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HORAN Capital Advisors

Quarterly Investor Letter

SPRING 2021

"It's not what you look at that matters. It's what you see."
- Henry David Thoreau

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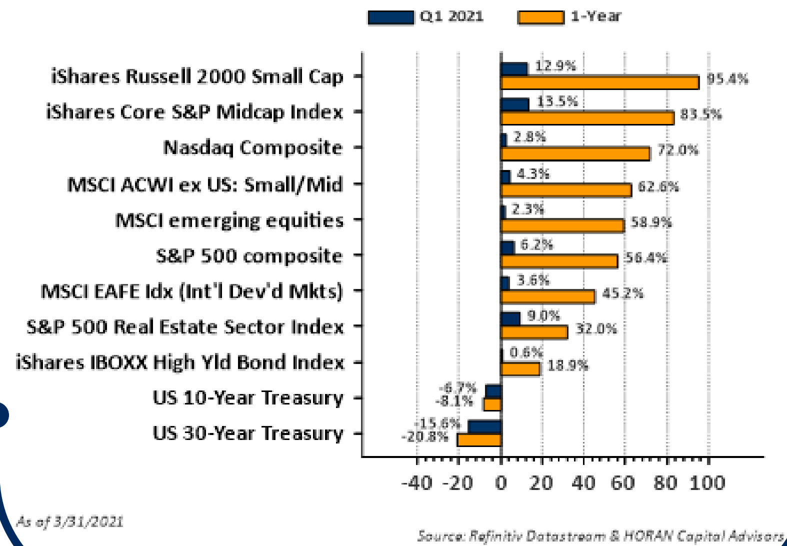
Market Recovery

The difference a year can make is ever more apparent when comparing equity market returns as of the close of the first quarter this year versus the first quarter in 2020. Near triple digit returns over the last twelve months were achieved in some stock indexes compared to 20%-30% declines a year ago. As we noted in our Winter 2020 Investor Letter, "while the Merriam-Webster Word of the Year for 2020 was 'pandemic,' the 2021 Word of the Year might be 'transition.'" Simply comparing the return difference now versus a year ago certainly gives credence to the view that investors are transitioning back into stocks. Another transition that is positive for the equity market is the broader performance participation in asset classes other than the mega cap stocks. The chart at right shows small cap, midcap and foreign small/mid stocks outpacing the S&P 500 Index over the last year. With respect to bonds or fixed income, one might think of U.S. Treasury bonds as a defensive asset class, yet the 30-Year U.S. Treasury bond is down over 20% in the last twelve months and down over 15% in the first quarter of this year. This decline in bond prices is due to the rise in intermediate to longer term interest rates. Importantly, as interest rates rise, the price of bonds declines and this has occurred over the past year.

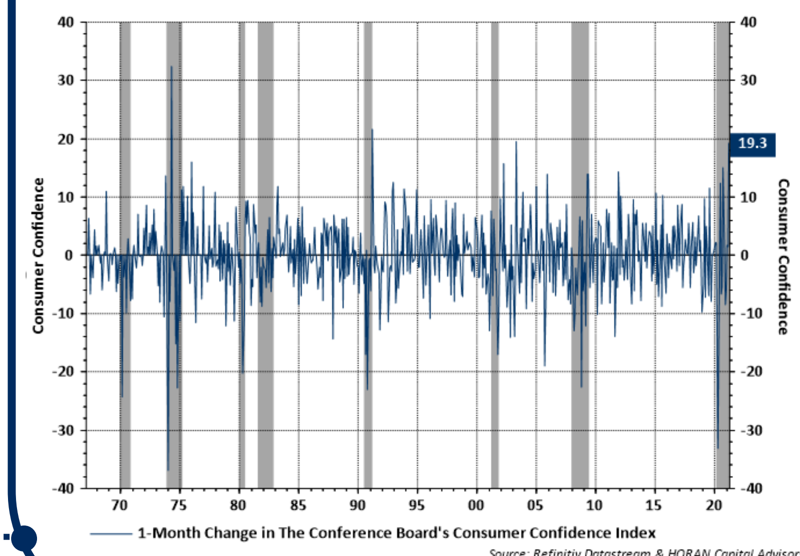
Asset Class Performance as of 3/31/2021



Economies Reopening

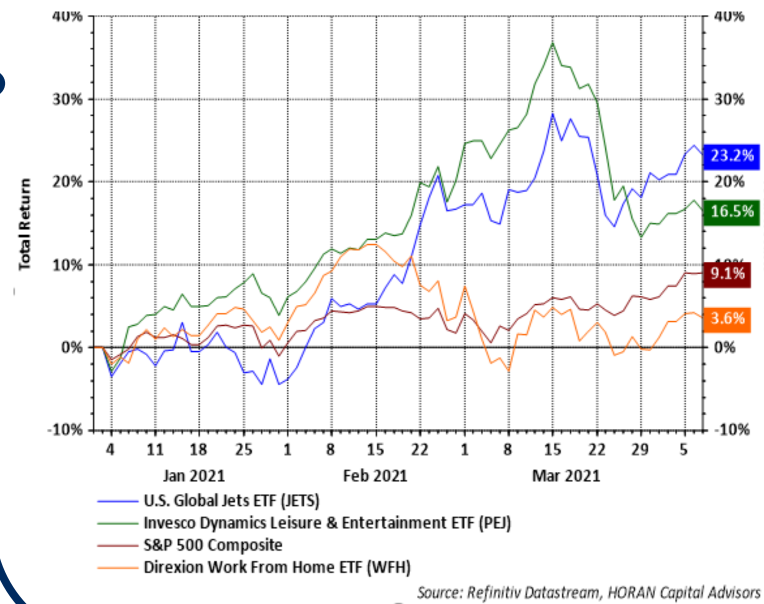
Sometimes it is said the stock market and the economy are not the same; however, the stock market does trade on future expectations. More economies are reopening, especially state economies in the U.S., and this is contributing to increased consumer confidence and demand. As this Investor Letter is written, even California is indicating the state desires to be fully reopened by June 15. California is the largest economy of all U.S. states at $3 trillion which is more than 10% of total U.S. GDP of approximately $21 trillion. The economic reopening and higher vaccination rates are leading to favorable sentiment by consumers which in turn is leading to satisfying pent up demand. The near chart shows the monthly change in The Conference Board's Consumer Confidence Index. The March 2021 change of 19.3 points was one of the largest increases for the confidence index going back to 1967.

1-Month Change in Consumer Confidence



The favorable economic activity resulting from reopening of economies is reflected in the performance of some theme-based index exchange traded funds (ETFs.) Three of these themed based ETFs are shown on the **chart at right,** U.S. Global Jets ETF (JETS), Invesco Dynamics Leisure & Entertainment ETF (PEJ) and Direxion Work From Home ETF (WFH). The WFH ETF is largely comprised of technology companies focused on investments in cloud, cybersecurity and document management that benefit from employees working from home. By the index names, the JETS and PEJ ETFs benefit from growing travel and reopening economic activity. Since the beginning of this year, these last two ETFs are outperforming the "work from home" index, a reflection of work activity beginning to transition to a more normal or pre-pandemic environment.

Reopening versus Work From Home



In the recently released employment situation report for March 2021 it is noted nonfarm payroll employment increased 916,000, which brought the unemployment rate down to 6%. The March report highlights that recent job gains are taking place in some of the industries that were most negatively impacted by the pandemic economic shutdown. The report notes job growth was widespread "with the largest gains occurring in leisure and hospitality, public and private education, and construction." Further, "leisure and hospitality increased by 280,000, as pandemic-related restrictions eased in many parts of the country. Nearly two-thirds of the increase was in food services and drinking places (+176,000)."

Despite the favorable employment market trend, far too many individuals remain unemployed. Of the 22.4 million jobs lost from February 2020 to April 2020, only 13.9 million have been regained. However, the continued reopening of more economies is resulting in an increase in job openings. The latest job openings report shows nearly 7.4 million jobs are available. Some of the industries with the largest job openings are in education and health services (1.6 million), healthcare and social assistance (1.4 million), leisure and hospitality (900 thousand) and retail trade (817 thousand).

Our New (Virtual) Address

We are proud to announce the launch of our new website! In an effort to better serve our clients, we have merged our website with www.horanassoc.com. We believe this will provide you with a better client experience and connect you to other services that you may need along your wealth and retirement journey.

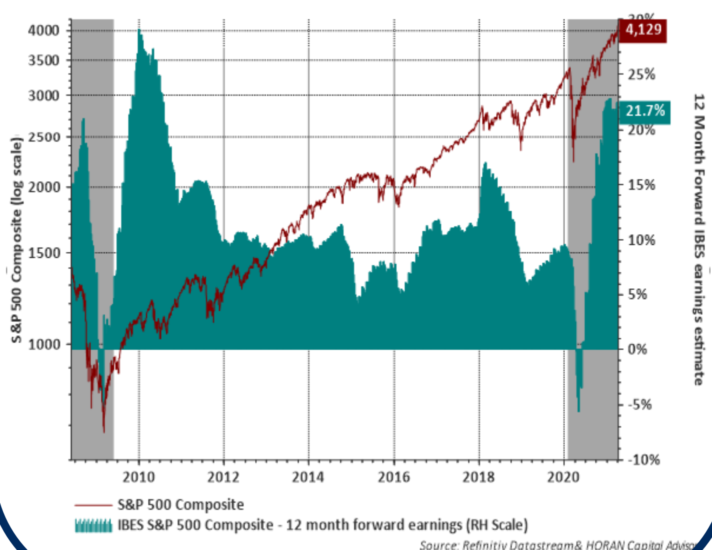
You will still be able to access information about our investment philosophy and approach, market commentary, blog posts, account login access and more on our new site.

To eliminate disruption, any bookmarks you may have saved linking to our old site will automatically be redirected to www.horanassoc.com. Please do not hesitate to reach out should you have any questions.

Corporate Earnings Rebound

Further evidence of a more favorable economic environment unfolding is the sharp snap back in the growth expectations for corporate earnings. **The chart below shows the contraction in earnings expectations** that occurred at the peak of the pandemic shutdown early in 2020. The 12-month forward earnings growth for S&P 500 companies is now projected to be 21.7%. Given the low earnings level in the second quarter last year, on a quarterly basis, Q2 2021 earnings are expected to be up 46%. This level of earnings growth is certainly having a positive impact on stock prices. One potential headwind for the equity markets may be the Biden administration's desire to raise taxes. The administration's proposal is to increase the federal corporate tax rate to 28% from the current 21%, resulting in a combined U.S. federal-state tax rate of approximately 32%, highest in the OECD group of 37 countries. Some tax proposals show the higher corporate tax rate could reduce corporate earnings by 15%.

S&P 500 Index with Estimated Growth of Forward Earnings

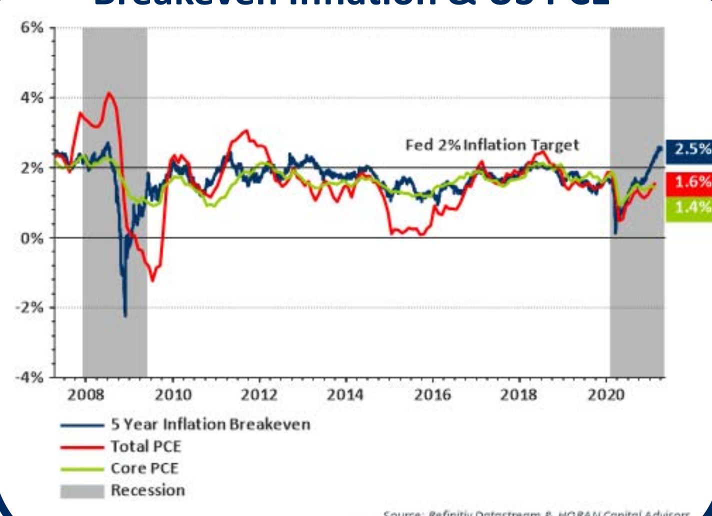


Inflation Debate

Due to the massive stimulus provided by the Federal Reserve and U.S. government during the past year, the inflation debate has begun to take on a more prominent role in the news and financial markets. There are many diverse opinions and views, but the signs indicate we will likely experience a heightened level of inflation near term. Most inflation measures are still subdued, but markets are beginning to price in higher inflation. **This chart shows the 5-year inflation expectation for the** bond market (blue line). The measure has increased from near 0% in 2020 to 2.5% recently. While it is not a perfect foreshadowing, it has trended well with the Fed's preferred measure of inflation, Core PCE (green).

Production bottlenecks are also adding to the inflation debate. A recent example is the global shortage in computer chips. The Fed has continued to signal they will likely keep an easy money policy well into the future and the fixed income markets are factoring in 2023 as the timeframe for any Fed movement on rates. Long and mid-term interest rates have moved higher this year on concern of overheating in the economy. This perception could be another potential headwind for the markets should there be a sustained pickup in inflation and therefore interest rates. While this issue bears continued scrutiny, we expect these inflation issues are likely to be transitory.

Breakeven Inflation & US PCE



Gamestop SPAC-ulation

While the massive support programs helped to minimize the duration of the economic contraction, it has also led to some speculative activity in the markets. Early in the first quarter, volatility hit stocks such as GameStop (GME) and others as they became the focus of trading in a Reddit forum called WallStreetBets. These traders uncovered the fact a hedge fund called Melvin Capital had a large short position in GME. When one is short a stock, they are betting the stock goes down with the intent of buying back the stock at a lower price. The Reddit forum members began purchasing the stock and pushed the stock price higher resulting in Melvin Capital losing 53% of its value in January. Then, in late March, another firm called Archegos Capital Management lost $20 billion in two days. Some of the financial institutions that handled Archegos trades are reporting substantial losses as Archegos unwinds its leveraged investment bets made through total return swaps. The bank Credit Suisse estimates its losses at $4.7 billion. This type of loss occurring at these two investment firms and spreading to some larger financial institutions is certainly reason to take pause. Importantly though, these situations have not caused a larger market contagion.

Another new trend has emerged in the market this year with the numerous public listings of so-called blank check companies also known as Special Purpose Acquisition Companies (SPACs). SPACs are companies with no operating business that are formed in order to raise capital through listing on the public markets. Once capital is raised, these companies must acquire businesses that do have operations, typically within 24 months, or the SPACs must return capital to shareholders. Roughly $83 billion was raised through SPACs in 2020 and in the first three months of 2021 SPACs have already raised $88 billion. These listings offer risk to investors as some SPACs do not disclose what companies they will be acquiring in advance.

Conclusion

The rapid and, at times, surreal changes that we have all experienced over the past 12 months are a reminder to focus on the things that matter most. In our personal lives this remains our health and relationships. In the markets it remains liquidity, risk, and corporate fundamentals. Several key issues will be important as the year unfolds, top of mind is the continued reopening of the economy. This depends largely on the swiftness of vaccine implementation and broad immunity. To date 36% of the U.S. population has had their first shot and 22% have received all doses, per CDC data. As reopening concerns subside, infrastructure spending will likely take center stage. The current proposal is for a nearly $2 trillion infrastructure bill, funded mostly by corporate tax hikes. This balancing act will likely be reflected in the market at some point as investors juggle these two issues. Foreign relations may also resurface as the China trade conflict still has not been resolved. All of these serve as both opportunities and risks for investors. One or more of these issues will likely “trip” markets during the year, but these stumbling blocks can be healthy for a “hot” market. A disciplined and opportunistic approach will result in long-term success.

Thank you for your continued confidence and support. We are always available to answer your questions and discuss our outlook further. Please be sure to visit us for company news, reports and our blog at: www.horanassoc.com/insights.