

So You're Telling Me There's a Chance

Lloyd: "I'm just saying, it's a one-in-a-million chance." Harry: "So you're telling me there's a chance?"

Dumb and Dumber (1994)

Executive Summary

- Concentration is at a historic extreme. The ten largest companies in the S&P 500 now make up close to 40% of the index, a level of top-heavy exposure not seen in roughly six decades. Passive allocations increasingly ride on one story going right.
- The AI trade has turned binary. Even as valuations on some hardware names have leveled off, market leadership still assumes a single set of outcomes will dominate. That is a uncertain bet dressed up as a certain outcome.
- Geopolitics reversed the calm. After weeks of easing US-Iran tension, renewed hostilities and rhetoric pushed Brent back toward \$80 and reignited inflation worries in the span of a day.
- A new Fed chair, a new tone. Kevin Warsh's first meeting left the target range at 3.50% to 3.75% as expected, but less forward guidance and a hawkish lean have pushed the front end of the curve higher.
- The through-line: diversification and time in the market. When a narrow group of outcomes is priced to perfection, the discipline to stay broadly invested matters more, not less.

Performance

Through 6/30/2026, equities finished a strong first half with a soft June. The S&P 500 returned 10.19% YTD despite slipping 0.95% on the month. Style and region told the real story: Russell 1000 Value led at 16.22% YTD while Russell 1000 Growth trailed at 5.33%, a reversal of the pattern that dominated recent years. International participated, with MSCI EAFE up 9.90% and MSCI EM, the standout, at 24.00% YTD. In fixed income, the U.S. Aggregate returned a muted 0.62% YTD while municipals gained 2.32%. The front end stayed firm as rate-cut expectations faded. At the sector level, Industrials (20.15% YTD) and Info Tech (19.76% YTD) led, while Consumer Discretionary (-0.77%) and Financials (-1.31%) lagged. Source: Bloomberg.

Market Performance Barometer (Through 6/30/2026)

	Performance					Performance			
	1 Mo	QTD	YTD	1-Year		1 Mo	QTD	YTD	1-Year
Equities					Fixed Income				
S&P 500 Index	-0.95%	15.20%	10.19%	22.29%	U.S. Aggregate	0.24%	0.67%	0.62%	3.79%
Russell 1000 Value Index	2.27%	13.87%	16.22%	27.05%	Corporate	0.19%	1.40%	0.86%	4.34%
Russell 1000 Growth Indx	-2.68%	16.74%	5.33%	17.70%	Municipal Bond Index	0.96%	2.50%	2.32%	7.03%
MSCI EAFE	0.09%	11.08%	9.90%	20.94%	1-5 Year	-0.62%	0.13%	0.56%	1.62%
MSCI EM	-1.37%	24.14%	24.00%	44.15%	U.S. Treasury	0.28%	0.32%	0.28%	2.72%

Top Sector Indexes (YTD)

S&P 500 INDUSTRIALS IDX	7.29%	14.85%	20.15%	27.13%
S&P 500 INFO TECH INDEX	-3.28%	31.79%	19.76%	37.48%
S&P 500 ENERGY INDEX	-5.06%	-13.45%	19.66%	29.04%

Bottom Sector Indexes (YTD)

S&P 500 COMM SVC	-7.78%	8.32%	0.80%	21.14%
S&P 500 CONS DISCRET IDX	-4.69%	9.27%	-0.77%	9.46%
S&P 500 FINANCIALS INDEX	4.37%	9.00%	-1.31%	3.91%

Source: Bloomberg





The 40% Problem

Start with the arithmetic, because the arithmetic is the argument. The ten largest names in the S&P 500 account for nearly 40% of the index, a concentration last seen in the mid-1960s. In emerging markets, the picture is even more lopsided, with a handful of semiconductor giants making up a disproportionate share of the benchmark. This is not inherently a problem: many of these are extraordinary businesses. The problem is the repercussions for a passive allocation. A market cap weighted index does not ask whether a business is strengthening or weakening, whether a moat is widening or narrowing, or whether today's price fairly compensates you for tomorrow's risk. It simply owns more of what has already gone up.

History offers some perspective on how these things resolve. In 1980, fossil fuels were roughly 29% of the S&P 500; today they sit near 3%. At the peak of Japan's late-1980s boom, Japan reached 44% of the MSCI World Index and now sits around 5%. These are not timing signals, and we would not treat them as such. In our view, they are reminders that benchmark weights can drift a long way toward a single theme before the market rethinks the wager. So, you're telling me there's a chance the leaders of this era stay the leaders of the next? There is, but the range of outcomes is simply wider than the index price implies. That is why concentration risk is now a portfolio decision, whether or not you made it on purpose, and rebalancing toward breadth is how you take the decision back.

A Binary Bet in Better Clothes

The AI trade has matured, but it has not diversified. Valuations on several hardware and semiconductor names have leveled off after years of blistering gains, which reads like cooling, but functions more like consolidation around the same conviction. Leadership remains narrow, and the market continues to reward the physical infrastructure layer of AI, the chips, power, and buildout, over almost everything else. The spending is real; large US technology firms have signaled AI investment approaching \$800 billion for 2026. The question is no longer whether AI is transformative, but rather does one set of winners, at today's weights and prices, deserves to carry the index.

That is what makes the current setup binary. When a theme is priced to perfection, the payoff skews: keep being right and the returns are incremental, be wrong on timing or magnitude and the drawdown is not. The sharp run-up in AI winners could leave the stock prices particularly exposed to profit-taking on any cooling in conviction. This is also why the frostier corners of the market, energy, materials, healthcare, and areas generating real free cash flow, have started to look interesting again as offsets rather than as afterthoughts. Owning the theme and owning its hedges are not contradictory positions. Participation in AI does not require concentration in AI, and building in offsetting exposures is how you stay in the trade without betting the portfolio on it.

Oil, Iran, and a One-Day Reversal

The calm did not last. After several weeks in which easing US-Iran tensions let risk assets rally and oil drift lower, the past day brought a sharp reversal. Renewed hostilities in the Persian Gulf and escalating rhetoric

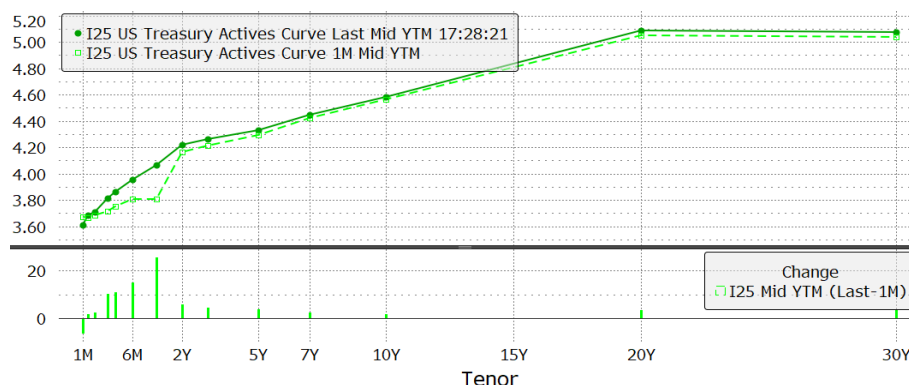


raised the threat of a return to open conflict. Reports of a second straight day of US strikes sent Brent briefly above \$80 and pushed stocks, bonds, and crypto lower together. The Strait of Hormuz, through which a meaningful share of global oil transits, is once again the variable markets cannot price with confidence.

The economic channel that matters here runs through inflation. A sustained move higher in oil feeds directly into headline prices and complicates an already cautious Fed. Federal Funds futures responded by lifting the odds of a rate hike by October. It would likely take a much larger, and more durable, rise in oil to materially alter the outlook for growth and earnings, and neither side appears to want a prolonged war. But the episode is a clean illustration of how quickly a benign backdrop can turn, and of how reacting to fast-moving headlines tends to produce worse portfolio outcomes than sitting still. Geopolitical shocks are unforecastable by design, which is precisely why the response belongs in the portfolio's construction rather than in a reaction to the news.

A New Chair, a Shorter Statement

The Federal Reserve held its target range at 3.50% to 3.75%, as expected, but the meeting was notable less for the decision than for the delivery. New Chair Kevin Warsh's first policy statement was markedly shorter than prior versions and stressed that the committee "will deliver price stability." The brevity is itself a signal: a shift in how the Fed communicates and how much forward guidance it is willing to offer. The June Summary of Economic Projections reinforced the hawkish read, with all but one participating policymaker expecting rates to hold or rise by year-end. Notably, one dot was missing entirely: Warsh did not submit his own projection. Markets got the message. Rate-cut expectations that had been priced into the front end earlier in the year have largely unwound, and implied policy has swung toward a prolonged pause, with a live probability of a hike rather than a cut. The 2s10s portion of the curve has flattened as short yields repriced higher. For portfolios, the practical effect is that the front end and belly of the curve are doing real work again, and the case for reaching far out on duration in search of yield has weakened. A less-telegraphed Fed means wider rate outcomes, and anchoring fixed income toward the shorter end keeps the portfolio from depending on a rate path no one, possibly including the Chair, is willing to commit to.



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Here is the thing about Lloyd's odds. He hears "one in a million" and walks away convinced the deal is as good as done. That is roughly how a fully concentrated, theme-driven benchmark behaves right now: a narrow set of outcomes, priced as though the other 999,999 do not exist. We are not AI pessimists, and we are not calling a top. In our view, the more useful posture is the one the best investors have always taken in moments like this: bold enough to own great businesses when the fundamentals justify it, humble enough to know that no single theme should dictate the shape of a portfolio.

That humility has a name, and it is diversification. Spreading exposure across styles, sectors, geographies, and asset classes is not a hedge against conviction; it is what lets conviction survive being early, wrong, or late. It pairs with the discipline that has outlasted every narrow market before this one: time in the market beats timing the market. The investors who compound are rarely the ones who guessed the reversal. They are the ones who stayed broadly invested through the tumultuous times. So, you're telling me there's a chance the concentrated bet keeps paying? Sure. We would just rather not need it to.

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