WORLDWIDE
ASSET MANAGEMENT

marketing · marketing · marketing · marketing · marketing

2024 – The Year of Index Concentration

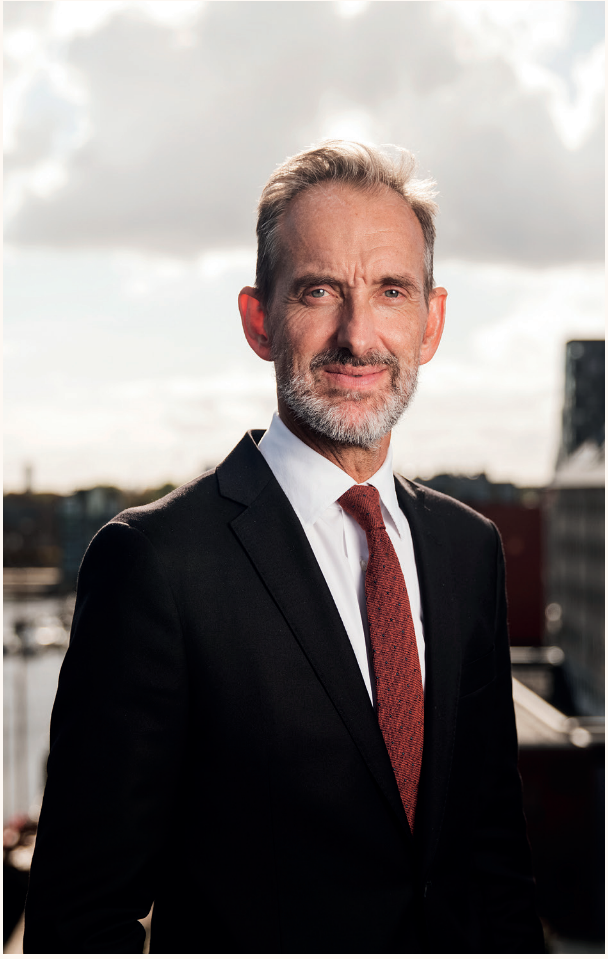
2024 will go down in history as the year of unprecedented Index concentration. For example, the market capitalisation of the seven largest US companies reached approximately USD 17 trillion. This is nearly 16% of the world economy and the top five crosses 28% of the S&P 500 index. Regarding the latter, this is considerably higher than the historical average over the past 60 years of 17%, with the previous peak from the mid-60s showing a concentration of 25%, led at that time by IBM and AT&T.

In this outlook, we argue the continuation of these extreme levels of index concentration and share our views on some important investment themes and the market outlook for 2025 and beyond.

Can the trend of concentration continue?

In the current environment, the largest companies are becoming even bigger through network effects and economies of scale, leading to increasing earnings and profitability. This supports the valuation of these companies to a greater extent than was the case during the last tech boom around the year 2000 when there was less earnings support. However, we believe that scale limitations due to the law of large numbers will eventually be a reckoning force. In the early 2000s, the world was in the sweet spot of globalisation, with China and global

"Magnificent Seven stocks dominated the stock markets in 2024, reaching a market value equivalent to 16% of the global economy."



Bo Knudsen
CEO and Portfolio Manager
C WorldWide Asset Management

trade accelerating. Today, the world order has changed to a more multipolar world, where the nation-state plays a larger role. It is harder to scale when the nation-state and populism play a bigger role.

Although there is currently strong earnings and profitability support from the biggest index constituents, trees don't grow into the sky. For example, the seven largest US index constituents have compounded a shareholder return of about 22% annually over the last decade. If they were to continue at this pace for the coming decade and assume a normal growth rate of 6% for the world economy, these seven companies would constitute a stunning and unrealistic 64% of the world economy (vs. 16% today).

We believe that regulation and competitive dynamics will hinder this extreme scenario, and that there is a limit to the dynamics of high-octane growth in a slower-growing world economy.

The element of being selective within this group will become even more crucial over the coming decade. In the meantime, our quest for sustainable compounders will remain relentless, and our investment mindset will most definitely not be on autopilot.

"We are reaching levels where we start to worry about the potentially negative consequences of indexation."

The role of indexation

Automatic buying of the index, or investing on auto-pilot, as we like to coin it, has reached a level never seen before. Is this the famous but seldom "free lunch"? We don't believe so. The obvious choice is seldom the right choice, and in our view, we are reaching levels where we start to worry about the potentially negative consequences of indexation. With the extreme level of concentration in indices, more global pension savings than ever depend on the stock price development of Nvidia and Apple. Though it worked well on the upside, index investing now entails an explicit stock-picking risk in absolute terms. And what happens when the tide turns and selling pressure builds on the downside? Relying on autopilot is seldom sustainable in the long term. Relying on index investing is like relying on AI without proper curation of the answers given.

The US is running large current account deficits, creating excess dollars globally. Historically, a large part of these dollars was recycled into US Treasuries; however, data indicates that an increasing part is invested back into – not US bonds but the S&P 500 Index. Gavekal Research estimates that over the past few years, about USD 1.2 trillion has been redirected from T-bills into other assets like the S&P500, where index investing is very pronounced.

We have recently published an insight, where we have analyzed the role of indexation and its effect on asset pricing. A key insight is that large companies have less liquidity when compared to their market capitalisation. Consequently, index flows create an artificial tailwind for the ultra-large caps, pushing the share price of these companies higher than the average company. This sustains the trend of ultra-concentration.

Opportunities beyond Nvidia

The backbone of our investment approach emphasises the sustainability and durability of growth rather than

> *"Index flows create an artificial tailwind for the ultra-large caps, pushing the share price of these companies higher."*

the magnitude of growth. Coupled with our longer-term investment mindset, this investment approach has served us well for decades and, in our opinion, is a repeatable framework.

The semiconductor industry has historically been cyclical, and with Nvidia challenging Apple to become the most valuable company in the world, the sheer size of Nvidia introduces more share price volatility. Granted, Nvidia has done much better than we expected. Its pricing power has been underestimated by many, including us. The company has grown revenues from about USD 11 bn in 2020 to expectations of around USD 125 bn in 2025, with market consensus estimates of USD 370 bn in revenues by 2030. This underscores the high level of expectations. Although we have not invested directly in Nvidia's current phase of growth, we have successfully invested in companies which benefit directly from Nvidia's growth – for example, TSMC, where Nvidia's success has been a major driver behind the companies' record revenues.

Investment Themes

1. We see cloud hosting as a multiyear opportunity with considerable thematic tailwinds. Instead of building your own IT infrastructure, companies can plug into the cloud provided by Microsoft, Amazon and Alphabet, gaining access to compute power and services at the highest level. This brings the opportunity to build neural networks or LLMs on the cloud platform. Microsoft highlights that it hosts 1700 large language models for clients. They have an enormous scale advantage in handling the choice of architecture, providing clear benefits for their clients. Quantum computing could be the next compute revolution, where only these giants can invest in this technology and share the benefit with clients. This technology will hopefully prevail as a more energy-efficient way forward, as energy consumption is a real challenge with the existing architecture. In sum, we think the cloud providers have a very sustainable business model.

2. Industrial policies are key to follow across the world. The theme of reshoring and reestablishing manufacturing in the US will continue, but economic growth is needed to fund this massive spending, not least in parts of the semiconductor industry where government support programs are necessary. US budget deficits are high and double the size compared to Europe. This could be a constraining factor. After a period of a political vacuum, perhaps 2025 could be the year when Germany and France establish a growth direction for Europe. Reshoring is also a priority for Japan, with a special focus on rebuilding semiconductor capabilities. We detail some of the investment opportunities here in our article Japan's High-Tech Renaissance.

3. India remains one of the most interesting investment opportunities, with President Modi continuing to support already implemented structural reforms with a clear focus on digitisation. India is supported by favourable demographics, where 65% of the population is under 35 years. This supports estimates of compounded real annual economic growth of +7% for the next 25 years[1]. This is a unique opportunity in a world where most countries struggle with high debt, dampening the prospects of high real economic growth. Finally, the theme of bigger government is more relevant than ever. According to Stanford University's populism database, there are currently 165 populist leaders world-

> ***"India remains one of the most interesting investment opportunities, with President Modi continuing to support already implemented structural reforms with a clear focus on digitisation."***

1 International Financial Services Center Authority

"The stock markets returns have been accelerating, and we will likely have to adjust to more moderate market returns over the next decade."

wide. In 1950, there were only 26. We must, therefore, expect voters' preferences to be more reflected in national policy priorities compared to the years of globalisation. More nationalistic policies revoke the country factor for global investors. Global investors must understand national policies and whether companies are on the right side of these policies.

Outlook for 2025 – Reason for Optimism

Our optimism is grounded in the broader equity markets, which have lagged the market cap-weighted indices. Our current focus is to avoid being too exposed, and in our view, too vulnerable, to the increasingly concentrated market indices. As we highlighted previously, we have real concerns about when current trends in market concentration reverse and when the pace of growth in passive allocations abates. Investing on autopilot is not a "free lunch" and could unravel, potentially resulting in adverse outcomes for enormous pools of capital.

Our optimism is also grounded in the robustness of our longer-term oriented portfolios, with companies that have a compounding growth model where the longer-term earnings power is key. In 2025 we believe that investors are going to increasingly reward these portfolio attributes going forward.

Undoubtedly, Donald Trump's policy choices will influence the global economy and stock markets in 2025. His intentions are clear. Trump supports rising stock markets and falling interest rates and wants to "Make America Great Again". Tariffs as a negotiation tool might be powerful, but time is also a factor. If negotiations become prolonged, there is a risk that MAGA policies will be inflationary and restrictive of growth. There is only so much you can control – even as the President of the US. At the time of writing, we are in the honeymoon period of marriage number 2 with Trump. Post-inauguration, it will be back to everyday life – and our everyday life is focusing on identifying longer-term sustainable earnings growth.

Staying Active

We are staying true to our core beliefs, and for us, the long game is not debatable. Where we choose to place our focus dictates how we invest. We prefer piloting our portfolio allocations ourselves, rather than an autopilot approach. Simply put, we prefer to know what we invest in. It's our core philosophy. A maximum of 30 stocks of high-quality well-positioned companies for the longer term.

Some companies in our global portfolio have delivered solid annual mid-teens earning growth for years without being rewarded by the market. This is partly due to the concentration factor. When market leadership broadens out, these companies should have a significant catch-up potential.

We advocate staying with the long-term mindset and staying invested. The global economy faces risks. However, we see many companies poised for continued earnings growth in the coming years, and barring a negative inflation surprise, the monetary environment should stay accommodative, offering support for global equities.

Disclaimers

EU: This is marketing material. This publication is prepared by C WorldWide Asset Management Fondsmaeglerselskab A/S. It is provided for information purposes only and does not constitute, and shall not be considered as, an offer, solicitation or invitation to engage in investment operations, as investment advice or as investment research. The publication has thus not been prepared in accordance with legal requirements designed to promote the independence of investment research, and it is not subject to any prohibition on dealing ahead of the dissemination of investment research. Opinions expressed are current opinions only as of the date of the publication. The publication has been prepared from sources C WorldWide Asset Management Fondsmaeglerselskab A/S believes to be reliable and all reasonable precautions have been taken to ensure the correctness and accuracy of the information. However, the correctness and accuracy is not guaranteed and C WorldWide Asset Management Fondsmaeglerselskab A/S accepts no liability for any errors or omissions. The publication may not be reproduced or distributed, in whole or in part, without the prior written consent of C WorldWide Asset Management Fondsmaeglerselskab A/S. Past performance does not indicate future performance.

US: This is marketing material. This publication has been prepared by C WorldWide Asset Management Fondsmaeglerselskab A/S (CWW AM). CWW AM is a registered Danish investment firm located at Dampfaergevej 26, DK-2100 Copenhagen, Denmark. CWW AM's Danish company registration no is 78420510. CWW AM is registered with the SEC as an investment adviser with CRD no 173234. This publication is provided for information purposes only and does not constitute, and shall not be considered as, an offer, solicitation or invitation to engage in investment operations, as investment advice or as investment research. The publication has thus not been prepared in accordance with legal requirements designed to promote the independence of investment research, and it is not subject to any prohibition on dealing ahead of the dissemination of investment research.Opinions expressed are current opinions only as of the date of the publication. The publication has been prepared from sources CWW AM believes to be reliable and all reasonable precautions have been taken to ensure the correctness and accuracy of the information. However, the correctness and accuracy is not guaranteed and CWW AM accepts no liability for any errors or omissions. The publication may not be reproduced or distributed, in whole or in part, without the prior written consent of CWW AM.All figures are based on past performance. Past performance does not indicate future performance. The return may increase or decrease as a result of currency fluctations.

UK: This document has been prepared by C WorldWide Asset Management Fondsmaeglerselskab A/S (CWW AM). CWW AM is a focused asset manager registered as an investment firm with the Danish FSA. CWW AM is located at Dampfaergevej 26, DK-2100 Copenhagen, Denmark, CVR registration number 7842 0510. This document is directed at persons having professional experience of participating in unregulated schemes (investment professionals) and high net worth companies (as defined under art. 14 and 22 of the Financial Services and Markets Act 2000 (Promotion of Collective Investment Schemes) (Exemptions) Order 2001). The document and any investment or investment activity to which it relates is available only to such persons and will be engaged in only with such persons. Any other person should not rely or act on the statements made in this document. The content of this presentation is confidential, and redistribution or reproduction is prohibited. The presentation is provided for information purposes only and does not constitute, and shall not be considered as, an offer, solicitation or invitation to engage in investment operations as investment advice or as investment research. CWW AM is not responsible for the suitability of the information in the presentation. Opinions expressed are current opinions only as of the date of the presentation. The presentation has been prepared from resources CWW AM believes to be reliable and all reasonable precautions have been taken to ensure the correctness and accuracy of the information. However, the correctness and accuracy are not guaranteed and CWW AM accepts no liability for any errors or omissions. This presentation contains information on investments which does not constitute independent research. Accordingly, it is not subject to the protections afforded to independent research and CWW AM, and its employees may have dealt in the investments concerned. It is emphasized that past performance is no reliable indicator of future performance ant that the return on investments may vary as a result of currency fluctuations.

C WORLDWIDE ASSET MANAGEMENT FONDSMAEGLERSELSKAB A/S

Dampfaergevej 26 · DK-2100 Copenhagen

Tel: +45 35 46 35 00 · Fax: +45 35 46 36 00 · VAT 78 42 05 10 · cworldwide.com

Q1 2025