

Market Insight

When Diversification Feels Broken

Understanding Today's Concentrated Market



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One of the most common questions investors are asking right now is simple: *If the S&P 500 is doing well, why isn't my diversified portfolio keeping up?*

It is a fair question. It is also one of the most important conversations investors and advisors should be having today. The answer is not that diversification has stopped working. The answer is that the S&P 500 itself has become far more concentrated than many investors realize.

1. The S&P 500 Is Not Equally Diversified

When many people hear “the S&P 500,” they naturally think of a broad, diversified basket of 500 leading American companies. Technically, that is true. The index does include roughly 500 companies across multiple industries.

But the S&P 500 is not equally weighted. It is **market-cap weighted**. That means the largest companies have the greatest influence on index performance. A company worth \$3 trillion has far more impact than a company worth \$30 billion. As a result, the S&P 500 may contain hundreds of companies, but its returns can be driven by a relatively small number of mega-cap stocks.

Today, the top 10 companies represent an unusually large share of the index. The so-called Magnificent Seven — Nvidia, Microsoft, Apple, Amazon, Alphabet, Meta, and Tesla — have represented roughly one-third of the S&P 500's total value. The top 10 companies have been closer to 40%.

SHARE OF S&P 500 BY MARKET VALUE



Illustrative and approximate — index weights are market-cap based and change daily. For illustration only.

That is not normal diversification in the way most investors understand it. It means the S&P 500 has increasingly become a diversified index with a very concentrated mega-cap technology and artificial intelligence overlay.

2. What Is Driving the Market?

The current market has been powered by several forces.

- ◆ **Artificial intelligence** has created a major growth narrative. Companies involved in semiconductors, cloud computing, data centers, software, and AI infrastructure have attracted enormous investor attention.
- ◆ **These are not speculative startups.** Many of the largest technology companies are highly profitable, cash-generating, globally dominant businesses. That makes today's market different from the late 1990s, when many technology companies had little or no earnings.
- ◆ **Passive investing has amplified the impact.** As more money flows into market-cap-weighted index funds, more dollars automatically go to the largest companies. When those companies rise, they become larger weights in the index, which attracts even more capital from index flows.

This creates a powerful feedback loop. The largest companies get larger. Their influence on the index grows. The index performs well. Investors add more money to the index. More money flows back into the same largest companies. This can continue for a long time. But it also creates risk.

3. Why Diversified Portfolios May Underperform

A thoughtfully diversified 20-stock portfolio may own excellent companies across financials, healthcare, industrials, consumer staples, energy, technology, and other sectors. That portfolio may be fundamentally sound.

But if it does not have the same heavy exposure to the handful of mega-cap technology stocks driving the index, it may lag the S&P 500 during periods of narrow market leadership. This is not necessarily a sign that the portfolio is broken. It may simply mean the benchmark has become unusually concentrated.

In other words, a diversified portfolio is not underperforming “the market” as much as it may be underperforming a concentrated group of mega-cap growth companies embedded inside the market. That distinction matters. A portfolio can be well-built and still trail a benchmark that is being driven by a small number of stocks.

4. Great Companies Are Not Always Great Portfolios

This is one of the most important lessons in investing.

A great company and a great investment portfolio are not the same thing.

A great company can have exceptional products, strong earnings, brilliant leadership, and a dominant market position. But if too much of an investor's portfolio depends on a small group of companies continuing to outperform, the portfolio may carry more risk than the investor realizes.

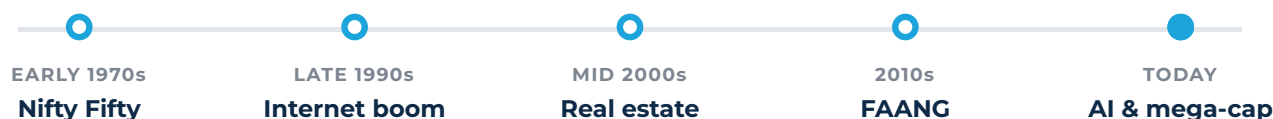
The issue is not whether Nvidia, Microsoft, Amazon, Alphabet, Meta, Apple, or other market leaders are good companies. Many of them are extraordinary companies. The issue is whether investors are becoming overly dependent on them.

Even great companies can disappoint if expectations become too high. Even revolutionary technologies can produce poor investment outcomes if investors overpay. Even dominant market leaders can go through long periods of underperformance. The question is not whether artificial intelligence is important — it almost certainly is. The question is whether current prices already reflect a great deal of that future success.

The same is true of even the greatest investors. Warren Buffett is widely regarded as one of the finest investors in history — the company he built, Berkshire Hathaway, compounded at roughly double the S&P 500's annual return over the six decades through 2024. Yet in this narrow, AI-driven market, Berkshire has trailed the S&P 500 by a wide, double-digit margin so far in 2026. Does that mean Buffett was wrong, or that disciplined, diversified investing no longer works? Almost no one would say so. It simply shows that even a great, time-tested strategy can lag a concentrated benchmark for a stretch — and that trailing the index for a period is not the same as being broken.

5. We Have Seen Similar Periods Before

Every market cycle is different, but history provides useful perspective.



The Nifty Fifty

In the late 1960s and early 1970s, investors became enamored with a group of dominant growth companies known as the Nifty Fifty. These were considered “one-decision” stocks. The idea was that investors could buy them and hold them forever because the companies were so strong.

Many of those businesses were excellent. The problem was not business quality. The problem was price and investor expectations. When valuations became excessive, many Nifty Fifty stocks produced disappointing returns for years. The lesson was simple: great businesses can become poor investments when too much optimism is already priced in.

The Late 1990s Technology Boom

The late 1990s may be the most obvious modern comparison. The internet was real. Technology did transform the economy. Many of the long-term predictions about digital commerce, software, and connectivity proved correct. But investors still overpaid.

By 1999 and early 2000, many investors believed traditional valuation discipline no longer mattered. Diversified portfolios looked outdated. Value managers looked foolish. Anything not tied to technology felt irrelevant. Then the bubble broke. The Nasdaq declined dramatically. Many technology stocks collapsed. Some disappeared entirely. Others survived and eventually thrived, but only after years of painful adjustment.

The lesson was not that technology was bad. The lesson was that even correct investment themes can become overpriced.

The FAANG Era

More recently, the FAANG stocks — Facebook, Apple, Amazon, Netflix, and Google — drove a significant portion of market returns for many years. Many diversified portfolios lagged during that period. Investors again questioned whether they should simply own the largest technology winners.

Then 2022 arrived. Several of those same leaders declined sharply. Diversification, valuation discipline, and risk management suddenly mattered again. The lesson repeated itself: market leadership changes.

6. The Risk Is Not Just a Market Decline

When people think about risk, they often think only about a major market crash. But concentrated markets create other risks too.

- ◆ **Valuation risk.** If expectations are too high, even strong earnings may not be enough.
- ◆ **Earnings risk.** If AI-related growth slows or monetization takes longer than expected, prices can adjust quickly.
- ◆ **Regulatory risk.** The largest companies attract scrutiny from governments, regulators, and competitors.
- ◆ **Business model risk.** Technology changes quickly. Today's dominant platform can become tomorrow's disrupted incumbent.
- ◆ **Portfolio construction risk.** Investors who believe they are broadly diversified may unknowingly own portfolios heavily dependent on a few companies.
- ◆ **Behavioral risk — and perhaps the most important.** When concentrated market leadership persists, investors become frustrated with disciplined strategies. They begin to compare everything to the hottest index or sector. They may abandon diversification, chase recent winners, and increase risk after much of the performance has already occurred.

That is often where the real damage happens.

7. Volatility Is Not the Real Enemy

At Parsonex, we have long believed that volatility itself is not the true risk. Volatility is expected. Markets decline. Corrections happen. Temporary downturns are part of long-term equity ownership. The greater risk is not temporary fluctuation.

The greater risk is making permanent mistakes in response to temporary frustration.

Investors often hurt themselves not because they owned a diversified portfolio, but because they abandoned it at the wrong time. They sell after underperformance. They chase what has already worked. They confuse recent returns with future certainty. They allow short-term comparison to override long-term planning.

That is why investor behavior is so important. A sound investment strategy can survive temporary underperformance. It cannot survive constant emotional changes.

8. What Investors Should Remember

The goal of investing is not to beat the S&P 500 every quarter or every year. The goal is to build and maintain a strategy that supports long-term financial independence. That requires owning productive assets, staying invested, managing liquidity, controlling behavior, and avoiding catastrophic mistakes.

There will always be a reason to question discipline. In the 1970s, it was the Nifty Fifty. In the late 1990s, it was internet stocks. In the mid-2000s, it was real estate. In the 2010s, it was FAANG. Today, it is artificial intelligence and mega-cap technology. Each cycle has its own story. Each story feels compelling. Each one creates pressure to abandon discipline. But the core principles of long-term investing remain remarkably consistent.

Own quality businesses. Stay diversified. Maintain perspective. Plan around goals, not headlines. Keep enough liquidity to weather temporary downturns. Avoid emotional decision-making. Let compounding work.

9. Our Perspective

We are optimistic about innovation. We are optimistic about American enterprise. We are optimistic about equities as a long-term asset class. We also recognize that optimism and discipline must coexist.

It is possible to believe in artificial intelligence and still recognize concentration risk. It is possible to admire great companies and still avoid building an entire strategy around a small number of them. It is possible to trail a concentrated benchmark over shorter periods and still be following a prudent long-term plan.

The S&P 500 is a useful benchmark, but it is not a financial plan.

It does not know a client's goals, income needs, tax situation, risk tolerance, time horizon, liquidity needs, or emotional capacity. That is where advice matters. The advisor's role is not simply to chase the index. The advisor's role is to help clients make good decisions through changing markets. That means explaining what is really driving returns. It means helping clients understand the difference between temporary underperformance and flawed strategy. It means keeping clients focused on the long-term outcome rather than the short-term scoreboard.

Final Thought

Periods of narrow market leadership can make diversification feel broken. But history suggests the opposite. These are precisely the periods when discipline matters most.

The biggest risk is not that a diversified portfolio trails a concentrated index for a period of time. The biggest risk is abandoning a thoughtful long-term strategy because a narrow group of stocks made everything else look temporarily inadequate.

Market leadership will change. Headlines will change. The dominant companies of one era will not always be the dominant investments of the next. But the principles that drive long-term success remain the same:

Patience. Discipline. Diversification. Quality advice. Long-term equity ownership. And the ability to stay the course when the market makes discipline feel uncomfortable.

That is not outdated. That is how lasting wealth is built.



ABOUT THE AUTHOR

Jonathan Miller is the Founder and CEO of Parsonex Enterprises, a multi-entity financial services holding company that includes FINRA-registered broker-dealers, SEC-registered investment advisory firms, and an integrated tax services practice. He is an Accredited Wealth Management AdvisorSM. His investment philosophy centers on disciplined long-term equity ownership, behavioral awareness, and the belief that financial independence — not retirement by a certain age — is the real goal of wealth management.

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