Market Concentration: What's really going on

If you've been following financial news lately, you've probably seen the headlines warning that the top 10 stocks now make up a larger share of major stock market indices than ever before. Most of these are technology and AI-driven companies, and if these giants stumble, the thinking goes, so will your portfolio.

It's a reasonable concern that we take seriously, but before rushing to make changes, it's worth examining what's actually happening beneath the surface.

These Aren't Really "10 Companies"

These aren't single businesses. They're conglomerates containing dozens of world-class operations that could easily stand alone as publicly listed companies.

Apple's AirPods division alone is thought to generate around $20 billion in annual revenue. If spun off tomorrow, it could be larger than Spotify, Nintendo, eBay, and Airbnb. Similarly, its Mac division, iPad division, and Wearables division would each rank among the world's largest technology companies if listed separately.

The same applies across the top 10. YouTube, buried inside Alphabet, generates $54 billion in revenue and would likely make it one of the 20 largest companies in the world. Amazon's AWS cloud division crossed $100 billion in revenue last year. Microsoft contains Azure, LinkedIn, Xbox, and Office 365, each generating billions independently.

The "top 10 concentration" is partly an illusion of corporate structure. If these companies reorganised into their component parts, the index would look far more diversified overnight, without any change in the underlying businesses you actually own.

Concentration Isn't New

Market leadership has always been concentrated. In the 1980s, it was oil companies and industrials. In 2000, it was the dot-com darlings, many of which no longer exist. The names at the top constantly change, but there's always a top 10 dominating returns.

What's different today is that these leaders have earned their position through actual revenue and profits, not speculation. The earnings generated by these companies justify much of their market weight. They sell real products to billions of real customers every day. This doesn't guarantee future success, but it's a more solid foundation than we've seen in previous concentration cycles.

The Index Self-Corrects

If these companies underperform, they will naturally become a smaller portion of the index. You're not locked in forever to today's winners.

Index investing is designed to automatically reduce your exposure to declining companies and increase exposure to rising ones. The next generation of market leaders, whatever they turn out to be, will gradually replace today's giants as their fortunes change. This process has played out countless times over the past century.

The Practical Question

Even if concentration does lead to higher risk or lower returns ahead, what's the alternative? Trying to predict which companies will decline? Moving to cash? Every alternative carries its own risks and usually involves speculation about an unknowable future.

We understand the concern, but when we look beneath the headlines, we find reasons for continued confidence in a diversified, long-term approach.

If you're investing for a decade or more, today's concentration is unlikely to determine your outcome. Staying diversified across thousands of companies remains the most sensible approach, even if a handful currently dominate the index.

As always, we're here if you'd like to discuss how this applies to your specific situation.