HORAN CAPITAL ADVISORS

Investor Letter

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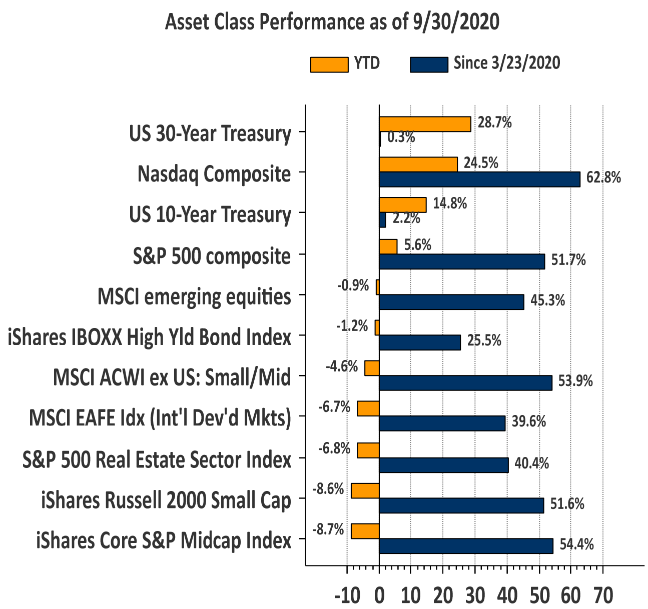
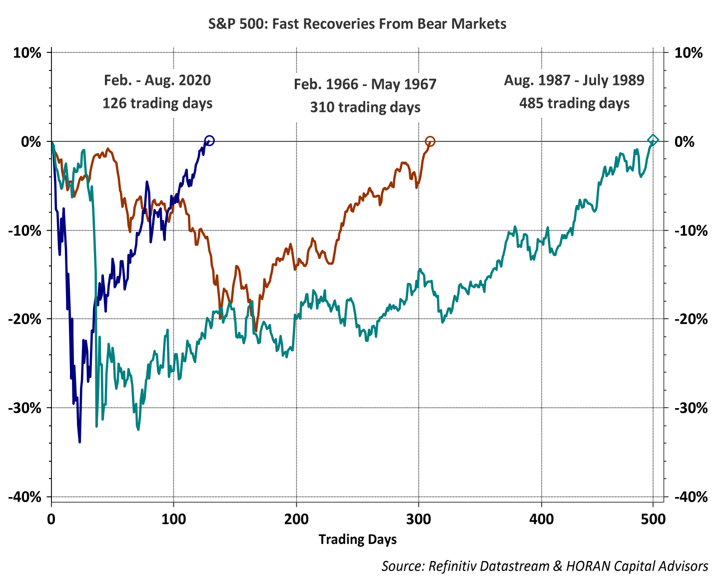
"You can't go back and change the beginning, but you can start where you are and change the ending." – C.S. Lewis

Market Strength Continues

Despite a 3.80% decline in September, the S&P 500 Index was up a solid 8.93% for the third quarter. This near double digit return is on the back of the second quarter's return of 20.54%. The blue bars on the chart at right show the various asset class returns from the March 23rd low. Clearly, a 'V-shaped' rebound has occurred from a stock market perspective. A further positive is the broadening in market participation. The returns for the small cap, mid cap and large cap stocks are nearly identical, up an astounding 50+%. Even small and midcap stocks outside the U.S. were up 53.9% as measured by the MSCI ACWI ex US-Small/Mid Index.



Source: Refinitiv Datastream & HORAN Capital Advisors



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In our Summer Investor Letter, we commented on the rapid market decline in the first quarter and the quick rebound that was unfolding. The quick rebound continued and by August, after a record short 126 trading days, the S&P 500 Index recovered all the loss that followed the February 19 high for the index. This fast rebound is compared to a few other quick market rebounds on the chart at left.

The increase in equity market volatility that occurred during the stock market pullback early in the first quarter has contributed to respectable fixed income returns. During periods of elevated equity market volatility, investors tend to be attracted to the safety of bonds and this has been the case this year. Also positively impacting bond prices is the Federal Reserve's over $6 trillion in monetary support. The programs enacted provided liquidity to the markets and eased financial conditions via lower interest rates. As seen on the bar chart on the previous page, the long-term 30-year U.S. Treasury bond has returned 28.7% through the end of the third quarter and the 10-year Treasury bond is up 14.8%. Just about all of the return was generated in the January to March period as the return since the equity market low on March 23rd is essentially flat.

A Presidential Election Year

As we have noted before, one thing investors and the equity market do not like is uncertainty. The unknown outcome of the upcoming election could very well create some added market volatility. However, a recent report by S&P Dow Jones Indices noted "the performance of the S&P 500 during election years has typically been similar to its performance during other years. The table to the right shows that the average (and median) calendar year S&P 500 price return, volatility and risk-adjusted returns have been similar across election and non-election years." Based on the above table, fourth quarter average and median returns do tend to be lower yet remain positive. Another favorable market data point is when the third quarter return is strong like the recently completed quarter, the fourth quarter returns tend to be favorable.

S&P 500 return characteristics have been similar between election and non-election years

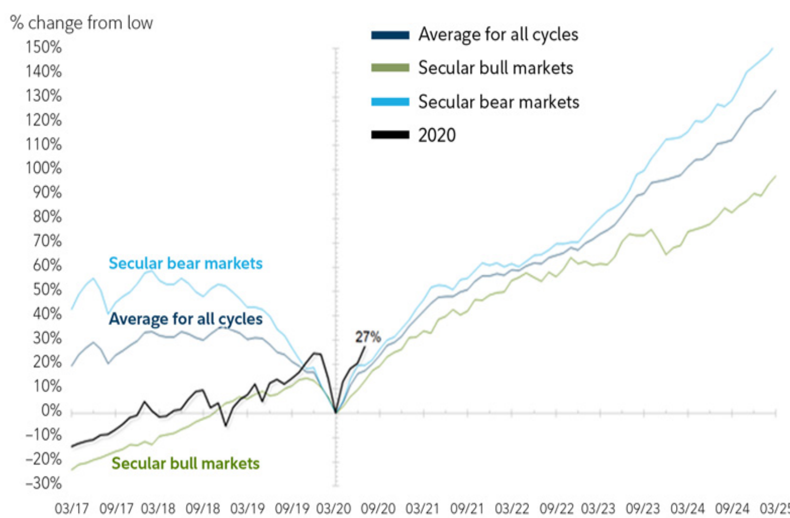
Average	Calendar Year			Fourth Quarter		
	Return	Volatility	Return/Volatility	Return	Volatility	Return/Volatility
Election	7.05	15.40	0.83	1.83	15.83	0.32
Non Election	7.88	16.00	0.77	2.80	16.89	0.34

Median	Calendar Year			Fourth Quarter		
	Return	Volatility	Return/Volatility	Return	Volatility	Return/Volatility
Election	9.54	12.75	0.81	2.91	11.83	0.22
Non Election	10.79	14.10	0.86	4.92	13.40	0.33

Source: S&P Dow Jones Indices LLC, based on daily S&P 500 closing price levels between Jan. 3, 1928 and Dec. 31, 2019. Volatility is calculated as the annualized standard deviation of S&P 500 price returns. Tables show the average and median values for price returns, volatility and return/volatility. Past performance is no guarantee of future results. Tables provided for illustrative purposes only.

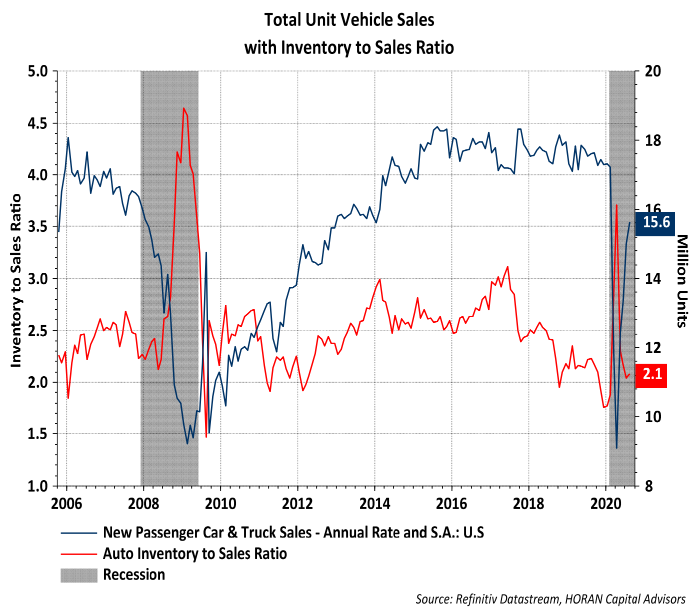
Finally, the economy and market were performing well prior to the virus mandated shutdown. We would say the equity market was, and remains, in a secular bull market. In secular bull markets, corrections tend to be fast and deep; however, a quick rebound tends to follow, not unlike what was experienced in the February/March pullback and subsequent recovery. In secular bear markets, market corrections tend to be long and drawn out as seen with the light blue line on the chart at right.

Bear market bottoms: Bull vs. bear markets



Dates along the x-axis begin with 2017. Monthly data as of 08/28/2020 for the S&P 500 Total Return Index.
Source: FMRCo, Bloomberg.

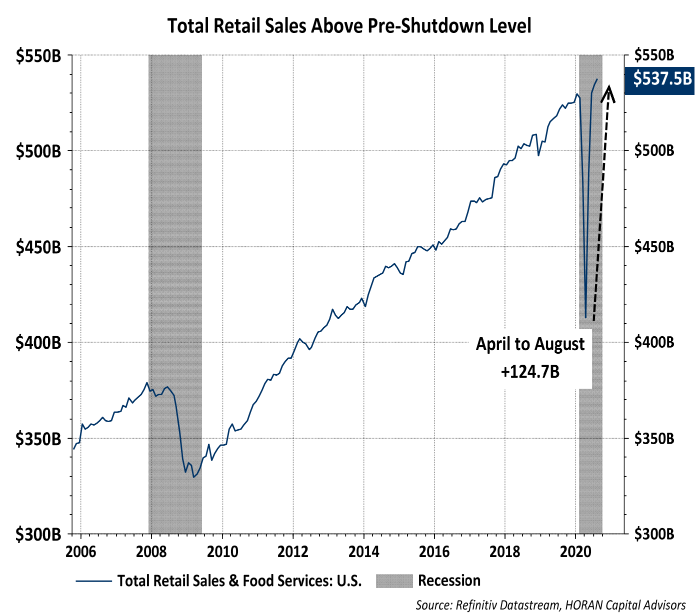
Economic Strength

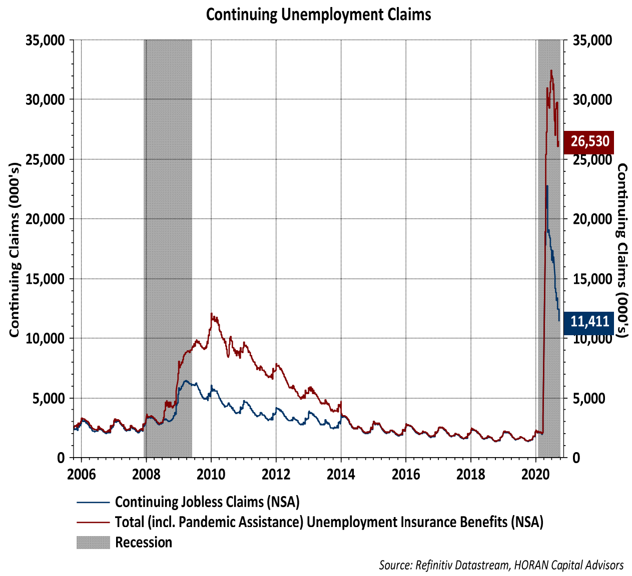


The final report for second quarter U.S. GDP showed the economy contracted at a 31.4% annual rate. This followed the 5% decline in GDP for the first quarter. Against this recessionary backdrop and as noted earlier, the equity market has made a significant recovery from the March 23rd low. As we have written before, the stock market and the economy are not necessarily the same and can diverge directionally over the short term. However, a strong economy coming out of a recession is important and can support equity prices as business activity picks up. With this noted, third quarter GDP growth is expected to be reported at an annual rate of 34.6% based on the Atlanta Fed's GDPNow model and further positive revisions are possible as more Q3 economic data points are reported.

One of the drivers of this economic rebound is the fact this recession was not triggered by activity normally associated with economic recessions. Companies generally did not have excess inventory at the time the U.S. government and many state governors began shutting down their economies. When economies and businesses began reopening, customer demand quickly reduced inventory levels. A good example is seen with auto sales. Vehicle sales have rebounded to a 15.6 million annual rate after falling to 9 million in April. This jump in vehicles sales has reduced the inventory to sales ratio down to 2.1 to 1 and is in sharp contrast to the recession in 2008/2009 when the ratio increased to over 4.5 to 1. The highest the ratio reached so far in this recession is 3.7 to 1.

Further, total retail sales are now at a level greater than before the shutdown. At the depths of the recession in April, retail sales fell to $412.8 billion. Since then, retail sales have increased $124.7 billion to $537.5 billion eclipsing the $529.6 billion reached at the beginning of the year. Clearly, some areas of retail have been especially hard hit by the shutdown, like restaurants and brick-and-mortar retail. Prior to the pandemic shutdown, many brick-and-mortar retail stores were struggling and the shutdown has accelerated the inevitable demise of some of these retailers. In other areas like restaurants, grocery store retail sales have made up for a portion of the decline in restaurant food sales. Additionally, with many people stuck at home, home projects have jumped to the top of project lists; thus, benefiting construction and hardware retail sales, like at Home Depot and Lowe's.





One area we continue to watch closely is the level of continuing unemployment claims. The maroon line on the chart at left includes continuing claims plus the Pandemic Unemployment Assistance (PUA) category. In short, the PUA category includes those individuals that do not qualify for regular unemployment. At 26.5 million people, this total of continuing claims is certainly too high. A silver lining is the fact nonfarm payrolls equal 142 million as of September 2020 and is 10 million below the pre-pandemic payroll level of 152 million. It is important to acknowledge that the loss of jobs in a recession tend to be swift while the subsequent recovery in employment is usually a longer duration event.

Conclusion

For many investors, the current economic and market environment may seem a little bit like being in limbo. Major equity indices have recovered, bonds yields have dropped significantly, and there is ample evidence that the economy is in recovery mode. However, there is uncertainty as the election is less than a month away plus concerns about the virus as we approach the winter season. The uncertainty has been reflected in how investors have shifted their investments this year. Year-to-date, nearly $334 billion has been pulled from equity investments while bond investments have attracted $254 billion. Additionally, money market assets ballooned to $4.4 trillion from $3.6 trillion at the start of the year. In short, many investors have attempted to time the markets unsuccessfully this year. We continue to stay focused not on timing the market, but rather sticking to our investment discipline and achieving the long-term goals of our clients.

Thank you for your continued confidence and support in HORAN Capital Advisors and we are always available to answer your questions and discuss our outlook further. Please be sure to visit us for company news, reports and our blog at www.horancapitaladvisors.com/blog.

Respectfully,

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