CORNERSTONE
INVESTMENT PARTNERS, LLC

Large Cap Market Review

Q4 2024

"Plus ça change, plus c'est la même chose"
"The more things change, the more they stay the same"

Jean-Baptiste Alphonse Karr, 1849

We are trained to assume things change quickly. It's the nature of our perception of time, and how differences are more memorable than similarities. Sometimes things don't change, however.

When we look at the fourth quarter, it was almost exactly like the full year of 2024 for the equity markets, which in turn looks like 2023. For the full year, the Russell 1000 Value returned 14.4%, with the S&P 500 at 25.0% and the Russell 1000 Growth up 33.4%. The leaders were similar, as well as their positive impact on the market- breadth in the market was remarkably low, with only 19% of S&P 500 constituents outperforming their own benchmark. Animal spirits and "Fomo" (Fear of Missing Out) seem to be a driver as well, with investors historically bullish on the market and many speculative assets, from meme-coins to quantum computing startups, which rocketed higher. **There were periods of outperformance for value-oriented stocks, but these proved to be short-lived, as continued excitement around AI and the expectation for value accruing to the largest players is still the consensus view of the market.**

Investor optimism is clearly high, as evidenced by the broad market being up significantly for the full year, expanded multiples, and elevated expectations for market appreciation. However, there are plenty of logical reasons for that optimism. U.S. GDP growth remains solid, with September U.S. Real GDP growth at 2.8% quarter over quarter, corporate earnings broadly have been healthy with actual results coming in well ahead of expectations, and inflation has continued to moderate. This backdrop has allowed the Fed to begin cutting rates gradually. The market typically performs much better in a slow rate cutting environment (a fast rate cutting environment typically indicates a hard landing and is not conducive for equity values.) This slow rate cutting environment represents the market's current base case today. Should inflation continue to remain moderate and the economy perform well, that gradual path to lower interest rates would remain on track.

If you focus on the S&P 500 (or another core benchmark), market multiples are no doubt elevated versus history, with a forward P/E of 21.5x. And combined with the limited breadth, there are investors who point to prior periods of exuberance. **While there are likely many companies which are overvalued, the average stock is not, with the equal-weighted S&P at an almost four turn discount on a forward EV/EBITDA basis to the traditional capitalization-weighted version, twice its five year average discount.**

However, we don't think this is the Tech Bubble. Outside of a few extreme and obvious examples, the companies which have led the market are remarkably good businesses. They are highly profitable, leaders in their market segments, and have either technological edge or massive scale and network effects in industries where those embedded characteristics can drive persistent operational outperformance.

If anything, it seems most similar to the Nifty Fifty period from the early 1970s. Then, like now, the key blue-chip stocks had a moniker that reflected their "must-own" status. Many companies will be familiar: American Express, Coca-Cola, Eli Lilly, IBM, Johnson & Johnson, McDonalds, Disney, Walmart. Others did not make the cut over time: Eastman Kodak, Polaroid, Simplicity Pattern, Sears. **But the multiples of the Nifty Fifty make most of the Magnificent Seven seem downright cheap. McDonald's traded for 96x forward P/E and Disney was at 82x. Even cosmetics (Avon Products) and sewing (Simplicity Pattern) businesses were given P/Es ratio over 60x. In comparison, as of December 31st, Alphabet traded at 21x and Meta**

at 23x. Even NVIDIA trades at one third the multiple that Polaroid did 50 years ago. Other blue-chip compounders are more expensive, with even Russell 1000 Value constituents Costar at 64x, Fair Isaac at 63x, and Walmart at 33x.

Cornerstone's value orientation and disciplined process, which starts with our inherent philosophy that fundamentals drive value over time, enables us to identify opportunities, when 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 time periods, is reflective of the benefits of that philosophy.

The market is not without some uncertainty, however.

We are keeping an eye on changes from a new presidential administration, which will be sure to create lots of headlines as well as opportunities and uncertainty. In the opportunity camp we likely have growth-friendly policies, less regulation that could improve margins, lower taxes, and a push for domestic production. On the uncertainty side we have potential for heavy use of tariffs, a shift in government spending priorities, volatile trade and foreign policy, as well has changes to immigration policies which may reduce labor supply.

We are also keeping an eye on 10-year Treasury bond yields, which have moved significantly higher over the last few months. To us, it reflects a divergence between near-term excitement and longer-term uncertainty. When you look at historical rate cutting campaigns and the subsequent change in 10-Year yields after the Fed starts cutting rates, the current experience stands out. Typically, the 10-Year falls or trades sideways; however, today we have a large upward move in the 10-Year yield. What does this mean? It may signal some nervousness around inflation in the market still. This can also be seen in the TIPS market with a corresponding move higher in yields during the fourth quarter. With the 10-Year closing the year solidly above 4.5%, it does create a more difficult backdrop for any additional multiple expansion and higher rates from here would likely put pressure on equity markets.

While Bob Dylan was correct with his song, "Times are A-changing", we recognize Jean-Baptiste Alphonse Karr's observation that some things do not change**. What this means to us is that active management will likely be particularly important going forward.** Cornerstone's deep fundamental work, combined with our valuation orientation and a consistent and disciplined process designed to mitigate behavioral errors, provides the ability to identity, assess and respond to opportunities in the market.

Sincerely,

The Cornerstone Investment Team

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