Edgemoor's Quarterly Report

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What a Year!

2021 was an outstanding year for equity investors. Combined with strong returns in 2020 and 2019, it marked the S&P 500's best three-year run since the mid-1990's. The S&P 500 index returned 28.7% for the year, on top of gains of 18.4% in 2020 and 31.5% in 2019. And most of this occurred during a global pandemic, now going on its third year.

Fourth Quarter and 2021 in Review

The reopening of the economy in the spring of 2021, combined with increasing consumer confidence, robust corporate earnings, and accommodative monetary and fiscal policies, caused the markets to soar to new heights.

The impressive performance of the S&P was powered by broad based gains across many sectors, including energy, financials, and consumer goods. Demand for everything from homes to cars to appliances surged as Americans returned to spending and traveling after a long period of hibernation.

The markets were even able to largely shrug off two new waves of Covid-19 variants, Delta in July/August, and Omicron in November/December, with a particularly noteworthy surge in the fourth quarter.

We did, however, start to see a rotation by investors out of the high-growth stocks, which have long-dominated the market, into more defensive, value-oriented segments. Rising interest rates through the year had the effect of discounting the value of future growth prospects for many high-growth businesses, a trend we have seen accelerate into the new year.

Rising rates also negatively impacted bonds, whose prices move inversely to interest rates. For the year, the Barclay's Aggregate Bond Index returned a negative 1.5%, the first negative-return year for bonds since 2013.

Interest Rates and Inflation

The powerful monetary and fiscal stimulus measures employed by the Federal Reserve and Congress during the pandemic helped avert a prolonged recession, but, when added to pandemic-related supply chain shortages, also pushed inflation to its highest level in decades. The Consumer Price Index (CPI), regarded as the broadest measure of inflation, soared to an annualized rate of 7.0% in December, far exceeding consensus expectations. This surge in prices appears to be less transitory, and part of a more long-term inflationary cycle than originally anticipated.

To combat this, the Federal Reserve signaled in its most recent FOMC meeting that it intends to

accelerate the tapering of its bond purchases and begin to hike interest rates. Specifically, the Fed expects to cut its monthly bond purchases by half in January 2022 to $60 billion per month, signaling it will stop adding bonds to its balance sheet by March 2022 rather than by mid-2022, as previously forecasted. Once its tapering is complete, the Fed expects to start raising the federal funds rate to further quell inflation, with three rates hikes indicated for 2022.

A rise in rates does not necessarily signal the end of the bull market. Research indicates that average S&P 500 returns are typically solid one year out from an initial rate hike, driven by strong economic growth and robust corporate profits. Also, a shift in monetary policy often works with a one-year lag, meaning any effects from interest rate increases in 2022 may not be felt in the economy until 2023. We do anticipate, however, that the headwinds presented by tighter monetary policy will lead to increased market volatility.

World Markets

The U.S. has not been alone in grappling with a slowdown in growth and a rise in inflationary pressures. Across the Atlantic, the Eurozone CPI index rose 5% in November, the highest level in decades. But so far, the European Central Bank has been reluctant to raise interest rates, instead choosing to stay the course to bolster the recovery.

China, which has taken a much tougher zero-tolerance stance against Covid, is experiencing a deeper and more sustained economic slowdown than its western counterparts, which we expect to continue.

Looking Ahead

As we consider the new year, we believe stock returns in 2022 will again be driven by growing corporate earnings. The U.S. economy should continue in its mid-cycle recovery, marked by sustained expansion with moderate GDP growth, low unemployment, and solid corporate profits. As evidence of this, the December unemployment rate hit a pandemic low of 3.9%, while expectations for 2022 GDP growth are a solid 3.5%, and corporate profits are projected to grow 8% in 2022.

In addition, the U.S. consumer continues to be bolstered by record-high net worth (driven by strong housing and stock market effects), pent-up savings (estimated at $2.5 trillion at year-end 2021), strong employment prospects, and wage growth.

On the other hand, we would not be surprised to see continued market volatility and even a market correction in 2022. A market correction is a decline of 10% to 20% from a recent high; a decline of greater than 20% is considered a bear market. Typically, corrections occur about once every year or two and we have not had a correction since the COVID-induced bear market in the spring of 2020. It seems likely that we will have a correction over the next year or two and we believe that the market will regain the losses from a correction within a few months, which is what usually occurs.

Portfolio Actions and Implications

We do not anticipate any major changes to our investment strategy, and we are actively pursuing new investment opportunities in areas we see as

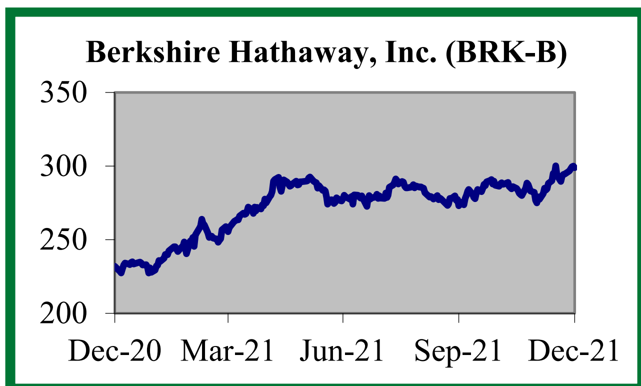
favorably positioned, like infrastructure and financial stocks. On the income side, we continue to favor dividend-paying securities like utilities, telecom, and real estate investment trusts, over fixed-rate bonds and Treasury securities.

Overall, we believe in the durability of the broadly diversified portfolios we construct for our clients, and we expect them to perform well through 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 company, these stocks are, in our opinion, priced attractively in the markets today.

Berkshire Hathaway Inc. (BRK.B)



Source for chart and financials: Yahoo Finance and Morningstar. Past performance is not indicative of future results. Please see disclosures on page 8.

Price (12/31/2021)	$299.00	Forward P/E	22.5
Market Cap ($B)	$695	Price/Book	1.5
Dividend Yield	0%	Price/Sales	2.0
Return on Equity	19.4%		

Berkshire Hathaway, one of our largest and longest-held stocks, is a holding company with multiple subsidiaries in a variety of industries, including property and casualty insurance and reinsurance, freight rail transportation, utility and energy generation and transmission, financial products and services, manufacturing, retailing, and newspaper publishing. In addition to its operating businesses, Berkshire manages a $311 billion portfolio of publicly-traded equity securities and holds $149 billion of cash as of September 30, 2021.

Run by Chairman and CEO Warren Buffett since 1965, Berkshire operates on a decentralized basis with the managers of each operating subsidiary empowered to make their own business decisions, leaving Buffett and his partner Charlie Munger to focus on investments and capital allocation. This highly successful formula has enabled Berkshire to generate stock returns in excess of the S&P 500 index over the company's 57-year history. Specifically, Berkshire stock delivered an annualized return of 20.2% between 1965-2021, compared with 10.5% for the S&P 500 index over the same period.

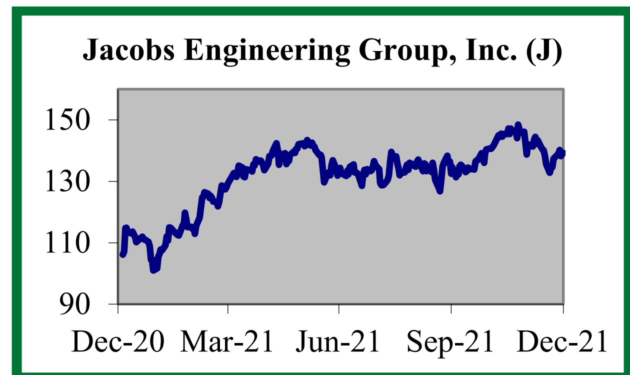
The engine of much of Berkshire's success is the insurance business segment, which includes GEICO and General Re. The insurance businesses generate significant cash from premiums, called "float", which the insurer receives in advance of any payouts. This low-cost capital has always been one of the most compelling advantages of Berkshire's business model. When combined with the operating cash flow of Berkshire's non-insurance businesses, this float, which stood at $145 billion as of September 30, 2021, provides Berkshire with a massive trove of capital to invest in public equities and opportunistic deals.

Given the enormous size and scale of Berkshire's operations, the biggest hurdle for the company has been the ability to find deals big enough to have a meaningful impact on its balance sheet and earnings. However, we believe that the growth of Berkshire's underlying companies will serve to increase shareholder value over time, even if the company does not make another large acquisition. For instance, Berkshire's railroad business, BNSF, carried more than 15% of all non-local ton-miles (a ton of freight moved one mile) of goods in the U.S. in 2020, which is more than any other carrier, regardless of transportation method. Because of the large share of goods which travel over BNSF infrastructure, the business is poised to continue to grow and generate solid returns on invested capital. This is only one example of the many attractive businesses under the Berkshire Hathaway banner.

Another challenge facing Berkshire is key man risk. In May 2021, Mr. Buffett put to rest the speculation of who will succeed him as CEO, naming Greg Abel, the long-standing CEO of Berkshire Hathaway Energy, as his successor. We believe Abel is eminently qualified for the role.

Berkshire stock outperformed the S&P 500 index in 2021, returning 29%, and we believe it will continue to be an excellent long-term investment. Mr. Buffett and his team are disciplined managers who we believe will be able to successfully invest Berkshire's enormous cash position as they have done for many decades.

Jacobs Engineering Group, Inc. (J)



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Price (12/31/2021)	$ 139.23	Forward P/E	18.0
Market Cap ($B)	$ 18.3	Price/Book	3.1
Dividend Yield	0.6%	Price/Sales	1.3
Return on Equity	8.1%		

Jacobs Engineering is one of the largest engineering and construction firms in the world that we expect will be a significant beneficiary of the infrastructure rebuild in the United States and across the world. Jacobs provides technical, professional, and construction services across a broad array of industries and should continue to benefit from increased spending on a host of important economic trends: digital modernization, cybersecurity, the rollout of 5G, the energy transition, water/transportation rebuilds, and supply-chain investments, among others.

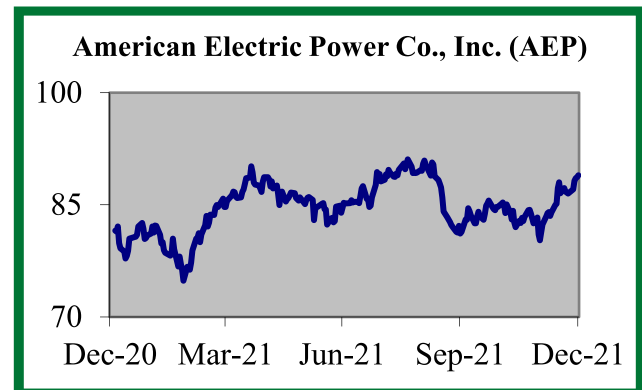
The company operates in three lines of business: People and Places Solutions (59% of FY21 revenues), Critical Mission Solutions (36% of revenues), and a newly organized division in PA Consulting (4%). Jacobs has considerable expertise in complicated, high-profile projects that are not easy to execute. They have built strong

relationships with governments and corporations over decades that typically result in future add-on business. Jacobs' businesses also have a massive opportunity from the $1 trillion infrastructure bill that was passed in November 2021. In fact, the company has noted that 95% of that bill's funding overlap with its businesses.

Over the past several years the company has gone through a transformation, selling certain oil-related businesses and streamlining their remaining operations from ten business lines down to three. This has resulted in a more efficient cost structure which they can now leverage to capture higher-margin business opportunities. There is a tailwind of growth in these higher margin opportunities as their government and corporate customers are increasingly required to meet ever-increasing challenges of digital and sustainability-driven disruptions.

The company generated $14.1 billion in sales in fiscal year 2021, and they currently have a new business pipeline of greater than $30 billion over the next 18 months. The stock trades at approximately 18 times forward earnings, which is below the current S&P 500 market multiple of 21 times. As a result, we believe the current share price is an attractive entry point for this high-quality, diverse company that will benefit from multiple secular growth trends and has a path to grow earnings at a mid-teens rate over the next several years.

American Electric Power Co., Inc. (AEP)



Source for chart and financials: Yahoo Finance and Morningstar. Past performance is not indicative of future results. Please see disclosures on page 8.

Price (12/31/2021)	$ 88.97	Forward P/E	17.8
Market Cap ($B)	$ 44.6	Price/Book	2.0
Dividend Yield	3.5%	Price/Sales	2.7
Return on Equity	11.2%		

American Electric Power operates the nation's largest electricity transmission system and more than 223,000 miles of distribution lines to safely deliver reliable and affordable power to 5.5 million regulated customers in 11 states. The company is also one of the nation's largest electricity producers, with approximately 31,000 megawatts of diverse generating capacity, including more than 5,900 megawatts of renewable energy. AEP is recognized consistently for its focus on sustainability and community engagement.

Following widespread COVID-19 vaccinations, the industry has seen increasing electricity demand in the commercial and industrial sectors, as many businesses reopened and factories resumed production. In our view, AEP is well positioned to drive earnings growth through

investments in its regulated businesses, while simultaneously benefiting from cost-reduction programs, which should contribute to stable earnings growth over the next few years. Environmental regulations, government incentives to modify aging infrastructure, and renewable energy growth are additional tailwinds for the company.

AEP's growth plans include increasing its renewable generation portfolio to approximately 50% of total capacity by 2030. The company is on track to achieve an 80% reduction in carbon dioxide emissions from 2000 levels by 2030 and has committed to achieving net zero emissions by 2050. AEP plans to invest $37 billion of capital from 2021 to 2025, with 100% allocated to regulated businesses and contracted renewables.

The company recently agreed to sell its Kentucky operations for $2.8 billion. Cash from this transaction will eliminate the need for a previously planned $1.4 billion stock sale, a positive for shareholders. AEP's 3.5% dividend has grown at a steady pace of 5.7% annually over the past five years. With a payout ratio of approximately 55% and solid earnings growth potential, we believe AEP has one of the more attractive dividend growth profiles in the utility sector. As a result, we view AEP as a solid, long-term income investment.

Source for text and charts: Morningstar, S&P, Schwab, ValueLine, Black Diamond Performance Reporting, Yahoo Finance, and Argus reports.

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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.

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