Rodney's Take

October 26, 2020

Best Pipeline Salesman Ever

When you live near Houston, Texas, much of the local world revolves around petrochemicals. Houston is the connection point where many pipelines end and where oil is converted into gasoline and distillates or loaded onto ships for export. It is also one of the places where oil is unloaded from ships and sent to refineries upstream. Oil extraction workers in the Houston area earn about two thirds of the sector's compensation in the state and almost half of the sector's compensation in the U.S. And you can't swing a dead cat around here without hitting an engineer of some type. So, when the purported frontrunner for President of the United States says he plans to move the nation away from hydrocarbon energy, Houstonians take notice.

But this isn't new. Government and corporate leaders around the world have been talking about moving away from fossil fuels for as long as we've been using the energy source. As recently as 20 years ago, it was about moving to sustainable sources instead of nonrenewable energy. Now it has morphed into a conversation about pollution and global warming. The voices calling for such a transition are getting louder, but that doesn't mean the move will happen anytime soon.

As I wrote in the *Rodney Johnson Report* this month, we're a long way from the world giving up its oil habit, especially in developing nations. Alternative sources simply aren't cheap enough or reliable enough for this to happen in the next decade or two and probably won't be for 30 to 40 years. But by watching developed nations, we can see how a government can increase restrictions on oil and gas as it forces the change, using such moves as ending oil exploration on federal lands and increasing the required fuel efficiency of automaker fleets.

Another possible move is to limit new gas and oil pipelines. That will restrict the amount of oil and gas that can move around the country, obviously, but it will also do something else. It will make current pipelines more valuable. In this way, Joe Biden could be the best pipeline salesman ever.

The energy sector has been the worst-performing area of the market this year, as we have radically upended our daily lives and reduced energy consumption. Demand is coming back, but it remains about 10% below what it was at the start of the year. Some of that consumption, such as commuting to work, will never fully return, and we're likely to see fewer people travel for business. But there's no doubt that planes will be full again someday, that many of us will go on distant vacations, and that the citizens of developing countries will demand more gas-powered cars and plastics. All of this will feed the demand for oil.

As the flow of oil across the nation increases, pipeline companies stand to gain. For this and several other reasons, I recommended two pipeline companies in my newsletter this month, one that yields 14% and one that yields 12.5%. Investors who have dabbled in this area in the past might have bad memories of tax time, as most pipeline companies are structured as Master Limited Partnerships (MLPs), which issue K-1s and are not IRA friendly. It's easy to avoid the tax issues by purchasing MLPs inside of funds.

No matter who wins the election, I’m a fan of this sector, and not because I live near the Texas coast. I like it because I’m a fan of cash flow, I think the income stream is relatively stable, and it looks like interest rates might tick a bit higher and then ding investors holding bonds. If you’re interested in more income and willing to accept a little volatility, now is a great time to consider such investments.

Rodney

Got a question or comment? You can contact us at info@hsdent.com.