WEALTHMANAGEMENT NOV. 2014

A CASE FOR MID-CAPS

EXECUTIVE SUMMARY

We believe an effective asset allocation strategy should include exposure to Small-cap, large-cap and often overlooked mid-cap stocks. At WT Wealth Management most models currently include and asset allocation to Mid-cap equities.

Mid-cap stocks have historically delivered strong returns relative to large and small caps, yet investors remain underexposed to this part of the equity market capitalization structure. Our intention is to offer a perspective on how this asset class can potentially offer investors: Diversification benefits and improved risk-adjusted performance potential.

In our opinion, mid-cap companies are in the “sweet spot” of the growth life cycle, having relative stability with a certain degree of scalability in their business. An appealing asset class for today’s markets as fundamentals are healthy, valuations are attractive and mergers & acquisitions (M&A) could start to increase, which could benefit mid-cap stocks

DEFINING MID-CAPS

Mid-cap companies are typically defined as having a market capitalization between $2 billion and $10 billion. In many cases, mid-cap companies tend to be more financially stable than their Small-cap counterparts, since they have moved beyond the volatile start-up phase, and just as stable as larger-cap companies. However, unlike large-cap firms, mid-cap companies offer greater growth potential as their businesses continue to develop from less established entities to more mature companies.

WHY HAVE EXPOSURE TO MID-CAPS?

Mid-cap stocks can potentially offer an attractive long-term risk/return tradeoff. Over the last 20 years, mid-cap stocks have outperformed small-cap stocks and with lower volatility, while offering higher returns than large-cap stocks with only slightly higher volatility. Thus, mid-cap stocks have delivered the strongest risk-adjusted performance as measured by Sharpe Ratio relative to small and large-cap stocks (see Exhibit 1 below).

Exhibit 1: 20-Year Annualized Return vs. 20-Year Annualized Standard Deviation as of November 30, 2013.

Asset Class	20 Year Avg. Annual Return	20 Year Standard Deviation	Cumulative Return%
Large-cap	9.12	15.25	469.11
Mid-cap	12.01	17.60	857.28
Small-cap	11.01	18.84	700.74

**Source: iShares as of 11/30/13; Large-cap = S&P 500, Mid-cap = S&P 400, Small-cap = S&P 600. Performance shown is not representative of the performance of any particular investment. It is not possible to invest directly in an index.

SLOW CHANGE IN SENTIMENT

As retail investors have recognized the benefits of investing in mid-cap equities, they have responded by increasing their mid-cap equity allocation. Despite this increase, we believe investors remain under-exposed to mid-cap equities when considering the strong risk-adjusted returns and potential improvement in portfolio diversification and performance characteristics.

Over the last twenty years, retail investors have nearly doubled their mid-cap allocation from approximately 8% to 12%, yet it has remained around 12% over the last seven years. While investors have allocated approximately 12% of their portfolios to mid-cap equities, this remains well below the composition of mid-caps within the portfolios of many institutional managers at 20%.

Despite this increase in recent years, we believe investors still remain under-exposed to mid-cap equities when considering the strong risk-adjusted returns and potential improvement in portfolio diversification and performance characteristics.

IS THERE A COMPELLING CASE TO INVEST IN MID-CAPS TODAY?

Mid-cap companies tend to be target rich areas for acquisitions for larger companies for a variety of reasons. Larger companies often target smaller rivals to increase their market opportunity, enhance competitive positioning, and augment growth.

While announced US M&A deals in 2012 were down slightly from the prior year, the number of deals picked up in the fourth quarter, increasing 13% from 2011. In 2013, deals are getting done, but at smaller sizes. In addition, corporate balance sheets are flush with cash, as cash/assets is near 11% for the S&P 500 Index, ex-financials, the highest level witnessed over the last four decades.

The combination of healthy balance sheets along with low interest rates to facilitate cheap debt financing, should support continued acquisition activity

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