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INVESTMENT MANAGEMENT

The Case for Mid-Caps: A Smarter Way to Balance Portfolios in 2025

Why Mid-Caps Now?

In today's environment of market volatility, stretched large-cap valuations and persistent policy uncertainty, advisors could be rethinking how to create durable value for clients. The large-cap S&P 500 Index is more concentrated than ever, with the top 10 companies driving a disproportionate share of returns. That leaves many portfolios overly exposed to a handful of mega-cap names — especially in tech and artificial intelligence (AI).

On the other end of the spectrum, small-caps have struggled. The asset class has shown elevated volatility over 40-plus years and inconsistent earnings going back nearly two decades, making it a challenging option when risk control is a priority.

That's where mid-caps come in. Historically, they've delivered strong, consistent performance across market cycles, often outperforming both large- and small-caps over long time periods. They also strike a balance of the aspirational growth potential of small-caps with the stability more common in large-caps.

Figure 1 Annualized Returns Through December 2024

	5 Years	10 Years	20 Years	30 Years	40 Years	LT[1]
Large-cap	15.8%	14.0%	10.6%	11.0%	11.7%	12.0%
Mid-cap	9.9%	9.6%	9.6%	11.2%	12.0%	12.8%
Small-cap	7.4%	7.8%	7.8%	9.0%	9.7%	11.0%

[1] Dec. 1978 – Dec. 2024

Source: Refinitiv Eikon; data as of Dec. 31, 2024. Large-cap = Russell Top 200 Index; Mid-cap = Russell Midcap Index; Small-cap = Russell 2000 Index.

To learn more about Jensen's Quality Mid Cap Strategy, please visit: jenseninvestment.com/quality-mid-cap

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Long-Term Outperformance with Lower Volatility

Figure 2 Annualized Standard Deviation of Returns Through December 2024

	5 Years	10 Years	20 Years	30 Years	40 Years	LT[1]
Large-cap	18.0%	15.3%	14.7%	15.2%	15.1%	15.1%
Mid-cap	21.4%	17.6%	17.5%	17.1%	17.0%	17.0%
Small-cap	24.5%	20.6%	20.2%	20.1%	19.7%	19.8%

[1] Dec. 1978 – Dec. 2024

Source: Standard deviations calculated based on return data from Refinitiv Eikon; data as of Dec. 31, 2024. Large-cap = Russell Top 200 Index; Mid-cap = Russell Midcap Index; Small-cap = Russell 2000 Index.

Since 1978, mid-cap stocks have outperformed small-caps over each of these rolling time periods: five, 10, 20, 30 and 40 years. They've even bested large-caps over the 30- and 40-year windows. These returns came with lower volatility than small-caps as well, making the evidence even more compelling. That means mid-caps haven't just delivered better performance, they've done it more consistently, with fewer drawdowns.

Fundamentals That Matter

Since 2007, mid-cap companies have:

- Grown revenues faster than both small- and large-cap peers
- Maintained higher earnings before interest and taxes (EBIT) margins and returns on equity (ROE) than small-caps
- Operated with lower debt levels

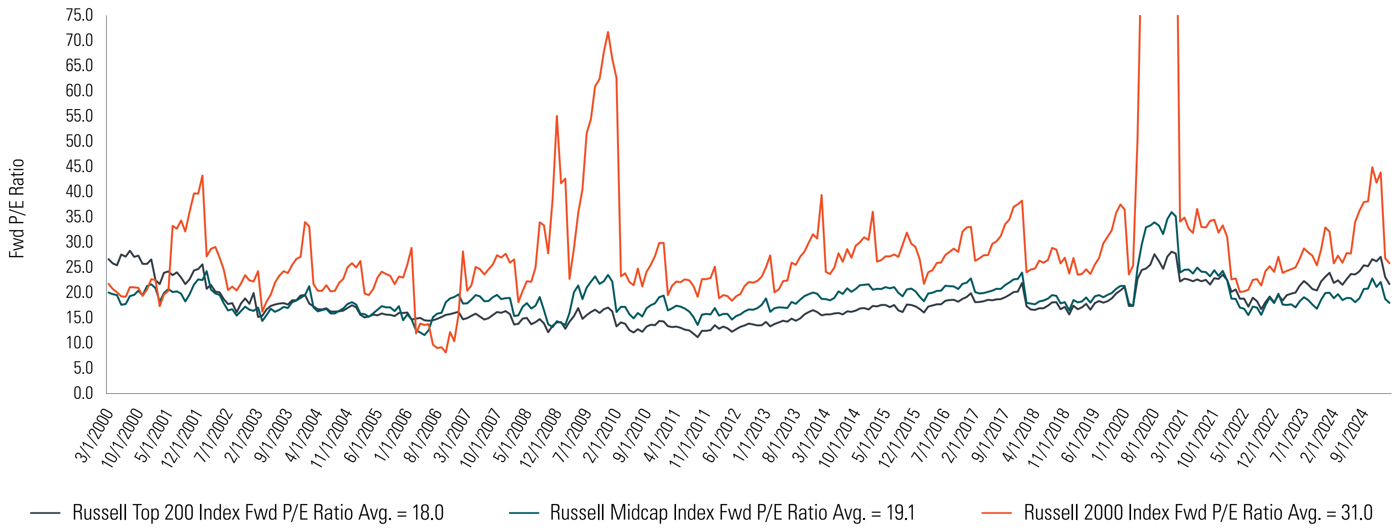
Figure 3 Average Fundamentals: 2007 - 2024

	Growth	**Profitability**		**Leverage**
	Revenue	EBIT Margin	ROE	Net Debit / EBITDA
Large-cap	4.3%	13.8%	15.4%	1.6
Mid-cap	5.9%	9.1%	9.3%	3.1
Small-cap	5.6%	4.7%	2.0%	4.4

Source: Bloomberg; data as of Dec. 31, 2024. Large-cap = Russell Top 200 Index; Mid-cap = Russell Midcap Index; Small-cap = Russell 2000 Index.

These are the kinds of fundamentals that support compounding over time — and they help explain why mid-caps have historically produced more attractive risk-adjusted returns.

Figure 4 | **Forward P/E Ratio 3/31/2000 - 3/31/2025:** Russell Top 200, Russell Midcap and Russell 2000 Indices



Source: Bloomberg; data as of March 31, 2025.

Valuation Advantage

Over the past 25 years, mid-caps have traded at a modest premium to large-caps (19.1x vs. 18.0x forward earnings), but that premium has vanished in recent years. Today, mid-caps are trading at a discount to large-caps and well below the lofty valuations of small-caps, which average around 31x forward earnings.

Put simply: mid-caps look like a bargain in today's market compared to small-caps.

Why Not SMID?

Some advisors favor small-cap/mid-cap blend (SMID) strategies to access both small- and mid-cap exposure. But history shows that small-caps have failed to keep pace with mid-caps across every major timeframe. And small-caps come with higher volatility and business risk. The numbers make a clear case: mid-caps can deliver the upside many seek in small-caps without the noise.

Mid-Caps in a Volatile World

Mid-cap companies tend to be more domestically focused than large-caps, insulating them from geopolitical shocks and trade policy swings (like tariff-related shifts). In a time of growing global complexity, that domestic tilt can help reduce headline risk.

A Better Way to Diversify

For advisors looking to reduce concentration risk without adding excessive volatility, mid-caps may offer an elegant solution. Whether as a replacement for small-cap exposure or a complement to large-cap holdings, mid-caps have historically provided a path to better outcomes.

To learn more about Jensen's Quality Mid Cap Strategy, a high-conviction approach focused on companies with consistent 15%+ return on equity (ROE) and durable growth characteristics, visit:
www.jenseninvestment.com/quality-mid-cap.

Definitions:

Debt to Capital: A measurement of a company's financial leverage, calculated as the company's debt divided by its total capital.

EBIT: Earnings before interest and taxes.

EBITDA: Earnings before interest, taxes, depreciation and amortization.

Forward P/E: A tool for comparing the prices of different common stocks. It is calculated by dividing the projected future earnings per share into the current market price of a stock.

Net Debt: Measures the ability of a company to pay of all of its debts if they become due immediately. It is the difference between a company's gross debt and the cash and other liquid assets it has on hand.

Price-to-Earnings (P/E) Ratio: Is a common tool for comparing the prices of different common stocks and is calculated by dividing the earnings per share into the current market price of a stock.

Return on Equity (ROE): Is equal to a company's after-tax earnings (excluding non-recurring items) divided by its average stockholder equity for the year.

Standard Deviation: This statistical measurement of dispersion about an average depicts how widely a mutual fund's returns varied over a certain period of time. Investors use the standard deviation of historical performance to try to predict the range of returns that are most likely for a given fund. When a fund has a high standard deviation, the predicted range is wide, implying greater volatility.

Generally, small- and mid-capitalization companies, and less-seasoned companies, have more potential growth than large-capitalization companies. They also often involve greater risk than large-capitalization companies. Small- and mid-cap companies may not have the management experience, financial resources, product diversification and competitive strengths of large-cap companies. Therefore, their securities tend to be more volatile than the securities of larger, more established companies, making them less liquid than other securities.

The information contained herein represents management's current expectation of how Jensen Quality Mid Cap Strategy will continue to be operated in the near term; however, management's plans and policies in this respect may change in the future. In particular, (i) policies and approaches to portfolio monitoring, risk management and asset allocation may change in the future without notice and (ii) economic, market and other conditions could cause the strategy and accounts invested in the strategy to deviate from stated investment objectives, guidelines and conclusions stated herein.

Certain information contained in this article represents or is based upon forward-looking statements, which can be identified by the use of terminology such as "may," "will," "should," "expect," "anticipate," "target," "project," "estimate," "intend," "continue" or "believe" or the negatives thereof or other variations thereon or comparable terminology. Due to various risks and uncertainties, actual events or results or the actual performance of a client account may differ materially from those reflected or contemplated in such forward-looking statements.

This information is current as of May 20, 2025, and is subject to change at any time, based on market and other conditions.

Indexes are unmanaged and one cannot directly invest in an index. Past performance is no guarantee of future results.

The Russell Midcap Index is a market capitalization-weighted index comprised of 800 publicly traded U.S. companies with market caps of between \$2 and \$10 billion. The 800 companies in the Russell Midcap Index are the 800 smallest of the 1,000 companies that comprise Russell 1000 Index.

The Russell Top 200 Index measures the performance of the largest-cap segment of the U.S. equity universe. It includes approximately 200 of the largest securities based on a combination of their market cap and current index membership.

The Russell 2000 Index measures the performance of the small-cap segment of the U.S. equity universe. It includes approximately 2,000 of the smallest securities based on a combination of their market cap and current index membership.

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