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The Accidental Death of Diversification

The classic 60/40 portfolio is now more concentrated than ever, but true diversification can still be revived.

Insight From sub-adviser Schroders Investment Management

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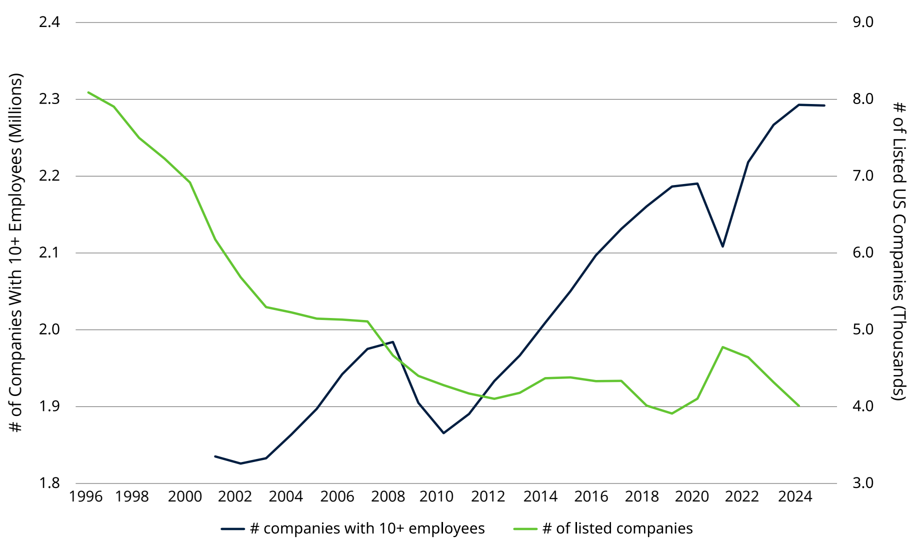
Ten years ago, allocating 60% to a broad US equity index and 40% to a core bond index resulted in a reasonably balanced portfolio: ownership of hundreds of American businesses hedged by a reliable fixed-income ballast. Today, the same allocation delivers something very different, with potentially far more risk: an equity position among the most concentrated in modern history, paired with a bond allocation that may no longer serve as a reliable hedge, leaving both sides of the portfolio heavily exposed to assets trading near historic highs.

Portfolio Overload: The Rise of Mega-Cap Stocks

Since the mid-1990s, the public-equity universe has quietly halved (**FIGURE 1**), and companies that do go public now tend to arrive older, larger, and past some of their fastest-growth years. At the same time, the S&P 500 Index[2] has grown dramatically more concentrated: the 10 largest stocks now represent nearly 40% of the Index's market value and an even greater share of its daily fluctuations (**FIGURE 2**).

FIGURE 1
A Shrinking Number of Publicly Listed US Companies
Total vs. Listed US Companies



Total number of companies as of 3/31/25. Number of listed companies as of 12/31/24. Data Sources: Schroders, Bureau of Labor Statistics, and World Bank.

Key Points

- Portfolios built using traditional US stock and bond mixes are now much more concentrated, exposing investors to higher risk as both asset classes trade near historic highs.
- The dominance of mega-cap US stocks and the weakening of bonds as a hedge have eroded diversification,[1] making portfolios more vulnerable to market volatility and regime shifts.
- Investors can restore true diversification by broadening equity exposure beyond US large-caps and actively managing interest-rate and credit risks within fixed income.

[1] Diversification does not ensure a profit or protect against a loss in a declining market.
[2] S&P 500 Index is a market capitalization-weighted price index composed of 500 widely held common stocks.

FIGURE 2

An Increasingly Concentrated Market

Weight of Top 10 Companies vs. S&P 500 Index

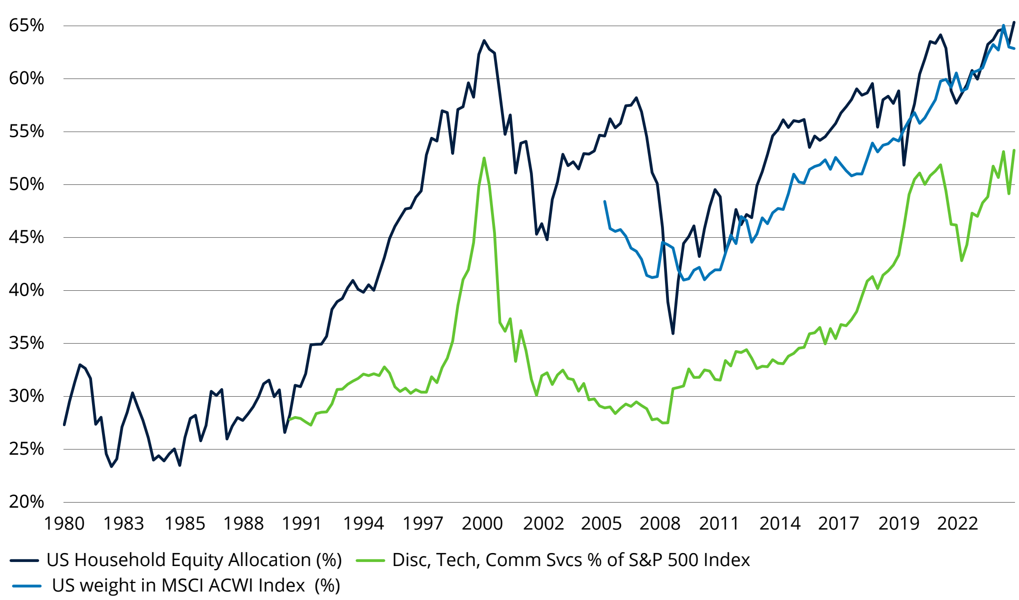
As of 11/30/25. **Past performance does not guarantee future results.** Indices are unmanaged and not available for direct investment. Company weights are from the Bloomberg 500 Index, a rules-based, float-adjusted, market-cap weighted benchmark that tracks the performance of the 500 largest publicly traded US companies by their freely tradable shares. Beta is a measure of risk that indicates the price sensitivity of a security or a portfolio relative to a specified market index. For illustrative purposes only. Data Sources: Schroders, S&P, and Bloomberg.

With household equity allocations at all-time highs and US stocks dominating global market share, most portfolios have become a concentrated bet on a handful of US mega-cap growth stocks (**FIGURE 3**).

FIGURE 3

Investors Have a Large Bet on a Small Group of Stocks

Equity Allocations and Index Weights



Household equity allocation as a percentage of corporate equity, debt and loans, and deposits, as of 6/30/25. Other weights as of 9/30/25. **MSCI ACWI Index** is a free float-adjusted market capitalization index that measures equity market performance in the global developed and emerging markets, consisting of developed and emerging market country indices. MSCI index performance is shown net of dividend withholding tax. For illustrative purposes only. Data Sources: Schroders, Federal Reserve, S&P, Bloomberg, and MSCI.

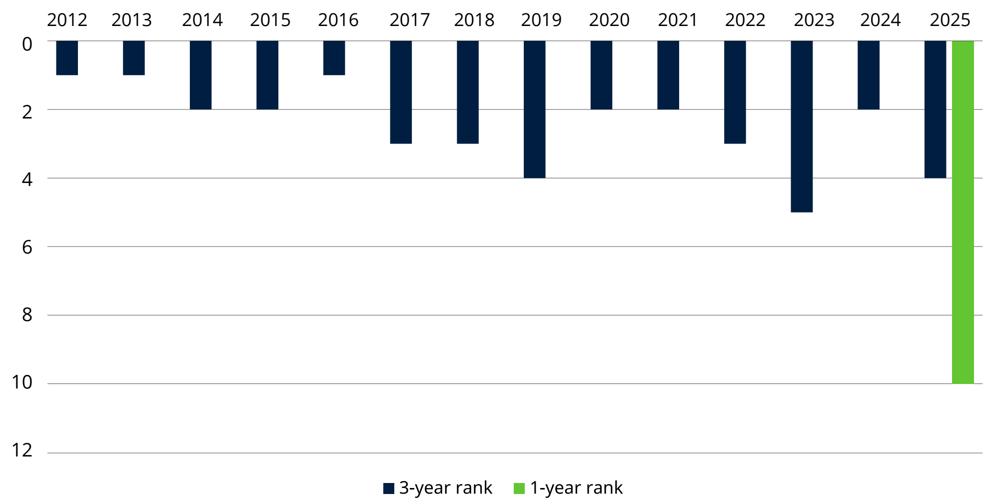
Global Markets Begin to Challenge US Dominance

Fundamental regime shifts often drive long-term changes in market leadership—and signs suggest this transition may already be underway. While the US has outperformed global peers over the past five years, its position in both 1- and 3-year performance rankings among major equity markets has been steadily slipping (**FIGURE 4**).

FIGURE 4

US Equities' Rank Among Global Leaders Is Slipping

US Rank Among Top-12 Global Stock Markets



As of 11/30/25. **Past performance does not guarantee future results.** Note: US equity performance ranked relative to the equity markets in Japan, China, UK, Canada, France, Taiwan, Switzerland, Germany, India, Australia, and Korea. Please see page 7 for representative index definitions. For illustrative purposes only. Data Sources: Schroders, MSCI, and Bloomberg.

Fixed Income Faces Shifting Risks

Historically, bonds have played a key role in diversifying portfolios by reducing the volatility of pure equity exposure. However, diversification weakens as correlations[3] rise, and today's stock-bond correlation may remain higher than above a three-decade high for at least two reasons:

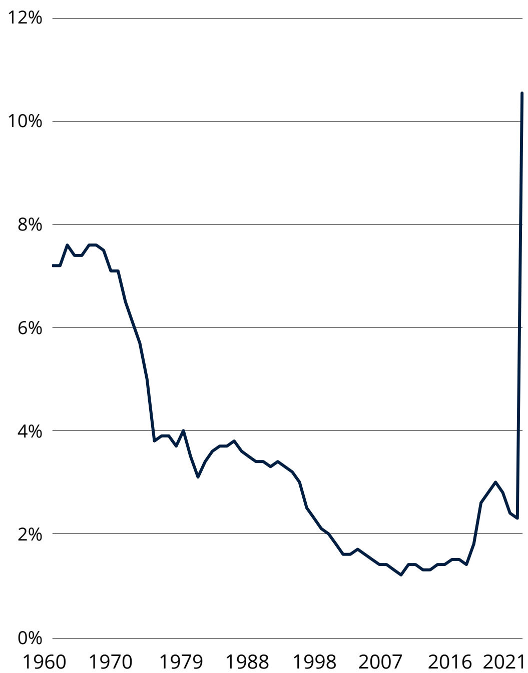
1. Deglobalization and ballooning fiscal deficits could lead to a prolonged period of higher and more volatile inflation and interest rates. When supply-chain decisions are driven by politics and trade barriers rather than efficiency, costs rise (**FIGURE 5**). Combined with the shift from post-Global-Financial-Crisis austerity to fiscal excess, this increases the risk of future inflation and higher tax rates (**FIGURE 6**).
2. Tight credit spreads[4] for corporate bonds recently hit a 27-year low, leaving less upside if corporate fundamentals stay strong and more downside if they weaken, which often coincides with stock-market downturns. Over the last 30 years, investment-grade (IG) spreads have never sustainably fallen below 50 basis points (bps),[5] but have routinely exceeded 200 bps during periods of credit stress (**FIGURE 7**). Tight spreads mean lower income and limited room for further tightening, reducing potential for capital appreciation. When spreads are narrow, corporate bonds behave more like Treasuries in calm markets and more like stocks in turbulent ones. This combination leaves investors exposed to the least attractive features of both asset classes.

[3] Correlation is a statistical measure of how two investments move in relation to each other. A correlation of 1.0 indicates the investments have historically moved in the same direction; a correlation of -1.0 means the investments have historically moved in opposite directions; and a correlation of 0 indicates no historical relationship in the movement of the investments.

[4] Spreads are the difference in yields between two fixed-income securities with the same maturity but originating from different investment sectors.

[5] A basis point is a unit that is equal to 1/100th of 1% and is used to denote the change in a financial instrument. The basis point is commonly used for calculating changes in interest rates, equity indexes and the yield of a fixed-income security.

FIGURE 5
US Average Effective Tariff Rate

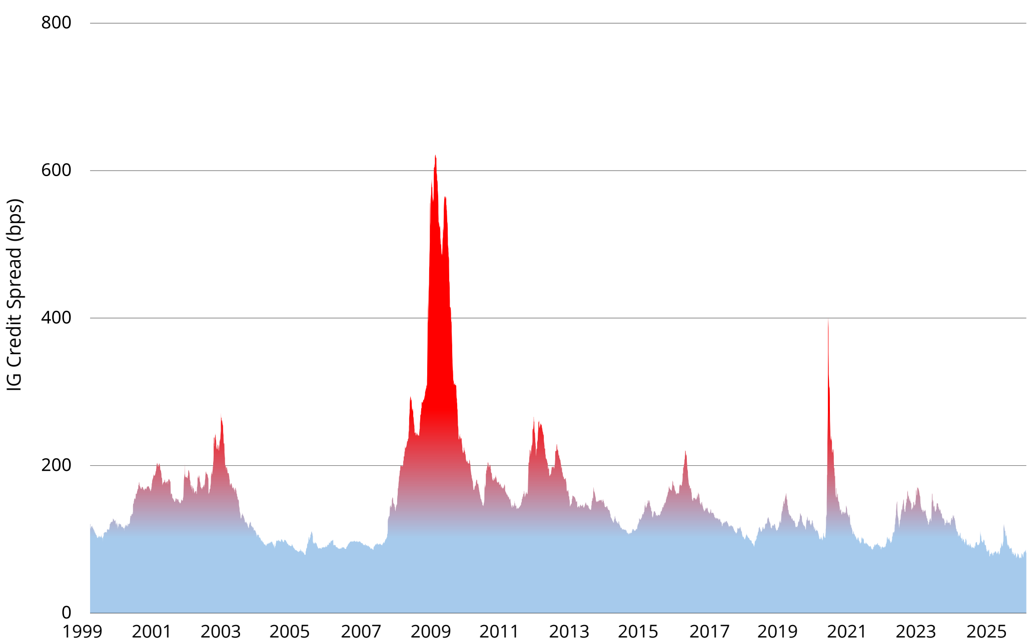


As of 8/31/25. For illustrative purposes only. Data Sources: Schroders, US International Trade Commission, and Bloomberg.

FIGURE 6
Government Debt/GDP (%) of Top-10 Economies

As of 10/25. For illustrative purposes only. Data Sources: Schroders, IMF, and Bloomberg.

FIGURE 7
IG Credit Spread Over Treasuries Coming off 30-Year Lows



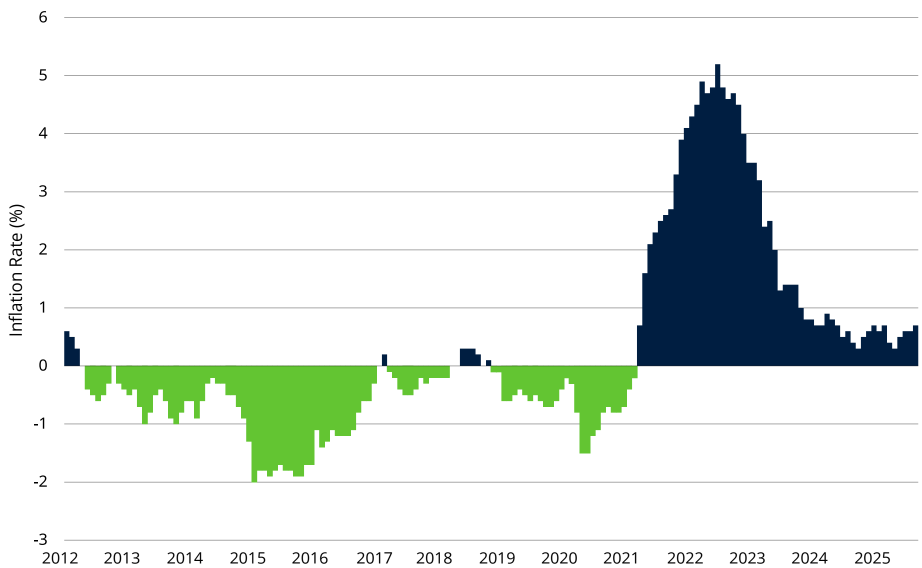
As of 11/30/25. **Past performance does not guarantee future results.** Data based on option-adjusted spreads. An option-adjusted spread is a measurement tool for evaluating yield differences between similar-maturity fixed-income products with different embedded options. Data Sources: Schroders and ICE BofA Indices.

Bonds Are Already in a New Regime

The effects of these regime changes are already visible in the bond market. Until the late 1990s, stock market corrections were almost always accompanied by rising bond yields—in 15 out of 16 instances, or 94%. From the late 1990s through the COVID-19 pandemic, that relationship reversed, and bond prices typically rose during stock market corrections (14 out of 16 times), providing an effective equity hedge. For nearly five years now, however, inflation has remained well above the Federal Reserve's (Fed) 2% target (**FIGURE 8**). Any loss of confidence in the Fed's commitment to its inflation mandate in favor of political considerations could reinforce this trend.

FIGURE 8

Inflation vs. 2% Fed Target

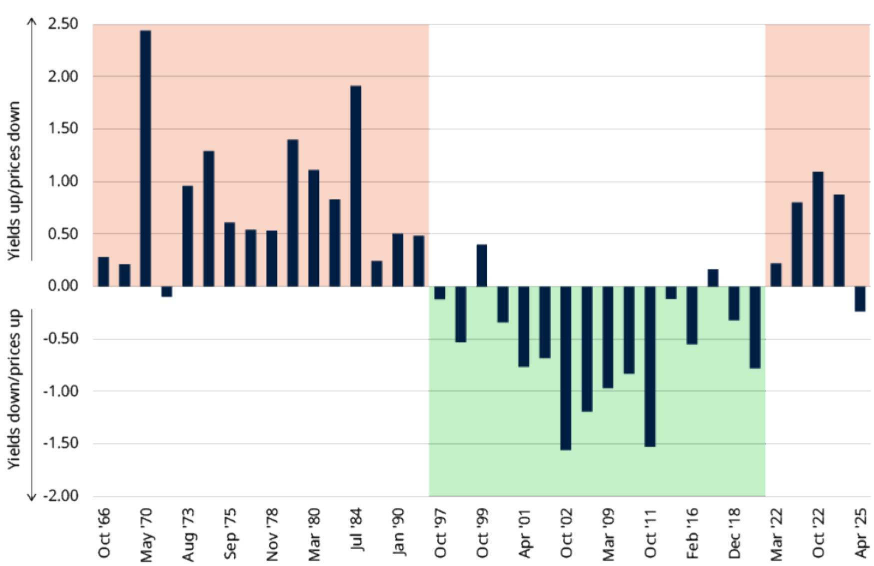


As of 8/31/25. Data Sources: Schroders, Bureau of Economic Affairs, and Bloomberg.

Persistent high inflation has triggered another major shift in the stock-bond relationship: Similar to the pre-1990s era, bond prices have once again been falling alongside stocks during market corrections (**FIGURE 9**).

FIGURE 9

Change In 10-Year Treasury Yields During 10%-Plus S&P 500 Index Corrections



Past performance does not guarantee future results. For illustrative purposes only. Data Sources: Schroders, S&P, and Bloomberg.

Reviving True Diversification in Today's Portfolios

The good news is that there's a potential solution that doesn't rely on bold forecasts or market timing: investors should consider broadening equity exposure and actively managing interest-rate and credit risk within fixed income.

Moving Beyond the Usual Suspects in Equity Investing

Current discussions around market concentration often point to how a broader equity universe could potentially help moderate associated risks. This isn't a call for the end of American exceptionalism or the collapse of the AI boom, but rather an acknowledgment that today's extreme concentration has become a portfolio risk worth addressing.

One way to broaden exposure is by recapturing the young, high-growth companies that historically went public early but now remain private longer. Within public markets, the most effective diversifiers are often the cheaper, under-owned segments. With attention focused on US large-cap growth stocks, areas such as international markets, small- and mid-caps, and value companies may offer more reasonable valuations and alpha[6] opportunities—both public and private.

Rethinking Bonds in Modern Portfolios

As discussed earlier, bond investors face two key challenges: (1) bond prices can no longer be relied upon to rise when stocks fall, and (2) compensation for risk, measured by spreads, is historically low. A growing focus in fixed income is managing volatility and drawdowns, even as interest-rate directions shift. Unlike passive strategies that tend to buy more of what's expensive and less of what's cheap, a flexible, tax-aware approach may be advisable. Investors may want to consider:

- **Adding interest-rate exposure when yields are high (bonds are cheap)** and trimming when yields are low (bonds are expensive), since higher yields may provide more income to cushion price declines.
- **Increasing credit risk when spreads are wide** (higher compensation for risk) and reducing risk when spreads are narrow.

In this new regime, disciplined active management of interest-rate and credit risk can help turn bonds from a liability into a portfolio stabilizer while still providing potential income.

Why Diversification Matters Most When It's Overlooked

Diversification hasn't disappeared; it's just been removed from the default settings of most portfolios. Restoring it doesn't require brilliance or perfect timing. It simply takes discipline: spreading equity risk across regions, sizes, and styles instead of concentrating in a few names, and adopting a more active approach to managing interest-rate and credit risk within fixed income. In an era of record concentration and shifting regimes, that discipline is no longer optional. It's the new definition of prudence.

[6] Alpha measures an investment's excess return relative to a benchmark index.

Representative Indices for Figure 4:

Australia is represented by the S&P/ASX 200 Index, which tracks the performance of the 200 largest companies on the Australian Securities Exchange, serving as Australia's leading stock-market indicator.

Canada is represented by the S&P/TSX Composite Index, which is Canada's main benchmark, tracking roughly 250 of the largest companies on the Toronto Stock Exchange to reflect the broader Canadian economy.

China is represented by the MSCI China Index, which captures the performance of large and mid-cap Chinese companies—including mainland and overseas listings—covering about 85% of the total investable Chinese market.

France is represented by the CAC 40 Index, which represents the 40 largest and most actively traded companies on Euronext Paris, serving as the flagship French stock market indicator

Germany is represented by the DAX Index, which tracks the performance of the 40 largest and most liquid German companies listed on the Frankfurt Stock Exchange.

India is represented by the Sensex Index, which is a benchmark of 30 of the most valuable and actively traded stocks on the Bombay Stock Exchange, representing India's economy.

Japan is represented by the MSCI Japan Index, which tracks the performance of large and mid-sized publicly traded Japanese companies, representing about 85% of Japanese stock market value

Korea is represented by the KOSPI Index, which measures the performance of all common shares listed on the Korea Exchange, weighted by their market values.

Switzerland is represented by the Swiss Market Index, which reflects how the 20 largest and most actively traded Swiss companies perform on the SIX Swiss Exchange.

Taiwan is represented by the Taiwan Taiex Index, which measures the price movement of all (non-preferred) stocks listed on the Taiwan Stock Exchange, weighted by their market value.

UK is represented by the MSCI UK Index, which measures the performance of large and mid-sized publicly traded UK companies, covering roughly 85% of the country's stock market.

US is represented by the S&P 500 Index.

To learn more about the role of diversification in your portfolio, please talk to a financial professional.