

Webinar Replay: Middle East Developments & What It Means for Global Energy Markets #5

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Mark Marifian:

All right. So welcome to our timely webinars. This is the Middle East crisis and what it means for global energy market markets. My name's Mark Marifian. I'm the Head of Product here at Tortoise Capital. We've been doing these webinars really all of March now, really designed to unpack all the complexities within energy in real time. We've been covering what's been happening with the Strait of Hormuz and energy crisis really since the beginning of the year. We published our first piece in January, outlining our thinking then. And certainly we've watched this evolve into a much more serious event. So for those who haven't joined before, quick housekeeping note, we'll leave time just a few minutes at the end for Q&A. So feel free to submit questions at any point. For those who have not listened to our webinar or are familiar with Tortoise, we're energy specialists. We have more than two decades of experience and really our expertise goes from the wellhead all the way down to the end user.

So we've tried to add a few new slides this week just to frame what's happening and continue to provide some background. This has really been changing day by day, hour by hour. I'd say if you take a step back, now you have a full month of digestion. Energy really has bifurcated from the rest of the market. The broader sector is up closer to 40% for the month. So I would say, again, higher prices are supportive for the complex in the short term. But again, if prices go too high, it ends up being a headwind for consumers, for economic growth, and ultimately it tightens financial conditions. And we've seen in the past how this can play out if this goes on too long. You had the spike in 2008 of WTI up to 147. Six months later, crude was down to 40 when we were in the midst of a serious recession.

So this can play out on both sides. If you go to the next slide, what's happening with the straight of horror moves? Why does this matter? I mean, 20% of the world's crude flows through that choke point. I think what people maybe are missing is that there's other products that go through there as well in critical commodities. So we've seen just a few tankers getting through that straight since the beginning of March. And you're starting to see this now bifurcate in prices across the Middle East and the rest of the world. So I'm looking at the Oman grade, which is closest to the conflict that the front month there is at about 125. Brent and WTI now are starting to gap out as well. Brent's closer to 119 today. WTI, which is the US benchmark, West Texas intermediate, that's closer to \$100. So you're seeing right now how that's really starting to impact the global indices.

And then the other picture that we have on the screen today is just Karg Island. And so this is the home of where Iran is exporting all of their energy production. It's an island right off the mainland. I'd say keep an eye on this one. There's potential concern. If there were to be a ground invasion, this could be one of the spots that it potentially is targeted by the US to stabilize energy flows. And so this, again, home to all the exports for Iran, but Iran has stated if there's escalation that with Karg Island, they will target energy infrastructure in other Gulf countries. And so that's a damage I think that makes it become much more serious, and then you end up having permanent deficits. And then one more thing not showing on the screen is if you went to the other side of Saudi Arabia, the west side, Saudi Arabia is bordered by the Red Sea.

Now this is important because Yemen's Houthi rebels, they announced earlier this week they're formally joining the conflict. And so there is a potential that they could actually put pressure on the Red Sea route passage. And that's really their main leverage is to threaten the export hub on Saudi Arabia's west side. And so Saudi Arabia's Choke Point is a Strait of Hormuz on the East, and then on the West side, it's in the Red Sea. So if you see commercial traffic disrupted there, that's another thing that could move prices higher and really disrupt and erode Iran's ability to bypass the Strait. Now, if we go to the potential flow impacts on a next page, we tried to add this one too just to put some numbers around this. So pre-war, about 20 million barrels were getting out of the Strait of Hormuz. Now there's some offsets here. Iran's still exporting from Karg Island, so that's about two million that's getting through.

Saudi and UAE have been able to reroute pipes. So you're still at a deficit of 13 and a half million barrels a day. And then there's other things that have happened that are allowing that 13 and a half number to be softened. So there's going to be

a coordinated release of the G7 countries that'll soften about one and a half million barrels a day. And then you have excess Russian and Iranian crude on the water, which is about three million barrels a day. So in total, you're somewhere around eight million, nine million barrels a day of onshore stocks and crude stocks that are not getting to market. And so ultimately the question is, how is this going to be filled? And more importantly, how long is this going to continue? If we go to the next page, and so we're seeing this big deficit. It's obviously terrifying to folks, but I think the question is, why hasn't this supply shock been felt at least domestically here?

I'd say it is started to be felt across the world. But when you look from the starting point that we were at, look at the red dotted line 2026 here, this is global observed crude inventories, and you can see we were over eight billion, and how that number had really gapped higher from where we'd been in previous years, 22, 23, 24, 25. And I think what's interesting too, as you can see 21 here, that was coming out of COVID. So we were drawing there and you saw how that ramped down over time. If you took this red dot and showed it to March, you're going to be down around that 8,790 level. So you're starting to see the buffer that was in the system. It's evaporating here. And I think the concern is, okay, well, this was March, what happens if this continues into April?

A significant portion of that of these barrels, they're sitting in SPR. So China was adding to their SPR and observable inventories going into this. And then some of these inventories, they're tied up outside of developed markets, so they're just not going to get to where they need to be. Some are in logistic and floating storage. They might be on the wrong side of the world. So again, this is a buffer that we have, but it's kind of quickly being drawn down. And then that leads to the next slide, which is where is the supply disruption being felt? We pulled this from the IEA in their March report, but you can see that this is really a much broader than crude. The Persian Gulf is an exporter of diesel, gas, pet chem, feedstocks, you kind of name it. All these flows have been disrupted. The example I'm going to use today is fertilizer, and you all may have heard about this, but natural gas is a key input into ammonia, and ultimately the production of a fertilizer, we're not getting LNG supply to the market.

And so now what you're seeing is it's forcing fertilizer plants, shutdowns across Southeast Asia. And so I think what you're going to see is a lag, but probably meaningful effect on not only the supply but the inflation as well. But right now it's Asia that's getting hit in real time, whether it's Southeast Asia, India, Bangladesh, you name it, there's headlines each day talking about the rationing and how these economies are feeling it. But it's certainly more acute in the products shortages versus just crude itself. Now, Iran is talking about selective passage that would let some neutral countries transit through the straits, so potentially you can soften this, but that doesn't really impact the US and its allies. This could more help the Asia-bound trade flows. In total, you're looking at about eight million barrels a day just from the Gulf producers, Saudi, UAE, Kuwait, and Iran that are not getting to market.

So it's a nice segue to the next slide. And this is one we've been showing for a while, which is the potential impact to crude prices. So we've been saying over the last couple weeks, we're sitting between scenario three and scenario four. I'd still say that's the case, although you started to see front month prices move up. So I highlighted the supply losses of the eight million barrels a day. You also have two million barrels a day of NGLs and condensates that's offline in the Gulf. And then you also have about three million barrels a day of refining capacity that's offline. So again, whether it's the production or the refining capacity, ultimately what this all leads to is not being able to get to barrels to market storage filling, and eventually you have to have shut-ins. And the shut-ins ultimately is what really is going to disrupt getting flows back to the market.

And so when we've had these conflicts, the pattern is for the markets to initially price them as temporary disruptions, but history continues to suggest that they last longer than you might expect. The positive I would say this week is that we really saw less meaningful escalation in terms of damage to energy infrastructure. So the prior week was not good when we saw Iran's gas field attacked, they in turn attacked the Rass Laffan LNG export facility in Qatar, and that was meaningful because Qatar is about 20% of the global LNG supply and 17% of that capacity got knocked offline. So that's about two BCF a day of their 10 that's coming offline. They spent \$26 billion to bring this facility online a couple years ago, and they had \$20 billion in damage. And I think the other thing that this points to is that they were actually planning to continue to expand and be it significant really with the US, those are the two significant exporters of LNG.

That's clearly not going to be happening, at least here in the next few years. That expansion of their 10 BCF of production is just not going to get to market. It's going to be more focused on bringing back the damaged infrastructure online. And the kicker here is that this is not just temporary. They estimate it's going to take three to five years to bring the gas back online. And I think this translates into Europe, European gas storage, that's been notably low. So you're going to see a crunch there from the industrial base and those users. And one thing that started to happen is that you started to see Venture Global, which is a US LNG exporter. They do not have as much fixed fee contracts like Cheniere does, but

they've been able to sign some long-term contracts since this escalation has broken out. I think the market's realizing just how much tighter global gas markets are going to be, and this really isn't just a short-term disruption.

And those LNG stocks, they've certainly reflected that move. They're down a bit today, but you're seeing that the LNG names are up 40% plus for the year. On refining, the Gulf Coast global and global diesel cracks really have expanded. How do you replace the three million barrels of exports from the Persian Gulf? You don't. You've seen refining margins expand significantly here in the US, our refiners are going to benefit from that. And last week at the CERA annual event, Mike Wars said, who's a CEO of Chevron, he just commented how product markets are really signaling much tighter conditions than crude itself. So this is a good transition to go to the next slide, which is really where is the curve today? And I would just say there's been a lot of, I'd say, jawboning and actions taken on both sides to, I'd say, try to manipulate the curve a bit.

But this past week, it was a little bit quieter. I think the significant action taken this week to calm the price of WTI and crude oil going higher was just effectively to push it to the right and say, "Hey, there's going to be no attacks on energy infrastructure until April 6th." And so you've stayed you're up a little bit this week from last, but overall, the backend of the curve has not moved too, too much. Weeks before, we tried tanker reinsurance, we tried a coordinated SPR release, which is going to help. You have formal hundred million barrels coming to market coordinated across the G7 countries. And then you also had the lifting of sanctions on Russian crude and Iranian crude. But again, these are all things that have taken place to alleviate that front month pricing and you're still up. So we're going to continue to watch this trajectory.

I think what the market is saying, look, is you're drawing down your oil on water, the floating storage is being exhausted. Where are the shock absorbers left? And you're starting to run out of them. And I think the concern is if this goes much deeper into April, the only place for prices to go is up and to the right. So we're certainly watching that. The front month, you can see that the blue line, it's repriced significantly from the green line from the beginning of March to the end of March, you're over a hundred versus where you were at 65 before. So 2026, you got nine months left. The average contract is up \$23 for the rest of this year. It's pretty significant, but now you're starting to see this go into 27 and 28, and the average contract's up \$12 on average per month in 2027 and 2028, less so as you get out into 29 and beyond, more than that \$6 range.

But you're starting to see how this is having a meaningful supply or meaningful change to the curve over the longer period of time versus just being the short duration supply shock like what initially happened. And then in terms of what else is happening, Brent and WTI, I mentioned that on the front end, the difference between Brent and WTI is typically three to \$5 per barrel, but now you're seeing these spreads really blow out. We're at \$19 today. So Brent's global, it's seaborne supply. Again, that floating storage, it's exposed to the Middle East, WTI, more inland based on US supply. So we're insulated for now, but I guess the question is how long can that insulation last? And really now inside of our walls, our portfolio team is saying, what's the right level for prices? And we're in that 60 to \$70 range prior to this conflict.

The question now we're asking is long-term, is \$75 too low? And so you can just see how the conversation really has shifted not only in the system, but inside of our walls where we've been following energy for a long, long time. And I think part of this is a nice transition into the next slide, which is the supply response. And so much has happened in terms of how the US energy market is thinking about it. And so what I'm showing here is rig counts, and those have really gone down. Now, the gas rigs have trended up. That's a light blue line, which is on the right side of the curve. And so those have gone from a hundred to 135 or so. But if you look at the left-hand side, which is crude rigs, you can just see how it's continued to decline over the last several years.

That's a dark blue line, and now it's sitting really at its lowest point in several years. So we've seen the US be able to technologically innovate, and that's allowed us to continue to ramp and increase our production. But there's also another part of this in that there's been a structural shift in the industry to really focus on capital discipline. So you're seeing less inventory that's been drilled in the higher quality basins over the past few years. And then even from ducts, which are drilled but uncompleted wells, that number's significantly lower than it was in the past. And so yes, the US still has capacity to bring on more production, but it's not going to respond and bring a million barrels or two million barrels on in a really, really short amount of time like we did in the past. I would expect you're going to see a supply response be more slower and gradual.

And I think those producers, they also want to see how is this conflict going to end up? How long does it take? Because from making a decision to getting it to market, that can take up to six months or longer. So what I'm seeing in terms of estimates and in terms of US production, we're looking at a couple hundred thousand. I've seen as high as a million barrels of additional crude production coming to market. And just for reference, we're at about 13.5 million barrels per day



of production. That is our all-time highs. But again, you can just see how the industry has been focused on capital returns and really living within their means in terms of what their spending looks like. So you go back to shale, it was spend, spend, spend, and growth will come and we'll get paid for it. This is a much more mature industry now.

You've had a significant turnover in terms of CEOs who aren't like Wildcat CEOs, but they're really in terms of focused on running a business longer term. And then this brings me to one of our final few slides, which is US energy security. This is one we've continued to show. And this month's events, I think they underscore the importance of North American energy infrastructure and US energy production. I think it's pretty clear just through all the charts that we've shown, how much higher our prices could be today if we didn't have the benefits of the US output and growth over the past two decades and the development of shale. So that's significant. Is the market pricing all this in? I'm not sure. I think there's a little bit of a disconnect still. There's worldwide, you have less ... Well, we had lower spare capacity. Now I would say there's a lack of spare capacity because you effectively can't even get it to market.

Clearly there's geopolitical risk premium. You don't have non-OPEC supply projects coming online, and US shale is a bit more mature. If you look at what ENP companies and majors are reflecting today, ENPs are trading like they're pricing in closer to \$70. The integrated Exxon, Chevron, they're pricing closer to 70 to \$75. So yes, we've rallied, but I'm not sure that it reflects the full commodity prices. And I would just say from a portfolio perspective, the role of energy continues to remain very, very important, but I'd say underrepresented. You look inside the S&P 500, energy is about 4% of the S&P 500. It's clear how important it is to the global economy. We've had periods of energy stress and inflationary regimes in the past, and we've seen the energy allocation get as high as 15% in 2008. And in the more severe conflicts in the 70s, energy was almost 30% of the S&P 500.

So I would just say to wrap this up, and I know I'm a few minutes over, but you think about energy, how does it play into your portfolio? You get a single allocation, and I see it serving three important roles in the portfolio, inflation protection and sensitivity there. These assets do generate income, particularly on the midstream side and the infrastructure side. And then lastly, it's a hedge to geopolitical risk.

So I'm seeing, just one question and we'll let everyone jump. If a piece deal occurs, what happens to oil prices? Do they fall, but stay at elevated prices? Yeah, I mean, I think if a peace deal occurs, you're going to see the front month drop pretty precipitously. What I've read is you drop closer to \$85, so you're talking about a \$15 drop or so. I don't think you'd see too, too much movement on the backend of the curve, although I would expect that to go down as well. So anyways, we will continue to do these weekly. Next week, we do monthly webinars, and so we're going to pause this. We're going to let our PMs recap the month, and they will obviously discuss where prices are, not only from the end of the month, but what's happens over the next week, and we'll continue to keep everyone abreast of the latest events that are unfolding.

But appreciate everyone jumping online for a quick few minutes. If you do have questions, feel free to email us at info@tortosecapital.com, and we'll talk to you all soon. Thank you.

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