July 6, 2015

Dear Friends of Coho Partners,

June was a good relative month for performance, but a bad month for absolute return with the S&P 500 and the Russell 1000 Value both down about 2%. The only sector to produce a positive return within the S&P 500 was Consumer Discretionary. The areas that suffered the greatest carnage this month were interest rate sensitive companies. Utilities were down 6.0% and the Alerian MLP index fell 8.3%. We have frequently been asked the question of how well will our portfolio hold up when rates begin to rise? We believe that our holdings will continue to perform well and although the month of June is a very short measurement period, we clearly were not impacted to the same degree as some of the more high yield oriented or interest rate sensitive areas of the market.

June's decline essentially erased all of the gains for the second quarter, leaving the benchmarks up fractionally for the quarter. Our performance was slightly behind the benchmarks for the second quarter and is mixed on a year-to-date basis. We are disappointed that we have not performed better on both an absolute and relative basis so far this year, but we are seeing companies with attractive valuations staying quite attractive, while stocks that already appear expensive are becoming even more so. We see a growing bifurcation in valuations and this is temporarily hurting our performance, but we are guarding against overpaying for consistent growth.

During the month, Reynolds American closed on its acquisition of Lorillard, which resulted in the portfolio receiving $50.50 of cash for each share and a fractional share of Reynolds American. As a result, we now have a small position in Reynolds and we redeployed the cash by increasing our weight in both Amgen and W.W. Grainger.

Our research effort at Coho Partners is primarily focused on understanding the long term operating and financial strategies of the companies in which we choose to invest, however, we remain vigilant on the macro issues as well. Clearly the crisis in Greece today is very much on investor minds and we would be remiss to not consider the consequences of the referendum vote on July 5th. This situation remains quite fluid, as it is as much a political issue as it is an economic issue. With Greece representing about 0.3% of global GDP and only about 1.3% of Europe's GDP, we do not believe the long term fundamentals of our holdings will be compromised in any meaningful way, regardless of the outcome. Perhaps this situation, along with the problems in Puerto Rico, can be the starting points for improving the long term viability of all Federal, State and Local entitlement programs.

At this specific moment in time, there does seem to be an above average number of domestic and international issues that could negatively impact valuations. As a result, we are on heightened alert to make sure our holdings are executing well and performing in accordance with our position papers. Additionally, when we make adjustments to position sizes we want to ensure that those changes are designed to lower overall portfolio risk by improving the expected returns and strengthening the portfolio characteristics, such as lowering the P/E, increasing yield and lowering beta.

We expect the upcoming second quarter earnings season will produce a wider range of outcomes for many companies. This recent pull back has improved expected returns for many of our holdings and we believe they are in a favorable "risk/return" position if they can deliver against their longer term earnings goals. As we begin the second half of this year, we have confidence in our ability to protect principal should the markets stay weak but still participate should a recovery ensue. Beyond this, we will carefully be monitoring the trends in the energy markets, the trade weighted US Dollar index and interest rates.

It is rare that we prognosticate on the magnitude or direction of market moves, and even rarer still that when we do, that we are close to being right. But since the end of last year, we have been concerned that the speed and magnitude in the drop in energy prices and a similarly dramatic increase in the dollar were going to flatten out corporate profits in 2015. Combining that with the understanding that the next move in interest rates will be up thus limiting any multiple expansion from here, led us to believe upside would be limited in the stock market for the time being. This has actually been the case so far this year and nothing much seems to have changed looking out over the next few quarters.

You may recall that oil, as measured by West Texas Intermediate prices (WTI) fell dramatically in the 4th quarter of 2014 from $91.17 at the end of September to $53.45 at the end of 2014. With WTI having bottomed twice at just over $44 in January and again in March, it is possible that we have seen the lows. WTI has now traded above $50 ever since April 15th. Our integrated energy holdings will have easier comparisons beginning in early 2016 and this could usher in two positives. One, earnings could begin to accelerate significantly, which could improve investor interest in this group and two, this acceleration will remove the current drag on the overall earnings for the S&P 500. With Energy being just over a 10% weight in the benchmark and earnings likely to be down 50% or so this year for the group, that alone is a 5% negative impact to S&P 500's earnings.

After a strong move up for the Trade Weighted US Dollar index, it actually fell a little more than 2% this past quarter. The strong dollar has negatively impacted reported results for many of our holdings because they have large international sales. Reported revenues for the S&P 500 will almost surely be down this year due to the dollar's strength, so any moderation in its appreciation would be a psychological positive.

Finally, we expect the Fed to be data driven in their ultimate action on rate increases. At this moment, it seems likely that the Fed will raise rates modestly sometime in the back half of this year. Any initial rate increases should not prove deleterious to equity prices from our point of view.

Overall, the second half of this year should prove to be quite interesting and we look forward to sharing our results as the year progresses. If you have questions or concerns about our outlook, please do not hesitate to call us.

We wish you all the best.

Peter A. Thompson

Brian L. Kramp, CFA