

Midstream: Outperforming is hard – but it’s near impossible in a passive ETF that accrues a 21% tax bill on all gains - realized and unrealized – before investors see a dollar. And yet, the largest midstream fund – the \$6.6bn Alerian MLP ETF, or AMLP – does exactly that. So much for a “low-cost ETF.” After 7 years without a tax bill, AMLP is back to paying taxes. What changed? Since 2015, AMLP has used net operating losses (NOLs) from the MLP crash to offset tax bills. Last month, AMLP exhausted all COVID-era NOLs. During 2010-14, (when AMLP was previously without NOLs), AMLP expense ratios were 4% to 9% annually, and cumulative lag vs. benchmark exceeded 50% - in a passive product! Despite attractive midstream fundamentals today, this type of taxation stacks the deck against investors. We think Recurrent funds and SMAs offer superior midstream exposure vs. AMLP.

NB: *none of Recurrent’s investment vehicles are subject to AMLP’s punitive tax structure – but ETFs, such as AMLP and MLPA, and actively-managed closed-end and open-end MLP funds are.*

Natural Resources: “How do energy and natural resource investments perform in a recession?” Our proprietary historical dataset shows that energy and resources are capable of significant outperformance in recessionary periods - but the key variable is capex. When capex is restrained – as it was in the 1970s and is again today (see our [white paper](#) for historical detail) – resource equities can serve as a defensive and diversifying allocation. When CPI is above 2.5%, energy’s relative performance skew gets even more positive. The pattern seen in 2022 – resources have outperformed broad equity and fixed income markets – fits the 1970s paradigm well. If low capex persists (as it did for much of the 1970s), history suggests commodity-levered equities could continue to provide outperformance in a recessionary environment.

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

MLP & Infrastructure

Performance review

During the month of November 2022, the Recurrent MLP & Infrastructure Strategy generated net returns of +2.53%, outperforming the Alerian MLP Index’s (AMZ) +1.06% return by +1.47%. Since the strategy’s July 2017 inception, Recurrent’s MLP & Infrastructure Strategy has outperformed the AMZ by +4.67% (annualized, net of fees). Please see the performance section at bottom for more detail.

For the last 7 years, midstream fund investors could ignore fund-level taxation – but that is about to change

The US tax code states that any 1940 Act Fund - mutual fund or ETF – becomes a fully taxable corporation – paying taxes on all realized and unrealized gains – if it invests more than 25% of its assets in MLPs. For the last 7 years, this crucial point has been moot – because massive tax losses incurred during the energy downturn of 2014-2020 have offset effectively all fund-level taxation.

(NB: all Recurrent strategies – funds and SMAs - invest less than 25% in MLP-structured investments, avoiding this MLP tax penalty).

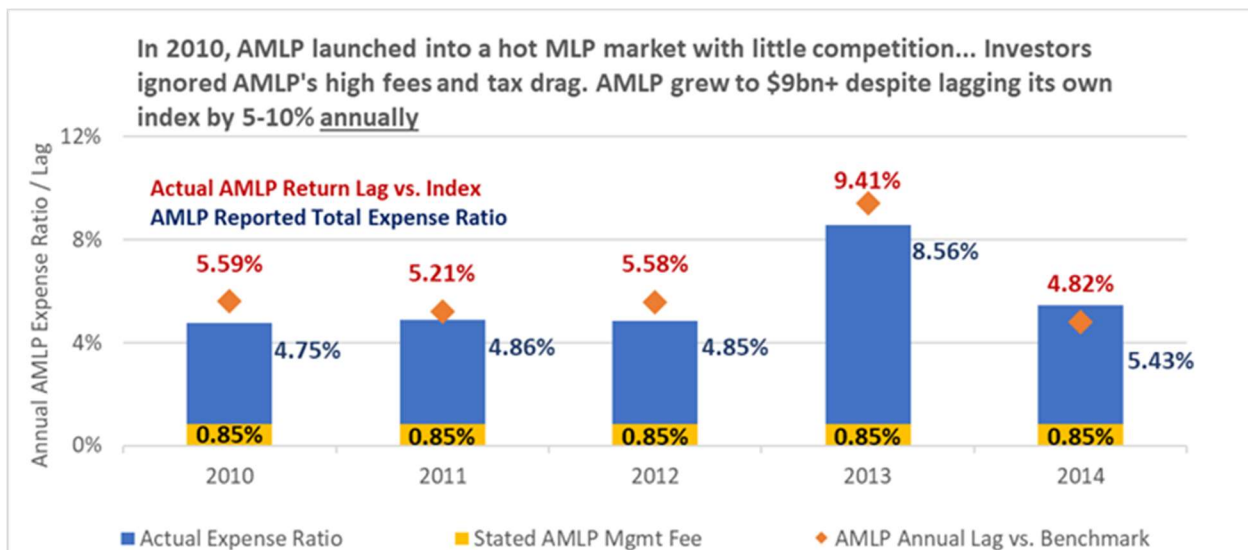
MLP-heavy mutual funds (open-end and closed-end) have **always** accrued expenses at the prevailing US corporate tax rate (21% today, 35% prior to the 2017 Trump tax cut). This accrual is assessed to all gains – **realized and unrealized** – in a fund where MLPs are >25% of assets. Prior to 2010, asset managers launched taxable closed-end funds (CEFs) with the justification that 35% debt leverage could offset 35% corporate taxation. Until 2010, the potentially massive tax drag discouraged asset management companies from launching unlevered MLP-heavy open-end funds and ETFs.

By 2010, soaring investor demand for MLPs had trumped concerns about high expense ratios and inefficient fund-level taxation – investors were clamoring for MLP-heavy portfolios, and were willing to accept a 35% tax on all gains to get it. Launched as a passive ETF, the AMLP – a taxable MLP fund – inevitably ended up in many non-taxable investor accounts (IRA and 401k), burdening those “non-taxable” accounts with an extra layer of corporate taxation.

2010-2014, when midstream investing options were limited, investors accepted AMLP’s high fees and massive tax drag

The AMLP was launched in August 2010, into a bullish market for MLPs, following massive MLP outperformance vs. broad equities before and after the Great Financial Crisis (GFC) of 2007-09. Active MLP funds were sufficiently high-cost that the market was ripe for a lower-cost 85bps “passive” product.

The demand for passive MLP exposure, without K-1s, was sufficiently strong that when the AMLP launched in 2010, it sported a high fee for a passive product (85 bps), and incurred 4% to 9% of annual fees in its first 5 years... but still became one of the fastest growing ETFs in the market, accumulating over \$9bn in assets by 2014, despite **cumulatively lagging its own Alerian MLP Infrastructure Index (AMZIX) by 53%** as of late 2014.



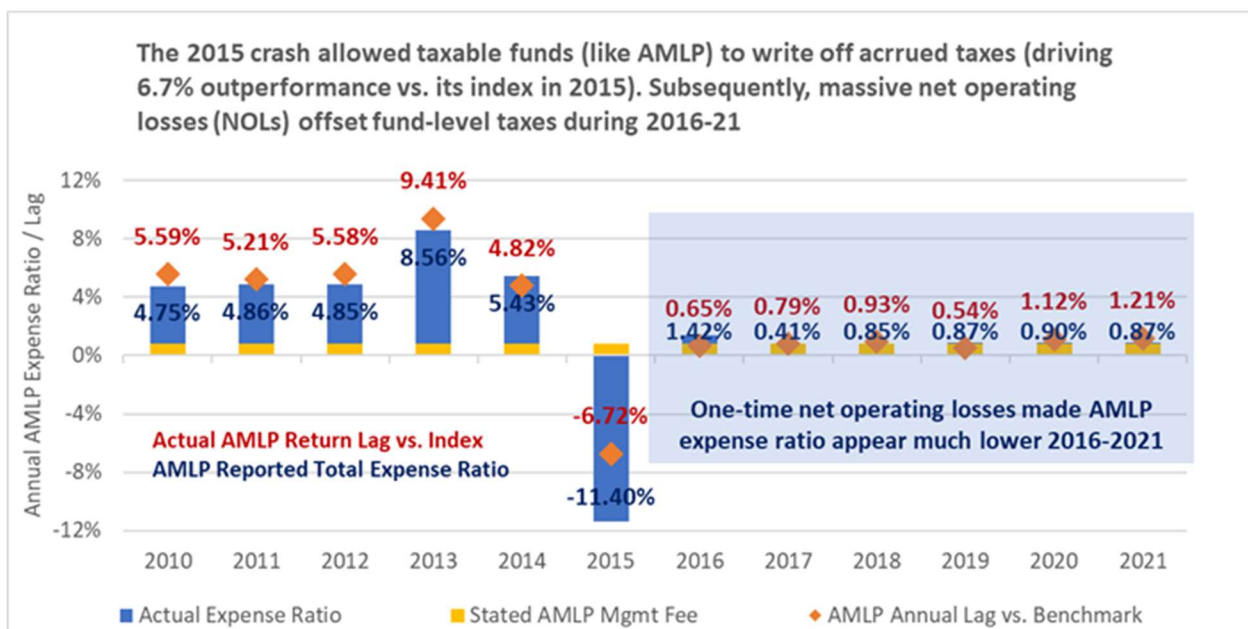
Source: AMLP SEC filings. Note: AMLP is Alerian MLP ETF. AMLP’s benchmark is the Alerian MLP Infrastructure Index (AMZIX). 2010 expense ratio (4.75%) was reduced to reflect Aug 25 (inception) through Dec 31. Actual 2010 expense ratio was 13.56%. For comparison purposes, the AMZ and AMZIX have exhibited substantially similar performance (within 0.5% annually) for the last 5+ years.

This graph reflects historical data, and should not be relied upon as an investment recommendation.

The 2015 crash was a disaster for MLPs, but may have saved high-cost MLP funds and ETFs (like AMLP)

As many investors were becoming increasingly fee- and tax-sensitive in the mid-2010s, something incredible happened. The oil crash of 2014-16 led to a massive decline in MLP valuations. The result was that MLPs - which held the majority of midstream market cap - largely converted to traditional corporate tax structures. Effectively, the 2014-16 crash inadvertently crushed MLPs, but may have saved taxable MLP funds.

How could the crash save MLP funds? After incurring massive tax accruals during 2010-2014, the AMLP was able to write-off much of its accrued tax bill due to massive losses incurred in 2015, leading to AMLP's only year of outperformance vs. its index, ever. With continued pullbacks in 2016-2020, the AMLP was able to generate sufficient net operating losses (NOLs) to offset fund-level taxation for 7 years, keeping expense ratios close to 1%.



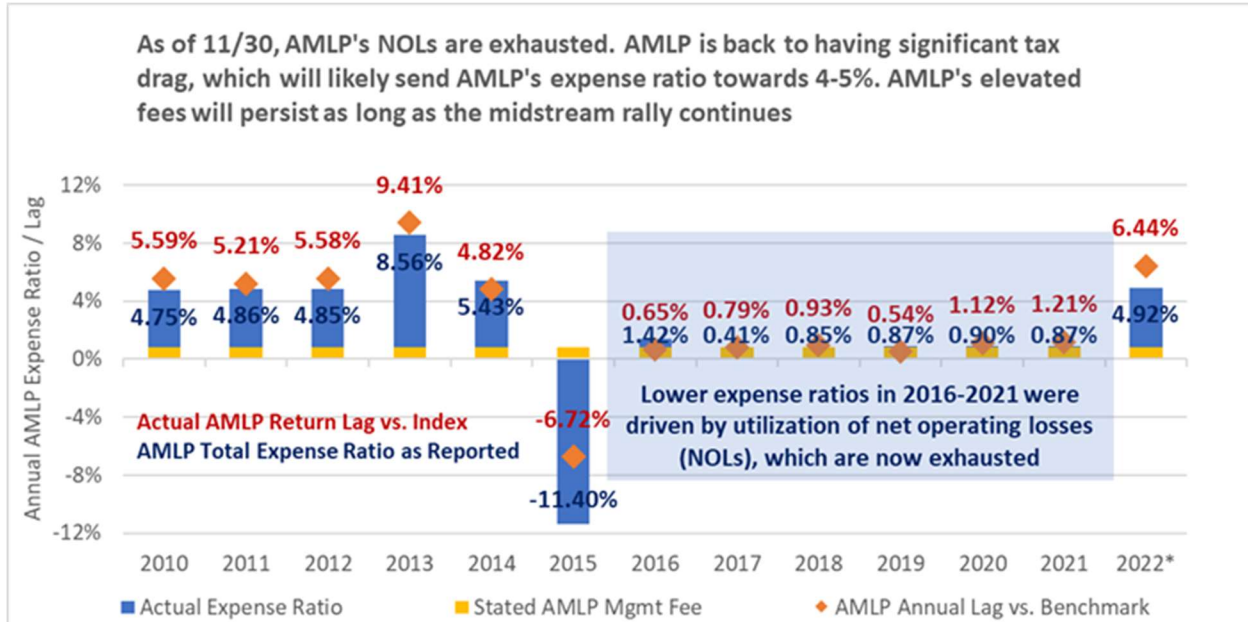
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History tells us that without NOLs, the AMLP can incur expense ratios that are dramatically higher than the average ETF

Last week, AMLP announced that after a 7-year hiatus from paying taxes, its COVID-era NOLs were exhausted. As a result, AMLP recorded a \$260mm tax expense (\$1.56/share). Going forward, if the midstream and MLP markets continue to appreciate future unrealized and realized gains are likely to be taxed at the 21% rate. This means that in addition to fund-level taxation, 20% appreciation would incur over a 4% fund-level expense. This expense must be recorded daily at the fund level, and therefore is unavoidable for investors in the AMLP fund.

There is a lot to like about midstream as a sector, but AMLP's 21% tax drag on all appreciation unnecessarily stacks the deck against midstream investors. As the midstream universe has evolved into a sector that is dominated by corporate, instead of MLP-structured investments, there's no longer a good justification for absorbing a significant tax bill that reflects midstream's MLP-heavy past.



Source: AMLP SEC filings. Note: AMLP is Alerian MLP ETF. AMLP's benchmark is the Alerian MLP Infrastructure Index (AMZIX). 2010 expense ratio (4.75%) was reduced to reflect Aug 25 (inception) through Dec 31. Actual 2010 expense ratio was 13.56%. 2022 estimated expense ratio (4.92%) reflects AMLP's announcement of a \$1.56/share tax expense as of 11/30/22. For comparison purposes, the AMZ and AMZIX have exhibited substantially similar performance (within 0.5% annually) for the last 5+ years.

This graph reflects historical data and an estimate of expense ratio for 2022, and should not be relied upon as an investment recommendation.

Natural Resources

Performance Review

During the month of November 2022, the Recurrent Global Natural Resources Portfolio returned +9.65% net of fees, in line with the S&P Global Natural Resources Index's +9.74% rise. The portfolio's overweight positions in the metals and mining sectors significantly added to performance, while overweight energy positions detracted from relative performance.

Investment Discussion

In recent discussions with clients and prospects, one of the questions we hear most frequently concerns the performance of energy during recessionary periods. Concerns about the performance of energy in recessionary environments is natural; in recessions, the implication is that demand will weaken causing "looser" commodity markets. In recent recessionary periods, commodity prices and the related equities performed poorly.

In our view, recessions impact commodity demand, which, by definition, is only part of the equation. However, to further examine historical recessionary periods, it is also important to incorporate the impact of supply. As a proxy for supply availability, we look at 3-year average CAPEX as an indication of

available supply. At the same time, given the current inflationary environment, it is important to analyze the impacts of recessions in both high and low inflationary periods. The causes and outcomes can differ greatly.

In the broadest sense, recessions have historically been correlated to poor market performance. To assess energy sector performance in market downturns, we look at absolute and relative performance for energy vs. the non-energy S&P 500, and then we use two variables to sharpen the analysis' focus – CAPEX and inflation.

We find that contrary to the (exceptional) case of COVID (a period of extremely low inflation) and 2015 (a period of excessive CAPEX amid a broader market rally), energy and natural resources performance in recessionary markets is actually quite strong, especially on a relative basis. And when CAPEX is low, energy/resources allocations relative performance grows even stronger, with low correlations to the equity markets – a historical pattern that has continued in YTD 2022.

	All Years	When Capex Low	When CPI High	When Capex Low + CPI High	When Market Down	Capex Low + CPI High + Market Down
Total Periods 1971-2022	51	35	34	25	18	12
Energy > S&P ex-Energy	30	23	27	21	16	12
% of yrs - energy up vs. S&P xEn	59%	66%	79%	84%	89%	100%
Energy up on absolute basis	35	24	25	19	9	7
% yrs - energy positive return	69%	69%	74%	76%	50%	58%
Shown below in...	Exhibit 1	Exhibit 2			Exhibit 3	

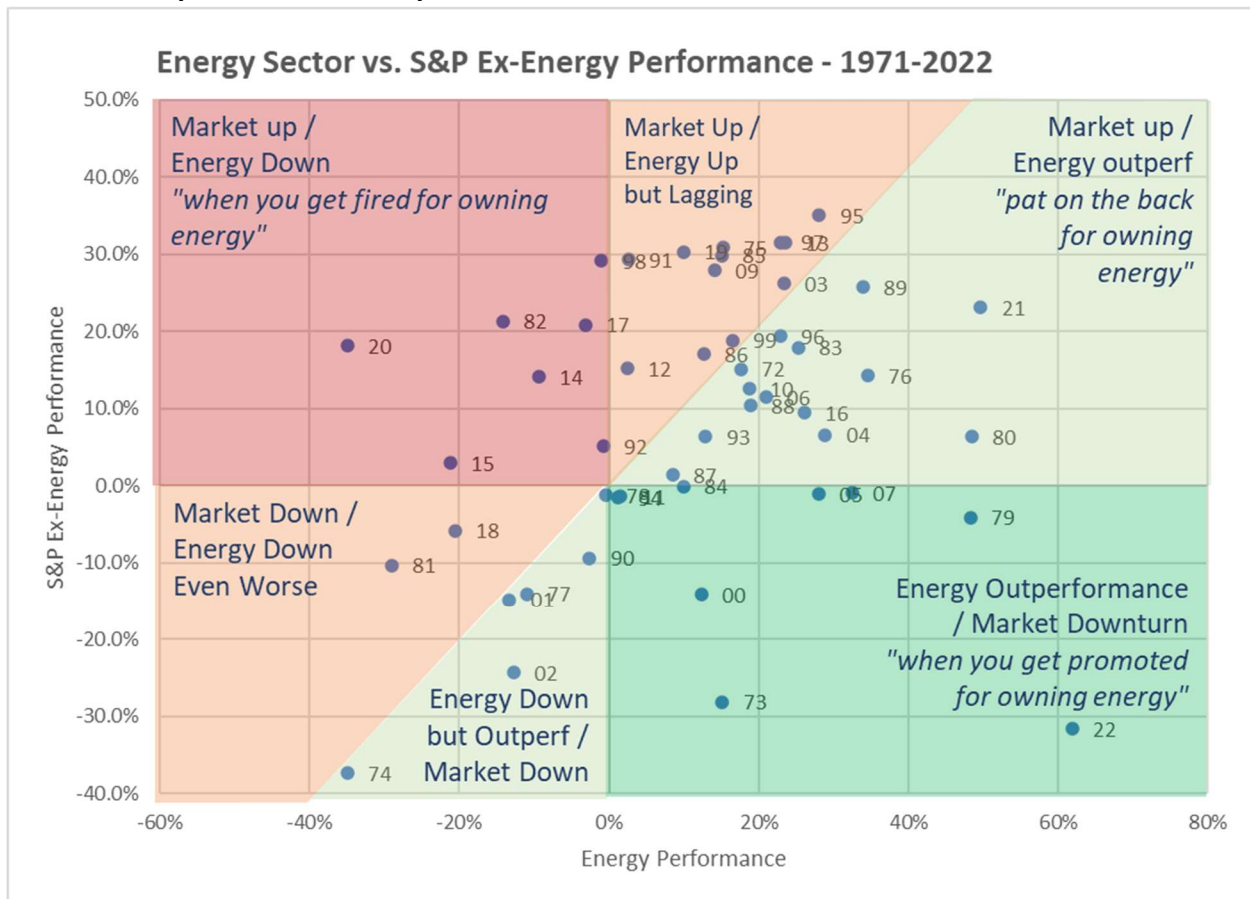
Source: Recurrent research, Bloomberg

All periods (1971-2022)

When looking at all periods, energy generally performs well, both in absolute and relative terms, compared to the broad market. Below, the red/orange shaded area reflects relative underperformance for energy. The green shaded areas reflect relative outperformance. As reflected in the table above, in the last 51 years, energy has provided relative performance 30 times vs. the S&P 500 ex-Energy, and absolute positive returns 35 times.

Despite energy offering relative strong performance more than half of the time, recency bias tends to drive the belief that energy is “riskier in a recession.” This reflects the fact that the most painful times to hold energy – when energy fell vs. in a rising market (darker red, top left) – are heavily concentrated in the recent past – 2014, 2015, 2017, and 2020.

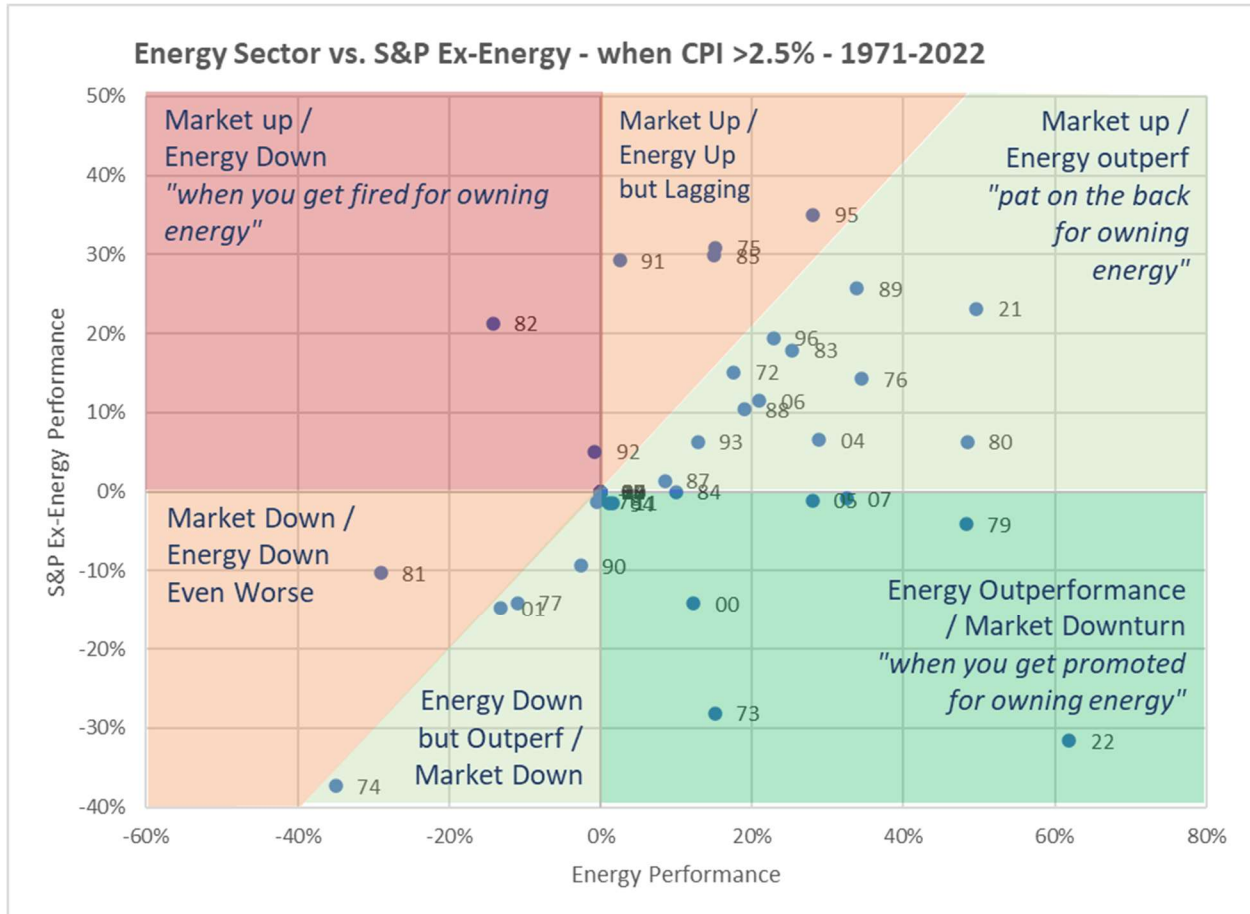
Exhibit 1: All periods, all CPI/capex levels



Inflationary Markets (>2.5% CPI)

In periods of high inflation, energy performs well in a higher percentage of years, with a much stronger positive skew. As shown in the table above, relative and absolute energy performance is positive 79% and 73%, respectively. Higher than average inflation clearly reduces negative outcomes, both on an absolute and relative basis, when compared to the broader market.

Exhibit 2: All periods when CPI>2.5%

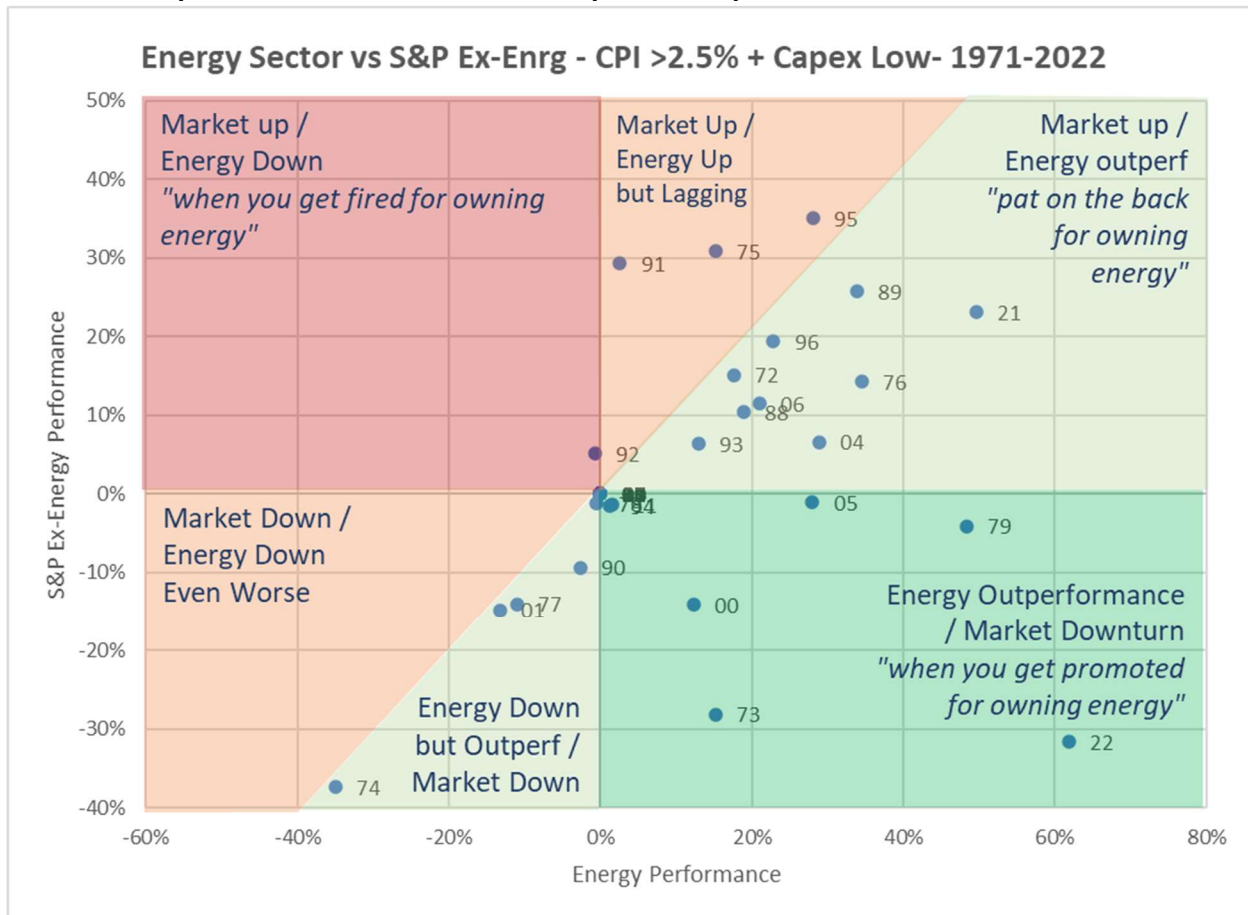


Source: Recurrent research, Bloomberg

Performance in times when CPI >2.5% and CAPEX is Low

As a final “screen”, we have included only periods when inflation is above average and CAPEX is below the 70th percentile. This further improves the positive skew to historical performance outcomes. These screens leave us **with no single period where energy underperformed in a down market**. Energy’s worst year came in 1974, when it barely outperformed in a falling broad market – but 1974 was embedded inside of a massive (500%+) period of energy outperformance that lasted from 1971-80.

Exhibit 3: All periods when CPI >2.5% and Capex is 70th percentile or lower



Source: Recurrent research, Bloomberg

In sum, the specific question of “what happens to energy in a recessionary environment?” is difficult to assess, in part because the difference in timing between market performance and economic data, and investors’ over-reliance on recently-experienced performance instead of longer-term history. Instead, the variables of high inflation and low CAPEX - both present today – prove to be much more predictive for strong absolute and relative performance.

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