

When it's unwise to concentrate

A key characteristic of many stock markets today is a heavy reliance on a handful of companies. Investors may well take advantage of this situation, often through index-tracking funds. As Julian Dieppe explains, however, the old adage about putting all your eggs in one basket still holds true.



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The debate over the respective merits of passive investing and active management is decades old. At their simplest and most wearily familiar, the arguments might be summarised as follows.

Passive investing tends to be relatively cheap but is inherently incapable of beating the market. Active management aims to add value through prudent stock selection and research-driven ideas but can entail higher fees and more fluctuation in performance.

Those are pretty much what might be described as the headline pros and cons – the principal discussion points in a nutshell. I would suggest, though, that it's becoming increasingly important to add a further consideration to this formative mix: concentration risk.

This is a phenomenon that's currently most readily associated with US markets. By way of illustration, take a passive fund that tracks the S&P 500 index – home of the “Magnificent Seven” technology stocks.

Without question, there has been something to be said for investing via such a fund in recent years. Allowing for occasional wobbles, Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia and Tesla have performed extremely well over a lengthy period, driving a hefty proportion of the S&P 500's returns.

Yet the devil is in the detail. It's well worth noting that the vast majority of S&P 500 companies failed to outperform the index in both 2024 and 2025. By any standard, this has become a remarkably narrow market – one that's conspicuously reliant on tech and, more specifically, the boom in artificial intelligence (AI).

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A passive investor might reasonably survey this scene and conclude there's merit in looking elsewhere. For example, why not indulge in a spot of geographical diversification – say, by investing in Asian equities via a fund that tracks the MSCI AC Asia Pacific Index?

Alas, much the same potential problem immediately rears its head. The MSCI AC Asia Pacific Index is dominated by a handful of mega-cap businesses with an explicit focus on technology and AI. Taiwan Semiconductor Manufacturing Co (TSMC), Samsung Electronics and SK Hynix are the major players, with Tencent and Alibaba next in the pecking order.

The issue becomes even more acute at the country level. TSMC alone lays claim to around 45% of Taiwan's Taïex Index, while Samsung and Hynix account for approximately a third of the Korea Composite Stock Price Index.

Now, it's essential to stress that companies such as Apple, Nvidia, TSMC and Samsung deserve to be viewed as attractive investment opportunities. As active managers, we're by no means averse to trillion-dollar businesses at the centre of one of the most far-reaching transformations in human history.

What we *are* averse to, however, is putting all our eggs in one basket. We don't like situations in which all hopes effectively rest with one region, one sector, one industry, one theme, one asset class or even one market-capitalisation category. That's what concentration risk is all about.

This is why passive investing can sometimes suffers from its own success. A particular stock's weighting in an index will hit its peak at exactly the moment when its price starts to fall – as a consequence of which passive investors are likely to experience an outsized negative impact in performance terms.

Little wonder, you might think, that so much of the investment world approaches tech titans' quarterly earnings calls with barely concealed trepidation. Check out, for instance, Broadcom's share-price woes during the past few weeks – largely a result of the US microchip designer's unexpected decision not to raise its revenue guidance for 2027¹.

So what's the lesson here? Contrary to the tit-for-tat tedium of one of investing's longest-running spats, I'm not merely attempting to demonstrate that active management is innately and vastly superior to its passive counterpart.

Rather, the point is that diversification really does matter – maybe more so now than for a long time. Not least against a backdrop of uncertainty and volatility, investing across regions, sectors, industries, themes, asset classes and market-capitalisation categories can be vital to establishing a sound balance between risk and reward.

This doesn't mean striking out in all directions in a vague bid to somehow cover all the bases and get lucky. Diversification should never give way to dilution. What's needed is a sensible and suitably informed blend.

To that end – and to return to one of the age-old arguments cited at the outset – prudent stock selection and research-driven ideas can help tick a lot of boxes. Sure enough, this is how we try to add value as the investment landscape continues to shift in the face of significant challenges, near-relentless innovation and often extraordinary progress.

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1. See, for example, *Motley Fool*: “Down more than 20% from its high, is Broadcom stock a buy?“, June 16 2026 – <https://www.fool.com/investing/2026/06/16/down-more-than-20-from-its-high-is-broadcom-stock/>.

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