January 7, 2016

Dear Friends of Coho Partners,

Looking back on 2015, we are reminded of the famous Forrest Gump quote "Life is like a box of chocolates. You never know what you're going to get." The year was filled with some "highs" and some "lows" and when all the dust settled, many benchmarks finished not far from where they began the year. The 4th quarter was by far and away the best quarter of the year, with the S&P 500 advancing 7.0% and the Russell 1000 Value gaining more than 5.6%. For the year, "growth" outperformed "value", "large" outperformed "small" and domestic exposure did better than international. These same divergences were even more pronounced when examined over the full year. For all of 2015, the S&P 500 rose 1.4%, while the Russell 1000 Value declined by 3.8%. The ten largest companies in the S&P 500 jumped about 18%, while the S&P Small Cap Index declined 2.0%. U.S. stocks this year thrashed foreign or emerging indices as the MSCI All Country World ex USA index fell 5.7%, while the MSCI Emerging Markets declined nearly 14.9%. These are all extremely large differences, which produced reasonably large divergences in benchmark returns. We would not be surprised to see a reversal in some of these trends.

At Coho Partners, we finished the year on a high note. We were essentially unchanged in December vs -1.6% for the S&P 500 and -2.2% for the Russell 1000 Value. For the quarter, we were virtually even with the S&P 500's strong 7.0% return but better than the 5.6% return seen for the Russell 1000 Value. However, for the full year, performance was mixed depending on your benchmark. We lagged the S&P 500 by 1.1% with our return being up about 0.3% vs 1.4% for the index. Against the Russell 1000 Value Index we compare much better since that index fell by 3.8%. All in all, we would have liked to have performed better.

For the year, there was also a wide disparity in sector returns. The price of crude finished 2014 at $57.33/ bbl but fell throughout the year and closed at $37.04, down 35%. Not surprisingly, therefore, Energy was the worst performing sector, falling more than 21%. This sector will likely remain very unstable and the recent heightened tensions in the Middle East will likely only add to the volatility. We remain modestly overweighted to Energy, but with all of our exposure in large integrated energy companies where we still believe the dividends are safe, the business models less volatile and normalized valuations very attractive. The best performing sector for the year was Consumer Discretionary up 9.8%, where we were slightly underweighted in our portfolio. Health Care and Consumer Staples, where we have large overweights, were the two next best sectors up 7.0% and 6.6% respectively, leading to a slightly positive impact overall for our sector allocations within the portfolio.

There are many issues to consider for 2016. One of the more critical items would be the trajectory of global GDP, which because of the exposure of the U.S. economy and stock market to foreign economies, will impact our markets. Global GDP in 2015 looks like it will come in around 3.1%, which is lower than the 3.4% posted in 2014 (source: FactSet). Estimates for 2016 appear to show an increase to 3.6%, with the U.S. holding near 2.3%, the Eurozone continuing to improve off its estimated 1.5% growth this year and then China slowing somewhat, but possibly still growing more than 6%. Emerging markets, such as Brazil and Russia, will likely struggle again this year with the low commodity prices and their geopolitical unrest. Much of the global GDP growth will be influenced by China, and we are skeptical in fully trusting any of the information that is released by their Government. Bottom line, we expect a similarly sluggish global environment in 2016 as per the last two years, so not a lot of help here.

Earnings growth for the broad indices will also be a prime consideration for the stock market this year. Trailing earnings for the S&P 500 for the year ending 09/30/2015 were up just 0.6% vs. the year ending 09/30/2014, while the P/E multiple on these earnings as of 12/31/15 was 17.4x vs a similar multiple of 17.6x at the end of 2014. The current year now seems to be shaping up in much the same way. While we had been expecting relatively easy comparisons in 2016 vs the weak energy prices and the strong dollar of 2015, this past year ended with oil prices at a new low and the dollar making new highs. If these levels remain where they are throughout 2016, then this will likely lead to flat to down S&P 500 EPS this year. Over 40% of the S&P 500's revenues are generated overseas and the strong dollar makes it more difficult to compete in foreign markets and also translates into lower EPS when foreign revenues are converted back into dollars. The massive contraction that we are seeing in the Energy sector given the low oil prices not only impacts Energy company earnings, but also the earnings of many other companies in the Industrial, Material and Utility sectors which are dependent to some degree on Energy capital spending and the various energy and commodity prices. Even many Financial companies (lenders) are likely to see more stress at the margin from loans made to these sectors and also to the Emerging Markets, which again, are heavily dependent on commodity prices.

The positive effects of lower energy/commodity prices on consumer real incomes and lower raw material costs used by corporations in the goods they produce, while meaningful, have not been enough yet to fully offset these negative impacts. We've seen some strong consumer spending in areas such as new automobile sales, but we have not really experienced the broad spending gains as in previous recoveries. One of the areas for a potential upside surprise could be that 2016 is the year the U.S. consumer "breaks out" because the unemployment rate is down, wages are trending up, inflation is controlled and consumers' net worth is up.

Finally, with the Federal Reserve now starting to increase the Fed Funds rate, while not exactly what we would call tightening, is indeed now less "easy" at the margin. We think it highly likely that this "tightening" will be a very slow and deliberate process in 2016, and therefore unlikely to have much impact on valuation multiples or market fundamentals for that matter. As such, given the outlook for flattish earnings and multiples in 2016, this year could look very similar to last. That said, given that we said this same thing this time last year AND it actually happened, it is much more likely that we will be way off the mark for reasons not anticipated here.

And so we will remain in our traditional posture of overweighting "demand defensive" companies while continuing to have some "economically sensitive" exposure, but only to the most high quality companies within those sectors. We expect dividend yield could supply a good portion of the total rate of return, so we will also remain focused on companies that pay a dividend and more importantly, those that tend to grow it annually. In 2015, all of our holdings with the exception of Chevron, Royal Dutch and Omnicom increased their dividends. Income growth for the Coho portfolio in 2015 was about 8%. We expect dividend growth in 2016 for the Coho portfolio to exceed that of the S&P 500, with analysts projecting dividend growth of just over 6% and we expect our portfolio to be closer to 8%.

In summary, the portfolio remains focused on companies that are positioned to deliver consistent earnings, dividend and cash flow growth at reasonable valuations.

As we look forward to a new year, we want to properly end this past one by sincerely thanking you for your continued confidence in Coho Partners. We continued to strengthen the firm this year through strong hires of John Musser in client relations and just a few days ago with Eric Hildenbrand in our Private Wealth group. We'd also like to take the opportunity to announce two new equity partners at Coho, Wayne LeSage and Ruairi O'Neill. We think it critical for our key employees to be significant owners of the firm to best align their long term interests and incentives with the success of you, our clients, which is the only way that we collectively succeed.

If you have questions or concerns about our outlook or the portfolio's positioning, please do not hesitate to contact us. In the meantime, we wish you a very peaceful and prosperous 2016.

Sincerely,

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