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A Close Look at Concentration Risk

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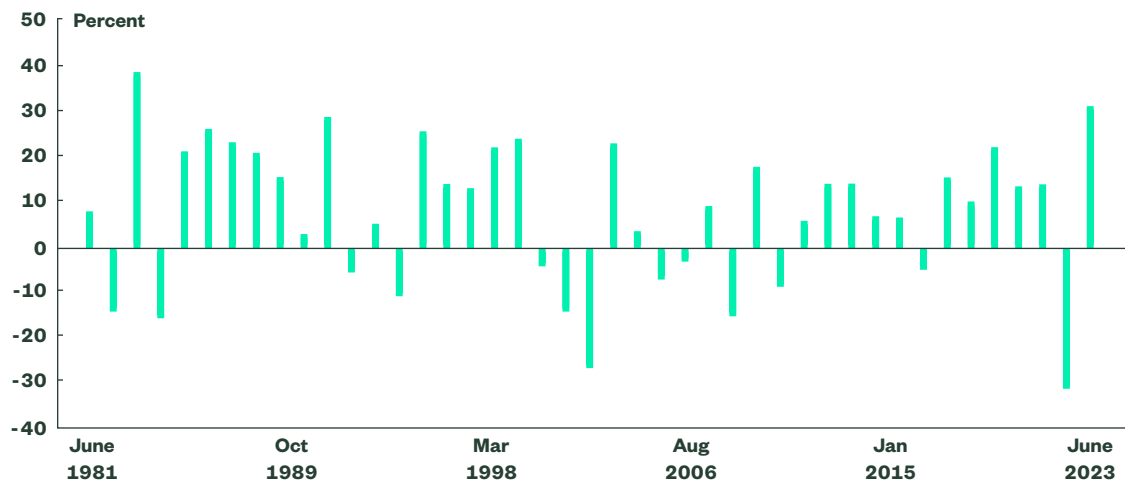
Looking beyond the headline grabbing performance of a few mega-cap US stocks, we see opportunities for active managers in less concentrated, and therefore less risky, parts of the market.

Performance of a few mega-cap stocks has been well commented on in prior commentaries as well as by other asset managers. Yet, we do not think equity markets should be solely defined by the headline grabbers. The Systematic Equity-Active¹ team believes that there are opportunities, especially after recent events, to generate excess returns outside the largest names with the benefits of reduced concentration risk.

A Comparative Look at Concentrations

The artificial intelligence (AI) craze which ignited after the release of ChatGPT at the end of November 2022 has driven equity markets to extremes over the first half of 2023. The Nasdaq Index, which serves as the poster child for this enthusiasm, has delivered as of June 2023 its strongest first half of the year in over 40 years (Figure 1).

Figure 1
**Nasdaq Index's First
Half Returns**

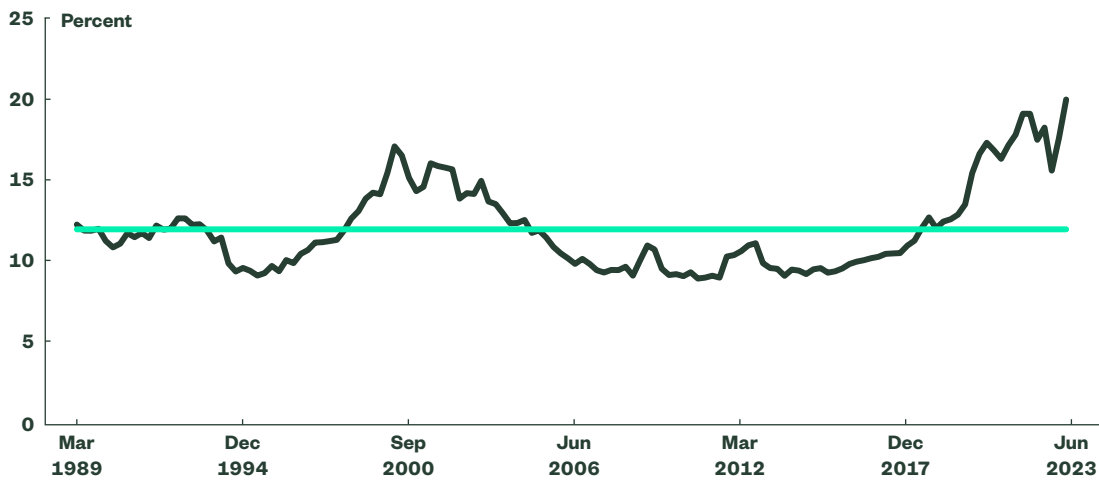


Source: Nasdaq Global Indexes Research, FactSet, State Street Global Advisors. Data as of June 30, 2023.

Even in broader cap-weighted indices, such as the MSCI World Index, we have noted a phenomenal concentration in weight and return contribution to just a few securities — all of them are listed in the US. The largest 10 stocks now account for over 20% of the weight of the index, which is far greater than what we have witnessed over the past few decades (Figure 2).

Figure 2
**Concentration Levels of
 10 largest stocks at
 Historic Highs**

■ Benchmark (MSCI World Index)
 Weight
 ■ LT Average Weight



Source: MSCI, FactSet, State Street Global Advisors. Data as of June 30, 2023.

The previous peak in concentration was in early 2000 driven by a bubble in technology, media, and telecommunication (TMT) stocks amid wild enthusiasm for the possibilities from the broadening adoption of the internet. By the end of March 2000, the top 10 stocks in the world by market capitalization were dominated by stocks affiliated with the TMT bubble.

The internet has had a tremendous impact on the way we live and work today, justifying in many ways the excitement in 2000. However, this euphoria did not justify the excessive valuations and hype around a few internet names, in our view. By the end of 2004, the market had returned to its long-term average, in terms of concentration in the largest 10 names, and only two of those previous high-fliers were still ranked among the largest 10 stocks (Figure 3).

If we look at today's market we see a similar pattern. Currently, eight of the largest securities in the market are affiliated with the technology and AI themes, albeit with only one stock (Microsoft) still present from the last bubble. When the market concentration reverts this time around back to more normal levels, who knows what the composition of this top end of the market will look like?

Figure 3
**Top 10 Stocks in the
 MSCI World Index:
 Then and Now**

March 2000	December 2004	June 2023
Microsoft Corporation*	General Electric Company	Apple Inc.*
Cisco Systems, Inc.*	Exxon Mobil Corporation	Microsoft Corporation*
General Electric Company	Microsoft Corporation*	Amazon.com, Inc.*
Intel Corporation*	Citigroup Inc.	NVIDIA Corporation*
Vodafone Group Plc*	BP p.l.c.	Tesla, Inc.*
Exxon Mobil Corporation	Pfizer Inc.	Alphabet Inc. Class A*
Nokia Oyj*	Bank of America Corp	Alphabet Inc. Class C*
Walmart Inc.	Johnson & Johnson	Meta Platforms Inc. Class A*
Deutsche Telekom AG*	HSBC Holdings Plc	UnitedHealth Group Incorporated
Oracle Corporation*	Vodafone Group Plc*	Berkshire Hathaway Inc. Class B

* Security associated with the craze of the day.

Source: MSCI, FactSet, State Street Global Advisors. Data as of June 30, 2023.

As active investors, we believe it pays to look beyond the headlines and in this case outside the US market. In the MSCI ACWI ex-US Index, which covers developed and emerging markets, we see far less concentration in names and return contribution. The largest names are diverse in terms of geography and sector, and only account for 11.5% of the index weight (Figure 4).

Figure 4
**Top 10 Stocks in the
 MSCI ACWI ex-US Index**

Security	Country	GICS Sector	Weight in MSCI ACWI ex-US Index (%)	Contribution to Index Return 2023 YTD
Taiwan Semiconductor Manufacturing Co., Ltd.	Taiwan	Technology	1.89	0.44
Nestle S.A.	Switzerland	Consumer Staples	1.37	0.09
ASML Holding NV	Netherlands	Technology	1.21	0.35
Novo Nordisk A/S Class B	Denmark	Healthcare	1.11	0.20
Tencent Holdings Ltd.	China	Consumer Discretionary	1.09	0.09
Samsung Electronics Co., Ltd.	Korea	Technology	1.09	0.25
LVMH Moet Hennessy Louis Vuitton SE	France	Consumer Discretionary	1.08	0.27
AstraZeneca PLC	UK	Healthcare	0.92	0.08
Roche Holding Ltd	Switzerland	Healthcare	0.89	-0.00
Novartis AG	Switzerland	Healthcare	0.86	0.12
Top 10			11.52	1.88
Total			100.0	9.47

Source: MSCI, FactSet, State Street Global Advisors. Data as of June 30, 2023.

The Bottom Line

Using our systematic investment process, our team generates return expectations for more than 18,000 stocks globally on a daily basis. This enables us to seek out attractive return opportunities wherever they may be found. Often, we identify opportunities that are outside the glare of the headlines and the largest names.

Endnote

- 1 As of May 2023, the former Active Quantitative Equity (AQE) team has been renamed as the Systematic Equity-Active team. These monthly commentaries will continue but under the name of Systematic Equity-Active.

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- Build from breadth
- Invest as stewards
- Invent the future

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* Pensions & Investments Research Center, as of December 31, 2021.

[†] This figure is presented as of March 31, 2023 and includes approximately \$65.03 billion USD of assets with respect to SPDR products for which State Street Global Advisors Funds Distributors, LLC (SSGA FD) acts solely as the marketing agent. SSGA FD and State Street Global Advisors are affiliated. Please note all AUM is unaudited.

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