

Global Equities

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The case for diversification in global markets



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For some time, we have stressed the importance of diversification in equity markets, and these predictions have begun to materialise in meaningful ways. The extreme concentration in US markets, combined with historic valuation levels, means that on a risk-reward basis, equity return opportunities now clearly favour diversification and active management.

Understanding market concentration

The persistent dominance of the US financial market has led to a very small number of companies dominating equity returns over the last decade, creating extreme levels of concentration, valuation and profitability – Goldman Sachs recently estimated all three metrics to be in the 97th percentile or higher compared with the last 100 years of data.

This concentration has significant implications for future returns. David Kostin at Goldman Sachs concluded in late 2024 that returns in the next 10 years in the US equity market are likely to be significantly lower than the previous decade – as low as 3% per annum. The implications are stark: £1,000 invested in the S&P 500 over the last ten years grew to £3,395, at a 13% growth rate. With only a 3% return for the next 10 years, investors would generate just £345 of profit. If this proves accurate, index investing, particularly in the US, won't be the only way forward.

The scale of concentration is at historic extremes. The 10 largest companies in the S&P now represent over 40% of that index, a historic high. While "Magnificent 7" company earnings have been growing strongly, investing in the S&P index now carries a high degree of stock-specific and theme-specific risk.

Does it matter that so much of the market value is held amongst a small number of names? I would say yes for two reasons. First, it makes the S&P index less representative of the broader economy. Second, large companies don't necessarily remain large forever. Data since 1950 shows only seven companies have held a position in

the top three in the S&P for five consecutive years or more. Leadership is never permanent. From General Motors to GE to Apple, each era crowns a champion. The risk lies in assuming today's champions are untouchable.

The valuation risk in passive investing

US markets are at their most expensive valuation since 1929 – way ahead of the dot-com boom period. Profitability, measured by return on equity for the S&P, stands at 21%, the highest in 100 years.

Over half the mutual fund market is now invested in passive, index tracking funds. The critical issue is that passive investing pays no attention to valuation. Passive funds don't make judgements about whether a company is cheap or expensive – they simply buy every stock in an index in proportion to its size. This means the only thing that drives their buying and selling is money flowing in or out of the fund, not whether valuations look attractive.

With US valuations at historically extreme levels and \$9.7 trillion in ETFs globally, over half in US large cap, passive investors are highly exposed to valuation risk in today's market.

Opportunities for diversification

Performance through the first three quarters of 2025 reveals significant opportunities beyond US markets. While the Magnificent 7 returned 17.6% and the S&P 13.2%, China gained 43% in dollars, the Eurostoxx rose 24.9%, and the Topix in Japan climbed 12.7%. Gold has been a standout performer, with gold miners proving particularly attractive for balancing opportunity and risk diversification. These varied drivers of return highlight the clear benefits of broadening exposure across regions, sectors and asset classes.

The case for diversified, active portfolios

After more than 25 years of managing money, these extremes in market concentration are unprecedented. The opportunities to diversify and create carefully curated portfolios are remarkable. The sheer size of disruptive change, magnified and concentrated in fewer names because of passive money flows, will catalyse diversification and benefit active investors.

Key Risks

Past performance does not predict future returns. The value of an investment and the income generated from it can fall as well as rise and is not guaranteed. You may get back less than you originally invested.

The issue of units/shares in Liontrust Funds may be subject to an initial charge, which will have an impact on the realisable value of the investment, particularly in the short term. Investments should always be considered as long term.

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