Dimensional

Market Concentration at High Valuations: What to Do?

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KEY TAKEAWAYS

- We find no reliable relation between US market concentration and the performance of traditional active funds.
- Systematic active solutions targeting the size, value, and profitability premiums may be more viable, especially in a global opportunity set.
- Such solutions can improve upon common alternatives that abandon market weights or provide indirect exposure to the premiums.

I. Introduction

At the end of 2025, US stock market indices appeared concentrated in a small number of companies. The top 10 holdings of the S&P 500, for instance, made up 41% of the total index value. Moreover, they commanded a weighted average price-to-earnings of 37x, more than 40% higher than the 26x for the remaining constituents. There is an ongoing debate among concerned investors—both within and outside the US—about what to do.

Some wonder whether this is active management's time to shine. High concentration, the argument goes, should imply ample opportunities for stock picking in more "under-appreciated" areas of the market. Others juxtapose the generally disappointing track record of active management with the current environment and see additional cause for skepticism: the exceptionally high opportunity cost of missing out on high-flying US mega caps. Among the skeptics are those who look to systematic managers for more reliable solutions.

This article discusses a few of the options available to investors seeking exposure to US stocks without sacrificing diversification or a prudent focus on valuations. We first look at stock picking and find no evidence that traditional active managers as a group have performed better or worse than average following periods of heightened concentration. We then make the case for solutions based on Dimensional's systematic active approach; namely, broadly diversified strategies that directly target reliable return premiums in a controlled manner, implemented using a flexible, continuous process that avoids the rigidities of indexing. We argue they constitute more compelling options than alternatives that abandon market weights or emphasize "quality" characteristics, especially for investors who can adopt a global opportunity set.

II. Market Concentration and Active Fund Performance

The generally disappointing track record of traditional active managers is well-documented in the academic literature and in industry reports.[1] Here, we ask whether periods of heightened market concentration are indicative of better (or worse) subsequent active fund performance.

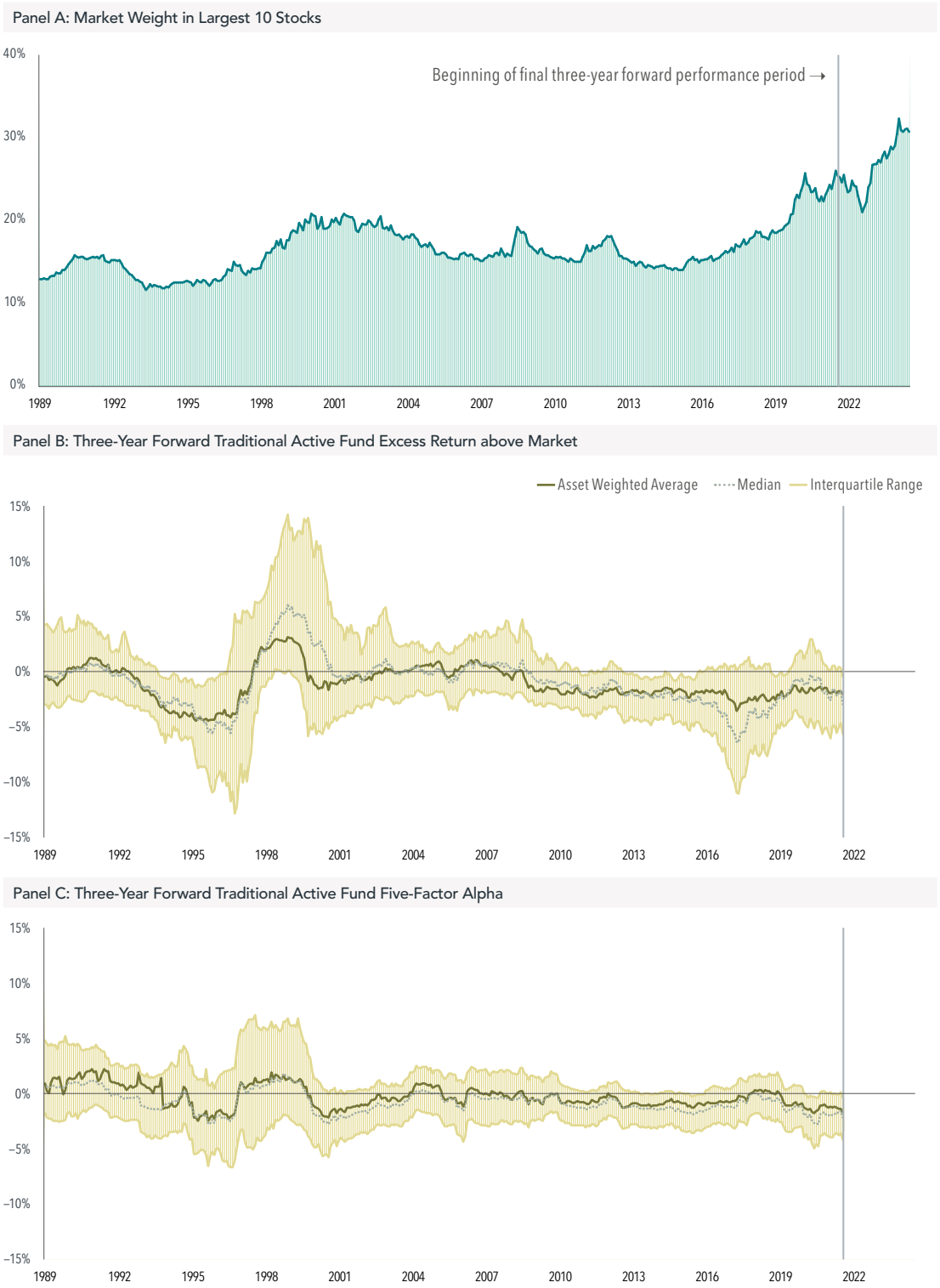
Exhibit 1 shows time-series plots of US stock market concentration and the subsequent net-of-fees performance of active funds focused on US stocks (see Appendix A for data definitions).[2] Panel A shows the market's weight in the 10 largest stocks; Panel B shows three-year forward fund excess returns above the market; Panel C shows the corresponding fund "alphas" (or "risk-adjusted returns") computed using the Fama and French (2015) five-factor model to account for differences in exposures to common factors across funds.[3]

The exhibit captures the top-heavy state of the US market at the end of our sample and the rapid ascension to that level of concentration over the past decade: The weight in the 10 largest stocks doubled from 15.2% in January 2015 to 30.7% in December 2024. The exhibit also captures how the asset-weighted average excess returns above the market and alphas delivered by active managers have hovered around zero over most of the sample, although with notable dispersion, particularly in the late '90s and early 2000s. In general, however, we see no discernible pattern linking concentration and subsequent active fund performance. Confirming this are the low and unreliable full-sample correlations between concentration and subsequent average performance: 21.1% with a t-statistic of 0.19 for excess returns and −20.1% with a t-statistic of −0.89 for five-factor alphas.[4]

These results suggest traditional active management is unlikely to be a reliable solution for investors concerned about the top of the US market. We next look at systematic solutions.

1. As an example, Dimensional's *Fund Landscape 2025* reports a survival rate of 46% and an outperformance rate relative to benchmark of 18% over the 20-year period ending December 2024 for US-domiciled active equity funds. Similar statistics are reported in other industry publications (e.g., by Morningstar and S&P Global). Fama and French (2010) find that while there are some active US equity funds that generate statistically reliable three-factor alphas, there are fewer of them than one would expect by random chance. Subsequent studies employing different methodologies have arrived at similar conclusions (e.g., Linnainmaa 2013 and Harvey and Liu 2022).
2. For simplicity, we measure concentration as the weight of the largest 10 among all US stocks, though the results are qualitatively similar using other definitions, e.g., the weight of the largest 30 or 50, or the Herfindahl–Hirschman Index.
3. Fund alpha is a measure of a fund's performance after accounting for the fund's exposures to common factors known to drive differences in returns. The Fama and French (2015) five-factor model produces alphas that account for exposures to the equity, size, value, profitability, and investment premiums. A positive fund alpha indicates the fund outperformed the expected return based on its exposures to the common factors.
4. Since we measure performance monthly but over rolling 36-month periods, we report t-statistics based on Newey-West standard errors adjusted for heteroscedasticity and autocorrelation with 35 lags to account for the overlap in the monthly performance observations.

EXHIBIT 1: Market Concentration and Subsequent Traditional Active Fund Performance



Time-series plots of monthly weight in the largest 10 stocks for the US market along with statistics from the subsequent sample distributions of fund-level monthly excess returns above the market and Fama/French five-factor regression intercepts ("alphas") based on rolling 36-month windows (minimum of 24 monthly observations). The market is represented by US common shares in the CRSP database. The sample of funds covers US-domiciled, US-equity invested funds in the CRSP Mutual Fund Database, excluding index and sector funds (see additional sample restrictions in the appendix). We annualize the statistics from the sample distributions of monthly excess returns and five-factor alphas by multiplying them by 12. Data are monthly and cover June 1989 through December 2024, where the start date is determined by the availability of a sufficient number of funds with a sufficiently long track record to compute the rolling performance measures. See Appendix for detailed sample criteria and data sources.

III. Systematic Active Solutions for Market Concentration at High Valuations

Systematic strategies may, potentially, provide more reliable solutions for concerned investors. Their proliferation, however, means a myriad of options, often with meaningful differences in design and implementation (see, e.g., Dai, Medhat, and Rizova 2023). These differences ultimately drive dispersion in outcomes.

Currently, popular systematic approaches involve 1) fundamental or equal weighting to curb concentration and 2) emphasizing "quality" characteristics to get "bang for the buck" given lofty valuations.[5] We argue both are indirect ways of pursuing the size, value, and profitability premiums. Fundamental weighting de-emphasizes high market values in favor of high accounting values, which is a back door to value and profitability tilts. Similarly, equal weighting is a mechanical tilt toward smaller size. In general, Dai and Saito (2022) show that weighting schemes that abandon market values "can result in extreme and uncontrolled deviations relative to the market, as well as excessive turnover and costs."[6] With regard to "quality," Medhat and Novy-Marx (2025) show that profitability subsumes any information about expected returns captured by a long list of quality metrics, including composite metrics, while the converse is false. In short, directly pursuing the premiums is likely a more efficient use of capital.

Dimensional's systematic active strategies directly target the size, value, and profitability premiums using controlled deviations from market-cap weights while maintaining broad diversification. They are implemented using a flexible, continuous process that seeks to add value daily while reducing costs by avoiding the rigidities of indexing. The strategies come in many forms—from marketwide to within asset classes and from single country to global exposure—and can be customized considerably for asset owners seeking bespoke solutions. Here, we present two marketwide examples: one among US stocks and one among all global stocks. We chose these because their investable universes are comparable to widely tracked market proxies, thus allowing us to showcase how well-designed, controlled deviations from market weights can help alleviate concerns around the stocks sitting atop the market. **Exhibit 2** illustrates the strategies' designs. It also shows selected characteristics at the end of 2025 for the strategies as well as their benchmark indices. Lastly, it shows strategy-to-benchmark weight ratios across size, valuation, and profitability groups.

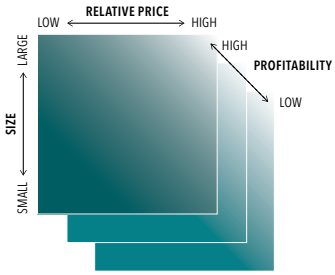
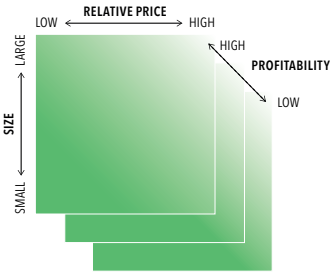
5. See, e.g., Emily Herbert, "*Investors Look to S&P's 'Forgotten 493' Stocks as Megacap Tech Wobbles,*" Financial Times, August 23, 2025; James McIntosh, "*Why Nvidia and Other AI Stocks Have Lost Their 'Quality' Status,*" The Wall Street Journal, December 7, 2025.

6. As an example, at the end of 2025, an equal-weighted S&P 500 would hold the largest stock, NVIDIA, at just 0.02x relative to its market cap weight while holding the smallest stock, News Corp, at 31x.

The US All Cap Core strategy is an example of a US marketwide solution that offers balanced exposure to all three premiums. Starting from market-cap weights, it employs controlled over- and underweights as well as exclusions to tilt toward securities with smaller size, lower valuation, and higher profitability. It can help investors alleviate concentration concerns through its broad coverage of US stocks of all capitalizations, its de-emphasis of mega cap growth stocks, and its explicit weight caps at the security and sector levels. At the end of 2025, the strategy had 30% of its weight in its top 10 holdings versus 36% for its benchmark, the Russell 3000 (recall the 41% for the S&P 500). It can also help investors maintain a prudent focus on lower valuations through its emphasis on value securities, particularly those with smaller size and higher profitability. At the end of 2025, it held value stocks with high profitability at 1.4x their weight in the benchmark while holding growth stocks with low profitability at 0.6x. As a result, its aggregate price-to-earnings was 22x versus 26x for the Russell 3000 (27x for the S&P 500).

The All Country All Cap Core Equity Strategy expands the investable universe beyond the US to all global markets, both developed and emerging. Like its US-only counterpart, it tilts toward securities with smaller size, lower valuation, and higher profitability within each investable universe, and it has built-in weight caps to manage concentration risk. In addition to allowing investors to pursue the premiums across regions, a global opportunity set is an effective antidote against concentration. At the end of 2025, the strategy held more than 14,000 securities and had just 13% of its weight in its top 10 holdings versus 23% for its benchmark, the MSCI All Country World IMI. This is despite the fact 61% of its weight was in the US, similar to the benchmark. Due to the strategy's emphasis on value stocks with high profitability, its aggregate price-to-earnings was 18x versus 22x for the benchmark.

EXHIBIT 2: Examples of Dimensional Systematic Active Equity Strategies
Characteristics and positioning as of December 31, 2025, for representative accounts

	Strategy			
	US All Cap Core Equity		All Country All Cap Core Equity	
Design Schematic				
Number of Holdings	2,360		14,222	
Weight in Top 10	30.1%		12.9%	
Weight in the US	100.0%		61.4%	
	Benchmark			
	Russell 3000 Index		MSCI All Country World IMI Index	
Number of Holdings	2,966		8,222	
Weight in Top 10	35.9%		22.9%	
Weight in the US	100.0%		62.7%	
	Strategy-to-Benchmark Weight Ratios			
Large	0.81x		0.65x	
Mid	1.37x		1.57x	
Small	2.10x		2.70x	
	Low Profitability	High Profitability	Low Profitability	High Profitability
Growth	0.61x	0.98x	0.62x	0.86x
Value	1.06x	1.38x	1.08x	1.59x

Holdings are subject to change.

Source: Dimensional, using Morningstar and Dimensional data. In the US, Large Cap is defined as approximately the largest 70% of market capitalization, Mid Cap the next 20% and Small Cap the smallest 10%. In developed markets except the US, Large Cap is defined as approximately the largest 70% of market capitalization in each country or region, Mid Cap the next 17.5% and Small Cap the smallest 12.5%. In emerging markets, Large Cap is defined as approximately the largest 70% of market capitalization in each country or region, Mid Cap the next 15% and Small Cap the smallest 15%. Designations between value and growth are based on price to book ratios. Value is defined as the 50% of market cap with the lowest price to book ratios by size category and growth is the highest 50%. Profitability is measured as operating income before depreciation and amortization minus interest expense scaled by book. High profitability is defined as the 50% of market cap with the highest profitability by size category and low profitability is the lowest 50%. REITs, Utilities, and Other Stocks includes REITs and Utilities, identified by GICS code, and stocks without size, relative price, or profitability metrics. Underlying holdings in rights, warrants, cash, cash equivalents, ETFs, and bonds are excluded. Indices are not available for direct investment. Frank Russell company is the source and owner of the trademarks, service marks, and copyrights related to the Russell Indexes. MSCI data © 2026, all rights reserved

IV. Conclusion

Investors seeking exposure to US stocks while managing concentration risk and maintaining a prudent focus on valuations face a myriad of potential solutions. While there is no one-size-fits-all when it comes to asset allocation, we argue that solutions based on Dimensional's systematic active approach may be more viable than those based on stock picking and provide a more direct targeting of reliable return premiums than solutions based on alternative weighting schemes or "quality" metrics. This is especially true for investors who adopt a global opportunity set.

Appendix: Stock and Active Fund Sample Criteria

Stock Sample in Exhibit 1

Data are from CRSP.

The sample includes US incorporated securities where the issuer type is not a REIT (Real Estate Investment Trust), the security type is common stock shares, and the share type has no special features or is a certificate. We require the primary exchange to be NYSE, AMEX, or Nasdaq and that data for the prior month cover the full period.

Active Fund Sample in Exhibit 1

Data are from the CRSP Mutual Fund Database.

The sample includes all US-domiciled, US-equity invested, open-end and exchange-traded funds, excluding sector funds, index funds, and funds-of-funds. We identify fund styles and objectives using CRSP's mapping of fund objective codes from the Strategic Insights, Wiesenberger, and Lipper databases as well as manual checking of fund names following the approach in French (2008) and Fama and French (2010). Returns are net of fees and aggregated from the share-class level to the fund level by total net assets. Funds enter the sample from the first month they reach total net assets of USD 5 million, measured in December 2024 dollars. Funds with fewer than 12 nonmissing monthly returns are excluded.

The full sample covers January 1984 through December 2024 and consists of 5,409 funds. There is an average of 1,865 funds per month with an unweighted average total net assets of USD 1.2 billion (December 2024 dollars). The sample used in the analysis starts in June 1986 to ensure a sufficient number of funds with enough data to compute excess returns and alphas.

Fama/French research data is from *Ken French's website*.

Glossary

Active manager: Portfolio manager who uses an approach that aims to outperform a market rate or return, or a specific benchmark, by choosing investments that deviate from the market portfolio or benchmark.

Alpha: The rate of return on an investment in excess of a benchmark or return predicted by a financial model. A higher alpha value implies greater outperformance.

Certificate: A legal document (or electronic record) that proves ownership of a specific number of shares in a company.

Equal weighting: An investment approach that weights every security equally.

Expected returns: Estimates of average anticipated returns informed by historical data.

Five-factor alphas: Risk-adjusted performance measures representing an investment's excess return above the expected return calculated by the Fama-French five-factor model. It measures performance after accounting for market, size, value, profitability, and investment factors.

Fundamental weighting: An investing approach that weights companies in proportion to accounting fundamentals instead of market values.

Growth stock: A stock trading at a high price relative to the company's book value.

Indexing: Fund management approach that uses a set of rules to determine what assets to hold and at what weights, seeking to mimic the stated index. These funds aim to track the index's performance.

Market-cap weights: The total market values of the available outstanding shares of securities used when defining the makeup of an investment approach.

Premium: A return difference between two assets or portfolios.

Price-to-earnings ratio (P/E): The ratio of a company's current share price to its earnings per share.

Profitability premium: The return difference between stocks of companies with high profitability over those with low profitability.

"Quality" characteristics: Attributes commonly used to evaluate the financial health of companies.

Size premium: The return difference between small capitalization stocks and large capitalization stocks.

t-Statistic: A statistical quantity commonly used to test whether a sample average is reliably different from a specified value (e.g., zero). Researchers often cite an absolute t-statistic value of at least 2.0 as the threshold for statistical reliability.

Valuation: A measure of a company's stock price relative to a fundamental factor like its earnings or book value.

Value premium: The return difference between stocks with low relative prices (value) and stocks with high relative prices (growth).

Value stock: A stock trading at a low price relative to its book value.

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