Why Invest in Mid-Cap Equities Now?

By Matt Orton, CFA, and Mark Pera, CIMA, AIF
Amid the historic rise in U.S. equity markets from the COVID-19-driven lows in March, most of the narrative has focused on the outperformance of mega-cap technology and the underperformance of small caps. However, one asset class has received little attention despite outperforming both large and small caps throughout the rebound: mid caps.

Although mid caps tend to be under-owned and absent from market dialogue, most of us are generally familiar with some of their key advantages: strong earnings growth potential, stable balance sheets, high-quality management, and potential inefficiencies as they are underrepresented in portfolios and sometimes not regarded as a discrete asset class. Perhaps most importantly, mid caps offer superior risk-adjusted returns relative to small, SMID, and large capitalizations, even after the strong showing of mega-cap technology companies during the March sell-off.

While the advantages of mid caps are fairly compelling, one must still consider the current environment and ask why it makes sense to invest in this asset class now? After all, mid caps have already rebounded strongly, outperforming large and small caps by 5.5% and 2.2% respectively, from the market low on March 23 through the end of June. However, history shows the outperformance of mid caps can last longer, particularly following periods of sharp market volatility like the “corona crash,” the Global Financial Crisis, or the bursting of the tech bubble. In fact, mid caps have historically performed best in modest-GDP growth environments, like we saw after these market events – and what we are likely to witness as the current economy recovers. The key is that this outperformance is not transitory, but can last longer term.

Perhaps most importantly, mid caps offer superior risk-adjusted returns relative to small, SMID, and large capitalizations.

History shows the outperformance of mid caps can last longer, particularly following periods of sharp market volatility like the “corona crash,” the Global Financial Crisis, or the bursting of the tech bubble.

Mid caps have provided stronger risk-adjusted returns than the other capitalization ranges

Russell index performance and standard deviation (1/1/1979–5/29/2020)

<table>
<thead>
<tr>
<th>Index</th>
<th>Annualized Return</th>
<th>Standard Deviation</th>
<th>Sharpe Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>Russell Midcap® Index</td>
<td>12.78%</td>
<td>16.85%</td>
<td>0.49</td>
</tr>
<tr>
<td>Russell Top 200® Index</td>
<td>11.41%</td>
<td>14.93%</td>
<td>0.46</td>
</tr>
<tr>
<td>Russell 2000® Index</td>
<td>10.91%</td>
<td>19.62%</td>
<td>0.32</td>
</tr>
<tr>
<td>Russell 2500® Index</td>
<td>12.16%</td>
<td>18.30%</td>
<td>0.41</td>
</tr>
</tbody>
</table>

Source: Bloomberg, as of 6/30/20
Why Invest in Mid-Cap Equities Now?

Additionally, as geopolitical concerns increase and global growth concerns linger, companies with more leverage to the U.S. economy could provide additional safety. Mid-cap equities are actually very similar to small-cap companies with respect to U.S. revenue exposure – the Russell Midcap® Index derives 72.0% of revenues domestically and the Russell 2000® derives 78.3%, while the Russell 1000® gets only 62.0% from the U.S. This domestic focus mattered last year when mid caps outperformed large caps for the first three quarters as trade tensions intensified.

They also outperformed small caps, which suffered from negative investor sentiment. Heading into November’s elections, both parties likely will heighten trade rhetoric, particularly if there are bumps in the recovery, potentially providing a continued tailwind for mid-cap equities.

While mid caps might stay under the radar in typical market dialogue, this asset class boasts the best risk-adjusted returns, has performed the best in modest growth GDP environments, can benefit from a larger U.S. focus, and remains underinvested. These characteristics all provide tailwinds for mid caps going forward.

Matt Orton, CFA
Director of Portfolio Specialists

Matt Orton is Director of Portfolio Specialists at Carillon Tower Advisers. He specifically works with the Growth Team of Eagle Asset Management and leadership team at Clarivest Asset Management. He also provides U.S. market commentary, strategy, and analysis for clients.

Orton has 10 years of investment experience and worked at BNP Paribas and Goldman Sachs Asset Management before joining Carillon Tower. He earned an M.B.A. with a concentration in capital markets and asset management from Cornell University and a bachelor’s degree from Vanderbilt University. He is a CFA charterholder.

Mark Pera, CIMA®, AIF®
Vice President, Portfolio Specialist

Mark Pera is a Vice President and Portfolio Specialist for Carillon Tower Advisers. He covers affiliate Scout Investments’ International, Mid Cap and Small Cap strategies as well as affiliate Cougar Global Investments.

Pera has 15 years of investment experience and joined Carillon Tower from Raymond James Asset Management Services. He previously worked at Morgan Keegan. He earned a Bachelor of Science in business administration in finance from Auburn University. He is a Certified Investment Management Analyst® and Accredited Investment Fiduciary®.
About Carillon Tower Advisers

Carillon Tower Advisers is a global asset management company that combines the exceptional insight and agility of individual investment teams with the strength and stability of a full-service firm. Together with our partner affiliates – ClariVest Asset Management, Cougar Global Investments, Eagle Asset Management, Reams Asset Management (a division of Scout Investments) and Scout Investments – we offer a range of investment strategies and asset classes, each with a focus on risk-adjusted returns and alpha generation. Carillon Tower believes providing a lineup of institutional-class portfolio managers, spanning a wide range of disciplines and investing vehicles, is the best way to help investors seek their long-term financial goals.

Risk Considerations:

Investments in mid-cap and small-cap companies generally involve greater risks than investing in larger capitalization companies. Mid-cap companies often have narrower commercial markets, more limited managerial and financial resources, and more volatile trading than larger, more established companies.

Mid-cap and small-cap stocks may temporarily fall out of favor or perform poorly relative to other types of investments. While stocks of mid-cap companies may be slightly less volatile than those of small-cap companies, they still involve substantial risk.

Growth companies are expected to increase their earnings at a certain rate. When these expectations are not met, investors may punish the stocks excessively, even if earnings showed an absolute increase. Growth company stocks also typically lack the dividend yield that can cushion stock prices in market downturns. The companies engaged in the technology industry are subject to fierce competition and their products and services may be subject to rapid obsolescence. The values of these companies tend to fluctuate sharply.

Real Estate Investment Trusts (REITs) may be affected by economic conditions including credit risk, interest rate risk and other factors that affect property values, rents or occupancies of real estate. Foreign investments present additional risks due to currency fluctuations, economic and political factors, government regulations, differences in accounting standards and other factors. Investments in emerging markets involve even greater risks. Groups of stocks, such as value and growth, go in and out of favor, which may cause certain portfolios to underperform other equity portfolios.

DEFINITIONS

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.

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

DISCLOSURES

The information provided should not be construed as a recommendation to buy, sell or hold any particular security. The data is shown for informational purposes only and is not indicative of future portfolio characteristics or returns. Portfolio holdings are not stagnant and may change over time without prior notice.

Opinions expressed are the current opinions as of the date appearing in this material only. This material should not be construed as research or investment advice. No part of this material may, without Carillon Tower Adviser’s prior written consent, be copied, photocopied or duplicated in any form, by any means.

Investors cannot invest directly in an index and unmanaged index returns do not reflect any fees, expenses or sales charges.

The S&P 500 Index measures change in stock market conditions based on the average performance of 500 widely held common stocks. It is a market-weighted index calculated on a total return basis with dividend reinvested. The S&P 500 represents approximately 75% of the investable U.S. equity market.

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.

Frank Russell Company (‘Russell’) is the source and owner of the trademarks, service marks and copyrights related to the Russell Indexes. Russell® is a trademark of Frank Russell Company.

Neither Russell nor its licensors accept any liability for any errors or omissions in the Russell Indexes and/or Russell ratings or underlying data and no party may rely on any Russell Indexes and/or Russell ratings and/or underlying data contained in this communication. No further distribution of Russell Data is permitted without Russell’s express written consent. Russell does not promote, sponsor or endorse the content of this communication.

©2020 Morningstar, Inc. All Rights Reserved. Certain information contained herein: (1) is proprietary to Morningstar and/or its content providers; (2) may not be copied or distributed; and (3) is not warranted to be accurate, complete or timely. Neither Morningstar nor its content providers are responsible for any damages or losses arising from any use of this information.

Contact us to learn more about our active mid-cap solutions.

Call 1.800.521.1195 or visit carillontower.com