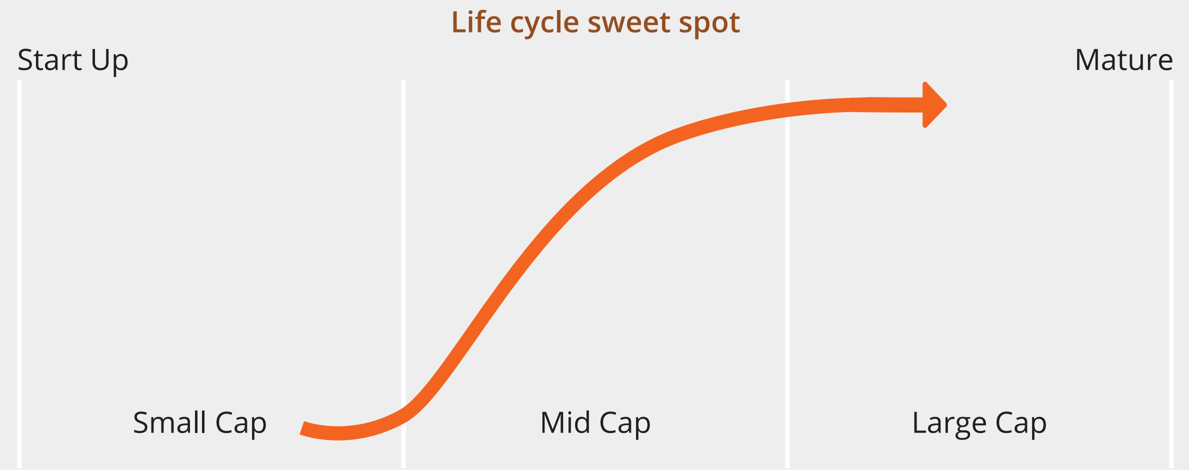
Mid Caps: An Opportune Time to Allocate to this Overlooked Asset Class?

The U.S. equity market is a vast universe of investment potential, consisting of companies large and small, stable and mature businesses, some young and fast-growing, and everything in between. Many investors are drawn to the largest and most well-known companies. Some may be taken in by the glamour effect, high-flying companies with a story that mesmerizes. Others chase young and unproven companies for a chance at an exponential return.

Often overlooked, mid cap companies tend to be more stable and established than small caps but are also growing faster than large, more mature companies. Mid caps typically capture the stage in an enterprise life cycle characterized by both a proven business model and a significant runway for potential growth. These companies are defined by a market capitalization typically between $1 billion and $50 billion.

Relative to large caps, mid caps tend to be under-followed by Wall Street analysts, leaving greater variance in valuation estimates and room for active investment managers to find strong businesses at attractive prices.[1] Relative to small caps, mid caps tend to be more diversified businesses, with pricing power at both the input (raw materials, labor, etc) and product output levels, greater access to capital markets, and an ability to adapt to changing environments.



Becoming more reliable and stable as they grow out of the young and rapid-growth small cap stage, mid caps are not as limited in their future growth prospects as large caps. Active managers can exploit market inefficiencies (price variations) in the fertile mid cap space to find the next large cap company at an attractive price.

[1] Source: FactSet

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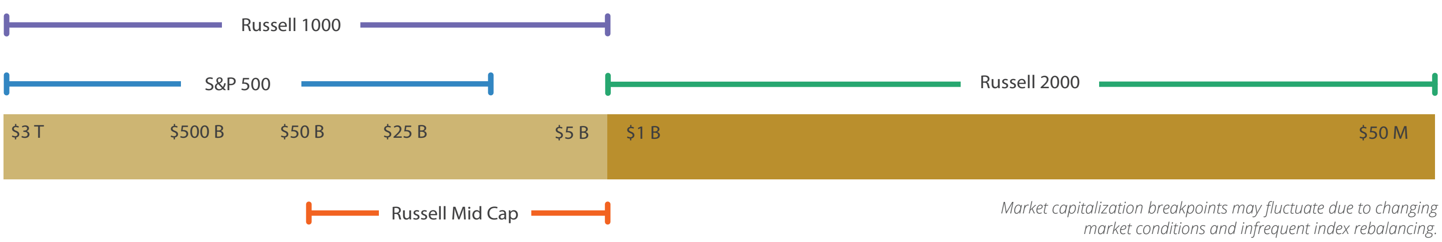
> “Mid caps are often overlooked. These businesses tend to be more established and stable than small caps while growing more quickly than large, mature companies.”

Defining Mid Cap

Within the equity market universe, mid caps typically reside between the largest 200 companies and those with market caps below $1 billion. Because of the makeup of broad market, cap-weighted indices, there tends to be some overlap between large and mid, and mid and small. For instance, the Russell 1000 Index is designed to measure the top 1000 U.S. stocks; the bottom 800 stocks within this index make up the Russell Midcap Index. This does not mean the Russell Midcap Index has an 80% overlap with the Russell 1000. Due to weighting by market capitalization, the largest 20% of stocks make up about 77% of the Russell 1000 Index.

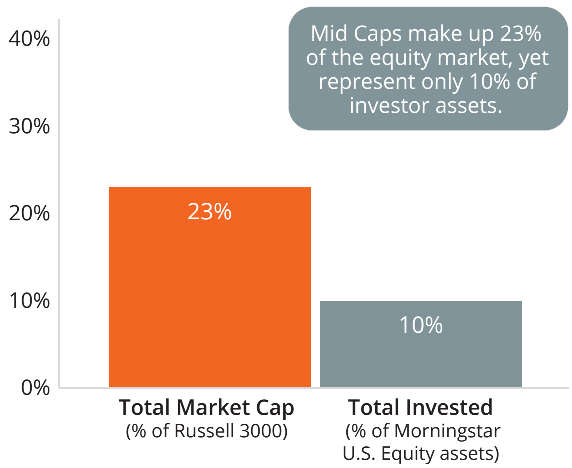


Market capitalization breakpoints may fluctuate due to changing market conditions and infrequent index rebalancing.

Investing in Mid Caps

An allocation to both large caps and small caps may produce some overlap in mid caps, but the evidence shows that mid caps continue to be under allocated to. As of 12/31/2023, mid cap stocks represent about 23% of all U.S. equity market capitalization, yet only 10% of investment exposure.[2]

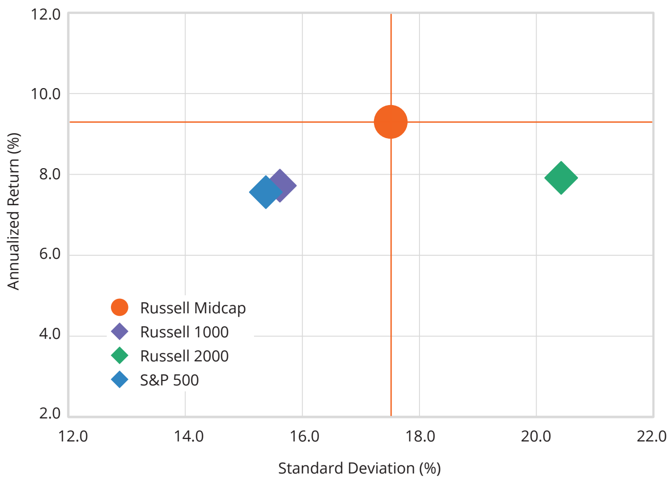
A dedicated mid cap allocation will deliver the true investment characteristics of companies in this size and life cycle stage.



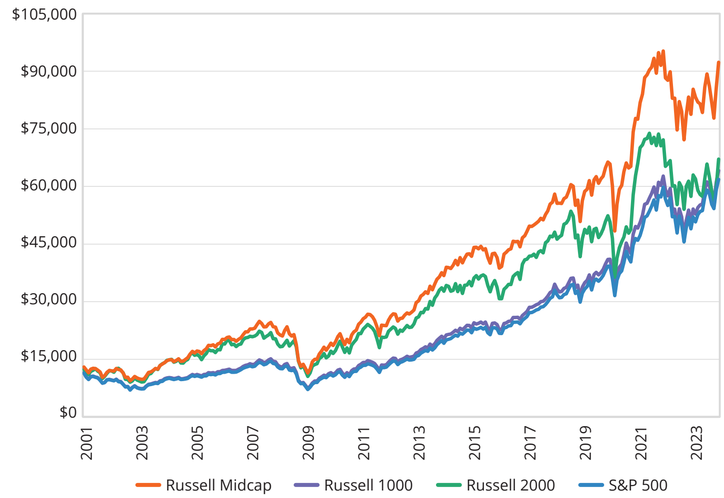
[2] Source: Morningstar

When examining historical performance, the case for mid caps becomes even more compelling. Relative to other asset classes, mid caps have produced a higher average annual return and lower volatility. Sharpe ratio, which measures the return of an investment with its risk, favors mid caps as well.[3]

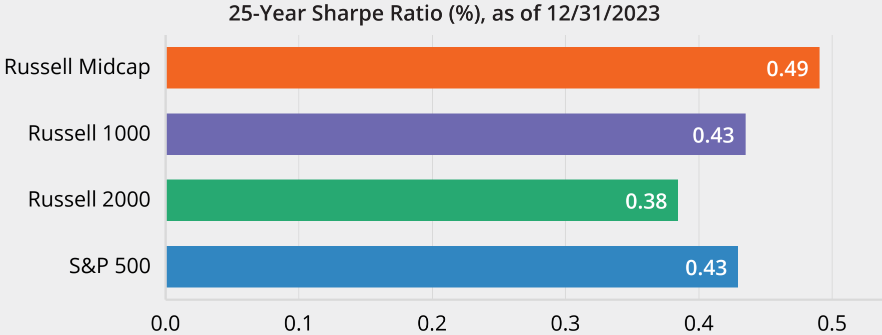
25-Year Average Annual Returns & Volatility, as of 12/31/2023



Growth of 10k, as of 12/31/2023



25-Year Sharpe Ratio (%), as of 12/31/2023

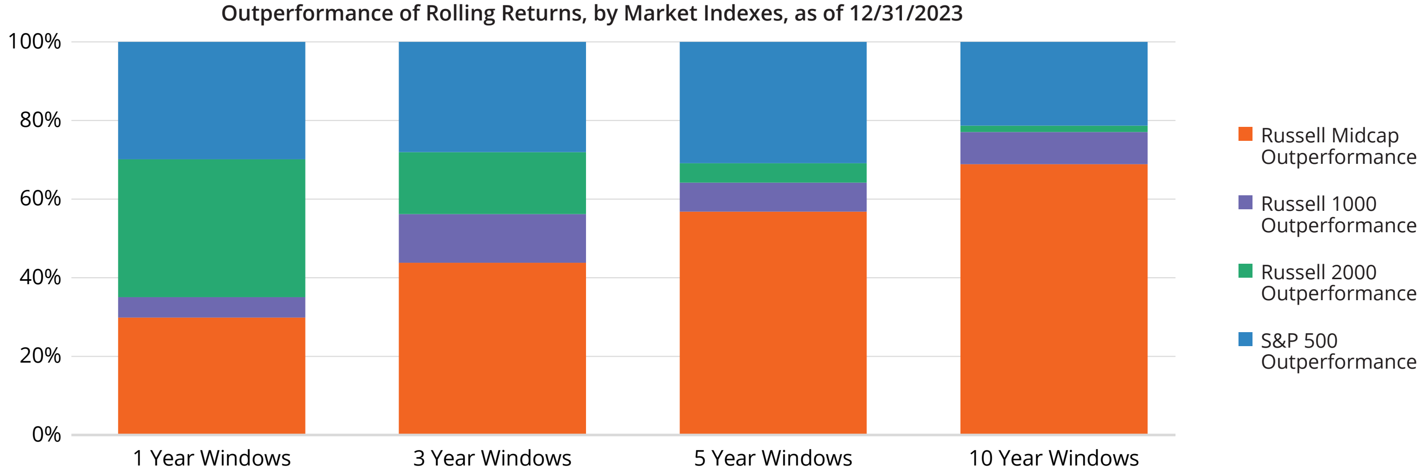


Sharpe Ratio:

A measure of an investment's risk-adjusted performance, calculated by comparing its return to that of a risk-free asset, such as a treasury bill or bond.

This trend is not just true for a point in time. Over multiple long-term rolling periods, mid caps have outperformed their large and small cap counterparts a majority of the time.

Outperformance of Rolling Returns, by Market Indexes, as of 12/31/2023



[3] Past performance is not a guarantee of future results.

What Makes Mid Caps Attractive Now?

Mid caps have shown an ability to emerge from significant downturns stronger than their large and small cap counterparts. Looking at the three years following the most recent market drawdowns[4], mid caps have outperformed large caps in each instance by an average of 32.85 percentage points and small caps in two of the past three periods by an average of 13.22 percentage points.

	1990	Largest Intra-Year Drawdown (1990)	1991	1992	1993	1991 - 1993 (Cumulative)
Russell Midcap	-11.50	-22.86	41.51	16.34	14.30	88.18
S&P 500	-3.10	-14.69	30.47	7.62	10.08	54.56
Russell 2000	-19.48	-29.08	46.04	18.41	18.88	105.58
	2002	Largest Intra-Year Drawdown (2002)	2003	2004	2005	2003 - 2005 (Cumulative)
Russell Midcap	-16.19	-25.50	40.06	20.22	12.65	89.68
S&P 500	-22.10	-28.36	28.68	10.88	4.91	49.70
Russell 2000	-20.48	-28.62	47.25	18.33	4.55	82.18
	2008	Largest Intra-Year Drawdown (2008)	2009	2010	2011	2009 - 2011 (Cumulative)
Russell Midcap	-41.46	-44.12	40.48	25.48	-1.55	73.54
S&P 500	-37.00	-37.66	26.46	15.06	2.11	48.59
Russell 2000	-33.79	-37.42	27.17	26.86	-4.18	54.59
	2022	Largest Intra-Year Drawdown (2022)	2023	2024	2025	2023 - 2025 (Cumulative)
Russell Midcap	-17.32	-24.3	17.23	--	--	--
S&P 500	-18.11	-23.9	26.29	--	--	--
Russell 2000	-20.44	-25.4	16.93	--	--	--

This performance does not happen by chance. As demonstrated by the long-term risk-adjusted returns in relation to both large caps and small caps, as well as how mid caps have historically fared following significant market downturns, we believe mid caps have earned the right to be viewed as a stand-alone component in an investment portfolio. While every market cycle presents new and unique risks, investors should consider how mid caps fit into the economy, markets, and investment portfolios.

— **Nimbleness:** While their business model tends to be more established and mature than smaller companies, it is less complex than large caps, giving them a greater ability to adapt to changing economic conditions.

— **Revenue:** While large caps tend to have operations around the globe, mid caps typically derive most of their revenue from within the U.S. This helps these companies reduce the impact of international risk dynamics and currency fluctuations.

— **Valuation:** Relative to large-caps, mid caps tend to be under-followed by Wall Street analysts, leaving greater variance in valuation estimates and room for active investment managers to find strong businesses at attractive prices.

— **Flexibility:** The breadth of the mid cap universe provides opportunities for managers to reach into the large or small cap space without compromising the portfolio's mid cap character.

[4] Drawdowns defined as a >19% decline in a calendar year for one or more major equity market index.

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Russell 1000® Index: measures the performance of the 1,000 largest companies in the Russell 3000® Index, which represents approximately 89% of the total market capitalization of the Russell 3000 Index.

Russell 2000® Index: measures the performance of the 2,000 smallest companies in the Russell 3000® Index, which represents approximately 11% of the total market capitalization of the Russell 3000® Index.

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Investments in midsize companies may entail greater risks than investments in larger, more established companies. Midsize companies tend to have narrower product lines, fewer financial resources, and a more limited trading market for their securities, as compared to larger companies. They may also experience greater price volatility than securities of larger capitalization companies because growth prospects for these companies may be less certain and the market for such securities may be smaller. Some midsize companies may not have established financial histories; may have limited product lines, markets, or financial resources; may depend on a few key personnel for management; and may be susceptible to losses and risks of bankruptcy.

Market Capitalization: the total dollar market value of a company's outstanding shares of stock.

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