EDGEMOOR
INVESTMENT ADVISORS

Edgemoor's Quarterly Report

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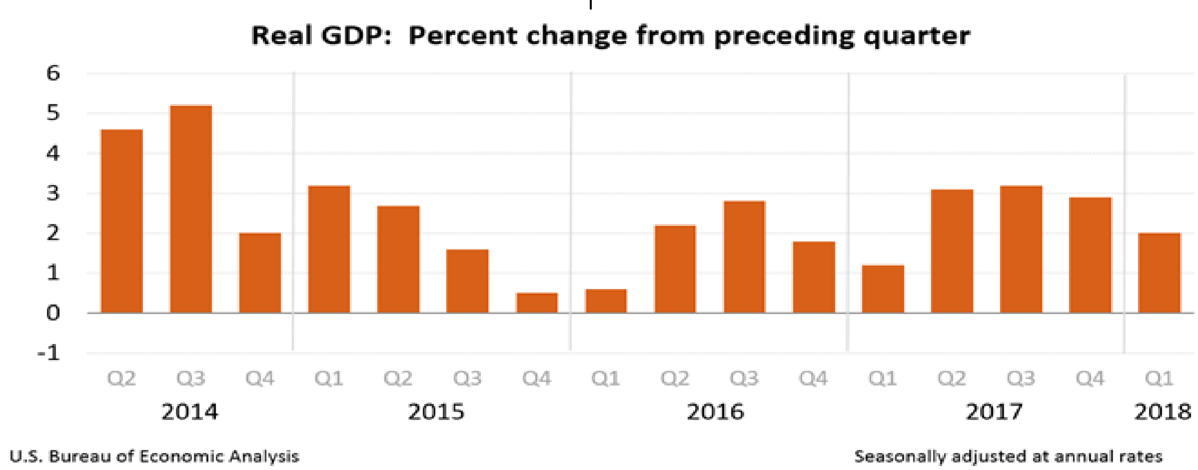
The U.S. stock market settled down in the second quarter from its turbulent first quarter swoon, as volatility moderated despite mixed signals regarding global trade, immigration, and geopolitical issues. For the first six months of the year, the S&P 500 index rose 2.6%, primarily on steady economic growth and strong corporate earnings. As interest rates rose during the first half of the year, bond prices fell, resulting in a 1.6% decline in the Bloomberg Barclays U.S. Aggregate Bond Index.

As the economy continues to grow and corporate profits rise, we expect positive returns for stocks over the remainder of this year. Interest rates should continue to increase modestly but not enough to jeopardize the economy. However, the increasing probability of a trade war poses challenges to the global economy that have investors on edge as we enter summer and the second half of 2018.

Focusing on Fundamentals

After a tumultuous first quarter that brought the first market correction (a drop of at least 10%) in two years, U.S. stocks delivered modestly positive returns in the second quarter with fewer sharp swings. Investors seemed to have largely resigned themselves to the trade bluster coming from the White House and focused primarily on the ongoing good news regarding the economy and corporate earnings. As the trade talk intensified at the end of the quarter, volatility picked back up a bit but did not spike as it had earlier this year.

First quarter U.S. GDP growth came in at 2.0%, a decrease from the 2.9% rate of the fourth quarter of 2017 but still an indication that the U.S. economy remains on its path of steady expansion, as shown in the chart below.



Past performance is not indicative of future results.

Because more people entered the labor force seeking jobs, unemployment rose slightly to 4.0% in June, still a low level that indicates a robust labor market. Employers added 213,000 jobs, compared to the average monthly gain of 198,000 over the preceding twelve months, and average hourly earnings increased 2.7% year-over-year. Inflation rose, partly due to higher wages, but remained relatively tame.

Reflecting the positive economic backdrop, corporate earnings surged. First quarter earnings growth of 25% was the highest since the third quarter of 2010. 78% of S&P 500 companies beat earnings estimates, the most since FactSet began tracking this data in 2008. The positive results reflected a combination of the tax cuts that went into effect this year and strong underlying business fundamentals.

After raising the federal funds rate to 1.75% in March, the U.S. Federal Reserve Board announced another 0.25% increase in June, saying that it expects economic growth to continue and will likely hike rates twice more this year. Bond prices declined as rates rose, adding to bonds' losses for the year, but rates are still at historically low levels.

While most of the economic and corporate news in the second quarter was good, the imposition of tariffs and potential for a damaging trade war cast a cloud over the global economy. The Trump administration directed much of its ire toward China, particularly restrictions on access to the Chinese market and efforts by the Chinese government to appropriate U.S. companies' proprietary technology and transfer it to domestic firms. The protection of intellectual property rights is an important issue that needs to be addressed. However, an all-out trade war with China would hurt both countries.

The Trump administration also threatened tariffs on trade with our longtime allies, including European countries, Japan, Canada, and Mexico, straining our relationships with them. The U.S. steel industry and others may benefit in the short term from these tariffs, but we believe the impact on the broader U.S. and global economies will be negative, especially if tariffs increase further, and could offset much of the benefit from the recent U.S. tax cuts. In one sign of the potential harm, iconic American company Harley-Davidson announced that it would move some production overseas partly to avoid the tariffs imposed by the European Union in retaliation for those announced by the Trump administration.

Our Outlook

Due to solid market fundamentals, we remain cautiously optimistic as we enter the third quarter, and we expect the global economy to remain on its path of steady expansion and corporate earnings to rise further. In our opinion, these trends and the availability of select stocks at attractive valuations should combine to provide positive returns for patient investors.

The employment situation in the United States continues to improve. The number of job vacancies recently surpassed the number of available workers for the first time since the U.S. Department of Labor began tracking this data in 2000, and we expect wage growth to pick up and lead to more spending by consumers. Businesses are optimistically investing in equipment and workers, partly due to the tax cuts that went into effect this year.

Analysts forecast strong corporate earnings again for the second quarter. The current expectation is for year-over-year growth of 20%, which would be the second highest increase since the third quarter of 2010.

The Fed's action and announcement in June were consistent with the market's expectations, and we expect two more 0.25% rate increases in 2018, in line with the Fed's statements. We will be watching closely for signs of rising wages and inflation due to the tightening labor market, which could cause the Fed to move more quickly than expected. Also, we are monitoring the relationship between short-term and long-term interest rates, known as the yield curve. Short-term rates have been rising more quickly than long-term, resulting in a smaller gap between the two and a flattening of the yield curve, an indication of potential economic weakness.

The biggest threat to the global economy and markets, in our opinion, is the potential for a global trade war, a situation that is more likely the longer the Trump administration sticks with its plans to impose tariffs on our trade partners, who are already retaliating. The market has so far taken the threats in stride. However, the potential for more tariffs and retaliation, combined with uncertainty regarding renegotiation of the North American Free Trade Agreement, has investors wary. We are optimistic that the United States will reach agreements with China, Japan, the European Union, Canada, Mexico, and others, but we are wary of this risk.

Other risks include the potential for additional regulation specifically directed at the technology sector, which has performed well recently but has come under fire for data privacy and security practices. In addition, restrictions on immigration could hurt the technology sector and others, such as agriculture, construction, and restaurants, which are heavily dependent on immigrants to fill jobs.

We will also be watching foreign economies closely for signs of strength or weakness. We expect to see evidence that the European economy continues to expand despite the removal of stimulus from the European Central Bank and the looming Brexit in 2019. Political unrest in Italy and weakness in the country's banks pose a potential threat to European economic growth and the future of the European Union. However, Italy has dealt successfully with similar issues before, and we expect it to do so again. Signs of slowing growth in China are concerning, but we are optimistic that the Chinese economy will stay strong.

In our opinion, equities valuations are still reasonable and are especially attractive for the securities we own. The S&P 500 index currently trades for a forward price/earnings ratio of about 16.8, roughly in line with long-term levels. We expect further earnings increases to support higher stock prices. The stocks we own trade at an average price/earnings ratio lower than that of the broad market and for prices significantly less than what we believe to be their intrinsic values, which leaves us optimistic regarding their long-term return potential.

We remain wary of long-term bonds, given still-low yields and the likelihood of interest rate increases. However, we have been buying some shorter-term bond funds that we believe should be less sensitive to interest rate increases and help provide some stability to our portfolios in the event of a stock market downturn.

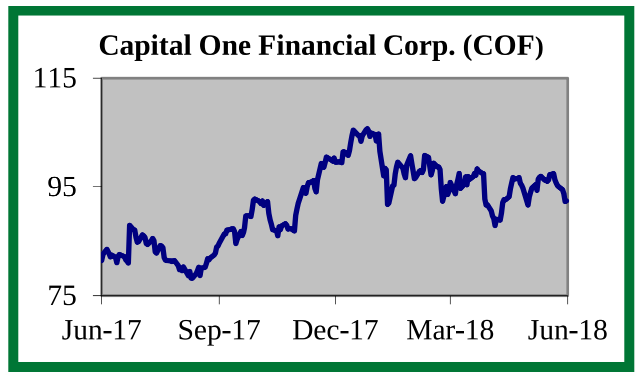
Addition of Foreign Benchmark to Reports

You will note on your quarterly statement that we have added to the performance section a third benchmark, the MSCI International ex USA Index (officially the MSCI ACWI ex USA Investable Market Index, but we have altered the name to be more clearly descriptive). Since foreign holdings comprise a significant portion, currently more than 20%, of our typical equities portfolios, we believe this broad index of foreign stocks is helpful in evaluating portfolio performance. We will continue to share the performance of the S&P 500 and the Bloomberg Barclays U.S. Aggregate Bond Index.

Analysis of Selected Securities

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

Capital One Financial Corp. (COF)



Past performance is not indicative of future results. Please see disclosures on page 9.

Price (06/30/2018)	$ 92.45	Forward P/E	9.1
Market Cap ($B)	$ 45.2	Price/Book	0.9
Dividend Yield	1.7%	Price/Sales	1.7
Return on Equity	4.6%		

Capital One is currently one of the largest and best-run banks in the United States, with a top-tier national credit card business complemented by a strong retail and commercial banking presence in many fast-growing regional markets like New York, Metro-D.C., and Texas. Capital One was one of the few U.S. banks to remain profitable through the financial crisis of 2008-2009 and since then has transformed itself from primarily a credit card company into one of the largest full-service bank holding companies in the United States. The company has made a series of opportunistic acquisitions in both traditional and nontraditional banking markets, which have allowed it to build national scale, gain critical market share, and solidify a low-cost, stable funding base.

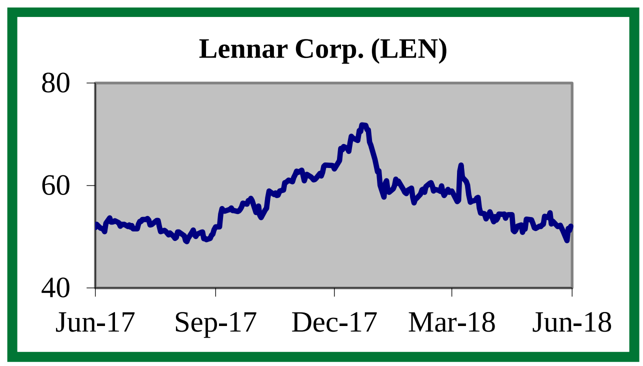
Capital One operates in three major segments: credit card lending (43% of total loans), consumer banking (30%), and commercial lending (27%). Credit cards still constitute the largest part of its business and contribute meaningfully to profitability. The company has managed its credit card portfolio well by expanding it wisely and keeping loan losses below the industry average. Management has consciously focused on higher credit quality by shunning practices like offering low introductory rates on high-risk credit card balance transfers. Capital One was a pioneer in offering attractive rewards programs to its cardholders, which has created a loyal cardholder base and a strong competitive advantage over its peers.

Capital One has also established itself as an innovative online banker in the United States. The acquisition of ING Direct's online banking business in 2012 greatly improved Capital One's liquidity and created a cheaper funding base than traditional branch deposits. The acquisition also lessened the need for expensive branches, lowering Capital One's overall cost structure and boosting profit margins.

Growth in loan volumes has been steady though uneven. While credit card and auto loan growth remain strong, commercial loan volumes have turned lower industry-wide as interest rates have risen. Despite this trend, this segment remains a stable source of profits for the bank. Capital One has long been known for its strong marketing and media presence, and we expect the bank to continue to spend heavily to build its brand and drive growth.

Capital One is financially sound, with a common equity Tier 1 ratio of 10.5% as of March 31, 2018. We currently expect profits to accelerate this year, partly due to a reduction in the company's corporate tax rate to 20% from 29% in 2017. The stock is attractively valued at 9.1 times 2018 earnings, well below its historical average. The dividend has remained steady for the last several years at $1.60 per share, resulting in a current yield of 1.7%. Overall, we believe Capital One to be one of the best, most conservatively run banks in the United States and an attractive long-term investment.

Lennar Corp. (LEN)



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Price (06/30/2018)	$	52.04	Forward P/E	10.6
Market Cap ($B)	$	17.3	Price/Book	1.3
Dividend Yield		0.3%	Price/Sales	0.9
Return on Equity		9.0%		

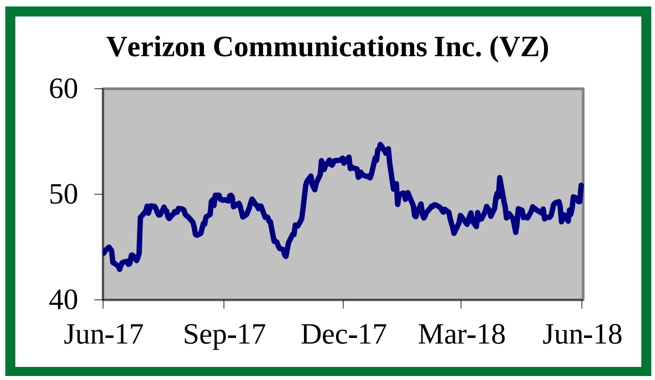
Headquartered in Miami, Lennar Corporation is today the nation's largest homebuilder as measured by the number and dollar value of homes delivered. Lennar builds a variety of homes at multiple price points, including step-up homes (68% of closings), entry level homes (28%), and retirement homes (4%), with an average selling price of $377,000. The company's East Coast region is its biggest geographic division, representing almost half of all deliveries. Lennar also provides mortgage financing, title insurance, and closing services. Total revenues topped $12.6 billion in 2017.

In February 2018, Lennar acquired West Coast rival CalAtlantic for $9.3 billion, expanding its national footprint and catapulting the combined company into the top market position. Lennar now enjoys a top three market share in 26 of the 30 fastest growing metropolitan markets in the United States. Due to the tremendous economies of scale, Lennar projects the merger will produce $100 million of cost savings in 2018 and $365 million in 2019 and will add to earnings this year.

Overall, the U.S. homebuilding market is at the midpoint of a long recovery from the Great Recession of 2008-2009. We expect favorable demographics and pent-up demand to increase housing sales through 2021. First-time buyers and revitalized move-up activity are leading the demand, and Lennar has positioned itself well to capture these new potential customers. The company has focused on entry-level buyers in affordable regions like Texas, Florida, and the Carolinas, while Lennar’s newer active-adult offering is expanding nationwide to capture the aging baby boomer population. Market experts expect the current cycle to continue until 30-year mortgage rates approach 6%, above the current level of 4.5%, and annual sales of single-family homes reach at least 800,000 units, up from the current annualized rate of 600,000 unit sales.

Lennar's financial position is solid. The company aggressively purchased attractively priced lots during the economic downturn of 2008-2009 and now controls an ample land supply to meet future demand. The company generates steady free cash flow and has a greater than one year backlog of homes to be delivered. Lennar stock is attractively valued at 10.6 times 2018 earnings, compared to a peer average of 12.5 times. We believe Lennar is a best-in-class homebuilder that should benefit from continued growth in the U.S. housing market.

Verizon Communications Inc. (VZ)



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Price (06/30/2018)	$ 50.86	Forward P/E	11.1
Market Cap ($B)	$ 212.8	Price/Book	4.2
Dividend Yield	4.6%	Price/Sales	1.6
Return on Equity	84.0%		

Telecommunications giant Verizon provides integrated communications, information, and entertainment products and services to U.S. consumers and businesses. Verizon is the largest wireless telecommunications services provider in the United States and in a duopoly with AT&T controls 70% of the U.S. wireless market. In 2014, the company bought out Vodafone’s 45%

interest in Verizon Wireless for $130 billion to assume full control of the subsidiary and take the top position in the U.S. market. Verizon also acquired AOL for $4.4 billion in 2015 and Yahoo! for $4.8 billion in 2017 to diversify its business into media, digital advertising, and internet services.

Verizon has two main lines of business: wireless and wireline. The wireless business includes wireless voice and data services, as well as equipment sales (mobile phones), and accounts for 71% of revenues and 87% of earnings. The wireline business provides voice, data, and video communications products, also includes the media and internet services operations, and accounts for 29% of revenues and 13% of earnings.

Verizon's core strategy has been to continually invest in technology to ensure that it delivers the highest network quality to its customers. The company led the rollout of 4G LTE networks in 2010 and expects to be the first major U.S. carrier to deploy 5G technology in a limited number of cities in 2018. This commitment to technological leadership and network quality has allowed Verizon to defend its subscriber base even in the face of increasing competition from rivals like Sprint and T-Mobile.

Verizon's size and scale afford it several competitive advantages. Verizon enjoys relatively lower fixed costs per connection than its rivals because its costs can be spread over a massive customer base of nearly 150 million wireless customers. In addition, the company's focus on network quality has enabled Verizon to charge premium prices (20-25% above its peers) while also maintaining high customer loyalty and lower rates of customer turnover.

In June 2018, Verizon announced the appointment of Hans Vestberg as CEO effective August 1, 2018. Although this move was a surprise, analysts have hailed Vestberg as an excellent choice to lead Verizon in its rollout of the next generation of 5G wireless infrastructure. Vestberg had previously been CEO and CFO of global telecom equipment company Ericsson, and he possesses a unique combination of technical, management, and finance skills.

Verizon's current financial position is strong, with healthy profit margins and steady free cash flow. The stock offers an attractive dividend yield of 4.6% and a reasonable valuation at 11.1 times 2018 earnings. We regard Verizon stock as a solid, long-term income holding.

Source for charts and text: Morningstar, S&P, 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 $922 million as of June 30, 2018 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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