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# S&P 500 OR S&P 5? (PART 1) – IS THE CURRENT CONCENTRATION SUSTAINABLE LONG TERM?

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A lot has recently been written on the exceptional concentration at the top of the S&P 500 and in technology stocks. In this two-part blog, we want to first dig into the drivers and impact of such concentration before focusing on the potential ramifications on US equity investments for the medium to long term.

The first part of the blog focuses on the S&P 500 itself. Looking back at a pretty unusual 2020, we observe that:

- The 5 largest holdings in the S&P 500 are larger than at any point in the last 30 years, including during the Dot-com Bubble<sup>1</sup>
- The Information & Technology sector's weight is nearing an all-time high. If one were to take into account other technology related sectors like Communications Services (Facebook, Alphabet) and Consumer Discretionary (Amazon), the S&P 500 is already breaching past a record of sectorial concentration
- Apple, Microsoft, Amazon, Facebook, and Alphabet contributed to almost 90% of the year to date performance of the S&P 500<sup>2</sup>.

Using the long history of the S&P 500 to try to decrypt potential future scenarios for the index, we notice that:

- in the past, when the concentration at the top of the S&P 500 got very acute, the index “deconcentrated” itself relatively quickly
- Companies have historically struggled to maintain their grip on a top 5 spot in the index being forced out by new entrants, new trends. This is interestingly enough true also for sectors with Technology dominating the 90s, then Energy in the 00s, then Tech again and so on...

**The S&P 500 is more concentrated and more geared toward Technology than at the height of the Dot-com Bubble**

Looking back at the S&P 500, we can observe in Figure 1 that the concentration of the five top holdings in the index has been breaching record after record in 2020. The largest single stock had never represented more than 5.5% of the index until recently but Apple currently stands above 7%. The five biggest stocks had never represented more than 18.2%, last seen at the height of the Dot-com Bubble in March 2000. Currently Apple, Microsoft, Amazon, Facebook and Alphabet represent 21% of the index, almost double the long-term average of 12.5%<sup>3</sup>.

Figure 1: Mega Stock weights in the S&P 500 over the last 30 years

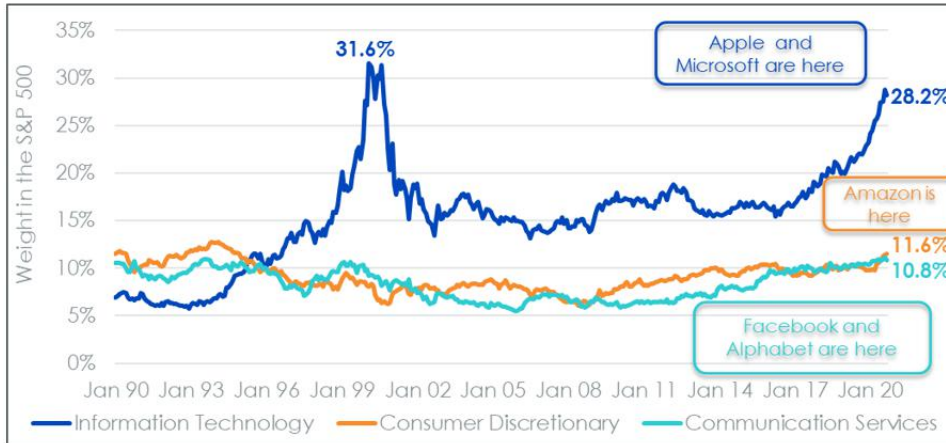


Source: wisdomTree, Bloomberg. January 1990 to September 2020. January 1990 has been selected as starting date because this is when detailed holdings data are available to us.

**Historical performance is not an indication of future performance and any investments may go down in value.**

The index does not look more diversified on a sector basis. The Information Technology (“IT”) sector is getting close to its Dot-com bubble’s all time high of 31.6% with a 28.7% high at the end of August. And let’s not forget that Tech is not just the IT sector anymore. As early as 2018, GICS (The Global Industry Classification Standard) tried to improve the sectorial diversification of the S&P 500 by splitting the IT sector. E-commerce companies like Amazon moved to Consumer Discretionary and Internet Services & Platforms like Google and Facebook moved to Communication Services. Those 2 sectors now also represent a large part of the index. Communication Services is at an all-time high close to 11%. Consumer Discretionary has not reached its 13%’s peaks dating from early the 1990s but with 11.6% it is getting close. Combined, those 3 sectors, are now worth more than 50% of the index compared to a 32% historical average and a previous peak at 48% in Feb 2000.

Figure 2: Tech stocks weight in the S&P 500 over the last 30 years



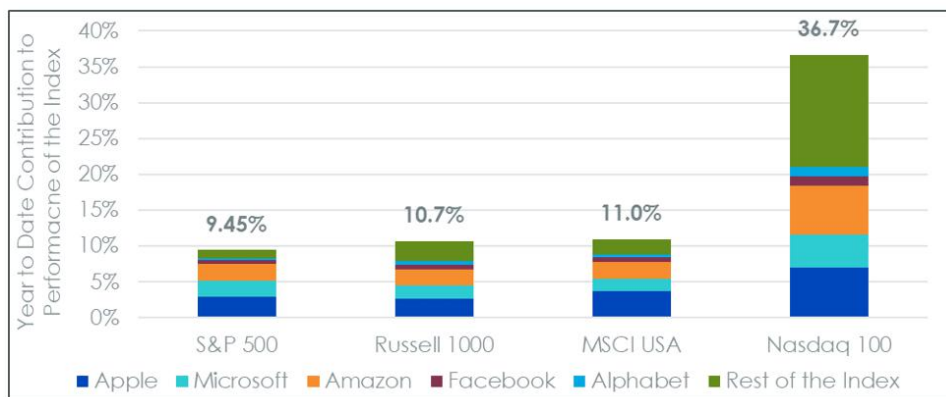
Source: WisdomTree, Bloomberg. January 1990 to September 2020. Using current GICS definitions for sectors.

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This exceptional concentration, however, does not just show in the makeup of the index. It shows as well in its performance. Year to Date the S&P 500 is up 9.45% but the contributions of Apple, Microsoft, Amazon, Facebook and Alphabet to that performance sum up to an incredible 8.35%. This means that the “other 495 stocks” in the index only contributed 1.1%.

This is not unique to the S&P 500 either. The 995 “other” stocks in the Russell 1000 only contributed 2.8% out of 10.7% year to date performance. The effect is less pronounced in the Nasdaq 100 but the top 5 stocks still contributed 21.1% out of the 36.7% of the year to date performance.

**Figure 3: Year to Date performance contribution of the five biggest stocks in different US Equity indices**



Source: WisdomTree, Bloomberg. 31st December 2019 to 16 October 2020. Using Gross TR Index in USD.  
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It is harder to stay at the top than to get there

Looking forward, the trillion-dollar question is, of course, can this trend continue?

While there is no certain answer to such a question, as always history can give us some keys to better anticipate our next moves.

Looking back at the last time the concentration at the top of the S&P 500 reached a similar height i.e. the Dot-com Bubble in 2000, the weight of the top 5 companies started to mean revert relatively fast. 6 months after reaching 18,2% in March 2000, their weight was down in the 14%, still above the long-term average of course, but a lot closer to it.

Also, one often overlooked point is that the 5 biggest stocks in the S&P 500 have not been a completely stable construct. Companies tend to go in and out of this group at a relatively quick pace. In fact, as recently as March 2020, Berkshire Hathaway was the 5th biggest stock before being pushed out by Alphabet.

Looking back at the biggest stocks in the 2000s and the 2010s, it is interesting to note how different they are from the companies currently in the top 5. Out of the 5 biggest stocks in December 2000, 3 were out of the top 10 a decade later. Out of the 5 biggest stocks in December 2010, 3 are out of the top 40 this year. In fact, none of the top 5 in December 2000, are in the top 20 this year and General Electric went from 1st to 116th in those 20 years.

Of course, 20 years is a relatively long timeframe, but it shows that it is quite hard to stay at the top of the S&P 500. The stocks in the top 5 are among the biggest in the world and to justify such valuations, it is not enough for those companies to do well, they need to continue growing, adapting and basically defend their spot against newcomers.

Figure 4: Past mega cap stocks tended to suffer a downward spiral. Rankings of different companies in the S&P 500 by market capitalisation



Source: WisdomTree, Bloomberg. As of 31st December 2000, 31st December 2010 and 30th September 2020.

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Overall, it is clear that we are living through an exceptional period in terms of the impact that the 5 biggest stocks have in the S&P 500. Both the concentration at the top of the index, the sector concentration, and the impact of those stocks on the index performance are at unseen levels. Going forward it is hard to think that this is sustainable in the medium to long term. In the second part of this blog, we will try to assess how such a reversal could impact US equity portfolios.

<sup>1</sup> A stock market bubble caused by excessive speculation in Internet-related companies in the late 1990s that reached its peak around March 2000.

<sup>2</sup> Source: WisdomTree, Bloomberg. As of 16 October 2020. Using Gross Total Return Indices in USD.

<sup>3</sup> Source: WisdomTree, S&P. Data from January 1990 to September 2020. January 1990 has been selected as starting date because this is when detailed holdings data are available to us.

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