Martin Capital Partners

Quarterly Point of View
The Comfort of Crowds

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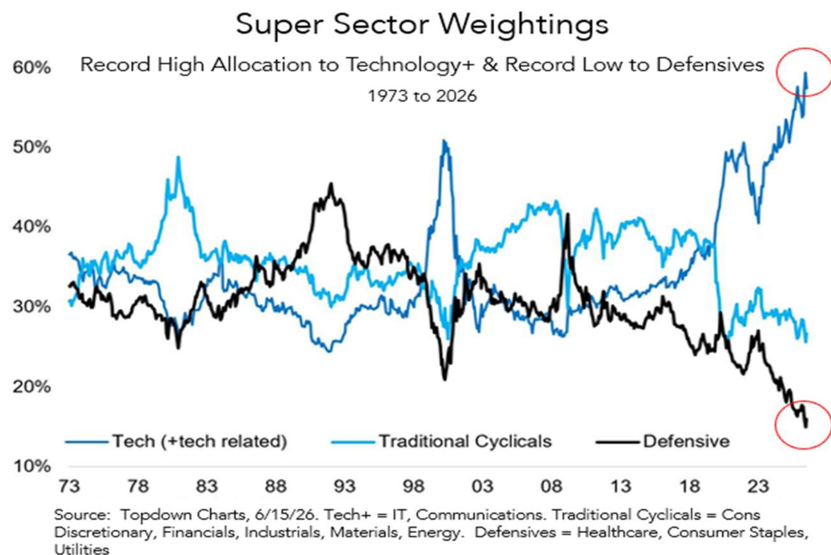
One of the more interesting developments in the modern market era has been the extent to which concentration has become less the result of active investment decisions and more the byproduct of market structure itself.

Historically, market concentration was largely the result of deliberate investment decisions. A portfolio manager might decide to overweight financials, technology, energy, or a particular investment theme because they believed the prospective returns justified the risk. Today's market environment is increasingly different. Concentration is often occurring automatically through the interaction of market capitalization weighted indices, passive investment vehicles, factor strategies, and systematic allocation frameworks that direct capital toward securities that have already appreciated the most.

As companies' capitalizations become larger, their representation within benchmarks increases. As benchmark weights increase, passive flows direct additional capital toward those businesses. Strong performance attracts attention, attention attracts capital, and additional capital can reinforce performance. The process becomes self-reinforcing, many times independent of any change in the underlying economics of the business itself.

This chart highlights an often-overlooked aspect of concentration risk: concentration is as much about what investors choose not to own as what they do. Technology and technology-related businesses have grown to represent the largest share of market capitalization in the post-war period, while defensive sectors have fallen to record low representation. Whether this ultimately proves justified is unknowable in advance. What history does suggest, however, is that periods in which investors become increasingly aligned around a narrow set of assumptions regarding growth, innovation, and future economic leadership have often been followed by environments in which diversification proved more valuable than expected.



Source: Topdown Charts, 6/15/26. Tech+ = IT, Communications. Traditional Cyclicals = Cons Discretionary, Financials, Industrials, Materials, Energy. Defensives = Healthcare, Consumer Staples, Utilities

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This observation should not be interpreted as criticism of today's market leaders. Many are extraordinary companies that have earned their position through innovation, execution, attractive economics, and significant competitive advantages. The more relevant question for investors is whether popularity and safety have gradually become conflated.

Large index weights often feel reassuring. Familiarity creates comfort, and broad ownership can create the impression of lower risk. Yet history has repeatedly demonstrated that risk often emerges not from the assets investors perceive as dangerous, but from those they collectively come to view as unquestionably safe.

Every generation tends to have its own version of permanence. Railroads occupied that role in an earlier era of American industrialization. Energy companies became synonymous with stability during the inflationary environment of the 1970s. Japanese financial institutions appeared unstoppable during the late 1980s. Telecommunications companies came to define the investment landscape during the technology boom of the late 1990s, while financial institutions assumed a similarly dominant position leading into the Global Financial Crisis.

What is notable in hindsight is that many of these businesses did not fail. Many remained important enterprises long after their period of market leadership had passed.

What changed were expectations. Investment outcomes are determined not simply by the quality of a business, but by the relationship between business performance and the expectations embedded in its valuation. Exceptional businesses can become disappointing investments if expectations become sufficiently demanding, while businesses receiving far less attention can often produce attractive long-term returns if expectations remain modest and execution remains strong.

This distinction becomes increasingly important in a market environment where index representation is frequently interpreted as a measure of business quality, resilience, or long-term durability. In reality, index weight measures market value and investor preference at a specific moment in time. It does not directly measure balance sheet strength, capital allocation discipline, shareholder alignment, competitive longevity, or the ability of a business to continue compounding value across multiple economic environments.

Markets are extraordinarily efficient mechanisms for measuring popularity. They are not always equally effective at measuring resilience. This is where consensus itself can become a source of risk.

The challenge with crowded trades is not that they must inevitably reverse, nor that market leadership cannot persist for extended periods of time. History suggests both are entirely possible. The challenge is that when ownership becomes concentrated around a narrow group of businesses, industries, or assumptions, portfolios become much less diversified than they appear on the surface.

Investors may own many securities, yet remain heavily dependent upon a relatively small number of economic outcomes. In those environments, changes in sentiment can produce higher correlations, diminished diversification benefits, and greater volatility precisely when investors expected the opposite. The issue is not necessarily the quality of the underlying businesses. Rather, it is the fragility that can develop when large numbers of investors come to rely upon the same assumptions regarding growth, profitability, valuation, or future market leadership.

None of this should be interpreted as a forecast. Forecasting market turning points has historically proven to be one of the least reliable activities in our profession. It is instead an argument for humility.

The future has consistently demonstrated an ability to surprise investors. Few anticipated the inflationary surge that followed the pandemic, the speed and magnitude of the subsequent interest rate cycle, or the extraordinary concentration of market returns that has characterized recent years. The next surprise will almost certainly differ from the last one, as it always has.

For that reason, we continue to believe that portfolio construction should not rely upon a narrow range of economic outcomes, a single investment narrative, or an unusually concentrated set of return drivers. Diversification across businesses, industries, and sources of return remains one of the few forms of risk management that does not depend upon accurate forecasts.

Periods of market concentration have occurred throughout financial history, and they will almost certainly occur again in the future. Some persist far longer than investors expect, while others unwind more quickly than consensus believed possible.

Our objective is not to predict when leadership will change, but to ensure portfolios remain durable across a range of economic cycles and market conditions.

It is a sincere privilege serving those that have entrusted us with their capital.

Respectfully,

Cameron K Martin
Chief Investment Officer
Martin Capital Partners, LLC

Statistical and analytical data provided by FactSet.
If you would like additional information on how Martin Capital Partners, LLC conducts business, we can provide a copy of our SEC Form ADV part II, firm brochure.

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