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"10 stocks make up nearly 35% of the S&P 500. These 10 stocks are responsible for 100% of year-to-date returns of the S&P 500."

- Marc Rowan, CEO of Apollo

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After a challenging year in 2022, stocks have been buoyed this year by resilient economic growth. Leading the charge have been the largest of market cap stocks in the U.S., with a nickname (doesn't it make you nervous when stocks get a nickname?) of "The Magnificent Seven."

These seven stocks – Nvidia, Tesla, Meta (Facebook), Apple, Amazon, Microsoft, and Alphabet (Google) – have an average return of 53%, YTD. The broad market S&P 500 index is up just 9.23% and, if you took these seven stocks out of the index, the S&P would have a **negative return**[2]. These are interesting stats that beg multiple questions:

"Do we have any exposure to these companies? If we do, why don't we own more of them?"

For many clients, their largest asset class allocation is large cap U.S. equity positions, which have direct exposure to these stocks through broad index holdings. In terms of owning more of these stocks, it is important to highlight the context of 2023's returns. These magnificent seven stocks were down 46% on average in 2022, as interest rates skyrocketed, and valuations compressed. Lest anyone tell you that investing is easy, the magnificent seven of this year were the maligned seven of last year.

"Isn't it a bad thing that market returns are so concentrated in just a few companies?"

Unusual, yes. But bad? Not necessarily. A handful of stocks do not usually account for the entirety of the market's return but there are plenty of instances where they were over 25% of the overall return.

Annual S&P 500 Contribution of 10 Largest Weights During Positive Performance Years

Year	Top 10 as % of Total	S&P 500 % Perf.
2023 YTD	96.5%	11.7%
2007	78.7%	3.5%
2020	58.9%	16.3%
1999	54.5%	19.5%
2021	45.0%	26.9%
1998	36.8%	26.7%
1996	33.9%	20.3%
2017	33.3%	19.4%
2019	32.8%	28.9%
1991	28.6%	26.3%
2006	27.6%	13.6%
2016	26.6%	9.5%
2003	23.6%	26.4%
1995	22.3%	34.1%
2014	22.2%	11.4%
2004	21.1%	9.0%
2005	20.5%	3.0%
2010	19.6%	12.8%
2012	19.2%	13.4%
1997	19.1%	31.0%
2013	17.6%	29.6%
2009	15.5%	23.5%
1992	14.9%	4.5%
1993	12.2%	7.1%

Source: Todd Sohn, Strategas

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Second, in the twenty most heavily concentrated years for the S&P 500, the index had an average return of 19.9%. Stock concentration has been a major driver of long-term equity returns[3].

"Given the high valuation of these companies, should we favor investments outside of U.S. large cap stocks?"

The magnificent seven stocks trade at a valuation of around 41x earnings, compared to 15x earnings for an equal weighted S&P 500 index. Given the high valuations within the magnificent seven, diversification makes a lot of sense as you are adding exposure to undervalued investments, even if they have been laggards in recent years. As highlighted in our most recent **Quarterly Investment Perspectives**, we discussed the appeal of both U.S. Treasury bonds, which are yielding over 5% at various maturity points, as well as the attractiveness of alternative investments, which could provide returns above bonds, without taking on the risk inherent in the stock market.

For the last decades, investors have been well served by their U.S. large cap stock exposure. Selling any other holding and just buying US large caps even took on nickname – TINA (short for There Is No Alternative) – and to be fair, the alternatives have not been nearly as attractive until this year. The S&P 500 has returned 11%, annualized, over the last five years, while bonds have a negative return, and emerging market, international, and U.S. small cap stocks have returned between 1-3%. One could make the case that the magnificent seven, given their presence in the rising tide of artificial intelligence, are poised to continue delivering stellar returns.

Yet investors are still in need of diversification. Valuations may compress and the AI hype could cool in the short-term as regulation ramps up. Because of the opportunity for 5% plus yields in safe fixed income, combined with the valuation spreads in small cap stocks (trading at historic discounts to large caps), investors would be remiss to not consider other areas within the investment landscape. It has been a difficult few years given the volatility of COVID, the rise of interest rates, and tragic geo-political events happening, yet we encourage investors to not be focused on the rear view but to take heart in the future return opportunities that these dislocations have presented.

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1: Marc Rowan, Apollo Earnings Call Transcript - https://seekingalpha.com/article/4645964-apollo-global-management-inc-apo-q3-2023-earnings-call-transcript

2: All company and index return data as of 11/3/2023 via Morningstar and Kwanti Portfolio Analytics

3: Chart via Affiliated Managers Group & Strategas