EDGEMOOR
INVESTMENT ADVISORS

Edgemoor's Quarterly Report

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October 2019

Plenty of News

In late September, a flurry of surprising events grabbed headlines and kept market watchers on their toes across the nation and around the world. From the strike on a key Saudi oil facility to the House's initiation of impeachment proceedings, the big news just kept coming. Fortunately, investors remained relatively calm, and the U.S. stock market largely held its gains.

The onslaught of attention-grabbing news continued into the fourth quarter, but investors appear to be focusing not on politics but instead on economic issues, such as the ongoing trade war between the United States and China, that more directly impact the market. Most economic and market fundamentals are strong enough to support stocks at current prices or higher, but resolution of issues with China and ongoing support from the U.S. Federal Reserve and other central banks will be critical.

Third Quarter Review

The S&P 500 index returned 1.7% in the third quarter, as generally positive if unspectacular economic data and reasonable valuations enabled stocks to hold onto the strong gains from the first half of the year. Bonds initially rose as investors sought safety amid concerns about economic growth and trade policy, but prices fell and yields rose later in the quarter as investors became more optimistic regarding expectations for the economy and stocks.

Economic growth continued, though at a slower rate than at the beginning of the year. We learned during the quarter that U.S. gross domestic product (GDP) increased by 2.0% in the second quarter, lower than the 3.1% rise in the first quarter. Employers continued to hire at a steady pace in September, annual wage increases held steady at around 3%, and the jobless rate hit a 50-year low of 3.5%.

U.S. Unemployment Rate 1969 - 2019

Past performance is not indicative of future results.

Consumer spending continued to be the bright spot in economic results, but businesses remained cautious about making investments due to uncertainty regarding the trade war with China. Inflation remained lower than the Fed's target level, a reflection of some pessimism regarding future economic growth.

As expected, the Fed cut the federal funds rate by 0.25% at its July meeting and again in September, citing pressures from the trade war as the main reason for its mid-cycle adjustment. The Fed now appears to be clearly on a path to easing rates, after increasing rates steadily from December 2015 through 2018.

A whistleblower's claim that President Trump improperly used his authority to gain Ukraine's assistance in an investigation of Joe Biden and his son led to the initiation of impeachment proceedings in the House of Representatives in late September. The proceedings will likely prevent any progress on important legislative issues over the coming months and will continue to dominate headlines, but the stock and bond markets have so far remained fairly calm in the face of this blockbuster news.

Our Outlook

The fourth quarter started with the release of another batch of economic data, including relatively weak reports on the manufacturing and service sectors, offset by the solid September jobs report that followed. Investors concluded that the economy is showing some signs of weakness but that the Fed will offset them with further rate cuts, and stocks ended the first week down only slightly. We expect similarly mixed economic news and market reactions through year end.

The impeachment proceedings loom as we begin the fourth quarter of 2019. While we cannot predict the ultimate result, the process has the potential to impact the 2020 presidential election and the U.S. economy. What we do know is that the markets generally dislike uncertainty, and the possibility of impeachment is likely to make investors anxious.

However, we can take some comfort from the market's reaction to past impeachment proceedings, during which investors tended to maintain a greater focus on economic fundamentals and other issues, despite the distraction brought by impeachment. From the initiation of impeachment hearings in February 1974 to President Nixon's resignation six months later, the S&P 500 index fell 13%, but that drop reflected other ongoing economic concerns. During the efforts to impeach President Clinton, which ultimately resulted in acquittal in the Senate in 1999, the S&P 500 index rose 28%, continuing its long bull market run. Our expectation is that the current process will dominate the news and grind Congress to a halt on other issues but is not likely to cause a significant stock market decline on its own. At this time, the trade war with China appears to be much more important to the market than impeachment.

In the meantime, we expect investors to maintain their focus on the U.S. and global economies and to be vigilant for any signs of a slowdown. Corporate earnings, which are the primary support of stock prices, have declined so far this year but are likely to rise slightly for the full year and resume higher rates of growth in 2020. Consumer sentiment remains positive, and consumer spending, which represents about 70% of U.S. GDP, should continue to provide a boost to the economy. U.S. GDP growth should be close to 2% over the coming quarters, steady but slower than in recent years.

Due to the mixed economic data, we expect the Fed to continue to support the economy by cutting rates again in late October and possibly December. As always, Fed action will depend on the economic data, including the impact of trade issues.

Trade is perhaps the most important single issue that impacts our ability to avoid a recession in the United States and abroad. We remain hopeful for progress toward resolution on trade disputes, since we still believe the administration will want to do whatever it can, including accepting incremental reform and claiming victory, to boost the U.S. economy heading into the 2020 election. We do not expect a recession in the near term, and progress on the trade front would likely enable the U.S. economy to continue to expand at a modest pace. However, failure to resolve trade issues could lead to recession.

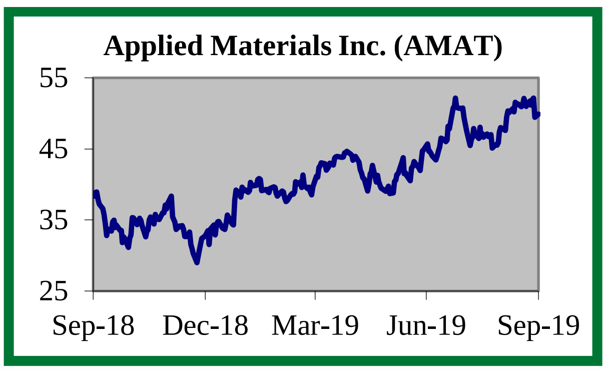
Overall, we are optimistic that stocks can deliver modest gains through the remainder of 2019, despite challenges abroad, such as the United Kingdom's potential exit from the European Union, and signs that the global economy is slowing. Stock valuations are reasonable (the S&P 500 index price/earnings multiple has stayed fairly steady at about 17 times projected earnings for the next year), interest rates and inflation are low, and earnings should resume growth in the current quarter. The strong U.S. employment picture and rising wages should continue to support consumer spending, which has been the linchpin of economic growth this year. In this environment, we are able to find stocks that meet our criteria for good, long-term investments, and we believe a well-diversified portfolio of high-quality, undervalued stocks provides the best opportunity to prosper through the inevitable cycles of economic expansion and contraction.

In addition to finding stocks that we believe to be undervalued, we continue to find attractive investments for the income portion of our portfolios, primarily among preferred stocks, pipeline companies, utilities, real estate investment trusts, and business development companies. Bonds took investors for a bit of a wild ride in the third quarter, with the yield on the 10-year Treasury hitting a record low, and we remain wary of the potential for yields to rise over the longer term and bond prices to fall. The bonds we currently favor have relatively short maturities, which would insulate them somewhat if rates do rise.

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 market today.

Applied Materials Inc. (AMAT)



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

Price (09/30/2019)	$ 49.90	Forward P/E	14.3
Market Cap ($B)	$ 46.4	Price/Book	5.7
Dividend Yield	1.7%	Price/Sales	3.2
Return on Equity	40.7%	Debt/Equity	0.7

Applied Materials provides manufacturing equipment, services, and software to the semiconductor, display, and related industries. Customers include manufacturers of semiconductor chips and wafers, liquid crystal and organic light-emitting diode displays, and other electronic devices. The company operates in three business segments: semiconductor systems (63% of sales), applied global services (22%), and display and adjacent markets (15%).

As the global leader in semiconductor fabrication tools and equipment, Applied Materials enjoys longstanding relationships with all major global chip manufacturers and has the broadest product portfolio in the industry, effectively offering one-stop shopping to its customers. The company has 40,000 field engineers stationed across nearly every chip-manufacturing facility around the globe, providing competitive insights into their customers' needs and processes. As semiconductor fabrication becomes increasingly complex, resulting in more process steps and requiring new manufacturing technologies, the company's existing relationships and insights into future technology needs should lead to steady new orders for state-of-the-art equipment.

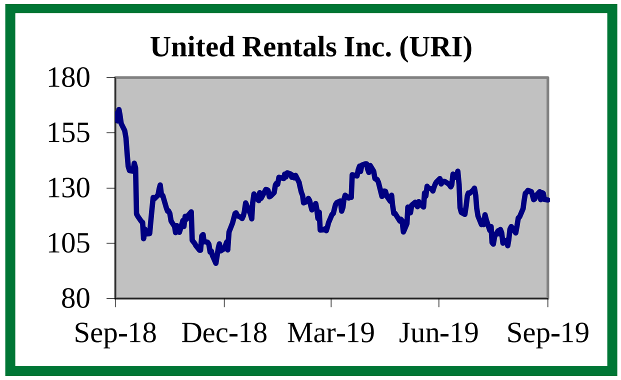
Applied Materials has been streamlining operations to reduce costs and stay competitive even during industry down-cycles. The chip industry is inherently cyclical, but the company's large scale, efficient operations, and huge installed base of customers and products allow it to weather business cycles better than its competitors and enjoy solid growth over the long term.

The areas of growth upon which Applied Materials is currently focused include artificial intelligence, big data, internet of things, robotics, and autonomous vehicles. These key technology advancements are projected to drive semiconductor demand for many years, which should in turn fuel growth for the company's products and services.

Management's growth strategy has also included strategic acquisitions, including the $2.2 billion purchase of Kokusai Electric Corp. announced in July. Kokusai is a provider of high-productivity batch processing systems for memory, foundry, and logic customers in Asia. The acquisition provides products and markets that complement the company's core business and will strengthen its supply-chain capabilities and customer support in the fast-growing Asia-Pacific region.

Applied Materials is financially strong and shareholder friendly. Cash and marketable securities totaled $3.5 billion at July 28, 2019, compared to total debt of just $5.3 billion. Gross profit margins topped 44%, and return on equity is over 40%. The company has been actively repurchasing shares, spending $1.9 billion so far this year, which should add $0.20 to annual earnings per share by 2020. In June 2019, management raised the quarterly dividend by 5% to $0.84 per share for a current dividend yield of 1.7%. At a forward price/earnings ratio of 14.3 times, we believe the shares are attractively valued given the company's strong market position and good growth prospects.

United Rentals Inc. (URI)



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

Price (09/30/2019)	$ 124.64	Forward P/E	6.2
Market Cap ($B)	$ 9.3	Price/Book	2.8
Dividend Yield	0.0%	Price/Sales	1.1
Return on Equity	32.8%		

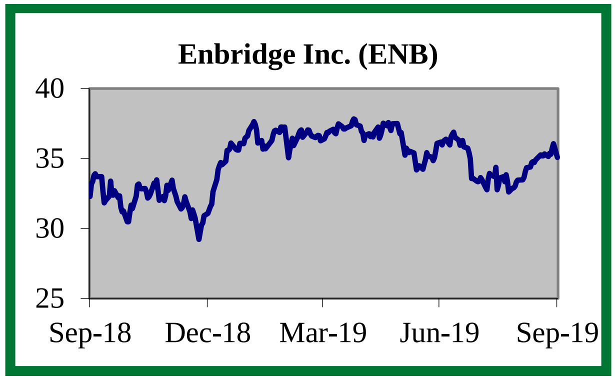
United Rentals is the largest rental equipment company in the world, with more than 1,180 rental locations across 49 states and 10 Canadian provinces. The company rents and sells a broad array of equipment, from heavy machinery to hand tools, to a diverse customer base that includes construction companies, contractors, industrial manufacturers, utilities, municipalities, and small businesses. United Rentals expects to generate total revenues of $9.4 billion in 2019, up from just $5.7 billion in 2014 due to a combination of organic growth and acquisitions.

The company's size and scale afford it numerous competitive advantages, including greater purchasing power, the ability to provide a broad range of equipment and services, and the flexibility to transfer equipment among locations to meet customer demand. United Rentals is also able to focus on larger, more profitable customers, who tend to rent for longer periods and are timelier in their payments.

United Rentals is benefiting from a long-term industry trend for companies to rent heavy equipment rather than buy it. The advantages of renting include the avoidance of large capital investments for equipment purchases; a reduction in storage, maintenance, and transportation costs; and the ability to access the latest technologies. We expect this trend to continue and to drive increased demand for the company's products and services. Recent initiatives aimed at streamlining field operations, reducing operating costs, and improving fleet utilization have resulted in accelerating profitability for the company even amidst modest global economic growth. Finally, the company's five-year earnings growth rate is projected to average 12% per year, due in part to recent acquisitions.

The company's stock is attractively priced at 6.2 times projected earnings, well below its 5-year average of 9.6 times projected earnings and its peer average of 14 times. Management is shareholder friendly, having initiated a new $1.3 billion share repurchase program in July 2018 that should be complete by year end 2019, representing more than 13% of the company's total market capitalization. Although United Rentals does not pay a dividend, its share buyback program and good growth prospects make the stock an attractive long-term investment.

Enbridge Inc. (ENB)



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

Price (09/30/2019)	$ 35.08	Forward P/E	17.0
Market Cap ($B)	$ 71.3	Price/Book	1.5
Dividend Yield	6.3%	Price/Sales	1.8
Return on Equity	8.0%	Debt/Equity	0.9

Enbridge is North America's largest energy distribution and transportation company, operating crude oil and natural gas pipelines throughout the United States and Canada, as well as Canada's largest regulated utility and natural gas distribution company. Enbridge's assets are considered among the highest quality in the North American energy transportation sector based on their location, density, cost-competitiveness, and reach.

The crown jewel of Enbridge's portfolio is the Canadian Mainline pipeline system. With shipping capacity of 2.9 million barrels of crude oil per day, the system represents approximately 70% of Canada's total pipeline capacity. The Mainline system transports primarily heavy crude oil from Canada's oil sands to refineries across North America, including Canada's east coast, the U.S. Midwest, and the U.S. Gulf Coast. The

Mainline system enjoys attractive, regulated tolls supported by long-term (20- to 25-year) contracts, which provide Enbridge with a steady, predictable source of cash flow.

While crude oil pipelines are Enbridge's primary business, the company also operates a diverse energy portfolio that includes natural gas pipelines and processing and transportation assets. In early 2017, Enbridge acquired Spectra Energy in a $28 billion all-stock deal to create North America's largest energy infrastructure company. Spectra was among the largest pure-play natural gas companies with over 90,000 miles of transmission pipelines, as well as storage and distribution facilities that provide a critical link for natural gas supplies to reach high-volume end markets throughout the United States and Canada. The deal further diversified Enbridge's operations toward natural gas and created another stream of reliable cash flow for the company.

Enbridge's financial position is solid. Revenues are projected to rise 6%-8% in 2019 as a result of increased system throughput and $3 billion of new capital projects that have come into service this year. Another $19 billion of projects are currently in process and should drive growth for the next 3-5 years. Also, the company has committed to increasing its dividend 10% per year through 2020 as part of its broad strategic plan, marking a continuation of Enbridge's twenty-year history of consistent dividend growth.

Enbridge's stock trades at an attractive 17 times projected earnings, which is well below its 5-year historical average of 20.5 times projected earnings. The shares currently yield 6.3%, and the generous and growing dividend is supported by the company's stable and reliable cash flows, lucrative expansion projects, and long-term contracts.

Source for text and charts: Bureau of Labor Statistics Current Population Survey, Morningstar, S&P, Schwab, ValueLine, Black Diamond Performance Reporting, Yahoo Finance, and Argus 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 over $1 billion as of September 30, 2019 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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