

The S&P 500 is supposed to be an index that tracks performance of the “500 leading companies” listed on U.S. exchanges. However, today it seemingly tracks performance of the 7 or 8 leading companies, maybe 10 if we are being generous. That is in part because of the extreme concentration that has become apparent in the index over the past few years. As a result, these top 10 companies are having a disproportionately, and unusually, large impact on the index. Most recently, on October 28th the S&P advanced by 0.23%, while 398 of the 500 stocks in the index declined. As Bespoke noted, that day was the S&P 500’s worst breadth day ever for an “up” market. The following day was not much better, as the S&P 500 closed flat while 378 stocks were lower. The market is truly being pulled higher by just a handful of stocks.

The top 10 names now account for nearly 40% of the index. Not a single time in the past 50 years has the index been as concentrated as it is now. This concentration is occurring for a few different reasons. First and foremost, it appears to be driven by hype around AI. 7 of those 10 have varying degrees of direct exposure to AI. Nvidia, Microsoft, Amazon, Broadcom, Meta, Alphabet, and Tesla all have considerable exposure to Artificial Intelligence.

The concentration also occurs because of what is essentially a feedback loop that results from passive investing flows, which has accelerated at an increasing rate. In the past 12 months (ending 9/30/2025), according to data from First Trust, passive vehicles have seen \$918 billion in inflows vs. \$177 billion in outflows for active strategies.

So, what actually happens when passive money moves into the index? Let’s say the S&P 500 receives a \$1 billion inflow. Today, the largest company, Nvidia would receive 8.32% of those dollars (\$83,200,000), while News Corp, the smallest weight in the S&P 500, would receive 0.0064% of those dollars (\$64,000). An \$83 million order has a much larger price impact than a \$64 thousand order. As a result, the price of Nvidia would go higher at a faster

rate than that of the market, which would make its weight in the index rise. News Corp, which would have been less affected by the market order, would fall in weight to the index as its impact was the smallest upon the constituents. So, Nvidia would no longer be 8.32% of the index, it would instead be 8.33% or 8.34% (or something along those lines) and News Corp would fall to 0.0062% (or something similar). Therefore, when the next \$1 billion order was placed, \$83.3m would now go into Nvidia and just \$62k into News Corp. This creates a price-positive feedback loop whereby the more dollars that flow into the index, the more concentrated it will become. Again \$918 billion has flowed into passive products alone over the past twelve months, which means this feedback loop has been working in overdrive. The flow into passive investing has arguably made this feedback loop inevitable over the past few years.

However, here is the rub (and the risk). That exact same feedback loop works in reverse. A \$1 billion outflow would have an outsized impact on Nvidia relative to News Corp. So, Nvidia would become a smaller piece of the index, while News Corp would become a marginally larger weight in the index. If outflows accelerated, it would become a self-fulfilling loop to the downside.

So, what could cause the feedback loop to reverse and when could it happen? On those points, unfortunately, I am no clairvoyant. I wish I was, as I’d be sitting in the sand somewhere with a drink in my hand. However, what I do know is this... the market is expensive, and I don’t really care which metric we use to measure its valuation. Whether we use a P/S ratio, P/E ratio, P/B ratio, or a dividend yield, the market is historically rich. **That’s a concern because valuation ultimately matters in the medium-to-long term.**

There are also some signs of exuberance within the market that are rooted in “hopes and dreams” rather than fundamentals. Among the best performing baskets of stocks this year have been things like “Meme Stocks”, “Unprofitable Tech” companies, and Quantum Computing. While these stocks have a compelling story, prices are seemingly not supported by any sort of fundamentals. There is a lithium-battery company, that at the time of writing, sports a market cap of \$10 billion and is up 280% this year. This company has never sold a product. They have \$0 dollars in revenue in nearly five years as a publicly traded company – yet “the market” has deemed it to be more valuable than Gap or American Airlines. There is another company that is in the business of making flying taxis with a market cap of \$15 billion which has risen more than 100% this year and has less than \$100,000 in sales over the past 12 months. To this writer’s eye, both of those examples speak to exuberance, not rationality. I believe those to be worrisome signs.

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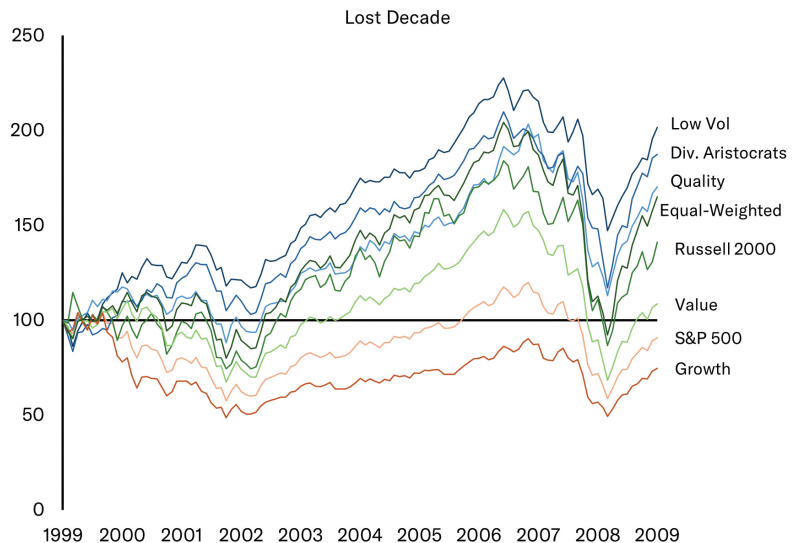
In that same vein, OpenAI (creator of ChatGPT) finds itself at the intersection of the aforementioned exuberance and AI hype train. At the end of October, it was reported that OpenAI, which is currently a private company, is beginning to lay the groundwork for a 2026 IPO which could value the company up to \$1 trillion. Now, this truly is a company that is changing the world. They have changed the way many people search for things on the internet, and they have changed the ways companies spend (but more on that in a bit). Despite this game changing technology, 98% of ChatGPT customers do not even pay for it. Of the 2% of paying customers, ChatGPT reportedly loses money anyway. According to CEO Sam Altman in a post on X earlier this year, OpenAI loses money on OpenAI Pro subscriptions – which cost \$200 per month. In other words, people are paying \$200/month for a super-charged Google subscription and OpenAI still cannot turn a profit.

The market is also historically concentrated in one single trade – AI (as already mentioned). If the trillions of dollars (that's correct, trillions! Morgan Stanley currently predicts that there will be \$2.9 trillion in AI infrastructure spending through 2028 alone, while Nvidia expects data center capex to reach \$3 to \$4 trillion by 2030) that are being spent on AI does not bear significant income producing fruit, then these names become hazardous. That's a real risk. An MIT study that gained attention back in August discussed how only 5% of businesses were generating "value" from implementing AI while the other 95% were seeing either zero return or no measurable impact.

One of the first things I was taught in this industry was that "this time is never different". One of the common pushbacks though to explain why this time is different is the argument that the Tech Bubble inflated due to companies that weren't profitable like Pets.com (an infamous example of the dot-com era crash). I believe there are clearly examples today that are similar to that of Pets.com, like some of the aforementioned companies, though it is true that Nvidia, Amazon, Meta, etc. are all highly profitable companies today. However, in 1999 AOL, Cisco, and Intel were all profitable companies too but that did not stop them from falling 80+%. **The price one pays for a security matters.**

At the end of the day, we believe that there is a bubble inflating – like dot-com stocks in the late 90s and like Meme stocks in 2021. Depending on the Tandem strategy you employ, there is some AI related exposure in the form of stocks like Microsoft or Amphenol. However, the S&P 500 has much more exposure through its Magnificent 7 names, plus a few other highflyers like Broadcom and Palantir. Those stocks add up to nearly 40% of the S&P 500 today. We do not believe that we are particularly exposed to that bubble, so it is not our expectation to perform similarly to this bubble – for better or worse.

Despite all of this, I still believe Artificial Intelligence seems likely to be game changing technology. Similarly, the internet ended up being game changing technology in the late 90s. However, the price you pay for a stock, or an index, matters. The last time investors got caught in a similar bubble was during the Tech



ANNUALIZED RETURNS

S&P 500 Low Volatility	7.3%
S&P 500 Dividend Aristocrats	6.5%
S&P 500 Quality	5.5%
S&P 500 Equal-Weighted	5.1%
Russell 2000	3.5%
S&P 500 Value	0.8%
S&P 500	-0.9%
S&P 500 Growth	-2.9%

Source: FactSet

Bubble. The thesis was correct – the internet changed the world. However, the price mattered. The S&P 500 was flat for nearly 10 years. That's a long time. **Valuation and price ended up mattering more than the hype.**

I believe we are in a similar place today. I don't know when the music stops playing. I don't know what causes this bubble to burst. However, I do not think this ends well for those that are passively invested or chasing the hype. On top of that, hoping to time the market is foolhardy. I believe that it cannot be done repetitively with any measure of success short of great luck. However, owning a portfolio of businesses that can consistently grow earnings, sales, cash flow, and dividends through any sort of economic environment – that's a horse I'd continue to back, even if the sun is not shining on those companies today. Companies that can do that will be okay in my belief over the medium-to-long term. For investors invested passively in the index during that Lost Decade, it was painful. However, for those that invested in something different and outside of the traditional style box – it wasn't too bad. Quality, Dividend Growth, and Low Volatility all ended up doing quite well in one of the worst decades in 50 years.

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