EDGEMOOR
INVESTMENT ADVISORS

Edgemoor's Quarterly Report

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Summer 2011

Better Than Advertised

Following its 5.9% surge in the first three months of 2011, the stock market took a breather in the second quarter, with the S&P 500 index returning 0.1%. Ask a typical investor or market-watching media pundit, and you will likely hear a tale of woe that seems inconsistent with the quarter's eventual flat performance. Emotional toll notwithstanding, the market held firm in the face of several adverse factors and ended June up 6% for the year to date.

Reasonable valuations and strong corporate earnings provided support to the market this spring, as companies again reported results that surpassed expectations and indicated a continuation of the economic recovery. Offsetting headwinds included more unrest in the Middle East, heightened concerns about the debt of Greece and other European nations, the intensifying debate over raising the U.S. debt ceiling, and, most disappointing, the lackluster labor market. Hiring reports for both May and June were weak, and real wages decreased in recent months, adding to consumers' woes.

In addition, several unusual events hindered the global economy, namely tornadoes and flooding in the United States and the lingering supply chain disruptions caused by the earthquakes and tsunami in Japan. As an example of the latter, Toyota's production in the United States fell from 111,000 units in February to 31,000 in May, but the company is now back to producing vehicles a rate of about 90,000 per month. The result of this mix of good and bad news was six straight weeks of stock market declines into mid-June before a strong rally in the last week of the quarter.

Second Half Outlook

After providing disappointing readings over the past few months, several key economic indicators released recently point to continued economic expansion, although at a relatively slow pace. The Conference Board Leading Economic Index® increased in May and forecasts economic growth through this summer and fall. According to the Institute for Supply Management, the manufacturing sector expanded in June for the 23rd straight month, and the service sector grew for the 19th consecutive month. Both also signal continued recovery over the coming months. Most analysts call for a 2.5%-3% increase in GDP in the second half, a rate which is slower than we would all like to see but will still keep the economy on the path of steady recovery, with at least some modest improvement in employment.

The recent pullback of commodities prices should help the economy regain strength. Just as the rising cost of oil, metals, grains, and fibers such as cotton was beginning to place strains on businesses and consumers, commodity prices started abating. In particular, some easing of tensions in the Middle East has reduced oil and gasoline prices as we enter the summer driving season, providing welcome relief to consumers. This reduction of inflationary pressures should enable the Federal Reserve to keep interest rates low in order to provide support for the recovery.

The near-term issue causing particular market angst is the debate over raising the U.S. debt ceiling, a challenge our government has tackled before but that appears to be particularly rancorous this time. Failure to reach agreement could cause the U.S. government to default on its debts, an outcome with potentially grave consequences for the markets. Negotiations will likely go down to the wire. Even with a successful outcome, there is some risk that the political maneuverings will spook the markets further and increase the United States' cost of borrowing.

We remain optimistic that the market will improve further, albeit with greater volatility, even in the face of these challenges. Most of the equities we own pay dividends and do not need government support to remain profitable and increase their earnings. Low interest rates make stocks attractive relative to other investments and also better long-term hedges against inflation. Finally, as we have noted before, 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.

Where to Invest

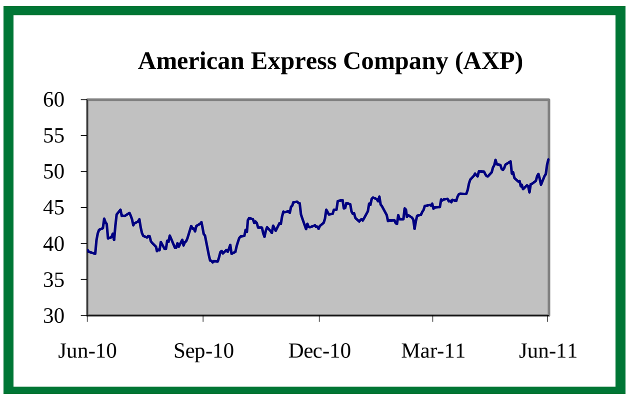
We continue to favor the stocks of large capitalization, multinational companies with strong balance sheets, cash flows, and dividends. These companies give us exposure to developed regions and also emerging markets, which we expect will lead the world in economic growth for the foreseeable future.

For income investments, we favor high yielding equities in the energy and utility sectors. In the energy sector, we find attractive midstream energy pipeline companies like Energy Transfer Partners (ETP), which yields 7.3%, and Canada-based Provident Energy (PVX), which yields 6.1%. In the utility sector, Spanish/Latin American telecom firm Telefonica, yielding 7.2%, and U.S. electric utility Exelon, yielding 4.9%, are two of our current favorites. We also continue to buy preferred stocks, including floating rate preferreds. At 3%, the yield on the 10-year Treasury is unattractive relative to these other opportunities for income. In addition, as interest rates increase, the value of Treasurys will decline.

Analysis of Selected Stocks

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

American Express Company (AXP)



Price (7/5/11)	$52.33	Forward P/E	13.6
Market Cap.	$62.9 B	Price / Sales	3.6
Dividend Yield	1.4%	Price / Book	2.2
Return on Equity	8.1%		

American Express is a leading global payments and travel company. Established in 1850, the company enjoys one of the most recognizable financial brands in the world. It operates in four main business segments: U.S. Card Services, International Card Services, Global Commercial Services, and Global Network & Merchant Services.

AmEx has evolved from a niche credit card player into a global payment giant, challenging market rivals Visa and Mastercard in recent years. Unlike Visa and Mastercard, AmEx can issue its own cards and does not rely on third party networks to process its transactions, which allows AmEx to control the full value chain of its card business.

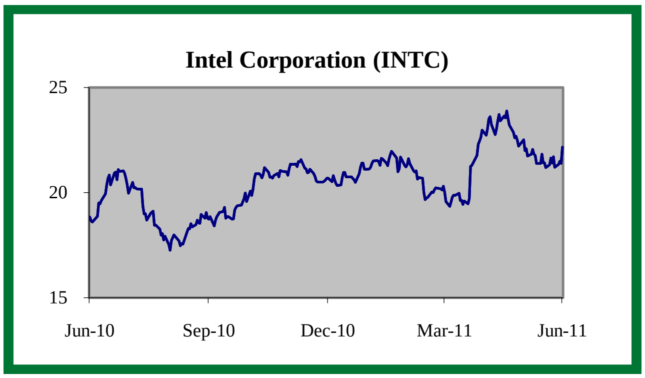
AmEx's earnings come mostly from fees as opposed to extending credit to cardholders, which helped to limit, though not eliminate, its loan loss exposure during the financial crisis. AmEx also has greater pricing power than its network rivals, because it services merchants and cardholders instead of large banks and financial institutions.

AmEx has started to open its closed-loop network in pursuit of growth opportunities. It has successfully reached agreements with most major U.S. banks to issue its card to their clients, thereby growing its client base with minimal new investment. Similarly, on the merchant side of its network, AmEx is working to boost the acceptance level of its cards and close the gap with Visa and Mastercard. These actions bode well for the company's growth prospects going forward.

AmEx has emerged from the financial crisis in a solid financial position. Revenues and earnings continue to grow at healthy rates, allowing the company to both reinvest in the business and return capital to shareholders. Its stated goal is to return 65% of free cash flow to shareholders through dividends and share repurchases, a promise it has lived up to for several years. Most notably, the company maintained its dividend throughout the financial crisis, something few financial institutions were able to do.

AmEx generates solid returns on equity (ROE) and trades for a reasonable forward P/E ratio of 13.6. We view this holding as an opportunity to own a high-quality, global financial leader with strong business fundamentals, a loyal and growing customer base, and exceptional brand name.

Intel Corporation (INTC)



Price (7/5/11)	$22.44	Forward P/E	9.9
Market Cap.	$119.0 B	Price / Sales	2.5
Dividend Yield	3.7%	Price / Book	2.8
Return on Equity	27.0%		

Intel is the largest chipmaker in the world. It designs and manufactures microprocessors and integrated circuits for the global personal computer market, as well as for industrial automation, communications, and military applications. Intel ships over 80% of the world's microprocessors and generates more than 85% of its sales in foreign markets.

Intel has long dominated the $30 billion computer processor market. Its low manufacturing costs, massive research and development budget, and aggressive new product introductions have allowed the company to maintain its market-leading position. The proliferation of smartphones and tablets poses both an opportunity and challenge to Intel. Whereas its processors for these mobile devices have not kept pace with those of competitor ARM, the need for substantial server build-outs to support cloud computing via these devices will benefit Intel's lucrative and growing Server Processor segment.

Intel is financially strong, with $7.7 billion of cash compared to $2.2 billion of debt. It generates significant free cash flow, which covers capital spending by nearly three times. The company is shareholder-friendly, with dividends increasing steadily over the past five years to the current yield of 3.7%. Intel's growth prospects are good, particularly in emerging markets and in non-PC categories like datacenters, servers, and mobile computing.

Intel is attractively priced at a forward P/E ratio of 9.9. We view this valuation as an opportunity to own a global technology giant with significant competitive advantages, a strong and durable balance sheet, and good long-term growth prospects.

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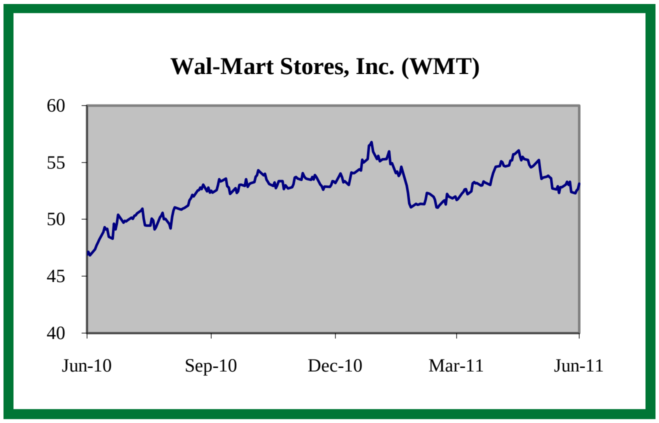
Wal-Mart Stores, Inc. (WMT)



Price (7/5/11)	$53.39	Forward P/E	11.9
Market Cap.	$185.4 B	Price / Sales	2.9
Dividend Yield	2.7%	Price / Book	0.5
Return on Equity	25.1%		

Wal-Mart is the largest retailer in the United States and is growing rapidly in international markets, as well. Wal-Mart currently operates 2,747 supercenters, 803 discount stores, 596 Sam's Clubs, and 158 Neighborhood Markets in the United States, plus 4,112 stores overseas, primarily in Latin America.

The company is known for providing a broad variety of consumer goods at everyday low prices. Wal-Mart pioneered the retail model of squeezing costs and efficiencies out of operations and passing these savings on to customers. This strategy has ensured a steady, recurring stream of customers, particularly throughout the economic downturn when many consumers have sought to reduce their spending.

Wal-Mart's business has continued to evolve. Groceries now account for over 50% of U.S. sales and are growing. International sales have seen the largest boost and are expected to post nearly 10% average annual growth versus 2%-3% in the maturing U.S. business. China is a particular focal point, where a ballooning middle class and the transition to a more consumer-driven economy are proving beneficial to the company. Wal-Mart's recent acquisition of South Africa-based MassMart has given it an important foothold in the rapidly developing South African economy. This deal reflects the company's international strategy to buy rather than build local retail chains and then implement its best operating practices.

Wal-Mart's financial metrics are strong, with an attractive return on equity (25.1%) and dividend yield (2.7%). The company generates significant free cash flow at 2x its annual capital expenditures, and management recently boosted the share buyback program to $15 billion.

We believe Wal-Mart is well positioned to prosper in the current economic environment, as rising food and fuel prices continue to drive customers to low-cost retailers. As such, we consider this holding a good defensive hedge against global inflationary pressures.

Source for charts and text: Morningstar, Value Line, S&P, 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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