HORAN CAPITAL ADVISORS
Investor Letter
Winter 2014
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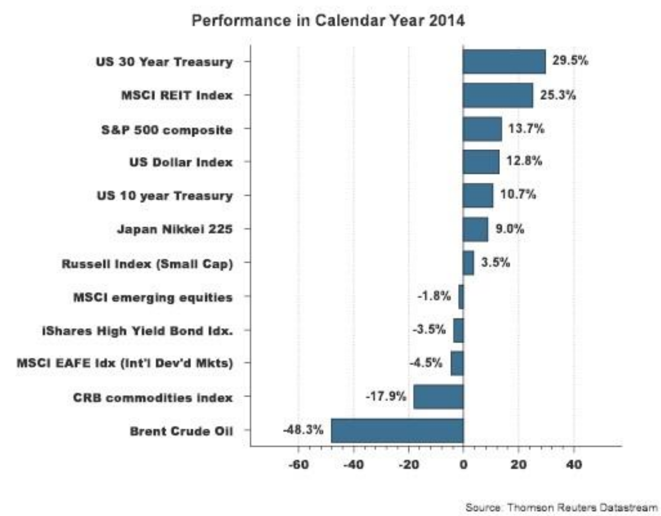
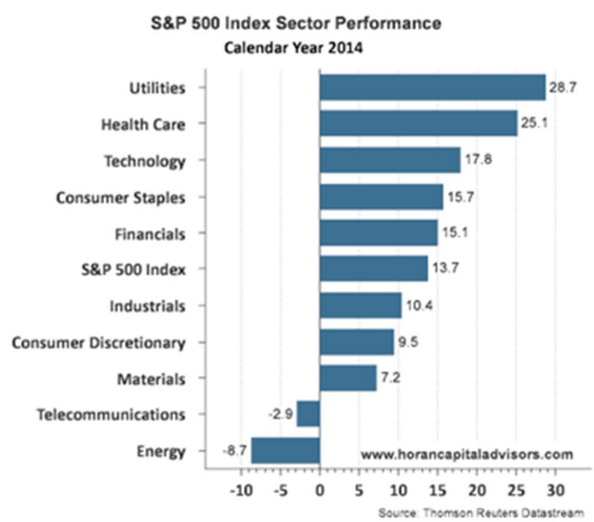
An important component of investment counseling is to regularly meet with clients to frame expectations based on the investment outlook. Client expectations can vary widely based on historical experiences, media buzz and general life experiences and viewpoints. We believe it is our responsibility to identify and communicate historical market perspective, the future drivers of market returns and foreseeable risks that could disrupt one's wealth accumulation or a comfortable retirement. What follows are insights on factors we believe will influence the markets in 2015.

Market Performance



Geographically, the U.S. equity markets continued to lead returns in 2014. However, the markets experienced some decoupling of returns across various asset classes and sectors. U.S. small-cap stocks significantly underperformed U.S. large-cap stocks by nearly 8 percentage points. Divergences were also seen across several S&P 500 Index sectors. Utilities led sector returns in 2014 as investors were attracted to the higher yields currently unavailable in traditional fixed income assets. The energy sector lagged in a significant way, as crude oil prices dropped by 50%. Oil prices are facing the laws of economics as the new marginal supply of oil is outpacing demand. Furthermore, most people believe OPEC is trying to force out smaller U.S. shale fracking producers by not curbing production to stop oil's free-fall. Even with the energy sector turmoil, the S&P 500 Index achieved a 13.69% return in 2014 and now boasts 6 consecutive years of positive performance. Our client equity investments have greatly benefited from the significant overweight to U.S. stocks.



An economic slowdown in foreign markets resurfaced in the summer of last year. The MSCI EAFE Index (developed international index) and MSCI Emerging Markets Index were -4.5% and -1.8%, respectively. Investors with direct commodity exposures also experienced negative returns as investable commodities' indices were down greater than 17% in most instances. Importantly, we have deliberately avoided such direct commodity exposure.

The decline in U.S. interest rates was an unexpected occurrence in 2014. Declining rates resulted in the widely followed Barclays Capital U.S. Aggregate Bond Index increasing 5.97% for 2014 while long-term bonds, measured by the 30-Year Treasury, garnered returns of +29.5%. This interest rate decline benefited higher yielding assets such as the aforementioned utility sector but also REITs as the MSCI REIT Index was up 25.3%.

Future Drivers

If one believes in quirky indicators, the unexpected win in last year's Super Bowl by the Seattle Seahawks is all an investor needed to know about the market's anticipated direction for 2014. The Seattle Seahawks are an NFC team and the Super Bowl Indicator has shown when an NFC team wins, the Dow is up 88% of the time for the balance of that year. Will Seattle be a repeat winner over New England this year?

There are certainly some common themes in the New Year. These include:

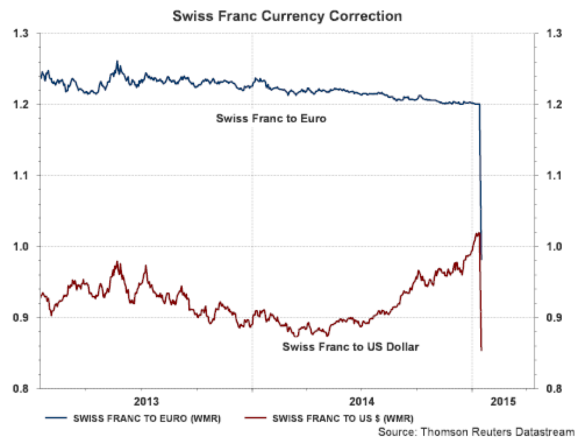
- The divergence of central bank policy, i.e., likely U.S. monetary tightening and European/Japanese loosening (easy money)
- Continued strengthening of the U.S. Dollar
- A continuation of slow but steady U.S. economic growth in the 2.5 - 3.5% range
- Inflation will remain contained

Steady growth in the U.S. economy seems likely. GDP growth of 2.5 - 3.5% coupled with mid to high single digit earnings growth appears likely as well, and would remain consistent with recent expectations and supportive of equity prices in general. Last year we witnessed the strongest job creation in fifteen years partially enabling consumers to repair their balance sheets. Savings at the gas pump are meaningful and economic data/surveys continue to point toward overall economic improvement.

1946-2014			
Inflation	Average P/E	Highest P/E	Lowest P/E
< 0%	12.9	26.7	5.9
0 – 1%	14.1	23.4	6.2
1 – 2 %	18.1	29.6	6.3
2 – 3%	17.7	29.6	7.2
3 – 4%	16.9	27.8	6.6
4 – 5%	14.9	22.9	7.1
5 – 6%	14.5	18.9	7.2
6 – 7%	10.7	15.9	7.5
>7%	9.7	21.4	6.7

Current S&P 500 trailing P/E @ 17.5

We continue with a favorable view of U.S. equity returns in the coming year. The near uninterrupted advance for U.S. equities since the end of the financial crisis in 2009 has been driven by a great deal of stimulus, corporate profit growth and valuation expansion. We do believe investors should now be prepared for more muted equity returns. A recent Goldman Sachs analysis describing the rational for muted returns noted higher valuations of U.S. stock prices, falling interest rates and a 58% price to earnings multiple expansion since 2011. Goldman's target S&P 500 return is 4% for the coming calendar year. Meanwhile, a survey of other Wall Street analysts has a mean price target of 2,177 for the S&P 500 Index; a 6% return expectation. The high/low targets ranged from +2% to +14%. At this market level, it is reasonable to expect lower returns in U.S. markets; that is unless earnings growth surprises on the upside. We do not think higher earnings growth is out of the realm of possibility. When comparing valuation levels in periods of time with low inflation, equities do not look



overextended as the above chart provided by Charles Schwab displays. *Institutional Investors'* perennially #1 ranked economist Ed Hyman of Evercore ISI recently stated, "Buy assets that can inflate in value. Publicly traded equities are probably the least loved asset class out there." In addition, Mr. Hyman believes we have merely bounced back from the financial crisis. We are beginning to see real economic growth placing the U.S. somewhere in the mid-cycle stage of a bull market trend.

Monetary policy around the world will certainly influence market returns. The U.S. seems likely to raise interest rates in the second half of this year although most strategists agree the Fed's communication will be telegraphed to minimize market volatility. A Bloomberg poll of 74 fixed income strategists identifies a mean target yield of 3% for the 10-Year Treasury. This is a 66% increase from the January 15th yield of 1.8%. Keep in mind virtually no strategist predicted interest rates would decline in 2014. Meanwhile, regions around the world like Japan, Europe and China are forcing yields lower by adopting and implementing stimulus policies in an effort to create economic growth. Worsening economic data in those geographic areas may be good news for investors as economic stimulus measures may push those markets higher. If the recent U.S. stimulus playbook is any indication, accessible capital, earnings growth and valuation expansion could drive foreign outperformance. There is a large caveat/headwind to the preceding statement. U.S. dollar strength dilutes overseas market returns when stocks owned in foreign currencies are converted back to Dollars. Investors recently experienced strong Japanese equity markets; however, Japanese Central Bank actions significantly devalued the Japanese Yen. This Yen weakness reduced overall Japanese performance for U.S. based investors.

Global currency fluctuations are certainly making headline news. The linkage between monetary policy, stimulus programs and structural debt comes with the risk of unexpected currency fluctuations. Recently, Switzerland made global headlines when its central bank ended support to peg its currency to the Euro. This announcement resulted in the Swiss Franc gaining strength versus the Euro and the U.S. Dollar by nearly 30%. This outsized move by a traditionally stable currency was a complete surprise to the market and speaks to the potential consequences of monetary actions of central banks around the globe.

(Un) Foreseeable Risks

The energy sell-off, which began in earnest in the third quarter, was far more significant than most investment professionals would have predicted. The widely read investor publication, *Barron's*, displayed a March 31, 2014 cover noting oil could fall to $75/barrel. Oil prices at the time were hovering around $100/bbl. As we write this newsletter, oil is trading under $50/bbl. The decline in oil should be a boon to consumers as they save money at the pump; however, as oil prices remain low, we recognize there are identifiable and unidentifiable repercussions. Howard Marks recently wrote, "The current situation with oil illustrates how difficult it is to understand the full range of potential ramifications." Marks later continued to outline how oil prices can influence currencies and corporate debt markets. We highlight this to illustrate the awareness that diversification matters and portfolio allocations are influenced by numerous factors that need to be assessed on a regular basis.

In July of last year, we eliminated our high-yield bond exposure in client accounts as credit spreads tightened to levels where the risk was not worth the reward in our view. The ensuing sell-off in oil placed pressure on energy related companies that issued a great deal of high-yield debt to finance their growth. This confluence of events, since oil peaked in June 2014, resulted in price declines greater than 6% for the high-yield bond market.

As Warren Buffet's long-time business partner, Charlie Munger, states, "there must be some wisdom in the folk saying: 'It's the strong swimmers who drown.'" Charlie acknowledges that over-confidence can be deadly. We agree and believe now is as good a time as any for investors to remain active in their asset allocation decisions and investment selections. Buying broad market allocations through passive strategies may prove detrimental as certain market segments look expensive and provide more downside risk exposure opposed to upside reward.

Our discipline focuses closely on fundamental and valuation metrics for investments. Fundamentals and valuations, vis-à-vis corporate earnings, cash flow, dividends and company management teams, ultimately drive the markets in the long-term. As we analyze equity earnings and global valuations, it is difficult to ignore the relatively inexpensive markets around the world when compared to the U.S. As the JP Morgan chart (left) denotes, Europe and the emerging markets trade at cheaper multiples compared to the U.S. On this basis alone, it would seem both are worthy of further consideration and possibly increased investment. However, beyond valuation, we see both tailwinds and headwinds for these markets. Finding the right entry points for tactical additions will take patience this year.

Tomorrow is another day down the path of achieving investment goals. As Ralph Seger stated, "An investor without investment objectives is like a traveler without a destination." As we continually analyze market data, it is important to structure portfolios for what is ahead and to set reasonable expectations for both risk and return. We look forward to serving our clients in 2015. We thank you and our corporate partners for continued confidence. Please visit us at www.horancapitaladvisors.com and please don't hesitate to contact us.

Warm regards,

HORAN Capital Advisors

* HORAN Capital Advisors, LLC is an SEC Registered Investment Advisor.

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