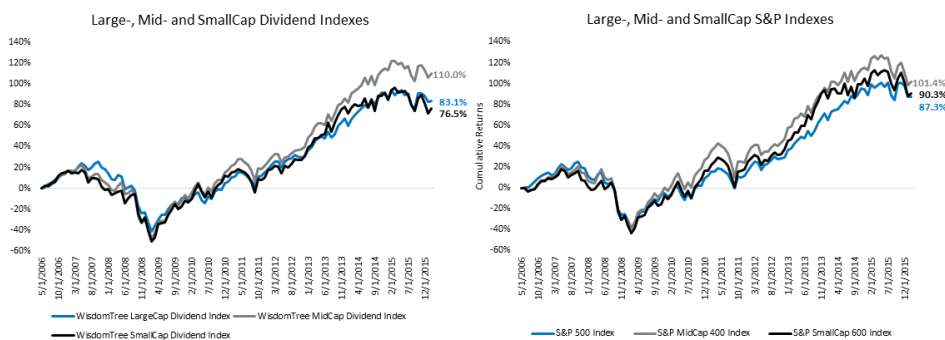


# FORGET MID CAPS ONLY AT YOUR PERIL

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It has been almost a decade since we launched our first [dividend](#)-focused strategies back in June of 2006. One of the stories that have stood out over this period has been the incredible performance of mid-cap stocks. **Mid-Cap Stocks Have Been Strong, Both in Dividends and in [Market Capitalization-Weighted](#) Indexes**



Source: Bloomberg, for period 6/1/2006–2/29/2016, with 6/1/2006 being the inception date for the WisdomTree Indexes shown. Past performance is not indicative of future results. You cannot invest directly in an Index.

Index performance does not represent actual fund or portfolio performance. A fund or portfolio may differ significantly from the securities included in the index. Index performance assumes reinvestment of dividends but does not reflect any management fees, transaction costs or other expenses that would be incurred by a portfolio or fund, or brokerage commissions on transactions in fund shares. Such fees, expenses and commissions could reduce returns.

*For definitions of indexes in the chart, visit our [glossary](#).* The mid-cap stocks' outperformance poses three important questions, which I will answer below. **Question 1: why Did Mid-Cap Stocks Outperform [Large Caps](#) and [Small Caps](#)?** *On the Dividend Side:* when comparing the [WisdomTree MidCap Dividend Index](#) to the [WisdomTree LargeCap Dividend Index](#), there were only four sectors in the MidCap Index that underperformed their respective counterparts in the LargeCap Index—Information Technology, Energy, Telecommunication Services and Health Care. Financials contributed the most to the relative outperformance, as the big banks were the primary component of the large-cap segment, and they did not do well over this period. While the mid-cap banks were not positive either, they did manage to hold up better than their large-cap counterparts. This allowed insurance companies and real estate companies—whose industry exposure within the large-cap segment was much smaller, to really shine. When comparing the wisdomTree MidCap Dividend Index to the [WisdomTree SmallCap Dividend Index](#), financials become the biggest detractor from relative performance, as the small-cap financials dramatically outperformed their mid-cap counterparts over this period. On the other hand, the Consumer Discretionary sector was the biggest contributor to relative outperformance—with retailing, consumer durables and consumer services contributing strongly to relative outperformance. *On the [Market Capitalization](#) Side:* Comparing the [S&P MidCap 400 Index](#) to the [S&P 500 Index](#) confirms that the biggest difference over the period was the mid-cap index' avoidance of the large banks—the same as in the dividend-focused comparison. However, although the Information Technology, Energy and Telecommunication Services (along with Consumer Discretionary) sectors within the S&P MidCap 400 Index also underperformed their respective counterparts within the S&P 500 Index, just like we saw in the dividend-focused comparison, the Health Care sector did not underperform—a notable difference of

the market capitalization-focused comparison. The comparison of the S&P MidCap 400 Index against the [S&P SmallCap 600 Index](#) showed a very different picture. Unlike the mid-cap and small-cap dividend indexes, financials did not have an average weight of approximately one-third of the entire index here and thus were relatively inconsequential. The Consumer Discretionary sector was the biggest relative contributor to outperformance—similar to the dividend-focused side—but Information Technology was the biggest relative detractor. **Question 2: Why Did Mid-Cap Dividend Payers Outperform Mid-Cap Stocks weighted by Market Capitalization?** When comparing the WisdomTree MidCap Dividend Index to the S&P MidCap 400 Index, the first thing that stands out over this period was that *only one* sector in the dividend-focused Index underperformed its respective counterpart in the market capitalization-weighted index: Health Care. Within Health Care, biotechnology and pharmaceuticals were strong performers, and the fact is, they don't tend to be early dividend payers in their life cycles, thereby not gaining inclusion in the WisdomTree MidCap Dividend Index. Consumer Discretionary was the sector responsible for the lion's share of the relative outperformance, and what was interesting is that the average weight to this sector between the two indexes was very similar. Focusing on dividend-paying stocks contributed 11% of the 13% relative performance difference. **Question 3: Can the Strong Performance of Mid-Cap Stocks Continue?** While this may be the single most important question, it is also the most difficult to answer. We approach it from two distinct standpoints: 1) **Valuation:** One way to think about valuation is the change in the [price-to-dividend ratio](#)—in other words, the reciprocal of the [dividend yield](#). The price level of the index per unit of dividends has decreased approximately 4.6% per year for the S&P MidCap 400 Index, even as the price level for this index increased 75% between June 1, 2006, to February 29, 2016. Also note the [price-to-earnings \(P/E\) ratio](#), which went from 20.7x to 19.2x over this same period. This tells us that even though prices increased—significantly!—the [fundamentals](#) appreciated even faster. 2) **Process:** If we had to make one distinction between the S&P MidCap 400 Index and the WisdomTree MidCap Dividend Index, it would be the [annual index screening](#) and [rebalancing](#) that is employed by WisdomTree and is focused on a measure of relative value—namely dividends. If a part of the dividend-paying mid-cap market appreciates quickly in price—faster than the growth of its dividends—the process of the WisdomTree MidCap Dividend Index will tilt weight away from it and toward areas where dividends have increased faster than prices. While we don't know if mid-caps will be strongest over the next 10 years, we believe that it's the focus on the process of mitigating valuation risk that could become more important.

*Unless otherwise noted, data source is Bloomberg, with period from 6/1/2006 to 2/29/2016.*

For standardized performance and the most recent month-end performance click [here](#) NOTE, this material is intended for electronic use only. Individuals who intend to print and physically deliver to an investor must print the monthly performance report to accompany this blog.

For more investing insights, check out our [Economic & Market Outlook](#)

View the online version of this article [here](#).

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## DEFINITIONS

**Dividend**: A portion of corporate profits paid out to shareholders.

**Market capitalization-weighting**: Market cap = share prices x number of shares outstanding. Firms with the highest values receive the highest weights in approaches designed to weight firms by market cap.

**Large-Capitalization (Large-Cap)**: A term used by the investment community to refer to companies with a market capitalization value of more than \$10 billion. Large cap is an abbreviation of the term “large market capitalization”. Market capitalization is calculated by multiplying the number of a company’s shares outstanding by its stock price per share.

**Small caps**: new or relatively young companies that typically have a market capitalization between \$200 million to \$2 billion.

**Market Capitalization**: Market cap = share prices x number of shares outstanding. Firms with the highest values receive the highest weights in approaches designed to weight firms by market cap.

**S&P MidCap 400 Index**: provides investors with a benchmark for mid-sized companies. The index covers over 7% of the U.S. equity market, and seeks to remain an accurate measure of mid-sized companies, reflecting the risk and return characteristics of the broader mid-cap universe on an on-going basis.

**S&P 500 Index**: Market capitalization-weighted benchmark of 500 stocks selected by the Standard and Poor’s Index Committee designed to represent the performance of the leading industries in the United States economy.

**S&P SmallCap 600 Index**: Market capitalization-weighted measure of the performance of small cap equities within the United States, with constituents required to demonstrate profitability prior to gaining initial inclusion.

**Valuation**: Refers to metrics that relate financial statistics for equities to their price levels to determine if certain attributes, such as earnings or dividends, are cheap or expensive.

**Price-to-dividend ratio**: Refers to the index price divided by the trailing 12-month dividends.

**Dividend yield**: A financial ratio that shows how much a company pays out in dividends each year relative to its share price.

**Price-to-earnings (P/E) ratio**: Share price divided by earnings per share. Lower numbers indicate an ability to access greater amounts of earnings per dollar invested.

**Fundamentals**: Attributes related to a company’s actual operations and production as opposed to changes in share price.

**Annual screening date**: The screening date refers to the date upon which characteristics of eligible constituent firms are measured, whereas the rebalance refers to when the results from the screening date are implemented by way of Index weights and constituents.

**Rebalance**: An index is created by applying a certain set of selection and weighting rules at a certain frequency. WisdomTree rebalances, or re-applies its rules based

selection and weighting process on an annual basis.