Midstream: what does a dollar invested in our midstream/energy portfolio get you today? In Q2, a dollar invested generated more free cash flow than ever before - in absolute terms and compared to the S&P 500. While most investors spent July preoccupied by rapidly-shifting macroeconomic forecasts as the Fed turned increasingly hawkish, Q2 earnings showed continued record free cash flow, dividend/buyback acceleration for our portfolio, with record cash returns – all despite extremely conservative payout and leverage ratios.

Natural Resources: In accordance with our recent white paper outlining the sustained underinvestment in the mining industries, we looked at four of the largest mining companies in the world. Many key commodities such as copper, nickel, aluminum, etc. are at or near decade-long peak prices, driving 2021 EBITDA approximately 70% higher than the previous peak. However, CAPEX is more than 50% lower than previous peak levels, highlighting industry-wide underinvestment which will elevate inflation, as we highlight in our white paper.

Click here for the latest white paper on the long-term relationship between inflation and capex

MLP & Infrastructure

Performance review

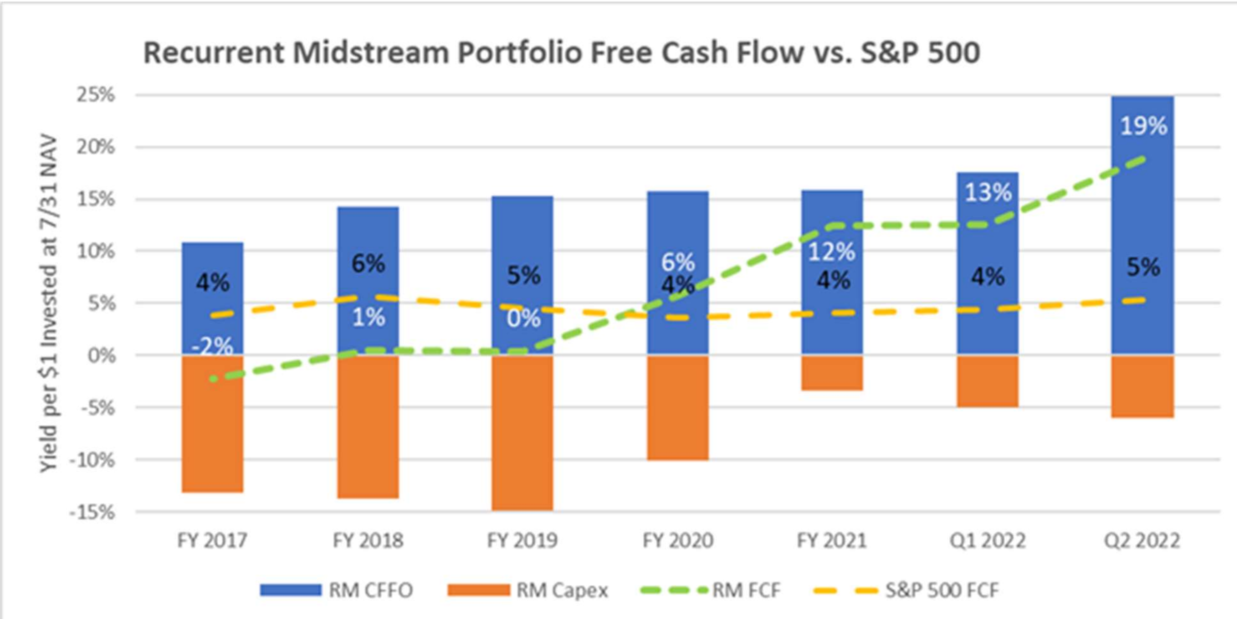
During the month of July 2022, the Recurrent MLP & Infrastructure Strategy generated net returns of +9.13%, lagging the Alerian MLP Index's (AMZ) +12.49% return by -3.36%. Since the strategy's July 2017 inception, Recurrent's MLP & Infrastructure Strategy has outperformed the AMZ by +5.44% (annualized, net of fees). Please see the performance section at bottom for more detail.

In July, strong fundamental updates from our companies were drowned out by a singular focus on hawkish Fed policy

What did a dollar invested in our portfolio generate in terms of free cash flow in Q2? As we show below, with a 19% FCF yield reported in Q2, and a 56% FCF payout ratio and dramatically improved leverage profile, we believe there is room for significant increases in payouts, even if commodity prices were to moderate in coming quarters/years. All periods below reflect our actual portfolio holdings as of 7/31/22, for sake of comparison. Of course, these portfolio weights/holdings are subject to change at any time, and any forward-looking statement is subject to considerable risk.

With so much macroeconomic noise driving volatility across broad markets, our monthly focuses on fundamentals and cash generating power of our portfolio. We would highlight that Q2's 19% annualized free cash flow yield nearly quadrupled that of the S&P 500, while other key financial metrics – which we review below – also met or exceeded S&P 500 levels. Capital expenditures remained subdued – the portfolio's 25% cash flow yield was mitigated by a 6% capital expenditure drag, leaving a 19% FCF yield. This compares to 2017-2020, when capex reduced FCF annual yields by more than 10% on average, driving FCF negative in 2017, before the meaningful FCF pivot we've highlighted for the last several years.

Exhibit 1: Low capex, high CFFO generated record FCF for our portfolio in Q2, further bolstering financial strength

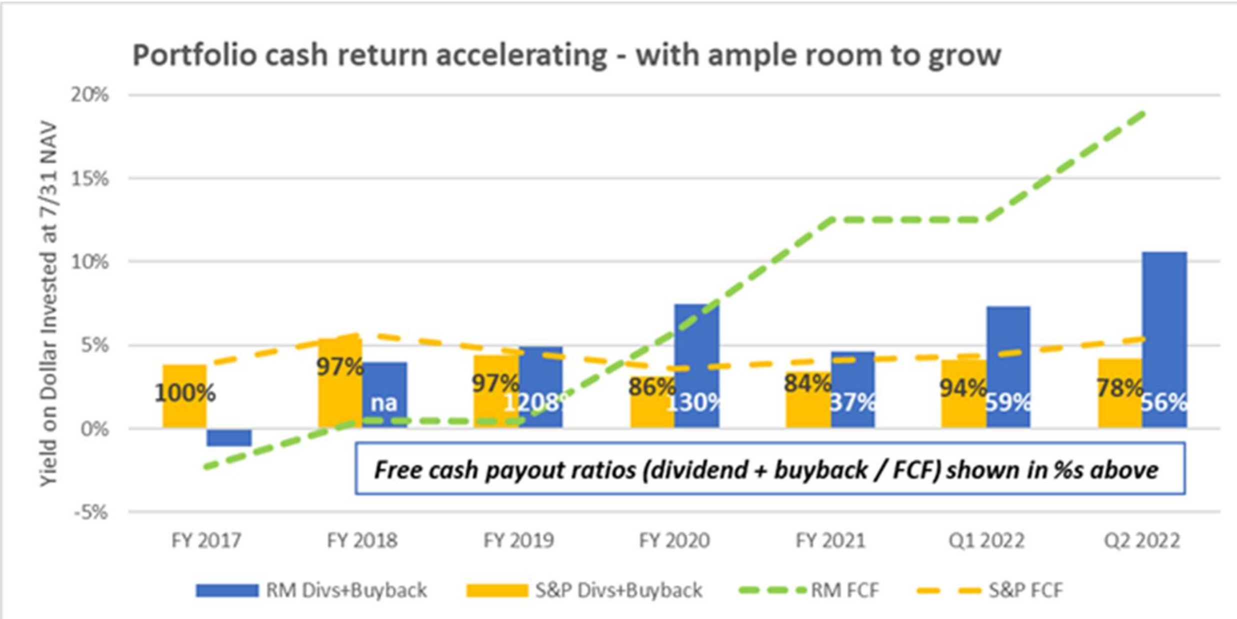


Note: Recurrent portfolio reflects actual Recurrent portfolio holdings as of 7/31/22.
Source: Recurrent research, Bloomberg data

Low payout ratios, falling debt sets up an option-rich multi-year period for our portfolio

The combined dividend+buyback yield of our portfolio exceeded 10% in Q2, as shown below, implying a 56% payout ratio. While outstanding Q2 earnings reports were largely expected for the energy sector, we would note that the positive fundamentals seen in our portfolio are not simply a temporary byproduct of high oil and gas prices. Longer-term drivers of value, which we've focused on for years – capex discipline, falling debt leverage, and lower payout ratios – continue to improve, both on an absolute basis and relative to the broad market – setting up for improved financial flexibility and higher cash returns for the next several years.

Exhibit 2: Cash return yields (buybacks+divs) surge, while payout ratios have fallen below S&P 500 levels

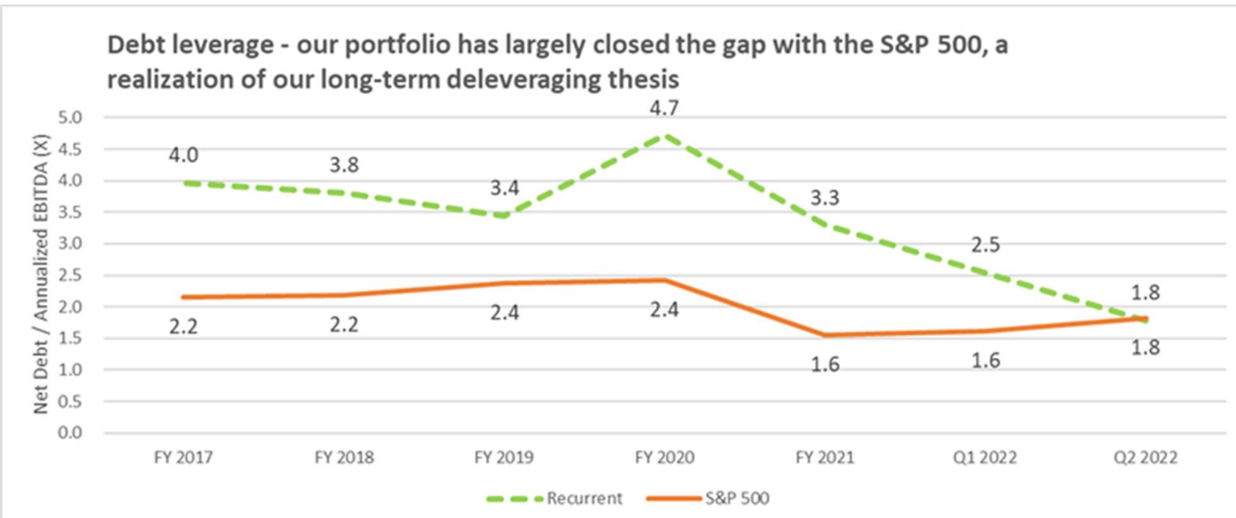


Note: Recurrent portfolio reflects actual Recurrent portfolio holdings as of 7/31/22.
Source: Recurrent research, Bloomberg data

Finally, our portfolio's debt leverage ratio is rapidly converging with the broad market

One key variable determining the sustainability of cash payouts is debt leverage. We've noted in the past that higher-than-normal debt was a key contributor to the sector's extended downturn during 2015-2020. As shown in exhibit 2 above, our portfolio's payout has been <60% of available FCF in 2022 (after a record low of 37% in 2021), compared to an S&P 500 FCF payout ratio of 94% in Q1 and 78% in Q2. This means that excess FCF (in excess of payout) is likely to further reduce absolute debt outstanding in future quarters. The low payouts of 2021 and 2022 have caused absolute debt to fall, and higher CFFO has dramatically compressed leverage. In absolute terms, debt across our portfolio has fallen 21%. Annualized portfolio cash flow grew by ~40% between 2017 and Q1 2022, and CFFO jumped another ~40% between Q1 and Q2 2022.

Exhibit 3: reduced leverage means that payouts can continue to rise without stressing our portfolio's balance sheet



Note: Recurrent portfolio reflects actual Recurrent portfolio holdings as of 7/31/22.
Source: Recurrent research, Bloomberg data

Natural Resources

Performance Review

During the month of July 2022, the Recurrent Global Natural Resources Strategy rose by +4.25% net of fees, outperforming the S&P Global Natural Resources Index's +3.52% return. During the month, stock selection in the oil and gas infrastructure and steel sectors added value to performance, as did sector overweights in the aluminum and copper sectors. Stock selection in the gold and paper products sectors detracted from relative performance.

Investment Discussion

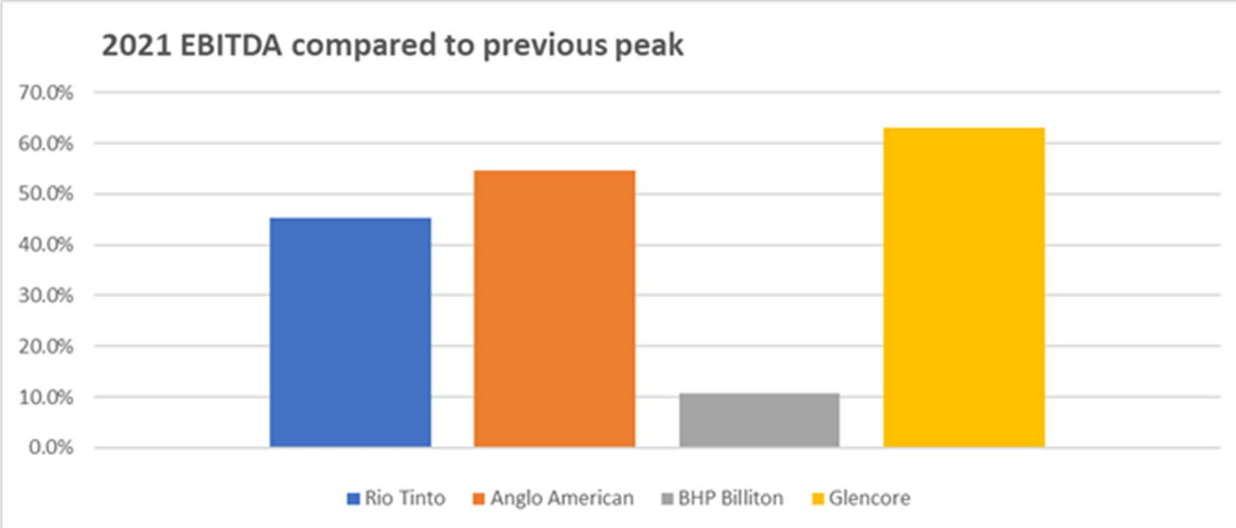
In our recent white paper, titled "The Great Inflation Misdiagnosis", we outlined that rising rates may help to reduce inflation temporarily. However, in order to secularly reduce inflation, we must increase supply via capital expenditures (CAPEX) in commodity related sectors. In our proprietary analysis of 60+ years of data, we highlight that while the Fed and Paul Volcker receive credit for increasing rates to reduce inflation in the late 1970s, in fact it was a near-tripling of commodity CAPEX during the first 4 years of the Volcker Fed which played a large yet unsung role.

In recent quarters, CAPEX has played an increasingly prominent role in investors' minds. In the past, high commodity prices would elicit calls for increased CAPEX, but today, investors increasingly prefer companies to return excess cash to shareholders. In fact, within 2022, many commonly found commodity prices have reached previous highs, as seen in the table below.

Commodity	Peak Price Previous Cycle	When Achieved	Recent Peak Price	When Achieved	Percent change
Copper	9600	4Q 2010	10674	Mar-22	11.2%
Nickel	44800	1Q 2007	48078	Mar-22	7.3%
Aluminum	3114	2Q 2008	3849	Mar-22	23.6%
Phosphate	1045	2Q 2008	1010	Mar-22	-3.3%
Gold	1772	3Q 2012	2051	Mar-22	15.7%

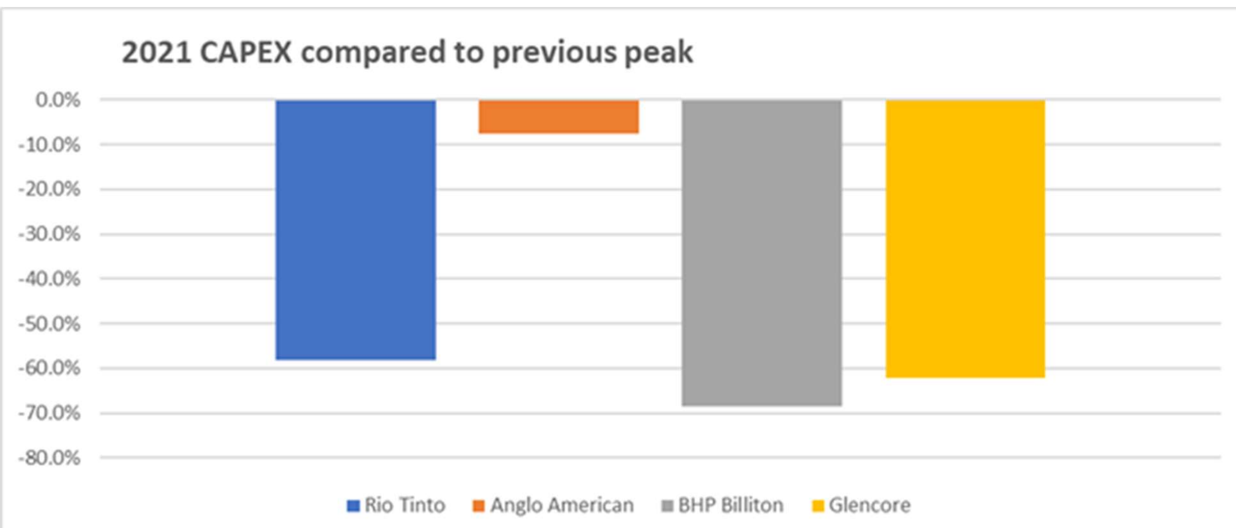
Source: Bloomberg, Recurrent Research

With all of these commodities at or near peak levels, the profitability of the sector is higher than ever before. As a proxy for spending in the mining industry, we looked at adjusted EBITDA for Rio Tinto, Anglo American, BHP Billiton, and Glencore. Compared to the previous peaks, in 2021 adjusted EBITDA for these four companies is an average of 43% higher. Since the Russia/Ukraine conflict began in 1Q 2022, there is a higher likelihood of the group's strong profitability continuing rather than peaking.



Source: Bloomberg, Recurrent Research

Many investors have assumed that the combination of high commodity prices and strong profitability would typically lead to a sharp increase in CAPEX. However, as our white paper illustrated, ill-considered inflation "fixes" – such as monetary tightening and threats of increased regulation – actually depress valuations and discourage additional investing, leading to periods (like the early- and mid-1970s, and today) where CAPEX remains constrained, despite high levels of cash flow and profits. We illustrate this low-CAPEX dynamic for the same four mining companies, as seen in the chart below.



Source: Bloomberg, Recurrent Research

While 2021 CAPEX was significantly below historical peaks, recent 2022 mid-year earnings call commentaries from major mining companies showed further capital constraint. Rio Tinto reduced 2022 CAPEX guidance by 7%! While Rio Tinto's 2023/2024 CAPEX guidance is 20% higher than 2022, 2023/2024 levels remain 40% below previous peaks. Glencore and Anglo American maintained their prior CAPEX guidance; in Glencore's case some 42% below previous peaks. BHP Billiton will announce its capital plans next week. Capital discipline remains a key focus for management teams, which is good for shareholders, but limits future supplies of key natural resources needed for the economy today, and the energy transition going forward. As we outlined in our white paper, secular declines in inflation occur after periods of significant commodity CAPEX. At current levels, despite generating peak profits, the major mining companies are maintaining their capital discipline. Without growth in future commodity supplies, the likelihood of persistently high inflation increases.

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