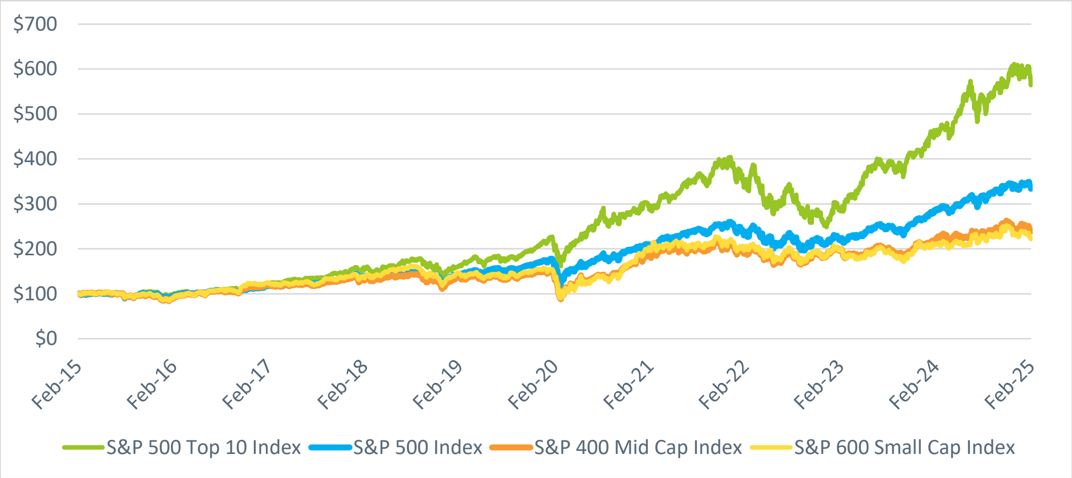
US Equity Market Concentration and Structure Update

In 2025, investors are once again faced with the risks associated with a top-heavy, concentrated US equity market. Following outsized gains in 2023 and 2024, the US mega-cap segment has only climbed higher even as competitive forces, regulatory scrutiny, rising expectations, and elevated valuations present challenges to future returns. The performance of the top 10 holdings within the S&P 500 has handily outpaced the broad market, as shown in the following exhibit.

Figure 1: Mega Cap Outperformance (Growth of $100)

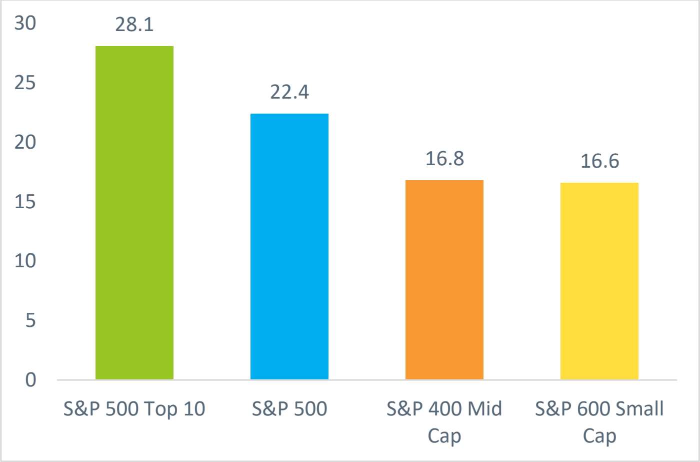


As of February 28, 2025. Source: S&P Dow Jones Indices LLC.

These top companies are not in their positions by accident—they have been innovative and purposeful in building wide economic moats. However, the disparity in valuation is significant even after accounting for the expected earnings of mega-cap companies, as shown below.

The success of these companies has created considerable company-specific risks for investors with exposure, even those invested in broad market indexes. This development has prompted recent action by index providers and frequent questions from investors regarding their options for controlling the risks associated with elevated concentration.

Figure 2: US Market Cap: Projected Price/Earnings



As of February 28, 2025. Source: S&P Dow Jones Indices LLC.

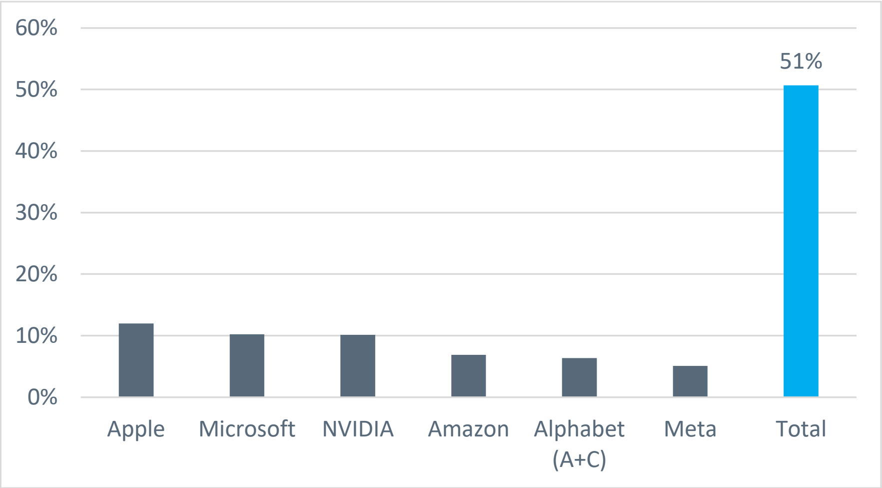
Recent Russell Index Methodology Updates

FTSE Russell is introducing a capping methodology to its style indexes following a consultation with allocators and investment managers. FTSE Russell will apply the following capping methodology to the Russell US Style Indexes beginning with its quarterly review scheduled for March 21, 2025.

- Individual company weights capped at 22.5%.
- All companies with an index weight greater than 4.5% will be constrained so that the aggregate sum of the weights will be no more than 45% of the index.

As of February 28, 2025, the aggregate capping rule would be binding for the Russell 1000 Growth Index. Should this group of stocks remain in breach, the companies with weights exceeding 4.5% will experience a proportional scaling down of their index allocations which will then be spread across the rest of the holdings in the index, pro-rata.

Figure 3: Largest Weights in the Russell 1000 Growth Index



As of February 28, 2025. Source: FactSet.

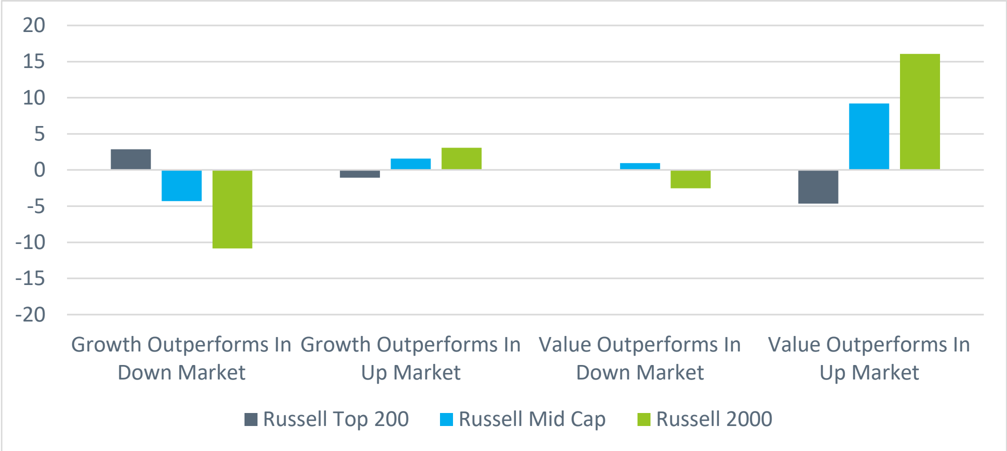
In a separate update, FTSE Russell announced that the Russell US Indices will move from an annual reconstitution to a semi-annual schedule beginning in November 2026. After this date, the impacted indices will be reconstituted on the 4th Friday in June (current date) and the 2nd Friday in November. This change is directed at the Russell indices for specific size segments (Russell Top 200, Russell Mid Cap, Russell 2000, etc.). The Russell US Style Indices will be adjusted in November to account for company migration between the size segments, but the full reconstitution will still occur in June.

Implications for Allocators

Despite the methodology change by FTSE Russell, the issue of US equity market concentration will persist, absent a major market decline for US mega-cap companies. Given that market capitalization indexes underly most passive allocations and represent building blocks used when developing capital market assumptions for return and risk, the issue of market concentration can be difficult for allocators to address.

It is always important to remember that diversification still matters. Relative to the broad market, the correlations between the market cap segments still point to potential risk mitigation through maintaining full exposure across large-cap, mid-cap, and small-cap stocks. The following exhibit showcases that the excess returns (relative to the Russell 3000 Index) of each market cap are variable dependent on market conditions. Put another way, should there be a period where US mega-cap companies underperform in the future, US mid-cap and US small-cap segments may provide a counterbalance for investors.

Figure 4: Historical Market Cap Performance (Excess Returns vs. Russell 3000, %)



Source: FTSE Russell and MPI Stylus. Excess Returns of the indices in both value-led and growth-led months are grouped together and then separated by whether the general market had positive or negative returns for a given month. The monthly returns within the four groups are annualized to illustrate the performance of each index in past style regimes over the past 300 months ending December 31, 2024.

Additionally, active manager excess returns remain more consistent in US small-cap, making it an important allocation for clients aiming to generate excess returns within US equity. The following exhibit includes results from RVK's annual Active/Passive Study.

Figure 5: Active US Equity Manager Excess Returns, %

Rolling 3-Years			
	25th Percentile	Median	75th Percentile
US Large Cap Equity	1.75	-0.03	-1.78
US Mid Cap Equity	1.88	-0.22	-2.26
US Small Cap Equity	3.46	0.87	-1.52

Source: eVestment.com and 2025 RVK Active/Passive Study. Excess returns are calculated versus manager-preferred benchmarks and are net of fees. January 2001 represents the start of the first 3-Year period through December 2024. The performance shown represents rolling 3-Year performance at each quartile and does not correspond to the long-term experience of any specific manager. Peer group constituents and managers' rankings change over time. Fee assumptions are based on eVestment peer group median fees for a $500 million mandate size in US Large Cap and $200 million in US Mid Cap and US Small Cap.

Multiple options exist for clients concerned with the concentration in US equity markets. These include, but are not limited to, the below:

- Implementation of high active share US large-cap strategies (including extension strategies).
- Considering allocations to US mid-cap, US small-cap, or non-US equities.
- Mitigating the risk through diversification outside of public equities.

If an investor decides to alter their portfolio to guard against US market concentration, maintaining reasonable expectations and remaining committed to the structure (even when US mega-cap performs well) will be essential to realize any future benefits. Importantly, any adjustments made should not hinder the equity portfolio's ability to fulfill its purpose and objectives within the overall portfolio's strategic asset allocation.

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