

Broadening in equities: now or never?

Understanding the implications of narrow market breadth

Xtrackers
by // DWS

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The dominance of market-cap-weighted index strategies, particularly in US equities, has reinforced investor confidence in passive investing. Yet indices such as the S&P 500, long regarded as neutral and diversified, now also carry concentrated exposures to a handful of names, sectors, and prevailing momentum. Nevertheless, investor allocations to these strategies remain strong as breadth seems increasingly out of reach. A look at financial market history, however, suggests that broadening is not a question of if, but when, and understanding the conditions that trigger it is key for positioning.

The Challenge of Beating the Benchmark

The role of market concentration

In today's equity market landscape, beating market-cap-weighted benchmarks has become increasingly challenging. The S&P 500 is a prime example of this, where 65% and 85% of active funds underperform over 1- and 3-years respectively according to the annual SPIVA study¹.

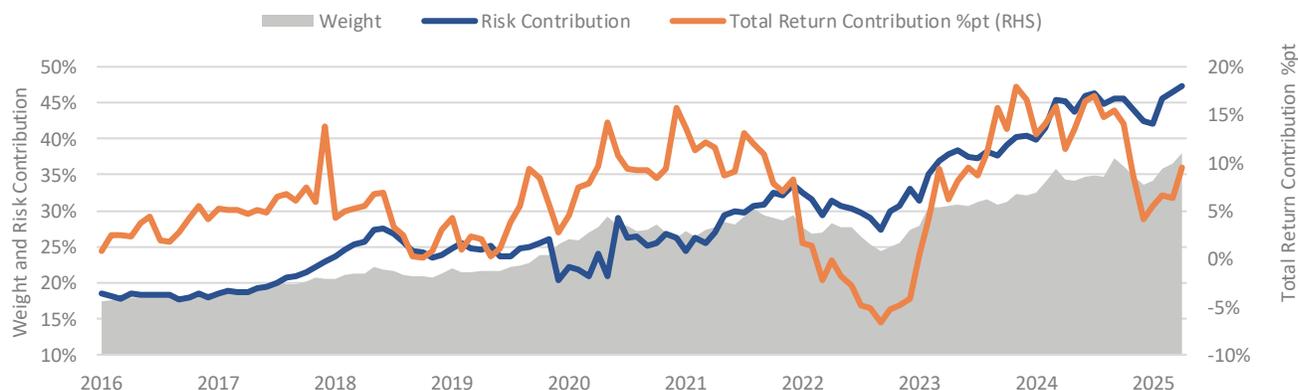
The most pronounced driver behind this is the well documented concentration trend. Over the past decade, the S&P 500 has increasingly evolved into a market with narrow leadership. As of November 2025, the top ten stocks account

for 38% of total index weight, more than double their share from a decade ago. And as they contributed 51% of the index's total performance over the past five years, performance attribution is remarkably straightforward: portfolios with greater exposure to these dominant names delivered stronger results. Broader diversified strategies, particularly those tilted toward smaller size or value, and those not picking these names faced limited opportunities to keep pace in this environment.

The role of skewness

For some investors, this episode may simply reinforce a long-standing truth: equity returns are inherently skewed. A small number of companies often drive a disproportionate share of market gains, and this cycle has been no exception. Over the past 25 years, the median return for S&P 500 constituents was just 59%, while the average was 452%, driven by a small "right tail" of exceptionally successful companies (Figure 2). Bessembinder's research over 90 years of U.S. market history even finds that fewer than 4% of stocks have generated nearly all net wealth creation. As a result, most stocks underperform the index, which compounds the success of a few exceptional winners.

Figure 1: S&P 500 top 10 weights, risk and return contributions

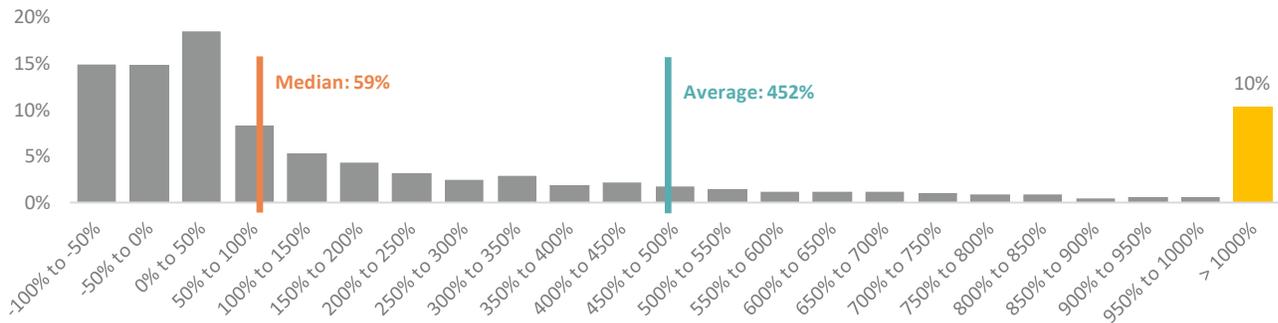


Source: DWS International GmbH, Bloomberg, Aladdin as of July 2025. Past performance, actual or simulated, is not a reliable indicator of future results. Monthly risk contribution, return contribution and weight data. 12-months rolling returns.

¹ Source: S&P SPIVA Year-End 2024.

² Bessembinder <https://wpcarey.asu.edu/departments-finance/faculty-research/do-stocks-outperform-treasury-bills-as-of-december-2019>

Figure 2: Distribution of S&P 500 constituent returns over a 25Y horizon



Source: DWS International GmbH, S&P Dow Jones Indices LLC, FactSet. Data from June 30, 2000 to June 30, 2025. Past performance is no guarantee of future results. Chart is provided for illustrative purposes.

This should however not be seen as proof of the superiority of market-cap-weighted indices. History shows that more diversified approaches, such as equal-weighted strategies, spread exposure across the full universe of stocks and improve the chances of capturing the few exceptional winners that drive long-term returns, at least in the long term.

This brings us to one of the defining feature of the current cycle: market breadth has not returned. Despite macro conditions that would typically support broader performance participation (rate cuts, liquidity, and resilient earnings), drivers remain scarce. Until breadth improves, strategies that rely more on the “average” stock will struggle to regain their historical advantage.

Time for Broadening?

The return of market breadth

The “Magnificent Seven” drove 63% of S&P 500 gains in 2024 and over 75% in 2023, significantly outpacing the broader market. This has led to one of the most persistent performance gaps between the S&P 500 and its equal-weighted counterpart. Under the surface of strong index performance, only 34% of stocks outperformed the S&P 500 Index over the last 12 months, versus a historical average of 56% (Figure 3). Such one-sided performance is rare, the last comparable episode was in 1998. Looking ahead, this gap can close in only two ways.

Figure 3: Share of the S&P 500 stocks outperforming the index



Source: DWS International GmbH, Bloomberg, Past performance does not predict future returns. As of October 2025.

Catch-up

The more benign scenario is a gradual broadening of leadership. Economic conditions, particularly a softer Fed stance, potential rate cuts, and continued labour market strength, could support cyclicals, value, and smaller constituents. Positive earnings momentum across sectors already reinforces this trend.

Catch-down

The alternative is less benign. Earnings disappointments among current market leaders could erode confidence in dominant franchises. Systemic shocks, such as recessionary pressures or geopolitical dislocations, may trigger broad risk-off sentiment, with growth equities bearing the brunt. While historically this scenario has often led to a narrowing of the performance gap, it is worth noting that today's market leaders offer more than momentum and growth. Strong quality characteristics make them appear comparatively resilient during periods of stress.

Equal-weighting and market breadth

The S&P 500 Equal Weight Index tends to move in line with market breadth. When breadth improves, equal-weighted strategies become increasingly attractive, offering a more balanced exposure across the market. From a factor and valuation perspective, equal-weighted approaches also stand out. They naturally tilt toward value and low-volatility stocks, with minimal compromise on quality - unlike small-cap indices such as the Russell 2000, which often carry higher volatility and weaker profitability.

While mega-cap dominance may not disappear overnight, leadership could gradually broaden. Early signs are emerging: small caps have outperformed the S&P 500 by 6.5% since July 2025. Supported by lower interest rates and a resilient U.S. economy, conditions are increasingly favourable for a more inclusive equity landscape.

This shift presents a timely opportunity to diversify across U.S. equity styles, sectors, and market capitalizations. By blending exposures, investors can build more resilient portfolios that are less dependent on a handful of names and manage both risk and return if market leadership begins to rotate.

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