CORNERSTONE
INVESTMENT PARTNERS, LLC

Large Cap Market Review

Q2 2026

"People think focus means saying yes to the thing you've got to focus on. But that's not what it means at all. It means saying no to the hundred other good ideas that there are."

Steve Jobs

There are 800 stocks in Cornerstone's actively constructed investable universe. Our investment team meets every day at 2 pm to discuss one of them. We talk about companies across different industries, different markets, different stages, each with different opportunities and risks. We analyze their businesses, their management teams, and their valuations. We consider how they stand on their own and how they fit within a balanced, attractive portfolio. We agree, we disagree, we debate. After all of that, we choose thirty of those 800 options. The rest don't make the cut. **While short-term stock price movements remain unpredictable, our disciplined investment process emphasizes that each allocation meets rigorous fundamental criteria.** We focus not on capturing every outlier, but on assembling a high-conviction portfolio built for long-term risk-adjusted outperformance.

Equity markets reversed course sharply during the quarter, unwinding much of the first quarter's dynamics across both style and capitalization factors. During the second quarter, the S&P 500 Index rose 15.2%, while the Russell 1000 Value Index gained a more modest 13.9%, lagging the broad market as technology stocks, particularly semiconductors, dominated market performance. The Russell 2000 Index, meanwhile, surged by approximately 21.5%, marking the strongest quarter of small-cap outperformance in five years. **The quarter's narrative again unfolded in two distinct acts.** Through most of the period, a powerful relief rally took hold as the military conflict with Iran de-escalated toward a formal ceasefire framework and Brent Crude collapsed from its wartime peak, lifting the inflation overhang that had gripped markets in March. This easing of geopolitical tensions and the lower risk of sustained higher energy prices, combined with continued optimism around the Federal Reserve's late-2025 rate-cutting cycle, led to renewed optimism in the economy. Additionally, excitement about AI infrastructure spending rewarded companies focused on relieving bottlenecks in the AI supply chain. The final weeks, on the other hand, brought a more discerning tone in response to new Federal Reserve Chair Kevin Warsh's first meeting and volatility around AI-related companies, including a sharp semiconductor sell-off and recovery.

The second quarter unfolded against an unusually turbulent geopolitical backdrop, dominated by the continuing fallout from the Iran conflict that began in late February. Iran's closure of the Strait of Hormuz drove crude prices sharply higher through March and April as the conflict escalated. A fragile geopolitical backdrop gave way to a formal ceasefire framework by mid-June, prompting a sharp collapse in crude prices and WTI posting its steepest quarterly decline since 2020. However, the temporary supply disruption left a distinct imprint on inflation data, with headline CPI accelerating to 4.2% year-over-year in May, its highest reading in more than three years, even as core inflation remained stable. While the next steps of the conflict remain unknown, if commodity prices remain at current levels, overall inflation may ease somewhat as excess energy spending declines.

Against this backdrop, the Federal Reserve navigated a leadership transition, as Kevin Warsh was confirmed as Fed Chair in mid-May and presided over his first policy meeting in June. The Fed held the federal funds rate steady for a sixth consecutive meeting, but the committee appears to be tilting more toward a hawkish stance, with half of participants penciling in a rate

hike by year-end. This is a notable reversal from the easing path the market had priced only a quarter earlier. Equity markets largely looked through this uncertainty as AI-related capital spending and solid corporate earnings results continued to power index-level returns, even as volatility resurfaced periodically. **The net effect was a quarter in which broad index returns masked considerable dispersion beneath the surface.**

We are encouraged by the increasing breadth in the market. Over the last year, only 8% of S&P 500 companies outperformed the benchmark. While we think we are certainly better than average at identifying potential outperformers, such a narrow market introduces a significant luck factor over shorter time periods. In contrast, June marked a welcome shift, with 57% of stocks outperforming. Additionally, the correlation between the capitalization-weighted S&P 500 and its equal-weighted counterpart has fallen to its lowest level in at least 35 years. For an active, concentrated manager, an environment in which individual stocks move on their own fundamentals rather than in lockstep is precisely the one that rewards the discipline of choosing thirty names and saying no to the rest.

Headline valuations for many companies appear high, and that is a core part of the discourse in the financial media, but the driver of the broader market has not been price, but earnings instead. Since the end of 2022, after the market last gave up on technology stocks, the S&P 500 has returned 105.1% on a total return basis. Only about one-fourth of that gain is from multiples. Almost all of the rest is driven by underlying sales growth and margin improvement. It may be easy to find stocks that appear to have low prices relative to their history. But we need to ensure that their past track records are relevant and repeatable, and for many of those companies, their ability to create value in the future is, if not impaired, materially more uncertain than it was a few years ago.

The divergence between the Russell 1000 Value and the S&P 500 has been a major point of discussion so far this year. **Perhaps ironically, it has been faster-growing AI names that have driven the Russell's relative success, with 97% of the Russell 1000 Value's 6.1% outperformance versus the S&P 500 coming from the Tech+ basket (the IT sector and non-IT Mag-7 names: Amazon, Meta, and Alphabet).** The Value index, however, is reconstituted semiannually, and we believe its most recent adjustment will have a material impact on performance going forward. While IT's overall weight remains around 18-19%, its underlying components have shifted: semiconductor exposure has fallen from 10% to 3%, and software exposure has risen from 2% to 6%. **We do not know the short-term direction of the market from here, but we recognize that the Value index is now positioned to move more, relative to the S&P 500, in opposition to the AI trade, than it has been over the past year.**

We are very proud of the strong performance we have generated for clients this quarter and over the last few years. But we recognize that the clock re-starts, not just every quarter or year, but every day. Whatever the market delivers from here, our task does not change: to keep saying no to the many good ideas so that we can say yes to the thirty great ones. We do not expect to deliver the magnitude of outperformance we achieved this quarter in every time period. But our commitment to the strict execution of our process remains unwavering, and the discipline that produced this quarter is the same one that will carry us through leaner ones. We remain confident in the multi-year prospects of our holdings.

Sincerely,

The Cornerstone Investment Team

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