

Large Cap Market Review

Q1 2026

"War is the realm of uncertainty; three quarters of the factors on which action in war is based are wrapped in a fog of greater or lesser uncertainty."

Carl von Clausewitz

Clausewitz wrote about the "fog of war" to describe the European battlefields of the 1830s, but he might just as well have been describing the first quarter of 2026. Investors began the year navigating a somewhat familiar market, such as elevated valuations, shifting Fed policy, and the ever-present tension between AI's promise and its price tag. Then, in late February, the fog thickened considerably. Clausewitz's counsel for commanders navigating uncertainty was not to freeze or to pretend the fog didn't exist. Instead, it was to act on conviction, with a disciplined process, on the information available to you, rather than letting doubt paralyze your decision-making. That is precisely how we manage portfolios. **Periods of elevated uncertainty compress time horizons and cause many investors to react emotionally. We also believe they expand the opportunity set for patient, disciplined investors who know what they own and why they own it.**

Equity markets diverged sharply during the quarter across both style and capitalization factors. The S&P 500 fell 4.3%, while the Russell 1000 Value rose 2.1%. The value benchmark outperformed the broad market by the largest quarterly margin for at least two decades as mega-cap technology stocks weighed heavily on the broader index. The quarter's narrative unfolded in two distinct acts. Through February, several factors drove a meaningful rotation away from mega-cap technology and into Value and smaller-cap stocks. That shift arrived on multiple fronts simultaneously: the Federal Reserve's late-2025 rate cuts began to meaningfully lower borrowing costs for more economically sensitive and domestically oriented businesses; small-cap earnings growth had finally begun to exceed that of large caps for the first time in over three years; and the more assertive U.S. foreign policy posture, including military actions in Venezuela and escalating geopolitical signaling toward Greenland and the Middle East reinforced a preference for domestic, "real economy" companies over globally exposed growth franchises. The net result was the S&P 500 advancing roughly 1% through February, while the Russell 1000 Value gained approximately 7% and the Russell 2000 rose approximately 6%.

The onset of a full-scale military conflict with Iran in late February then fundamentally altered the market's character. As Brent crude surged above \$100 per barrel for the first time since 2022 driven by the effective closure of the Strait of Hormuz, inflation concerns displaced growth optimism. Investors broadly de-risked in response, with the S&P 500 posting its worst month in March since September 2022. Not surprisingly, Energy was the only S&P 500 sector to advance that month, benefiting directly from the commodity shock. Additionally, style and capitalization became less of a factor, with the S&P 500, Russell 1000 Value, and Russell 2000 each down around the same amount (~5%). A late quarter relief rally on ceasefire hopes provided some reprieve but was not sufficient to offset the month's losses.

The U.S. economy entered the quarter on a solid footing: steady consumer spending, stable corporate earnings, and a labor market that, while gradually cooling, remains healthy. The Federal Reserve, following its late-2025 rate cuts, maintained an accommodative stance as inflation trends stayed generally contained. **What the quarter revealed, however, is how quickly domestic stability can be tested by events abroad.** The Iran conflict and the resulting energy shock has re-introduced inflationary pressures that the Fed had largely tamed. This serves as a reminder that in an interconnected global economy, the fog of geopolitical uncertainty rarely stops at the border. Higher energy prices, if sustained, could weigh meaningfully

on consumer spending and complicate the Fed's path forward. The uncertainties facing the Fed and its impact on investors are further impacted by the likely ascension of a new Chair in May 2026. We are watching this dynamic carefully, as its resolution will be an important factor in the market's trajectory for the remainder of the year.

Artificial Intelligence continues to be a source of both uncertainty and opportunity - fitting, perhaps, for a quarter defined by fog. While infrastructure and hardware beneficiaries remain well supported, parts of the software ecosystem have come under pressure as investors reassess the potential for AI to disrupt existing business models. Specifically, concerns around future pricing power, competitive moats, and long-term margin sustainability (which today have not yet come to fruition) have led some investors to sell their software holdings immediately due to high levels of uncertainty about the change in expected terminal values. At the same time, we continue to see attractive opportunities in areas that enable AI adoption rather than compete directly with it. As demand for data processing and transmission continues to grow, the need for robust connectivity and infrastructure remains critical. **Our focus remains on identifying companies with durable competitive advantages that can benefit from these structural trends without relying on speculative assumptions. We recently published a thought paper on our website exploring how AI is likely to reshape business models in the years ahead, and we recommend it to those interested in the topic.**

The market broadened this quarter, with 54% of companies outperforming the S&P 500 in Q1, compared with only 18% last year. Some of this has been driven by the pullback in mega-cap technology, with none of the Magnificent 7 outperforming the S&P for the quarter. With increased industry-level or idiosyncratic volatility in the market, many newer, unique opportunities are emerging in our process. At one point early in the quarter, dispersion spiked to levels at the 99th percentile over the last 30 years. **We now have more companies in Quality Control (stocks that the investment team has unanimously approved for potential inclusion in the portfolio) than at any time since the firm's inception.** This provides us with greater flexibility to build a long-term, attractive, balanced portfolio.

We know that we are neither able to eliminate the fog of uncertainty, nor fully see through it. But neither do other market participants, which creates an opportunity for us to take advantage of periods when stock prices diverge from a company's underlying value. And **over time, it is the combination of our people, philosophy, and process that allows us to respond to a constantly-changing market with discipline.** We continue to manage the portfolio with consistency and diligence, holding high-conviction positions trading at discounts to our conservative estimates of intrinsic value. We remain confident in the multi-year prospects of our holdings.

Sincerely,

The Cornerstone Investment Team

The opinions expressed represent the views of the Cornerstone Investment Partners investment team. Past performance does not indicate future results. As with all investments, the possibility for profit is accompanied by the risk of loss.