

Could you be more flexible?

How Opportunistic Investing Unlocks Long-Term Value

Fast Reading:

- The Brown Advisory U.S. Flexible Equity strategy employs a value philosophy to a broad spectrum of investment opportunities across both “growth” and “value” equities. Portfolio Manager Maneesh Bajaj seeks to invest in attractive businesses when the market presents them at bargain prices, enabling him to dynamically adjust the portfolio, capitalizing on market dislocations while actively managing concentration risks.
- The recent surge in equity markets, driven by a small group of mega-cap technology stocks, highlights both the risks of index concentration and the need for active management and thoughtful diversification to protect portfolios.
- Long-term value is unlocked through rigorous research, patience, and a focus on intrinsic business quality rather than short-term trends.

“The stock market is filled with individuals who know the price of everything, but the value of nothing”

Phillip Fisher

A flexible investment strategy empowers investors to adjust their portfolios in response to evolving opportunities and risks, rather than adhering to rigid allocations. Maneesh Bajaj, Portfolio Manager, emphasizes that he is not constrained by traditional style boxes, whether growth or value. Instead, he and the team seek opportunities wherever they arise, guided by a clear-eyed view of intrinsic value and long-term potential.

This flexibility allows a dynamic response to market dislocations — moments when fear, uncertainty or macroeconomic shocks cause prices to diverge from fundamentals, such as those seen in 2024 when markets were driven more by momentum and speculation and in early 2025 after the tariff-induced shock of “Liberation Day.” These dislocations, while unsettling, often present fertile ground for disciplined, long-term investors.

The State of the Market

The U.S. large-cap equity market, particularly the Russell 1000® Growth Index and S&P 500® Index, has seen exceptional performance, reaching record highs on multiple occasions over the past few years. Amid this euphoria, it would be easy to assume that all U.S. stocks have reached meteoric levels. Yet, when you drill down beyond the headlines, you find that these gains have been driven by a relatively narrow group of stocks: a combination of the “Magnificent Seven,” the top 10 largest companies, and AI-related names, many of which overlap.¹ This concentration has led to a skewed representation of the broader market, with these stocks significantly influencing index performance.

A large part of these gains was driven by the excitement surrounding the potential for artificial intelligence (AI), with the world’s biggest technology companies investing heavily in this

emerging technology. Chipmaker NVIDIA (which rallied 171.2% in 2024) saw its earnings rapidly multiply as AI relies heavily on its advanced semiconductors.²

We can’t emphasize strongly enough that it is largely impossible to predict the near-term path of the stock market. Skewing one’s portfolio heavily toward a strong bullish or strong bearish belief is speculation. We believe that investing in equities should be a balancing act, not an exercise in placing bets on one side of the scale or the other. At any given time, we need to weigh the risk and opportunity we see in the economy, in the stock market and in individual companies — all to balance the possible positive and negative outcomes of every investment we make.

Index Concentration

The dominance of the “AI trade” and the mega-cap stocks underlines the first reason why active equity strategies have been unable to match the market’s performance in recent years. It is easy to forget that when investors refer to “the market,” they are really referencing specific market indices — for U.S. large-cap core, it is the S&P 500 Index. These indices don’t actually represent the market but rather are investment products created by companies such as MSCI, S&P, FTSE Russell, etc.

These indices serve as a representative subset of a specific market by selecting a sample of relevant companies as defined by the index provider’s particular methodology. Designed to be representative of the market, the S&P 500 is widely accepted as the benchmark for U.S. large-cap equities. While it serves its purpose as a reference point, its construction methodology is mechanistic.

INDEX CONCENTRATION (%): S&P 500® INDEX

December 31, 1985 - September 30, 2025



Source: Factset, as of 09/30/2025. Data covers the 39-year period from December 1985 through September 2025 and uses the S&P 500 Index only.

The inclusion criteria, such as market capitalization (currently at least \$22.7 billion), liquidity (minimum float-adjusted liquidity ratio of 0.75), public float (at least 50%) and financial viability (positive GAAP earnings over the last four quarters and the most recent quarter), are necessary for index stability, but, in our view, they are not sufficient for discerning quality. Sector balance is considered only in aggregate terms, and constituent selection is ultimately at the discretion of an Index Committee.²

Now, we fully acknowledge the inherent bias in this critique; active managers will always challenge the limitations of passive construction. But the argument here is not rhetorical but structural, as indices rely on static thresholds, whereas active managers typically apply dynamic judgment and proprietary research. The S&P 500 Index is a useful tool for measuring market performance, but it is not a measure of business quality, nor is it a substitute for proprietary investment research.

Yet, this more rigorous analysis has been less effective in a market dominated by the AI momentum trade. At the same time, the current lack of diversification in indices can present hidden risks. Eric Gordon, CFA, portfolio manager at Brown Advisory, wrote about some of the sector trends our team is seeing in his most recent [Equity Beat: Anything But Routine](#). Of note, he shares that “fundamentally, AI data center demand shows no signs of cracking, [yet] nearly every peer we spoke with believes this theme will eventually end badly for investors.”

Diversification: Constraints and Opportunities

We believe recent market dynamics underscore the importance of a flexible approach. Market concentration has been much discussed, and even the word “bubble” has been thrown around. But had the Magnificent Seven not been included, the S&P 500 would have posted negative earnings growth in 2023. Large-cap indices have benefited immensely from the dominant leaders in software, cloud computing and AI. This momentum has delivered some strong returns, but it also introduces hidden risks for passive investors, particularly the erosion of

diversification and susceptibility to sector-specific shocks.

Defining investment success purely on performance terms can leave investors exposed to hidden and avoidable risks. The market’s high concentration of returns exemplifies such risk and underpins the qualities beyond performance that active strategies also offer: risk mitigation through diversification, less-correlated returns and the ability to provide downside protection, as well as the potential to outperform during more turbulent and down-market conditions.

While it can be tempting to focus on a few familiar investments, keeping your portfolio diversified is a simple (but not easy) way to help manage risk. Diversification also helps smooth out the ups and downs of market volatility, allowing your portfolio to stay resilient through changing conditions over the longer term.

A flexible strategy can help avoid these pitfalls by actively reallocating capital based on fundamentals rather than index weightings, enabling investors to sidestep overvalued areas and uncover mispriced opportunities across the full market spectrum.

A Framework for Finding Long-Term Value

We believe that anyone well-versed in securities valuation, as we expect all thorough investors to be, would acknowledge that both “growth” (prospects of growth) and “value” (more precisely, valuation) are essential components of the same equation in fundamental investing. Yet, investors and asset allocators often lean toward one, neglecting the other. Growth investors sometimes dismiss investment opportunities that may not be growing at a rate above a certain arbitrary threshold, regardless of the stock’s attractive price and return potential. Similarly, value investors might intentionally overlook companies experiencing rapid growth because their stock prices are trading at a multiple exceeding a self-imposed limit, ignoring the possibility that these companies could become significantly more valuable in the future.

Portfolio Manager Maneesh Bajaj's process for identifying opportunities is methodical:

- **Valuation Discipline:** Estimating a range of intrinsic value based on future cash flows and business outlook.
- **Quality Filter:** Investing only in businesses with durable economics and shareholder-friendly management.
- **Catalyst Awareness:** Understanding what might unlock value — be it a turnaround, regulatory change or strategic shift.
- **Time Arbitrage:** Being patient while others chase short-term trends.

This framework was evident in his decision to reinvest in The Charles Schwab Corporation (“Schwab”), a company our investment team knows well. Schwab faced significant headwinds during the 2023 regional banking crisis, including deposit outflows and balance sheet stress due to rising interest rates. Over time, Schwab's balance sheet has improved. While it's not fully repaired, we believe it is in a much stronger position: A significant portion of its longer-dated securities have matured, high-cost borrowings have declined, and capital ratios have improved. Our investment team's ability to monitor and dynamically react to such company-specific changes enables us to respond when opportunities present themselves.

Turning Volatility Into Long-Term Opportunity

It will come as no surprise to our long-term Flexible Equity clients that, among the top ten holdings in the portfolio a decade ago, three names — Mastercard, Visa and Berkshire Hathaway — still rank among the top ten today. These companies have been strong performers, contributing substantially to Flexible Equity returns over this extended timeframe, though not consistently every year. There have been times when these stocks meaningfully underperformed, impacting the overall performance.

The business environment for these companies has been quite dynamic, with various risks surfacing over time. For Visa and Mastercard, concerns such as regulatory changes impacting revenue, economic slowdowns (e.g., during Covid), and the potential erosion of their competitive moats by emerging fintech innovations (e.g., cryptocurrency, Buy Now Pay Later schemes) have arisen periodically during the holding period. Each time, the Flexible Equity team has revisited the investment thesis, and, so far, their decision to maintain the holdings has been based on a favorable risk/reward assessment.

Maneesh's ability to capitalize on market dislocations has also been evident in his timely investments in exceptional companies at attractive valuations. Notably, Netflix and Adobe were both added to the portfolio in 2022 during a broad market rotation away from growth stocks, demonstrating a disciplined focus on long-term value rather than short-term sentiment.

Market disruptions can also create opportunities to increase an allocation to existing holdings when valuations become compelling. A good example this year was Taiwan Semiconductor Manufacturing Company (TSM). During the market sell-off in April, TSM's share price pulled back, allowing Maneesh to increase his position. With its near monopoly in

advanced chip manufacturing and significant ongoing infrastructure investments, TSM remains a foundational player in the AI and high-performance computing revolution.

In keeping with Flexible Equity's long-term philosophy and disciplined investment approach, Maneesh deploys capital only when a company trades below the team's estimate of intrinsic value — essentially, when it represents a true bargain. He continues to uphold this discipline and will not invest in a stock simply because it is likely to go up from investors' newfound love for anything AI.

Risk Management: Avoiding Value Traps

Of course, no investments are without risk, but active managers can be more focused on risk mitigation. Maneesh emphasizes the importance of distinguishing between what is merely cheap and what is genuinely undervalued. A low price alone is not a sufficient reason to invest; there must be a clear path to value realization supported by strong fundamentals. To manage downside risk, the team relies on their continuous monitoring of each investment thesis, resulting in rigorous position sizing within the portfolio. This disciplined approach ensures that capital is deployed where the margin of safety is real, not just perceived, and that the portfolio remains skewed to the most attractive investments that offer a favorable mix of upside potential and downside risk, improving resilience of the portfolio when the market or economy falters.

Conclusion: Why Flexibility Matters

A flexible approach to investing, one that looks beyond style labels and benchmarks, offers a distinct advantage in navigating volatile and uncertain markets. By applying a disciplined value philosophy across both growth and value opportunities, we believe we can respond thoughtfully to dislocations, uncovering durable businesses that are temporarily mispriced.

In these moments, patience, discipline and flexibility become invaluable. Rather than viewing volatility as a threat, we see it as a source of opportunity — staying grounded in fundamentals, maintaining a margin of safety and approaching each investment with a long-term, business-owner mindset.

The Brown Advisory U.S. Flexible Equity team searches for investment bargains among long-term attractive businesses with shareholder-oriented managers — those with productive assets and productive managers. These businesses should have or develop competitive advantages that result in good business economics, managers who allocate capital well, capacity to adjust to changes in the world and the ability to grow business value over time. What Maneesh calls a “bargain moment” in share prices can arise for various reasons but is often due to short-term investor perceptions, temporary business challenges that will improve, company or industry changes for the better or as-yet-unrecognized potential for long-term growth and development. Despite the occasional investment that goes awry and stretches when the general stock market, or our investment selection, is unrewarding, we are optimistic about the long-term outlook for equities of good businesses at reasonable prices and our ability to find them.

1. "Magnificent Seven" (Mag 7) stocks: Alphabet, Amazon, Apple, Meta, Microsoft, NVIDIA and Tesla.
2. Source: Factset, as of 12/31/2024
3. Source: [S&P U.S. Indices Methodology](#), as of 09/30/2025.
4. Source: [Are the Magnificent 7 Still Driving the Market—or Losing Steam?](#), as of 02/20/2025.

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