

TIME FOR A CHANGE

ELECTING A NEW MIDSTREAM BENCHMARK

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Benchmarking performance of the midstream sector has become increasingly challenging as structural clean-up drives midstream assets away from the MLP structure. The traditional and most well-known benchmark, the Alerian MLP Index, is no longer an accurate representation of the performance of midstream, because corporations, Canada and general partners are not eligible for inclusion in that MLP Index. We believe the new Alerian Midstream Energy Index (AMNA) is the best benchmark by which to evaluate midstream/MLP managers going forward.



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KEY POINTS

- The midstream universe now consists of less than 50% K-1 MLPs.
- A midstream benchmark should have exposure to midstream companies in proportion to their market cap within the universe, regardless of structure.
- Investors are missing out on midstream exposure by using very popular passive MLP vehicles.
- With no passive options for the broader midstream universe, active management is critical.
- We believe the new Alerian Midstream Energy Index (AMNA) best represents the North American midstream opportunity set, because it is structure agnostic and inclusive of Canada.

EXHIBIT 1: MIDSTREAM REPRESENTATION VARIES ACROSS BENCHMARKS

	CBRE Clarion Midstream Universe	Alerian Midstream Energy Index (AMNA)	Alerian MLP Index (AMZ)	Alerian Midstream Energy Select Index (AMEI)	Alerian U.S. Midstream Energy Index (AMUS)
# of Constituents	90	67	40	39	58
Market Capitalization	\$654 billion	\$615 billion	\$334 billion	\$491 billion	\$481 billion
Top 10 Weights	57.0%	70.8%	61.6%	65.3%	72.5%
Sectors Excluded	None	Marine Transport	Corporations, Canada	Marine Transport	Canada, Marine Transport
Yield	6.16%	6.14%	8.04%	5.75%	6.30%
	CBRE Clarion Midstream Universe	Alerian Midstream Energy (AMNA)	Alerian MLP Index (AMZ)	Alerian Midstream Energy Select (AMEI)	Alerian U.S. Midstream Energy (AMUS)

The traditional and most well-known benchmark, the Alerian MLP Index, is no longer an accurate representation of the performance of midstream.

Source: CBRE Clarion, Alerian. Data as of 09/30/2018. An index is unmanaged and not available for direct investment. Yields fluctuate and are not guaranteed. Information is the opinion of CBRE Clarion, which is subject to change and is not intended to be a forecast of future events, a guarantee of future results, or investment advice. Forecasts and any factors discussed are not a guarantee of future results.

FRESH LOOK AT INDEX OPTIONS

Taking a fresh look at the midstream index options relative to the updated universe, AMZ screens worst on the most important metric we believe investors should consider: **universe capture**.

ASSESSING THE CANDIDATES

In Exhibit 1 on the previous page, we break down our midstream universe alongside several midstream and MLP indexes. The Alerian Midstream Energy Index (AMNA) most closely resembles our investible universe. Each of the others carries structural biases to certain areas of the universe:

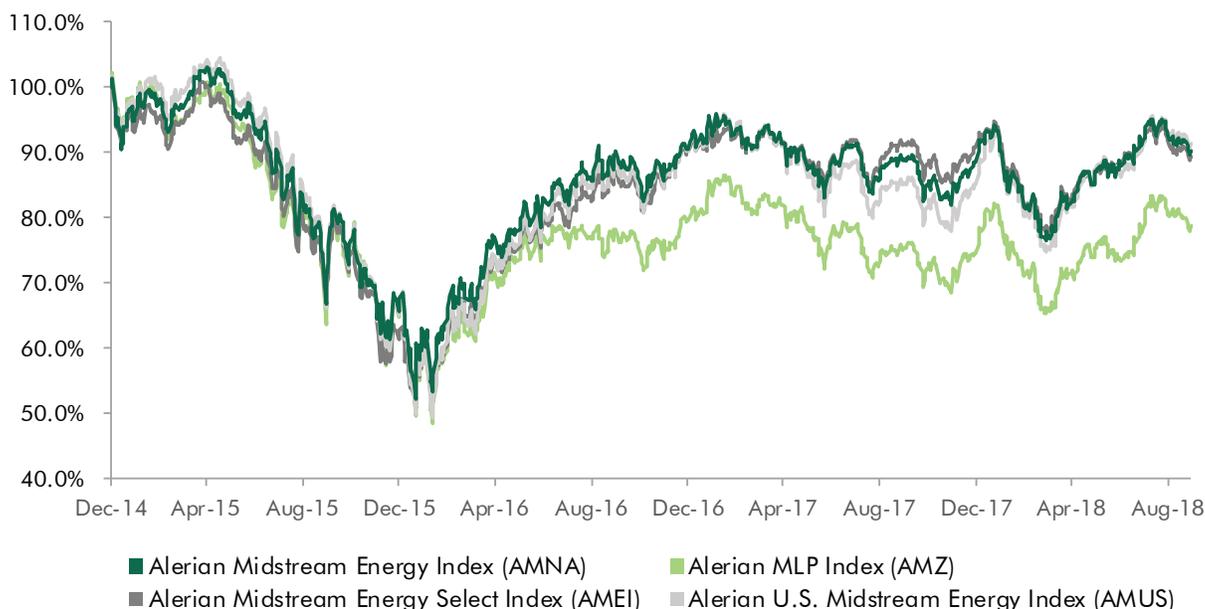
- AMZ is the most biased, excluding U.S. midstream corporations, Canadian midstream corporations and general partners
- AMEI limits MLP exposure to 25% to mirror restrictions of a registered investment company (RIC)
- AMUS limits exposure to U.S., ignoring some of the largest midstream companies in North America that are listed in Canada

We recognize certain investor groups may prefer to limit their investments to U.S. only or to MLPs only. At CBRE Clarion, we aim to offer a midstream strategy that offers an attractive return and risk profile relative to the midstream universe and relative to all benchmarks. We are also happy to oblige institutional separate accounts that choose to exclude certain parts of the universe. The AMZ has popularity, transparency, a long data history and relative independence. Long data history is not as important today after the steady stream of buyouts, rollups, and spin offs make re-creating historical returns challenging. Transparency of methodology and relative independence (outside of marketing passive products linked to indexes) carry over with Alerian to the new indexes, including our preferred AMNA.

ANTICIPATED PUSHBACK

Does it even matter? Will the Alerian MLP Index (AMZ) provide a decent proxy for all of midstream? In our opinion, the definitive answer is “No”. In fact, some of the largest pure-play midstream operators in the market are not eligible for inclusion in the AMZ, including Kinder Morgan (KMI), Williams Companies (WMB), ONEOK (OKE), Cheniere Energy (LNG), Targa Resources (TRGP) and all the Canadian midstream companies, which combined own some of the highest quality assets and represent \$295bn in investable market cap. The exclusion of these core companies has led to wide variance in performance and risk across indexes, as shown in Exhibits 2 and 3.

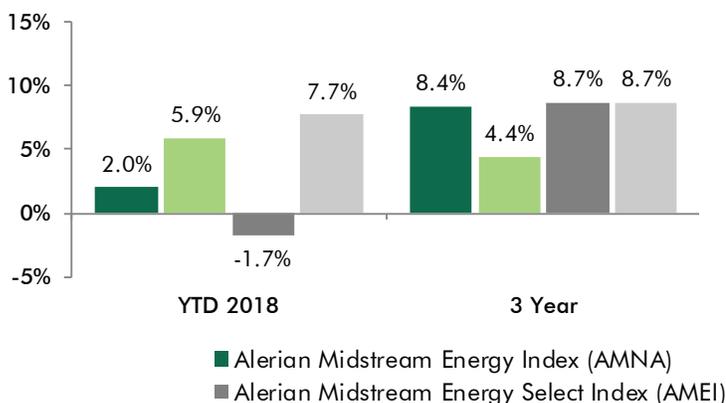
EXHIBIT 2: MIDSTREAM TOTAL RETURN SINCE 12/31/2014



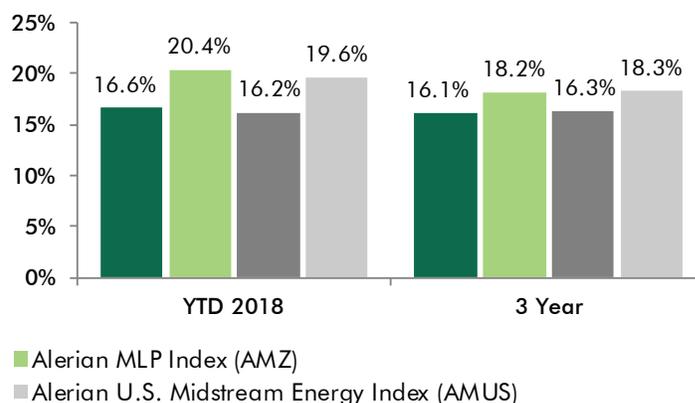
Source: Morningstar as of 9/30/2018.

EXHIBIT 3: LONG-TERM RISK AND RETURN

TOTAL RETURN



STANDARD DEVIATION



Source: CBRE Clarion data as of 09/30/2018. Index performance reflects the reinvestment of earnings and gains but does not reflect the deduction of any fees or expenses, which would reduce returns. Performance over 1-year is annualized. An index is unmanaged and not available for direct investment. Past performance is no guarantee of future results. Standard deviation measures the dispersion or uncertainty in a random variable (in this case, investment returns). It measures the degree of variation of returns around the mean (average) return. There is no guarantee that risk can be managed successfully. Standard deviation is annualized.

FAKE YIELD

We often hear that the high yield of the AMZ, 8% nominal yield as of 9/30/18 as shown in Exhibit 1, is a key reason investors remain fixated on it relative to the broader universe. We would argue that nominal yield will not be realized by investors following that index, because of distribution cuts, both of the backdoor and outright variety. We discussed in detail in our 2016 whitepaper, *The Path Forward for Midstream MLPs*, the impact of distribution cuts on the take-home yield of MLP investors, and the phenomenon continues today.

For example, Energy Transfer Partners (ETP) was a 10% weight in the Alerian MLP Index, and its nominal yield was approximately 10%, bringing up the AMZ yield. Upon the

close of its merger with Energy Transfer Equity, L.P., the distribution received was reduced by 31% up front. The new combined entity is now a 10% weight in the AMZ, and over time the nominal yield of AMZ will reflect its lower yield. In addition to ETP, there are other pending backdoor distribution cuts, including SEP, EEP and ENLK. In addition, BPL recently announced a 41% distribution cut to what was a 15%+ yield, which will have a significant negative impact on AMZ's nominal yield given BPL's nearly 4% weight in the Index. By the beginning of next year, that highly-attractive 8% yield should be more closely aligned with the rest of the midstream sector at closer to 6%.

IMPLICATIONS OF NEW BENCHMARK

If we can agree that AMNA or AMUS (for those investing solely within the U.S.) are superior to the traditional MLP-only indexes, then there are implications for those allocating capital to the midstream sector. First, there are not many good passive options available for exposure to midstream. Most of the passive vehicles track MLP-only indexes. The well-known AMZ and AMZI indexes have the largest passive assets tracking them at \$4bn and \$11bn, respectively. To date, there has not been a widely-adopted midstream-focused passive vehicle. As such, for exposure to midstream today, active management against the entire universe is the best available alternative.

The second implication is that those active managers should

be held to a more honest standard when it comes to measuring alpha. In recent years, as the AMZ has become less relevant, managers have been able to game the system by adding exposure to midstream stocks not eligible for inclusion in the index, adding positions in midstream corporations (like KMI, OKE) and general partners (like ETE, WGP).

Adding non MLP exposure to an active strategy has also hurt active managers at times, including this year, when the average MLP manager is underperforming the Alerian MLP Index. The point is for allocators to have a clear picture of how their chosen benchmark can determine a manager's alpha simply due to biases within the index construction.

CONCLUSION

After 4 long years of chaos, including distribution cuts, IDR simplifications and fold-in transactions; the midstream sector that is emerging includes lower leverage, higher coverage ratios, and an increasing number of non-MLPs. On their own, MLPs are not large and liquid enough to stand alone as a sector that has dedicated institutional allocations. Together,

midstream and MLPs represent an investible sector with compelling secular themes. To better reflect that midstream sector of today and tomorrow, we believe the Alerian MLP Index should be cast aside in favor of a new benchmark that captures an investible universe of midstream stocks, regardless of structure: the Alerian Midstream Energy Index.

ABOUT CBRE CLARION SECURITIES

CBRE Clarion Securities is an industry-leading global investment management firm specializing in the management of listed real asset securities including real estate, infrastructure, and master limited partnerships (MLPs). CBRE Clarion manages client portfolios with a focus on generating attractive risk-adjusted returns through a total return, income focused, and absolute return-oriented strategies. Headquartered near Philadelphia, Pennsylvania, the firm has over 85 employees located in offices in the United States, United Kingdom, Hong Kong, Japan, and Australia.

The global transfer of ideas, in-depth local market research, and market intelligence distinguishes CBRE Clarion. Our team of 40 dedicated listed real asset investment professionals draws upon the research and resources of CBRE's global organization. Our global perspective and local infrastructure and real estate market insight combined with our disciplined investment approach enhance our teams' ability to underwrite risks and capitalize on potential opportunities.

CBRE Clarion Securities is the listed equity management arm of CBRE Global Investors, an industry-leading global real asset investment firm sponsoring investment programs across real estate, infrastructure, and private equity.

IMPORTANT DISCLOSURES

Alerian MLP Index is a composite of the 50 most prominent energy Master Limited Partnerships (MLPs) that provides investors with an unbiased, comprehensive benchmark for this emerging asset class. The index, which is calculated using a float-adjusted, capitalization-weighted methodology, is disseminated real-time on a price-return basis (NYSE: AMZ) and on a total-return basis (NYSE: AMZX).

Alerian Midstream Energy Select Index is a composite of North American energy infrastructure companies. The capped, float-adjusted, capitalization-weighted index, whose constituents are engaged in midstream activities involving energy commodities, is disseminated real-time on a price-return basis (NYSE: AMEI) and on a total-return basis (NYSE: AMEIX).

Alerian Midstream Energy Index is a broad-based composite of North American energy infrastructure companies. The capped, float-adjusted, capitalization-weighted index, whose constituents earn the majority of their cash flow from midstream activities involving energy commodities, is disseminated real-time on a price-return basis (AMNA) and on a total-return basis (AMNAX).

Alerian U.S. Midstream Energy Index is a broad-based composite of US energy infrastructure companies. The capped, float-adjusted, capitalization-weighted index, whose constituents earn the majority of their cash flow from midstream activities involving energy commodities, is disseminated real-time on a price-return basis (AMUS) and on a total-return basis (AMUSX).

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