RADNOR
FINANCIAL ADVISORS

QUARTERLY MARKET COMMENTARY

Second Quarter 2020

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Enclosed is our mid-year market commentary. We hope that you and your family are healthy and safe and coping with the current environment.

The coronavirus pandemic continues to have a significant impact on global health and economic activity. While we are seeing a shift to re-opening, we are also seeing a resurgence of coronavirus cases. Until there is a more permanent medical solution, the level of uncertainty will remain high.

As a result of the decreased economic activity from the coronavirus lockdowns, the National Bureau of Economic Research (NBER) declared that a recession began in February. This was the fastest declaration NBER has made, reflecting the severity and rapidity of the downturn. However, as the economy re-opens, the hope remains that the period of negative economic growth will be short.

Perhaps the biggest shock of the 2nd quarter was how quickly stocks have begun to recover. The S&P 500 was up about 20% in Q2 and is now only down about 3% at the end of the quarter. We recognize it is hard to reconcile the disconnect between the strong equity markets and the weak economic environment. However, equity markets are forward looking, and thus focusing on the re-opening process and resumption of economic activity. In addition, markets have been buoyed by monetary and fiscal stimulus, which has been quick, significant, and supportive of the economy.

As investors look at the expected returns going forward of cash (zero) and bonds (subdued due to low interest rates), some may feel there is no alternative to stocks to generate returns.

Investors should not get complacent following the Q2 market gains. While economic activity will improve, it will likely be with fits and starts, as new spikes of the virus may lead to a slowdown in the re-opening process. In addition, traditional risks like the November election, the deterioration of the US/China relationship and trade disputes with Europe, which were somewhat overlooked in the peak of the coronavirus fear, may gain renewed attention.

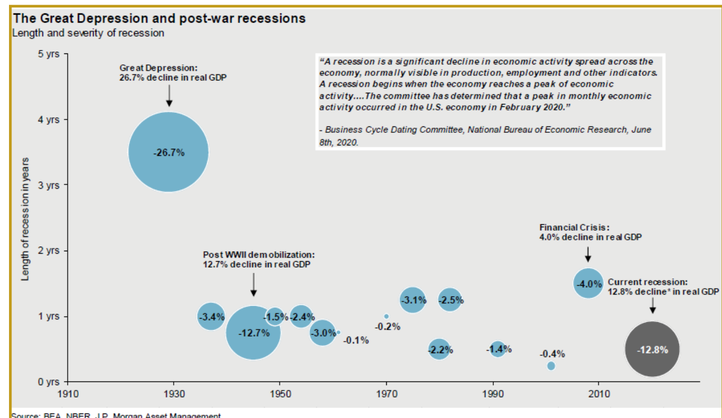
As we look forward, the coronavirus pandemic is the type of generational event that can have lasting impact and transform behaviors. Activities such as remote work and e-commerce will be more accepted and impact many sectors and industries. Growth over the next few years may be slightly lower given the massive fiscal and monetary stimulus, which likely serves to pull demand forward.

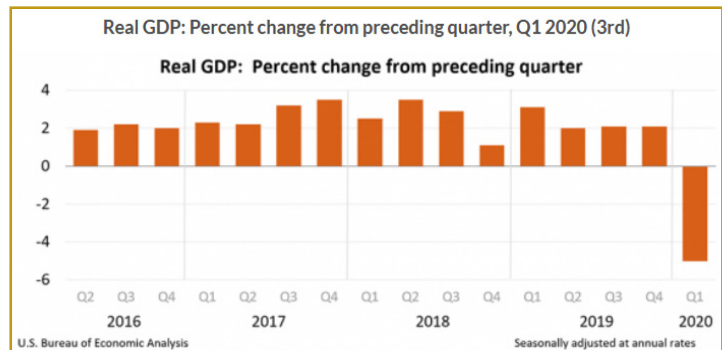
In these uncertain times, it is important to maintain discipline, ignoring short-term market noise and focusing longer-term. In Q3, we will plan to review your long-term allocation with you to assure it continues to accurately reflect your risk tolerance. In the meantime, please call if you have any questions.

- Investors have been whipsawed over the past four months. After a stunningly quick decline where the S&P 500 fell about 34% from its February high to its March low in 23 days, markets quickly rebounded and went up 39% in just a few months to nearly get back to break-even for the year by the end of Q2.
- Short-term interest rates are now zero or negative in most of the developed world.
- The longest expansion in US history ended in February. The current recession may be the deepest since the Great Depression, but hopefully will also be the shortest if it can be limited to the first half of 2020.
- The unemployment rate was at 3.5% in February, but rose swiftly to the mid-teens in reaction to the shut-down of the economy. While the unemployment rate fell back to 11.1% in June, returning to 2019 levels may be a lengthy process.
- Overall, things could have been worse if not for the massive monetary and fiscal stimulus enacted globally.
- While the actual period of negative economic growth may be short lived, its impact is likely to last much longer.
- We recognize this is not a normal recession. In the face of an uncertain future, it is important to remember that we will get through this crisis, but it is going to take some time. Americans have always proven to be resilient, and we expect that will prove to be the case this time as well.

Investment Performance (Total Return) 06/20

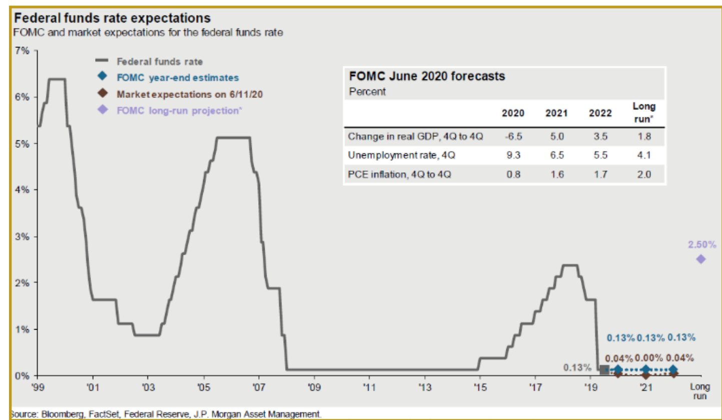
	2Q	YTD	1-Year	3-Year	5-Year	10-Year
S&P 500	20.5	-3.1	7.5	10.7	10.7	14.0
Russell 1000 Growth	27.8	9.8	23.3	19.0	15.9	17.2
Russell 1000 Value	14.3	-16.3	-8.8	1.8	4.6	10.4
Russell 2000	25.4	-13.0	-6.6	2.0	4.3	10.5
Russell 2000 Growth	30.6	-3.1	3.5	7.9	6.9	12.9
Russell 2000 Value	18.9	-23.5	-17.5	-4.4	1.3	7.8
MSCI EAFE	14.9	-11.3	-5.1	0.8	2.1	5.7
MSCI EAFE SC	19.9	-13.1	-3.5	0.5	3.8	8.0
MSCI EME	18.1	-9.8	-3.4	1.9	2.9	3.3
Wilshire REIT	10.6	-17.8	-12.3	0.2	4.0	9.2
HFR Fund-of-Funds Comp	7.2	-2.3	-0.2	2.0	1.4	2.7
Barcap Aggregate Bond	2.9	6.1	8.7	5.3	4.3	3.8
Barcap Muncipal	2.7	2.1	4.5	4.2	3.9	4.2
Bloomberg Commodity	5.1	-19.4	-17.4	-6.1	-7.7	-5.8





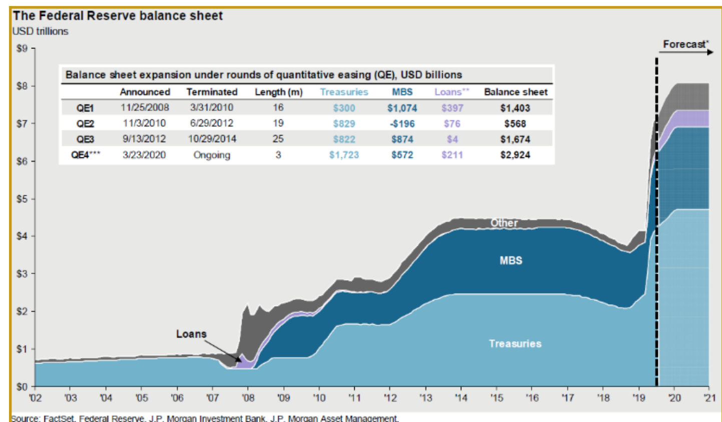
FEDERAL RESERVE: WHATEVER IT TAKES

- The Federal Reserve has indicated it remains committed to using its full range of tools to support the U.S. economy in this challenging time.
- Following the FOMC meeting in June, the Fed maintained the federal funds rate at a target range of 0.0% - 0.25%. However, the bigger insight from the meeting was the "dot plot" projections wherein nearly all Fed officials think the fed funds rate will remain near zero through 2022.
- In the press conference following the June FOMC meeting, Chairman Powell indicated that the central bank has no plans to raise interest rates, stating "we're not even thinking about thinking about raising rates".
- The Federal Reserve also indicated that it intends to increase its balance sheet over the coming months at least at the current pace to support markets and assure smooth market functioning. As a result, the Fed's balance sheet is expected to increase significantly.
- In recent testimony before Congress, Chairman Powell indicated that more policy measures are likely to be necessary to limit long-term economic damage, as significant uncertainty remains about the timing and strength of the recovery.
- Overall, the Fed remains guided by its mandate to promote maximum employment and stable prices. However, they also recognize they have a role to assure stability of the financial system.



FOMC June 2020 forecasts
Percent

	2020	2021	2022	Long run*
Change in real GDP, 4Q to 4Q	-6.5	5.0	3.5	1.8
Unemployment rate, 4Q	9.3	6.5	5.5	4.1
PCE inflation, 4Q to 4Q	0.8	1.6	1.7	2.0



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	$397	$1,403
QE2	11/3/2010	6/29/2012	19	$829	-$196	$76	$568
QE3	9/13/2012	10/29/2014	25	$822	$874	$4	$1,674
QE4***	3/23/2020	Ongoing	3	$1,723	$572	$211	$2,924

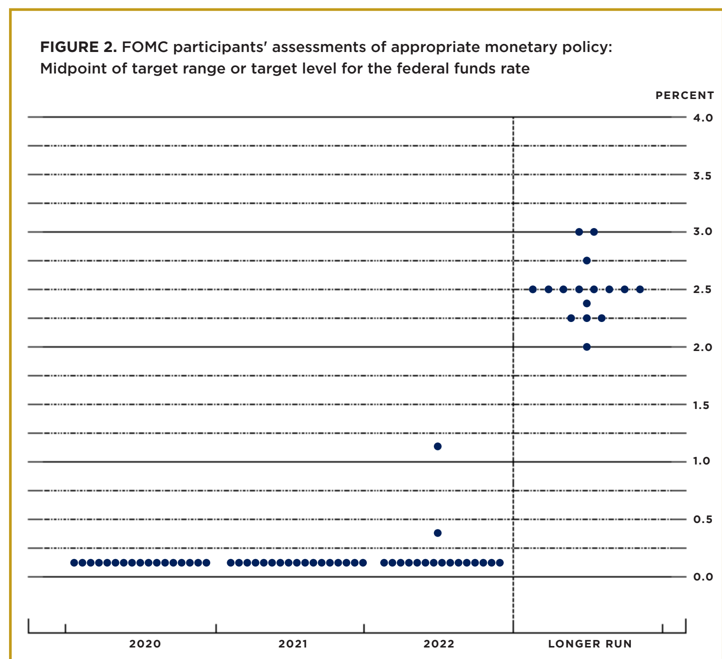
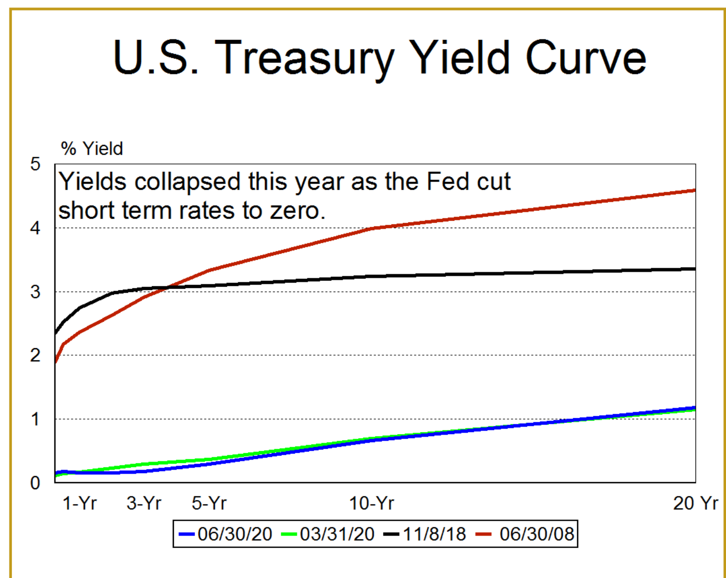
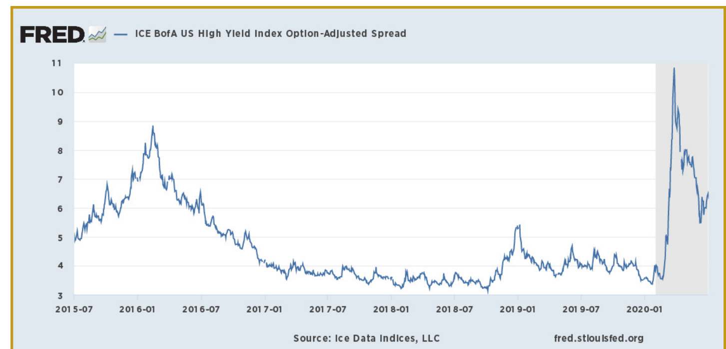


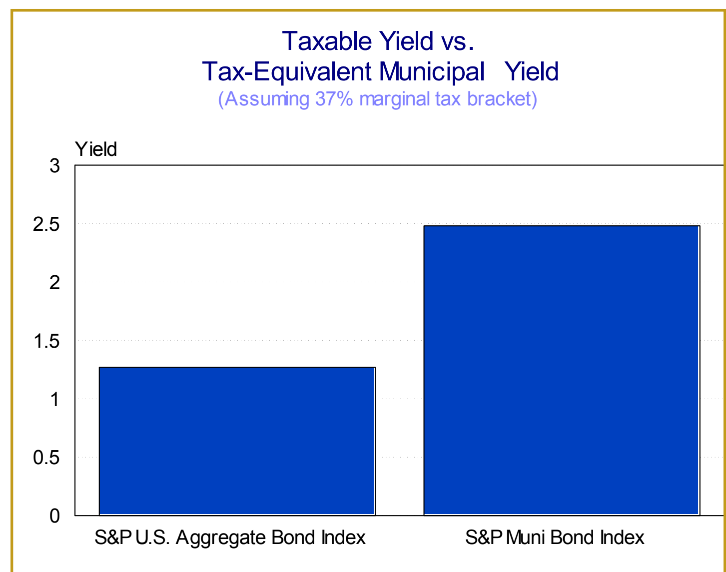
FIGURE 2. FOMC participants' assessments of appropriate monetary policy: Midpoint of target range or target level for the federal funds rate

FIXED INCOME: RATES LIKELY TO REMAIN LOW

- The Bloomberg Barclays US Aggregate Bond Index has performed well in 2020, returning 2.90% in Q2 and 6.14% YTD as investors seek less volatile investments in an uncertain environment.
- While the riskier parts of the bond market that experienced stress in Q1 witnessed significant recovery in Q2, they remain in negative territory YTD. Emerging market bonds are down -2.76% and high yield bonds are down -4.78% YTD, despite spreads narrowing in Q2.
- The 10-year Treasury Bond traded in a relatively narrow range in Q2, hitting a high of 0.91% in early June before ending the quarter at 0.67% (about where it was at the end of March).
- Municipal bonds continue to be impacted by the uncertain environment, as investors try to gauge the impact of lower tax revenues and increased costs. As such, municipal yields relative to treasury yields remain attractive, with the tax-equivalent yield on the S&P Muni Bond Index nearly double that of the S&P US Aggregate Index for those in the highest tax bracket.
- In light of high unemployment and weak growth, inflation expectations remain well below the Fed's 2% target near-term.
- With risk-free rates low, investors need to accept interest rate risk or credit risk to generate a return. However, no matter how you look at it, returns for core bonds over the next few years will be low.
- Given the low return expectations for core bonds, we continue to prefer utilizing managers with a more flexible investment mandate.
- The market turmoil in the first half of 2020 should serve to remind investors why they hold bonds to provide stability within a diversified portfolio. This remains attractive even if returns from fixed income are likely to be less generous over the next few years.

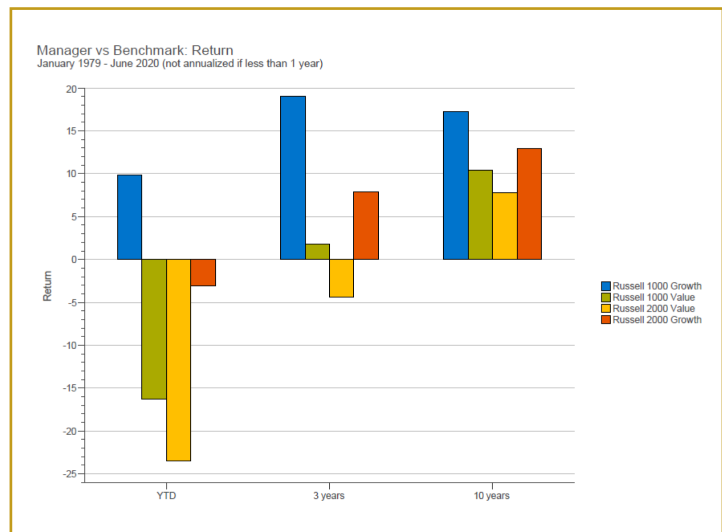


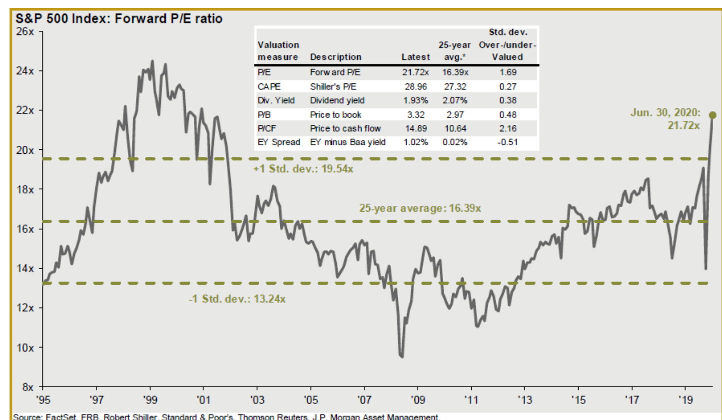




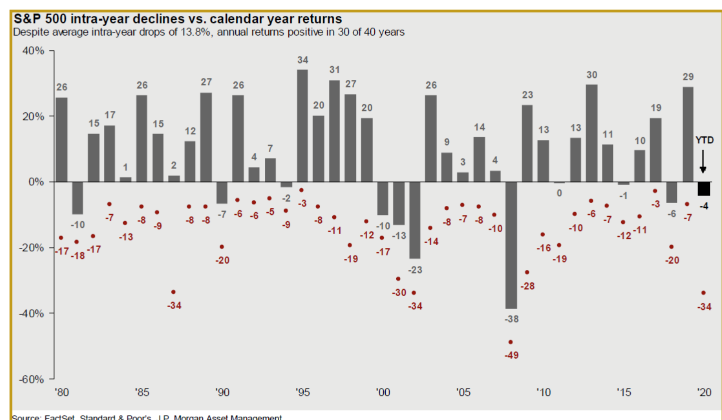
US EQUITIES: STILL THE ONE

- Stocks slipped into a bear market with warp speed in Q1, and then promptly surged with a big recovery in Q2, with the S&P 500 up 20%, small-cap stocks up 25%, and international stocks up 15% during the quarter.
- Growth stocks continued to outperform value stocks, with a historically wide spread of 26% YTD (although both were up double-digits in Q2). Or, from another angle, the S&P technology sector is up 12% YTD while the financial, industrials and energy sectors are down -24%, -14% and -35%, respectively.
- Corporate earnings have declined dramatically as a result of the economic shut down, but investors anticipate a faster recovery than has occurred historically. At this stage, it remains difficult to forecast earnings.
- Recent events have cast a renewed light on ESG (Environmental, Social, Governance) investing. Recent surveys suggest this is an opportunity for companies to recognize that their stakeholders include their employees, customers, and the environment, in addition to shareholders.
- The 34% market decline in February and March serves as a stark reminder of the volatility of equities, as well as why investors receive a return premium for holding equities over time.
- We continue to expect returns from equities over the next 10-years will surpass those from cash and bonds. However, returns are likely to be lower than their historical average as the world adjusts to less growth, more debt, and margin pressures.



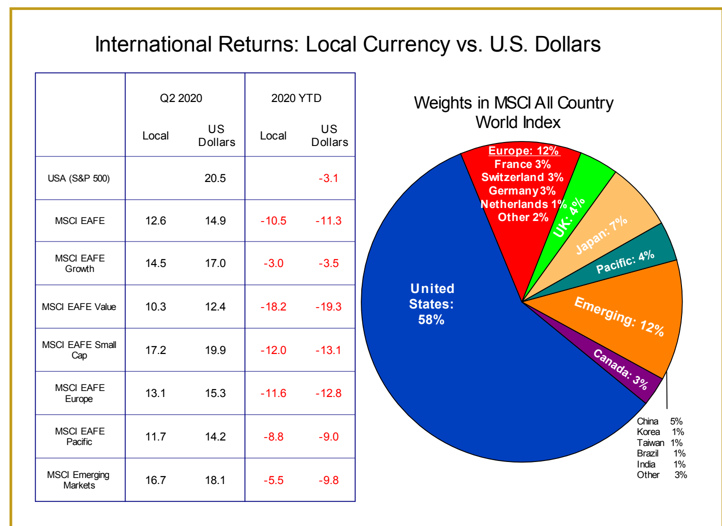


Valuation measure	Description	Latest	25-year avg.*	Std. dev. Over-/under-Valued
P/E	Forward P/E	21.72x	16.39x	1.69
CAPE	Shiller's P/E	28.96	27.32	0.27
Div. Yield	Dividend yield	1.93%	2.07%	0.38
P/B	Price to book	3.32	2.97	0.48
P/CF	Price to cash flow	14.89	10.64	2.16
EY Spread	EY minus Baa yield	1.02%	0.02%	-0.51



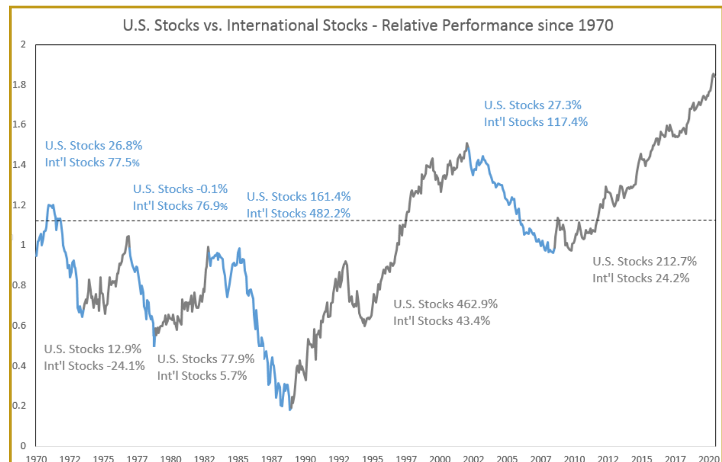
INTERNATIONAL EQUITIES: GLOBAL DIVERSIFICATION

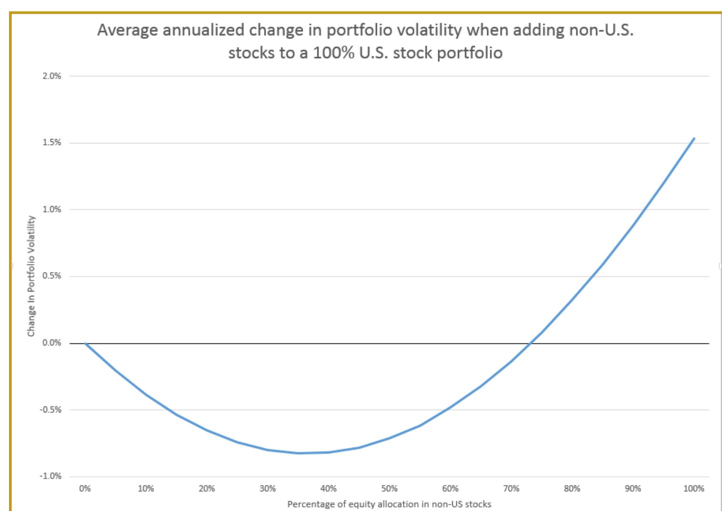
- While countries are at different stages in dealing with the coronavirus pandemic, global equity markets rebounded in Q2, with the MSCI EAFE up 14.9%, MSCI EAFE Small Cap Index up 19.9%, and MSCI Emerging Markets Index up 18.1%
- Of the 23 developed markets countries in the MSCI EAFE Index, all were positive in Q2 (both in dollars and local currency).
- YTD, the US dollar has been mixed, appreciating 5.4% vs. the world basket, but falling -0.8% vs. the Yen and -0.2% vs. the Euro.
- The scale, speed, and global response of central bank and government actions has been impressive. The European Central Bank, Bank of England, and Bank of Japan have all implemented easy monetary policies, indicating that they are willing to do whatever is necessary to get through the coronavirus crisis.
- Brexit tensions persist, with the coronavirus environment slowing UK and EU negotiations for a year-end trade deal.
- The resurgence in tensions between the US and China is a concern, as China tightens it grip on Hong Kong.
- US stocks continue to outperform international stocks. However, it is important to recognize the cycles of outperformance between US and international can be quite long, and thus investors need to be patient and maintain diversified exposure to equities globally.
- International equities diversify portfolios by providing exposure to different economic conditions, currencies, and demographics.



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

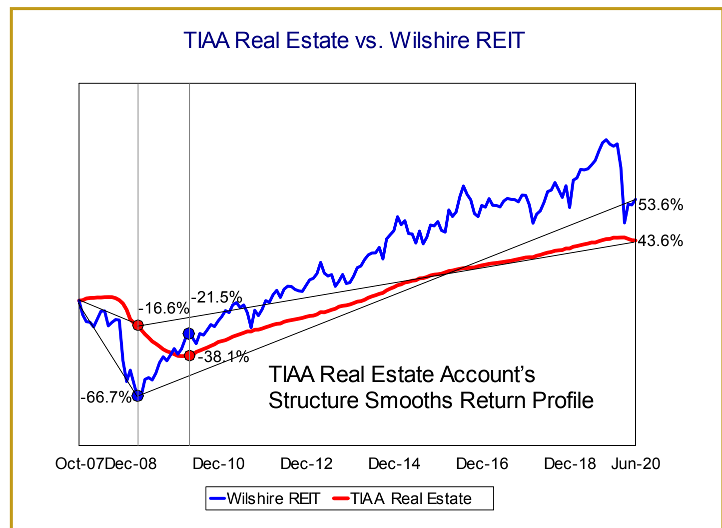
	Q2 2020		2020 YTD	
	Local	US Dollars	Local	US Dollars
USA (S&P 500)		20.5		-3.1
MSCI EAFE	12.6	14.9	-10.5	-11.3
MSCI EAFE Growth	14.5	17.0	-3.0	-3.5
MSCI EAFE Value	10.3	12.4	-18.2	-19.3
MSCI EAFE Small Cap	17.2	19.9	-12.0	-13.1
MSCI EAFE Europe	13.1	15.3	-11.6	-12.8
MSCI EAFE Pacific	11.7	14.2	-8.8	-9.0
MSCI Emerging Markets	16.7	18.1	-5.5	-9.8





REAL ESTATE: FOLLOWING THE ECONOMY WITH A LAG

- After falling -25.6% in Q1, REITs bounced back in Q2, up 10.6%, but remain down -17.6% YTD. Direct real estate, which was flat in Q1, performed with its usual lag, but with much a more moderate decline then publicly traded REITs. The TIAA Real Estate Account declined –1.5% and the Green Street Commercial Property Index declined -10% in Q2.
- The recession will likely put downward pressure on rents and upward pressure on cap rates, as across the world some tenants have stopped paying rent. However, reasonable valuations leading into the downturn may mute the impact for those sectors less impacted by the shutdown.
- As we have noted previously, direct real estate properties are only appraised quarterly, and as such, valuations lag publicly traded REITs. Moreover, the investment structure of direct real estate, lower leverage levels and pricing process allow direct real estate to exhibit more moderate volatility over time.
- We continue to prefer direct real estate, given its lower volatility, low correlation with traditional investments, and as a potential hedge against inflation (from increasing rents and property values).



HEDGE FUNDS: PROVIDING DOWNSIDE PROTECTION

- The HFRI Hedge Fund-of-Funds Composite was up 7.2% in Q2, but remains down –2.3% YTD. Returns over the past 10-years have been disappointing (+2.7%), especially given the attractive long-term returns which hedge funds exhibited prior to the great recession.
- While hedge funds did experience a more moderate decline in Q1, their ability to generate attractive returns consistently remains in question.
- The appeal of hedge funds remains their potential to generate attractive risk-adjusted returns with low correlation to traditional stocks and bonds.

BUSINESS DEVELOPMENT COMPANIES: ROUGH PATCH

- The S&P BDC Index rebounded in Q2, increasing +29.7%. Unfortunately, YTD returns remain quite dismal (-30.9%).
- The significant price decline which public BDCs experienced in Q1 reflect concerns about increases in underlying loan defaults.
- Publicly traded BDCs experienced both a decline in their quarterly net asset value and a decline in their market price. We continue to expect realized losses will be less than the mark-to-market adjustments, and thus valuations will recover over time.
- We continue to believe investing in middle market loans is attractive longer-term. However, we prefer to invest through private vehicles to moderate the volatility.

QUOTES OF NOTE:

"After a decade of steady growth and rising asset prices, economies and financial markets were rocked by the COVID-19 pandemic. The global health crisis forced most governments to lock down their communities, halting economic activity almost overnight and causing financial markets to reprice lower at an unprecedented speed. Policymakers responded with extraordinary monetary and fiscal support measures, leading to an equally dramatic upside move in risk assets. The challenge facing investors today is how to construct portfolios in an environment where asset prices appear disconnected from the real economy and the resolution of the health crisis is murky."

- *PIMCO, Asset Allocation Views, July 2020, Building Resiliency Amid Uncertainty*

"The unusual degree of uncertainty confronting consumers and investors may constrain economic activity for the rest of the year and keep a lid on the stock market."

- *Brian Signer, William Blair, Barrons July 2nd, 2020, 3 Scenarios for Playing the Coronavirus Economy in the Second Half*

"But be mindful of the emotions of fear and greed – stay disciplined, especially around diversification and periodic rebalancing. Long-term investment success does not require precisely picking market tops and bottoms. That's gambling on moments in time, while investing should always be a process over time."

- *Liz Ann Sonders, Charles Schwab, 2020 Mid-Year Outlook: US Stocks and Economy*

"Injustice anywhere is a threat to justice everywhere. We are caught in an inescapable network of mutuality, tied in a single garment of destiny. Whatever affects one directly, affects all indirectly."

- *Martin Luther King Jr., Letter from the Birmingham Jail*

COMPANY UPDATES

With summer upon us, we have had the pleasure of welcoming this year's summer interns to Radnor Financial Advisors.

- **LILLI SMITH** and **EVAN KAISER** are joining us from Temple University, where they are both current students in the financial planning program. Although their internships may look somewhat different this year given the advent of COVID-19, we are committed to delivering an exceptional learning experience to promote a solid foundation for the next generation of financial planners in this highly dynamic environment.

Over the last few months, we have been navigating through the COVID-19 pandemic in response to evolving recommendations and mandates, and have established a transition plan for safely reopening our office in phases. While we continue to work remotely for the time being, we remain fully capable of delivering seamless client service and supporting future growth during these unprecedented times. We welcome the opportunity to stay connected with our clients and build new relationships virtually, so that we can help you maximize your financial resilience in the face of change.

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

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