HORAN CAPITAL ADVISORS Investor Letter

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The Presidential Cycle

Historically, the third quarter in a midterm election year has been the worst performing during a four-year presidential cycle. The second and third quarters combined have been the worst consecutive period for returns over that four-year stretch dating back to 1949. Investors that follow history may have been inclined to raise cash earlier this year to avoid a period averaging -2.3%. However, those who remained fully invested were rewarded as the S&P 500 Index generated a total return of 3.4% in the second quarter followed by a strong 7.8% in the third quarter.

S&P 500 Index Average Return (Since 1949)

Presidential Cycle	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
Year 1	-0.24%	2.20%	0.87%	3.66%
Year 2	1.04%	-2.38%	0.10%	7.81%
Year 3	7.08%	4.91%	0.59%	3.22%
Year 4	1.36%	1.76%	1.08%	2.00%

Source: Schaeffer's Investment Research

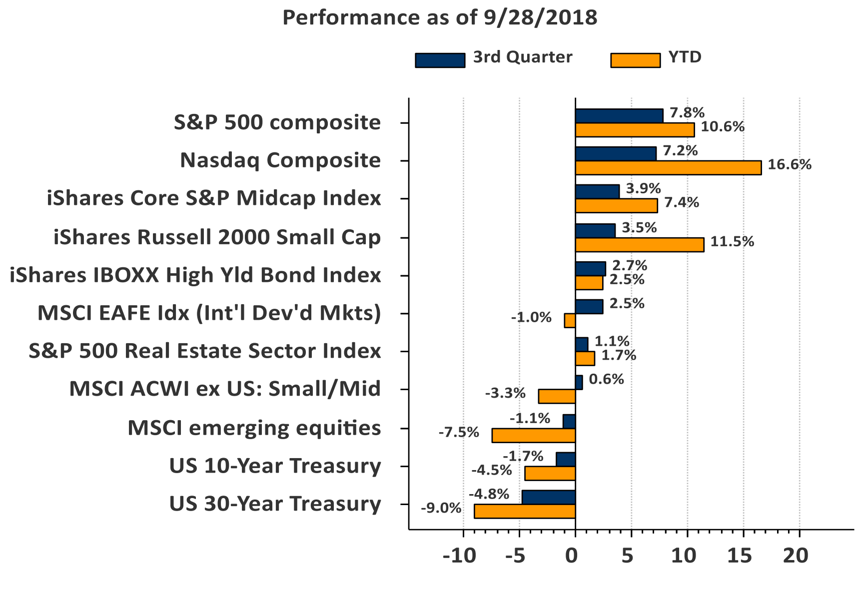
History also shows the fourth quarter of a midterm election year combined with the first quarter of the following year are the two strongest returning quarters for the market over the four-year presidential cycle. As we write this letter, the start of the fourth quarter may lead investors to believe something other than the historical data. Days into the quarter, markets have turned lower and volatility has increased to a more normal level. Although this is unsettling, the underlying economic and market fundamentals are still supportive of favorable equity returns looking ahead. Interestingly, going back to 1946 there have been 18 midterm elections and according to LPL Research, the S&P 500 Index was higher one year later every time.

A Challenging Year for Diversification

The bar chart on the following page provides returns for various market segments during the third quarter. It is sorted from strongest to weakest performance. The bond market, faced with stiff headwinds, has fared poorly. Long-term, high quality bonds as represented by U.S. Treasury securities are at the bottom of the chart. The 30-year Treasury was -4.8% in the third quarter and -9.0% year to date, while the 10-year Treasury return was -1.7% in the quarter and -4.5% year to date. Our bond strategy fared better and was mostly positive due to a short term structure and exposure to floating rate bonds where underlying bond rates adjust higher as interest rates increase. Bond prices move inversely to interest rates and the Federal Reserve continues to tighten monetary policy by raising interest rates. In the last week of September, the Federal Reserve Open Market Committee increased the Fed Funds rate another 0.25%, or 25 basis points, the eighth such increase since the Fed began the current tightening cycle in December 2015. Most economists and investors anticipate another increase in December followed by several more over the next two years.

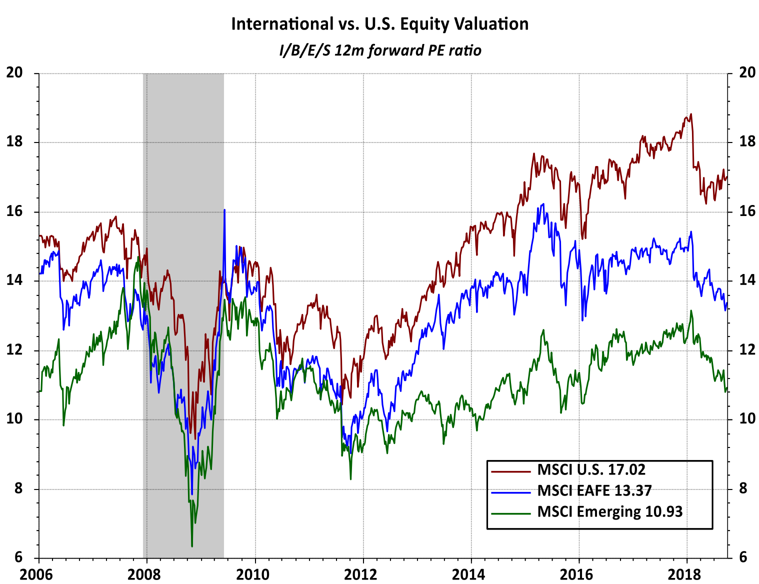
U.S. equities were the clear winner during the third quarter. The S&P 500 Index return represented the largest quarterly gain since the fourth quarter of 2013. U.S. mid cap and small cap equities also faired well during the quarter. For the most part, the U.S. market has shrugged off worries regarding a tariff war and although those worries may not have impacted the U.S., one may argue they have had influence in the emerging markets.

Emerging markets were down slightly more than 1% during the quarter and have struggled year to date at -7.5%. In addition to tariff considerations, higher interest rates in the U.S. have placed pressure on the emerging markets. Dollar strength increases the expense for emerging market economies to pay back Dollar denominated debt.



Source: Thomson Reuters Datastream & HORAN Capital Advisors

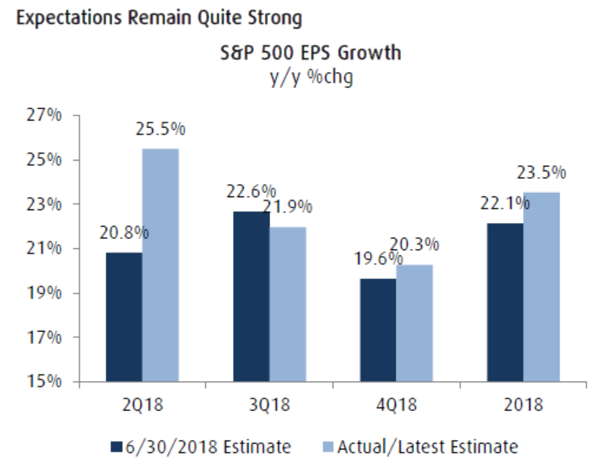
The recent weakness in broad international markets comes on the heels of strong outperformance in 2017. Last year developed international equites were up 25.0% and emerging market equities were up 37.3%. Emerging markets far outpaced U.S. stocks in 2017. A recent Wall Street Journal article titled, *'Dumb' Money Is Bailing on U.S. Stocks - That's Smart* notes, "Individual investors and their financial advisers…seem to be adding money to international stocks as a systematic way of taking some money off the table as U.S. shares keep rising."



Source: Thomson Reuters Datastream & HORAN Capital Advisors

Working in favor of international equities is the lower relative valuation of foreign stocks versus their U.S. counterparts. As seen in the chart at left, the valuation, or Price to Earnings ratio (P/E), of foreign equities is quite a bit lower than U.S. equities. Emerging market equities trade at just under 11 times earnings while U.S. stocks are trading at 17 times earnings. According to Bank of America Merrill Lynch, this valuation gap is the widest since 2009. As Warren Buffett once said, "Price is what you pay, value is what you get." International equities may be offering investors a value opportunity that some investors are beginning to recognize.

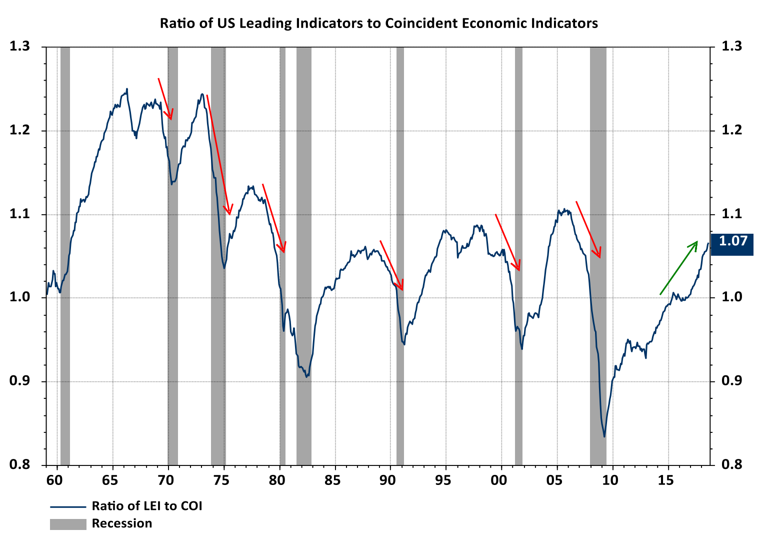
The attractive valuation of international equities does not mean U.S stocks should be avoided. The current P/E for the S&P 500 Index is 17 times earnings and is only slightly higher than the 25-year long term average P/E of 16.1. Equity fundamentals and economic factors remain favorable in the U.S. Not only have the tax cuts boosted bottom line earnings growth, but also companies are experiencing strong top line revenue growth. In the second quarter, S&P 500 revenues grew 9.5% and the revenue growth expectation for the third quarter is a positive 7.5%. Earnings growth expectations have been guided higher as the year has progressed. If this positive trend continues, earnings growth for S&P 500 companies will be more than 23% for 2018. Companies appear to be hitting on all cylinders.



Source: BMO Capital Markets Investment Strategy Group, FactSet, IBES.

<u>Do Not Let Facts Get in the Way of the Story</u>

"Soft data" such as business and consumer confidence remain at record high levels, and the "hard data" such as unemployment claims, new orders, etc., signal a strong U.S. economy. The Non-Manufacturing Index (NMI) jumped in September to its highest level since August 1997, and the second highest on record, indicating a significant acceleration in services' activity. However, with the economy approaching the longest expansion on record, recession fears are a frequent discussion topic. Economic expansions don't die of old age, they die of excess.

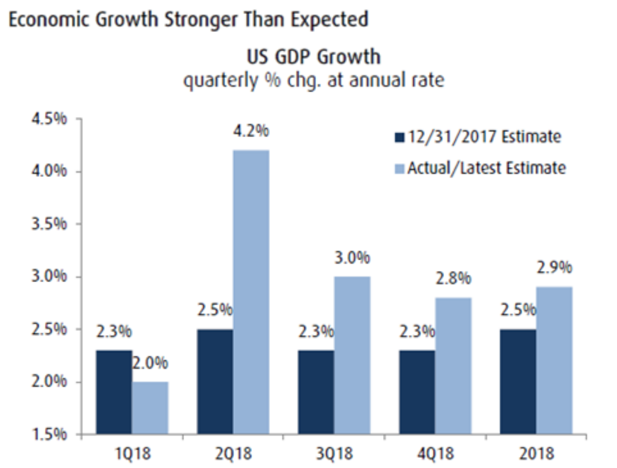


Source: Thomson Reuters Datastream & HORAN Capital Advisors

The chart at left shows the ratio of the Conference Board's Leading Economic Index to the Board's Coincident Index. The indicators consist of components that provide readings on economic activity, such as manufacturing new orders, trade sales, etc. The comparison of the indicators provides insight into the potential nearness of a recession. Historically, this ratio has turned lower leading up to a recession. As the chart shows, this ratio is continuing to climb higher, suggesting recessionary risk remains low.

Economic growth, as measured by GDP, has experienced significant revisions to the upside since the end of 2017 (chart on next page). At the end of last year expected GDP growth for the second quarter of 2018 was 2.5%. At the end of September, the final reading on second quarter GDP came in at 4.2%, nearly 70% higher than originally expected. The Atlanta Fed's GDPNow forecast is estimating third quarter GDP of 4.1%. The expectation for GDP growth in calendar year 2018 is 3%. This contrasts with to average GDP of 1.5% per year in the previous decade ending 2017.

There are many indicators pointing to continued strength in the U.S. economy including increased manufacturing activity, robust readings from the service sector and low unemployment levels last seen 49 years ago. Employee wages are rising, and the labor market is benefiting from the current growth in the economy. We view the low levels of unemployment and continued wage growth as a positive signal for the economy.



Source: BMO Capital Markets Investment Strategy Group, Bloomberg.

Since mid-August interest rates, especially longer-term rates, have spiked higher. The 10-year U.S. Treasury is up 40 basis points to 3.23% in about a six-week period. Long-term interest rates are driven primarily by growth and inflation expectations. Scott Grannis, former Chief Economist for Western Asset Management noted recently, "The higher rates we are seeing of late are being driven not by higher inflation expectations, but by higher real yields. This is healthy. A stronger economy goes hand in hand with higher real interest rates." There is a point where higher interest rates do create competition for stocks. Historically, this has not occurred until the 10-year yield approaches 5%.

<u>Diversification</u>

In 2017 investors were strongly rewarded for diversification across asset classes with international returns exceeding U.S. market returns. Thus far in 2018 the reverse has been true. In addition, bond market performance has pulled down returns in investors' portfolios. We believe diversification continues to serve an important role in managing portfolio risk and investors' long-term returns.

As 2018 draws toward an end we would not be surprised to see continued heightened market volatility around issues such as the mid-term elections, trade and tariff talks and concern around the path of future interest rate increases. As these concerns subside we believe markets will refocus on business and economic fundamentals, both of which remain strong in our view.

Thank you for your continued confidence in HORAN Capital Advisors. Please be sure to visit us at www.horancapitaladvisors.com.

Warm regards,

HORAN Capital Advisors