EDGEMOOR
INVESTMENT ADVISORS

Edgemoor's Quarterly Report

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No Reason to Panic

The most important message of our newsletter this quarter is not to panic. While both the stock and bond markets are down significantly so far this year, there are several important underlying strengths in the U.S. economy and financial markets. We will discuss all these factors – both good and challenging – in this report. In the meantime, our best advice to our clients is to be disciplined and patient.

The Third Quarter – More Volatility

The third quarter, ended September 30th, 2022, was marked by continued volatility in both the stock and bond markets. What began as a relief rally in July, that saw stock prices climb 18% from their mid-June bottom, fizzled by late-August as inflation numbers remained stubbornly high. This led the U.S. Federal Reserve to accelerate its aggressive rate-tightening stance, raising the federal funds rate by 0.75% in July and again in September and signaling that more rate increases are likely before year-end.

This caused markets to sharply reverse course in September, sending the S&P 500 Index down 4.9% for the quarter, and putting it in bear market territory for the year with a negative total return of 23.9%. The tech-heavy NASDAQ fared even worse, down 32% year-to-date.

The bond market, as measured by the Barclay's Aggregate Bond Index, also posted negative returns, falling 4.8% in the quarter and 14.6% for the year, as rising interest rates caused bond prices to fall sharply. It was the worst year-to-date performance for the bond market in U.S. history.

The U.S. Economy – Slowing but Sturdy

Despite these headwinds, the U.S. economy remained sturdy, albeit slowing through the third quarter. Robust job and wage growth, combined with resilient consumer spending, formed the underpinnings of a still healthy economy. The September employment report showed that job growth cooled a bit, following strong reports in July and August. The U.S. unemployment rate fell to 3.5% from 3.7% the prior month, one of the lowest unemployment rates since the 1960s.

Consumer spending also remained solid. Consumers spent a bit more in August than the previous month, a sign the economy is holding up even as inflation lifts prices for food, rent, and other essentials. Total retail sales for the period of June through August grew 9.3% from the same period in 2021, and overall consumer spending is projected to increase at an inflation-adjusted rate of 0.5% for the July through September period.

Corporate earnings, a key economic indicator for most investors, also continue to show positive growth, though at a slower rate than earlier forecasts. Consensus estimates for FY2022 S&P

500 corporate earnings call for 7.7% earnings growth, down from the 10% growth forecasted in June, but still solid.

Energy prices fell to their lowest level since January, with crude oil prices falling 14% in the third quarter and nearly 40% from their 52-week high. These declines have significantly eased the pressure on consumers' wallets at the gas pump.

Finally, consumer and corporate balance sheets remain strong, with consumer credit ticking up only slightly in July 2022, while the personal savings rate stayed steady.

Challenges – GDP Growth, Inflation, Mortgage Rates, and Recession Fears

Challenges do lie ahead. U.S. GDP growth was negative in the first and second quarters of 2022, falling 1.6% and 0.6%, respectively. Two consecutive quarters of negative GDP growth is often an indicator of recession, though current sentiment is that the U.S. did not enter a recession in the first half of the year due in part to the continuing strong labor market. We await the third quarter GDP number to see if it proves this out, as current forecasts are for modestly positive growth in the quarter.

In the meantime, consumers are feeling the pinch of higher costs for everything from food to cars to housing. The Consumer Price Index, the broadest measure of inflation, moderated slightly in August but remained stubbornly high at an annualized rate of 8.3%, compared to 8.5% in July. Higher food costs led the way, increasing 11.4% year-over-year, followed by new vehicles (+10.1%) and shelter (+6.2%).

The rise in interest rates has sent mortgage rates sharply higher, with the 30-year fixed-rate mortgage averaging 6.75% as of September 30th, compared to 3% a year ago. In response, mortgage applications in the U.S. fell 14.2% in the week ended September 30th, according to the Mortgage Bankers Association.

While there are clear signs that U.S. economic growth is slowing, the question is whether this slowdown is a prelude to recession. A key determinant of that may be the Federal Reserve's rate actions over the next few months.

The Fed's Next Move?

Federal Reserve Chairman Jerome Powell has emphatically reiterated the Fed's commitment to bring inflation under control, despite the short-term pain it inflicts on the economy. This determination has led to three 75-basis point hikes in the short-term fed funds rate so far this year, and an indication that another two hikes of 50 and 75-basis points each are likely before year-end 2022. That would bring the target fed funds rate to 4.25%-4.5% by year-end from near zero at the start of the year.

The market instability that has resulted from the Fed's aggressive actions, particularly in September, has some believing that the Fed may "pause" at some point to avoid a deep recession. If that becomes the case, then the pace and steepness of rate hikes may slow sooner than the market currently expects. Whether the Fed can manage the delicate task of bringing inflation under control without causing a recession remains to be seen.

Opportunity – Treasury Yields

In the meantime, investors have the first opportunity in years to earn attractive yields on ultra-safe Treasury bonds. The two-year Treasury yielded 4.22% on September 30th, up dramatically from 2.84% at the start of the quarter and less than 1% at the start of the year. Those are significant moves for a short-term government bond.

We recently purchased short-term Treasury bonds yielding 4.25% and a short-term Treasury bond ETF currently yielding 2.8% (which resets monthly to a potentially higher yield) for client accounts with available cash. We will continue to look for similarly safe and attractive income opportunities, including short-term, high-quality corporate bonds, for the income portions of client portfolios.

Overseas – Treacherous Times

Economies and markets outside the United States have struggled even more than the U.S. The ongoing war in Ukraine, which triggered a European energy crisis, has roiled European economies, while China's zero Covid policy, combined with a troubled real estate sector, have stunted growth there.

Inflation in the 19-member Eurozone is accelerating at a faster rate than in the U.S., largely due to the energy crisis. In September, consumer prices were up 10% from a year earlier (the first double-digit increase ever), as energy prices soared 40.8% and food prices climbed 11.8%. Germany saw the highest rates of inflation, with consumer prices up 10.9%, compared to 9.5% in Italy, 9.3% in Spain, and 6.2% in France.

Our Outlook

We have a cautious outlook for U.S. stocks in the near term, as we expect markets to remain volatile through year-end as uncertainties about interest rates, inflation, and other global challenges weigh on investors.

But the outlook for stock market returns over the next 3-5 years is now much brighter than in recent years due to lower current valuations. The S&P 500's forward price-to-earnings ratio stood at 15.8x at the end of the third quarter, compared to 23x last year and a 5-year average of 18.6x.

In addition, history shows that in the nine instances since 1950 that the S&P 500 has declined by 25% or more, the returns in the next 1, 3, and 5 years have averaged better than 21%, 36%, and 83%, respectively.

Despite the pain of a market downturn, it is normal and healthy for markets to recalibrate themselves every few years. Investors who stay patient and disciplined with their investment plan should be rewarded over time.

Maintaining our Investment Approach

Our investment approach remains unchanged. We take an active and disciplined approach to individual security selection; we favor value-oriented, dividend-paying securities in high-quality companies; and we construct durable portfolios that are well-diversified across industry sectors and asset classes. And during market downturns, we do not panic and sell good investments at depressed prices.

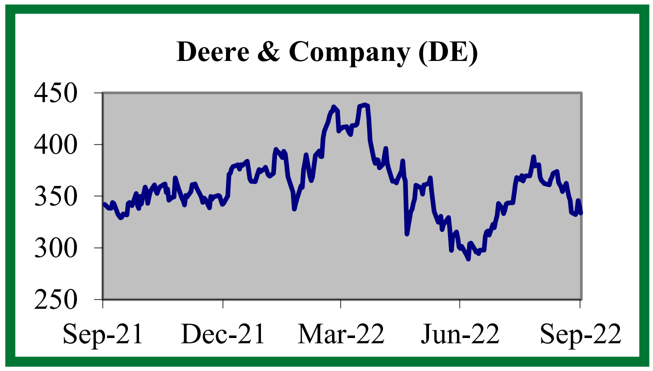
As previously discussed, we have begun to invest in short-term, ultra-safe Treasury securities at yields of 3%-4% as an alternative to cash. We will continue to look for other high-yielding opportunities among high-quality corporate bonds, REITs, utilities, and preferred stocks to supplement our income strategy. And, as always, we seek income securities with a history of dividend growth and the potential for increasing payouts over time.

Overall, it remains a challenging time for all investors, but we are confident that new opportunities will emerge in select equity and income categories, offering the potential for attractive, long-term positive returns over a full market cycle.

Analysis of Selected Securities

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

Deere & Company (DE)



Source for chart and financials: Yahoo Finance and Morningstar. Past performance is not indicative of future results. Please see disclosures on page 9.

Price (09/30/2022)	$ 333.89	Forward P/E	13.6
Market Cap ($B)	$ 106.8	Price/Book	5.6
Dividend Yield	1.3%	Price/Sales	2.3
Return on Equity	35.5%		

Deere is the world's largest manufacturer of farm equipment, as well as a large producer of construction machinery and lawn & garden equipment. For over a century, the company has been the pre-eminent manufacturer of mission-critical agricultural equipment, creating one of the world's most valuable brands. The company operates across four business segments: Production and Precision Agriculture (38% of fiscal 2021 sales), Small Agriculture and Turf (27%), Construction and Forestry (26%) and Financial Services (9%).

Deere has a long and successful track record of innovation, creating new products and upgrades to existing ones that drive greater machine efficiency. Deere's equipment helps farmers reduce costs while increasing crop yield, which has led to intense brand loyalty and pricing power. The company's products are sold through an unmatched dealer network, with nearly 2,000 dealer locations in North America and 3,700 globally. Deere has spent decades cultivating these dealer relationships and they are a significant competitive advantage for the company.

Deere is continuously adding new technology to its products, from guidance systems to seed placement and spacing to customized spraying applications. These value-added services help customers increase productivity, profitability, and sustainability. For example, Deere's autonomous "See and Spray" system reduces herbicide use by 77% on average using machine learning and vision processing technology to identify and spray weeds with unrivaled precision. These next-generation products and services increase Deere's addressable market opportunity, and also allow the company to generate and maintain healthy margins through various cycles.

In addition, limited arable land and rising global food demand act as a significant long-term tailwind for their critical equipment. Deere generates a substantial amount of cash flow which has been deployed to buy back stock, increase the dividend, and maintain an "A" debt rating from Standard and Poor's. The company's stock is currently trading at 13.6 fiscal year 2023 earnings estimates, which we view as an attractive valuation for a high-quality business with a valuable brand, unmatched competitive advantages, and strong growth tailwinds.

Amazon.com, Inc. (AMZN)

Source for chart and financials: Yahoo Finance and Morningstar. Past performance is not indicative of future results. Please see disclosures on page 9.

Price (09/30/2022)	$113.00	Forward P/E	50.3
Market Cap ($T)	$ 1.2	Price/Book	9.3
Dividend Yield	0.0%	Price/Sales	2.5
Return on Equity	9.4%		

Amazon.com is the largest U.S. e-commerce retailer and among the top e-commerce sites globally. The company also has several service offerings, including fulfillment, advertising, publishing, gaming, and cloud computing via Amazon Web Services (AWS). The company's Prime membership subscription service is a key differentiator in online retail services, as it offers free shipping for members and exclusive media content like music, videos, and audible books.

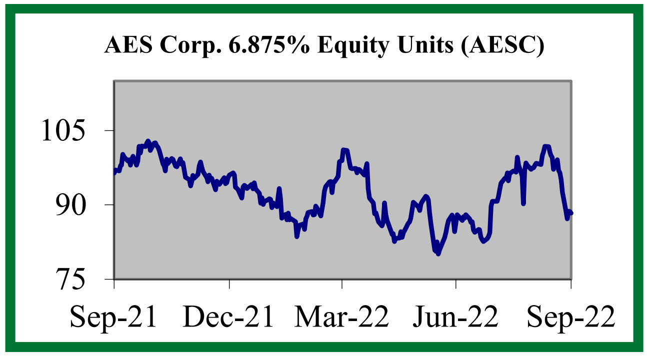
Amazon is also the largest global provider by market share of cloud-based infrastructure services through its AWS platform, serving 34% of the market, which is well ahead of second place Microsoft Azure's 21%. Amazon's other business platforms include Whole Foods Market, acquired in 2017, digital voice assistant Alexa, and the popular Kindle e-reader.

In 2020, the COVID-19 pandemic ignited an explosion of demand for online retail services and cloud-based business operations. This demand is likely to remain elevated, as retail customers are accustomed to the ease and efficiency of ordering goods online, and many businesses may never return to the office full-time. Additionally, the overall secular shift toward e-commerce remains unabated and Amazon continues to reap market share gains despite its size.

Amazon has been reshaping the traditional retail industry for over 20 years, while also emerging as the leading infrastructure-as-a-service provider through AWS, two phenomena that contribute to the company's wide economic moat. It's competitive advantages include strong network effects, cost advantages, scalability, and intangible assets. Moreover, Amazon's trajectory is promising, with AWS, advertising, and subscriptions being the company's main growth drivers going forward.

Amazon shares have declined this year, in-line with the broader technology sector. However, we believe the company's dominant position across its various markets, compelling growth prospects, and prevailing valuation metrics offer a long runway of positive returns for Amazon investors.

AES Corp. 6.875% Equity Units (AESC)



Source for chart and financials: Yahoo Finance and Morningstar. Past performance is not indicative of future results. Please see disclosures on page 9.

Price (09/30/2022)	$88.37	Par Value	$100
Market Cap ($B)	$ 1.0	Coupon Rate	6.9%
Dividend Yield	7.8%		

The AES Equity Units are a mandatory convertible security issued by AES Corp, a globally diversified power generation and utility holding company, that we have purchased for client accounts as an income investment. This convertible pays interest quarterly, at a rate of 6.9% based on its par value of $100. Selling at a discount to par value, the units currently yield an attractive 7.8%. As a mandatory convertible security, the units will convert to a variable number of AES shares no later than February 15, 2024, using a formula based on a $100 conversion price and the market price of AES common stock at the time of conversion.

AES owns three regulated utilities in the United States and is a leading operator and developer of renewable power worldwide. The company is taking advantage of favorable trends in clean power generation, transmission and distribution, and LNG infrastructure as it looks to be an industry leader in the world's decarbonization efforts. In its generation business, 43% of AES's capacity is fueled by renewables. Longer-term, the company sees over 60 gigawatts of development pipeline, weighted heavily toward wind and solar, in the United States. The recently passed Inflation Reduction Act, which includes incentives for renewable energy sources, could provide additional investment opportunities.

Over the past several years, AES has divested unprofitable non-core assets and narrowed its geographical focus. It has also strengthened its balance sheet and now carries investment grade ratings from all the major credit rating agencies. We believe that AES is committed to optimizing its portfolio of regulated and non-regulated assets, which should result in above-average earnings and dividend growth, and we anticipate holding AES shares after the conversion.

Source for text and charts: Morningstar, S&P/CFRA, Schwab, ValueLine, Black Diamond Performance Reporting, Yahoo Finance, Bank of America, JP Morgan Markets 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 $930 million as of September 30, 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.

The NASDAQ stock exchange is the first electronic stock market listing over 5000 companies. The NASDAQ stock market comprises two separate markets, namely the Nasdaq National Market, which trades large, active securities and the Nasdaq Smallcap Market that trades emerging growth companies.

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