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MONEY FOR LIFE

The Enduring Engine of Progress: Why Market Rotation May Be a Passive Investor's Ally

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For Financial Advisers Only

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The Enduring Engine of Progress: Why Market Rotation May Be a Passive Investor's Ally

An analysis of the current global market reveals the concerning concentration of market value within a small group of U.S. technology companies. This cohort, often referred to as the "Magnificent Seven," includes titans such as Alphabet, Apple, Amazon, Microsoft, Meta Platforms, NVIDIA, and Tesla (though some might swap in Broadcom for those who find Tesla's valuation hard to justify). The scale of this dominance is historically significant. As of Q3 2025, these seven firms alone accounted for approximately one-third of the entire market value of the S&P 500 Index.[1] Their influence extends globally, constituting more than 20% of the MSCI World Index's total market capitalisation.[3] This level of concentration is prompting valid questions and concerns among investors about portfolio diversification and risk.

However, while the specific companies are new, the phenomenon of market concentration is not. It is a recurring feature of dynamic economies. The anxieties surrounding today's tech giants echo the concerns investors felt at the peak of the dot-com bubble in 2000, when a different set of tech giants dominated the indices, or even during prior eras when industrial conglomerates and energy supermajors were the market leaders.[4]

This report seeks to demonstrate that for the disciplined, long-term passive investor, such concentration is not an unmanageable flaw given the self-correcting mechanism inherent in market tracking indices and portfolios. This unseen force, market rotation, is the engine that drives progress. It systematically manages the decline of yesterday's leaders and the rise of tomorrow's innovators, ensuring that a passive portfolio remains aligned with the direction of growth.

How Market-Cap Weighting Drives Automatic Rebalancing

At the heart of passive portfolios, including Timeline's, lies the powerful mechanics of the market-capitalisation-weighted index. For example, an index like the S&P 500, which represents approximately 80% of the U.S. stock market's value, allocates weight to its constituent companies based on their total tradeable market value, or known as "free-float market capitalisation". Therefore the larger and more valuable a company becomes, the greater its representation and influence on the index's performance. In contrast, as a company's market value shrinks, its influence on the index automatically diminishes.

The mechanism creates a dynamic and unemotional system of capital allocation that functions as a self-correcting force. The index does not attempt to predict which companies will succeed or fail; it simply reflects the collective, real-time judgment of millions of market participants. When a company innovates successfully and its profits grow, investors bid up its stock price. As its market capitalisation swells, its weighting in the index increases, effectively allocating more of an investor's capital to that winner. On the other hand, if a company falters, becoming obsolete, its falling market capitalisation leads to a reduced weighting in the index. This process embodies the principle of "creative destruction", coined by economist Joseph Schumpeter, to describe how capital is constantly being reallocated from declining enterprises to rising ones. [5]

This built-in discipline may provide an advantage. An active fund manager faces the dual challenge of correctly identifying when to sell a declining leader and when to buy an emerging one, two decisions fraught with potential for bias and error. Any market-cap-weighted index, by its very design, executes this rebalancing act. It is not a static portfolio but a dynamic one that automatically "sells" losers by reducing their weight and "buys" more

of the winners by increasing theirs, harnessing the market's evolutionary power.

Market Leadership Then and Now

To understand the power of market rotation, one might look back to the dot-com bubble in the late 1990s, which lasted until the year 2000. It was a period of intense market concentration that mirrors the present day. Fuelled by a rapid rise in valuation over the preceding decade, technology stocks had swelled to represent over 30% of the S&P 500's total value.[6] By early 2000 and shortly before the correction, the top ten companies commanded around 27% of the index at the peak.[7] Though today's market has pushed this to a greater extreme. As of August 2025, the top ten companies represent over 35% of the S&P 500's value. Despite the greater scale of concentration today, the dot-com era provides an interesting case study of what happens when a highly valued, concentrated group of market leaders begins to falter, and how the market's self-correcting mechanism of rotation works.

The identities of the market leaders at that time paint a picture of a dramatically different economic landscape. A direct comparison of the top S&P 500 constituents from the end of 1999 to the present day provides a stark illustration of the relentless turnover at the apex of the market.

Table 1: The S&P 500's Shifting Titans (December/1999 vs. September/2025)[8]

Rank	Company (1999)	S&P 500 Weight (%)	Sector	Company (2025)	S&P 500 Weight (%)	Sector
1	Microsoft	4.9	Information Technology	Nvidia	7.1	Semiconductors
2	Cisco	2.9	Information Technology	Microsoft	6.4	Information Technology
3	Walmart	2.5	Consumer Staples	Apple Inc.	6.1	Information Technology
4	General Electric	2.5	Energy	Amazon	4.3	Consumer Discretionary
5	Exxon Mobil	2.3	Energy	Meta	3.3	Communication Services
6	Intel	2.2	Semiconductors	Broadcom	2.8	Semiconductors
7	Citigroup	1.6	Financials	Alphabet (Class A)	2.6	Information Technology
8	IBM	1.5	Information Technology	Alphabet (Class C)	2.4	Information Technology
9	Home Depot	1.3	Consumer Staples	Tesla	2.0	Automotive
10	Oracle	1.3	Information Technology	Berkshire Hathaway	1.8	Financials

Of the ten largest companies during the height of the dot-com bubble, only Microsoft remains today. The others have experienced a dramatic reordering. Industrial conglomerate General Electric, once the most valuable company, fell out of the top 20 place by 2009 and was split into three separate businesses in 2024. Cisco Systems, also temporarily the world's most valuable business, now holds a weight of less than 0.5% on the S&P 500. And there are many more examples, which all document fundamental economic paradigm shifts. The prior list represented a diversified cross-section of the 20th-century economy: industrial manufacturing (GE), energy (Exxon Mobil), finance (Citigroup), and the foundational hardware of the PC era (Intel). Today's list is dominated by companies whose value is derived from intangible assets: data, software, and network effects.

What is remarkable is that the passive index investor automatically participated in this historic transition. By investing in a market-tracking portfolio, one reallocates capital from the old guard to the new engines of growth without needing to be an expert on cloud computing or artificial intelligence.

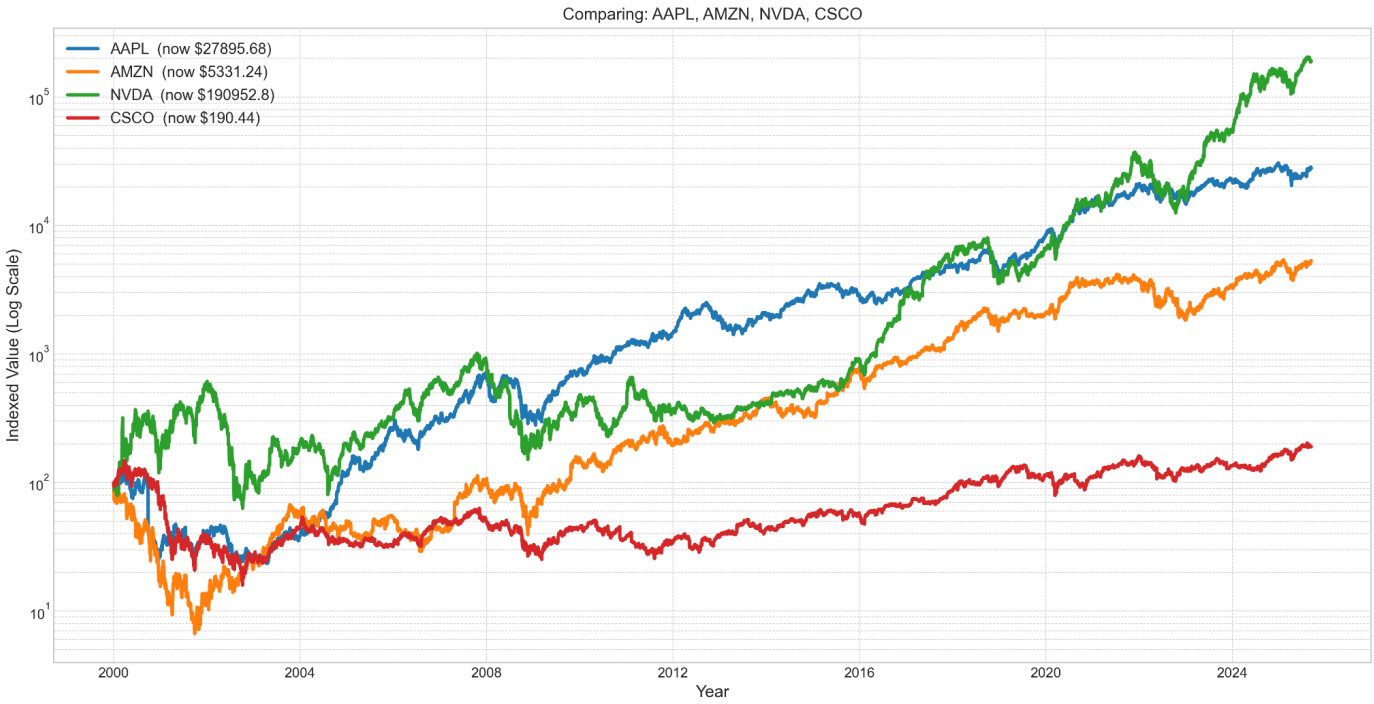
We can take a closer look at how a passive investment approach manages risk. In the 1990s, as the premier provider of networking equipment that formed the backbone of the internet, Cisco experienced a meteoric rise. In March 2000, it briefly surpassed Microsoft to become the world's most valuable company, boasting a market capitalisation that exceeded $500 billion. Its weight in the S&P 500 swelled to 4.3%, making it the index's single largest

component at one point.[9] When the bubble burst, the consequences were severe. Cisco's share price plummeted 88%, collapsing from a peak near $80 to below $9 just two years later. The company actually survived until this day and continues to grow. But its stock has never since returned to its 2000 high.

The important question: did the collapse of such a top holding, along with numerous other companies like GE, Yahoo,[11] and IBM, destroy the prospect of positive returns for index investors in the following years?

For a passive investor, the market-cap mechanism acted as an automatic shock absorber. As Cisco's market value cratered, its weight in equity indices automatically shrank. This implicitly "divested" capital was gradually reallocated across hundreds of other companies within the U.S economy. Among them were the next generation of innovators; firms like Amazon, Apple, Google, and Nvidia, whose own rising market values grabbed a greater share of the index. The long-term result: despite the failure of yesterday's leaders, the U.S equity market recovered and climbed to unimaginable new highs, powered by a very different set of holdings. This is illustrated by the graphs below.

Chart 1: Value of $100 Invested in Apple, Amazon, Nvidia vs. Cisco (03-01-2000 to 09-09-2025) (Log Scale)



Source: Yahoo Finance

Chart 2: S&P 500 Index Value (03-01-2000 to 09-09-2025)

Source: Yahoo Finance

Navigating Crisis

Investors might wonder whether an alternative approach to index investing, such as active fund management, could have helped tactically navigate such periods of creative destruction. A common argument for active management is that skilled managers can protect capital in a downturn by selling leaders before they fall and buying the next winners before they rise. The more recent 2008 Global Financial Crisis (GFC) and its aftermath provide a case study to test this claim.

The Standard & Poor's Indices Versus Active Funds (SPIVA®) Scorecard is a semi-annual report that compares the performance of actively managed mutual funds against their relevant benchmark indices. An analysis of the SPIVA Scorecard from year-end 2010 reveals the challenge active managers faced. For the three-year period ending in 2010, the report shows that 51.7%, more than half of actively managed US equity funds, were outperformed by their benchmark. If we extend the analysis to a 5-year period, a timeframe that captures the entire GFC, 57.7% of all U.S. domestic equity funds were outperformed by their benchmark. The figure for large-cap funds was even more stark, with nearly 62% failing to beat the S&P 500.

Crucially, these figures are corrected for survivorship bias, which occurs when failed funds are excluded from performance studies. The SPIVA data shows that active fund failure was a significant risk during this period, as shown in the table below.

Table 3: U.S. Domestic Active Fund Performance During the GFC (3 and 5-Year Period Ending Dec. 31, 2010)

Metric	All Domestic Funds	All Large-Cap Funds
% Outperformed by Benchmark 2007-2010	51.7%	57.7%
% Outperformed by Benchmark 2005-2010	57.6%	61.8%
% Merged or Liquidated 2005-2010	24.4%	27.1%

Source: S&P SPIVA Year-End 2010 Report. Liquidation rate is calculated as 100% minus the survivorship rate.[14]

Over the five years covering the crisis, nearly a quarter of all domestic US equity funds were merged or liquidated. An investor at the start of the period had a one-in-four chance that their chosen active fund would not even exist five years later. This evidence suggests that even during a historic market rotation, the approach of active management proved, for the majority, less effective than the disciplined, unemotional mechanism of a passive index investing.

This trend was not only observed for US funds; the challenges for active managers during the crisis were a global phenomenon. The SPIVA data for global funds shows that over the same five-year period ending in 2010, 60.2% of global active funds underperformed their benchmark. And international equity funds, which also invest globally but exclude the US market, experienced an even more pronounced pattern of underperformance as a staggering 81.7% of active international funds failed to beat their benchmark. The story was similar for funds focusing on developing economies, where 89.6% of emerging markets funds lagged their index. Furthermore, survivorship was a significant issue globally, with around one-fifth of all international and global funds being merged or liquidated during that timeframe.

Metric	Global Funds	International Funds	Emerging Market Funds
% Outperformed by Benchmark 2005-2010	60.2%	81.7%	89.6%
% Merged or Liquidated 2005-2010	18.4%	21.0%	10.5%

Source: S&P SPIVA Year-End 2010 Report.

The evidence is consistent across both U.S. and international markets; a majority of active funds failed to outperform their passive benchmarks from 2005 to 2010. This underperformance was compounded by the substantial risk of fund closure, leaving investors exposed to a dual threat of lagging returns and portfolio disruption. The disciplined, unemotional mechanism of a passive, market-cap-weighted index proved to be a more reliable and resilient strategy for long-term investors during this particular period of intense financial stress.

Beyond Borders

The principle of market rotation is not confined to the technology sector or to U.S. markets; it is a universal force that reshapes entire industries and global economies.

Perhaps the most dramatic example of rotation occurred on the global stage with the rise and fall of the Japanese stock market. At its peak at the end of 1989, Japan's economy was an industrial powerhouse, and its equity market accounted for an astonishing 44% of the MSCI All-Country World Index (ACWI). The United States, by contrast, made up only about 30%.[12] Following the bursting of its massive asset price bubble in 1991 and 1992, Japan entered a multi-decade period of economic stagnation often referred to as its "lost decades." In 1989, of the world's top ten largest companies by market cap, eight of them were Japanese. Now, none of them are.

For a global investor, predicting this seismic shift would have been difficult. Yet, a passive investor holding global market-cap-weighted index funds navigated it naturally. As the market capitalisation of Japanese companies stagnated relative to the rest of the world, their weight in the index systematically declined. Simultaneously, as U.S. companies grew, their weight increased. The result was a complete reversal of the global order.

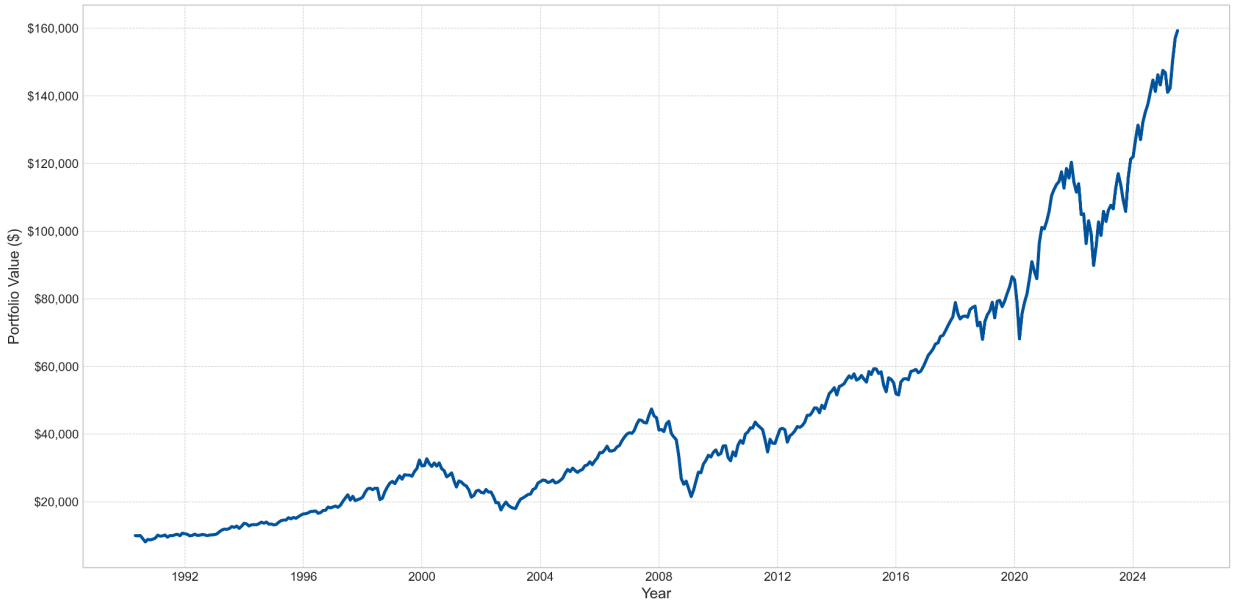
Table 2: Global Power Shift - MSCI ACWI Country Weights (December 1989 vs. August 2025)

Country/Region	Approximate Index Weight (1989)	Index Weight (Current)
Japan	≈44%	4.9%
United States	≈30%	64.6%

Sources: Historical data and current MSCI factsheets[14]

Again, one might assume that the prolonged slump of the once massive Japanese market throughout the 1990s and 2000s would have crippled a global investment portfolio for extended periods of time. However, the data reveals a story of resilience. An initial $10,000 investment in the MSCI ACWI at its May 1990 launch would have more than tripled to $33,136 by May 2010, and continued to grow to reach $159,282 by August 2025, weathering not only the burst of Japan's bubble, the dot-com bubble, but also more recently the aftermath of the global financial crisis.

Chart 3: Value of $10,000 Invested in MSCI ACWI Index (May-1990 to July-2025)



Source: Curvo[15]

The collective growth of the global market was only possible because, as Japan was declining, other markets rotated and developed to become the new engines of growth. This included not only the U.S but also members of the emerging markets, such as China, South Korea, and India. This reallocation of capital highlights how passive investing in a market-tracking portfolio requires no complex forecasts about which country will lead in the next cycle. Market indices automatically shift capital toward nations with growing and dynamic public companies and away from those that are stagnating. By holding one's investment, an investor benefits from the collective wisdom of the global marketplace to adapt to significant long-term economic trends.

Conclusion: The Patient Investor's Ally

The evidence from market history is clear and consistent. The fall of dot-com era giants and the dramatic global economic shift away from Japan were not catastrophic events for disciplined, passive investors. In each case, a capitalisation-weighted market portfolio would perform its function. It unemotionally reduced exposure to fading leaders while simultaneously reallocating capital to emerging ones. This is not to deny that rotation would very likely produce pain in the near term, especially given the highly interconnected world we live in today and how crises can easily spread across markets. But even in a scenario where the U.S tech giants actually start to falter, just as Japanese companies once did, other firms and markets may rotate to deliver the next round of growth.

The high market concentration we observe today is a snapshot in the long, dynamic story of the market. The concern it generates is very understandable, but history shows that even though market leadership can be fleeting, the forces of competition and innovation are relentless. The true "magnificence" for a long-term investor lies not in any single group of stocks, but in the enduring, self-correcting engine of the market itself.

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