

Webinar Replay: Middle East Developments & What It Means for Global Energy Markets #6

April 21, 2026

Mark Marifian:

Okay everyone, good afternoon and welcome to our timely webinar, the Middle East and What It Means for Global Energy Markets. My name is Mark Morifian. I am the Head of Product at Tortoise. We've been doing these webinars here over the last, I don't know, seven or eight weeks. And really the point is to unpack all the energy complexities here in real time. So we started writing about this in January, outlining the risks then. So this has continued and we're going to dive in today. A quick housekeeping note, we will leave time at the end for Q&A. So if there are questions, please do submit them at any point. For those of you new to Tortoise, welcome. We are energy specialists. We have more than two decades of experience managing today, approximately \$11 billion, and those investments are across the energy value chain from the wellhead to the end user.

So we've added a few slides this week to continue to frame the dynamics that are happening with the Strait of Hormuz and the crisis. So let's go ahead and jump in. We'll talk first on the macro front and then the second part, we'll have a few slides on just how this is impacting the energy sector itself. So what do you see in here? Why the Strait of Hormuz matters? I think we're all probably pretty familiar with that at this point. It's a choke point for commodity flows globally. 20% of global crude goes through there, 25% of LNG. Again, this is a narrow 21-mile corridor. So we have now had a physical disruption in place for 50 days. And you can see here on the right-hand side that the number of tankers that have consistently made it through is about 10% of pre-conflict levels. So we were at 20 million barrels a day, and this number has stayed pretty depressed, hovering right around that two-million-barrel mark.

So we did have some news this week. I'll just recap that. So last week, the US began its blockade just outside the Strait of Hormuz, essentially blocking any Iranian ships coming in or exiting. And then on Friday, Iran announced that the Strait of Hormuz was completely opened. That was April 17th. The following day, the Strait was then closed. That was April 18th. And so we're really, yes, we might've opened it for a day. You didn't really see much traffic out, and then it was closed subsequently the next day. And then upcoming this week, the next major news flow or topical item is April 22nd. So tomorrow at 8:00 Eastern is when the ceasefire is set to expire. So we'll see what happens. We'll keep certainly keeping our eyes peeled, but it has been two plus weeks since there's been any conflicts. Iran did state in comments that I saw that in an escalation to conflict could mean additional attacks on energy infrastructure.

And they commented on three spots specifically. Saudi Arabia is a Yanbu export hub that's in the Red Sea. They're also their east-west pipeline. And then the UAE has a pipeline going north to south, which moves about one and a half million barrels a day and bypasses the Strait. So again, if we see an escalation, this is where the concern is that energy infrastructure could be impacted. And ultimately, this would weaken the Gulf States and it certainly would send prices much higher. If we go to the next slide, this is a repeat slide here, but we did update it. This is courtesy of our friends at Goldman Sachs who are updating this every week. So you can see on the left-hand side here, the red

bar, that is the normal flows on the crude side going through the Strait of Hormuz, 20 million barrels a day.

What the major change this week was is that we saw pipeline redirections. That number increased from about three and a half million barrels a day to 5.2 million barrels a day. So that's a slight improvement. That means in that hit to oil stocks is down a bit from 13 closer to 11.9. And we're just seeing, I commented on this last week, but I'll just read it. The lengths that countries are going to get their exports out, not have to shut in production, pretty extreme here. Iraq, they're transporting by truck through Syria and Jordan to Turkey just to get their exports out. They're doing that with about 250,000 barrels a day. So we're looking at all the workarounds we can, but at the end of the day, you're still short. You do have the largest SPR release ever at 400 million barrels per day. You can see that that adds up to about two million barrels of additional supply.

But net net, you're still facing an export deficit of 12 million barrels a day. And then you have barrels on ships and in storage tanks in the Middle East, that's where stocks have built. So that's about one and a half million barrels a day. So really, when you come to the end of this all the way to the right, you're at about 10 and a half million barrels a day of each day this crisis goes on. That's a net hit to inventories, which we'll see how that's played out on a bigger scale on the next slide. In terms of shut-ins, we do not want shut-ins. Those are harder to reverse than export disruptions. And so they also damage reservoirs and really extend the timeline to bring production back online. So I guess the next question is, if we go to the next page, okay, why hasn't the supply shock been felt?

We saw crude prices move up and down this week, but we started going into this crisis. You can see how inventories globally had really ramped from the beginning of 25, really throughout the entire year and into 26. So you started off at about 7.6 billion barrels of global inventory that reached about 8.2 billion barrels. And now that you're starting to see that sharply decline, this chart probably needs to be updated, but it's showing about 7.9 billion barrels per day at present time. But there will be a buffer period. Even if the Strait was opened and you had repositioning of tankers and started to bring production back online, it doesn't mean it's all going to flow right away. So I did see a sell side note earlier this week and it was estimating three scenarios. So the bull case would be 900 million barrels a day, which is not on that page.

If you look on the right-hand side, you're at 7.6 billion, you'd be at 7.3 billion. The base case is about 1.3 billion barrels decline in inventory. The bearish case that they laid out was 1.7 billion draw of inventory. So that would have us at the lowest inventories on record, and you just continue to see how the system is burning through these shock absorbers day by day. Another, I'd say, key development if we go to the next page is where is this disruption starting to be felt? And I'd say most acutely in the product markets and in Asia, we've shown this the last couple weeks, but again, you can see naphtha, gasoline, fuel oil, liquid petroleum gases. Asia Pacific is a big importer of all those commodities from the Gulf Coast or from the Strait of Hormuz those Gulf coast countries. So we are short there.

You're starting to see those prices really increase in Asia. But I think what's going to start becoming more topical potentially in newsflow, and we saw a few headlines late last week, is that this could start to leak into Europe and specifically look at jet fuel prices. Those have continued to really edge up over the last five days since we showed the last week's chart. Supply is getting tighter there. We heard from the EU that European should start conserving energy and work from home. And then there was an article last week saying that there's maybe six weeks of jet fuel supplies remaining that

was ahead of the IEA saying that last week. So I don't know that necessarily we'll run out in six weeks, but you could start to see flight cancellations soon if oil supplies continue to remain blocked. So again, I would guess you're going to start to see more mainstream coverage of the potential shortages in Europe as we go through the next few weeks.

If we go to the next page, okay, this is just grounding us where we've been in terms of the scenarios we laid out in January. You can see one and two scenarios. This is where the spot price was at the time of doing that, 60 to \$70. We've clearly moved well above that. So the third scenario, a temporary disruption, that would look at spot prices at 75 to 80. And then an extended closure, you could see spot prices being \$100 plus. So again, I've said this the last couple weeks. I think we're still between scenario three and scenario four. Before the crisis, we were kind of anchoring long-term at \$65 as our long-term target. I would say we're probably closer to \$75 today. And again, you're continuing to add up these supply losses, 10 million barrels a day of crude, but you're also having NGL and condensates offline.

You also have about three million barrels of refining capacity that's been in and offline. So again, no matter which way you cut it, it's really an extraordinary disruption to the supply chain. In terms of meaningful escalation, again, nothing last week, I mentioned about 60 energy infrastructure facilities targeted last week. That number looks like it's closer to 80 in total. Again, the most severe one was Qatar's LNG export facility, which accounted for roughly 20% of global LNG supply, Qatar does, and their facility that was damaged about 17% of that 20% was damaged. So the world's out about two BCF a day of production, and you're looking at potential repair timelines of three to five years. And I would say the most important effect of the Qatar LNG facilities going down, it's not spot prices, but all of a sudden, I'd say there is improved leverage for US LNG projects, particularly ones that have been seeking long-term contracts.

So last week we saw Glencore and EQT each commit to additional LNG for Commonwealth LNG, which is a project in the Gulf Coast. They agreed to 20-year contracts. And so this is moving a prospective LNG project closer to a material final investment decision. So that's the leverage that these companies are starting to see from the crisis. In terms of refined products, markets remain, I think, tighter than crude itself, we've seen crack spreads really increase quite significantly. Again, you have about three million barrels of refined product exports from the Persian Gulf that have been offline. And our US benchmarks have doubled on the refineries from about \$20 per barrel to \$40 margins per barrel in recent weeks. So I would expect as we go into earning season that you're going to see US refiners capture some of these margins. I think they're going to have strong export demand.

The one interesting thing here is that we are wrapping up maintenance season, and so margins actually could potentially tighten even further as plants return to full operating rates as you hit peak summer demand. So something to be on the lookout for there. If we go to the next chart, this is our price curve, and actually you had literally zero movement last week. So you can see the blue and the green line.

We're in backwardation here where that means the front month price is higher than the longer term prices here, and it's pretty severe. So the front end has repriced significantly since this conflict started. You're looking at 2026 contracts up about \$24 over the past since the beginning of the crisis that the other line we're showing here is February 27th right before the conflict started. And then if you go out to 27 and 28, you're up \$12. So you're starting to see this get into be priced into the curve

in the outer years. As you go into 29, 30, 31, you're up a little bit more modest, about \$7 or so. We're going to dive into this a little bit more next week, but I think even if this conflict is deescalated, we open everything back up. I think what's really interesting here is that the SPR, our strategic petroleum reserve, the world's strategic petroleum reserve, I think this is going to be a bigger part of conversation and crude markets as we move forward here.

So at least in the US here, we've done large releases. And in recent years, we recall we did a larger one of 172 million barrels in 2022. Long-term, our emergency crude inventories are now well below peak levels. And I would say we do not have that immediate buffer that we've had in the past. And so that's something that not only is happening within the US, but it's also a phenomenon that the rest of the world is going to be dealing with that probably leads to prices being higher for longer. So look forward to digging into that more. If we go to the next slide, okay, now we're going back to how this impacts the US producers and energy production. So the US supply response has been structurally slower than it has been in the past. You can see here rig counts are well below prior peaks despite these higher prices.

We have not seen a meaningful acceleration of activity yet. And I think some of this is rooted in a structural shift in the industry, so we have better capital discipline. We aren't drilling ducks, which is drilled at uncompleted wells. That number has gone way down, so that's a way to get production in the market much sooner. And so again, you just have a more measured approach to grow. So it doesn't mean that we're out of inventory or the US is going to not be a significant player. It just means that from bringing production to market, there are different incentives for the energy industry. In the past, it was based on production. Today, it's based on return of invested capital, and so that economic emphasis is really clear here versus past cycles. US production overall has been flat the last two and a half years at about 13 and a half million barrels a day.

I do think if you see prices over 75, \$80 here for extended period, say four to eight months, you are going to start to see supply come back online. We saw continental resources a couple weeks ago. They sounded more constructive on growth. So I do think that we will see some production as a result of the higher prices, but even your days of growing a million, million and a half barrels a day like we did in 2018, 2019, I think those days are behind us, but could we see nice low single digit growth off that 13.5 million barrel per day base? I certainly think that that's a possibility here.

And then if we go to the next slide, this is exports, and this is what's really changed when you look at the US and over the last 10, 15 years is that we are exporting more energy than we ever have. We are world's largest exporter of crude, LNG, net gas, liquids, refined products all listed here. I think that the short-term increase, we're seeing crude exports go from about four million barrels a day to about five million barrels per day. And in total, now you're looking at US energy exports of about 17 million barrels a day equivalent of oil. So it really underscores America's role in the global supply. We will be the last, I think, to ultimately see the prices flow to us in terms of price increases. So I think refined product exports, particularly gas and diesel, they are essential, as you can see in the chart to balancing the global shortages.

So you might've heard of all these ships starting to come. The VLCC's very large crude carriers coming, not into the Hormuz Strait, but to the US, that's going to start drawing on our supply and it could lead to higher prices. And then the other proof point I would say is just yesterday, the Trump administration invoked emergency authority under the Defense Production Act to support domestic fossil fuel production. This is something that I would say is really highlighting energy security and

treating energy as a national security. So this is for oil, refining products, pipelines, LNGs, coal, you name it, fossil fuels. The administration is viewing energy and energy infrastructure as strategic infrastructure. I don't know that this ultimately changes anything from a day-to-day standpoint, but I think it reinforces a constructive policy for conventional, traditional energy, and certainly LNG development that we have here in the country.

And then the last page, okay, this is energy still under own, still reasonably valued. So we pulled a couple charts here. How have all the recent events changed how investors are thinking about energy? So I would just say we looked at earning estimates 26 and 27. They're up about 4% since January, and energy is accounted for about half of that upward revision. So pretty significant. That's not shown on the page, but what the charts on the page highlight, energy overall remains attractively valued. So you're showing here a 15 PE forward multiple versus the average of 21 for the S&P 500, so still at a discount there to the broader market. And then the right side shows investor positioning, and it has improved, but I'd say certainly you remain far from crowded. This was from Q4, 25, so a little bit dated at this point. We'll get this updated when Q1 numbers come in, but mutual funds are slightly over weight versus their 10-year average.

But I think the big grounding mechanism here is that energy is still just 4% of the S&P 500. You go back to the last time oil spiked significantly in 2008, for example, energy was at 15%. So you got a nice combination for the sector. It's strategically important. Valuations are reasonable. Ownership, it hasn't really recovered from where it's been relative to its longer, longer term history. And then US LNG, I'd say that we're particularly well positioned there for future global gas supply. And then pipelines, they remain one of the lowest cost sources to move that natural gas, and we need that infrastructure and we need more of that infrastructure built. So to round this out from a portfolio perspective, I'd say highlight energy serving three objectives, inflation sensitivity, income generation, you're certainly going to get that through midstream assets and infrastructure assets. And then obviously we're very uncertain in terms of geopolitical hedge, the risk premium there.

And so whether it's supply disruptions, demand disruptions, it's a nice geopolitical hedge. So we'll see how this continues to play out. I think the key questions now are for how long the disruption lasts, how severe will it become? Ultimately, what are the higher sustained energy costs, and will that contribute to a broader slowdown for recession? So let me see. There's just looks like a couple questions here trying to get through them.

First one, how long do you think Iran can claim control of the Strait of Hormuz? I mean, if we bring in forces, I think that obviously changes things, but I would think about it from a import to export perspective. So Iran has storage, and ultimately if we are blockading their ships and they can't load the ships and then export those volumes, ultimately they're going to hit storage tank tops as well. So I think that's what the administration's trying to do within their blockade is let's block any ships from coming. And ultimately they're going to run out of storage. I've heard 14 to half a month to a month is potentially how long they could last. Who knows what that number is? I would expect that you're going to see them throttle down their supply so they don't have to shut in production. Again, if you shut in production, it's not coming back. So I think that's part of what the thought is in terms of the US blockade.

Okay. Keeping the lag in mind, how much has the total world supply been impacted by actual refinery damage that will take years to repair? So yeah, you think about the US, I mean, we're well positioned here from our standpoint. So three million barrels a day going offline, you're seeing that the margins



are increasing 20 to 40%. How long will it take to rebuild the manufacturing infrastructure itself? I think it just depends on the facility. For refining, I think some of the damage is not as severe as the LNG infrastructure that we saw in Qatar. No one stated that it's going to be multiple years of timeline to bring back damaged infrastructure, but it does start to add up. And then one thing we didn't cover here is that Russia is also seeing, and the Russia-Ukraine conflict, they've seen damage to their refineries. So we'll look into what's the overall refineries offline.

I would just say generally, we've been in a long, long period of having excess capacity for refineries. The US hasn't built a new refinery in 30 plus years. Have you expanded the refineries? Yes, but you also saw several refineries closed down during COVID. And I think that speaks to some of the long-term challenges that the refineries had had historically prior to 2020. So we'll dig into that one a little bit more. How long until you see demand destruction is the last question.

We could potentially already be seeing demand destruction if you looked at that chart. If we go back to the global products page, you can see how jet fuel has risen, how some of these other distillates gas has started to rise. I think you're going to see demand destruction. What's interesting here is that the demand destruction that we're seeing, we're probably not going to hear about it as much because unfortunately it's going to be more the third world countries that are going to be the first to see demand destruct. And we can just accept the higher price, and so we'll continue to pay, but it's some of the not as well off countries that you'll start to see demand destruction first. So again, a lot happening here. We'll continue to keep everyone apprised, and we'll do these weekly updates as long as we continue to have topical news to share.

So I want to thank everyone for joining today. If you have any follow-up questions, please reach out to your Tortoise sales rep and you can also reach us on our website, email us at info@tortoscapi.com. So thanks everyone for joining. Hope you have a good rest of the afternoon, and we'll talk to you next week.

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