Midstream: In 2020, we wrote that midstream was well-positioned to become the "next tobacco," by shifting away from growth and focusing on free cash flow (FCF) generation. Other investors argued Shale E&Ps are a superior "tobacco-style" investment, and a superior inflation hedge. In inflation's early stages, it is true that Shale is highly exposed to improving commodity prices. But as commodity prices level off after an initial surge, operating costs and CAPEX increase, and E&P cash flows decline, while midstream is uniquely positioned: midstream capex is expected to be 40% lower than 2019 levels; Shale E&P capex is expected to be 12% higher than 2019 levels, despite lower production growth. This shifts FCF rate of change strongly in favor of midstream in coming years.

Natural Resources: As the Chinese economy re-opens after COVID, many natural resources investors closely watch Chinese economic data for signs of increased commodity demand. In our April 2019 monthly commentary, we noted that the relationship between Chinese GDP and the Goldman Sachs Commodity Index was strong between 1999-2008. However, since 2008 the relationship has significantly weakened, and since COVID, the relationship may have weakened further, as underinvestment and emerging secular trends such as decarbonization and electrification create new (non-China) sources of demand.

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

## MLP & Infrastructure

### Performance review

During the month of February 2023, the Recurrent MLP & Infrastructure Strategy generated net returns of -3.42%, lagging the Alerian MLP Index's (AMZ) -1.19% return by -2.23%. Since the strategy's July 2017 inception, Recurrent's MLP & Infrastructure Strategy has outperformed the AMZ by +3.68% (annualized, net of fees). Please see the performance section at bottom for more detail.

### In the dark days of 2020, battered energy investors hoped that one day, energy companies could be as well-loved as tobacco

As energy stocks cratered in early 2020, following years of high spending and poor returns on capital, a well-known CNBC personality declared that energy was like tobacco – deeply out of favor with investors, disdained by society, and, worst of all, "uninvestible."

From these harsh words, certain energy investors (like ourselves) actually drew hope: if we looked at tobacco's darkest hour, the 1999 DOJ lawsuit that rendered tobacco companies "uninvestible," the reality was that the tobacco sector subsequently outperformed the S&P 500 by a cumulative ~900% in the 17 years that followed. Tobacco companies were saved as the government removed the ability to grow (and by declining societal acceptance), and instead focused on generating massive FCF and returning it to shareholders via buybacks and dividends.

### Emerging from the COVID downturn, energy investors debated which energy subsector was to become the "next tobacco"?

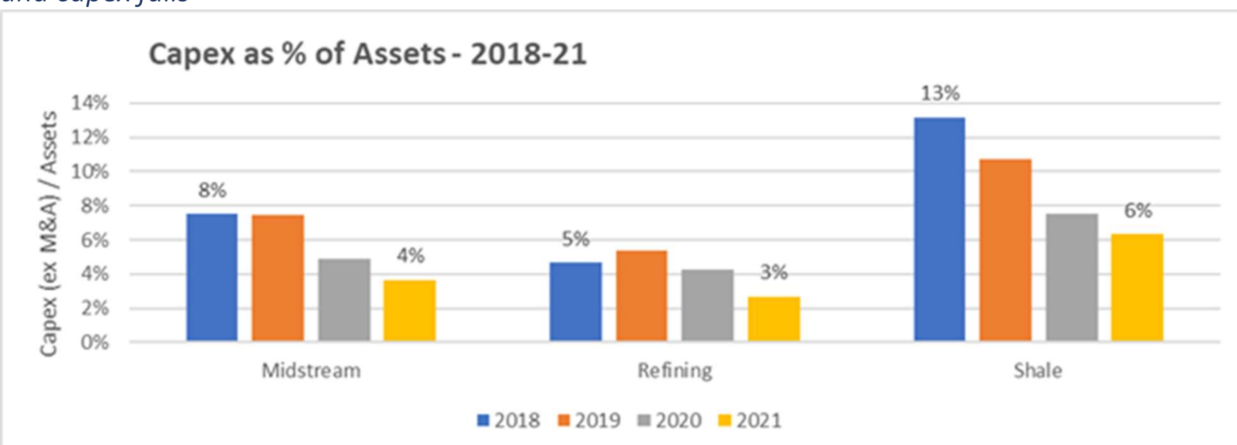
With tobacco's 20-year FCF-driven comeback as a model for midstream, we argued that midstream –

with its generally stable and long-life asset bases, low reinvestment requirements, and ability to pass through costs – was an excellent analog for the tobacco industry.

Some investors disagreed with our white paper, arguing that Shale E&Ps were a better analog for tobacco, as Shale FCF yields were surging by late 2020 thanks to falling capex while revenues surged on rising commodity prices. And sure enough, in the early stage of our current inflationary experience, Shale E&Ps saw capital intensity fall, as seen in exhibit 1 below.

In 2020-21, the entire energy industry made incredible progress in cost reduction, and Shale cost cuts appeared to be among the deepest (although much of the capex "discipline" was disguised by extensive acquisition activity by Shale companies during 2020-21). However, as commodity "price takers," energy companies are only as good as their **full-cycle** cost discipline. And based on 2022 actual results (and 2023 guidance), this next stage of the cycle is where Midstream is poised to shine and Shale appears poised to stumble.

*Exhibit 1: "early stage" inflation benefits short-cycle assets (like Shale) as commodity prices surge and capex falls*




*Notes: Midstream Universe includes KMI, TRP, ENB, WMB, PBA, EPD, LNG, CQP, TRGP, OKE, PAA, ENLC, KEY CN, WES, CEQP, DCP, GEL, ETRN, MMP, NS, ET, MPLX, GLP, HEP, USAC, SUN, VPK NA, GEI CN, MUSA. Refining includes VLO, MPC, PSX. Shale includes PXD, DVN, EOG, FANG, COP, EQT, AR, OVV, CTRA, OXY. Capex totals exclude M&A.*
*Sources: Recurrent research, public filings, Bloomberg consensus estimates.*

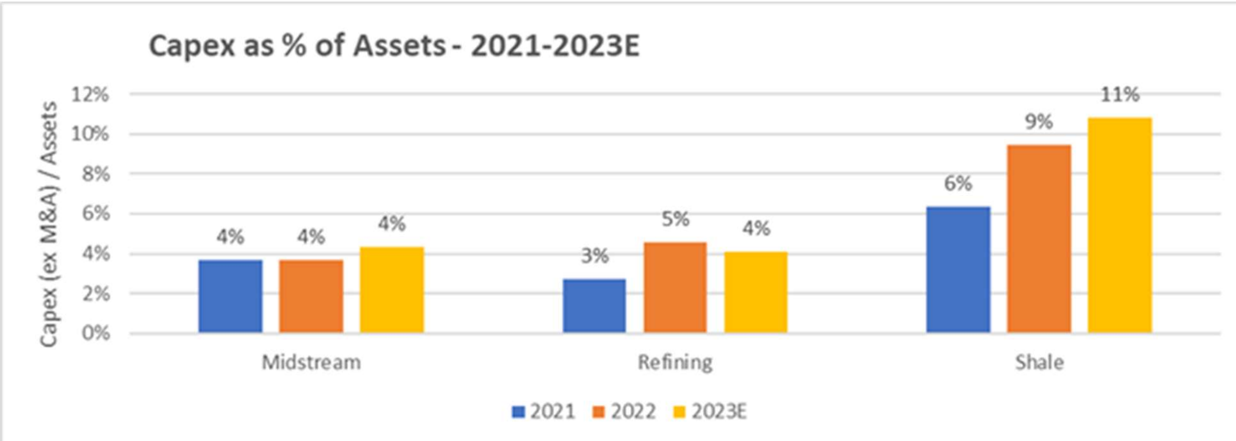
## To be like tobacco, energy companies must generate FCF through the cycle – but not all energy companies can do it

As mentioned above, Shale's high capital-intensity and short-lifespan is an asset in the early stage "commodity surge" – but in a time of persistent inflation, it quickly becomes a liability.

Since Shale assets deplete rapidly, they must be replaced constantly. In the second stage of the inflation cycle, as the commodity surge fades and cost pressures become more persistent, assets with shorter lifespans are most exposed to inflationary pressures – and Shale's lifespan is dramatically shorter than that of Midstream or Downstream assets.

"Management discipline" – a pillar of the pro-Shale argument – does not appear to have an effect in preventing Shale capex inflation. At current capex levels, Shale companies are expected to generate negligible oil production growth in 2023. And yet, this "maintenance" capex is +80% higher vs. 2021 levels in dollar terms, and +70% higher as a % of book assets (which have grown for the Shale industry since 2021).

*Exhibit 2: as inflation persists, the cost of maintaining short-cycle assets rises much faster than for long-cycle assets*




*Notes: Midstream Universe includes KMI, TRP, ENB, WMB, PBA, EPD, LNG, CQP, TRGP, OKE, PAA, ENLC, KEY CN, WES, CEQP, DCP, GEL, ETRN, MMP, NS, ET, MPLX, GLP, HEP, USAC, SUN, VPK NA, GEI CN, MUSA. Refining includes VLO, MPC, PSX. Shale includes PXD, DVN, EOG, FANG, COP, EQT, AR, OVV, CTRA, OXY. Capex totals exclude M&A.*
*Sources: Recurrent research, public filings, Bloomberg consensus estimates.*

### In 2 years, CPI has risen +15%, midstream capex is +18%, and Shale capex is +70%... how "inflation hedged" is Shale?

In our early 2022 white paper, we noted that Shale's short-cycle time was likely to attract more capital investment to Shale development, even as Shale breakeven costs increased. The reality is that as ESG has driven up the cost of capital for energy, 30-year greenfield offshore oil developments cannot deliver a quick enough payback for today's skittish energy capital.

However, even higher-cost Shale can deliver high IRRs and a tidy exit for investors within 3-5 years, assuming commodity prices cooperate. So even as Shale cost structures inflate, we expect capital will continue to flow into "short-cycle" Shale projects, likely further benefitting Midstream FCF while maintaining capex cost pressures in the Shale space.

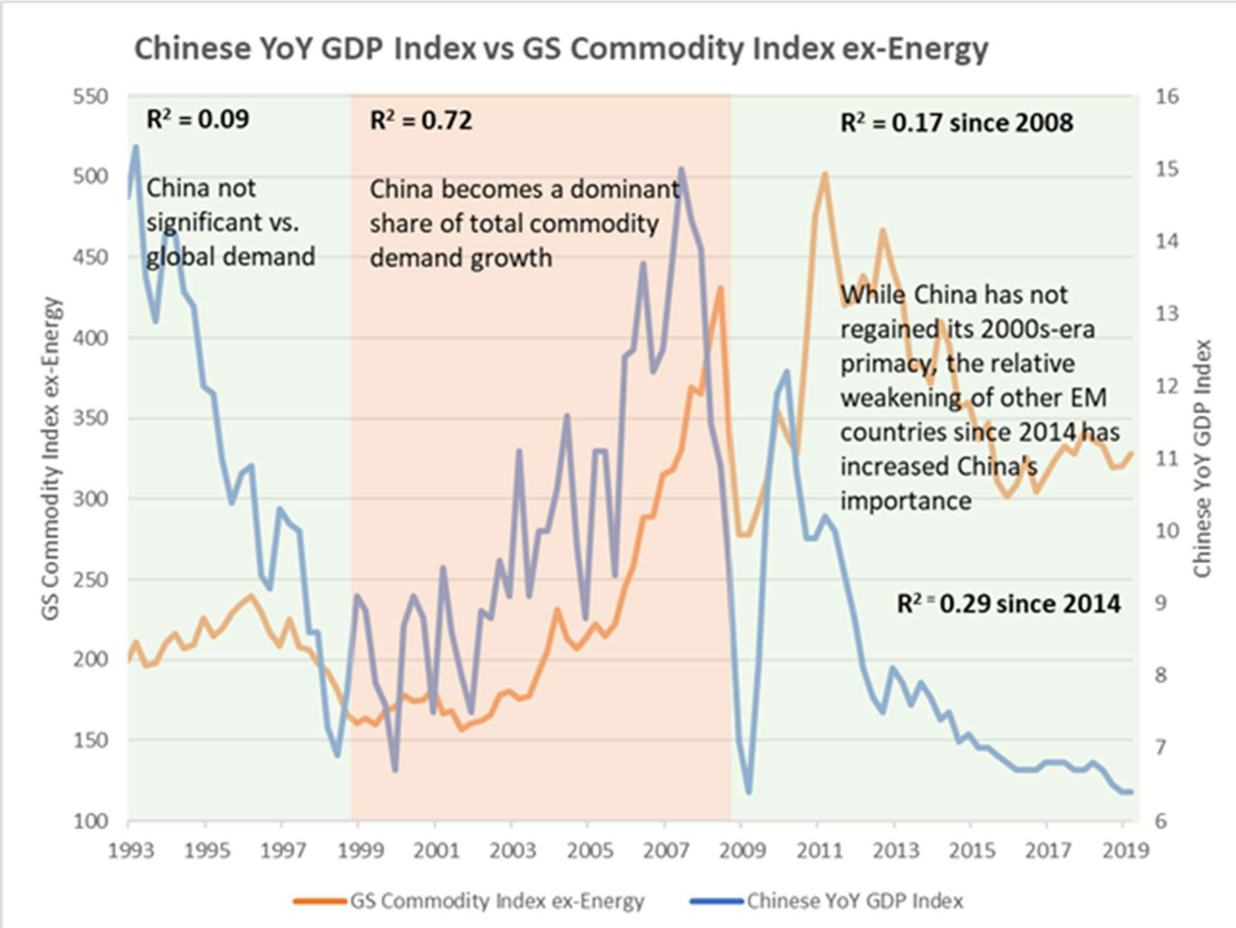
## Natural Resources

### Performance Review

During the month of February 2023, the Alma Recurrent Global Natural Resources Fund fell -6.24% net of fees, more than the S&P Global Natural Resources Index's -5.52% decline. Since the Strategy's June 2018 inception, the Fund has outperformed the benchmark by 3.22% (annualized, net of fees).

### Investment Discussion

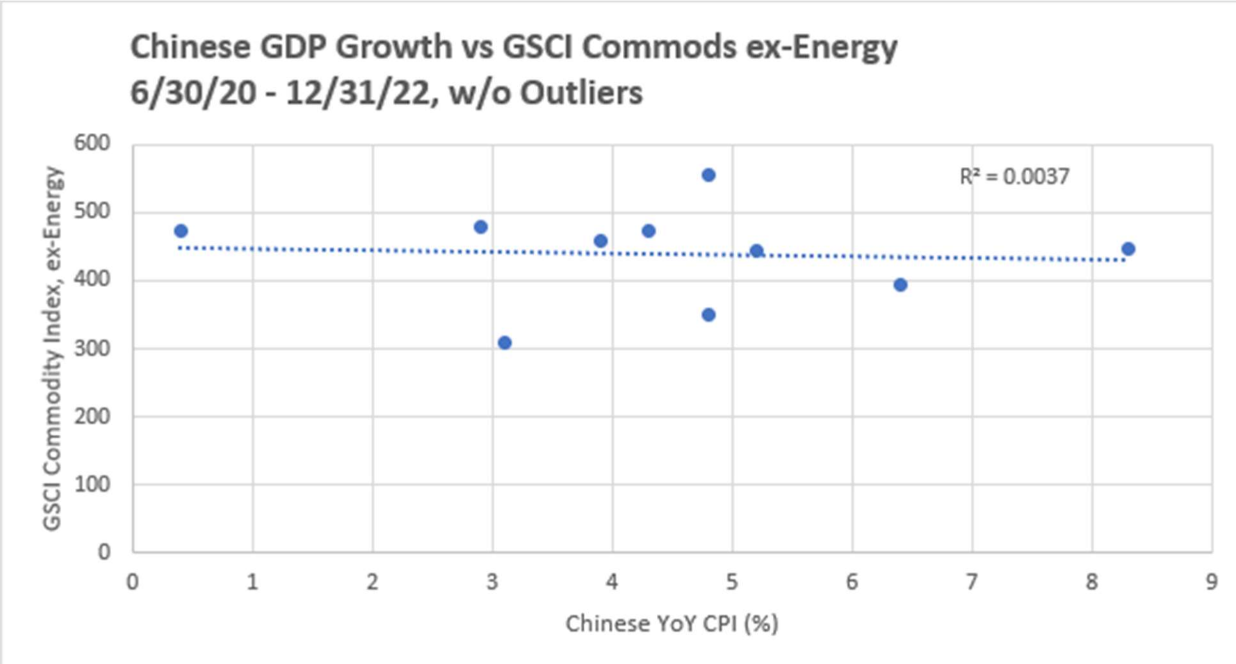
In our April 2019 monthly commentary, we looked at the correlations between Chinese GDP and the Goldman Sachs Commodity Index (GSCI), ex-Energy. During the Chinese hyper-growth era from 1999-2008, the correlation between Chinese GDP and commodity prices was very high, with an $R^2$ of 0.72. However, in the periods both before and after the 1999-2008 period, the relationship between Chinese GDP and the GSCI ex-Energy Index was much weaker, R2 of 0.09 and 0.17, respectively, as seen in the chart below.




*Source: Bloomberg, Recurrent Research*

Today, the Chinese economy has shown early stages of recovery, as China reopens in the aftermath of COVID. While growth in a large economy such as China is undoubtedly positive for the outlook for commodities, the question of the direct relationship between Chinese GDP and commodities ex-Energy is less certain, especially in light of continued underinvestment along with the emergence of secular commodity demand drivers, such as electrification and decarbonization.

The data set since COVID is relatively immature, with only 11 quarterly measurements. Early results, however, do not exhibit a high correlation between Chinese GDP and the GSCI ex-Energy Index. In fact, the correlation since COVID approximates zero, showing no predictive value.




*Source: Bloomberg, Recurrent Investment Advisors*

With regard to the investment attributes for natural resources, much of the financial commentary has recently revolved around the Chinese economy opening. While qualitatively, the idea that a re-opened Chinese economy would correlate well to commodity prices, since COVID, the relationship has not proven to be predictive.

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