HORAN CAPITAL ADVISORS
Investor Letter
Summer 2014
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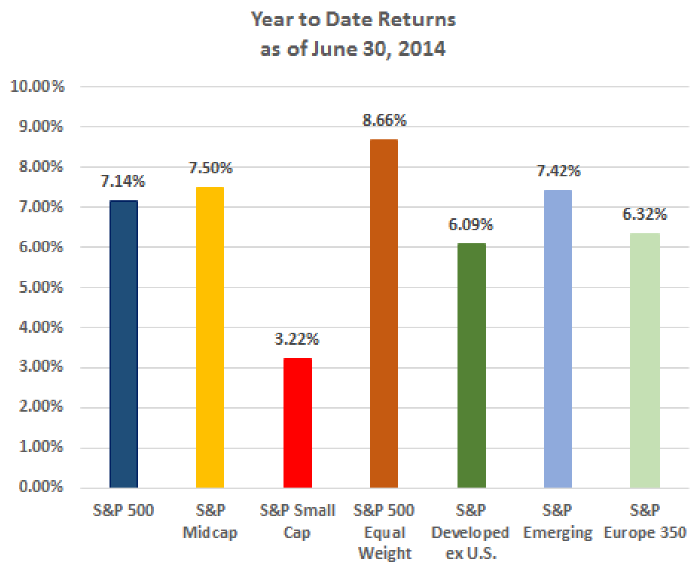
Bull market tops are more difficult to call than bear market bottoms because doubt is a far more resilient emotion than hope. The under-invested cling to doubt in bull markets but the fully-invested quickly abandon hope in bear markets. This is why the average bull market lasts 45 months while the average bear market only lasts 10 months.

- Michael Batnick author of *The Irrelevant Investor*

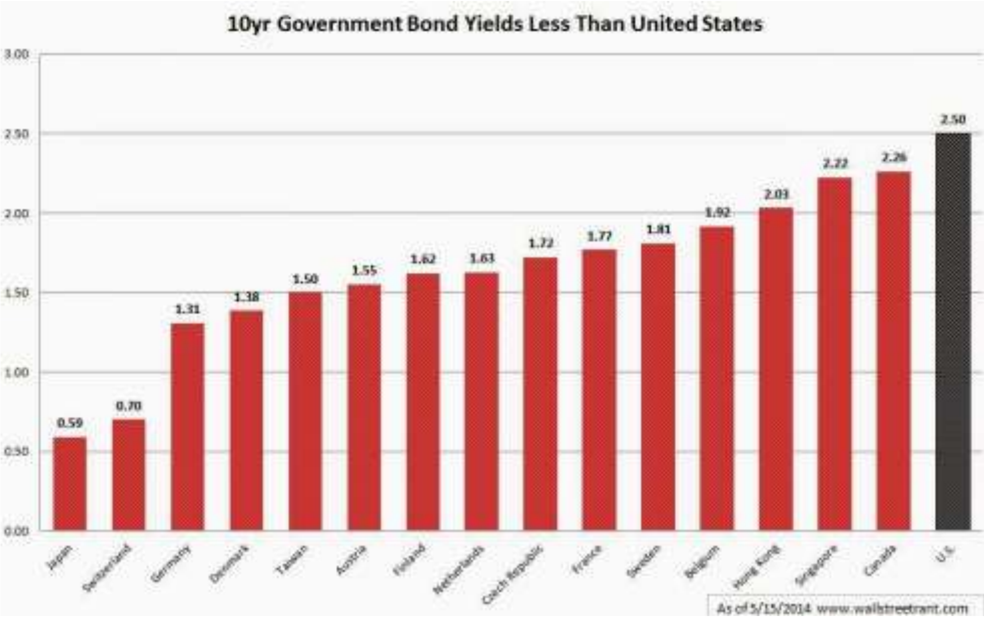
On April 11th the S&P 500 Index closed at 1815.69 which left it down 1.8% for the year and had many investors wondering if it was too late to "sell in May, and go away." However, from that day forward, the S&P 500 has been up almost 8% and as we write, continues to trade at a near record high with 25 consecutive months without a 10% correction. It is often said, we say it frequently, the market likes to climb a wall of worry and the second quarter of 2014 was certainly no exception.



The economy was very weak in the first quarter as measured by the final GDP number, which showed the economy contracting at a 2.9% annual rate. Insert "wall of worry" brick number one here. Yet, we believe the first quarter weakness can be mostly related to the extreme winter weather across much of the U.S. The magnitude of the decline surprised many economic forecasters with weakness in the GDP report largely attributable to weaker inventory build. For the quarter the change in inventories equaled $45.9 billion versus $111.7 billion in the fourth quarter of 2013. Other bricks in the "wall of worry" included geopolitical events in the Middle East and Ukraine, concerns about Chinese economic growth and an over-levered financial system, weak European economic growth data, particularly in France, Italy and Portugal, near $4.00 per gallon gasoline prices and, well, you get the message. As Winston Churchill said, "You will never reach your destination if you stop and throw stones at every dog that barks." Our goal is to evaluate and extrapolate the daily signals and noise, yet stay focused on the economic and market fundamentals which drive our investment thinking.

What’s Next for Interest Rates?

The Fed’s June FOMC minutes contained pointed language calling for the end of bond purchases (QE3) this October (insert another brick in our “wall of worry”). Surprisingly, given the Fed’s reduced bond purchasing, interest rates are actually lower than they were before the tapering began. This would seem to be indicative of a couple of factors. First, other large buyers have stepped in and replaced the Fed, likely including foreign buyers less attracted to the lower yields of many non-U.S. government bonds. Second, weak first quarter economic growth led some investors to seek the relative safety of bonds. So, can we interpret the Fed’s message to mean markets and the economy need less support?



Rising bond yields are not necessarily bad, particularly if they are rising from very low levels to more normal levels accompanied by improving economic growth. This is viewed as part of the economic healing process. Rising rates would be viewed as problematic if they rise to normal or above normal levels without economic growth. This could occur due to higher demand for borrowing, higher inflation or credit (solvency) concerns.

Many prognosticators are calling for year-end yields on the 10-Year Treasury to be between 3 - 3.25%. This move would likely strip away the year-to-date positive performance in fixed income portfolios. Inflation may be picking up as recent input cost inflation numbers registered a five- month high. We are not overly concerned about inflation in the near-term, but it could have future implications for both monetary policy and more importantly our clients’ asset allocations. We continuously evaluate where risks reside for our clients and significant inflation could be one such risk. Cash and fixed income holdings will hinder portfolio performance in an inflationary environment while equities and real assets can provide protection.

A recent analysis by Guggenheim Investments ranked fixed income investments by levels of over and under-valuation relative to U.S. Treasuries. High-yield corporate bonds fell into the second highest quartile of over-valuation. Although arguments could be made that certain market forces are supportive of high-yield debt, we won’t claim the ability to exit at the exact moment over-valuation turns to capital loss. Over the past four years, HORAN Capital Advisors held a significant allocation to high-yield bonds. As interest rate spreads narrowed, meaning high yield was outperforming it’s more conservative brethren, we trimmed our positions in a measured manner. A past allocation of 7 - 8% is now down to 2 - 3%. We are evaluating whether to completely exit the high-yield bond position in the not too distant future.

Where Is The Correction?

If there is one significant brick in that "wall of worry," it is doubt about the continued strength of the equity markets. The S&P 500 Index has not experienced a correction of over 10% since 2011; therefore, a correction would seem overdue. Avondale Asset Management's Chief Investment Officer recently wrote an article noting the current bull market run. The S&P 500 Index is now in its sixth longest period without a 10% correction. As the table shows though, bull market rallies without a 10% correction can certainly advance far longer than 25 months.

Bull Market Rallies Without a 10% Drawdown			
Start	Peak	Number of Months	Percent Increase
Oct 1990	Oct 1997	84	233%
Mar 2003	Oct 2007	54	95%
Jun 1962	Feb 1966	44	80%
Jun 1984	Aug 1987	38	126%
Jul 1950	Jan 1953	30	60%
Jun 2012	Present	25	53%
Sep 1953	Sep 1955	24	101%
Dec 1987	Oct 1989	22	61%
Oct 1957	Aug 1959	21	56%
Aug 1982	Oct 1983	14	69%

Doubting the future prospects of the equity market is not uncommon, but what does the current economic and fundamental data suggest or indicate? Chris Williamson, Chief Economist at Markit noted, "U.S. manufacturers exhibited strong business conditions with the fastest expansion of output and new orders in four years. June Manufacturing PMI was the highest since May 2010. Also, service sector jobs hit a nine month high." But how does this translate into company earnings? Thomson Reuters recently stated, "If you've scrutinized S&P 500 earnings as long as we have, the action in the S&P 500 is understandable this year, just looking at the revisions and forward estimates around earnings. The fact is, despite the negativity, S&P 500 earnings are growing at mid to high single digits, and starting to improve."

There is a reason the stock market is considered a leading indicator. It has historically been one. Yes, the market occasionally gets ahead of itself or declines without provocation. As Paul Samuelson so eloquently said, "Wall Street indexes predicted nine of the last five recessions." Currently though, the supporting data is broadly good. Beyond this, we believe the attempt to time the market in the short-term is a difficult proposition with costly long-term consequences for many investors. As we have noted in the past, we do not know any famous market timers. We bring value to our client relationships by allocating capital to assets that are attractively priced both absolutely and relatively. We regularly sell or trim holdings, which we believe have become overvalued. This would recently include exiting U.S. small cap stocks, trimming MLPs and the reduction or sale of multiple individual stocks in our client portfolios.

Final U.S. Manufacturing PMI™ Summary

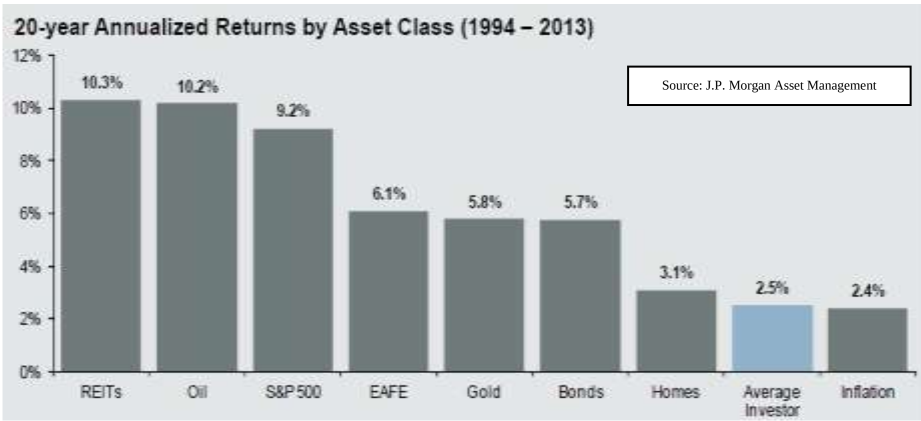
50.0 = no-change on previous month (seasonally adjusted)

Index	Jun'14	May'14	Change signalled
PMI	57.3	56.4	Expansion, faster rate
Output	61.0	59.6	Expansion, faster rate
New Orders	61.2	58.8	Expansion, faster rate
New Export Orders	50.6	52.2	Expansion, slower rate
Employment	54.0	53.7	Expansion, faster rate
Backlogs of Work	56.0	56.0	Expansion, unchanged rate
Output Prices	52.1	50.4	Rise, faster rate
Input Prices	57.6	56.4	Rise, faster rate
Stocks of Purchases	49.7	52.0	Decline, change of direction
Stocks of Finished Goods	45.2	47.9	Decline, faster rate
Quantity of Purchases	57.9	59.2	Expansion, slower rate
Suppliers' Delivery Times	46.8	47.1	Lengthening, faster rate

Source: Markit.

Long-term Returns

The Pension Partners' blog recently equated a story from Malcolm Gladwell's bestselling book *Blink* regarding "positive sentiment override" to current stock market action. Gladwell's book describes psychologist John Gottman's findings where positive emotion overrides any irritability. Gottman claimed he could predict divorce with 95% accuracy based on verbal and non-verbal cues from spouses. Positive cues needed to out-weigh negative ones by a margin of 5 to 1 for marriages to last. While we wouldn't argue that market sentiment has been high (not sure 5 investors to 1), let's not forget the lost decade of the 2000's. One might say we are just playing catch up in the equity markets. Long-term investors received no price return gain from the 2000 peak until April of 2013 and many companies are just now reaching the same price level they traded at 14 years ago! Asset class returns for the past 20 years are just now reaching more normalized and rewarding levels for the long-term investor. Although we recognize a correction can occur at any time, we continue to be attracted to the prospects for equity investments over the intermediate to long-term. We also remain concerned about the risk and reward probabilities for fixed income investments over those same time horizons. In addition, we believe a healthy allocation to alternative investments, that provide adequate upside return potential with hedged downside protection, is a compelling complement to client portfolios.



We thank our clients for their continued confidence. We hope all are having a happy and healthy summer.

Please visit us at www.horancapitaladvisors.com .

Respectfully,

HORAN Capital Advisors

** HORAN Capital Advisors, LLC is an SEC Registered Investment Advisor.*

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