Coho Relative Value Equity

Monthly Portfolio Commentary

December 31, 2024

As we reflect on 2024, we are disappointed with the performance of the Coho Relative Value Equity portfolio. The year presented us with many of the same challenges as 2023 with breadth remaining narrow, the Magnificent 7 driving the preponderance of returns, Growth trouncing Value, and Economically Sensitive sectors handily outperforming our preferred Demand Defensive sectors. While those factors played a meaningful role in our relative underperformance, we also endured an unusual number of stock-specific issues. Some were fundamental challenges like Dollar General and CVS Health Corporation, some related to inherent (though elongated) cyclicality like Microchip Technology, and some were frankly unimaginable like the late-year weakness in UnitedHealth Group following the murder of one of its senior executives. The year ended with the S&P 500 Index up 25%, the Russell 1000 Value Index up 14%, and the Coho Relative Value Equity portfolio up less than 1%.

Our process is designed to provide downside protection with reasonable upside participation. With the rather extreme factor headwinds in 2024, our upside participation remained challenged, but we should have performed better with our stock selection. Throughout 2024, we maintained our focus on continually improving the portfolio's return and risk profile. Most recently this included adding new names like insurance holding company, W.R. Berkley, and auto parts retailer and distributor, AutoZone. Neither stock has previously been owned in Coho's 25-year history. We have also worked to enhance our process while staying true to our disciplines and philosophy. This includes additional quantitative analysis of the Coho 250 universe and heightened attention to our Position Papers, a tool that has proved invaluable to our performance over time.

Performance in 2024 does not accurately reflect Coho's demonstrated long-term pattern of returns that, even inclusive of recent performance, has delivered ≥100bps of annualized outperformance versus the S&P 500 and Russell 1000 Value indices over the past 25 years with lower volatility of returns. As we look forward, we remain confident in the ability of the portfolio to deliver consistent fundamentals (Table 1) in line with those that have produced that outperformance over the past quarter century. Markets can overlook that consistency in the short term, but history has shown that stock prices always follow fundamentals over the long term.

Table 1
EPS Compound Annual Growth Rates

	Trailing 10-year		Forward
	Projected	Actual	2-year
S&P 500	11.4%	7.3%	13.9%
Russell 1000 Value	8.2%	3.9%	12.0%
Coho Relative Value	8.8%	8.3%	8.4%

Sources: Coho Partners, FactSet

The past year proved once again that there is the Magnificent 7 and then there is everything else. The Mag 7 contributed 55% of the S&P 500's impressive return, with NVDA alone accounting for more than 20%. The dominance of that small cohort of stocks resulted in a record high concentration of market cap among the top 10 names in the index, which reached nearly 39%, well above the dot.com peak of 27% (Chart 1).

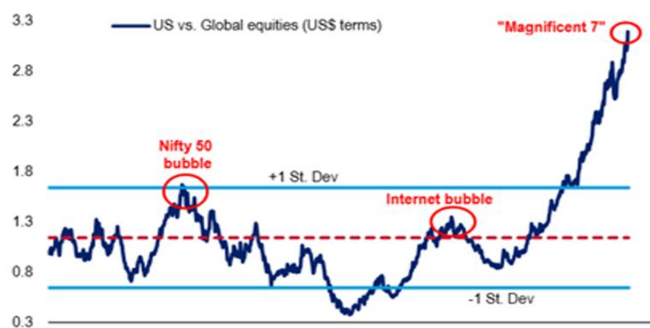
Chart 1
Top 10 Companies % of S&P 500 Market Cap

Sources: BofA Global Investment Strategy, Bloomberg

Earnings justified some of that move, but multiple expansion played an outsized role just as it did in 2023. Market structure dynamics play a part in this, particularly the shift to passive indexing which forces each dollar invested in the S&P 500 to buy $0.38 of the Mag 7 stocks regardless of valuation. But as 2022 demonstrated, momentum works both ways and modest shifts in expectations can create large moves not just up, but also down. As Table 1 shows, the market tends to be optimistic about earnings growth and estimates for 2025 currently point to an above average 15% expectation for the S&P 500. At a forward P/E of 21.5x, the market is priced for the good times to continue.

We sense an unusual level of complacency among investors amidst a robust list of potential pitfalls. The overwhelming consensus is that a soft landing has been achieved, and any talk of a recession has all but disappeared. We appreciate and tend to agree with the American exceptionalism argument. But as Chart 2 on the following page shows, investors have priced in an exceptional level of exceptionalism compared to the rest of the world. We also see froth in the Nasdaq 100 which is hovering around all-time highs versus the S&P 500 implying that Technology is not only dominant but more dominant than it has been at any time in history (Chart 3).

Chart 2
U.S. Dollar Value of U.S. Equities vs. Global Equities



Sources: BofA Global Investment Strategy, Bloomberg

Chart 3
Nasdaq 100 vs. S&P 500 Relative Price

Sources: BofA Global Investment Strategy, Bloomberg

Like others, we marvel at the transformative technologies being developed and deployed, but we are risk averse at our core and remain leery of extremes. Many contend that there are limited signs of a bubble like that which occurred during the dot.com era. We might point to a former dot.com boom and bust turned leveraged Bitcoin play with MicroStrategy being added to the Nasdaq 100 on December 23rd as an example. More fundamentally we look to Morgan Stanley's latest CIO survey that highlights the "high hurdles to enterprise AI adoption" where reluctance among respondents included a lack of actual use cases, prohibitive costs, unproven returns, and data and security concerns. Yet the largest hyper-scalers are forging ahead undaunted with capital expenditure budgets for just the top four spenders (Amazon, Microsoft, Google, and Meta) ballooning to levels 40% higher than expected just 12 months ago.

The dot.com bubble burst when it became clear that acceptable returns on excessive spending would never be realized. Table 2 shows that, like today, Technology companies dominated the S&P 500 at the peak in March 2000. A short nine months later half of those Tech companies fell out of the top 10 and the remainder saw their weights shrink by more than 40%. Today's Tech dominance is even more extreme, and to the argument that "it's different this time," perhaps it is, but in March of 2000 the weight was also concentrated in very profitable companies.

Table 2
Top 10 Weights in the S&P 500
(Blue shading denotes company in the Technology sector)

As of: 3/24/2000	S&P 500 Weight
Microsoft	4.5%
Cisco	4.2%
GE	4.0%
Intel	3.6%
Exxon Mobil	2.1%
Wal-Mart Stores	1.9%
Oracle	1.9%
IBM	1.7%
Lucent	1.6%
Citigroup	1.6%
Top 10 Weight	**27.1%**

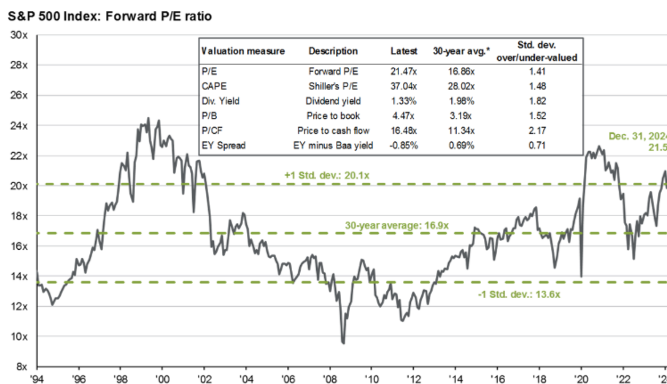
As of: 12/31/2000	S&P 500 Weight
GE	4.1%
Exxon Mobil	2.6%
Pfizer	2.5%
Cisco	2.4%
Citigroup	2.2%
Wal-Mart Stores	2.0%
Microsoft	2.0%
American Int'l Group	2.0%
Merck & Co.	1.8%
Intel	1.7%
Top 10 Weight	**23.2%**

As of: 12/31/2024	S&P 500 Weight
Apple	7.6%
NVIDIA	6.6%
Microsoft	6.3%
Amazon	4.1%
Alphabet	4.0%
Meta	2.6%
Tesla	2.3%
Broadcom	2.2%
Berkshire Hathaway	1.7%
JPMorgan Chase	1.4%
Top 10 Weight	**38.7%**

Sources: FactSet, Coho Partners, Ltd.

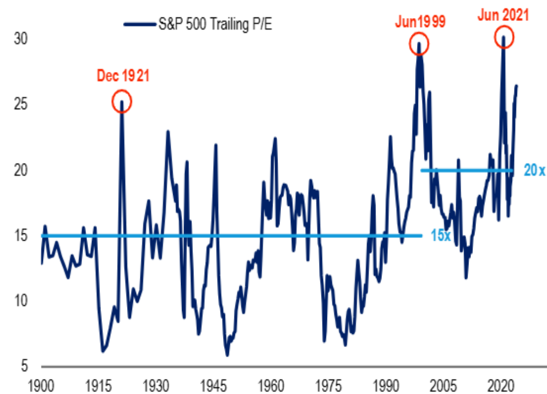
Our underperformance in part has been a result of our adherence to our philosophy and valuation discipline. We believe we would sacrifice our ability to provide downside protection if we chased Technology stocks higher or abruptly shifted the portfolio towards highly cyclical sectors perceived as election beneficiaries like Financials and Industrials that drove the preponderance of the Russell 1000 Value return this year. Chart 4 below shows the market is objectively expensive by most measures, and Chart 5 highlights that the S&P 500 trailing P/E is at its fourth highest levels in the past 125 years.

Chart 4
S&P 500 Forward P/E



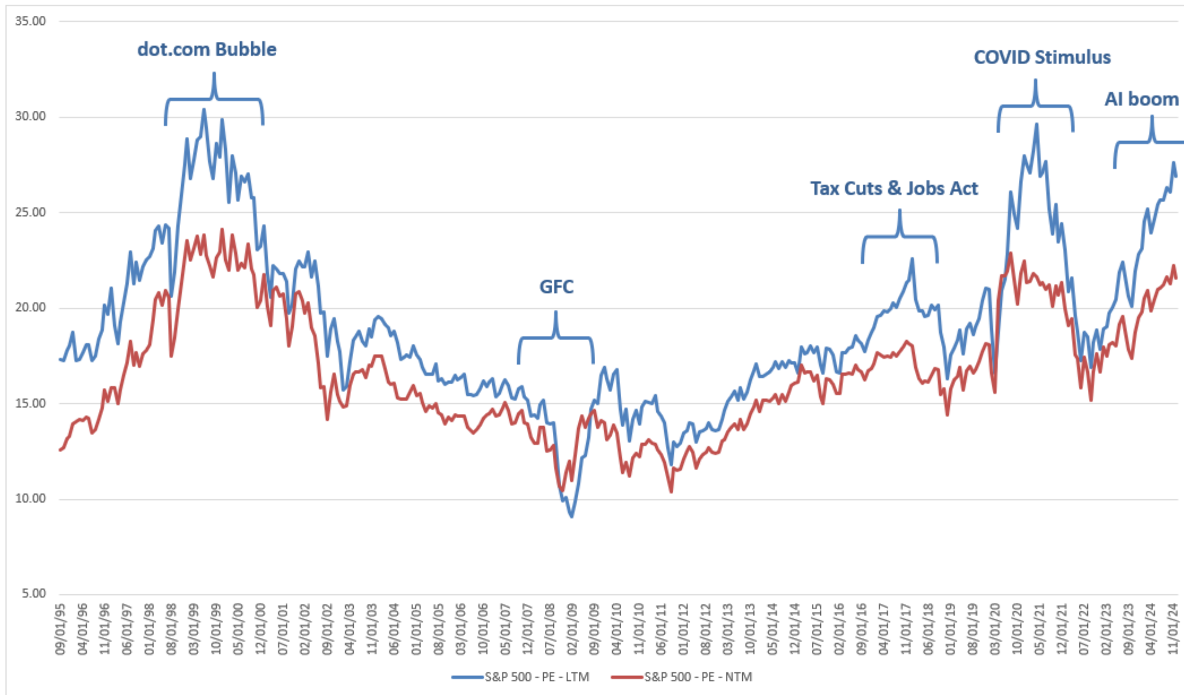
Sources: FactSet, FRB, Refinitiv Datastream, Robert Shiller, Standard & Poor's, Thomson Reuters, J.P. Morgan Asset Management

Chart 5
S&P 500 Trailing P/E



Sources: BofA Global Investment Strategy, Bloomberg

Chart 6
S&P 500 Trailing 12-mth P/E vs. Forward 12-mth P/E

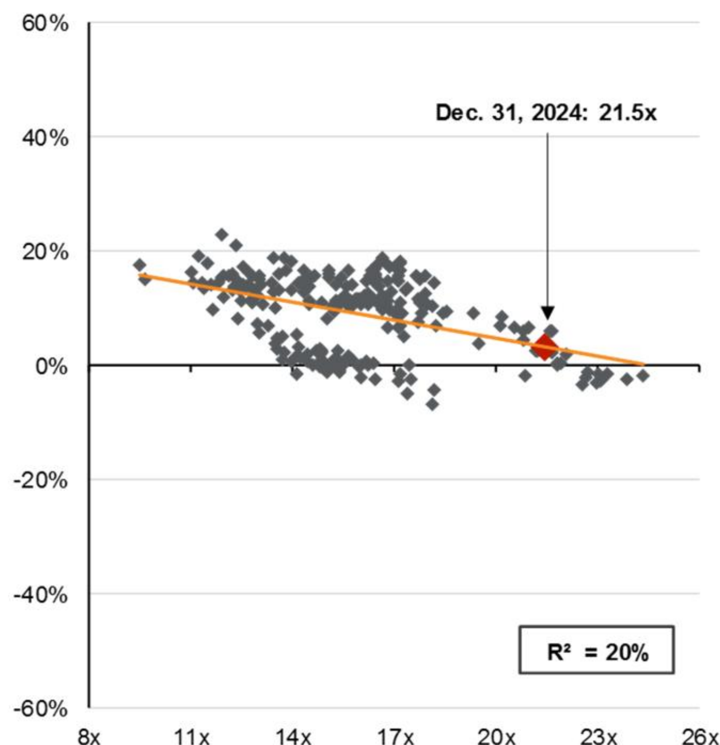


Sources: FactSet, Coho Partners, Ltd.

It is also instructive to look at the spread between the trailing and forward P/E over time. Chart 6 above shows that the spread has widened ahead of almost every meaningful market correction over the last 30 years. The lone exception was the Great Financial Crisis when the forward P/E of the S&P 500 was a modest 15.1x. To us this implies that as valuations rise (i.e., multiple expansion vs. earnings growth driving performance), investors seek to justify those valuations by assuming robust earnings growth in the year ahead to make forward multiples appear more palatable. Said another way, investors are discounting robust future growth with the assumption the stocks will grow into their lofty valuations. As Table 1 showed, forward earnings projections routinely overshoot. This is something to keep in mind with consensus assuming 15% earnings growth for the S&P 500 in 2025 and the trailing vs. forward P/E gap widening again.

Studies of the market show that valuation often does not matter in the short term, but it always matters in the long term. That generally means that when we enjoy excess returns in the near term, we should expect less robust returns going forward. Chart 7 on the following page plots the expected 5-year forward rate of return for the market at any given P/E multiple. At current levels, it suggests low- to mid-single annualized returns are a reasonable expectation. Similarly, looking back over the past 80 years, when the market rises more than 40% over a two-year period as it did in 2023 through 2024, the average return in the following year was 4% with the median return <1%.

Chart 7
S&P 500 Forward P/E vs. Subsequent 5-year Annualized Total Return



Sources: FactSet, FRB, Refinitiv Datastream, Robert Shiller, Standard & Poor's, Thomson Reuters, J.P. Morgan Asset Management

If we are entering a period of more modest returns, that bodes well for our preferred Demand Defensive sectors. Table 3 shows that over the past 30 years, in periods in which the S&P 500 returns 10% or less, Demand Defensives have outperformed 100% of the time. When it returns 20% or more, Economically Sensitive sectors have outperformed 100% of the time. Looking back over the last 100 years, the number of annual returns above and below that 10% threshold have been roughly even which speaks to the tendency of markets to mean revert.

Table 3
Demand Defensive vs. Economically Sensitive Performance in Various Return Environments

	Demand Defensive Outperforms	Economically Sensitive Outperforms
Outperformance in down markets	100%	0%
Outperformance when S&P 500 returns 0% to 10%	100%	0%
Outperformance when S&P 500 returns 10% to 20%	14%	86%
Outperformance when S&P 500 returns >20%	0%	100%

Sources: FactSet, Coho Partners, Ltd.

We face many years in which we will lag on the upside due to our preference for defensive sectors, but as Table 4 illustrates, there have only been two years in Coho's 25-year history when the spread between Demand Defensive and Economically Sensitive sectors has exceeded 20%. Those years were 2023 and 2024. If we look back five years before our founding we can add one more example, 1999, the year before the dot.com bubble burst.

Table 4

Demand Defensive vs. Economically Sensitive Relative Performance									
1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
7.5%	-9.7%	4.7%	1.8%	-36.8%	38.6%	3.8%	10.2%	-14.6%	-4.5%
2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
2.7%	-2.8%	5.2%	15.2%	-15.1%	-10.5%	16.7%	-4.1%	-0.4%	11.6%
2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
5.6%	-13.4%	-5.7%	8.0%	-10.4%	-9.5%	-7.6%	21.3%	-35.2%	-23.6%

Sources: FactSet, Coho Partners, Ltd.

As we noted at the outset of this commentary, our performance this year was disappointing and did not meet the expectations we set for ourselves and our clients. We acknowledge and own our mistakes. We are continually enhancing our process to improve the performance of the things within our control while staying unwaveringly true to the philosophy and process that has resulted in favorable risk-adjusted returns over our long history. Staying true to that philosophy means we can face stiff headwinds for longer than we would like, but the winds will shift. They always do. And when the headwinds reach extremes, the turn can be swift and powerful. We look forward to once again enjoying the winds at our back, and until that time we will stay true to the process that has served our clients well over the past 25 years despite the last two being admittedly rough seas.

If you have questions or concerns about our outlook or the portfolio's positioning, please do not hesitate to call us. We look forward to updating you on the progress of the portfolio as the year progresses.

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