

# The Best Equity Performance May Surprise You

*Analysis reveals that mid-cap stocks provide a differentiated investment opportunity*

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## KEY TAKEAWAYS

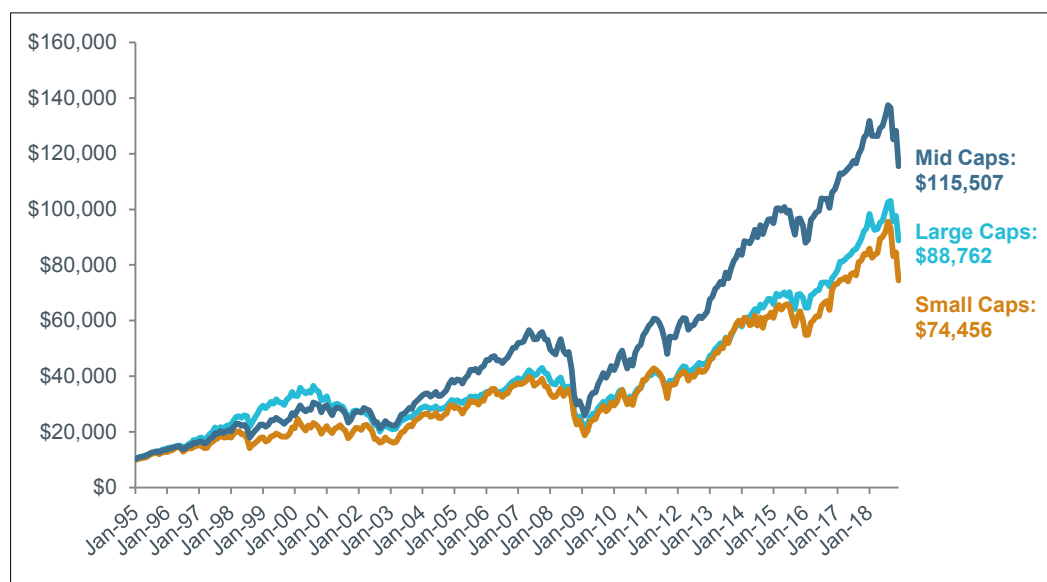
- Since 1995 mid-cap stocks have outperformed large- and small-cap stocks<sup>1</sup>
- Investors that are under-allocated to the mid cap asset class are potentially accepting greater risk AND missing out on available return, which we review later in this paper
- Mid-cap companies often exhibit the nimbleness and growth potential of small caps with the stability of large caps

## STRENGTH AND CONSISTENCY OF LONG-TERM OUTPERFORMANCE

Since 1995 mid-cap stocks have outperformed large- and small-cap stocks by a meaningful margin. Perhaps more impressive is the consistency that mid-caps have shown relative to their more widely used peers. Looking at monthly rolling five year average returns since December of 1995, mid caps have outperformed both large caps and small caps in a remarkable 156 of 229 periods, or 68% of the time! The data also shows that over these same 229 periods, mid cap has outpaced large cap 75% of the time and small cap 92% of the time.

### Strength of Long-Term Performance

Growth of a \$10,000 Investment  
1995-2018



Source: Russell Index Calculator and Baird Equity Asset Management.

## UNDERAPPRECIATED ASSET CLASS

Most asset allocation models and investors tend to migrate to small- and large-cap asset classes believing this adequately covers mid-cap exposure. In our view, the data below suggests these investors are missing available returns and accepting greater risk. Consider the following chart which illustrates strong relative mid-cap returns and a middling standard deviation<sup>2</sup>, which results in a Sharpe Ratio<sup>3</sup> of 0.57. This is a positive risk-to-return metric compared to 0.53 for large cap and

### *Did You Know?*

Since 1995, mid-cap stocks have outperformed large-cap stocks and small-cap stocks more than 30% and 50%, respectively.

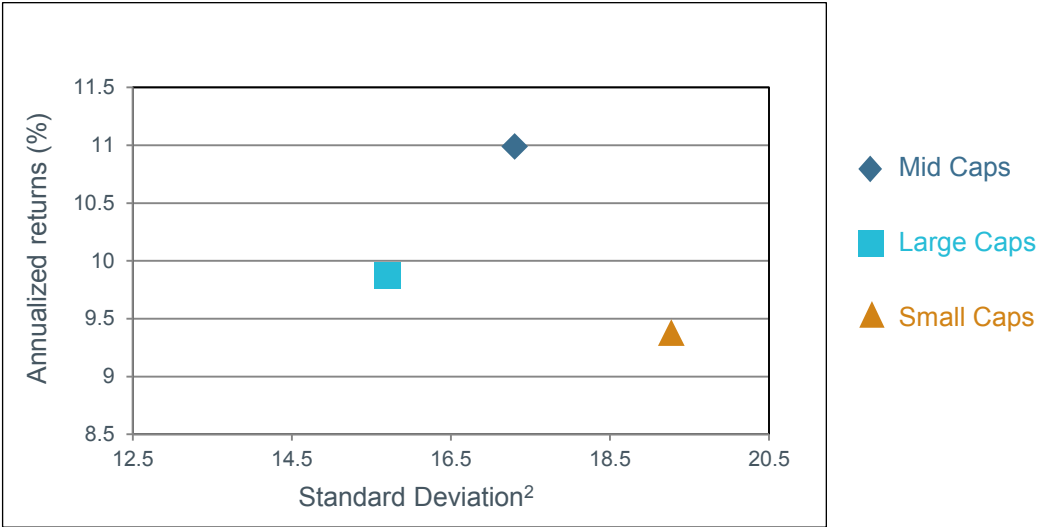
<sup>1</sup>Mid-cap, large-cap and small-cap stocks as defined by the Russell Midcap Index, Russell 1000 Index and Russell 2000 Index, respectively. All data is as of 12/31/2018.

<sup>2</sup>Standard Deviation is a statistical measure of the extent to which returns of an asset vary from its average.

<sup>3</sup>Sharpe ratio measures risk adjusted return and is defined as excess portfolio return over a unit of risk (standard deviation).

0.41 for small caps since 1995\*. This simply reflects that larger-cap returns are weaker relative to their risk level, while smaller caps have posted returns that are relatively weaker, yet have more volatility versus mid caps.

**Risk/Return Profile**  
(versus other Equity Asset Classes)  
1/1/1995 – 12/31/2018



\*Source: PSN, Morningstar Direct and Baird Equity Asset Management

We believe advisors making asset allocation decisions can use the above data as a source of positive differentiation with clients, creating a strong value add that will improve business prospects. As indicated earlier, most advisors recommend small- and large-cap solutions, but under allocate to mid cap, which may result in a missed opportunity to provide a more compelling risk-adjusted portfolio than their competitors.

**FUNDAMENTAL FACTORS DRIVING THE OUTPERFORMANCE**

Growth is a large determinant of driving long-term outperformance, as evidenced in the table below—since 1995, mid caps have outpaced large caps and small caps in revenue growth.

	Average Annual Revenue Growth	Average Annual Returns
Mid Caps – Russell Midcap Index	6.2%	9.8%
Large Caps – Russell 1000 Index	4.4%	8.4%
Small Caps – Russell 2000 Index	6.2%	7.9%

Source: Bloomberg and Baird Equity Asset Management. Data as of 12/31/2018.

With respect to outpacing large caps, we believe one key reason this occurs is mathematics—it is simply easier to grow from a smaller base than a larger one. Also consider that mid-cap companies tend to have greater exposure to developing opportunities or markets with lower penetration. In most cases, mid-market companies are more nimble relative to large companies that may not be able to effectively participate in these areas.

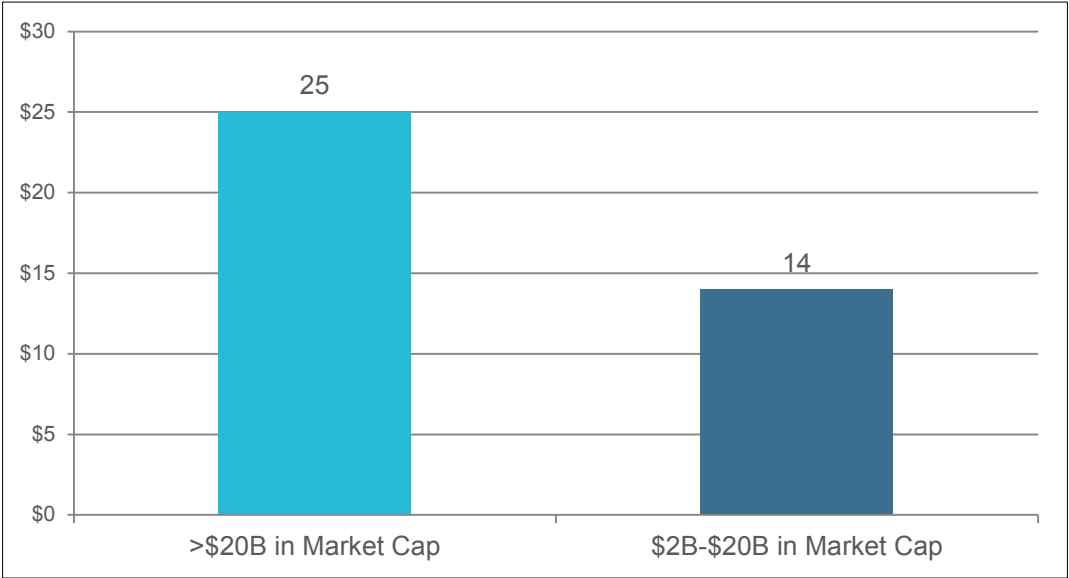
Mid-cap companies have general growth advantages over smaller cap companies as well. They are typically more mature and, therefore offer better cash flow and more stable balance sheets than smaller caps. Mid caps also tend to have more experienced management teams and better established brands, products and relationships. And, given their relative size, maturity and financial capability, they are in a better position to participate globally, which will be important in capturing growth over the next several years.

A second key factor is lack of analyst coverage, which results in the market taking longer to appreciate the value of mid-cap companies. We reviewed the constituents of the Russell 3000 Index, which contains a sizable number of large-, mid- and small-cap companies. Large-cap

**Did You Know?**  
Since 1995, the Russell Midcap Index has provided a better risk/return profile versus the Russell 1000 Index and the Russell 2000 Index.

companies today (greater than \$20B in market cap) have 25 analyst recommendations on average resulting in strong market efficiency, where company information is reflected quickly into its share price. By contrast, those companies in the true mid cap range (\$2B-\$20B), have 14 analyst recommendations on average which results in slower dissemination of market information.

**Average Analyst Recommendations**  
(Large Cap versus Mid Cap)



Source: Bloomberg and Baird Equity Asset Management

**MID CAPS OFFER A VALUE-ADDED SOLUTION**

This review illustrates how mid caps can offer a high quality yet overlooked solution in the market that can benefit investors. Advisors tend to under-allocate to mid caps, typically choosing to rely on large caps and small caps to provide exposure to a wider range of equity market capitalizations. However, data shows that mid caps provide historically better risk-adjusted returns for a wide variety of time horizons and can act as a source of value added differentiation for advisors willing to break from the masses.

**BAIRD EQUITY ASSET MANAGEMENT**

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GROWTH	VALUE	INTERNATIONAL
Mid Cap Growth Equity (BMDIX)	Small Cap Value Equity (BSVIX)	Chautauqua Global Growth Equity (CCGIX)
Small/Mid Cap Growth Equity (BSGIX)	Small/Mid Cap Value Equity (BMVIX)	Chautauqua International Growth Equity (CCWIX)

Tickers above represent Institutional share classes.

To learn more about our viewpoints on the outlook for mid-cap stocks or about Baird mid cap investment opportunities, please call (800) 792-4011.

## DISCLOSURE

*The Russell Midcap Index measures the performance of the 800 smallest companies, by market capitalization, in the Russell 1000 Index. The Russell 1000 Index measures the performance of the 1,000 largest companies in the Russell 3000 Index. The Russell 2000 Index consists of the smallest 2,000 companies in the Russell 3000 Index. It is not possible to invest directly in an index. The Russell Indices are a trademark of the Frank Russell Company. Russell is a trademark of the Frank Russell Company.*

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