MEKETA

Market Concentration

and the Case for Deliberate Exposure

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US equity market concentration has risen to historically elevated levels in recent years. A small group of large cap companies now represents a substantial share of US market capitalization and earnings, and the US slice of the global pie has grown. These facts have led many institutional investors to question whether portfolios remain adequately diversified and how they should adapt to this more concentrated market structure. For many investors, the question is not whether concentration can feel uncomfortable, but whether that discomfort warrants changes to long-term equity exposure.

Against this backdrop, this paper examines how investors might approach decisions regarding broad equity exposure and portfolio structure in the context of heightened market concentration. It does not claim that concentration is risk-free, nor does it argue that institutional investors should ignore valuation, governance, or diversification. Instead, it explores concentration as a feature of market structure rather than as a condition that necessarily requires tactical intervention. The intent is to support long-horizon governance decisions by clarifying what concentration measures capture, why concentration can persist, and what trade-offs arise when investors attempt to engineer it away.

Key Takeaways

- Equity market concentration is not inherently risky. Risk depends more on whether firms share common economic drivers that may cause returns to move together. The current level of concentration stems from a few mega-cap companies accruing dominant market share and building lasting advantages through innovation and scale. This reflects underlying economic structure, not just a fleeting market distortion.
- Today's concentration differs from prior episodes. Historical periods of elevated concentration often coincided with less durable business models and weaker balance sheets. Many current leaders exhibit strong profitability, significant free cash flow, and global revenue exposure, rather than speculative excess alone.
- Many large US companies function as diversified operating platforms. The largest firms increasingly resemble modern conglomerates, with multiple business lines, global revenue sources, and internal capital allocation that reduce reliance on any single growth engine.
- Equity wealth creation is highly skewed. A small subset of companies has historically accounted for the majority of long-run wealth creation. Sustained exposure to leading firms can be a structural feature of successful index-based investing.
- Efforts to mechanically reduce concentration introduce meaningful trade-offs that are structural and persistent. Equal-weighted, capped, and constrained indices reduce headline concentration but also alter factor exposures, increase turnover, and can reduce participation in the small number of firms that historically drive long-term wealth creation. They have the unintended consequence of muting an investor's exposure to the meaningful structural, technological, and competitive advantages of the underlying companies.
- For long-horizon investors, portfolio context and governance discipline may matter more than index structure. Most institutions have already chosen their equity risk through policy decisions and rely on other assets to mitigate drawdowns. Concentration should therefore be evaluated within the total portfolio's risk budget and rebalancing policies rather than addressed in isolation.

What is All the Fuss About?

Over the past several years, US equity markets have become increasingly concentrated. A small number of large cap companies now account for a historically elevated share of total market capitalization, index returns, and aggregate earnings. This development has generated understandable concern among investors, as concentration is often associated with heightened risk, reduced diversification, and vulnerability to adverse shocks. Many investors can recall the level of concentration during the Dot-com bubble and see parallels with today's environment. Periods of elevated concentration can create pressure to respond, particularly when recent returns have been driven by a narrow set of companies. These conditions often invite adjustments intended to reduce perceived risk, even when underlying policy exposures remain unchanged.

Though the exact amount varies based on market fluctuations, the top seven companies currently represent roughly 30% of the S&P 500 index's total market capitalization. However, this is not as unprecedented as some investors might assume. While the level of equity market concentration seems quite high to today's investors, it would have felt rather normal to investors from the 1930s through 1960s (see Figure 1).

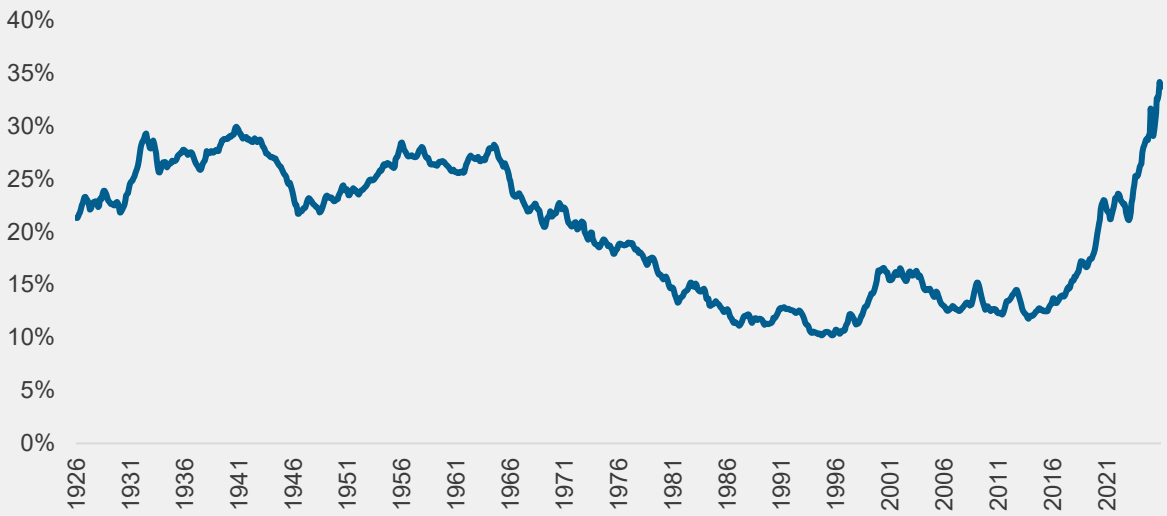
The implication some investors draw from the current level of market concentration is that a market with a small number of dominant firms must be more fragile and is prone to disappoint in the future.[1] This conclusion can be reasonable in certain settings and has some basis in history. If there is a common theme among those companies, it seems intuitive that they share a mutual risk factor. And if this cohort appears to be more expensively priced than the broader market, it might be inferred that this reflects speculative pricing.

For example, a narrow group of mega-cap growth stocks known as the "Nifty Fifty" dominated index performance in the early 1970s. The top five stocks comprised approximately 23% of the S&P 500 index at the peak, an extreme level for the era. These stocks also traded at very high multiples (average P/E around the low 40s, well above the market at the time). Hence market concentration coincided with high expectations embedded in valuation. Once growth disappointed and the macro regime shifted, concentration magnified the downside and led to an extended period of subpar returns. Over the five-year period after the peak, broader market returns were low (essentially flat), and many Nifty Fifty stocks materially underperformed the index.

The exuberance of the Dot-Com bubble of the late 1990s offers a similar example. Market concentration peaked around 1999-2000, with technology and growth stocks dominating index weights. This was the highest level of US market concentration until the current cycle, reflecting narrow leadership and elevated expectations. After the peak, the S&P 500 delivered near-zero annualized returns over the subsequent decade. Some investors are quick to note that equal-weight and smaller stocks materially outperformed cap-weighted indices during this period.

Figure 1
Top 7 Companies' Share of S&P 500 Market Capitalization

Sources: Bye, Per and Soerlie Kvaerner, Jens and Werker, Bas J.M., "Magnificent, but Not Extraordinary: Market Concentration in the US and Beyond" (January 16, 2026); for the period January 1926 through December 2024. FactSet data used January 2025 through December 2025.



Why Many Institutions Own Equities for the Long Term (and Why That Matters for Concentration)

For most institutional investors, equity ownership is not a short-term decision. It reflects a long-term policy choice intended to support growth, preserve purchasing power, and improve the probability of meeting return objectives over multi-year and multi-decade horizons. Ownership of the broad equity market (on a cap-weighted basis) has been a substantial force for long-term wealth creation historically (see Figure 2). While short-term equity volatility can be significant, many institutions accept that volatility as the cost of earning a long-run equity risk premium.

What Market Concentration Measures, and What It Does Not

Market concentration is most commonly measured by the share of total market capitalization represented by the largest companies in an index. Analysts may also use the Herfindahl-Hirschman Index (HHI), which summarizes how market capitalization distributes across constituents (see Figure 3).[2]

These measures provide useful context, but they have limitations. They do not separate fundamentals from valuation. A higher top-ten weight can reflect higher expected cash flows, higher valuation multiples, or both. They do not indicate fragility by themselves. Concentration can coincide with stable profitability and strong balance sheets. And they do not describe economic exposure. A US-domiciled company can derive a large share of revenues and profits from outside the United States.

Figure 2
Long-Term Wealth Creation of the US Equity Market

Sources: InvMetrics and NYU Stern. Data is as of December 31, 2025. Indices used: S&P 500 Total Return, 3-Month T-Bill, 10-Year US Treasury Bonds, Baa Corporate Bonds.

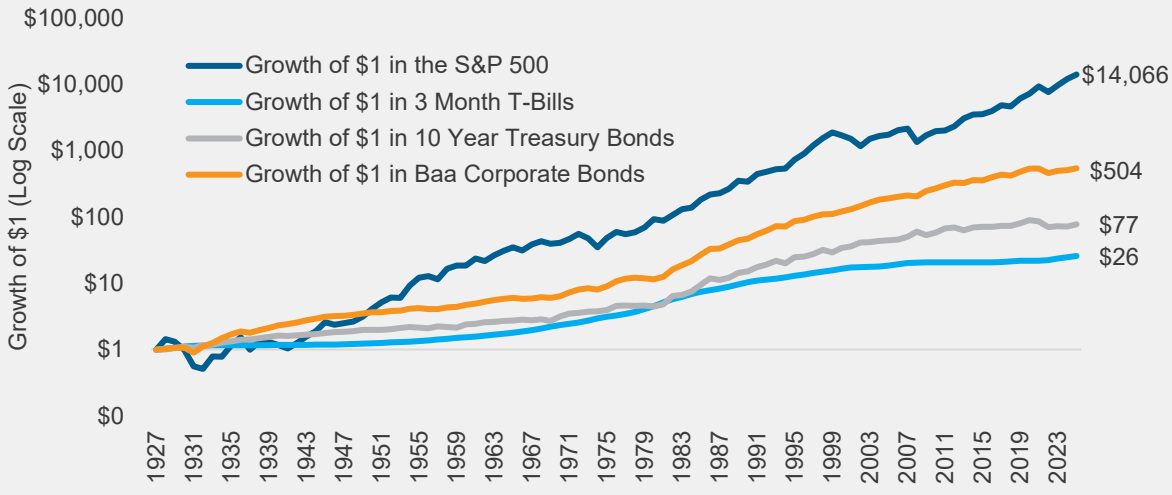
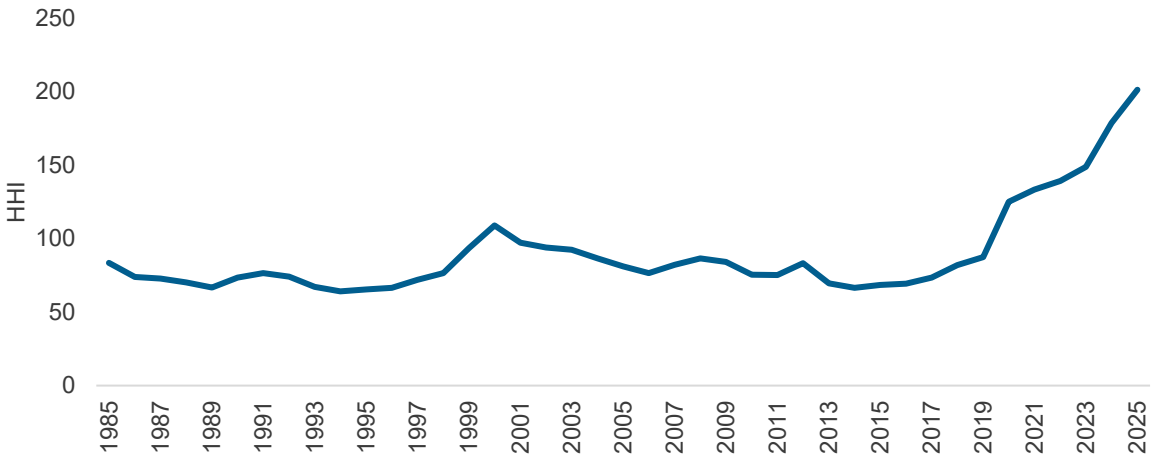


Figure 3
Market Concentration

Source: FactSet. Data is as of December 31, 2025. Based on the S&P 500 index.



Empirical evidence also challenges the assumption that the largest stocks are inherently more fragile. Historical size-decile analyses show that the largest capitalization cohorts often exhibit lower volatility and comparable, if not more favorable, return patterns than smaller stocks.[3] Concentration in large firms does not necessarily imply greater standalone instability.

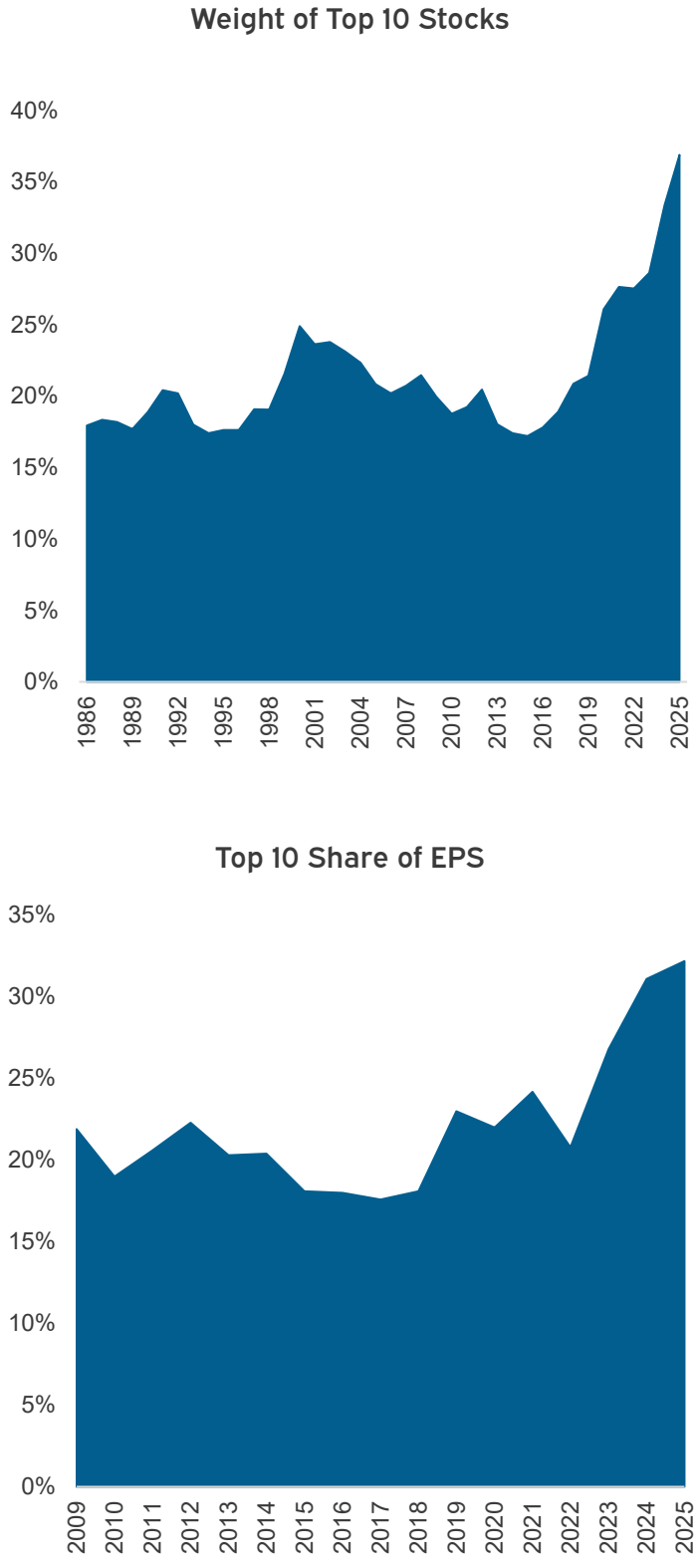
Market capitalization is a result of investors' collective assessments of company fundamentals and market conditions, not something that directly causes other outcomes. It reflects investor expectations about future cash flows, profitability, and growth. Concentration in market value often coincides with concentration in underlying economic drivers, including earnings, margins, and returns on invested capital (ROIC).

Several studies imply that capitalization-weighted indices, which are governed by compounding and skewed outcomes, naturally evolve toward concentration.[4] In that sense, concentration may reflect the arithmetic of compounding and return dispersion rather than excess. Another factor in concentration could be the lower number of publicly traded companies. In the US, the number of publicly traded companies has fallen from over 7,000 stocks to around 4,000 stocks today.[5] However, this has likely had minimal, if any, impact, given that many of the companies that would otherwise have gone public would not have contributed meaningfully to overall market cap.

Figure 4 illustrates the relationship between market capitalization concentration and earnings concentration. Periods of higher earnings concentration have generally coincided with periods of higher index concentration, though index concentration has risen more rapidly in recent years.

This alignment suggests that concentration is not necessarily a distortion. In many cases, it may represent capital aggregation toward firms with superior economic characteristics.

Figure 4
Share of S&P 500 Market Capitalization vs. Share of S&P 500 Earnings Attributable to Top 10 Companies



Sources: FactSet. Data is as of December 31, 2025. Index used is S&P 500.

Conglomerates

Part of the reason the market looks so concentrated is that several of the largest US firms increasingly resemble modern conglomerates rather than single-line businesses. Each of the Magnificent Seven companies operates across multiple, economically distinct segments that span consumer, enterprise, infrastructure, advertising, hardware, software, and financial services. While they are often grouped under a single sector label, their revenue and profit streams are diversified across activities that historically would have belonged to separate industries.

These firms also perform a form of internal capital allocation that mirrors the role of traditional conglomerates. Large, mature cash-generating segments fund investment in newer or more volatile businesses, allowing management to shift capital dynamically in response to changing opportunities. Cloud infrastructure, artificial intelligence, subscription services, hardware ecosystems, logistics networks, and digital advertising are often housed within the same corporate structure, reducing reliance on external capital markets and smoothing earnings through the cycle.

Finally, the scale and integration of these businesses create diversification benefits that are not captured by standard sector classifications. Revenue sources are global, customer bases span households and enterprises, and margins vary meaningfully across segments. As a result, the risk profile of these firms reflects a portfolio of activities rather than a single economic exposure, reinforcing the view that today's market leaders function less like narrow sector bets and more like diversified operating platforms.

If each of the Magnificent Seven were split up into multiple businesses, the market would be less concentrated, but no less risky, as exposure to those businesses would not have changed. Rather, it could be argued it would now be riskier as these individual firms would not have the corporate balance sheet or diversified revenue stream to backstop them.

Investors should arguably be less concerned with concentration by market cap than with concentration by source of economic drivers (e.g., revenue and profit growth). In mathematical terms, "reducing concentration is not helpful unless it reduces weighted covariance. Risk doesn't come from portfolio weights, it comes from portfolio weights interacting with returns."[6]

Concentration Risk: Common Drivers and Effective Concentration

Market cap concentration is an incomplete proxy for concentration risk. The Magnificent Seven are in different businesses from each other (in addition to having different businesses of their own, as noted above). The more relevant question is arguably whether the largest companies share common drivers of earnings and valuation, such that a shock to one is likely to transmit to many.

For example, many mega-cap companies have large expected cash flows far into the future (or are valued as if they do). That means their valuations tend to be more sensitive to changes in interest rates than is the average stock's valuation. Even if their businesses differ, their stock prices can move together when rates move.

Some of the largest firms today also tend to share traits associated with the quality factor, such as high margins, strong balance sheets, consistent cash flow, and high ROIC.[7] If the market's willingness to pay for quality declines, many leaders could weaken together.

Many top firms depend on intangible-heavy models, including software/data, brand ecosystems, network effects, and low marginal costs. This provides scalability and "winner-take-most" dynamics.[8] These dynamics lead to persistent leadership because incremental growth reinforces existing advantages rather than redistributing market share evenly. However, if regulation or competition changes the economics of platforms (e.g., privacy, app stores, antitrust), multiple leaders could face parallel headwinds.

Similarly, in the current cycle, even firms that do not look similar on the surface have become connected through AI-related spending. Examples of shared dependencies include cloud capex cycles, demand for advanced chips, data center buildouts, and energy availability and grid constraints. In other words, they are susceptible to the AI investment cycle and its profitability. A slowdown in AI monetization or capex payback could ripple across multiple mega-cap firms.

These shared exposures suggest that concentration risk can be meaningful even when the underlying businesses differ. However, compared with prior episodes such as the late-1990s technology bubble (see Figure 5),[9] today's concentration rests more heavily on realized profitability and free cash flow generation, which may reduce, but not eliminate, the probability of abrupt and disorderly reversals.

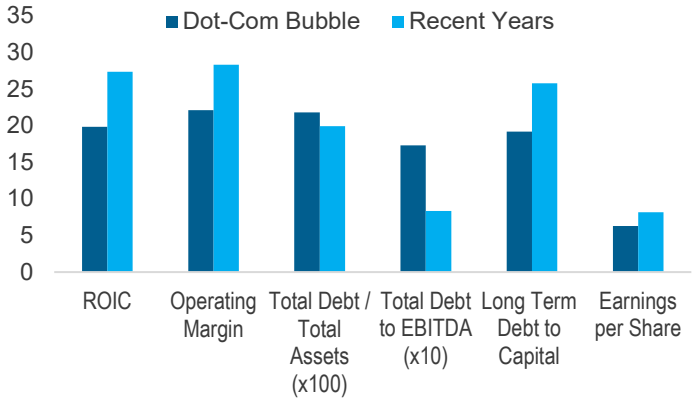
Economic Drivers of Today's Concentration

Concerns about concentration often draw on historical analogies, such as the Nifty Fifty of the early 1970s or the technology sector during the late 1990s. These episodes offer useful lessons, but the comparisons have limits. In prior periods, high concentration often coincided with elevated valuations that were unsupported by sustainable profitability. Many firms lacked durable competitive advantages or faced rapid technological obsolescence. When growth expectations reset, the share prices of the market leaders plummeted and concentration declined sharply.

By contrast, today's largest firms tend to exhibit high and persistent profitability, strong balance sheets, and diversified revenue sources. Although current valuations may exceed long-term averages, they are reinforced by substantial cash flow generation, which was largely absent during prior periods of concentration. While this distinction does not eliminate the possibility of a substantial drawdown, it suggests that concentration, in isolation, offers limited insight into future returns or risks without consideration of underlying fundamentals.

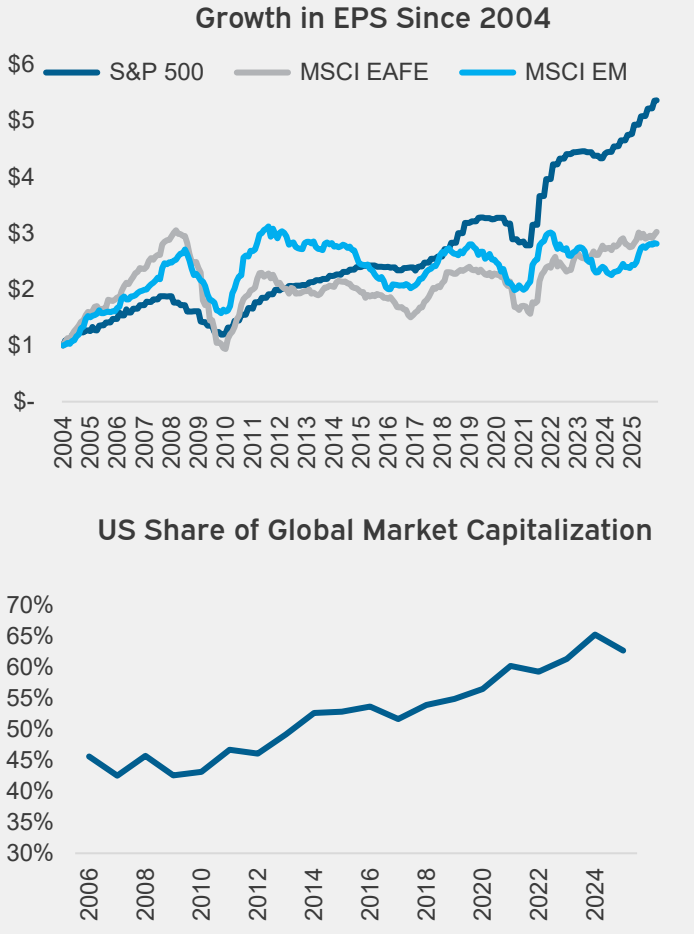
Several structural factors help explain why concentration has increased in recent decades. US markets over this period have been more profitable and have grown faster than others. As a result, investors have rewarded US companies with higher average valuations and a much larger share of global market cap (see Figure 6).

Figure 5
Average Financial Metrics of the Top 10 Stocks in the Russell 3000



Source: FactSet. Period for the Dot-Com Bubble is 1998 to 2002. Period for Recent Years is 2021 to 2025. Total Debt to Total Assets and Total Debt to EBITDA are multiplied by 100 and 10, respectively, for the purposes of viewing this chart. All ratios are as of December 31, 2025.

Figure 6
EPS Growth and Growth in US Share of Global Market Cap



Source: Bloomberg. Trailing 12-Month EPS and Market Cap data is as of December 31, 2025. Indices used are S&P 500, MSCI EAFE, MSCI Emerging Markets, MSCI ACWI IMI, and MSCI USA IMI.

Although the current enthusiasm for artificial intelligence has contributed to elevated valuations, it reflects a broader, long-term trend driven primarily by increasingly concentrated corporate profits. The present high level of stock market concentration is largely a direct consequence of sustained profit growth among mega-cap growth companies over the past decade. Additionally, these large firms are now valued at higher multiples than they were ten years ago, presumably in anticipation of continued strong earnings growth. Together, these factors have resulted in a smaller number of highly profitable companies comprising an ever-larger share of global market cap (i.e., a more concentrated equity market).[10]

The dominance of technology and related stocks largely follows a similar line of reasoning. The tech sector and firms that can scale based on technology (e.g., some mega-caps in the consumer discretionary sector) have been the dominant factor behind earnings growth in the equity market (see Figure 7). These companies have been fairly unique in being able to grow earnings while simultaneously improving the quality of returns over time (i.e., they have continually progressed in becoming more efficient). This has been recognized in how the market values them, both in higher valuations and a larger share of the market (see Figure 8).[11]

Figure 7
Annualized Average US Earnings Growth by Sector

Source: Bloomberg. Data for the twenty years ending December 2025. Index used: S&P 500. The real estate sector was established in September 2016 and performance is shown since inception. The communication services sector was announced in 2017 and fully implemented in September 2018. The Magnificent Seven stocks include information technology, consumer discretionary, and communication services sectors though they are often collectively referred to as technology stocks in the media. For example, Meta and Alphabet were moved to communication services in September 2018.

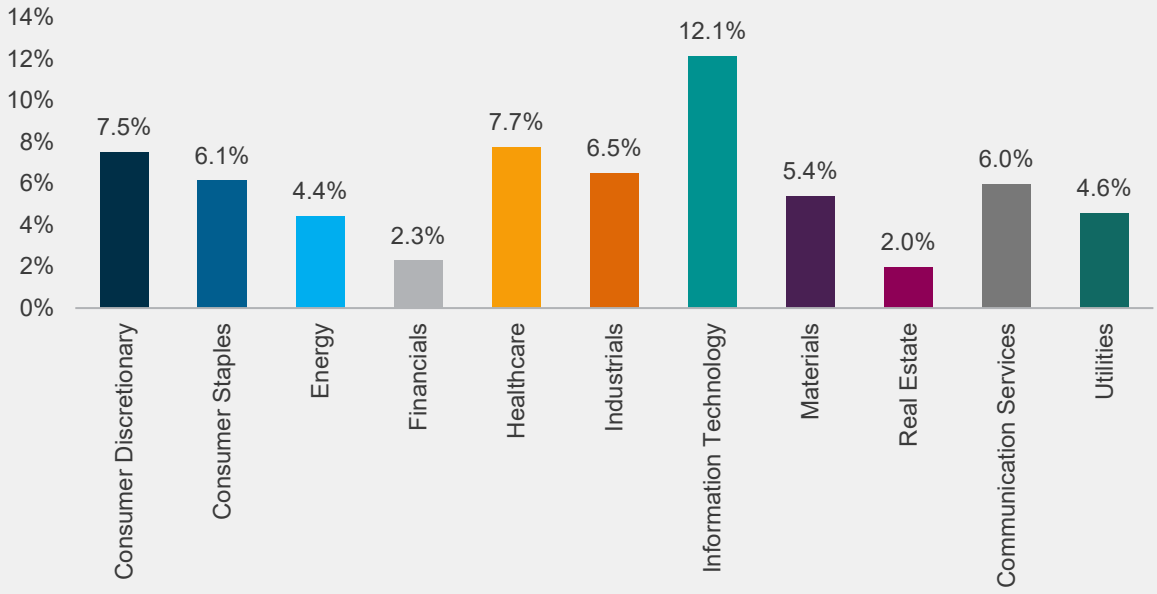
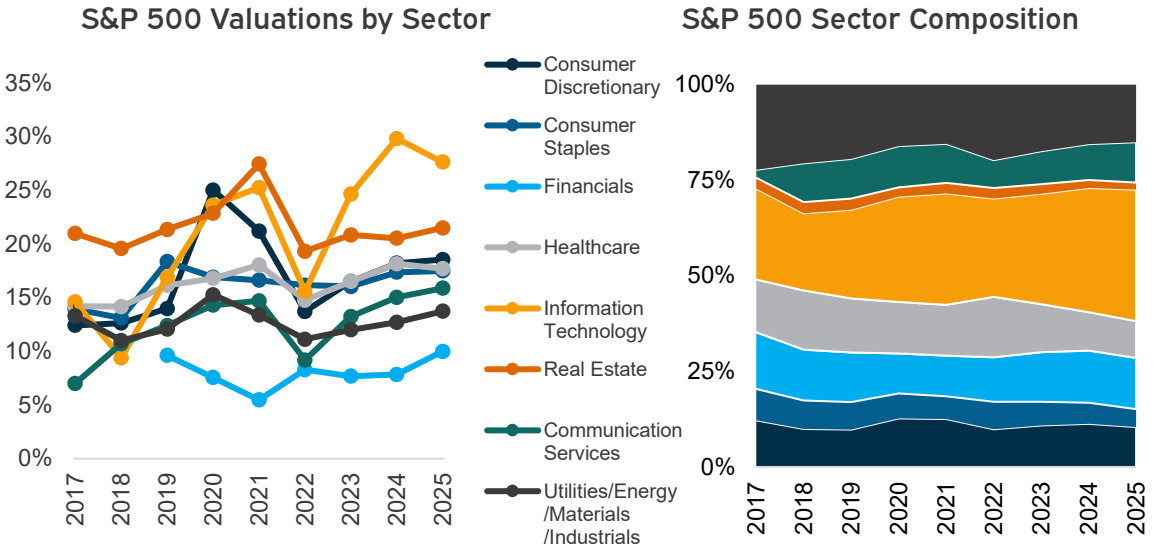


Figure 8
Sector Valuations and Weightings

Source: Bloomberg. Sector Weights and Current EV to Trailing 12 Month EBITDA Sector Valuations data is as of December 31, 2025. Index used is S&P 500. Utilities/ Energy /Materials/ Industrials combined sector valuation is a simple average.



Scale Economics and Winner-Take-Most Dynamics
Many leading US companies benefit from scale economics, network effects, and intangible assets. Software platforms, data-driven business models, and intellectual property allow successful firms to expand revenues with relatively low incremental capital. These dynamics can produce winner-take-most outcomes, particularly in global markets.

Large firms also benefit from global distribution networks, high fixed-cost platforms, and proprietary ecosystems. These advantages can support persistent differences in margins and returns on incremental invested capital, which in turn support larger index weights.

Lower Capital Intensity and Stronger Cash Flow Conversion
The low capital intensity of the Magnificent Seven stocks was a positive driver of their total enterprise value over the past decade.[12] This is because firms with high margins and lower reinvestment requirements can return capital to shareholders while continuing to grow. Over time, these characteristics compound into larger market weights. As companies announce significant changes to their capex spending, markets may reassess their estimates for future profitability and revenue generation.

Global Revenues
Large US companies often operate across dozens of countries (or more), with diversified customer bases and revenue streams. As a result, their growth prospects may be less tied to domestic economic conditions than their index classification alone would suggest.

These dynamics and characteristics help explain why capital has accumulated in a relatively small number of firms. These attributes are all true as of this writing, indicating that the companies are not presently facing imminent financial distress. However, the market tends to worry about (and price in) not just what is happening today, but the collective expectation for the future. Thus, high valuations today are based not only on strong current financials but also in anticipation of strong future financials. Arguably, the future outlook for these companies are highly dependent on the prospects for continued innovation and the potential of AI, and the market is intentionally willing to take on these risks.

Figure 9
Selected Financial Metrics for 10 Largest US Stocks vs. the Remaining Stocks

Strategy	10 Largest Stocks in Russell 3000	Remaining Stocks in Russell 3000
Operating Margin	36.9%	21.4%
ROIC	46.5%	14.6%
Net Debt / EBITDA	0.6	2.3
Share of Revenue Outside the US	50.6%	20.5%

Source: FactSet. Data is as of December 31, 2025. Index used: Russell 3000. Financial ratios calculated uses weighted averages. The Remaining Stocks in Russell 3000 category uses a weighted windsorized average to replace extreme values beyond a specified percentile threshold (e.g., the top and bottom 1%) with the nearest remaining values to reduce the influence of outliers.

Persistence: Why Leadership Can Last Longer Than Expected

Concerns regarding market concentration frequently assume that market leadership is inherently mean-reverting and subject to abrupt shifts. However, historical evidence indicates that leadership often endures until there are significant changes in underlying technologies, competitive dynamics, or consumer behavior (see Figure 10). For example, markets were dominated by industrial giants and energy companies in the 1970s and 1980s. IBM and Exxon Mobil spent multiple decades in the top ten. However, in market-driven economies, successful firms tend to be imitated, prompting competition that gradually diminishes the advantages previously held by market leaders, especially if they do not adapt and evolve.

Yet, in markets where scalability is a defining feature, leading firms may maintain their dominance for longer than the traditional mean-reversion narratives imply. The relevant question becomes not whether concentration exists, but whether the economic foundations supporting leadership remain intact, and for how long that will be the case. Notably, many of today's largest firms have demonstrated an ability to reinvent themselves, potentially justifying expectations that they are well equipped to sustain their market-leading positions in the future.

Figure 10
Changes in Market Leadership: The Ten Largest US Stocks by Decade

Sources: S&P Dow Jones Indices, FactSet. Largest companies for 1970 through 2000 are based on historical S&P 500 concentration research and contemporaneous accounts of market structure. 2010 and 2020 are based on data from FactSet. Reflects top ten companies by market cap, as of December 31 for the respective years.

1970	1980	1990	2000	2010	2020
IBM	IBM	IBM	GE	ExxonMobil	Apple
AT&T	AT&T	Exxon	Exxon	Microsoft	Microsoft
General Motors	Exxon	GE	Pfizer	Apple	Amazon
Exxon	Amoco	Philip Morris	Citigroup	Walmart	Alphabet
GE	Schlumberger	Procter & Gamble	Cisco	Berkshire Hathaway	Facebook (Meta)
Mobil	Shell Oil	Royal Dutch Petroleum	Walmart	GE	Berkshire Hathaway
Texaco	Mobil	Bristol-Myers Squibb	Microsoft	Procter & Gamble	Visa
DuPont	Chevron	Merck	AIG	Johnson & Johnson	Johnson & Johnson
Procter & Gamble	Atlantic Richfield	Walmart	Merck	Pfizer	Tesla
Eastman Kodak	GE	AT&T	Intel	Coca-Cola	Walmart

This perspective does not preclude changes in market leadership. Instead, it suggests that structural underweights based solely on current levels of concentration may be premature. While it is quite likely that many of today's top ten names will not be in the top ten in five or ten years, history would point to some of those names staying in the top ten for an extended period.

Much of the durability of recent market leadership has been linked to technological innovation. Innovation, however, introduces its own set of risks. For example, if today's market leaders determine that they must invest exceptionally large sums in capital expenditures to defend or maintain their dominant position, this intensive spending could compress their future returns, even if the overall demand for their products or services remains robust. In this scenario, the need to continually reinvest profits into sustaining advantages could lead to lower-than-expected earnings and returns, highlighting a structural risk associated with high concentration in leading firms.

This dynamic does not invalidate the case for concentration, but it does complicate it: innovation can reinforce leadership and earnings scale while simultaneously increasing uncertainty around future returns. For investors, the relevant question is not whether innovation will continue, but whether adjusting equity exposure in response to that uncertainty improves outcomes relative to accepting the inherent variability associated with long-duration, innovation-driven businesses.

Skewness and Long-Run Wealth Creation

A compelling structural rationale for maintaining exposure to stock markets, particularly market leaders, is supported by the distribution of equity returns.[13] Equity returns are not symmetrically distributed across companies. Rather, a small proportion of stocks accounts for the majority of cumulative wealth creation, while most companies deliver modest or even negative lifetime returns. This pattern implies that equal-weighted exposure across companies would result in far less wealth creation than a portfolio that allows successful companies to appreciate without constraint (i.e., let the winners run). By selling the best performers too early, an investor systematically cuts off from the biggest payoffs.

One now widely-circulated study showed how long-term wealth creation in the stock market is highly concentrated (see Figure 11). The data showed that 55.2% of US stocks and 57.4% of non-US stocks failed to match the returns of Treasury bills. The other 40% or so created $89.5 trillion in value. Just 2% of the companies produced 90% of the aggregate wealth creation, and the top six (Apple, Microsoft, NVIDIA, Alphabet, Amazon, and ExxonMobil) alone added $17.1 trillion.[14]

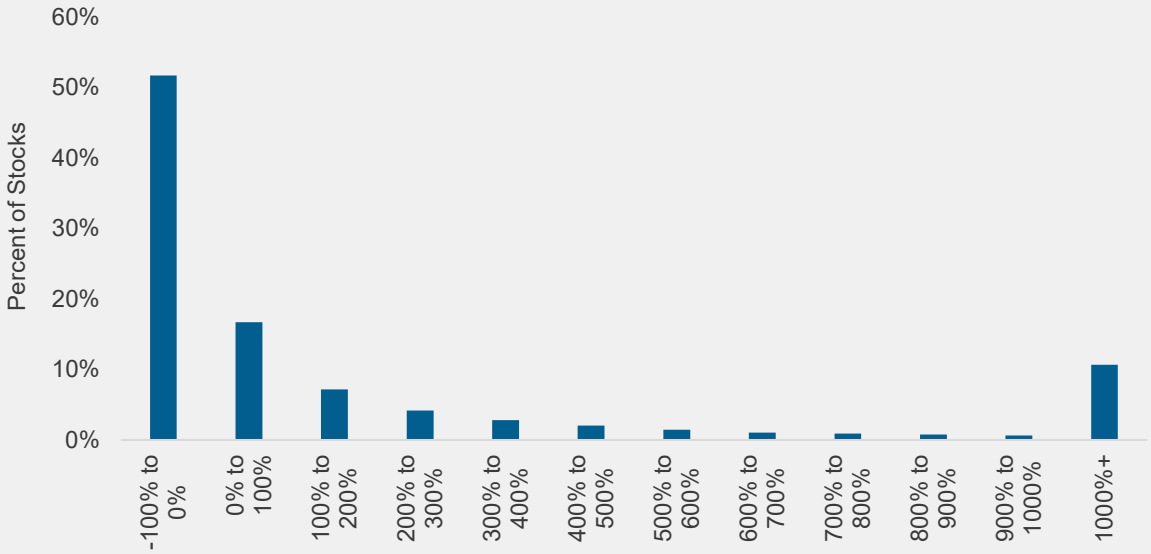
Notably, the average maximum drawdown for these six companies was 80%, similar to the average of each stock in the market.[15] That is, they each suffered severe losses at one point during their lifetime, losses that far exceeded those that would have been experienced by holding a broad market index. However, investors who retained their shares throughout these periods and up to the present have been substantially rewarded for their perseverance.

Viewed through the lens of asymmetric wealth creation, investors may choose diversified portfolios not solely to mitigate risk, but also to enhance the likelihood of including high-performing assets (i.e., to ensure they are holding the next proverbial lottery ticket). This perspective does not imply that the current market leaders will maintain their status indefinitely or that markets always price assets correctly. Rather, it suggests that concentration may be a feature, not a bug, of indexing.

Conventional capitalization-weighted indices, such as the S&P 500 or Russell 3000, systematically allocate more capital to firms with rising valuations, which often reflect expectations about the firms' ability to capture scale advantages, platform economics, and network effects. Conversely, strategies that mechanically cap or equalize weights inherently decrease exposure to these firms and implicitly reallocate toward firms with a lower historical contribution to aggregate returns. A portfolio design that systematically limits exposure to large winners may reduce the probability of capturing the right tail of equity outcomes (i.e., outsized wealth creation).

Figure 11
Cumulative Wealth Creation by Percentile of Stocks

Source: Hendrik Bessembinder, "Do Stocks Outperform Treasury Bills?" Journal of Financial Economics, Vol. 129, No. 3, September 2018, 440-457. Data updated through December 2023. Indicates the percent of stocks with full sample period buy-and-hold (cumulative) return.



Risks Associated with Concentration

Investors who maintain meaningful exposure to the largest firms should recognize several structural risks. Dominant firms are likely to attract greater scrutiny, rising competition, and higher expectations, leading to a wider range of possible outcomes.

When large firms trade at elevated valuations, their future returns become increasingly sensitive to shifts in either discount rates or growth expectations. In such environments, even modest changes in interest rates, inflation assumptions, or the perceived durability of a company's growth can have an outsized impact on valuations. This risk is particularly acute when market prices diverge from reasonable forecasts of long-term cash flow generation, meaning that if underlying fundamentals fail to meet market optimism, significant price corrections may follow. Consequently, investors exposed to highly valued firms should be aware that the margin for error narrows as valuations rise, and the potential for volatility or underperformance increases if expectations are not met.

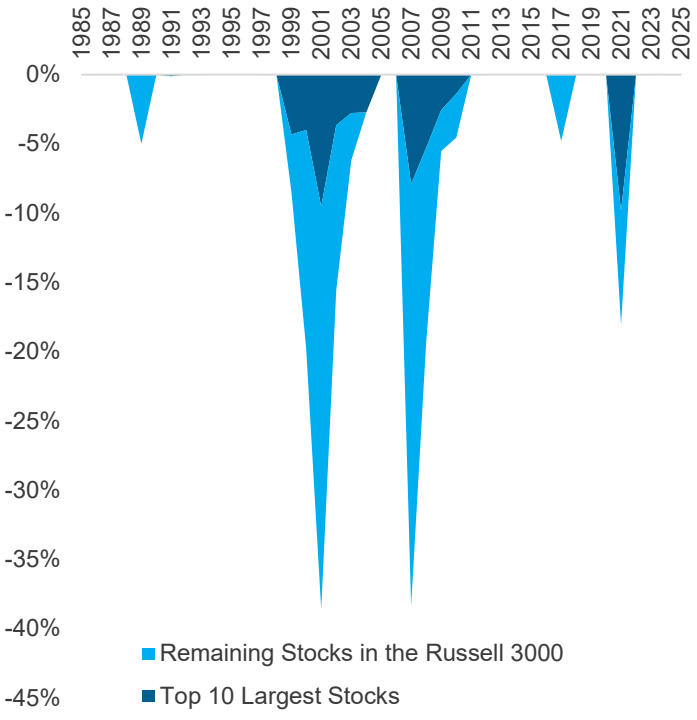
Dominant firms frequently encounter heightened regulatory scrutiny. Regulatory authorities may impose stricter oversight in areas such as antitrust and competition policy, aiming to prevent monopolistic practices and maintain market fairness. Additionally, evolving privacy regulations (e.g., data protection laws) can introduce new compliance requirements, forcing firms to adapt their business models or invest in costly infrastructure to safeguard user information. Changes in taxation policy can further affect the bottom line of market leaders. International trade rules also play a critical role, as shifts in tariffs, export controls, or geopolitical tensions may disrupt supply chains and limit market access. The cumulative effect of these regulatory pressures can lead to increased constraints on growth. As a result, investors should recognize that regulatory risk is an integral aspect of owning shares in dominant firms, and this risk may intensify as companies grow in influence and visibility.

Market leadership depends on continued reinvestment effectiveness and adapting as markets change. If incremental returns on invested capital decline, it can slow growth and impact company valuations. In an environment where capex is both increasing and increasingly related to a common theme for many of the largest companies (e.g., AI), this reinvestment risk may be higher than usual. Some argue that this makes the market more sensitive to disruption. Still, competition and creative destruction have long made the US market dynamic and contributed to its vitality. Several of the most highly valued firms will almost surely fail to meet expectations, but the majority are well positioned to meet the challenges ahead, and it is at least as plausible that many of them will beat expectations.

Even if fundamentals remain strong, future returns may disappoint if valuations embed overly optimistic growth assumptions. These risks are inherent to ownership of leading firms and should be understood as part of the expected return distribution rather than as automatic signals for adjustment. The relevant question is whether structurally reducing exposure to market leaders improves the expected outcome or merely substitutes one set of risks for another. Of note, during the major downturns over the past forty years, the largest firms have typically fared better than the broader market (see Figure 12). The underlying rationale is that investors may gravitate toward these companies, which possess diversified and stable revenue streams as well as substantial cash reserves that can provide a buffer during periods of economic uncertainty.

Figure 12

Contribution of Top 10 Constituents to Russell 3000 Drawdowns



Source: FactSet. Data is as of December 31, 2025. Index used is Russell 3000.

The Trade-Offs of Reducing Concentration

Attempts to decrease concentration through alternative index constructions or structural reweighting can address headline exposure. Further, equal-weighted strategies proved quite successful in the wake of the Dot-com bubble bursting and the Global Financial Crisis (GFC). However, their relative success following these bubbles depended on extended periods in which market leaders delivered persistently low returns, not merely on high starting concentration. Moreover, equal-weighted and capped indices also change the character of the equity allocation in less visible ways, introducing several structural trade-offs that investors should consider.

Equal-weighted indices tilt portfolios toward smaller-cap and value-oriented exposures relative to capitalization-weighted indices. This shift occurs because equal weighting systematically reduces the influence of large, high-growth firms, instead allocating more capital to companies with lower market capitalizations. This can alter the portfolio's risk profile in ways that are not fully captured by concentration statistics.

Equal-weighted and capped indices generally necessitate more frequent rebalancing than their capitalization-weighted counterparts. This increased turnover can lead to higher transaction costs, which erode portfolio returns. Frequent trading can also introduce operational complexity and frictions.

Historical simulations that reduce equity exposure when concentration rises have not consistently improved outcomes relative to maintaining a stable allocation. They show that such strategies have reduced returns without delivering commensurate risk reduction. Moreover, the largest stocks have not historically exhibited systematically worse risk characteristics than smaller stocks.[16]

Because the process of wealth creation in equity markets is highly skewed, limiting exposure to the largest and fastest-growing firms can significantly reduce an investor's ability to benefit from outsized gains, or "right tail" outcomes. As a result, strategies that mechanically lower concentration may inadvertently constrain exposure to the primary sources of wealth generation, potentially limiting overall portfolio growth. In the current environment, they also represent an implicit relative bet by underweighting the primary drivers of earnings growth and technological innovation.

These effects are not necessarily undesirable, but they represent substantive trade-offs that extend beyond concentration itself and can persist long after the initial motivation for change has faded.

Total Portfolio Context

Assessing portfolio exposure requires a comprehensive view that extends beyond public equities. For example, many institutional investors have a meaningful allocation to private equity in addition to their allocation to public equities. While diversified private equity programs tend to have a substantial allocation to the technology sector, perhaps even higher than that of their public equity portfolio, many probably have much lower relative exposure to AI-driven opportunities. This is because most mature private equity portfolios, reflecting average exposures accumulated over the past 10 to 15 vintage years, likely did not start adding meaningful AI exposure until recent years, and even that was likely primarily (or only) in the venture capital portion of their portfolio. As a result, investors relying heavily on private equity may inadvertently miss out on the growth potential associated with AI, given that these investments often lag current market trends. A holistic portfolio review is essential to ensure that exposure to innovation is balanced across both public and private market holdings, aligning with long-term objectives and the evolving opportunity set.[17]

Hence, if an investor has a sizable private equity allocation and is bullish on AI (i.e., they believe it will be a truly transformative technology), this argues for allowing a large weight in public equities to AI-driven opportunities, to balance their underweight position in private equity. That is, investors may be well served by looking at their exposure to AI across both public and private markets and making a deliberate choice as to the exposure they wish to have across the combined portfolio.[18] In the current environment, there is a balancing act to be considered – the risk of being concentrated versus exposure to innovation and transformative technologies.

Extending this logic a bit further, an investor should also consider what exposure they might have to AI, even if indirectly, throughout the rest of their portfolio. Such a holistic approach might, for example, consider exposure to capex spending (and the associated borrowing) related to data centers in their private credit, real estate, and infrastructure portfolios.

Staying the Course

In practice, most institutional investors do not arrive at their equity exposure by reacting to market conditions. They establish an equity allocation through an investment policy process that considers time horizon, liquidity constraints, spending needs, funded status (where relevant), risk tolerance, and governance capacity. Once set, that policy allocation often serves as the anchor for portfolio construction decisions (e.g., target allocation is determined along with an acceptable allocation range). This process helps separate strategic intent from tactical discomfort during periods of market stress.

This context matters for how investors interpret market concentration. Concentration can increase the dispersion of outcomes within the equity portfolio. It can also raise questions about diversification within a US equity index. However, many institutions manage equity drawdown risk primarily through the total portfolio, not by attempting to reduce the influence of the largest equity constituents.

Most policy portfolios include assets specifically intended to dampen equity risk during severe downturns. High-quality fixed income is the most common example. For many institutions, core bonds play a clear and distinct role: they act as a stabilizer in periods of equity market stress, support liquidity needs, and help maintain the ability to rebalance into risk assets at more favorable prices. Some investors allocate to Risk Mitigating Strategies,[19] an approach that is designed to exhibit low to negative conditional correlations to equities during drawdowns. Hence, many investors have intentionally designed hedges against equity-driven drawdowns in their portfolios.

From this perspective, the key governance question is not whether US equities have become more concentrated, but whether the institution remains comfortable with the overall level of equity risk it has already chosen to bear. If an investor believes the policy target allocation to equities appropriately balances long-term return needs with drawdown tolerance - and if the portfolio includes an adequate allocation to assets intended to hedge during equity selloffs - then a more concentrated equity market may not require a structural response.

To help determine this, in the process of setting a target allocation to equities, the investor likely modeled the impact of an equity drawdown. And ideally their tolerance for such a drawdown (and its impact on the total portfolio) should have driven their equity allocation decision. In the words of one famed investor, "if you're not willing to react with equanimity to a market price decline of 50 percent 2 or 3 times a century, you're not fit to be a common shareholder and you deserve the mediocre result you are going to get."[20] This perspective serves as a reminder that meaningful drawdowns are an expected part of participating in equity markets, underscoring the importance of maintaining a long-term outlook and resilience in the face of market fluctuations.

This does not imply that concentration is irrelevant. It suggests that the appropriate first step is to evaluate concentration in the context of the institution's existing risk budget and hedging framework. For many long-horizon investors, the decision to maintain broad US equity exposure reflects a deliberate acceptance of equity risk, paired with other portfolio components designed to mitigate the impact of severe equity downturns.

Policy Discipline

A concentration-tolerant approach does not imply passivity. It emphasizes discipline and clarity about what risks the portfolio intends to take. For many long-horizon investors, staying close to capitalization-weighted US equity exposure is a reasonable default. Concentration concerns may be addressed through implementation policies such as rebalancing or risk budgeting rather than structural redesign.

Rebalancing discipline helps investors avoid inadvertently increasing risk exposures during extended rallies or abandoning exposures during drawdowns. A clear policy can also support governance by reducing the temptation to make ad hoc changes. Such a policy should have clear targets, ranges, and triggers for when rebalancing should occur.

Some institutions may have set a risk budget that allows for modest deviations from capitalization-weighted exposure to manage risk (and seek higher returns). These risk budgets are based on tracking error versus a policy portfolio rather than deviations from target allocations. Risk budgets can help define the size and purpose of deviations, rather than allowing concentration concerns to drive open-ended portfolio drift.

Conclusion

US equity market concentration is elevated by historical standards, but market capitalization alone provides an incomplete picture of risk. Concentration becomes problematic primarily when it reflects a narrow set of shared economic drivers, fragile business models, or excessive reliance on sentiment rather than fundamentals. Hence, while discomfort with concentration is understandable, concentration does not necessarily imply an increase in portfolio risk, particularly when concentration reflects earnings dominance or persistent leadership rather than shared fragility. In the current environment, concentration coincides with strong profitability, substantial free cash flow generation, and business models that operate across multiple end markets and geographies. These characteristics do not eliminate risk, but they do distinguish today's market structure from past episodes often cited as cautionary parallels.

For long-horizon institutional investors, the relevance of concentration depends on portfolio context. Most institutions have already made an explicit policy decision regarding equity risk and have constructed portfolios that rely on other asset classes, such as high-quality fixed income and risk mitigating strategies, to provide ballast during equity market drawdowns. Within that framework, concentration inside the equity allocation does not automatically undermine diversification at the total portfolio level. Addressing concentration in isolation risks obscuring the role equities are intended to play within the broader investment program.

Attempts to mechanically reduce concentration through index design or systematic reweighting introduce trade-offs that deserve careful consideration. Such approaches can alter factor exposures, increase turnover, and reduce participation in the subset of firms that historically account for a disproportionate share of long-term equity wealth creation. These costs are often gradual and may only become evident over full market cycles, making them harder to evaluate than more visible and near-term measures of risk reduction.

A more durable response to concentration emphasizes monitoring rather than engineering. Investors may benefit from focusing on whether the fundamentals supporting market leadership remain intact, whether valuation assumptions remain plausible, and whether correlations among large firms are rising in ways that meaningfully impair diversification. Within this framework, concentration becomes one input into ongoing governance rather than a trigger for structural change. The best way to mitigate equity risk may be through asset allocation and portfolio construction.

Ultimately, elevated concentration should prompt analysis rather than reflexive action. For many institutions, maintaining broad exposure to US equities while adhering to established rebalancing and risk-management disciplines may offer a clearer path to meeting long-term objectives. This perspective does not eliminate or ignore risk, nor does it suggest that current conditions will persist indefinitely. It suggests that concentration, by itself, may not warrant structural changes to policy portfolios absent clearer evidence of valuation extremes or deterioration in fundamentals.

Appendix

Fragility

When people talk about "market fragility," they are usually pointing to how easily shocks propagate, not simply how volatile prices are. Some of the commonly used metrics include VIX (implied volatility), average pairwise correlation, and systemic risk (see Figure 13). None of these is definitive on its own, and they all tend to be backward-looking rather than predictive (i.e., they spike after fragility has already materialized).

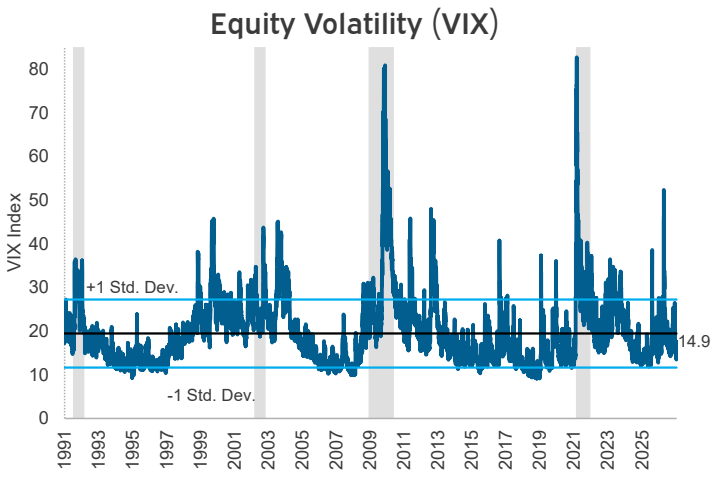
Global Capital Allocation and US Market Dominance

US equity concentration should be considered in the context of global capital allocation. The United States combines deep capital markets, relatively strong investor protections, and a high concentration of firms operating at the technological frontier. As a result, global portfolios increasingly express exposure to economic growth and innovation through US markets. This dynamic reinforces the market capitalization of leading firms and links US concentration to global portfolio construction rather than domestic investor behavior alone.

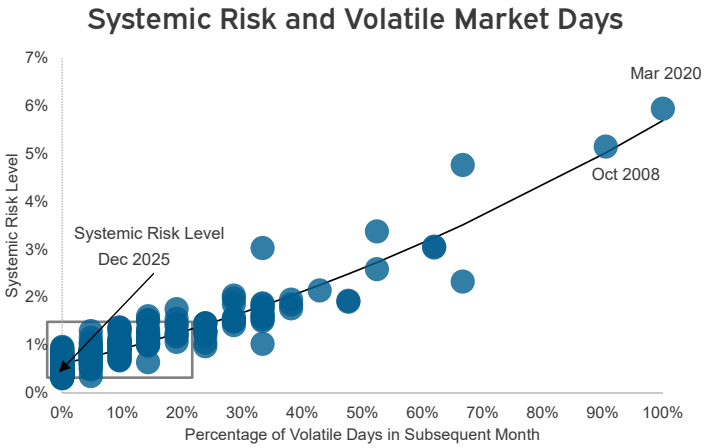
Some investors forget that the US equity market is less concentrated than most other stock markets (see Figure 14). It is only when those various markets are combined (as in a global index like the MSCI EAFE or MSCI EM) that the concentration of those markets dissipates.

Figure 13

Measures of Market Fragility



Source: FRED, and Meketa Investment Group. Equity volatility is proxied by the VIX Index, a measure of implied option volatility for US equity markets.

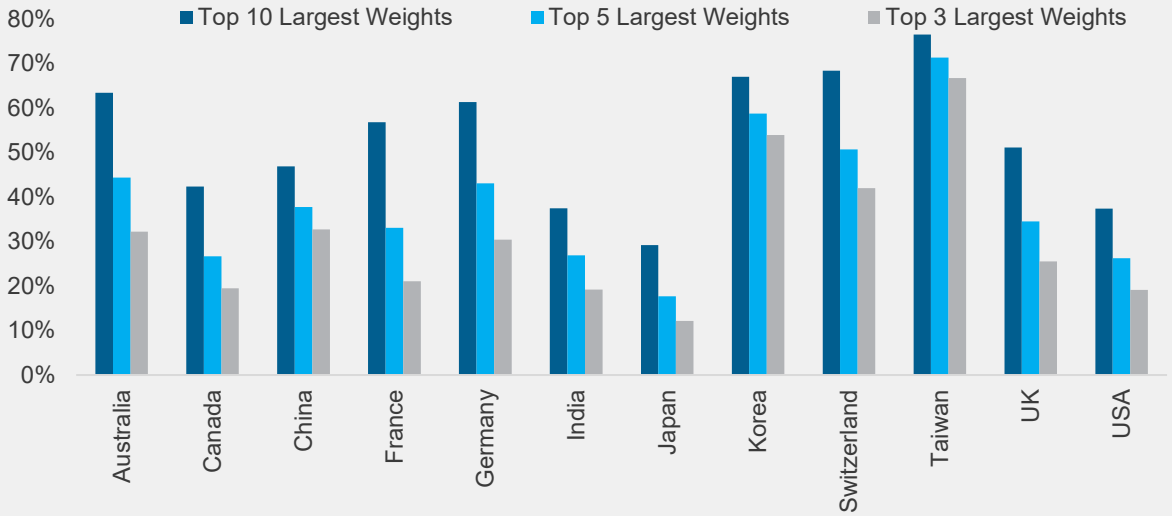


Source: Meketa Investment Group. Volatile days are defined as the top 10 percent of realized turbulence, which is a multivariate distance between asset returns.

Figure 14

Index Concentration by Country

Source: MSCI Factsheet. Data is as of January 31, 2026. Indices used: MSCI Australia, MSCI Canada, MSCI China, MSCI France, MSCI Germany, MSCI India, MSCI Japan, MSCI Korea, MSCI Switzerland, MSCI Taiwan, MSCI UK, MSCI USA.



One contributing factor to US market concentration is the limited number of viable alternatives for global investors (see Figure 15). Investment opportunities in China are constrained not least from a regulatory standpoint, while Europe may not provide compelling growth prospects, and emerging markets remain relatively small and heterogeneous. Thus, global capital continues to seek destinations large enough to absorb investment flows, and the US remains the primary option. This framing does not imply that US equities will always dominate. It highlights why US market concentration can persist when global capital pools favor deep liquidity and scalable business models.

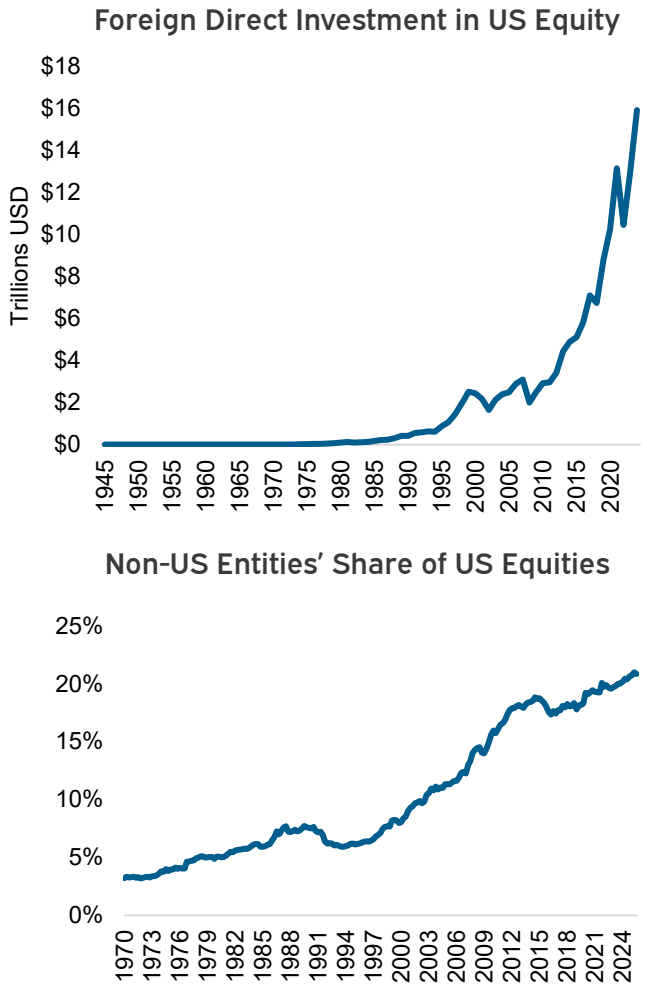
Active Management

Actively managed equity portfolios can also reduce concentration while seeking to outperform the broader market. While these strategies can effectively serve specific goals, they also come with trade-offs, the most notable of which may be reducing exposure to the fastest growing, most innovative companies.

This discussion does not address the long-term debate between active and passive management. Rather, we note that it is logically quite possible that some active managers may be able to build a portfolio that outperforms the market while maintaining lower concentration by judiciously selecting companies with strong potential for future performance. However, historical data implies that the likelihood of achieving such results varies by mandate and overall is relatively low (see Figure 16).

Figure 15

"TINA" – Foreign Investors Prefer US Markets



Source: FRED. Foreign Direct Investment in US Equity by Market Value data is as of December 31, 2024 (2025 data not yet available as of February 2026). Non-US Entities' Share of US Equities is as of July 2025. Note that "TINA" is an acronym for There Is No Alternative.

Figure 16

Outperformance of Actively Managed Equity Managers

	Primary Benchmark	Since Inception Median Net Outperformance	Trailing 10 Year Median Net Outperformance	Trailing 5 Year Median Net Outperformance	Median Fee
US Equity	Russell 3000	0.00%	-1.38%	-1.46%	0.60%
US Large Cap Equity	Russell 1000	-0.07%	-1.06%	-0.99%	0.51%
US Mid Cap Equity	Russell Mid Cap	-0.13%	-0.68%	-0.27%	0.64%
US Small Cap Equity	Russell 2000	1.06%	0.23%	1.32%	0.78%
US Growth Equity	Russell 1000 Growth	-0.07%	-1.63%	-2.04%	0.56%
US Value Equity	Russell 1000 Value	-0.08%	0.33%	0.65%	0.52%

Source: Meketa analysis of data from eVestment, as of September 30, 2025. The table represents manager returns over one year minus the benchmark return for the period where data is available. Inception date starts when there are at least 10 funds to evaluate. Median sliding fee on a $100 million mandate for all product types as of November 2025. Backdated fee information is unavailable. See Meketa's Manager Alpha Whitepaper for more information on methodology.

End Notes

[1] See, for example, "Market Concentration and Lost Decades," by Bill Pauley, Kevin Bales, and Adam Schreiber. Market Concentration and Lost Decades - CFA Institute Enterprising Investor. The authors note that there have been multiple "lost decades" throughout market history, with most of them occurring after periods of extreme market concentration and relative valuations.

[2] Note that the Herfindahl-Hirschman Index (HHI) was originally developed as a tool in industrial organization economics to quantify how competitive or concentrated a market is by measuring the distribution of market share among firms. It has been adapted to measure how much market capitalization is dominated by a few firms. The HHI calculates concentration by summing the squares of each constituent's market share, with higher values indicating greater concentration. Alternatively, another way to measure concentration is the "effective number of constituents," calculated as the reciprocal of the HHI. This measure translates weight concentration into the equivalent number of equally weighted stocks.

[3] See "The Fallacy of Concentration" by Mark Kritzman and David Turkington, published October 6, 2025.

[4] See "The Fallacy of Concentration" by Mark Kritzman and David Turkington, published October 6, 2025; and "Stock Market Concentration: How Much Is Too Much?", Michael Mauboussin and Dan Callahan, Counterpoint Global Insights, Morgan Stanley Investment Management, June 3, 2024.

[5] See "The Decreasing Number of Public Companies" published by Meketa in September 2024.

[6] Source: Acadian Asset Management, Owen Lamont, "Higher Stock Market Concentration Does Not Mean Higher Risk", Acadian Asset Management, March 2024.

[7] The equity quality factor refers to characteristics of stocks such as strong balance sheets, stable earnings, and reliable cash flows that theoretically indicate a company's overall financial health and business strength.

[8] Winner-take-most dynamics describe markets in which scale, network effects, or high fixed costs allow a small number of firms to capture a disproportionate share of revenues and profits without eliminating competitors entirely.

[9] During the Dot-Com bubble, concentration risk was high in both weight and shared drivers (e.g., the "new economy" narrative), and the shared-driver component proved fragile.

[10] With credit to the FT's Robin Wigglesworth and Acadian's Owen Lamont. See "The US stock market has never been more concentrated. Does it matter?" Published in the Financial Times, January 7, 2025.

[11] This is despite four of the Magnificent Seven (Alphabet, Meta, Amazon & Tesla) being officially classified as either communication services or consumer discretionary.

[12] Capital intensity is usually a ratio of capital expenditure as a percentage of revenue. High capital intensity companies must spend a higher percentage of their income to maintain factories, equipment, and fleets to maintain operations. For example, high capital intensity sectors might include energy, utility, materials, and industrial companies.

[13] Source: Hendrik Bessembinder, "Do Stocks Outperform Treasury Bills?" Journal of Financial Economics, Vol. 129, No. 3, September 2018, 440-457.

[14] Source: Hendrik Bessembinder, "Do Stocks Outperform Treasury Bills?" Journal of Financial Economics, Vol. 129, No. 3, September 2018, 440-457. Data updated through December 2024. For updated data see: https://wpcarey.asu.edu/department-finance/faculty-research/do-stocks-outperform-treasury-bills.

[15] Source: "Drawdowns and Recoveries: Base Rates for Bottoms and Bounces", Michael Mauboussin and Dan Callahan, Counterpoint Global Insights, Morgan Stanley Investment Management, May 21, 2025.

[16] See "The Fallacy of Concentration" by Mark Kritzman and David Turkington, published October 6, 2025.

[17] For a longer review of this topic, see Bridgewater's "Wrestling with Concentrated Equity Allocations in the Age of AI", January 2026.

[18] Note that obtaining industry-level data for private markets might come with added cost and complexity.

[19] Risk Mitigating Strategies (RMS) portfolio might include long volatility, trend following, global macro, long-duration Treasuries, and alternative risk premia. Rather than relying on a single hedge, this portfolio approach seeks to provide convex or defensive payoffs across different drawdown paths, helping offset equity losses while maintaining a positive long-term expected return.

[20] Source: "Charlie Munger: Boom and Bust Is Normal," BBC News, October 26, 2009.

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