July 7, 2017

Dear Friends of Coho Partners,

For the month of June, the Coho portfolio increased just over 1%, modestly ahead of the S&P 500 and about 0.8% behind the S&P 500 Value Index. The month saw a notable reversal in sector performance, with Information Technology giving back some of its gains from earlier in the year and Financials recovering some of its losses versus the S&P 500. The Coho portfolio benefited from an overweight in Health Care, which appreciated 5%, and an underweight in Information Technology, which declined 3%.

From a stock perspective, Kroger provided disappointing earnings guidance leading to the underperformance of the shares. The company is dealing with a more competitive food pricing environment than expected and is investing in higher wages/hours to improve store productivity and shopping experience. This was disappointing, certainly, but we believe it is temporary and fixable, and not fatal to the investment thesis, and that longer-term Kroger can grow earnings in the high-single digits and the dividend even faster than that. Compounding the weak earnings release, however, was the unexpected announcement by Amazon that it intends to acquire Whole Foods. Amazon has clearly signaled its desire to enter the grocery business, but we believe there are a number of major challenges that could limit its success. First, acquiring, storing, curating, packing, and delivering fresh and prepared foods to your kitchen is much different than shipping standard, non-perishable items from a distribution center to your porch. Second, while the grocery business is large in terms of revenues, $600-900 billion annually, depending on how you measure it – profit margins are notoriously small. Finally, Amazon's primary price advantage versus retail was *not* being encumbered by the expenses and limitations of owning and operating the physical stores. Now it is. We don't discount Amazon's incredible and disruptive successes across many areas, and presume they will achieve some here. But Walmart and Kroger represent approximately 25% combined share of U.S. grocery and particularly in Kroger's case, have the scale, customer analytics, technology, and experience to successfully compete against Amazon. While it will certainly be fascinating to watch Amazon adapt, we believe that the myriad of smaller grocers that cannot spend enough to compete will be the likely victims. Kroger is now trading at about 11x EPS or a 34% discount to the S&P 500.

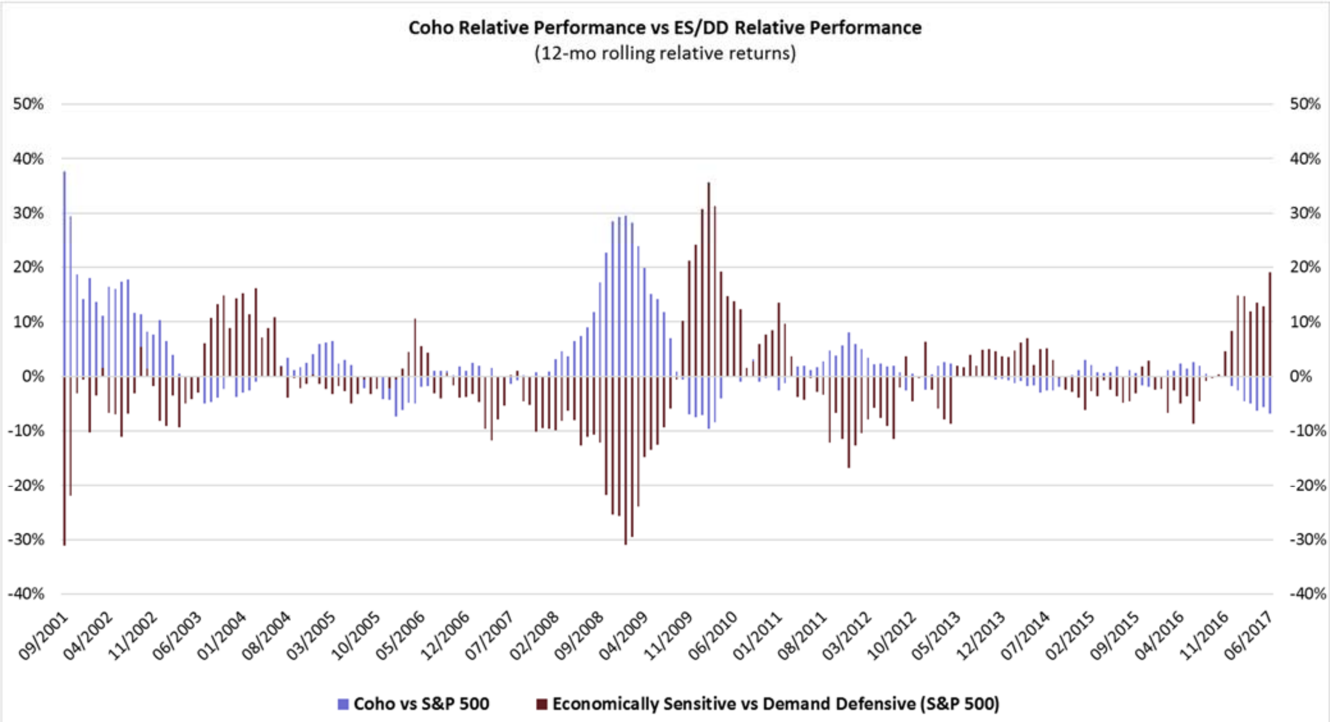
The company recently announced a dividend increase and a new $1 billion buyback authorization, representing about 5% of the market capitalization, which we expect to be executed over the next 12-18 months.

For the quarter, the portfolio was up 2.2%, lagging the S&P 500 by less than 1% but ahead of the S&P 500 Value Index by 0.7%. Sector performance was reasonably balanced between defensives and cyclicals, with Health Care the best performing sector, up 7%, followed by Industrials and Financials, each up 4%. Telecom and Energy were the only two sectors in negative territory, each down about 7%. Allocation was neutral for the quarter, with our overweight in Health Care and underweight in Telecom offsetting an underweight in Information Technology. Stock selection detracted from performance, with Grainger joining Kroger in delivering an earnings shortfall. In the case of Grainger, the company has accelerated pricing actions to consolidate share of large customers' spot buying needs and improve competitiveness with its profitable mid-size customer base. While negatively impacting margins in the near-term, we expect these actions to stimulate volume and drive market share gains over time. It is very early in this process; however, we are encouraged by the volume improvements to-date where these changes have been made. Lastly, Grainger is focused on driving its Canadian business to profitability, which we expect it to achieve in 2018.

On the positive side of the ledger, we had good performance from our Health Care holdings, with UnitedHealth Group, Abbott Laboratories and AmerisourceBergen all up about 10% and ahead of the sector's gain of 7%. Among the Financial holdings, State Street was up 13% on an improving earnings outlook and recently came through the annual capital review by Federal regulators with flying colors, being approved for an 11% dividend increase and $1.4 billion share repurchase program. The repurchase plan is 4% of the current market capitalization and this will be completed within the next 12 months.

With half the year now closed, the portfolio is up over 7% which lags the S&P 500 by a little more than 2% but is ahead of the S&P 500 Value Index by a little over 2%. There has been a massive gap between growth and value this year with the former leading the latter by 8.5%. In addition, the market gains have been narrowly focused on a handful of stocks, mostly within the Information Technology sector, with Apple, Amazon, Facebook, Microsoft and Alphabet accounting for about a quarter of the S&P 500's total return of 9.3%. The majority of these five stocks are not in our Coho 250 universe as they do not have the earnings, cash flow, and capital allocation stability and growth characteristics we require.

On a trailing one-year basis, the portfolio is up 10% lagging the S&P 500 gain of 18% and the S&P 500 Value gain of 16%. While we never like to trail the indices, over the history of Coho there have been similar periods of performance in the past, particularly during bull markets as illustrated in the following chart.



The chart shows 12-month rolling returns from inception for the Coho portfolio, with our relative performance (Coho vs S&P 500) colored in blue. Economically sensitive stocks versus demand defensive stocks (within the S&P 500) are colored in red. When economically sensitive stocks are outperforming significantly, as they have done over the past year (rising 25% against a gain of 5% for the demand defensives), the Coho portfolio tends to lag. This can clearly be seen in the bull market post the financial crisis in 2009 and in the bull market of 2003-2004 post the tech bear of 2000-2002. We have no way of telling how long the current bull market will last, though now more than eight years into it, we are mindful of our primary objective of protecting in down markets. In any case, we have been through periods like this before and while we look to participate in the market gains, we want to ensure we are true to our investment philosophy of protecting on the downside and providing outperformance over the market cycle with lower-than-market volatility. As such, we will continue to execute on the investment process, emphasizing companies that exhibit stable and growing earnings, cash flow and dividends.

As we prepare for the second quarter earnings season we are encouraged by what we have seen during the first quarter, with ten of our holdings increasing 2017 full-year EPS guidance, a significant development this early in the year. In addition, we saw eight holdings announce dividend increases during the quarter with notables including UnitedHealth Group at 20%, Lowe’s up 17%, State Street at 11%, and Marsh & McLennan up 10%.

In summary, it has been a challenging first half and trailing 12-months for relative portfolio performance as the economically sensitive segment of the market has rallied strongly and as we have had a few earnings disappointments among our holdings. Our research focus remains on the long-term operating and financial strategies of companies that possess what we believe are advantaged business models supported by strong balance sheets. We remain committed to our investment philosophy and process. While our philosophy is designed to build wealth over the long term and not necessarily every quarter, we fully expect to narrow our recent period of underperformance by adhering to the disciplines that have proven successful for us over the past 17 years. We look forward to updating you on our progress.

If you have questions or concerns about our outlook or the portfolio's positioning, please do not hesitate to call us.

Sincerely,

Brian Kramp, CFA   Christopher Leonard, CFA   Ruairi O'Neill, CFA   Peter Thompson