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MARKET COMMENTARY  
Putting Net Zero by 2050 in Perspective — *Be Prepared to Walk*

***In Our View: The IEA's Energy Transition Pathway to Net Zero Emissions by 2050 is Highly Uncertain***

In May, The International Energy Administration (IEA) released, "Net Zero by 2050, A Roadmap for the Global Energy Sector." This detailed report highlights ***one possible pathway*** to achieve global net-zero emissions by 2050 and limit the long-term increase in average global temperatures to 1.5 degrees Celsius. This herculean (or "impossible," according to some skeptics) task "requires all governments to significantly strengthen and then successfully implement their energy and climate policies." The IEA report grabbed headlines for noting in its roadmap that to achieve the targeted emissions goals, there should be no new investments in oil and gas exploration projects starting in 2021. Under this scenario, oil and natural gas demand would fall by about 50% and 75%, respectively, by 2050. Fossil fuels' share of energy supply would fall from about 80% to 20%. Solar will become the dominant source and account for about 20% of energy supply. OPEC's market share of a shrinking pie would grow from about 37% to 52%. To be fair, the IEA acknowledges that this road to net-zero emissions ***is uncertain and additional pathways may need to be considered. We agree.***

***Globally, we're moving in the right direction.***

Approximately 70% of global emissions of CO2 can be eliminated if all countries fulfill their pledges. However, these commitments still fall far short of what is required. Unfortunately, according to the IEA, most pledges are not yet underpinned by near-term policies and measures.

- 1) **Ambitious milestones need to be reached by 2030.**
  - Energy efficiency needs to dramatically improve *by about three-times* the average rate achieved over the last two decades. In other words, *although the world economy is expected to be 40% larger than today, it will use 7% less energy.*
  - Solar and wind generation capacity will need to grow by 630 gigawatts (GW) and 390 GW annually or *four-times the record levels set in 2020.*
  - Electric vehicles will account for more than 60% of global car sales in 2030 from about 5% currently.
- 2) **Aggressive policy initiatives need to be adopted in the IEA pathway.**
  - Internal combustion engine (ICE) car sales end by 2035.
  - In buildings, bans on new fossil fuel boilers need to start being introduced globally in 2025.
  - No new oil and gas fields approved for development and no new coal mines or mine extensions approved in 2021.
- 3) **Clean technologies to reach net zero post 2030 do not yet exist.**

Current technologies are sufficient to reach the CO2 emissions target by 2030 in the IEA's roadmap. However, post 2030, almost half of the emission reductions come from technologies that are under development. The three big technology opportunities are advanced batteries, hydrogen and carbon capture and storage.

- 4) **Behavioral changes are required.**  
The IEA estimates that about 55% of the cumulative emissions reductions in its pathway will require consumer choices such as purchasing an EV, retrofitting a house with energy efficient technologies, or installing a heat pump.
- 5) **Be prepared to walk!**  
Around 4% of the cumulative emissions reductions come from replacing car trips with walking, cycling or public transportation.
- 6) **The World in 2050.**  
Energy demand is 8% smaller than today in an economy that is twice as big and a population with 2 billion more people. Fossil fuels account for slightly more than 20% of supply versus about 80% today. The bulk of energy is supplied by renewables. Electricity accounts for almost 50% of total energy consumption.
- 7) **Net 9 million new jobs created by 2030.**  
While the traditional oil and gas industry suffers a loss of 5 million jobs, the clean energy sector creates 14 million new jobs and adds to global GDP.
- 8) **It won't be cheap.**  
A substantial ramp up in the investment of electricity, infrastructure and the end-use sectors will be required. Investment in electricity generation alone is estimated to jump to \$1.6 trillion annually to 2030 from an average of \$500 billion over the past five years. Total energy investments will jump to \$5 trillion annually by 2030 and fall to \$4.5 trillion by 2050. This compares to about \$2 trillion currently.
- 9) **There will be additional challenges beyond technological breakthroughs, international cooperation, financing and behavioral changes.**  
Specifically, will there be enough rare earth minerals mined to support batteries?
- 10) **There will be bountiful opportunities for those energy companies willing and able to embrace clean energy.**  
Investment opportunities include the following:
  - Carbon capture, utilization, and storage (CCUS)
  - Hydrogen
  - Biofuels
  - Offshore Wind
  - Infrastructure
- 11) **Cybersecurity risk is increasing.**  
As the electrification of the global economy grows so will cybersecurity risk. The shutdown of the Colonial Pipeline that crippled the East Coast's flow of gasoline, diesel and jet fuel is a painful example of the potential harmful effect of a cyber-attack.

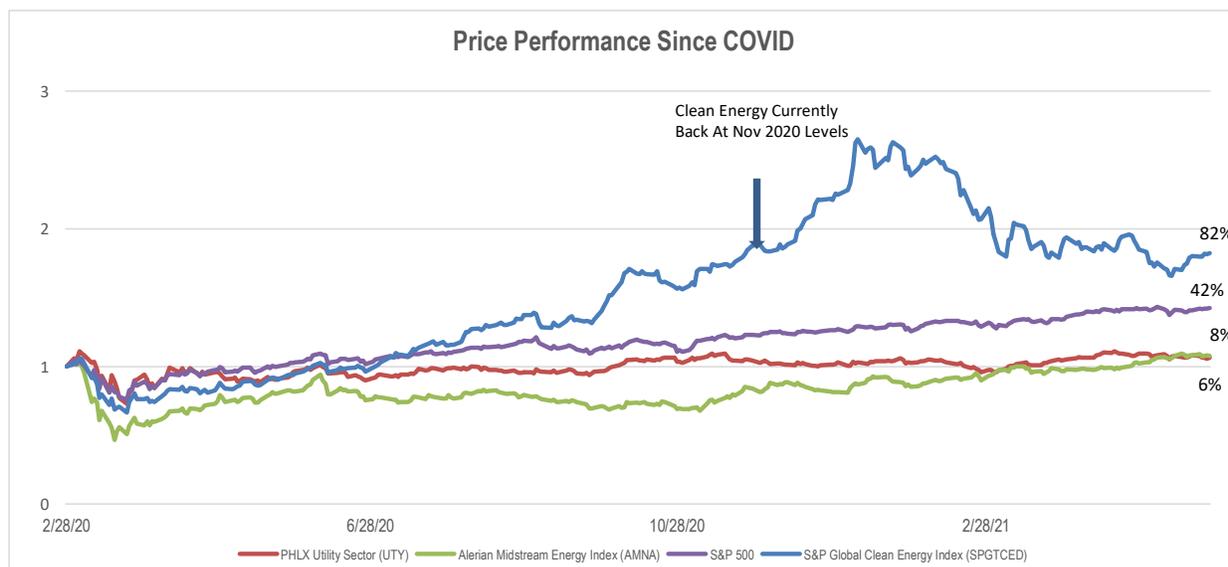
**Energy sector outperforms in May despite negative headlines; extends strong year-to-date performance.**

Energy's outperformance is noteworthy given negative headlines for conventional oil and gas during the month of May. As we discussed above, the IEA issued a special report that depicts a major decline in fossil fuel production in its proposed pathway to net zero carbon emissions by 2050. Additionally, Exxon Mobil lost three board seats to start-up activist investor Engine-1. Royal Dutch Shell was ordered by a Denmark court to cut emissions 45% by 2030. And lastly, Biden's 2022 fiscal budget contains tax proposals that would be positives for clean energy but eliminate fossil fuel subsidies if enacted. Ironically, the big winners under Biden's revenue proposals are clean energy stocks and they performed poorly in May although their long-term fundamental outlook is shining even brighter. Year-to-date, the S&P Global

Clean Energy Index is down 18.8% vs. gains of 32.3% and 11.9% for the Alerian Midstream Energy Index (AMNA) and S&P 500, respectively. The pullback in clean energy stocks is a correction of the quick and steep appreciation (i.e., +~300%) from COVID trough levels in March 2020 to peak valuations in January 2021. (See *Price Performance Since Covid* chart below).

Energy was the best performing sector in the S&P 500 in May, driven by higher commodity prices, momentum, and value investing. The S&P 500 Energy was up 4.9% vs. a gain of 0.55% for the S&P 500. Crude oil prices were up 4.4% to \$66.31 per barrel (WTI). All energy sectors (E&P, Oil Service and Midstream) posted strong gains for the month, with the exception of the S&P Utilities, which was down 2.8%. Year-to-date, energy is the best performing sector, up 36.2% while utilities are the worst, up only 3.3%. The energy sector is enjoying the recovery in demand and higher commodity prices, while defensive sectors such as utilities lag the sectors that benefit from a strong economic rebound.

Our Infrastructure Income Strategy continues to perform well, having generated a total return of 3.6% for May versus 0.7% for the S&P 500 (with dividends included). Year-to-date, the portfolio has returned 22.9% (net of fees) versus 12.6% for the S&P 500. We believe a diversified approach to investments in midstream, utilities, and renewables will deliver the best *risk adjusted* returns. Our Midstream investments' total return for May was 7.7% vs. 6.3% for the AMNA, while our Utilities holdings' total return of -1.0% was better than -2.5% for the PHLX Utilities index (UTY). However, our Renewable Energy holdings underperformed the S&P Global Clean Energy Index (SPGTCED), at -5.0% vs. -1.4%.



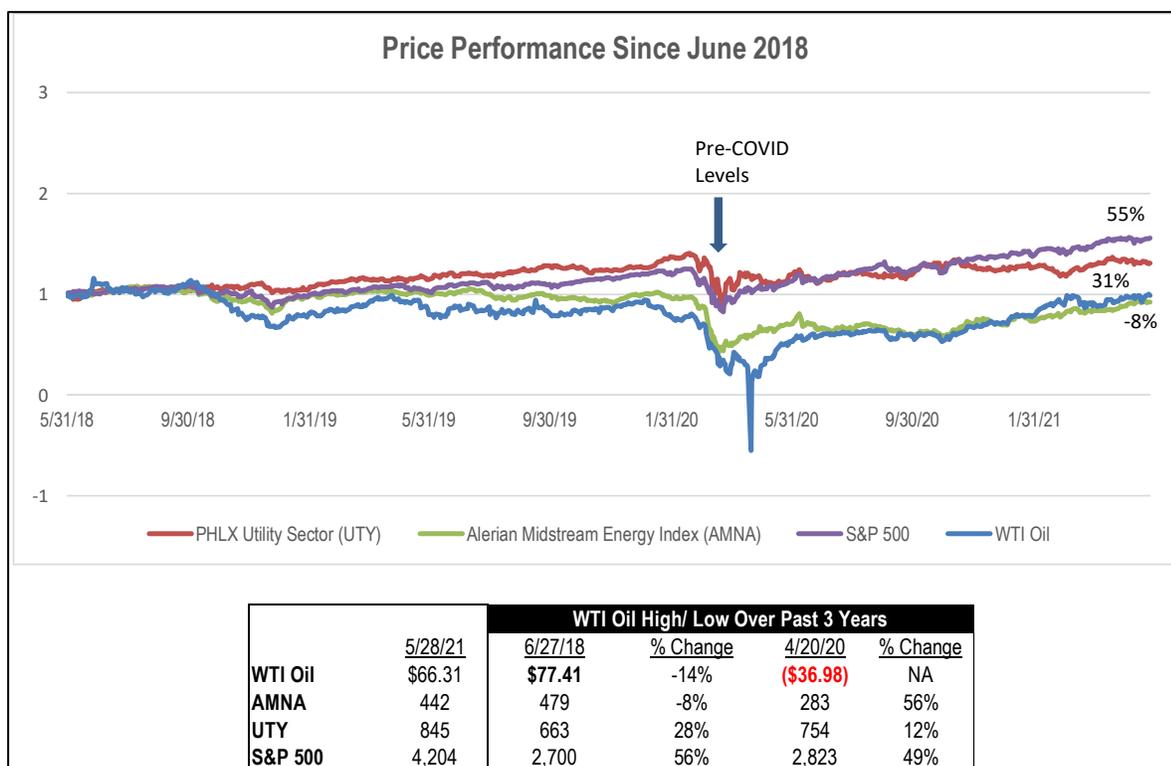
[Source: S&P Global, NASDAQ and Alerian]

## KEY MONTHLY TAKEAWAYS

### **Midstream Valuations Have Not Fully Recovered Despite Higher Crude Prices.**

During the month of May, WTI crude oil prices remained solidly in the \$65 per Bbl range — this approximates prices three years ago and rises above pre-COVID levels. Despite the rebound in crude prices, the midstream sector has underperformed both the overall market as well as the utilities sector over the past three years. Specifically, as of 5/28/21, the AMNA was about 8% below three years ago (vs. 5/28/18) and 7% below the pre-COVID timeframe (vs. 12/31/19). This compares to the S&P 500's gains of

55% and 30%, respectively, and the PHLX Utility Sector's (UTY) gains of 31% and 2%, respectively, during the comparable periods. We believe Midstream is well-positioned to re-rate higher and trade closer to its historical metrics. The group is currently trading at an EV-to-EBITDA multiple of 9.3x vs. 9.9x as of Q4'19 according to Wells Fargo Securities.



[Source: S&P Global, NASDAQ and Alerian]

### **M&A Activity Is On The Rise.**

There were several notable M&A transactions for both upstream and midstream recently. We believe that *the consolidation of the domestic energy industry is welcome as it leads to better financial discipline and less volatility*. As we had previously predicted, the merger bug is migrating to the midstream sector. On 6/2/21, Brookfield raised its bid for Inter Pipeline (IPL) in response to a competing bid by Pembina Pipeline Corporation (PBA), which is expected to yield \$150-200MM of cost synergies and potential commercial synergies. On 6/1/21, Kinder Morgan, Inc. (KMI) announced the acquisition of Stagecoach Gas Services LLC (41 Bcf of natural gas storage facilities and 3 gas pipelines) from Crestwood Equity Partners, L.P. (CEQP) and Consolidated Edison (ED) for \$1.225B. On the upstream front, Southwestern Energy Company (SWN) agreed to acquire Indigo Natural Resources, LLC for \$2.7B, expanding its gas operations in the Gulf Coast (e.g., Haynesville shale). On 6/8/21, Independence Energy, LLC (backed by KKR & Co.) and Contango Oil & Gas Company (MCF) announced plans to combine in an all-stock transaction valued at \$5.7B. The entity will focus on consolidation opportunities in the oil and gas space.

### **Biden's Proposed 2022 Fiscal Budget Prioritizes Clean Energy.**

President Biden has articulated a goal of reducing greenhouse gas emissions by at least 50% below 2005 levels by 2030 and to net zero by 2050. It's not surprising that his pathway utilizes the tax code to continue incentivizing the buildout of renewables through incentive tax credits (ITCs) and production tax credits (PTCs) while eliminating fossil fuel tax preferences. The latter includes repealing the advantageous

tax status of master limited partnerships (MLPs). However, this is not the only approach. The House Ways and Means Committee has a proposal in the Green Act that would not eliminate the MLP structure but rather expand qualifying activities to include renewables, alternative energy and CCUS. It's a good bet that incentives for renewables will pass but the details have yet to be determined. MLPs have a very good argument to advance that the structure, as its intent, did result in substantial investment in infrastructure and the MLP is an appropriate vehicle to stimulate additional investment in clean energy. It is much too early to write-off MLPs, especially given the slim Democratic majority.

## **OUR STANCE: The Outlook is Bright and Our Conviction is Stronger — We're Bullish**

Fundamentals for the three sectors (midstream, utilities, renewables) in which we invest are encouraging. **Several points to make:**

1) ***Free cash flow generation is accelerating.***

Energy companies have visible positive fundamentals at least for the next several years notwithstanding longer-term environmental challenges. The energy sector is well positioned to generate free cash flow and reward shareholders with secure dividends that should grow over time.

2) ***Value creation through financial discipline.***

The energy sector can create shareholder value by paying down debt, stock repurchases and prudent capital investments.

3) ***Value creation by embracing the energy transition.***

The energy transition will take decades to evolve but there is a sense of growing urgency to take action now. The winners will be those companies that are planning and investing now in the clean energy future. Midstream is starting to direct capital investments toward clean energy. They are well-positioned to provide the requisite infrastructure in a net zero carbon world.

4) ***Valuations matter.***

The year-to-date underperformance of clean energy stocks is best characterized as a significant correction given such strong outperformance since the stock market bottom in March of 2020. The value of companies with rapidly growing earnings is more susceptible to rising interest rates as those later year's earnings are discounted to the present.

**SAM Partners' Infrastructure Income Strategy** seeks to provide sustainable income and growth with capital preservation. This is accomplished by investing in a concentrated portfolio of high-quality midstream energy companies, utilities, and renewable energy companies. In a world starved for yield, we believe these stocks offer a compelling value proposition. Our Infrastructure Income Strategy offers investors a current yield of ~6% (as of 5/28/21) and growth potential of 3% to 4%. The midstream portion of the portfolio has a sustainable yield of ~7% while utilities and renewables provide yields of 3% and 4%, respectively.



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