WHITE PAPER

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THE CURIOUS CASE OF THE MISSING MID CAPS

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EXECUTIVE SUMMARY:

- Typically ranging from \$5 - \$65 billion, mid caps comprise roughly a quarter of the U.S. equity universe.
- However, most investors are underweight mid cap exposure when compared to the addressable market.
- Mid cap stocks tout a strong risk/return profile historically and attractive valuations presently.
- Industries like Trucking, Cruise Lines, Homebuilders, and REITs are best accessed via mid caps.
- Active managers are well-positioned to capitalize on mid cap informational inefficiencies via specialized research and stock selection skills.
- Investors should consider a higher allocation to actively managed mid cap stocks.

The overall capitalization level of the U.S. equity market has expanded substantially over the past decade, mid caps included. Once characterized as stocks within the \$2 - \$10 billion range, today's mid caps reflect valuations between \$5 - \$101 billion; averaging out at \$29.8 billion within the Russell Mid Cap Index.

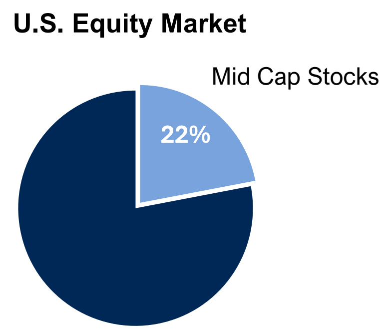
	Average (\$B)	Max (\$B)
Large Cap	1,318	4,533
Mid Cap	29.8	101.6
Small Cap	4.5	31.3

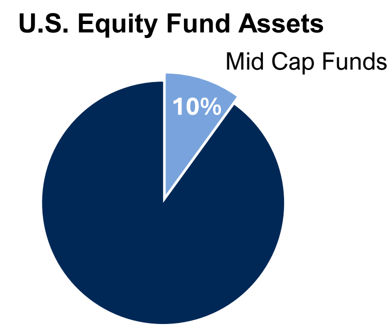
Source: FactSet. Data as of 12/31/25. Indexes used:
Large Cap R1000, Mid Cap RMC, and Small Cap R2000.

Standing at nearly a quarter of the addressable universe by name[1] with valuations in the tens of billions each, it's fair to say that mid cap companies comprise a significant segment of the U.S. market. However, data suggests that both institutional and individual investors remain significantly under-allocated to the space.

Broadly speaking, U.S. investors hold lower than half the mid cap stock exposure versus to the addressable market, as represented by the Russell 3000. The average U.S. investor's exposure stands near 10%, when compared to the index's 22%, per Morningstar. The deficiency is even greater within the \$11 trillion Defined Contribution space, where combined small and mid cap holdings comprise only 7.2% of U.S. retirement plan assets, as reported by Callan[2]. Why?

[1] Russell 3000 Index captures approximately 98% of listed U.S. stocks. Mid cap companies typically comprise 22 - 26% of the index by name and 6 - 8% by revenue.
[2] Callan Research Institute, March 31, 2024, data





Source: FactSet, FTSE Russell and Morningstar Direct, as of 3/31/24. U.S. Equity Market = Russell 3000 Index. Mid-Cap Equity Market = Russell Midcap® Index. U.S. Equity Fund Assets = Morningstar U.S. Mid-Cap categories.

Some investors choose to eschew mid caps entirely. This decision can be based on any number of factors: fundamental, technical, lack of familiarity, et al. But these investors purposefully avoid mid cap ownership.

Another camp prefers to access mid caps via SMID mandates. However, there are structural issues at play here: unless a SMID manager is significantly overweight mid cap names, this approach will dilute an investor's overall exposure, splitting an already small piece of the portfolio pie into a "sub-slice."

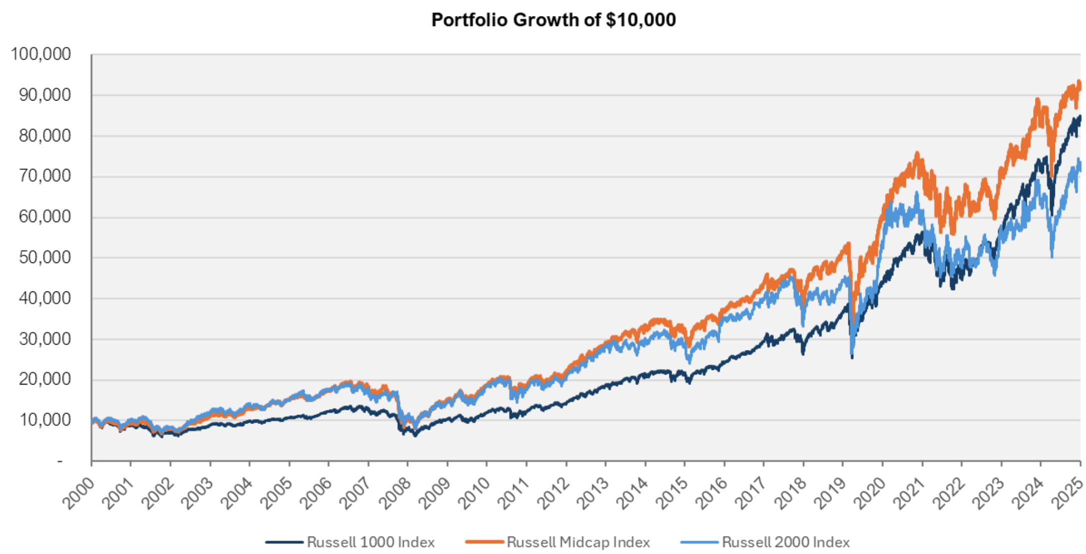
Still others employ a "barbell" approach, reasoning that a combination of small and large cap exposure "averages out" to mid cap ownership. This method is fundamentally flawed: owning small and large cap stocks averages out to owning small and large cap stocks; you simply don't own mid caps.

Interestingly, certain categories are accessible almost exclusively via the mid cap market. Below is a partial list of S&P industries with the largest company in each. For example, the largest U.S. Trucking company touts a $32.8 billion market cap. However, a stock of this size may be too small for a large cap mandate, leaving large cap managers unable access the Trucking category. With limited exception, the industries listed below are not represented within the large and mega cap universe. The dominant players are mid caps. And while investors can gain access via small caps, the benefits of owning a well-funded & diversified operator often outweigh the risks of owning their smaller competitors.

Industry	Largest Company	Ticker	Mkt Cap ($B)
Video Gaming	Take-Two Interactive Software, Inc.	TTWO	$46.3
Auto Components	Aptiv PLC	APTV	$16.4
Casinos	Las Vegas Sands Corp.	LVS	$44.0
Cruise Lines	Royal Caribbean Group	RCL	$76.1
Homebuilders	DR Horton, Inc.	DHI	$42.0
Grocery Stores	Kroger Co.	KR	$39.5
Trucking	Old Dominion Freight Line, Inc.	ODFL	$32.8
Airlines	Delta Air Lines, Inc,	DAL	$45.3
Media	Fox Corp.	FOX	$31.0
Retail REITs	Simon Properties Group, Inc.	SPG	$60.4

Source: FactSet. Data as of 12/31/25.

Moving to performance, mid cap stocks have outperformed their peers, exhibiting only slightly elevated volatility versus large caps and lower versus small since the year 2000. Mid cap stocks are also efficient with their risk, touting a Sharpe ratio far exceeding that of small caps, while matching that of large.



Index	CAGR	Std. Dev.	Sharpe Ratio
Russell 1000	8.88%	19.36%	0.45
Russell Midcap	9.26%	20.53%	0.45
Russell 2000	8.18%	24.14%	0.33

Source: Bloomberg. Data as of 12/31/25.

While indexing the space is indeed an option, we believe active managers hold a decisive edge versus passive. A lack of sell-side research offers mid cap specialists a valuable opportunity to assess idiosyncratic strengths and weaknesses: identifying the best- while avoiding the worst- companies for investment.

Active managers also hold an empirical advantage. Concentrated, high-conviction portfolios typically yield the most attractive results. Tracking error and active share measure a portfolio's differentiation versus its index. Research confirms that managers with strong selection skills, a repeatable process and high Active Share are those who outperform the market most consistently[3].

[3] Based on the work of Martijn Cremers and Antii Petajisto (source: "How Active is your Fund Manager" University of Notre Dame, 2000) and several related studies since.

CONCLUSION:

All investors hold large cap stocks and most hold small caps. Yet many are underweight or entirely avoid mid cap stocks. These investors are missing out.

Mid cap companies exhibit lower risk than small caps yet, possess solid growth potential. Mid cap companies have attractive risk/return profiles and trade at discounted valuations to large caps today. Finally, attractive investment opportunities in Trucking, Cruise Lines, Homebuilders and other categories exist almost exclusively within the mid cap universe.

Active managers are well-positioned to identify strong mid cap names. And a high conviction, high Active Share approach to portfolio construction typically delivers the most attractive results. As such, most investors would likely benefit from a higher allocation to actively managed, mid cap stocks.

ABOUT US:

Vaughan Nelson is a $15.1* billion, Houston-based investment manager focused US and International equity strategies. Vaughan Nelson constructs fundamental driven, high active share, factor diversification portfolios with a targeted return philosophy seeking investments positioned to compound at double-digit rates annually.

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* As of 12/31/25.