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QUARTERLY INVESTMENT COMMENTARY

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Market efficiency tells us that prices, at any given time, reflect the collective judgment of millions of investors. It is a comforting idea, but it also means that when the largest companies dominate market returns, those valuations embody a great deal of shared confidence. The current concentration of the S&P 500 may make index investors uneasy as the success of their financial plan increasingly hinges on the performance of just a few holdings.

However, this concentration also highlights one of the great strengths of index investing: participation in the process of creative destruction—as smaller firms innovate, scale, and prove their worth, they rise in weight, while less competitive companies fade. A typical index, by design, adapts to the shifting landscape of winners and losers over time.

The New Face of Innovation

Creative destruction is often treated as a countdown clock. New ideas appear, incumbents falter, and leadership turns over. That story is true often enough to be instructive. It is not the whole story of this cycle. The largest U.S. companies have not stood in the way of creative destruction. Instead, they have organized it, monetized it, and scaled it. The investment

question is not whether leadership will change over decades. It will. The question is whether the most visible companies today have built operating models and reinvestment engines that can keep converting innovation into cash flows for long enough to justify their prominence in portfolios.

History offers useful humility. U.S. Steel defined an era, then yielded to autos and chemicals. AT&T was a national utility, then faced deregulation and software. IBM's hardware dominance gave way to the PC and the cloud. The lesson is that dominance fades, but it usually fades at the pace of industrial change rather than overnight. That matters for investors who must balance near-term risk with the compounding that occurs when strong businesses keep reinvesting.

Why Today's Leaders Look Different

The concentration debate is the starting point for many readers, and it deserves clear framing. The largest cohort of U.S. companies now represents an unusually large share of the S&P 500. Their economic footprint is also immense. While representing a smaller share of earnings than their weight in the index implies, they're responsible for a disproportionate share of the earnings growth of the index. It is both the realized and projected growth of their income statements that drive them higher.



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This is where the comparison to the late 1990s can clarify rather than inflame. The dot-com era reflected a boom in expectations that outran cash generation. Many leaders of that moment were single line businesses with limited pricing power and thin balance sheets. When the growth path disappointed, there was no cushion. Today's leaders generally report substantial free cash flow, high returns on invested capital, and balance sheets that allow them to fund multiple initiatives while still returning capital to shareholders. That does not make them invincible. It does mean the base case for endurance is stronger than it was in 1999.

The breadth of their business models is the other key difference. The strongest companies today are not one-trick stories. Their cloud infrastructure, mobile operating systems, global advertising networks, and artificial intelligence (AI) all contribute to diversified profit pools with long runways for growth. A single product can likely miss without breaking the franchise. These firms generate enough cash to fund multiple initiatives, refine products that need time to succeed, and sunset projects that do not. Many dot-com era leaders did not have this luxury.

So far, the big platforms have earned their staying power on three reinforcing advantages:

- Integrated ecosystems that keep customers, developers, and advertisers tied in and make it costly and inconvenient to leave.
- Enormous cash flows that give management the ability to fund new ventures while investing in their core businesses.
- Control of both distribution channels and data that allows them to see quickly what works, fix what does not, and bring innovations to market faster.

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What Risks Might They Face?

While these businesses are not invincible, the risks they face appear to be mostly external rather than self-inflicted.

- A genuine shift in technology could compress the moats of today's hardware and software leaders.
- Policy can reset the rules around data, bundling, or export controls and can do so in discrete steps.
- Expectations can simply run too far ahead of realized profit growth, particularly when market weight exceeds earnings share.

What This Means for Investors

What should a disciplined investor do with this picture? The first step is recognizing that there is no risk-free path. Investing too little in these market leaders risks missing the innovation that could drive asset prices higher. In a world where AI is threatening the status quo, it is likely better to be an owner of AI than a victim of it. Owning too much, however, exposes an investor to the risk that AI may be a less profitable business than promised.

Remember that Cisco and Netscape didn't "win the internet" era; the capital expenditures spent to build the internet were a pittance compared to the profits made from those companies who embraced it. Just as the profits of the internet ultimately went to its adopters over its enablers, AI has the power to transform otherwise staid businesses into innovators of their own.

The bottom line is that creative destruction has not been paused. Today's leaders have earned their place through scale, reinvestment, and the ability to disrupt others before being disrupted themselves. That does not make them permanent. It does mean they are more durable than past giants that relied on a single product cycle. For investors, the challenge is to respect that durability while managing the risks of concentration and valuation in a disciplined way.