EDGEMOOR INVESTMENT ADVISORS

Edgemoor's Quarterly Report

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Keeping Warm

Following a strong 2017, the U.S. stock market brushed off the extreme winter chill gripping much of the nation and roared into 2018, notching its best start to a year since 2006. We expect this initial momentum to cool, but stocks should still benefit from a combination of steady global economic expansion, low and slowly rising interest rates, tame inflation, and solid corporate earnings growth. Be on the lookout for greater volatility, however, as we do not believe the markets can maintain the remarkably smooth ride investors enjoyed last year.

2017 in Review

2017 was a year of records in the U.S. stock market, as the S&P 500 and other major indexes hit new highs throughout the year. The S&P 500 index returned 21.8%, including dividends, its best performance since 2013, and delivered a positive return in every month for the first time. No single day's move in the index exceeded 2%, an extremely low level of volatility not seen since the mid-1960s. Foreign stocks, led by those in emerging markets, performed even better than those in the United States as they also benefited from the global economic expansion and low interest rates.

The U.S. economy added more jobs during the fourth quarter for a total of 2.1 million new jobs during the year, compared to 2.2 million added in 2016, and unemployment in December was a low 4.1% for the third consecutive month. Annual wage growth was 2.5% in December, roughly in line with readings throughout the year and an indication that employers have not yet needed to increase worker pay significantly, though there are signs that wages may soon rise more rapidly. Assuming estimates for the fourth quarter prove accurate, GDP growth was above 3% for each of the past three quarters, providing impetus for further improvement in corporate earnings.

As expected, in December the U. S. Federal Reserve boosted the federal funds rate for the third time in 2017, to a still low range of 1.25%-1.5%, but markets took this increase in stride. Consumer and business confidence remained high, and the Institute for Supply Management's indexes, widely watched by economists and investors, pointed to ongoing growth in the manufacturing and service sectors.

Technology companies continued their strong run and were the best performers for the year, though the materials, consumer discretionary, financial services, healthcare, and industrial sectors also generated high returns. The dollar's 7.5% drop in 2017 against a basket of foreign currencies helped U.S. exporters, whose goods became less expensive to foreign buyers. The price of oil jumped 12% during the year to $60 per barrel, the highest in 2 ½ years but still far below its $147 peak.

Investors applauded the many positive earnings surprises announced during each quarter of the year and the resulting 18% surge in S&P 500 annual operating earnings (including fourth quarter estimates). Anticipation of positive benefits in future years from large corporate tax cuts and reduced regulation also boosted markets.

The multiple of earnings investors were willing to pay for stocks increased only slightly during the year, the first pause in the multiple's steady increase since 2011. The S&P 500 index now trades for approximately 19 times projected 2018 operating earnings, though earnings estimates may increase as analysts factor in the positive impact of the new tax bill.

Edgemoor's Outlook for 2018

We expect more solid returns for stocks in 2018 as economies around the world continue to expand. However, we do not believe returns will be as strong as last year, and volatility is likely to increase from recent low levels.

The Fed currently intends to raise rates three times this year, but we think these actions are unlikely to derail economic growth or rattle the stock market. Inflation is perhaps the most important factor impacting the timing of the Fed's moves. Though inflation remains below the Fed's target of 2% per year, we believe the tightening job market will soon lead to increasing wages as businesses compete to hire more employees. We forecast a modest rise in inflation this year as a result, though further automation of manufacturing processes and other cost efficiencies could mitigate pressure on companies to raise prices to maintain profit margins. While unlikely in our opinion, a spike in inflation is one possible factor that could hurt stocks.

The recently enacted U.S. tax cuts have lifted business optimism and should increase corporate earnings, good news for stocks. We expect corporations to boost dividends and repurchase shares with the additional cash resulting from lower taxes and profits brought back to the United States from overseas. S&P 500 index companies currently hold $2.3 trillion of such cash abroad, concentrated in large technology and pharmaceutical businesses. Firms will also likely use some of these funds to increase wages and hire more workers. Any pickup in inflation resulting from these moves may cause the Fed to move more rapidly in raising interest rates, though markets currently appear to reflect little concern that this inflation would threaten further gains.

The U.S. economy could receive more support from any infrastructure spending bill that may emerge this year from the federal government. Even without this additional help, we expect corporate revenue and earnings to rise further, supporting higher stock prices.

Finally, we do not currently see signs of a recession on the near horizon. However, if short-term interest rates rise to the point of being higher than long-term rates, odds of a recession would increase; this condition, known as an inverted yield curve, would indicate pessimism regarding the economic outlook. We do not expect to see an inverted yield curve anytime soon, and a recession does not follow each one, but we will be watching rates closely for any signals.

Our outlook for the rest of the global economy is also positive. As in the United States, foreign central banks are beginning to remove some of the stimulus provided in the wake of the financial crisis, but they are doing so gradually and only when economic trends seem strong enough to withstand the reductions. Stocks in Europe, Asia, and other regions trade for lower multiples of earnings than those in the United States, and in many cases they offer higher potential earnings growth. We continue to believe that exposure to global assets is important for a diversified portfolio and expect more positive returns from our holdings abroad.

As usual, there are risks to the global economy and markets. Topping the list are geopolitical risk, including nuclear threats in North Korea and turmoil in the Middle East, the impact of changes to U.S. global trade policies, and the potential for monetary policy changes to hinder economic growth. While we consider the possibility of a major disruption to be low, we must also be prepared for any of these or others to occur.

Overall, we are optimistic regarding the U.S. and foreign stock markets, but we also know that we are long overdue for a correction (decline of 10%-20%) in stock prices. Though we cannot predict exactly when the stock markets will pull back, we do expect greater volatility this year and are prepared for a significant drop at some point. While such an event is never pleasant, we have lived through many in the past and believe the markets and our portfolios would again rebound. In our opinion, sticking with a portfolio of carefully chosen securities is a better strategy than trying to time the market with trades in and out. Fortunately, we currently see few of the typical signs of investor overconfidence that have preceded past market tops.

For income investments, we have added some bonds to our portfolios to provide some stability in case of a stock market pullback. However, we are sticking to relatively short-term bonds to protect against rising interest rates, and we continue to prefer other high-yielding securities over bonds for the bulk of our income positions. These securities include preferred stocks, pipeline companies, and utilities yielding about 5% on average, even in the current low interest rate environment, and we believe many of these also have the potential for price appreciation.

Analysis of Selected Securities

Following is a discussion of three securities we own and have bought recently. Due to issues specific to each company, these stocks are, in our opinion, priced attractively in the markets today.

Alphabet, Inc. (GOOG)

Past performance is not indicative of future results. Please see disclosures on page 8.

Price (12/31/2017)	$1,046.40	Forward P/E	24.1
Market Cap ($B)	$ 745.5	Price/Book	4.7
Dividend Yield	0.0%	Price/Sales	7.1
Return on Equity	14.4%	Debt/Equity	.03

Alphabet, Inc., the parent of Google, is a global technology company best known for its dominant internet search engine, which currently controls 80% of global online searches. The company's revenue growth has averaged nearly 18% annually for the last three years and topped 24% year-over-year in the third quarter of 2017. This growth has been driven by substantial increases in both desktop and mobile advertising revenue, which together account for 87% of total company revenues.

In addition to search, the company's array of internet services includes Gmail, YouTube, Google Maps, Google Earth, and Google Play, as well as the

Chrome internet browser and the mobile Android operating system, which powers an estimated 75% of smartphones around the world. We believe these core assets provide a cohesive, end-to-end experience for consumers and, most importantly, drive internet advertisers to Google sites.

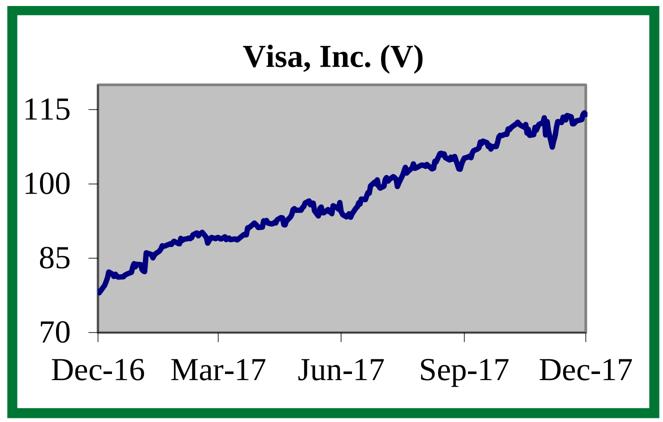
As the online advertising market has matured, advertisers have increasingly consolidated their spending around companies like Google with broad platforms, a vast user base, and unique assets. Consumers use Google products almost habitually (an estimated 90% of all mobile searches are performed on the Google platform), creating a switching cost based on familiarity and not just technology, which we believe will continue to protect the company's online dominance and fuel growth.

Alphabet also invests heavily in emerging technologies, including enterprise cloud services, artificial intelligence, and autonomous vehicles. These investments leverage the company's technological expertise and have the potential to drive growth for decades to come.

Alphabet's financial position is currently as strong as its market presence. The company should generate a record $107 billion of revenues in 2017, an increase of 19% over 2016. Alphabet also generates approximately $25 billion of free cash flow annually and held $100 billion of cash and marketable securities at September 30, 2017. We believe the balance sheet is solid, with just $4 billion of long-term debt and over $150 billion of total shareholder equity.

At 24 times estimated 2018 earnings, Alphabet stock trades at a premium to the S&P 500 average of 19 times, but it trades closer to that average when adjusted for the company's large cash position. Furthermore, we believe the company's higher than average growth prospects and strong competitive advantages justify a premium and make Alphabet stock an attractive long-term investment.

Visa, Inc. (V)



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Price (12/31/2017)	$ 114.02	Forward P/E	27.9
Market Cap ($B)	$ 268.8	Price/Book	9.8
Dividend Yield	0.6%	Price/Sales	14.9
Return on Equity	24.6%	Debt/Equity	0.6

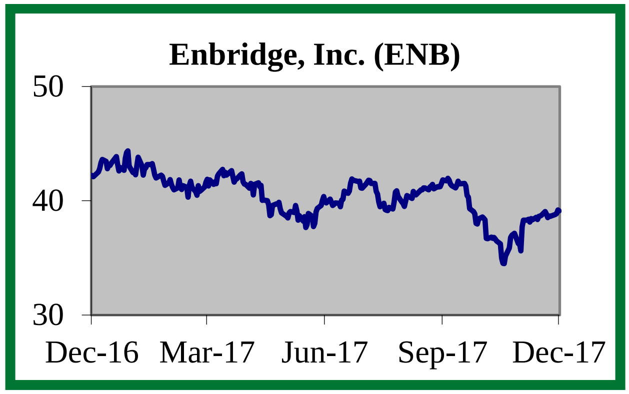
Visa is the largest provider of electronic payment processing services, with a 58% global market share compared to the 26% market share of its closest competitor, MasterCard. Visa is accepted by 44 million merchants worldwide and has over 3.1 billion cards in circulation, twice that of MasterCard. The Visa network processed $8.2 trillion worth of transactions in the twelve months ended September 30, 2017, more than MasterCard, American Express, and Discover combined. Over 16,800 financial institutions are part of Visa's worldwide network, the biggest in the industry.

Visa's growth has been propelled by increased consumer spending as the global economy has recovered and by the increasing use of digital payments over cash transactions. Still, more than 85% of the world's retail transactions are conducted with cash or checks, leaving significant upside for all electronic processors to grow. For consumers, the transition from cash to plastic brings numerous benefits including convenience, safety, and increasingly attractive rewards programs.

In June 2016, Visa completed its acquisition of affiliate Visa Europe for EUR18.3 billion. The combination provides scale advantages, cost savings, and revenue opportunities to Visa, as the company will now capture 100% of Visa Europe's growing cross-border volumes, fees, and profits. The acquisition is expected to be accretive to Visa's earnings this upcoming year. Visa is also eyeing expansion in China, where the state bank clearing system was recently opened to Visa and MasterCard to launch card-processing networks as early as 2018.

We consider Visa's financial position to be sound, with high operating margins, strong free cash flow, and modest debt. Management is shareholder-friendly and returned $8.5 billion to investors during 2017 in the form of stock buybacks and dividends. Visa stock trades at a premium to the market at 27.9 times estimated 2018 earnings, but we believe that premium is justified by the company's dominant market position, strong brand equity, and significant growth prospects driven by Visa Europe.

Enbridge, Inc. (ENB)



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Price (12/31/2017)	$ 39.11	Forward P/E	20.5
Market Cap ($B)	$ 68.2	Price/Book	1.7
Dividend Yield	5.1%	Price/Sales	1.7
Return on Equity	8.5%	Debt/Equity	1.2

Enbridge, Inc. is an energy distribution and transportation company operating in the United States and Canada. The company operates crude oil and natural gas pipelines and also owns Canada's largest natural gas distribution company.

The Canadian Mainline crude oil pipeline is the crown jewel of Enbridge's diverse midstream portfolio. With shipping capacity of approximately 2.9 million barrels a day, the pipeline transports primarily heavy oil from Canada's oil sands to refineries across North America, including on Canada's east coast, in the U.S. Midwest, and along the U.S. Gulf Coast.

While crude pipelines are Enbridge's primary business, the company operates a diverse energy portfolio that also 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 biggest pure-play midstream 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 a behemoth in the energy infrastructure business.

We believe Enbridge's financial position is solid. Revenues are currently projected to rise 20% in 2018 as a result of the Spectra merger and $9 billion of new capital projects brought into service in 2017. A total of $31 billion of secured growth projects are currently in the pipeline. Also, the company recently announced plans to increase its dividend 10% per year through 2020 as part of its broad strategic plan, marking a continuation of Enbridge's 20 consecutive years of dividend growth.

Enbridge's stock trades at a slight premium to the market at 20.5 times estimated 2018 earnings and pays an attractive and growing dividend that currently yields 5.1%. We believe the premium valuation is justified by the company's valuable network of infrastructure assets, lucrative expansion projects that are underpinned by long-term contracts, and stable and reliable cash flows. In our opinion, these factors should allow Enbridge to continue to generate sustainable, excess returns on invested capital and reward shareholders along the way.

Source for charts and text: 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 approximately $948 million as of December 31, 2017 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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