MID CAP FUNDS
SEEKS LONG-TERM GROWTH OPPORTUNITIES FOR INVESTORS

The ICC World Cup was being played in the United Kingdom. All focus was on young cricketers from across the world, who are fighting it out for their team. With the right training and attitude, the young talent has the potential to excel in the sport in the future. We use this analogy in this article because similar to sports, it is important for investors to look for hidden gems of opportunity that may give their portfolio an optimum boost. In the equity market, these gems may be inferred to be mid cap stocks, which though dwarfed by the large caps, have the potential to become one in the future. For instance, analysis of AMFI classified large, mid and small cap stocks in the past three years ended December 2018 shows that there were nearly 14 mid cap stocks which metamorphosed into large cap stocks during the period. Not only do they have the potential to become behemoths, but also the potential to generate higher returns in the long term.

Mid cap stocks

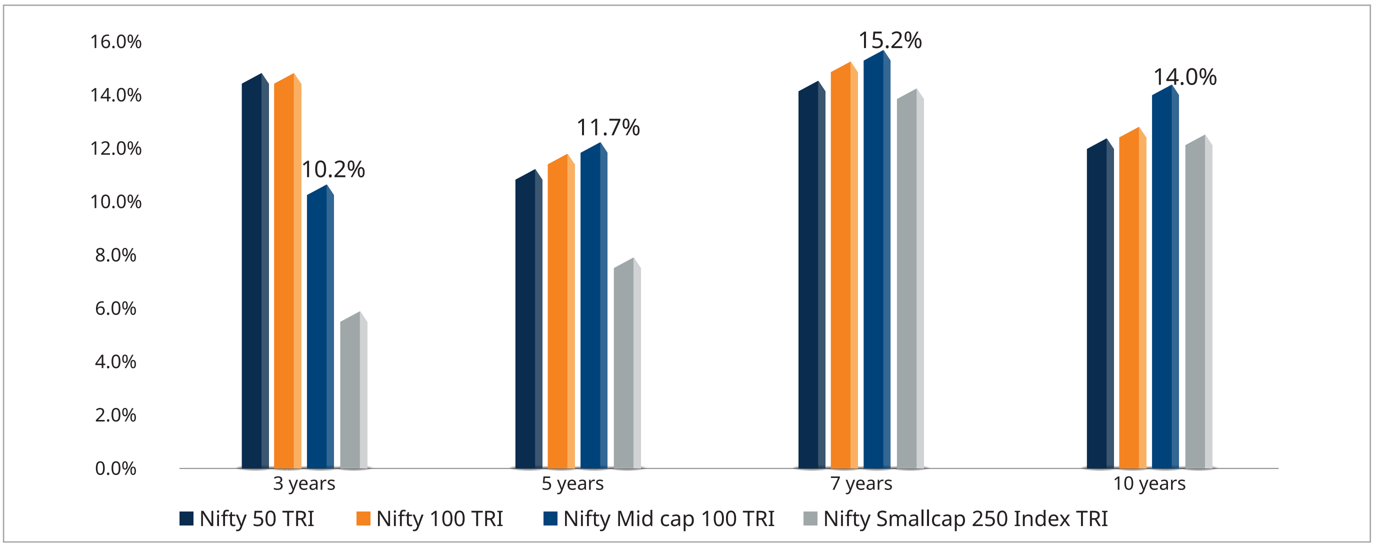
As per SEBI's definition, mid cap stocks are stocks ranked 101st to 250th in terms of full market capitalisation (cap) in the Indian stock market. In terms of average market cap of listed companies during the six months ended 30th June, 2019, the full market cap of these companies ranges from ₹8,858 crore to ₹27,454 crore. In layman terms, these are companies which have the history of growth potential, and are expected to grow more and aim to increase profits, market share and productivity.

Performance

Performance analysis of mid cap stocks versus large and small cap stocks, represented by their respective indices, shows that mid caps have outperformed large as well as small caps over 5, 7 and 10 years.

Source: AMFI, July 2019

Point to point annualised performance analysis as on June 20, 2019



Note – Nifty 50 TRI and Nifty 100 TRI represent large cap stocks, Nifty Mid cap 100 TRI represents mid cap stocks, while Nifty Smallcap 250 TRI represents small caps. Source: CRISIL Dated 20th June, 2019.

During a bull phase, mid cap stocks tend to benefit more than large caps but lesser than small caps, while their performance in the bear phase lies between these two categories. As can be inferred from the next table, these stocks have generated higher returns than large caps during bull phases with considerable margin even as their decline during the bear phase has been limited compared with small cap stocks.

Index / market phase	**Subprime crisis**	**Post subprime crisis**	**European crisis**	**Post European crisis**	**Chinese slowdown**	**Global liquidity and domestic reforms-driven rally**
	(23-May-2008-31-Mar-2009)	**(01-Apr-09-31-Dec-10)**	**(01-Jan-11-28-Jun-13)**	**(01-Jul-13-27-Feb-15)**	**(01-Mar-15-29-Feb-16)**	**(01-Mar-16-19-Jun-17)**
Nifty 50 TRI	-38.3%	50.4%	-0.7%	29.0%	-20.1%	17.3%
Nifty 100 TRI	-39.6%	54.7%	-0.7%	30.2%	-18.9%	17.0%
Nifty Mid cap 100 TRI	-48.7%	74.3%	-5.9%	41.7%	-11.1%	13.0%
Nifty Smallcap 250 Index TRI	-58.0%	76.5%	-12.2%	56.3%	-17.2%	10.6%

Colour code: Returns move from high to low as the shade goes from green to red for respective investment horizon
Returns above one year are annualised, otherwise absolute. Source: CRISIL Dated 20th June, 2019.

To augment their outperformance characteristics, we did rolling returns analysis of the same categories across the periods since April 2005 (inception dates of Nifty Smallcap 250 Index TRI). The analysis shows that mid caps have generated superior returns in almost all periods analysed*.

Table – Rolling returns analysis

Index / periods	1 Year	3 Years	5 Years	7 Years	10 Years
Nifty 50 TRI	16.3%	11.3%	11.7%	11.1%	11.6%
Nifty 100 TRI	16.9%	12.0%	12.4%	11.7%	12.3%
Nifty Mid cap 100 TRI	19.3%	14.2%	14.6%	13.3%	14.6%
Nifty Smallcap 250 Index TRI	19.5%	12.5%	13.0%	11.3%	12.6%

Colour code: Returns move from high to low as the shade goes from green to red for respective investment horizon
Returns above one year are annualised, otherwise absolute
Rolling return period of analysis 1-April 2005 to June 20, 2019. Source : CRISIL

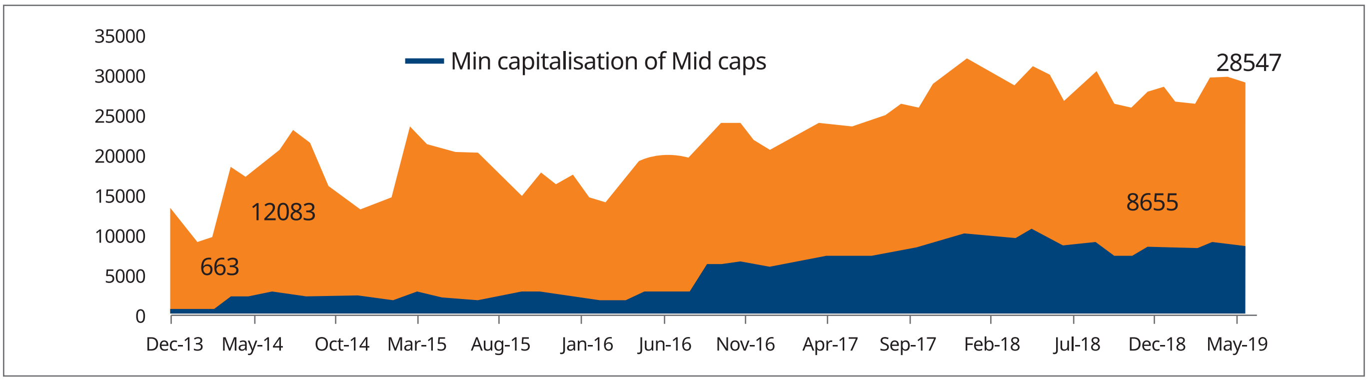
*The analysis are conducted through internal research team, you are requested to consult your financial advisor before investing

Mid cap stocks' attributes reflect outperformance

The outperformance of mid cap stocks over the long term and during bull phases is also reflected in the stocks' attributes. For instance, the minimum capitalisation of stocks within the category has gone up to nearly ₹8,655 crore compared with about ₹663 crore six years back, a multiple of nearly 13 times, reflecting the significant value growth seen in the underlying stocks during this period. Growth in the minimum capitalisation of large caps, on the other hand, grew only about 2.5 times to nearly ₹28,550 crore during this period.

Source: AMFI, July 2019

Market capitalisation growth witnessed in large and mid cap stocks



Source: CRISIL Dated 20th June, 2019.

Another factor that investors previously used to worry about liquidity of the underlying stocks within mid caps is also slowly and surely fading with the rise in investment in the category. This is reflected in the reduction of impact cost, which represents the cost of executing a transaction in a given stock for a specified order size (in this case ₹5 lakh) at any given point of time. Impact cost is a practical and realistic measure of liquidity of the underlying stocks. As can be seen from the table below, mid cap stocks have seen a sharp decrease in the impact cost over the five years ended May 2019 in line with the market trend, showcasing an improvement in liquidity of these stocks.

Trend of impact cost (%) of stocks across market cap over the past five years

	Impact cost (%)				
Category / period	**May-15**	**May-16**	**May-17**	**May-18**	**May-19**
Large caps	0.08	0.05	0.04	0.04	0.04
Mid caps	0.18	0.21	0.11	0.09	0.10
Small caps	3.38	2.46	2.02	1.71	2.47

Denotes the average of the impact costs of stocks as defined by SEBI's across market capitalisation categories for the respective month end periods. Source: SEBI, AMFI, BSE Dated: 31st May, 2019.

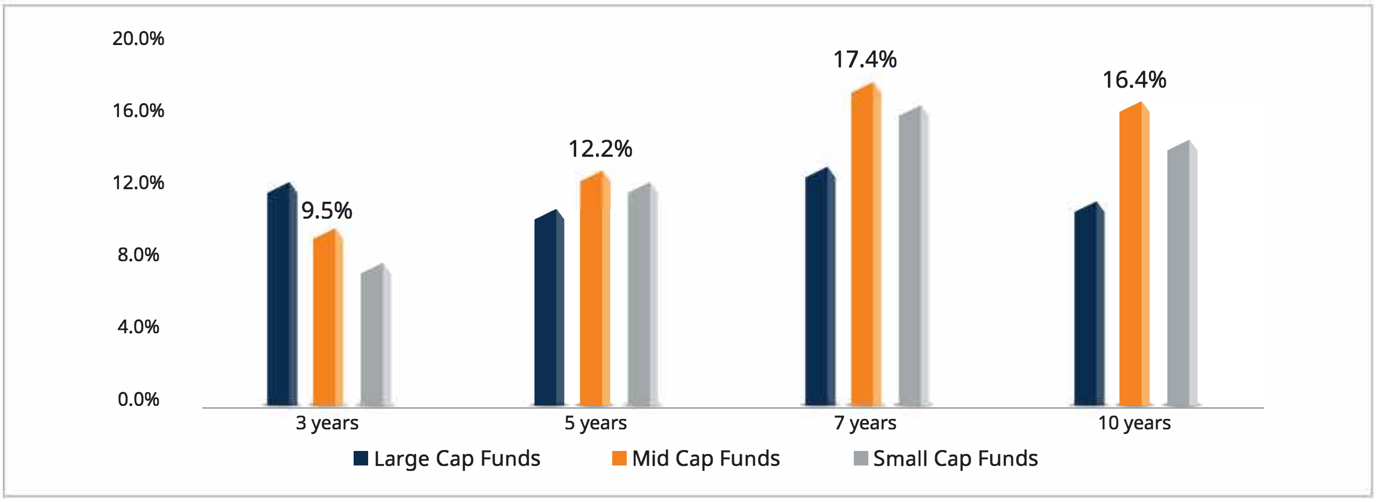
Diversification solution

Mid caps are also higher in number which correlates to a higher sectoral diversification quotient compared with the larger counterparts. This is because mid caps might be present in hitherto uncharted or unexplored territories of large caps or new sunrise sectors untapped by the larger companies. A quick glance of Nifty Midcap 100 shows that the index is diversified within 29 sectors compared with 18 for Nifty 50, with nearly 14 unique sectors accounting for 30% exposure of the mid cap index not covered by the large cap benchmark. This provides an investment as well as a diversification factor for investors in the category.

Mid cap funds – an able investment solution, isn't it?

While mid cap stocks provide an optimum investment diversification for equity investors, finding the right stock through in-depth research might not be easy for individuals without the wherewithal. Instead, investors may look at investing in the category of stocks through mid cap funds. These, as mandated by the regulator SEBI, are required to invest at least 65% of their investment in mid cap stocks. As seen in the stock (index) performance, mid cap funds have performed well in the mid to long term, delivering potentially higher returns than all other categories.

Annualised performance of mid cap funds versus other categories as on June 20, 2019



Source: CRISIL Dated 20th June, 2019.

By investing in mid cap funds, investors may enjoy the following benefits as well:

Diversification

Investment spread across several mid cap stocks and sectors, which makes equity funds moderately risky than direct investment

Professional management

Stock picking, market tracking and portfolio rebalancing done by the fund manager, who is backed by a dedicated research team and is able to make tactical calls based on the market condition

Easily redeemable

Open ended equity funds can be easily redeemed based on the prevailing net asset value of the units. Closed ended equity funds have a lock in period and can be redemeed through exchange

Lower investment amount

Investment in equity mutual funds may be started with as small an amount as ₹500

Summing up

Mid cap funds provide an able alternative for investors to derive benefit from mid cap stocks over the long term. Investors should however note that since these tend to be riskier than the large caps, they should limit their exposure to this category. Further, investors would be better off investing in equity mutual funds through the systematic investment plans (SIP) route over the long term. Not only does it inculcate discipline in investing, but also reduces the volatility associated with the markets, which is also called rupee cost averaging.

Another fallacy that investors follow is to look at the recent performance of funds before investing. It is important that investors look at the long term performance of the scheme versus the benchmark and peers, and the portfolio trends of the scheme. Further, track and review your investments post investing.