RADNOR
FINANCIAL ADVISORS

QUARTERLY MARKET COMMENTARY

First Quarter 2022

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Committed to Positively Impacting Our Clients' Lives

Enclosed is our Q1 2022 quarterly commentary. Q1 had so much going on. We experienced a stock market correction, rising bond yields, and continued high inflation. We also experienced the unusual occurrence of bonds and stocks both falling, but with bonds falling more than stocks.

The biggest headline was Russia's invasion of Ukraine and the tragic human impact. The war in Ukraine also has a wide-ranging and diverse economic impact, which has been especially pronounced in commodities such as oil/gas and wheat/corn. Various government policy responses to the war create additional risks and uncertainties, which would be exacerbated if the conflict expands beyond Ukraine.

Perhaps the second biggest headline was the Federal Reserve and their pivot away from accommodative monetary policy. The Fed increased interest rates by 25 basis points in March and suggested they may raise rates by another 150 basis points in 2022. They also indicated they will begin reducing their balance sheet at a more aggressive pace.

Normally inflation hitting 7.9% would be the biggest story, especially since it's such a change from the low inflation we have gotten used to. Hopefully, as imbalances in supply/demand recede over time, inflation will start to fall back (but likely remain above the Fed's 2% target).

Covid concerns remain ever present. While new strains have been detected (Omicron, BA.1, BA.2, XE), the US economy seems to have adjusted as many Americans have either been vaccinated, infected, or are simply adapting to the new environment.

Given all the negative headlines, it seems remarkable that the S&P was only down -4.6% in Q1.

With the war in Ukraine, most experts have lowered their GDP growth forecast for 2022. However, absent a deterioration in current conditions, they still see a low risk of recession this year.

Core fixed income investments were down in Q1 in response to higher inflation and anticipated Federal Reserve actions. The yield on the 10-year Treasury Bond ended the quarter at 2.32%, up from 1.52% at year-end, and has continued to rise in April (exceeding 2.7%).

The S&P 500 fell -4.6% in Q1, but that masks the intra-quarter volatility, as the S&P was off about 13% from its early-January high. Similarly, the NASDAQ saw a decline more than 20%, reflecting the challenging environment for growth stocks given rising rates.

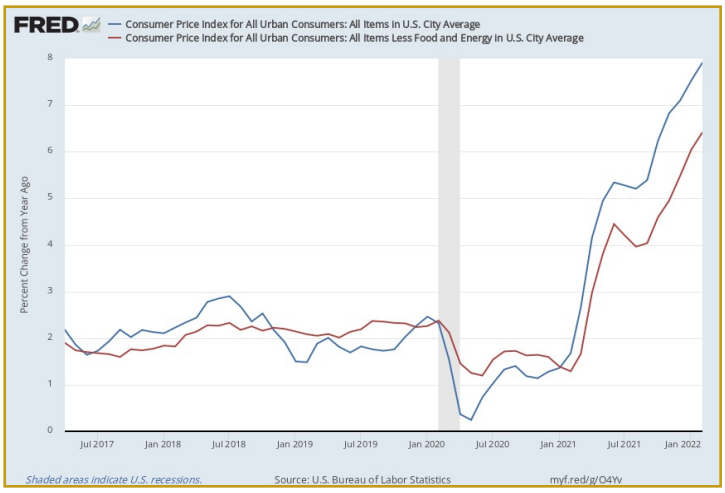
Looking forward, we continue to expect markets to be challenging over the next few years as we adjust to a new environment. Rising interest rates, stickier inflation, and fully valued equity markets will make it more difficult to generate attractive returns with traditional stock and bond investments. As such, we will likely look to add additional non-traditional investments that can achieve attractive returns but are less correlated to traditional markets.

As always, we continue to strive to ignore the short-term noise and focus on constructing portfolios that are balanced and diversified. We want to build portfolios that can achieve attractive returns over time and are resilient in the face of surprises, rather than portfolios whose success depends on our predicting the surprises.

- Q1 was a quarter to remember (or perhaps forget), as we saw war develop with Russia invading Ukraine, the Fed increasing interest rates, inflation reaching nearly 8%, the yield curve inverting, unemployment dropping to 3.6%, and covid concerns continuing as new variants emerged.
- Given the range of uncertainties, markets declined, with the S&P 500 down -4.6%, the Russell 2000 down -7.5%, the MSCI EAF down –5.9% and Emerging Markets down -7.0%. Bonds were also down, with the Bloomberg Barclay's Aggregate Bond Index down -5.9%. The only positive performance came from commodities, with the Bloomberg Commodity Index up 25.6% (although it is also the only asset class with a negative annualized return over the past 10-years; -0.7%)
- Economic growth is expected to slow markedly in Q1 to the 1-2% range, significantly slower than the 6.9% pace in Q4 2021. Economists expect full year GDP to be in the 3-4% range.
- The labor market continues to recover, with the March unemployment rate at 3.6%. In Q1, nonfarm payroll job growth increased at a monthly pace of 562,000.
- Inflation remains well above the Fed's 2.0% target, with March CPI at 8.5%. While inflation may moderate in the second half of 2022, it is likely to remain above trend.
- Looking forward, while we continue to expect the pandemic to gradually recede (but likely not disappear), we also expect corporate earnings growth to slow as well.

Investment Performance (Total Return) 03/22

	1Q	1-Year	3-Year	5-Year	10-Year	15-Year
S&P 500	-4.60	15.65	18.92	15.99	14.64	10.26
Russell 1000 Growth	-9.04	14.98	23.60	20.88	17.04	12.92
Russell 1000 Value	-0.74	11.67	13.02	10.29	11.70	7.36
Russell 2000	-7.53	-5.79	11.74	9.74	11.04	7.99
Russell 2000 Growth	-12.63	-14.33	9.88	10.33	11.21	8.81
Russell 2000 Value	-2.40	3.32	12.73	8.57	10.54	6.91
MSCI EAFE	-5.91	1.16	7.78	6.72	6.27	2.91
MSCI EAFE SC	-8.53	-3.63	8.51	7.42	8.30	4.47
MSCI EME	-6.97	-11.37	4.94	5.98	3.36	3.79
Wilshire REIT	-3.87	29.14	11.94	10.04	9.90	6.26
HFR Fund-of-Funds Comp	-2.70	1.25	5.88	4.64	3.93	2.35
Barcap Aggregate Bond	-5.93	-4.15	1.69	2.14	2.24	3.56
Barcap Muncipal	-6.23	-4.47	1.53	2.52	2.88	3.72
Bloomberg Commodity	25.55	49.25	16.12	9.00	-0.70	-1.40

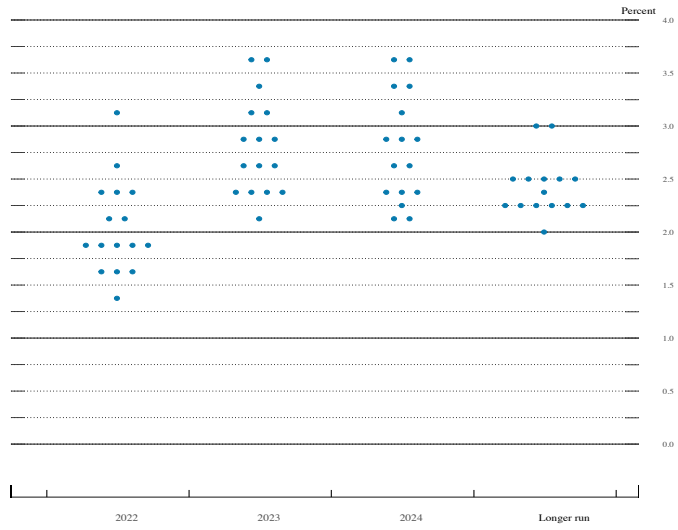


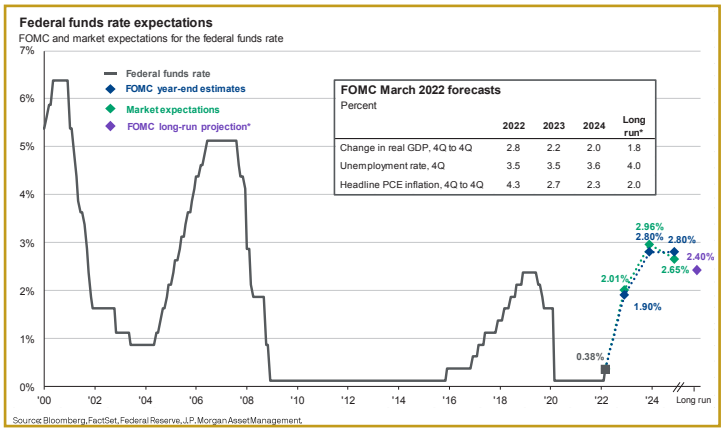
- We recognize the challenging market environment and the need to adapt our investment strategy. We also recognize long-term investment success will continue to require diversifying sources of return and rebalancing portfolios periodically. While we will continue to maintain a long-term perspective, we may need to be open to utilizing a higher allocation to private investment opportunities, seeking to earn an attractive return in exchange for accepting some illiquidity and/or complexity.

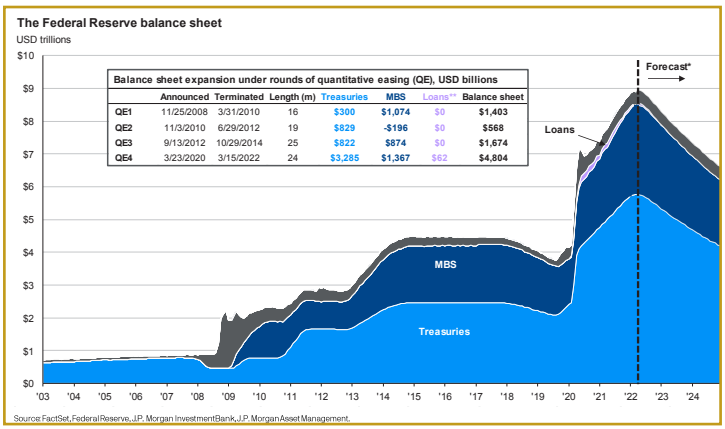
FEDERAL RESERVE: QUANTITATIVE TIGHTENING

- The Federal Reserve raised the federal funds rate by 0.25% at its March meeting to a target range of 0.25% - 0.50%. The accompanying dot plot chart projections suggest members anticipate the federal funds rate rising to 1.875% by year-end and to 2.75% by the end of 2023.
- The Fed also indicated it plans to begin reducing its holdings of Treasury and mortgage-backed securities, perhaps as soon as the May meeting. In recent comments, Fed officials indicated they would likely reduce their balance sheet at a much more rapid pace than the last round of quantitative tightening that began in the fall of 2017, perhaps allowing up to $95 billion in securities to mature every month without being replaced.
- Regarding inflation, it has remained more persistent than the Fed expected, with the CPI rising 7.9% year-over-year in February. As a result, the Fed has indicated they could increase rates by 0.50% at a future meeting.
- Going forward, the Fed faces a difficult balancing act as they tighten monetary policy to slow inflation, while at the same time running the risk of causing a recession.
- As we have noted previously, President Biden has nominated Jerome Powell for a second term as Fed Chairman and Lael Brainard as Vice Chair.

Figure 2. FOMC participants' assessments of appropriate monetary policy: Midpoint of target range or target level for the federal funds rate

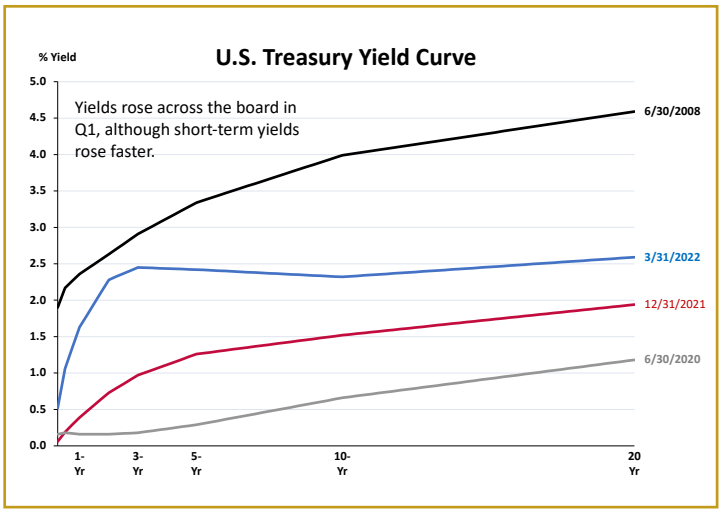


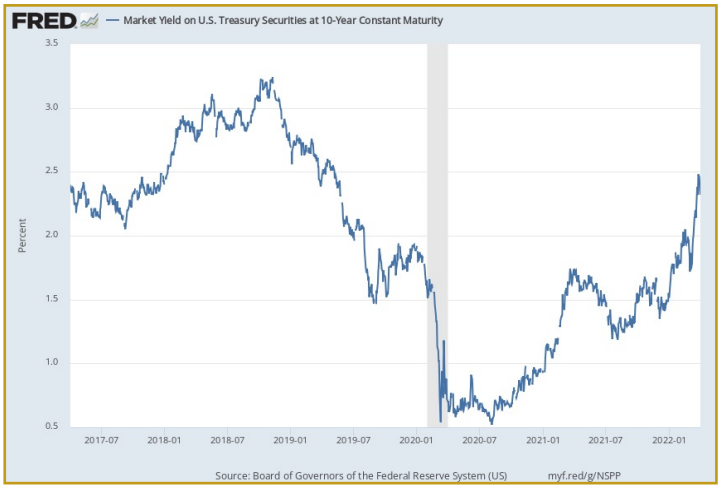


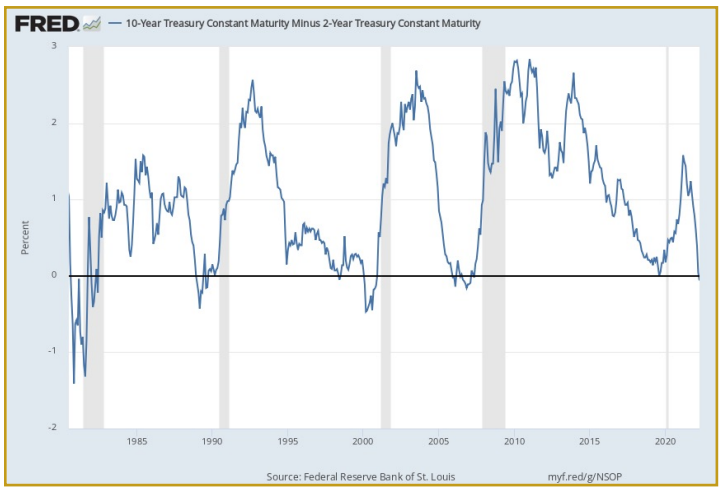


FIXED INCOME: WORST QUARTER IN 40 YEARS

- The Bloomberg Barclays US Aggregate Bond Index experienced its worst quarter in more than 40 years, down -5.93%. The Bloomberg Global Aggregate Ex-US was down -6.15%., the BofA High Yield Index was down -4.51%, and the JP Morgan EM Bond Index was down -10.02%.
- The yield on the 10-year Treasury bond ended the quarter at 2.35%, up from 1.52% at year-end (since quarter-end, the yield has climbed above 2.7%).
- At the end of Q1and into Q2 the yield on the 2-year Treasury bond was higher than the yield on the 10-year Treasury bond, resulting in an inverted yield curve. Historically, inverted yield curves have often (although not always) preceded recessions, with a lag of 6-30 months.
- With the Fed poised to hike interest rates through 2023, it will be a challenging environment for bonds. Bonds seem likely to encounter a second consecutive year of negative returns in 2022, and possibly a third in 2023.
- While yields have risen across the board, credit spreads remain relatively tight. As such, corporate and high yield bonds might face an additional challenge should credit spreads begin to widen.
- Private credit investments are appealing, given their ability to generate attractive risk-adjusted returns vs. traditional fixed income, in exchange for accepting less liquidity and more complexity.
- Bonds continue to be important for providing capital preservation should stocks fall. However, base case return expectations for 2022 and 2023 are poor.



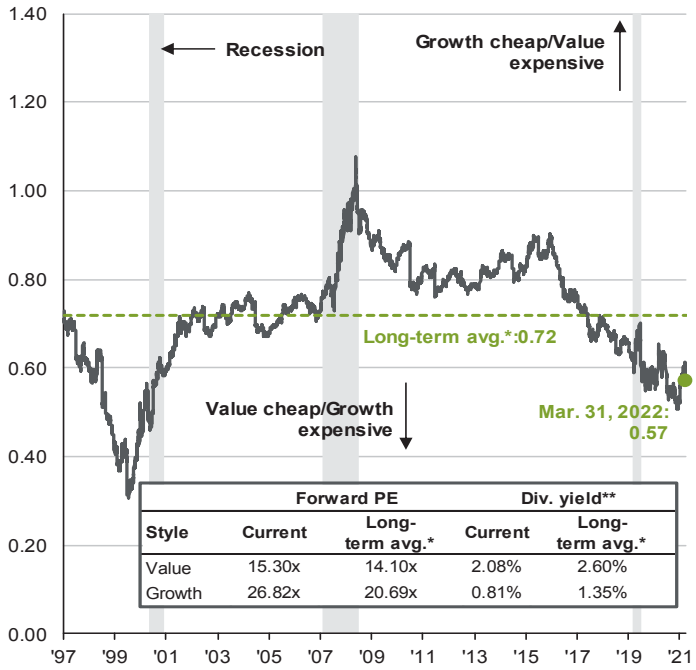




US EQUITIES: BEST DIRTY SHIRT IN THE CLOSET?

- The S&P 500 entered correction territory in Q1, falling about 13% from its 2022 high before rebounding to finish the quarter down -4.6%. Small-cap stocks didn't fare well either, down –7.5% for the quarter and at one point off -15% from their high (and off 20% from 2021 high).
- After years of outperformance, growth stocks underperformed value stocks in Q1. Value stocks remain cheap relative to growth, and higher commodity prices and rising interest rates may disproportionally impact growth stocks.
- US stock valuations remain elevated, with the S&P 500 trading at a 19.5x forward P/E ratio. Valuations for the top 10 stocks in the index, which represent about 30% of the market capitalization, remain especially pricey, trading at a 30.7x forward P/E ratio. As economic growth normalizes, market leadership may begin to rotate.
- After a dramatic rebound in corporate earnings in 2021, profit growth is likely to slow in 2022 given slower economic growth, higher interest rates, and inflation likely resulting in higher wage costs.
- As we noted last quarter, after providing above average annualized returns in excess of 15% over the past decade, it seems unlikely that equities can keep up that pace in the face of rising interest rates, full-valuations, and slowing economic growth.
- While equity returns are likely to be more modest over the next 5–10 years than they have been over the last dozen years, they may still provide more attractive returns than those available from cash and bonds.

Value vs. Growth relative valuations
Rel. fwd. P/E ratio of Value vs. Growth, 1997 - present



	Forward PE		Div. yield**	
Style	Current	Long-term avg.*	Current	Long-term avg.*
Value	15.30x	14.10x	2.08%	2.60%
Growth	26.82x	20.69x	0.81%	1.35%

Source: FactSet, FTSE Russell, NBER, J.P. Morgan Asset Management.

P/E ratio of the top 10 and remaining stocks in the S&P 500
Next 12 months

	Current	Average	% of avg.
Top 10	30.7x	19.9x	154%
Remaining stocks	16.6x	15.7x	106%
S&P 500	**19.5x**	**16.4x**	**119%**

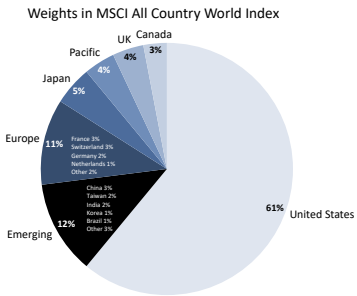
Source: FactSet, Standard & Poor's, J.P. Morgan Asset Management.

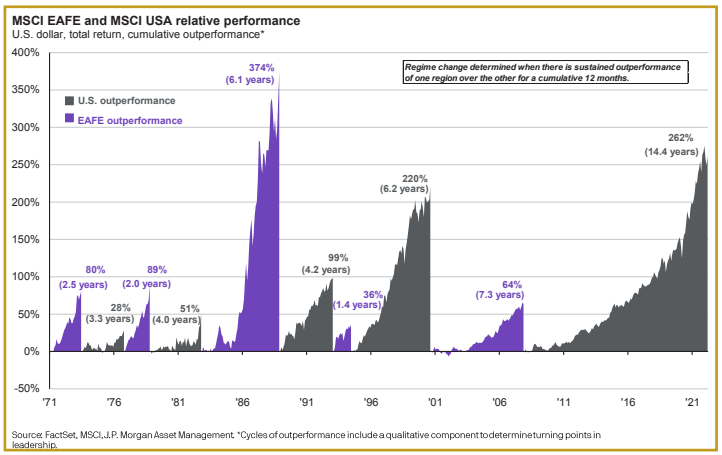
INTERNATIONAL STOCKS: PAST IS RARELY PROLOGUE

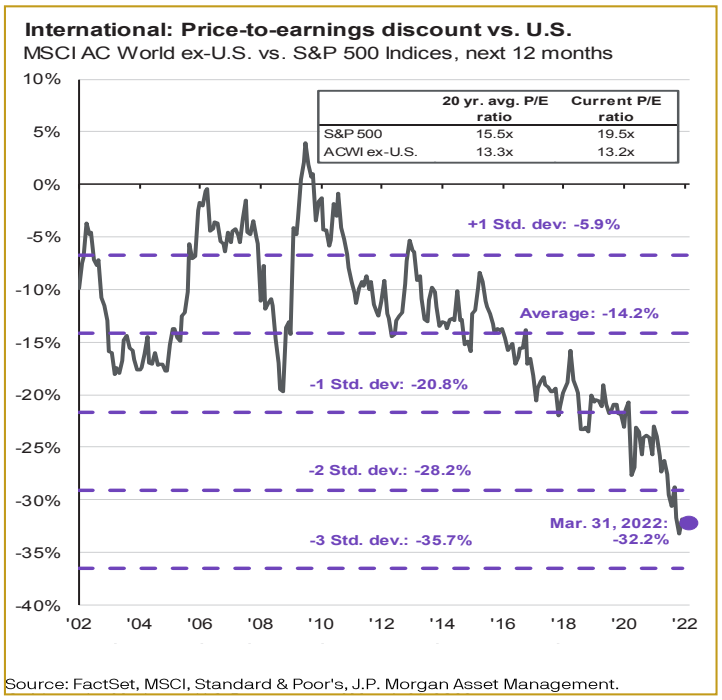
- International stocks declined in Q1, with the MSCI EAFE down -5.9%, the MSCI EAFE Small-Cap Index down -8.5% and the MSCI EM Index down -7.0%.
- The US dollar was up in Q1, +5.6% vs the Yen, +2.7 vs the Euro and +0.03% vs. the World Basket.
- The European Central Bank (ECB) announced a faster wind-down of its buying program in response to higher inflation, likely ending this summer. Expectations are that the ECB could then begin raising interest rates as early as Q4.
- The Bank of Japan (BOJ) could end its negative interest rate policy in Q4 as well.
- As we have noted for several years, US and international stocks have historically gone through leadership cycles over extended periods of time. The current cycle favoring US stocks has been especially long (14.4 years), leading investors to question the continued benefits from international investing.
- So why invest internationally? The rationale goes like this: (1) roughly half of the world market capitalization and 80% of world GDP is outside the US (and thus international markets provide exposure to some of the top companies in the world, (2) including international equities has reduced portfolio volatility (with the greatest risk reduction when international equities are about 30%-40% of the equities), (3) international markets provide exposure to local markets, differing political and economic factors, demographics, and currency movements, and (4) international stock valuations vs. US stocks are cheap.

International Returns: Local Currency vs. U.S. Dollar

	Q1 2022		2021	
	Local	USD	Local	USD
USA (S&P 500)		-4.60		28.71
MSCI EAFE	-3.73	-5.91	18.70	11.26
MSCI EAFE Growth	-9.92	-11.94	19.03	11.25
MSCI EAFE Value	2.68	0.33	17.99	10.89
MSCI EAFE Small Cap	-6.39	-8.53	17.28	10.10
MSCI EAFE Europe	-5.36	-7.37	22.61	16.30
MSCI EAFE Pacific	-0.49	-3.11	11.98	2.63
MSCI Emerging Markets	-6.11	-6.97	-0.19	-2.54

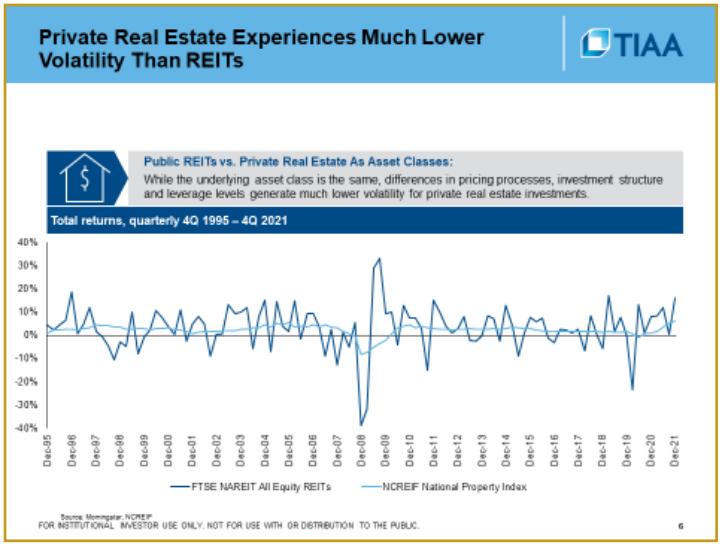






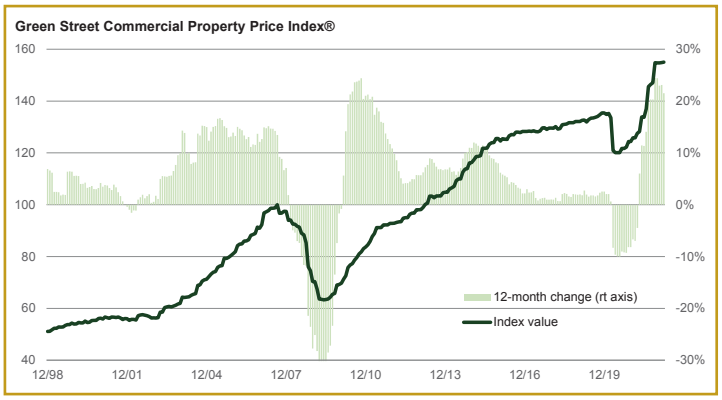
REAL ESTATE: ADJUSTING TO POST-PANDEMIC WORLD

- REITs fell -3.8% in Q1 in response to rising rates and various other issues. Direct real estate (Green Street CPPI) was flat (+0.2%).
- Rising interest rates clearly impact commercial real estate given the leveraged nature of real estate investments. However, value is also based on expectations for future income growth.
- As we have noted previously, the pandemic has altered the way investors view real estate. The acceptance of lifestyle changes such as on-line shopping and remote work will likely have longer-term impacts. As a result, there is greater uncertainty in the office and retail sectors (which have underperformed since Covid) and greater demand for the industrial and apartment sectors. There is also greater interest in the alternative property sector, in areas like self-storage, data centers, and medical office.
- We continue to prefer to invest in real estate via private/direct vehicles vs. publicly traded REITs. Historically, private real estate has provided similar exposure to real estate as REITs, but through a vehicle with steadier income and more modest volatility.
- Given more modest return expectations for stocks and bonds, private real estate offers the opportunity to achieve attractive returns with much lower volatility than publicly traded real estate.



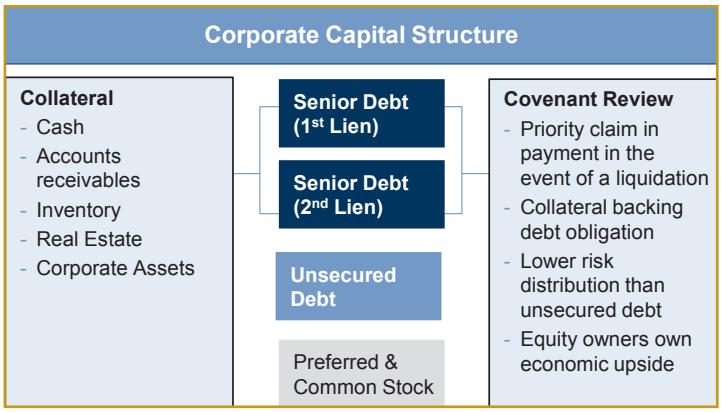
Green Street CPPI®: Sector-Level Indexes

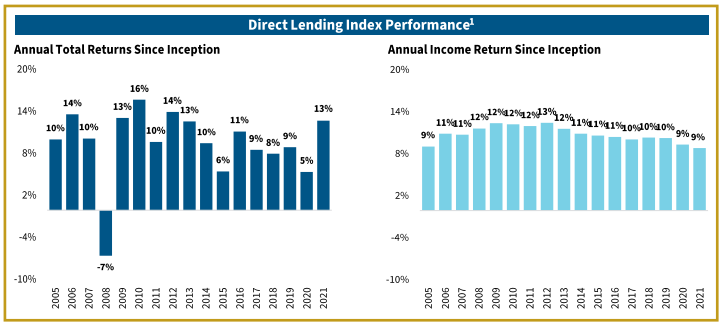
	Index Value	Change in Commercial Property Values		
		Past Month	Past 12 Mos	From Pre Covid
All Property	155.0	0%	22%	15%
Core Sector	159.8	0%	24%	18%
Apartment	190.7	0%	28%	23%
Industrial	253.9	0%	34%	53%
Mall	93.7	-4%	21%	-3%
Office	113.6	0%	6%	-4%
Strip Retail	131.8	4%	35%	17%
Health Care	148.8	-1%	8%	4%
Lodging	110.2	2%	14%	1%
Manufactured Home Park	323.8	0%	24%	34%
Net Lease	115.7	0%	21%	17%
Self-Storage	312.9	0%	64%	69%
Student Housing	168.7	0%	15%	9%



BDCS: STEADY INCOME/RETURNS

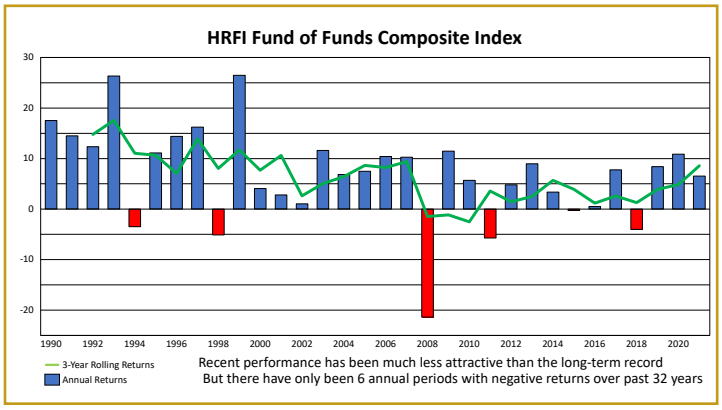
- Publicly traded Business Development Companies (BDCs) had a good quarter, up +3.6% when most investments declined.
- We like the investment opportunity afforded by BDCs and middle market loans. They provide an attractive return, have low exposure to interest rate risk (since most loans are floating rate), and have exhibited low default risk (since most loans are senior secured and have structural covenant protections).
- We continue to believe investing in middle market loans through private BDCs is preferred to publicly traded BDCs. Like our comment on real estate, we prefer the more modest volatility and steady income provided by private BDCs vs. the higher volatility associated with public BDCs.





HEDGE FUNDS: DIDN'T BUCK THE TREND IN Q1

- Like most investments, hedge funds declined in Q1, with the HFRI Hedge Fund-of-Funds index down -2.7%.
- While certain segments of hedge funds have performed well, returns of hedge funds as a class have been disappointing since the great financial crisis.
- Given the low return expectations for stocks and bonds, we continue to monitor hedge funds, noting their potential to generate attractive risk-adjusted returns.



QUOTES OF NOTE:

"The key message from the Fed is that it is focused on fighting inflation and is prepared to hike short-term interest rates steadily and reduce its balance sheet until it reaches its goals. We have no reason to doubt the Fed's intentions but see a risk that it may be over-correcting after having missed the inflation surge since late last year. Investors should be prepared for a bumpy ride."

- *Liftoff: Fed Hikes Rates, Signals More to Come; Kathy Jones, Charles Schwab Asset Management; March 16, 2022*

"It is easy to second-guess complex decisions after the fact. The Federal Reserve (the Fed) and the government did the right thing by taking bold dramatic actions following the misfortune unleashed by the pandemic. In hindsight, it worked. But also in hindsight, the medicine (fiscal spending and QE) was probably too much and lasted too long."

- *Jamie Dimon's Letter to Shareholders, JP Morgan, March 2022*

" . . . but there's also an element of uncertainty around the balance sheet. I think we have a much better sense, frankly, of how rate increases affect financial conditions and, hence, economic conditions. Balance sheet [policy] is still a relatively new thing for the markets and for us, so we're less certain about that."

- *Federal Reserve Chairman Jerome Powell, Press Conference 01/26/22*

"[Equities} seem less dirty than guaranteed negative real return on cash due to high inflation; highly volatile commodities and cryptocurrencies; and bonds that remain vulnerable to further price drops."

- *Mohamed El-Erian's Argument Against Market-Timing; Morningstar 04/07/22*

"CEOs and boards are wrestling with an economic environment with more volatility that's projected to look quite different than it has over the past several decades. The confluence of rising rates, inflation, digital transformation and disruption, energy transition, geopolitical decoupling, and supply-chain vulnerability, among a host of other factors, will drive accelerated change. That change can create opportunities for those that can adapt quickly and pivot, so there is a lot of focus on trying to track where the puck is going."

- *Caryle Group's CEO on Why the Deals Keep Coming, Barron's 04/08/22, Reshma Kapadia*

"Despite recent market angst over yield-curve inversion, we remain confident that a near-term recession is not in the cards, based on several indicators: positive real corporate profits growth, low and falling unemployment, and strong corporate and household balance sheets."

- *Nuveen CIO Weekly Commentary, 04/04/22; Saira Malik, Chief Investment Officer*

"Appreciating why the financial markets acted as they did forestalls rash decisions. Indeed, I would argue that the largest benefit from studying financial history is not to learn which assets have performed best – that information may be quickly learned – but instead to develop a tolerance for the marketplace's bumps. Better to be reflective than angry, frightened or confused."

- *John Rekenthaler, Mohamed El-Erian's Argument Against Market-Timing; Morningstar 04/07/22*

COMPANY UPDATES

Heading into 2022, we have been committed to leveraging the advantages of our association with the larger CI Private Wealth (CIPW) platform on behalf of our clients. This past February our Radnor partners attended the inaugural CIPW partner retreat, designed to foster collaboration, connection, and knowledge-sharing across the CIPW partner network. We continue to forge professional relationships with our partner firms and learn of their respective expertise.

Internally, we were happy to welcome Mike Higgins to our team as an Associate Financial Planner. Having a solid team of professionals that continues to attract top talent supports our ability to consistently deliver exceptional service and expertise. This is reflected in our industry achievements, and we're honored that Michael Mattise was recognized on the Barron's 2022 Top 1200 Financial Advisors List for the 7th consecutive year.

Please feel free to share our quarterly commentary with anyone that you feel may find it helpful. We would welcome the opportunity to share our expertise and unparalleled service with any of your family members, friends, or colleagues who may be seeking prudent, customized financial advice.

IMPORTANT DISCLOSURE INFORMATION