The Implications of a **Concentrated Market**

The concentration within the top ten stocks in the S&P 500 is the highest in decades, and the market may be poised for a change in leadership.

In Summary

- While mega-cap stocks appear extended, there are opportunities in reasonably valued segments like large cap value, small cap equities, core fixed income, and diversifying strategies, offering potential for returns amidst market volatility.
- The dominance of the Magnificent Seven stocks has driven market concentration to historic highs, and we recommend diversification given the potential implications for future returns.
- Skilled active managers are poised for a comeback, leveraging differentiated portfolios to outperform as market leadership shifts, presenting opportunities for alpha generation.

Historically Concentrated and Hinting at Change

The Magnificent Seven[1] stocks gained an astounding 71% in 2023, significantly outpacing the S&P 500 which was up 26% for the year. These companies, already large weightings in the benchmark, became even larger following the outsized returns and the broader inflection point of artificial intelligence seen at the end of 2022. With market concentration at historic levels, investors should be aware of the implications of a top-heavy index for future returns. As the majority of investors are increasingly growing exposure to these themes and related companies today, OAM Research emphasizes the benefits of diversification and active management via allocations to relatively more attractively priced equity segments and less correlated strategies.

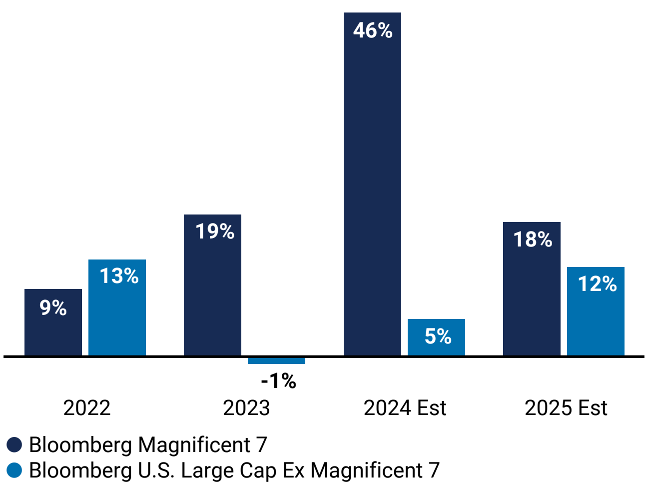
The weight of the top 10 names in the index has been growing rapidly since 2017, driven in large part by the strength of the Magnificent Seven companies. A period of ultra-low interest rates following the Great Financial Crisis created a big tailwind for interest rate sensitive growth businesses, particularly in technology and tech-oriented areas of the market. The narrow breadth was further catalyzed by the Covid-19 pandemic, as the Fed slashed interest rates to zero and the government handed out sizable stimulus checks. Retail investors, with higher levels of excess cash during lockdowns, poured capital into the equity markets. The beneficiaries that saw the largest inflows were growth-oriented funds, both passive and actively managed, as investors chased the strong performance of the pandemic winners.

[1] Magnificent Seven includes: Facebook/Meta, Amazon, Microsoft, Alphabet, Apple, Tesla, and Nvidia.

More recently, following Fed-induced growth headwinds in 2022, the Magnificent Seven resumed their leadership. The revelation of ChatGPT at the end of 2022 sparked AI-driven euphoria in the market, and capital flowed to the early leaders in the artificial intelligence race. With favorable year-over-year earnings comparisons to a challenging year like 2022, the Magnificent Seven stocks experienced incredible earnings growth in 2023 and drove the majority (58%) of the S&P 500 returns for the year. Conversely, the remaining 493 stocks in aggregate saw their earnings decline for the year compared to 2022.

Magnificent Seven Earnings Growth

EPS YoY Growth Rate



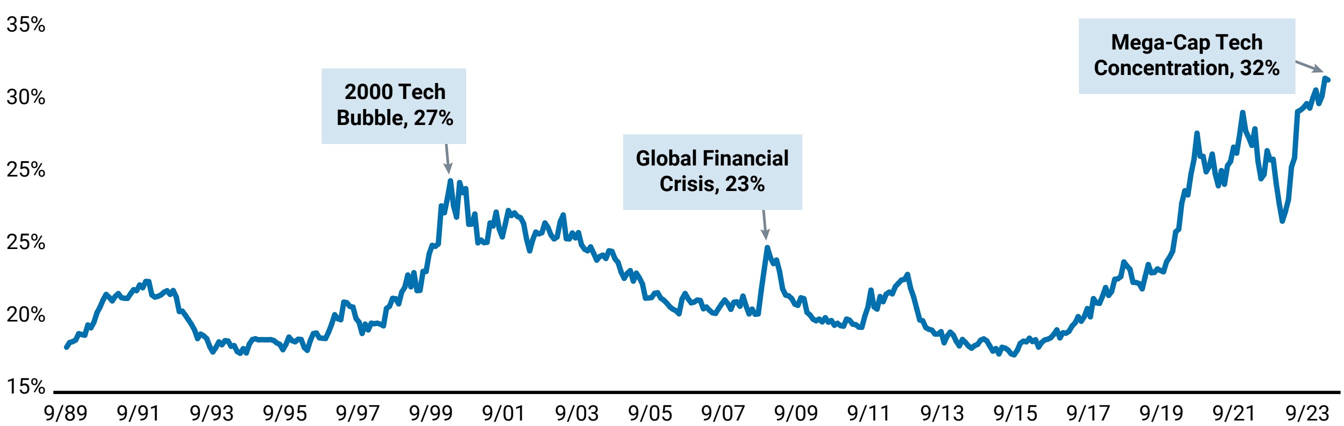
Source: Bloomberg. Update April 8, 2024.

By year-end, these seven stocks accounted for 28% of the S&P 500's composition, and the weight in the top 10 names grew to more than 30% of the index. This is the least diversified the index has been dating back to 1980.

While investors chasing the performance of market leaders has been a predictable and frequent occurrence, the historical performance of these names in subsequent periods has generally disappointed. As these stocks rally, investors have a habit of extrapolating that performance into the future to justify new investments. Unfortunately, these stocks have the potential to experience subsequent mean reversion. In the most extreme examples, the Nifty 50 stocks in 1973 and the Tech Bubble in 2000, significant declines in the top holdings ignited a broader market drawdown. Many of the top companies at the peak of the Tech bubble took many years to recoup losses. With that said, if a market reversion or drawdown can be avoided in 2024, another plausible scenario is a broadening out of leadership within other segments of the index. If economic growth remains resilient and the consumer continues to spend, the latest market rally may continue to broaden out to other sectors that present better entry points for investors today.

S&P 500 Concentration is at Highest Level in 30+ Years

Weight of Top 10 S&P 500 Holdings Over Time (Sept 89 - Mar 24)



Source: Morningstar Direct.

Investors should be prudent when considering their allocations to the top positions in the index. Although valuations for these companies today have not reached prior bubble levels and fundamentals remain relatively healthier than in those periods, these stocks appear to be priced for perfection. Recent earnings strength has justified rallies in some of these stocks, but this growth may be challenging to sustain going forward. Conversely, while the top ten stocks are expensive, the remaining 490 stocks in the S&P 500 are trading at much more modest premiums relative to history. Within the broader U.S. market, value stocks and smaller cap companies are only trading moderately above their long-term averages.

With more reasonable valuations outside of the mega-cap tech stocks, a broadening out of market leadership seems likely over the intermediate-term. Indeed, while the Magnificent Seven continued to drive returns, the rest of the market has rallied since the October lows. Although these seven still outperformed in aggregate in the first quarter of 2024, there was wide performance dispersion within this basket. The top performer continued to rally more than 82% in the quarter, two of the seven names were negative, and one declined almost -30% and fell out of the top 10 holdings by the end of Q1. Perhaps the market is becoming more discerning with its winners and losers, in which case a diversified portfolio should benefit.

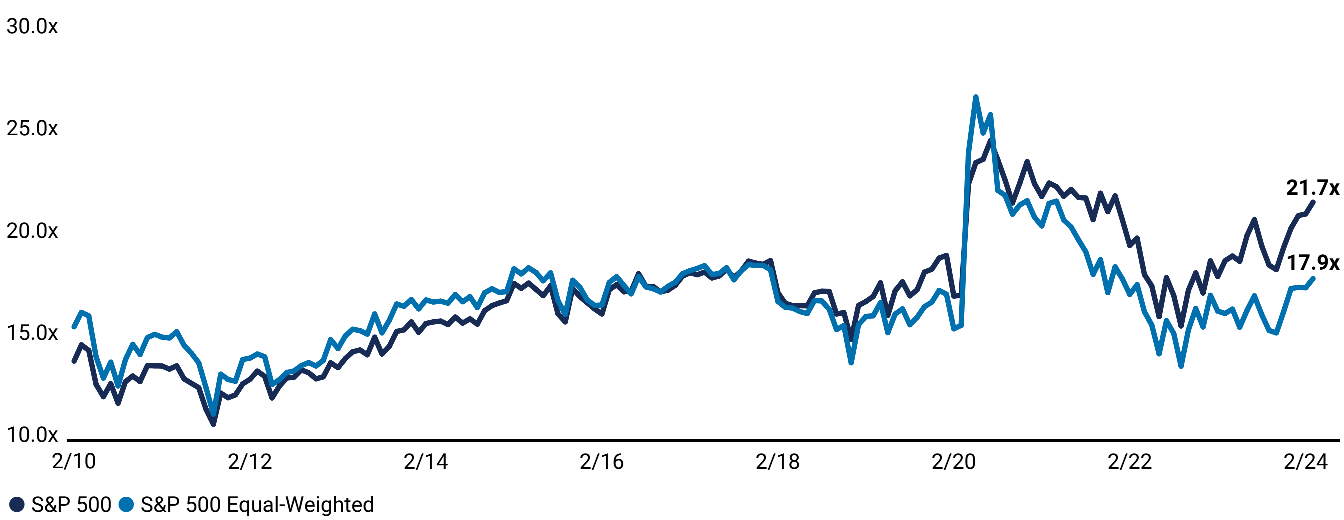
Active Management Primed for a Comeback

Active managers are also poised to benefit from healthier market breadth. U.S. large cap equity managers, particularly those in the large cap growth universe, have had a difficult time beating their benchmarks in recent years. Active managers typically look to identify mispriced opportunities, variant views and overlooked stories, which often times leads to limiting exposure to crowded names and maintaining a level of appropriate diversification in their mandates. In doing so, outperforming or generating significant alpha in a concentrated market where index performance is driven by a small subset of stocks has been nearly impossible.

OAM Research strongly believes that skilled active managers who run differentiated portfolios with a consistent, repeatable process have the propensity to outperform over time. The index concentration will

Mega-Cap Stocks Trade at a Premium

12 Month Forward PE



Source: Bloomberg as of 3/29/2024
A Forward P/E ratio is the current price of each index, divided by the expected earnings of the index over the next 12 months.

not persist in perpetuity, and we expect the recent trends in active manager underperformance to reverse course as market leadership broadens out. Fortunately, there is evidence that the opportunity for active management improves as market breadth widens. Although the large cap space has remained challenging, active alpha looks much more encouraging when evaluating managers that invest in more diversified and inefficient market segments. U.S. small cap managers that typically benchmark to the Russell 2000, a more diversified index, have historically been more successful at identifying mispricings and beating their benchmark over time. Similarly, the majority of active fixed income managers have historically been able to outperform over the trailing five years given the issuer, credit rating, and sector diversification within their benchmarks.[2]

Whether the market rally broadens out across companies and sectors, or if the largest constituents suffer a correction, the environment for fundamental investment management should experience a notable improvement.

Untapped Areas of Opportunity

Although mega-cap stocks within the U.S. market appear to be extended, OAM Research sees opportunities in other areas of the market that in our view are more reasonably valued. Large cap value and small cap equities are trading at valuations only slightly above their long-term averages. A tilt towards quality companies within these segments should provide downside protection if inflation becomes persistent and leads to a higher for longer interest rate regime, or if the economy turns and we experience a slowdown. On a global basis, non-U.S. developed and emerging market equities continue to trade at steep discounts relative to U.S. stocks. Although many of these economies experienced turbulence in the back half of 2023, there are signs that growth may be starting to inflect higher in some countries and could be an opportunistic area to deploy capital for investors with a higher tolerance for risk.

Current P/E as % of 15Yr Average P/E

Forward P/Es, Russell Indexes

	Value	Blend	Growth
Large	**112%**	**125%**	**139%**
Mid	**103%**	**106%**	**128%**
Small	**107%**	**109%**	**94%**

Source: Bloomberg, as of March 31, 2024.

A Forward P/E ratio is the current price of each index, divided by the expected earnings of the index over the next 12 months. The percentage shown for each style box (represented by the Russell style indices) is the current Forward P/E (as of 3/31/24) divided by the index's 15-year average Forward P/E.

Outside of equities, yields continue to look very attractive in the core fixed income space. Given the elevated yields, further downside from another move higher in interest rates appears limited, while the capital appreciation potential stemming from interest rate cuts is substantial. Although corporate credit spreads are tight and yields are off the highs from the fall, investment-grade corporate bond yields are near the highest they've been since the Financial Crisis. Credit spreads look much more attractive within the securitized products market. Among diversifying strategies, real assets can serve as an attractive inflation hedge if those pressures remain in place longer than the market anticipates. Uncorrelated strategies such as merger arbitrage also continue to be effective portfolio diversifiers and are designed to provide downside protection if a spike in interest rates creates losses for both equities and bonds.

[2]Manager data sourced from PGIM, as of 3/31/24. Although the statements of fact and data in this report have been obtained from, and are based upon, sources that the Firm believes to be reliable, we do not guarantee their accuracy, and any such information may be incomplete or condensed.

Asset Class Detail

This chart outlines OAM Research's macroeconomic and asset class views.

Negative · Slightly Negative · Neutral · Slightly Positive · Positive

Global Equity

U.S. Large Cap (Neutral)
Large cap fundamentals appear healthy, though earnings growth outside of the mega-cap stocks has been more subdued. The market seems to be underappreciating tail risks such as sustained inflation or a slowdown in growth. Growth equity valuations remain very stretched, but value stocks appear more reasonably priced. Higher-quality companies with pricing power should be more resilient, and investors may benefit from allocating to strategies focused on quality and downside protection.

U.S. Small-Mid Cap (Neutral)
Small and mid-cap stocks are trading at discounts relative to large caps, and valuations appear reasonable on a historical basis. Smaller companies are facing the same headwinds as their larger counterparts, primarily due to the impact of higher interest rates, higher cost of labor and lending pressures but are navigating the environment with less diversified product lines. Smaller cap stocks tend to underperform as economic growth slows, so neutral positioning is warranted despite more attractive valuations.

International Developed (Slightly Negative)
Most major economies outside of the U.S. experienced weak growth in 2023, but central banks have made progress on inflation and are preparing to cut interest rates. International equities continue to trade at meaningful discounts compared to the U.S., but a sustained inflection in the growth data is needed to gain conviction in the recovery.

Emerging Markets (Neutral)
Valuations remain reasonable and look attractive relative to developed equities. China's economy continues to face headwinds, but other emerging economies have been resilient. Active managers can take advantage of bifurcated performance by allocating to countries with more promising growth prospects.

Global Equity - Alternatives

Long/Short Equity is considered part of the strategic asset allocation for equities based on each fund's underlying investments.

Long/Short Equity (Slightly Positive)
Long/short strategies should benefit from increased dispersion and market dislocation, leveraging active management of both long and short positions. However, if a broad downward revision of earnings across sectors were to occur, it would likely adversely impact strategies.

Global Fixed Income

U.S. Core Fixed Income (Slightly Positive)
Interest rates remain elevated as the market repriced overly rosy expectations for rate cuts at the start of 2024. Sticky inflation data may further delay Fed action, but today's yields offer attractive current income with significant capital appreciation potential when the Fed eventually moves. Investment-grade credit spreads are tight, but corporate balance sheets are generally healthy. Spreads for high-quality securitized products represent attractive entry points.

High Yield Credit (Neutral)
Spreads have continued to grind tighter year-to-date and look tight if U.S. growth stalls. Defaults have picked up since 2022 and could accelerate if the economy worsens. Absolute yields today remain attractive, but the yield pickup relative to investment-grade has been reduced given the spread tightening.

International Fixed Income (Neutral)
Yields in most developed markets remain less attractive than U.S. yields. Emerging market debt looks more attractive within the non-U.S. market, both from a yield perspective and as a portfolio diversifier, though the asset class may suffer if global growth slows meaningfully.

Diversifying Strategies

Real Assets (Slightly Positive)
Midstream energy infrastructure continues to benefit from elevated commodity prices, improved fundamentals and attractive yields. Other infrastructure segments with lower equity betas should provide stability if volatility picks up. REITs continue to feel pressure from interest rates and loan concerns, but valuations have improved and fundamentals in many segments remain sound.

Event Driven/Uncorrelated (Positive)
Event-driven strategies have rebounded from volatility in 2023 and continue to perform well as deals continue to see completion despite heightened regulatory scrutiny and deal flow has begun to recover. Managers with opportunistic credit exposure may additionally benefit from stressed and distressed situations that arise. Other strategies such as multi-manager continue to provide uncorrelated and steady returns with their ability to flexibly lean on multiple sub-strategies amid elevated volatility and higher rates.

Authors

Anusha Rodriguez, CFA, CAIA
Head of OAM Research and OAM Alternatives
Managing Director

Christopher Barsky, CFA
Head of OAM Consulting
Managing Director

Edita Raslova, CFA
OAM Consulting
Executive Director

Marlo Palumbo, CAIA
OAM Alternatives
Executive Director

Michael Deo, CFA
OAM Consulting
Executive Director

Sanjana Krishnakumar, CFA
OAM Alternatives
Senior Director

Kole Henry
OAM Market Strategy
Director

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Adopting a fee-based account program may not be suitable for all investors; anticipated annual commission costs should be compared to anticipated annual fees.

S&P Equal Weighted is the equal-weight version of the S&P 500. The index is comprised of the same stocks of the S&P 500, but each company is allocated a fixed percentage (.2%) of the total index.

MSCI AC World ex-USA Index captures large- and mid- cap representation across 22 of 23 developed-market countries (excluding the U.S.) and 24 emerging-market countries.

MSCI EAFE is an index in U.S. dollars based on the share price of companies listed on stock exchanges in 21 developed countries outside of North America. This Index is created by aggregating the 21 different country Indices, all of which are created separately. It is considered to be generally representative of overseas stock markets.

Russell 2000 Index measures the performance of the 2,000 smallest companies in the Russell 3000 index. Frank Russell Co. ranks the U.S. common stocks from largest to smallest market capitalization at each annual reconstitution period. The Russell 2000 Index represents a very small percentage of the total market capitalization of the Russell 3000 Index. It is considered to be generally representative of U.S. Equity Small and Mid Cap performance.

Russel 1000 Value Index measures the performance of the Russell 1000 companies with lower price-to-book ratios and lower forecasted growth values.

MSCI Emerging Markets Index is a market capitalization weighted Index in U.S. dollars representing 26 emerging markets in the world. The Index is created by aggregating the 26 different country Indices, all of which are created separately. It is considered to be generally representative of overseas stock markets.

Russel 1000 Growth Index measures the performance of the Russell 1000 companies with higher price-to-book ratios and higher forecasted growth values.

S&P 500 Sector/Information Technology TR Index consists of stocks chosen for their representation in the Info Tech industry. Companies considered are involved in technology software and technology hardware and equipment. It is a market value weighted Index (stock price times number of shares outstanding), with each stock's weight in the Index proportionate to its market value.

LTM PE Ratio is the last 12-month price-to-earnings ratio.

Indices are unmanaged, do not reflect the costs associated with buying and selling securities and are not available for direct investment.

Risk Factors

The success of an investment program may be affected by general economic and market conditions, such as interest rates, the availability of credit, inflation rates, economic uncertainty, changes in laws and national and international political circumstances. These factors may affect the level and volatility of securities prices and the liquidity of a portfolio's investments. Unexpected volatility or illiquidity could result in losses. Investing in securities is speculative and entails risk. There can be no assurance that the investment objectives will be achieved or that an investment strategy will be successful.

Special Risks of Foreign Securities

Investments in foreign securities are affected by risk factors generally not thought to be present in the United States. The factors include, but are not limited to, the following: less public information about issuers of foreign securities and less governmental regulation and supervision over the issuance and trading of securities. International investments may involve risk of capital loss from unfavorable fluctuation in currency values, from differences in generally accepted accounting principles or from economic or political instability in other nations.

Special Risks of Small- and Mid-Capitalization Companies
Investments in companies with smaller market capitalization are generally riskier than investments in larger, well established companies. Smaller companies often are more recently formed than larger companies and may have limited product lines, distribution channels and financial and managerial resources. These companies may not be well known to the investing public, may not have significant institutional ownership and may have cyclical, static or moderate growth prospects. There is often less publicly available information about these companies than there is for larger, more established issuers, making it more difficult for the Investment Manager to analyze that value of the company. The equity securities of small- and mid-capitalization companies are often traded over-the-counter or on regional exchanges and may not be traded in the volume typical for securities that are traded on a national securities exchange. Consequently, the investment manager may be required to sell these securities over a longer period of time (and potentially at less favorable prices) than would be the case for securities of larger companies. In addition, the prices of the securities of small- and mid- capitalization companies may be more volatile than those of larger companies.

Special Risks of Fixed Income Securities
For fixed income securities, there is a risk that the price of these securities will go down as interest rates rise. Another risk of fixed income securities is credit risk, which is the risk that an issuer of a bond will not be able to make principal and interest payments on time. Liquidity risk is the risk that you might not be able to buy or sell investments quickly for a price that is close to the true underlying value of the asset. When a bond is said to be liquid, there's generally an active market of investors buying and selling that type of bond. Fixed income securities markets are subject to many factors, including economic conditions, government regulations, market sentiment, and local and international political events. Further, the market value of fixed-income securities will fluctuate depending on changes in interest rates, currency values and the creditworthiness of the issuer.

High Yield Fixed Income Risk
High yield fixed income securities are considered to be speculative and involve a substantial risk of default. Adverse changes in economic conditions or developments regarding the issuer are more likely to cause price volatility for issuers of high yield debt than would be the case for issuers of higher-grade debt securities. In addition, the market for high yield debt may be less attractive than that of higher-grade debt securities.

Special Risks of Event-Driven Strategies
Investing in event or disruption driven strategies carries the risk of the unforeseen nature of events, such as corporate transactions falling through or changes in the economic or political environment. A reduction in money market liquidity or pricing inefficiency, as well as other market factors, can potentially reduce the scope for these investment strategies. Such funds may be adversely affected by unforeseen events, including forced redemptions of securities or acquisition proposals, break-up of planned mergers, unexpected changes in relative value, short squeezes, inability to short stock or changes in tax treatment.

Special Risks of Long/Short Equity
Long/short equity strategies utilize leverage, and may do so through direct borrowing, short selling, options and other instruments (including, without limitation, derivatives) and arrangements with embedded leverage. While strategies, techniques and instruments that employ leverage increase the opportunity to achieve higher returns on the amounts invested, they also increase the risk of loss. Hedging and selling securities short entails losing an amount greater than proceeds received or possible default by the other party to the transaction.

Special Risks of Uncorrelated Strategies
Strategies such as multi-strategy, macro and CTA utilize leverage, and may do so through direct borrowing, short selling, options and other instruments (including, without limitation, derivatives) and arrangements with embedded leverage. Hedge funds, commodity pools and other alternative investments involve a high degree of risk and can be illiquid due to restrictions on transfer and lack of a secondary trading market. In addition, they may be subject to commodity risk, derivatives risk, foreign investment risk, foreign currency risk, and credit risk. Many hedge funds employ a single investment strategy. Thus, a hedge fund or even multi-strategy hedge funds may be subject to strategy risk, associated with the failure or deterioration of an entire sub-strategy. Strategy specific losses can result from excessive concentration by multiple hedge fund managers in the same investment or broad events that adversely affect particular strategies.

Special Risks of Alternative Investments
Alternative investments are not appropriate for all investors and only may be offered to certain qualified investors. Investors must be able to bear the economic risk of such an investment for an indefinite period and can afford to suffer the complete loss of investment. An Investor's ability to redeem from such investments is limited to specific time periods (e.g. monthly, quarterly, semi-annually, annually) with certain notice requirements. Investing in securities is speculative and involves substantial risk. There can be no assurance that any investment strategy will be successful. This information is provided for informational purposes only and should not be construed as an endorsement of or a solicitation to invest in any specific program. There is a substantial risk of loss when investing in alternative investments and, for each specific fund, the risk of underperforming the general markets or other funds.

Special Risks of Real Assets
Master limited partnerships are publicly listed securities that trade much like a stock, but they are taxed as partnerships. MLPs are typically concentrated investments in assets such as oil, timber, gold and real estate. The risks of MLPs include concentration risk, illiquidity, and exposure to potential volatility, tax reporting complexity, fiscal policy and market risk. MLPs are not suitable for all investors. Common risks associated with an investment in a REIT include, but are not limited to, real estate portfolio risk (including development, environmental, competition, occupancy and maintenance risk), general economic risk, market and liquidity risk, interest rate risk, sector diversification and geographic concentration risk, leverage risk, distribution risk, capital markets risk, growth risk, counterparty risk, conflicts of interest risk, key personnel risk, and structural and regulatory risk.

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Oppenheimer & Co. Inc.
85 Broad Street
New York, NY 10004
(212) 668-8000
(800) 221-5588

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