Edgemoor's Quarterly Report

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Goodbye to the Third Quarter, and Good Riddance

Investors' concerns about global economic growth, falling commodity prices, the timing of the U.S. Federal Reserve Bank's changes to interest rates, and geopolitical uncertainty combined to bring stocks down sharply in the third quarter. After this pullback, the S&P 500 index was off 5.3% for the first nine months of the year, including dividends, and foreign markets fared worse.

While perhaps not a major drop compared to historical market performance, this downturn rattled investors who had grown accustomed to markets that marched steadily upward with barely a pause along the way. The third quarter brought the first correction, a drop of 10% or more from recent highs, since 2011. On average, the market experiences a correction about once per year, so by that measure this one may have been long overdue.

Fortunately, the markets have rallied to begin the fourth quarter, and our portfolios have already recovered about half of their third quarter declines. The energy sector, whose profits analysts believe fell over 60% in the third quarter, accounted for much of the stock market drop, and energy shares have risen sharply since on higher oil prices. Energy costs are still low enough, though, to potentially provide a boost to consumer spending and other parts of the economy.

Volatility continues in the stock market, and we think it will stick around for a while. In the meantime, we see potential opportunity amidst the relatively mild turmoil and are buying shares of companies that we think have been unfairly punished. We remain optimistic that stocks can end the year with positive gains and our current outlook is bullish for the shares we own over the coming years.

Around the World in 90 Days

Our last report focused on Greece and China. Subsequently, Greek voters rejected early in July the terms of an international bailout proposal, but Greece ultimately received aid and in exchange agreed to impose higher taxes and further spending cuts. Attention quickly shifted to China's slowing economy and its impact on the rest of the world, which the markets deemed to be negative. China is a major export market for resource rich countries, as well as for manufacturers of automobiles, machinery, and equipment required by the Chinese real estate and infrastructure boom, which now seems to be coming to an end. As China's economy matures and growth slows to levels below the recent 7%, other nations' economies are at risk.

Markets largely shook off these risks until August, when the Chinese government surprised the world by devaluing its currency, heightening concerns about Chinese economic growth. On the heels of the Chinese slowdown, oil prices dropped below

$40 per barrel for the first time since the Great Recession, and other commodity prices also fell. The combination of these events caused markets to plunge and sent the U.S. market into its first correction in four years.

Finally, the U.S. government also contributed to the unease, as investors eagerly awaited the Fed's September meeting and tried to guess whether the Fed would increase the federal funds rate. The decision to hold rates steady rattled already nervous investors, who saw the lack of a Fed move as a sign of concern about the U.S. economy. Indeed, some recent indicators, including a weak employment report, seemed to validate the Fed's decision and outlook.

Waiting for Earnings and the Fed

Expectations for third quarter earnings are tepid overall. Earnings, excluding the energy sector, should rise modestly from last year. However, because of the expected 60% decline in energy sector earnings in the third quarter, analysts currently forecast total S&P 500 index earnings to decline 3% from the previous year.

We believe earnings growth will improve in coming quarters. Consumer spending, in particular, and also the automotive and housing sectors remain strong and should fuel further U.S. economic expansion. The growth of the European economy remains slow but steady with support from the European Central Bank's stimulus.

Meanwhile, talk from the Fed governors points to an increase of 0.25% in the federal funds rate before year-end, though Fed Fund futures seem to indicate no increase until next year. Whatever the timing of the initial hike, in our opinion the path toward higher rates will be gradual. We also think the eventual rise will likely be a reflection of the improving health of the U.S. and global economies, which should be good news for investors.

Seeking – and Finding – Opportunities

Like many previous market downturns, this most recent one has been largely indiscriminate. Certain stocks that had gotten a bit ahead of themselves, particularly in such sectors as biotechnology and information technology, have suffered. But so have what we believe are reasonably priced stocks of companies whose prospects do not appear to be different now compared to a few months ago.

While the securities in our portfolios are not immune to factors affecting the global economy, we think the market has overreacted to the headline news and has unfairly punished stocks of some companies that are doing quite well. For example, as we discuss in the following section of this report, Berkshire Hathaway's various businesses and investments are primarily focused on the United States and are producing good results. Nevertheless, the stock was down 13% through the end of the first three quarters, potentially creating a buying opportunity for the shares.

Similarly, energy pipeline operators, known in the industry as midstream businesses, have suffered sharp drops over the past six or so months, due to falling energy prices and concerns about prospects for future pipeline construction and company cash flows. We believe some of the pullback is justified, since lower energy prices do affect drilling expenditures for exploration and production companies, which in turn can influence the amount of new pipeline construction needed and product volumes transported from production fields.

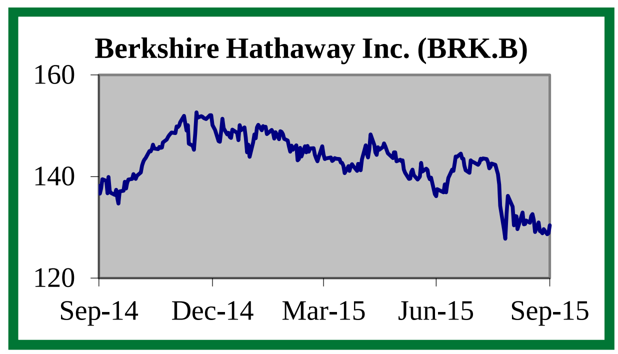
However, we believe the share price decline of these midstream companies overstates the potential negative impact of lower energy prices and ignores the fact that many midstream companies derive the vast majority of their cash flows from transportation of oil and gas under long-term contracts, not from production. Consequently, these businesses, which collect a toll on throughput, do not suffer from lower energy prices in the same way that energy producers do. In fact, some companies have maintained or increased their distributions to investors during 2015, and we think the outlook for them is favorable.

As you know, we do not believe in market timing, or broad moves into and out of the market with significant portions of our portfolios. In our view it is too difficult for anyone to know what will happen in the short term for such moves to do anything but hurt returns, as studies have repeatedly shown. What has worked for us in the past and, in our opinion, will continue to work in the future is to find opportunities to take advantage of the current downturn by buying shares of good companies that have been marked down below our estimate of their intrinsic values. We will remain both disciplined and patient investors.

Analysis of Selected Securities

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

Berkshire Hathaway Inc. (BRK.B)



Past performance is not indicative of future results. Please see disclosures on page 8.

Price (9/30/2015)	$ 130.40	Forward P/E	15.5
Market Cap ($B)	$ 324.7	Price/Book	1.3
Dividend Yield	0.0%	Price/Sales	1.6
Return on Equity	7.5%		

Berkshire Hathaway, one of our largest positions and longest-held stocks, is a holding company owning operating subsidiaries which are engaged in a variety of businesses including property and casualty insurance and reinsurance, freight rail transportation, utility and energy generation and transmission, financial products and services, and manufacturing, retailing, and newspaper publishing. Run by Chairman and CEO Warren Buffett since 1970, Berkshire operates on a decentralized basis with the managers of each operating subsidiary empowered to make their own business decisions, while Buffett and his partner Charlie Munger limit their role to investment and capital allocation decisions. This successful formula has allowed Berkshire to increase its book value per share at a compound annual rate of 19.4% from 1965 to 2014.

Given the enormous size and scale of Berkshire's operations, one hurdle for the company has been the difficulty in finding deals big enough to have a substantial impact. In August, however, Berkshire announced its largest deal ever, the $32 billion acquisition of aerospace company Precision Castparts. This deal fell into Buffett's category of "buying a wonderful business at a fair price," and we believe it has the potential to contribute meaningfully to future earnings and book value. Similarly, Berkshire's 2013 acquisition of H.J. Heinz has produced significant non-cash gains to date, and Heinz's recently announced merger with Kraft Foods Group (in which Berkshire and its partner 3G Capital invested an incremental $10 billion in July 2015) should provide further gains. Even absent more mega-deals, the growth of Berkshire's other underlying companies should serve to increase shareholder value over time.

Berkshire's biggest and most profitable business, insurance, continues to generate significant cash from premiums called "float," which totaled $85 billion at the end of the second quarter of 2015. This float consists of unearned premiums and unpaid claim reserves, a low-cost source of capital that has been and remains, in our view, one of the most compelling advantages of Berkshire's business model. When combined with the operating cash flow of its seventy other, non-insurance businesses, this float provides Buffett with the capital and the clout to make large, opportunistic deals like the preferred stock investments in Goldman Sachs, Bank of America, and General Electric that Berkshire struck during the 2008-2009 credit crisis and have proved very lucrative to shareholders.

The other well-publicized challenge facing Berkshire – succession risk – is not of great concern to us. It looks increasingly likely that Buffett's three main roles – Chairman, CEO, and investment manager – will be split upon his retirement among several highly qualified internal candidates. Furthermore, we believe that Buffett's track record of successful investing will continue to benefit shareholders after he is gone.

Despite these positive attributes, the market has sent Berkshire shares down 13% year-to-date, reflecting in part lower underwriting and investment results in the first half of the year. But overall earnings are expected to rise 15% next year to $8.35 per share, putting today's share price of about $130 at an attractive 15.5 times forward earnings. And at 1.3 times book value, the shares are below their historical median value of 1.5 times book value. We continue to be buyers of Berkshire Hathaway, as we have been for more than 15 years, and view it as a core, long-term holding.

Southwest Airlines (LUV)

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Price (9/30/2015)	$ 38.04	Forward P/E	10.6
Market Cap ($B)	$ 25.9	Price/Book	3.5
Dividend Yield	0.7%	Price/Sales	1.4
Return on Equity	21.5%		

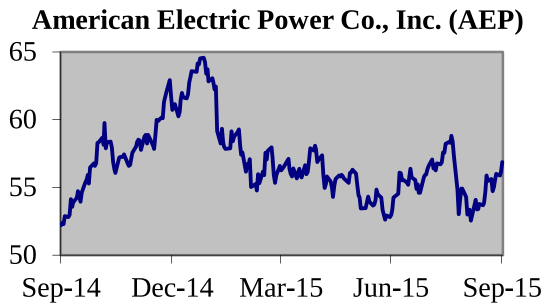
Southwest Airlines is a low-fare, low-cost airline that was founded in Dallas, Texas in 1971 and today is the largest domestic airline in the United States. Southwest serves 95 destinations in 40 states and 5 foreign countries. The company has 50,000 employees and has remained profitable for 41 consecutive years.

Southwest pioneered short-haul, high-frequency airline service, which differs from the more common hub-and-spoke model used by most domestic airlines. The point-to-point model allows Southwest to focus on less congested secondary airports with a uniform fleet of aircraft (the Boeing 737), which maximizes plane utilization and employee productivity while minimizing scheduling, training, and maintenance expenses. These factors have long been the source of Southwest's low-cost advantage.

Southwest has experienced considerable growth over the last few years, beginning with its 2011 acquisition of competitor AirTran, which opened up 37 new markets including Atlanta's Hartsfield-Jackson airport. In 2014, the airline won 54 new slots at D.C.'s Reagan National Airport and 12 at New York's LaGuardia Airport. Southwest also began international flights in 2014 and intends to expand routes and frequency in the years to come.

We believe the company's financial position is strong, with a clean balance sheet, low operating expenses, and healthy cash flow. Total fuel costs are down more than 30% year-over-year, resulting in $500 million in cost savings in the second quarter. And because Southwest does not hedge its fuel purchases, the company should continue to benefit from sustained low oil prices. Southwest has $2.7 billion of debt and $3.1 billion of cash on the balance sheet, and it is the only U.S. airline with an investment-grade credit rating. Finally, we also consider the company to be shareholder friendly, with a recently approved $1.5 billion share buyback program and a steadily increasing dividend payout.

American Electric Power Co., Inc. (AEP)



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Price (9/30/2015)	$ 56.86	Forward P/E	15.2
Market Cap ($B)	$ 28.2	Price/Book	1.6
Dividend Yield	3.8%	Price/Sales	1.6
Return on Equity	10.3%		

American Electric Power is one of the largest electric utilities in the United States, delivering electricity to more than 5.3 million customers in 11 states. It operates 32,000 megawatts of generating capacity and 40,000 miles of transmission lines, representing a better than 10% market share throughout the central United States. The breakdown of its generating capacity is approximately 60% coal, 23% oil/gas, 8% wind and hydroelectric, and 5% nuclear.

Over 80% of AEP's revenues are from regulated operations, as the company has steadily moved away from its non-regulated businesses. This strategic repositioning of the business should reduce the company's exposure to risky and volatile commodity markets for power, coal, and natural gas. The shift should also allow management to focus on AEP's more stable and higher margin transmission, environmental, and regulated businesses.

We believe transmission investment is AEP's most attractive long-term growth opportunity, given the federal government's incentives to upgrade the nation's power grid. AEP has several multi-billion dollar projects in the works and plans to spend more than $5.2 billion in 2015-2017. Environmental investments are also a potential growth opportunity for AEP, as it plans to spend another $5 billion over the next five years to retrofit its fleet of coal-fired plants. Given its good operating history with regulators, the company should be able to win rate increases to recover its investments and earn a solid return on its capital outlays. In our opinion, this ability to drive earnings and dividend growth through continued investment in its regulated business is what makes AEP an attractive long-term income investment.

AEP's dividend has grown at a steady pace, averaging annual increases of more than 4% over the past five years. With a low payout ratio and solid earnings growth potential, we believe AEP has one of the more attractive dividend growth profiles in the utility sector.

Source for charts and text: Morningstar, S&P, Schwab, Value Line, and Argus research reports.

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INVESTMENT ADVISORS

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