EDGEMOOR
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Edgemoor's Quarterly Report

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Spring 2011

March Madness and the Market's Remarkable Resilience

Stock markets around the world faced a barrage of challenges in the first quarter of 2011, including unrest in the Middle East and North Africa, a resurgence of concerns regarding government debts in Europe, and the devastating tsunami, earthquake, and nuclear meltdown in Japan. Nevertheless, the S&P 500 index rose 5.9%, an encouraging start to the year. If interviewed, Mr. Market might sound like one of the players after a game in the just ended NCAA basketball tournament: "People doubted us, we had to overcome a lot of adversity, but we focused on the fundamentals and came through." For the stock market in the first quarter, robust corporate earnings and continued economic recovery were the fundamentals that overcame the reasons for apprehension.

While the market's resilience in the first quarter is remarkable, it is hardly unusual. Economies and stocks have previously rebounded quickly from sharp falls in the wake of calamities including the Chernobyl nuclear reactor meltdown, the Kobe earthquakes in Japan, the 9/11 terrorist attacks, Hurricane Katrina, and the oil spill in the Gulf of Mexico. Natural disasters such as the recent events in Japan typically slow economic expansion in the short term, but the subsequent rebuilding results in a boost to the economy. We expect a similar pattern this time, with minimal long-term impact on the global economy and markets despite the tragic human suffering.

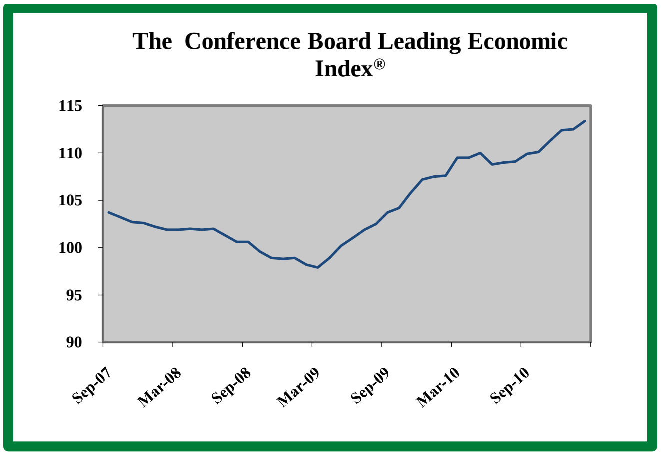
With oil prices gaining nearly 17% during the quarter, energy was the best performing sector in the market. Small- and mid-cap stocks outgained large-cap, continuing a trend that we think will end as the recovery matures. After declining in late 2010, Treasury bonds stabilized and ended the quarter yielding 3.5%. Unlike a year ago, however, investors are now putting more money in stocks than bonds as they seek greater returns and are more willing to accept some risk.

Outlook

Since the depths of March 2009, the S&P 500 has gained over 95% (excluding dividends) and is now within about 15% of its October 2007 peak. Extraordinary actions by the U.S. Treasury, U.S. Federal Reserve, and foreign governments buoyed the global economy, thereby strengthening corporate earnings and helping markets to rebound. Even after these gains of the past two years, we believe the market has plenty of room left to run.

Recent reports provide encouraging signs that the economy will continue to expand, supporting further increases in corporate earnings and stock prices. The Conference

Board Leading Economic Index®, shown in the chart below, increased again in February and points to more robust economic expansion over the coming months.



In addition, the manufacturing sector has improved for nineteen consecutive months and the service sector for fifteen. The rate of expansion in both has risen recently.

Hiring by private employers is picking up, and total employment has increased by 1.5 million since February 2010. As employment continues to rebound, consumers should be able to maintain their spending, which is crucial to the economy. Finally, the third year of a Presidential cycle is usually good for the stock market, as the White House tries to boost the economy in advance of elections.

Amidst these improving conditions, the S&P 500 trades at a multiple of less than 14 times 2011 earnings, below the historical average. Stocks offer rising earnings and dividends and remain attractive at current levels for long-term investors. Particularly appealing are shares of high quality, well capitalized, multinational companies that pay dividends and trade at significant discounts to intrinsic value.

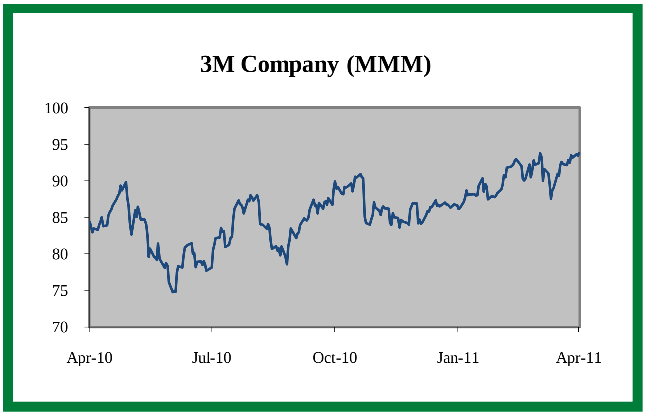
For sure, all is not rosy on the global economic and political scene. The U.S. housing market remains in a prolonged slump, and unemployment is still too high. Here and abroad, commodities prices are rising, although unused manufacturing capacity and high unemployment reduce the risk of broad inflation. If inflation increases, the Federal Reserve may hike interest rates sooner than it would like, threatening the economic recovery.

Despite these obstacles, we are optimistic that the U.S. and global economies and corporate earnings will continue to expand. One of the keys to investing success is a willingness to avoid selling good investments in the face of short-term challenges, as demonstrated in the first quarter.

Analysis of Selected Stocks

Following is a discussion of several of the securities we own and have been buying recently.

3M Company (MMM)



Price (4/4/11)	$93.64	Forward P/E	13.4
Market Cap.	$66.7 B	Price / Sales	2.5
Dividend Yield	2.3%	Price / Book	4.3
Return on Equity	28.7%		

Over its nearly 100-year history, 3M has invented some of the world's most used and recognized consumer products, including Scotch-Tape and Post-It Notes. This highly-diversified, industrial manufacturer sells more than 50,000 products in 60 countries across six major business segments, including Industrial & Transportation (32% of 2010 revenues), Healthcare Technologies (17%), Display & Graphics (14%), Consumer & Office (14%), Electro & Communications (11%), and Safety, Security & Protection (12%). The company is an S&P 500 component and a part of the Dow Jones Industrial Average.

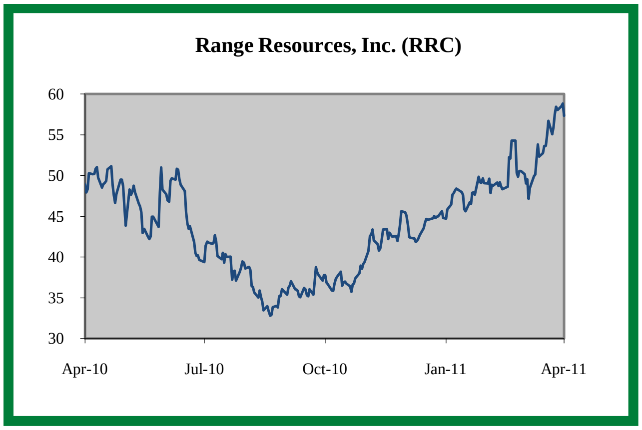
3M weathered the 2008-2009 recession well, remaining operationally profitable, continuing to invest in new products, and capitalizing on attractive acquisition opportunities both here and abroad. International sales now account for 65% of total revenues and 75% of operating profits, as management has pursued a growth strategy of expanding its footprint in high growth markets like China, Brazil, and India by investing in localized manufacturing, distribution, and R&D centers.

3M has long been known for its innovative culture. Its own "vitality index" – the percentage of sales stemming from products introduced over the previous five years – now stands at an impressive 30%, up from 20% just a few years ago. Furthermore, 3M's ability to leverage those innovative technologies across multiple product platforms has enabled it to generate impressive returns on invested capital, which have averaged 25% over the past five years as compared to 7.2% for the S&P 1500 Industrial Conglomerates.

The company enjoys a healthy balance sheet, with $3.3 billion in cash, $4.2 billion in debt, and $15.7 billion in shareholder's equity at year-end 2010. 3M also generates strong free cash flow equal to 13% of sales.

3M sells at a reasonable forward P/E ratio of 13.4 and offers an above-market yield of 2.3%, making this stock an attractive long-term holding.

Range Resources, Inc. (RRC)



Price (4/4/11)	$58.53	Forward P/E	39.7
Market Cap.	$9.4 B	Price / Sales	8.8
Dividend Yield	0.3%	Price / Book	4.2
Return on Equity	-10.4%		

Based in Fort Worth, Texas, Range Resources is engaged in the exploration, development, and acquisition of oil and gas properties in the U.S., primarily in the Southwest (TX, OK) and Appalachian (VA, PA) regions. At year-end 2010, the company controlled 2 million net acres with 4.4 trillion cubic feet (cfe) of proved reserves. Its daily production approximates 495 million cfe, of which nearly 80% is made up of natural gas.

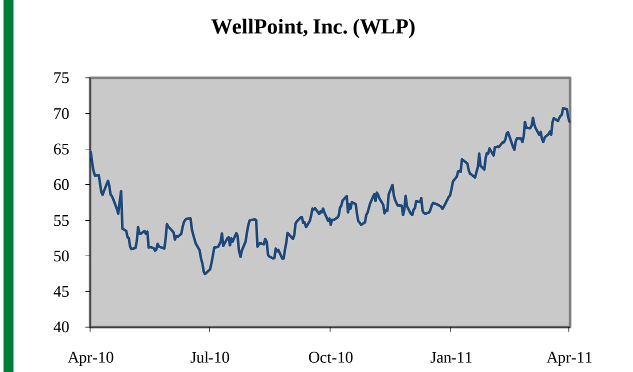
Range is among the most consistent operators in the industry, recently posting 32 consecutive quarters of sequential production growth. Much of that growth comes from the Marcellus Shale, arguably the premier shale gas play in the U.S. Range was early to invest there and maintains the dominant position among drillers, controlling 800,000 acres under long-term, low-cost leases with an estimated 3 trillion cubic feet of production potential.

One of Range's major strengths is its efficient allocation of capital. Unlike many exploration and production companies, Range has shown a willingness to opportunistically sell assets to redirect capital to its most attractive production opportunities. Since 2007, the company has sold nearly $2 billion worth of properties in other regions, which has allowed it to avoid excessive leverage or shareholder dilution. In February 2011, it announced the sale of its Barnett Shale properties in the Fort Worth Basin for $900 million. Proceeds will help fund 2011 capital expenditures of $1.4 billion, much of it planned for the Marcellus Shale.

Range enjoys one of the leanest cost structures in the industry, giving it enormous flexibility to continue drilling through periods of price weakness such as today. It also generates significant cash flow, which approximated $675 million in 2010. Range's balance sheet is modestly leveraged with 47% debt/equity. Its $1.9 billion worth of long-term debt carries no maturities until 2015, and the company has over $1 billion of unused revolver capacity from its banks.

Because Range's continuing heavy investment in production results in negative earnings, traditional valuation measures such as price/earnings ratios (P/E) and return on equity (ROE) are not as applicable as the long-term earnings potential of the company. We expect the demand for natural gas and, therefore, its price to increase, driven in part by the continuing push for clean energy in this country. Meanwhile, Range will increase production and position itself to be the long-term beneficiary of these trends. We believe shareholders, too, will be rewarded over time.

WellPoint, Inc. (WLP)



Price (4/4/11)	$70.61	Forward P/E	9.6
Market Cap.	$26.5 B	Price / Sales	0.5
Dividend Yield	1.4%	Price / Book	1.1
Return on Equity	11.9%		

WellPoint is the largest U.S. health insurer by medical membership, serving almost 33.3 million people. It holds the exclusive license for Blue Cross and/or Blue Shield plans in fourteen states, including California, Georgia, New York, and Ohio. The company provides managed care plans (PPOs, HMOs, POS plans, and others), managed care services to self-insured customers, pharmacy benefit management services, and dental, vision, and behavioral health plans. It also conducts insurance operations in all fifty states and Puerto Rico, providing group term, disability, workers comp, and long-term care insurance.

WellPoint benefits from unmatched regional scale, significant pricing power, and strong operating leverage. The regional concentration of its fourteen Blue Cross/Blue Shield plans gives it strong bargaining power when negotiating discounts with healthcare providers. The company has also shown the ability to pass through increasing medical costs in the form of higher premiums, thereby maintaining its profit margins in a highly competitive industry.

The uncertainties surrounding healthcare reform legislation weighed heavily on sector stocks in early 2010, due to the risks of limitations on premiums and/or mandated benefits. When signed into law, the Patient Protection and Affordable Care Act (PPACA) also contained positive provisions such as new insurance subsidies for uninsured individuals and an expansion of Medicaid coverage. On balance, we expect the effect on WellPoint's earnings of the current legislation to be modest.

WellPoint's financial health is solid. The company generates significant free cash flow of $2.5 billion annually and has a conservatively leveraged balance sheet at 27% debt/equity. Management has been using this free cash flow to benefit shareholders, spending $4.4 billion in 2010 to repurchase 17% of its outstanding shares and reinstating a $0.25 per share dividend.

We expect WellPoint's strong market position and numerous competitive advantages to continue to benefit shareholders in the post-reform marketplace.

Source for charts and text: Morningstar, Value Line, company reports, EIA estimates.

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 $500 million 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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