# Energy MLP Total Return Fact Sheet & Commentary

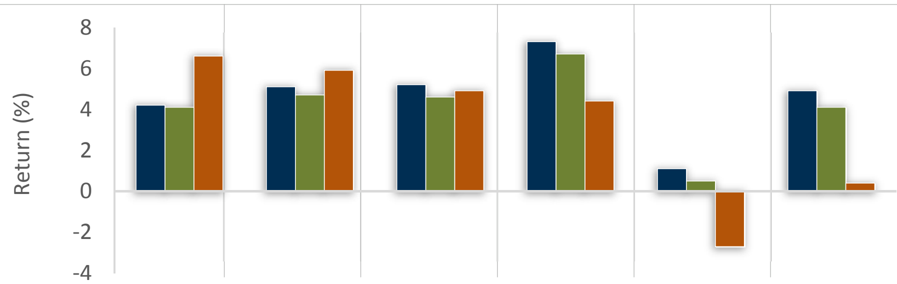
Quarter Ending September 30, 2018

DUFF & PHELPS INVESTMENT MANAGEMENT CO.
A VIRTUS INVESTMENT PARTNER

## PORTFOLIO STRATEGY

| | |
|---|---|
| ▪ Holdings | 25-30 securities |
| ▪ Security Target | 80% midstream MLPs and GPs |
| ▪ Single Position | No greater than 10% at purchase |
| ▪ Individual holding market cap | < $250 million at purchase |
| ▪ Turnover | Typically < 25% |
| ▪ Benchmark | Alerian MLP Index |

## PERFORMANCE (%)[1]

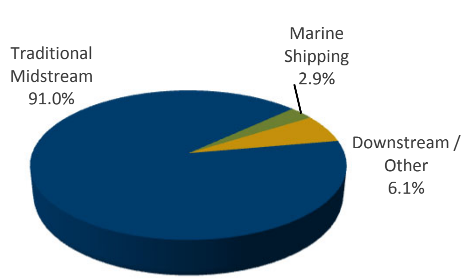



| | QTD | YTD | 1 Year | 3 Years | 5 Years | Since Inception |
|---|---|---|---|---|---|---|
| **Composite Gross Return** | **4.2%** | **5.1%** | **5.2%** | **7.3%** | **1.1%** | **4.9%** |
| Composite Net Return | 4.1% | 4.7% | 4.6% | 6.7% | 0.5% | 4.1% |
| Alerian MLP Index | 6.6% | 5.9% | 4.9% | 4.4% | -2.7% | 0.4% |

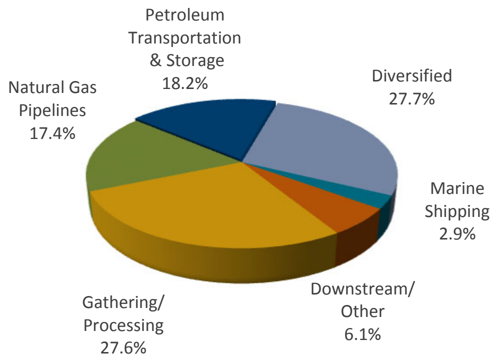
## INVESTMENT PHILOSOPHY

- We focus on midstream assets and believe a rigorous fundamentally driven investment process will produce superior risk-adjusted returns.
- We construct a concentrated portfolio with a long-term investment horizon which allows us to capitalize on our highest conviction ideas.
- Our disciplined investment process allows us to be opportunistic by taking advantage of the inefficiencies in the sector.
- Our portfolio focuses on maximizing total return by owning companies with visible distribution growth, low commodity exposure and geographic footprints in key basins.
- Our team approach is an integral part of uncovering new opportunities, while also controlling downside risk should our thesis on a name change.

## MLP CLASSIFICATION [2]




## SUB-SECTOR [2]




## PORTFOLIO CHARACTERISTICS

| | Portfolio[2] | Benchmark |
|---|---|---|
| Cash Flow Multiple (P/DCF), 2019 est. | 10.6 | 9.6 |
| Distribution Yield | 6.7% | 8.0% |
| Distribution Growth, NTM | 8.8% | 3.2% |
| Distribution Coverage, 2019 est. | 1.4 | 1.4 |
| Weighted Avg. Market Cap (bn) | $18.9 | $17.2 |
| Median Market Cap (bn) | $7.3 | $4.2 |

*Sources: Bloomberg Finance L.P., Alerian*

## TOP TEN HOLDINGS[3]

| | Portfolio ( %)[2] |
|---|---|
| The Williams Cos Inc. | 9.0 |
| Enterprise Products Partners LP | 8.1 |
| Targa Resources Corp. | 6.8 |
| Energy Transfer Partners LP | 6.4 |
| Plains All American Pipeline LP | 5.5 |
| MPLX LP | 5.4 |
| Tallgrass Energy LP | 5.4 |
| Magellan Midstream Partners LP | 5.3 |
| ONEOK Inc. | 4.6 |
| EnLink Midstream Partners LP | 4.5 |

## RISK/RETURN (SINCE INCEPTION)

| | Composite | Benchmark |
|---|---|---|
| Alpha | 4.6% | 0.0% |
| Total Return Beta | 1.0 | 1.0 |
| Sharpe Ratio | 0.2 | 0.0 |
| Standard Deviation | 18.5% | 18.0% |
| Information Ratio | 1.2 | 0.0 |
| Tracking Error | 3.7 | 0.0 |

*Source: eVestment*

## CONTACT INFORMATION


**Sarah Honold**
Consultant Relations
312-917-6548 | sarah.honold@dpimc.com

**Robert Hiebert**
Senior Relationship Manager
312-917-6560 | robert.hiebert@dpimc.com

## Market Review

Momentum from the second quarter continued into the third quarter as North American Energy Infrastructure stocks rallied hard in July and the first half of August, jumping 12.65% (as measured by the Alerian MLP Index). Nevertheless, the sector hit a wall in the final six weeks of the quarter and saw half its gains erased. While the sector still finished the quarter up 6.57%, it ended up trailing the 7.70% gain posted by the broader U.S. market (as measured by the S&P 500).

The sector continues to benefit from strong fundamentals. Capacity for midstream assets across U.S. basins remains very tight, thereby driving wide differentials in prices and strong demand for new projects. During the quarter, we saw a number of new projects get contracted and announced. Management teams remain very bullish in their outlooks, and this bullishness was confirmed by another strong quarter of earnings. Bellwether MLPs Enterprise Products, Energy Transfer and Plains All-American all posted especially good quarters. Perhaps the biggest news of the quarter for MLPs was an order from the FERC that it was significantly softening its March 15 announcement. Recall the original announcement curtailed the ability of MLPs to include a tax allowance in “cost-of-service” contractual rates charged to customers on certain pipelines, and, at the time, sent the sector into a tailspin. On July 18, the FERC announced that MLPs eliminating their income tax allowance could also eliminate their entire accumulated deferred income tax (ADIT) balance, effectively creating an offsetting benefit for the MLPs faced with the largest revenue reduction.

Despite the FERC announcement, both Williams and Enbridge moved forward with their previously announced simplification transactions. On May 17, Williams had announced a deal with Williams Partners at a 6.4% premium and that deal closed on August 10. Also on May 17, Enbridge had announced its intention to buy in its MLPs, Spectra Energy Partners (SEP) and Enbridge Energy Partners (EEP). Enbridge and SEP reached a deal on August 24 for Enbridge to buy SEP in at a 9.8% premium to the original offer and less than a month later it announced a deal to buy EEP at an 8.7% premium to the original offer. The big news on simplification, however, came on August 1 when Energy Transfer Equity announced it would buy in Energy Transfer Partners (ETP) at an 11% premium. ETP was the last of large-cap MLPs that needed to simplify. The companies had indicated for while that they would likely merge, but a deal was not expected until 2019 given concerns about the parent company’s investment grade credit rating. Nevertheless, due to the strong industry fundamentals and the company’s robust earnings, Energy Transfer was able to convince the ratings agencies to let it move forward on an accelerated basis.

The oil backdrop also remains very constructive even though oil prices were quite volatile in the quarter. Recall in our last letter that we had speculated that oil prices might be a little weaker in the near-term as new Saudi and Russian production hit the market in preparation for the Iranian sanctions taking effect. Sure enough, oil fell over $9 in the first half of the quarter before making up almost the entire loss in the second half to close down less the $1. Interestingly, oil traded exactly the opposite of the MLPs which, as mentioned above, were strong in the first half and weak in the second half. While oil was mixed, ethane and NGL prices remained robust. Ethane prices, which had jumped almost 50% in the first half of the year, jumped another 62% in the third quarter.

The sector’s performance in the second half of the quarter left us and many other dedicated MLP investors scratching our heads. In examining the pullback, we would point to a couple different factors. First, retail funds flows were very weak in the quarter, and accelerated post the FERC announcement. There was a big pickup in fund flows in the second quarter, and with the sector rebounding over 19% from the end of March until the end of July, certain investors may have decided to take their gains. Another overhang also emerged for the sector with Colorado Proposition 112. This initiative, which will be on the ballot in Colorado in November, would require 2,500 foot setbacks from any building for all oil and gas developments. While innocent sounding, the initiative would essentially ban fracking in Colorado as it is estimated that it would eliminate drilling on over 85% of the non-Federal surface area. While industry professes confidence that it will be able to defeat the proposition (a similar initiative was defeated in 2016), stock prices for MLPs with Colorado exposure have taken a big hit.

## Portfolio Review

It was not a great quarter for the Duff & Phelps Midstream Energy MLP Total Return Strategy. While the strategy finished up 4.24%, it trailed the Alerian index by over 2%. Opposite of last quarter, general partners underperformed in the quarter, especially versus their own MLPs, which hurt the strategy. In addition, partly as a result of the FERC reversal, a lot of lower quality names posted strong quarters, which also contributed to underperformance as the strategy has a quality tilt.

In terms of specific names, the biggest contributor to the portfolio was Energy Transfer Partners which benefitted from strong earnings and the 11% announced takeout by its parent. It should be noted that while ETP was the biggest contributor, we were underweight the name vs. its 10% weighting in the Alerian index and so it was actually a significant alpha detractor. The next biggest contributor was Targa Resources which was up 15.8% in the quarter and was helped by its strong Permian position and its exposure to surging NGL volumes and prices. Our third biggest contributor was Enlink Midstream (ENLK) which benefitted from its strong position in the SCOOP-STACK basin in Oklahoma and speculation that simplification with its general partner, Enlink Midstream LLC (ENLC), might be close at hand. The first and third worst contributors were Noble Midstream Partners and Western Gas Partners, both of which have significant exposure to Colorado and have gotten hit on the ballot proposal. Williams Company (WMB) was our second biggest detractor. For a while, we have owned positions in both Williams Partners (WPZ) and WMB. Both stocks moved up into the closing of the merger as there was significant S&P 500 index buying (WPZ was actually our fourth biggest contributor for the quarter). However, as soon as the deal closed and the WPZ shares converted to WMB shares, the index buying stopped and we saw a significant drop in the WMB share price. So while WMB was actually up 1.49% in the quarter, it turned out to be a significant negative contributor for the strategy. We believe most the move down was technically driven and we remain very constructive on WMB's assets and strategic positioning.

## Investment Outlook

We remain very constructive on the overall sector. We expect another strong quarter of earnings which should be a further catalyst. While we are dismayed by the fund flows, we continue to believe that investors will at some point have difficulty ignoring the strong secular growth story and attractive distribution yields and valuations. Unlike the last 3 years, there also may not be widespread tax loss selling into year-end since midstream enters the fourth quarter with a positive YTD return and there had been a dearth of equity offerings earlier in the year. While the group may have been swept up in the sell-off of high yielding assets as interest rates rose into third quarter-end, we believe this presents a buying opportunity as MLPs have historically demonstrated a fairly low correlation with rates. Further underscoring our bullish sentiment, we have seen significant insider buying by top executives of ETE, KMI, and ANDX, to name a few. Clearly, the most immediate issue is the Colorado vote which while impacting only roughly 10%-15% of the sector, is still an overhang. Rational thought tells us that this will not pass. Most of the key politicians in the state, including both the nominees for governor and the Denver mayor, are against it, and industry is outspending the opposition by roughly 30:1. It is also important to remember the oil and gas industry is a significant employer in the state and pays over $1 billion in taxes (in a balanced budget state no less). Nevertheless, at this point, we all know that elections can be highly unpredictable. And while we think there is a lot of downside priced into the Colorado-exposed MLPs, we also have no doubt that the initial reaction to the proposition passing would be for these stocks to be sold hard. Hence, we continue to review the risk-reward around the Colorado names. In addition, we are trying to analyze the long-term value of these stocks in the event the initiative does indeed pass. It is important to note that several of our Colorado-exposed holdings are affiliated with large diversified E&P sponsors who have the ability to shift capital and drilling rigs to other shale basins.

The Energy Transfer simplification was a big deal as it was the last of the large MLPs that had to restructure. Nevertheless, this does not mean the restructurings are done. We are still waiting on both Antero Midstream and Equitable Midstream to announce what they are going to do. As mentioned, Enlink has talked openly about simplification. Incentive distribution rights (IDRs) also remain a key focus for investors, and MLPs that are in the high splits such as Shell, Valero, Phillips and DCP Midstream are under particular scrutiny. Buckeye Partners announced it is reviewing its strategic options and its distribution. Ultimately, what all of this means is that there is still noise that the sector needs to work through. This noise remains an overhang because, as we have said in the past, the sausage making has not been pleasant. Nevertheless, with each quarter, we are getting closer to the finish line, and hopefully as we get closer, new investors will feel comfortable taking the plunge.

As always, thank you for your continued support of our team and investment strategy.

DAVID GRUMHAUS, JR.
Senior Portfolio Manager

CHARLES GEORGAS, CFA
Portfolio Manager

## GIPS Compliant Presentation

| Year-end (12/31) | Annual Composite Return (%) | | Annual Benchmark Return (%) | 3-Year Annualized Standard Deviation (%) | | Number of Accounts | Asset-weighted Dispersion (%) | Composite Assets (US $M) | Firm Total Assets (US $B) |
|---|---|---|---|---|---|---|---|---|---|
| | Gross | Net | | Composite | Benchmark | | | | |
| 2017 | -1.12 | -1.67 | -6.52 | 20.20 | 19.06 | <5 | n.a. | 480.2 | 10.2 |
| 2016 | 19.57 | 18.74 | 18.31 | 21.08 | 19.95 | <5 | n.a. | 477.7 | 10.3 |
| 2015 | -29.23 | -29.78 | -32.59 | 19.11 | 18.50 | <5 | n.a | 362.6 | 9.2 |
| 2014 | 14.30 | 13.46 | 4.80 | n.a | n.a | <5 | n.a | 507.1 | 10.8 |
| 2013 | 34.57 | 33.59 | 27.58 | n.a | n.a | <5 | n.a | 395.2 | 9.2 |
| 2012* | -2.59 | -2.65 | -3.12 | n.a | n.a | <5 | n.a | 240.6 | 8.9 |
| Annualized Return Since Inception (November 30, 2012 – December 31, 2017): | | | | | | | | | |
| | 4.55 | 3.82 | -0.68 | | | | | | |

*Partial year return. Composite inception is November 30, 2012.*

**Duff & Phelps Investment Management Co. claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. Duff & Phelps Investment Management Co. has been independently verified for the periods January 1, 1993 through December 31, 2017. The verification reports are available upon request. Verification assesses whether (1) the firm has complied with all the composite construction requirements of the GIPS standards on a firm-wide basis and (2) the firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards. Verification does not ensure the accuracy of any specific composite presentation.**

**1. Organization** – Duff & Phelps Investment Management Co. ("Duff & Phelps" or the "firm") is a registered investment adviser and a wholly owned subsidiary of Virtus Investment Partners. Duff & Phelps manages assets on behalf of institutional and retail separate accounts and open-end and closed-end funds. Registration of an investment adviser does not imply any level of skill or training.

**2. Composite Description** – The Midstream Energy MLP Total Return Composite includes all fully discretionary accounts investing primarily in midstream energy master limited partnerships ("MLPs") with a focus on both income and capital appreciation. The inception date of the Composite is November 30, 2012 and the Composite was created on December 31, 2012. The Composite contains less than 5 portfolios.

**3. Benchmark** – The Composite Benchmark is the Alerian MLP Index, the leading gauge of energy master limited partnerships. The float-adjusted, capitalization-weighted index, whose constituents represent approximately 85% of total float-adjusted market capitalization, is disseminated real-time on a price-return basis (AMZ) and on a total-return basis (AMZX).

**4. Calculations** - Returns are total, time-weighted rates of return expressed in U.S. dollars and include accrued income. The Composite and Benchmark results reflect the reinvestment of dividends and other earnings. Portfolios are valued on a trade date basis. Monthly performance is calculated by linking daily returns. The Composite return is an asset weighted average of the performance results of all the portfolios in the Composite based on beginning of month values. Composite dispersion is not presented for periods with 5 or fewer portfolios. The 3-year annualized ex-post standard deviation measures the variability of the Composite and the Benchmark returns over the preceding 36-month time period and is not presented for performance periods of less than 36 months.

**5. Performance and Fee Information** – Investment performance returns are presented on both a gross of fee and net of fee basis. Gross composite returns are calculated net of trading costs, but do not reflect any deduction for investment advisory fees, custodial charges or other costs that a client might incur in connection with the management of an account. The firm's fee schedule for management of institutional separate accounts is: .75% on assets up to $25 million, .70% on the next $25 million, .65% on the next $50 million, and .60% on amounts in excess of $100 million. Returns realized by clients will be reduced by these costs. Actual investment advisory fees incurred by clients may vary. Initial minimum account size for institutional accounts is $5 million. Effective October 1, 2016, net composite returns are calculated by subtracting actual separate account investment management fee rates from gross account returns based on month-end assets. Previously, net composite returns were calculated by subtracting the highest separate account investment management fee in effect for the period. Index returns do not reflect the deduction of any fees.

**6. Additional Information** – Duff & Phelps's policies for valuing portfolios, calculating performance and preparing compliant presentations, as well as a complete list of composite descriptions, are available upon request.

**Past performance is not indicative of future results.**

**Investors should consult their tax adviser to fully understand the implications of owning MLPs.**

[1]Composite Inception Date: November 30, 2012. Time periods over one year are annualized. Please see the GIPS Compliant Presentation for more information.
[2]Portfolio information is based on a representative institutional account excluding cash. Holdings are subject to change.
[3]It should not be assumed that securities identified were or will be profitable. The top ten holdings list represents the largest percentage holdings at quarter end of a representative institutional account excluding cash and does not represent all of the securities held in client portfolios. The securities identified may no longer be held in client portfolios and the holdings of any particular client portfolio may vary. The list is provided for illustrative purposes and should not be considered a recommendation to purchase or sell a particular security. A complete list of holdings and transactions for the previous twelve months is available upon request.

Due to the distribution characteristics of MLPs, a portion of the distributions may include a return of capital, which should not be confused with yield or income.

Past performance is not indicative of future results. Returns are expressed in U.S. dollars and include the reinvestment of dividends and other earnings. Indices are not available for direct investment and index returns do not reflect the deduction of any fees. This material has been prepared using sources of information generally believed to be reliable; however, its accuracy is not guaranteed. Opinions represented are subject to change and should not be considered investment advice or an offer of securities. Forward-looking statements are necessarily speculative in nature. It can be expected that some or all of the assumptions or beliefs underlying the forward-looking statements will not materialize or will vary significantly from actual results or outcomes.

The securities identified were selected from all of the holdings of a representative account for the period based on contribution to the account's return. The securities identified do not represent all of the securities purchased, sold or recommended for advisory clients and the securities identified may no longer be held in client accounts. The methodology used to calculate the contribution to return or a list showing every holding's contribution to the account's return for the period is available upon request.