RADNOR
FINANCIAL ADVISORS

QUARTERLY MARKET COMMENTARY

Fourth Quarter 2021

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Committed to Positively Impacting Our Clients' Lives

Enclosed is our year-end quarterly commentary. As we look back, if we had been told at the end of 2019 that a multi-year pandemic was about to begin, we would never have predicted the investment returns that followed. Equities earned positive returns for seven consecutive quarters. In 2021, the S&P 500 was up 28.7% and hit 70 record highs (which is more than ¼ of the trading days).

While the emergence of the Delta variant impacted markets in September and the Omicron variant spooked investors over Thanksgiving, vaccine deployment and adaptation to the Covid environment have allowed economies to withstand successive virus waves.

Despite the uncertain environment from Covid, the economy remains strong. Gross Domestic Product (GDP) surpassed its pre-pandemic level in 2021 and growth is likely to be in excess of 5% for 2021, aided by monetary and fiscal support as well as the resumption of activity.

Economic growth is expected to remain above trend in 2022, but there will likely be greater headwinds. Fiscal stimulus from the American Rescue Plan Act of 2021 will begin to fade, and the future of the Build Back Better legislation is uncertain. The direction of monetary policy may be more predictable. The Fed will likely accelerate tapering of asset purchases, consider raising interest rates (perhaps as early as March) and contemplate reducing its balance sheet.

Geopolitical risks remain, with tensions between the US and China and issues involving Russia/Ukraine as well as the Middle East.

Core fixed income investments were down slightly in 2021, as yields drifted higher in response to continued inflationary pressures, economic growth, and expectations that the Fed will be less accommodative. The yield on the 10-year Treasury Bond ended the year at 1.52%, after starting the year at 0.93% and rising as high as 1.74% in March (it has since ticked higher again in early 2022).

2021 saw relatively calm markets, with the S&P 500's biggest drawdown only 5% and interest rates trading in a fairly narrow range for much of the year. However, certain investments saw what former Fed Chair Alan Greenspan might term irrational exuberance, including SPACS, cryptocurrencies and meme stocks. The market for nonfungible tokens seemed particularly exuberant, as a digital collage of images by an artist who goes by the name Beeple sold for $69.3 million at a Christie's auction in March.

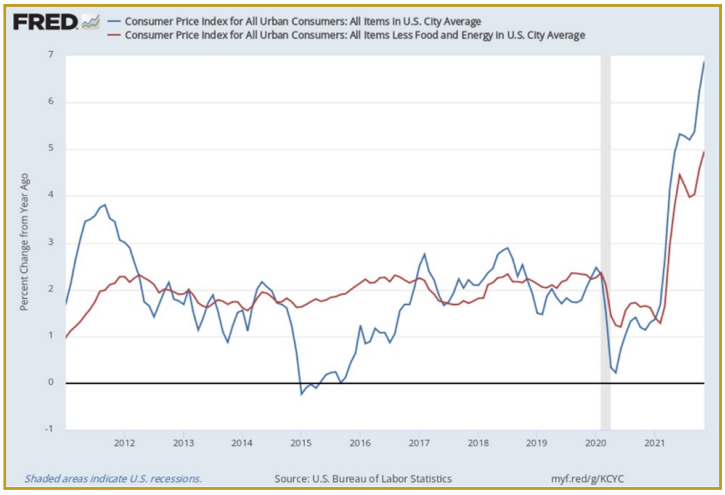
So where do we go from here? 2022 is likely to be more challenging as central banks unwind monetary accommodation and fiscal support starts to fade. Rising interest rates and more persistent inflation pressures will likely make it difficult to generate attractive returns from traditional fixed income. It will also likely be a more moderate return environment for equities as well, especially given that investors have become accustomed to the 16%+ annualized return over the past decade. As such, we continue to seek non-traditional investments that can achieve good returns but are less correlated to traditional stocks and bonds.

We continue to position portfolios to achieve attractive returns, while also being prepared should we experience a more challenging environment. Although many uncertainties remain, we will continue to focus on the basics: diversify, rebalance, and remain disciplined.

- 2021 was another terrific year for equity investors, with the S&P 500 up 28.7% and up 26.1% annualized over the past three-years. US small-cap stocks and international stocks trailed US large-cap stocks in 2021, but still provided attractive returns. Bonds and emerging market equities declined.
- A strong dollar, the renewed surge in Covid infections late in the year (particularly in Europe and emerging markets) and China's policy-induced economic slowdown helped drive the disparity of returns.
- Economic growth rebounded in Q4 after posting a disappointing 2.3% increase in Q3. Economists expect full year 2021 GDP to be in excess of 5% and 2022 GDP to remain above trend.
- The labor market continues to recover, with the unemployment rate at 3.9%. However, November and December saw a slowdown in hiring, and overall employment remains nearly 3.5 million workers lower than pre-Covid.
- Inflation remains elevated, as the December CPI hit 7.0%. While inflation is likely to moderate in the second half of 2022 as supply chain disruptions fade, it will likely remain above the Fed's 2% target.
- Looking forward, we expect the pandemic to recede (but perhaps not disappear), and corporate earnings growth to slow.

Investment Performance (Total Return) 12/21

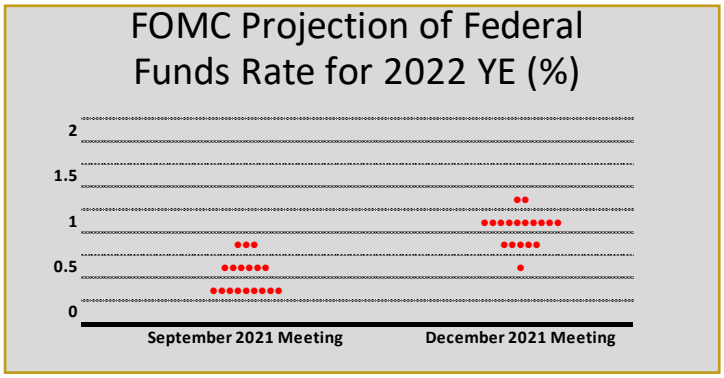
	4Q	YTD	3-Year	5-Year	10-Year	15-Year
S&P 500	11.03	28.71	26.07	18.47	16.55	10.66
Russell 1000 Growth	11.64	27.60	34.08	25.32	19.79	13.72
Russell 1000 Value	7.77	25.16	17.64	11.16	12.97	7.51
Russell 2000	2.14	14.82	20.02	12.02	13.23	8.69
Russell 2000 Growth	0.01	2.83	21.17	14.53	14.14	9.97
Russell 2000 Value	4.36	28.27	17.99	9.07	12.03	7.19
MSCI EAFE	2.69	11.26	13.54	9.55	8.03	3.60
MSCI EAFE SC	0.07	10.10	15.62	11.04	10.80	5.58
MSCI EME	-1.31	-2.54	10.94	9.87	5.49	4.45
Wilshire REIT	17.14	46.18	19.19	10.92	11.47	6.80
HFR Fund-of-Funds Comp	0.76	6.53	8.59	5.78	4.59	2.78
Barcap Aggregate Bond	0.01	-1.54	4.79	3.57	2.90	4.09
Barcap Muncipal	0.72	1.52	4.73	4.17	3.72	4.22
Bloomberg Commodity	-1.56	27.11	9.86	3.66	-2.85	-2.59

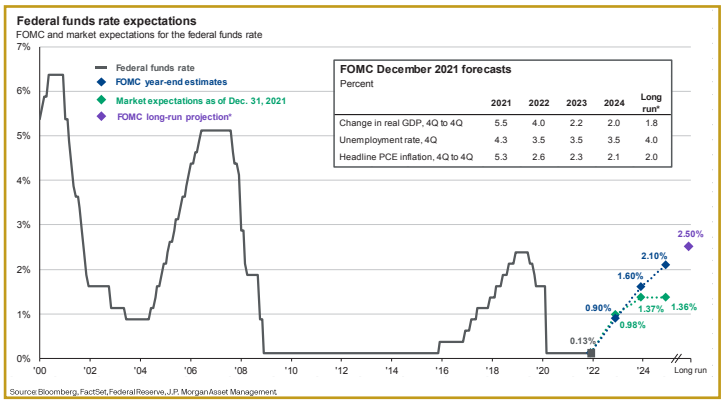


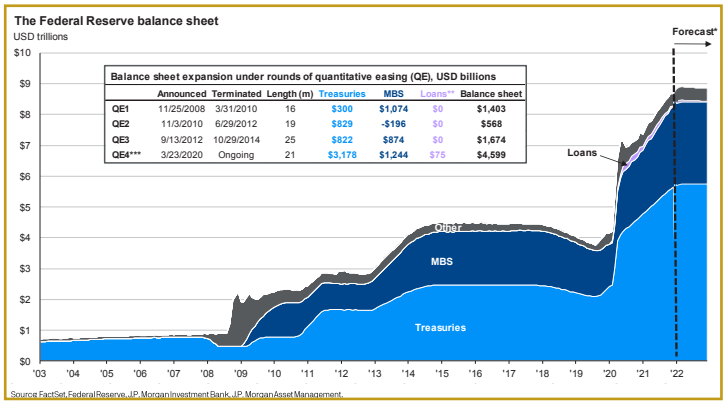
- As always, we try to remain disciplined, maintain a long-term perspective and avoid overreacting to short-term market noise. We believe the key to long-term investment success remains diversifying sources of return and rebalancing portfolios periodically. It also helps to be open to unique private investment opportunities where available to earn the potential premium for accepting illiquidity and/or complexity.

FEDERAL RESERVE: POLICY PIVOT

- In its policy statement following the November FOMC meeting, the Fed announced that it would taper bond purchases. Following the December meeting, they noted they would accelerate the tapering to $30 billion per month, which puts them on track to end bond purchases in March of 2022.
- While the Fed has maintained the federal funds rate at a target range of 0.0% - 0.25%, the December dot plot projections suggest members anticipate three rate hikes in 2022 (possibly beginning as early as March), a significant policy pivot.
- After the Fed completes the wind-down of their bond purchase program and begins raising interest rates, the next item they'll likely undertake is how they would shrink their nearly $9 trillion portfolio of US Treasury and mortgage-backed securities.
- With regard to inflation, Fed Chairman Jerome Powell suggested it's probably time to retire the word "transitory" in describing inflation pressures. Inflation has been more persistent than the Fed expected, with the CPI rising 7.0% year-over-year in December. However, while the risk of higher inflation has increased, the Fed still believes inflation will moderate over the course of 2022.
- In November, President Biden eliminated some uncertainty by nominating Jerome Powell for a second term as Fed Chairman and Lael Brainard as Vice Chair.

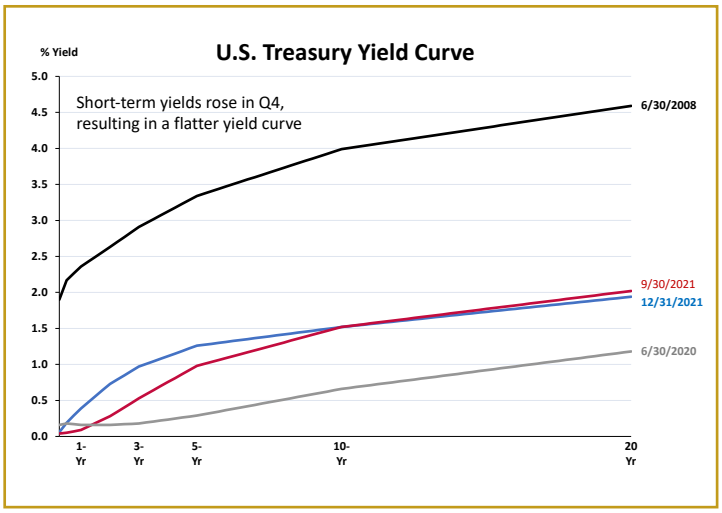


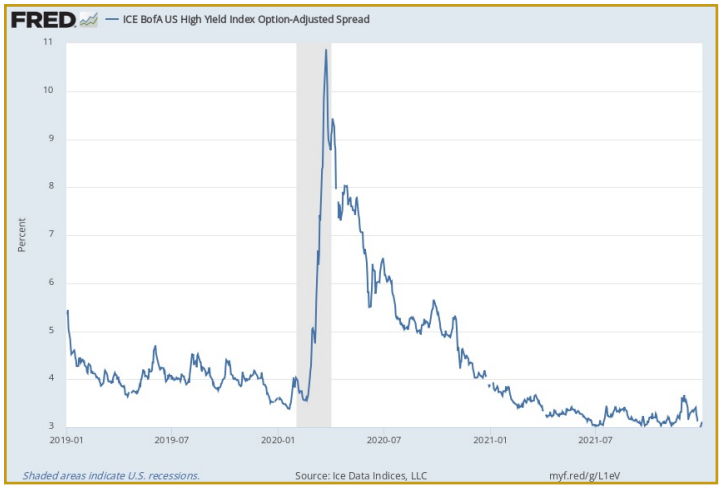




FIXED INCOME: 2ND NEGATIVE YEAR AHEAD?

- 2021 was challenging for core bonds, as the Bloomberg Barclays US Aggregate Bond Index was down -1.54% and the Bloomberg Global Aggregate Ex-US was down -7.05%. The BofA High Yield Index was up 5.36%, while the JP Morgan EM Bond Index was down -1.80%.
- The yield on the 10-year Treasury bond ended the year at 1.52%, off the 1.74% March highs, but has since ticked back up.
- The environment for fixed income investors continues to look challenging, given current low yields, inflation pressures continuing, and a Fed poised to begin raising interest rates. The bond math associated with such an environment suggests the potential to encounter a rare second consecutive year of negative returns for core bond allocations.
- While high yield bonds performed well in 2021, credit spreads remain tight, and the rising interest rate environment will likely begin to have a negative impact on total returns over the next few years (as yields rise and credit spreads likely widen).
- Private credit remains attractive, as investors can generate reasonable risk-adjusted returns compared to traditional fixed income, but need to give up some liquidity and accept some complexity.
- Despite the challenging environment for bonds, they continue to play an important role in providing capital preservation should the economy slip and equities drop. We continue to utilize flexible bond strategies and private/less liquid fixed income investments to provide a more attractive return opportunity within the fixed income allocation.





US EQUITIES: EARNINGS REMAIN KEY

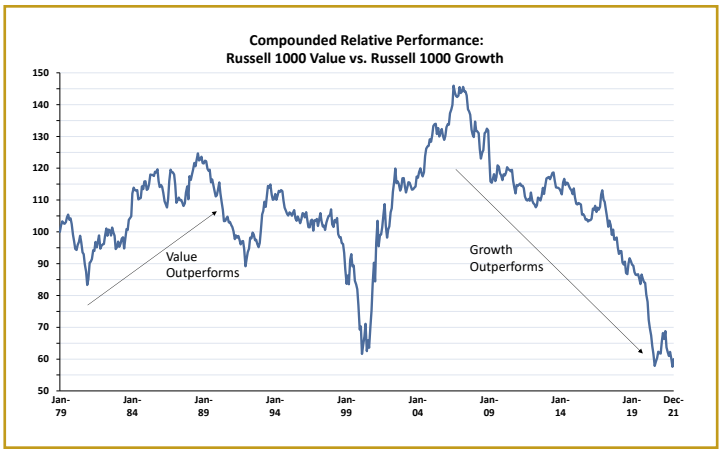
- Large-cap US stocks had another amazing year, up 28.71% and up 26.07% annualized over the past three-years. While small-cap stocks trailed large-cap stocks, they also performed very well, up 14.82% and up 20.02% annualized over the past three-years.

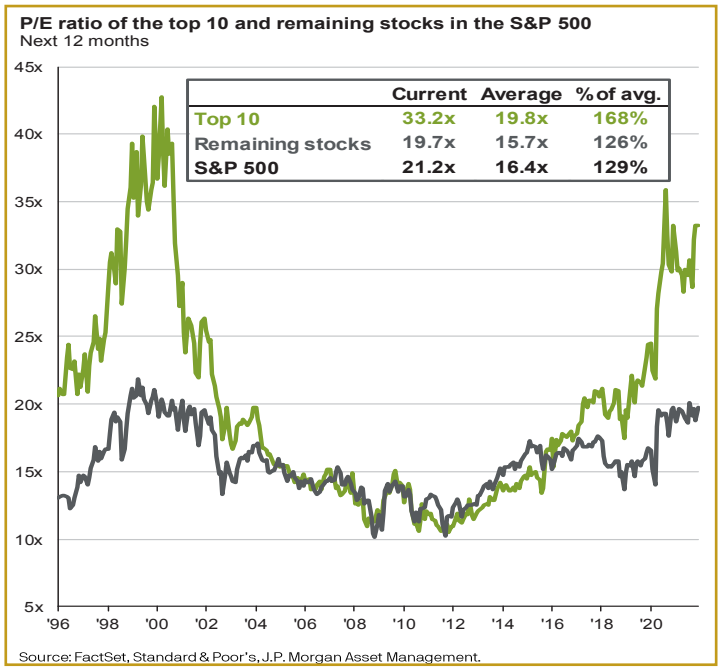
- Large-cap growth stocks again outperformed value stocks in 2021, but only slightly. Given the significant outperformance by growth stocks over the past five-years and recognizing the likely rising interest rate environment, investors continue to wonder if there will be a rotation to value. While value stocks appear cheap vs. growth stocks, we continue to maintain a balanced allocation.

- Within US equities, academic research suggests that factors such as company size, relative price, and profitability are drivers of return over the long-term. As such, we continue to include allocations to small-cap stocks and value-stocks despite recent underperformance.

- US stock valuations remain elevated, trading at a 21.2x forward P/E ratio. This is especially so for the 10 largest companies, whose market cap now accounts for over 30% of the S&P 500. As economic growth normalizes, market leadership is expected to broaden.

- US large-cap stocks have provided an annualized return of 16.55% over the past ten-years, significantly outpacing annualized long-term returns. While we remain constructive on equities, more muted return expectations seem sensible at this stage of the market cycle as earnings growth is expected to moderate in 2022.



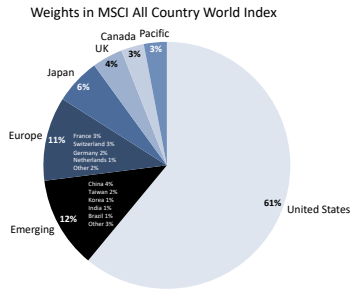


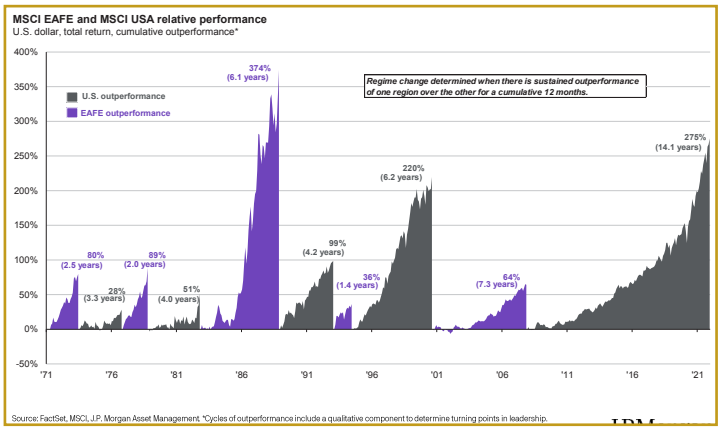
INTERNATIONAL STOCKS: PAST IS RARELY PROLOGUE

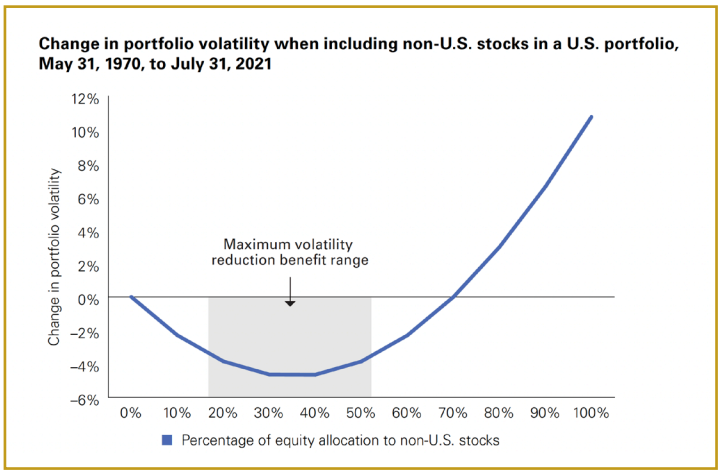
- International stocks posted strong returns in 2021 despite dollar strength, with the MSCI EAFE Index up 11.26% and the MSCI EAFE Small-Cap Index up 10.10%. Emerging Market stocks did not fare as well, falling -2.54%.
- The US dollar was up in 2021, +11.5% vs the Yen, +7.5% vs the Euro and +3.3% vs the World Basket. This remains a headwind to international returns.
- Historically, US and International stocks go through leadership cycles, often for extended periods of time and by wide margins. However, over the past 50-years, on an annual return basis they have each performed best about ½ of the time.
- When comparing the S&P 500 vs. the MSCI EAFE, there are significant differences in the makeup of both indices. For instance, the S&P 500 has a much higher allocation to growth sectors like consumer services and information technology (~ 40%) vs. the more cyclically oriented MSCI EAFE (~ 14%).
- After 14 years of international stocks underperforming US stocks, it's certainly reasonable for US investors to question the benefits of a globally diversified portfolio.
- The rationale for including international stocks in a US investors investment portfolio are based on (1) expectations for equity-like returns from international equities over time (2) recognizing that including some international equities has reduced portfolio volatility (with the greatest risk reduction when international equities are about 30%-40% of the equities), and (3) international markets provide exposure to some of the top companies in the world.

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

	Q4 2021		2021	
	Local	USD	Local	USD
USA (S&P 500)		11.03		28.71
MSCI EAFE	3.91	2.69	18.70	11.26
MSCI EAFE Growth	5.35	4.09	19.03	11.25
MSCI EAFE Value	2.35	1.17	17.99	10.89
MSCI EAFE Small Cap	1.32	0.07	17.28	10.10
MSCI EAFE Europe	6.51	5.66	22.61	16.30
MSCI EAFE Pacific	-0.78	-2.72	11.98	2.63
MSCI Emerging Markets	-0.91	-1.31	-0.19	-2.54



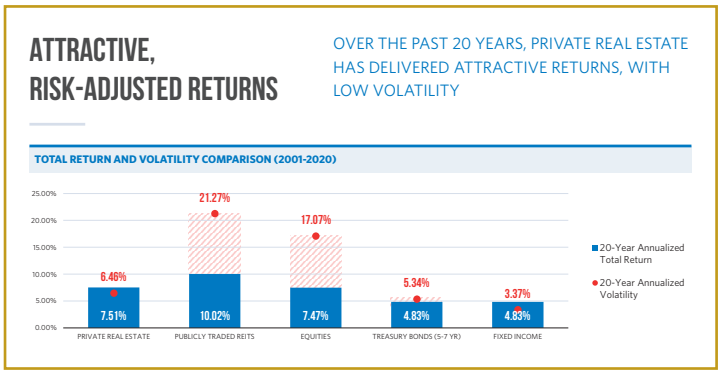


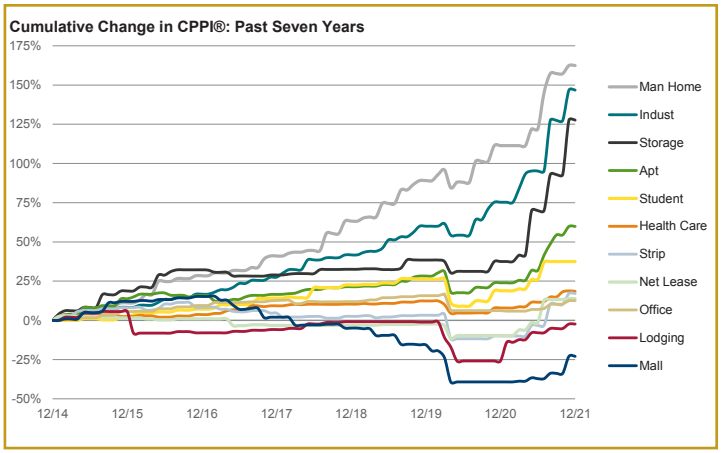


- We continue to believe international stocks are an important component of a diversified portfolio, broadening the opportunity set via exposure to different economic conditions, currencies, and demographics.

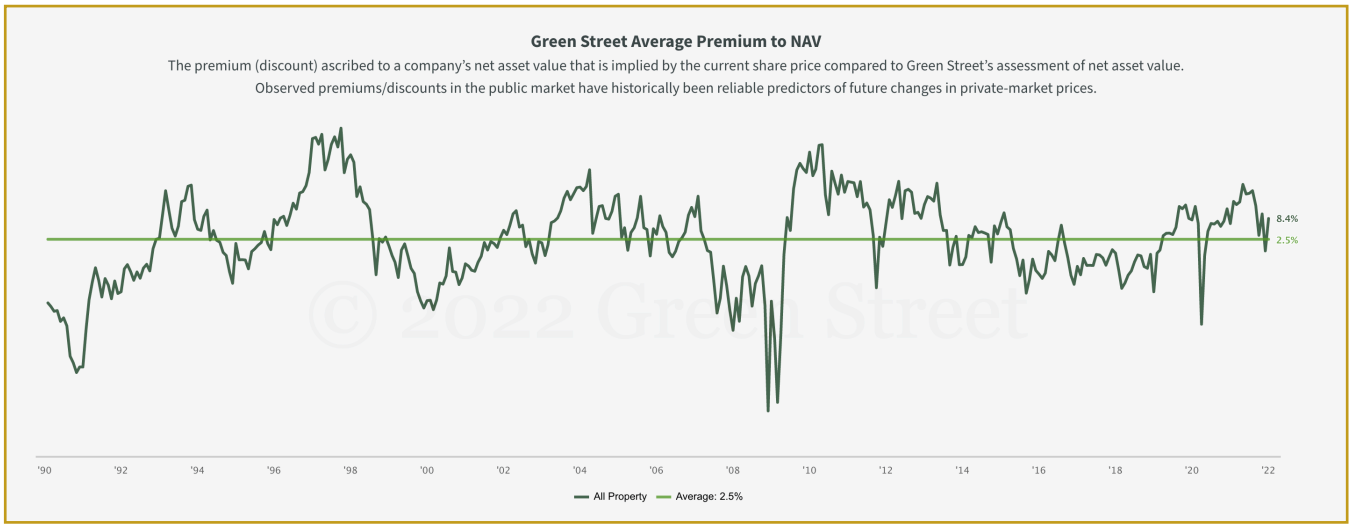
REAL ESTATE: DIVERSIFY, INCOME, INFLATION HEDGE

- REITs were terrific in 2021, up 17.1% in Q4 and up 46.2% for the year. Direct real estate (Green Street CPPI) also performed very well, up 24.4% in 2021.
- The pandemic has provided opportunities and challenges to traditional real estate. It has accelerated real estate trends (such as online shopping) and introduced new ones (such as expanded acceptance of remote work). These changes have increased the demand for core sectors such as industrial and apartment and cast uncertainty over the retail and office sectors. It has also made investment in "alternative" property types such as self-storage, data centers, medical office, and student housing more standard.
- The net zero carbon drive is influencing the real estate space. Assets that meet the low-carbon challenge are likely to outperform.
- In a world with more modest return expectations for traditional investments, non-publicly traded real estate can help diversify portfolios, provide income with moderate volatility, and provide a hedge against inflation (from rising rental income and property values over time).



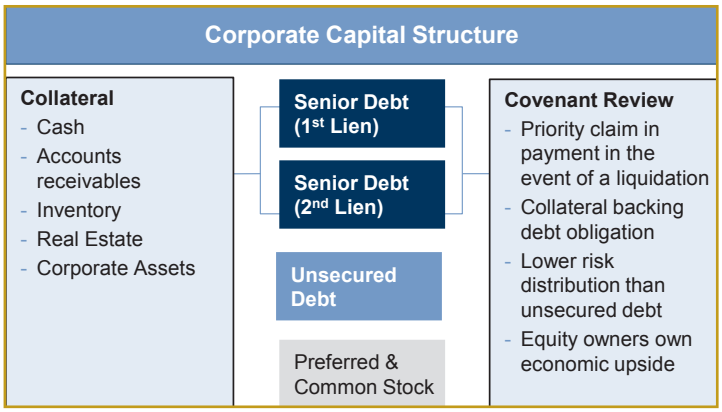


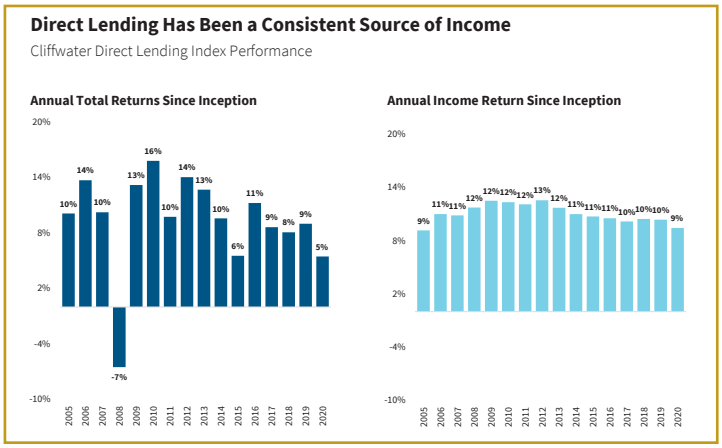
- We generally prefer to invest in private/direct real estate vs. publicly traded REITs. While both provide exposure to the benefits of investing in real estate, we prefer the lower volatility exhibited by private real estate, especially given that REITs historically trade at a premium to NAV.



BDCS: ATTRACTIVE AND STABLE RETURNS

- Publicly traded BDCs had a terrific 2021, returning 37.4%, reflecting the recovery off the spring 2020 decline as well as increased activity in both the public and private credit markets as the economic environment improved.
- 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 public or private 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.
- The increase in private equity activity generates a diverse set of financing needs. While periods of market volatility intermittently disrupt transaction volume, the overall trend remains an increase in lending opportunities.
- Overall, 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 limited credit risk (since most loans are senior secured and have structural covenant protections).

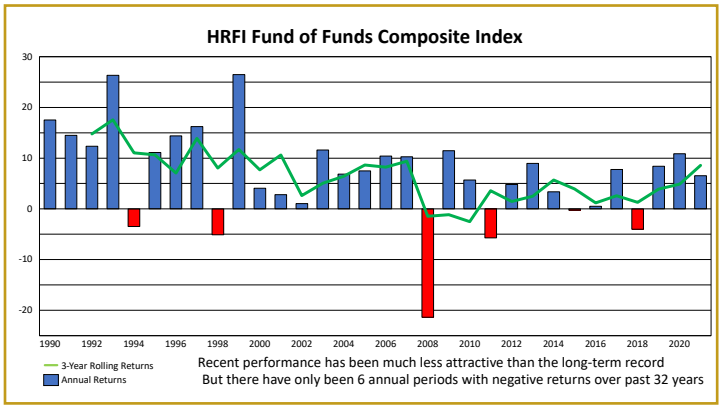




- When investing in middle market loans, we prefer to access via private BDCs vs. public BDCs, seeking the more moderate volatility associated with quarterly NAV valuation vs. daily pricing volatility associated with public BDCs.

HEDGE FUNDS:

- Hedge funds performed well in 2021, up 6.5%, but hedge funds have seen a downward trend in performance over the past decade. However, given the muted return expectations for stocks and bonds, they continue to provide potential to generate attractive risk-adjusted returns.



QUOTES OF NOTE:

"Although health outcomes will remain important in 2022 given the emergence of the Omicron variant, the outlook for macroeconomic policy will be more crucial as support and stimulus packages enacted to combat the pandemic-driven downturn are gradually removed."

- *The Vanguard Group, 2022 outlook at a glance*

"2022 will likely be more challenging for investors, as the Fed and other central banks progressively unwind accommodative policy in response to the ongoing economic recovery/expansion and elevated inflation readings. While economic and earnings growth are likely to be good, a "too-high" inflation backdrop and rising real interest rates suggest less favorable and more volatile conditions for investors than have prevailed since the pandemic lows."

- *Tug of war between earnings tailwinds and valuation headwinds; Robert C. Doll, Chief Investment Offer, Crossmark Global Investments; January 2022*

"I think the overall markets are priced for perfection. Almost every asset class is trading at or near all-time highs. The market seems to be discounting the risk of volatility or potential shocks to the system, potentially from factors that may not even be on our radar today. Admittedly, while a dislocation may feel long overdue, it's very hard to predict when or if one will occur."

- *Stay the Course; Craig Packer, Co-Founder Blue Owl; January 2022*

"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*

'So now we find ourselves at the doorstep of 2022 and we've just seen the S&P 500 hit record highs – again. But not all investors perceive this as good news. Record highs make many people nervous, because they think that what goes up must come down. When markets are working as they should, reaching record highs with some frequency is exactly the outcome we would expect. That makes intuitive sense, because if stocks didn't have a positive expected return, no one would invest in them."

- *Why I'll Always Be Optimistic About the Market; David Booth, Executive Founder and Chairman of Dimensional Funds; 12/14/21*

"So at the end of every year, we look back and forward. What do we think the next year will bring? I don't know. No one does. Think about it: No one does. After these last two years, this lesson should be obvious to all of us."

- *Why I'll Always Be Optimistic About the Market; David Booth, Executive Founder and Chairman of Dimensional Funds; 12/14/21*

COMPANY UPDATES

We were happy to welcome two new team members in the fourth quarter as part of our strategic efforts to grow our team. Jackie Cooper has joined Radnor in the role of Financial Support, and Teresa Logan has joined us as Investment Administrator. As we collectively navigate a dynamic global environment, ensuring we consistently have strong talent on board allows us to provide unwavering service excellence and support the ever-evolving needs of our clients.

In a world that continues to operate in a largely virtual capacity, we were happy to close out 2021 hosting a couple of virtual events in the spirit of connection. Our Speaker Series educational webinar on Understanding Cryptocurrency was well-attended and helped demystify this alternative investment strategy. We were also delighted to welcome back renowned baker Dan Langan for our 2nd annual holiday baking event. Please visit our website to view video and highlights of these sessions, respectively, and to sign up for more information about our future Speaker Series events: **https://www.radnorfinancial.com/speaker-series/**.

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