



A Case For Mid Cap Equities

Mid-cap companies can provide opportunities to enhance portfolio returns with an attractive risk/return profile. However, investors may be missing this key asset class in their portfolios. Explore the following qualities of mid caps:

- I. Risk/Return Characteristics
- II. A Blend of Attributes
- III. Overlooked Opportunity

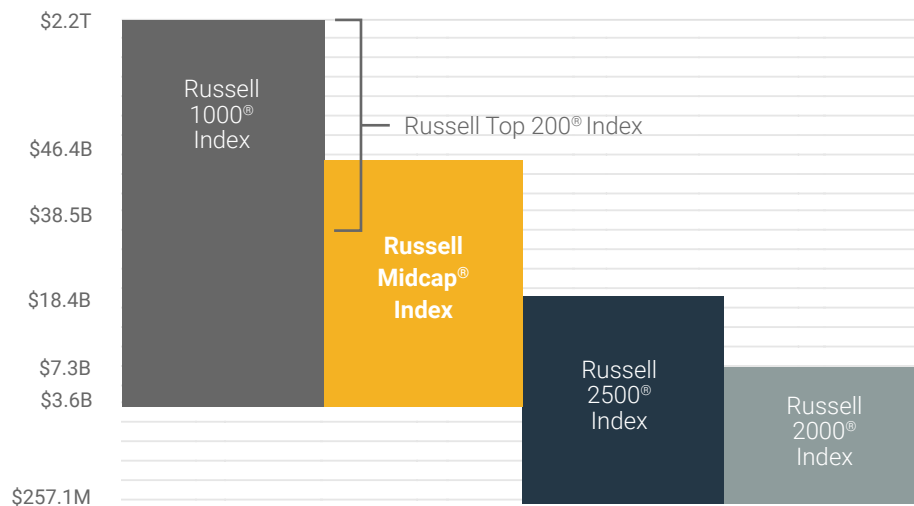
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The Missing Piece: Mid Caps

The Russell Midcap® Index consists of companies with market caps between roughly \$3.6 billion and \$46.4 billion. Investors with allocations to large, small/mid-cap (SMID) or small-cap stocks may have parts of this index covered, but they may be missing out on the full potential of mid-cap stocks.

Due to index market cap weighting methodologies, roughly 52% of the Russell 1000® Index is allocated to just the Russell Top 200® Index companies (as of December 31, 2021), and the Russell 2500® Index only carries the smaller mid-cap companies. Large-cap managers may tend to gravitate toward the bigger names in the Russell Top 200®. That means you may miss out on potentially about half of the market capitalization of the mid-cap space.¹

UNCOVER THE MISSING PIECE



AIM FOR THE MIDDLE

| Index (as of 5/7/2021*) | Low end (billion) | High end (billion) | Wtd. Avg. (billion) |
|----------------------------|----------------------|-----------------------|------------------------|
| Russell Top 200® | \$38.5B | \$2.2T | \$559.5B |
| Russell 1000® | \$3.6B | \$2.2T | \$411.9B |
| Russell Midcap® | \$3.6B | \$46.4B | \$21.6B |
| Russell 2500® | \$257.1M | \$18.4B | \$6.9B |
| Russell 2000® | \$257.1M | \$7.3B | \$3.0B |

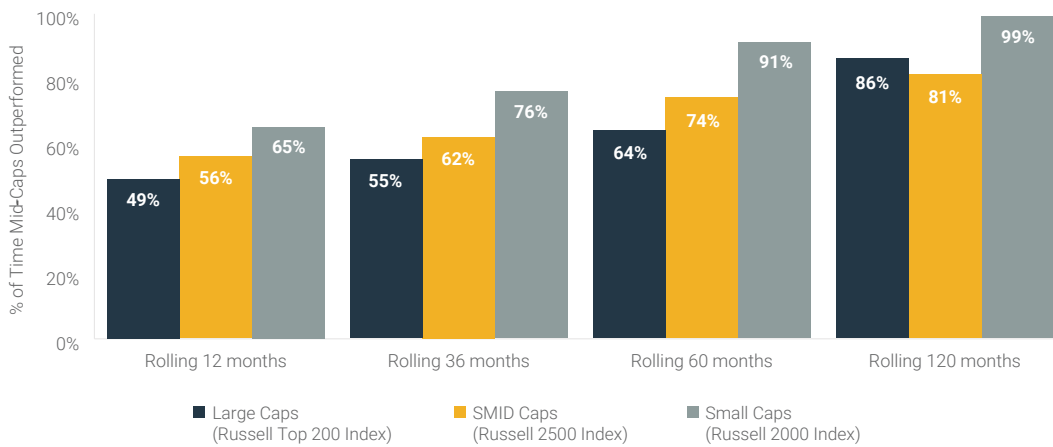
*most recent available data

I. Risk/Return Characteristics

Mid-caps have typically provided higher long-term risk-adjusted returns than large- or small-caps over certain rolling time periods. Large-cap stocks – the 200 largest companies in the Russell 1000® Index that comprise the Russell Top 200® – are generally favored for their stability and perceived lower risk. Small-cap stocks, the constituents of the Russell 2000® Index, can be more volatile than larger stocks but have historically offered higher returns over longer time periods.

MID CAP PERFORMANCE RELATIVE TO OTHER ASSET CLASSES

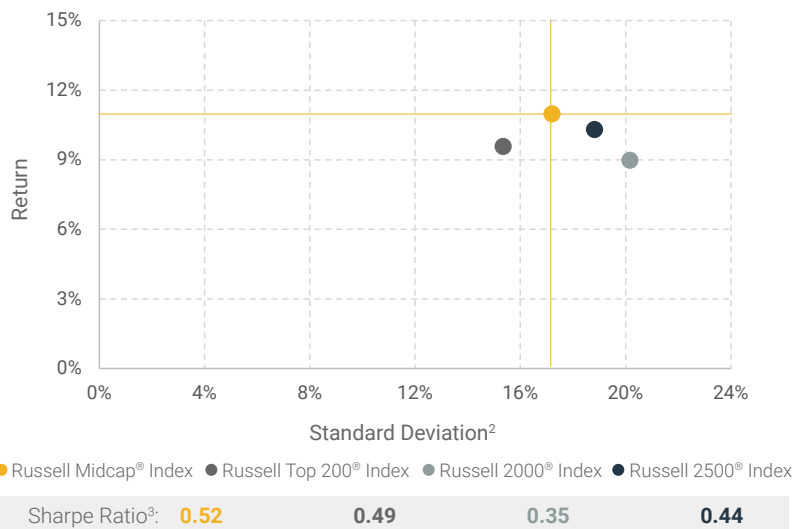
Figure 1: Percent of Time Mid-Cap Stocks Outperformed Large, Small/Mid and Small Cap Stocks (11/30/1994 - 12/31/2021)



As of 12/31/2021. Bloomberg, Russell. Large caps are represented by the Russell Top 200® Index. Small/mid (SMID) caps are represented by the Russell 2500® Index. Small caps are represented by the Russell 2000® Index. Mid caps are represented by the Russell Midcap® Index.

RISK/RETURN ADVANTAGES

Figure 2: Risk-Reward Analysis (1/1/1997 - 12/31/2021)



Investors may have missed out on mid-cap stocks’ potential to add absolute returns and diversification to their investment portfolios. Figure 2 (left) highlights that investors may not need to take the risks associated with small-caps to possibly see similar returns. This is also evidenced by the fact that mid-caps have – over time – provided a higher Sharpe ratio compared to small-, small-/mid- and large-cap stocks.

Risk/reward data as of 12/31/2021. (Source: Morningstar Direct, Russell) Sharpe ratios as of 12/31/2020, reflecting the period from 1/1/1997 - 12/31/2021. (Source: Morningstar)

II. A Blend of Attributes

Mid-cap companies combine some of the best attributes of larger and smaller companies, which also ties into their favorable risk-return characteristics. The ability to help limit risk in down markets is generally associated with large-cap stocks, while the potential to perform competitively in up markets is generally associated with small-caps. The mid-cap space has demonstrated the potential to do a bit of both and it's worth exploring some of the growth characteristics that could make this possible.



Diversification Benefits

The ability to help minimize downside risk typically comes from the stability of a company's cash flow and the strength of its balance sheet. Having multiple products and/or services across a variety of end markets in many geographic regions can vastly improve the stability of cash flows. If one product faces competitive challenges, it can be offset by others that are flourishing; and if one region of the world is experiencing a recession, it can be offset by economic expansion in another region. While mid-caps are not as diversified as large-caps, they have sufficient product and geographic diversification and tend to be significantly more diversified than small-cap companies. This ties into the balance sheet strength of mid-cap companies – they tend to have a longer operating history and more stable cash flows, which provides them with deeper access to capital markets during more challenging times.



Adaptability

The potential to perform well in up markets may be related to, among other things, a company's size and ability to execute. Relative to large-cap companies, mid-cap companies benefit from being more nimble and can more quickly scale up or down operations.



Organic Growth

Smaller companies are better able to create shareholder value through organic growth. In large-cap companies, incremental R&D spending may not always move the growth needle, and many of the most attractive geographic expansion opportunities may already have been exploited.



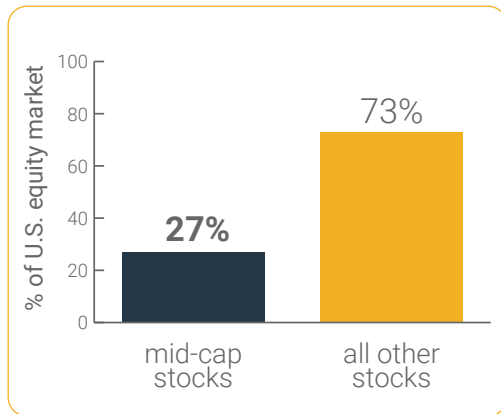
Better Management Teams

In many cases, mid-cap companies are still growing, but they've been around long enough to learn some lessons. Larger companies can have more experienced management teams with a proven ability to execute as well as more established corporate governance practices. Mid-cap companies have the potential to realize growth as new management teams are hired from larger companies with experience improving margins, diversifying across products and geographies and hiring new talent.

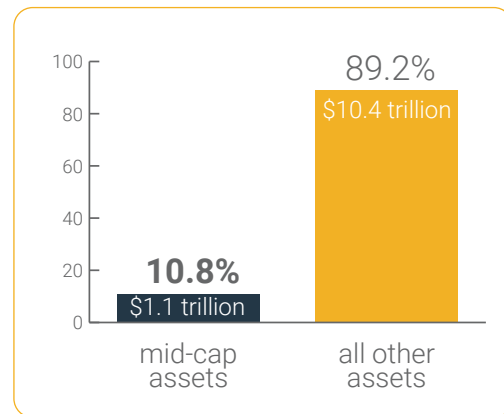
III. Overlooked Opportunity

While mid-cap stocks represent 27% of the companies in the overall market, they account for less than 11% of assets in U.S. domestic mutual funds. Only \$1.1 trillion of the roughly \$10.4 trillion in total assets invested in U.S. open-ended equity mutual funds (as of December 31, 2021) were in the mid-cap space, according to Morningstar.

BY THE NUMBERS*



Mid-cap stocks represent **27%** of the overall market...



...but make up less than **11%** of total assets.

Source: Assets Invested in U.S. Open-Ended Equity Mutual Funds

*Mid-cap stocks represent approximately 27 percent of the holdings in the U.S. Equity market. (Russell as of 12/31/2021). However, only \$1.1 trillion of the roughly \$10.4 trillion in total assets invested in U.S. open-ended equity mutual funds (as of 12/31/2021) were in the mid-cap space, according to Morningstar.

Mid-cap stocks are positioned in a relatively under-covered market capitalization space. Investors may believe they are adequately invested in mid caps if they have exposure to the Russell 1000® Index. However, the approximately 200 top large-cap stocks in the Russell 1000® Index can eclipse the mid-cap holdings in their weightings.

Investors seeking mid-cap exposure should not rely on large-cap managers to provide it. Investing with a dedicated mid-cap manager can be an effective way to gain exposure to this important asset class.

Please consider the investment objectives, risks, charges, and expenses of any fund carefully before investing. Call 1.800.421.4184 or your financial professional for a prospectus, which contains this and other important information about the funds. Read the prospectus carefully before you invest or send money.

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 funds to underperform other equity funds.

A fund may, at times, experience higher-than-average portfolio turnover, which may generate significant taxable gains and increased trading expenses, which, in turn, may lower the fund's return.

¹As of 12/31/2021, according to Russell data as presented by the Factset Portfolio Analytics, the market capitalization of the Russell Midcap[®] Index was \$13.060 trillion. The top 200 largest companies of the Russell Midcap[®] Index had a market capitalization of \$6.816 trillion, making up 52.19% or over half of the Russell Midcap[®] Index.

²Risk 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.

³Sharpe ratio: a measure that indicates the average return minus the risk-free return divided by the standard deviation of return on an investment.

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

The Russell 2500[®] Index measures the performance of the smallest 2,500 companies covered in the Russell 3000[®] index, and is constructed to measure the small-to mid-cap segment of the U.S. equities market.

The Russell 2000[®] Index measures the performance of the 2,000 smallest companies in the Russell 3000[®] Index, which represents approximately 10% 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 26% 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 93% 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 67% of the total market capitalization of the Russell 3000[®] Index.

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Contact us for more information on our active mid-cap solutions.
Call 1.800.421.4184 or visit carillontower.com.



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