# Midstream/MLPs: Cutting Through the Noise

July 20, 2021
Author: Mauricio Samaniego

## Summary

- Fee-based businesses and contract protections equip the midstream space to better withstand commodity price volatility relative to its energy peers while delivering attractive income and greater cash flow stability.
- Resilient natural gas prices and steady demand benefit midstream and help alleviate effects from the uncertainty permeating the oil market.
- Oil and natural gas production forecasts were revised higher for 2021 and 2022, with both crude oil and natural gas production expected to grow in 2022, which fares well for midstream' s volume driven, fee-based business model.

Following nine consecutive months of positive equity performance[1], midstream stocks experienced some turbulence last week, finishing lower as short-term selling pressures shook oil prices and broader equity markets over concerns surrounding the COVID-19 variant and its effect on the economic recovery and oil demand. With the news headlines and short-term price movements likely raising some level of concern for midstream investors, this piece takes a deeper look to decipher the noise and highlight midstream' s unique ability to endure commodity price headwinds.

## Midstream has the upper hand relative to energy peers.

After posting highs not seen since 2018 during the first half of June, oil prices trended lower last week amidst dampening optimism, extending their selloff on Monday as concerns over demand disruptions were met with shifting supply dynamics following OPEC's announcement it had reached a formal agreement to gradually raise production—aiming to unwind production curbs by September 2022. While uncertainties over renewed lockdowns and its effect on oil demand are still premature—and have not led to downward revisions in economic growth forecasts—midstream stands out amongst the energy space for its fee-based business model and contract protections that support cash flow stability and help insulate the space from a volatile crude oil environment. From a quantitative standpoint, although cross-asset correlations and correlations with WTI prices tend to increase during drastic price declines, the historical correlation between midstream MLPs and WTI crude has been the lowest relative to broader energy represented by the Energy Select Sector Index (IXE) and the energy subsectors shown below.

**Correlations to WTI Crude Among Energy**

| Index | Ticker | Description | 3-year | 5-year |
|---|---|---|---|---|
| Alerian MLP Infrastructure Index | AMZI | Midstream MLPs | 0.477 | 0.464 |
| Alerian Midstream Energy Select Index | AMEI | Midstream | 0.540 | 0.532 |
| S&P Oil and Gas Exploration & Production Select Industry Index | SPSIOP | Exploration & Production | 0.408 | 0.419 |
| Energy Select Sector Index | IXE | Broad Energy | 0.523 | 0.528 |
| PHLX Oil Service Sector Index | OSX | Oilfield Services | 0.624 | 0.618 |

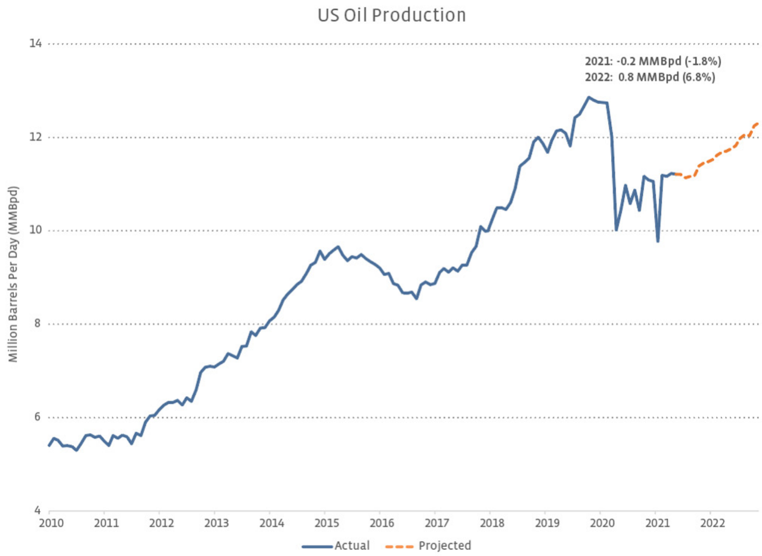
Correlations are based on monthly data
Source: Bloomber as of 7/19/2021

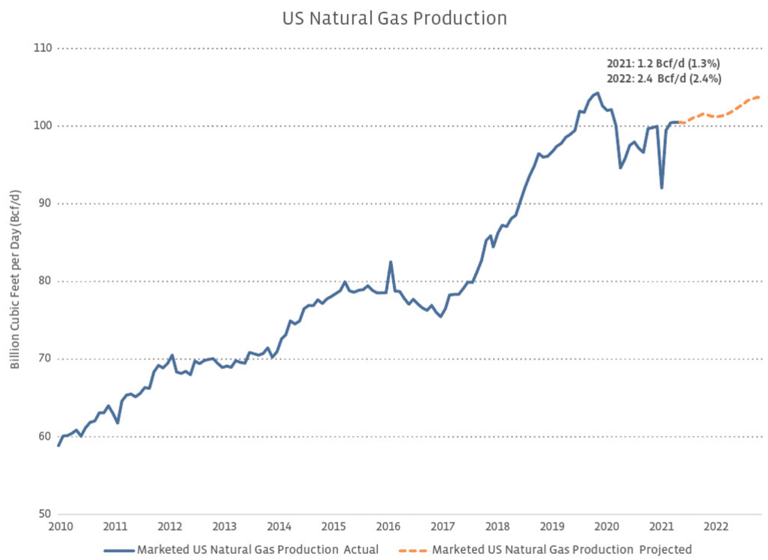
1. Represents monthly performance for the AMZI and AMEI on a total return basis.

## Resilient natural gas prices and higher production fare well for midstream

Despite volatility inflicted upon the crude oil market, the midstream space continues to benefit from resilient natural gas demand as the summer heat wave, rising liquified natural gas (LNG) exports, and tighter supply have kept natural gas prices hovering around a two-and-half-year high. As of the end of June, the weighted exposure to natural gas gathering, processing, transportation, or liquefaction for the Alerian MLP Infrastructure Index (AMZI) and the Alerian Midstream Energy Select Index (AMEI) stood at 61% and 65%, respectively.

Admittedly, midstream stock prices are not fully immune from the implications of the decline in commodity prices, particularly from a sentiment standpoint, but they do benefit from steady production growth given the volume driven, fee-based nature of the business. As production picks up across the globe following OPEC+'s announcement, expectations that US shale producers will gradually raise production are also intact—with production estimates being revised higher this month as the effects of the reopening economy continue to show up in the data. In its July Short-Term Energy Outlook, the US Energy information Administration (EIA) raised its forecasts for both US crude and natural gas production. For 2021, the updated projections incorporate upward revisions of 0.02 million barrels per day (MMBpd) for crude and 0.37 billion cubic feet per day (Bcf/d) for natural gas, while projections for 2022 were raised by 0.06 (MMBpd) for crude and 0.76 (Bcf/d) for natural gas.




Source: US Energy Information Administration as of 07/19/2021

## Bottom Line:

While longer term implications to global oil demand and a potential derailment of the economic recovery would fare negatively for midstream and energy broadly, fee-based business and contract protections equip the midstream space to better withstand commodity price volatility while delivering attractive income and greater cash flow stability relative to its energy peers. In addition, vast exposure to natural gas help alleviate the effects of oil price fluctuations amid resilient natural gas prices and steady demand. On the supply side, although higher oil and natural gas production can inflict downward pressure on commodity prices, midstream benefits from more supply coming online due to its volume driven, fee-based business.

*AMZI is the underlying index for the Alerian MLP ETF (AMLP) and the ETRACS Alerian MLP Infrastructure Index ETN Series B (AMUB). AMEI is the underlying index for the Alerian Energy Infrastructure ETF (ENFR).*

## Related Research

Midstream Income Opportunities: Dividends Resilient Throughout Recent Quarters
US Energy Independence: On the Home Stretch

## About Alerian and S-Network Global Indexes

Alerian is a leading independent index provider focused on building innovative, index-based investment strategies. Alerian acquired S-Network Global Indexes in 2020, expanding the firm's index offerings and services to partners. Combined, the firm serves the global investment community through indexing, benchmarking, and calculation services. Built on a foundation of data rigor and specialty research, Alerian and S-Network Global Indexes offer a comprehensive family of energy, income, and thematic indexes. Today, the firm has over $23 billion in total assets benchmarked to its indexes and over 200 customers world-wide.

## Disclaimers

**This Document Is Impersonal and Not a Solicitation.** In jurisdictions where Alerian, S-Network Global Indexes, or their affiliates do not have the necessary licenses, this document does not constitute an offering of any security, product, or service. Alerian and S-Network Global Indexes receive compensation in connection with licensing its indices to third parties. All information provided by Alerian and S-Network Global Indexes in this document is impersonal and not customized to the specific needs of any entity, person, or group of persons. Alerian, S-Network Global Indexes, and their affiliates do not endorse, manage, promote, sell, or sponsor any investment fund or other vehicle that is offered by third parties and that seeks to provide an investment return linked to or based on the returns of any Alerian or S-Network Global Indexes index.

**No Advisory Relationship.** Alerian and S-Network Global Indexes are not investment advisors, and Alerian, S-Network Global Indexes, and their affiliates make no representation regarding the advisability of investing in any investment fund or other vehicle. This document should not be construed to provide advice of any kind, including, but not limited to, tax and legal.

**You Must Make Your Own Investment Decision.** It is not possible to invest directly in an index. Index performance does not reflect the deduction of any fees or expenses. Past performance is not a guarantee of future returns. You should not make a decision to invest in any investment fund or other vehicle based on the statements set forth in this document, and are advised to make an investment in any investment fund or other vehicle only after carefully evaluating the risks associated with investment in the investment fund, as detailed in the offering memorandum or similar document prepared by or on behalf of the issuer. This document does not contain, and does not purport to contain, the level of detail necessary to give sufficient basis to an investment decision. The addition, removal, or inclusion of a security in any Alerian or S-Network Global Indexes index is not a recommendation to buy, sell, or hold that security, nor is it investment advice.

**No Warranties.** The accuracy and/or completeness of any Alerian or S-Network Global Indexes index, any data included therein, or any data from which it is based is not guaranteed by Alerian or S-Network Global Indexes, and it shall have no liability for any errors, omissions, or interruptions therein. Alerian and and S-Network Global Indexes make no warranties, express or implied, as to results to be obtained from use of information provided by Alerian and S-Network Global Indexes and used in this service, and Alerian and S-Network Global Indexes expressly disclaim all warranties of suitability with respect thereto.

**Limitation of Liability.** While Alerian and S-Network Global Indexes believe that the information provided in this document is reliable, Alerian and S-Network Global Indexes shall not be liable for any claims or losses of any nature in connection with the use of the information in this document, including but not limited to, lost profits or punitive or consequential damages, even if Alerian and S-Network Global Indexes have been advised of the possibility of same.

**Research May Not Be Current.** This document has been prepared solely for informational purposes based on information generally available to the public from sources believed to be reliable. Alerian and S-Network Global Indexes make no representation as to the accuracy or completeness of this document, the content of which may change without notice. Alerian and S-Network Global Indexes expressly disclaim any obligation to update the contents of this document to reflect developments in the energy Master Limited Partnership sector. The methodology involves rebalancings and maintenance of indices that are made periodically throughout the year and may not, therefore, reflect real-time information.

**Linked Products.** Alerian and S-Network Global Indexes licenses its indexes to third parties for the creation of investment funds or other vehicles. Alerian and S-Network Global Indexes are not responsible for the information on these websites or for anything that they provide.

**Policies and Procedures.** Analytic services and products provided by Alerian and S-Network Global Indexes are the result of separate activities designed to preserve the independence and objectivity of each analytic process. Alerian and S-Network Global Indexes have established policies and procedures to maintain the confidentiality of material non-public information received during each analytic process. Alerian, S-Network Global Indexes, and their affiliates provide a wide range of services to, or relating to, many organizations, and may receive fees or other economic benefits from these organizations.



**Alerian**
alerian.com
info@alerian.com | 972.957.7700
3625 N. Hall St., Suite 1200, Dallas, TX 75219

**S-Network Global Indexes**
snetworkglobalindexes.com
info@snetworkinc.com | 646.467.7928
267 Fifth Avenue, Suite 508, New York, NY, 10016