January 5, 2017

Dear Friends of Coho Partners,

The year 2016 ended well as the benchmarks posted meaningful gains in December. We participated in the advance, but not to the extent of the benchmarks. For the year, we also lagged the benchmarks but our absolute return was about 10%. We never like to underperform, but the pattern of returns this year was consistent with past practices. The first half of the year favored the more defensive sectors with the S&P 500 up just under 4% over that period. Telecommunications and Utilities led with 20%+ returns, while Energy, Real Estate and Consumer Staples also performed well with first half returns above 10%. The market tilt to favor low beta was equally dramatic as the lowest two beta quintiles outperformed the highest three quintiles by about 800 basis points. Since we tend to favor these more defensive sectors, we had a modest advantage over the Russell 1000 Value Index and a more meaningful lead over the S&P 500 at mid year. However, the second half of the year favored the more economically sensitive sectors and within those sectors, the higher beta companies. Those factors presented a headwind for us. The strongest second half sector was Financials, which rose by nearly 30% and a good portion of this return came post the election when the Federal Reserve officially raised the Federal Funds rate by 25 basis points. Technology and Industrials were the next best sectors with double digit returns, but Real Estate, Utilities, Consumer Staples, Healthcare and Telecommunications were actually down for this period. Higher beta stocks swamped lower beta stocks by over 14%. Hence, when you combine these different periods for the entire year, our 10% advance lagged the S&P 500 by about 2% and the Russell 1000 Value by about 7%.

It has now been eight straight years of positive returns for the S&P 500 and over this period, the S&P 500 has gained nearly 200%. The Russell 1000 Value Index actually declined in 2015, but it has risen in seven of the past eight years, while advancing about 175%. These returns equate to annualized rates of well over 13% per year. At Coho Partners we aim to be competitive during rising markets, and we returned about 190% over this same period. This surpassed the return of the Russell 1000 Value Index and nearly matched the return for the S&P 500.

January of 2017 will usher in a new President and his economic priorities would appear to be pro-business and possibly good for financial markets. Although our research effort is very much a bottom up, company specific process, we do believe there are four primary policy levers that can significantly impact valuations: they are fiscal policy, regulatory policy, monetary policy and trade policy.

In terms of fiscal policy, we believe this could be turning into a positive force. Clearly the President Elect has been vocal about lowering both corporate and personal taxes. We believe this would be beneficial to the economy as it would raise after-tax earnings for companies and give tax paying consumers more discretionary income. A possible secondary benefit would be the narrowing of the corporate tax differential between countries which could alleviate some of the desire to move businesses out of the U.S.

Eliminating unnecessary regulations would also be a positive for economic growth. The Financial sector is the poster child for excessive regulation and this sector's recent outsized advance is surely related to the hope that some regulatory relief will come. More regulation in general raises the cost of doing business, which in many cases cannot be passed on to the consumer. Hence over-regulation can negatively impact both current margins and long term growth prospects. We are not advocating an elimination of all regulations, but we do believe there is room for some prudent reductions in overly burdensome or extraneous regulations which would not hurt the economy or compromise the safety of consumers.

It would appear that the Federal Reserve is now on a measured course of gently and methodically raising short term rates. The current consensus thinking is that the Fed will have two rate hikes this year. Given that the current Fed Funds rate is only 50 basis points, we believe there is ample room for multiple rate increases before it would compromise economic activity and equity valuations. We do consider the current Fed stance to still be very accommodative, but to a gradually lessening degree, until real rates rise considerably higher. So this policy lever is not a major concern at the moment.

Trade policy is the one which we worry most about because we generally favor free trade over limited trade or worse, trade wars. The positive slant here would be that the U.S. may be successful in tilting the current trade environment to be more favorable to the U.S. by taking better advantage of our scale and the strong long term relative growth prospects of our economy. The negative outcome would be some sort of trade war resulting from the new administration upsetting the status quo. So here the outlook is much less clear, but we would hope that cooler heads will prevail and that the focus would be on expanding global GDP, which would be beneficial to all.

Therefore, at the margin, most of these levers now appear to be moving in more favorable directions from the standpoint of the economy. We will be monitoring all of these possible policy developments, but our primary focus will remain on analyzing the long term operating and financial strategies of the companies within our research universe. The attractiveness of each holding within the portfolio varies, but collectively we are encouraged by the potential of the overall portfolio. We typically expect each of our companies to post higher earnings in the new year than they did in the prior, and we would further expect each company to raise its dividend. In 2016, all but one of our companies raised its dividend, so this forecast is very similar to past years. If energy prices can hold at today's level, we should see improving earnings from our integrated energy holdings. This was the only sector in our portfolio to show down earnings in 2016. It is impossible to forecast short term results, so we will stay focused on the longer term and to that end, we remain confident and optimistic. Many of the holdings in the portfolio are poised to deliver margin expansion and earnings growth independent of the macro environment. Examples of such "self-help" positions include Amgen, Becton Dickinson, Illinois Tool Works, Lowes, Microchip Technology and State Street.

As we look forward to a new year, we want to sincerely thank you for your continued confidence in Coho Partners. The people at Coho Partners are committed to providing a consistent pattern of returns, which should provide meaningful protection during declining markets and competitive returns during the rising markets. Furthermore, we also are committed to providing outstanding client service. To assure ourselves of these pledges, we welcomed five new professionals to our family this year. Jacqueline Pasquarello joined the investment team as our first dedicated trader. Though we don't trade often, it has been nice having Jackie available to handle these duties and add depth to our operations team. Our distribution team expanded by two members. Lisa Marlin arrived to elevate our client relations effort, and Jena Dietrich joined as our first full-time head of marketing. Jena focuses on our website, client and marketing materials, requests for proposals and other brand-related matters. Our private client group gained one person and sadly lost another. Sheila Heenan, who was one of our longest tenured employees, recently lost her brave battle with cancer. She will be greatly missed by all of us at Coho Partners and many of you who enjoyed her warm personality. Roseann Dittmar joined our team to assist in the internal servicing of our private clients. Finally Brian Gibson joined the business operations group to assist in managing all the operational aspects of the firm.

In 2017, we plan to add professionals to the client relations and investment teams as qualified candidates are identified.

We'd also like to take the opportunity to announce that Joanne Powell, who has been with us for three years became our latest equity partner. We think it is critical for our 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. In the fullness of time, we expect all members of our firm to be equity partners.

If you have questions or concerns about our outlook or the portfolio's positioning, please do not hesitate to call us. In the meantime, we wish you a very peaceful and prosperous 2017.

Sincerely,

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