

**Energy Infrastructure:** With strong midstream performance YTD, investors should have little to complain about. But one factor - fund-level tax expenses – have reduced after-tax returns for some MLP fund and ETF investors by >\$1bn in the last 12 months. In [December 2022](#), we detailed how COVID-era tax assets were nearly depleted across many MLP funds, exposing billions of dollars of midstream AUM to rising tax bills in 2023 and beyond. These fund-level taxes impact NAV, so they diminish returns even for tax-exempt investors. Since 2022, 11 taxable “C-corp” funds (representing >\$20bn or 2/3 of all midstream fund AUM) have exhausted tax assets, incurring >\$1bn in corporate tax! Another \$0.5bn was possibly incurred YTD 2024 given strong performance. *While Recurrent cannot ever guarantee future performance, we can assure investors that none of our funds or SMAs incur an additional layer of fund-level corporate tax expense.* [Click here](#) for our new midstream white paper, which explores midstream’s excess (and growing) yield vs. fixed income.

[Click here](#) for our white paper on the long-term relationship between inflation and capex

**Natural Resources:** Despite increased demand for commodities critical to the energy transition, the four largest metals and mining commodity producers have reduced CAPEX by >50% since the last CAPEX peak more than a decade ago. With EBITDA for the four companies on average 9.7% higher than the previous peak, the financial wherewithal exists to invest more, but the companies remain hesitant to invest while valuations remain well below 2013 levels.

[Click here for our 2022 white paper on Shale’s increased strategic importance in a time of ESG](#)

### March 2024 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](mailto:info@recurrentadvisors.com).

## MLP & Infrastructure

### Performance review

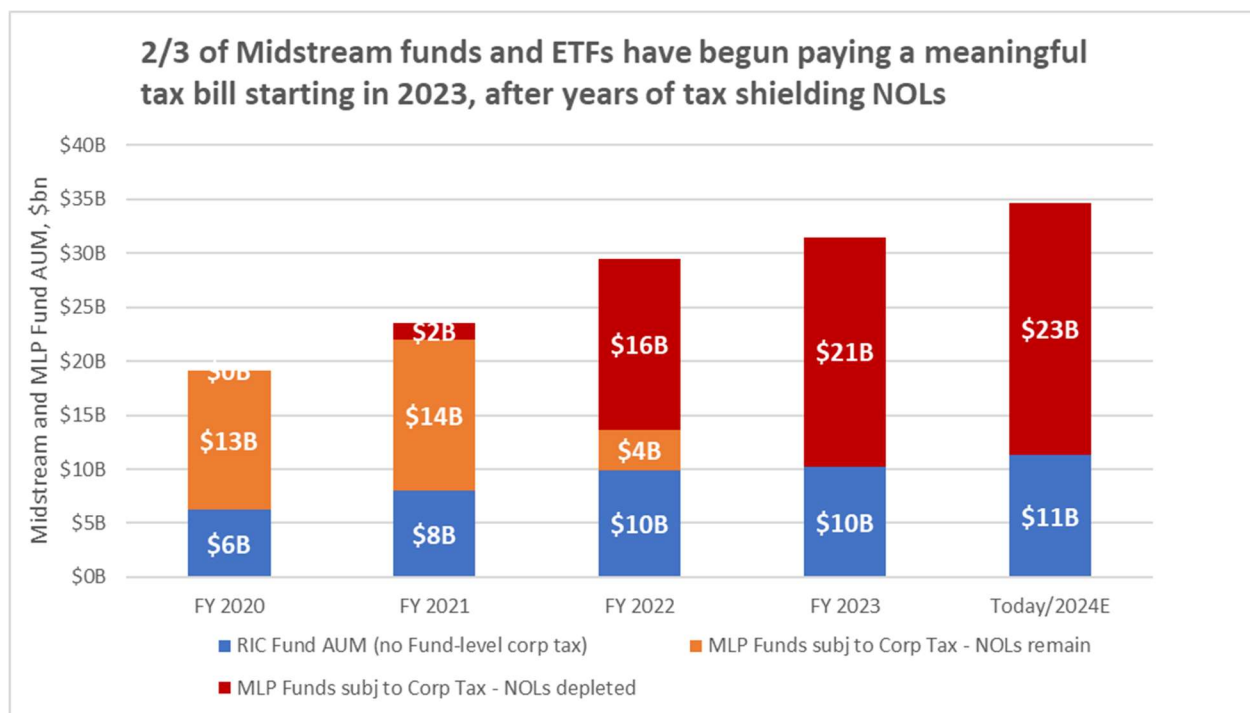
During the month of March 2024, the Recurrent MLP & Infrastructure Strategy generated net returns of +8.72%, leading the Alerian MLP Index’s (AMZ) +4.53% return by +4.20%. Since the strategy’s July 2017 inception, Recurrent’s MLP & Infrastructure Strategy has outperformed the AMZ by +29.46% (+2.66% annualized), net of fees. On a gross basis, the Strategy has outperformed by +47.32% and +4.11% respectively. Please note that we have also added the Energy Infrastructure Strategy, which seeks to emulate much of our MLP & Infrastructure Strategy while excluding MLP exposures, which has historically represented 15-25% of our core strategy. See performance section at bottom for more detail.

### Since our Dec 2022 note, over two-thirds of midstream/MLP funds have returned to incurring significant corporate taxes

In December 2022, we noted how the depletion of the AMLP’s net operating losses (NOLs) was likely a harbinger of higher tax bills to come for investors in many competitor midstream/MLP funds and ETFs.

Long-time readers likely are familiar with the unique history of taxable MLP fund products, which we've recounted in more detail elsewhere. But for today's purposes, we'll simply remind our readers that many of the midstream funds and ETFs we compete against (>\$20bn, or roughly 2/3 of the midstream fund market) incur corporate tax at the fund level, up to a 21% statutory corporate tax rate, regardless of whether the holder is tax-exempt.

Over a decade ago, when the sector was almost entirely comprised of MLPs, this unpleasant layer of corporate tax was viewed as a necessary evil for investors seeking to avoid K-1s. Then, during 2015-2020, most midstream market cap restructured away from the MLP structure, but significant losses across midstream funds meant that no funds were required to pay corporate taxes, rendering the question of fund structure temporarily moot. Since 2022, a majority of midstream fund AUM has returned to paying corporate taxes.

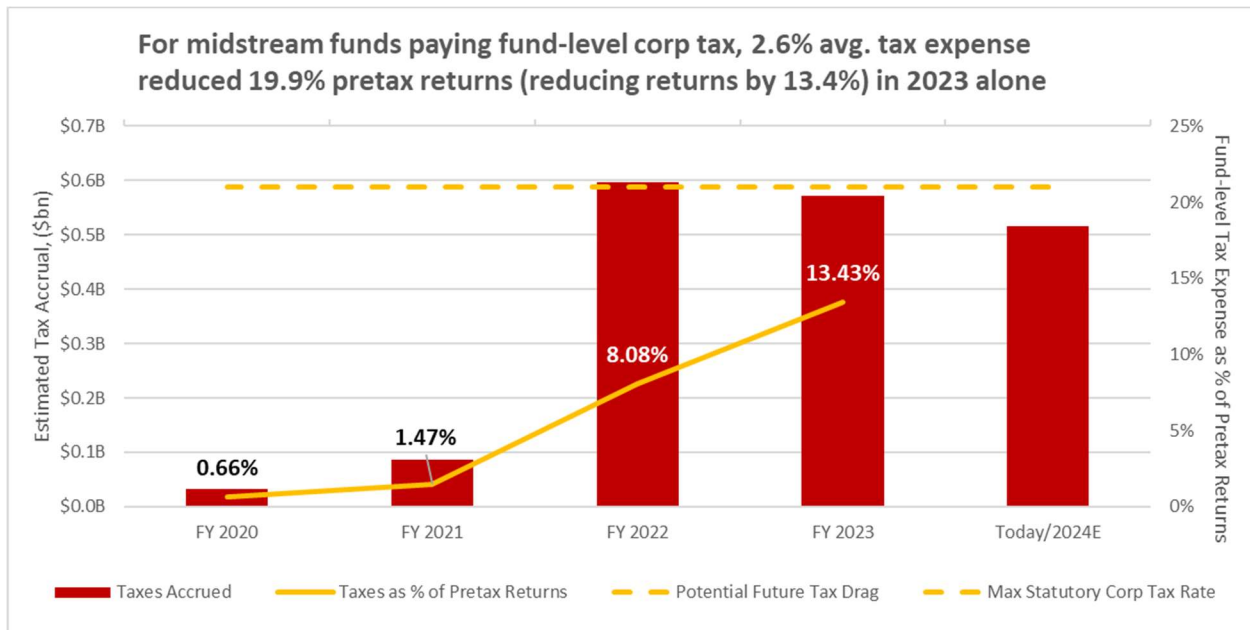


Source: Recurrent research, Bloomberg, SEC public filings. Includes all Funds and ETFs in the Energy Limited Partnership Morningstar Category as well as the ETFs and CEFs listed below.

## We believe investors have incurred \$1bn in unnecessary fund-level taxes since 2022 – a trend unlikely to reverse

The magnitude of tax expenses paid by midstream funds subject to corporate taxation is meaningful. In the last 2 years, \$20bn of fund AUM has incurred over \$1bn of tax expense. Given strong Q1 2024 returns, we believe that these same funds have incurred approximately \$0.5bn of tax expense in Q1 2024 alone (these tax expense numbers won't be public until after mid-year, given mutual fund SEC filing timing).

As seen below, 13.43% or roughly one-seventh of all pretax gains in fiscal year 2023 were negated by corporate taxation. This 13.43% tax drag (which we define as tax expense / pretax returns) compares to 1.47% and 8.08% tax drags in FY 2021 and FY 2022. Understandably, in 2021, this 1.47% drag hardly registered. Given strong absolute performance in 2022 and 2023, investors may not have been focused on this growing performance drag.

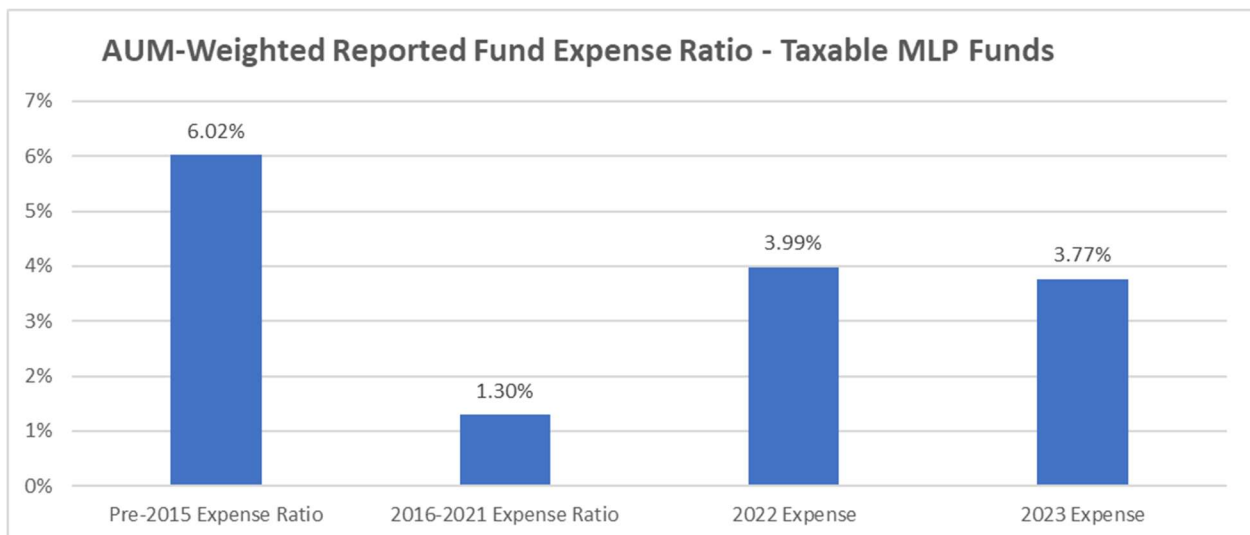


Source: Recurrent research, Bloomberg, SEC public filings. Includes taxable “C-corp” structured funds and ETFs listed in the chart below.

It is hard to justify a (growing) layer of tax that is effectively optional for the end investor. There are many fund and ETF vehicles today with similar investment propositions and similar yield profiles that do not incur this layer of corporate tax.

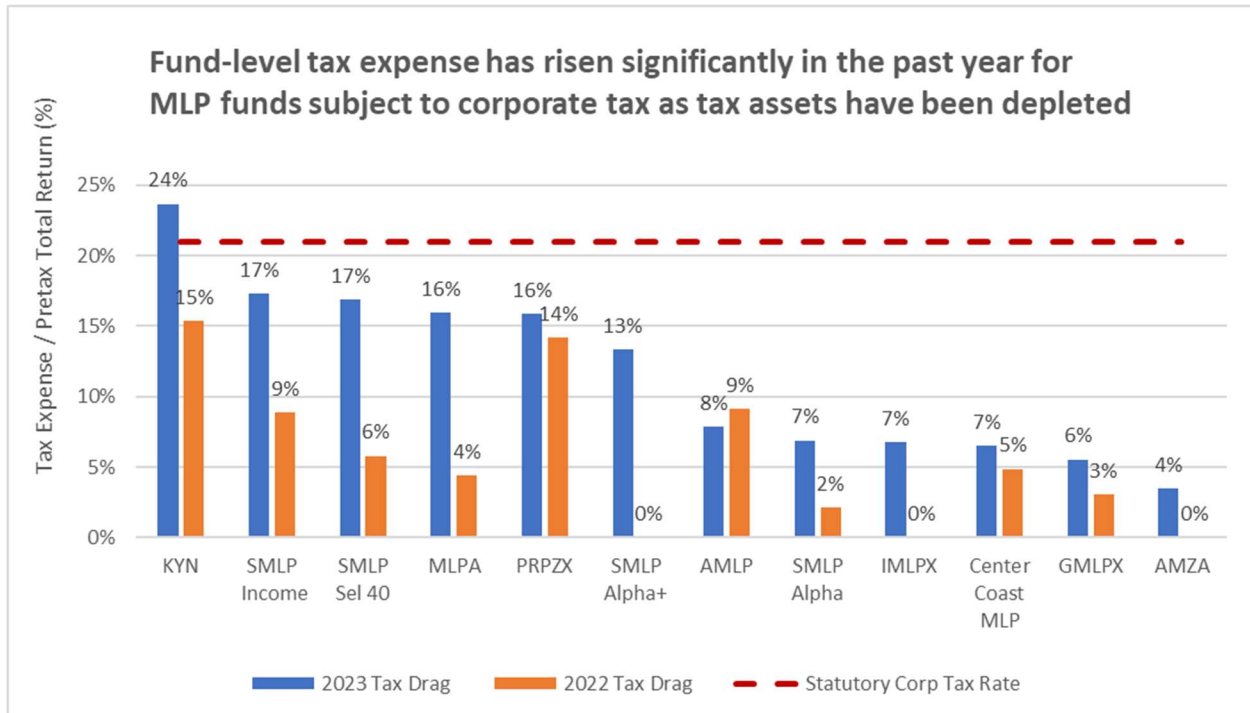
As investors, we are always worrying – but we are happy to not worry about growing fund-level taxes in any of our investment vehicles

As seen below, the eye-watering pre-2015 expense ratios dropped significantly as funds incurred significant NOLs. While the Trump-era TCJA reduction in corporate taxes mitigated some of the tax expenses in 2022 and 2023, the average expense ratio has returned to levels that are rarely-seen in today’s fee-conscious investment landscape.



Source: Recurrent research, Bloomberg, SEC public filings. Includes taxable “C-corp” funds and ETFs listed in the chart below.

Below, readers can examine the composition of the increasing average tax drag – almost all taxable funds have seen a meaningful increase as NOLs/tax assets have been depleted by the rally of the last 4 years. The overall tax expense (as a % of pretax total returns) is likely to increase as funds that have only recently exhausted NOLs remain well below the 21% statutory corporate tax rate. As those funds continue to appreciate and further deplete remaining NOLs, we expect that these funds’ overall tax bills will move towards 21%.



Source: Recurrent research, Bloomberg, SEC public filings.

## Natural Resources

### Performance Review

In the month of March 2024, the Alma Recurrent Global Natural Resources Fund rose +9.97% net of fees, outpacing the S&P Global Natural Resources Index's +8.24% return. During the month, portfolio holdings Freeport McMoran and Alcoa each rose more than 24%, benefiting relative performance. The portfolio's underweight position in gold mining equities detracted from relative performance, since the index's gold sector rose 16.78% in the month.

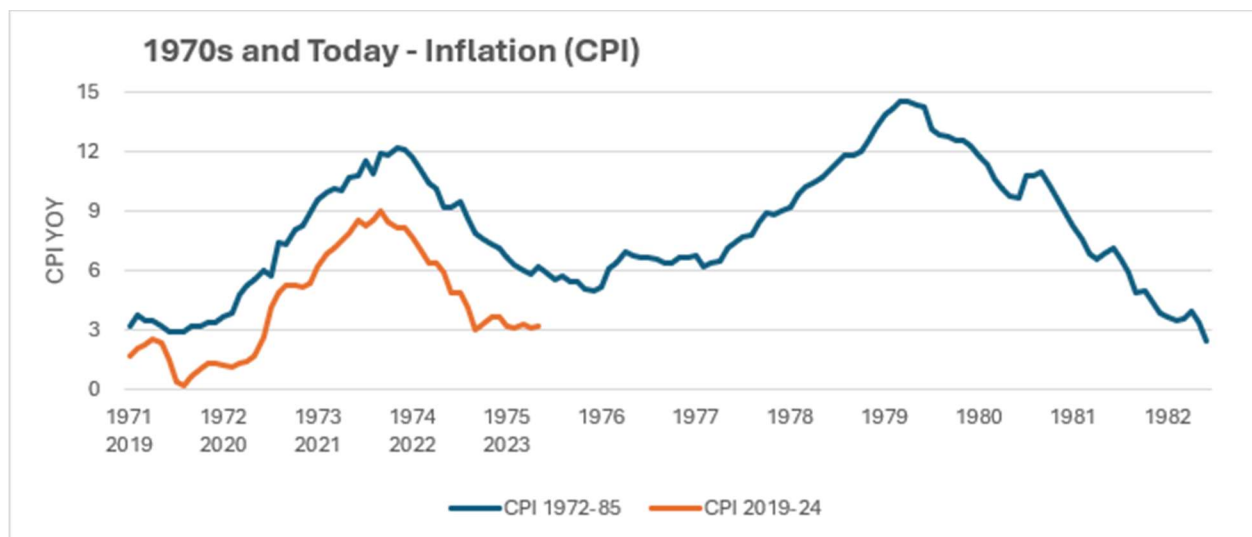
### While inflation gauges have fallen, we have not seen the surge in CAPEX necessary to keep commodity prices sustainably lower

As an investor in capital intensive businesses, we have long identified the impact of capital expenditures (CAPEX) on the operational and financial success of companies. Both the magnitude and efficiency of capital expenditures impact corporate returns, debt leverage, and free cash flows.

While the direct impact of CAPEX on business cycles is fairly well understood, in our July 2022 white paper, we additionally identified the predictive value between CAPEX in commodity sectors and broader economic inflation. In the paper, we highlighted that as commodity CAPEX increased, supply increased over time, reducing commodity prices which reduced economy-wide inflation.

Since the publishing of the white paper, inflation has broadly fallen, with US CPI falling from 9.1% in 2Q 2022 to 3.2% in March 2024. With moderate economic growth and inflation "under control", many market observers have called for global Central Banks to reduce interest rates to spur growth. In fact, as of the time of the writing of this commentary, some global Central Banks have already reduced interest rates, with the Swiss National Bank cutting rates on March 21<sup>st</sup>.

While reduced interest rates should spur additional economic growth, our analysis of the 1970s showed that a period of high inflation in the early 1970s was met with significantly higher interest rates, which lowered economic growth and inflation. In an attempt to reinvigorate economic growth, the Fed reduced rates in the mid-1970s, spurring economic growth. Interestingly, since commodity supply remained constrained due to underinvestment, as economic growth returned so did inflation, which lasted until the early 1980s. See the graph below for an illustration of the dual inflationary peaks of the 1970s.

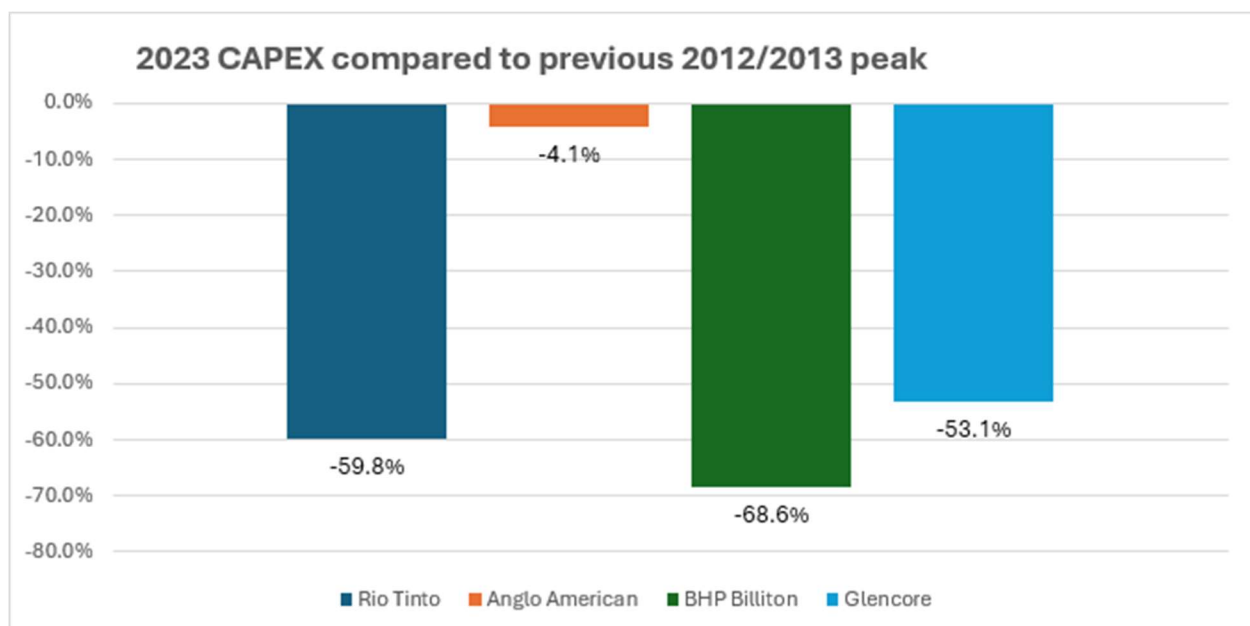


Source: St. Louis FRED, Bloomberg, Recurrent research

## CAPEX data indicate that commodity production is likely to remain muted, with implications for long-term inflation trends

With the 1970s experience in mind, in conjunction with the specter of lower interest rates, we wanted to revisit our 2 year old analysis of the CAPEX trajectory of the largest diversified mining companies. With continued economic growth combined with lower inflation, many investors perspective remains biased toward interest rates driving inflation. In contrast, our understanding of the CAPEX cycle can offer insights as to the evolution of inflation.

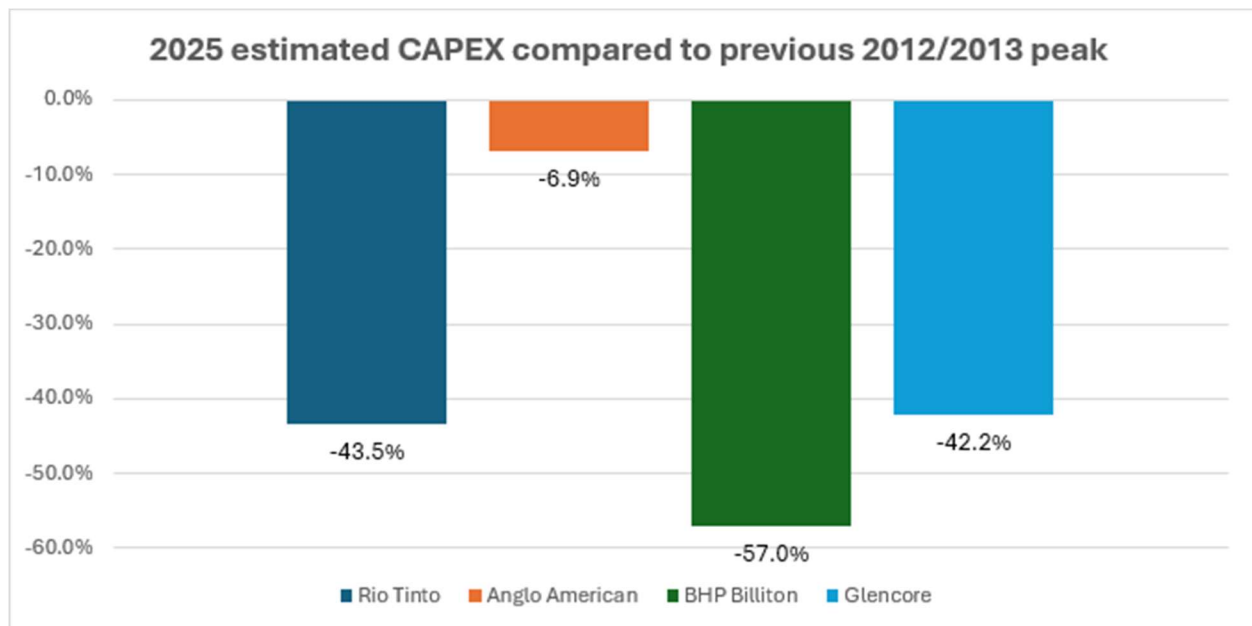
The comparison of Rio Tinto, Anglo American, BHP Billiton and Glencore 2023 CAPEX levels to the previous peak of 2012/2013 shows that aggregate nominal CAPEX remains 52.1% lower as of 2023, as seen in the chart below. Moreover, on an inflation-adjusted basis, since the 2013 peak, CAPEX spending is -70%.



Source: Bloomberg, Recurrent research

Interestingly, Anglo American, the company with the smallest CAPEX decrease over the last decade, announced a CAPEX reduction in December 2023 which will reduce company-wide production volumes by an estimated 4% in 2024, and an additional 3% in 2025. So while Anglo's CAPEX decrease from the peak has fallen the least, forward looking CAPEX continues to fall, along with volumes.

Rio Tinto, BHP Billiton and Glencore's CAPEX expectations are all higher in the coming years, while from a lower base compared to the 2012/2013 peak. In aggregate, the four companies' estimated 2025 CAPEX will be 39.7% lower than the 2013 peak. With CAPEX levels only starting to rise off of trough levels, commodity supply is unlikely to materially increase for many years. Instead of deflation across the broader economy, as many analysts suggest, low commodity CAPEX is more likely to cause persistent inflation as global economic growth re-emerges.



Source: Bloomberg, Recurrent research

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