RADNOR CAPITAL MANAGEMENT

3rd Quarter Small Cap Strategy Commentary

The "Big" picture:

As we write these quarterly pieces, we like for them to be, at least loosely, episodic. We have been discussing (warning?) the topic of inflation in these letters since late winter '21. While the Fed had been holding fast to the notion that the current blossoming inflation is transitory and that they have the tools to ensure that it will be, we believed inflation would be far stickier. We have watched the evolution of Fed Chair Powell gradually acknowledging that inflation was becoming a problem and likely more durable that originally thought. Having noted this, we are all a bit fogged- in by the cross currents of COVID-19 (21?), the economy's jagged recovery, logistic bottle necks that were originally kicked-off by a massive containership being stuck sideways blocking the Suez Canal for weeks – jams that have now become viral, a disabling semi-conductor fab fire in Japan with ensuing worldwide shortages, historic, unprecedented, government spending programs pouring money into an economy already with fewer items available to buy, Congressional disfunction, leadership challenges, bellicosity from China towards Taiwan against the backdrop of a collapse of China's debt laden real estate market (been there, done that), food, energy and general price inflation rising to levels and rates of change not seen in 40 years, and volatile, rising interest rates.

Speaking of 40 years of history, the term stagflation is reentering the lexicon. The Atlanta Fed Now produces GDP growth estimates that have been generally accurate. Here is the pattern of GDP growth estimates from February 2021 – September 2021: 6.3% to 3.7% to now, 1.3%; a stagnating economy. In memorializing the current level of inflation, the Social Security Administration just announced a cost-of-living adjustment for 2022 of 5.9%, the highest such adjustment since 1982. So, there you have it-stagflation.

From this view one would think the stock market would be cratering, but no, at least on the headline numbers. We noted last quarter something that has gained little attention, and that is a collapse on the rate of change in the money supply since February '21. According to the Leuthold Group it was growing at a 26% rate then to 9% in May, to 4% currently. Monetary policy normally operates with a 6-month lag time – right on schedule! The Fed possesses an array tool: setting short term interest rates, so-called quantitative easing (the Treasury prints $120 billion dollars/month – the Fed takes that and buys $120 billion in bonds, releasing $120 billion into the economy/month), controlling the supply of money into the economic system through what is called Open Market Operations (measured by M2), and moral suasion or jawboning. So, this dramatic slowing in rate of change in money growth indicates that the Fed has started to put the brakes on, but merely tapping them as they say. That has been reflected in the stock market but without much attention. According to Strategas Research Partners, the average stock in the Russell 2000 Index of Small Companies had declined by 28% from the February highs through September, yet due to capitalization weightings, the Index itself only declined by 7%. Hidden in here is a pretty good correction in the Index; that's been a good thing and we believe it sets the stage for a better Q4…but no bets or guarantees! The flip of the negatives noted here is a consumer with $3 trillion in reserves, consumer balance sheets that are in the best condition in decades as is the savings rate, the need for new housing is significant (the U. S. is estimated to be 3.5 million units short), continuing extremely low interest rate leaves the bond market as an alternative asset class moribund, and in time, these logistical lockups/shortages will resolve themselves.

The “Small” picture:

On to your portfolio specifics, let’s first look at valuation. At the center of our disciplined approach is valuation. The normalized price-to-earnings ratio is 21.4 x for your portfolio, at a discount to the Russell 2000 at 22.4x, but with far better other statistics; approximately 300 basis point higher return on equity, or profitability, accomplished with very low levels of debts. The portfolio turnover of its positions is quite low by industry standards while supporting our average holding period of about three years for a security. This is especially important to our tax paying clients. In short, the portfolio is far more profitable (ROE) than the Index, accomplished with very low levels of debt, and acquired at a discount price (P-E) to the Index. This has been the classic trademark of Radnor Small Cap portfolios.

The portfolio had the following characteristics on September 30, 2021:

	RCM Portfolio	Russell 2000*
Normalized Price to Earnings	21.4x	22.4x
Price to Book Value	3.5x	2.5x
Return to Equity	10.3%	5.0%
Total debt/book capital**	27.2%	29.3%
Market cap ***	$4,455M	$1,241M
Number of Issues	37	~2000
Portfolio turnover***	35%	NA

* Russell 2000 iShares is used as proxy for the index (actual index info unavailable under our FactSet subscription). ** Net debt means difference of total debt minus cash & short-term investments on balance sheet. *** This is an annualized statistic, measured in number of issues in and out of the portfolio. The Russell 2000 Index rebalances its positions annually at 6/30, RCM does not.

Maybe repetitive but with a number of new clients a couple of operational points are important to reemphasize before we go deeper into the portfolio specifics. Our process is “bottom-up”. We make individual valuation-based stock assessments through a repeatable process. We don’t attempt to mimic an index; in fact, we strive to look very different than the Russell Index, and we do that with a compact portfolio, just 37 positions currently. A compact portfolio as ours will experience more volatility relative to the Russell 2000 as the differing movements of 2,000 stocks can dilute the result versus a mere 37 or so. We eschew companies with heavy debt levels. Our shopping universe is defined as being within the market cap ranges of the Russell 2000, the highest of which is now $12.4 billion (as indicated in the nearby statistical panel your portfolio market cap is $4.4 billion). *We do not time the market– we are always statistically fully invested.*

As for your account, viewing the quarter by *weighted contribution* to return, the *top five contributors* were all long-term holdings: hard infrastructure operator, **Quanta Services,** up 25.6% contributing .84% to results; the eponymous **Montrose Environmental Group,** up 20.4% or a .25% addition to returns; **Williams-Sonoma,** the eponymous retailer of home furnishings also sold under Pottery Barn, West Elm, up 10.4% for a .5% contribution; RV manufacturer (think Airstream Travel Trailers) and possibly our longest held small cap name, **Thor Industries,** up 9.7%, contributing .25%; and for the second quarter running **Jeffries Financial**, up 9.3% adding .3%, having recently announced that Japan's Mitsui Financial Group will purchase up to a 4.9% stake. Congratulations on the **Greyscale Bitcoin Trust** recommendation! As of today, it is up about 44% with a corresponding 14% weighting in the portfolio. As it was it was acquired on August 6th, it made competitive contribution, but not “in” for the full quarter.

Of the bottom five detractors it was a bit more difficult to classify, but some would be considered "growth stocks" and hence our inclusion of that Index in the performance panel in the lead: Stitch Fix, the on-line creator customized and delivered fashion packages, down 35.9%"costing" 80 basis points (a basis point, or bp, is 1/100th of 1%); and AeroVironment, a leader in unmanned aerial vehicles, primarily for military applications, -62 bp.; retailer, The Gap, was off 30%, "costing" 84 bp: drug company Jazz Pharmaceutical, specializing in sleep related issues, was down 21.7%, or 47 bp subtraction: manufacturer of several brands of artificial sweeteners, Whole Earth Brands, declined by 18.8% While not making this list, there were some shenanigans going on during the last day of quarter with the position in John Bean Technology. The stock reached a 52-week high of $160/share on September 23rd. A scant 5 trading days later, the last day of the quarter, it was down $15/share to close at $140/share. On a 3% position the last quarter's last day's decline, alone, cost 40 basis points to quarterly performance. Now, we believe that all this washes out with time, but our guess, as there was no news, is some investor had sold short a heretofore good performer and acted to make his short position look better at quarter end…frustrating.

Moving from contribution to sectoral attribution, the higher weighting of larger positions in a concentrated portfolio will heavily influence those sector results. We define an over/under weight as +/- 1% to the Index's weighting. Ironically, the underweighted sectors but with better stock selection or owning less "of a bad thing" were the contributing groups. The underweighted sector of Financials added 45 basis points to results (again, a basis point, or bp, is 1/100th of 1.0%), as did Health Care adding 118 bp, however underweighted Information Technology added 85 bp, Materials added 1 bp, and owning no utilities added 9 bp. Our most costly overweight was in Consumer Discretionary which subtracted 219 bp from overall results.

In portfolio activity we eliminated Madison Square Garden Entertainment, and Jazz Pharmaceutical each under our "down 20 review/sell discipline". This little device forces us to address underperforming issues and, in many cases, has saved clients from a deeper loss and at the same time provided portfolio space to increase a "working" existing position and/or introduce a new position. There were several other minor reductions in order to finance the Grayscale position at 10% weight. The only new positions in the quarter were Grayscale and Figs, which is adding a fashion, comfort, durability, and the convenience of on-line acquisition aspect, to medical scrubs and gowns.

Sincerely,

Doug Pyle

Important Disclosures:

Past performance may not be indicative of future results. The individual account performance information reflects the reinvestment of dividends, and is net of applicable transaction fees, investment management fee (if debited directly from the account), and any other related account expenses. Account information has been compiled by Advent using the time weighted rate of return methodology and has not been independently verified. Historical performance results for investment benchmarks have been provided for general comparison purposes only, and generally do not reflect the deduction of transaction and/or custodial charges, the deduction of an investment management fee, nor the impact of taxes, the incurrence of which would have the effect of decreasing historical performance results. It should not be assumed that your account holdings correspond directly to any comparative benchmarks. Radnor Capital Management can provide you with a list of the firm's recommendations for the preceding 12 months. The Russell 2000® Index is a market value weighted index comprised of small-sized companies that cover up to 2,000 companies in the U.S. market. The Russell 2000® Index is a registered trademark of Russell Investments.