



Funds That Focus on the Mid-Caps: A Happy Medium Between Big & Small

By John Markese

Just when you thought you had the stock fund categories figured out, the mutual fund industry develops a new one.

Market capitalization is one way to categorize stocks. The market capitalization of a stock is simply its share price times the number of shares outstanding, and it serves as an indicator of firm size. At one end of the capitalization scale are corporate behemoths like AT&T and Exxon, while at the other end are newly emerging start-up firms, the embryos of the corporate world.

Is firm size an important consideration in putting together a well-diversified portfolio of stock mutual funds?

Yes. Firms of different capitalization behave differently—they have different risks, different mixes of industries in different stages of development. Historically, large-capitalization and small-capitalization stocks have not been perfectly synchronized in returns—they have performed in their own cycles and have recorded different average compound returns.

The mutual fund industry has for many years created funds that focus on either large-cap or small-cap stocks. More recently, however, they have created new funds that emphasize mid-cap stocks, the land between large-cap and small-cap stocks. The problem is that there appear to be as many definitions of mid-cap, large-cap, and small-cap, as there are stocks.

Several benchmarks for mid-cap stocks are detailed in Table 1, in which the three mid-cap indexes are flanked by a large-cap index and a small-cap index for perspective. Mid-cap size is obviously open to some interpretation, with the Wilshire Mid-Cap index having the lowest median capitalization and the narrowest range. Both the S&P MidCap index and the Russell Mid-Cap index, which include firms pushing \$7 billion in market capitalization, strain the concept of “mid-cap.”

Table 2 compares two different categorizations of market capitalization, one by Morningstar, a mutual fund information publisher, and the other by Prudential Securities, a brokerage firm. Morningstar has more categories in the upper ranges, while Prudential has more in the lower ranges. Both have categories defined as “medium” capitalization; if medium is akin to mid-cap, the two “mediums” do not match up.

Just what is, then, a definition of the mid-cap range? Well, clearly it overlaps at the extremes with large-cap and small-cap. So a useful working range is over \$500 million and less than \$5 billion to base judgments upon. But, there is no real consensus.

What’s the point of all these comparisons?

Mid-cap stock funds have at times outperformed large-cap stock funds, and have less risk than small-cap stock funds. For investors wishing to diversify and cover all bases, mid-caps make sense. For investors seeking higher returns, but who are uncomfortable with the risk of small stocks, mutual funds concentrating on mid-caps may make sense. But unless you are careful and alert, as the differences in indexes and categorization point out, you may invest in a fund that holds predominately large-caps or small-caps, while trying to hit the mid-cap market. And while most funds that have mid-cap in their name are likely to have significant mid-cap holdings, there are other funds that have surprisingly large amounts of “mid-cap” holdings that do not state their emphasis in their fund name.

Table 3 lists no-load and low-load funds that identify themselves (through their name) as mid-cap funds; the table also provides index comparisons, and an example of a fund—Ariel Appreciation—that has an emphasis on mid-cap stocks in its investment strategy.

Mid-cap funds fall generally in the aggressive growth and growth categories, since they are primarily bought for growth, although they may produce some dividend income. As a check, the median market capitalizations of the stocks held by the mid-cap funds in Table 3 match up fairly closely with

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Table 1.
Stock Capitalization Benchmarks

	Large-Cap Index S&P 500	Mid-Cap Indexes:			Small-Cap Index
		S&P MidCap 400	Wilshire MidCap	Russell Mid-Cap	S&P Small- Cap 600
Where Stocks Are Listed					
Nasdaq (%)	8.0	27.0	31.2	20.1	47.7
New York Stock Exchange (%)	91.0	71.0	65.6	78.2	48.6
American Stock Exchange (%)	1.0	2.0	3.1	1.7	3.7
Size of Stocks					
Median Capitalization (\$ million)	4,717	1,189	946	1,600	329
Largest Capitalization (\$ million)	136,951	7,236	2,000	6,600	2,207
Smallest Capitalization (\$ million)	315	117	296	257	33

of \$500 million, the fund operates near the lower end of the mid-cap universe.

Ariel Appreciation Fund is an example of a fund that concentrates on mid-caps, but does not advertise the fact by squeezing in mid-cap in the fund name. The prospectus notes that the fund focuses on what they term medium-size firms, and while the lower limit of the capitalization range pokes into the small-cap arena, their

median market capitalization of \$1.1 billion says mid-cap.

Does the promise of returns that are higher than large-caps but somewhat less than small-caps hold up?

The list of funds in Table 3 is a small sample, and few have been around for five years. However, the three-year performance figures of the funds compared to the S&P 500 are generally favorable, as shown in Table 4. Over the last five years the S&P MidCap 400 index returned 15.2% annually compared to the S&P 500's annual return also of 15.2%.

How well do these mid-cap funds do in bull markets and how hard do they fall in bear markets? As expected, the funds tend to outperform large-caps on the upside and fall farther on the downside, as can be seen in Table 4. The risk issue becomes obvious when examining bear market losses of the three S&P indexes based on market capitalization—the downside increases from -6.6% for large-caps, down to -

Table 2.
Definitions of "Size"

Morningstar		Prudential Securities	
Definition	(\$ million)	Definition	(\$ million)
giant	over 25,000	large	over 3,000
large	5,000 to 25,000	medium /large	1,500 to 3,000
medium	1,000 to 5,000	medium	750 to 1,500
small	250 to 1,000	medium/small	250 to 750
micro	less than 250	small	100 to 250

the three mid-cap indexes of Table 1 with the exception of Wasatch Mid-Cap, which has a relatively lower median market capitalization of \$500 million.

What a fund states in its prospectus can be informative, particularly when numbers are attached to the text. The mid-cap range stated in the prospectus for these funds hovers around the \$500 million to \$5 billion range, but some slip down into the small-caps or nudge up into large-cap territory. Statements about what percentage of the portfolio will be held in mid-caps, when made, are equally informative. For instance, the Wasatch Mid-Cap prospectus states that at least 65% of its assets will normally be invested in the stocks of mid-cap companies and their stated range of \$300 million to \$5 billion confirms that their strategy indeed centers on mid-cap stocks. But because of their median market capitalization

Table 3.
Funds That Focus on Mid-Caps*

Fund	Category	Average Stock Size (\$ billion)	Objective Size Range (as stated in prospectus)
Dreyfus S&P MidCap Index	Growth	1.2	\$56 million – \$9.6 billion
Fidelity Mid Cap Stock	Growth	2.0	\$158 million – \$6.6 billion
IAI MidCap Growth	Growth	1.5	\$500 million – \$5 billion
Marshall Mid-Cap Stock	Aggressive Growth	1.8	\$200 million – \$7.5 billion
T. Rowe Price Mid-Cap Growth	Growth	1.6	\$300 million – \$4 billion
Wasatch Funds:Mid-Cap	Aggressive Growth	0.5	\$300 million – \$5 billion
Ariel Appreciation**	Growth	1.1	\$200 million – \$5 billion
Indexes for Comparison			
S&P 500		4.7	
S&P MidCap		1.2	
S&P SmallCap		0.3	

* Funds that target the mid-cap market as evidenced by their name.

** Example of a fund that invests in the mid-cap sector, but whose name doesn't reflect the focus.

Table 4.
Mid-Cap Performance Characteristics

Fund	Category	Annual Return (thru 9/30/96)			Bull	Bear	Dividend
		1 Year	3 Years	5 Years	Market	Market	
		(%)	(%)	(%)	Return**	Return**	Yield
					(%)	(%)	(%)
Dreyfus S&P MidCap Index	Growth	13.3	12.8	14.7	51.5	-9.7	1.3
Fidelity Mid Cap Stock	Growth	19.3	na	na	76.1	na	0.3
IAI MidCap Growth	Growth	17.0	17.2	na	59.1	-5.5	0.0
Marshall Mid-Cap Stock	Aggressive Growth	23.0	16.5	na	77.8	-13.6	0.0
T. Rowe Price Mid-Cap Growth	Growth	24.9	21.4	na	78.8	-7.1	0.0
Wasatch Funds:Mid-Cap	Aggressive Growth	-2.6	20.0	na	84.3	-12.6	0.0
Ariel Appreciation	Growth	19.5	11.2	10.4	34.8	-5.5	0.7
Indexes for Comparison							
S&P 500	Index	20.3	17.3	15.2	63.6	-6.6	2.2
S&P MidCap	Index	13.9	13.3	15.2	53.0	-9.5	1.6
S&P SmallCap	Index	15.3	na	17.0	na	-11.3	0.9

* First six months of 1996

**Bull market period: July 1, 1994, to September 30, 1996. Bear market period: February 1, 1994, to June 30, 1994.

9.5% for mid-caps and even further down to -11.3% for small-caps.

Table 4 also includes dividend yields for the various size categories. Not surprisingly, dividend yield declines with capitalization size, since the largest, most mature firms pay the highest dividends and the smallest emerging firms pay little or no dividends. The mid-cap funds show very low or zero dividend yields due to the lower dividend yields of mid-cap stocks. In addition, dividend yields for mutual funds reflect fund expenses that are netted out against investment income before fund dividends are paid.

So having sifted through all these numbers and compar-

isons, the question remains—Do you need a mid-cap fund in your portfolio? There are two arguments in favor of such a holding:

- If you want to be completely diversified in U.S. stocks to reduce portfolio risk and to participate in the potential growth of mid-cap stocks then, yes, you need a mid-cap fund unless your large-cap fund and small-cap fund stretch their capitalization ranges and no hole in the middle exists.

• If you are invested in large-cap stocks and seek more growth, but are leery of the volatility of small-caps and micro-cap stocks, a mid-cap fund may fulfill some of that growth goal without taking on substantial risk.

The point that shouldn't escape anyone, though, is that any common stock mutual fund investor should carefully read the prospectus to determine the capitalization range in which the mutual fund managers they have hired are operating. Size does matter.



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