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MLPA – Global X MLP ETF

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GLOBAL X ETFs RESEARCH

MLP Insights Q4 2020: Macro Improvements Drive Midstream

COVID-19 ravaged demand-sensitive sectors like Energy last year when economies around the world came to a standstill. From mid-February to mid-April 2020, energy demand in countries in full lockdown declined 25% on average and 18% in countries in partial lockdown, according to the International Energy Agency (IEA). But by Q4, clouds over the Energy sector began to part as vaccine approvals provided hope, economic activity picked up, and future energy policy in the US came into focus. In our view, these developments along with rising inflation expectations make the sector, particularly midstream companies, attractive as part of an income-oriented investment strategy.

Key Takeaways

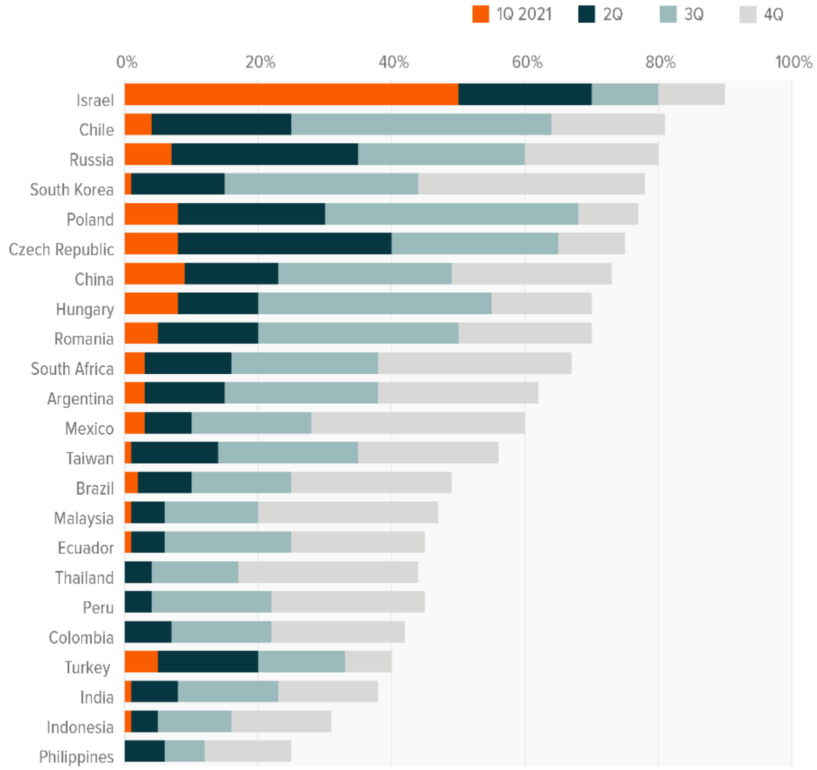
- Many macro and political overhangs lifted by the end of Q4, with optimism about the re-opening economy driving Energy sector gains.
- Value sectors like Energy shined as the economy rebounded, and small cap and cyclical sectors became market leaders.
- With rising inflation, midstream equities offer an attractive potential income stream due to high yield spreads compared to most other asset classes.
- The Energy sector outlook is compelling as macro fundamentals strengthen and an infrastructure bill is discussed.

Macroeconomic and Political Overhangs Lifted

Energy is quite sensitive to economic activity, so economies on pause due to a global pandemic has significant repercussions for the sector. However, vaccine approvals and initial vaccinations rollouts around the world provided a healthy dose of optimism toward the end of 2020. In the US, the Food & Drug Administration (FDA) approved the Moderna and Pfizer-BioNTech COVID-19 vaccines for emergency use in December. With more vaccine approvals on the horizon globally and increasingly efficient vaccination programs, an end date to the COVID-19 ordeal is gradually coming into sight.

EXPECTED COVID-19 VACCINATION COVERAGE OF POPULATION IN SELECT COUNTRIES, BY QUARTER IN 2021

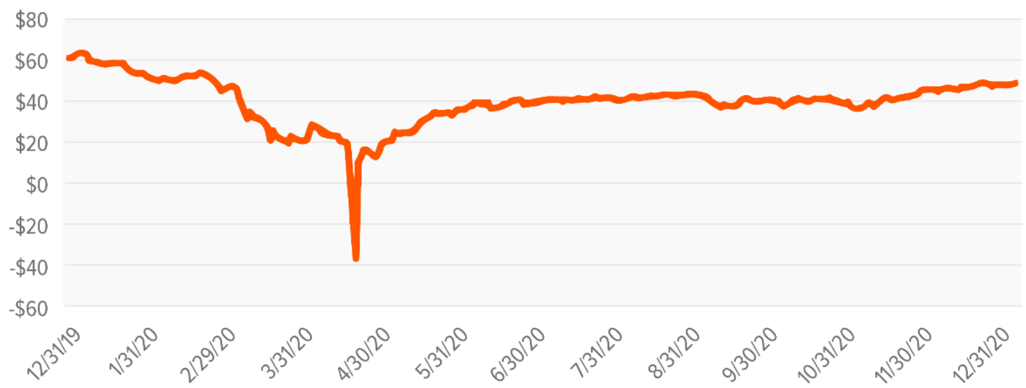
Source: WSJ, Goldman Sachs. Jan 31, 2021.



After a long period of malaise, oil prices increased from $40 to $49 in Q4 as global economic activity picked up with restrictions easing. The initial shock of the COVID-19 pandemic caused oil prices to crater, even turning negative for the first time ever in April. A slow recovery took prices to the $40 range, where they middled along for months before starting to climb again mid-Q4.

WTI OIL PRICES

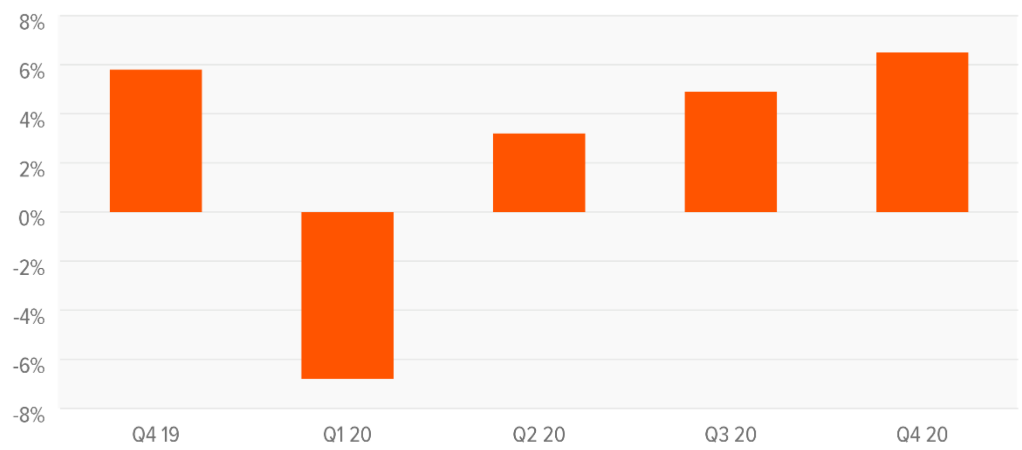
Source: Bloomberg. Data from 12/31/19 to 12/31/20.



Economic growth in the US and China, the world's largest economies, turned for the better in Q4, and growth expectations are continuing to rise. As a region, Asia handled the pandemic response particularly well and data there gradually returned to normalcy throughout the second half of the year. China's manufacturing data was a standout, with its Purchasing Managers' Index (PMI) increasing from 50.9 in June to 51.9 in December. That result helped China's GDP growth rise from 3.2% year-over-year in Q2 to 6.5% in Q4.[1]

CHINA GDP GROWTH (YoY)

Source: National Bureau of Statistics, Bloomberg. Data from 12/31/19 to 12/31/20.



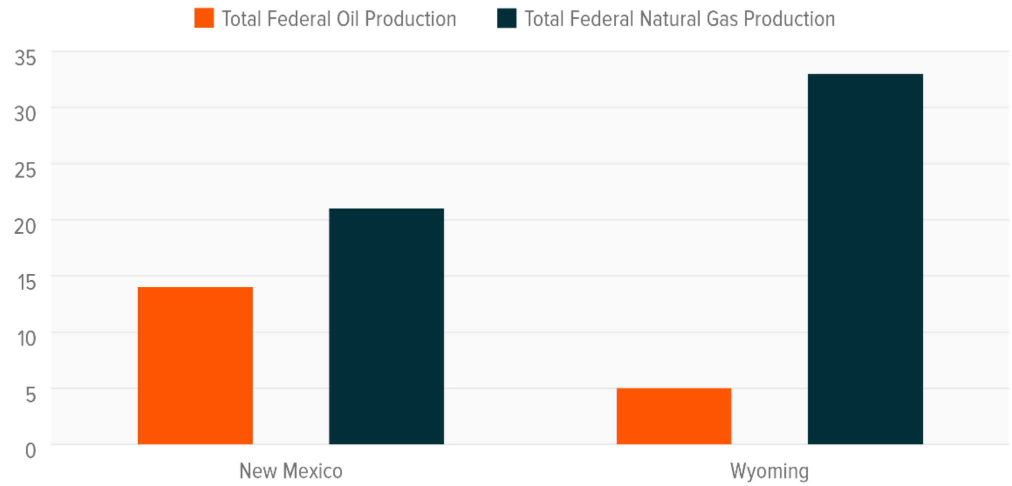
Like in China, the US's PMI increased from 52.2 in June to 60.5 in December. The December improvement helped drive the US' Q4 GDP growth to 4%, following abnormal readings of +33.4% in Q3 and -31.4% in Q2. With this result, the Congressional Budget Office estimates the US economy will grow 4.6% in 2021.[2]

The US election also provided much-needed clarity for the Energy sector. In the run-up to November 3, the market feared that a Democrat-controlled House, Senate, and White House could bring legislative risks to the traditional oil and gas industry. But the risks are more centralized, reflective of a society that increasingly favors a coordinated approach to cleaner energy sources. President Biden's energy agenda focuses on putting a lid on widespread Energy sector growth, rather than trying to systematically eliminate the sector's presence in the economy.

For example, as promised during the campaign, Biden halted new oil and gas leases on federal lands, but he still allowed existing leases on federal land to continue. This move may limit downside to specific companies and geographies with at-risk assets, rather than impact the broader industry. For context, 22% of total oil production and 12% of total natural gas production in the US is on federal lands.[3] The states most affected by these measures are New Mexico and Wyoming, as they have the most federal acres under lease.[4]

NEW MEXICO & WYOMING SHARE OF FEDERAL OIL AND GAS PRODUCTION

Source: Institute for Energy Research. Data from 2018.

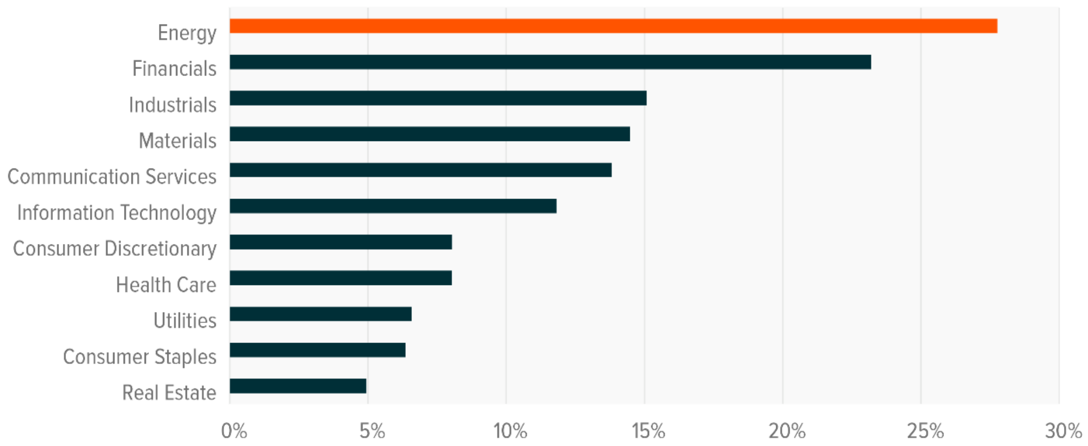


Q4 Performance: Value Sectors Shine As Demand Rebounds

In response to Q4's positive news flow, growth-oriented sectors like Technology took a backseat to value sectors like Energy. In another sign of cyclical strength, small caps vastly outperformed the broader market and high growth indexes. The Russell 2000 returned 31.36% versus just 13.09% for the Nasdaq 100 and 12.14% for the S&P 500 during the quarter.[5] The Energy sector rallied 27.76% in this time frame and midstream MLPs returned 25.51%.[6] A resurgence of value and small caps often is a sign the market believes economic conditions are improving. The domestic economy is often strong in these periods, meaning services sector demand and the consumer are operating at higher than average levels. This signals greater demand for energy consumption.

Q4 2020 SECTOR PERFORMANCE

Source: Bloomberg. Data based on GICS Level 1 sectors. Data from 9/30/20 to 12/31/20.



Initially, the shock of COVID-19's spread led to black swan-like fears in the energy market. Financing conditions proved challenging. A bond yield blowout in the sector made credit issuance extremely challenging, and a longer-term shift away from equity issuance left energy companies in an uncertain position. But two factors kept the sector afloat.

First, the Federal Reserve stabilized the credit markets. The Fed slashing interest rates to zero gave energy debt investors a lower yield spread. Second, the market came to believe that it overestimated credit riskiness in the energy patch. High yield credit markets rallied after the initial yield blowout when it was clear energy demand wouldn't be entirely shut down and OPEC+ support - via production cuts - would be extended for months to come. Fed actions and the government's emergency stimulus measures also helped to assuage fears and reset energy asset prices when the economy began laying the normalization groundwork in Q4.

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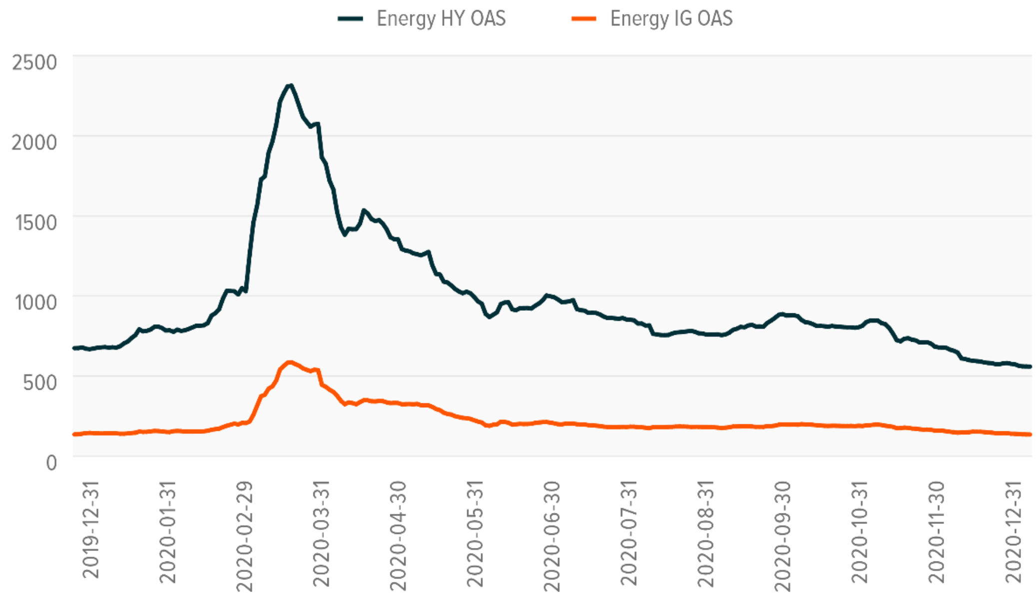
ENERGY OPTION ADJUSTED SPREADS (BASIS POINTS)

Source: Bloomberg. Data from 12/31/19 to 12/31/20. High Yield OAS measured by spreads in the USD High Yield Energy Sector. Investment Grade OAS measured by spreads in the USD Investment Grade Energy Sector. USD HY Energy OAS: Option Adjusted Spread (weighted by market value) of the US Dollar High Yield Energy sector. USD IG OAS: Option Adjusted Spread (weighted by market value) of the US Dollar Investment Grade Energy sector.

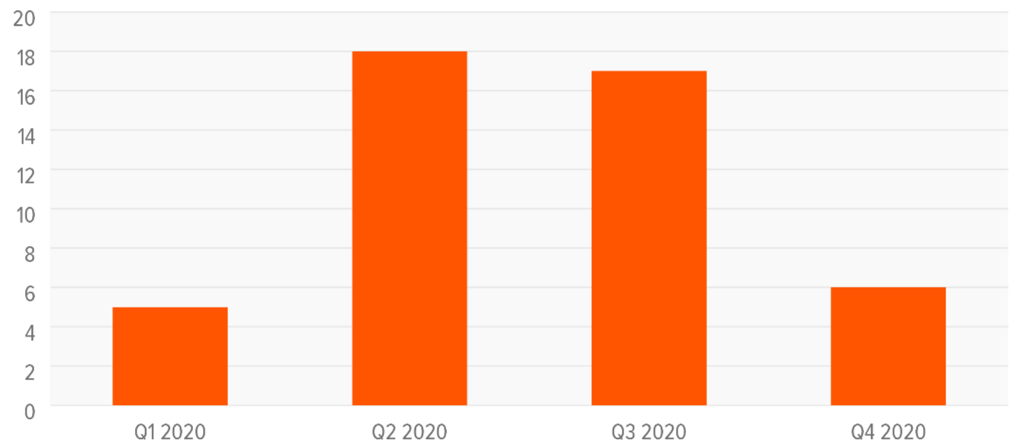


Energy also benefitted from some clarity on midstream contracts in Q4 as bankruptcies were settled. Bankruptcies spiked after the oil price collapse last March, but the pace slowed considerably throughout 2020 as fundamentals improved. Midstream companies have a vested interest in recovering as much as they can from Exploration & Production (E&P)'s during the bankruptcy process. Bankruptcy court is fraught with uncertainty, but these settlements indicate distressed upstream E&Ps are willing to work with their midstream counterparts in this environment.

- Extraction Oil & Gas, which declared bankruptcy last year, settled with Elevation Midstream to provide the firm with approximately 60% of what it claimed it was owed.[7]
- Extraction entered a new supply agreement with NGL Energy Partners (NGL), retaining Extraction's crude volumes on NGL's Grand Mesa Pipeline.[8]
- Chesapeake Energy settled with Williams Cos (WMB) for $112 million and WMB entered into a new gas supply commitment with Chesapeake.

2020 NORTH AMERICA E&P BANKRUPTCIES

Source: Haynes and Boone. "Haynes and Boone Oil Patch Bankruptcy Monitor." December 31, 2020.



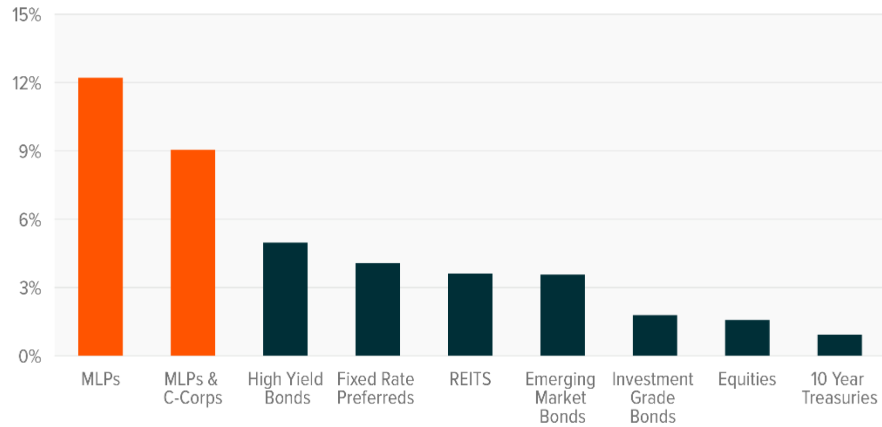
With Rising Inflation, Midstream Equities Become A Key Potential Income Strategy

In Q4, the 10-year US breakeven rate, a measure of inflation, rose from 1.63% to 1.99% and oil prices went from $40 to $49. In the 10-year period through 2020, the 10-year breakeven rate had a 55% correlation to monthly oil prices in the US.[9] It's not necessarily a 1-to-1 move, but higher oil prices are typically associated with inflation. Oil's rise in Q4 could be a directional indicator of inflation to come. For more thoughts on the inflation outlook, see our latest Income Monitor.

Inflation historically pushes up bond yields, but often the rise is only in nominal terms, as real yields, which account for inflation, remain relatively flat. To maintain high real yields, investors may want to consider asset classes with high yield spreads to US treasuries. Currently, yield spreads on midstream are some of the most attractive in the market, finishing the year at 8.13%.[10] At the same time, there were no distribution cuts to major midstream companies in Q4 and coverage ratios for distributions are strong at 2.2x on average for the Q4 period, indicating that the high yields appear sustainable.[11] Further, midstream entities have established certain contractual escalators on tariff rates to mitigate the cash flow risks associated with higher interest rates. After the multi-year transition to the self-funding model, many midstream companies paid down debt and reduced leverage ratios to the 4.5x range in an effort to limit refinancing risks. In addition, FERC regulated pipeline tariff rates are tied to the Producer Price Index for oil pipelines, so pipelines can pass through inflation to customers.

MIDSTREAM & MLP YIELDS COMPARED TO OTHER ASSET CLASSES

Source: Bloomberg. Data as of 12/31/20. Asset class representations are as follows, MLPs, Solactive MLP Infrastructure Index; MLPs & C-Corps, Solactive MLP & Energy Infrastructure Index; High Yield Bonds, Bloomberg Barclays US Corporate High Yield Bond Index; Fixed Rate Preferreds, ICE BofA Diversified Core U.S. Preferred Securities Index represented by yield to worst; REITs, FTSE NAREIT All Equity REITs Index; Emerging Market Bonds, Bloomberg Barclays Emerging Markets Hard Currency Aggregate Index; Investment Grade Bonds, Bloomberg Barclays US Corporate Bond Index; Equities, S&P 500 Index represented by 12-month dividend yield; 10 Year Treasuries represented by Constant Maturity Rate.



Energy Outlook Compelling with Improving Fundamentals, Infrastructure a Priority

COVID-19 wreaked havoc on energy production in the US last year. Oil production peaked at 13 million barrels per day (mbpd) last March and then began its slide to a low of 9.7 in August. But production stabilized in the 11 mbpd range towards the end of 2020 and appears set to trend higher as an increasingly vaccinated economy ramps back up. How to get that production from Point A to Point B is part of a broader strategic prioritization by federal and even state governments, most visibly through a potential infrastructure bill at the federal level. Investors looking to capitalize on energy infrastructure opportunities may see government focus as a point of interest. The recent cold weather crisis in Texas and middle America showed that the case for, and discussions about, improved energy infrastructure isn't going away anytime soon. The latest Infrastructure Report Card from the American Society of Civil Engineers gave the US a C-grade.[12]

Higher-yielding income assets like midstream equities may look more attractive to investors in 2021 with rate expectations increasing. Midstream's 8.13% yield spread to the 10-year treasury is well above other income-oriented asset classes like REITs & Utilities, at 3.95% and 2.52%.[13] Midstream's income profile is an upgrade too. MLPs for example often distribute Return of Capital (ROC), potentially providing greater after-tax income. For investors concerned about idiosyncratic risks in midstream, eschewing active management for a broad-based passive offering like the Global X MLP & Energy Infrastructure ETF (MLPX) could be an efficient and low-cost way to gain exposure to a space well-positioned for a re-opening economy.

1. National Bureau of Statistics of China, Bloomberg.
2. Bureau of Economic Analysis, Congressional Budget Office. Growth forecast as of 2/1/21.
3. American Petroleum Institute. "Americans are Big Winners with Natural Gas and Oil Development." 12/9/20.
4. Institute for Energy Research. Data from 2018.
5. Bloomberg. Data from 9/30/20 to 12/31/20. Total return numbers.
6. Bloomberg. Midstream represented by Solactive MLP & Energy Infrastructure Index.
7. S&P Global. 12/18/20. "Extraction Settles with Some Midstream Firms; others fight Chapter 11 Exit Plan."
8. NGL Energy Partners. 12/21/20. "NGL Energy Partners LP / Grand Mesa Pipeline Announce Settlement with Extraction Oil and Gas, Inc."
9. Bloomberg. Data measured on monthly correlations.
10. Bloomberg. Data as of 12/31/20 and midstream represented by Solactive MLP & Energy Infrastructure Index.
11. As measured by the Solactive MLP & Energy Infrastructure Index, company filings, Global X Research.
12. American Society of Civil Engineers, "Infrastructure Report Card," 3/3/21.
13. Midstream represented by Solactive MLP & Energy Infrastructure Index, REITs represented by FTSE NAREIT All Equity REITs Index, and Utilities represented by S&P 500 Utilities Sector GICS Level 1 Index. Data as of 12/31/20.

DEFINITIONS

Solactive MLP Infrastructure Index: The Solactive MLP Infrastructure Index is intended to give investors a means of tracking the performance of the energy infrastructure MLP asset class in the United States. The index is composed of Midstream MLPs engaged in the transportation, storage, and processing of natural resources.

Solactive MLP & Energy Infrastructure Index: The Solactive MLP & Energy Infrastructure Index tracks the performance of MLPs and energy infrastructure corporations.

Bloomberg Barclays US Corporate High Yield Total Return Index: The Bloomberg Barclays US Corporate High Yield Bond Index measures the USD-denominated, high yield, fixed-rate corporate bond market. Securities are classified as high yield if the middle rating of Moody's, Fitch and S&P is Ba1/BB+/BB+ or below. Bonds from issuers with an emerging markets country of risk, based on Barclays EM country definition, are excluded

ICE BofA Diversified Core U.S. Preferred Securities Index*:* The index tracks preferred securities such as floating, variable and fixed-rate preferreds, cumulative and noncumulative preferreds, and trust preferreds in the United States.

FTSE NAREIT All Equity REITs Index: A free float adjusted market capitalization weighted index that includes all tax qualified equity REITs listed in the NYSE, AMEX, and NASDAQ National Market.

Bloomberg Barclays Emerging Markets Hard Currency Aggregate Index: A flagship hard currency Emerging Markets debt benchmark that includes USD – denominated debt from sovereign, quasi-sovereign, and corporate EM issuers.

S&P 500 Index: S&P 500 Index tracks the performance of 500 leading U.S. stocks and captures approximately 80% coverage of available U.S. market capitalization. It is widely regarded as the best single gauge of large-cap U.S. equities

Bloomberg Barclays US Corporate Bond Index*:* Measures the investment grade, fixed-rate, taxable corporate bond market. It includes USD denominated securities publicly issued by US and non-US industrial, utility and financial issuers.

SEI Investments Distribution Co. (1 Freedom Valley Drive, Oaks, PA, 19456) is the distributor for the Global X Funds.

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Investing involves risk, including possible loss of principal. International investments may involve risk of capital loss from unfavorable fluctuation in currency values, from differences in generally accepted accounting principles or from economic or political instability in other nations.

Investments in securities of MLPs involve risk that differ from investments in common stock including risks related to limited control and limited rights to vote on matters affecting the MLP. MLP common units and other equity securities can be affected by macro-economic and other factors affecting the stock market in general, expectations of interest rates, investor sentiment towards MLPs or the energy sector, changes in a particular issuer's financial condition, or unfavorable or unanticipated poor performance of a particular issuer (in the case of MLPs, generally measured in terms of distributable cash flow). The Global X MLP Funds invest in the energy industry, which entails significant risk and volatility. The Funds invest in small and mid-capitalization companies, which pose greater risks than large companies. MLPA has a different and more complex tax structure than traditional ETFs and investors should consider carefully the significant tax implications of an investment in the Fund. The Funds are non-diversified. Current and future holdings are subject to risk.

MLPA is taxed as a regular corporation for federal income tax purposes, which differs from most investment companies. Due to its investment in MLPs, the fund will be obligated to pay applicable federal and state corporate income taxes on its taxable income as opposed to most other investment companies. The fund expects that a portion of the distributions it receives from MLPs may be treated as tax-deferred return of capital. The amount of taxes currently paid by the fund will vary depending on the amount of income and gains derived from MLP interests and such taxes will reduce an investor's return from an investment in the fund. The fund will accrue deferred income taxes for any future tax liability associated certain MLP interests. Upon the sale of an MLP security, the fund may be liable for previously deferred taxes which may increase expenses and lower the fund's NAV.

The potential tax benefits from investing in MLPs depend on them being treated as partnerships for federal income tax purposes. If the MLP is deemed to be a corporation then its income would be subject to federal taxation at the entity level, reducing the amount of cash available for distribution to the fund which could result in a reduction of the fund's value.

Bonds and bond funds will decrease in value as interest rates rise. High yield bonds involve greater risks of default or downgrade and are more volatile than investment grade securities, due to the speculative nature of their investments. In addition to the normal risks associated with investing, real estate and REIT investments are subject to changes in economic conditions, credit risk and interest rate fluctuations. Emerging markets involve heightened risks related to the same factors as well as increased volatility and lower trading volume. Preferred stock is subject to many of the risks associated with debt securities, including interest rate risk. In addition, preferred stock may not pay a dividend, an issuer may suspend payment of dividends on preferred stock at any time, and in certain situations an issuer may call or redeem its preferred stock or convert it to common stock. U.S. Treasury securities are considered to be of high credit quality and are backed by the full faith and credit of the U.S. government. U.S. Treasury securities, if held to maturity, guarantee a return of principal while no other securities mentioned in this material offer such a guarantee.

Shares of ETFs are bought and sold at market price (not NAV) and are not individually redeemed from the Fund. Brokerage commissions will reduce returns.

Carefully consider the Funds' investment objectives, risk factors, charges, and expenses before investing. This and additional information can be found in the Funds' summary and full prospectuses, which may be obtained by calling 1-888-GX-FUND-1 (1-888-493-8631), or by visiting www.globalxetfs.com. Read the prospectus carefully before investing.