Super-cycles and Stable Cash Flows

Contributed by

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Last week, I had the opportunity to attend Capital Link's forum on Closed End Funds and ETF's, a full day event held at the Metropolitan Club, which was enormously interesting. Though shipping is a valuable specialization, anyone trying to understand the place of shipping in the investing firmament must see how the maritime business fits in between the larger pieces. When I studied economics, the textbooks offered up the concept of "derived demand", which implies that the users of the vessels will be reacting to forces exogenous to shipping itself. Expressed differently, shipping may be a part of investor's efforts to play certain broader themes. As a shipping analyst, such an understanding is vital, hence my attention in my work and in these articles to emerging trends in the movement of energy commodities.

The conversations at the CEF/ ETF forum- full of non-familiar faces, were fabulous, every time. A number of perceptions about shipping seemed to be common among folks that I was chatting with during the numerous networking opportunities. One concerns over-supply, most mainstream media reporters covering the business are aware of the large orderbooks. Another concerns volatility- though not everybody follows every spike, or zig and zag, like shipping insiders, most outsiders (from my very limited and highly unscientific sampling from chatting at the Metropolitan Club) hold that revenues can fluctuate wildly. Of course, the missing link in all this is how the "derived demand" mentioned at the beginning of the article interacts, exactly, with the supply of vessels- which is generally known with some certainty for maybe a year or eighteen months out into the future.

One session at the forum touched on the topic of the commodity super-cycle, where shipping is a front and center player, again- not causing the cycle, but being caught up in it. The turn upward post 2008 has seen a generally measured upturn for commodities, so that they've been useful to investors wishing to diversify their broader portfolios. To wit, 2013 was a really good year for equities generally, and a bad year for traditional commodities such precious metals and "agriculturals" (wheat, corn and beans). However, it was suggested that investors be watchful about a possible return of inflation, and, with it, the commodity super-cycle. With the Capesize composite of routes quoted by the Baltic Exchange at just under \$10,000/day (compared to \$39,000/day at the end of 2013), and the product tanker "triangulation" route at \$6,800/day (compared to \$23,000/day late last year) it's hard to imagine an upward run, just now. Nevertheless, shipping investors might keep a weather eye on the commodity dynamic generally, which- for now, seems all clear.

There a number of ways to play commodity investing, though fewer vehicles for investing in a grouping of shipping companies. Though there is one shipping ETF still afloat after some tumult in the past few years.The Guggenheim Global Shipping ETF, with the symbol "SEA", which has amazingly attracted nearly \$120 million, despite the varied nature of its holdings. However, the big trend is the very sensible linkage between the energy sector and companies that move energy, owning crude / product tankers, and, more recently, owners of fleets hauling LNG, as well as owners of boats and sometime rigs that play a role in energy E & P.

A session that I participated in covered Master Limited Partnerships (MLPs), where the word "Midstream" came up more than once. I remember a few year ago, one highly regarded tanker player describing itself as a maritime midstream specialist, a prescient branding decision that shifted the investors' perceptions of the company away from "shipping" (in their case, tankers) towards oil industry infrastructure- that pesky demand factor. Where vessels are held by MLP's, revenue streams need to be predictable, which means that vessels are on medium (at least three years) to long term (for tenors of 12 or even 15 years) charters.

The renewed interest in transporting of oil, refined products and gas is linked closely with MLPs- a structure created in the 1980's to encourage investment in energy processing and transportation. The Capital Link forum saw presentations by several providers of products which have created bundles of MLPs for investors. Swank Capital, through its wholly-owned investment adviser subsidiary, Cushing MLP Asset Management, LP, brings highly experienced asset management to publicly traded energy infrastructure MLPs. The roster of holdings within its Cushing MLP Premier fund, with assets of more than \$1.5 billion, includes a 5.8% allocation to shipping MLPs. Kinder Morgan, among its top 10 holdings, is in the process of acquiring a large owner of Jones Act tankers, serving the U.S. coastal trades. Kayne Anderson, another presenter, offers a diverse group of investment products. Its closed end "MLP Investment Company", with assets of \$6.8 billion, allocates 3% of its assets to shipping MLPs.

The universe of shipping MLP's is about to grow; as this article appears, word has hit the street that another owner of LNG vessels, GasLog- has submitted regulatory filings for an MLP that will initially own three vessels, all on to BG, for periods of four years, with options well out into the next decade. Each new public listing will provide more opportunities for MLP funds to invest in shipping- an essential part of energy supply chains.