October 7, 2014

The third quarter of 2014 was fairly benign on the surface with the S&P 500 up 1.1% and the Russell Value 1000 index down 0.2%. The quarter was a little more turbulent underneath the surface, falling more than 2% by early August, rallying 5% off that low by early September and then trailing off again to end the quarter up just over 1%. Smaller cap stocks as represented by the Russell 2000 Index, had a very difficult three months, down 7.9%, their worst quarter since the third quarter of 2011. Outside of the stock market, the price of oil dropped from $105 per barrel to $90 per barrel while the US dollar rallied by almost 7% on a trade-weighted basis. The Coho portfolio did take modest advantage of the underlying market volatility and picked up approximately 1.9% for the quarter, putting us slightly ahead of the market over that timeframe and closing some of the gap for the year-to-date. For the first three quarters of 2014, the S&P 500 is up 8.3%, the Russell Value 1000 is up 8.1%, and the Coho portfolio is just behind at 7.7%. Overall, it has been another good year for the markets thus far, though not particularly remarkable.

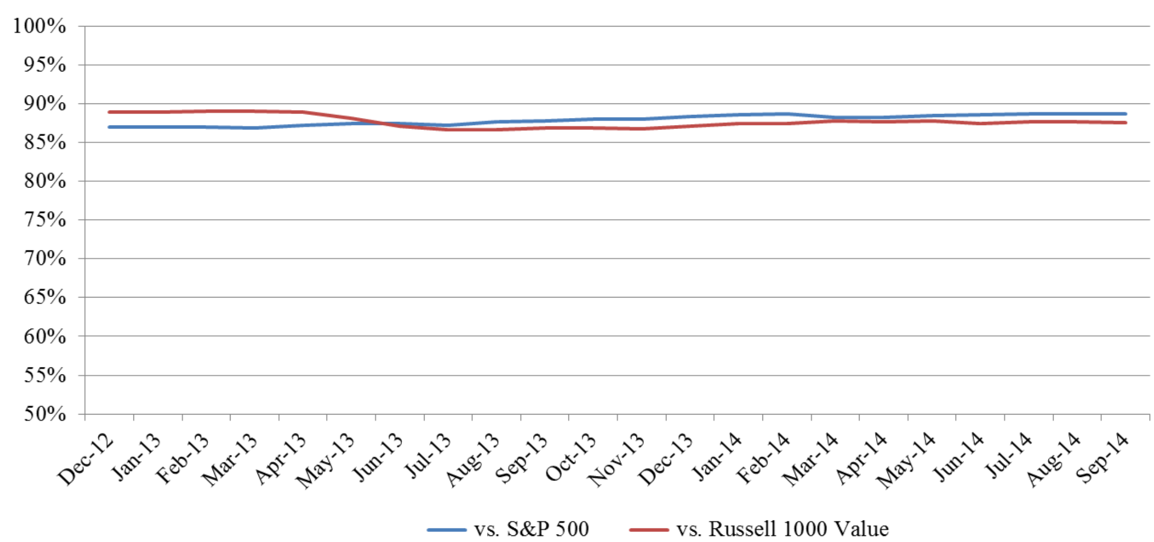
What has been rather remarkable, however, is when we look back over the past 1 ¾ years to the beginning of 2013. The S&P is up an incredible 43.4% over that time period. While the Coho portfolio has participated in this rally and broadly kept up with the market averages, we want to again highlight the manner in which these results have been achieved. From the table below, the Coho portfolio returns appear to be very much in-line with the U.S. large cap index returns for the two most recent calendar years, capturing approximately 96% of the recent upswing throughout the past 7 quarters.

	YTD 2014	**2013**
Coho Relative Value Equity (Gross of Fees)	7.7%	31.9%
Coho Relative Value Equity (Net of Fees)	7.4%	31.3%
S&P 500 Index	8.3%	32.4%
Russell 1000 Value Index	8.1%	32.5%

While the similarity in returns over that timeframe may suggest that the portfolio is just mimicking the market index, we encourage our clients to view these returns in a richer context. At Coho Partners, we evaluate every investment through a risk-oriented discipline. We focus a lot of attention on the stability and the predictability of a prospective company's fundamentals and populate the portfolio only with those companies that exhibit the characteristics that we believe will preserve our desired pattern of returns. Our investment process is rooted in its primary objective of providing downside protection during periods of stock market turbulence. A close secondary objective is to be reasonably competitive when the stock market is moving upward. As the market navigates through a full economic cycle, we believe the Coho pattern of returns is the most effective way to create and sustain wealth for our clients. Given this desired pattern of outcomes, we expect there will be times when our returns are much different from the market (during downturns) and much more similar to the market (during broad upturns).

Figure 1 below illustrates the concept of maintaining an 'active' investment approach relative to the broader market averages. We utilized the "Active Share" calculation to demonstrate, mathematically, how different the Coho portfolio is relative to the S&P 500 Index and the Russell 1000 Value Index. Active Share essentially measures the percentage of the portfolio market value that is different from the index market value. A fully active portfolio (completely different from the index) would have a maximum score of 100% and an index fund would have the minimum Active Share score of 0%. The figure below shows the Active Share of the Coho portfolio on a monthly basis since the beginning of 2013 through September 2014 has ranged between 87% to 89%. This implies that there is only 11% to 13% overlap with the index market value. The chart demonstrates that the Coho portfolio makeup is consistently and materially different, or 'active', versus each index.

Figure 1. Coho Relative Value Equity - Active Share (%)



Index proxies: SPDR S&P 500 ETF, iShares Russell 1000 Value Index ETF
Source: Thomson ONE Analytics, Coho Partners Ltd.

The 'active' orientation depicted above stems from the differentiated investment approach we apply at Coho Partners. Our research process favors companies whose business models are 1) reasonably impervious to economic shocks or dislocations and 2) growing their earnings at a rate similar to the market over time. To that end, our companies generally provide a product or service where demand is relatively inelastic, even amidst changing economic environments. This leads to consistent growth in earnings, cash flows and dividends over time. We also support these models by demanding strong balance sheets that offer further protection on the downside and financial flexibility during the good times. These characteristics overall are very much appreciated by investors during downturns and yet because these are competitively growing companies, they also remain attractive during expansionary times. Finally, through the implementation of our valuation discipline and portfolio construction methodology, we concentrate our investments in what we believe are the most compelling opportunities. We believe this 'active' orientation is central to our ability to manage risk in your portfolio and precisely what sets us apart from the index and our peers.

Meanwhile, we continue to exercise our value discipline and look to enhance the expected risk adjusted return in the portfolio at every opportunity. While the trades this quarter were not necessarily meant to be a pure swap from one into the other, they are not an atypical example of our portfolio management process.

Very early in the third quarter we sold Air Products (APD) and added to our position in Walmart (WMT). APD is an industrial gas company, with a fair amount of cyclicality given end customers in various parts of the manufacturing sector, albeit with APD's cyclicality lessened via take-or-pay contracts on a majority of its business. We had purchased APD several years ago when they were being punished for their cyclicality in a fearful market and some recent management missteps, despite having a wonderful business model and long term prospects. Over the ensuing years, along came a better outlook for the economy, an activist investor, promising new management, a much higher P/E multiple, and a higher set of expectations for the future, pretty much in that order. Always mindful of our downside risk, we feared that the valuation now required a near perfect economy and management execution to justify the stock price, so we eliminated the position.

Conversely, WMT is in a place similar in expectations to where APD was a few years ago, with a great business tainted by recent mediocre management performance and also by end markets (low income consumers) that have had a tough go of it. We are optimistic about the new management team at WMT, a promising new small-format store in the U.S., improved execution internationally and a low income consumer who should benefit from better employment and lower fuel prices over the intermediate term. In the process of selling APD and buying WMT, we lowered our P/E multiple, decreased our beta, increased our yield, lessened our cyclical exposure and we believe enhanced our forward expected return.

Stock	Trailing P/E	Forward P/E	Yield	5 Year Beta
Air Products	23	20.5	2.40%	1.09
Walmart	15.2	14.5	2.50%	0.46

There are plenty of old worries right now with Europe continuing to flail, the upcoming elections in the US, reasonably high valuations, high margins and a potential turn in Fed policies. And there are some new worries that weren't even on the radar screen several months ago such as Ebola, enterovirus, ISIS, protests in Hong Kong and a runaway dollar. But we've also seen improving job growth, lower fuel prices, higher consumer confidence and continued well-behaved inflation. We will be the first to admit that we're not particularly good at predicting markets, but we do feel particularly good about a differentiated portfolio filled with high quality companies with resilient earnings streams, growing dividends, great balance sheets and reasonable levels of expectations and valuations.

Please do not hesitate to call us with questions or concerns about our outlook or your portfolio. Thank you for your confidence and continued support of Coho Partners.

Sincerely,

Peter A. Thompson   Brian L. Kramp, CFA

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