RADNOR
FINANCIAL ADVISORS

QUARTERLY MARKET COMMENTARY

Third Quarter 2021

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Committed to Positively Impacting Our Clients' Lives

Enclosed is our September quarterly commentary. The past 18-months have been a whirlwind, with Covid-19 abruptly halting economic activity in the first half of 2020. In response, we saw an outpouring of monetary and fiscal stimulus enacted to help support economies. Equity markets responded initially by falling dramatically and then recovering equally fast. Equities have now posted six consecutive quarters of positive returns, despite the September dip.

While Covid-19 case are currently receding, the Delta variant tempered growth in Q3, with GDP likely to be about ½ of the Q2 GDP growth of 6.7%. However, economists expect the recovery will reaccelerate as the virus eases. Nevertheless, we expect uncertainty will remain in the fall, given continued Covid-19 pressures, uncertain fiscal stimulus as Congress grapples with the infrastructure bill and the reconciliation bill (focused on "social infrastructure"), tax changes, and the likelihood that the Federal Reserve will start tapering its bond buying. After six quarters of gains, equity investors might be reminded this fall that higher volatility is why stocks generate higher returns.

The Fed continues to be a focal point in the recovery. Following their September FOMC meeting, the Fed suggested that it could be appropriate to reduce the pace of asset purchases this year (i.e., tapering), possibly as soon as its next meeting in November. Fed Chairman Powell also noted that the uptick in inflation might last longer than they anticipated, although he expects many of the underlying factors are transitory and will eventually fade.

A key development we will be monitoring in Q4 is potential tax law changes. The House Ways and Means Committee released tax provisions as part of the Build America Back Better Act. The proposal included provisions such as raising the corporate tax rate to 26.5%, increasing the highest marginal income tax bracket to 39.6%, and increasing the capital gains tax rate to 25%. The proposal also seeks to revert the unified estate/gift tax credit back to $5 million per taxpayer, adjusted for inflation (so roughly $6 million per taxpayer), effective 01/01/22.

Fixed income investments were flat in Q3, as yields increased in response to continued inflationary pressures and expectations that the Fed will begin a less accommodative monetary stance. The yield on the 10-year Treasury Bond ended the quarter at 1.52%, after falling as low as 1.19% in early August.

Equities experienced volatility in September, falling -4.65%. Market action suggests the risk from the Delta variant is manageable. While earnings may slow, they are likely to remain above pre-pandemic levels.

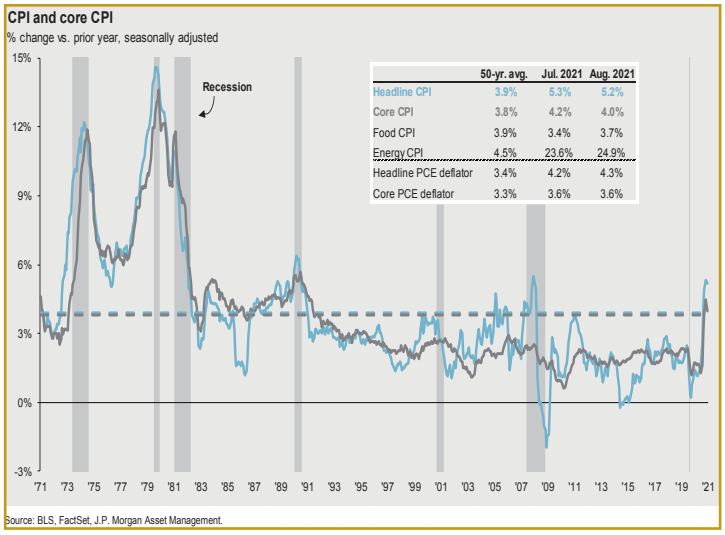
We remain cautious that returns over the next few years may be more modest. Core fixed income has a low current yield and it will be difficult to generate attractive total returns as interest rates begin to rise. At the same time, it seems unlikely that equities will be able to repeat the 16% annualized return from the past 10-years, and may fall short of the 10% -12% historical annualized expected return. As such, we will continue to seek non-traditional investments that we believe can achieve attractive returns but are less dependent on the broad bond and stock markets.

We will continue to manage portfolios to be resilient across a range of market conditions while seeking attractive returns over time. As always, we remain available to assist if you, your family, or friends have any questions.

- As we enter the fall of 2021, the economy continues to rebound from the pandemic, but is experiencing a few hiccups due to the Delta variant and continued supply chain disruptions. We will likely continue to see economic challenges in the coming months but remain hopeful that 2022 will see a broadening global recovery.
- Q3 2021 saw a sixth consecutive quarter of positive returns for equity investors, with the S&P 500 up 0.58%. Bonds were also positive for the quarter, up 0.05%, despite an uptick in interest rates. However, the Russell 2000 fell -4.36% and the MSCI EAFE fell -0.45%.
- Economic growth likely moderated in Q3, with economists expecting GDP to be about ½ of the 6.7% from Q2. While full-year GDP expectations have fallen a little, 2022 GDP expectations have risen.
- The labor market continues to recover, with the unemployment rate at 4.8% in September. However, after losing 22.4 million jobs in the early stages of the pandemic, the recovery remains incomplete.
- Inflation continues to be a concern as CPI has been tracking above 5% year-over-year since the start of the summer. While portions of the increase in inflation are likely temporary, others such as those resulting from supply chain disruptions are proving to be more persistent. The key will be how core inflationary factors like wages react longer-term. In any case, it looks like inflation will remain above the Fed's 2% target for some time.

Investment Performance (Total Return) 9/21

	3Q	YTD	1-Year	3-Year	5-Year	10-Year
S&P 500	0.58	15.92	30.00	15.99	16.90	16.63
Russell 1000 Growth	1.16	14.30	27.32	22.00	22.84	19.68
Russell 1000 Value	-0.78	16.14	35.01	10.07	10.94	13.51
Russell 2000	-4.36	12.41	47.68	10.54	13.45	14.63
Russell 2000 Growth	-5.65	2.82	33.27	11.70	15.34	15.74
Russell 2000 Value	-2.98	22.92	63.92	8.58	11.03	13.22
MSCI EAFE	-0.45	8.35	25.73	7.62	8.81	8.10
MSCI EAFE SC	0.90	10.02	29.02	9.05	10.38	10.73
MSCI EME	-8.09	-1.25	18.20	8.58	9.23	6.09
Wilshire REIT	1.64	24.79	38.04	10.39	6.97	11.30
HFR Fund-of-Funds Comp	1.37	6.38	15.00	6.72	5.93	4.53
Barcap Aggregate Bond	0.05	-1.55	-0.90	5.36	2.94	3.01
Barcap Muncipal	-0.27	0.79	2.63	5.06	3.26	3.87
Bloomberg Commodity	6.59	29.13	42.29	6.86	4.54	-2.66



- As always, we try to maintain a long-term perspective and avoid overreacting to short-term market noise. We believe the key to long-term investment success remains diversifying sources of return and rebalancing portfolios periodically. It also helps to take advantage of unique investment opportunities where available.

FEDERAL RESERVE: TIME TO TAPER?

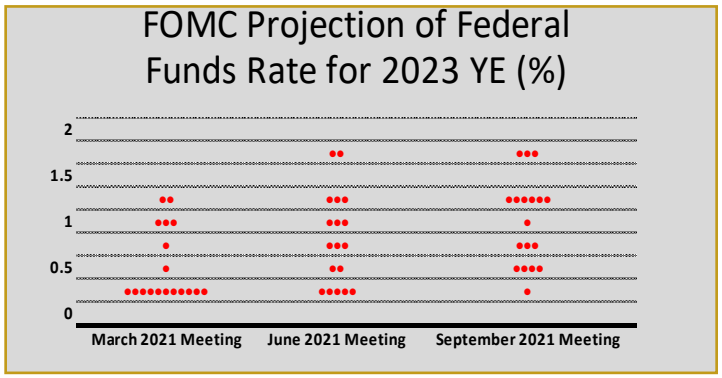
- In its policy statement following the September FOMC meeting, the Fed noted "a moderation in the pace of asset purchases may soon be warranted." Moreover, Fed Chair Jerome Powell indicated in his post meeting press conference that the winding down of the Fed's $120 billion per month bond purchases may begin this year and wind down fully by mid-2022.

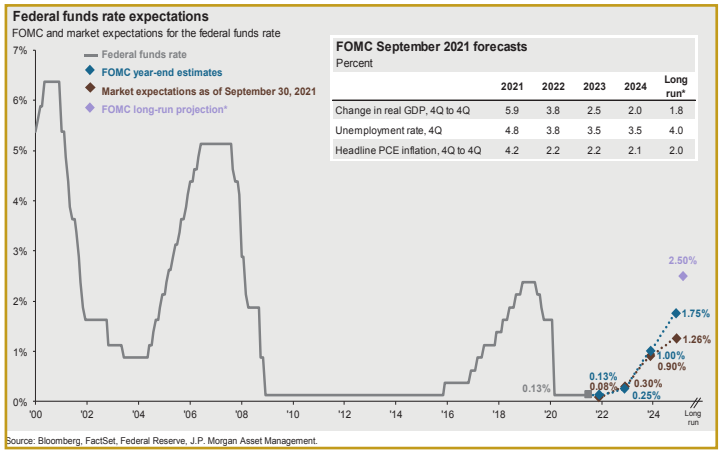
- While the Fed maintained the federal funds rate at a target range of 0.0% - 0.25%, the dot plot projections suggest half of the 18 members see a rate hike in 2022 and all but one now sees at least one rate hike in 2023.

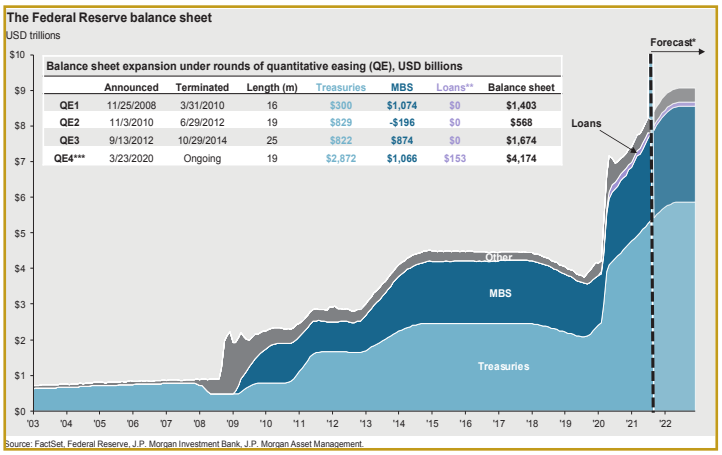
- Inflation moderated somewhat in the summer after spiking in the spring, as CPI was up 0.5% in July and 0.3% in August, with the 12-month increase at the end of August at 5.2%. While the Fed acknowledges that the recent spell of higher inflation might last longer than anticipated, they continue to expect much of the inflation pressure to be transitory, and that inflation will fade over time.

- President Biden will play a big part in reshaping the Fed. Jerome Powell's term as chair expires on 02/05/22. While he has generally received high marks for steering the economy through the pandemic and would likely be confirmed if renominated, progressive groups are voicing concerns on issues that are traditionally not major points of contention (such a financial regulation) or have never come up before as a Fed goal (such as climate change).

- Richard Clarida's term as Vice Chair and Randal Quarles term as Vice Chair for Supervision expire next year and are unlikely to be renominated. There is also a current vacancy, so President Biden may have three board positions to fill in addition to choosing the Chair.

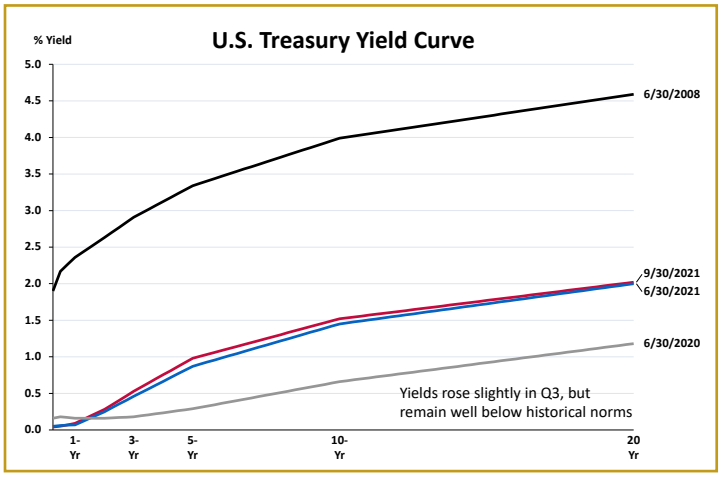






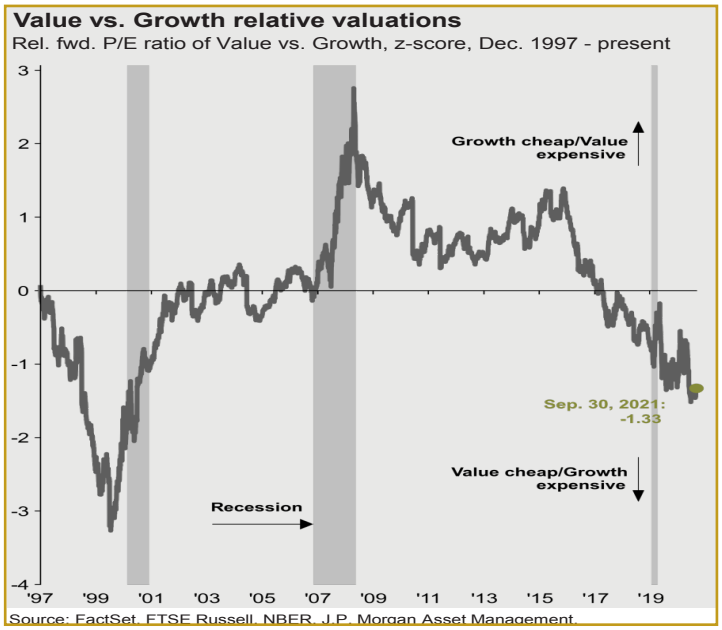
FIXED INCOME: CHALLENGE OF INVESTING IN BONDS

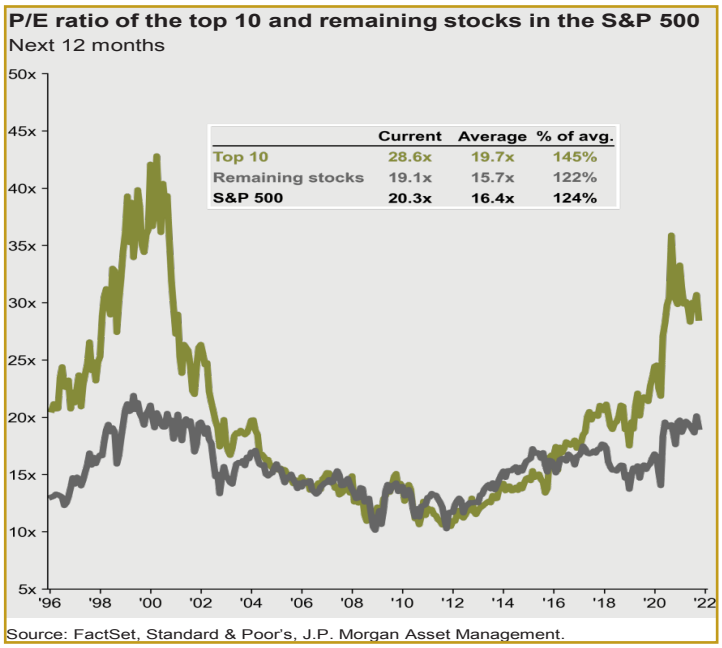
- The Bloomberg Barclays US Aggregate Bond Index was up 0.05% in Q3. The BofA High Yield Index was up 0.94% in Q3, while the S&P Levered Loan Index was up 1.11% and the JP Morgan EM Bond Index was down -0.70%.
- The yield on the 10-year Treasury bond ended Q3 at 1.52%, up from its quarterly low of 1.19% in early August and up slightly from 1.45% at the end of Q2.
- 2021 has been a challenging year for bond investors, as reflected in the -1.55% total return of the Bloomberg Barclays US Aggregate Bond Index. The fact that yields have been relatively stable in an environment of higher inflation and expectations of Fed tapering is surprising.
- Zero/negative interest rate policy remains a key market support and has led to a record supply of investment grade corporate bonds.
- Returns from traditional bonds are not expected to be much above zero over the next few years. Credit spreads are tight and the expected rising interest rate environment will challenge total returns given the low level of current rates.
- Nevertheless, fixed income can continue to play an important role in diversifying portfolios and provide capital preservation to offset the volatility of equities.
- Within portfolios, we will continue to utilize flexible bond strategies and private/less liquid fixed income investments to diversify portfolios and provide a more attractive return opportunity within the fixed income allocation.

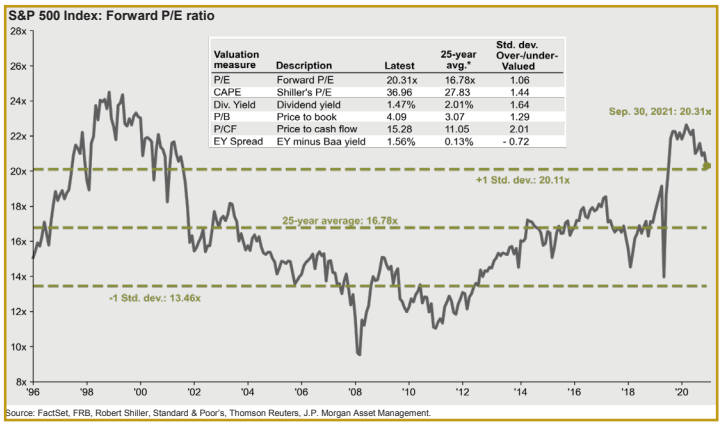


US EQUITIES: WHAT'S NEXT? EARNINGS KEY

- Large-cap US stocks eked out a small gain in Q3 (+0.58%) and continue to have robust returns YTD (+ 15.92%). Small-cap stocks fell in Q3 (-4.36%) but remain up YTD (+12.41%).
- While large-cap value stocks started the year outperforming, growth outperformed again in Q3 and returns YTD are about the same. The question everyone is grappling with is whether the rotation to value from growth has taken a pause or whether the rotation was short-lived. Although value stocks continue to appear cheap vs. growth stocks, given the uncertain environment, we continue to suggest maintaining a balanced approach.
- Over the past 12-months, the Russell 2000 Index has returned 47.68% vs. 30% for the S&P 500. However, over the past few months large-cap stocks outperformed. Again here, investors are wondering whether the rotation to small-cap stocks was short-lived or has just taken a pause. We continue to maintain a direct allocation to small-cap stocks expecting to earn a return premium over time.
- While valuations for US stocks remain elevated (especially for the largest 10 companies), the P/E ratio has been falling given the increase in earnings. Moreover, low interest rates may justify higher stock valuations versus historical averages.
- After an impressive showing YTD in 2021 and having posted an annualized return of 16.6% over the past 10-years, what can we expect going forward from stocks? Unfortunately, starting points matter, and while we remain constructive on equities, more muted return expectations seem sensible at this stage of the market cycle.





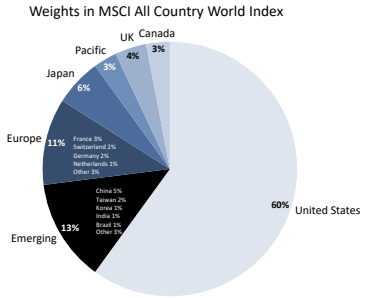


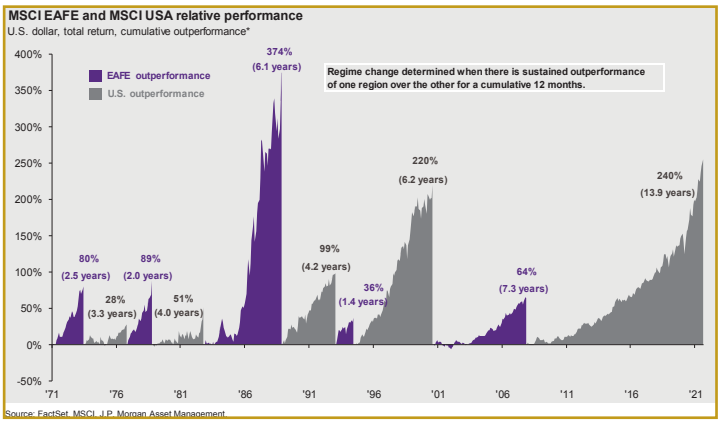
INTERNATIONAL STOCKS: OPPORTUNITIES?

- Although YTD returns remain positive, developed international stocks fell slightly in Q3 (-0.45%) and emerging market stocks fell -8.09%, although international small-cap stocks were up 0.90%.
- The US dollar has been up in 2021, +7.95% vs. the Yen, +5.62% vs. the Euro and +2.99% vs. the World Basket.
- The economic restart appears to be broadening, leading to hopes that a more synchronized global expansion can take hold as supply chain problems fade and vaccination rates increase to the point where international mobility improves.
- Historically, both US and International stocks have taken turns leading global markets, often for long periods of time and by wide margins. Since the 2008-2009 global financial crisis, US stocks have dominated. However, over the past 50-years, the MSCI EAFE has outperformed the S&P 500 24 times.
- The predominant approach to classifying securities geographically is based on the company's domicile. However, it may also be important to recognize the geographic revenue exposure of companies. Many US companies have significant revenue outside of the US and many international companies have significant revenue in the US.
- September saw two significant elections. In Japan, Fumio Kishida was elected Prime Minister, while in Germany, the Social Democratic Party (SDP) won, but not with enough seats in parliament to form a government, likely resulting in a centrist coalition government.

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

	Q2 2021		YTD 2021	
	Local	USD	Local	USD
USA (S&P 500)		0.58		15.92
MSCI EAFE	1.32	-0.45	14.23	8.35
MSCI EAFE Growth	1.81	0.07	12.99	6.88
MSCI EAFE Value	0.82	-0.97	15.28	9.61
MSCI EAFE Small Cap	2.61	0.90	15.75	10.02
MSCI EAFE Europe	0.54	-1.55	15.12	10.07
MSCI EAFE Pacific	2.77	1.55	12.86	5.50
MSCI Emerging Markets	-6.69	-8.09	0.73	-1.25





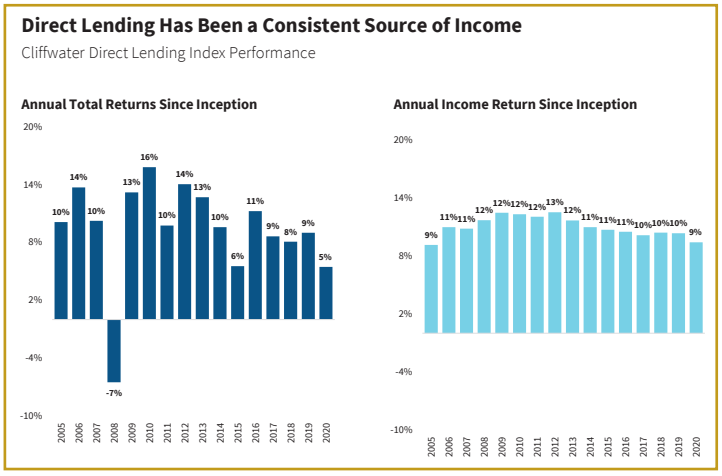
- September also saw the ECB announce plans to taper bond purchases.
- International small-cap stocks have outperformed developed international large-cap stocks over the past 20-years, but are generally overlooked by US investors.
- International markets have been a staple of a diversified portfolio, representing about 40% of the worldwide market capitalization and more than 80% of global GDP. We continue to believe international stocks provide diversification through exposure to different economic conditions, currencies, and demographics, thereby expanding the investment universe and broadening potential return opportunities.

REAL ESTATE: INCOME, STABILITY, INFLATION HEDGE

- REITs continued their upward climb in Q3, up 1.65% and up 24.79% YTD. Direct real estate (Green Street CPPI) has trailed REITs YTD, but have also performed very well, up 9% in Q3 and up 18% YTD.
- Uncertainty persists, especially in the retail and office sectors as office subleasing increases available supply and the adoption of e-commerce continues to expand.
- Given the lower return expectations for core real estate assets and as allocations to traditional office and retail shrink, investment in alternative property types is becoming mainstream. Interest is increasing in areas such as medical office, data centers, self-storage and single-family rentals, which have differentiated supply-demand drivers.
- Our primary reason for owning real estate is that it offers an attractive return with modest volatility. However, with the recent increase in inflation, we are reminded that real estate also benefits from rising rental income and rising property values over time, thus providing inflation protection.
- We continue to like direct private real estate (private investment in institutional-quality commercial property) as a consistent component of a diversified portfolio. Real estate provides attractive cash-flow and returns that are less volatile and less correlated with public market investments given its quarterly NAV, consistent income and illiquidity premium.

BDCS: CONSISTENT SOURCE OF INCOME

- The S&P BDC Index provided a total return of +2.3% in Q3 and is now up +31% YTD, reflecting the recovery of public BDCs after having dropped significantly in the spring of 2020.
- Business Development Companies (BDCs) lend money to private small- and medium-size companies. At least 70% of a BDCs assets must be invested in US companies with market capitalizations under $250 million. They also must distribute at least 90% of their taxable income to shareholders each year as ordinary dividends, which allows them to avoid tax at the corporate level.
- When investing in middle market loans, we believe it is important to have a partner that takes a long-term underwriting view of credit and focuses on downside risk protection.



- Overall, we like the investment opportunity afforded by BDCs and middle market loans. They have low exposure to interest rate risk (since most loans are floating rate), limited credit risk (since most loans are senior secured and have structural covenant protections), and historically have tended to provide a persistent opportunity set regardless of economic cycle.

QUOTES OF NOTE:

"Fixed income investors face hurdles to building resilient portfolios that meet their objectives. Low overall interest rates and compressed yield spreads portend weak returns in coming years. At the same time, investors may be exposed to rising longer-term inflation and increased volatility as economies recover and central banks reduce support."

- *Flexible Fixed Income: How to Navigate the Challenges of 2021 and Beyond; PIMCO Featured Solution, September 2021*

"Valuation expansion has accounted for much of U.S. equities' greater-than-expected returns over a decade characterized by low growth and low interest rates. That is, investors have been willing, especially in the last few years, to buy a future dollar of U.S. company earnings at higher prices than they'd pay for those of ex-U.S. companies. Just as low valuations during the global financial crisis supported U.S. equities' solid gains through the decade that followed, today's high valuations suggest a far more difficult climb in the decade ahead. The big gains of recent years make similar gains tomorrow that much harder to come by unless fundamentals also change. U.S. companies will need to realize rich earnings in the years ahead for recent investor optimism to be similarly rewarded."

- *Why market forecasts mater to long-term investors; Joe Davis, The Vanguard Group, 09/23/21*

"Lower return expectations, particularly for bonds, mean the standard 60/40 portfolio is less likely to produce the returns it has historically. At the same time, alternative asset classes such as private equity and private debt are becoming more accessible to individual investors, expanding the universe of potential investment options within their portfolios."

- *Beyond 60/40: Allocating to Private Markets; Hamilton Lane; Summer 2021*

"Investors seem ready to move on from the "there is no alternative" mind-set that has guided their decisions since the 2008 crisis. But TINA may be harder to quit than they think."

- *There Is Still No Alternative for Investors, Wall Street Journal, 09/29/21*

"I think you take a long-term perspective. You decide how much risk you 're willing to take, and then you choose a mx of bonds, stocks, Treasury Inflation-Protected Securities, and whatever else satisfies your long-term goals. And you forget about the short term. Maybe you rebalance occasionally because the weights can get out of whack, but don't try to time the market in any way, shape or form. It's a losing proposition."

- *Inflation: An Exchange Between Eugene Fama and David Booth, Second Quarter, 2021*

"Important disciplines to heed in the current environment are diversification – both within and among asset classes – and periodic rebalancing. With regard to rebalancing, it's one of the most beneficial disciplines in that it forces us to do what we know we're supposed to do – add low, trim high. Notice I adjusted that from the classic "buy low, sell high" adage; which can infer an all-or-nothing strategy. Frankly, investors should never think of investing as either "get in" or "get out". That is gambling on moments in time; while investing should always be a disciplined process over time."

- *You Take My Breadth Away: Market's Underlying Deterioration; Liz Ann Sonders; Charles Schwab Market Commentary 08/23/21*

COMPANY UPDATES

We are proud to report that Justin Spike, Casey Shure, Carl Rosenfeld, and Mike Mattise were honored with the Five Star Wealth Manager award again this year, demonstrating our firm's collective commitment to delivering best-in-class service and expertise to our clients. Our bench of strong talent continues to grow following the culmination of another successful summer internship program, and we are pleased that our summer intern, Max Elfenbein, has accepted a full-time position as Associate Planner. We are also excited to welcome two new faces to the extended Radnor family—Kapil Patel's baby girl, Ella, and Joe Moffitt's baby girl, Gemma, both made their debut in September.

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