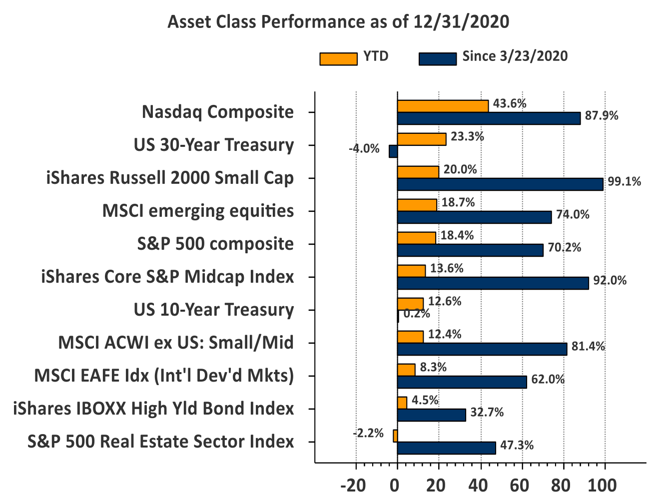
HORAN CAPITAL ADVISORS

Investor *Letter*

"The easy thing to do in this market is to predict that it isn't going to keep running higher. The hard thing to do is to keep looking for long trades and to keep pressing. Typically, the hard thing pays better than the easy thing." - James DePorre

A Strong Finish

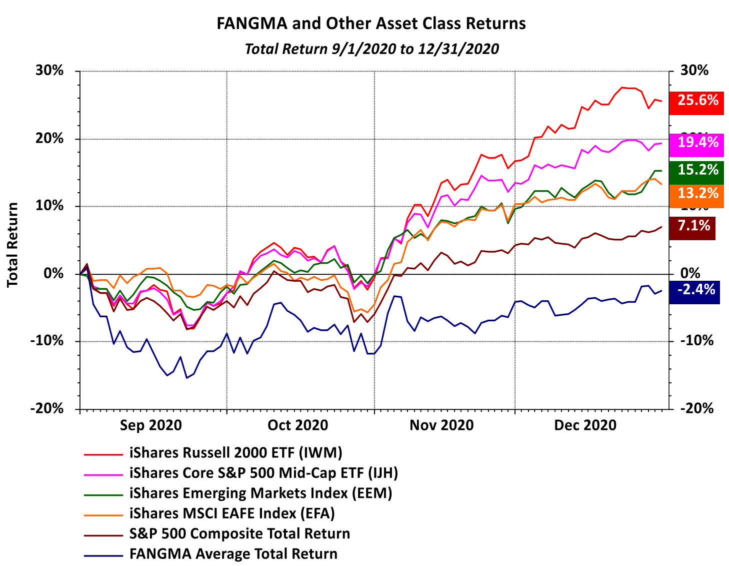
With the calendar page turned to 2021, it seems like a bittersweet farewell to 2020. As 2020 unfolded, investors could hardly imagine that the S&P 500 Index would finish the year up 18.4% and close at a record high, after being down 23.1% in the first quarter. As the chart at right shows, since the March 23, 2020 low, the S&P 500 Index was up 74.0% through the end of the year. This 'V-shaped' rebound took place without much of a pullback, with the largest being a 9.6% decline in September.



As of 12/31/2020

Source: Refinitiv Datastream & HORAN Capital Advisors

One aspect of the S&P 500 Index return in 2020 was the return concentration in some of the index's largest constituents. These larger companies took on the acronym of the FANGMA stocks, Facebook, Amazon, Netflix, Google, Microsoft and Apple. These six stocks accounted for over 66% of the index's 2020 return or 12.15 percentage points of the 18.4% total index return. Although the positive return in the large company stock space seemed narrow, a positive development over the course of the year was the broadening market participation in other asset classes like midcap, small cap and international stocks. As the chart at left shows, since the beginning of September, the FANGMA stocks and the S&P 500 Index underperformed many other asset classes. One of the best performing asset classes was small company stocks

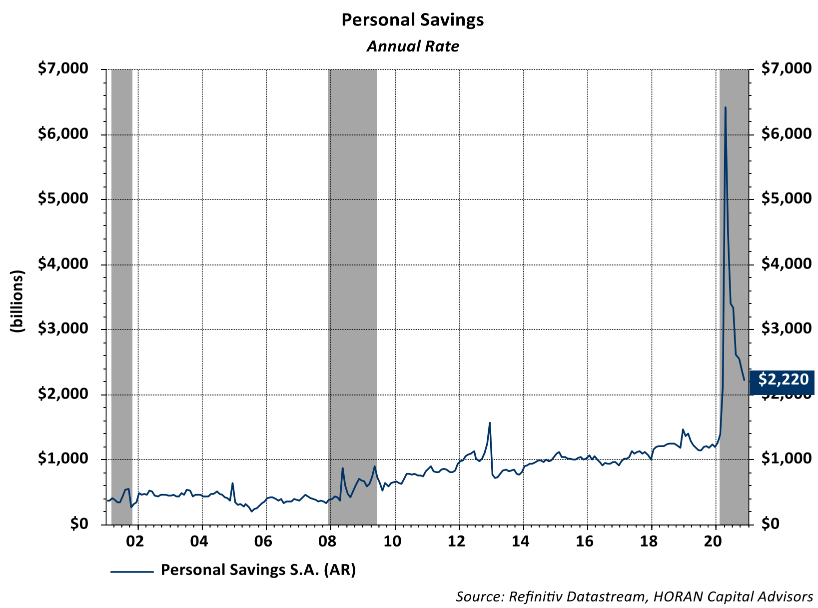


Source: Refinitiv Datastream & HORAN Capital Advisors followed by midcap companies, emerging markets and developed international markets.

The bond market did not disappoint investors either. The bar chart on the previous page shows the 30-year U.S. Treasury generated a total return of 23.3% and was the second-best performing asset class on the chart. Most of the intermediate and core taxable bond indices were up mid-single digits to low double digits. Even with an estimated 40% of state economies under some type of activity restriction, the municipal bond market has not been significantly impacted from a negative return perspective. In the recent Quarterly Summary of State and Local Tax Revenues from the Census Bureau it is noted, “tax revenues for the first three quarters of 2020 are down about 1% relative to the same period of 2019.” The $10.4 trillion in aid provided by the U.S. central bank and federal government has been significant and supported economic activity in the past year.

A Roaring ‘20’s Like Economy

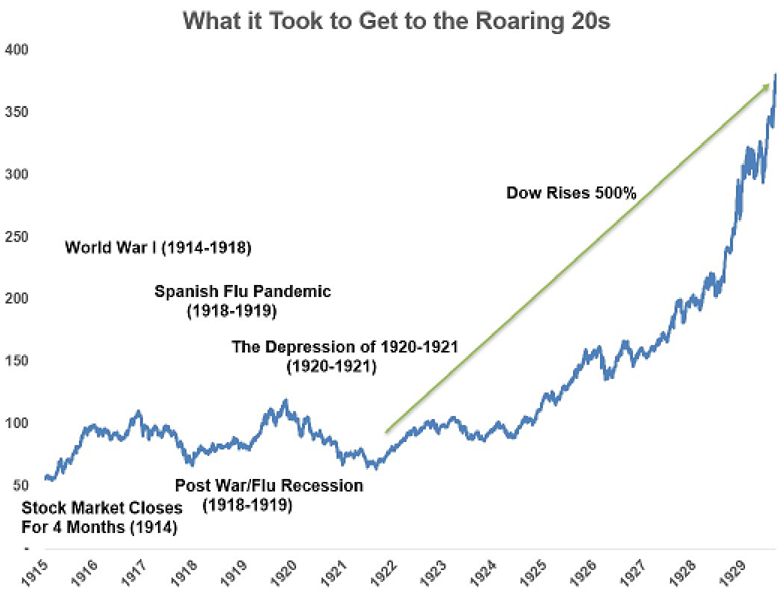
The onset of this recession was triggered by an unusual event, i.e., a virus mandated economic shutdown. Recessions are triggered by a wide range of factors; however, overproduction and loose credit conditions are often key contributors. These are often followed by tighter credit conditions, higher interest rates, and slowing production which can combine to constrain growth and potentially lead to an economic contraction. During this current recession the trigger was not too much production or too loose credit conditions. As fiscal and monetary support early in the pandemic enabled consumer activity to remain robust following a very short downturn, companies are now faced with depleted inventories and restocking is leading to an improvement in economic activity. More stimulus is being pushed into the economy. One outcome of this is the level of savings increase, which may ultimately be spent in subsequent quarters. With the additional stimulus approved by Congress, spending in the first and second quarters of this new year may serve as a tailwind for the consumer part of the economy.



The Atlanta Fed’s GDPNow model is estimating fourth quarter 2020 GDP to increase at an annual rate of 8.6%. HORAN Capital Advisors’ expectation is GDP growth in 2021 falls in the range of 5-7%, supported by positive activity resulting from vaccination against the Covid-19 virus. The vaccine alone is likely to enable more states to relax their activity restrictions. The increase in activity will require firms to increase the pace of hiring, reducing the level of unemployment.

Of the numerous economic green shoots, one of the most impactful on economic activity is the strength in the housing market. After existing home sales fell to an annual rate of 3.9 million units in May, activity has spiked higher to an annual rate of 6.7 million units in November. Although existing home sales are not included in GDP, housing’s multiplier effect on the economy is estimated to be 1.3 to 1.6 dollars for every dollar spent on housing.

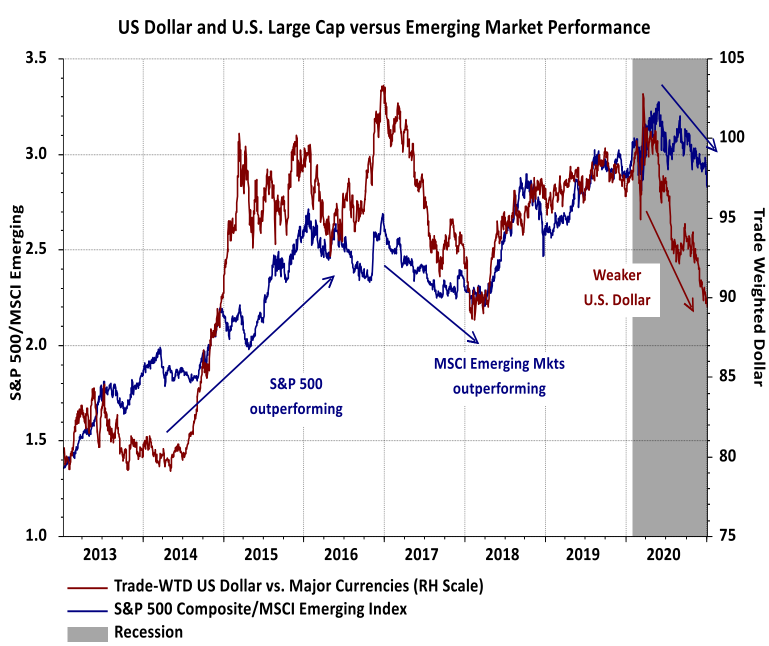
A robust or roaring economy followed not far behind the end of the Spanish Flu in 1919. A recent article on Medium describing the environment after the Spanish Flu of 1918/1919 noted, "Each day seemed to sprout another idea, another product, another thing to buy. And buy they did — Americans consumed more than ever before, relying on the assembly line to satisfy every need. Estimates show that the economy grew 42% (no, that's not a typo) in the 1920s, while the stock market increased by a yearly average of 12%." The near chart shows the Dow Jones Industrial Index from 1914 to its interim peak in 1929. The market's advance following the Spanish Flu pandemic is partially attributable to the pent-up demand that helped kick off the Roaring 1920's. Could the economy and market be in store for something similar following the Covid-19 pandemic?



Source: A Wealth of Common Sense

The U.S. Dollar and International Markets

The global pandemic and increased level of fiscal and monetary support in the U.S. are factors contributing to a weaker U.S. Dollar. Predicting the direction of currency moves is a difficult task. One relatively consistent factor thus far, however, is that the Dollar tends to trade in a 7-year cycle, partially in sync with the global economic cycle. Over the course of the past year or so, the Dollar Index (DXY) has been on a weakening trend, declining from 99 to just under 90. For investors, one interplay with a weakening U.S Dollar is its impact on the performance of international investment returns. As the near chart shows, when the Dollar is in a persistent weakening trend, emerging international markets tend to outperform the US market. A return tailwind occurs when converting a foreign currency into the weaker Dollar. Also, many foreign countries, especially the emerging market countries, borrow in US Dollars. When the Dollar is weak, it takes less foreign currency to purchase Dollars that are used to pay back a foreign country's debt; thus, providing some budget stability in these emerging market countries.



Source: Refinitiv Datastream, HORAN Capital Advisors

Healing Corporate America

S&P 500 analysts' earnings estimates are now turning higher. Typically, earnings estimates are too high at the beginning of a quarter or year and estimates are reduced as the quarter or yearend approaches. This is not the case now as analysts overestimated the severity and length of a recovery for corporate America. Record earnings are expected for the S&P 500 Index in 2021 at $164. This will exceed 2019's earnings rate of $157. In fact, the earnings component in the most recent report on third quarter 2020 GDP reached a record $2.1 trillion, exceeding the Q4 2019 amount of $2 trillion.

Conclusion

Merriam-Webster's 2020 Word of the Year was "pandemic", but HORAN Capital Advisors believes "unprecedented" may be a more appropriate selection for financial markets. That said, "transition" might be a preliminary front-runner for 2021. Transitioning political leadership, consumer behavior, and economic momentum appear to be on the horizon in the U.S. These shifts in the real economy have implications for market action and, although U.S. equity markets posted impressive results in 2020, there is still opportunity for investors. There is no opportunity without risk, however, which currently includes vaccine implementation errors, government/central bank policy missteps, further lockdowns, and other unforeseen events. A combination of discipline, opportunistic-thinking, and patience will continue to serve investors in a year of transition.

Thank you for your continued confidence and support in HORAN Capital Advisors and 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.horancapitaladvisors.com/blog.

Respectfully,

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