

As US markets become concentrated, Japan remains more diversified

High US concentration may reflect an early-stage innovation cycle, while Japan could offer more diversified exposure

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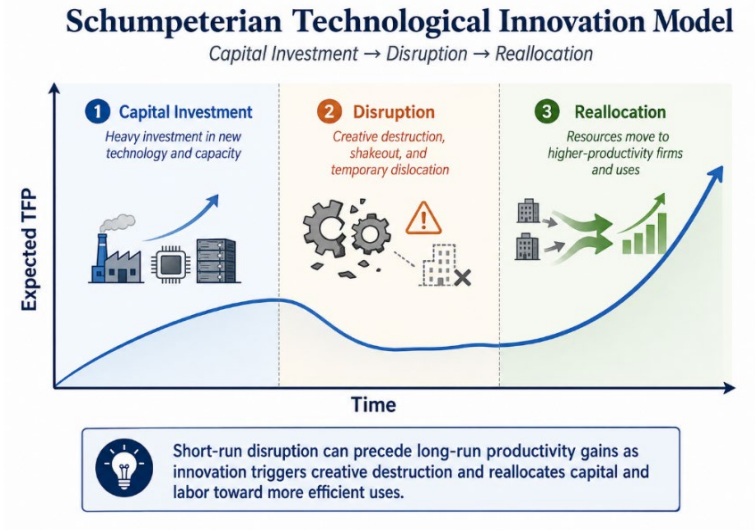
Large-cap equity indices have always been influenced by their biggest constituents. What is different today is the degree of that influence. Market concentration—notably in the US—is now more extreme than at any point in decades, and "owning the market" no longer means broad diversification. In contrast, Japan still offers a broader market structure.

Market concentration: early-cycle feature or diversification risk?

Whether market concentration is a problem for global equity markets is an often debated topic. One way of looking at it is that market concentration may be a natural feature of an intense investment phase within a technological innovation cycle. In this interpretation, large firms with access to capital, infrastructure, talent and distribution channels coordinate the early buildout phase of the investment cycle, creating the base for subsequent disruption, diffusion and reallocation.

What we described above is broadly consistent with the Schumpeterian view of innovation, in which innovation is the primary driver of economic development. In this view, technological progress begins with concentrated investment and market leadership, before waves of competition, adoption and productivity diffusion spread the gains more broadly across the economy (see Exhibition 1).

Exhibition 1: Visualising total factor productivity over the innovation cycle



Source: Amova Asset Management

However, regardless of its role in the innovation cycle, concentration may still present challenges for investors. For example, index concentration creates a practical portfolio issue. Investors seeking broad market exposure through capitalisation-weighted indices automatically end up accepting the same concentration risks embedded in the index. As concentration rises, “owning the market” increasingly means possessing a narrower set of dominant firms and business models. It is therefore useful to gauge the diversification risk of each market by measuring market concentration over time.

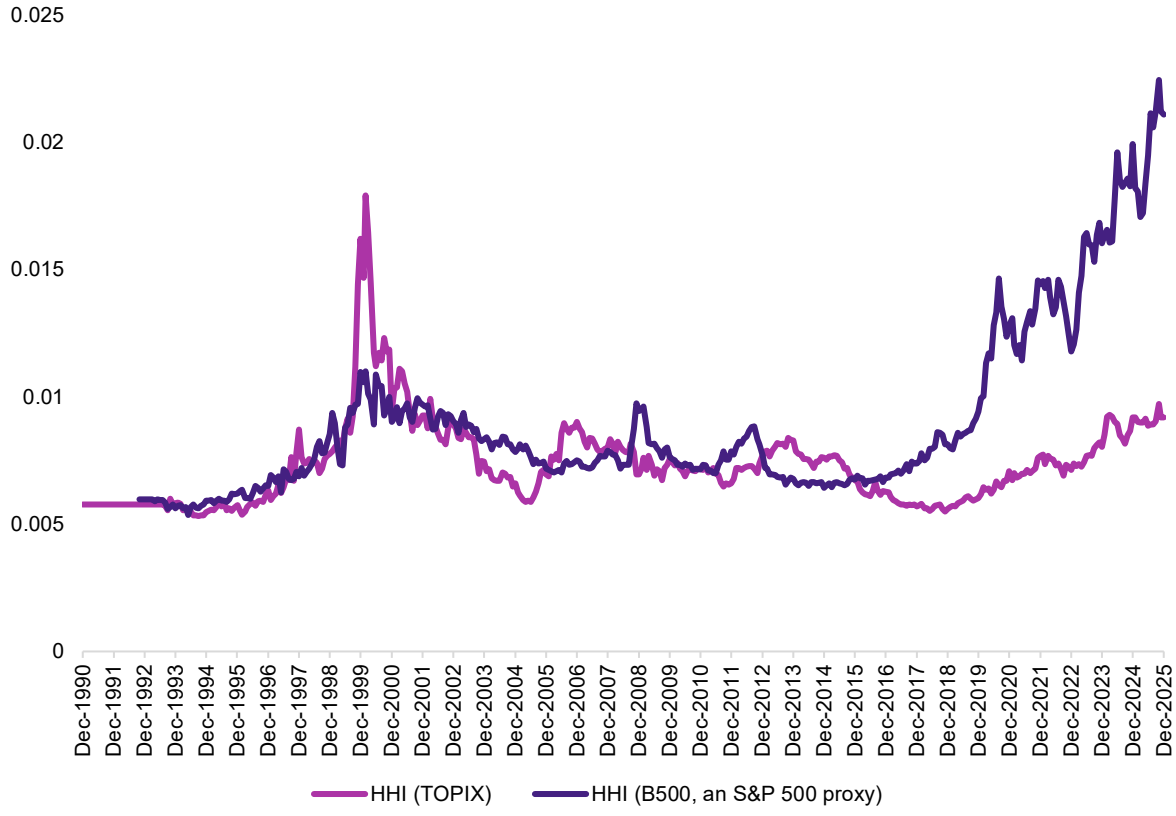
Concentration is now at extreme levels

We calculate concentration using the Herfindahl-Hirschman Index (HHI), which captures how much weight is concentrated in an index’s largest constituents. The measure is useful as it is comparable across indices representative of distinct geographies and constituencies.

For the S&P 500, concentration has risen sharply and now exceeds the dot-com era peak by a considerable margin. By this measure, the S&P 500 is almost twice as concentrated as it was at the height of the dot-com bubble, with its HHI at a 36-year high.

Although it is obvious that the concentration of the S&P 500 is at a recent historical extreme, it is also useful to compare concentration across geographies. In Chart 1, we plot the HHI for the B500 (an S&P 500 proxy with consistent data on index constituent weights) against the same measure for the TOPIX, which provides a broad measure of the Japanese equity market. Although concentration in the TOPIX has edged higher, it remains well within its recent historical ranges. Moreover, it is substantially below the concentration observed around the boom era of the 2000s, when telecom, mobile-internet and technology-related names led a narrow recovery in an otherwise deflation-beset Japanese market.

Chart 1: HHI for B500 (an S&P 500 proxy) and TOPIX



Source: Amova AM, based on Bloomberg data

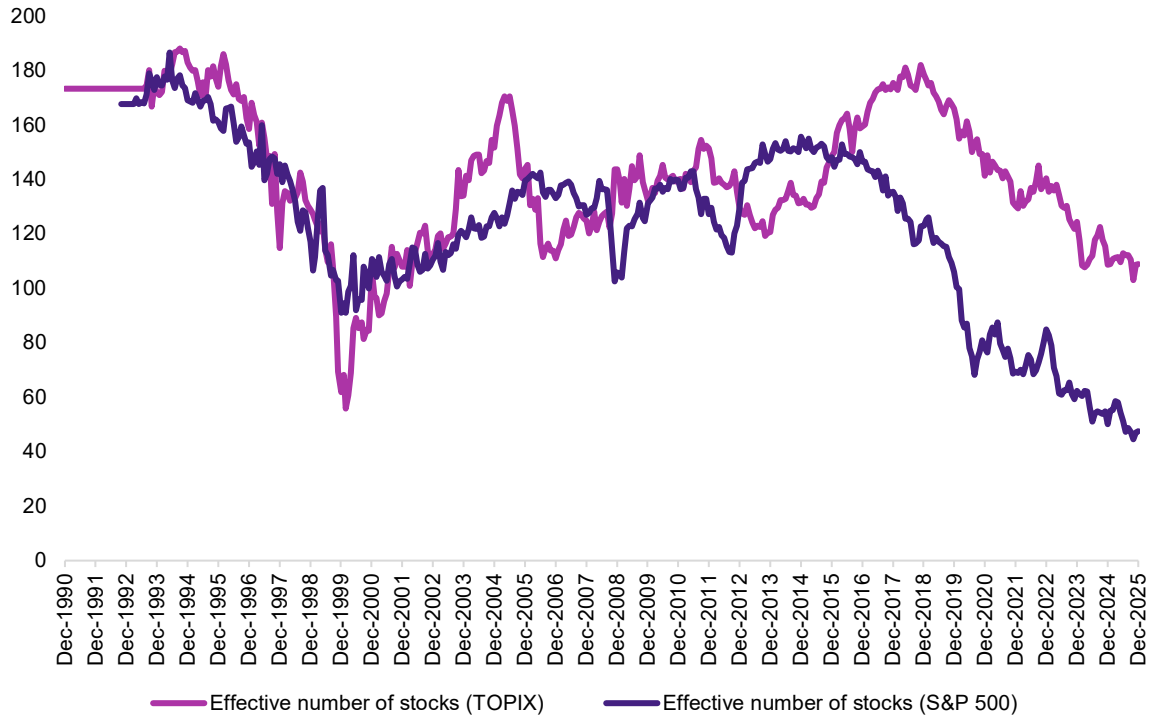
The effective number of stocks in the S&P 500 is shrinking rapidly

The HHI also allows us to calculate the "effective number of stocks"—the number of equally-weighted stocks needed to achieve the same degree of diversification as the market-weighted index.

For the S&P 500, the effective number of stocks has fallen to a record low of roughly 45–50, implying that the index's diversification profile is much narrower than its headline count of 500 constituents would suggest (Chart 2).

The effective number of TOPIX constituents has also fallen but it is currently around 105–110 (compared to below 56 in early 2000), suggesting a broader and more balanced market structure than the S&P 500.

Chart 2: Effective number of stocks in the S&P 500 and TOPIX



Source: Amova AM, based on Bloomberg data

Relative diversification value in Japan could pay off

While the US equity market is increasingly concentrated around a small number of dominant platform and AI-infrastructure firms, Japan remains more diversified.

Of course, the lofty valuations of today's market leaders likely reflects their position as the main beneficiaries of the ongoing capex cycle. However, history suggests that it takes time for the broader economy to fully benefit from investments driven by innovation. It is possible that productivity gains have still not spread widely in the US, and that the country is yet to experience both the disruption and reallocation phases.

By contrast, the lower concentration in Japan's market could mean that it is already displaying a broader diffusion of growth. This could be particularly relevant given the critical juncture at which Japan finds itself, as the economy gradually reflates and builds capacity more widely for the first time in 30 years.

The question, then, is not whether concentration is inherently bad or good. Instead, it is whether current concentration levels reflect an early phase of the cycle—one that requires wider productivity gains and adoption of innovative technologies in the future.

If that is the case, and if markets are pricing today's concentration as a sign of durable economic profits (often called "moats" to describe how they keep competitors at bay), there is a risk of such an assumption proving too optimistic. In more concentrated markets, prices may need to adjust through market dislocations before the benefits of innovation are fully distributed across the economy.

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