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The High Income Factor

Unlocking Powerful Strategies to Achieve Superior Returns

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Ride the Oil Boom to Ever-Greater Income

My wife and I have been taking our son on a new round of college visits. It's been a breath of fresh air for us to get out of the house after being cooped up all winter, and the trips have given us all some overdue family time.

Lately, we've been so busy with our individual lives, we haven't spent as much time with one another as usual. But traveling in a car for several hours at a time brings us all together again. I learn a lot on these trips.

For example, I learned that I can't hear very well anymore. I noticed that my son is as impatient as I am. And I also discovered that my wife still doesn't like sarcasm.

I gleaned insights from the college visits themselves too. I observed what real college-age kids actually look like, and how much I've aged. I noticed that my son can't stand anything quaint. I also found out that $55,000 in tuition costs per year doesn't even include a parking space.

But the main point of the trip was for our son to learn something about what type of college will suit him best. It's hard to say if he has gathered all of the information he needed, but at least he seems much closer to a decision. My wife and I are very excited for him. I only wish I were 18 years old again, looking forward to starting college in the fall. It's a great moment in life, with the world all laid out in front of you.

During our adventures, I also learned something I could use. In fact, on one particular trip, a seemingly uneventful driving experience encapsulated a central rationale behind this month's High Income Factor pick.

I was driving west on a major highway at sunset . . . and so I was heading directly into the annoying glare of the setting sun. But even though I kept traveling on the highway as the sun continued its descent, the sun-glare problem wasn't constant. It came and went. The thing was, half the time I wasn't even going west.

> "By following clear trends, we can get a much better idea of how investments will likely move over time."

If you look at a large-scale map, the highway seems to go straight west. But that's only the main trend. Often, the road bends and curves and goes north, south, northwest, and southwest. Ultimately, the highway would deliver and get us to our westerly destination. But it didn't always go west in the process. It just overwhelmingly *trended* west.

I never doubted that I was going the right way. I knew the highway led to the right place and the satellite GPS also confirmed it. So, temporary misdirects never concerned me.

However, as we all know, the trend of the stock market isn't so clearly mapped out. It's far more difficult in the short term to distinguish between temporary misdirects and permanent changes in trajectory. Unfortunately, there is no map or satellite image to show us where the market and our investments are ultimately headed.

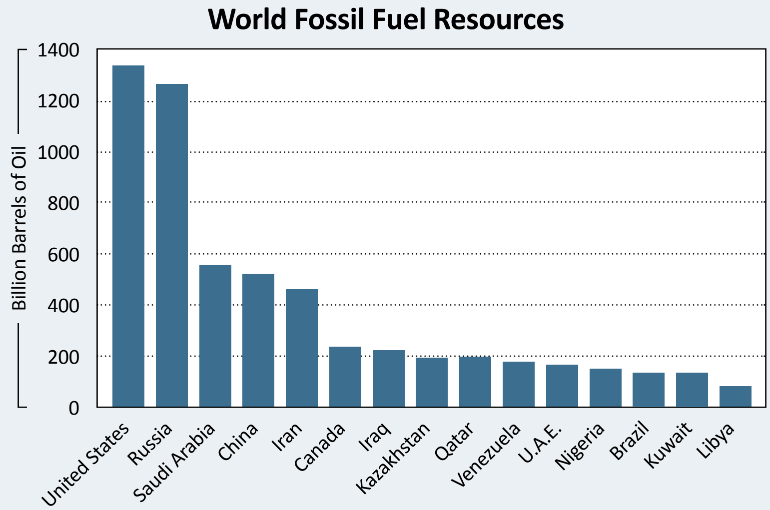
That said, there is something else we can use in place of a map — the general trend. The word "trend" is defined as "the general course or prevailing tendency." By following clear and pronounced trends, we can get a much better idea of how investments will likely move over time.

One such pronounced trend today is the American energy revolution. New technologies have unlocked massive sources of oil and gas, and energy production has exploded in way that couldn't have been imagined just a few years ago.

The energy renaissance is a sweeping change so profound that it will affect the course of the U.S. economy and change the global economic balance of power.

By getting in front of this trend from an investment standpoint, we can greatly increase our odds of success. This month I found an income-paying security of a company located in the epicenter of the energy boom that should benefit mightily in the months and years to come. Before I get to that, though, a discussion of the current environment is necessary to demonstrate why.

Chart 1



A report issued a few years ago by the Congressional Research Service estimated that this country's fossil fuel reserves (including oil, gas, and coal) are more abundant than those of any country on earth. In fact, the study estimated that U.S. fossil fuel resources add up to more than those of Saudi Arabia, China, and Canada combined.

SOURCE: CRS

The American Energy Revolution

There's been a lot of emphasis on things that are bad and going the wrong way in recent years. I've been guilty of this myself. There's the lingering employment problem, political gridlock and the lack of fundamental reforms from Washington, and the spiraling national debt, to name a few. There are problems, no doubt.

But, at the same time, there is some remarkably good news. In just a few short years, one of our greatest problems has transformed into one of our greatest assets.

This country went from importing 10 percent of its oil in 1970 to 58 percent by 2007. Hundreds of billions of dollars were being exported every year to pay for our massive oil dependence. Oil tycoon T. Boone Pickens warned that the United States was in the process of the greatest transfer of wealth in human history.

Our trade deficits soared to record heights last decade and the value of the dollar plunged to new lows. Energy imports accounted for about a third of the crippling deficit. We became entangled in Middle Eastern wars that drained our blood and treasure largely because of our dependence on oil.

At the same time, the global supply of energy was dwindling and new demand from emerging markets taxed existing supplies and sent oil prices through the roof. The future looked bleak.

But that was last decade. This decade the situation has completely reversed itself.

New technologies in horizontal drilling and hydraulic fracturing, or "fracking" as it's commonly known, have unlocked massive amounts of previously irretrievable oil and gas from vast deposits of shale rock. (See the February 2012 issue for more on this.)

These technologies have been such a game changer that a report issued by the Congressional Research Service in 2010 estimated that this country's fossil fuel reserves (including oil, gas, and coal) are more abundant than those of any country on earth. In fact, the study estimated that U.S. fossil fuel resources add up to more than those of Saudi Arabia, China, and Canada combined. (See Chart 1.)

Every year there are a number of official agencies and private companies that publish reports to estimate oil and gas reserves in the United States. While estimates vary from year to year and report to report, they generally have one thing in common — the estimates keep going up. By most accounts, this country has enough oil reserves for another 100 years at current consumption rates, enough natural gas for another 100 years, and enough coal for 200 years.

Such fossil fuel abundance is fortuitous, to say the least. Global demand for energy is anticipated to skyrocket by more than 40 percent between 2012 and 2035 (according to a recent report issued by BP), and the International Energy Agency (IEA) estimates that fossil fuels will account for more than 75 percent of energy consumption until 2035.

'I Never Thought I'd See the Day'

I recall a moment when I was a young man at work in the early '90s. At the time the Soviet Union was in the process of disintegrating as the Cold War came to an end. A much older coworker, discussing the news with me, said, "I never thought I'd see the day." All his life, such an event seemed implausible. But it happened.

In the same vein, something that was unthinkable just a few years ago is on the verge of happening now. The United States will soon surpass Saudi Arabia as the world's largest oil producer. In fact, Bloomberg estimates that we will pass it as soon as 2015.

If you're old enough to remember the 1973 oil embargo, you can appreciate the magnitude of this change. In retaliation for U.S. support for Israel in the Arab-Israeli war, OPEC imposed an oil embargo on the United States, which tripled gas prices and sent our economy reeling. That embargo and the long gas lines that followed cemented the humiliating image of U.S. oil dependency for a generation.

The once mighty United States looked powerless at the hands of a few oil sheiks. The event seemed to usher in a snowballing series of negative consequences, such as the decline of the auto industry, persistent inflation, and a rapid deterioration of American prestige and power.

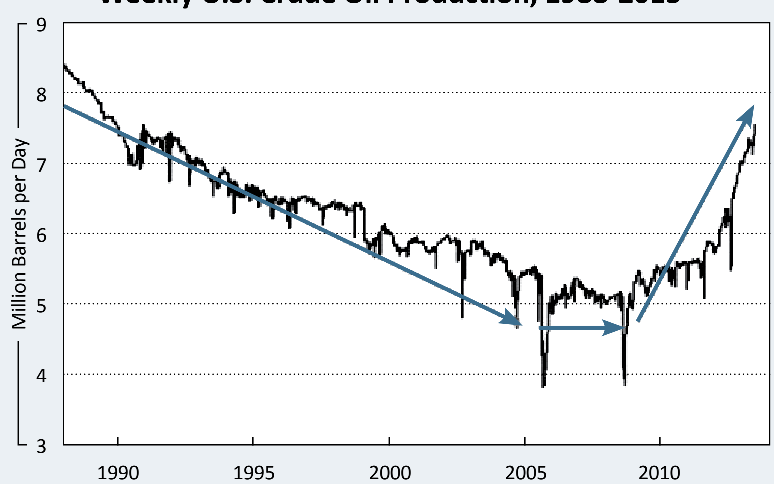
But my, how things are changing. (See Chart 2.) The United States is now the fastest-growing oil producer in the world. These numbers will give you an idea of the scope of this turnaround.

The United States produced 5.3 million barrels per day (bpd) of oil in 2009. That amount grew more than 22 percent by 2012 to 6.5 million bpd. The Energy Information Administration (EIA) reported oil production in 2013 surged by nearly a million barrels per day (bpd), the fastest year-over-year growth rate in U.S. history. The same agency estimates that production will increase another 1 million bpd in 2014, and total production will reach 9.3 million bpd by 2015.

Assuming the agency is correct, next year's oil

Chart 2

Weekly U.S. Crude Oil Production, 1988-2013



The United States produced 5.3 million barrels per day (bpd) of oil in 2009. That amount grew more than 22 percent by 2012 to 6.5 million bpd.

SOURCE: Department of Energy, Carpe Diem Blog

▸ About Tom Hutchinson

I've worked in finance my entire career, from the back office of a Wall Street firm to the floor of the New York Mercantile Exchange learning how markets work. Eventually, I became a financial adviser where I met with thousands of investors and managed the portfolios of hundreds over the course of about 15 years. I left my career as a financial adviser, writing for The Motley Fool as well as StreetAuthority LLC, researching companies, industries, and markets. In The High Income Factor, I can bring you the full benefit of my years of investing experience.

production will near the level of the all-time peak U.S. production in 1970 of 9.5 million bpd and represent an increase in production of more than 75 percent in just five years. We are now in the middle of a massive surge in production.

And that's just oil. The rise in natural gas production also has been impressive. Shale gas has been the biggest driver of U.S. production over the past several years, helping boost overall natural gas production volumes 25 percent from 2007 to 2013.

Production has plenty of room for growth. The EIA estimates that there are approximately 2,200 trillion cubic feet (TCF) of reserves, about the same as the size of Saudi Arabia's proven oil reserves. The agency expects U.S. natural gas production will increase 44 percent between 2011 and 2040, saying almost all this growth will be due to shale gas.

The Economic Impact

There are a number of ways that such a sweeping shift will change the economy well beyond the energy industry.

- **Manufacturing and Job Creation:** By several estimates, the energy boom has created about 2 million jobs so far. It's important to note that many of the jobs associated with energy production and distribution are labor intensive and relatively high paying. This is a huge benefit in an environment of persistent unemployment where such opportunities are rare.

But this may be just the beginning. There are also a myriad of job possibilities outside of the energy industry that are made possible by the increased energy supply. For example, manufacturing is starting to make a comeback in the U.S. as companies gravitate toward the tremendous advantage of access to a large supply of cheap energy in the form of natural gas. This is giving the U.S. a tremendous manufacturing advantage over Europe and China and manufacturers are starting to move here. The energy boom is creating a manufacturing boom.

- **International Balance of Trade:** The national trade deficit soared to all-time highs last decade (see the May 2012 issue for in-depth discussion of trade deficits). As a result, the dollar declined 40 percent versus the euro between 2001 and 2007. Such high deficits also had the effect of sending jobs overseas. And oil imports were the single largest driver of the imbalance.

But the energy boom is changing things. Recently, the United States crossed a key line and produced more crude oil than it imported.

As a direct result, the trade deficit in 2013 fell to the lowest point since the recession. Reducing or eliminating the trade imbalance will have the effect of increasing U.S. competitiveness, strengthening the dollar, and creating jobs.

- **GDP Growth and Government Revenue:** The abundance of energy has made it cheaper for certain businesses, especially those that use natural gas. Natural gas is currently about one-third the price it is in Europe and one-fifth of the cost in Asia. A lower-cost energy source gives businesses more money for expansion. Energy itself is also the fastest growing manufacturing industry in the country and business is booming.

The oil boom is also providing the government with additional revenue that can help lower the deficit. Beyond the oil-business taxes, the government can draw additional revenues from ancillary businesses in manufacturing and other areas that benefit from the energy boom.

Furthermore, there is much potential oil and gas located on federal lands. These sources have not yet been fully developed. Not only could they add tax revenues, but they also could pay royalties to the government. A decreasing deficit is necessary for the country to get a handle on the spiraling debt situation.

Investment Opportunities

Of course, the key for income investors is investing in the securities of companies that will likely benefit from all the new energy production. The energy revolution is a huge wave that will carry many well-positioned companies to great profitability in the years ahead. Many of these companies pay a high income as well.

The High Income Factor portfolio currently has several securities that are poised to benefit. Two master limited partnerships (MLPs), **Kinder Morgan Partners** (**KMP**) and **Williams Partners** (**WPZ**), are directly involved the piping and storage of gas and oil and will likely expand and enjoy rising profits as the desperately needed infrastructure build-out continues. As MLPs, these companies pay a high regular income that should continue to grow.

SeaDrill Limited (**SDRL**) benefits from the rapidly increasing drilling of oil and gas deep under the sea floor. U.S. waters, by some estimates, control a third of all global deep-sea reserves. SDRL supplies state-of-the-art deep-sea drilling rigs to oil producers. The stock currently yields more than 10 percent.

BP plc (**BP**) is one of the world's largest integrated oil companies and the single largest energy producer in the United States. The company is turning the corner from the 2010 oil spill and is currently selling at a sizable discount to its peers, and is positioned to directly benefit from the U.S. energy boom.

Legacy Reserves LP (**LGCY**) is a MLP involved in the production of oil and gas in the United States The partnership has been consistently expanding its production capacity and will likely grow its earnings and already sizable dividend in the quarters ahead.

Teekay LNG Partners (**TGP**) is an MLP that will capitalize on the fact the natural gas is far cheaper in the United States than in other parts of the world. In order for natural gas to be exported and sold at higher prices, it needs to be cooled to liquid form and transported via water.

Teekay is one of the few large tanker companies specializing in the transport of natural gas liquids (NGLs). The export market for NGLs is about to skyrocket, and TGP is in the right place. In the meantime, the MLP pays a 6-plus percent yield.

There is also another area of the energy business that is not represented in the portfolio: refining. The refinery business can be volatile, but I believe this is a low point in the cycle in an era when the U.S. refinery industry is achieving unprecedented profitability.

Let the Golden Age of Refining Pay You

Have you ever wondered why all this new oil supply hasn't led to cheaper prices at the pump? Oil is flowing like water in this country but the price of gasoline hasn't budged. What the heck?

The reason for the apparent anomaly is that the prices charged for petroleum products like gasoline and diesel are largely determined by the global price of crude oil, which is affected by myriad uncontrollable factors half a world away.

And for the past several years, while the boom in U.S. oil supply has made U.S.-produced crude oil cheaper, global crude oil prices have remained higher. While these lower U.S. crude prices haven't really benefited you or me at the gas pump, there is a group that is benefiting immensely — oil refiners.

Here's why. A barrel of crude oil is useless to you. You can't do anything with it. There's too much garbage in it. You can't use it in your car or your furnace. Only after it is refined into useful products like gasoline, heating oil, asphalt, or Vaseline is it of any use.

Consumers don't use crude oil. It's only a feedstock used by refiners. They're the ones who turn it into energy and useful products. The difference in the price of crude oil feedstock and the finished product sold to consumers is called the "crack spread," essentially the profit margin made by refiners.

The current environment is enabling many U.S. oil refiners to buy cheaper U.S. crude oil and sell finished petroleum products at the higher international-based prices. As a result, they're in a position to make a lot of money.

Benchmark Disparity

There are two major oil price benchmarks to consider: North Sea Brent Crude (Brent) and West Texas Intermediate (WTI).

Brent is a type of oil sourced from the North Sea. This oil serves as a benchmark to price European, African, and Middle Eastern oil that is exported to the West. Brent's price is the primary basis of value when pricing refined products such as gasoline.

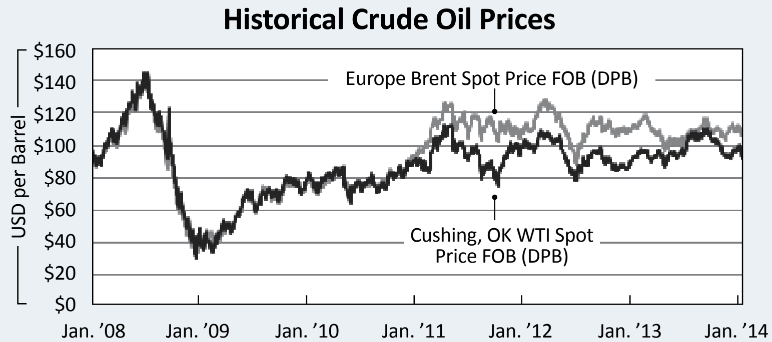
WTI, also known as Texas light sweet, is considered the benchmark for crude oil prices in the United States. In layman's terms, it's light because there's less sediment and garbage in it than most other sources. And it's sweet because it contains less sulfur, which has to be refined out. In short, it's good stuff. It's cheaper to refine than Brent.

For years, the price of Brent and WTI remained about the same. But that situation has changed in recent years, as Chart 3 illustrates.

In an ideal market, the price of Brent and WTI would remain about the same. All the new U.S. crude production would go out into the international market. The demand for the U.S. crude would lift the price of WTI, and the greater global supply of oil would lower the price of Brent, the international benchmark, and the two benchmarks would move together.

But this hasn't been an ideal market. The massive influx of newly pumped crude oil from previously untapped locations has been bottled up with no place to go. Enormous amounts of new crude production in North Dakota as well as Canada (which relies on the United States for about 98 percent of refining) have caused a major bottleneck at the hub in Cushing, Oklahoma, where WTI is priced.

Chart 3



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SOURCE: Seeking Alpha

Sufficient infrastructure does not yet exist. There simply isn't an adequate pipeline network to move the oil to the Gulf Coast, East Coast and West Coast, where much of U.S. refining capacity exists. And the Midwest, where most of the bottleneck exists, doesn't have enough refining capacity to process the excess supply.

As a result, much of the new oil has been sitting around in storage hubs filled to capacity. The excess inventory has been lowering the price of WTI. Moreover, because of a 1975 law, there is an export ban on crude oil. Much of the oil isn't getting into the global supply where it can put downward pressure on global prices.

The Midwestern refiners are the primary beneficiaries, as they are located where they have access to the cheaper oil, most often even cheaper than WTI. Much of the oil can only get to refineries on the coast by rail or truck, which adds significant cost. But the coastal refineries are still benefiting.

Canada, which is undergoing its own oil boom, is flooding the already inundated U.S. market with its crude supply, often having a lower priority than U.S. supplies. The price of this Canadian oil has dipped as much as $40 below the WTI price. Even after the cost of rail transportation, this oil is still a lower cost input for Gulf Coast refineries.

The availability of large supplies of cheaper crude has led to what some are calling "a golden age of refining." U.S. refiners have become a force to be reckoned with all over the world. In 2010, the United States became a net exporter of refined product for the first time since World War II.

Many European refiners have closed shop in the face of the high profit margin U.S. onslaught. With less competition and steadily increasing new demand from emerging markets, things have been snowballing. The volume of refined petroleum products sold by U.S. refiners has increased a staggering 65 percent since 2010 and has almost tripled in the past 10 years.

Stock performance has also been stellar. Morningstar's refining and marketing group has an average annual return of 30 percent for the past five years. But what can we expect going forward?

Progress has been made on easing the bottleneck. In January 2013, a big part of the Seaway Crude Pipeline System (SCPS) came online. The SCPS is a joint venture between Enterprise Products and Enbridge to pipe oil from Cushing to the Gulf Coast refineries. Capacity was increased to 400,000 barrels per day last year and an additional 450,000 barrels per day is expected in 2014.

Other pipeline systems are coming online in other production hubs to the coast refineries as well.

Ultimately, sufficient infrastructure will be in place to relieve the oversupply conditions and efficiently transport the new oil to refineries. The disparity between WTI and Brent will eventually dissipate. But an imbalance should still persist for some time. New supply keeps coming and infrastructure takes a long time to build. An analyst at JPMorgan recently said that the spread between WTI and Brent is likely to continue through 2015.

Also, certain refiners in the Midwest have access to new crude supply in the growing production areas that is often priced well below WTI. These refiners will likely continue to enjoy margin advantages if even the WTI/Brent spread goes away.

Although discounts have varied over the past year, they are expected to remain at levels well above historical averages. U.S. refiners, particularly in the middle of the continent, should benefit.

A Crazy Business

While abundant supplies of cheaper oil will likely continue to be a boon for refiners, owning refining stocks can be a wild ride in the short run.

Despite the current advantages, the refinery business is still inherently volatile. These stocks are volatile not only because of changes in commodity prices but also because of the relationship of these commodity prices with each other. Even in a profitable era for the industry, earnings can vary a lot from month to month, quarter to quarter, and even year to year.

The industry is vulnerable to multiple changing factors. These factors continue to move all the time and in different, often unpredictable directions. Here are just a few of the factors that continually affect earnings.

1. WTI/Brent Spread: Even with a favorable dynamic and average spread over time, the relationship between these benchmarks is volatile. In just the past year, the spread has varied from WTI being as much as $20 per barrel cheaper than Brent to a point at which WTI was actually higher. And the average spread in 2013 was significantly less than it was in 2012.

This key advantage for U.S. refiners can be affected by changes in U.S. crude inventory as well as by international headlines. In the spring and summer of 2013, the spread evaporated and U.S. supply gluts were relieved, raising the WTI price. At the same time, more Libyan oil coming on the market, as well as an easing of tensions with Iran, helped to lower the price of Brent.

This spread greatly affects profit margins for refiners and numerous far-flung factors can change it at the drop of a hat.

2. Price and Demand for Gasoline and Diesel: Refiners are also highly dependent on the price at which they can sell the finished product. Everything could be going well on the crude side of things, but if the price of gasoline plummets, margins get squeezed. A bad economy can sink the price of gas and diesel. And oversupply can also put pressure on gas prices.

It's also important to realize that what truly matters is the relationship between crude prices and gasoline prices. The price for both can go up or down in a profitable way. But if gas and diesel prices plummet relative to crude oil, profitability suffers, and vice versa.

3. Crude Oil Price Disruption: Tensions in the Middle East could send the price of crude skyrocketing. Such a short-term aberration would probably not be followed by a commensurate rise in the price of gas and diesel. Refiners would likely operate at a loss until the price came back down.

Just like the highway I took during that college visit, the refining business can often go in the wrong direction for a while. But like the highway that trends in the right direction over the long haul, the refining business has the necessary dynamic to trend overwhelmingly toward high profitability.

The best approach is to try and buy into a security during a weak period and be willing to hang on through some volatility. As of this writing, the WTI/Brent spread is only about $7. But the EIA recently forecast an average spread of $11.46 per barrel in 2014 and $11.34 in 2015. If that comes true, profitability should remain strong.

Northern Tier Energy (**NTI**) is a Master Limited Partnership (MLP) primarily involved in the refining of crude oil into gasoline and other petroleum products at its St. Paul Park Refinery in northern Minnesota. The refinery processes crude oil from Canada and the Bakken Shale in North Dakota and distributes it throughout the Midwestern United States.

Refining accounts for about 70 percent of NTI's revenues. But the MLP also has storage and transportation assets, as well as retail business operations through its ownership of 163

PICK AT A GLANCE

NORTHERN TIER ENERGY LP (NTI)

SECURITY TYPE: Master Limited Partnership (MLP)
INDUSTRY: Oil refining
PRICE: $26.90 (as of March 11, 2014)
52-WEEK RANGE: $17.83–$31.75
YIELD: 6.1%
PROFILE: NTI is an oil refinery company structured as an MLP that draws crude oil feedstock from new, booming oil-producing sites in Canada and North Dakota.

POSITIVES

- NTI has higher margins than other U.S. refiners because it buys crude oil at cheaper prices.
- Momentum is shifting operationally and business is on the upswing.
- The stock is selling at historically cheap valuations.

RISKS

- The company depends on just one refinery and is highly exposed if any problems occur there.
- The refining business is notoriously volatile and profits can be negatively affected by numerous factors outside the company's control.

convenience stores (and 73 franchised operations) under the SuperAmerica brand. The stores are located primarily in Minnesota and Wisconsin and sell gasoline and diesel, as well as consumable items like snacks, tobacco products, and beer.

NTI has a short history. The company was formed in June 2010 and the IPO took place on July 31, 2012. The general partner changed in November to midsized U.S. refiner **Western Refining (WNR)**, which bought a 38.7 percent limited partner stake in NTI along with 100 percent of the general partner interest for $775 million.

The refiner is in a similar business and will likely offer synergies and drop-down assets that the prior general partner could not. The market reacted very favorably to the news and Northern Tier stock rallied 10 percent in the week following.

The refinery gets 56 percent of its crude oil for processing from U.S. sources (mostly North Dakota Bakken) and 44 percent from Canada. About half of the refined product produced is gasoline and the rest includes diesel, jet fuel, and asphalt. Much of this gasoline and diesel is marketed through its own SuperAmerica outlets, where it essentially provides all the fuel.

The Operational Advantage

The thing that separates Northern Tier from other refiner stocks and MLPs is its highly advantageous location. The St. Paul Park Refinery serves the PADD 2 region (Petroleum Administration for Defense Districts), one of five districts in the United States. It serves the Midwest (see Chart 4).

This particular area has historically enjoyed a very beneficial supply and demand dynamic for refined petroleum products, and the St. Paul Park Refinery is one of only two in Minnesota and of just four in the Upper Great Plains. More importantly, the location provides NTI with access to an abundant and growing supply of favorably priced crude oils from Canada and North Dakota.

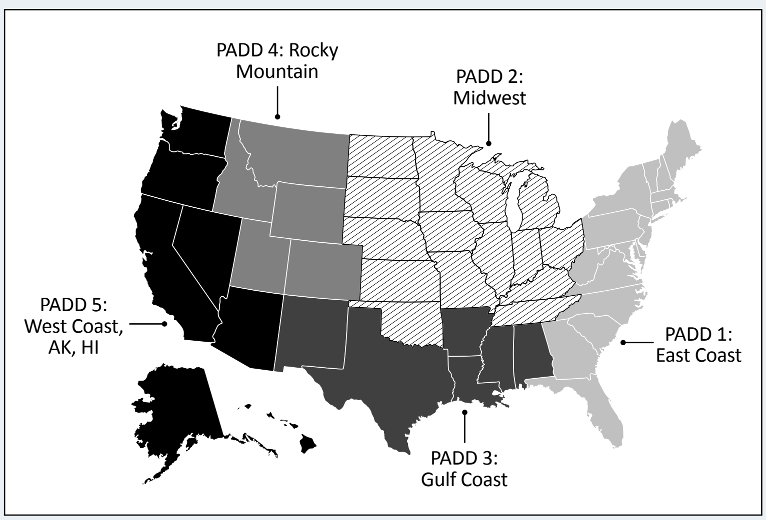
Huge Growth We Can't Ignore

Northern Tier gets its crude oil feedstock from two regions that are in the wheelhouse of the North American energy renaissance. Western Canadian crude oil production is expected to grow a whopping 30 percent between 2011 and 2015 (from 3 million bpd to 3.9 million bpd) and more than double between 2011 and 2030.

The Bakken Shale in North Dakota pumped a record 313.5 million barrels in 2013, a 29 percent

Chart 4

Petroleum Administration for Defense Districts



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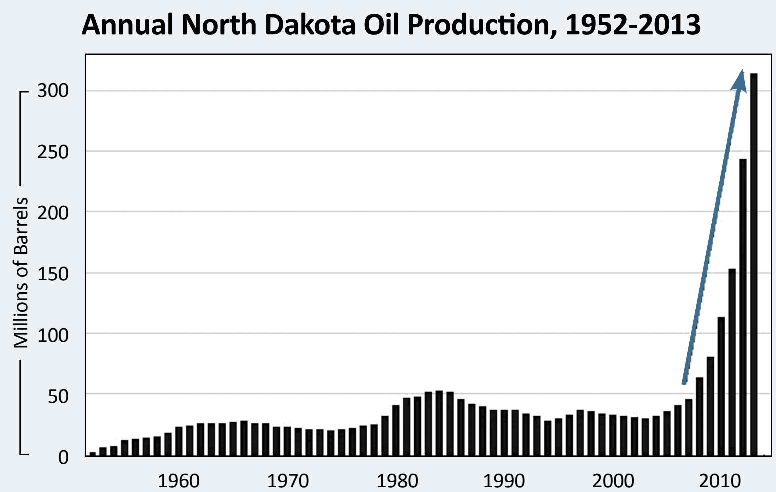
SOURCE: EIA

jump from just a year earlier. Crude oil production in North Dakota overall has exploded eightfold between 2005 and 2012 and more than doubled in just the past two years, from about 400,000 barrels per day in 2011 to about 1 million in 2013. The furious pace should continue as well: Wells in operation have increased 76 percent between June 2011 and September 2013. (See Chart 5.)

Skyrocketing production has created excess supply and there is not enough refining capacity in the Midwest to ingest it. The oversupply is causing inventory gluts and consequently cheaper prices.

Chart 5



The Bakken Shale in North Dakota pumped a record 313.5 million barrels in 2013, a staggering 29 percent jump from just a year earlier. Crude oil production in North Dakota overall has exploded eightfold between 2005 and 2012 and more than doubled in just the past two years.

SOURCE: North Dakota Department of Mineral Resources

Cheaper Crude

North Dakota Light (NDL) and Western Canadian Select (WCS) are crude oil input sources that typically trade at discounts to WTI. The lower-cost crude enables Northern Tier to sell its refined gasoline and diesel at higher margins than the competition. According to the company, over the five years ended Sept. 30, 2013, Northern Tier has sold its refined products at an average premium crack spread of $4.53 per barrel versus its benchmark peer group.

In more recent years the spread has trended higher. As recently as November, NDL traded about $15 per barrel lower than WTI and, as of late February, WCS traded at a discount of $22.50 per barrel less than WTI. Of course, these spreads periodically expand and contract, but a pricing advantage is still likely to remain for some time.

This cheaper crude separates Northern Tier from the pack in my opinion. In addition to the WTI/Brent spread enjoyed by all American refiners, NTI has a whole other level of pricing advantage. In refining, crack spreads equal profits, and the ability to generate higher crack spreads makes NTI a higher profit margin refiner.

Recent Stumbles, Positive Steps

While the lower input costs give the partnership an advantage, it is still vulnerable to the fluctuating profit margins inherent in the business. Northern Tier, like all refiners, has seen profit margins plunge over the past year. As WTI prices have come closer to Brent Sea Crude Oil prices, the bloated margins of 2012 and early 2013 have evaporated.

Northern Tier also had some other setbacks over the past year. In the second quarter of 2013, the refinery underwent a revamp and turnaround that lowered throughput by 32 percent (compared to the prior year's quarter) and in the third quarter the plant had a fire, causing a 7 percent drop in throughput. In addition to the slimming WTI/Brent margins, the margins for its crude oil sources also contracted during the year.

In 2013, throughput volume fell as a result of the revamp/repair, and crack spreads contracted. For the full year 2013, refining operating income fell to $255.7 million from $707.3 million in 2012.

As an MLP, NTI pays no tax at the corporate level and must pay out the bulk of earnings in the form of distributions. Due to the volatile nature of the refining business, NTI's distributions vary with earnings. As a result, the quarterly payouts have plummeted over the past year.

Date	Quarterly Payout
Nov. 2012	$1.48
Feb. 2013	$1.27
May 2013	$1.23
Aug. 2013	$0.68
Nov. 2013	$0.31

But things are turning around. The WTI spreads as well as crude feedstock spreads have trended higher. Also, Northern Tier invested $100 million last year in the refinery and expanded capacity by 10 percent. These expenses are out of the way and are expected to be only $35 million in 2014.

Perhaps most indicative of where things are going is the recent February dividend of $0.41 per share. It's the first time the quarterly dividend has been raised. The company also has estimated that throughput in the first quarter will increase by about 10 percent from the fourth quarter.

At the same time, the stock is at an advantageous valuation, selling 15 percent below the 52-week high and at just 10 times earnings, compared to the industry average of 12.2 times and the overall market average of 17.9.

▸ **Conclusion: NTI has sizable advantages over most of its competition and represents a great way for income investors to play the American energy revolution. NTI is appropriate for the more aggressive portion of an income portfolio. (Also note that MLPs do come with some unique tax implications, so you may want to consult with your accountant before adding this pick to your portfolio. But don't let that scare you away from the great income potential represented in MLPs.) I recommend Northern Tier Energy (NTI) at or below $26 per share for the Wealth Builder Portfolio.**

Best Buys of the Month

"Best buys" highlights what I think are especially good values among all the holdings in our portfolio as we go to press. The basis on which each security is chosen each month is not a specific formula, and the picks are not necessarily those with the cheapest price compared to their recommended "buy in" level. What they are, however, is a good guideline, especially for those new to the High Income Factor newsletter. They're the answer to the question, "If I were just starting to invest in the High Income Factor Portfolio, which securities would I buy first?"

MARCH BEST BUYS

Security	Price	52-Week Range	Yield
Health Care REIT (HCN)	$58.86	$52.43–$80.07	5.40%
Teekay LNG Partners (TGP)	$40.43	$38.17–$45.42	6.68%
SeaDrill Limited (SDRL)	$35.07	$33.16–$48.09	10.84%

As of March 11, 2014

Health Care REIT (HCN)

This holding has been a "best buy" selection for the past couple of months. The price has moved up more than 10 percent so far this year (as of March 11) but I still think it is a good buy anywhere up to $60 per share. While the American energy revolution detailed in this issue is one trend, the aging of the population is another big trend. HCN operates medical and senior-living properties and will likely be an ideal beneficiary of the rapidly escalating demand for such facilities as the population ages. At the same time, REITs are advantageously priced after an overdone sell-off last year.

Teekay LNG Partners (TGP)

As I mentioned earlier, Teekay is a shipper of natural gas liquids (NGL) at a time when demand for such services is about to surge. The company is sort of operating in a trend within a trend — the boon in natural gas production and the race to export NGLs.

SeaDrill Limited (SDRL)

This stock has certainly hit a rough patch lately. The price is down 10 percent so far this year and 23 percent from the 52-week high. I am still holding the stock in the portfolio and recommending that aggressive investors buy at these levels too.

SeaDrill is in the business of contracting out highly sophisticated, state-of-the-art drilling rigs to oil companies drilling for oil in the deep water. The number of offshore oil discoveries exploded in recent years and demand for drilling rigs followed suit. SeaDrill's rigs are the most modern in the industry and the company enjoyed robust demand for its products and rising prices for its services over the past couple of years.

But the industry has been a victim of its own success. The rising rig demand led to increased contract prices, and many companies built new rigs to cash in on the bounty. Now many new builds are hitting the market while demand is leveling off. This industry dynamic has left investors concerned about SeaDrill's growth prospects and ability to maintain its lofty 10.3 percent yield.

I believe the concerns are overblown. SeaDrill should be able to maintain its dividend in the foreseeable future (but management has stated that the payout won't be rising any time soon). The powerful fundamental trend is still in place. The industry is just in a temporary pullback, or misdirect. SDRL is still in position to deliver on a high dividend and appreciation going forward. ■

The High Income Factor Portfolio

THE HIGH INCOME PORTFOLIO

Recommendation	Ticker	Entry Date	Entry Price	Recent Price	Buy at or Under	Current Yield	Effective Yield	Dividend Pay Date	Total Return
Navios Maritime Partners	NMM	01-Mar-12	$16.37	$18.24	$17.50	9.70%	10.81%	5/13/14	37.24%
SeaDrill	SDRL	01-Feb-12	$35.24	$35.07	$36.00	10.84%	10.78%	3/20/14	22.17%
Terra Nitrogen	TNH	01-Apr-12	$249.75	$163.00	$255.00	8.80%	5.75%	6/3/14	-16.16%
Legacy Reserves LP	LGCY	01-Sep-12	$27.78	$26.51	$29.00	8.83%	8.42%	5/14/14	13.69%
FLY Leasing Limited	FLY	27-Nov-12	$11.97	$15.39	$16.00	5.72%	7.35%	5/20/14	37.02%
Teekay LNG Partners LP	TGP	20-Dec-12	$38.30	$40.43	$42.00	6.68%	7.05%	5/12/14	14.48%
Prospect Capital	PSEC	26-Feb-13	$11.06	$10.79	$11.50	12.33%	12.03%	3/21/14	7.86%
Main Street Capital	MAIN	21-Aug-13	$29.21	$34.56	$32.00	5.73%	6.78%	3/19/14	23.12%

THE WEALTH BUILDER PORTFOLIO

Recommendation	Ticker	Entry Date	Entry Price	Recent Price	Buy at or Under	Current Yield	Effective Yield	Dividend Pay Date	Total Return
PepsiCo	PEP	01-Apr-12	$66.74	$82.81	$72.00	2.74%	3.40%	4/30/14	31.49%
Eli Lilly	LLY	01-Apr-12	$40.48	$58.43	$52.00	3.35%	4.84%	3/10/14	56.22%
Williams Partners	WPZ	01-May-12	$57.30	$50.14	$58.00	7.12%	6.23%	5/12/14	8.41%
Vodafone	VOD	27-Sep-12	$28.72	$37.55	$34.00	4.29%	5.61%	5/7/14	25.00%
Intel	INTC	27-Nov-12	$19.98	$24.73	$23.00	3.64%	4.50%	6/3/14	29.02%
Philip Morris	PM	04-Feb-13	$87.00	$79.52	$87.00	4.73%	4.32%	4/14/14	-4.78%
Riocan REIT	REI-UN.TO	20-Mar-13	$26.97	$23.84	$29.00	5.89%	5.21%	3/13/14	7.04%
General Mills	GIS	19-Apr-13	$49.94	$50.74	$50.00	3.00%	3.04%	6/3/14	4.00%
Kinder Morgan Energy Partners	KMP	22-May-13	$88.50	$75.00	$88.50	7.20%	6.10%	5/14/14	-12.35%
Brookfield Infrastr Partners	BIP	03-Jun-13	$36.00	$37.14	$40.00	4.63%	4.78%	4/28/14	5.72%
Health Care REIT	HCN	15-Aug-13	$60.00	$58.86	$60.00	5.40%	5.30%	5/20/14	0.74%
BP plc	BP	22-Nov-13	$47.65	$48.22	$50.00	4.73%	4.78%	3/20/14	2.36%
Realty Income	O	18-Dec-13	$39.14	$41.87	$40.00	5.22%	5.58%	4/19/14	7.92%
HSBC Holdings	HSBC	27-Jan-14	$52.98	$51.46	$60.00	3.89%	3.78%	5/19/14	-2.87%
Verizon	VZ	21-Feb-14	$47.27	$46.70	HOLD	4.54%	4.48%	5/5/14	-1.20%
Magellan Midstream Partners#	MMP	—	—	$68.61	$49.00	3.40%	—	—	—
Deere & Company#	DE	—	—	$89.11	$80.00	2.30%	—	—	—
BUY Northern Tier Energy#	NTI	—	—	$26.90	$26.00	6.10%	—	—	—

INCOME STRATEGIES PORTFOLIO

Recommendation	Ticker	Entry Date	Entry Price	Recent Price	Buy at or Under	Current Yield	Effective Yield	Dividend Pay Date	Total Return
Blackrock Enhanced Cap Fund	CII	01-Jan-12	$12.50	$14.40	$13.00	8.33%	9.60%	4/30/14	36.20%
Barclays 7.75 Preferred	BCS-PC	27-Sep-12	$25.52	$25.40	Hold	8.03%	7.99%	4/16/14	11.64%
PowerShares Preferred	PGX	24-Oct-12	$14.84	$14.08	Hold	6.31%	5.98%	4/3/14	1.66%
Osterweis Strategic Income	OSTIX	25-Sep-13	$11.80	$12.04	$12.00	4.97%	5.07%	4/17/14	2.97%
PowerShares Sr Loan Portfolio	BKLN	25-Sep-13	$24.77	$24.87	$25.00	4.05%	4.07%	4/3/14	2.09%
SPDR Barclays Cap ST HY Bond	SJNK	25-Feb-14	$31.03	$30.89	$32.00	5.13%	5.10%	3/10/14	-0.45%

Notes on all portfolios: In order to receive the dividend payment, you will need to own the stock several weeks before the pay date. The "Total Return" column includes all reinvested dividends at concurrent recommended buy prices. Returns calculated based on a purchase of $1,000 of the security on the listed entry date and price. The "Effective Yield" column reflects the yield investors receive assuming they bought at the entry price and followed all subsequent recommendations. # Denotes recommendation not yet purchased. To see the chart of previous "sold" positions, subscribers can log onto www.highincomefactor.com (under the "Portfolio" tab). All chart data is as of close March 11, 2014.

Closing Thoughts →

The
High Income Factor

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Closing Thoughts

It's easy to mistake temporary misdirection in the markets as permanent. By focusing on the longer-term trend, however, we can stay invested and benefit over time.

Short-term market movements continually confound and make fools of people who make millions and millions of dollars to predict such things. Even with large staffs of Ivy League lackeys and massive offices with all kinds of computer screens, these Wall Streeters are usually wrong. As income investors more focused on the longer term, we don't have to play that game.

By considering the main trend, we have a much better idea of where businesses are likely headed. If we are patient through some volatility in the short run, it can ultimately pay off big in the long run. And we can collect dividends the whole time.

Northern Tier Energy (**NTI**) is one of the very best positioned U.S. refiners in the middle of a golden age for U.S. refiners. As a refiner, it will be a somewhat volatile stock to hold. But the massive wave from the energy revolution will very likely deliver the stock to a much higher priced destination over time and pay you a high income for the whole ride.

Actions to Take Now

Action No. 1: Look for an opportunity to add **Northern Tier Energy** (**NTI**) to your Wealth Builder Portfolio at or under $26 per share.

Action No. 2: If you're building or adding to your High Income Portfolio, consider my best buys of the month, **Health Care REIT** (**HCN**), **Teekay LNG Partners** (**TGP**) and **SeaDrill Limited** (**SDRL**).

Action No. 3: Visit our website, www.highincomefactor.com, to find past monthly issues, and weekly updates. (For password assistance, feel free to contact my customer service team at 800-485-4350 or customerservice@newsmax.com.)

Sincerely,

Tom Hutchinson

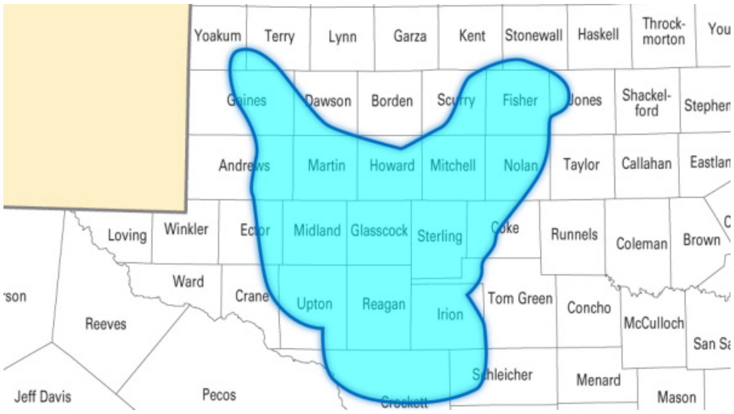
— ADVERTISEMENT —

Bigger than the Bakken: The Next Oil Bonanza

Hundreds of drill sites are being cleared... crews are moving in...
and new prolific wells are building a small fortune for investors.

Everyone knows that the worst-kept secret in the United Sates is that we're in the middle of a full-blown oil boom.

And one area is producing more oil than anywhere else – a place that the locals have dubbed the "Petroplex."



This region in West Texas has pumped out over 35 BILLION BARRELS since its first well was drilled in May of 1923.

Years ago, companies started to write-off the Petroplex, where production was steadily declining.

What happened next was nothing short of a technological miracle.

And as **you'll see in just a moment,** you'll understand precisely why drillers are feverishly digging into the Petroplex once again.

You see, now that American oil companies are utilizing advanced horizontal drilling technology together with hydraulic fracturing techniques, they can finally tap into the massive source rocks that were believed to be too expensive to drill.

Let me explain...

Oil flows like water in the Petroplex

It's easy to see why oil workers are so excited over the Petroplex...

Large parts of the Petroplex shale are between 3,500 and 4,000 feet thick. That's about ¾ of a mile in length.

That's huge. Nothing like it has ever been discovered before.

Forbes put it this way, "the region [Petroplex] is producing more oil than the pipelines can handle... new infrastructure is being laid to send oil from the Petroplex straight to the refinery center in Houston..."

And here's the real kicker for individual investors looking for a piece of the action – it's not just quantity, it's also high quality oil.

We're talking about the light, sweet crude that refiners dream about.

Let me be clear about one fact: <u>These aren't some wildcatters exploring for oil.</u>

And you don't have to invest in the big oil companies to bank your share of the Petroplex profits.

One single company – trading for under $8 per share right now – is already pumping thousands of barrels of crude oil out of the Petroplex right now.

If history repeats itself (and it almost always does), this $8 Petroplex driller should be trading double – *if not triple* – its current per-share-price in a few months.

My name is Keith Kohl, and I'm the investment director for Angel Publishing's *Oil & Gas Trader.* I created my investment advisory so that individual investors like you can finally capitalize on the fast-paced energy stocks that are driving America's oil and gas boom.

And it's no surprise that my readers are flooding me with notes on their performance...

"Raked in 41% in just 4 weeks"

"Your trade on Matador raked in 41% in just 4 weeks for my portfolio. And the most recent 30% you helped me make on the recently puts my total return on the same company to 71%! That's what I call building wealth... can't wait to do it again.

– Kevin Y.

"Your insight has been great: NOG, Gran Tierra is up 230% in less than a year!"

"Long-time member here. Thanks to your recommendations, I've been able to make boost retirement savings considerably over the years. Your insight has been great: NOG, Gran Tierra is up 230% in less than a year!"

– R. Manning

"... up 252%, 165%, and 101%"

"Just wanted you to know how much I appreciate the hard work you do in finding the great companies for your readers. Currently I'm up 252%, 165%, and 101%. You've made a believer out of me."

– Kris Mills

"12 for 12 – a Perfect Score"

"I signed up for Oil & Gas Trader only a few weeks after the service began. It's almost unbelievable that I went 12 for 12 in my trading since. Every single trade I made has gone into double-digits... absolutely incredible!"

– George B.

I want to give you all the details on this small Petroplex driller right now, before the rest of the investment herd catches wind of it.

To learn more about it, simply <u>click here.</u> You'll get full access to my investment presentation on this company, and how you can invest.

You can also call my Customer Service department any weekday during market hours. They'll be more than happy to help you get in a position to profit immediately. Dial toll-free 1-855-877-8623 to reach a live person, and tell them you're calling about Keith's Petroplex opportunity.