HORAN CAPITAL MANAGEMENT

HCM News

Danforth Associates
An HCM Company

April 2015

20 Years and Still Going

It was February, 1995, in the basement of a private residence, when two men decided to embark upon a journey that would have a lasting impact for years to come. No, I am not talking about Steve Jobs and Steve Wozniak building the first Apple computers. I am referring to Patrick Horan, John Heinlein and the beginning of Horan and Associates Financial Advisors at Pat's house in Glen Arm, Maryland. Beginning with $16 million in assets under management, a couple of desks, computers, and a few phones, Pat and John started writing financial plans and managing investments for a handful of clients.

Twenty years later, some things have changed. The firm moved out of Pat's basement and changed its name to Horan Capital Management (HCM). Our client base expanded nationally and we experienced rapid growth during one of the most difficult stretches in the market. In 2012, we purchased Danforth Associates, a small family run financial services firm in Massachusetts and successfully integrated their clients under our management. In 2014, John Heinlein succeeded Pat as the sole owner of the company, and we moved our headquarters to a new location in 2015 which provides us more space as we continue to grow. We now have 13 employees in three different states and we manage just under $500 million in client assets.

But the most important things have stayed the same. Our investment philosophy has not changed through the up and downs of the market over the last 20 years. We continue to manage customized portfolios for every client. On the financial planning side, although the software has advanced dramatically, we are still providing clients with the sound, objective financial advice that they have come to expect.

What does the next twenty years hold for our clients? We cannot predict the future, but there are a few things we do know. We have made a significant investment in industry leading technology for our clients. In the second quarter we will be rolling out a client interface which will dramatically enhance how you receive and review data about your portfolio. You will receive important information in a more timely and customizable manner and it will be available through a variety of devices. Later this year, we will implement a new trade order management system and new client relationship management system, both of which will create additional efficiencies internally.

Thanks to all of you for being partners in our first twenty years and we look forward to serving you and your family over the next twenty years and beyond.

*As always, please call our client service team at **(800) 592-7534** if you have any questions. Our representatives can also provide you with up-to-date information about your holdings and discuss any changes in your personal financial situation.*

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Market Commentary

By Tim Hai, CFA®, CAIA

Market Review *

- Small caps outperformed large caps as the Russell 2000 returned +4.32% while the S&P 500 returned +0.95% (including dividends).
- Growth outperformed value across all market capitalizations.
- Non-U.S. markets (MSCI EAFE: 5.00% in USD) generally outperformed U.S. equity markets.
- Non-U.S. equity markets (developed and emerging) handily outperformed U.S. markets, especially on a local currency basis. This was due to the 17% rise in the U.S. dollar (relative to a basket of other foreign currencies).
- Brazil (-14.60%), Russia (18.60%), and Japan (10.30%) were notable in 1Q2015 based on their extreme performance changes (all quoted in USD).
- U.S. markets were led by Consumer Discretionary (4.80%) and Health Care (6.50%) stocks. Utilities and the Energy sector were the weakest sectors, falling -5.20% and -2.90%, respectively in 1Q2015.
- The U.S. Corporate bond sector led other Fixed-Income markets (2.30%). 10-Year U.S. Treasury yields fell from 2.175% at the beginning of the year to today's 1.934%.
- The U.S. dollar surged against most other currencies (+11.24% versus the Euro, +4.79% versus the British Pound) but was essentially flat versus the Yen (0.03%).

* Unless otherwise noted, performances stated above reflect data provided by Standard and Poors, Russell Investments, MSCI, and Barclay's Capital.

Market Commentary

The S&P 500 forged ahead during the last quarter (+0.95% including dividends) despite six years of annual performance gains (through 2014). However, the market seemed uncharacteristically "macro" driven (rather than fundamentally driven by corporate earnings). Consider that small cap stocks, (as measured by the Russell 2000) outperformed large cap stocks by gaining 4.32%; oil prices climbed higher; and international markets outperformed U.S. markets, as the MSCI EAFE returned 5% (11% on a local currency basis) - all were reversals from last year. Some trends from last year however, remained intact: the U.S. dollar gained 17% versus a basket of foreign currencies (+11.24% versus the Euro and +4.79% versus the British Pound) and U.S. markets were again led by Consumer Discretionary and Health Care stock sectors.

"Oh, what a tangled web we weave..."

What have been the main drivers of these trends? We would suggest sector rotation (i.e. an investment strategy whereby investors opportunistically move from sector to sector to take advantage of changes that are occurring in the macro-economic environment) driven by a mixture of interest rate and inflationary (or lack thereof) concerns as the causes. They, and a host of other symptoms of central bank manipulation (i.e. fluctuations in the U.S. dollar, changes in oil prices, equity and bond market performance, etc.), are interwoven and connected. A passage from Sir Walter Scott's poem, Marmion, "Oh, what a tangled web we weave..." adequately describes today's market.

Small caps have outperformed large caps largely on the basis of their being domestic revenue plays. Many large cap stocks are global in nature, deriving much of the revenues and earnings abroad. Large cap revenues and earnings have been damaged recently by the rising U.S. dollar, both on a translation basis (as U.S. companies convert their foreign denominated revenues and earnings back into dollars), and as a direct hit to sales as global consumers seek cheaper alternatives to U.S. dollar denominated products.

Market Commentary

Continued

In addition to supply and demand issues, it is thought that oil prices are also impacted by changes in the purchasing power of the U.S. dollar. Consider that the previous bull market in oil prices (between 1998 and 2014) coincided with the most recent period of decline in the U.S. dollar. This link between oil prices and the U.S. dollar exists because oil prices are quoted in U.S. dollars. Declines in the value of the U.S. dollar implies that foreign buyers of oil are receiving a discount relative to the U.S. buyer (a tail wind for oil prices as demand from countries like China and India climbed due to cheaper oil over the past decade). The opposite is true when the value of the U.S. dollar rises - foreign buyers of oil are paying a premium relative to the U.S. buyer (the loss of foreign demand is a headwind for oil prices).

International stocks rebounded during the quarter as major central banks globally followed the U.S. by introducing quantitative easing measures (i.e. an attempt by the central bank to spur the economy through lower interest rates and increases in the supply of money) to stabilize their economies. International stocks are thought to be direct beneficiaries of these measures as reflected in their quarterly gains. International stocks were also beneficiaries of the higher U.S. dollar as global consumers substituted their purchases of American goods with cheaper ones produced by foreign ones.

Consumer Discretionary and Health Care stocks have outperformed other sectors since early 2014. Consumer Discretionary stocks (globally) have been bid up as they are thought to be beneficiaries of the U.S. consumers' increased purchasing power (due to the rise in the U.S. dollar) in addition to having more funds available due to the decline in oil prices, having cheap access to loans, higher home and real estate prices, an up-trending stock market, and better economic stability. Health Care stocks have benefited from regulatory changes in U.S. healthcare law and a favorable mergers and acquisitions market driven by low interest rates. Utilities underperformed as some investors locked in gains as markets speculated a potential increase in interest rates by the Federal Reserve. The Energy sector continued its fall despite a slight rebound in oil prices.

The U.S. Federal Reserve has a dual mandate to maintain price stability (inflation) and minimize unemployment. It was in the pursuit of the latter goal that led monetary policy towards the current low interest rate environment. Low interest rates further exacerbated an already falling U.S. dollar. It was only the global financial crises that helped to strengthen the U.S. dollar; a flight to safety that belied concurrent weakness in the U.S. Currently, central banks around the world are belatedly enacting their own measures to fix their economies, further weakening foreign currencies and by default strengthening the U.S. dollar. Thus, the investment climate today is a byproduct of Federal Reserve decisions made years ago (and to a lesser extent driven by actions of foreign central banks). Most, if not all of the symptoms discussed above have their genesis in Federal Reserve monetary policy. The financial crises of 2008 drove the Federal Reserve to take unprecedented actions. These actions enabled six straight years of positive S&P 500 performance. Given monetary stimulus by the Federal Reserve of epic proportions (and central banks globally), a typical economic cycle may not be realized. What was once normal, may no longer be so.

What was once normal, may no longer be so.

Despite six straight years of positive performance in the S&P 500, the markets may continue to climb or economies may continue to stagnate or hobble along; nothing is assumed. For this reason, we do not speculate on the direction of the markets or concern ourselves overly with macro-economic matters. We do not allow market chatter to alter our investment discipline. Regardless of what was the root cause, we have conviction in our strategy that buys great companies at a discount to their intrinsic values. We believe that over the long-run, our clients' portfolios will benefit from this methodical strategy and will outperform. Horan Capital Management would like to thank you, our clients, for continuing to believe in us and our message. We hope the best for you and your family in the remaining year and beyond. As always, never hesitate to contact us should you have any questions or concerns.

John G. Heinlein –
Chief Executive Officer and
Chief Investment Officer

The following discussion mentions stocks that are widely — but not universally — held by clients of Horan Capital Management. Client portfolios are customized, so this commentary may or may not be directly applicable to any given client or account. Our intention is to provide general insight into portfolio holdings and into our overall approach and to highlight situations of interest, both positive and negative. The mention of any stock is neither advice nor a solicitation to buy or sell any particular investment and our opinions regarding securities are subject to change without notice. Investing involves risk of loss. See the legal disclosures at the end of this publication and on our website for more information.

Portfolio Activity

By John G. Heinlein

POSITIONS SOLD

Applied Materials, Inc. (AMAT) Shares of AMAT were recently sold (or reduced in selected accounts) based on price appreciation. The position has performed well since our initial purchase. However, given the highly cyclical nature of the semiconductor industry, we believed that shares were fairly valued. Proceeds from the sale have funded new portfolio purchases or were redistributed to other portfolio holdings.

Canadian Natural Resources Ltd. (CNQ) Shares of CNQ were recently sold or trimmed in selected non-taxable accounts to secure gains (the decision to sell or retain shares in taxable accounts was made on an account-by-account basis with client tax considerations in mind). Although companies dependent on oil prices have encountered extreme volatility in recent months, we continue to have confidence in the viability of CNQ, and of the inherent investment qualities that drove HCM to own the shares originally. We will continue to monitor this stock and leave open the option that we may re-invest in it or add to it if an opportunity presents itself.

Covidien PLC (COV) It was recently announced that Covidien would be purchased by Medtronic, another medical device manufacturing firm. The combined company will offer cardiovascular, restorative therapy, surgical, and respiratory solutions. Shares of both companies had risen significantly since the acquisition was announced in June, 2014. We believe that COV's shares fully reflected Medtronic's offer price. As such, we believe that there are more efficient uses for the proceeds from the sale of these investments.

National Oilwell Varco, Inc. (NOV) Shares of NOV were recently sold or trimmed in selected accounts to secure gains (the decision to sell or retain shares in taxable accounts was made on an account-by-account basis with client tax considerations in mind). Although companies dependent on oil prices have encountered extreme volatility in recent months, we continue to have confidence in the viability of NOV, and of the inherent investment qualities that drove HCM to own the shares originally. We have been monitoring this stock and have in selected accounts, where appropriate and possible, established a new position (see "New Purchases" comment below). We will continue to repurchase the stock in selected accounts as opportunities present themselves and where appropriate.

REDUCTIONS OF EXISTING POSITIONS

Berkshire Hathaway Inc. (BRK.B) Shares of BRK.B were trimmed in selected accounts based on price performance and an over-weighted position. Proceeds from the sale were redistributed to other portfolio holdings. Shares of BRK.B continue to look attractive as a core holding in HCM portfolios.

Portfolio Activity

Continued

Cisco Systems (CSCO) Shares of Cisco Systems were trimmed in selected accounts based on price performance and an over-weighted position. Proceeds from the sale were redistributed to other portfolio holdings. Shares of Cisco continue to look attractive as a core holding in HCM portfolios.

NEW PURCHASES

Fastenal (FAST) Fastenal (NASDAQ: FAST) is a wholesale industrial distributor which distributes several types of industrial equipment including fasteners along with safety, plumbing, electrical and welding equipment. Fastenal has a wide moat stemming from a network effect and a cost advantage over smaller competitors. A combination of zero debt, a strong sales force, a large network of stores, same-day delivery services, and vending services enables Fastenal to earn high margins and very high, consistent returns on capital which has averaged 24% over the past 10 years. Fastenal's shares have suffered recently due to softening sales growth. We are using the pullback in the shares to enter a long term position in what we believe to be a great business.

Las Vegas Sands (LVS) Las Vegas Sands is the world's largest operator of fully integrated resorts featuring casino, hotel, entertainment, food and beverage, retail, and convention center operations. While best known in the U.S. for its Venetian and Palazzo casino hotels in Las Vegas, the vast majority of the earnings of Las Vegas Sands (LVS) are generated in China (Macau) and Singapore. The company has a strong economic moat, thanks to its possession of one of only two licenses to operate casinos in Singapore and one of six licenses to operate casinos in China. A weaker economy and the recent crackdown on corruption in China have pressured gambling volumes in Macau, especially in the portion of the business catering to VIP customers. We view the recent slowdown in Macau as a temporary phenomenon that has given us the opportunity to own one of the best-positioned global gaming companies at a significant discount to our estimate of intrinsic value. Meanwhile, shareholders currently are benefiting from a dividend yield that is projected to be almost 5% and an owner-operator management team that is buying back stock.

National Oilwell Varco, Inc. (NOV) National Oilwell Varco, Inc. designs, manufactures, and sells equipment and components used in oil and gas drilling, completion, and production; and provides oilfield services to the upstream oil and gas industry worldwide. Shares of NOV were recently (re)purchased in selected accounts. The company had encountered extreme volatility in recent months due to falling oil prices. The company still retains the same inherent investment qualities that drove HCM to own the shares originally; namely, a dominant position as a supplier of equipment and services to the drilling industry.

Qualcomm, Inc. (QCOM) QCOM was purchased in selected accounts. QCOM is the proprietor behind the premier CDMA wireless network technology which is used by most cell phones today. The company also manufactures semiconductors for mobile phone and issues licenses to mobile phone producers to utilize the network. We believe this company has solid growth potential and because of recent complications surrounding its licensing practices in China, sells at a discount to intrinsic value. We believe QCOM's discount to intrinsic value, coupled with its potential for growth offer sufficient margin of safety.

Swatch Group AG (SWGAY) Swatch Group AG manufactures and sells finished watches, jewelry, and watch movements and components worldwide. Swatch has a wide economic moat based on its numerous brand of Swiss watches and its role as supplier of components (i.e. watch movements – the inner workings of the watch) to over 60% of the Swiss watch industry. Swatch's wide moat is also evidenced by the company's strong profit margins and high returns on invested capital - all-the-while producing strong free cash flow and utilizing no debt. The company's stock has been impacted most recently by currency headwinds (Swiss Franc), its China/Asia exposure, and potential competitive pressures from the soon-to-be introduced Apple iWatch (and the greater smart watch market). We believe the combined negative effect of these issues on the company's stock price to be excessive. At current prices, Swatch's stock represents good value for a company with a wide economic moat, suggesting a large margin of safety.

Viacom, Inc. Cl. B (VIA.B) Viacom is a global media company with several leading cable properties (Media Networks 73% of revenues) and a film studio, Paramount pictures (Filmed Entertainment 27% of revenues). Viacom holds a valuable portfolio of cable networks, a large production studio, and a deep library of content. Strong brands include Nickelodeon and MTV networks. Shares have been under pressure recently due to lower advertising revenues. Also, concerns of a shift in viewers from cable to digital TV services such as Netflix, Hulu and Amazon Prime have affected shares. We believe that despite this long term issue, Viacom's video content value will continue to increase even as distribution markets change.

Exxon Mobil (XOM) ExxonMobil is not only the largest publicly

Portfolio Activity

Continued

traded producer of oil and natural gas, it is one of the largest companies by market capitalization. The Company's ability to allocate capital and operate vertically integrated businesses within the Energy sector is virtually unmatched. If there is any company within the highly competitive oil and gas market with an economic moat (typically considered an oxymoron), this is it. The Company boasts quality assets and economies of scale that enable it to achieve high industry level profit margins and high returns on equity and capital (ROE/ROIC). The Company's ability to generate tremendous levels of free cash flows reflects its great balance sheet. The Company's attractive dividend yield is sizable, seemingly well protected, and a handsome reward while awaiting a rebound in the fortunes of the sector. We expect the Company's management to take full advantage of the price dislocations within the sector by opportunistically acquiring quality assets of weaker competitors. The result: a more powerful company that can compound investment returns for the foreseeable future. Current market pricing of the Company's shares signals an opportune time to invest in a great company at a good price.

ADDITIONS

Amazon.com, Inc. (AMZN) The Company is playing a prominent role in the structural shift away from brick-and-mortar retail. We think the company's potential is undeniable and believe its valuation is misunderstood. We purchased the stock for selected accounts during the quarter.

Bank of America Corporation (BAC) We believe many of the problems that plagued the company are behind it. With its low valuation, its expenses in decline and profitability rebounding, we think the shares were worthy of purchase during the quarter.

Berkshire Hathaway Inc. (BRK.B) Shares of BRK.B were recently added in selected new accounts. BRK.B is a core holding in HCM portfolios.

Citigroup (C) Like BAC, Citigroup is in the process of recovery after the financial crisis. The balance sheet is shrinking and expenses are falling. We like the improving prospects and valuation so we purchased shares for selected accounts.

Coach Inc. (COH) The luxury handbag maker has stumbled recently as it transitions its business into a lifestyle brand. With the recent stock slump, we are able to accumulate the company's shares at what we consider a bargain price. We like the company's long-term potential, particularly in China and other developing markets.

General Electric (GE) The diversified manufacturer has positioned itself as a leader in all markets in which it competes. Since the financial crisis, the company has rebuilt its finance arm and improved its capitalization while working to pare non-core assets. With its global presence and rebuilt capital arm, we believe the company's future looks promising. We continued to purchase shares for selected accounts.

Google (GOOG) The search engine provider generates over 80% of its revenues through advertising or "clicks". Recent performances by GOOG have missed consensus expectations, resulting in share price declines. We view these declines as buying opportunities for GOOG as we believe that the market continues to underestimate the company's growth capabilities and intrinsic value. We continued to purchase shares for selected accounts.

IBM (IBM) The stock has underperformed recently due to the fears of cloud computing which is shifting the enterprise IT landscape. With the shares trading at approximately 12 times trailing earnings, we think that the concerns are more than reflected in the stock price and have used the opportunity to build long term positions in this globally dominant IT company.

McDonald's (MCD) Missteps in its Chinese operations combined with cyclical and competitive pressures have weighed on McDonald's operating results driving the share price down to what we believe is an attractive level for purchase. We believe the company's brand and scale will allow it to compete well in the evolving $900 billion global quick service restaurant industry.

Microsoft (MSFT) A recent pullback of MSFT stock due to a missed earnings expectations offered an opportunistic moment to add shares to new accounts. The company is a core holding in HCM portfolios.

Proctor & Gamble (PG) The global products company is going through some challenges as it tries to right-size its brand mix. We like the portfolio of leading brands that are essential for retailers to drive traffic in their stores. The valuation is attractive in our view and we have used the opportunity to buy positions for selected accounts.

Risks that Matter Most

By Tim Hai, CFA®, CAIA

Volatility is a measure of the variation in a stock's price over time. In layman's terms, it represents the constant fluctuation in stock prices that concerns many investors - our clients included, and with good reason. The chatter on investment news channels or in printed journals is a constant reminder to us that stocks are continuously traded on an exchange or over-the-counter. Prices for these investments are updated to the second and are easily obtained. Therefore, they weigh on us heavily when the outcome is negative and is not to our advantage. We here at Horan Capital Management ("HCM") believe that this is unnecessary.

> **Our focus on the long-term is not fantasy...volatility is dampened considerably through the passage of time.**

We believe that the more important worry, or risk, is that of a potential loss of capital. The differences are many. Volatility is readily observable; risk of a potential loss of capital is not apparent until a sell transaction is made. One is unrealized (volatility) and the other is not (risk of a potential loss of capital). Volatility can be used as an opportunity to invest in a good stock at a cheaper price; a realized loss of capital offers no such recourse and is permanent. Investors too easily allow themselves to be swept up in the moment of a temporary pricing event that will either make them very happy or very sad. This is anecdotally similar to a sports game where the score changes frequently, as both sides gain or lose a temporary point advantage. Fans cheer or grimace throughout, sometimes needlessly. However, a loss or victory is never assured until the game clock is at zero. Investors should similarly understand that regardless of the fluctuation in a stock price, any gain or loss is never realized until a sale transaction is made.

> **We consider ourselves investors in businesses and not in stocks.**

Our game plan at HCM is to give more attention and credence to the risk of a potential loss of capital. We consider it our highest priority to avoid losing our clients' monies. How do we do that? For starters, we turn off CNBC. We tune out the constant chatter that coalesces collectively into market noise. We consider ourselves investors in businesses and not in stocks. To extend this concept, we consider ourselves investors in private businesses. What's the difference? One is long-term and one is not. One entails the constant distraction of real-time pricing while the other does not. Without the noise of real-time pricing inherent to public market investing, we are free to focus on building value for our clients over the long-term. HCM marries our clients' long-term time horizons with business investments that are long-term in nature. Renowned investor Benjamin Graham once said that "In the short run, the market is a voting machine but in the long run, it is a weighing machine." By this he meant that in the short-term, stock prices are heavily influenced by market participants; over the long-term, stock prices are determined by their intrinsic values.

At HCM, we tune out the ticker of stock prices. Our investment process is such that we determine the intrinsic value for the businesses we own or are interested in. We do not believe that the intrinsic values for these businesses fluctuate as wildly as the market suggests. And although we train our focus on protecting our clients from the risk of a potential loss of capital, we are cognizant of their apprehensions regarding market and stock specific volatility. How do we accomplish this? First and foremost, by being value investors. We minimize portfolio turnover - requiring long-term holding periods for our investments (which incidentally also increases the after-tax potential and lowers trading costs associated with our investments). We prudently diversify our holdings to optimally balance the goals of lower volatility and achieving unfettered value-add. Most importantly, we demand a large margin of safety or discount to intrinsic value for the investments that we own and purchase. It is with these tools that we hope to assuage volatility fears.

Our focus on the long-term is not fantasy. Studies show that volatility is dampened considerably through the passage of time. By accepting some unrealized volatility in the short-term, we can position the portfolio to avoid the larger and more detrimental risk of a potential loss of capital. We hope and urge our clients to view the investment decisions we make for them in a similar fashion.

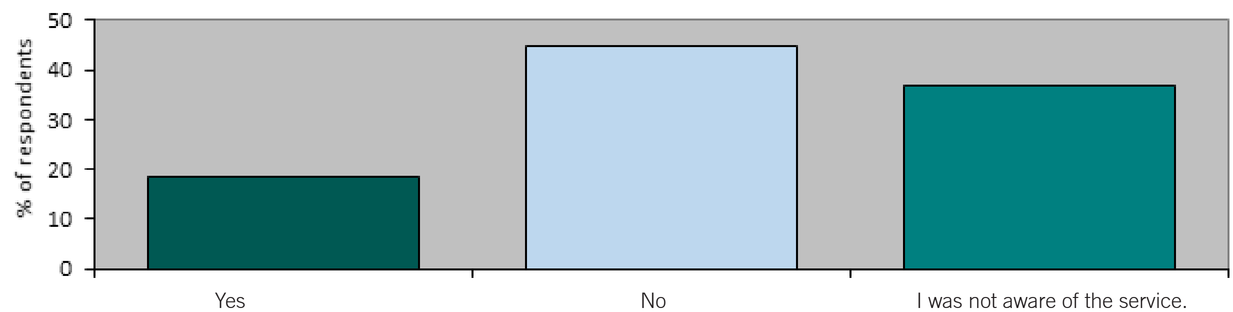
The Results Are In !!!

It has been a little over a year since the ownership of our firm has changed. During that time, much of our effort went into ensuring our processes were sound and we invested in human capital to ensure we had the resources to serve our clients and continue to grow our business. This year, we are intensely focused on the client experience and we wanted to take the pulse of our clients and find out what is working and where we need to improve.

During the first quarter we conducted our first comprehensive Customer Satisfaction Survey. We are pleased to report the number and quality of responses far exceeded our expectations. With a 36% response rate, we went well beyond the typical response rates of 10 – 25% for similar types of surveys. For those of you who were able to give us your feedback, we are incredibly appreciative, and we are working diligently to take any necessary actions as a result of your responses.

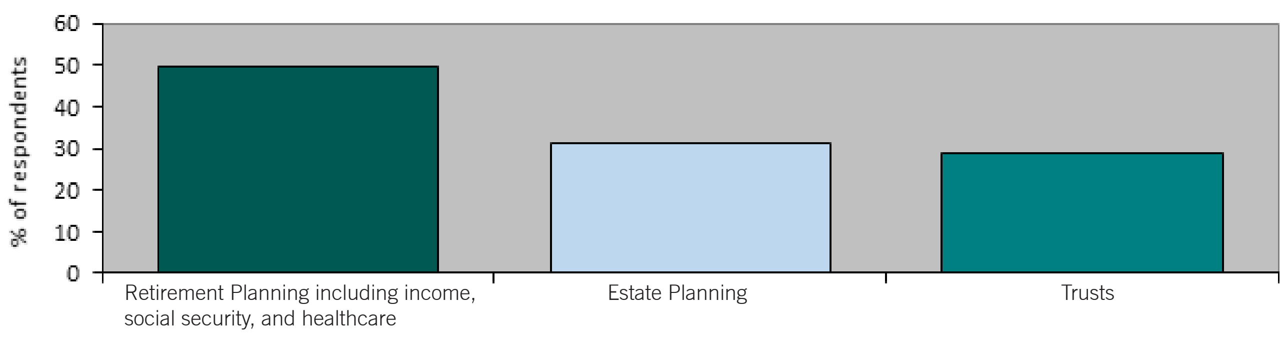
Let's take a look at some of the broader responses:

Q: Have you utilized our complimentary financial planning services?



As a client utilizing our investment management, the financial planning service is included as part of our overall fee structure. Depending on your current financial life situation, this resource will prove invaluable as you contemplate retirement, plan for a child's education, review your insurance coverage or ensure you efficiently pass your assets to your intended beneficiaries.

Q: What financial planning topics would you be interested in learning more about from HCM?



We are actively working to provide the real time answers to our clients' needs. To enhance the advice we are able to provide through our financial planning, we have recently subscribed to a Social Security analyzer. This will allow us to provide more robust advice around timing and strategies for claiming Social Security payments to ensure you are maximizing the amount you will receive over your lifetime. We continue to look for more tools like this to provide the best advice to help you achieve your financial goals.

Lastly, you gave us high marks on your confidence in HCM, and for that we are most appreciative. Nearly 96% of those of you who responded were very satisfied to satisfied with your overall relationship with HCM, and over 92% of you would definitely or probably recommend us to a family member, friend, or colleague. As we continue to strive for excellence in providing the best overall client experience and sound, un-biased financial advice, we will look to improve upon those numbers. And certainly, we would appreciate the opportunity to help others progress down the path of achieving their financial life goals.