



Over the long run, investors have underperformed by investing in markets with high past GDP growth, compared to lower-growth markets. (UBS)

Is concentration really a threat to US equities?

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US equities closed February on a high note. Both the S&P 500 and Nasdaq 100 indexes were at record highs, and they have made gains for four consecutive months.

In addition to a solid growth backdrop and the prospect of lower interest rates, the rally has largely been driven by the Magnificent 7 amid increasing artificial intelligence (AI) capex spending and the technology's broadening demand. Since the start of November, the S&P 500 has risen 20.3%, while the Magnificent 7 have seen an increase of 32.2%.

Many have worried that the rally has been too concentrated, posing a risk to the broader US equity market. The ten biggest companies in the S&P 500 now account for about 32% of the index's entire market capitalization.

However, according to findings in the latest *Global Investment Returns Yearbook*, a study sponsored by UBS and conducted for 25 years by professors Elroy Dimson of Cambridge University and Paul Marsh and Mike Staunton of the London Business School, the US is one of the most diverse among global markets. In fact, only Japan has less concentration in its biggest companies.

In addition, while the dominance of the US market among global equities is underpinned by the industrial transformation, it is also a function of underperformance elsewhere. In fact, over the long run, investors have underperformed by investing in markets with high past GDP growth, compared to lower-growth markets.

So, despite the recent large gains in US large-cap stocks, we think investors still need to have a core allocation to this segment with exposure that best helps their long-term financial goals. We also think that ex-US equities, small-caps, and quality bonds should be other core building blocks of investors' portfolios.

US tech companies are leading the AI revolution. We believe generative AI will be the growth theme of the decade, with industry revenue growing by some 70% a year until 2027. As many of the companies in the industry are already present across multiple stages of the AI value chain, we think the largest players today are poised to grow larger still. In our view, investors should have at least some exposure to AI, and the US is home to the vast majority of these disruptors. However, we also believe investors need to optimize their exposure to technology and US large-caps more generally by increasing their allocation if necessary and diversifying where appropriate.

A diversified equity exposure could capture the market's next leg up. As historical data suggest, the US market hasn't always led, and we think exposure to differing economic growth regimes and favorable demographics in emerging markets provide a fertile backdrop for companies in these regions to grow. Equity valuations in most markets outside the US are currently cheaper based on their 12-month forward price-to-earnings ratios, while those for small-caps are equally appealing. In addition, with rate cuts on the agenda this year, smaller companies' higher use of floating rates in their debt means they should feel the easing of financial conditions faster than their larger peers.

Quality bonds remain an effective portfolio diversification. Bonds have historically insulated portfolios effectively during periods of equity market turbulence. As high-quality bonds are among the safest investments based on the creditworthiness of their issuers, it makes them an effective way of preserving capital, reducing volatility, and stabilizing portfolios. We also think that the current risk-reward proposition for quality bonds is attractive, with yields expected to fall this year on falling rates.

For investors willing and able to manage risks inherent to alternative assets, we think hedge funds and private markets should also be an important component of portfolios for potentially higher returns and broader exposure.

For more information on the Global Investment Returns Yearbook, [click here](#).

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