

# THE CASE FOR MID-CAP EQUITIES

Mid-cap equities offer favorable risk/reward characteristics over the long term.

## EXECUTIVE SUMMARY

- Mid-cap stocks have survived the start-up phase of their life cycles – often the riskiest stage – and may be entering a period of long-term growth.
- These stocks are under-researched and under utilized, offering active investors an opportunity to outperform.
- Historically, adding mid-cap exposure to an investment portfolio has increased returns with only a minimal increase in risk.

Mid-cap stocks have been a “sweet spot” in the U.S. equity markets given their risk/return characteristics. These stocks have produced excellent relative performance in both up and down markets, capturing more of the market in up periods and less of the market in down episodes over the same time period than their large-cap or small-cap counterparts.

### In the “Sweet Spot”

According to Morningstar Direct (Sept. 30, 2010), only \$812.1 billion of the \$5.7 trillion in total assets invested among U.S. equity products were in the mid-cap space, and many investors have missed out on mid-cap stocks’ ability to add absolute returns and diversification with lower volatility.

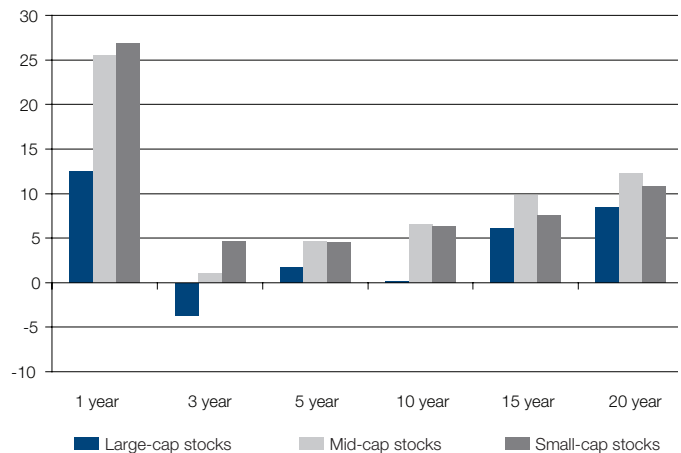
Large-cap stocks, the 200 largest names in the Russell 1000 Index that comprise the Russell Top 200, are generally favored for their stability and perceived lower risk. Small-cap stocks, the constituents of the Russell 2000 Index, are inherently more volatile than larger stocks but have historically offered higher returns over longer time periods. Market inefficiencies in the mid-cap arena make them more compelling, and the growth rates for companies in the mid-cap space often are higher than their larger counterparts. Long term growth estimates help to illustrate this point. As of Dec. 31, 2010, the long term growth estimate for the Russell Top 200 Index was 10.6 percent, while the Russell Midcap Index’s was 11.9 percent.

Mid-cap stocks are positioned in a relatively under-covered market capitalization space, despite a history of strong returns accompanied by volatility only slightly higher than larger stocks. Although there are more than 800 stocks in the Russell Midcap Index, representing 27 percent of U.S. market capitalization, many of those stocks are not covered by Wall Street analysts. This information gap presents good opportunities for skillful, active portfolio managers to find companies before they become widely known.

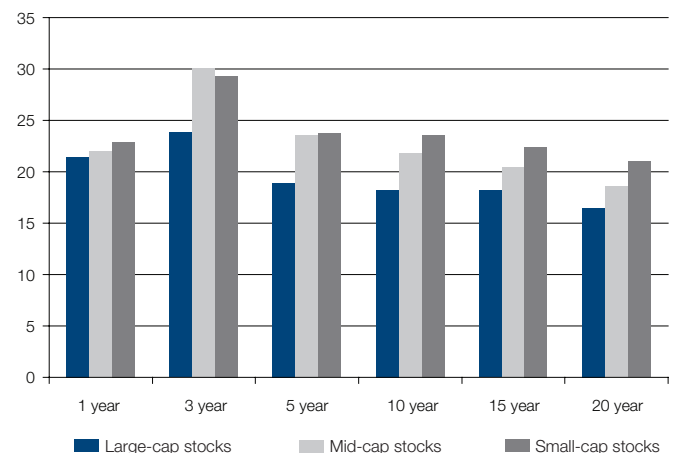
### Mid-Cap Stocks Offer Favorable Risk/Return Characteristics

The charts below show returns and risk for the same time periods. As the chart demonstrates, mid-cap stocks have had stronger performance than small- or large-cap stocks over longer holding periods. Importantly, the returns came with lower volatility than small-cap stocks over longer time periods.

Returns



Standard Deviation

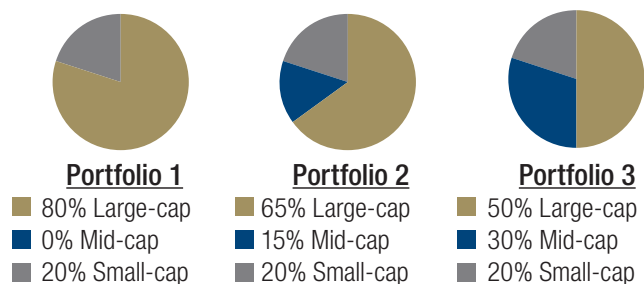


Source: CAI, for the period ended Dec. 31, 2010

Large-cap stocks are represented by the Russell Top 200 Index, mid-cap stocks by the Russell Midcap Index and small-cap stocks by the Russell 2000 Index.

## Effects of Adding Mid-Cap Exposure on Risk and Return

The chart below shows that adding mid-cap exposure has historically added value for investors with only minimal increase in risk, and has the potential to do the same in the future.



### Returns

	Portfolio 1	Portfolio 2	Portfolio 3
One Year	15.29	17.20	19.14
Three Year	-2.44	-1.71	-0.98
Five Year	2.41	2.86	3.29
10 Year	1.49	2.44	3.40

### Standard Deviation

	Portfolio 1	Portfolio 2	Portfolio 3
One Year	21.64	21.72	21.80
Three Year	24.82	25.68	26.57
Five Year	19.62	20.24	20.91
10 Year	19.02	19.51	20.04

Source: CAI, for periods ended Dec. 31, 2010.

Large-cap stocks are represented by the Russell Top 200 Index, mid-cap stocks by the Russell Midcap Index and small-cap stocks by the Russell 2000 Index.

The mid-cap segment of the market offers good liquidity and potential for portfolio diversification.

Size and liquidity, of course, help mitigate the risk involved in mid-cap investing compared to small-cap investing. In addition, mid-caps tend to be more mature

companies than their smaller counterparts, their business cycles tend to be less extreme and they exhibit less operational risk through more diversified business offerings. Mid-cap stocks have been a rewarding area of the market but, as you would expect, not all companies will flourish and risk still matters. Eagle believes active, quality-driven fundamental stock selection is the key to capturing returns and managing risk in this segment of the market.

### The Potential of Mid-cap Equities

Mid-cap companies combine some of the best attributes of larger and smaller companies. They are generally able to grow sales at a much faster pace than larger companies and are established enough to have critical mass and deeper balance sheets for stability. The companies are typically large enough to increase earnings with some consistency, yet small enough to grow more rapidly than the overall economy.

Mid-cap companies have outgrown the start-up phase but retain important structural advantages typically associated with smaller companies. It's often easier for a company to increase its capitalization fivefold, from \$2 billion to \$10 billion, than it is for a larger company's stock to grow by the same multiple (climbing

## Compelling Reasons to Consider Mid-Caps

There are several compelling reasons to consider mid-cap investing as part of a diversified portfolio:

- I Attractive risk/return characteristics:** Mid-cap indices have had excellent risk/return characteristics compared with large- and small-cap indices.
- I Strong balance sheets:** Mid-cap companies typically have stronger balance sheets than small caps, reducing their financial volatility, especially in choppy and down markets.
- I Growth opportunity:** Mid-cap companies are smaller

than large caps, allowing for significantly higher potential growth rates.

- I Diversification:** Investors can benefit from having access to all parts of the market as they build diversified portfolios. Mid-caps represent 31 percent of the total domestic stock-market capitalization.
- I Opportunity for alpha generation:** The opportunity for greater added value may exist in the mid-cap space.
- I Under-researched:** The mid-cap universe is not widely followed by securities analysts.

from \$20 billion to \$100 billion, for example). Similar to large-cap companies, mid-caps typically offer greater stability (e.g., established products and services, solid management and longer operating histories) than small-cap stocks. They have proven their ability to compete on a sustained basis. Yet they remain nimble, like small-cap stocks, and can adapt more easily to market changes.

A subset of the large-cap asset class, mid-cap equities generally have been underappreciated and underutilized, despite reasonable valuations and rewarding growth profiles. This asset class tends to be underweighted in many portfolios, but offers a unique opportunity for outperformance. Investors may believe they are adequately invested in mid-caps if they have exposure to the Russell 1000 Index. However, the approximately 200 large-cap stocks in the Russell 1000 Index eclipse the mid-cap holdings in their weightings.

As of Nov. 30, 2010, the average market capitalization of Large-cap Blend managers in Morningstar's universe was \$58.1 billion, a far cry from the Russell Midcap Index's \$5.1 billion average market cap. Investors seeking mid-cap exposure must not rely on large-cap managers to provide it. Investing with a dedicated mid-cap manager is the best way to gain exposure to this important asset class.

## Experience Matters

Eagle Asset Management's experienced portfolio managers employ strategies that focus on long-term investing opportunities, not market fads. We believe a disciplined, thorough fundamental process helps cull the mid-cap universe to stocks that offer what we believe are the greatest opportunities and can eliminate those names that are likely to underperform. Eagle's mid-cap portfolio managers strive to provide a careful balance between risk management and risk-adjusted returns. And they share the belief that in-depth research leads to sound, long-term investment decisions.

In short, Eagle believes mid-cap equities are an essential component to a diversified portfolio.

Eagle's Mid Cap Growth product offers a long-term track record of alpha-driven outperformance and could benefit portfolios missing an allocation to this important segment of the market.

The risks associated with investing in mid-sized companies are based on the premise that mid-sized companies will increase their earnings and grow into larger, more valuable companies. However, 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. Historically, mid-cap stocks have experienced greater volatility than other equity asset classes, and they may be less liquid than large-cap stocks. Thus, relative to larger, more liquid stocks, investing in mid-cap stocks involves potentially greater volatility and risk. The biggest risk of equity investing is that returns can fluctuate and investors can lose money.

**To learn more about mid-cap investing and how Eagle's Mid Cap Growth program can complement your portfolio, please visit [eagleasset.com](http://eagleasset.com).**

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May Lose Value

No Bank Guarantee