

Extreme Concentration – Addendum Australia and Emerging Markets

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Our recent paper on Extreme Concentration focussed on the US (and so Developed Markets). This was the natural as the central issue of concentration was among the top 10 stocks in the US, among them, the “Magnificent 7”.¹

This paper has received a significant and very positive response in a number of ways:

- It brings to light and reinforces the stock, sector and growth style concentration in equity markets that many others have spoken about.
- It points out sharply why a market capitalisation-weighted (market cap) index fund or ETF getting exposure to the US or Developed Markets is not diversified in the way advertised.
- It shows that the RQI approach to Value investing does not suffer from this concentration in stocks or sectors.

At one point the paper mentions that the Australian and Emerging Markets (EM) do not show this recent upward trend in concentration. This has led many to seek the evidence for this. Thus, the present paper aims to provide evidence for this finding.

Rather than rehashing the material presented in the first paper, we look at these markets in terms of:

- The weight distribution over time – do the largest stocks increase their share?
- Does the RQI Core model top 10 weight differ from that of the relevant benchmark?
- How different are the 12-month forward yields for these largest (top 10) stocks?

We find the following four points:

- 1 The largest stocks do not grow in weight over time for either market. There is some variation but not the dramatic growth we have seen in the US.
- 2 The Australian market (ASX200) is always highly concentrated, with the top 10 stocks always taking up approximately 50% of the weight of the benchmark (sometimes more!). We do not see this in Emerging Markets, where the top 10 only take up between 20% and 25% of the benchmark weight (MSCI EM)².
- 3 The top 10 RQI EM Core³ weights are a smaller component of the portfolio (about 20%) than the top 10 benchmark weights (about 25%), starting in 2018. Prior to this, the inclusion of Chinese stocks was treated differently by both MSCI and RQI Core.
- 4 The 12-month forward earnings yield for RQI Core is higher than for the benchmarks, again demonstrating that the RQI strategy is Value tilted. The spread in Australia is smaller (currently at about 1.5%), but in EM the spread is much higher (currently at about 8%).

This large difference reflects the very different weights of the top 10 stocks in MSCI EM and RQI EM Core, but especially due to holdings of TSMC (11% in the benchmark but 3% in RQI Core), Ping An Insurance (0.5% in the benchmark but 3% in RQI Core) and RQI Core holdings in Chinese banks (China Construction Bank 2%, Bank of Communications 1.8%, Chinese Merchants Bank 1.8%), which are high yield (i.e., good value) and much smaller weights in the benchmark.

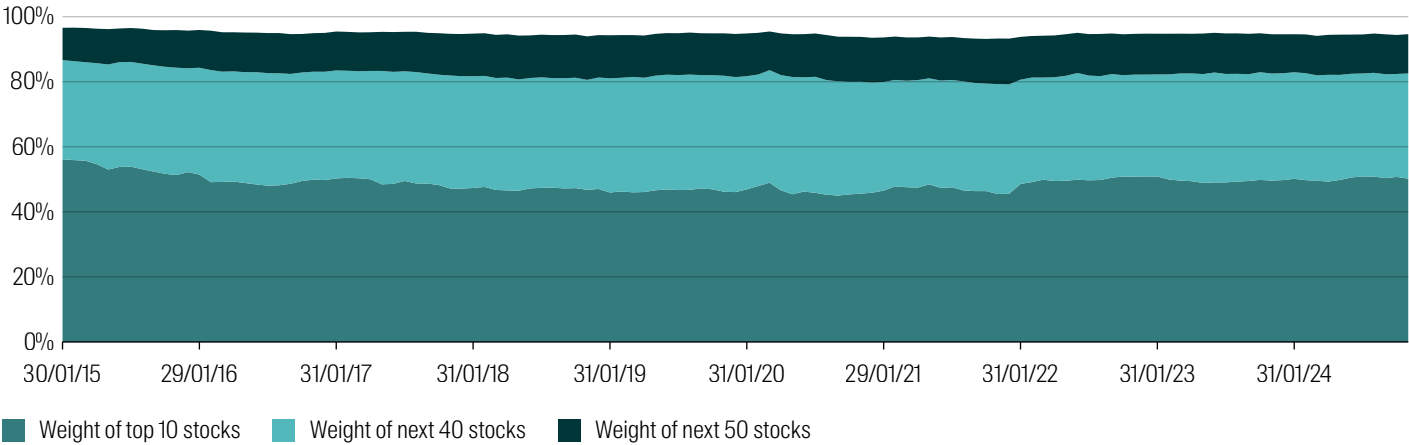
1 Apple, Meta, Alphabet (Classes A and C), Nvidia, Tesla, Microsoft and Amazon.

2 The number of stocks in the MSCI EM has moved a great deal since 2015 when it held around 850 stocks. In June 2018, China A shares were added, increasing the number of stocks to approximately 1150 stocks. These were included at very small investible weight. Continued growth and addition to the benchmark has lifted this to around 1250 stocks, although there remains a tail of very small stocks.

3 Recall that RQI's approach to Value investing deliberately avoids chasing this sort of concentration in market cap. We build a Core portfolio based on the reported dollar value of a small set of accounting variables. Price (and so market cap) is not used. This means that the starting point of our Value strategies is already much more diversified/less concentrated than the usual cap weighted benchmark.

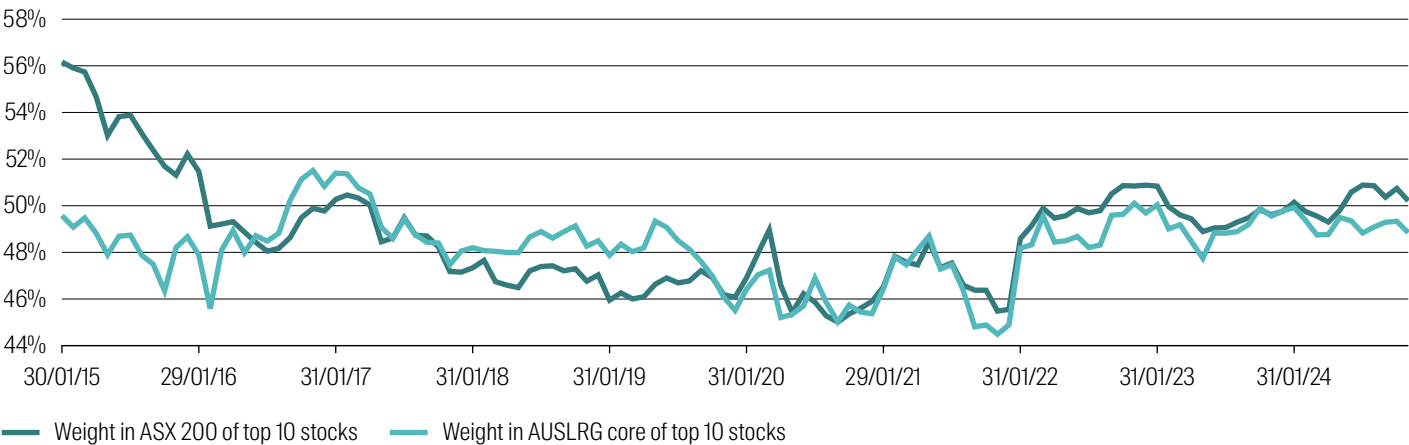
Charts 1 and 2 below show the details for the conclusions outlined above.

Chart 1: Panel A: Weight of stocks in three size ranges for ASX200. Data is monthly.



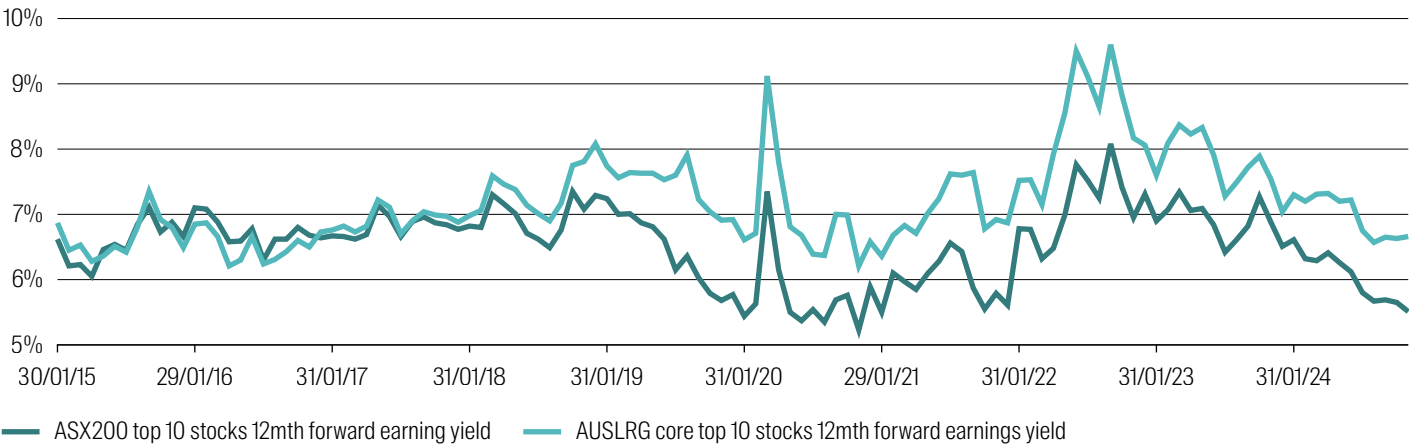
Source: RQI, Factset. Data as at 31 December 2024

Chart 1 Panel B: Weight of top 10 stocks in ASX200 compared with weight of top 10 stocks in RQI Australian Large Core



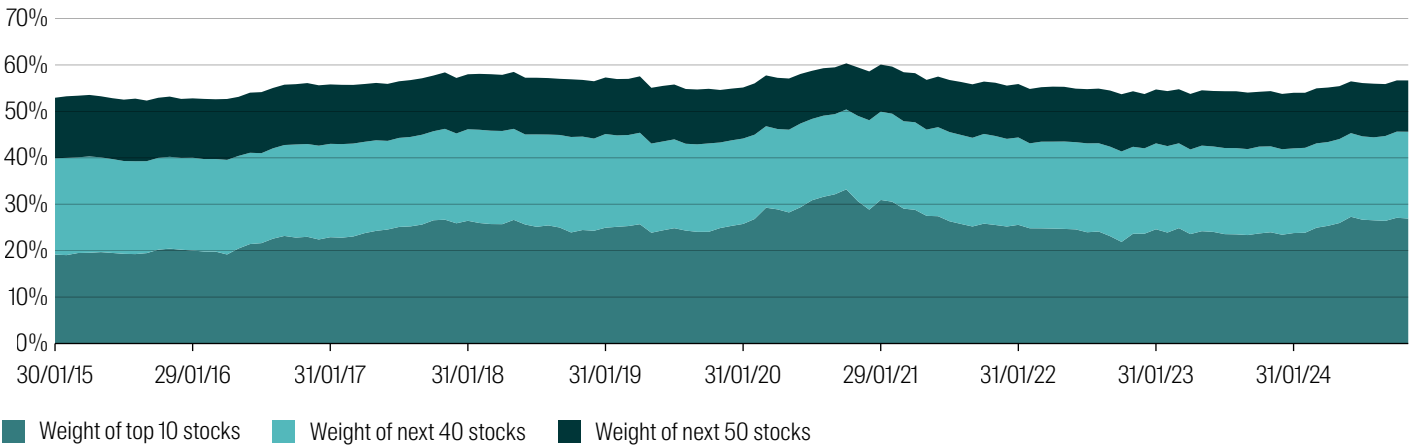
Source: RQI, Factset. Data as at 31 December 2024

Chart 1 Panel C: 12-month forward earnings yield for the ASX200 and for the RQI Australian large Core model. Monthly data.



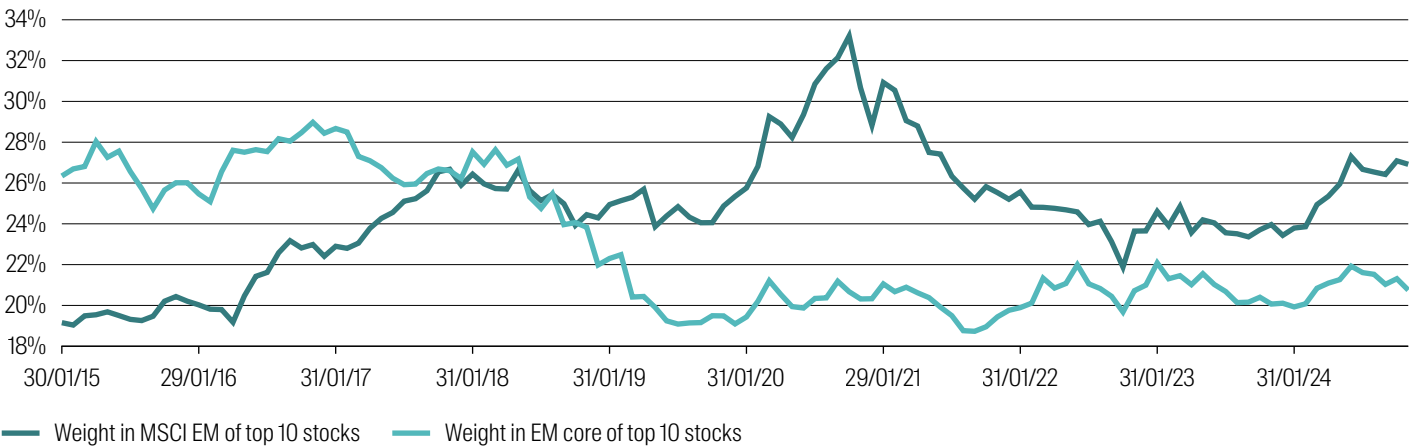
Source: RQI, Factset. Data as at 31 December 2024

Chart 2 Panel A: Weight of stocks in three size ranges for MSCI EM. Data is monthly.



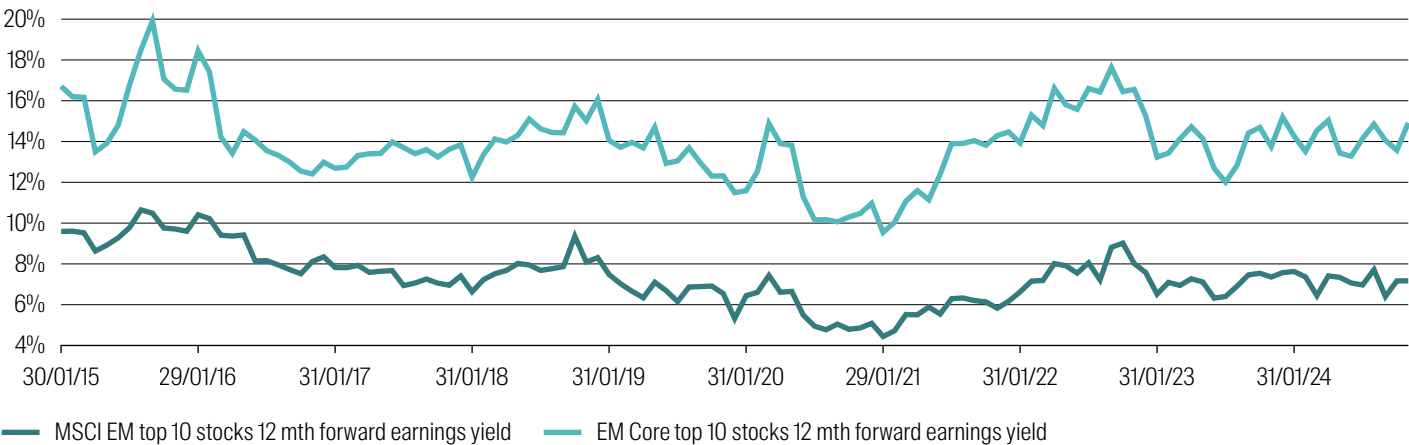
Source: RQI, Factset. Data as at 31 December 2024

Chart 2 Panel B: Weight of top 10 stocks in MSCI EM compared with weight of top 10 stocks in RQI EM Core.



Source: RQI, Factset. Data as at 31 December 2024

Chart 2 Panel C: 12-month forward earnings yield for the MSCI EM and for the RQI EM Core model. Monthly data.



Source: RQI, Factset. Data as at 31 December 2024

Conclusion

We look to answer some follow ups from our well received paper on US equity market concentration. These follow ups relate to Australia and Emerging Markets.

The largest stocks do not grow in weight over time for either market. The Australian market (ASX200) is always highly concentrated. We do not see this in Emerging Markets.

Note that the MSCI EM benchmark includes China A shares at small weights from June 2018, which sharply changed the number of names in the benchmark but not the weight (as these stocks were included at low weight).

The 12-month forward earnings yield for RQI Core is higher than for the benchmarks, again demonstrating that the RQI strategy is Value tilted. The spread in Australia is smaller (currently at about 1.5%), but in Emerging Markets the spread is much higher (currently at about 8%). This reflects the very different nature of the top 10 stocks in MSCI EM and RQI EM Core.

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