

Large Cap Market Review

Q4 2025

"You don't have to see the whole staircase, just take the first step."

Martin Luther King, Jr.

Many investors believe the market can be distilled into an Excel spreadsheet. In reality, it is a complex adaptive system driven by an infinite number of shifting variables and human emotions. **Investing is rarely about possessing a perfect forecast; if it were, it would be easy. Instead, it is about the conviction to recognize when price and value diverge and to act on the information directly in front of us.** 2025 presented an Escher-style maze of macroeconomic headlines and speculative cycles, including a double-digit correction in April after "Liberation Day." It would have been easy to feel overwhelmed by the noise and fall into the trap of short-term overreaction. **Over the last twenty-five years, we have learned instead that the clearest path to success is found by focusing on one disciplined step at a time.**

The fourth quarter saw equity markets extend their gains through year-end. However, the aggressive rotation into small caps observed in the prior period moderated. As the Federal Reserve signaled a more stable path of policy easing following last quarter's initial cuts, the S&P 500 climbed 2.7% and the Russell 1000 Value 3.8%. On the small cap side, the Russell 2000 Index, which led the market in Q3, returned a more measured 2.2% as the "rate-cut euphoria" transitioned into a more discerning focus on earnings quality and balance sheet strength. Overall, market participation remained healthy, but speculative fervor in unprofitable segments began to cool, giving way to a preference for companies with proven cash flows and defensible margins.

From a macroeconomic perspective, the narrative exiting 2025 is one of moderation rather than deterioration. Economic growth slowed modestly but remained positive, consumer spending held up reasonably well, and corporate earnings continued to come in better than feared. While the labor market showed additional signs of cooling—most notably through slower job growth and easing wage pressures—unemployment and jobless claims remain historically low. Inflation trends, while still uneven, continued to move in a favorable direction. Goods inflation remained benign, services inflation showed gradual improvement, and longer-term inflation expectations stayed well-anchored. Against this backdrop, the Federal Reserve delivered additional rate cuts during the quarter, reinforcing its intent to balance labor market risks with its inflation mandate, and markets are pricing in at least two additional cuts next year. Importantly, financial conditions eased meaningfully as markets gained confidence that policy is no longer restrictive in a way that threatens economic stability. Overall, credit markets suggest that recession fears remain low, with the lowest High Yield spread since 2007.

AI continues to be a driver of both market greed and fear. On the one hand, AI-linked stocks represent approximately 50% of the S&P 500 as capital has flowed into these names at a rapid pace. On the other hand, Deutsche Bank recently reported that "investors have never before been in such agreement about the biggest market risk for a year ahead" in reference to AI. Performance, however, has been led by earnings, not multiple expansion. Even with the Magnificent Seven more than tripling the rest of the S&P 500 over the last five years, the forward P/E of the Index has actually declined.

While much of the market's attention has remained focused on a narrow set of high-profile AI beneficiaries, we continue to see opportunities further down the value chain. **As AI workloads scale, demand for the underlying infrastructure required to move, store, and process vast amounts of data has increased meaningfully.** In particular, memory, networking, and



inference-related solutions have emerged as critical enablers of this buildout, benefiting from the shift from the initial development of AI models to the adoption of AI solutions. This trend is likely to continue, with hyperscaler capital expenditure high, adoption rising, and increases in business productivity demonstrating AI's value.

There was a broadening of the market at the end of the quarter, with 50% of companies outperforming the S&P 500 in December, compared with only 22% for the quarter and 18% for the year. While one month is a short time, **further broadening of the market suggests that active management should benefit from stock selection going forward.**

We are certainly proud of our results during 2025, but recognize that tomorrow doesn't care about yesterday. **Our performance in recent years, amid sharp shifts in style between core and value, reflects the benefits of our investment philosophy. In the short term, the market reacts emotionally; in the long term, it responds to fundamentals.** 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.

2026 marks the 25th anniversary of Cornerstone's founding. We are honored by the trust that you and all of our clients have placed in us over the last quarter-century. Few investment firms reach this milestone, and it is only due to our partnership with you that this was possible. We believe we have fulfilled our mission to be an independent group of experienced investors that provides investment excellence & exceptional client service. But we cannot, and will not, rest on our laurels. Tomorrow is another day, another step, and we look forward to our shared success over the next 25 years.

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.