



VettaFi's Morris: For Investors Playing Defense, Midstream Companies Make Sense

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Chuck Jaffe, in this episode of The NAVigator podcast interviewed Stacey Morris, head of energy research at VettaFi, part of the team involved in the Alerian Energy Infrastructure Index suite. Read the Q&A below as Stacey says that energy markets are likely to remain tight and keep dealing with inflation in 2023, both of which can be tailwinds to energy companies, and especially midstream companies, but she notes that the midstream/pipeline companies have cash-



flow stability that makes them the more-defensive options in the energy space and particularly attractive in a recessionary environment.

Stacey Morris

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CHUCK JAFFE: Stacey Morris, head of energy research at VettaFi is here, we're talking midstream energy infrastructure investing now on The NAVigator. This is The NAVigator, where we talk about all-weather active investing and plotting a course to financial success with the help of closed-end funds. The NAVigator is brought to you by the Active Investment Company Alliance, a unique industry organization that represents all facets of the closed-end fund industry from users and investors to fund sponsors and fund creators. If you're looking for excellence beyond indexing, The NAVigator's going to point you in the right direction. And today we're heading in the direction of energy. We're talking with Stacey Morris, the head of energy research at VettaFi, where she's part of the team involved in the Alerian

Energy Infrastructure Index suite. You can learn more about all of that at VettaFi.com. You can also learn more about business-development companies, interval funds, and closed-end funds at AICAlliance.org, the website for the Active Investment Company Alliance. Stacey Morris, welcome to The NAVigator.

STACEY MORRIS: Thanks Chuck, it's so great to be with you today.

CHUCK JAFFE: Let's start with a basic introduction. I know that there are plenty of people out there who understand what midstream energy infrastructure is, but a quick reminder. More importantly, give that reminder with why this is a specific space that's distinctive from the rest of the energy market and something that investors want to look at?

STACEY MORRIS: So when we talk about midstream energy infrastructure, we're talking about the companies that really perform the shipping and handling function of the energy value chain. What's unique about midstream relative to the rest of the energy space is that these companies are earning fees and they generate very stable cash flows, and they use the stable cash flows to pay out attractive dividends. So typically this space includes those MLPs, master limited partnerships and C-corps. So most people associate this space with pipelines, but these companies also store and process hydrocarbons and really just connect supply with demand, so this is a very unique portion of the energy space because it's less sensitive to what's happening with commodity prices. And so again, that cashflow stability, the fact that these are fee-based businesses, that tends to result in more defensive energy exposure compared to other energy sectors like exploration and production companies that are fully dependent on the price of oil and natural gas.

CHUCK JAFFE: In other words, these are the toll takers, that's why it's consistent. How have these kinds of companies performed relative to energy during a time when energy has been the only really good sector out there for most of this year?

STACEY MORRIS: They've done well. If you look at MLPs this year through December 14th, they're up over 20%. If you look at broader midstream, it's up about 15%. So not as strong as those energy companies that are more exposed to the commodity price and that people may kind of default to when they see a strong energy tape, but still a very good year especially when considering what the rest of the market looks like.

CHUCK JAFFE: In terms of accessing the MLP space, this is a case where structure sometimes matters. So are investors going to be better off looking for exchange-traded funds, exchange-

traded notes, closed-end funds? Are you perhaps a little bit more agnostic to structure? What's the benefit of holding them in different types of formats?

STACEY MORRIS: Sure. You're exactly right, structure does matter here. And obviously a lot of this depends on what the end investor is looking for. You can obviously buy MLPs directly for example, but then you get a K-1, and a lot of people don't want to have to deal with a K-1, some people don't mind. But one of the advantages of accessing this space through a product like an exchange-traded fund, like a closed-end fund, like an exchange-traded note, is that you get diversified exposure to this space in this form 1099 instead of having to deal with the K-1. So diversification and the avoidance of the K-1 are really key benefits to accessing this space through a product, and then when you know that you want to access through a product there are other nuances that you need to keep in mind for your situation. Of course, some closed-end funds in the space will use leverage, they may have a higher yield, that may be desirable. But then you're also looking at how those are trading relative to NAV, premiums, discounts, et cetera. From an ETF perspective, MLP-focused ETFs often replicate the tax advantages of MLPs, namely potential for tax-deferred income, so that's something that can be desirable for investors. And then from an ETN perspective, those are typically going to make more sense in a tax-advantaged account because as notes, coupons would be taxed as ordinary income, and so you would rather have that in something that's tax advantaged for tax exempt. So there's a lot of nuances and things to think about, but the big story is diversification and avoidance of a K-1 would be key reasons for accessing this space through products.

CHUCK JAFFE: In terms of the last two years, like I said, energy has been great. It's been pretty much the only safe haven for a lot of the market in 2022. What's your outlook for the sector and for the midstream companies?

STACEY MORRIS: So if we look to 2023, I think this space can continue to do well. Energy broadly and midstream companies are really focused on generating free cash flow, and they're returning that excess cash flow to investors through both dividend increases and buy-backs. From a backrow perspective, I think energy can continue to work. I think energy markets are probably going to remain tight next year, and that can be supportive for sentiment for energy companies broadly including midstream. And I think we're still going to be dealing with inflation next year, and inflation can actually be a tailwind for the energy

space as opposed to headaches for some other sectors. And from a valuation perspective, I think this space is by no means expensive, we still see valuations in the midstream space at a discount to historical averages based on forward EV to EBITDA. So I think there's a lot of reasons to be constructive on this space, and I think the risk for energy broadly is a recession, and potentially how deep the recession is and the impact on oil demand. But overall I think it can be another strong year for this space.

CHUCK JAFFE: Given the worry that you have about recession and its possible impact on energy, for those folks who have some energy exposure but maybe don't have the midstream exposure, or vice versa for that matter. If somebody's already been in love with midstream companies and has liked the toll takers but not necessarily the big energy stocks, et cetera, how much diversification benefit is there? Are they going to move so much in sync that you don't care, energy's energy? Or does midstream have enough difference to it that you want to make sure if you don't have exposure to it that you use it as a bit of that recession protection?

STACEY MORRIS: If we see a recession you would expect midstream to hold up better than other sectors of energy because of its defensive qualities, because of the attractive income that these companies are providing. MLPs today are yielding around 7.6% based on the underlying index for the Alerian MLP ETF, ticker AMLP. And if we look at midstream more broadly represented by the Alerian Midstream Energy Flex Index, ticker AMEI, that's the underlying index for the Alerian Energy Infrastructure ETF, that's yielding just over 6%. So the income here is still very attractive, and when you see a down move, having that income can be particularly helpful from a total return perspective. But to your point, if people have energy exposure and they're maybe looking to take some money off the table, shifting toward midstream could be a good option if they are worried about a recession. On the other hand, if people are really bullish on commodities and the energy space, then they may want to look at something that is a little riskier than the midstream space, so maybe they're looking at broad energy allocation or focusing more on exploration and production companies, those companies that actually produce oil and natural gas.

CHUCK JAFFE: Stacey, this has been really interesting. Thanks so much for taking the time to join me on The NAVigator.

STACEY MORRIS: Thanks so much, Chuck. I appreciate it.

CHUCK JAFFE: The NAVigator is a joint production of the Active Investment Company Alliance and Money Life with Chuck Jaffee. And yes, that's me, and you can learn all about my show at MoneyLifeShow.com or any place where you find good podcasts. To learn more about interval funds, closed-end funds, and business-development companies go to AICAlliance.org, the website for the Active Investment Company Alliance. On Facebook and LinkedIn @AICAlliance. Thanks to my guest Stacey Morris, head of energy research at VettaFi, where she's part of the team involved in the Alerian Energy Infrastructure Index suite. You can learn more about all of that at VettaFi.com and on Twitter @Vetta_Fi. The NAVigator podcast is new every Friday, ensure you don't miss an episode by going to where you get all those great podcasts and following us there. We'll see you again next week, and until then, happy investing everybody.

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