DAC Insights:
Midstream Energy, MLPs & Opportunities

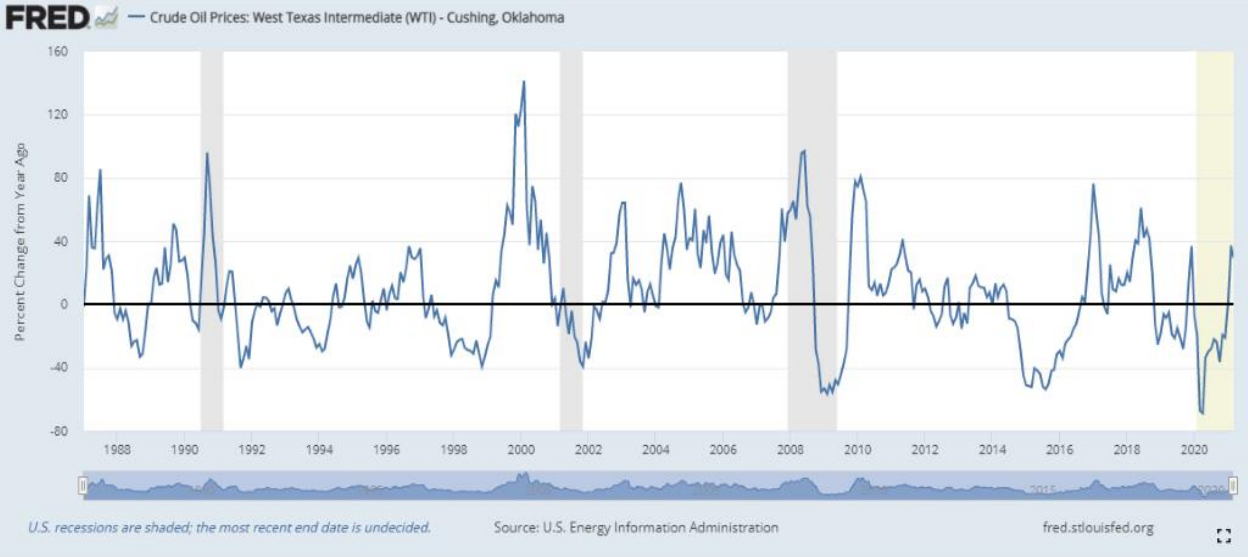
DIVIDEND ASSETS CAPITAL, LLC
INVESTMENT ADVISORS

DIVIDEND ASSETS CAPITAL – INVESTMENT STRATEGIES FOR RISING INCOME & GROWTH

Energy bulls are driving the market higher, OPEC+ shocked many by extending existing supply cuts through April and escalating vaccinations are advancing us to more robust economic activity and energy demand. Could we see $100 per barrel oil? It is possible, but not certain.

As we progress further into 2021, we wanted to share a few highlights to reinforce our bullish outlook on energy and midstream investments.

- **Economic growth will likely continue to fuel demand increases**: EIA estimated that the daily global consumption of petroleum and liquid fuels in February was down 1.64% from February 2020. That decline represents the smallest YOY drop since the COVID-19 pandemic began. They forecast that the YOY average daily global consumption will increase 5.75% in 2021.
- **Oil prices are a relevant indicator**: Since 1987, West Texas Intermediate ("WTI") crude oil has gone positive YOY about 10 months after its worst recession-driven comp. That means WTI should have progressed north of $50 in February, as it did ($61.50/bbl a/o 2/26/21). As the chart below demonstrates, oil prices recover when the global economy recovers, and that is the early-stage trend we are in currently. Prices could run up quite a bit more from here, before threatening economic growth. History indicates that >80% price increase in a year is a warning sign. Currently, that would be about $72.00/bbl which is a threshold DAC is keeping an eye on.



- **Valuations**: early in 2020, we saw the valuations of many midstream energy companies and MLPs sink to record lows. Subsequently, we have seen significant price appreciation (momentum) in these securities. However, they remain significantly undervalued by almost any measure. P/B, EV/EBITDA, P/DCF are all still at record lows and the spread to Treasury Yield remains at an all-time high. Morningstar recently reported that "Energy Remains the Most Undervalued Sector".
- **Scarcity value**: while pipeline operators prefer higher oil prices, 2020's low price environment may actually help boost the value of existing infrastructure. Throughout last year, depressed oil demand and prices led energy companies across the board to hold back on new investments/projects. According to the American Petroleum Institutes, in Q3 2020, capital expenditures were less than half the lowest level recorded in the economic crisis in 2009. Simply put, without any new infrastructure competition coming online soon, the existing assets have become ever more valuable.

- **Institutional buyers seem to be coming back**:
  - In November 2020, Berkshire Hathaway's energy subsidiary closed a nearly $10 billion deal to acquire energy assets from Dominion Energy, gaining ownership of 7,700 miles of natural gas pipelines and vast storage facilities.
  - S&P Global reported that during Q4'20 there was a net 10%+ increase in ownership among the top 5 select midstream companies traded by institutional buyers and sellers versus a net decrease of 2.8% in Q3'20. Further, the net change in institutional share ownership among their top 10 select midstream companies increased by about 117 million shares from Q3'20 to Q4'20.
  - Fund flows into MLPX (the Global X midstream MLP ETF) turned positive and have remained positive since 10/16/2020. Subsequently, flows into AMLP (the Alerian midstream MLP ETF) turned positive and have remained positive since 11/06/2020.
- **Active management** (data below a/o 12/31/20):
  - 100% of the positions in DAC's North American Midstream Energy (NAME) strategy maintained or increased their distributions YOY in 2020 vs. 48% in the Alerian MLP Index (AMZ).
  - 67% of NAME held Investment-Grade securities vs. 33% in AMZ.
  - We have increased exposure to companies that are diversifying their revenue sources through renewable energy related activities which has helped to enhance recent results.
- **High income**: midstream energy companies and MLPs continue to have the highest Yields among most asset classes (TTM Yields a/o 12/31/20: Midstream Energy… 7.9%; HY Bonds… 4.2%; REITS… 3.6%). The enhancement to portfolio income they produce is hard to replace with more traditional, liquid, investment solutions.
- **Stay invested**: Just a fraction of individual days typically makes up a year's annual return in volatile markets. We can look at AMZ performance in 2009 as an example. When the AMZ rallied 61.9%, after a major sell off in 2008, only 70 (27%) of the trading days accounted for that performance, spread throughout the year. To fully realize the gains of that year, an investor had to own the AMZ on those days. Without the luck or skill to identify those days ahead of time, their best course of action would have been to invest in the index for the entire period.
  - For existing investors… now is not the time to cash out but be patient for a potentially strong 2021.
  - For new investors seeking alternative sources of portfolio income… now may be one of the best times in a long time to incorporate midstream energy companies and MLPs into an investment portfolio to enhance income needs.

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Clarity: A transparent and understandable approach to portfolio management.	**Simplicity**: Dividends are the best indicator of the future price performance of a stock.	**Devotion**: We build confidence through a disciplined process and strong devotion to our investment philosophy and clients.

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