CORNERSTONE
INVESTMENT PARTNERS, LLC

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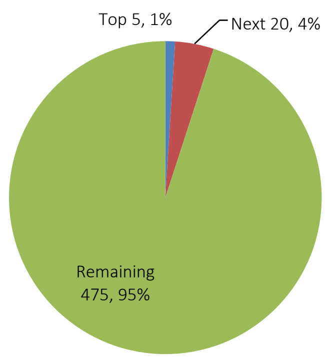
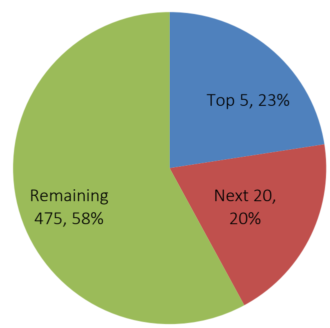
Since when was a 6% positive quarter in the Russell 1000 Value Index considered a low volatility environment? 2020 has and continues to be a surprising, complicated, and often frustrating period, unlike anything we have seen before. Based on traditional capitalization-weighted benchmarks like the S&P 500 and Russell 1000, the market is back above its February peak, before investors started to react to the COVID-19 pandemic. That is true for passive investors in ETFs and mutual funds that track those benchmarks. However, that is not the case for the Russell 1000 Value Index, down 12% year-to-date while the S&P 500 and Russell 1000 increasingly represent the fortunes of a few mega-cap names.

Share of S&P 500 by Number of Stocks



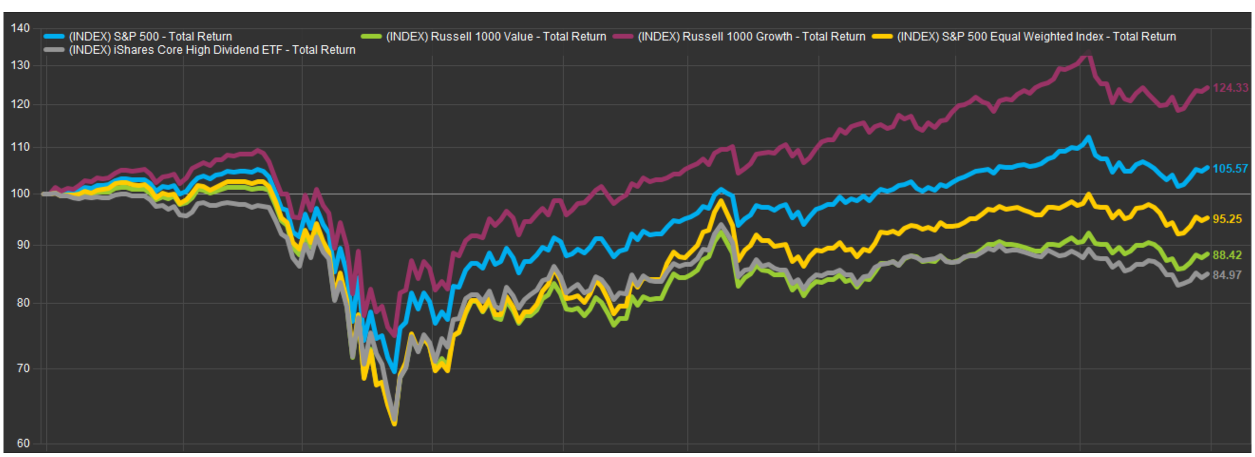
Share of S&P 500 by Market Capitalization



Source: iShares, Cornerstone Investment Partners. Data as of 9/30/20

While the media likes to discuss that the S&P 500 and Russell 1000 are up 6% year-to-date, the equal-weight version of them is actually down around 5%, and only 4 in 10 companies in the S&P 500 are up for the year.

Year-To-Date Total Return of Key Large Cap Market Indices



Source: Factset, Cornerstone Investment Partners. Data as of 9/30/20

Investments are made by people and reflect their perception of how the current and future environment impacts company valuations. But people overreact by nature, and it is this divergence between stock prices (a perception of value) and fundamentals (the driver of value) that underlies our investment philosophy. Individual investment decisions can appear rational, but the collection of all of them leads to broader market outcomes, intended or unintended. While history doesn't repeat itself, it does rhyme.

The first nine months of 2020 can be summarized in part by the following:

- Reality: A massive global shock has changed the way most businesses need to operate in the near-term
- Perception: A wide divergence between "winners" and "losers"
- Outcome: A crowded and concentrated market

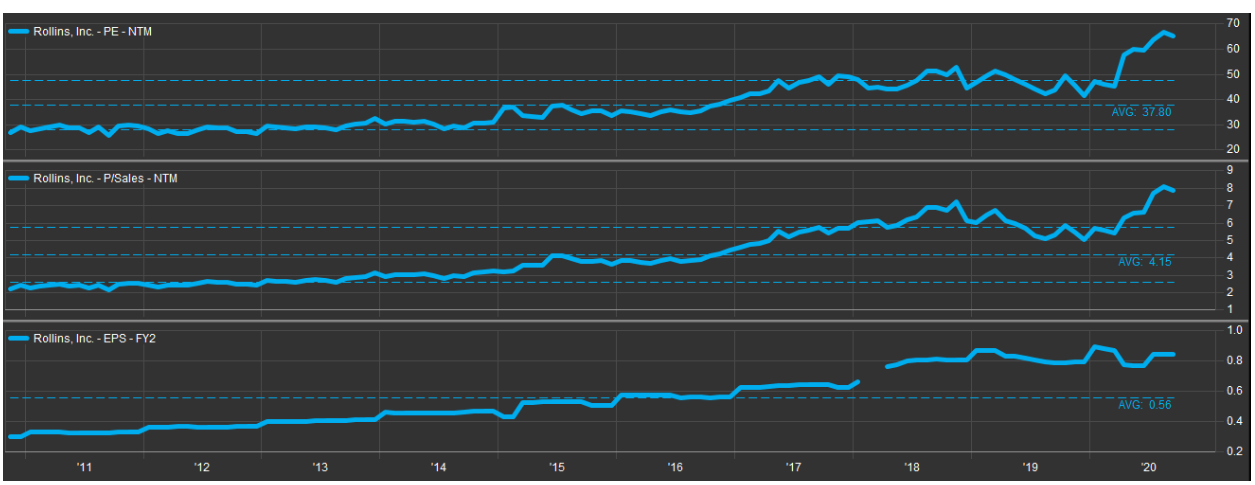
While caused by different reasons, we saw a somewhat similar outcome about 20 years ago during the Tech bubble:

- Reality: A new technological advancement has disrupted a wide range of industries and created an opening for new types of companies
- Perception: A wide divergence between "winners" and "losers"
- Outcome: A crowded and concentrated market

During these periods, people are willing to pay any price for the "winners" and will avoid the "losers" at any cost. In 2000, the world was uncertain, and those winners provided perceived certainty that they would survive a technological onslaught and wouldn't be left behind. Looking back, it's easy to make fun of fly-by-night startups like WebVan and Pets.com, but Cisco and Microsoft, both fantastic companies that have generally continued to grow revenues and profits ever since, were also overvalued at that time. It took them each over a decade (almost two decades in the case of Cisco) to once again reach tech bubble highs.

Today, the world is uncertain for a different and more tragic reason. Like WebVan and others, there are businesses that we may look back to as easy examples of today's exuberance, such as Nikola and Virgin Galactic. However, the majority of winners are instead just businesses that provide perceived certainty that they will survive an economic onslaught, either by a pull-forward in demand or pandemic-proof business models.

Pest control company Rollins, for example, which has seen expected long-term earnings decline this year, trades at 67x forward earnings. Again, this is a great business – it has grown earnings consistently over time as it has scale in a highly fragmented market and sells a service that consumers won't do on their own. But 67x earnings is egregious. At its (still-strong) historical growth rate of 10%, it would take 16 years to grow into a "more reasonable" 20x multiple.



Source: Factset, Cornerstone Investment Partners. Data as of 9/30/20.

Household and personal care product company Procter & Gamble is another example. With more people at home, it's seen a slight improvement in earnings expectations over time, which is what you would expect from a company with the largest laundry detergent business in the US. But even though it has grown EBITDA less than 1% for the last five years, it is trading like it is now selling software at a forward P/E multiple (over 25x) that it hasn't seen since 2000.

These companies appear to have experienced this multiple expansion not because of what they are doing – but instead because of what they aren't doing. They aren't losing sales or showing declining profits today. We've talked in the past that investors often overemphasize short-term results versus their actual impact on long-term values. We don't deny that Rollins and P&G are well-positioned for today's environment. More people are working from home for now, but will they create so many crumbs in the future that the number of cockroaches will skyrocket or will they go through shampoo like it's water?

Yes, there's a lot of risk in the market right now, and it feels good to own businesses that are holding up better than others. But everyone else is buying them for the exact same reason, and when investors don't need that feeling anymore, or something changes either to the company, its industry, or the market as a whole, they'll sell just as quickly and their share prices will decline. On the other hand, good businesses trading at attractive prices are more likely to deliver sustained performance over time. Going forward, that means investors continue to need to look at more than just what the company does, and instead focus on what it's worth. The companies we own in our large cap portfolios have deeply embedded characteristics, and have proven track records of success, but more importantly, also trade at attractive valuations.

In other news, we have also started to post relevant materials, links, and perspectives on our LinkedIn page and Twitter account (@CornerstoneIP) – please follow! For our first piece of content, we posted a thought paper and our video in August, discussing the once-in-a-generation opportunity for active value investing, which remains just as attractive in October. We hope this helps you to remain close to us even during these virtual-first times and understand what we are seeing in the market. Please of course continue to reach out when you have questions – our responsibility is to you first.

Thank you again for your continued support, and may you and your families stay safe.

Sincerely,

Cornerstone Investment Partners