

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

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SECTION 1: INTRO & ABOUT TORTOISE CAPITAL

All right Welcome everyone. Good afternoon and welcome to our timely webinar, the Middle East Crisis: What It Means for Global Energy Markets. I'm Mark Marifian, head of product at Tortoise Capital. This is our eighth webinar since the crisis unfolded and really these webinars are designed to unpack energy in real time, the complexities here in real time. So, before we dive in, a quick housekeeping note, we'll leave time for Q&A at the end, so do feel free to submit any questions that you have throughout the webinar and we'll get them answered at the end. For those who haven't joined before, welcome. We are Energy Specialists. At Tortoise, we've been managing energy for more than two decades. Today we have 11 billion in assets. Really, our expertise lies within infrastructure and the full energy value chain. We've added a few new slides for this go around just to help frame what's happening in terms of background.

SECTION 2: RECAPPING POTENTIAL FLOW IMPACTS

We'll hit the macro front first and then we'll talk about more importantly, how that macro is impacting the energy sector itself. So go to the next slide here and really just kick it off with what's this all about? We know that the Strait of Hormuz is blocked. That's 20 million barrels a day. That's where more crude oil and LNG flow through that quarter than any other spot in the entire globe. So the physical disruption has caused quite a bit of changes in prices. From a news flow perspective, more recently the US blockade began on April 13th, so that was used as leverage on our end. We had a ceasefire extended now several times starting in April. Today it's now rumored to be a 60-day ceasefire, and we'll see if that happens. But ultimately, I think you're seeing the blockade has really supplanted the threat of military escalation as the intended source of US leverage.

So I think you're going to see less escalation risk, but potentially longer disruptions in terms of the strait and that's I think certainly played out here in May. Now the other thing you'll see, and the bigger note here is on the right-hand side. So the big picture here is that you've had 20 million barrels of flow a day and that's been cut down to 10 million. We've been tracking Goldman Sachs's nowcast in terms of their estimates and in terms of commercial oil stocks and the overall disruption. I'd point you to a few things in this chart. We are working around getting half of those barrels out, whether it be via some of the barrels passing via pipelines, you've had some Gulf builds, you've had some excess supply, but more importantly, I think what's noted on this chart here is that blue bar and that's demand destruction.

And so that's something that I think we all need to monitor in terms of how impactful will the demand draw down be and potentially this expands into the broader market. So the question remains how long? And Iran's ability to store oil is finite. We do know that. That's a leverage on the other side here. Once their storage capacity is reached, they could have shut-ins that can trigger severe economic stress for them. Today, Iran produces about three and a half million barrels and about two million of

that is exported. So experts have been saying two to four weeks of storage capacity remains there. We'll see. We do know that they've been sanctioning tankers that haven't been used in 30 years to store crude. So I think that their stress is real alongside the global stress that you're seeing as well. And then let's assume that what happens in terms of all these headlines of a ceasefire actually plays out.

SECTION 3: ENERGY MARKET NORMALIZATION TIMELINE

And we can go to the next slide here. I think that the main point is here is yes, you could have a ceasefire, but normalizing the broader energy system and the global trade, it's going to take a long time, much more than these diplomatic headlines. So we just tried to play out at a high level what a timeline could look like. We'll just walk through a few of these. So reopening the strait, it won't just be as easy as snapping your finger. The first thing to think about is that the strait needs to be cleared for mine sweepers. And so the G7 is, and Britain specifically is talking about deploying mine sweeper ships that can help with some of the mines that have potentially been laid in this strait. So that's one hurdle that we'll have to deal with there. From a tanker repositioning standpoint, many of the tankers globally are now traveling in large part to the US and these are very large crew carriers that can carry two million barrels a day of crude.

And so we're going to need to reposition them. They were into Gulf and now they're transiting to America. These destination trips can take 30 to 45 days. So that's another delay that you're going to have as you try to normalize the flow of commodities. And then as you're normalizing these tankers, the countries, they're not going to be able to have their full export capacity. So Saudi Arabia, UAE, Kuwait, Iraq, Qatar, they may have production capacity that starts to come back online, but the export logistics are still going to need time to normalize. From there, you put them back on a ship and then you go to refineries, but it's not a guarantee that refineries can instantly maximize in the production of the refinement of all their products simultaneously. Refineries could shift or may have shifted from gasoline to diesel or vice versa. So I think we're going to see oil prices.

They may normalize first and then you could see refined product prices and availability normalized later. And then finally you're going to need to rebuild inventories and we just don't know what the prolonged restocking cycle is going to look like. It's historic. We'll get into this in terms of how much we've drawn. But I think globally each region and country is going to have different comfort levels in terms of how much storage they want. So we'll see the restocking and how those inventories are rebuilt. I mean, that high level, these are all considerations in terms of how we're going to normalize the energy market.

SECTION 4: WHAT HAPPENS TO OIL PRICES IF THE BLOCKADE ENDS TODAY

If we go to the next page, this is a question that we've started to get quite a bit and it's what happens if oil prices, if the blockade ends today and you have more of a permanent ceasefire. And I think we've actually had this priced in a bit here over the last two weeks as more details have potentially emerged as to what a deal could look like.

We saw WTI fall from close to 105. Today we're kind of the low to mid 90s. So we would expect you're going to be in that 90 to 95 range if a ceasefire agreement and a long-term agreement is reached, you're going to have backwardation in the curve, but that would ease and really it's front months that eased the most versus the backend. Again, we talked about normalization not being immediate, but I think the market's going to need clarity on several items, production recovery, what inventory draws are happening, and then ultimately what is the demand response globally. So again,

a lot in the air, but I think short-term, we're going to see prices move to that 90 to \$95 range if we have a resolution. If we go to the next slide, this is more the meat of inventories have delayed the shock, but they haven't eliminated it.

SECTION 5: OIL INVENTORIES AND RESERVES

And so two charts here, I think both very interesting. So you can see on the left-hand side, these are global visible oil inventories and you've seen these inventories range between 75 and close to 90 to 95 over the last eight years since 2018. We are going to be at our lowest level since 2018. So this is more or less getting into uncharted territory. I'd say that the system is getting tighter and more fragile. And I think you're starting to see that play out potentially in the bond markets as you saw a bit of a sell off here over the last week plus. So right now we're talking about 70 days of global demand in terms of inventories. And if we go through June, you're going to be in the high 50s. So we have operated at these levels before. We've been as low as 50 to 55 days of inventory, but this was pre-shale.

And so again, this is kind of uncharted territory, but there is some room. There's still a bit of cushion, but I think it starts getting priced into the markets sooner than later. The other question we've started to get is, are we running out of oil? And the answer's no, we're not running out of oil. Clearly there's plenty of inventories left, but I would say that that 50 days that I just mentioned is a bit deceiving in terms of what we're seeing from sell side estimates is that to operate the global crude system, you have to have a minimum storage level for landed oil. And that typically is probably going to remain in that 30 to 40-day range. So you have to keep oil flowing in storage tanks, in pipelines, refineries, et cetera. So right now we're at 70. Historically, you've been in the 50s. The 30s and 40s is the no-go range.

So as you start to approach this, I think that's where you'll start to see a lot of angst within the market. So just putting a bow on this high level, we entered about 2.5% above historical levels going into the year, you were probably going to be 7.5% below historical levels and you're really seeing that be accelerated now by the strategic petroleum reserves for the OECDs, the developed countries. You can see on that right-hand chart how that number's dipped over a hundred million since the beginning of March. Okay.

SECTION 6: WHERE IS DEMAND DESTRUCTION OCCURRING

If we go to the next slide, where is demand destruction occurring and not occurring? This goes back to that first slide we showed in that blue bar of 1.8 million barrels a day of destruction.

What I pulled here on the left-hand side is a chart of Europe and it's jet fuel imports. So right now you're seeing Europe high levels gone from about 500,000 of imports a day to less than 300,000, about 250,000. It's been in half. Why? Refineries are not, they're stepping back. You got higher prices, they have weaker margins, and really there's not as much incentive to buy here. And I'm showing the Europe jet fuel and I do expect we'll have demand pull there at some point, but we're also seeing this not just in Europe, you're seeing this within China as well. Their crude oil imports, which is not shown here, but they've gone from 12 million barrels a day to six million barrels a day. So again, this is demand pull that's not happening that would normally happen in the system right now. The other notable thing on the left-hand chart here is the bright orange, that's US imports to Europe. You can see every other region globally is declining. The US is increasing. And this is the same response we had. This is to Europe, but this is the same response we had in 2022 where we started importing our LNG to Europe from our LNG exporter. So again, the US really playing a pivotal role as

that swing producer as the Middle East is more or less out of commission. On the right-hand side, this is the positive side and I've shown this a couple times, but you're seeing the Asian economies be much more resilient. Their oil consumption intensity has really declined significantly over the last 20 years. India's down by a third and it's all for the reasons that we saw somewhat during COVID, you're working from home, we're utilizing public transit more and EVs as well are not demanding and pulling on oil like they did in the past.

So there is some substitution, but again, you had this buffer, it's starting to go away, just a few charts there. Okay, let's go to the next chart.

SECTION 7: WHAT THIS MEANS FOR SUPPLY

All right, this is our forwards curve. We've showed this time and time again on each of these webinars, but I'd say before the crisis we were in that 60 to \$65 long-term range punchline is at Tortoise internally, we now look at the forward curve and we're at \$75 on a go forward range. And the curve is more or less reflecting that the curve is at \$90, \$90 for the rest of 2026. It's at \$75 on average in 2027 and then you go 28 to 30, it's about 70. So again, you're seeing near-term backwardation, but again, we have to replace these barrels and we can't get them back. And so you're now in the month three of this, hence our price curve has gone up as this has persisted. Several other notes on this page and I would just say that as a whole, the sector has been very capital disciplined for a number of years here out of post- COVID.

You're largely seeing that still. We saw Diamondback and Continental, Diamondbacks in the Permian, Continentals in the Bakken. They did announce they were going to revise up their production expectations. So you can see that in the lower left, that changed where they said \$70 is not enough to justify more drilling. That has changed as of their most recent earnings call. And then you look at the rig count and in the middle here, we're just starting to get initial signs that the rigs are starting to be put back to work. So last week the crude oil rig count for the US and North America rose 10 to 425. That's the biggest jump we've seen since 2022. So these are, again, initial signals, but it's taken this long even for US producers to start to react. Where's the crude oil activity picking up? It's in West and South Texas, no surprise there That's Supermi.

And then just on the right-hand side, what does this all mean for supply? I mean, look, we've been at very flat production the last two and a half years. Some have said shale's matured. I'd argue that there's meaningful capacity. It's just you're seeing a different way that the operators are going about their production. And so you're seeing better recovery rates, you're seeing better technology. They're using AI across their existing acreage. So I think the days of growing a million barrels a day are likely behind us, but I do expect you're going to see an uptick from private even E&Ps, small cap names. And then finally, last would be large cap and the majors. But today we're at 13.5 million barrels a day of production. Even low to mid-single digit growth will be helpful here as a meaningful source of global supply growth, where you're not seeing it in the rest of the world.

SECTION 8: U.S. ENERGY: A CRITICAL SOURCE OF STABLE SUPPLY

Go to the next page, few more here. Just a couple charts here. You're starting to see the demand pull for US exports, hit this in several different fronts, most notably on the crude side on the right-hand chart. So we actually exported over six million barrels a week at the end of April and since then we've been in that mid-fs range. Again, we never were above five and mostly in the fours prior to the crisis. So you're starting to see how the US is really flexing its muscle in terms of energy exports. And with all these BLCCs coming from around the world, I expect that number's going to be even higher and

higher. On the right, you can see this is not just a crude oil story, but we're exporting LNG, natural gas liquids and refined products. So again, a very supportive thesis for North American energy.

SECTION 9: WILL THE MARKETS SHIFT TO REWARDING CAPEX AND GROWTH?

We go to the next page and I think this is the opportunity for everyone on the call is the market going to shift its stance and start rewarding the CapEx and start rewarding growth, or is it going to focus on prioritizing cash to shareholders? So two different things going on here in this slide. So the dark blue line correlates to the red dash line. The dark blue line is CapEx as a percent of cashflow and you can see it's about 10% below its history, 15% below its history, historical norms. So we are not reinvesting like we have historically. On the other side, you look at the light blue paired with the green dashes and you can see that the energy sector is distributing a lot more dividends or buying back as a percent of cash flow from operations versus the 30-year history. So I think that the book is out here, what's going to happen?

I think you're starting to see some potential signs of this shifting, but it's pretty early here. From a performance standpoint, it's wild to me, we've seen the XLE, the E&Ps refiners. I mean, we just haven't had a big move yet in terms of prices. We'll go to that on the next slide here.

SECTION 10: ENERGY: STILL UNDER OWNED, STILL REASONABLE VALUED

So look at the right-hand side, you can see the enterprise value to EBITDA. That's how we're looking at the overall price moves. OFS has moved a bit, but if you're oil or a large cap producer, if you're integrated oil and gas name, if you're for natural gas producer, we have not seen the significant expansion of EV to EBITDA multiples here. So I think there's an opportunity here. Yes, you're up year to date, but really since the conflict took place, we have not gone up that much as an overall sector. And then on the left-hand side, energy just is trading at a lower PE multiple versus the rest of the market. Yes, we have had less growth in this sector, but you could potentially starting to see that inflect. And the first telltale sign would be that rig count that we talked about just a bit ago.

SECTION 11: 5 KEY TAKEAWAYS FROM THE MIDDLE EAST CRISIS

But in general, we're trading at a 15 times forward PE versus the broader markets at 21 times. And then just one last slide to wrap things up here, just high level, the key takeaways just to wrap this up. I think this crisis has exposed how fragile global energy logistics are and really how dependent we are to get that energy out of the Strait of Hormuz. Inventories have delayed the shock. They haven't eliminated it and potentially there's more shocks to come. Even with a deal, the floor for oil has been set significantly higher versus where it was two, three months ago. I think we kind of hit it nauseam, but US energy again is stepping up and really strategically important. And then finally, I would say energy, we're starting to be repriced as a potential portfolio hedge in terms of geopolitical disruptions. But in addition to that, you can get income generation, particularly on the midstream side and the infrastructure assets, you also get the inflation sensitivity as well from the sector.

So again, I think this is still playing out. Yes, the headlines have kind of tampered down. We're reacting more to true social announcements than what is actually happening physically and what's happened physically has been a significant disruption for almost three months now.

SECTION 12: Q&AS, DISCLAIMER AND OUTRO

So we will see what questions are out there, but that is all I have for the prepared remarks. And let me just go through those real quick.

With the oil blockage now almost three months long, how come oil keeps going down? Does the market know something? I think the market again is planning that the strait is opened pretty soon, but there is some cushion here again with the inventories, but when you start getting below that 70-day mark and into the 50s, I think you could start to see prices potentially move up much more significantly. Next question's on tanker insurance rates and will they be higher for longer? I would imagine so. I'm not an expert on a tanker insurance market, but from what I have heard is they have significant pricing power here. And so I would expect those companies are probably doing very well in terms of getting the tankers to where they need to be. Will this keep tanker insurance rates high for the US oil and LNG? Potentially. We'll have to look into that one, not too sure on the insurance rates and impact to the LNG industry.

And then last one, what has been learned from the Gulf War in terms of bringing damage and closed wells back online? What new technology and extraction methods have we learned since then? It's funny, I took this slide out this time. I recovered it on a couple previous slides, but the gist is that there are lower-pressure wells in parts of the Gulf, most notably in Iran. And so those low-pressure wells, if you have to force to shut in production, it may be difficult to bring that production back online. The rest of the Gulf has medium production pressure or higher. So I think that we're going to be okay in terms of bringing back some of the wells that potentially have to be shut in, at least in those other countries. I would expect the technology certainly has helped since then. But again, the question is a good one in that we are not going to overnight go back to 100% of the production levels that we were at prior to the war.

Historically, it's taken over a year, sometimes two years to get back to those levels. The estimates that I've heard, the whisper estimates is you'll get back to 80% of the existing production pretty quickly. So again, that's an opportunity long term for US and the energy markets here. We didn't even talk about LNG here. Qatar had several of their facilities damaged. And so the US LNG industry alongside the crude industry, I think is going to be being positioned to be a big winner, not only short-term, but probably medium-term at this point, given how long we've had these barrels offline. So that's it for the prepared remarks. Really appreciate everyone's joining and we'll look forward to keep doing these over the next couple of weeks and keeping you guys informed of the latest and greatest in the oil markets. So we'll talk to you soon. Thank you.

Disclaimers:

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