Edgemoor's Quarterly Report

Suite 315
7250 Woodmont Avenue
Bethesda, MD 20814
301-543-8881
www.edgemoorinv.com
www.edgemoorblog.com

Summer 2015

Greece Is the Word - Or Is It?

All eyes have been on the twists and turns of the 2015 Greek drama. As we write, the world awaits the final outcome of the Greeks' negotiations with the European Union for more assistance in exchange for further austerity. Meanwhile, the Chinese stock market has rapidly plunged 25% from its recent highs, raising serious concerns about China's markets and economy and the impact on the rest of us. The U.S. Federal Reserve Board also continues its deliberations regarding the timing of long anticipated interest rate hikes.

It is hard to know which of these major factors, among the many threats to economic prosperity and rising markets, is most important. We take the position that we should keep an eye on Europe but remember that Greece is not the final word. Let us also not forget that there are positive trends afoot that leave us still thinking that the U.S. stock market will show positive gains for the year.

Second Quarter in Brief

Global stock markets paused in the second quarter, ticking up slightly to leave the S&P 500 index with a total return (including dividends) of 1.2% for the first half of 2015. Uncertainty about the U.S. and global economies and Fed action along with meager corporate profits combined to keep a lid on stock prices. First quarter earnings inched up less than 1% but beat the forecast of a nearly 5% decline; however, this modest increase in earnings was still not enough to propel stocks much higher. Bonds and other income generating investments fell as investors parsed the Fed's interest rate signals.

Conditions around the World

As we have mentioned in recent reports, our portfolios have direct and indirect exposure to global markets and economies. Our direct exposure comes through ownership of securities of companies headquartered in foreign countries, while we get our indirect exposure through ownership of multinational companies headquartered in the United States but generating significant profits abroad. We believe this foreign exposure to be an important element of a properly diversified portfolio, and following are our current thoughts regarding global markets.

<u>United States</u>

The U.S. economy continues to expand at a slow pace and is on track for GDP growth of about 2% for the full year. Consumer spending has been the primary factor helping GDP and has boosted sectors such as autos and housing. Reduced energy prices and the ability of consumers to borrow at rock bottom interest rates have supported increased spending. We anticipate energy prices and interest rates will remain low, even if the Fed begins to gradually raise the federal funds rate. Businesses have been more reluctant than consumers to spend, as the strong dollar has hurt exports and hindered economic growth.

Following the rise of price/earnings multiples over the past few years to levels that are in line with historical averages, the U.S. stock market is dependent upon corporate earnings to support higher prices. As in the first quarter, second quarter earnings are expected to be on the weaker side and may decline slightly compared to last year. Primary culprits are continued dollar strength and low energy company profits. Even so, we anticipate better earnings later this year as the U.S. and foreign economies gain momentum.

Forecasts for the timing of Fed interest rate increases keep slipping, and current indicators point to the most likely scenario being a first Fed move either late this year or in 2016. The market has been anticipating rate increases for a long time, one of the reasons stock market gains have remained low. We still expect the Fed to raise rates gradually as businesses hire more workers and the unemployment rate falls. We believe a gradual rise in rates due to improved economic conditions will be a good sign for the stock market, which has performed well in past times of incremental rate hikes. We also believe the timing of the Fed's initial increase will not negatively impact our investments.

Europe

It currently appears that Greece will most likely remain in the European Union and receive additional bailout funds to help its economy recover. However the Greek situation resolves, we expect continued volatility in Europe over the coming months but limited long-term impact on the European economy or markets.

Fortunately, conditions are much better in Europe now than during the first flare up of the Greece issues in 2010. The European economy is improving, banks are much healthier, and we do not foresee Greece's problems spreading to other members of the EU. Based on our optimistic outlook for Europe over the coming years, we increased our exposure to the region earlier this year seeking to take advantage of opportunities amidst the turmoil.

China

Perhaps more troubling than the Greek situation are the signs in China of economic weakness and the dramatic drop in the Chinese stock market. Having more than doubled over the past year due to government policies that encouraged investing, stocks in China reached unreasonably high valuations and may fall more than their recent plunge. The Chinese government and regulators have intervened somewhat clumsily in an attempt to stem the decline.

Even if the government succeeds in stabilizing the stock market, the lower expected growth rate of the Chinese economy poses a long-term challenge. As the world's second largest economy, China is a major export market for resource rich countries such as Brazil and Australia, as well as for manufacturers of automobiles, machinery, and other goods that have been involved in the Chinese infrastructure boom. As China's economy matures and growth slows to levels below the current 7%, other nations' economies are at risk.

Investment Outlook

Now that we have reviewed our biggest concerns, it is important that we also share the reasons for our optimism and belief that we should continue to invest in current market conditions. First, the global economy and financial system have improved over the past several years, and we do not believe that today's issues have the potential to harm markets in a manner similar to what we saw during the financial crisis of 2008. Banks have much more capital, governments have better tools at their disposal, and there are fewer signs of bubbles around the world.

Second, we believe valuations remain reasonable, partly because the issues we currently face have been known to investors for a while and have already been factored into stock prices. Stocks are trading at approximately fair value, although low interest rates and high profit margins could support higher valuations. Increased corporate earnings have supported gains over the past several years and continue to support current prices.

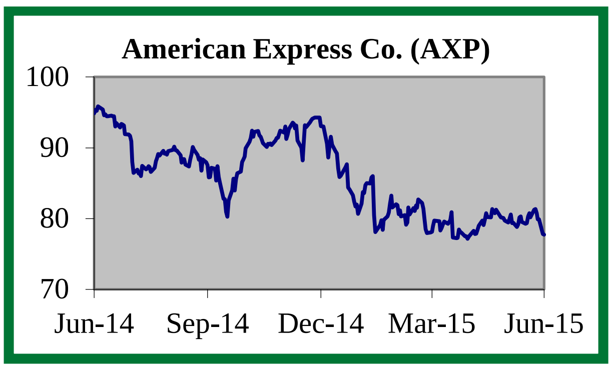
Third, and what we view as most important, our portfolios contain positions that we have carefully selected based on our analysis of their future prospects and low valuations in relation to earnings. Accordingly, the average forward price/earnings multiple for the securities we are buying is lower than that of the S&P 500 index. We have also adjusted our portfolios as prospects have changed, as when early this year we reduced our energy exposure due to concerns about the impact of lower oil prices on companies in the sector.

We will continue to adjust, as necessary and as conditions change. For example, we expect to resume buying bonds at some point when interest rates rise to attractive levels, though we still favor master limited partnerships, utilities, preferred stocks, and other high dividend equity investments over bonds in the current environment of extremely low interest rates. We are optimistic about the prospects for our portfolios and know that holding these positions through the good times and the bad, rather than pursuing a strategy of attempted market timing, is in our view the best way to provide solid returns for our clients over the long haul.

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.

American Express Co. (AXP)



Past performance is not indicative of future results. Please see disclosures on page 7.

Price (6/30/2015)	$ 77.72	Forward P/E	13.5
Market Cap ($B)	$ 78.8	Price/Book	3.6
Dividend Yield	1.4%	Price/Sales	2.4
Return on Equity	28.6%		

Established in 1850, global payments and travel services company American Express has one of the most recognizable financial brands in the world. The company operates in four main business segments: U.S. Card Services, International Card Services, Global Commercial Services, and Global Network and Merchant Services.

American Express has evolved from a niche credit card issuer into a global payment company, with a proprietary "closed-loop" network that both issues cards to consumers and acquires and processes transactions from merchants. As a result, the company controls all aspects of its card business and has a wide economic moat, the type of durable competitive advantage that we seek in our investments.

American Express's strategy is based on several core elements: a focus on acquiring and retaining high-quality, high-spending consumers; the use of strong incentives and rewards programs to increase cardholder spending; the development of co-branding relationships with corporate partners; a multi-card offering that promotes the use of several American Express card products by its customers; and the maintenance of the highest quality customer service. These strategies have solidified American Express's premium brand while generating robust profits for the company.

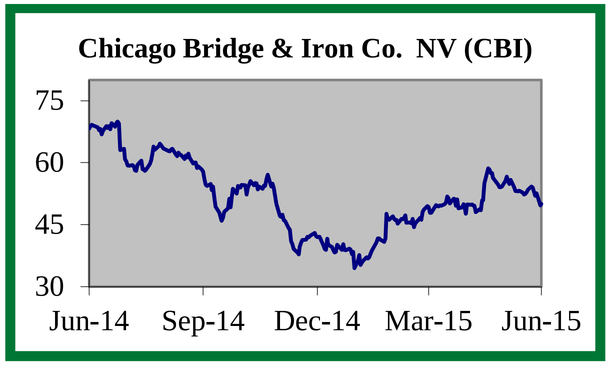
The majority of American Express's earnings come from merchant fees rather than from extending credit to its cardholders, an approach that limited the company's loan loss exposure during the financial crisis and remains a major factor in the company's strong portfolio credit quality today. American Express also enjoys greater pricing power than its network rivals, because it services individual cardholders and merchants, rather than large banks and financial institutions.

Recent challenges have included the negative effects of the strong U.S. dollar on the company's global revenues and the company's decision to terminate a co-branding relationship with Costco in 2016, due to adverse renewal terms. Management appears to be steering the company well through these challenges, reporting an 11%

rise in earnings per share and 29% return on equity in the last quarter. While the Costco loss will impact earnings in the near term, management expects to retain over half of the Costco volume through replacement programs, thanks to the brand loyalty and high customer satisfaction of its users.

We believe American Express is financially sound and its shareholder focus friendly. Management's capital allocation target is to return 50% of earnings to shareholders and retain 50% to fund growth initiatives. The company has steadily increased its quarterly dividend over the last few years, after being one of the few financial institutions to maintain its dividend throughout the financial crisis. American Express stock trades at an attractive forward price-to-earnings ratio of 13.5 times, compared to its historical average of 16 times and the broad S&P 500 index average of over 17 times.

Chicago Bridge & Iron Co. NV (CBI)



Past performance is not indicative of future results. Please see disclosures on page 7.

Price (6/30/2015)	$ 50.04	Forward P/E	7.5
Market Cap ($B)	$ 4.9	Price/Book	1.8
Dividend Yield	0.6%	Price/Sales	0.4
Return on Equity	22.2%		

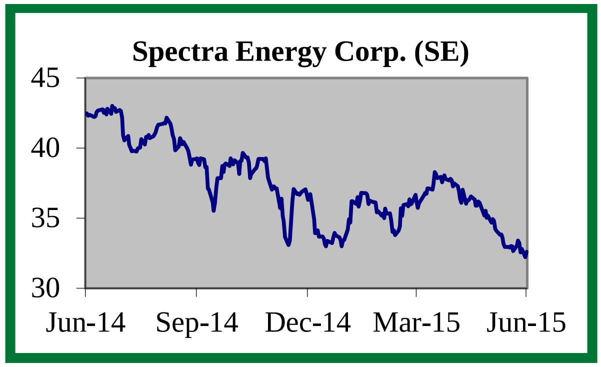
Chicago Bridge & Iron (CBI) is a global engineering, procurement, and construction company specializing in turnkey projects for the energy infrastructure and other natural resource markets. Based in The Netherlands, the company derives approximately half of its revenues from projects within the United States.

CBI's global portfolio of projects includes natural gas processing plants in Asia, nuclear plants in the United States, refining facilities in South America, and chemical plants in Africa. Most of these are large, long-term projects, and CBI's involvement in every aspect, from design and engineering through construction and maintenance, gives the company strong visibility on future earnings.

We believe CBI has navigated the uncertainties of the energy markets well, focusing on high-growth markets like liquefied natural gas (LNG) exports and pursuing selective acquisitions. The company recently announced a major new project win of a multi-billion dollar joint venture for an LNG facility in East Africa. In addition, management has realized cost savings of $50 million over the last two years from realigning business segments.

We also believe CBI's financial position is strong. The company saw 17% revenue growth in 2014 and projects 10% growth in 2015. Profit margins have been stable, in our view due to effective project execution and cost controls that have offset the negative impact of a strong U.S. dollar. The stock has experienced downward pressure recently due to the continued volatility in energy markets as well as delays at a nuclear project CBI is building for Southern Company. Despite near-term challenges, we believe CBI's underlying business fundamentals are strong and that the stock, currently trading at an attractive valuation of 7.5 times forward earnings, can provide solid returns for investors over the long term.

Spectra Energy Corp. (SE)



Past performance is not indicative of future results. Please see disclosures on page 7.

Price (6/30/2015)	$ 32.60	Forward P/E	22.7
Market Cap ($B)	$ 21.3	Price/Book	2.8
Dividend Yield	4.6%	Price/Sales	3.8
Return on Equity	11.5%		

Spectra Energy, a 2007 spin-off from Duke Energy, is one of the largest pure-play natural gas pipeline companies in North America. Based in Houston, Texas, the company operates over 22,000 miles of transmission pipelines and controls nearly 12% of U.S. natural gas storage capacity. Spectra's valuable infrastructure includes gathering, processing, transportation, storage, and distribution assets that provide critical links for natural gas supplies to reach high-volume end markets throughout the United States and Canada.

Unlike most energy-related businesses, Spectra's revenues are 88% fee-based, making only 12% of its revenues directly vulnerable to commodity price swings. With nearly half of its earnings tied to long-term contracts for its transmission and storage capacity, the company has highly stable and visible earnings. Spectra's stock has sold off this year like the shares of many other pipeline companies with far more commodity exposure, a situation that we believe has presented a buying opportunity.

Spectra continues to pursue its core strategy to own and operate natural gas assets with local monopolies, which we believe can maximize switching costs for its customers and allow the company to consistently earn attractive returns on its invested capital. Spectra has booked $7.5 billion of approved projects that should come into service between now and 2019 and has identified another $20 billion of additional projects. Management recently raised the dividend by 10%, even amidst declining energy prices, highlighting its commitment to dividend growth and its confidence in the future cash flows of the company. Overall, we like Spectra Energy for what we believe to be its wide economic moat, well-positioned asset footprint, fee-based revenue model, attractive and growing dividend currently yielding 4.6%, and good long-term growth prospects.

Source for charts and text: Morningstar, S&P, Schwab, Value Line, and Argus research 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 $815 million as of June 30, 2015 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.

Thomas P. Meehan – President
(301) 543-8881
tmeehan@edgemoorinv.com

Timothy C. Coughlin, CFP® – Managing Director
(301) 543-8371
tcoughlin@edgemoorinv.com

R. Jordan Smyth, Jr., CFA – Managing Director
(301) 543-8370
jsmyth@edgemoorinv.com

Paul P. Meehan, CFA – Managing Director
(301) 543-8373
pmeehan@edgemoorinv.com

Gay S. Truscott, CFP® – Senior Vice President
(301) 543-8375
gtruscott@edgemoorinv.com

Christine J. Potts – Vice President
(301) 543-8365
cpotts@edgemoorinv.com

Sara R. Parker – Vice President
(301) 543-8363
sparker@edgemoorinv.com

Anne Baker – Executive Assistant
(301) 543-8366
abaker@edgemoorinv.com

Suite 315
7250 Woodmont Avenue
Bethesda, MD 20814
(301) 543-8358 fax

www.edgemoorinv.com
www.edgemoorblog.com