

COMMENTARY

TIMELESS MARKET WISDOM THAT MATTERS NOW

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Investment Diversification: What Are You *Really* Holding?

How often have you heard the phrase, “Don’t put all your eggs in one basket?” The concept of diversification is a cornerstone of our investment philosophy at McRae Capital Management. By spreading investments across different asset classes,

sectors, industries, and geographic regions, diversification minimizes risk in any single area. This helps improve the overall stability of an investment portfolio, so it’s less vulnerable to market volatility and more likely to deliver consistent long-term returns.

What Does It Mean To Be Diversified?

How do you know if you are diversified enough—and what corrections should you make to your portfolio if it's not there yet? Every portfolio is different, of course, and your strategy may change as your life progresses. But there are three basic ways to think about evaluating how diversified a portfolio is. They are:

1. ASSET CLASS DIVERSIFICATION

(Your overall asset mix)

The first area of diversification to consider is your overall asset mix. You may have exposure to stocks, bonds, real estate and maybe some collectibles like art. Most of us become more risk averse as we age. In our youth, with decades in front of us to build an asset base, we can accept more volatility in our desire for higher returns, and perhaps invest more heavily in stocks. As we age toward retirement, and we transition from paychecks to living off our accumulated assets, volatility becomes less desirable, and many reduce the relative weight of stocks in their portfolios.

2. SECTOR DIVERSIFICATION

(How your asset mix is spread across different industry groups)

The next area of consideration is an industry-level look at how your assets are allocated. Owning 100 different stocks and bonds sounds pretty diverse, and a good way to spread the risk of an individual company failure. But if all those stocks and bonds are related to banks, for example, you might be at high risk of any industry-wide downturn.

3. INDIVIDUAL INVESTMENT DIVERSIFICATION

(The individual investments that make up your asset mix)

A popular question clients and prospects ask is “Should I buy this stock?”

As you might guess by now, the decision needs to be considered in the context of the entire portfolio. At McRae, we typically target 20 to 25 individual stock holdings, with each making up about 4% to 5% of your total stock portfolio. Positions like these are large enough that you can make a meaningful return on your investment, but if a stock doesn't work out as planned, any negative effect is more muted.

Putting It All Together

When considering an investment, you need to consider all these risks on your overall financial picture. If there is a new restaurant stock you want to buy, we first want to consider what adding this investment will do to your overall asset picture. Will it make your stock weight too high? You then need to consider what is your current allocation to the restaurant industry. Do

CASE STUDY

DIVERSIFICATION: How the S&P 500 Index has changed over the past 10 years

Combined Weight of Top 10 S&P 500 Stocks

Year	Combined Weight of Top 10 Stocks (%)	Market Context
2015	~20%	More balanced across energy, consumer staples, and tech (ExxonMobil, Apple, Microsoft)
2025	~40%	Highly concentrated in mega-cap tech (NVIDIA, Microsoft, Apple, Amazon)

SOURCES: S&P Dow Jones Indices, FactSet, Morningstar, and recent ETF holdings

The top 10 companies now represent nearly 40% of the index, with the remaining 490 stocks accounting for 60%. This is almost double the impact from 10 years ago. Moreover, the 40% is dominated by technology and communication companies. Passive investors in S&P 500 funds are increasingly exposed to a narrow set of companies, especially in AI and cloud computing.

you add this new restaurant, or do you replace a current restaurant holding to keep your balance the same? Finally, you need to see if you already own this specific restaurant stock and think about how big a position you want to own. How does the investment in this restaurant compare to the size of other investments you make? Portfolio construction needs to incorporate all of these considerations and can be as much of an art as it is a science.

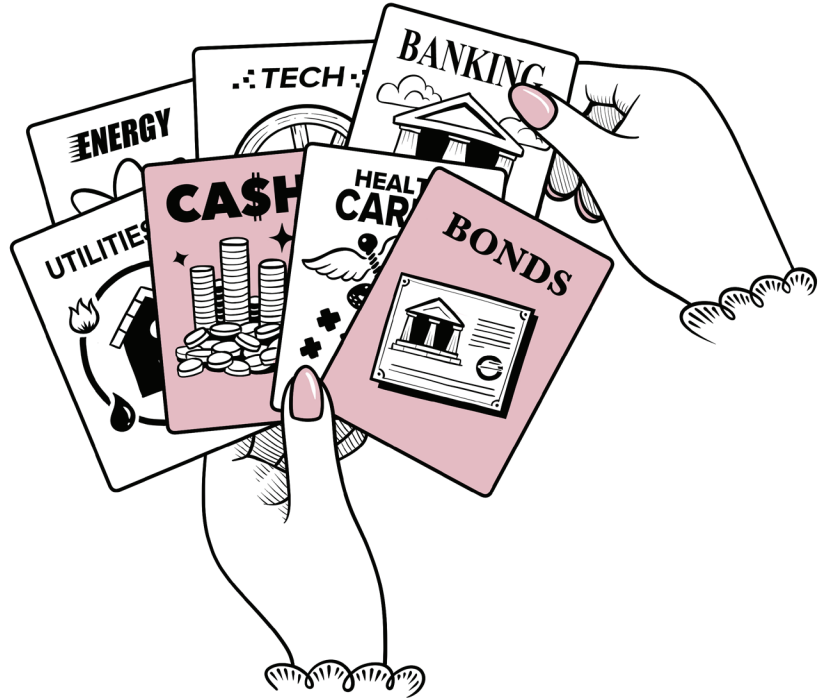
Are You As Diversified As You Think?

When a prospective client wants to discuss the investment of their portfolio, one of the first questions we ask is, “What do you own?” And we find that many are less diversified than they think they are—sometimes by a lot.

Let’s take the example of an investment in the S&P 500: a basket of the 500 largest publicly traded companies. It’s one of the most commonly quoted and followed indices, and if you’re invested in the S&P 500, you might think you are extremely diversified. But if you’re assuming your investments are divided equally among those 500 companies—with each representing 1/500th of your investment—that is not correct. The S&P 500 is a **market capitalization** weighted index, meaning the larger a company is, the more impact it has on the index’s value and movement—and the more of it you own, relative to your position with the other 499 companies in the index.

However, what many people overlook is how the composition of these indices has evolved over time. This shift means that while the index still includes hundreds of companies, its returns are disproportionately driven by just a few. As a result, the diversification that once defined index investing has changed, and investors may be exposed to more

Investors (and others who haven’t taken a close look at their holdings) may not be as diversified as they think they are.



sector and company-specific risk than they realize. According to Morningstar, as of October 2025, the top 10 companies in the S&P 500, which represent only 2% of the names in the index, account for around 40% of the performance of the index. This is up from approximately 20% a decade ago. If you take the top 100 stocks (20% of the names in the index), they account for nearly 75% of the performance. This means an investment in the S&P 500 results in owning 100 companies at a significant level, with the majority in the technology sector. In other words, an investment in the S&P 500 is less diversified than you might expect.

Investors may feel buying actively managed mutual funds will diversify

your assets, but that may not be a quick fix either. Many actively managed funds track the same indices, and hence hold the same securities. For example, an investment firm may market an aggressive growth fund, a balanced growth fund, a dividend growth fund, and a target date retirement fund. Spread your assets across these funds in an effort to diversify your holdings and you may well find that they contain the same company names (i.e., they might all own Microsoft as a top 5 holding).

To be clear, index investing can be very successful, and we’re not disparaging this kind of investment. But index investors (and others who haven’t taken a close look at their holdings) may not be as diversified as they think they are,

exposing them to higher risk levels than they intend.

Conclusion

Diversification is a critical strategy for investors seeking to enhance performance while managing risk. While it comes with its challenges, the benefits of reducing volatility while fostering long-term growth make it an essential component of sound financial and strategic planning. Understanding how to implement and manage diversification effectively can lead to more resilient portfolios, providing stability in an ever-changing economic landscape.

At McRae, we consistently stress the value of truly knowing what you own, and we leverage tools like thoughtful diversification to personally balance portfolios to match clients' risk tolerance. To find out more, reach out for a free consultation today.

DISCLAIMER: We cannot stress this enough: All investments come with risk. All of them. This commentary is designed to speak in generalizations and not in any way suggest any investment strategy. Investments should only be made after careful consideration of the specific risks of a proposed investment, as well as how adding them would impact your portfolio.

A Helpful Guide of Stock Indices

When most people think of the stock market, they think of a market index—a specific portfolio of pre-selected investments that can be tracked based on how the sum of their individual components behave when considered together. The Dow Jones Industrial Index was the first of these in America, but today investors also follow the S&P 500 index and the Nasdaq Index, and there are many, many others out there. Here's a quick rundown of the big three.

1

The Dow Jones Industrial Average – Commonly known as the Dow, this is one of the oldest and most widely followed stock market indices in the world, tracking the performance of 30 large companies that trade on the New York Stock Exchange and the NASDAQ. This index is **price weighted**, meaning that the higher the price of the stock, the more impact it has on the index itself. (A stock selling at \$50 a share will have a bigger impact on the index than a stock that trades at \$25.)

2

The S&P 500 – This index tracks 500 of the largest companies—more than 16 times as many components as the DJIA. This index is weighted by **market capitalization**: The larger the company, the more heavily it impacts the index. In practice, this means several large technology stocks have an outsize impact on the index.

3

The NASDAQ 100 – This index holds 100 of the largest non-financial companies listed on the NASDAQ exchange. Also market capitalization weighted, this index is heavily influenced by the technology sector. Per Morningstar, as of October 2025, the top 10 names in the NASDAQ 100 account for nearly 70% of the performance of the index.



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If there's ever anything we can help you with, please don't hesitate to give us a call.

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