6% Yields on MLPs Are Looking Attractive

Another day and another new low for crude oil. Since stocks are moving with oil, trying to figure out the short term direction of the equity market requires being an oil trader. Few of us are any good at this although it’s easy to have an opinion. For our part, we don’t bet on the direction of oil although many of our investments react to it so we’re certainly experiencing the moves.

Master Limited Partnerships (MLPs) as I write this are close to flat on the year (as represented by the Alerian index). Distribution yields have drifted up to 6%. Midstream MLPs care about volumes of product, crude and refined, that they gather and process, store and transport. Lower oil is currently forecast to add 0.5% to US GDP in 2015 as the tax cut that it represents feeds through to higher consumption. Energy demand is unlikely to fall, and obviously should increase at the margin. Americans will drive a little more and worry a little less about conservation. The outlook for MLPs is generally good.

The shale boom may slow, with reductions in capex and therefore at the margin some growth projects that could fuel faster distribution growth may be delayed or cancelled altogether. U.S. oil production may not grow as fast as expected. Of course, it’s not only U.S. production that may slow. Halliburton announced 1,000 job cuts in response to weaker demand for their services across Europe, Russia, Africa and the Middle East. Day rates for offshore drilling are plummeting as reported by Transocean (RIG) and Diamond Offshore (DO). The U.S. is one of the few places where productions costs are falling. Range Resources (RRC) has been reducing its output costs of natural gas from SW Pennsylvania by 7% annually for several years.

Seasonally, MLPs typically rally in December and January as retail investors reallocate cash. So far December is not typical. But 6% yields are attractive with even half the growth you thought MLPs might be generating, and there's certainly no reason to expect any demand destruction which is what most hurts their businesses. Falling asset prices are never pleasant for the holders of those assets. But an unleveraged investment in MLPs at today's levels is likely to look prescient a year from now.