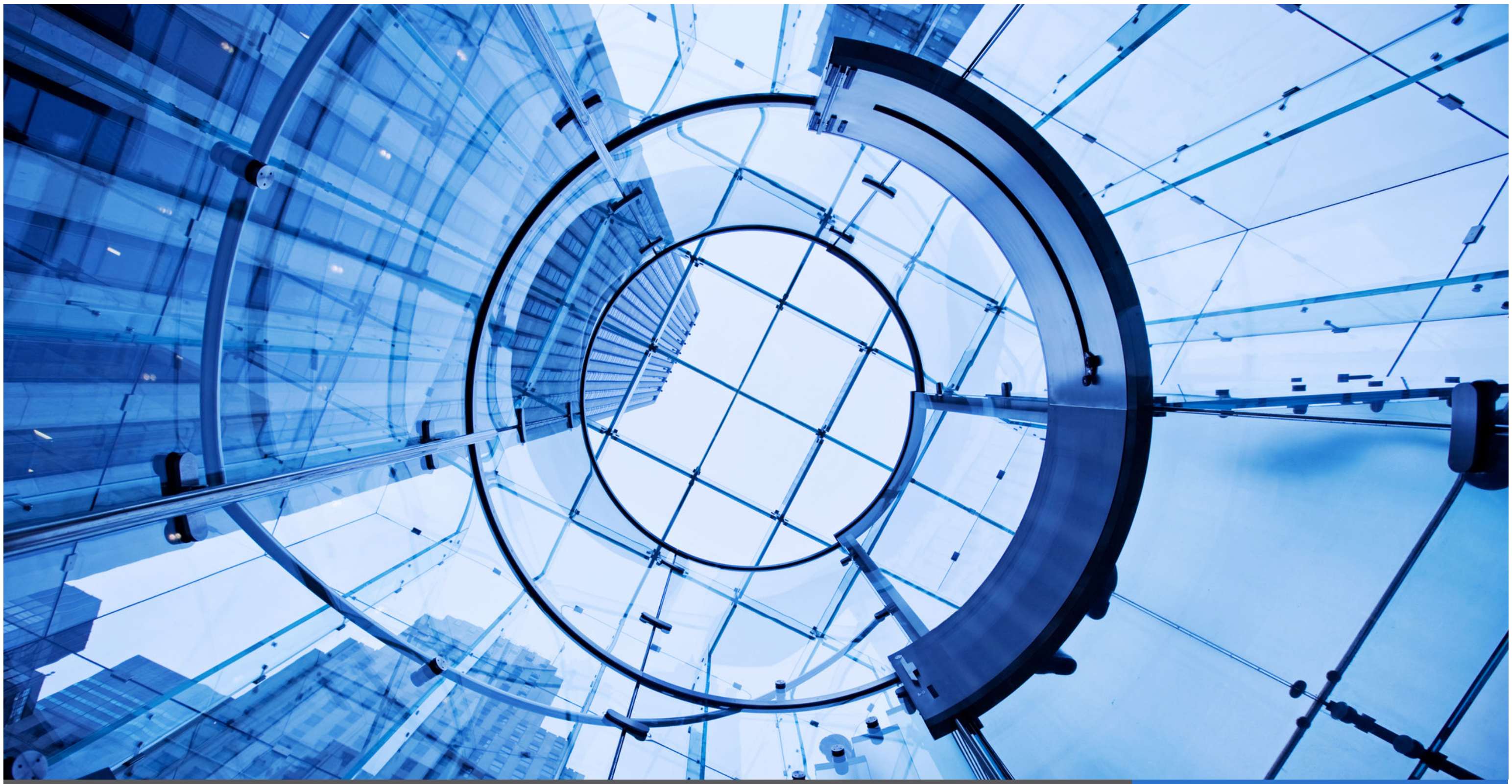

US Mid-Cap Equities: A Forgotten Allocation

Artisan Partners U.S. Value Team

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Investment Risks: Investments will rise and fall with market fluctuations and investor capital is at risk. Investors investing in strategies denominated in non-local currency should be aware of the risk of currency exchange fluctuations that may cause a loss of principal. These risks, among others, are further described on the last page, which should be read in conjunction with this material.

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US Mid-Cap Equities: A Forgotten Allocation

Despite their attractive long-term risk and return characteristics, US mid-cap equities are often overlooked by investors. We discuss a few possible reasons this may occur and review the case for a strategic dedicated allocation to the US mid-cap asset class. The case is made even stronger by current relative valuations, especially for mid-cap value stocks.

How Much Mid-Cap Exposure Do You Really Have?

Investors may believe they have adequate exposure down the market capitalization spectrum via passively managed ETFs and index funds that track broad-based US equity indices like the S&P 500® Index and Russell 1000® Index. However, because these indices are market-cap weighted, their returns are dominated by the largest stocks. FTSE Russell employs a modular index construction, defining the Russell Midcap® Index as the smallest 800 companies in the Russell 1000® Index. Due to being market-cap weighted, the largest 200 companies represent more than 76% of the Russell 1000® Index. In fact, the five largest stocks alone account for 20% of the index. Concentration among the largest stocks is exacerbated by the wide year-to-date performance gap between a handful of mega-cap companies and the rest of the US equity market, which follows a multi-year period of outperformance by large caps.

Investors in actively managed equity strategies may also be underexposed to mid-cap stocks. Some allocators are choosing to simplify their manager lineups. Rather than have a dedicated allocation with a mid-cap manager, they instead may pair a large-cap manager with a small-cap manager to get their mid-cap exposure. There's a belief that large-cap managers tend to come down in market cap relative to the large-cap benchmark indices, while small-cap managers frequently go up in market cap. However, this view may be wishful thinking. The average large-cap core strategy has a weighted average market cap over $500bn compared to less than $40bn for the average mid-cap core strategy (Exhibit 1). Likewise, there's also a sizable gap in market capitalizations between small-cap and mid-cap strategies. The average small-cap core strategy's market cap is $4bn, nearly $32bn less than the average mid-cap core strategy.

Today's muted enthusiasm for mid-cap stocks may also be due to recency bias. Large caps have meaningfully outperformed over the past 5 and 10 years, while year to date, the largest stocks have driven the bulk of US equities' returns as investors have crowded into the "magnificent seven", as the largest seven stocks in the US have been dubbed. Year to date as of September 2023, the "magnificent seven" have an average total return of 88%, while contributing 76% of the Russell 1000® Index's total return.

Exhibit 1: Market Capitalizations by Asset Class for Active Strategies

ASSET CLASS CATEGORY	WEIGHTED AVG. MARKET CAP ($BN)
Large Cap Core	505.0
Large Cap Growth	667.9
Large Cap Value	182.8
Mid Cap Core	36.1
Mid Cap Growth	32.8
Mid Cap Value	27.1
Small Cap Core	4.4
Small Cap Growth	5.8
Small Cap Value	3.5

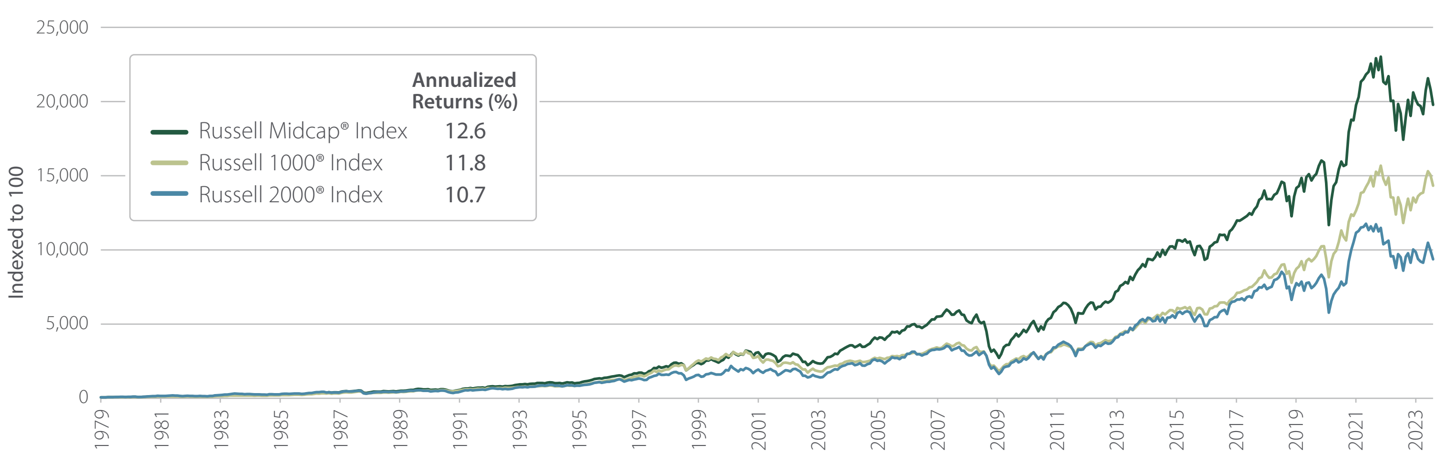
Source: eVestment/Artisan Partners. As of 30 Jun 2023. Categories defined by eVestment.

The Long-Term Opportunity

The mid-cap segment may offer a risk-return "sweet spot" of the US equity market. Mid-sized companies tend to have better growth prospects than the largest companies, have greater takeover potential and because they are less followed by Wall Street, may present greater opportunity for skilled investors. Compared to small caps, mid-cap companies typically have stronger competitive positions in their industries, are more diversified, whether by products, business lines and geographies, and often have better managements.

The advantages of mid-cap stocks are borne out by historical performance. Based on data from 1979 to 2023, the Russell Midcap® Index has outperformed both the Russell 1000® and 2000® indices (Exhibit 2). The mid-cap index outperformed by an average of 0.8 percentage points per year. While that may seem small, the power of compounding can result in large differences as one's time horizon expands. For example, a $100 investment in the Russell® Midcap Index made on January 1, 1979, would have grown to 38% more than an equal investment in the Russell 1000® Index over this timeframe.

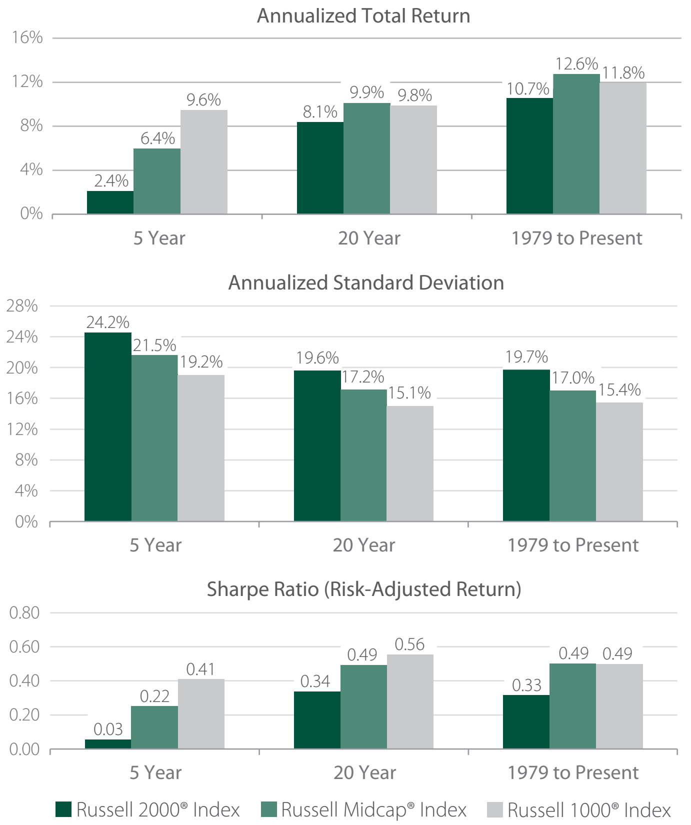
Exhibit 2: Historical Outperformance Delivered by Mid-Cap Equities



Source: FactSet/Artisan Partners. As of 30 Sep 2023. **Past performance is not indicative of future results.**

Additionally, mid caps have historically provided favorable risk-return characteristics. They are less volatile than small caps and have similar risk-adjusted returns to those of large caps over long timeframes (Exhibit 3).

Exhibit 3: Historical Performance Trends

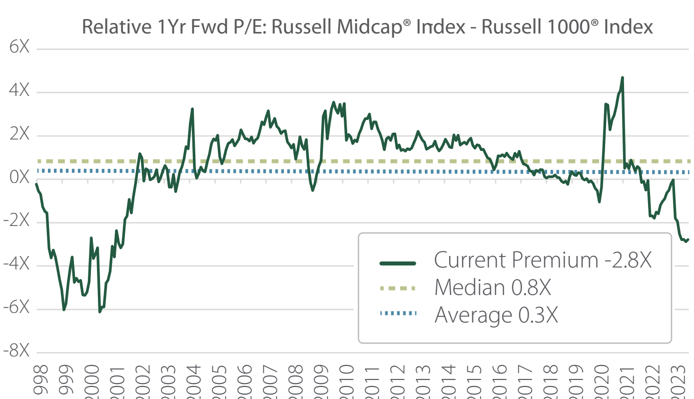


Source: FactSet/Artisan Partners. As of 30 Sep 2023. **Past performance is not indicative of future results.**

The Opportunity Today

The case for allocating to mid-cap stocks is made even more compelling by relative valuations. Mid-cap stocks haven't been this cheap on a relative basis since coming out of the tech bubble in the early 2000s (Exhibit 4). On average, mid-cap stocks trade at a small premium to large-cap stocks due to their faster growth rates, however today they sell at a discount of nearly three multiple points.

Exhibit 4: Mid Caps Are Cheap Relative to Large Caps



Source: FactSet/Artisan Partners. As of 30 Sep 2023. Price-to-earnings ratios are based on forward one-year consensus earnings estimates of the Russell Midcap® and Russell 1000® indices using monthly figures. **Past performance is not indicative of future results.**

While valuations may not be of much use as a timing tool, the last time the valuation discount was this large back in the early 2000s, a multiple-year period of mid-cap stock outperformance ensued (Exhibit 5).

Exhibit 5: Calendar Year Returns (2000-2005)

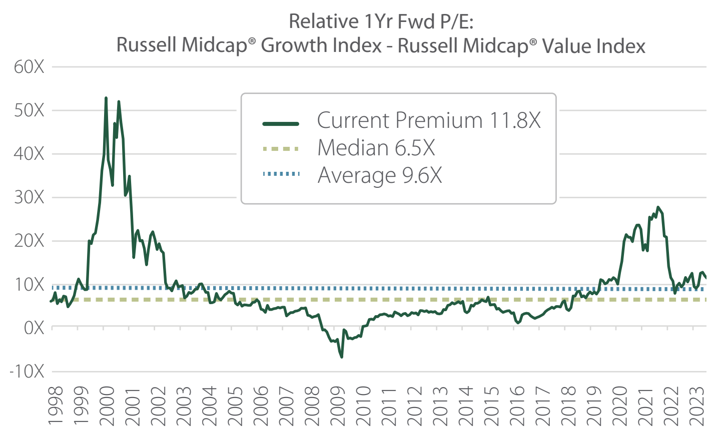
	BEAR MARKET			BULL MARKET		
	2000	2001	2002	2003	2004	2005
Russell 1000® Index	-7.79	-12.45	-21.65	29.89	11.40	6.27
Russell Midcap® Index	8.25	-5.62	-16.19	40.06	20.22	12.65

Source: FTSE Russell. **Past performance is not indicative of future results.**

Value Is (Still) Cheap

Within the mid-cap space, valuations are particularly attractive for value stocks. Aside from the pandemic years of 2020 to 2021, value hasn't been this cheap relative to growth since the aftermath of the tech bubble. The Russell Midcap® Value Index trades for 14.4X FY1 estimated earnings. The Russell Midcap® Growth Index trades at 26.2X FY1 estimates. The average and median valuation spreads between these indices have been 9.6 and 6.5 percentage points over the past 25 years. Today, it's 11.8 percentage points (Exhibit 6).

Exhibit 6: Value Is Cheap Relative to Growth



Source: FactSet/Artisan Partners. As of 30 Sep 2023. Price-to-earnings ratios are based on forward one-year consensus earnings estimates of the Russell Midcap® Value and Russell Midcap® Growth indices using monthly figures. **Performance is not indicative of future results.**

Not only did mid-cap value stocks hold up better during the 2000-2002 bear market—one of the worst in US history—mid-cap value stocks generated positive returns and continued to participate strongly during the subsequent bull market (Exhibit 7).

Exhibit 7: Calendar Year Returns (2000-2005)

	BEAR MARKET			BULL MARKET		
	2000	2001	2002	2003	2004	2005
Russell Midcap® Growth Index	-11.75	-12.45	-21.65	29.89	11.40	6.27
Russell Midcap® Value Index	19.18	-5.62	-16.19	40.06	20.22	12.65

Source: FTSE Russell. **Past performance is not indicative of future results.**

Whether today's valuations result in a similar outcome, we believe investors should consider a dedication allocation to US mid-cap value stocks.

Mid caps have a history of attractive long-term risk-adjusted performance, and the current relative valuations of mid-cap value stocks are among the cheapest in our investment careers. The valuation spread remains wide despite mid-cap value closing the gap significantly over the past three years. Through September 2023, the Russell Midcap® Value Index's 3-year annualized return of 11.1% was more than 8 percentage points higher than the Russell Midcap® Growth Index's 2.6% return. This was driven by the extended starting valuations of growth stocks and the influence of rising interest rates. History has shown, these value/growth cycles can persist for several years.

Artisan U.S. Value Team

The investment team leverages high degrees of experience and knowledge within a disciplined investment process. The investment team is led by three portfolio managers—Dan Kane, Tom Reynolds and Craig Inman. The team operates in a highly collaborative manner as each member has a high level of trust and confidence in each other's capabilities. In addition to Artisan U.S. Mid-Cap Value Strategy, they manage Artisan Value Equity Strategy and Artisan Value Income Strategy.

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