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Asset Allocation
Chart of the Month

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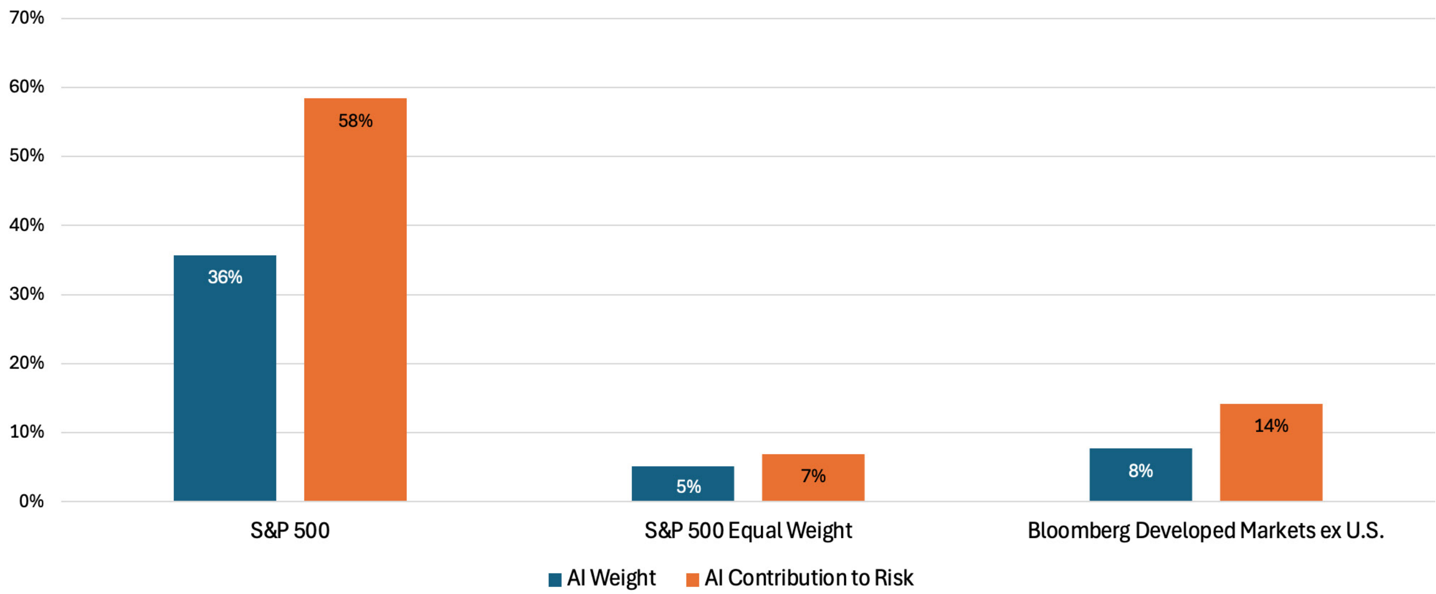
Beware of Hidden AI Concentration

- **AI is simultaneously supporting economic growth and corporate earnings while becoming a key driver of market returns.** Its influence now extends well beyond Technology into Industrials, Utilities, Real Estate, and other businesses benefiting from the infrastructure buildout. As a result, companies in seemingly different sectors and industries may increasingly depend on the same underlying driver: continued AI investment.
- **We remain constructive on the S&P 500.** Earnings are strong, estimates are being revised higher, and AI investment remains robust. But those same forces have left the index increasingly dependent on the AI cycle. Bloomberg estimates that companies with significant AI exposure represent roughly 36% of the S&P 500 but contribute 58% of its overall risk. By comparison, AI-related companies account for less than 8% of developed ex-U.S. equities and about 14% of risk.
- That creates a form of concentration that traditional sector labels can miss. **The important question isn’t how many stocks or sectors you own, but what your portfolio ultimately depends on.** If a slowdown in AI investment would affect an increasingly large share of the portfolio at the same time, diversification may be less robust than it appears. The issue is simply that the consequences of being wrong about AI are growing as more of the portfolio becomes connected to it.
- **Some investors may question the need for diversification after years of U.S. large cap outperformance.** But diversification isn't designed to outperform the market's best-performing asset. If we knew the winner in advance, there would be little reason to diversify. Its purpose is to reduce dependence on any single outcome, particularly after years of strong performance have increased that exposure.
- **Investors don't have to abandon what has worked to improve diversification.** International equities offer exposure to AI beneficiaries while relying less heavily on the AI theme, while small and mid cap equities provide access to a broader set of earnings drivers that are less represented in the S&P 500. **The objective is not necessarily to own less U.S. large cap, but to complement it with what is different.**

AI Risk Exposure



Source: Bloomberg Intelligence. As of July 2026. AI contribution to risk estimates how much AI-related companies contribute to the overall volatility of an index. It considers not only how much of the index they represent, but also how volatile they are and how closely they move with other stocks.

Word About Risk

Fixed-income securities can experience reduced liquidity during certain market events, lose their value as interest rates rise and are subject to credit risk which is the risk of deterioration in the financial condition of an issuer and/ or general economic conditions that can cause the issuer to not make timely payments of principal and interest also causing the securities to decline in value and an investor can lose principal. When interest rates rise, the price of debt securities generally falls. Longer term securities are generally more volatile. Investment grade debt securities may be downgraded by a Nationally Recognized Statistical Rating Organization to below investment grade status. Non-investment grade debt securities are considered speculative with respect to the issuers' ability to make timely payments of interest and principal, may lack liquidity and has had more frequent and larger price changes than other debt securities. Equities are subject to market volatility and loss. Growth stocks may be more volatile than investing in other stocks and may underperform when value investing is in favor. Value stocks may not appreciate in value as anticipated or may experience a decline in value. Stocks of large-cap companies may be unable to respond quickly to new competitive challenges. Stocks of small- and mid-cap companies may be subject to more erratic market movements than stocks of larger, more established companies. Investments in foreign, and emerging market securities carry the associated risks of economic and political instability, market liquidity, currency volatility and accounting standards that differ from those of U.S. markets and may offer less protection to investors. The risks associated with investing in foreign markets are magnified in emerging markets, due to their smaller and less developed economies.

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The indexes mentioned are unmanaged statistical composites of stock or bond market performance. Investing in an index is not possible.

For Index Definitions see: TouchstoneInvestments.com/insights/investment-terms-and-index-definitions

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