

Stocks and Bonds performed well during the first quarter. Periods of volatility drove stocks in both directions, but the quarter ended with a five-week rally and the S&P up 5.4%. Small-cap stocks fared even better, up 8.9%, while international stocks fared a little worse, up 0.9% (primarily due to the strengthening dollar). Similarly, yields fell amid uncertainty early in the quarter, before rising again at

Investment Performance (Total Return) 03/10						
	YTD	1-Year	3-Year	5-Year	10-Year	15-Year
S&P500	5.4	49.8	-4.2	1.9	-0.7	7.8
Russell 1000 Growth	4.7	49.8	-0.8	3.4	-4.2	6.6
Russell 1000 Value	6.8	53.6	-7.3	1.1	3.1	8.7
Russell 2000	8.9	62.8	-4.0	3.4	3.7	8.0
Russell 2000 Growth	7.6	60.3	-2.4	3.8	-1.5	5.1
Russell 2000 Value	10.0	65.1	-5.7	2.8	8.9	10.3
MSCI EAFE	0.9	54.4	-7.0	3.8	1.3	4.9
MSCI EME	2.1	77.3	2.8	13.0	7.3	5.9
Wilshire REIT	9.8	113.5	-12.0	3.4	11.4	10.7
HFR Fund-of-Funds Comp	1.5	12.8	-1.7	2.9	3.4	6.7
Barcap Aggregate Bond	1.8	7.7	6.1	5.4	6.3	6.6
Barcap Government Bond	1.1	-0.1	6.0	5.2	5.9	6.3
Barcap Credit	2.3	20.8	6.0	5.4	6.7	6.9
Barcap Municipal	1.3	9.7	4.6	4.6	5.6	5.7
GSCI	-0.9	25.9	-8.8	-6.9	3.7	4.9

quarter-end. Over the quarter, the yield on the 10-Year Treasury was virtually unchanged (3.84% vs. 3.83%), although it fell as low as 3.59% and rose as high as 3.91%. For the quarter, the Barclay's Capital US Aggregate Bond Index was up 1.8%.

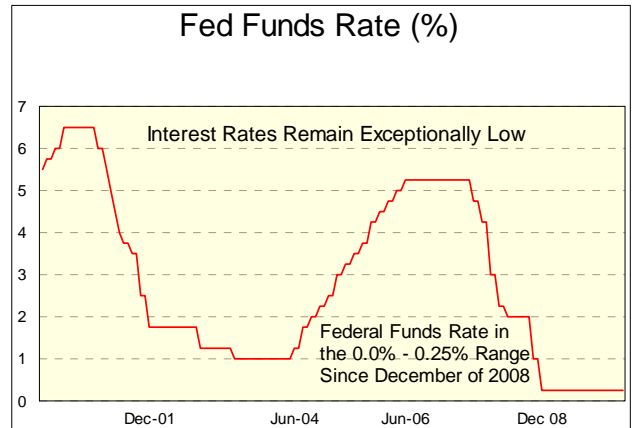
**Where Are We Now?**

While the S&P 500 has rallied significantly since the March 2009 lows (up 73%), it remains substantially below the October 2007 high. As we noted last quarter, the size and swiftness of the equity market rally has investors concerned they may have missed the recovery. However, while markets are certainly not as cheap as they were in March of 2009, thus far they have recovered only 492 of the 888 points lost from the 10/09/07 peak to the 03/09/09 trough. As such, from the quarter-end level, the S&P 500 still has to go up about 34% to reach the October 2007 peak.



**Federal Reserve: Exit Strategy**

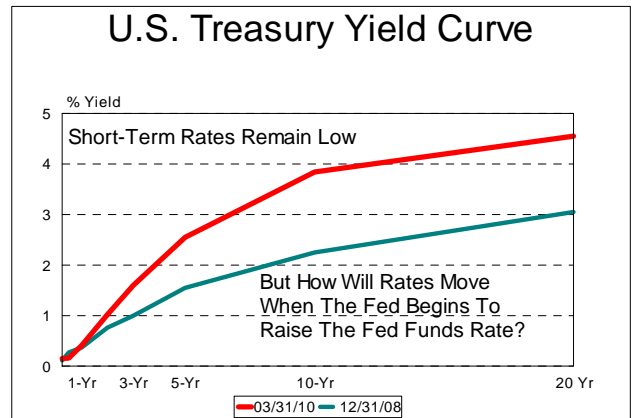
The Federal Reserve remains accommodative. Following its March 16<sup>th</sup> meeting, the Fed again indicated it “continues to anticipate that economic conditions, including low rates of resource utilization, subdued inflation trends, and stable inflation expectations, are likely to warrant exceptionally low levels of the federal funds rate for an extended period.” The Fed also confirmed that they are closing all of the special liquidity facilities, except for the Term Asset-Backed Securities Loan Facility, which is scheduled to close on June 30<sup>th</sup> for loans backed by new-issue commercial mortgage-backed securities.



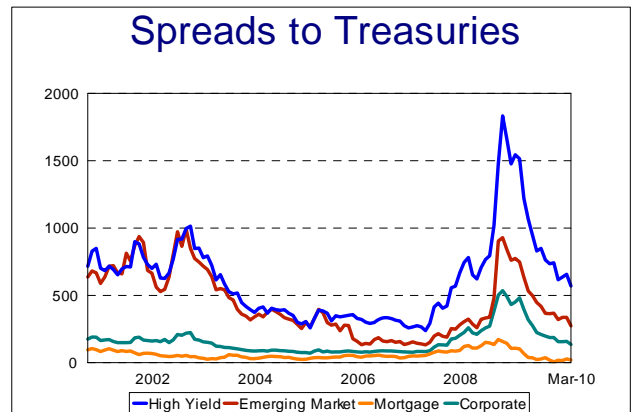
The recession and financial crisis led to extraordinary monetary policy. The Fed now must orchestrate a difficult balancing act as it removes these measures. The Federal Funds rate has been held to an extraordinarily low range between 0% and 0.25% since December of 2008. At some point, the Fed will begin tightening monetary policy (or at least removing the “emergency measures”), raising the Fed Funds rate at least to the 1.0% to 2.0% range.

**Fixed Income: Rising Rates Inevitable? When?**

Fixed income securities provided attractive returns during the first quarter, with the Barclays Capital Aggregate Bond Index up 1.8%. After 2008’s dislocation, fixed income markets normalized in 2009. As a result, investor fund flows into bond funds have been significant (\$409 billion into bond funds out of a total \$506 billion into mutual funds over the past 12-months).



However, looking forward, we remain concerned with the fixed income markets. Interest rates really have only one direction to go from here -- up. While we don’t know when, by how much, or how fast, it certainly looks like trouble is on the horizon.



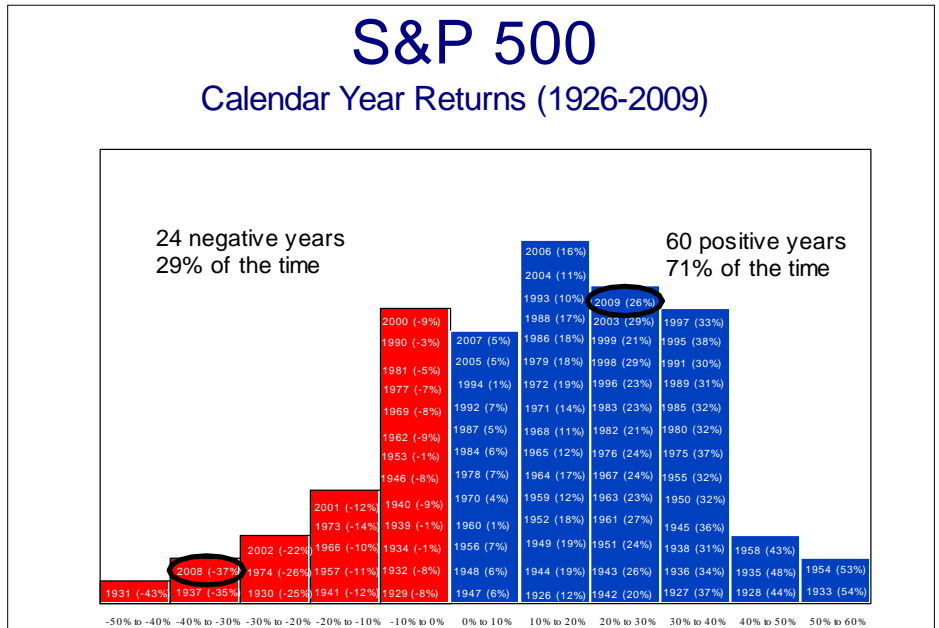
Looking at the Barclays Capital Aggregate Bond Index, its current yield is 3.5% with a duration of 4.5 years, not very enticing. As such, we remain cautious with our fixed income allocation. We continue to prefer safety, stability and liquidity. While certain of our managers have a flexible investment mandate, we have directed the majority of the fixed income allocation to high-quality short-term securities and stable value investments where available.

**U.S. Large Cap Stocks: Accentuate The Positive**

Large-cap stocks performed well in the first quarter, up 5.4%, the fourth consecutive quarter of positive returns. Since the market lows on March 9<sup>th</sup> of 2009, the S&P 500 is up about 73%.

As a result of the positive returns, investor sentiment for equities is turning positive, with fund flows into equities positive for the third consecutive month.

In retrospect, when the details of 2009 have somewhat faded from memory, 2009 will be reflected positively (in stark contrast to the year that preceded it). One of the worst time periods ever for stocks (October 2007 through March 2009) has been followed by a remarkable rebound, reminding investors why it is import to stay invested, even through difficult periods.

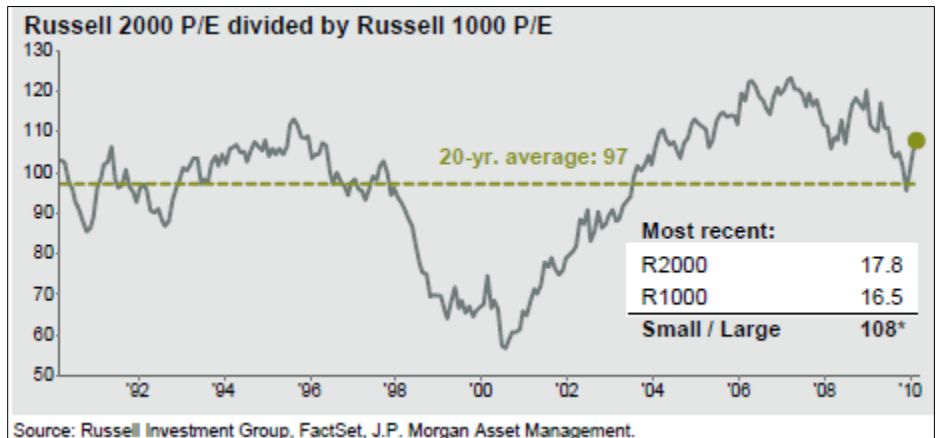


Within large-cap stocks, value outperformed growth in the first quarter (6.8% vs. 4.7%), although growth has outperformed value over the past three-years (-0.8% vs. -7.3%). Within your portfolio, we remain roughly neutral with our growth/value allocation.

**U.S. Small Cap Stocks: On A Roll**

Small-cap stocks out-performed large-cap stocks during the first quarter (8.9% vs. 5.4%) and have significantly outperformed since the March 2009 lows (93% vs. 77%).

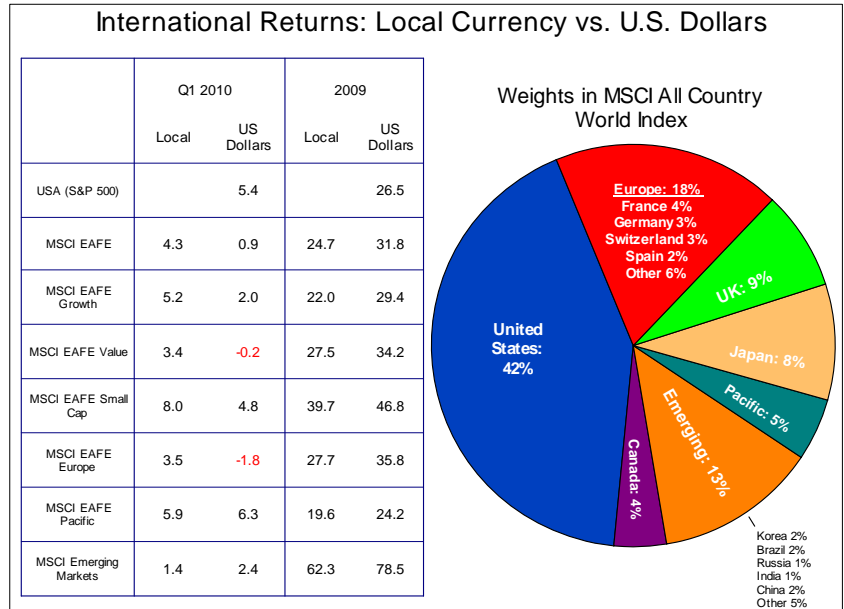
As the economic recovery matures and investors return to equities, it is expected they may turn to the more familiar large-cap stocks which they perceive as more stable.



Within small-cap, value outperformed growth for the quarter (10.0% vs. 7.6%), and for the past twelve months (65.1% vs. 60.3%). We remain comfortable underweighting small-cap stocks and maintaining a neutral growth/value allocation within small-cap.

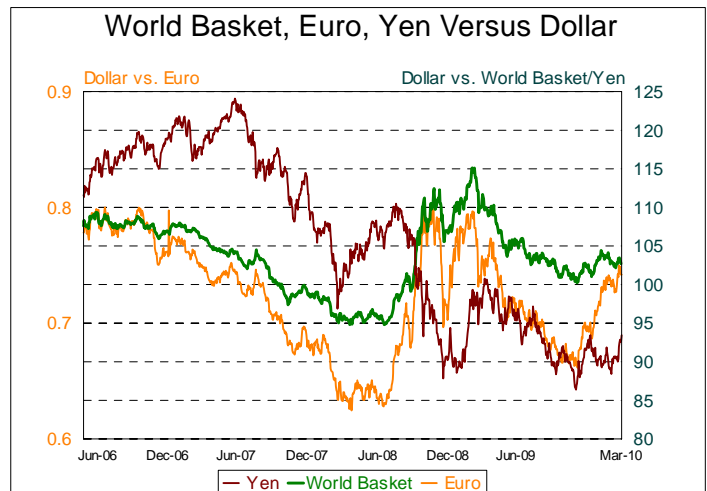
**International Stocks:**

International stocks were up 4.3% during the first quarter in local currency, but only up 0.9% in dollars, reflecting the strong appreciation of the dollar during the quarter. Within International, in dollar terms, Pacific outperformed Europe (+6.3% vs. -1.8%), growth outperformed value (+2.0% vs. -0.2%) and small-cap outperformed large-cap (+4.8% vs. +0.9%). Emerging markets were up 2.4% (but only 1.4% in local currency, reflecting the weakness of the dollar vs. emerging market currencies). Reviewing the twenty-two non-US developed markets, returns in dollar terms were widely different, ranging from a high of 11.9% (Finland) to a low of -15.3% (Spain).



The dollar was strong versus the euro and British pound, but weak versus many emerging market and natural resource nations. The fallout from the Greek debt crisis led to increased concerns with certain other European countries as well (primarily Portugal, Italy, Spain), thus the weakening euro.

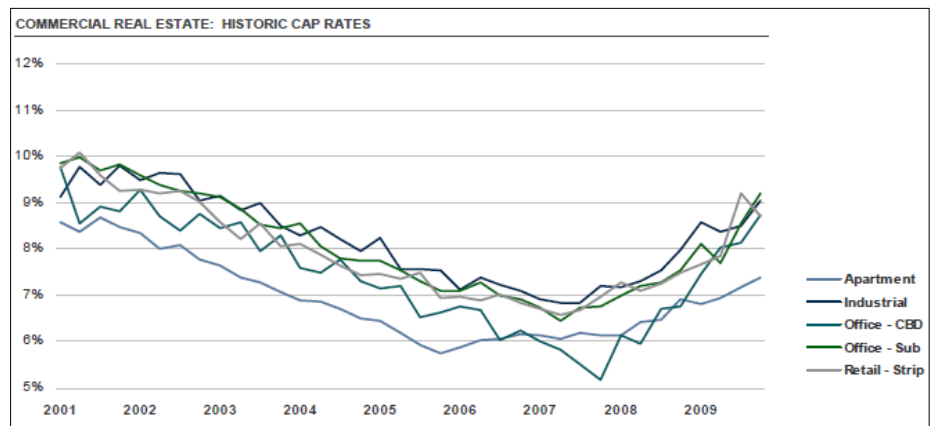
Within your portfolio, we are maintaining a roughly neutral allocation to international equities, and within international have allocated about 25% to small-cap stocks. We also have an indirect allocation to emerging markets via our active manager's investment in emerging markets stocks.



Although international stocks underperformed for the second consecutive quarter, we continue to believe it is important to maintain a reasonable allocation to international investments. As we have noted previously, international investments help to moderate overall portfolio risk/volatility, increase the investment opportunity set (as two-thirds of the world market capitalization is outside of the U.S.) and potentially increase returns from exposure to future growth in foreign economies.

**Real Estate: Springtime For Real Estate?**

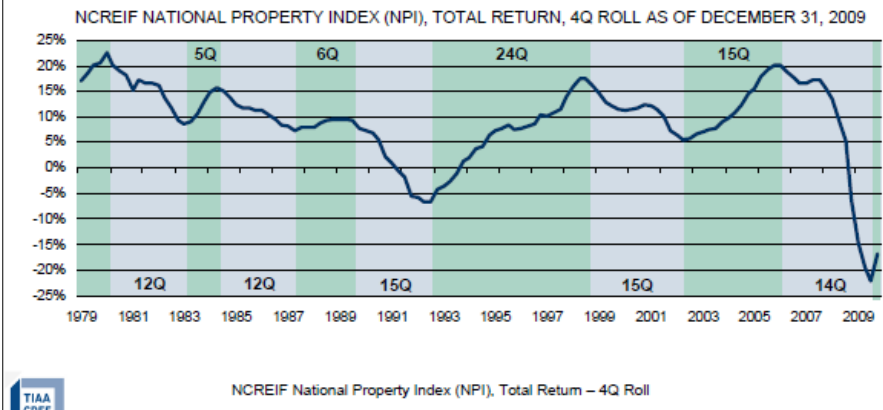
REITs continued their winning ways during the first quarter, up 9.8% and up 113.5% over the past 12-months. Direct real estate continued to lag (down 1.9% for the quarter and down 22.5% over the past 12-months). However, March did finally see an up month for the TIAA Real Estate Account (+0.16%).



Unsurprisingly, U.S. private commercial real estate was the last sector to fall and looks to be the last sector to recover. Direct real estate returns are based on appraisals, which are influenced by comparables and thus lag versus REITs public market trading with daily pricing. REITs survived and ultimately prospered in 2009 by raising equity, paying down debt, and trimming expenses.

**U.S. COMMERCIAL REAL ESTATE CYCLES**

- The 30% drop in NPI property values through 4Q2009 is setting the stage for the opportunity to acquire U.S. CRE at cycle low prices

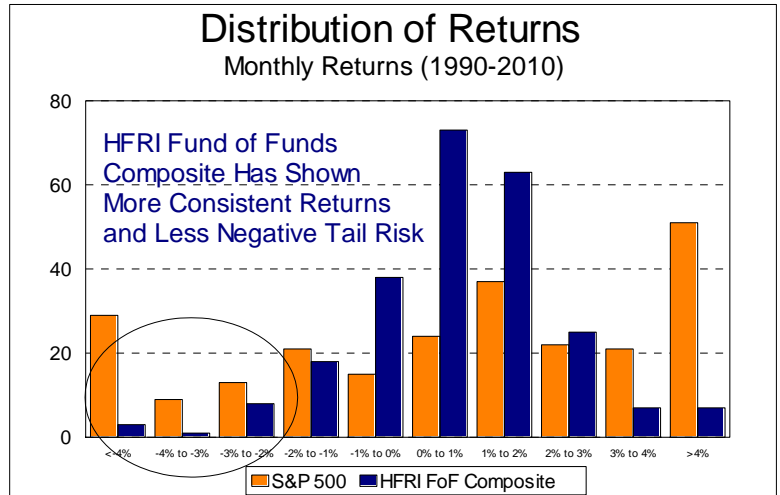


Looking forward, high unemployment, falling occupancies, capacity utilization, debt refinancing, and lower rents suggests the recovery for commercial real estate may be difficult. However, it is important to remember that we didn't see overbuilding during the last economic expansion, the economy is improving, and there are signs that negative absorption and rising vacancy rates are easing. As such, we are reviewing our stance on direct real estate investments.

**Hedge Funds:**

Hedge funds were up 1.5% during the first quarter, lagging the equity markets. Although hedge funds outperformed cash and bonds over the past 12-months, their returns have been disappointing compared to equities. However, longer-term, hedge funds have shown the ability to provide attractive equity-like returns with about ½ the volatility of equities (since 1990, the HFRI Fund-of-Funds Composite was up 8.2% vs. 8.4% for the S&P 500, with a standard deviation of 5.9% vs. 15% for the S&P 500).

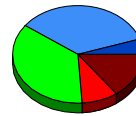
Looking at the historical distribution of returns for the HFRI Fund-of-Funds Composite vs. the S&P 500, the tail risks for hedge funds have been significantly less than the tail risk for stocks. The majority of the monthly returns from hedge funds fall within the -1% to +2% range, a much more stable distribution than the S&P 500.



Looking at an overall portfolio, based on the data since 1990, adding hedge funds to a balanced portfolio was able to reduce overall portfolio volatility while maintaining portfolio returns.

**Adding Hedge Funds to a Traditional Balanced Portfolio**

Traditional 60/40 Stock/Bond Portfolio



60/40 Portfolio with 15% Hedge Funds



■ 1-Month US T-Bills ■ Lehman Aggregate Bond ■ S&P 500 ■ Russell 2000  
■ MSCI EAFE ■ HFRI Fund of Funds Composite

Annual Returns	Traditional 60/40 Portfolio	60/40 Portfolio with Hedge Funds
1990-2009	7.58	7.69
Standard Deviation	11.73	9.98
Worst Year	-20.95	-18.44
Best Year	24.52	21.74

Going forward, we believe the changing market environment ahead will provide attractive return opportunities for hedge funds. Many hedge funds are structured to seek an absolute return versus the relative return/benchmark orientation of long-only managers. As we have noted previously, we believe the flexibility afforded via the hedge fund vehicle will be helpful in the coming environment. We also believe hedge funds provide access to some of the most talented managers, due to the compensation structure, intellectual freedom and investment flexibility. Finally, we remain confident that our fund-of-funds managers, utilizing thorough due diligence, will maintain an attractive portfolio of hedge fund managers who will benefit from the opportunities presented by a challenging market environment.

**Commodities: Positioning For Improving Economy, Hedging Inflation & Dollar**

Commodities struggled during the first quarter, with the GSCI Index falling 0.9% and the more diversified DJ-UBS Index falling 5%. Both indices remained substantially below prior highs.

Our thesis for including commodities in the portfolio is based on our expectation that commodities should benefit from the recovery in the world economy. The long-term structural case for investing in commodities is compelling—economic growth, growing world population, increased energy demands, emerging market diet development, hedge against inflation, hedge against the dollar (or other currencies). As we noted last quarter, we recognize that inflation may not be a short-term concern, but believe it is appropriate to begin building a position now given the expected improving economic environment and longer-term inflation possibilities.

**Quotes of Note**

“By our analysis, the recession in the United States ended in the summer of 2009 as unprecedented and massive policy stimulus was able to break the downward spiral in credit markets, economic activity and asset prices. The economy, however, is only now beginning to experience a self-sustaining revival in confidence and spending.” *Bob Doll, Vice Chairman and Chief Equity Strategist, BlackRock*

“We continue to expect a slowing to 1½ % in the 2H10, as the support from fiscal stimulus and inventory rebuilding fade, followed by a reacceleration in 2011 into a 2½% to 3½% range.” *Goldman Sachs April 2010 Market Pulse*

“The Federal Reserve (Fed) is apt to keep short-term interest rates near zero until they’re confident the economy is on a clear road to self-sustaining recovery (that is raising rates of resource utilization and mitigating disinflation risks). A much stronger job markets is a must. On that score, the recent data have been encouraging but hardly definitive. The Fed is unlikely to shift until late 2010 at the earliest, and the bulk of the recalibration of policy to a more neutral setting is likely to wait for 2011 and beyond.” *Josh Feinman, Chief Economist, Deutsche Asset Management, April 2010 US Economic Outlook*

“Despite troubling headlines concerning the budget problems faced by municipalities across the country, the Barclay’s Capital Municipal Bond Index returned 1.3% during the first quarter. Without question, many municipalities are dealing with a host of challenges, ranging from declining tax receipts to ballooning pension obligations—all of which have the potential to affect the investment results for municipal bond investors. In spite of these issues, there have been some positive developments in the municipal bond market. The most notable of these is the fact that municipalities have remained able to access the new issuance market to meet many of their financial needs.” *Global Market Currents, First Quarter 2010*

“Many investors have shortened duration in anticipation of rising interest rates; however, shortening duration won’t necessarily insulate you from rising rates. In fact, investors have moved into precisely the area where—if bond market expectations are correct—the poorest returns could occur. The target federal funds rate is near 0%, a record low triggered by the credit market seizure of 2008 and the recession that followed. At some point in the economic recovery, the Federal Reserve will begin raising its target for short-term rates to a more normal level to stay ahead of inflationary pressures. Rising rates typically hurt bonds with the longest maturities the most. However, the bond market is currently pricing in a “bear flattening” with steep increases expected at the short end of the curve and little change at the long end.” *Joseph David, Vanguard Chief Economist, 2010: A counterintuitive year for bond fund investors; 03/17/10*

“The Dow Jones Industrial Average posted its best first-quarter performance since 1999, while the 5.4% return posted by the S&P 500 index in March was its best monthly showing since August. This again helps illustrate the dangers of trying to “time” the market. Investors who were waiting for a sizable pullback before investing more in stocks missed another nice upward move. We continue to urge investors who have not done so to bring their equity allocations up to appropriate levels given investment time horizons and risk tolerances.” *Liz Ann Sonders, Chief Investment Strategist, Charles Schwab & Co., April 9, 2010 Schwab Market Perspective*

“These macro predictions appear adequately discounted. We submit that they are baked into prices because so many investors share the same concerns. The magnitude of the 2008 stock market declines was extremely anomalous, especially compared to previous bear markets associated with severe economic downturns, wars, or double-digit inflation. Prices reacted far more negatively than the recession’s meaningful impact on companies.” *Mason Hawkins, Chairman and CEO Southeastern Asset Management, April 2010 Quarterly Client Letter*

“With the rise in the markets, valuations do not currently appear cheap short-term, with emerging markets the least so, but confirming evidence of a bottoming in some areas and economic recovery in others likely makes for reasonably valued markets short-term. Additionally, the historical return on capital analyses we use continue to show markets as cheap versus longer-term mid-point levels and point to the funds’ holding to a material net long positioning.” *Tom Claugus, Bay Resource Partners March 2010 Quarterly Client Letter*

“Our choice—by no means a “solution”—is to only very slightly underweight global equities on the grounds that, when tilted to quality, they are still adequate in terms of return potential. We also have to swallow our distaste for parking the rest in unattractive fixed income.” *Jeremy Grantham, GMO Quarterly Letter, January 2010*

“A distressed owner is one that may have paid too much, borrowed too much or simply doesn’t have the capital needed to maintain, upgrade or re-lease a property that is otherwise well-positioned. Lacking capital, this owner, which can be a person, a partnership or another entity, needs to overcome these issues by either selling the property, giving it to the lender or finding a new capital source. This is where the real estate opportunity exists today, and where the aforementioned liquidity will be put to work. Indeed, this opportunity should be sizable, considering the high delinquency rates on commercial real estate loans at commercial banks.” *Martin Cohen, Cohen & Steers, April 2010 Viewpoint, Next Shoe To Drop: The Commercial Real Estate Recovery*

“Suppose you put, say, only 60% of your portfolio in stocks and 40% in bonds because you bet that stocks are in fact risky over the long run. Suppose you are wrong. Your wealth will still grow over time if stocks continue to work their miracles over the long run, even if not to the sky. But suppose you put 100% of your portfolio into stocks because you bet that stocks are less risky over the long run. Now suppose you are wrong, and miracles are not forthcoming. Good-bye wealth!” *Peter L. Bernstein, The Journal Of Portfolio Management, 1998*

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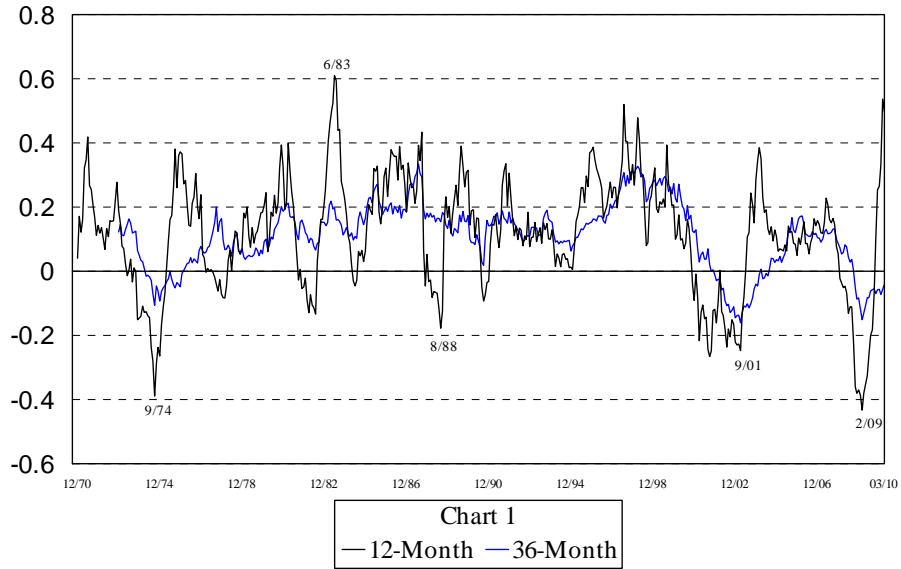
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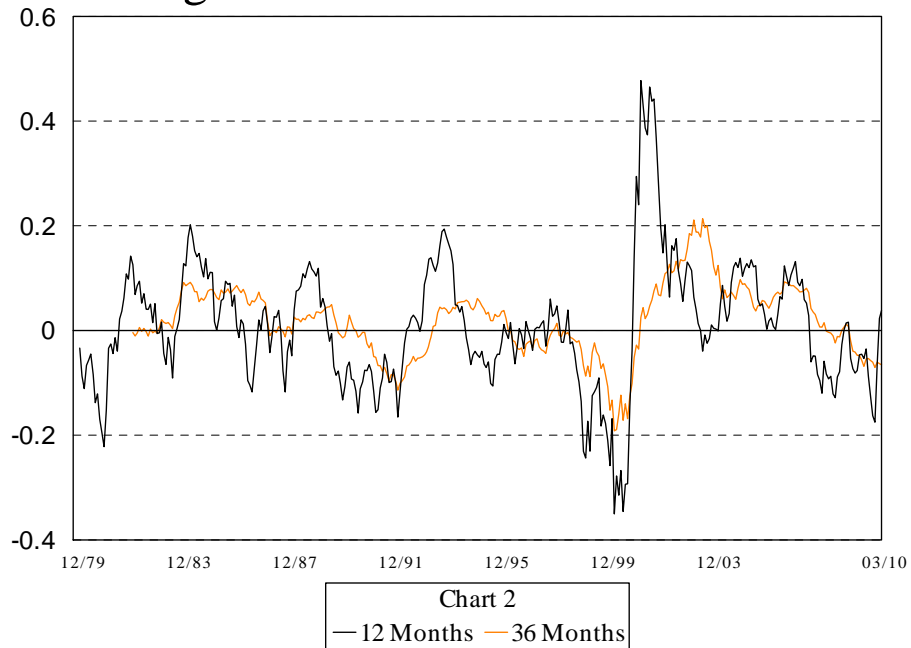
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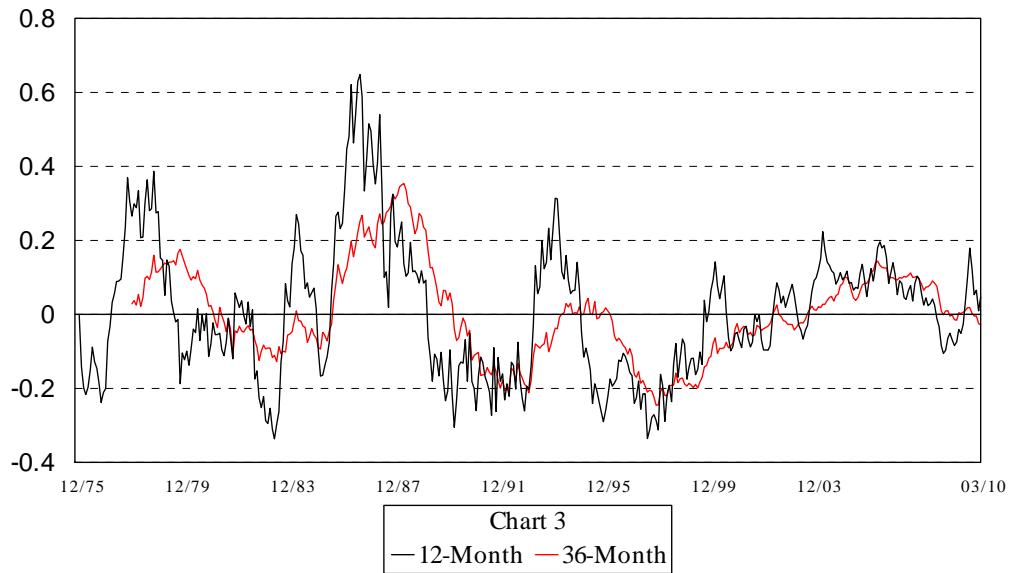
## S&P 500 Rolling 12-Month & 36-Month Returns



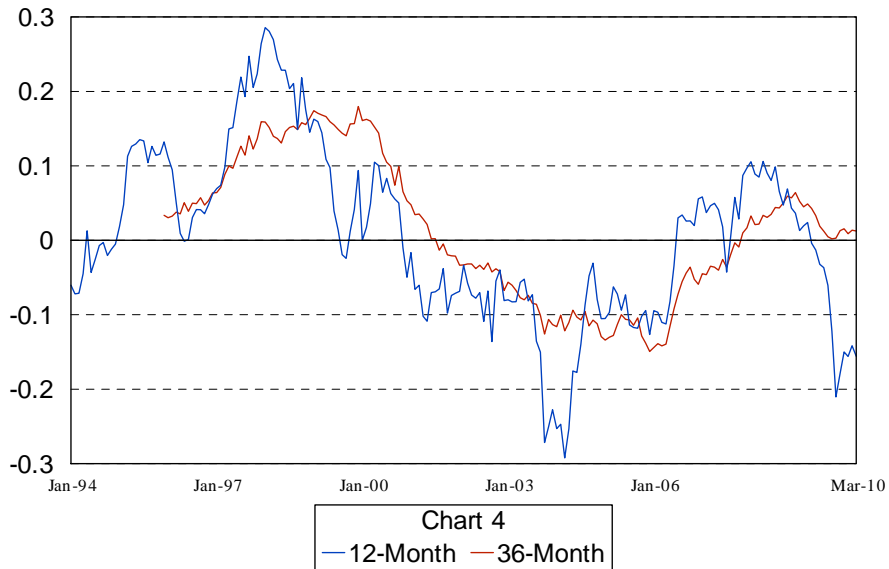
## Russell 1000 Value Minus Growth Rolling 12-Month & 36-Month Returns



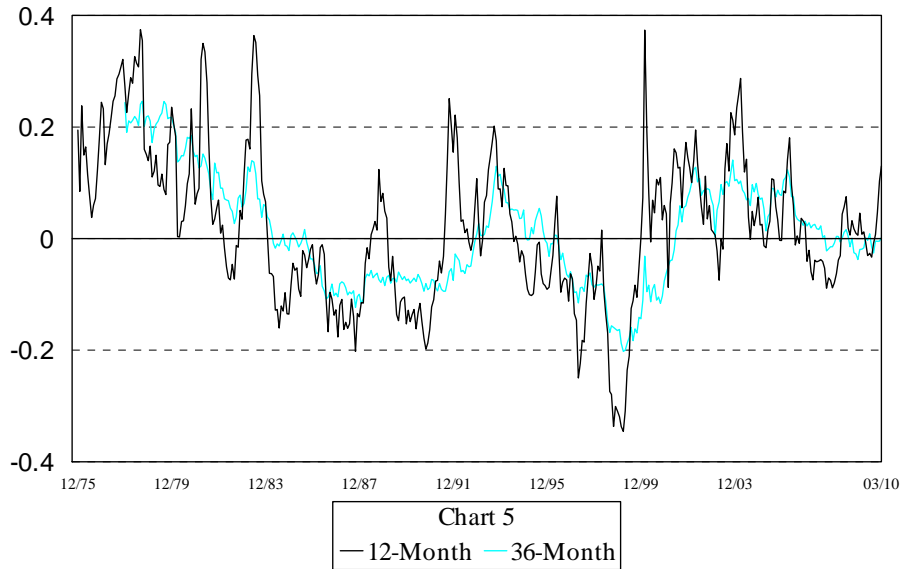
## EAFE Minus S&P 500 Rolling 12-Month & 36-Month Returns



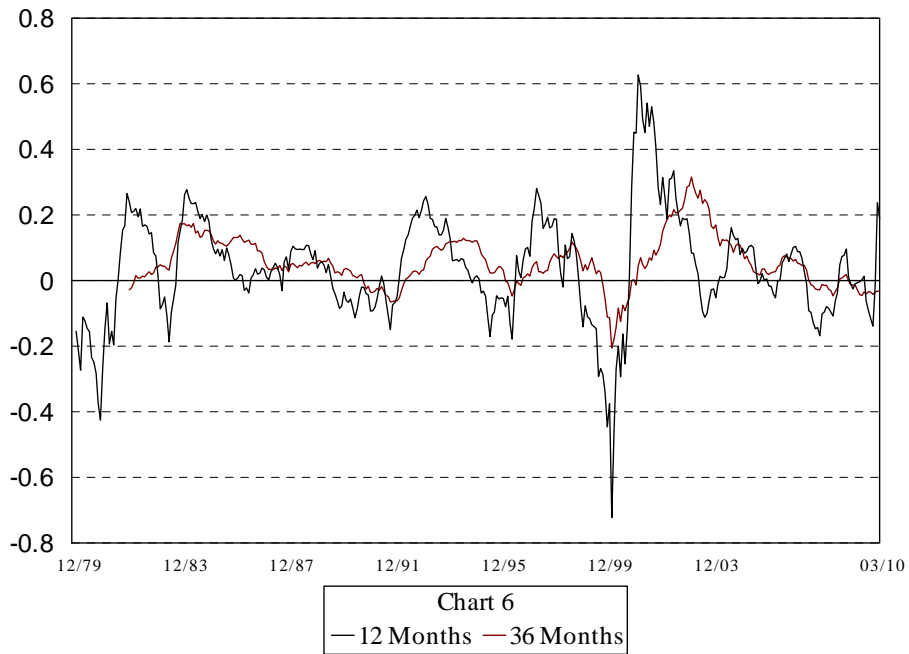
## MSCI EAFE Minus EAFE SC Rolling 12-Month & 36-Month Returns



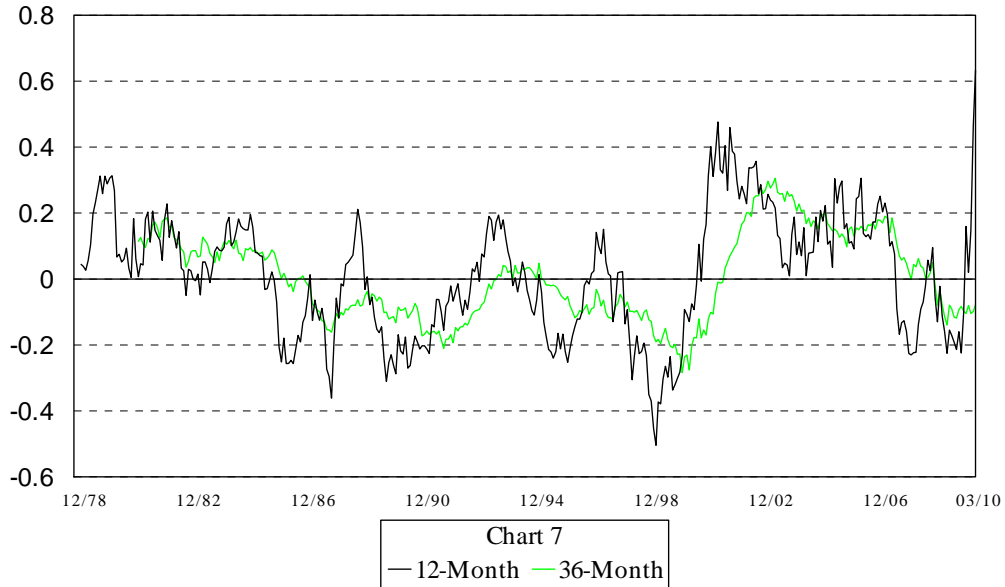
## Russell 2000 Minus S&P 500 Rolling 12-Month & 36-Month Returns



## Russell 2000 Value Minus Growth Rolling 12-Month & 36-Month Returns



## Wilshire REIT Index Minus S&P 500 Rolling 12-Month and 36-Month Returns



## GSCI Minus S&P 500 Rolling 12-Month & 36-Month Returns

