

Don't Overlook Mid Caps

Fidelity Viewpoints

July 30, 2009

Many investors focus on small- and large-cap stocks, and sometimes overlook an asset class in between—mid caps. They are commonly defined as those stocks that fall within the \$2 billion–\$20 billion market capitalization range.

Now may be a good time to see if an allocation to mid caps, as part of a diversified portfolio, may make sense for you. Mid-cap stocks have been trading at relatively low valuations and have historically performed well coming out of a recession. Plus, they may offer exposure to an attractive part of the business lifecycle, and different risk/return potential than small- and large-cap stocks.

"Many mid-cap companies have business models that over time have proven successful," explains Shep Perkins, portfolio manager of the Fidelity Mid-Cap Stock Fund (FMCSX). "That's because at one point every mid cap was a successful small cap that grew. Because of this, they don't have the same inherent risks and volatility as many untested small caps."

On sale?

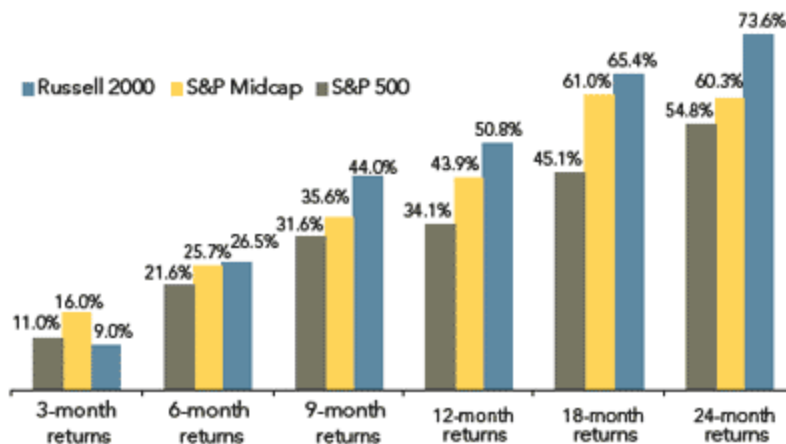
Mid-cap stocks recently reached valuation levels not seen since the recession of 1990–1991. Despite a strong run in the second quarter of this year, they're still trading below their historical average on a number of valuation metrics, including price to earnings, price to sales, and price to book.¹ While they have been trading at a slight premium to large caps, they've recently traded at valuation levels below that of small caps.²

Coming out of a recession

As the economy slowly turns the corner and extracts itself from the worst economic retraction since the Great Depression, it can be instructive to look to the past to see how certain asset classes perform when transitioning out of a recession.

Since 1981, there have been four recessions as defined by the National Bureau of Economic Research. In the three months following the recessions of 1982, 1987, 1990, and 2002, the cumulative return for mid-cap stocks was 16% versus 11% and 9% for the S&P 500[®] and Russell 2000,[®] respectively. Over longer time periods, as shown in the chart below, mid caps typically performed better than large caps (as measured by the S&P 500 Index), but trailed small caps (as measured by the Russell 2000).

Cumulative returns following a recession



Source: Factset, National Bureau of Economic Research

Compared with small and large caps

The attractiveness of small- and large-cap companies is understandable. But equally attractive are companies that navigated their way through start-up (e.g., unpredictable cash flows, financing concerns) to become mid-cap stocks. Having endured the uncertainty faced by new companies fighting for survival, mid caps have the potential for more robust earnings and an improved competitive position when compared with many small-cap companies. An improved cash flow may also enable some mid-cap companies to pay out dividends, which may be attractive to traditional large-cap stock investors looking for income. It can also potentially help stabilize their stock prices.

"Mid caps typically have large, yet focused, growth opportunities, whereas large caps may have nearly penetrated their market potential and, as a result, may diversify away from their core business," says Perkins. "This combination of proven business models and growth opportunities has borne out in better stock performance for mid-cap stocks. For example, since the beginning of this decade the S&P MidCap 400SM Index has appreciated 46%

versus -26% for the S&P 500 and 14% for the Russell 2000."³ Of course, past performance is no guarantee of future results. In addition, it is important to remember that investments in mid-cap companies usually carry additional risks as compared with large-cap companies, so you should consider carefully before investing in them.

Mid-cap companies have also delivered risk-adjusted returns that eclipse those of both small- and large-cap stocks since the inception of the MidCap Index in 1991. In fact, the Sharpe Ratio for mid-cap stocks over that time period is higher than that of small and large caps.⁴

What do to now

The relative attractive pricing of mid-cap stocks, along with the risk/return benefits they've historically provided, may make them an appropriate addition to a well-diversified portfolio. If you believe that mid-cap funds may be suitable for your portfolio use Fund Picks from Fidelity[®] to identify specific securities.

In addition, you may want to use Fidelity's Portfolio Review⁵ (login required) to help identify the appropriate asset allocations for your portfolio. Mid caps typically fall into the domestic stock portion of a portfolio.

Before investing, consider the funds' investment objectives, risks, charges, and expenses. Contact Fidelity for a prospectus containing this information. Read it carefully.

Investments in mid-sized companies may involve greater risks than those in larger, more well known companies, but may be less volatile than investments in smaller companies.

1. Merrill Lynch Small Cap Research; Russell Investment Group.

2. Relative to the Russell 2000[®] Index, through June 30, 2009, the Standard & Poor's MidCap 400 Index had a lower trailing and forward price-to-earnings multiple as well as a lower price-to-sales multiple. While the price-to-book level of the MidCap 400 was higher than that of the Russell 2000, it still trades at an 18% discount to its historical average. Source: Merrill Lynch Small Cap Research; Russell Investment Group.

3. Cumulative returns from January 1, 2000 to June 30, 2009.

4. Source: Morningstar. Sharpe Ratio is a measure of risk-adjusted return that divides the excess return of an investment by its total risk as measured by standard deviation. The result is the amount of outperformance generated per unit of total risk.

5. Portfolio Review is an educational tool offered for use by Fidelity Brokerage Services LLC, member NYSE, SIPC.

The Russell 2000® Index is an unmanaged market capitalization-weighted index measuring the performance of the smallest 2,000 companies in the Russell 3000® Index.

The S&P Midcap 400 Index is an unmanaged market capitalization-weighted index of 400 medium-capitalization domestic stocks chosen for market size, liquidity, and industry group representation.

The S&P 500® Index (S&P 500) is an unmanaged market capitalization-weighted index of 500 common stocks chosen for market size, liquidity, and industry group representation to represent U.S. equity performance.

Past performance is no guarantee of future results.

As with all your investments, you must make your own determination whether an investment in any particular security or securities is consistent with your investment objectives, risk tolerance, financial situation, and your evaluation of the security. Fidelity is not recommending or endorsing these investments by making them available to you. These opinions do not necessarily represent the views of Fidelity or any person in the Fidelity organization and are subject to change at any time based on market or other conditions. Fidelity disclaims any responsibility to update such views. These views may not be relied on as investment advice and, because investment decisions for a Fidelity fund are based on numerous factors, may not be relied on as an indication of trading intent on behalf of any Fidelity fund.

Brokerage products and services are provided by Fidelity Brokerage Services, Member NYSE, SIPC, 300 Puritan Way, Marlborough, MA 01752.

#527744.1

Copyright 1998-2009 FMR LLC
