Edgemoor's Quarterly Report

Suite 315
7250 Woodmont Avenue
Bethesda, MD 20814
(301) 543-8881
www.edgemoorinv.com
www.edgemoorblog.com

October 2023

Equity Markets Remain Positive for 2023, Bonds Modestly Negative

The S&P 500 index maintained a strong 13.1% total return through September 30th, 2023, despite recent market volatility. The Bloomberg Barclay's Aggregate Bond Index, on the other hand, notched a modestly negative return of 1.2% year-to-date.

In the third quarter, both indices posted negative total returns, reversing course following two quarters of gains. The S&P 500 posted a negative 3.3% total return in Q3, while the bond index returned negative 3.2% for the quarter.

Much of the downturn in stocks and bonds came in September, with the S&P down 4.8% and the bond index down 2.5% for the month. This was a rapid reversal for markets, even for the month that is historically the worst for equities.

Why the Change?

A major contributor to the market selloff in Q3 was the rapid rise in Treasury yields since mid-summer. The benchmark 10-year Treasury bond reached its highest yield in nearly 16 years in late September, at nearly 4.6%. This marked a dramatic increase from its yield of 3.75% at the end of June 2023. As yields rise, the price of fixed-rate bonds falls, at a rate of approximately 3.4% for every 1% rise in rates for the 10-year Treasury bond.

The surge in Treasury yields came in reaction to the Federal Reserve's latest statement that interest rates may need to stay higher for longer to bring inflation back to its target rate of 2%. This resolve to quell inflation disappointed investors, who had hoped for a quick pivot by the Fed to cut rates in late 2023, after it paused rate hikes in June and September.

All Eyes (and Ears) on the Fed

While the Federal Reserve held its benchmark Fed funds rate steady at 5.25% to 5.5% at its September meeting, it also indicated that another quarter-point hike is possible before year-end. So, for now, it appears that the Fed will continue to tip-toe along a narrow line between raising rates just enough to continue bringing down inflation, but not too much to tip the economy into recession.

Looking ahead into 2024, investors are currently expecting a half-point reduction in the fed funds rate by late next year, down from the one-point cut anticipated by many earlier in the summer. Either way, while the worst of monetary tightening is likely behind us, the direction from here remains uncertain and likely points to a higher for longer interest rate environment.

U.S. Economy Holds Steady

The U.S. economy has remained remarkably resilient during the Fed's rapid rate-hiking campaign over the last 18 months. Bolstered by a still-robust labor market, solid consumer spending, and-better-than expected corporate earnings, the U.S. economy has so far averted the long-awaited recession that many had predicted for 2023.

U.S. GDP growth – a key measure of the health of the overall economy – was a solid 2.1% in the second quarter ended June 30th and is now predicted by the Atlanta Fed's GDPNow model to top 3.5% for the third quarter. This optimistic forecast reflects, in part, an expected rebound in the manufacturing and industrial sectors, as supply chain disruptions continue to ease, the reshoring drive remains a priority of many businesses, and the heightened use of artificial intelligence boosts worker productivity. In addition, supportive government policies, including the Bipartisan Infrastructure Law (2021), the CHIPS and Science Act (2022), and the Inflation Reduction Act (2022), are expected to spur longer-term growth for many sectors of the U.S. economy.

The labor market also remains seemingly bulletproof. U.S. businesses have added more than 200,000 jobs in each of the last three months, including September's blow-out number of 336,000 new non-farm payrolls, a massive surprise to the upside from the consensus estimate of 170,000. The U.S. unemployment rate held steady at 3.8%, only slightly above the 3.6% rate that prevailed before the Fed started raising rates in March 2022.

How is it that the labor market seems to be holding up so well, despite higher rates and a slowing economy? Economists point to several factors, including strong labor-force participation, a boom in small business creation, and continued growth in service sectors like healthcare, leisure, and hospitality. Each of these factors has helped keep labor demand strong enough to withstand the impact of higher interest rates. The result has been a labor market that may keep the U.S. economy out of recession or, at least, cushion it enough for a "soft-landing."

Inflation Remains in the Spotlight

Notwithstanding these positive points, there are several headwinds facing the economy and markets. Headline inflation remains elevated in the U.S., despite dropping significantly from its recent highpoint in June 2022. The Consumer Price Index, or CPI, which is the broadest measure of inflation, held steady at 3.7% in September, but remained above July's 3.3% rate for the second month in a row. The factors contributing to the recent uptick in inflation have been sharply higher energy prices and still stubbornly high rent/shelter costs, which alone account for nearly 40% of the index.

This level of inflation is significantly below the 9.1% rate just fifteen months ago, but remains above the Fed's 2% target, meaning that interest rates will likely have to stay higher for longer to get the inflation rate down further.

Other Headwinds

We continue to monitor several other headwinds facing the economy and markets.

Congress averted a government shutdown on October 1st, but only by kicking the can for a budget deal down the road to mid-November. Further dysfunction was on display when House Republicans ousted its Speaker for the first time in history and have not yet been able to agree on a new leader.

The UAW auto strike is spreading, and may soon trickle down to suppliers, dealers, and consumers. In addition, energy prices have risen sharply, just as cold weather is setting in, with oil topping $95 a barrel briefly in late September. Both these factors could put a crimp on consumer spending, which so far this year has held up pretty well.

Finally, S&P 500 earnings are projected to be flat year-over-year in Q3, after three straight quarters of declines for the index. For the full year 2023, S&P 500 earnings are projected to rise 1% over 2022, reflecting the expectation for a rebound in the fourth quarter, which we will be watching closely.

Geo-Political Risks

Even as U.S. growth has powered ahead, global momentum has faltered. China has been a particular disappointment. Its post-Covid reopening has sputtered, with the construction sector, a key growth engine, facing a severe slowdown. Property sales are down 20% year-over-year and down 50% compared to the 2019-2021 period. In addition, business confidence is faltering, regulations are tightening, and exports are contracting. Overall, expected growth for the Chinese economy this year is less than 5%, compared to a historic average of 8-9% over the last 20 years.

In Europe, growth is also faltering as inflation remains stubbornly high. Core inflation is stuck at over 5.3% in the eurozone, causing business surveys to weaken to their lowest levels since 2020. And the wars in Ukraine and the Middle East run the risk of further destabilizing global markets and putting economic growth at risk.

All in all, the global economic landscape looks uncertain at best, though a full-fledged global recession isn't expected by most economists.

Outlook

Given all these uncertainties, our outlook for the economy and markets is mixed.

We remain cautiously optimistic on equities but are concerned about the lack of corporate earnings growth this year. To sustain the gains and halt any further downward pressure on stocks, a return to earnings growth in the near-term will be critical.

In addition, we hope to see a broadening of market leaders beyond the "Magnificent Seven" tech companies, which have so far dominated the market's momentum, both to the upside and the downside this year.

Longer term, our outlook for earnings growth and the markets remains positive due to several structural tailwinds, including ongoing technological advancements, increasing worker productivity, widening consumer demand globally, as well as breakthroughs in the biotech and healthcare industries. We also expect our income investments to have positive returns going forward, as interest rates moderate and valuations recover.

Portfolio Implications and Actions

The market's recent re-pricing in September and early October has presented some new pockets of opportunity, which we are actively evaluating. We are focusing on companies and sectors which we believe have been overly punished, but still have good overall fundamentals and growth prospects. The write-up of Schwab in the next section of this report is an example of such an opportunity which we identified earlier this year.

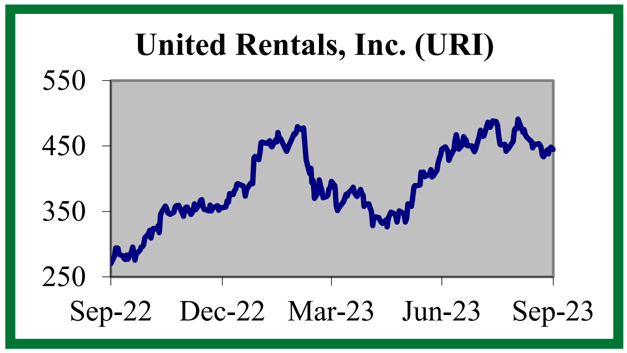
In the meantime, we are still favoring short-term Treasury bonds and money market funds at better than 5% annualized yields for client cash.

We believe our active, disciplined approach to individual security selection continues to be the most appropriate investment strategy for long-term outperformance for our clients.

Analysis of Selected Securities

What follows are reviews of three securities we are currently buying for client accounts.

United Rentals Inc. (URI)



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

Price (09/30/2023)	$ 444.57	Forward P/E	11.0
Market Cap ($B)	$ 29.7	Price/Book	4.1
Dividend Yield	1.4%	Price/Sales	2.4
Return on Equity	34.0%		

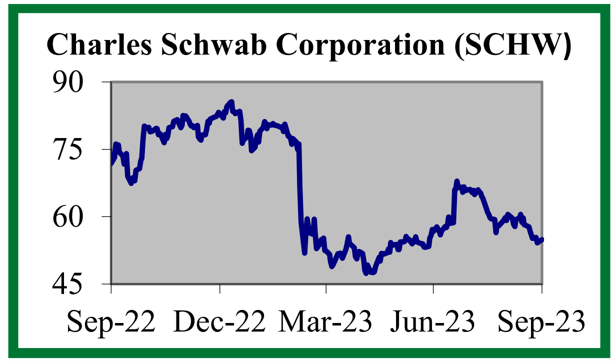
United Rentals is the largest equipment rental company in the world with an integrated network of 1,543 rental locations throughout the United States, Canada, Europe, Australia, and New Zealand. The company's U.S. network, representing 90% of total revenues, operates in 49 U.S. states predominantly in the South and West, serving the following three principal end-markets: Industrial and other Non-Construction, Commercial Construction, and Residential Construction. The breakdown of total revenues is as follows: Equipment Rentals (87%), Rental Equipment Sales (8%), Service and Other Revenues (2%), New Equipment Sales (1%), and Contractor Supplies (1%).

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. Logistics, utilization, and equipment availability are extremely important to its customers, and United Rentals' increasing scale has only served to cement their competitive advantage in those areas.

United Rentals stands to benefit from the continuing shift from owning equipment to renting, which conserves capital, reduces equipment downtime, and lowers overall costs for its end customers. In addition, there are significant revenue tailwinds for the industry tied to investments in clean energy, the ongoing modernization of the electric vehicle industry, reshoring of manufacturing capacity, as well as an increase in federal infrastructure programs related to the $1.2 trillion Infrastructure Investment and Jobs Act.

United Rentals has steadily improved its free cash flow over the past decade. In early 2023, the company initiated a quarterly dividend and restarted its share repurchase program. The stock has generated average annual returns above 20% per year over the past 5, 10, and 15-year periods. Despite that, the stock still trades at just 11 times forward earnings estimates, which is well below the market's current multiple. We believe that the company's competitive advantages and strong growth prospects should allow it to continue to generate attractive returns over the long term.

Charles Schwab Corporation (SCHW)



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

Price (09/30/2023)	$ 54.90	Forward P/E	17.2
Market Cap ($B)	$ 97.3	Price/Book	3.6
Dividend Yield	1.8%	Price/Sales	4.9
Return on Equity	20.8%		

Schwab is a leading provider of financial services, with 34 million active brokerage accounts and $8 trillion in client assets. The company offers wealth management, securities brokerage, banking, asset management, custody, and financial advisory services to individuals and institutional clients via two segments: Investor Services (76% of 2023 revenues) and Advisor Services (24%).

The Investor Services segment provides retail brokerage, investment advisory, and banking and trust services to individual investors. This segment also offers retirement plan services and other corporate brokerage services to businesses and their employees. The Advisor Services segment provides custodial, trading, banking and trust, as well as retirement business services, to independent investment advisors and recordkeepers.

In 2023, Schwab completed its $22 billion acquisition of TD Ameritrade, creating one of the largest brokerage firms in the world. In addition to being a brokerage powerhouse, Schwab also has one of the largest banks in the U.S., with more than $304 billion in deposits as of June 30, 2023.

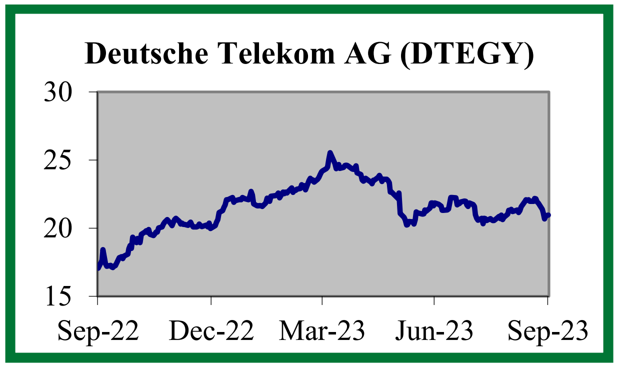
Schwab enjoys numerous avenues for growth going forward. The merger with TD Ameritrade provides material revenue and expense synergies that will be realized over the next couple of years. The company's large client base and low-cost structure gives it flexibility to create new products and services that can ramp up quickly and are comparable or superior to that of its peers. Schwab is also now the fifth largest provider of exchange traded funds, the fastest growing segment of the retail investor market.

Management is shareholder friendly, returning cash to shareholders via both dividends and share repurchases. Schwab has repurchased $2.8 billion of its common stock so far this year, and approximately $8.7 billion remains under its share repurchase authorization. Year-to-date, the company has paid just over $1.1 billion in dividends and the stock currently yields 1.8%.

We began buying shares of Schwab in the spring when the collapse of Silicon Valley Bank ignited a broad-based sell-off of financial stocks, including Schwab. We viewed this as an over-reaction by the market, given Schwab's sound business principles, robust balance sheet, and strong footing in the industry.

Shares of Schwab remain attractively priced at a forward P/E of 17.2, which is below its 5-year average of 18.6 and the S&P 500's forward P/E of 18. This appealing valuation, combined with the company's good growth prospects and solid industry position, makes this stock an attractive long-term holding.

Deutsche Telekom AG (DTEGY)



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

Price (09/30/2023)	$ 20.96	Forward P/E	12.1
Market Cap ($B)	$ 103.6	Price/Book	1.6
Dividend Yield	3.5%	Price/Sales	0.9
Return on Equity	36.2%		

Deutsche Telekom is Europe's largest telecommunications company and the incumbent telecommunications operator in Germany. It is also a major player in the U.S. telecommunications market through its 51.4% controlling stake in T-Mobile U.S.

T-Mobile's 2020 merger with Sprint substantially expanded its customer base and placed it solidly among the top three U.S. wireless carriers. Deutsche Telekom shares offer exposure to T-Mobile's growing business at a considerable discount to directly owning shares of T-Mobile while also receiving an attractive, growing dividend.

Strong results from T-Mobile, which now accounts for more than 60% of company earnings, have been a key driver of Deutsche Telekom's recent results. T-Mobile management has done an outstanding job integrating Sprint and retaining customers, and now possesses a strong spectrum position with industry leading network performance. Future growth in the U.S. market will, in large part, be determined by T-Mobile's ability to scale its spectrum position in the 2.5GHz mid-band range, while further capitalizing on synergies and margin improvement resulting from the Sprint integration.

In Europe, Deutsche Telekom has strategically invested in upgrading its copper networks while charging incrementally higher prices when customers migrate to faster broadband speeds. This has resulted in steady revenue growth and healthy cash flow. Over the next decade, growth in Europe will be driven by a gradual rollout of fiber-to-the-home, which should further solidify Deutsche Telekom's position as a broadband leader.

We own Deutsche Telekom in our income portfolios for its strong dividend, which currently yields 3.5%, and growth potential. The dividend was increased 9% in 2023 and is expected to grow at a mid-to-upper single digit rate over the next several years, supported by a conservative payout ratio and solid wireless and broadband cash flows. In addition to a growing dividend, we believe the company's stable business model, steady revenue growth, and healthy margins will also benefit shareholders.

Source for text and charts: Morningstar, S&P/CFRA, Schwab, ValueLine, Black Diamond Performance Reporting, Yahoo Finance, Bank of America, JP Morgan Markets, MarketWatch, WSJ 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 September 30, 2023, 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.

Anne B. Baker
Office Administrator
(301) 543-8366
abaker@edgemoorinv.com

Philipp B. Bentley
Senior Investment Analyst and Lead Trader
(301) 543-8369
pbentley@edgemoorinv.com

Timothy C. Coughlin, CFP®
Managing Director
(301) 543-8371
tcoughlin@edgemoorinv.com

Steven D. LaRosa, CFA, CFP®
Director and Senior Portfolio Manager
(301) 543-8361
slarosa@edgemoorinv.com

Paul P. Meehan, CFA
Managing Director
(301) 543-8373
pmeehan@edgemoorinv.com

Thomas P. Meehan
President
(301) 543-8881
tmeehan@edgemoorinv.com

Sara R. Parker
Vice President
(301) 543-8881
sparker@edgemoorinv.com

Christine J. Potts
Senior Vice President
(301) 543-8881
cpotts@edgemoorinv.com

Bryce Sistrunk-Lewis
Analyst and Assistant Trader
(301) 543-8374
bsistrunklewis@edgemoorinv.com

Gay S. Truscott, CFP®
Director
(301) 543-8375
gtruscott@edgemoorinv.com

7250 Woodmont Avenue, Suite 315
Bethesda, MD 20814
(301) 543-8881, (301) 543-8358 fax
www.edgemoorinv.com www.edgemoorblog.com

Past performance is not indicative of future results. The opinions expressed are those of Edgemoor Investment Advisors. The opinions referenced are as of the date of publication and are subject to change due to changes in the market or economic conditions and may not necessarily come to pass. Forward looking statements cannot be guaranteed. Material presented has been derived from sources, including Bank of America, JP Morgan Asset Management, BlackRock, Fidelity Investments, Morningstar, S&P, Schwab, ValueLine, Argus, Credit Suisse, Black Diamond Performance Reporting, and Yahoo Finance, considered to be reliable, but the accuracy and completeness cannot be guaranteed. The information provided in this report should not be considered financial advice or a recommendation to buy or sell a particular security. There is no assurance that any securities discussed herein will be included in or excluded from an account's portfolio. The securities discussed may not represent an account's entire portfolio and, in the aggregate, may represent only a small percentage of an account's portfolio holdings. It should not be assumed that any of the securities transactions discussed were or will prove to be profitable, or that the investment recommendations or decisions we make in the future will be profitable or will equal the investment performance of the securities discussed herein. The current yields of the specific securities referenced herein may not be a reliable guide to future performance. Yields and gross returns to individual investors will be reduced by investment advisory fees and other expenses that may be incurred in the management of the account. Edgemoor Investment Advisors, Inc. reserves the right to modify its current investment strategies and techniques based on changing market dynamics or client needs. All recommendations for the last 12 months are available upon request.

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 MSCI ACWI ex USA Index captures large and mid-cap representation across 22 of 23 Developed Markets (DM) countries (excluding the US) and 24 Emerging Markets (EM) countries*. With 2,308 constituents, the index covers approximately 85% of the global equity opportunity set outside the US.

Edgemoor Investment Advisors, Inc. is an independent investment adviser registered under the Investment Advisers Act of 1940, as amended. Registration does not imply a certain level of skill or training. More information about Edgemoor Investment Advisors, Inc. including our investment strategies, fees, and objectives can be found in our ADV Part 2, which is available upon request.