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## Energy MLP Strategy

### Key Takeaways

- ▶ Midstream energy infrastructure outperformed broad equities in the quarter due to strength in pipelines focused on natural gas, which are benefiting from the need to ensure power grid stability and meet energy demand from a variety of sources, such as AI and data centers.
- ▶ The sector remains well-positioned to benefit from growing U.S. hydrocarbon production volumes while maintaining limited commodity price exposure.
- ▶ Increased M&A activity under a new presidential administration could provide a catalyst for investors to embrace the new midstream energy business model, while any move toward less stringent permitting for pipelines would also be a positive.

### Market Overview

Despite inklings of a market broadening in the fourth quarter sparked by Donald Trump's election victory and further interest rate cuts from the Federal Reserve, the post-election rally proved short-lived and momentum-led with relatively narrow leadership. Rate cuts came amid strong economic data that began to support the case for a slower easing cycle from the Federal Reserve than had been expected. This, along with potentially reflationary policy from the Trump administration, such as tariffs, as well as slight upticks in inflation, put some upward pressure on interest rates, causing some weakness in economically sensitive such as energy and rate-sensitive sectors. The broad market S&P 500 Index rose 2.41%, with the S&P energy sector declining -2.44% despite crude oil prices edging up in the quarter, from \$68.17 to \$71.72 per barrel.

Midstream energy infrastructure stocks including energy master limited partnerships (MLPs) performed well in this environment, with the Alerian MLP Index's return of 4.94% outpacing broad equities due to strength in pipelines focused on natural gas. Investors throughout 2024 have grown more positive on the growth outlook for natural gas pipelines, driven by the need to ensure power grid stability and meet energy demand from a variety of sources, such as AI and data centers, as well as from the potential for increased LNG exports, especially to European countries looking to reduce exposure to Russian production.

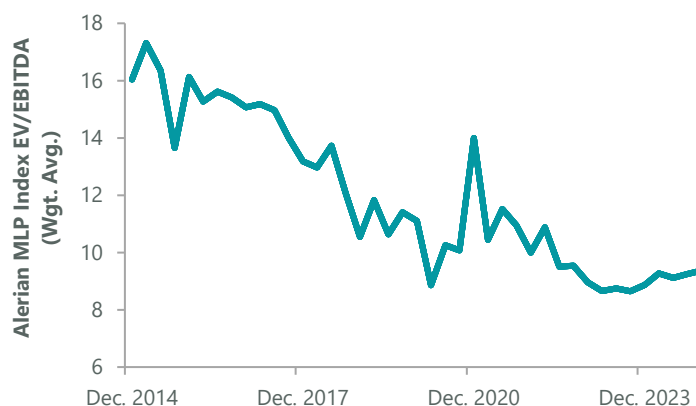
Strong performance for midstream energy infrastructure in 2024 is consistent with our constructive views on the sector. Demand for U.S.

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 federal 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. Such production 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, which 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.

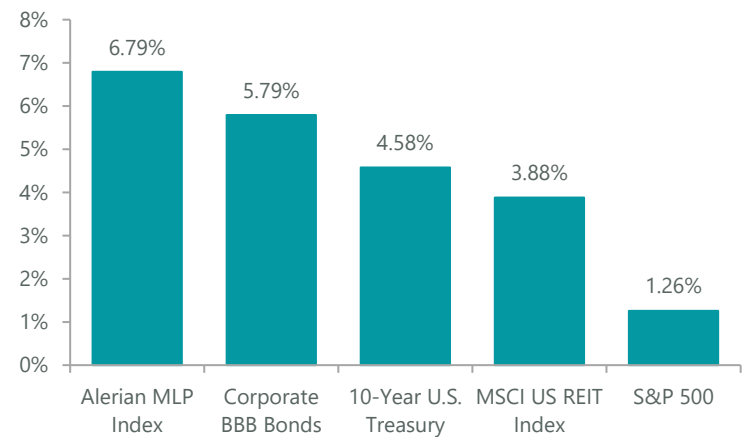
Meanwhile, midstream energy valuations remain attractive, in our view. For example, using EV/EBITDA as one valuation metric, the Alerian MLP Index is still trading at modest multiples, especially compared to its long-term history (Exhibit 1). In addition, based on current distribution yields, the Alerian 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 Dec. 31, 2024. Source: ClearBridge Investments, Factset.

Exhibit 2: Midstream Energy Dividend Yield Vs. Other Securities

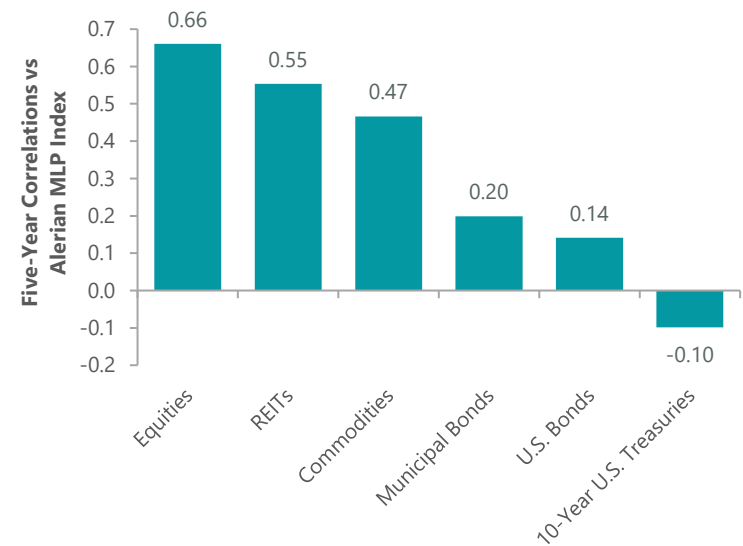


As of Dec. 31, 2024. Source: ClearBridge Investments, Factset.

The sector would also stand to benefit from deregulation. While midstream energy companies should not need to access capital markets in the near future, an environment of greater M&A and capital markets activity broadly, which we expect to inflect higher with the arrival of the incoming U.S. administration, would add another catalyst to the stocks. 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 Dec. 31, 2024. 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. Treasuries), 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 holdings are Targa Resources, which is focused on natural gas and natural gas liquids, ONEOK, likewise focused on natural gas, and Energy Transfer LP, which owns and operates natural gas transportation pipelines and storage facilities. These are the largest positions in the portfolio and reflect our conviction that these companies are well-positioned to not only maintain distributions but exhibit growth over time. During the quarter we added to Delek Logistics Partners LP, a growth-oriented MLP headquartered in Tennessee and focused on crude oil and refined products logistics.

### 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, balanced 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 in managing through the high level of volatility in the energy market. Oil supply is adequate for the time being but could be at risk if the war in the Middle East were to target oil-related infrastructure such as that in Iran, or should geopolitical tensions involve increased oil/natural gas sanctions on Russia. We continue to emphasize balance sheet strength, asset footprint diversity and quality, and we carefully assess our holdings with an eye toward managing successfully through the short-term volatility and thriving in the long term. We continue to believe that in the long term, midstream energy infrastructure represents an attractive investment opportunity as the U.S. further cements its status as an energy superpower. Subsequently, sustained hydrocarbon production increases can bode well for high-quality midstream companies 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 fourth quarter. In terms of absolute performance, all four primary subsectors in which the Strategy is

invested made positive contributions, with the diversified energy infrastructure subsector the main contributor.

On a relative basis, the Strategy outperformed due to stock selection and sector allocation effects. In particular, stock selection in the diversified energy infrastructure, gathering/processing and liquids transportation & storage subsectors, an underweight allocation to liquids transportation and storage and overweight to diversified energy infrastructure drove positive results, while an overweight to the gathering/processing subsector detracted.

In terms of individual holdings, Energy Transfer LP, Targa Resources, Kinder Morgan, Williams Companies and ONEOK were the main contributors. The sole individual detractors were Genesis Energy LP, Brookfield Infrastructure Partners LP, Sunoco LP, Suburban Propane Partners LP and Plains All American Pipeline LP.

During the quarter we received and retained shares of South Bow following its spinoff from portfolio holding TC Energy.

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Performance source: Internal. Benchmark source: Alerian MLP Index.

Performance source: Internal. Benchmark source: Standard & Poor's.