RADNOR CAPITAL MANAGEMENT, LLC
Investment Counsel

J. August Gerhardt, CFA
Senior Portfolio Manager
agerhardt@RadnorCM.com
38 West Avenue
Wayne, PA 19087
T: 484-584-4885
F: 484-427-5145
RadnorCM.com

1st Quarter 2021 Commentary

The fact that we already see full asset prices so early in the recovery is a source of risk. But on the other hand, the fact that the economy is likely to grow for several years is also encouraging. -Howard Marks

The market advance of 2020 extended into the 1st Quarter of 2021 with the S&P 500 generating a return of 6.2%. Unlike 2020, the advance was largely driven by stocks that lagged the broader market over the past 5 years (i.e. financials, energy, and materials). The outperformance of these sectors was due to a rotation to value-oriented businesses that tend to protect and, even, benefit investor capital during inflationary periods.

Inflation, for good reason, was on the minds of investors with the Federal Reserve prioritizing the recovery of the employment market. There are, after all, nearly 10 million fewer employed today than at the beginning of 2020.[1] Evidence of inflationary concerns were apparent as the 10 Year Treasury rose from a low of .85% in the quarter to 1.74% by quarter end. Google reported that searches for "inflation" reached a 13-year high in the quarter.[2] Inflation, however, is not expected to increase dramatically even if the economy is allowed to run hot. This departure from prior policy, according to Jerome Powell, is due to the fact that full employment over the past decade did not lead to inflation as expected.[3]

Count us skeptical. In addition to zero-bound interest rates and monthly open market activity from the Fed, the country's policy makers have embarked on a fiscal agenda with unknown consequences. Since the pandemic's outset to the approval of the 'American Rescue Plan' this past March, fiscal stimulus has totaled $5.2 trillion or 25% of U.S. GDP. Figure 1 breaks out the contribution of each fiscal plan. These plans have given the economy a temporary boost by providing businesses and consumers with relief until vaccines are administered across the country. The table, however, does not include the approximate $2.3 trillion 'American Jobs Plan' proposed by President Biden for infrastructure, transportation, research and

Covid-Era Fiscal Stimlus

When	What	Amount	% GDP
6-Mar-20	Coronavirus & Vaccine R&D	$8 Billion	0.0%
18-Mar-20	Paid Sick Leave & Un. Claims	$192 Billion	0.9%
27-Mar-20	CARES ACT	$1.7 Trillion	7.9%
21-Apr-20	Payroll Protection Plan	$483 Billion	2.2%
27-Dec-20	Phase 4	$900 Billion	4.2%
11-Mar-21	American Rescue Plan	$1.9 Trillion	8.8%

Fig. 1. Covid-Era Fiscal Stimulus (Source: Strategas)

[1] Trennert, Jason. 1Q'2021 in Review In Charts. Strategas. April 5, 2021
[2] Beilfuss, Lisa. "Google Searches for 'Inflation' Have Surged". Barron's. March 17, 2021. https://www.barrons.com/articles/google-searches-for-inflation-have-surged-heres-why-that-matters-51615996794
[3] 60 Minutes. April 11, 2021

development, and home and community-based care. This plan would not only provide stimulus but a much-needed upgrade to the country's infrastructure.

Economists expect the stimulus and corresponding economic reopening to generate GDP growth of over 6% in 2021. This would be the highest rate of growth since 1983.[4] Corporate earnings are also expected to bounce back in 2021 with analysts projecting growth of over 25%.[5] The projected recovery in corporate earnings would surpass the earnings record set prior to the pandemic. The magnitude of the government's intervention is unlike anything we have witnessed since World War II. Its impact on inflation will be felt over time.

Inflation eats away at the value of all investments, but it can be particularly painful for bondholders. The 1.74% yield on the 10 Year Treasury at the end of the 1st Quarter looked particularly attractive to investors willing to purchase the same security with a .85% yield earlier in the quarter. If, however, the Fed successfully generates inflation moderately above 2% for an extended period then investors will be subject to negative real returns. This headwind will be compounded for investors holding bond mutual funds. Due to the risk inflation presents, we continue to hold higher than normal levels of cash and purchase shorter-term bonds on average.

Stocks have proven to be a better hedge against inflation over the long-term. Particularly stocks with exposure to businesses that have the ability to pass pricing increases along to customers. Financials (banks), energy, materials, and technology businesses have historically fit the bill. In a 1980 Annual Letter to Berkshire Hathaway shareholders, Warren Buffett highlighted the characteristic a business must possess to succeed in an inflationary environment. In an inflationary environment, "business earnings consistently must increase in proportion to the increase in the price level without any need for the business to add to capital - including working capital - employed." Warren Buffett goes on to state that, "only a few businesses come close to exhibiting this ability."[6]

We strive to purchase businesses that grow without corresponding investment in all market environments. However, as stated above, few businesses exhibit the characteristic. Even fewer exist at a valuation suitable for investment.

Over the past quarter, we have found suitable investments in a basket of pharmaceutical businesses which continue to play an instrumental role in the development, production, and distribution of Covid-19 vaccines. In addition to Covid-19, these businesses are leaders in the oncology, immunology, vaccine, and animal health industries. Shares of these businesses have appreciated modestly since the pandemic's outset but have dramatically underperformed the broad indices. A basket of these businesses currently trades for approximately 10x 2021 earnings or less than half the valuation of the S&P 500 (22.5x 2021 estimates) while also paying shareholders over 3.5% on average. Further, these businesses are currently projected to grow earnings over 10% per year for the next 3 to 5 years.[7] Yet investors continue to treat

---

[4] Guilford, Gwynn and DeBarros, Anthony. "With Economy Poised for Best Growth Since 1983, Inflation Lurks". WSJ. April 11, 2021. https://www.wsj.com/articles/with-economy-poised-for-best-growth-since-1983-inflation-lurks-11618149601

[5] Trennert, Jason. 1Q'2021 in Review In Charts. Strategas. April 5, 2021

[6] Buffett, Warren. Letter to the Shareholder of Berkshire Hathaway Inc. 1980.

[7] Factset Research System

these businesses as though everything will go wrong while treating the broader market as though everything will go right. We are happy to own a piece of these unloved businesses.

Markets continue to trade at elevated levels on a historical basis. This is a source of risk. We expect continued bouts of uncertainty to lead to heightened volatility. We will continue to use volatility as an opportunity to put money to work in businesses we believe can withstand inflationary pressures.

We thank you for the chance to manage your assets. If you have any questions about this report and/or your investment portfolio, please do not hesitate to contact us at 484-584-4885.

Sincerely,

J. August Gerhardt, CFA

The views expressed are those of Radnor Capital Management, LLC as of March 2021, and are subject to change at any time based on market and other conditions. Information, research and data throughout the is acquired through multiple sources, including company websites, annual reports, presentations, SEC filings, and conference call transcripts; third-party research and news articles from various sources. While the information presented herein is believed to be reliable, no representation or warranty is made concerning its accuracy. Forecasts, estimates and certain information contained herein are based upon proprietary research and should not be considered as investment advice or a recommendation of any particular security, strategy or investment product. No part of this material may be reproduced in any form, or referred to in any other publication, without express written permission. Past performance may not be indicative of future results. Therefore, no current or prospective client should assume that the future performance of any specific investment or investment strategy (including the investments and/or investment strategies recommended by the adviser) will be profitable or equal to past performance levels. The S&P 500 is an unmanaged index used as a general measure of market performance. You cannot invest directly in an index. Accordingly, performance results for investment indexes do not reflect the deduction of transaction and/or custodial charges or the deduction of an investment-management fee, the incurrence of which would have the effect of decreasing historical performance results. This material is intended to be educational in nature, and not as a recommendation of any particular strategy, approach, product or concept for any particular advisor or client. Radnor Capital Management, LLC, is registered as an investment adviser with the United States Securities and Exchange Commission. Registration as an investment adviser does not imply any certain degree of skill or training.