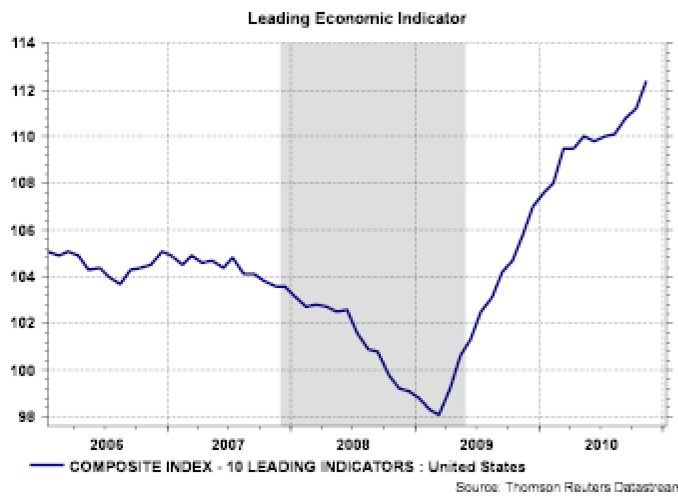
HORAN CAPITAL ADVISORS

Investor Letter

A Rising Tide

Stocks had another very strong quarter. The S&P 500 Index was up 10.76% for the 4th quarter and 15.06% for the year. The strongest sectors in 2010 were Consumer Discretionary (+25.72%), Industrials (+23.92%), Materials (+19.92%), and Energy (+17.86%) as a broad economic recovery continued and consumers increased spending. The laggards included Health Care (+.71%) as concern over health care reform continued and Utilities (+.86%) which could have been negatively impacted by a rise in interest rates. In short, these defensive sectors could not keep pace with the broader market.



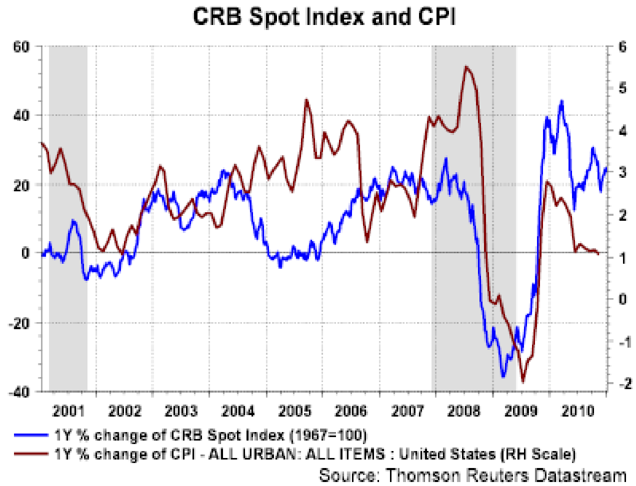
This market strength coincides with a significant improvement in the Leading Economics Indicator Index. The Conference Board notes nine of the ten leading indicators increased in November. The only negative contributor was building permits.

General Motors Company, or more humorously known as Government Motors, had its initial public offering of stock on November 18th. The initial offering raised more than $23 billion. Having skirted a whopping debt burden and arguably the due process of bankruptcy law, GM's clean balance sheet and global footprint should provide the company with financial stability and flexibility. You, the U.S. taxpayer, still own 35.24% of the outstanding shares.

With the prospect of a second round of quantitative easing (QE2), longer-term interest rates began rising during the quarter, increasing the steepness of the yield curve. One could argue that once again the famed "Fed Put" is back and working its magic. The Fed's policies of a near zero Federal Funds Rate (two years running) and a second round of quantitative easing are serving to re-inflate asset prices. Most notably in Q4, equities and commodities rose significantly. We believe a continued upward movement in interest rates seems inevitable. Upon opening fourth quarter statements, bond investors may be surprised to see the level of underperformance within their bond portfolios relative to equities.

A steep yield curve is good for bank profitability as those institutions pay nearly zero on short-term deposits while lending at a healthy margin. The KBW Bank Index was up 16.0% in December alone. As the economic recovery strengthens, banks should begin to perform better but there will undoubtedly be continued concern over loan demand and potential charge-offs in 2011. Nevertheless, the perception of bank stability is important for a prosperous economy.

Higher Prices



The widely followed CRB Commodities Index was up 14.1% in the 4th quarter and 17.6% for all of 2010. Increasing commodity prices typically get translated into higher prices for final goods and services purchased by consumers. This is a stealth tax that impacts an already stretched consumer and can put downward pressure on corporate profit margins. At the time of this writing, crude oil surged to above $91 a barrel, partially as a result of production issues and speculative investment.

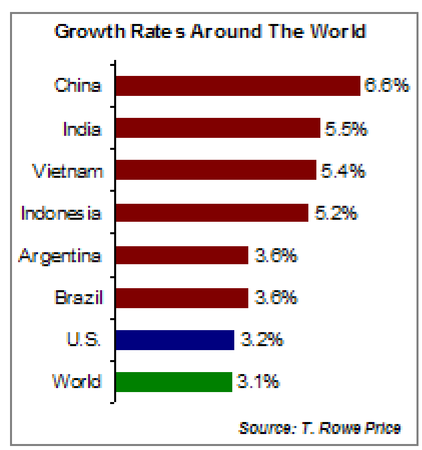
A recent article by Alan Abelson of Barron's highlighted Bill King's 10-year assessment on the price of goods and services.

> "The annual tab for homeowners' insurance is up some 108% since the turn of the century. During this period, yearly taxes on real estate have climbed 77%. A gallon of heating oil costs a whopping 150% more. The average electricity bill is 50% higher. And filling up your rig at the friendly neighborhood service station is more than twice as much per gallon. Monthly Medicare Part B premiums have climbed 143%. A humble potato goes for 67% more than it did 10 years ago, an equally humble egg 93% more, and the price of a loaf of plain old white bread is up a decidedly unappetizing 50%."

These increases are quite surprising considering U. S. statistical data measured by the Consumer Price Index (CPI) shows little to no inflation over the period as noted on the above chart.

An Emerging Consumer

Many emerging market countries are both heavy consumers and producers of commodity goods. Emerging market leaders have vocalized their dissatisfaction with the U.S.'s quantitative easing program, the resulting commodity price inflation, and U.S. attempts to weaken the Dollar. In 2011, listen for increased commentary regarding protectionism via trade sanctions and price controls by developing countries.



The crisis of 2009 provided important information relative to global growth. The GDP of developed nations declined on average by 3.6% whereas emerging economies were able to grow by 1.7% on average. The chart on the right projects annual GDP growth rates to 2020 for countries around the world. Countries in Asia are expected to grow at rates that far exceed those of the U.S. and other developed countries.

Emerging market economies tend to be inflationary ones. More recently, China has taken action to tighten monetary policy to rein in inflation; this may hinder their growth in 2011. We still favor a full position in emerging market equities, relative to our baseline allocation, due to stronger anticipated growth, little accumulated debt, better demographics, and improving governance. However, we are a bit more cautious in the short-term as tightening fiscal policy and dollar devaluation could hurt emerging market exports.

Prudent Care

The beginning of the 4th quarter saw continued strong demand for fixed income investments. In October Goldman Sachs issued $1.3 billion of 50-year bonds. Goldman originally anticipated the size of the bond offering to equal $250 million; however, the issue was heavily oversubscribed! Additionally, in late October the Treasury sold $10 Billion worth of inflation-protected securities (TIPS) at a negative yield. This was the first time in history this occurred. Investors buying these TIPs will receive no return beyond the consumer price inflation adjustment. In late November and early December, market fixed income rates did begin to rise significantly. In our last quarterly letter, we commented about the importance of shortening the maturities of one's fixed income portfolio. Additionally, our more recent positions in floating rate debt provided a hedge to our clients' portfolios as rates rose.

Those preparing for retirement will have a difficult time meeting their expenses with fixed income generating 1-3%. Fixed income portfolios are often built to protect lifestyles and match retirement liabilities. While investors may be reaching for higher yields at these low levels of interest rates, they may very well be increasing the probability of a dramatic loss in principal. Warren Buffett once said,

> "The less prudence with which others conduct their affairs, the greater prudence with which we must conduct our own affairs."

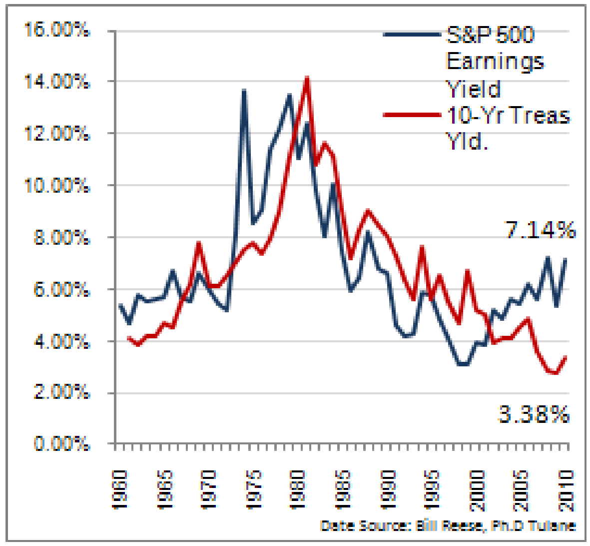
Given what we see in some of the fixed income transactions occurring in the market place, we believe Warren Buffet's above statement is a timely one for fixed income investors to keep in mind.

Looking Ahead

Forecasts for 2011 have become more optimistic. Supportive tailwinds include increasing corporate profits, high levels of corporate cash, the increased availability of credit, a steeper yield curve, and improving investor sentiment all of which should help the market grind higher. We believe the pace of mergers and acquisitions is likely to accelerate as companies search for growth in a more moderate growth environment and their large cash balances act as a drag on earnings. According to the New York Times, private equity firms are sitting on nearly $500 billion in uncommitted capital which must be deployed or returned to shareholders.

The single largest issue of uncertainty moving forward may be the government's response to reducing deficit spending at the federal, state, and municipal level. Reducing entitlement outlays is the 800 pound gorilla in the room and will likely be a lightning rod for any who dare to touch it. In addition to reducing entitlement spending, Congress will also likely focus on some tax increases. Both of these actions would be contractionary in the short run and could dramatically slow economic growth. To date, the government's response to the financial crisis has been centered on stimulating consumer spending and attempting to stabilize the housing industry. A stronger emphasis on job creation in the production side of the economy should be Washington's next agenda item. The unemployment rate remains stubbornly high. The new health care legislation and its implementation or appeals process will certainly be a story line in 2011. Fortunately, our corporate partner HORAN Associates will keep us well informed on structural changes.

Our long-term strategic allocation remains biased towards equities. Stock valuations look attractive when looking at a number of valuation variables, especially in high quality large company equities. The earnings yield for the S&P 500 Index (the inverse of the P/E ratio) equaled 7.14% at year end. The yield on the 10-year Treasury bond was at a near record low of 3.38%. This is often referred to as the Fed Model and when the S&P 500 earnings yield is greater than the 10-year treasury yield, investors should favor stocks over bonds. Although this one valuation metric is rudimentary, our valuation work has a similar conclusion: high quality stock valuations are cheap on a long term basis. Heck, even legendary bond investor Bill Gross has been touting equities more recently. Don't fight the Fed's attempt to inflate asset prices! We do believe that the 30-year secular bond rally is nearing its end.



Our goal is to structure our clients' portfolios in a way that protects their lifestyle. We do believe that the complexity of the global arena and the significant structural issues we face are likely to cause heightened periods of volatility as far as the eye can see. Our investment approach at HORAN Capital Advisors is one where we are placing importance on risk control, selectivity, discipline and patience. We once again thank you for your trust and confidence. We wish all our clients and partners a prosperous 2011.

Our blog frequently posts updated commentary and may be found at www.horancapitaladvisors.com or http://disciplinedinvesting.blogspot.com/.

Warmest regards,

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