OUTLOOK 2009

What's Next for the Markets & the Economy

TRANSCRIPT

Finding Opportunities in Mid-Cap Stocks

An Interview with Richard Bernstein, Chief Investment Strategist, and Steven DeSanctis, Chief Small-Cap Strategist, Banc of America Securities-Merrill Lynch Research

RICHARD BERNSTEIN: Hi, I'm Rich Bernstein, Chief Investment Strategist, and with me today is Steven DeSanctis. Steven is our Chief Small-Cap Strategist. Steven, we're here today to talk a little bit about mid-cap stocks. Could you just start by telling us: what are mid-cap stocks?

STEVEN DeSANCTIS: Mid-cap stocks are companies with market capitalizations between $1 and $11 billion obviously fitting in between the smaller cap space and more of the mega cap area. They do actually have some good characteristics in which they provide similar return characteristics as small-cap companies but also have a little less volatility than small-cap.

RB: In 2008 ... now 2008, everything performed miserably, but mid-caps really underperformed the most.

SD: Right.

RB: Should we, because of that underperformance, now be looking at mid-cap stocks?

SD: First of all, it's very hard to time the individual cycles on when to be in small and mid-cap stocks, but generally if you look at the valuations for mid-caps, they trade at the lowest P/E multiple out of the three size segments, and also they're going to tend to give you better performance coming out of bear markets ... out of recessions ... in the large cap space and consistently do so over longer periods of time.

RB: Now, most investors right now, given what we went through in 2008, are very concerned about risk and volatility. How do mid-caps typically kind of score in risk and volatility?

SD: They tend to underperform when volatility is rising and also when there's lots of risk out there in terms of credit spreads.

RB: Uh-huh.

SD: Or just people wanting to be more risk adverse. They're going to tend to do poorly relative to large caps, but a little bit better than the small-cap space. However, when things start to turn around so volatility has peaked and we start to see people move out onto the risk spectrum, mid-caps do tend to do a little bit better.

RB: Right. Now, your small-cap strategy group not only looks at large, mid, and small-cap stock size segments, but you also look at growth and value.

SD: Right.

RB: Where in that spectrum of growth and value--large, mid, and small--do you think investors should be right now?

SD: We tend to favor growth over value. Growth was the worst-performing group, small-cap and mid-cap growth, and so therefore, they are carrying very cheap valuations, in our opinion, relative to value. In addition, earnings have held up better in growth and in value. And then, lastly, if you do think, coming out ... we're coming out of a bear market this year or even next year ... coming out of an economic recession, growth tends to outperform value. So we think we're better positioned in growth then value.

RB: So, overall, it would be mid-cap growth would be really where you would put your focus right now?

SD: Mid-cap growth is definitely the area that's the most attractive out of the size segments and the styles that I look at.

RB: Great. In terms of structuring a portfolio—an overall portfolio--should small and mid ... what percent of a portfolio would you normally say a typical individual investor should have in small and mid-cap stocks?

SD: If you go back and look historically in the U.S. market, small and mid-caps have represented about 8 to 10 percent of the overall market capitalization. So, without making any bets one way or the other, 8 to 10 percent of a client portfolio should be down the market cap spectrum to get the additional return that small and mid tends to offer.

RB: That's great. Thanks very much.

SD: Thank you.

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