Stronger U.S. Economic Growth in 2015 Could Help Boost Interest in Small- and Mid-Cap Stocks

View from the Observation Deck

1. Investors may have noticed that small- and mid-capitalization stocks have lagged their larger counterparts in 2014.
2. From 12/31/13-10/22/14, the S&P 500 Index posted a total return of 5.97%, compared to 1.86% and -4.78%, respectively, for the S&P MidCap 400 Index and the Russell 2000 Index.
3. As of 10/7/14, the International Monetary Fund (IMF) was forecasting a real U.S. GDP growth rate of 3.1% for 2015, according to its own release. The U.S. economy has grown at a rate closer 2.0% since the recovery began in Q3’09.
4. While there is no assurance that the IMF’s 3.1% estimate will prove accurate, we thought it would be interesting to see how a 50/50 split between small- and mid-cap stocks has performed in years in which real U.S. GDP growth exceeded 3.0%.
5. As indicated in the chart, of the eight years that real GDP growth exceeded 3.0% since 1994, only one of them (1994) was accompanied by a negative total return (-3.38%) for the 50/50 split.
6. What is unique about 1994? The Federal Reserve raised the federal funds target rate from 3.00% to 5.50% in 1994, and then on to 6.00% in February 1995.
7. That was a fairly aggressive pace of tightening, in our opinion. We do not expect the Fed to adopt such a strategy in 2015 at this point in time.
8. As of 10/23/14, Bloomberg’s 2015 consensus earnings growth rate estimates for the S&P MidCap 400 Index and the Russell 2000 Index were 14.39% and 35.01%, respectively.

This chart is for illustrative purposes only and not indicative of any actual investment. There can be no assurance that any of the projections cited will occur. The illustration excludes the effects of taxes and brokerage commissions or other expenses incurred when investing. Investors cannot invest directly in an index. The S&P MidCap 400 Index is a capitalization-weighted index comprised of 400 stocks used to measure the performance of the mid-range sector of the U.S. stock market, while the Russell 2000 Index is comprised of the smallest 2000 companies in the Russell 3000 Index. It represents approximately 8% of the Russell 3000 total market capitalization.