CORNERSTONE
INVESTMENT PARTNERS, LLC

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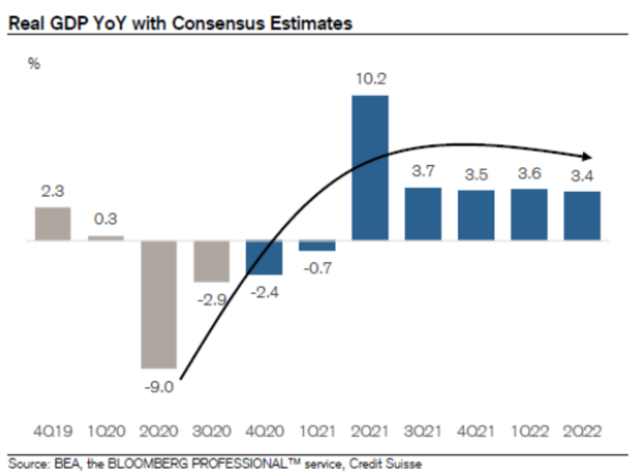
In 2002, then-Secretary of Defense Donald Rumsfeld made a statement during a press conference where he laid out the concept of the knowns and unknowns. Although often now attributed to him, Rumsfeld didn't develop this – it's a 50-year old psychological concept, the "Johari Window." We would apply this framework for equity investing as such:

- Known Knowns: Today's stock price and a company's proven fundamentals
- Known Unknowns: Near-term future sales and profits
- Unknown Unknowns: A global pandemic will shut down the economy and we'll all get puppies while working at home

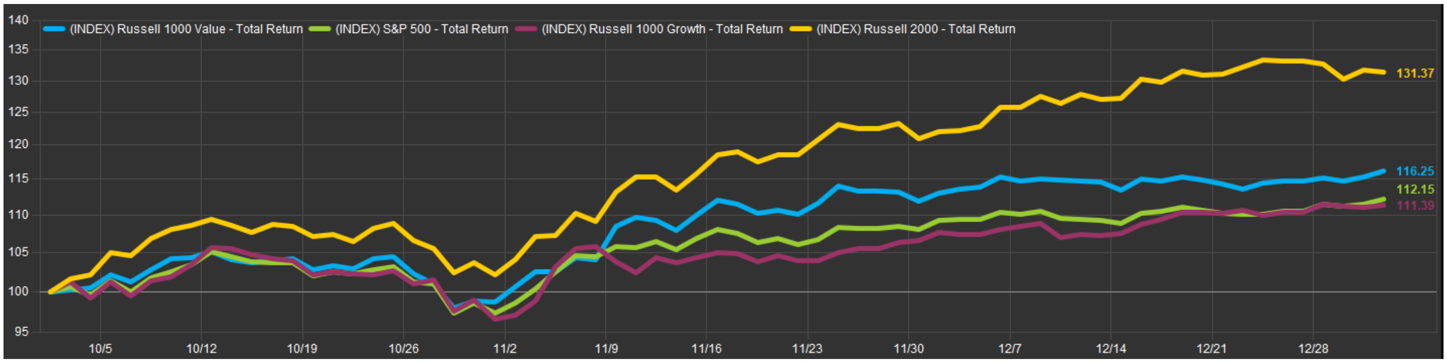
Over time, the unknown unknowns become known unknowns – people have been discussing the risk of a global pandemic like COVID-19 for years, and it had been in the news since December. However, investors didn't build it into their models until February and March, when it materially started to affect the US directly. Since it both impacted the market and themselves personally, investors, as is often the case, overreacted. We saw an extreme focus on short-termism. Investors threw away any company that would be disproportionally negatively impacted by the pandemic and put that capital into "lower-risk' options like safety stocks, technology companies, and bonds. Even SPACs have aggressively returned to the market, as FOMO ("Fear of Missing Out") has driven public investors to oversubscribe to the IPOs of these (and many other similarly risky) securities without even knowing what company they might eventually own. Frankly, it can be difficult for many to do otherwise when facing a market force as strong as your own potential mortality.

COVID-19's impact on the economy has been real. US Real GDP growth went from 2.3% in Q4 of 2019 to a decline of 9.0% by Q2 of 2020 – that's in just two quarters.



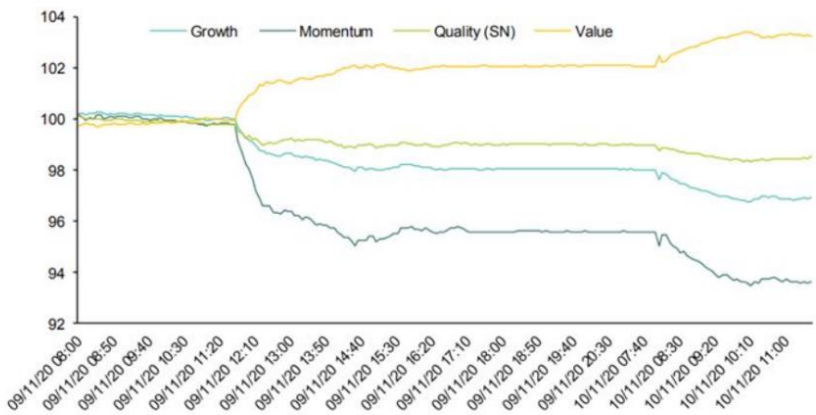
Outside of the largest 5 companies, the earnings of the S&P 500 are down year over year. Unemployment spiked to almost 15%. But that impact is temporary. As we always do, we focused our investing approach on identifying companies with strong embedded characteristics trading at attractive valuations.

Beating growth-oriented stocks for the first quarter in two years, value-oriented stocks came roaring back. For the quarter, the Russell 1000 Value Index was up 16.3% ahead of the S&P 500 Index, up 12.2%. Additionally, the Russell 2000, which often trades with value stocks, itself returned 31.4%.



Given the long period of value underperformance and its opportunity compared to growth (our paper this summer on "A Generational Opportunity for Active Value Investors" goes into detail on this topic) we hope this is only the first step of a longer return to value's historical primacy. Particularly since the announcement that the Pfizer vaccine showed great promise in late-stage trials (paving a path for its and Moderna's approval by global governments), investors were able to look beyond the uncertainty of next week or next month, and into the relative normalcy of the next decade. As we've written before, while near-term future results (say, the next two years) usually represent the majority of investor mindshare, they represent a small minority (~4-6% or so in a traditional model) of a company's actual value. On just November 9th, when Pfizer's vaccine results were first reported, the Russell 1000 Value Index was up 4.1%, while the Russell 1000 Growth Index was down 1.8%, a 600 basis point swing. It was as if that veil of short-termism was lifted.

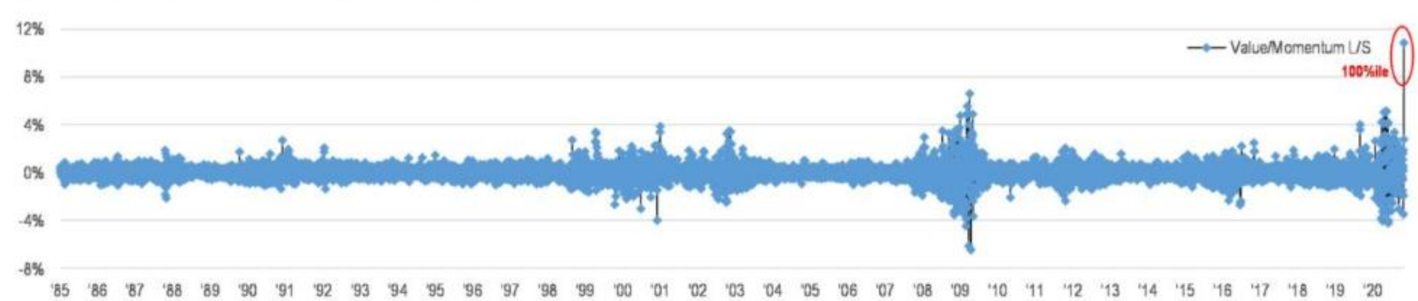
EXHIBIT 1: **The scattering of factor performance in response to the vaccine news**



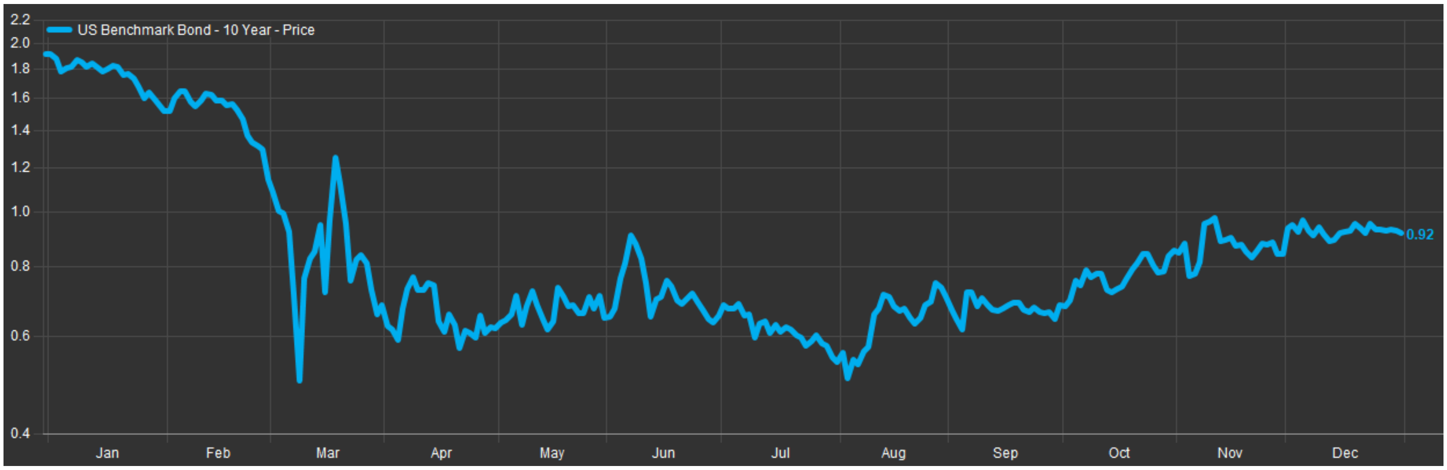
Intra-day performance of factors in Europe relative to the market. Source: Bloomberg, Bernstein analysis

According to JPMorgan, a long momentum/short value portfolio returned a 16-standard deviation event on that day!

Figure 9: Value vs Momentum Daily Performance



We published a thought paper in November about inflation and its impact on value-oriented stocks, "The Cases For and Against Future Inflation during the COVID Economy." One key message is that in an environment of higher inflation, through its impact on interest rates, disproportionally negatively affects valuations of high-multiple growth-oriented stocks and can fundamentally benefit value-oriented stocks like banks. Inflation expectations have risen, and 10-year interest rates have returned to levels from this spring.



Additionally, the 2010s remain the first decade that value-oriented stocks underperformed growth-oriented peers. This bodes well for continued strength out of our style of investing.

Following a strong quarter for our style, there is always a risk of becoming complacent. It's entirely possible that growth-oriented stocks regain market leadership, like some other recent head-fakes. Stocks that moved significantly higher likely have compelling stories and are enjoyable to reflect on well-timed purchases or adds at much cheaper prices. In moments of excitement when the market turns your direction, sometimes you can feel vindicated, and that that feeling will last forever, particularly after such a long period of a growth bias. However, we have all learned over the past few years just how quickly it can go the other direction. As a team, we work hard to avoid these behavioral traps and know that exceptional returns come from making the tough and uncomfortable decisions, not the easy ones. We are continually examining our portfolio and our convictions to ensure that we hold stocks trading at material discounts to our conservative assessments of their fair value. This may require exiting positions that feel great, and stepping into others that have lagged or are encountering new difficulties.

We don't know what the next set of unknowns will be. But we remain excited about the future prospects for our strategy. We know that our valuation methodology has a long history of proven success. We know that our investment process is robust, reasonable, and repeatable. And we know we have a great team of disciplined investors focused every day on executing that process on behalf of our clients. Even after a strong quarter for our approach, the data continue to suggest to us that the current opportunity set for value-oriented investors is one of the most attractive in the last few decades.

Sincerely,

The Cornerstone Team

Disclaimer: Past performance does not indicate future results. As with all investments, the possibility for profit is accompanies by the risk of loss.