October 13, 2017

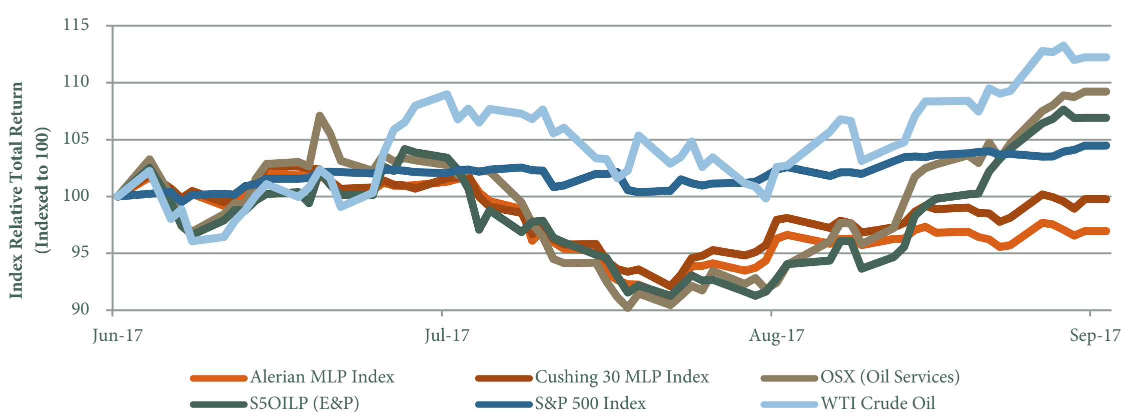
2017 Third Quarter Midstream Energy Market Review

Dear Investors,

Investor frustration continued into the third quarter of 2017 ("the period"), as the performance of midstream master limited partnerships ("MLPs") experienced yet another quarter of elevated volatility and negative total returns. The market cap-weighted Alerian MLP Index (AMZ) produced a –3.05% total return for the period, while the equal-weighted Cushing® 30 MLP Index (MLPX) produced a –0.23% total return. This negative performance was despite a strong rebound in the price of crude oil, which was up +12.23% for the period, as measured by the price of West Texas Intermediate crude oil.

Following the move in crude oil, the more commodity sensitive components of the energy sector delivered positive returns for the quarter, with the S&P 500 Oil & Gas Exploration and Production Index ("S5OILP") producing a +6.90% total return, and the Philadelphia Oil Service Sector Index ("OSX") producing a +9.21% total return.

Third Quarter 2017 Performance for Select Indices



Note: Represents relative price performance from June 30, 2017 through September 30, 2017. Indexed to 100.
Source: Bloomberg.

We remain convinced the underlying fundamentals for the midstream energy space have greatly improved since the cycle lows and continue to do so; however, investor sentiment (and resulting fund flows) remained stubbornly elusive. There was no shortage of investor grievances and concerns (which we will discuss later); however, we believe these factors have been overly discounted in current MLP valuations. On the other hand, there are also many, significant and real, positive drivers that investors seem to be giving little credit for or ignoring completely. In our opinion, it often feels that as MLPs continue to underperform, investors and analysts are at times "backsolving" for a rationale to the underperformance, creating contradictory and/or circular arguments in some cases. We believe this too will end. MLPs may not be a consensus "buy," but we believe our call is supported by compelling valuations and underlying drivers that continue to point positively.

A Trifecta of Negative Events to Begin the Third Quarter of 2017

Alongside extreme negative energy sector sentiment, MLP performance, as measured by the AMZ, hit a new low for the year during the middle of the period. While there were a myriad of factors, we believe this low, established on August 21st and representing a –10.5% price decline from June 30th, was the result of three key events that occurred in the first half of the period.

First, on August 1st, Pioneer Natural Resources Co. (NYSE: PXD), a bellwether exploration and production (E&P) company in the Permian basin and a key customer for several midstream companies, reported disappointing second quarter earnings. This release, combined with management commentary on operational delays and issues regarding increased gas-to-oil ratios (GORs), created a fury of new concerns regarding the stability and timing of oil production growth from the Permian basin, widely considered to be the most stable/growing and profitable basin in the U.S. PXD's stock price fell by ~26% over the following week, dragging other E&P and midstream companies with it, especially those with Permian basin exposure.

We were somewhat surprised by the negative reaction in midstream equities to PXD's announcement, as we expected higher GORs (more associated natural gas production) in the Permian to be mostly positive for midstream. All else equal, we believe this will likely result in a greater need for natural gas infrastructure and processing capacity in the basin, and may put more pressure sooner on natural gas basis (a positive for intrastate pipelines). With regards to a possible a slower volume ramp for crude oil, we remain confused as to the market's logic here. If MLP equity prices are depressed because of investor fears that significant volume ramps in the Permian will continue to put pressure on crude oil prices, then shouldn't a slower ramp incrementally relieve commodity price pressure? *More on this later.*

Second, on August 7th, Plains All American Pipeline, LP (NYSE: PAA) reported yet another quarter of disappointing results from its Supply and Logistics segment (i.e. marketing), while also lowering forward guidance and suggesting a possible "reset" of its distribution (which was confirmed later that month). PAA's stock price fell by ~25% over the following week, sending another shockwave through the midstream sector.

Finally, Energy Transfer Partners, LP (NYSE: ETP) commenced a public offering on August 14th, raising over $1 billion of equity in an overnight deal. Coming within one week of a positive earnings release (on August 8th), investors were generally critical of the deal not only because recent management commentary had suggested that equity was not necessary, but also due to the significant dilution and implied cost of equity from the deal. With an offering price of $18.65, ETP's yield was almost 12% at the time of the offering. When considering the incentive distribution rights (IDRs) held by ETP's general partner, the effective equity cost of capital for this deal approached 18%.

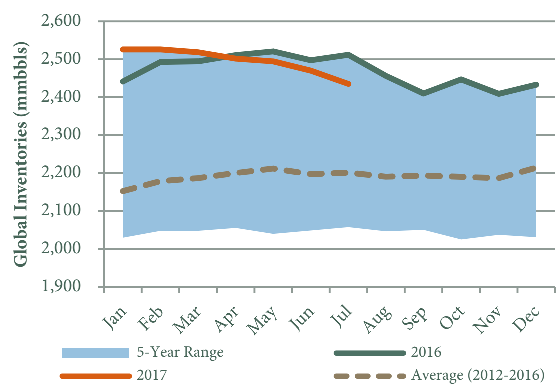
Of note, we attended a midstream conference in the middle of August (immediately after the events mentioned above), and investor sentiment was one of the worst we have ever seen it – eclipsing (or at least on par with) the first quarter of 2016 and the financial crisis of 2008. Tempers flared in many of our small group meetings, as confrontational investors vented their frustrations to management teams regarding poor equity performance despite constructive fundamentals. Coincidentally, the end of this conference also marked the bottom of the AMZ for the quarter (and year-to-date). Perhaps these events will serve as the "clearing of the decks" for the space to continue to grind higher.

Improving Energy Macro: Crude Oil Prices Rebounded, Inventories Continued to Decline

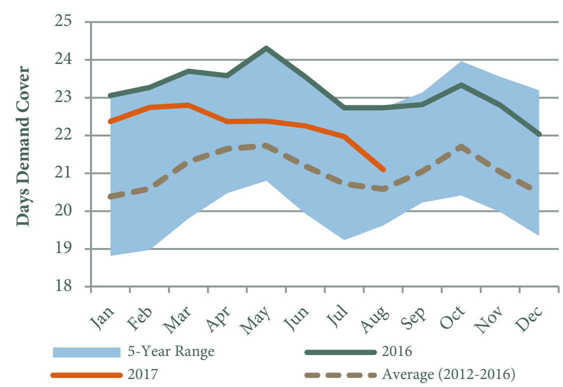
As mentioned earlier, crude oil prices were up +12.23% for the period, increasing to $51.67 by the end of the period. While we admit we have no insight into what actions OPEC will take after the current production cuts expire in March 2018, we will note that OPEC enacted the cuts in the first place in order to reduce global inventory levels back within 5-year averages in an effort to stabilize/impove prices. The most recent data seems to be proving their strategy is working, as global inventories continued to decline in the U.S., OECD member countries and OPEC member countries as well.

Globally, stockpiles have decreased by approximately 3.6%, or nearly 100 million barrels, since the peak, and are trending towards the OPEC target of 5-year averages. Perhaps more importantly, days of demand cover (which represents inventory levels divided by daily demand) has decreased more sharply and was near 5-year average levels as of the end of the period. This can be explained by the steady growth in global demand over the last three years, which has received less attention than the absolute level of global inventories. In our opinion, days of demand cover is a better metric by which to gage "normal" inventory levels. We also think crude prices near $50 or higher seem to be an important psychological level for energy sentiment.

Global Inventory Levels [1]



Inventory Demand Cover [2]



1) Source: IEA, Bloomberg Energy, AIS, International Enterprise Singapore.
2) Source: : Citi Research, Energy Weekly, August 22, 2017, Energy Intelligence Group, IEA, EIA, JODI, METI, APEX, Chinese Customs

E&Ps Re-Focus on Returns?

With regards to the upstream sector, an important customer base for the midstream base, investor angst continued to grow during the period, with increasing pressure on E&P management teams to stop acting like commodity speculators, stop destroying capital and start generating acceptable returns throughout the commodity cycle. Under this pressure, there were signs that a change is at hand as management teams may finally be listening to investor frustrations and may be willing to increase their emphasis on return on invested capital in order to attract sustained capital inflows.

We believe one E&P analyst stated it well, "*We believe the [E&P] industry is on the cusp of a gradual, long overdue shift to returns-focused investing… the deafening silence of long-only investors that left the space amid frustrations about capital intensity is now being heard by managements/Boards, in our view. Amid range-bound commodity prices, more prudent growth outlooks are needed… Low full-cycle costs and relatively strong ROCE metrics should be* *differentiators as companies pivot into manufacturing mode… we believe subsequent displays of prudency by E&Ps will bring the marginal long-only investor back to the space.* ***Discipline will attract capital*** *[emphasis added].*"[1]

In response, Anadarko Petroleum Corporation (NYSE: APC) authorized a $2.5 billion share-repurchase program. From the press release, Al Walker, APC Chairman, President and CEO stated, "*Going forward, we will continue to demonstrate financial discipline with a focus on returns. Our 2018 upstream investment plan is anticipated to produce substantial free cash flow, assuming an average oil price of $50 per barrel, while total capital spending, including midstream investments, should be approximately break-even to discretionary cash flow from operations.*"[2]

Additionally, EQT Corporation (NYSE: EQT) announced its intent to exclude production volume from long-term compensation calculations. From the press release, the company states, "*production volume will no longer be a performance metric for EQT's long-term compensation programs and will be replaced by efficiency metrics. The performance goals for the 2018 compensation program will be based on operating and development cost improvement, relative total shareholder returns, and return on capital employed.*"[3]

As for "backsolving" for rationale to midstream underperformance, some investors have claimed this renewed discipline on the part of E&Ps will be a negative for midstream (all else equal, it could equate to a slower volume ramp). We strongly disagree, not only because this is a highly simplistic view of the issue, but we also contend that a healthier and more prudent E&P sector to be a distinct positive for the midstream sector.

Lingering Issues within the Midstream Space

While we continue to be encouraged by the fundamental improvements at both the energy macro level (e.g. domestic crude oil production is approximately back to pre-downturn levels) and the partnership/company level (in general, lower costs of capital, healthier balance sheets and distribution coverage), we remained frustrated with the sluggish equity performance of the midstream energy sector during the period. Make no mistake; we are not ignoring the slate of challenges that still face this space. However, while at times some of these sound more like excuses for weak trading in a volatile market environment, we nonetheless believe they are overly discounted in current valuations.

Some of the key fundamental issues in the ongoing "wall of worry" include: 1) state-level regulatory challenges to various infrastructure projects; 2) environmentalist protest/resistance (e.g. DAPL, Trans Mountain, etc.); 3) competition from a private equity sector that is flush with cheap capital; 4) for Tier 1 basins, fierce competition for volumes/projects – potentially leading to lower volume commitments, lower rates/margins and ultimately lower returns for projects; 5) for Tier 2 basins, current midstream systems below 100% capacity – potentially leading to lower rates and volumes once existing contracts roll off; and maybe most important for recent equity performance, 6) anemic MLP product fund flows and continuing challenges with traditional capital raises that are needed to fund growth (i.e. large offering discounts, "equity overhangs," etc.).

Other factors affecting investor sentiment and/or trading behavior include: 1) lower beta for midstream stocks (driving underperformance vs. oilfield service and E&P stocks in the context of a risk-on commodity environment); 2) an increasing drumbeat from investors who want management teams across the energy industry to prioritize returns on invested capital, per share/unit metrics, and investor returns; 3) frustration with the slow pace of

[1] "Disciplined Spending in E&P Land: Fad or the New Normal?" Timothy Rezvan. Mizuho Securities. September 21, 2017.
[2] "Anadarko Announces $2.5 Billion Share-Repurchase Program." Anadarko Petroleum Corporation. September 20, 2017.
[3] "EQT Accelerates Plan to Address Sum-of-the-Parts Discount." EQT Corporation. September 13, 2017.

industry consolidation; and 4) corporate governance, the conflicting interests of LPs and GPs and the frequency of corporate actions that have had unpredictable and significant impacts on shareholder/unitholder returns.

Additionally, we often hear circular/confusing lines of thinking from other MLP traders seeking to explain the performance of MLPs. One goes something like this: on a day when crude oil prices are down, "Sell MLPs because crude oil prices are down… there's too much production." But, wait, volume growth is good for MLPs in general, right? Then, on a day when crude oil prices are rising, "Crude oil prices are rising because rig activity growth is slowing, sell MLPs because this means lower volumes for MLPs." A separate argument suggests that higher crude oil prices could lead to higher rigs and higher production, but that will then short-circuit the ultimate energy recovery, leading to lower crude oil prices and rigs/production/throughput, all else equal.

Yet another related but equally confusing trading narrative is this: on a day when crude oil prices are down, "Sell MLPs because they have commodity sensitive contracts and are clearly correlated to crude oil prices." But then on a day when crude oil prices are rising, "Buy E&P stocks and sell MLPs because E&Ps are the better commodity play, and MLPs have fixed fee businesses and are not directly correlated to crude oil prices."

You see why we can be so frustrated. In what environment are we supposed to buy MLPs? (*Obviously, a rhetorical question*). As mentioned earlier, sometimes it feels to us like investors are trying to "backsolve" for a rationale to the underperformance. Again, we understand and monitor all of these issues, and we acknowledge there are several, but we continually stress our investment theses and continue to believe these risks to be overly discounted in current midstream valuations.

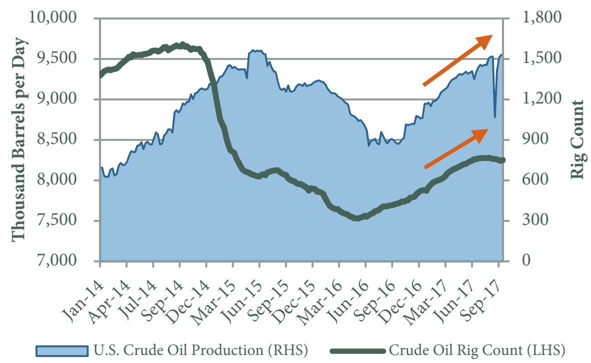
Underlying Midstream Fundamentals Increasingly Constructive

Despite these lingering issues and the AMZ Index ending the period in line with levels at the end of December 2015, the underlying fundamentals for the energy sector as a whole, including the midstream sector, have greatly improved over this 21-month period. The simple fact is that U.S. shale oil producers have proven capable of reducing their per-barrel costs and competing in the global market at price points that would have been unimaginable just a few years ago. As we've stated before, if energy commodity prices remain low as a result of continued U.S. production increases, this should benefit midstream companies, as the increased volumes should flow through their systems.

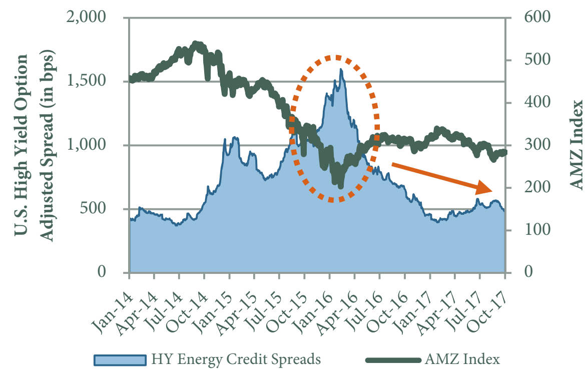
Today, domestic crude oil production has returned to pre-downturn levels, and the growth outlook remains robust (see chart next page left). In general, E&Ps have fortified their balance sheets, are better positioned for a lower-for-longer commodity price environment, and have placed a renewed emphasis on capital discipline, responsible growth and shareholder returns.

Concurrent with this positive energy macro-level backdrop, midstream companies have, in general, bolstered their position at the partnership/company level. Costs of capital have been reduced, balance sheets have been strengthened and distribution coverage levels have increased. We believe management teams are now less beholden to the capital markets, and are increasingly focused on capital efficiency and "per unit" growth metrics.

U.S. Crude Oil Rig Count and Production (1)



High Yield Energy Spreads Have Compressed (2)(3)



1) Source: Bloomberg. Rig count data from Baker Hughes. Crude oil production from EIA. Data shown for the period January 1, 2014 through June 30, 2017.
2) Source: Bloomberg. "Energy Sector HY Credit" is the Bloomberg sourced USOHHYEN Index, an option adjusted spread of the USD HY Energy Sector. Data shown for the period January 1, 2014 through June 30, 2017.
3) **PAST PERFORMANCE IS NOT INDICATIVE OF FUTURE RESULTS.**

With regards to the capital markets, although equity markets remain depressed, high yield energy spreads have compressed (see chart above right), and MLPs have been successful in accessing alternative forms of equity capital (preferreds, units to sponsors, direct offerings, etc.). As an example, Buckeye Partners, LP (NYSE: BPL), Shell Midstream Partners, LP (NYSE: SHLX) and Phillips 66 Partners LP (NYSE: PSXP) recently raised a total of $575mm through direct offerings to MLP institutional investors, including MLP dedicated funds, in September, a sign that investor sentiment and MLP product fund flows may finally be improving. Additionally, there was another MLP initial public offering during the period, increasing the year-to-date count to five, which is a distinct improvement from one offering completed during all of last year. Of note, BP p.l.c. (NYSE: BP), a major international energy company, announced the planned initial public offering of its MLP, BP Midstream Partners, LP, during the period.

Several major projects currently underway appear to be finally overcoming regulatory hurdles (e.g. Rover, Mariner East, Atlantic Sunrise, etc.), with significant cash flow uplifts projected following in-service dates. As expected, pipe-on-pipe competition appears to be working itself out with several joint venture formations announced during the period and early October (e.g. Gulf Coast Express, Grand Prix, Pasadena Marine, etc.).

Heading into the end of the year, we believe the factors are in place for positive earnings impacts as well. Third quarter earnings will likely be messy as a result of Hurricane Harvey, but we believe investors will generally look past these items as "one time" in nature. Irrespective of hurricane impacts, just a few of the positive midstream-specific drivers for earnings include: 1) natural gas basis differentials continue to widen in Texas, a positive for intrastate pipelines; 2) Natural gas liquids (NGL) prices and the "frac spread" continues to strengthen, a positive for gas and NGL processing; and 3) WTI-Brent crude oil price spreads continue to widen, a positive for crude oil pipelines delivering into the Gulf Coast, crude oil export facilities and supply and logistics operations in select basins.

Of note, Moody's Investors Service finally upgraded the outlook for the global midstream energy sector to positive on September 27, 2017, based on expectations for improving fundamental business conditions over the next 12 to 18 months. From the release:

> *"The U.S. E&P industry has ramped up development activity in 2017, with the U.S. land rig count more than doubling from trough levels seen in the second quarter 2016 through mid-2017.*

"The ongoing increase in oil and gas production is translating to greater volumes for midstream operators to process," observed Moody's Vice President James Wilkins. "And as a result, further investment in infrastructure will drive higher earnings for the midstream sector."

Moody's expects EBITDA for the midstream energy sector will grow 8%-10% in 2018, which would be well above the 5% threshold normally required for a positive sector outlook."[4]

And finally, against the backdrop of the increasingly constructive fundamentals mentioned above, current valuations remain compelling regardless of the metric. As the tables and graphs below illustrate, we believe MLPs are cheap relative to their own history, relative to other components of the energy sector and relative to other yield-oriented assets.

Current Versus Historical MLP Valuation Metrics

MLP Valuation Metrics	Current	5-Year Average	Premium (Discount)	10-Year Average	Premium (Discount)
Midstream MLP Yield	8.00%	6.5%	(19%)	6.9%	(14%)
Price-to-DCF	11.2x	12.4x	(10%)	12.1x	(8%)
EV-to-EBITDA	11.3x	13.4x	(16%)	12.3x	(8%)
Spread-to-10-Year Treasury – discount (premium)	563	470	--	422	--
Spread-to-Investment Grade Bonds – discount (premium)	360	191	--	127	--
Spread-to-High Yield Bonds – discount (premium)	281	72	--	(63)	--

Source: "Midstream Monthly Outlook: October 2017." Wells Fargo Securities. October 5, 2017.

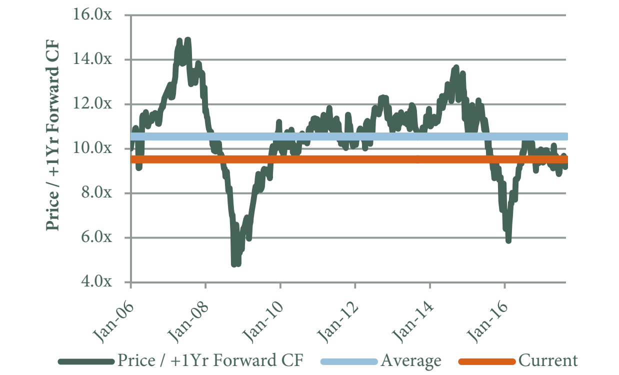
Current Versus Historical Relative Valuation Metrics

EV-to-EBITDA Multiples	Current	5-Year Average	Premium (Discount)	10-Year Average	Premium (Discount)
MLPs	11.2x	13.4x	(16%)	12.3x	(8%)
Midstream C-Corps.	12.4x	15.1x	(18%)	13.5x	(8%)
Energy:					
Exploration and Production	8.3x	6.7x	24%	5.9x	41%
Refiners	7.1x	5.4x	31%	5.1x	39%
Integrated Exploration and Production	7.9x	5.3x	49%	4.8x	65%
Oilfield Services	8.7x	7.8x	11%	7.1x	23%
Yield:					
S&P Utilities	10.3x	8.7x	18%	8.0x	29%
REITs	17.2x	16.6x	4%	15.1x	14%
Market:					
S&P 500	11.1x	9.2x	20%	8.5x	30%

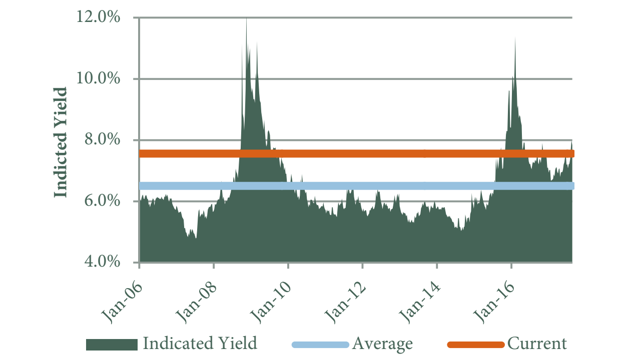
Source: "Midstream Monthly Outlook: October 2017." Wells Fargo Securities. October 5, 2017.

[4] "Moody's: Global Midstream Energy Outlook to Positive from Stable on Improving Business Conditions." Moody's Investor Service. September 27, 2017.

AMZ Price to +1Yr Forward Cash Flow (1)



AMZ Yield to 10-Year Treasury (1)



1) Source: Bloomberg, as of September 30, 2017. **PAST PERFORMANCE IS NOT INDICATIVE OF FUTURE RESULTS.**

Concluding Remarks

As we continue in the recovery phase of the energy cycle, our frustration has increased but our conviction has not waned. We think, in short, that MLPs will benefit from improving operational economics and growing volumes, a favorable shift in the regulatory environment and renewed interest by providers of capital. MLPs have continued to make headway in simplifying structures and reducing or eliminating incentive distribution rights ("IDR") burdens. Companies have, in large part, responded to pressures from the market to improve balance sheets and distribution coverage and, we believe, are well positioned to take advantage of future growth opportunities.

We thank you for your support and your confidence in choosing Cushing Asset Management to manage your MLP investments. We are, as always, available to answer any questions you may have.

Cushing Investment Team

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Investments in MLPs are subject to price changes in crude oil and natural gas, as well as regulatory and interest rate risks, among others.

Glossary of Indices: The Alerian MLP Index (AMZ) is a composite of the most prominent energy master limited partnerships. The Cushing® 30 MLP Index (MLPX) is an equal weighted index that tracks the performance of 30 publicly traded MLP securities that hold midstream energy infrastructure assets in North America. The S&P 500 Index is a capitalization-weighted index of 500 stocks. The index is designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries. The S&P 500 Energy Index (S5ENRS) is a capitalization-weighted index comprised of those companies included in the S&P 500 that are classified as members of the GICS energy sector. The S&P 500 Oil & Gas E&P Sub Industry Index (S5OILP) is a capitalization-weighted index. This is a GICS Level 4 Sub-Industry group. The Philadelphia Stock Exchange Oil Service Sector Index (OSX) is a price-weighted index composed of 15 companies that provide oil drilling and production services, oil field equipment, support services and geophysical/reservoir services. The S&P 500 Utilities Index is comprised of those companies included in the S&P 500 that are classified as members of the GICS utilities sector. The S&P 500 Real Estate Investment Trusts REITS Industry Index (S&P 500 REITS) is comprised of stocks in the S&P 500 Index that are classified as members of the GICS REITs sector.

Indices are included for comparative purposes only.

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