Pipeline Earnings in a Market Focused Elsewhere

Earnings season for midstream energy infrastructure kicks off with Kinder Morgan (KMI) on Wednesday. In April we identified growing free cash flow (see The Coming Pipeline Cash Gusher) as the most important catalyst for higher security prices. We'll be reviewing quarterly earnings for evidence that the sector remains on track to generate increasing amounts of excess cash that can be used to reduce debt, increase payouts and buy back stock. There should also be some useful guidance on activity from the sector's upstream customers. Investors and analysts seems weary of persistent low valuations, so any positive surprises should draw buyers.

The American Energy Independence Index (AEITR) is +16.9% YTD, having pulled back around 3.5% so far in October. It's 11% ahead of the Alerian MLP Index, because its 80% weighting towards corporations (more ESG-friendly) better reflects investor preferences, which is to favor pipeline corporations over MLPs (see MLPs No Longer Represent Pipelines and ESG Investors Like Pipelines)

Do We Have a Deal?

Although earnings and company guidance ought to dominate sector performance in the weeks ahead, there are a growing number of macro and geopolitical issues that are impacting investor sentiment.

- Making a deal with China in time to eliminate this as a potential election-year negative seems obvious (see Trade Wars: End in Sight). However, the latest signs of agreement have left the market nonplussed given the fitful journey followed so far.
- Middle East. Like many observers, we were surprised at how quickly crude oil prices retraced gains following the attack on Saudi infrastructure. Clearly, oil traders regard any disruption of supplies as unlikely, even after the more recent missile attack on an Iranian tanker in the Red Sea near Jeddah. Nonetheless, American midstream energy infrastructure doesn't face similar risks from terrorists or foreign powers.
- Another EU deadline approaches in this most riveting drama (see Another Gripping Episode of Brexit). This is of little global consequence unless the UK somehow leaves the EU without an agreement (a "hard Brexit"). This is unlikely, but not impossible if one bluff too

many is called.

Earnings may be overshadowed by developments. Global slowdown fears continue to spread. 2019 S&P500 earnings estimates have been softening all year, from $178 per share last October to $164 now, according to Factset. Bond yields remain highly unattractive. The Equity Risk Premium still shows stocks as a far preferable investment (see Stocks Offer Bond Investors an Opening).

Bill Gross recently recommended investors load up on high quality dividend-yielding stocks rather than negative-yielding government debt. We think bond markets are distorted in part by rigid investment guidelines followed by pension funds that require them to maintain large fixed income allocations regardless of return prospects (see Pension Funds Keep Interest Rates Low).

Equities remain attractive, and pipeline stocks exceptionally so.

We are invested in KMI.