Edgemoor's Quarterly Report

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Another Strong Year for Equities

2024 proved to be another strong year for equity investors. The S&P 500 Index, the broadest measure of the U.S. stock market, delivered its second consecutive year of 25%-plus returns, the first time since 1997-1998 that the index notched back-to-back 20%-plus gains.

The positive momentum in equity markets was propelled by a combination of strong GDP growth, cooling inflation, solid corporate earnings, and falling interest rates. These favorable factors made the U.S. economy the standout among global economies, most of which had to endure slowing growth as a tradeoff for curbing inflation.

For the year, the S&P 500 had a total return of 25.0%, on top of the 26.3% gain generated in 2023. The Communications Services and Information Technology sectors once again drove the gains, with Financials and Utilities not far behind. Volatility returned late in the fourth quarter, as equities declined 2.4% in December.

The bond market also experienced some weakness at year-end. The 10-year Treasury yield, a key barometer of the bond market, jumped from 3.6% in September to 4.6% in December, sending bond prices down. (Bond prices move in the opposite direction of interest rates or yields). As a result, the Bloomberg Barclays Aggregate Bond Index returned just 1.3% for the year, driven down by a 3.1% loss in the fourth quarter.

The Fed Slows Down

The Federal Reserve capped off this year's rate-easing cycle that began in September with a modest 25 basis point (one-quarter of 1%) cut to its benchmark Federal Funds rate in December 2024. This brought the total rate cuts in 2024 to 100 basis points, or a full 1%, to a final range of 4.25% - 4.5%.

Chairman Jerome Powell also signaled in his remarks a cautious stance for 2025, indicating the likelihood for just two additional rate cuts this year, down from four cuts expected earlier in the fall. The caution stemmed from a number of factors, including still-high inflation forecasts coupled with strong growth and employment expectations.

The U.S. equity markets reacted negatively to the Fed forecast, with the S&P dropping nearly 3.0% and the Nasdaq sinking 3.6% on the day of the announcement. Long-term rates, for everything from 10-year Treasuries to 30-year mortgages, also responded by rising sharply, sending bond prices plummeting. It appears we may be in a higher-than-expected long-term rate environment for the near term.

Inflation Remains Sticky

While inflation has come down significantly since its peak in June 2022, the absolute level of prices in the U.S. still remains high, especially in areas

such as food, housing, and services (think insurance premiums).

The Consumer Price Index, or CPI, which is the broadest measure of inflation, was up 2.7% year-over-year in November 2024, which marked the third monthly increase after several months of steady declines going back to March. Higher prices for food and housing were once again the biggest contributors to the inflation gauge and were only partially offset by declines in energy costs. Housing comprises roughly 35% to 40% of the CPI index and is proving to be the biggest and most difficult obstacle to the Fed reaching its 2% inflation target.

The Productivity Factor

The U.S. economy has achieved a favorable combination of strong GDP growth, low unemployment, and cooling inflation due in part to surges in both productivity and available labor. Between 2022 and 2024, productivity increased by 4% cumulatively, nearly double the average annual rate for the prior ten years. The labor supply grew by nearly 2% during the same period, as the post-Covid economy drew many back to work.

These labor advances resulted from a confluence of factors, including a surge in new business formations, technological advances that boosted worker efficiencies, and expansionary U.S. fiscal policies that targeted major domestic initiatives like semiconductor production.

Looking forward, the meteoric rise in the use of Artificial Intelligence (AI) and its promise to transform everything from healthcare delivery to manufacturing to energy production has the potential to further boost economic productivity for many years to come. However, it can take years to find profitable commercial uses for AI technologies that can significantly improve productivity. So while promising, the AI boom is still in its early stages with the ultimate outcomes still not fully known.

U.S. Economy: The Fundamentals are Still Strong

The fundamentals of the U.S. economy – GDP growth, unemployment, corporate earnings, and consumer spending – all remain on solid footing. Third quarter GDP growth was a strong 3.1%, following 3% growth in the second quarter. For the full year 2024, GDP growth is expected to be 2.7% followed by 2% growth in 2025.

The U.S. unemployment rate dropped to 4.1% in December from 4.2% in November, as employers added a better-than-expected 256,000 jobs during the month. For all of 2024, over 2.2 million jobs were added to the U.S. economy, on top of the 3 million added in 2023. While hiring has slowed, the overall unemployment rate remains low by historical standards and layoffs are still somewhat rare.

Corporate earnings also continue to grow. According to FactSet, the S&P 500 index reported third quarter earnings growth of 5.8% and consensus expectations are for nearly 12% growth for the fourth quarter of 2024, which would be the highest year-over-year growth in three years. For the full year, the growth in earnings is expected to top 9.4% for 2024 and 14.8% for 2025. Earnings growth is perhaps the largest driver of market returns for the S&P 500 index over the long term.

And finally, consumer spending has remained remarkably resilient, even in the face of higher inflation, rising 3.1% in the third quarter and expected to grow another 3.0% in the fourth quarter. It was propelled by a record $1 trillion in holiday spending during December, according to the National Retail Federation. Consumer spending accounts for nearly two-thirds of U.S. economic activity.

What's Next?

With the November Presidential election now behind us, investors are waiting to see what economic policies will actually get implemented by the new administration. Most are expecting an easing of regulations, a tightening of immigration policies, the extension of tax cuts for both consumers and corporations, and the imposition of tariffs on a wide array of goods and services.

So, who might be the winners and losers from such policies? No one really knows at this point, but the potential beneficiaries could be banks and other financial institutions, domestic manufacturers, and energy companies, while retail, construction, and agricultural businesses could see a decline in labor supply, depending on the extent of new immigration policies.

Risks We are Watching

Despite the many positives in the U.S. economy currently, there are both internal and external risks which could impact markets in the near term.

First, the internal risks. A resurgence of inflation is seen as a key risk of both tighter immigration policies and stiffer tariffs on our trading partners and could increase the risk of recession, if they in fact are enacted. Even without these risks to the underlying economy, a market correction of 10% or more is also seen by some as statistically overdue.

Externally, the ongoing conflicts in the Middle East and Ukraine are of continuing global concern, while the economic slowdown in China has created economic uncertainty for companies and consumers worldwide. While inflation is now near target in the Eurozone, it has come at the price of economic stagnation. And finally, a slowdown in global trade represents a key economic risk worldwide.

Portfolio Implications and Actions

We remain cautiously optimistic about U.S. stocks, despite lofty current valuations. The forward price-to-earnings ratio for the S&P 500 is currently 21.7 times, higher than the five-year average of 19 times. But not all sectors or companies carry such high valuations, and we have been able to find pockets of opportunity in areas like energy, healthcare, and financials at substantially lower valuations.

We also expect to see a further broadening of market performance beyond just the tech giants that have dominated market returns for the last several years. Specifically, we have already seen a positive shift in investor sentiment towards sectors previously left behind, including utilities, telecom, and real estate, all segments we own.

Looking ahead, the risk-return trade-off of bonds has become more attractive. Higher starting yields and lower future rates should combine for attractive long-term returns and a valuable ballast to equity exposure in balanced portfolios.

Outlook: Momentum or Valuation?

Overall, we maintain a positive long-term outlook for the U.S. economy and markets. But it remains to be seen whether momentum or valuation will dictate investment returns in 2025.

History tells us that momentum is a very powerful force that can propel markets higher for several quarters or even years. If the U.S. economy remains in this productivity boom driven by AI and a strong labor market, which many expect, then positive market momentum could prevail through 2025.

On the other hand, valuations are always an important market determinant, and at current levels they can be considered stretched. As long as growth and earnings remain solid, particularly in technology-related sectors, then higher equity valuations may be justified.

Overall, we consider the current U.S. economy to be on solid footing and the near-term risk for recession to be low. Absent an economic or policy shock, equity markets should continue to generate positive returns into 2025.

Edgemoor's Approach

We believe our patient, disciplined approach to individual security selection offers our clients strong long-term return potential in a cost effective and tax efficient manner. Even though markets can be volatile quarter-to-quarter and year-to-year, we emphasize to our clients the importance of sticking to a long-term investment plan focused on their specific goals and objectives. We appreciate your confidence in our time-tested investment philosophy.

Analysis of Selected Securities

The following are analyses of three selected securities we are currently buying for client accounts:

Amazon.com, Inc. (AMZN)

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

Price (12/31/2024)	$219.39	Forward P/E	35.1
Market Cap ($T)	$ 2.31	Price/Book	8.9
Dividend Yield	0.0%	Price/Sales	3.8
Return on Equity	18.8%		

Amazon is the largest e-commerce company in the world by both market capitalization and revenue. The company also has numerous service offerings, including fulfillment, advertising, publishing, gaming, and cloud computing via Amazon Web Services (AWS). The company's Prime membership subscription is a key differentiator in online retail services, as it offers free shipping for members and exclusive media content, including TV and movie streaming, music, and audible books.

Amazon is also the largest global provider by market share of cloud-based infrastructure services through its AWS platform, serving 31%

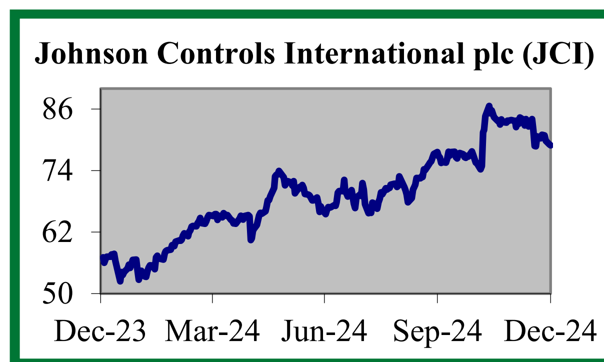
of the market, which is well ahead of second place Microsoft Azure's 20%. Amazon's other business platforms include Whole Foods Market, acquired in 2017, digital voice assistant Alexa, and the popular Kindle e-reader.

In 2020, the COVID-19 pandemic ignited an explosion of demand for online retail services and cloud-based business operations. This demand persisted, as retail customers became accustomed to the ease and efficiency of ordering goods online, and many office employees have never returned to the office full-time. Amazon continues to reap benefits from the ongoing secular shift toward e-commerce.

Amazon has been disrupting the traditional retail industry for over 20 years, while also emerging as the leading cloud service provider through AWS. The company enjoys a wide economic moat due to its many competitive advantages, including a strong network effect, cost advantages, scalability, and brand loyalty. In addition, Amazon's growth trajectory remains promising. AWS and online advertising should be the main growth drivers going forward, in addition to continuing growth in e-commerce, which should accelerate earnings growth due to the high profit margins of these businesses.

Shares of Amazon returned 44% in 2024, vastly outperforming the industry and the overall market. We believe Amazon's dominant position across its various markets, compelling growth prospects, and current valuation metrics provide a long runway for positive investor returns.

Johnson Controls International plc (JCI)



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

Price (12/31/2024)	$78.93	Forward P/E	21.7
Market Cap ($B)	$ 52.3	Price/Book	3.3
Dividend Yield	1.9%	Price/Sales	2.3
Return on Equity	8.2%		

Johnson Controls International (JCI) is a global industrial conglomerate that offers intelligent building systems, efficient energy solutions, integrated infrastructure, and transportation systems to mainly commercial building customers. The company began in 1885 as the inventor of the first electric thermostat and today is an innovator of products ranging from thermal detection devices to security systems and integrated energy control systems. JCI organizes its operations into four business segments: Building Solutions (North America) - 39% of sales; Building Solutions (EMEA) - 15%; Building Solutions (Asia Pacific) - 10%; and Global Products – 36%.

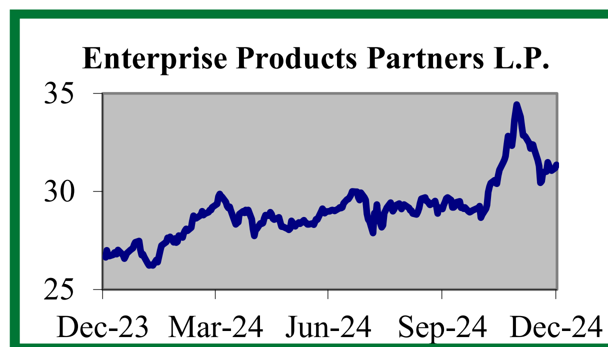
Johnson Controls has gone through a transformation over the past several years in order to streamline its business and focus on commercial building technologies and engineering solutions. Most recently, the company announced the sale of

its residential Heating, Ventilating and Air Conditioning (HVAC) unit to Bosch, with net proceeds of $5 billion going toward debt reduction and share repurchases. Previously, the company also sold its Air Distribution business to a private equity firm. These strategic sales have streamlined JCI into a more simplified, higher growth company with a stronger margin profile.

The company's installed base of products, such as air filtration systems, touchless access controls, and fire-detection systems, are mission-critical to the ongoing operation of a commercial building. Few of JCI's competitors offer such a comprehensive suite of commercial building systems and related services. In addition, Johnson Controls has created digitally connected building automation platforms such as Metasys and OpenBlue that further set it apart from its competitors and also generate attractive recurring subscription-based revenues.

Johnson Control's order growth has been steadily increasing, and the company ended the most recent quarter with a record backlog of $13.1 billion. Increasing demand for energy-efficient building solutions, specifically in data centers, has been a key growth driver. Management has also shown itself to be shareholder friendly, targeting 100% of free cash flow to be returned to shareholders through dividends and share repurchases over the long term. The shares currently yield 1.9%, and the company has paid a consistent dividend since 1887. Overall, we believe JCI is a core industrial holding that will continue to benefit from secular growth trends in more intelligent building solutions and integrated infrastructure in their key government, health care and higher education end markets.

Enterprise Products Partners L.P. (EPD)



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

Price (12/31/2024)	$31.36	Forward P/E	11.0
Market Cap ($B)	$ 68.0	Price/Book	2.4
Dividend Yield	6.7%	Price/Sales	1.2
Return on Equity	18.7%		

Enterprise Products Partners L.P. is a North American provider of midstream energy services to producers and consumers of natural gas, natural gas liquids (NGLs), crude oil, refined products, and petrochemicals. The partnership's assets include more than 50,000 miles of pipelines, 260 million barrels of oil storage capacity and 14 billion cubic feet of natural gas storage capacity.

Enterprise Products is one of the world's largest midstream companies, with operations across the full hydrocarbon value chain and in most producing regions of the lower 48 states. The company's diverse operations can aggregate supply of every type of hydrocarbon from multiple sources in major producing basins, delivering this inventory to multiple end markets, such as refiners, petrochemical producers, and exporters. Enterprise Products size and scale are competitive advantages that are the source of its wide economic moat.

Enterprise Products' geographic and asset diversity also allow it to grow in nearly any energy environment. As the dominant player in the NGL market, Enterprise Products is best positioned to benefit from anticipated NGL export growth in the U.S. The company currently has $4 billion in growth projects that are expected to enter service in the next several years.

Enterprise Products is transitioning to mainly fee-based businesses supported by long-term contracts. This allows the company to have one of the lowest costs of capital and highest distribution rates among its peer group. Enterprise Products has increased its dividend for 27 consecutive years, which is expected to continue. With a current dividend yield of 6.6%, the company is an attractive income investment for balanced portfolios.

We believe Enterprise Products will continue to gain market share and grow its earnings based on its dominant market position, attractive growth investments, and high barriers to entry for the industry. Overall, the company exhibits the characteristics Edgemoor seeks in income investments, including solid business fundamentals, growing earnings, and increasing dividend payouts over time.

Source for text and charts: FactSet, 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 $1.4 billion as of December 31, 2024, 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 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.

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