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Edgemoor's Quarterly Report

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Markets Rebound Strongly in Q2 2026

Equity markets rebounded strongly in the second quarter ended June 30, 2026, after their sharp sell-off in March tied to the start of the U.S. - Iran War.

Markets pushed higher in Q2 despite a series of daunting world events – including the escalation of tensions with Iran and throughout the Middle East, an historic oil shock tied to the closing of the Strait of Hormuz, as well as concerns about higher-for-longer inflation and interest rates, and lingering questions around a potential AI bubble. Markets were led higher by a surge in semiconductor stocks as well as strong gains in industrial, financial, and healthcare shares.

In this newsletter, we will analyze how this has happened and look at the challenges and opportunities ahead, which could determine whether this upward momentum continues.

Q2 2026 Performance Review

The S&P 500 Index, the broadest measure of the U.S. equity market, posted a total return of 15.2% in Q2, its best second quarter performance since 2020. It also reversed the negative total return in Q1, which was driven by the sharp sell-off in March. For the year-to-date period ending June 30th, the S&P 500 index returned 10.2%.

The tech-heavy NASDAQ delivered even stronger returns, gaining 20% in Q2 and 12.8% year-to-date. Bonds were essentially flat, with the Bloomberg Aggregate Bond Index returning just 0.7% in Q2 and 0.6% for the year.

Within the S&P 500 Index, 9 of the 11 industry sectors generated positive returns in the second quarter, while only two posted negative returns. Technology stocks reclaimed the top position in terms of quarterly outperformance, returning 31.8% in Q2, driven largely by surges in semiconductor chip makers and other beneficiaries of AI-related spending. However, other sectors like industrials, financials, and healthcare also posted strong returns, as overall the market continued to broaden beyond the Magnificent 7 technology behemoths.

What's Driving This Market?

Many investors have been asking the question, "How does the stock market keep hitting new highs when the world seems to be filled with so much turmoil?" To answer that question, we need to look at corporate earnings.

We have often said that corporate earnings are arguably the largest factor driving the long-term performance of the stock market. We are seeing that play out in real time today. While day-to-day headlines may move markets in the short term, it is the broad fundamentals of the U.S. economy, most notably corporate earnings, that drive markets higher over the long term.

Right now, corporate earnings are on a tear. They have been growing at double-digit rates for the last three years and are showing no signs of slowing down. The growth is partially explained by the many companies benefiting from massive AI spending, but it's not actually all tied to AI. Other sectors including energy, communications services, and materials have also seen significant earnings growth so far in 2026.

For the full year 2026, the S&P 500 Index is expected to report year-over-year earnings growth for its underlying companies of 24.1%, after growing 13% year-over-year in 2025. This year's estimated growth rate has accelerated meaningfully since the beginning of the year, when it stood at 18%. For 2027, current estimates are for earnings to grow 17% year-over-year.

We believe that strong corporate fundamentals, which include earnings growth, revenue expansion, and balance sheet strength, provide the underpinnings for positive, sustainable market returns over the long term.

A.I. Still a Driving Force

Artificial Intelligence and its massive capital expenditures continue to be a defining force in the global economic landscape. A multi-year capex cycle is underway across data centers, power generation, and chip manufacturing, with more than $5 trillion projected to be spent through 2030. The AI boom is so massive that some economists have predicted that, even if all other sectors of the economy experienced zero growth, overall global GDP would still be positive.

Adoption of AI across the broader economy is also accelerating, laying the foundation for future productivity and profitability gains. Already, U.S. labor productivity is trending nearly 2x higher than it has over the last 15 years, even as AI has only started to penetrate many areas of the economy. This suggests to many that we are in the early stages of a long-term, AI-driven productivity and growth cycle.

Other Positive Economic Factors

Elsewhere in the economy, U.S GDP growth remains positive, consumer spending has shown remarkable resilience, and the labor market is slow but stable.

U.S GDP grew at a solid annual rate of 2.1% in the first quarter of 2026 and is projected to grow 2.3% for the full year 2026. Consumer spending, which makes up nearly 70% of U.S. GDP, has held up in the aggregate this year, despite the headwinds of inflation. However, it remains bifurcated across income groups, with high income earners continuing to spend on discretionary items like travel and entertainment, while low-income earners struggle to afford everyday necessities like gas, food, and shelter.

Finally, while labor markets are weaker than they were in the post-Covid era, they have generally stabilized in a lower-growth mode. Many economists have labeled it a “low hire, low fire” labor market, with an unemployment rate that has stayed relatively steady at around 4.2%, in line with historical averages.

Overall, these positive factors suggest slow but steady economic growth, with little near-term risk of recession in the U.S. economy.

Economic Headwinds

Of course, the U.S. and global economies do face several economic headwinds which could delay or derail near-term growth. The most concerning issue is inflation, which has evolved meaningfully since the start of the year and is impacting almost every sector of the economy.

The conflict in Iran and shipping disruptions in the Strait of Hormuz have driven up energy, fertilizer, and shipping costs. The impacts have spread quickly to businesses, consumers, and global commodity markets. Meanwhile, all this is happening just as the impact of last year's tariffs and supply-chain disruptions have started to ease.

Higher inflation has also meant higher interest rates. At the beginning of 2026, investors expected the Federal Reserve to cut interest rates during the year. But that expectation changed with the inflation pressures brought on by the Mideast war, and the markets are now pricing in a higher-for-longer interest rate environment. In fact, traders are now assigning a high probability to Fed rate hikes in September and December. Higher sustained interest rates tend to undermine economic growth.

What We are Watching for Next

We will be watching closely for additional signs from the new Federal Reserve Chair Kevin Warsh about his views on inflation and interest rates. So far, he has taken a somewhat neutral stance, as evidenced in the minutes of his first FOMC meeting in June. We will see if he becomes more hawkish in the months ahead in the event inflation persists.

We are also closely monitoring the continuing AI boom, and whether the seemingly endless demand for new data centers, power sources, and chip manufacturing will continue to drive growth across the economy. We will also be looking to identify who will emerge as the ultimate winners (and losers) in this race. However, given the still early stage of this AI super cycle, it may be quite some time before we know the answers to those questions.

Finally, we will be watching the lead up to the November midterm elections, which could cause some short-term volatility in the markets. Looking back at midterm elections since 1950, the S&P 500 has seen an average drawdown of 12.7% between June and October. But history also shows that post-election returns can be very strong, which is why we will be sticking to our long-term investment philosophy and not acting on short-term political events.

Outlook

Although we expect volatility to continue until there is more clarity around the war in the Middle East, the direction of inflation and interest rates, and the outcome of the midterm elections, we remain optimistic about the longer-term prospects for the U.S. economy and the stock market.

The overall valuation of the S&P 500 Index is currently 20.4 times forward earnings, roughly in line with its 5-year average of 19.9 times and its 10-year average of 19.0 times. Going a step further and looking within the index, we find that not all sectors or companies are fully valued, so we remain actively focused on finding opportunities to buy great companies at prices below our estimate of their intrinsic value.

We expect that markets will continue to reward companies with strong competitive advantages, good growth prospects, healthy balance sheets, and shareholder-friendly management teams – exactly the kinds of companies we like - both within the technology sector and among the broader sectors of the economy.

Portfolio Implications and Actions

Our disciplined, patient approach to individual security selection paid off in the second quarter, as we added three new securities to our equity buy list – Boeing (BA), Eli Lilly (LLY), and DXJ (Japan Hedged Equity Fund). We believe each of these holdings represents a unique opportunity to add non-tech/non-AI-related exposure to client portfolios and enhance the diversification and defensive elements of portfolios to reduce their overall risk profiles.

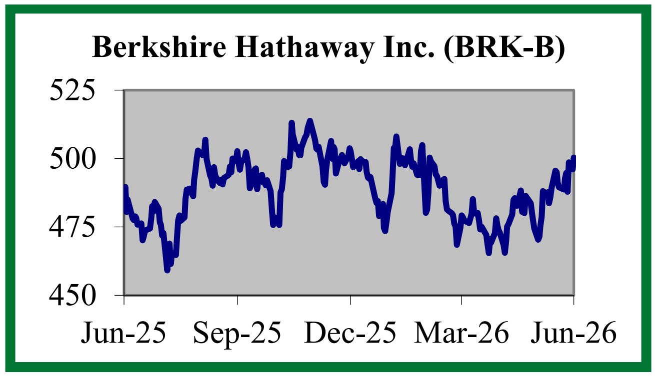
In addition to individual equities, we continue to favor high quality bonds and dividend-paying securities that generate current income for clients with balanced portfolios. With current yields of 4% – 6%, these securities offer an income cushion that offsets the potential volatility of the equity holdings. We also find 6-to-12 month Treasury bills with annualized yields of 3.8% - 4.0% attractive.

Overall, our long-term, time-tested investment philosophy continues to favor high-quality companies with strong revenue and cash flow characteristics, leading market shares, wide economic moats, and solid growth prospects. We believe our active approach to individual security selection leads to broadly diversified portfolios across industries, market capitalizations, and geographies, allowing our client portfolios to weather market turmoil and be well-positioned for long-term growth and appreciation.

Analysis of Selected Securities

The following are reviews of three selected securities we are currently buying for client accounts.

Berkshire Hathaway Inc. (BRK.B)



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

Price (06/30/2026)	$500.39	Forward P/E	23.7
Market Cap ($T)	$ 1.08	Price/Book	1.5
Dividend Yield	0%	Price/Sales	2.9
Return on Equity	11.5%		

Berkshire Hathaway, one of Edgemoor's largest and longest-held positions, is a holding company with subsidiaries in a wide variety of industries, including primary insurance, reinsurance, freight rail transportation, utilities, energy generation and transmission, and numerous other businesses engaged in a variety of manufacturing, services and retailing activities. In addition to its operating businesses, Berkshire manages a $288 billion portfolio of publicly traded equity securities and holds a record $381 billion of cash, as of March 31, 2026.

After managing the company for 60 years, famed investor Warren Buffett officially retired as CEO of Berkshire Hathaway on January 1, 2026. The transition to new CEO Greg Abel, who was previously vice-chairman of all non-insurance operations, has been well-telegraphed and largely seamless. Berkshire continues to operate on a decentralized basis with the managers of each operating subsidiary empowered to make their own business decisions, while Abel has assumed Buffett's responsibility over new investments and the allocation of capital. In addition, Abel has made it clear that he will uphold the same tenets and culture that have made the company so successful over the past six decades.

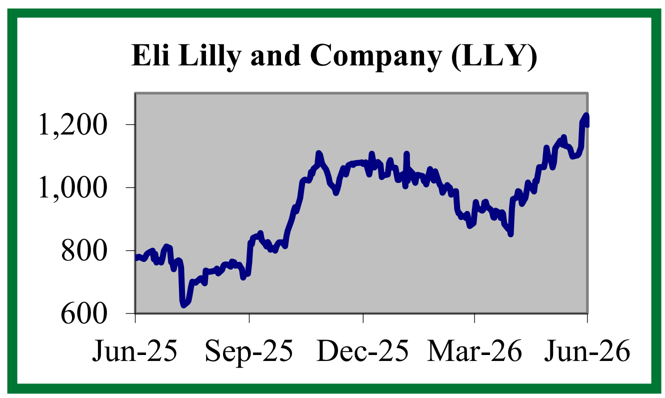
The engine of much of Berkshire's success has been the insurance business segment, which includes GEICO and General Re. The insurance business generates significant cash from premiums, called "float", which the insurer receives in advance of any payouts. This low-cost capital has always been one of the most compelling advantages of Berkshire's business model. When combined with the operating cash flow of Berkshire's other businesses, this float totaled $177 billion as of 3/31/2026. The company's significant liquidity position provides a massive trove of capital to invest in opportunistic deals, especially during market dislocations.

Berkshire's elevated cash position along with its free cash flow could also allow for more aggressive share repurchases. After six full quarters with no share repurchases, the company repurchased $235 million worth of stock in the first quarter of 2026. Meanwhile, Berkshire maintains a pristine balance sheet and carries AA and Aa2 ratings from S&P and Moody's, respectively.

While Berkshire shares consistently outperformed the S&P 500 index during Buffet's tenure, the stock has underperformed over the past year. We believe that Berkshire's collection of strong and diversified businesses acquired over the years by Warren Buffett remain among the best in their respective industries and enjoy good growth prospects ahead.

Therefore, we consider Berkshire Hathaway to be a high-quality investment that will continue to reward shareholders over the long term.

Eli Lilly and Company (LLY)



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

Price (06/30/2026)	$1,199.43	Forward P/E	29.6
Market Cap ($T)	$ 1.1	Price/Book	36.3
Dividend Yield	0.6%	Price/Sales	14.9
Return on Equity	75.0%		

Headquartered in Indianapolis, IN, Eli Lilly is the largest pharmaceutical company in the world by market capitalization. The firm engages in the discovery, development, manufacture, and sale of pharmaceutical products in the areas of diabetes, oncology, immunology, neuroscience, and others. Eli Lilly operates proprietary R&D facilities and manufacturing plants in seven countries, while it also conducts clinical research in more than 55 countries and sells and markets its products in 125 countries worldwide.

Eli Lilly has experienced exponential growth in recent years tied to the success of its diabetes drug Mounjaro, and its obesity and weight-loss drug Zepbound, both of which have grown to become multi-billion-dollar products. But, throughout its history, Lilly has produced over a dozen blockbuster drugs (generating more than $1 billion in annual sales.), making Mounjaro and Zepbound just their latest global successes.

Eli Lilly also possesses a wide array of other drugs in both its current portfolio and future pipeline, with its primary drugs enjoying patent protection for many years to come. The company's wide economic moat is rooted in these patents, as well as in its size, scale, and powerful distribution network. Additionally, Lilly's business is non-cyclical and non-discretionary, which enhances its pricing power and ultimately the firm's economic moat.

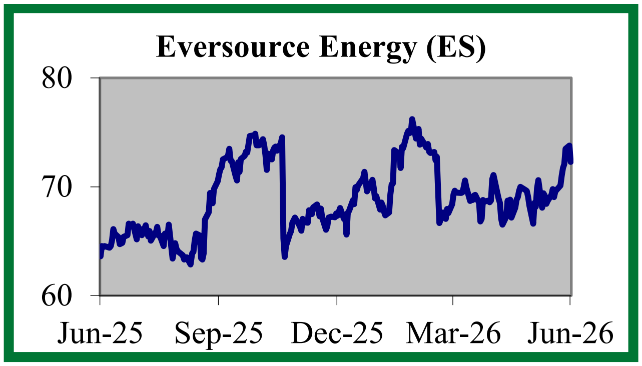
Looking ahead, Eli Lilly will benefit from the continued expansion of the global addressable market for many of its primary drugs. For example, the shift from injections to oral medications for its diabetes and weight-loss drugs is a huge growth catalyst, as it eliminates a major point of friction for users and unlocks an entirely new population of patients. In addition, the aging population is another tailwind, as Eli Lilly is at the forefront of Alzheimer's treatments as well as addressing the growing need for cancer therapies.

The firm continues to execute on a targeted acquisition strategy, while also building out the largest domestic manufacturing expansion in its history, with more than $50 billion committed to expanding U.S. manufacturing. Also, Lilly and NVIDIA have entered into a multi-billion-dollar strategic collaboration aimed at integrating advanced AI, accelerated computing, and robotics directly into pharmaceutical research and supply chain infrastructure. All these initiatives provide the company with a long runway for continued growth.

Shares of the company are currently trading at 29.5 times their next-twelve-months earnings estimate, meaningfully below their five-year average multiple of 37 times, offering investors a comfortable margin of safety. The company's stock is also significantly less volatile than the market, with a beta of just 0.59.

Given the company's discounted equity valuation, industry-leading market position, and huge growth trajectory, we believe shares of LLY are an attractive core holding for investors.

Eversource Energy (ES)



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

Price (06/30/2026)	$72.27	Forward P/E	15.1
Market Cap ($B)	$ 27.1	Price/Book	1.6
Dividend Yield	4.3%	Price/Sales	2.0
Return on Equity	6.3%		

Eversource Energy, a regulated utility founded in 1966, is a high dividend-paying security we buy for the income portions of client portfolios. The company has increased its dividend for 26 consecutive years, making it a dividend aristocrat.

Headquartered in Springfield, MA, Eversource is a diversified holding company that provides rate-regulated electric, gas, and water distribution services to over 4 million customers throughout the Northeast. The company exited most of its unregulated businesses in 2006 and since then, management has scaled the business through strategic acquisitions and partnerships. The company's 2024 divestiture of its offshore wind assets further streamlined the business, allowing it to focus on its core competencies.

The steep rise in U.S. energy demand driven by AI-fueled power needs has presented a generational growth opportunity for U.S. utilities. Eversource should benefit from the massive investment cycle needed to build electric and gas infrastructure to support New England's clean energy goals, data center power demand, and manufacturing growth. Eversource itself plans to invest over $25 billion in its electric and gas infrastructure over the next five years, providing a long runway for revenue growth via capacity expansion.

As a regulated utility, regulatory risk over caps on rate increases remains a potential headwind to the company's growth plans. This risk is somewhat mitigated by Massachusetts' constructive regulatory stance and its need for grid modernization. Also, nearly all of Eversource's revenue is decoupled from usage, reducing its reliance consumption-based price increases.

We believe that Eversource's service territory monopolies, efficient scale advantages, secular tailwinds, and strategic investments will allow the company to continue to realize returns well above its cost of capital. In addition, the company's consistent earnings growth and relatively low payout ratio of ~50% suggest that its current 4.3% dividend is safe and has room to grow. The 5-year annualized growth rate for the dividend has been 5.8%.

We view Eversource as an attractive income investment with a generous dividend that should continue to grow, while also offering the potential for modest price appreciation to enhance the total return for investors.

Sources: FactSet, Morningstar, S&P/CFRA, Schwab, ValueLine, Black Diamond Performance Reporting, Yahoo Finance, Bank of America, JP Morgan Markets, MarketWatch, WSJ and Argus reports.

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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 NASDAQ measures all NASDAQ domestic and international based common type stocks listed on The NASDAQ Stock Market. The NASDAQ Composite includes over 3,000 companies.

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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