ADVISORY RESEARCH
INVESTMENT MANAGEMENT

MLP Equity Review

March 2017

COMMENTARY

Master Limited Partnerships ("MLPs"), as represented by the Alerian MLP Index ("Index") returned 4.0% during the quarter ended March 31, 2017; this compares to a 6.1% return for the S&P 500 Index over the same period. For the one-year period, MLPs returned 28.3% versus the S&P 500 return of 17.2%. It is noteworthy that while the S&P 500 is near all-time highs, MLPs remain 28.4% off of their previous highs set in August 2014.

OUTLOOK

Coming off of a solid first quarter we continue to expect double-digit returns for MLPs in 2017 with longer-term expectations of 7-11% per annum. It is worth noting that April is historically the best month for MLP performance as investors look to buy in prior to the distributions being paid late in the month.

Key Issues

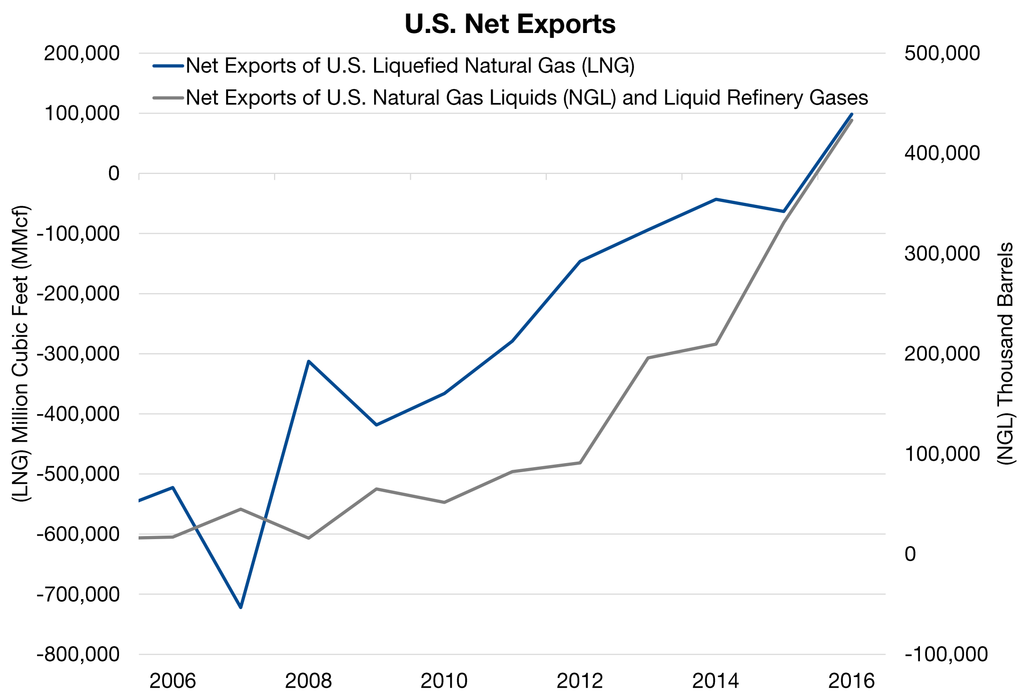
Our current overview of the likely drivers of MLP returns is in the table below.

Key Issues	Positive	Neutral	Negative	Comment
Political and Regulatory	☑			Regulatory and policy outcomes remain uncertain; but expectations are for an improved business environment
Commodity Prices		☑		OPEC production cuts have supported commodity prices
Valuations	☑			MLPs remain cheap versus comparable asset classes
Interest Rates			☑	Interest rate increases expected to impact higher yielding securities
Distribution Growth		☑		Estimates have stabilized in the mid-single digits for MLPs
Energy Infrastructure Build-Out	☑			Expectations for increased spending in 2017 and 2018

Our key-issues table is more positive this quarter than last. In our year-end letter we outlined an expectation that the political and regulatory environment would improve in the first quarter. Our expectations were met as the new administration's cabinet appointments and executive orders were generally friendly to energy infrastructure. In its first 100 days in office, the new administration helped move forward the Dakota Access and Keystone XL pipeline projects and has installed several energy-friendly appointees to cabinet level positions. The stage appears set for the executive branch and federal agencies to help, rather than impede, the growth of the U.S. energy industry over the coming years. While we will be monitoring the expected upcoming debate on a tax bill and an infrastructure bill for impacts to energy infrastructure, we are not building any meaningful legislative action into our outlook. Our positive outlook is based on an expectation that the federal government will be more supportive of the energy industry than the last administration. This includes an expectation that the current tax advantage for MLPs will be maintained.

We are also more bullish on the near term outlook for the build out of energy infrastructure than we were at the end of the year. There are several factors driving our improving outlook. Commodity prices, specifically oil, have started to stabilize. More stable prices combined with the perception of an improving business environment have incented producers to expand their production plans. According to the U.S. Energy Information Administration, capital expenditures of onshore focused oil production companies increased 72% Q4 '16 over Q4 '15. This capital is being spent primarily on drilling and completing new wells. New wells lead to new production which in turn supports existing infrastructure and may require new midstream energy infrastructure if production levels exceed previous highs, which seems possible. A good example of this is the rapid recovery in oil drilling activity in the prolific Permian Basin, whose oil rig count is up more than 140% from its low at the end of April 2016. This increase in activity has led to the announcement of multiple oil, natural gas liquids (NGL) and gas pipeline take-away projects from the Permian to accommodate expected volume growth and prevent possible supply bottlenecks. Overall this is a favorable fundamental back drop for MLP and energy infrastructure security performance, but we remain vigilant on oil prices as they seem to underpin improved investor sentiment.

As the U.S. reasserts its leadership role in the global energy industry, it is evidenced by a recent uptick in export volumes. While many may be aware of the Obama administration's shift to allow crude oil exports or that the U.S. recently started exporting liquefied natural gas (LNG), the broad impacts may not be as well known. As the chart below illustrates, the U.S. has become a net exporter of LNG, ethane, propane, and petroleum products. Access to global markets has the potential to drive demand for domestic energy production and infrastructure utilization. Although only a recent trend, it bears watching as it could have profound impacts on our market over time.

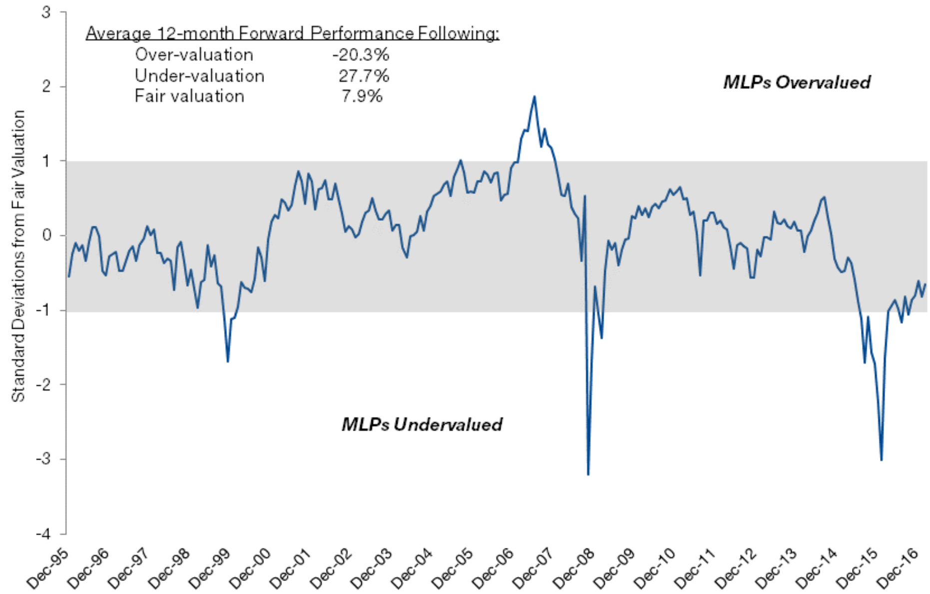


Source: Advisory Research, U.S. Energy Information Administration

Valuation

Valuation remains reasonable with MLP absolute and relative valuations near historical averages, with the exception being the comparison to high-yield corporate bonds, which make MLPs look inexpensive. MLPs remain 28.4% below their all-time highs. The solid fundamental outlook combined with reasonable valuation supports our view of double digit total returns in 2017 and longer term returns of 7-11%.

MLP Valuation

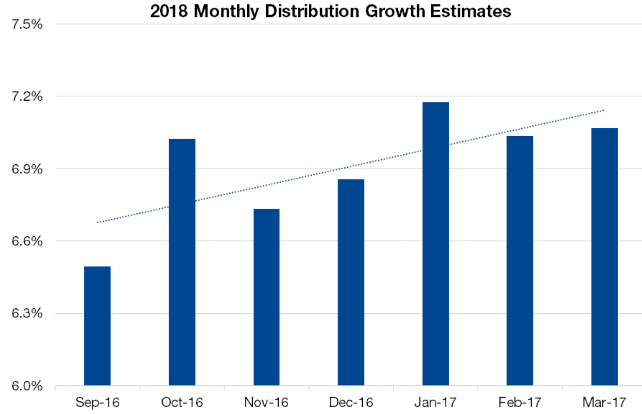


Data Source: FactSet
Period: Jan 1996 - Mar 31, 2017

Portfolio Positioning

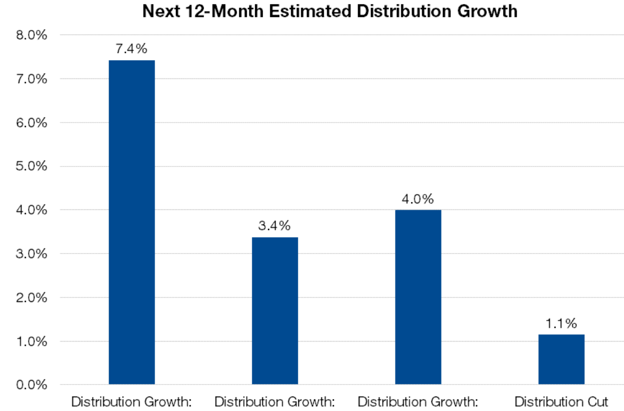
We observed two related market trends in the quarter that are driving a gradual shift in positioning. The first trend is that MLPs are once again trading down when they indicate or announce distribution cuts. For most of the history of the MLP market this was the expected reaction to a distribution cut. During the bear market we observed that, for a time, the market was rewarding MLPs for cutting distributions. The rationale was likely that MLPs traded down so much during the bear market that distribution cuts were already built into their price. When the cut was actually announced, investors were often pleased that the cut was less than expected or at the least increased certainty around the MLP's future plans. In general, investors gave MLPs a pass during the bear market to cut distributions in an effort to appease credit agencies or position themselves better for future growth. As we entered 2017, we returned to the more traditional market reaction to distribution cuts of selling the announcement. An example of this that impacted our portfolios was Enbridge Energy Partners' late January indication that a meaningful distribution cut was likely. The market's reaction was a quick 25% decrease in Enbridge's price. To us this shift in attitude surrounding distribution cuts is one indication that normal markets have returned and that MLPs are once again expected to grow, not reduce, their distributions. With this trend that expectations for future distribution growth are increasing, the result was higher growth MLPs outperformed lower growth MLPs for the first time since the fourth quarter of 2015. Below is a chart showing the increasing expectations for 2018 distribution growth and a second chart showing the return of higher growth MLPs versus lower growth MLPs during the quarter.

Alerian MLP Index
2018 Monthly Distribution Growth Estimates



Note: The Alerian MLP Index is rebalanced on a quarterly basis. AMZ constituents change on a quarterly basis.
Source: FactSet Research Systems, Alerian, Advisory Research

Alerian MLP Index Q1 2017 Performance
Next 12-Month Estimated Distribution Growth



Source: FactSet Research Systems, Advisory Research

It is our observation that both of these trends indicate that the market is not only expecting, but more willing to pay for growth. We are reacting to this changing trend by increasing our portfolio holdings in higher growth MLPs where our team believes that the growth is highly achievable and where valuations remain reasonable. A good example of a higher growth MLP is Tallgrass Energy Partners LP, a midstream natural gas infrastructure player. Tallgrass is growing through organic capital expenditures and the acquisition of an increasing stake in the Rocky Mountain Express pipeline (REX). REX was originally built by Kinder Morgan to bring stranded Rocky Mountain region gas east where it could receive a better price. This was conceived before the Marcellus shale production potential was truly appreciated. Kinder Morgan eventually sold the pipeline and Tallgrass purchased it with a new vision, to move Marcellus gas west. This bi-directional optionality of the pipeline makes what was once a single purpose pipe a true artery of the country's natural gas infrastructure. In only the last few quarters the growth of Tallgrass was questioned by market participants, but the eventual success of this new strategy is becoming more clear.

ATTRIBUTION

The trends away from higher-yielding and smaller-cap MLPs that started late in the fourth quarter of 2016 continued into early 2017. A trend that carried over from last year was the underperformance of the lowest quality MLPs. These market trends did not materially impact our portfolio's relative performance during the quarter. Security selection was a larger driver of relative return than were market factors such as growth, yield or capitalization. The portfolio's relative return was impacted by security selection, particularly Enbridge Energy Partners.

Note: This commentary contains forward-looking statements about various economic trends and strategies. You are cautioned that such forward-looking statements are subject to significant business, economic and competitive uncertainties and actual results could be materially different. There are no guarantees associated with any forecast; the opinions stated here are subject to change at any time and are the opinion of Advisory Research, Inc. The data is obtained from sources we deem reliable; it is not guaranteed as to its accuracy. Past performance does not guarantee future results. Investing in Master Limited Partnerships may require tax filings in multiple jurisdictions. This report is for informational purposes only and is not an offer to sell or a solicitation of an offer to buy any securities. Actual client portfolios may vary from the model portfolio. The Alerian MLP Index is a leading gauge of energy Master Limited Partnerships (MLPs). 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). It is not possible to invest directly in an index.