Concentrated Leadership in the S&P 500

March 2020

OVERVIEW

- **The collective weight of the top five holdings in the S&P 500 has approached levels last seen in 2000.**
- **Concentration has become more prominent as five companies have accounted for nearly one-third of the S&P 500's total return since 2017.**
- **International and US Small Cap indices historically exhibit far lower concentration in holdings, potentially offering more balanced exposure.**

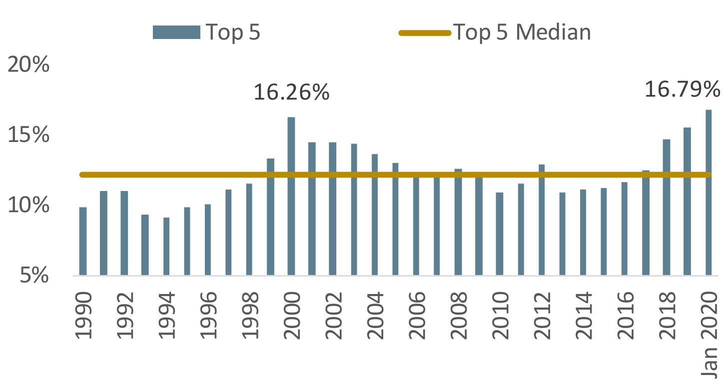
Background

Over recent years investors have migrated toward passive investment products, particularly in efficient segments of the market where many active investment managers have historically struggled to generate outperformance relative to their benchmarks. Many passive products track indices that follow market capitalization weighting methodologies, meaning each index constituent's weight is determined by its market cap's proportional share of the overall index. While this weighting technique offers several benefits, such as reduced turnover and lower transaction costs, these indices are susceptible to top-heavy allocations to companies that significantly outperform the broader market over time. Since 2017, returns of the S&P 500, which weights constituents by market cap, have been led by five companies. By the end of 2019 Alphabet (Google), Amazon, Apple, Facebook, and Microsoft contributed 14.4% to the S&P 500's 53% cumulative three-year return, accounting for 27% of the index's performance. Meanwhile, these five stocks saw their collective weights in the index increase from 11% to approximately 17% over this period.

Implications for Index Diversification

While passive investors have benefited from the S&P 500's returns over the last several years, concentration in the index today is far above historical averages and has approached levels last seen during the Dot-Com bubble. Since 1990, the annual average weight of the top five holdings in the S&P 500 had a median value of 12.2%, a level that was surpassed in 2017. From that point, concentration in the top five holdings expanded, and is currently in line with levels last seen in 2000. Compared to the S&P 500, International and Small Cap indices have been less susceptible to concentration due to their large number of holdings. The top five holdings within the MSCI ACWI ex-US and Russell 2000 currently make up 6.5% and 1.6% of each index, respectively. Concentration in the Russell 2000 is also limited by its reconstitution process, periodically removing companies from the index that surpass a maximum market cap threshold.

Average Annual Weights of Largest Five S&P 500 Holdings



Source: Morningstar Direct

Historical Comparisons

The S&P 500's allocation to the Information Technology (IT) sector approached 24% at the end of 2019, similar to the level in 1999. The market's current concentration in top holdings and tilt toward IT has drawn comparisons to the Dot-Com bubble of the late-90s, when IT and Telecom companies' valuations were driven to excessive levels prior to a large drawdown in the S&P 500 that began in 2000. While the degree of narrow leadership by IT and concentration in top holdings are similar, valuation levels and earnings contribution of the top names differ across these two periods. The Shiller CAPE and 12-month trailing P/E ratios at the end of 2019 were 31x and 25x, respectively, compared to 44x in and 29x in January 2000. At the end of 2019, the top ten S&P 500 holdings made up nearly 23% of the index, compared to 25% in 1999. However, these top ten companies contributed 18% to the index's annual earnings in contrast to just 14% in 1999. While current US Large Cap valuations are elevated relative to historical averages, they are not at the levels of exuberance seen in the late-90s, and today's top constituents are currently contributing more to the S&P 500's trailing earnings.

S&P 500 Cap-Weighted and Equal-Weighted Comparison

	Cap-Weighted		Equal-Weighted	
Year	Return %	Avg Market Cap ($Bn)	Return %	Avg Market Cap ($Bn)
2009	26.46	43.9	46.31	10.6
2010	15.06	48.1	21.91	12.8
2011	2.11	49.1	-0.11	12.6
2012	16.00	54.8	17.65	14.3
2013	32.39	66.6	36.16	19.5
2014	13.69	72.1	14.49	21.3
2015	1.38	73.8	-2.20	20.3
2016	11.96	80.6	14.80	22.7
2017	21.83	97.2	18.90	26.0
2018	-4.38	94.0	-7.64	23.1
2019	31.49	123.9	29.24	28.8

Source: eVestment and Morningstar Direct

ACG's Position

Maintaining a long-term focus and following strategic allocations to a diverse set of asset classes can help manage portfolio volatility while enhancing risk-adjusted returns. While reallocating to an S&P 500 Equal-Weight product may alleviate concerns over holdings concentration, investors should consider the dispersion in returns, lower average market cap, and higher expense ratios and turnover relative to passive products tracking the cap-weighted index. As US Large Caps have significantly outperformed US Small Cap and International indices over the last decade, investors may wish to review their current allocations in relation to their strategic targets and rebalance if appropriate.

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