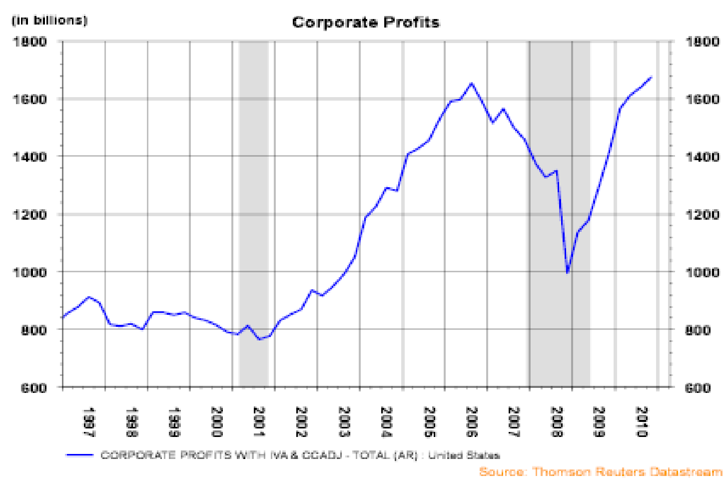
HORAN CAPITAL ADVISORS
Investor Letter
FIRST QUARTER 2011 www.horancapitaladvisors.com

Looking Back

The 1st quarter of 2011 was anything but short of market moving news. The Middle East and North Africa were entangled in political turmoil while Japan was struck with an 8.9 magnitude earthquake and subsequent tsunami. Meanwhile, sovereign debt issues in Europe continue to linger and the U.S. intensified the fight over budget deficits and entitlement spending.

Equity and credit markets were volatile during the quarter with certain stock sectors pressured because of rising oil costs. Both the Middle East and Japan have been forced to address supply chain disruptions while the world copes with higher oil prices again. At the time of this writing, Brent Crude Oil was trading at $122/barrel.

It's likely that Japan will provide additional monetary stimulus to their economy in an effort to rebuild the damaging effects from the earthquake and tsunami. This may offset some of the effects of their economic slowdown. Japan contributes nearly 6% to global GDP so it is unlikely that a short-lived production slowdown will hinder 2011 world growth; however, the supply disruptions may result in the continuation of elevated commodity prices.



Europe has seen its currency dramatically strengthen with the European Central Bank (ECB) taking a hard-line stance on future inflation issues in spite of the continued struggles of Portugal, Ireland, Greece and Spain. Watch for rising rates in Europe in the coming year and the net affect it will have on sovereign borrowing costs.

The U.S. kicked off 2011 by way of Collective Bargaining Agreements. We aren't referring to the NFL labor dispute, but a more heated government debate which has reached Washington via Ohio and Wisconsin. In an effort to tackle entitlement and benefit programs, Republican governors, from Ohio and Wisconsin as examples, pushed to limit the powers of public sector unions. It's perceived that stripping these unions from their ability to collectively bargain may help states control runaway budgets.

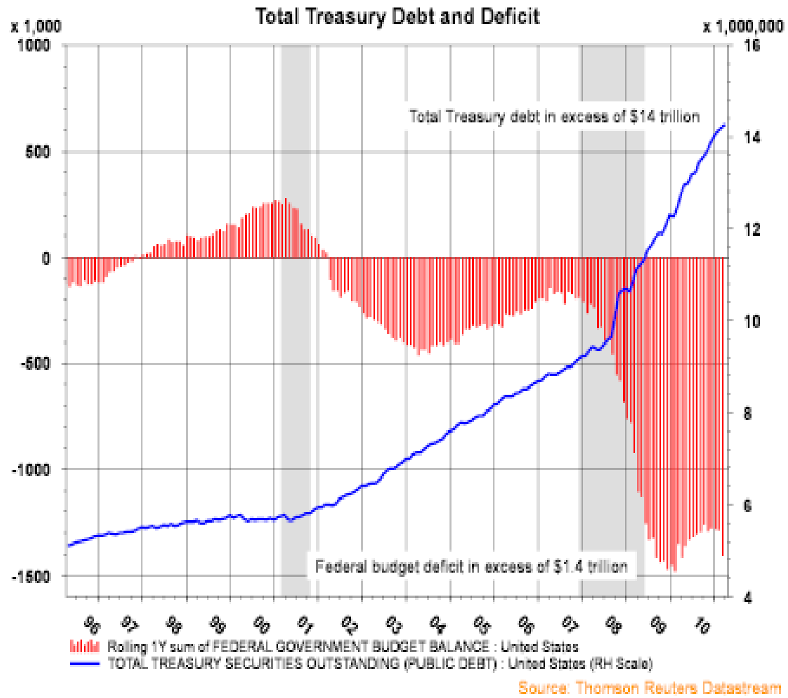
For the most part, economic fundamentals were decidedly favorable in the first quarter (excluding housing and inflation) and this served as a tailwind for equity markets.

- The Federal Reserve continued to inject liquidity into the economy through QE2 (second round of quantitative easing)
- Strong corporate profit growth in the fourth quarter (see chart above)
- Strength in manufacturing and industrial production

- ISM Non-Manufacturing Index reported at 57.3 and numbers above 50 indicate expansion

Certainly, there are areas of concern:

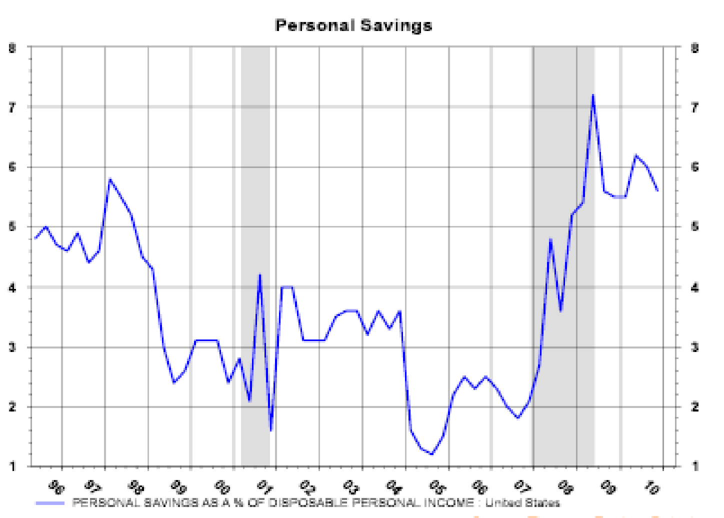
- The impact of higher commodity prices, particularly energy, on corporate margins
- Inflation at the producer and consumer level
- Year over year earnings comparisons become more difficult as we progress through 2011 following a dramatic recovery in 2010
- The Federal budget showdown and the market’s perception of our willingness to tackle our fiscal imbalances
- The prospect for higher interest rates worldwide with the ECB beginning to raise rates and emerging market countries attempting to slow down their economies



Analyzing the Balance Sheet

It seems clear government balance sheets are anything but healthy. Any business that handled its finances the way the government does would be classified as insolvent. As the above chart depicts, the 2011 expected federal deficit is nearly $1.4 trillion, $3.5 billion a day. The accumulated debt is $14.2 trillion. Current unfunded future liabilities from entitlement programs like Social Security, Medicare and Medicaid are an estimated $66 trillion expense as reported by the Department of Treasury, Department of Health & Human Services Center. We believe any long-term effective budget and deficit reduction solution will likely include a heavy emphasis on expense controls and tax hikes.

Fortunately, corporate America has shown extreme resilience. Corporate balance sheets are as healthy as ever. As indicated by the chart on the first page, corporate profits are at an all-time high. However, much of the profit improvement is the result of companies reducing overall expenses, most notably employee costs. The consequence is an unemployment rate that has remained high while the employment participation rate has declined. Companies carrying significant cash balances do have the ability to make investments in capital expenditures and new employees once economic confidence strengthens and government policy becomes more transparent. Recent monthly job numbers (+200,000 jobs) would support increased optimism.



Individuals, like corporations, have repaired their respective balance sheets. The American savings rate is up. During the period of 2000 through early 2008, the personal savings rate generally fluctuated between 2% and 4% while bottoming at 1.2% (see chart bottom page 2). The monthly rate has more recently fluctuated between 5% and 6%. Consumers have committed to deleveraging while a 2% social security tax cut is helping to provide excess savings. People have also refinanced mortgage debt into a more favorable payment, paid down principal, or left homes behind.

Climbing the Wall of Worry

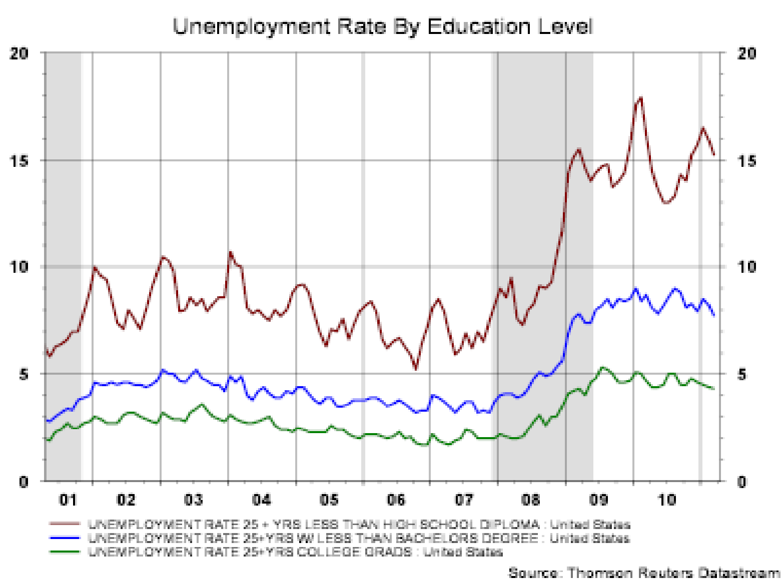
The S&P 500 had a strong 1st quarter when considering the amount of global noise and disruption. The index was up 5.9% including dividends, with the energy sector (+16.3%) and industrials sector (+8.2%) leading the way. The lagging sectors were the defensive ones: utilities (+1.6%) and consumer staples (+ 1.7%). From a valuation perspective, 2011 S&P 500 earnings are projected to equal more than $95 per share. This puts the market's forward P/E at a reasonable valuation of about 13.5 times earnings.

The recent performance of financial stocks has experienced several false starts as it appears the impairment these companies experienced over the last several years is not fully behind them. We do believe there will be an opportunity to benefit from a recovery in financials/banks at some point, but we remain somewhat cautious about the timing.

Persistently high unemployment has resulted in a bifurcated consumer market. As the chart below shows, the unemployment rate is not equal for individuals based on their education level. This generation of consumers, regardless of education level, has a hard time not spending money and it poses the questions where will they most likely spend it? The disparity in the unemployment rate based on education level creates two distinct markets for investors to consider.

We remain constructive on the equity markets and more specifically, we are attracted to companies that seek global growth in regions unhampered by structural imbalances. We see selective challenges for some smaller companies that may find that they are competing for capital in a rising interest rate environment. With larger corporations sitting on record amounts of cash, M&A activity will continue to act as an equity market driver. Further, capital expenditures and commitments to projects will likely be stronger in the near-term.

We currently find the best opportunities in high quality multinational companies from a valuation perspective and believe investors will be well rewarded with these companies over the next several years. We are cognizant of the dramatic recovery equity markets have experienced from the March 2009 lows with the Fed's QE2 liquidity program providing a partial catalyst for the equity market advance. Many segments of the market have bright prospects and are supported by strong fundamentals.



We expect 1st quarter corporate profits to continue their upward trajectory with consensus expectations showing a 12% improvement compared to the same quarter last year. In 2011, S&P 500 companies are on a path to achieving cumulative all-time record earnings. Nearly 75% of companies beat profit expectations in the 4th quarter of 2010; however, we expect comparisons to become more difficult later this year. Margin improvement has largely been accomplished on the expense side with commodity and other costs pressures beginning to emerge. We believe a number of companies will be able to pass through a large portion of these added cost pressures while labor costs remain in check. More importantly though, it now becomes critical to see companies generate top line revenue growth.

Interest rate moves within the 1st quarter were muted with the 10-year U.S. Treasury yield bottoming during the Japanese earthquake disaster but rallying back to a level which was higher than the beginning of the year. The 10-year U.S. Treasury yield stood at 3.47% on March 31. As mentioned earlier, the end of QE2 will prove to be an interesting inflection point in the debt markets as well as the equity markets. With the Fed pulling away as the primary buyer of government debt, we can only hope that natural buyers of US Treasuries emerge. PIMCO, the world's largest bond manager, recently announced their departure from the treasury market, while the famed Jeffrey Gundlach of DoubleLine announced his recommendation that investors purchase treasuries. And that's how you make a market, as they say.

Economic data continues to improve and while we feel good about continued market growth, we recognize that a boxer is rarely knocked out by the punch he expects. Our client portfolios are well positioned with high quality investments to fully participate in growth and reasonably withstand market shocks. Our sincerest gratitude is extended to our clients and partners who continually entrust us with their confidence.

Our blog frequently posts updated commentary and may be found at www.horancapitaladvisors.com or http://www.horanassoc.com/horan-capital-advisors/blog.aspx.

Warmest regards,

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