

# Growth Potential of Mid Caps

An advantage of investing in mid-cap stocks is that midsized companies may still have plenty of growth potential. Mid-caps can give investors a way to gain an early position in companies that might become tomorrow's blue-chip stocks. Since growth often drives share price, it's not surprising that this asset class has done well over the years. Mid-caps historically have outperformed other asset classes since the inception of the Russell indices in 1979 (see Figure 2).[1]

Gina Martin Adams, chief equity strategist at Bloomberg Intelligence, was quoted in a Bloomberg article regarding the growth of mid-cap companies: "Earnings growth rates over time are much faster for mid-caps relative to large caps, and part of that is probably due to maturity of the businesses."[2]


Figure 1. As of 6/30/2018. Source: FactSet

* Small Cap: Russell 2000® Index
Mid Cap: Russell Midcap®Index
Large Cap: Russell 1000® Index

## ATTRACTIVE ACQUISITIONS?

Midsized companies can also become attractive targets for acquisition by larger companies. It's often easier for companies to purchase a particular innovation or product line through acquisition than it is to build that competency internally.

"Given the pace of innovation … a lot of strategics [companies involved in strategic acquisitions] have looked at the middle market as a space — without having to invest the time and resources for a build project — to buy what's necessary quickly and move on and get to what you do best," said Michael Ingrassia, senior counsel, strategic transactions at MasterCard International, on a roundtable webcast, "2018 Outlook Middle Market M&A".[3]

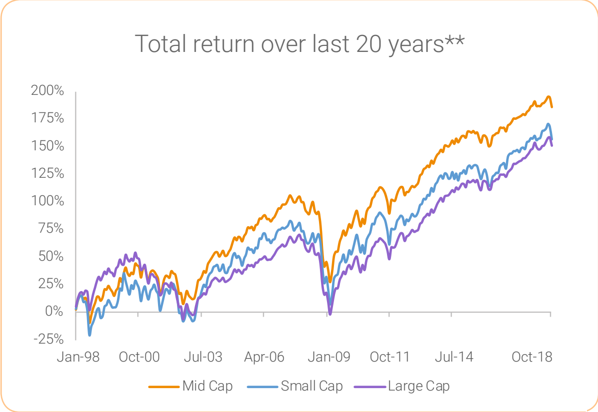


Figure 2. As of 11/19/2018. Source: Bloomberg

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Mid Cap: Russell Midcap®Index
Large Cap: Russell 1000® Index

## TAX CUTS SPUR GROWTH

Another key factor favorable for mid-cap growth has been the federal government's passage of corporate tax cuts. The tax cuts freed up cash flow that has been used for two important drivers of growth: share buybacks and capital expenditures.

The corporate tax cuts have made it attractive for companies to buy back shares of their own stock. These buybacks may help investors because they increase one key measure of a stock's success – earnings per share. Based simply on supply and demand, this buyback reduces supply, thus increasing demand which can drive the share price higher. Buybacks for the S&P 500® totaled a record $189 billion in Q1 and $190.6 billion in Q2 2018. This is an increase of 59 percent compared to Q2 2017.[4]

In addition, U.S. companies are finally investing not just to maintain, but also to expand capacity. U.S. capital expenditure intentions exploded in anticipation of the tax reform. The Philadelphia Fed survey component for future "capex" spending reached its highest level since the late 1980s (see figure 3).

In a nutshell, investors can use mid-caps to help solve the puzzle of growth potential while owning an asset class that has historically provided outperformance. If you are seeking to diversify your portfolio across small, midsized and large companies, mid-caps might deserve a closer look.


Figure 3. Source: Bloomberg, FactSet

[1]As represented by the Russell 2000® Index, the Russell Midcap® Index and the Russell 1000® Index.

[2]Schaber, O. (2018, July 30.) Mid-Cap Stocks Still Have Room to Run as 'M&A Effect' Kicks In. Retrieved from Bloomberg. https://www.bloomberg.com/news/articles/2018-07-30/mid-cap-stocks-still-have-room-to-run-as-m-a-effect-kicks-in.

[3]Terrarosa, T. (2018, Jan. 30) Outlook for Middle Market M&A. Retrieved from http://www.thedeal.com/outlook-middle-market-ma/

[4]S&P Dow Jones Indices.

Risk Considerations: Investing in mid-sized companies is based on the premise that relatively smaller companies will increase their earnings and grow into larger, more valuable companies. Historically, mid-cap stocks have experienced greater volatility than other equity asset classes, and they may be less liquid than larger cap stocks. Thus, relative to larger, more liquid stocks, investing in mid-cap stocks involves potentially greater volatility and risk. In addition, mid-cap stocks have experienced greater volatility than other classes of securities. Mid-cap stocks can also be less liquid than those of large companies, and illiquidity increases the potential for volatility. As with all equity investing, there is the risk that a company will not achieve its expected earnings results, or that an unexpected change in the market or within the company will occur, both of which may adversely affect investment results. The biggest risk of equity investing is that returns can fluctuate and investors can lose money.

Past performance does not guarantee or indicate future results. The information presented is for illustrative purposes only and should not be used as the sole basis for an investment decision. This information should not be construed as a recommendation to buy, sell or hold any particular security. Investors cannot invest directly in an index and unmanaged index returns do not reflect any fees, expenses or sales charges.

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