EDGEMOOR
INVESTMENT ADVISORS

Edgemoor's Quarterly Report

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Winter 2015

Another Solid Year for Stocks

2014 was another good year to be invested in U.S. stocks, which rose again due to continued recovery in the U.S. economy, increased corporate earnings, and support from the Federal Reserve. The S&P 500 index gained 13.7%, including dividends, but elsewhere in the world stock prices generally fell, primarily due to weaker economic conditions.

Like last year, stocks are off to a bit of a volatile start to 2015, this time amid concerns regarding oil prices, the global economy, and geopolitical events, including terrorism. The market likely will remain volatile, and we expect to see a correction at some point during the year.

However, we are optimistic that investors will again be rewarded in 2015 for a willingness to hold onto good investments despite what may happen over any short period of time. We foresee continued economic recovery in the United States and low interest rates around the world, even though the Fed may begin to gradually raise the federal funds rate later this year. We intend to maintain our focus on long-term results and take advantage of opportunities to buy discounted securities that offer promising returns.

Following are some thoughts regarding the most important trends that we will be watching as this year unfolds.

Oil!

Energy prices stole the headlines from the Fed over the past several months, as the dollar price of crude oil dropped more than 50% since June. The dramatic rise in production of oil and gas in the United States in recent years has boosted supplies, while waning global economic growth has lowered demand. The increase in the value of the dollar has further exacerbated the price drop in the United States. We would not be surprised to see prices go even lower before they bottom.

How you feel about the largest drop in energy prices since the great recession depends on your perspective. If you are a consumer, you are happy that you will spend less to fill up your car with gas and will therefore have more money to spend on other goods and services, spending that will benefit many businesses. Companies that use large amounts of energy as inputs into their manufacturing processes will enjoy lower costs and higher profits.

On the other hand, oil and gas producers will earn less from the sale of their products, and they are already beginning to trim investments in new projects. The U.S. economy is more heavily dependent on these energy exploration and production companies today than in the past, and the negative effect on them of lower prices will ripple through the economy.

There are many other examples of the impact of reduced energy prices, and it is difficult to quantify the overall effect on the U.S. and global economies. Nevertheless, we believe that, on balance, the drop in prices will be a net benefit that will support ongoing U.S. economic growth and help to boost the earnings and stock prices of many of the companies we own. For now, we have slightly reduced our exposure to the energy sector and are keeping a close eye on price trends and their effect on prospects for all of our holdings.

The Fed and Its Global Cousins

Oil may have stolen some headlines, but the policies of the U.S. Federal Reserve remain among the most important factors impacting the U.S. economy and stock market. The end of the Fed's bond buying program in October did not cause rates to rise, as many had feared, nor did the recent, slight tweak to the Fed's language regarding its outlook. In fact, long-term rates have declined, sending bond prices higher. Investors will be closely watching for any hints from the Fed regarding upcoming changes in its rate policies. Current expectations are for an increase in the federal funds rate in the second half of this year, but the exact timing will depend on the Fed's view of economic conditions.

Other central banks are being more aggressive than our Fed as they face slowing economic growth. The European economy is particularly fragile, and there is renewed discussion of problems with Greece and a potential exit of the economically troubled country from the eurozone. The European Central Bank has maintained its commitment to policies intended to keep interest rates low, boost economies, and protect eurozone members from problems in particularly troubled countries. Interest rates in Germany, Japan, and many other countries are even lower than here in the United States, making our government bonds relatively attractive despite their low yields.

Because long-term interest rates are low and we expect them to rise eventually, we continue to shun bonds from our portfolios. Bonds performed better than expected in 2014 as interest rates dropped during the year. Still, when rates do increase, the value of bonds will fall, and we do not want to be heavily invested in bonds when that time finally comes. Meanwhile, rates are currently so low that the rewards for holding bonds are not attractive enough to offset the risks of buying them. We continue to prefer utilities, real estate investment trusts (REITs), preferred stocks, master limited partnerships, and convertible securities for income, given their higher yields and our expectations that many will increase payouts to investors over time.

Inflation

Lower prices for oil and other commodities, combined with slow global economic growth, have kept a lid on inflation, which is currently expected to remain low in the United States and recently turned negative in Europe. Tame inflation frees the Fed and other central banks to maintain their stimulative monetary policies, good news for the stock market. The potential danger is that low inflation primarily reflects weak economies.

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The Dollar

The increase in the value of the dollar versus other currencies reflects the relative strength of the U.S. economy, marginally higher interest rates in the United States than abroad, and investor confidence in the United States. We expect the U.S. economy to continue its steady expansion and the dollar, therefore, to remain attractive compared to other currencies.

The dollar's strength benefits consumers and businesses heavily dependent on imported goods, but it makes U.S. companies' products more expensive in other countries. We are monitoring our positions for any signs that the dollar's rise, or a sluggish global economy, is negatively impacting the ability of companies we own to generate profits. Offsetting the dollar's rise and its adverse impact on exports is the lower cost of energy for our manufacturing industry.

The Road Ahead

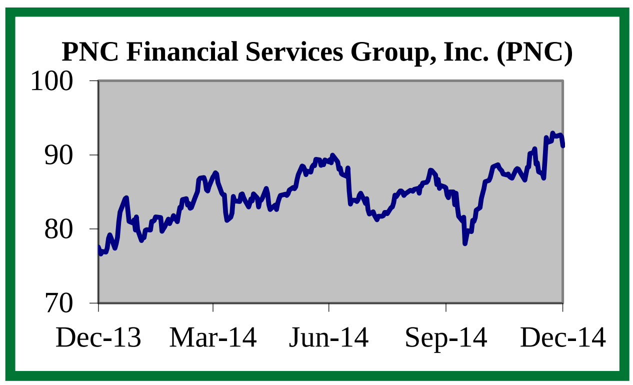
Overall, we remain cautiously optimistic regarding prospects for the stock market and more so for the specific stocks in our portfolios. The S&P 500 index currently trades at a price/forward earnings ratio of 15.5, close to historical averages. The stocks we are buying, however, trade at an average price/forward earnings ratio of 12.4, a significant discount to the broad market. We expect the market to rise in line with corporate earnings and for our holdings to outperform due to their reasonable valuations and favorable business prospects.

The past several years have once again demonstrated the importance of sticking with a sound investment strategy despite the various uncertainties and fears that arise along the way. Our disciplined approach has enabled us to weather storms in the past, and we expect it to continue to succeed through the good times and bad.

Analysis of Selected Securities

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

PNC Financial Services Group, Inc. (PNC)



Price (12/31/14)	$ 91.23	Forward P/E	11.2
Market Cap ($B)	$ 46.6	Price/Book	1.0
Dividend Yield	2.2%	Price/Sales	3.0
Return on Equity	9.3%		

PNC is a diversified financial services company and one of the top ten largest bank holding companies in the United States, with an expansive network of 2,800 branches serving 6 million consumers and small businesses across 19 states throughout the Midwest, Mid-Atlantic, and Southeast.

PNC management navigated the financial crisis with great discipline, avoiding many of the pitfalls of subprime mortgages and complex securitizations that plagued so many of the bank's competitors. As a result, PNC has emerged as one of the strongest super-regional banks, with a healthy Tier 1 capital ratio, steadily declining loan losses (down to just 0.16% of total loans), and a stable, low-cost deposit-funding base covering nearly 90% of total assets.

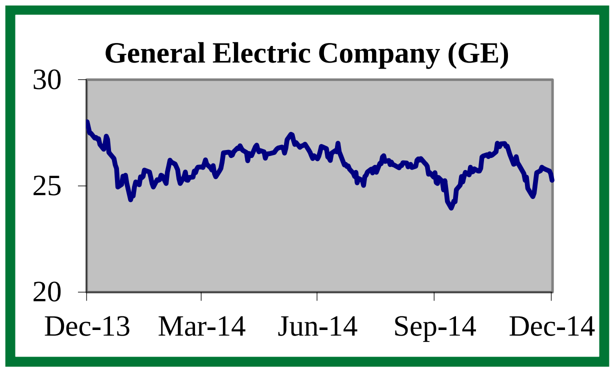
After a period of strong growth propelled by selective acquisitions of distressed banks (National City in 2008, RBC Bank in 2012), PNC has refocused on organic growth and strategic efficiencies to boost profitability. Specifically, the bank has emphasized the cross-selling of commercial and retail loans in underserved markets like the Carolinas, Alabama, Georgia, and Florida, where it has nearly doubled its market share. The bank also achieved cost-savings of more than $1.2 billion over the last two years, ahead of its planned timetable.

PNC is distinguished among its banking peers by its focus on generating asset management fees. Through a strategic investment in BlackRock, the world's largest asset manager with over $4.5 trillion in assets under management, PNC controls a 21% voting interest in BlackRock's common shares, which provides nearly $250 million in cash dividends per year.

In March 2014, PNC won approval from the Federal Reserve to raise its quarterly stock dividend and to repurchase up to $1.5 billion of common stock. The bank has since boosted its payout to $0.48 per quarter, for a yield of 2.2%, and repurchased more than 6.8 million shares in 2014 at a cost of $583 million.

As we have tracked the recovery of the banking sector over the last several years, we have been continuously impressed by the results at PNC. Management has maintained strict discipline in its pursuit of growth, in its core underwriting and balance sheet management, and in overall expense controls. We chose PNC as the first bank stock to add back to our core equity portfolio after the financial crisis and continue to expect it to perform well and reward shareholders.

General Electric Company (GE)



Price (12/31/14)	$ 25.27	Forward P/E	12.9
Market Cap ($B)	$ 243.8	Price/Book	1.8
Dividend Yield	3.7%	Price/Sales	1.7
Return on Equity	10.3%		

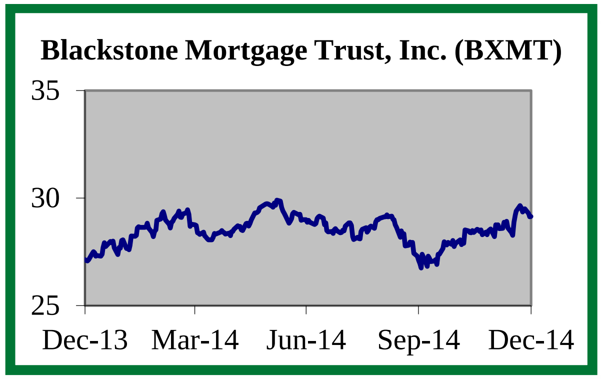
General Electric has been transforming itself since the financial crisis of 2008 nearly crippled this once-believed unshakeable industrial giant. By shedding underperforming businesses, streamlining costs, and refocusing on its core industrial businesses, GE has once again positioned itself to be the leader in all major industrial markets in which it competes.

Today, GE operates through four main segments (down from six), which include Technology Infrastructure, Business Services, Energy Infrastructure, and Capital Services. Its portfolio of businesses is focused on the industrialization of growing economies, in particular in aviation, transportation infrastructure, and energy. Specific offerings include water treatment systems, clean energy products (wind, gas, and solar), drilling and production equipment, and railway and transportation solutions. These high-potential areas are expected to drive GE's growth over the next decade, as evidenced by a record backlog today of $200 billion in infrastructure orders.

GE Capital Services, the financial services arm, has also rebounded significantly since the financial crisis. The unit has returned to profitability even as its portfolio has continued to shrink. It remains focused on middle-market commercial and industrial loans, equipment leasing, and aircraft finance, with a particular emphasis on captive financing of GE's industrial products. GE's focus on combining complementary businesses with opportunities for cross-selling and information sharing marks one of GE's strongest competitive advantages.

We view the recent divestiture of GE's appliance division as a prudent way to reduce the company's exposure to cyclical consumer spending. The company has also successfully delivered nearly $1 billion in cost savings as of year-end 2014. We believe the ongoing streamlining of GE's businesses will further buoy its profitability, balance sheet strength, and overall market position in the global economy.

Blackstone Mortgage Trust, Inc. (BXMT)



Price (12/31/14)	$ 29.14	Forward P/E	12.2
Market Cap ($B)	$ 1.7	Price/Book	2.3
Dividend Yield	7.1%	Price/Sales	9.2
Return on Equity	10.6%		

Blackstone Mortgage Trust (BXMT) is a real estate investment trust (REIT) that originates senior mortgage loans on commercial properties throughout the United States and Europe. Backed by the Blackstone Group, one of the largest asset management companies in the world with over $200 billion in global real estate investments, Blackstone Mortgage Trust had a successful initial public offering in May 2013 at $25.50 per share. It has since invested over $5.2 billion in commercial real estate loans, with the majority of them in major real estate markets like New York, California, and the United Kingdom. Blackstone invests across a variety of commercial property types, including office (43%), hotel (28%), multi-family (10%), and retail (5%).

This REIT's affiliation with the Blackstone Group gives it several important advantages. Blackstone invested $99 million of equity in BXMT at its launch and provides valuable market data, collateral valuation, and proprietary deal flow. Also, the Blackstone real estate platform has one of the best long-term track records in the institutional real estate market, returning an average of 16% per year to pension funds and other institutional investors since 1991. Blackstone Mortgage Trust has given individual investors access to that experience and expertise through a public REIT vehicle.

Commercial real estate is generally benefiting from favorable market conditions, including a sustained economic recovery in the United States and England, renewed interest from real estate investors worldwide, and growing confidence of businesses to invest and expand. These positive market fundamentals contrast with a banking system that is still reluctant to invest in real estate, making for abundant opportunities for non-bank lenders like BXMT.

The fundamentals of BXMT stock are also compelling. The stock trades at a below-market 12.2x forward price/earnings ratio and pays an attractive and sustainable 7.1% dividend yield. That payout has increased dramatically from a rate of $0.27 per quarter in 2013 to $0.52 in the fourth quarter of 2014. We believe continued growth in the dividend will be driven by the fact that 100% of Blackstone's mortgage loans are floating rate and will therefore benefit from rising interest rates over time. Overall, BXMT exhibits many of the qualities we seek in income investments, including being a disciplined, well-managed company with consistent earnings and dividend growth.

Source for charts and text: Morningstar, S&P, Schwab, Value Line, and Argus research reports.

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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 $780 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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