RADNOR
FINANCIAL ADVISORS

# QUARTERLY MARKET COMMENTARY

*Second Quarter 2021*

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# *Committed to Positively Impacting Our Clients' Lives*

*Enclosed is our June quarterly commentary. The rapid pace of the Covid-19 driven decline and subsequent recovery has resulted in unprecedented economic and market cycles. An abundance of positive factors continues to support the economy and markets: progress with vaccinations, removal of Covid-19 restrictions, increased activity from the release of pent-up demand, ongoing fiscal stimulus, and accommodative monetary policy. As a result, equity markets around the world continued their upward climb in Q2 and have now posted positive returns for 5 consecutive quarters.*

The big story at the end of Q2 was the Fed meeting in mid-June which the markets interpreted as having a hawkish tone. The Fed surprised markets in their Summary of Economic Projections by indicating they may increase rates earlier than expected, although Chairman Powell subsequently clarified that the Fed does not intend to raise rates pre-emptively.

On the fiscal policy front, it appears there is agreement on a $579 billon bipartisan infrastructure package. This will likely be followed by a larger partisan plan focused on human infrastructure. Still to be determined are what tax measures will be put in place to pay for the increased spending. The prospect for tax increases include possibly raising the top federal tax bracket, increasing the capital gains tax rate for those earning above $1 million, and doing away with the step-up in basis at death.

Fixed income investments stabilized in Q2, with the yield on the 10-year Treasury Bond ending the quarter at 1.45% , down from 1.74% at the end of March but still up from 0.93% at the end of 2020.

Equity markets will be focused on whether earnings growth can meet current lofty expectations. Also, while equities have generated returns above inflation over longer-term time horizons, equity returns typically experience a pull-back as markets adjust to a higher inflationary environment.

As we move to the second half of 2021, we expect the economic recovery to continue, but perhaps unevenly and with greater uncertainty. We also recognize there are a number of risks as well, including the more infectious Delta variant of Covid-19, higher inflation, timing of Fed tapering, potential tax increases, and potentially peaking corporate earnings growth rates.

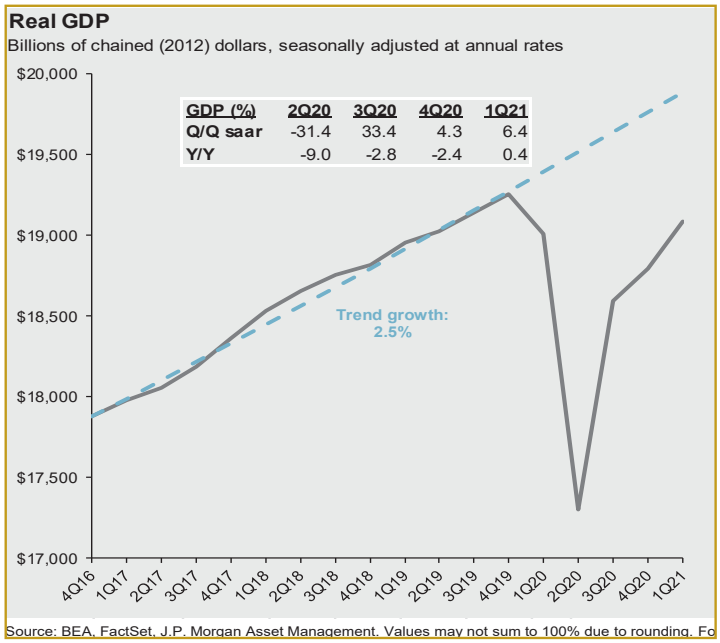
As we have noted previously, we are concerned that returns over the next few year may be more moderate as the reopening settles in and the benefits from fiscal and monetary stimulus fade. We are especially concerned with core fixed income markets, as it will be difficult to generate attractive returns as rates begin to rise. As such, we expect to continue to seek non-traditional investments that we can add to portfolios to provide attractive base returns and provide some inflation protection.

Overall, while our base case remains positive, the range of outcomes seems much wider than usual. As such, we seek to continue to build portfolios that can be resilient across a range of potential scenarios, while providing attractive returns over time. As always, we remain available to assist if you, your family, or friends have any questions or concerns.

- Following a challenging 2020, the US economy and markets are seeing a sweeping recovery powered by a fading of the Covid-19 pandemic and significant monetary and fiscal stimulus.
- In Q2 2021, equity investors experienced their fifth consecutive quarter of positive returns, with the S&P 500 up 8.6%, the Russell 2000 up 4.3%%, and the MSCI EAFE up 5.2%. Bonds were also positive, up 1.8% as rates fell back a bit.
- Economic growth collapsed in the second quarter of 2020 as a result of the lockdowns and subsequently surged in the third quarter. While growth moderated a bit over the winter, it has reaccelerated and recovered beyond the pre-pandemic level in the second quarter. While GDP growth for 2021 is expected to be in the 7% range, it will likely fall back toward a 2% pace after the initial surge.
- The labor market has experienced a similar wild swing, shedding over 22 million jobs between February and April of 2020, resulting in an unemployment rate of 14.8%. The subsequent recovery has added nearly 15 million jobs, reducing the unemployment rate to 5.9% in June (but still higher than the 3.5% in February of 2020).
- While inflation concerns appear to have moderated, the June reading was a surprising 5.4%. While inflation will likely remain above the Fed's 2% target for some time, as the base effects of 2020 pass, supply chain disruptions ease, consumer spending moves toward service/ experience and away from durable goods, and as fiscal stimulus begins to fade, inflation should stabilize.

Investment Performance (Total Return) 06/21

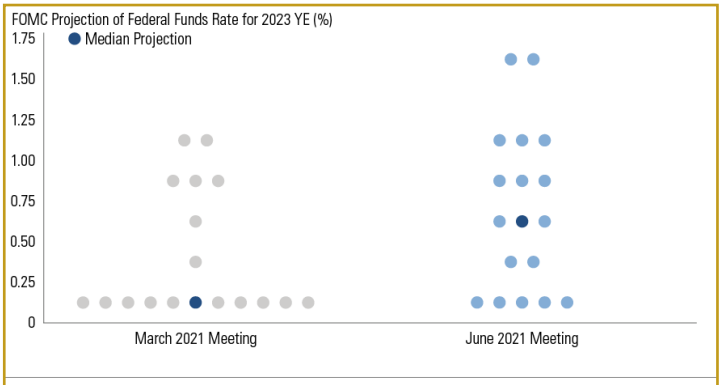
| | 2Q | YTD | 1-Year | 3-Year | 5-Year | 10-Year |
|---|---|---|---|---|---|---|
| S&P 500 | 8.6 | 15.3 | 40.8 | 18.7 | 17.7 | 14.8 |
| Russell 1000 Growth | 11.9 | 13.0 | 42.5 | 25.1 | 23.7 | 17.9 |
| Russell 1000 Value | 5.2 | 17.1 | 43.7 | 12.4 | 11.9 | 11.6 |
| Russell 2000 | 4.3 | 17.5 | 62.0 | 13.5 | 16.5 | 12.3 |
| Russell 2000 Growth | 3.9 | 9.0 | 51.4 | 15.9 | 18.8 | 13.5 |
| Russell 2000 Value | 4.6 | 26.7 | 73.3 | 10.3 | 13.6 | 10.9 |
| MSCI EAFE | 5.2 | 8.8 | 32.4 | 8.3 | 10.3 | 5.9 |
| MSCI EAFE SC | 4.3 | 9.0 | 41.0 | 8.4 | 12.0 | 8.4 |
| MSCI EME | 5.1 | 7.5 | 40.9 | 11.3 | 13.0 | 4.3 |
| Wilshire REIT | 12.8 | 22.8 | 37.5 | 10.1 | 6.4 | 9.4 |
| HFR Fund-of-Funds Comp | 2.7 | 4.8 | 18.1 | 6.3 | 6.1 | 3.8 |
| Barcap Aggregate Bond | 1.8 | -1.6 | -0.3 | 5.3 | 3.0 | 3.4 |
| Barcap Muncipal | 1.4 | 1.1 | 4.2 | 5.1 | 3.3 | 4.3 |
| Bloomberg Commodity | 13.3 | 21.2 | 45.6 | 3.9 | 2.4 | -4.4 |



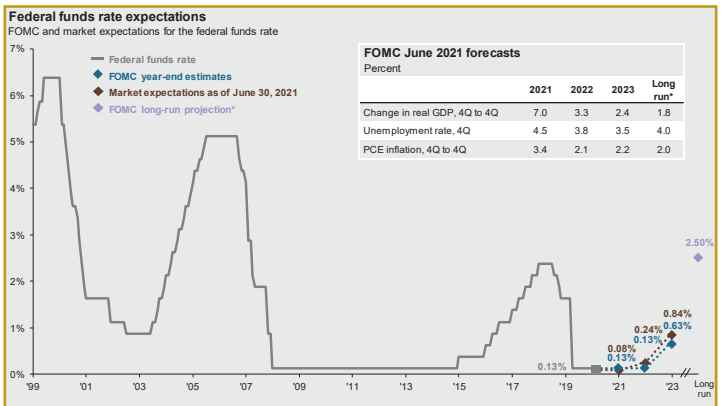

- Throughout this unusual period, we have maintained a long-term view and focused on positioning portfolios to reflect the changing investment backdrop. To us, the key to successful investing remains to diversify, rebalance, and maintain patience. As always, we will continue to focus longer-term and try to avoid over-reacting to short-term market noise.

## FEDERAL RESERVE: STILL ACCOMMODATIVE POSTURE

- Following the Federal Reserve's June FOMC meeting, Chairman Powell said: "You can think about this meeting that we had as the 'talking about talking about tapering" if you like."
- While the Fed continues to signal that it intends to remain supportive of the economy, the June dot plot chart was more hawkish, with 13 of the 18 members expecting a rate hike in 2023 and 7 members seeing a hike in 2022.
- Following the June FOMC meeting, the Fed maintained the federal funds rate at a target range of 0.0% - 0.25% and indicated it would continue bond purchases at a pace of $120 billion per month until substantial further progress is made in the recovery. As such, the Fed's balance sheet will continue to grow.
- Inflation has popped higher in the past few months, with the CPI up 5.4% in June after being up 5% in May and 4.2% in April. However, the Fed continues to believe the higher inflation figures are transitory and will settle back once pressures from pent-up demand and supply bottlenecks subside.
- The current environment may test the Fed's new average inflation targeting framework. Under this new strategy, if the economy is below full employment, the Fed will allow inflation to run moderately above its 2% target for some time to make up for periods where inflation undershoots its 2% target. Essentially, the Fed is seeking to maintain a 2% average inflation over time, which gives them more flexibility in adjusting rates.



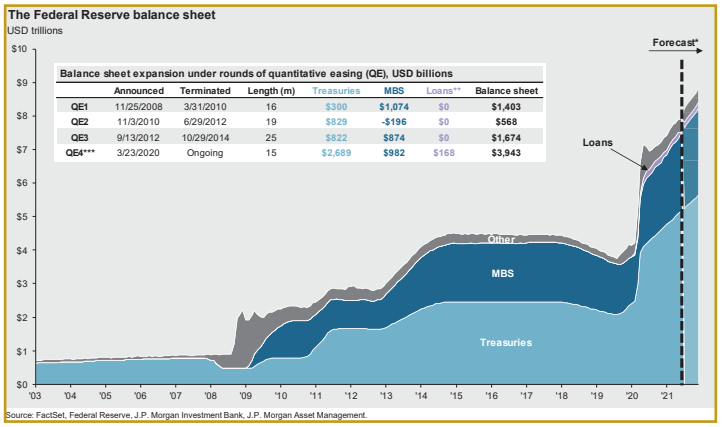

Source: Federal Open Market Committee and Goldman Sachs Asset Management




FOMC June 2021 forecasts
Percent

| | 2021 | 2022 | 2023 | Long run* |
|---|---|---|---|---|
| Change in real GDP, 4Q to 4Q | 7.0 | 3.3 | 2.4 | 1.8 |
| Unemployment rate, 4Q | 4.5 | 3.8 | 3.5 | 4.0 |
| PCE inflation, 4Q to 4Q | 3.4 | 2.1 | 2.2 | 2.0 |

Source: Bloomberg, FactSet, Federal Reserve, J.P. Morgan Asset Management.



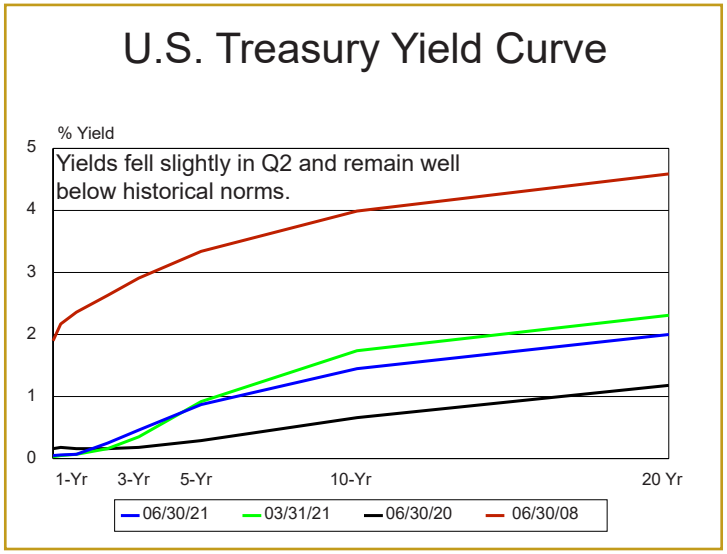

Balance sheet expansion under rounds of quantitative easing (QE), USD billions

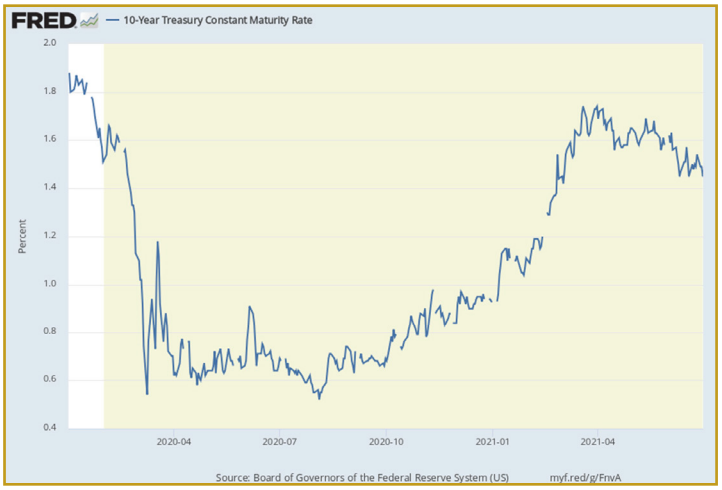
| | Announced | Terminated | Length (m) | Treasuries | MBS | Loans** | Balance sheet |
|---|---|---|---|---|---|---|---|
| QE1 | 11/25/2008 | 3/31/2010 | 16 | $300 | $1,074 | $0 | $1,403 |
| QE2 | 11/3/2010 | 6/29/2012 | 19 | $829 | -$196 | $0 | $568 |
| QE3 | 9/13/2012 | 10/29/2014 | 25 | $822 | $874 | $0 | $1,674 |
| QE4*** | 3/23/2020 | Ongoing | 15 | $2,689 | $982 | $168 | $3,943 |

Source: FactSet, Federal Reserve, J.P. Morgan Investment Bank, J.P. Morgan Asset Management.

## FIXED INCOME: WHAT TO MAKE OF YIELDS?

- The Bloomberg Barclays US Aggregate Bond Index was up 1.8% in Q2, as interest rates eased. The BofA High Yield Index was up 2.8% in Q2, while the S&P Levered Loan Index was up 1.5% and the JP Morgan EM Bond Index was up 4.1%.
- The yield on the 10-year Treasury bond ended the quarter at 1.45%, down from 1.74% at the end of March, but up from 0.93% at the end of 2020 and the 0.52% low in August of 2020.
- Despite the recovery in Q2, this remains a challenging year for bond investors. Q2 was especially unusual as higher inflation figures were accompanied by declining interest rates. This may be more reflective of short-term factors, including global investors desire for "safe haven" assets in a world where the yield on the 10-year German bond is negative and the yield on the 10-year Japanese bond is near zero.
- While short-term rates will likely remain anchored near zero for some time, intermediate-term and long-term rates could begin to tick up given the restarting economy and significant fiscal stimulus. Moreover, as we look at the direction of interest rates over the next few years, they seem clearly tilted toward moving higher.
- While fixed income will continue to play an important role in diversifying portfolios to offset the volatility of equities, it may be challenging for traditional fixed income investments to generate attractive returns over the next few years. As such, we continue to explore private/less liquid fixed income investments to diversify portfolios and provide a more attractive return opportunity.



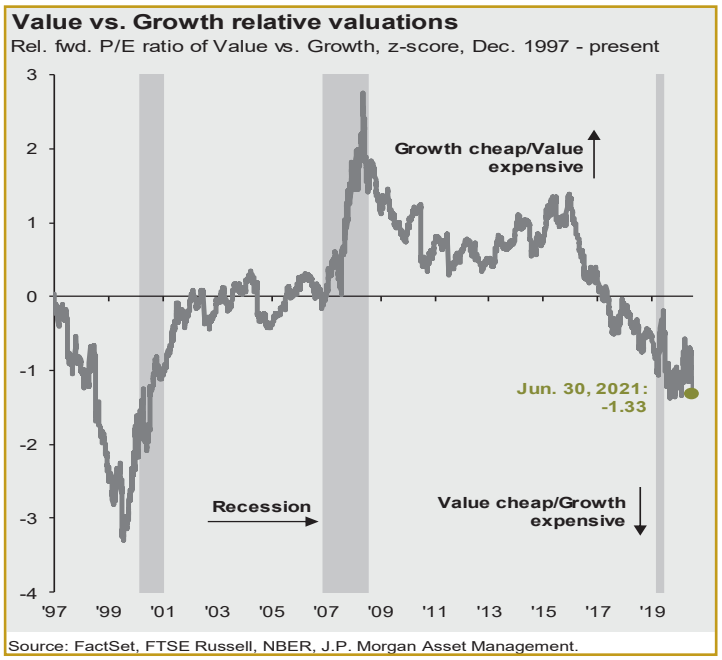

## US EQUITIES: EARNINGS ARE KEY

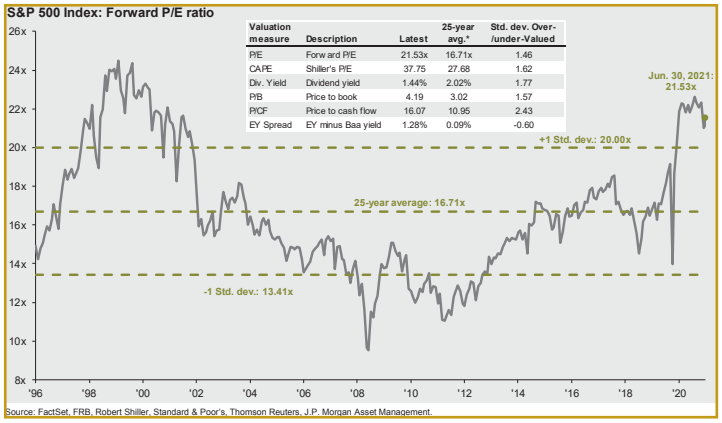
- US stocks posted double-digit gains in the first half of 2021, with the S&P 500 Index up 15.3% and the Russell 2000 Index up 17.5%. Value stocks outperformed growth stocks, although the rotation to value from growth took a pause in Q2 as large-cap growth outperformed. Small-cap value remains the best performer, up 26.7%.

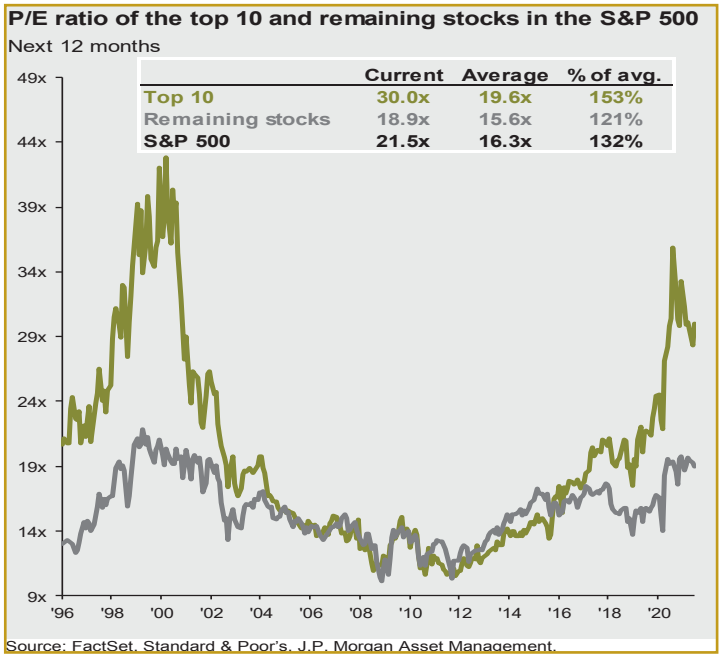
- Small-cap stocks ended June with their ninth consecutive month of gains. The Russell 2000 Index has returned 54% since September of 2020 vs. 29% for the S&P 500. While the Russell 2000 index includes the same sectors as the S&P 500, it is weighted more heavily to financial and industrial companies, which historically have tended to be more sensitive to the economy. Moreover, small cap companies tend to have less diversified businesses and more volatile earnings than large-cap stocks.

- Value stocks continue to appear cheap vs. growth stocks, and additional infrastructure spending should be a positive for value stocks. However, once we get past the pandemic recovery, growth may slow, and growth stocks have traditionally performed better in a slow growth environment. As such, we continue to suggest maintaining a balanced approach.

- While valuations for US stocks remain elevated (especially for the largest 10 companies), the P/E ratio has been falling given the rapid acceleration of earnings. Moreover, low interest rates may justify higher stock valuations versus historical averages.



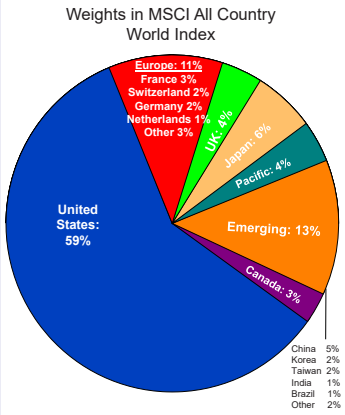



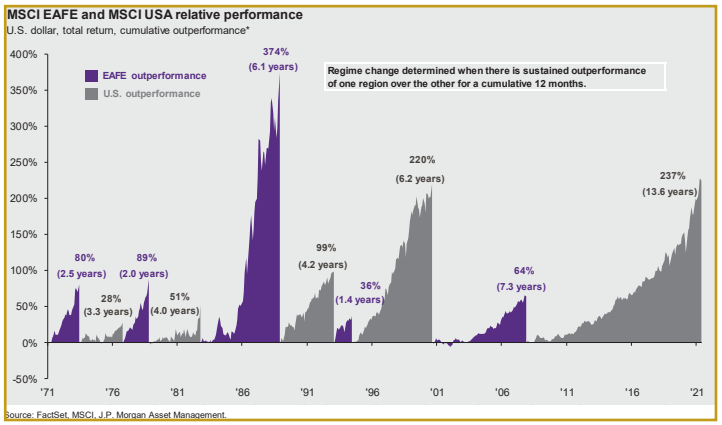
## INTERNATIONAL STOCKS: WHY BOTHER?

- Developed international stocks were up 5.2% in Q2, with international small-cap stocks (4.3%) and emerging market stocks (5.1%) slightly trailing.
- Of the 23 developed markets countries in the MSCI EAFE Index, only two have not produced positive returns in 2021 (Portugal and New Zealand).
- The US dollar was mixed in Q2, rising +0.41% vs. the Yen but falling -0.87% vs. the Euro and -1.14% vs. the world basket.
- While the European Central Bank (ECB) has upgraded its economic outlook for the eurozone, it indicated it would keep its aggressive monetary stimulus in place. Unlike the US economy, which is back to its pre-pandemic size, the eurozone isn't expected to recover until next year.
- Similarly, the Bank of Japan (BOJ) indicated that its economy is recovering, but that it will continue all monetary policy stimulus. This includes extending the purchase of commercial paper and corporate bonds through March of 2022.
- Given the significant outperformance by US stocks now continuing over 13 years, investors may be wondering why bother investing in international stocks. While US stocks have performed extremely well, is it reasonable to expect this trend to continue for the next 13 years while the rest of the world is taking a bigger share of the global economy? Moreover, it is important to remember that investing is unpredictable and that the main purpose for investing in international equities is to increase the likelihood that your portfolio will benefit from global growth.

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

| | Q2 2021 | | 2021 YTD | |
|---|---|---|---|---|
| | Local | US Dollars | Local | US Dollars |
| USA (S&P 500) | | 8.6 | | 15.3 |
| MSCI EAFE | 4.8 | 5.2 | 12.8 | 8.8 |
| MSCI EAFE Growth | 6.9 | 7.4 | 11.0 | 6.8 |
| MSCI EAFE Value | 2.7 | 3.0 | 14.4 | 10.7 |
| MSCI EAFE Small Cap | 4.1 | 4.3 | 12.8 | 9.0 |
| MSCI EAFE Europe | 6.5 | 7.4 | 14.5 | 11.8 |
| MSCI EAFE Pacific | 1.9 | 1.3 | 9.8 | 3.9 |
| MSCI Emerging Markets | 3.8 | 5.1 | 8.0 | 7.5 |

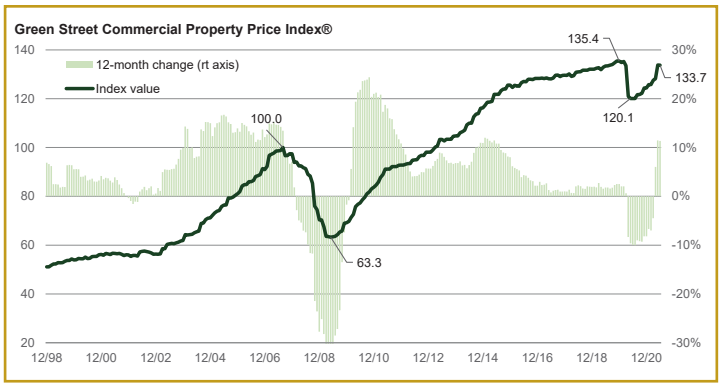


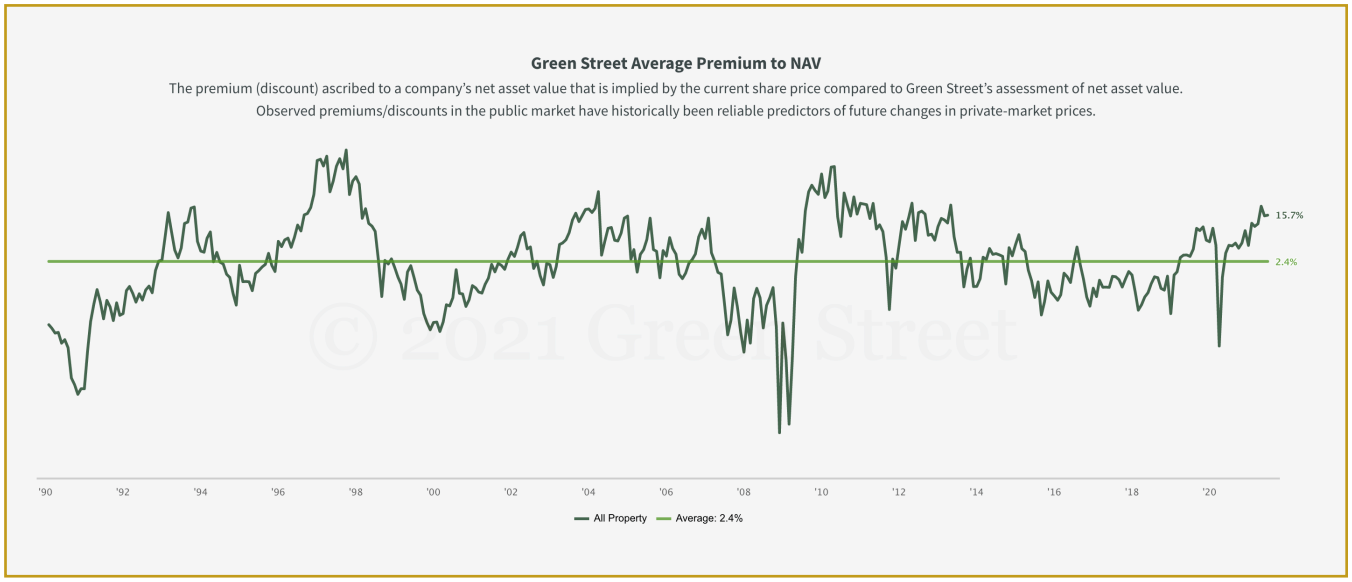




- Within international, we continue to allocate to international small-cap stocks, which historically have been a less efficient asset class, with lower correlation to US stocks, while outperforming developed international large-cap stocks.
- We continue to believe international equities are an important part of a portfolio. They provide diversification through exposure to different economic conditions, currencies, and demographics, thereby expanding the universe of investments and potential return opportunities.

## REAL ESTATE: MORE THAN JUST DIVERSIFICATION

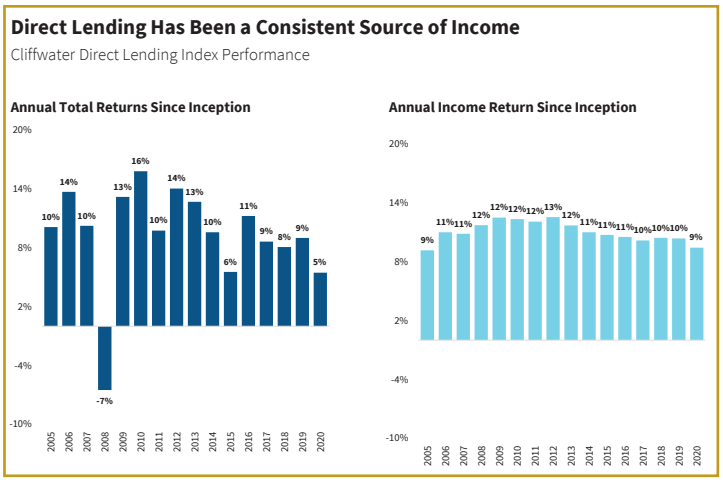
- REITs had a terrific first half, up 12.8% in Q2 and up 22.8% YTD. Direct real estate (Green Street CPPI) has also performed well, up 8% YTD, but trailed REITs.
- After suffering a significant decline last year (-42.8%), REITs have recovered and are again trading at a significant premium to their net asset value.
- Although real estate values recovered from their pandemic lows, uncertainty persists, especially in the retail and office sectors. Retail landlords are struggling as tenants seek rent relief or default, and properties are being repurposed as the adoption of e-commerce accelerates. While office has been resilient near-term due to long-term leases and lenient lenders, more flexible office and work-from-home policies lead to a less certain future.
- Overall, commercial real estate markets were remarkably resilient during the pandemic. Values declined much less than during the 2008 financial crisis and the number of forecloses barely increased (thanks in large part to the government's efforts to support the economy and provide banks with flexibility).
- Going forward, alternative property types will likely become a mainstay in real estate portfolios. Medical office, life science facilities, data centers, cell towers, self-storage facilities and single-family rentals are likely to garner more attention, as tenant demand for these non-traditional property types differs from core real estate.
- Given increased concerns with inflation, real estate's ability to benefit from rising rental income and property values is attractive. We continue feel direct/private real estate is an attractive part of a diversified portfolio, providing income with low correlation to traditional stocks and bonds.

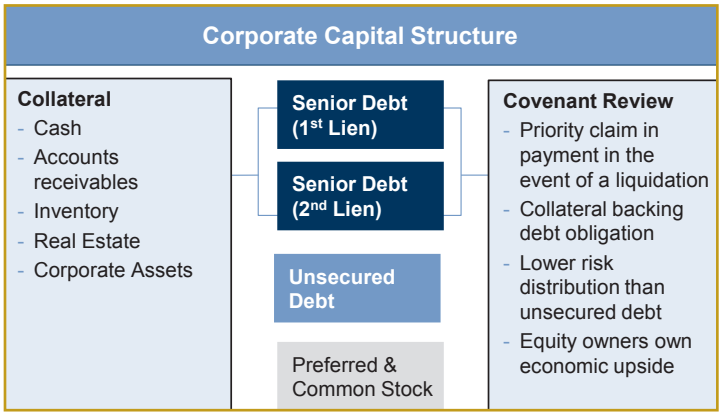


## BDCS: PROVIDING AN ATTRACTIVE YIELD

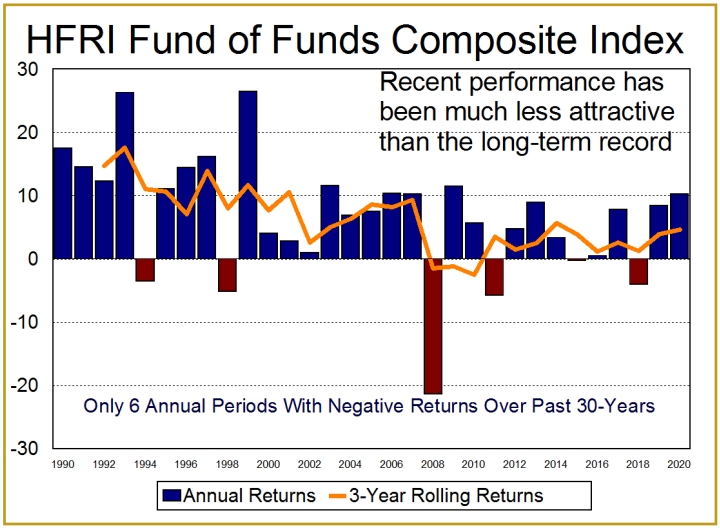
- The Wells Fargo BDC Index's total return in Q2 was up 7.5% and up 26.4% YTD.
- We continue to like private middle market loans. As traditional bank lenders have exited the space, private capital has stepped in to meet the demand.
- We believe it is important to partner with private lenders that take a long-term underwriting view of credit and focus on downside risk protection (recognizing that in credit, you make money by collecting interest and not losing principal).
- Borrowers are willing to pay higher yields and accept financial and maintenance covenants from private lenders who provide certainty of execution, have flexibility in deal structure, and have the ability move quickly and at any size.
- We believe direct lending provides an opportunity to earn an attractive return via loans that are senior secured and primarily floating rate (thus providing a hedge against rising interest rates and inflation).




## HEDGE FUNDS: BETTER PROSPECTS?

- The HFRI Hedge Fund-of-Funds Composite was up 2.7% in Q2 and is up 4.8% YTD. However, returns over the past decade remain disappointing (3.8%).
- As we have noted previously, given the more modest return expectations for traditional investments, the appeal of hedge funds remains their potential to generate attractive risk-adjusted returns with low correlation to stocks and bonds.



## QUOTES OF NOTE:

*"We are mindful that the COVID-19 pandemic remains a serious challenge, despite largely successful vaccination efforts in the U.S. and other developed countries."*

- *Nuveen Weekly Equity Market Commentary, June 21, 2021*

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*"We believe the pandemic was the market equivalent of a major natural disaster and what we are seeing now in the United States primarily reflects a steep climb back to normalcy. It is our contention that inflation is rapidly approaching its peak as year-over-year comparisons begin to look less startling. Nonetheless, we acknowledge that longer-term US risk-free rates are likely too low relative to fundamentals, and we look for the US 10-year Treasury yield to rise from its current 1.50% toward 2% in the near-to-intermediate term as the global economy continues to recover."*

- *Outlook on the United States, July 2021, Lazard Asset Management*

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*"Second quarter is likely the peak growth rate for both the economy and corporate earnings; with positive economic surprises waning."*

- *2021 Mid-Year Outlook: U.S. Stock and Economy, June 1, 2021, Liz Ann Sonders, Charles Schwab*

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*"Over the past three decades, US core inflation has remained low and relatively stable. Recent price pressure stemming from economic reopening and recovery has increased the latest May US core PCE print to 3.4% YoY. While elevated, history shows that even in low inflation regimes, episodes of higher inflation occurred and proved transitory in the past. We expect this time to be similar."*

- *Goldman Sachs Market Monitor, June 25, 2021*

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*"It is true that every crisis is different, but I think the best way to deal with them is always the same. We can't control crises, but we can control our response to them. You want to be prepared to deal with the unexpected before it happens. Not when you're stuck in the middle of it."*

- *David Booth on the "Old Normal", Dimensional Fund Advisors, 06/25/20*

## COMPANY UPDATES

As the second quarter was coming to a close, it was announced that Radnor Financial Advisors had signed an agreement to join CI Financial, a leading global asset and wealth management firm that is actively expanding in the U.S. We believe this gives Radnor the benefit of the size and scale of CI Financial while maintaining the small firm culture and fiduciary client focus we have always exhibited. From your perspective, we expect the transition to be seamless, as there is no change to who you work with at Radnor, the services we provide or how you contact and interact with us. We are excited about the future of Radnor and the strong alignment of mission, vision and values we share with CI Financial.

One of our greatest assets is ensuring we are attracting and retaining exceptional talent, and building a strong and supportive community. Jason Swartz and Max Elfenbein are students at Temple University who have joined us for our summer intern program. Lilli Smith, one of our interns from last summer, officially joined Radnor full-time in May as an Associate Planner. Laura Russell also came on board in May as Financial Support. The Radnor family has additionally expanded by a couple of new faces with the birth of Austin Hoggan's twin boys, August and Bennett, who arrived in early July. While our close-knit family at Radnor continues to steadily grow, we are also celebrating the 10-year work anniversary of Kapil Patel this summer. We're delighted to welcome our new team members and we congratulate Austin and Kapil on these exciting milestones.

*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

Please remember that past performance may not be indicative of future results. Different types of investments involve varying degrees of risk, and there can be no assurance that the future performance of any specific investment, investment strategy, or product (including the investments and/or investment strategies recommended or undertaken by Radnor Financial Advisors, LLC), or any non-investment related content, made reference to directly or indirectly in this quarterly market commentary will be profitable, equal any corresponding indicated historical performance level(s), be suitable for your portfolio or individual situation, or prove successful. Due to various factors, including changing market conditions and/or applicable laws, the content may no longer be reflective of current opinions or positions. Moreover, you should not assume that any discussion or information contained in this quarterly market commentary serves as the receipt of, or as a substitute for, personalized investment advice from Radnor Financial Advisors, LLC. To the extent that a reader has any questions regarding the applicability of any specific issue discussed above to his/her individual situation, he/she is encouraged to consult with the professional advisor of his/her choosing. Radnor Financial Advisors, LLC is neither a law firm nor a certified public accounting firm and no portion of the quarterly market commentary content should be construed as legal or accounting advice. A copy of the Radnor Financial Advisors, LLC's current written disclosure statement discussing our advisory services and fees is available for review upon request. Please Note: Radnor Financial Advisors, LLC does not make any representations or warranties as to the accuracy, timeliness, suitability, completeness, or relevance of any information prepared by any unaffiliated third party, whether linked to Radnor Financial Advisors, LLC's web site or quarterly market commentary or incorporated herein, and takes no responsibility therefore. All such information is provided solely for convenience purposes only and all users thereof should be guided accordingly.