

EQUAL-WEIGHTING CAN CUT CONCENTRATION. HERE'S THE CATCH

WHAT INVESTORS MAY OVERLOOK WHEN TURNING TO EQUAL WEIGHTING

When faced with a concentrated market, the instinctive response to mitigate exposures is often to own less of what has become dominant. Equal weighting offers a simple way to do that. The challenge is that simplicity can obscure important trade-offs that may materially alter a portfolio's risk and return profile.

LOOKING BEYOND CONCENTRATION RISK

U.S. market concentration has become one of the most frequently discussed topics in our client conversations, and it's easy to understand why. No matter how you look at it, U.S. equity markets are as concentrated as they have been in recent memory. For example, the weight of the top 10 holdings in the S&P 500 now hover around 40%, after sitting in the high teens as recently as a decade ago. This has coincided with an increased divergence in valuation, with the cap-weighted index being increasingly more expensive than its equal-weighted counterpart (**Exhibit 1**).

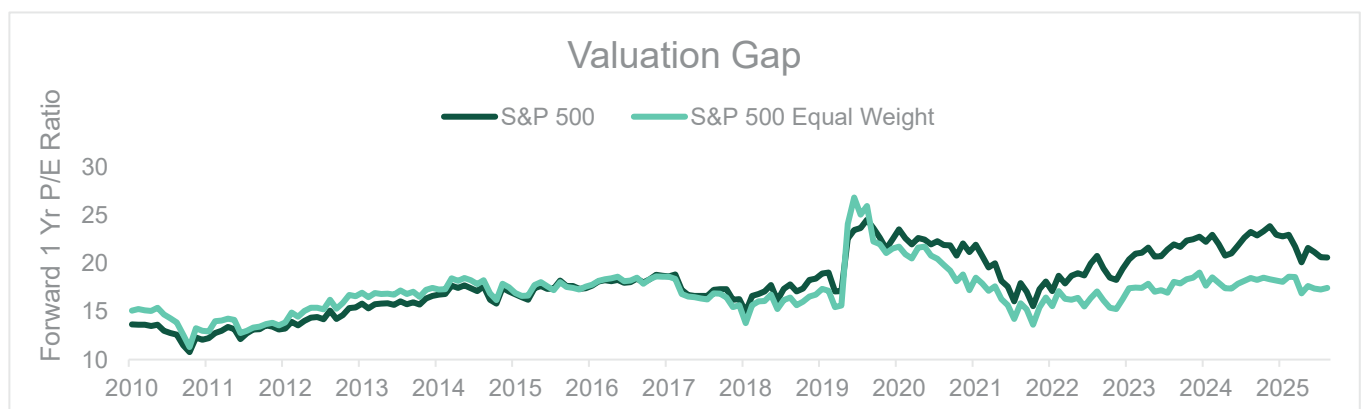
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EXHIBIT 1: EQUAL-WEIGHTING: INEXPENSIVE OR CHEAP FOR GOOD REASON?

The S&P 500 has become increasingly expensive compared to its equal-weighted counterpart.



Source: Northern Trust, S&P-Dow Jones. From 12/31/2010 through 7/31/2026. It is not possible to invest directly in any index.

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Given those developments, many investors are asking whether traditional market-cap-weighted portfolios depend too much on a handful of names. At first glance, equal-weighting seems like an obvious solution. It reduces reliance on the market's largest stocks and increases exposure to a broader set of companies.

However, investors should keep three things in mind:

- Concentrated indexes can still be diversified.
- Equal-weighting may introduce unintended risks.
- Reducing concentration may divert your portfolios from your desired outcomes.

CONCENTRATION DOESN'T HAVE TO DESTROY DIVERSIFICATION

Many discussions about concentration assume that because a handful of stocks account for a significant share of the market, investors are effectively making a single bet.

That assumption does not hold up well under scrutiny.

Today's largest companies each participate in very different businesses and economic ecosystems. Microsoft derives revenue from enterprise software, cloud computing and AI infrastructure. Amazon spans e-commerce, logistics, advertising and cloud services. Alphabet participates in search, digital advertising and cloud computing. Apple, Nvidia, Meta and Tesla each have distinct revenue drivers and competitive dynamics.

EXHIBIT 2: DIVERSITY IN THE DETAILS

Even though technology, hyperscaler and AI companies dominate the S&P 500, their underlying businesses vary significantly.

Company	Examples of Major Business Lines
Microsoft	Software, Cloud, AI Infrastructure, Gaming
Amazon	E-commerce, Logistics, Advertising, Cloud
Alphabet	Search, Advertising, Cloud
Apple	Hardware, Services, Payments
Meta	Social Platforms, Advertising
Nvidia	Semiconductors, Data Center, AI Infrastructure
Tesla	Vehicles, Energy Storage, Software

Source: Northern Trust Asset Management

This is important because diverse business models tend to produce differentiated return profiles. While there is naturally some overlap among the Magnificent Seven (after all, they are all part of the U.S. economy and the broad technology ecosystem), the group is not a monolithic bet on a single industry or economic outcome. That is clear in their stock performance: despite representing a significant share of the index, the average active pairwise return correlation among the group has been just 0.20 since 2015 and only 0.04 over the past 12 months as shown below.

The important distinction is that concentration in holdings does not necessarily imply concentration in risk.

EXHIBIT 3: MINIMAL CORRELATION DESPITE CONCENTRATION

There's relatively little pairwise correlation across the Magnificent Seven, even though many belong in the technology sector or are otherwise grouped together.

Industry		AAPL	NVDA	META	GOOGL	AMZN	TSLA	MSFT
Tech Hardware, Storage	AAPL	1.00						
Semiconductors	NVDA	0.14	1.00					
Interactive Media & Services	META	0.14	0.20	1.00				
Interactive Media & Services	GOOGL	0.15	0.16	0.31	1.00			
Broadline Retail	AMZN	0.18	0.22	0.36	0.33	1.00		
Automobiles	TSLA	0.15	0.21	0.08	0.08	0.16	1.00	
Software	MSFT	0.20	0.24	0.23	0.27	0.32	0.07	1.00

Source: Northern Trust, Bloomberg. Shows the correlation of daily active returns (stock return minus S&P 500 Index) from 06/30/2025 through 06/30/2026. It is not possible to invest directly in any index.

EQUAL WEIGHTING MAY TRIGGER UNINTENDED RISKS

Equal-weighting addresses concentration by reducing exposure to the largest companies and increasing exposure to smaller ones. But the implications go well beyond stock weights.

Relative to a market-cap-weighted index, equal-weight portfolios allocate more capital to smaller companies, alter sector exposures, and require regular rebalancing to maintain their equal-weight structure. Less obvious is that they also reduce exposure to many of the characteristics associated with strong long-term performance, including “high-quality” fundamentals and positive price trends. Also, equal-weighting does not necessarily protect investors from drawdown risk. In fact, from 2020 to 2025, equal-weighting had an average annual drawdown that was slightly steeper than cap-weighting (**Exhibit 4**).

Equal-weighting is not simply a hedge against concentration. It is a different portfolio with different risk and return drivers.

EXHIBIT 4: SELECTION BIAS

Multiples for the S&P 500 and its equal-weighted counterpart show that equal-weighted portfolios select against several desirable performance metrics.

Metric	S&P 500 Equal Weight	S&P 500	Implication
Average of Annual Max drawdowns (2020 – 2025)	-17.2%	-16.7%	Equal-weighting should not be relied upon for downside protection.
Forward P/E ratio	17.6x	21.3x	Equal-weighting appears cheaper on a headline valuation basis.
PEG ratio	1.4x	1.2x	After adjusting for expected growth, the apparent valuation advantage largely disappears.
Earnings growth	13.7%	20.9%	Equal-weighting currently tilts toward slower-growing companies.
Return on equity	18.7%	23.7%	Equal-weighting reduces exposure to companies with stronger profitability profiles.
Operating margin	20.4%	27.7%	Equal-weighting currently owns businesses with lower operating efficiency.
Debt-to-capital	44.3%	35.2%	Equal-weighting carries higher balance-sheet leverage.
Valuation exposure	Currently less “expensive”	Currently more “expensive”	Equal-weighting is currently less expensive, but this is neither deliberate nor persistent across market environments.
Liquidity	Greater exposure to smaller, less-liquid stocks	Greater exposure to larger, more-liquid stocks	Trading less-liquid stocks may widen bid-ask spreads and increase market-impact costs, particularly during rebalancing.
Turnover	24.09% 2025	2.78% in 2025	Maintaining equal weights requires substantially more turnover, which can increase transaction costs.
Tax Efficiency	Systematically trims outperformers and adds to underperformers	No forced trading based on relative price movement, limiting forced realization of gains	Periodic rebalancing may realize taxable gains by trimming outperformers and can reduce opportunities to defer gains or harvest losses, potentially lowering after-tax returns.
Momentum	Persistently anti-momentum	Carries the momentum of the broader universe	Equal-weighting bets against momentum, which has been a potent factor in the long run.

Source: Northern Trust, S&P-Dow Jones, FactSet. As of 7/31/2026.

DECONCENTRATION MAY NOT BE THE DESTINATION

None of this suggests that equal weighting is inherently good or bad. There will be environments in which equal-weight strategies outperform, and for investors concerned about market concentration, they can be an effective tool. Investors should, however, understand the risks associated with an equal weighting approach.

Investors rarely define success in terms of concentration levels. They care about outcomes: long-term returns, downside risk, diversification, and achieving their financial objectives. If investors are willing to deviate from a cap-weighted benchmark, the discussion should focus on the characteristics they want to own rather than simply the weights they want to avoid.

That perspective opens the door to a broader set of solutions. Rather than mechanically reducing exposure to market leaders, investors can seek approaches that more intentionally and consistently emphasize desired characteristics such as quality, valuation, downside protection, or income generation. In many cases, the resulting portfolio may exhibit lower concentration, but that outcome is a consequence of pursuing desired portfolio characteristics rather than the objective itself. Equal weighting may be one answer, but only if it supports those objectives in addition to reducing a headline number.

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