Fourth Quarter 2010 Commentary

January 12, 2011

Dear Friends of Coho Partners:

The returns during the final month and quarter of this year were very generous and we captured the majority of this advance. Returns for the full year were greatly influenced by the returns this quarter. Given that we had outperformed over the first three quarters when returns were small, we posted a competitive full year return vs the benchmark. While nowhere near as extreme as 2009, 2010 was characterized by the market still favoring smaller capitalization, higher beta and more cyclical stocks and sectors. Despite these headwinds, our disciplined approach of owning high quality, growing companies with reasonable valuations produced a competitive return this year. Our performance was typical of what we would have hoped for as the breadth of this two year bull market broadened. The market ended the year with considerable momentum and expectations for another year of strong growth in 2011. At this point, we would cautiously agree with this assessment.

Table 1 shows how our Relative Value Tax Exempt composite has performed over the past one, three, five and ten year periods.

Table 1
Annualized Returns Gross of Fees for the Period Ending December 31, 2010

	1 Year	3 Years	5 Years	10 Years
Coho Relative Value	**16.0%**	**4.5%**	**7.1%**	**6.0%**
Russell 1000 Value	**15.5%**	**-4.4%**	**1.3%**	**3.3%**
S&P 500	**15.1%**	**-2.9%**	**2.3%**	**1.4%**

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Our conservative investment philosophy favors industries with understandable business models, above average profit margins, high recurring revenue streams and low capital intensiveness. Therefore, our advantaged universe of research ideas tends to include many consumer goods and staples companies and healthcare related companies. These companies make and sell products to an expanding universe of consumers around the globe. Our long term investment thesis for many of our companies is predicated on our belief that as global per capita incomes continue to rise and as more and more people move into the middle class, they will increase their consumption of these types of products. The majority of the world's population currently lives in developing or emerging countries, where the demand for these products is still small. However, over time this will change and the consumption from these countries will ultimately dwarf the consumption that presently comes from the developed markets. As an example, private consumption in China today is estimated at $1.7 trillion vs $10 trillion for the U.S. By 2020, China's private consumption should grow to $11.2 trillion as 270 million Chinese consumers move into the ranks of the middle class. This is roughly equivalent to the size of the middle class in the U.S. today. (1) If correct, this implies a 20% annual increase in private consumption.

(1) From Proctor & Gamble's 2010 Investor Day Conference

The world is being segmented into "developed", "developing" and "emerging" countries and although there is some disagreement as to where each country falls, it is safe to say that the largest population base remains in the developing and emerging nations. The BRICIT countries (Brazil, Russia, India, China, Indonesia and Turkey), which are a major part of the developing and emerging markets are the focal point for many global companies. These six countries represent a major growth opportunity over the next decade and if we use these countries as a proxy for our investment thesis of rising per capita incomes over large population bases, the magnitude of the investment opportunity becomes apparent. Table 2 shows recent per capita GDP across these six countries and how this compares to the world and to the U.S.

Table 2
2009 Per Capita GDP on a Purchasing Power Parity Basis (2)

Brazil	Russia	India	China	Indonesia	Turkey	World	USA
$10,427	$18,945	$3,275	$6,838	$4,205	$13,905	$10,706	$46,436

(2) Wikipedia (http://en.wikipedia.org/wiki/list_of_countries_by_GDP_(PPP)_per_capita)

Per capita GDPs for the BRICIT nations are many multiple times smaller than ours. It is unrealistic to expect any of these countries to approach our per capita level any time soon, but it is not unrealistic to see these gaps close over time. One example that we could cite would be the fact that over the past ten years, India's per capita GDP has doubled, while ours has obviously not. At a recent P&G Investor Day conference, management showed per capita consumption of P&G products by country, which highlighted the differences across developed and non-developed geographies.

Per Capita Sales of P&G Products in Select Countries

U.S.	$96
UK	$66
Germany	$41
Mexico	$20
China	$3
Indonesia	$1
Sub Sahara Africa	$1
India	$0.70

Again, we do not expect many of these countries to reach our level of per capita spending, nor does P&G management, but if China, Indonesia, Sub Sahara Africa and India's consumption got to Mexico's level, it would increase P&G's revenues by $60 bil, which is about 75% of its current base. The reality is that the success of our investment thesis is much more tied to rising per capita incomes than it is to further population growth.

However, as logical as this thesis is for industries such as consumer goods and healthcare related companies, it also has application for many industrials. Consider the outlook for 3M, a world class manufacturer of a wide range of consumable and industrial products, which was given at a recent investor conference. Table 3 depicts their long term forecast by geography.

Table 3
Share of Global GDP

	2010	2040
China	9%	29%
India	3%	13%
Other Developing	26%	29%
Total Developing	**38%**	**71%**
U.S.	23%	12%
Western Europe	26%	12%
Other Developed	13%	5%
Total Developed	**62%**	**29%**

If 3M management is even close to correct in their forecast, this would suggest that the real growth driver to future global GDP growth will come from the "developing nations" and this would only be happening if per capita incomes are rising in those countries.

So, to sum up, when you combine rising incomes in countries with large population bases, you should get a wonderful business tail wind that should last for decades. We have noted before in some of our writings that millions of people are moving each and every year from rural locations to more urban locations. This is particularly true in the BRICIT nations. The reason for this change is directly related to their upward financial mobility. Although the definition of an "urban area" varies amongst countries, we have seen reports that estimate that roughly 44% of the world's population now lives in an urban area, which is up from 27% in 1990 and 37% in 2000.

Looking out through 2011 and beyond, we are encouraged by the prospects for our companies. The portfolio consists of a reasonably concentrated group of companies with well defined operating strategies and the financial resources to achieve them. The portfolio's dividend yield remains higher than that of the benchmark, and we would note that all but three of our holdings increased their dividend in 2010. The P/E multiple for 2011 essentially matches that of the benchmark, but we believe that the sustainable earnings growth rate for our holdings is better than that of the benchmark. These companies have strong competitive market positions and healthy balance sheets with which to build long term shareholder value.

We hope you all had an enjoyable holiday season with family and friends. We look forward to updating you on the opportunities and challenges that start with every new year. In the meantime, please do not hesitate to call us if you have questions.

Sincerely,

Peter A. Thompson
Partner

Brian L. Kramp
Partner

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