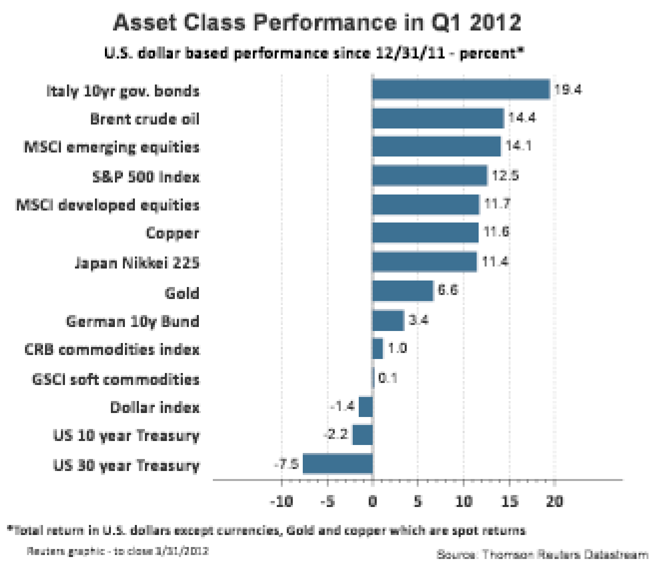
HORAN CAPITAL ADVISORS

Investor *Letter*

FIRST QUARTER 2012 www.horancapitaladvisors.com

Strong Consecutive Quarters

Investors continued to enjoy bullish market sentiment during the first quarter as most equity markets were, once again, up for the quarter. Global equity markets ended Q1 2012 with returns that most investors would find acceptable for the entire year. The S&P 500 Index was up 12.5%, the MSCI Developed Equities Index was up 11.7% and the MSCI Emerging Markets Index was higher by 14.1%. Little negative news from the Eurozone supported the market rally in Q1, although we believe Eurozone debt issues will continue to impact the market for a number of years to come. The sovereign debt market displayed more confidence in Italy's efforts to deal with its economic woes. The Italian 10-year government bond returned 19.4% in the first quarter (chart right). On the opposite end of the return spectrum was the negative returns generated in U.S. government bonds. The 10-year Treasury was down 2.2% while the 30-year treasury was off by 7.5%. Investors should note the poor performance in the U.S. Treasury market and question whether a 30-year secular bond rally may be nearing an end.



The defensive sectors within the S&P 500 Index, such as utilities and telecommunications were the weakest performers in Q1. Technology, financial and consumer discretionary sectors generated the strongest returns averaging nearly 19% for the quarter.

The trend in economic data has been mostly positive, but certainly on occasion mixed. Recent reports on the Empire Manufacturing Index, Philly Fed Index, and Retail Sales all continued to indicate modest economic growth. However, shortly after these reports, the Chicago Purchasing Managers Index experienced a 2.8% decline from the month of February. This Chicago regional data is a good microcosm of broad national data related to manufacturing and non-manufacturing distribution. Gross Domestic Product (GDP) was reported at 3% for the fourth quarter of 2011; its strongest quarter of 2011. Most GDP estimates for

2012 fall between 2.0% and 2.5%.

Favoring U.S. Equities

Global equity markets continue to look attractively priced, but like the macro-economic data, there have been mixed reports. Although valuations seem attractive, S&P 500 Index earnings estimates for 2012 have fallen by nearly 7%. Importantly, current estimates are still positive year-over-year with analysts calling for a wide range of anywhere between 3% and 9% growth. Early Q1 earnings reports have come in better than anticipated.

Investors continue to favor dividend paying equities. Within the S&P 500 Index, 80% of its constituents pay a dividend while S&P company dividend payouts are expected to be a record in 2012. Economic growth and accumulated cash balances are leading companies to raise their dividend payouts. This year it is likely that dividends will grow faster than realized earnings as companies make the conscious effort to return cash to shareholders.

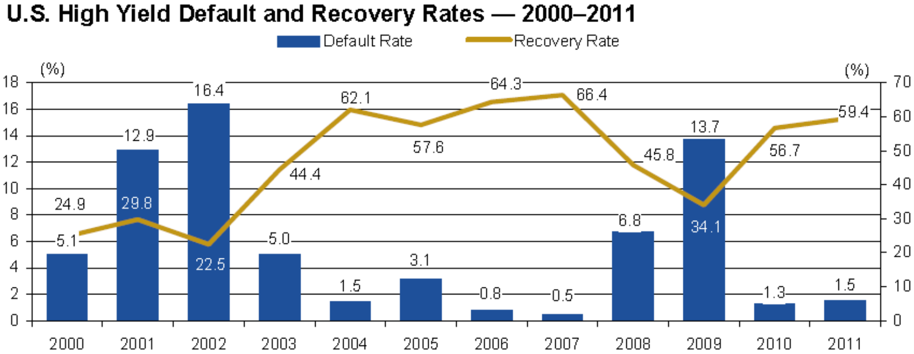
As reported by *S&P Indices*, the technology sector is now the second largest payer of dividends. 55% of technology companies pay a dividend, which is not surprising, as the sector has the largest cash holdings at 14% of market value. Even Apple jumped on the dividend paying bandwagon this past quarter. The company said it will pay a $2.65 per share quarterly dividend and institute a $10 billion stock buyback program.

As we have frequently noted, dividends matter, particularly in low interest rate environments. In May of 1988, the dividend yield for the S&P 500 Index was 3.8% whereas the yield on the 10-Year Treasury note stood at 5.65%. Today, the S&P 500 Index yield is 2.0% while the 10-Year note also stands at 2.0%. Historically, also noted by *S&P Indices*, the yield for the S&P 500 Index is 43% of the 10-Year Treasury. Notably, HORAN Capital Advisors' individual equity portfolio currently yields 2.6%. This is a 30% premium over both the S&P yield and 10-Year Treasury yield.

Short-Term High Quality & Credit Bias

The fixed income market softened with the overall improvement of general market data during the first quarter. Treasuries were hit the hardest as money moved out of the treasury market and into higher yielding assets and/or risk-based assets. The 10-Year Treasury note moved from 1.89% at the beginning of the quarter to 2.22% at the end – a 17% move resulting in a -2.24% decline on the price of the note. Corporate credit spreads tightened during the quarter which led to a rise in corporate bond prices. High-yield was an outperformer as the BofA Merrill Lynch High-Yield Index posted a 5.15% return.

U.S. High Yield Default and Recovery Rates — 2000–2011



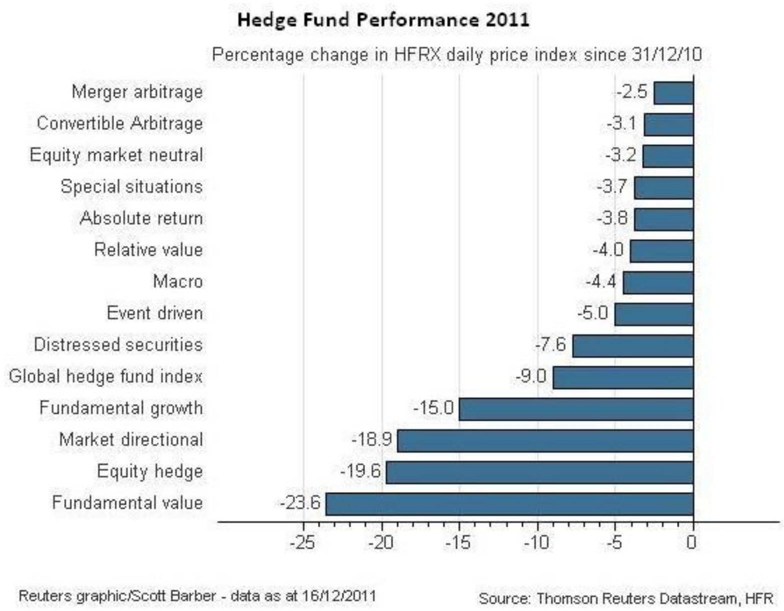
Source: Fitch U.S. High Yield Default Index, Advantage Data.

Our broad fixed income positioning proved to be rewarding during the quarter. Our two-front strategic approach of short-term/high quality corporate bond exposure (underweight treasury exposure) and more credit sensitive/higher yielding investments provided healthy returns for the quarter. We believe corporate bonds are still reasonably undervalued as compared to treasuries, while high-yield bonds continue to pay annual interest in the neighborhood of 7-8%. High-yield bonds are also experiencing low historical default rates, less than 2% (chart above), as economic conditions improve.

The risk and impact of rising interest rates on an investor's portfolio can be damaging. We believe it is important that investors comprehend the negative price impact rising rates have on bond prices. In the context of risk, we find long-maturity bonds to be potentially one of the most risky areas of the market although we do recognize the prolonged possibility that interest rates remain very low for a considerable period of time.

The FED's control over interest rates has indicated their bias to keep rates low through 2014 and in fact, their actions have driven longer-term rates lower via *operation twist.* Ben Bernanke and the Fed are very well aware of the consequences rising interest rates could have on the U.S. deficit, interest expense, housing and corporate borrowing.

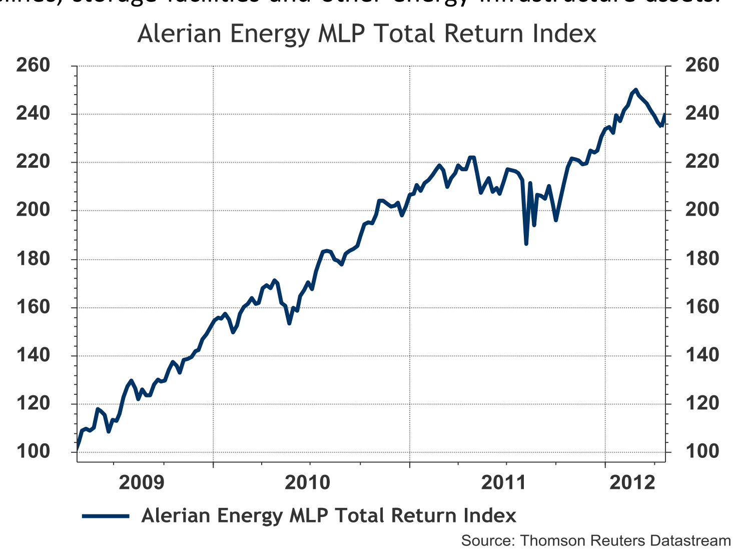
Alternatives Positioning – MLPs & Long-Short Equity Bias



We continue to allocate capital to alternative investments and in particular long/short equity exposure and master limited partnerships (MLPs). Long/short equity exposure gives us the ability to be invested in the equity market with hedged properties. The volatility measurements of these investments are more closely related to fixed income investments than equity investments, however we believe these investments should outperform fixed income over full market cycles. Low current interest rates certainly play a factor in this investment thesis.

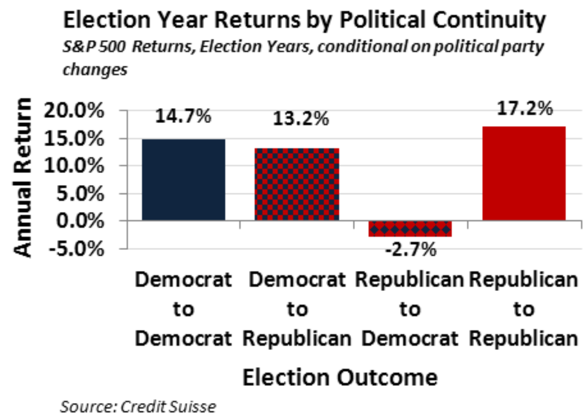
In 2011, our recommended hedged equity mutual fund managers returned anywhere between 0.4% and 3.4% with less than half the market volatility of the S&P 500 Index which returned 2.11%. As noted in the chart above, similar hedged equity strategies found in hedge funds did not perform as well. Performance in equity hedged strategies, market directional strategies and absolute return strategies ranged from -3.8% to -19.6%. Hedged investment strategies historically utilized in hedge funds are now commonly and effectively utilized in mutual funds. These mutual funds offer better liquidity and lower fees. It's not to say that hedge funds don't have their place within select investment portfolios, but we place a lot of emphasis on the ability to invest with the right managers while collecting additional return for the lack of liquidity and higher level of fees.

Master limited partnerships (MLPs) have been a constructive part of our asset allocation since inception. MLPs are publicly traded companies that own and operate pipelines, storage facilities and other energy infrastructure assets. MLPs offer investors the ability to generate a high level of current income and the prospect for capital appreciation. Historically, income distributions have gone up thus providing a reasonable inflation hedge. The strong performance of MLPs over the past decade (3 Year Chart right – Alerian Index) is likely to continue as the broad infrastructure build out of oil and gas pipelines continues. As Kyri Loupis, a top MLP analyst at Goldman Sachs, states, "it is not unreasonable to expect about $250 billion of new spending over the next 20 years to support new oil and gas discoveries." It may be surprising to note that the U.S. is the fastest growing oil and gas producer in the world. It is quite possible with high overseas oil and gas prices that the U.S. will become a more significant exporter of these commodities.

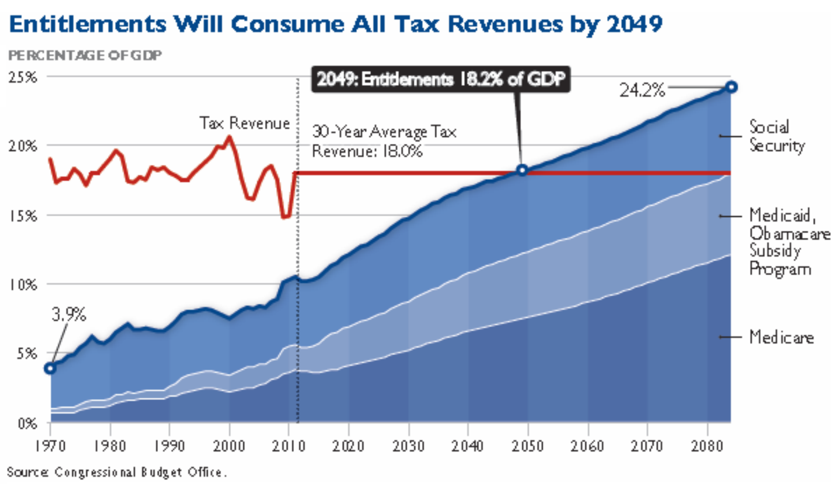


Eye on the Election

Mitt Romney is solidifying support as the republican presidential candidate in November. This election, like most others, will certainly have influence on the public markets. From a stock market perspective, party continuity at the Presidential level has historically played a role regarding future returns. Currently, there are only two possible scenarios. The Democrats can retain presidential control or Republicans can win that position. In either case, history indicates favorable future performance (chart right).



Given the size of the federal government's budget deficit, the debate surrounding government spending and tax revenues will be at the forefront of this election. It is estimated current unfunded entitlement liabilities are in excess of $60 trillion and growing (chart below).



Outlook

Absent of material economic shocks around the world, we see corporate growth continuing to progress. Broad equity markets continue to have favorable tailwinds supporting future upside from current levels. Reported inflation remains subdued while the FED remains accommodative. GDP growth is likely to be within the range of 2.0% to 2.5% this year. This will not help lower the unemployment numbers, but should keep unemployment from rising. It is likely cash and short-term fixed income instruments will continue to present investors with negative *real* returns. This scenario concerns us over the long-term and drives us to seek investments that provide more favorable return metrics.

As always, we thank you for the confidence you place in us. We continue our primary focus of client service and customized investment management. We are grateful for your continued referrals. Our blog frequently posts updated commentary and may be found at www.horancapitaladvisors.com or http://www.horanassoc.com/horan-capital-advisors/blog.aspx. Please do not hesitate to contact us with questions or comments.

Warmest regards,

HORAN Capital Advisors

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