

VIEWPOINT

A Focus on Relative Value Mid Cap

DIANE JAFFEE | FEBRUARY 2, 2018



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Ms. Jaffee is the Senior Portfolio Manager for the TCW Relative Value Large Cap, TCW Relative Value Dividend Appreciation, and TCW Relative Value Mid Cap strategies and funds. She joined TCW through the acquisition of SG Cowen Asset Management in 2001. She had been a Senior Portfolio Manager at Cowen Asset Management since 1995 and continues in that role at TCW. She has more than 30 years of investment experience. Before joining Cowen, she was Vice President and Portfolio Manager at Kidder, Peabody & Co from 1986 to 1995. Prior to that, she was Vice President at Lehman Management Company from 1985 to 1986 and an Equity Analyst with Prudential Insurance from 1982 to 1985. In 2007, Ms. Jaffee was named the Separately Managed Accounts Award winner in the Large Cap Equity category by Standard & Poor's and its award partners Prima Capital and Investment Advisor magazine. The TCW Relative Value Large Cap, Dividend Appreciation, and Mid Cap mutual funds have been each awarded Wall Street Journal's "Category Kings" in their respective categories, multiple times in 2012, and the TCW Dividend Appreciation Fund was ranked the #1, top performing fund among Lipper Equity Income Funds for 2012. In 2013, the TCW Relative Value Large Cap mutual fund was ranked #1 fund for the first quarter and the #6 fund for the one-year period ending March 31, 2013 among Large Cap Value peers, while the Dividend Appreciation Fund ranked #2 for the quarter and #3 for the one-year period ending March 31, 2013 among Equity Income peers. Ms. Jaffee holds a BA in Economics from Wellesley College (1982). She has completed post-graduate work in Finance and Accounting at Rutgers University Graduate School of Management and is a CFA charterholder. Ms. Jaffee is also a member of the New York Society of Security Analysts, the Economic Club of New York, and the CFA Society.

As we enter 2018, we hold a very high conviction for the Relative Value Mid Cap (RVMC) strategy. RVMC has been recognized for excellent performance throughout 2017. Mid caps present a compelling investment case as they have outperformed large caps by approximately two percentage points on an annualized basis over the last 20 years (as measured by Russell Midcap and S&P 500 Indices) and they deserve to play a more significant role in investors' portfolios. At this point in the cycle, concurrent with a long economic expansion, corporate tax cuts could be the spark to drive domestic-oriented mid cap stocks.

RVMC has been ranked a WSJ "Category King" for outstanding performance in 2012, 2016 and eight times in 2017. The WSJ ranks the strategies by either year to date (YTD) performance, at month end or 1 year performance at quarter end.

2017 Accolades

1. YTD as of January (ranked 6th)
2. Last 12 months ending March (ranked 4th)
3. Last 12 months ending June (ranked 3rd)
4. YTD as of July (ranked 9th)
5. Last 12 months ending September (ranked 1st)
6. YTD as of October (ranked 5th)
7. YTD as of November (ranked 6th)
8. Last 12 months ending December (ranked 5th)

2017 Performance

RVMC (gross)	+20.97%
RVMC (net)	+20.00%
Russell Midcap Value	+13.34%
Russell Midcap	+18.52%

3 years ending 12/31/2017 (annualized)

RVMC (gross)	+10.94%
RVMC (net)	+10.05%
Russell Midcap Value	+9.00%
Russell Midcap	+9.58%

A Focus on Relative Value Mid Cap

Below are some reasons to consider RVMC:

- The TCW Relative Value team took over management of the Mid Cap strategy effective July 1, 2011 upon the retirement of the former PM. It is managed using the Relative Value time tested philosophy and process along with an investment team that has worked together for over 16 years.
- The tax bill should have a greater impact on small and mid cap companies as they generally pay much higher effective tax rates than large cap companies (which many have offshore lower tax jurisdictions).
- Over the past 20 years, ending 12/31/2017, the Russell Midcap (mid cap stock index) posted an average annual total return of 10.33% versus the Russell 1000 (large cap stock index) and the Russell 2000 (small cap stock index) returns of 8.49% and 8.52%, respectively, per Bloomberg. Mid cap outperformance holds true over the past 10 and 15 years as well and is in line for the last five years.
- RVMC has a high active share of 94% versus the Russell Midcap (as of the end of 2017). This provides the opportunity for benchmark outperformance and the strategy's suitability for pairing with a passive investment or with other, complementary midcap strategies.
- In addition to offering greater total return potential, mid cap stocks can counterbalance an overly conservative stock portfolio and can do so with potentially less risk than small cap stocks. Mid cap stocks can provide some of the stability of blue chips along with some of the accelerated small cap growth potential.
- Mid cap stocks receive less Wall Street analyst coverage than their large cap brethren which presents an opportunity for investors to find companies whose prices may not yet reflect their value or potential. For instance, FactSet indicates mid cap Beazer Homes is followed by only five sell-side analysts whereas large cap Lennar is followed by 21. Greatest investment rewards are frequently correlated with less investor coverage.
- Since the collapse in energy prices in 2014 and 2015, earnings for energy companies of all sizes, especially less diversified mid caps, have suffered. The Russell Midcap has had higher weights in energy and materials for the past few years, a characteristic that continues relative the Russell 1000, S&P 500, and Russell 2000. The potential for a recovery in oil and other commodities will benefit mid cap companies that have a specific self-help catalyst. As of 12/31/2017, materials + energy make up ~12% of Russell Midcap and ~13% of RVMC versus ~9% in the Russell 1000 and S&P 500.
- Despite the higher standard deviation relative to large caps, according to Zephyr, over the past 15 and 20 years, mid caps sported higher Sharpe ratios than the Russell 1000, S&P 500, and Russell 2000, ending November 2017. For the 5 and 10 year periods, the Russell Midcap Sharpe ratio ranks between the large cap and small cap indices. ■

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