The 1-2-3 of Investing
Part 6: Market Capitalization

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Stocks can be grouped in a variety of ways. One way is by market capitalization. Market cap refers to the total value of a company's outstanding shares—calculated by multiplying the number of publicly traded shares by the price per share. It defines a stock's risk and growth potential and falls into one of four categories: mega-cap, large-cap, mid-cap, and small cap.

A mega-cap stock would belong to one of the world's largest publicly traded companies with a market capitalization in excess of $200 billion. Examples include Apple, Microsoft, and Amazon. Their stocks are usually found in broad market indexes such as the Standard & Poor's 500. While these industry giants offer stability and brand recognition, their massive size limits growth opportunities.

Large-cap stocks have market capitalizations above $10 billion. Exxon Mobil, Bank of America, and Tyson Foods are examples. In truth, mega-cap stocks are a subset of large-caps and are sometimes used synonymously.

Mid-cap stocks are shares of medium-size companies with market capitalizations between $2 billion and $10 billion. They offer a balance between growth potential (like small-caps) and stability (like large-caps). These companies also promise diversification with a mix of large- and small-cap stocks while outperforming them at the same time. The book <u>A Random Walk Down Wall Street</u> hails mid-caps as the best investments for young investors. Examples include Kohl's, Pure Storage, and United Therapeutics.

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Small-caps are associated with relatively small, publicly traded companies with a market cap between $250 million and $2 billion. They offer great potential growth but come with greater risk and volatility. Examples of small-cap stocks are Mister Car Wash, Worthington Steel, and Strategic Education.

Despite the clear differences between cap sizes, their respective 1-, 5-, and 10-year performances are quite similar. See the chart below, which reports average returns for the S&P 400, S&P 500, and S&P 600 (which respectively consist of mid-cap, large-cap, and small-cap stocks). Historically, average annual returns for all stocks (not just those on these indices) rank mid-caps first (11.9%), small-caps second (11.1%), and large-caps third (10.4%).

Index	**Cap size**	**1-Year**	**5-Year**	**10-Year**	**20-Year**
S&P 400	Mid-	10.6%	8.7%	11.1%	*
S&P 500	Large-	5.0%	16.1%	13.6%	11.1%
S&P 600	Small-	6.5%	6.9%	10.5%	*
* = not in existence					

A recent development is the shrinking difference between returns from mid-cap stocks and those from large-caps. Reasons include the gains of large tech companies, slower mid-cap earnings growth, and the tendency of large-caps to offer more stability during market corrections. That decline is apparent from the weight of mid-cap stocks in portfolios that now hovers around ten percent. Reasons for not abandoning mid-caps are two-fold. One, many analysts believe a comeback by mid-caps is imminent; and two, well-diversified portfolios require a mix of staggered capitalizations.