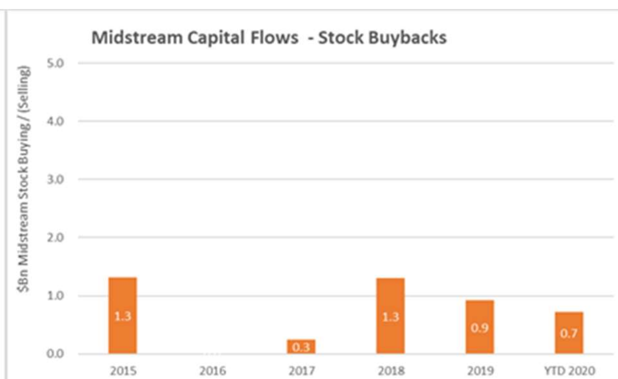
A persistent investor concern: "what is the catalyst?" – Q3 management commentaries point to a potential dramatic tightening in midstream equity markets

As we've noted in previous monthlies, most midstream companies are actually expected to generate **more** free cash flow (cash flow after capex) in 2020 than pre-COVID estimates, due to resilient cash flow and drastically reduced growth capex. Given strong fundamentals and languishing stock performance, many investors have asked, "What is that catalyst for midstream stocks?"

One key issue hampering performance, in our view, has been steady selling pressure from investors in midstream mutual funds and ETFs (thankfully Recurrent has generally been excluded from this trend). This selling has not been mitigated by buybacks from the companies themselves (hamstrung by credit agencies as COVID drove near-term uncertainty in early 2020), and new pools of investor capital have also been hard to come by. We believe this "buyers' strike" dynamic could rapidly change in 2021.

Fund and ETF outflows have accelerated 2015-2020, but midstream buybacks were constrained by credit, COVID (until now)





Source: Recurrent research, Bloomberg data
Note: Funds include all Morningstar-listed "Energy Partnership" open-end funds, as well as AMLP and AMJ, the 2 key index products in midstream.

The stage is set for an unprecedented level of buybacks in 2021-22, enough to more than offset any historical experience of selling pressure from open-end midstream funds

Despite a dramatic fall in midstream equities YTD, midstream companies have kept the bond markets onside, with yields tightening vs. high yield benchmarks and credit ratings improving in 2H 2020 after a slew of smaller-cap downgrades in 1H 2020. As a result, incremental free cash flow is generally available for buybacks, which was not the case during 1H 2020, when COVID uncertainty was peaking.

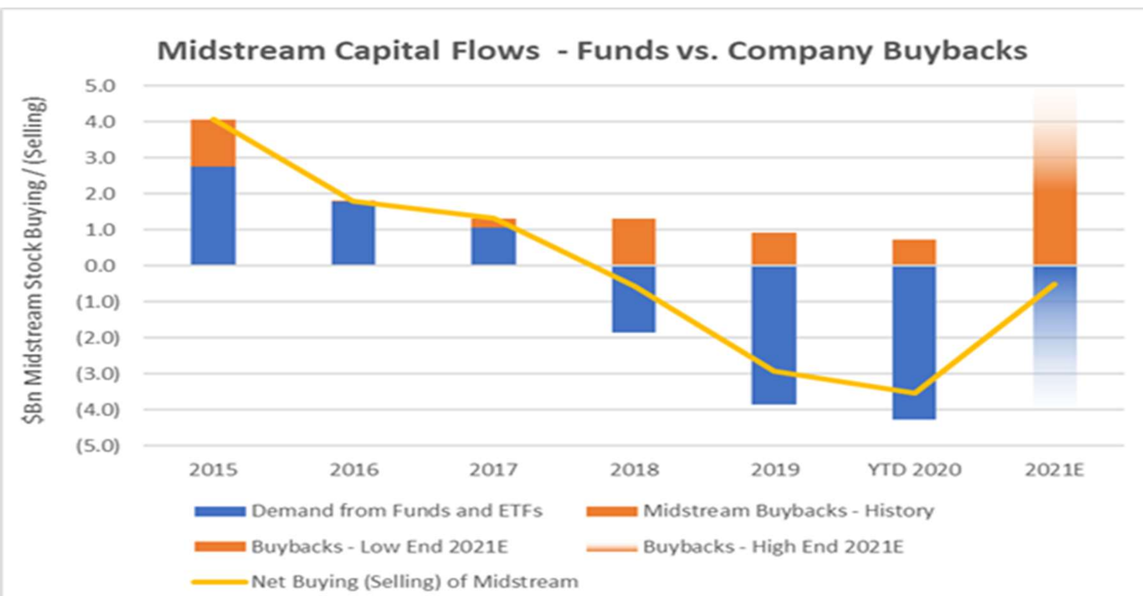
Bloomberg estimates imply a **$15bn improvement** in free cash flow from 2020 to 2021 across the midstream sector (compared to a market cap between corps and MLPs of roughly $300bn). With dividends largely covered by free cash flow already, this increased FCF will largely go to debt reduction and stock buybacks.

Using a conservative estimate of 2021E midstream buybacks, capital flows into midstream could reverse by $4bn vs. 2020

Accordingly, 12 companies representing nearly $200bn (or 2/3) of midstream market cap discussed 2021 buybacks on recent Q3 calls. According to Bloomberg, these 12 companies are expected (based on consensus estimates) to generate roughly $5bn of free cash flow in 2021. **This level of free cash flow, if largely dedicated to stock repurchases, would be sufficient to mitigate even the record midstream capital outflows in 2020 YTD.**

Below, we visualize the net impact of midstream open-end fund selling (including AMLP and AMJ, the 2 largest passive funds) since 2015. The orange bars reflect buybacks by the companies themselves, and the blue bars represent net inflows/(outflows) from all midstream open-end funds, which in turn drive selling by the fund managers themselves.

In short, the net impact of mutual fund selling in 2018-2020 has been dramatic - $10bn in total - and unprecedented in midstream history. If the buyback potential indicated on Q3 conference calls is realized, it would dramatically outstrip any previous buyback level, and would be sufficient to more than offset the massive outflow levels of 2019-2020, averaging $4bn/year.



Source: Recurrent research, Bloomberg data

Natural Resources

Performance Review

For the month of October, the North American Natural Resources Strategy fell by -0.32%, preserving capital better than the S&P North American Natural Resources' -2.31% return. During the month, portfolio overweights in the materials sector strongly benefited relative performance, as well as stock selection in the paper packaging sector. Stock selection in the integrated oil sector detracted from relative performance.

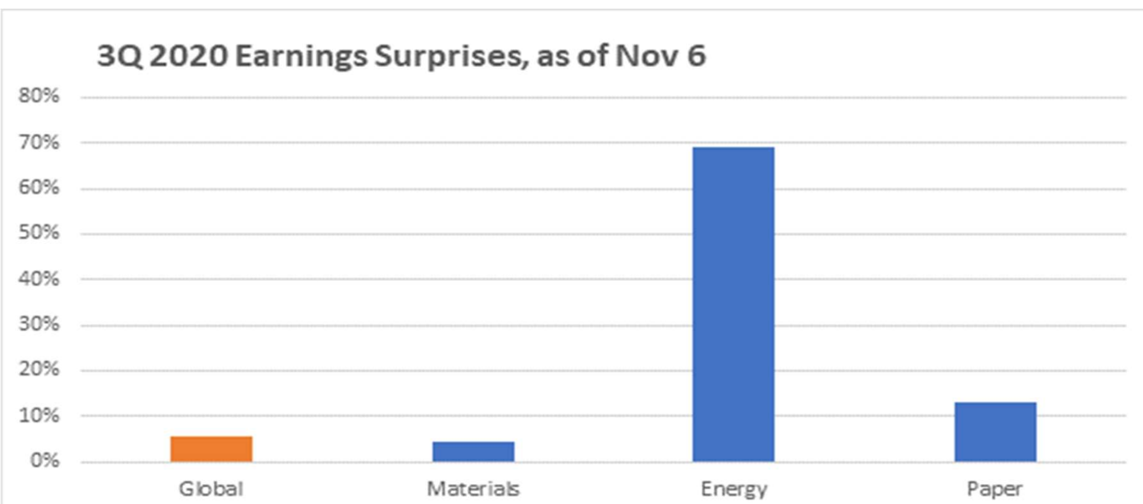
Portfolio Discussion – the changing nature of energy sector betas, before and during COVID

As mentioned above, the prospect of a split US government is broadly supportive of natural resources. With more moderate investments in green energy, industrial and conventional energy benefits from an extension of the status quo. The improved economic prospects as a result of a successful COVID vaccine disproportionately benefit economically sensitive industries, many of which are suffering from weak demand, unusually weakening both pricing and volume.

COVID-era underperformance has caused “value” investors to look more closely at the natural resources sectors. While there are many ways to identify “value”, many experienced value investors look to combine inexpensive valuations with improving profitability to identify attractive entry points.

From an operating perspective, 3Q 2020 operating results have generally exceeded market expectations, indicative of companies’ ability to adapt to the COVID environment

The second quarter of 2020 saw tremendous profit declines, and a quick look at the third quarter results shows that most global natural resources companies exceeded earnings expectations. Below is the average earnings surprise for the 10 largest companies of each global sector, compared to the broader global index. Economic recovery is outpacing the expectations of the market, at least when viewed on a company-by-company basis.



Source: Recurrent research, Bloomberg

The strong quarterly earnings of economically sensitive sectors, and especially energy, highlight companies’ ability to adjust to market environments. Additionally, companies are proving able to retain the benefits as conditions improve from the trough.

Inexpensive sector valuations – on both an asset and operational metrics – offer support in an improving economic environment

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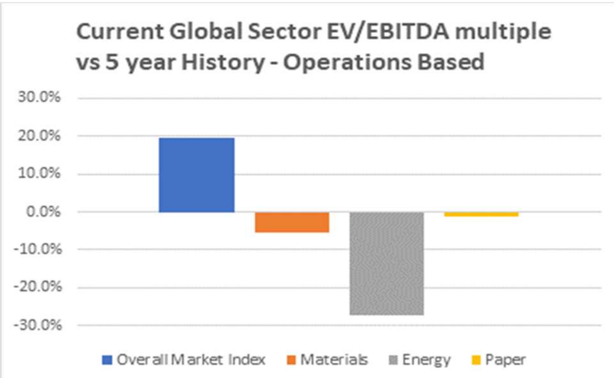
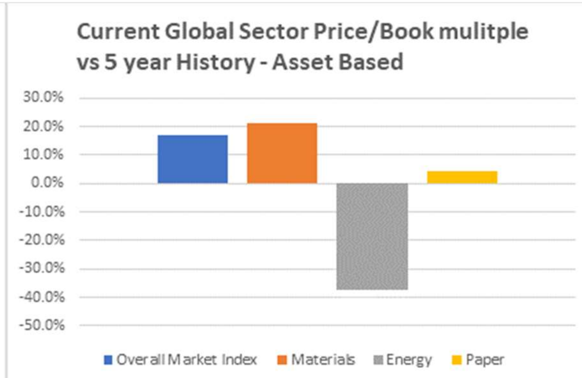
Monthly Investment Commentary
October 2020

With the economy showing initial signs of recovery and companies outpacing expectations, valuations remain depressed. On both EV/EBITDA and Price/Book valuation methodologies, which encompass operational and asset-based valuation measures, respectively, current global natural resources sectors' valuations remain at significant historical discounts to the broader market.





Source: Recurrent research, Bloomberg

While the broader market trades at a nearly 20% premium to 5-year averages, natural resources sectors generally trade in line – or at a discount – to historical averages. Energy sector valuations, trading at 25-35% discounts to recent history, uniquely stand out for their discount to recent history.

In the period from February 28 through the end of October, the global natural resources index underperformed the broader global equity index by more than 11%. Pfizer's November 9 announcement of a successful vaccine test trial brings relative value into even sharper focus. As seen in the above chart, compared to the broader market, the underlying sectors trade at inexpensive valuations. Due to their economic sensitivity, strongly rising earnings estimates in natural resources sectors are likely to appear even more attractive using operational valuation metrics like EV/EBITDA.

Historically, in traditional "value" sectors, the combination of inexpensive valuation and positively inflecting operations provides favorable conditions for strong performance. With weak relative performance leading into COVID due to global trade disruption, natural resources sectors are inexpensively valued, and stand to benefit from a return to "normal".