

IS THE MARKET TOO CONCENTRATED?

EXPLORING OPPORTUNITIES BEYOND THE TOP STOCKS

There's a lot of buzz about the market being too concentrated these days. But what exactly does that mean and what are the implications?

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The US stock market is becoming increasingly concentrated in just a handful of stocks. Heading into 2025, the so-called "Magnificent Seven" stocks continue to look strong in terms of market capitalisations. In total, they accounted for over 31% of the S&P 500 and 21% of the MSCI All Country World Index (ACWI), as of the end of December 2024.¹ Of this group, Nvidia, Microsoft, and Apple collectively accounted for a staggering \$8 trillion in market capitalisation and about a fifth of the US stock market back in July 2024 – a level unseen since the 1960s.²

Today's concentration, driven by the rapid rise of artificial intelligence (AI) technologies, raises concerns about the diversification and sustainability of these leading stocks. As an active equity-focused asset manager, Comgest looks beyond index performance and aims to offer investors exposure to leading quality growth companies that take advantage of long-term trends.

FEELING THE BENEFIT OF VARIETY

At the end of December 2024, the top 10 market capitalisations of the S&P 500 represented nearly 37% of the entire benchmark.³ But does this concentration reflect their underlying quality and competitive advantages? These companies' profits represent a greater share of the benchmark's total profits compared to their share of market capitalisation, suggesting that profitability is a key factor underpinning their market dominance.

The rise of passive investing could be another reason contributing to this concentration.⁴ Passive ownership of the S&P 500 has increased over the past two decades from 18% to around 26% today.⁵ By trying to replicate an index, investors may find themselves overly reliant on a few top-performing stocks, which could drag their portfolio down if those same stocks start to lose momentum. Nine of the top 10 contributors

to the MSCI ACWI index's performance last year were AI-related stocks, with only American banking giant JPMorgan Chase standing apart.⁶

In contrast, our Comgest Global Equity strategy includes two AI contributors in the top 10—Microsoft and TSMC—which were established technology leaders long before the commercial arrival of AI. As the world's largest technology companies race to invest in AI, we believe there are still unresolved issues.⁷ In our view, there is still uncertainty surrounding consumer applications of AI and the risk of overbuilding infrastructure, which could result in underutilised data centres. Amid this uncertainty, we believe that the benefits of diversifying into other growth sectors can lead to resilient performance and offer a buffer against potential market headwinds.

RESILIENT GROWTH DRIVERS

At Comgest, we leverage our bottom-up research to identify established companies that benefit from durable competitive advantages, including visible growth, healthy free cash flow, high barriers to entry and strong corporate culture. We seek quality companies that are well-positioned to benefit from secular growth trends.

This is why we have built our Comgest Global Equity strategy to offer exposure not just to market leaders, but also key players in sectors made up of essential products, such as healthcare and critical data.⁸ We believe this is a group of resilient stocks that should grow regardless of geopolitics and macroeconomic developments. In our view, they may not always be the high-flying growers, but they have the attributes to remain consistent, no matter the environment.

Recently introduced regulatory requirements, for instance, are driving the need for more robust data management and cybersecurity solutions.⁹ Verisk, the US-based data analytics company, partners with global insurance providers to improve underwriting and claims

outcomes. From our perspective, Verisk's proprietary data sets are a clear advantage over its competition. We believe that Verisk's clients cannot operate without Verisk data, which has resulted in a clear pathway towards the firm being able to stay resilient in the face of turbulence.

We also believe that a global ageing population makes healthcare a trusted and diverse sector for investment in the wider economy. Pharmaceutical companies, like Eli Lilly, have a rich history of conducting research and developing treatments across a wide variety of medical fields, including diabetes, oncology, and immunology. Over the past decade, the company has increased its margins by excelling in its core specialties and leveraging research and development to take hold of new opportunities in the significant new obesity market. The unfortunate rise of the global obesity rate – affecting one in eight people around the world – has created a growing market for Eli Lilly to offer treatment.

FOCUSED ON FUTURE GROWTH

With an investment team spread across the globe, our collaborative research approach helps reaffirm our convictions, uncover growth areas and review peer companies in various markets. While the Comgest Global Equity strategy includes a few of the Magnificent Seven stocks, our unconstrained approach enables us to invest in what we believe to be quality companies across a range of sectors, with a forward-looking lens and valuation discipline. We are confident that our portfolio is benefiting from diverse secular growth drivers. Drawing on nearly 40 years of experience, we strive to build resilient portfolios that should deliver sustainable, long-term earnings growth in all market conditions.

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¹Source: Comgest/Factset, data as of 15-Jan-2025.

²Chisholm, Denise. "Stock Market Outlook July 2024: Is the Stock Market Too Concentrated?" Fidelity, 24-Jul-2024.

³Source: Comgest/Factset, data as of 15-Jan-2025.

⁴Passive Investing and the Rise of Mega-Firms." London School of Economics and Political Science. Accessed 19-Nov-2024.

⁵Kostin, David, Ben Snider, Ryan Hammond, Jenny Ma, and Daniel Chavez. "The Rise of Passive Ownership across the S&P 500 and Its Impact on Company Valuation and Performance." Goldman Sachs, 1-Nov-2024.

⁶Source: Comgest/Factset, data as of 15-Jan-2025.

⁷Rosenberg, Scott. "AI Companies' Triathlon: Who's Leading in Models, Users and Infrastructure." Axios, 27-Nov-2024.

⁸Comgest, percentage of holdings in the portfolio relative to the indicated theme as of 31-Aug-2024.

⁹Feingold, Spencer, and Filipe Beato. "Cybersecurity Rules Saw Big Changes in 2024. Here's What You Need to Know." World Economic Forum, 17-Oct-2024.