Edgemoor's Quarterly Report

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Market Gains Continued into Q3, but with Increased Volatility

Equity markets continued to post gains in the third quarter of 2024, but with higher volatility than in the first half of the year. The S&P 500 Index saw relatively few days with a 1% or more market change between January and June 2024, but in the July – September quarter, the rate of 1% daily price changes nearly doubled. Uncertainty surrounding the election, interest rates, and global conflicts contributed to the market swings, as did a temporary shift away from the long-dominant Magnificent Seven tech giants which have dominated the market for the last several years.

Despite this increased volatility, the overall trajectory of the markets remained positive in Q3 and for the year. The S&P 500 Index, the broadest measure of the stock market, posted a total return of 5.9% in Q3 and 22.1% year-to-date in 2024. Through September, the index suffered just one negative return month in April 2024.

Bonds also gained ground in the third quarter, with the Bloomberg Barclays Aggregate Bond Index posting a total return of 5.2%. For the year-to-date period through September, bonds were up 4.4%, reversing a negative total return from the first half of the year.

The Fed Goes BIG!

The Federal Reserve lowered its benchmark Federal Funds rate by 50 basis points (one-half of 1%) on September 18th, in a move that surprised many market watchers who were expecting a more modest 25 basis point cut. But the Fed went big, citing a labor market that has slowed and an inflation rate that is moving sustainably toward its target of 2%.

The Federal Reserve has two policy mandates: stable prices and full employment. After two and a half years of increasing interest rates to bring down inflation, the Federal Reserve has shifted its focus to the labor market. While the unemployment rate is still hovering near generational lows, some weakness in underlying employment trends have appeared. Therefore, Fed Chairman Jerome Powell indicated that a "recalibration" of interest rates was necessary. In its most recent policy statement, the Fed stated that it will make future decisions meeting-by-meeting, but left the door open for additional rate cuts later this year and into 2025. Stay tuned.

U.S. Economy Still Growing, Albeit Slowly

The U.S. economy maintained positive growth in the third quarter, although signs of a slowdown emerged. The labor market showed the most weakness through August 2024, though it surprised to the upside in September. Overall, the unemployment rate has risen over the last year to

4.1% in September from a cycle low of 3.5% in July 2023. The total number of unemployed people has also risen, to 6.8 million people in September 2024 from 6.3 million people a year earlier. On a positive note, despite an overall slowdown in employment, the number of actual layoffs remains quite low.

On the inflation front, core inflation continues to decline toward the Fed's 2% annual target. In August, core CPI was 2.5%, below the consensus forecast of 2.6% and well below July's rate of 2.9%. The August reading was the smallest increase in inflation since February 2021 and significantly less than the peak of 9.1% in June 2022. Despite this progress, not all sectors of the economy have seen a slowdown in price inflation. Shelter inflation remains stubbornly high, rising for the fifth consecutive month in August. Prices for food moderated slightly but were still higher month-over-month. But offsetting these increases were energy prices, which declined significantly in August, continuing a positive trend that started in May 2024.

Consumer-related data also remains robust, with consumer spending rising 2.8% in August and core retail sales up nearly 4% year-over-year. This helped U.S. GDP grow a healthy 3% in the second quarter, up from 1.3% in the first quarter. Consumer spending accounts for nearly 70% of U.S. GDP growth. For the third quarter of 2024, the Fed's GDPNow model currently forecasts U.S. GDP growth to grow 2.5%.

Corporate earnings also continue to grow. Third quarter S&P 500 earnings are projected to increase 4.6% year-over-year, which would mark the fifth consecutive quarter of earnings growth for the index. For the full year 2024, analysts are projecting 10% earnings growth, followed by 15% growth in 2025. Earnings growth is perhaps the biggest driver of market performance for the S&P 500 index.

And finally, U.S. mortgage rates have finally started to decline, thanks to the Fed's actions in September. While we still have a long way to go to solve the nation's housing affordability issues, this is an important first step and one which home buyers and those looking to refinance are most certainly applauding.

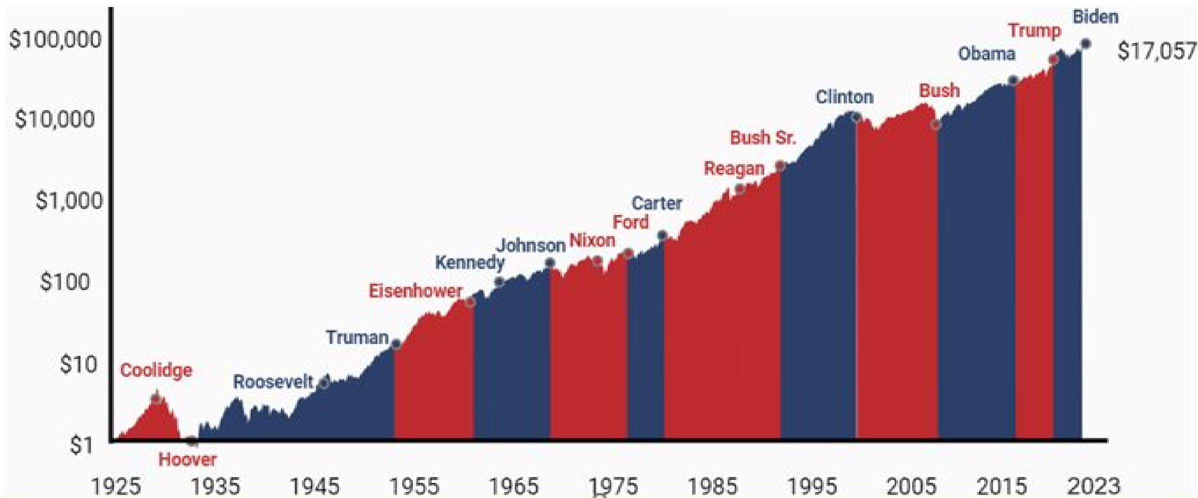
All Eyes on the November Election

With November 5th fast approaching, we expect this highly charged and razor-thin Presidential race will continue to impact markets in the near term. But history has shown, over and over again, that elections do not drive markets over the long term. Instead, it is the underlying health of the economy, including corporate earnings, GDP growth, and interest rates that drive long-term market returns.

It is our job as investment advisors to put the political noise aside and focus on the economic and business fundamentals of the securities we own. Our goal is to stay invested in high-quality companies and continue to look for new investment opportunities, remaining focused on fundamentals such as earnings, growth, and valuation.

The following chart shows that through both Republican and Democratic administrations going back to the 1920s, the overall trajectory of the stock market has been consistently positive.

Growth of $1,000 investment from 1925 to 2023



Source: Fisher Investments

Risks We are Watching

Despite the many positives in the U.S. economy cited above, there are both internal and external risks which we are watching carefully.

First, the internal risks. Consumer confidence fell in September to its lowest level in three months. Americans were worried about three things, in no particular order: 1) the job market, given the steady rise in unemployment and the greater difficulty finding work; 2) the high cost of living, after several years of soaring inflation; and 3) the upcoming Presidential election, and its divisive impact on the American electorate. These are all very real concerns and any one of them, if they worsen, could undermine the health of the U.S. economy and lead to a market downturn.

Externally, the continuing conflicts in the Middle East and Ukraine are of deepening concern globally, while the economic slowdown in China has created uncertainty for companies and consumers worldwide. While our direct investment exposure to each of these regions is minimal, the de-stabilizing impact of these situations cannot be ignored.

Portfolio Implications and Actions

We are cautiously optimistic about U.S. stocks, despite lofty valuations. The forward price-to-earnings ratio for the S&P 500 is currently 21.4 times, higher than the five-year average of 19 times. But not all sectors or companies carry such high valuations, and we have been able to find pockets of opportunity in areas like energy, healthcare, and financials at substantially lower valuations.

This selective strategy has and should continue to benefit disciplined, value-oriented investors (like us), as a long-awaited broadening of the market rally beyond just the tech giants continues to take hold and reward sectors previously left behind. Specifically, we are seeing a shift in investor focus to utilities, telecom, and real estate, all segments which we own and should benefit from lower interest rates going forward.

We also still find short-term Treasury bills attractive at risk-free rates of 4% - 4.5% and are looking in some cases to extend those maturities to lock in these rates for longer durations.

Outlook

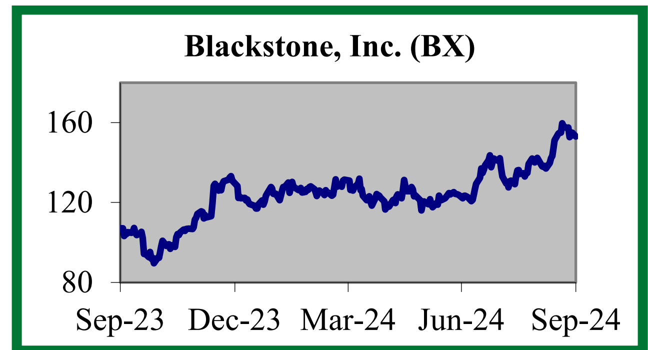
Overall, we maintain a positive long-term outlook for the U.S. economy and markets. It appears that the Fed has orchestrated the "soft-landing" that it targeted, but which many thought was unachievable given the delicate task of slowing the economy enough to tame inflation but not too much to send it into recession. Although recession risk is never completely eliminated, we do not see it as a major risk in the near term.

We believe our patient, disciplined approach to individual security selection offers our clients strong long-term return potential in a cost effective and tax efficient manner. Even though markets can be volatile quarter-to-quarter and year-to-year, we emphasize to our clients the importance of sticking with a long-term investment plan focused on their specific goals and objectives. We appreciate your confidence in our investment philosophy.

Analysis of Selected Securities

The following are analyses of three selected securities we are currently buying for client accounts:

Blackstone, Inc. (BX)



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

Price (09/30/2024)	$153.13	Forward P/E	27.7
Market Cap ($B)	$ 187.0	Price/Book	27.4
Dividend Yield	2.2%	Price/Sales	11.2
Return on Equity	31.7%		

Blackstone is the world's largest manager of alternative assets, including private equity, real estate, credit funds, hedge funds, and closed-end mutual funds. The firm's total assets under management (AUM) were approximately $1.1 trillion as of June 30, 2024. In 2018, Blackstone laid out a goal to achieve $1 trillion in AUM by 2026; they reached that milestone in 2023, three years ahead of plan.

Industry-wide, assets under management in the alternatives segment has grown to approximately $12 trillion as of June 30, 2024. However, that asset level is still dwarfed by the $225 trillion in

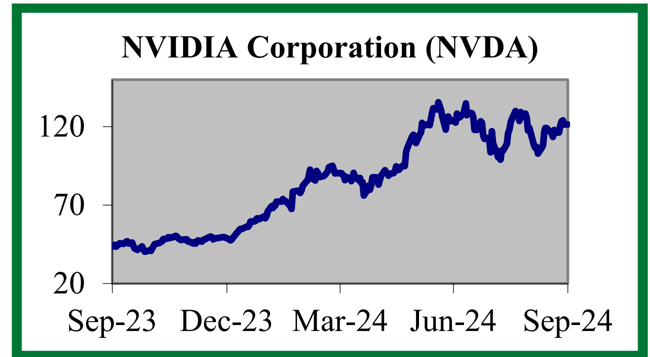
public market investments such as stocks and bonds. As a result, a long runway of growth remains for alternative assets to steadily increase as a share of global investment portfolios, of which Blackstone should be a key beneficiary.

Blackstone enjoys one of the strongest and most respected brands in the alternatives segment, supported by a long, successful track record of investment performance. Blackstone's scale and depth of knowledge across key product areas should allow the company to continue to lead in fundraising for new products, which in turn drives revenue growth. In fact, the second quarter of 2024 marked Blackstone's 58th consecutive quarter of year-over-year growth in base management fees.

More recently, Blackstone has been focused on increasing AUM that they define as "perpetual capital," which are assets that Blackstone manages with an indefinite term. Unlike traditional private equity vehicles, where there is a requirement to liquidate assets and return capital to investors within a specified period of time (usually 7-10 years), perpetual capital vehicles retain fee-earning assets indefinitely. Perpetual capital represents a significant and growing portion of Blackstone's AUM, and results in smoother and steadier earnings for the company. This reduces the variability of the company's earnings, raises the prospect for higher dividend distributions, and potentially increases the valuation multiple applied to BX shares.

Blackstone's business is highly scalable and requires relatively low amounts of capital, which results in high returns on equity. The company's ever-increasing scale, diversified product offering, record of solid investment performance, and strong client relationships position the firm well to continue to grow and generate attractive returns in a variety of market conditions.

NVIDIA Corporation (NVDA)



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

Price (09/30/2024)	$121.44	Forward P/E	33.2
Market Cap ($T)	$ 2.98	Price/Book	51.3
Dividend Yield	0.0%	Price/Sales	31.3
Return on Equity	123.8%		

Nvidia Corp, arguably one of the most talked about stocks in today's market, holds a dominant position in the design and manufacturing of advanced GPU (graphics processing unit) chips used in a wide array of applications, including artificial intelligence (AI). Nvidia is benefiting from an enormous first-mover advantage in the implementation of AI across a variety of industries and users, creating a powerful network effect among the company, AI developers, and data center operators.

As the market's most advanced AI hardware and software player, Nvidia is crucial to the global buildout of AI infrastructure, which is still in the early stages. Its upcoming Blackwell advanced

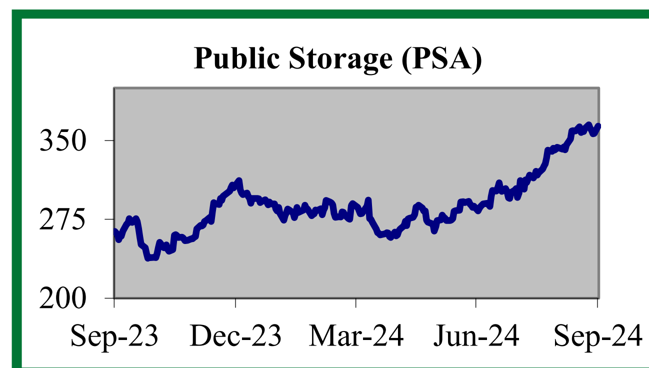
chip will mark the launch of the firm's next generation product and commence its next leg of growth. The company's CUDA software is widely used and deeply embedded in the AI ecosystem. This combination of best-in-class hardware and software offerings gives the company a wide economic moat with strong competitive advantages, entrenched customers with high switching costs, and intangible assets.

Strong demand for Nvidia's advanced chips has led to triple-digit year-over-year revenue and earnings growth for the past five consecutive quarters. Investors have good reason to believe that this growth is a durable, multi-year trend for the company, having already propelled it this year to a market capitalization of $3 trillion, behind only Apple and Microsoft.

As one prominent tech CEO aptly stated, the long-term risk to enterprises is underinvestment in AI, not overinvestment. Nvidia will continue to be a beneficiary of this flow of capital spending, as companies find new ways to adopt and monetize AI. We have a favorable view of the company's prospects, as it has solidified a critical role in the global AI ecosystem by continuing to innovate and produce the world's most reliable, powerful, and efficient AI chips.

With a forward P/E-to-growth ratio of 1.2, well below its 5-year average of 1.9, we view the shares as modestly undervalued and thus a good opportunity for long-term investors. The company also executed a 10-for-1 stock split in June 2024, making shares more attractively priced for retail investors.

Public Storage (PSA)



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

Price (09/30/2024)	$363.87	Forward P/E	21.1
Market Cap ($B)	$ 63.9	Price/Book	11.9
Dividend Yield	3.3%	Price/Sales	13.8
Return on Equity	23.6%		

Public Storage is a real estate investment trust (REIT) that acquires, develops, owns, and operates self-storage facilities for personal and business use. Public Storage is the largest owner of self-storage facilities in the United States, with physical presence in most major markets and across 40 states.

As of June 30, 2024, the company held interests in 3,049 self-storage facilities, aggregating approximately 219 million net rentable square feet. Additionally, Public Storage has roughly 1.1 million net rentable square feet of commercial and retail space and manages 260 facilities for third parties. Public Storage's occupancy rate is consistently above 92%, which is among the highest in the industry. The company's strategy is to own and operate self-storage facilities within a 3-5 mile radius of densely populated urban centers and invest aggressively in enhancing its coverage,

scale, brand, operating efficiency, and technology platform.

The self-storage sector outperformed all other real estate asset classes during the global financial crisis and is considered a recession-resilient industry as demand is steady and largely driven by naturally occurring life transitions. Today, the traditional self-storage uses like downsizing, moving, and adding space are being supplemented by additional demand drivers, such as urbanization, the decluttering trend, increasing business demand, migration, population growth, and lower home affordability.

Self-storage remains a highly fragmented industry, with the five largest players controlling approximately 36% of the U.S. inventory and the remaining 64% being owned by regional operators. This paves a long runway of growth for Public Storage, with just 11% market share, as the company continues to make acquisitions and take market share from smaller competitors.

As a REIT, Public Storage is required to pay out 90% of its taxable income as dividends to shareholders and its shares currently yield 3.3%. The company has increased its dividend at an 8.8% compound annual growth rate over the last 10 years.

We believe Public Storage will continue to gain market share and grow its earnings based on its scale, strategically located facilities, brand recognition, superior data and market intelligence, and access to low-cost funding. Overall, Public Storage exhibits the characteristics Edgemoor seeks in income investments, including solid business fundamentals, growing earnings, and increasing dividend payouts over time.

Source for text and charts: FactSet, Morningstar, S&P/CFRA, Schwab, ValueLine, Black Diamond Performance Reporting, Yahoo Finance, Bank of America, JP Morgan Markets, MarketWatch, WSJ 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 approximately $1.4 billion as of September 30, 2024, 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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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 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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