

# Economic Situation and Strategy

17 May 2024

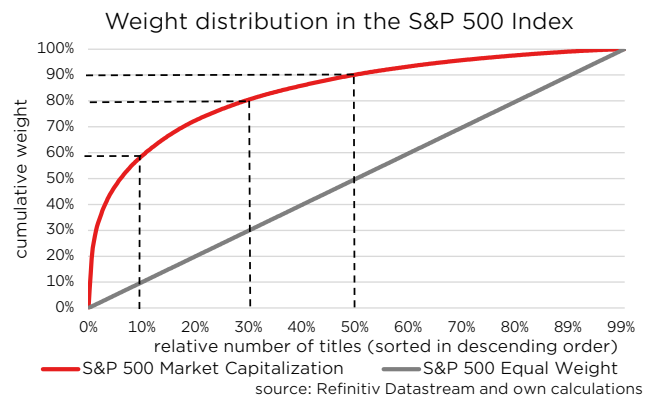
## Stock market indices: How big is the cluster risk?

Every day we come across products from Microsoft, Apple, Amazon, Meta (including Facebook, Instagram and WhatsApp), NVIDIA and Alphabet (Google). However, US companies also play a prominent role in many securities portfolios due to their high market capitalization. They are either directly included in the portfolio as individual stocks or are prominently represented in equity funds. For example, Microsoft's portfolio weighting in the MSCI World is around 4.4 percent - a considerable weighting for an index made up of 1,465 individual stocks. But Apple (around four percent) and Amazon (around 2.6 percent) are also heavyweights in the MSCI World. However, US companies not only play a dominant role in the MSCI World Index, but are also prominently represented in other popular indices such as the S&P 500 or Nasdaq 100 Index. What does this mean? It is not uncommon for investors to hold an S&P 500 and/or Nasdaq 100 ETF in their portfolio alongside the MSCI World ETF, so that the cluster risks at individual stock, country and sector level increases significantly. In this issue of Economic Situation and Strategy, you can find out how high the cluster risk is for the three popular stock market indices and how you can take countermeasures.

### Cluster risks at individual security level

Possible cluster risks in an index can be recognized, for example, by the sum of the ten largest portfolio weights. In the MSCI World Index, the ten largest positions account for around 22 percent. In the S&P 500 and Nasdaq 100 indices, the ten largest positions account for 32 percent and 47 percent respectively. In other words, the majority of the performance and fluctuations in value of the

three popular stock market indices are determined by a small number of stocks.



The figure above shows just how extreme the concentration is. The 50 largest companies in the S&P 500 Index (the ten percent largest companies) make up almost 60 percent of the overall index. This is due to the fact that the weighting in the S&P 500 - as in most stock market indices - is based on market capitalization, i.e. companies with a higher market capitalization are given a relatively higher weighting in the index. In the equally weighted S&P 500 Index, the sum of the 50 largest companies logically amounts to ten percent - a difference of almost 50 percentage points compared to the weighting based on market capitalization! The weightings of the 150 largest companies (30 percent of all stocks) even add up to 80 percent and half of all positions account for around 90 percent of the overall index. A qualitatively analogous picture emerges for the MSCI World and Nasdaq 100 Index.

### Country and sector concentration

However, alarm bells are ringing not only at individual stock level from a risk perspective, but also when looking at the country and sector distribution. For example, the

# Economic Situation and Strategy

weighting of US equities in the MSCI World Index, which covers the stock markets of 23 industrialized countries, is around 70 percent. With a country share of around six percent, Japan is the second-largest country in the MSCI World, well behind the USA. Furthermore, an analysis of the sector distribution in the MSCI World and the S&P 500 Index underlines the high weighting of technology stocks: While almost one in four companies in the MSCI World Index comes from the technology sector, this figure is almost one in three in the S&P 500 Index. If, in addition to the MSCI World and the S&P 500 Index, you also hold thematic funds with a focus on artificial intelligence, robotics or cyber security, the cluster risk increases further at individual stock, country and sector level.

Table 1: Country and sector distribution of popular stock market indices

Country	MSCI World	S&P 500	Nasdaq 100	Sector	MSCI World	S&P 500	Nasdaq 100
USA	70%	100%	100%	Technology	23%	29%	59%
Japan	6%	0%	0%	Finance	15%	13%	0%
UK	4%	0%	0%	Health Care	12%	12%	6%
France	3%	0%	0%	Non-Consumer Staples	11%	11%	18%
Switzerland	3%	0%	0%	Industry	11%	8%	5%
Canada	3%	0%	0%	Telecommunications	7%	9%	4%
Germany	2%	0%	0%	Consumer Staples	6%	6%	4%
Australia	2%	0%	0%	Energy	4%	4%	1%
Netherlands	2%	0%	0%	Basic Materials	3%	2%	2%
Others	5%	0%	0%	Others	7%	6%	2%

source: Refinitiv Datastream

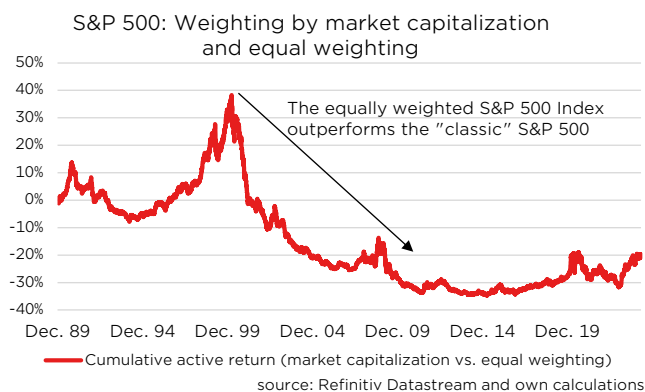
## What should investors do?

We recommend three steps to identify possible cluster risks and take countermeasures if necessary:

Firstly, a country and sector distribution should be drawn up with the help of a portfolio analysis. To do this, funds must also be broken down into their individual positions so that possible duplications of individual stocks become visible. The results are sometimes surprising!

The next step is to compare the status quo of the portfolio with the target allocation. Is a possible cluster risk at individual stock, country or sector level really intentional and consistent with your own target picture? Important: A cluster risk, for example in the form of a high weighting in the USA or the technology sector, does not necessarily have to be wrong if you believe that the US equity market and the technology sector will generate above-average returns going forward. In our opinion, too extreme concentration on individual countries and sectors is not conducive to asset accumulation from a diversification point of view. After all, putting all your capital on one horse entails considerable risks!

If certain cluster risks are not wanted, countermeasures must be taken. What options are available? Firstly, individual country or sector indices can be added to the portfolio in order to reduce excessive concentrations. The high US share in the MSCI World Index is often a thorn in the side of many investors. In this case, globally oriented equity market indices that completely exclude the USA are already available. However, cluster risks can also be reduced by equally weighted indices. Each position is given the same weighting in the index, so that larger (smaller) companies are relatively underweighted (overweighted). A look at the past shows, for example, that the equally weighted S&P 500 Index performed relatively better between 2000 and 2011 than its counterpart with a weighting based on market capitalization. Most recently, however, it was the large US companies in particular that achieved an above-average performance, meaning that the equally weighted S&P 500 Index performed relatively below average.



## What is our conclusion?

Investors should be aware of the potential cluster risks in their portfolio. In particular, if you have allocated the MSCI World, the S&P 500, the NASDAQ 100 and/or thematic funds with a focus on technology stocks, there is a high risk that the portfolio's performance and fluctuations will be attributable to just a few stocks. At the same time, such a portfolio is likely to have a high concentration on the US equity market and the technology sector. Such a concentration is not necessarily "wrong" per se, but in the worst case it deviates significantly from your own target allocation. It is therefore essential to regularly review your own portfolio.

Simon Landt

## Market data

	As of	Change versus				
	17.05.2024 08:19	10.05.2024 -1 week	16.04.2024 -1 month	16.02.2024 -3 months	16.05.2023 -1 year	29.12.2023 YTD
<b>Stock markets</b>						
Dow Jones	39869	0,9%	5,5%	3,2%	20,8%	5,8%
S&P 500	5322	1,9%	5,4%	6,3%	29,5%	11,6%
Nasdaq	16698	2,2%	5,3%	5,8%	35,3%	11,2%
DAX	18739	-0,2%	5,5%	9,5%	17,9%	11,9%
MDAX	27508	2,9%	5,9%	5,2%	0,7%	1,4%
TecDAX	3444	1,2%	4,6%	1,0%	6,4%	3,2%
EuroStoxx 50	5072	-0,2%	3,2%	6,4%	17,5%	12,2%
Stoxx 50	4521	-0,1%	4,5%	6,0%	12,0%	10,5%
SMI (Swiss Market Index)	11947	1,6%	6,7%	5,6%	3,7%	7,3%
Nikkei 225	38787	1,5%	0,8%	0,8%	30,0%	15,9%
Brasilien BOVESPA	128284	0,5%	3,1%	-0,3%	18,6%	-4,4%
Russland RTS	1208	2,5%	4,5%	9,1%	17,2%	11,5%
Indien BSE 30	73900	1,7%	1,3%	2,0%	19,3%	2,3%
China CSI 300	3648	-0,5%	3,9%	8,4%	-8,3%	6,3%
MSCI Welt	3469	1,4%	5,2%	5,6%	23,8%	9,5%
MSCI Emerging Markets	1099	2,5%	8,8%	8,1%	12,2%	7,3%
<b>Bond markets</b>						
Bund-Future	131,58	83	37	-138	-372	-564
Bobl-Future	116,97	24	-25	42	-106	-231
Schatz-Future	105,25	6	-22	-8	-48	-130
3 Monats Euribor	3,82	-9	-9	-9	43	-7
3M Euribor Future, Dec 2024	3,25	-4	6	34	50	95
3 Monats \$ Libor	5,59	1	0	2	25	0
Fed Funds Future, Dec 2024	4,96	-3	-1	43	193	113
10 year US Treasuries	4,38	-13	-29	7	83	51
10 year Bunds	2,47	-3	0	9	13	47
10 year JGB	0,95	4	11	22	55	33
10 year Swiss Government	0,75	-8	0	-17	-24	5
US Treas 10Y Performance	585,27	1,0%	2,6%	0,3%	-3,1%	-2,6%
Bund 10Y Performance	551,91	0,6%	0,6%	0,2%	1,8%	-2,4%
REX Performance Index	442,54	0,3%	0,3%	0,1%	0,7%	-1,2%
IBOXX AA, €	3,37	-6	-7	-5	-19	30
IBOXX BBB, €	3,94	-7	-9	-10	-60	18
ML US High Yield	7,98	-13	-43	-6	-73	19
<b>Commodities</b>						
MGBase Metal Index	456,89	2,7%	7,5%	21,0%	19,9%	16,9%
Crude oil Brent	83,74	0,1%	-7,2%	0,6%	11,7%	7,8%
Gold	2383,75	0,9%	-0,1%	18,6%	19,2%	15,4%
Silver	29,71	5,1%	5,2%	27,4%	25,3%	22,5%
Aluminium	2534,34	2,0%	-0,6%	15,3%	12,4%	8,1%
Copper	10343,18	4,5%	10,6%	23,0%	28,1%	22,2%
Iron ore	116,85	-0,1%	10,2%	-9,6%	9,4%	-14,3%
Freight rates Baltic Dry Index	1817	-14,7%	2,1%	12,9%	23,1%	-13,2%
<b>Currencies</b>						
EUR/ USD	1,0866	0,8%	2,2%	0,9%	-0,1%	-1,7%
EUR/ GBP	0,8577	-0,3%	0,4%	0,2%	-1,4%	-1,0%
EUR/ JPY	169,18	0,8%	2,8%	4,5%	14,4%	8,2%
EUR/ CHF	0,9851	0,7%	1,4%	3,8%	1,2%	6,4%
USD/ CNY	7,2218	-0,1%	-0,3%	0,2%	3,5%	1,7%
USD/ JPY	155,39	-0,2%	0,4%	3,4%	13,9%	10,2%
USD/ GBP	0,79	-1,2%	-1,7%	-0,6%	-1,3%	0,7%

Source: Refinitiv Datastream

Carsten Klude  
+49 40 3282-2572  
cklude@mmwarburg.com

Dr. Rebekka Haller  
+49 40 3282-2452  
rhaller@mmwarburg.com

Martin Hasse  
+49 40 3282-2411  
mhasse@mmwarburg.com

Dr. Christian Jasperneite  
+49 40 3282-2439  
cjasperneite@mmwarburg.com

Simon Landt  
+49 40 3282-2401  
mlandt@mmwarburg.com

This article does not constitute an offer or an invitation to submit an offer but is solely intended to provide guidance and present possible business activities. This information does not purport to be complete and is therefore not binding. The information provided should not be considered a recommendation to purchase financial instruments individually but serves only as a proposal for a possible asset allocation. The opinions expressed herein are subject to change without notice. Where statements were made with respect to prices, interest rates or other indications, these solely refer to the time when the information was prepared and do not imply any forecasts about future development, particularly regarding future gains or losses. In addition, this information does not constitute advice or a recommendation. Before completing any deal described in this information, a product-specific consultation tailored to the customer's individual needs is required. This information is confidential and exclusively intended for the addressee described herein. Any use by parties other than the addressee is not permissible without our approval. This particularly applies to reproductions, translations, microfilms, saving and processing in electronic media as well as publishing the entire contents or parts thereof.

This article is freely available on our website.