Volume 2

Two or Three Legged Stool: The case for Mid Cap Growth

Regardless of quality, the producer of two legged stools would have a difficult time finding enthusiastic buyers. Clearly such a manufacturer would find that producing three legged stools that actually stood upright on their own would prove the more successful design. A variation on the above theme can also be found in the realm of investment portfolio design and construction.

Many investors and advisors follow a conventional approach to portfolio construction using a standard style box consisting of four main asset classes (large growth, large value, small growth and small value). However, investors may be missing an opportunity following such a methodology, as the mid cap asset class may overlooked. Allocating specifically to the mid cap asset class holds the potential to improve the returns and overall diversification of an investment portfolio.

So what are mid cap stocks, and why should they be considered as a unique asset class? As the name implies, mid cap stocks occupy the capitalization range between small and large cap stocks. There is no official definition of the asset class, but many consider the range between $ 1 billion to $15 billion as reasonable.

It is important to note that mid cap stocks have unique attributes that make them a compelling asset class for investors. Consider that such mid sized companies have moved up from the sink or swim world of small cap stocks. They may well have multiple products and sales channels available to them unlike many of their small cap brethren. Successfully moving from the small cap arena into the world of mid caps also provides a valuable education to both management and staff as to what it takes to succeed, and move forward in their marketplace. One can say that successful mid cap companies have graduated from the "school of hard knocks."

The success in transitioning from small to mid cap status may also imply a transition in the product cycle and earnings streams of such firms. Interestingly, while the potential for broader and deeper earnings growth is obvious, mid cap stocks are at a unique advantage relative to large cap stocks. In contrast to large cap stocks, mid cap firms will typically have shorter timelines, and less internal bureaucratic roadblocks when it comes to new product development. Additionally, it can be argued, that creating double digit sales growth is relatively more difficult for a massive established company versus a more nimble smaller competitor. Therefore mid cap investors can get the benefit of a more stable established company (unlike many small caps) while enjoying the flexibility and responsiveness within their respective industries to new sales and product placement opportunities (unlike many large caps).

Manager vs Benchmark: Return through August 2006
(not annualized if less than 1 year)
ZephyrStyleADVISOR: Navellier & Associates

	7 Years	5 Years	3 Years	1 Year
Russell Mid Cap Growth	4.07%	7.55%	12.93%	6.00%
Russell 1000 Growth	-3.25%	1.69%	7.00%	3.68%
Russell 2000 Growth	2.91%	6.20%	10.61%	6.00%

Although the debate over allocations between growth and value investing may best be addressed in another article, investors using the growth style may wish to seriously contemplate using mid cap growth within their growth allocations. Through the period ending in the second quarter of 2006, the Russell Mid Cap Growth Index has outperformed the Russell 1000 Growth and Russell 2000 Growth indexes on a trailing three, five, and seven year basis. While performance differences are inherent in the nature of the investment markets, the use of an additional unique asset class may help to achieve the ultimate risk and return goals of many investors.

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