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Index Concentration Comes Back to Bite Investors

Your portfolio may not be as diversified as you think.

Two seemingly contradictory statements can both be true:

- The US was one of the worst-performing stock markets
- The best-performing stocks in the world were mostly US companies

On the first, after years of being top dog, the US equity market (as represented by the MSCI USA Index[1]) lost 19% for investors last year. The loss put the US in 17th position out of the 23 countries in the MSCI World Index[2] of developed-market stocks.

But this was driven by a handful of tech behemoths, which dragged the market down. A portfolio of the seven-largest US companies from a year ago would have lost investors 40% in 2022 (**FIGURE 1**). A portfolio of the rest would have lost only 14%.

FIGURE 1

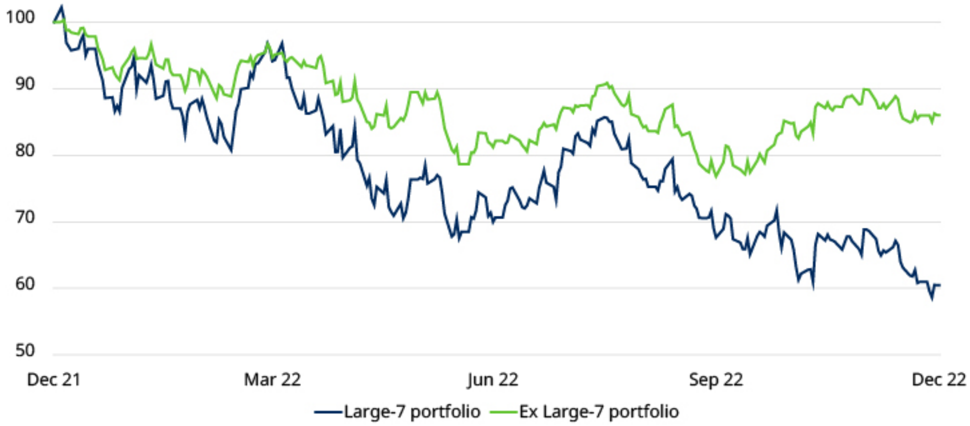
The Biggest 7 Companies Accounted for Most of the US Market's Poor Performance

	Index Weight	2022 Total Return
Apple	6.8%	-26%
Microsoft	5.6%	-28%
Alphabet (Google)	4.0%	-50%
Amazon	3.5%	-39%
Tesla	2.1%	-65%
Meta (Facebook)	1.9%	-64%
Nvidia	1.7%	-31%
Large-7 portfolio	25.5%	-40%
Ex Large-7 portfolio	74.5%	-14%

Past performance does not guarantee future results. As of 12/31/22. Based on constituents of the MSCI USA Index. Indices are unmanaged and not available for direct investment. Sources: Refinitiv Datastream and Schroders.

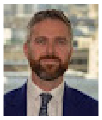
FIGURE 2

US Equities Didn't Do Half as Bad Outside of the Biggest 7 Companies



Past performance does not guarantee future results. As of 12/31/22. Large-7 portfolio is the portfolio of the seven-largest companies by free-float market capitalization. These are Apple, Microsoft, Alphabet (Google), Amazon, Tesla, Meta (Facebook), Nvidia. Based on constituents of the MSCI USA Index. Sources: Refinitiv Datastream and Schroders.

Insight from sub-adviser Schroders Investment Management



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Key Points

- The US market, as measured by the MSCI USA Index, has become increasingly concentrated in recent years, a risk we've been highlighting for some time.
- But US companies made up about 41% of the MSCI World Index at the start of 2022. These companies punched above their weight in delivering good performance.
- It's very important for investors to understand the concentrated exposures they're taking on, often unwittingly, when allocating to broad market indices.

The US market has become increasingly concentrated in recent years, a risk we've been highlighting for some time. A small number of companies have been in the driver's seat in terms of market performance. That risk came home to roost last year.

It's within those remaining companies that many of the best-performing stocks globally could be found in 2022. Eight of the top-10 performers were US companies. Sixteen of the top 25 also were US-based, as were 53 of the top 100. US companies made up about 41% of the MSCI World Index at the start of the year, so they've punched above their weight in delivering good performance.

Most of these very good performers are in the energy sector, including all eight in the top 10. With a 119% return, Occidental Petroleum is top of the pile, followed by Hess, Exxon Mobil, Marathon Petroleum, and Schlumberger (the oilfield services company). Further down the top 25 are steel producer Steel Dynamics and three US healthcare companies.

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FIGURE 3

US Companies Dominated the Global Top Performers in 2022

Position	Company	Country of Listing	Sector	2022 Total Return ($)
1	**Occidental Petroleum**	**US**	**Energy**	**119%**
2	**Hess**	**US**	**Energy**	**94%**
3	**Exxon Mobil**	**US**	**Energy**	**87%**
4	**Marathon Petroleum**	**US**	**Energy**	**87%**
5	**Schlumberger**	**US**	**Energy**	**81%**
6	Mitsubishi Heavy Industries	Japan	Industrials	76%
7	Tourmaline Oil	Canada	Energy	76%
8	**Valero Energy**	**US**	**Energy**	**75%**
9	**Halliburton**	**US**	**Energy**	**75%**
10	**Conocophillips**	**US**	**Energy**	**71%**
11	Tenaris	Italy	Energy	71%
12	Swire Pacific 'A'	Hong Kong	Real estate	63%
13	Cenovus	Canada	Energy	61%
14	Woodside Energy Group	Australia	Energy	61%
15	**Steel Dynamics**	**US**	**Materials**	**60%**
16	Dassault Aviation	France	Industrials	59%
17	**Chevron**	**US**	**Energy**	**58%**
18	**Eog Resources**	**US**	**Energy**	**57%**
19	**Cardinal Health**	**US**	**Healthcare**	**54%**
20	Thales	France	Industrials	53%
21	**McKesson**	**US**	**Healthcare**	**52%**
22	**Devon Energy**	**US**	**Energy**	**51%**
23	Keppel	Singapore	Industrials	50%
24	**Phillips 66**	**US**	**Energy**	**50%**
25	**Merck & Company**	**US**	**Healthcare**	**49%**

Past performance does not guarantee future results. Data as of 12/31/22. Based on constituents of the MSCI World Index. Sources: Refinitiv Datastream and Schroders.

The strong performance of energy companies shouldn't be a surprise given the rise in oil prices in response to the war in Ukraine. If we were to repeat this same analysis in a year's time, the top performers could almost certainly be different.

But what may continue to be the case is that high levels of concentration in the US stock market (as well as in other ex-US markets) means only a handful of stocks will exert an outsized influence on the returns investors earn.

In previous years, this was a benefit to US stock-market investors. Over the 2020-2021 period, US equity returns would have been around 20% lower without these seven companies (34% vs. 54%). But last year it was to their detriment.

It's very important for investors to understand the concentrated exposures they're taking on, often unwittingly, when allocating to broad market indices. This could be in terms of stock, sector, style, or region. Achieving balance and diversification is, sadly, not as simple as investing in a portfolio of global stocks.

Your financial professional can help you develop strategies for maintaining a well-balanced, diversified portfolio.

[1] MSCI USA Index is a free float-adjusted market capitalization-weighted index that is designed to measure the performance of the large- and mid-cap segments of the US market.

[2] MSCI World Index is a free float-adjusted market capitalization-weighted index that is designed to measure the equity market performance of developed markets.

Important Risks: Investing involves risk, including the possible loss of principal. • Investments in the commodities market and the natural-resource industry may increase liquidity risk, volatility, and risk of loss if adverse developments occur. • There are risks of focusing investments in securities of companies in the utilities and industrials sectors which may cause the performance to be sensitive to developments in those sectors. • Risks of focusing investments on the healthcare-related sector include regulatory and legal developments, patent considerations, intense competitive pressures, rapid technological changes, potential product obsolescence, and liquidity risk. • Diversification does not ensure a profit or protect against a loss in a declining market.