# Global Energy Strategy

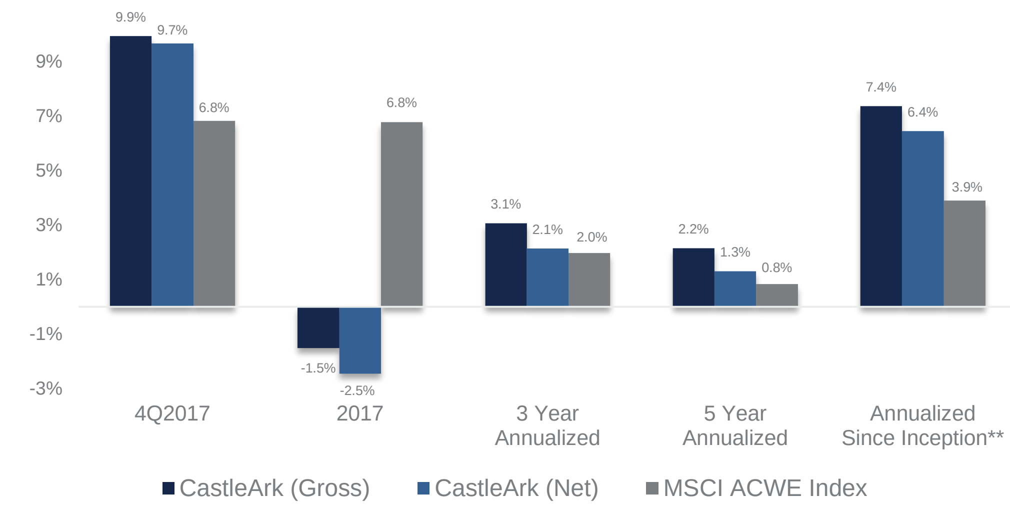
CASTLEARK

**December 31, 2017**

## Fourth Quarter 2017 – Performance Update

The Global Energy Strategy rose +9.92% (gross) and +9.65% (net) during the fourth quarter of 2017, outperforming MSCI's All Country World Energy (ACWE) Index which rose +6.81%. Since inception, September 2009, the Global Energy Strategy has outperformed and returned an annualized +7.35% (gross) and +6.44% (net) compared to the +3.89% return of the ACWE benchmark for the period ending December 31, 2017.

## CastleArk Global Energy Performance




Past performance is no guarantee of future results.
**Inception 06/30/2009

## Fourth Quarter 2017 – Portfolio Review

There are not too many other ways to describe the global equity performance in 2017: Largest up year since 2003 (netting the 2008-'09 rollercoaster). Every Developed equity market was up during the quarter, while Emerging stock markets registered gains in all but Russia. Almost every market of the top 30 countries posted new highs in their largest and most liquid equity indices.

For 2017, global developed equity markets (EFA Exchange Traded Fund) rose 25.1%, while the global emerging (EEM ETF) index posted a 37.3% return. During the 4th quarter, Consumer sectors registered the highest returns with Technology and Financials a close second. Utilities and Health Care were the quarter's laggards.

2017's investment performance is perhaps even more impressive in light of the Street's view over these past 12 months. Not only did the world's economies not completely collapse after Brexit, the US presidential election, and the certainty of breakdowns in international cooperation around trade, security, regulations, etc., but global GDP grew at 3.4% in 2017 and appears to be accelerating off of that pace.

Global capital markets also spent much of 4Q absorbing the reality that this global growth appears to be fairly widespread across both developed and emerging regions. Fiscal stimulus, led by passage of a new US tax code, is increasing at a much stronger rate than modeled at the end of 3Q. And finally, all this economic activity is taking place in a tightening, global monetary environment.

OPEC conducted their annual, year-end review with the requisite mini dramas playing out among the fringe members. Russia and the Saudis appear to have found some common ground in production quotas, while the Venezuelans are building a sizeable lead in the race to the bottom of global oil producers.

## Top 10 Portfolio Holdings*

| | |
|---|---|
| EOG Resources, Inc. | 4.8% |
| Encana Corporation | 3.6% |
| Diamondback Energy, Inc. | 3.6% |
| Royal Dutch Shell plc (ADR) | 3.6% |
| Continental Resources, Inc. | 3.5% |
| Total SA (ADR) | 3.4% |
| Chevron Corporation | 3.4% |
| RSP Permian, Inc. | 3.4% |
| Pioneer Natural Resources Company | 3.4% |
| Cheniere Energy, Inc. | 3.3% |
| **Percentage of Total Assets** | **35.9%** |

## Portfolio Characteristics*

| | CastleArk Global Energy | MSCI All Country World Energy |
|---|---|---|
| Number of Companies | 47 | 134 |
| Forward P/E | 20.3x | 17.3x |
| Historical EPS Growth | -13.7% | -18.1% |
| Expected Growth | 22.1% | 16.1% |
| Return on Equity | 1.9% | 5.7% |
| LT Debt/Capital | 31.5% | 30.8% |
| Weight by Market Cap | $51.5B | $127.5B |
| Median Market Cap | $14.8B | $14.6B |

*Representative client portfolio.

## Global Energy Team

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## Fourth Quarter 2017 - Portfolio Review (continued)

**The Waiting Is the Hardest Part**. The world's investment community slowly began to see glimmers of energy equities joining the global growth story in the 4th quarter. All three fundamentals in the Energy equation – Supply, Demand & Inventories – simultaneously moved towards a much tighter balance in 2017. 2018 should remove any doubts about the direction.

Institutional investor memories however are still sharp enough to remember 2017's opening salvo of global energy performance. After a strong 4Q16 rally and first couple of weeks in the new year, these same broader energy indices dropped 15-20% over the following 7 months.

This Strategy would never doubt the wisdom of the global investment market and its valuations. However, the sector's penchant for punctuality has also never been in question. Energy investment cycles equally have some serious amplitude due to commodity volatility.

Global demand for virtually every kind of energy molecule may have posted new, all-time highs during the 2H of 2017.Global supplies concurrently, save the US, are off approximately 3-5%. This combination has effectively decimated the past 3 years of build in global crude stocks.

OPEC extended their agreement in the 4th quarter, and spent the last few months of 2017 quietly congratulating the Saudis on their perseverance in drawing down global crude stocks. Even the sharpest of Wall Street analysts has now figured out that 9 mmbbl/day for the Kingdom at $60/bbl generates more revenue than 10 mmbbl/d at $50/bbl. And while the US producers effectively filled that Saudi supply gap, global demand has marched along at a +1.75 mmbbl/d pace in the 4th Q. As we type this update, Brent crude has touched $70 a bbl.

A strong winter has settled across the more economic centric hemisphere. Global GDP has accelerated in the 4th quarter, and macro energy demand has dutifully followed. US petroleum exports have now become a major catalyst in the energy space. Led by distillates and combined with light crudes and other products, US exports are now averaging ~6.5 mmbbl/d. Add in LNG, and the US may soon be exporting 10 mmbbl of energy equivalent every day.

What has made this recovery so frustrating for investors has been the resiliency of US producers and their response to lower prices w/ new technology, cost compression and production efficiencies. Every other new global source of supply has struggled below $60/bbl. The success of this US geologic resource has masked a multitude of failures to bring on new barrels from conventional deposits. Moreover, evidence is piling up that development costs did bottom in 2017, and are up 10-20% across all energy supplies, including US shales. The world's average breakeven exploration and development costs continue to ramp to $65/bbl.

## Market and Portfolio Outlook

Energy sentiment continued its positive rotation from 2Q's Negative to 3Q's Concerned to 4Q's NotAgain stage. As recently as this past September, very few Street analysts could have imagined a year end $60 price a bbl price, let alone $70. Investment pundits and markets alike had a very high degree of confidence in virtually unlimited oil supplies at sub $50 commodity prices. Today, investors have moved beyond forensic analysis to portfolio re-construction: How to make up lost performance without completely ignoring risk parameters and disciplines. With apologies to long time readers for the repetition – we continue to expect the market to be surprised by both the magnitude of the capital expenditure effort required, and duration needed to return to the surplus inventory levels of early 2017.

## CastleArk Global Energy Strategy

CastleArk's investment philosophy follows the discipline of identifying growth companies that have demonstrated a consistent ability to generate high returns on a fully loaded capital basis through a normal commodity cycle. Our team uses fundamental analysis to construct a high-conviction portfolio of holdings that seeks to diversify across all subsectors of the global energy universe. Active monitoring of the Strategy's custom factors and portfolio tracking error are the principal drivers of risk management. There are size limits on all holdings, and we look to exit positions when long-term growth fundamentals and growth outlook have deteriorated to the market's consensus levels.

### Fourth Quarter 2017 Best and Worst Contributors*

| Best: | Contri-bution |
|---|---|
| 1. Continental Resources, Inc. | 1.07% |
| 2. Diamondback Energy, Inc. | 0.91% |
| 3. HollyFrontier Corporation | 0.75% |
| 4. EOG Resouces, Inc. | 0.58% |
| 5. Pioneer Natural Resources Co. | 0.55% |
| 6. RSP Permian, Inc. | 0.54% |
| 7. Royal Dutch Shell Plc Spon ADR | 0.49% |
| 8. Cheniere Energy, Inc. | 0.42% |
| 9. Concho Resources, Inc. | 0.42% |
| 10.Encana Corporation | 0.39% |

| Worst: | Contri-bution |
|---|---|
| 1. Southwestern Energy Co. | -0.28% |
| 2. Tesla, Inc. | -0.25% |
| 3. Chesapeake Energy Corp. | -0.16% |
| 4. Superior Energy Services, Inc. | -0.13% |
| 5. U.S. Silica Holdings, Inc. | -0.13% |
| 6. Range Resources Corporation | -0.11% |
| 7. China Petroleum & Chemical Corp. Sponsored ADR | -0.07% |
| 8. TransCanada Corporation | -0.03% |
| 9. Centennial Resource Dev., Inc. | -0.03% |
| 10.Eni SpA Sponsored ADR | -0.00% |

*Representative client portfolio. A complete list of each security's contribution to performance and description of the calculation methodology is available upon request.

### Contact


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