Level Set - How To Beat the S&P500 - The Q&A that Matter

We have written and researched various aspects of portfolio strategy and theory for years. There are basic questions every portfolio manager needs to answer both for today, and conceptually for how they think about investing over a 10-year period.

1. What's the right beta for your portfolio?
2. How many stocks / how much of your total fund's exposure do you own for alpha vs. risk management?
3. How much diversification or concentration should you have?
4. How do you think about position sizing?
5. What's your strategy for blow-up avoidance / downside mitigation?
6. What set of macro conditions are best for your portfolio performance?

Many long-only institutional portfolio managers compare their performance to the S&P500. However, many of these investors have very disparate rules by which they must operate. Some have legal, regulatory, or other "internal" constraints which dictate how they answer the above questions. In recent years, depending on the specific risk constraints, some of these limitations have evolved from mere burdens to partial justifications for recent underperformance, and ultimately to major factors behind substantial underperformance. In today's work we address how to best run a portfolio in this environment, and how we would answer the above questions. Importantly, we have CHANGED OUR MIND on a few of our answers.

QUESTION 1: What's the "right" beta for your portfolio? We showed in three written pieces of research earlier in 2025 that the alpha destruction from high-beta securities is so large, that over a long-period of time, a long-only S&P500 bench-marked portfolio manager should have a total book with a beta less than 1.0, in the .95-1.0 range. We also showed that growth portfolio managers are better off distributing these betas in extreme deciles, i.e., to achieve their .95 beta portfolio they should own stocks with extreme betas, to comprise this portfolio average. But in last week's Level Set, we pointed out that the Great 8 stocks are 41% of the S&P00 by market cap., and 55% on a beta-adjusted basis (see below). NVDA, TSLA, AVGO, AMZN, and META all have betas well above 1.0. We also concluded that investors are best off being close to market-weight this group, as the ability to consistently generate performance among these names is very challenging.

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Attributes of Largest 8 Stocks Market Cap. and Beta As of End-October, 2025 Ticker	Market Cap. ($US Bil.)	Percent of S&P500 Market	Beta	Beta- Adjusted Size
NVDA	4,921	8.6%	1.59	13.6%
AAPL	3,995	7.0%	1.22	8.5%
MSFT	3,849	6.7%	0.95	6.4%
GOOGL	3,397	5.9%	1.05	6.2%
AMZN	2,611	4.5%	1.37	6.2%
AVGO	1,746	3.0%	1.64	5.0%
META	1,635	2.8%	1.34	3.8%
TSLA	1,518	2.6%	2.00	5.3%
Great 8 Total	23,672	41.2%	1.33	55.0%
S&P500	57,430	100%	1.00	100%

Source: Trivariate Research, LP

This week, we realized perhaps our suggestions are just incongruous. If one follows our advice and is market-weight the Great 8, at 41.2% of the S&P500 at 1.33 combined total beta, that means 55% of their total beta-adjusted portfolio is in those names. If the goal is to manage an S&P500 portfolio with a total beta between 0.95 and 1.0, say 0.975, then in order to get the total portfolio to have this beta, the rest of the portfolio would have to have an exposure-weighted beta of 0.73 (see below).

S&P500 Theoretical Beta Exposures As of End-October, 2025 *Stocks*	*Raw Exposure*	*Beta*	*Beta-Adjusted Exposure*
Great 8	*41.2%*	*1.33*	*0.55*
Rest of Portfolio	*58.8%*	*0.73*	*0.43*
Total Portfolio	*100.0%*		*0.975*

Source: Trivariate Research, LP

Today, about 30% of the mega/large cap. universe, or 126 stocks, has a beta below 0.73 (see below). If a portfolio manager runs a diversified fund of nearly 100 stocks, they will be forced to own a lot of the low beta universe or a few ENORMOUS positions in low beta stocks, in order to make the math work at the portfolio level. Given how large the Great 8 are, and how the aggregate group runs with a beta greater than 1, we think it will be really challenging to get a portfolio with a beta below 1 in today's environment. The constitution of this low beta universe is wildly different from the broader market. The S&P500 is 32% Technology. The universe of stocks with below 0.73 beta has only TWO Technology stocks, amounting to $113 Billion market cap. Meantime, the low beta universe is loaded with Healthcare and Consumer Staples. In part, this is why we like Healthcare the most for portfolio diversification.

Distribution of Stocks with Less than 0.73 Beta Mega-/Large-Cap. Universe As of November 6th, 2025 Sector	Market Cap,	Percent	Stocks
Communication Services	664,658.03	4.2%	6
Consumer Discretionary	1,131,462.17	7.2%	9
Consumer Staples	2,761,325.38	17.6%	15
Energy	1,024,190.25	6.5%	6
Financials	2,272,409.47	14.5%	15
Healthcare	4,319,402.31	27.5%	27
Industrials	1,423,418.99	9.1%	17
Technology	112,649.23	0.7%	2
Materials	692,660.69	4.4%	9
Real Estate	466,017.23	3.0%	7
Utilities	828,632.66	5.3%	13
Total	15,696,826.41	100.0%	126

Source: Trivariate Research, LP

QUESTION 1 CONCLUSION: While the long-term data show you want to run a portfolio with a beta below 1, we think that is nearly impossible today with an S&P500 mandate. The Great 8 are too big and too high beta, so the risk of being very underweight this group seems imprudent in our judgment. **Hence, the portfolio beta will need to be above 1 and toward the upper end of the range that a manager runs with over a long career.**

QUESTION 2: How many stocks / how much of your total fund's exposure do you own for alpha vs. risk management? Years ago, most portfolio managers would have said they own 100% of their book for alpha, and zero for risk management. However, a long-only portfolio manager benchmarked against the S&P500 in today's environment would likely admit they own a reasonable amount of their book for risk purposes. After all, the S&P500, as we have written several times, is essentially an AI index. We think market-weight the Great 8 for risk purposes is sensible. Many stocks, like Palantir (PLTR) seem difficult to value on fundamentals for the foreseeable future. This means owning it in market-weight, for risk purposes, is likely sensible. Why let something un-analyzable hurt or help you? Mid-frequency valuation-neutral quant. and fundamental money, and retail flows, can make fundamentals less relevant for a longer period today than in the past, or so it seems.

QUESTION 2 CONCLUSION: Our view is that the answer to this above question is probably "the most in my career." Our best guess, is that a long-only S&P500 portfolio should probably have 75% of its total market cap. for risk purposes. To be a bit harsh, if you are one of those portfolio managers who think 100% of our stocks are for alpha, and none for risk management, there is no way you can truly view your benchmark as the S&P500. Obviously, for those with no benchmark, hedge funds, etc., the answer is quite different, but for long-only, S&P500 benchmark-focused portfolio managers, **ou**r advice is do not tell your allocators you own 100% of your stocks for alpha. But in terms of name of names, this ties into our 3rd question:

QUESTION 3: How much diversification or concentration should you have? Investors have various mandates, requirements, strategies and approaches when it comes to how many names to own in their portfolios. Some believe in sector-based diversification. We do not, given the constitution of the S&P500, and how themes run through sectors. There are some very well-known and extremely concentrated funds like Pershing Square and TCI (The Children's Investment Fund Management), and others that are extremely diversified such that they own in some fashion nearly every stock in the S&P500. Much of the answer to this can be explained by how firms raised their assets, and what they communicate to their Limited Partners. Some, use judgment based on data, some say they use "feel and experience." But, addressing the bulk of long-only managers with diversified portfolios, we would say the range of investors we talk to and analyze portfolios for with our custom risk process indicate the range here is 30 to 110 names. A relatively concentrated fund is around 50 stocks, a diversified one more than 90. Of course, the total assets can matter some here, as a long-only manager of a $100 billion in a fund likely bumps up against far more mandates on the amount of any individual stock they can own, whether they want to file a Form 13-D or 13-G, and other considerations.

QUESTION 3 CONCLUSION: We think the answer today is to run an extremely concentrated fund AND a very diversified risk-managed fund simultaneously. Huh? What we mean is, we think a long-only portfolio manager should think about running two portfolios separately to equal the one total. We recommend that the total portfolio should have a high number of stocks vs. history, i.e., **very diversified.** If you think over a 10-year period you will run your fund between 60-80 names, we think you should be at 80 today! Meaning, push this to the outer limits of what you previously would have found acceptable. Be EXTREMELY DIVERSIFIED. Why? Because we think owning as many stocks as possible for risk management is prudent (our answer to question 2). Because of that, let's say we own the Great 8 in market-weight, plus 52 other stocks for risk management, then we hold 60 stocks, and probably 75% of our exposure for risk reasons. That's our "first portfolio." That leaves us with owning 20 stocks, preferably in big positions relative to their exposures, which is our "second portfolio." **So our idea for beating the market today is to own a lot of stocks for risk management, and a few large ones for alpha. That of course is tied to our fourth question;**

QUESTION 4: How do you think about position sizing? We think if investors are good stock pickers, they should take big positions in stocks that have high company-specific risk and are hard to replicate with other stocks. That way, if they are right, they will over time separate from the index more. It's our view that investors should take big positions, in their "second" or fundamental portfolio, the stocks they own for alpha. We have our own proprietary seven-factor model for computing company-specific risk. We also see how replicable each stock is in the market, by computing the rolling daily return correlation over the last six months with each other stock in the market.

QUESTION 4 CONCLUSION: Because so much of a portfolio is owned for risk management, the stocks owned for alpha have to be very large positions. Below we show the mega-/large-cap. stocks that have high company-specific risk and are hard to replicate. Many of these stocks are in the Healthcare sector. So we first show stocks fitting the criteria that are not in Healthcare. This means if you have a big over-or-underweight in these names, like WMT or IBM, we would recommend making them BIGGER. This doesn't mean you should own them, just that if you have a fundamental view and are ultimately proven to be correct that you will separate from the index more by having huge positions vs. the index weight in these names. Meaning own either 5-6% of WMT or zero, if you have a high conviction view. Often when we analyze clients' portfolios we push on them to have larger positions in these names. We also are constantly surprised how investors are willing to have 2-3% active weights in Great 8 names, but NOT in any other name, as if active weight is somehow associated with the bench weight. It is not.

Least Replicable Mega / Large Cap. Stocks with High CSR, Ex-Healthcare
End-October, 2025

Ticker	Company	Market Cap. (US$ Bil.)
WMT	Walmart Inc.	806.69
PLTR	Palantir Technologies Inc.	475.58
IBM	International Business Machines	287.35
TMUS	T-Mobile US, Inc.	234.94
PM	Philip Morris International Inc.	224.67
MELI	MercadoLibre, Inc.	117.99
LMT	Lockheed Martin Corporation	113.82
CME	CME Group Inc.	95.74
SBUX	Starbucks Corporation	91.94
RBLX	Roblox Corporation	79.82
NU	Nu Holdings Ltd.	77.85
MSTR	Strategy Inc	77.38
MNST	Monster Beverage Corporation	65.25
CPNG	Coupang, Inc.	58.28
AXON	Axon Enterprise, Inc.	57.48
EA	Electronic Arts Inc.	49.88
TTWO	Take-Two Interactive Software, Inc.	47.29
KR	The Kroger Co.	42.17
CMG	Chipotle Mexican Grill, Inc.	41.90
EBAY	eBay Inc.	37.16

Source: Trivariate Research, LP

There are also several mega-/large-cap. Healthcare companies with high company-specific risk that are hard to replicate. Those are shown below and include LLY, UNH, and GILD, among others. (NOTE: For those interested in SMID cap. names, don’t hesitate to reach out).

Mega / Large Cap. Healthcare
Least Replicable Stocks with High CSR
End-October, 2025

Ticker	Company	Market Cap. (US$ Bil.)
LLY	*Eli Lilly and Company*	*772.59*
UNH	*UnitedHealth Group Incorporated*	*309.40*
GILD	*Gilead Sciences, Inc.*	*148.78*
HCA	*HCA Healthcare, Inc.*	*107.56*
CVS	*CVS Health Corporation*	*99.21*
COR	*Cencora, Inc.*	*65.49*
CI	*The Cigna Group*	*65.29*
ALNY	*Alnylam Pharmaceuticals, Inc.*	*60.25*
CAH	*Cardinal Health, Inc.*	*45.33*
INSM	*Insmed Incorporated*	*40.44*

Source: Trivariate Research, LP

QUESTION 5: What's your strategy for blow-up avoidance / downside mitigation? We are periodically surprised when we talk to investors that they don't view owning a stock as a risk. For those long-only managers focused on beating an index, what you don't own can help or hurt your performance just as much as what you do own, since it is a relative game. An investor mentioned to us this past week that they feel like when AI-related stocks eventually roll over that they will lose a lot of money. My answer was - "Of course you will, you are an S&P500 index long-only manager. The only question is what will your downside capture be." We spend a lot of bandwidth on blow-up avoidance, and think that this is a crucial discipline for long-only managers.

Because so much of our current portfolio strategy advice is to be market-weight names that we would ordinarily be underweight for valuation reasons, like say PLTR, we think there are a few tried and tested rules that would make us cautious on a big position.

QUESTION 5 CONCLUSION: We think blow-up avoidance is key.

Below are factors that if we saw large exposures, we would want to alert investors they are fishing in choppy waters:

- Bottom-decile of free cash flow conversion with declining free cash flow conversion
- Large increases in inventory-to-sales
- Large intangible accruals
- Most expensive decile on enterprise value-to-forecasted sales or cheapest decile on price-to-forward earnings

QUESTION 6: What set of macro conditions are best for your portfolio performance? We have periodically heard investors in the last year say that they aren't even sure what set of macro conditions would be best for their portfolios. From the risk work we do and conversations we have, our best guess is that many seem better positioned for a flat or down market where top half-quality works. A strong market rally with low-quality performance leaves lower-turnover portfolio managers way behind the index. Hence, it is useful to think about the macro landscape that best positions a portfolio manager for success.

QUESTION 6 CONCLUSION: Our recommendation of a risk-focused book combined with a concentrated set of alpha-focused investments to make a diversified above 1.0 beta portfolio relies on stock selection being accurate. Cleary, bad stock selection will hurt in this set up. But another broader macro risk we see as potentially damaging to many portfolio managers is if high-quality stocks have more downside capture during the next eventual correction than they had upside capture over the past year. As we noted recently, quality has lagged junk for more than five years now. Many investors are positioned in a way where it is hard for them to outperform in an up-tape. Hopefully risk managing the upside and downside coming from high-beta stocks combined with good stock selection in names that have high company-specific risk and are hard to replicate enables them to have 90% upside capture with less than 90% downside capture.

Important Disclosures

Analyst Certification

The analysts, Adam Parker, Maxwell Arnold, Chang Ge, Colin Cooney and Ryan McGovern, responsible for the preparation of this research report certifies that: all the views expressed in this research report accurately reflect the research analyst's personal views.

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