WEEKLY MARKET COMMENTARY

April 7, 2025

WEEK IN REVIEW

Market indexes declined last week as investors adjusted their future expectations in response to increasing global trade tensions.

- The S&P 500 declined **-9.08%**
- The Dow Jones Industrial Average dropped **-7.86%**
- The tech-heavy Nasdaq fell **-9.77%**
- The 10-Year Treasury yield closed at **3.99%**

Last week, markets were transfixed by the sweeping tariffs presented by U.S. President Trump and the idea of an ever-escalating trade war. However, in the background, several key economic reports were released that might have been overlooked. Here is a summary of the important economic reports from last week.

The labor market data was significant. February's Job Openings and Labor Turnover Survey (JOLTS) report showed fewer job openings than forecast, confirming a softening labor market. On Wednesday, the ADP Nonfarm Payrolls report for March came in higher than expected, adding 155,000 jobs compared to the expected 118,000, contrasting February's underperformance. Friday's Bureau of Labor Statistics Nonfarm Payrolls report confirmed March's labor market strength, with employment changes beating forecasts, adding 225,000 jobs compared to the expected 137,000. The Private Nonfarm Payrolls report also exceeded expectations at 209,000. The Unemployment Rate for March ticked higher to 4.2%. Weekly employment data provided mixed signals, with continuing jobless claims higher than expected and initial jobless claims lower.

Survey data from the Services and Manufacturing industries was also notable. S&P Global revised both the Manufacturing and Services Purchasing Managers' Indexes (PMI) upward, providing optimism. However, ISM Manufacturing and Services PMI data disappointed. The ISM survey, which focuses on larger companies and is based on data from purchasing and supply executives, indicated conflicting inflationary pressures. Manufacturing prices rose, while services prices fell.

Overall, last week's data highlighted the complexity of the economy. The mixed signals from various reports suggest that market participants, including the Federal Reserve, will need to carefully navigate the ever-changing economic landscape. The contrasting data points underscore the importance of a nuanced approach to economic analysis and policy-making.

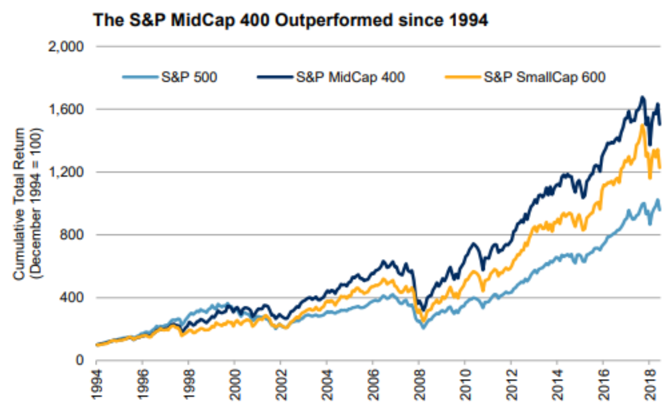
SPOTLIGHT

The Underrated Power of Mid-Cap Stocks: Growth, Returns, and Diversification

In the dynamic world of investing, mid-cap stocks offer a compelling blend of growth potential and relative stability, often overlooked despite their strong historical performance and diversification benefits. This article explores the key advantages of mid-cap investing, highlighting their outperformance, attractive risk-adjusted returns, growth potential, and diversification benefits, while also addressing their under-allocation and inherent risks.

A History of Outperformance and Enhanced Risk-Adjusted Returns

Historically, mid-cap stocks have demonstrated a strong track record of outperforming both large and small-cap equities. MSCI data shows the MSCI World Mid Cap Index surpassed both larger and smaller companies between October 2008 and October 2012. This trend is further supported by SPDR's analysis of the S&P MidCap 400 between beginning in 1994, which reveals an average annualized excess return of 1.12%. Specifically, the S&P MidCap 400 has outperformed the S&P 500 (large caps) by 2.03% and the S&P SmallCap 600 by 0.92% annually since December 1994 (through 2018). This long-term data underscores mid-caps' potential for delivering strong returns relative to the risk taken, often exhibiting enhanced risk-adjusted returns.



Source: S&P Dow Jones Indices LLC. Data from Dec. 30, 1994, to May 31, 2019. Index performance based on monthly total return in USD. Past performance is no guarantee of future results. Chart is provided for illustrative purposes.

However, recent performance has seen a shift, with the S&P 500 outperforming both small and mid-caps in the last five years. This outperformance in large-cap stocks was particularly pronounced after March 2020, coinciding with the Federal Reserve's interest rate cuts that significantly benefited high-growth technology stocks, a large component of the S&P 500. Despite this recent divergence, the longer-term historical data still highlights the compelling risk-adjusted return potential of mid-cap investments over extended periods.

The Sweet Spot: Balancing Growth and Stability

Mid-cap stocks occupy a unique middle ground, offering a balance between the high growth potential of small caps and the relative stability of large caps. MSCI notes that mid-caps provide higher growth potential than large caps with more stability than small caps. These companies are often in a significant expansion phase, possessing the agility to pursue growth while having established a degree of operational maturity. SPDR supports this, describing mid-caps as nimble with high growth potential alongside more established management. This blend positions mid-caps as attractive for investors seeking growth without the higher volatility often associated with smaller, less proven entities.

An Overlooked Opportunity: The Under-allocation of Mid-Caps

Despite their historical performance and growth profile, mid-cap stocks are frequently under-allocated in investment portfolios compared to small-caps. Data indicates similar allocation proportions despite mid-caps representing roughly twice the market capitalization of small-caps. This under-allocation, particularly in active funds, suggests a potentially overlooked segment offering opportunities for investors.

Mid-Caps Appear Under-Allocated Compared to Small-Caps

SIZE	PROPORTION OF ASSETS ALLOCATED (%)		
	ACTIVE AND PASSIVE	ACTIVE	PASSIVE
MUTUAL FUNDS – RETAIL			
Large	84.51	83.85	85.10
Mid	8.22	7.56	8.81
Small	7.27	8.58	6.09
MUTUAL FUNDS – INSTITUTIONAL			
Large	79.82	58.28	86.59
Mid	12.18	19.95	9.74
Small	8.00	21.77	3.67
MUTUAL FUNDS – RETAIL AND INSTITUTIONAL			
Large	82.50	76.80	85.88
Mid	9.92	10.98	9.29
Small	7.58	12.22	4.83

Source: Morningstar. Data as of Dec. 31, 2018. Past performance is no guarantee of future results.
Table is provided for illustrative purposes.

Enhancing Portfolio Diversification

Incorporating mid-cap stocks into an investment portfolio can significantly enhance diversification and potentially improve overall risk-adjusted returns. MSCI's research indicates that including mid-caps can lead to superior risk-adjusted performance by providing exposure to a distinct market segment. SPDR's analysis supports this, demonstrating that mid-caps can improve returns without a corresponding increase in volatility, resulting in better Sharpe and Sortino ratios compared to small caps. The inclusion of the S&P MidCap 400 in a multi-asset portfolio has been shown to offer better diversification benefits. The chart below indicates that S&P MidCap 400 currently provides a greater level of diversification out of the technology sector.

SECTOR WEIGHTINGS

	December 31, 2011			December 31, 2024		
	Russell Midcap® Index	Russell 2000® Index	S&P 500® Index	Russell Midcap® Index	Russell 2000® Index	S&P 500® Index
Communication Services	3.32%	3.08%	7.43%	3.64%	2.69%	9.37%
Consumer Discretionary	12.13%	10.71%	7.19%	10.86%	9.66%	11.28%
Consumer Staples	7.04%	4.00%	11.46%	4.83%	2.82%	5.53%
Energy	7.50%	6.49%	12.10%	5.30%	5.13%	3.16%
Financials	13.91%	16.38%	13.28%	16.96%	18.65%	13.67%
Health Care	9.00%	11.80%	12.09%	9.30%	16.34%	10.09%
Industrials	13.05%	17.20%	11.15%	17.11%	17.55%	8.18%
Information Technology	11.86%	14.53%	16.07%	13.52%	13.82%	32.39%
Materials	6.55%	4.48%	3.14%	5.25%	4.52%	1.89%
Real Estate	7.73%	7.74%	2.13%	7.59%	6.11%	2.10%
Utilities	7.90%	3.61%	3.97%	5.65%	2.71%	2.33%

Data is obtained from FactSet Research Systems and is assumed to be reliable.

Source: Kayne Anderson Rudnick: The Case for Mid-Caps

Potential Downside Risks and Volatility

While offering compelling benefits, mid-cap stocks also carry inherent risks. Compared to large-caps, they often have fewer financial resources, making them more vulnerable during economic downturns. Saxo Bank notes their generally higher volatility compared to larger companies due to their size and less established markets. They can also have a narrower focus, increasing sector-specific risks and tend to have less analyst coverage. Investors should be aware of this potentially higher volatility compared to large-caps.

Conclusion

Mid-cap stocks offer a compelling combination of historical outperformance, attractive risk-adjusted returns, significant growth potential, and valuable diversification benefits. While acknowledging recent large-cap strength and the inherent risks of the asset class, the evidence suggests that a strategic allocation to mid-caps can be a valuable component of a well-rounded investment portfolio, potentially enhancing long-term growth and overall performance.

Works Referenced:

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WEEK AHEAD

This week is packed with significant economic releases. On Monday, the Federal Reserve will release the monthly change in the total value of outstanding consumer credit, providing insights into consumer borrowing trends. Tuesday will see the American Petroleum Institute reporting inventory levels of crude oil, petrol, and distillate, which are crucial indicators for the energy market. The Federal Open Market Committee (FOMC) meeting minutes will be published on Wednesday, offering a detailed account of the discussions and decisions made during the latest policy meeting. Thursday brings the initial jobless claims and Core Consumer Price Index (CPI) data, both of which are key indicators of the labor market and inflation trends. Finally, on Friday, the Core Producer Price Index (PPI) and Michigan Consumer Expectations will be released, shedding light on producer inflation and consumer sentiment, respectively. This array of data will provide a comprehensive view of the current economic landscape.

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The Dow Jones Industrial Average (DJIA) is a price-weighted index composed of 30 widely traded blue-chip U.S. common stocks. The S&P 500 is a market-cap weighted index composed of the common stocks of 500 leading companies in leading industries of the U.S. economy. The NASDAQ Composite Index is a market-value weighted index of all common stocks listed on the NASDAQ stock exchange.

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