

When Success Becomes Risk: The Perils of Concentration Creep

One of Modern Portfolio Theory’s most groundbreaking insights reveals that diversification can reduce portfolio risk without sacrificing expected returns – what Nobel laureate Harry Markowitz famously termed the only “free lunch” in investing. Yet human nature consistently undermines this principle through a phenomenon we encounter regularly in our practice: the difficulty of selling a winner.

Like a gardener who hesitates to prune a flourishing rose bush, investors often allow their best performers to grow unchecked, transforming a carefully constructed portfolio into something quite different – and considerably riskier – than originally intended. As those assets appreciate relative to others, they naturally claim an increasingly larger percentage of the total portfolio, embedding concentration risk where diversification once provided protection. This “concentration creep” represents one of the most insidious threats to long-term investment success.

Different Paths to Concentration

Stock pickers fall into this trap most often. Losses are easy to sell; winners are not. The better an investment performs, the more emotionally difficult it becomes to reduce exposure. Eventually, their portfolios become collections of can’t sell positions – assets that dominate risk not because of analysis, but because of inertia and embedded taxes. The issue is rarely a lack of intelligence or effort, rather, it is the absence of a disciplined process that removes emotion from decisions.

Not even index funds are immune. Considered the granddaddy of passive investing and an antidote to concentration risk, they carry their own vulnerabilities. Market-cap-weighted indexes naturally allocate more capital to the stocks that have appreciated the most. In effect, they re-balance in the opposite direction of discipline. 10 companies make up roughly 40% of the S&P 500 today meaning only a small handful of the 500 companies the index holds drive it’s return... and risk. This is not a flaw; it’s how the index is designed. But it means index funds often look diversified on the surface while being heavily concentrated underneath. True diversification considers how assets behave relative to one another, not simply how many there are.

Asset class investing addresses this directly. Instead of overemphasizing individual stocks or letting a cap-weighted index do the concentrating for you, it allocates across broad categories of investments that don’t move in lockstep. No single asset class outperforms forever; they rotate. Periods of strength plant the seeds of future weakness as valuations rise and expectations peak. An asset class approach makes that drift visible and gives a framework to act on it before the rotation arrives.

Lessons From the Market

• Nifty Fifty (1960’s)	A group of large, high-quality U.S. growth stocks dominated portfolios in the 1960s. These companies were widely believed to be “one-decision” stocks that could be bought at any price and held forever. During the 1970s, many of these stocks experienced severe draw downs and long periods of under performance, even when the businesses themselves remained sound. Even “best-in-class” companies can deliver poor long-term returns when bought after prolonged out-performance and valuation expansion.
• Japanese Equities (1970’s)	Japanese stocks were among the best-performing equity markets globally for decades leading up to 1989. By the late 1980s, Japan represented over one-third of global equity market capitalization and was widely viewed as an unstoppable economic model. Valuations became extreme. After peaking in December 1989, the Nikkei entered one of the longest bear markets in modern history taking roughly 34 years to recover. An investor who was 40 years old at the peak would have been 74 before breaking even in nominal terms. The fundamentals had been real. The conviction had been justified. The concentration was still devastating.

• Technology Stocks (1990's)	Technology stocks consumed an ever-larger share of cap-weighted indexes. Then the bubble burst. When leadership finally rotated, the Nasdaq fell nearly 80%. The S&P 500 entered what became known as "The Lost Decade." Meanwhile, asset classes that had been unfashionable for years (small value, international) quietly delivered strong returns. The damage was concentrated among investors who had let their portfolios drift toward what had worked most recently.
• U.S. Large Growth (2020's)	The same pattern may be unfolding now. U.S. large-cap growth has dominated for over a decade. Whether 2025 marked the beginning of another rotation remains to be seen. But the structural question is the same one it has always been: is your portfolio positioned for what comes next, or anchored to what just happened?

The Discipline that Prepares You

Total market crashes are rare. What most often happens is a rotation of asset class leadership. The challenge isn't predicting when that rotation will come, it's making sure your portfolio isn't unintentionally positioned on the wrong side of it when it does.

Systematic re-balancing is the answer. It's not a forecast. It's a discipline that trims what has grown dominant, reinforces what has lagged, and restores the structure a portfolio was designed to have. Done consistently, it preserves diversification and quietly adheres to the one principle every investor believes in but few practice: buying low and selling high. Not emotionally. Mechanically.

As Harry Markowitz once observed,

“

The chief mistake of the small investor is buying when the market goes up on the assumption it will continue, and selling when the market goes down on the assumption it will fall further.

”

If you're reading this as a client, your portfolio already reflects this discipline. We rebalanced systematically, and we don't let winners drift into concentration. That's the work.

But if you know someone who has watched a single stock or sector grow to dominate their portfolio, someone whose confidence feels strongest precisely where their risk is highest, we'd welcome the conversation. The greatest value an advisor provides isn't forecasting markets. It's holding the line when your emotions are telling you not to.



Written By

Lachlan MacLean Jr.
Vice President, Financial Advisor

There is no guarantee that asset allocation or diversification will enhance overall returns, outperform a non-diversified portfolio, nor ensure a profit or protect against a loss. Investing involves risk, including possible loss of principal.

This information is not intended as a recommendation. The opinions are subject to change at any time and no forecasts can be guaranteed. Investment decisions should always be made based on an investor's specific circumstances. Investing involves risk, including possible loss of principal.