EDGEMOOR
INVESTMENT ADVISORS

# Edgemoor's Quarterly Report

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**April 2022**

**Turbulent Times**

The markets have had a rough start to the year. Fears of high inflation and rising interest rates, combined with the geopolitical shock of Russia's invasion of Ukraine, sent the S&P 500 index into correction territory in late February, its first such correction since the onset of the pandemic in March 2020. For the quarter, the S&P logged a return of negative 4.6% through March 31, 2022.

The bond market also posted losses, with the benchmark Bloomberg Barclay's Aggregate U.S. Bond Market index down 5.9% for the quarter, as falling bond prices exceeded the return of the interest payments on low-yielding bonds.

**Uncertainty Abounds**

Investors don't like uncertainty and the first quarter gave them a heavy dose of it, despite overall solid economic conditions in the United States. Russia's invasion of Ukraine in late February shocked the world and shifted investors' focus momentarily from inflation and interest rates to geopolitics. Although Russia accounts for less than 2% of global GDP, it is a major producer of oil, natural gas and other commodities, prices of which have been rising sharply since February.

Already squeezed by soaring housing prices since the onset of the pandemic, U.S. consumers suddenly were faced with skyrocketing gas prices at the pump and food prices in the grocery store.

Crude oil prices jumped 51% during the quarter to a high of $130.50 per barrel, though they have since subsided to close at just over $100 per barrel on March 31, 2022. Other commodities, as measured by the Bloomberg Commodity index, rose by 31% during the quarter.

All told, the U.S. Consumer Price Index, or CPI, the broadest measure of inflation, increased at an annualized rate of 8.5% in March, its highest rate in four decades.

The Federal Reserve Bank's primary tool to combat rising inflation is to raise short-term interest rates. In response to recent trends, the Federal Reserve took the long-anticipated action of raising the short-term fed funds rate at its March meeting, hiking the rate by a quarter percentage point to a range of 0.25% to 0.50%, its first rate increase since 2018.

Given that the increase in inflation no longer appears to be as "transitory" as originally thought, we expect the Fed's hawkish stance to continue and for both short-term and long-term rates to continue to rise substantially through the year. The odds now favor a 0.50% hike in the fed funds rate in May, followed by another 3-4 half-point increases before the end of the year. This will have an especially dampening effect on consumers who carry credit card debt, auto loans, and home mortgages.

**U.S. Economy Shows Resilience**

Despite all the uncertainties, the U.S. economy remains solid by most measurements, albeit slowing. Real U.S. GDP growth is forecast to be 3.3% for 2022, down from 5.7% in 2021, but above the historical average of the last twenty years. With most pandemic-era restrictions now lifted and supply-chain disruptions easing, the U.S. consumer is once again spending and traveling. This is good news for the economy, since consumer spending accounts for roughly 70% of U.S. GDP. In addition, U.S. households have accumulated an estimated $2.5 trillion of excess savings since the start of the pandemic, which should further support spending and growth.

U.S. unemployment hit a post-pandemic low of 3.6% in March 2022, down from a high of 14.7% in April 2020. As unemployment has declined, wages have continued to climb, rising 5.6% year-over-year in March, the largest increase in decades.

Finally, U.S. corporate earnings, which are the major driver of stock market performance, continue to show a steady recovery from the pandemic low point. Consensus estimates for 2022 are for S&P 500 earnings to grow 9% to $227 per share, from $208 per share in 2021.

**Outlook**

While we expect market volatility to continue in the near term, we remain cautiously optimistic that the U.S. economy will post positive growth this year, corporate profits will increase, and the U.S. stock market will continue to move higher.

History shows us that geopolitical shocks like the Russian invasion of Ukraine tend to have limited effects on economic and market fundamentals. Bank of America studied a dozen geopolitical events between 1962 and 2016 and found that the average S&P 500 price return 12 months after these events was a positive 8.6%.

**Portfolio Implications and Actions**

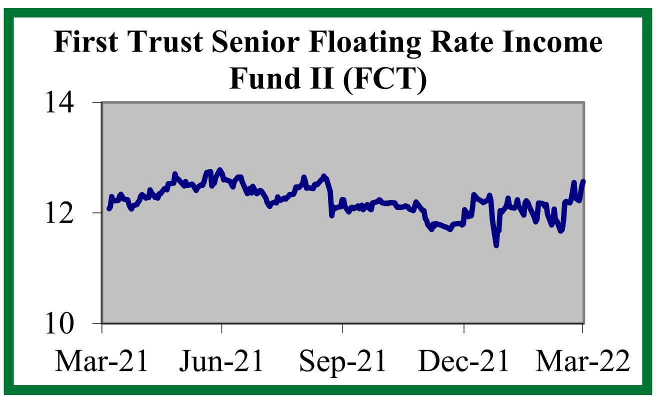
Our response to current market and economic conditions is to stay the course with high quality, value-oriented, dividend-paying equity and income investments through our disciplined process of individual security selection. We continue to avoid long-term, fixed-rate bonds, which are particularly vulnerable to rising interest rates. And we remain committed to our overall investment strategy of creating well-diversified, durable portfolios for our clients that can weather market downturns and provide positive, long-term returns through full market cycles.

## Analysis of Selected Securities

This quarter, our discussion of selected securities features two income securities which we are buying for client portfolios. We favor these dividend-paying securities over fixed-rate bonds because, as interest rates continue to rise through 2022, bonds are likely to post further negative returns.

Following is a discussion of three securities we own and have bought recently. Due to factors specific to each investment, these securities are, in our opinion, priced attractively in the markets today.

### First Trust Senior Floating Rate Income Fund II (FCT)




Source for chart and financials: Yahoo Finance and Morningstar. Past performance is not indicative of future results. Please see disclosures on page 7.

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|---|---|---|---|
| Price (03/31/2022) | $ 12.57 | NAV | $11.97 |
| Market Cap ($M) | $ 329.3 | | |
| Dividend Yield | 6.9% | | |

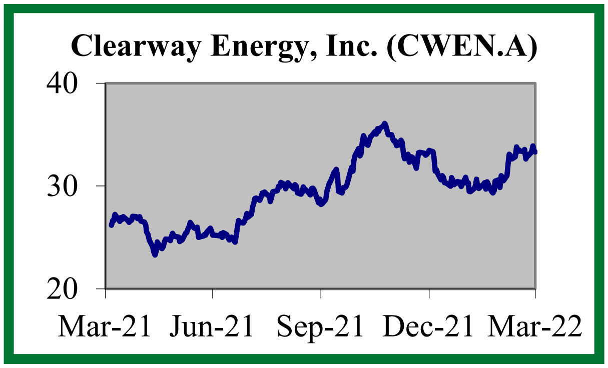
First Trust Senior Floating Rate Income Fund II (FCT) is a diversified, closed-end fund that invests primarily in a portfolio of senior secured floating-rate corporate loans. These loans pay a floating-rate coupon that is typically tied to a benchmark rate, meaning that as the benchmark interest rate rises, so does the coupon paid on the senior loan. This floating-rate feature significantly reduces interest rate risk and is an attractive attribute in an environment of rising interest rates, as markets are experiencing now.

FCT's portfolio is broadly diversified across companies and industries. As of February 28, 2022, the top holding represented just over 3% of total fund assets and the top ten holdings accounted for less than 25% of total fund assets. The top five industries represented in the fund are software (19%), healthcare providers and services (14%), pharmaceuticals (11%), insurance (10%), and healthcare technology (7%).

Senior loans generally hold the senior position in the capital structure of the issuing company and are typically secured by specific collateral. This gives loan holders a senior claim on the assets of the company, ahead of subordinated debt or equity holders.

FCT pays an attractive dividend which currently yields 6.9%. FCT is purchased in income portfolios for both its current yield and its potential to hedge against rising interest rates.

**Clearway Energy, Inc. (CWEN.A)**




Source for chart and financials: Yahoo Finance and Morningstar. Past performance is not indicative of future results. Please see disclosures on page 7.

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| Price (03/31/2022) | $ 33.32 | Forward P/E | 34.7 |
| Market Cap ($B) | $ 3.8 | Price/Book | 2.1 |
| Dividend Yield | 4.1% | Price/Sales | 3.1 |
| Return on Equity | 2.8% | | |

Clearway Energy, Inc. is a renewable energy company that owns, operates, and acquires renewable and conventional energy generation assets throughout the United States. The company's portfolio is focused on renewable energy and includes approximately 5,000 net megawatts (MW) of wind and solar generation projects, as well as 2,500 net MW of highly efficient natural gas generation facilities.

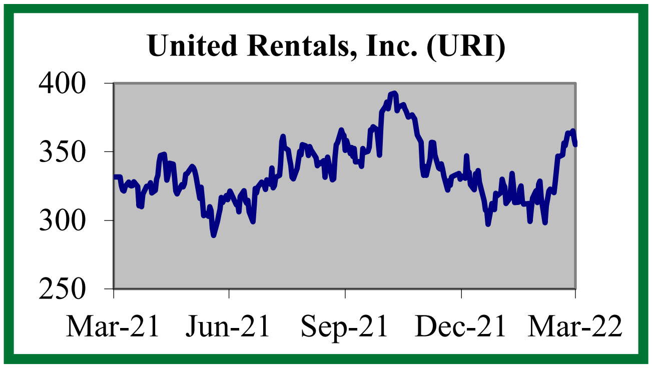
Clearway generates the majority of its revenues from selling energy and capacity under long-term, fixed-price contracts to local utilities across the United States. Clearway added $820 million of growth investments in 2021, including the remaining 50% of a 530 MW Utah solar portfolio and a 35% interest in a 290 MW Arizona solar project. Overall, its projects have an average remaining contract length of approximately 12 years.

New assets and strong operational performance at its facilities sent year-over-year fourth quarter cash available for distribution 16.7% higher. On its fourth quarter earnings call, management projected cash available for distribution to grow nearly 18% for 2022, which should enable Clearway to comfortably achieve its targeted 5-8% annual dividend growth.

The recently announced sale of its thermal infrastructure segment to private equity firm KKR, scheduled to close in the first half of 2022, will provide $1.35 billion in net proceeds for Clearway to invest in new growth projects. In addition, Clearway expects to acquire an additional $250 million of assets from its corporate parent in 2022.

Clearway has raised its dividend by a total of 7% over the past four quarters and the shares currently yield 4.1%. It is an example of the kind of income investment we favor due to its growing, sustainable dividend and stable, long-term growth model.

**United Rentals, Inc. (URI)**

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|---|---|---|---|
| Price (03/31/2022) | $ 355.21 | Forward P/E | 13.5 |
| Market Cap ($B) | $ 23.0 | Price/Book | 3.9 |
| Dividend Yield | 0.0% | Price/Sales | 2.4 |
| Return on Equity | 26.3% | | |

United Rentals is the largest equipment rental company in the world, operating 1,345 rental locations throughout the United States, Canada, Europe, Australia, and New Zealand. The company's North American network, representing 90% of total revenues, serves three core equipment rental end-markets: Industrial and other Non-Construction, Commercial Construction, and Residential Construction. Equipment rentals account for roughly 85% of total company sales, with equipment sales, service, and contractor supplies making up the remainder.

The company's size and scale afford it numerous competitive advantages, including a large and diverse rental fleet, significant purchasing power, operating efficiencies, and strong brand recognition. United Rentals is also able to focus on larger, more profitable customers, who tend to rent for longer time periods and have stronger credit profiles.

United Rentals stands to benefit from continued post-pandemic growth in industrial, commercial, and retail markets, as well as the surge in federal infrastructure programs related to the $1.2 trillion Infrastructure Investment and Jobs Act. As the industry leader, United Rentals can provide customers with better equipment availability and reliability than smaller competitors. To further optimize the company's operations, United Rentals employs telematics, which is a method of monitoring cars, trucks, equipment, and other assets by using GPS technology and on-board diagnostics to plot the asset's movements on a computerized map. This provides United Rentals and its customers valuable data and enhances operational efficiency.

In addition, United Rentals' management is shareholder-friendly, having unveiled a new $1 billion share repurchase program in January 2022, which is slated for completion by the end of the year. We believe strong management, combined with the company's solid business prospects, should provide a long growth runway for United Rentals.

*Source for text and charts: Morningstar, S&P/CFRA, Schwab, ValueLine, Black Diamond Performance Reporting, Yahoo Finance, and Argus reports.*

*Edgemoor Investment Advisors is an independent wealth management firm providing investment and financial planning advice to individuals, retirement plans, trusts, family foundations, and an equity mutual fund. We manage approximately $1.1 billion as of March 31, 2022, for our clients and focus on long-term capital appreciation, preservation of capital, and income generation through disciplined management of value-oriented equity and income portfolios. Please contact us if you would like more information.*

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The S&P 500 index is an unmanaged market-capitalization-weighted index of 500 common stocks chosen for market size, liquidity, and industry group representation to represent U.S. equity performance. The S&P 500 index is discussed for comparative purposes only. The comparisons have limitations because the indexes have volatility, investment, and other characteristics that differ from the investment strategies of Edgemoor. Further, it is not possible to invest directly in the indexes.

The Barclays U.S. Aggregate Bond Index is a broad base, market capitalization-weighted bond market index representing intermediate term investment grade bonds traded in the United States. The Index is frequently used as a stand-in for measuring the performance of the U.S. bond market. In addition to investment grade corporate debt, the Index tracks government debt, mortgage-backed securities (MBS) and asset-backed securities (ABS) to simulate the universe of investable bonds that meet certain criteria. In order to be included in the Index, bonds must be of investment grade or higher, have an outstanding par value of at least $100 million and have at least one year until maturity.

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