ELCO Management Company, LLC

April 2018

ELCO Infrastructure and MLP SMA 2018 Update

At ELCO, we have been investors in the MLP/Midstream Infrastructure asset class for better or worse since the group's early days. We have experienced many cycles as market participants watching the group go from the penthouse to the dog house and back again. Managing a long-only portfolio of MLP and C-Corp Midstream companies has had recent challenges. However we believe the pendulum has swung too far. Investor sentiment is flat out rotten and valuations are bouncing along all-time lows all while fundamentals are probably the best they've been in over a decade. This disconnect cannot last, in our opinion, especially when catalysts we have been so excited about over the last 5 years are finally tangible and operational i.e. major gains in LNG, crude oil, and refined products exports, U.S. petrochemical renaissance, and record crude oil and natural gas production. Therefore, we wanted to dive into some of the issues that caused the underperformance and highlight some of the core positions in our Infrastructure and MLP Separately Managed Account program and communicate how they are benefitting from improving fundamentals. We believe there is an incredible opportunity as the market is significantly discounting the group's intrinsic value.

Please also see the recent Barron's article titled "MLPs Look Attractive Again, and Yield as Much as 8%", the publication had been critical of the midstream space for quite a while. This is another sign the tide is changing.

What happened?

The first quarter was a bumpy ride as the groups benchmark, the Alerian MLP Index was down 11.12%. (ELCO Infrastructure and MLP SMA was down 10.02%) This underperformance can be attributed to weak fund flows, confusion over the group's structure, compounded by an unfortunate press release from the Federal Energy Regulatory Commission (FERC) relating to a reversal of a longstanding income tax allowance on FERC regulated pipelines. This unfortunate news came at a time when the

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industry is going through some radical changes in corporate structure. Most midstream management teams have accepted the new reality. A change we welcome and believe will benefit the shareholder in the next cycle. This new environment brings stronger balance sheets, reduced leverage, the elimination of incentive distribution rights, and management teams whose compensation is tied to returns not just growth of the distribution. We have called this a "maturity process" and believe these changes will open this asset class to more institutional investors, something we believe has just begun.

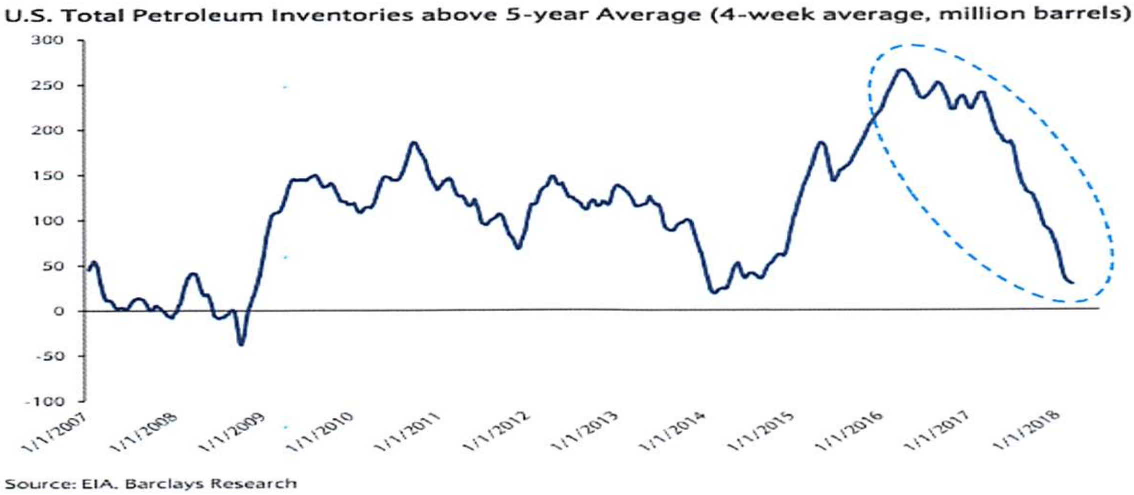
What the FERC?

On March 15th 2018 the FERC proposed to disallow the recovery of income tax allowances for regulated interstate natural gas pipelines operating under the coast of service contract structure. The proposed ruling has potential to negatively impact only about 3 midstream companies Enbridge, TC Pipeline, and Dominion Midstream (<u>none of which are in our portfolio</u>). Unfortunately, this news impacted the overall space even companies that have **no** FERC regulated assets like Targa Resources and Sunoco LP. Most of the pipeline contracts are negotiated fees and are thus not impacted. In addition, even in terms of cost of service contracts, there are so many other variables (i.e. cost inflation as well as current rate structure) that make a onetime generalization impact ill informed. This was "a baby with the bath water" event. In response, all midstream companies in our portfolio have issued press releases stating the proposal is non-material and are preparing comments to the commission. More recently, the FERC Chairman admitted the issue was handled poorly by the commission and that they would address the industry's challenges of the decision and how it was communicated.

Comments on Commodity Prices

Oil prices have improved to levels not seen since 2014. OPEC's cooperation and strong global demand can be attributed to the improvement. The International Energy Agency (IEA) raised its forecast for oil demand this year to 99.3 million barrels per day (bpd), up from 97.8 million bpd in 2017. We have been closely monitoring the volatile situation in Venezuela which is clearly vulnerable to an accelerated decline in production and the heightened geopolitical intensity surrounding the Middle East producers. Since the 2015-

2016 oil price downturn, the world has failed to invest in future production and development, a failure we believe is beginning to play out (see below: recent inventory draws). There is potential for supply shortages that could disrupt and dictate the market's discussion around energy stocks. If the U.S. is looked upon to meet the demand shortages with increased shale production, undue stress could be put across the entire energy value chain, especially infrastructure.



Where do we go from here?

As said the above industry fundamentals have dramatically improved and are probably the best they have been in about a decade and catalysts we've written about at length (new projects going operational) are finally producing cash flow. The United States is producing records amounts of oil, natural gas, and natural gas liquids. All of which are flowing through under-utilized pipeline infrastructure allowing the midstream companies to benefit from operational leverage. The record hydrocarbon production has created an export boom for the industry as well. Demand from emerging markets for refined products has increased activity at export docks along the gulf coast. Crude oil, refined petroleum products, liquefied natural gas, raw natural gas liquids (NGLs), and refined NGLs in the form of ethylene and propylene (the building blocks of all plastics) are all leaving U.S. docks. Companies like Enterprise, Targa, Energy Transfer, Plains All-

American, and Magellan are all benefitting from this increased activity. Ethane demand is estimated to be more than double as the petrochemical buildout is completed. This dynamic would have major positive impact to fractionation margins for Enterprise, Targa, Williams, Energy Transfer, and Oneok. We now have two operational LNG Export facilities in the U.S., Cheniere's Sabine Pass and Dominions Cove Point, which required significant pull on natural gas production and increased pipeline throughput. Mexico has provided another outlet as our southern neighbor requires increased natural gas supply to feed their growing natural gas power generation build out. The five largest positions in our portfolio Energy Transfer, Enterprise, Magellan, Williams, and Targa have built and/or acquired integrated infrastructure assets that can gather hydrocarbons from the well-head and get them on a ship. This is a business model we believe will have growing scarcity value due to limited real estate and a complexity in constructing the necessary infrastructure.

These are high impact catalysts that have the potential to generate significant returns. We believe the tide is already turning albeit slowly. We look forward to hearing from these companies on their quarterly conference calls and expect solid results and very healthy outlooks. Noteworthy, our portfolio is currently yielding ~8%.

Sincerely,

Paul Elliot, CFA   Dan Tulis, CFA   James Elliot, CFA Paul Doran