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An Introduction to Alerian's Midstream Dividend Indexes

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Author: Caroline Mahavier

Introduction

The Alerian Midstream Energy Dividend Index (AEDW) and the Alerian MLP Infrastructure Dividend Index (AMDW) are two fundamentally-weighted indexes based on the liquid, dividend-paying portion of the North American energy infrastructure universe. AEDW includes both midstream MLPs and North American C-Corporations, while AMDW only includes midstream MLPs. This piece will provide an introduction to the new indexes and the implications of weighting by dividend payments rather than the more traditional weighting by market capitalization.

Introducing Alerian's midstream dividend indexes

The Alerian Midstream Energy Dividend Index (AEDW) and Alerian MLP Infrastructure Dividend Index (AMDW) are fundamentally-weighted indexes, meaning that constituents are selected and weighted based on a fundamental equity valuation criterion. While AEDW and AMDW are weighted by dividend payments, other common fundamental-weighting methodologies may include revenues, free cash flow, or book value.

The process of weighting fundamentally by dividend payments is straightforward. Each company's total distribution is calculated as shares outstanding multiplied by its annualized dividend based on the most recent dividend¹. Each constituent's weight is then calculated by taking its total distribution and dividing by the sum of all index constituent distributions. Finally, a 10% cap is applied to constituent weights. Simply put, companies that pay out more cash flow per share are weighted higher relative to peers that distribute less.

While their weighting scheme is unique among Alerian indexes, AEDW and AMDW share similar constituent universes with the [Alerian Midstream Energy Index](#) (AMNA) and the [Alerian MLP Infrastructure Index](#) (AMZI). The table below compares AEDW with AMNA and AMDW with AMZI. Note that the comparisons contain backtested data. Unlike AMNA, AMZI, and the rest of Alerian's index suite, it is important to note that AEDW and AMDW are rebalanced quarterly and reconstituted annually. Quarterly rebalanceings occur in January, April, July, and October, with only the weightings of constituents adjusted. Excluding spin-offs, companies can only be added to AMDW or AEDW during the annual reconstitution in October. However, constituents can be removed from the index between reconstitutions due to special situations such as mergers, acquisitions, or bankruptcies.

Methodology Overlap	AEDW	AMNA	AMDW	AMZI
Number of Constituents	33	54	18	20
Universe	MLPs + C-Corps	MLPs + C-Corps	MLPs only	MLPs only
Constituents Capped at 10%	✓	✓	✓	✓
Minimum Trading Volume Requirement ²	✓	✓	✓	✓
Distribution Requirement ³	✓		✓	✓
Rebalancings	Quarterly	Quarterly	Quarterly	Quarterly
Reconstitutions	Annually	Quarterly	Annually	Quarterly

Number of Constituents as of 1/31/2020

² Minimum Trading Volume Requirement: Stocks must have a median daily trading volume of at least \$5 million for the trailing six-month period to be included in AEDW, AMDW, and AMZI. Stocks must have a median trading volume of at least \$1 million to be included in AMNA.

³ Distribution requirement: Stocks must have declared a cash dividend or distribution for each of the trailing two quarters

The dividend-weighted indexes outperform in the long-term despite overlap

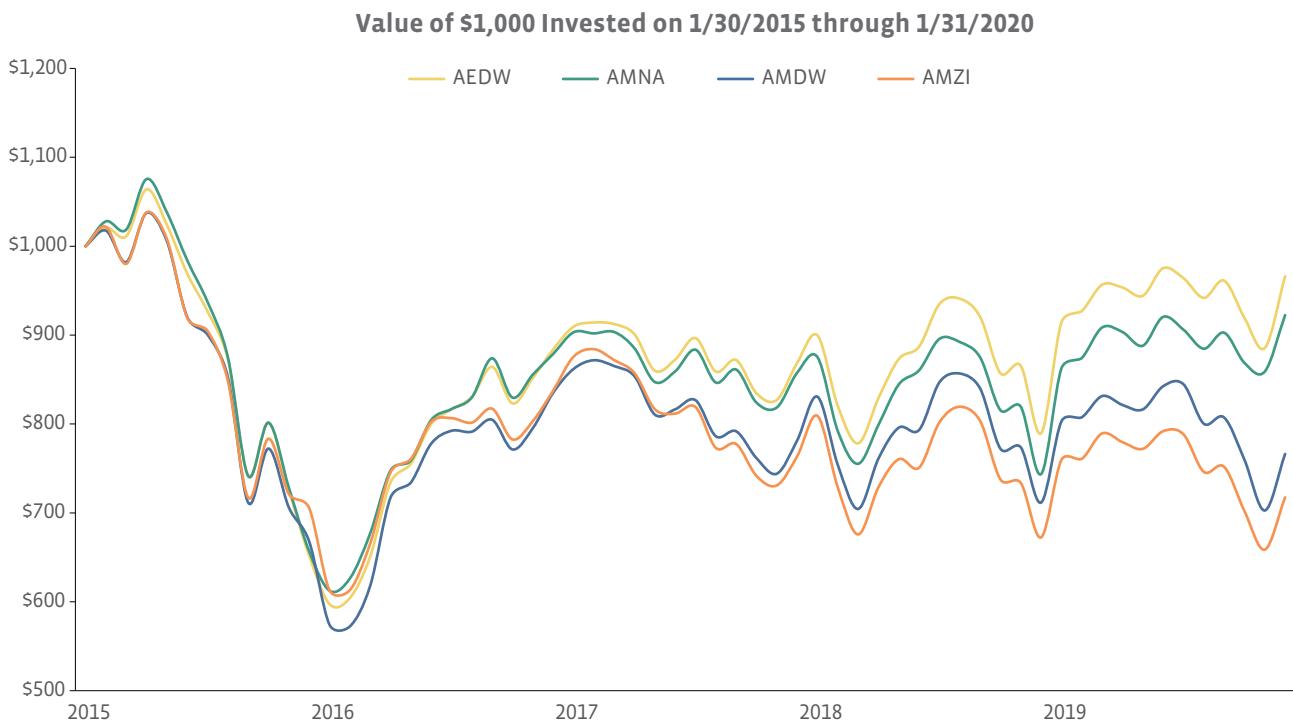
As reflected in the Methodology Overlap table [on page 2], AEDW/AMNA and AMDW/AMZI clearly have similar characteristics. As of January 31, 2020, AEDW and AMNA had an overlap of 77.4% by weighting. AMDW and AMZI had an overlap of 81.1%. This overlap is further evident in the comparison of top ten holdings below. Cheniere Energy (LNG), which currently does not pay a dividend, is the only top ten AMNA constituent not included in AEDW's top ten, while AMDW and AMZI share seven top ten holdings.

Top 10 Constituents as of 1/31/2020

AEDW	Ticker	Weight	AMNA	Ticker	Weight
Enbridge Inc	ENB CN	10.9%	TC Energy Corporation	TRP CN	10.5%
Energy Transfer LP	ET	10.1%	Enbridge Inc	ENB CN	10.4%
Enterprise Products Partners LP	EPD	9.7%	Kinder Morgan Inc	KMI	10.3%
MPLX LP	MPLX	7.9%	Enterprise Products Partners LP	EPD	9.5%
Kinder Morgan Inc	KMI	7.3%	ONEOK Inc	OKE	8.2%
TC Energy Corporation	TRP CN	7.1%	Energy Transfer LP	ET	7.8%
The Williams Companies Inc	WMB	5.2%	The Williams Companies Inc	WMB	6.7%
ONEOK Inc	OKE	5.0%	Pembina Pipeline Corporation	PPL CN	5.6%
Pembina Pipeline Corporation	PPL CN	3.1%	Cheniere Energy Inc	LNG	4.0%
Plains All American Pipeline LP	PAA	2.9%	Magellan Midstream Partners	MMP	3.7%

AMDW	Ticker	Weight	AMZI	Ticker	Weight
Energy Transfer LP	ET	10.6%	Energy Transfer LP	ET	10.5%
Enterprise Products Partners LP	EPD	10.1%	Magellan Midstream Partners	MMP	10.3%
MPLX LP	MPLX	9.9%	MPLX LP	MPLX	10.0%
Plains All American Pipeline LP	PAA	8.9%	Enterprise Products Partners LP	EPD	9.6%
Magellan Midstream Partners	MMP	8.4%	Plains All American Pipeline LP	PAA	9.4%
Phillips 66 Partners LP	PSXP	7.9%	Phillips 66 Partners LP	PSXP	6.7%
Western Midstream Partners, LP	WES	7.6%	Tallgrass Energy LP	TGE	5.6%
Cheniere Energy Partners LP	CQP	7.2%	Western Midstream Partners, LP	WES	5.4%
EQM Midstream Partners, LP	EQM	6.4%	NuStar Energy LP	NS	4.3%
Enable Midstream Partners LP	ENBL	4.8%	Shell Midstream Partners LP	SHLX	3.9%

Given the significant overlap, one may expect similar performance between the fundamentally-weighted and market capitalization-weighted indexes. However, depending on the period, performance differences have been somewhat significant (see chart and table below). AEDW and AMDW have outperformed AMNA and AMZI, respectively, in the long-term. However, in the recent periods, AMZI and AMNA have performed better than their dividend-weighted counterparts. This performance difference alludes to the statistics that will be covered in the following section – among them, AEDW and AMDW have higher standard deviations, reflecting more volatility.



Performance Data

	3 Month	6 Month	YTD	1 Year	3 Year	5 Year
AEDW	0.0%	-4.6%	-4.9%	16.4%	1.9%	7.1%
AMNA	3.0%	-1.3%	-3.0%	20.3%	1.4%	6.4%
AMDW	-6.5%	-15.9%	-7.3%	-0.2%	-3.1%	1.2%
AMZI	-3.8%	-14.4%	-5.9%	0.4%	-4.0%	-0.9%

Total return performance as of 1/31/2020

Dividend-weighted indexes have generated higher risk-adjusted returns

To better evaluate the risk-return profile of AEDW and AMDW relative to AMNA and AMZI, it is informative to look at the metrics in the table below. Based on standard deviations alone, the dividend-weighted indexes suggest more risk than their capitalization-weighted peers. However, despite having a higher standard deviation, AEDW and AMDW generated higher risk-adjusted returns over the five-year analysis period as evidenced by their Sharpe ratios displayed in the table below. Even though AEDW's standard deviation is 0.5% greater than AMNA's, its Sharpe ratio is higher by 0.04. AMDW's standard deviation is 0.8% higher than AMZI's and its Sharpe ratio is 0.07 higher.

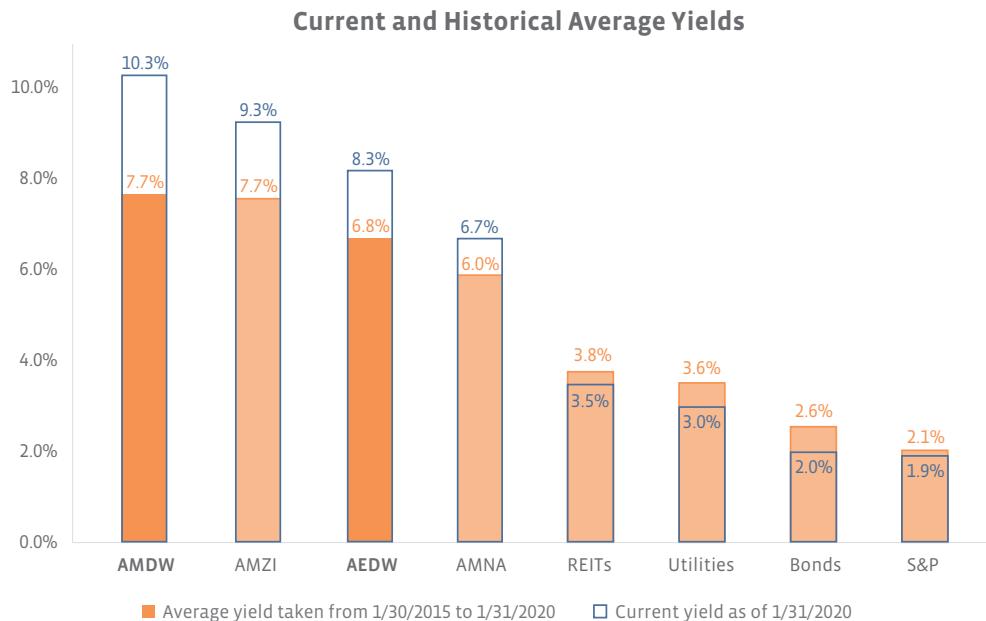
Comparison Statistics

	AEDW	AMNA	AMDW	AMZI
Value of \$1,000	\$919	\$895	\$710	\$675
% Positive Months	53.3%	51.7%	50.0%	46.7%
Standard Deviation	19.6%	19.1%	21.2%	20.4%
Sharpe Ratio	-0.04	-0.08	-0.27	-0.34

Calculated as of 1/31/2020 using historical data trailing 5 years

Dividend-weighted indexes screen attractively for yield

Compared to their capitalization-weighted counterparts, the dividend-weighted strategies also screen more attractively in terms of yield as shown below. The midstream MLP space is known for its steady cash flows and tax-advantaged distributions, which may lend itself to an indexing strategy that emphasizes the total dividend payout of its constituents.



Utilities are represented by the S&P 500 Utilities Index, a composite of utility stocks in the S&P 500. Real Estate Investment Trusts (REITs) are represented by the Real Estate 50 Index, a supplemental benchmark to the FTSE NAREIT US Real Estate Index Series to measure the performance of larger and more frequently traded equity REITs. The S&P 500 is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy. Bonds are represented by the Barclays US Aggregate Total Return Bond Index.

While these strategies emphasize dividends, it is important to not view yield in a vacuum. Large swings in equity prices can quickly inflate yields. Capitalization-weighted indexes rely on the theory that market capitalization is the best measure of a company's value. As the price rises, so does the company's weighting in a capitalization-weighted index. Weighting by total distribution (dividend multiplied by shares outstanding) does not take into account price; instead it deems a company's ability to pay out distributions as more deterministic of its long-term value.

Bottom line

The addition of AEDW and AMDW to the Alerian index suite provides stakeholders with new benchmarking tools and an index strategy based on dividends. Although they have historically carried slightly higher risk than their market capitalization-weighted counterparts, AEDW and AMDW have delivered higher long-term returns, higher long-term Sharpe ratios, and higher average yields.

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Contact

www.alerian.com
info@alerian.com // 972.957.7700
3625 N. Hall St., Suite 1200, Dallas, TX 75219