Stealing the Spotlight: Is a Narrow Market a Concern?

The S&P 500 Index has been strong this year, but only a small number of companies are driving returns.

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So far in 2023, S&P 500 Index[1] returns exhibit a healthy and robust stock market, with a 16.89% return through the end of June.[2] Looking under the hood, though, the story shifts to a very narrow, concentrated market that lacks breadth.

Just seven mega-cap companies have accounted for about 75% of the Index's returns year-to-date (YTD) (**FIGURE 1**). At the close of the second quarter, these seven stocks—also known as the Magnificent Seven—accounted for nearly one-third of the Index by weight and are the top-seven stocks by market cap.

FIGURE 1
Just Seven Companies Are Driving S&P 500 Index Returns
S&P 500 Index Mega-Cap Company Returns YTD

	Returns YTD (%)
Apple	49.65
Microsoft	42.57
Nvidia	189.52
Amazon	55.19
Meta	138.47
Tesla	112.51
Alphabet	35.67

As of 6/30/23. Source: Morningstar Direct.

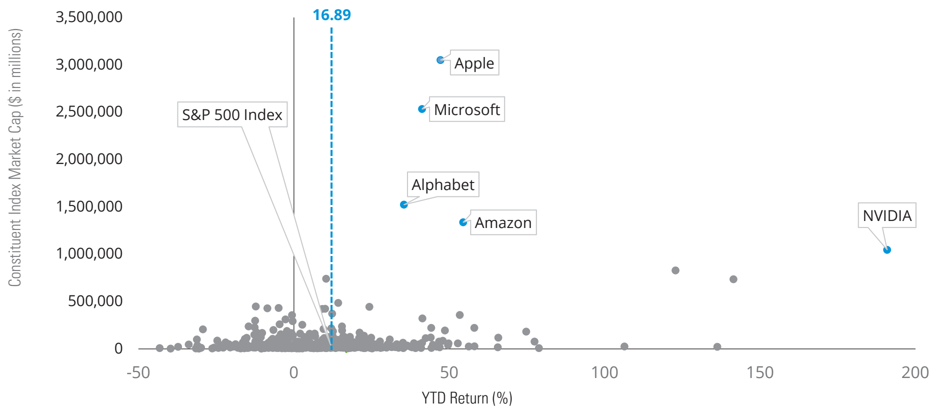
Not all these stocks fall within the information-technology sector, but they're almost always collectively referred to as "big tech" due to their sheer size and innovation impact. While these businesses are quite different, they tend to move up and down in sync, which can have a sizable impact on the direction of market-cap weighted indices and products.

To illustrate how narrow performance has been in the S&P 500 Index YTD, **FIGURE 2** plots constituents by market cap and YTD returns. Of the 503 companies in the Index, 74% are underperforming the Index's total return, and 40% have experienced flat-to-negative performance YTD.

Key Points

- While the S&P 500 Index has, so far, been robust in 2023, only seven mega-cap companies are driving returns.
- These big name stocks tend to move in sync, which can have a sizable impact on the direction of market-cap weighted indices and products.
- Big tech has been benefitting from the recent boom in artificial intelligence, declining inflation, and optimism that the Federal Reserve is nearing the end of its rate-hiking, but its pace may not be sustainable.

FIGURE 2
Market Performance Is Being Driven by a Handful of Companies
YTD Market-Cap Exposure and Return (%) for S&P 500 Index Companies



As of 6/30/23. **Past performance does not guarantee future results.** Investors cannot directly invest in indices. The S&P 500 Index's seven largest companies as measured by free-float market capitalization. Data sources: FactSet and Hartford Funds, 7/23.

Nasdaq is also facing this top-heavy concentration. In July, the Nasdaq 100 Index[3] underwent a "special rebalancing" after the magnificent seven exceeded a stipulated threshold, triggering the process. The rebalancing is meant to reduce the degree to which Index performance is determined by a small number of stocks—taking some of the portfolio weight from the largest stocks and redistributing it among the other Index constituents. On July 3, the top-seven stocks made up 55% of the Index's weighting. Following the rebalance, it dropped to about 43%.[4]

Big tech has benefitted from the recent boom in artificial intelligence, declining inflation, and optimism that the Federal Reserve is nearing the end of its rate-hiking campaign. But is the exceptional performance from tech heavy hitters sustainable?

Takeaways

- If you believe that the concentrated performance of mega-cap tech is unsustainable, consider strategies that emphasize diversification and invest deeper into an index.
- If you believe the US is likely to avoid a recession and poised to recover, consider investing in mid- and small-cap US equities.
- If you believe US strength has hit its peak and is at an inflection point, consider investing in international equities since they have more attractive valuations.

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

[1] S&P 500 Index is a market capitalization-weighted price index composed of 500 widely held common stocks.

[2] As of 6/30/23. Source: Morningstar Direct.

[3] The Nasdaq 100 Index is a stock index of the 100 largest companies by modified market capitalization trading on Nasdaq exchanges.

[4] Nasdaq, "Nasdaq-100 Rebalance: What ETF Investors Should Know," 7/24/23.

Important Risks: Investing involves risk, including the possible loss of principal. • Diversification does not ensure a profit or protect against a loss in a declining market. • Small- and mid-cap securities can have greater risks and volatility than large-cap securities. • Foreign investments, including foreign government debt, may be more volatile and less liquid than US investments and are subject to the risk of currency fluctuations and adverse political, economic and regulatory developments.