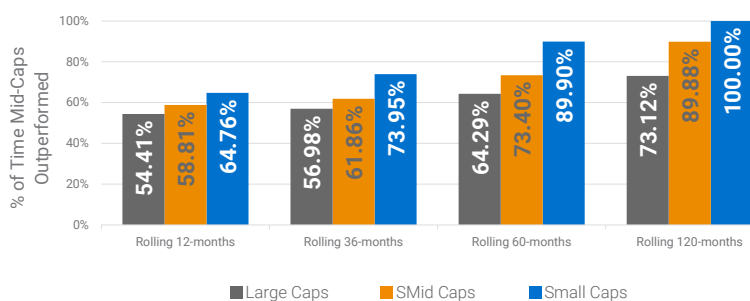


## THE MISSING PIECE | Mid Caps

Mid-cap stocks have outperformed both large caps, small/mid caps (SMID) and small caps since the inception of the Russell indices in 1979<sup>1</sup>. They have provided long-term performance, with higher risk-adjusted returns and exposure to a wide range of market capitalizations that can't be easily replicated with combinations of other caps.

### MID CAP PERFORMANCE

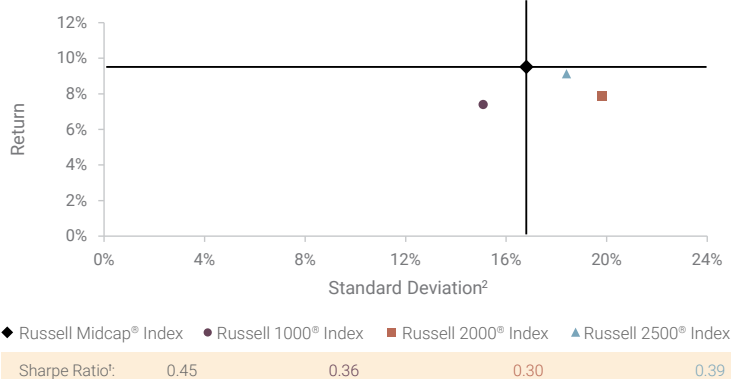
Figure 1: Percent of Time Mid-Cap Stocks Outperform Large, Small-/Mid- and Small-Cap Stocks (1979 – 2017)



- Over all rolling 10-year periods since the Russell Midcap Index started on Jan. 1, 1979, mid-cap stocks outperformed small-cap stocks **100 percent of the time**, SMID stocks **90 percent of the time** and large-cap stocks **73 percent of the time**.
- Mid-cap stocks also outperformed small, SMID and large-cap stocks over the majority of all rolling one, three- and five-year periods.

### RISK/RETURN ADVANTAGES

Figure 2: 20-Year Risk-Reward Analysis (Jan. 1, 1998 – Dec. 31, 2017)

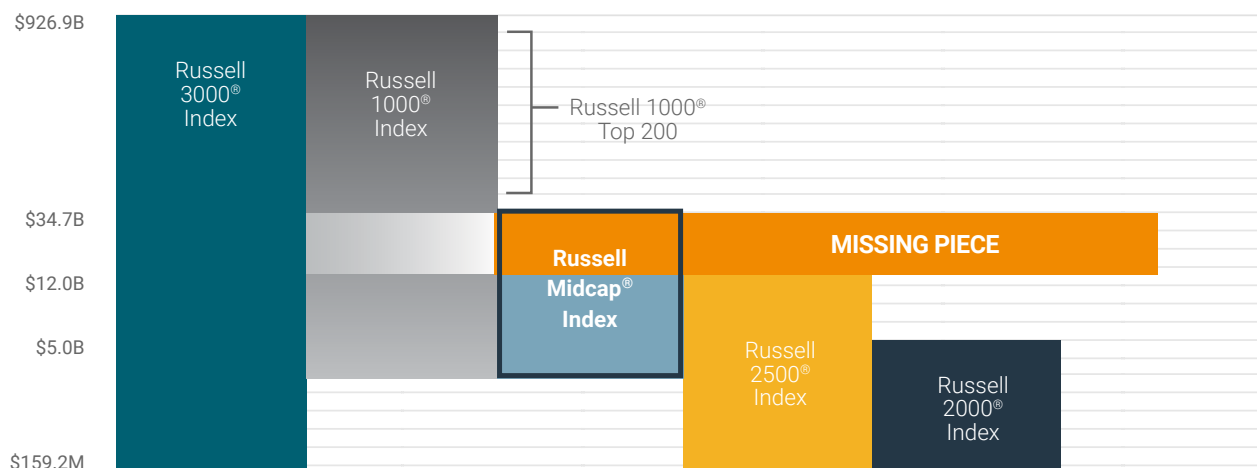


- Investors are often told they need to assume the added risk of investing in small caps to get additional returns; however, this is not always the case. Mid-cap stocks have outperformed small-cap and SMID stocks with lower volatility. Mid-caps offer higher potential returns than large-cap stocks with only slightly higher volatility.
- The risk-adjusted returns of mid-cap stocks can be seen in the Sharpe ratios in Figure 2.

### KEY TAKEAWAYS

- Despite investors' affinity for high-flying small-cap stocks and blue-chip large-cap stocks, mid-cap stocks have provided more favorable risk/return characteristics than their larger and smaller equity peers over time.
- Mid-cap companies tend to be more financially stable than their small-cap counterparts since they have generally moved beyond the volatile start-up phase. As they mature, these firms often become as stable as larger-cap companies.
- The growth potential of mid-cap stocks, coupled with increased stability relative to small caps, helps to explain historic outperformance. However, there is also evidence that mid-cap firms are less covered by analysts and under-owned<sup>3</sup> by investors. Investors could be best served by exploring whether mid-cap stocks have a place in their portfolio.

# MISSING MID CAPS



Mid caps are an under-owned<sup>3</sup> asset class, despite the benefits. Many investors believe they have the mid-cap space covered by way of an allocation to the larger and small-/mid-cap indices; however, there is a significant gap where returns may be hiding.

Roughly two-thirds<sup>4</sup> of the market capitalization of the Russell Midcap® Index may not receive adequate exposure in a client's portfolio<sup>3</sup>. This "missing piece" is the exact market cap previously described as offering compelling risk/reward characteristics over time.

Index (as of 5/11/18)	Low end (billion)	High end (billion)	Wtd. Avg. (billion)
Russell Top 200®	\$25.0B	\$926.9B	\$240.9B
Russell 1000®	\$2.5B	\$926.9B	\$240.9B
<b>Russell Midcap®</b>	<b>\$2.5B</b>	<b>\$34.7B</b>	<b>\$14.5B</b>
Russell 2500®	\$159.2M	\$12.0B	\$4.7B
Russell 2000®	\$159.2M	\$5.0B	\$2.1B

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.

<sup>1</sup>As represented by the Russell 2500® Index, the Russell 2000® Index and the Russell 1000® Index.

<sup>2</sup>Risk is measured by standard deviation. Standard deviation measures the risk or volatility of an investment's return over a particular time period; the greater the number, the greater the risk.

<sup>3</sup>Only \$844 billion of the roughly \$7.0 trillion in total assets invested in U.S. open-ended equity mutual funds – or roughly 12 percent – were in the mid-cap space, according to Morningstar Direct (as of 6/30/2018). This excludes money market funds, funds of funds and obsolete funds.

<sup>4</sup>As of 6/30/2018, according to Russell data, the market capitalization of the Russell Midcap® Index was \$8.237 trillion. The top 300 largest companies of the Russell Midcap® Index had a market capitalization of \$5.285, making up 64.3 percent or roughly two-thirds of the Russell Midcap® Index.

It is not possible to invest in an index.

The Russell 2500® Index measures the performance of the smallest 2,500 companies covered in the Russell 3000® index, which represents approximately 19 percent of the total market capitalization of the Russell 3000® Index.

The Russell 2000® Index measures the performance of the 2,000 smallest companies in the Russell 3000® Index, which represents approximately 8 percent of the total market capitalization of the Russell 3000® Index.

The Russell Midcap Index measures the performance of the mid-cap segment of the U.S. equity universe. The Russell Midcap is a subset of the Russell 1000® Index. It includes approximately 800 of the smallest securities based on a combination of their market cap and current index membership. The Russell Midcap represents approximately 31% of the total market capitalization of the Russell 1000 companies.

The Russell 1000® Index measures the performance of the 1,000 largest companies in the Russell 3000® Index, which represents approximately 92 percent of the total market capitalization of the Russell 3000® Index.

The Russell Top 200® Index measures the performance of the 200 largest companies in the Russell 3000® Index, which represents approximately 63% of the total market capitalization of the Russell 3000® Index.

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<sup>5</sup>Sharpe ratio: a measure that indicates the average return minus the risk-free return divided by the standard deviation of return on an investment.

## Contact us for more information on our active mid-cap solutions.

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