CORNERSTONE
INVESTMENT PARTNERS, LLC

Large Cap Market Review

Q1 2025

"If you don't understand the wave, you can't respect it. And if you don't have respect, it's only a matter of time before the ocean teaches you to get some."
Laird Hamilton

Atlanta is five hours from the nearest beach, so the Cornerstone team does not surf much more than the internet. But we recognize that surfing is an activity where you can only control yourself. As much as we know the tides will forever ebb and flow, individual waves are unique and can be affected by both permanent and known factors, like the shape of the shoreline, and hidden and ephemeral ones, like a storm hundreds of miles away. **You cannot stop or change a wave, even as much as we wish we could – you can only ride it, leveraging years of experience to adjust your technique.** Investing is much the same, where we prepare for and respond to the market at any given time. And it is the combination of thoughtful, hard-working investors, a disciplined, repeatable process, and a timeless philosophy that allows us to keep the portfolio best positioned in response to whatever market we face.

The broad market, as measured by the S&P 500, declined 4.3% during the first quarter on a total return basis. Market leadership rotated meaningfully, and heightened volatility, particularly around trade, led investors to reassess growth expectations. In this environment, Value stocks outperformed as capital rotated out of Growth and into more defensive or "safety" stocks offering perceived earnings stability. Reflecting this trend, the Russell 1000 Value Index actually increased 2.1%, leading to the biggest quarter of Value outperformance in at least 20 years. Not surprisingly, smaller-cap stocks fared worse, with the Russell 2000 down 9.5%, as investors shifted into a risk-off posture.

Last quarter, we suggested that we were keeping an eye on changes from a new presidential administration, including tariffs and spending cuts. Those topics have become front and center, with DOGE leading aggressive shifts in federal government priorities during the quarter, and global tariffs finally implemented over the last week.

Despite steady economic growth—evidenced by Q4 real GDP coming in at 2.5%—uncertainty spiked during the quarter, primarily due to the new administration's aggressive and unpredictable stance on trade negotiations with Mexico, Canada, and China. Since quarter-end, this tariff focus has broadened further across global trade partners. One way to quantify this uncertainty is the U.S. Economic Policy Uncertainty Index, which incorporates the frequency of policy-related news articles, the number of expiring federal tax provisions, and the dispersion of macroeconomic forecasts among economists. Current readings are near historical highs, excluding the COVID-19 period.

At the end of the first quarter, this growing uncertainty had already begun to show an impact. The longer it persists, the greater the potential economic consequences. The earliest effects have appeared in soft data, such as consumer confidence and sentiment, both of which declined notably in March. Thus far, hard data—like industrial production and nonfarm payrolls—remain resilient, but the outlook is increasingly uncertain. Tariffs are also creating upward pressure on inflation. The two-year breakeven rate has risen sharply since the start of the year, as many companies explore supply chain diversification or pass costs on to consumers through price increases. Economic growth fears have become more pronounced, with the Atlanta Fed's GDPNow estimate turning negative. While earnings estimates have not yet meaningfully declined, they tend to lag actual conditions. Many analysts are awaiting company earnings reports and forward guidance before adjusting estimates, reflecting the challenge of quantifying the current environment.

On any given day, the stock market represents a snapshot of global capital flows and confidence in those future capital flows. As the last week after the quarter has demonstrated, that snapshot can change rapidly in response to geopolitics, government policy, and macroeconomic sentiment, even over the course of a single day. **That means that we as investors and stewards of our clients' capital have to live in a world of what *could be*, rather than a world of what *should be*.**

We don't know how this will unfold—and acknowledging that uncertainty allows us to focus on what we do know: how to identify and invest in mispriced stocks with strongly embedded characteristics. Our concentration allows us to take advantage of the potential outperformance of those opportunities. Cornerstone's value orientation and disciplined investment process, which starts with our investment philosophy that stock prices are more volatile than the fundamentals that determine value, enables us to identify opportunities when stock prices do not reflect a company's proven track record and embedded characteristics, and risks, where attractive absolute values mask less attractive fundamentals. **We believe our performance over the past few years, when core and value benchmarks have been so volatile relative to each other and diverged so widely during shorter-term periods, reflects the benefits of that philosophy.**

It is also during these periods that active portfolio management matters. In addition to our daily large cap research meetings, we also meet at least weekly and sometimes daily to take a step back and look at the portfolio as a whole. This helps us understand how the combination of stock selection and weight will likely respond to market changes. Looking at this period of uncertainty and volatile shifts in sentiment, we sought a balanced portfolio that would hopefully allow our stock selection to drive relative outcomes regardless of the style factor dominating for a given period. This comes from quantitative risk assessments, historical stock performance during similar periods, and our own years of experience.

Also crucial to longer-term success is our relative value approach. The last two quarters have effectively been oppositional in terms of style. During the fourth quarter of 2024, the Russell 1000 Value was down 2.0%, underperforming the S&P 500's 2.4% return by 4.4%. Just one quarter later, it was up 2.1% and beat the S&P's -4.3% by 6.4%. In total over those six months, the Russell 1000 Value was effectively flat, while the S&P was down 2.0%.

There will likely be many investors who get thrown off the wave we are facing today. **We believe periods of elevated volatility expand the opportunity set for active, disciplined, bottom-up investors like us, and we believe our performance over the past few years, when core and value benchmarks have been so volatile relative to each other and diverged so widely during shorter-term periods, reflects the benefits of that philosophy.** Down markets are emotionally challenging for most of the market. Fearful investors make mistakes, selling everything in a period of fear without regard to the underlying merits of the assets. These mistakes produce compelling long-term opportunities for patient, disciplined investors like us. We continue to manage our portfolio with consistency. As we emphasized last quarter and wish to reiterate, we continually re-examine our portfolio to ensure we hold high-conviction positions trading at discounts to our conservative estimates of intrinsic value. We remain excited about our holdings and confident in their prospects over a multi-year horizon.

Sincerely,

The Cornerstone Investment Team