HORAN CAPITAL ADVISORS

Investor Letter

Second Quarter 2013 www.horancapitaladvisors.com

"Health is the greatest possession. Contentment is the greatest treasure. Confidence is the greatest friend." - Lao Tzu

The investment markets are extremely dynamic. There is no shortage of data points or available information that enables one to draw any number of conclusions relative to a particular investment. Although we don't believe there are specific macro-economic data points that have repeatedly lead to a successful investment, we do believe identifying trends and analyzing valuation criteria can produce successful investment results. As Mark Twain once said, "History does not necessarily repeat itself, but it does tend to rhyme."

Our recent investment biases have served our clients well. Strategically we have favored U.S. equities and shorter maturity bonds while at the same time avoiding gold (broad commodities for that matter), preferred stocks and long-term bonds. The table below details the returns for various asset classes as of June 30, 2013.

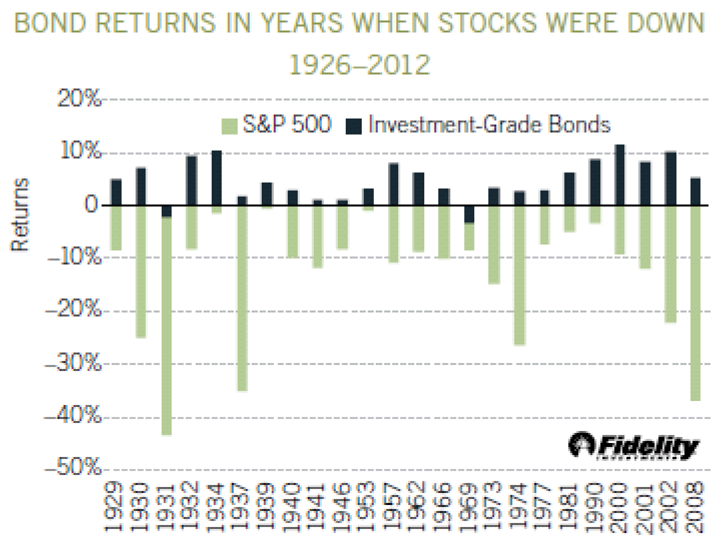
					Annualized
Market	Underlying	Q2 2013	Year-to-Date	1 Year	3 Year
U.S. Large Cap	S&P 500 Index	2.91%	13.82%	20.60%	18.45%
Developed International	MSCI EAFE Index	-0.98%	4.11%	18.62%	10.04%
Foreign Emerging	MSCI Emerging Markets	-8.08%	-9.57%	2.87%	3.38%
Preferred Stocks	S&P U.S. Preferred	-1.60%	1.49%	7.36%	9.80%
U.S. Long Government Credit	Barclays Capital U.S. Long Gov/Cred	-6.11%	-7.97%	-4.69%	7.01%
U.S. Corporate Bonds	Markit iBoxx Investment Grade Index	-4.34%	-4.85%	0.66%	6.22%
Foreign Emerging Bonds	JPMorgan Emerging Market Bonds	-6.03%	-8.68%	0.74%	7.61%
Commodities	Dow Jones UBS Commodity Index	-9.45%	-10.47%	-8.01%	-0.26%
Gold	SPDR Gold Shares (GLD)	-25.50%	-28.52%	-25.74%	-1.81%

Data Provided by BlackRock & SPDR

It has been our contention for some time that U.S. equities look favorable relative to other equity investments due to valuation, strong balance sheets and the largest stimulus program in U.S. history. Our overweight bias in U.S. equities and underweight in foreign equity has been rewarded with significant outperformance of U.S. stocks over multiple time periods as illustrated above.

Also, it has been our viewpoint that interest rates were bound to make a secular bottom and the clearest path of least resistance was for interest rates to move higher. The Fed's commentary in May and June related to the "tapering" of its quantitative easing program, along with a more positive U.S. economic outlook, pushed interest rates significantly higher. The degree to which the yield curve steepened may have been overdone in the short run, but nonetheless, over the previous two months the 10-Year Treasury yield increased from 1.66% on May 2nd to 2.52% on June 28th. The 10-Year Treasury yield has increased 76% since July 25, 2012 when the yield bottomed at 1.43%. This move in rates is significant on a percentage basis; however, absolute yields remain low from a historical perspective. There is ample room for more normalized or higher yields across the yield curve. If the Fed's views on the labor front and economic growth become more optimistic, interest rates may continue to increase and bond prices would decline further.

We do believe interest rates will continue their upward climb, but by no means will the path be orderly or in a straight line. Given our intermediate term outlook on interest rates, we have structured our clients' bond portfolios with shorter maturity fixed income investments, complemented with an allocation to high yield bonds, global bonds and floating rate bond investments. A well-constructed and selective bond allocation will be important if interest rates continue to move higher. The conundrum becomes, if rates are expected to continue their move higher, why own bonds at all?



Past performance is no guarantee of future results. Bond returns represented by the performance of the Barclays Aggregate Bond Index from January 1976 and by a composite of the IA SBBI Intermediate-Term Government Bond Index (67%) and the IA SBBI Long-Term Corporate Bond Index (33%) from January 1926 through December 1975. Stock returns represented by the performance of the S&P 500 Index. Source: Morningstar EnCorr, Fidelity Investments (AART) as of Mar. 31, 2013.

There are two reasons investors would continue to allocate a portion of their investment funds to bonds. First, bonds tend to exhibit less volatility than stocks even in a rising interest rate environment. Second, bonds tend to be a good diversifier when stocks decline as noted in the chart at left. There are still economic factors that could result in equity markets retracing recent gains.

From an equity strategy perspective, we have adjusted the characteristics of our individual equity holdings on two recent occasions. Late last year we added to some of the defensive sectors (consumer staples, utilities and health care) due to market concerns around the fiscal cliff and the election. Specifically, we added or increased position sizes in ConAgra, Kroger, Johnson & Johnson and Thermo Fisher Scientific. During the first half of the year the equity market continued to move higher, shrugging off any political or economic concerns. One would have expected our defensive sector allocation to lag; however, the opposite occurred. This was primarily driven by investors allocating funds to "bond-like" equities, i.e., higher dividend yielding stocks. Consequently, investor demand pushed the valuations of these stocks to historically high levels. During the second quarter, we took steps to reduce our clients' exposure to some of the defensive stocks/sectors that looked expensive from a valuation standpoint. We sold or reduced Johnson & Johnson, Philip Morris International, Kraft Foods and Teco Energy. We added to some of the more economically sensitive sectors by purchasing Fluor, EMC Corp and Schlumberger, to name a few. Many cyclically sensitive stocks look attractive and should produce stronger returns than the broad market as interest rates rise and the economy enters its mid-cycle phase.

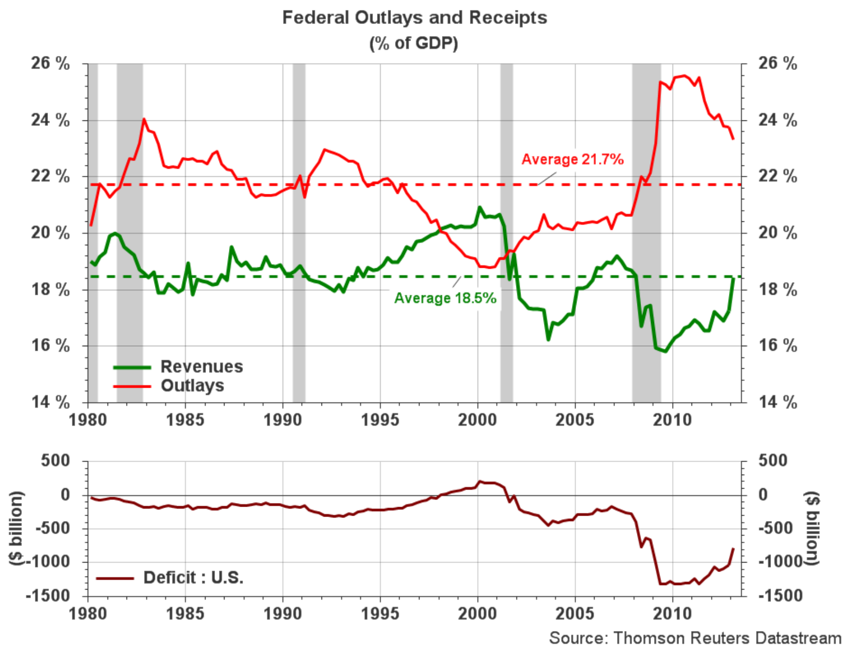
Sector Performance During Periods of Rising and Falling Interest Rates

	Performance (Rising Rates)			Performance (Falling Rates)		
	Average	Median	% of Time Positive	Average	Median	% of Time Positive
Cons Discret.	28.52	13.97	100	-0.79	1.55	60
Consumer Staples	11.85	5.64	83	2.38	1.59	100
Energy	19.18	17.99	100	-6.97	-2.89	0
Financials	40.95	18.64	100	-10.07	-9.81	20
Health Care	14.24	6.73	100	0.99	1.46	60
Industrials	28.88	17.43	100	-5.25	-1.03	20
Materials	24.93	16.53	100	-6.05	-1.76	20
Technology	23.78	11.94	100	-3.91	-2.90	40
Telecom Svcs	7.64	6.27	83	3.70	6.34	60
Utilities	5.87	1.40	67	4.45	4.96	80
S&P 500	**21.52**	**14.05**	**100**	**-3.49**	**-2.47**	**40**

= Instances where falling rates was better than rising rates.

We believe multiple catalysts will continue to drive the U.S. equity markets including a manufacturing renaissance driven by a U.S. move towards energy independence, a more competitive wage rate as global wages increase, an improving consumer balance sheet and continued foreign direct investment.

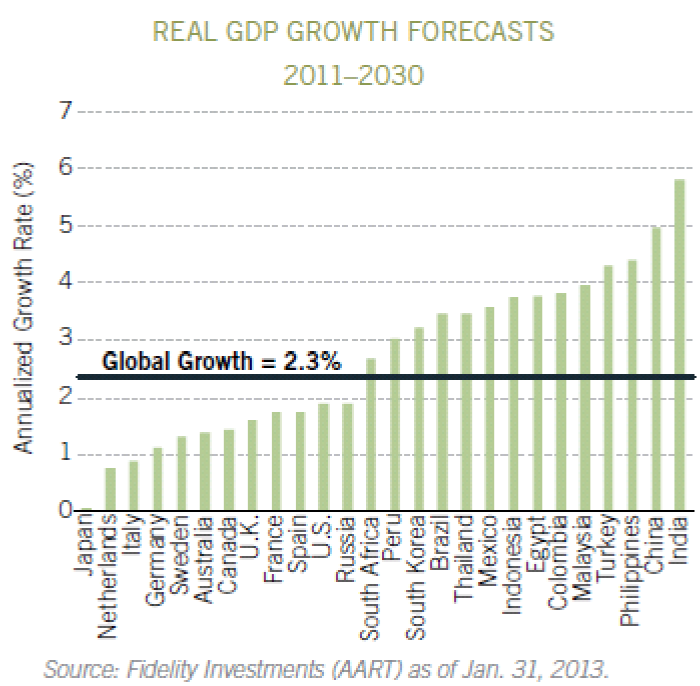
Another positive aspect favoring U.S. economic growth is the continued deleveraging within the public sector. Admittedly, some government spending can stimulate growth in the short term depending on where the stimulus is allocated; however, at high absolute levels of public sector debt, the debt servicing requirement can become a drag on economic growth.



Liz Ann Sounders of Charles Schwab recently noted many commentators have dismissed the $117 billion budget surplus generated in June because of the profits from Fannie Mae and Freddie Mac. "Those profits accounted for only $66 billion; which means even excluding that figure, we're still looking at a surplus of $51 billion."

"In June, the 12-month total of federal receipts increased 13.4%; the fastest pace since mid-2006, and nearly double the average annual 6.8% gain. The main sources of improvement included individual and corporate income tax receipts, as well as employment taxes. Corporate income tax receipts increased 23.6% on a year-over-year trend basis, and accounted for 10% of total government, near its highest share since early 2009. Individual income taxes rose 13.8%, while employment tax receipts rose 9.7%, surpassing the prior peak in mid-2006. The latter reflects the increase in payroll taxes at the start of this year, and the steady increase in nonfarm payrolls- up 5.1%, or 6.582 million jobs, since reaching a trough in early-2010."

"Much has been said about the "new normal" rate of economic growth; sometimes referred to as "stall speed" growth. But that's inclusive of government. Less noted is the "old normal" rate of growth by the private sector. Since the recession ended in June 2009, the overall average rate of growth of US real gross domestic product (GDP) is a relatively paltry 2.1%. However, excluding the government (federal, state and local) sector, the average pace of real GDP has been 3.1% over the same period. It shows that the government can and should continue to deleverage without tanking the economy, thanks to the relatively healthy private sector."



Tighter U.S. fiscal policy coupled with slower global economic growth has driven capital out of foreign economies, in particular emerging markets on both the equity and debt side. Foreign equity valuations may be creating compelling valuations in foreign investments; thus, a potentially good entry point for investors underweight in international investments. There is still ample data which supports emerging market leadership regarding global economic growth, but the direction of the growth rate plays a key role in a country's investable market. This decrease in the growth rate of GDP in countries like China and India can cause short-term market disruptions and has resulted in weak emerging market equity performance. There are many additional factors one must consider, such as fiscal policy, financial data quality, and political stability or lack thereof. However, it does appear some emerging market investments do offer return opportunities for investors, albeit, these markets are likely to remain more volatile than developed market equities. It is estimated the emerging markets will continue to capture a larger share of the world's GDP and this will likely have a positive impact on emerging equities. Although we still favor U.S. equity investments, it's likely we will add to our allocations in foreign markets at some point in the not too distant future.

We have seen strong equity market returns over the past five years and we are pleased our investment selections and asset class biases have added meaningful value to our clients' portfolios. Given the strong equity market performance, many investors are questioning the market's future direction. Recently, Standard & Poor's reported the following data specific to the S&P 500 Index and while they are simply historical data points, they are positive and promising but do not guarantee future results.

- "This year has one thing in common with 26 other years since 1945: the S&P 500 was up in both January and February. In all 26 of the prior years, the "500" posted a positive full-year total return averaging 24%. What's more, in 24 of these 26 years, the market rose further in the 10 months after the signal was received."

- **Fifth-Year Bull** — "In March, the S&P 500 celebrated its 5th birthday. Since 1945, 83% of the bull markets that celebrated their 4th birthday went on to celebrate their 5th birthday. In addition, the S&P 500 gained an average 21% in price during that 5th year."

- **Positive First Half** — "A positive price return for the market in the first half increased the likelihood of a gain in the second half. Since WWII, whenever the S&P 500 rose in the first half, it gained an average 5.4% in the second half and increased in price 74% of the time. What's more, if the first half gain was greater than 10%, the market jumped an average 7.5% in the second half and rose in price 76% of the time."

We continue to thank you for your business, referrals and confidence. As always, do not hesitate to contact us with any questions or comments.

Respectfully,

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