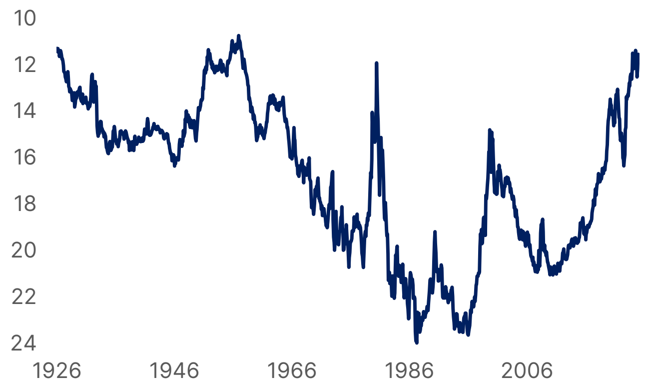
The market is concentrated. Does it matter?

We find no link between market concentration and risk

In a market-capitalization weighted index, the largest stocks have the greatest influence on returns. Today, a handful of big tech firms dominate. Are such focused weights imprudent, or are they justified?

One has to look back almost 50 years to match today's concentration (see Exhibit). The real question, though, is whether high concentration signals bad outcomes ahead. History does not show any such pattern.

Exhibit 1: Industry concentration (effective number)



Source: State Street Markets. Chart shows the effective number of industries since 1926 using Ken French's 49 industry portfolios data. The measure is the reciprocal of weights concentration.

In our paper on this topic we consider multiple angles. First, is it a good idea to scale back exposure to US stocks as the market index becomes more concentrated? We implemented this rule based on industry concentration dating back to 1936 and found that reducing exposure proportionally to concentration added no timing benefit. In fact, it generated worse returns and higher risk than a buy-and-hold position with the same average exposure to the index.

Second, we note that the level of concentration in US top-level sector indices varies dramatically across industries and across time. Does a sector's concentration tell us anything about its return, volatility, downside volatility, or maximum drawdown in the following year? A battery of predictive regressions reveals no meaningful relationships over the past 26 years. Avoiding concentration has not paid.

Third, we show that large companies are not equivalent to small companies. Large companies are safer. Consider, for example, that over the past 26 years the largest quintile of S&P 500 companies (8 stocks on average) totaled the same market cap as the smallest quintile (328 stocks on average), but the portfolio of 8 had slightly *lower* volatility, less negative skewness, and lower kurtosis of monthly returns. Intuitively, large companies are intrinsically more diversified and safer than small companies due to their client base, product breadth, geographical spread, and heightened scrutiny from investors and regulators. Concentration is a natural consequence of growth and the overall highly efficient allocation of capital. Bubbles do occur, but identifying and timing them is challenging, and weight concentration by itself has not offered a useful gauge for risk or return.

For more on this topic, see our 2025 working paper: **"The Fallacy of Concentration"** by Mark Kritzman and David Turkington.

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