ClearBridge
A Franklin Templeton Company

Energy MLP Strategy

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Key Takeaways

- While U.S. equities bounced back from a first-quarter correction and survived tariff, growth and geopolitical scares to deliver solid gains in the second quarter of 2025, tariff uncertainty and geopolitical tensions drove negative returns for midstream energy stocks.
- Midstream stocks would stand to benefit from deregulation, an environment of greater M&A and capital markets activity broadly, which we expect to inflect higher under the Trump administration.
- We continue to emphasize balance sheet strength, asset footprint diversity and quality and carefully assess our holdings with an eye toward managing successfully through short-term disruptions and thriving in the long term.

Market Overview

U.S. equities bounced back from a first-quarter correction and survived tariff, growth and geopolitical scares to deliver solid gains in the second quarter of 2025. The broad market S&P 500 Index returned 10.9%. Stocks fell after President Trump unveiled wide-ranging reciprocal tariffs on April 2 but recovered as delays in their implementation, a handful of bilateral trade deals and a softened tone from Trump on both China and Federal Reserve policy improved the outlook.

The rebound following April's tariff scare was marked by a return to AI market leadership, with hyperscalers showing their commitment to high levels of AI-driven capex, and both they and semiconductor companies buoyed by solid earnings and renewed expectations of widespread adoption of AI. Concerns over the deficit and inflation kept Treasury yields elevated and led to more modest returns for income-oriented sectors such as utilities and consumer staples and largely flat returns for real estate. Tariff uncertainty and geopolitical tensions capped gains for economically sensitive financials and materials stocks and drove negative returns for the energy sector.

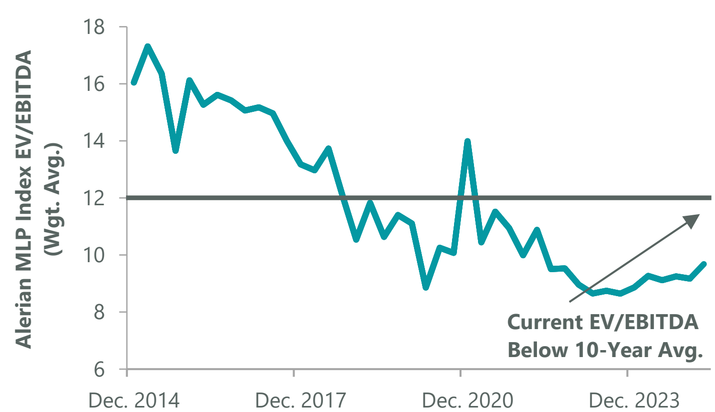
Energy sector performance was also hindered by a 9% decline in the price of oil as traders bet the current Middle East conflict would spare energy assets and be short lived. Natural gas prices likewise fell, from \$4.119/mmBtu to \$3.490/mmBtu in the quarter. In this environment the Alerian MLP Index returned -4.9%.

Demand for U.S. oil and gas is increasing amid concerns about geopolitical risks in the Middle East and Europe; the U.S. has surpassed Russia and Saudi Arabia in production of crude oil, and it is seeing substantial growth in liquified natural gas exports as it asserts its growing presence as an energy superpower. In addition, we expect the new administration to be less onerous in its regulatory framework, with less stringent controls on exports as well as pipeline permitting, all of which give us a fair degree of confidence in the future of U.S. oil and gas production growth and the placement of midstream to capture value.

Such hydrocarbon production growth is positive for midstream energy, which is well-positioned to benefit from growing volumes while maintaining limited commodity price exposure. This growth, combined with capital discipline on the part of midstream companies, makes us constructive on free cash flow, revenue, distribution and EBITDA growth in the sector as a whole. Midstream energy has moved from being free cash flow negative to free cash flow positive and balance sheet leverage (debt/EBITDA) has decreased significantly, strengthening capital profiles. With little to no need for midstream companies to access capital markets for the foreseeable future, we expect excess cash flow (above and beyond capital spending and dividends/distributions) to be used for incremental share buybacks and further raising dividends/distributions.

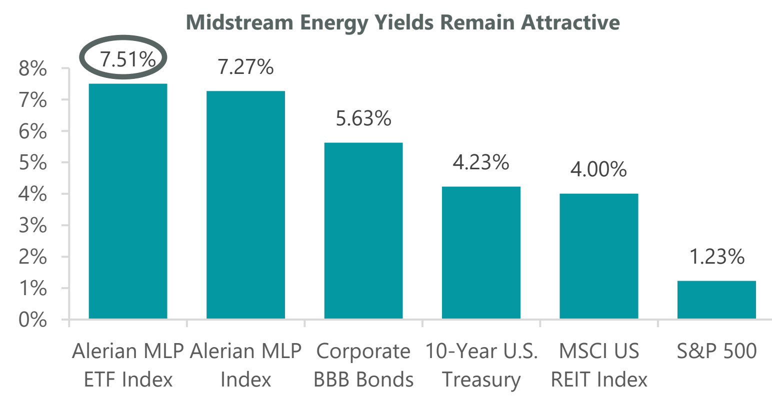
Meanwhile, midstream energy valuations remain attractive, in our view. For example, using EV/EBITDA as one valuation metric, the Alerian MLP Index is still trading at modest multiples, especially compared to its long-term history (Exhibit 1). In addition, based on current distribution yields, the Alerian MLP Index not only screens attractive on a relative and absolute basis compared to yields in other equity asset classes, but also against high-quality fixed income securities (Exhibit 2).

Exhibit 1: Midstream Energy Trades at Modest Multiples



As of June 30, 2025. Source: ClearBridge Investments, FactSet.

Exhibit 2: Midstream Energy Dividend Yield Vs. Other Securities

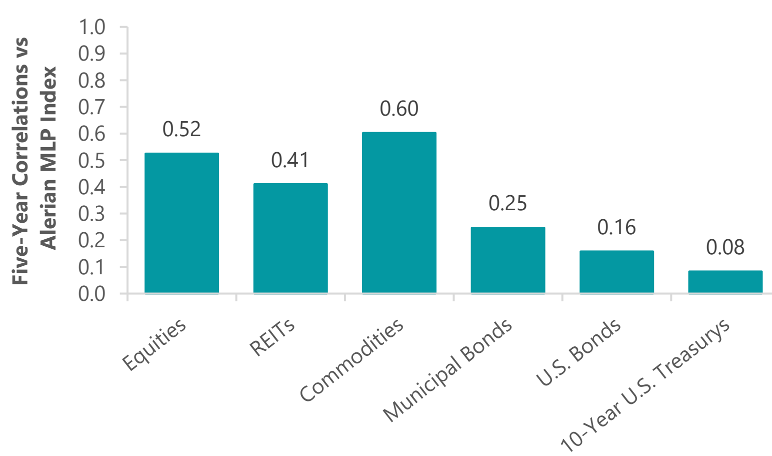


As of June 30, 2025. Source: ClearBridge Investments, FactSet.

The sector would also stand to benefit from an environment of greater M&A, which we expect to inflect higher under the Trump administration. M&A activity could provide an incentive for investors to embrace the new midstream energy business model, while any move toward less stringent permitting for pipelines would also be a positive.

One potentially overlooked benefit of midstream energy is its low correlation to other asset classes, including to bonds and interest rates, and its powerful role as a portfolio diversifier (Exhibit 3).

Exhibit 3: Midstream Offers Low Correlation to Other Asset Classes



Source: FactSet, as of June 30, 2025. Five-year correlation of Alerian MLP Index (midstream), S&P 500 Index (equities), S&P GSCI Energy Index (commodities), Bloomberg U.S. Municipal Bond Index (municipal bonds), Bloomberg Capital U.S. Aggregate Bond Index (U.S. bonds), Bloomberg Capital U.S. Treasury 7-10 Year Note (10-year U.S. Treasurys), FTSE NAREIT All Equity REITs (REITs).

Portfolio Positioning

We view the best way to take advantage of this opportunity is with an active diversified portfolio emphasizing balance sheet strength, asset footprint diversity and quality, and we have positioned the Strategy to capitalize on the opportunity while using only prudent leverage. On a sector basis, our largest exposure is to diversified energy infrastructure, where our largest holding is Targa Resources, which is focused on natural gas and natural gas liquids. Our largest individual holdings are Kinder Morgan and Enbridge, two natural gas–focused companies in the liquids transportation & storage subsector. These position weights reflect our conviction that these companies are well-positioned to not only maintain distributions but exhibit growth over time.

Outlook

With high relative yields, expected growth in income, limited interest rate risk and limited commodity exposure, energy infrastructure stocks remain well positioned. The transformed midstream business model, including emphasis on free cash flow after dividends/distributions, balance sheet delevering, share buybacks and dividend/distribution increases, is still in the early innings of being recognized by investors. This, coupled with high current yields, could allow for the midstream sector to experience cash flow multiple expansion (relative to today’s undemanding multiples).

We remain opportunistic and tactical in managing through the high level of volatility in the energy market. Oil supply is adequate for the time being and the risk of flooding the market with additional barrels from Saudi Arabia is a continuing development we are watching. We continue to emphasize fundamentals and risk management with an eye toward executing successfully through the short-term disruption and thriving in the long term. We still believe that in the long term, midstream companies and MLPs represent an attractive investment opportunity as the U.S. cements its status as an energy superpower through sustained hydrocarbon production increases. This trend bodes well for high-quality energy MLPs as volumes to be processed are poised to increase over time.

Portfolio Highlights

The ClearBridge Energy MLP Strategy outperformed its Alerian MLP ETF benchmark during the second quarter. In terms of absolute performance, three of the four primary subsectors in which the Strategy is invested made positive contributions, with the gathering/processing subsector contributing the most and the diversified energy infrastructure subsector the sole detractor.

On a relative basis, the Strategy outperformed due to stock selection and sector allocation effects. In particular, stock selection in the gathering/processing, natural gas transportation & storage and liquids transportation & storage subsectors contributed, while stock selection in the diversified energy infrastructure subsector detracted.

In terms of individual holdings, Cheniere Energy, DT Midstream, Williams Companies, Kinder Morgan and Antero Midstream were the main contributors. The main detractors were ONEOK, Targa Resources, Plains GP Holdings LP, Hess Midstream LP and Chevron.

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