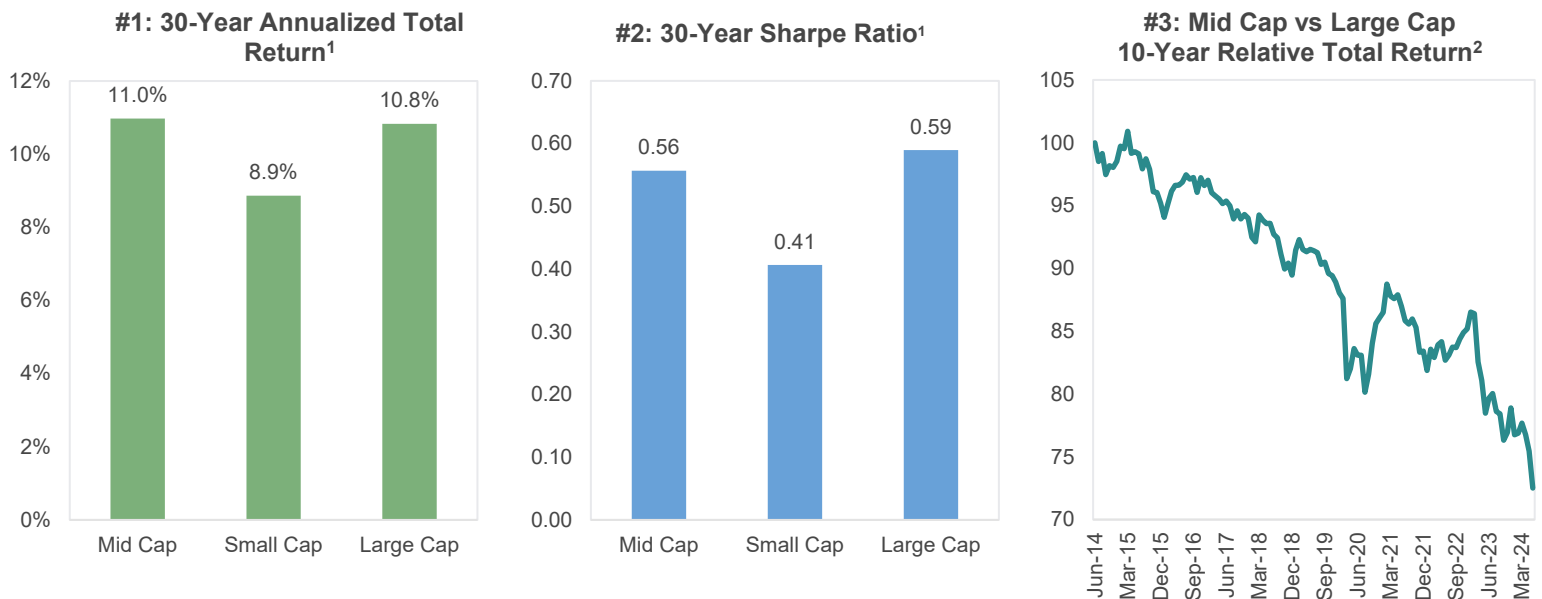


Down but Not Out: Why Mid-Cap Value Appears Increasingly Attractive

September 2024

For almost a decade, large-cap growth has been a dominant factor driving market returns. However, we see mounting evidence mid-cap value stocks are due for a comeback. We have long argued mid caps are a potential “sweet spot” for investors. We believe they boast better liquidity, stronger balance sheets, and more durable competitive advantages than small-cap peers and are often more nimble, focused, and less well covered by the sell side than large caps. This combination has led to strong risk-adjusted returns. Below we show the thirty-year annualized returns for large, mid, and small caps measured by the Russell 1000® Index, Russell MidCap® Index, and Russell 2000® Index, respectively (Chart #1). For total return, mid caps have edged out large caps and comfortably beaten small caps all with favorable risk-adjusted metrics (Chart #2). Mid cap’s long-term performance is notable, as it includes the sharp underperformance relative to large caps over the last decade (Chart #3). With that as today’s setup, we believe it is a good time to revisit the category.



We attribute much of mid cap’s recent underperformance to the anomalous concentration in market returns. The S&P 500® Index has returned +14.5% through 2Q24, but 57% has come from five stocks: Nvidia, Alphabet, Microsoft, Meta and Amazon. Nvidia alone has contributed 30%, the largest by a single stock in over a century. This echoes last year when those same five companies accounted for almost half the index’s return. To put this in context, there have only been nine instances where five stocks or fewer have contributed at least 40% of market returns in the last sixty years. We just experienced two back-to-back.

This ever-increasing concentration is now spilling into index construction. Russell reconstitutes its benchmarks each June, and we believe there are some noteworthy stats this year. The top ten holdings of the Russell 1000® Growth Index now account for 60% of the index (Chart #4), the highest concentration ever. The Russell Midcap® Growth Index only has 288 constituents, the fewest ever. Meanwhile the Russell Midcap® Value Index boasts 713 holdings, roughly in-line with history, and the top ten account for 7.4%, slightly below the historic average of 7.6%.

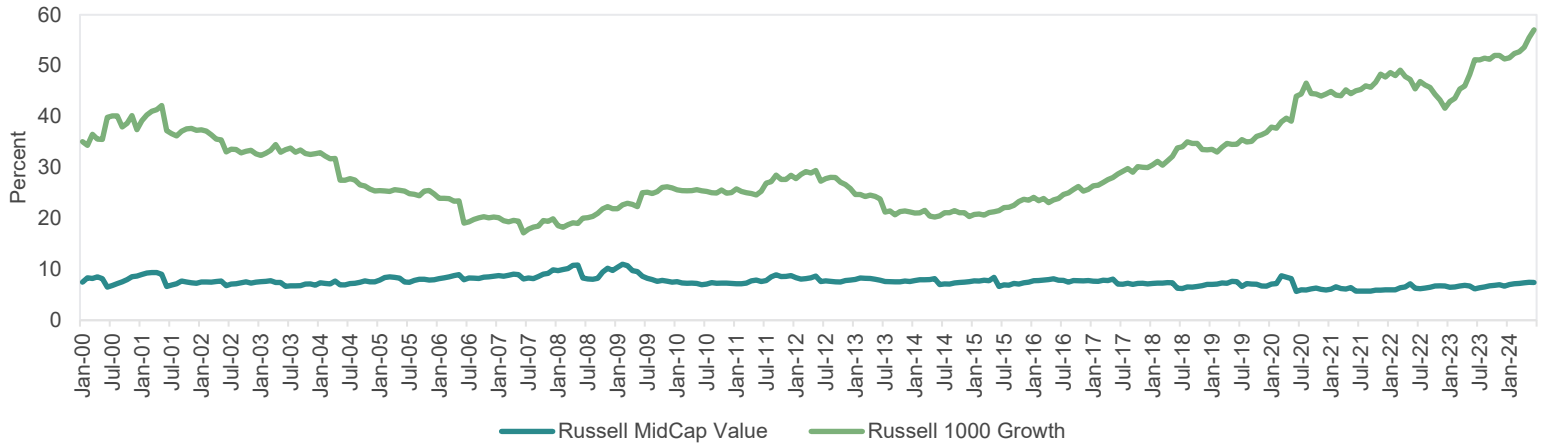
¹Chart source: Morningstar. ²Chart source: FactSet.

Data for all charts is as of 06.30.2024. Charts are for illustrative purposes only. The views expressed represent the opinions of Sterling Capital Management. Any type of investing involves risk and there are no guarantees that these methods will be successful.

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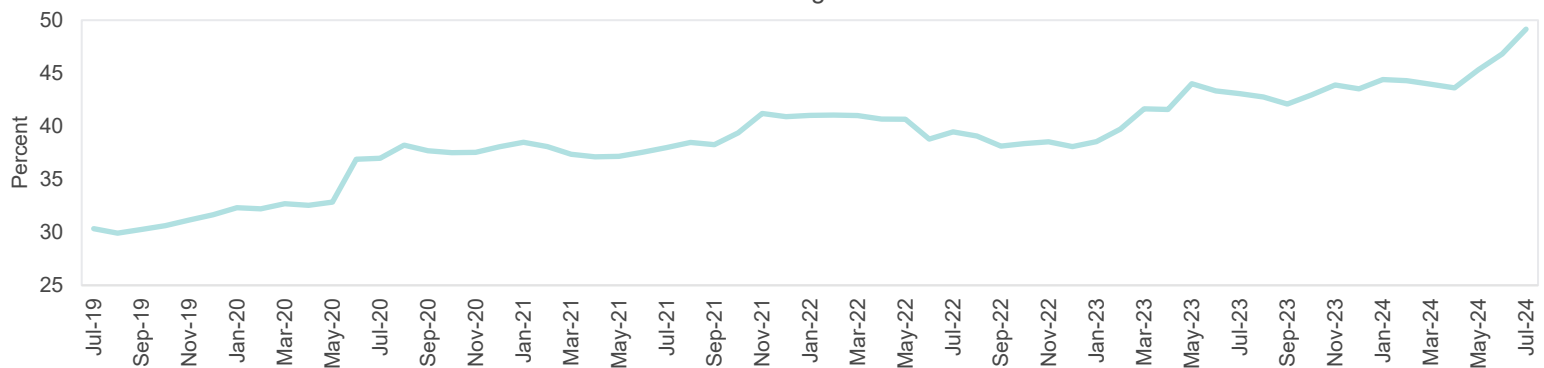
September 2024

#4: Percentage of Top Ten Holdings³
01.01.2000 - 06.30.2024

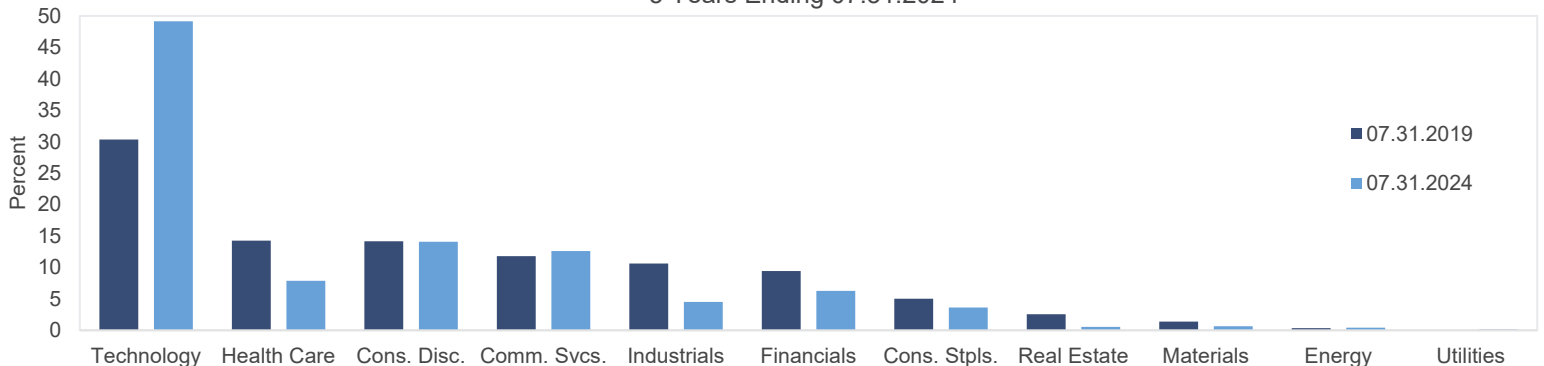


An analysis at the sector level (Chart #5, #6) highlights even greater disparities. The Russell 1000® Growth now has a 50% weighting to technology, the highest ever, and more than 5x higher than its value equivalent, the Russell 1000® Value. Concentration is now so high that many indices would run afoul of the requirements to be considered diversified funds stipulated in the Investment Company Act of 1940. We see this as a risk for allocators and one that may be reduced by revisiting mid-cap value where concentration remains in line or below history.

#5: Russell 1000® Growth Technology Sector⁴
5 Years Ending 07.31.2024



#6: Russell 1000® Growth Sector Weights⁴
5 Years Ending 07.31.2024



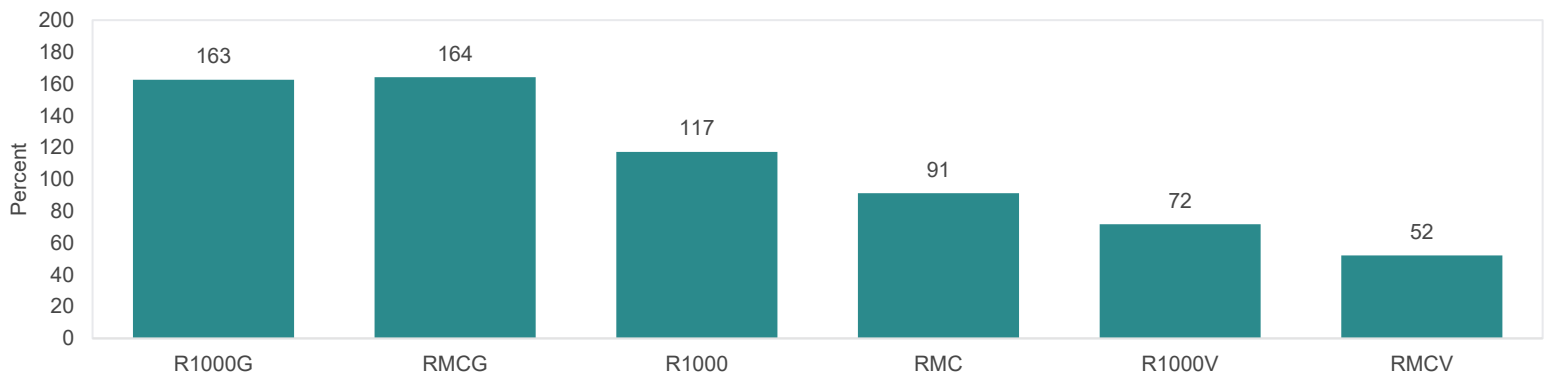
³Chart source: Morningstar. ⁴Chart source: FactSet. Charts are for illustrative purposes only. The views expressed represent the opinions of Sterling Capital Management. Any type of investing involves risk and there are no guarantees that these methods will be successful.

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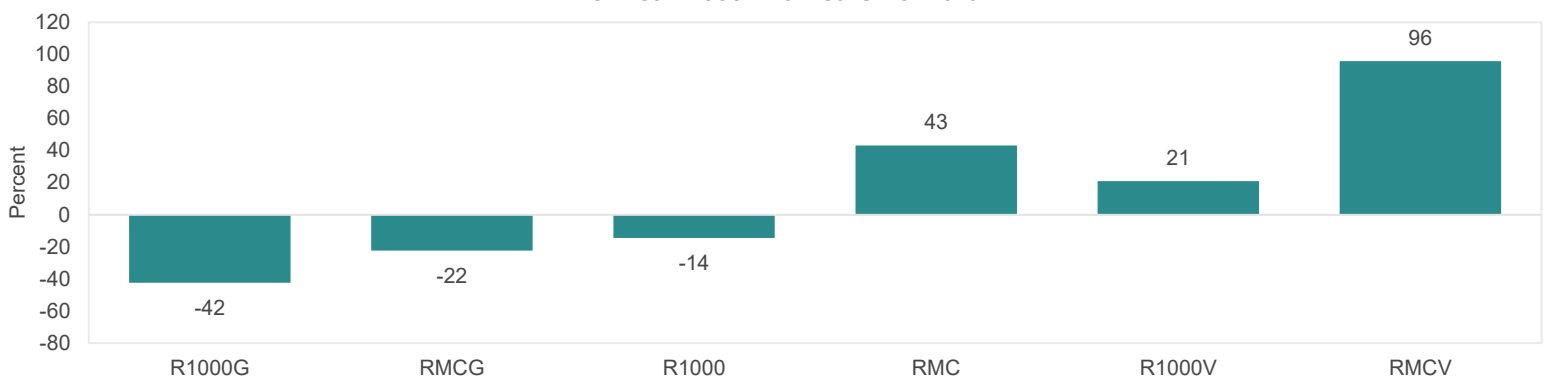
September 2024

History provides some context regarding whether large-cap growth can continue to dominate forward returns. Investors saw a similar scenario in the run up to the dot-com bubble where large-cap growth stocks trounced their mid-cap value peers (Chart #7). However, once the bubble burst, mid caps delivered a decade of solid performance. The Russell Midcap® Value nearly doubled while the Russell 1000® Growth declined a cumulative 42% (Chart #8). We argue the starting point looks similar today given the magnitude of large cap's overperformance over the last ten years and the current enthusiasm for technology stocks.

#7: 1997 - Peak 2000



#8: Peak 2000 - 10-Years Forward



In conclusion, we are optimistic on mid caps given their history of strong returns and attractive risk metrics. It is always difficult to call the peak of a cycle, however we believe the current setup is favorable. Today's unprecedented concentration suggests the spring is coiled tightly should a recovery materialize. For almost twenty years our strategy has aimed to own good businesses with good management at a good price. We are hopeful these attributes will prove favorable as the breadth of the market widens in time.

R1000G = Russell 1000 Growth; RMCG = Russell Midcap Growth; R1000 = Russell 1000; RMC = Russell Midcap; R1000V = Russell 1000 Value; RMCV = Russell Midcap Value. Chart data is sourced from the Morningstar. Charts are for illustrative purposes only. The views expressed represent the opinions of Sterling Capital Management. Any type of investing involves risk and there are no guarantees that these methods will be successful.

Important Information



Will Smith, CFA®
Executive Director | Portfolio Manager

Will C. Smith, CFA®, Executive Director, joined Sterling Capital Management in 2015 and has investment experience since 2002. Will is a co-portfolio manager of Sterling's Fundamental Equity Small Cap Value strategy and Fundamental Equity Mid Cap Value strategy. Prior to joining Sterling, he was an executive director with Goldman Sachs in London as the lead sell side analyst covering the global media and telecommunications sector. Prior to Goldman Sachs, he worked for Jefferies International as the lead sell side analyst covering the global media sector. Will received his B.E. in Structural Engineering from Vanderbilt University and his M.B.A. from the London Business School. He holds the Chartered Financial Analyst® designation.

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Technical Terms: a **Sharpe Ratio** is commonly used to gauge the performance of an investment by adjusting for its risk. **Dotcom Bubble** is a stock market bubble that was caused by speculation in dotcom or internet-based businesses from 1995 to 2000. The **Investment Company Act of 1940** is an act of Congress that regulates the organization of investment companies and the activities they engage in. It sets standards for the investment company industry. A primary purpose of the Act is to protect investors by ensuring that they're aware of the risks associated with buying and owning securities. (The technical terms are sourced from Corporate Finance Institute and Investopedia.)



Important Information

A Note on Indices: The volatility of an index varies greatly. All indices are unmanaged and investments cannot be made directly in an index.

The Russell 1000® Index measures the performance of the large-cap segment of the U.S. equity universe. It is a subset of the Russell 3000® Index and includes approximately 1,000 of the largest securities based on a combination of their market cap and current index membership. The Russell 1000® represents approximately 92% of the U.S. market. The Russell 1000® Index is constructed to provide a comprehensive and unbiased barometer for the large-cap segment and is completely reconstituted annually to ensure new and growing equities are included.

The Russell 1000® Growth Index measures the performance of the large-cap growth segment of the U.S. equity universe. It includes those Russell 1000® companies with higher price-to-book ratios and higher forecasted growth values. The Russell 1000® Growth Index is constructed to provide a comprehensive and unbiased barometer for the large-cap growth segment. The index is completely reconstituted annually to ensure new and growing equities are included and that the represented companies continue to reflect growth characteristics.

The Russell 1000® Value Index measures the performance of the large-cap value segment of the U.S. equity universe. It includes those Russell 1000® companies with lower price-to-book ratios and lower expected growth values. The Russell 1000® Value Index is constructed to provide a comprehensive and unbiased barometer for the large-cap value segment. The index is completely reconstituted annually to ensure new and growing equities are included and that the represented companies continue to reflect value characteristics.

The Russell Midcap® Index measures the performance of the mid-cap segment of the U.S. equity universe. The Russell Midcap® Index is a subset of the Russell 1000® Index. It includes approximately 800 of the smallest securities based on a combination of their market cap and current index membership. The Russell Midcap® Index represents approximately 31% of the total market capitalization of the Russell 1000® companies. The Russell Midcap® Index is constructed to provide a comprehensive and unbiased barometer for the mid-cap segment. The index is completely reconstituted annually to ensure larger stocks do not distort the performance and characteristics of the true mid-cap opportunity set.

The Russell Midcap® Growth Index measures the performance of the midcap growth segment of the U.S. equity universe. It includes those Russell Midcap® Index companies with higher price-to-book ratios and higher forecasted growth values. The Russell Midcap® Growth Index is constructed to provide a comprehensive and unbiased barometer of the mid-cap growth market. The index is completely reconstituted annually to ensure larger stocks do not distort the performance and characteristics of the true mid-cap growth market.

The Russell Midcap® Value Index measures the performance of the midcap value segment of the U.S. equity universe. It includes those Russell Midcap® Index companies with lower price-to-book ratios and lower forecasted growth values. The Russell Midcap® Value Index is constructed to provide a comprehensive and unbiased barometer of the mid-cap value market. The index is completely reconstituted annually to ensure larger stocks do not distort the performance and characteristics of the true midcap value market.

The Russell 2000® Index measures the performance of the small-cap segment of the U.S. equity universe. The Russell 2000® Index is a subset of the Russell 3000® Index representing approximately 10% of the total market capitalization of that index. It includes approximately 2,000 of the smallest securities based on a combination of their market cap and current index membership. The Russell 2000® is constructed to provide a comprehensive and unbiased small-cap barometer and is completely reconstituted annually to ensure larger stocks do not distort the performance and characteristics of the true small-cap opportunity set.

The S&P 500® Index is a readily available, carefully constructed, market-value-weighted benchmark of common stock performance. Currently, the S&P 500 Composite includes 500 of the largest stocks (in terms of stock market value) in the United States and covers approximately 80% of available market capitalization.