HORAN CAPITAL ADVISORS

Investor *Letter*

Spring 2015

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"Far more money has been lost by investors preparing for corrections or trying to anticipate corrections than has been lost in corrections themselves." *- Peter S. Lynch*

The first quarter of 2015 once again was a period that saw data suggesting a mixed economic picture for the global economy. Interest rates declined slightly leading to positive returns for nearly all U.S. bond market segments. This was once again influenced by lower yields outside the U.S. and the strengthening Dollar. Worries about an economic slowdown have resulted in Europe, Japan and China incorporating additional economic stimulus via interest rate decreases and bond purchase programs. For many investors, the prospect of weak economic news is good for equity markets as central banks pursue stimulus programs to reinvigorate economic growth. Stimulus seems to create a floor for equity markets as liquidity finds its way into the market. Interestingly, we are witnessing stronger foreign equity market performance as foreign stocks outperformed U.S. stocks in the first quarter. One popular conversation point over the quarter was surrounding stock market valuations and whether the U.S. market was over-valued. In the face of this pessimism though, nearly all U.S. equity market indices were higher in the quarter with the best performing segment being mid cap equities (S&P Midcap 400 Index) up 5.31% and the S&P 500 Index up .95%.

U.S. Equity: Valuation Measures

Valuation Measure	Description	Latest	Historical Averages: 1-year ago	5-year avg.	10-year avg.	25-year avg.*
P/E	Price to Earnings	16.9x	15.5x	13.6x	13.8x	15.7x
CAPE	Shiller's P/E	27.8	25.9	22.7	22.9	25.4
Div. Yield	Dividend Yield	1.9%	1.9%	2.0%	2.0%	2.1%
REY	Real Earnings Yield	3.9%	4.2%	5.0%	4.5%	2.9%
P/B	Price to Book	2.8	2.7	2.3	2.4	2.9
P/CF	Price to Cash Flow	11.8	11.1	9.4	9.7	11.3
EY Spread	EY Minus Baa Yield	1.4%	1.7%	2.2%	1.3%	-0.6%

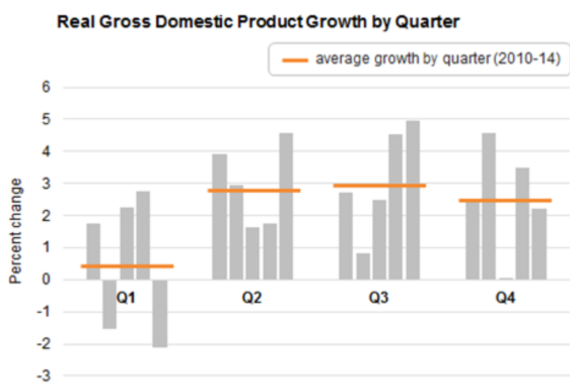
Source: JP Morgan

We wrote in our previous *Investor Letter* that our U.S. equity market return expectations were tempered as compared to a number of markets outside the U.S. and compared to the returns achieved in U.S. equities since the end of the financial crisis. In light of higher U.S. equity valuations, the prospect for rising interest rates and the strengthening dollar, we believe short–term equity volatility will be more prevalent. The previous years' strong market returns have placed U.S. stocks at valuations slightly above historical norms. However, one could argue valuations are reasonable in light of low interest rates and subdued inflation. The impact of a further strengthening of the U.S. Dollar garners our attention as Dollar strength has a negative impact on multinational company earnings domiciled in the U.S. and therefore, company valuations. Currency trends, such as Dollar strength, tend to be long-cycle. This may continue to challenge U.S. companies as global competitors gain a pricing advantage.

A Weak First Quarter Again

Since the end of the financial crisis the U.S. Federal Reserve bank and central banks around the globe have resorted to artificial stimulus (quantitative easing) in an effort to prop up their respective economies. This action has resulted in flooding the financial system with massive and unprecedented liquidity. Investors are conditioned to believe weak economic news will result in a continuation of these stimulative actions by the various central banks globally. Investors then anticipate better equity market returns in the belief some of the funds from QE activities find their way into equities.

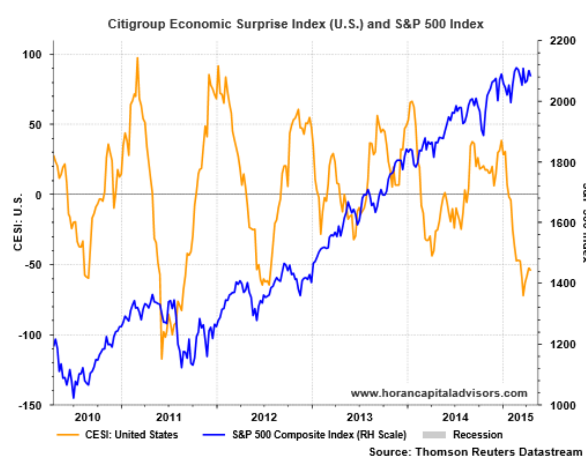
Looking specifically at economic growth or GDP, the Federal Reserve Bank of Atlanta notes the weakness in GDP in each first quarter since 2010. Some attribute this first quarter weakness to poor weather. However, the Atlanta Fed notes seasonal adjustments since the Great Recession could be negatively influencing first quarter GDP reports as well. As the chart at left shows, weaker economic activity in the first quarters since 2010 is very apparent. The average GDP growth in the first quarter since 2010 has been .6% versus 2.9% for the remaining quarters of the year. The advance estimate for the first quarter of 2015 will be reported on April 29th and the Fed's tracking of data shows Q1 2015 GDP at just above zero. Several items contributing to the weakness include the Port shutdown on the west coast, sluggish residential spending and weaker than expected consumer spending. Much like 2014, we believe economic growth will accelerate as 2015 unfolds.



Note: Data indicate seasonally adjusted annual rate.
Source: U.S. Bureau of Economic Analysis and Federal Reserve Bank of Atlanta

Economic reports continue to be mixed but on the weaker side of the scale. The "weak economic reports is good for stocks" view is centered around the notion that economic weakness may result in the Fed raising rates later versus sooner as many might be expecting. This delay in raising rates can be viewed as good for equities so long as the economy does not tip into a recession. One indicator reviewed by strategists is the Citigroup Economic Surprise Indexes (CESI). This index measures a large number of economic reports compared to strategists' expectations. A positive reading of the CESI suggests economic releases have been beating consensus expectations. As can be seen in the chart below, the CESI for the U.S. is decidedly negative. As noted in a recent article in the *Wall Street Journal*,

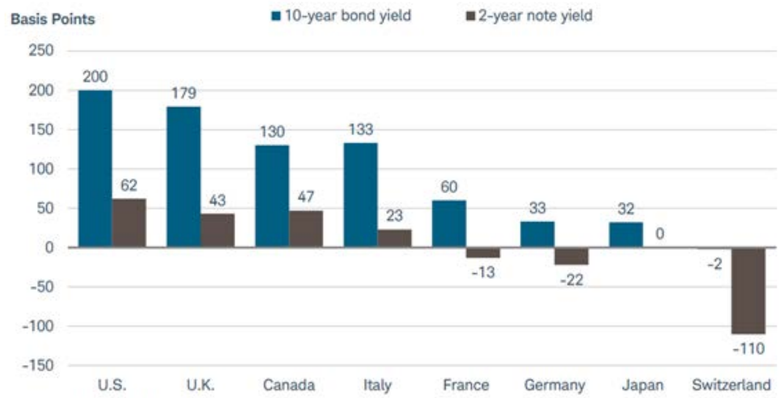
- *"When the index is deeply negative, as it is today, that is usually a good sign for stocks. Following the weakest 5% of observations since 2003, the S&P 500 rose by 14.4%, on average, during the following six months. Conversely, it rose by just 5.5% following times when the surprise index was highest."*
- *"Today's trough puts the index in the lowest 8% of readings. This is unusual given stocks are within spitting distance of all-time highs, despite softer-than-expected economic reports."*



This recently weak or mixed economic data, can be good for stocks as the timing of the first Fed rate hike is pushed out to late 2015.

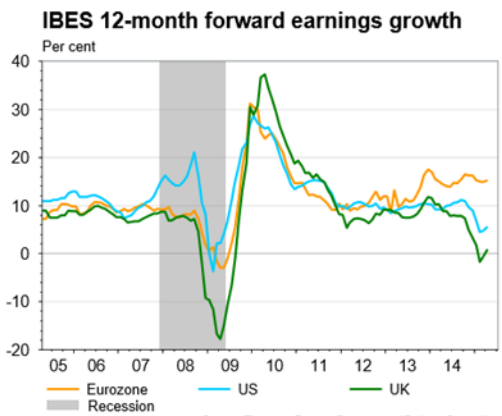
Foreign Markets and Greece

Foreign markets had strong returns in the first quarter in spite of the unresolved debt issues in Greece. Eurozone finance ministers are set to meet on April 24th in an effort to agree on some type of debt repayment terms for Greece. If no agreement is reached at this meeting, Greece could default on its debt as early as May.



Source: Charles Schwab

Foreign market data has been mixed but stimulative actions by foreign central banks and weaker local currencies have helped both credit creation and exports. One consequence of the stimulative actions by the central banks is the downward pressure placed on bond yields. Bond yields around the world are entering uncharted territory and as Bessemer Trust notes, "$4 trillion worth of government bonds worldwide have negative yields." Buying foreign bonds with negative yields means an investor's return of capital is less at maturity. Bessemer also notes, "15 of 19 member countries in the European Monetary Union are experiencing deflation." This environment is forcing investors out of bonds and into both European and U.S. equities.



Source: Thomson Reuters Datastream / Fathom Consulting

The good news is earnings seem to be in an upward trend in the Eurozone. Earnings upgrades for Eurozone companies have turned decidedly positive with positive earnings revisions exceeding negative revisions. Additionally, forward earnings growth for European companies has been greater than that of companies in markets outside the Eurozone. This phenomenon has been occurring for several years; however, investors are now more attracted to European equities due in part to the European Central Bank's quantitative easing program.

Emerging market equities exhibit attractive valuation characteristics with higher growth rates; however, emerging market growth frequently has been revised lower, which does raise caution flags. In addition, many emerging economies have borrowed funds in U.S. Dollars, which could prove costly to pay back given the U.S. Dollar appreciation.

We have increased our client allocations to foreign equities over the past three quarters. We anticipate further additions while taking into account the impact of a strengthening U.S. Dollar. Importantly, the Euro/Dollar exchange rate has dropped some 25% during the last year. As the chart below outlines, returns in "local" currencies look far more attractive as compared to those converted back to U.S. Dollars.

As of 3/31/2015	YTD		2014	
Country / Region	Local	USD	Local	USD
Regions / Broad Indexes				
U.S. (S&P 500)	-	1.0	-	13.7
EAFE	11.0	5.0	6.4	-4.5
Europe ex-U.K.	15.4	5.7	7.4	-5.8
Pacific ex-Japan	8.0	3.2	5.8	-0.3
Emerging Markets	4.9	2.3	5.6	-1.8
MSCI: Selected Countries				
United Kingdom	4.0	-0.9	0.5	-5.4
France	18.0	4.8	3.6	-9.0
Germany	22.1	8.4	2.8	-9.8
Japan	10.4	10.3	9.8	-3.7
China	8.1	8.1	8.3	8.3
India	4.5	5.4	26.4	23.9
Brazil	2.7	-14.6	-2.8	-13.7
Russia	15.7	18.6	-12.1	-45.9

Source: JP Morgan

In February, we purchased a currency hedged European stock market ETF for our client accounts. Both strong European returns coupled with currency hedging have provided attractive near-term returns for our clients.

Diversification and Leadership

The current market environment resembles one where leadership is changing. We see this change occurring rather quickly as well as vacillating back and forth between the various markets. This would include equity leadership, interest rate fluctuations, currency moves, commodity price variation (oil), etc. We continue to believe diversification is wise in light of potentially higher volatility and global uncertainty. When we diversify client investments, we focus on the properties the asset displays in the portfolio. Diversification is not just investing in various segments of the world or different asset classes, but rather, diversification enables the differing investments to play a particular role within the portfolio. For example, some assets are growth oriented, some are income producers and some are principal protectors. Diversifying into the income producing investments has been the most challenging in recent years as interest rates have declined and stayed at very low levels. Many of the investments that historically paid higher rates of interest or higher dividends look expensive from a valuation perspective as investors have gravitated towards these investments in search of higher yields. Balancing one's portfolio between growth oriented investments and income oriented investments (growth + income = total return) likely generates the best risk adjusted return in a market where volatility is expected to be higher.

In spite of potentially higher volatility in the investment markets in the coming year and investing in a market that has experienced only small pullbacks or consolidation periods, we remain constructive about longer-term potential equity returns available to investors around the globe. Corporate balance sheets are generally quite healthy with leverage near decade lows. Excluding the impact of currency headwinds facing U.S. multinational firms, cash flow at companies is strong. Companies are using this cash flow to reward investors with higher dividend payments as well as increased stock buybacks. We do believe these increased dividend payments will account for a larger portion of a stock's total return this year.

We thank you and our corporate partners for continued confidence. Please visit us at www.horancapitaladvisors.com and please don't hesitate to contact us.

Warm regards,

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