Quasar

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When an index isn’t a portfolio

An empirical note

Quasar Capital Management

Market-cap index funds are often treated as a complete portfolio by default. They are better understood as a coherent strategy for holding equity beta—with a visible risk budget. In this note we bring a skeptical but constructive lens to that distinction. We identify four empirical limits of relying on market-cap passive (alone or with a classic bond sleeve) as the whole book: rising concentration, historically large drawdowns and long underwater periods, equity correlations that rise in stress, and the 2022 stock–bond co-drawdown. We close with what those limits imply for construction: a complete portfolio is a broader design choice than a single equity-beta sleeve.

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About Quasar Insights

Quasar Insights publishes educational Research for prospective and existing investors. Notes emphasize process, evidence, and risk awareness—not forecasts or urgency marketing. This issue is the first in a series on diversification, passive risk budgets, and systematic multi-strategy construction.

Introduction: Beyond the default

Cap-weighted index investing solved a real problem: cheap, transparent exposure to a broad equity market without stock-picking theater. That success sometimes slides into a stronger claim—that a single market-cap index *is* the portfolio.

It is more accurate to treat market-cap passive as a **strategy**: it delivers equity risk premium exposure under explicit mechanical rules. Like any strategy, it carries a risk budget. The question for this piece is not whether indexes are “good” or “bad.” It is what that risk budget looks like in the data, and why a diversified *index* is not the same thing as a diversified *portfolio*.

Investor conversations often collapse three ideas into one label: low-cost market exposure, “owning everything,” and a finished multi-driver allocation. Only the first follows automatically from a broad cap-weighted fund.

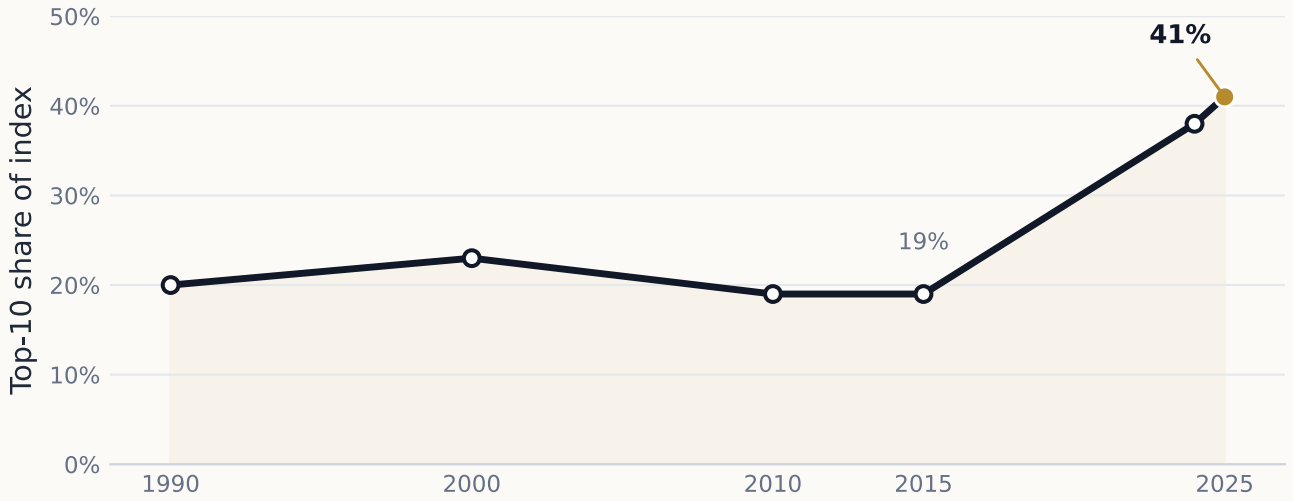
> **Working premise.** Own-the-index is a coherent beta strategy—not automatically a multi-driver portfolio.

Why concentration matters

A float-adjusted, capitalization-weighted index assigns larger weights to larger companies by design—so when a handful of firms dominate market value, they dominate index risk and return. “The S&P 500” is often heard as diversified U.S. equities; in portfolio terms it is a single rules-based equity sleeve whose risk is reallocated continuously toward whatever is largest.

Third-party snapshots put the **ten largest S&P 500 constituents near roughly 37–41% of index weight** in late-2024 to 2025 windows (Avantis 37.3% at end-2024; RBC about 41% by end-2025), versus near **19%** around the mid-2010s. Methodologies differ and the prints are dated levels—not a continuous Quasar-owned series—but the direction is clear: top-of-book weight is much higher than a decade ago. Exhibit 1 puts that rise in a longer-run frame.

Exhibit 1. S&P 500 top-10 weight



Source: Visual Capitalist long-run series; RBC Wealth Management; Avantis Investors. Approximate compiled levels; methodologies differ.

Concentration is not only a “big tech” headline. Higher weights mean larger contributions to index return and drawdowns, and a narrower set of earnings and multiple assumptions behind more of the portfolio. Investors who treat the index as a diversified “whole market” book can understate how much of the outcome rides on a short list of companies and themes.

When leadership is narrow, a cap-weighted book can look diversified by ticker count while behaving like a concentrated growth or megacap sleeve. That does not make cap-weighting “wrong” as a beta delivery tool—it is transparent, investable, and hard to beat as a low-cost way to hold equity market risk. It does change the **risk budget** of that tool.

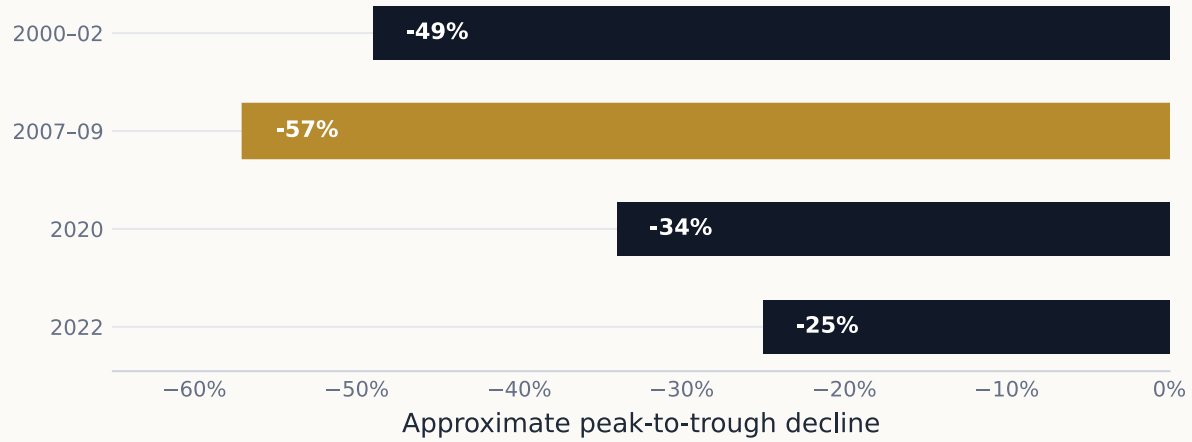
The point is narrower than an indictment of indexes: **concentration changes what diversification the index actually provides.** Breadth of ticker count is not breadth of economic exposure. Prior episodes of narrow leadership have come and gone; what matters for risk budgeting is that **when** leadership is narrow, the path is less “500 independent stories” and more “a few dominant ones.”

> **Exhibit 1 takeaway.** Ticker count ≠ diversification of economic drivers when cap weights concentrate.

Drawdowns: the price of equity beta

Equity indexes have delivered long-run growth alongside repeated, deep declines. Compiled bear-market histories of the S&P 500 commonly show:

Exhibit 2. Peak-to-trough declines



Source: Public bear-market compilations and Northern Trust-style drawdown histories. Price-based approximations; total-return series differ.

Episode	Peak-to-trough	Decline length	Recovery character
2000–02	−49%	30 months	Multi-year
2007–09	−57%	17 months	Multi-year
2020	−34% (daily)	1 month	Months
2022	−25%	9 months	Quarters to 2 years

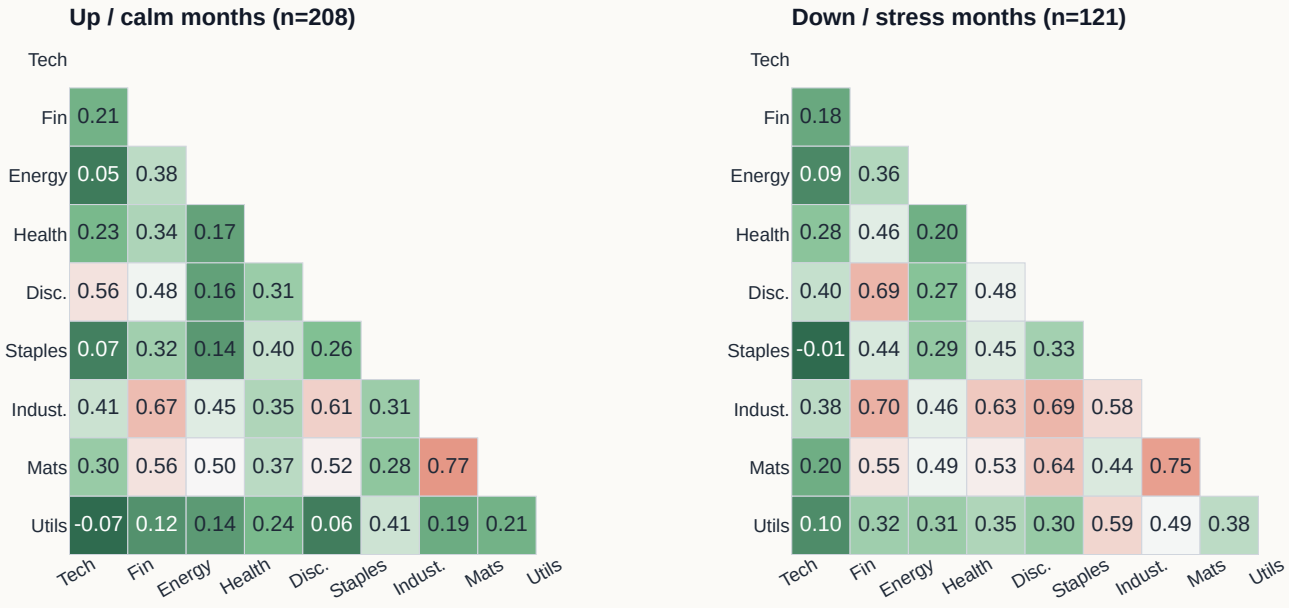
Sources for these ranges include public bear-market compilations and institutional drawdown notes. Exact percentages shift with total-return versus price series and with daily versus month-end sampling. The qualitative message does not: **accepting market-cap equity beta includes accepting large interim losses and, at times, long periods underwater.** That is not an argument against equities. It is the risk budget stated plainly.

> **Exhibit 2 takeaway.** Equity beta's cost is paid in depth and time underwater—not only in volatility headlines.

When stocks move together

Diversification inside an equity book relies on imperfect co-movement among holdings—including across sectors. In calm markets that assumption often looks reasonable. In down markets, sector co-movement tends to rise—so diversification can shrink when it is most needed.

Exhibit 3. Sector correlations in calm versus stress



Source: Quasar calculation from Select Sector SPDR month-end returns (XLK, XLF, XLE, XLV, XLY, XLP, XLI, XLB, XLU). Axis labels: Tech, Fin, Energy, Health, Disc., Staples, Indust., Mats, Utils. Stress = SPY < 0; calm = SPY ≥ 0. Sample Feb 1999–Jun 2026. Avg pairwise corr ≈ 0.32 calm → ≈ 0.41 stress.

We compute pairwise correlations across nine classic S&P sector ETFs, splitting months by the sign of SPY. Average pairwise sector correlation rises from about **0.32** in up/calm months to about **0.41** in down/stress months. The stress panel is not uniformly "everything goes to one," but economy-sensitive pairs often move more together when SPY is down—so sector labels can look like diversification in a calm tape and still deliver a more common factor in a weak tape.

That pattern matches the conditional-correlation literature (Pollet and Wilson, 2010). The exhibit is a sector-ETF illustration—not stock-level pairwise correlation; XLC/XLRE are omitted for history. For a cap-weighted index investor, the implication is direct: **stress does not only reduce prices; it can also thin within-equity diversification.** An index that already concentrates risk (Exhibit 1) and can spend years underwater after deep drawdowns (Exhibit 2) asks a lot of sector mixing alone when correlations rise.

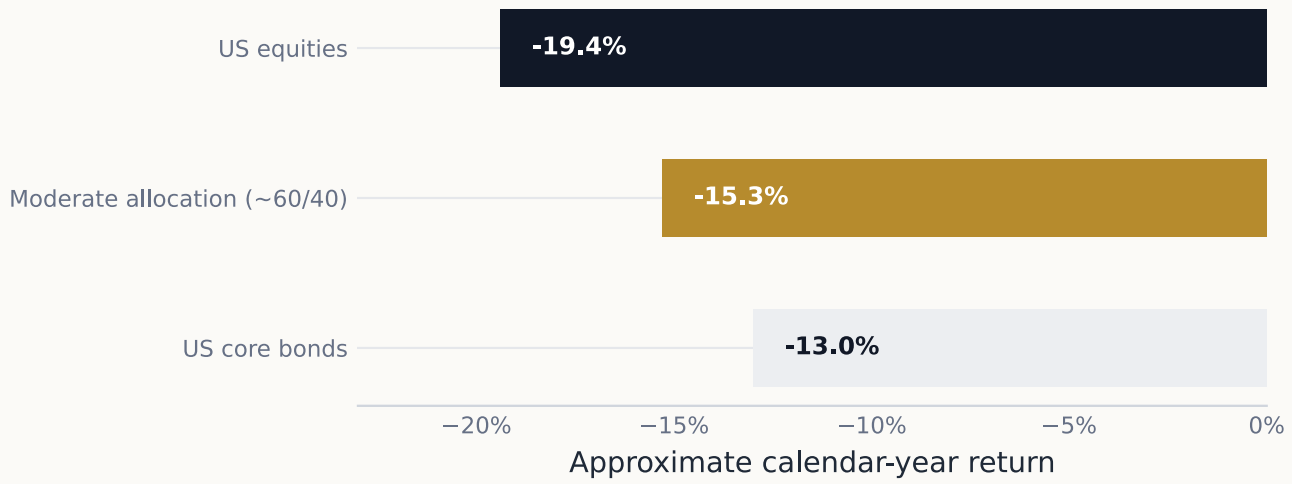
> **Exhibit 3 takeaway.** Within-equity sector diversification often thins in down markets—exactly when investors need it most.

When bonds do not ballast: 2022

A common passive completion of “own the stock index” is a stock–bond mix—classically 60/40. For much of the post-1990s disinflation era, bonds often helped when equities struggled. That relationship is **regime-dependent**, not a law of nature.

Calendar year 2022 is the recent stress test. Morningstar reported that its **US Moderate Target Allocation Index**—a diversified 60/40-style benchmark—fell about **15.3%** in 2022, while its US equity market measure fell about **19.4%**. Bonds did not provide the usual offset amid high inflation and rapid policy tightening; equities and duration both hurt.

Exhibit 4. Calendar 2022 returns



Source: Equity and Moderate Target Allocation figures from Morningstar commentary on 2022. Core-bond figure is an approximate Agg-like illustration; confirm the preferred series before publication.

Sleeve (2022)	Approx. return	Role in a passive book
US equities (Morningstar US Market)	−19.4%	Growth / equity beta
Moderate allocation 60/40 (Morningstar)	−15.3%	“Balanced” completion
US core bonds (Agg-like, illustrative)	−13%	Intended ballast—also negative

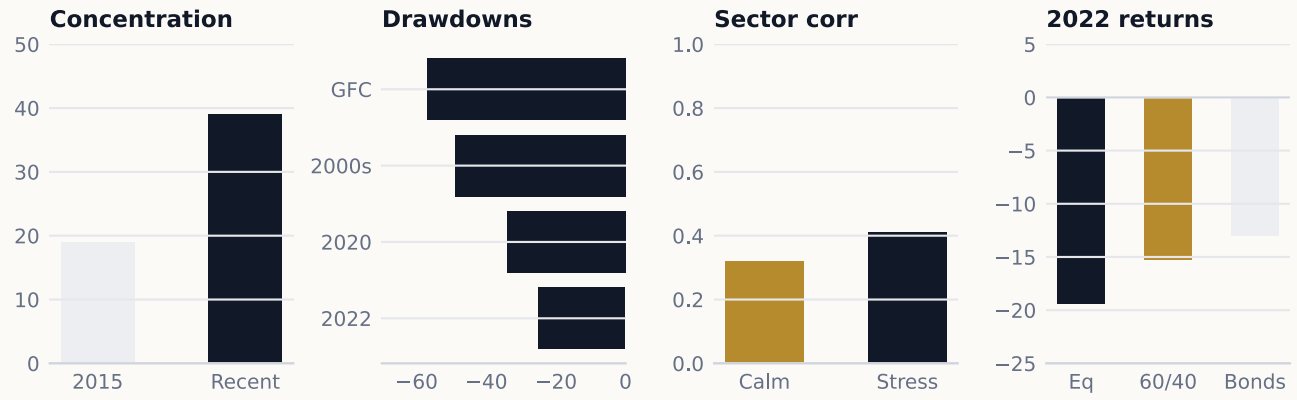
The lesson is not that 60/40 is obsolete. It is that a passive stock–bond book can experience **joint drawdowns**, and that “balanced” is not a guarantee of ballast in every macro regime.

> **Exhibit 4 takeaway.** Stock–bond ballast is regime-dependent; 2022 showed joint drawdowns are possible.

Synthesis: index ≠ multi-driver portfolio

Put the four exhibits together:

Synthesis snapshot



Source: Summary of Exhibits 1–4; illustrative compiled levels.

1. Cap-weighting can concentrate risk in a few names even inside a broad index.
2. Equity beta carries historically large drawdowns and underwater periods.
3. Within-equity sector diversification can weaken in down markets as sector correlations rise.
4. Even a classic stock–bond passive mix can fail to diversify when both legs decline together.

None of this says investors should abandon index funds. It says **an index is a tool for equity beta**, and a portfolio that only holds that tool—or that tool plus a single bond sleeve—has not automatically diversified across distinct return drivers.

Read as a sequence, the exhibits are failure modes of one habit: treating market-cap passive as a finished allocation. Concentration changes **who** drives the outcome; drawdowns change **how expensive** it can be; stress correlations change **how much** within-equity diversification remains when prices fall; 2022 changes whether the usual ballast sleeve works in every regime.

Those limits need not arrive together, and the four exhibits are not a timing signal. They keep the risk budget of the equity tool—and of any one bond completion—visible in ordinary portfolio language. A useful test is role clarity: say what the index is meant to deliver, under which regimes a bond sleeve is meant to ballast, and which economic drivers “diversification” is supposed to make independent. Ambiguity about roles is how a coherent beta instrument gets asked to do the work of an entire multi-driver book.

Beyond a single beta book

The four limits above do not prescribe a single replacement portfolio. They describe a design problem: if equity beta is concentrated, deep in drawdowns, more correlated in stress, and only imperfectly ballasted by bonds, then a book that relies on one beta sleeve—or one beta sleeve plus one bond sleeve—is asking that sleeve to do too many jobs at once.

Quasar Capital Management manages the **Horizon Dynamic Multi-Strategy Portfolio** as one institutional response to that problem: multiple systematic sleeves combined under account-level construction and risk constraints. The design premise is the same point this note makes empirically—**no single edge or single beta book has to carry the entire investment case every month.**

In practical terms, that means separating **roles** that a cap-weighted index often conflates. One sleeve may be asked to harvest equity risk premium. Another may be built around defensive rotation, trend, calendar effects, or volatility-related premia. Account-level construction then sizes those roles jointly, subject to cash buffers, leverage limits, and the investor's constraints. The goal is not to "beat the S&P every month." It is to avoid making market-cap passive the sole carrier of growth, ballast, and diversification at the same time.

A multi-sleeve book is also a way of taking the exhibits seriously without turning them into market timing. Concentration (Exhibit 1) argues for not confusing ticker count with economic breadth. Drawdowns (Exhibit 2) argue for sizing equity beta as a risk budget, not as an all-purpose default. Stress correlations (Exhibit 3) argue that within-equity diversification can thin when it is most needed. The 2022 episode (Exhibit 4) argues that stock–bond ballast is regime- dependent. None of those observations requires a forecast of the next regime; each one argues for **explicit role design** instead of hoping a single index sleeve covers every role by implication.

Process matters as much as sleeve labels. Signals are sleeve-specific; account-level construction sets weights; risk controls sit above any one strategy's local view. That hierarchy is why Horizon communications emphasize construction and constraints—not a promise that every sleeve will help in every month.

That architecture is also a reminder of what this note is **not**. It is not a claim that concentration will reverse, that correlations will stay elevated, or that 2022-style joint stock–bond losses are the new normal. Regime dependence cuts both ways. The durable point is simpler: understand the risk budget of the tools you already own before treating any one of them as the whole portfolio. The construction of Horizon's sleeves belongs to a separate discussion; this note stays with the problem statement—market-cap passive is a powerful equity-beta instrument, and a complete portfolio is a broader design choice.

References and further reading

1. Avantis Investors, “Heavy Weights: The Real Story Behind Current Market Concentration” (end-2024 top-10 weight 37.3%).
2. RBC Wealth Management, “The ‘Great Narrowing’: S&P 500 concentration.”
3. Visual Capitalist, historical top-10 share of S&P 500 market cap.
4. Northern Trust and public S&P 500 bear-market / drawdown compilations.
5. Pollet, J., & Wilson, M. (2010). “Average correlation and stock market returns.” *Journal of Financial Economics*.
6. T. Rowe Price, “When Diversification Fails.”
7. Morningstar, commentary on 2022 60/40 / Moderate Target Allocation outcomes.

Methodology and exhibit notes

1. Concentration observations combine dated third-party snapshots; they are not a continuous Quasar-owned index series.
2. Drawdown figures are approximate price-index measures. Results differ when dividends, daily versus month-end observations, or alternative recovery definitions are used.
3. Sector correlation matrices are Quasar-computed from Select Sector SPDR month-end returns (XLK, XLF, XLE, XLV, XLY, XLP, XLI, XLB, XLU). Stress months are months with negative SPY returns. They are not stock-level pairwise correlations; Communication Services (XLC) and Real Estate (XLRE) are omitted to preserve a long overlapping history through the late 1990s.
4. The 2022 bond figure is an Agg-like approximation. Named Morningstar figures should be checked against the preferred publication source before release.

Disclosures

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