HORAN CAPITAL MANAGEMENT

HCM News

October 2015

Planning = Path to Success

If we told you that your chances of **financial success** could be increased **10x** just by writing down your goals, would you do it? According to a Harvard Business School study, 3% of graduate students who had written goals were earning, on average, 10x as much as the other 97% put together.

At HCM, we think the same way about Financial Planning, which is why we offer **Financial Planning at no additional cost**. We do not charge for this service because we believe it is so important and cost should not stand in the way.

Many clients have taken advantage of this **FREE** service, but there are still many who have not. Contact your advisor today to get started on your own personalized financial plan.

*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 Review

By Tim Hai, CFA®, CAIA

Market Review *

• Equity markets underperformed fixed-income markets with S&P 500 falling 6.4% (including dividends; -5.3% YTD) and the Barclay's Capital U.S. Aggregate Bond index rose 1.2% (up 1.1% YTD).

• Small caps underperformed large cap stocks (S&P 500) as the Russell 2000 returned -11.9% (down 7.7% YTD).

• Growth outperformed value across all market capitalizations and over most periods (Qtr/YTD/1/3/5-year, etc.).

• Non-U.S. markets (MSCI EAFE**: -10.2% in USD; -4.9% YTD) generally underperformed U.S. equity markets.

• Emerging markets underperformed developed markets (MSCI EAFE**) as the MSCI Emerging Markets Index fell 17.8% in USD (-15.2% YTD).

• Brazil (-33.6%), China (-22.7%), Australia (-15.3%), Russia (-14.4%), Canada (-14.0%), and Japan (-11.7%) were notable based on their extreme performance changes (all quoted in USD).

• U.S. market sectors were led by Utility stocks (+5.4%). Energy and Materials were the weakest sectors, each falling 17.4% and 16.9%, respectively. Though not an economic sector as listed by S&P, US REITs rose 2.1%.

• The U.S. Treasury bond sector led all bond sectors (+1.8%). 10-Year U.S. Treasury yields fell from 2.3% at the beginning of the quarter to today's 2.1%.

• The U.S. dollar rose +3.7% versus the British Pound (as well as versus most other currencies), but fell -2.1% versus the Yen and -0.2% versus the Euro.

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

** The MSCI EAFE Index is a large capitalization, developed market benchmark that tracks non-U.S. or foreign equity markets.

Market Commentary

By Tim Hai, CFA®, CAIA

The US economy is not immune to economic forces that occur beyond its shores

If it wasn't fully understood before, it should be now: the U.S. economy is not immune to events or economic forces that occur beyond its shores. This past quarter was another stark reminder that the U.S. economy has not "de-coupled" from the global one. Consider that at this time last quarter, we were discussing the unraveling of Greek society and what that would mean for its European neighbors and beyond. In August, Greek leaders blinked in their game of chicken with its European creditors and accepted the harsh terms of yet another bailout of its debt obligations. Markets calmed in response to the new deal. Not long after however, markets would be disrupted again, this time due to worse-than-expected economic data originating from China. This would be followed by a devaluation of the Chinese Yuan. Chinese stocks plunged leading the government to initiate extraordinary measures to contain the damage, including halted trading for select stocks and hundreds of billions of dollars in direct equity securities purchases meant to prop up the stock market. A global selloff in equities ensued. In September, the U.S. Federal Reserve stoked the volatility fire by not following through on what it had signaled as a forgone conclusion: a rise in the short-term interest rates. The Federal Reserve suggested that "adverse global and financial developments" would be an impediment to growth and implied that an increase in interest rates might further destabilize the global economy. It also perhaps implied that the U.S. economy was more fragile than what was widely believed. We can only suspect that the weak September payroll data announced last week was previously known to the committee ahead of its decision to hold off on lifting interest rates (there was probably a good indication present given that the previous two months of labor data was revised downwards as well).

U.S. markets responded to the quarter's news reel with extreme volatility that led each of the major U.S. stock indices (DJIA, NASDAQ, and S&P 500) to enter into correction territory (when markets are down below 20% from their most recent highs) for albeit brief periods during the quarter. The CBOE Volatility Index or Fear index, which measures stock market volatility, reached 40% in August for the first time since 2011 (it had hovered near 20% for much of that time span). A 40% reading on the Fear index is not common and was last breached amid the initial stages of the European debt crises and a downgrade to the U.S.' credit rating by Standard & Poor's. As further evidence of the considerable volatility, consider this: a two-week stretch in mid-August experienced seven days of 2% or more swings in the Dow Jones index; the Dow had only breached 2% one other time over the past year (December 2014).

In August, we sent you a letter reiterating our investment philosophy and addressing the increased volatility in the markets. We thank everyone for their kind responses. We mentioned that our value principle and long-term time horizon were central tenets to our investment philosophy and key to defending our clients' portfolios during the times of volatility. We wrote the letter understanding that the volatility and market retrenchment was not a singular, one-time event where we had to react immediately or risk missing out on the opportunity. Markets are still down from their highs and have been so for several months now. Some clients have already seen changes to their portfolios that we believe take advantage of the market's mispricing and volatility. We will continue to review our client's portfolio and make further opportunistic changes as warranted. We acknowledge that every client's circumstances are unique, and that some changes will not affect every portfolio. It is also important to understand that we are not high turnover managers (prone to excessive trading) as this runs counter to our long-term investing goals and our preference for companies that can compound in value over time. In addition, excessive trading is not tax efficient and can add unnecessary costs. We commend our clients in their ability to understand that market volatility does not necessarily translate to permanent portfolio losses. Volatility also signals opportunity. After six years of uninterrupted gains, markets have seemingly hit a rough patch. We can make it through this temporary phenomenon by being opportunistic and staying the course in terms of investment philosophy with a steadfast commitment to value investing with a long-term perspective.

We take advantage of the market's mispricing and volatility.

Simple Estate Planning Tools

By: Jay Schuman, CFP®

The conversations we often have with clients revolve around their investments, allocations and yes, performance. All are very important topics. Conversely, one item we find that is often overlooked by clients is just as important and usually encompasses more than just the assets managed at Horan Capital. We are speaking of the relatively simple tools concerning estate planning. Whether it's wills, beneficiary designations, or trusts, these tools help people manage their future and potentially their heir's future as well. These are not necessarily complex legal contracts, but frequently simple steps to make sure that your wishes and goals for your assets are carried out, even if you are no longer here.

Probably the simplest tool to help direct where your assets go once you have passed, is regularly overlooked and sometimes out of date if in place at all. We are speaking of the beneficiary designation, a specific determination of where a specific asset or account is to go. Many are familiar with this on their IRA and other retirement accounts, as it is usually required information when opening such an account. Keep in mind, this designation should be reviewed from time to time so that it remains true to your wishes. What many clients do not realize is that taxable accounts (i.e. individual, joint and others) can have beneficiary designations as well. These are commonly referred to as Transfer on Death (TOD) designations, and like retirement accounts, can include anyone, from family to friends. A simple form is all that is needed to add this to most existing accounts.

Beneficiary designations and wills help ensure your assets pass on to the people of your choosing.

When we have these discussions with clients, a will is almost always brought up. A will is a terrific safety net to have. If it is drawn up correctly by an attorney, it covers all of your assets that do not have specific beneficiary or other types of designations attached to them. Of course, as many of you know, a will includes the need for the state of residence to become involved in what is known as the probate process. There is not necessarily anything wrong with probate, but is usually takes time, makes the process part of public record, and there is generally a fee.

Trusts are another tool used by certain clients for various reasons including the distribution resolution of assets. A trust can be a very effective mechanism to determine control of not only who gets assets, but also how they will get them. Trusts are legal documents drawn up by attorneys that can range from simple and direct to the very complex, often determined by a client's situation and how much money they want to spend for their attorney's time. A very important estate planning tool needed by some, but not by everyone.

The last topic that should not be forgotten in this discussion is the storage of this information. Whether just copies of account applications with beneficiary designations or trust documents, all of this information should be safely stored and easily retrieved. A simple floor fire safe may be just fine, or maybe bank deposit box. A new thought in important document storage and protection is digital storage. Here, copies of documents and other important papers are kept on servers or the ubiquitous Cloud. Obviously, many people have certain feelings about using online services, but this is becoming a very well thought of option.

It is apparent that there are many ways to make sure wishes and goals for your assets are carried out once you are gone. The most important step is to determine if you have these directives in place and then whether they are set up as you wish. We are here to help you determine which options maybe best for you.

*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

NEW PURCHASES

Emerson Electric Co. (EMR) Emerson Electric Co. provides technology and engineering solutions to industrial, commercial, and consumer markets worldwide. Recently, the company has faced severe headwinds in FX/foreign currency exposure (58% of revenues are generated outside the U.S.), a weak global market, and exposure to oil & gas (through its Process Management division). Emerson's oil and gas exposure in particular has weighed on the entire company and has drawn the market's ire. We believe that the company has less exposure to oil and gas than the market suspects and that the company's shares have been over penalized for it. We believe shares of Emerson are undervalued today and that growth will return to the company as normalization occurs in oil-gas markets, FX/foreign currency, and the global economy.

Fossil Group. Inc. (FOSL) Fossil Group is best known for the company's watches which are most commonly sold in partnership with strong consumer brands such as Burberry or Michael Kors. The company's stock price has been impacted of late as the investment community parses the impact of the Apple Watch on the company. We are not as pessimistic on Fossil and the greater watch industry as a result of the Apple Watch introduction. We believe that the new watch's launch will more likely grow the market for all watches in general as potential buyers for the Apple Watch are more likely to be new watch owners rather than existing ones. We view this as an excellent opportunity to purchase a very well-run company at a significant discount to intrinsic value.

Merck & Co., Inc. (MRK) Merck provides health care solutions worldwide. Like other drug manufacturers, the source of Merck's economic moat is based on the strength of its portfolio of branded and patent-protected drugs (which also enable it to have scale in manufacturing, distribution, and R&D). The company's current drugs, which includes diabetes drug Januvia (over $6 billion in sales) and new star Keytruda (PD-1 lung cancer) will help the company protect sales and margins as other products within its roster have lost patent exclusivity and now face generic competition. We believe shares of Merck are currently attractive on a relative basis versus peers and the company's own distinguished history. More importantly, we believe shares of Merck are attractive on an absolute level.

ADDITIONS

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

ExxonMobil (XOM) ExxonMobil is not only the largest publicly 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

Portfolio Activity
Continued

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, 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. Current market pricing of the company's shares signals an opportune time to invest in a great company at a good price.

Fastenal (FAST) Fastenal 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. We continued to purchase shares for selected accounts.

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 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.

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.

Qualcomm, Inc. (QCOM) Qualcomm was purchased in selected accounts. Qualcomm 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 Qualcomm's discount to intrinsic value, coupled with its potential for growth offer sufficient margin of safety.

Union Pacific Corp. (UNP) Union Pacific Corporation, operates railroads in the United States and offers freight transportation services. Infrastructure changes made after the turn of the century have positively improved capacity and prices, lowered costs, and thereby widened industry margins for the long-term. Negative headlines due to high profile railcar accidents, business interruption due to the west coast port shutdown, and forecasts for lower oil and coal railcar traffic have caused shares to weaken. Prices are currently attractive, allowing an opportunity to invest in a dominant and efficient railcar company.

Wal-Mart Stores, Inc. (WMT) With over $475 billion in annual global sales, Walmart has tremendous scale and pricing power which should drive long-term earnings power. The largest retailer in the world has seen its shares lag over the recent past, placing its valuation at an attractive level in our opinion. We have purchased the stock for selected accounts.

POSITIONS SOLD

Chemours Co. (CC) Chemours, formerly the performance chemicals business of Dupont, was recently spun-off to the company's shareholders. Shares were sold soon after the spin-off as the company did not fit the mold of a business we are typically interested in – it had no discernable moat. The company offers cyclically weak margins, free cash flows, and returns, and has no clear avenues for growth aside from a rebound in titanium prices. In addition, the company is saddled with over $4 billion in debt and seemed like a good candidate for a dividend cut.

International Business Machines Corp. (IBM) Shares of IBM were recently sold in taxable accounts. This was done primarily to generate tax losses to help offset some of the gains that we have taken so far this year in client accounts. Shares in non-taxable accounts were kept. We still have conviction in IBM and its ability to re-invent itself in the face of macro-economic headwinds. Shares of IBM are undervalued and may be reintroduced into portfolios at a later date.

Sysco Corp. (SYY) Shares of Sysco were recently sold in selected accounts based on valuations and despite the company's failed acquisition of U.S. foods (the company's shares were elevated largely based on the prospects of the acquisition). Proceeds from the sale have funded new portfolio purchases or have been redistributed to other portfolio holdings.

Portfolio Activity
Continued

REDUCTIONS OF EXISTING POSITIONS

Amazon.com, Inc. (AMZN) Shares of Amazon.com 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 Amazon.com continue to look attractive as a core holding in HCM portfolios.

C.H. Robinson Worldwide, Inc. (CHRW) Shares of C.H. Robinson 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 C.H. Robinson continue to look attractive as a core holding in HCM portfolios.

Clorox Co. (CLX) Shares of Clorox 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 Clorox continue to look attractive as a core holding in HCM portfolios.

PepsiCo, Inc. (PEP) Shares of PepsiCo 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 PepsiCo continue to look attractive as a core holding in HCM portfolios.

We Want More Great Clients Like You !!!

Do you know anyone who can benefit from our financial planning and asset management services? Horan is currently accepting new clients and we want more great clients just like you. Please contact your advisor today if you have a friend or family member who would be a good fit for our firm. We'll be happy to talk to them about their current situation and provide a complimentary financial consultation.

One of the greatest compliments you can give us is the referral of a friend or family member.

It's Fall, Have You Taken Your RMD?

In the calendar year in which you turn 70.5, your first required minimum distribution is calculated and must be taken no later than April 1st of the following year. Each year thereafter the amount is recalculated and must be withdrawn by December 31st. The accounts subject to RMDs include traditional IRAs, beneficiary IRAs, Simple IRAs, SEP IRAs, Keogh plans, 401k, 457 and 403b plan.

Some key points regarding RMDs:

- The RMD amount is calculated by taking the value of your account on December 31st of the prior year and dividing by your life expectancy factor for the current year, which can be found in the Uniform Lifetime Table compiled by the IRS.
- RMDs for beneficiary IRAs also use the December 31st value from the prior year, but a separate life expectancy factor. The Single Life Expectancy table is used for these accounts. Your life expectancy factor will be based on your attained age in the year after you inherit the IRA. Each year thereafter you subtract one from the previous year's life expectancy factor.
- Distributions may be made all at once, or on a periodic basis over the course of the calendar year.
- The deadline for completing your RMD is December 31st. The only exception is for your first RMD which can be postponed until April 1st of the following year.
- RMDs are taxed as ordinary income.
- RMDs are calculated on a per account basis. However, if you have more than one account subject to an RMD, the amount may be aggregated and disbursed from one account. As long as the full amount is withdrawn by December 31st, your obligation is satisfied regardless of which account the distribution came from.
- It is critical to take out what is required. Failure to take your full distribution will be met with a 50% penalty from the IRS on the amount not taken.
- Your custodian will calculate the RMD amount for each account and send the information out during the first quarter of the year.

Every year starting in October, our financial advisors review all accounts with an RMD to make sure owners have either taken a full distribution or are on track to do so by the end of the year. For those accounts that still need to have additional funds withdrawn to satisfy RMD requirements, we will be in touch during the quarter.

Potential Tax Reforms Loom as 2016 Presidential Race Heats Up

The 2016 Presidential Race is in full swing and one topic that will ultimately impact all of us personally is each candidate's stance on potential tax reform. Many of the candidates have already provided glimpses of what's in store and we expect the rest to follow suit in short order. We have seen a wide range of proposals thus far and thought it would be interesting to report what has been offered at this point by the candidates.

According to Taxfoundation.org, the information on the chart below includes the tax proposals offered since January 1st of this year. Along with the proposals on ordinary income and capital gains tax rates, candidates have also offered proposals on corporate tax rates and the estate tax. If a candidate is not listed, they have not yet specified their proposals.

Candidate	Rates on Ordinary Income	Rates on Capital Gains and Dividends
Jeb Bush	Three tax brackets with rates of 10%, 25% and 28%	Eliminates the net investment income surtax. Taxes interest income at capital gains and dividend tax rates.
Ben Carson	Flat rate of 10% to 15%, phased in over time	No specific proposal
Chris Christie	Three tax brackets ranging from 8% to 28%	No specific proposal
Hillary Clinton	No specific proposal	Raises rates on medium-term capital gains (< 6 year holding period) to between 24% and 39.6%
Ted Cruz	Flat rate, level not yet specified	No specific proposal
Jim Gilmore	Three tax brackets with rates of 10%, 15% and 20%	No specific proposal
Lindsey Graham	Flat rate in the high teens or low twenties	No specific proposal
Mike Huckabee	Eliminates the individual income tax and creates a federal sales tax rate of 23%	Eliminates the individual income tax and creates a federal sales tax rate of 23%
Rand Paul	Flat rate of 14.5%	Lowers the rate on capital gains and dividend income to 14.5%
Marco Rubio	Two tax brackets of 15% and 35%	Lowers the rate on capital gains and dividend income to 0%
Bernie Sanders	No specific proposal	Increases the net investment income surtax to 10%
Rick Santorum	Flat rate of 20%	Retains a 20% rate on capital gains and dividends income
Donald Trump	Four tax brackets of 0%, 10%, 20% and 25%	Lowers the top rate from 23.8% to 20% through the elimination of the surtax on investment income

Despite the wide variety in proposals listed above, it is interesting to note that, in general, there seems to be a concerted effort by everyone to simplify the tax structure. And of course, we all know that what is proposed early on is often refined by the candidate as the election progresses or modified post-inauguration to increase chances of passing through Congress.

From our standpoint, the proposals in all four areas of taxation would have an impact not only on your wallet today, but also on your long term financial plans and even our approach to managing your money. Even though we will not see any potential changes until 2017 at the earliest, we will be paying close attention to the proposals and the potential impacts to our clients' financial life.